St. John's Law Review

Volume 85
Number 1 *Volume 85, Winter 2011, Number 1*

Article 2

October 2011

The Financial Meltdown of 2008 and the Government's Intervention: Much Needed Relief or Major Erosion of American Corporate Law? The Continuing Story of Bank of America, Citigroup, and General Motors

Janet E. Kerr

Follow this and additional works at: https://scholarship.law.stjohns.edu/lawreview

This Article is brought to you for free and open access by the Journals at St. John's Law Scholarship Repository. It has been accepted for inclusion in St. John's Law Review by an authorized editor of St. John's Law Scholarship Repository. For more information, please contact selbyc@stjohns.edu.

THE FINANCIAL MELTDOWN OF 2008 AND THE GOVERNMENT'S INTERVENTION: MUCH NEEDED RELIEF OR MAJOR EROSION OF AMERICAN CORPORATE LAW?

THE CONTINUING STORY OF BANK OF AMERICA, CITIGROUP, AND GENERAL MOTORS[*]

JANET E. KERR[†]

INTRODUCTION

The year 2008 found the American public following two dramatically different news stories: the divisive, yet exciting, presidential campaign and that of the struggling American economy. Housing prices were plummeting, leading to a meltdown in the sub-prime mortgage lending arena, Lehman Brothers filed for bankruptcy, and the government found itself watching several other American institutions on the verge of collapsing. Instead of allowing the economy to recover on its own, the government stepped in and attempted to revive many corporations, and in turn, the economy, on a much grander scale than what the American people generally expect of their

[*] This Article addresses the events and legal implications that were present at the time of publication. It likely will take several years for these issues to be resolved in their entirety.

[†] Professor of Law and Executive Director of the Geoffrey H. Palmer Center for Entrepreneurship and the Law, Pepperdine University School of Law; LL.M, 1979, New York University School of Law; J.D., 1978, Pepperdine University School of Law; B.A., 1975, Pepperdine University. The author has published extensively in the areas of corporate governance, corporate social responsibility, and securities regulation, and additionally serves on the boards of directors of several publicly traded companies. Elizabeth Throne, a Pepperdine law student, provided research and invaluable commentary and insight. Without her help, this Article could not have been completed. Laurie Henderson and Lacey Osborn, also Pepperdine law students, provided editorial comments for this Article.

government.[1] One way in which the government began this attempted revival was through the passage of the Emergency Economic Stabilization Act of 2008 (the "Act"), which was signed into law on October 3, 2008.[2] The Act was created to help stabilize the American financial system and prevent further damage—a goal it sought to accomplish through the creation of the Troubled Asset Relief Program ("TARP"), among other measures.[3] Through TARP, the government ultimately lent up to $700 billion to many financial institutions in the hopes of saving

---

[1] The United States is typically assumed to "celebrate[ ] laissez-faire capitalism as the economic ideal," but the nation has often drifted from that principle by buying interests in railways, coal mines, and steel mills when necessary. Steve Lohr, *Bold Action with Basis in History*, N.Y. TIMES, Oct. 14, 2008, at A1. One period of history in which the American government significantly intervened was during the Great Depression, which began with the stock market crash of 1929. *See generally* HOWARD ZINN, A PEOPLE'S HISTORY OF THE UNITED STATES: 1492–PRESENT 386–87 (Harper Perennial Modern Classics reprint 2005) (2001) (describing the stock market crash of 1929). During this time, more than five thousand banks shut their doors, large numbers of businesses closed, and approximately fifteen million people, or one-quarter to one-third of the labor force, were out of work. *Id.* at 387. In order to alleviate the situation, the government created many programs, including the Reconstruction Finance Corporation started by President Hoover. DAVID M. KENNEDY, FREEDOM FROM FEAR: THE AMERICAN PEOPLE IN DEPRESSION AND WAR, 1929–1945, at 84 (2005). Often described as "bank relief," Congress capitalized the program at $500 million and authorized it to borrow up to an additional $1.5 billion. *Id.* The program provided "emergency loans to banks, building-and-loan societies, railroads, and agricultural stabilization corporations." *Id.* The government also intervened in the economy through a variety of programs known as the "New Deal," which collectively either created entities that provided jobs for Americans or increased the regulatory power of the American government, or both. *See generally id.* at 364–80 (discussing generally the variety of programs created under the New Deal, including the Tennessee Valley Authority, the Securities and Exchange Commission, and the National Labor Relations Board).

[2] Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765.

[3] *See id.* § 101. The official purposes of the Act are as follows:

> (1) to immediately provide authority and facilities that the Secretary of the Treasury can use to restore liquidity and stability to the financial system of the United States; and (2) to ensure that such authority and such facilities are used in a manner that—(A) protects home values, college funds, retirement accounts, and life savings; (B) preserves homeownership and promotes jobs and economic growth; (C) maximizes overall returns to the taxpayers of the United States; and (D) provides public accountability for the exercise of such authority.

Id. § 2, 122 Stat. at 3766 (codified at 12 U.S.C.A. § 5201 (West 2011)). The Act also included the Energy Improvement and Extension Act of 2008 in division B, and the Tax Extenders and the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 in division C. *Id.* div. B–C, 122 Stat. at 3807–933 (codified in scattered sections of 26 U.S.C.).

them from collapse.[4] The government gave billions more to other corporations in the form of mortgage-backed security purchases, direct investments, loan guarantees, and loans, totaling over $1.33 trillion.[5] The government then became a creditor of many major corporations, as well as a majority or controlling shareholder in some situations.[6] A year after the crisis started and on the anniversary of Lehman Brothers' collapse, President Barack Obama addressed Wall Street bankers, advising them to "embrace serious financial reform, not fight it."[7]

In the case of Bank of America, the government simply loaned money, first through TARP to help it survive, and later lent more to help it buy another failing financial institution, Merrill Lynch.[8] In September 2008, Bank of America agreed to purchase Merrill Lynch, and the shareholders approved the transaction on December 5, 2008.[9] In agreeing to the transaction and in persuading shareholders to approve it, Bank of America's board of directors relied on representations made in September 2008 as to Merrill Lynch's financial condition.[10] However, in

---

[4] Django Gold, *Uncle Sam in the Boardroom*, DIRECTORSHIP, Feb. 5, 2009, at 23, *available at* http://www.directorship.com/uncle-sam-in-the-boardroom/. The TARP program provided loans to, among others, Fannie Mae and Freddy Mac, Citigroup, AIG, JPMorgan Chase, Bank of America, Wells Fargo, GM, Morgan Stanley, Goldman Sachs, and Chrysler. *Id.* at 25.

[5] *Id.* In addition to TARP funds, the government provided debt and mortgage-backed security purchases to Fannie Mae and Freddie Mac, direct investment and loan guarantees to Citigroup, and $30 billion to JPMorgan Chase for the Bear Stearns acquisition. *Id.*

[6] The United States government became a creditor of Bank of America, a majority shareholder of General Motors, and an owner of thirty-four percent of Citigroup, which as described in the article, arguably makes Citigroup a controlling shareholder. *See* Dan Fitzpatrick et al., *U.S.A. Inc.: In Merrill Deal, U.S. Played Hardball*, WALL ST. J., Feb. 5, 2009, at A1 [hereinafter *In Merrill Deal, U.S. Played Hardball*]; John D. Stoll & Neil King, Jr., *GM Set To Exit Bankruptcy*, WALL ST. J., July 10, 2009, at A1; David Ellis, *It's Official: You Own a Piece of Citi*, CNNMONEY.COM (July 30, 2009), http://money.cnn.com/2009/07/30/news/companies/citigroup_stake/index.htm?section=money_latest.

[7] Elizabeth Williamson & Damian Paletta, *Obama Urges Bankers To Back Financial Overhaul*, WALL ST. J., Sept. 15, 2009, at A4 (internal quotation marks omitted). Lehman Brothers Holdings filed for chapter 11 bankruptcy protection in September 2008 after the United States government declined to help potential buyers—including Barclays PLC and Bank of America—finance the purchase of the struggling company. *See* Carrick Mollenkamp et al., *Crisis on Wall Street as Lehman Totters, Merrill Is Sold, AIG Seeks To Raise Cash,* WALL ST. J., Sept. 15, 2008, at A1.

[8] *See In Merrill Deal, U.S. Played Hardball*, *supra* note 6.

[9] *See id.* The agreement was previously approved by the Board of Governors of the Federal Reserve. *See id.*

[10] *See id.*

mid-December 2008, Bank of America's board of directors learned that Merrill Lynch's financial condition was not as it was represented to them in September 2008.[11] In fact, it was significantly worse.[12] Nevertheless, Bank of America went forward with the transaction, allegedly under pressure from government officials to complete the transaction and not disclose the information concerning Merrill Lynch's financial condition to shareholders.[13] Alleging that such omissions were material, the Securities Exchange Commission ("SEC") filed suit against Bank of America and began investigating why Bank of America did not disclose Merrill Lynch's deteriorating financial condition sooner.[14] While Judge Jed Rakoff dismissed the first settlement proposed by the parties because it unfairly punished the shareholders,[15] he eventually—albeit reluctantly—approved a $150 million settlement in January 2010.[16] Indeed, Judge Rakoff harshly criticized the settlement and chastised the bank for "hiding material information from its shareholders," claiming that the actions of Bank of America amounted to "fraud."[17] Furthermore, although the SEC refused to file a suit against any individual executives, the settlement approval did not thwart a similar suit from New York Attorney General Andrew Cuomo, who charged the bank and two top executives with civil securities fraud.[18] While many conflicting accounts exist, this transaction between Bank of America and Merrill Lynch raises important legal questions regarding the government's interaction with and influence over the private sector. Saving a corporation or multiple corporations from failure is certainly commendable, especially when these efforts may significantly help the overall American economy. However, is it legal, or at the very least good corporate governance, for boards of directors to yield to

[11] *See id.*

[12] *See id.* By mid-December, Merrill Lynch had lost almost $21 billion on a pretax basis, which constituted approximately $15 billion in net losses. *Id.* Merrill Lynch's fourth quarter losses amounted to $15.31 billion according to the figure announced to Bank of America shareholders on January 16, 2009. *Id.*

[13] *See id.*; *infra* notes 46–51 and accompanying text.

[14] *See* Dan Fitzpatrick & Kara Scannell, *BofA Hit by Fine over Merrill*, WALL ST. J., Aug. 4, 2009, at A1 [hereinafter *BofA Hit by Fine over Merrill*].

[15] Dan Fitzpatrick et al., *Rakoff Backs BofA Accord, Unhappily*, WALL ST. J., Feb. 23, 2010, at C1 [hereinafter *Rakoff Backs BofA Accord*].

[16] *Id.*

[17] *Id.* (internal quotation marks omitted).

[18] *See id.*

governmental pressure and consider the welfare of the overall American economy, which arguably equates to considering the American public at large, when making such decisions?

In addition to becoming a creditor, the government also became either a majority or a controlling shareholder in several other American corporations, most notably General Motors and Citigroup.[19] In the case of General Motors, the government became a sixty percent owner[20] after the corporation emerged from one of the largest industrial bankruptcies in history.[21] Like Bank of America, Citigroup initially received funding from the government through the TARP program[22] and then later converted the government's preferred shares to common shares, thus leaving the government with a thirty-four percent stake in the corporation.[23] While the government claims that it is a "reluctant shareholder,"[24] boards have started to consider the government as a "new addition to their board . . . as activist investor, lawmaker, and regulator."[25] Indeed, when the government owns a significant stake in corporations and also has the dual role as a governmental regulator, how and when does it cross the line from only serving as a traditional shareholder?[26]

---

[19] The government also became a majority shareholder in AIG, but this Article will only discuss the government's involvement with General Motors and Citigroup due to specific differences between the government's ownership of AIG and its involvement in General Motors and Citigroup.

[20] John D. Stoll & Kevin Helliker, *Board Debut for GM's New Chairman*, WALL ST. J., Aug. 3, 2009, at B1. Other sources have stated that the U.S. government owns 60.8% of General Motors. Peter Whoriskey, *GM Emerges from Bankruptcy After Landmark Government Bailout*, WASH. POST (July 10, 2009), http://www.washingtonpost.com/wp-dyn/content/article/2009/07/10/AR2009071001473.html.

[21] Neil King, Jr. & Sharon Terlep, *GM Collapses into Government's Arms*, WALL ST. J., June 2, 2009, at A1.

[22] Gold, *supra* note 4, at 25.

[23] Ellis, *supra* note 6. See *infra* Part I.C for further details regarding the conversion of Citigroup's preferred shares to common shares.

[24] Neil King, Jr. & Sharon Terlep, *supra* note 21; *see also Fact Sheet on Obama Administration Auto Restructuring Initiative for General Motors*, THE WHITE HOUSE, http://www.whitehouse.gov/the_press_office/Fact-Sheet-on-Obama-Administration-Auto-Restructuring-Initiative-for-General-Motors/ (last visited Mar. 16, 2011).

[25] Gold, *supra* note 4, at 26.

[26] Shareholders are traditionally considered to be the owners of a corporation, and they elect directors to manage the corporation and to achieve the goal of maximizing their profits. *See* Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 437 (2006). Shareholders are sometimes considered the "underpinning of corporate governance" and theoretically can vote directors out of their positions or sell the shares they own in the corporation to voice their dissatisfaction. Omari Scott Simmons, *Taking the Blue Pill: The Imponderable*

For example, when the government begins acting as a creditor, shareholder, regulator, and stakeholder,[27] many of the established lines in corporate law blur, and significant questions emerge as a result of such government intervention. Specifically, if the government is a creditor, how much is it allowed to influence the board of directors? What happens when the government is a majority or controlling shareholder, and its conduct breaches the fiduciary duty it owes to minority shareholders? Can boards of directors begin viewing the United States economy, or the American public, as a stakeholder, in addition to the "traditional" stakeholders such as employees and the community?[28]

This Article explores these questions and more with respect to the current role the government is playing in three corporations—Bank of America, General Motors, and Citigroup—and the relevant issues raised within corporate law. Specifically, this Article discusses whether boards of directors may have acted in such a way that potentially breaches traditional fiduciary duties—duties of due care, loyalty, and good faith—and whether the business judgment rule still protects these boards when they were pressured by the government. Furthermore, this Article also explores whether there were violations under Rule 10b-5 of the Securities Exchange Act of 1934,[29] the duty of candor required in Delaware, and the duty of fairness. This Article also

Impact of Executive Compensation Reform, 62 SMU L. REV. 299, 349 (2009). There are two typical types of shareholders: (1) the individual shareholder, who, because he or she is one of many, is often apathetic regarding participating in governing the corporation; and (2) institutional shareholders. *See id.* at 349–50. Institutional shareholders often have the ability to monitor corporations and become involved in corporate governance. *Id.* at 350. The stereotypical institutional investors include (1) pension funds; (2) mutual funds; (3) insurance companies; (4) foundations; (5) university and charitable endowments; (6) banks investing trust funds; (7) brokerage firms; and (8) investment vehicles for sophisticated investors. ROBERT W. HAMILTON ET AL., CASES AND MATERIALS ON CORPORATIONS, INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES 520 (11th ed. 2010). The government, as neither an individual nor a group of investors, does not fit into either category of "normal" shareholders.

[27] "Stakeholder" has many definitions, but the term is typically considered to include the "employees, suppliers, customers, creditors, [and] communit[y]" of a corporation. Wai Shun Wilson Leung, Note, *The Inadequacy of Shareholder Primacy: A Proposed Corporate Regime that Recognizes Non-Shareholder Interests*, 30 COLUM. J.L. & SOC. PROBS. 587, 622 (1997). Neither the American economy, nor the American public, has ever been considered a stakeholder.

[28] *See id.*

[29] 15 U.S.C.A. § 78a (West 2011).

analyzes the duties the government owes fellow shareholders when it acts as either a majority or controlling shareholder and addresses the idea that the U.S. government may be beginning to engage in what many foreign governments already utilize, the golden share. Part I discusses the financial crisis of 2008 with respect to Bank of America, General Motors, and Citigroup. Part II summarizes the traditional triad of fiduciary duties owed by, and legal protections provided to, boards of directors under common law. Part III details the fiduciary duties owed by directors to shareholders under the duty of candor in Delaware. Part IV discusses additional relevant laws and issues, including Rule 10b-5, the duty of directors to be fair to all shareholders, and the duty of loyalty owed by majority and controlling shareholders to minority shareholders. Part V analyzes all the legal implications of the financial crisis of 2008 with respect to the three profiled companies.

I. THE FINANCIAL CRISIS OF 2008: THE BACKGROUND TO DISCUSSING THE GOVERNMENT'S EROSION OF AMERICAN CORPORATE LAW

The various legal doctrines and laws briefly discussed above all became very relevant in late 2008 when the American economy began to crumble. Suddenly, major corporations were either failing or only surviving after receiving significant financial assistance from the government. Through the Act, which was signed into law on October 3, 2008, the government created TARP to help stabilize the economy.[30] Two programs of the Act, the Capital Purchase Program and the Capital Assistance Program, were specifically designed to assist banks by providing capital.[31] While many major financial institutions and

[30] *See* Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765.

[31] The Capital Purchase Program is a voluntary program in which the Treasury Department provides capital to healthy financial institutions that want additional capital to ensure stability. *See* Press Release, U.S. Dep't of the Treasury, Treasury Announces TARP Capital Purchase Program Description (Oct. 14, 2008), *available at* http://www.treasury.gov/press-center/press-releases/Pages/hp1207.aspx. The program provides additional capital by purchasing banks' preferred shares on standardized terms, including warrants for future Treasury Department purchases of common stock. *Id.* In return, the financial institutions must pay the Treasury Department a five percent dividend on senior preferred shares for the first five years after the investment and nine percent per year thereafter. *Id.* Two-hundred fifty billion dollars were allotted to the program. *Id.* The application period to receive

corporations were impacted, three in particular became significantly involved with the government: Bank of America, General Motors, and Citigroup.[32]

A. *Bank of America and the Shareholders It Left in the Dark*[33]

Bank of America initially received $15 billion from TARP as part of the Capital Purchase Program in fall 2008.[34] Later, Bank of America CEO and Chairman Ken Lewis stated that this investment had a "dilutive effect" on existing shareholders and was not requested by Bank of America, but was instead taken at the request of Treasury Secretary Henry Paulson and others.[35]

---

funding under the Capital Purchase Program ended in late 2008 and early 2009 with due dates varying based on the different types of companies. *Capital Purchase Program*, U.S. DEP'T OF TREASURY, http://www.treasury.gov/initiatives/financial-stability/investment-programs/cpp/Pages/capitalpurchaseprogram.aspx (last visited Mar. 16, 2011). The Capital Assistance Program, which the Treasury Department announced on February 25, 2009, has two objectives: (1) to analyze whether any of the major American banks need to establish additional capital as a buffer during the financial crisis; and (2) to provide common equity as a "bridge to private capital in the future" to qualifying financial institutions. U.S. DEP'T OF THE TREASURY, TREASURY WHITE PAPER, THE CAPITAL ASSISTANCE PROGRAM AND ITS ROLE IN THE FINANCIAL STABILITY PLAN 2 (2009), http://www.treasury.gov/press-center/press-releases/Documents/tg40_capwhitepaper.pdf. Additionally, the Automotive Industry Financing Program, which was also created under TARP, has provided $76 billion in loans or equity investments to General Motors, GMAC, Chrysler Holding, and Chrysler Financial, in order to avoid "disorderly bankruptcy." *Automotive Industry Financing Program*, U.S. DEP'T OF THE TREASURY, http://www.treasury.gov/initiatives/financial-stability/investment-programs/aifp/Pages/autoprogram.aspx (last visited Mar. 16, 2011).

[32] Hundreds of financial institutions and other corporations have been involved in the programs. For a complete list of which institutions have received funding, how much funding, what the government received, and who has repaid the government, see *Reports*, U.S. DEP'T OF THE TREASURY, http://www.treasury.gov/initiatives/financial-stability/briefing-room/reports/Pages/Home.aspx (last visited Mar. 16, 2011).

[33] At the time of writing, the current events surrounding Bank of America were still rapidly evolving.

