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Case No: CL-2014-000921

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
QUEEN'S BENCH DIVISION
COMMERCIAL COURT

Royal Courts of Justice
Rolls Building, Fetter Lane, London EC4A 1NL

Date: 9 November 2018

Before :

MR JUSTICE ANDREW BAKER

- -

Between :

TOBIAS GRUBER **and 22 others**	**Claimants**
- and -	
(1) AIG MANAGEMENT FRANCE, S.A. **(2) AIG FINANCIAL PRODUCTS CORP.** **(3) AMERICAN INTERNATIONAL GROUP, INC.**	**Defendants**

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Daniel Oudkerk QC, Amy Rogers & Jamie Susskind (instructed by **Stephenson Harwood LLP**) for the **Claimants**
Andrew Hunter QC & Peter Head (instructed by **Paul Hastings (Europe) LLP**) for the **Defendants**

Hearing dates: 30 April, 1-4, 8-9, 16-17 May 2018

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Judgment Approved

Mr Justice Andrew Baker :

Introduction

1. On Monday 15 September 2008, Lehman Brothers Holdings filed for Chapter 11 protection in New York, Lehman Brothers International (Europe) entered administration in London, and a fully-fledged global financial crisis was born. A decade later, global economies and markets continue to feel the effects and litigation over the consequences continues.

2. Whereas Lehman Brothers was not ‘bailed out’ by public funds, the AIG group was. The group had assets of the order of US$1 trillion. However, it was heavily exposed to the tumultuous effects of the crash because of credit default business written by its financial products division under the leadership of Joe Cassano. Treated as ‘too big to fail’, AIG secured emergency funding from the Federal Reserve Bank of New York.

3. That funding was agreed in principle on 16 September 2008, the day after the collapse of Lehman Brothers, and was formalised by a revolving credit facility for lending of up to US$85 billion entered into on the following Monday, 22 September 2008. The borrower was the seventh defendant ('AIG Inc'), the parent company of the AIG group. With the benefit of that funding, AIG Inc in turn extended a revolving credit facility to the second defendant ('AIG-FP'), also dated 22 September 2008, for lending of up to US$65 billion. AIG-FP was and is a wholly-owned subsidiary of AIG Inc. (For accuracy – nothing turns on this – I should say that initially the lender to AIG-FP was another group company, AIG Funding Inc, but its rights and obligations under the AIG-FP facility were later taken into the parent, AIG Inc.) AIG-FP has continued in business ever since, and does so today, only thanks to the support of AIG Inc through that bail-out facility. It has drawn on it heavily over the years, at one point the amount drawn down reaching US$56 billion, more recently standing at around US$35 billion.

4. By early October 2008, at the strategic direction of AIG Inc as parent, AIG-FP commenced an orderly winding down of its business. The most significant element of that involved the closing out of a large portion of AIG-FP's open transactions through the 'Maiden Lane III' structure to which I refer further below. The completion of the Maiden Lane III close-out realised in AIG-FP losses on credit default transactions of the order of US$30 billion in November 2008 and US$10 billion in December 2008.

5. The claimants are 23 former employees in the AIG financial products division working for the first defendant ('Banque AIG') in London. Strictly, they are 22 such former employees and the executrix of 1 such former employee, but no distinction was drawn in relation to her position at trial so I hope she will forgive me if I do not mention her different status again in this judgment. Banque AIG was and is a 90% subsidiary of AIG-FP. Most of the claimants were employed by Banque AIG; a few were employed by AIG-FP but seconded to Banque AIG. It is said that none of the claimants was personally involved in the credit default business of AIG-FP that brought the AIG group to the point of collapse (but for the Federal bail-out). Whether or not that is true was not explored in any detail in evidence and is irrelevant to the issues that arise.

6. The claimants claim that they were or should have been entitled to substantial deferred bonus payments pursuant to deferred bonus plans operated by AIG-FP. The claimants' participation in those plans, to the extent they participated, was an entitlement of theirs under their respective contracts of employment governed by English law. The plans themselves were contracts governed by Connecticut law.

7. Contrary to a submission advanced by the claimants, the plans were not incorporated into the claimants' employment contracts. Rather, it was a term of those employment contracts that the claimants could and would participate in the plans. The point does not matter, however, as the dispute concerns the meaning and effect of the plans, and it is agreed that they are to be construed in accordance with Connecticut law. No question arises of the plans being altered in response to the financial crisis in a way that would be both adverse to the claimants and effective under Connecticut law, so as perhaps to give rise to a claim against the employer such as was considered in *Attrill v Dresdner Kleinwort* [2013] 3 All ER 607, *per* Elias LJ at [101]-[140].

8. Nor does any question arise of some judgment or discretion being exercised by or on behalf of the claimants' employer in such a way, though seemingly permitted by the contractual language of the plans, as to involve a breach of the employer's implied

obligation of fair employee treatment described, for example, by Lord Nichols in *Eastwood v Magnox Electric plc* [2005] 1 AC 503 at [11]. If, as the defendants contend, the claimants do not have the entitlements they claim, it is because those claimed entitlements are contrary to the meaning and effect of their terms, properly construed, indeed (the defendants would say) contrary to the essence of the plans. The issues in the case do not concern the making of judgment calls or the exercising of discretions, but concern rather the basic purpose and effect of the plans, according to their terms.

9. If and to the extent that the claimants did have entitlements under the plans but have not been paid, or would have had such an entitlement but for an incorrect operation of the plans:

    i) they claim payment, or damages for breach of contract, against AIG-FP and Banque AIG (except that the claimants employed by AIG-FP do not say they can claim on Banque AIG), and

    ii) they claim damages against AIG Inc in tort, alleging either

        a) that the corporate veil between AIG Inc and AIG-FP is to be pierced in relation to the failure to honour the plans or operate them correctly, a claim it is agreed should be determined under Delaware law, or

        b) that AIG Inc is guilty of wrongful interference in the performance of the plans by AIG-FP, a claim it is agreed should be determined under either English law or Connecticut law.

10. The defendants say that the deferred bonus plans were operated correctly, so that nothing is owed to the claimants under them, and that any liability would be a contractual liability only of AIG-FP and, where relevant, Banque AIG, without any liability on the part of AIG Inc.

11. If AIG-FP or Banque AIG has a liability to any of the claimants, the claimants have made clear they will say that payment of any resulting judgment debt is guaranteed by AIG Inc under certain guarantees governed by New York law. However, any consideration of that is beyond the scope of this judgment. It will arise only if there is now a money judgment against AIG-FP or Banque AIG that goes unsatisfied, the claimants look to AIG Inc as alleged guarantor for payment and AIG Inc does not pay.

12. In the immediate aftermath of the collapse of Lehman Brothers and the bail-out of the AIG group, the payment of bonuses generated by the 'boom' years but payable (if at all) after the 'bust' was publicly and politically contentious. The central issue in this litigation is the extent to which the claimants were indeed entitled, after the crash and despite its impact on AIG-FP, to be paid bonus amounts credited to them before the crash but deferred on the terms of the AIG-FP Deferred Compensation Plan ('the DCP'), which dated from 1995. The case also concerns bonus amounts credited to the claimants after the crash (plus, in the case of one of the claimants, one bonus amount he says should have been, but was not, credited to him), payment of which was again deferred on the terms of the DCP or on terms materially identical to those of the DCP.

13. The DCP provided for deferred bonus amounts credited to participating employees to be "*reduced*" by reference to "*losses*" incurred, and for there to be "*restoration*" of

amounts deducted by way of such reductions. It is common ground that the contractual provisions in question will not have been drafted in contemplation of a crisis such as overtook AIG-FP in late 2008 or, therefore, in contemplation of the disastrous and lasting consequences of that crisis for AIG-FP. The task for the court is to construe those provisions, applying the principles of Connecticut law as the governing law of the plans, so as to ascertain their meaning and effect – in short, to decide how, on its terms, this 'reduction / restoration' scheme worked. The outcome of the claimants' contractual claims will be a function of that decision, applied to the (unexpected and unexpectedly extreme) circumstances of and since late 2008.

Plans

DCP

14. The DCP, established in 1995, amended in 2003, 2004 and 2005, and again at the end of 2008, is a contract governed by Connecticut law between, on the one hand, "AIGFP", defined since 2003 to mean AIG-FP and its subsidiaries together with AIG Trading Group Inc and its subsidiaries ("AIGTG"), and, on the other hand, "Participants" (participating employees) and AIG Inc (referred to in the DCP just as "AIG"). Its preamble states that it "*provides the Plan participants a sharing of the risks and rewards of AIGFP's business and reflects the participants' commitment to the long term integrity of AIGFP. The Plan objectives are:*
1. To promote the formation of capital in AIGFP;
2. To ensure that the interests of AIGFP Executives and AIG are aligned to promote the long term success of AIGFP;
3. To focus AIGFP on success measured not only by revenue growth but also by return on capital, quality of earnings, and enhancement of the AIG name and reputation in financial services;
4. To serve as an investment opportunity that will attract the most talented people to AIGFP and to retain those already here; and
5. To be simple, straightforward and efficient."

15. The preamble goes on to explain the background, namely that whereas before the DCP, "Distributable Income" had been distributed annually 70% to AIG Inc and 30% to AIGFP employees, "*Under the Plan a portion of the Distributable Income, apportioned 70% from AIG and 30% from AIGFP Executives, will not be paid currently but instead will be retained by AIGFP. Such retention will form part of the capital base of AIGFP and, absent losses which exhaust current revenues and reserves, will be paid subsequently to participants according to a schedule tied to the duration of AIGFP's business. The Plan will be administered so that the amounts retained under the Plan will be apportioned between AIG and AIGFP Executives on a 70%/30% basis.*"

16. Under the DCP, each Participant, and AIG Inc, had a "Deferred Compensation Account" ('DCA') established on AIG-FP's books to which was to be credited his or her, or its, share of the portion of Distributable Income, distribution of which was deferred under the Plan. Distributable Income was defined to "*mean, with respect to any financial year of AIGFP, revenues, less expenses and credit and market reserves taken for that year, as the same shall be determined by the Board from time to time.*" Rather than being awarded a simple cash bonus, as prior to the DCP, under and by virtue of the DCP Participants were awarded an annual "Notional Bonus Amount", part of which would be "*a cash bonus amount that is paid currently*", and the balance of

which would be "Deferred Compensation", "*credited by AIGFP to the Participant's Deferred Compensation Account and distributed to the Participant on a deferred basis subject to and in accordance with the terms hereof.*"

17. There were mandatory minimum deferrals for Participants with Notional Bonus Amounts exceeding US$250,000, namely 10% of the first US$500,000, 20% of the next US$250,000, 30% of the next US$250,000, 40% of the next US$250,000 and 50% of any remainder. So, for example, for an employee with a total annual bonus of US$2,000,000, a minimum of US$650,000 would be Deferred Compensation for distribution on a deferred basis and he or she would be entitled to receive US$1,350,000 as a cash (non-deferred) bonus. Participants were entitled, however, to elect to defer more than these minimum proportions, and many did. Deferred Compensation credits generated interest at a three-month US$ LIBOR rate, payable quarterly in arrears.

18. Deferred Compensation credits were applied to DCAs as of 31 December in any given year. The first instalment payment in respect of a DCA credit applied at the end of one year would be payable together with the interest payment for the fourth quarter of the following year. So, for example, a 31 December 2006 credit would generate a first scheduled instalment payment in January 2008, payable at the same time as Q4 2007 interest. For any given annual Deferred Compensation credit, a Participant could elect for payment (of instalments and interest) in Yen, €, £ or HK$ rather than US$, so long as the election was made on or before 1 December of the year for which the credit was made (e.g. 1 December 2006 for the example I just gave). In that case, the DCA credit amount was to be converted to the chosen currency at a spot exchange rate for the credit date (e.g. 31 December 2006) determined in good faith by AIGFP and interest would then accrue and be paid on that credit by reference to a three-month LIBOR rate for that currency rather than by reference to US$ LIBOR.

19. In addition to interest on Deferred Compensation credit balances, Participants (but not AIG) could be credited with "Additional Return Payments" under Section 3.04 of the DCP, colloquially referred to within the AIG group as 'equity kickers'. These would be credited on 1 January and would be a share of AIGFP earnings for the previous year that the President of AIGFP, with the approval of the Board, determined should be allocated to that purpose, distributed between Participants in proportion to their DCA credit balances on 1 October of the year to which they related.

20. Section 3.04 specified that these equity kickers would come out of the 30% of Distributable Income that would otherwise fall to be allocated to AIGFP employees as Notional Bonus Amounts for the year in question. So, for example, equity kickers credited and paid in January 2007, by reference to Participants' DCA balances on 1 October 2006, would reduce the 2006 Notional Bonus Amounts which would include 2006 Deferred Compensation amounts payable in instalments not starting until January 2008. Participants were only eligible for equity kickers if still employed by AIGFP when they were payable. Thus, the equity kicker element of the DCP favoured longer-serving employees with large accumulated DCA balances who stayed with the firm. Equity kickers aside, interest and instalment payment entitlements under the DCP generally survived cessation of employment (Section 4.03). (There was a narrowly crafted exception (*ibid*) for Participants guilty of theft or embezzlement from AIG or AIGFP, or similar.)

