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FIFTH AMENDMENT — ILLEGAL EXACTION — COURT OF FEDERAL CLAIMS HOLDS THAT GOVERNMENT ACQUISITION OF EQUITY SHARE IN AIG EFFECTED AN ILLEGAL EXACTION. — *Starr International Co. v. United States*, 121 Fed. Cl. 428 (2015).

In the fall of 2008, the Federal Reserve Bank of New York (FRBNY) agreed to lend American International Group (AIG) \$85 billion to save the insurance giant from insolvency.¹ As consideration for the loan, the FRBNY demanded a 79.9% equity stake in the company, among other things.² Recently, in *Starr International Co. v. United States*,³ the Court of Federal Claims held that the Federal Reserve Act⁴ did not authorize the FRBNY to acquire equity in AIG, and that the FRBNY's doing so effected an illegal exaction.⁵ The court concluded, however, that AIG shareholders suffered no economic loss, because without the government's loan the company would have declared bankruptcy.⁶ Therefore, the court awarded zero damages.⁷ This no-damages finding allowed the court to condemn the government's behavior while avoiding an undesirable practical repercussion — a potentially huge bill to taxpayers.⁸ But *Starr* is troubling for at least two reasons. First, the court narrowly interpreted the Federal Reserve Act's incidental powers clause,⁹ unnecessarily restricting the government's ability to respond to future financial crises. Second, the court relied exclusively on the damages question to resolve plaintiffs' illegal exaction claim, a reliance that may be misplaced given the Supreme Court's recent decision in *Horne v. Department of Agriculture*.¹⁰ Because *Starr International Co. (Starr)* has appealed,¹¹ the Federal Circuit will have an opportunity to revisit and perhaps revise the lower court's analysis.

The U.S. financial system was in fragile shape in September 2008.¹² Defaults in the housing market had sparked fire sales of certain assets,

¹ See *Starr Int'l Co. v. United States*, 121 Fed. Cl. 428, 430–31 (2015).

² See *id.* at 446–47. The form of the equity was to be newly issued preferred voting stock. See *id.* at 445. The government's share was not controlling for regulatory accounting purposes, see *id.* at 443 n.8, but conferred effective control of AIG's management, see *id.* at 447–48.

³ 121 Fed. Cl. 428.

⁴ Pub. L. No. 63-43, 38 Stat. 251 (1913) (codified as amended at 12 U.S.C. §§ 221–522 (2012)).

⁵ *Starr*, 121 Fed. Cl. at 434; see also *id.* at 464 (“[I]llegal exaction . . . involves money . . . ‘improperly paid, exacted, or taken from the claimant in contravention of the Constitution, a statute, or a regulation.’” (quoting *Eastport S.S. Corp. v. United States*, 372 F.2d 1002, 1007 (Ct. Cl. 1967))).

⁶ *Id.* at 436.

⁷ *Id.*

⁸ See *id.* at 430 (“Starr claims damages in excess of \$40 billion.”).

⁹ Federal Reserve Act § 4, 12 U.S.C. § 341 (2006) (amended 2010).

¹⁰ 135 S. Ct. 2419 (2015). In *Horne*, a Fifth Amendment takings case, the Court rejected a damages approach that closely resembled the *Starr* court's analysis. See *id.* at 2431–33.

¹¹ See *Starr Int'l Co. v. United States*, No. 15-5133 (Fed. Cir. Aug. 14, 2015).

¹² The account of the 2008 financial crisis that follows is that reported by *Starr*. See *Starr*, 121 Fed. Cl. at 437–60. Although this account is the one relevant for the legal analysis here, it is

including mortgage-backed securities and collateralized debt obligations.¹³ As the prices of these assets fell, their value as collateral for short-term lending fell too.¹⁴

AIG was in a uniquely unenviable position in the midst of this crisis. Most of AIG's liquidity problems stemmed from its securities lending program.¹⁵ Through this program, AIG held many troubled housing assets.¹⁶ Worse, it also had issued a large number of credit default swaps, requiring AIG to pay cash when these assets defaulted or suffered various other negative credit events.¹⁷ After unsuccessfully attempting to improve the company's precarious position,¹⁸ AIG's CEO sought some sort of public assistance from the Treasury Department and FRBNY.¹⁹ At the time, the FRBNY determined that AIG's survival was as important to the health of the financial system as any bank's, and it agreed to work with AIG toward a solution.²⁰