[34] *See* U.S. DEP'T OF THE TREASURY, TROUBLED ASSET RELIEF PROGRAM, TRANSACTIONS REPORT FOR PERIOD ENDING JANUARY 12, 2011, CAPITAL PURCHASE PROGRAM 1 (Nov. 18, 2010), http://www.treasury.gov/initiatives/financial-stability/briefing-room/reports/tarp-transactions/DocumentsTARPTransactions/11-18-10%20Transactions%20Report%20as%20of%2011-16-10.pdf [hereinafter TRANSACTIONS REPORT, CAPITAL PURCHASE PROGRAM].

[35] Editorial, *Busting Bank of America*, WALL ST. J., Apr. 27, 2009, at A14 (internal quotation marks omitted). While Lewis did not explain what he meant by "dilutive effect," he possibly was referring to the fact that the government received preferred stock with warrants by injecting capital into Bank of America, thus diminishing the power of other preferred shareholders. *See generally* Press Release,

Then, Bank of America received additional funds to help finance Bank of America's purchase of Merrill Lynch. The total amount the United States provided to the corporation to reach $45 billion.[36] The $45 billion was eventually returned to the government a year later, on December 9, 2009.[37] While Bank of America's shareholders were aware of the $15 billion received in TARP funds, they were not aware of the additional financing provided by the government and the terrible financial condition of Merrill Lynch until Bank of America notified shareholders and the public in January 2009.[38]

To provide a timeline of significant events regarding the merger of Bank of America and Merrill Lynch, on September 15, 2008, after less than forty-eight hours of due diligence,[39] Bank of America entered into an agreement to purchase Merrill Lynch to ultimately save the company from collapse.[40] This agreement was approved by the Board of Governors of the Federal Reserve on November 26, 2008, and on December 5, 2008, the shareholders of both Merrill Lynch and Bank of America approved the transaction.[41] However, by mid-December, Merrill Lynch's finances were not what they were when Bank of America had agreed to purchase the company.[42] In fact, the substantial losses, some of which remained undisclosed to shareholders even though they had become known to Bank of America executives

U.S. Dep't of the Treasury, Treasury Announces TARP Capital Purchase Program Description (Oct. 14, 2008), *available at* http://www. treasury.gov/press-center/press-releases/Pages/hp1207.aspx (describing the Capital Purchase Program).

[36] Eric Dash et al., *Bank of America to Receive $20 Billion More*, NY TIMES, Jan. 16, 2009, at B1.

[37] David Mildenberg, *Bank of America Names Moynihan CEO, Replacing Lewis,* BUS. WK. (Dec. 17, 2009), http://www.businessweek.com/bwdaily/dnflash/content/dec2009/ db20091216_513214.htm?chan=rss_topStories_ssi_5.

[38] *See Busting Bank of America*, *supra* note 35.

[39] *In Merrill Deal, U.S. Played Hardball*, *supra* note 6; *see also* Letter from Andrew M. Cuomo, Attorney Gen., New York, to Christopher J. Dodd, Chairman, U.S. Senate Comm. on Banking, Hous., & Urban Affairs 1 (Apr. 23, 2009) [hereinafter Cuomo Letter], *available at* http://www.marketwatch.com/ story/text-cuomo-letter-merrill-lynch ("Time was of the essence for Merrill Lynch, as the company was not likely to survive the following week without a merger.").

[40] *See Bank of America and Merrill Lynch: How Did a Private Deal Turn into a Federal Bailout? Part III: Hearing Before the H. Comm. on Oversight and Government Reform*, 111th Cong. 23–24 (2009) [hereinafter *Hearing*] (statement of Henry M. Paulson, U.S. Secretary of the Treasury).

[41] *Id.* at 22.

[42] *In Merrill Deal, U.S. Played Hardball*, *supra* note 6.

prior to the shareholder vote,[43] amounted to $13.3 billion in pretax losses for the preceding two months alone.[44] On December 17, 2008, Lewis flew to Washington to inform federal regulators that he was considering invoking the material adverse change ("MAC") clause to rescind the merger agreement,[45] which was a legal course of action.[46] According to Lewis, Federal Reserve Chairman Ben Bernanke and Paulson pressured Lewis to continue with the merger agreement but to not inform shareholders of the newly-discovered details regarding Merrill Lynch's financial losses.[47] Government officials warned Lewis that backing out of the transaction would upset the markets, ignite lawsuits against Bank of America, and hurt the bank's reputation.[48] Furthermore, government officials told Lewis that future requests for government assistance would lead officials to contemplate having more control over Bank of America's operations.[49] Most importantly, Lewis stated that Paulson advised him that the government would remove Bank of America's board and management if the bank invoked the MAC clause and backed out of the merger.[50]

---

[43] Cuomo Letter, *supra* note 39, at 2. Bank of America's CFO, Joseph Price, informed Lewis that "Merrill Lynch's financial condition had seriously deteriorated at an alarming rate." *Id.*

[44] *In Merrill Deal, U.S. Played Hardball*, *supra* note 6.

[45] A "[m]aterial [a]dverse [e]ffect" or "material adverse change" is "any material adverse change or effect on the business, condition (financial or otherwise), assets, results of operations or prospects of the [c]ompany and its [s]ubsidiaries, taken as whole." John D. Amorosi, *Significant Topics in Private Equity*, *in* TENTH ANNUAL PRIVATE EQUITY FORUM 2009, at 161, 166 (PLI Corp. Law Practice Course Handbook Series No. 18,819, 2009). Most merger agreements have MAC clauses, which allow a party to walk away from a transaction without suffering consequences if the other party to the transaction has incurred a MAC. Robert T. Miller, *The Economics of Deal Risk: Allocating Risk Through MAC Clauses in Business Combination Agreements*, 50 WM. & MARY L. REV. 2007, 2007 (2009).

[46] *See In Merrill Deal, U.S. Played Hardball*, *supra* note 6 ("Bank of America had a legal basis to abandon the deal."). *But see Hearing*, *supra* note 40, at 5 (statement of Henry M. Paulson, U.S. Secretary of Treasury) ("I was expressing what I am confident was the strong opinion of the Federal Reserve, namely, that exercise of the MAC clause was not a legally viable option.").

[47] *See* Liz Rappaport, *Lewis Testifies U.S. Urged Silence on Deal*, WALL ST. J., Apr. 23, 2009, at A1. If Bank of America's shareholders had been informed of Merrill Lynch's losses, they potentially could have stopped the purchase and instead allowed Merrill Lynch to fail. *Id.*

[48] *See id.*

[49] *See In Merrill Deal, U.S. Played Hardball*, *supra* note 6.

[50] Rappaport, *supra* note 47. Lewis testified:

On December 22, 2008, Lewis met with the board of directors to inform them of his decision not to invoke the MAC clause.[51] According to the minutes of that meeting, Lewis listed the key points of his discussions with Paulson and Bernanke:

> (1) [F]irst and foremost, the Treasury and [Federal Reserve] are unified in their view that the failure of [Bank of America] to complete the acquisition of Merrill Lynch would result in systemic risk to the financial services system in America and would have adverse consequences for [Bank of America]; (2) second, the Treasury and [Federal Reserve] stated strongly that were [Bank of America] to invoke the [MAC] clause in the merger agreement with Merrill Lynch and fail to close the transaction, the Treasury and [Federal Reserve] would remove the Board and management of the Corporation . . . .[52]

The board held another meeting on December 30, 2008, where Lewis revealed the government's influence over the bank:

> [W]ere it not for the serious concerns regarding the status of the United States financial services system and the adverse consequences of that situation to [Bank of America] articulated by the federal regulators . . . [Bank of America] would, in light of the deterioration of the operating results and capital position of Merrill Lynch, assert the [MAC] clause in its merger agreement with Merrill Lynch and would seek to renegotiate the transaction.[53]

Although Bank of America's board clearly recognized the gravity of Merrill Lynch's financial situation, the company did not disclose Merrill Lynch's significant losses or its impact on the

---

> I can't recall if [Paulson] said, "We would remove the board and management if you called it [off]" or if he said "we would do it if you intended to." I don't remember which one it was . . . . I said "Hank, let's deescalate this for a while. Let me talk to our board."

Id. (second alteration in original). Moreover, Paulson later stated that he made this threat regarding the board's removal at the request of Bernanke. Cuomo Letter, *supra* note 39, at 3. As Bank of America's primary regulator, the government has the authority to remove executives when it concludes that they are "behaving irresponsibly." *In Merrill Deal, U.S. Played Hardball*, *supra* note 6.

[51] Cuomo Letter, *supra* note 39, at 3.

[52] Minutes of Special Meeting of Board of Directors of Bank of America Corporation 2, Dec. 22, 2008, *available at* http://online.wsj.com/public/resources/documents/ExhibitB-cuomo04232009.pdf (exhibit B to Cuomo Letter, *supra* note 39).

[53] Minutes of Special Meeting of Board of Directors of Bank of America Corporation 2, Dec. 30, 2008, *available at* http://online.wsj.com/public/resources/documents/ExhibitC-cuomo04232009.pdf (exhibit C to Cuomo Letter, *supra* note 39).

merger.[54] Nevertheless, the final details of Bank of America's purchase of Merrill Lynch were completed on January 1, 2009.[55] On January 20, 2009, Bank of America announced that it planned to accept $20 billion in TARP funds from the government and that Merrill Lynch had lost $15.3 billion in the fourth quarter of 2008.[56] Shareholders were furious with Bank of America's lack of disclosure regarding Merrill Lynch's financial condition, as evidenced by threats of large institutional investors, such as TIAA-CREF[57] and CalPERS,[58] to vote against Lewis's re-election as Chairman of the board.[59] Consequently, on April 29, 2009, Lewis was removed as Chairman of Bank of America, although he remained the CEO and still served on the board of directors.[60]

---

[54] Cuomo Letter, *supra* note 39, at 4.

[55] Rappaport, *supra* note 47.

[56] *See In Merrill Deal, U.S. Played Hardball*, *supra* note 6; Rappaport, *supra* note 47. The minutes of the board meeting held on December 30, 2008 illustrate that Bank of America was attempting to "time its disclosure of Merrill Lynch's losses to coincide with the announcement of" the bank's January earnings and its additional receipt of TARP funds. Cuomo Letter, *supra* note 39, at 4.

[57] TIAA-CREF is a financial services company that provides retirement assistance to those working in the "academic, research, medical, and cultural fields." *Overview*, TIA-CREF, http://www.tiaa-cref.org/about/press/about_us/facts.html (last visited Mar. 18, 2011). As of September 30, 2010, TIAA-CREF managed more than $434 billion in assets and served more than 3.7 million people. *Id.*

[58] CalPERS, or the California Public Employees' Retirement System, provides "retirement, health, and related financial programs and benefits to more than 1.6 million public employees, retirees, and their families and more than 3,000 public employers" in California. CALPERS, http://www.calpers.ca.gov/ (last visited Mar. 19, 2011). The institution owns 22.7 million shares of Bank of America. *See* Tom Petruno, *CalPERS Joins Efforts To Oust BofA Board*, L.A. TIMES, Apr. 29, 2009, at B2.

[59] Petruno, *supra* note 58. CalPERS said that it would vote against the reelection of all eighteen directors. *Id.* In regard to Bank of America's failure to disclose information to shareholders about its purchase of Merrill Lynch, the CalPERS board president Rob Feckner stated, "[t]he entire board failed in its duties to shareowners and should be removed." *Id.* (internal quotation marks omitted). Additionally, many proxy-advisory firms, including Egan-Jones, advised shareholders to not vote for Lewis, as well as other directors. *See* Press Release, Egan-Jones Proxy Service, Egan-Jones Issues Statement on Bank of America (Apr. 24, 2009), *available at* http://www.bloomberg.com/apps/news?pid=conewsstory&refer=conews&tkr=MER:US&sid=aZ7gMpmiDzxo.

[60] *Changing Course*, ECONOMIST, May. 2, 2009, at 73. Walter Massey, a veteran of Bank of America's board of directors, replaced Lewis as chairman. *Id.* In 2008, a proposal to split the chairman and CEO positions was approved by thirty-six percent of stockholders' votes because they wanted to promote the board's independence. *See* Jonathan Stempel & Martha Graybow, *BofA Investor Sees Chariman/CEO Job Split*, REUTERS, Apr. 16, 2009, http://www.reuters.com/article/ousivMolt/

In February 2009, Lewis testified under oath before New York Attorney General Andrew Cuomo, stating that Paulson and Bernanke instructed him to remain silent about the financial situation of Merrill Lynch leading up to the merger.[61] While not explicitly told to withhold information from shareholders, Lewis testified that he believed the government wanted him to remain silent, as he was instructed that "[w]e do not want a public disclosure."[62] In fact, when Lewis asked Bernanke to put something down in writing, Lewis stated that Paulson responded, "this would be a disclosable event and we do not want a disclosable event."[63] As a result of this exchange, nothing was written down about the December negotiations between Lewis and the government.[64] Moreover, Lewis has acknowledged that he believed Paulson was asking Bank of America's shareholders to take some of Merrill Lynch's losses in order to avoid widespread financial disaster.[65] Essentially, Lewis was stating

---

idUSTRE53F5K120090416. The proposal was submitted again in 2009 and passed with 50.34% supporting it and 49.66% not supporting it. Ieva M. Augstums & Mitch Weiss, *Ken Lewis Ousted as Bank of America Chairman*, HUFFINGTON POST (Apr. 29, 2009), http://www.huffingtonpost.com/2009/04/29/bank-of-america-sharehold_n_192838.html.

[61] *'It Wasn't Up to Me': Excerpts from Ken Lewis's Testimony*, WALL ST. J. (Apr. 23, 2009), http://online.wsj.com/article/SB124050112892948367.html [hereinafter *It Wasn't Up to Me*].

[62] *Id.* (internal quotation marks omitted).

[63] *Id.* By "disclosable event," Lewis was likely trying to say that Paulson was referring to "material" information, which the bank would have been required to disclose. In Delaware, for information to be "material," there must be a "substantial likelihood" that the nonpublic information would have been a significant factor when deciding whether to "buy, sell, vote, or tender stock." *In re* Oracle Corp., 867 A.2d 904, 934 (Del. Ch. 2004), *aff'd*, 872 A.2d 960 (Del. 2005) (citing Rosenblatt v. Getty Oil Co., 493 A.2d 929, 944 (Del. 1985)). On the federal level, the Securities and Exchange Commission ("SEC") has a similar standard of disclosure for material information. In certain situations, boards of directors must disclose material information to stockholders. One example is Form 8-K, which the SEC requires a corporation to file when announcing "major events that the shareholders should know about." *Form 8-K*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/answers/form8k.htm (last visited Mar. 18, 2011). This requirement is trigged in a variety of circumstances, including entry into or termination of a material definitive agreement, material impairments of financial information, and any other event that is not called for by Form 8-K but that the corporation considers important to security holders. *See id.*

[64] *It Wasn't Up to Me*, *supra* note 61.

[65] *See id.* In response to the question, "Wasn't Mr. Paulson, by his instruction, really asking Bank of America shareholders to take a good part of the hit of Merrill losses?," Lewis responded, "What [Paulson] was doing was trying to stem financial disaster in the financial markets from his perspective." *Id.*

that Paulson and Bernanke forced the entire merger on him and the board.

Curiously, after Lewis testified before Cuomo in February, he, Bernanke, and Paulson testified in the summer of 2009 in front of the House Committee on Oversight and Government Reform with Mr. Lewis providing conflicting stories of what happened during the final months of 2008.[66] First, Lewis backed off on what he initially testified to Cuomo.[67] Instead, Lewis stated that "[he] would say they strongly advised and they spoke in strong terms, but [that] it was with the best intentions."[68] Lewis continued by stating that Bernanke "never said we should not disclose something that should be disclosed."[69] Bernanke later denied that he threatened Lewis with taking his job if he did not follow through with the purchase.[70] Paulson, on the other hand, defended the government's actions and stated that he warned Lewis that Bank of America's management could be replaced if they backed out of the transaction.[71]

Since the fallout from the Merrill Lynch purchase, major shake-ups in management and the board of directors have occurred at Bank of America. In addition to Lewis being voted out as Chairman in spring 2009, on June 5, 2009, it was announced that the Chief Risk Officer for Bank of America, Amy Woods Brinkley, as well as director Robert Tillman, would be leaving the company in the midst of a United States-mandated

---

[66] *See* Michael R. Crittenden & Dan Fitzpatrick, *Lewis Takes Heat but Defends Merrill Deal*, WALL ST. J., June 12, 2009, at C1.

[67] *See id.*

[68] *Id.* (internal quotation marks omitted).

[69] *Id.* (internal quotation marks omitted). He also testified:

> Bank of America concluded that there were serious risks to declaring a material adverse change, and that proceeding with the transaction, with governmental support, was the better course . . . . [It] made sense for the stability of the markets.
>
> . . . .
>
> I believe that committed people of good intentions . . . worked desperately hard in late 2008 to prevent a collapse of the global financial system that would have resonated throughout the global economy.

Bank of America and Merrill Lynch: How Did a Private Deal Turn into a Federal Bailout? Before the H. Comm. on Oversight and Government Reform and Subcomm. on Domestic Policy, 111th Cong. 24–25 (2009) (statement of Kenneth D. Lewis, Chief Executive Officer, Bank of America).

[70] *See* Michael R. Crittenden & Jon Hilsenrath, *Bernanke Blasted in House*, WALL ST. J., June 26, 2009, at A1.

[71] *See* Michael R. Crittenden, *Paulson Lambasted for Crisis*, WALL ST. J., July 17, 2009, at C1.

review.[72] Additionally, on that same day, four outside directors were appointed to the board of Bank of America.[73] These directors were selected as a result of "strong suggestions" from federal regulators that Bank of America improve its corporate governance.[74] Furthermore, on September 30, 2009, Lewis announced that he was resigning from his position as CEO of Bank of America, effective at the end of 2009.[75] Lewis stated that it was his decision to resign, and according to a company spokesperson, he did not decide to resign due to government pressure.[76] Shortly thereafter, Lewis agreed to return the $1 million in salary he had received for the year and not to accept the additional $1.5 million he was to receive for the rest of the year.[77] Bank of America said that Lewis voluntarily chose to forgo his 2009 pay, but it was at the suggestion of the pay czar, who felt that Lewis's compensation package of $69.3 million was sufficient.[78] A Bank of America spokesperson stated, "Mr. Lewis . . . felt it was not in the best interest of Bank of America for him to get involved in a dispute with the paymaster."[79] In

[72] Dan Fitzpatrick & Michael R. Crittenden, *BofA's Risk Officer Leaving Amid Review*, WALL ST. J., June 5, 2009, at C3. Brinkley, 53, had been at the company since 1978 and once was considered a possible successor to Lewis. *Id.* The spokesman for Bank of America stated her leave was "a management decision" and that Lewis and Brinkley "mutually agreed that a change be made to better deal with the credit environment as it is evolving." *Id.* (internal quotation marks omitted).

[73] Dan Fitzpatrick & Joann S. Lublin, *BofA Gets New Blood for Board*, WALL ST. J., June 6, 2009, at B1.

[74] *Id.* Two of the new board members have ties to the government: Susan Bies is a former Federal Reserve Governor and Donald Powell is a former FDIC Chairman. *Id.*

[75] *See* Dan Fitzpatrick & Joann S. Lublin, *Bank of America Chief Resigns Under Fire*, WALL ST. J., Oct. 1, 2009, at A1.

[76] *See id.* Lewis wrote to employees, "I will simply say that this was my decision, and mine alone." *Id.* (internal quotation marks omitted).

[77] Deborah Solomon & Dan Fitzpatrick, *Czar Blocks BofA Chief's Pay*, WALL ST. J., Oct. 16, 2009, at A1 [hereinafter *Czar Blocks BofA Chief's Pay*]. However, Lewis did keep his pension fund, worth $53 million and consisting of $3.5 million a year in payouts, for the rest of his life. Colin Barr, *BofA CEO: $53 Million Retirement Score*, CNNMONEY.COM (Oct. 1, 2009), http://money.cnn.com/2009/10/01/news/newsmakers/lewis.payout.fortune/index.htm.

