This Case Involves Two Legal Claims

1. Whether the conduct at issue constituted an Illegal Exaction?

   - An illegal exaction exists when the Government, without authorization, exacts a citizen's money or property as a condition of taking action or conferring a benefit. *Eastport S.S. Corp. v. United States*, 372 F.2d 1002, 1007-08 (Ct. Cl. 1967); *Aerolinas Argentinas v. United States*, 77 F.3d 1564, 1573 (Fed. Cir. 1996).

2. Whether the conduct at issue constituted a Fifth Amendment Taking?

   - "The Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensation was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States*, 364 U.S. 40, 49 (1960); *see also Palazzolo v. Rhode Island*, 533 U.S. 606, 617-18 (2001).

Two Fundamental Background Legal Principles

1. Even where the Government is free to deny a benefit altogether, it cannot tie the granting of the benefit to the surrender of rights or property the Government is not authorized to demand.

   - "If the state may compel the surrender of one constitutional right as a condition of its favor, it may, in like manner, compel a surrender of all. It is inconceivable that guaranties embedded in the Constitution of the United States may thus be manipulated out of existence." *Frost v. R.R. Comm'n of State of Calif.*, 271 U.S. 583, 594 (1926).

2. Claims of emergency and crisis do not justify ignoring the requirement for statutory authorization.

   - "In view of the ease, expedition and safety with which Congress can grant and has granted large emergency powers, certainly ample to embrace this crisis, I am quite unimpressed with the argument that we should affirm possession of them without statute. ***Such power either has no beginning or it has no end***." *Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579, 653 (1952) (Jackson, J., concurring) (emphasis added).

This Case Primarily Involves Two Sections Of The Federal Reserve Act

Section 13(3) of the Federal Reserve Act

- **"In unusual and exigent circumstances**, **the Board of Governors of the Federal Reserve System, by the affirmative vote of not less than five members**, may authorize any Federal reserve bank, during such periods as the said board may determine, **at rates established in accordance with the provisions of section 357 of this title**, to discount for any individual, partnership, or corporation, notes, drafts, and bills of exchange when such notes, drafts, and bills of exchange are indorsed or otherwise **secured to the satisfaction of the Federal reserve bank**: *Provided*, that before discounting any such note, draft, or bill of exchange for an individual or a partnership or corporation the Federal reserve bank **shall obtain evidence that such individual, partnership, or corporation is unable to secure adequate credit accommodations from other banking institutions**. All such discounts for individuals, partnerships, or corporations shall be subject to such limitations, restrictions, and regulations as the Board of Governors of the Federal Reserve System may prescribe." 12 U.S.C. § 343 (2006) (emphasis added).

Section 14 of the Federal Reserve Act

- "Every Federal reserve bank shall have power to establish from time to time, subject to review and determination of the Board of Governors of the Federal Reserve System, rates of discount to be charged by the Federal reserve bank for each class of paper, **which shall be fixed with a view of accommodating commerce and business**, but each such bank shall establish such rates every fourteen days, or oftener if deemed necessary by the Board." 12 U.S.C. § 357 (emphasis added).

Legal Under 13(3)

- ✔ unusual and exigent circumstances
- ✔ unable to secure adequate credit accommodations
- ✔ secured to the satisfaction of the Federal reserve bank
- ✔ the affirmative vote of not less than five members

Plaintiffs' Illegal Exaction Claim Is Established By One Factual Finding And Two Legal Conclusions

- The factual finding (which is undisputed) is that Defendant required 79.9% of Plaintiffs' equity as compensation for Defendant's 13(3) loan to AIG.

- The first legal conclusion (which Defendant has not disputed) is that it is an Illegal Exaction for the Government to require a citizen seeking Government action or benefit to provide compensation the Government is not authorized to demand.

- The second legal conclusion (which is clear from the plain language of the Federal Reserve Act, this Court's prior rulings, and Defendant's own statements prior to this litigation) is that Defendant was not authorized to require the surrender of a private company's equity as compensation for a 13(3) loan.

The Government Took 79.9% Of Plaintiffs' Equity And Voting Control As "Additional Compensation" For The Loan

- Federal Reserve Vice Chairman Kohn: "Importantly, the Revolving Credit Facility was (and remains) secured by a pledge of a substantial portion of the company's assets, including AIG's ownership interests in its domestic and foreign insurance subsidiaries. ***As additional compensation for the Revolving Credit Facility, AIG agreed to issue to a trust for the benefit of the Treasury, preferred stock convertible into 79 percent of AIG's outstanding common stock***." (PTX 449 at 50) (emphasis added).

- FRBNY General Counsel Baxter: "On September 16, 2008 the Board of Governors authorized the New York Fed to lend up to $85 billion to AIG through a secured revolving credit facility ('Fed Facility'). The Fed Facility was (and remains) secured by a pledge of a substantial portion of AIG's assets, including ownership interests in the company's domestic and foreign insurance subsidiaries. ***As additional compensation for this Facility, AIG issued, to a trust for the benefit of the Treasury, preferred stock convertible into approximately 78 percent of AIG's outstanding common stock***." (PTX 564 at 190-91) (emphasis added).

- Report of the Board of Governors to Congress: "***As additional compensation to the U.S. government for the Credit Facility, AIG will issue 100,000 shares of a new series of perpetual, non-redeemable convertible participating serial preferred stock (the Preferred Stock) to a trust that will hold the Preferred Stock for the benefit of the U.S. Treasury Department.***" (PTX 339 at 7) (emphasis added).

There Was No Precedent Or Authority For Requiring The Surrender Of Equity And Voting Control To Obtain A Section 13(3) Loan

- During the financial crisis of 2007-2009, over 200 private entities received Section 13(3) assistance.

- No private entity other than AIG has ever provided equity in exchange for access to credit under Section 13(3) since its enactment in 1935 (*See* Def.'s Resp. to Pl.'s 1st RFAs No. 18.0).

- As this Court has held, "the 'only consideration for a loan prescribed by Section 13(3) is an interest rate subject to the determination of the Board of Governors.'" *Starr Int'l Co., Inc. v. United States*, 107 Fed. Cl. 374, 378 (2012) (quoting *Starr Int'l Co., Inc. v. United States*, 106 Fed. Cl. 50, 85 (2012)).

