THE GOVERNMENT AS SHAREHOLDER AND POLITICAL RISK: PROCEDURAL PROTECTIONS IN THE BAILOUT

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In the wake of the fall of Lehman Brothers and the surrounding financial instability, Congress passed the Emergency Economic Stabilization Act of 2008, giving the Treasury Department unprecedented power to intervene directly in the financial markets and the economy at large. Though the original intention of the bill was for Treasury to purchase "toxic" assets from financial institutions in order to bring immediate relief to the financial sector, the Treasury Department instead purchased equity from such institutions and became the largest shareholder of corporations like Citigroup, A.I.G., and Bank of America. As a shareholder, the government possessed great informal influence over corporate policy—influence that it did not hesitate to exercise. This influence, paired with the lack of judicial review in the bailout bill, created a new kind of political risk for investors uncertain of whether the government would use its shareholder position to advance its own political goals. This Note analyzes and evaluates this political risk created by government control and explains why neither administrative law nor corporate law constrained the government as shareholder in the financial crisis following Lehman's failure. Given that the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act fails to address what the government should do in the event of a future financial crisis, this Note suggests a clearer outline for the government's role in corporate management when it acts as a shareholder and argues for judicial review to provide procedural protections to shareholders, thereby reducing political risk.

Introduction

Crisis demands response. The financial crisis of 2008–2009 prompted massive government intervention in the private sector, leading Congress to pass the Emergency Economic Stabilization Act of 2008 (EESA).[1] The Treasury Department, using the $700 billion the EESA set aside for strengthening Wall Street's financial institutions,

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1 Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (to be codified in scattered sections of U.S.C.).

gave money to banks in exchange for shares, making the government a shareholder in a wide swath of the financial industry. For the most troubled institutions—Citigroup, A.I.G., and Bank of America—the government became their largest shareholder. In this position, the government wielded considerable influence over corporate policy.

This influence went unchecked by traditional procedural protections, as the EESA effectively blocked all judicial review of the government's actions. Congress passed the bailout legislation in a time of crisis and panic that required immediate action by the government to stabilize the economy. The lack of judicial review was intended to enable Treasury to respond quickly to the financial crisis without being tied up in court. The immediate threat of the financial system's collapse eventually passed. The government, however, continued to maintain its equity position in the largest corporations and continued to hold sway over corporate policy.

Congress designed the EESA initially to provide short-term liquidity and stability to the financial markets, primarily by enabling the purchase of "toxic" assets, like mortgage-backed securities, through the Troubled Asset Relief Program (TARP).[2] It provided no guidance as to how Congress expected the government to manage corporations beyond stabilizing the economy. The bill addressed crisis relief, not corporate governance. Plaintiffs traditionally look to the courts to protect against government abuse of its regulatory power or a shareholder's use of a corporation for its own financial gain, but neither safeguard exists when the shareholder *is* the government and is immune from judicial review, as the EESA provides.

When the government's political interests in corporate policy are not aligned with other shareholders' financial interests, and when the government can use its leverage as a shareholder to influence that policy, shareholders must account for the risk that the government's actions can diminish the value of the corporation. This risk is a form of political risk, one that is compounded when there is no procedure for reviewing the government's actions. While today the largest banks have agreed to repay their obligations under TARP and the government's role as a shareholder is generally coming to a close,[3] the issue

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[2] *Id.* § 101.

[3] *See, e.g.*, Neil King, Jr., *U.S. Fingerprints All Over GM IPO*, WALL ST. J., Aug. 19, 2010, at B1 (describing government's desire to "liquidate its 61% stake in GM as quickly and lucratively as possible"); *Wells' TARP Plan Brings End to Bailout Era*, DEALBOOK (Dec. 14, 2009, 6:33 PM), http://dealbook.blogs.nytimes.com/2009/12/14/wells-fargo-to-repay-25-billion-to-us (describing Wells Fargo's plan to repay $25 billion in government bailout funds).

of risk is likely to arise again in any future financial bailouts.[4] Some commentators, like the Special Inspector General for TARP, have suggested the government should have used its leverage as a shareholder to further influence corporate policy.[5] A future bailout where the government owns equity would be more efficient if procedural protections are used to reduce political risk. These protections would discourage government conduct that creates uncertainty and destroys shareholder wealth, and the protections would thereby promote more efficient allocation of capital to corporations in a financial crisis and reduce the cost and duration of a bailout. Thus, this Note recommends a set of principles to guide the government's management of corporations it temporarily controls and recommends pairing those principles with effective judicial review.

Several commentators have already addressed some of the implications of the government's response to the financial crisis. Steven Davidoff and David Zaring evaluated the government's response in the early stages of the crisis, focusing on Bear Stearns, Lehman Brothers, and what they term "regulation by deal."[6] Articles by J.W. Verret and by Marcel Kahan and Edward Rock focus primarily on what government as shareholder means for the development of corporate law in the bailout era.[7] This Note adds to this burgeoning literature by focusing on how the government's actions are not presently

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4 For TARP, the Treasury Department chose to use equity investments over other available tools, and this decision will likely be repeated in any future bailout. *See, e.g.*, Press Release, U.S. Dep't of the Treasury, Remarks by Secretary Henry M. Paulson, Jr. on Financial Rescue Package and Economic Update (Nov. 12, 2008), *available at* http://www.treasury.gov/press-center/press-releases/Pages/hp1265.aspx (rejecting purchasing assets as ineffective method of deploying TARP funds); *see also infra* note 9 and accompanying text (describing failure of financial reform bill to address bailout issue).

5 *See* Jessica Pressler, *94 Minutes with Neil Barofsky*, N.Y. MAG., Feb. 8, 2010, at 16 ("And now we've let [the banks] leave the TARP program, so whatever thin leverage we could have had as shareholders is gone."); *see also* Deborah Solomon, *Bailout Anger Undermines Geithner*, WALL ST. J., Feb. 22, 2010, at A1 (describing how Treasury Secretary Timothy Geithner acted as "brake" against administration officials, who argued for more government intervention in bailed-out corporations, and members of Congress, who wished for banks to remain "under Treasury's thumb").

6 Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 ADMIN. L. REV. 463 (2009) (arguing that government's response to crisis was hindered by focus on transactional approach to handling legal constraints); *see also* Marcel Kahan & Edward Rock, *How To Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware, and the Strategic Use of Comity*, 58 EMORY L.J. 713 (2009) [hereinafter Kahan & Rock, *Bear Stearns*] (describing litigation surrounding sale of Bear Stearns to J.P. Morgan).

7 J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory and Practice*, 27 YALE J. ON REG. 283 (2010); Marcel Kahan & Edward Rock, *When the Government Is the Controlling Shareholder* (Univ. Pa. Inst. for Law & Econ., Research Paper No. 10-10, N.Y. Univ. Law & Econ., Research Paper No. 10-20, 2010) [hereinafter Kahan & Rock, *Controlling Shareholder*], *available at* http://ssrn.com/abstract=1616266.

addressed by either administrative law or corporate law and what the implications are for constraining the government's actions in future bailouts. For example, commentators have already noted that the 2010 Dodd-Frank Act[8] fails to address the likely scenario where the government is once again forced to bail out financial institutions.[9] As Professor David Moss suggested, responding to allegations that the government pressured A.I.G. to waive lawsuits against major banks during the height of the crisis, "We have to vet [the regulators' actions] now because otherwise, if we face a similar crisis again, federal officials are likely to follow precedents set this time around."[10]

To this end, Part I identifies the unique political risk posed by the government as shareholder. It discusses how, as the largest shareholder of several public corporations, the government could—and evidence suggests did—use its position and leverage to influence corporate policy. This influence, coupled with the lack of a clear government mission, creates two kinds of political risk: first, the danger that the government's actions will decrease the value of the corporation; and second, the uncertainty associated with an unaccountable, unconstrained controlling shareholder. Part II evaluates the traditional mechanisms for review of government action and explains why these traditional procedural safeguards do not mitigate this political risk for shareholders. It first discusses how typical review of agency action under the Administrative Procedure Act (APA)[11] did not apply to the bailout and could not be used to challenge the government's actions as a shareholder. This Note then explains why Delaware corporate law[12] would likely not constrain government action, and, even if it did, how it would hamstring the government's ability to respond effectively to crises. Part II also discusses nonjudicial, political checks on the government's management of corporations it controls. Reform

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

[9] *See* Christine Hauser, *Banks Likely To Offset Impact of New Law, Analysts Say*, N.Y. TIMES, June 25, 2010, http://www.nytimes.com/2010/06/26/business/26reax.html ("They missed the crisis . . . . This is a bill, despite its length and complexity, that's more geared to the elections than the financial system. . . . [I]n no way does it address the too-big-to-fail issue. . . . [A]t its core we're going to be back where we were the day that Lehman failed." (quoting Prof. Cornelius Hurley of Boston Univ. Sch. of Law)); Louise Story & Gretchen Morgenson, *Inside U.S. Bailout of A.I.G.: Extra Forgiveness for Big Banks*, N.Y. TIMES, June 30, 2010, at A1 ("Even with the financial reform legislation that Congress introduced last week, David A. Moss . . . said he was concerned that the government had not developed a blueprint for stabilizing markets when huge companies like A.I.G. run aground and, for that reason, regulators' actions during the financial crisis need continued scrutiny.").

[10] Story & Morgenson, *supra* note 9.

[11] Administrative Procedure Act, 5 U.S.C. §§ 500–706 (2006).

[12] DEL. CODE ANN. tit. 8 (2001).

for future bailouts should try to mitigate political risk while preserving enough flexibility for the government to respond effectively to financial crisis. Thus, Part III proposes a solution that uses administrative law to constrain agency action and signal stability in government policy to investors. It suggests a limited set of objectives for Treasury to align the government's interests with the corporation's interests whenever possible. Additionally, permitting equitable relief against agency action that is arbitrary and capricious, as outlined by the APA,[13] would provide a mechanism for shareholders to enforce these objectives. This reform would influence Treasury's conduct ex ante, resulting in a more predictable government management strategy, thereby reducing political risk.

I
Government Intervention and Political Risk

Congress passed the EESA in response to the growing instability in the financial markets. As Section A describes, rather than purchasing toxic assets as originally imagined by Congress, the Treasury Department used the EESA to purchase equity in banks. Section B discusses how, in its newfound position as a shareholder, the government gained leverage over bailed-out corporations above and beyond its power as a legislator and regulator. From this position, the government could influence corporate policy through informal means. Although the evidence paints a mixed picture of the extent to which the government exercised this influence, Section C describes how the potential for informal policymaking creates political risk for investors, lowering the value of corporations where the government is a shareholder.

A. The Emergency Economic Stabilization Act of 2008

The core of the EESA was the Troubled Asset Relief Program (TARP).[14] The purposes of the EESA, according to Congress, were not only to "restore liquidity and stability to the financial system," but also to "protect[ ] home values, college funds, retirement accounts, and life savings," "preserve[ ] homeownership and promote[ ] jobs and economic growth," "maximize[ ] overall returns to the taxpayers," and "provide[ ] public accountability" for Treasury's exercise of its

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13 5 U.S.C. § 702 (2006).

14 Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, §§ 101–136, 122 Stat. 3765, 3767–3800 (to be codified at 12 U.S.C. §§ 5211–5241).

authority.[15] TARP gave Treasury $700 billion to purchase toxic assets from failing banks,[16] with the hope that a bank with a clean balance sheet would increase lending and thaw frozen credit markets.[17]

The Treasury Department, however, quickly abandoned the idea of purchasing toxic assets from troubled banks.[18] Based on the actions of his counterparts in Europe[19] and the market's tepid response to the asset purchase program,[20] then–Treasury Secretary Henry Paulson shifted from using TARP funds to purchase assets *from* troubled banks to purchasing equity *in* the banks themselves.[21] When equity

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15 *Id.* § 2; *see also id.* § 103 (outlining additional purposes, including not discriminating among financial institutions seeking aid, helping small financial institutions that serve low- and moderate-income communities, and ensuring stability for municipal governments).

