CITIZENS OR SHAREHOLDERS?: ANALYZING THE FEDERAL GOVERNMENT'S FIDUCIARY DUTIES AS A CONTROLLING SHAREHOLDER IN CORPORATIONS RECEIVING FUNDS FROM THE TROUBLED ASSET RELIEF PROGRAM

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Introduction

On October 3, 2008, Congress passed the Emergency Economic Stabilization Act ("EESA") in an effort to end a financial crisis that was the worst in a generation and one of the most severe of all time.[1] This unprecedented and unfortunate "confluence of events placed severe financial stresses on financial markets and institutions,"[2] as well as the broader economy, and many lawmakers and economists believed that swift government intervention was the only way to stop the crisis.[3]

"The Great Recession of 2008"[4] was largely the result of "weak [mortgage] underwriting standards," a corresponding proliferation of "increasingly complex and opaque" mortgage backed securities that led to excessive leverage and the subsequent bursting of the housing bubble.[5] During most of the 2000s, housing values appreciated at an enormous rate.[6] As a result, a growing number of people bought homes for both residential and investment purposes. Banks and other mortgage originators relaxed lending standards, granting many subprime loans to unqualified borrowers with the belief that steadily increasing home prices would provide protection if the borrower defaulted.[7] From 2006-2007, many of these subprime loans reset to a higher interest rate while at the same time declining home prices prevented borrowers from refinancing.[8] As a result, many borrowers defaulted on their loans, leading to a wave of foreclosures and a corresponding downward spiral in housing prices.[9]

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1. Emergency Economic Stabilization Act of 2008 (EESA), 12 U.S.C. §§5201 (2008) *et seq*.

2. U.S. DEPARTMENT OF THE TREASURY: OFFICE OF FINANCIAL STABILITY, ANNUAL REPORT: TROUBLED ASSET RELIEF PROGRAM FOR THE YEAR ENDED SEPTEMBER 30, 2009, 7 [hereinafter TARP REPORT].

3. *See* Michael A. Fletcher & Neil Irwin, *Bernanke Warns of 'Grave Threat' to U.S. Economy*, WASH. POST, Sept. 25, 2008, at D01.

4. Catherine Rampell, *'Great Recession': A Brief Etymology*, N.Y. TIMES ECONOMIX BLOG (Mar. 11, 2009, 5:39 PM), http://economix.blogs.nytimes.com/2009/03/11/great-recession-a-brief-etymology/.

5. Group of Twenty [G-20], *Declaration of the Summit on Financial Markets and the World Economy*, (Nov. 15, 2008), http://georgewbush-whitehouse.archives.gov/news/releases/2008/11/20081115-1.html (site is no longer updated).

6. *CSI: Credit Crunch*, THE ECONOMIST Oct. 18, 2007.

7. *See* Souphala Chomsisengphet & Anthony Pennington-Cross, *The Evolution of the Subprime Mortgage Market*, 88(1) FED. RESERVE BANK OF ST. LOUIS REV. 31 (2006) (describing what makes a mortgage subprime and the methods banks used to grant and manage the risks on these mortgages).

8. *See CSI: Credit Crunch, supra* note 6 ("With hindsight, it is clear that the rot started when the teaser rates ran out and the American housing market slowed. Subprime defaults started to climb.").

9. Ruth Simon, *Housing Pain Hits Borrower: Foreclosures Increase as Troubles Worsen Outside of Subprime*, WALL ST. J., June 6, 2008, at A5.

Compounding the effect of the burst in the housing bubble and the wave of foreclosures was the fact that most banks and mortgage originators had securitized the mortgages they originated by selling them in groups to investment banks, hedge funds and other institutional investors.[10] This gave the mortgage originators a greater pool of capital from which to originate loans and also greatly expanded the parties that stood to lose money from the wave of defaults that began in 2006 and 2007. As borrowers began to default on their mortgages, the mortgage-backed securities that had been sold to institutional investors began to plummet in value. The problems that began in the mortgage sector reverberated throughout the entire financial system, leading to a decrease in available credit and borrowing.[11] The drastic loss in value on what was considered a safe investment[12] and corresponding freezing of the credit markets struck at the very core of the U.S. financial system and brought many of its major players to their knees. The bankruptcy of Lehman Brothers on September 15, 2008[13] was the dramatic culmination of this process and spurred the federal government into action.

The EESA was a far-reaching measure intended to both stimulate the economy and stabilize the collapsing and frozen financial system.[14] A central component of the plan was the $700 billion Troubled Asset Relief Program ("TARP"), which was originally envisioned as a system through

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10. *See CSI: Credit Crunch, supra* note 6 ("Financial assets of all sorts, from credit-card receivables to companies' debt repayments, had been turned into securities that could be bought and sold. Mortgages—both subprime and mainstream—were no exception.").

11. *See* Timothy F. Geithner, President and Chief Exec. Officer, Fed. Reserve Bank of N.Y., Reducing Systemic Risk in A Dynamic Financial System: Remarks at the Economic Club of New York, New York City (June 9, 2008), *available at* http://www.newyorkfed.org/newsevents/speeches/2008/tfg080609.html (providing a clear and in-depth description of the origins of the credit crisis).

12. These securities were rated AAA by the major rating firms like Moody's and Standard and Poor's, an indication that they were the safest investments around with a risk comparable to U.S. Treasuries. This rating was largely the result of flawed rating methodology and pressure to bless the assets with high ratings to encourage investments. *See* Elliot Blair Smith, *Bringing Down Wall Street as Ratings Let Loose Subprime Scourge*, BLOOMBERG.COM (Sept. 24, 2008), http://www.bloomberg.com/apps/news?pid=20601109&sid=ah839IWTLP9s ("Flawed AAA ratings on mortgage-backed securities that turned to junk now lie at the root of the world financial system's biggest crisis since the Great Depression.").

13. TARP REPORT, *supra* note 2, at 6.

14. *Id.* at 7. "The purposes of EESA were to provide authority and facilities that the Secretary of the Treasury could use to restore liquidity and stability to the financial system of the United States, and to ensure that such authority and facilities were used in a manner that protected home values, college funds, retirement accounts, and life savings; preserved home ownership; promoted jobs and economic growth; maximized overall returns to the taxpayers of the United States; and provided public accountability for the exercise of such authority." *Id.*

which Treasury would buy "troubled assets"[15] from financial institutions in order to improve liquidity in the financial system. This original plan, however, was not implemented as Treasury instead decided "that the most timely, effective step to improve credit market conditions was to strengthen bank balance sheets quickly through direct purchases of equity in banks."[16] As a result, through the Capital Purchase Program ("CPP"), the federal government became an equity holder in 685 apparently healthy financial institutions.[17] As recognized by Secretary Paulson, this was an unprecedented situation, as "before [this] time, the only instances in which Treasury had taken equity positions was in rescuing a failing institution."[18]

Secretary Paulson assured the public that it would be protected from the downside risk of this equity ownership through "significant taxpayer protections and conditions,"[19] but what would serve to protect shareholders of the participating corporations from the potential pitfalls of government ownership? In the traditional corporate law paradigm, minority shareholders are protected against controlling shareholder's harmful acts to the corporation by, among other things, the controlling shareholder's fiduciary duties of loyalty and care. This doctrine provides that controlling shareholders "have a fiduciary responsibility to the minority and to the corporation to use their ability to control the corporation in a fair, just and equitable manner."[20] As a result, the controlling shareholder is constrained in its use of power and must always consider the best interests of the corporation and the proper corporate purpose.

But what happens when this controlling shareholder is the federal government? Does the federal government, like any other shareholder, always have to exercise its power as a shareholder to maximize corporate profits? Requiring the federal government to always maximize corporate profits would seem to starkly contradict its role as a sovereign. If the federal government is bound by fiduciary duties to always use its power as a shareholder to further the traditional corporate purpose of wealth

15. *Id.* at 8. "Troubled assets are defined by EESA as residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March, 14, 2008, the purchase of which the Secretary of the Treasury determines promotes financial market stability; and any other financial instrument that the Secretary of the Treasury, after consultation with the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability." *Id.* at 8.

16. Press Release, Henry M. Paulson, Jr., Sec'y 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.

17. TARP REPORT, *supra* note 2, at 24.

18. Paulson, *supra* note 16.

19. *Id.*

20. Jones v. Ahmanson & Co., 1 Cal. 3d 93, 108 (1969).

maximization, it could be forced to take actions that contravene the best interests of society as a whole. Furthermore, it could conceivably be subject to a flood of lawsuits challenging any actions taken by the federal government that harm the share price of an institution in which it is a controlling shareholder.[21]

This potential for conflict between the public interest and the interests of minority shareholders can arise in many circumstances and lead to diverse and deep conflicts of interest. For example, the federal government is a regulator of banks and other financial institutions through agencies like the Federal Reserve, Treasury and the FDIC, among many others.[22] As a result of TARP, the federal government is also a controlling shareholder in many of these federally-regulated institutions. This creates a stark conflict of interest as the federal government now has the dual roles of regulator and owner of the regulated party. Should concepts of fiduciary duties prevent the federal government from implementing regulations that could hurt the financial well-being of the entities in which it owns stock?

Even more troubling, the federal government has imposed conditions on institutions in which it has taken an equity interest through TARP.[23] Is the imposition of these conditions subject to a fiduciary duties analysis? Should the federal government be liable for a breach of fiduciary duties for imposing limits on executive pay, limits on foreign hiring, or rules about mortgage lending on companies in which it owns stock? These actions have a potential negative impact on the corporate profits and the stock price and, thus, could be characterized as a violation of the federal government's fiduciary duties as a controlling shareholder. But they are also arguably in the best interests of the public at large and certainly within the discretion and policy-making power of the federal government. How are these

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21. While these actions would likely be precluded by sovereign immunity, it appears that there are at least some grounds for a rational argument to abrogate this immunity. *See* J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory and Practice*, 27 YALE J. ON REG. 283, 299-306 (2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1461143. Even if the government was protected by sovereign immunity, this could create needless waste in the judicial system as the government would probably have to litigate to establish this immunity, at least initially, and it would still have to respond to the complaints that were filed.

22. The specific regulating agency for a given bank is determined by the type of charter the institution chooses, and banks are almost always regulated by more than one agency. *See* NELSON, WHITMAN, BURKHART & FREYERMUTH, REAL ESTATE TRANSFER, FINANCE, AND DEVELOPMENT: CASES AND MATERIALS 918-23 (8th ed. 2009). Other agencies that regulate the banking industry include The Office of Thrift Supervision, The Federal Housing Finance Agency, and The Office of the Comptroller of the Currency. *Id.* at 917.

23. For example, the Capital Purchase Program requires participating companies to restrict the payment of dividends. Additionally, the Treasury has placed limits on executive compensation and hiring of workers on foreign visas at recipient institutions. *See infra* Part III.C.

conflicting duties, that of the federal government as a controlling shareholder and that of the federal government as a sovereign, to be resolved?

In this comment, I conclude that the federal government meets the definition of a controlling shareholder for all of the companies in which it has taken an equity interest through TARP. Furthermore, as a result of its role as sovereign, the federal government is likely to have interests that are divergent from those of the paradigmatic value-maximizing shareholder. Consequently, the federal government's control would seem to necessitate the imposition of fiduciary duties to protect minority shareholders and ensure that the federal government uses its power for a proper corporate purpose. I argue, however, that the federal government is unique in that it is not only bound by the corporate law, but also by its duties as a sovereign as well as by the specific statutory language of the EESA.[24] When corporate purpose is viewed more broadly, rather than as simple shareholder wealth maximization, the federal government's goals fit within the permissible corporate purpose and thus they align with the interests of the corporation. Because it is bound to pursue the statutory objectives of the EESA, which fit within the proper view of corporate purpose, the federal government does not need to be bound by fiduciary duties

In Part I of this comment, I will briefly describe the mechanics of the Troubled Asset Relief Program in order to allow the reader to better understand the program and to give the background knowledge necessary to evaluate my claims.