The Federal Reserve Act Does Not Implicitly Authorize Defendant To Demand Equity And Voting Control As A Condition Of A 13(3) Loan

- "because the FRA only permits the Board to demand consideration in the form of interest rates, the Board did not have implied authority to demand the transfer of equity as consideration for the loan to AIG". *Starr Int'l Co. v. United States*, 107 Fed. Cl. 374, 378 (2012); *see also Starr Int'l Co. v. United States*, 106 Fed. Cl. 50, 87 (2012).
- "authority to do a specific thing carries with it by implication the power to do whatever is necessary to effectuate the thing authorized – not to do another and separate thing, since that would be, not to carry the authority granted into effect, but to add an authority beyond the terms of the grant". *Fed. Reserve Bank of Richmond v. Malloy*, 264 U.S. 160, 167 (1924).
- The law governing national banks confirms that the Federal Reserve lacks the incidental authority to acquire equity in exchange for a discount under section 13(3): "The power to purchase or deal in stock of another corporation, as we have said, is not expressly conferred upon national banks, *nor is it an act which may be exercised as incidental to the powers expressly conferred*." *Cal. Nat'l Bank v. Kennedy*, 167 U.S. 362 (1897).
  - This limitation applies with even greater force to the Federal Reserve Banks given the comparatively greater power that national banks have to set the consideration for a loan.
- Chairman Bernanke: "The Federal Reserve is authorized under the Federal Reserve Act to extend credit in various forms, but is not authorized to purchase equity securities of financial institutions" (PTX 363 at 2).
- Secretary Paulson: the Federal Reserve "legally couldn't do preferred. They legally could only make a loan" (PTX 417 at 11).
- Secretary Geithner: "Under Section 13(3) of the Federal Reserve Act, the Fed is prohibited from taking equity or unsecured debt positions in a firm. At its core, this restriction reflects the importance of maintaining the line between the responsibilities and authorities of the fiscal authority, and those of the monetary authority" (PTX 409 at 177).

AIG Was Solvent, But Illiquid

- Secretary Paulson: The Federal Reserve "could make a loan to help AIG because, with AIG, you were dealing with a liquidity problem, not a capital problem" (Paulson Dep. 73:10-17).

- Secretary Geithner: "AIG had a vast global empire of income-generating insurance businesses, which over time could offset the losses from" AIGFP (PTX 709 at 209).

- OTS Director Polakoff: "It is critically important to note that AIG's crisis was caused by liquidity problems, not capital inadequacy" (PTX 449 at 53).

- Federal Reserve Staff: "AIG was an $85 billion revolving line of credit to an institution that was solvent and had lots of assets. They truly had a liquidity crisis. They had value in their insurance subsidiaries, but not cash to pay their bills" (PTX 594 at 63-64).

- Chairman Bernanke: "AIG's problems appeared at the time to be more classical liquidity needs that were quantifiable in amounts and could be covered with borrowings secured by valuable available collateral – the shares of stock of profitable insurance companies and other businesses" (PTX 616 at 15).

Because AIG Was Solvent, The 13(3) Loan To AIG Could Be, And Was, Fully Secured

- FRBNY General Counsel Baxter: "before any money was disbursed to AIG on September 16, AIG delivered share certificates to the New York Fed that we continue to hold as collateral in our vaults. These shares **fully secured** every penny we lent to AIG on September 16, 2008. And today, the credit extended to AIG by the New York Fed remains **fully secured**" (PTX 598 at 11) (emphasis added).
- Chairman Bernanke: "The credit facility was **fully secured** by assets that AIG was able to pledge under the associated Guarantee and Pledge Agreement and that had an estimated value in excess of the maximum size of the credit facility" (PTX 561 at 5) (emphasis added).
- Chairman Bernanke: "**AIG had a very substantial business, a huge business, more than a trillion dollars in assets and a large insurance business** that could be used as collateral to borrow the cash needed . . . **the Federal Reserve will absolutely be paid back by AIG**" (PTX 599 at 37) (emphasis added).
- Federal Reserve General Counsel Alvarez: The "credits were each **fully secured** at the time they were made" (PTX 587 at 25) (emphasis added).
- FRBNY General Counsel Baxter and FRBNY Head of AIG Monitoring Team Dahlgren: "we were making a **fully secured** loan" (PTX 587 at 55) (emphasis added).
- FRBNY Senior Vice President and Senior Policy Advisor, Markets Group, Susan McLaughlin: "we would not have lent that amount had we not had sufficient lendable value of collateral" (McLaughlin Dep. 76:19 –77:14).

FRBNY Was Fully Repaid With Interest For Its Credit Agreement Loan To AIG

- Even without the equity taken from AIG shareholders, FRBNY was "fully repaid" for the money loaned to AIG under the Credit Agreement and in addition received $6.7 billion in interest payments and fees in connection with the Credit Facility (PTX 720 at 1).

Issues That Would Be Raised If We Were To Assume That Defendant Were Authorized To Demand Equity And Voting Control As Consideration For A 13(3) Loan

- Was the Federal Reserve authorized to demand equity and voting control to **penalize** AIG shareholders?
  - **NO**. The only consideration for a 13(3) loan permitted by the Federal Reserve Act is an interest rate "fixed with a view of accommodating commerce and business." 12 U.S.C. § 357.

- Was the Federal Reserve authorized to penalize AIG shareholders **without any investigation, analysis, or hearing for findings** concerning whether punishment was appropriate?
  - **NO**. There is no statutory authority for Defendant to take punitive measures against AIG shareholders, and the imposition of punishment, in any event, requires notice of the alleged misconduct and some opportunity to be heard. *See Londoner v. City & Cnty. of Denver*, 210 U.S. 373, 385-86 (1908); *Matthews v. Eldridge*, 424 U.S. 319, 333 (1976).

Defendant Required Shareholders To Surrender 79.9% Of Their Equity As Punishment

- Secretary Paulson: The "taking of equity in companies that receive government assistance" is "a **punitive** condition" (Paulson Dep. 308:5-10). The Government "basically killed the shareholders" of AIG (PTX 706 at 316) (emphasis added).
- Secretary Geithner as reflected in Federal Reserve General Counsel Alvarez's handwritten notes of Board of Governors September 16 meeting: "TG" – "**conditions need to be punitive**" (JX 80 at 1-2) (emphasis added).
- Secretary Paulson: "as a matter of fact **we were too punitive** . . . we not only fired the CEO but we came in in a way in which we largely wiped out the shareholders" (PTX 506 at 14-15) (emphasis added).
- Secretary Geithner: "We replaced the management and the boards of directors. We forced losses on shareholders proportionate to the mistakes of the firm. And we made it clear in the GSEs and AIG that they would be dismembered, not allowed to live on as independent entities with the scope and reach they had before the crisis" (PTX 648 at 8).
- Treasury Chief Restructuring Officer Millstein: "FRBNY took nearly 80% of AIG's fully diluted common equity to provide additional compensation to taxpayers for their assistance, and **to penalize the shareholders** of the Company for the fact that the Company had no alternative but to ask the government for extraordinary assistance" (PTX 587 at 212) (emphasis added).

