III. *Starr International Co. v. United States*: The AIG Bailout Ruling

A. Introduction

On November 21, 2011, Starr International Company, Inc. (Starr) commenced a lawsuit against the United States Government (Government), challenging the terms of its financial bailout of American International Group, Inc. (AIG).[1] Starr Chief Executive Officer and former AIG Chief Financial Officer, Maurice R. Greenberg, claimed on behalf of AIG shareholders that the takeover's unprecedented punitive terms constituted an illegal exaction, or alternatively a taking, in violation of the Fifth Amendment.[2] Judge Thomas C. Wheeler's June 2015 decision, which is now being appealed by both Starr and the Government, held that the bailout was an illegal exaction, but that the shareholders were not entitled to money damages.[3] This decision has important implications, and could prevent the Government from rescuing failing financial institutions in the future.[4]

This article begins with a discussion of AIG's liquidity collapse caused by the 2008 financial crisis. Part B describes the terms of the Government's bailout of AIG, and addresses the unprecedented scope of such terms. Next, Part C analyzes the case

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[1] Starr Int'l. Co., Inc. v. United States, 121 Fed. Cl. 428, 430 (2015).

[2] *See id.* at 430.

[3] *See* James Passeri, *AIG Bailout Ruling Now Contested by Both U.S. and Hank Greenberg*, THE STREET (Aug. 12, 2015, 3:51 PM), http://www.thestreet.com/story/13253876/1/aig-bailout-ruling-now-contested-by-both-us-and-hank-greenberg.html [http://perma.cc/5DD4-KCCV] ("First, former AIG CEO Hank Greenberg . . . appealed U.S. Federal Claims Judge Thomas Wheeler's decision not to award damages. Now, the U.S. government is appealing the judge's refusal to dismiss the case as well as his final ruling that the Federal Reserve acted improperly.").

[4] *See* Andrew Ross Sorkin, *In A.I.G. Case, Surprise Ruling that Could End All Bailouts*, N.Y. TIMES DEALBOOK (June 15, 2015), http://www.nytimes.com/2015/06/16/business/dealbook/surprise-ruling-finds-bailout-shorted-aig.html?_r=0 [http://perma.cc/YAU4-SDD3] ("The judge's decision could have far-reaching consequences should another financial crisis occur . . . . Legal experts say that the ruling, coupled with certain provisions of [the Dodd-Frank Act] makes it unlikely the government would ever rescue a failing institution, even if an intervention was warranted.").

brought against the Government by Starr on behalf of AIG shareholders in response to the punitive terms of the bailout. Part D then analyzes three aspects of Judge Wheeler's holding: the illegal exaction claim, the takings claim, and damages as they relate to the economic loss doctrine. Lastly, Part E discusses the appeals brought by both parties and the impact the *Starr* holding might have on the constitutionality of government interventions in economic crises to come.

B. AIG and the 2008 Financial Crisis

August 2007 marked the start of the most devastating economic crisis in America since the Great Depression.[5] The financial crisis began with a crash of the housing market, which caused a vast increase in foreclosures and a drop in liquidity available to nearly every financial firm.[6] The U.S. economy's crash is attributed to five sources.[7] First, financial firms overextended credit by engaging in careless lending practices and offering low interest rates on home loans, resulting in the "housing bubble."[8] Second, subprime mortgages' floating interest rates rose during 2006 and low-income homeowners defaulted on their commitments.[9] Third, the "originate-to-distribute" model of mortgages, in which originators would transfer or sell mortgages before maturity, created more money for housing loans and further reduced scrutiny of borrowers' credit.[10] These mortgages often were sold to special purpose vehicles, which would form collateralized debt obligations

