

NOTES

Shotgun Weddings: Director and Officer Fiduciary Duties in Government-Controlled and Partially-Nationalized Corporations

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Shotgun Wedding: *An agreement or compromise made through necessity, as in “Since neither side won a majority, the coalition government was obviously a shotgun wedding.” The expression alludes to a marriage precipitated by a woman’s pregnancy, causing her father to point a literal or figurative gun at the responsible man’s head.*

- *THE AMERICAN HERITAGE DICTIONARY OF IDIOMS*¹

Corporate law considers the affairs of a corporation to be private activity.² The prevailing concept of the firm is a nexus of private contract rights among participants in an economic enterprise.³ But for many U.S. auto and financial services corporations, the events of the fall of 2008 and the winter of 2009 turned this presumption on its head. The U.S. government’s \$700 billion bailout injected an alien actor—the United States Treasury—into this once-private enterprise. The bailout enabled the Treasury to take a direct equity stake in many of the nation’s struggling auto and financial services corporations.⁴ In the fall of 2008, for example, the Treasury purchased \$300 billion of stock in over 600 banks.⁵ A few months later, it invested \$100 billion in American automakers.⁶ Everyone from GM and Citigroup to your local First State Bank is now owned, at least in part, by the federal government.⁷ For many of these companies, the

1. CHRISTINE AMMER, *THE AMERICAN HERITAGE DICTIONARY OF IDIOMS* 579 (1997).

2. Robert J. Rhee, *Fiduciary Exemption for Public Necessity: Shareholder Profit, Public Good, and the Hobson’s Choice During a National Crisis*, 17 *GEO. MASON L. REV.* 661, 773 (2010).

3. *Id.*

4. *See infra* Part III(A) (describing the federal bailout including how and when the federal government became an equity owner in financial-service and auto corporations).

5. *See infra* Part III(A).

6. *See infra* Part III(A).

7. J.W. Verret, *Is the Government a Controlling Shareholder?*, *VOLOKH CONSPIRACY* (Oct. 14, 2009 2:19 PM), <http://volokh.com/2009/10/14/treasury-inc-is-the-government-a-controlling-shareholder/>.

government is a powerful shareholder due to the size of its equity stake. But the government also has a power that no other shareholder has: it regulates the companies it owns.⁸

After the bailout, corporate scholars immediately began to debate the impact the presence of this regulator-shareholder would have on corporate law. Much of this scholarship focuses on the obligations and responsibilities of the government itself, and what, if any, duties the government owes to the corporation and its shareholders as a result of its equity stake.⁹ Interestingly, little, if anything, has been written on the effect a powerful regulator-shareholder's presence has on the fiduciary obligations of corporate *directors*. This is particularly odd, considering that the government's influence on directorial decisionmaking is at the heart of many lawsuits currently pending against directors and will continue to be a focus of future suits so long as the government maintains a substantial equity position in these corporations. This Note focuses on this largely ignored issue.

As a case study, I examine the government's ownership stake in Bank of America ("BOA") and the effect that ownership had on the decision of the BOA Board of Directors to consummate the merger with Merrill Lynch ("Merrill") in the winter of 2009. Specifically, I argue that, despite holding a relatively inconsequential amount of BOA stock, the Treasury's equity position in BOA enabled it to exert an unprecedented level of control over BOA's Board and effectively force the Board to consummate the BOA-Merrill merger. I further argue that the Treasury's equity position in BOA may result in enough control over the day-to-day action at BOA to qualify the Treasury as the company's controlling shareholder. Finally, I engage in a fiduciary analysis of the BOA Board's actions to show that corporate law can and should account for the Treasury's substantial influence and control.

While the BOA-Merrill merger provides a convenient lens through which to evaluate the effect of a regulator-shareholder on corporate governance, this Note's analysis and solution are in no way limited to BOA and its directors. For hundreds of corporations in which the government holds a substantial equity stake, the story of the BOA-Merrill merger is a familiar one. In this new world of partial corporate nationalization, directors are frequently forced to walk a

8. *Id.*

9. See generally J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory and Practice*, 27 YALE J. ON REG. 283 (2010) (arguing that Congress should pass legislation establishing a fiduciary duty for Treasury to maximize the value of its investment any time it takes an equity stake in a corporation).

tightrope between their obligations to the corporation and the demands of the government. Directors run the risk that adhering to those obligations, rather than acquiescing to the government's demands, could alienate a powerful regulator who also happens to be a vital source of the company's financing. With this in mind, I turn to the story at hand: the hurried engagement and shotgun wedding of BOA and Merrill.

I. THE SHOTGUN WEDDING OF BANK OF AMERICA AND MERRILL LYNCH

A. *Courtship or Arranged Marriage?*

In the early morning hours of Saturday, September 13, 2008, Kenneth Lewis, the Chairman and Chief Executive Officer ("CEO") of BOA, received a telephone call from John Thain, the CEO of Merrill.¹⁰ Thain, who had just ducked out of an all-night meeting at the New York Federal Reserve,¹¹ informed Lewis that efforts to identify a purchaser for Lehman Brothers Holdings, Inc. ("Lehman") appeared to be futile.¹² Without a buyer, Lehman—one of the world's largest financial services firms—would be forced into bankruptcy by Monday morning.¹³

Thain saw the writing on the wall.¹⁴ Lehman's bankruptcy would weaken an already fragile financial market, and lenders would stop providing crucial funding to firms with large exposure to mortgage-linked assets.¹⁵ Without this funding, Merrill would face

10. Susanne Craig et al., *The Players Remaking Financial World*, WALL ST. J., Sept. 19, 2008, at A1, available at <http://finance.yahoo.com/banking-budgeting/article/105802/Street-Scenes:-The-Players-Remaking-Financial-World>.

11. *Frontline: Breaking the Bank* (PBS television broadcast June 16, 2009) (describing the meeting held at the New York Federal Reserve on September 12–13 of 2008). The September 12–13 meeting was presided by Secretary of the Treasury Henry Paulson and SEC Chairman Christopher Cox. William D. Cohan, *Three Days that Shook the World*, CNNMONEY.COM (Dec. 16, 2008), http://money.cnn.com/2008/12/12/magazines/fortune/3days_full.fortune. Paulson and Cox had assembled Thain and the heads of most major investment banking firms at the New York Federal Reserve Building. *Id.* Although discussions focused primarily on efforts to find a buyer for Lehman so as to avert the company's impending bankruptcy, participants also discussed the reality that if Lehman failed, Merrill, who like Lehman was holding large amounts of illiquid mortgage-backed securities, would likely follow. *Id.*

12. Craig et al., *supra* note 10.

13. *Id.*

14. *Id.* ("John Thain, Merrill's chief executive, was busy at the New York Fed working on Lehman's problems when a sudden realization hit him: If he didn't act fast, his own brokerage firm, Merrill, might not survive this crisis.")

15. *Id.*

severe liquidity problems as early as Monday morning.¹⁶ Thain was desperate. His beloved company, a ninety-four-year-old pillar of Wall Street, needed a buyer, and it needed one fast. “Ken,” Thain said, “I think we should talk about a strategic arrangement.”¹⁷ Lewis didn’t hesitate.¹⁸ This was a once-in-a-lifetime opportunity—a chance for Lewis to elevate his corporation to an unparalleled strategic position as his rivals crumbled around him.¹⁹ By 2:30 p.m., the two men were sitting face-to-face in BOA’s corporate apartment in New York.²⁰ A thirty-six-hour marathon negotiation ensued.²¹

While Thain was seeking a buyer for Merrill, Federal Reserve Chairman Ben Bernanke and Treasury Secretary Henry Paulson were working frantically to prevent the collapse of Lehman Brothers.²² As the extent of Lehman’s liquidity problems had become apparent that Friday, Bernanke and Paulson immediately summoned the heads of the world’s largest investment firms, including Thain, to a meeting at the New York Federal Reserve Building.²³ The meeting lasted all night. Bernanke and Paulson had a single goal: to stabilize as many of the nation’s financial services giants as possible before the market opened on Monday morning, and, if possible, to do so without taxpayer assistance.²⁴ Standing in the high-ceilinged conference room at the massive stone-and-iron building in lower Manhattan, Paulson sought to persuade these rival executives that it was their job, not the government’s, to fix the unfolding mess at Lehman.²⁵ “You have a

16. See *Frontline: Breaking the Bank*, *supra* note 11 (noting that Thain knew that with the tightening of the credit markets following the Lehman bankruptcy, Merrill would face severe liquidity issues beginning “Monday morning,” September 15, 2008).

17. *Id.*

18. *Id.*

19. Consolidated Amended Class Action Complaint at 19–21, *In re Bank of Am. Corp. Sec., Derivative, and Emp’t Ret. Income Sec. Act (ERISA) Litig.*, No. 09 MDL 2059 (DC) (S.D.N.Y. Sept. 25, 2009).

20. Craig et al., *supra* note 10.

21. See Bank of Am. Corp., Merger Proxy (Schedule 14A), at 49–51 (Oct. 2, 2008) (providing a detailed factual summary of the extraordinary circumstances under which the BOA-Merrill Merger Agreement was struck).

22. Cohan, *supra* note 11.

23. See *Frontline: Breaking the Bank*, *supra* note 11.

24. Cohan, *supra* note 11; see generally *Bank of America and Merrill Lynch: How did a Private Deal Turn into a Federal Bailout?: Hearing Before the H. Comm. On Oversight and Gov’t Reform*, 111th Cong. (2009) (statement of Ben S. Bernanke, Chairman, Fed. Reserve Sys.), available at <http://oversight.house.gov/images/stories/documents/20090624185603.pdf>; *Bank of America and Merrill Lynch: How did a Private Deal Turn into a Federal Bailout?: Hearing Before the H. Comm. On Oversight and Gov’t Reform*, 111th Cong. (2009) (testimony by Henry M. Paulson, former Sec’y of the Treasury), available at <http://oversight.house.gov/images/stories/documents/20090715180923.pdf>.

25. Craig et al., *supra* note 10.

responsibility to the marketplace,” he said.²⁶ Without a buyer, Paulson emphasized, Lehman’s collapse would likely be the first in a series of falling dominos that could result in a financial freefall of unparalleled proportions—a freefall that likely would put all of their jobs in jeopardy.²⁷

Not surprisingly, when Chairman Bernanke and Secretary Paulson caught wind of a potential BOA-Merrill merger, they immediately injected themselves into the negotiations.²⁸ Here, they thought, was a chance to shore up Merrill in a private merger with BOA, perhaps the only individual buyer large enough to digest a Merrill balance sheet plagued by mortgage-backed securities, which were now considered “toxic assets.”²⁹ As negotiations continued, Bernanke and Paulson insisted that Thain and Lewis reach a deal before the markets opened on Monday morning.³⁰ There was simply no time for the luxuries of a robust due diligence period. “John, you’d better make sure this happens [by Monday],” Paulson told Thain.³¹

It did. On Monday morning, September 15, 2008, BOA announced that it had reached an agreement with Merrill and that, pending shareholder vote, the companies had agreed to merge in a staggering \$50 billion, all-stock transaction.³² The largest acquisition in Wall Street history had, under “immense pressure” from the federal

26. *Id.*

27. See generally Robert J. Rhee, *The Decline of Investment Banking: Preliminary Thoughts on the Evolution of the Industry 1996–2008*, 5 J. BUS. & TECH. L. 75 (2010) (discussing the collapse of the investment banking sector).

28. Consolidated Amended Class Action Complaint at 19–21, *In re Bank of Am. Corp. Sec., Derivative, and Emp’t Ret. Income Sec. Act (ERISA) Litig.*, No. 09 MDL 2058 (DC) (S.D.N.Y. Sept. 25, 2009).

29. “Toxic asset” is a popular term for a financial asset whose value has fallen significantly and for which there is no longer a functioning market, so that such an asset cannot be sold at a price satisfactory to the holder. For a description of why mortgage-backed securities (“MBS”) and collateralized debt obligations (“CDOs”) had become toxic assets, see Rhee, *supra* note 27, at 88–91.

30. *Frontline: Breaking the Bank*, *supra* note 11.

Thain: Hank [Paulson] . . . was very strongly encouraging me to make sure that got a transaction done prior to the opening [of the markets] on Monday. . . . They very much wanted us to get a transaction done.

Interviewer: What form [did] that “strongly encouraging” take? How strongly?

Thain: You know, in a meeting, it is, “John, you’d better make sure this happens.”

Interviewer: That straightforward?

Thain: Mm-hmm.

31. *Id.*

32. Bank of Am. Corp. & Merrill Lynch, Merger Proxy (Schedule 14A), at 49 (Nov. 3, 2008). BOA was to pay \$50 billion for Merrill in an all-stock transaction whereby each share of Merrill would be exchanged for .08595 shares of BOA. *Id.* The agreement valued Merrill stock at \$29 per share—a 70% premium to Merrill’s \$17 per share closing price on September 12. *Id.*

government, been negotiated,³³ approved,³⁴ and announced in less than forty-eight hours.

While Paulson and Bernanke were successful in arranging the engagement of BOA to Merrill, their matchmaking efforts for Lehman failed. On September 15, 2008, the nation learned of both the largest merger and the largest bankruptcy in Wall Street history.³⁵ The once invincible Lehman Brothers announced it had filed for Chapter 11.³⁶ The markets reeled; the Dow Jones lost 500 points (or 4.4%)—the largest single-day drop since the days following the attacks on September 11, 2001.³⁷

B. Cold Feet

Although BOA and Merrill announced their engagement on September 15, 2008, the marriage of these financial services giants was far from final. The Merger Agreement was contingent upon the approval of both companies' shareholders, and it contained clauses that would in certain instances allow either party to stop short on their way to the altar. Immediately, both companies began working feverishly to file proxy statements and obtain the necessary shareholder approval. If all went according to plan, the shareholders would approve the merger at special meetings scheduled for December 5, 2008 and two of the nation's most respected financial services corporations would get hitched on New Year's Day.³⁸

33. *Id.*

34. *See id.* at 51 (stating that the BOA Board unanimously approved the Merger Agreement and recommended all shareholders vote to approve the merger during a special meeting to be held on December 5, 2008).

35. *See* Andrew Ross Sorkin, *Lehman Files for Bankruptcy; Merrill Is Sold*, N.Y. TIMES, Sept. 15, 2008, at A1 (noting that BOA-Merrill merger unites two of the largest financial service firms on Wall Street); Yalman Onaran & Christopher Scinta, *Lehman Makes Largest Bankruptcy Filing in History*, FIN. POST, Sept. 15, 2008, <http://www.financialpost.com/story.html?id=790965> (noting that Lehman's bankruptcy, which listed more than \$613 billion of debt, dwarfs WorldCom Inc.'s in 2002 and Drexel Burnham Lambert's in 1990 and was the largest in U.S. history).

