The Economic Freedom Amendment: A States-Based Response to the Nationalizing Effects of Bailouts and Federal Ownership of Corporate Stock

*By Aaron Jack**

Note from the Editor:

This paper discusses a proposed state constitutional amendment that would deny federal ownership of stock in state-chartered corporations. As always, The Federalist Society takes no position on particular legal or public policy initiatives. Any expressions of opinion are those of the author. The Federalist Society seeks to foster further discussion and debate about the constitutional and policy issues surrounding such an amendment. To this end, while this is a new proposal and thus has been the subject of little debate to date, we offer links below to different views on the financial crisis, and we invite responses from our audience. To join the debate, please e-mail us at info@fed-soc.org.

Related Links:

• Barbara Black, *The U.S. as "Reluctant Shareholder": Government, Business and the Law*, 5 Entrepreneurial Bus. L.J. 561 (2010): http://moritzlaw.osu.edu/eblj/issues/volume5/number2/black.pdf

• Steven M. Davidoff, *Uncomfortable Embrace: Federal Corporate Ownership in the Midst of the Financial Crisis*, 95 Minn. L. Rev. 1733 (2010): http://www.minnesotalawreview.org/articles/uncomfortable-embrace-federal-corporate-ownership-midst-financial-crisis/

• Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 Tex. L. Rev. 1293 (2011): http://www.texaslrev.com/sites/default/files/issues/vol89/pdf/KahanRock.pdf

• Benjamin A. Templin, *The Government Shareholder: Regulating Public Ownership of Private Enterprise*, 62 Admin. L. Rev. 1127 (2011): http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1636491&http://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=7&ved=0CF8QFjAG&url=http%3A%2F%2Fpapers.ssrn.com%2Fsol3%2FDelivery.cfm%3Fabstractid%3D1636491&ei=ZIcEUJ6_GceP0QHi9dDnBw&usg=AFQjCNEx2KYZ520oPgKa3lSnwkyOEVLH8g&sig2=bwdsY3hyFAeGAQYAVEJPLQ

The founding ideals of our Republic include adherence to the notion that we are a nation of laws and that these laws must be predictable and consistently enforced. However, during the 2008 financial crisis, the federal government set new precedents that may make it more likely that in the event of a future financial crisis, various high-ranking officials, some of whom are unaccountable to Congress or the President, could suspend current rules and contractual agreements.[1] The federal intervention during the most recent crisis substantially changed lien laws, bankruptcy priority rules, interest rate risk, freedom of contract, and private property rights, causing many to argue that the federal government promoted uncertainty and thus adversely impacted investors. State corporate law has neither anticipated nor accounted for adequately protecting shareholders in the midst of these changes.

I. The Financial Crisis and the Federal Response

In response to the 2008 financial crisis, the United States government instituted a massive bailout of banks, financial institutions, and automobile manufacturers.[2] While there had been isolated instances in the nation's history of direct governmental intervention intended to stem perceived threats to the national economy,[3] the methods used by the federal government to implement the 2008 bailout were unprecedented in nature and scope.[4]

In March 2008, when it appeared inevitable that the investment bank Bear Stearns was going to fail, the Treasury Department orchestrated a deal for J.P. Morgan to acquire Bear Stearns.[5] This government-sponsored merger contained provisions that did not follow established corporate law precedent.[6] During the implementation of the Troubled Asset Relief Program ("TARP"), there were instances in which the Treasury Department and the Federal Deposit Insurance Corporation ("FDIC") essentially required healthy banks to accept bailout funds.[7] Nearly a year later, General Motors ("GM") and Chrysler went into bankruptcy proceedings that were pre-negotiated by the federal government and contained terms that went beyond established bankruptcy procedure and creditor priority laws.[8] In short, throughout the 2008 financial crisis, the federal government suspended the rule of law in its efforts to stabilize the country's financial system. While some use a "success narrative" to defend these actions, the methods employed by the government during the financial crisis amount to what could be deemed the equivalent of the implementation of economic martial law.[9]

The bailout also led to the de facto nationalization of several state-incorporated companies.[10] Starting with the September

....

** Aaron Jack, J.D., M.B.A., is the Kansas Securities Commissioner, a position he was appointed to by Kansas Governor Sam Brownback in 2011. Aaron was previously the West-Central Zone Director for New York Life where his 3,200 registered representatives produced over $1.5 billion in sales annually. Aaron was the first director in the history of New York Life to raise $1 billion in new assets for the company's investment management subsidiary, NYLIM.*

2008 bailout of insurance giant American International Group, Inc. ("AIG"), the federal government acquired equity stakes in a multitude of private companies and became the controlling shareholder in some of the nation's largest auto manufacturing and financial companies.[11] As will be discussed in detail below, a myriad of ongoing issues are caused by this novel reality.[12] In its newfound role as controlling shareholder of private enterprise, the federal government has pressured these companies to take actions that are not intended to maximize shareholder value. Moreover, the federal government's sovereign immunity likely prevents minority shareholders from suing the government in shareholder suits. As a result, it will be more difficult for minority shareholders in these circumstances to protect their investment. This level of entanglement between the federal government and private industry is unprecedented in the United States.[13]

This article discusses the ability of individual states to enact legislation preventing the federal government from acquiring equity interests in state-incorporated companies.[14] Specifically, this article concludes that the federal government could be prevented from acquiring such interests if individual states amended their constitutions to ban the transfer of equity interests in companies to the federal government.