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[5] Starr, 121 Fed. Cl. at 437.
[6] *Id.*
[7] *Id.*
[8] *Id.* at 437-38 ("The 'housing bubble' was caused by low interest rates and poor lending practices by mortgage originators and banking and financial institutions. . . . The low interest rates in turn overstimulated the housing market and resulted in the over extension of credit.").
[9] *Id.* at 438 ("[S]ubprime mortgages, included floating interest rates. When interest rates began to rise during 2006 and home prices began to drop, many low income homeowners could no longer meet their mortgage commitments and either became delinquent or defaulted on their loans.").
[10] *See id.* at 437 ("This 'originate-to-distribute' model increased the amount of money available for housing loans and resulted in mortgage originators paying less attention to a borrower's credit and making loans without 'sufficient documentation or care in underwriting' because the risk of non-payment had been transferred to others.").

(CDOs), securities representing tiered rights to be paid from the revenue of the pool.[11] The securitization of the housing market began with the pooling of multiple mortgage loans, which were then sold as securitized instruments known as residential mortgage-backed securities (RMBS).[12] Most subprime mortgages written in the years leading up the financial crash were packaged into RMBS, which were then purchased by managers of CDOs of asset-backed securities.[13] Rating agencies' misrepresentations of these risky securities were the fourth cause of the housing crash.[14] Fifth, after providing trillions of dollars of short-term liquidity to financial firms and growing larger than the traditional banking sector, the alternative banking system collapsed.[15] When the "housing bubble" eventually burst and the alternative banking system collapsed, nearly every financial firm faced a crippling liquidity crisis.[16]

At the time of the crash, AIG had stopped writing credit protection on multi-sector CDOs, but its Financial Products Division nevertheless faced risks from its credit default swap (CDS) portfolio.[17] CDS contracts operate similarly to financial insurance, with the CDS seller guaranteeing performance of a debt obligation for a premium.[18] AIG's CDS agreements allowed CDO managers to substitute pre-2006 RMBS with riskier 2006-7 RMBS with credit

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[11] Starr, 121 Fed. Cl. at 438 ("Under the 'originate-to-distribute' model, 'originators would transfer mortgages to other entities instead of holding them to maturity'. . . . Mortgage originators would first transfer or sell mortgages to a special purpose vehicle ('SPV'). This process would then lead to the creation of CDOs . . . .").

[12] Georgette Chapman Phillips, *The Jumbled Alphabet Soup of the Collapsed Home Mortgage Market: ABCP, CDO, CDS and RMBS*, 18 U. MIAMI BUS. L. REV. 143, 147 (2010).

[13] Starr, 121 Fed. Cl. at 438 ("Between 2004 and 2007, 'nearly all of the adjustable rate subprime mortgages written were packaged into residential mortgage-backed securities ('RMBS') and a large share of these subprime RMBS were purchased by managers of CDOs of asset backed securities.'").

[14] *Id.* at 437 ("There were five major causes of the September 2008 financial crisis . . . (3) the rating agencies' misrepresentations of the riskiness of certain securities such as collateralized debt obligations ('CDOs') . . . .").

[15] *Id.*

[16] *Id.* at 439.

[17] *Id.* at 439-40.

[18] *Id.* at n.6 ("A CDS is a 'credit default swap contract' . . . whereby the CDS seller collects premium payments in exchange for guaranteeing the performance of a debt obligation.").

issues.[19] AIG did not hedge against its risk from multi-sector CDS contracts and was subject to liquidity risks as a result of the fact that AIG had to post cash collateral in four circumstances.[20] In sum, the CDS transactions in which AIG engaged were low risk in the pre-2007 thriving housing market, but became high risk after the housing crash. Furthermore, the worsening market conditions and industry-wide liquidity freeze overwhelmed AIG's extensive pre-crisis efforts to raise capital and conserve cash.[21] And while AIG is frequently cited as the "poster child" for engaging in high-risk lending practices, many other financial institutions engaged in riskier, often fraudulent conduct.[22] Regardless of AIG's comparative culpability, the Government recognized that the country would face disaster if it allowed AIG to file for bankruptcy, and proposed a loan to AIG.[23]