In Part II, I will examine the development of the doctrine of controlling shareholder fiduciary duties, in order to test its application to the federal government. I will analyze the government's status as a controlling shareholder in three distinct groups of TARP institutions, delineated by the size of the federal government's equity stake, in order to conclude that the federal government fits the definition of a controlling shareholder for all TARP institutions.

In Part III, I will argue that the federal government is a unique shareholder with the potential to have interests that are diverse and possibly adverse to that of the paradigmatic value-maximizing investor and the traditional corporate purpose. I will analogize the federal government to pension funds and other institutional investors, and apply the fiduciary standards applicable to these entities to the federal government's TARP actions. Furthermore, I will discuss the similarities between TARP and social investing from both a normative and empirical perspective.

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24. *See* TARP REPORT, *supra* note 2, at 10 (Stating the goals of TARP as "[e]nsur[ing] the overall stability and liquidity of the financial system," "[p]revent[ing] avoidable foreclosures and help[ing] to preserve homeownership," while "[p]rotect[ing] taxpayer interests," and "[p]romot[ing]" transparency.").

After concluding in Part III that the federal government has interests that are potentially misaligned with the average shareholder and the traditional corporate purpose, I will conclude in Part IV that this is not as troublesome as it may seem. I will analyze the proper purpose of a corporation, summarizing the classic Berle-Dodd debate and argue that, at least in the case of TARP institutions, the proper corporate purpose should be understood as more than just maximization of shareholder wealth. Building upon this conclusion, I will argue that because the federal government is bound by the statutory language of the EESA to pursue goals that fit within this expanded definition of corporate purpose, fiduciary duties are unnecessary to ensure that the federal government pursues a proper corporate purpose in exercising its power through TARP.

I. THE MECHANICS OF TARP

After the bankruptcy of Lehman Brothers in September 2008,[25] Congress passed the EESA in order to "provide the Secretary of the Treasury with the authorities and facilities necessary to stabilize the U.S. Financial System."[26] The resulting Troubled Asset Relief Program (TARP) contained several programs to achieve both the statutory goals of the EESA and TARP's operational goals of "ensur[ing] the overall stability and liquidity of the financial system, . . . prevent[ing] avoidable foreclosures and help[ing] to preserve homeownership, . . . protect[ing] taxpayer interests, [and] . . . 'promot[ing] transparency.'"[27] Of primary importance for our discussion is the Capital Purchase Program (CPP),[28] through which the federal government "provided capital infusions directly to banks and insurance companies deemed viable by their regulators but in need of a stronger asset base to weather the crisis,"[29] and the Automotive Industry

25. *See* Intro *supra*. For a more detailed description of the events leading up to the EESA and TARP *see* TARP REPORT, *supra* note 2, at 6-8.

26. *Id.* at 9.

27. *Id.* at 10.

28. See Capital Purchase Program, U.S. Department of Treasury, http://www.treasury.gov/initiatives/financial-stability/programs/investment-programs/cpp/Pages/Test-Program.aspx (last visited September 12, 2011) (providing a summary of the terms of the Capital Purchase Program, as well as the ability to view the actual agreements for all CPP participants).

29. TARP REPORT, *supra* note 2, at 10. Treasury also "provided direct aid to certain financial industry participants through the Targeted Investment Program (TIP) and the Asset Guarantee Program (AGP), as well as the program originally known as the Systemically Significant Failing Institutions (SSFI) program [later renamed the AIG Investment Program]." *Id.* TARP also provided funding to GM and Chrysler as part of a related program, the Automotive Industry Financing Program (AIFP). *Id.* Additionally, Treasury purchased $40 billion in senior preferred stock from AIG through the SSFI (later renamed the AIG

Finance Program (AIFP), which similarly provided funds to GM and Chrysler.

The CPP and the AFIP "put the federal government in the unwelcome position of owning sizeable stakes in private sector companies."[30] As a result, Treasury "has established a core set of principles to guide its actions"[31] to ameliorate the potential uncertainties of this position. Chief among these principles is the desire "to protect taxpayers by minimizing the long-term consequences of the current economic and financial crisis with as little direct cost to the taxpayer as possible."[32] While this statement makes clear the federal government's goals in the program, it also seems to make clear that if the interests of the taxpayer and the corporations are not aligned, the federal government will act in the best interest of the taxpayer.

Through the CPP, the federal government provided over $200 billion in capital to participating institutions. Roughly half of this funding went to eight of the country's largest financial institutions[33] with the remainder going to banks, savings and loans, and other similar companies that submitted an application to their federal regulators.[34]

Through the AFIP, the federal government provided roughly $76 billion in loans and equity infusions to GM, Chrysler, and their financing arms in order to prevent a disruption of the industry or a liquidation that was feared to cause distress to the economy as a whole.[35] The federal government invested $20 billion in both Bank of America and Citigroup through the Targeted Investment Program (TIP),[36] which sought "to provide additional or new funding to financial institutions that were critical to the functioning of the financial system."[37]

Finally, the federal government has "taken a series of actions related to AIG in order to prevent AIG's disorderly failure and mitigate systemic risks."[38] Through a series of transactions and a cash infusion by the federal government of roughly $40 billion, The Federal Reserve Bank of New York "received convertible preferred stock representing approximately 79.8

Investment Program). *Id.* The terms among the programs are substantially similar for the purposes of my analysis.

30. TARP REPORT, *supra* note 2, at 4.
31. *Id.* at 4.
32. *Id.*
33. *Id.* at 24.
34. *Id.*
35. *Id.* at 33-34.
36. *Id.* at 26.
37. *Id.*
38. *Id.* at 27.

percent of the fully diluted voting power of the AIG common stock" which was then "deposited in a trust … for the benefit of the U.S. taxpayers."[39]

II. The Federal Government is a Controlling Shareholder in TARP Institutions

The federal government has become a shareholder of 685 publicly traded companies through the CPP, as well as several other companies through programs such as the AFIP and the AIG Investment Program.[40] The amount of the federal government's stake in each company varies with the contribution amount and ranges from a very small percentage to the ownership of a majority of outstanding shares.[41]

In order to analyze the fiduciary duties of the federal government as a shareholder, I will divide the institutions receiving TARP funding into three distinct groups delineated by the size of the federal government's ownership stake. I will refer to the first group as "majority-owned" institutions. This group will include those companies in which the federal government owns a majority of the outstanding equity and will include AIG,[42] General Motors,[43] Fannie Mae[44] and Freddie Mac.[45] The second group will be those companies in which the federal government is one of the largest shareholders, but does not hold a majority of the outstanding shares, and will include Citigroup,[46] Chrysler[47] and GMAC.[48] For the sake of

39. *Id.* For a more detailed description of the specific transactions that led to the end result of 79.8% stock ownership of AIG, see *Id*. Although many terms of this program are similar to the CPP, it is important to note that these investments call for eight percent annual dividends and "impose greater reporting requirements and harsher restrictions on the companies than under the CPP terms, including restricting dividends to $0.01 per share per quarter, restrictions on executive compensation, restrictions on corporate expenses, and other measures." *Id.* at 26.

40. *Id.* at 24.

41. S*ee supra* note 28 (providing a list of Capital Purchase Program participants and the amount of investment made in each).

42. Holman W. Jenkins, Jr., *The Weekend Interview with Hank Greenberg: Can AIG Be Saved?*, WALL ST. J., Jan. 9, 2010, at A11 (noting the federal government's 79.9% ownership of AIG).

43. Neil King, Jr., *USA Inc.—The State of Capitalism: Politicians Butt in at Bailed-Out GM*, WALL ST. J., Oct. 29, 2009, at A1 ("the federal government took a 60% stake in the auto maker when the slimmed-down GM emerged from bankruptcy.").

44. Editorial, *Fannie and Freddie: The Last SIVs*, WALL ST. J., Feb. 23, 2010, at A18 (noting that "Treasury took controlling ownership stakes" of Fannie Mae and Freddie Mac in 2008).

45. *Id.*

46. Editorial, *A Backdoor Nationalization*, WALL ST. J., Apr. 21, 2009, at A20 (noting the federal government's 36% ownership stake in Citigroup).

47. Neil King Jr. & Jeffrey McCracken, *Chrysler Pushed into Fiat's Arms --- Italian Car Maker, UAW Main Owners; Obama Pledges Brief Stay in Bankruptcy; Creditors Take Hit*, WALL ST. J., May 1, 2009, at A1 (noting federal government's 8% stake in Chrysler).

simplicity, I will refer to these companies as "plurality-owned" institutions to recognize that the federal government owns the largest individual portion, but not a true majority. Finally, the vast majority of TARP recipients will be included in the third group, which includes all other institutions in which the federal government holds an equity stake but does not hold either a majority or plurality of outstanding shares. In order to maintain consistency, I will refer to these companies as "minority-owned" institutions. Because the analysis of the federal government's ability to control the companies in question is much more straightforward for the majority-owned companies, the bulk of my analysis will focus on whether the federal government is a controlling shareholder of the plurality-owned and minority-owned institutions.

A. Majority-Owned Institutions

To begin, I will analyze the fiduciary duties of the federal government with regards to the majority-owned group of TARP recipients.[49] Established law makes it abundantly clear that a shareholder who holds a majority of the outstanding shares of a corporation is subject to fiduciary duties. As stated by the California Supreme Court in *Jones v. Ahmanson & Co.*: "[t]he courts of appeal have often recognized that majority shareholders . . . have a fiduciary responsibility to the minority and to the corporation to use their ability to control the corporation in a fair, just, and equitable manner."[50] The court goes on to further clarify the standards of this rule by stating that "[a]ny use to which [majority shareholders] put the corporation or their power to control the corporation must benefit all shareholders proportionately and must not conflict with the proper conduct of the corporation's business."[51]

The federal government clearly fits this classic definition of a controlling shareholder subject to fiduciary duties with regards to the

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48. John D. Stoll, *Cut from GM, GMAC Uses New Strength to Expand*, WALL ST. J., Sept. 24, 2009, at B1 ("The U.S. government owns 35%.").

49. As noted earlier, this group contains AIG, General Motors, Fannie Mae and Freddie Mac. *See supra* notes 42-45.

50. Jones v. Ahmanson & Co., 1 Cal.3d 93, 108 (1969); *see also* Weinstein Enters., Inc. v. Orloff, 870 A.2d 499, 507 (Del. 2005) ("In the context of imposing fiduciary responsibilities, it is well established in the corporate jurisprudence of Delaware that control exists when a stockholder owns, directly or indirectly, more than half of a corporation's voting power."). Courts have long recognized the gravity of the relationship between controlling shareholders and minority shareholders and the importance of placing limits on this relationship. *See* Ervin v. Oregon Ry. & Nav. Co., 27 F. 625, 631 (S.D.N.Y. 1886) ("When a number of stockholders combine to constitute themselves a majority in order to control the corporation as they see fit, they become for all practical purposes the corporation itself, and assume the trust relation occupied by the corporation towards its stockholders.").

51. Jones, 1 Cal. 3d at 108.

majority-owned TARP institutions. The federal government owns a majority of the outstanding shares of these corporations. Thus, from a simple numerical standpoint, the federal government is a controlling shareholder.