16 *Id.* §§ 101, 115; *see* STAFF OF H. COMM. ON FIN. SERVS., 110TH CONG., SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION 1 (Comm. Print 2008), *available at* http://financialservices.house.gov/EESABill_section-by-section.pdf (reporting purpose of section 101 of TARP plan was to authorize Secretary to purchase "troubled assets" from financial institutions); *Turmoil in U.S. Credit Markets: Recent Actions Regarding Government Sponsored Entities, Investment Banks and Other Financial Institutions: Hearing Before the S. Comm. on Banking, Hous. and Urban Affairs*, 110th Cong. 29–30 (2008) (statement and subsequent remarks of Henry M. Paulson, Jr., Treasury Secretary) (describing how purchasing toxic assets would address underlying problem in credit markets); 154 CONG. REC. H10775 (daily ed. Oct. 3, 2008) (statement of Rep. Steny H. Hoyer) ("The heart of the bill remains a plan for the government to buy up bad financial assets."); 154 CONG. REC. H10778 (daily ed. Oct. 3, 2008) (statement of Rep. Sheila Jackson Lee) ("[T]he Assistant Secretary indicated Treasury's intervention in the markets will afford it the opportunity to purchase toxic assets.").

17 *See, e.g.*, Remarks on the National Economy, 44 WEEKLY COMP. PRES. DOC. 1225, 1226 (Sept. 19, 2008) (arguing that purchasing toxic assets would allow financial institutions to resume lending); Press Release, U.S. Dep't of the Treasury, Statement by Secretary Henry M. Paulson, Jr. on Emergency Economic Stabilization Act (Sept. 28, 2008), *available at* http://www.treasury.gov/press-center/press-releases/Pages/hp1162.aspx ("I am confident this legislation gives us the flexibility to unclog our financial markets . . . .").

18 *See* Edmund L. Andrews & Mark Landler, *U.S. May Take Ownership Stake in Banks To Ease Credit Crisis*, N.Y. TIMES, Oct. 9, 2008, at A1 (reporting on emergence of Treasury's recapitalization plan); Press Release, U.S. Dep't of the Treasury, Remarks by Secretary Henry M. Paulson, Jr. on Financial Rescue Package and Economic Update (Nov. 12, 2008), *available at* http://www.treasury.gov/press-center/press-releases/Pages/hp1265.aspx (rejecting purchasing assets as ineffective method of deploying TARP funds).

19 *See* Julia Werdigier, *Britain Announces Huge Bank Bailout*, N.Y. TIMES, Oct. 8, 2008, http://www.nytimes.com/2008/10/09/business/worldbusiness/09britain.html (announcing British bailout plan whereby banks would receive capital injections in exchange for shares).

20 *See* David Gaffen, *Stocks' Initial Reaction to Bailout: Blecch*, WALL ST. J. MARKET BEAT, (Sept. 29, 2008, 11:02 AM), http://blogs.wsj.com/marketbeat/2008/09/29/stocks-initial-reaction-to-bailout-blecch/ (ascribing decline in U.S. equities to disappointment with initial TARP plan).

21 *See* Press Release, U.S. Dep't of the Treasury, Treasury Announces TARP Capital Purchase Program Description (Oct. 14, 2008), *available at* http://www.treasury.gov/press-center/press-releases/Pages/hp1207.aspx (announcing recapitalization plan). Equity injections, Treasury argued, were a faster way of shoring up liquidity, *see* Press Release, U.S. Dep't of the Treasury, Remarks by Secretary Henry M. Paulson, Jr. on Financial Rescue Package and Economic Update (Nov. 12, 2008), *available at* http://www.treasury.gov/press-

injections became the focus of the bailout,[22] Treasury's plan shifted from a short-term liquidity crisis bailout to medium-term[23] corporate management.[24] The government's equity injections made it the largest shareholder of several public corporations.[25]

It appears Congress did not expect the TARP to include government management of corporations through equity control.[26] The language of the EESA is certainly broad enough to include equity injections,[27] but legislative history suggests Congress expected the TARP to be used primarily to purchase toxic assets; equity purchases were intended to be only a secondary tool to allow the government to

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center/press-releases/Pages/hp1265.aspx, allowed the taxpayer to share in the potential upside of a market recovery, *see* U.S. DEP'T OF THE TREASURY, CAPITAL PURCHASE PROGRAM [hereinafter CPP FACTSHEET], *available at* http://www.treasury.gov/initiatives/financial-stability/investment-programs/cpp/Pages/capitalpurchaseprogram.aspx (last visited Feb. 22, 2011), and would reassure investors that banks were sufficiently capitalized. *See* U.S. DEP'T OF THE TREASURY, TREASURY WHITE PAPER: THE CAPITAL ASSISTANCE PROGRAM AND ITS ROLE IN THE FINANCIAL STABILITY PLAN 3 (2009) [hereinafter CAP WHITE PAPER], *available at* http://www.treasury.gov/press-center/press-releases/Documents/tg40_capwhitepaper.pdf.

22 Treasury supplemented the Capital Purchase Program (CPP) in February of 2009 with the Capital Assistance Program (CAP), which raised the government's dividend from 5% to 9% and allowed corporations to convert preferred shares to common equity. U.S. DEP'T OF THE TREASURY, CAPITAL ASSISTANCE PROGRAM TERM SHEET (2009) [hereinafter CAP TERM SHEET], *available at* http://www.treasury.gov/press-center/press-releases/Documents/tg40_captermsheet.pdf.

23 This Note uses "medium-term" to acknowledge that the government did not plan to hold these equity investments forever. Instead, it planned to sell its investment in the long term. "Short-term" refers to the immediate financial instability that prompted the creation of the TARP program.

24 *See, e.g.*, Neil King & Jeffrey McCracken, *Control Would Create Conflicts for Government*, WALL ST. J., Apr. 28, 2009, at A8B (citing government sources for statement that government would not sell its stake in General Motors for at least several years).

25 A.I.G., Citigroup, and General Motors are some of the largest corporations in which the government took a substantial ownership stake. The government owned just under 80% of A.I.G., Andrew R. Sorkin & Mary W. Walsh, *U.S. Is Said To Offer $30 Billion More To Help Insurer*, N.Y. TIMES, Mar. 2, 2009, at A1, 34% of Citigroup, Eric Dash, *The Walking Wounded: Why Citigroup May Stay a U.S. Ward for Years*, N.Y. TIMES, June 11, 2009, at B1, and 60.8% of the new General Motors, *In re* Gen. Motors Corp., 407 B.R. 463, 482 (Bankr. S.D.N.Y. 2009).

26 *See* Recent Developments, *Emergency Economic Stabilization Act of 2008*, 46 HARV. J. ON LEGIS. 569, 581 (2009) ("This reorientation of EESA happened entirely without [c]ongressional approval."); Kahan & Rock, *Controlling Shareholder*, *supra* note 7, at 44 ("[I]t is crystal clear that . . . Congress was not thinking about direct investments in equity . . . .").

27 The Secretary had the power to purchase any asset that he "determine[d] the purchase of which [was] necessary to promote financial market stability." Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, §§ 3(9)(B), 101, 122 Stat. 3765, 3767–68 (to be codified at 12 U.S.C. §§ 5202, 5211); *see also id.* §§ 102, 106, 109–111 (giving Secretary other powers including ability to insure troubled assets, manage Treasury's asset portfolio, give assistance to homeowners facing foreclosure, and set limits on executive pay).

share in the upside of any recovery.[28] The structure of the EESA provides no guiding principles for Treasury to manage corporations. Because the purposes section of the EESA outlines so many conflicting goals, it is difficult to discern clear priorities for managing corporations under government control.[29]

B. Government as Shareholder, Government as Policymaker

Without voting stock,[30] the government did not possess the same kind of control over corporations as a traditional controlling shareholder. It lacked the power to elect its own board of directors and to vote on major corporate events such as mergers.[31] However, the gov-

[28] *See* 154 CONG. REC. H10763 (daily ed. Oct. 3, 2008) (statements of Rep. James P. Moran, Jr. and Rep. Barney Frank) (noting that EESA gives Treasury Secretary authority to purchase not only assets but also equity); *supra* note 16 (outlining statements regarding toxic assets); *see also* Roger D. Congleton, *On the Political Economy of the Financial Crisis and Bailout of 2008–2009*, 140 PUB. CHOICE 287, 307 (2009) (describing purchase of shares as "an option discussed only in passing in congressional hearings"). Legislative history on the EESA is scant, as the bill was passed in a short time frame. *See generally* 2008 U.S.C.C.A.N. 1504 (collecting legislative history of Pub. L. No. 110-343).

[29] *See* Kahan & Rock, *Controlling Shareholder*, *supra* note 7, at 35 (stating EESA provides no guidelines for Treasury); *supra* note 15 and accompanying text (outlining conflicting purposes of EESA).

[30] Under the general terms of both the CPP and the CAP, the government received preferred, nonvoting shares. U.S. DEP'T OF THE TREASURY, TARP CAPITAL PURCHASE PROGRAM TERM SHEET 1–3 (2008) [hereinafter CPP TERM SHEET], *available at* http://www.treasury.gov/press-center/press-releases/Documents/document5hp1207.pdf; CAP TERM SHEET, *supra* note 22, at 3–5. The government also received preferred, nonvoting shares from A.I.G. *See, e.g.*, SECURITIES EXCHANGE AGREEMENT BETWEEN DEPARTMENT OF THE TREASURY AND AMERICAN INTERNATIONAL GROUP, § 1.1, at 1 (Apr. 17, 2009), *available at* http://www.treasury.gov/initiatives/financial-stability/investment-programs/AIG/Documents/Series.E.Securities.Exchange.Agreement.pdf. Although the government's holdings in Citigroup began on the general contract terms of the CPP, *see* SECURITIES PURCHASE AGREEMENT BETWEEN DEPARTMENT OF THE TREASURY AND CITIGROUP INC. (Oct. 26, 2008), *available at* http://www.treasury.gov/initiatives/financial-stability/investment-programs/cpp/Documents_Contracts_Agreements/Citigroup_10262008.pdf, the government converted its preferred shares to common stock with an agreement not to vote its shares. EXCHANGE AGREEMENT BETWEEN DEPARTMENT OF TREASURY AND CITIGROUP INC. (June 9, 2009), *available at* http://www.treasury.gov/initiatives/financial-stability/investment-programs/agp/Documents/Citigroup%20Exchange%20Agreement.pdf. The government also owned common stock of GM. *See In re* Gen. Motors Corp., 407 B.R. at 482. In addition to shares and dividends, the government also received warrants to purchase nonvoting common stock. *See* CAP TERM SHEET, *supra* note 22, at 7–8; CPP TERM SHEET, *supra*, at 4–5. For a more thorough overview of the TARP contracts, see generally John M. Brandow et al., *The Capital Twist*, *in* DAVIS POLK FINANCIAL CRISIS MANUAL: A GUIDE TO THE LAWS, REGULATIONS, AND CONTRACTS OF THE FINANCIAL CRISIS 67, 69–79 (2009) [hereinafter DAVIS POLK FINANCIAL CRISIS MANUAL].

[31] *See* DEL. CODE ANN. tit. 8, § 211 (2001) (providing for shareholder power to elect board); *id.* § 251 (providing for shareholder power to approve or reject merger). *But see* Kahan & Rock, *Controlling Shareholder*, *supra* note 7, at 18 (arguing that government can influence elections when its share decides whether quorum exists at shareholder meeting).

ernment was not merely a passive investor who made loans and called them shares. There were several ways the government could exercise its power as a shareholder. Congress, for example, could modify or supplement, through statutory enactments, any contracts executed between Treasury and corporations receiving TARP money.[32] Additionally, executive compensation for the officers of corporations receiving TARP funds was subject to approval by the government.[33]

The government also had these powers if it simply loaned money to the banks.[34] But, unlike a loan, which could be repaid, any repurchase of the government's equity by a company had to be approved by Treasury.[35] Treasury's veto right limited corporations' ability to end their relationships with the government unilaterally. The government's ability to dictate how long it would remain the owner of the firm significantly increased the value of its first two powers. The sum of these powers, in addition to the government's influence as regulator and lawmaker, gave Treasury leverage over corporations to a degree unavailable to traditional controlling shareholders or through other bailout tools.[36]

The government's power as a regulator also increased its powers as a shareholder.[37] First, although agency regulations and determinations are subject to judicial review under the APA,[38] actions taken

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[32] The contracts explicitly acknowledged this power, giving Treasury the power to alter the contract unilaterally in accord with subsequent statutory enactments. *E.g.*, SECURITIES PURCHASE AGREEMENT BETWEEN DEPARTMENT OF THE TREASURY AND CITIGROUP INC., *supra* note 30, § 5.3, at 34; *see also* Brandow et al., *supra* note 30, at 73 & n.12 (stating that this "highly unusual contractual term" was included because congressional action was expected and Treasury sought to prevent arguments against retroactive contract amendments).