36. Sorkin, *supra* note 35.

37. Michael Grynbaum, *Wall St.'s Turmoil Sends Stocks Reeling*, N.Y. TIMES, Sept. 15, 2009, at C7, available at <http://www.nytimes.com/2008/09/16/business/worldbusiness/16markets.html?hp>.

38. The deal was set to close on January 1, 2009. Press Release, Bank of Am., Bank of America Buys Merrill Lynch, Creating Unique Financial Services Firm (Sept. 15, 2008), available at http://www.ml.com/index.asp?id=7695_7696_8149_88278_106886_108117; *see also* Press Release, Bank of Am., Bank of America Completes Merrill Lynch Purchase (Jan. 1, 2009) (announcing the successful consummation of the BOA-Merrill merger on January 1, 2009).

But like many engagements,³⁹ all did not go according to plan. As it became clear that federal bailout funds would not be used to purchase toxic assets from struggling banks, the value of those assets fell even further. Merrill, in particular, was taking a beating. Throughout the next two and a half months, Merrill began to project fourth-quarter losses that were much larger than either company had originally anticipated.⁴⁰ In October and November alone, Merrill was anticipating “horrifying” losses of between \$12-18 billion.⁴¹ Lewis and the rest of BOA’s Board of Directors were becoming increasingly concerned that Merrill’s losses would test BOA’s own solvency.⁴²

Despite these concerns, neither Merrill nor BOA announced the extent of Merrill fourth-quarter losses to its shareholders. And on December 5, the shareholders of both BOA and Merrill met at special meetings held in Charlotte and New York, respectively, where they voted and approved the BOA-Merrill Merger Agreement.⁴³

By December 17, the catastrophic effect of Merrill’s exposure to toxic assets was clear. In the less than two months since BOA had announced the merger, Merrill had lost more than \$20 billion.⁴⁴ Cracks were forming in the relationship between Merrill and BOA,

39. In an online national poll of 565 single adults, 20% said they had broken off an engagement in the past three years, and 39% said they knew someone else who had done so. Pamela Paul, *Calling it Off*, TIME, Oct. 1, 2003, <http://www.time.com/time/connections/article/0,9171,1101031006-490683,00.html#ixzz0g0smmC>. Fortunately, I was able to coerce my wife down the aisle despite her undoubtedly legitimate reservations. I thank her for her unending patience and support; without it, I never would have finished this Note.

40. Ken Lewis Testimony Before N.Y. Att’y Gen’s Office, at 11–12 (Feb. 26, 2009) [hereinafter Lewis Testimony] (identifying December 5 through 14 as the period when he and BOA became aware of the extent of Merrill’s losses); Shawn Tully, *Behind Ken Lewis’s Departure*, CNNMONEY.COM, Oct. 1, 2009, http://money.cnn.com/2009/10/01/news/companies/ken_lewis_bank_america.fortune/index.htm. *But see* Consolidated Amended Class Action Complaint at 6, *In re Bank of Am. Corp. Sec., Derivative, and Emp’t Ret. Income Sec. Act (ERISA) Litig.*, No. 09 MDL 2058 (DC) (S.D.N.Y. Sept. 25, 2009) (alleging that the BOA’s due diligence was inadequate and Lewis knew or should have known of Merrill’s fourth-quarter losses well before December).

41. Dan Fitzpatrick et al., *In Merrill Deal, U.S. Played Hardball*, WALL ST. J., Feb. 5, 2009, at A1, available at <http://online.wsj.com/article/SB123379687205650255.html> (“But by early December, Merrill’s losses were spiraling out of control. Internal calculations showed Merrill had a horrifying pretax loss of \$13.3 billion for the previous two months, and December was looking even worse.”).

42. *Id.*; Lewis Testimony, *supra* note 40, at 37.

43. Dan Fitzpatrick et al., *BoFA’s Latest Hit*, WALL ST. J., Jan. 16, 2009, at C1, available at http://online.wsj.com/article/SB123205960618787447.html?mod=todays_us_money_and_investing (describing the lawsuits that followed BOA’s failure to disclose Merrill’s fourth-quarter losses until its January 16, 2009 earnings release).

44. Consolidated Amended Class Action Complaint at 6–7, *In re Bank of Am. Corp. Sec., Derivative, and Emp’t Ret. Income Sec. Act (ERISA) Litig.*, No. 09 MDL 2058 (DC) (S.D.N.Y. Sept. 25, 2009).

and BOA's directors began to rethink the wisdom of hitching itself to a partner with so much baggage.

Lewis and the BOA Board became convinced that BOA should call off the wedding. The Board quickly began examining its right to invoke the Material Adverse Change clause ("the MAC clause") in the Merger Agreement.⁴⁵ As drafted, the MAC clause entitled BOA to either (1) withdraw from the Merger Agreement and renegotiate the deal at a reduced price; or (2) terminate the Merger Agreement altogether upon a "material and adverse change" in the value of Merrill's assets.⁴⁶ It was "almost certain that [Lewis] didn't want to walk from the deal," but, presuming the MAC had been triggered by Merrill's fourth-quarter losses,⁴⁷ "the Merrill [B]oard would have had little choice but to agree to a multi-billion reduction [in price]."⁴⁸

On December 17, Lewis contacted Paulson to inform him that a "material adverse change had occurred in Merrill's financial condition, and [BOA] would seek to terminate the merger pursuant to the terms of the MAC clause."⁴⁹ Paulson immediately summoned Lewis to Washington.⁵⁰

Paulson and Bernanke feared that the delay of invoking the MAC clause would force an insolvent Merrill into bankruptcy and further destabilize the nation's financial markets.⁵¹ They argued that Merrill's failure would have devastating systemic repercussions that would be detrimental to the entire financial services industry, including BOA. In response, Lewis agreed to delay invoking the MAC, supply the Federal Reserve ("Federal Reserve" or "Fed") with information on Merrill's fourth-quarter performance, and allow the

45. Fitzpatrick et al., *supra* note 41.

46. Tully, *supra* note 40; see generally Robert T. Miller, *The Economics of Deal Risk: Allocating Risk Through MAC Clauses in Business Combination Agreements*, 50 WM. & MARY L. REV. (2009).

47. Importantly, for the purposes of this analysis, I will defer to BOA's General Counsel at the time, Brian Moynihan, who believed that BOA had a valid right to invoke the MAC clause and renegotiate the merger. *Contra* Rhee, *supra* note 2, at 688–92. Whether the MAC clause could have been executed is a matter of contract law, and largely outside the scope of this Note. This Note assumes that BOA could invoke the MAC in order to use the BOA-Merrill merger as a lens through which to address an emerging issue in corporate law.

48. Tully, *supra* note 40.

49. Lewis Testimony, *supra* note 40, at 40; Consolidated Amended Class Action Complaint at 132–46, *In re* Bank of Am. Corp. Sec., Derivative, and Emp't Ret. Income Sec. Act (ERISA) Litig., No. 09 MDL 2059 (DC) (S.D.N.Y. Sept. 25, 2009) (asserting that in late November, BOA's "senior executives debated whether Merrill's losses were so severe that the bank could walk away from the deal, citing the 'material adverse effect' clause in the merger agreement").

50. Lewis Testimony, *supra* note 40, at 40.

51. Anne Flaherty, *Paulson Said He Told BOA's Lewis That Fed Could Fire Him*, USA TODAY, June 10, 2009, http://www.usatoday.com/money/industries/banking/2009-07-16-paulson-scrutiny_N.htm.

Fed time to review this information before taking any action to terminate or renegotiate the BOA-Merrill merger. The parties agreed to discuss the issue again in a few days.⁵²

On December 21, less than one full business week before the closing date, Lewis contacted Paulson at his ski cabin in Colorado. He informed Paulson that BOA simply could not absorb Merrill's staggering fourth-quarter losses and that Lewis and the BOA Board intended to invoke the MAC clause. Lewis and the rest of the BOA Board believed that it was simply no longer in the best interest of BOA or its shareholders to proceed with the merger in light of Merrill's continued financial decline.⁵³

Paulson disagreed. Without the pending merger, Merrill was bankrupt,⁵⁴ and any effort "to recast the deal and hold new shareholder votes [would have taken over a month]."⁵⁵ With the credit markets frozen, Paulson knew that Merrill would be unable to obtain the short-term funding it needed to survive the delay.⁵⁶ Another massive investment bank wasn't going to fail on his watch. He informed Lewis that, if BOA invoked the MAC clause, the federal government would clean house.⁵⁷ Using its authority as a banking regulator, the Treasury would fire BOA's senior management and the BOA Board.⁵⁸

Paulson had drawn the shotgun—the marriage of BOA and Merrill was going to happen, with or without Lewis and the rest of the BOA board. Paulson did, however, recognize the potential of BOA's own collapse under the weight of Merrill's staggering fourth-quarter losses; thus, he agreed that the federal government would provide BOA with a \$20 billion direct-equity investment and a \$118 billion guarantee against any losses suffered as a result of BOA's exposure to Merrill's toxic assets.⁵⁹ In effect, Paulson gave BOA a \$138 billion dowry to proceed down the aisle.

52. *Id.*

53. *Id.*

54. Silla Brush, *Fed, Treasury Pressured BoA to Buy Merrill Lynch*, HILL, June 10, 2009, <http://thehill.com/homenews/administration/20062-fed-treasury-pressured-boa-to-buy-merrill-lynch>. An internal Federal Reserve study undertaken in December said that Merrill "could not survive as a stand-alone entity." *Id.*

55. Tully, *supra* note 40.

56. *Id.*

57. Lewis Testimony, *supra* note 40, at 52.

58. *Id.*; Flaherty, *supra* note 51.

59. *See infra* Part III(B) (describing the Treasury's investment contracts in detail).

C. I Do . . . I Guess

The next day, December 22, at a Special Meeting of the BOA Board, Lewis informed the Board of his heated conversation with Secretary Paulson. The minutes of the meeting summarize the conversation between Paulson and Lewis:

First and foremost, the Treasury and Fed are unified in their view that the failure of the Corporation to complete the acquisition of [Merrill] would result in systemic risk to the financial services system in America and would have adverse consequences for the Corporation;

Second, the Treasury and Fed stated strongly that were the Corporation to invoke [the MAC clause] in the merger agreement with [Merrill] and fail to close the transaction, *the Treasury and Fed would remove the Board and management of the Corporation;*

Third, the Treasury and Fed have confirmed that they will provide assistance to the Corporation . . . to protect the Corporation against adverse impact of certain [Merrill] assets; and

Fourth, the Fed and Treasury stated that the investment and asset protection promised could not be provided or completed by scheduled closing day of the merger, January 1, 2009; that the merger should close on schedule, and that the Corporation can rely on the Fed and Treasury to complete and deliver the promised support by January 20, 2009⁶⁰

After hearing Lewis recount his conversation with Paulson, the BOA Board reversed course.⁶¹ The Board voted not to invoke the MAC clause or to inform the shareholders of Merrill's losses prior to the planned disclosure.⁶² The wedding was back on. As Lewis later explained, circumstances had changed, and the Board now believed it was in BOA's best interest to proceed with the merger "as [we] had been *instructed*" because "if [the government] felt that strongly then that should be a strong consideration for us to take into account."⁶³

But Lewis, who had spent his entire professional life with BOA's management, must have known that BOA's shareholders would

60. Minutes of Special Meeting of Board of Directors of Bank of America Corporation, at 2 (Dec. 22, 2008), *available at* http://www.oag.state.ny.us/media_center/2009/apr/pdfs/Exhibit_B_to_4.23.09_letter.pdf (emphasis added).

61. Consolidated Amended Class Action Complaint at 6, 42, *In re Bank of Am. Corp. Sec., Derivative, and Emp't Ret. Income Sec. Act (ERISA) Litig.*, No. 09 MDL 2059 (DC) (S.D.N.Y. Sept. 25, 2009). Lewis testified, in a deposition taken by the New York Attorney General's office, that before receiving Paulson's threat, "we were going to call the MAC" but that, after this telephone call, Lewis and the rest of the BOA Board reversed course. Lewis Testimony, *supra* note 40, at 11–12.

62. Minutes of Special Meeting of Board of Directors of Bank of America Corporation, at 2–3 (Dec. 22, 2008) ("Mr. Lewis stated the purpose of the special meeting is to insure that the Board is in accord with management's recommendation to complete the acquisition of [Merrill] as scheduled on January 1, 2009, pursuant to the [merger agreement] and . . . after due consideration of the undertaking and admonishments of the federal regulators.").

63. Lewis Testimony, *supra* note 40, at 94, 151.

lose money in the transaction. And, like night follows day, shareholder lawsuits follow shareholder losses. If this deal was going to close as “instructed” by federal officials, Lewis was going to try to insulate the BOA Board from direct personal liability from what he (correctly) foresaw as a slew of shareholder lawsuits.

Later that day, Lewis contacted Chairman Bernanke and requested that the Treasury provide the BOA Board with immunity from civil liability. Specifically, Lewis asked Bernanke “whether he could use as a defense that the [government] ordered him to proceed [with the BOA-Merrill merger] for systemic reasons.” Bernanke replied flatly, “No.”⁶⁴

Lewis then requested a letter from Bernanke that he could use in BOA’s defense. Specifically, he requested a letter stating that BOA had been formally advised by the Federal Reserve that invoking “a MAC is not in the best interest of his company.”⁶⁵ Instead of implying that the Federal Reserve had “ordered” or “commanded” BOA to proceed with the BOA-Merrill merger, the letter would simply state that, in the Fed’s opinion, the merger was in the best interest of both BOA and its shareholders. Bernanke contacted Scott Alvarez, the Fed’s General Counsel, to discuss the proposed letter. Alvarez advised Bernanke to “hold fast” on any such letter, stating simply, “I want to avoid the Fed being the centerpiece of the litigation.”⁶⁶

Despite significant reservations and without any protection from personal liability, the BOA Board consummated the merger on January 1, 2009. The shotgun wedding of these two financial services giants was final.

As the extent of Merrill’s fourth-quarter losses became public, BOA’s stock plummeted. In less than two weeks, the company’s shares lost more than half of their value, falling from \$12.99 on January 9 to \$5.10 by January 20.⁶⁷ On January 16, *The Wall Street Journal* noted that the current market value of the combined BOA-Merrill entity was less than BOA’s stand-alone value prior to the announcement of the merger. By the end of January, BOA had lost more than \$50 billion in market cap and suffered the worst loss of its financial history.⁶⁸ *The*

64. William D. Cohan, *The Final Days of Merrill Lynch*, ATLANTIC, Sept. 2009, <http://www.theatlantic.com/doc/200909/bank-of-america/2>. (emphasis added).