Some will argue such action is unnecessary due to the fact that the crisis is past and the federal government is not actively acquiring equity in private companies.[15] Others will maintain that the precedent of acquiring equity in private companies has been set,[16] and, if it is not prohibited from doing so, the federal government will be able to resort to such actions in times of stability or crisis. Passing a state constitutional amendment would ensure the ability of minority shareholders to protect themselves, create an obstacle to nationalization of private industry, and restore greater predictability to our national economy.[17]

II. Federal Government Ownership of State-Incorporated Companies During The Financial Crisis

The 2008 financial crisis began with the collapse of Bear Stearns in March 2008.[18] Although the federal government never acquired equity in Bear Stearns, it did orchestrate a deal that allowed J.P. Morgan to acquire Bear Stearns.[19] This involvement by the federal government in the Bear Stearns deal was significant because it sent a signal that large financial firms would not be allowed to fail.[20] However, in September 2008, the federal government allowed Lehman Brothers to fail,[21] opening itself to criticism by some that it was engaged in the practice of arbitrarily picking winners and losers.[22]

At the same time that the Bear Stearns and Lehman Brothers saga was playing out, insurance giant AIG was faltering.[23] The government employed a different strategy with AIG than it did with Bear Stearns. Instead of orchestrating an acquisition of AIG, the Federal Reserve gave AIG an $85 billion loan.[24] In exchange, the federal government received preferred shares in AIG that were convertible into common stock.[25] These shares represented 79.9% of the voting interest in AIG.[26] Eventually, the preferred shares were converted, and by March 2011, the government owned 92.1% of the outstanding shares of AIG common stock.[27] With this transaction, the federal government was in the business of owning equity stakes in state-incorporated companies.[28]

In October 2008, Congress passed the Emergency Economic Stabilization Act ("EESA"), which created TARP.[29] TARP authorized the Secretary of the Treasury to purchase toxic assets, including credit default swap obligations and other mortgage-backed securities, from struggling financial institutions.[30] The Act did not specifically authorize the government to purchase equity in the companies themselves.[31] Nonetheless, in its implementation of TARP, the Treasury Department continued the practice of purchasing equity interests in state-incorporated companies that it began with its pre-TARP acquisition of AIG.[32] Many scholars have stated that little evidence exists to suggest that Congress intended TARP funds to be used in this manner.[33]

In its implementation of TARP, the federal government also acquired interests in the financial conglomerate Citigroup.[34] By September 2009, the government held approximately 33.6% of Citigroup's common stock.[35] The Treasury Department began selling its Citigroup common stock in April 2010 and was fully divested by the end of that year.[36] This interest in Citigroup, though short-lived, led to criticism from some sectors that the federal government was willingly exercising control over the company to advance political goals.[37]

The Treasury Department used the Capital Purchase Program ("CPP"), an initiative of TARP, to purchase smaller equity stakes in a vast array of banks.[38] Reports indicate the Treasury Department spent $205 billion to acquire equity interests in 707 institutions.[39] Of the $205 billion, approximately $134 billion was injected into eight of the United States' largest financial institutions.[40] The remaining funds were invested in banks and financial institutions of various sizes across the country.[41] Notably, many of these banks were pressured by regulators to accept the TARP funds against their wishes.[42]

Starting in December 2008, the Treasury Department interpreted TARP to give itself the authority to intervene in the automobile industry by pouring capital into both GM and Chrysler.[43] Subsequently, both companies were restructured in bankruptcies that were pre-negotiated by the federal government. When the restructuring was completed, the federal government held 61% of the "new" GM and 8% of the "new" Chrysler.[44] While the federal government later entirely divested its equity interest in Chrysler in a deal coordinated with the Italian automaker Fiat, the new GM completed an initial public offering in November 2010. As of February 15, 2012, the federal government still held 31.9% of GM's outstanding common stock.[45]

Additionally, GMAC (later renamed Ally Financial), the financing company closely associated with GM, also received significant TARP funds when the federal government purchased large blocks of preferred stock.[46] This preferred stock was later converted into common stock.[47] As of February 28, 2012, the federal government held approximately 74% of Ally Financial's common stock voting power.[48] GMAC was clearly eligible to receive TARP assistance because GMAC was a bank holding company and TARP was specifically designed to assist such financial institutions.[49] However, as one scholar has illustrated, GM and Chrysler (as automobile manufacturers) did not fall within TARP's plain-meaning definition of a financial institution:

> For GM and Chrysler to fit [the] definition [of a "financial institution" under TARP], one must read the phrase "any institution, including, but not limited to" to sweep in institutions that are not financial institutions under any normal understanding of the term. As a matter of statutory interpretation, that argument hardly passes the smell test. As a matter of politics, the Treasury had little choice: Congress had already rejected a request to authorize funds to bail out the auto industry and had only passed the EESA on its second try. But however thin the basis under the EESA, it did not help the secured bondholders who objected in the Chrysler bankruptcy; they found out that they did not have standing to make the argument.[50]

The Treasury Department thus interpreted the EESA and TARP broadly to effectuate its bailout policies.

III. The Consequences of Nationalizing State-Incorporated Companies

Significant consequences are incurred when the federal government purchases equity in private companies. These consequences apply to the companies that were nationalized, their shareholders, and their competitors. The consequences manifest themselves through a series of conflicts of interest called "moral hazard."[51] Importantly, the effects of such conflicts of interest are not isolated to wealthy shareholders. These conflicts affect large institutional investors as well as small retail investors. Every person holding a mutual fund, individual retirement account, 401(k) account, or pension fund is touched.[52] In this manner, the consequences of nationalizing private industry are borne by the average Main Street investor.

One conflict of interest that can affect ordinary shareholders occurs when the federal government pressures a company to choose actions intended to advance the public interest rather than actions intended to maximize firm value because "[t]he government's interests are political not financial."[53] Thus, when the federal government is involved in a business as a going concern, the company might embark on a mandated course of action designed to enhance the federal government's political objectives at the expense of ordinary shareholders.