C. Term Sheet and Credit Agreement

The Federal Reserve Bank of New York provided AIG's Board of Directors and the Board of Governors with a term sheet for a proposed $85 billion credit facility on September 16, 2008.[24] AIG's Board of Directors had one meeting lasting two hours to consider the term sheet, and no power to negotiate the loan requirements, which exceeded the breadth and depth of any governmental bailout terms in history.[25] The agreement would bind AIG to punitive terms including a 12% loan interest rate, governmental equity ownership of nearly 80% (which the government would retain after repayment of the

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[19] *Id.* at 439 ("AIG's CDS agreements contained substitution provisions which allowed CDO managers to swap pre-2006 RMBS with 'more suspect' 2006 and 2007 subprime RMBS that presented 'more problematic credit issues.'").
[20] *See id.* ("The CDS contracts 'carried substantial liquidity risks for AIG' because they required AIG to post cash collateral in three [sic] circumstances: (1) a default in a covered CDO; (2) a decline in the CDOs' market value; (3) a downgrade of an individual CDO tranche; or (4) a rating downgrade for AIG itself.").
[21] *See id.* at 440.
[22] *Id.* at 457 ("During the financial crisis, many financial institutions engaged in much riskier and more culpable conduct than AIG . . . [and] made representations and disclosures that the Government later concluded were false and misleading.").
[23] *See Id.* at 443.
[24] *See id.* at 445.
[25] *Id.* at 444.

loan), and the implementation of new government-appointed management, including a new CEO.[26] Without approval by the Board of Governors or AIG, the Government changed the form of its equity ownership from warrants on a fully-diluted basis,[27] which did not give the Government automatic voting rights, to convertible preferred stock, which did.[28] Furthermore, realizing that it might not have the legal authority to take the shares given to the Treasury under the terms of the Credit Agreement, the Government (again, without approval by the Board of Governors) formed the AIG Credit Facility Trust (the Trust), which was eventually executed on January 16, 2009.[29] The Federal Reserve Bank of New York created this trust to hold the shares of AIG stock for the sole benefit of the Treasury in order to circumvent the Federal Reserve's lack of authority to hold equity.[30]

Nevertheless, the AIG Board of Directors acknowledged that the loan was a better option than bankruptcy, and executed the Credit Agreement on September 22, 2008 without shareholder approval.[31] Accordingly, the primary class of AIG shareholders that brought suit against the Government (represented by Starr, AIG's largest shareholder at the time of the bailout) was comprised of those who held AIG common stock during the negotiation of the bailout from September 16, 2008 to September 22, 2008 and were denied a right

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[26] *Id.* at 431 ("Operating as a monopolistic lender of last resort, the Board of Governors imposed a 12 percent interest rate on AIG . . . . [T]he Board of Governors imposed a draconian requirement to take 79.9 percent equity ownership in AIG as a condition of the loan. . . . AIG's [CEO] . . . would be forced to resign, and would be replaced with a new CEO of the Government's choosing.").

[27] *Id.* at 443 n.9.

[28] *Id.* at 447 ("Changing the form of equity from warrants to voting convertible preferred stock in the Credit Agreement yielded important benefits to the Government. Avoiding a shareholder vote was a key governmental objective.").

[29] *Id.* at 449 ("In mid-September 2008, the Government recognized that the Treasury and FRBNY might not have the legal authority to take the . . . stock given to the Treasury under the terms of the September 22, 2008 Credit Agreement. . . . [T]he Government formally decided to issue the [stock] to an AIG Credit Facility Trust, established for the benefit of the Treasury.").