21. If there were a "Distribution Event", namely the death of a Participant or his or her "Permanent Disability" (as defined in the DCP), a Participant's total DCA credit balance became payable in full as a lump sum (Section 3.05(a)). In addition, Section 3.05(c) allowed the "Committee" (comprising AIG-FP's CEO, COO, CFO and Secretary), subject to approval by the Board, to direct an "Early Distribution" of DCA balances.

22. Absent a Distribution Event or Early Distribution, the default position for distribution of each Deferred Compensation credit was the instalment payment schedule for that credit under Section 3.05(b), which provided as follows:

> "*Installment Payments. Except as provided below, amounts in the Participant's Deferred Compensation Account attributable to Deferred Compensation contributions shall be paid to such Participant and to AIG annually in arrears on the Interest Payment Date for the Interest Period beginning in October of each year in equal pro rata installments ("Installment Payments") over a period of time (the "Distribution Period") corresponding to the approximate average life of AIGFP's swap transaction portfolio, as last determined by the Board before the beginning of the calendar year preceding the date of the Deferred Compensation contribution. However, for calendar year 2009 and 2010, the period of time that shall be used is six years…. The Distribution Period for a Deferred Compensation contribution shall commence on the Interest Reset Date in January of the calendar year next succeeding the calendar year in respect of which the Deferred Compensation contribution was made, with the first Installment Payment therefore being distributed on the Interest Payment Date for the Interest Period beginning in October of the calendar year in which the Distribution Period commences.….* "

23. By Section 4.04 of the DCP, the Committee was empowered, subject to approval by the Board, to amend its terms in whole or in part, "*provided, however, that any such amendment (i) shall be effective as of the next succeeding Interest Reset Date falling in January (other than an amendment to this Deferred Compensation Plan that (a) has the effect of altering or eliminating the voluntary deferral rights of Participants under Section 3.01(b) hereof or of reducing the portion of Participants' Notional Bonus Amount that is subject to automatic deferral under Section 3.01(a) hereof, or (b) is adopted in connection with the adoption or proposed adoption of, or change or anticipated change in, any federal, state or other law or regulation (including any tax law or regulation) applicable to the Deferred Compensation Plan; any such amendment described in such clause (a) or (b) shall be effective immediately or as otherwise specified therein) and (ii) cannot, subject to Section 4.01 hereof, reduce or delay payment of any Participant's or AIG's benefits accrued up to the date of such amendment. … .*"

24. Section 4.05 of the DCP provided for Connecticut law to govern its interpretation, application and operation. Section 4.06 required claims for benefits under the DCP to be filed with the Committee which was to accept or deny any claim within 30 days of filing. The denial of a claim by the Committee could be appealed to the Board. I had some evidence at trial of written denials of claims under the Section 4.06 procedure. There is no suggestion, however, that they are in any way binding or that any defence might arise out of a failure to make a Section 4.06 claim or to appeal a denial of claim by the Committee.

25. Section 4.09, introduced by the December 2008 amendment, states the intention that amounts awarded or deferred under the DCP would not be taxable under Section 409A of the US Federal Internal Revenue Code and that the DCP was to be interpreted and administered, to the extent possible, in a manner that did not result in a 'plan failure' within the meaning of Section 409A(a)(1). Section 4.10, also part of the December 2008 amendment, provides that the rights of a Participant not subject to US income tax on DCP benefits are to be determined under the terms of the DCP as they stood prior to that amendment or under the amended terms, whichever be more favourable to the Participant as determined by the Committee. Section 4.10 may perhaps be the reason the DCP as amended in December 2008 shows the December 2008 amendments as tracked changes, something I have for convenience ignored thus far when quoting from the DCP.

26. I shall return to Section 409A and DCP Section 4.09 when considering the restoration limb of the reduction / restoration scheme. That scheme was created by the key provision in the case, Section 4.01(b) of the DCP. Section 4.01(b) is a lengthy provision that needs to be read together with Section 4.01(a), an even lengthier provision. The Appendix to this judgment sets out Section 4.01 in full, with numbering added in square brackets for ease of cross-reference when I come to deal with the issues of construction. I have retained the tracked changes formatting of the 2008 amendments in the Appendix.

27. The reduction / restoration scheme in the DCP, then, in the numbering I have added, is constituted by Section 4.01(b)[1]-[2] (reduction) and Section 4.01(b)[3]-[6] (restoration).

<u>SIP</u>

28. There are issues for me to resolve over what were "*losses incurred … for any year*", by reference to which DCA credit balances might fall to be reduced under Section 4.01(b)[1] of the DCP. But on any view, they included losses realised by AIG-FP on the credit default transactions that would ultimately bring the AIG group to its knees. Reflecting their economic similarity to insurance contracts, those transactions typically generated (1) a positive revenue stream for AIG-FP during their life (akin to insurance premium income) in return for accepting the risk of (2) a lump-sum debt obligation if triggered (akin to an insured loss occurring). The debt obligation arising on a triggered credit default swap (for example) would be a realised loss, incurred when the swap was triggered.

29. Prior to 2007, AIG-FP did not mark its swaps portfolio to market so the trades as kept on its books were valued at par and only realised losses would ever be booked. In 2007, AIG-FP was required for the first time to book *unrealised* losses, derived from a mark to market revaluation of the portfolio. In AIG-FP's books, these would appear as (unrealised) losses incurred in 2007 on swaps that had not been triggered and might never be triggered. If they were never triggered, any such unrealised losses would be reversed over time (generating corresponding *unrealised* gains). In fact, the position would be dynamic – the unrealised losses carried in the books from day to day would fluctuate with the market. However the portfolio ultimately turned out, the one-off (but unrealised) 'hit' incurred by a first mark to market revaluation in 2007 would have a large, negative impact on Distributable Income for 2007 and therefore on 2007 bonuses (cash and deferred); and there were not going to be any 2007 equity kickers.

30. In December 2007, therefore, the AIG-FP "2007 Special Incentive Plan" ('the SIP') was launched. Its terms were amended in December 2008 and again in December 2010. All but one of the claimants were eligible to and did participate in the SIP. The SIP began by identifying that it provided for the award to "Covered Executives" of "2007 SIP Credits" (which I shall shorten to 'SIP Credits') that were to be "*independent of the Notional Bonus Amounts paid to employees of AIGFP for 2007 and the portions thereof deferred in accordance with the [DCP]. The terms and operation of the [DCP] are not affected by the [SIP].*"

31. The SIP then referred to the impact on the DCP of the 2007 unrealised losses and stated:

> "*The purpose of the [SIP] is to provide an additional compensation opportunity for Covered Executives while at the same time:*
>
> > *(i) providing incentives for Covered Executives to continue developing, promoting and executing AIGFP's business,*
> >
> > *(ii) recognizing the serious effect that the unrecognized losses associated with the valuation adjustment have had,*
> >
> > *(iii) continuing to ensure that AIGFP's and its employees' interests are aligned with those of AIG and AIG's shareholders, and*
> >
> > *(iv) building and maintaining the formation of capital in AIGFP, including for purposes of ensuring that amounts are available to absorb losses in the event that AIGFP realizes losses on super senior credit derivatives that would have an impact on AIGFP's capital structure.*"

32. Covered Executives were individuals with a 2007 DCP Notional Bonus Amount of at least US$1,250,000 or who would have had an equity kicker for 2007 had there been any. AIG Inc was also to participate, its SIP Credit being 7/3 of the aggregate SIP Credits awarded to Covered Executives. If a Covered Executive's employment ceased prior to 1 January 2009, the SIP Credit would be reduced to zero; if after 1 January 2009 but prior to 1 January 2010, the SIP Credit would be reduced by two thirds; unless, in both cases, the employment ceased because of dismissal or termination without cause, death or permanent disability. Amounts by which SIP Credits were thus reduced were to be treated as an addition to Participants' 30% share of Distributable Income under the DCP for the year in which SIP Credits were paid out to Covered Executives.

33. SIP Credits were to be paid out in January 2013, at the same time as Q4 2012 interest payments under the DCP, except in a case of death or permanent disability which would trigger immediate payment. Interest was to accrue and be paid quarterly in arrears, as with DCA balances under the DCP. Likewise, there was provision for equity kickers distributable by reference to SIP Credit balances. All balances and payments under the SIP were to be in US$ - there was no currency election regime as there was under the DCP.

34. Section 4.01 of the SIP, the reduction / restoration regime, was materially identical to Section 4.01 of the DCP, except that the December 2008 amendments were not shown as tracked changes even though Section 4.09 was in the same terms as Section 4.10 of the DCP.

35. Section 4.04, the provision allowing the Committee to amend the terms, was rather shorter and simpler than in the DCP, providing just that "*The Committee may from time to time, with the approval of the Board, amend these 2007 SIP Terms in whole or in part; provided, however, that any such amendment may not, subject to Section 4.01 hereof, reduce or delay payment of any Covered Executive's or AIG's benefits accrued up to the date of such amendment. Any such amendment shall be effective immediately or as otherwise specified therein and shall be communicated in writing to all Covered Executives and to AIG.*"

36. Section 4.06, as in the DCP an internal claims procedure clause, provided in addition for claims by Covered Executives to be subject to the exclusive jurisdiction of either the US District Court for the District of Connecticut or the Connecticut Superior Court for Fairfield County, and required the internal claims procedure to be exhausted before suit might be filed. No point was taken as to that, however, and the defendants fought the claimants' claims under the SIP on the merits at trial.

ERP

37. In March 2008, AIG-FP established the third plan I have to consider, its "2008 Employee Retention Plan" ('the ERP'), effective 1 December 2007. The terms of the ERP were amended in December 2008, April 2009 and March 2010.

38. According to its preamble, the ERP set out "*the 2008 and 2009 Guaranteed Retention Awards to be provided hereunder to certain employees and consultants of AIG-FP (which terms includes subsidiaries).*" The objectives of the ERP were stated to be the following:

> "*1. To provide incentives for AIG-FP's employees and consultants to continue developing, promoting and executing AIG-FP's business;*
>
> *2. To recognize the uncertainty that the unrealized market valuation losses in AIG-FP's super senior credit derivative and originally-rated AAA cash CDO portfolios have created for AIG-FP's employees and consultants;*
>
> *3. To ensure that AIG-FP's and its employees' and consultants' interests continue to be aligned with those of AIG and AIG's shareholders;*
>
> *4. To continue to build and maintain the formation of capital in AIG-FP; and*
>
> *5. To show the support by AIG of the on-going business of AIG-FP by implementing a meaningful employee retention plan.*"

39. The ERP provided that there were to be "Guaranteed Retention Awards" for "Covered Persons", being "*amounts guaranteed to be awarded*" to such persons for the 2008 and 2009 "Compensation Years". Those were the years to 30 November 2008 and 30 November 2009 respectively. A Covered Person's "2007 Total Economic Award" was (for my purposes) effectively his or her 2007 DCP Notional Bonus Amount plus his or her SIP Credit but excluding any SIP Credit amount awarded in lieu of a DCP equity kicker.

40. A Covered Person's Guaranteed Retention Award for each of the 2008 and 2009 Compensation Years was then 100% of his or her 2007 Total Economic Award except for certain individuals designated as the "Senior Management Team" for the purpose of the ERP, whose Guaranteed Retention Award was 75% of their 2007 Total Economic Award.

41. A Covered Person's "Total Award" for each Compensation Year was his or her Guaranteed Retention Award plus any discretionary bonus awarded on top. By Section 3.05(a) of the ERP, each Total Award was subject to partial mandatory deferral and subsequent payment under and on the terms of the DCP. Thus whereas SIP Credits were made to separate SIP Accounts, the balances on which were subject to a reduction / restoration scheme set out in the SIP, albeit materially identical to that of the DCP, to the extent that the ERP generated deferred bonus amounts, they would be subject to the DCP reduction / restoration scheme directly, in that they would be constituted by and recorded as Deferred Compensation credits to employees' DCAs.

42. To the extent not deferred, payment of ERP Guaranteed Retention Awards was formally guaranteed by AIG Inc, in that Section 3.03 of the ERP provided that, to that extent, payment of ERP Guaranteed Retention Awards was subject to the "AIG General Guarantee Agreement", a December 1995 guarantee issued by AIG Inc capable of covering debts of AIG-FP. To the extent not deferred, ERP Total Awards were payable by 15 March 2009 for the 2008 Compensation Year and by 15 March 2010 for the 2009 Compensation Year.

43. Section 3.02(a) of the ERP is in these terms: "*Under the existing arrangement between AIG, AIG-FP, and it employees, Distributable Income of AIG-FP is payable each year on the basis of 70% to AIG and 30% to AIG-FP employees (and consultants) as bonuses (such 30% referred to hereunder as the "<u>Bonus Pool</u>"). The Bonus Pool will continue to equal 30% of Distributable Income of AIG-FP subject to calculation consistent with past practices and the provisions of Sections 3.02(b) and 3.02(c).*" One purpose of that provision was to determine whether AIG had to fund Guaranteed Retention Awards. Thus, Section 3.02(c) provided that if for either the 2008 or 2009 Compensation Year the Bonus Pool was less than the aggregate ERP Guaranteed Retention Awards for the year, "*AIG will cover the shortfall so that Covered Persons are paid their full Guaranteed Retention Awards (subject, for the avoidance of doubt, to deferral pursuant to Section 3.05(a)). Any such Bonus Pool shortfall shall, for purposes of Section 3.07 related to the carry-forward of Capped Realized Losses, be deemed to give rise to a Capped Realized Loss equal to the amount of such shortfall.*" (By Section 3.03 of the ERP, payment of deferred portions of ERP Guaranteed Retention Awards, when they became payable, was expressly not guaranteed by AIG Inc under the AIG General Guarantee Agreement. That might perhaps create room for argument over the meaning and effect of AIG Inc's obligation under Section 3.02(c) to "*cover*" AIG-FP so as to ensure those portions were paid. But any issue as to that does not need to be resolved by this judgment.)

