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THE U.S. AS “RELUCTANT SHAREHOLDER”: GOVERNMENT, BUSINESS AND THE LAW

BARBARA BLACK*

I. INTRODUCTION

In October 2008, Congress passed the Emergency Economic Stabilization Act of 2008 (EESA) that created the Troubled Asset Relief Program (TARP) and appropriated \$700 billion to “restore liquidity and stability to the financial system”¹ Pursuant to TARP, the U.S. Government’s extraordinary investment in private business was undertaken to combat the financial crisis.² The amount of federal assistance to financial institutions and the automotive industry was staggering. As of March 31, 2010, the U.S. Department of the Treasury (Treasury) had planned TARP expenditures of approximately \$497 billion, of which approximately \$382 billion had been disbursed.³ Financial institutions accounted for the largest amount of funds, primarily in the form of direct investment of capital through financial institution support programs (\$320.7 billion) as well as another \$51 billion categorized as asset support programs, the purpose of which was to support the liquidity and market

* Charles Hartsock Professor of Law and Director, Corporate Law Center, University of Cincinnati College of Law. Thanks to the editors of the *Entrepreneurial Business Law Journal* for inviting me to participate in the March 2010 Symposium, *The Relationship Between American Government and American Business*. John Wolfenden, University of Cincinnati College of Law, expected 2012, and Aaron Bernay, Rosina Caponi and Jerrod Kuhn (all University of Cincinnati College of Law, expected 2010) provided excellent research assistance. This article reflects events as of July 1, 2010.

¹ Emergency Economic Stabilization Act of 2008 § 2(1), 12 U.S.C.A. § 5201 (West 2008).

² While government bailouts are not new, earlier forms of assistance generally took the form of loans, guaranties, insurance or other subsidies. See Cheryl D. Block, *Overt and Covert Bailouts: Developing a Public Bailout Policy*, 67 IND. L.J. 951, 1031-34 (1992) (describing past government bailouts). In the savings and loan crisis of the 1980s, the FDIC took preferred shares or warrants in a number of failed banks; the U.S. government received warrants in Chrysler Corp. in the automaker’s previous bailout. *Id.*

³ OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, QUARTERLY REPORT TO CONGRESS, 33 (Apr. 2010) [hereinafter SIGTARP, QUARTERLY REPORT TO CONGRESS Apr. 2010].

value of assets owned by financial institutions.⁴ Support to the automotive industry accounted for \$84.8 billion.⁵

Through the TARP program, the government became a substantial equity holder in five major U.S. companies. Two of them—American International Group, Inc. (AIG), an international insurance organization,⁶ and Citigroup Inc. (Citigroup), a global diversified financial services holding company⁷—are publicly traded corporations; three are currently privately owned—General Motors Company (GM), one of the world’s largest automakers that traces its roots back to 1908,⁸ Chrysler Group LLC (Chrysler), for years America’s third largest automaker,⁹ and GMAC Inc. (GMAC), now known as Ally Financial Inc. (Ally), which was founded in 1919 to provide financing to purchasers of automobiles.¹⁰

By mid-2010, the government’s investment in business is winding down.¹¹ Many of the banks and financial services firms that were recipients of TARP funds have returned to profitability and have repaid their loans ahead of schedule.¹² Treasury began divestiture of its Citigroup shares through sales in the market.¹³ In June 2010, Treasury announced a TARP “milestone”: repayments (\$194 billion) exceeded the amount of TARP funds outstanding (\$190 billion).¹⁴ It also announced that Treasury had received approximately \$23 billion in interest, dividends and other income and that the overall projected cost of the TARP program was estimated at

⁴ *Id.* at 35 fig.2.2.

⁵ *Id.*

⁶ AM. INT’L GRP., INC., 2009 ANNUAL REPORT (2010), available at http://www.aigcorporate.com/investors/2010_April/2009AnnualReport.pdf.

⁷ CITIGROUP, CITI ANNUAL REPORT 2009, at 4 (2010), available at http://www.citigroup.com/citi/fin/data/ar09c_en.pdf.

⁸ *About GM*, GENERAL MOTORS, <http://www.gm.com/corporate/about/> (last visited July 21, 2010).

⁹ *Chrysler LLC*, N.Y. TIMES, http://topics.nytimes.com/top/news/business/companies/chrysler_llc/index.html (last updated Aug. 10, 2010).

¹⁰ *Our History*, ALLY FINANCIAL, <http://www.ally.com/about/company-structure/history/index.html> (last visited Sept. 12, 2010).

¹¹ In December 2009, the Treasury Secretary exercised his power under EESA and extended TARP through October 3, 2010. TARP’s focus shifted to home foreclosures and small-business and community lending initiatives. SIGTARP, QUARTERLY REPORT TO CONGRESS Apr. 2010, *supra* note 3, at 33.

¹² *Id.* at 5.

¹³ Press Release, U.S. Dep’t of the Treasury, Treasury Announces the Completion of its Current Trading Plan to Sell Citigroup Common Stock (July 1, 2010), available at <http://www.treas.gov/press/releases/tg764.htm>.

¹⁴ Press Release, U.S. Dep’t of the Treasury, Treasury Dep’t Announces TARP Milestone: Repayments to Taxpayers Surpass TARP Funds Outstanding (June 11, 2010), available at <http://www.treas.gov/press/releases/tg742.htm>.

\$105.4 billion, an amount less than the original forecast.¹⁵ Although it is unlikely that the government will be able to extricate itself from AIG in the near future,¹⁶ and the government has put forth no solutions¹⁷ for the intractable problems of the government-sponsored enterprises Fannie Mae and Freddie Mac that were placed in conservatorships in September 2008,¹⁸ the era of federal bailouts appears to be drawing to an end—for now.

Indeed, government, the American taxpayer, and business alike all fervently wish for an end to government bailouts, for the alliance of government and business has been an uneasy one. Treasury consistently described itself as a “reluctant shareholder”¹⁹ to express its discomfort with the role, and Main Street resented the money and the attention paid to Wall Street while home foreclosures and unemployment rates went up.²⁰ TARP recipients complained about having to account to a variety of federal bureaucrats with competing and conflicting demands;²¹ businesses that did not receive federal assistance complained of disadvantages from competing with government-assisted businesses.²²

The bailouts present many troubling issues that will be analyzed and debated for years to come. To date, congressional committees and panels have held over one hundred hearings²³ on the federal bailout, Congress has set up the Congressional Oversight Panel to oversee the TARP program²⁴

¹⁵ *Id.*

¹⁶ In its Annual Report on Form 10-K for the year ending Dec. 31, 2009, AIG states that should certain risks occur it may require additional federal assistance, without which there is substantial doubt about its continued existence as a going concern. Am. Int'l Grp., Inc., Annual Report (Form 10-K), at 17 (Feb. 26, 2010).

¹⁷ Sewell Chan, *Under Pressure, the White House Ponders How to Remake Fannie and Freddie*, N.Y. TIMES, Mar. 23, 2010, at B3.

¹⁸ Press Release, U.S. Dep't of the Treasury, Statement by Secretary Henry M. Paulson, Jr. on Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers (Sept. 7, 2008), available at <http://www.treas.gov/press/releases/hp1129.htm>.

¹⁹ See, e.g., OFFICE OF FIN. STABILITY, U.S. DEP'T OF THE TREASURY, AGENCY FINANCIAL REPORT, FISCAL YEAR 2009, at 42 [hereinafter OFS FINANCIAL REPORT 2009].

²⁰ This was reflected, for example, in the public's anger toward bonuses paid to AIG executives. Brady Dennis & David Cho, *Rage at AIG Swells As Bonuses Go Out*, WASH. POST, Mar. 17, 2009, at A1.

²¹ See, e.g., Monica Langley & David Enrich, *Citigroup Chafes Under U.S. Overseers*, WALL ST. J., Feb. 25, 2009, at A1.

²² See, e.g., Colin Barr, *Former GMAC Bank Under Attack*, CNNMONEY, June 3, 2009, <http://money.cnn.com/2009/06/03/news/ally.enemy.fortune/index.htm>.

²³ I am grateful to Shannon Kemen, University of Cincinnati Law Library, for compiling a list from government sources. Information on file with author.

²⁴ *About Us*, CONGRESSIONAL OVERSIGHT PANEL, <http://cop.senate.gov/about/> (last visited Oct. 10, 2010).

and the Financial Crisis Inquiry Commission to examine the causes of the financial crisis,²⁵ and both the U.S. Government Accountability Office (GAO)²⁶ and the TARP Special Inspector General (SIGTARP)²⁷ are responsible for monitoring the administration of TARP and issuing reports periodically to Congress. The lessons we learn can have important implications for future government action. Notwithstanding the assertions that federal bailouts and “too big to fail” are over,²⁸ the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act)²⁹ contains little that will prevent firms from being “too big to fail” in the future. Businesses will continue to take risks to maximize profits, and it is likely that they will operate with an assumption that, in the face of systemic risk, the government will again bail them out.

Despite the likelihood of future bailouts, the government has not articulated a consistent policy to deal with private enterprise failure, and there is no rule book for how the government should act as a shareholder. This is not surprising; the philosophy of free market capitalism, so deeply engrained in the U.S. economic system, is difficult to reconcile with the government’s rescue of businesses that fail in that system.³⁰ Unlike some other countries, the U.S. government does not invest surplus funds or engage in entrepreneurial activities for economic gain.³¹ The phrase “nationalizing private business” conveys serious negative connotations.

Accordingly, how the government behaves when it is a significant shareholder in private business is a question worthy of examination. Part II of this Article sets forth, as background, general principles of corporate

²⁵ FINANCIAL CRISIS INQUIRY COMMISSION, www.fcic.gov (last visited Sept. 21, 2010).

²⁶ See U.S. GOV’T ACCOUNTABILITY OFFICE, www.gao.gov (last visited Sept. 21, 2010).

²⁷ See SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, www.sig tarp.gov (last visited Sept. 21, 2010).

²⁸ See SENATE COMM. ON BANKING, HOUS., AND URBAN AFFAIRS, 111TH CONG., BRIEF SUMMARY OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (2010).

²⁹ Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), Pub. L. No. 111-203, 124 Stat. 1376 (July 2010) (to be codified in scattered sections and titles of U.S.C.).

³⁰ Block, *supra* note 2, at 990-93 (asserting a free-market presumption against public bailouts); Press Release, U.S. Dep’t of the Treasury, Joint Statement by the Treasury, FDIC, OCC, OTS and the Federal Reserve, (Feb. 23, 2009), *available at* <http://www.treas.gov/press/releases/tg38.htm> (stating that “our economy functions better when financial institutions are well managed in the private sector”).

³¹ Others have explored the conflicting philosophies of government and business. See, e.g., Benjamin A. Templin, *State Entrepreneurism* (Thomas Jefferson Sch. of Law, Research Paper No. 1428108, 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1428108.

governance as well as the TARP bailout policy as articulated by Congress and the executive branch. Part III then closely examines the government's actions as an equity holder. It begins with the closest parallel to the current situation, the Federal Deposit Insurance Corporation's (FDIC) 1984 acquisition of an eighty percent ownership interest in the public holding company of Continental Illinois National Bank and Trust Co. (Continental Illinois), which was, before its failure, one of the ten largest banks in the United States.³² The paper then looks at the 2008-09 bailouts of AIG, Citigroup, GM, Chrysler and Ally and shows that the government has developed a policy for how it acts as a shareholder. Moreover, notwithstanding the government's assertions of a "reluctant shareholder" policy, the government has been deeply involved in these companies as a creditor, regulator, and legislator.

