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# When the Government Attempts to Change the Board, Investors Should Know

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# When the Government Attempts to Change the Board, Investors Should Know

William O. Fisher\*

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##### I. INTRODUCTION

It was an extraordinary time, the years 2007 through 2009. The world's financial system shuddered. Governments intervened.<sup>1</sup> The U.S. Treasury invested billions of dollars in American financial institutions.<sup>2</sup>

Many of these institutions were public companies, as their stocks were traded on national exchanges.<sup>3</sup> Securities laws and regulations required those companies, and large investors in them, to file disclosure documents with the Securities and Exchange Commission (SEC). These filings aimed to provide the public with information, including information about each company's board of directors.

Disclosure about boards is critical because boards occupy a special place in corporate governance. Boards sit atop the corporate hierarchy. Boards control corporations. In an important sense, a corporation's board is the corporation.

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1. See 12 U.S.C.A. § 5211 (Supp. V 2011) (establishing the Troubled Assets Relief Program).

2. See Meena Thiruvengadam, *U.S. Bailouts So Far Total \$2.98 Trillion, Official Says*, WALL ST. J., Mar. 31, 2009, <http://online.wsj.com/article/SB123851108664173877.html>.

3. Michael Simkovic, *Secret Liens and the Financial Crisis of 2008*, 83 AM. BANKR. L.J. 253, 253 n.2 (2009) (noting the financial institutions assisted by the federal government during the crisis, including: Wells Fargo, Morgan Stanley, and Goldman Sachs).

Not surprisingly, therefore, as the federal government sought to influence the actions of financial companies at the epicenter of the credit crisis, the government turned its attention to those companies' boards. Extending its powerful reach, the government in some cases effectively dictated which directors stayed, which left, and which joined anew.<sup>4</sup> But neither the government nor the affected corporations timely disclosed these moves through public filings with the SEC.<sup>5</sup> They didn't have to.<sup>6</sup>

The experience at two huge public companies, American International Group, Inc. (AIG) and Bank of America Corporation (BofA), provides a close-up look at this phenomenon. The government's actions to push some directors out at AIG and BofA, and to usher other directors in, were reported slowly and incompletely in the first case<sup>7</sup>—and not at all (until the press discovered the facts) in the second.<sup>8</sup> Slow SEC filings at AIG and no SEC filings at BofA resulted, in part, from the federal government's complete immunity from reporting obligations under the Securities Exchange Act of 1934 (the Exchange Act). But even had this blanket immunity been absent, other possibly relevant rules—designed to force private market actors to disclose their efforts to change public company boards—would not have required disclosure of the *government's* moves.

Using AIG and BofA as case studies, this Article makes a simple claim: When the government takes steps to change the composition of a board at a company that is publicly traded, a new SEC filing should report those steps, just as SEC filings must report the efforts of private market actors trying to change the directors.<sup>9</sup> The analysis proceeds so: Part II describes the board change at AIG and BofA and the filings with the SEC that provided slow (in one case) or no (in the other) disclosure of the government's efforts to change the directors at those companies. Part III identifies one large hole in the law governing securities filings, and several more technical ones, that permitted government intervention in board composition to escape the prompt disclosure required when other market participants intervene. Part IV argues that prompt revelation of who is influencing board change, and why they are doing so, is important for reasons both practical and theoretical—and that the securities laws and regulations already recognize

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4. For a discussion of how the government did, in two cases, effectuate a change in the board, see *infra* Parts II.A.3, II.B.4.

5. See, e.g., *infra* Parts II.A.4, II.B.5.

6. See, e.g., *infra* Part III.

7. See *infra* Part II.A.4.

8. See *infra* Part II.B.5.

9. See *infra* Parts IV–V.

this truth by requiring timely disclosure of such efforts by private market actors. Part V proposes a new securities rule that would require quick disclosure of government steps to change board composition at public companies and identifies a limited exception that should be included in the rule. Because the government officials and companies involved may have their own incentives to avoid disclosure, only a new *rule* will effectively close the odd information loophole that permits the government to do what private market actors cannot: to take secret actions to change directors at publicly traded firms.

## II. THE GOVERNMENT TAKES CONTROL OF TWO BOARDS

In 2008 and 2009, the federal government put billions of bailout dollars into AIG and BofA.<sup>10</sup> The government then engineered changes in the board of directors at each of those companies. At AIG, securities filings effectively disclosed that the government had the power to dictate the composition of the AIG board, but the filings did not disclose the government's use of that power in the departure of particular directors or disclose, in a timely way, the selection of new ones.<sup>11</sup> At BofA, securities filings failed to disclose the government's role in board change altogether.<sup>12</sup>

### A. *American International Group*

This section begins the AIG case study with the government investment.<sup>13</sup> It then turns to the board change<sup>14</sup> and the government's role in that change.<sup>15</sup> The section ends by describing the securities filings that accompanied the board change, noting that some filings did not reveal the government's action at all, while others did, but only long after the fact.<sup>16</sup>

#### 1. The Government's Shareholder Interest

On the brink of collapse, AIG entered into a Credit Agreement with the Federal Reserve Bank of New York on September 22, 2008.<sup>17</sup> By that

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10. *See infra* Parts II.A.1, II.B.1.

11. *See infra* Part II.A.4.

12. *See infra* Part II.B.5.

13. *See infra* Part II.A.1.

14. *See infra* Part II.A.2.

15. *See infra* Part II.A.3.

16. *See infra* Part II.A.4.

17. Am. Int'l Grp., Inc., Current Report (Form 8-K) (Sept. 26, 2008), at Ex. 99.1 (Credit Agreement between American International Group, Inc. and Federal Reserve Bank of New York) (Sept. 22, 2008) [hereinafter AIG Change of Control Credit Agreement]. Throughout, I date all SEC documents by their filing.

agreement, the government provided an \$85 billion revolving credit facility to AIG in exchange for, among other things, AIG's promise to issue to the government preferred stock that would vote with the common stock on all matters submitted to the shareholders.<sup>18</sup> The deal required the preferred stock to hold 79.9% of the total voting power at AIG<sup>19</sup> and mandated that AIG issue the preferred stock to a trust that the government would create to hold that stock (the Trust).<sup>20</sup> The Credit Agreement further and expressly required that AIG "use all reasonable efforts to cause the composition of [AIG's] board of directors . . . to be, on or prior to the date that is ten days after the formation of the Trust, satisfactory to the Trust in its sole discretion."<sup>21</sup>

The government formed the Trust in mid-January 2009.<sup>22</sup> The New

18. *Id.* at 1, 43 (§ 5.11), Ex. D.

19. *Id.* at Ex. D; Am. Int'l Grp., Inc., Quarterly Report (Form 10-Q), at 44 (Nov. 6, 2009). AIG received other assistance from the government during the credit crisis, and the government received other AIG securities as part of providing additional assistance. For example, the U.S. Treasury purchased Series D Fixed Rate Cumulative Perpetual Preferred Stock from AIG on November 25, 2008 for \$40 billion. Am. Int'l Grp., Inc., Current Report (Form 8-K) (Nov. 26, 2008). For a summary of the assistance, and restructuring of the government aid, see William K. Sjostrom, Jr., *The AIG Bailout*, 66 WASH. & LEE L. REV. 943, 963-75 (2009). Among other things, restructuring reduced the percentage of the government's total voting power to 77.9%. Am. Int'l Grp., Inc., Quarterly Report (Form 10-Q), at 44 (Nov. 6, 2008).

The government and AIG recast their relationship in January 2011. AIG completely paid all amounts owing on the September 22, 2008 Credit Agreement. Am. Int'l Grp., Inc., Current Report (Form 8-K) (Jan. 14, 2011). AIG preferred stock held by the Trust described in the text converted to AIG common stock, and AIG preferred stock owned directly by the Treasury converted partly to AIG common stock, partly to a new class of preferred, and partly to interests in other special investment vehicles. *Id.* The Trust transferred all of its AIG common stock to the Treasury. *Id.* After this recapitalization, the Treasury held 92% of all AIG common. *Id.* In May 2011, AIG sold 100 million shares of AIG common stock to the public, and the government sold 200 million of its common shares to the public. Am. Int'l Grp., Inc., Current Report (Form 8-K) (May 27, 2011). In 2012, the government sold more than 206 million shares in March, more than 188 million in May, more than 188 million in August, almost 637 million in September, and more than 234 million in December. Am. Int'l Grp., Inc., Current Report (Form 8-K) (Mar. 13, 2012); Am. Int'l Grp., Inc., Current Report (Form 8-K) (May 10, 2012); Am. Int'l Grp., Inc., Current Report (Form 8-K) (Aug. 8, 2012); Am. Int'l Grp., Inc., Current Report (Form 8-K) (Sept. 14, 2012); Am. Int'l Grp., Inc., Current Report (Form 8-K) (Dec. 14, 2012). The last of these sales brought the government's common stock holding in AIG to an end. Am. Int'l Grp., Inc., Prospectus Supplement (Rule 424(b)(3)), at S-3 (dated Dec. 10, 2012, filed Dec. 12, 2012).

20. AIG Change of Control Credit Agreement, *supra* note 17, at 43. Section 1.01 of the agreement defines the "Trust." *Id.* at 19.

21. *Id.* at 43 (§ 5.11).

22. Am. Int'l Grp., Inc., Current Report (Form 8-K) (Jan. 23, 2009), Ex. 10.1 (Jan. 16, 2009), at 2-3 [hereinafter AIG Credit Facility Trust Agreement]. Subsection 1.01 formed the Trust. *Id.* at 2. Subsection 2.01(a) stated that the trustees would establish a securities account. *Id.* at 3. Subsection 2.02(a) stated that the preferred stock would be deposited in the securities account. *Id.* at 4.

York Federal Reserve Bank appointed the trustees, “in consultation with the Treasury Department,”<sup>23</sup> and AIG issued Series C Convertible Participating Preferred stock to the Trust on March 4, 2009.<sup>24</sup> The trustees then “possess[ed] all right, title, and interest” in the shares<sup>25</sup> and had “the exclusive right to exercise any and all voting . . . rights . . . attached to” those shares.<sup>26</sup> The trustees held the stock “for the sole benefit of the Treasury.”<sup>27</sup> As AIG repeatedly acknowledged, the preferred stock gave the government the power to control director elections.<sup>28</sup>

## 2. The Board Change

To see the government’s effect on the AIG board, we must trace the board’s composition back to the spring of 2008 and keep in mind that the government’s initial investment in the company—which included the condition that the government acquire voting control of AIG—occurred in September 2008.<sup>29</sup> We must also recall that (i) directors are elected by shareholders at annual meetings;<sup>30</sup> (ii) the sitting board, with the help of its nominating committee, nominates a slate of candidates—usually the incumbent directors—to run for director positions at the annual shareholder

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23. *Id.* at 2 (§ 1.02).

24. Am. Int’l Grp., Inc., Current Report (Form 8-K) (Mar. 5, 2009); *see also* Am. Int’l Grp., Inc., Current Report (Form 8-K/A) (Mar. 13, 2009), at Ex. 10.1 (Series C Convertible, Participating Preferred Stock Purchase Agreement) (Mar. 1, 2009).

25. AIG Credit Facility Trust Agreement, *supra* note 22, at 3 (§ 2.01(a)).

26. *Id.* at 6 (§ 2.04(a)).

27. *Id.* at 3 (§ 2.01(a)).

28. Am. Int’l Grp., Inc., Annual Report (Form 10-K), at 27 (Mar. 2, 2009) [hereinafter AIG 2008 Annual Report] (“As a result of its ownership of the Series C Preferred Stock, the [government-formed] Trust will be able . . . to elect all of AIG’s directors . . .”); Am. Int’l Grp., Inc., Proxy Statement (Schedule 14A), at 12 (June 5, 2009) [hereinafter AIG 2009 Proxy Statement]. The government selected not only AIG’s board, but also its CEO. Edward Liddy assumed the top executive spot “in connection with the transactions entered into between AIG and the NYFed and the Department of the Treasury.” AIG 2009 Proxy Statement, *supra*, at 18; *see also infra* note 61. When Liddy later left the company—announcing his decision even before the 2009 shareholder meeting, *id.* at 15—AIG stated that the search for his replacement would “include participation by both the reconstituted Board of Directors,” which included a majority picked by the government, and “the Trustees of the AIG Credit Facility Trust.” Am. Int’l Grp., Inc., Current Report (Form 8-K) (May 21, 2009). As AIG had stated in its Annual Report for 2008, the government had the ability “to control . . . the selection and tenure of AIG’s Chief Executive Officer.” AIG 2008 Annual Report, *supra*, at 27.

29. “On March 1, 2009, AIG entered into the Series C Preferred Stock Purchase agreement with the Trust . . . . The aggregate purchase price . . . was \$500,000, with an understanding that additional and independently sufficient consideration was also furnished in September 2008 by the NY Fed in the form of its \$85 billion lending commitment under the Fed Credit Agreement.” AIG 2008 Annual Report, *supra* note 28, at 42.

30. DEL. CODE ANN. tit. 8, § 211(b) (2011).

meetings;<sup>31</sup> and (iii) when directors resign or die during their term, the sitting board elects replacements who serve until the next annual meeting.<sup>32</sup> Accordingly, board change occurs only in two circumstances: when incumbents running for reelection lose in contested director elections,<sup>33</sup> or when incumbent board members resign, die, or decline to run for reelection. In the latter case, their successors are either elected to the board—between shareholder meetings—by the sitting board, or nominated (usually by the sitting board) to run for election at the next annual meeting.<sup>34</sup>

In this case, the AIG board nominated thirteen candidates for directorships in 2008.<sup>35</sup> The shareholders elected all of them at the 2008 AIG annual meeting in May of that year.<sup>36</sup> All this occurred before the government bailout.<sup>37</sup>

But after the September 22, 2008 bailout in which AIG agreed to give the federal government voting control,<sup>38</sup> the board dramatically changed. Between the bailout and the 2009 election, eight directors including the CEO either resigned or decided against running for another term.<sup>39</sup> The sitting

31. See, e.g., NEW YORK STOCK EXCHANGE, LISTED COMPANY MANUAL § 303A.04(b)(i) (2013), available at <http://nysemanual.nyse.com/lcm/> [hereinafter NYSE LISTED COMPANY MANUAL].

32. DEL. CODE ANN. tit. 8, § 223(a)(1) (2011). As an alternative to replacing a director who dies or resigns, the company can reduce the size of the board.

33. This rarely happens. A famous study found only forty-five instances in the period from 1996 through 2005 in which “rivals seeking to oust incumbent [directors] succeeded in gaining control” of a company. Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 687 (2007) [hereinafter Bebchuk, *Shareholder Franchise*]. In neither the AIG nor the BofA case was a director election contested and, accordingly, no director turnover at either company occurred as a result of a board member’s defeat in a shareholder vote.

34. See DEL. CODE ANN. tit. 8, §§ 211(b), 223(a)(1).

35. Am. Int’l Grp., Inc., Proxy Statement (Schedule 14A), at 7–9 (Apr. 4, 2008).

36. Am. Int’l Grp., Inc., Quarterly Report (Form 10-Q), at 124 (Aug. 6, 2008).

37. See AIG 2008 Annual Report, *supra* note 28, at 42.

38. See *supra* notes 17–20 and accompanying text.

39. Between the 2008 election and the 2009 election, eleven directors left the board, with the dates of their departures showing that eight left after the September 22, 2008 deal. Am. Int’l Grp., Inc., Current Report (Form 8-K) (June 16, 2008) (concerning the departure of CEO Sullivan); Am. Int’l Grp., Inc., Current Report (Form 8-K) (July 1, 2008) (also concerning the departure of CEO Sullivan); Am. Int’l Grp., Inc., Current Report (Form 8-K) (July 17, 2008) (announcing Holbrooke resignation); Am. Int’l Grp., Inc., Current Report (Form 8-K) (July 22, 2008) (announcing Futter resignation); Am. Int’l Grp., Inc., Current Report (Form 8-K) (Sept. 24, 2008) (announcing Willumstad resignation); Am. Int’l Grp., Inc., Current Report (Form 8-K) (Nov. 3, 2008) (announcing Langhammer resignation); Am. Int’l Grp., Inc., Current Report (Form 8-K) (Mar. 25, 2009) (stating Tse not running for reelection); Am. Int’l Grp., Inc., Current Report (Form 8-K) (Mar. 31, 2009) (stating Rometty and Sutton not running for reelection); Am. Int’l Grp., Inc., Current Report (Form 8-K) (May 21, 2009) (stating Bollenbach, Feldstein, and Orr not running for reelection); see also AIG 2009 Proxy Statement, *supra* note 28, at 13.



board elected<sup>40</sup> two new directors, one of whom was the new CEO, Edward Liddy.<sup>41</sup> The board then nominated eleven candidates for election at the 2009 shareholder meeting.<sup>42</sup> The shareholders—with the government holding almost eighty percent of the votes—elected all of them<sup>43</sup> to a board now reduced from thirteen to eleven members.<sup>44</sup>

As the next section shows, the government had seized control.

### 3. The Government's Role in the Change

In evaluating the government's influence on the radical restructuring of the AIG board, consider first the departures from the board. Then consider the additions.

It is fair to infer that the government caused or at the least agreed to the eight departures from the AIG board that occurred after AIG signed the Credit Agreement on September 22, 2008 and before the 2009 director elections. Delaware law provided the government—once it acquired the majority voting power as a result of that agreement—the power to remove any AIG director, with or without cause.<sup>45</sup> Thus, if a director had not resigned when the government wanted him or her to do so, the government could have simply forced the director out. Moreover, the September 2008 deal explicitly required AIG to use “all reasonable efforts to cause the composition of [the] board . . . to be . . . satisfactory to the Trust.”<sup>46</sup> The government's voting power, and the express language of the agreement, both strongly suggest that the government was behind the eight directors' decisions to resign or decline to stand for reelection.

Turning from departures to additions, AIG explicitly reported in its proxy statement for the 2009 shareholder meeting that “the U.S. Treasury in connection with transactions entered into between AIG and the New York Fed[ederal Reserve Bank]” had recommended two of the eleven 2009 director

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40. As a Delaware corporation, AIG's organic documents and applicable law permitted the board itself to fill vacant seats. AIG 2008 Annual Report, *supra* note 28, at cover page; *see also* DEL. CODE ANN. tit. 8, § 223(a)(1) (2010); Am. Int'l Grp., Inc., Current Report (Form 8-K), at Ex. 3.1 (Jan. 17, 2008) (amending Bylaws section 2.2 to conform to the statute) [hereinafter AIG Bylaws].

41. Between the 2008 and 2009 shareholder meetings, the AIG board voted three new directors onto the board, with two of them voted on after September 22, 2008. Am. Int'l Grp., Inc., Current Report (Form 8-K) (July 17, 2008) (stating Johnson elected to the board by the board); Am. Int'l Grp., Inc., Current Report (Form 8-K) (Sept. 24, 2008) (stating the new CEO Edward Liddy elected to the board by the board); Am. Int'l Grp., Inc., Current Report (Form 8-K) (Nov. 13, 2008) (stating Dammerman elected to the board by the board).

42. AIG 2009 Proxy Statement, *supra* note 28, at 13–15.

43. Am. Int'l Grp., Inc., Quarterly Report (Form 10-Q), at 201 (Aug. 6, 2008).

44. AIG 2009 Proxy Statement, *supra* note 28, at 13–15.

45. DEL. CODE ANN. tit. 8, § 141(k) (2011).

46. AIG Change of Control Credit Agreement, *supra* note 17, at 43 (§ 5.11).

nominees—including the new CEO.<sup>47</sup> These were the two directors who had joined the board after the September 2008 deal, but before the next election, and who were then nominated for shareholders to elect for a full term.<sup>48</sup> The proxy statement also said that five other director candidates were recommended by the trustees of the government-formed Trust that held the stock that the government had bought from AIG.<sup>49</sup>

In short, we can infer with considerable confidence that the government sent the majority of the AIG board packing after taking voting control. We know for certain that the government picked seven new directors, and that, after the 2009 election, those seven constituted a majority of an eleven-director board. The government seized—and then changed—the board, installing its own choices as the majority.

#### 4. Disclosure of the Government's Role

In 2008 and 2009, AIG filed Forms 8-K disclosing that (i) the company had signed the agreement to issue preferred stock with controlling voting rights to the government; (ii) the government had formed the Trust to hold the preferred stock; and (iii) AIG had issued the preferred stock to the Trust.<sup>50</sup> AIG attached the operative transaction documents to each of these filings and, in each case, the company filed the Form 8-K within four business days of the action the form reported.<sup>51</sup> The public therefore knew, in a timely manner, that the government had the power to control AIG's board membership. But none of those filings revealed the government's role in removing, or adding, *particular* directors to the AIG board. And, while AIG also filed Forms 8-K to announce the resignation of sitting directors between the September 22, 2008 deal and the 2009 elections, and the election to the board (by the board) of new directors during that period, none of those Forms 8-K mentioned any government role in those individual goings or comings.<sup>52</sup> Moreover, the government itself filed no document with the SEC to disclose any role it played in any director change at AIG.

It was only in its publicly filed May 21 preliminary and June 5 final proxy statements for the director election at the 2009 shareholder meeting that AIG disclosed the role that the U.S. Treasury, the Federal Reserve Bank

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47. AIG 2009 Proxy Statement, *supra* note 28, at 18.

48. *Id.*; see also *supra* note 41 and accompanying text.