44. However, in addition, Section 4.06 of the ERP, by proviso to its general rule that the terms and operation of the DCP were not affected by the ERP, stated that "*to the extent there is any inconsistency between the terms of [the ERP] and the terms of the [DCP] with respect to the treatment of Guaranteed Retention Awards, <u>the determination of Distributable Income or the Bonus Pool</u>, or the application of the terms of that plan to*

Stock-Indexed Deferrals, the terms of [the ERP] shall govern" (my emphasis). That is important because:

i) Section 3.06(a) of the ERP provided that "*The Bonus Pool for any Compensation Year beginning with the 2008 Compensation Year will not be affected by the incurrence of any mark-to-market losses (or gains) or impairment charges (or reversals thereof) arising from (i) the CDO Portfolio or (ii) super senior credit derivative transactions that are not part of the CDO Portfolio.*" So whereas for 2007 it was recognised that unrealised credit default losses were arising that would reduce DCP Notional Bonus Amounts and the SIP was put in place as a one-off for that year, the ERP anticipated an ongoing issue of such losses and amended the DCP to exclude them from the Distributable Income calculation for 2008 and subsequent years. Unrealised credit default gains were likewise excluded from that calculation, that being only logical if unrealised credit default losses were being ignored.

ii) Section 3.06(b) of the ERP provided that for 2008 and subsequent years, "Realized Losses" (or gains) arising from any source were to affect the Bonus Pool but subject to limitations provided for in Section 3.07. A definition of Realized Losses for the ERP was provided by an attached Schedule 2. Thus, subject to the Section 3.07 limitations, Realized Losses (and gains), whatever their source, were to be part of the 2008 and later Distributable Income calculations. It should be noted, though, that a Bonus Pool shortfall, whilst deemed to give rise to a "Capped Realized Loss" for the specific purpose of applying Section 3.07(a) of the ERP (see paragraphs 43 above and 45 below), was <u>not</u> a Realized Loss as defined by Schedule 2.

45. By Section 3.07(a), "Capped Realized Losses" were Realized Losses in AIG-FP's CDO Portfolio and deemed Capped Realized Losses under Section 3.02(c) (see paragraph 43 above), and for 2008 and later Distributable Income calculations their (negative) contribution was capped at US$225 million for any given year (thus capping the associated reduction in the Bonus Pool for that year at US$67.5 million). Capped Realized Losses in excess of US$225 million, to the extent of the excess, carried forward to the following year's Distributable Income (and Bonus Pool) calculation. So, for example, if 2008 Capped Realized Losses were US$500 million and there were none in 2009 or 2010, that US$500 million would be spread across the 2008, 2009 and 2010 Distributable Income calculations as (negative) elements in the calculation of US$225 million, US$225 million and US$50 million respectively. If instead the Capped Realized Losses for 2008, 2009 and 2010 were US$500 million, US$250 million and US$100 million, they would create negative contributions in the 2008, 2009, 2010 and 2011 Distributable Income calculations of US$225 million, US$225 million, US$225 million and US$175 million, so that if there were 2011 Capped Realized Losses of more than US$50 million there would yet again be an excess to carry over to the 2012 calculation.

46. By Section 3.07(b), "*Current and future balances under the [DCP] … and SIP (including the deferred component of 2008 and 2009 Total Awards …) will remain subject to reduction as a result of Realized Losses from the CDO Portfolio or otherwise in accordance with the terms of the [DCP] … and SIP (without reference to any annual limits, which will relate solely to the determination of the Distributable Income for Bonus Pool calculation purposes in the 2008 and subsequent Compensation Years).*" It

seems to me that language merely provided or confirmed that Realized Losses in the CDO Portfolio were not subject to any annual cap for the purposes of the reduction element of the reduction / restoration scheme that I have to consider and did not touch the question whether unrealised losses formed part of that scheme. However, it was common ground, at all events by the end of the trial, that unrealised losses (and, logically therefore, unrealised gains) in the CDO Portfolio or super senior credit derivative transactions not part of that Portfolio (as referred to in Section 3.06) were excluded by Section 3.07(b) from any calculation of "*losses incurred*" under Section 4.01(b) of the DCP or SIP, if (that is) they would otherwise have been included.

47. Under Section 3.04 of the ERP, a Covered Person whose employment with AIG-FP terminated prior to payment of a Guaranteed Retention Award might or might not lose any right to that Award, depending on the circumstances. Even if not lost, however, the 2009 Award was to be reduced by the amount of any earnings paid by another employer for work done in 2009.

48. The internal claims procedure provision, Section 4.05 of the ERP, was similar to Section 4.06 of the SIP, but again no point was taken under it and the claimants' claims under the ERP were contested on the merits at trial.

Sums at Stake

49. Prior to interest, the amount credited to the claimants' DCAs under the DCP or ERP, or to their SIP Accounts under the SIP, but never paid, the subject of claims at trial, was c.US$108 million in aggregate. The claimants are however nothing like the entire population of eligible employees under the Plans. There are 23 claimants, but I was told that there were approaching 300 eligible employees in all.

50. The total of the deferred bonus amounts across all eligible employees that might in principle be affected by the issues raised at trial, again prior to interest, is c.US$800 million, comprising unpaid DCP Deferred Compensation accumulated up to and including 2007 and SIP Credits of c.US$600 million in aggregate, plus c.US$100 million each in 2008 and 2009 credits to DCAs generated by the ERP.

51. The total sum at stake is therefore, in a sense, c.US$2.667 billion (scaling US$800 million up by 10/3 to factor in AIG Inc's participation). However, as I shall explain in the course of dealing with the contentious issues, AIG-FP's only means of funding any liability to restore and pay out these amounts is to borrow from AIG Inc in order to do so, under the bail-out facility that remains in place, and there is no prospect of AIG-FP now generating profit to enable it to repay any such further borrowing. The bail-out facility is available to AIG-FP for it to meet all "*direct and legitimate business needs*". There could be no more direct or legitimate business need than to pay staff remuneration (whether basic salaries or bonuses, cash or deferred), as and when such payments fall due for payment. The practical reality of the case, then, is that if indeed AIG-FP has a liability to the claimants (and/or to others similarly situated who have not yet sued), discharging that liability will not cost AIG-FP anything, but it will cost AIG Inc, unless, because of that prospective cost (to AIG Inc), AIG-FP is put into insolvent liquidation instead, that possibility perhaps being one motivation for the intimated contention, not considered here, that any judgment debt would be guaranteed by AIG Inc.

Contractual Issues

Restoration Obligation

52. The claimants' primary contention is that the failure to have restored by now the amounts deducted, or even to have adopted any plan to do so, is in breach of the terms of the Plans. They say the Plans imposed an unqualified obligation on AIG-FP to put a restoration plan in place; and that Participant balances had to be restored by no later than 31 December 2013.

53. The claimants say that is the effect of the language of the reduction / restoration scheme in the Plans and that restoration not being mandatory is not in line with the objectives of the Plans, their purpose being to incentivise and retain employees in a time of financial trouble.

54. The defendants say the obligation to make restoration is dependent on the profitability of AIGFP. There is no obligation to restore (or, therefore, to adopt any plan for restoration) unless and until AIGFP has positive distributable income. The need for a plan to be adopted, the defendants say, arises because if there would be positive distributable income, subject to the burden of any restoration of previously reduced balances, any restoration of balances then effected would reduce it. Thus, restoration of 'old' balances previously taken out by losses would reduce the amount available for distribution to Participants by way of 'new' DCP bonus amounts (cash and/or deferred). Balancing the differing interests of different groups of Participants would therefore be an inherent part of any decision about when to restore previously reduced balances. The defendants also argued that it was inherent in the reduction / restoration scheme, and the effect of its language, that no question of restoration could arise unless and until balances, if restored, would not be subject to reduction for losses.

55. The defendants pleaded in addition, and at all events at the start of the trial were still pursuing, a contention that AIG-FP's balance sheet insolvency precluded the restoration of balances. That contention did not withstand scrutiny, however. The reality is as I stated it in paragraph 51 above. Because AIG-FP continues to enjoy the support of AIG Inc, through the AIG-FP 'bail-out' facility, AIG-FP's balance sheet insolvency is not an impediment to the honouring of obligations, if otherwise owed, to restore and pay out previously reduced DCP and SIP balances. That is not affected by the fact that AIG-FP's balance sheet insolvency is now the by-product of that self-same facility so that drawing down on the facility to obtain additional general funds (cash) with which to pay restored balances would increase *pro tanto* AIG-FP's net balance sheet deficit. The defendants' false logic that there could be no restoration in the face of balance sheet insolvency substantially infected their case on the construction of the restoration obligations. For example, in the defendants' opening it was said to be "*self-evident that AIGFP could only ever adopt a restoration plan as and when it had general funds available from which to commence restoration*"; but under the bail-out facility AIG-FP had materially unlimited general funds available to it at all times. Or again it was said that "*AIGFP's capital cannot be an available source of general funds*", if it had a negative balance sheet; but because of the bail-out facility, the negative balance sheet did not deprive AIG-FP of working capital and/or general funds. Or again that "*the only way a restoration plan could work is as an additional liability of AIGFP payable from revenues (being the only possible source of general funds)*"; but AIG-FP in fact had the bail-out facility as its primary, and for present purposes materially unlimited, source of general funds.

56. In that regard, I also reject a somewhat sophisticated, specific variant of the argument advanced by the defendants. That argument was this: AIG Inc also participates, so any restoration and payment of previously reduced balances should apply to AIG Inc's balances as well as to Participants' balances; restoration and payment of AIG Inc's previously reduced balances would be an unlawful distribution to the shareholder by an insolvent company; it cannot have been the intention to require that; therefore, it cannot have been the intention to require restoration of Participants' balances. In my judgment, no question arises of an unlawful distribution to AIG Inc. The recognition of Plan debts to Participants, by restoring balances, would carry with it the recognition of a corresponding Plan debt to AIG Inc. Discharging that Plan debt to AIG Inc by drawing on the AIG-FP facility would leave AIG-FP's position neutral, the Plan debt to AIG Inc simply being re-constituted as increased indebtedness under the facility. If the Plans otherwise required restoration and payment of Participant balances previously reduced, then it would be no more improper for AIG-FP to discharge those obligations than for it to discharge, as it continues to do, all its other ongoing obligations, e.g. to employees or otherwise by way of overheads and to trade creditors, all with the support of AIG Inc (if required) via the bail-out facility.

57. The specific argument asserting improper distribution was allied to an argument that restoration when AIG-FP is balance sheet insolvent would give priority to Participants, contrary to the express terms of the Plans that AIG-FP's liability was to be subordinate to other debts. I reject that argument too. No relevant issue of priorities or subordination arises unless and until AIG-FP enters into formal insolvency, so the argument merely returns us to paragraph 55 above. In an insolvency process, Participants could have: unpaid Plan balances that had never been reduced; unpaid Plan balances constituted by restoration, to the extent restoration had occurred, of balances previously reduced; Plan balances that had been reduced and not restored prior to the insolvency. The Plans contained express provision as to the status of the first two types of balances, as regards priorities and subordination, and in respect of the third type of balances the Plans provided that Participants were to have a claim in the insolvency equal in status to any claims for the first two types of balances, in the amount of the unrestored balances. In my judgment, none of that, as regards priorities and subordination, has anything to do with AIG-FP's obligation, if otherwise created by the language of the Plans, to restore and pay previously reduced balances in the absence of any formal insolvency process, just as in that absence it has nothing to do with AIG-FP's obligation to pay out over time Plan balances (if any) that were never reduced, or to pay cash bonus amounts that were not subject to deferral at all. (As will be seen below, the provision for the third type of balance in an insolvency in fact assists the claimants on the argument as to whether there was an obligation to restore.)

'<u>Negative Balances</u>'

58. The second major controversy debated between the parties has been whether the Plans provided for 'negative balances' for Participants in their DCAs and/or SIP accounts. That focus for the debate was understandable. On the evidence, in early October 2008 a decision was taken that at the year end, Participants' balances would be stated as negative amounts, not merely as nil balances. I state that in general and neutral terms for present purposes – by whom and why that decision was taken was explored on the facts as relevant to the claims in tort against AIG Inc. The notion of Plan balances becoming negative, not merely being reduced (perhaps even wiped out, i.e. reduced to

nil), struck at least some of the claimants as alien (I was not shown evidence to know, if it mattered, whether all of the claimants had that same reaction). So I find it understandable that a complaint came to be formulated in terms of negative balances being impermissible.

59. As the trial progressed, however, it seemed to me that this obscured somewhat the real issues. For closing argument, therefore, I asked for a focus upon the questions, the defendants' answer to which generated the effect expressed at the time by stating negative DCA and SIP account balances.

60. The better, primary focus, then, is on whether under the Plans losses carry forward. It was common ground that the Plans call for a single, annual assessment of losses, for each Compensation Year (running from 1 December-30 November). The question is whether (e.g.) 2008 losses (i.e. losses for the year to 30 November 2008) carry forward to the 2009 Compensation Year (year to 30 November 2009), if and to the extent they are not absorbed by reductions in Plan balances at the end of 2008.