Finally, in Part IV, I argue that government intervention in business has become sufficiently regular that the government should develop policies for the future so that its actions are more forthright and transparent. To that end, I set forth a modest proposal consisting of three suggestions. First, when Treasury is a substantial shareholder, it should work with corporate management to provide regularly the general public with clear specific statements about government intervention and its effect on the corporation. The public is entitled to more information because this is not "business as usual." The second and third proposals contemplate that the government will exercise the customary power of a substantial shareholder and select directors that will represent the taxpayers' interests in the boardroom. Specifically, as the second proposal, when Treasury is a substantial shareholder in a public corporation, it should use its power to nominate and run its own nominees for the board of directors, who would serve on the board as representatives of Treasury in order to represent the interests of the U.S. taxpayer. Third, when Treasury, as a shareholder in either a public or private corporation, has the power to elect or appoint directors, it should select at least some high-level Treasury officials to those directorships. Unlike directors who come from the business sector, they will be able to present the government's perspectives and concerns to management and the other members of the board. They, in turn, will have greater knowledge and understanding about the corporation that the government substantially owns. Treasury's active participation in the corporate boardroom could promote greater understanding of the respective positions of government and business and alleviate some of the tensions and conflicts resulting from the uneasy alliance of government and business.

³² FED. DEPOSIT INS. CORP., *MANAGING THE CRISIS: THE FDIC AND RTC EXPERIENCE 1980-1994*, at 545-65 (1998).

II. PRINCIPLES OF CORPORATE GOVERNANCE AND THE BAILOUT LEGISLATION

A. *Principles of Corporate Governance*

I begin with a summary review of well-established principles of corporate governance. A corporation's objective is "the conduct of business activities with a view to enhancing corporate profit and shareholder gain."³³ The corporation, however, may take into account ethical considerations and support public welfare and other purposes, whether or not they advance the economic objective.³⁴ Accordingly, the corporate objective is primarily to earn profits within a broad concept of "profits," short or long-term.

Under the accepted director primacy model,³⁵ the board of directors has broad discretion to determine the appropriate balancing of these considerations. In exercising this discretion, directors are expected to act in good faith and in the best interests of the corporation³⁶ and to live up to their duties of loyalty³⁷ and care.³⁸ If they do so, the business judgment rule protects the directors from liability for bad decisions. In the last two decades, a board of directors consisting of at least a majority of independent³⁹ directors has become the model for corporate governance at public corporations.⁴⁰ Thus, in public corporations, the role of the board has changed from determining corporate business policy (for which experience and expertise in the specific business would be required) to monitoring the corporate managers (for which general business experience and gravitas are valued). The typical independent director today is an experienced businessman, typically a retired CEO, who may sit on several other boards.

An integral function of the monitoring board is to assure that the corporation has in place adequate systems and controls to assure that the

³³ PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(a) (1994).

³⁴ *Id.* § 2.01(b).

³⁵ DEL. CODE ANN. tit. 8, § 141(a) (2010); MODEL BUS. CORP. ACT § 8.01(b) (2005).

³⁶ MODEL BUS. CORP. ACT § 8.30(a) (2005).

³⁷ DEL. CODE ANN. tit. 8, § 144 (2010); MODEL BUS. CORP. ACT § 8.61 (2005).

³⁸ *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963); *see also* MODEL BUS. CORP. ACT § 8.30(b) (2005).

³⁹ Definitions of "independent directors" are found in NASDAQ, INC., MARKET PLACE RULES § 5605(a)(2) (2006) [hereinafter NASDAQ RULES], *available at* http://nasdaq.cchwallstreet.com/NASDAQ/pdf/new_listing_rules.pdf; NYSE, INC., LISTED COMPANY MANUAL § 303A.02 (2010) [hereinafter NYSE MANUAL].

⁴⁰ NASDAQ RULES § 5605(b)(1); NYSE MANUAL § 303A.01.

corporation complies with the law⁴¹ and adequately manages enterprise risks.⁴² Even before the financial crisis, this model of corporate governance had its critics,⁴³ and the deficiencies in risk assessment on the part of managers and boards of banks and financial services firms raise again the question of the effectiveness of the monitoring board and the director primacy model.⁴⁴

The role of the shareholders in corporate governance is, first and foremost, to elect the directors and, as a corollary, to remove directors if they have lost the confidence of the shareholders.⁴⁵ As a practical matter, however, directors' elections are rarely contested, and directors are seldom removed unless part of a well-funded effort to take control of the board, frequently to redeem a poison pill.⁴⁶ Shareholders also have the power to veto certain major corporate decisions proposed by the board of directors, such as a merger or sale of all the assets⁴⁷ or amendments to the certificate of incorporation.⁴⁸ Consistent with their passive role, shareholders have limited rights to obtain information about the company that is not disclosed in SEC and other public filings.⁴⁹ In addition, shareholders generally do not owe any duties to their fellow shareholders; they are free to act in a self-interested manner and do not have to take into account the effect of their actions on fellow shareholders.⁵⁰ "Controlling" shareholders, however,

⁴¹ U.S. SENTENCING GUIDELINES MANUAL § 8B2.1(a)(2) (2007); MODEL BUS. CORP. ACT § 8.01(c)(iv) (2005).

⁴² See generally MODEL BUS. CORP. ACT § 8.01(c)(ii), (vi); COMM. OF SPONSORING ORGS. OF THE TREADWAY COMM'N, EFFECTIVE ENTERPRISE RISK OVERSIGHT: THE ROLE OF THE BOARD OF DIRECTORS (2009).

⁴³ See, e.g., Lucian A. Bebchuk, *Letting Shareholders Set the Rules*, 119 HARV. L. REV. 1784 (2006).

⁴⁴ See Stephen M. Bainbridge, *Caremark and Enterprise Risk Management*, 34 J. CORP. L. 967, 970–71 (2009) (reporting results of a 2002 survey of corporate directors in which forty-three percent said that their board had ineffective, or no, process for identifying and managing risk and a 2008 survey of CFOs who expressed concern about their own companies' risk management practices); see also Andrew Clark, *US Politicians Amazed as Ex-AIG Boss Martin Sullivan Pleads Ignorance*, GUARDIAN, July 1, 2010, at 24.

⁴⁵ DEL. CODE ANN. tit. 8, §§ 141(b), (k), 211(b) (2010); MODEL BUS. CORP. ACT §§ 7.01, 808 (2005).

⁴⁶ See Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 856 (2005) (stating that outside the hostile-takeover context, challenges to incumbent directors are rare).

⁴⁷ DEL. CODE ANN. tit. 8, §§ 251, 271 (2010); MODEL BUS. CORP. ACT §§ 11.02, 12.02 (2002).

⁴⁸ DEL. CODE ANN. tit. 8, § 242 (2010); MODEL BUS. CORP. ACT § 10.02 (2005).

⁴⁹ DEL. CODE ANN. tit. 8, § 220 (2010); MODEL BUS. CORP. ACT §§ 16.02, 16.04 (2005).

⁵⁰ STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS § 7.4 (2002).

have equitable limitations placed on their power to extract value from the corporation to the detriment of minority shareholders.⁵¹

In contrast to the director primacy model, shareholder activists seek a greater voice for shareholders in corporate governance. While the shareholder activist movement is not monolithic, an overarching theme is greater accountability of the corporate board to the shareholders. Some advocates for greater shareholder empowerment argue for limits on the board's discretion in order to maximize shareholder value⁵² and specifically seek to curtail the board's power to adopt "poison pills" without shareholder approval.⁵³ Other advocates want to make the election of directors a more meaningful exercise of shareholder voting rights by allowing shareholders access to the management proxy statement for nomination of directors.⁵⁴ In recent years, many shareholder groups have focused on generous executive compensation packages for senior management and advocate for a nonbinding shareholder vote on compensation ("say on pay").⁵⁵ Shareholder activism, however, is not a call for a radical restructuring of the corporate norm, but rather argues for some limitations on board power in order to realize shareholder value or achieve greater accountability.⁵⁶

Finally, although creditors are not formally part of the corporate governance structure, major creditors can wield considerable power because they can negotiate for controls on the corporation to protect their investment that are more extensive than those possessed by shareholders.⁵⁷ Creditors owe no fiduciary duties to the corporation or its shareholders.⁵⁸

⁵¹ *Id.*

⁵² Bebcuk, *supra* note 46, at 911.

⁵³ *See, e.g.,* Bebcuk v. CA, Inc., 902 A.2d 737, 739, 743 (Del. Ch. 2006).

⁵⁴ *See, e.g.,* *Corporate Governance Policies*, COUNCIL OF INSTITUTIONAL INVESTORS, § 3.2, <http://www.cii.org/UserFiles/file/CII%20Corp%20Gov%20Policies%20Full%20and%20Current%2009-29-10%20FINAL.pdf> (last updated Sept. 29, 2010).

⁵⁵ In response, Congress required TARP recipients to adopt say-on-pay, *see infra* OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, QUARTERLY REPORT TO CONGRESS 118 (July 21, 2009) [hereinafter SIGTARP, QUARTERLY REPORT TO CONGRESS July 2009]; *see infra* note 72 and accompanying text.

⁵⁶ *See, e.g.,* *About the Council*, THE COUNCIL OF INSTITUTIONAL INVESTORS <http://www.cii.org/about> (last visited July 21, 2010) (stating that "[g]ood corporate governance is a system of checks and balances that fosters transparency, responsibility, accountability and market integrity").

⁵⁷ *See generally* Kelli A. Alces, *Strategic Governance*, 50 ARIZ. L. REV. 1053 (2008).

⁵⁸ *See* N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99 (Del. 2007).

As I discuss later, the government embraced the director primacy model, with its emphasis on independent directors overseeing the business and a “hands-off” shareholder policy. The government, however, has not exercised its power as a significant shareholder to nominate and elect directors charged with the responsibility to represent the U.S. taxpayers’ interests in the boardroom.

We turn next to Congressional legislation authorizing the bailout to ascertain Congress’s expectations with respect to corporate governance.

B. *The Bailout Legislation*

In EESA, Congress made clear its expectation that Treasury would seek to maximize investment returns in order to minimize the impact on the national debt.⁵⁹ Consistent with this, it specifically directed Treasury, when providing assistance to an exchange-traded financial institution, to take an equity interest to allow for the potential of upside gain.⁶⁰ Congress, however, did not expect that Treasury would exercise rights as a shareholder; the statute directs the Treasury Secretary to agree not to exercise voting power if it acquires voting stock.⁶¹ It is not clear why Congress did not want Treasury to vote; it may reflect either a general disinclination on policy grounds or a specific distrust of how the executive department might exercise voting power. It is incongruous, however, to adopt a policy of shareholder maximization while denying the shareholder voting power. As we will see later, the government has exercised its voting rights, albeit in a limited fashion.

Congress also attached conditions to TARP assistance, the most significant of which relate to controls on executive compensation. All TARP recipients are subject to executive compensation restrictions. So long as the TARP recipient has an outstanding “obligation” to the federal government, it must comply with guidelines on executive compensation promulgated by Treasury, currently set forth in its Interim Final Rule on TARP Standards for Compensation and Corporate Governance (the “Rule”).⁶² Treasury created the Office of Special Master for TARP Executive Compensation (the “Special Master”), whose responsibilities include reviewing and approving executive compensation of TARP recipients, as follows:

⁵⁹ Emergency Economic Stabilization Act of 2008 § 103(1), 12 U.S.C.A. § 5213 (West 2006).

⁶⁰ 12 U.S.C. § 5223 (2006).

⁶¹ *Id.*

⁶² OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, QUARTERLY REPORT TO CONGRESS 101 (Jan. 2010) [hereinafter SIGTARP, QUARTERLY REPORT TO CONGRESS Jan. 2010].