This type of conflict is not merely theoretical. The post-bailout landscape contains many examples of companies being forced to take actions that advanced the government's goals but were not necessarily beneficial to the company's bottom line. For instance, in October 2009, Citigroup sold a highly profitable energy trading unit at a bargain price due to the federal government's displeasure with a bonus that the unit's chief was scheduled to receive.[54] The federal government was more concerned with cracking down on executive compensation than maximizing shareholder value. One Citigroup shareholder summarized the situation in this fashion: "The message is that Vikram Pandit is not the C.E.O. of the company. You take the only division in the last 10 years that has consistently made money, and you give it away because you can't take government backlash. Nobody in their right mind would make this deal."[55] In an effort to explain the sale, a Citigroup executive is reported to have said, "We had to think of the risks the company would be under from an irritated administration or pay master."[56]

The Citigroup sale of its energy trading unit is not an isolated case. Since its restructuring, GM has increased its emphasis on hybrid and electric vehicles at the behest of the Administration and not because of sound economic reasons.[57] Both the Obama Administration and Congress pressured banks that had received bailout funds to increase lending, despite the banks' fears that such lending was unsound.[58] The most recent 10-Ks for GM and Ally Financial contain statements disclosing the fact that the Treasury Department owns a substantial interest in the companies and that the Treasury Department's interests "may differ from those of our other stockholders."[59] GM and Ally Financial view the moral hazard created by federal ownership as material enough to be disclosed to other shareholders.

Federal ownership of equity in private industry also allows individual members of Congress to pressure companies to choose actions that advance the congressperson's political interests rather than actions intended to maximize shareholder value. When GM decided to close several dealerships across the country, members of Congress stepped in to "save" dealerships in their districts. For example, Sens. Amy Klobuchar of Minnesota and Jay Rockefeller of West Virginia (among several others)[60] intervened to rescue dealerships in their home states.[61] Rep. Barney Frank of Massachusetts apparently persuaded GM to postpone the closing of a parts distribution center in Norton, Massachusetts.[62] Additionally, when GM decided to quit purchasing palladium from a mine in Montana and instead purchase it from cheaper suppliers in Russia and South Africa, Sens. Max Baucus and Jon Tester of Montana convinced GM to continue using the more expensive Montana supplier.[63] As a result of these actions, members of Congress were able to garner the favor of constituents while putting shareholder value at risk. While a member of Congress fighting for what is best for his or her constituents is not problematic in itself, moral hazard occurs when that member of Congress must choose between protecting their constituents and fulfilling their fiduciary duty as a controlling shareholder.

At a more basic level, the federal government's traditional role within the marketplace has been as regulator, not co-owner or competitor. But now that the federal government has an ownership interest in a few hand-picked companies that it regulates, companies in which the government has an interest may consequently receive preferential treatment compared to their competitors and new entrants. In other words, preferential treatment from regulators gives companies that are owned by the federal government a competitive advantage. The result is an uneven playing field that could negatively impact the value of shares in firms that compete with federally owned firms.

Once again, this is more than a theoretical concern. One scholar has observed that "government-owned banks receive regulatory preferences and are more likely to obtain government backing than non-government institutions."[64] Additionally, as part of GM's restructuring, the IRS allowed certain operating losses from the old GM to pass forward to the new GM. The new GM was given a tax break that could be worth up to $45 billion. However, a company that restructures as GM did is not normally entitled to such a tax break.[65]

The Treasury Department's equity stake in TARP recipients, combined with its ability to influence the management of those companies, likely makes it a controlling shareholder under state corporate law. The risk disclosures within AIG's February 2012 10-K report specifically acknowledge the federal government as a controlling shareholder.[66] Ordinarily, minority shareholders in a corporation can sue a controlling shareholder in state court for breach of fiduciary duty in order to remedy certain conflicts of interest.[67] However, the doctrine of sovereign immunity "holds that the U.S. Government cannot be sued except insofar as it has waived its immunity."[68] Because the federal government is legally a controlling shareholder in TARP companies, it is likely that its sovereign immunity, unless waived, will block any shareholder suit for breach of fiduciary duty against the federal government.[69] Consequently, the protections that state law affords minority shareholders mean little when the federal government acquires equity in state-incorporated companies.[70] Our current corporate law structure does not contemplate federal ownership of these companies and is therefore inadequate to deal with these developments.

IV. A Proposal to Prevent Federal Government Ownership of Private Industry

In the last few years, scholars have proposed various new laws, regulations, and rules that attempt to provide an expanded legal framework for federal ownership of private industry.[71] Although echoing these scholars in concluding that our current political and legal system is ill-suited to cope with the federal government as a shareholder, this paper proposes that a prohibitory, rather than a regulatory, approach should be adopted. This proposal is based on the belief that the nationalizing effect of the federal government's ownership in private companies is in fundamental disagreement with our founding principles and constitutional framework.[72] By prohibiting the transfer of equity interests in private companies to the federal government, policymakers can more aptly restore the rule of law within our legal system and, correspondingly, will more amply protect shareholders.

a. Current Federal Law Does Not Prevent Federal Ownership of Private Enterprise

Despite stated attempts to "end too big to fail" and "end bailouts," Congress has not yet prohibited governmental ownership of state corporations in the wake of the 2008 crisis. In 2010, Congress responded to the public outcry caused by the pre- and post-TARP bailouts by enacting the Dodd-Frank Wall Street Reform & Consumer Protection Act ("Dodd-Frank").[73] Dodd-Frank was intended to end future bailouts and the policy of "too big to fail."[74] A discussion of whether Dodd-Frank is an effective solution in preventing another financial crisis is outside the scope of this article.[75] However, for purposes of this proposal, no Dodd-Frank Act provision or corresponding agency-adopted rule directly prohibits the federal government from acquiring interests in state-incorporated companies.[76]