61. Suppose a Participant with Plan balances totalling US$2,000,000, prior to any application of 2008 losses to reduce Plan balances, whose proportionate share of 2008 losses is US$5,000,000. On any view, the US$2,000,000 balance will be wiped out when the 2008 losses are applied (subject to (i) any point on timing / accounting dates and (ii) restoration). But what of the fact that the allocated losses exceed the unreduced balance? It has never been suggested (at the time or in the litigation) that the Participant will ever owe anything to AIG-FP – there is no obligation on him or her to make good, on my example, the US3,000,000 excess. Therefore, to my mind, stating that the Participant now has a balance of (US$3,000,000) is a nonsense. The DCAs and SIP Accounts are debt accounts, stated from the perspective of the Participants (or AIG Inc) and they can only ever be Plan creditors of AIG-FP, never Plan debtors. Whereas, therefore, Participants' (and AIG Inc's) Plan accounts can never be overdrawn, stating them to have negative balances was precisely to state that they were overdrawn.

62. The negative balances as stated in respect of Participants' accounts were, on analysis, a device (I do not mean that in a pejorative sense) to record the consequence of the stance being taken that the unabsorbed balance of 2008 losses would remain available indefinitely, unless and until itself absorbed, to reduce any future Plan balances, whether entirely fresh balances created by new credits or balances created by credits generated by a restoration plan in respect of prior reductions.

63. A secondary issue arising, also to some extent masked initially by the focus on negative balances, concerns the nature of Participants' Plan balances. The claimants say that unabsorbed annual losses do not carry forward. If that is right, then (e.g.) 2008 losses cannot wipe out, or reduce at all, subsequently accrued Plan credits. On that basis, if there should have been positive Plan balances on 1 January 2009, they should have generated interest payments for 2009, even if the principal balances were then wiped out at the end of the year by 2009 losses. There is a related question, of accrual and book-keeping dates, by reference to which the claimants suggest that their Plan balances were not in fact reduced to nil until after at least one instalment payment should have been, but was not, made.

64. On that same basis, i.e. that unabsorbed annual losses do not carry forward, the claimants went further still, contending that instalment payments that would have been

due in 2009, by reference to the instalment schedules set by the Plans for prior Plan credits, should still have been paid, up to the limit of Plan balances as of 1 January 2009, even if the unpaid balance of those prior Plan credits had been wiped out by the 2008 losses. In my judgment there is no force at all in that contention. On the language of the Plans, payments are referable to particular credits and the payment schedules in respect thereof are fixed by the Plans when they are credited to Plan accounts. A new credit balance as of 1 January 2009, on which interest would begin to accrue immediately but which would be payable as to principal in instalments starting in January 2010 (subject always to the other terms of the Plans), is of no relevance to the amount (if any) payable as to principal in 2009 in respect of credits for prior years. Or again, the payment schedule that would have applied for the payment in instalments of any balance that would have stood on a Plan account at the end of 2008, had that balance not been reduced for losses, including, if this would have been the case, any instalment payable in January 2009, was just that: the payment schedule for that hypothetical balance, consisting of instalments totalling the amount of that balance. Where that balance is reduced, obviously the instalments reduce with it. Where the balance is wiped out (reduced to nil), the instalments are likewise wiped out. Subject in due course to any future restoration, the wiping out of balances leaves nothing capable of being paid to Participants, in 2009 or ever; the timing of payment, e.g. any instalment payment schedule, for future restored balances would be a matter determined by the restoration plan under which they were restored.

Qualifying Losses

65. The third substantial issue at trial was what (type(s) of) losses fell within Section 4.01(b)[1], so as to be capable of reducing Plan balances from time to time. One focus was losses incurred not in ordinary trading, but in closing out or unwinding positions and/or disposing of assets as part of the closing down of AIGFP as a trading business, a process that still continues even if the major part by far was achieved by the end of 2008 through the completion of the Maiden Lane III transactions. However, that was not the only point.

66. The claimants submitted that the Plans permit reductions on account of trading losses incurred in ordinary trading and that the defendants have instead kept AIGFP in being as a going concern (albeit massively balance-sheet insolvent), disposing of assets at a loss and ceasing to trade for profit. The losses thereby crystallised, the claimants say, do not qualify to reduce their accrued, but deferred, entitlements under the Plans. Put another way, the claimants argued that losses may not be applied by way of Plan reductions if those losses have been generated by 'fundamental changes in AIG's commercial strategy'. In the alternative, the claimants said that in any event only losses on AIGFP's financial products transactions were within Section 4.01(b)[1]. On any view, therefore, they contended, the cost to AIG-FP of servicing its debt under the bail-out facility should not be included in any calculation of losses by which Plan balances might be reduced. As I understood it, they extended that argument to a conclusion that the cost of servicing the bail-out facility should not have been part of any calculation of current year income by which under Section 4.01(b) losses might be absorbed so as to avoid or lessen reductions to Plan balances.

67. The defendants submitted that there was no 'ordinary trading', 'consistent commercial strategy', or other limitation on the losses incurred by AIGFP that qualified them to be applied by way of Plan balance reductions. A deliberate decision to incur abnormal

losses motivated by a desire to deprive Participants of deferred bonus payments might give rise to different considerations. For example, an employment contract claim might arise as in *Attrill v Dresdner Kleinwort* (referred to in paragraph 7 *supra*), or a claim for breach of the duty of good faith implied in the Plans under Connecticut law. Absent any consideration of that kind (and none arises on the facts), I agree that there is nothing in Section 4.01(b) to limit qualifying losses as proposed by the claimants' primary argument. In that regard, in particular, I detected genuine concern on the claimants' part over the way the Maiden Lane III close-out had crystallised such huge losses so soon after the initial Federal bail-out; and on the evidence it was clear to me that it involved unwinding a large proportion of AIG-FP's portfolio at something of a forced pace that, all things being equal, would have been thought less than optimal for minimising ultimate levels of realised loss. However, all things were very far from equal. I am satisfied on the evidence that (a) the pace was dictated by the burden of the market pressures in the extreme circumstances of Q4 2008 and thus, at least indirectly, by the pressure of having been bailed out by Federal funds, and (b) AIG Inc did its reasonable best to explore other options for survival (private sector solutions), so that (c) in truth Maiden Lane III, in conjunction with and as a follow-up to the initial bail-out funding, saved the AIG group (and AIG-FP in particular) from being wound up. Certainly, it was not entered into or structured for the purpose of prejudicing Plan Participants. The fact that Maiden Lane III later realised a large gain for the US Treasury and AIG Inc is no reason for any contrary conclusion, or for excluding or reducing the realised losses incurred in AIG-FP in November and December 2008 when Maiden Lane III was created, for the purposes of Section 4.01(b)[1] of the DCP.

68. The defendants in fact submitted, and this (they said) met the claimants' alternative argument, that the DCP, properly construed, called for a single, annual calculation of distributable income: if positive, distributable income was available (as to 30%) for distribution to Participants under the DCP as bonus for the year in question (subject to deferral, to the extent required by the DCP) except to the extent used instead for equity kickers or restoration of previously reduced DCP balances; if negative, that constituted loss by reference to which existing Plan balances fell to be reduced (subject to the impact of reserves).

69. Irrespective of any other issues, it was common ground that the annual calculation of the losses by reference to which Plan balances might fall to be reduced should have been confined to current year losses. The claimants pleaded, and at the start of the trial may still have been pursuing, an allegation that past losses had been included, or at all events that it had not been shown that only current year losses had been included (teeing up a possible argument over whether the defendants bore the burden of proof as to the legitimacy of the reductions effected). I am satisfied on the evidence that there is nothing in this point, and to their credit the claimants accepted as much and Mr Oudkerk QC asked me in closing not to trouble with it.

70. The parties were agreed (reflecting agreement between the accountancy expert witnesses) that the Plans do not specify any particular accounting principles (e.g. GAAP) to be used in the calculation of Distributable Income and/or of qualifying losses.

Judgment on Contractual Issues

71. The applicable principles of contractual construction under Connecticut law established by the helpful evidence of the expert witnesses, Prof. Schwartz called by the claimants and Mr Horton called by the defendants, are these:

    i) The contractual intent of the parties is to be determined from the language of their contract and the circumstances connected with their transaction.

    ii) A written contract is to be construed primarily by analysing its text.

    iii) In that regard, the contract is to be construed as a whole and all relevant provisions are considered.

    iv) The parties will not be relieved from anticipated or actual difficulties created by the language of a valid contract, applied to circumstances that arise. "*Courts do not unmake bargains unwisely made*" (*Geysen v Securitas Sec. Servs. USA Inc* 322 Con 385).

    v) A contract is regarded as unambiguous when its language is clear and conveys a definite, precise intent. An unambiguous intent conveyed by the language of the contract is to be given effect. In that regard, (a) the fact that parties advance different interpretations of the language does not necessitate a conclusion that the language is ambiguous, and (b) any ambiguity must stem from the words in the contract itself – the language itself must be unclear.

    vi) If the language of the contract is fairly susceptible of two or more interpretations, the more (or most) equitable, reasonable and rational meaning is to be preferred.

    vii) Extrinsic evidence may be used to resolve an ambiguity, failing which (as a construction aid of last resort) contracts should be construed *contra proferentem*, which in the present case would mean adopting the meaning less favourable to AIG-FP and more favourable to the Participants.

72. It was common ground between the experts that there is under Connecticut law a term implied in all contracts that the parties will act in good faith. There was some measure of disagreement between them as to the precise scope of that implied term. But for the reasons I gave in paragraphs 7-8 above, in my judgment no question arises of any claim for breach of the implied term of good faith that might affect the outcome here. If the claimants are correct as to their entitlements under the Plans, properly construed, they will be entitled to relief putting them in the position they should have been in if those entitlements had been recognised and AIG-FP's corresponding obligations had been performed.

73. True it is that in their factual case, the claimants asserted that it was understood at the time by those making decisions that Plan obligations were not being honoured. However, there was no claim that breach of the implied obligation of good faith would generate any different or additional relief, or that it might affect the measure of any financial relief. In those circumstances, it will not be necessary to consider the implied term of good faith further in this judgment. I would though add this, namely that both experts recognised as authoritative a statement by the Connecticut Supreme Court in *Geysen v Securitas Sec. Servs.*, *supra*, to the effect that acting upon an honest, but

mistaken, understanding of contractual rights or duties will not put a party in breach of the implied term.

74. Turning, then, to the language of Section 4.01, I construe it as it appears in and applies to the DCP (as amended by the ERP). I did not understand either side to contend that the identical reduction / restoration scheme provisions of the SIP might have any different meaning or effect from those of the DCP. For my own part, I can see no reason why they would. So it will not be necessary to conduct any separate exercise to construe the SIP.

75. The reduction / restoration scheme of Section 4.01(b) was plainly designed to be an integral part of the executive bonus scheme of AIG-FP as a thriving concern, profit-seeking for both the shorter and longer term. Any construction of its language needs to make sense in that context. Thus, in particular and to this extent agreeing with one aspect of the claimants' submissions, the highly unexpected way in which, in the event, AIG-FP has incurred catastrophically destructive losses yet has survived as a going concern, but no longer profit-seeking, rather than being put into a formal insolvency process, ought not to influence the proper construction of the contractual language. (That is true also of the SIP, or for that matter the ERP. Though concluded at times when, as we now know, the catastrophic financial storm that broke in Q4 2008 was brewing, they were not concluded in anticipation of such a calamity, but rather under an expectation that though the profitability of the AIG-FP book was in doubt for the shorter term, the business was fundamentally sound and liable to thrive again in the longer term.)

76. Most of Section 4.01(a) is of no relevance to the construction of the reduction / restoration scheme of Section 4.01(b). Sections 4.01(a)[4]-[6D] inclusive concern only what happens if AIG-FP becomes subject to a formal insolvency process (as more precisely defined in Section 4.01(a)[4]). Section 4.01(a)[2] provides that payment obligations of AIG-FP are not guaranteed by AIG Inc. Section 4.01(a)[3] contains provisions reinforcing the basic statement in Section 4.01(a)[1] that benefits payable under the DCP constitute (only) an unsecured debt of AIG-FP.

77. That basic statement (Section 4.01(a)[1]) is of some importance, however. It confirms that a positive DCA balance in favour of a Participant (or AIG Inc) indeed represents a debt owed by AIG-FP. One purpose of deferring payment of bonuses, as stated by the DCP, was to promote the formation of capital in AIG-FP; one particular purpose for that (as in due course the SIP stated in terms, though it is self-evident) would be to assist AIG-FP to absorb losses, if it incurred any, on credit default transactions. That is the immediate context for the reduction / restoration scheme created by Section 4.01(b).

78. The primary reduction provision is Section 4.01(b)[1]. Its subject matter is each Participant's (and AIG Inc's) outstanding balance credited to their DCA. Section 4.01(b)[2] states that reductions will be made pro rata between Participants and AIG Inc (which must mean pro rata to their respective credit balances at the time when they fall to be reduced). The precise meaning and effect of Section 4.01(b)[1], then, is not straightforwardly apparent, but that is because of the lack of express, specific definition of the losses that are to generate reductions rather than because its structure or broad scope is unclear.