Defendant Nationalized AIG Without Statutory Authority And Without Compensation

- Secretary Geithner: “By that point we had already effectively **nationalized** the GSEs and AIG, and could decide how to carve up, dismember, sell or restructure those institutions” (PTX 663 at 14) (emphasis added).

- Secretary Paulson:

  “MR. KASHKARI: do you feel like we've **nationalized** AIG?

  SECRETARY PAULSON: Yes.” (PTX 399 at 3) (emphasis added).

Defendant Punished AIG Shareholders Without Any Investigation, Analysis, Hearing, Or Findings

- Chairman Bernanke:

  Q. Was any of the consideration that you had in terms of how much compensation to require for the AIG loan a function of a conclusion that you or the Fed reached that AIG had somehow mismanaged its business or taken on excessive risks?

  A. No. (Bernanke Dep. 199:20-200:3).

- Secretary Geithner: "we had no basis of having any direct knowledge of the nature of the risks they were taking" (Geithner Dep. 108:11-15).

There Were “Unusual And Exigent Circumstances” In September 2008

- Secretary Geithner: The 2008 Financial Crisis was the “worst financial crisis since the Great Depression” (PTX 709 at 10).
- Chairman Bernanke: “September and October of 2008 was the worst financial crisis in global history, including the Great Depression” (PTX 548 at 24).
- “The American economy had not faced such a severe economic downturn since the Great Depression” (PTX 680 at 10).
- The market conditions in September 2008 were “unprecedented in the recent history of financial markets” (PTX 2161 at 33).
- Secretary Geithner described the Lehman bankruptcy on September 15, 2008 as “the most destabilizing financial event since the bank runs of the Depression” (PTX 709 at 228).

The Freezing Of Credit Markets And The Collapse Of The Financial System In September 2008 Resulted In Widespread Liquidity Problems

- Chairman Bernanke: One effect of the Lehman bankruptcy was a "money market fund run, in which investors in these funds began to pull out their money just as quickly as they could" (PTX 708 at 88).
- As money market funds "began to face runs, they in turn began to dump commercial paper as quickly as they could. As a result, the commercial paper market went into shock" (PTX 708 at 90).
- Secretary Geithner: "**Basically, short-term financing – whether secured by collateral or not – was vanishing**" (PTX 709 at 211) (emphasis added).
- AIG's Counsel Rodgin Cohen at Sullivan & Cromwell: "the country's financial system had collapsed" (Cohen Dep. 108:10-11).

Many Other Financial Institutions Faced The Liquidity Problems AIG Faced

- Chairman Bernanke: Of the 13 "most important financial institutions in the United States, 12 were at risk of failure within a period of a week or two" (PTX 548 at 24).

- After Lehman's bankruptcy: "Key regulators feared that nearly all of the nation's major financial institutions were at risk of failure within a period of a week or two" (PTX 680 at 16).

- Morgan Stanley's "liquidity pool had shrunk from $130 billion to $55 billion in a week" (PTX 709 at 219).

- "Goldman Sachs, the strongest of the investment banks, watched helplessly as half its $120 billion in liquidity evaporated in a week" (PTX 709 at 214-215).

What Was AIG's Role In The 2008 Financial Crisis

- AIG purchased and/or offered protection for subprime mortgage-backed securities (PTX 449 at 58).

- In purchasing and/or offering protection for subprime mortgage-backed securities, AIG, like other market participants and the Federal Reserve itself, relied on the representations made by the companies marketing such securities, and by the rating agencies (PTX 650 at 8; Dudley Dep. 16:16-17:1; PTX 11 at 10).

- Defendant has never accused AIG of any fraudulent or wrongful conduct in connection with the marketing of subprime mortgage-backed securities.

- By contrast, in other proceedings Defendant has accused the financial institutions that marketed subprime mortgage-backed securities to AIG and others of fraudulently misrepresenting the value and risks of those securities (PTX 690; PTX 2232 at 1; PTX 2473 at 1; PTX 2485; PTX 2504; PTX 2527 at 2; PTX 2529).

- Defendant has also accused rating agencies of fraudulently misrepresenting the risks of subprime mortgage-backed securities (PTX 661).

Defendant Has Admitted In Other Proceedings That The Financial Crisis Of 2008 Was Caused By The Wrongful, And Often Criminal, Fraud Of Institutions Who Misled AIG And Other Market Participants

- Defendant has asserted in other proceedings that many of the financial institutions that it assisted, without punitive terms and without any requirement to surrender equity and voting control, fraudulently misrepresented the subprime mortgage-backed securities that AIG (and others) purchased and/or offered protection for (PTX 690; PTX 2232 at 1; PTX 2473 at 1; PTX 2485; PTX 2504; PTX 2527 at 2; PTX 2529).

- AIG, like other investors and like the Federal Reserve, relied on the representations and disclosures of the financial institutions that originated and sold the subprime mortgage-backed securities for which AIGFP offered protection and in which AIG's securities lending business invested, in making its decision to offer protection for, or invest in, such securities (PTX 650 at 8, PTX 11 at 10).

- AIG, like other investors and like the Federal Reserve, also relied on the ratings given subprime mortgage-backed securities by ratings agencies (PTX 650 at 8; Dudley Dep. 16:16-17:11; PTX 11 at 10).

- Defendant has also asserted in other proceedings that the rating agencies misled market participants concerning the risks and value of subprime mortgage-backed securities (PTX 661).