[78] *See Czar Blocks BofA Chief's Pay*, *supra* note 77. The pay czar, Kenneth Feinberg, is the United States Treasury Department's "special master" regarding compensation. *Id.*

[79] *Id.* (internal quotation marks omitted).

December 2009, Brian T. Moynihan, then in charge of the consumer banking division of Bank of America, was named the new CEO of the company.[80]

Furthermore, on July 16, 2009, *The Wall Street Journal* reported that Bank of America was operating under a secret memorandum of understanding ("MOU"),[81] which was imposed in May by the government.[82] The agreement required Bank of America to "overhaul its board" and tackle problems associated with risk and liquidity management.[83]

By the end of summer 2009, Bank of America began to experience legal trouble, in addition to strong criticism from the press and public, regarding its acquisition of Merrill Lynch and its lack of disclosures to shareholders. First, the SEC alleged that proxy documents sent to Bank of America's shareholders at the end of 2008 stated that Merrill Lynch would not pay year-end bonuses or compensation before the purchase was finalized without permission from Bank of America.[84] However, Merrill Lynch employees received $3.6 billion in bonuses shortly before Bank of America officially purchased the company.[85] Due to the size of the bonuses and the poor financial health of Merrill Lynch, the SEC alleged this omission was material and that

[80] Mildenberg, *supra* note 37.

[81] An MOU is the most common informal enforcement proceeding federal regulators implement against banks. James M. Rockett, *Confronting a Regulatory Crisis: A View from the Trenches During Troubled Times*, 126 BANKING L.J. 307, 311 (2009). Regulators use this document to inform banks of corrective actions they must take within a specified time period. *Id.* An MOU is used when the weakness regulators see within the institution is not considered to be an immediate threat to the bank's health. *Id.* It is not a public document, and thus the general public cannot review its terms on the bank's or regulatory institution's websites. *Id.* Accordingly, the nonpublic MOU has been called the "weakest type of enforcement action." Arthur E. Wilmarth, Jr., *Wal-Mart and the Separation of Banking and Commerce*, 39 CONN. L. REV. 1539, 1619 (2007). In the past, regulators chose to issue them because they feared public disclosure of a bank with an MOU would result in a " 'crisis of [public] confidence' in the banking system." *Id.* (alteration in original); *see also* Paul L. Lee, *Risk Management and the Role of the Board of Directors: Regulatory Expectations and Shareholder Actions*, 125 BANKING L.J. 679, 695–96 (2008).

[82] Dan Fitzpatrick, *U.S. Regulators to BofA: Obey or Else*, WALL ST. J., July 16, 2009, at C1 [hereinafter *U.S. Regulators to BofA*]. An MOU is the "most serious procedural action taken against Bank of America by federal regulators since the financial crisis erupted." *Id.*

[83] *Id.*

[84] *See BofA Hit by Fine over Merrill*, *supra* note 14.

[85] Kara Scannell et al., *Judge Tosses out Bonus Deal*, WALL ST. J., Sept. 15, 2009, at A1.

investors should have known about the bonuses at the time of the December vote.[86] The SEC filed suit, but in August 2009, it was announced that Bank of America and the SEC had reached a $33 million deal to settle the lawsuit, with Bank of America neither admitting nor denying any wrongdoing.[87] However, in September 2009, United States District Court Judge Jed Rakoff dismissed the deal, pointing out that it was the shareholders that were being asked to pay the fine for the alleged wrongdoing, despite also being the victims.[88] In January 2010, the SEC expanded its lawsuit against Bank of America by filing charges against the corporation for withholding information from shareholders about Merrill Lynch's financial losses after they approved the merger.[89] In February 2010, Judge Rakoff unhappily approved a $150 million settlement between the SEC and Bank of America.[90] Indeed, Judge Rakoff stated that what Bank of America did "in effect if not in intent" amounted to "a fraud."[91]

Moreover, five pension funds have sued Bank of America over the allegations that the company withheld Merrill Lynch's losses from shareholders before they voted in December 2008.[92] The pension funds are from Ohio, Texas, Sweden, and the Netherlands, and had previously filed suits independently of one another but later joined their suits at the end of September

---

[86] *BofA Hit by Fine over Merrill*, *supra* note 14.

[87] *Id.*

[88] *See* Scannell et al., *supra* note 85. Judge Rakoff said that imposing the fine, which ultimately would hurt shareholders, "does not comport with the most elementary notions of justice and morality," and that if the bank's executives relied on attorneys when creating the proxy statements, "why are the penalties not then sought from the lawyers?" *Id.* (internal quotation marks omitted).

[89] *See* Zachary A. Goldfarb, *Regulator Broadens Charges on Bank of America for Crisis Moves*, WASH. POST, Jan. 12, 2010, at A13.

[90] *Rakoff Backs BofA Accord*, *supra* note 15. Bank of America agreed to a long list of new policies in the agreement, including allowing shareholders a voice on pay vote and creating a "super-independence" standard for compensation committee members. Kristin Gribben, *BofA Agrees to Governance Changes in SEC Settlement*, AGENDA, Feb. 8, 2010. Judge Rakoff grudgingly accepted the settlement, stating that the fine was "paltry," and "hid[ ] material information from its shareholders." *Rakoff Backs BofA Accord*, *supra* note 15 (internal quotation marks omitted). He accused the SEC of being "content with modest and misdirected sanctions." *Id.* (internal quotation marks omitted).

[91] *Rakoff Backs BofA Accord*, *supra* note 15 (internal quotation marks omitted).

[92] Marshall Eckblad, *BofA Sued by Funds over Merrill*, WALL ST. J., Sept. 29, 2009, at C3.

2009.[93] Ohio Attorney General Richard Cordray, the lead plaintiff in the case, plans to seek damages not only from the corporation, but also from individual executives and directors.[94]

Although the SEC settled its lawsuits against Bank of America,[95] it declined to file individual charges against the individual executives and lawyers who approved the decisions concerning the transactions.[96] While bank officials were lucky not to be charged individually by the SEC, two management officials, as well as the bank itself, did indeed face civil charges from Cuomo on February 4, 2010.[97] In the State of New York Cuomo charged Lewis and Price, the finance chief when Bank of America bought Merrill Lynch and the current consumer-banking chief, with misleading investors by not disclosing Merrill Lynch's losses before the shareholders voted affirmatively to buy the company.[98] Specifically, Cuomo argues that Bank of America and its two top management executives, Lewis and Price, engaged in a concerted effort to deceive shareholders and the board of directors.[99]

---

[93] *Id.*

[94] *Id.* One document filed in March 2009 detailed losses of hundreds of millions of dollars; however, the plaintiffs in the case had not formally stated the amount of damages they were requesting. *See id.*

[95] *See supra* notes 87–91 and accompanying text.

[96] *See Rakoff Backs BofA Accord*, *supra* note 15. In order to sue individuals for fraud, the SEC must prove that such individuals sought to mislead investors. *See* Dan Fitzpatrick & Kara Scannell, *Ex-BofA Chief Sued for Fraud*, WALL ST. J., Feb. 5, 2010, at A1 [hereinafter *Ex-BofA Chief Sued for Fraud*]. The SEC has stated that it did not find any evidence that "executives deliberately concealed information from lawyers or that internal or outside lawyers intentionally sought to mislead shareholders." *Id.*

[97] *See Ex-BofA Chief Sued for Fraud*, *supra* note 96.

[98] *See id.* Cuomo brought the charges under the Martin Act, a New York law that does not require a finding that one acted intentionally in securities fraud. *See id.*; *see also* N.Y. GEN. BUS. LAW §§ 352–53 (McKinney 2010). During a telephone press conference, Cuomo stated, "We believe the bank management understated the Merrill Lynch losses to shareholders, then they overstated their ability to terminate their agreement to secure $20 billion of TARP money, and that is just a fraud." Karen Freifeld & David Scheer, *Ken Lewis, Bank of America Sued by Cuomo for Fraud over Merrill*, BLOOMBERG.COM (Feb. 5, 2010), http://www.bloomberg.com/apps/news?pid=20601087&sid=avbhw22ygkMA (internal quotation marks omitted).

[99] *See* Press Release, Andrew M. Cuomo, Attorney Gen., New York, Attorney General Cuomo Files Fraud Charges Against Bank of America, Former CEO Kenneth Lewis, and Former CFO Joseph Price (Feb. 4, 2010), *available at* http://www.ag.ny.gov/media_center/2010/feb/ feb04a_10.html. Cuomo's complaint states that "[m]any of the statements made by Lewis and Price in the period from the merger's announcement to its closing were false, misleading, or became so in

These events raise questions and invoke dialogue regarding the business judgment rule, the duty of candor, Rule 10b-5, and golden shares.

B. General Motors and Its Majority Shareholder, the United States Government

Until 2008, General Motors ("GM") was the world's largest auto manufacturer, producing over nine million cars and trucks a year in thirty-four different countries.[100] The company had 463 subsidiaries and employed 234,500 people—91,000 in America alone—paying $476 million in salaries each month.[101] Moreover, GM provided health care and pension benefits for 493,000 retired workers and spent $50 billion each year buying parts and services from 11,500 vendors.[102] However, the company had not made a profit since 2004, and on June 1, 2009, it became one of the largest industrial bankruptcies in history.[103] In its bankruptcy filing, GM declared that it had $172 billion in debt with only $82 billion in assets.[104] The filing came after President Obama, on March 30, 2009, "laid out a framework for [GM] to achieve viability that required the [c]ompany to rework its business plan, accelerate its operational restructuring and make far greater reductions in its outstanding liabilities."[105] After approving GM's plan, the government agreed to provide approximately $30 billion, in addition to the $20 billion the government had already provided, to support GM's restructuring plan.[106]

---

light of the events" that occurred over fall 2008. Complaint at 70, New York v. Bank of Am. Corp., 2010 WL 430118 (N.Y. Sup. Ct. Feb. 4, 2010) (No. 4501152010), *available at* http://www.ag.ny.gov/media_center/2010/feb/BoA_Complaint.pdf. Those statements include making misleading statements about due diligence, misleading the market, supporting the merger despite growing losses at Merrill Lynch, issuing a misleading proxy statement, supporting the merger at the shareholder vote, and issuing a press release on January 1, 2009 to announce the merger without disclosing all of the events that had occurred over the previous few months. *See id.* at 70–80.

[100] *A Giant Falls*, ECONOMIST, June 6, 2009, at 1.

[101] *Id.*

[102] *Id.*

[103] King & Terlep, *supra* note 21.

[104] *See A Giant Falls*, *supra* note 100.

[105] *Fact Sheet on Obama Administration Auto Restructuring Initiative for General Motors*, *supra* note 24.

[106] *See id.* The government had already put approximately $20 billion into GM at the time of the bankruptcy filing, leading the total cost to taxpayers to be around

The government wasted no time in reshaping GM's board of directors in the hope of creating the "New G.M."[107] On June 9, 2009, Edward E. Whitacre Jr., the former Chairman of AT&T, was handpicked by the government's auto task force and named the new Chairman of GM.[108] Whitacre replaced GM's longtime Chairman and Chief Executive Richard Wagoner, who resigned in March 2009 upon the request of President Obama.[109] While five existing directors remained on the board,[110] six other board members retired in accordance with the government's restructuring plan.[111] To replace these resigned directors, the United States government, who has taken a sixty percent stake in the company, stated that it would name four more directors to serve on the board.[112] Furthermore, the Canadian government, who would own twelve percent of the company after giving $9

$100 billion. *See A Giant Falls*, *supra* note 100, at 3. GM had received the initial loan from the government as part of its auto industry bailout. *See* Stoll & King, *supra* note 6.

[107] *Edward E. Whitacre Jr.*, N.Y. TIMES, http://topics.nytimes.com/topics/reference/timestopics/people/w/edward_e_whitacre_jr/index.html?inline=nyt-per. (last updated Aug. 12, 2010).

[108] *See* Bill Vlasic, *G.M. Chairman's Task: Bring Fresh Perspective*, N.Y. TIMES, June 10, 2009, at B4. In February 2009, President Obama assembled the auto task force to restructure the nation's auto industry by analyzing the various corporations and by making recommendations to auto companies on how to survive. *See* Neil King Jr. & John D. Stoll, *Auto Task Force Set To Back More Loans*, WALL ST. J., Mar. 26, 2009, at A1. The head of the team, who has taken a "crash course" with the whole team in the workings of the auto industry, reports to the Treasury Secretary and the Chief White House Economic Adviser. *Id.* Known as the Presidential Task Force on the Auto Industry, it is comprised of ten cabinet members and other top officials, but also includes many senior policy aids. David Shepardson & Gordon Trowbridge, *Auto Task Force Taking Shape*, DETROIT NEWS, Feb. 21, 2009, at B1. The appointment of Whitacre reflected the President's top auto advisers' belief that an outsider was needed to lead GM in the right direction. *See Edward E. Whitacre Jr.*, *supra* note 107.

[109] *See* Vlasic, *supra* note 108; Micheline Maynard, *G. Richard Wagoner Jr.*, N.Y. TIMES, http://topics.nytimes.com/top/reference/timestopics/people/w/g_richard_wagoner_jr/index.html?inline=nyt-per (last updated Mar. 30, 2009). In a statement following his resignation, Wagoner stated that he had been "urged to 'step aside' " by government officials. *Id.*

[110] Initially, six existing directors remained on the board. *See* Vlasic, *supra* note 108. However, on December 1, 2009, GM announced that Frederick A. Henderson, the company's CEO, was resigning and would be succeeded by Whitacre. *See Frederick A. Henderson*, N.Y. TIMES, http://topics.nytimes.com/top/reference/timestopics/people/h/frederick_a_henderson/index.html?inline=nyt-per (last updated Dec. 1, 2009).

[111] *See* Vlasic, *supra* note 108.

[112] *See* Stoll & King, *supra* note 6.

billion in aid, would name one director to the board.[113] Lastly, the United Automobile Workers ("UAW") health care trust, "which own[ed] 17.5% of [the company], ha[d] already named its representative to the board."[114] The new government-assembled board of directors planned to work with management during the end of 2009 to revamp GM's business strategy for 2010.[115] On July 10, 2009, GM emerged from bankruptcy after only forty days in court and a $50 billion commitment from the government.[116]

The government has stated that it is a reluctant shareholder in GM and would not become overly involved in the corporation.[117] White House Press Secretary Robert Gibbs stated, "There obviously is a balancing act . . . . While not running an auto company on a day-to-day basis, obviously there will be concern about investments by the taxpayer, as there should be."[118] Accordingly, the government has outlined four principles that will apply to its equity stake in GM:

> The government has no desire to own equity stakes in companies any longer than necessary, and will seek to dispose of its ownership interests as soon as practicable. . . .
>
> In exceptional cases where the U.S. government feels it is necessary to respond to a company's request for substantial assistance, the government will reserve the right to set upfront conditions to protect taxpayers, promote financial stability and encourage growth. . . .

---

[113] *See id.*

[114] *Id.* Bondholders and other creditors will receive the remaining ten percent stake in the company. *See* John Hughes et al., *GM Begins Bankruptcy Process with Filing for Affiliate*, BLOOMBERG.COM (June 1, 2009), http://www.bloomberg.com/apps/news?pid=20601110&sid=ahXd19xtoPx0.

[115] *See* John D. Stoll, *GM Board To Help Update Strategy*, WALL ST. J., Oct. 9, 2009, at B1.

[116] *See* Stoll & King, *supra* note 6.

[117] *See* King & Terlep, *supra* note 21. President Obama emphasized that they were "acting as a reluctant shareholder because this is the only way to help GM succeed." Eamon Javers, *Obama: 'Reluctant Shareholder' in GM*, POLITCO.COM (June 1, 2009), http://www.politico.com/news/stories/0509/23165.html (internal quotation marks omitted). President Obama said the goal was to "get GM back on its feet, take a hands off approach and get out quickly." *Id.* (internal quotation marks omitted). As a shareholder, government officials promised to only vote on "core governance issues," including the selection of the board of directors and significant corporate events and transactions. *Id.* (internal quotation marks omitted).

[118] Neil King Jr. et al., *The GM Bankruptcy: Potential Conflicts Abound in Government Role*, WALL ST. J., June 1, 2009, at A14 [hereinafter *The GM Bankruptcy*] (internal quotation marks omitted).

> After any up-front conditions are in place, the government will protect the taxpayers' investment by managing its ownership stake in a hands-off, commercial manner. . . .
> As a common shareholder, the government will vote on core governance issues, including the selection of a company's board of directors and major corporate events or transactions.[119]

The government has insisted that it will not be involved in the day-to-day affairs, stating that it will only help pick GM's first set of board members, remaining uninvolved after this action is complete.[120] In fact, the Treasury Department plans to hold its shares of GM in a blind trust.[121]

GM's government-assisted bankruptcy raises the issue of what duties the government owes other shareholders when it serves as both the majority shareholder and the governmental regulator. This issue differs from the situation at Bank of America where the government was allegedly pressuring the board of directors to take certain actions.[122]

C. *Citigroup and Its Controlling Shareholder, the United States Government*

Citigroup, a financial services corporation that had served as an aggressive player in the securitized mortgage market before the housing bust, first received $25 billion in TARP funds in October 2008.[123] The company then received a second lifeline from the government in December in the form of $20 billion,

[119] *Fact Sheet on Obama Administration Auto Restructuring Initiative for General Motors*, *supra* note 24. In its press release, the government does not provide specifics as to what it means by managing in a "hands-off" manner and what "upfront-conditions" might be required. *Id.* It is interesting to note that the government does not mention its duty to other GM shareholders. As the majority shareholder, they owe fiduciary duties to other shareholders. *See infra* Part IV.C.

[120] *See The GM Bankruptcy*, *supra* note 118.

[121] *Id.* Blind trusts are utilized to manage assets like traditional trusts, except that in blind trusts, the beneficiary is unable to watch over the trustee and is, in essence, "blind." *See* Megan J. Ballard, *The Shortsightedness of Blind Trusts*, 56 U. KAN. L. REV. 43, 58 (2007). The trustee does not tell the beneficiary about the identity and management of the trust property. *Id.*

[122] *See supra* Part I.A.

[123] *See Citigroup Inc.*, N.Y. TIMES, http://topics.nytimes.com/top/news/business/companies/citigroup_inc/index.html (last updated Dec. 7, 2010); *In Merrill Deal, U.S. Played Hardball*, *supra* note 6. Citigroup received these funds on October 28, 2008 through the sale of preferred stock and warrants to the Treasury Department under TARP's Capital Purchase Program. *See* Citigroup, Inc., Annual Report (Form 10-K), at 7 (Feb. 26, 2010); TRANSACTIONS REPORT, CAPITAL PURCHASE PROGRAM, *supra* note 34.

resulting in a total of $45 billion in government loans.[124] Citigroup received these additional funds from the government after its stock fell sixty percent to a sixteen-year low in November 2008.[125] To boost its capital reserves, and thus signal its future ability to absorb losses, Citigroup announced in February 2009 a plan to offer investors the option of exchanging a significant portion of preferred stock into common stock.[126] However, Citigroup received a setback in May 2009 when the government, after conducting an in-depth analysis to evaluate the bank's "ability to withstand future losses," decided that Citigroup still needed to raise an additional $5 billion to stay afloat.[127] In response, Citigroup announced that it would expand its previously disclosed public exchange offers to investors to convert an extra $5.5 billion of its preferred shares into common stock, resulting in an overall total of $58 billion of preferred stock to be exchanged for common stock, assuming full participation by

[124] *See In Merrill Deal, U.S. Played Hardball*, *supra* note 6. Once again, this loan was received through the sale of preferred stock and warrants to the Treasury Department. Citigroup, Inc., Annual Report (Form 10-K), at 7 (Feb. 26, 2010).