Furthermore, although an amendment to our Federal Constitution would be the most effective method of limiting the federal government's ability to acquire ownership interests in private companies, no such constitutional ban has been enacted to date. In January 2011, Rep. Michael Turner of Ohio introduced such a proposal in the U.S. House of Representatives, but the proposed amendment never passed and did not receive a full chamber debate.[77]

b. States-based Response to Federal Ownership of Private Companies

If Congress is unwilling, either statutorily or constitutionally, to effectively limit the federal government's ability to nationalize private industry, it is left to the states to lead. States can act by amending their constitutions to prohibit the transfer of equity stakes in entities that are formed under state law to the federal government. Proposed language for such an amendment is as follows:

> Any transfer to the United States, or any entity controlled by the United States, of any ownership interest in any entity formed pursuant to the laws of this state shall be prohibited, provided, the foregoing prohibition shall not apply to any investments through pension funds operated by the United States or any entity controlled by the United States.

This proposed amendment allows states to adopt an absolute policy against the nationalization of private industry. By inserting the prohibition in its constitution, an adopting state will be placing a premium on the issue and enabling itself to protect shareholders against the effects of federal government ownership in state-incorporated companies.

It should be noted that a broadly drafted amendment, absent a phrase exempting federal pension plans, may prevent pension funds that are operated by the U.S. government from holding stock in companies formed under state law. Many of the same criticism of federal ownership of private companies as a means of preventing systemic collapse can and have been made of federal investment in the stock market by federal pension plans.[78] However, enforcing a prohibition that would extend to federal pension plans may create a complicated legal framework and corresponding unforeseen consequences. To alleviate this concern, an appropriate limiting phrase has been included in the language of the proposed amendment.[79]

c. The Constitutionality of the Proposed Amendment

1. The Supremacy Clause

A state prohibition on federal government action immediately raises questions of constitutionality. After all, the Supremacy Clause of the U.S. Constitution makes it clear that valid federal laws prevail over conflicting state laws.[80] However, U.S. Supreme Court jurisprudence has traditionally held that the general power to charter corporations is the province of the states.[81] In this role, states have had the authority to determine the privileges and rights associated with corporate shares.[82] Such authority has been held to extend to regulating and even prohibiting certain types of corporate share transfers.[83]

Therefore, a state constitutional amendment that prohibits certain transfers of corporate shares is well within a state's power.

Moreover, the fact that the proposed amendment prohibits "transfers" to the federal government does not make the amendment unconstitutional. Notably, the Supreme Court has previously upheld a state's prohibition on transferring property to the U.S. government. In *United States v. Fox*, the Supreme Court upheld a New York statute prohibiting testamentary transfers to the U.S. government of real estate located within the state of New York.[84] In support of its conclusion, the Court stated:

> The power of the State to regulate the tenure of real property within her limits, and the modes of its acquisition and transfer, and the rules of its descent, and the extent to which a testamentary disposition of it may be exercised by its owners, is undoubted. It is an established principle of law, everywhere recognized, arising from the necessity of the case, that the disposition of immovable property, whether by deed, descent, or any other mode, is exclusively subject to the government within whose jurisdiction the property is situated . . . . The title and modes of disposition of real property within the State, whether inter vivos or testamentary, are not matters placed under the control of federal authority. . . . Every person must, therefore, devise his lands in that State within the limitations of the statute or he cannot devise them at all. His power is bounded by its conditions.[85]

The Court reached this conclusion despite the federal government's argument that "its power to take and hold lands, either by gift, contract, or force, is not derived from, nor can it be defeated by, State legislation."[86]

The *Fox* decision was reaffirmed in 1950 by the Court in *United States v. Burnison*.[87] In *Burnison*, the federal government challenged a California statute that prohibited a California resident from making an unrestricted testamentary gift to the United States.[88] The federal government argued that such a statute violated the Supremacy Clause and asked the Court to overrule the *Fox* decision.[89] Instead, the Court upheld the California statute.[90] Furthermore, the concept that a state can prohibit the testamentary transfer of real estate to the federal government was extended to also include personal property.[91] As a result, just as a state can prohibit testamentary transfers of real or personal property to the federal government and because equity interests are personal property, a state can also prohibit the transfer of equity interests in entities that are incorporated under state law to the federal government.[92]

2. The Dormant Commerce Clause

A state prohibition on the transfer of corporate shares to the federal government does not violate the Dormant Commerce Clause. In *CTS Corp v. Dynamics Corp of America*, the Supreme Court affirmed the constitutionality of an Indiana statute that regulated the acquisition of "control shares" for companies that were incorporated in Indiana.[93] The Court began by pointing out that the statute would have the same effect on both Indiana residents and residents of other states, and thus the statute did not "discriminate against interstate commerce."[94] The Court went on to declare that the statute did not subject shareholders to inconsistent regulations.[95] The Court found that as long as each state regulates only "the corporations it has created, each corporation will be subject to the law of only one State."[96] The Court supported this conclusion by stating that "no principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations . . . ."[97] Finally, the Court explained that the corporation exists as a creature of state law.[98] Thus, "it possesses only those properties which the charter of its creation confers upon it . . . ."[99] Furthermore, the Court found that the state that creates a corporation has an interest in protecting the rights of shareholders and "promoting stable relationships among parties involved in the corporations it charters . . . ."[100] Consequently, when a state regulates its own corporations, even to the extent that certain transactions are prohibited, the Dormant Commerce Clause is not violated.