At The Time AIG Offered Default Protection For Subprime Mortgage-Backed Securities, The Financial Institutions Marketing Those Securities, And The Rating Agencies Rating Those Securities, Represented Those Securities As Having, And The Federal Reserve Itself Believed These Securities Had, Extremely Little Risk

- The Financial Institutions marketing the subprime mortgage-backed securities for which AIG offered default protection represented that those securities were AAA+.
- The Rating Agencies rating those securities rated them as AAA+ (PTX 624 at 240; PTX 549 at 26 n.32; PTX 661 at 3-4).
- The Federal Reserve accepted that those securities were AAA+ (PTX 624 at 146-148).
- AIG stopped offering default protection for those securities at the end of 2005 (PTX 449 at 12, Agreed to Stipulations ¶¶ 42-43).
- Many of the Financial Institutions regulated, assisted, and protected by the Federal Reserve continued to market those securities in 2006 and 2007 – for example, Citibank increased its origination of those securities by 85% in 2006 and continued to originate such securities in 2007 (PTX 1191 at 10).

Compare The Federal Reserve's Treatment Of AIG And Certain Favored Financial Institutions

	AIG	Citibank	Morgan Stanley
Sued for fraud by Defendant in marketing subprime RMBS	No	Yes	Yes
Fined by Defendant for causing the financial crisis	No	Yes	Yes
Would have failed without government assistance	Yes	Yes	Yes
Allowed Bank Holding Company status in 2008	No	No	Yes
Given a 13(3) Loan in 2008	Yes	Yes	Yes
Given Access to PDCF	No	Yes	Yes
Required shareholder equity to be surrendered for its 13(3) Loan	79.9%	None	None
Interest charged for 13(3) loan*	14.0%	3.5%	3.25%

*On date of authorization of borrowing.

Because It Is Undisputed That Defendants Actually Acquired 79.9% Of Plaintiffs' Equity And Voting Control, Plaintiffs' Takings Claim Is Established By Two Proposed Findings Of Fact Or One Mixed Finding Of Fact And Conclusion Of Law

- The two Proposed Findings are:

  1. The AIG Board's agreement to the Credit Agreement was under duress.

  2. At the time of the Credit Agreement, Defendant controlled AIG.

- The one mixed Finding of Fact and Conclusion of Law is:

  3. The AIG Board's agreement to the Credit Agreement does not bar Plaintiffs' direct claims.

The Legal Criteria For Proof Of Duress

- To establish duress, a plaintiff must establish: "(1) it 'involuntarily accepted' the other party's terms; (2) 'circumstances permitted no other alternative'; and (3) 'said circumstances were the result of coercive acts of' the other party." *Starr Int'l Co., Inc. v. United States*, 106 Fed. Cl. 50, 77 (2012).
- The "involuntarily accepted" prong is satisfied by proof of the other two prongs. *Pew Forest Prods. v. United States*, 105 Fed. Cl. 59, 67 (2012).
- A party claiming duress need not establish that it lacked *any* alternative – only that it had no "reasonable alternative." *Starr Int'l Co., Inc. v. United States*, 106 Fed. Cl. 50, 78 (2012) (quoting *David Nassif Assocs. v. United States*, 226 Ct. Cl. 372, 385 (1981)).
  - An alternative is not reasonable if it would cause the plaintiff to incur "heavy financial loss." Restatement (Second) of Contracts § 175, comment b (1981).
- Defendant's wrongful conduct need only contribute substantially to the plaintiff's financial distress and lack of reasonable alternatives – it need not be the sole cause. *Aircraft Assocs. & Mfg. Co. v. United States*, 174 Ct. Cl. 886, 896-97 (1966).
- "An act can be coercive without being illegal." *Rumsfeld v. Freedom NY, Inc.*, 329 F.3d 1320, 1330 (Fed. Cir. 2003). For example, an act may be wrongful and hence, coercive, if it "violates notions of fair dealing." *Id.* (quoting *Sys. Tech. Assocs. Inc. v. United States*, 699 F.2d 1383, 1387-88 (Fed. Cir. 1983)).

The Evidence Shows Defendant Acted Wrongfully

- "Duress, understood most concretely, is the situation in which one person obtains a temporary monopoly that it tries to use to obtain a benefit to which it is not entitled." *Prof'l Serv. Network, Inc. v. Am. Alliance Holding Co.*, 238 F.3d 897, 900 (7th Cir. 2000).

- Defendant acted wrongfully when it exploited a citizen's need for a discretionary benefit to obtain the unauthorized acquisition of equity and voting control.

- Defendant acted wrongfully when it discouraged other sources of liquidity to AIG.

- Defendant acted wrongfully when it increased pressure on AIG by giving it only an unreasonably short period to consider the terms of the loan.

- Defendant acted wrongfully when it imposed a penalty without authority to do so, and without notice and an opportunity to be heard.

- Defendant acted wrongfully when it discriminated against AIG compared to financial firms who were much more culpable than AIG.

Defendant's Regulatory Failures Contributed Significantly To The Financial Crisis And To AIG's Duress

- Chairman Bernanke: The "actions of the Federal Reserve" in regulating the mortgage market during the housing boom was "a very significant failure": "It was, indeed. I think it was the most severe failure of the Fed in this particular episode" (PTX 599 at 27).

- Secretary Geithner: "There was plenty of blame to go around, some of it mine. Citi's many regulators, including the New York Fed, had failed to save Citi from itself during the boom. We had recognized its vulnerabilities too late" (PTX 709 at 268).

  – "I took too much comfort in analyses downplaying the risk of large nationwide declines, which hadn't happened in the United States since the Depression" (PTX 709 at 118).

- Vice Chairman Kohn: "financial markets have evolved substantially in recent decades – and, in retrospect, by more than we had recognized prior to the crisis. . . . Among other things, the structures exposed the banking system to risks that neither participants in financial markets nor regulators fully appreciated" (PTX 586 at 5-6).

Defendant Also Contributed To AIG's Duress By Repeatedly Telling Potential Private Sources Of Liquidity There Would Be No Government Assistance For AIG Even Though Defendant Knew That Some Government Assistance Was Essential To A Solution

- In the summer of 2008, Defendant recognized that AIG would benefit from financial assistance of the type provided to other financial institutions (PTX 33 at 1, PTX 34 at 1, PTX 35 at 2), but Defendant refused to provide such assistance to AIG and repeatedly stated it would not provide assistance to AIG (PTX 715 at 1-2, PTX 588 at 3, PTX 587 at 96, 114-115).
- As early as March 2008, the Federal Reserve recognized that the prices for subprime backed securities did not reflect underlying values, but rather were "just being driven by fear" (PTX 1196 at 22).
- AIG CEO and Chairman Robert Willumstad told FRBNY President Geithner on September 12: "efforts to find private financing underway," but there was "no solution possible without the Federal Reserve" (PTX 715 at 1-2).
- Goldman Sachs reporting on a meeting between the Government and potential sources of liquidity for AIG: Geithner "informed the group that AIG has a massive liquidity issue and the government will not put in any money" (PTX 605 at 3).
  - Goldman Sachs later on September 15: "Geithner repeated there would be no government money and they were running out of time" (PTX 605 at 4).