- Review and approve any payments of compensation for their five senior executive officers (“SEOs”) and twenty next highly paid employees of TARP recipients that have received “exceptional assistance;”⁶³
- Review and approve the structure of compensation of TARP recipients that have received exceptional assistance for their hundred most highly paid employees;⁶⁴
- Review bonuses, retention awards, and other compensation paid to SEOs and the twenty next most highly paid employees before February 17, 2009, by all TARP recipients and, where appropriate, negotiate reimbursements;
- Provide advisory opinions with respect to the application of the Rule and whether compensation payments and plans are consistent with law and the public interest.⁶⁵

The Special Master is required to use specific principles in his review of compensation arrangements, including:

- “risk—the compensation structure should avoid incentives for employees to take unnecessary or excessive risks that could threaten the value of the TARP recipient...”
- “tax payer return—the compensation structure . . . should reflect the need for the TARP recipient to remain a competitive enterprise, to retain and recruit talented employees who will contribute to the TARP recipient’s future success, and ultimately to be able to repay TARP obligations.”⁶⁶

Other relevant considerations include appropriate allocation of the components of compensation (salary, pensions, bonuses and incentives), performance-based compensation, comparable structures and payments, and employee contribution to the TARP recipient’s value.⁶⁷

⁶³ Recipients of exceptional assistance include AIG, GM, GMAC, and Chrysler. It previously included Citigroup and Bank of America. *See SIGTARP QUARTERLY REPORT TO CONGRESS July 2009, supra note 55, at 123.*

⁶⁴ According to the Treasury, this is to ensure that compensation is fair and structured, to protect taxpayer interests and to promote long-term shareholder value. *Id.*

⁶⁵ SIGTARP, QUARTERLY REPORT TO CONGRESS Jan. 2010, *supra note 62, at 102.*

⁶⁶ SIGTARP, QUARTERLY REPORT TO CONGRESS July 2009, *supra note 55, at 122.*

⁶⁷ *Id.* at 123; *see also Compensation in the Financial Industry-Government Perspectives: Hearing Before the H. Comm. on Fin. Servs., 111th Cong. (2010) (testimony of Kenneth R. Feinberg, Special Master for TARP Exec. Comp., U.S. Department of the Treasury) (describing the variables and considerations at issue when determining whether compensation levels or structures are appropriate).*

In addition, the American Recovery and Reinvestment Act of 2009 (ARRA),⁶⁸ as implemented by the Rule, provides for additional controls on executive compensation. Each TARP recipient must establish a board compensation committee consisting of independent directors, whose responsibilities include meeting at least semi-annually to review with senior risk officers the proposed compensation plans of all employees and to ensure that the TARP recipient is not unnecessarily exposed to risk.⁶⁹ In addition, the committee must evaluate CEO compensation plans to ensure that the plans do not encourage the CEOs to take unnecessary and excessive risks that could threaten the value of the TARP recipient and file reports with the Treasury on its work.⁷⁰

TARP recipients also are required, under ARRA: to permit an annual non-binding vote by the shareholders on executive compensation ("say on pay") as required by SEC regulations;⁷¹ to adopt company-wide policies to define and prevent excessive expenditures on entertainment and other "luxury" expenses;⁷² and to require that bonuses paid to CEOs and the next twenty most highly paid employees be subject to a clawback if the payment was based on materially inaccurate performance criteria.⁷³ Golden parachute payments to a CEO or the next five mostly highly paid employees are prohibited.⁷⁴

In addition to the Congressionally mandated provisions, Treasury imposed additional requirements to protect shareholder value and increase transparency, including a prohibition on tax gross-ups, a requirement that TARP recipients provide additional disclosure of perquisites, a requirement that TARP recipients provide disclosure about compensation consultants, and certification and reporting requirements.⁷⁵

The restrictions on executive compensation reflect Congressional and public anger over large compensation packages paid to executives of failed firms,⁷⁶ as well as the conventional wisdom that many forms of

⁶⁸ American Recovery and Reinvestment Act of 2009 (ARRA), Pub. L. No. 111-5, 123 Stat. 115 (codified in scattered sections and titles of U.S.C.).

⁶⁹ SIGTARP, QUARTERLY REPORT TO CONGRESS July 2009, *supra* note 55, at 124.

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.* at 121. The rule also requires that the TARP recipient exercise its clawback rights unless it can demonstrate that it would be unreasonable to do so.

⁷⁴ *Id.*

⁷⁵ *Id.* at 125–26.

⁷⁶ See, e.g., Michael Lewis, *Mass Hysteria Over AIG Obscures Simple Truths*, BLOOMBERG, Mar. 20, 2009, <http://www.bloomberg.com/apps/news?pid=20601039&sid=atIHxXH7FweQ> ("[T]he one thing you can do right now in Washington without getting an argument is to rail against the ethics of AIG's bonus payment.").

performance-based incentive compensation encouraged managers to engage in excessive risk-taking by focusing on stock price as a measure of performance.⁷⁷ Congress consistently stated that these provisions were necessary to restore shareholder trust,⁷⁸ but it is an open question whether Congress intended to adopt a corporate governance model with greater emphasis on shareholder rights or was simply responding to constituents' anger. Assuming Congress did intend the former, the legislative measures are not radical measures. The government can veto executive compensation only of those companies receiving "exceptional assistance;" with respect to other TARP recipients, the Special Master's power is strictly jaw-boning.⁷⁹ Exchange-traded corporations have been required since the Sarbanes-Oxley Act of 2002 (SOX) to have independent compensation committees,⁸⁰ clawbacks were first instituted in SOX,⁸¹ and "say on pay" resolutions have routinely been included on management proxy statements.⁸² Nevertheless, some corporations found these conditions sufficiently burdensome that they created an incentive to repay the TARP funds, and most large bank recipients repaid their TARP funds in order to get out from these restrictions.⁸³

The Dodd-Frank Act that is intended to provide long-term solutions to these problems gives the best evidence of the current Congressional commitment to corporate governance reform. The Act contains provisions

⁷⁷ See William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653 (2010). *But see* Sanjai Bhagat & Roberta Romano, *Reforming Executive Compensation: Simplicity, Transparency and Committing to the Long-Term* 3 (Yale Law & Econ. Research, Working Paper No. 393, 2009), available at <http://ssrn.com/abstract=1506742> (stating that best available evidence suggests that incentive compensation did not affect performance of financial institutions during the financial crisis).

⁷⁸ See Bratton & Wachter, *supra* note 77, at 657 (quoting former SEC Chairman Arthur Levitt that "the subprime collapse, the Bear Stearns implosion, and revelations of poor risk management at large financial firms 'had injected a dangerously large degree of mistrust into markets,' and that restoring the shareholder voice 'would go a long way in helping to restore trust'").

⁷⁹ SIGTARP, QUARTERLY REPORT TO CONGRESS Jan. 2010, *supra* note 62, at 102-05. Mr. Feinberg maintains a mandatory role in TARP recipients that have received "exceptional assistance," including the review of the payments of compensation and the structure of the payments for the 100 most highly compensated employees. Mr. Feinberg plays an advisory role in his review of prior payments and in his "interpretation" of current compensation plans at all TARP recipient institutions.

⁸⁰ See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002); 15 U.S.C. § 78j-1(m)(3)(A) (2002).

⁸¹ 15 U.S.C. § 7243(a)(1) (2006).

⁸² See, e.g., Marathon Oil Corp., SEC No-Action Letter, 2010 WL 147282 (Jan. 8, 2010).

⁸³ *Bank of America to Repay TARP, Raise Cash*, ASSOCIATED PRESS, Dec. 2, 2009, available at http://www.msnbc.msn.com/id/34245560/ns/business-us_business/.

on executive compensation, compensation committees and “say on pay” that are substantially the same as those in the TARP legislation.⁸⁴ The Act also adds additional disclosures⁸⁵ and authorization for the SEC to grant shareholders proxy access to nominate directors.⁸⁶ Most likely, Congress viewed these provisions as symbolic of shareholder protection rather than effecting meaningful change.

C. *The Administration’s Guiding Principles*

Consistent with the Congressional directive to take equity investments to maximize investment return,⁸⁷ most outstanding TARP funds, as of mid-2010, are in the form of equity ownership in troubled companies, principally in common and preferred stock.⁸⁸ Specifically, the U.S. government holds substantial interests in two public corporations: 79.77% of the voting power of AIG⁸⁹ and approximately eighteen percent of the common stock of Citigroup (down from 33.6% at December 2009).⁹⁰ The government also owns majority interests in two private corporations—60.8% of GM⁹¹ and 56.3% of Ally⁹² as well as a 9.85% interest in Chrysler, also a private corporation.⁹³ The voting interest in AIG is in the form of a preferred stock; the equity interests in Citigroup, GM, Chrysler and Ally are in common shares. The decision to take these substantial holdings in common shares was driven by the inability of the firms to take on more debt given the precarious condition of their balance sheets. The necessity for financial services firms to maintain minimum levels of capital placed an upper limit on the amount of Citigroup’s and Ally’s debt,⁹⁴ and GM and

⁸⁴ Dodd-Frank Wall Street Reform and Consumer Protection Act § 951–54, Pub. L. No. 111-203, 124 Stat. 1376 (July 2010) (to be codified in scattered sections and titles of U.S.C.).

⁸⁵ *Id.* § 955 (employee and director hedging); *id.* § 956 (compensation structure); *id.* § 972 (chairman and CEO structures).

⁸⁶ *Id.* § 971 (proxy access).

⁸⁷ See *supra* note 60 and accompanying text.

⁸⁸ SIGTARP, QUARTERLY REPORT TO CONGRESS Apr. 2010, *supra* note 3, at 34.

⁸⁹ OFS FINANCIAL REPORT 2009, *supra* note 19, at 27.

⁹⁰ SIGTARP, QUARTERLY REPORT TO CONGRESS Jan. 2010, *supra* note 62, at 72.

⁹¹ U.S. GOV’T ACCOUNTABILITY OFFICE, TROUBLED ASSET RELIEF PROGRAM: THE U.S. GOVERNMENT ROLE AS SHAREHOLDER IN AIG, CITIGROUP, CHRYSLER, AND GENERAL MOTORS AND PRELIMINARY VIEWS ON ITS INVESTMENT MANAGEMENT ACTIVITIES, GAL-10-3257, at 11 (2009) [hereinafter GAO, THE U.S. GOVERNMENT ROLE AS SHAREHOLDER].

⁹² SIGTARP, QUARTERLY REPORT TO CONGRESS Apr. 2010, *supra* note 3, at 116.

⁹³ See GAO, THE U.S. GOVERNMENT ROLE AS SHAREHOLDER, *supra* note 91, at 11.

⁹⁴ Government infusions of additional capital followed the government’s spring 2009 stress testing of banks. See Press Release, U.S. Dep’t of the Treasury, Statement From Treasury Secretary Tim Geithner Regarding the Treasury Capital

Chrysler, emerging from government-engineered bankruptcies, needed infusions of capital.⁹⁵ Thus, the business needs dictated the form of investment as least as much as the Congressional goal of maximizing taxpayers' gain.

Indeed, Treasury has repeatedly stated it is a "reluctant shareholder."⁹⁶ In its mission statement it states: "We want to see the capital base of our financial system return to private hands as quickly as possible, while preserving financial stability and promoting economic recovery."⁹⁷

Treasury has set forth its Managing Guiding Principles as follows:

- Protect taxpayer investments and maximize overall investment returns within competing constraints;
- Promote stability for and prevent disruption of financial markets and economy;
- Bolster market confidence to increase private capital investment;
- Dispose of investments as soon as practicable in a timely and orderly manner that minimizes financial market and economic impact.⁹⁸

These principles, however, do not acknowledge the intractable conflicts confronting the government as shareholder. The first principle, for example, calls for "protecting" the investment—which suggests a conservative business strategy—while at the same time "maximizing" returns, which connotes an aggressive business strategy, all within amorphous "competing constraints." Consistent with its position that it is a "reluctant shareholder," the fourth principle calls for prompt divestiture, but it has to minimize market and economic impact. The second and third principles reflect concerns beyond investment returns and focus instead on a general policy goal—the well-being of capital markets. If these principles all carry equal weight (and Treasury has not indicated that it weights them), then there are potentially serious conflicts that Treasury has not acknowledged in its dual roles as shareholder and "steward of the U.S.