79. The structure and broad scope of Section 4.01(b)[1] are plain enough. At a glance, it is clear that:

    i) what is subject to reduction is a Participant's (or, pro rata, AIG Inc's) outstanding DCA credit balance;

    ii) losses incurred by AIGFP may generate reductions from time to time, with detailed wording that will need to be studied for a full understanding of what losses generate what reductions; and

    iii) part of the complexity of the detailed wording is created by the fact that AIGTG is treated as part of AIGFP, but only as from 1 January 2003.

80. Given the nature and purpose of DCA credit balances (paragraph 77 above), to reduce an outstanding credit balance is to reduce AIG-FP's indebtedness to a Participant (or AIG Inc), i.e. it is to discharge, to the extent of the reduction, the debt represented by the credit balance. That in turn is how AIG-FP's indebtedness constituted by outstanding DCA balances can operate as working capital, absorbing losses incurred by AIG-FP, up to the amount of the indebtedness, preventing them, to that extent, from impacting on (the rest of) the balance sheet.

81. I turn to the detailed wording as to what losses generate what reductions, the meaning of which is not immediately clear. Having registered, at a glance, that part of the complexity is generated by the need to treat AIGTG as part of AIGFP but only as from 1 January 2003, it is natural to look past that. In other words, it is natural to seek the substance of the contractual intent by taking as read the detailed wording by which AIGTG is included but only as from that date, and thus to identify that there is to be reduction "*from time to time to the extent of losses incurred …, which losses … for any year … exceed the outstanding market and credit reserves and current-year income …, but before base capital … (… consisting of equity, retained earnings, if any, and subordinated debt).*"

82. That conveys a notion that losses only generate reductions where they exceed, in aggregate, the market and credit reserves and current year income available to AIGFP to offset those losses when they are incurred. So DCA balances are to be used to help AIGFP to absorb losses only where reserves and current year income at the time will not do so in full. That suggests that reserves and current year income are to be 'hit' first by losses, if incurred; and that makes sense since reserves, when taken, reduce Distributable Income from which DCA balances are generated. However, the linguistic construct used is "*to the extent of losses incurred …, which losses … exceed …*", in other words 'to the extent of losses that exceed' rather than 'to the extent that losses exceed'. The former meaning, read literally, would seem to produce the result that AIGFP's reserves and current year income would absorb losses in full if they could, leaving Plan balances entirely unaffected, yet if reserves plus current year income could not absorb losses in full (even if only by US$1), losses would 'hit' Plan balances first, potentially therefore Plan balances might even then absorb losses in full so as to leave reserves and current year income unaffected.

83. To my mind, that makes no sense, in the context of the DCP; and it is a result for which I understood neither side to contend. Although it involves accepting an imperfection or error in the language, in my judgment the proper construction of Section 4.01(b)[1] is

that when losses are incurred that exceed (in aggregate) the reserves and current year income then available to AIGFP, DCA balances fall to be reduced so as to absorb the excess (up to the amount of those balances). The position was clearer on the original language of Section 4.01(b), prior to the amendment to bring in AIGTG ("*... reduction from time to time to the extent of losses incurred by AIGFP in excess of [reserves plus current year income] ...*"); but that superseded wording is not, I think, relevant to the proper construction of the applicable wording.

84. The qualification that DCA balances absorb excess loss only up to the amount of those balances is important, but to my mind it is plain on the language of Section 4.01(b)[1] and the DCP as a whole. Indebtedness of AIGFP to Participants (and to AIG Inc) under the DCP can only absorb losses incurred by AIGFP up to the amount of the indebtedness. If losses are incurred that wipe out not only the reserves and current year income available to AIGFP at the time, but also AIGFP's total DCP debt at that time, how (if it can) AIGFP will absorb and survive the excess is not something that any of those means can help with and is not something the DCP seeks to address (except in the limited, indirect, sense that it makes provision for Participants' entitlements in the event of a formal insolvency process and such a process could result if AIGFP could not survive the excess losses).

85. Further, to my mind, the clear focus of the language used in Section 4.01(b)[1] is the absorption of losses, if incurred, when they are incurred. It was common ground, as I have noted already, that Section 4.01(b) called for a single, annual, assessment of losses, comparing them against reserves and current year income to determine whether there was an excess that DCA balances could be called upon to help AIGFP to absorb. There is no statement in the contractual language, nor in my view any implication or suggestion from it, that any unabsorbed excess of loss carries forward to a future year. Again, as I read the language it simply does not address what AIGFP is to do if there is such an ultimate excess of loss.

86. Mr Hunter QC submitted that reduction "*to the extent of*" losses conveyed that the full amount of qualifying losses was to be deducted from DCA balances (hence *inter alia* the expression of positions after such deductions in terms of negative balances). In my judgment, the words relied on do not bear the weight of that submission. Properly construed, as I have concluded, they serve only to identify that the loss that DCA balances are to help AIGFP to absorb is the excess of annual losses incurred over the reserves and annual income available at the time to absorb loss without reference to those balances. They do not convey, in addition, the (impossible) notion that DCA balances are to absorb loss greater in amount than those balances.

87. That brings me to the meaning, or content, of "*losses*" for these purposes, and the related submission by Mr Hunter QC that where reserves are nil, the excess loss generating DCA balance reductions is, in effect, just negative Distributable Income. He submitted, in other words, that if reserves are nil and no new annual reserves are taken, then under the DCP, annual revenues less expenses, if positive, is Distributable Income capable of generating *inter alia* new DCA credits; and the same, if negative, is the excess loss to be absorbed by the outstanding balance remaining of old DCA credits (to the extent it can absorb it, as I would add). There is thus a complete symmetry, on Mr Hunter's argument, between the (positive) Distributable Income that generates DCP bonus amounts and the "*losses*" to be absorbed by deferred bonus amounts. But there is no *a priori* need for such symmetry; and the most obvious way to create it, if that were the

intention, has not been used, namely drafting Section 4.01(b)[1] by reference to Distributable Income as a defined term. The question is what the language actually used means, with no assumption or presumption as to whether the symmetry proposed by Mr Hunter's argument was intended. Thus, Mr Hunter's particular submission that the defendants must be right about restoration because "*the [Plan] accounts are in essence retained earnings accounts [that] can and should only be restored from future net earnings*" to my mind just begged the question.

88. It is apparent from the contractual language that "*losses*" for these purposes are: distinct from matters of current year income; matters in respect of which reserves might have been set aside; negative financial outcomes for which it will be possible to identify, for AIGTG, whether they result from transactions entered into on or after 1 January 2003. Further, the DCP relates generally to the business of AIGFP, typified by transactions with characteristics such as I summarised in paragraph 28 above, and more specifically to the deferral of bonus payments so that they will fall to be paid (subject to the impact of this reduction / restoration regime) over a period related to the profile of the credit default book as it stood when the deferred bonus amounts were awarded.

89. In those circumstances, in my judgment the claimants are correct in their alternative argument as to qualifying losses – "*losses*" in Section 4.01(b)[1] means losses, i.e. capital losses, incurred under the financial product transactions entered into by AIGFP and making up its book or portfolio of business from time to time. Mr Hunter QC pointed out in closing that in AIG Inc's consolidated financial statements, capital losses (realised and unrealised) on transactions in AIGFP's portfolio were in fact reported as negative revenues within the Consolidated Statement of Income (Loss); and the ERP provided that capital losses were part of the Distributable Income calculation (subject to particular rules about unrealised losses, and the capping of realised losses, from the credit default book), which amended the DCP if it would not otherwise have had that effect. But none of that can drive the meaning of Section 4.01(b)[1], in the language of which "*losses*" are explicitly contrasted with, and so cannot be included within, "*current year income*". If that means "*current year income*" for Section 4.01(b)[1] is not everything reported in statutory accounts as 'income', so be it. This interpretation of "*losses*" as used in Section 4.01(b)[1] is supported, in my judgment, by the preamble provision I quoted in paragraph 15 above.

90. Furthermore, given the history (paragraph 29 above), in my judgment Section 4.01(b)[1] only ever referred to *realised* losses, although that does not matter, thanks to the parties' agreement about Section 3.07(b) of the ERP (paragraph 46 above), since no question of effecting reductions to Plan balances arose until the end of 2008, after the ERP was in place. If there might have been room to debate exactly what counted as a realised loss for these purposes prior to the ERP (not something the parties addressed at trial), in my judgment that was resolved by the clear and detailed definition of Realized Losses set out in Schedule 2 to the ERP.

91. On the other hand – in this respect agreeing with Mr Hunter QC's submissions – the "*current year income*" referred to must mean net income, i.e. revenues <u>less</u> expenses, including the interest expense incurred under the AIG-FP bail-out facility. There was some debate between the accountancy experts as to whether, in the books of AIG Inc as facility lender, AIG-FP's debt under the bail-out facility should be written down very heavily, perhaps even written off, to reflect the reality that AIG-FP is not expected to be in a position to repay any or any substantial part of that debt. That would effectively

treat the amount of any such write-down as supplementary capital contribution by AIG Inc as shareholder. It is easy to see the importance of that – the massive net negative balance on AIG-FP's balance sheet, representing its indebtedness under the bail-out facility, should not be shown in AIG Inc's books as an asset of equivalent, positive, value, if there is no real prospect of recovery. But in my judgment that says nothing about the proper treatment in AIG-FP's books of its bail-out facility liabilities. There is no basis for a finding that they have been waived by AIG Inc, or discharged otherwise than by payment (using funds generated from ongoing revenues and/or, if required, further drawings under the facility). Therefore, in my judgment interest obligations under the bail-out facility continue properly to be accounted for by AIG-FP as they accrue as expenses of its continuing in business. They are not "*losses*" within Section 4.01(b)[1]; but they serve to reduce the net income generated in any given year that will be available that year to absorb "*losses*", i.e. they reduce "*current year income*" within Section 4.01(b)[1].

92. On that basis, I reject Mr Hunter QC's submission that if there are no reserves, there is an equation between negative Distributable Income and the excess of losses that is the subject of Section 4.01(b)[1]. The Distributable Income calculation could give a negative number in a year in which there are no Realized Losses, indeed it could do so in a year where there are substantial realised gains, rather than losses, on AIGFP's financial products transactions. That makes sense, given the purpose of the Distributable Income calculation in the DCP – if in any given year there were no Realized Losses, perhaps even realised gains, yet also, overall, there was no (positive) Distributable Income that year, there would be nothing out of which to award discretionary bonus amounts for that year. (For completeness, to the extent that Realized Losses were incurred but absorbed by reductions to DCA balances, I would understand they would not reduce Distributable Income (or, strictly, the losses would to that extent be balanced out in the Distributable Income calculation by the gain generated by discharging DCA balances otherwise than by payment), but that is a separate point.) On this aspect, Mr Hunter submitted at various times that it was common ground that there was the equation between negative Distributable Income and excess Section 4.01(b)[1] losses for which he contended, but in that regard he was relying on comments of the expert accountants or the fact that the claimants did not challenge the evidence of Mark Balfan, CFO of AIG-FP at material times, that he understood there to be such an equation. It was neither Mr Balfan's nor the expert accountants' task to construe the DCP for the court; and Mr Hunter rightly did not seek to rest on the suggestion that there was no issue, but addressed the issue as one of construction.

93. Though Realized Losses will reduce Distributable Income, there is no reason why current year results not being good enough to generate new discretionary bonuses should also be the touchstone for reducing (i.e. depriving Participants of) previously awarded bonus amounts. To the contrary, in my judgment, on the proper construction of Section 4.01(b)[1], if for a given year there are no Realized Losses to be absorbed, there can be no question of reductions under Section 4.01(b)[1], whatever contribution (if any) current year income might have made towards absorbing those losses had there been any, i.e. whatever buffer current year income might have provided, if any, before Plan balances could have been affected, had there been losses to absorb.

94. That also means, contrary to a specific submission by Mr Hunter QC, that when it comes to restoration, there is no logical impossibility about an obligation to restore DCA balances where Distributable Income is negative (or will be rendered negative by the restoration). I agree with his submission that since a prior DCA balance reduction will have discharged *pro tanto* AIG-FP's DCP debt, whereby (to that extent) to absorb losses, so a restored DCA balance would create a fresh DCP debt, reducing current year income for the year in question. That is not the creation of a "*loss*" within Section 4.01(b)[1] in like amount, however. If there are Section 4.01(b)[1] "*losses*", i.e Realized Losses, in the year in question, since a DCA balance restoration would reduce current year income for that year, such a restoration could mean there was a balance of losses (after current year income and reserves) generating a fresh round of reductions. I can see how an assessment in good faith, on projections as to AIG-FP's expected financial performance, that if balances were restored in a particular year they would just be wiped out afresh by losses in that year might properly influence the content of a restoration plan; but I reject the argument that losses in years following reductions (or the possibility thereof) prevent there being an obligation to restore deductions made under Section 4.01[b], or (therefore) to plan for such restoration.

95. Finally, as regards Section 4.01(b)[1], the reference to base capital is a little enigmatic because it is connected to what precedes it by "*but before*". To my mind it conveys that base capital (as defined) is to be ignored for the purpose of assessing whether losses are large enough to generate any reduction and, if so, what reduction they generate. Thus, DCA balances are to absorb losses (to the extent they can) after current income and reserves are exhausted, "*but before*" base capital. It might be said with some force that the other contractual language does not suggest that base capital (as defined) might come into the assessment of DCA balance reductions, so that the reference to base capital is surplusage if it merely confirms that it does not. However, unless it has that effect, as a provision for the avoidance of doubt, I am unable to attribute any relevant meaning to it at all. That said (as to surplusage), the reference to the role of base capital in my view does support my rejection of the idea of losses carrying over under the DCP. Its inclusion reflects and is sensibly explained by, so therefore it conveys, a notion that any excess balance of losses incurred in any year, after current year income, reserves and DCA balances, is indeed then to be absorbed (if it can be) by base capital. That supports the claimants' submission and my conclusion that such an excess balance of losses does not carry over to be set against future DCA balances.