65. *Id.*

66. *Id.*

67. For historical daily price quotes of BOA stock, see YAHOO! FINANCE, <http://finance.yahoo.com>.

68. Consolidated Amended Class Action Complaint at 132–146, *In re Bank of Am. Corp. Sec., Derivative, and Emp’t Ret. Income Sec. Act (ERISA) Litig.*, No. 09 MDL 2059 (DC) (S.D.N.Y. Sept. 25, 2009).

New York Times described the BOA-Merrill merger as “one of the greatest destructions of shareholder value in financial history.”⁶⁹ More than thirty shareholder lawsuits followed. The complaints alleged violations of federal securities and pension laws as well as breaches of the Board’s state law fiduciary duties. The U.S. District Court for the Southern District of New York subsequently consolidated more than thirty actions into three on June 30, 2009.⁷⁰

In February 2009, BOA shareholders stripped Lewis of his position as Chairman of the BOA Board.⁷¹ This vote “marked the first time that a company in the [S&P] 500-stock index had been forced by shareholders to strip a CEO of Chairman duties.”⁷² In the wake of mounting criticism, Lewis announced his retirement from BOA in April of 2009 after thirty-five years with the bank.⁷³

II. THE ORDER OF SERVICE

The BOA-Merrill merger provides a useful lens through which to view an important new question in corporate law: What, if any, impact should the federal government’s increased ability to influence corporate action have on the traditional analysis of director and officer fiduciary duties? More specifically, if the government now stands in the dual role as both a regulator and a substantial, if not controlling, shareholder of many U.S. auto and financial services corporations,⁷⁴ how should the traditional corporate law analysis of director and officer fiduciary duties adjust to this new dynamic?

In order to adequately frame these questions and offer a solution, I first provide some necessary background. Specifically, in Part III(A), I briefly summarize the federal government’s bailout plan, including how and when the federal government took significant equity stakes in many of the U.S. financial services corporations. I also give the details of the government’s equity investment in BOA.

69. Rob Cox & Lauren Silva Laughlin, *Bank of America’s Difficult Choice*, N.Y. TIMES, Jan. 26, 2009, at B2, available at <http://www.nytimes.com/2009/01/27/business/27views.ready.html>.

70. *In re Bank of Am. Corp. Sec. Derivative and Emp’t Ret. Income Sec. Act (ERISA) Litig.*, 258 F.R.D. 260, 272 (S.D.N.Y. 2009).

71. *Id.*

72. *Stocks End Mixed after Chrysler Bankruptcy*, BUSINESSWEEK, Apr. 30, 2009, http://www.businessweek.com/investor/content/apr2009/pi20090430_028598.htm.

73. Louise Story & Eric Dash, *Deal Advice on Merrill Will Be Aired*, N.Y. TIMES, Oct. 12, 2009, at B1; see also Tully, *supra* note 40 (describing Lewis as a legendary Wall Streeter who was essentially forced to consummate a deal by the government and run out of BOA as a result of this misfortune).

74. Verret, *supra* note 7.

Then, in Part III(B), I introduce the obligations imposed on directors as a result of their status as fiduciaries of a corporation. In particular, this Part highlights that directors must exercise their independent business judgment in a good-faith effort to advance the corporate interest for the benefit of *all* shareholders and must not let their business judgment be skewed or obstructed by the demands of a single shareholder—even if that shareholder owns a controlling stake in the corporation.⁷⁵ Indeed, it is a fundamental tenet of corporate law that a fiduciary has an unwavering obligation to act in what she believes to be the best interest of the corporation, irrespective of the threats or demands of a controlling or otherwise powerful shareholder.

Part IV tests whether this fundamental tenet of corporate law should hold true when the *government* is the shareholder making the demand. Specifically, Part IV(A) argues that, in spite of relatively low minority interest, the Treasury is a controlling shareholder in many of the corporations that accepted federal bailout cash,⁷⁶ and even when the government's ownership does not reach the status of controlling, it nonetheless exerts substantial influence over corporate decisionmaking as a direct result of its equity investment in these companies. Part IV(C) applies a traditional fiduciary analysis to the actions of Lewis and the rest of the BOA Board. Under this analysis, the Treasury is treated like any old shareholder, and therefore Lewis and the BOA Board have an unwavering obligation to act in what they believe to be the best interest of the corporation and its shareholders, irrespective of the threats and demands of Paulson and Bernanke.⁷⁷

Part V develops the central thesis of this Note: a fiduciary duty analysis that fails to account for the presence of the government as a powerful regulator-shareholder is fundamentally inadequate in addressing the conflicting interests and obligations of directors and officers in government-controlled and partially-nationalized

75. Our starting point is that directors, rather than shareholders, manage the business and affairs of the corporation and must exercise their independent business judgment to that end. DEL CODE ANN. tit. 8, § 141(a) (2010); *Aronson v. Lewis*, 473 A.2d 805, 811–12 (Del. 1984). In exercising this judgment, directors are charged with an unyielding fiduciary duty to protect the interests of the corporation and to act in the best interests of *all* shareholders. *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1280 (Del. 1988). Thus, in order to maintain the protection of the business judgment rule, the directors must remain disinterested and independent. *See, e.g., In re W. Nat'l Corp. S'holders Litig.*, No. 15927, 2000 Del. Ch. LEXIS 82, at *87–88 (Del. Ch. May 22, 2000) (“Because the absence of a controlling shareholder removes the prospect of retaliation, the business judgment rule should apply to an independent special committee’s good faith and fully informed recommendation.”).

76. *See generally* Verret, *supra* note 9.

77. *See supra* notes 53–58 and accompanying text.

corporations.⁷⁸ In this Part, I acknowledge an emerging reality in corporate law that corporate decisionmaking is no longer a purely private affair,⁷⁹ and argue that a fiduciary analysis that rests upon the false assumption that it *is* a purely private affair leaves much to be desired. For BOA and others like it, corporate decisionmaking is a coordinated public-private process in which corporate directors must balance the need to assert their own independent business judgment against the risk that doing so could result in a retaliatory response from the corporation's regulator-shareholder. Courts that ignore this reality will quickly run the risk of imposing liability on directors when no liability is warranted⁸⁰ and depleting an already limited supply of director talent.⁸¹

To avoid this unjust and inefficient result, I argue for the adoption of a modernized fiduciary duty analysis that would explicitly account for the influence of the federal government on corporate decisionmaking. The traditional fiduciary duties of care and loyalty are adequately flexible to account for the expanding level of

78. The term "partially-nationalized" is used in this Note to refer to corporations that have accepted significant amounts of federal capital but for whom that investment may not rise to the level of a controlling stake. For a somewhat similar use of the term, see David Cho et al., *U.S. Forces Nine Major Banks To Accept Partial Nationalization*, WASH. POST, Oct. 14, 2008, <http://www.washingtonpost.com/wp-dyn/content/article/2008/10/13/AR2008101300184.html>.

79. Rhee, *supra* note 2, at 696.

80. Importantly, much of the control exerted by the government over BOA appears to be a direct product of the Treasury's status as a shareholder. Treasury obtained control that it did not have before its investment when it invested in BOA. This is particularly important to the rationale behind the solution proposed in this Note. On one hand, if the government's control over corporate action stems *purely* from its regulatory authority, then under existing corporate law, a board could consider the benefits of aligning corporate initiatives with the initiatives of those of its regulator. On the other hand, if the regulator-shareholder's influence is *solely* the product of its status as a shareholder, then the directors would have an unwavering obligation to act in what they believe to be the best interest of the corporation, irrespective of the regulator-shareholder's demands. When control stems from both the government's presence as a shareholder and its presence as regulator or from some synergy between its shareholder and its regulator status, the result is uncertain. As the lines between regulatory control and shareholder control blur, so does the right of the board to consider a regulator-shareholder's initiatives and demands when making corporate decisions. By advocating that courts explicitly allow a director to take into account the demands and threats of a regulator-shareholder, this Note seeks to (1) create clarity where current doctrines create ambiguity; and (2) fairly and accurately evaluate the actions of directors in government-controlled and partially-nationalized corporations.

81. The fear of decreasing the pool of outside directors willing to serve on boards is one shared by both legal scholars and the courts. See, e.g., Scott J. Davis, *Would Changes in the Rules for Director Selection and Liability Help Public Companies Gain Some of Private Equity's Advantages?* 76 U. CHI. L. REV. 83, 105-06 (2009) (discussing the infamous WorldCom settlement, in which outside directors were paid out-of-pocket, and the resulting effect of the settlement—namely, chilling corporate risk taking and depleting the pool of outside directors willing to serve on corporate boards); *Sun-Times Media Group, Inc. v. Black*, 954 A.2d 380, 405 (Del. Ch. 2008) (noting that imposing liability when no liability is warranted or even subjecting directors to unwarranted litigation decreases the number of outside directors willing to serve).

government control; however, these fiduciary obligations will only function as intended if courts face the government's impact on corporate decisionmaking head-on. In short, the federal government is not any old shareholder, and a fiduciary duty analysis that recognizes this reality will be more successful at adequately regulating directorial conduct than one that does not.

III. SETTING THE STAGE: THE FEDERAL GOVERNMENT BECOMES AN INVESTOR

In order to adequately address how the government's presence as a shareholder affects director and officer fiduciary duties, it is important to examine how and when the government took significant equity stakes in BOA and the other corporations that accepted federal bailout cash and to understand the nature of the fiduciary obligations imposed on directors and officers under current corporate law.

A. So What Does \$45 Billion Buy You These Days? The Troubled Asset Relief Program and the Government's Equity Investments

In response to the dramatic credit freeze that both caused and followed the failures of Lehman Brothers and Bear Stearns, Congress approved an emergency bailout plan of the financial industry.⁸² And on October 3, 2008, President George W. Bush signed that plan—the Emergency Economic Stabilization Act of 2008 (“EESA”)—into law.⁸³ The centerpiece of the EESA was the creation of the Troubled Asset Relief Program (“TARP”). TARP established a mind-blowing \$700 billion bailout fund, the use of which was left largely to the discretion of the Treasury. As originally envisioned, the Treasury would use the TARP funds to purchase and sell the so-called “toxic assets” that were plaguing the balance sheets of many of the nation's most venerable financial services firms.⁸⁴ That is, the Treasury would simply substitute good assets for bad ones on the balance sheets of hundreds

82. See generally Rhee, *supra* note 27 (discussing the collapse of Bear Stearns, Lehman Brothers, and Merrill and the subsequent legislative and regulatory responses).

83. Pub. L. No. 110-343, 122 Stat. 3765 (2008) (codified as amended in scattered sections of 5 U.S.C., 12 U.S.C., 15 U.S.C., and 31 U.S.C.); see David M. Herszenhorn, *Bailout Plan Wins Approval; Democrats Vow Tighter Rules*, N.Y. TIMES, Oct. 3, 2008, at A1, available at <http://www.nytimes.com/2008/10/04/business/economy/04bailout.html> (describing the legislative enactment and subsequent presidential authorization of the EESA).

84. SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, QUARTERLY REPORT TO CONGRESS: JULY 2009, at 3, available at http://www.sigtar.gov/reports/congress/2009/July2009_Quarterly_Report_to_Congress.pdf [hereinafter JULY 2009 REPORT].

of U.S. banks, but take no direct ownership stake in these corporations.⁸⁵

As predicted by some scholars—namely Eric Posner⁸⁶—this plan was quickly shelved in lieu of twelve alternate programs that enabled the Treasury to directly invest TARP funds into “qualified financial institutions” in exchange for an equity stake in those institutions.⁸⁷ Qualified financial institutions included banks, bank holding companies, and other “systematically significant”⁸⁸ institutions (in other words, those institutions the Treasury deemed either “too big” or “too important” to fail).⁸⁹

The Treasury made its first equity investments in qualified financial institutions under EESA’s Capital Purchase Program (“CPP”). Under the CPP, the Treasury invested \$203.2 billion in exchange for preferred stock and common-stock warrants in 649 different qualified financial institutions.⁹⁰ Of these 649 institutions, eight institutions accounted for \$134.2 billion of the initial \$203.2 billion investment, including \$25 billion each in BOA, Citigroup, JP Morgan, and Wells Fargo, and \$10 billion each in Goldman Sachs and Morgan Stanley.⁹¹ Through the Targeted Investment Program (“TIP”), the Treasury invested an additional \$40 billion in BOA and Citigroup, with each company receiving \$20 billion.⁹² By the end of January 2009, the Treasury had taken unprecedented equity stakes in many of

85. *Id.*

86. Eric Posner, *Does Congress Think That Paulson Asked for Not Enough Power?*, VOLOKH CONSPIRACY (Sept. 23, 2008, 8:01 PM), <http://www.volokh.com/posts/1222214474.shtml> (“So Treasury will be able to obtain equity stakes whenever it believes that doing so makes sense (presumably, so as to obtain a portion of the upside if Treasury overpays for the securities), and will have to exercise *whatever control its equity interest gives it*, including possibly a say in the management of the firm (think of AIG).”) (emphasis added).

87. JULY 2009 REPORT, *supra* note 84, at 3 (noting that “the primary tool of TARP for assisting financial institutions thus far has been a direct investment of capital”).

88. *See id.* at 36 (defining a “systematically significant institution” as a “financial institution whose failure would impose significant losses on creditors and counterparties, call into question the financial strength of other similarly situated financial institutions, disrupt financial markets, raise borrowing costs for households and businesses, and reduce household wealth”).

89. *Id.*

90. *See id.* at 51 (demonstrating that the vast majority of the first \$300 billion of the federal bailout was used to purchase stock); *see also* OFFICE OF FIN. STABILITY, U.S. TREASURY DEP’T, TRANSACTION REPORT FOR PERIOD ENDING OCTOBER 28, 2009, [http://www.financialstability.gov/docs/transaction-reports/10-30-09 Transactions Report as of 10-28-09.pdf](http://www.financialstability.gov/docs/transaction-reports/10-30-09%20Transactions%20Report%20as%20of%2010-28-09.pdf) (providing a comprehensive list of the 649 firms that accepted CPP capital injections in October of 2008, the amounts of those injections, and a brief description of the rights acquired in exchange).

91. Verret, *supra* note 9, at 294.

92. *Id.*

the world's largest financial services corporations—including a \$45 billion investment in BOA.⁹³

The Treasury didn't, however, own any of BOA's common stock.⁹⁴ This makes the seemingly simple question—"How much of BOA is owned by the U.S. government?"—surprisingly complex to answer.

The Treasury's \$45 billion investment in BOA came in the form of three targeted capital injections for which the Treasury received senior-preferred stock and warrants to purchase common stock:

First, on October 28, 2008,⁹⁵ the Treasury made a CPP investment of \$15 billion of TARP funds in BOA in exchange for 600,000 shares of Series N preferred stock and warrants to purchase 73.1 million shares of BOA common stock.⁹⁶

Second, on January 9, 2009, the Treasury made a similar \$10 billion investment through the CPP in exchange for 400,000 shares of Series Q senior-preferred stock and warrants to purchase an additional 48.8 million shares of BOA common stock.

