

Business Insurance

Greenberg's Starr sues U.S. over AIG bailout actions

Suit says rescue plan unconstitutional, seeks at least \$25B

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Starr International Co. Inc., which is headed by former AIG CEO Maurice R. Greenberg, alleges that the federal government unconstitutionally took the property and rights of AIG's shareholders without compensation.

WASHINGTON—Starr International Co. Inc. is taking an unusual course in suing the federal government on constitutional grounds for actions it took in 2008 to rescue American International Group Inc. from the brink of collapse, say some legal experts.

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In a suit filed last week in the U.S. Court of Federal Claims in Washington, Starr—which is headed by former AIG CEO Maurice R. Greenberg—alleges that by taking control of nearly 80% of AIG in 2008, the federal government unconstitutionally took the property and rights of AIG's shareholders without compensation.

Beginning in 2008 “and continuing through at least January 2011, the government ignored the Constitution and singled out AIG common stock shareholders for discriminatory and unlawful treatment in clear violation of the takings, due process and equal protection clauses of the United States Constitution,” according to the Starr complaint.

The suit seeks at least \$25 billion in damages for shareholders and AIG.

Tim Massad, assistant secretary for financial stability at the Treasury Department, defended the government's actions.

“It is important to remember that the government provided assistance to AIG—and stopped it from collapsing—in order to prevent a meltdown of the entire global financial system,” Mr. Massad said in a statement. “Our actions were necessary, legal and

constitutional. We are reviewing the lawsuit and expect to defend our actions vigorously.”

A few hours after filing the first suit in Washington, Starr filed another suit against the Federal Reserve Bank of New York in federal court in New York. Among other allegations, it holds that the New York bank breached its fiduciary duty to AIG shareholders and that the bank in effect engaged in a “backdoor bailout” of AIG counterparties.

“There is no merit to these allegations,” a spokesman for the New York Fed said in an email. “AIG's board of directors had an alternative choice to borrowing from the Federal Reserve and that choice was bankruptcy. Bankruptcy would have left all AIG shareholders with worthless stock. “

Legal observers questioned the strength of Starr's case.

“It is somewhat unusual, but the constitutional takings clause and the guarantee against taking property without due process of law can apply to things like shareholder value,” said Paul Rothstein, professor of law at Georgetown University Law School in Washington.

“But I think the suit is weak for several reasons,” he said. “First, AIG's board did approve the deal with the government, and AIG got something for what they gave; and as long as the government pays something that can be regarded in any way as fair compensation, the government can take your property for a public use. I would add that the value of what the government took may be a lot smaller than people think because AIG was in severe trouble.”

The suit against the Fed “is much more interesting in two notable respects” than the suit against the government, because it focuses on transactions or issues that occurred after the government assumed majority control of AIG, said Lawrence A. Hamermesh, a professor of corporate and business law at Widener University Law School in Wilmington, Del.

“First, there are challenges to post-acquisition decisions that are claimed to have harmed AIG—and indirectly, its common stockholders—but favored the interests of its controlling stockholder,” he said. “I haven't dug into the details of those transactions, but that's a much more plausible claim than the one challenging the initial stock acquisition,” said Mr. Hamermesh.

“Second—and even more interesting to me—there is a claim that a vote of common stockholders is required to authorize the common stock necessary to satisfy the government's rights to convert its preferred stock to common stock. The claim is that a reverse stock split was essentially an end run around that required vote of common stockholders voting separately as a class. I'm a little skeptical about this claim, but it seems nontrivial, at the very least,” the professor said.

Ronald D. Rotunda, a professor of law at Chapman University School of Law in Orange, Calif., said he hasn't seen a case like this before but also said, "The Great Recession we haven't seen before."

"At the time, people wondered how this could all be done," he said. "General Motors was taken into bankruptcy, but AIG didn't go into bankruptcy. We're not sure of the statutory authority. This was all done in such haste. There well may be something to this because the government did squeeze out the shareholders."

"The takeover prevented the company from filing for bankruptcy," said Roger Pilon, vp-legal affairs at the libertarian-oriented Cato Institute in Washington. "The shareholders would have been at the front of the line for such assets as there were after creditors were paid."

Neither Starr nor its law firm responded to a request for comment. A spokesman for AIG declined to comment.