[125] *See* David Enrich et al., *U.S. Agrees To Rescue Struggling Citigroup*, WALL ST. J., Nov. 24, 2008, at A1. At the time, Citigroup had "more than 200 million customer accounts in 106 countries," and thus a sharp drop in stock price would inevitably scare customers and hurt the bank. *Id.*

[126] *See Citigroup Opens Its Share Offer*, WALL ST. J., June 11, 2009, at C3. Specifically, Citigroup initially expected to convert $58 billion worth of preferred stock and trust securities held by the government and private investors into common stock. *See id.*; *Citi Sets Plan To Convert $58 Billion in Stock*, N.Y. TIMES (June 10, 2009), http://dealbook.nytimes.com/2009/06/10/citi-sets-plan-to-convert-58-billion-in-stock/. Preferred shareholders' rights are spelled out in a corporation's articles of incorporation, and thus they are contractual in nature. *See In re* Appraisal of Metromedia Int'l Group, Inc., 971 A.2d 893, 899 (Del. Ch. 2009), *modified*, No. 3341-CC, 2009 Del. Ch. LEXIS 92 (Del. Ch. May 28, 2009), *aff'd*, 985 A.2d 389 (Del. 2009). By taking the preferred shares, which the government acquired through the loans they provided to the banks, and converting them into common shares, the government does not provide any additional money but the bank gains additional capital. *See* Edmund L. Andrews, *U.S. May Convert Banks' Bailouts to Equity Share*, N.Y. TIMES (Apr. 19, 2009), http://www.nytimes.com/2009/04/20/business/20bailout.html.

[127] *See* Deborah Solomon et al., *Banks Need at Least $65 Billion in Capital*, WALL ST. J., May 7, 2009, at A1. In spring 2009, the Federal Reserve and the Treasury Department conducted a two-and-a-half month analysis, or "stress test," of the nineteen largest financial institutions in America to assess their financial health and their ability to absorb losses. *Id.* While six banks were not required to raise any additional funds, other banks, including Citigroup, were told they needed to raise capital in order to survive. *See id.* Other institutions that needed additional capital included Bank of America, Wells Fargo, and Morgan Stanley. *See id.*

investors.[128] On June 10, 2009, Citigroup publicly announced that the government had approved the conversion plan and had agreed to convert $25 billion of its $45 billion preferred investment in the bank into approximately 7.7 billion shares of common stock.[129] Finally, on July 30, 2009, the transaction was completed and resulted in the government holding a thirty-four percent equity stake in the company.[130]

In mid-September 2009, Citigroup executives began exploring options for reducing the government's thirty-four percent ownership of the corporation, including issuing new shares to the public and having the Treasury Department sell part of its stake in Citigroup.[131] On December 23, 2009, Citigroup repaid the $20 billion in TARP preferred securities held by the Treasury Department, enabling the company to raise approximately $20.3 billion in common equity.[132] As of December 31, 2009, the Treasury Department continued to hold approximately 7.7 billion shares—approximately twenty-seven percent—of Citigroup's common stock, and the Treasury Department and the Federal Deposit Insurance Corporation ("FDIC") continued to hold approximately $5.3 billion of the company's trust-preferred securities.[133] Nevertheless, on January 19, 2010, Citigroup reported a $7.6 billion loss for the fourth quarter of 2009,[134] causing officials of the Treasury Department to delay any plans to release the company from the

[128] *See Citigroup Opens Its Share Offer*, WALL ST. J., June 11, 2009, at C3. Regarding the plan, CEO Vikram Pandit said, "Citi[group] will be among the best capitalized banks in the world." *Id.* (internal quotation marks omitted).

[129] *See* Citigroup, Inc., Annual Report (Form 10-K), at 7 (Feb. 26, 2010); Citigroup, Inc., Preliminary Proxy Statement (Schedule 14A), at 19 (Feb. 26, 2010); David Enrich & Deborah Solomon, *Citigroup Explores Bid To Pare U.S. Stake*, WALL ST. J., Sept. 15, 2009, at C1; Press Release, Citigroup Inc., Citi Announces Public Share Exchange Launch, Finalizes Definitive Agreement with U.S. Government (June 10, 2009), *available at* http://www.citibank.com/citi/press/2009/090610a.htm.

[130] *See* Ellis, *supra* note 6. According to Robert Thomson, the Editor-in-Chief of Dow Jones, this large government stake is one of the many reasons Citigroup was removed from the Dow Jones Industrial Average on June 8, 2009. *See* E.S. Browning, *Travelers, Cisco Replace Citi, GM in Dow*, WALL ST. J., June 2, 2009, at C1.

[131] *See* Enrich & Solomon, *supra* note 129.

[132] *See* Citigroup, Inc., Annual Report (Form 10-K), at 8 (Feb. 26, 2010).

[133] *Id.* at 6, 8.

[134] *Citigroup Inc.*, *supra* note 123. Citigroup announced a total loss for 2009 of $1.6 billion. *Id.* Moreover, the fourth quarter loss was attributed to a "$10.1 billion accounting charge tied to the repayment of [the company's] bailout money." *Id.* Such losses highlight the general concern over Citigroup's financial condition. *See id.*

government's control.[135] The report represented a "significant setback" for the company and its efforts to reclaim its independence.[136]

In addition to providing funds to Citigroup, the government made substantial efforts to influence the company's management. Specifically, the FDIC[137] pressured Citigroup to replace some of its management because government officials were frustrated with the "company's pace of change" and were especially concerned about the lack of commercial banking experience among the senior executives.[138] Accordingly, federal officials contacted Jerry Grundhofer, who had recently joined Citigroup's board and served as the former U.S. Bancorp CEO, to address this perceived lack in leadership.[139] Because the bank was so heavily dependent upon government aid, many believed that the FDIC would be successful in its efforts to exert influence over the company.[140]

---

[135] *See* Eric Dash, *U.S. Is Said To Rethink Quick Sale of Citi Stake*, N.Y. TIMES, Dec. 17, 2009, at B1.

[136] *Citigroup Inc.*, *supra* note 123. However, in March 2010, Herbert Allison, who oversees the government's financial rescue plan, stated before Congress that the government had no plans to buy more interest in Citigroup and that it intends to "rapidly" rid itself of its investment in the corporation over the next year. *See* Michael R. Crittenden & Matthias Rieker, *Clash over 'Too Big To Fail'*, WALL ST. J., Mar. 5, 2010, at C3.

[137] The FDIC is an independent agency "funded [solely] by premiums that banks and thrift institutions pay for deposit insurance coverage and from earnings on investments in U.S. Treasury securities." *Who Is the FDIC?*, FED. DEPOSIT INS. CORP., http://www.fdic.gov/about/learn/symbol/index.html (last visited Mar. 19, 2011). The FDIC examines and supervises approximately 4,900 financial institutions by "monitoring and addressing risks" in order to protect insured depositors. *Id.*

[138] Damian Paletta & David Enrich, *FDIC Pushes Purge at Citi*, WALL ST. J., June 5, 2009, at A1. For example, CEO Vikram Pandit has an investment banking background while the majority of Citigroup's problems are in the consumer loans area. *Id.*

[139] *Id.* In addition to Grundhofer, who was appointed in March, Citigroup appointed three more board members in July, all of whom have experience with changing distressed financial institutions and understanding regulatory issues. Robin Sidel, *Citi Taps Directors with Fix-It Expertise*, WALL ST. J., July 25, 2009, at B1. The new directors are Diana Taylor, who served as New York State Banking Department Superintendent; Timothy Collins, "who helped turn around a failing Japanese bank"; and Robert Joss, who restructured an Australian bank. *Id.*

[140] *See* Paletta & Enrich, *supra* note 138. In addition to TARP funds, the FDIC is currently helping Citigroup finance a roughly $300 billion loss-sharing agreement, and Citigroup has already issued around $40 billion in FDIC-backed debt since December 2008. *Id.*

FDIC Chairman Sheila Bair appeared to be utilizing her influence when she pressed another regulator to lower the government's confidential ranking of Citigroup's health, which would allow regulators to even further control the company.[141] As of the writing of this Article, Citigroup officials believed that the FDIC would place Citigroup on its "problem" list of banks if the company did not remove CEO Vikram Pandit and other executives.[142] According to *The Wall Street Journal*, Citigroup's removal of CFO Edward Kelly served as an attempt to appease federal regulators.[143] In fact, Citigroup Chairman Richard Parsons had been trying to defuse a "standoff between the company and [certain] federal officials," leading Pandit to reluctantly remove Kelly under pressure from both Parsons and federal officials.[144]

In October 2009, a government-ordered outside review of Citigroup's management was released.[145] Conducted by consulting firm Egon Zehnder International,[146] the review

---

[141] *See id.* Apparently, Bair has become more willing to challenge her peers than in the past, and thus, the FDIC is gaining significant influence in the financial world. *See id.* Bair predicted the housing crisis before many of her equals did, and the FDIC has played a pivotal role in dealing with the current financial crisis. *Id.* Thus, Bair and the FDIC have been able to exert more influence and pressure on Citigroup than they have exerted on financial institutions in the past. *See id.*

[142] *Id.* Being placed on the problem list could limit Citigroup's access to federal aid and cause trading partners and clients to take their business elsewhere. *Id.* Because the FDIC's problem list is confidential, it is unknown if Citigroup has been added to the list. *Id.*

[143] *See* David Enrich & Robin Sidel, *Citigroup Shakes up Leaders To Pacify U.S.*, WALL ST. J., July 10, 2009, at A1. Kelly, whose qualifications had been questioned by some federal regulators, had only been CFO from March 2009 to the beginning of July 2009. *See id.* He is now a vice chairman and advisor to Pandit. *See id.*

[144] *Id.* In June, Kelly "referred to the [FDIC] as 'our tertiary regulator,' behind the Federal Reserve and the Office of the Comptroller of the Currency," a statement that was not well received by the FDIC and further intensified the feud between the two. *Id.* Kelly, before leaving the company, stated, "Regulators are making it impossible for me to do my job . . . . I'm becoming a hindrance to the company." *Id.* (internal quotation marks omitted).

[145] *See* David Enrich & Joann S. Lublin, *Good Marks, Mostly, for Citi Management*, WALL ST. J., Oct. 8, 2009, at C1 [hereinafter *Good Marks, Mostly, for Citi*]. The review occurred after the government's spring 2009 stress tests. *See id.* Companies that needed more capital had to review their management and then notify federal regulators of their results. *Id.*

[146] *Id.* According to *The Wall Street Journal*, the FDIC required Citigroup to utilize an outside firm to review its management. *Id.* In fact, the FDIC initially rejected Citigroup's first-choice firm to conduct the review, leading the FDIC to send Citigroup a list of firms the company would be allowed to use. David Enrich &

awarded mostly high marks to Citigroup's management, with Pandit being reviewed favorably and only a few senior management positions receiving negative reviews.[147] However, shortly after the review was released, FDIC officials were skeptical about the validity and strength of the report.[148] As a result, the FDIC may not rely heavily on the report during its next regulatory review of Citigroup's management, which could have a negative effect on the FDIC's rating of the company.[149]

Due to the large ownership stake the government now has in Citigroup, it is arguably a controlling shareholder in the corporation.[150] Accordingly, the recent events occurring between Citigroup and the government raise many questions regarding the fiduciary duties the government owes other Citigroup shareholders. Similar to GM's situation, the government must simultaneously act as the governmental regulator of Citigroup and own a significant portion of the corporation.

II. THE TRADITIONAL TRIAD OF FIDUCIARY DUTIES OWED BY, AND THE LEGAL PROTECTIONS AVAILABLE TO, BOARDS OF DIRECTORS RELEVANT TO ANALYZING THE FINANCIAL CRISIS OF 2008

Since boards of directors consist usually of a relatively small number of individuals making important decisions on behalf of many people—the shareholders—they are vulnerable to criticism and lawsuits. Fortunately, the law provides various forms of protection to ensure that directors do not fear costly litigation every time they make a decision for the corporation and its shareholders.[151] These protections include the business

---

Randall Smith, *Review of Citi Draws Wary FDIC Response*, WALL ST. J., Oct. 9, 2009, at C1 [hereinafter *Review of Citi Draws Wary FDIC Response*].

[147] *See Good Marks, Mostly, for Citi*, *supra* note 145. Two directors that did not receive favorable reviews were Vice Chairman Lewis Kaden and Chief Administrative Officer Don Callahan. *See id.*

[148] *See Review of Citi Draws Wary FDIC Response*, *supra* note 146. Part of the review utilized interviews with Citigroup executives regarding their opinion of the effectiveness of their co-workers. *See id.*

[149] *See id.* The ratings, which are determined in part by a review of a bank's management, are a factor in whether a bank is subject to tight regulatory control, which Citigroup is currently under. *See id.*

[150] See *infra* Part IV.C for a discussion of controlling shareholders.

[151] DOUGLAS M. BRANSON ET AL., BUSINESS ENTERPRISES: LEGAL STRUCTURES, GOVERNANCE, AND POLICY: CASES, MATERIALS, AND PROBLEMS 591–92 (2009) (discussing the various means of protection provided to corporate directors and

judgment rule, the board's ability to place exculpatory provisions in the articles of incorporation, and the simple fact that shareholder derivative litigation is rarely successful.

A. *The Business Judgment Rule*[152]

Shareholders may technically own a corporation, but directors are given broad authority over how to run the corporation in jurisdictions all over the country.[153] If shareholders are unhappy, they certainly have the right to sue directors for breach of fiduciary duty in a shareholder derivative action; however, directors are generally protected by the business judgment rule.[154] The business judgment rule is the backbone of American corporate law and is frequently addressed in American

officers, including exculpatory provisions and the business judgment rule). Also, Branson discusses how indemnification in the form of reimbursing directors and/or officers for litigation costs and liability and director and officer insurance protect directors; however, these two forms of protection are beyond the scope of this Article and will not be discussed. *Id.* Additionally, Branson discusses the difficulty of bringing a shareholder derivative suit and the decrease in the number of such suits filed since the 1980s due to special litigation committees' ability to halt these types of lawsuits. *Id.* at 467–68.

[152] This Article will discuss only those provisions of the business judgment rule relevant to the analysis of Bank of America, Citigroup, and GM.

[153] *See* 3A WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 1036 (perm. ed., rev. vol. 2002). Indeed, section 141(a) of the Delaware General Corporation Law, which is important not only because most public companies incorporate in Delaware but also because most states look to Delaware for guidance in shaping their own corporate laws, states that the "business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors." DEL. CODE ANN. tit. 8, § 141(a) (2010).

[154] FLETCHER ET AL., *supra* note 153. If shareholders wish to sue the board of directors, they must first demand the board of directors to sue on behalf of the corporation. If the board refuses such demand, the court applies the business judgment rule in reviewing the board's refusal to act pursuant to the shareholders' demand. *Id.* However, if the shareholders can state reasons with particularity that the demand on the board should be excused as futile, the shareholders retain the ability to initiate the derivative action. *See* Aronson v. Lewis, 473 A.2d 805, 808, 818 (Del. 1984) (holding that the shareholders "failed to allege facts with particularity indicating that the [corporation's] directors were tainted by interest, lacked independence, or took action contrary to [the corporation's] best interests," thereby negating any doubt as to the applicability of the business judgment rule). In determining demand futility, the court "must decide whether, under the particularized facts alleged [by the shareholders], a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of [the board's] business judgment." *Id.* at 814. See *infra* Part II.C for a further discussion of shareholder derivative litigation.

courtrooms.[155] Created approximately two centuries ago, the business judgment rule has been continuously developing through American common law.[156] Today, the business judgment rule is almost exclusively an American concept.[157] Despite the fact that the business judgment rule is consistently applied in courtrooms and analyzed by scholars, many consider it to be "one of the least understood concepts in the entire corporate field."[158]

The business judgment rule can best be defined as "a presumption that[,] in making a business decision[,] the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[159] In Delaware,[160] a shareholder plaintiff must prove that the directors of a corporation "breached . . . one of the *triads* of their fiduciary duty—good faith, loyalty[,] or due care"—in order to overcome the presumption of the business judgment

---

[155] *See* Lyman P.Q. Johnson, *Corporate Officers and the Business Judgment Rule*, 60 BUS. LAW. 439, 453 (2005); E. Norman Veasey, *Counseling Directors in the New Corporate Culture*, 59 BUS. LAW. 1447, 1454 (2004).

[156] *See* Ann M. Scarlett, *A Better Approach for Balancing Authority and Accountability in Shareholder Derivative Litigation*, 57 U. KAN. L. REV. 39, 58 (2008) (citing S. Samuel Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93, 93 (1979)). The business judgment rule has remained uncodified. Douglas M. Branson, *The Rule that Isn't a Rule—The Business Judgment Rule*, 36 VAL. U. L. REV. 631, 633 (2002).

[157] Branson, *supra* note 156, at 633. However, in 1999, Australia enacted a new law based on the American construction of the business judgment rule. *Id.*

[158] Johnson, *supra* note 155 (quoting Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 270 (1967) (internal quotation marks omitted)).

[159] *Aronson*, 473 A.2d at 812. This definition is the most quoted definition of the business judgment rule in Delaware courts. Branson, *supra* note 156, at 635 n.16. Other definitions include the American Law Institute ("ALI") version of the business judgment rule, which has been adopted by several states. *Id.* at 634. The ALI version is as follows:

> (c) A director or officer who makes a business judgment in good faith fulfills the [duty of care] if the director or officer: (1) is not interested in the subject of the business judgment; (2) is informed with respect to the subject of the business judgment to the extent the director or officer reasonably believes to be appropriate under the circumstances; and (3) rationally believes that the business judgment is in the best interests of the corporation.

AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01(c) (1994) (citation omitted).

[160] Delaware is the leader in American corporate law and is thus the best place to consult when analyzing the developments and current status of corporate law, including the business judgment rule. *See* Scarlett, *supra* note 156, at 59.

rule.[161] If a plaintiff overcomes that presumption, the burden shifts to the directors, who then have the opportunity to prove their case and free themselves from liability.[162] Thus, decisions made by directors will not be reversed by courts unless the following circumstances can be proven:

> the directors are interested or lack independence relative to the decision, do not act in good faith, act in a manner that cannot be attributed to a rational business purpose[,] or reach their decision by a grossly negligent process that includes the failure to consider all material facts reasonably available.[163]

Through this presumption, the board of directors' business decisions are protected from being second-guessed by judges in a courtroom so long as the decisions are "made in good faith and in the exercise of due care."[164] Thus, the business judgment rule acts as a standard of review for analyzing the decisions made by boards of directors in order to determine liability,[165] with directors only needing to demonstrate "some (slight) care and only a rational (plausible) basis for the decision made."[166] Additionally, the business judgment rule helps promote the full exercise of managerial power, so that the directors, and not the shareholders, make the decisions and control the affairs of a corporation.[167]

---

[161] Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993). The business judgment rule will not apply if the directors committed an act of fraud, illegality, or waste. *See* Scarlett, *supra* note 156, at 59–60. Moreover, the duty of good faith is not always considered a stand-alone duty, but is instead viewed as a sub-category of the duty of loyalty. *See infra* notes 181–88 and accompanying text.

[162] *See Cede & Co.*, 634 A.2d at 361 (stating that "[i]f the [business judgment] rule is rebutted, the burden shifts to the defendant directors, the proponents of the challenged transaction, to prove to the trier of fact the 'entire fairness' of the transaction to the shareholder plaintiff" (quoting Nixon v. Blackwell, 626 A.2d 1366, 1376 (Del. 1993))); *see also* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (Del. 1989); Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983); FLETCHER ET AL., *supra* note 153.

[163] Brehm v. Eisner, 746 A.2d 244, 264 n.66 (Del. 2000).

[164] Veasey, *supra* note 155, at 1454.

[165] Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 87 (2004). In his article, Bainbridge argues that the business judgment rule often acts more like an abstention doctrine as courts "refrain from reviewing board decisions unless exacting preconditions for review are satisfied." *Id.*

[166] Branson, *supra* note 156, at 635.

[167] Janet E. Kerr, *Developments in Corporate Governance: The Duty of Good Faith and Its Impact on Director Conduct*, 13 GEO. MASON L. REV. 1037, 1074 (2006).