The proposed constitutional amendment is similar to the Indiana statute that was affirmed in *CTS*. First, it applies evenly to both residents and non-residents of an adopting state. Second, it only applies to entities formed under the adopting state's law. Third, states have a strong interest in protecting shareholders and corporations formed under state law. Therefore, Supreme Court precedent establishes that the proposed amendment does not violate the Dormant Commerce Clause.[101]

3. The Takings Clause

Finally, the proposed amendment does not violate the Takings Clause. The amendment effectively prohibits both individuals and corporations from transferring ownership interests in companies formed under state law to the federal government. It could be argued that this prohibition amounts to a regulatory taking because it restricts the free alienation of corporate shares and thus reduces their value. However, such an argument is not likely to succeed.

Traditionally, the Takings Clause has only been applied to real property. Personal property has been treated as being "less protected from regulatory takings than real property."[102] Moreover, the Supreme Court has implied that even regulation that renders personal property economically worthless would not violate the Takings Clause.[103] Because ownership interests in companies are undisputedly personal property, a regulation that restricts the alienability of corporate shares is not likely to violate the Takings Clause.

Furthermore, even as applied to real property, the Takings Clause is not violated unless a governmental regulation prohibits all economically beneficial use of the property.[104] Prohibiting the transfer of corporate shares to the federal government will not render the shares worthless. In fact, the proposed amendment may increase the value of those investments by removing the risks created by the uncertain legal framework for government ownership. Accordingly, it is not likely that the proposed amendment would violate the Takings Clause.

V. Conclusion

In order to deal with the unprecedented federal ownership of private companies in the wake of the 2008 financial crisis, the nation and the individual states face the choice of either expanding the administrative state in an attempt to protect shareholders from possible harms caused by this ownership or drawing a bright-line rule prohibiting such nationalization. The overall policy of the amendment proposed above is based on fostering state and national markets in which clear rules of law govern the conduct of competing entities. A state ban on the transfer of equity interests in companies to the federal government would slow the nationalizing and market-distorting effects of this type of government intervention. The proposed amendment would protect non-government shareholders in these companies from being exposed to the unique risks created when the federal government becomes a controlling shareholder of private companies. Moreover, because states have broad authority to regulate companies that are formed under state law, a state prohibition on transfers of interests in those companies to the federal government would likely survive constitutional challenges under long-standing Supreme Court jurisprudence.

The proposed amendment will not prevent all types of future market intervention by the federal government, but it will prevent the most egregious form of intervention— federal acquisition of equity stakes in state-incorporated companies. As a result, the proposed amendment realigns state and federal economic policies with our founding principles by limiting the federal government to its proper role as a neutral regulator rather than a vested owner of private enterprise.

Endnotes

1 *See* C. Boyden Gray & John Shu, *The Dodd-Frank Wall Street Reform & Consumer Protection Act of 2010: Is It Constitutional?* Engage, Vol. 11, Issue 3, at 66 (2010).

2 *See generally* Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 Admin L. Rev. 463 (2009).

3 Baird Webel, Marc Labonte & N. Eric Weiss, Cong. Research Serv., The Cost of Governmental Financial Interventions, Past and Present 6-8 (Jan. 8, 2009).

4 J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory & Practice*, 27 Yale J. on Reg. 283, 293 (2010). The U.S. government has a long history of federally chartering corporations in order to accomplish a public purpose. *See generally* Kevin Kosar, Cong. Research Serv., Federal Government Corporations: An Overview (June 8, 2011). This history includes national use of state-incorporated companies to accomplish federal goals. *See* Lebron v. Nat'l R.R. Passenger Corp., 513 U.S. 374, 386-91 (1995) (discussing the "long history of corporations created and participated in by the United States for the achievement of governmental objectives"). Prior to the 2008 financial crisis, however, never before had the federal government taken a controlling stake in publicly traded, state-incorporated businesses solely in order to save the profitability of (and thus reduce systemic risk caused by) those companies. J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory & Practice*, 27 Yale J. on Reg. 283, 293 (2010). "Despite a rich history of government involvement in creating business and privatizing government functions as business, 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." *Id.*

5 Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 Admin L. Rev. 463, 473 (2009).

6 *Id.* at 475.

7 *Documents: Paulson forced 9 banks to take TARP,* Hartford Business.com, May 14, 2009, http://www.hartfordbusiness.com/news8920.html.

8 Todd Zywicki, *The Auto Bailout and the Rule of Law*, Nat'l Aff., Issue 7, at 66, 74-76 (Spring 2011).

9 Todd Zywicki, *The Auto Bailout and the Rule of Law*, Nat'l Aff., Issue 7, at 66, 69-70 (Spring 2011); Vern McKinley, Financing Failure: A Century of Bailouts 32 (2011) (describing "success narrative").

10 As used in this article, the term "state-incorporated" is used to mean any private or publically traded company incorporated or otherwise formed under the business entity formation laws of a state.

