Appeal Nos. 2015-5103, -5133

United States Court of Appeals
for the
Federal Circuit

STARR INTERNATIONAL COMPANY, INC.,
in its own right and on behalf of two classes of others similarly situated,

Plaintiff-Appellant,

– v. –

UNITED STATES,

Defendant-Cross-Appellant,

– and –

AMERICAN INTERNATIONAL GROUP, INC.,

Defendant-Appellee.

APPEALS FROM THE UNITED STATES COURT OF FEDERAL CLAIMS IN CASE NO. 1:11-CV-00779-TCW, JUDGE THOMAS C. WHEELER

BRIEF OF *AMICUS CURIAE* FEDERAL RESERVE BANK OF NEW YORK IN SUPPORT OF DEFENDANT CROSS-APPELLANT

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December 14, 2015

CERTIFICATE OF INTEREST

Counsel for *amicus curiae* Federal Reserve Bank of New York ("FRBNY") certifies the following:

1. The full name of every party or *amicus curiae* represented by counsel is:

   Federal Reserve Bank of New York.

2. The name of the real party in interest represented by counsel is:

   N/A.

3. Pursuant to Federal Rule of Appellate Procedure 26.1, FRBNY states:

   FRBNY is a corporation chartered under the laws of the United States pursuant to the Federal Reserve Act of 1913, 12 U.S.C. § 221 *et seq.* FRBNY, a corporate instrumentality of the United States government, has no parent company, nor any publicly owned subsidiaries or affiliates. Although stock of FRBNY is owned by member commercial banks within the Second Federal Reserve District, the stockholders do not control FRBNY. Stock of Federal Reserve banks, unlike stock in a private corporation, is not acquired for investment purposes or for purposes of control. Rather, such stock is acquired because its ownership is a condition of bankers' membership in the Federal Reserve System. Unlike owners of a private corporation, Federal Reserve Bank stockholders do not possess a residual equity interest in Federal Reserve Bank assets. That residual interest remains always with the United States. FRBNY is governed by a board consisting of representatives of various constituencies prescribed by statute.

4. The names of all law firms and the partners or associates that appeared for the *amicus curiae* in the trial court or are expected to appear in this Court are:

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5. No counsel for a party authored this brief in whole or part, and no person or entity other than *amicus curiae* and its counsel made a monetary contribution to its preparation or submission.

Dated: December 14, 2015

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STATEMENT OF INTEREST

The Federal Reserve Bank of New York ("FRBNY") submits this brief as *amicus curiae* in support of the arguments by cross-appellant, the United States, that this Court should reverse the trial court's ruling that "the Credit Agreement Shareholder Class shall prevail on liability," A000169, but should affirm in all other respects.[1]

This case presents important questions of separation of powers – of the roles of the judiciary, Congress, and federal agencies. These questions arise in the context of the most severe threat to the economy since the Great Depression. And, if not remedied on appeal, this case will set a detrimental precedent for how the Nation's financial overseers exercise their discretion to act when confronted with future economic emergencies.

In September 2008, American International Group ("AIG") approached a bankruptcy that would de-stabilize the U.S. economy. There was no prospect of a private rescue; no private entity had the capacity to stabilize AIG, which ultimately required the Federal Reserve and the United States Department of the Treasury to provide $182 billion in financial assistance. As an alternative to a bankruptcy

---

[1] No counsel for a party authored this brief in whole or part, and no person or entity other than *amicus curiae* and its counsel made a monetary contribution to its preparation or submission. All parties have consented to the filing of this brief.

filing, AIG requested and received FRBNY's assistance in the form of the largest rescue loan in history, an $85 billion credit facility.

Three years later, after enjoying the benefits of the rescue loan, AIG's largest shareholder, Starr International Co. ("Starr"), sued both FRBNY and the United States. In its action against FRBNY, Starr alleged that FRBNY had breached fiduciary duties and denied Starr the equal protection of the laws. That case was dismissed, and the dismissal was affirmed. *See Starr Int'l Co. v. Fed. Reserve Bank of New York*, 906 F. Supp. 2d 202, 216 (S.D.N.Y. 2012) (characterizing Starr's claims as "paint[ing] a portrait of government treachery worthy of an Oliver Stone movie"), *aff'd* 742 F.3d 37 (2d. Cir. 2014), *cert. denied* 134 S. Ct. 2884 (2014). Starr's suit against the United States in the Court of Federal Claims – the case now before this Court – raised two alternative claims: a government taking for which just compensation was due, or an illegal exaction. The Court of Claims (Wheeler, J.) adopted Starr's illegal exaction theory. It concluded that "Section 13(3) [of the Federal Reserve Act] did not authorize the Federal Reserve Bank to acquire a borrower's equity as consideration for the loan." A000100. In the trial court's view, "the *only* consideration" allowed for an emergency loan is an interest rate set by the Board of Governors of the Federal Reserve System (the "Board"). A000151 (emphasis added). This conclusion yields an unworkable result and is inconsistent with the statute and its purpose.

Ordinary consideration for most loans – lending fees and representations and warranties, for example – also would be prohibited under the trial court's ruling. This cannot be what Congress intended.

The trial court's interpretation of Section 13(3) imposes extra-textual restrictions on the discretion Congress conferred on the Federal Reserve. As a lender of last resort, the Federal Reserve must address extraordinary events and maintain the stability of the financial system. *See Starr*, 742 F.3d. at 40-41 (describing Section 13(3) as conferring "the power to provide discretionary *emergency* loans," "extend[] *emergency* credit," and "carry out… *emergency* lending") (emphases added). Emergency lending requires loans tailored to unforeseen circumstances. Congress entrusted the Federal Reserve with the necessary discretion to fashion the terms for such lending, all done in the public interest. The public interest does not require the Federal Reserve to accept less on behalf of taxpayers than commercial lenders would accept, or to subordinate taxpayers' interests to those of shareholders of a borrower *in extremis*. The trial court's decision holds otherwise. It usurps Federal Reserve discretion and establishes a dangerous, unworkable precedent.