Analyzing the rationale for imposing fiduciary duties on majority shareholders further clarifies the fact that the federal government fits the definition of a controlling shareholder. The classic justification of shareholder fiduciary duties, like those of directors and officers, relies on the ability to control the corporation and the potential for a conflict between the best interests of the corporation and the best interests of the controlling individual.[52] Black letter corporate law dictates that the shareholders are empowered to elect the directors of a corporation, who will in turn run the organization.[53] Because a majority shareholder has the power to elect any and all of the directors by virtue of the ability to cast fifty-one percent of the vote in any election, the directors know that they are beholden to the majority shareholder for re-election. Thus, they will make decisions that are in the best interest of the majority shareholder and they can be counted on to implement the majority shareholder's wishes in order to assure reelection. As a result, the majority shareholder is in control of the corporation, therefore, subject to fiduciary duties.[54]

The federal government fits this rationale, as it is able to exert the same amount of control, if not more, as any other majority shareholder would on the majority-owned companies. Just as any other majority shareholder, the federal government has the power to control the votes on director elections, potential tender-offers and any other shareholder proposals. Even if the federal government does not directly participate in the elections by refraining to vote its shares, directors and managers are certainly aware of the federal government's majority share and its corresponding ability to affect change. As I will explain in more detail in my analysis of plurality-owned and minority-owned institutions,[55] there are also several other factors that militate towards viewing the federal government as a controlling shareholder, including the ability to influence

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52. *See* Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1269 (2008) ("Indeed, the degree to which a shareholder controls the board has become the judicial touchstone of shareholder fiduciary duty.").

53. *See e.g.* DEL. CODE ANN. tit. 8, § 141(a) (West 2011) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.").

54. The classic example of the use of this control by the majority shareholder to harm the minority is the freeze-out, in which the majority shareholder votes to sell all of the shares of the corporation at an artificially low price to a holding company that is owned by the majority shareholder. *See* Anabtawi & Stout, *supra* note 52, at 1266.

55. *See infra* Part II. B-C.

public opinion, the policy-making power of the federal government and covenants in the TARP agreements themselves that allow the federal government to exert control over TARP recipients. Because the federal government has even more power than a traditional majority shareholder, it undoubtedly fits the definition of a controlling shareholder for the majority-owned institutions.

B. Plurality-Owned Institutions

The federal government also fits the established definition of a controlling shareholder subject to fiduciary duties for the plurality-owned[56] TARP institutions.

A shareholder who holds the largest or one of the largest groups of shares can exhibit significant control over a corporation. Fiduciary duties follow control in corporate law,[57] and courts have noted that "a shareholder owes a fiduciary duty only if it owns a majority interest in or *exercises control* over the business affairs of the corporation."[58] Thus, courts have explicitly recognized that a shareholder need not own a majority of a corporation's outstanding shares in order to owe fiduciary duties to the corporation. Courts have further clarified this concept by stating that "[f]or a dominating relationship to exist in the absence of controlling stock ownership, a plaintiff must allege domination by a minority shareholder through actual control of corporate conduct."[59] Again, it is clear that control is the trigger of fiduciary duties.[60]

Before beginning my analysis of the federal government as a controlling shareholder of the plurality-owned companies, it is important to properly frame the argument. As suggested by the preceding quote from *Citron,* a finding of fiduciary duties for a controlling, but less than majority shareholder, depends on the actual exercise of control.[61] My analysis will focus on whether the federal government *could* be subject to fiduciary duties as a controlling shareholder as a result of its ownership stake in these

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56. I define plurality-owned institutions as those institutions in which the government owns a significant stake, though not a numerical majority. These companies include Citigroup, Chrysler and GMAC. *See supra* notes 48-50 and accompanying text.

57. *See* Anabtawi & Stout, *supra* note 52, at 1269 ("Indeed, the degree to which a shareholder controls the board has become the judicial touchstone of shareholder fiduciary duty.").

58. Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1113-14 (Del. 1994) (quoting Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344 (1987)).

59. Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 70 (Del. 1989).

60. S*ee* Anabtawi & Stout, *supra* note 52, at 1269-71 (discussing two leading cases in which courts have found control and imposed fiduciary duties without majority ownership).

61. *See Citron,* 569 A.2d at 70 ("a plaintiff *must allege* domination by a minority shareholder through *actual* control of corporate conduct") (emphasis added).

plurality-owned institutions, not on whether it *has taken* the necessary steps to invoke fiduciary duties. Stated another way, I will attempt to focus on whether a court could potentially find that the federal government acted as a controlling shareholder through actions taken as a result of TARP ownership, not on whether the federal government has, at this time, undertaken the control acts necessary to be deemed a controlling shareholder.

When examining the ability of a minority shareholder to control, "courts tend to engage in cautious, detailed factual analysis of whether that particular shareholder, individually or together with associates, owns enough shares to give the shareholder clear voting power to replace the board of directors."[62] Thus, from the perspective of the courts, the numerical percentage of ownership is very important. This recognizes the fact that voter turnout in corporate elections is frequently less than one hundred percent.[63] Most state corporate law, subject to modification in the articles of incorporation of individual companies, simply requires a plurality of votes cast, not a plurality of outstanding shares, for director elections.[64] Thus, a large block of stock frequently becomes a majority of votes cast in any given election even though it is not a majority of all outstanding shares. As a result, shareholders who control a substantial portion of stock can often elect directors in the same way that a true majority shareholder can.

The plurality-owned institutions fit the rationale for finding control on the basis of voting power. As noted earlier, the federal government owns roughly thirty-six percent of Citigroup, ten percent of Chrysler and thirty-five percent of GMAC[65]; this ensures a large block of voting shares will be under the federal government's control. Additionally, courts consider not only the amount of shares actually owned by the investor, but also the number of shares upon which the investor can exert control over the voting.

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62. Anabtawi & Stout, *supra* note 52, at 1269.

63. *See* William K. Sjostrom, Jr., *The Case Against Mandatory Annual Director Elections and Shareholders' Meetings*, 74 TENN. L. REV. 199, 219 (2007) (noting that shareholder turnout in U.S. director elections is routinely around 80%, but that this figure can be misleading as to overall shareholder participation because of the large percentage of shares that are cast by institutional investors).

64. *See e.g.* DEL. CODE ANN. tit. 8, § 216 (West 2011) ("Directors shall be elected by a plurality of the votes of the shares *present in person or represented by proxy* at the meeting and entitled to vote on the election of directors") (emphasis added); MODEL BUS. CORP. ACT §7.28(a) (1991) ("Unless otherwise provided in the articles of incorporation, directors are elected by a plurality of the *votes cast* by the shares entitled to vote in the election at a meeting at which a quorum is present.") (emphasis added). Shareholder voting on other matters follows a similar pattern, but instead requires a majority of the votes cast instead of a plurality. *See e.g.* DEL. CODE ANN. tit. 8 § 216(2) (West 2011); MODEL BUS. CORP. ACT §7.25(c) (1984).

65. *Supra* notes 46-48 (noting the federal government's 36% ownership stake in Citigroup, 8% stake in Chrysler, and 35% stake in GMAC).

In the case of the federal government, this number is potentially quite large. Other investors, including both small investors who do not have the resources to do their own research and large investors who do not want to anger the federal government by voting against it, are likely to follow the federal government's votes. Aggregating the significant portion of shares owned by the federal government and the potentially sizable amount of votes that will follow the federal government's votes, leads to the conclusion that the federal government is a controlling shareholder in these corporations.

The federal government has also taken several actions that strongly suggest an exercise of control over the plurality-owned companies. To begin with, the federal government has dictated limits on executive compensation to all TARP recipients.[66] Additionally, the federal government has specifically intervened in bonus and compensation decisions at Citigroup, AIG, General Motors and GMAC, exercising direct control over the affairs of the corporations.[67] The federal government has exercised direct control of Chrysler by guiding it through bankruptcy and facilitating the sale of a large portion of the company to foreign automaker, Fiat.[68] The aforementioned actions are strong indicia of the ability to control. When taken together, the substantial portion of stock controlled by the federal government and the affirmative actions taken to control these plurality-owned companies outside the traditional corporate control paradigm strongly suggest that the federal government is a controlling shareholder. Thus, it seems fairly certain that the federal government, if it has not done so already, could exercise the necessary control over these companies to support a holding that it is a controlling shareholder subject to fiduciary duties.

C. Minority-Owned Institutions

Apart from the relatively straightforward application of controlling shareholder status in the largest TARP recipients, the federal government could also be subject to fiduciary duties for the minority-owned institutions. Again, this imposition of fiduciary duties follows control. Although it does

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66. *See* TARP Standards for Compensation and Corporate Governance, 31 C.F.R § 30 (2009).

67. David Ellis & Ed Henry, *Pay Czar Issues Salary Caps for Execs*, CNNMONEY.COM (Dec. 11, 2009), http://money.cnn.com/2009/12/11/news/companies/feinberg_compensation/index.htm.

68. *See*, *e.g*. King & McCracken, *supra* note 47; Chris Isidore, *Chrysler Won't Repay Bailout Money*, CNNMONEY.COM, http://money.cnn.com/2009/05/05/news/companies/chrysler_loans/ (last updated May 6, 2009); Voice of America, *Obama Rejects GM, Chrysler Bailout Plans* (Mar. 30, 2009), http://www.voanews.com/english/news/a-13-2009-03-30-voa37-68812652.html.

not have the specific power to control the board of directors in these corporations, the federal government can still exhibit considerable influence as an activist shareholder.[69] By using such tools as the language of the TARP agreement itself, the bully pulpit, and its unique ability to make law and policy, the federal government could exert de-facto control over minority-owned institutions. Thus, the federal government meets the threshold of control and could conceivably be subject to fiduciary duties.

With the rise of institutional investors, hedge funds and shareholder advisory services, "[s]hareholders are becoming both more powerful and more divided, giving rise to troubling consequences."[70] As a result of this changing paradigm and newfound shareholder power, Professors Stout and Anabtawi have proposed that:

> [A]ll shareholders, like all directors and officers, be viewed as owing latent duties to the firm and their fellow shareholders. These latent duties would be triggered whenever a particular shareholder - whether or not it is technically a shareholder capable of controlling the board's decisions as to all matters- in fact manages to successfully influence the company's actions with regard to a particular issue in which that shareholder has a material, personal economic interest.[71]

The federal government presents the ultimate example of this new paradigm in shareholder power. As noted earlier, the federal government has an immense repertoire of tools at its disposal to affect the governance of TARP institutions. This ability to control could, in turn, lead to imposition of fiduciary duties.

Contrary to the average shareholder, the federal government has almost unlimited resources with which to analyze the companies it owns stock in and to influence corporate policy. The federal government has the staff, money and, perhaps most importantly, access to information that makes it unique in this regard. Because it can access sensitive financial details of the institutions receiving TARP funding, the federal government has the ability to exert more control over the companies themselves.

An example of this access to information is provided by the "stress tests" in which federal regulators examined the financial stability and capital requirements of banks receiving TARP funds.[72] These stress tests were a direct result of the federal government's unique position as both a

69. *See* Anabtawi & Stout, *supra* note 52.
70. *Id.* at 1274.
71. *Id.* at 1295.
72. *See* Deborah Solomon & Damian Paletta, *Banks to Get Stress Test Before Aid*, WALL ST. J., Feb. 10, 2009, at A3.

shareholder and a regulator. The program allowed the federal government, acting as a regulator, to access privileged and sensitive financial information about companies in which the federal government held stock as a shareholder. The terms of the program also allowed the federal government to mandate increased capital requirements and other programs for the institutions that failed the tests. Thus, the federal government was able to protect its investment by using its regulatory powers to implement a program that allowed it to access sensitive financial information and force vulnerable companies to shore up their capital base. This program is certainly more far-reaching than anything a normal shareholder could implement and serves to demonstrate the extensive control that the federal government can exert on TARP institutions, despite the lack of a majority or even a significantly large stake in the companies.