[30] *Id.*

[31] *See id.* at 447.

to vote on the agreement.[32] Despite its harsh terms, however, the Credit Agreement successfully prevented AIG from going bankrupt, and in turn, avoided the otherwise inevitable complete loss of investment return for all AIG common stockholders, and the defaulting of AIG on its commitments to many other large financial institutions, which were already on the verge of collapse.[33]

However, the Credit Agreement proved insufficient to rescue AIG from its liquidity demands, and AIG unsuccessfully sought concessions from its counterparties to allow AIG to terminate the CDS transactions that were the source of its liquidity crisis.[34] In response, the Government immediately lent AIG an additional $37.8 billion for AIG's securities lending program.[35] Shortly thereafter, the Government restructured the Credit Agreement to include $40 billion in TARP support; a reduction in the interest rate by 5.5% and an extension of the loan term from two years to five years; and two special purpose vehicles to transfer RMBS investments from AIG's securities lending portfolio while eliminating AIG's CDS posting obligations and liquidity risks.[36] These subsequent transactions caused AIG's debt owed to the Government to rise to nearly $185 billion.[37]

D. *Starr International Co. v. United States*

The lawsuit filed on behalf of the affected AIG shareholders raised two main issues. First, the court considered whether the Federal Reserve Bank of New York possessed the legal authority to

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[32] *Id.* at 431.

[33] *See id.* at 430 ("AIG's failure likely would have caused a rapid and catastrophic domino effect on a worldwide scale.").

[34] *Id.* at 453.

[35] *Id.* at 451.

[36] *Id.* at 451-52 ("The restructuring package contained elements intended to avert an AIG downgrade and bankruptcy, including: (a) $40 billion of TARP ('Troubled Asset Relief Program') capital support; (b) modifications to the original loan terms including a reduction in interest rate by 5.5 percent, a reduction in the undrawn funds interest rate to 0.75 percent, and an extension of the loan term from two years to five years; (c) transfer of AIG's RMBS investments from its securities lending portfolio to a newly created special purpose vehicle called Maiden Lane II; and (d) creation of another special purpose vehicle called Maiden Lane III to eliminate AIG's CDS posting obligations to and CDS-related liquidity risks.").

[37] Passeri, *supra* note 3.

acquire a borrower's equity as a term of a loan under Section 13(3) of the Federal Reserve Act, or whether such a term constituted an illegal exaction.[38] Second, the court considered whether, in light of AIG's Board of Directors voting to approve the terms of the Credit Agreement, the terms amounted to a taking without just compensation, under the Fifth Amendment to the Constitution.[39]

1. Illegal Exaction Claim

Under Section 13(3) of the Federal Reserve Act, the Board of Governors of the Federal Reserve System may lend money to a corporation "in unusual and exigent circumstances" as long as the corporation meets certain requirements.[40] While the bank is not limited to its express powers, and may exercise incidental powers that are "necessary to carry on the business of banking," Section 13(3) does not explicitly authorize the bank to take equity.[41] Despite the fact that Congress carved out this loaning authority, the Federal Reserve had not made a loan to an investment bank since the Great Depression until it bailed out Bear Stearns at the start of the 2008 financial crisis.[42] Furthermore, prior to the AIG bailout, the Government had never demanded equity ownership from a borrower institution in the 75-year history of Section 13(3) of the Federal Reserve Act.[43]

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[38] Starr, 121 Fed. Cl. at 431.
[39] *Id.* at 431.
[40] 12 U.S.C. § 343 (2012) ("In unusual and exigent circumstances, the Board of Governors of the Federal Reserve System . . . may authorize any Federal reserve bank . . . to discount for any participant in any program or facility with broad-based eligibility, notes, drafts, and bills of exchange . . . ."); Starr, 121 Fed. Cl. at 466 ("Four requirements must be met in order for Section 13(3) to apply: (1) unusual and exigent circumstances; (2) the loan must be authorized by an affirmative vote of not less than five members of the Board of Governors; (3) the loan must be secured to the satisfaction of the lending Federal reserve bank; and (4) the borrower must be unable to secure adequate credit accommodations from other banking institutions.").
[41] 12 U.S.C. § 357 (2012); Starr, 121 Fed. Cl. at 468.
[42] David Wessel, *Fed Invokes 'Unusual and Exigent' Clause – Again*, WALL ST. J. BLOG (Sept. 16, 2008, 9:29 PM), http://blogs.wsj.com/economics/2008/09/16/fed-invokes-unusual-and-exigent-clause-again/ [http://perma.cc/B6T5-K7SN].
[43] Starr, 121 Fed. Cl. at 433.