Third, on January 16, 2009, the Treasury used the TIP to invest an additional \$20 billion in BOA in exchange for 800,000 shares of Series R preferred stock and warrants to purchase 150.4 million shares of common stock.⁹⁷ The Federal Reserve also agreed to provide BOA with insurance from the losses on \$118 billion in assets acquired in the BOA-Merrill merger.⁹⁸ BOA would be expected to absorb the first \$10 billion of losses related to the assets and any additional losses would be shared between BOA (10%) and the U.S. government (90%).⁹⁹ As a fee for this arrangement, BOA agreed to issue the Treasury a total of \$4 billion worth of a new class of preferred stock and warrants to acquire 73 million shares of BOA common stock.¹⁰⁰

93. *See id.* at 289 (providing the history of the U.S. government as shareholder and noting that the TARP investments were unprecedented in size, scope, and duration).

94. *Id.* at 289–93.

95. Bank of Am. Corp., Annual Report (Form 10-K), at 158 (Feb. 27, 2009) [hereinafter BOA 2009 Annual Report].

96. *Id.*

97. *Id.* at 16.

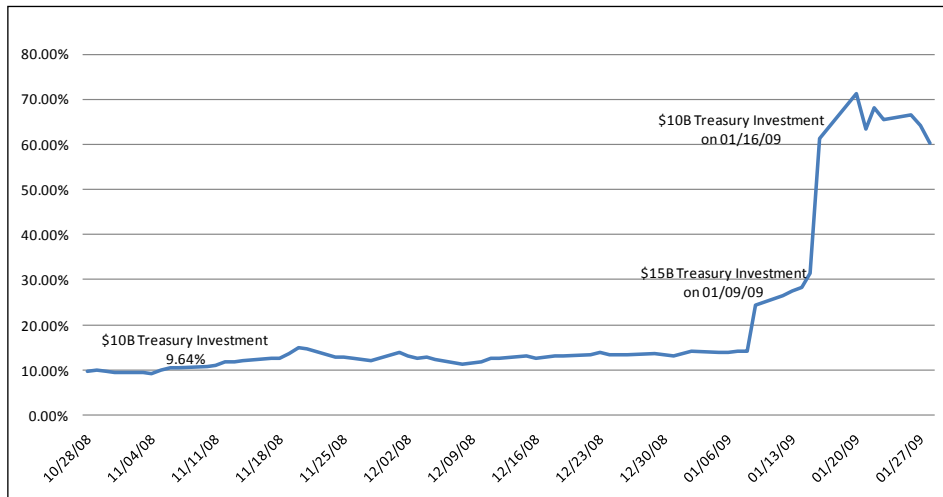
98. *Rhee, supra* note 2, at 672 (citing Bank of Am. Corp., Current Report (Form 8-K), at 2 (Jan. 16, 2009)).

99. BOA 2009 Annual Report, *supra* note 95, at 184.

100. *Rhee, supra* note 2, at 668 (citing Bank of Am. Corp., Current Report (Form 8-K), Item 1.01 (Oct. 31, 2008)). In connection with this asset insurance contract, BOA agreed to continue with the "current mortgage loan modification programs" discussed in Part IV(B) below. Additionally, any increase in the quarterly common stock dividend for the next three years would require the consent of the U.S. government. *See infra*. Part IV(B).

By January 30, 2009, the government had more raw dollars invested in BOA than did any other equity owner. As shown in Chart 1 below, after the BOA-Merrill merger, the Treasury's equity contribution as a percentage of total BOA market cap was between 65% and 70%.¹⁰¹

CHART 1. PERCENTAGE OF TREASURY EQUITY INVESTMENT
IN DOLLARS TO TOTAL BOA MARKET CAP



101. Chart 1 compares Treasury's total investment dollars with the market value of the common shares issued and outstanding and the balance sheet value of the preferred shares outstanding. Daily market values were obtained from YAHOO! FINANCE, <http://finance.yahoo.com> (last visited Sept. 10, 2010). While the preferred shares balance sheet value represents the historical issue price rather than the fair market value ("FMV"), the FMV is not easily ascertainable. However, because the vast majority of these shares (approximately 97%) were issued during 2008, the balance sheet value is a fairly accurate proxy of the FMV of these shares during the relevant period. BOA 2009 Annual Report, *supra* note 95, at 158–59. No source currently tracks the total shares issued and outstanding of BOA on a daily or weekly basis. Thus, as used in Chart 1, common BOA shares issued and outstanding for dates before the BOA-Merrill merger on January 1, 2009 include the annualized quantities from balance sheet dates of September 30, 2008, and December 31, 2008. *Id.* This provides the best estimate of common shares outstanding between September and December of 2008. Common shares outstanding after the BOA-Merrill merger include total shares outstanding on December 31, 2008 and all shares issued in conjunction with the BOA-Merrill merger. *Id.* at 163, 166. Since Chart 1 only portrays percentage ownership in the first month of 2009, this provides the most accurate estimate of shares outstanding for that period. An analogous calculation was performed for preferred share value. Specifically, preferred share values for the dates before the BOA-Merrill merger on January 1, 2009 are annualized share values as of balance sheet dates September 30, 2008 and December 31, 2008. *Id.* Values after the BOA-Merrill merger include only the balance sheet data for December 31, 2008 and the value of the preferred shares issued in conjunction with the BOA-Merrill merger. *Id.*

Interestingly, despite this tremendous capital investment in BOA, the Treasury controlled a very small percentage of BOA's total stock issued and outstanding, and didn't own any standard voting stock.¹⁰² The Treasury employed similar investment strategies in many of the banks that accepted federal bailout funds.¹⁰³ In an attempt to curb fears that it was nationalizing the U.S. banking system, the Treasury initially purchased *only* non-voting senior-preferred stock in the banks that accepted federal bailout cash.¹⁰⁴ And the Treasury has only occasionally converted these shares to common stock, such as in the case of Citigroup, discussed in Part IV(A) below.

In BOA, for example, despite a \$45 billion investment, the Treasury held less than 0.1% of BOA's total shares outstanding in January of 2009.¹⁰⁵

102. *See infra* tbl.1.

103. Verret, *supra* note 9, at 340.

104. *Id.*

105. *See infra* tbl.1. As used in this table, "PS" means preferred shares and "CS" means common shares. For a description of how PS issued and outstanding and CS issued and outstanding were calculated, see *supra* note 101.

TABLE 1. TREASURY SHARE OWNERSHIP IN RELATION TO TOTAL BOA SHARES OUTSTANDING

Purchase Date	# PS Purchased	# CS Warrants Purchased	App. CS Issued and Outstanding	App. PS Issued and Outstanding	Total PS and CS Shares	% of Total Shares	% of PS	Total Shares if Warrants Exercised
10/28/08	600,000	73,010,000	4,789,745,076	8,994,395	4,798,739,471	0.01%	6.67%	1.51%
01/09/09	400,000	48,800,000	5,018,811,074	8,210,647	5,027,021,721	0.02%	12.18%	2.39%
01/16/09	800,000	150,400,000	5,018,811,074	8,210,647	5,027,021,721	0.04%	21.92%	5.17%

But the shares the Treasury owns provide it with a tremendous amount of influence over BOA and its assets. In many respects, the preferred shares BOA issued to the federal government are more closely analogous to debt instruments than to standard equity investments.¹⁰⁶ Much like corporate bonds, the shares: (1) take a senior status to both common shares and other preferred shares in the event of liquidation; (2) maintain a high mandatory rate of return (in the form of dividends, which must be paid before any other share dividends);¹⁰⁷ and (3) include a profusion of restrictive covenants that require BOA to establish various corporate initiatives and obtain approval of various corporate activities.¹⁰⁸

However, unlike even the most restrictive corporate debt contracts, which might impose requirements on BOA's minimum capital balances or limit the type of business activities that can be engaged in by the company,¹⁰⁹ the provisions and obligations imposed as a result of the Treasury's investment are far more expansive. Everything from the compensation of BOA's executives, to the manner and means by which BOA would refinance certain adjustable-rate mortgage loans ("ARM loans") for homeowners in default, is subject to

106. See WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATIONS 115–19 (3d ed. 2009) (providing and comparing the traditional characteristics of corporate debt and corporate securities via a discussion of capital structure).

107. Specifically, the Series N and Series Q preferred stock purchased on October 28, 2008, and January 9, 2009, respectively, paid mandatory quarterly dividends at a 5% annual rate; this rate increases to 9% after five years. BOA 2009 Annual Report, *supra* note 95, at 14. The Series R preferred stock purchased on January 16, 2009 pays a mandatory quarterly dividend at an 8% interest rate. *Id.* All three preferred Series stocks are considered senior-preferred stock and thus take priority over all other preferred stock and common stock in both liquidation and the distribution of dividends. *Id.*

108. See *infra* Part IV(B).

109. See ALLEN, *supra* note 106 at 115–19 (discussing how debt securities relate to contracts and addressing the legal characteristics of debt).

the Treasury's control as a result of its equity investment in BOA.¹¹⁰ These requirements are discussed in more detail in Part IV(B) below.

In short, while the Treasury was perhaps BOA's most important shareholder (irrespective of its power as BOA's regulator),¹¹¹ it was by no means the largest. Even if the Treasury exercised its stock warrants, it would control less than 6% of BOA's total voting stock issued and outstanding.¹¹² But both before and after the BOA-Merrill merger, the Treasury was a substantial (if not the primary) source of BOA's total investment capital.¹¹³ Furthermore, upon consummation of the merger, the Treasury was the only entity willing and large enough to offer BOA insurance against the growing losses resulting from the bank's exposure to \$118 billion of Merrill's toxic assets.

Despite having a relatively small ownership percentage of BOA's corporate stock, the federal government was clearly a substantial and powerful BOA shareholder. This position naturally put pressure on BOA's directors to comply with the government's wishes—especially considering the fact that it had the ability to regulate, tax, and otherwise enforce BOA's compliance with an array of federal laws and regulations. However, this pressure potentially conflicts with traditional fiduciary duties, which require directors to adhere to their independent business judgments notwithstanding the threats or demands of a controlling or other powerful shareholder, even when that shareholder is the federal government.

B. Director Fiduciary Duties: The Lynchpin of Corporate Law

It is a fundamental principle of corporate law that the business and affairs of a corporation are managed under the sole direction of its board of directors, and not its shareholders.¹¹⁴ Ownership is separate

110. See *infra* Part IV(C).

111. See *supra* notes 106–08 and accompanying text.

112. See *supra* tbl.1.

113. See *supra* Chart 1 (providing a dollar-to-dollar comparison of Treasury's investment to BOA total market cap, and demonstrating that Treasury's investment accounted for approximately 11–14% of BOA's total market cap in October 2008 to more than 70% of BOA's total market by January 2009). This unusual disparity between total investment dollars and total shares obtained is common among many of the companies that accepted federal bailout cash. Therefore, BOA should serve as a useful lens through which to view the impact of Treasury's equity investment in other corporations that accepted federal bailout cash.

114. DEL. CODE ANN. tit. 8, § 141(a) (2010) (“The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors”); *McMullin v. Beran*, 765 A.2d 910, 916 (Del. 2000) (“One of the fundamental principles of the Delaware General Corporation Law statute is that the business affairs of a corporation are managed by or under the direction of its board of directors.”); *Quickturn Design Sys., Inc. v.*

from control.¹¹⁵ Directors are appointed to represent the best interest of *all* shareholders and are obligated to maintain the separation of ownership and control by not permitting any single shareholder—no matter how powerful—to dominate or obscure the director’s “independent business judgment.”¹¹⁶ Closely related to this core principle are three fiduciary duties that directors owe to a corporation and its shareholders.

The first and most basic of these fiduciary obligations is a director’s “duty of obedience.” This duty requires that a director adhere to the legal documents that establish her authority.¹¹⁷ Thus, if a corporation’s charter or a provision of its bylaws charges its directors with certain tasks, such as holding an annual meeting on a fixed date, the director may face liability for failing to do so, even if the failure occurred in good faith.¹¹⁸

The remaining two duties—the “duty of loyalty” and the “duty of care”—are the central mechanisms for the regulation of directorial action. The duty of loyalty requires that a corporate fiduciary exercise her authority in a good-faith attempt to advance corporate purposes.¹¹⁹ A director breaches her duty of loyalty in three instances: (1) “the fiduciary *intentionally acts* with a purpose other than that of advancing the best interest of the corporation;” (2) “the fiduciary acts with the *intent* to violate applicable positive law;” or (3) “the fiduciary *intentionally fails to act* in the face of known duty to act, demonstrating a *conscious disregard* of [her directorial responsibilities].”¹²⁰ In each instance, the director either acts in a

Shapiro, 721 A.2d 1281, 1291–92 (Del. 1998) (“One of the most basic tenets of Delaware corporate law is that the board of directors has the ultimate responsibility for managing the business and affairs of a corporation. Section 141 (a) confers upon any newly elected board of directors *full* power to manage and direct the business and affairs of a Delaware corporation.”) (citations omitted); Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) (“A cardinal precept of the General Corporation Law of the State of Delaware is that directors, rather than shareholders, manage the business and affairs of the corporation.”).

115. See ALLEN, *supra* note 106, at 101–02 (listing “centralized management” as one of the central features of the corporate form and discussing the separation of ownership from management in American corporation).

116. See Rales v. Blasband, 634 A.2d 927, 936 (Del. 1993); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (noting that in order to maintain their independence and the corresponding protection of the business judgment rule a director must remain independent and uninfluenced by a personal financial benefit).

117. See RESTATEMENT (THIRD) OF AGENCY §§ 8.07, 8.09 (2006) (describing this obligation as the “duty of obedience”).

118. ALLEN, *supra* note 106, at 239.

119. *Id.*

120. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 67 (Del. 2006). The duty of loyalty also bars corporate officers and directors from competing with the corporation, from

manner she knows is not in the corporate interest or consciously fails to act in a manner she knows would be in the corporate interest. Thus, in each instance the director consciously abdicates her primary directorial obligation to exercise her own independent business judgment for the best interest of the corporation and *all* its shareholders.¹²¹

By contrast, the duty of care covers every aspect of a director's conduct, including those actions taken in good faith.¹²² In its classic formulation, the duty of care requires a corporate fiduciary to act in her directorial capacity "with the care that an ordinarily prudent person would reasonably be expected to exercise in like position and under similar circumstances."¹²³ Despite the expansive scope of this language, the duty of care is litigated far less often than the duty of loyalty.¹²⁴ This is primarily because corporate law's business judgment rule insulates directors from liability for corporate losses stemming from their business decisions, so long as those decisions are informed, disinterested, and made in a good-faith effort to advance a corporate initiative.¹²⁵ Simply stated, the business judgment rule is the presumption that informed business decisions made in a good-faith effort to advance corporate interests are nonnegligent.¹²⁶ In order to overcome the presumption in claiming a breach of the duty of care, a

misappropriating corporate property—including business opportunities—and from transacting business with it on unfair terms. ALLEN, *supra* note 106, at 239.