11 Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 Admin L. Rev. 475 (2009). Part of the contemporaneous arguments and later "success narratives" used to justify the government's purchase of equity in troubled firms included the assertion that U.S. taxpayers would end up profiting from the "investments." *See, e.g.*, Bob Blandeburgo, *U.S. Turning a Profit on TARP, But Big Loans Remain in Banks' Hands*, Money Morning, Sept. 1, 2009, *available at* http://moneymorning.com/2009/09/01/tarp-profit; Philip van Doom, *TARP Yields $20 Billion Profit, Treasury Says*, The Street, Mar. 17, 2011, *available at* http://www.thestreet.com/story/11049777/tarp-yields-20-billion-profit-treasury-says.html; Steve Schaefer, *Treasury Says TARP Turning into a Moneymaker for Taxpayers*, Forbes, Apr. 13, 2012, *available at* http://www.forbes.com/sites/steveschaefer/2012/04/13/treasury-says-tarp-is-turning-into-a-moneymaker-for-taxpayers. However, arguments against the "moral hazard" created by such governmental ownership supersede the "profit-motive" justification. *See infra* notes 51-71 and accompanying text. Moreover, the federal government's claims that U.S. taxpayers have actually profited from its TARP "investments" have been recently called into question, most notably by the Special Inspector General for TARP ("SIGTARP"), Christy Romero. *See* Office of the SIGTARP, Quarterly Report to Congress (Apr. 25, 2012), *available at* http://www.sigtarp.gov/Quarterly%20Reports/April_25_2012_Report_to_Congress.pdf (hereinafter "SIGTARP Report"); *see also* John Lott, *Obama and GM Cook the Books*, Nat'l Rev., May 16, 2012, *available at* http://www.nationalreview.com/articles/300075/obama-and-gm-cook-books-john-lott-jr#. According to the April 25, 2012 SIGTARP report, "[i]t is a widely held misconception that TARP will make a profit. The most recent cost estimate for TARP is a loss of $60 billion. Taxpayers are still owed $118.5 billion (including $14 billion written off or otherwise lost.)" *See* SIGTARP Report at 5; *see also* David Harsanyi, *Inspector General Report Ends Myth that TARP 'Turned A Profit,'* Human Events, May 7, 2012, *available at* http://www.humanevents.com/article.php?id=51297.

12 *See infra* section III.

13 *See supra* note 4.

14 The state legislation proposed in this article would apply to all non-governmental business entities formed under the general laws of a state and not just those taking the corporate form (e.g., limited liability companies, limited liability partnerships, etc.). To distinguish from those companies and corporations "chartered" by a governmental entity, this article uses the term "state-incorporated" as opposed to "state-chartered" to describe these types of non-governmental for-profit businesses. *Contra* J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory & Practice*, 27 Yale J. on Reg. 283, 293 (2010) (distinguishing corporations created by "government charter" from "state-chartered" companies).

15 Baird Webel, Cong. Research Serv., Troubled Asset Relief Program (TARP): Implementation and Status 3 (Mar. 4, 2011).

16 *See* Louise Story & Gretchen Morgenson, *In U.S. Bailout of A.I.G., Forgiveness for Big Banks*, N.Y. Times, June 29, 2010, *available at* http://www.nytimes.com/2010/06/30/business/30aig.html?pagewanted=all.

17 *See infra* section IV, subsection b.

18 *See* Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 Admin L. Rev. 463, 473 (2009).

19 *See id.* at 474.

20 *See id.*

21 *See id.* at 493.

22 This paper does not fundamentally challenge the decision of the federal government to allow Lehman Brothers to fail, but rather the decision to treat similarly situated businesses unequally. In fact, the decision to allow Lehman Brothers to fail was more consistent with the federal government's traditional role as regulator rather than market intervener. As one scholar has noted, the failure of Lehman Brothers actually more quickly infused certainty into the markets, while the decision to "bail out" and nationalize AIG created residual uncertainty: "[One of the benefits of the Lehman Brothers failure was that] Lehman [now] is resolved and no longer hangs over the financial system as an uncertainty, unlike the status of bailed-out, nationalized institutions like AIG, Fannie Mae, and Freddie Mac, which have lingered on for many years after the initial bailout." Vern McKinley, Financing Failure: A Century of Bailouts 32 (2011).

23 *See* Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 Admin L. Rev. 463, 494 (2009).

24 Steven M. Davidoff, *Uncomfortable Embrace: Federal Corporate Ownership in the Midst of the Financial Crisis*, 95 Minn L. Rev. 1733, 1738 (2010-2011).

25 *Id.*

26 *Id.*

27 Baird Webel, Cong. Research Serv., Troubled Asset Relief Program (TARP): Implementation and Status, 3 (Mar. 4, 2011). It is now reported that the government ownership interest is approximately 70%. *See* Carol Massar & Noah Buhayar, *AIG's Miller Says U.S. Exit Could Be Done Within 12 Months*, Bus. Rep. (2012), *available at* http://www.bloomberg.com/news/2012-04-13/aig-s-miller-says-u-s-exit-could-be-done-within-12-months-1-.html.

28 AIG, along with all other companies discussed in this article (e.g., Citigroup, GM, Chrysler, and GMAC/Ally) are companies formed under state law. Although the federal government also nationalized Fannie Mae and Freddie Mac, which were federally chartered institutions, the scope of this article deals solely with the government's acquisition of equity interests in state-incorporated companies.

29 Baird Webel, Cong. Research Serv., Troubled Asset Relief Program (TARP): Implementation and Status (Mar. 4, 2011).

30 *Id.* at 3.

31 Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 Tex. L. Rev. 1293, 1343 (2011).

32 *See generally* Baird Webel, Cong. Research Serv., Troubled Asset Relief Program (TARP): Implementation and Status (Mar. 4, 2011).

33 Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 Tex. L. Rev. 1293, 1343 (2011); Matthew R. Shahabian, *The Government as Shareholder and Political Risk: Procedural Protections in the Bailout*, 86 N.Y.U. L. Rev. 351, 357 (2011); J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory & Practice*, 27 Yale J. on Reg. 283, 294 (2010).