Apart from an erroneous interpretation of a federal statute, the trial court's opinion is riddled with material, clearly erroneous findings of fact. These include its findings that "[t]he legal staffs of FRBNY and the Federal Reserve

acknowledged that they could not obtain or hold equity… of a commercial entity" (A000122, A000153); that the Trust was a sham established as a "classic elevation of form over substance" to "circumvent the Federal Reserve's lack of authority to hold equity" (A000122, A000155-56); and that FRBNY "controlled" the Trust and AIG (A000119-22, A000155-56). These findings, which informed the outcome below, should be corrected because they misrepresent the historical record of an important event in the Nation's financial history.

FRBNY is one of 12 Federal Reserve Banks that, together with the Board and the Federal Open Market Committee, make up the Federal Reserve System, the United States' central bank. FRBNY, however, is not a part of the United States government, nor is it a party to this particular action. It is a "federal instrumentality" – a corporation entrusted by statute with important federal functions. In all actions relevant to this case, FRBNY was closely allied with, but legally separate from, the United States.

FRBNY is well-suited, as *amicus curiae*, to explain why the trial court's interpretation of the Federal Reserve Act impinges on FRBNY's statutory discretion to set the terms for extraordinary lending to foster financial stability. And, as a central participant in the underlying events, FRBNY has a unique knowledge of the errors in the trial court's decision.

SUMMARY OF ARGUMENT

The trial court's conclusion that FRBNY acted unlawfully when it set the terms for its loan to AIG is founded on a judicial rewriting of Section 13(3), a flawed analysis of the bases for the AIG loan terms, and clearly erroneous factual findings regarding FRBNY's actions. The trial court's interpretation of Section 13(3) sets a precedent that eliminates the Federal Reserve's discretion to set rescue loan terms, harms taxpayers and the public interest, and undermines Congress's constitutional prerogative to decide what powers to grant to federal agencies.

The United States' brief explains the legal bases for FRBNY's authority to set the conditions of its $85 billion rescue loan. The starting point is the words of Section 13(3). In September 2008, Section 13(3) empowered the Board to authorize a Reserve Bank to lend to "any individual, partnership, or corporation" subject to certain conditions. In particular, Section 13(3) expressly provides that any authorized loan "shall be subject to such limitations, restrictions, and regulations as the [Board] may prescribe." 12 U.S.C. § 343. It also requires that any such lending must be at "rates established in accordance with the provisions of" Section 14(d) of the Act. Section 14(d) provides that these interest rates are "subject to review and determination of the [Board]," and "shall be fixed with a view of accommodating commerce and business." 12 U.S.C. § 357.

Through its "incidental powers" provision, the Act reinforces Federal Reserve Banks' capacity to act in ways that are not expressly prohibited. That provision explicitly supplements Reserve Banks' enumerated powers under the Act by also conferring on them "such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by [the Act]." 12 U.S.C. § 341.

The Federal Reserve Act nowhere provides that interest is the *only* acceptable form of consideration for a Section 13(3) loan. The trial court, not Congress, introduced that limitation. Neither the Act nor any limitations in the Board's September 16, 2008 authorization constrained FRBNY's authority to seek equity from AIG as part of the consideration for its rescue loan. The trial court's contrary conclusion is legally erroneous.

A full discussion of FRBNY's legal authority to receive equity appears in the United States' brief. We offer four additional points:

> (i) The court disregarded the evidence establishing FRBNY's reasons for including the challenged equity term as part of the loan consideration. Instead, the court substituted its own views, displacing both FRBNY's judgment and the bilateral agreement representing the loan terms.
>
> (ii) The court's finding that FRBNY and Board decision-makers did not believe the Federal Reserve had the authority to obtain and hold equity as partial consideration for a rescue loan is both legally irrelevant and flatly contradicted by the documentary and testimonial record.
>
> (iii) The court's conclusion that the use of the Trust to hold the equity interest was an improper attempt to "circumvent the Federal

Reserve's lack of authority to hold equity" and an unsustainable "elevation of form over substance" (A000155-56) is directly contrary to the evidence.

(iv) The court's conclusion that FRBNY improperly "controlled" the Trust and AIG is legally and factually incorrect – as well as irrelevant.

In sum, the Federal Reserve Act's emergency lending and incidental powers provisions allowed what they did not expressly prohibit. FRBNY had the broad legal authority to set the consideration for lending – whether interest or equity or both. This discretion was limited only by the language of the statute – *e.g.*, requiring "unusual or exigent circumstances" – and by any case-specific instructions contained in the Board's authorization. In this case, there was no statutory or Board-imposed limitation on the acceptable species of consideration. The trial court's contrary, erroneous legal conclusion that equity consideration was impermissible is reason enough to reverse its June 15, 2015 judgment. The trial court's other errors and the substitution of its own policy judgments for the policy judgments of experienced Federal Reserve officials provide further bases for reversal.

ARGUMENT

I. FRBNY'S DECISION TO REQUIRE THE CHALLENGED EQUITY TERM WAS LAWFUL AND CORRECT

A. The Extraordinary Nature of Section 13(3) Rescue Loans

Recognizing the exceptional nature of rescue loans, Congress vested the Board and the Reserve Banks with broad discretion to tailor particular loan terms.

The trial record established that FRBNY and the Board decided to include an equity provision as part of the consideration for FRBNY's loan to AIG in light of the extraordinary circumstances and to protect the public interest. The decision below improperly supplanted these judgments with the court's own views about what terms were appropriate.