The FRBNY established an \$85 billion line of credit for AIG,²¹ invoking its authority under section 13(3) of the Federal Reserve Act to lend to nonbanks in "unusual and exigent circumstances,"²² "subject to such limitations, restrictions, and regulations as the Board of Governors . . . may prescribe."²³ The terms of the AIG loan were approved by the Federal Reserve Board and included, among other things, the granting of a 79.9% equity share to the government.²⁴ AIG's Board of

by no means the only account, nor is it necessarily the correct account. *See, e.g.*, HAL S. SCOTT, COMM. ON CAPITAL MARKETS REGULATION, INTERCONNECTEDNESS AND CONTAGION (2012), http://www.aei.org/wp-content/uploads/2013/01/interconnectedness-and-contagion-by-hal-scott_153927406281.pdf [<http://perma.cc/9LH8-M2SW>] (suggesting that an AIG failure would not have spread to other financial institutions through direct asset and liability connections to AIG, *see id.* at 4–5, but rather through contagious "run-like behavior" to which the financial system is particularly vulnerable, *id.* at 6).

¹³ *See Starr*, 121 Fed. Cl. at 437–38.

¹⁴ *See id.* at 439–40.

¹⁵ *See id.* at 440.

¹⁶ *See id.* (discussing investments by AIG's securities lending program).

¹⁷ *See id.*

¹⁸ In the spring and summer of 2008, AIG raised \$23.25 billion, *see id.* at 440, mainly in the form of around 275 million shares of varying stock issues, *see A.I.G.'s Raising of Capital Depresses Its Share Price*, N.Y. TIMES (May 21, 2008), <http://www.nytimes.com/2008/05/21/business/21insure.html>. These shares constituted 9.3% of AIG's non-government-owned outstanding shares on September 24, 2008 (2.953 billion). *See Starr*, 121 Fed. Cl. at 472–73. By the fall of 2008, however, AIG had found no private investors "willing to provide sufficient financing to stabilize the company," *id.* at 442, given its increasing liquidity problems and rumors of an imminent credit rating downgrade, *see id.* at 441–42.

¹⁹ *See Starr*, 121 Fed. Cl. at 440–42.

²⁰ *See id.* at 442–43.

²¹ *See id.* at 444–45.

²² *Id.* at 466 (quoting Federal Reserve Act § 13(3), 12 U.S.C. § 343 (2006) (amended 2010)).

²³ Federal Reserve Act § 13(3), 12 U.S.C. § 343.

²⁴ *See Starr*, 121 Fed. Cl. at 445–46 (finding the agreed-upon exchange to be "[e]quity participation equivalent to 79.9% of the common stock of AIG on a fully-diluted basis" (alteration in original)). The terms specified no limit on how long the government could hold this equity. *Id.* at 431.

Directors considered this offer (the “Credit Agreement”) on September 16, 2008, on a take-it-or-leave-it basis and under a very tight deadline.²⁵ Facing the company’s bankruptcy, the Board authorized AIG to enter into the Credit Agreement.²⁶

On November 21, 2011, Starr — one of AIG’s largest shareholders²⁷ — initiated a lawsuit in the Court of Federal Claims against the United States.²⁸ Starr offered two theories: (1) the loan term allowing the FRBNY to take 79.9% equity in AIG constituted an illegal exaction not authorized by the Federal Reserve Act; and (2) even if the equity term were authorized, it effected a taking without just compensation.²⁹ In either case, Starr argued, the FRBNY had violated Starr’s Fifth Amendment rights by diluting the value of its shares by approximately \$40 billion.³⁰

As a preliminary matter, the United States argued that section 13(3) of the Federal Reserve Act authorized the FRBNY to issue a loan subject to certain “limitations, restrictions, and regulations.”³¹ The government maintained that under the incidental powers clause of section 4 of the Act³² the equity requirement was both *necessary* and *incidental* to the FRBNY’s exercise of its section 13(3) power, because it “provide[d] a return to adequately compensate for the significant risk of lending to AIG.”³³ The government also argued that there was no illegal exaction or taking because AIG’s Board of Directors voluntarily accepted the Credit Agreement.³⁴ Finally, the government offered expert testimony that AIG shareholders suffered no economic loss from AIG issuing additional shares to the government because AIG’s share price increased after the initial Credit Agreement on September 16.³⁵

²⁵ See *id.* at 444.