The federal government, unlike other shareholders, also has the power to directly affect corporate decisions through specific provisions in its share purchase agreement (the terms of the CPP, AIFP and other TARP programs). The CPP agreement specifically restricts the issuance of dividends,[73] and sets limits on executive compensation.[74] These covenants are effective irrespective of the size of the federal government's ownership stake in the institution and are well beyond anything that an average investor is likely to include in a stock purchase agreement. This significant concession obtained by the federal government as a condition for its stock purchase leads to the unmistakable conclusion that the federal government is different from other shareholders. The federal government's unusual and uniquely strong bargaining position allowed it to dictate corporate policy outside of the constraints of the formal corporate power structure. Because the exercise of this power over corporate policy is usually subject to fiduciary duties, these duties could logically be extended to the federal government.

The federal government also has the unique ability to exert control over TARP institutions by making law and policy. Moving beyond the language of the TARP agreements, the federal government has passed laws that relate only to TARP institutions. These regulations include limits on foreign hiring,[75] limits on executive compensation,[76] and even regulations

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73. U.S. Dep't of Treasury, TARP Capital Purchase Program Senior Preferred Stock and Warrants (2008), *available at* http://www.treasury.gov/press-center/press-releases/Documents/document5hp1207.pdf.

74. *Id.* at 4.

75. *See* Employ American Workers Act, Pub. L. No. 111-5, § 1611 (2009) (requiring all TARP recipients to take the additional steps required of a "H-1B dependent employer" before hiring a foreign worker under the H-1B program).

76. *See* American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 7001 (2009) (declaring that "during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding, each TARP recipient shall be

regarding lending and mortgage modifications.[77] Again, the federal government has controlled a corporation in which it is a minority shareholder outside the traditional corporate power structure and, thus, outside the traditional constraints of fiduciary duties. This control is not exerted through the traditional corporate law power structure of directors, officers and majority shareholders, and is thus outside the constraints of fiduciary duties.

Finally, the federal government can exercise control over minority-owned institutions by influencing public opinion through the use of the bully pulpit. The federal government, through the executive branch, can speak directly to the public and greatly influence public opinion, including the views of other shareholders in TARP institutions. Using this power, the federal government can drive changes in corporate policy by politicking to the masses. To see this strategy in action, one need only look at the public outcry over executive compensation and bonuses at TARP institutions, such as Goldman Sachs, Citigroup and Merrill Lynch.[78] By using its resources and access to the public to make this a political issue, the federal government can influence public opinion, and in turn corporate policy, in a way that a normal shareholder almost certainly could not. Thus, the federal government again is able to exert control over a minority-owned institution outside of the normal corporate power structure, demonstrating that it is a controlling shareholder despite owning only a minority stake.

Although my research has found no court that has adopted this theory of "de-facto" control by a shareholder who is in the distinct minority, this fact is not fatal to my argument. Federal government ownership through TARP could serve as the perfect test case for the courts to adopt Professors Stout and Anabtawi's alternative conception of fiduciary duties as triggered "by that shareholder's ability to influence the outcome of a particular corporate decision in which it has a personal conflict of interest" rather than their "ability to direct corporate decision-making in the abstract."[79] Because the federal government certainly has the practical power to affect individual corporate decisions, if not the formal power to affect corporate decision-making as a whole, it could be subject to fiduciary duties.

Federal government ownership presents the perfect case for an expansion of the definition of a controlling shareholder. With regards to

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subject to the standards established by the secretary under this section" and describing those standards).

77. *See* Emergency Economic Stabilization Act (EESA) of 2008, 12 U.S.C. §§ 5219-5220 (2008) (encouraging foreclosure mitigation efforts and providing for assistance to homeowners).

78. *See* Michael Shnayerson, *Wall Street's $18.4 Billion Bonus*, VANITY FAIR (Mar. 2009), http://www.vanityfair.com/politics/features/2009/03/wall-street-bonuses200903.

79. Anabtawi & Stout, *supra* note 52, at 1295.

minority-owned institutions, the federal government certainly does not fit the standard conception of a controlling shareholder as one who holds a majority of the outstanding shares. The federal government *does,* however, have the power to exert control over minority-owned institutions outside of the traditional corporate control context and has in fact exercised that power in certain situations. The rationale for imposing fiduciary duties on officers, directors and majority shareholders, namely that they can exert control over the corporation, applies equally well to the federal government. Thus, the federal government could be subject to fiduciary duties and this provides the perfect set of circumstances for courts to adopt Professors Stout and Anabtawi's argument that "the duty of loyalty should be activated by *any* factual situation . . . in which a shareholder seeks to promote a corporate strategy."[80]

III. THE FEDERAL GOVERNMENT IS A SHAREHOLDER WITH INTERESTS THAT DIVERGE FROM THOSE OF THE PARADIGMATIC SHAREHOLDER

A. Control + Divergence of Interests = Fiduciary Duty

Although it is generally the touchstone for imposition of fiduciary duties, control power in the abstract does not present a problem in and of itself. If interests are perfectly aligned between the controlling party and the minority, there is no cause for concern: the controlling party will always act in the best interests of the minority, because that is in *his* interest as well. Only when interests are misaligned does a problem emerge. If the best interests of the controlling party are different from those of the minority party, then the controlling party will likely use his power to pursue his own interests at the expense of the minority. It is this potential abuse that fiduciary duties are designed to protect.[81] Fiduciary duties bind the

80. *Id.*

81. An example of misaligned interest outside of the corporate law context will serve to ground the reader and help them better understand the concept of misaligned interests and the use of fiduciary duty to control them. Consider, for example, the case of two participants in a game. Participant A has a natural advantage, so that if he merely plays by the rules, he is almost certain to win the game. Participant B is almost certain to lose the game without cheating, but is very likely to win if he does so. If either party is caught cheating, they will automatically lose the game, but will suffer no other penalty. The interests of A and B are thus misaligned. A is motivated to play by the rules of the game and achieve victory without risking disqualification, while B is motivated to cheat in an attempt to win, disregarding the risk of disqualification because that result is no different than losing while playing by the rules. In order to cure these misaligned interests and ensure fair play, further restraints must be placed on the participants. In this example, the rules of the game could be modified so that if either party is caught cheating they will have to pay a monetary penalty, or be banned from the game for life. If this penalty is calibrated correctly, the fear of this punishment will deter cheating behavior by B and will cure the problem of misaligned

controlling party to consider the interests of other parties, namely minority shareholders and the corporation itself, when using its control power. Thus, fiduciary duties are only necessary and appropriate when the interests of the controlling party are not aligned with those of the minority party and the proper corporate purpose.

B. The Federal Government has Misaligned Interests

The paradigmatic shareholder in a publicly traded firm is chiefly concerned with profit-maximization and generating a return on their capital investment. Individual shareholders in large public institutions tend to invest no firm-specific capital and are linked to the firm only by the money they have invested. The robust public stock markets allow for easy liquidity of investments and a recovery of (at least a portion of) this capital at will. If the firm underperforms, the investor can always allocate her capital to another firm by selling her stock and purchasing stock in a different company. Thus, the paradigmatic investor has little regard for the long-term prospects of any given firm, focusing instead on the profits that the firm is able to generate.

A diversified investor is even more inclined to focus solely on returns and will often care only about generating large profits, even at the expense of undertaking risky strategies.[82] In addition to the lack of a firm-specific investment, the diversified investor is influenced by insulation from "the firm-specific risk which goes with picking individual stocks."[83] Thus, she will be even more focused on profits at any given firm, as the other stocks in the portfolio will balance out any that fail due to excessive risk-taking.

"Because the goal of investing is to generate the greatest possible return at the lowest possible risk, it seems fair to presume that rational investors *must* diversify."[84] We must assume that the average shareholder in a TARP institution is a rational investor. Therefore, we should assume that the average shareholder in a TARP institution is a diversified investor. Because they are a diversified investor, they are likely to prefer a strategy that focuses on return on investment, as opposed to other concerns such as

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interests: it will be in the best interests of both parties to play by the rules. This outside factor, the punishment for cheating, thus serves to alleviate the problem of misaligned interests. Similarly to this punishment for cheating, fiduciary duties seek to remedy the problem of misaligned interests in the corporate law paradigm by acting as an outside restraint on self-interested action by controlling shareholders, directors or managers.

82. *See* Richard A. Booth, *Stockholders, Stakeholders, and Bagholders (or How Investor Diversification Affects Fiduciary Duty)*, 53. BUS. LAW 429, 442 (1998) ("[A] diversified investor will prefer that management of any individual company pursue the highest risk-adjusted return even at the risk of the ruin of the company.").

83. *Id.*

84. *Id.* at 444.

preserving jobs for employees or increasing lending and liquidity in the capital market. Thus, the average shareholder in a TARP institution is interested primarily in the generation of profits. This coincides with the traditional view of the purpose of a corporation as existing solely to generate profits for its shareholders.[85]

The federal government, on the other hand, is drastically different from the paradigmatic diversified investor that represents shareholders of the TARP firms. Although concerned with "maximiz[ing] overall returns to the taxpayers of the United States,"[86] TARP was primarily implemented "to help prevent the collapse of our financial system and lay the foundation for economic recovery."[87] The stated purposes of the EESA included "restoring liquidity and stability to the financial system" and "protect[ing] home values, . . . life savings, preserv[ing] home ownership [and] promot[ing] jobs and economic growth."[88] Unlike the average shareholder, the federal government was motivated by much more than the prospect of profits in making its investment.[89] Although profit realization was *a* goal of the federal government in the implementation of TARP, it certainly cannot be argued that it is the *chief* goal of the program.

Thus, the interests of the federal government as a controlling shareholder are misaligned with those of the average shareholder in TARP institutions. While the average shareholder is concerned chiefly with profit maximization, the federal government's chief concern is the overall well-being of the economy and the stability of the financial system. As will be

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85. This classic view is embodied by *Dodge v. Ford* where the Michigan Supreme Court emphatically states that "[t]here should be no confusion . . . [a] business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end . . . and do[ ] not extend to . . . other purposes." Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919).

86. TARP REPORT, *supra* note 2, at 7.

87. *Id.* at 4.

88. *Id.* at 7.

89. In hindsight it seems that while probably not a primary motivation of the program, the federal government has made profits on many of the transactions undertaken through TARP. *See e.g., id.* at 13 (noting that "[a]s of September 30, 2009, Treasury-OFS currently projects that four programs will produce a net return to taxpayers. The Capital Purchase Program, the Targeted Investment Program, the Asset Guarantee Program, and the Consumer and Business Lending Initiative had reported net income of $19.5 billion."); Randall Smith & Deborah Solomon, *U.S. May Exit Citi $7 Billion Richer*, WALL ST. J., Mar. 30, 2010 at C1 ("The U.S. government could earn a profit of more than $7 billion on its investment in Citigroup Inc. under its plan to sell off its $32 billion stake over about six months."); Walter Hamilton, *Bank Bailouts Appear to be Paying off; the U.S. Gets Billions Back as Wall Street Rebounds. But Critics Say TARP Fund Will Still End Up in the Red*, L.A. TIMES, Dec. 4, 2009, at A1 (quoting President Obama that "TARP . . . has been much cheaper than any of us anticipated" and that Bank of America paid "about $10 billion in dividends and interest.").

detailed, this conflict is potentially troubling, both on its face and based on past experience.

C. These Misaligned Interests are Facially Troubling Because of the Role of Government

Government ownership of private institutions is very unusual, although not unheard of, in the United States. [90] Although the government owns Amtrak[91] and has chartered and owned stock in several private corporations, "there is 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."[92] The fact that the government has never before owned stock in private corporations on this scale is related to two fundamental tenets of the American system: a respect for private property and a devotion to markets free from government intervention.