Congress enacted Section 13(3) in 1932 to give Reserve Banks authority to provide rescue funding not only to banks, but also to non-banks (described in the statute as "individual[s], partnership[s], or corporation[s]") in "unusual and exigent circumstances." The Federal Reserve has a long-standing history of restraint against lending to non-banks. After making a number of small loans during the Great Depression, A000148-49, Reserve Banks did not make a single loan under Section 13(3) between 1936 and 2008. Instead, for more than 72 years, they left millions of failing non-bank entities to the market discipline of bankruptcy.

B. The Particular Nature of the Loan to AIG

The trial court emphasized that AIG was the only Section 13(3) borrower required to provide equity as partial consideration for its borrowing, but disregarded extensive evidence about why the AIG loan was different.

The AIG loan remains the largest rescue loan in history. And it remains one of only two individualized rescue loans intended to keep a single institution solvent

to avoid systemic consequences to the US economy.[2] All other Section 13(3) loans extended during the crisis were made through broad-based lending facilities, established to inject liquidity into certain markets critical to the national economy. A000136-37; A304945.

The AIG loan, by contrast, featured a different kind of borrower, particularly strong policy and moral hazard considerations, and a unique scale of risk. FRBNY officials, in consultation with members of the Board, properly believed these considerations justified special loan terms.

1. AIG's Nature as a Borrower

FRBNY President Timothy Geithner and members of the Board were acutely mindful that their response to AIG's pending bankruptcy could be seen as extending the federal safety net from the banking industry to the insurance industry, and perhaps beyond. Lending to AIG could prompt urgent requests for assistance from a wide variety of companies that similarly had no prior expectations of Federal Reserve support. A201699; A400215; A400216. As Mr. Geithner testified, the Federal Reserve Act made backstop lending available to banks in exchange for banks' acceptance of Federal Reserve supervision of their

[2] The second was the loan made to facilitate J.P. Morgan Chase's acquisition of Bear Stearns, as to which the Federal Reserve obtained a form of equity-like consideration, from which it ultimately profited. A100865:5-A100866:4, A100888:8-A100889:9 (Baxter).

conduct, the imposition of constraints on their risk-taking, and Federal insurance for their deposit liabilities. A101709:25-A101711:8. AIG, which principally operated in the insurance industry, had no prior relationship with the Federal Reserve and was not subject to prudential supervision or regulatory constraints on bank risk-taking. A101765:13-A101766:10.

2. Policy and "Moral Hazard" Concerns

Mr. Geithner and the Board were also concerned about the "moral hazard" implications of using public funds to insulate equity holders from the consequences of failure. They worried that future investors might take excessive risk or forego painful private solutions in the hope of obtaining a government rescue. As Mr. Geithner explained:

> [We] had to make a judgment of whether the benefits of our action would be significant relative to the risks we were taking and relative to the moral hazard risk we were creating, and that was a judgment partly on policy and partly on whether we had the ability to design a facility that would … give us some protection against the risks we were taking, mitigate the moral hazard risk we were creating, and be effective in helping the company avoid collapse.

A101763:25-A101764:15, A101708:21-A101709:24.

In addition, the decision-makers were concerned that, by providing a rescue loan to AIG, they would be using taxpayer dollars to treat investors in large enterprises that presented systemic risk more favorably than investors in smaller enterprises. A101708:21-A101709:24, A101712:1-17, A101765:23-A101766:10,

A101781:11-21 (Geithner); A102169:22-A102171:9, A102186:14-A102187:9, A102225:16-A102226:5 (Bernanke).

These concerns motivated FRBNY and the Board to craft lending terms that would mitigate any perceived windfall to shareholders. The loan's purpose was not to benefit AIG or its shareholders, but to safeguard the American economy from systemic risk. A101711:9-19, A101765:23-A101766:10, A101770:18-A101771:7, A101778:12-A101779:1 (Geithner); A101986:6-12 (Bernanke).

In concluding that the Federal Reserve "singled out" AIG and treated it "much more harshly than other institutions," A000099, the trial court disregarded evidence that the policy implications and "moral hazard" risk of rescuing AIG from bankruptcy were materially different from those of providing broad-based liquidity support to certain critical markets through other loan facilities initiated under Section 13(3). Consequently, the terms of the lending to AIG differed from the terms of loans providing market liquidity. Federal Reserve policy makers wanted firms to borrow from the broad-based facilities "because they were able to then take that cash and redistribute it into the financial system and help reduce the overall instability, so we actually actively sought to get primary dealers and banks to come borrow from us in order to … redistribute liquidity into the system." A101994:9-21, A102171:10-A102172:21 (Bernanke). That was not the case with the loan to AIG.

3. The Extraordinary Risk of the AIG Loan

The trial court also ignored the extraordinary risk of the mammoth AIG loan, which justified additional consideration. Other Section 13(3) loans were made through broad-based facilities. They were overnight or otherwise very short-term. And they were secured by securities or other collateral with an identifiable price that could readily be sold to satisfy the borrower's debt if it defaulted. A101755:1-A101756:1, A101756:11-A101757:7 (Geithner); A102244:9-17 (Bernanke); A102461:7-21 (McLaughlin). Those overnight loans could be rolled over for additional days only if the collateral's updated market value was sufficient to cover the full indebtedness plus a cushion. If not, additional collateral could be added. A102500:14-A102501:11 (McLaughlin).