The plaintiff shareholders asserted that the Government demanding equity ownership in AIG and voting control as a condition of its bailout loan constituted an illegal exaction.[44] "An illegal exaction occurs when the Government requires a citizen to surrender property the Government is not authorized to take as consideration for an action the Government is authorized to take."[45] Put simply, the plaintiffs claimed that the Government was authorized under Section 13(3) to make a loan to AIG under the circumstances of the economic crisis, but was not authorized to take 80% equity ownership as consideration for that loan.[46]

The Government's main arguments in defense of the terms of the loan are twofold. Evidence revealed during the 37 day trial demonstrated that legal personnel at the Federal Reserve Bank of New York and the Federal Reserve acknowledged that holding equity and acquiring voting control of a corporation was outside the Government's express statutory authority.[47] Although the Government asserted that the creation of a trust to hold shares of AIG stock made the Federal Reserve's equity ownership legal, the trust was merely a vehicle engineered for the sole benefit of the Treasury and was executed four months after the Government took control of AIG.[48] The trust did nothing to protect minority shareholders, with its three trustees (appointed by the Federal Reserve Bank of New York in consultation with the Treasury) owing only a duty to protect the Federal equity stake in AIG.[49]

Additionally, the Government asserted voluntariness as a defense to the illegal exaction claim, since the AIG Board of Directors had voted to approve the Government's takeover.[50] The voluntariness of the vote was disputed, since the Directors' only alternative was to have AIG declare bankruptcy and default on its

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[44] *See id.* at 434.
[45] *Id.* at 467.
[46] *See id.* at 434.
[47] *See id.* at 470.
[48] *Id.* at 471.
[49] *Id.* ("FRBNY, in consultation with [sic] Treasury, had the power to appoint the trustees. . . . The trustees' standard of care was to act 'in or not opposed to the best interests of the Treasury'. . . . The trustees were the 'protectors of the Federal equity stake in AIG' and 'should not care about the AIG minority shareholders.'").
[50] *See id.* at 470 ("It is debatable whether the vote of the AIG Board of Directors on September 16, 2008 was voluntary, or whether acceptance of the Government's terms was the only realistic choice.").

widespread investments in every sector of the insurance and finance industries.[51] While the Government argued that "a choice between a rock and a hard place is still a choice,"[52] acceptance of terms offered by the Government is not a defense to an illegal exaction claim because an "entity cannot ratify an illegal government action."[53] In essence, the Government's defenses to the shareholders' illegal exaction claims focused on form over substance in asserting that the formation of a trust and the approval of the board authorized their equity ownership, regardless of the Government's express or implied powers.[54]

Judge Wheeler held for plaintiff shareholders on the illegal exaction claim.[55] The court focused on the limitations of the Federal Reserve Bank's incidental powers, bolstered by the Supreme Court's declaration that "[a]uthority to do a specific thing carries with it by implication the power to do whatever is necessary to effectuate the thing authorized—not to do another and separate thing, since that would be, not to carry the authority granted into effect, but to add an authority beyond the terms of the grant."[56] Although the government is granted an express right to make loans to corporations in "unusual and exigent circumstances" under Section 13(3), it is not granted an express or incidental right to condition that loan on the bank taking equity ownership in the corporation.[57] By extension, when the Government decides to confer a nonobligatory benefit (like a loan under Section 13(3)), it cannot "demand the surrender of rights it lacks authority to demand."[58] The Government's lack of authority in this situation is supported by the Government Corporation Control Act of 1945, which prohibits the government from acquiring a controlling stake in a corporation without express Congressional approval, where it would effectively turn the corporation into an