²⁶ See *id.* at 445. The Board also authorized the company to accept a \$14 billion demand note from the FRBNY, *id.*, which made funds available to the company until the final Credit Agreement was executed on September 22, see *id.* at 447.

²⁷ See *id.* at 430. Starr’s controlling shareholder is Maurice R. Greenberg, who served as CEO of AIG until 2005. *Id.*

²⁸ See *id.*

²⁹ See *id.* at 431.

³⁰ See *id.* at 430, 461. Starr used the AIG share price on September 24, 2008, to calculate a “conservative” damages estimate, as this was the lowest price during the three-day period following the alleged illegal exaction/taking. *Id.* at 435–36.

³¹ See *id.* at 469 (quoting Federal Reserve Act § 13(3), 12 U.S.C. § 343 (2006) (amended 2010)); see also *id.* at 468–69.

³² Federal Reserve Act § 4, 12 U.S.C. § 341 (granting “incidental powers . . . necessary to carry on the business of banking within the limitations prescribed by this chapter”).

³³ *Starr*, 121 Fed. Cl. at 462 (alteration in original) (quoting government’s expert).

³⁴ See *id.* at 470–71.

³⁵ See *id.* at 462; see also *American International Group, Inc. (AIG): Historical Prices*, YAHOO! FINANCE, <http://finance.yahoo.com/q/hp?s=AIG+Historical+Prices> (start: Sept. 1, 2008; end: Sept. 24, 2008) [<http://perma.cc/2WQ3-AWAG>].

The Court of Federal Claims agreed with Starr that the terms of the bailout constituted an illegal exaction in violation of the Due Process Clause of the Fifth Amendment.³⁶ The court determined that “there [was] nothing in the Federal Reserve Act or in any other federal statute that would permit a Federal Reserve Bank to take over a private corporation.”³⁷ Therefore, the equity requirement effected an illegal exaction.³⁸ Because “the same government action cannot be both an unauthorized illegal exaction and an authorized taking,” the court declined to consider Starr’s takings claim.³⁹

Turning to the question of damages, the court ultimately found that AIG shareholders suffered no economic loss from the government’s illegal exaction. Although “[c]ommon sense suggest[ed] that the Government should return to AIG’s shareholders the \$22.7 billion in revenue it received from selling the AIG common stock it illegally exacted from [them],”⁴⁰ the court lamented that “case law construing ‘just compensation’ under the Fifth Amendment” required the court to “look to the property owner’s loss, not to the Government’s gain.”⁴¹ The “Achilles’ heel” of Starr’s argument was that, but for the government’s loan, AIG would have filed for bankruptcy, in which case the shareholders’ interests would have been worth nothing.⁴² Thus, the court determined it could not award the plaintiffs damages based on the AIG share price on September 24, 2008, as they had requested,⁴³ because that price would not have been possible without the government’s assistance.⁴⁴

The court’s approach seemingly provides a balance between the competing desires to curb governmental power and to shield taxpayers from the high cost of ordering the government to pay damages. But the court’s analysis may face at least two major challenges on appeal. First, the Federal Reserve Act’s incidental powers clause can be read more broadly than the court suggests. Second, the court’s damages analysis may be incompatible with a recent Supreme Court holding regarding the calculation of economic loss under the Fifth Amendment.⁴⁵

³⁶ *Starr*, 121 Fed. Cl. at 434–35, 467; *see also* U.S. CONST. amend. V (“No person shall be . . . deprived of life, liberty, or property, without due process of law . . .”).

³⁷ *Starr*, 121 Fed. Cl. at 434.

³⁸ *Id.*

³⁹ *Id.* at 472.

⁴⁰ *Id.* at 473.

⁴¹ *Id.* (citing *Brown v. Legal Found. of Wash.*, 538 U.S. 216, 235–36 (2003)); *see also id.* at 436 (“[A] troubling feature of this outcome is that the Government is able to avoid any damages notwithstanding its plain violations of the Federal Reserve Act.”).