Assistance Program and the Supervisory Capital Assessment Program (May 7, 2009), available at <http://www.treas.gov/press/releases/tg123.htm>.

⁹⁵ See *infra* notes 198–200 and accompanying text. It is not clear why the government felt the necessity of putting so much capital into Ally. See *infra* note 240 and accompanying text.

⁹⁶ OFS FINANCIAL REPORT 2009, *supra* note 19, at 42.

⁹⁷ Press Release U.S. Dep't of the Treasury, Treasury Department Releases Text of Letter from Secretary Geithner to Hill Leadership on Administration's Exit Strategy for TARP (Dec. 9, 2009), available at <http://www.treas.gov/press/releases/tg433.htm>.

⁹⁸ OFS FINANCIAL REPORT 2009, *supra* note 19, at 39–40.

economic and financial systems,"⁹⁹ conflicts that are exacerbated because of its power as controlling shareholder and its concomitant obligation to other shareholders.

Finally, Treasury articulates a policy of shareholder restraint. It has stated that, in its view, it would be inappropriate to exercise its voting power except on matters that directly pertain to its responsibility under EESA to manage its investments in a manner that protects the taxpayer.¹⁰⁰ Treasury thus has adopted the prevailing corporate governance model of director primacy:¹⁰¹ a strong board of directors, no interference in day-to-day management decisions, and limited voting rights on core shareholder issues.¹⁰²

Treasury imposed additional requirements on those companies receiving "exceptional assistance,"¹⁰³ including internal controls, monitoring and reporting requirements, and additional restrictions on expenditures.¹⁰⁴ Creditors and senior security holders frequently bargain for such protections, and they are appropriate for the protection of the government investments. In addition, employees from Treasury's Office of Financial Stability (OFS) have met with exceptional assistance corporations to discuss the company's governance structure and processes related to TARP requirements.¹⁰⁵

III. THE GOVERNMENT AS SHAREHOLDER: PAST AND PRESENT

In this Part, I describe specifically how the government has acted in its role of shareholder. I begin, for the sake of comparison, with the FDIC's acquisition, in 1984, of an eighty percent interest in the public holding company of Continental Illinois and then proceed to examine the 2008-09 bailouts of AIG, Citigroup, the automakers, and Ally.

⁹⁹ *Duties & Functions of the U.S. Department of Treasury*, U.S. DEP'T OF THE TREASURY, <http://www.ustreas.gov/education/duties/> (last update May 25, 2010)

¹⁰⁰ Press Release, U.S. Dep't of the Treasury, Treasury Announces Voting of its Shares at Citigroup Annual Meeting (Apr. 20, 2010), available at <http://www.treas.gov/press/releases/tg647.htm>.

¹⁰¹ See DEL. CODE. ANN. tit. 8, § 141(a); *supra* note 35 and accompanying text.

¹⁰² GAO, THE U.S. GOVERNMENT ROLE AS SHAREHOLDER, *supra* note 91, at 12.

¹⁰³ AIG, GM, GMAC and Chrysler were exceptional assistance recipients.

Citigroup repaid its exceptional assistance loans in December 2009. SIGTARP, QUARTERLY REPORT TO CONGRESS Jan. 2010, *supra* note 62, at 135-36.

¹⁰⁴ *Id.* at 135.

¹⁰⁵ *Id.*

A. *Continental Illinois*

The FDIC's 1984 bailout of Continental Illinois engendered controversy, coined the phrase "too big to fail,"¹⁰⁶ and raised concerns about moral hazard.¹⁰⁷ In that bailout the FDIC assumed eighty percent control of Continental Illinois Corporation (CIC), Continental Illinois's publicly traded holding company. Its story is worth recounting in some detail as it provides the closest parallel to the current government interventions.

In March 31, 1984, Continental Illinois had over \$40 billion in assets and was the seventh largest bank in the United States in both assets and deposits.¹⁰⁸ Unfortunately, it achieved this growth through an aggressive lending policy that ultimately caused the bank's downfall; from 1982–1984 the bank's non-performing assets had significantly increased, and the holding company's stock price tumbled. In May 1984, rumors of the bank's imminent failure led to a run on the bank, and the FDIC intervened with interim assistance. When the FDIC's attempts to arrange an assisted acquisition of the bank with private institutions and investors proved unsuccessful,¹⁰⁹ it worked out, in July 1984, a permanent solution to address the potential deposit run that faced the bank.¹¹⁰

According to the head of the FDIC at the time, there were two key components of the program: "top management changes" and "substantial financial aid."¹¹¹ With respect to the second component, the FDIC took a number of actions. These included the removal of non-performing "troubled loans" from the bank¹¹² and the implementation of provisions to provide funding for its banking operations and to increase its capital

¹⁰⁶ The phrase referred to differential treatment of banks depending on their size and the resulting perceptions of inequity. Lee Davison, *Continental Illinois and "Too Big To Fail,"* in 1 HISTORY OF THE EIGHTIES—LESSONS FOR THE FUTURE 235, 236 (1997).

¹⁰⁷ *Inquiries into Continental Illinois Corporation and Continental Illinois National Bank: Hearings Before the Subcomm. on Fin. Inst. Supervision, Regulation and Ins. of the S. Comm. on Banking, Fin. and Urban Affairs, 98th Cong.* 382 (1984) [hereinafter *Hearings*].

¹⁰⁸ FED. DEPOSIT INS. CORP., *Continental Illinois National Bank and Trust Co., in MANAGING THE CRISIS: THE FDIC AND RTC EXPERIENCE 1980–1994*, at 545, 546 (1998).

¹⁰⁹ 1985 FDIC, ANN. REP. 4 (1985).

¹¹⁰ FED. DEPOSIT INS. CORP., *supra* note 108, at 552. The plan was not officially implemented until September 26, 1984, after shareholders of the Continental holding company gave the required approval of the assistance package.

¹¹¹ *Hearings, supra* note 107, at 461.

¹¹² 1985 FDIC, *supra* note 109, at 43. FDIC entered into an asset management contract with the bank to liquidate the portfolio. FED. DEPOSIT INS. CORP., *supra* note 108, at 555.

base.¹¹³ The FDIC purchased two separate issues of preferred stock in CIC: first, the FDIC purchased a \$720 million issue of permanent, nonvoting, junior preferred stock.¹¹⁴ This preferred stock was convertible upon a sale to a third party into 160 million shares of common stock, which effectively gave the FDIC control of eighty percent of the common stock.¹¹⁵ Furthermore, the FDIC purchased \$280 million of permanent, adjustable-rate, cumulative preferred stock (11.2 million shares) of CIC.¹¹⁶ The FDIC took non-voting shares to signal that it did not intend to hold these positions for a significant amount of time.¹¹⁷ The FDIC also acquired a “make whole” option that gave it the power, after five years, to purchase 100% of the outstanding CIC shares at a nominal price if the FDIC suffered losses exceeding \$800 million under the loan purchase agreement.¹¹⁸ The FDIC exercised the “make whole” arrangement on October 24, 1989 and purchased from the holding company the remaining 10.1 million shares.¹¹⁹ The FDIC retained its holdings for almost seven years until May 1991,¹²⁰ when it announced a public sale of its remaining equity holdings.¹²¹

The FDIC established several guiding principles with respect to corporate governance. First, as noted above, “top management changes” were important, both to strengthen the bank’s management and to hold accountable those responsible for the bank’s disastrous lending policies. The FDIC not only required appointment of a new Chief Executive Officer and a new chairman of the Board of Directors,¹²² it recruited and selected the new officers.¹²³ It also insisted on the removal of those directors who were on the board during the years the bank adopted its disastrous expansion policy, in order to “send a message about directors’ responsibilities.”¹²⁴ Second, the FDIC made assurances that it did not seek

¹¹³ FED. DEPOSIT INS. CORP., *supra* note 108, at 553.

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ Davison, *supra* note 106, at 248 n.44.

¹¹⁸ FED. DEPOSIT INS. CORP., *supra* note 108, at 553. There was also an option that the FDIC could exercise based on smaller losses: “If the FDIC suffered loss under the loan purchase agreement, or in the carrying costs and cost of collection, the FDIC could exercise its option rights in proportional amounts according to the amount of that loss. The purchase price was to be calculated on the basis of one share of stock for every \$20 of the FDIC’s stock.”

¹¹⁹ Davison, *supra* note 106, at 557.

¹²⁰ June 1984–May 1991.

¹²¹ 1991 FDIC, ANN. REP. 13. The FDIC had a twenty-six percent equity interest that it sold at that time.

¹²² FED. DEPOSIT INS. CORP., *supra* note 108, at 552.

¹²³ IRVINE E. SPRAGUE, BAILOUT: AN INSIDER’S ACCOUNT OF BANK FAILURES AND RESCUES 200–209 (1986) (describing FDIC’s selection of new management).

¹²⁴ *Id.* at 215.

to “nationalize” Continental, but rather sought either to minimize costs associated with the aid package or maximize the return on the FDIC investment.¹²⁵ To this end, while the FDIC effectively had an eighty percent interest in the holding company, the stock had no voting rights while owned by FDIC, although it had a veto power over the nomination of any director.¹²⁶ Third, the FDIC stated repeatedly that it did not seek to interfere with day-to-day operations, but rather sought only to exercise influence in limited areas, such as board hiring and proposed mergers.¹²⁷ In these ways, the FDIC sought to exercise control to achieve the bank’s timely recovery and recover its investment, but to avoid direct involvement that would signal a “nationalized” bank. Despite this balancing act, both the banking community and Continental Illinois expressed concerns about potential competitive disadvantages because of perceptions that the bank was a “nationalized” bank.¹²⁸

Ultimately, the bailout cost the FDIC approximately \$1.1 billion.¹²⁹ It also established principles that were applicable in the 2008–2009 interventions.

B. *AIG*

AIG suffered about \$22 billion in losses principally related to credit default swaps on mortgage-related assets and was technically insolvent in September 2008.¹³⁰ Through a series of complicated transactions, Treasury and the Federal Reserve Bank of New York (FedNY) provided financial assistance to AIG in excess of \$180 billion.¹³¹ As a result of the financing, Treasury owns, through a Trust established for its benefit, preferred shares that have 79.77% of the voting power.¹³² In addition, because AIG missed four quarterly dividends on two other classes of preferred shares owned by Treasury, Treasury exercised its right in April 2010 to appoint two

¹²⁵ *Hearings, supra* note 107, at 465. After the fact, the head of the FDIC at the time described the bailout as “nationalization.” William M. Isaac, *Bank Nationalization Isn’t the Answer*, WALL ST. J., Feb. 24, 2009, at A13.

¹²⁶ *Hearings, supra* note 107, at 461; FED. DEPOSIT INS. CORP., *supra* note 108, at 550.

¹²⁷ *Hearings, supra* note 107, at 461. In the less formal and unofficial account, however, Sprague makes it clear that the FDIC would not allow the bank to fail, SPRAGUE, *supra* note 123, at 206.

¹²⁸ Davison, *supra* note 106, at 556–57.

¹²⁹ *Id.* at 558.

¹³⁰ Am. Int’l Group, Inc., Quarterly Report (Form 10-Q) (Nov. 10, 2008).

¹³¹ See William K. Sjostrom, *The AIG Bailout*, 66 WASH. & LEE L. REV. 943 (2009) (setting forth the terms of the government bailout).