49. AIG 2009 Proxy Statement, *supra* note 28, at 18.

50. See *supra* notes 17–27.

51. *Id.*

52. See *supra* notes 39, 41.

of New York, and the Trust had played in recommending seven individuals, identified by name, for AIG directorships.<sup>53</sup>

Five of these seven had never served on the board and were running for initial election.<sup>54</sup> The disclosure of government involvement in the selection of these five was therefore timely because the government's role was clear before they joined the board.<sup>55</sup> However, the proxy statement also revealed that the government had recommended new CEO Liddy, who had joined the board in September 2008,<sup>56</sup> nearly eight months *before* the proxy statement disclosure, and another director, who had joined the board in November 2008,<sup>57</sup> nearly six months *before* the disclosure. And the proxy statement, like the Forms 8-K before it,<sup>58</sup> said nothing about government influence in the departure of the eight directors who either left the AIG board between September 2008 and the 2009 shareholder meeting, or declined to seek reelection in 2009.<sup>59</sup>

In sum, the government made no securities filing revealing its role in the AIG board change. Nor did AIG disclose—until it filed its proxy statement for the 2009 election—the government's *actual* role, as opposed to the power that its voting control provided, in the selection of two directors (including new CEO Liddy) who had been added to the board *between* the 2008 and 2009 director elections.

On the other hand, the AIG filings in September 2008 fully disclosed that the government was obtaining majority voting power at the company, and revealed at the same time that the deal with the government expressly required that the AIG board be acceptable to the government.<sup>60</sup> From that timely reported transaction, any investor or other member of the public might have fairly assumed that the government was playing a central role in *all* decisions affecting the composition of the AIG board following the September 2008 deal. Moreover, outside the SEC filings, the financial press reported that the government ousted AIG's sitting CEO and replaced him

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53. Am. Int'l Grp., Inc., Preliminary Proxy Materials (Schedule 14A), at 18 (May 21, 2009). Mr. Liddy and Mr. Dammerman were identified for the [AIG Nominating and Governance Committee of the AIG board] by members of the U.S. government in connection with the transactions entered into between AIG and the NY Fed and the Department of the Treasury. Ms. Koellner and Messrs. Golub, Lynch, Martinez and Miller were identified to the Committee by the trustees of the Trust [holding the stock giving controlling voting power to the government].

*Id.*; see also AIG 2009 Proxy Statement, *supra* note 28, at 18.

54. See AIG 2009 Proxy Statement, *supra* note 28, at 18.

55. See *id.*

56. See *supra* note 41.

57. *Id.* This other director was Dennis Dammerman.

58. See *supra* notes 39, 41.

59. See the preliminary and final proxy statements cited *supra* note 53.

60. See *supra* notes 19, 21, 25 and accompanying text.

with Liddy—providing that information as those events unfolded.<sup>61</sup>

Simply put, there were “holes” in the disclosure of government influence over AIG’s board change, but investors were by no means left entirely in the dark.

### *B. Bank of America*

BofA presents a very different case than does AIG because, although the government bought stock in BofA, that stock did not provide voting rights, and the government effected board change through regulatory action rather than through voting power.<sup>62</sup> This section begins with the government’s investment in BofA,<sup>63</sup> then describes the government’s regulatory move.<sup>64</sup> It proceeds next to the board change<sup>65</sup> and evaluates whether that change likely resulted from the regulatory action or other events.<sup>66</sup> This section finishes

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61. Willumstad left the CEO position and the board, and Liddy was appointed the CEO and elected to the board on September 18, 2008. Am. Int’l Grp., Inc., Current Report (Form 8-K) (Sept. 24, 2008). While the AIG securities filings at the time did not disclose the government’s hand in this change, the financial press reported that Treasury Secretary Paulson had personally asked Willumstad to step down as CEO and had tapped Liddy to succeed him.

As part of the [first bailout] deal, Treasury Secretary Henry Paulson insisted that AIG’s chief executive, Robert Willumstad, step aside. Mr. Paulson personally told Mr. Willumstad the news in a phone call on Tuesday, according to a person familiar with the call.

....

Mr. Willumstad, who recently took over as AIG’s chief executive to try to turn around the firm, was surprised by the request. “If that’s what you want, I’ll do it,” he said to Mr. Paulson, according to a person familiar with the call. AIG’s board was unhappy with the decision but felt it had no choice but to go along, as the only other option was bankruptcy.

....

By tapping Mr. Liddy as AIG’s next CEO, the government is turning to someone with deep experience in the insurance industry . . . .

Matthew Karnitschnig et al., *U.S. to Take Over AIG in \$85 Billion Bailout*, WALL ST. J., Sept. 16, 2008, at A1. The day after the changes, the financial press reported that Treasury Secretary Paulson had “asked Mr. Liddy to step in at AIG.” Liam Pleven, *The Financial Crisis: AIG’s New Chief Sees Smaller, Nimbler Firm*, WALL ST. J., Sept. 19, 2008, at A3.

62. See *infra* Parts II.B.1–II.B.4.

63. See *infra* Part II.B.1.

64. See *infra* Part II.B.2.

65. See *infra* Part II.B.3.

66. See *infra* Part II.B.4.

the BofA case study by describing the woefully inadequate securities filings.<sup>67</sup>

### 1. The Government's Shareholder Interest

On October 26, 2008, the U.S. Treasury agreed to pay \$15 billion to Bank of America for Series N Fixed Rate Cumulative Perpetual Preferred Stock and a warrant to purchase more than 73 million shares of the bank's common stock.<sup>68</sup> On January 9, 2009, the Treasury agreed to pay another \$10 billion to the bank, this time to purchase Series Q Fixed Rate Cumulative Perpetual Preferred Stock, and to replace the earlier warrant with one to purchase almost 122 million shares of common stock.<sup>69</sup> On January 15, 2009, the Treasury agreed to pay an additional \$20 billion to buy Series R Fixed Rate Cumulative Perpetual Preferred Stock and a warrant to purchase an additional 150 million shares of common stock.<sup>70</sup>

The preferred stock did not provide the government with even a single vote in director elections, unless BofA missed the mandatory dividend payments on the stock,<sup>71</sup> which never happened. And the warrants provided no voting rights.<sup>72</sup> Moreover, in December 2009, BofA repurchased from the government all of the Series N, Series Q, and Series R preferred stock.<sup>73</sup>

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67. See *infra* Part II.B.5.

68. Bank of Am. Corp., Current Report (Form 8-K) (Oct. 30, 2008) [hereinafter First BofA Bailout 8-K].

69. Bank of Am. Corp., Current Report (Form 8-K) (Jan. 13, 2009) [hereinafter Second BofA Bailout 8-K]. The Treasury had contemplated buying \$10 billion of preferred stock to be issued by Merrill Lynch & Co., Inc. (Merrill). Since BofA bought Merrill, the government bought the stock from BofA. At the same time, the government substituted, for its initial BofA warrant, a warrant entitling it to buy more BofA common stock. *Id.*

70. Bank of Am. Corp., Current Report (Form 8-K) (Jan. 22, 2009) [hereinafter Third BofA Bailout 8-K].

71. In each case, the preferred stock carried the right to elect two directors if the bank missed six dividend payments, and the shares carried the right to vote as a class on mergers and on certain other matters, such as issuance by the bank of stock senior to the preferred stock the government was buying. First BofA Bailout 8-K, *supra* note 68, at Ex. 3.1 A-8-9 (§ 7(b) & (c)) (Certificate of Designations of Fixed Rate Cumulative Perpetual Preferred Stock, Series N); Second BofA Bailout 8-K, *supra* note 69, at Ex. 3.1 A-8-9 (§ 7(b) & (c)) (Certificate of Designations of Fixed Rate Cumulative Perpetual Preferred Stock, Series Q); Third BofA Bailout 8-K, *supra* note 70, at Ex. 3.1 A-7-8 (§ 7(b) & (c)) (Certificate of Designations of Fixed Rate Cumulative Perpetual Preferred Stock, Series R). But the preferred shares carried no voting rights other than the limited and specific ones set out in the deal documents. First BofA Bailout 8-K, *supra* note 68, at Ex. 3.1 A-7 (§ 7(a)); Second BofA Bailout 8-K, *supra* note 69, at Ex. 3.1 A-7 (§ 7(a)); Third BofA Bailout 8-K, *supra* note 70, at Ex. 3.1 A-7 (§ 7(a)).

72. First BofA Bailout 8-K, *supra* note 68, at Ex. 4.2 (§ 6) (Warrant to Purchase Common Stock); Third BofA Bailout 8-K, *supra* note 70, at Ex. 4.2 (§ 6) (Warrant to Purchase Common Stock).

73. BofA announced on December 2, 2009 that it would repurchase all of the stock sold to the government. Bank of Am. Corp., Current Report (Form 8-K) (Dec. 3, 2009). On December 9, BofA reported that it had completed repurchasing all of that stock. Bank of Am. Corp., Current Report

The government then sold the warrants—which it had never exercised—in March 2010.<sup>74</sup> Thus, unlike the AIG case, the government *never* had any formal corporate power to dictate the composition of the BofA board.

## 2. The Government's Regulatory Action

The government's lack of voting power, however, did not prevent it from pressuring BofA to change its board. BofA is a bank holding company.<sup>75</sup> It is therefore regulated by the Board of Governors of the Federal Reserve System (the Fed).<sup>76</sup> Among the Fed's many regulatory tools is the Memorandum of Understanding (MOU), which the Fed can effectively force upon any bank holding company. The Fed describes its MOUs as "highly structured, written but informal, agreements that are signed by both the Reserve Bank and the [regulated] bank's board of directors."<sup>77</sup> The Fed uses MOUs "when a bank has multiple deficiencies" but "circumstances warrant a less severe response than those provided by formal supervisory actions."<sup>78</sup>

The financial press reported that BofA and federal bank regulators had entered into an MOU in early May 2009,<sup>79</sup> after the bailout investment and before BofA repurchased the preferred stock. According to the *Wall Street Journal*, the MOU required BofA "to overhaul its board."<sup>80</sup> As set out

(Form 8-K), at Item 8.01(b) (Dec. 9, 2009).

74. Bank of Am. Corp., Current Report (Form 8-K), at 3 (Mar. 9, 2010).

75. Bank of Am. Corp., Annual Report (Form 10-K), at 1 (Feb. 27, 2009).

76. 12 U.S.C. § 1813(q)(3)(F) (Supp. V 2011).

77. FEDERAL RESERVE BOARD, COMMERCIAL BANK EXAMINATION MANUAL, FORMAL AND INFORMAL CORRECTIVE ACTIONS § 5040.1, at 6 (Nov. 2003), available at <http://www.federalreserve.gov/boarddocs/supmanual/cbem/200904/5000.pdf> [hereinafter FED. BANK EXAMINATION MANUAL].

78. *Id.* Examples of formal disciplinary sanctions include (i) cease-and-desist orders issued when, for example, a bank is violating the law or engaging in an unsound banking practice, *id.* § 5040.1 at 1, 12 U.S.C. § 1818(b)(1) (2006); and (ii) removal of officers or other affiliated parties at banks when, for example, those officers or other affiliated parties have violated the law, engaged in unsafe and unsound practices, or violated fiduciary duties and that conduct has or probably will hurt the bank financially, and the acts of the officers or other affiliated parties involve dishonesty, 12 U.S.C. § 1818(e) (2006 & Supp. V 2011). See also FED. BANK EXAMINATION MANUAL, § 5040.1 at 1, 3.

79. Dan Fitzpatrick, *U.S. Regulators to BofA: Obey or Else*, WALL ST. J., July 16, 2009, at C1 [hereinafter Fitzpatrick, *Obey*] (reporting that "[t]he order was imposed in early May").

80. *Id.* ("[BofA] is operating under a secret regulatory sanction that requires it to overhaul its board . . ."). A later story details some of the inside-government history leading to the MOU. Carrick Mollenkamp & Dan Fitzpatrick, *With Feds, BofA's Lewis Met His Match*, WALL ST. J., Nov. 9, 2009, at A16. Although the MOU never surfaced publicly, the reliability of the paper publishing

below, that *Wall Street Journal* report did not repeat information provided by a securities filing, for no such filing revealed the MOU.<sup>81</sup> And the story did not break until July 2009—weeks after the government had put the MOU in place.<sup>82</sup>

### 3. The Board Change

As with AIG, understanding the government's impact on board composition at BofA requires us to look back at the board as it existed before the government intervened. Thus, at BofA's April 29, 2009 annual meeting—less than a month before the government regulatory action—shareholders elected eighteen directors.<sup>83</sup> All of them were incumbents.<sup>84</sup>

Almost immediately thereafter, the government and BofA signed the MOU, and the newly elected board quickly and drastically changed. Within two months, nine—fully half—of the recently elected eighteen directors resigned.<sup>85</sup> By the end of September, six new directors—all elected to the board by the sitting directors—joined the board.<sup>86</sup> This left fifteen directors on the board, and the company reduced its board size to that number.<sup>87</sup> The CEO, Ken Lewis, thereafter left his executive position and vacated his board

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the stories about it, the granularity of the second story's account describing the run-up to the MOU, and the fact that BofA did, indeed, change half its board shortly after reports that the MOU was signed make, together, a very convincing case that the MOU existed and required the bank to change a considerable number of its directors.

81. See Fitzpatrick, *Obey*, *supra* note 79 (referring to the MOU as a “secret regulatory sanction”). Review of BofA securities filings on Forms 10-K, 10-Q, and 8-K after May 2009 reveals no reference to the MOU.

82. *Supra* note 79.

83. Bank of Am. Corp., Quarterly Report (Form 10-Q), at 211 (Aug. 7, 2009) [hereinafter BofA 2009 2Q 10-Q].

84. Bank of Am. Corp., Proxy Statement (Schedule 14A), at 15–17 (Mar. 18, 2010).

85. Bank of Am. Corp., Current Report (Form 8-K) (May 29, 2009) (announcing Sloan resignation); Bank of Am. Corp., Current Report (Form 8-K) (June 4, 2009) (announcing Tillman resignation); Bank of Am. Corp., Current Report (Form 8-K) (June 8, 2009) (announcing Ward and Mitchell resignations); Bank of Am. Corp., Current Report (Form 8-K) (June 19, 2009) (announcing Prueher and Franks resignations); Bank of Am. Corp., Current Report (Form 8-K) (July 31, 2009) (announcing Collins, Barnet, and Countryman resignations).

86. As at AIG, the bank's organic documents and applicable law permitted the board itself to fill vacant seats. Bank of Am. Corp., Annual Report (Form 10-K), at 1 (Feb. 27, 2009) [hereinafter BofA 2009 Annual Report] (“Bank of America Corporation . . . is a Delaware corporation.”); see also DEL. CODE ANN. tit. 8, § 223(a)(1) (2011) (a vacancy on the board may be filled by vote of a majority of directors in office at time of the vacancy); Bank of Am. Corp., Current Report (Form 8-K), at Ex. 3.2 (Dec. 15, 2008) [hereinafter BofA Bylaws] (amended and restated Bylaws, Art. IV § 4 conforming to § 223); Bank of Am. Corp., Current Report (Form 8-K) (June 5) (stating Bies, Boardman, Jones, and Powell elected to the board by the board); Bank of Am. Corp., Current Report (Form 8-K) (August 21, 2009) (stating Scully elected to the board by the board); Bank of Am. Corp., Current Report (Form 8-K) (September 21, 2009) (stating Holliday elected to the board by the board).

87. Bank of Am. Corp., Current Report (Form 8-K), at Ex. 99.1 (Sept. 21, 2009).

seat.<sup>88</sup> The board replaced Lewis with a new top executive, Brian Moynihan, and the sitting directors elected Moynihan to the board.<sup>89</sup>

The company then reduced the number of directors to thirteen, effective at the 2010 annual meeting, and two of the fifteen incumbent directors did not stand for reelection.<sup>90</sup> The thirteen 2010 nominees—all sitting directors, by virtue of the departures and arrivals between the 2009 and 2010 elections—ran successfully for reelection at the 2010 annual shareholder meeting.<sup>91</sup> After that 2010 election, only six directors remained from the original eighteen who had been elected in 2009, shortly before the MOU.<sup>92</sup> And those six now constituted a minority. As the MOU reportedly directed, BofA had “overhauled” its board.<sup>93</sup>

#### 4. The Government’s Role in the Change

Because the board that the shareholders elected in 2010 was the board that was reconstituted by director departures and arrivals between the 2009 and 2010 elections, this section concentrates on those departures and those arrivals. The section considers departures first. It considers arrivals second.

Ten BofA directors resigned between the 2009 and 2010 shareholder meetings (the nine who left shortly after the MOU and the CEO who left later), and two declined to run for reelection.<sup>94</sup> The government reportedly did not pressure the bank to push out CEO Ken Lewis,<sup>95</sup> and the two directors who declined to run for reelection did so long after the May 2009 MOU.<sup>96</sup> So it is the nine directors who left between the early May MOU and

88. Bank of Am. Corp., Current Report (Form 8-K) (Oct. 1, 2009) (noting that CEO Lewis advised the board that he would vacate both his executive and board positions effective January 31, 2009).

89. Bank of Am. Corp., Current Report (Form 8-K) (Dec. 17, 2009) (announcing Brian Moynihan elevated to chief executive and elected to the board by the board).

90. Bank of Am. Corp., Proxy Statement (Schedule 14A), at 17 (Mar. 17, 2010) [hereinafter BofA 2010 Proxy Statement]. A comparison of the board before the election, *id.* at 10, with those standing for reelection, *id.* at 21, shows that directors Massey and Ryan did not seek reelection.

91. *Id.* at 17–21; Bank of Am. Corp., Current Report (Form 8-K) (May 3, 2010).

92. Compare BofA 2009 2Q 10-Q, at 211 with Bank of Am. Corp., Current Report (Form 8-K) (May 3, 2010).

93. Fitzpatrick, *Obey*, *supra* notes 79–80.

94. See *supra* notes 85, 88, 90.

95. Louise Story & Eric Dash, *Ending Rocky Tenure, Chief Is to Leave Bank of America*, N.Y. TIMES, Oct. 1, 2009, at B1 (“[While] regulators have urged other management and board level changes at Bank of America,” “[f]ederal officials did not call on Mr. Lewis to step down.”). All *New York Times* citations are to the Late Edition.

96. BofA 2010 Proxy Statement, *supra* note 90.



the end of July whose departure the government seems to have prompted.

Of course, it is possible that these nine directors departed for reasons other than government pressure. The directors may have resigned, in part, to avoid controversy. BofA's 2009 election was contentious, with advocacy groups and longtime shareholders urging votes against incumbents (particularly CEO Ken Lewis),<sup>97</sup> on ballots that permitted a vote "for" or "against" each director candidate even though each ran unopposed.<sup>98</sup> As a result, the percentage of shares voted "for" several of the incumbents constituted, for corporate elections,<sup>99</sup> an extremely low percentage of the total votes cast.<sup>100</sup> The stockholders also approved a resolution,<sup>101</sup> which the incumbent board opposed, to separate the board chair position from that of the CEO,<sup>102</sup> thereby stripping CEO Lewis of his chairmanship.<sup>103</sup> That

97. Louise Story, *Investors Air Discontent With Bank of America*, N.Y. TIMES, Apr. 20, 2009, at B1 (stating that (i) two proxy advisory services—RiskMetrics Group and Glass, Lewis and Company—recommended voting against Ken Lewis, the CEO and board chair; (ii) CitW Investment Group, which works with union pension funds, led a campaign to vote against Lewis; and (iii) the Finger family, longstanding BofA shareholders, set up a website and broadcast television commercials encouraging votes against Lewis).

98. See Bank of Am. Corp., Proxy Statement (Schedule 14A), at Proxy Card (Mar. 18, 2009) [hereinafter BofA 2009 Proxy Statement].

Federal regulations require that a proxy form to vote shares in a director election "shall clearly provide . . . [one of several defined] means for security holders to withhold the authority to vote for each nominee," or, "[i]f applicable state law gives legal effect to votes cast against a nominee," the proxy form may "provide a . . . means for security holders to vote against each nominee" either instead of, or in addition to, the opportunity to withhold votes for the nominee. 17 C.F.R. § 240.14a-4(b)(2), Instruc. 2 (2012).

99. In a sample of 2488 shareholder meetings in 2003 through 2005, 94.27% of shares voting were cast for director nominees on average. Jie Cai et al., *Electing Directors*, 64 J. OF FIN. 2389, 2397 Table 1 (2009).

100. As examples, from BofA 2009 2Q 10-Q, *supra* note 83, at 211:

Name	Shares Voted For Number (Percent)	Shares Voted Against Number (Percent)	Shares Abstaining Number (Percent)
Kenneth D. Lewis	3,585,483,520 (66.30%)	1,739,904,717 (32.17%)	82,576,830 (1.53%)
Monica C. Lozano	4,022,922,490 (74.39%)	1,316,622,875 (24.35%)	68,419,702 (1.27%)
O. Temple Sloan, Jr.	3,330,503,450 (61.59%)	1,990,078,420 (36.80%)	87,383,197 (1.62%)
Robert L. Tillman	4,040,832,297 (74.72%)	1,299,812,405 (24.04%)	67,320,365 (1.24%)
Jackie M. Ward	3,833,873,175 (70.89%)	1,506,235,467 (27.85%)	67,856,425 (1.25%)

101. BofA 2009 2Q 10-Q, *supra* note 83, at 212.

102. BofA 2009 Proxy Statement, *supra* note 98, at 51–53.

103. The resolution amended the company's bylaws to require that the board chair be an

resolution created a public stir,<sup>104</sup> and board members may have viewed the vote on that resolution as a rebuke.

Another possibility is that directors departed in 2009 due to the continuing controversy surrounding BofA's acquisition of Merrill Lynch through a deal signed on September 15, 2008<sup>105</sup> and approved by the shareholders on December 5.<sup>106</sup> That acquisition produced shareholder unrest for three reasons. First, Merrill advised—after BofA shareholders voted in favor of the merger but before the transaction closed—that Merrill's losses were dramatically higher than previously estimated, but the BofA board and management proceeded with the deal nevertheless.<sup>107</sup> Second, Merrill paid about \$3.6 billion in bonuses shortly before the merger, drawing criticism both because the bonuses appeared too generous for a then-failing company to pay<sup>108</sup> and because the proxy statement urging BofA shareholders to approve the merger had not disclosed the bonus payments.<sup>109</sup> Third, Merrill's former CEO resigned from his post-merger position at BofA amid stories that he had engineered the just-before-merger bonuses and had ostentatiously redecorated his office.<sup>110</sup> All of this may have worn down BofA directors and motivated their departure.