34 Baird Webel, Marc Labonte & N. Eric Weiss, Cong. Research Serv., The Cost of Governmental Financial Interventions, Past and Present 6-8 (Jan. 8, 2009).

35 Steven M. Davidoff, *Uncomfortable Embrace: Federal Corporate Ownership in the Midst of the Financial Crisis*, 95 Minn L. Rev. 1733, 1742 (2010-2011).

36 *Id.* at 1744.

37 Matthew R. Shahabian, *The Government as Shareholder and Political Risk: Procedural Protections in the Bailout*, 86 N.Y.U. L. Rev. 351, 362 (2011); *see infra* notes 52-54 and accompanying text.

38 J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory & Practice*, 27 Yale J. on Reg., 283, 294 (2010).

39 U.S. Dep't of the Treasury, Investment Programs: Capital Purchase Program, http://www.treasury.gov/initiatives/financial-stability/programs/investment-programs/cpp/Pages/capitalpurchaseprogram.aspx (last visited June 8, 2012); Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 Tex. L. Rev. 1293, 1303 (2011).

40 J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory & Practice*, 27 Yale J. on Reg. 283, 294 (2010).

41 *See generally* Troubled Asset Relief Program (TARP), Monthly Report to Congress, March 2012 (Apr. 10, 2012).

42 *Documents: Paulson Forced 9 banks to take TARP*, HartfordBusiness.com, May 14, 2009, *available at* http://www.hartfordbusiness.com/news8920.html.

43 Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 Tex. L. Rev. 1293, 1311-12 (2011); *see* Todd Zywicki, *Government by Waiver*, Nat'l Aff., Issue 7, at 66, 68-69 (Spring 2011) (describing the history of the auto bailouts and the corresponding political process).

44 Todd Zywicki, *The Auto Bailout and the Rule of Law*, Nat'l Aff., Issue 7, at 66, 68-69 (Spring 2011).

45 *See* Press Release, U.S. Dep't of the Treasury, Treasury Exits Investment in Chrysler Group LLC (July 21, 2011), *available at* http://www.treasury.gov/press-center/press-releases/Pages/tg1253.aspx; Todd Zywicki, *The Auto Bailout and the Rule of Law*, Nat'l Aff., Issue 7, at 66, 68-69 (Spring 2011).

46 Baird Webel, Cong. Research Serv., Troubled Asset Relief Program (TARP): Implementation and Status 8 (Mar. 4, 2011).

47 *Id.*

48 Ally Financial Inc., Annual Report (Form 10-K), at 22 (Feb. 28, 2012).

49 Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 Tex. L. Rev. 1293, 1311-12 (2011) (citing 12 U.S.C. § 5202(5)).

50 Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 Tex. L. Rev. 1293, 1311-12 (2011).

51 *See generally* Kevin Dowd, *Moral Hazard and the Financial Crisis*, 29 Cato J. 141 (2009); *see also*, Benjamin A. Templin, *The Government Shareholder: Regulating Public Ownership of Private Enterprise*, 62 Admin. L. Rev. 1127, 1128-29 (2010) (listing a series of ethical questions posed when the government intervenes in the marketplace as an active shareholder). Although one scholar has referred to such instances of moral hazard as mere "misunderstandings," the concessions she makes in her justifications of these instances are notable:

> Of course there has been government involvement [in board decisions of bailed-out companies], and indeed the government would be acting recklessly if it did not act to protect the billions of dollars of government funds at risk. Accordingly, the government has intervened behind the scenes principally in its roles as creditor, regulator, and politician. The government has intervened in a less systematic and more confrontational manner that has led to misunderstandings, as for example: the TARP Special Master making decisions on executive compensation that made no business sense to the AIG Chairman; Citigroup being confused about what the various federal regulators expected from it; and Congress placing restrictions on the ability of the automakers to cancel dealerships and downsize.

See Barbara Black, *The U.S. as "Reluctant Shareholder": Government, Business and the Law*, 5 Entrepreneurial Bus. L.J. 561, 593 (2010).

52 J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory & Practice*, 27 Yale J. on Reg. 283, 288 (2010).

53 Mathew R Shahabian, *The Government as Shareholder and Political Risk: Procedural Protections in the Bailout*, 86 N.Y.U. L. Rev. 351, 364 (2011).

54 Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 Tex. L. Rev. 1293, 1305 (2011).

55 Eric Dash & Jack Healy, *Citigroup Sheds Energy Unit and Its $100 Million Trader*, N.Y. Times, Oct. 9, 2009, *available at* http://www.nytimes.com/2009/10/10/business/10citi.html.

56 *Id.*

57 Todd Zywicki, *The Auto Bailout and the Rule of Law*, Nat'l Aff., Issue 7, at 66, 76 (Spring 2011).

58 Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 Tex. L. Rev. 1293, 1303 (2011).

59 GM 10-K at 22-23; Ally 10-K at 22.

60 Arizona Representative Gabrielle Giffords, New York Senator Charles Schumer, and New York Representative Dan Maffei also directly intervened in GM affairs to keep open dealerships in their districts. Todd Zywicki, *The Auto Bailout and the Rule of Law*, Nat'l Aff., Issue 7, at 66, 77 (Spring 2011).

61 *Id.*

62 Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 Tex. L. Rev. 1293, 1304 (2011).

63 Todd Zywicki, *The Auto Bailout and the Rule of Law*, Nat'l Aff., Issue 7, at 66, 68-69 (2011).

64 Verret, *supra* note 4, at 306.

65 Randall Smith & Sharon Terlep, *GM Could Be Free of Taxes for Years*, Wall St. J., Nov. 3, 2010, *available at* http://online.wsj.com/article/SB100014240527487044627045755906421491032 02.html.