Defendant Also Contributed To AIG's Duress By Making A Non-Negotiable, Take-It-Or-Leave-It Offer With A Very Short Time Limit On September 16

- Secretary Geithner: "I get on the phone with Willumstad and basically said we're going to send you a term sheet, you're not going to like it, but you have an hour to get your Board to approve it, two hours, we gave them a deadline, and you are not going to be running the company" (PTX 673 at 24).

- FRBNY General Counsel Baxter: "AIG was told this was 'take it or leave it'. Nothing could be negotiated" (PTX 126 at 1).

- Defendant "admits that Mr. Geithner and Mr. Willumstad had a telephone conversation on September 16, 2008, during which Mr. Geithner told Mr. Willumstad that the Term Sheet was the only proposal for liquidity assistance that FRBNY would make to AIG" (Def.'s Resp. to Pl.'s 1st RFAs Nos. 7.2, 7.6).

Defendant Controlled AIG At The Time That It Took Plaintiffs' Equity And Voting Control As A Condition Of The Credit Agreement

- On September 16, 2008, Defendant chose a new CEO for AIG, without consulting AIG's Board or management (PTX 706 at 263; Paulson Dep. 201:14-21).
- Federal Reserve Vice Chairman Kohn: On "September 16, the government in the form of the Federal Reserve, working with the Treasury, became very deeply involved in the overall strategy of the company" (PTX 449 at 16).
- Morning of September 17, FRBNY Vice President and Head of the AIG Monitoring Team gave senior AIG management the message "the New York Fed was here and you're going to cooperate" (Dahlgren Dep. 46:3-7).
- AIG General Counsel Anastasia Kelly: On September 17, Liddy "got us all into the boardroom and just started, as I said, being CEO" (Kelly Dep. 89:9-89:21).
- On September 18, the AIG Board was told that Mr. Liddy understood "the Department of the Treasury and the Federal Reserve Bank of New York to expect, that Mr. Liddy would be both Chief Executive Officer and Chairman" (JX 94 at 2).
- FRBNY Vice President Dahlgren: On September 19, AIG's General Counsel "agreed going forward that all securities filings, press releases, and any other significant releases or communications would be run past our lawyers (DPW) in advance of anything issued" (PTX 155 at 1).
- Defendant's hand-picked CEO, Edward Liddy: "We do not do a single thing of strategic import without making certain that we have talked to the Federal Reserve about it and we have given them an opportunity to weigh in on it" (PTX 471 at 75).

The Warrants Which The Federal Reserve Board Of Governors Approved And Which Were Thereafter Demanded Of The AIG Board Required Shareholder Approval To Exercise And Had No Vote Until They Were Exercised

- On September 16, when it approved the original warrant structure, the Board of Governors "knew that shareholder approval was required for the issuance of enough shares to fulfill the 79.9 percent on a fully diluted basis" (Kohn Dep. 298:12-14).

- Treasury Advisor Dan Jester on September 16, 2008: the Government "will need approval of AIG s/h; economic incentive; increase fees to encourage s/h approval" (JX 82 at 2).

Defendant Changed Its Equity Requirement From Warrants To Preferred Stock In An Attempt To Give Defendant Voting Control Of AIG While Avoiding A Shareholder Vote Or Other Challenge To Its Control

- Secretary Geithner: the Government moved away from warrants due to “a corporate governance objective. If I’m not mistaken, the warrants would not have come with voting rights” (Geithner Dep. 237:15-239:13).

- FRBNY General Counsel Baxter: “The difficulty was with warrants, that you couldn’t exercise the power to vote, that would be a problem” (Baxter Dep. 212:18-23).

- Treasury Counsel Stephen Albrecht: “We originally pushed for voting rights to help fend off the shareholder attempts to ‘reclaim’ the company” (PTX 349 at 1).

- “Q. One of the differences between warrants, which are limited to exercise on transfer, and voting preferred, is that with voting preferred the United States gets both an economic interest and voting control, whereas with warrants they would get the economic interest but not voting control, correct?
  A. That’s right.” (United States 30(b)(6) Dep. (Alvarez) 233:8-15).

- FRBNY Counsel Charles Gray to FRNBY Vice President Sarah Dahlgren on September 21, 2008: “Rich Charlton just came up and shared with Tom your concern about whether the terms of the equity investment will adequately protect us against activism among minority shareholders at AIG” (PTX 184 at 1).

- FRBNY General Counsel Baxter on September 21, 2008: “I am trying to keep this moving because of a concern there will be shareholder action” (PTX 183 at 1).

Requiring Preferred Stock Representing 79.9% Of AIG's Equity And Voting Control Was Also Unauthorized Because The Federal Reserve Board Of Governors Never Approved Such Preferred Stock Or The Credit Agreement

- The Federal Reserve Board of Governors is the only governmental entity with authority to approve a Section 13(3) loan. 12 U.S.C. § 343.

- But the Federal Reserve Board of Governors never considered or approved the preferred stock and voting control taken in the Credit Agreement.

Although Defendant Internally Had Decided To Demand Voting Preferred Stock Rather Than Non-Voting Warrants, Defendant Withheld This Information From AIG's Board Until Shortly Before The September 21, 2008 Board Meeting

- AIG General Counsel Anastasia Kelly to AIG executives on September 21 at 9:27 a.m.: "we have not yet received the equity piece, which is the most important" (PTX 182 at 1).
- September 21 at 3:03 p.m. AIG Board Secretary Eric Litzky to AIG Board: "The terms of the equity participation have not yet been received" (PTX 189).
- "At 6:31 pm on September 21, 2008, AIG's directors received via email notice that the proposed form of equity set forth in the Credit Agreement would be 'Preferred Shares'" (Agreed to Stipulations ¶ 140).
- AIG September 21 Board Minutes for meeting convened at 8:00 p.m.:
  - "It was noted that although the Board had originally been led to believe that the form of equity participation by the Treasury Department would be warrants, the form of equity participation to be issued in connection with the Credit Agreement is now proposed to be convertible preferred stock, **the terms of which were reflected in a term sheet delivered to Board members prior to the meeting**" (JX 103 at 3) (emphasis added).