Finally, it is possible that public criticism of the board caused some or all of the nine to leave. Press articles claimed that the BofA board was too

"independent" director within the meaning of the New York Stock Exchange listing standards. *Id.* at 52. A CEO is not independent under those standards. NYSE LISTED COMPANY MANUAL, *supra* note 31, § 303A.02(b)(i).

104. See, e.g., Louise Story, *Big Loss for Lewis*, N.Y. TIMES, Apr. 30, 2009, at B1 (stating that "[Lewis was dealt] a stinging blow that leaves his stewardship and legacy in doubt" by a vote "[a]t a contentious annual . . . meeting" in which "angry investors held him accountable for what they view as a series of missteps that forced the once-mighty bank to accept . . . government bailouts").

105. Bank of Am. Corp., Current Report (Form 8-K) (Nov. 12, 2008).

106. Bank of Am. Corp., Current Report (Form 8-K) (Dec. 5, 2008).

107. See Julie Creswell, *Price Paid for Merrill Is Rising*, N.Y. TIMES, Jan. 24, 2009, at B1.

108. Aaron Smith, *Watchdog blasts Merrill bonuses*, CNN MONEY, Feb. 11, 2009, [http://money.cnn.com/2009/02/11/news/companies/merrill\\_bonuses/index.htm](http://money.cnn.com/2009/02/11/news/companies/merrill_bonuses/index.htm) (reporting the New York Attorney General asking: "What did they do to deserve that money?" given that Merrill "has failed"); see Michael J. de la Merced & Louise Story, *Nearly 700 at Merrill In Million-Dollar Club*, N.Y. TIMES, Feb. 12, 2009, at B1 (noting that the New York Attorney General "raised hackles by disclosing how Merrill Lynch distributed its 2008 bonus" and "criticized Merrill for moving up the bonus payments to December, just before shareholders approved the merger [with BofA], instead of the usual time in January").

109. See Complaint ¶¶ 2–3, SEC v. Bank of Am. Corp., No. 09CV06829 (Aug. 3, 2009), 2009 WL 2364171; see also SEC v. Bank of Am. Corp., No. 09 Civ. 6829(JSR), 10 Civ. 0215(JSR), 2010 WL 624581, at \*1 (S.D.N.Y. Feb. 22, 2010).

110. Louise Story & Julie Creswell, *Love Was Blind*, N.Y. TIMES, Feb. 8, 2009, § 3 (Money and Business), at 1 (referring to "Mr. Thain's lavish \$1.2 million office renovation and last-minute bonuses that he paid out to Merrill employees days before the deal [with BofA] closed").

close to the CEO.<sup>111</sup> Such criticism may have hit particularly hard because BofA's stock price dropped even more precipitously than stock prices of the company's peers.<sup>112</sup>

Since the nine board resignations started in May 2009,<sup>113</sup> however, the timing tells. These directors had already pulled through the awful wave of publicity surrounding the Merrill merger, and through the fractious April 2009 shareholder meeting.<sup>114</sup> The fact that they began resigning shortly after the MOU was signed led the *Wall Street Journal* to characterize the bank as having "responded swiftly" to the MOU by sending these directors out the door.<sup>115</sup> Given the timing and press reports, the most persuasive inference is that the government—acting through its regulatory power rather than through its shareholding power—had a hand in the nine director departures in May through July of 2009.

Less clear is what role the government played in the arrival of the seven new board members between the 2009 and 2010 elections. BofA stated in

111. Louise Story & Julie Creswell, *Bank of America Board Under Gun From Critics*, N.Y. Times, Jan. 28, 2009, at B1.

112.

Date	Value of \$1 Invested on 9/30/08 in BofA stock	Value of \$1 Invested on 9/30/08 in Capitalization-Weighted Index of Peer Companies
9/30/08	1.00	1.00
12/31/08	.41	.66
4/29/09 (date of director election at annual meeting)	.25	.60
5/29/09 (date of first director resignation after MOU)	.33	.69
7/31/09 (date of last director resignation in waive after MOU)	.43	.71

The peer companies used in this computation were Bank of New York Mellon Corporation, BB&T Corporation, Citigroup, Inc., Goldman Sachs Group, Inc., JP Morgan Chase & Co., KeyCorp, Morgan Stanley, State Street Corporation, U.S. Bancorp, SunTrust Banks, Inc., and Wells Fargo & Company.

113. O. Temple Sloan, Jr. resigned first. Bank of Am. Corp., Current Report (Form 8-K) (May 29, 2009); see *supra* note 85.

114. See David Ellis, *Ken Lewis out as BofA chairman*, CNN MONEY, Apr. 29, 2009, [http://money.cnn.com/2009/04/29/news/companies/bofa\\_shareholders/](http://money.cnn.com/2009/04/29/news/companies/bofa_shareholders/) (noting that "[v]otes at annual shareholder meetings usually do not reach [that] level of controversy" and "several investors were not shy about making known their feelings about . . . the past year").

115. The *Wall Street Journal* article reported that BofA had "responded swiftly" to the MOU, "with six directors resigning since May 26." Fitzpatrick, *Obey*, *supra* note 79. Three more departed shortly after this July 16, 2009 article appeared. See *supra* note 85.

its 2010 proxy statement that one special committee of the board had found six of the seven directors appointed during that time, with the help of “outside legal counsel and third-party advisors,”<sup>116</sup> and that a second special committee had identified the seventh new board member, the new CEO.<sup>117</sup> The proxy statement did not describe or refer to any government role in selecting any of these directors. At least one story in the financial press, however, reported that the government had effectively exercised a veto power over the selection of the new chief executive.<sup>118</sup>

### 5. Disclosure of the Government’s Role

As an “informal supervisory action,” an MOU is “not published or publicly available,” although according to the Fed a bank “may” have to disclose an MOU in the bank’s securities filings.<sup>119</sup> Here, BofA did not include, describe, or even refer to its MOU in *any* SEC filing.<sup>120</sup> And the government filed no disclosure document with the Commission setting out the government’s role in the bank’s board turnover. In short, within a few months of shareholders electing a board at one of the largest financial institutions in the country, the government reportedly removed half of the directors and played a role, as well, in the selection of the bank’s new CEO, with no securities filing revealing the government role at all.<sup>121</sup>

The absence of any such filing grates, particularly when comparing BofA to AIG. At AIG, the market could have anticipated direct and conclusive government intervention in board composition, resulting from the publicly disclosed shift in voting control to the Treasury-created Trust.<sup>122</sup> But the government held no voting stock at BofA whatsoever.<sup>123</sup> Instead of using publicly disclosed voting control, the government at BofA exercised

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116. BofA 2010 Proxy Statement, *supra* note 90, at 6, 17.

117. *Id.* at 8.

118. Dan Fitzpatrick & Michael R. Crittenden, *BofA to Select Emergency CEO*, WALL ST. J., Oct. 5, 2009, at C3 (reporting that one BofA board committee was trying to select a possible replacement for Lewis if legal actions forced his quick departure and stating that “[r]egulators will be asked to sign off on the choice,” with “[a] separate Bank of America board committee formed on Friday . . . sifting through possible successors for Mr. Lewis, with the change to occur at year end . . .”; further reporting that “a narrowed list of candidates [assembled by this second committee] will be presented to the U.S. government for review. . .”).

119. FED. BANK EXAMINATION MANUAL, *supra* note 77, § 5040.1 at 6.

120. *See supra* note 81.

121. *See supra* notes 76–118 and accompanying text.

122. *Supra* note 19 and accompanying text.

123. *See supra* notes 71 and 72 and accompanying text.

its control by the publicly unavailable MOU, which only came to light through a reporter's diligence, and then only weeks *after* the document was in place.<sup>124</sup> Without the news reports on the MOU, no investor would have known that the government muscled half the BofA board out the door. Even with the press reports, the market learned of the government involvement late.

### III. HOLES IN SECURITIES LAW REPORTING THAT PERMIT GOVERNMENT CONTROL OF BOARDS TO REMAIN IN THE DARK

With the AIG and BofA cases set out and the deficiencies in securities filings identified, we turn now to a central puzzle: how was it that the government could change the boards at huge, publicly traded companies without timely and complete securities filings describing the government's maneuvers? Securities law recognizes the importance of board change, imposing multiple requirements to disclose not only director departures and arrivals, but also plans to change board composition by major shareholders, shifts in control that could affect board composition, and even the names of those who recommend candidates for director seats at a shareholder election.<sup>125</sup> This section sets out these disclosure requirements, explains why they left disclosure "holes" in the AIG and BofA board change cases, and shows why investors (and the wider public) had some information to "fill in the blanks" at AIG, but not at BofA.

#### A. Tender Offer Disclosure

A party tendering for shares of a company may well wish to acquire, by the tender, a sufficient block of shares to change the board of directors—either so that a reconstituted board will favor a full takeover by the tendering party or so that the company will make business changes that will increase the value of the stock that the tendering party owns. Any party making a tender offer for stock of a public company must, if consummation of the tender would leave that tendering party with more than five percent of the company's stock, file a Schedule TO.<sup>126</sup> That Schedule TO—the basic tender offer disclosure document—must include "any plans, proposals or negotiations that relate to or would result in . . . [a]ny change in the present board of directors."<sup>127</sup> Since the government never made a tender offer for

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124. See *supra* notes 79–82 and accompanying text.

125. See *infra* Parts III.A–D, IV.B.

126. 15 U.S.C. § 78n(d)(1) (2006); 17 C.F.R. §§ 240.14d-1(a), 240.14d-3(a)(1) (2012).

127. 17 C.F.R. § 229.1006(c)(4), 240.14d-100 (Item 6) (2012).

AIG or BofA stock, government action at those companies never triggered this “Schedule TO Disclosure.”

### *B. More-Than-Five-Percent Equity Shareholder Disclosure*

Any shareholder, or group of shareholders, acquiring more than five percent of any class of an “equity security” that is registered under section 12 of the Securities Exchange Act must file a Schedule 13D.<sup>128</sup> That Schedule 13D must include “any plans or proposals which the reporting persons may have which relate to or would result in . . . [a]ny change in the present board of directors.”<sup>129</sup> A first look suggests that this “Schedule 13D Disclosure” would have required the government to reveal its efforts to change the boards at AIG and BofA and, indeed, even its plans to undertake those efforts. But closer examination shows that the government was able—quite legally—to avoid any such obligation.

Consider first the AIG case. The government purchased all of the Series C Convertible Participating Preferred Stock that AIG sold.<sup>130</sup> Even assuming that the Series C stock constituted a distinct “class”<sup>131</sup> of an AIG equity security so that the government owned 100% of that class, the government was not obligated to make a Schedule 13D Disclosure for two reasons. First, Exchange Act section 3(c) states that *no provision of the Act* applies to “any executive department or independent establishment of the United States . . . or any officer, agent, or employee of any such department [or] establishment” unless that provision specifically states that it so applies.<sup>132</sup> Since section 13(d) does not specifically state that it applies to the

128. 15 U.S.C. §§ 78m(d)(1), 78m(d)(3) (2006 & Supp. V 2011); 17 C.F.R. §§ 240.13d-1(a), 240.13d-101 (2012).

129. 17 C.F.R. § 240.13d-101 (Item 4(d)).

130. Am. Int’l Grp., Inc., Current Report (Form 8-K) (Sept. 26, 2008).

131. Section 13 contains no definition of a “class” of security. Since section 13 refers to section 12(g), which defines “class” “for purposes of [that] subsection” to mean “all securities of an issuer which are of substantially similar character and the holders of which enjoy substantially similar rights,” 15 U.S.C. § 78l(g)(5) (2006), a section 13 “class” might be defined in that same way. Alternatively, a “class” might be defined by “the common usage of the day in the legal and financial worlds.” *Ellerin v. Mass. Mut. Life Ins. Co.*, 270 F.2d 259, 262 (2d Cir. 1959). Either way, a stock is a separate “class” if it has sufficiently important unique characteristics, including voting rights. Surely, the preferred stock that AIG sold to the government (which handed over voting control of the company) was a separate “class” for section 13(d). And the labeling of that stock as a “series” instead of a “class” should not affect the analysis. For an analogy, see 17 C.F.R. § 240.12d1-1(d) (2012) (“If a class of a security is issuable in two or more series with different terms, each such series shall be deemed a separate class for the purposes of this section.”).

132. 15 U.S.C. § 78c(c) (2006).

government,<sup>133</sup> the government had no Schedule 13D Disclosure obligation, provided that the Trust holding the AIG stock for the government fit within the phrase “any executive department or independent establishment of the United States.”<sup>134</sup>

That proviso posed no problem. Since the Federal Reserve Bank of New York created the Trust and the Trust held the AIG stock for the sole benefit of the U.S. Treasury,<sup>135</sup> the Trust almost certainly qualified as an “independent establishment of the United States.”<sup>136</sup> The courts interpret section 3(c) as applying to the Federal Reserve<sup>137</sup> and the Federal Deposit Insurance Corporation (FDIC).<sup>138</sup> Neither the Federal Reserve nor the FDIC seems closer to the section 3(c) description of protected entities than a trust established by the executive for the sole benefit of an executive department. Section 3(c) therefore applied, and cut the Schedule 13D Disclosure off at the knees.

In addition, Schedule 13D Disclosure is required, with exceptions not relevant here, only when the security that the shareholder owns is registered pursuant to section 12 of the Exchange Act.<sup>139</sup> AIG did not register the Series C Convertible Participating Preferred under section 12 of the Exchange Act<sup>140</sup> and was not required to do so.<sup>141</sup> Thus, the Schedule 13D

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133. 15 U.S.C. § 78m(d).

134. 15 U.S.C. § 78c(c).

135. AIG Credit Facility Trust Agreement, *supra* note 22, § 1.01 (providing that the Federal Reserve Bank of New York “hereby establishes a trust designated as the AIG Credit Facility Trust for the sole benefit of the [U.S.] Treasury”).

136. 15 U.S.C. § 78c(c).

137. *Howe v. Bank for Int’l Settlements*, 194 F. Supp. 2d 6, 23–24 (D. Mass. 2002).

138. *Colonial Bank & Trust Co. v. Am. Bankshares Corp.*, 439 F. Supp. 797, 802 (E.D. Wis. 1977).

139. 15 U.S.C. § 78m(d) (2006 & Supp. V 2011).

140. SEC, Annual Report (Form 10-K), at 6 (2010) [hereinafter SEC Form 10-K], requires that companies list on the cover of the Form those stocks that they have registered under sections 12(b) and 12(g). AIG’s Form 10-Ks for 2008 and 2009 listed other securities that AIG had registered under section 12, but did not list the Series C Convertible Participating Preferred. AIG 2008 Annual Report, *supra* note 28; Am. Int’l Grp., Inc., Annual Report (Form 10-K) (Feb. 26, 2010).

141. Section 12(a) of the Exchange Act prohibits brokers from effecting transactions on a national exchange involving a security that is not registered under that Act. 15 U.S.C. § 78l(a) (2006). This effectively requires issuers to register a security under section 12(b) if it is listed on an exchange. *Id.* § 78l(b). But the AIG Series C Preferred did not trade on any exchange.

Section 12(g) of the Exchange Act and SEC Rule 12g-1 required that a company register any class of equity security if (i) the issuer had total assets in excess of \$10 million and (ii) the record owners of that class of security numbered 500 or more (since increased). 15 U.S.C. § 78l(g) (2006); 17 C.F.R. § 240.12g-1 (2009). Both before and after the government bought the Series C Preferred on March 4, 2009, AIG had more than \$10 million in assets. *See* Am. Int’l Grp., Inc., Quarterly Report (Form 10-Q), at 3 (May 7, 2009) (reporting more than \$819 billion in assets on Mar. 31, 2009); Am. Int’l Grp., Inc., Quarterly Report (Form 10-Q), at 3 (Aug. 7, 2009) (reporting more than \$830 billion on June 30, 2009); Am. Int’l Grp., Inc., Quarterly Report (Form 10-Q), at 3 (Nov. 6, 2009) (reporting more than \$844 billion on Sept. 30, 2009). But the government was the only

Disclosure obligation would not have applied to the government, by reason of its ownership of the Series C stock, even if section 3(c) had not categorically precluded the application of section 13 to Uncle Sam.

Turning from the AIG case to the BofA case, the government's case for making no Schedule 13D Disclosure was even stronger. Again assume that each series of preferred stock that the government bought from BofA constituted a separate "class" for section 13(d) analysis (with the Treasury owning 100% of each such class).<sup>142</sup> Even so, the section 3(c) exemption relieved the government of any Schedule 13D Disclosure obligation.<sup>143</sup> Moreover, BofA—like AIG—did not have to register the government-purchased preferred stock under Exchange Act section 12 and did not register that stock under that section, which meant that section 13(d) did not apply to the owner of that stock.<sup>144</sup> Finally, the preferred stock that the government bought from BofA provided no voting rights unless BofA missed dividend payments owed on that stock.<sup>145</sup> Since BofA never missed dividend payments, that BofA preferred stock never had a *current* vote in

purchaser of the Series C—far below the 500 minimum necessary to trigger a section 12(g) registration.

142. Whether a series of preferred stock constitutes a separate "class" depends on its unique characteristics. *See supra* note 131. Arguably, the Series N and Series R preferred stock that the government purchased from the bank constituted a separate "class" because that stock uniquely subjected the bank's compensation to federal government control. First BofA Bailout 8-K, *supra* note 68, Ex. 3.1 Annex A § 4.10 (series N designations, requiring BofA to "take all necessary steps to ensure that its Benefit Plans with respect to Senior Executive Officers comply in all respects with § 111(b) of the [Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765] as implemented by any guidance or regulation . . . that has been issued and is in effect as of the Closing Date"); Third BofA Bailout 8-K, *supra* note 70, Ex. 10.1 § 4.10 (Stock Purchase Agreement, including the same requirement as the series N designation); *see* BofA 2010 Proxy Statement, *supra* note 90, at 28 (reporting that the "amount and form" of compensation paid to certain bank executives was subject to specific federal approval).

143. The argument for the section 3(c) exclusion is even stronger in the BofA case, since the Treasury itself, rather than a trust, owned the BofA stock. *See supra* text accompanying notes 68–70.

144. The covers to BofA's Forms 10-K for the years 2008 and 2009 list other securities that the company had registered under section 12 but not the Series N, Q, or R Fixed Rate Cumulative Perpetual Preferred Stock issued to the government. Bank of Am. Corp., Annual Report (Form 10-K) (Feb. 27, 2009); Bank of Am. Corp., Annual Report (Form 10-K) (Feb. 26, 2010).

Just as the federal securities laws did not require AIG to register the preferred stock it sold to the government, those laws did not require BofA to register the preferred stock that BofA sold to the United States. Only one shareholder owned the preferred series that the government bought from the bank, so the section 12(g) registration requirement—triggered in part by 500 or more shareholders of record—did not apply. *See supra* note 141. Further, the BofA Series N and R preferred stock did not trade on any exchange, and hence did not need registration under sections 12(a) or (b).

145. *See supra* note 71 and accompanying text.



director elections and was accordingly never an “equity security”<sup>146</sup> falling within the coverage of section 13(d) at all.

### C. Form 8-K Disclosure

Form 8-K requires public companies to disclose any of more than twenty different events shortly after they occur.<sup>147</sup> Three of the described events are particularly pertinent here.

#### 1. Director Change

Within four business days of a director’s resignation or refusal to stand for reelection, a public company must file a Form 8-K disclosing that fact.<sup>148</sup> Moreover, when a director resigns or declines to stand for reelection “because of a disagreement with [the company on whose board he or she sits] . . . on any matter relating to the [company’s] operations, policies, or practices,”<sup>149</sup> the company not only must disclose the departure or refusal, but must also describe the disagreement.<sup>150</sup> Here, AIG and BofA dutifully reported director departures but did not, in any of the filings, report any “disagreement” between the board member heading offstage and the company over company “operations, policies[,] or practices.”<sup>151</sup> There easily could have been none, even if the government pressed the director to leave. The director might have simply agreed to leave for the good of the company, reasoning that the company needed government financial or regulatory support (or both) and that, if leaving would improve the chance of that support, then leaving was the right thing to do. In that case, even if the director disagreed *with the government* that he or she should leave, any such disagreement might have been appropriately characterized as no disagreement *with the company*, and thus not subject to mandatory reporting in an 8-K filing. A good argument for this position—whether it necessarily would have survived scrutiny before a court or the SEC—could have been enough to convince AIG or BofA that none of the directors left as a result of any such “disagreement.”<sup>152</sup>

Putting it another way, the Form 8-K director change disclosure—

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146. SEC rules exclude “non-voting securities” from the definition of “equity securities,” and define “voting securities” as those “the holders of which are *presently* entitled to vote for the election of directors.” 17 C.F.R. §§ 240.13d-1(i), 240.12b-2 (2012) (emphasis added).

147. SEC, Current Report (Form 8-K) (2011), available at <http://www.sec.gov/about/forms/form-8-k.pdf> [hereinafter SEC Form 8-K].

148. *Id.* at Item 5.02(a)–(b), General Instruction B.1.

149. *Id.* at Item 5.02(a).

150. *Id.* at Item 5.02(a)(1)(iii).

151. See the Form 8-Ks identified in notes 39, 85 *supra*.

152. SEC, Current Report (Form 8-K) at Item 5.02(a)(1).

though broadly phrased to pick up intra-company controversy leading to a director departure—simply does not contemplate influence from outside the company to remove a director. In the private sphere, outside pressure to remove directors might come from a large shareholder or perhaps a hostile bidder making a tender offer. The Schedule 13D Disclosure and the Schedule TO Disclosure would, respectively, require those private actors to disclose plans to change the board and thereby make up for any deficiency in the 8-K disclosure.<sup>153</sup> But, as we have seen, neither of those shareholder disclosure mandates applied to the government’s actions at AIG or BofA.