96. As events transpired, 2008 losses overwhelmed not only reserves, current year income and DCA balances, but also base capital. But for the AIG-FP bail-out facility, itself facilitated by the Federal Reserve's willingness to step in so as to prevent the whole AIG group from failing, I envisage that AIG-FP would have fallen into insolvency proceedings of some kind and the provisions of Section 4.01 that cater for that eventuality would then have applied. As it is, however, AIG-FP instead obtained from the bail-out facility the additional working capital it needed to stay in being. As Mr Oudkerk QC submitted, whilst AIG-FP indeed remains in being, it must meet its obligations as they fall due even though that may mean to some extent, or even entirely, that its obligations are in effect met by AIG Inc through further borrowing under the bail-out facility that will not be repaid. If on the language of Section 4.01(b) those obligations include some obligation to restore and pay previously reduced DCA balances, there is no reason not to give effect to that language and enforce that obligation. Any oddity in the fact that AIG Inc will thus find itself funding those historic

employee bonus amounts (unless it chooses to put AIG-FP into a formal insolvency process) is a by-product of the denuded state in which AIG-FP now exists, at AIG Inc's instance, a consequence in turn of the extreme events of late 2008.

97. Turning to the language of the restoration obligation in Section 4.01(b)[3], the obligation "*subsequently to restore amounts so deducted*" (my emphasis) does not convey that there is some precondition to restoration beyond that there has first been a deduction calling for restoration. Any restoration must of course come after that. If that means "*subsequently*" adds nothing, so be it – I do not think there is any force in an argument against surplusage there. As Mr Oudkerk QC submitted, 'if we reduce your balances we shall restore them afterwards' or similar is perfectly good, natural English in which 'afterwards' is unnecessary. The sense here is the same.

98. Mr Hunter QC submitted that because of "*subsequently*" there was no obligation to restore until after a time when any restored balances would be immediately wiped out by further losses. (It must be further losses, on my reading of Section 4.01(b), since any balance of losses not absorbed by the original deductions does not carry forward.) I disagree. As will be seen below, in my judgment Section 4.01(b)[4] required the adoption of a plan for restoration when deductions were made. Section 4.01(b)[1] would apply to any balances restored in accordance with any such plan. If that meant deductions had to be made from restored balances, Section 4.01(b)[3]/[4] would apply again, requiring restoration and the adoption of a plan in that regard. Reverting to the first deductions and associated restoration plan, and as I have already indicated, if when those deductions were made the view were taken in good faith that there would be further losses that under Section 4.01(b)[1] would wipe out any restored balances, I envisage that could properly be taken into account in settling the restoration plan. But that is a different point.

99. Section 4.01(b)[4] requires that the Board "*shall adopt a plan ... setting forth a schedule under which [AIG-FP] shall restore amounts deducted ...*". That is to be done "*in connection therewith*", i.e. in connection with AIG-FP's obligation subsequently to restore amounts deducted. As a matter of language and logic, there is no reason why the setting of a schedule for restoration of amounts deducted must come after a first date when any restoration might be made or capable of being made. To the contrary, in fact, in the context of the DCP, a scheme for deferred bonus payments to employees, the language of Section 4.01(b)[4] naturally conveys that adopting a plan for restoration would be part and parcel of making deductions. Paragraph 75 above is also apposite on this aspect. The lack of a specified time by which a restoration plan is to be adopted is to be explained, in my view, not by the notion that AIG-FP was to take as long as it might care to consider restoration (or for that matter never get round to it at all), but by the notion that AIG-FP would be expected to consider restoration when making deductions, adopting a plan there and then for the restoration of the amounts being deducted.

100. Section 4.01(b)[3]/[4] conveys, in my judgment, an obligation to restore in full amounts deducted under Section 4.01(b)[1], generating, ultimately, obligations to pay those amounts in full, assuming no formal insolvency process intervenes triggering Section 4.01(b)[7] instead. That leaves a difficulty of construction (or perhaps a need for implication) because no limit of time is set by Section 4.01(b)[3]/[4] for effecting restoration. Subject to that, the meaning I think is clear – an unqualified contractual obligation to restore in full amounts deducted, for which the Board must adopt a plan

setting a schedule. (In my judgment, that is consistent with the provision in the preamble on which both sides relied, quoted in paragraph 15 above. That provision can be read as indicating that losses affect only when deferred compensation will be paid or as indicating that they can impact on whether it will be paid. It is therefore neutral as to the meaning and effect of Section 4.01(b)[3]/[4].)

101. Section 4.01(b)[5] (part of the December 2008 amendments) resolves the difficulty of construction (or possible need for implication) to which I have just referred. The restoration plan must provide for restored amounts to be paid in 2013. Given the unqualified nature of the primary language of obligation that precedes it, in my judgment "*any restored amounts*" (a forensic emphasis of Mr Hunter QC's) does not convey that AIG-FP is entitled to schedule, by the restoration plan the Board must adopt, anything less than full restoration. Similarly, "*Any such restoration plan*" does not to my mind dilute the force of "*the Board shall adopt a plan*". "*Any such restoration plan*" conveys 'the restoration plan to be adopted, whenever such a plan is called for by Section 4.01(b)[4]', not 'a restoration plan adopted, if AIG-FP chooses to adopt one'; and "*any restored amounts*" conveys 'the amounts required by Section 4.01(b)[3] to be restored, whenever a restoration plan is called for by Section 4.01(b)[4]', not 'such amounts as AIG-FP chooses to plan to restore'. I agree with Mr Oudkerk QC that those specific points (about Section 4.01(b)[5]) and my more general conclusions on the unqualified tenor of the obligation to restore are supported by Participants' entitlement by Section 4.01(b)[7] to claim in an insolvency for the full amount of reductions not restored by the time the insolvency commences. That treats Participants' eventual entitlement to have Plan balances restored and paid as unqualified and not in doubt, the only question being one of timing (so that an insolvency might intervene).

102. There is of course a distinction between restoration and payment. Restoration will affect Distributable Income for the year in which the restoration occurs even if payment of the restored balance is (further) deferred; and no doubt the Board would be entitled to take that into account, at all events if Distributable Income continued to be the basis upon which new annual bonus amounts were awarded, when setting a restoration schedule (see paragraph 54 above). But on any view, there cannot be payment prior to restoration, so that by requiring any restoration plan to provide for payment of restored balances to be in 2013, Section 4.01(b)[5] requires the plan to provide for restoration in or prior to 2013.

103. Section 4.01(b)[6] makes specific provision for the eventuality that deducted amounts are not in fact restored in full by 31 December 2013. I do not see that as inconsistent with the construction I have given to Section 4.01(b)[3]/[4]. Section 4.01(b)[6] provides that "*to the extent amounts have not been restored by 31 December 31, 2013, all restoration rights shall permanently lapse except to the extent [AIG-FP] determines it may amend the [DCP] to provide for payment of restored amounts without violating Internal Revenue Code Section 409A*". Making provision for the possibility that to at least some extent amounts deducted may not in fact be restored by a certain date does not imply entitlement in AIGFP not to effect full restoration, or not to do so by that date. It merely means that (absent further amendment of the DCP) matters will finally crystallise at the stated date.

104. Contrary to a submission by Mr Hunter QC, Section 4.01(b)[6] (likewise Section 4.01(b)[5]) is relevant to all of the claimants, not only to those who are US taxpayers. It only does not apply to claimants who are not US taxpayers if it renders the DCP less

favourable for them. To be fair to Mr Hunter's submission, it assumed that the effect of Section 4.01(b)[6] was to defeat any claim that might otherwise be made good under the DCP. The first task, then, is to identify the effect of Section 4.01(b)[6].

105. Since the context of Section 4.01(b)[6] is, expressly, Section 409A of the US Internal Revenue Code and a desire to avoid 'violating' it (and see also Section 4.09 of the DCP), the effect of Section 4.01(b)[6] cannot sensibly be considered without an understanding of Section 409A. The meaning and effect of Section 409A is a matter of US Federal tax law. Surprisingly, the parties did not seek permission for expert evidence on that, there was no such evidence at trial and any rival positions as to its relevant meaning and effect were neither pleaded nor set out in the opening submissions for trial. The 'presumption' that the content of foreign law is the same as English law (more properly, the default rule that English law applies absent proof of the content of some applicable foreign law) cannot have sensible application in this specialist context. Thankfully (else I would have needed to adjourn the trial part heard so expert evidence could be obtained), the following exposition provided on instructions in the defendants' written closing submissions was accepted by the claimants and therefore I proceed on the basis of common ground that:

> "*23. Section 409A was an amendment to the Internal Revenue Code ("**IRC**") introduced by section 885 of the American Jobs Creation Act 2004. It provides, at section 409A(a)(1)(A)(i), that if at any time during a taxable year a 'non-qualified deferred compensation plan' fails to meet certain requirements, or is not operated in accordance with such requirements, a 'plan failure' will occur, namely: "… all compensation deferred under the plan for the taxable year and all preceding taxable years shall be includible in gross income for the taxable year to the extent not subject to a substantial risk of forfeiture and not previously included in gross income."*
>
> *24. 'Non-qualified deferred compensation plan' is defined under section 409A(d)(1) as "any plan that provides for the deferral of compensation, other than a qualified employer plan, and any bone fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan."*
>
> *25. In the event of a plan failure, the tax imposed on an individual participant who is a US taxpayer is increased by an amount of interest set out under section 409A(a)(1)(B)(ii) and an amount equal to 20% of the compensation which was required to be included in gross income. …*
>
> *26. One of the requirements with which affected plans must comply is that compensation deferred under the plan may not be distributed earlier than "a specified time (or pursuant to a fixed schedule) specified under the plan at the date of the deferral of such compensation" (section 409A(a)(2)(A)(iv)).*
>
> *27. Proposed regulations under Section 409A produced by the Internal Revenue Service ("**IRS**") and the Treasury Department were published on 4 October 2005 providing for a proposed effective date for Section 409A of 1 January 2007. However, … transitional relief was provided by, inter alia, announcing that the final regulation would not become effective until 1*

January 2008. That transitional relief was in turn extended further … until 31 December 2008.

28. *Accordingly, AIGFP had a long stop date of 31 December 2008 by which to ensure that the DCP and SIP complied with Section 409A for US taxpayers … . … the DCP and SIP provide[d] for reductions in the event of losses but require[d] AIGFP … to adopt restoration plans with respect to such reductions. However the Plans did not, prior to the amendments of 29 December 2008, specify any fixed time for making restoration plan payments if a restoration plan were adopted. Mr Dooley [of AIG] [stated in a Memorandum to Plan Participants dated 29 December 2008] that: "[t]his lack of a fixed payment date would, if not corrected by an amendment, likely cause the plans to violate 409A".*"

106. Armed with that understanding of Section 409A:

i) The language in Section 4.01(b)[6] of 'violating' Section 409A is slightly loose. Section 409A does not proscribe anything, it merely provides that in certain circumstances deferred compensation will attract an income tax treatment unfavourable to the taxpayer. Since, then, the possibility of unfavourable tax treatment under Section 409A is the concern, since that unfavourable tax treatment is triggered by a failure to meet or comply with requirements set by Section 409A, and recalling again the terms of Section 4.09 of the DCP, the reference to 'violating' Section 409A must, I think, be understood to mean failing to meet or comply with Section 409A requirements so as to create a Section 409A plan failure.

ii) I find it elusive to identify that the reduction / restoration scheme of the DCP created any Section 409A difficulty prior to the December 2008 amendments. The requirement said to have been engaged is that the plan not permit payment of deferred compensation earlier than at a time or in accordance with a schedule fixed when the compensation was deferred. As a first step, plainly the DCP did provide a payment schedule for Deferred Compensation that was fixed at the time of deferral. Although payment could be accelerated, as against that original schedule, in the case of a Distribution Event or Early Distribution, that possibility is not suggested to have involved or risked plan failure. On the unamended language, it seems to me inconceivable in practice that a restoration plan would be adopted following reductions that might accelerate payment of restored amounts as against their original payment schedule. It might perhaps be said that the reduction / restoration scheme provisions did not in terms rule that possibility out. But it is then, as I say, elusive to see why a failure in terms to rule that possibility out should be a problem if the Early Distribution provisions were not.

iii) If there was a real Section 409A problem in the reduction / restoration scheme prior to the December 2008 amendments, it was not the lack of a fixed payment date as suggested by Mr Dooley's Memorandum. (I explain Mr Dooley's role at AIG below, when dealing with the claims against AIG Inc.) The requirement not to permit acceleration of payment (as against the payment schedule set at the point of deferral) was surely most readily satisfied simply by stipulating explicitly that any restoration plan would provide for payment of restored

amounts not earlier than they would have been paid absent the corresponding deductions.

iv) Indeed, far from curing any difficulty of non-compliance with the non-acceleration requirement, on the face of things by Section 4.01(b)[5] the December 2008 amendments created that difficulty by requiring payment in 2013 of restored amounts some of which may originally have been payable only later.

v) Be all that as it may, the defence asserting that claims pursued in these proceedings fail because restoration rights 'permanently lapsed' at the end of 2013 cannot succeed. Pursuant to the amendment mechanism of the DCP, the reduction / restoration scheme provisions could be amended to comply with the non-acceleration requirement. The defendants therefore have not persuaded me that any rights lapsed by operation of Section 4.01(b)[6]. The defendants argued that the reference to the possibility of amending the DCP further was included in case Section 409A was amended. But that is simply not what the provision says.

vi) Finally, there are only untoward tax consequences under Section 409A at all if the deferred compensation in question, the timing of payment of which is under scrutiny, is not subject to a substantial risk of forfeiture. One can see why it may have been felt proper to tax on an accrual rather than a receipts basis as a result (which is the basic concept). But on that basis, choosing to cater for Section 409A at all in the context of the DCP rather supports the claimants' case that restoration was mandatory and unqualified. Mr Hunter QC submitted that this was not a strong point because the meaning of 'substantial risk of forfeiture' in this context was complex and highly technical as a matter of US Federal tax law. But there is neither pleading nor evidence to that effect.