Government ownership through TARP is in apparent conflict with these accepted principles and is thus troubling on its face. Because the interests of the federal government are not perfectly aligned with other shareholders,[93] the federal government could use its power as a controlling shareholder to pursue goals that are in opposition to the profit maximization goals of the average shareholder. This fact is troubling from a theoretical standpoint because of the interference with individual property rights that it represents and the appearance of government intervention that will affect the market economy. It is also troubling from a practical standpoint, as shareholders are at the mercy of a controlling shareholder with interests that are diverse from their own.

The foreign hiring restrictions imposed on TARP firms through the Employ American Workers Act[94] provide an example of the misaligned

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90. *See* Verret, *supra* note 21, at 289-93 (discussing the history of government ownership in the United States).

91. *Id.* at 289; *see also* Lebron v. Nat'l R.R. Passenger Corp., 513 U.S. 374, 386 (1995) (summarizing the status of Amtrak and the history of government owned corporations in the United States).

92. *Id.* at 293. The author goes on to note that "[w]e find no example from among this rich history in which the government owned a controlling stake in a publicly traded business incorporated under state law." *Id.*

93. *See supra* Part III.

94. *See* Moira Herbst, *H-1B Visas: 'Buy American' Comes to TARP*, BLOOMBERG BUSINESS WEEK (Feb. 6, 2009), http://www.businessweek.com/blogs/money_politics/archives/2009/02/h-1b_visas_buy.html; U.S. Citizenship and Immigration Servs., *Questions and Answers: Employ American Workers Act and its Effect on H-1B Petitions*, http://www.uscis.gov/portal/site/uscis/menuitem.5af9bb95919f35e66f614176543f6d1a/?vgnextoid=1eb19b5d82420210VgnVCM1000004718190aRCRD&vgnextchannel=e7d696cfcd6f

interests arising from the competing goals of TARP. This bill, passed as an amendment to the stimulus package, essentially makes it more difficult for TARP recipients to hire foreign workers by subjecting them to additional verification requirements.[95] The policy behind this bill, reserving jobs for American workers that would otherwise go to H-1B visa recipients, is arguably sound and is certainly within the power of the federal government. This policy is aligned with the federal government's interests, as it seeks to promote one of the stated goals of the EESA and TARP, to "promote jobs and economic growth."[96]

This action, however, does not align with the profit maximization objective of the average shareholder or the traditional view of corporate purpose. Although the effect of this restriction on the financial performance of TARP institutions is unclear, it could theoretically harm the profitability of these firms. If they are unable to hire foreign workers, TARP institutions could suffer because they might be unable to find the necessary skilled workers in the United States. Furthermore, even if they do find the necessary workers, they likely would have to pay them more than their foreign counterparts, harming the company's profitability. Finally, even if they are able to hire foreign workers after fulfilling the requirements, the process to do so has become more costly, again hurting the company's profitability. The federal government has thus used its power and influence over a private corporation to pursue a goal that is arguably adverse to the profit-maximization goal of the average shareholder and the traditional corporate purpose.[97] The federal government has used its power to pursue

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f110VgnVCM1000004718190aRCRD (last visited Mar. 6, 2010); Employ American Workers Act, Pub. L. No. 111-5, § 1611 (2009).

95. Employ American Workers Act, Pub. L. No. 111-5, § 1611(b) (2009) (the law requires all TARP recipients to take the additional steps required of a "H-1B dependent employer" before hiring a foreign worker under the H-1B program); 20 C.F.R. §655.736(a) (2011) (an H1-B dependent employer is one whose workforce is made up of more than 15% H1-B recipients). These employers are required to take extra steps before hiring any H1-B workers that essentially entail making the job available to American workers. *See* 20 C.F.R. §655.739 (2011) ("An employer that is subject to this additional attestation obligation . . . is required . . . to take good faith steps to recruit U.S. workers in the United States for the job(s) in the United States for which H-1B nonimmigrant(s) is/are sought.").

96. TARP REPORT, *supra* note 2, at 7.

97. The fact that this restriction was enacted as part of an act of Congress, rather than as an action by the federal government as a controlling shareholder, does not change the analysis. The law was not made broadly applicable to all firms, but rather only to those receiving funds under the EESA, Public Law 110-343, or Section 13 of the Federal Reserve Act, 12 U.S.C. 342 *et seq.* Pub. L. 111-5, § 1611(b). Although these restrictions are not a part of the actual TARP agreement, they should still be seen as part of the TARP bargain and thus can be viewed as imposed by the federal government as a controlling shareholder. Furthermore, the federal government is best viewed as one unitary body for the purposes of this analysis, so that actions taken by any arm of the federal government are viewed under the same framework.

an interest, protecting American jobs, that is adverse to the interests of the paradigmatic profit-maximizing shareholder and "conflict[s] with the proper conduct of the corporation's business,"[98] traditionally viewed as maximizing corporate profits.

D. TARP is Similar to Social Investing

The federal government's pursuit of goals other than profit maximization through stock ownership can be analogized to social investing.[99] This analogy to social investing is troublesome for two reasons. First, empirical research has shown that social investing tends to depress returns on investments.[100] Second,[101] social investing by pension funds is arguably a breach of fiduciary duties under the Employee Retirement Income Security Act of 1974 (ERISA)[102] and potentially under the Labor

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98. Jones v. Ahmanson & Co., 1 Cal.3d 93, 108 (1969).

99. *See* Benjamin A. Templin, *Full Funding: The Future of Social Security*, 22 J.L. & POL. 395, 434-42 (2006) (providing a description of social investing in the context of social security). Templin explains that "[s]ocial investing is a values-based investment strategy which seeks, in broad terms, either to invest in assets that promote broader social purposes or to avoid unethical or immoral firms."; *see also* Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 796-98 (1993) (describing social pressures faced by public pension funds that lead to "distinctive investment conflicts that limit the benefits of their activism").

100. *See* Romano, *supra* note 99, at 798 ("There is an inverse relation . . . between return on investments and policies favoring social investing.").

101. Even though these acts refer specifically to pension funds, the standards for fiduciary duties and their application to social investing will help to enlighten the analysis of the federal government's actions. First, pension funds are frequently arms of state governments, and are thus government actors who are focused on more than just returns to plan beneficiaries. Second, the fiduciary standard imposed on plan trustees is similar to that imposed on controlling shareholders, and thus the analysis of social investing under this standard is analogous to our situation. Finally, like pension funds, the federal government is a powerful investor who has significant assets and resources to both analyze and influence corporate policy.

102. 29 U.S.C. §§1001-1461 (2006). *See also* Templin, *supra* note 99, at 439 ("Commentators note that the ERISA fiduciary standard prevents social investing, and thus private pension plans subject to ERISA . . . could not engage in such investing without a breach of that duty."); Romano, *supra* note 99, at 798 ("If activist public funds are required to embrace such an investment agenda, then their investment objective will diverge from that of other equity holders, who desire to maximize share value and will therefore not benefit from public funds' increased role in corporate governance."); Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018, 1077-79 (1998) (noting that "ERISA holds trustees to a prudent-person standard and requires diversified investments" and "[t]he Department of Labor more or less consistently has advocated an 'other things equal' test, in which pension funds can make investments that benefit unions or workers if the risk-adjusted return matches other investments.").

and Management Relations Act of 1947 (Taft-Hartley).[103]

TARP is similar to social investing by pension funds because the ultimate goal of TARP is not profit maximization, but "restoring liquidity and stability to the financial system" while "protect[ing] home values, . . . life savings; preserv[ing] home ownership [and] promot[ing] jobs and economic growth."[104] Similarly, the ultimate goal of social investing is not targeting investments that maximize return, but targeting those that "promot[e] a broader social purpose" including "pursuing investments that will lead to economic development."[105] In fact,"[a] popular social investment is the acquisition of privately insured mortgage-backed pass-through securities, which is intended to aid local housing markets by increasing the supply of mortgage funds for local home ownership. Like a pension fund investor targeting socially beneficial investments at the expense of the profit maximization norm, the federal government has implemented socially beneficial policies at TARP institutions arguably at the expense of shareholder profit maximization.

E. Social Investing is Empirically Harmful to Stock Price

The analogy to social investing is potentially harmful to the shareholders of the TARP institutions, not just because of the abstract conflict between the goals of the EESA and the profit maximization norm, but because empirical evidence has proven that "social investing typically results in lower rates of return."[106] This means that shareholders potentially will receive a lower rate of return on their investments because of the federal government's pursuit of objectives like the protection of American jobs or the modification of troubled mortgages.

Although a theoretical concern, it is very unlikely that the federal government's ownership of stock in the TARP institutions and pursuit of goals besides profit maximization has *actually* depressed shareholder returns. Many of the TARP institutions would likely have failed, or at least suffered greatly, without government intervention.[107] Furthermore, it is

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103. 29 U.S.C. §§141-197 (2006). *See also* Schwab & Thomas, *supra* note 102, at 1075-78 (describing the Taft-Hartley Act and noting that "[t]he Taft-Hartley Act also imposes a fiduciary duty on plan trustees" and that although the Act "[does] not directly regulate where the pension fund could place its investments . . . and there are many anecdotes of union pension funds making bad or corrupt investment . . . fiduciary duty-lawsuits sporadically policed abuses.").

104. TARP REPORT, *supra* note 2, at 7.

105. Templin, *supra* note 99, at 434.

106. Templin, *supra* note 99, at 438.

107. In fact, former Treasury Secretary Henry Paulson argued that if not for the bailout of AIG the unemployment rate would have risen to 25% as a result of the failure of many businesses who would have lost their savings. *Paulson: 25% Unemployment Rate*

likely that the stock-price of most of the TARP institutions has benefited from the implicit guarantee against failure that comes with government ownership, if not from the direct infusion of capital itself.[108] As a result, although the non-profit maximizing objectives of the federal government in TARP are similar to social investing and could lead to lower returns, it is very unlikely that any investor could point to specific harm to the stock price because of the immense positive benefit that federal government ownership has had on TARP firms.

F. TARP Actions Would Violate ERISA

Because of the similarities between social investment by pension funds and the federal government's investments through TARP, fiduciary standards for pension fund social investing will prove informative. Private pension funds are regulated by ERISA, which "holds trustees to a prudent-person standard and requires diversified investments."[109] Public funds, while subject to the regulation of the states instead of ERISA,[110] are also frequently subjected to the prudent person fiduciary standard.[111] Because "social investing typically results in lower rates of return . . . [it] can be seen as a breach of fiduciary duty [to maximize returns]."[112]

Because the federal government's TARP ownership position is similar to that of a pension fund trustee, I will apply the ERISA fiduciary standards to the federal government. The federal government has other goals for the TARP program besides shareholder profit maximization. It is thus logical to expect that the federal government might use its power to achieve these other goals, at the expense of profit maximization. We have, in fact, already seen the use of this power in the form of the foreign hiring restrictions imposed upon TARP institutions.[113] The apparent goal of this policy is to

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Without AIG Bailout, MARKETWATCH (Jan. 27, 2010) http://www.marketwatch.com/story/paulson-25-unemployment-rate-without-aig-bailout-2010-01-27-131520.

108. *See* David Reiss, *The Federal Government's Implied Guarantee of Fannie Mae and Freddie Mac's Obligations: Uncle Sam Will Pick Up the Tab*, 42 GA. L. REV. 1019, 1023-26 (2008), *available at* http://works.bepress.com/david_reiss/1 (arguing that regulatory preferences and interrelationships with the federal government imply that the federal government will bail out Fannie Mae and Freddie Mac and that this, in turn, affects their share price).

109. Schwab & Thomas, *supra* note 102, at 1077-78.

110. For the purpose of this analysis I will not make a distinction between the standard mandated by ERISA and the standards mandated by various states; thus, I will not make a distinction between private and public funds.