[33] *See* Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 111, 122 Stat. 3765, 3776–77 (to be codified at 12 U.S.C. § 5221) (providing standards for executive compensation that apply if Treasury purchases corporation's troubled assets). Congress modified and expanded this section of the EESA, granting Treasury review over executive compensation, in the stimulus bill. *See* American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 7001, 123 Stat. 115, 516–20 (creating additional executive compensation and corporate governance standards for TARP recipients). For a broader treatment of the issues surrounding controls on executive compensation, see Beverly Chase et al., *Executive and Employee Compensation*, *in* DAVIS POLK FINANCIAL CRISIS MANUAL, *supra* note 30, at 233, 233–59.

[34] *See* Emergency Economic Stabilization Act § 111(a) ("Any financial institution that *sells troubled assets* to the Secretary under this Act shall be subject to the executive compensation requirements of [this section] . . . ." (emphasis added)).

[35] *See* CPP TERM SHEET, *supra* note 30, at 3 (requiring Treasury's consent for share repurchases).

[36] *See* Kahan & Rock, *Controlling Shareholder*, *supra* note 7, at 20–21 (describing controlling government shareholder as "gorilla" with regulator and creditor powers).

[37] This is setting aside the fact that not all corporations receiving TARP funds (e.g., A.I.G., GM) were directly regulated by the federal government.

[38] 5 U.S.C. § 706 (2006).

pursuant to the government's role as shareholder are unreviewable by the judiciary, as this Note discusses in Part II. Second, where ordinary agency action is subject to the procedures in the APA, such as giving notice and allowing for comment on proposed regulations,[39] the government could use its position as a shareholder to bypass these procedural safeguards and influence corporate policy informally.[40] Third, the government held additional leverage over a corporation and its executives through limitations on executive pay, corporate luxury expenses, and lobbying expenditures, and through the power to determine when its control over the corporation would end.[41] While the government, of course, possesses some degree of informal influence as a regulator/lawmaker, the *structure* created by these powers and by the position of the government as controlling shareholder changed more than just the degree of influence—it changed the kind of influence wielded by Treasury.[42]

The extraordinary power the government possessed over corporations as a shareholder, coupled with the lack of congressional guidance for the postcrisis management of these corporations, created a potential problem for other shareholders. Without procedural safeguards, the government can use its position to further political goals and engage in informal policymaking by influencing corporate policy—actions outside the contemplated scope of EESA. Without clear priorities for government management, Treasury (and the Executive) decided what that policy would be. The government stated

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39 *Id.* § 553.

40 *Cf.* Mark Seidenfeld, *Bending the Rules: Flexible Regulation and Constraints on Agency Discretion*, 51 ADMIN. L. REV. 429, 468 (1999) (describing how "backhanded" regulatory policy made outside context of APA "decrease[s] the ability of the full Congress to evaluate whether the agency's policy has political support, and the courts to discern whether the policy comes within the agency's statutory authority"). As Professors Kahan and Rock point out, the power of a controlling shareholder usually does not rest in its formal voting power; rather, it gains control through informal influence. *See* Kahan & Rock, *Controlling Shareholder*, *supra* note 7, at 18.

41 *See, e.g.*, SECURITIES PURCHASE AGREEMENT BETWEEN CITIGROUP INC. AND DEPARTMENT OF THE TREASURY § 4.10, at 31–35 (Dec. 31, 2008), *available at* http://www.treasury.gov/initiatives/financial-stability/investment-programs/tip/Documents_Contracts_Agreements/Citigroup_12312008.pdf (outlining restrictions on executive compensation, corporate expenses, and lobbying); *see also* Chase et al., *supra* note 33, at 255–56 (discussing lobbying restrictions); Kahan & Rock, *Controlling Shareholder*, *supra* note 7, at 8–11 (discussing congressional outcry over and response to executive compensation in government-controlled corporations).

42 *See* Kahan & Rock, *Controlling Shareholder*, *supra* note 7, at 18 (describing how equity position creates "power" and "opportunities to interfere" and "minimizes the political cost of interference") (emphasis omitted).

it was taking a noninterference approach to management,[43] but the evidence presents a mixed picture.

The case of A.I.G. is one of the most illustrative examples of government influence. After rescuing A.I.G. from collapse in the fall of 2008, the government became deeply involved in negotiations with major financial institutions to settle the money that A.I.G. owed those institutions on their credit default swaps. Documents surrounding the negotiations released two years later, following a congressional subpoena,[44] show that the original settlement terms were modified to include A.I.G.'s waiving all legal claims against those financial institutions.[45] According to a *New York Times* report, this waiver was added after "federal regulators forced [A.I.G.] to accept it."[46] In light of ongoing questions over whether the banks misled the public about these financial products,[47] commentators have criticized the waiver as "unfairly handcuff[ing]" A.I.G. and "undermining the financial inter-

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[43] *See, e.g.*, Letter from Timothy Geithner, Sec'y, U.S. Dep't of the Treasury, to Elizabeth Warren, Chair, Cong. Oversight Panel (July 21, 2009), *reprinted in* Cong. Oversight Panel, August Oversight Report: The Continued Risk of Troubled Assets app. V, at 134 (Aug. 11, 2009), *available at* http://cop.senate.gov/documents/cop-081109-report.pdf (describing Treasury as "a reluctant shareholder"); CAP White Paper, *supra* note 21, at 3 ("The economy functions better when banking organizations are well managed in the private sector. U.S. government ownership is not an objective of CAP."); Press Release, The White House, Obama Administration Auto Restructuring Initiative: General Motors Restructuring (Mar. 30, 2009) [hereinafter White House, GM Fact Sheet], *available at* http://www.whitehouse.gov/the_press_office/Fact-Sheet-on-Obama-Administration-Auto-Restructuring-Initiative-for-General-Motors/ (describing government's "limited" role in GM management).

[44] *See* Story & Morgenson, *supra* note 9 (describing how *New York Times* reviewed documents released by House Committee on Oversight and Government). For examples of released documents, including over 250,000 pages of emails and electronic documents, see Index of E-mails and Electronic Files of A.I.G., H. Comm. on Oversight & Gov't Reform, http://documents.republicans.oversight.house.gov/E-mails-and-electronic-files/ (last updated Aug. 9, 2010).

[45] *Compare* Termination Agreement Between Counterparty, Maiden Lane III LLC, and A.I.G. Financial Products, Inc. (Nov. 5, 2008), *available at* http://documents.nytimes.com/aig-bailout-documents#document/p379 (lacking waiver), *with* Termination Agreement Between Counterparty, Maiden Lane III LLC, and A.I.G. Financial Products, Corp. 2–3 (Nov. 6, 2008), *available at* http://documents.nytimes.com/aig-bailout-documents#document/p385 (including waiver).

[46] Story & Morgenson, *supra* note 9. *But see* Thomas C. Baxter Jr., Letter to the Editor, N.Y. Times, July 9, 2010, at A22 (stating that "[r]egulators did not force A.I.G. into the waiver clause," but that release was "mutual"). Nonetheless, the *New York Times* maintains that its story "was based on sources with direct knowledge of the events." Serena Ng, *N.Y. Fed Says A.I.G. Lawyers Put in Waiver*, Wall St. J., July 10–11, 2010, at B3 (quoting *New York Times* as maintaining veracity of Story & Morgenson, *supra* note 9).

[47] *See, e.g.*, Complaint, SEC v. Goldman Sachs & Co., No. 10 Civ. 3229 (S.D.N.Y. Apr. 16, 2010) (alleging Goldman Sachs misrepresented circumstances surrounding credit-default swaps sold to investors).

ests of taxpayers."[48] Additionally, as a shareholder, the government explored spinning off some of A.I.G.'s divisions to reduce the systemic risk that the insurance giant posed to the overall economy.[49]

Citigroup provides another interesting example of government influence. At Citigroup, the government pushed for a variety of goals, including permitting judicial modification of mortgages and selling business lines not wholly consistent with Citigroup's main mission.[50] In order to curry favor with the government, Citigroup reduced mortgage payments for certain homeowners who lost their jobs.[51] Additionally, a dispute between the government and Citigroup over the pay of one of Citigroup's top traders led the corporation to sell its highly profitable commodities trading division at a "bargain-basement price" in order to avoid a potential confrontation with the government.[52] Citigroup repaid its TARP funds to extricate itself from government control and influence, particularly with respect to executive compensation.[53]

In the case of General Motors (GM), the automobile manufacturer conspicuously prioritized environmental considerations coincident with the bailout, and the government announced that it would push the company to reduce the number of GM brands.[54] Additionally, legislators pushed to have new GM plants opened in their dis-

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48 Story & Morgenson, *supra* note 9.

49 *See* Deborah Solomon, *A Revamp Pro for Uncle Sam's Portfolio*, WALL ST. J., June 3, 2009, at C1 (noting Obama administration's desire to shrink A.I.G. in order to remove systemic risk).

50 *See* Verret, *supra* note 7, at 305; David Enrich, *Citi Unit Grows—With Feds' Help*, WALL ST. J., Jan. 11, 2010, at A1 (describing how government officials pushed Citigroup to "radically downsize" after receiving TARP funds).

51 *See* Ruth Simon, *Citi To Allow Jobless To Pay Less on Loans*, WALL ST. J., Mar. 3, 2009, at A4 (reporting Citigroup's reduction in mortgage payments for homeowners who lost their jobs and were behind in mortgage payments by sixty days or more).

52 David Enrich et al., *How Occidental Scored Citi Unit Cheaply*, WALL ST. J., Oct. 10–11, 2009, at B1.

53 Interestingly, Treasury reversed course, first approving the repayment of Citigroup's TARP funds, then withdrawing that approval when it became clear Treasury would lose money on its overall TARP investment in Citigroup, David Enrich, *Treasury Halts Plan To Sell Off Citi Stock*, WALL ST. J., Dec. 17, 2009, at A1, before finally approving the repayment. *See* Matthias Rieker, *Paid in Full: Wells, Citi Clear TARP*, WALL ST. J., Dec. 24, 2009, at C3 (noting that Citigroup's eagerness to repay reflected its desire to be freed from restrictions on executive compensation and that Treasury intended to begin selling its shares in 2010).

54 *See* King & McCracken, *supra* note 24 (speculating that government control of GM might create conflict between economic and environmental goals); Neil King, Jr. & John D. Stoll, *Political Criteria Factored into GM Plant*, WALL ST. J., July 6, 2009, at B2 (citing "'community impact' and 'carbon footprint'" as "the first two criteria" in selecting Detroit as site for new plant over cheaper locations in Tennessee and Wisconsin); White House, GM Fact Sheet, *supra* note 43 (outlining GM's plan to move from breakeven point of sixteen million cars per year to ten million).

tricts and to reopen plants and dealerships.[55] The Obama administration took steps to minimize government intrusion into corporate management, for example, by pushing back against Congress on GM.[56] It is unclear, however, whether this restraint was self-imposed or whether some other constraint operated to limit the government's power.[57] Although some of the more extreme examples of government interference may be only theoretical now that the current crisis has passed,[58] formal, procedural constraints on agency action are needed to prevent theory from becoming reality—to prevent political pressure from forcing the government to take excessive action.