121. *In re Walt Disney*, 906 A.2d at 67–68.

122. ALLEN, *supra* note 106, at 240.

123. AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE § 4.01 (1994).

124. ALLEN, *supra* note 106, at 240.

125. *Id.* While the classic expression of the duty of care mirrors the negligence standard found in tort law, the duty of care is not just another negligence standard. *Gagliardi v. Trifoods Int'l*, 683 A.2d 1049, 1053 (Del. Ch. 1996). In corporate law, ownership is separated from control. *Id.* Corporate directors invest the money of corporate shareholders; a legal standard that would hold directors personally liable for monetary losses stemming from their negligence is both unfair and inefficient. *Id.* Shareholders can diversify the risks of their corporate investments but directors cannot. *Id.* at 1055. Directors would bear the full risk of personal liability for shareholder losses but would receive only a small fraction of the gains from a risky decision. *Id.* Simply stated, "[s]hareholders don't want (or shouldn't rationally want) directors to be risk adverse," and a fiduciary duty that imposed liability on directors for merely negligent acts would do just that. *Id.* at 1052. Furthermore, unlike an analysis of a car accident or slipping on a banana peel, which draws from the everyday experiences of the common person, judges often lack the institutional competence to determine the reasonableness of business decisions. ALLEN, *supra* note 106, at 241. Courts rightfully fear that imposing hindsight bias and personal liability on directors for their perceived failures in business judgment would chill socially efficient behavior in the aggregate. *Id.* Thus, corporate law has long afforded its directors the protection of the business judgment rule. *Gagliardi*, 683 A.2d at 1053.

126. *In re Walt Disney*, 906 A.2d at 67.

plaintiff must demonstrate that the board's actions rose to the level of gross negligence.¹²⁷

Furthermore, under the business judgment rule, courts review business decisions not “by reference to the content of the board decision,” as such a review would arguably lie outside of institutional competence of the courts, but rather by the “rationality of the process employed” in reaching that decision.¹²⁸ Thus, the rule only protects directors who “act[] on an informed basis” and employ a “rational process” in their efforts to advance corporate initiatives.¹²⁹ A failure in process, including a failure to become informed, constitutes gross negligence and is not protected by the business judgment rule.¹³⁰

To remain under the protective shield of the business judgment rule, a director must maintain independence and act in the best interest of *all* shareholders.¹³¹ A director's fiduciary duties require her to exercise her *independent* business judgment in a good-faith effort to advance the corporate interest for the benefit of all those with an equity stake—not just the controlling or most powerful shareholder. Thus, if a controller demands that a director take certain action for

127. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (“While the Delaware cases use a variety of terms to describe the applicable standard of care, our analysis satisfies us that under the business judgment rule director liability is predicated upon concepts of gross negligence.”). For a potential explanation of why the duty of care is stated as a simple negligence standard and then subsequently heightened to a standard of gross negligence via the business judgment rule, see ALLEN, *supra* note 106, at 243.

128. *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 122 (Del. Ch. 2009).

129. *Id.* at 124. If the 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. *Nixon v. Blackwell*, 626 A.2d 1366, 1376 (Del. 1993); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983). Under the entire fairness standard of judicial review, the defendant directors must establish to the court's satisfaction that the transaction was the product of both fair dealing and resulted in a fair price. *Weinberger*, 457 A.2d at 710–11.

130. *Aronson*, 473 A.2d at 812 (“[T]o invoke the rule's protection directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them.”).

131. Classic examples of director self-interest in a business transaction involve either a director appearing on both sides of a transaction or a director receiving a personal benefit from a transaction not received by the shareholders generally. See *Nixon*, 626 A.2d at 1375 (in which the court recognized and addressed unfair business practices and analyzed the actions of corporate defendants whose independent business judgment was skewed by their personal financial self-interest in a transaction); *Aronson*, 473 A.2d at 812 (explaining that the protection of the business judgment rule can only be claimed by disinterested directors and that directors with an personal financial interest in a transaction are not disinterested for the purposes of assessing their fiduciary obligations); *Weinberger*, 457 A.2d at 710 (discussing a board's duty of loyalty to its shareholders and noting that when directors of a Delaware corporation are on both sides of a transaction they have a duty of good faith and fairness).

the controller's benefit, the director must not let her independent business judgment be skewed or obstructed by those demands.¹³²

This is true despite the fact that the controlling shareholder may be able to remove the director from her position or that the controller may retaliate against the corporation or its shareholders.¹³³ Corporate law seeks to regulate a controller's retaliatory responses by imposing independent fiduciary obligations directly on the controller. Specifically, a controller owes a duty of fairness to all shareholders whenever they exercise any aspect of their control over the corporation.¹³⁴ In this sense, corporate law largely separates regulation of the controller from regulation of the directors, and thus logically obligates directors to make informed business decisions *irrespective* of a controller's threats or the director's fears that the controller will use its control to adversely impact the corporation, its directors, or its minority shareholders. In short, under current corporate law, a director's obligation to act in what *she perceives* to be the best interest of the company is unwavering and unchanged in the face of a threat from a controlling or otherwise powerful shareholder.¹³⁵ But should a director be required to ignore the threats and demands of a shareholder when that threat comes, not from any

132. See, e.g., *Kahn v. Lynch*, 638 A.2d 1110, 1124 (Del. 1995) (holding that because the special committee gave way to the demands and threats of the controller in a squeeze-out transaction, the independent business judgment of the special committee was effectively "neutralized" and thus could not shift the burden on entire fairness review). "A director's greatest virtue is the independence which allows him or her to challenge management decisions and evaluate corporate performance from a completely free and objective perspective." Robert H. Rock, *Letter from the Chairman: Caesar's Wife*, DIRECTORS & BOARDS, Summer 1996, at 5.

133. See, e.g., *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954-55 (Del. 1985) (recognizing that a director's demonstrated desire to remain entrenched is sufficient self-interest to pierce the business judgment rule). While an action contrary to the controller that could *potentially* result in loss of position is not enough to create a loyalty issue, a direct, credible threat that the controller would remove the director *or* officer is likely sufficient. Rhee, *supra* note 2, at 687-88 (citing *Gantler v. Stephens*, 965 A.2d 695, 706 (Del. 2009)). Under Delaware law, a director has a conflict of interest if she will be materially affected by a board's decision in a manner not shared by the corporation or its shareholders. *Seminaris v. Landa*, 662 A.2d 1350, 1354-55 (Del. 1995).

134. See, e.g., *Weinberger*, 457 A.2d at 715 (describing the controller's duty to act fairly whenever exercising any aspect of its control over corporation or its assets).

135. As noted in *Cede & Co. v. Technicolor*, the starting point for this conclusion is the fundamental principle that the business and affairs of a corporation are managed by or under the direction of its board of directors. 634 A.2d 345, 360 (Del. 1993) (citing DEL. CODE ANN. tit. 8, § 141(a) (2006)). In exercising these powers, directors are charged with an unyielding fiduciary duty to protect the interests of the corporation and to act in the best interests of *all* shareholders—not just the most powerful or dominant shareholders. *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1280 (Del. 1988). See *generally* ERNEST L. FOLK, DELAWARE GENERAL CORPORATION LAW: A COMMENTARY AND ANALYSIS § 141.2 (3d. ed. 1992); ROBERT C. CLARK, CORPORATE LAW §§ 4.1-5.4 (1986).

plain vanilla shareholder, but from a shareholder as powerful, important, and vital to the company as the federal government?

IV. WHEN DOES INFLUENCE BECOME CONTROL?

This Part will demonstrate that, even if the government is not a controlling shareholder in many of the companies that accepted federal bailout cash, its equity investment enables it to exercise substantial control over corporate decisionmaking. While this fact would be largely irrelevant under a traditional understanding of director fiduciary obligations, which would require a director to act in what she believes to be the best interest of the corporation irrespective of any shareholder's influence, the government's ability to influence corporate action can and should be considered when evaluating board conduct.

In BOA, for example, despite owning less than 0.1% of BOA's stock issued and outstanding, the Treasury exerts substantial influence over BOA and may rise to the level necessary to qualify the Treasury as a controlling shareholder. Specifically, the government's equity investment provides it with significant financial and contractual control over BOA. This control takes the form not of traditional regulatory mandates or shareholder activism, but rather of a direct substitution of federal regulatory decisionmaking for the decisionmaking power of the Board.¹³⁶

Recognizing this reality makes clear that the marriage of BOA and Merrill was a shotgun wedding compelled by the Treasury and the Federal Reserve. While traditional corporate law analysis would require directors to ignore the regulator-shareholder's influence, the directors' and officers' decision to acquiesce to the government's demands and consummate the merger deserves a new type of legal analysis when it comes to shareholder litigation.

A. What Makes a Controlling Shareholder a Controlling Shareholder?

Courts presume that a majority-block shareholder (a shareholder that holds more than 50% of a corporation's common voting stock) exercises control over corporate assets and corporate decisionmaking, and thus should be considered a controlling shareholder subject to the attendant fiduciary obligations of

136. See *infra* Part IV(C).

controllers.¹³⁷ This presumption is logical. A majority-block shareholder holds enough voting shares in the company that no single stockholder or coalition of stockholders can successfully oppose a motion from the majority owner.¹³⁸ Furthermore, in most instances, a majority-block shareholder can appoint and elect a majority of the members of the corporation's board.¹³⁹ Thus, majority-block shareholders can steer corporate action both by electing directors and by dominating shareholder votes on issues of key importance to the corporation.

In certain instances, however, courts have found that a shareholder that holds less than 50% of the common voting stock can still exercise sufficient control over the corporation to be considered a controlling shareholder subject to the attendant fiduciary duties of controllers. These courts commonly define a controlling shareholder as a shareholder who "owns a majority interest in *or* exercises control over the business affairs of the corporation."¹⁴⁰ Rather than use a bright line test of control, these courts apply a multifactor test that seeks to add the values of various factors of control to determine if the shareholder can or actually does dictate corporate decisionmaking.¹⁴¹ In *In re Cysive Inc. Shareholders Litigation*,¹⁴² for example, the Delaware Court of Chancery held that a shareholder with a 35% equity stake and an option to purchase another .5% of outstanding stock was a controller.¹⁴³ The court noted that (1) the shareholder was the single largest shareholder in an otherwise diffusely held corporation; (2) the shareholder was the Chairman and CEO of the corporation and thus had considerable influence over board decisionmaking; and (3) the shareholder's brother and brother-in-law, both of whom were employed at the corporation, each held an additional .5% of the stock.¹⁴⁴ Thus, despite the fact that the shareholder held a non-majority block of the corporate stock, when these factors are viewed in sum, the shareholder had the ability to

137. See ALLEN, *supra* note 106, at 309 (discussing controlling shareholders and the fairness standard).

138. *Id.*

139. *Id.*

140. *Ivanhoe Partners v. Newmont Mining Corp.*, 535 A.2d 1334, 1344 (Del. Ch. 2003) (citing *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 958 (Del. 1985)).

141. Verret, *supra* note 9, at 302.

142. 836 A.2d 531 (Del. Ch. 2003).

143. *Id.* at 551-53.

144. *Id.*

steer corporate action in a manner common only to controlling shareholders.¹⁴⁵

Conversely, in *In re Western National Corp. Shareholders Litigation*,¹⁴⁶ the Delaware Court of Chancery held that a 46% stockholder was not a controller when the stockholder was limited to electing two members of the six-person board and was subject to numerous restrictions on the purchase of additional shares.¹⁴⁷ Importantly, the plaintiff had failed to allege any particularized instances suggesting that the shareholder could have or had dictated corporate action in a way unique to controllers.¹⁴⁸

B. The Government as Shareholder

Professor J.W. Verret's recent article *Treasury Inc.: How the Bailout Reshapes Corporate Theory and Practice* presents a similar analysis to that of the Delaware Court of Chancery in *In re Cysive*. However, Verret makes the unique argument that the government's regulatory authority should be included in the calculus for determining whether the government qualifies as a controlling shareholder.¹⁴⁹

Professor Verret explains that corporate control is an elusive concept that turns, not simply on total share ownership, but on a variety of factors, all of which seek to determine whether a shareholder can directly or indirectly dictate corporate decisionmaking.¹⁵⁰ Percentage ownership and voting power often indicate whether a shareholder can dictate corporate decisionmaking, but they are not always determinative.¹⁵¹ Thus, while it is perhaps obvious that the government can directly or indirectly dictate corporate decisionmaking at both American International Group, Inc. ("AIG"), in which it holds 80% of the corporation's common voting stock, and General Motors Company ("GM"), in which it holds more than 60% of the corporation's common voting stock, the analysis is more complex when evaluating companies in which the Treasury

145. *Id.* at 553.

146. No. 15927, 2000 WL 710192 (Del. Ch. May 22, 2000).

147. *Id.* at *6

148. *Id.* at *1. In many ways the court's analysis is analogous to Verret's analysis discussed in Part IV(B) *infra*, except in this instance factors reduced rather than increased the corporate control: 46% common voting equity - limitations on director appointments - restrictions on acquiring additional equity = *no* effective control.

149. Verret, *supra* note 9, at 307.

150. *Id.* at 299, 301.

151. *Id.* at 302.

holds a non-majority block. According to Verret, at some point a minority voting interest combined with regulatory control and other incentive-creating power causes the federal government to “exercise[] control over the business affairs of the corporation” and become a controlling shareholder under corporate law.¹⁵²

Professor Verret uses Citigroup, Inc. (“Citigroup”) as an example.¹⁵³ As of January 2009, the government’s equity investment in Citigroup totaled \$50 billion.¹⁵⁴ But unlike the approach it took with BOA, the Treasury converted its initial preferred stock investment to common stock voting shares.¹⁵⁵ The Treasury now holds 36% of Citigroup’s common shares issued and outstanding.¹⁵⁶ Verret argues that when the Treasury’s 36% common share ownership is combined with the Treasury’s status as Citigroup’s largest and most powerful creditor as well as its ability to steer corporate action through its influence as Citigroup’s regulator, the Treasury exerts a level of control over Citigroup that is common only to controlling shareholders.¹⁵⁷ To support his argument, Verret points to real-life examples in which the Treasury has directed corporate decisionmaking at Citigroup since making its equity investment in the corporation.¹⁵⁸ Actual ability to control, he contends, is indicative that the power to control exists.¹⁵⁹ In many ways, Verret’s analysis of Citigroup is comparable to an equation for corporate control: 36% common share ownership + substantial influence as a regulator and creditor = “effective control” over corporate decisionmaking at Citigroup.