¹³² Am. Int’l Group, Inc., Definitive Proxy Statement (Schedule 14A), at 10 (Apr. 12, 2010) [hereinafter AIG, Proxy Statement Apr. 2010].

additional directors.¹³³ Thus, the Trust controls AIG, and, as stated in the AIG proxy statement, “the interests of the Trust and the U.S. Treasury may not be the same as the interests of AIG’s other shareholders.”¹³⁴

Following the Continental Illinois policy of “top management changes,” the government insisted, as a condition of the September 22, 2008 financing, on the resignation of CEO Robert Willumstad (who had been CEO for less than four months) and selected Edward Liddy, formerly CEO at AllState, as the new CEO and Chairman of the Board.¹³⁵ Mr. Liddy came out of retirement to accept the position as a “public service” and received a nominal \$1 per year salary.¹³⁶ There was also considerable turnover on the board of directors from September 2008 through May 2009. Besides Mr. Willumstad, seven AIG directors resigned or announced they would not run for reelection.¹³⁷ At the first annual meeting at which the government was a controlling shareholder, held on June 30, 2009, the board of directors nominated, and the shareholders elected, six independent directors. By the June 12, 2010 annual meeting, there were only three (out of eleven) directors up for election by the common shareholders whose tenures predated the bailout.

The board of directors nominated all the directors elected by the shareholders at the 2010 annual meeting. While we do not know the extent of the government’s influence on the selection of the nominees, the Trustees who vote the government shares testified before Congress in May 2009 that they were actively recruiting new directors¹³⁸ and had

¹³³ Am. Int’l Group, Inc. (Form 8-K) (Apr. 1, 2010).

¹³⁴ AIG, Proxy Statement Apr. 2010, *supra* note 132, at 10.

¹³⁵ *AIG: Where is the Taxpayer’s Money Going?: Hearing Before the H. Comm. on Oversight and Gov’t Reform*, 111th Cong. 15–22 (2009) [hereinafter *AIG: Where is the Taxpayer’s Money Going?*] (statement of Edward Liddy, Chairman and Chief Executive Officer, American International Group).

¹³⁶ Mary Williams Walsh, *Leave Executive Drafted to Run A.I.G., Will Step Down*, N.Y. TIMES, May 22, 2009, at B1 (Mr. Liddy announced his resignation on May 21, 2009, stating that the job was “too big and complex” for one person and that the company and federal government would not find anyone else to take the position at a nominal salary). The board of directors selected Robert Benmosche, a former CEO at MetLife, as the CEO in August 2009. Liam Plevin et al., *AIG Selects Ex-Chief of MetLife as CEO*, WALL ST. J., Aug. 4, 2009, at C1.

¹³⁷ Fred Langhammer (Oct. 28, 2009), Edmund Tse (Mar. 25, 2009), Virginia Rometty and Michael Sutton (May 7, 2009), Stephen Bollenbach, Martin Feldstein and James Orr (May 21, 2009). Another director (Dennis Dammerman) resigned Feb. 28, 2010.

¹³⁸ *AIG: Where is the Taxpayer’s Money Going?*, *supra* note 135, at 75–85 (statement of the Trustees of the AIG Credit Facility Trust: Hearing on the Collapse and Federal Rescue of AIG Before the H. Comm. on Oversight and Gov’t Reform); see also Am. Int’l Group, Inc., *Mission Statement of the Trustees of the AIG Credit Facility Trust*, INFORMATION ABOUT THE AIG TRUSTEES 2,

recommended five nominees to the board.¹³⁹ In addition, we can make the logical assumption that AIG would not nominate any director who did not have at least tacit government approval. Accordingly, looking at the directors who assumed office after September 2008 gives us a sense of the characteristics the government looks for in directors. Besides CEO Robert Benmosche, there are seven directors elected by the shareholders at the 2010 shareholders meeting who joined the board after September 2008. Six of these seven directors are men; the median age is sixty-four. Six are retired CEOs or other senior management; one is currently senior management. The median service on other boards is two. The principal areas of expertise identified by the board were: restructuring (five times); finance (five times); managing large, complex, international institutions (four times); and professional experience in financial services industry (four times); accounting, risk management, and experience in airline and aircraft industries were also identified.¹⁴⁰ The two directors who were appointed by Treasury directly¹⁴¹ fit the same profile; both are male retired CEOs of approximately the same age.¹⁴² In short, the new AIG directors are a very homogeneous group who fit the template of the independent director in a publicly traded corporation: a predominately white, male cohort of retired CEOs who also serve on several other corporate boards.

AIG is the only government investment in which the shares were placed in a Trust. FedNY, which provided the initial federal assistance to AIG, set up the Trust and appointed the initial three Trustees, two of whom have significant connections with FedNY.¹⁴³ The Trust Agreement states that this arrangement was chosen “to avoid any possible conflict with FedNY’s

http://www.aigcreditfacilitytrust.com/aigweb/internet/en/files/Mission%20Statement_tcm1121-242395.pdf (last visited May 5, 2010) [hereinafter *Mission Statement of the Trustees*] (the Trustees’ Mission Statement identifies as their primary initial focus “to ensure that AIG has a capable and effective board of directors.”).

¹³⁹ *AIG: Where is the Taxpayer’s Money Going?*, *supra* note 135, at 119 (statement of Douglas L. Foshee).

¹⁴⁰ AIG, Proxy Statement Apr. 2010, *supra* note 132.

¹⁴¹ The Treasury was able to appoint these two directors directly because of its ownership of two other series of preferred shares.

¹⁴² These two directors have less service on other boards (one and zero).

¹⁴³ Jill M. Considine is the former Chairman, the Depository Trust & Clearing Corporation and a former member of the New York Fed Board of Directors. Chester B. Feldberg is the former Chairman, Barclays Americas and was previously employed by the New York Fed for thirty-six years. Douglas L. Foshee, who resigned in February 2010, is the President and CEO of El Paso Corporation and Chair of the Board of Directors of the Houston Branch of the Federal Reserve Bank of Dallas. Foshee was replaced by Peter A. Langerman, Chairman, President and CEO of the Mutual Series fund group of Franklin Templeton. *See Biographies, Information about the AIG Trustees*, AM. INT’L GROUP, INC. (Mar. 3, 2010), http://www.aigcreditfacilitytrust.com/Bios_1121_239155.html.

supervisory and monetary policy functions.”¹⁴⁴ In addition, use of the Trust may have been viewed as a way to deal with conflicts resulting from the government’s dual roles as both a lender and shareholder or to minimize political meddling in corporate affairs. Finally, the use of the Trust may be an effort to distance the government from AIG governance because of aversion to “nationalizing” a private business.¹⁴⁵

The Trustees have two principal responsibilities: to improve corporate governance¹⁴⁶ and to dispose of the stock.¹⁴⁷ While the Trust Agreement purports to give the Trustees broad discretion, their actual powers have significant limitations.¹⁴⁸ Most pertinently, the Trust Agreement prohibits the Trustees from becoming AIG directors.¹⁴⁹ Moreover, the Trust Agreement provides direction to the Trustees. It states that “in exercising their discretion . . . the Trustees are advised that it is the FedNY’s view” that (1) maximizing the company’s ability to repay the government and (2) being managed in a manner that will not disrupt financial market conditions are consistent with maximizing share value.¹⁵⁰ With respect to the disposition of the shares, the Trustees are required to develop a divestiture plan with the goal of disposing of the shares “in a value maximizing manner.”¹⁵¹ Ultimately, the decision to dispose of the shares rests with the government, since any disposition of the shares is subject to the prior approval of FedNY, after its consultation with Treasury.¹⁵²

To date, the Trustees have sought to keep a low profile and have resisted attempts to engage them in the public debate and controversy over AIG. The Trustees testified at a congressional hearing in spring 2009 (one of their few public statements about their role)¹⁵³ and acknowledged that they were operating in “uncharted waters.”¹⁵⁴ They identified their first priority as enhancing corporate governance to restore public confidence in

¹⁴⁴ AM. INT’L GROUP, INC., AIG CREDIT FACILITY TRUST AGREEMENT 2 (2009).

¹⁴⁵ *Id.*

¹⁴⁶ The purchase agreement obligates AIG and its board of directors to “work in good faith with the Trustees to ensure corporate governance arrangements satisfactory to the Trustees.” Am. Int’l Group, Inc., (Form 8-K) (Mar. 5, 2009).

¹⁴⁷ AM. INT’L GROUP, INC., *supra* note 144, § 2.05.

¹⁴⁸ *Id.* at 2. Under the Trust Agreement, the Trustees have “absolute discretion and control” over the shares, subject to its terms.

¹⁴⁹ AM. INT’L GROUP, INC., *supra* note 144, § 2.04(f). In addition, the Trustees may not vote to elect any director who has been, within the past year, an officer, director or senior employee of FedNY or Treasury. *Id.* § 2.04(e).

¹⁵⁰ *Id.* § 2.04(d).

¹⁵¹ *Id.* § 2.05(a)(ii).

¹⁵² *Id.* § 2.05(a)(iii).

¹⁵³ AIG: *Where is the Taxpayer’s Money Going?*, *supra* note 135.

¹⁵⁴ *Id.* at 75.

the company and, to this end, they were actively recruiting new directors¹⁵⁵ and had recommended five nominees to the board.¹⁵⁶ They requested then-CEO Liddy to undertake a review and develop a comprehensive compensation policy.¹⁵⁷ They reviewed the adequacy of financial and accounting controls and the financial reporting process¹⁵⁸ and engaged in working sessions with AIG management, FedNY and Treasury on the company's business plan.¹⁵⁹ They emphasized they were a "staff of three,"¹⁶⁰ and because of the government's monitoring of AIG, they believed it was not cost-effective for them to hire staff or consultants to assist them in their efforts.¹⁶¹ They testified that it was premature to develop a plan for disposition of the shares; when that eventuality became imminent, they would engage experts to assist with the process.¹⁶² When Congressional members asked about their views on the business plan, the Trustees' response was a polite, but firm "not our job."¹⁶³ Indeed, some Committee members expressed frustration and confusion over the Trustees' activities, with Chairman Towns asking them what was their role.¹⁶⁴

Other attempts to involve the Trustees in public debate over AIG have failed. An activist shareholder urged their support for its shareholder resolution on executive compensation; the Trustees supported management and voted against the resolution.¹⁶⁵ Eliot Spitzer, the former Governor of New York who has become something of a corporate gadfly,¹⁶⁶ urged the Trustees to put pressure on the board of directors to disclose non-privileged AIG emails to permit an "open source" investigation;¹⁶⁷ the Trustees did not publicly respond.

Although the Trustees have maintained a low profile, the involvement of government in its roles as creditor and regulator has been more intrusive

¹⁵⁵ *Id.* at 118. Similarly, the Trustees' Mission Statement identifies as their primary initial focus "to ensure that AIG has a capable and effective board of directors." Am. Int'l Group, Inc., *supra* note 138.

¹⁵⁶ *AIG: Where is the Taxpayer's Money Going?*, *supra* note 135, at 119 (statement of Douglas L. Foshee).

¹⁵⁷ *Id.* at 83. Although they requested him to report back to them regularly, I have not found any follow-up on this.

¹⁵⁸ *Id.* at 84.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.* at 135.

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ *Id.* at 134-36.

¹⁶⁴ *Id.* at 134 ("What is your role in trying to turn this around?").

¹⁶⁵ Am. Int'l Group, Inc., Quarterly Report (Form 10-Q) (Aug. 7, 2009).

¹⁶⁶ See, e.g., Eliot Spitzer, *The Incentives Catastrophe*, SLATE, June 23, 2010, <http://www.slate.com/id/2257955>.

¹⁶⁷ Eliot Spitzer, Frank Partnoy & William Black, Op-Ed., *Show Us the E-Mail*, N.Y. TIMES, Dec. 20, 2009, at WK9.

and, in some instances, the source of considerable tension for AIG management. In its role as creditor, FedNY maintains on-site monitoring of AIG; according to the AIG website, "[a]s creditor, the FRBNY monitors the implementation of AIG's restructuring and divestiture plan and participates as an observer in the corporate governance of AIG."¹⁶⁸ Because AIG received "exceptional assistance" under TARP, AIG is subject to special conditions regarding executive compensation, company expenses and lobbying, for which Treasury has responsibility to monitor compliance.¹⁶⁹ In addition, the Special Master must approve compensation payments to AIG's top five CEOs and twenty next highly paid employees.¹⁷⁰ The Special Master's determinations on AIG executive compensation so upset the newly appointed CEO Robert Benmosche in November 2009 that he threatened to resign even before starting,¹⁷¹ and AIG Chairman Harvey Golub criticized some of the Special Master's determinations as making "little business sense."¹⁷²

In addition, critics have questioned the motives behind some of the government's regulatory actions.¹⁷³ Perhaps the most controversial instance were allegations that FedNY reviewed and edited AIG's SEC filings to cover up details of some transactions, to avoid political fallout from the fact that FedNY paid AIG counterparties (including Goldman Sachs) full value to terminate their credit default swaps.¹⁷⁴ FedNY insisted that its actions

¹⁶⁸ *Government Investment*, AM. INT'L GROUP, INC., www.aigcorporate.com/GIinAIG/role_trustees.html (last visited Sept. 21, 2010).