By contrast, FRBNY's loan to AIG had a two-year term, and was secured by a pledge of shares in AIG's insurance subsidiaries. A101754:13-A101756:1 (Geithner); A102176:20-A102177:18 (Bernanke). FRBNY's position as a secured creditor could change enormously over these two years, and the amount of collateral could not be adjusted upward to protect FRBNY as needed, because AIG had no more subsidiary shares to pledge. A100613:12-A100614:3 (Alvarez). Unlike the marketable securities used to secure loans made through broad-based facilities, AIG's collateral also had no easily discernible market price and could not readily be liquidated following a default. A102454:13-18, A102459:7-17,

A102461:7-21, A102501:25-A102502:13 (McLaughlin). Most significantly, the value of the pledged collateral carried so-called "correlation risk": If AIG failed, that would enormously reduce the value of its subsidiary shares, just when the value was needed most. A101757:8-12, A101812:7-23 (Geithner); A102237:3-15 (Bernanke); A102455:6-23 (McLaughlin).

Mr. Geithner testified that until just before the September 16 decision to rescue AIG, he was concerned whether he could reach the judgment required by Section 13(3) that FRBNY would be secured to its "satisfaction." A101727:11-17. When he conveyed to the Board on September 16 the required judgment, it was based on a forecast that the rescue would succeed. If it did not succeed and AIG defaulted, that failure would drastically impair the pledged collateral's value. A101755:1-A101756:10, A101870:16-A101872:9 (Geithner); A201700. Mr. Geithner also made clear – in his trial testimony, contemporaneously recorded September 16, 2008 statements, and presentations to Congress – that he believed the loan to AIG was extraordinarily risky and carried a significant prospect of taxpayer loss. A101754:1-12, A101758:13-A101759:21, A101940:16-A101941:24; A201591-92; *see* A102236:8-25 (Bernanke).

In light of the costs and risks of this enormous commitment of public resources, FRBNY and the Board were well-founded in concluding that interest

alone was insufficient, and that equity was a legal and appropriate form of additional consideration.

4. The Equity Term was Consistent with Commercial Market Terms

The 79.9% equity provision originated with commercial banks – who had no concern about public policy. Shortly before FRBNY made its rescue loan to AIG, a group of bankers led by J.P. Morgan Chase's James Lee (a renowned arranger of syndicated loans) developed a term sheet for a proposed $75 billion private-sector loan that included a 79.9% equity term. A201589; A107073:2-25, A107079:22-A107082:15 (Lee). Mr. Lee testified that this equity term was consistent with market practice. Without equity as additional consideration, even a very high interest rate would not adequately compensate lenders for the loan's extraordinary risk. As he explained, lenders to a distressed borrower like AIG typically require equity because they are effectively taking "equity risk" (in that the borrower's value protecting the loan has essentially disappeared) and the lending creates equity value where there otherwise would be none. A107085:15-A107086:20.[3]

[3] Other evidence presented at trial reinforced that the equity term was consistent with commercial practices and appropriate to compensate for the loan's risk. Even before FRBNY expressed willingness to lend to AIG, Robert Willumstad, AIG's CEO, told AIG's directors that AIG should expect to have to convey equity to any lender that emerged to save the company. A200029.

Ultimately, no private lenders were willing to lend to AIG even with the inducement of a 79.9% equity interest. A107074:1-A107075:17, A107076:23-A107077:9 (Lee). Nevertheless, their proposed terms provided an important guidepost to FRBNY of what the private-sector considered appropriate loan consideration, aiding the Federal Reserve in evaluating suitable consideration for FRBNY's rescue loan package. A101583:24-A101584:9, A101770:18-A101771:17 (Geithner). In preparing the term sheet for FRBNY's rescue loan, FRBNY and its counsel used the private-sector term sheet as a model. A103748:25-A103749:9 (Head); A101571:10-A101572:7, A101580:12-16, A101583:24-A101584:9, A101749:5-16, A101770:22-A101771:17 (Geithner); A105938:17-A105939:10 (Huebner); A201668-71.

It was vital that FRBNY's terms be no less stringent than private-sector terms. If FRBNY received less consideration than a private-sector lender, taxpayers would not have a fair deal. Conversely, it was appropriate for the taxpayers who stood behind FRBNY's extraordinary loan to share in the value created by that loan – its upside potential – just as commercial bankers would when lending to a distressed borrower. Without such terms, other firms could perceive Federal Reserve assistance as more attractive than private-sector assistance. A101712:1-17, A101772:16-A101773:10, A101776:18-25 (Geithner);

A100516:15-A100517:9 (Alvarez). This could have the undesirable effect of incenting such potential borrowers to look to the Federal Reserve for similar loans.

C. The Trial Court's Ruling Improperly Disregarded the Bases for FRBNY's Discretionary Policy Judgments and Substituted Its Own Judgment as to Appropriate Lending Terms

The trial court appeared to base its statutory interpretation on a belief that it was "unfair" that AIG was the only Section 13(3) borrower asked to deliver equity. In making this criticism, the court improperly substituted its policy judgment for that of the Federal Reserve.

As explained in the United States' brief, the Federal Reserve Act assigns to the Reserve Banks and to the Board full discretionary authority to determine whether and on what terms to provide emergency rescue loans to non-bank borrowers (provided the loan terms do not violate some other law). As Mr. Geithner explained:

> [T]his design gives us broad discretion in making judgments about … what might be appropriate to do in different conditions with respect to different firms, different points in time. So, the statute gives us the ability to distinguish, to differentiate, to set different conditions based on the circumstances, the policy judgments we make.

A101932:22-A101933:12. Borrowers, in turn, have full capacity to decide whether to accept the terms offered by the Federal Reserve, and are never required to accept them. The trial court's substitution of judgment is inappropriate not only because it disrupts the statutory assignment of official discretion, but also because it re-

writes an agreed-upon contract between the borrower and the lender in a manner hostile to the taxpayer. *See Raichle v. Fed. Reserve Bank of New York*, 34 F.2d 910, 914-15 (2d Cir. 1929) ("The remedy sought would make the courts, rather than the Federal Reserve Board, the supervisors of the Federal Reserve System, and would involve a cure worse than the malady.") (dismissing claim that the interest charged by FRBNY was "unreasonably high").