C. Picking Up Where Verret Left Off

Professor Verret deserves commendation for recognizing that the government’s regulatory influence should be included in the calculus when determining whether a regulator-shareholder “exercises control over the business affairs of the corporation.” But his analysis stops short of providing a useful test for evaluating the government’s

152. *Id.* at 306.

153. *Id.* at 303–06.

154. *Id.* at 296.

155. *Id.* at 304.

156. *Id.*

157. *Id.* at 307.

158. *Id.* at 303–05. For example, Citigroup has agreed to restrictions on its lobbying activities during the term that the government continues to own an interest in it. Additionally, the federal government pressured Citigroup to find six new independent board directors acceptable to the government. *Id.*

159. *Id.* at 303.

influence in most of the companies that accepted federal bailout funds. Verret's analysis of Citigroup, in which the government owns 36% of the company's voting shares, is not easily applicable to the majority of companies that accepted federal bailout cash. In the case of BOA, for example, the government holds only 0.1% of the company's total shares and no common voting shares.

Furthermore, as demonstrated above, both Verret and traditional corporate law view control as binary reality: a shareholder either "is" or "is not" a controlling shareholder. Such an analysis is perhaps useful when attempting to determine the fiduciary obligations of the *controller*. That is, a shareholder either can or cannot control corporate decisionmaking and thus either does or does not owe a fiduciary duty as a result of its ability to exercise that control.¹⁶⁰ But such an analysis is not as useful when trying to determine how, if at all, the federal government's ownership in a corporation affects a *director's* fiduciary obligations.

Verret's analysis should be extended by developing a more useful equation for ascertaining the level of control the government exercises over a corporation as a result of its investment. Additionally, even when the government's control does not rise to the level necessary to qualify it as a controller, this influence can and should inform a fiduciary analysis of corporate directors' actions. A modernized fiduciary analysis recognizes the reality that in a post-bailout world, a corporation's survival is often directly related to the corporation's favor with its federal regulator. Thus, a director must account for the government's ability to exercise control over the corporation in order to fulfill her chief fiduciary obligation to act in the best interest of the corporation and *all* its shareholders.

1. Is the Government the Controlling Shareholder of BOA?

While the federal government's equity investment in BOA was no doubt substantial (following both its initial capital infusion on October 28 and the subsequent investments on January 9 and January 16), it is far less clear if it could be deemed BOA's "controlling shareholder" as that term is defined under Delaware corporate law. As discussed previously, the Treasury was BOA's most substantial source

160. Ultimately, as Verret notes, the federal government enjoys sovereign immunity for any alleged breach of its fiduciary obligations to the minority. *Id.* at 283. Thus, the federal government's obligations to the minority are largely determined by what it can politically withstand. The *directors'* fiduciary obligations, in contrast, are unwavering. These obligations can and will be the subject of numerous lawsuits, including that of BOA's shareholders against Lewis and the rest of the BOA Board.

of equity capital, but it never held more than 0.1% of BOA's approximately five billion shares of issued and outstanding common stock.¹⁶¹ Under a traditional corporate law analysis—in which voting power is the central factor—the Treasury simply does not own enough stock to be viewed as the controller. Indeed, I have found no example in which a shareholder that controls less than 35% of total voting shares has been deemed the controlling shareholder of a corporation.

But the government used this seemingly miniscule amount of share ownership to obtain direct control over many of the day-to-day operations at BOA. Decisions that have been traditionally left solely to the discretion of BOA's directors and officers have found their way onto the desks of federal regulators. This influence often takes the form of a direct substitution of federal regulatory decisionmaking for the decisionmaking power of the Board.

For example, as a condition of the Treasury's investment in BOA, the bank must vet executive compensation packages through the Special Master for TARP Compensation, commonly known as the Compensation Czar.¹⁶² If the Compensation Czar deems the package "excessive," the package can be denied and returned to the BOA Board for further "evaluation."¹⁶³ Decisions about executive compensation, like the vast majority of decisions regarding the expenditure of corporate resources, fall squarely within the decisionmaking authority of the corporation's board of directors and have traditionally been subject only to the fiduciary review of state corporate law.¹⁶⁴ Yet these decisions are now largely in the hands of federal regulators.¹⁶⁵

161. See Bank of Am. Corp., Current Report (Form 8-K), at 2 (Jan. 16, 2009) (providing a list of the total shares issued to the government); *supra* tbl.1 (providing a comparison of the Treasury's share ownership with total BOA shares issued and outstanding).

162. Deborah Solomon, *U.S. Pay Czar to Rework Contracts Deemed High*, WALL ST. J., July 27, 2009, at C7, available at <http://online.wsj.com/article/SB124865384313282569.html>.

163. *Id.*

164. See, e.g., *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 56 (finding that the board of directors did not breach their fiduciary duties by approving a \$130 million severance package). Section 141(a) of Delaware's General Corporation Law provides that "[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . ." DEL. CODE ANN. tit. 8, § 141(a) (2010). Decisions regarding expenditure of corporate funds fall squarely within the corporation's "business and affairs." See *CA, Inc. v. AFSCME Emp. Pension Plan*, 953 A.2d 227 (Del. 2008) (holding a stockholder-proposed bylaw that would mandate the expenditure of corporate funds in certain circumstances would violate Delaware law).

165. See Solomon, *supra* note 162 ("[The Pay Czar] holds enormous power over the . . . firms he oversees under the bailout, formally known as the Troubled Asset Relief Program. He must approve or reject compensation for the most highly paid employees and oversee the structure of each firm's compensation. Among the things he will examine is whether a firm's compensation rewards risk, is comparable to that of peers and is tied to long-term performance. His decisions aren't subject to appeal . . .").

Similarly, at the direction of federal regulators, banks receiving TARP funds have canceled employee reward programs and training events that arguably are immaterial compared to their massive budgets, because such cancellations are politically popular moves for government regulators.¹⁶⁶ For example, after the Treasury invested \$45 billion into BOA, it effectively ordered BOA to cancel its Spirits Points Program, which rewarded high-performing employees for their efforts to improve corporate profitability.¹⁶⁷ Despite the contention of BOA management that the Spirits Points Program increased profitability by motivating key employees, such “bonus programs” were seen as politically unpopular and a waste of corporate assets (which now included taxpayer money).¹⁶⁸ Thus, upon the Treasury’s recommendation, the Sprit Points Program was dismantled.¹⁶⁹

As a further condition for receiving the federal government’s insurance for certain toxic assets,¹⁷⁰ BOA agreed to develop and maintain specific mortgage loan modification programs. Under these programs, BOA would assist homeowners who were falling behind on their ARMs to refinance their loans under terms suitable to the federal government.¹⁷¹ Although specific data is not available for BOA, similar programs have resulted in substantial losses for BOA’s competitors.¹⁷²

As a further contingency of the Treasury’s equity investment, BOA agreed that any increase in the quarterly common stock dividend for the next three years would require the consent of the U.S. government.¹⁷³ This might be the most dramatic condition of all. There is perhaps no more settled tenet of corporate law than that the decision to pay corporate dividends falls squarely within the control of a corporation’s board of directors.¹⁷⁴

166. Verret, *supra* note 9, at 305.

167. Robin Sidel, *Capital Clash: Banks vs. Rescue*, WALL ST. J., Feb 16, 2009, at C3.

168. *Id.* This example should not be construed as indicative of my personal views regarding executive compensation. I use this example of executive compensation merely to demonstrate that a purely corporate decision, one vested firmly in the authority of the board of directors under Delaware law, has been stripped from the board and relegated to the authority of federal regulators—not through direct positive regulation but through the Federal Reserve’s new ability to influence corporate action in its role as shareholder.

169. *Id.*

170. *See supra* Part III(A).

171. BOA 2009 Annual Report, *supra* note 95, at 16.

172. Ruth Simon, *Citi to Allow Jobless to Pay Less on Loans*, WALL ST. J., Mar. 3, 2009, at A4.

173. BOA 2009 Annual Report, *supra* note 95, at 16.

174. *Gabelli & Co., Inc. v. Liggett Group Inc.*, 479 A.2d 276, 280 (Del. 1984) (“It is settled law in [Delaware] that the declaration and payment of a dividend rests in the discretion of the corporation’s board of directors in the exercise of its business judgment.”) (citing *Moskowitz v.*

Furthermore, in the banking industry, federal regulators can influence corporate decisionmaking through their ability to remove and replace the bank's directors and officers. This threat of replacement is, of course, *the* central feature of a controlling shareholder's ability to influence corporate action.¹⁷⁵ But while controlling shareholders can replace directors through appointment and election, the Fed's ability to remove a corporate officer finds its origin in the United States Code. A "federal banking agency" can remove "[any institutional-affiliated party] from office or prohibit any further participation by such party, in any manner, in the conduct of the affairs of any insured depository institution."¹⁷⁶ As defined, the Federal Reserve is a "federal banking agency,"¹⁷⁷ and an "institutional affiliated party" includes "any director, officer, [or] employee" of the corporation.¹⁷⁸ It is this authority that Paulson referenced when he threatened to dismiss BOA's directors and officers if they failed to consummate the BOA-Merrill merger. In May of 2009, federal regulators flexed this authority and pressured BOA to replace six members of the BOA Board with directors suitable to the federal government.¹⁷⁹

The Treasury can also exert significant indirect influence on corporate decisionmaking as a result of its primacy as a source of equity capital to BOA. Simply put, if BOA's Board had not aligned its interests with those of the federal government, not only would it have

Bantrell, 190 A.2d 749 (Del. 1963)). Before the courts will interfere with the judgment of the board of directors in the payment of dividends, the plaintiff-shareholder must prove fraud or gross abuse of discretion. Courts act to compel the declaration of a dividend only upon a demonstration "that the withholding of it is explicable only on the theory of an oppressive or fraudulent abuse of discretion." *Eshleman v. Keenan*, 22 Del. Ch. 82, 194 (Del. Ch. 1937); *see also* *Baron v. Allied Artists Pictures Corp.*, 337 A.2d 653, 659 (Del. Ch. 1975).

175. ALLEN, *supra* note 106, at 401.

176. 12 U.S.C. § 1818(e)(1) (2009). To remove a director or officer, the banking authority must show unsafe conduct, injury or likelihood of injury to the bank, and moral turpitude or scienter. *Id.*

177. *Id.* § 1813(z).

178. *Id.* § 1813(u).

179. Dan Fitzpatrick & Damian Paletta, *BofA Urged by Regulators to Revamp Board of Directors*, WALL ST. J., May 15, 2009, at C1, available at <http://online.wsj.com/article/SB124235572006122687.html>. A week after the BOA Board named Walter Massey to replace Lewis as chairman, Massey unveiled a committee to recommend changes to the Board's structure and size. *Id.* The committee would also oversee the bank's response to a federal "stress test" that showed the need for \$33.9 billion in additional equity. *Id.* Prior to those moves, federal banking regulators had made clear such steps would be "well received by the federal government." *Id.* When BOA spokesman Robert Stickler was asked if he thought such federal oversight improperly blurred the line between federal authority and corporate decisionmaking, he somewhat sheepishly replied that "every bank" that participated in the recent U.S. stress tests "was directed to review [its] board and management." *Id.*

risked alienating its regulator, but it also would have risked alienating a vital source of capital in an increasingly volatile market. The Treasury was a substantial investor in nearly every one of BOA's competitors. And, as the Treasury's investment moved from 10% to over 70% of BOA's total market cap,¹⁸⁰ the Board undoubtedly became increasingly aware of the importance of the Treasury as a source of equity capital. If BOA didn't play ball, it risked losing a vital source of financing in an increasingly uncertain economic climate.

Interestingly, despite the clear evidence that the U.S. government exerts substantial control over corporate decisionmaking through its equity investment in companies like BOA, the government views its role in these companies as largely passive. In March of 2008, for example, Chairman Bernanke explained that the federal government has explicitly resisted common stock purchases so as to avoid fears of nationalizing the banking sector.¹⁸¹ But Bernanke's statement ignores the reality of corporate control.

Since taking an equity stake in BOA, the U.S. government has exhibited many of the practical indicia of control common to controlling shareholders: (1) it largely dictates corporate decisions that were once left to the directors and officers of the company (such as those regarding executive compensation, employee reward programs, and mortgage refinancing); (2) it can remove and replace BOA directors; (3) it can veto any attempt to pay dividends to other shareholders; and (4) it is a vital source of equity capital and thus can informally influence directorial decisionmaking via the silent threat that it will pull its investment if not obeyed. The actual exercise of control signifies that control exists, and since the Treasury took an equity stake in BOA, it has exercised a level of direct control over the day-to-day corporate decisionmaking at BOA that extends well beyond its traditional regulatory influence.

2. The Importance of the Source of the Treasury's Control Over BOA

As demonstrated above, the Treasury's ability to influence corporate decisionmaking at BOA appears to be, in large part, the direct product of its equity position in the company. Control that did not exist before the Treasury's investment became apparent after the Treasury's investment.¹⁸² This is particularly important to the

180. See *infra* Chart 1.

181. See Verret, *supra* note 9, at 304.

182. Indeed, the Treasury's ability to (1) control BOA's executive compensation packages; (2) cancel employee rewards programs; (3) require BOA to refinance certain ARM loans; and (4)

Solution proposed by this Note. If the government's control over corporate action was *purely* the product of its regulatory authority, then under existing corporate law, the Board could legitimately consider the benefits of aligning corporate initiatives with the initiatives of those of its regulator. On the other hand, if the Treasury's influence over BOA was *solely* the product of the government's presence as a shareholder, then, as noted previously, the directors would have an unwavering obligation to act in what they believe to be the best interest of the corporation, irrespective of the regulator-shareholder government's threats and influence. When control stems from the government's presence as a shareholder *and* its presence as a regulator, these two competing doctrines collide.

As the line between the Treasury's regulatory control and its shareholder control blurs, so does the right under existing corporate law for the BOA Board to consider the Treasury's demands in exercising its business judgment. This is particularly true because it appears that a substantial portion of the control over corporate decisionmaking stems from the Treasury's status as a shareholder rather than its status as BOA's regulator. In these instances, the traditional corporate law principles would presumably drive the analysis, and directors would be required to exercise their independent business judgment irrespective of the threat that a regulator-shareholder will use its shareholder control to retaliate against the company. As demonstrated below, this creates a significant risk that a court will impose liability on the directors for acquiescing to a regulator-shareholder's demands.

*D. Covering Familiar Territory: The Duties of Bank of America's
Directors Under Existing Law*

A traditional fiduciary analysis of BOA's decision not to invoke the MAC clause would likely impose liability on BOA's Board for breaching its duty of loyalty. Recall that after Lewis recounted his December 21, 2008 conversation with Paulson to the BOA Board, the Board made the crucial decision not to exercise the MAC clause or attempt to terminate or renegotiate the Merger Agreement with Merrill.¹⁸³ Under an analysis that treats the government like any other shareholder and thus requires directors to exercise their independent business judgment irrespective of the government's

influence director decisionmaking as a result of its importance as a source of BOA capital are the direct product of the Treasury's investment in BOA.