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[51] *See id.*
[52] *Id.* at 435.
[53] *Id.* at 470.
[54] *Id.* at 471.
[55] *Id.* at 434.
[56] *Id.* (quoting Fed. Reserve Bank of Richmond v. Malloy, 264 U.S. 160, 167 (1924)).
[57] 12 U.S.C. § 357 (2010); Starr, 121 Fed. Cl. at 468.
[58] Starr, 121 Fed. Cl. at 468 (citing Koontz v. St. Johns River Water Mgmt. Dist., 133 S. Ct. 2586, 2596 (2013)).

agency of the government.[59] And while it is true that an emergency might elicit the use of an authorized power previously not exercised, "emergency does not create power"[60] and the power of a federal entity can never exceed the powers delegated to it by Congress.[61] Accordingly, the Government's equity ownership constituted an illegal exaction.

2. Fifth Amendment Taking Claim

On September 16, 2008, AIG's Board of Directors voted to approve the Credit Agreement, which imposed a 12% interest rate on AIG—nearly three times the rate imposed on the Government's loans to other financial institutions—and allowed the Government to take and retain nearly 80% ownership interest in AIG.[62] The plaintiff shareholders asserted, in the alternative to the illegal exaction claim, that the agreement constituted a taking without just compensation under the Fifth Amendment,[63] which stipulates, "private property [shall not] be taken for public use, without just compensation."[64] A taking must be based upon authorized governmental action.[65] Therefore, if a court finds the Government has not acted within its authority, a takings claim inevitably fails.[66] Because the Court found the terms of the Federal Reserve Bank's loan to AIG constituted an illegal exaction outside the scope of the bank's authority, the terms

[59] Government Corporation Control Act of 1945, 31 U.S.C. § 9102 (2012) ("An agency may establish or acquire a corporation to act as an agency only by or under a law of the United States specifically authorizing the action."). *See* Starr, 121 Fed. Cl. at 469 ("[The Government Corporation Control Act of 1945] prohibits government entities from acquiring a controlling stake in a corporation so as to make the corporation an agency of the Government without express congressional authorization.").

[60] Starr, 121 Fed. Cl. at 468 (quoting Home Bldg. & Loan Ass'n v. Baisdell, 290 U.S. 398, 425-26 (1934)).

[61] *Id.* at 469 (quoting Fed. Res. Bank of Richmond v. Malloy, 264 U.S. 160, 167 (1924)).

[62] *See id.* at 431. *See generally id.* at 457, Section M: Treatment of Other Distressed Financial Entities.

[63] *Id.*

[64] U.S. CONST. amend. V.

[65] Starr, 121 Fed. Cl. at 472.

[66] *Id.*

of the loan did not also constitute a taking without just compensation.[67]

3. Damages and the Economic Loss Doctrine

Although Judge Wheeler ruled in favor of the plaintiff shareholders on their illegal exaction claim, this moral victory came with a huge caveat: the shareholders were not entitled to monetary damages.[68] The plaintiffs asserted that the revenue the Government gained by illegally exacting shares of stock and selling the shares on the open market should be returned to the AIG shareholders that rightfully owned the shares.[69] In other words, the plaintiffs argued that their compensation should be linked to the amount of the Government's illegal enrichment.

The Court's decision focused on how the economic loss doctrine applies to cases in which property is illegally exacted. The Government had gained $22.7 billion in revenue by selling the AIG common stock, which it had purchased for a mere $500,000.[70] Logically, it would seem that if the Government profited from its illegal exaction of common stock, the rightful owners of that stock should be entitled to that gain. Judge Wheeler, however, focused on the economic loss doctrine in the context of Fifth Amendment takings without just compensation claims. Justice Holmes asserted, "[T]he question is, What [sic] has the owner lost? not [sic], What [sic] has the taker gained?"[71] Precedent dictated that where a corporation could not allege that it would have avoided bankruptcy "but for the Government's intervention" the lack of net negative economic impact did not afford the plaintiffs monetary damages, since the corporation would have lost all value otherwise.[72] In this case, but for the Government's intervention, AIG would have filed

