The Government as Investor/Owner in the US

Transatlantic Corporate Governance Dialogue

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Jeff Gordon – Columbia Law School

Overview

1) How the USG came to be an “investor”/”owner”
   - Specific deals:
     - Financial firms (AIG, Citibank)
     - Auto firms (GM, Chrysler)
   - General deals:
     - TARP capital infusions to financial firms

2) The Corporate Governance Consequences

   -- Quick exits

   -- Slow exits: special challenges of GM & AIG

3) US v. EU: “Liberal Markets” v. “Coordinated Markets”: Is there a Difference?

The decision to intervene

- Ownership born of a crisis rather vs. policy choice about state/market relationship
- In critical cases, produces one-off solutions
- Solutions are often constrained by available authority; with more tools, solutions change

The Post-Intervention Consequence

Governance of the “Public Public Company” Is Not the Same as the Governance of the “Public Company”

AIG – A Trip to the Emergency Room

- USG's ownership in AIG began simple but became complex.
  - Jim Millstein, afternoon speaker, is Treasury's "Chief Restructuring Officer," with AIG as major responsibility
  - AIG, in extremis even before Lehman failure, receives $85 BB loan from Fed
  - Eventually AIG receives nearly $120 BB in Fed + TARP support (net)

AIG, Cont.

- Invocation of Fed emergency authority structures the acquisition of ownership
- As partial consideration, Fed receives special class of preferred stock with 79.9% of voting rights and cash flow rights

  -- Less than 80% to avoid consolidation on USG balance sheet

  -- Held in trust, to avoid conflict with Fed's supervisory and monetary authority role, "for benefit of the US Treasury"

  -- Authority to take ownership under Fed as "lender"?

AIG, Cont.

- Evading the corporate law constraints:

  Emergency as well under NYSE Listing Rules which permit waiving an otherwise required shareholder vote for such dilution that would "seriously jeopardize the financial viability of the listing company's enterprise"

AIG Governance

- Specific -- Trust structure:
  - "To avoid conflict with its supervisory and monetary policy functions, the FRBNY does not intend to exercise any discretion or control over the voting and consent rights associated with the Trust stock."
  - FRBNY appointed 3 trustees, giving them full discretion
  - Since Preferred Stock and Common stock vote as a class, Trust (UST?) can pick the board

AIG Governance– specific

- Board picked new CEO: Does the USG really mean it over "autonomy?" :
- NYT 9/14/09:

  "A few weeks ago, there were anguished grimaces inside the Treasury Department as the new chief executive of A.I.G., Robert H. Benmosche, whose roughly $9 million pay package is 22 times greater than Mr. Obama's, ridiculed officials in Washington — his majority shareholders — as "crazies." Causing even more unease to policymakers, Mr. Benmosche insisted that A.I.G. — one of the worst offenders in the risk-taking that sent the nation over the edge last year — would not rush to sell its businesses at fire-sale prices, despite pressure from Fed and Treasury officials, who are desperate to have the insurer repay its $180 billion government bailout."

AIG Governance--General

- TARP constraints on exec comp (of which more in later panel)
- Note how specific decision of AIG Trust & Board in approving bonuses was overturned by Congressional enactment that swept generally

    -- Corporate governance in the shadow of the potential legislative review and override

Citibank -- Ownership

- Citibank issuance of preferred stock in exchange for TARP infusions in Oct. & Dec. 2008 ($45 BB) & Loss Sharing on $301 BB in assets (Jan 2009)
- Preferred was converted into Common Stock (Sept 2009) into 34% of Citi common
- Discussions may have already begun for a side-by-side Citi issuance of new common and UST sale to reduce the USG stake

Citibank -- Governance

- Uncertain relevance of stock ownership for Banks in financial distress
- FDIC appears to be the key governance actor, acting under supervisory authority over insured banks facing distress (and fired up by its potential loss exposure)
- Here: Pressure for board changes, management changes, and strategy changes

Other Financial Firms

- General: 8 banks called down to Treasury in October 2009 to agree to receive TARP infusions in exchange for sale of preferred stock + warrants
- Specific: Bank of America gets an additional $20 BB (so $45 BB total) plus loss-sharing support, for its Merrill deal
- Mixed: 100’s of smaller financial firms receive support; GE Capital, GMAC

Automobile Industry

- Chrysler: Restructuring in Bankruptcy
  - The decider: The President, not Treasury/Fed
- UST: approx $10 BB (a TARP-use stretch)
- UST Ownership: 8%
- Others:
  - UAW Employee Benefits Trust: 55%
  - Canadian Govts: 2%
  - Fiat (who will be the main operator), 20% to 51% (depending on performance)

Chrysler Governance

- Board seats, thus governance rights, not allocated in accord with cash flow claims
- 8 person Board
- UST: 4 directors: 4 initial appointments + continuing right to reappoint or replace
- -- going forward, 3 UST-designated directors (including 2 independent directors), who elect a 4th
- Fiat: 3 directors

Chrysler Governance

- UAW: 1 independent director, who must vote with the majority of the board
- UST has disclaimed interest in day-to-day management, but retains strong governance rights, if not control
- Governance subject to legislative override: Potential protection of terminated dealers

GM

- GM: Restructuring in Bankrupcty
  - Presidential decision; not so in financial firms
- UST: Approx $50 BB, 61% equity stake
- Other stakeholders own the rest
  - UAW Employee Benefit Trust, 17.5%
  - Canadian Govts., 12%
  - Old GM, 10%

GM – Governance

- UST: 10 of 13 directors
- UAW Trust: 1 director
- Canadian govts: 1 director
- Current CEO
- 2/3 of total must be “independent” per NYSE

GM Governance

- Strong chairman model
- Anticipation of an IPO within 1 year

GM – Congressional Governance

- WSJ, 8/3/09:

  "Some Montana legislators have been pushing to get GM to stick with U.S. suppliers of precious metals -- such as those mined in Montana -- instead of switching to foreign sources. In July, GM executives traveled to Ohio to meet with congressmen asking questions about a plan to close a plant. Before that, GM agreed to keep open a parts depot in Massachusetts after Rep. Barney Frank (D., Mass.) pressed Mr. Henderson on the matter."

General Corporate Governance Consequences

- Quick exits: USG as a bridge lender
- Slow exits: much more likely in GM & AIG
  - AIG: equity sits under $120 BB in US debt
  - GM: does it have a profitable operating business?
  - Has the USG made a credible commitment to manage its control rights as a maximizing private shareholder? Should it?
  - What would a "government remote" governance structure look like?
    - Historical example: the Reconstruction Finance Corporation

US v. EU

- “Liberal Market Economy” vs. “Coordinated Market Economies”
- Auto industry restructurings seem recurrent under both systems.
- Saw real differences in how employees, shareholders, & managers were treated across US v. EU in 1970s & 1980s

US v. EU

- Hypothesis: in CMEs, existing government bureaucracy smoothly handles distressed private firm; in US, each rescue is a one-off, so high barriers
- Watershed: Privatizations starting in UK in the 1980s and spreading elsewhere. Govts go out of the business of running financial or industrial firms
- Result: in 2008-09: restructurings in US v. EU are more common than different