111. Romano, *supra* note 99, at 800 ("Public pension funds are regulated by the states, as they are exempt from ERISA, the federal regime applicable to private pension funds. . . . [a] majority of states subject funds to a 'prudent person' fiduciary standard.").

112. Templin, *supra* note 99, at 438-39.

113. *See supra* notes 94-95 and accompanying text.

protect American jobs, a policy that is certainly socially and politically beneficial, while not so clearly beneficial to the shareholders of TARP institutions.

Similarly, it is not hard to imagine an investment by a pension fund in a failing local company that was made primarily to save the jobs of the workers by infusing fresh capital into the company. Assume further that there was an investment opportunity with lower risk and a higher reward, perhaps in a competing company, but that making that investment would ensure that the local plant closed down. In choosing to make the local investment the pension fund has likely breached its fiduciary duties to its members by putting another objective, albeit the socially beneficial objective of saving jobs, ahead of the profit maximization of the shareholders.

Just as the hypothetical pension fund likely violates the ERISA fiduciary standard by putting social goals ahead of profit maximization, so too does the federal government in placing the socially beneficial goal of protecting American jobs ahead of profits at TARP institutions. Although the federal government is not subject to ERISA in its exercise of control power, the analogy is informative because ERISA provides standards that are applied in a similar situation. Because the federal government's actions would likely violate ERISA, they must be looked upon with caution if we accept that the goal of a corporation is to maximize profits for its shareholders.

It is quite clear that the federal government, the controlling shareholder in TARP institutions, has interests that are not perfectly aligned with those of the average profit-maximizing shareholder in these same institutions. Specifically, the federal government is focused on goals besides profit maximization, and has demonstrated a willingness to use its power as a controlling shareholder in addition to its other powers as a regulator and a legislator to pursue these goals. Under the traditional view of a corporation existing solely to generate profits for shareholders, these actions seem to be adverse to the interests of the corporation and thus necessitate the imposition of fiduciary duties to alleviate these misaligned interests. As we will see in Part IV, however, when a more expansive view of corporate purpose that encompasses more than simple profit maximization for shareholders is taken, the potential for misalignment of interests, and, thus, the necessity of fiduciary duties, becomes less clear.

IV. WHEN A MORE EXPANSIVE VIEW OF CORPORATE PURPOSE IS TAKEN, FIDUCIARY DUTIES BECOME UNNECESSARY

As noted in Section III, the federal government has interests that are not perfectly aligned with those of the average profit-maximizing shareholder of TARP institutions or the traditional view of corporate purpose. Specifically, the federal government has other goals besides maximization of shareholder wealth. To many corporate law scholars, this would end the discussion as profit maximization is traditionally the only permissible goal for a corporation. It is thus necessary to impose fiduciary duties on the federal government in order to cure the problem of misaligned interests and force the federal government to pursue the proper corporate purpose of profit maximization. If the federal government pursues goals that are in conflict with this profit maximization objective, it would violate these fiduciary duties and theoretically would be subject to liability. Imposing fiduciary duties on the federal government is thus a necessary step to prevent it from taking actions that harm the shareholders of TARP institutions and conflict with the "proper" corporate purpose.

Traditional corporate law, however, is not well-suited to explain "the unique confluence of factors"[114] that has led to the government taking a controlling ownership interest in private companies.[115] The federal government is not motivated by a desire to maximize its investment, but chose to become a shareholder in these institutions nonetheless. In this case, if not as a universal matter, it makes sense to view the corporate purpose as more than just the maximization of shareholder wealth, as this is certainly the view taken by the federal government and by the Congress, which approved the EESA and TARP.

The EESA clearly states its goals,[116] which go beyond simple profit maximization to include socially beneficial outcomes. With an expansive view of corporate purpose, these socially beneficial goals are in accord with a proper corporate purpose. Because the federal government is bound to pursue the purposes enumerated in the EESA and TARP program, it is thus bound to pursue a proper corporate purpose. Because it is bound to pursue a proper corporate purpose, the federal government's interests are aligned with those of the corporation and we do not need the extra constraint of

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114. Verret, *supra* note 21, at 293.

115. *See generally id.* at 315-26 (providing an in-depth discussion of the failure of corporate law theory and practice to adequately respond to TARP); *see also id.* at 283 (updating "the six central theories of corporate law to reveal that none function adequately when considered with a controlling government shareholder" and "offer[ing] predictions for how Treasury's stock ownership reshapes the practice of corporate law").

116. Emergency Economic Stabilization Act (EESA) of 2008, 12 U.S.C. §§ 5201 (2008) *et seq.; see also* TARP REPORT, *supra* note 2, at 7 (stating the goals of the EESA).

fiduciary duties to remedy misaligned interests. Thus, if we accept a broad definition of the proper purpose of a corporation, we need not impose fiduciary duties on the federal government as a controlling shareholder.

A. The Debate Over the Proper Corporate Purpose

The debate over whom a corporation should serve "has origins deep in the past."[117] From the birth of the United States through the nineteenth century, "business enterprises were incorporated principally to serve some needed public purpose."[118] As time wore on, however, the American public became increasingly frightened of corporations and "the specter of enormous concentrations of power crushing down upon them" that they represented.[119] Consequently, the public began to distrust corporations. This growing fear was confirmed by "dramatic corporate abuses of power" that came to light in the aftermath of the 1929 market collapse.[120]

In the shadow of this growing public distrust of corporations came the famous 1932 publication by the Harvard Law Review of a "debate between two preeminent corporate scholars on the proper purpose of the public corporation."[121] On one side of the debate, Adolf Berle argued that "all powers granted to a corporation or to the management of a corporation, or to any group within the corporation . . . are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears."[122] On the other side of the debate, E. Merrick Dodd championed "a view of the business corporation as an economic institution which has a social service as well as a profit-making function."[123] Thus, at its core, the debate focused on whether the corporation must always act to maximize profits for shareholders or whether it can take actions that don't directly benefit shareholders, but might benefit others or society at large.[124] The issue debated by Professors Berle and Dodd has continued to rage on throughout the years, with "[l]aw journals . . . filled with articles arguing the different viewpoints."[125]

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117. A.A. Sommer, Jr., *Whom Should the Corporation Serve? The Berle-Dodd Debate Revisited Sixty Years Later*, 16 DEL. J. CORP. L. 33, 36 (1991).

118. *Id.*

119. *Id.*

120. *Id.*

121. Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1189 (2002) [hereinafter Stout, *Shareholder Primacy*].

122. A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931).

123. E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1148 (1932).

124. *See* Sommer, *supra* note 117, at 36 (providing an in-depth description of the history of corporate purpose and the events leading up to the Berle-Dodd debate).

125. *Id.* at 38.

Berle's view that corporations exist to make profits is supported by the familiar and frequently cited Michigan Supreme Court Decision of *Dodge v. Ford*, in which the court famously stated that, "[a] business corporation is organized and carried on primarily for the profit of the stockholders."[126] Although this quotation was "merely judicial dicta, quite unnecessary to reach the court's desired result," it "is cited almost invariably as evidence that corporate law requires corporations to have a 'profit maximizing purpose'[127] and that 'managers and directors have a legal duty to put shareholders' interests above all others.'"[128] As a result of this frequently cited opinion, as well as other well-known works such as Milton Friedman's *The Social Responsibility of Business is to Increase Its Profits,*[129] and Michael Jensen's *A Theory of the Firm*,[130] "most regulators and many scholars ha[ve] come to accept the maximization of shareholder wealth as the only goal of corporate governance."[131] Although the tradition of scholarly debate has continued, it has largely been confined to the pages of law reviews and other scholarly journals, rather than mainstream discussion in courts and legislatures.[132]

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126. Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) (holding that Henry Ford could not withhold dividends from shareholders because he thought the company was making too much money and wanted to invest in capacity to produce more affordable cars for the public good).

127. Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford*,* 3 VA. L. & BUS. REV. 163, 165 (2008) (internal quotations quoting Robert Charles Clark, CORPORATE LAW 678 (1986)) [hereinafter Stout, Dodge v. Ford].

128. *Id.* (second internal quotation quoting Joel Bakan, THE CORPORATION: THE PATHOLOGICAL PURSUIT OF PROFIT AND POWER 36 (2004)).

129. Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, at 33.

130. *See generally* Michael C. Jensen, A THEORY OF THE FIRM: GOVERNANCE, RESIDUAL CLAIMS, AND ORGANIZATIONAL FORMS (2000) (arguing that directors are agents hired by shareholders as principals and obligated to do everything in their power to maximize profits). This led to the principal-agent model of the corporation, which had broad appeal among scholars, the media, and practitioners and helped to advance the cause of shareholder primacy. *See* Lynn A. Stout, *Shareholders Unplugged,* LEGAL AFFAIRS, Mar./Apr. 2006, at 21[hereinafter Stout, *Shareholders Unplugged*].

131. Stout, *Shareholders Unplugged*, *supra* note 130, at 21; *see also* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV 247, 253 (1999) (noting that shareholder primacy "has been prominent in the legal and the economic literature for decades, but has become especially dominant in the last twenty years."); D. Gordon Smith, *The Shareholder Primacy Norm,* 23 J. CORP. L. 277 (1998) (discussing reasons why the shareholder primacy norm became so pervasive in the last two decades) (cited by Blair & Stout *supra* at 253 n.15); Roberta S. Karmel, *Should a Duty to the Corporation be Imposed on Institutional Shareholders?*, 60 BUS. LAW. 1, 1 (2004) ("[T]he shareholder primacy model has become the dominant model in scholarship theories with regard to the firm, although other models have been proposed and debated.").

132. Stout, Dodge v. Ford *supra* note 127, at 164 ("Although there is a tradition of scholarly debate among legal academics on this point, it has attracted little attention outside the pages of specialized journals.").

B. The Proper Corporate Purpose Should be More than Shareholder Wealth

Despite this widespread acceptance of shareholder primacy, Professor Dodd's view of the socially responsible corporation is far from dead. Several corporate law scholars continue to argue for a broader corporate purpose.[133] Professors Blair and Stout note that even the famed shareholder primacist, Adolf Berle, was ready to concede by the 1950s that corporations should use their powers for the entire community.[134] This view "is supported by a series of mid- and late-twentieth-century cases that have allowed directors to sacrifice shareholders' profits to stakeholders' interests when necessary for the best interest of 'the corporation.'"[135] As an example, the professors point out that:

> [J]udges have sanctioned directors' decisions to use corporate funds for charitable purposes; to reject business strategies that would increase profits at the expense of the local community . . . and to fend off a hostile takeover bid at a premium price in order to protect the interests of employees or the community.[136]

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133. *See*, e.g. Blair & Stout, *supra* note 131, at 253-54 n.16 (listing several works that adopt the argument of the "'communitarian' or 'progressive' school of corporate scholars who believe that corporate law ought to require directors to serve not only the shareholders' interests, but also those of employees, consumers, creditors and other corporate 'stakeholders.'"); Stout, *Shareholder Primacy, supra* note 121 (analyzing and dismissing common arguments for shareholder primacy); Karmel, *supra* note 131, at 4 (Examining how shareholder primacy contributed to scandals such as Enron and proposing "that managers and directors be required to consider the corporation as an enterprise as well as stockholders in making business decisions."); Booth, *supra* note 82, at 430-31 n.1 (noting that "[i]t is unclear . . . that any court has ever held management liable for its failure to maximize stockholder wealth or gain other than in the context of a takeover" and that "it is not entirely clear what it means to maximize stockholder wealth"); *see also* Stout, Dodge v. Ford, *supra* note 127 (arguing that Dodge v. Ford does not support the principle that profit maximization is the only permissible end for a corporation); Blair & Stout, *supra* note 131, at 253 (Arguing that a firm is made up of enterprise specific investments by members of a team and that "boards exist not to protect shareholders per se, but to protect the enterprise-specific investment of *all* the members of the corporate 'team.'").