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[67] *See id.*
[68] *Id.* at 436.
[69] *Id.* at 472 ("Starr asserts that, in an illegal exaction case, the plaintiff's damages recovery should be the return of the monetary value of the property seized or obtained by the Government.").
[70] *Id.* at 457 ("Defendant's only payment to AIG for the Series C Preferred Stock was $500,000 in loan forgiveness that FRBNY provided to AIG in September 2008.").
[71] *Id.* at 473 (quoting Bos. Chamber of Commerce v. Boston, 217 U.S. 189, 195 (1910)).
[72] *See id.* at 473-74.

for bankruptcy and shareholders would have likely lost 100% of their stock value, since the assets of AIG's insurance subsidiaries would have been seized to preserve value for insurance policyholders.[73]

Furthermore, had the shareholders been entitled to money damages, valuation would remain an issue. The plaintiffs asserted not that the $22.7 billion earned by the Government through unauthorized transactions should be returned,[74] but rather that they should be reimbursed based on the September 24, 2008 closing price of AIG stock of $3.31 per share (the lowest closing price during the period between September 22-24, 2008).[75] Although this stock price might appear conservative, the Court held that the price was undeniably influenced by the $85 billion Government credit facility.[76] "To award damages on this [closing price]," the Court held, "would be to force the Government to pay on a propped-up stock price that it helped create . . . ."[77] As AIG's counsel contested during closing arguments, "[if] the Fed wanted to harm AIG in some way, all it had to do was nothing."[78] Therefore, while the plaintiffs prevailed on the illegal exaction claim, they recovered zero damages.

E. Critical Response to *Starr*

A testament to the controversial nature of the *Starr* holding, both parties have since appealed the June 15, 2015 decision.[79] While the AIG shareholder class wants damages, the Government fears that

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[73] *Id.* at 436.
[74] *Id.* at 435.
[75] *Id.* at 435-36 ("Starr's claim for shareholder loss is premised upon AIG's stock price on September 24, 2008, which is the first stock trading day when the public learned all of the material terms of the FRBNY/AIG Credit Agreement.").
[76] *Id.* at 436.
[77] *Id.*
[78] *Id.*
[79] Angela Chen, *U.S. Appeals Ruling in AIG Bailout Dispute*, WALL ST. J. (Aug. 12, 2015, 4:54 PM), http://www.wsj.com/articles/u-s-to-appeal-ruling-in-aig-bailout-dispute-1439407639?cb=logged0.1889783414080739 [http://perma.cc/3YX6-F5VD] ("The U.S. Government . . . filed to appeal a judge's ruling that it violated the law when it took a controlling stake in [AIG] in 2008. . . . In addition to the government's appeal, AIG's former longtime chief executive Maurice 'Hank' Greenberg said he would appeal the decision not to award shareholders any of the $40 billion in damages they were seeking.").

this precedent might prevent future necessary bailouts,[80] especially when considered in combination with certain provisions of the Dodd-Frank Act of 2010.[81] The effects of the decision reflect the unsettled, tense nature of regulatory restrictions on financial institutions, especially those (like AIG) that are not traditional banks subject to strict regulatory standards. Arguments for and against the allowance of bailouts with punitive terms present seemingly irreconcilable issues.