⁴² *Id.* at 436.

⁴³ *See id.* at 472–73.

⁴⁴ *Id.* at 474.

⁴⁵ *See* *Horne v. Dep’t of Agric.*, 135 S. Ct. 2419 (2015).

Accordingly, either party can plausibly persuade the Federal Circuit on appeal to take a different approach from that of the lower court.

In a matter of paragraphs, the *Starr* court concluded that the incidental powers clause allows the FRBNY to do only what the rest of the Federal Reserve Act expressly authorizes.⁴⁶ In so doing, the court clipped the Federal Reserve's wings, without even the slightest nod to the potential negative consequences of its ruling in future crises.⁴⁷ Moreover, the court's interpretation ignores precedent interpreting similar language more broadly. Therefore, the United States may convince the Federal Circuit to revisit the lower court's interpretation.

First, the United States could show that the lower court needlessly cabined the FRBNY's authority under the Federal Reserve Act's incidental powers clause.⁴⁸ This clause grants Federal Reserve Banks "such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by this chapter."⁴⁹ The *Starr* court found that because "there is no express power" under section 13(3) to demand anything other than an interest rate as consideration, the taking of equity "was not incidental to any Federal Reserve power."⁵⁰ This interpretation renders the incidental powers clause superfluous: if the FRBNY's incidental powers include only those expressly granted by Congress, what purpose do the words "*and* such incidental powers as shall be necessary" serve?⁵¹ Further, for its interpretation the *Starr* court relied heavily on three cases decided before 1925 that at best tangentially involve the Federal Reserve and its parent act.⁵² Finally, contrary to the court's assertion, section 13(3) arguably contemplates that Federal Reserve Banks will set terms other than an interest rate when it says that all loans "shall be subject to such limitations, restrictions, and regulations as [the Federal Reserve Board] may prescribe."⁵³

Moreover, the court's interpretation is contrary to how other courts have interpreted identical language in the National Bank Act.⁵⁴ In *Arnold Tours, Inc. v. Camp*,⁵⁵ the First Circuit held that incidental powers "necessary to carry on the business of banking"⁵⁶ are those

⁴⁶ See *Starr*, 121 Fed. Cl. at 469–70.

⁴⁷ See *id.* at 469.

⁴⁸ Federal Reserve Act § 4, 12 U.S.C. § 341 (2006) (amended 2010).

⁴⁹ *Id.*

⁵⁰ *Starr*, 121 Fed. Cl. at 469.

⁵¹ Federal Reserve Act § 4, 12 U.S.C. § 341 (emphasis added).

⁵² See *Starr*, 121 Fed. Cl. at 469 (citing *Fed. Reserve Bank of Richmond v. Malloy*, 264 U.S. 160, 167 (1924); *First Nat'l Bank in St. Louis v. Missouri ex rel. Barrett*, 263 U.S. 640, 659 (1924); *Cal. Bank v. Kennedy*, 167 U.S. 362, 369 (1897)).

⁵³ Federal Reserve Act § 13(3), 12 U.S.C. § 343.

⁵⁴ See 12 U.S.C. § 24 (2012) (allowing national banks to exercise "all such incidental powers as shall be necessary to carry on the business of banking").

⁵⁵ 472 F.2d 427 (1st Cir. 1972).

⁵⁶ *Id.* at 432 (quoting 12 U.S.C. § 24).

“convenient or useful in connection with” an express power.⁵⁷ In its analysis, the First Circuit expressly rejected the district court’s equation of “necessary” with “*sine qua non*” as too narrow an interpretation.⁵⁸ The FRBNY’s equity demand — while perhaps not absolutely indispensable — constitutes at the very least a “convenient” way of exercising its section 13(3) powers. As Starr itself admitted, AIG had a significant risk management problem⁵⁹ — the FRBNY may reasonably have believed voting control of AIG was essential to ensuring loan repayment.⁶⁰ And the United States can easily argue that the equity requirement was connected to the FRBNY’s express powers under section 13(3) because it served as a direct “limitation” or “restriction” on the FRBNY’s loan to AIG.

