Banking and Finance Law Daily Wrap Up, TOP STORY—Fed. Cir.: Appellate court rejects Starr International claims over AIG bail-out, (May 9, 2017)

Banking and Finance Law Daily Wrap Up

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By Richard A. Roth, J.D.

Starr International Co. and the other American International Group shareholders it wanted to represent did not have standing to sue the government on claims that, under the 2008 AIG bail-out, the government illegally took control of AIG, the U.S. Court of Claims for the Federal Circuit has decided. Such claims were derivative of claims that belonged exclusively to AIG, according to the court. Starr's claims arising from a subsequent reverse stock split also were rejected (*Starr International Co., Inc., v. U.S.*, May 9, 2017, Prost, S.).

At what could be described as the height of the financial crisis, AIG found itself in desperate need of liquidity and was more than $75 billion short of what it needed, according to the court. The Federal Reserve Bank of New York agreed to bail AIG out of its troubles in order to avoid further damage to a financial system that already was severely stressed, due in part to the failure of Lehman Brothers.

Credit terms. The Federal Reserve Board's terms for the loan were harsh, indeed punitive, according to the Court of Federal Claims judge whose opinion was on appeal. AIG was to receive an $85 billion loan for which it would pay 12 percent interest. It also would transfer 79.9 percent of the ownership of AIG to the New York Fed in the form of preferred stock that could be converted to common stock.

Not long after, the New York Stock Exchange threatened to delist AIG due to a severe decline in the price of the company's shares. AIG shareholders—including Starr itself—voted in favor of a 1:20 reverse stock split. However, the split applied only to issued AIG shares, not to shares that were authorized but unissued. According to the majority opinion, this had two results:

1. The number of issued shares fell from about three billion to about 150 million, which caused share prices to increase enough to avoid the threatened delisting.
2. The number of issued shares was reduced enough that there were sufficient unissued shares for the government to convert its preferred shares to common shares.

That conversion took place more than a year later, and the government then was able to sell the common shares for a gain of more than $17.5 billion, the opinion said.

Starr's claims. Starr raised a number of claims against the government, but only two remained on appeal:

- The government's acquisition of AIG equity constituted an illegal exaction because the Fed did not have the authority to hold an equity interest in a company.
- The reverse stock split illegally deprived AIG shareholders of their right to stop the government from diluting their interest in the company by converting its preferred shares.

The Court of Federal Claims judge decided that the government had illegally taken the AIG interest. However, he also determined that AIG was due no compensation because, in the absence of the bailout, AIG would have collapsed. While the New York Fed's takeover reduced shareholders' equity to only 20 percent of what they once had, 20 percent of something was better than 100 percent of nothing (see *Banking and Finance Law Daily*, June 15, 2015).

Standing to sue. Before the merits of Starr's illegal exaction claim could be considered, the court had to determine whether the company had standing to sue the government. There was no dispute that the company had standing under the Constitution, the majority agreed. However, the question was whether Starr would have

been directly injured, as opposed to having been indirectly injured as a consequence of an injury to AIG. Starr could sue only for a direct injury, the majority pointed out, because one generally cannot sue to vindicate another person's rights.

Starr's action was derivative of injuries to AIG, not a direct action, the court decided. To prove an illegal exaction, the company would have to prove that AIG either was forced to overpay for the Fed's loan or to issue the shares without any legal basis. Either of these would be a direct harm to AIG, the opinion said. Any harm to the shareholders would be due to a reduction in the value of AIG, and that was an indirect claim.

According to the opinion, Starr's main argument in support of standing was based on a Delaware law "dual nature" exception, which recognized that some claims raised by a company's shareholders could be both direct and derivative. This exception applied if a majority or controlling shareholder used that power to cause the company to issue shares that increased the shareholder's ownership proportion.

Starr's problem was that the government was neither a majority nor a controlling shareholder at the time the 79.9 percent interest transfer was agreed to, the court said. AIG's desperate situation might have given the government great leverage in negotiations for the loan, but it did not impose on the government any duty to protect the shareholders' interests.

Other theories presented by Starr, based on a Supreme Court opinion the appellate court deemed to be irrelevant, on the Fifth Amendment "Takings Clause," and on a claim that the government intended to punish AIG's shareholders, failed as well.

Reverse stock split. Starr's claim that the government illegally reduced shareholders' interest in AIG through the reverse stock split and subsequent share conversion was a direct claim, the court agreed. However, the evidence did not show that the government had done anything illegal.

Starr alleged that the government had arranged and timed the reverse split in a manner that was intended to prevent the shareholders from being able to block the share conversion. The court disagreed, saying it was clear that the motivation behind the reverse split was to avoid the delisting of AIG's stock. Several facts supported that conclusion: the government could have converted much of its preferred holdings without the reverse split; common shareholders, including Starr, voted in favor of the split; and the government waited more than a year after the split to convert the preferred shares to common shares.

Concurring opinion. A concurring opinion by Judge Wallach would have rejected Starr's exaction claim for a different reason—that the Court of Federal Claims did not have jurisdiction under the Tucker Act in the absence of a "money-mandating source of law," which was not present.

Continuing, he said he believed that there was jurisdiction over Starr's claim that the government had taken its ownership interests without just compensation, in violation of the Fifth Amendment. However, Starr had no standing to bring the claim because it could not demonstrate that it had suffered a particularized injury—an injury to its own interests as opposed to the interests of AIG shareholders generally.

The case is No. 2015-5103 and No. 2015-5133.

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Companies: American International Group, Inc.; Starr International Company, Inc.

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