Broadly, the bailout of AIG prevented the inevitable drastic ripple effect that would have occurred had AIG gone bankrupt.[82] Counterparties in transactions were paid in full, a liquidity crisis was minimized, and AIG shareholders received 20% of their original investments instead of zero percent.[83] Proponents of the bailout and its punitive terms emphasize that AIG's Board of Directors voted to approve the terms, and that such terms reduce moral hazard, acting as a disincentive to financial institutions from engaging in high risk transactions, especially relating to securities.[84] These proponents criticize the *Starr* holding, claiming that it will prevent future bailouts, even when they might be necessary to prevent broad economic crises.[85]

Conversely, critics of the terms of the bailout fear the constitutional implications of allowing the Government to bailout and take ownership of private institutions, without express

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[80] *Id.*

[81] Richard Christopher Whalen, *Dodd-Frank and the AIG Litigation: Implications for Investors*, ZERO HEDGE BLOG (July 8, 2015), http://www.zerohedge.com/news/2015-07-08/dodd-frank-and-aig-litigation-implications-investors [http://perma.cc/ABV9-J8HF] ("Read together with the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act, the Court's decision greatly narrows the discretion of the Fed in making emergency loans to troubled financial institutions.").

[82] Starr, 121 Fed. Cl. at 433-34.

[83] *See id.* at 436.

[84] Passeri, *supra* note 3 ("The decision is disturbing in several respects and uses flawed logic . . . . It seems to feel that the Fed has a duty to be fair to failing financial institutions because of its 'monopolistic' position. Under that dubious logic, the Fed might be sued for not granting a bailout when it thought the risk was too high or the social need was too low. All in all, this is a check on financial regulators who were already too equivocal and undemanding.").

[85] Sorkin, *supra* note 4.

Congressional authority.[86] These supporters of the *Starr* holding assert that the penalties imposed on AIG were "draconian" and that the bailout was unfair to investors who were intentionally excluded from the process.[87] Conceding the critics' argument that the moral hazard of potential bailouts unencumbered by punitive terms is risky, proponents of the exaction holding might argue that the collapse of the constitutional separation of powers is riskier.[88] Not only would private institutions-turned-government agencies enjoy the benefit of having access to otherwise protected governmental information and thereby disintegrate a financial system based on fair competition,[89] but these agencies would act without direct Congressional approval in a manner that could hurt taxpayers, investors, and institutions alike.

F. Conclusion

Judge Wheeler held that the goal of the AIG takeover was to "maximize benefits to the government and the taxpaying public,"[90] but that its harsh treatment of AIG had no purpose.[91] However, to say that the AIG takeover was altruistic and beneficial to taxpayers is viewing a lopsided negotiation costing taxpayers $185 billion through rose-colored glasses. Further, to say that the punitive terms served "no purpose" is to underestimate the moral hazard of allowing financial institutions to engage in risky practices that cause such crises free from risk of punishment. Between the defendant Government and the plaintiff shareholders, however, exists the

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[86] Whalen, *supra* note 81 ("In the 1930s, the restructuring of troubled banks and companies were handled by specifically empowered *fiscal* agencies . . . . In contrast, the financial rescues of AIG and Citigroup . . . were financed in haste and relied upon the balance sheet of the central bank as the financing mechanism. These bailouts by the Fed and Treasury evaded legal and Constitutional limits on government agencies incurring liabilities in the name of the public.").
[87] Sorkin, *supra* note 4.
[88] Passeri, *supra* note 3.
[89] Starr, 121 Fed. Cl. at 470 ("[T]he Federal Reserve has access to substantial amounts of confidential information about a variety of financial institutions and that there would be a perception that AIG would have . . . access to that information or the New York Reserve Bank would use that information to benefit AIG.").
[90] *Id.* at 434.
[91] *Id.*

taxpaying American public who both experienced the backlash of AIG's risky investment behaviors and bore the tax burden of a $185 billion bailout, yet had no effect on Judge Wheeler's holding.[92] As this case makes its way to appeal and, likely, the Supreme Court,[93] perhaps a shift in focus from two parties who have each done wrong, to the innocent people who have been wronged, would yield a more equitable and lasting standard.

Mary Grace Patterson[94]

[92] *See* Sorkin, *supra* note 4.
[93] *Id.*
[94] Student, Boston University School of Law (J.D. 2017).