183. See *supra* Part I(C) (detailing the BOA-Merrill merger and the decision not to invoke the MAC clause).

threats, the BOA Board probably breached its duty of loyalty to shareholders by giving more weight to governmental interests than to those of shareholders.

1. Duty of Care

While the Board's decision not to invoke the MAC clause was (at least arguably) a poor one,¹⁸⁴ a duty of care claim challenging this decision will likely fail under the protective weight of the business judgment rule.¹⁸⁵ Assuming Merrill's fourth-quarter losses triggered the MAC clause, BOA was in a strong position to lower the price it was willing to pay for Merrill.¹⁸⁶ Although it is almost certain that Lewis and the rest of the BOA Board did not want to walk away from the deal,¹⁸⁷ as Merrill's losses continued to grow, Merrill "would have had little choice but to agree to a multi-billion dollar reduction [in price]."¹⁸⁸ Nonetheless, the Board's decision not to invoke the MAC clause does not appear to rise to the level of gross negligence necessary to impose liability under the duty of care.¹⁸⁹ There was, of course, a risk that a "material adverse change" sufficient to invoke the MAC clause had *not* occurred, and improperly invoking the MAC clause could have resulted in substantial litigation costs and even direct monetary liability for breach of contract.¹⁹⁰

More importantly, a court will not impose its own hindsight bias on a board's decision based on the *content* of that decision.¹⁹¹ Doing so would invariably pull the court outside its institutional

184. *See supra* note 125 and accompanying text (discussing protections provided by the business judgment rule).

185. *Cf. Aronson v. Lewis*, 473 A.2d 805, 813 (Del. 1984) ("[A] conscious decision to refrain from acting may nonetheless be a valid exercise of business judgment and enjoy the protections of the rule.").

186. Tully, *supra* note 40.

187. *Id.* (noting that Lewis had always coveted Merrill because Merrill filled several strategic voids for BOA).

188. *Id.*

189. *See Aronson*, 473 A.2d at 813 (noting that the business judgment rule can be pierced by demonstrating gross negligence); *Kamin v. Am. Express Co.*, 383 N.Y.S.2d 807, 811 (N.Y. 1976) ("Questions of policy of management, expediency of contracts or action, adequacy of consideration, lawful appropriation of corporate funds to advance corporate interests, are left solely to their honest and unselfish decision, for their powers therein are without limitation and free from restraint, and the exercise of them for the common and general interests of the corporation may not be questioned, although the results show that what they did was unwise or inexpedient.") (quoting *Pollitz v. Wabash R.R. Co.*, 100 N.E. 721, 724 (N.Y. 1912)).

190. *See Rhee*, *supra* note 2, 688–92 (arguing that invoking the MAC clause could have resulted in significant losses from the subsequent litigation).

191. *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 122 (Del. Ch. 2009).

competence.¹⁹² Thus, in order to succeed on a duty of care claim, the plaintiff would have to demonstrate that the *process* by which the BOA Board reached its decision not to invoke the MAC clause was grossly negligent.¹⁹³ There is no evidence that this is the case.¹⁹⁴ The Board's decision appears to have been at least reasonably well researched and informed. Even if the Board's decision was a poor one, a negligent one, a reckless one, or even a stupid one, the Board's decision will be entitled to the protection of the business judgment rule, so long as that decision was disinterested and informed.¹⁹⁵ This is the very essence of the business judgment rule: "A court will not substitute its judgment for that of the board" so long as the decision was disinterested and informed and can be "attributed to [a] rational business purpose."¹⁹⁶

2. Duty of Loyalty

On the other hand, the business judgment rule does not protect directors and officers for their alleged breaches of the duty of loyalty. When the BOA Board acquiesced to Paulson's threats and voted to not invoke the MAC clause (despite the Board's stated belief that invoking the MAC clause was in the best interest of BOA and its shareholders), the Board appears to have violated that duty.

192. *Id.*

193. *Id.*; *Aronson* 473 A.2d at 812–13 (noting the standard for piercing the business judgment rule under the duty of care is gross negligence).

194. Indeed the plaintiff's complaint makes explicit that the Board decided not to invoke the clause knowing full well the losses that would likely follow. Consolidated Amended Class Action Complaint at 132–146, *In re* Bank of Am. Corp. Sec., Derivative, and Emp't Ret. Income Sec. Act (ERISA) Litig., No. 09 MDL 2059 (DC) (S.D.N.Y. Sept. 25, 2009).

195. *In re* Caremark Intern, Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996) (“[W]hether a judge or jury considering the matter after the fact, believes a decision substantively wrong, or degrees of wrong extending through to ‘stupid’ to ‘egregious’ or ‘irrational’, provides no ground for director liability, so long as the court determines that the process employed was either rational or employed in a *good-faith* effort to advance corporate interests.”).

196. *Unocal v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985) (quoting *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971)); *see also Aronson*, 473 A.2d at 813 (Del. 1984) (noting that a conscious decision to refrain from taking action may nonetheless be a valid exercise of business judgment). Additionally, in response to the Delaware Supreme Court's seminal decision in *Smith v. Van Gorkom*, the Delaware legislature enacted section 102(b)(7) of the Delaware General Corporations Law. This provision permits corporations to relieve their directors in advance of liability for the money damages stemming from their duty of care violations. BOA has a 102(b)(7) waiver in its charter. Thus, the directors will enjoy a further layer of protection for any alleged violation of their duty of care. However, since section 102(b)(7) does not address the question of an injunction, its adoption does not moot entirely the standard of care question, which could be relevant under a different set of facts. Furthermore, 102(b)(7) offers BOA's Board no protection from alleged breaches of the duty of loyalty.

During the December 22 board meeting, the members of the BOA Board were faced with a choice. They could either invoke the MAC clause and risk dismissal, or acquiesce to Paulson's and Bernanke's demands and continue to enjoy their status as the directors and officers of one of the world's largest and most prestigious financial institutions. At this moment, the members of the Board became "interested parties" to the transaction, as they could no longer "act[] free of personal financial interest or other improper extraneous influences."¹⁹⁷ While in many instances a pure entrenchment motive is not sufficient to constitute self-interest, Paulson's direct, credible threat to the Board and Lewis was likely sufficient.¹⁹⁸ This is especially true for Lewis, whose annual compensation package from BOA approached \$30 million.¹⁹⁹ Clearly, if Paulson followed through on his threat and fired the members of the BOA Board, Lewis and the rest of the Board would be materially and adversely affected by their corporate decision in a way that BOA and its shareholders would not.

It could be argued that the Board was trying to mitigate the potential risk to the corporation that not acquiescing to a substantial shareholder's demand would result in retaliation from the shareholder. Under a traditional fiduciary duty analysis, however, this argument falls on its face. As mentioned above, corporate law regulates the risk that a controller will respond in retaliation against the minority by imposing *independent* fiduciary duties on the controller—not by permitting a director to weigh these retaliatory responses in its corporate decisionmaking.²⁰⁰

By December 21, the Board had determined its intention to invoke the MAC clause.²⁰¹ The Merrill deal was simply no longer in the best interest of BOA or its shareholders.²⁰² Only after Paulson's threat did Lewis and the Board reverse course. Based on facts that are publicly available, it appears that when the members of the BOA Board abandoned their decision to invoke the MAC clause in order to keep their jobs, the members of the BOA Board "*intentionally acted* with a purpose other than that of advancing the best interests of the

197. *Rales v. Blasband*, 634 A.2d 927, 935 (1993).

198. Rhee, *supra* note 2, at 687–88 (citing *Gantler v. Stephens*, 965 A.2d 695, 707 (Del. 2009)).

199. *Top 100 CEO's by Pay*, FORBES, Apr. 30, 2008, http://www.forbes.com/lists/2008/12/lead_bestbosses08_Kenneth-D-Lewis_PAU6.html.

200. See *supra* Part II (discussing director fiduciary duties).

201. See *supra* Part I(B) discussing the timeline of events surrounding merger).

202. See *supra* Part I(B) (discussing the timeline of events).

corporation” and therefore violated their duty of loyalty to the shareholders.²⁰³

This breach does not automatically impose personal liability on the BOA Board nor would it automatically void the BOA-Merrill merger. Instead, a breach of the duty of loyalty merely rebuts the business judgment rule and shifts the burden to the directors to prove that the transaction was entirely fair.²⁰⁴ The Board must prove the transaction both was a product of fair dealing and resulted in a fair price for all shareholders. While the complexities of an entire fairness review of the BOA-Merrill transaction are beyond the scope of this Note, it is important to recognize that there are “enormous substantive law, not just procedural, consequences to employing the entire fairness form of judicial review.”²⁰⁵ Entire fairness review is an exacting and rigorous level of judicial scrutiny.²⁰⁶ Indeed, the burden of entire fairness review is so “onerous” that its application “frequently is determinative of the outcome of the litigation.”²⁰⁷ Simply put, the BOA directors are far more likely to face personal liability under entire fairness review than under the protection of the business judgment rule. Furthermore, in a transaction described as “one of the greatest destructions of shareholder value in financial history,”²⁰⁸ it appears likely that the BOA Board would be unable to overcome this onerous burden.

So, under conventional corporate law, we have a problem with companies like BOA where the government assumes either a

203. See Part IV(D)(2) (emphasis added) (discussing the duty of loyalty).

204. See *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 371 (Del. 1993) (“A breach of either the duty of loyalty or the duty of care rebuts the presumption that the directors have acted in the best interests of the shareholders, and requires the directors to prove that the transaction was entirely fair.”); *Weinberger v. UOP, Inc.* 457 A.2d 701, 710 (Del. 1983) (“The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.”). Under Delaware General Corporation Law, section 144(a), “[n]o contract or transaction . . . in which one or more of [the corporation’s] directors or officers . . . have a financial interest, shall be void or voidable solely [by reason of this interest].”

205. *Cinerama, Inc. v. Technicolor, Inc.*, No. 8358, 1991 WL 111134, at *11 (Del. Ch. June 24, 1991), *rev’d in part on other grounds*, *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345 (Del. Super. Ct. 1994).

206. *E.g.*, *Mills Acquisition Co. v. Macmillan, Inc.*, 559 A.2d 1261, 1280 (Del. 1989); *Weinberger*, 457 A.2d at 710–11; *Gottlieb v. Heyden Chem. Corp.*, 91 A.2d 57, 58 (Del. 1952).

207. *Macmillan*, 559 A.2d at 1279 (quoting *AC Acquisition Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103, 111 (Del. Ch. 1986)); see also *Stahl v. Apple Bancorp, Inc.*, 579 A.2d 1115, 1123 (Del. Ch. 1990) (observing that the determination that the propriety of a decision is to be measured by the permissive business judgment form of review “would ordinarily end the matter, practically speaking”).

208. Rob Cox & Lauren Silva Laughlin, *Bank of America’s Difficult Choice*, N.Y. TIMES, Jan. 26, 2009, at C1 available at <http://www.nytimes.com/2009/01/27/business/27views.ready.html>.

significant or controlling interest in a private company. Directors and officers obviously face a whole new set of threats and incentives that affect their performance, but they face a significant risk that courts will apply the same sort of analyses of their behavior as if they are acting in a vacuum. They are asked to pretend that the government is like any old shareholder, and to ignore the reality that government favor often results in corporate profitability and government disfavor may very well result in corporate demise. In order to address this new reality of governmental ownership in private companies, courts need to modify existing corporate law to account for the special role of Hobbes's Leviathan when it finds its way into private companies.²⁰⁹

V. SOLUTION: SHAKING HANDS WITH THE ELEPHANT IN THE ROOM

While a fiduciary duty analysis that treats the government like any other shareholder would indicate that the BOA Board had violated its duty of loyalty and thus require the BOA Board to overcome the onerous burden of entire fairness review, an analysis that explicitly accounts for the government's role in the merger would likely reach a different conclusion. It is, of course, possible under any fiduciary analysis that Lewis and the BOA Board were motivated not to invoke the MAC clause by a concern to protect their respective positions in BOA.²¹⁰ But a fiduciary duty analysis that directly accounts for governmental influence raises an alternative motivation for the Board's action: the BOA Board recognized the risk of pursuing a corporate initiative that was directly counter to initiatives of a powerful regulator-shareholder, weighed this risk against the potential benefits of invoking the MAC clause, and made a good-faith decision not to invoke the MAC clause because it believed that such a decision was in the best interest of BOA and its shareholders. Simply put, the BOA Board shook hands with the elephant in the room. It recognized that the Treasury is not just any old shareholder and that aligning corporate initiatives with those of its regulator-shareholder is often in the best interest of the corporation.

In order to explain how and why this modernized fiduciary duty analysis would reach a different result and then argue for its adoption, I will first outline the specifics of the analysis and then apply it to the actions of the BOA Board.

209. See generally THOMAS HOBBS, *LEVIATHAN* (Penguin Books 3d ed. 1985) (1651) (describing the ever-developing and ever-increasing presence of the government in private lives).

210. Such a determination is, after all, largely a question of fact and intent.

A. Fiduciary Duties 2.0

A modernized fiduciary analysis is comprised of two separate inquiries. First, the court should determine the level of control the regulator-shareholder exercises over corporate decisionmaking. Second, the court should evaluate the board's actions in the context established by the first inquiry. Unlike traditional corporate law, under the latter inquiry the board can and indeed should consider the potential risks of pursuing a corporate decision that is directly counter to the initiatives of the regulator-shareholder.

1. Inquiry 1: The Continuum of Corporate Control

The purpose of the first inquiry is not to determine whether the government is the controlling shareholder of the company—subject to the attendant fiduciary obligations of controllers—but rather to determine whether the government has become such a powerful shareholder in the company that failure to align corporate initiatives with the initiatives of the government could be damaging to the corporation and its shareholders. Unlike conventional corporate law, which categorizes a shareholder as either “controlling” or “non-controlling,” this analysis seeks to place the regulator-shareholder's influence on a point along a continuum—from the government having little to no control over corporate decisionmaking to having absolute control over corporate decisionmaking.

While the conventional “you-are-or-you-aren't” determination may be helpful when evaluating the obligations of the government as a *shareholder*, such a determination is largely unhelpful when trying to understand and evaluate the actions of *directors* in government-controlled or partially-nationalized corporations. When evaluating the influence the government's presence as a shareholder has on directorial action, the question is one of degree, not of kind. And the exact amount of influence makes all the difference.