The trial court's revision of the Federal Reserve's emergency lending authority improperly changes the landscape of possible rescue lending to one where the *only* acceptable consideration would be interest. A000151-52. Lending fees, representations and warranties, covenants, equity, and other common components of consideration, would, in this strange, judge-made environment, be impermissible. One may doubt whether any lending in this judge-made environment would even be practicable. There should be no doubt, however, that the trial court's removal of the Federal Reserve's discretion to craft lending terms that protect taxpayers in circumstances where interest alone would be inadequate is detrimental to the public interest and contrary to Congressional will.[4]

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[4] The court's other substitutions of its policy judgments for those of Federal Reserve officials are similarly beyond the judicial power. For example, the court devoted substantial attention to explaining why it thought AIG was less responsible for the financial crisis than other recipients of Section 13(3) loans. A000099, A000134-39. That analysis had nothing to do with the Federal Reserve's decision-making regarding the AIG loan terms. A101778:12-

II. THE TRIAL COURT'S FINDINGS REGARDING THE TRUST ARE LEGALLY AND FACTUALLY INCORRECT AND DO NOT SUPPORT A RULING OF ILLEGAL EXACTION

A. The Trust was Created to Address Policy and Prudential Concerns, Not To "Circumvent" the Law

Because the legality of the challenged equity term is a question of law, its validity should not depend on the beliefs of the legal officers of FRBNY and the Board. Nevertheless, the trial court went out of its way to discuss – and, in multiple instances, misstate –the views of Federal Reserve lawyers. The court asserted that Thomas Baxter, FRBNY's general counsel, and Scott Alvarez, the Board's general counsel, believed FRBNY's obtaining and holding AIG equity would be beyond its legal authority. The record established otherwise. Both attorneys advised during the crisis and testified at trial that the Federal Reserve had the legal authority to condition a rescue loan on the borrower's conveyance of equity.

Further, and contrary to the trial court's ruling, the record overwhelmingly demonstrated that the Trust was not established "as a way to circumvent the Federal Reserve's lack of authority to hold equity," A000122, A000155-56.

A101779:1 (Geithner); A102227:1-20 (Bernanke). And while the court suggested that the Federal Reserve inappropriately required "punitive" terms, A000103, the record reflected that the adjective "punitive" is merely a central banking term-of-art for a high rate of interest reflecting moral hazard and related policy concerns. A101777:8-13 (Geithner); A102187:23-A102188:8 (Bernanke); A101243:16-A101244:10 (Paulson).

Rather, it was a useful and appropriate device to place control of stock in the hands of trustees better suited to cast shareholder votes than Federal Reserve officials.

1. FRBNY and Board Opinions Finding Statutory Authority for Equity Consideration

In March 2008, almost six months before the AIG loan, FRBNY attorneys, including Mr. Baxter, analyzed and reached conclusions confirming FRBNY's authority to condition Section 13(3) lending on borrowers' provision of equity as part of the loan consideration. A400001; A100865:5-A100866:4 (Baxter). In the context of the Bear Stearns rescue, Mr. Geithner had asked his lawyers why FRBNY could not purchase equity but could receive it in connection with a loan. Mr. Baxter explained the critical distinction in legal authorization that the trial court disregarded (A000122): No statute authorized FRBNY to finance a failing entity by purchasing its equity, but Section 13(3) permitted FRBNY to obtain equity as part of the consideration for a rescue loan because the equity component is incidental to the Section 13(3) lending. A400001; *see* A100455:10-23 (Alvarez). Mr. Alvarez similarly wrote a Board memorandum analyzing the scope of the Federal Reserve's authority under Section 13(3). He concluded that FRBNY's receipt of equity-like consideration was permissible under the broad statutory grant of authority to set loan conditions. A201499-02; A100434:8-A100435:11 (Alvarez); *see* A400154-55.

In early July 2008, FRBNY attorneys again confirmed, in a written legal opinion presented to Mr. Geithner, that FRBNY could require the conveyance of equity as a condition of lending under Section 13(3) and could itself hold such equity after delivery. A400151-55; A100883:7-14 (Baxter); A101786:19-A101788:9 (Geithner).

As reflected in both testimony and contemporaneous writings, Messrs. Baxter and Alvarez also confirmed to Mr. Geithner and the Board on September 16, 2008 that the proposed loan to AIG – including the equity component – fell within the Federal Reserve's statutory authority. A100452:14-22, A100501:5-A100502:15, A100505:2-A100506:1, A100516:5-14 (Alvarez); A201591 (Alvarez September 16, 2008 handwritten notes) ("Legal? Under 13(3), yes.").

The legality of FRBNY's *holding* in the long-term the AIG shares was a separate question from its authority to condition lending on the conveyance of those shares. As to the permissibility of holding shares, Mr. Baxter believed strongly that FRBNY had the legal authority but could not proceed unless Mr. Alvarez confirmed that doing so was within the Board's September 16 authorization. A100805:7-10, A100865:5-A100866:7, A100873:6-A100877:19, A100883:7-14, A100894:1-12, A100941:6-A100942:7 (Baxter). Mr. Alvarez was confident FRBNY could legally hold the shares for some period of time in connection with a transfer to a third party, but he had not yet reached a conclusion

– one way or the other – as to whether it could do so indefinitely. A100271:16-19, A100272:21-A100273:12, A100443:2-A100444:18, A100449:12-A100451:11, A100556:10-A100557:5 (Alvarez); *see* A400174. When Mr. Baxter suggested that AIG convey the shares to a Trust rather than FRBNY, both he and Mr. Alvarez agreed that doing so was prudent and consistent with the Board's authorization, and eliminated the need to resolve the open legal question about FRBNY's "holding" the equity.[5] A100560:12-A100562:24 (Alvarez).