By September 21, 2008, Facts And Circumstances Had Changed So Dramatically That AIG Had No Reasonable Alternative But To Accept The Terms Imposed By Defendant In The Credit Agreement

- During the September 21 Board meeting, AIG's counsel, Rodgin Cohen of Sullivan & Cromwell, advised the Board: "if the Board accepted the Bank transaction, the Board would have properly exercised its business judgment," but that "if the Board chose to file for bankruptcy, he was not prepared to render a similar opinion to the Board" (JX 103 at 5-6).
  - In contrast, on September 16, Cohen advised the Board it "could accept either option" – that is, proceeding with the Defendant's proposed terms or filing for bankruptcy (JX 74 at 5).
- As AIG Vice Chairman Jacob Frenkel wrote: "the government stole at a [sic] gunpoint 80 percent of the company" (PTX 228 at 1).

Defendant Also Contributed To AIG's Duress By Requiring AIG To Accept The Credit Agreement In A Matter Of Hours, Threatening That Otherwise Defendant Would Call The Interim Funding And Demand Notes Defendant Held

- AIG's new CEO Edward Liddy told the AIG Board during the September 21, 2008 meeting: "the Corporation will be required by the Bank and the Treasury Department to finalize the documentation and sign the Credit Agreement before the opening of the market the following day" (JX 103 at 2).

- The AIG Board's outside counsel, Michael Wiseman of Sullivan & Cromwell, advised the Board that "based on his conversations with the General Counsel of the Bank, he believed that if the Board did not approve the transaction that evening, the likely result would be that the bank would refuse to fund the Corporation the next day" (JX 103 at 4) and that the Bank "would call Note" (PTX 195 at 3).

- Handwritten Notes of AIG Corporate Secretary Kathleen Shannon:

  - "RC [Rodgin Cohen]": "Fed. Res. has indicated that if BOD does not approve, they will refuse to fund tomorrow" (PTX 195 at 3).

  - "MW [Michael Wiseman]": "EL [Ed Liddy] made approach. Spoke to Tom Baxter – made it clear likely result would not fund + would call Note" (PTX 195 at 3).

The AIG Board's Approval Of The Credit Agreement Is Legally Irrelevant

- A citizen's agreement to the Government's demand for unauthorized consideration for the Executive Branch's exercise of discretion is not a defense to an Illegal Exaction claim – indeed, if it were, it would swallow the Illegal Exaction doctrine.

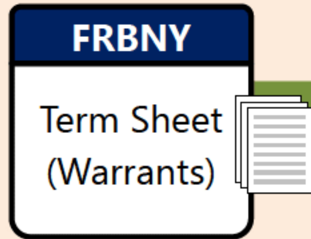
- In any event, the AIG Board's approval of the Credit Agreement was under duress.

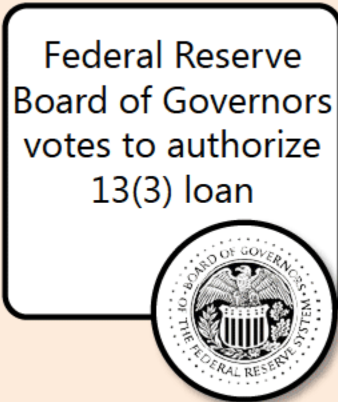
- Moreover, with respect to Plaintiffs' Takings Claim, Defendant was a controlling lender at the time the Credit Agreement was signed and a controlling lender and shareholder at the time of the Reverse Stock Split.

- Even if the Board's approval of Defendant's Taking was not the result of Defendant's control or duress, such approval would not bind AIG's shareholders with respect to their direct claims – particularly in light of the Government's role in preventing shareholders from having an opportunity to consider the surrender of 79.9% of their equity and voting control.

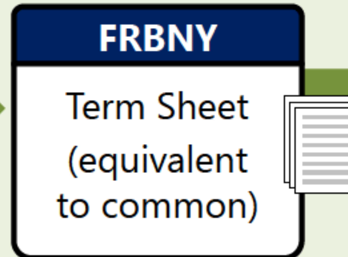
Final Agreement for Equity

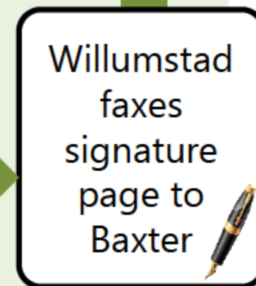
Internal Drafts of Term Sheet





The Terms Offered to AIG





1:00 pm | 2:00 pm | 3:00 pm | 4:00 pm | 5:00 pm | 6:00 pm | 7:00 pm | 8:00 pm | 9:00 pm

Sept. 16, 2008

The Reverse Stock Split And Related "Exchange" Constitute An Additional Wrong

- Defendant concedes that "common shareholders have a right to a separate class vote before a Delaware corporation can change the number of authorized common shares or change their par value" (Def.'s Summary Judgment Br. at 49).

- Delaware law prohibits stratagems to deprive shareholders of their voting rights. *Paramount Commc'ns, Inc v. QVC Network Inc.*, 637 A.2d 34, 42 (Del. 1993).

- There is no provision of Delaware law that allows a reverse stock split to be used to obtain the same result as the authorization of more common shares requiring a class-only vote.

- Defendant controlled AIG at the time of the reverse stock split.

- "The Constitution constrains governmental action by whatever instruments or in whatever modes that action may be taken". *Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 392 (1995) (quotation marks omitted).

Because Defendant's Preferred Shares Could Not Be Converted To The More Valuable Common Stock Without Approval By A Class Vote Of Common Shareholders, Defendant Improperly Circumvented The Required Shareholder Approval By Having AIG "Exchange" Its Preferred Shares For Common Stock After The Reverse Stock Split

- On November 7, 2008, AIG informed the court in the *Walker* litigation that it agreed a class vote would be required for the conversion of Defendant's preferred shares to common shares (JX 143 at 7), and thereafter represented the same in an SEC filing (JX 150 at 28) and to global regulators (PTX 410 at 6).
- On November 19, 2008, Davis Polk, counsel to FRBNY and Treasury, advised: The "only vote the Trust or Treasury doesn't control is the class vote of the common stockholders that's required to permit the convertible preferred to convert into common stock" and noted that "we have an alternative for the sale of the investment if the convertible preferred can't be converted" (JX 156 at 1).
- AIG and Defendant never held a vote because they knew a vote would fail.
  - Davis Polk representative John Brandow: there was "a concern that the proposal would not be approved by the shareholders" (DPW 30(b)(6) (Brandow) Dep. 145:20-23).
  - AIG Auditor PricewaterhouseCoopers: "Management believes that there is an inherent economic disincentive for shareholders to approve the amendment" (PTX 511 at 2).
- Defendant controlled the timing and content of the proxy AIG submitted to its shareholders.
- Trustee Doug Foshee to FRBNY Vice President Dahlgren: "I'm trying to put together a process for getting us from where we are to a proxy filing. Do have any updated info on when company wants to file and when Treasury will let them file?" (PTX 2731).