No clear-cut answer exists as to why the business judgment rule was developed,[168] but several theories have been promulgated. One of the primary justifications for the business judgment rule is that "judges are not business experts."[169] Indeed, the Delaware Court of Chancery has stated that "[b]ecause businessmen and women are correctly perceived as possessing skills, information and judgment not possessed by reviewing courts . . . courts have long been reluctant to second-guess such decisions when they appear to have been made in good faith."[170] Thus, the business judgment rule encourages directors to take risks without fear of being held liable for their decisions, promoting the view that directors should not be held liable for actions that in hindsight are not ideal.[171] Moreover, because the law and the marketplace value the board of directors' authority, the business judgment rule provides protection from judicial encroachment.[172] Furthermore, the business judgment rule prevents stockholders from asserting and forcing their demands, which may not be in the best interest of the majority of shareholders, upon directors.[173] Lastly, the business judgment rule recognizes that shareholders "voluntarily undertake the risk of a business judgment," but always retain the power to vote directors out of office.[174]

The first of the three triads of the business judgment rule is the duty of due care. The duty of due care "places an affirmative obligation on the directors to protect the interests of the corporation and its shareholders when making decisions on behalf of the corporation."[175] As a result, "directors must critically assess relevant information before making a

[168] *See* Kenneth B. Davis, Jr., *Once More, the Business Judgment Rule*, 2000 WIS. L. REV. 573, 573 (stating, "thousands of pages of corporate law scholarship and commentary have been devoted to these fundamental questions, yet we remain short of any broad consensus as to the answers").

[169] Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919).

[170] *In re* J.P. Stevens & Co. S'holders Litig., 542 A.2d 770, 780 (Del. Ch. 1988).

[171] *See* Johnson, *supra* note 155, at 455–56.

[172] *See* Bainbridge, *supra* note 165, at 108.

[173] Kerr, *supra* note 167, at 1074–75.

[174] *Id.* at 1075.

[175] Ann M. Scarlett*, Confusion and Unpredictability in Shareholder Derivative Litigation: The Delaware Courts' Response to Recent Corporate Scandals*, 60 FLA. L. REV. 589, 610 (2008) [hereinafter Scarlett, *Confusion and Unpredictability*]; *see* Briggs v. Spaulding, 141 U.S. 132, 147 (1891) (stating that directors have a duty "to supervise the business with attention . . . [and] to use proper care in the appointment of agents").

decision."[176] The duty of due care "requires directors to act with the same 'amount of care which ordinarily careful and prudent [persons] would use in similar circumstances.' "[177] Moreover, the duty of due care requires directors to " 'consider all material information reasonably available' in making business decisions."[178] The duty of due care is breached once a director, while making a decision on behalf of the corporation, fails "to act in an informed and deliberate manner"[179] or simply makes "an unintelligent and unadvised judgment."[180]

The duty of loyalty is the second facet of the business judgment rule. "[T]he duty of loyalty mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally."[181] The duty of loyalty, "requir[ing] an undivided and unselfish loyalty to the corporation[,] demands that there be no conflict between duty and self-interest."[182] To illustrate, a director may be considered "interested" if he or she will receive a financial gain from a transaction that is greater than the benefit received by the stockholders,[183] or if the director takes action to avoid the repercussions of a decision that would impact him or her

[176] Scarlett, *Confusion and Unpredictability*, *supra* note 175.

[177] Bainbridge, *supra* note 165, at 88 (quoting Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963)).

[178] *In re* Walt Disney Co. Derivative Litig. (*Disney I*), 907 A.2d 693, 749 (Del. Ch. 2005) (quoting Brehm v. Eisner, 746 A.2d 244, 259 (Del. 2000)), *aff'd*, 906 A.2d 27 (Del. 2006).

[179] Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985).

[180] *Id.* (quoting Mitchell v. Highland-Western Glass Co., 167 A. 831, 833 (Del. Ch. 1933)).

[181] Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993); *see* Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983).

[182] *Disney I*, 907 A.2d at 751 (citing Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939)). The case further states:

> A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers.

Id.

[183] *See* Rales v. Blasband, 634 A.2d 927, 936 (Del. 1993) (citing Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)).

negatively but would not necessarily have the same effect on the corporation.[184] Additionally, a director can be viewed as "interested" if he or she "receives a substantial benefit from supporting a transaction."[185] The duty of loyalty can also be breached through self-dealing, the receipt of excessive compensation, the use of corporate funds to perpetuate control, insider trading, the usurpation of corporate opportunities, and competition among the companies of corporate officers and directors.[186]

The third duty of the business judgment rule triad is the duty of good faith. While "good faith" was a considered in early business judgment rule cases, it has seldom been the deciding factor.[187] Moreover, some disagreement exists as to whether it is a stand-alone duty or a sub-category of the duty of loyalty.[188] In the past, the duty of good faith was defined in the context of bad faith, as the Delaware Supreme Court once stated, "[i]n the absence of a showing of bad faith on the part of the directors or of a gross abuse of discretion[,] the business judgment of directors will not be interfered with by the courts."[189] Bad faith involves a "fiduciary intentionally fail[ing] to act in the face of a known duty to act, demonstrating a conscious disregard for his duties."[190] Today, the duty of good faith "works as part of the articulation of the business judgment rule that applies to the directors' decision-making process and it is part of the directors' oversight responsibility."[191] Moreover, the duty of good faith has been said

---

[184] *See id.*

[185] *Cede*, 634 A.2d at 362.

[186] *See* STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 306–07, 320–23 (2002).

[187] *See* Scarlett, *Confusion and Unpredictability*, *supra* note 175, at 619.

[188] *See* Kerr, *supra* note 167, at 1049–50. In *Stone v. Ritter*, 911 A.2d 362 (Del. 2006), the Delaware Supreme Court clarified its earlier ruling in *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996), by holding that failing to implement a system of monitors or controls, or a conscious failure to use an implemented system of monitors or controls, would constitute a breach of a director's duty of loyalty "by failing to discharge that fiduciary obligation in good faith." *Stone*, 911 A.2d at 369–70.

[189] Warshaw v. Calhoun, 221 A.2d 487, 492–93 (Del. 1966).

[190] *In re* Walt Disney Co. Derivative Litig. (*Disney II*), 906 A.2d 27, 67 (Del. 2006).

[191] Veasey, *supra* note 155, at 1455. In *In re Caremark*, the court stated that a director owes a duty of good faith to ensure that a corporation has a monitoring and reporting system, which the board approves, and failure to do so can make the director liable for damages to the company for illegal activity by employees. *See In re Caremark*, 698 A.2d at 970.

to "involve all the aspects of honesty and integrity,"[192] and requires that directors' motivation stem from "a true faithfulness and devotion to the interests of the corporation and its shareholders."[193] The duty of good faith can be violated by "intentional or unintentional misconduct[,] reckless behavior given a certain duration or magnitude[,] conscious disregard of known risks[,] and behavior that cannot rationally be explained on any other grounds."[194]

The Delaware Supreme Court recently addressed the duty of good faith in *Lyondell Chemical Co. v. Ryan*,[195] where shareholders sued the board of directors of Lyondell Chemical Company for not acting in good faith while selling the company.[196] While the board of directors failed to perform an auction or a market check before selling the company,[197] they did meet several times during the week they considered the buyer's offer, and the CEO attempted to negotiate better terms for the transaction.[198] Thus, while the board of directors' behavior was not perfect, the Delaware Supreme Court did not find that their behavior reached the level of bad faith as "the directors' failure to take any specific steps during the sale process could not have demonstrated a conscious disregard of their duties."[199] The court also noted that a "vast difference [exists] between an inadequate or flawed effort to carry out fiduciary duties and a conscious disregard for those duties."[200]

[192] E. Norman Veasey, *Seeking a Safe Harbor from Judicial Scrutiny of Directors' Business Decisions—An Analytical Framework for Litigation Strategy and Counseling Directors*, 37 BUS. LAW. 1247, 1251 (1982).

[193] *In re* Walt Disney Co. Derivative Litig. (*Disney I*), 907 A.2d 693, 755 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006); *see also In re* RJR Nabisco, Inc. S'holders Litig., No. 10389, 1989 WL 7036, at *15 (Del. Ch. Jan. 31, 1989) (elaborating further).

[194] Kerr, *supra* note 167, at 1042.

[195] 970 A.2d 235 (Del. 2009).

[196] *See id.* at 237.

[197] *Id.* at 243.

[198] *Id.* at 242. Additionally, "the directors were disinterested and independent; . . . they were generally aware of the company's value and its prospects; and . . . they considered the offer, under the time constraints imposed by the buyer, with the assistance of financial and legal advisors." *Id.* at 237.

[199] *Id.*

[200] *Id.* at 243. However, the court suggested that the board of directors may have breached their duty of care. *See id.*

B. Exculpatory Provisions in the Articles of Incorporation

In addition to the business judgment rule, boards of directors are often protected from liability for their decisions by state statutes.[201] Indeed, Delaware enacted section 102(b)(7) of the Delaware General Corporation Law in response to the Delaware Supreme Court's decision in *Smith v. Van Gorkom*,[202] where the court held directors of a corporation personally liable for breaching their duty of care in a lawsuit initiated by shareholders.[203] Section 102(b)(7) allows shareholders to adopt a clause in their corporation's articles of incorporation protecting directors from personal liability for monetary damages for breaching the duty of care.[204] Since Delaware enacted section 102(b)(7), all other jurisdictions, with the exception of the District of Columbia, have enacted a similar provision.[205] The provisions adopted by other states either completely eliminate holding directors personally liable for monetary damages for the breach of duty of due care, or instead, allow the articles of incorporation to eliminate director liability if the shareholders choose to adopt such a provision.[206] Additionally, virtually every corporation has adopted an exculpatory provision to address the situation where the state statute did not eliminate liability but rather gave corporations the option to adopt an exculpatory provision.[207]

---

[201] *See* Dennis R. Honabach, Smith v. Van Gorkom*: Managerial Liability and Exculpatory Clauses—A Proposal To Fill the Gap of the Missing Officer Protection*, 45 WASHBURN L.J. 307, 307 (2006).

[202] 488 A.2d 858 (Del. 1985).

[203] *See* Honabach, *supra* note 201; *see also* DEL. CODE ANN. tit. 8, § 102(b)(7) (2010). Before this case, directors were assumed to not be liable for breaching the duty of care. *Id.* However, they could still be held personally liable for breaching the duty of loyalty. *Id.*

[204] *See* § 102(b)(7). The statute also provides that the exculpatory provision must not include immunity from liability for the following: (1) breaching the duty of loyalty; (2) not acting in good faith, omissions not made in good faith, or acts or omissions involving intentional misconduct or knowingly violating the law; (3) unlawful payment of dividends or unlawful stock purchases or redemptions; or (4) transactions where the director receives an inappropriate personal benefit. *See id.*

[205] *See* Honabach, *supra* note 201.

[206] *See* Lawrence A. Hamermesh, *Why I Do Not Teach* Van Gorkom, 34 GA. L. REV. 477, 490 (2000).

[207] *See id.*; Honabach, *supra* note 201, at 313.

C. Shareholder Derivative Litigation[208]

In addition to the business judgment rule and exculpatory provisions provided for in articles of incorporation, boards of directors are protected from liability in lawsuits simply because shareholder derivative litigation is rarely successful. When shareholders wish to bring derivative litigation, they face several challenges that are in place to ensure the litigation will be valuable, and not detrimental, to the corporation.[209] Thus, shareholder derivative litigation is often quickly dismissed, protecting the board of directors.[210] However, through the growth in shareholder activism, as well as the increase in proxy access, shareholder derivative litigation is growing and exposing boards more than ever before.[211]

Shareholder derivative litigation has increased and survived more motions to dismiss post-2001, due arguably in part to the corporate scandals that occurred in 2001, namely Enron and Worldcom.[212] While Delaware has not announced new standards for the business judgment rule, it appears that judicial enforcement of these standards has changed.[213] Indeed, the former Chief Justice of the Delaware Supreme Court, Norman E. Veasey, has acknowledged that Delaware courts are applying new scrutiny, yet also the "same law," to defendants in derivative actions, and that Delaware courts' "expectations of directors are

[208] This Section does not provide a complete discussion of shareholder derivative litigation, but instead only discusses those aspects relevant to the current issue.

[209] *See* Larry E. Ribstein, *Litigating in LLCs*, 64 BUS. LAW. 739, 740 (2009). Shareholder plaintiffs often must place a demand on the corporation or have their lawsuit approved by the special litigation committee. *See id.*

[210] *See generally id.* (describing derivative suits).

[211] First, in the hopes of increasing shareholders activism, the SEC has taken steps to make proxy information available on the Internet, making it much easier for shareholders to submit proxy materials and participate in their corporation's voting process. *See* Blake H. Crawford, *Eliminating the Executive Overcompensation Problem: How the SEC and Congress Have Failed and Why the Shareholders Can Prevail*, 2 J. BUS. ENTREPRENEURSHIP & L. 273, 294 (2009). Additionally, since the 1950s, institutional ownership of shares in corporations has increased dramatically, with those institutions becoming very active shareholders through the process of submitting shareholder proposals. *See* Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 447, 449 (1991).

[212] Scarlett, *Confusion and Unpredictability*, *supra* note 175, at 590, 593.

[213] *See id.*

evolving."[214] The best example of this new shift is found in *In re Walt Disney Co. Derivative Litigation*,[215] where Disney shareholder plaintiffs survived multiple pretrial motions and the case subsequently went to trial.[216] While the plaintiffs ultimately lost,[217] the fact that the case survived so many pre-trial motions indicates that shareholder derivative litigation may be exposing boards of directors more than in previous years.

While boards of directors are still somewhat protected from shareholder derivative litigation, one of the consequences of the recent change in the American economy is that corporations are being sued more frequently and for more reasons.[218] Indeed, more securities class-action lawsuits have occurred since the financial crisis began.[219] Thus, while shareholder derivative litigation does act as a way of protecting boards of directors, the current financial crisis has led plaintiffs to find other ways to hold directors liable for their poor business decisions.

---

[214] John Gibeaut, *Stock Responses: Shareholders Ask for Changes in Corporate Governance and the Courts Are Starting To See It Their Way*, 89 A.B.A. J. 38, 40 (2003) (internal quotation marks omitted).

[215] *In re* Walt Disney Co. Derivative Litig. (*Disney II*), 906 A.2d 27 (Del. 2006).

[216] *See id.* at 35; *see also In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106 (Del. Ch. 2009); *In re* Nat'l Auto Credit, Inc. S'holders Litig., No. Civ.A.19028, 2003 WL 139768 (Del. Ch. Jan. 10, 2003); Omni Care, Inc. v. NCS Healthcare, Inc., 822 A.2d 397 (Del. 2002); Levco Alternative Fund Ltd. v. Reader's Digest Ass'n, 803 A.2d 428 (Del. 2002); Telxon Corp. v. Meyerson, 802 A.2d 257 (Del. 2002).

[217] *See Brehm*, 906 A.2d at 35–36.

[218] *See* James L. Sanders, *Am I Liable?*, DIRECTORSHIP, June/July 2009, at 46. Not only are boards of directors being sued by angry shareholders, but the government is increasing its scrutiny of boards of directors through its own regulatory agencies, including the SEC. *See id.* Indeed, Citigroup was recently sued in a shareholder derivative action for excessive payments made to a former CEO on the basis that the payment was wasting corporate assets. *See In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d at 112. In fact, the court denied the motion to dismiss the claim for corporate waste. *Id.* at 140.

[219] *See* Alistair Barr, *Financial Crisis Triggers More Class-Action Suits*, MARKETWATCH (Dec. 30, 2008), http://www.marketwatch.com/story/financial-crisis-triggers-more-class-action-lawsuits. According to Barr's article, Stanford Law School's Securities Class Action Clearinghouse found 220 securities class action lawsuits in 2008, 173 in 2007, and 115 in 2006. *Id.* The most recent time that there were this many class action lawsuits was in 2002, during "the dot-com bust" and the Enron and WorldCom affairs. *See id.*

III. THE DUTY OF CANDOR: DELAWARE'S ADDITIONAL DUTY OWED TO SHAREHOLDERS BY DIRECTORS

In addition to the fiduciary duties owed to shareholders under the business judgment rule, Delaware, as well as other states, has developed an additional duty known as the duty of candor.[220] The duty of candor "flows from the broader fiduciary duties of care and loyalty."[221] Sometimes it is credited as being a stand-alone duty, while at other times it is considered part of the duty of due care and the duty of loyalty.[222] Over the past twenty years, it has gained prominence, in part due to the popularity of exculpatory provisions in articles of incorporation that eliminate duty of due care suits.[223] As a result, duty of candor violations and subsequent litigation have become more important to shareholder plaintiffs. However, because it is unclear whether it is part of the duty of due care, duty of loyalty, or a stand-alone duty, courts are inconsistent with how they treat duty of candor allegations.[224]

---

[220] *See* BRANSON ET AL., *supra* note 151, at 462 (stating that "[c]ourts in states other than Delaware have recognized the right and utilized the duty of candor terminology"). Branson points to *Persinger v. Carmazzi*, 441 S.E.2d 646, 652 (W. Va. 1994), and *Potter v. Pohlad*, 560 N.W.2d 389, 395 (Minn. App. 1997), as examples. *Id.* The duty of candor in Delaware is relevant to this discussion, as the three corporations profiled in this Article are all incorporated in Delaware. *See* BankAmerica Corporation, Amended and Restated Certificate of Incorporation of BankAmerica Corporation (Apr. 28, 2010), *available at* http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzM0NTR8Q2hpbGRJRD0tMXxUeXBl PTM=&t=1; Citigroup Inc., Restated Certificate of Incorporation of Citigroup Inc. (Oct. 30, 2009), *available at* http://www.citigroup.com/citi/corporategovernance/data/citigroup_rci.pdf?ieNocache=934; General Motors Holding Company, Amended and Restated Certificate of Incorporation of General Motors Holding Company (Nov. 1, 2010), *available at* http://www.gm.com/investors/corporate-governance/docs/GM CertificateofIncorporation.pdf.

[221] Turner v. Bernstein, 776 A.2d 530, 542 (Del. Ch. 2000).

[222] BRANSON ET AL., *supra* note 151, at 461 (stating that "the [Delaware] court has been somewhat coy pinning down whether the duty of candor springs from the duty of care, the duty of loyalty, or is a free standing obligation"). However, the issue of whether shareholders have been notified of the necessary information to make an informed decision is not related to the management of the corporation, and thus not a decision the business judgment rule would protect, supporting the argument that the duty of candor is not under the business judgment rule. *See In re* Anderson, Clayton S'holders' Litig., 519 A.2d 669, 675 (Del. Ch. 1986).

[223] BRANSON ET AL., *supra* note 151, at 461; *see also infra* Part II.B.

[224] *Compare* BRANSON ET AL., *supra* note 151, at 461 (stating that "articles of incorporation can result in exculpation and dismissal of duty of candor violations, at least if no self dealing or 'intentional misconduct or a knowing violation of law was involved' " (citing Arnold v. Soc. for Savings Bancorp, 650 A.2d 1270 (Del. 1994)), *with* Zirn v. VLI Corp., 621 A.2d 773, 783 (Del. 1993) (stating that an exculpatory

Known alternatively as the duty of disclosure,[225] the duty of candor is breached when directors make "a materially false statement, [omit] a material fact, or [make] a partial disclosure that is materially misleading."[226] The duty of candor does not create an original disclosure rule, but instead "represents nothing more than the well-recognized proposition that directors of Delaware corporations are under a fiduciary duty to disclose fully and fairly all material information within the board's control when it seeks shareholder action."[227] Furthermore, in *Malone v. Brincat*, the Delaware Supreme Court stated:

> Delaware law also protects shareholders who receive false communications from directors even in the absence of a request for shareholder action. When the directors are not seeking shareholder action, but are deliberately misinforming shareholders about the business of the corporation, either directly or by a public statement, there is a violation of fiduciary duty.[228]

Thus, even if shareholder action has not been requested by the board of directors, directors of corporations have a "fiduciary duty to shareholders to exercise due care, good faith and loyalty" when communicating to the public or to shareholders regarding the business of the corporation.[229] What is not clear after *Malone*, however, is if the information that the directors presented to shareholders later becomes false, whether it is a violation of the duty of candor to not communicate the new information to shareholders.[230]

---

provision did not excuse directors from duty of candor liability). In essence, it appears that if a duty of candor allegation stems from a violation of the duty of loyalty or another duty, it can escape dismissal. BRANSON ET AL., *supra* note 151, at 461 (citing *In re* Reliance Sec. Litig., 91 F. Supp. 2d 706, 731–32 (D. Del. 2000)).