2. Policy Concerns About Having FRBNY Hold and Vote the AIG Shares

FRBNY and the Board shared the view that Federal Reserve officials should not hold or vote the AIG shares, given the access that these officials had to sensitive non-public information concerning economic policies, financial markets, and individual companies—including customers or counterparties of AIG. A100801:9-19, A100938:8-A100939:16 (Baxter); A101686:19-A101687:11 (Geithner). It also seemed preferable to avoid having FRBNY retain any economic interest in these shares, so that there would be no appearance of conflict of interest or unfair competitive advantage for AIG given FRBNY's regulatory and monetary

[5] Mr. Alvarez also confirmed with Chairman Bernanke and Vice Chairman Kohn that they believed having the equity held by the Trust was consistent with the Board's September 16 authorization, so that no further authorization was necessary. A201703; A102029:1-11, A102246:12-20 (Bernanke); A100574:13-A100575:24, A100576:15-A100577:24 (Alvarez).

policy roles. *Id.*; A100552:23-A100554:5 (Alvarez). FRBNY and the Board therefore decided to have the equity delivered to a separate entity: a Trust for the benefit of the U.S. Treasury (the public fisc, not the Treasury Department), A200212, operated independently by three trustees with relevant financial industry expertise.

Mr. Baxter testified that he had prior experience using a trust device while working on the resolution of the Bank of Credit and Commerce International ("BCCI") in the early 1990s. A100747:19-A100749:13, A100936:13-A100937:9, A100942:13-A100943:6, A100988:10-A100989:3. In that case, a federal district court created a trust to separate ownership and control of several banks that had been BCCI subsidiaries from BCCI or any of its affiliates. The trust protected the going concern value of the subsidiary banks until the shares could be sold. *See United States v. BCCI Holdings (Luxembourg), S.A.*, 69 F. Supp. 2d 36 (D.D.C. 1999). In extolling how well the trust device worked, that court observed that the trust's performance "exceeded the Court's most optimistic expectations." *Id.* at 49.

When Mr. Baxter suggested that FRBNY establish the AIG Credit Facility Trust in September 2008, he was following lessons from BCCI, not engaging in circumvention. Just as the BCCI trust was used to separate subsidiary banks from BCCI, the AIG Trust was used to separate the Federal Reserve from AIG. Placing ownership and control of the AIG shares into a separate juridical entity managed

by independent Trustees, with U.S. taxpayers as the beneficiaries, avoided policy concerns that would have been implicated by FRBNY's ownership and control of AIG equity. A100801:9-19, A100945:14-18 (Baxter); A100559:1-A100560:18 (Alvarez); *see* A201620 (seventh "WHEREAS" clause).

3. The Trial Court's Findings Ignore Direct Evidence and Selectively Rely on Hearsay and Secondary Sources

The trial court disregarded extensive evidence that decision-makers believed FRBNY could lawfully receive and hold equity as partial consideration for a Section 13(3) loan. The court instead selectively cited to and misconstrued a limited number of documents shown to have been unreliable and inconsistent with prior written opinions by Messrs. Baxter and Alvarez, and with their trial testimony.

For example, the court cited *draft* memoranda it attributed to Mr. Alvarez without addressing Mr. Alvarez's testimony and his handwritten markups showing that those drafts were authored by subordinates and did not reflect Mr. Alvarez's views. A000152-53, A000155 (citing PTX-368 (A300148) and PTX-370-A (A300162)); A300162-67 (handwritten markup striking the cited statement); A100565:6-A100569:1 ("I didn't agree with that part of the memo ... [and] I struck whole parts of the memo, including that discussion."); A100371:12-A100372:9 (Mr. Alvarez did not author and had never before seen PTX-368); A100569:20-A100570:1, A100570:23-A100571:1 (PTX-373 (A304793), an earlier version of

PTX-368, was drafted by subordinates); A100570:12-22, A100571:9-17 (Alvarez did not agree with the cited statements in PTX-368 or PTX-373).

The court also cited statements attributed to Mr. Baxter in hearsay documents authored by others, without addressing Mr. Baxter's testimony that those secondary source documents did not accurately capture his views. A000153, A000155 (citing PTX-2211 (A303994) and PTX-580 (A301566)); A100720:23-A100721:24 (the cited statement in PTX-2211 did not relate to FRBNY's statutory authority to hold shares); A100796:23-A100797:4, A100797:13-A100798:14, A100798:21-A100799:20 (the cited statement in PTX-580 did not reflect Mr. Baxter's views). The court's reading of and reliance on those documents is irreconcilable with Mr. Baxter's legal opinion—repeatedly expressed in both testimony and contemporaneous written documents – that FRBNY had statutory authority to receive and hold equity as consideration for a section 13(3) loan. A400001; A400151-55; A100805:7-10, A100865:5-A100866:7, A100874:3-A100877:19, A100883:7-14, A100894:1-12.

B. The Trust Was Independent

The trial court's further determination that the Trust was insufficiently independent from FRBNY to be free from any asserted prohibitions on FRBNY's ownership of the AIG shares is both legally incorrect and contrary to the evidence. Notably, Judge Engelmayer rejected this conclusion as a matter of law in the

related case Starr brought against FRBNY. *See Starr,* 906 F. Supp. 2d at 226-29. Neither the Trust's structure nor FRBNY's unexceptional interactions with the Trustees provided any basis to doubt their independence, or to deny that the Trust was separate and distinguishable from FRBNY.