Defendant Continued To Control AIG At The Time Of The Reverse Stock Split

- Chairman Bernanke on March 3, 2009: "AIG is effectively under our control" (PTX 447 at 50).
- Federal Reserve Vice Chairman Kohn on September 23, 2008: "we're definitely acting like we own the company" (PTX 233).
- AIG's regulator, the Office of Thrift Supervision, "didn't want the responsibility for supervising the company anymore" because "in their words, the government owns the company" (Dahlgren Dep. 88:17-89:2).
- Defendant attended and participated in AIG Board meetings:
  - Defendant was "consulted in advance on the agendas of items to be brought before the board" (United States 30(b)(6) (Millstein) – Dec. 18, 2012 Dep. 208:7-21).
  - Mr. Liddy: The "Federal Reserve is present at every one of our strategic discussions at all of our board meetings and committee meetings" (PTX 516 at 29).
  - AIG former Director Stephen Bollenbach: "There were representatives of the government that attended the board meetings and, through words or actions, made it fairly clear on what they expected the board to do" (Bollenbach Dep. 125:3-15).
- Defendant participated in the recruitment of new AIG Board members (Def.'s Resp. to Pl.'s 2nd RFAs No. 806).
- FRBNY Vice President Dahlgren on May 29, 2009: Mr. Liddy had "no decisionmaking authority" and was "paralyzed at this point" (PTX 485).

The Proxy That Was Issued For The June 30, 2009 Annual AIG Meeting Was Misleading

- The proxy did not contain a proposal to increase the number of authorized common shares to a level sufficient to allow Defendant to convert its preferred shares to common shares.

- Instead, the proposal provided for a 20:1 reverse stock split that applied only to issued – **not all authorized** – shares.

  – The misleading purported explanation for the reverse stock split was to avoid delisting.

  – Avoidance of delisting could have been achieved based on a 5 to 1 ratio, or by application of the reverse stock split to all authorized shares.

- The proxy was also misleading because it stated "AIG currently has no plans for these authorized but unissued shares of AIG Common Stock other than those shares previously reserved for issuance under AIG's Equity Units, the Warrants and AIG's employee benefit plans" (JX 221 at 70).

Both Plaintiffs' Illegal Exaction Claim And Plaintiffs' Takings Claim Require Defendant To Compensate Plaintiffs For The Actual Fair Market Value Of The Equity And Voting Rights Defendant Improperly Acquired

- Where, as here, Defendant directly appropriated tens of billions of dollars of property from Plaintiffs, "the government must provide just compensation to the owner." *Nat'l Food & Beverage Co., Inc. v. United States*, 103 Fed. Cl. 63, 69 (2012).

- "Just compensation" for a taking is based on the "fair market value of the property on the date it is appropriated." *Kirby Forest Indus., Inc. v. United States*, 467 U.S. 1, 10 (1984).
  - "The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." *United States v. Cartwright*, 411 U.S. 546, 551 (1973).

- Where the Government exacts property from a plaintiff in contravention of its statutory authority, that plaintiff is entitled to receive the value of its property. *Casa de Cambio Comdiv S.A. de C.V. v. United States*, 48 Fed. Cl. 137, 145 (2000).

- The value of the equity and voting control should be calculated as of the date the equity and voting control were illegally exacted. *Gmo. Niehaus & Co. v. United States*, 373 F.2d 944, 961 (Ct. Cl. 1967).

Defendant's Hypothetical "But For" And "Offset" Arguments Are Legally Irrelevant

Defendant argues that without a 13(3) loan AIG would have filed for bankruptcy and shareholders would be even worse off than they were from the surrender of 79.9% of their equity and voting control.

- Defendant relies on cases involving regulatory takings where the Government does not actually acquire property and the question is not the fair market value of property acquired by the Government, but whether the Government action so burdens a citizen's use or enjoyment of property that it constitutes a *de facto* taking; in this case, Defendant actually and directly acquired Plaintiffs' equity and voting control.
- Moreover, a threshold issue is whether Defendant could properly tie a 13(3) loan to surrender of Plaintiffs' equity and voting control – if it could not, there is no basis for offsetting the asserted value of the loan against the indisputable damage resulting from surrendering 79.9% of Plaintiffs' equity and voting control.
- In any event, the factual premise of Defendant's argument is wrong. The evidence is undisputed that Defendant would not have permitted AIG to file for bankruptcy even if the AIG Board refused Defendant's demand for 79.9% of Plaintiffs' equity and voting control.

Defendant Has Conceded That AIG's Bankruptcy Was Not An Option Because Of The "Catastrophic" Consequences For The Overall Economy

- Secretary Geithner: "We did not have the option of bankruptcy; we did not have the option of defaults; we did not have the option of selective haircuts. It would have been catastrophic to let the institution fail" (PTX 564 at 139).
- Secretary Geithner on the morning of September 16: We "needed to make this loan to avoid the systemic consequences that would result from an AIG filing" (United States 30(b)(6) (Baxter) Dep. 53:21-24).
- "Letting AIG fail seemed like a formula for a second Great Depression. It was essential that we do everything in our power to try to avoid that" (PTX 709, *Stress Test*, at 209).
- FRBNY General Counsel Baxter: "At no point did we believe we should let AIG file" for bankruptcy (PTX 2211 at 12).
- Secretary Paulson: "It would have been, in my judgment, unthinkable to have AIG declare bankruptcy" (PTX 205 at 4).
- Secretary Paulson: AIG's collapse "would have buckled our financial system and wrought economic havoc on the lives of millions of our citizens" (PTX 564 at 142).
- Chairman Bernanke: "AIG's demise would be a catastrophe" (PTX 599 at 77) and "could have resulted in a 1930s-style global financial and economic meltdown with catastrophic implications for production, income, and jobs" (PTX 480 at 16).