134. Blair & Stout, *supra* note 131, at 303.

135. *Id.*

136. *Id.*; *See, e.g.* Theodora Holding Corp. v. Henderson, 257 A.2d 398 (Del. Ch. 1969) (use of funds for charitable purposes); Shlensky v. Wrigley, 237 N.E.2d 776 (Ill. App. Ct. 1968) (rejection of increased profit strategies that harm local community); Cheff v. Mathes, 199 A.2d 548 (Del. 1964) (rejection of hostile tender offer to protect jobs of employees).

The ongoing debate in the academic literature and the examples from case-law demonstrate that shareholder primacy and profit maximization, while widely accepted, are far from a universal conclusion.[137]

The debate over corporate purpose and the theory of corporate structure has produced several new theories of the firm. One of these theories, the team production theory, convincingly explains the functioning of a firm while allowing for consideration of interests besides shareholder profit maximization.[138] In addition to these alternate theories of the firm, other factors including the growth of constituency provisions in both state statutes and corporate charters, the increase in socially focused pension and hedge funds, and a growing diversity of shareholder interests, further support the view that a corporation can, and perhaps should, pursue goals besides pure profit maximization.

C. The Team Production Theory

The team production theory, developed by Professors Margaret M. Blair and Lynn A. Stout, views a corporation as a "team" of members who each make firm-specific investments.[139] The board of directors exists to encourage and protect these firm-specific investments by team members; thus, the purpose of the board of directors is "not to protect shareholders per se, but to protect the enterprise-specific investments of all the members of the corporate 'team,' including shareholders, managers, [and] rank and file employees."[140] Directors properly focus on the survival of the firm in order to protect these firm-specific investments and it is thus sometimes appropriate to sacrifice shareholder profits in order to ensure firm survival.[141] By recognizing that directors have an interest in the continued survival of the firm, this model allows for a broader view of director duties. Directors need not be concerned solely with maximizing shareholder profits, which represent the interests of only one member of the "team," but

137. *See* Stout, *Shareholder Primacy*, *supra* note 121, at 1190 (providing a detailed and convincing argument against shareholder primacy and a rebuttal of several of the primary justifications on which it is based). Stout addresses several justifications for the shareholder primacy norm and contends that the "arguments . . . are, as a positive matter, inaccurate, incorrect, and unpersuasive to the careful and neutral observer."

138. *See* Blair & Stout, *supra* note 131, at 288 (Arguing that corporate law treats directors as "independent hierarchs who are charged not with serving shareholders' interests alone, but with serving the interests of the legal entity known as the 'corporation'" and describing these corporate interests as "a joint welfare function of *all* the individuals who make firm-specific investments . . . [including] executives, rank-and-file employees, and equity investors . . . or even the local community.") (emphasis in original).

139. *See id.* at 288-89.

140. *Id.* at 253.

141. *See id.* at 293 ("[C]ase law makes clear that directors owe their fiduciary duties primarily to the corporation itself.").

they should focus on protecting the interests of all team-members who make contributions to the organization including "[e]xecutives, rank-and-file employees, and even creditors or *the local community*."[142] The team production model thus clearly views a firm as existing for more than the sole benefit of shareholders.

Under the team production model, fiduciary duties become less important as a restraint on director actions because of the board's primary focus on ensuring the survival of the firm. Directors clearly have a vested interest in the survival of the firm, as they are members of the team and have provided firm-specific investment. Furthermore, directors are obviously dependent on the continued existence of the firm in order to keep their job as directors, which they presumably desire to do.[143] Thus, they will be motivated to fulfill their duties to protect the firm-specific investments of team members by taking actions to ensure firm survival. Because the director's personal interests are largely aligned with the interests of the other team members, namely firm survival, fiduciary duties become less important to control their conduct.[144] Furthermore, these limited fiduciary duties are owed to the firm instead of to shareholders or any other specific team member.[145]

Similar to directors, the federal government as a controlling shareholder should be viewed as a member of the team who has provided firm specific investments and has a vested interest in the survival of TARP firms. The federal government has provided firm specific investments in the form of its capital infusion through TARP. Although equity ownership in a publicly traded firm generally does not fit the definition of firm specific investment because of the ability to sell the shares and re-invest in another firm, the federal government's ownership stake is different. The federal government has infused capital in TARP recipients with the specific purpose of stabilizing the recipient institutions and the economy at large.[146] Thus, this ownership stake is not freely alienable, as is traditional stock ownership, and the investment *is* firm specific. Although not specifically

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142. *Id.* at 250 (emphasis added).

143. *See id.* at 283 ("Directors are compensated, often quite handsomely, for their services to the coalition. This gives them an incentive to try to maintain their positions by satisfying the minimum demands of all of the important corporate constituencies, lest some critical constituents withdraw and the coalition fall apart. (After all, if the team falls apart, the directors lose their jobs.)").

144. *See supra* Part II. A-B.

145. Blair & Stout, *supra* note 131, at 289 ("By preserving directors' independence and imposing on them fiduciary obligations that run to the firm as a whole and not to any particular team member, corporate law reinforces and supports an essential economic role played by hierarchy in general, and by corporate boards of directors in particular.").

146. *See* TARP REPORT, *supra* note 2, at 3-4 ("These investments were not made to make money, but to help prevent a collapse of our financial system and lay the foundation for economic recovery.").

barred by the EESA or TARP guidelines, it is almost inconceivable that the federal government would sell its equity stake in a recipient institution to avoid suffering a monetary loss from the firm's failure or poor performance. Furthermore, the federal government has spent considerable political capital in the implementation of the TARP program. Allowing member institutions to fail or selling stock to avoid a loss would be extremely damaging politically. Thus, the investment is firm specific, because the fate of the federal government's investment is tied inseparably to the fate of the TARP firms.

In addition to providing firm specific investments, the federal government has a vested interest in the survival of the firm in order to protect other interests. Like directors, the federal government is motivated by factors other than return on investment in its exercise of control power. As noted earlier, directors focus on the survival of the firm in order to maintain their jobs and to a certain extent, their reputation (one is presumably less likely to be hired as a director at another firm after being a director at a failed firm). Similarly, the federal government is motivated by outside interests to ensure that TARP firms survive. At the very beginning of the TARP 2009 Annual Report, the executive summary clearly states that "[t]hese investments were not made to make money, but to help prevent a collapse of our financial system and lay the foundation for economic recovery."[147] TARP was seen as a last resort to prevent massive bank failures and to prevent a collapse of the financial system. The success of the program depended not on returns generated for shareholders of recipient institutions, but rather on the survival of these institutions themselves and on the stabilization of the entire financial system. Because of this primary goal of stabilizing the economic system through strengthening and ensuring the survival of TARP recipients, the federal government can be expected to use its power as a controlling shareholder to ensure firm survival, in accordance with the ultimate goal of the TARP program. Thus, like a director who can be expected to take actions that ensure firm survival, the federal government can be "trusted" without the added constraints of fiduciary duties because of its desire to ensure firm survival.[148]

When viewed through the prism of the team production theory, it becomes unnecessary to subject the federal government to fiduciary duties. The federal government, like a director, has both firm specific investments and other motivations that give it a vested interest in ensuring survival of

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147. *Id.*

148. Professors Blair and Stout, among others, note that traditional corporate law provides at best very weak restraints on director behavior. *See* Blair & Stout, *supra* note 131, at 291 ("American law in fact grants directors tremendous discretion to sacrifice shareholders' interests in favor of management, employees, and creditors in deciding what is best for 'the firm.'").

TARP firms. Because of this vested interest in firm survival, it is safe to assume that the federal government will act in the best interest of the *firm* (though not necessarily to maximize profits) in exercising its power as a controlling shareholder. The federal government will take actions that ensure firm survival and protect the firm-specific investments of the members of the "team" that make up the firm. Fiduciary duties are thus unnecessary because of the alignment of interests between the federal government and the team-members that compose TARP recipient firms.

D. Constituency Statutes

The growth of state law constituency statutes[149] provides further support for a broader view of corporate purpose.[150] Broadly speaking, constituency statutes allow the board of directors to consider the interests of other stakeholders, in addition to shareholders, in making corporate decisions.[151] These statutes largely grew out of the amendments to corporate charters that emerged in the late 1970s and early 1980s and allowed directors to consider "social and economic effects" on "employees, suppliers, customers and others" when deciding issues of corporate control.[152] These constituency statutes were passed as part of "the spate of state anti-takeover statutes passed in the 1970s and 1980s," largely as a result of the public's belief "that the takeover 'market for corporate control' caused . . . a geographical redistribution of wealth [and] an attendant loss of jobs."[153] Currently, thirty states have corporate constituency statutes.[154]

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149. As noted by one commentator, these statutes go by a variety of different names and the naming convention is at least partially dependent on the author's view of these provisions. *See* Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 16 (1992) ("Commentators refer to these statutes by different names, the choice of label depending chiefly on the author's view of the statutes."). Like Professor Orts, I will refer to the statutes by the "neutral label" of constituency statutes because it is both "conveniently short" and "comports with the avowed purpose of the statutes to include in corporate governance a broader 'constituency' of interests beyond those of shareholders." *Id.* at 18.

150. *See generally* Orts, *supra* note 149 (providing an overview of corporate constituency statutes and the myriad issues surrounding their passage and interpretation); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579 (1992).

151. Orts, *supra* note 149, at 16 ("[T]he statutes purport to expand the traditional view that directors of corporations have a duty to make business decisions primarily, if not exclusively, to maximize shareholders' wealth by explicitly permitting consideration of non-shareholder interests.").

152. *Id.* at 20 (quoting Robert H. Winter et. al., 1 Shark Repellants and Golden Parachutes 1293-94 (Supp. 1990)).

153. Orts, *supra* note 149, at 24.

Although constituency statutes were passed at least in part as an anti-takeover tool, they give directors broad leeway in making ordinary business decisions outside of the takeover context. Constituency statutes generally do not specifically focus on anti-takeover decision-making, but rather allow directors to "consider the effects of any action upon employees, suppliers and customers of the corporation, communities in which officers or other establishments of the corporation are located, and all other pertinent factors."[155] By explicitly allowing, and in some cases even requiring,[156] a consideration of the interests of non-shareholders, constituency statutes undermine the argument that shareholder profit maximization is the only permissible corporate purpose.

The broad array of interests that constituency statutes allow directors to consider supports the argument that they are inconsistent with the view of a corporation existing solely for the benefit of shareholders. The constituencies that directors may consider include "employees, suppliers and customers, [and] the communities in which the corporation does business."[157] Some states broaden this definition even further, allowing directors to consider "the economy of the state and nation" in making corporate decisions.[158] The inclusive nature of these constituency provisions make it clear that directors are not bound to solely consider shareholder profits. Additionally, the proliferation of these statutes among the states validates the broader view of corporate purpose by demonstrating its widespread appeal. Given the specific requirements of TARP that the federal government utilize its control power to "restore liquidity and stability to the financial system"[159] and to protect the American economy, a broad constituency provision, such as those that allow directors to consider the national and state economies, would likely shield the federal government from actions for breach of fiduciary duties.

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154. Brett H. McDonnell, *Corporate Constituency Statutes and Employee Governance*, 30 WM. MITCHELL L. REV. 1227, 1231 (2004) ("A total of thirty states now have some variant of a corporate constituency statute.").

155. 15 PA. CONS. STAT. ANN. § 5716 (West 1990). This is an example of an early constituency statute and is a good representation of the general language used in these statutes.

156. Orts, *supra* note 149, at 73-74 ("Connecticut *requires* consideration of non-shareholder interests. Iowa, Indiana, and Pennsylvania specifically provide that no particular interest, including shareholders, is to be considered 'dominant' or 'controlling.'") (emphasis added).