In many respects, the analysis proposed under this inquiry mirrors the multifactor analysis discussed in Part IV(C) above, in which I concluded that, despite having less than a 0.1% total share ownership in BOA, the Treasury was BOA's most important and powerful shareholder. This analysis first addresses and evaluates the regulator-shareholder's (1) financial and voting controls; (2) contractual controls; (3) regulatory controls; as well as (4) any practical indicia of control—including evidence that the shareholder can or actually has influenced corporate decisionmaking as a result of its equity investment. Then, this analysis considers the totality of

these controls to determine whether the regulator-shareholder can exercise such control over the corporation that failure to align corporate initiatives with the initiatives of the government could be damaging to the corporation and its shareholders.

Under a conventional analysis of control, voting control is king. Control is largely seen as a by-product of the ability to control key initiatives and appoint directors via shareholder votes. But when the government takes a substantial stake in a private corporation, it may (and often does) exert tremendous financial control over the corporation despite its lack of voting control. As demonstrated in the example of BOA, the government may become a vital source of the company's equity capital and therefore create a fear that it will pull its investment if not obeyed. This is particularly true when (1) the government's equity investment comes at a time of significant market volatility (as with the TARP bailout), and (2) when the government is a significant equity owner in many of the company's competitors (such as is the case in the auto and financial services industries). As demonstrated with EESA and TARP, the government often enters markets because other investors are retreating from the markets.

As with BOA, financial controls will frequently be accompanied by significant contractual controls. As a premium for its willingness to make substantial and timely investments in volatile markets, a regulator-shareholder can and often will acquire a profusion of contractual controls. Unlike traditional preferred stock and debt covenants, which might impose requirements as to minimum capital balances or limit the type of business activities that can be engaged in by the company,²¹¹ the contractual controls that accompany the government's equity investment are often far more expansive and allow the regulator-shareholder to directly substitute corporate decisionmaking for its own. These financial and contractual forms of control will often combine with the regulator-shareholder's ability to regulate, tax, and otherwise enforce the company's compliance with a myriad of laws and regulations. The regulatory controls often appear to fill the holes in the control left behind by the financial and contractual controls. For example, while the Treasury's non-voting preferred shares don't allow it to replace Lewis and the BOA Board, the ability of a "federal banking agency" (defined to include the Federal Reserve) to replace directors and officers of "insured depository institution" (defined to include BOA) serves as an adequate proxy.

211. See ALLEN, *supra* note 106, at 261.

2. Inquiry 2: Fiduciaries Operating in the Context of Inquiry 1

The second inquiry applies a traditional fiduciary analysis in light of the degree of governmental control over the company's decisions established under the first inquiry. But unlike traditional corporate law, which requires a director to exercise her independent business judgment irrespective of a shareholder's demands, under this fiduciary analysis a board *can* and indeed *should* consider the potential risks of pursuing a corporate decision that is directly counter to the initiatives of the regulator-shareholder. That is, after determining the potential influence of the regulator-shareholder under the first prong and establishing that the government's control derives (at least in part) from its presence as a shareholder, the second inquiry permits and even encourages the director to weigh the potential risks of not aligning corporate action with the directives of the regulator-shareholder. Applying the proposed analysis to the BOA Board's decision to consummate the Merrill deal is illustrative.

3. Applying the Proposed Analysis to the Actions of the BOA Board

In the few short months during which BOA negotiated and consummated the deal with Merrill, the BOA Board had watched as the Treasury took substantial equity stakes in nearly every one of BOA's major competitors, including investing \$50 billion in Citigroup, \$25 billion each in JPMorgan Chase & Co. and Wells Fargo, and \$10 billion each in Goldman Sachs and Morgan Stanley.²¹² During this same period, Paulson had orchestrated government takeovers of insurer AIG and mortgage giants Fannie Mae and Freddie Mac. And in March of 2008, Paulson had helped structure a rescue of Bear Stearns, which included an agreement that the Federal Reserve would take on \$30 billion of Bear Stearns's assets if JPMorgan Chase & Co. would buy the struggling investment bank.²¹³

Lehman Brothers—the once invincible giant of Wall Street—was not so lucky. The BOA Board had watched as the federal government stood by and let Lehman Brothers file for Chapter 11. The Board was well aware that, in the uncertain economic climate of late 2008 and early 2009, the federal government largely decided which firms lived and which firms died, picking winners and losers with the power of the federal purse. When BOA was considering invoking the MAC clause, it had already received a much-needed \$10 billion

212. Verret, *supra* note 9, at 296–99.

213. Craig et al., *supra* note 10.

infusion of TARP capital. It was, at least for now, a “winner.” But as the economic climate was growing more uncertain by the day, BOA could not risk losing a vital source of investment capital. Additionally, this vital source of equity was already demonstrating that its equity came at a price. If BOA wanted to continue to maintain federal capital, it was required to permit the federal government to become directly involved in many of the decisions that were traditionally left to its board of directors.

Recognizing this influence dramatically recasts the Board’s choice during its December 22 meeting. The bank had only two options: (1) it could invoke the MAC clause and risk alienating a tremendously powerful regulator-shareholder, a vital source of capital, which was shoring up some banks and watching others fail; or (2) it could align its interests with those of its regulator-shareholder and continue to maintain a largely positive relationship with the Treasury.

After considering the severity of the government’s threat, the Board now believed it was in the best interest of BOA to proceed with the merger, not because the BOA Board was trying to maintain a non-pro rata benefit for either itself or the Treasury, but because not consummating the merger might alienate perhaps the most powerful shareholder in the world—certainly BOA’s most important shareholder. As Lewis explained during his testimony before the New York Attorney General’s Office, the Board believed that losing the support of its most significant source of equity capital and its regulator would have been devastating for BOA. Thus, he said, “We proceeded as [we] had been instructed” because “if [the government] felt that strongly then that should be a strong consideration for us to take into account.”²¹⁴ Rather than asking Lewis and the BOA Board to close their eyes to the expanding influence of the federal government in corporate decisionmaking, the Board was right to acknowledge the elephant in the room and weigh the benefits and consequences of aligning corporate initiatives with those of the federal government.

In this light, the Board’s decision not to invoke the MAC clause was not made in its own self-interest. Instead, it was a valid exercise of business judgment that in no way rose to the level of gross negligence necessary to impose liability under the duty of care. Furthermore, courts should include this type of decisionmaking under the business judgment rule’s protection and should not impose their own hindsight biases on a board’s independent business decision with regard to how it weighed the benefits and consequences when making the decision. Simply put, “[a] court [should] not substitute its

214. Lewis Testimony, *supra* note 40, at 11–12.

judgment for that of the board” so long as the decision was disinterested and informed and can be “attributed to [a] rational business purpose.”²¹⁵ Under this modernized fiduciary analysis, a rational business purpose should include maintaining a positive relationship with the Treasury.

B. Addressing Criticisms

As noted in the BOA-Merrill example, a modernized fiduciary analysis would sometimes push a duty of loyalty claim under the protective umbrella of the business judgment rule and thus provide the plaintiff with little hope of holding the directors liable. Consequently, one could argue that the adoption of an analysis encouraging directors to consider government influence would allow a regulator-shareholder to institute an “indirect public takeover of corporate governance function” anytime “it appear[s] the board [will] undermine federal policy,”²¹⁶ and that such a law allows board members to simply toss their fiduciary obligations to the side, point to the government, and claim they had “no choice” because “the government made me do it.” Furthermore, as some scholars contend, even if the government is the controlling shareholder in companies that accepted federal bailout cash, the government enjoys “sovereign immunity from liability as a controlling shareholder.”²¹⁷ Thus, the government can effectively hijack corporate decisionmaking and pursue political interests via its control over the corporation. Such action may not be in the best interest of shareholders, and neither the board nor the government will face liability. Plaintiffs will be left without recourse, and corporate law will have, in effect, waived a white flag at regulating the internal affairs of these corporations.

While there is some merit to these concerns, the argument seems to put the metaphorical cart before the horse. For Lewis and the rest of the BOA Board, a lawsuit that threatens their personal monetary liability is pending *now*. No such lawsuit is pending against the Treasury. A fiduciary duty analysis that would force Lewis to treat the Treasury like any old shareholder, and turn a blind eye to the emerging reality that corporate survival is sometimes directly correlative to corporate favor with a regulator-shareholder, risks imposing direct personal liability on a board when no such liability is

215. *Unocal v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985) (quoting *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971)).

216. Rhee, *supra* note 2, at 732.

217. Verret, *supra* note 9, at 307.

warranted. And in a suit like the one pending against BOA's Board, in which corporate losses are sizable, liability may go beyond the board's director and officer insurance and dip directly into the pockets of the corporate directors.²¹⁸ The same is true for many of the corporations in which the U.S. government stands in the dual role of both a powerful shareholder and a powerful regulator.

As a result, the most talented directors, who are needed at the helm of companies that are receiving government subsidies and investments, might simply decline to serve for those companies. BOA, for example, struggled to appoint a replacement CEO upon Lewis's departure. As noted by Anil Shivdasani, a finance professor at the University of North Carolina at Chapel Hill, "[g]iven the extent of the involvement of the U.S. government [and] the [P]ay [C]zar, . . . it has been hard to find a capable CEO that would want to take this job."²¹⁹

Furthermore, under a modernized fiduciary analysis, the U.S. government's impact on corporate decisionmaking will not go unchecked. In fact, a judicial opinion that employs the modified fiduciary analysis proposed in this Note will push the reality of the government's influence on corporate decisionmaking to the center of the public eye. An opinion that finds, for example, that the board is not liable because it logically acquiesced to the demands of a powerful regulator-shareholder will give special credence to an emerging reality of the post-bailout world: corporate decisionmaking is no longer a purely private affair. Instead, it is a public-private coordinated process²²⁰ in which directors must balance the need to assert their own independent business judgment against the risk that doing so could result in a retaliatory response from the corporation's regulator-shareholder.

Thus, the check on expanding federal influence will come in a familiar form: democratic accountability to the voters. Furthermore, unlike the congressional hearings involving Paulson and Bernanke that followed the BOA-Merrill merger, which were largely split along

218. Davis, *supra* note 81, at 105–106.

219. Ieva M. Augstums, *Bank of America Struggles to Replace Retiring CEO*, NEWS TRIB., Nov. 26, 2009, available at <http://www.thenewstribune.com/2009/11/26/969723/bank-of-america-struggles-to-replace.html>. See generally Peter Cohan, *At Least New BofA CEO Knows the Bank Well*, DAILY FIN., Dec. 17, 2009, available at <http://www.dailyfinance.com/story/at-least-new-bofa-ceo-brian-moynihan-knows-the-bank-well/19284910/> (describing the months of nationwide searches that ultimately culminated in appointing BOA's General Counsel, Brian Moynihan, to the helm and noting the effect the government's presence in day-to-day decisionmaking at BOA had on the search).

220. Rhee, *supra* note 2, at 732.

party lines,²²¹ a judicial opinion that recognizes the role of the U.S. government in corporate governance of partially-nationalized companies comes from a more neutral source. Voters will be less likely to discount a *judicial* opinion as mere political posturing.

Unfortunately, if, as Verret contends, the federal government enjoys sovereign immunity from suits by shareholders,²²² then neither the traditional fiduciary duty analysis nor a new modernized approach will enable the plaintiff to bring suit against the U.S. government for its role as a controlling shareholder. But, as discussed at the outset, the focus of this Note is the fiduciary obligations of *directors* in partially-nationalized corporations—not the obligations of the U.S. government as shareholder or controlling shareholder. Much has been and will be written about the obligations of the U.S. government as shareholder, and whether a private right of action should be established to contend with the government as a shareholder.²²³ In many respects, this commentary moves to Step 2 before addressing Step 1. Right now, courts are facing Step 1 in deciding the suit against the BOA Board, and the impending barrage of suits against directors of other partially-nationalized corporations. And in order to properly steer *directorial* decisionmaking, a fiduciary should directly consider the threats of powerful regulator-shareholders and should not be forced to turn a blind eye and pretend that the U.S. government is just any shareholder.

VI. CONCLUSION

The duties of care and loyalty have governed the internal affairs of U.S. corporations for more than 150 years.²²⁴ The government's presence as both a regulator and substantial, if not controlling, shareholder in many U.S. auto and financial services companies has thrown a wrench into the steadily-turning gears of corporate law. While much has been and will be written about the obligations of the federal government whenever it takes an equity stake in a corporation, little if anything has been written about the

221. See Kim Dixon & John Whitesides, *Lawmakers Blast Fed, Treasury, BoFA over Merrill*, June 11, 2009, available at <http://www.reuters.com/article/idUSN1146939520090611> (reviewing the statements of both Democrats and Republicans on the congressional oversight committee).

222. See Verret, *supra* note 9, at 307-315.

223. *Id.* (arguing that Congress should pass legislation establishing a fiduciary duty for Treasury to maximize the value of its investment and establish a private right of action whenever Treasury takes action in violation of that obligation).

224. ALLEN, *supra* note 106, at 109-111.

obligations of the directors in partially-nationalized or government-controlled corporations. This Note begins to fill that void.

Specifically, this Note has demonstrated four key concepts. First, even when a regulator-shareholder holds a small percentage of total shares issued and outstanding, it can and often will exercise an unprecedented level of control over corporate decisionmaking as a direct consequence of that equity investment. Second, under traditional fiduciary duty analysis, corporate directors must exercise their independent business judgment in good faith to advance the corporate interest for the benefit of all shareholders. They must not let their business judgment be skewed or obstructed by demands of a single shareholder, even if that shareholder has tremendous influence over the corporation. Third, in cases involving threats from a regulator-shareholder—such as in the BOA-Merrill merger—this fiduciary obligation risks imposing personal, monetary liability on directors for whom no liability is warranted, and subsequently depleting a limited supply of director talent. Finally, a modified fiduciary duty analysis (that is, an analysis that directly accounts for the increased influence of the government in the companies that it partially owns) is better suited to addressing the actions of directors in these companies than is the conventional fiduciary analysis. Specifically, a fiduciary duty analysis that directly accounts for government influence more fairly and accurately addresses directorial action in the face of pressure from the federal government, and it has the simultaneous benefit of redirecting questions regarding the extent of the federal government's influence over corporate decisionmaking to where they belong: the public constituency.

The BOA-Merrill merger will not be the last shotgun wedding orchestrated by the federal government in its new role as a regulator-shareholder.²²⁵ As long as the government maintains a substantial equity stake in private corporations, directors will be continually confronted with instances in which their fiduciary obligations to the corporation run headfirst into the demands of a regulator-shareholder. If we pretend the government is any old shareholder, we risk imposing

225. See generally Marcel Kahan & Edward Rock, *How to Prevent Hard Cases From Making Bad Law: Bear Stearns, Delaware, and the Strategic Use of Comity*, 58 EMORY L.J. 713 (2009) (discussing the immense government pressure in the J.P. Morgan Chase-Bear Sterns transaction).

liability on directors for doing exactly what we want them to do—exercising their business judgment in a good-faith effort to advance corporate interests.

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