[225] *See* Stroud v. Grace, 606 A.2d 75, 84 (Del. 1992) (preferring the term "duty of disclosure"). However, after *Stroud*, courts continued using "duty of candor." BRANSON ET AL., *supra* note 151, at 460–61.

[226] Pfeffer v. Redstone, 965 A.2d 676, 684 (Del. 2009).

[227] *Stroud*, 606 A.2d at 84; *see also* Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998) (stating that "[t]he duty of disclosure obligates directors to provide the stockholders with accurate and complete information material to a transaction or other corporate event that is being presented to them for action").

[228] 722 A.2d 5, 14 (Del. 1998).

[229] *Id.* at 10.

[230] One commentator has suggested that an affirmative obligation to disclose information when shareholder action is not requested should only occur when either the scenario is one where the federal laws do not protect shareholders or "where Delaware law can logically invoke traditional fiduciary duty principles to fill in that

Thus, under the duty of candor, directors owe a fiduciary duty to disclose all material information to shareholders in the following situations: (1) when seeking shareholder approval of transactions that require a shareholder vote; (2) when seeking shareholder approval of "invalid or suspicious transactions," including self-dealing or compensation transactions; and (3) when directors willfully communicate to shareholders or the public about the corporation.[231] As expected, the duty of candor is especially relevant to the situations of Bank of America.

IV. ADDITIONAL RELEVANT LAWS AND DUTIES DIRECTORS AND MAJORITY AND CONTROLLING SHAREHOLDERS MUST FOLLOW

Various common laws and state statutes may protect directors, but directors still owe fiduciary duties under state law to stockholders and must comply with federal laws, such as Rule 10b-5 of the federal securities laws. Additionally, majority or controlling shareholders can owe fiduciary duties to their fellow shareholders. However, it is unclear whether these fiduciary duties change when the government begins acting as both an influence on the board of directors and as a majority or

---

gap." Holly M. Barbera, Note, *Fiduciary Duties and Disclosure Obligations: Resolving Questions After* Malone v. Brincat, 26 DEL. J. CORP. L. 563, 578 (2001). Barbera further suggests that there should be no general disclosure duty when there is not a request for stockholder action, as there are business concerns regarding disclosing information to the public and federal laws that protect shareholders. *See id.* at 575–76. However, a history exists between Delaware laws and the state's blue sky laws, which consequently overlap with federal securities law Rule 10b-5. Specifically, section 7303 of the Delaware Securities Act states:

> It is unlawful for any person, in connection with the offer, sale or purchase of any security . . . [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading.

DEL. CODE ANN. tit. 6, § 7303 (2010). As such, in response to the commentator, simply because the Delaware laws and the federal laws overlap does not mean that the duty of candor should only apply when no overlap exists and the federal laws fail to protect shareholders. In fact, the overlap of laws is truly irrelevant because overlap does not signify that the laws are ineffective. In fact, it is suggested later in this Article that the duty of candor should be extended to include a disclosure duty when new material information has been learned that would clarify a previously made statement. *See infra* Part V.A.5.

[231] *See* Shannon German, *What They Don't Know Can Hurt Them: Corporate Officers' Duty of Candor to Directors*, 34 DEL. J. CORP. L. 221, 233 (2009).

controlling shareholder. Parts A and B discuss the duties owed by directors, and Part C addresses the duties owed by majority and controlling shareholders.

A. Rule 10b-5

In addition to the duties directors owe to shareholders under common law,[232] directors must comply with the federal securities law known as "Rule 10b-5." Section 10 of the Securities Exchange Act was created to "protect investors, to help ensure fair dealing in the securities markets, and to promote ethical business practices."[233] Section 10(b) is a "catch-all" provision that concerns the purchase or sale of a security and covers both publicly and privately traded corporations.[234] Rule 10b-5 states, in relevant part:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange . . . (b) [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . . in connection with the purchase or sale of any security.[235]

To prove a section 10(b) violation, the plaintiff—either the SEC or a private individual[236]—must prove the following: (1) that the requisite jurisdictional means are satisfied; (2) that the defendant is either a purchaser or seller of the security at issue; (3) that there was "manipulation" or "deception," and not merely a breach of a fiduciary duty; (4) that the misstatement or omission of fact was material; (5) that the defendant acted with scienter; (6) if relevant, that the plaintiff relied on the misrepresentation; (7) that causation is established; (8) that the manipulation or deception was connected to the purchase or sale of security; (9) that the defendant had a duty to disclose if the allegation is based upon silence; and (10) that damages were suffered.[237]

---

[232] *See supra* Part II.A, III.

[233] MARC I. STEINBERG, SECURITIES REGULATION 393 (rev. 5th ed. 2009).

[234] *Id.*

[235] 17 C.F.R. § 240.10b-5 (2010).

[236] BRANSON ET AL., *supra* note 151, at 517.

[237] *Id.* at 518–19. A material fact has been defined by the Supreme Court as one that, if omitted, a "substantial likelihood [exists] that a reasonable shareholder

In determining whether the scienter element has been satisfied, most courts have concluded that recklessness is sufficient.[238] Reckless conduct has been defined as

> a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.[239]

Such state of mind can be found in a variety of ways. If an individual does not know a statement is false, yet utters it for

---

would consider it important in deciding how to vote." TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

[238] William H. Kuehnle, *On Scienter, Knowledge, and Recklessness Under the Federal Securities Law*, 34 HOUS. L. REV. 121, 179 (1997); *see* McLean v. Alexander, 599 F.2d 1190, 1197 (3d Cir. 1979) (holding reckless conduct to be the "minimum threshold for liability under [section] 10(b)"); Rolf v. Blyth, Eastman Dillon & Co., 570 F.2d 38, 44 (2d Cir. 1978) (holding that "recklessness satisfies the scienter requirement"); Sanders v. John Nuveen & Co., 554 F.2d 790, 793 (7th Cir. 1977) (holding that "the definition of 'reckless behavior' should not be a liberal one," but rather "a lesser form of intent"). In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), the Supreme Court raised, but did not decide, the issue as to "whether, in some circumstances, reckless behavior is sufficient for civil liability under [section] 10(b)." *Id.* at 193 n.12. Furthermore, in an effort to deter abusive securities litigation practices and reconcile the conflicting pleading standards among the circuits, Congress passed the Private Securities Litigation Reform Act of 1995, 15 U.S.C.A. § 78u-4 (West 2011) ("PSLRA"). Christopher J. Hardy, *The PSLRA's Heightened Pleading Standard: Does Severe Recklessness Constitute Scienter?*, 35 U.S.F. L. REV. 565, 565 (2001). The PSLRA requires a plaintiff, "with respect to each act or omission alleged, to . . . state with particularity *facts giving rise to a strong inference* that the defendant acted with the *required state of mind*." *Id.* at 571 (first alteration in original) (quoting 15 U.S.C.A. § 78u-4(b)(2)) (internal quotation marks omitted). While this provision seeks to heighten the pleading standard required of plaintiffs, the PSLRA's vague statutory language fails to define the term "strong inference." *Id.* Nevertheless, most circuits have concluded that some form of recklessness satisfies the scienter element under section 10(b), but they differ "in the degree of recklessness required." *Id.* at 572; *see* Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1282 (11th Cir. 1999) (holding that section 10(b) requires a showing of "extreme recklessness"); *In re* Silicon Graphics Sec. Litig., 183 F.3d 970, 974 (9th Cir. 1999) (holding that a plaintiff "must plead, in great detail, facts that constitute strong circumstantial evidence of deliberately reckless or conscious misconduct"); *In re* Comshare Inc. Sec. Litig., 183 F.3d 542, 549 (6th Cir. 1999) (holding that "plaintiffs may plead scienter [under section] 10(b) . . . by alleging facts giving rise to a strong inference of recklessness"); *In re* Advanta Corp. Sec. Litig., 180 F.3d 525, 534–35 (3d Cir. 1999) (holding that reckless conduct remains a sufficient basis for liability under section 10(b)); Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 538 (2d Cir. 1999) (holding that simple recklessness satisfies the scienter requirement).

[239] Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033 (7th Cir. 1977) (quoting Franke v. Midwestern Okla. Dev. Auth., 428 F. Supp. 719, 725 (W.D. Okla. 1976)).

others to rely on when lacking affirmative knowledge of its truth, he or she is considered reckless.[240] Additionally, if an individual deliberately avoids the truth by failing to consult available information, a finding of recklessness will likely be made.[241]

The most relevant element for the topic at hand concerns whether the defendant had a duty to disclose. Generally, the mere fact that a party holds material information does not mean that the corporation must disclose that material information to stockholders.[242] Indeed, the duty to disclose hinges on the terms of Rule 10b-5, which prohibits omissions of a material fact only if the fact was "necessary . . . to make the statements made" not materially misleading.[243] In this context, the focus turns on the presence of a duty to update and a duty to correct. The "duty to update may exist when a prior disclosure that, although accurate when made, . . . becomes materially misleading" and continues to be relied upon by investors.[244] In determining whether a duty to update exists, courts consider "the significance and type of information contained in the earlier statement, the predictive quality of the statement, and the time lapse between the earlier statement and current information."[245] The duty to correct concerns statements that were "materially untrue, incomplete, or misleading" when they were made.[246] Specifically, "if a disclosure is . . . misleading when made, and the speaker thereafter learns of this [fact]," a duty to correct arises.[247] With regards to projections, even if a statement is accurate when made, but has forward-looking intent or relates to policies or practices that the company has stated it will follow, such statement may give rise

240 Kuehnle, *supra* note 238, at 192.

241 *Id.* at 192–93.

242 *See In re* Time Warner Inc. Sec. Litig., 9 F.3d 259, 268 (2d Cir. 1993) ("We do not hold that whenever a corporation speaks, it must disclose every piece of information in its possession that could affect the price of its stock."); Weiner v. Quaker Oats Co., 129 F.3d 310, 316 (3d Cir. 1997) ("In general, [s]ection 10(b) and Rule 10b-5 do not impose a duty on defendants to correct prior statements—particularly statements of intent—so long as those statements were true when made." (citing *In re* Phillips Petroleum Sec. Litig., 881 F.2d 1236, 1245 (1989)).

243 17 C.F.R. § 240.10b-5 (2010).

244 MARC I. STEINBERG, SECURITIES REGULATION: LIABILITIES AND REMEDIES 2-7 (1984); *see Weiner*, 129 F.3d at 316 (citing *In re Phillips Petroleum Sec. Litig.*, 881 F.2d at 1245).

245 STEINBERG, *supra* note 244, at 2-7 to 2-8.

246 Jeffrey A. Brill, *The Status of the Duty To Update*, 7 CORNELL J.L. & PUB. POL'Y 605, 617 (1998); *see* STEINBERG, *supra* note 244, at 2-24.

247 STEINBERG, *supra* note 244, at 2-24 (internal quotation marks omitted).

to a duty to update when it becomes inaccurate because of a subsequent event.[248] Additionally, as part of what is known as "Item 303," when public companies file certain documents with the SEC, the company must also "[i]dentify any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the [company's] liquidity" materially changing.[249] As expected, Rule 10b-5 is of particular relevance to the government's interaction with Bank of America.

B. *The Duty of Directors To Be Fair to Shareholders*

It is true that "directors of Delaware corporations stand in a fiduciary relationship not only to the stockholders but also to the corporations upon whose boards they serve."[250] However, shareholders elect the directors to the board, and as with any election, directors often may know which shareholder, or which group of shareholders, was responsible for their election. These directors have been defined as "constituency directors," or "representative directors," as they "represent" a group of shareholders.[251] Accordingly, similar to other elections, directors may feel a responsibility to serve the constituency that helped them obtain their position. However, the board of directors must serve all shareholders fairly, as they owe a fiduciary duty to the corporation itself and all the shareholders, not just the shareholders that elected them to the board.[252] Moreover, even if a director feels a responsibility to a certain constituency of a corporation or particular block of shareholders, "the directors' duties to stockholders must trump their concerns for other

[248] *See id.* at 2-25.

[249] 17 C.F.R. § 229.303 (a)(1) (2010).

[250] Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998) (citing Guth v. Loft, 5 A.2d 503, 510 (Del. 1939)).

[251] E. Norman Veasey & Christine T. Di Guglielmo, *How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors*, 63 BUS. LAW. 761, 763 (2008) (internal quotation marks omitted). Examples of constituency directors include those "designated by creditors, venture capitalists, labor unions, controlling or other substantial stockholders, or preferred stockholders; directors elected by a particular class of stockholders or by a minority interest under a cumulative voting scheme; or directors representing other constituencies." *Id.*

[252] *In re* MONY Group, Inc. S'holder Litig., 853 A.2d 661, 676 (Del. Ch. 2004) (stating that "[t]he board owes its fiduciary duties to the corporation and its stockholders, not merely to a set of stockholders as of a certain record date").

constituencies."[253] In fact, it has been argued that a constituency director should always assume that (1) his fiduciary duties are owed to the corporation and its shareholders; and (2) if the interests of the corporation and the shareholders are not the same, a judge may employ equitable principles to reach a decision as to whether a director breached his or her fiduciary duty.[254] Therefore, while a director may be aware that a block of shareholders, such as the majority, was responsible for electing him or her to the board, this knowledge does not give the director permission to favor this constituency when making decisions.[255] This duty of fairness is especially relevant to Citigroup and GM, where the government owns significant amounts of shares in each corporation.

C. The Fiduciary Duty Owed by the Majority and Controlling Shareholders to Minority Shareholders

Directors and management owe the traditional fiduciary duties to shareholders; however, shareholders can also owe a fiduciary duty to fellow shareholders.[256] Generally, it is the majority shareholder who owes a fiduciary duty to the minority shareholders.[257] "Under Delaware [state] law, a shareholder owes a fiduciary duty only if it owns a majority interest in or exercises control over the business affairs of the corporation."[258] Furthermore, the Supreme Court stated that "[t]he majority has

---

[253] Veasey & Di Guglielmo, *supra* note 251, at 766. Veasey and Di Guglielmo point out that one constituency, creditors, have other means to protect their interests, including contracts, fraud and fraudulent conveyance law, bankruptcy law, commercial law, and implied covenants of good faith and fair dealing, among other laws. *See id.* at 766–67, 767 n.17.

[254] *Id.* at 767. For further discussion of the duties owed by constituency directors that are beyond the scope of this article, see *id.*

[255] *See* Beam v. Stewart, 845 A.2d 1040, 1049 (Del. 2004) ("The primary basis upon which a director's independence must be measured is whether the director's decision is based on the corporate merits of the subject before the board, rather than extraneous considerations or influences." (citing Rales v. Blasband, 634 A.2d 927, 936 (Del. 1993)).

[256] *See* Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN L. REV. 1255, 1261–62 (2008). There are three key groups in corporations—shareholders, the board of directors, and management—each having certain rights, privileges, duties, and responsibilities. *Id.* at 1257.

[257] *See* 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 (Del. 1987)).

[258] *Ivanhoe*, 535 A.2d at 1344 (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 958 (Del. 1985)).

the right to control; but when it does so, it occupies a fiduciary relation toward the minority, as much so as the corporation itself or its officers and directors."[259]

Even if a shareholder does not own the majority of shares in a corporation, in some situations, he or she can still be a controlling shareholder through a finding of a dominating relationship, and thus owe fiduciary duties to fellow shareholders. According to the Delaware Supreme Court:

> [A] shareholder who owns less than 50% of a corporation's outstanding stocks does not, without more, become a controlling shareholder of that corporation, with a concomitant fiduciary status. For 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 corporation conduct.[260]

"Control" and "domination" have been defined as implying "a direction of corporate conduct in such a way as to comport with the wishes or interests of the corporation (or persons) doing the controlling."[261] Thus, no actual percentage or threshold exists that qualifies one as a "controlling shareholder," but instead one's behavior determines if one qualifies as a controlling shareholder.[262] In most cases where a shareholder has been considered to be a controlling shareholder, he or she has owned almost fifty percent of the corporation; however one New York case found a controlling shareholder in a corporation in which the shareholder owned three percent of the company yet had six director nominees.[263]

[259] S. Pac. Co. v. Bogert, 250 U.S. 483, 487–88 (1919). Additionally, the Court stated, "[i]t is the fact of control of the common property held and exercised, not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation." *Id.* at 492.

[260] *Kahn*, 638 A.2d at 1114 (quoting Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 70 (Del. 1989)); *see* Kaplan v. Centex Corp., 284 A.2d 119, 122–23 (Del. Ch. 1971). When the court is discussing an "absence of controlling stock ownership," it is referring to an absence of a majority stock ownership. In *Kahn*, the court found that minority shareholder Alcatel, U.S.A., a corporation, which held a 43.3% minority share of stock in corporation Lynch Communications Systems, Inc., was a controlling shareholder because it exercised control of Lynch by dominating its corporate affairs, particularly at board meetings with the Alcatel-appointed directors. *See Kahn*, 638 A.2d at 1115.

[261] *Kaplan*, 284 A.2d at 123.

[262] *See Kahn*, 638 A.2d at 1114; *Kaplan*, 284 A.2d at 123.

[263] *See In re* Caplan, 20 A.D.2d 301, 246 N.Y.S.2d 913 (1st Dep't), *aff'd*, 14 N.Y.2d 679, 198 N.E.2d 908, 249 N.Y.S.2d 877 (1964); Marcel Kahan & Edward

The specific fiduciary duty owed to the minority shareholders by the majority or controlling shareholders is that of loyalty.[264] The majority or controlling shareholders must not use the fact that they own the majority of shares or act as the controlling shareholder of the corporation to dominate the affairs of the corporation in a way that is advantageous to them such that they receive a material financial benefit at the cost of the minority shareholders.[265] However, if a controlling shareholder can prove that a transaction was still "intrinsically fair" to the corporation despite also benefiting the controlling or majority shareholder, he or she can avoid being held liable.[266] Indeed, the Supreme Court in a seminal case once stated that

> a dominant or controlling stockholder or group of stockholders [is a fiduciary]. Their powers are powers in trust. Their dealings with the corporation are subjected to rigorous scrutiny[,] and where any of their contracts or engagements with the corporation is challenged[,] the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein.[267]

V. ANALYSIS

The situations concerning the recent financial crisis not only make for dramatic stories of political power struggles that either directly or indirectly affect most Americans, but also illustrate many potential violations of federal and common law corporate

---

Rock, *How To Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware, and the Strategic Use of Comity*, 58 EMORY L.J. 713, 743 n.176 (2009). Thus, even though the government only has a thirty-four percent equity interest in Citigroup—with only twenty-seven percent of that being in common stock—if its actions are enough that it is exercising control and domination over the corporation, it will be considered a controlling shareholder. *See supra* notes 130, 133, and accompanying text. See *infra* Part V.B.2 for a discussion of the government's duties as Citigroup's controlling shareholder and regulator.

[264] *See* Anabtawi & Stout, *supra* note 256, at 1265–66.

[265] *See id.* (citing Jones v. H.F. Ahmanson & Co., 460 P.2d 464, 471–72 (Cal. 1969)); *see also Kahn*, 638 A.2d at 1115; Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971). A traditional example of the controlling shareholders violating their duty of loyalty to the minority is in a "freeze-out" merger, where the minority, thanks to the influence of the majority or controlling shareholders, must sell their shares at an extremely low price to a corporation owned by the controlling or majority shareholder. *See* Anabtawi & Stout, *supra* note 256, at 1266.

[266] *See* Anabtawi & Stout, *supra* note 256, at 1266.

[267] Pepper v. Litton, 308 U.S. 295, 306 (1939) (citations omitted).

laws. Indeed, these situations highlight a brand new territory in American corporate law: what is and is not legal when the government interacts with and gains influence and control over the private sector. Additionally, the financial crisis has led to hints of change in governmental influence in the corporate sector, which may only be the beginning of a sweeping change in the government's role in business in America.