157. *Id.* at 26-27.

158. *Id.* at 29 (quoting FLA. STAT. ANN. § 607.0830(3) (West Supp. 1992); HAW. REV. STAT. § 415-35(b)(2) (Supp. 1991); MISS. CODE ANN. § 79-4-8.30(d)(2) (Supp. 1992); N.M. STAT. ANN. § 53-11-35(D)(2) (LexisNexis Supp. 1992); OHIO REV. CODE ANN. § 1701.59(E)(2) (Supp. 1991).

159. TARP REPORT, *supra* note 2, at 7.

There is no reason why the broad leeway to consider other interests granted to directors by constituency statutes should not be extended to the federal government as a controlling shareholder. The federal government is mandated by the enabling legislation of TARP to take actions to stabilize the national economy and financial system, through stabilizing individual institutions. This action clearly fits within the broad swath painted by corporate constituency statutes that allow consideration of communities in which companies do business and in some cases, even the state and national economy. Because the goals of TARP are a proper corporate purpose, there is no misalignment of interests and fiduciary duties are an unnecessary restraint on the federal government's power as a controlling shareholder.

E. Diversity of Shareholder Interests

The growing diversity of shareholder interests further bolsters the argument for a broader view of corporate purpose. As shareholder interests become increasingly heterogeneous, it becomes less tenable to view the corporation as existing solely for the economic benefit of shareholders. Because shareholders have diverse interests, even if the board was required to act *only* in their interests it would be hard to concretely define this interest. Surely many shareholders desire simple profit maximization, but "[o]n close analysis, shareholder interests look highly fragmented."[160] The current landscape of share ownership of U.S. public companies is dominated by institutional investors such as hedge funds, mutual funds, pension funds and life insurance policies.[161] This diversification leads to a splintering of shareholder goals, with some organizations, like pension funds, seeking long-term return on equity while others, such as hedge funds, seek short term growth in order to boost their track record.

Professor Anabtawi identifies "five schisms among modern shareholders" which include "the time horizon over which they expect to hold their shares . . . the extent to which their portfolios are diversified," and, most interestingly for our discussion, a conflict between traditional shareholders and those who "have targeted, non economic interests."[162] Each of these "schisms"[163] provides an independent justification for a

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160. Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 564 (2006).

161. *See id.* at 573 (discussing the rise in institutional investors); Romano, *supra* note 99, at 799 ("Pension funds hold a substantial and growing proportion of all corporate equity. . . . by 1989, they held over twenty-six percent."); Karmel, *supra* note 131, at 7 ("Institutional investors account for over half the ownership and seventy-five percent of the trading in equities listed on the New York Stock Exchange, Inc.").

162. Anabtawi, *supra* note 160, at 578-90.

163. *Id.* at 578.

broader view of corporate purpose and, thus, of the inappropriateness of imposing fiduciary duties on the federal government.

Investors with a short time frame, primarily hedge funds and mutual funds, will seek to increase the current value of the company's stock while sacrificing future profitability.[164] Long-term investors, such as pension funds and life insurance policies, prefer a stable and growing company, foregoing current profits to ensure future growth by investing in research and development and capital infrastructure that will pay off in the future.[165] This presents an obvious dilemma for a director or manager who "has a legal duty to put shareholders' interest above all others."[166] Whose interest should the director or manager consider? Those of the short-term or of the long-term shareholder?

Similar dilemmas are presented by the conflict between diversified and undiversified investors. In this case, the issue essentially boils down to tolerance for risk. All else being equal, diversified shareholders will desire riskier strategies, with higher potential returns because any potential loss is offset by other holdings in the diversified portfolio.[167] On the other hand, undiversified shareholders will desire safer strategies that will protect both their investment and, in many cases, their jobs.[168] Again, directors must make a decision in order to fulfill a mandate to act in the best interest of the shareholder without knowing precisely on which shareholder they should focus.[169]

Finally, conflict arises between those shareholders who have a non-economic purpose, such as socially focused hedge funds, pension funds, or labor unions and those who are solely motivated by a desire for profit.[170]

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164. *Id.* at 581.

165. *Id.* at 580-81.

166. Stout, Dodge v. Ford, *supra* note 127, at 165.

167. *See* Booth, *supra* note 82, at 434-35 (1998) (discussing the differences of preference in diversified versus undiversified investors, noting that the prototypical investor in the current market is diversified, and arguing for a conception of fiduciary duty "owed to an undiversified stockholder and thus owed to the corporation").

168. *Id.* Professor Booth notes that, "the prime example of an undiversified (but nonetheless rational) investor is management itself" and that they prefer less-risky strategies that will "assure the survival of the corporation" and are thus "more likely to act in the interests of other constituencies such as creditors, employees, and others." *Id.* at 436.

169. Professor Booth claims that even though the paradigmatic modern investor is diversified, management should make decisions that would be preferred by an undiversified investor, which "has the effect of incorporating a duty to other constituencies." *Id*. This view certainly seems to support a broader view of corporate purpose, as making decisions with an undiversified investor in mind leads the board to strongly consider the survival of the corporation and thus implicitly consider the interests of other constituencies.

170. *See* Anabtawi, *supra* note 160, at 588-90; *see also* Romano *supra* note 99 (describing and analyzing social investing by institutional investors); Marleen O'Connor, *Employees and Corporate Governance: United States: Labor's Role in the American Corporate Governance Structure*, 22 COMP. LAB. L. & POL'Y J. 97 (2000) (proposing a

Again, there is great difficulty defining the shareholder interests that a director must pursue. This conflict, as with the others, starkly demonstrates that due to diversity of shareholder interests, mandating that directors act only in the interest of shareholders is a mandate without meaning. Because of the wide diversity of shareholder interests, directors can pursue outside goals without breaching even the strictest standards of fiduciary duties that require directors to consider *only* the interests of shareholders. Directors can pursue these non-economic policies, at the expense of profit-maximization, and still be acting in the interests of at least *some* shareholders. This conflict tracks closely with the issues raised by constituency statutes and it demonstrates that many shareholders care about more than just profit maximization. Corporate law should recognize this reality and allow directors to consider interests other than the profit maximization goal of the paradigmatic investor.

Diversity of shareholder interests makes it impossible to define what it means to act in the best interest of shareholders. As a result, a mandate that directors act only in the best interests of shareholders lacks meaning because it is extremely difficult to identify these interests. Additionally, directors could plausibly argue that almost any actions that are in the interest of the broader corporate constituency (employees, suppliers, the community) are also in the interest of at least some conceivable shareholder.[171] As a result, it is more logical to avoid these complications and potential equivocations and recognize a broader corporate purpose that, as with constituency statutes, explicitly allows directors to consider the interests of employees, suppliers and the community at large, in addition to maximization of shareholder profits.

F. A Broader View of Corporate Purpose Makes Fiduciary Duties Unnecessary

Once it is accepted that corporate purpose should be viewed more broadly than mere profit maximization, the federal government's role as a controlling shareholder becomes less troublesome. The federal government is obligated by the enabling legislation of TARP to, among other goals, stabilize the national economy and the financial system and help preserve

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fiduciary duty of management to the worker and discussing the effectiveness of union pension fund activism to protect the interests of workers).

171. For example, a director could argue that an action taken to protect employees from job loss at the expense of profits could be viewed as an action taken to ensure long-term corporate survival and thus is in the best interest of an undiversified shareholder or an employee pension fund. A decision to refrain from environmental, but profitable, activities could be justified as being in the best interest of an environmentally-focused hedge fund or a state pension fund that used its shareholder power to advance the state's political views on environmental safety.

jobs.[172] Because a broader view of corporate purpose would accept these goals as legitimate corporate objectives, the interests of the federal government as a controlling shareholder are not misaligned with the proper corporate purpose. Thus, fiduciary duties are not necessary for the federal government, as it is obligated by statute to act in a way that is compatible with a proper corporate purpose and thus aligned with the interests of the corporation.

CONCLUSION

"The Great Recession of 2008"[173] has undeniably shifted the landscape of American society. It has fundamentally changed the functioning of the United States financial system, as well as the economy as a whole. While the unique situation of the federal government's large-scale ownership of equity in private institutions presents many challenges to traditional corporate law paradigms,[174] the problem of fiduciary duties is not as daunting as it first may seem.

The federal government is a controlling shareholder in all of the TARP institutions. It has taken definitive actions in many cases that demonstrate this control and it maintains the power to take further control actions.[175] The federal government's status as a controlling shareholder naturally leads to the conclusion that it should be subject to fiduciary duties to prohibit it from pursuing interests that may run contrary to the traditional corporate profit maximization norm.

Furthermore, the purposes of TARP and the underlying role of the government make it clear that the federal government's interests are misaligned with the paradigmatic corporate purpose: to generate profits for shareholders. The federal government is obligated to use its TARP power to stabilize the economy, to ensure the survival of participating institutions and to pursue the other goals of the EESA.[176] These goals can reasonably be analogized to social investing, which has been empirically shown to diminish returns.[177] Thus, it is clear that the federal government has

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172. *See* TARP REPORT, *supra* note 2, at 7 (stating the purposes of the EESA).

173. Rampell, *supra* note 4.

174. *See* Verret, *supra* note 21 (analyzing the applicability of six central theories of corporate law and concluding that none function adequately when confronted with a controlling government shareholder).

175. The federal government's control over TARP institutions is further evidenced by the recent trend of TARP recipients repaying funds in order to escape restrictions imposed as a condition of the program. *See* Matthias Rieker, *Citigroup, Wells Repay TARP Funds—Banks' Ability to Raise Capital is Sign of Health Though Concerns About Financial Industry Linger*, WALL ST. J., Dec. 24, 2009 at C3.

176. TARP REPORT, *supra* note 2, at 7.

177. Romano, *supra* note 99.

interests that go well beyond the traditional corporate purpose of shareholder wealth maximization and fiduciary duties would seem to be the natural tool to remedy these misaligned interests.

This could conceivably lead to an endless array of lawsuits challenging government actions as a breach of its fiduciary duty as a controlling shareholder because of the potential harm to profits from any given decision.

But we need not simply accept the argument that the only permissible corporate purpose is increasing shareholder wealth. Although increasing shareholder wealth is widely viewed as the primary corporate purpose,[178] this view is subject to vigorous academic debate.[179] Furthermore, the dominance of this view is being eroded by the proliferation of constituency provisions in both state statutes and corporate charters.[180]

If we accept a broader vision of corporate purpose, one that embraces not just shareholder profit maximization but also the general well-being of employees, shareholders and the local community, then the federal government's interests are no longer misaligned with the corporate purpose. The federal government's goals of stabilizing the national economy, preventing the failure of TARP firms and saving jobs coincide with this expanded view of corporate purpose.

This comment rejects the narrow view of a corporation as existing solely for the profits of its shareholders and embraces a broader view of a corporation with "a social service, as well as a profit-making function."[181] By adopting this broader view of corporate purpose, the federal government's interests are aligned with those of the corporation and it is therefore unnecessary to impose fiduciary duties upon the federal government, despite its status as a controlling shareholder.

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178. Stout, *Shareholders Unplugged*, *supra* note 130.

179. *See e.g.,* sources cited *supra* note 133; Aaron A. Dhir, *Realigning the Corporate Building Blocks: Shareholder Proposals as a Vehicle for Achieving Corporate Social and Human Rights Accountability*, 43 AM. BUS. L.J. 365 (2006); Kent Greenfield, *New Principles for Corporate Law*, 1 HASTINGS BUS. L.J. 89 (2005); G. Mitu Gulati, William A. Klein & Eric M. Zolt, *Connected Contracts*, 47 UCLA L. REV. 887 (2000).

180. *See supra* Part IV D.

181. Dodd, *supra* note 123, at 1148.