In addition to director departures, Form 8-K requires public companies to disclose, within four days, the election by the board of new directors who join the board between shareholder meetings.<sup>154</sup> This disclosure must include “a brief description of any arrangement or understanding between the new director and any other persons, naming such persons, pursuant to which such director was selected as a director.”<sup>155</sup> None of the Forms 8-K announcing new directors who joined the AIG or BofA boards between shareholder meetings included any statement about any such “arrangement or understanding.”<sup>156</sup> Of course, the government could have had an “arrangement or understanding”<sup>157</sup> with the *company* (AIG or BofA) pursuant to which the new director joined the board. But Form 8-K identifies the only reportable “arrangement or understanding” as one between “any other person[.]” and “the new director.”<sup>158</sup>

## 2. Material Definitive Agreement

A public company must file a Form 8-K to disclose, within four days, the company’s entry into a material definitive agreement that is not made in the ordinary course of business.<sup>159</sup> AIG and BofA filed Forms 8-K to comply with this requirement when those companies entered into the deals by which the government bought the preferred stock issued by each of those corporations.<sup>160</sup> Both AIG and BofA attached the deal documents to their

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153. See *supra* Parts III.A., III.B., III.C.1.

154. SEC Form 8-K, *supra* note 147 at Item 5.02(d).

155. *Id.* at Item 5.02(d)(2).

156. See the Forms 8-K identified in notes 41, 86 *supra*.

157. *Supra* note 155 and accompanying text.

158. *Id.*

159. SEC Form 8-K, *supra* note 147 at Item 1.01(a), General Instruction B.1.

160. When a company files a Form 8-K, that filing must “contain the number . . . of the applicable item.” *Id.* at General Instruction D. The Forms 8-K that AIG and BofA filed to describe

Forms 8-K and thereby fully disclosed all terms of the preferred stock that the government bought.<sup>161</sup>

The full report of the AIG transaction—disclosing the shift of voting power on all matters (including director elections) to the government and the express statement in the deal documents that the AIG board must be satisfactory to the trustees of the Trust that would hold the stock for the government—was enough to signal that the government would control who stayed on the AIG board, who left the board, and who joined that board.<sup>162</sup>

But the reports of the BofA transactions did nothing of the sort.<sup>163</sup> The government's purchases of preferred stock from BofA provided no right to even a single vote in director elections, unless the bank missed required dividend payments.<sup>164</sup> The warrants provided no voting rights at any time.<sup>165</sup> Thus, by the transaction documents that BofA attached to its Forms 8-K, investors could see that the stock and warrants did *not* provide voting rights and, therefore, investors would *not* have gleaned from the description of those investments that the government was effecting board change.

Moreover, neither company filed any “material definitive agreement” Form 8-K that separately discussed government influence on the departure or arrival of individual directors. Most important in this regard is BofA's failure to file an 8-K to disclose, as a material definitive agreement, the existence and the terms of the MOU by which, according to press reports, the bank agreed to radically reconfigure its board.<sup>166</sup>

Though at first consideration surprising, the bank's decision against such disclosure arguably complied with Form 8-K requirements. Form 8-K defines a “material definitive agreement” as “an agreement that provides for obligations that are material to and enforceable against the [company], or rights that are material to the [company] and enforceable by the [company].”<sup>167</sup> An obligation to change the board of directors would be “material” for all the reasons set out in Part IV.B below. But as an “informal supervisory action,” the MOU was, in the Fed's view, “not enforceable.”<sup>168</sup>

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sales of preferred stock to the government stated that they were filed to comply with Item 1.01. *See* the Forms 8-K identified in notes 17, 68–70 *supra*. Both companies also filed—for the bailout transactions—Forms 8-K under Item 3.02 (requiring disclosure of the sale of unregistered securities), Item 3.03 (requiring disclosure of events that materially modify the rights of existing securities holders), and Item 5.03 (requiring disclosure of amendments to articles of incorporation). *See* the Forms 8-K identified in notes 24, 68–70 *supra*.

161. *See supra* notes 17, 22, 24, 68–70.

162. *Supra* notes 19, 21 and accompanying text.

163. *See supra* Part II.B.5.

164. *Supra* note 71 and accompanying text.

165. *Supra* note 72 and accompanying text.

166. *See supra* Part II.B.5

167. SEC Form 8-K, *supra* note 147, at Item 1.01(b).

168. FED. BANK EXAMINATION MANUAL, *supra* note 77, § 5040.1 at 6.

And, as an unenforceable agreement, it fell outside the 8-K definition of “material definitive agreements.”<sup>169</sup> Of course, as a practical matter, most banks’ managements and boards will comply with a “supervisory action” by its primary regulator, even if that action is “informal” and in some sense not “enforceable.”<sup>170</sup> But by applying pressure through an MOU, the government (intentionally or not) armed the bank with a persuasive argument that the Fed’s pressure to change the BofA board need not be publicly reported.<sup>171</sup> Disclosure was not clearly required.

### 3. Change of Control

A public company must file a Form 8-K within four business days after its board or its officers learn that “a change in control . . . has occurred.”<sup>172</sup> When it sold the voting stock to the government in March 2009, AIG filed a Form 8-K pursuant to this requirement.<sup>173</sup> But BofA never filed such a Form 8-K to disclose the control that the government exercised by the MOU.<sup>174</sup> It is difficult to know why. The portion of Form 8-K concerning change of control does focus in part on “the percentage of voting securities” owned by the party taking control,<sup>175</sup> and, as set out above, the government held no securities with voting rights at the bank. But the securities law definition of “control” is broad, extending expansively to power from any source, whether exercised “through the ownership of voting securities, by contract, or otherwise.”<sup>176</sup> Perhaps BofA did not file a change of control Form 8-K because the MOU affected only selected aspects of BofA’s operations and governance, whereas control, as defined by the SEC, is arguably broader—the “power to direct or cause the direction of the management and policies” of a company.<sup>177</sup> By this interpretation, or maybe because the MOU was not “enforceable” and therefore perhaps could not provide “control,” a Form 8-K to disclose the MOU as a change of control was arguably not required.

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169. See SEC Form 8-K, *supra* note 147, at Item 1.01(b).

170. If the bank fails to comply, the Fed can impose other, mandatory, enforcement measures. See *supra* note 78.

171. Obviously, if in another case the government applied pressure without an “agreement” at all, the Form 8-K requirement to disclose material definitive agreements would not apply.

172. SEC Form 8-K, *supra* note 147, at Item 5.01(a), General Instruction B.1.

173. Am. Int’l Grp., Inc., Current Report (Form 8-K) (Mar. 5, 2009).

174. See *supra* Part II.B.5.

175. SEC Form 8-K, *supra* note 147, at Item 5.01(a)(3).

176. 17 C.F.R. § 240.12b-2 (2012) (emphasis added).

177. *Id.*

#### D. Proxy Disclosure

The federal proxy rules require that a company state how it came to nominate a director candidate.<sup>178</sup> Specifically, when the nominating committee of a public company's board puts forward a director candidate for a vote at a shareholder meeting and the board seeks proxies to vote shares for that nominee, the company must disclose "which one or more of the following categories of persons or entities recommended [the] nominee: [s]ecurity holder, non-management director, chief executive officer, other executive officer, third-party search firm, or other specified source."<sup>179</sup>

While this disclosure requirement seems tailor-made for the kind of influence that the government might exercise over a company's board, there is a timing problem. The proxy rule requirement to identify the source of a nominee applies only when a company files and distributes its proxy statement seeking votes for director candidates that the company's board has nominated.<sup>180</sup> Thus, a company whose board elects a director to the board *between* shareholder meetings will not have to disclose the party recommending the new director until the director runs for reelection at the next shareholder meeting, which may be months away.<sup>181</sup> It is this timing problem that created the late disclosures about Liddy and one other director at AIG: they joined the board months before the company was required, by the proxy statement rule, to describe the government role in their ascension.<sup>182</sup>

#### E. The Holes in Whole

The government's general exemption from Exchange Act compliance categorically excuses it from any reporting under that Act when the

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178. 17 C.F.R. § 229.407(c) (2012) (Item 407).

179. 17 C.F.R. § 240.14a-101 (2012) (emphasis added) (Item 7(d), cross-referencing Reg. S-K Item 407(c)(2) at 17 C.F.R. § 229.407(c)(2), which includes the quoted requirement in subpart (vii)).

180. The proxy disclosure schedule in 17 C.F.R. § 240.14a-101 only applies to a company when the company seeks shareholder proxies. 17 C.F.R. §§ 240.14a-2, 14a-3(a)(1). And Item 7(d) of that disclosure schedule—by its terms—only applies if, at the shareholder meeting for which proxies are sought, "action is to be taken with respect to the election of directors."

181. This rule does not apply to nominees who are "directors standing for reelection." *Id.* Read literally, therefore, the rule appears to exempt directors who are elected to a board, by the board, between shareholder meetings because, by the time they are listed on the company's proxy card, those directors are "standing for reelection." The SEC has, however, foreclosed that reading. SEC, Item 407 of Regulation S-K—Corporate Governance at Question 3.02 (Mar. 13, 2007), available at <http://www.sec.gov/divisions/corpfin/guidance/execcomp407interp.htm>.

182. Liddy joined the board in September 2008 and Dammerman in November 2008. See *supra* note 41. AIG filed its preliminary proxy statement for the next director election on May 21, 2009. See *supra* note 53.

government actively seeks to change the board at a public company.<sup>183</sup> The loophole remains open even when the government holds a majority voting interest in a company, as it did in AIG.<sup>184</sup> With the government not required to report its influence on board changes, the only other party in a position to do so is the company whose board the government affects. Yet gaps in the statutes and rules permit a company to avoid or delay disclosure as well.<sup>185</sup> None of the existing disclosure rules requires that the company disclose government pressure to *remove* board members, unless that pressure results in a disagreement between a departing director and *the company*, or the government applies pressure through an “enforceable” agreement.<sup>186</sup> Existing rules require company disclosure of government pressure to add an individual to a board, but only if the government “recommends” that individual to the company’s board, or the government applies pressure through an “enforceable” agreement with the company, or the government has an “arrangement or understanding” with the newly appointed director.<sup>187</sup> A banking company subject to an “informal” enforcement action by a federal regulator can avoid disclosing that the agency is pressing for a board change through a “material definitive agreement” because the “informal” action is not “enforceable.”<sup>188</sup> And, even when the government “recommends” a candidate who joins a board between shareholder meetings, the government may have no arrangement or understanding with the new director, so that the company need not disclose the government’s role until the director runs for election at the next annual shareholder meeting.<sup>189</sup>

In sum, the most likely applicable disclosure rules have holes through which timely and complete disclosure of government efforts to change a public company’s board can slip. And slip it did in the AIG case, even more so in that of BofA.<sup>190</sup>

#### IV. WHY WE SHOULD PLUG THE HOLES

Thus far, the discussion has examined government influence on the composition of boards at two public companies, demonstrated that securities

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183. See *supra* note 132 and accompanying text.

184. *Id.*

185. See *supra* Part III.A–D.

186. See *supra* Part III.C.1–2.

187. See *supra* Part III.C.1–2, D.

188. See *supra* Part III.C.2.

189. See *supra* Part III.C.1, D.

190. See *supra* Parts II.A.4, and II.B.5.

filings did not fully disclose that influence, and provided the technical reasons for the disclosure gap.<sup>191</sup> The analysis now turns to why we should close the gap. This section focuses, first, on the central place that the board occupies in a corporation<sup>192</sup> and, second, on the express recognition in existing securities regulations that disclosure of board changes—and disclosure of who influences those changes—is important.<sup>193</sup> The section then argues, third, that all major theories of the corporation attribute importance to the composition of a board and, expressly or implicitly, attribute significance to the identity of those who control board composition.<sup>194</sup> Fourth and finally, this section addresses two strains of academic thought that go the other way—one arguing that, despite their lofty formal status, boards wield little practical influence, and the other arguing that shareholder control of board composition is an illusion.<sup>195</sup> While those scholarly contentions imply that the disclosure deficiencies identified in this Article need not concern us, regulatory actions addressing these very matters, as well as increased shareholder activism, demonstrate that the disclosure holes are important after all.

#### *A. The Board's Formal and Practical Control of a Company*

The law grants sweeping power to a corporation's board. State corporate law—represented for the purposes of this Article by the Delaware General Corporation Law<sup>196</sup>—provides that “[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors.”<sup>197</sup> The board serves as a kind of benign oligarchy looking out for the company's long-term health and, in so doing, enjoys the authority to act even in ways that harm shareholders in the short term. For example, although shareholders must vote to approve a merger, a merger agreement only goes to a shareholder vote *after* the board has approved the deal.<sup>198</sup> Accordingly, a board can “just say ‘no’” to a premium offer that would reward shareholders with a certain and immediate gain on the basis that the merger interferes with a long-term strategy that the board has adopted in the

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191. See *supra* Parts II–III.

192. See *infra* Part IV.A.

193. See *infra* Part IV.B.

194. See *infra* Part IV.C.

195. See *infra* Part IV.D.

196. Delaware supplies the prevalent law. *Division of Corporations*, STATE OF DELAWARE, <http://corp.delaware.gov/> (last visited Jan. 25, 2013) (“more than 50% of all U.S. publicly-traded companies and 63% of the Fortune 500” are incorporated in Delaware). The laws of other states vary on some of the matters discussed below.

197. DEL. CODE ANN. tit. 8, § 141(a) (2011).

198. DEL. CODE ANN. tit. 8, § 251 (2011).

hope to generate projected (but uncertain) out-year gains.<sup>199</sup> When a board says “no,” the shareholders never vote on the premium offer at all, and, absent a tender offer, do not receive the immediate premium.<sup>200</sup> Even when a potential acquirer makes a tender offer, a board can defeat the offer by adopting a “poison pill” and declining to redeem the pill during a takeover battle.<sup>201</sup> The board’s power to thereby control shareholder access to bountiful buyouts has important effects on investors. Shareholders in companies whose boards successfully resist acquisitions reap, on average, lower returns than shareholders in companies that are acquired.<sup>202</sup>

Just as the board plays a central role in takeovers, it plays a key role in

199. See *Paramount Commc’n, Inc. v. Time, Inc.*, 571 A.2d 1140, 1150, 1154 (Del. 1989).

[A]bsent a limited set of circumstances as defined under *Revlon* [as when a board has put a company up for immediate sale], a board of directors, while always required to act in an informed manner, is not under any *per se* duty to maximize shareholder value in the short term, even in the context of a takeover.

....

The fiduciary duty to manage a corporate enterprise includes the selection of a time frame for achievement of corporate goals. That duty may not be delegated to the stockholders. [*Smith v.*] *Van Gorkom*, 488 A.2d [858.] 873 [(Del. 1985)]. Directors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy.

*Id.* (internal citations omitted). While a board’s vote to “just say ‘no’” to a premium offer is limited by fiduciary duties, courts review such decisions for breach of the duty of care, applying the business judgment rule. Provided that the directors’ procedure for reaching their conclusion (including the manner in which they inform themselves of facts) does not constitute gross negligence and the directors act in good faith, the directors commit no duty of care violation. *Van Gorkom*, 488 A.2d at 873; see also *Gantler v. Stephens*, 965 A.2d 695, 706 (Del. 2009) (elsewhere, overruling *Van Gorkom* on an unrelated point).

200. See generally *Chrysogelos v. London*, 18 Del. J. Corp. L. 237, 250 (Del. Ch. Mar. 25, 1992) (“[O]ur courts have recognized that shareholders have no contractual right to receive takeover bids, and that the shareholders’ ability to gain premiums through takeover activity ‘is subject to the good faith business judgment of the board of directors in structuring defensive tactics.’”) (quoting *Moran v. Household Intern., Inc.*, 490 A.2d 1059, 1079 (Del. Ch. Jan. 29, 1985), disapproved of on another point, *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1035 (Del. 2004)).

201. See *Moran v. Household Int’l, Inc.*, 500 A.2d 1346, 1351, 1357 (Del. 1985) (holding poison pill plan validly adopted); EDWARD P. WELCH ET AL., *FOLK ON THE DELAWARE GENERAL CORPORATION LAW* §141.2.6.6 (5th ed. 2013) [hereinafter *FOLK ON DGCL*] (summarizing cases denying orders for redemptions of pills).

202. See Lucian Ayre Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 925, 934 Table 3 (2002) (examining ninety-two hostile takeover bids initiated and resolved between January 1996 and December 2000 and finding an 18.2% average nine-month shareholder return at companies that remained independent compared to a 54.5% return for the companies that were sold, and an average 25.0% thirty-month return for companies that remained independent compared to a 79.7% return at companies that were sold).



declaring dividends.<sup>203</sup> Absent extraordinary circumstances, shareholders cannot compel the board to pay out the company's cash to them.<sup>204</sup> The board can pay no dividends if, in its judgment, husbanding the company's cash for other purposes is better use of the money than paying it to shareholders<sup>205</sup>—as, for example, when the board decides to use the cash to finance efforts that may prove profitable in years to come, instead of making dividend payments to stockholders right now.

The board also sets a public corporation's business strategy, writ large.<sup>206</sup> The board can force implementation of the strategy it selects because the board hires and fires top management.<sup>207</sup> And the board, through its compensation committee, sets the pay for top officers, including the objectives that the officer must meet to receive incentive payments—thus controlling company strategy, writ small.<sup>208</sup>

Boards not only possess power; they exercise it. For example, boards exercise their power to replace top executives. One study of large company CEOs reports that, of 981 CEOs leaving between 1971 and 2006, seventeen percent departed because of pressure from the board.<sup>209</sup> One scholar's examination of firms suffering during the credit crisis purports to find that boards acted efficiently to remove top executives at companies that experienced financial distress during the 2008 market decline.<sup>210</sup> Anecdotal

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203. *See* *Gabelli & Co. v. Liggett Grp., Inc.*, 479 A.2d 276, 280 (Del. 1984).

204. *Id.*

205. FOLK ON DGCL, *supra* note 201, § 170.7 (the “declaration of a dividend is ordinarily the sole prerogative of the board of directors”; “the mere fact that assets exist from which a dividend may be declared is insufficient” to justify a court order that a dividend be declared).

206. CORPORATE LAWS COMM., ABA BUS. LAW SECTION, CORPORATE DIRECTOR'S GUIDEBOOK 13 (6th ed. 2011) (stating that a board's “principal responsibilities” include “provid[ing] general direction and guidance with respect to the corporation's strategy”).

207. Bylaws govern appointment of officers. DEL. CODE ANN. tit. 8, § 142(e) (2011). Bylaws routinely give the board the power to appoint the CEO. *See, e.g.*, AIG Bylaws, *supra* note 40, at Art. IV § 4.1 (“As soon as practicable after the annual meeting of stockholders in each year, the Board of Directors shall elect a Chief Executive Officer . . .”); BofA Bylaws, *supra* note 86, at Art. VI § 2 (“The officers of the Corporation shall be elected by the Board of Directors or by a committee or an officer authorized by the Board of Directors or a committee to elect one or more officers; provided, however, that no officer may be authorized to elect . . . the Chief Executive Officer . . .”).

Bylaws can also govern the removal of the CEO. DEL. CODE ANN. tit. 8, § 142(b); *see e.g.*, AIG Bylaws, *supra* note 40, at Art. IV § 4.2 (“The Board may remove any officer with or without cause at any time.”); BofA Bylaws, *supra* note 86, at Art. VI § 4 (“The Board of Directors, by the affirmative vote of a majority of its members, may remove . . . the Chief Executive Officer . . . whenever in its judgment the best interest of the Corporation would be served thereby.”).

208. NYSE LISTED COMPANY MANUAL, *supra* note 31, § 303A.05(b)(i)(A).

209. Lucian A. Taylor, *Why Are CEOs Rarely Fired? Evidence from Structural Estimation*, 65 J. OF FIN. 2051, 2065, Table II (2010).

210. Brian R. Cheffins, *Did Corporate Governance “Fail” During the 2008 Stock Market Meltdown? The Case of the S&P 500*, 65 BUS. LAW. 1, 37–40 (2009) (“Factiva searches for the thirty-seven companies removed from the S&P 500 during 2008 reveal publicized CEO turnover in nine firms, publicized senior (but non-CEO) executive turnover in eight, and turnover of both sorts

evidence also supports the notion that a key board role is to fire the CEO when it is in the interest of the company to do so. The Hewlett-Packard board, which forced out Carly Fiorina,<sup>211</sup> and the Merrill Lynch board, which forced out Stanley O'Neal,<sup>212</sup> provide well-known examples.

Moreover, studies show that the *composition* of a board, and its committees, affects a company in important ways. Boards with greater accounting expertise—particularly boards that place directors with accounting expertise on their audit committees—provide better financial reporting.<sup>213</sup> The speed with which a board discharges a CEO when a company underperforms its peers increases with director independence from management and increases with director ownership of stock.<sup>214</sup> At least one study finds that CEO pay is lower, and firm value is higher, when a board includes a director who is independent of management and who either controls at least one percent of the equity voting power or owns at least one percent of the equity cash flow rights—with those correlations stronger if the

in four companies . . . . The . . . turnover . . . was not randomly distributed. Instead, all but two of the companies involved were financials and the action focused almost exclusively on 'at risk' companies. This is what would have been anticipated with well-functioning corporate governance . . . .").

211. See Gary Rivlin, *Hewlett's Board Forces Chief Out After Rocky Stay*, N.Y. TIMES, Feb. 10, 2005, at A1; Pui-Wing Tam, *Fallen Star: H-P's Board Ousts Fiorina as CEO*, WALL ST. J., Feb. 10, 2005, at A1 (detailing board-CEO discussions over several months that culminated in the firing).