C. Political Risk—Effect on Investors and the Marketplace

Typically discussed in the context of foreign investment,[59] political risk is a vague concept subject to many definitions.[60] This Note uses "political risk" to describe two distinct effects of government as shareholder on the value of a corporation. First, it refers to the downside risk presented by misaligned incentives—the risk that the government will use its leverage as a shareholder to interfere with a corporation in a way that reduces the value of the firm. Second, it refers to risk in the context of uncertainty—that is, because shareholders do not know how the government will manage and influence a corporation, it is difficult to price the company's value.

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[55] *See* Neil King, Jr., *Politicians Butt In at Bailed-Out GM*, WALL ST. J., Oct. 29, 2009, at A1 (noting that political pressure influenced decision to keep certain dealerships open); Neil King, Jr. & Kate Linebaugh, *Lawmakers Seek To Influence Plant Locations*, WALL ST. J., June 2, 2009, at A12 (discussing legislators' desire to influence GM's plant and dealership locations); Neil King, Jr. & Josh Mitchell, *Aid to Car Dealers Stirs Fight*, WALL ST. J., July 22, 2009, at A5 (describing how legislators' pressure on GM to salvage dealers and plants upset Obama administration because such political calculations could jeopardize government's ability to recover funds put into GM); *see also* Kahan & Rock, *Controlling Shareholder*, *supra* note 7, at 11 (discussing Senate hearings on GM's and Chrysler's decisions to close dealerships).

[56] *E.g.*, King & Mitchell, *supra* note 55 (describing Obama administration's opposition to "congressional efforts to reinstate as many as 3200 dealerships cut through the bankruptcy").

[57] *See infra* Part II.C (discussing nonjudicial constraints on agency action).

[58] *See, e.g.*, Kahan & Rock, *Controlling Shareholder*, *supra* note 7, at 3–4 (describing law school exam fact pattern where government runs automobile corporation for its political gain).

[59] *See generally* CHARLOTTE H. BRINK, MEASURING POLITICAL RISK: RISKS TO FOREIGN INVESTMENT (2004) (offering investors guidance on how to measure political risk in foreign markets).

[60] *See* Ephraim Clark, *Valuing Political Risk*, 16 J. INT'L MONEY & FIN. 477, 477–78 (1997) ("In spite of the widespread coverage of the subject, political risk has not received a clear cut definition."); Claire A. Hill, *How Investors React to Political Risk*, 8 DUKE J. COMP. & INT'L L. 283, 293–94 & n.45 (1998) (explaining how political risk does not have one clear definition).

Private investors assume that a corporation seeks to maximize profits. But the government's interests do not align with a private investor's interests or a corporation's interests. The government's interests are political, not financial.[61] Political interests may coincide with increasing the value of the corporation,[62] but they also may include interests related to the bailout that may reduce the value of the firm, like limiting systemic risk or executive compensation, or political interests outside of the direct issues presented in the financial crisis, like increasing the amount of loans made before an election.[63] While private investors weigh the prospect of losing their investments, the government does not directly internalize monetary losses.[64]

Private investors will weigh the risk of political interference when making their investment decisions and will demand a higher return on their investment as compensation for political risk. Both types of political risk can affect the price of a stock. For downside risk, the government's actions may negatively affect the actual value of a corporation through its cash flows.[65] A general government policy of interference with troubled corporations may also present a pervasive risk that investors cannot avoid through diversifying, increasing the formal cost of capital used to value a corporation.[66] For uncertainty risk, if political risk cannot be accurately priced, uncertainty will force investors to take precautions ranging from demanding a higher risk premium to refusing to invest in corporations the government con-

[61] *See* Maxim Boycko et al., *A Theory of Privatisation*, 106 ECON. J. 309, 311 (1996) ("[T]he politician does not care directly about the share of the profits foregone by . . . private shareholders, which matter only to the extent that angering shareholders reduces the net potential political benefit . . . ."); Daryl J. Levinson, *Making Government Pay: Markets, Politics, and the Allocation of Constitutional Costs*, 67 U. CHI. L. REV. 345, 356–57 (2000) (discussing why government does not behave like profit-maximizing firms).

[62] *See, e.g.*, Enrich, *supra* note 53 (describing how Treasury pulled back on allowing Citigroup to exit TARP in order to preserve value for taxpayers).

[63] *See* I. Serdar Dinç, *Politicians and Banks: Political Influences on Government-Owned Banks in Emerging Markets*, 77 J. FIN. ECON. 453 (2005) (discussing how government ownership of banks leads to politically motivated lending, especially in election years); Paola Sapienza, *The Effects of Government Ownership on Bank Lending*, 72 J. FIN. ECON. 357, 377–80 (2004) (finding government-owned banks charge lower interest rates when there is strong party affiliation between geographical area and bank's chairperson).

[64] *See* Levinson, *supra* note 61, at 357–61 (asserting that economic loss does not necessarily translate to political accountability).

[65] *See* Alan C. Shapiro, *Capital Budgeting for the Multinational Corporation*, 7 FIN. MGMT. 7, 7 (1978) (arguing adjusting cash flows more accurately accounts for political risk than increasing required return).

[66] *See* Kirt C. Butler & Domingo Castelo Joaquin, *A Note on Political Risk and the Required Return on Foreign Direct Investment*, 29 J. INT'L BUS. STUD. 599, 600 (1998) ("In the context of the capital asset pricing model, investors only care about political risks that cannot be diversified away . . . .").

trols.[67] Although political risk is a familiar concept in foreign investment, it remains to be analyzed how it will be treated by investors domestically.[68]

Investors are reluctant even to purchase assets with the government as a short-term partner. The Treasury Department created the Public-Private Investment Program (PPIP) in March of 2009 to induce private investors to purchase toxic loans from troubled banks.[69] In theory, if the government co-invested with private investors, protecting them from the risk of losses, it would be easier for banks to clear their balance sheets of toxic assets.[70] The PPIP, however, was met with tepid response from private investors who were worried about doing business with the government, which unilaterally could alter the terms of the deal.[71]

Some level of political risk is inevitable when the government intervenes in the marketplace. But if the government uses its owner-

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[67] Whether investors demand higher prices or simply exit the market depends entirely on whether investors believe political risk can be accurately priced. Some scholars have argued that political risk, rather than being a "risk" that has an expected value based on probability and outcomes, approaches the level of "uncertainty," where investors cannot even weigh probability or possible outcomes accurately. *See* Hill, *supra* note 60, at 298–304 (quoting Frank H. Knight, Risk, Uncertainty and Profit 233 (1921)); *see also* Bradley Keoun, *Citigroup Stuck with Bernanke Offer Rival Banks Plan To Refuse*, Bloomberg (June 1, 2009), http://www.bloomberg.com/apps/news?pid=20601087&sid=ans2mNbxPb2o ("Every time I try to pitch an idea to investors that has some government involvement, the automatic reaction is, 'I don't want to get involved.'" (quoting Kevin Starke, analyst at CRT Capital Group LLC)). These arguments about the nature of political risk influence the debate about transition relief—whether the government should provide relief, based on difficulties in pricing political risk, to private actors for regulatory changes that negatively impact such private persons. *See generally* Jonathan S. Masur & Jonathan Remy Nash, *The Institutional Dynamics of Transition Relief*, 85 N.Y.U. L. Rev. 391 (2010). Whether political risk can be priced or not, the risk increases the compensation potential investors demand to invest in government-controlled corporations.

[68] *See* Randall D. Guynn et al., *Emergency Economic Stabilization Act: The Original Version*, *in* Davis Polk Financial Crisis Manual, *supra* note 30, at 41, 55 ("The intensity and scope of retroactive political risk in the [United States] is new and it remains to be seen whether we are experiencing a paradigm shift or a phase.").

[69] U.S. Dep't of the Treasury, Public-Private Investment Program White Paper 3 (2009), *available at* http://www.treasury.gov/press-center/press-releases/Documents/ppip_whitepaper_032309.pdf ("This program will attract private capital to purchase eligible loan assets from participating banks through the provision of [Federal Deposit Insurance Corporation] debt guarantees and Treasury equity co-investment.").

[70] *Id.* at 1–2.

[71] *See* David Enrich et al., *Wary Banks Hobble Toxic-Asset Plan*, Wall St. J., June 29, 2009, at A1 ("Lawyers for hedge funds and private-equity investors warned clients about the risks of doing business with the government. The industry was unnerved by the restrictions placed on banks participating in another federal bailout program, the Troubled Asset Relief Program."); *see also* Guynn et al., *supra* note 68, at 54. *But see* Enrich et al., *supra* (noting government's explanation that improving markets reduced demand to sell toxic assets).

ship position in corporations to reach informal policy goals without setting clear priorities for management, that risk increases. Political risk in turn increases the cost of capital for the firm and reduces the firm's market value. Political risk also creates inefficiency in the marketplace by reducing the efficient allocation of capital:[72] Firms that may be able to grow with more investment will not receive capital as cheaply as they should because of the political risk created by government control.[73] Conversely, mitigating political risk would help bailouts end more quickly and cheaply, as improved capital allocation makes it easier both for corporations to get financing and for the market to reflect their true value.

II
The Failure of Traditional Checks on Government Control

The government as shareholder, acting also as policymaker, blurs the line between government action and corporate action. In most circumstances, private parties can traditionally turn to the judiciary for procedural safeguards to address their grievances against government agencies. If an agency acts arbitrarily, abusively, or contrary to congressional intent, an injured party may sue for relief under the

[72] *See* Jeffrey Wurgler, *Financial Markets and the Allocation of Capital*, 58 J. Fin. Econ. 187, 188 (2000) (explaining efficient capital allocation shifts capital from projects with low returns to projects with high returns). *See generally* Jeremy C. Stein, *Agency, Information and Corporate Investment*, *in* Handbook of the Economics of Finance: Corporate Finance 111 (George M. Constantinides et al. eds., 2003) (surveying empirical literature on allocative efficiency of corporate investment).

[73] *See* The World Bank, Global Development Finance: Harnessing Cyclical Gains for Development 149–50 (2004) (including political risk in set of "bottlenecks" preventing "healthy flow of capital" to developing countries from international markets); Wurgler, *supra* note 72, at 188 ("[E]ffective laws against misuse of minority investors' funds determine the supply of finance to good projects."). Of course, government control may not always increase the cost of capital for the firm; in some cases it may actually decrease it. *See, e.g.*, IRS, Internal Revenue Bulletin 2012-2, Notice 2010-2 (Dec. 11, 2009), *available at* http://www.irs.gov/pub/irs-drop/n-10-02.pdf (lessening burden imposed by Internal Revenue Code § 382, which generally acts to limit net operating loss carryover available subsequent to ownership change, for recipients of TARP funds); Eric Dash, *A Tax Break for Citigroup with Payback of Bailout*, N.Y. Times, Dec. 16, 2009, at B3 (describing how IRS exempted Citigroup from rule that would have forced it to write off deferred tax assets when government sells its stake in Citigroup). Empirical studies likely will be needed to determine whether benefits of government ownership outweigh the cost of political risk. *Cf.* Andrea Beltratti et al., State Ownership, Political Risk, and Asset Prices (Oct. 2009) (unpublished manuscript), *available at* http://www.bernardobortolotti.com/Userfiles/attach/20107281554514State%20Ownership%20Political%20Risk%20and%20Asset%20Prices.pdf (conducting empirical analysis and finding European corporations with at least residual state ownership and control were more valuable than fully privatized firms). Whatever the net effect of political control, however, a government shareholder acting without clear priorities increases political risk.

Administrative Procedure Act (APA). Likewise, if a controlling shareholder uses a corporation for its own interest at the expense of other shareholders, the other shareholders may sue under corporate law. But, as this Part explains, in the financial crisis following the fall of Lehman Brothers, where the government agency *was* the controlling shareholder, neither administrative law nor corporate law imposed procedural constraints on government action that would limit political risk. Section A discusses how the EESA blocks effective relief under the APA by not allowing courts to grant equitable relief. Section B describes how Delaware corporate law fails to constrain the government as shareholder appropriately, both because it is too rigid to accommodate an effective response to crisis and because Delaware courts do not wish to adjudicate a federal bailout. This lack of procedural protection amplifies the political-risk problem identified in Part I. Section C evaluates nonjudicial checks on agency action as possible substitutes for the lack of traditional procedural protections.