107. Were I wrong in paragraph 106(v) above, even so that would not avoid the claims now made. Section 4.01(b)[6] would have disentitled Participants from having balances restored that had not in fact been restored by the end of 2013. That would not have any impact on claims for damages for making wrongful deductions in the first place or for breach of the obligation created by Section 4.01(b)[3]-[5] to adopt, when deductions were made, a plan for their restoration providing for payment of restored amounts in, and therefore restoration by, 2013. The circumstances, if any, in which under the DCP a restoration plan adopted in fulfilment of that obligation could lawfully not be executed were not explored at trial. They would be relevant to questions of causation and quantum that I am not in a position to determine in this judgment.

108. The result, therefore, is as follows, as regards DCA and SIP Account balances (and ignoring for these purposes Distribution Events, Early Distributions or the provisions for loss or partial loss of entitlements upon termination of employment):-

i) Such balances represented debts owed by AIG-FP to the Participants or to AIG as the case may be, for payment of which Banque AIG also had contractual responsibility in the case of Participants employed by Banque AIG, payable as regards each separate annual credit upon a payment schedule set at the time the credit was made (for DCA credits) or in January 2013 (for SIP credits), subject to the operation of the reduction / restoration scheme.

ii) Where a balance was properly reduced under Section 4.01(b)[1], that discharged the debt represented by that balance to the extent of that reduction.

iii) It follows (and this will be important when applying this analysis to the facts) that Participants had and have no entitlement *in debt* arising out of non-restoration of balances. Any claim that balances were not restored when they should have been, or for failure to adopt a restoration plan, will be a *damages* claim, not a claim for an unpaid debt.

iv) The "*losses*" falling within Section 4.01(b)[1], and therefore the subject matter of the reduction / restoration scheme, were realised losses in the AIGFP transaction book (but limited to transactions entered into on or after 1 January 2003 in respect of AIGTG business). They are not to be equated to (negative) Distributable Income plus reserves taken in the year, as contended by the defendants. Though not more precisely defined prior to the ERP, as from 1 December 2007 (the effective date of the ERP), upon the proper construction of the DCP and SIP the "*losses*" falling with Section 4.01(b)[1] were Realized Losses as defined by Schedule 2 to the ERP.

v) In the reduction phase of the scheme, such losses (if any) occurring each year were to be absorbed first by then available reserves and current year income, second by DCA and SIP Account balances (which bore that burden pro rata), third by base capital. That is to say: balances fell to be reduced in any given year only if such realised losses that year exceeded the reserves and current year income then available to absorb them; if that excess of losses was greater than the aggregate DCA and SIP Account balances available to absorb it, the remaining balance of losses hit base capital and did not carry over to future Plan years; Plan balances could not be negative.

vi) The current year income for any year, by reference to which (together with reserves, if any) to assess whether there was an excess of realised losses incurred that year to be applied to any available Plan balances, was net income, i.e. revenues less expenses including the interest expense incurred under the AIG-FP bail-out facility.

vii) In the restoration phase of the scheme, a balance restored would be a new debt owed by AIG-FP to the Participant in question or AIG, as the case may be, payable in 2013 (thanks to Section 4.01(b)[5]). Such new debt is not a Section 4.01(b)[1] loss such that it would necessarily wipe itself out if there are no reserves and negative current year income at the time of restoration. However, a balance restored will reduce current year income available to absorb any realised losses for the year, so that (depending on the facts) it could be that a restored balance became immediately subject to reduction under Section 4.01(b)[1].

viii) Acting by the Board, AIG-FP was obliged by Section 4.01(b)[4]-[6] to adopt a restoration plan providing a schedule for the restoration in full of amounts deducted (plus interest) and for payment of restored amounts in 2013, and to do so when reductions were applied to balances under Section 4.01(b)[1]. The purpose of doing so was to plan the performance of AIG-FP's obligation under

Section 4.01(b)[3]/[5], which was an obligation to restore in full (and with interest) amounts deducted under Section 4.01(b)[1].

ix) Any rights the Participants had to have balances restored, upon the foregoing interpretation of Section 4.01(b) applied to the facts, did not permanently lapse after 31 December 2013 under Section 4.01(b)[6]. Even if any such rights did then lapse, Participants would still be entitled in principle to claim damages for deductions wrongfully made or for failure to adopt a restoration plan when deductions were made.

Application to the Facts

109. Subject to the timing issue I mentioned in paragraph 63 above which I deal with below and on which I find in the defendants' favour, the claimants' 2008 opening DCA and SIP Account balances, and the DCA credit balances generated by the ERP, were properly reduced to nil before any instalments of principal fell due for payment. To the extent the claimants have claimed such sums in debt, their claims therefore fail. Since Banque AIG's own obligation under the Plans was limited to an obligation owed to Participants employed by it to make payments due under the Plans, that failure of the claimants' claims in debt means that the only contractual claims in respect of 2008 opening Plan balances or ERP amounts, whether the claimants were employed by Banque AIG or by AIG-FP, are claims against AIG-FP, for damages for breach of contract in respect of the restoration limb of the reduction / restoration scheme. The claimants who were employed by Banque AIG emphasised that remuneration is fundamental to an employment relationship and that Banque AIG as the employer had ultimate liability for its employees' remuneration. That does not in my judgment alter the contractual structure by which the relevant employees were remunerated, i.e. salary plus participation in the Plans, with Banque AIG liable for salary (obviously) plus such sums as might fall due for payment under the Plans. I do not see any need to stretch the language of the Plans so as to render Banque AIG liable in damages in respect of breaches by AIG-FP of its obligations in respect of the operation of the Plans for which employees' participation in the Plans entitled them to claim directly on AIG-FP, just as they are doing in these proceedings.

110. As a result of Maiden Lane III, Realized Losses in November 2008 (hitting the 2008 DCP year) and December 2008 (hitting the 2009 DCP year) were so large that under Section 4.01(b)[1], all DCA and SIP Account balances at year end 2008 (including new DCA balances accruing then under the ERP) were wiped out (reduced to nil) and the new DCA balances accruing at year end 2009 under the ERP were also wiped out as soon as they accrued. However, DCA and SIP Account balances could not be negative. AIG-FP was incorrect to assert otherwise, or to state and carry forward negative balances, as it did (and has continued to do ever since), but on the figures that does not affect what I have just said about the 2008 and 2009 year ends.

111. The annual Distributable Income calculation has returned a negative result for every year since (and including) 2008. That was common ground at trial, subject to the correct treatment of unrealised gains and the interest expense of the bail-out facility. On those aspects, as the defendants contended, unrealised gains are not part of the calculation, but bail-out facility interest is. On that basis, the detailed calculations put forward by the defendants were agreed*, showing annual (negative) Distributable Income as follows:

2008 (US$25,264,713,604)	**2009** (US$12,362,086,421)	**2010** (US$2,744,573,327)
2011 (US$1,145,499,598)	**2012** (US$280,123,862)	**2013** (US$377,396,475)
2014 (US$32,485,842)	**2015** (US$266,562,067)	**2016** (US$445,890,768)

* These annual figures were set out in a table in which they were labelled '**Total Losses for AIGFP**', reflecting the defendants' case that, with nil reserves, the excess of "*losses*" to be applied in reduction of Plan balances under Section 4.01(b)[1] was the same as (negative) Distributable Income. I have rejected that case. However, that does not affect the point made in this and the next paragraph. The rejection of that case rejects the label attached to these results, not the results themselves. The calculations were actually Distributable Income calculations, following the Distributable Income definition of the DCP (as amended by the ERP).

112. That means, in turn, that there has never been any question of new (non-ERP) DCA balances generated by the DCP itself for 2008 or any subsequent year.

113. That of course does not affect the deferred part of Guaranteed Retention Awards under the ERP. As will have been clear from my introduction of the ERP, its 2008 and 2009 Guaranteed Retention Awards were guaranteed in up to three different senses: (i) their full amount was guaranteed to be awarded whatever the size of the Bonus Pool for 2008 and 2009 respectively, which would be a function of the Distributable Income calculation, but subject then to deferral requirements and thence to the reduction / restoration scheme for deferred portions; (ii) payment of the cash (non-deferred) portions was formally guaranteed by AIG Inc; (iii) (subject to any argument over the meaning or effect of this), if the Bonus Pool was smaller than the aggregate of the Guaranteed Retention Awards, AIG Inc would "*cover*" the shortfall. The use of 'Guaranteed' in the ERP defined term, I think, was really only intended as a reflection of the first of those, but whether that is right or not it does not indicate that DCA credits for the deferred portion of ERP Awards were in any way immune from the reduction / restoration scheme, whatever otherwise its effect might be. Be all that as it may, the present point is simply that the absence of positive Distributable Income did not disentitle Participants from having their 2008 and 2009 ERP Guaranteed Retention Awards, so far as they were deferred, credited to their DCAs. The question then is whether, when thus credited, those new balances were immediately subject to reduction on account of losses (i.e. Realized Losses within Schedule 2 to the ERP) under Section 4.01(b)[1] of the DCP, bearing in mind that prior year losses do not carry forward for that purpose so that in operating all of this AIG-FP should never have been showing negative Plan balances.

114. Apart from the ERP, Participants may have had bespoke arrangements entitling them to additional DCA credits irrespective of the ordinary operation of the DCP, to which what I have just said about the deferred parts of ERP Guaranteed Retention Awards equally applies. Thus, for example, Ian Rosen, one of the claimants from whom I heard

evidence, had a bespoke arrangement involving an entitlement to DCA credits over and above any credits generated by the ordinary operation of the DCP. In his case, that was an element of his agreed remuneration package intended to compensate for share or share option entitlements at Deutsche Bank he gave up by moving to Banque AIG in 2007.

115. That aspect of Mr Rosen's position gives rise to the point I mentioned in passing in paragraph 12 above. It was Mr Rosen's evidence, I think not challenged but which in any event I accept, that the final annual instalment of US$365,000 under this element of his remuneration package was not credited to his DCA in January 2011, as scheduled in his contract, or at all. Under Mr Rosen's contract, his entitlement to that final DCA credit in January 2011 was subject generally to the proviso that he was then still employed by Banque AIG (and had not given or received notice to terminate that employment). But that proviso was in turn subject to provisos, the effect of one of which was that if Mr Rosen's employment by Banque AIG terminated on or before 31 December 2010 otherwise than for cause or as a result of death, ill-health or disability, the general proviso did not apply, i.e. the entitlement stood. On the facts, Mr Rosen's employment by Banque AIG was terminated prior to 31 December 2010, but not for cause or as a result of death, ill-health or disability. On the face of things, therefore, Mr Rosen had a good claim that, in breach of contract, US$365,000 was not credited to his DCA in January 2011. I understood it to be agreed at trial, however, that that claim is not currently pleaded and that the parties would consider further in the light of this judgment whether it could be added now and, if so, whether it should be.

116. AIG-FP did not adopt any plan for the restoration of amounts deducted, either at the time DCA and SIP Account balances were reduced pursuant to Section 4.01(b)[1] or at any time since. Upon the proper construction of the reduction / restoration scheme, as I have judged it, that was a breach of contract. By Section 4.01(b)[3]-[6], acting by the Board, AIG-FP was obliged to restore all deducted amounts, in full (plus interest), and for the purpose of performing that obligation it was obliged, when deductions were made under Section 4.01(b)[1], to adopt a restoration plan providing for a schedule for such full restoration and for payment of restored amounts in 2013.

117. Instead, incorrect approaches having been adopted, (a) that losses carried forward, so that Plan balances all became hugely negative, (b) that (in the absence of reserves) negative Distributable Income amounted and equated to excess loss to be deducted from Plan balances, and (possibly) (c) that absent positive Distributable Income amounts deducted did not have to be restored, no real consideration was given, certainly no proper consideration, to the adoption of a restoration plan at any stage. I have expressed that deliberately in the passive, so as not to beg questions that arise in the tort claims against AIG Inc as to where any relevant decisions were or were not being taken.

118. On this trial, there will therefore be judgment for the claimants against AIG-FP, for damages to be assessed. Part of that assessment will be the application of this judgment to the individual position of each claimant. But there will also be 'global' issues to consider.