212. Graham Bowley & Jenny Anderson, *Where Did the Buck Stop at Merrill?*, N.Y. TIMES, Nov. 4, 2007, § 3 (Money and Business), at 1 ("Merrill's board acted decisively immediately after the firm's huge losses were disclosed and after it was further revealed that Mr. O'Neal had made an unauthorized merger approach to Wachovia. Within days, the board showed him the door . . ."). While "[h]is ouster was being described as a retirement," Landon Thomas, Jr., *Merrill Chooses Insider To Lead Search for Chief*, N.Y. TIMES, Oct. 31, 2007, at C1, Mr. O'Neal testified later that "the Board asked me to retire shortly after we announced a large sub-prime related write-down in late 2007," *CEO Pay and the Mortgage Crisis: Hearing Before the H. Comm. on Oversight and Gov't Reform*, 110th Cong. 184 (2008) (statement of E. Stanley O'Neal, former CEO of Merrill Lynch).

213. See Lawrence A. Cunningham, *Rediscovering Board Expertise: Legal Implications of the Empirical Literature*, 77 U. CIN. L. REV. 465, 480 (2008) (summarizing "[e]xtensive research" showing "the correlation between various conceptions of audit committee expertise and related proxies for financial reporting quality (sometimes thought of as audit committee effectiveness)").

214. See Sanjai Bhagat & Brian Bolton, *Corporate Governance and Firm Performance*, 14 J. CORP. FIN. 257, 261 Table 269, Table 7, 270 (2008) (using data for percentage of unaffiliated and independent directors from 1996 to 2003 (9317 observations) and data for median dollar value of director stock ownership from 1998 to 2002 (6126 observations); finding that, considered together, "the dollar value of the median director's stock ownership and the percentage of directors who are independent[]increase[] the probability of disciplinary turnover for poorly performing firms," with poor performance measured by two years' stock returns after controlling for industry returns, among other variables).

large shareholder sits on the board's compensation committee.<sup>215</sup>

In sum, because the law puts the board at the top of the corporation control pyramid, the party controlling board composition can dominate a company. That domination affects everything from mergers and the quality of financial reports to the value of the company. If the government controls the composition of a corporation's board, the government may thus affect the enterprise profoundly.

### *B. The Recognition that Influence on Board Composition Is Material*

Federal securities laws regulate the revelation of "material" information.<sup>216</sup> Information about a company is material if there is a substantial likelihood that a reasonable investor would consider the information important in deciding whether to buy or sell the securities of the company, taking into account the total mix of information available and relevant to that decision.<sup>217</sup>

Existing disclosure rules reflect a judgment that changes in board composition—and the reasons for and identification of the parties behind such changes—are material and therefore should be disclosed. When the Commission last adopted major changes in Form 8-K, the SEC stated that the facts companies must reveal in 8-K filings are "unquestionably or presumptively material" and therefore "must be disclosed currently."<sup>218</sup> As Part III.C.1 shows, those facts include director arrivals and departures, together with agreements by which directors join a board and disagreements causing directors to leave.<sup>219</sup> The existing rules also recognize the importance of disclosing *who* is trying to add or remove directors, with Schedule 13D requiring disclosure by shareholders with more than five

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215. Anup Agrawal & Tareque Nasser, *Blockholders on Boards and CEO Compensation, Turnover and Firm Valuation* 7, n.8, 8, 26 (Sept. 2012) (unpublished draft) (on file with author and available at <http://bama.ua.edu/~aagrwal/IDB-CEO.pdf>) (defining an IDB as "an independent director who is (or represents) a blockholder" with the voting power or financial interest set out in the text; using a sample of 11,547 firm-years over 1998–2006). The study found, after controlling for other variables, that an individual or hedge fund IDB on a board is associated with lower CEO compensation, *id.* at 16–17, an IDB presence correlates to a much higher probability of CEO turnover in the face of poor market-adjusted stock return, *id.* at 21–22, and IDB directors lead to a higher industry-adjusted Tobin's *q*, *id.* at 22–23, a measure that the authors used for firm valuation, *id.* at 22. The researchers concluded that "these effects are substantial and are generally larger when an IDB serves on the board's compensation committee." *Id.* at 26.

216. 1 THOMAS LEE HAZEN, *THE LAW OF SECURITIES REGULATION* §3.4[2] (6th ed. 2009) ("The basic dividing line between what has to be disclosed and what information may be withheld is determined by the concept of materiality . . .").

217. *Basic, Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988).

218. *Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date*, 69 Fed. Reg. 15,594, 15,595 (Mar. 25, 2004).

219. *See supra* text accompanying notes 148–50, 154–55.

percent of a class of stock if the shareholders harbor “any plans” to change board composition.<sup>220</sup> Such disclosures aim “to provide investors with notice of a possible change in management or the direction of a business as it ‘may affect their judgment as to whether the stock should be sold, bought[,] or held’”<sup>221</sup>—the very definition of materiality. And existing rules acknowledge the importance of disclosing who “recommended” director candidates that the company nominates, with the proxy rules mandating identification of such recommenders.<sup>222</sup> Indeed, when the SEC imposed the rule requiring disclosure of parties recommending candidates for the board, it rejected the argument that that information was not material.<sup>223</sup>

Given the acknowledged importance of revealing director changes and who orchestrates those changes, it is especially strange that *government* influence should be shielded from disclosure. The goal of a private market actor that is engineering a board change is almost certainly to change the company so that the return on the stock it holds will increase. But the government’s goal in controlling a board might be quite different. For example, the government might be using corporate regime change to reduce the risk that a bank poses to the financial system, without regard to whether doing so will increase or even *decrease* expected returns to shareholders. Since the government could have such a vastly different purpose than a more traditional market actor, disclosure of the government’s role is especially important.

### *C. The Importance of Board Composition in Corporate Theory*

Not only is government influence over board composition practically important to investors, and not only is that influence material by security law standards, but government influence also implicates corporate theory. The

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220. See *supra* text accompanying notes 128–29.

221. *Independence Fed. Sav. Bank v. Bender*, 332 F. Supp. 2d 203, 213 (D.D.C. 2004) (citing *Marshall Field & Co. v. Icahn*, 537 F. Supp. 413, 416 (S.D.N.Y.1982)). The purchaser of a more-than-five-percent block must reveal plans to change the board “regardless of whether one of the purposes of the purchase is to acquire control of the issuer.” Filing and Disclosure Requirements Relating to Beneficial Ownership, 43 Fed. Reg. 18,484, 18,493 (Apr. 28, 1978).

222. See *supra* note 179 and accompanying text.

223. Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors, 68 Fed. Reg. 69,204, 69,208 (Dec. 11, 2003) (noting that the proposed rule “to identify the source of all director nominees” had drawn “extensive comment,” including the argument that it should not be imposed because “naming the specific source . . . would be immaterial,” but including the new requirement because the SEC “continue[d] to believe that information regarding the sources of company nominees is important for security holders.”).

three principal theories of the corporation all attribute importance to the board, and to the identity of those who control board membership. This section summarizes the three theories in skeletal form, without the intricacies added by a legion of scholars.<sup>224</sup> The purpose is not to evaluate the theories, much less to select one that is “best.” This section aims only to show that influence by the government on board composition is a matter of extreme importance under *each and every one* of these theoretical constructs.

### 1. Shareholder Primacy Theory

“Shareholder primacy” can describe corporations or serve as a normative rule for corporate operations. As a descriptive theory, shareholder primacy posits that the shareholders “own” the business and elect directors who, in a sense, serve as the shareholders’ agents in running the corporation by, among other things, appointing the officers.<sup>225</sup> The line of action starts with shareholders, then proceeds to the directors, and then to the officers.

That description suggests the normative conclusion that a corporation should be run for the benefit of the shareholders, because they own it.<sup>226</sup> Shareholder primacy as a normative theory, however, is not tied exclusively to shareholder primacy as a descriptive device.<sup>227</sup> Even some scholars who do not find it useful to *describe* corporate action as flowing from the owners (shareholders) to their agents (directors) to the employees (officers) still conclude that shareholder wealth maximization is the appropriate corporate goal for economic reasons.<sup>228</sup> They argue, for example, that maximizing shareholder return minimizes the cost of capital and deters shirking by

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224. A more elaborate taxonomy would subdivide the categories in the text and find a larger number of analytically distinct theories. Moreover, the theories to some extent blend into one another. For my very limited purposes, however, the three-theory division is sufficient.

225. See, e.g., William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 264–65 (1992). The directors are not the shareholders’ agents in a legal sense for a variety of reasons, including that the shareholders cannot control the directors’ actions after the shareholders elect the board. RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. f(2) (2006). However, the shareholder primacy model—as a descriptive construct—sees the directors as the shareholders’ economic agents.

226. Allen, *supra* note 225, at 265 (under this analysis, “[t]he corporation’s purpose is to advance the purposes of these owners (predominantly to increase their wealth), and the function of directors, as agents of the owners, is faithfully to advance the financial interests of the owners”).

227. See STEPHEN M. BAINBRIDGE, *THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE* 53 (2008) (“Although they are often used interchangeably, the terms ‘shareholder primacy’ and ‘shareholder wealth maximization’ in fact express distinct concepts. The shareholder wealth maximization norm is a basic feature of U.S. corporate governance.”).

228. *Id.* at 65–75.

executives and workers.<sup>229</sup>

Corporate law reflects shareholder primacy theory to a significant degree. Delaware law<sup>230</sup> requires that *shareholders* elect directors.<sup>231</sup> Delaware also provides that *shareholders* can remove directors, even without cause.<sup>232</sup> And Delaware closely guards the right of the shareholders to control board membership in these ways. For example, the board itself cannot remove a director.<sup>233</sup> Even a court's power to do so is limited.<sup>234</sup> Absent exceptional circumstances, "[t]he only persons empowered to remove a director are the corporation's shareholders."<sup>235</sup> As another example, Delaware employs a special rule to scrutinize companies that seek to defeat the shareholder franchise by thwarting a shareholder-led effort to change the board.<sup>236</sup> If actions that in fact frustrate such a shareholder effort are undertaken "for the primary purpose of impeding the exercise of stockholder voting power" to elect new directors, those actions only survive judicial review if the sitting board bears "the heavy burden of demonstrating a compelling justification."<sup>237</sup>

229. Since the shareholders only receive the cash from operations and sale of the company or its assets after the executives, employees, outside advisors, and creditors are paid, the shareholders are the ones with the incentive to ensure that all of the other actors function effectively. *Id.*

230. See *supra* note 196 (Delaware law predominant among large, publicly traded companies).

231. See, e.g., DEL. CODE ANN. tit. 8, § 211(b) (2011).

232. DEL. CODE ANN. tit. 8, § 141(k) (2011) (providing also that, if different classes or series elect different directors, only a vote of the shareholders who elected a particular director can remove that director).

233. *Nevins v. Bryan*, 885 A.2d 233, 251–52 (Del. Ch. 2005), *aff'd*, 884 A.2d 512 (Del. 2005) ("Section 141(k) of the DGCL states that directors may be removed with or without cause by a majority of the shares of the company. [B]y negative implication intended by the draftsmen, directors do not have the authority to remove other directors.") (internal quotation marks omitted) (quoting *Rohe v. Reliance Training Network, Inc.*, No. 17992, 2000 WL 1038190, at \*11 n.30 (Del. Ch. July 21, 2000)); FOLK ON DGCL, *supra* note 201, § 141.5.4.

234. DEL. CODE ANN. tit. 8, § 225(c) (2011); *Shocking Techs., Inc. v. Michael*, C.A. No. 7164-VCN, 2012 WL 1352431 at \*1 & n.5 (Del. Ch. Apr. 10, 2012); *Ross Sys. Corp. v. Ross*, Civ. A. No. 10378, 1993 WL 49778 at \*17–18 (Del. Ch. Feb. 22, 1993).

235. *Id.* at \*17 (citing DEL. CODE ANN. tit. 8, § 141(k) (2011)). The stockholders' power to remove directors implements the normative principle of shareholder primacy. See *Bebchuk, Shareholder Franchise*, *supra* note 33, at 682 ("[A] viable shareholder power to replace directors . . . is necessary to provide directors with strong affirmative incentives to focus on shareholder interests.").

236. *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988).

237. *Id.* at 661. While *Blasius* phrases its test so generally that it could apply to any effort to thwart shareholder voting, later cases largely limit it to instances in which the interference with shareholder voting affects director elections—confirming that the exceedingly difficult standard should be reserved for instances in which the action undermines the fundamental principle that shareholders control board composition. See *Mercier v. Inter-Tel (Del.)*, Inc., 929 A.2d 786, 808–09 (Del. Ch. 2007); *In re The MONY Group, Inc. S'holder Litig.*, 853 A.2d 661, 674 (Del. Ch. 2004).

Delaware's solicitude for shareholder power over board composition derives from the principle that the board rightly exercises power precisely *because* the corporation's owners elect the board. As one opinion puts it, "[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests."<sup>238</sup> Delaware accordingly "recognize[s] the transcending significance of the franchise to the claims to legitimacy of our scheme of corporate governance."<sup>239</sup>

As a descriptive construct, shareholder primacy relates simply and directly to government control of the board. If the government owns shares with controlling voting power, as was true at AIG<sup>240</sup>—and if the company is properly described as a corporation—the government should control board composition. As a normative matter, if the government is a shareholder, the company should be run for the financial benefit of the government (as well as the rest of the shareholders).<sup>241</sup>

But where the government is not a voting shareholder, as was true at BofA,<sup>242</sup> then shareholder primacy theory is unremittingly hostile to government power over director selection and retention. If the government can come in from the side and disturb the clear vertical hierarchy running from the shareholders to their economic agents (the board) and to employees (the officers), then the description of the corporation as an entity controlled by the shareholders through election of the board is no longer accurate. Using shareholder primacy as a descriptive construct, a corporation whose board composition is determined to a significant degree by the government without shareholder votes is not a corporation at all.

Normatively, government influence on director selection and retention—when the government does not exercise that control through its share ownership—threatens the very legitimacy of the board, which rests on the directors' election by *owners*. Government control threatens, as well, to turn the ends of the corporation from maximizing shareholder wealth to some other, politically determined, purpose. That purpose might diminish the healthy influence that the focus on shareholder return produces on the efforts of other corporate participants.

## 2. Stakeholder Theory

Stakeholder theorists argue that shareholders are not "owners" of the corporation within the ordinary meaning of that word<sup>243</sup> and that the

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238. *Blasius*, 564 A.2d at 659.

239. *Id.* at 662.

240. *See supra* Part II.A.1.

241. *See supra* note 226 and accompanying text.

242. *See supra* Part II.B.1.

243. *See* Martin Lipton & Paul K. Rowe, *The Inconvenient Truth About Corporate Governance*:

directors are not “agents” of the shareholders.<sup>244</sup> These theorists describe the corporation as a social actor that affects and is affected by a variety of constituencies—not only shareholders, but also employees, suppliers, customers, the communities in which the corporation does business and, in the view of some, the earth itself.<sup>245</sup>

Beyond describing the corporation in this more diffuse way, stakeholder theory argues normatively that corporations should not seek solely to increase the wealth of shareholders. Instead, the corporation should decide its actions after taking into account the effects on all constituencies—each of which has a moral claim on the corporation that goes beyond contract terms and beyond regulatory requirements.<sup>246</sup> This broader normative focus derives, to some extent, from the simple notion that a corporation affecting multiple “constituencies” has the duty to treat each of them well.<sup>247</sup> Some academics further justify a concern for non-shareholder constituencies on an

*Some Thoughts on Vice-Chancellor Strine’s Essay*, 33 J. CORP. L. 63, 66 (2007) (“The whole point of the corporate form is to make clear that shareholders are not owners—that their share ownership gives them no right to claim or exercise control over their pro rata share of the corporation’s assets or profits.”).

244. Martin Lipton & William Savitt, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733, 754–55 (2007) (“Equally misleading is the similar myth that directors are ‘agents’ of shareholder ‘principals.’”).

245. Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1491 (1992) (“A classic question in the theory of corporate law is whether a corporation’s managers should ever exercise their discretion to further the interests of constituencies other than providers of capital. . . . Corporate social responsibility [largely derived from stakeholder theory] may include attention to constituencies such as workers, communities, and consumers, and to goals such as preservation of the environment.”).

246. See, e.g., Michael R. Siebecker, *A New Discourse Theory of the Firm After Citizens United*, 79 GEO. WASH. L. REV. 161, 174–75 (2010) (“With the identity of the corporation organically shifting to accommodate its enhanced role in shaping markets and communities, [c]orporate internal governance issues, once considered strictly economic and confined to internal corporate stakeholders, have been broadened to include . . . the concerns of outside stakeholders beyond the regulatory authority of the chartering state.”) (quoting Larry Catá Backer, *The Private Law of Public Law: Public Authorities as Shareholders, Golden Shares, Sovereign Wealth Funds, and the Public Law Element in Private Choice of Law*, 82 TUL. L. REV. 1801, 1807 (2008)); Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 454 (2006) (“To be a meaningful concept, [corporate] social responsibility [to stakeholders other than shareholders] must extend beyond legal requirements—and thus, by definition, cannot be legally enforceable.”).

247. See, e.g., Reuven S. Avi-Yonah, *The Cyclical Transformations of the Corporate Form: A Historical Perspective on Corporate Social Responsibility*, 30 DEL. J. CORP. L. 767, 814 (2005) (referring to one school of thought that “emphasizes the benefits of corporate existence derived from the state” that create “an implicit contract . . . that the corporation will help the state in mitigating harms that [the corporation] causes even in the absence of legal responsibility”). And other scholars rest broad corporate moral obligations on the notion that parties affected by a business rely upon it. See David Millon, *Communitarianism in Corporate Law: Foundations and Law Reform Strategies*, in PROGRESSIVE CORPORATE LAW 1, 9, 10 (Lawrence E. Mitchell ed., 1995).



economic basis. One set of scholars, for example, characterizes business output as “team production,” with the team including participants other than shareholders and with the corporation able to flourish economically only if it honors obligations to other team members by taking actions beyond those to which the company is legally bound.<sup>248</sup>

Some aspects of current corporate law reflect stakeholder theory. Delaware decisions allow target boards to consider non-shareholder “constituencies” when making decisions on takeover proposals, at least when the target is not simply selling itself to the highest bidder.<sup>249</sup> Even more strikingly, many state corporate statutes—largely in response to hostile takeovers in the 1980s—contain provisions that expressly permit (and in a few instances require) boards to consider constituencies other than shareholders when making business decisions.<sup>250</sup>

The theory and law embodying stakeholder theory’s normative component, however, quickly encounters a central problem. With many different “stakeholders,” the interests of some may conflict with the interests of others, and, if the corporation really owes moral duties to different constituencies (or duties which must be faithfully discharged in order to produce desirable economic results), the business will at times have to make tough choices between stakeholders.<sup>251</sup> For example, a company may have to determine the extent to which it should forego shareholder returns in order to keep its employment numbers high and thereby benefit its labor force. As

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248. The “team production” theorists see participants in a business enterprise (shareholders, creditors, employees, management) as making firm-specific investments of labor or capital—difficult or impossible to retrieve at a value equal to the initial cost—and together creating a product or service that is hard to conceptually disassemble in order to attribute portions of its value to different participants. Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 249, 276 (1999). These theorists therefore argue that, beyond contract, the participants enter into a pact to resolve disputes through a designated hierarchy that “can be viewed as a substitute for explicit contracting . . .” *Id.* at 278; *see also id.* at 319–20. The job of the hierarchy—with the board sitting at the top—is to serve the team as a whole by “control[ling] shirking and rent-seeking” by the different members and to “balance team members’ competing interests in a fashion that keeps everyone happy enough that the productive coalition stays together.” *Id.* at 280–81.

249. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (permitting a board, in analyzing the threat posed by a takeover bid, to consider “the impact on ‘constituencies’ other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)”). *But see* *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (limiting consideration of other constituencies to instances in which “there are rationally related benefits accruing to the stockholders” and prohibiting such consideration altogether when a board is auctioning the company).

250. Martin Lipton, *Twenty-Five Years After Takeover Bids in the Target’s Boardroom: Old Battles, New Attacks and the Continuing War*, 60 BUS. LAW. 1369, 1371 n.3 (2005).

251. *See* Millon, *supra* note 247, at 14 (“In the situations that communitarians are concerned about, the interests of particular non-shareholder constituencies conflict with those of shareholders, and there may well be conflicts among the interests of different nonshareholder constituencies as well.”).

another example, a company owning a plant that operates legally, but unfortunately degrades the air quality in the surrounding community, might have to choose between shutting down that plant (thereby benefiting the community at the expense of both shareholders and the laborers employed at the plant) or continuing to operate the plant (thereby imposing environmental costs on the community while saving the jobs of those who work at the facility and making more money for the shareholders).

Some central corporate body must aggregate the interests of the different stakeholders and mediate trade-offs between them.<sup>252</sup> Not surprisingly, stakeholder theorists have selected the board of directors, occupying the top spot in the corporate hierarchy, to play this key role.<sup>253</sup> Clearly, then, if the government controls or influences board composition, the government can affect the trade-offs between stakeholders, perhaps even wildly shifting the company's priorities.