A. Judicial Review Under the APA

Agency policymaking is typically reviewable under the APA.[74] An agency's actions, for example, must not violate the Constitution, exceed the agency's statutory authorization, or be arbitrary or capricious.[75] This review, however, hinges on the availability of effective relief. The United States possesses sovereign immunity from all suits—immunity that only it can waive.[76] Section 702 of the APA waives sovereign immunity for suits against the government seeking equitable relief,[77] but this waiver may be circumscribed by any other statute that retains sovereign immunity.[78] The EESA does just that.

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74 Sections 702 and 704 allow for judicial review of final agency decisions, subject to modification by other statutes. 5 U.S.C. §§ 702, 704 (2006); *see also* 5 U.S.C. § 551(1) (2006) (defining "agency").

75 5 U.S.C. § 706 (2006). Arbitrary and capricious review entails determining if an agency considered all relevant factors for the decision reached or "whether there has been a clear error of judgment." Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971).

76 *See* United States v. Mitchell, 463 U.S. 206, 212 (1983) ("It is axiomatic that the United States may not be sued without its consent and that the existence of consent is a prerequisite for jurisdiction.").

77 5 U.S.C. § 702; *see also* Bowen v. Massachusetts, 487 U.S. 879, 891–92 (1988) ("[I]t is undisputed that the 1976 amendment to § 702 was intended to broaden the avenues for judicial review of agency action by eliminating the defense of sovereign immunity in cases covered by the amendment . . . ."); ERWIN CHEMERINSKY, FEDERAL JURISDICTION § 9.2, at 634 (5th ed. 2007) ("The statute is clear: The United States has waived its sovereign immunity in suits requesting other than monetary relief.").

78 *See* 5 U.S.C. § 702(2) ("Nothing herein . . . confers authority to grant relief if any other statute that grants consent to suit expressly or impliedly forbids the relief which is sought.").

The EESA seemingly permits suits under the APA—including holding arbitrary and capricious agency action unlawful[79]—but the exceptions to relief gut the judicial review provision of any real enforcement power. Section 119 blocks a judge from granting equitable relief for any suit pursuant to sections 101 (authorizing Secretary to purchase troubled assets), 102 (providing that Secretary shall insure troubled assets), 106 (giving Secretary broad permission to manage, sell, and exercise rights accompanying troubled assets), and 109 (requiring Secretary to minimize mortgage foreclosures), except for violations of the Constitution.[80] Thus, the APA's waiver of sovereign immunity is virtually meaningless.[81] Aside from constitutional claims, there does not appear to be any viable suit against Treasury if it were to use its position as a shareholder to influence corporate policy in an arbitrary and capricious manner.[82] It is unclear why Congress would write a section providing judicial review that in effect blocked all relief, but there does not appear to be an adequate explanation.[83]

From a short-term perspective, limiting judicial review of Treasury's actions seems justified. The government needed to move quickly and decisively to stabilize the economy, and delays caused by

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79 Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 119(a)(1), 122 Stat. 3765, 3787–88 (to be codified at 12 U.S.C. § 5229). In his initial proposal to Congress, then-Secretary Paulson sought a complete block of judicial or administrative review for actions taken pursuant to the bailout. U.S. DEP'T OF THE TREASURY, LEGISLATIVE PROPOSAL FOR TREASURY AUTHORITY TO PURCHASE MORTGAGE-RELATED ASSETS § 8 (2008), *available at* www.foxx.house.gov/uploads/Administration%20 Proposal.doc.

80 Emergency Economic Stabilization Act § 119(a)(2)(A) ("No injunction or other form of equitable relief shall be issued against the Secretary for actions pursuant to section 101, 102, 106, and 109, other than to remedy a violation of the Constitution.").

81 A plaintiff can seek only equitable relief when challenging an agency decision under the APA. 5 U.S.C. § 706 (2006); *see also* Lawrence H. Tribe, *Death by a Thousand Cuts: Constitutional Wrongs Without Remedies After* Wilkie v. Robbins, 2007 CATO SUP. CT. REV. 23, 46 n.88 (noting that, under APA, court may only "order, or set aside, agency action," and characterizing such relief as "equitable").

82 *See* Davidoff & Zaring, *supra* note 6, at 520 ("And so the bill appeared to grant judicial review in one section, and then took it away, by taking away equitable relief, in the other section."); Recent Developments, *supra* note 26, at 579 ("[I]t appears only constitutional rights will be protected when the government acts pursuant to EESA."); *see also* Verret, *supra* note 7, at 307–15 (rejecting possibility of claims being brought under other federal statutes).

83 *See* Davidoff & Zaring, *supra* note 6, at 520 ("Perhaps attributable to the speed of the bailout's passage[,] . . . the precise availability of the judicial review provisions of the bill were [sic] never clarified by Congress."). As previously discussed, legislative history on the EESA is scant. *See supra* note 28; *see, e.g.*, STAFF OF H. COMM. ON FIN. SERVS., 110TH CONG., SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION 4 (Comm. Print 2008), *available at* http://financialservices.house.gov/EESABill_section-by-section.pdf (describing section 119 as providing "standards for judicial review, including injunctive and other relief, to ensure that the actions of the Secretary are not arbitrary, capricious, or not in accordance with law").

litigation could have frustrated the entire purpose of giving Treasury emergency powers.[84] This short-term justification, however, does not apply to the government's management of corporations in the medium term—beyond the initial crisis. Because of the short-term focus of the EESA, even if relief were available it would be difficult for a court to judge Treasury's ongoing management of corporations it controlled against a statute that was not intended to address the government as shareholder.[85]

B. Corporate Law

Delaware corporate law[86] protects minority shareholders from controlling shareholders who use the corporation to advance their own interests at the expense of other shareholders. It does so both by imposing fiduciary duties on the directors and officers of a corporation, including duties of care, loyalty, and good faith,[87] and extending those duties to any shareholder who exercises control over a corporation.[88] Although control is typically defined as owning more than fifty percent of the outstanding shares of a corporation, Delaware also looks to see if a shareholder with less than fifty percent dominates the board, using its position to take actions in its interests that are against the corporation's interests.[89]

During the bailout, the government owned more than fifty percent of some corporations[90] and likely would have been treated as a

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[84] In the Chrysler bankruptcy, Chrysler reported that it lost $100 million each day during which a court order stayed its sale to Fiat, pending appellate review. Chad Bray & Alex P. Kellogg, *Court Affirms Chrysler Sale but Puts Deal on Hold Until Monday*, WALL ST. J. (June 5, 2009, 6:32 PM), http://online.wsj.com/article/SB124423529553090069.html; *see also* Davidoff & Zaring, *supra* note 6, at 519 ("[J]udicial review is slow and *ex post*, judges are inexpert at complicated financial matters, and in the case of the savings and loan bailout it was adjudged by some to be ineffective.").

[85] *See supra* notes 15–17 and accompanying text (outlining purposes of EESA); *supra* notes 26–29 and accompanying text (describing congressional intent).

[86] More corporations incorporate in Delaware than anywhere else. Kahan & Rock, *Bear Stearns*, *supra* note 6, at 714 & n.1. More importantly for the purposes of this discussion, the major public corporations the government rescued are incorporated in Delaware. *See, e.g.*, Gen. Motors Co., Current Report (Form 8-K), at 1 (July 10, 2009); Citigroup Inc., Annual Report (Form 10-K), at 2 (Feb. 27, 2009); Am. Ins. Grp., Annual Report (Form 10-K), at 3 (Mar. 2, 2009). Thus, this Note will evaluate only Delaware corporate law.

[87] *See* Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) (placing duty of good faith under duty of loyalty, despite colloquial existence of "triad" of duties).

[88] Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) (discussing fiduciary duties in context of parent-subsidiary relationship).

[89] *See, e.g.*, Kahn v. Lynch Comm. Sys., 638 A.2d 1110, 1113–14 (Del. 1984) (deeming parent corporation with 43.3% minority share controlling shareholder because it exercised actual control of corporate conduct).

[90] For example, A.I.G. and General Motors. *See supra* note 25.

controlling shareholder.[91] With respect to corporations of which the government owned less than fifty percent,[92] evidence suggests it attempted to influence corporate policy directly.[93] In those cases as well, a court could have found the government was a controlling shareholder.[94]

Even if relief were theoretically available, it is unlikely that shareholders would have a viable claim under Delaware law.[95] As part of its duty of loyalty, a controlling shareholder has a duty not to self-deal,[96] but Delaware courts have defined self-dealing only as involving a personal financial interest.[97] In the case of the government shareholder, a

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91 *See Kahn*, 638 A.2d at 1113–14 (explaining Delaware law imposes fiduciary duties on shareholders who own majority interest in corporation).

92 For example, Citigroup, Dash, *supra* note 25, and Bank of America, Eric Dash et al., *Bank of America to Receive Additional $20 Billion*, N.Y. TIMES, Jan. 16, 2009, at B1.

93 Reports suggest the government forced Bank of America to rescue Merrill Lynch and threatened management shakeups. Michael R. Crittenden, *Fed Emails Bash BofA Chief in Tussle Over Merrill Deal*, WALL ST. J., June 11, 2009, at A1; Dash et al., *supra* note 92; Deborah Solomon & Michael R. Crittenden, *Former Treasury Secretary To Get Back in the Fray*, WALL ST. J., July 16, 2009, at A4.

94 *See* Verret, *supra* note 7, at 302–07 (outlining why government would be considered controlling shareholder of several corporations).

95 Section 702 of the APA—in the absence of the EESA restrictions on equitable relief—would allow a court to void or rescind a self-dealing transaction, an equitable remedy used by Delaware courts to grant relief for self-dealing. *See, e.g.*, *In re* MAXXAM, Inc., 659 A.2d 760, 775 (Del. Ch. 1995). Section 702 is a broad waiver of sovereign immunity for equitable relief that extends beyond traditional agency review as covered in the APA and reaches, for example, tort claims. *See* U.S. Info. Agency v. Krc, 989 F.2d 1211, 1216 (D.C. Cir. 1993) (applying APA waiver in context of tortious interference with contract suit against government employer), *cited with approval in* Christopher v. Harbury, 536 U.S. 403, 420 (2002); *see also* CHEMERINSKY, *supra* note 77 ("The statute is clear: The United States has waived its sovereign immunity in suits requesting other than monetary relief."). On the other hand, the Federal Tort Claims Act (FTCA) likely would block a suit for damages, as the Treasury Department likely is protected under the discretionary function exception, which preserves sovereign immunity for suits arising due to a government official's exercise of discretionary power related to their function or duties. 28 U.S.C. § 2680(a) (2006). *See generally* Mark C. Niles, *"Nothing But Mischief": The Federal Tort Claims Act and the Scope of Discretionary Immunity*, 54 ADMIN. L. REV. 1275 (2002) (surveying discretionary function exception). The Federal Tort Claims Act grants jurisdiction to federal courts to hear tort claims against the United States, 28 U.S.C. § 1346(b) (2006), including those under state law. *See, e.g.*, Richards v. United States, 369 U.S. 1 (1962) (evaluating Oklahoma negligence law suit under FTCA). Breach of fiduciary duty is considered a tort. *See* RESTATEMENT (SECOND) OF TORTS § 874 (1979). *But see* Kahan & Rock, *Controlling Shareholder*, *supra* note 7, at 29–32 (questioning whether breach of fiduciary duty is clearly tortious act).

96 Sinclair Oil Corp. v. Levien, 280 A.2d 717, 721 (Del. 1971). Self-dealing is defined as a controlling shareholder's use of its influence to receive a benefit while excluding minority shareholders. Solomon v. Armstrong, 747 A.2d 1098, 1112 n.35 (Del. Ch. 1999).

97 Though the original Delaware court decision addressing self-dealing did not define what sort of "benefit" extracted against minority shareholders counts as self-dealing, the case involved a financial benefit—an oil company blocked its subsidiary from filing breach of contract claims against another subsidiary. *Sinclair*, 280 A.2d at 720, 722–23. Later

minority shareholder likely would have to claim that the government's policy actions constitute political self-dealing that benefited the government at minority shareholders' expense. But this is not *financial* self-dealing.[98] Although a plaintiff could argue the same underlying rationale of protecting minority shareholders from financial self-dealing applies to political self-dealing, such a claim would only prevail if, for the first time, Delaware extended self-dealing to political situations.