Section 13(3) Lending From September 16th Through September 29th Of 2008

Sep 16 (Tue)

13(3) Lending to Primary Dealers:

- Total: **$155.9 billion**
  - PDCF: $38.4 billion at 2.25%, **no equity** (PTX 728)
  - TSLF: $117.5 billion outstanding at .25% or less, **no equity** (PTX 2565)

Sep 17 (Wed)

13(3) Lending to Primary Dealers:

- Total: $**177.3 billion**
  - PDCF: $59.8 billion at 2.25%, **no equity** (PTX 728)
  - TSLF: $117.5 billion outstanding at 3% or less, **no equity** (PTX 2565)

Sep 18 (Thu)

13(3) Lending to Primary Dealers:

- Total: **$280 billion**
  - PDCF: $92.5 billion at 2.25%, **no equity** (PTX 728)
  - TSLF: $187.5 billion outstanding at 3% or less, **no equity** (PTX 2565)

Sep 19 (Fri)

13(3) Lending to Primary Dealers:

- Total: **$261.8 billion**
  - PDCF: $74.3 billion at 2.25%, **no equity** (PTX 728)
  - TSLF: $187.5 billion outstanding at 3% or less, **no equity** (PTX 2565)
- Fed is informed that Morgan Stanley and Goldman Sachs will fail on Monday (September 22) without Federal assistance. (PTX 175)

S E P T E M B E R 2 0 0 8

Sep 16 (Tue)

- Federal Board of Governors approves an IPC 13(3) loan to AIG in the form of an $85 billion revolving credit facility at (a) a rate of 12% in annual interest; (b) 3.0% in commitment fees; and (c) warrants exercisable to acquire a 79.9% equity interest in AIG. (JX 63)
- AIG's board approves non-binding terms with the understanding that the 79.9% equity interest would be in the form of warrants. (JX 75)
- 13(3) Lending to AIG:
  - Total: **$14 billion** at 12%
  - Pursuant to fully secured demand notes (JX 83 at 1)

Sep 17 (Wed)

- **9:00 a.m.** Liddy arrives at AIG to take over as CEO.
- 13(3) Lending to AIG:
  - Total: **$28 billion** at 12%
  - Pursuant to fully secured demand notes (JX 84 at 1-2)

Sep 18 (Thu)

- AIG files 8-K describing potential financing as including warrants subject to shareholder approval. (JX 96)
- 13(3) Lending to AIG:
  - Total: **$34 billion** at 12%
  - Pursuant to fully secured demand notes (JX 84 at 1-3)

Sep 19 (Fri)

- At Government's insistence, AIG files an 8-K/A restating that the form of the equity interest has yet to be determined.
- Marshall Huebner at DPW emails Tom Baxter responding to AIG 8-K filing, stating, "**I don't see how we leave this asset at risk of minority shareholder takeover**." (PTX 154 at 1)
- 13(3) Lending to AIG:
  - Total: **$37 billion** at 12%
  - Pursuant to fully secured demand notes (JX 84 at 1-4)

Section 13(3) Lending From September 16th Through September 29th Of 2008

Sep 21 (Sun)

- Federal Reserve extends PDCF credit to the US and London based affiliates of Merrill Lynch, Goldman Sachs, and Morgan Stanley. (PTX 728)
- Federal Reserve enables each of Morgan Stanley and Goldman Sachs to become a Bank Holding Company ("BHC") in just two days. (PTX 198)
- **4:45 p.m.** Ed Liddy attends Goldman Sachs board meeting at which Goldman Sachs board approves converting Goldman Sachs to BHC. (PTX 193)

Sep 22 (Mon)

13(3) Lending to Primary Dealers:

- Total: **$286.9 billion**
  - PDCF: $99.4 billion at 2.25%, **no equity** (PTX 728)
  - TSLF: $187.5 billion outstanding at 3% or less, **no equity** (PTX 2565)

Sep 29 (Mon)

13(3) Lending to Primary Dealers:

- Total: **$428 billion**
  - PDCF: $155.8 billion at 2.25%, **no equity** (PTX 728)
  - TSLF: $272.2 billion outstanding at 3% or less, **no equity** (PTX 2565)
- Morgan Stanley alone borrows over **$100 billion:**
  - PDCF MS U.S. = **$40 billion**
  - PDCF MS U.K. = **$21 billion**
  - TSLF MS = **$36 billion** outstanding

S E P T E M B E R 2 0 0 8

Sep 21 (Sun)

- **9:27 a.m.** AIG's General Counsel sends an internal email stating that AIG had "not yet received the equity piece, which is the most important part." (PTX 182 at 1)
- **6:30 p.m.** AIG's Board receives for the first time the revised equity interest term sheet specifying that the equity would be in the form of Convertible Participating Preferred Stock. (PTX 196)
- **8:00 p.m.** AIG Board Meeting:
  - Three hours after leaving Goldman Sachs board meeting, Ed Liddy attends AIG Board meeting, and informs the AIG Board that there were indications the Federal Reserve "was not going to come to the aid of other troubled issuers and turmoil was expected." (JX 103 at 2)
  - AIG's Board approves the revised equity structure after being told that the Government would refuse to fund AIG the following day if it declined, and that AIG's counsel would not provide an opinion that they satisfied their fiduciary duties if they did not approve the RCF. (JX 103)

Sep 22 (Mon)

- $85 Billion Revolving Credit Facility. (JX 107 at 9)
- Terms:
  - **2% commitment fee** on entire $85 billion facility (JX 107 at 37-38)
  - Interest:
    - 12% on drawn amounts (JX 107 at 7, 26)
    - 8.5% on undrawn amounts (JX 107 at 25)
  - Provide **79.9% voting preferred shares** on fully diluted basis to be issued to a new trust to be formed for benefit of Treasury (JX 107 at 46-47, 137-139)
- Total amount drawn **$37 billion** (not including accrued fees). (JX 107 at 38-39)

Sep 29 (Mon)

- Government in control of AIG since September 16.
- AIG shareholders were diluted by 79.9% without shareholder vote on September 22.
- 13(3) Lending to AIG:
  - Total amount drawn **$55 billion** (PTX 1648) at 12% (not including accrued fees)
  - 2% commitment fee
  - 79.9% equity in form of voting preferred stock