¹⁶⁹ See OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, TREASURY'S MONITORING OF COMPLIANCE WITH TARP REQUIREMENTS BY COMPANIES RECEIVING SPECIAL ASSISTANCE, SIGTARP 10-007, at 5-9 (July 29, 2010) (criticizing compliance implementation as too slow, overly reliant on the companies to self-report and inadequately staffed).

¹⁷⁰ SIGTARP, QUARTERLY REPORT TO CONGRESS Jan. 2010, *supra* note 62, at 102-05.

¹⁷¹ Anastasia Kelly, AIG's General Counsel, did resign because of Mr. Feinberg's reduction of her base salary. Carol Loomis, *Inside the Crisis at AIG*, CNNMONEY, Feb. 18, 2010, http://money.cnn.com/2010/02/17/news/companies/aig_bailout_kelly.fortune/index.htm?postversion=2010021815.

¹⁷² Press Release, Harvey Golub, Chairman, Am. Int'l Group, Inc., Chairman's Message (Feb. 26, 2010), available at <http://www.aigcorporate.com/investors/AIG09AR-Chairman.pdf>.

¹⁷³ See OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, EXTENT OF FEDERAL AGENCIES' OVERSIGHT OF AIG COMPENSATION VARIED, AND IMPORTANT CHALLENGES REMAIN, at 16 (Oct. 14, 2009). Treasury also received considerable criticism for not taking action to prevent the payment of bonuses, in March 2009, to AIG employees, although the payments were not prohibited under EESA and ARRA.

¹⁷⁴ See OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, FACTORS AFFECTING EFFORTS TO LIMIT PAYMENTS TO AIG COUNTERPARTIES (Nov. 17, 2009). The House Oversight & Government Reform

were taken to protect the taxpayers' investment.¹⁷⁵ Whether or not there is any truth to these allegations, the controversy illustrates the suspicion that surrounds governmental involvement in private business and illustrates the need for greater transparency.

If we compare the Continental Illinois guiding principles with the government's actions in AIG, the significant difference is that in the former case the shares held by the FDIC had no voting power, while the AIG shares have voting power—although the government chose not to exercise the votes directly. The use of the Trust Agreement suggests that, at least at the time of the AIG bailout, the government was uncomfortable in its role as shareholder. In other respects, the principles remain the same: replace the CEO and some of the directors and assert a “hands-off” policy on operational decisions while exerting considerable control behind the scenes.

C. Citigroup

Citigroup became a financial super-firm through the 1998 merger of Citicorp and Travelers Group Inc., a combination that brought about the repeal of the Glass-Steagall Act of 1933, the law that had previously separated commercial and investment banking.¹⁷⁶ Ten years later, Citigroup was financially devastated as a result of its aggressive activity in the securitized mortgage market.¹⁷⁷ In fall 2008, Treasury expended forty-five billion dollars in TARP funding to Citigroup in the form of preferred shares and warrants.¹⁷⁸ In July 2009, at the request of Citigroup, the government converted a portion of its preferred shares into common stock because the Federal Reserve stress test found that Citigroup needed

Committee held a hearing addressing this issue on January 27, 2010. *The Federal Bailout of AIG: Hearing Before the H. Comm. on Oversight and Gov't Reform*, 111th Cong. (2010) (statements of Timothy F. Geithner, Secretary, U.S. Treasury Department & Thomas C. Baxter, Executive Vice President and General Counsel, Federal Reserve Bank of N.Y.).

¹⁷⁵ *Factors Affecting Efforts to Limit Payments to AIG Counterparties: Hearing Before the H. Comm. on Oversight and Gov't Reform*, 111th Cong. 13 (2010) (statement of Thomas C. Baxter, Executive Vice President and General Counsel of the Fed. Reserve Bank of N.Y.).

¹⁷⁶ See Robert Schmidt & Jesse Westbrook, *Wall Street Rules May Fall Short of Glass-Steagall*, BUS. WK., May 26, 2010, <http://www.businessweek.com/news/2010-05-26/wall-street-rules-may-fall-short-of-glass-steagall-update1-.html>.

¹⁷⁷ See Bradley Keoun, Michael J. Moore & Jesse Westbrook, *Citi's Prince Says No One Saw CDO Losses Coming*, BLOOMBERG, April 8, 2010, <http://www.bloomberg.com/news/2010-04-08/citi-s-prince-says-no-one-saw-cdo-losses-coming.html>.

¹⁷⁸ The government also agreed to share losses on a portfolio of approximately \$301 billion of Citigroup assets. Press Release, U.S. Dep't of the Treasury, Written Testimony of Assistant Secretary Allison before the Congressional Oversight Panel (March 4, 2010), *available at* <http://www.treas.gov/press/releases/tg573.htm>.

additional capital. As a result, the government obtained a 33.6% common stock interest.¹⁷⁹ In December 2009, Citigroup repurchased the balance of the preferred shares owned by the government in order to exit from the "exceptional assistance" program.¹⁸⁰ The government wants to conclude its equity investment in 2010 and has begun to sell off its common stock, subject to market conditions.¹⁸¹ Currently it has reduced its ownership position to approximately eighteen percent of the common stock.

In contrast to the trust arrangement for the AIG shares, Treasury owns the Citigroup securities directly. It has full discretion to vote the shares for the election or removal of directors, approval of major transactions and share issuances, and amendments to the certificate of incorporation and bylaws. On all other matters, it agrees to vote in the same proportion as the other shares.¹⁸²

In contrast to the other bailouts, the government did not require the removal of the CEO, probably because Charles Prince, the CEO who famously stated in summer 2007 that the bank "was still dancing,"¹⁸³ had already resigned in November 2007 because of Citigroup's losses.¹⁸⁴ While there were frequent reports that the government would require the resignation of Mr. Prince's successor, Vikram Pandit, in connection with the July 2009 transaction, he remains CEO as of mid-2010.¹⁸⁵

There has been considerable turnover on the Citigroup board since the government bailout, including the retirements of two directors associated with the Prince era: Robert Rubin, who served as Chairman,¹⁸⁶ and Sir Win Bischoff, who served as acting CEO, after Mr. Prince's resignation.¹⁸⁷ The extent to which these resignations were driven by the government is impossible to know, but according to published reports, the government put

¹⁷⁹ OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, QUARTERLY REPORT TO CONGRESS at 68 (Oct. 21, 2009); *see also* Citigroup, Inc., Current Report (Form 8-K), at pt.3.02 (June 10, 2009).

¹⁸⁰ SIGTARP, QUARTERLY REPORT TO CONGRESS Jan. 2010, *supra* note 62, at 74.

¹⁸¹ Press Release, U.S. Dep't of the Treasury, *supra* note 13.

¹⁸² Citigroup, Inc., *supra* note 179.

¹⁸³ *See* Michiyo Nakamoto & David Wighton, *Citigroup Chief Stays Bullish on Buy-Outs*, FIN. TIMES, July 10, 2007, at 1.

¹⁸⁴ In the Citigroup press release, Mr. Prince stated, "it is my judgment that given the size of the recent losses in our mortgage-backed securities business, the only honorable course for me to take as Chief Executive Officer is to step down." Press Release, Citigroup, Inc., Robert E. Rubin to serve as chairman of the Board of Citi; (Nov. 4, 2007), available at http://www.businesswire.com/portal/site/google/index.jsp?ndmViewId=news_view&newsId=20071104005057&newsLang=en.

¹⁸⁵ *See* Eric Dash, *Citi is Urged to Replace its Chairman*, N.Y. TIMES, Jan. 12, 2009, at B1 (reporting that Mr. Pankit has Timothy Geithner's support).

¹⁸⁶ Citigroup, Inc., Current Report (Form 8-K) (Jan. 9, 2009).

¹⁸⁷ *Id.*; *see also* Dash, *supra* note 185.

considerable pressure on Citigroup to shake up its board of directors, to signify a fresh start.¹⁸⁸ Since the government bailout, the board of directors has nominated, and the shareholders elected, eight new independent directors.¹⁸⁹ The personal and professional characteristics of this cohort are very similar to those of the AIG directors: seven are men; the median age is 63; four are retired CEOs, two are current CEOs or senior management, one is an academic, and one is the former President of Mexico.¹⁹⁰ The median number of other boards on which they serve is two.

In addition to its voting power, Treasury exercises oversight through its monitoring of Citigroup's financial condition. Thus, Citigroup agreed to provide Treasury with access to corporate books and financial and accounting records until government ownership drops below a specified percentage.¹⁹¹ Treasury monitors Citigroup's liquidity, capital, profits and losses, loss reserves and credit ratings, and hired an outside asset management firm to monitor its investment.¹⁹² Finally, the government asserts considerable influence over the company in its multiple roles as regulator of the bank and other financial services firms that comprise Citigroup; the press has frequently reported on the conflicting messages and resulting confusion within the company resulting from the multiple federal regulators.¹⁹³

If we compare the Continental Illinois/AIG guiding principles, the significant difference is that, as of July 2009, Treasury directly owns voting shares. This was, as I discuss next, approximately the same time that Treasury acquired its voting shares in the automakers and suggests that by this time it had become more comfortable with its role as shareholder. While the Citigroup CEO was not replaced, the principles otherwise remain the same: replace some of the directors and assert a hands-off policy on operational matters while exercising considerable control behind the scenes.

D. GM and Chrysler

GM and Chrysler are both icons of American industry whose continued existence was in jeopardy because of decades of poor business decisions and the slump in consumer spending occasioned by the financial crisis.¹⁹⁴

¹⁸⁸ Deborah Solomon & David Enrich, *U.S. to Take Big Citi Stake and Overhaul the Board*, WALL ST. J., Feb. 27, 2009, at C1.

¹⁸⁹ Citigroup, Inc., Definitive Proxy Statement (Schedule 14A), at 22 (Mar. 12, 2010).

¹⁹⁰ *Id.*

¹⁹¹ Citigroup, Inc., *supra* note 179, at Item 3.02.

¹⁹² GAO, THE U.S. GOVERNMENT ROLE AS SHAREHOLDER, *supra* note 91, at 16.

¹⁹³ See Langley & Enrich, *supra* note 21.

¹⁹⁴ Press Release, The White House, Office of the Press Sec'y, Remarks by the President on General Motors Restructuring (June 1, 2009), available at

In December 2008, the administration set up the Automotive Industry Financing Program under TARP,¹⁹⁵ and the Obama administration established an automotive task force to force the companies to make difficult decisions.¹⁹⁶ After twice submitting restructuring plans to the government, the automakers went through a rapid bankruptcy process under government pressure and assurances of government support. As the press frequently noted, Chrysler was the first major U.S. automaker to file for bankruptcy since 1933.¹⁹⁷ In June 2009, Chrysler emerged from bankruptcy, with Treasury owning 9.85% equity,¹⁹⁸ and entered an alliance with the Italian automaker Fiat. In July 2009, GM emerged from bankruptcy, with Treasury owning 60.8% equity and \$2.1 billion in preferred shares.¹⁹⁹ Unlike AIG and Citigroup, whose bailouts were driven by fears of the impact on the financial markets, the government bailed out GM and Chrysler because of the importance of the automobile industry as an employer, particularly in the industrial Midwest, an area hard hit by the financial crisis.²⁰⁰ Indeed, the government conditioned its financing on commitments from both companies to produce a portion of their vehicles in the U.S.²⁰¹ Government assistance was also conditioned on the companies' best efforts to reduce total compensation paid to U.S. employees to levels comparable with total compensation paid by Honda, Nissan or Toyota at their U.S. facilities.²⁰²

Treasury holds its common shares in the automakers directly and in each case has entered a shareholders agreement with the other shareholders. Prior to the GM IPO (which may occur in the latter part of 2010)²⁰³

http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-on-General-Motors-Restructuring/.