To protect its legitimacy as the leading forum for corporate law, Delaware likely will not extend self-dealing beyond personal financial interest. As shown by the Delaware Chancery Court's actions when Bear Stearns was sold to J.P. Morgan Chase, Delaware courts do not want to get involved in a federal bailout:[99] Even though the Bear Stearns–J.P. Morgan Chase deal was arguably invalid under Delaware law,[100] the chancery court stayed the shareholder litigation filed in Delaware in favor of pending litigation in New York.[101] According to Professors Kahan and Rock, the court used this atypical deferral to avoid blocking federal action viewed as necessary to save the financial system.[102] Since Delaware is the preeminent forum for business disputes, the Delaware Chancery Court did not want to place itself willingly in conflict with the federal government and risk delegitimizing Delaware's authority in corporate matters.[103] Similarly, because self-

Delaware cases suggest only a financial benefit will qualify as self-dealing. *See In re* LNR Prop. Corp. S'holders Litig., 896 A.2d 169, 175 (Del. Ch. 2005) ("A well settled precept of Delaware corporate law is that a fiduciary is considered interested where he or she will receive a personal *financial* benefit from a transaction that is not equally shared by the stockholders." (emphasis added)).

98 *See supra* notes 62–64 and accompanying text (describing how government's interest in corporations is political, not financial).

99 Kahan & Rock, *Bear Stearns*, *supra* note 6, at 715.

100 *Id.* at 723–38 (citing Omnicare v. NCS Healthcare, Inc., 818 A.2d 914 (Del. 2003); Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995); Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988); Unocal Corp. v. Mesa Petroleum Corp., 493 A.2d 946 (Del. 1985); and Condec Corp. v. Lunkenheimer Co., 230 A.2d 769 (Del. Ch. 1967)) (arguing that by issuing to J.P. Morgan new shares equivalent to approximately 40% of outstanding stock prior to shareholder vote, merger violated variety of Delaware precedent designed to protect shareholders from coercive takeovers).

101 *In re* Bear Stearns Cos. S'holder Litig., No. 3643-VCP, 2008 WL 959992 (Del. Ch. Apr. 9, 2008).

102 Kahan & Rock, *Bear Stearns*, *supra* note 6, at 757–78. Although the court held the litigation raised no novel or substantial issues, *In re Bear Stearns*, 2008 WL 959992, at *6, Kahan and Rock assert that this rationale was disingenuous, considering Delaware rarely defers to other states on matters of Delaware corporate law, particularly for high-profile litigation. *See* Kahan & Rock, *Bear Stearns*, *supra* note 6, at 745–52 (pointing to unsettled issues in *Omnicare*, 818 A.2d 914, and *Blasius*, 564 A.2d 651).

103 Kahan & Rock, *Bear Stearns*, *supra* note 6, at 744–45 (outlining "Delaware's dilemma" of choosing between deferring to New York state courts and locking horns with federal government).

dealing transactions by controlling shareholders invoke heightened scrutiny,[104] Delaware courts would not want to take a step that could place them in constant conflict with the federal government as shareholder acting to save the economy.[105]

Further, even if Delaware law did reach Treasury's control of corporations, corporate law is not an adequate system to constrain agency action. If the government's actions could be constrained by shareholder suits, the pendulum of agency constraint would swing too far in the opposite direction—toward a government unable to effectively respond to a financial crisis. Though Delaware law creates a standard for the government to abide by, that standard takes into account only the interests of minority shareholders and the corporation. This presents two problems. First, it puts the government in a position where actions deemed necessary to the stability of the national economy could be blocked by a state court if it determined that the actions harmed the affected corporation or disadvantaged its minority shareholders.[106] Second, a system where government interests are subordinated to shareholder interests will increase the risk of moral hazard if corporations know that government as shareholder is no different from other shareholders.[107] Delaware corporate law, both in principle and in practice, is not a sufficient mechanism to constrain agency conduct.

C. *Nonjudicial Constraints on Agency Action*

Though there appears to be no judicial review of agency actions under TARP, there are political checks that could constrain the government's management of the corporations it controls. Modifying Secretary Paulson's original proposal for TARP, Congress added provisions requiring regular reports from Treasury to Congress, estab-

104 *See* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 719–20 (Del. 1971) (holding standard for evaluating self-dealing transaction involving controlling shareholder is heightened standard of showing transaction's "intrinsic fairness" to minority shareholders).

105 Kahan & Rock, *Controlling Shareholder*, *supra* note 7, at 26–27.

106 For example, if the government tried to force A.I.G. to spin off divisions to lower the systemic risk A.I.G. posed as an insurance behemoth, a minority shareholder could sue and argue the sale unfairly disadvantaged A.I.G. and its shareholders. *See supra* note 49 and accompanying text (reporting how government considered spinning off A.I.G.'s financial products group).

107 Some scholars argue if management knows how the government will rescue corporations in response to a crisis, those investors will account for that government insurance and take more excessive risks. *See, e.g.*, Thomas E. Hellmann et al., *Liberalization, Moral Hazard in Banking, and Prudential Regulation: Are Capital Requirements Enough?*, 90 AM. ECON. REV. 147, 148 (2000) (discussing how banks "gambl[e] on resurrection").

lished a Congressional Oversight Panel,[108] and authorized the Comptroller General of the United States to audit the Treasury's actions under the EESA.[109] Congress has used this power to review the conduct of both the Treasury Department and the Federal Reserve in managing the bailout. For example, Federal Reserve Chairman Ben Bernanke and former Secretary Paulson were chastised before Congress in connection with the government's actions in the sale of Merrill Lynch to Bank of America.[110] To the extent the government reaches "too far" in managing corporations under TARP, officials can expect to be called before Congress. This oversight mechanism creates political constraints on agency action.[111] Congress also has the authority to modify a bailout through statutory enactments. During the past financial crisis, Congress strengthened the restrictions on executive compensation for corporations receiving TARP funds[112] and enhanced the powers of the inspector general in regard to such corporations.[113]

Despite this increase in its power over TARP recipients, an independent inspector general may not provide much of a constraint. The inspector general was charged with investigating and auditing any action taken pursuant to the EESA.[114] Though the inspector made several recommendations to the Treasury Department in connection with TARP programs, the Treasury Department declined to follow

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[108] Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 125, 122 Stat. 3771, 3791 (codified at 12 U.S.C. § 5233).

[109] *Id.* § 116.

[110] Michael R. Crittenden, *Paulson Lambasted for Crisis*, WALL ST. J., July 17, 2009, at C1; Edmund L. Andrews, *Bernanke Defends Role on Merrill*, N.Y. TIMES, June 26, 2009, at B1.

[111] Whether members of Congress believe government management has gone "too far" may partly be a matter of party affiliation. *See* Guynn et al., *supra* note 68, at 55 n.40 ("Politicians, depending on their views and party affiliations, are alternately 'troubled that the private sector must now incorporate the concept of "political risk" into [their] due diligence analysis' or they are angrily denouncing 'unseemly' corporations and threatening further government involvement in the private sector." (quoting CONG. OVERSIGHT PANEL, JULY OVERSIGHT REPORT, SECTION TWO: ADDITIONAL VIEWS (2009), *available at* http://cop.senate.gov/documents/cop-072109-views.pdf (statements by Rep. Jeb Hensarling and Sen. John E. Sununu) (alteration in original))).

[112] *See* American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 7001, 123 Stat. 115, 516–20 (discussing executive compensation requirements for executives of corporations receiving TARP funds).

[113] Special Inspector General for the Troubled Asset Relief Program Act of 2009, Pub. L. No. 111-15, 123 Stat. 1603. On the other hand, Congress's modifying a financial bailout through statute arguably could *create* political risk, although of a form different from the political risk created by the government as shareholder analyzed in this Note.

[114] *See* Special Inspector General for the Troubled Asset Relief Program Act § 2 (amending Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 121, 122 Stat. 3765, 3788 (to be codified at 12 U.S.C. § 5231)) (laying out Special Inspector's investigative and auditing authority).

them.[115] The inspector's influence may be limited to informing Treasury of concerns it has yet to consider, but Treasury is under no requirement to follow the inspector's recommendations.

These nonjudicial checks on agency action may help explain why the Obama administration took a restrained position in the last financial crisis,[116] but they do not reduce the political risk to shareholders in government-controlled corporations. Congress's interest in restraining government influence likely would be limited to protecting the taxpayers'—that is, the voters'—interests.[117] Shareholders would have trouble vindicating their interests through Congress, as they will not be able to organize as effectively as other interest groups.[118] Thus, where the taxpayers' interest differs from shareholders' interests, nonjudicial checks do not provide procedural protection against political risk.

III
Providing Procedural Review of Government Management

There is a need to balance the government's legitimate interest in rapidly responding to a financial crisis with a broader interest in preventing situations where the government can assert its influence over corporations for as long as it chooses, with little oversight, accountability, or transparency. This Part suggests one approach to how the government should manage corporations it controls. To balance competing interests, timing is key. In the beginning of any major crisis, the judiciary will inevitably play a minor role. The courts lack the ability to act swiftly and with the same authority as the other branches of government.[119] But when the crisis passes, the judiciary can step back in. Procedural review through the APA can mitigate

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115 William J. Fenrich et al., *Investigations and Enforcement*, *in* Davis Polk Financial Crisis Manual, *supra* note 30, at 207, 220 & nn.60–61.

116 *See supra* notes 44–57 and accompanying text (detailing government influence in corporations receiving TARP funds).

117 *See, e.g.*, Michael R. Crittenden & Dan Fitzpatrick, *Lewis Takes Heat but Defends Merrill Deal*, Wall St. J., June 12, 2009, at C1 ("Why did a private business deal [Bank of America-Merrill Lynch], announced in September, and approved by shareholders in December, with no mention of government assistance, end up costing taxpayers $20 billion in January?" (quoting Rep. Edolphus Towns)).

118 *See* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 Nw. U. L. Rev. 547, 590–91 (2003) (explaining that, as political interest groups, shareholders have far less power than do nonshareholder constituencies of corporation).

119 *See, e.g.*, The Federalist No. 70, at 392 (Alexander Hamilton) (Clinton Rossiter ed., 1961) (describing unique ability of executive to act with "[d]ecision, activity, secrecy, and dispatch").

some of the political risk associated with government control without cabining the government's ability to respond decisively to a financial crisis. Section A draws upon the EESA and corporate law to suggest a hierarchy of three principles to guide government management of bailed-out corporations: 1) act in the immediate interest of economic stability, 2) protect the taxpayers' investment, and 3) act in the interests of the corporation. Section B describes how procedural review can balance effective restraint with necessary flexibility and gives an example of how this review would operate.

The real benefit of procedural review, however, may not be in the ability of shareholders consistently to vindicate their rights against the government. Rather, as Section C describes, procedural review forces the government to *justify* the decisions it makes in the context of the principles suggested in Section A. These justifications would flesh out inherently vague standards and help mitigate political risk both by reducing uncertainty and by changing the government's incentives and conduct ex ante.