1. The Trustees Were Independent

The prospect of AIG being controlled by FRBNY could have suggested that the playing field was not level – with AIG purportedly receiving an advantage from non-public information as well as public funds. By contrast, the Trustees held none of the sensitive non-public information about markets, monetary policy, or supervised companies that FRBNY officials held. The Trust addressed the potential perception of unfair advantage, and both FRBNY and the Trustees made sure that the Trustees would be independent decision-makers.

The evidence established that both FRBNY and the Trustees expected the Trustees to exercise independent judgment. A103399:15-A103400:6 (Feldberg) ("[Mr. Baxter] was very clear … that it was absolutely critical … that the trustees be independent…."), A103406:14-A103407:18, A103399:4-14 ("I wanted to be sure going in that it was a real job… [and] that they were looking for trustees that would act independently…."); A107159:3-A107160:17 (Langerman).

The court's assertion that the Trustees nonetheless lacked independence because some had former professional ties to the Federal Reserve, A000123, is

incorrect as a matter of corporate law. *See Starr*, 906 F. Supp. 2d at 227 (ruling that Starr's allegations that two of the three trustees had prior ties to FRBNY "fail, as a matter of law, to draw the trustees' independence from FRBNY into question"); *In re CompuCom Sys., Inc. Stockholders Litig.*, No. 499-N, 2005 WL 2481325, at *9 & n.51 (Del. Ch. Sept. 29, 2005) (existence of former professional relationships did not establish lack of independence); *In re W. Nat'l Corp. S'holders Litig.*, No. 15927, 2000 WL 710192, at *17 (Del. Ch. May 22, 2000) ("[A] director's past employment with the company on whose board he sits does not alone establish that director's lack of independence.").

To protect taxpayers' interest in the upside potential of the AIG equity, FRBNY recruited Trustees with business experience relevant to the challenges facing AIG and with a demonstrated history of integrity. A100986:23-A100987:8, A100988:10-A100989:6, A100987:18-A100988:5 (Baxter); A107155:8-25, A107160:24-A107162:5 (Langerman); A304848-50 (Trustee biographies). Beyond an assertion of historical connection, the trial court did not identify any ways that the Trustees' former professional relationships impaired their exercise of independent judgment.

2. The Trust Agreement Safeguarded the Trustees' Independence

The Trust Agreement was the product of extensive, arms-length negotiations between FRBNY and the Trustees, who were represented by independent counsel.

A103339:1-25, A103340:8-18, A103405:8-21 (Feldman); A100992:14-20 (Baxter). The final agreement included numerous provisions maintaining separation between FRBNY and the Trust and safeguarding the Trustees' independence.

Most notably, the Trust Agreement gave the Trustees "full discretionary power" to vote the Trust stock, and required them always to exercise their independent judgment. A201625-26 (§§ 2.04(d), (g)). The Trustees also insisted on edits to an early draft setting forth FRBNY's views on the appropriateness of seeking to maximize the value of the Trust stock, to make clear that FRBNY's views were precatory. This satisfied the Trustees that they would have unfettered discretion to act as they thought best. A103406:4-A103407:18, A103410:17-A103411:11, A103411:20-A103412:12 (Feldberg); A107163:10-A107164:4 (Langerman); *see* A400217-18.

The court's assertion that other provisions of the Trust Agreement limited the Trustees' independence is legally incorrect. *See Starr*, 906 F. Supp. 2d at 227-28 ("Starr cherrypicks portions of the Trust's founding Trust Agreement …. [T]he portions on which Starr seizes fail to plausibly support Starr's thesis of control.") FRBNY, as settlor of the Trust, was empowered to appoint the Trustees, and could remove them only under exceptional circumstances involving dishonesty, untrustworthiness, or deception, not if it disagreed with their business judgment.

A201629 (§ 3.02(d)); A100990:1-10 (Baxter). The provision indemnifying the Trustees so long as they acted "in or not opposed to the best interests of the Treasury" merely required, consistent with trust law, that the Trustees not act affirmatively against the interests of the Trust's sole beneficiary, the U.S. Treasury. A201630 (§3.03(a)); A103414:5-22, A103518:7-9 (Feldberg); A103583:8-19 (Foshee). These unexceptional provisions did not limit the Trustees' independence or discretion. A103411:3-11 (Feldberg); A103583:8-19, A103584:20-A103585:4 (Foshee). The trial court cited no evidence that the Trustees ever placed the government's interest ahead of the interests of AIG shareholders. This should come as no surprise. The government's desire to restore AIG to safe and sound operation, where it would no longer threaten financial stability, and the Trustees' desire to maximize the value of the AIG equity, were in harmony.

3. The Trustees Performed Their Duties Independently

The trial court did not identify a single instance in which the Trustees failed to exercise independent judgment. For example, it found that Trustees "received information about AIG" from FRBNY and occasionally consulted with FRBNY prior to voting the Trust stock, A000124, but disregarded that the Trustees also regularly met with AIG and its advisors, accountants, and auditors, A103418:13-A103419:4 (Feldberg), A103513:4-17 (Foshee), and that they fully recognized the distinction between broadly obtaining inputs and remaining independent about

decisions. A103404:18-A103405:7, A103411:20-A103412:12 (Feldberg) ("We were happy to have whatever views anybody wanted to give us, but when it got around to making the decision, the decisions were our decisions."); A101006:9-16 (Baxter); A102901:1-8 (Dahlgren); A201626 (§ 2.04(g)).