A. *Possible Legal Issues Arising When the Government Influences Boards of Directors*

As discussed above, the government has exerted its influence on boards of directors, causing directors to make decisions they would not otherwise had made if they were acting independently. However, boards of directors still owe their fiduciary duties to shareholders, not the government when it is simply acting as a creditor or stakeholder in the corporation.[268] Thus, boards of directors, such as the boards of Bank of America and Citigroup, are likely not immune from liability from the various forms of protection discussed.

1. The Duty of Loyalty and the Bank of America Board

First, the business judgment rule may not protect the board in the event that they have violated their fiduciary duties to stockholders. For example, if the board of directors of Bank of America continued in their transaction with Merrill Lynch as a result of government pressure, the fear of job loss, and self-interest, violation of the duty of loyalty becomes an issue.[269] In February 2009, it was revealed that government officials allegedly told Lewis that they would remove executives and directors from Bank of America if the company did not follow

[268] See *supra* note 27 for definition of a stakeholder. Creditors are often considered stakeholders. However, while directors are allowed to consider the interests of stakeholders when making decisions on behalf of the corporation through constituency statutes and relevant case law, directors are not required to consider the interests of stakeholders when making decisions. *See* Leung, *supra* note 27; *infra* notes 334–40 and accompanying text. For further discussion of duties owed to stakeholders, or more accurately the lack of fiduciary duties owed to stakeholders, see *infra* Part V.C.

[269] The testimony regarding this issue is conflicting. *See supra* notes 61–71 and accompanying text. Furthermore, the board may have acted to help the American economy, an issue that is further addressed in discussing the duty of care. *See supra* notes 65, 276, and accompanying text.

through with purchasing Merrill Lynch.[270] In response, after Lewis reported these discussions to the board, Bank of America continued with the transaction without notifying shareholders of Merrill Lynch's $15 billion loss in the fourth quarter of 2008.[271] While the reasons for these actions are unknown, pursuant to testimony, the board of directors was pressured into buying Merrill Lynch by the government for the benefit of one very large "stakeholder"—the United States economy.[272] Thus, when a director makes a decision under pressure from the government, while fearing for his or her job to the detriment of the shareholders, the director is likely failing to uphold the duty of loyalty owed to shareholders by considering the interests of the board before the interests of the shareholders.

As discussed in Part II, directors owe a duty of loyalty to the shareholders of their company.[273] Directors must act selflessly so that the shareholders' interests, and not the directors' interests—or potential benefits—are their absolute priority.[274] If Lewis and other directors at Bank of America feared losing their jobs when choosing to buy Merrill Lynch, their selected course of action likely constituted a violation of their fiduciary duty of loyalty to the shareholders.

2. The Duty of Due Care and the Bank of America and Citigroup Boards

Additionally, the boards of directors of Bank of America and Citigroup will not be protected by the business judgment rule if they violated their duty of due care to shareholders by making an "unadvised judgment" through gross negligence.[275] While many due care causes of action for monetary damages have disappeared due to exculpatory provisions and the difficulty of bringing shareholder derivative suits, the issues here could

[270] *See In Merrill Deal, U.S. Played Hardball*, *supra* note 6.

[271] *See Changing Course*, *supra* note 60.

[272] See *infra* Part V.C for a discussion of considering stakeholders when making a decision on behalf of the corporation and specifically for a discussion about why this author does not feel that the United States economy is a legitimate "stakeholder."

[273] *See supra* text accompanying notes 181–86.

[274] *See supra* text accompanying notes 181–86.

[275] *See supra* note 180 and accompanying text. The standard for violating due care is acting with gross negligence, and thus an "unadvised judgment" is not just a simple mistake. *See* Brehm v. Eisner, 746 A.2d 244, 262 (Del. 2000).

potentially survive a duty of due care cause of action for injunctive relief.[276] A due care cause of action for injunctive relief, but not monetary damages, is potentially still relevant for two "unadvised" decisions made with gross negligence: the failure to invoke the MAC clause and subsequent purchase of Merrill Lynch, and the failure to notify shareholders of the MOU.[277] While the merger and MOU have already occurred, if any remaining issues or transactions in conjunction with these two problematic decisions exist, they likely would be grounds for injunctive relief for breaching the duty of due care.[278]

Indeed, the board of directors who wanted to enact the MAC clause knew it was an appropriate course of action in the situation and in the best interest of the corporation to do so, but chose to instead complete the purchase of Merrill Lynch allegedly at the request of the government.[279] Moreover, the board's additional decision to not disclose to shareholders the terms of the MOU that it began operating under in May 2009 may be viewed as an "unadvised judgment" to withhold material information that shareholders should have considered when reviewing the terms of the transaction.[280] This set of facts raises the issue of a possible breach of the duty of due care.

[276] *See supra* note 204 and accompanying text (stating that section 102(b)(7) allows shareholders to adopt an exculpatory provision protecting directors from personal liability for *monetary damages* for breaching the duty of care). Of course, exculpatory provisions do not excuse directors from causes of action for breaches of the duties of loyalty or good faith.

[277] *See supra* Part I.A. The board of director's decision to not disclose the financial condition of Merrill Lynch is not relevant under the duty of due care.

[278] For example, if any transactions related to the merger are still pending, such as the selling of assets, the transactions could potentially be enjoined. Furthermore, any management or board decisions stemming from the MOU that are still pending could also potentially be enjoined.

[279] *See supra* notes 61–71 and accompanying text.

[280] *See supra* notes 61–71 and accompanying text. While the government is not required to disclose the MOU to the public, the board of directors has somewhat of a choice regarding whether or not to inform shareholders of this agreement. A Form 8-K describes the events that trigger a company's requirement to file a report with the SEC that in turn notifies shareholders of key news regarding the company. *See Form 8-K*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/answers/form8k.htm (last visited Mar. 19, 2011). The two relevant provisions of Form 8-K for Bank of America's MOU are Item 1.01, which calls for disclosure when a company enters into a "Material Definitive Agreement," and Item 8.01, which simply discusses "Other Events," or those events "that are not specifically called for by Form 8-K, that the registrant considers to be of importance to security holders." *See id.* While shareholders would argue that an MOU is material, and thus Bank of America's failure to disclose constitutes an unadvised judgment under the duty of due care,

Furthermore, Citigroup's board of directors' decision to remove Kelly as the CFO may be viewed as a breach of the duty of due care if it was "unadvised" and may also be grounds for injunctive relief, such as enjoining similar management decisions in the future.[281] If, however, the board's decision to remove Kelly was an informed, reasoned decision, despite the governmental pressure that was exerted on the board, it will not be considered a breach of the duty of due care. Boards of directors must act independently when making decisions, and if Citigroup's board independently concluded that it was reasonable to remove Kelly, then no breach of the duty of due care occurred.

If the government or another third party, however, influences a board to eject management, whether or not a decision was informed and reasoned, the decision appears suspicious. If a decision was made under pressure from the government, there may have been an uninformed decision and, thus, one not made with due care. Furthermore, Citigroup's board of directors has a duty to be fair to all shareholders, and the government's role as a shareholder places suspicion on the board's obligation to treat all shareholders fairly.[282] Thus, while all the facts may not be known regarding the board's removal of Kelly from management, it is possible that the board breached its fiduciary obligations to shareholders by not acting with due care, which in turn means it may have also violated its duty to be fair to shareholders.

3. The Duty of Good Faith and the Bank of America Board

Furthermore, the board of directors of Bank of America may have violated the third prong of the business judgment rule: the duty of good faith.[283] As discussed in Part II, the duty of good

---

Bank of America would likely claim that because it is an informal procedure, where it is unclear what action would be taken for a violation of the MOU, it does not trigger a Form 8-K filing obligation. However, because Bank of America's MOU involves corporate governance and Item 5.02 requires filing a Form 8-K when a departure or election of officers occurs, once change happens in corporate governance, it will be disclosed to shareholders. *See id.* Thus, while shareholders have a case for arguing that failing to disclose the MOU is a breach of the duty of due care, Bank of America's likely arguments for why they chose not to disclose the MOU will, in the author's opinion, win over any potential shareholder arguments.

[281] *See supra* notes 143–44 and accompanying text.

[282] *See supra* Part IV.B.

[283] See Kerr, *supra* note 167, at 1049–51, for a discussion about whether or not the duty of good faith is a stand-alone duty or part of the duty of loyalty.

faith requires that directors' motivations stem from "a true faithfulness and devotion to the interests of the corporation and its shareholders."[284] Moreover, violating the duty of good faith often involves a showing of bad faith, which is defined as a "fiduciary intentionally fail[ing] to act in the face of a known duty to act, demonstrating a conscious disregard for his [or her] duties."[285] Conscious disregard is difficult to prove, and thus distinguishes the duty of good faith from the duty of loyalty, where a plaintiff only needs to show that a director either was conflicted between duty and self-interest or did not demonstrate an undivided loyalty to the corporation and its shareholders.[286] For example, the board of directors in *Lyondell* failed to take all of the preferred steps before a merger,[287] but because they took some steps, and thus did not act with conscious disregard, they were not found to have violated the duty of good faith.[288] The Delaware Supreme Court stated that they may have breached the duty of due care, but their behavior simply did not equate with conscious disregard and a violation of the duty of good faith.[289]

Bank of America's board of directors failed to disclose material information to shareholders that would have corrected a previously made statement that was now false. However, simply failing to take action does not automatically mean a director has violated the duty of good faith; instead, it must be shown that the director consciously chose to avoid a duty. In the case of Bank of America, it is unknown if the directors consciously chose not to inform shareholders of Merrill Lynch's deteriorating financial condition because they were considering their own job security or the interests of the American economy. If these considerations played a significant role in their actions towards the shareholders, and if one considers the duty of good faith to be a

---

[284] *In re* Walt Disney Co. Derivative Litig. (*Disney I*), 907 A.2d 693, 755 (Del. Ch. 2005), *aff'd*, 906 A.2d 27 (Del. 2006); *see also In re* RJR Nabisco, Inc. S'holders Litig., No. 10389, 1989 WL 7036, at *15 (Del. Ch. Jan. 31, 1989) ("The business judgment rule [is not] available to a fiduciary who could be shown to have caused a transaction to be effectuated . . . for a reason unrelated to a pursuit of the corporation's best interests.").

[285] *In re* Walt Disney Co. Derivative Litig. (*Disney II*), 906 A.2d 27, 67 (Del. 2006).

[286] *See Disney I*, 907 A.2d at 751.

[287] *See* Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 237 (Del. 2009).

[288] *Id.*

[289] *Id.*

separate duty from the duty of loyalty, then they likely violated the duty of good faith, even though they may have felt such actions were integral to their patriotic duty.

If the board did not act with conscious disregard in choosing to not correct their previously incorrect statement, they likely did not violate the duty of good faith. Nevertheless, their failure to disclose material information to shareholders may still raise other legal issues, such as the duty of loyalty, duty of candor, and Rule 10b-5.

4. Rule 10b-5 and the Bank of America Board

The SEC recently settled a lawsuit with Bank of America for $150 million for, among other items, failing to disclose to shareholders the financial losses of Merrill Lynch.[290] Thus, the issue of Rule 10b-5 liability between the SEC and Bank of America has effectively been settled. However, this decision does not mean that the issue of Rule 10b-5 liability is completely over with regard to Bank of America's lack of disclosure to shareholders since Rule 10b-5 may still be pursued by individuals in private civil suits.[291] As previously discussed, Bank of America did not disclose to shareholders (1) the dismal financial situation of Merrill Lynch, which Bank of America discovered shortly after the December 5, 2008 shareholder vote that approved the purchase of Merrill Lynch; and (2) the secret MOU agreement.[292] Of the ten elements required to prove a 10b-5 violation,[293] the elements that will be of issue in a civil suit are whether there was a duty to disclose, whether the information was material, and whether the defendants acted with scienter.[294] Because a duty to disclose will arise when an event occurs that makes a previous statement inaccurate,[295] Bank of America had a duty to disclose to shareholders the financial losses at Merrill Lynch, as it would have corrected their previous statements regarding how it was a good decision to purchase the corporation. Furthermore, that information will be considered material, as financial information related to a merger is traditionally

[290] *See supra* note 90 and accompanying text.
[291] *See* BRANSON ET AL., *supra* note 151, at 517.
[292] *See supra* Part I.A.
[293] *See supra* note 237 and accompanying text.
[294] *See supra* note 237 and accompanying text.
[295] *See In re* Time Warner Inc. Sec. Litig., 9 F.3d 259, 267 (2d Cir. 1993).

considered to be material.[296] Even though shareholders had approved the transaction before the directors learned of the complete financial condition of Merrill Lynch, the transaction had not yet been finalized and could have been stopped had shareholders known. Also, Bank of America likely had an obligation to disclose the secret MOU agreement, as it impacted management decisions that shareholders would also likely find material.[297] The only difficulty in proving both causes of action will stem from proving scienter.[298] However, as most circuits have concluded that recklessness is sufficient to meet the scienter element, Bank of America's failure to disclose Merrill Lynch's financial condition and the existence of an MOU agreement will likely amount to a "highly unreasonable omission," thus satisfying the reckless conduct standard.[299] Initially, when Bank of America first made the statements concerning Merrill Lynch's financial condition, the board of directors likely could not have been held liable, as it did not know that such statements were false.[300] Conversely, after Bank of

[296] A material fact has been defined by the Supreme Court as one that if omitted, "a substantial likelihood [exists] that a reasonable shareholder would consider it important in deciding how to vote." TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); *see In re* Lear Corp. S'holder Litig., 926 A.2d 94, 114 (Del. Ch. 2007) (stating that "a reasonable stockholder would want to know an important economic motivation of the negotiator singularly employed by a board to obtain the best price for the stockholders"); Turner v. Bernstein, 776 A.2d 530, 532 (Del. Ch. 2000) (stating that financial details withheld during a merger were material and the board "defaulted on its affirmative obligation to disclose the information" to shareholders).

[297] The MOU called for Bank of America to overhaul its management, and six directors promptly resigned between May 26 and June 17, 2009. *See U.S. Regulators to BofA*, *supra* note 82. On June 5, 2009, Bank of America announced that it had elected four new directors to its board. Press Release, Bank of America, Four New Directors Elected to Bank of America Board (June 5, 2009), *available at* http://mediaroom.bankofamerica.com/phoenix.zhtml?c=234503&p=irol-newsArticle&ID=1390236&highlight=. On August 21, 2009, Bank of America announced the election of the fifth new director to the board. *See* Press Release, Bank of America, Bank of America Board Elects Scully as New Director (Aug. 21, 2009), *available at* http://mediaroom.bankofamerica.com/phoenix.zhtml?c=234503&p=irol-newsArticle&ID=1390269&highlight=. Finally, on September 21, 2009, Bank of America announced the election of the sixth new director to the board. *See* Press Release, Bank of America, Bank of America Board Elects Holliday as New Director (Sept. 21, 2009), *available at* http://mediaroom.bankofamerica.com/ phoenix.zhtml?c=234503&p=irol-newsArticle&ID=1390283&highlight=.

[298] *See supra* notes 237–41 and accompanying text.

[299] *See supra* notes 238–41 and accompanying text.

[300] *See In Merrill Deal, U.S. Played Hardball*, *supra* note 6.

America's management discovered the truth as to Merrill Lynch's poor finances, the board of directors' decision to remain silent on the issue and to enter into a secret MOU may likely qualify as reckless conduct.[301] Accordingly, if a plaintiff is able to fulfill the scienter requirement, he or she will likely succeed in proving the remaining elements of Rule 10b-5 against Bank of America.

5. The Duty of Candor and the Bank of America Board

Similar to Rule 10b-5, the duty of candor in Delaware imposes a fiduciary duty on directors to disclose all material information to shareholders in situations requiring shareholders' approval or votes or when willfully communicating to shareholders or the public about the corporation.[302] Here, Bank of America had already communicated to shareholders and gained their approval in early December 2008 about the Merrill Lynch transaction. However, by mid-December 2008, Merrill Lynch's financials were not what had been represented to shareholders and the transaction was finalized weeks before shareholders ever learned of Merrill Lynch's losses and of Bank of America's subsequent governmental loan to finalize the transaction.[303]

While the board of Bank of America may not have violated the duty of candor, or any other fiduciary duties, when it first requested shareholders to vote on the proposed merger—although allegations made by Cuomo may indicate otherwise[304]—the board could have violated the duty of candor once it learned that its previous statements concerning Merrill Lynch's financial condition were false. According to *Malone v. Brincat*, if directors are not seeking shareholder action, "but are deliberately misinforming shareholders about the business of the corporation, either directly or by a public statement, there is a violation of fiduciary duty,"[305] as directors of corporations have a "fiduciary duty to shareholders to exercise due care, good faith[,] and loyalty" when communicating to the public or to shareholders

[301] *See supra* notes 51–56, 81, and accompanying text.
[302] *See supra* note 231 and accompanying text.
[303] *See supra* Part I.A.
[304] *See* Cuomo Letter, *supra* note 39, at 2. Cuomo alleged that some of Merrill Lynch's substantial losses "had become known to Bank of America executives prior to the merger vote." *Id.*
[305] Malone v. Brincat, 722 A.2d 5, 14 (Del. 1998).

regarding the business of the corporation.[306] Moreover, this "duty to disclose fully and fairly all material information within the board's control when it seeks shareholder action" applies not only to proxy statements, but also to "any other disclosures in contemplation of stockholder action."[307] In essence, *Malone* failed to address the situation of an omission by directors where no shareholder action is being sought, leaving questions unanswered as to what qualifies as "shareholder action."

Once the board of Bank of America learned in mid-December 2008 that the statements made to shareholders before the vote were incorrect, the board should have disclosed these material findings before the merger was finalized on January 1, 2009.[308] Although "shareholder action" is generally defined in connection with a request for shareholder vote or approval, because the directors of Bank of America could have solicited a new vote after informing shareholders of Merrill Lynch's losses, shareholder action arguably could still have been sought in this context before the merger was officially finalized.[309] Furthermore, in the unlikely event that a second vote could not have occurred, shareholders could still have sought an injunction to prevent the merger from going forward. In essence, when further shareholder action—in the form of a revote or an injunction—could be taken in response to new material information that must be disclosed to correct previously made false statements, the duty of candor should encompass the directors' decision to omit such disclosure. Accordingly, under this standard, Bank of America's failure to disclose the material information concerning Merrill Lynch's financial condition constitutes a violation of the duty of candor.[310]

---

[306] *Id.* at 10.

[307] Gantler v. Stephens, 965 A.2d 695, 710 (Del. 2009) (quoting Stroud v. Grace, 606 A.2d 75, 84–85 (Del. 1992)).

[308] While the merger had closed on January 1, 2009, a merger is not truly finalized until the transaction is consummated.

[309] In this context, the board of Bank of America could have issued a revised proxy informing the shareholders of Merrill Lynch's substantial losses and seeking a second vote to approve the merger. As such, the directors would be in compliance with the duty of candor's requirement "to disclose fully and fairly all material information within the board's control when it seeks shareholder action." *See Gantler*, 965 A.2d at 710 (quoting Stroud v. Grace, 606 A.2d 75, 84 (Del. 1992)).

[310] If shareholders have an interest in pursuing a lawsuit against the government for pressuring the board of Bank of America into this decision, it may be feasible. *See infra* note 329.

B. *Potential Conflicts and Legal Issues Arising from the Government's Role as Shareholder and Regulator*

As previously discussed, the government also serves as a shareholder in many corporations, including GM and Citigroup. As both a majority and controlling shareholder in these corporations, respectively, the government may have already violated its duties to fellow shareholders or is in a situation where it could potentially violate its duties to fellow shareholders.

1. GM and the Government as a Shareholder and Regulator

First, the government is clearly the majority shareholder of GM since it owns sixty percent of the company.[311] The White House released a statement detailing its plans as a "reluctant shareholder,"[312] and hopefully the government will act in such a way. As of the writing of this Article, the government has only appointed five members to the thirteen-person board,[313] and is therefore complying with the Delaware corporate voting laws.[314] However, unlike controlling shareholders, who do not owe fiduciary duties to other shareholders unless the other shareholders prove domination or control,[315] majority shareholders have the ability to control the corporation and therefore owe fiduciary duties to other shareholders.[316] The government cannot state that it is a "reluctant shareholder" and avoid the duties it owes to the shareholders as a majority shareholder, while also attempting to control GM in a number of ways. What is not clear is what happens when the government, as a regulator, pressures the board of directors, conveniently side-stepping its role as a shareholder. While the government may hold the power to influence some issues as a regulator, when does it cross the line as a shareholder? Specifically, when do its

---

[311] *See supra* note 20 and accompanying text.