A. How Should the Government Manage Its Stake?

A set of principles for government management should seek to alleviate the problems posed by political risk. It should provide clear objectives to keep the government from expanding beyond what Congress intended, signal stability to investors about how the government will manage rescued corporations, and avoid creating a rigid system that subordinates the government's interest in protecting the economy to minority shareholders' interests.[120] With these goals in

[120] The closest historical model for the government's position as a shareholder is the Reconstruction Finance Corporation (RFC), a separately chartered government corporation that provided loans and purchased preferred stock from banks (and other corporations) during the Great Depression. *See* Reconstruction Finance Corporation Act, ch. 8, 47 Stat. 5 (1932); Emergency Banking Relief Act of 1933, ch. 1, § 304, 48 Stat. 1 (expanding RFC power to include purchasing preferred stock). *See generally* James S. Olson, Saving Capitalism: The Reconstruction Finance Corporation and the New Deal, 1933–1940, at 123–24, 131 (1988) (describing vast equity and debt holdings of RFC); Walker F. Todd, *History of and Rationales for the Reconstruction Finance Corporation*, 28 Econ. Rev. 22 (1992). The RFC could both sue and be sued. Reconstruction Finance Corporation Act § 4; *see* Reconstruction Fin. Corp. v. J.G. Menihan Corp., 312 U.S. 81, 84–86 (1941) (holding Congress waived sovereign immunity for RFC through § 4). The RFC rarely interfered with corporate policy, a fact which supports this Note's thesis that the availability of procedural remedies can help reduce political risk. *See* Olson, *supra*, at 125–26 (describing letter from RFC Chairman Jesse Jones to President Franklin Delano Roosevelt, explaining RFC would not interfere with corporate policy unless management was "wholly inadequate"); *see also* Todd, *supra*, at 22–23, 26 (describing RFC as having "clearly defined network of checks and balances" through corporate structure). Any comparison to the EESA is limited, however, as the RFC was a politically separate, independent corporation with a personality uniquely shaped by its Chairman, Jesse Jones. *See*

mind, this Note proposes modifying the EESA's short-term focus on crisis management to reflect all of the time horizons associated with the government's equity stake: short term, medium term, and long term.[121] By recognizing that there are competing interests in the government's management of its equity stake, this Note attempts to balance those interests appropriately given the context of the time frame.[122] These time frames should not be construed as strictly discrete from each other. For instance, short-term economic stability will always be a concern, and circumstances may change, justifying a different short-term response.

1. *Short Term: Economic Stability*

The first principle addresses the government's short-term interest: protect the stability of the economy. This principle explicitly extends the main objective of the EESA to the government's management of corporations.[123] The government should be able to use its equity stake to influence management in order to alleviate immediate threats to economic stability.[124] It is important to emphasize this principle's requirement of immediacy. As previously discussed, criticism of government management of corporations in the financial crisis stemmed principally from a shift from short-term crisis response to medium-term management.

OLSON, *supra*, at 125 (noting Jones had "no desire to control or manage the banks"); *see also* JESSE H. JONES, FIFTY BILLION DOLLARS: MY THIRTEEN YEARS WITH THE RFC (1932–1945), at 452 (1951) (insisting on running RFC "on a business basis"). For a discussion of other bailouts, see Joseph R. Mason, *The Evolution of the Reconstruction Finance Corporation as a Lender of Last Resort in the Great Depression*, *in* BAILOUTS: PUBLIC MONEY, PRIVATE PROFIT (Robert E. Wright ed., 2010); Kahan & Rock, *Controlling Shareholder*, *supra* note 7, at 53–58 (describing UK approach to 2008 financial crisis and Israeli approach to 1983 bank crisis). *See also* Verret, *supra* note 7, at 289–93 (outlining history of government involvement in marketplace and finding "no precedent for the unique confluence of factors for those businesses that have taken TARP funding in exchange for giving the government an ownership, and often controlling, stake").

121 *See* Kahan & Rock, *Controlling Shareholder*, *supra* note 7, at 59 (listing "indefinite v. time-limited ownership" as key design choice in bailout policy).

122 This Note addresses the challenge issued by one commentator who suggested Treasury develop "a code of fiduciary duty which defines its obligations to taxpayer beneficiaries of TARP as well as other shareholders in TARP banks." Verret, *supra* note 7, at 345–47. Verret notes such a code would reduce political risk. *See id.* at 347 n.316.

123 Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 2(1), 122 Stat. 3765 (to be codified at 12 U.S.C. § 5201).

124 Actions that would fall under this category include reducing the systemic risk posed by a firm or pushing a bank to make more loans in order to unfreeze the credit markets. *See, e.g.*, *supra* note 49 (describing government's interest in shrinking A.I.G. to reduce systemic risk).

In effect, this single principle absorbs the grab bag of purposes outlined in the EESA.[125] Take the example of the Citigroup mortgage reduction plan[126]: If a foreclosure wave posed a serious threat to financial stability, the government could push a corporation to negotiate with homeowners. But that same purpose should not apply over the medium term. Otherwise, any bank that is forced to renegotiate mortgage terms or increase liquidity becomes, in effect, a quasi–Fannie Mae—a government corporation created to serve the public interest.[127] In this situation, the government has used the corporation for political self-dealing,[128] devaluing the corporation.

Where political self-dealing creates political risk and inefficiency that is more expensive than if the government did *not* influence policy, that self-dealing should be blocked. Thus, attempting to stave off an economic catastrophe justifies creating some political risk in the short term, but influencing policy beyond a crisis unnecessarily reduces capital allocative efficiency.[129] This economic-stability principle may constrain the government's flexibility during an economic downturn, but only to the extent that it uses corporate control as an informal policy tool. The government will have other methods within its discretion, such as using the resolution authority for insolvent corporations created by the financial reform bill.[130] By limiting the government's ability to influence corporate policy to crisis response situations, this principle would still allow the government to maintain a powerful tool to avert economic disaster. Limiting this power to the short term, however, mitigates the political risk created when the government continues to use the corporation as an informal policy tool beyond the initial crisis.

[125] *See* Emergency Economic Stabilization Act §§ 2, 103 (outlining "Purposes" and "Considerations").

[126] *See supra* note 51 and accompanying text (describing mortgage reduction plan).

[127] Fannie Mae, a private corporation chartered by Congress with a public mission to increase home ownership, failed and was placed into conservatorship in the fall of 2008. *See, e.g.*, Dwight Jaffe et al., *What To Do About the Government-Sponsored Enterprises?*, *in* RESTORING FINANCIAL STABILITY: HOW TO REPAIR A FAILED SYSTEM 121, 121 (Viral V. Acharya & Matthew Richardson eds., 2009).

[128] *See supra* notes 96–98 and accompanying text (characterizing government's actions as form of political self-dealing).

[129] *See supra* notes 72–73 and accompanying text (describing how political risk reduces capital allocative efficiency).

[130] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 201–217, 124 Stat. 1376, 1442–520 (2010) ("Title II – Orderly Liquidation Authority"); *see also* U.S. DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 76–79 (2009) (outlining proposed government tools for crisis response such as establishing conservatorship or receivership for failing firms, providing loans, purchasing assets, guaranteeing liabilities, or making equity investments).

2. *Medium Term: Taxpayer's Interest*

In the medium term, the relevant principle should be to maximize the government's return and sell its investment as quickly as possible. This principle—protecting the interests of the taxpayer—seeks to realign the government's political interests with a normal shareholder's profit motive. This principle is also borrowed from the EESA purposes[131] but would differ from the EESA by imposing a duty to cash out as quickly as possible without jeopardizing economic stability.

Ranking this principle second encourages government to seek profits for taxpayers if it is not acting to stabilize the economy. This profit-seeking motive reduces the risk of political self-dealing and thus lowers the political risk associated with government control. The market can then price the corporation more accurately in line with its growth prospects. Accurate pricing will, in turn, reduce the cost of a bailout and increase the value of the government's equity stake.

Further, time pressure limits the opportunity for government to expand its objectives through management and signals predictability by forcing the government to divest itself of equity holdings when it can do so without destabilizing the economy.[132] Indeed, one proposed congressional bill would have modified the TARP plan by forcing the government to liquidate its equity positions by 2011 unless "that liquidation would not maximize the profitability of the company and the return on investment to the taxpayer."[133] Obviously, in some instances the government would sacrifice direct financial gains by selling its investment early. Here, however, the taxpayer's interest expands beyond direct financial gains to the broader, indirect financial gains in the economy created by a shorter, more efficient bailout.

3. *Long Term: Corporate Interests*

For the long term, the principle should be to otherwise act in the best interests of the corporation. This third principle in effect imposes controlling shareholder fiduciary duties on the government, but only when those duties do not conflict with the goals of protecting the economy and protecting the taxpayer's interest. It borrows the corpo-

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

132 *See* Kahan & Rock, *Controlling Shareholder*, *supra* note 7, at 61 ("Binding time limits on government ownership are the single most powerful means of insulating firms from political pressure.").

133 TARP Recipient Ownership Trust Act of 2009, S. 1280, 111th Cong. § 3(d) (2009) (proposing TARP funds be managed in independent trust similar to management of A.I.G.'s TARP funds).

rate law principle of not allowing the controlling shareholder to use its position to benefit itself at the expense of minority shareholders.[134] But it expands past the limitations of corporate law because it need not be bound to Delaware's definition of self-dealing as only involving financial interest.

This principle does not preclude the government from taking actions necessary for the economy or in the best interests of its investment. Rather, it functions as a residual principle to prevent the government from using its position to set corporate policy for *political* goals. It discourages bureaucratic expansion of objectives and signals stability to private investors by attempting to align the government's medium-term interests with the long-term interests of the corporation when they do not conflict with principles one or two.

Although the second principle already imposes a profit motive on the government, the government's equity stake in any bailout is likely only temporary. This principle seeks to address the long-term interest of the corporation and to assure investors that when the government is not addressing the immediate economic crisis, it is acting in the best interest of the corporation—even beyond the time period associated with the government's own financial interest.

B. Enforcement Through Review Under the APA

In order truly to reduce political risk, there must be some form of procedural review that forces an agency to internalize the principles outlined above. Traditionally, parties can seek administrative review of an agency decision under the APA.[135] Because Treasury's actions did not use the formal decisionmaking mechanisms provided in the APA,[136] they would either be reviewed as informal rulemaking or informal adjudication, both of which are subject to the arbitrary and capricious standard of review.[137]

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134 *See* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720–21 (Del. 1971) (extending fiduciary duties to controlling shareholder).

135 Article III courts traditionally hear APA challenges, although specialized courts have been used for specific forms of litigation tied to particular circumstances. *See, e.g.*, Regional Rail Reorganization Act of 1973, 45 U.S.C. § 719(b) (2006) (setting up special federal court with exclusive jurisdiction to hear litigation related to railroad bailout of 1970s); John Minor Wisdom, *Views of a Friendly Observer*, 133 U. PA. L. REV. 63 (1984) (describing Judge Wisdom's experience on railroad court and ascribing its success to management of Judge Friendly); *see also* Richard L. Revesz, *Specialized Courts and the Administrative Lawmaking System*, 138 U. PA. L. REV. 1111 (1990) (analyzing merit of specialized courts).

136 *See* 5 U.S.C. §§ 553–554 (2006) (outlining formal rulemaking and adjudication procedures).

137 *See* 5 U.S.C. § 706(2)(A) (2006) (instructing reviewing court to "set aside agency action, findings, and conclusions found to be . . . arbitrary, capricious, an abuse of discre-

In addition to granting a right of review, however, effective enforcement also should include relief. Thus, the EESA's block on equitable relief should not apply to the government's management of corporations it controls.[138] Although at the time the EESA passed it made sense to block equitable relief that could impose delays and cause the financial system to collapse, this justification does not apply to the medium-term management of a corporation.[139] Removing this restriction for government management of corporations provides a procedural right of review for shareholders.[140]

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tion, or otherwise not in accordance with law"). Informal adjudication, not covered in the APA, is reviewed under the arbitrary and capricious standard. Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 413–14 (1971); *see also supra* note 75 (describing arbitrary and capricious standard).

138 *See* Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 119(a)(2)(A), 122 Stat. 3765, 3787 (to be codified at 12 U.S.C. § 5229) (prohibiting equitable relief for actions taken under EESA).

139 It is worth noting that reviewing an agency decision can be a painstaking process, often taking years. *See, e.g.*, Scenic Hudson Pres. Conference v. FPC, 453 F.2d 463 (2d Cir. 1971) (affirming agency decision five years after previously remanding for development of adequate examination of all issues). The EESA, however, contains provisions for expedited review for injunctive relief, which would make sense to maintain in any future bailout, given the cost of delay. *See* Emergency Economic Stabilization Act § 119(a)(2)(B)–(D) (commanding court to judge temporary restraining orders and permanent injunctions on expedited basis); *supra* note 84 (reporting Chrysler's financial loss due to court stay order).