### 3. Nexus of Contracts Theory

Yet a third theory describes the corporation as a network of contractual relationships.<sup>254</sup> This description posits that the company is “an aggregate of various inputs acting together to produce goods or services,”<sup>255</sup> with “explicit and implicit contracts establishing rights and obligations among the various inputs.”<sup>256</sup> The contracts define shareholder rights against the board and board rights against management—rights set out in the articles of incorporation and the corporate law of the state in which the company is organized.<sup>257</sup> The contracts include, as well, the debt agreements that define

252. See Blair & Stout, *supra* note 248, at 278.

253. See Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L. Q. 403, 435 (2001) (“Just as directors are free to listen (if not always to respond) to the shareholders’ wishes, they are free to listen (if not always to respond) to the wishes of creditors, top executives, and rank and file employees.”); Leo E. Strine, Jr., *The Social Responsibility of Boards of Directors and Stockholders in Charge of Control Transactions: Is There Any “There” There?*, 75 S. CAL. L. REV. 1169, 1174 (2002) (noting the view that “the board acts as a ‘mediating hierarch’ that balances the respective interests”); see also Allen, *supra* note 225, at 271 (“Resolving the often conflicting claims of [the] various corporate constituencies calls for judgment, indeed calls for wisdom, by the board of directors . . .”).

254. BAINBRIDGE, *supra* note 227, at 28–30.

255. *Id.* at 28.

256. *Id.*

257. See FOLK ON DGCL, *supra* note 201, § 102.16 (“A certificate of incorporation is a contract among the stockholders of the corporation” with “[t]he contract rights of the stockholders of the corporation . . . also subject to the provisions of the Delaware General Corporation Law.”). Even the law itself is a matter of contract in an important sense. The organizers of a business choose its form

the rights of those who loan money to the company, and employment agreements with executives and with the non-management labor force.<sup>258</sup>

Some individual or group must coordinate all the contracts so that the corporation operates in some reasonably purposeful way.<sup>259</sup> That coordinator—the “nexus” of the network of contracts—is, by at least one prominent theorist, the board of directors.<sup>260</sup> Indeed, that same theorist, relying in part on the description of the modern corporation as an interconnected set of contracts, argues that public companies today display not shareholder primacy but “director primacy,”<sup>261</sup> claiming that “to the limited extent . . . the corporation is properly understood as a real entity, it is the board of directors that personifies the corporate entity.”<sup>262</sup>

While this analysis has not influenced the law as directly as shareholder primacy and stakeholder theory, the nexus of contracts construct is well recognized among corporate scholars<sup>263</sup> and puts the board at the center of the web of relationships constituting the company.<sup>264</sup> The identity of board members and those who select directors arguably ranks at the top of all corporate concerns for anyone who embraces this theory—certainly for those who conclude that corporations today display “director primacy.”

Thus, this third theory, too, highlights the importance of government influence over director selection. If the government controls the board, it controls the nexus of the contracts. Such control could affect any or all of the principal contracts constituting the corporation and could pull the entire web of contracts in one direction or another.

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(e.g., “as a corporation, trust, partnership, mutual, or cooperative”). FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 2 (1991). They choose the state in which to incorporate, with that state’s law thereafter governing the “internal affairs” of the company, including “the powers and obligations of a corporation’s managers vis-à-vis the corporation and its shareholders, and the rights and duties of the . . . shareholders vis-à-vis the corporation, its management and the other shareholders . . .” FRANKLIN A. GEVURTZ, *CORPORATION LAW* §§ 1.2, 1.2.1 (2d ed. 2010).

258. See Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 Nw. U.L. REV. 547, 553 (2003) [hereinafter Bainbridge, *Director Primacy*].

259. *Id.* at 556.

260. BAINBRIDGE, *supra* note 227, at 33–34 (citations omitted):

[T]he defining characteristic of a corporation is the existence of a central decision maker vested with the power of fiat—i.e., a central coordinator that is a party to the set of contracts we call the firm and that has the power to effect adaptive responses to changed conditions by fiat.

If the corporation has such a nexus, where is it located? The Delaware code, like the corporate law of every other state, gives us a clear answer: the corporation’s “business and affairs . . . shall be managed by or under the direction of the board of directors.” Put simply, the board is the corporate nexus of contracts.

261. Bainbridge, *Director Primacy*, *supra* note 258, at 550.

262. *Id.* at 560.

263. See, e.g., ARTHUR R. PINTO & DOUGLAS M. BRANSON, *UNDERSTANDING CORPORATE LAW* 109 (3d ed. 2009).

264. See Bainbridge, *Director Primacy*, *supra* note 258, at 550.

*D. A Response to Critics*

As the previous sections show, government control over board membership is important from a number of different perspectives. Two strains of academic thought, however, argue against any urgency in bringing government influence on public company board membership out of the darkness and into the light.<sup>265</sup>

The first concludes that boards—despite their legal authority and their effect on some important business matters—have little impact on most companies' business most of the time.<sup>266</sup> This view suggests that the identity of directors—and those who select the directors—is of so little importance that the disclosure of currently cloaked government efforts to change boards is not worth the cost such disclosure would impose.<sup>267</sup> The second strain argues that shareholders inevitably have scant influence on board membership.<sup>268</sup> This school of thought implies that “protecting” the shareholder franchise by revealing how government influence supplants it, or simply revealing government influence because it deviates from the norm of shareholder control over director selection, protects a mere chimera or reveals a departure from a formal but empty protocol.<sup>269</sup> Neither school of thought should deflect us from the reform this Article advocates.

## 1. The Argument That Most Boards Are Mostly Unimportant

Some scholars contend that, although state law nominally places the board of directors at the top of the corporation, and although the financial press has published the extraordinary actions of a handful of boards, the boards of most publicly traded corporations are overwhelmingly passive, and, hence, unimportant. Board passivity, these academics posit, derives from a host of factors. Boards fail to effectively monitor executive performance in part because the boards themselves selected the executives, and boards fail to skeptically evaluate the results of corporate strategy because the boards in one way or another approved those strategies before or while the executives implemented them.<sup>270</sup> Ironically, this debility increases

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265. See *infra* Parts IV.D.1–2.

266. See *infra* Part IV.D.1.

267. *Id.*

268. See *infra* Part IV.D.2.

269. *Id.*

270. See, e.g., JONATHAN R. MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 70 (2008).

as boards become more deeply involved in strategy and executive hiring.<sup>271</sup> The greater their involvement, the greater the directors' personal commitment to any strategic or hiring decision and, therefore, the more difficulty the board experiences in critically evaluating that decision.<sup>272</sup>

In addition to this inherent weakness, boards are often "captured" by top executives because top executives are inevitably involved in the selection of new directors and the recommendation for re-nomination of sitting board members, and the directors, well knowing this to be the case, are reluctant to criticize their patrons.<sup>273</sup> Further, management's control over the agenda of board meetings, and over the information that the board considers as it attends to that agenda, weakens the board as a source of independent power.<sup>274</sup> The need for speedy board decisions on such matters as mergers and acquisitions—after executives dump data on directors—aggravates this initiative/information disparity.<sup>275</sup> So do social norms of collegiality, which discourage aggressive questions and frank criticism by board members of management plans and results.<sup>276</sup> And, of course, those board members who are not officers are part-time participants in the corporation, inherently at a disadvantage as compared with management in influencing company action, because management works at the company full time.<sup>277</sup>

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271. *See id.* at 63 ("Boards cannot be expected to be more objective in their evaluations of senior management at the same time that they are being required to become increasingly involved with senior management in the decisions about strategy . . .").

272. *See id.*

273. *Id.* at 93–95.

274. *See* MACEY, *supra* note 270, at 83 ("Generally speaking, management's control of the flow of information to the board . . . creates a dynamic in which management is able to capture its board . . . by controlling the nature of the information available to directors when making decisions."). "Boards . . . lack both the inclination and the capacity to generate information for themselves through a process that is independent of management." *Id.* at 94. "The asymmetry of information . . . [between management and a board] has long been recognized as an impediment to the ability of boards . . . to monitor management effectively." *Id.* at 96.

275. *See id.* at 60–61 ("Directors who challenge management's recommendations or who simply demand more information risk being . . . accused of impeding the company's ability to respond to new opportunities efficiently.").

276. *Id.* at 61–62.

[D]irectors are supposed to be 'team players' who 'get along' with senior executives and their fellow directors, and perform their duties in an atmosphere of comfortable collegiality.

....

Where a CEO makes a proposal to a group of board members, the first board member to raise questions or to disagree with management bears the greatest risk of being branded uncooperative or non-collegial. With this in mind . . . he has an incentive to remain quiet . . .

*Id.*

277. George W. Dent, Jr., *Academics in Wonderland: The Team Production and Director Primacy Models of Corporate Governance*, 44 HOUS. L. REV. 1213, 1242 (2008) ("Most boards meet about once a month, too little time to match the managers' knowledge about the firm."); Oliver E. Williamson, *Corporate Boards of Directors: In Principle and in Practice*, 24 J.L. ECON. & ORG.

If all of these considerations mean that boards are fundamentally unimportant—as a matter of fact rather than theory and corporate statutes—then the identity of those who influence the composition of boards is also of little moment. In that case, there is no pressing need to override whatever considerations counsel against disclosure of government influence on the selection and retention of directors.

One powerful answer is that society has made a very determined effort in the last two decades to address the problems just identified in order to increase the power of boards, particularly in relation to top management. In 1999, all three major domestic trading platforms adopted rules effectively requiring public company boards to have audit committees and requiring that the audit committees—rather than management—possess ultimate authority over the hiring, evaluation, and replacement of the outside auditor.<sup>278</sup> After the Enron and WorldCom debacles, Congress, through the Sarbanes-Oxley Act, put this requirement into law.<sup>279</sup>

The scandals also prompted the exchanges, particularly the New York Stock Exchange, to radically revise listing standards to invigorate boards of directors in other ways.<sup>280</sup> Today, those listing standards require that a majority of directors serving on each public company board be “independent,”<sup>281</sup> precisely so that the board can “exercise independent judgment in carrying out [its] responsibilities.”<sup>282</sup> To increase the probability that this majority will vigorously monitor management and substantively contribute to corporate actions, the listing standards—in

247, 254 (2008).

278. Order Approving Proposed Change in NASDAQ Audit Committee Requirements, 64 Fed. Reg. 71,523, 71,524–25 (Dec. 14, 1999); Order Approving Proposed Change in American Stock Exchange Audit Committee Requirements, 64 Fed. Reg. 71,518, 71,519 (Dec. 14, 1999); Order Approving Proposed Change in New York Stock Exchange Audit Committee Requirements, 64 Fed. Reg. 71,529, 71,529–30 (Dec. 14, 1999).

279. See Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002). The new law required the SEC to issue regulations requiring the exchanges to decline to list securities unless an issuer’s audit committee is “directly responsible for the appointment, compensation, and oversight of the work of [the auditor] . . . (including resolution of disagreements between management and the auditor regarding financial reporting)” and unless the auditor reports “directly to the audit committee.” *Id.* § 301; 15 U.S.C. §§ 78j-1(m)(1)(A), 78j-1(m)(2) (2006). See the resulting regulation, 17 C.F.R. §§ 240.10A-3(a)(1), 240.10A-3(b)(2) (2012), and the listing standards requiring compliance with the regulation, NYSE LISTED COMPANY MANUAL, *supra* note 31, § 303A.06; NASDAQ, INC., STOCK MARKET RULE 5605(c)(3), available at <http://nasdaq.cchwallstreet.com/>.

280. See generally Order Approving Proposed Rule Changes Relating to Corporate Governance at NYSE and NASDAQ Listed Companies, 68 Fed. Reg. 64,154 (Nov. 4, 2003).

281. NYSE LISTED COMPANY MANUAL, *supra* note 31, § 303A.01.

282. *Id.* § 303A.01 cmt.

addition to imposing a general test for independence—exclude from “independent” directors those who have specified relationships that might cause them to unduly favor management.<sup>283</sup> For example, a director is not independent if he or she receives “more than \$120,000 in direct compensation from the . . . company” “during any twelve-month period”—compensation that management could control and use to influence the director’s action in the boardroom.<sup>284</sup> In order to “empower non-management directors to serve as a more effective check” on executives, the NYSE listing standards also mandate that “the non-management directors of each listed company meet at regularly scheduled executive sessions,” without company officers present.<sup>285</sup>

In a further effort to increase independent decision making by directors, the NYSE requires that each listed company’s board have, in addition to an audit committee, both a nominating/corporate governance committee and a compensation committee.<sup>286</sup> *All* of the directors serving on these three key committees must satisfy the new “independence” definition.<sup>287</sup> And the NYSE standards include lists of specific tasks that these three committees must undertake in order to ensure that they actually perform their work.<sup>288</sup>

The independent directors on the nominating committee, for example, are charged with “identify[ing] individuals qualified to become board members, consistent with criteria approved by the board, and . . . select[ing], or . . . recommend[ing] that the board select, the director nominees for the next annual meeting of shareholders.”<sup>289</sup> At least formally, this takes director selection out of management’s hands and thereby removes the influence that the top executive can exercise over directors by controlling their tenure on the board. To ensure that the nominating committee can control the search for director candidates, the commentary to the NYSE listing standards states that “the charter [for each such committee] should give [that] committee sole authority to retain and terminate any search firm to be used to identify director candidates, including sole authority to approve the search firm’s fees and other retention terms.”<sup>290</sup>

Similarly, by federal law, the listing standards now require express

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283. *Id.* § 303A.02.

284. *Id.* § 303A.02(b)(ii).

285. *Id.* § 303A.03.

286. *Id.* §§ 303A.04, 303A.05, 303A.06.

287. *Id.* §§ 303A.04(a), 303A.05, 303A.07(a).

288. The standards impose the committees’ duties by requiring that each committee have a written charter addressing specific duties and responsibilities that the standards lay out. For example, the standards set out eight specific duties for the audit committee. *Id.* § 303A.07(b)(iii); *see also id.* § 303A.04(b)(i) (tasks for the nominating/corporate governance committee); *id.* § 303A.05(b)(i) (tasks for the compensation committee).

289. *Id.* § 303A.04(b)(i).

290. *Id.* § 303A.04 cmt.

authority for each audit committee “to engage independent counsel and other advisors, as it determines necessary to carry out its duties” and require each public company to pay for any advisor that the audit committee hires.<sup>291</sup> The recent Dodd-Frank Wall Street Reform Act requires that compensation committees have similar power to hire advisors.<sup>292</sup>

All of these laws, regulations, and listing standards reflect society’s determination that boards should—and can—serve as an independent force at the top of the corporate hierarchy. Instead of giving up on boards as have some academics, society has by these reforms doubled down on directors. This is, accordingly, not the time to conclude that boards are so unimportant that the general thrust of federal securities law—disclosure—should be ignored when the government actively attempts to control board membership.

## 2. The Argument that Shareholder Election of Boards Accomplishes Naught

As set out above, prevalent state law prescribes that the shareholders elect and remove directors.<sup>293</sup> The notion that we need disclosure when government influence on board composition displaces shareholder control over board membership implies that shareholder control over director selection and retention is “ordinary,” or “better,” or “more legitimate,” in some sense, than government control.<sup>294</sup> That implication, in turn, rests on a notion that shareholders exercise their franchise to elect boards in a meaningful way.

For years, however, academics have argued that the shareholders of widely held public corporations do not care about who the directors are and that, even if the shareholders care in some abstract sense, they do not, in practice, evaluate director candidates carefully. By this view, shareholders are “rationally apathetic” in part due to collective-action problems; it simply does not pay for one shareholder, holding a sliver percentage of total shares, to spend the resources to change a board,<sup>295</sup> or even in many instances to

291. 15 U.S.C. §§ 78j-1(m)(5), 78j-1(m)(6) (2006); 17 C.F.R. §§ 240.10A-3(b)(4), 240.10A-3(b)(5)(ii) (2012).

292. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010 & Supp. V 2011), § 952 (codified as amended at 15 U.S.C. §§ 78j-3(c)–(e) (2006 & Supp. V 2011)) [hereinafter Dodd-Frank].

293. See *supra* notes 231–35 and accompanying text.

294. See *supra* Part IV.C.1.

295. Consider an investor who holds one million shares of a company with one billion shares



gather information to decide how to vote in director elections.<sup>296</sup> Rational apathy affects even institutional investors, such as mutual funds, since they often diversify their holdings among many different portfolio companies, owning only a small proportion of the stock issued by any one of them.<sup>297</sup>

Even if shareholders were sufficiently motivated to seek information about director candidates, shareholders in the main (so the argument goes) simply can never obtain the facts they need to make intelligent choices.<sup>298</sup> And if shareholders—one by one—could somehow get hold of and analyze relevant information, they would risk securities law violations—absent expensive compliance with complicated securities rules—if they ran their own director candidates and solicited proxies for that dissident slate.<sup>299</sup>

To top it off, most director elections are uncontested,<sup>300</sup> with only the candidates nominated by the sitting board running,<sup>301</sup> so that the shareholders do not really have a choice anyway. And plurality voting—the default voting protocol under state statutes<sup>302</sup>—ensures that in uncontested elections a director candidate receiving even one vote in his or her favor will win a seat on the board, even if all the other votes are “withheld” in protest.<sup>303</sup>

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outstanding. Suppose that investor could, by spending \$1,000,000, elect a new board and that the new board’s actions would raise the stock price by seventy-five cents a share. Shareholders overall would enjoy a huge gain—\$750,000,000. But the investor who went to the trouble of organizing and funding the campaign for board change would see an increase of only \$750,000 in his shareholdings, thereby suffering a net \$250,000 loss on the effort. See Dent, *supra* note 277, at 1253.

296. MACEY, *supra* note 270, at 203.

297. *Id.* at 199–200.

298. A sophisticated version of this argument contends that companies will never disclose all pertinent information, and therefore shareholders will never have all such information. Therefore, as ill-informed shareholders acquire power at the expense of better-informed management, the probability that a company will be operated in a way that optimizes its fundamental value—as opposed to its stock price—declines. See William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 696–703 (2010).

299. If “two or more [shareholders] agree to act together for the purpose of . . . voting . . . equity securities of an issuer, the group formed thereby shall be deemed to have acquired beneficial ownership . . . of all equity securities of that issuer beneficially owned by any such persons.” 17 C.F.R. § 240.13d-5(b)(1) (2012). Such a group collectively owning more than ten percent of a class of equity securities is subject to the reporting requirements in section 16(a) of the Exchange Act. 15 U.S.C. § 78p(a) (2006 & Supp. V 2011); 17 C.F.R. § 240.16a-1(a)(1) (2012). Such a group purchasing more than five percent of such a class of securities is subject to the reporting requirements in section 13(d). See 15 U.S.C. § 78m(d) (2006); 17 C.F.R. § 240.13d-5(b)(1). If such a group “solicits” proxies for voting in director elections, then, with some exceptions, that group must comply with the proxy solicitation law and regulations. 15 U.S.C. § 78n(a) (2006 & Supp. V 2011); 17 C.F.R. §§ 240.14a-1–240.14a-15 (2012).

300. See Bebchuk, *Shareholder Franchise*, *supra* note 33, at 682–83 (finding only about thirty contested elections per year during 1996 through 2005).

301. See, e.g., NYSE LISTED COMPANY MANUAL, *supra* note 31, § 303A.04.

302. See, e.g., DEL. CODE ANN. tit. 8, § 216(3) (2011).

303. William K. Sjostrom, Jr. & Young Sang Kim, *Majority Voting for the Election of Directors*, 40 CONN. L. REV. 459, 466–67 (2007); Vincent Falcone, Note, *Majority Voting in Director*

Vast changes—both in the investing industry and, very determinedly, in the rules and regulations that govern that industry—have attacked virtually all these problems over the last several decades. On the industry side, activist hedge funds have acquired stockholdings in a fair number of publicly traded companies.<sup>304</sup> Those funds seek to change the companies' businesses—in many cases by threatening a proxy fight for board seats and in some cases by carrying out that threat.<sup>305</sup> The hedge funds overcome the collective-action problem in part simply by owning a sufficient stake to make their efforts worthwhile to them, and, in part, by a “wolf pack” effect—with one activist hedge fund leading the attack and other such funds then buying stock in the attacked public company and supporting the initiating aggressor.<sup>306</sup> And, once an activist hedge fund launches an attack on a management and an incumbent board, traditional institutional investors such as mutual funds sometimes join the fight.<sup>307</sup> The companies that the funds assault generally improve their performance.<sup>308</sup> All of this works because the shareholders are employing, or threatening to employ, their franchise.

Institutional investors' reliance on professional proxy advisors, who gather information on director candidates and other matters on which shareholders vote, also reduces collective-action problems by effectively spreading the cost of acquiring information among the proxy advisor's many clients.<sup>309</sup> Those advisors reduce costs still more by shouldering the

*Elections: A Simple, Direct, and Swift Solution?*, 2007 COLUM. BUS. L. REV. 844 (2007).

304. See generally William W. Bratton, *Hedge Funds and Governance Targets*, 95 Geo. L.J. 1375 (2007).

305. See *id.* at 1401–05, Table IV (finding 130 domestic companies attacked by hedge fund between January 1, 2002 and June 30, 2006, at 1385, and describing typical hedge fund tactics, including 60 cases in which the hedge fund initiated a proxy contest); see also Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX. L. REV. 987, 998–1001 (2010).

306. Bratton, *supra* note 304, at 1403.

307. Kahan & Rock, *supra* note 305, at 1003–05.

308. Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1730–31, 1739 (2008) (examining hedge fund activism against 882 target companies from the beginning of 2001 through the end of 2006; finding “large positive average abnormal [target company stock price] returns, in the range of 7% to 8%, during the (–20,+20) announcement window,” with “the positive returns at announcement . . . not reversed over time, as there is no evidence of a negative abnormal drift during the 1-year period subsequent to the announcement” and “[t]he positive market reaction . . . also consistent with ex post evidence of overall improved performance at target firms”).