[312] *See supra* note 117.

[313] *See supra* notes 108, 112.

[314] According to Delaware General Corporation Law section 212(a), unless otherwise provided in the articles of incorporation, each stockholder in a Delaware corporation is entitled to one vote for each share of capital stock they hold. DEL. CODE ANN. tit. 8, § 212(a) (2010).

[315] *See supra* notes 260–63 and accompanying text.

[316] *See* Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1113–14 (Del. 1994) (citing Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344 (Del. 1987)).

roles as regulator and shareholder conflict, harming other shareholders as a consequence? The unclear, conflicting nature of the government's dual role as majority shareholder and regulator is likely to be problematic in the future.

However, potential conflicts and breaches of the government's fiduciary duty to fellow shareholders exist currently. The government, which is pushing aggressive new fuel-economy and emissions targets, will not only be GM's largest shareholder, but also its chief regulator of vehicle fuel-efficiency standards.[317] As GM is known for making large, fuel-inefficient vehicles, this situation could become problematic if the government forces GM—either through regulations or by simply directly telling it to do so—to manufacture cars that the government, and not GM, wants to manufacture.[318] Also, fears have developed that if the government initially pushes new fuel-standards—or safety standards or any other standard on cars—and the Office of Management and Budget realizes that the standards will be too costly for GM, and in turn the government, the standards will be eliminated.[319] While the government may be GM's regulator, it is also its majority shareholder, and thus any action it takes with the company must involve fulfilling its fiduciary duty to fellow shareholders.

In fact, Congress has already exerted its power over GM's affairs. Once out of bankruptcy, GM planned to expand its imports of cars made at GM factories in China. But after pressure from Congress, GM agreed to reopen an American factory to build smaller models that are not currently produced in the United States.[320] While keeping the factory in the United States may be best for local workers, it may have been in the best interests of GM to move the plant to China.[321]

[317] King et al., *supra* note 118.

[318] *See id.* Some of GM's most profitable cars are the Chevy Silverado and Cadillac Escalade, both of which require a significant amount of fuel. *See id.* President Obama recently signed new fuel-economy and emissions targets. *See id.* Meeting these goals, but maintaining the vehicles that provide a profit to GM, may be a problem for the government when it is also a shareholder. *See id.*

[319] *Id.*

[320] *See id.* GM decided to open this factory in the United States during its negotiations with the UAW. *See id.*

[321] *See id.* John Casesa, a Wall Street analyst, stated, "The government has conflicting policy objectives now . . . [that will] create substantial risk to the government earning a good return on its investment." *Id.* (internal quotation marks omitted).

2. Citigroup and the Government as Shareholder and Regulator

While the government is clearly the majority, and thus controlling, shareholder of GM, the situation for Citigroup is not so clear. On July 30, 2009, the government officially became the owner of thirty-four percent of Citigroup, twenty-seven percent being held as common stock and the rest as preferred securities.[322] Thus, the government comprises the largest block of shareholders.[323] Although thirty-four percent is well under the fifty percent threshold for being considered the majority shareholder,[324] shareholders who own less than fifty percent of the corporation can still be considered controlling shareholders, depending upon how much control and dominion they exercise over the corporation.[325]

The government's behavior indicates that it has exercised enough domination and control over Citigroup's board of directors to qualify as a controlling shareholder, despite owning less than a majority of the corporation, based on the definitions discussed above.[326] Moreover, no other shareholder owns more shares than the government, so the government is easily able to continue exercising dominion and control over the corporation if it wishes to do so. Currently, the government is successfully attempting to influence how Citigroup's board manages the company, despite owning less than the majority of the corporation. First, Citigroup spun-off Smith Barney into a joint venture with Morgan Stanley at the request of federal regulators.[327] Next, the FDIC pressured Citigroup to restructure its management, even going so far as allegedly threatening to lower the government's confidential ranking of Citigroup if the company refused to remove Pandit and others from

[322] *See supra* notes 130, 133, and accompanying text.

[323] *See* Citigroup Inc., Preliminary Proxy Statement (Schedule 14A), at 19 (Feb. 26, 2010).

[324] Anabtawi & Stout, *supra* note 256, at 1269 ("[A] shareholder who owns more than 50% of the company's outstanding shares has become the archetypal 'controlling' shareholder.").

[325] *See supra* notes 260–63 and accompanying text; *see also In re* Caplan, 20 A.D.2d 301, 246 N.Y.S.2d 913 (1st Dep't), *aff'd*, 14 N.Y.2d 679, 198 N.E.2d 908, 249 N.Y.S.2d 877 (1964) (explaining that a shareholder who owns a small percentage in the company can still qualify as a controlling shareholder based on his or her actions as a shareholder).

[326] *See supra* Part IV.C.

[327] Paletta & Enrich, *supra* note 138.

management.[328] Accordingly, even though the government only owns thirty-four percent of Citigroup, it has loaned so much money to Citigroup through the TARP program that it can technically still strongly influence the board of directors. Moreover, similar to the situation with GM, the government also serves as the regulator of Citigroup.

Thus, the government's involvement in these corporations will be interesting to watch, as it certainly can be considered a majority shareholder of GM and is most likely a controlling shareholder of Citigroup. The government's possible role as a controlling shareholder means that it must exercise caution in its dealings with Citigroup to ensure that it complies with the fiduciary duties owed to its fellow Citigroup shareholders.[329]

C. Expanding the Definition of a Stakeholder: Can Boards of Directors Consider the United States Public a Stakeholder?

One of the justifications given for Bank of America's purchase of Merrill Lynch, and for its failure to disclose its true financial state, was that following through with the purchase was for the overall good of the American economy.[330] The

---

[328] *See id.*

[329] In the event that the government breaches the duties owed to other shareholders in Citigroup, and those shareholders decide to sue, those shareholders will be in a unique situation, as they would be suing the government. However, absent an express statutory waiver, the theory of sovereign immunity shields the federal government and its agencies from suit. Fed. Deposit Ins. Corp. v. Meyer, 510 U.S. 471, 475 (1994) (citing Loeffler v. Frank, 486 U.S. 549, 554 (1988)). Under the Administrative Procedure Act ("APA"), the government's sovereign immunity is waived for actions that seek injunctive relief. 5 U.S.C. § 702 (2006).

> A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof. An action in a court of the United States seeking relief other than money damages and stating a claim that an agency or an officer or employee thereof acted or failed to act in an official capacity or under color of legal authority shall not be dismissed nor relief therein be denied on the ground that it is against the United States or that the United States is an indispensable party.

Id. Furthermore, Congress has waived this immunity for a wide range of suits, including suits that seek money damages. Dep't of Army v. Blue Fox, Inc., 525 U.S. 255, 260 (1999).

[330] Crittenden & Hilsenrath, *supra* note 70. In Bernanke's Capitol Hill testimony, he stated the decision to buy Merrill Lynch was "taken under highly unusual circumstances in the face of grave threats to our financial system and our economy." *Id.* (internal quotation marks omitted). Furthermore, in Lewis's Capitol Hill testimony, he stated that he was told by Bernanke and Paulson that the merger needed to be finalized, or else it would "impose a big risk to the financial system" of

altruistic notions of the government forcing boards of directors to consider the health of the national economy, however impressive, do not agree with corporate law principals. Traditionally, directors could only consider the interests of shareholders when making such decisions;[331] recently, however, corporations have increasingly considered stakeholders' interests.[332] As early as the 1960s, an Illinois court stated that "the effect on the surrounding neighborhood might well be considered by a director,"[333] and the Delaware Supreme Court has held that directors may consider stakeholders' interests when making decisions.[334] Boards of directors have the right to consider stakeholder interests under constituency statutes and are also seeking direct approval from stockholders to do so.[335] The consistency statutes generally allow, but do not mandate, officers and directors of corporations to consider stakeholders' interests when making decisions on behalf of the company.[336] Those stakeholders generally consist of

---

the entire United States. Rappaport, *supra* note 47 (internal quotation marks omitted). Paulson told Lewis that "the U.S. government was committed to ensuring that no systemically important financial institution would fail." *Id.* (internal quotation marks omitted).

[331] *See* Robert A. Ragazzo, *Unifying the Law of Hostile Takeovers: Bridging the* Unocal/Revlon *Gap*, 35 ARIZ. L. REV. 989, 1023 (1993) ("The traditional common law rule was that, absent proof of a benefit to shareholders, disbursements on behalf of nonshareholder constituencies were *ultra vires*.").

[332] *See* Alissa Mickels, Note, *Beyond Corporate Social Responsibility: Reconciling the Ideals of a For-Benefit Corporation with Director Fiduciary Duties in the U.S. and Europe*, 32 HASTINGS INT'L & COMP. L. REV. 271, 272 (2009).

[333] Shlensky v. Wrigley, 237 N.E.2d 776, 780 (Ill. App. Ct. 1968).

[334] The Delaware Supreme Court has considered directors' obligations to shareholders' interests in four cases, all of which arose in the context of a takeover. *See* Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34 (Del. 1994) (reiterating shareholder primacy); Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1990) (allowing the directors to merge with a company when a better price was offered by another company in order to preserve the company's culture, allowing for consideration other than that of the shareholders); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 176 (Del. 1986) ("[W]hile concern for various corporate constituencies is proper when addressing a takeover threat, that principle is limited by the requirement that there be some rationally related benefit accruing to the stockholders."); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (stating that, in situations involving control of the corporation, directors are allowed to consider the interests of stakeholders). Essentially, taken together, these cases state that shareholders come first, unless special circumstances exist.

[335] Mickels, *supra* note 332, at 290.

[336] *See* Kathleen Hale, Note, *Corporate Law and Stakeholders: Moving Beyond Stakeholder Statutes*, 45 ARIZ. L. REV. 823, 829 (2003). The specifics of stakeholder statutes vary from state to state, with some states only applying them to directors,

employees, suppliers, creditors, and the local community where the business is located.[337] However, Delaware has not enacted a constituency statute,[338] and thus considering stakeholders' interests in Delaware is governed by case law, which permits, but does not require, the consideration of stakeholders.[339] It follows that courts will allow directors—and sometimes officers—to consider stakeholders when making decisions, but directors and officers do not owe specific fiduciary duties to stakeholders; instead, they owe fiduciary duties to the corporation.[340] Considering stakeholders' interests, in addition to those of the shareholders, derives from the concept of corporate social responsibility ("CSR").[341] Considering stakeholders' interests, or being "socially responsible," can also lead to larger profits, and thus is one of the many reasons why corporations are encouraged to engage in CSR.[342]

Thus, it may appear that Bank of America's and the government's decision to follow through with the purchase of Merrill Lynch for the sake of the United States economy was based on the interests of a major stakeholder, the American public. However, including the American public as a stakeholder goes far beyond what is typically considered a stakeholder—

some states only applying them to certain circumstances, and other states only addressing the specific interests they are allowed to consider. *See id.* at 833–36. "Connecticut is the only state that requires directors and executives to consider stakeholders' interests." *Id.* at 834. The statutes were enacted "to provide corporate leaders with a mechanism for considering stakeholder interests without breaching their fiduciary obligations to shareholders." *Id.* at 832.

[337] *See* Mickels, *supra* note 332, at 292.

[338] *See* Hale, *supra* note 336, at 833.

[339] *See supra* note 334.

[340] *See* Bernard S. Sharfman, *Enhancing The Efficiency of Board Decision Making: Lessons Learned from the Financial Crisis of 2008*, 34 DEL. J. CORP. L. 813, 829 (2009).

[341] *See* Colin Marks & Nancy B. Rapoport, *The Corporate Lawyer's Role in a Contemporary Democracy*, 77 FORDHAM L. REV. 1269, 1273, 1280 (2009) (defining CSR as a "business's responsibility to the wider societal good beyond, but in addition to, the business's economic performance"). There are four pillars to CSR: economic responsibilities, legal responsibilities, ethical responsibilities, and discretionary or philanthropic responsibilities. *Id.* at 1273. Discretionary or philanthropic responsibilities include contributing to "various kinds of social, educational, recreational, or cultural purposes." *Id.* at 1274 (quoting Dirk Matten & Andrew Crane, *Corporate Citizenship: Toward an Extended Theoretical Conceptualization*, 30 ACAD. MGMT. REV. 166, 167 (2005)) (internal quotation marks omitted).

[342] *See* Janet E. Kerr, *The Creative Capitalism Spectrum: Evaluating Corporate Social Responsibility Through a Legal Lens*, 81 TEMP. L. REV. 831, 835 (2008).

generally, the local community.[343] Even if it is argued that the United States is the community to which Bank of America belongs, it is this author's opinion that this community is far too large to be considered a traditional stakeholder. Bank of America's decisions cannot be justified through the umbrella of CSR, as the directors and officers owe fiduciary duties first to the corporation. The board *may* consider stakeholders under CSR, but only those groups whose interests are impacted by the corporation—employees, creditors, suppliers, and the *local* community.[344] The consideration of stakeholders cannot possibly extend to the entire economic health of the nation. Therefore, the justification for not enacting the MAC clause or for not disclosing to shareholders the financial health of Merrill Lynch for the benefit of the American economy does not have any merit under any corporate law theories or doctrines.

D. Golden Shares: The Future of Government Interaction in the Private Sector in the United States?

In addition to analyzing the current blurry legal lines of governmental interaction in the private sector, it is important to reflect on what may become a trend in government regulation and ownership of American corporations if the government divests its interests in the companies discussed. If the United States government opts to divest its interests in private companies but retain ownership and control, the United States will be engaging in a concept similar to that used by foreign governments to protect national security interests.[345] Through the concept known as "golden shares," many foreign governments retain influence in corporations without actually owning a single share.[346] The golden share attaches special rights to the government, allowing the government to veto or approve company decisions.[347] Thus, the government can exercise control

---

[343] *See* Mickels, *supra* note 332, at 292.

[344] *See id.*

[345] *See* Marcelo Moscogliato, *Foreign Direct Investment in Corporations: Restrictions in the United States and Brazil on the Grounds of National Defense*, 9 OR. REV. INT'L L. 67, 102 (2007).

[346] *See* Christine O'Grady Putek, Comment, *Limited But Not Lost: A Comment on the ECJ's Golden Share Decisions*, 72 FORDHAM L. REV. 2219, 2220 n.4 (2004).

[347] *See id.* The United Kingdom first started utilizing golden shares in corporations in the 1980s, specifically "as a means of protecting its sovereignty and national security." Christopher M. Weimer, Note, *Foreign Direct Investment and*

over certain companies, which can in turn represent entire sectors of the economy, despite the fact that the companies are private.[348] Some governments, including those of Brazil and the United Kingdom, claim that national defense needs justify creating golden shares, as golden shares can encourage economic privatization while at the same time allowing governments to have a say in key defense corporations.[349]

The most obvious comparison to an American golden share is the government's current ownership stake in many corporations discussed in this Article. While beginning the process of divesting some of its substantive interests in companies, the government has also begun to increase its regulatory power—a move that further enables the government to exert influence and control over corporations. One example of such activity is the government's decision to appoint a pay czar, Kenneth Feinberg.[350] Feinberg announced in October 2009 that the salaries for 175 employees at companies receiving government aid will be cut, with the majority being lowered to under $500,000.[351] Additionally, the annualized total pay level of the impacted companies will be fifty percent less than in the previous year.[352] Those companies include Bank of America, Citigroup, and GM.[353] While cash salaries will be reduced, employees will still receive salary in stock that cannot be accessed for at least four years.[354] Owning shares in these corporations and

---

National Security Post-FINSA 2007, 87 TEX. L. REV. 663, 678 (2009). It began with the privatization process of firms owned by the government, with the government only retaining specific rights. *See id.* at 679. For example, some golden share provisions include "the requirement that the British government sign off on any sale of Rolls-Royce's nuclear operations, the requirement that the [British] government accede to any purchase of more than a fifteen-percent stake in British Energy, and the capability to oversee business decisions in the firms comprising the system of Royal Dockyards." *Id.* at 678.

[348] *See* Moscogliato, *supra* note 345, at 99, 101.

[349] *See id.* at 102.

[350] *See* Deborah Solomon & Dan Fitzpatrick, *Pay Slashed at Bailout Firms*, WALL ST. J., Oct. 22, 2009, at A1. The Treasury Department created a "pay czar" after the drama surrounding the bonus payments at AIG in March 2009. *Id.*

[351] *Id.*

[352] Aaron Luchetti et al., *Fed Hits Banks with Sweeping Pay Limits*, WALL ST. J., Oct. 23, 2009, at A1.

[353] Solomon & Fitzpatrick, *supra* note 350. AIG, GMAC, Chrysler Group LLC, and Chrysler Financial have also been affected by the pay czar's actions. *Id.*

[354] *See id.* The Obama Administration had Feinberg connect compensation to long-term performance in order to stop "employees from taking unnecessary risks for short-term gains." *Id.*

maintaining control over the salaries at these corporations, among the other regulatory powers already conferred upon the government, provides the government with unprecedented access to and control over corporations. The government has the right to regulate corporations; however, there is a point when regulation will exceed its acceptable limit, and that time may have come. Moreover, it is as if the government is setting up the mechanisms and regulations now to control corporations in the future once its interest as either a creditor or shareholder has been divested. Thus, the stage is being set for the concept of golden shares to be exercised in the United States.

Of course, in other countries the justification for golden shares is protecting a nation's national security interests. Protecting a nation's economic health may be just as important as protecting the nation's security interests. However, the ability to protect the security of a nation through the issuance of golden shares is fairly limited, as only a small number of corporations engage in this sector of the economy. On the other hand, the number of corporations whose success is vital to the economic health of the nation is enormous; in fact, almost every major corporation could be considered to be vital to the economic health of the economy. Is allowing the government to have a voice in every corporation's decisionmaking process essential to the health of the American economy? Has the time come when the economic health of the nation *is* a national security issue? If the government's influence in Bank of America's purchase of Merrill Lynch and partial ownership of GM and Citigroup is justifiable on these grounds, what is next? It may only be a few corporations now, but it could potentially be the beginning of strong governmental influence in corporate boardrooms across the country and the subsequent rewriting of American corporate law. While the government is not technically issuing golden shares, its behavior appears to mark the beginning of what may become the issuance of golden shares in America.

CONCLUSION

Although one often assumes that the government and the private sector should not become intertwined, during desperate times it can arguably be a welcomed source of quick relief. Certainly, it was, for the most part, well-received during the Great Depression when approximately fifteen million people were out of work and the government developed many programs in the hopes of creating jobs and stimulating the economy.[355] However, in the case of the corporations discussed in this Article—Bank of America, GM, and Citigroup—only time will tell if the government's intervention was not only necessary to their survival, but also crucial to the survival of the American economy. Even if the government's intervention in the private sector was necessary, one should not wait to explore what is already apparent: The government's intervention has significantly blurred American corporate laws.

Indeed, the government's intervention may have clearly wiped away boards of directors' protection under the business judgment rule and may have exposed them to liability under the triad of traditional fiduciary duties of loyalty, due care, and good faith, as well as the duty of candor, the duty to be fair, and Rule 10b-5. Additionally, the government's new role as a majority or controlling shareholder and creditor has raised many vital questions about the fiduciary duties the government owes shareholders when it serves as both a corporation's chief regulator and majority or controlling shareholder. Even if the government's actions in these three corporations prove to be effective, this behavior may not be effective in future situations. Furthermore, the government's current behavior may be setting the stage for the practice of golden shares in the United States, which would dramatically change the way in which the government interacts with corporations. Thus, it is important to evaluate the current situation not only to ensure that if corporate laws were violated in 2008 and 2009 that they will not be violated in the future, but also to monitor what may be the beginning of a dramatic change in government ownership and the regulation of American corporations.

[355] *See* ZINN, *supra* note 1, at 386–87, 392–93.