140 In terms of specific equitable relief, a court could invalidate the agency's actions, and, although it would likely be a question of first impression, hold actions of the corporation made on the agency's request to be government actions that can be enjoined or declared invalid. *Cf.* Lebron v. Nat'l R.R. Passenger Corp., 513 U.S. 374, 394 (1995) (holding Amtrak, government created and controlled corporation, was "agency or instrumentality of the United States" for constitutional purposes). The *Lebron* opinion cites several cases where corporations created and controlled by the government have been held to be government instrumentalities. *See id.* at 395–96 (citing Reconstruction Fin. Corp. v. J.G. Menihan Corp., 312 U.S. 81, 83 (1941) (holding RFC is government instrumentality as it "acts as a governmental agency in performing its functions"); Cherry Cotton Mills, Inc. v. United States, 327 U.S. 536 (1946) (same); and Inland Waterways Corp. v. Young, 309 U.S. 517, 523–24 (1940) (holding Inland Waterways Corp., government-chartered corporation, as government instrumentality)). Although in this case the government would control, but not create, these corporations, the Supreme Court's opinion in *Lebron* centered on how the corporation was controlled. Justice Scalia distinguished Amtrak in *Lebron* from Conrail in *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 152 (1974), an earlier case in which the Court had held that Conrail was not a government entity. The Court noted that Amtrak served public policy goals, where Conrail was managed with only a profit motive; that the government asserted control over Amtrak as a "policymaker" and shareholder, as opposed to merely a passive creditor of Conrail; and that, unlike Conrail, the government's control position in Amtrak could never be terminated without its consent. *Lebron*, 513 U.S. at 399 ("Amtrak is worlds apart from Conrail . . . ."). *But see id.* at 397–99 (contrasting Amtrak with situation where private corporation "whose stock [came] into federal ownership" is temporarily controlled by the government, though still distinguishing between "merely hold[ing] some shares" and "control[ling] the operation of the corporation").

The appropriate standard of review must balance deference to the agency's decision-making process with society's interest in ensuring agency compliance with its mandate. The traditional administrative review standard advocated here, arbitrary and capricious review, is generally considered a deferential standard of review.[141] The agency must show that it has taken into account all the factors prescribed in the governing statute[142]—in this case, the hierarchy outlined in Section A of this Part.[143] But even if a court engaged in "hard look review," carefully examining the decision an agency reached,[144] a reviewing court would defer to that decision provided that the agency can show that it considered all factors and that its decision was fully informed and not implausible.[145] Although a court may determine a decision was inadequately justified and remand to the agency for further justification,[146] it is a much higher burden for a plaintiff to show that a decision demonstrated a "clear error of judgment" and thus should be entirely invalidated.[147] That being said, arbitrary and capricious review is not a toothless standard—empirical evidence suggests that, at least in the Environmental Protection Agency and National Labor Relations Board context, the government loses challenges to agency actions about 35% of the time.[148]

The principles proposed in Section A of this Part hold the government to a high standard of conduct. However, as the standard of review for such conduct is the deferential arbitrary and capricious

141 Nat'l Ass'n of Home Builders v. Defenders of Wildlife, 551 U.S. 644, 658 (2007).

142 *Overton Park*, 401 U.S. at 416.

143 These principles could be implemented either through a statutory enactment or through Treasury promulgating its own regulations, which it would have to abide by (or subsequently modify). *Cf.* Ariz. Grocery Co. v. Atchison, Topeka & Santa Fe Ry. Co., 284 U.S. 370, 389 (1932) (holding agency bound by own regulations, which it may not retroactively "repeal").

144 See *National Lime Association v. EPA*, 627 F.2d 416, 451 n.126 (D.C. Cir. 1980), for a discussion of how the term "hard look review" came to be applied to judicial review of agency decisions.

145 *See* Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins., 463 U.S. 29, 43 (1983) (looking for "rational connection between the facts found and the choice made" (quoting Burlington Truck Lines, Inc. v. United States, 371 U.S. 156, 168 (1962))); *see also* Am. Dental Ass'n v. Martin, 984 F.2d 823, 831 (7th Cir. 1993) ("[O]ur duty . . . is merely to patrol the boundary of reasonableness . . . .").

146 *See, e.g.*, *Overton Park*, 401 U.S. at 420–21 (remanding to Department of Transportation for further explanation of why proposed highway needed to cut through Overton Park in downtown Memphis).

147 *See* Inova Alexandria Hosp. v. Shalala, 244 F.3d 342, 351 (4th Cir. 2001) (holding that clear error occurs only when decision lacks any rational basis).

148 *See* Thomas J. Miles & Cass R. Sunstein, *The Real World of Arbitrariness Review*, 75 U. Chi. L. Rev. 761, 767 (2008); *see also* Davidoff & Zaring, *supra* note 6, at 520 ("The . . . arbitrary and capricious standard is a favorable one for the government but not overwhelmingly so.").

standard, governmental actors will maintain flexibility to act without fear of liability under most circumstances. This parallels the Business Judgment Rule in Delaware corporate law, which creates an ordinary negligence standard of conduct for directors to uphold their fiduciary duties but does not impose liability unless the conduct reaches *gross* negligence.[149] The Business Judgment Rule gives management enough flexibility to make business decisions in good faith that may later turn out to have been bad decisions.[150]

For a bailout, a lower standard of review would allow Treasury discretion to respond to changing circumstances in the financial markets without the fear that its every decision will be at risk of being overturned. It avoids a situation where the guiding principles outlined in Section A of this Part constrain agency action more than is intended out of fear of liability.[151] This way, Treasury can err on the side of protecting the economy as opposed to protecting against liability. Additionally, this standard of review would keep the judiciary focused on procedural protections rather than on second-guessing substantive decisions made by the agency.

It will be helpful to provide an example of how this review would operate. Consider a situation similar to A.I.G., where the government allegedly forced the rescued institution to waive lawsuits against other banks.[152] A shareholder could file suit against the agency seeking review under the APA, arguing that the forced waiver of the lawsuits was arbitrary and capricious. On review, Treasury would have to justify its decision, likely by arguing the waiver was in the immediate interest of financial stability.[153] As David Moss suggested with respect to A.I.G., "[i]f the reason was to avoid a slew of lawsuits that could have further destabilized the financial system in the short term, this [waiver] may have been reasonable."[154] Since arbitrary and capricious

149 *See* Brehm v. Eisner, 746 A.2d 244, 259 (Del. 2000) (en banc) ("[D]irectors' [decision-making] process is actionable only if grossly negligent.").

150 It was thought that shareholders could deal with bad business decisions through shareholder voting, rather than through shareholder suits. *Id.* at 256. In contrast, the typical corporate law standard for evaluating self-interested transactions, the heightened standard of "entire" or "intrinsic" fairness to minority shareholders, would subject Treasury to too demanding a standard of review, as described *supra* notes 106–07 and accompanying text. *See* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) (holding intrinsic fairness standard, not Business Judgment Rule, applied to self-dealing transaction).

151 *See generally* Steven L. Schwarcz, *The 'Principles' Paradox*, 10 EUR. BUS. ORG. L. REV. 175 (2009) (describing how agency subject to unpredictable principle will hew to most conservative reading of principle in order to avoid liability).

152 *See supra* notes 44–49 and accompanying text (describing forced waiver of A.I.G. lawsuits).

153 *See supra* notes 45–48 and accompanying text (describing waiver).

154 Story & Morgenson, *supra* note 9.

review "patrol[s only] the boundary of reasonableness," a court likely would defer to the agency's justification in this situation,[155] but shareholders would know what that justification was—thus they would have insight into how the government was approaching management.[156]

C. Constraining Agency Conduct Ex Ante

Considering the deferential nature of agency review, the benefit of an arbitrary and capricious standard is not in overturning individual agency decisions. This review structure is necessarily incomplete—the agency must fill in the details when it acts. But by forcing the agency to announce how it interprets its role, this review framework signals to the market the reduced risk of investing in corporations owned by the government.

Any suit against the government likely will challenge the action on the grounds that it was not truly necessary to further the immediate interest of financial stability. What is necessary for stability is inherently a judgment to be made by the Treasury Department, and any interpretation of what counts as "immediate" likely will receive deference from a reviewing court.[157] So if Treasury can still interpret these provisions to its advantage, how does this system of review create consistency or increase investor confidence?

First, there is the benefit of the government's taking a position on how it will act in managing corporations that suggests how it will act in future cases. Unless an agency explicitly changes its position, it is bound to act in accordance with its announced position.[158] Thus, since investors generally know how they can expect the government to act, even if they do not know specifically what it will do, they can more accurately value the risk of investing in government corporations and reduce the risk of the unknown.[159] Additionally, the starting template

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[155] Am. Dental Ass'n v. Martin, 984 F.2d 823, 831 (7th Cir. 1993).

[156] If, on the other hand, the justification were inadequate, the court could invalidate the waiver. *See supra* note 140 (describing how equitable relief could apply to corporate actions taken under government's control).

[157] *See* Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842–45 (1984) (holding courts should defer to agency interpretation when traditional methods of statutory interpretation render ambiguous meaning).

[158] *See* Ariz. Grocery Co. v. Atchison, Topeka & Santa Fe Ry. Co., 284 U.S. 370, 389 (1932) (holding agency may not retroactively "repeal" regulation).

[159] *See* Seidenfeld, *supra* note 40, at 434–35 (describing how rules increase predictability, efficiency, and democratic accountability); *id.* at 491–92 (explaining that "process review" that forces agency to justify decisions trickles down to all levels of policymaking in agency). This, of course, does not completely eliminate the potential that Treasury defines its interpretation in a way that leaves so much ambiguity as to signal no stability to the market at all.

for prioritizing the government's objectives as a shareholder can lead to the creation of more specific agency "norms" that help create predictability in agency conduct.[160] As Mark Seidenfeld describes, it is difficult to shape agency norms ex ante without ex post review of agency conduct.[161]

Second, political costs can constrain agency action. If Treasury officials act in ways that seem to extend beyond what Congress prescribed, they can expect to be questioned by Congress in public hearings.[162] Though this threat exists even without a system of review in place, adding ex post arbitrary and capricious review would have two beneficial effects. It would give clearer standards against which Congress (and the public) can judge agency action. Additionally, it would create more transparency and disclosure by forcing the government to justify its decisions in a lawsuit. If the government had to justify its decisions, it might be less inclined to take actions like forcing A.I.G. to waive lawsuits against other financial institutions. Absent such transparency Congress and the public did not learn about the situation until almost *two years* after the events took place.[163]

Third, facing the prospect of injunctive relief, the government would shy away from unnecessary interference to avoid being dragged into lawsuits and potentially having their actions invalidated. Thus, although Treasury might win most lawsuits, the *threat* of litigation would influence its conduct to conform to the principles outlined in Section A of this Part.

Conclusion

Government control of private corporations creates political risk for shareholders. Although the evidence presents a mixed picture of how active the government has been and will continue to be in influencing corporate policy, downside risk and the uncertainty of government control paired with no procedural safeguards means shareholders must account for this political risk. Thus, the potential for informal policymaking, abuse, and discouragement of private

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160 *See id.* at 449–50 (describing agency norms as way to guide discretion).

161 *Id.* at 455; *see also* Story & Morgenson, *supra* note 9 ("We have to vet [agency actions as shareholder] now because otherwise, if we face a similar crisis again, federal officials are likely to follow precedents set this time around." (quoting Prof. David A. Moss, Harvard Bus. Sch.)).

162 *See supra* Part II.C (evaluating nonjudicial checks on agency action).

163 *See* Story & Morgenson, *supra* note 9 (describing how federal regulators went to great lengths to resist disclosing information about bailout until receiving congressional subpoena in January 2010).

investment illustrates that any future financial bailout should include procedural protections for shareholders.

This Note proposed a hierarchy of principles to create procedural review while allowing adequate discretion for the government to respond effectively to financial crises. By focusing review on vindicating procedural interests, judges can protect the process by which the government controls bailed-out corporations without second-guessing the government's substantive decisions. Providing guidance without unduly cabining discretion can influence the government's conduct ex ante and help mitigate political risk. The judiciary may be ineffective in a crisis, but when that crisis passes, judicial review can improve the resolution of government response for both the rescuer and the rescued.