In 1876, the Supreme Court held that the National Bank Act impliedly prohibited national banks from “[d]ealing in stocks,” yet held that a national bank could accept securities and stock in the course of renegotiating a troubled asset.⁶¹ The prohibition applied to any bank engaging in the “ordinary business of buying and selling [stocks] for profit,” but not to stock trades “resulting from ordinary banking transactions.”⁶² The FRBNY did not acquire its equity share through any “ordinary business of buying and selling for profit,” but rather through its authorized practice of lending to nonbanks in “unusual and exigent circumstances.” Today, the National Bank Act expressly limits “[t]he business of dealing in securities and stock.”⁶³ The absence of such limiting language in the Federal Reserve Act might support an even more expansive reading of its incidental powers clause. Thus, the government may persuade the Federal Circuit to find there had been no illegal exaction.⁶⁴

On the other hand, Starr may attack the lower court’s decision from a different angle: its intuitive and seemingly straightforward

⁵⁷ *Id.* The First Circuit’s interpretation has been adopted in other circuits as well. See, e.g., *Starr Int’l Co. v. Fed. Reserve Bank of N.Y.*, 742 F.3d 37, 41 n.4 (2d Cir. 2014); *Wells Fargo Bank N.A. v. Boutris*, 419 F.3d 949, 960 (9th Cir. 2005); *Indep. Ins. Agents of Am., Inc. v. Hawke*, 211 F.3d 638, 640 (D.C. Cir. 2000).

⁵⁸ See *Arnold Tours*, 472 F.2d at 430. Professor John Manning’s recent Foreword would suggest that the First Circuit quite reasonably imported an expansive reading of “necessary” to congressionally delegated powers. See John F. Manning, *The Supreme Court, 2013 Term — Foreword: The Means of Constitutional Power*, 128 HARV. L. REV. 1, 48–67 (2014).

⁵⁹ *Starr*, 121 Fed. Cl. at 439.

⁶⁰ See *id.* at 462 (noting a government expert’s testimony that the equity “provide[d] a return to adequately compensate for the significant risk of lending to AIG” (alteration in original)).

⁶¹ *First Nat’l Bank of Charlotte v. Nat’l Exch. Bank of Balt.*, 92 U.S. 122, 128 (1876).

⁶² *Id.*

⁶³ 12 U.S.C. § 24 (2012).

⁶⁴ If it so found, the Federal Circuit would have to address the takings claim as well. For an argument against Starr’s takings claim, see Defendant’s Motion to Dismiss at 23–28, *Starr*, 121 Fed. Cl. 428 (No. 11-779C), 2012 WL 671925.

damages analysis. In *Horne v. Department of Agriculture*, decided one week after *Starr*, the Supreme Court held that a regulation requiring raisin handlers to set aside a certain percentage of their crop for the government effected a Fifth Amendment taking without just compensation.⁶⁵ The government argued that the regulation's positive effect on the price of raisins should be accounted for in determining the plaintiffs' damages.⁶⁶ Dismissing this "hypothetical-based" argument, the Court chose to follow instead "a clear and administrable rule for just compensation,"⁶⁷ namely, that "just compensation normally is to be measured by 'the market value of the property at the time of the taking.'"⁶⁸ And the government, the Court noted, had already calculated the fair market value of the raisins when it fined the raisin handlers for failing to comply with the reserve requirement.⁶⁹

Horne likely calls *Starr*'s damages analysis into question. A taking (*Horne*) is different from an illegal exaction (*Starr*). When the government seizes property *lawfully*, it effects a taking and must provide just compensation to the owner.⁷⁰ When it seizes property *unlawfully*, it effects an illegal exaction and must return the seized property.⁷¹ However, as the Court of Federal Claims explained, takings and illegal exactions are "two sides of the same coin."⁷² And because illegal exaction claims generally involve payments of money to the government,⁷³ there is limited precedent for calculating damages in the event that a return of the property is not an option.⁷⁴ Thus, while at first blush the court's equation of illegal exactions and takings in its just-compensation analysis may seem overly simple, it is at the very least not unreasonable.