¹⁹⁵ U.S. GOV'T ACCOUNTABILITY OFFICE, TROUBLE ASSET RELIEF PROGRAM: CONTINUED STEWARDSHIP NEEDED AS TREASURY DEVELOPS STRATEGIES FOR MONITORING AND DIVESTING FINANCIAL INTERESTS IN CHRYSLER AND GM, GAO-10-151, at 1 (Nov. 2009) [hereinafter GAO, CONTINUED STEWARDSHIP], available at <http://www.gao.gov/new.items/d10151.pdf>.

¹⁹⁶ See Press Release, U.S. Dep't of the Treasury, Ron Bloom, Senior Advisor at the U.S. Treasury Dep't Statement before the Cong. Oversight Panel Regarding Treasury's Automotive Industry Financing Program (AIFP) (July 27, 2009), available at <http://www.treas.gov/press/releases/tg236.htm> [hereinafter Press Release, U.S. Dep't of the Treasury].

¹⁹⁷ Jim Rutenberg & Bill Vlasic, *Chrysler Files to Seek Bankruptcy Protection*, N.Y. TIMES, May 1, 2009, at A1.

¹⁹⁸ GAO, CONTINUED STEWARDSHIP, *supra* note 195, at 2.

¹⁹⁹ *Id.*

²⁰⁰ Press Release, The White House, Office of the Press Sec'y, *supra* note 194.

²⁰¹ GAO, CONTINUED STEWARDSHIP, *supra* note 195, at 15.

²⁰² *Id.* at 12.

²⁰³ Soyoung Kim & Philipp Halstrick, *GM IPO Filing, in Auto Loan Talks: Sources*, REUTERS, June 23, 2010, <http://www.reuters.com/article/idUSTRE65M5L220100624>.

Treasury can vote its shares as it determines.²⁰⁴ Thereafter, the government's voting policy with respect to its GM and Chrysler shares is essentially the same: it can vote its shares for (1) director removal, (2) director election as agreed, (3) change of control transactions, (4) amendments to the certificate of incorporation and bylaws that would affect voting rights, and (5) other matters, solely to the extent its vote is required and in the same proportion as the public shareholders.²⁰⁵

Finally, so long as Treasury owns at least ten percent of common stock, GM must provide all financial statements, budgets, reports, liquidity statements, and other information pursuant to the credit agreement, as well as a monthly report, the format and content of which Treasury has the right to specify.²⁰⁶

The CEOs of both companies announced their resignations during the negotiations with the administration over the restructurings. It was widely reported in the press that the administration forced out G. Richard Wagoner, Jr., GM's CEO, as a condition of the restructuring,²⁰⁷ while Robert Nardelli, the Chrysler CEO, stated he made the decision voluntarily.²⁰⁸ At GM, there were subsequent changes at the top. In December 2009, the GM board, in a surprise move, asked Frederick "Fritz" Henderson, Mr. Wagoner's successor, to resign, reportedly because as a twenty-five year GM employee, he was not "enough of a change agent;" Treasury stated it was not involved in the decision.²⁰⁹ Edward Whitacre succeeded Mr. Henderson, first as interim CEO, then as permanent CEO in January 2010.²¹⁰ The administration had selected Mr. Whitacre, a former AT&T CEO, to be Chairman of the GM board when GM emerged from bankruptcy.²¹¹

²⁰⁴ General Motors, Co., Stockholders Agreement (Form 8-K) (July 16, 2009).

²⁰⁵ *Id.*; see GAO, THE U.S. GOVERNMENT ROLE AS SHAREHOLDER, *supra* note 91, at 13.

²⁰⁶ General Motors Co., *supra* note 204, at art. IV § 5.4; GAO, THE U.S. GOVERNMENT ROLE AS SHAREHOLDER, *supra* note 91, at 14.

²⁰⁷ Neil King, Jr. & John D. Stoll, *Government Forces Out Wagoner at GM*, WALL ST. J., Mar. 30, 2009, at A1.

²⁰⁸ David Welch & David Kiley, *Chrysler Files for Bankruptcy*, BUS. WK., Apr. 30, 2009, http://www.businessweek.com/bwdaily/dnflash/content/apr2009/db20090430_841531.htm.

²⁰⁹ Bill Vlasic, *G.M. Asks Its Chief to Resign*, N.Y. TIMES, Dec. 2, 2009, at B1.

²¹⁰ General Motors, Co., Current Report (Form 8-K) (Dec. 7, 2009). Mr. Henderson stepped down after increased pressure from the Board of Directors. See John D. Stoll & Kate Linebaugh, *GM's Chairman Seizes the Wheel*, WALL ST. J., Dec. 1, 2009 at A1.

²¹¹ Bill Vlasic, *G.M. Chairman Vows to Defend Market Share*, N.Y. TIMES, Aug. 4, 2009, at B1.

Pursuant to the GM Shareholders Agreement, Treasury can designate ten of the thirteen directors.²¹² In the case of the Chrysler board, Treasury can designate four of the nine directors.²¹³ The profile of these fourteen directors appointed by Treasury again fits the profile of the typical independent director. Eleven of the fourteen directors are men; the median age is 60. Five are current CEOs or senior management, seven are retired CEOs or senior management, two are academics (one of whom is Chancellor of a major state university system). The median number of other boards is between one and two.²¹⁴

While the heavy hand of the government was visible in forcing the companies into bankruptcy, both the President and Treasury reiterated the "reluctant shareholder" policy. President Obama emphasized that the financial crisis "[has] put our government in the unwelcome position of owning large stakes in private companies for the simple and compelling reason that their survival and the success of our overall economy depend on it."²¹⁵ The government stated that it would seek to exit as soon as practicable,²¹⁶ planned to manage its interest in a hands-off manner²¹⁷ and did not plan to manage its interests to achieve social policy goals.²¹⁸ Notwithstanding the administration's characterization of itself as a passive shareholder, the GM and Chrysler bailouts show that it will negotiate for conditions driven by concerns other than corporate profitability. Conditioning the financing on the automakers' commitment to produce a

²¹² The GM CEO is one of the directors, one is designated by UAW Retiree Medical Benefits Trust, and one is designated by Canada Holdings. At least two-thirds of all directors must be independent under NYSE rules. General Motors Co., *supra* note 204.

²¹³ Fiat appoints three, the Canadian government appoints one, and the UAW Retiree Medical Benefits Trust appoints one. Michael. J. de la Merced & Micheline Maynard, *Fiat Takes over Chrysler after 42-Day Bankruptcy*, N.Y. TIMES, June 11, 2009, at B4.

²¹⁴ See *Board of Directors*, GENERAL MOTORS CO. (Aug. 10, 2010), <http://www.gm.com/corporate/about/board.jsp> (containing information on GM Board of Directors); see also Press Release, U.S. Dep't of the Treasury, Treasury Department Statement on Chrysler's Board of Director Appointments (July 5, 2009) (listing the appointments that the Treasury made to the Chrysler Board of Directors), available at <http://www.ustreas.gov/press/releases/tg197.htm>; see also *Board of Directors*, CHRYSLER GROUP LLC, <http://www.media.chrysler.com/bios.do?jsessionid=59EA2F095383CD9943E4E9C096D1776A?> (last visited Aug. 10, 2010 (information on the Board of Directors currently at Chrysler)).

²¹⁵ Press Release, The White House, Office of the Press Sec'y, *supra* note 194.

²¹⁶ Treasury agreed to use its best efforts to cause an IPO within one year. See General Motors Co., *supra* note 204.

²¹⁷ Press Release, The White House, Office of the Press Sec'y, *supra* note 194 (stating that "what we are not doing--what I have no interest in doing--is running GM").

²¹⁸ Press Release, U.S. Dep't of the Treasury, *supra* note 196.

portion of their vehicles in the United States was driven by the desire to save jobs for U.S. workers.²¹⁹ This same tension between jobs and profitability resurfaced in the controversy over the closings of dealerships.

The controversy over the closing of auto dealerships provides the best example of a clash between business policy and politics. The business strategy of both automakers required reducing the number of dealerships to become leaner and more cost-effective.²²⁰ Auto dealerships, however, have political clout, and it was much in evidence.²²¹ Although there were no reports that the administration interfered in these decisions, individual Congressional representatives expressed indignation at the perceived unfairness.²²² Senator Jay Rockefeller (D-W.V.) expressed a typical sentiment: "Let me be very clear—I don't believe that companies should be allowed to take taxpayer funds for a bailout and then leave local dealers and their customers to fend for themselves with no real notice and no real help. It's just plain wrong."²²³ Indeed, as in the case of the Congressional hearing on the AIG Trustees,²²⁴ many members of Congress showed a misunderstanding of the shareholder's role. Thus, Senator Mark Warner (D-Va.) acknowledged the danger of "micro-managing" the companies but concluded that as government owners "we've got the right and responsibility to ask these questions."²²⁵ In the end, Congress did intervene and gave terminated dealers a right to arbitration.²²⁶ Approximately 1100 GM dealers appealed termination decisions; GM recently announced it

²¹⁹ OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, FACTORS AFFECTING THE DECISIONS OF GENERAL MOTORS AND CHRYSLER TO REDUCE THEIR DEALERSHIP NETWORKS 3 (JULY 19, 2010), available at http://www.sigtar.gov/reports/audit/2010/Factors%20Affecting%20the%20Decisions%20of%20General%20Motors%20and%20Chrysler%20to%20Reduce%20Their%20Dealership%20Networks%207_19_2010.pdf.

²²⁰ GM announced that it planned to reduce the number of GM dealers in the U.S. from 6000 to approximately 3600. Press Release, General Motors, Co., The New General Motors Launches Today (July 10, 2009), available at http://www.buicknaias.com/content/media/us/en/news/news_detail.brand_gm.html/content/Pages/news/us/en/2009/Jul/0710_NewGMLaunches. The bankruptcy judge overseeing the Chrysler bankruptcy allowed it to terminate about twenty-five percent of its dealer franchises immediately: *Judge Says Chrysler Has Good Case for Franchise Cuts*, USA TODAY, June 5, 2009, http://www.usatoday.com/money/autos/2009-06-04-chrysler-court_N.htm.

²²¹ Carl Hulse & Bernie Becker, *Auto Dealers at Risk Turn to Washington*, N.Y. TIMES, June 12, 2009, at B1.

²²² *Id.*

²²³ Peter Whoriskey & Kendra Marr, *Senators Blast Automakers Over Dealer Closings*, WASH. POST, June 4, 2009, at A15.

²²⁴ See *supra* note 164 and accompanying text.

²²⁵ See Whoriskey & Marr, *supra* note 223.

