Who is the villain, who is the hero in AIG case?

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Trials are dramas in which heroes and villains are revealed. And a drama of apocalyptic proportions just ended its latest chapter on June 15 in the case of Starr International Co. Inc. v. United States.

The case is about the controversy surrounding the federal government bailout of AIG, the global insurance company, during the Great Recession. By way of background, Judge Thomas C. Wheeler writes a chilling history of the financial crisis that nearly sunk the entire global economy.

"In September 2008, the American economy faced the worst financial crisis since the Great Depression of the 1930s," Wheeler wrote. "... In the United States, the initial loss of household wealth was five times as severe as compared to the initial loss of wealth during the Great Depression."

"Between March and September 2008, the financial markets continued to deteriorate," Wheeler continued. "... By September 2008, panic among financial institutions had caused the private market to freeze and stop functioning altogether. ... Of the 13 most important financial institutions in the United States, 12 'had either failed or were at risk of failure.' "

The judge observed that AIG failed to properly manage its investment risks, and suffered an inescapable liquidity squeeze. AIG had no place to turn except to the Federal Reserve, the lender of last resort.

Officials in charge of the Federal Reserve and the U.S. Treasury realized they had to stem the downward spiral of the U.S. economy, especially after Lehman Brothers had filed bankruptcy, creating a new flashpoint. AIG was too interconnected with all the major financial institutions around the world to be allowed to fail. But officials also were concerned about the temptation created for other financial institutions in the future to throw caution to the wind and simply rely on the U.S. Treasury to bail them out.

So the officials strong-armed AIG to take loans at extremely high interest rates. Worse yet, they seized 79.9 percent of AIG stock, fired AIG's president and replaced him with their own choice and closely monitored the management of the company. Eighty percent of the shareholders' equity value immediately went to zero when the government seized 80 percent of the equity.

The government ended up loaning about $120 billion to AIG to keep it afloat during the crisis. By 2012, the government had received back all the money loaned, sold the stock in AIG, and made a profit (for U.S. taxpayers) of $23 billion.

The shareholders of AIG sued the government for unauthorized taking of their stock. Judge Wheeler agreed that the government's actions were not authorized by law. But then the judge said the plaintiff shareholders cannot collect any damages from the government, because they would have lost all their stock value in a bankruptcy, had not the government stepped in. The judge refused to make the government pay for a value that it itself created by backstopping the survival of the company with loans. AIG survived and continues today as a successful publicly held company traded on the NYSE.

So who is the villain and who is the hero?

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