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Second Circuit Holds that Federal Reserve Bank of NY Was Not Subject to State Law Fiduciary Duty Claim for Actions During Financial Crisis

If you wish to receive more information on the topics covered in this publication, you may contact your regular Shearman & Sterling contact person or any of the following:

Contacts

Douglas P. Bartner
New York
+1.212.848.8190
dbartner@shearman.com

Solomon J. Noh
London
+44.20.7655.5795
solomon.noh@shearman.com

Fredric Sosnick
New York
+1.212.848.8571
fsosnick@shearman.com

Andrew V. Tenzer
New York
+1.212.848.7799
atenzer@shearman.com

Edmund M. Emrich
New York
+1.212.848.7337
edmund.emrich@shearman.com

Jill Frizzley
New York
+1.212.848.8174
jfrizzley@shearman.com

Ned S. Schodek
New York
+1.212.848.7052
ned.schodek@shearman.com

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Late last month, in *Starr Int'l Co. v. Fed Reserve Bank of N.Y.*,[1] the Second Circuit held that the Federal Reserve Bank of New York ("FRBNY") could not be held liable for state law fiduciary duty claims when it was acting under its statutory mandate to rescue a corporate entity. In doing so, the court made clear that such protections would extend to the Federal Reserve Bank where it is alleged that, in some of the actions it took, FRBNY had exceeded its statutory authority.

The *Starr Int'l* case arose out of the bailout of American International Group ("AIG") in 2008.[2] Starr, which had been a principal shareholder of AIG, alleged that actions taken by FRBNY were designed to benefit FRBNY and the United States Treasury to the detriment of AIG's shareholders in a manner that would constitute a breach of fiduciary duties owed to shareholders of a Delaware corporation.[3] As part of the AIG rescue, FRBNY made available $85 billion to AIG under a new credit agreement (the "Credit Agreement") on the condition that AIG give the federal government an 80% interest in AIG common stock to be held in a trust (the "Trust").[4] Prior to entering into the Credit Agreement, AIG replaced its existing CEO with Edward Libby, whom Starr alleged to have been under the control of FRBNY.[5]

Starr commenced litigation in the United States District Court for the Southern District of New York focused solely on the actions of FRBNY after AIG's entry into the Credit

[1] No. 12-5022-cv (2d Cir. Jan. 29, 2014).

[2] *Id. slip op.* at 2-3.

[3] *Id.* at 3.

[4] *Id.*

[5] *Id.*

Agreement with FRBNY.[6] Specifically, Starr alleged that FRBNY violated its fiduciary duties to shareholders of AIG by causing a special purpose entity ("Maiden Lane II"), which was funded by both FRBNY and AIG, to purchase $62 billion of assets from credit default swap counterparties at par, when, according to Starr, the counterparties would have been willing to settle at a discount to par.[7] As a separate breach of fiduciary duty, Starr pointed to the 20:1 reverse stock split that AIG used to provide the 80% of the shares of common stock to the Trust as required by the Credit Agreement, after shareholders had rejected an increase in the number of authorized shares.[8]

The District Court dismissed the claims against FRBNY on the basis that state fiduciary law did not apply to FRBNY's actions, because those actions were in furtherance of the uniquely federal interest of stabilizing the national economy.[9] On appeal, the Second Circuit affirmed the dismissal.[10]

In its decision, the Second Circuit started by noting that although Congress specifically authorized federal reserve banks to be sued, it provided that any such suits "shall be deemed to arise under the laws of the United States."[11] The Second Circuit concluded that under that statute the laws of the United States do not include state corporate law, reasoning that:

> Because of the uniquely federal interests at stake in FRBNY's rescue of AIG, at the height of the 2008 financial crisis, which would be compromised by the application of state fiduciary duty law, we hold that federal law preempts state fiduciary duty law and provides the rule of decision.[12]

Starr argued that even though FRBNY could not be held to the standard of Delaware corporate law if it were properly acting within the scope of its Congressionally granted authority, it nevertheless was exposed to state law claims because, in Starr's view, FRBNY's actions were outside of the scope of its statutory powers.[13] Without evaluating whether FRBNY was acting within the scope of its powers, the Second Circuit summarily rejected Starr's argument by adopting the District Court's view that no case law had been identified that "limits the scope of preemption to the scope of a federal instrumentality's lawful operation, or that makes state law inherently available to police excesses of authority by federal actors."[14]

In reaching its decision, the Second Circuit did not address federal court claims that may be brought against a federal instrumentality for exceeding the scope of its statutory authority, which presumably leaves those claims open for future cases, even in the Second Circuit. Moreover, due to the unique procedural posture of the case—which did not challenge the initial rescue terms—it is also possible that federal claims, such as Fifth Amendment takings claims could be brought against instrumentalities of the federal government in future rescue cases. At least in the Second Circuit, however, it is

[6] Starr apparently was time barred in its ability to assert claims for the period prior to November 21, 2008. *Id.* at 3-4.

[7] *Id.* at 4.

[8] *Id.*

[9] *Starr Int'l Co. v Fed. Reserve Bank of N.Y.*, 906 F. Supp. 2d (S.D.N.Y. 2012).

[10] *Starr Int'l*, No. 12-5022-cv slip op at 3 (2d Cir. Jan. 29, 2014).

[11] *Id.* at 5-6. (citing 12 U.S.C. § 632).

[12] *Id.* at 6.

[13] *Id.* at 7.

[14] *Id.* at 7 (quoting *Starr*, 906 F. Supp. at 242).

clear that state fiduciary duty claims are not a viable means of attacking actions of the federal government to stabilize the economy.

599 LEXINGTON AVENUE | NEW YORK | NY | 10022-6069