309. Kahan & Rock, *supra* note 305, at 1005–07.

mechanical burden of casting institutional investors' votes in corporate elections.<sup>310</sup>

To address the issues created by plurality voting, shareholder advocates, including institutional investors, have urged boards to adopt "majority voting" rules.<sup>311</sup> Those rules prevent seating a director who, when running unopposed, fails to receive "for" votes from a majority of shares cast on his or her candidacy.<sup>312</sup> Beginning in earnest in 2004 with about a dozen shareholder proposals for such voting,<sup>313</sup> the majority-voting protocol, in one form or another, governed director elections at nearly eighty percent of Standard & Poor's 500 companies by 2012.<sup>314</sup>

To address the difficulty created by elections offering shareholders only candidates selected by the incumbent board, the SEC twice (in 1978 and 2003) adopted regulations to facilitate shareholder suggestions to nominating committees.<sup>315</sup> Much more aggressively, the SEC in 2003 proposed, but did not adopt, a regulation requiring each public company to include in its proxy statements and on its proxy forms the names of candidates nominated by a shareholder, or a group of shareholders.<sup>316</sup> The SEC proposed another version of such a rule in 2009,<sup>317</sup> and adopted that regulation, with further revisions, in 2010,<sup>318</sup> after Congress explicitly granted the Commission the authority to issue such a proxy access rule.<sup>319</sup> While the D.C. Circuit vacated the SEC regulation in 2011 on the ground that the Commission had not adequately apprised itself of costs and

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310. *Id.* at 1005.

311. *See* Falcone, *supra* note 303, at 853–56.

312. Kahan & Rock, *supra* note 305, at 856.

313. *Id.* at 854–55.

314. Holly J. Gregory, *Trends in Director Elections: Key Results from the 2012 Proxy Season*, PRACTICAL LAW THE JOURNAL 20, 20 (2012) ("According to data from Alliance Advisors (using FactSet and company filings), about 80% of S&P 500 companies have since adopted some form of majority voting . . .").

315. Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally, 43 Fed. Reg. 58,522, 58,527, 58,831 (Dec. 14, 1978) (adding then Item 6(d) to Schedule 14A, which, in 6(d)(2), required that a company seeking proxies for election of directors disclose whether its nominating committee would consider candidates suggested by shareholders, and, if so, the procedure that shareholders should follow to make suggestions); Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors, 68 Fed. Reg. 69,204, 69,221 (Dec. 11, 2003) (revising 17 C.F.R. § 240.14a-101 Schedule 14A Item 7(d) (2012), which now cross-references 17 C.F.R. 229.407(c)(2), with subparts (ii) and (iii) requiring a company to describe its nominating committee's policy regarding nominees recommended by shareholders and to state, if it does not have a policy, why the company believes it is appropriate not to have one).

316. Security Holder Director Nominations, 68 Fed. Reg. 60,784 (Oct. 23, 2003).

317. Facilitating Shareholder Director Nominations, 74 Fed. Reg. 29,024 (June 18, 2009).

318. Facilitating Shareholder Director Nominations, 75 Fed. Reg. 56,668 (Sept. 16, 2010).

319. Dodd-Frank, *supra* note 292, § 971 (codified at 15 U.S.C. § 78n(a)(2) (Supp. V 2011)).

benefits,<sup>320</sup> the persistent effort to give shareholders access to the company's proxy solicitation machinery in order to provide alternatives to the candidates nominated by the sitting board reflects a continuing commitment to ensure that the shareholders have a meaningful role, rather than only a formal role, in selecting corporate directors.

The SEC has also acted to require that mutual funds cast their votes in director elections in a thoughtful way. As the owner of the stock in its portfolio companies, a mutual fund has the right to vote that stock in the director elections at those companies.<sup>321</sup> Specifically to "encourage funds to become more engaged in corporate governance of issuers held in their portfolios,"<sup>322</sup> the SEC adopted in 2003 rules that (i) require the investment advisors running the funds to adopt and implement "written policies and procedures that are reasonably designed to ensure that the advisor[s] vote[]" portfolio company shares "in the best interest of" the funds<sup>323</sup> and (ii) require the funds to disclose how they vote in corporate elections.<sup>324</sup>

This Article's purposes do not include arguing that these regulatory reforms significantly increase shareholder power in most board elections, or that shareholder votes in director elections regularly and significantly affect corporate policy.<sup>325</sup> But these reforms aim directly at the very factors that observers say prevent shareholders from effectively exercising their voting

320. *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011).

321. *Disclosure of Proxy Voting Practices and Proxy Voting Records by Registered Management Investment Companies*, 68 Fed. Reg. 6,564, 6,564–65 (Feb. 7, 2003) [hereinafter *Mutual Fund Proxy Voting Disclosure*].

322. *Id.* at 6566.

323. *Proxy Voting by Investment Advisors*, 68 Fed. Reg. 6,585, 6,586, 6,593 (now providing, at 17 C.F.R. § 275.206(4)–6(a), that it is a "fraudulent, deceptive, or manipulative act, practice or course of business" under the Investment Advisors Act to exercise voting authority for a fund without adopting and implementing such policies and procedures).

324. *Mutual Fund Proxy Voting Disclosure*, *supra* note 321, at 6,581–85 (requiring funds to disclose their votes in an SEC filing available to the public via the Commission's database and revising various forms to mandate that mutual funds advise their shareholders that they can obtain fund voting records by accessing the SEC database or by requesting information from the fund or, if the fund posts its voting record on its website, by visiting the fund website); *see also* 17 C.F.R. § 270.30b1-4 (2012); SEC, Form N-1A, at Item 27(d)(5) (2010); SEC, Annual Report of Proxy Voting Record of Registered Management Investment Company (Form N-PX) (2003).

325. Recent research shows that shareholder voting can affect company policy even in uncontested elections. Cai et al., *supra* note 99, at 2410, 2417 (finding that "a 1% decrease in the average vote for a compensation committee member reduces unexplained [positive] CEO compensation by \$143,000 in the next year" and that "a 1% decrease in the compensation committee chair votes is associated with a reduction in unexplained [positive] CEO compensation by approximately \$220,000 in the following year," with "unexplained CEO compensation" being the compensation that cannot be predicted by such factors as industry and recent stock returns).

rights. And the reforms have continued into very recent years. The reforms therefore manifest a continuing societal commitment to shareholder power—including, particularly, shareholder power to elect directors. That commitment—together with the emergence of activist hedge funds that have, at least in some number of cases, achieved corporate change through the threat of shareholder votes in director elections<sup>326</sup>—weakens any argument that it is unnecessary or unimportant to know whether government, instead of shareholders, controls board composition because shareholder control is either illusory or irrational. It would be passing strange to make all these efforts to realize shareholder control over board composition, then deliberately forego shedding light on active interference with that control by the government—particularly in cases like BofA, where the government does not exercise such control through any shareholder voting rights that it holds.<sup>327</sup>

#### IV. A PROPOSAL TO CLOSE THE HOLES

Disclosure of government attempts to influence the composition of a public company's board in a securities filing available on the SEC's website solves all the problems set out above. It provides prompt, material information about government influence. It permits shareholders to consider what that influence portends for company strategy. It lets all of us consider whether government influence is consistent with our notion of what a corporation is and what purposes it should serve.

This Article therefore proposes a new SEC reporting requirement aimed specifically at government efforts to change a public company's board membership, a requirement to file a new Form GIB ("Government Influence on Board"), which when submitted would be immediately available on the database that the SEC maintains for public access. Such a proposal raises five questions, addressed in the subparts that follow: (1) What should a Form GIB disclose?;<sup>328</sup> (2) When should the Form be filed?;<sup>329</sup> (3) Who should file the Form?;<sup>330</sup> (4) Should the filing requirement include an exception applying when the government determines that disclosure is likely to produce significant harm?;<sup>331</sup> and (5) Do we really need to *require*

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326. See Bratton, *supra* note 304, at 1405–06 (documenting a high proportion of instances in sample in which activist funds in hostile engagements with targets obtained concessions, including "board membership (40% of the hostile targets), sale or liquidation of the target (28%), and the sale or the sale or spin off of a division (21%)").

327. See *supra* Part II.B.

328. See *infra* Part V.A.

329. See *infra* Part V.B.

330. See *infra* Part V.C.

331. See *infra* Part V.D.

disclosure by creating the new Form GIB, or can we simply rely on companies and the government to tell us when the government tries to change a board?<sup>332</sup>

#### A. *What to Disclose*

Clearly, disclosure should include the fact of government influence, identify the communication through which the government exercised its influence, and provide the date of the communication. But the report should identify the participants in the communication as well—the name and title of the government official and the name and title of the company participant.<sup>333</sup> The more highly placed the government participant, or the more power the official has over the company as a result of his or her position, the greater the pressure will be. The more influential the company participant, the more likely the pressure will be communicated to those in the company who matter—who could encourage sitting directors to leave the board or affect the selection of new directors between shareholder meetings, or control nominations at future shareholder meetings.

The report should include the substance of the communication—what was said. That substance includes the board change that the government requests, suggests, demands, or recommends, set out in the same detail as in the communication itself. If the government includes a time frame in which it wishes or demands or recommends the change occur, the report should include that, too. The extent and the schedule of the government's desired change constitute, by definition, the influence that the government seeks to exert. If the government states that unless the company makes the change, the government will take some action against the company or withhold some benefit from the company, the Form GIB should include those statements. That part of the communication identifies the power that the government is using to effectuate the change and affects the likelihood that the company will make the change the government wants.

The report, relatedly, should include the form of the communication.

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332. *See infra* Part V.E.

333. The securities law in other areas requires accounts of particular conversations or meetings. For example, a company seeking proxies from shareholders to approve a merger must describe past contacts and negotiations leading to the proposed deal. 17 C.F.R. § 240.14a-101, Schedule 14A, Item 14(b)(7) (2012) (cross-referencing 17 C.F.R. §§ 229.1005(b)–229.1005(c)). See the descriptions of two conversations between Ken Lewis and John Thain on September 13, 2008 included in the proxy solicitation to shareholders of BofA and Merrill Lynch in connection with the merger of those two companies. Bank of Am. Corp., Proxy Statement (Schedule 14A), at 49 (Nov. 3, 2008).

The form of the suggestion, recommendation, or demand affects the power behind it.<sup>334</sup> In the BofA case, the fact that the government sought a board change through a bank regulatory enforcement mechanism (the MOU) put special force behind the government's stated desire.<sup>335</sup>

The report should include the reason or purpose for the government's request, suggestion, demand, or recommendation to the extent that the communication revealed that reason or purpose. Particularly in the case of a bank in which the government does not have a significant equity interest and therefore does not have a simple profit motive—and in light of the fact that bank regulatory authorities can issue an MOU whether or not the government owns an equity interest in a bank or its holding company—the reason *for the government's effort to change the board* may be unclear. That is, even where the government has a well-defined reason for intervening in the affairs of a financial institution (e.g., to prevent the bank from engaging in unsound practices consisting of particular kinds of transactions), identification of that reason may not explain why the government is seeking to *change the board* as opposed to, for example, simply forbidding the bank from entering into the kind of transaction that the government deems unsound. The government might want a board change because it concludes that the board cannot adequately monitor the executives at a company, or because the government believes that the board needs greater expertise in some area such as risk analysis and control.<sup>336</sup> Whatever the expressed reason, the Form GIB should reveal it.

#### *B. When to Disclose*

We should require disclosure only of serious government efforts to change a public company board. A casual comment by one government official to another—no matter how lofty their positions on an organization chart—should not trigger a filing, for such a trigger would inhibit discussion among officials. Nor should an out-loud rumination by a midlevel government worker to a company officer or employee of modest authority

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334. Fitzpatrick, *Obey*, *supra* note 79, at C1 (reporting that BofA was operating under a secret regulatory sanction that required it to overhaul its board and “address perceived problems with risk and liquidity management”).

335. *Id.* (“The MOU is the most serious procedural action taken against Bank of America by federal regulators since the financial crisis erupted.”); *see supra* Part II.B.2.

336. The securities laws and regulations are no strangers to a requirement that filers state their purpose. A purchaser of more than five percent of a class of a public company's equity securities must file a Schedule 13D that, among other things, must state the “purpose of the purchase or prospective purchases,” including “any plans or proposals” for an extraordinary corporate transaction such as a merger, a sale of a material amount of the company's assets, or “any other major change in [the issuer's] business or corporate structure.” 15 U.S.C. § 78m(d)(1)(C) (2006); 17 C.F.R. §§ 240.13d-1(a), 240.13d-101 Items 4, 4(b), (c), (f) (2012).

prompt a report. Such talk is so unlikely to change board membership that reporting it would needlessly clutter the information landscape.<sup>337</sup>

The effort to define a disclosure trigger could proceed by considering a wide continuum of government-company contacts, all varying by participants and substance. Such an analysis could produce a multifactor test that would determine when to require disclosure of government pressure. The law, securities law in particular, includes such tests.<sup>338</sup> But multiple criteria of this sort are hard to apply, and while securities law sometimes employs deliberately general rules,<sup>339</sup> the SEC often opts for bright lines.<sup>340</sup> This Article favors a clear and easily applied test, in part because it will facilitate compliance and lower cost by minimizing counsel hours spent mulling multiple factors.

A bright-line test will also advance the goal of *timely* disclosure. The current Form 8-K requires a report of board departures and additions<sup>341</sup> within four business days of the event.<sup>342</sup> This Article proposes a similar deadline for disclosure of government pressure to change a board. A bright-line trigger should help reporting parties identify a reportable event quickly, without any need for lengthy legal consultation, and thereby meet this four-day deadline.

To ease compliance, permit rapid identification of instances in which a report is due, and capture the instances in which serious government pressure to change a board occurs, a Form GIB should be filed within four business days of:

337. The securities laws have long been sensitive to this very consideration. *See, e.g.*, *Basic, Inc. v. Levinson*, 485 U.S. 224, 231 (1988) (noting the need to avoid setting too low a floor for materiality, as a “minimal standard might bring an overabundance of information within its reach” and produce “an avalanche of trivial information”) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 448 (1976)).

338. *See, e.g.*, Non-Public Offering Exemption, 27 Fed. Reg. 11,316, 11,317 (Nov. 16, 1962) (describing the five-factor test for integration of offerings); HAZEN, *supra* note 216, § 4.24[1] (explaining the multifactor test for an exemption from registration under section 4(2) of the Securities Act of 1933).

339. The legal test for materiality is very general, and the Supreme Court has rejected efforts to reduce that test to a bright-line criterion, even in specific contexts. *See Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1318–21 (2011).

340. To address the uncertainty created by the multifactor test for integrating offerings, the rules for exempt offerings include bright-line safe harbors that will ensure that offerings are not integrated. *See, e.g.*, 17 C.F.R. § 230.502(a) (2012). To address the uncertainty created by the multifactor test for the section 4(2) exemption from registration, the regulations governing exempt offerings include a detailed rule, which, if issuers comply with its more certain criteria, will exempt an offering from the 33 Act registration requirement. 17 C.F.R. § 230.506 (2012).

341. *Supra* notes 148–50, 154–55 and accompanying text.

342. SEC Form 8-K, *supra* note 147, at General Instruction B.1.



1. a communication by any federal government official in the executive branch (including any independent entity in that branch, such as the Federal Reserve),
  - a. acting in his or her official capacity,
  - b. directly or indirectly,
2. with a public company's chief executive officer, or any current board member,
3. in which the government official,
  - a. directs, requests, recommends, or states a preference that the company change its board membership (including any endorsement of a board change, where the company has requested such an endorsement, and any statement that the government does not object to a board change, where the company has asked whether the government objects or not), or
  - b. states that the government will direct a change in board membership unless the company makes the change that the official identifies, or
  - c. states that another government action, which affects the company, is more or less likely depending on whether the company changes its board membership.

By limiting the trigger to contacts between the government and the corporation, the trigger will not require a report when the government, *inter se*, discusses the desirability of a board change. By limiting the trigger to contacts with the highest executive in the public company or any member of the sitting board, the trigger will require a report only when the government's direction, request, endorsement, or statement of preference is so serious that the government has communicated it to the very highest levels of the company. By limiting the trigger to communications from an official in the executive branch acting in his or her official capacity, the rule permits any official to express a personal opinion without triggering a report. The "official capacity" limitation also forestalls GIB filings to report off-the-cuff comments that do not reflect government policy.

By mandating a filing when an executive branch official makes the reportable communication "indirectly," as well as "directly," the trigger aims to defeat efforts to bypass the disclosure requirement by communicating a direction, request, statement of preference, or endorsement to an intermediary such as a general counsel, and asking that the intermediary pass

the substance of the communication on to the CEO or the current board. Admittedly, including indirect contacts introduces a modicum of ambiguity. But without including “indirect” communications, the reporting rule could be easily bypassed. Moreover, the securities laws and rules regularly employ the phrase “directly or indirectly,”<sup>343</sup> so it is familiar to lawyers advising the reporting parties.

Including communications by the government “directly or indirectly” with a company’s top executive or any board member would reach any case like BofA. A government official might, by bureaucratic rule, address an MOU or other stylized communication to some particular corporate officer—such as a compliance officer—with the intention that the document travel to the CEO and the board. Without including “indirect” communications in the new rule, such a bureaucratic routine could frustrate disclosure.

Similar reasoning motivates the inclusion of communications in which the government endorses a board change that the company suggests, where the company seeks such an endorsement. Without requiring disclosure of those contacts, the government and companies could defeat the disclosure mandate by simply adding a few steps to the dance. For example, a top Treasury official might say to a board chair that the Treasury would like to “be in the loop” on board changes. The board chair might then run prospective changes by some Treasury official, asking in each case whether the Treasury had an objection. A government official stating that the Treasury had no objection would state a preference within the meaning of the rule, and the rule would therefore require a filing to report the Treasury’s blessing.

To trigger a report, a communication must concern a “change in board membership.” For this purpose a “change in board membership” means the departure of one or more directors or the addition of one or more directors. A departure includes a resignation, removal for cause, a failure to re-nominate for another term, or a refusal to stand for reelection. An addition includes the election of a director by the board between shareholder meetings or the nomination of a director candidate who is not an incumbent. The new rule would require a report when the government identifies

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343. See, e.g., 15 U.S.C. § 78j(b) (2006 & Supp. V 2011) (and related 17 C.F.R. § 240.10b-5 (2012), prohibiting “any person” [from] “directly or indirectly” committing deceptive acts in connection with the purchase or sale of securities); 15 U.S.C. § 78n(d)(1) (2006 & Supp. V 2011) (making it unlawful for “any person, directly or indirectly” to make a tender offer without filing forms as the SEC requires if, after successful completion of the offer, the person would own more than five percent of an equity security registered under section 12 of the Exchange Act).

particular directors who should resign or be added, or when the government phrases the desired board change in more general terms, such as that some particular number or percentage of the directors should be replaced or that directors with particular characteristics should be added to the board.

A communication triggers a report under this new rule not only when the government directs that a public company change its board but also when the government requests such a change or when the government states a preference for such a change. Otherwise, the government could avoid a report by pressuring a company for a change without employing words that constituted a direction or even a request. If a government official tells the CEO or a sitting director at a public company that the federal government prefers that the company change the membership of its board of directors, the CEO or director will almost certainly pass that statement of preference on to the board as a whole, and the board will almost certainly feel pressured to make the change.

The other instances in which a communication triggers a report require little comment. Clearly, the government applies pressure for board change when it tells a company's top management or the company's board that the government will order a change if the company does not make the change itself. And a communication that government action is more or less likely depending on whether a company makes a board change is pressure of perhaps the most effective sort. For example, the government could have very effectively exerted pressure on a bank during the credit crisis simply by stating that, unless the company changed its board, the government would be unlikely to provide financial assistance to the bank if the bank experienced financial distress.

The new rule covers only communications from the executive branch and does not apply to communications between legislators and public companies. The rule's efficacy suffers to some extent as a result. Legislators can pressure companies and, if they affect board composition, their pressure implicates all the concerns previously set out. But senators and representatives generally speak for themselves rather than for the branch of government of which they are a part, and so are less likely to wield effective pressure. Moreover, a legislator may well actively seek publicity for any demand or request that he or she makes for a board change, believing that the publicity itself will increase the pressure that he or she applies. Therefore, *required* disclosure is likely not needed. As set out below, just the opposite is true when an arm of the executive branch applies the pressure: there are sound reasons to conclude that the executive branch is *unlikely* to disclose the pressure it exerts absent a requirement that it do so.<sup>344</sup>

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344. See *infra* Part V.E.

### C. Who Should Disclose

Logically, there are only two candidates on whom to impose the disclosure obligation: (i) the public company whose board composition the government tries to influence or (ii) the government itself.<sup>345</sup> It is tempting to require the government to file. As set out in Part V.A, the disclosure ideally should state *why* the government is trying to change the board. The government knows its purpose better than the company. Moreover, if (as Part V.A proposes) the report only includes the government's reasoning when the government includes that reasoning in the triggering communication, the government can avoid inclusion of its purpose in a Form GIB filing simply by refraining from stating that purpose in the government's communication with the company.

While all of these reasons argue for imposing the filing requirement on the government, doing so invites implementation and enforcement problems. First, a government filing would require legislation. Congress would need to except the new filing from Exchange Act section 3(c), the law that generally exempts the government from securities compliance.<sup>346</sup> Second, the SEC is itself a part of the executive branch.<sup>347</sup> It could prove awkward for the SEC to bring an enforcement action against another part of the executive branch for failing to file a Form GIB.

On the other hand, the securities laws regularly impose disclosure obligations on public companies,<sup>348</sup> and the Exchange Act provides the authority for a regulation requiring that companies file Form GIB.<sup>349</sup> Those companies have internal staffs and protocols, as well as outside counsel, who routinely assist them in complying with disclosure obligations, so a compliance infrastructure is already in place.<sup>350</sup> Moreover, the securities

345. The current requirement lies with the company, *see supra* Part III.D, and the government is the only other party with influence regarding composition decisions under these circumstances.

346. *See supra* note 132 and accompanying text.

347. The SEC "is a freestanding component of the Executive Branch." *Free Enterprise Fund v. Public Co. Accounting Oversight Bd.*, 130 S.Ct. 3138, 3163 (2010). The president appoints the SEC commissioners. 15 U.S.C. § 78d(a) (2006).