Similarly, the court's criticism that the Trustees "consulted with FRBNY" prior to voting in a slate of director candidates, A000124, disregarded that the Trustees already had independently identified all of those candidates (in consultation with a search firm they had separately retained) *before* discussing them with FRBNY. A103419:13-A103421:18, A103424:1-A103425:10 (Feldberg); A103521:19-A103522:25, A103524:6-12 (Foshee); A102926:10-A102927:16 (Dahlgren). While FRBNY did not suggest any candidates for the Trustees' consideration, the Trustees rejected every candidate in a separate slate proposed by the Treasury Department. A103425:1-A103426:5 (Feldberg); A103528:5-9 (Foshee). This demonstrates Trustee independence, not government control. Furthermore, receiving information from FRBNY, among others, is what would be expected of a fiduciary seeking to make well-informed decisions. Being well-informed makes for good judgment, not controlled judgment.

The court's incorrect determination and findings – which disparage the reputation of the Trustees, each of whom performed a significant public service

and acted independently of FRBNY and the Government – warrant correction by this Court.

III. THE COURT'S RULING THAT FRBNY "CONTROLLED" AIG IS BOTH IRRELEVANT AND INCORRECT

The trial court devoted extensive discussion to its belief that FRBNY "controlled" AIG. In addition to being entirely irrelevant to the legal question the trial court was tasked with deciding – the scope of FRBNY's statutory authority to condition its lending on AIG's agreement to convey equity – the court's conclusion that FRBNY "controlled" AIG is both factually and legally incorrect. The court did not identify a single instance where FRBNY supplanted the judgment of AIG's board of directors – the actual legal standard for control of a company. *See* Del. Code tit. 8, § 141(a) (the "business and affairs" of a corporation are "managed by or under the direction of [its] board of directors"); *In re KKR Fin. Holdings LLC S'holder Litig.*, 101 A.3d 980, 993 (Del. Ch. 2014) ("actual domination and control over" the board "is the operative question under Delaware law").

To the contrary, the court expressly recognized that "AIG's directors were independent of FRBNY and the Government, with no affiliation with or dependence on FRBNY or the Government for their livelihood," and that with regard to the decision to accept FRBNY's loan terms including the challenged equity provision, "[t]he AIG directors believed doing so was in the best interests of AIG and its shareholders and that it was a better alternative to bankruptcy."

A000115. These factual findings belie the court's assertions regarding Federal Reserve "control" of private enterprise. They demonstrate, to the contrary, that FRBNY did not "control" the challenged AIG decisions; AIG's directors did.

The trial court also cited AIG's agreement to replace its CEO as evidence that FRBNY controlled AIG. FRBNY's condition that AIG replace Mr. Willumstad does not mean that FRBNY thereafter controlled his replacement, Mr. Liddy (much less AIG).[6] *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984) ("It is the care, attention and sense of individual responsibility to the performance of one's duties, not the method of election, that generally touches on independence."). The court's implicit suggestion that Mr. Liddy violated his fiduciary duty (as disparaging to Mr. Liddy as the court's incorrect determination about control is to the Trustees) is irreconcilable with the extensive record establishing that Mr. Liddy – and all of AIG's other directors – acted in the best interests of AIG and its shareholders. A103216:13-A103219:11, A103209:7-19, A103235:9-A103236:21, A103256:4-21, A103268:4-17 (Liddy) (AIG managed its affairs independently of FRBNY); A107896:12-A107897:4 (Offit); A102825:14-18 (Dahlgren).

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[6] Although the court found that FRBNY also had sought to replace other board members, only a single director other than Mr. Willumstad resigned and was replaced prior to June 2009, when the Trustees, on their own initiative, voted in a new slate of directors they independently had selected. A103419:13-A103421:8, A103424:1-25 (Feldberg).

Also contrary to the trial court's finding, a lender's monitoring of the use of loan proceeds is a routine and prudent measure, and emphatically not a basis for a determination that the lender controls the borrower. *See, e.g., Vornado PS, L.L.C. v. Primestone Inv. Partners, L.P.*, 821 A.2d 296, 322 (Del. Ch. 2002) (rejecting claim that contractual provisions protecting lender's interests amounted to control over borrower). The trial court discussed the size of FRBNY's monitoring team and quoted stray remarks in staff emails, A000120-22, but presented no analysis of what the monitoring team actually did.

The monitoring team's job was "to understand what was going on at AIG, understand their financial condition, understand the difficulties that they were in, and to make sure that the funds that were being lent to AIG were being used in an appropriate way." A102805:6-13, A102835:16-A102836:17 (Dahlgren); A101809:4-11 (Geithner). The monitoring team did not make decisions for AIG's board of directors. A102834:20-A102836:24 (Dahlgren); A103216:13-A103219:11 (Liddy); A107905:10-A107906:5, A107968:17-21 (Offit) ("[Q.] [D]id you believe that the Government's involvement in AIG had any effect on your ability to exercise your independent judgment? A. Absolutely not."). Nor did it make any decisions concerning AIG's day-to-day operations, which remained the responsibility of AIG's management. A106613:18-A106614:21 (Schreiber). The monitoring team was a responsible condition on lending $85

billion of taxpayer money to a company that nearly ran itself into bankruptcy. FRBNY would have been reckless in *not* monitoring how that money was spent.

CONCLUSION

For the reasons stated in this brief and the brief of the United States, this Court should reverse the trial court's ruling that "the Credit Agreement Shareholder Class shall prevail on liability," but should affirm in all other respects.

Dated: December 14, 2015

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Federal Rule of Appellate Procedure 32(a)(7)(B), as it contains 6,995 words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii).

This brief also complies with the typeface and type-style requirements of Federal Rule of Appellate Procedure 32(a)(5) and (a)(6), as it has been prepared in a proportionally-spaced typeface using Microsoft Word 2010 in 14-point Times New Roman font.

Dated: December 14, 2015

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CERTIFICATE OF SERVICE

On the 14th day of December, 2015, I caused the foregoing Brief of *Amicus Curiae* Federal Reserve Bank of New York to be filed using the Court's CM/ECF system, which will provide notification to all registered users.

Dated: December 14, 2015

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