The government might argue that *Starr*'s claim is distinguishable from that in *Horne* — after all, *Horne* involved the *physical seizure* of raisins,⁷⁵ while *Starr* has alleged diminishment in the value of relative-

⁶⁵ See *Horne v. Dep't of Agric.*, 135 S. Ct. 2419, 2428 (2015); *Horne v. U.S. Dep't of Agric.*, 750 F.3d 1128, 1133–34 (9th Cir. 2014) (explaining how the reserve requirement was used by the Department of Agriculture to stabilize the supply and price of raisins each season), *rev'd on other grounds by Horne*, 135 S. Ct. 2419.

⁶⁶ See *Horne*, 135 S. Ct. at 2431–32.

⁶⁷ *Id.* at 2432.

⁶⁸ *Id.* (quoting *United States v. 50 Acres of Land*, 469 U.S. 24, 29 (1984)).

⁶⁹ *Id.* at 2433.

⁷⁰ U.S. CONST. amend. V.

⁷¹ See *Aerolíneas Argentinas v. United States*, 77 F.3d 1564, 1572–73 (Fed. Cir. 1996) (“[A]n illegal exaction claim may be maintained when ‘the plaintiff has paid money over to the Government . . . and seeks return of all or part of that sum’ that ‘was improperly paid, exacted, or taken . . . in contravention of the Constitution, a statute, or a regulation.’” (quoting *Eastport S.S. Corp. v. United States*, 372 F.2d 1002, 1007 (Ct. Cl. 1967))).

⁷² *Starr*, 121 Fed. Cl. at 464.

⁷³ See *Aerolíneas Argentinas*, 77 F.3d at 1572–73.

⁷⁴ See, e.g., *Bowman v. United States*, 35 Fed. Cl. 397, 401 (1996).

⁷⁵ See *Horne v. Dep't of Agric.*, 135 S. Ct. 2419, 2428 (2015).

ly abstract property rights. But a close look at *Horne* suggests this argument will bear little fruit. *Horne* distilled takings jurisprudence into two broad categories, physical and regulatory takings.⁷⁶ Physical takings, the Court explained, come in all shapes and sizes, and include both real and personal property.⁷⁷ Regardless of the *type* of property at issue, the government faces the same “‘categorical duty’ under the Fifth Amendment to pay just compensation.”⁷⁸ According to the Court, this duty extends with identical force even to the intangible property rights of patent holders.⁷⁹ By grouping such a wide variety of property together, the Court made it difficult for the government to argue that AIG shares are meaningfully different from raisins.

The Court admits one exception to its general just-compensation rule: a slightly more complex calculation that accounts for benefits of a government action as well as its costs.⁸⁰ In *Horne*, the “regulatory benefits” of the raisin reserve pool — increased price stability in the raisin market — did not trigger this exception.⁸¹ The government could argue that the price stability made possible by the FRBNY’s loan differs in some significant way from that of the Department of Agriculture’s regulation, and that any damages calculation on appeal may account for such benefit. On the whole, however, *Horne* allows Starr to argue that its burden is simply to prove the *actual market value* of the AIG common stock at the time of the illegal exaction, not its *hypothetical value* had the FRBNY not agreed to lend to AIG.⁸²

As early as 1819, the Supreme Court recognized the importance of the government’s “capacity to avail itself of experience, to exercise its reason, and to accommodate its [actions] to circumstances.”⁸³ The Court of Federal Claims was not so generous, leaving many stones unturned in its haste to chastise the United States for bailing out AIG. On appeal, the government can argue for a broader interpretation of the FRBNY’s powers. But Starr will also have the opportunity to advocate for *Horne*’s damages rule, which would be more favorable than the rule applied by the lower court.

⁷⁶ See *id.* at 2427 (“Our cases have stressed the ‘longstanding distinction’ between government acquisitions of property and regulations.” (quoting *Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg’l Planning Agency*, 535 U.S. 302, 323 (2002))).

⁷⁷ See *id.* at 2425–28.

⁷⁸ *Id.* at 2425 (quoting *Ark. Game & Fish Comm’n v. United States*, 133 S. Ct. 511, 518 (2012)).

⁷⁹ See *id.* at 2427 (citing *James v. Campbell*, 104 U.S. 356, 358 (1882)).

⁸⁰ See *id.* at 2432; see also *id.* at 2434–36 (Breyer, J., concurring in part and dissenting in part).

⁸¹ *Id.* at 2432 (majority opinion).

⁸² Cf. *id.* at 2432–33.

⁸³ *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 415–16 (1819).