²²⁶ Dana Hedgpeth, *GM to Reinstate 600 Dealerships Slated to Close*, WASH. POST, Mar. 6, 2010, at A12.

would reinstate about 600 of them.²²⁷ SIGTARP examined the process used to terminate auto dealerships and was sharply critical of the government's role in these decisions, particularly its failure to take greater account of job losses at the terminated dealerships.²²⁸

While the rationale for the bailouts was different in the case of the automakers than it was for the financial services firms, otherwise the Continental Illinois/AIG/Citigroup principles were followed: removal of the CEOs, changes in the composition of the board of directors, assertion of a "hands-off" policy. While there is less evidence of Treasury's exercising behind-the-scenes control in the case of the automakers, Congress in fact directly interfered with the companies' business strategy through its intervention in the dealership closings.²²⁹

E. *Ally (f/k/a GMAC)*

Ally was established in 1919 as a GM subsidiary to provide automotive financing.²³⁰ Over time it expanded into other areas, including real estate finance, and in 2006 GM sold the company to Cerberus.²³¹ The company was hard hit by the collapse of both the housing and the automobile markets. In December 2008, the Federal Reserve approved its application to create a bank,²³² and the government provided infusions of capital into the company, for a total of \$16.3 billion.²³³ As a result of the third investment in December 2009, the government's equity interest was

²²⁷ *Id.*

²²⁸ OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, *supra* note 219, at summary of report (stating that "perhaps it is inevitable that public ownership of private companies will have the effect of blurring the Government's appropriate role"). Treasury stated that it strongly disagreed with the report. *Id.* at app.D.

²²⁹ As additional evidence of Congressional meddling: a spokesperson for Rep. Darrell Issa objected to GM's gift of a free sports car to a Detroit Tigers baseball player who was robbed of a perfect game by an umpire's bad call, stating that "[u]ntil G.M. has repaid the taxpayers in full for the money they have borrowed, every action that G.M. takes should advance them in that direction." Nick Bunkley, *Luxury Car As a Gift Stuns a Few*, N.Y. TIMES, June 5, 2010, at B1.

²³⁰ *GMAC Gets New Name: Ally Financial*, 1853 CHAIRMAN (May 7, 2010), <http://www.1853chairman.com/2010/05/09/gmac-gets-new-name-ally-financial/>.

²³¹ Press Release, Cerberus Capital Mgmt., LP, GM Reaches Agreement to Sell Controlling Stake in GMAC (Apr. 3, 2006), *available at* http://www.cerberuscapital.com/news_press_release_040306.html.

²³² GMAC, LLC, Current Report (Form 8-K) (Dec. 24, 2008).

²³³ Hibah Yousuf, *GMAC Receives 3rd Round of Bailout Funds*, CNNMONEY, Dec. 30, 2009, http://money.cnn.com/2009/12/30/news/companies/gmac_bailout/index.htm.

increased to fifty-six percent (from the previous thirty-five percent),²³⁴ and Treasury has the right to appoint four (up from previous two) of nine directors.²³⁵ The governance agreement provides that in connection with any IPO the parties will “revisit the terms of the agreement and work together in good faith to make such modifications as may be reasonably necessary to facilitate such public offering”²³⁶

While the board removed its CEO Alvaro de Molina in November 2009 because of the company’s failure to raise additional funds required by the government stress tests, the administration stated that it played no part in that decision.²³⁷

To date the government has appointed only three directors of the four directors it is entitled to name. Again they fit the pattern: two are men, and the median age is sixty-one. One is currently a CEO, one is an investment banker, and one is a principal in a private equity firm.²³⁸

We do not know much about the government’s involvement in Ally; Treasury’s failure to appoint the full number of directors it is authorized to name suggests that its involvement is minimal. The Congressional Oversight Panel was critical of the government’s bailout of the company, since Ally did not present systemic risk and it was not “too big to fail.”²³⁹ It also noted that Treasury had yet to require a business plan from its management.²⁴⁰ Perhaps the message from Ally is that the administration has become too comfortable with bailouts and too willing to expend government funds on private business.

IV. A MODEST PROPOSAL

Despite assertions from Congressional members that the era of federal bailouts is over, the reality is that there will be future financial crises and the government will bail out businesses whose failure presents systemic risk to the financial markets. Many of the government’s actions since fall 2008

²³⁴ SIGTARP, QUARTERLY REPORT TO CONGRESS Jan. 2010, *supra* note 62, at 46.

²³⁵ See Michael J. de la Merced & Eric Dash, *Lending Giant GMAC Asks for More U.S. Aid*, N.Y. TIMES, Oct. 28, 2009, at B1; see also Press Release, U.S. Dep’t of the Treasury, Treasury Names Appointee to Ally Board of Directors (May 26, 2010) (listing the two newest appointees, totaling the number of government appointments to four), available at <http://www.ustreas.gov/press/releases/tg720.htm>.

²³⁶ GMAC, LLC, Current Report (Form 8-K) (May 21, 2009).

²³⁷ Dan Fitzpatrick & David Enrich, *GMAC Chief Ousted by Board*, WALL ST. J., Nov. 17, 2009, at A1.

²³⁸ Ally Financial, Inc., Annual Report (Form 10-K) (Mar. 3, 2010).

²³⁹ CONGRESSIONAL OVERSIGHT PANEL, MARCH OVERSIGHT REPORT: THE UNIQUE TREATMENT OF GMAC UNDER TARP, 121 (Mar. 10, 2010).

²⁴⁰ *Id.* at 46.

have been ad hoc decisions made in extremely pressured situations. As the bailouts wind-down, policymakers should focus on the normative questions: when is it appropriate for the government to intervene, what form should the intervention take, and (the specific issue that is the focus of this paper) how should the government act when it becomes a shareholder in private business.

As I have shown in Part III, from Continental Illinois through Ally, the government developed a set of principles about how it will act as a shareholder: removal of the CEO, substantial changes on the board of directors, and expression of a hands-off policy as shareholder with behind-the-scenes influence in other capacities. In essence, the government has adopted the prevailing model of corporate governance, with its emphasis on independent directors and strong internal controls. Moreover, the directors that have been elected since the government's tenure generally fit the profile for independent directors of public corporations: they are predominately white males who are retired CEOs or senior management, presumably chosen because of their general business experience and gravitas. Consistent with this model, the role of the government as shareholder has been passive; the AIG Trustees have resisted efforts to become activist shareholders, and the government consistently states that it is a "reluctant shareholder."

Of course there has been government involvement, and indeed the government would be acting recklessly if it did not act to protect the billions of dollars of government funds at risk. Accordingly, the government has intervened behind the scenes principally in its roles as creditor, regulator and politician. The government has intervened in a less systematic and more confrontational manner that has led to misunderstandings, as for example: the TARP Special Master making decisions on executive compensation that made no business sense to the AIG Chairman,²⁴¹ Citigroup being confused about what the various federal regulators expected from it,²⁴² and Congress placing restrictions on the ability of the automakers to cancel dealerships and downsize.²⁴³

Moreover, members of the public understandably want greater transparency in order to assess for themselves how these uneasy alliances between government and business are working out. Accordingly, Treasury's reluctance to disclose the identities of the AIG counterparties in the company's SEC filings, whatever the motivation, unfortunately fueled public distrust.²⁴⁴ A review of the AIG and Citigroup SEC filings reveals very little concrete information about the nature and extent of government

²⁴¹ See *supra* note 172 and accompanying text.

²⁴² See Press Release, The White House, Office of the Press Sec'y, *supra* note 194.

²⁴³ See *supra* notes 223–28 and accompanying text.

²⁴⁴ See *supra* notes 174–75 and accompanying text.

involvement. The 2010 AIG proxy statement does little more than identify as a risk factor the government's stock ownership and warn that the government's interest may be different from other shareholders.²⁴⁵ Similarly, the Citigroup proxy statement and Annual Report do not provide information on the effect of government involvement, except with respect to executive compensation decisions. Citigroup only identifies a risk factor the effect the sale of the government shares may have on the stock price.²⁴⁶ While it may seem silly to get upset that GM gave a car to a Detroit baseball player,²⁴⁷ the adverse public reaction to this gift may reflect a frustration about lack of information.

Perhaps it is time to consider another approach. My modest proposal accepts that the director primacy model is the prevalent corporate governance theory. Working with that model, I make three suggestions: (1) When Treasury is a substantial shareholder, it should work with corporate management regularly to provide the general public with clear specific statements about government intervention and its effect on the corporation. (2) When Treasury is a substantial shareholder in a public corporation, it should use its power to nominate and run its own nominees for the board of directors, who would serve on the board as representatives of Treasury in order to represent the interests of the U.S. taxpayer. (3) When Treasury, as a shareholder in either a public or private corporation, has the power to elect or appoint directors, it should select at least some high-level Treasury officials to those directorships. Unlike directors who come from the business sector, they will be able to present the government's perspectives and concerns to management and the other members of the board.

As to the first proposal: the classic corporate governance model provides shareholders with little information apart from SEC filings and what management may voluntarily disclose.²⁴⁸ Limited access to information is consistent with the passive role of shareholders. In a corporation in which the government has taken a substantial equity interest, however, members of the general public have reason for concern, for this is an extraordinary situation in which all U.S. taxpayers have a sizable stake. It is also understandable that, given the unusual situation, the public would be confused or mistrustful of government intervention. Under these circumstances, the government should work with management to provide maximum transparency, consistent with protecting the corporation's legitimate needs for confidentiality.

The principal objection to this proposal is that it would put undue burdens on management and government at a time when decisions and

²⁴⁵ See *AIG: Where is the Taxpayer's Money Going?*, *supra* note 135.

²⁴⁶ CITIGROUP, *supra* note 7, at 56; Citigroup, Inc., *supra* note 189, at 48.

²⁴⁷ See *GMAC Gets New Name: Ally Financial*, *supra* note 230.

²⁴⁸ See BAINBRIDGE, *supra* note 50.

judgments affecting the company's continued viability would likely have to be made in a compressed time frame. A related concern is the increased risks of federal securities fraud liability for intentional false disclosures relating to material information. These objections are consistently made whenever expanded disclosure duties are advocated. In order to establish liability for securities fraud disclosure violations, however, plaintiffs must establish scienter, which requires proof of intentional misconduct or reckless conduct, and federal courts maintain high standards for plaintiffs to meet the burdens of pleading and proof. It is unlikely that this provision would increase directors' potential liability. Another objection is that it would put the corporation at a competitive disadvantage vis-à-vis companies that did not need bailing out. While this may be true, it is a cost of the bailout and should not override the public's need to know.

As to the second and third proposals: the participation in the corporate boardroom of directors who are identified as government representatives could do much to alleviate the tensions between the business and the government. The government directors would be members of the body charged with the responsibility of acting in the best interests of the shareholders and would participate in the important business decisions. As members of the board of directors, the government representatives would be in the best position to explain the government's concerns and to listen to the management's concerns. A greater understanding on the part of all directors could promote a more informed balancing of competing interests. In addition, because the directors would be better informed about the business, they would be better able to monitor the government's investment. In this way, perhaps business and government objectives could both be advanced in a more sustained, policy-oriented, less confrontational manner.

A principal objection to my proposal is that the government representatives, as members of the board of directors, would owe fiduciary duties to the corporation that could conflict with their obligations to the U.S. government. However, as discussed earlier,²⁴⁹ boards have broad discretion to take into account social and policy considerations in exercising their business judgment; operating a business in a manner reasonably designed to pay off government debt would surely pass muster. Moreover, so long as directors act in good faith and without gross negligence, their actions will be protected by the business judgment rule. Finally, the government, as a controlling shareholder, may already owe a fiduciary duty to the minority shareholders in at least some circumstances.²⁵⁰

Another objection is that the U.S. corporate model views with disfavor "special interest" directors because the board of directors is supposed to act

²⁴⁹ See *supra* notes 35–38 and accompanying text.

²⁵⁰ See *supra* note 52 and accompanying text.

as a collective decision-maker and arrive at business decisions that reflect the consensus. That is an ideal, however, that may not conform with actual practice. Use of a controlling shareholder's voting power to place its representatives on a board, moreover, is accepted practice, and some boards do include directors that represent a constituency, as when preferred shares get voting rights because of unpaid dividends or the certificate of incorporation allows for cumulative voting.

Finally, another objection is that this is yet another step closer to "nationalizing private business" or even "socialism." Because of the U.S. aversion to these concepts, this objection may well be a conversation stopper, in which case we will muddle along, hope that the government can extricate itself from these companies and pray that this will never happen again. That would be unfortunate.