66 American International Group, Inc., Annual Report (Form 10-K), at 40 (February 23, 2012).

67 Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 Tex. L. Rev. 1293, 1323 (2011).

68 *Id.* at 1325.

69 *See id.* at 1323-45.

70 *See id.*

71 *See generally* J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory & Practice*, 27 Yale J. on Reg. 283 (2010); Mathew R Shahabian, *The Government as Shareholder and Political Risk: Procedural Protections in the Bailout*, 86 N.Y.U. L. Rev. 351 (2011); Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 Tex. L. Rev. 1293 (2011).; Benjamin A. Templin, *The Government Shareholder: Regulating Public Ownership of Private Enterprise*, 62 Admin. L. Rev. 1127, 1128-29 (2010). One scholar concludes that, while governmental ownership of private enterprise is "inherently unstable," nevertheless, because he believes that instances of government ownership are likely to be rare in the future due to the political and legal atmosphere, "there is no need at this point to wade into the debate about whether government ownership is ever appropriate, and if so, under what circumstances it is justified." Steven M. Davidoff, *Uncomfortable Embrace: Federal Corporate Ownership in the Midst of the Financial Crisis*, 95 Minn. L. Rev. 1733, 1736, 1773-74 (2010-2011).

72 *See* Barbara Black, *The U.S. as "Reluctant Shareholder": Government, Business and the Law*, 5 Entrepreneurial Bus. L.J. 561, 567 (2010).

73 *See* Wall Street and Consumer Protection Act, H.R. 4173, 111th Cong. (2010).

74 *Id.* "An Act To promote the financial stability of the United States by improving accountability and transparency in the financial system, *to end 'too big to fail', to protect the American taxpayer by ending bailouts*, to protect consumers from abusive financial services practices, and for other purpose." *Id.* (emphasis added).

75 For a micro-sample of the literature discussing whether Dodd-Frank has or will accomplish its stated purpose, see Andrew Verstein & Roberta Romano, *Roundtable on Assessing Dodd-Frank*, Apr. 1, 2011, *available at* http://www.law.yale.edu/documents/pdf/WGM_Roundtable_July.pdf; Jeffrey Gordon & Christopher Muller, *Confronting Financial Crisis: Dodd-Frank's Dangers and the Case for a Systemic Emergency Insurance Fund*, 28 Yale J. on Reg. 151, 152-53 (2011); Peter J. Wallison, *The Error at the Heart of the Dodd-Frank Act*, Fin. Services Outlook, Sept. 6, 2011, *available at* http://www.aei.org/article/economics/financial-services/the-error-at-the-heart-of-the-dodd-frank-act.

76 *See generally* Wall Street and Consumer Protection Act, H.R. 4173, 111th Cong. (2010).

77 Proposing an Amendment to the Constitution of the United States to Prohibit the United States from Owning Stock in Corporations, H.R.J. Res. 22, 112th Cong. (2011) (introduced in U.S. House in January 2011). The proposed amendment reads: "The United States shall not own, subscribe to, or otherwise have any interest in the stock or equity of any company, association or corporation: *Provided*, That the foregoing prohibition shall not apply to any investments through any pension funds." *Id.*

78 Cong. Budget Office, Evaluating and Accounting for Federal Investment in Corporate Stocks and Other Private Securities 4-7 (Jan. 2003).

79 This type of exception was included in the proposed amendment to the United States Constitution discussed above.

80 U.S. Const. art. VI, par. 2.

81 *See, e.g.*, Burks v. Lasker, 441 U.S. 471, 477-79 (1979). "Corporations are creatures of state law, . . . and it is state law which is the font of corporate directors' powers. By contrast, federal law in this area is largely regulatory and prohibitory in nature—it often limits the exercise of directorial power, but only rarely creates it." *Id.* at 478.

82 CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, 91 (1987)

83 *See id.* at 90.

84 94 U.S. 315 (1877).

85 *Id.* at 320.

86 *Id.* at 318.

87 339 U.S. 87 (1950).

88 United States v. Burnison, 339 U.S. 87, 89-90 (1950).

89 *Id.* at 91.

90 *Id.* at 93.

91 *Id.*

92 It is a near-universal principle that equity interests are personal property. *See, e.g.*, Del. Code Ann. tit. 8, § 159 ("The shares of stock in every corporation shall be deemed personal property and transferable . . . ."); Stevenson v. Metsker, 120 Kan. 251 (1930) (Harvey, J., dissenting) (quoting 26 Am. & Eng. Ency. Of Law (2d Ed.) 826 for the proposition that "it is now settled that stock is personal property"); Lawyers Coop. Publ'g Co. v. Muething, 65 Ohio St.3d 273 (1992) ("We hold that [party's] claim of a loss in value of his interest in his law practice is essentially a claim of injury to personal property . . . .").

93 481 U.S. 69 (1987).

94 *Id.* at 87.

95 *Id.* at 89.

96 *Id.*

97 *Id.*

98 *Id.* at 94.

99 *Id.* at 89.

100 *Id.* at 91.

101 Following the Supreme Court's decision in *CTS,* some lower courts have invalidated certain state anti-takeover statutes. However, such statutes applied to companies formed both in-state and out-of-state. The decisions are distinguished from *CTS* on those grounds. *See, e.g.*, Rocket Acquisition Corp. v. Ventana Med. Sys., Inc., 2007 WL 2422082 (2007).

102 Bridget C. E. Dooling, *Take It Past the Limit: Regulatory Takings of Personal Property*, 16 Fed. Circuit B.J. 445, 446 (2007).

103 Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1027-28 (1992).

104 *Id.* at 1015-16.