348. *See* 15 U.S.C. § 78m(a) (2006) (companies with stock registered under section 12 of the Securities and Exchange Act shall file with the SEC such information and reports as the SEC requires).

349. The Commission could rely on sections 10, 12, 13, 15, and 23 of the Securities Exchange Act for the new form, just as it has for changes in Form 8-K. Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date, 69 Fed. Reg. 15,594, 15,613 (Mar. 25, 2004).

350. And companies already disclose government actions that the acting agencies do not disclose. For example, SEC investigations are confidential, and the agency accordingly does not publicize them. 17 C.F.R. § 202.5(a) (2012). Yet, companies may, under some circumstances, have to

laws provide the SEC with a panoply of enforcement tools to apply to companies, and individuals within them, who fail to file prescribed reports.<sup>351</sup>

#### *D. Possible Objections and Exceptions*

The government might assert that disclosing its efforts to change boards will hurt, not help. In particular, the government might argue generally, or in a particular case, that disclosing its efforts to change the board at a financial institution might cause a “run on the bank,” thereby forcing the closure of an institution that otherwise could have survived. The government might also contend, either generally or in a particular case, that disclosing its attempts to effectively fire or hire directors at a company such as BofA could hurt that company’s innocent stockholders.

Such arguments have little merit in most cases. The proposal here is limited to those actions designed to change the boards at companies that are already publicly traded and that will continue to operate after the anticipated board change.<sup>352</sup> Those companies already must file compendious financial information with the SEC in periodic reports (on Forms 10-Q and 10-K),<sup>353</sup> and in reports (on Form 8-K) addressing particularly important financial

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disclose them. See Steven S. Scholes, *An Overview of SEC Investigations and Enforcement Proceedings*, in INTERNAL INVESTIGATIONS 2011: INVESTIGATIONS IN THE AFTERMATH OF DODD-FRANK 291, 315–17 (Practising Law Institute 2011). The regulatory authorities already recognize that banks may in some circumstances have to disclose MOUs in SEC filings. See *supra* note 119 and accompanying text. Some companies have disclosed MOUs. See, e.g., First Chester Cnty. Corp., Current Report (Form 8-K) (Oct. 20, 2009).

351. See 2 MARC I. STEINBERG, SECURITIES REGULATION LIABILITIES AND REMEDIES ch. 12 (2012).

352. The proposal would therefore not affect any confidentiality required at the inception of a receivership under Title II of Dodd-Frank. See Dodd-Frank, *supra* note 292, §§ 202(a)(1)(A)(iii), 202(a)(1)(C) (codified at 12 U.S.C. § 5382(a)(1)(A)(iii) & (C) (Supp. IV 2011)). Although the receiver must “ensure that the [directors] responsible for the failed condition” of the failed financial institution “are removed,” 12 U.S.C. § 5386(5) (Supp. IV 2011), the receiver rather than the board runs the company during the receivership, 12 U.S.C. § 5390(a)(1)(A) (Supp. IV 2011), and may exercise all powers of the board, § 5390(a)(1)(C)—in order to liquidate and wind up the financial institution, 5390(a)(1)(D). See also S. REP. NO. 111-176, at 4 (2010) (“liquidation is the only option; the failing financial company may not be kept open or rehabilitated”). Accordingly, the receivership inaugurates not board change at a company that will continue in business but replacement of the board by the receiver at a company that will go out of business. Accordingly, communications about a receivership would not trigger a Form GIB filing.

353. If a company trades on a national exchange, it must as a practical matter register under § 12 of the Securities Exchange Act of 1934 (the “Exchange Act”). 15 U.S.C. § 78(a) (2006). Companies registered under the Exchange Act must file reports on Forms 10-K and 10-Q. 17 C.F.R. § 240.13a-1 (2012) (requiring annual reports on the forms the SEC prescribes); 17 C.F.R. § 249.310(a) (2012) (identifying Form 10-K as the default form for annual reports); 17 C.F.R. § 240.13a-13 (2012) (requiring companies registered under section 12 to file Form 10-Q). Both reports require financial statements and discussion of financial condition and results. SEC Form 10-K, *supra* note 140, at Items 7, 8; SEC, Quarterly Report (Form 10-Q), at Part I, Items 1, 2 (2010).

events that occur between the periodic reports.<sup>354</sup> Accordingly, if the government seeks to change a publicly traded company's board for a reason related to financial missteps that threaten solvency, the public should in most cases already know of that dismal performance before the government acts. For example, it was clear to all—before the MOU with BofA in May 2009—that BofA was experiencing severe financial distress.<sup>355</sup> And the company's stock price had already fallen by the time the government imposed the MOU.<sup>356</sup> Moreover, neither the *Wall Street Journal* story on the MOU nor any of the announced director departures or arrivals in May through September of 2008 caused a run on the bank.<sup>357</sup>

While the BofA case provides an instance in which disclosure of the government effort to change the board had no ill effects, it is possible that disclosure of such an effort might cause harm in some other case. This section therefore proposes a narrow exception to the new disclosure requirement. For the government to employ the exception, the new rule requires that, before filing a Form GIB, a public company must advise the government official making the triggering communication that the company is about to file. The company will thereafter *not* file only if two conditions are satisfied:

1. the most senior government officer at the government entity trying to make the board change notifies the company that he or she has concluded that disclosure would harm the public interest, *and*

354. Companies registered under section 12 of the Exchange Act must file Forms 8-K, 17 C.F.R. § 240.13a-1, 240.13a-11, with an 8-K filing required after such financial developments as the creation of a direct or off-balance sheet financial obligation in a material amount, events that accelerate or increase such an obligation, material charges associated with exiting a business or disposing of a business, and impairment charges in material amounts. SEC Form 8-K, *supra* note 147, at Items 2.03–2.06.

355. BofA reported net income for the 2007 year of \$14.982 billion. Bank of Am. Corp., Annual Report (Form 10-K), at 89 (Feb. 28, 2008). The company reported net income of only \$4.008 billion for 2008. Bank of Am. Corp., Annual Report (Form 10-K), at 110 (Feb. 27, 2009). The company cut its quarterly dividend from \$.64 per share to \$.32 per share in the fourth quarter of 2008 and reduced the dividend to \$.01 per share in the first quarter of 2009. Bank of Am. Corp., Annual Report (Form 10-K), at 13 (Feb. 26, 2010).

356. The closing price of BofA's stock plummeted from \$ 53.33 per share on January 3, 2007, to \$ 40.56 on January 2, 2008, to \$ 14.33 on January 2, 2009, to \$8.70 on May 1, 2009. See Bank of America (BAC), *Historical Prices*, YAHOO! FINANCE, <http://finance.yahoo.com/q/hp?s=BofA+Historical+Prices>.

357. See *supra* Part II.B.

2. the government's effort to change the company's board is related to events that are not yet public.

The government has two business days in which to provide this notification, and those two days do not count towards the four days within which the company must file the Form GIB.

The first condition for the exception means that, if the communication by which the government exerted its influence originates from an office inside the Department of the Treasury, only the Secretary of the Treasury can make the determination that disclosure will harm the public interest. If the communication originates from the Federal Reserve Bank, only the Federal Reserve Board Chairman can make the determination. Requiring the official at the apex of that part of the government seeking board change to make a formal determination that disclosure will hurt the country provides accountability and emphasizes that such a determination to deprive investors and the public of disclosure is a serious matter and, hence, the rare exception.

As a second, separate, and independent condition for the disclosure exception, the government can only prevent the Form GIB filing if the filing's harm to the public interest results from secret circumstances. Put another way, if the circumstances prompting the government to exercise its influence over the composition of the publicly traded company's board are public knowledge, then the company must file the Form GIB—regardless of what any officer in the executive branch thinks about possible harm that the filing will cause. This additional condition makes sense for two reasons. First, without some objective test of this sort, it will be all too easy for an executive branch official to conclude that a filing will harm the public interest because, for the reasons set out below, the filing will harm the government official.<sup>358</sup> For example, an officer chary of being labeled a socialist if his or her effort to change a private company's board is reported in the media might easily talk himself or herself into the conclusion that the public is better off not knowing of the effort at all.<sup>359</sup>

The second reason derives from the circumstance that the harm to the public interest—for example by a run on the bank—will derive, most likely, not from the government's intervention to change directors, but from some underlying condition that prompts that intervention. Accordingly, if that underlying condition is already public, then the public interest is already likely to have suffered any "harm," from that knowledge, with no additional harm likely from the subsequent revelation that the government is acting to

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358. See *infra* Part V.E.

359. See *infra* notes 366–74 and accompanying text.

address the problem.<sup>360</sup> On the other hand, if for example a bank is somehow in deep trouble that is not revealed by its own securities filings, and revelation of a federal effort to change the board might signal that distress and thereby cause a run, the case for an exception to the new disclosure strengthens.

#### *E. Why Disclosure Must Be Required*

A final and critical question remains: if disclosure of government influence on public company board composition benefits investors and the rest of the public, why cannot we simply leave disclosure to the good thinking of those who control the government or those who control the companies? They could take the template set out above and make *voluntary* disclosures.

The BofA case<sup>361</sup> provides an immediate response. Though apparently dated in early May 2009,<sup>362</sup> the BofA MOU did not surface until mid-July.<sup>363</sup> Even then, only a vigilant press brought that MOU to light.<sup>364</sup> Neither the government nor BofA disclosed the document,<sup>365</sup> which suggests that both had reasons for not doing so. Voluntary disclosure did not get the job done.

We do not know the motives for secrecy particular to the BofA case. But we can speculate on those motives intelligently based on the events during which that case unfolded. With our understanding of human nature and the nature of government and corporations, we can also speculate more generally about the reasons that those in government, and those in corporations, may wish to keep Uncle Sam's influence on board membership in the shadows.

The government—really the individuals within the executive branch who are behind a board change—may want to keep their influence quiet in order to avoid political criticism for interference with private enterprise. The experience of 2008 and 2009 brings this home. As the Treasury took equity positions in hundreds of banks and the government invested in AIG and General Motors,<sup>366</sup> the dreaded word “nationalization” vibrated through

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360. As was the case with BofA. See *supra* notes 355–56 and accompanying text.

361. See *supra* Part II.B.

362. Fitzpatrick, *Obey*, *supra* note 79 (“The order was imposed in early May. . .”).

363. *Id.*

364. *Id.*

365. See *supra* Part II.B.5.

366. An early 2010 transaction report showed purchases of preferred stock, warrants, and debt obligations in hundreds of banks and financial institutions, as well as General Motors, GMAC, and



the financial press,<sup>367</sup> with that word in popular parlance encompassing “effective control” of banks or other companies even without majority ownership.<sup>368</sup> Pundits, politicians, and professors opined that nationalization was un-American.<sup>369</sup> While the administration shied away from the term,<sup>370</sup> even the possibility of nationalization reportedly drove day-to-day stock market declines.<sup>371</sup> Concerns emerged that, once started, nationalization would spread in a “contagion”<sup>372</sup> and that, once the government got into the

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Chrysler. U.S. Treasury Dep’t, Office of Financial Stability, Troubled Asset Relief Program, Transactions Report (Mar. 24, 2010) (on file with author).

367. See Jonathan Alter, *A Plan That Obama Can Bank On*, NEWSWEEK, Mar. 23, 2009, at 30 (“The second option is to nationalize the banks. True nationalization means permanent government ownership, which is favored only by a few aging socialists. If things get bad enough, we could get a temporary takeover, but calling it nationalization just polarizes the debate.”); Andy Kessler, *Why Markets Dissed the Geithner Plan*, WALL ST. J., Feb. 11, 2009, at A17 (“Six months to a year from now, big banks may still be weak and the ugly . . . word . . . nationalization will be back.”); Paul Krugman, Op-Ed., *Wall Street Voodoo*, N.Y. TIMES, Jan. 19, 2009, at A25 (“Washington remains deathly afraid of” that word.).

368. See David E. Sanger, *Selling a New Deal, but Promising It Will Be Brief*, N.Y. TIMES, Feb. 25, 2009, <http://www.nytimes.com/2009/02/25/us/politics/24web-sanger.html>.

By the time Mr. Obama speaks, taxpayers may already own 40 percent of Citigroup. As Senator Charles Grassley, Republican of Iowa, asked yesterday in a letter to Treasury Secretary Timothy Geithner, wouldn’t that “give the government effective control of the bank, and therefore, be a de facto nationalization of the bank”?

*Id.*

369. A Princeton economist offered that “nationalization runs counter to deeply ingrained American traditions and attitudes.” Alan S. Blinder, *Nationalize? Hey, Not So Fast*, N.Y. TIMES, Mar. 8, 2009, § 3 (Money and Business), at 5. Financial historian Charles Geisst agreed, saying that “[n]ationalization . . . ‘is just not a term in the American vocabulary.’” David E. Sanger, *US Bank and Trust?*, N.Y. TIMES, Jan. 26, 2009, at A1. One columnist opined that “[f]ew words conjure the specter of radicalism quite so well as nationalization,” bringing to the popular mind visions of “leftist governments” and images of Lenin and Hugo Chavez. David Leonhardt, *The Way We Live Now: Banks of America*, N.Y. TIMES, Mar. 1, 2009, § 6 (Magazine), at 11. A publisher and commentator asked and answered: “Nationalize banks? A horror.” Steve Forbes, *1933 Is Coming Again*, FORBES, Mar. 16, 2009, at 13. The *Wall Street Journal* reported that “Republicans already are uncomfortable with . . . the effective nationalization of . . . insurer AIG.” Greg Hitt et al., *Bailout Turns on Auto Makers’ Viability*, WALL ST. J., Nov. 13, 2008, at A3.

370. See Edmund L. Andrews, *Common Stock Offers Leeway in Bank Rescue*, N.Y. TIMES, Apr. 20, 2009, at A1 (“Nationalization, or even just the hint of nationalization, is a politically explosive step that White House and Treasury officials have fought hard to avoid.”).

371. See Jon Hisenrath et al., *Heard on the Street: Banks Hit by Nationalization Fears*, WALL ST. J., Jan. 21, 2009, at A1 (“Shares of the biggest names in American banking plunged Tuesday as some investors feared that the government would need to nationalize the most deeply wounded financial institutions, wiping out shareholders.”).

372. See Tyler Cowen, *Three Rocky Roads to a Bank Rescue*, N.Y. TIMES, Mar. 1, 2009, § 3 (Money and Business), at 5.

The most obvious problem with nationalization is the risk of contagion. If the government wipes out equity holders at some banks, why would investors want to put money into healthier but still marginal institutions? A small number of planned nationalizations could thus lead to a much larger number of undesired nationalizations.

*Id.*

banking business, it would be hard to get the government out.<sup>373</sup> All of this evoked an even more reviled word—“socialism.”<sup>374</sup>

Surely, no executive branch official seeking to influence board composition at a publicly traded company would relish triggering such a public relations firestorm. He or she would, instead, seek to avoid even the remotest possibility of such a PR disaster. The official would grasp at any rationale to keep actions behind the curtain.

Executive officials might wish to proceed behind closed doors, as well, because an open effort could draw congressional attention, with the possible need to accommodate the idiosyncratic preferences of those legislators who might seek out cameras and microphones to express their views on the “right” directors to have at the company in question. Again, the experience of 2008 and 2009 supports this fear, when representatives and senators sought to influence all kinds of actions taken by companies that the government was helping. Congress politicized bonus payments at AIG.<sup>375</sup> Legislators used the bully pulpit to force companies to sell corporate planes.<sup>376</sup> When the federal plan to restructure General Motors involved

373. See Paul Ryan, *A Republican Road to Economic Recovery*, WALL ST. J., Mar. 2, 2009, at A15 (“There are no easy or painless solutions, but the most damaging solution over the long term would be to nationalize our financial system. Once we put politicians in charge of allocating credit and resources in our economy, it is hard to imagine them letting go.”).

374. See Steve Lohr, *Bold Action With Basis In History*, N.Y. TIMES, Oct. 14, 2008, at A1 (“Elsewhere, government bank-investment programs are routinely called nationalization programs. But that is not likely in the United States, where nationalization is a word to avoid, given the aversion to anything that hints of socialism.”); Gerald P. O’Driscoll, *The Problem with ‘Nationalization,’* WALL ST. J., Feb. 23, 2009, at A15 (addressing a Greenspan comment that bank nationalization occurs about once a century and Senator Graham’s view that nationalization should proceed if it works, a Cato Institute senior fellow opined: “That is the kind of pragmatism that leads to socialism.”).

375. When AIG paid out \$165 million in bonuses after the government bailout of that company, CEO Edward Liddy endured sharp questioning in congressional testimony even though he said he had asked bonus recipients to give back one half of the money; “Democratic leaders in Congress” were reportedly “furious” that the bonuses were paid. Mary Williams Walsh & David M. Herszenhorn, *A.I.G. Seeking Return of Half of Its Bonuses*, N.Y. TIMES, Mar. 19, 2009, at A1. The House even passed a ninety percent retroactive tax on the bonuses. Carl Hulse & David M. Herszenhorn, *A.I.G. and Wall St. Confronts an Upsurge of Populist Fury*, N.Y. TIMES, Mar. 20, 2009, at A1.

376. When the heads of the three auto companies flew into Washington on private jets to seek bailout assistance, legislators mocked the executives for their extravagance. Robert Pelee, *They’d Rather Be Flying*, N.Y. TIMES, Nov. 19, 2008, <http://wheels.blogs.nytimes.com/2008/11/19/theyd-rather-be-flying/>. Shortly thereafter, General Motors, though claiming not to act in response to public pressure, reduced its fleet of corporate planes from five to three. Joseph Rhee & Maddy Sauer, *GM Downsizing Jet Fleet, CEO Still Flies High*, ABC NEWS, Nov. 21, 2008, <http://abcnews.go.com/Blotter/WallStreet/story?id=6307092&page=1>. About two months later, the financial press reported that, “[f]acing outrage from some lawmakers, Citigroup now says that it will

closing dealerships, Congress held a hearing on that move.<sup>377</sup> The executive branch might fear that publicly aired efforts to reconstitute a large company's board would draw similar fire.

Where Congress travels, so will lobbyists. And the government officials suggesting or imposing a board change might wish to avoid lobbying by stakeholders in a corporation at which the government seeks board change. Lobbyists working for institutional investors, labor unions, and business affiliates, such as the car dealers in the case of General Motors, might pitch their board candidates, perhaps warning of political backlash should the names they suggest be ignored. Finally, the government may believe that applying pressure cloaked from the public eye will serve some public purpose apart from politics, in particular protecting a financial institution from a run on the bank, as Part V.D discussed.

The company whose board the government seeks to change may also want to avoid disclosure. The sitting directors may, perhaps rightly, see the government pressure as a judgment that they have failed to properly discharge their duties. In that case, the departing directors may prefer a low-profile exit to headlines in business publications suggesting that they have been sent packing for poor performance. The current directors may also fear that disclosure of government pressure to make changes at the very top of the corporation will hurt the company's stock price. Or the board and management might remain silent because the government demands that the company make no disclosure. Indeed, if the company's condition is such that it will change its board at the government's behest, the company is probably in no condition to resist an additional admonition to keep the government role in corporate regime change on the QT.<sup>378</sup>

For these several reasons, the public will not *assuredly* get disclosure unless it is required. As in the BofA case, an enterprising press *may* bring to light government efforts to give the boot to some directors and a warm welcome to others. But we cannot count on the press regularly defeating what could be coordinated company and government efforts to keep the pressure under wraps. Only a disclosure *requirement* will get the news out reliably.

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not take delivery of a brand-new \$50 million corporate jet." Cyrus Sanati, *Citi Reverses Course on \$50 Million Jet*, N.Y. TIMES, Jan. 27, 2009, <http://dealbook.nytimes.com/2009/01/27/citi-reverses-course-on-50-million-jet/>.

377. See Bernie Becker, *Closing Dealers Is Painful but Vital, G.M. and Chrysler Tell Panel*, N.Y. TIMES, June 4, 2009, at B4.

378. Or, as the younger crowd would say, on the DL.

## VI. CONCLUSION

The credit crisis—with its massive government investment in multimillion dollar publicly traded companies—has faded. The government has unwound many of its investments and aims to unwind virtually all, if possible.<sup>379</sup> Government control over public company boards *by virtue of federal stock holdings*—as at AIG—may therefore be rare, at least in the near future. Moreover, as this Article has shown, investors (and the general public) can guess pretty intelligently about government control over board composition after a public revelation that the government has acquired majority shareholder voting rights at a company.<sup>380</sup>

Unlike direct government investment in voting stock, however, bank regulation lives on today, complete with the power to issue MOUs that require board change.<sup>381</sup> The BofA case, in which the government intervened *without* share-based voting power, could easily repeat itself. And that case, as we have seen, was far more troublesome, as virtually no SEC rule required contemporaneous disclosure of government influence on director departures or arrivals at the bank.<sup>382</sup> It is precisely to shed light on that worse case that the SEC should adopt the disclosure rule that this Article advocates. For when the government takes control of a board, the government knows. The company knows. Investors should know, too.

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379. When the government restructured its investment in AIG in early 2011, see *supra* note 19, the Acting Assistant Treasury Secretary for Financial Stability labeled the AIG transaction a “milestone in the government’s long-stated efforts to exit our investments in private companies as soon as practical while protecting taxpayers.” Michael J. de la Merced, *U.S. Prepares to Sell Part of A.I.G. Stake*, N.Y. TIMES, Dec. 8, 2010, <http://dealbook.nytimes.com/2010/12/08/a-i-g-plans-big-sale-of-treasurys-shares-next-quarter/>. And the government has indeed sold all of its AIG common stock. See *supra* note 19.

380. See *supra* Part II.A.4.

381. See FED. BANK EXAMINATION MANUAL, *supra* note 77, § 5040.1 at 6.

382. See *supra* Part II.B, Part III.E.

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