119. On the approach that losses carried forward, generating huge negative balances, negative Distributable Income (year on year) further reduced those balances (i.e. rendered them even further negative), and positive Distributable Income was a *sine qua non* of any relevant entitlements, I can see the end result for which the defendants

contended, namely that in reality there was nothing to plan for and in any event no loss was suffered. But I have held that in each respect that approach is incorrect. There will therefore need to be a counterfactual assessment of what should have happened.

120. One major element of that will be finding (if it cannot be agreed) what Realized Losses within Schedule 2 to the ERP were incurred for the 2010 and subsequent years and the extent to which, for each year, they exceeded current year net income (given that reserves have been nil throughout). It may be the work required has already been done, but it was not a specific focus at trial. The extent of 2010 and later Realized Losses in excess of current year income will be relevant to the assessment of what should have happened because balances that should have been restored, implementing a restoration plan adopted when deductions were made, would be subject to a fresh application of the reduction / restoration scheme by reference to such excess of Losses.

121. The point I mentioned at the end of paragraph 107 above may also need to be addressed. This judgment finds AIG-FP to have been in breach for not adopting a restoration plan, when making deductions from Plan balances, as it was required by Section 4.01(b)[3]-[6] to do, and that the plan it was required to adopt, (a) had to provide for payment of restored balances in 2013, and so necessarily (b) had to provide for restoration not later than in 2013. That is not quite the same as finding that the claimants must have been paid in 2013, upon a proper discharge of its obligations by AIG-FP. Whether that is the outcome may depend, it seems to me, on the point in paragraph 107 above. Likewise, the right of the Board to amend the Plans further may need to be considered, depending on the extent of Realized Losses in and since 2010, and their impact upon the counterfactual assessment. Perhaps the parties will identify other variables too. I envisage, therefore, that the assessment of damages may require a more substantial process than just directing the parties to undertake, and agree if possible, calculations by reference to the current evidence.

122. The final matter to consider in relation to the claimants' contractual claims is the point arising out of paragraph 63 above. It takes a little explaining to see that there is a point, but I was assisted by helpful worked examples using the figures for Charles Scheyd, one of the claimants from whom I heard evidence. Those examples modelled a slightly bewildering range of permutations. One of those was whether the claimants or the defendants were correct about 'ring-fencing'. That is the point on which I agreed with the defendants in paragraph 64 above. Everything that follows takes that decision as a given.

123. Before any reduction for losses under Section 4.01(b)[1], Mr Scheyd had an aggregate non-ERP DCA and SIP Account balance of US$587,598, i.e. that was his 2008 opening Plan balance. His ERP DCA credits were US$700,000 each for 2008 and 2009. To explain the point I have to determine, it is not necessary to go beyond the 2008 ERP Award amount. It is common ground that entitlement accrued on 31 December 2008, so Mr Scheyd was entitled to have his DCA credited with US$700,000 as of that date. The reduction of DCA and SIP Account balances on account of 2008 losses was booked only in May 2009. That is to say (if I may use this old-fashioned language in a world of electronic spreadsheets), the relevant book-keeping was only done in May 2009. Following that book-keeping, also in May 2009, summary account statements were issued to Participants 'dated' 31 March 2009 but stating balances as of 1 January 2009. In Mr Scheyd's case, that statement stated a balance prior to allocation of 2008 losses of US$1,287,598 (being US$587,598 plus US$700,000), an allocated share of 2008

losses of (US$7,688,780), and therefore a Plan balance as of 1 January 2009 of (US$6,401,182). On the basis of this judgment, (a) the allocated share of 2008 losses may not be correct but the correct share will have exceeded on any view the opening balance of US$1,287,598, and (b) the closing balance should have been nil, not a negative balance.

124. The claimants then submitted as follows as to the proper working of the Plans:

i) Mr Scheyd's Plan balance on, and as of, 1 October 2008, the Q4 2008 Interest Reset Date, was US$587,598. Q4 2008 interest was therefore payable in January 2009, calculated on that balance.

ii) Mr Scheyd's Plan balance became US$1,287,598 on 31 December 2008, so that was his balance on 1 January 2009, the Q1 2009 Interest Reset Date. Therefore:

a) an instalment of principal fell due and payable in January 2009, namely US$181,924 (the aggregate of the annual instalment amounts for five credits that made up the US$587,598, those annual instalments having been set when those credits accrued on 31 December 2003, 2004, 2005, 2006 and 2007);

b) Q1 2009 interest was payable in April 2009, calculated on the 1 January balance; and

c) Mr Scheyd has a good claim in debt for (a) and (b) (neither of which was paid).

iii) Mr Scheyd's Plan balance going forward, therefore, and his balance on 1 April 2009, the Q2 Interest Reset Date, was US$1,105,674 (treating the instalment referred to in (ii)(a) above as having been paid as it should have been). Therefore, Q2 2009 interest was payable in July 2009, calculated on the 1 April balance, and Mr Scheyd has a good claim in debt for that interest amount, which was not paid.

iv) That Plan balance was then wiped out by losses, but only in May 2009. Nothing further became payable (whether interest or principal) in respect of Mr Scheyd's 2008 opening balance, or his 2008 ERP credit of US$700,000 (unless it be through the restoration limb of the scheme or by way of damages for breach of contract in respect of that limb).

125. Paragraph 124(i) above was common ground. The resulting Q4 2008 interest was paid and has not been in issue. It was also common ground that none of the other payments the claimants said should have been made were made. The defendants however disputed that any of those payments should have been made. In summarising the claimants' submission, my change of language is deliberate – from 'on, and as of' (paragraph 124(i)) to 'on'/'in' (paragraph 124(ii)-(iv)) – and encapsulates the dispute. The claimants' case is built upon differentiating between accrual dates and book-keeping dates and mixing the two to suit the case (the ERP credit is given its accrual date but the allocation of losses its book-keeping date).

126. As such, in my judgment the claimants' case is an artificial construct and I reject it. To be fair to the claimants, the defendants for their part took until the eve of the trial to identify and articulate the correct answer to the claimants' point; but that answer is nonetheless plainly correct. The Plans are structured around annual calculations and awards, accruing on 31 December, and then quarterly interest resets within the year. The date(s) when the book-keeping catches up is irrelevant to Participants' entitlements. Leaving aside any possible damages claim for misstatement or some estoppel (neither of which was alleged), what may have been stated, on or as of what date, in statements of account sent to Participants, is likewise irrelevant. If those statements got amounts or accrual dates wrong, replacement statements correcting the error could be sent out. The obligation on AIG-FP in Section 4.07 of the DCP to provide quarterly statements of Participants' DCA positions in a specified format does not alter those conclusions or justify the claimants' suggestion that the defendants were claiming a 'power to backdate' the application of losses. For completeness, to be clear, my analysis is not that a counterfactual exercise is involved, asking when the loss allocation book-keeping would have been done had no one conceived of negative balances. To some extent, the defendants presented their submissions on the basis of such an analysis; so to that extent, I do not accept their case. But that goes to why 31 December annually is the answer rather than whether it is the answer. In my judgment, the issue is when, as a matter of the operation of the DCP on its terms, an annual (excess of) losses within Section 4.01(b)[1] accrues against Plan balances.

127. In that regard, taking Mr Scheyd's case again to illustrate, the 'March 2009' statement sent to him in May 2009: correctly stated that he had no positive Plan balance as of 1 January 2009 (albeit it incorrectly purported to state that he had a large negative balance rather than a nil balance); correctly stated what would have been his positive Plan balance as of that date but for the allocation of 2008 losses to that balance; and stated the amount of losses allocated to that balance. It did not, therefore, state that the accrual date for the loss allocation was May 2009, when the statement was sent, March 2009, the 'date' of the statement, or even 1 January 2009, the date 'as of' which the statement set out to summarise Mr Scheyd's position. Mr Scheyd was 'wiped out' under the Plans as of 1 January 2009 equally whether the loss allocation accrued on 1 January 2009 or (as I have held it did) the day before. The statement prior to that 'March 2009' statement was 'dated' 31 December 2008 but sent early in 2009. It did not purport to state any Plan balance as of 31 December 2008, however. It contained a careful and perfectly clear explanation that what it stated was Mr Scheyd's Plan balance as of 1 January 2008 and the quarterly interest therefore accrued and paid (including the Q4 interest paid in January 2009), and that that 2008 opening balance was due for reduction on account of 2008 losses, figures for which were being finalised but which (it was asserted) would result in substantial negative balances as of 30 November 2008.

128. The annual process of allocating losses (a 'one-off' process, as I have held, not carrying forward to later years any unabsorbed balance of losses) must in my judgment have the same accrual date of 31 December by reference to which the Plans entirely operate. To the extent there was error in the statements I have just summarised (over and above their incorrect statement or anticipation of negative balances and any error in the allocated loss amount), it is the 'December 2008' statement's incorrect suggestion that the accrual date for the allocation of losses would be 30 November 2008 rather than 31 December 2008. That cannot and does not alter the claimants' rights or AIG-FP's obligations.

129. As a result, very simply, and as I said in paragraph 110 above subject to the timing point I have now dealt with: Participants' 2008 opening Plan balances, plus their 2008 ERP DCA credits accrued on 31 December 2008, were wiped out by the allocation of 2008 losses to Plan balances as required by Section 4.01(b)[1], that allocation also accruing on 31 December 2008; and their 2009 ERP DCA credits accrued on 31 December 2009 and were immediately wiped out by the allocation of 2009 losses to Plan balances also accruing on that date. The only viable claims, therefore, in respect of 2008 opening balances or 2008 and 2009 ERP DCA credits, are claims for damages for breach by AIG-FP of the restoration limb of the reduction / restoration scheme of the Plans.

130. The timing point, since the claimants are correct that unabsorbed losses do not carry forward, could mean, I envisage, that some claimants might have valid claims that bespoke DCA credits were improperly reduced, leading to valid debt or damages claims against AIG-FP and possibly valid debt claims against Banque AIG. Taking the example of Mr Rosen, already mentioned, his bespoke DCA credits accrued in January 2009, 2010 and 2011. They were wrongly treated as instantly wiped out by his 'negative balance', i.e. by the wrongful carry forward of unabsorbed losses. I envisage therefore at least that they should have generated interest payments during the year in which they were credited. Whilst the 2009 credit was then (properly) reduced to nil at the end of the year, whether the same is true of the 2010 credit or would have been true of the 2011 credit if it had been applied to Mr Rosen's DCA, so that no principal instalments ever fell due for payment, will depend on what Realized Losses were incurred during each of those years.

Tort Claims

131. As I indicated at the outset (paragraph 9(ii) above), the claimants say they can pierce the corporate veil, under Delaware law (agreed to be the law applicable to any such claim), rendering AIG Inc liable for any breach of contract on the part of AIG-FP in respect of the operation of the Plans, or alternatively that AIG Inc is liable on the basis of tortious interference in the operation of the Plans. These tort claims do now arise, since I have held that, in breach of contract, AIG-FP indeed did fail properly to operate the Plans.

Alter Ego Claim

132. For their *alter ego* claim, the claimants said it was AIG Inc, not AIG-FP, that took all relevant decisions and actions, dominating and dictating what happened so as to overwhelm the separate corporate identity of its subsidiary in the operation of its Plans and therefore in the matter of what, if anything, was ever to be paid to Participants by way of deferred bonus amounts under the Plans.

133. The claimants say that in the face of substantial public outcry and political pressure about the payment of AIG executive bonuses after the group had been bailed out using US taxpayers' funds, an agreement was reached between AIG Inc and New York Attorney-General Cuomo in October 2008 that nothing would be paid out of the DCP/SIP $600m deferred compensation pool, irrespective of contractual entitlement. The claimants say that AIG-FP was not involved – there was an utter failure of good and proper separate corporate governance – and was left with no choice but to implement the parent's will in the matter.

Tortious Interference Claim

134. The claimants pleaded, in the alternative, that AIG Inc tortiously induced AIG-FP to breach its contractual obligations owed under or by reference to the Plans. In closing, Mr Oudkerk QC focused on the *alter ego* claim, recognising that if the claimants' case for that claim was made out on the facts, they more naturally fitted a Delaware law *alter ego* analysis than any tortious interference analysis; and if the claimants' *alter ego* case was not made out on the facts, then it was difficult to see how it might be said that there was any tortious interference in the Plans. I did not understand him to have abandoned the alternative claim, however, if it might succeed where the *alter ego* claim did not.

135. As regards applicable law, it was common ground that if the events giving rise to the damage alleged occurred on or after 11 January 2009, the applicable law is then English law, under the Rome II Regulation. It was common ground also that if those events occurred before 11 January 2009: (i) the question was governed not by Rome II but by the Private International Law (Miscellaneous Provisions) Act 1995 ('the 1995 Act'); and (ii) the issue would be whether Connecticut law was applicable (as the defendants contended) by operation of s.12(1)(b) of the 1995 Act.

136. None of the material events constituting the alleged tort occurred in Connecticut – they all occurred either in New York or in London. The law applicable to the tort under the 1995 Act would therefore be either New York law or English law, under the general rule set by s.11(2)(c), unless that general rule was displaced under s.12(1)(b). But neither side pleaded any case as to the content of New York law, and there was no expert evidence of New York law, on tortious interference claims. So it makes no difference for my purposes whether the general rule, if not displaced, would apply New York law rather than English law, or, if displaced, would be displaced in favour of English or New York law rather than Connecticut law. The only question that might have any impact is whether the general rule is displaced in favour of Connecticut law, the burden being on the defendants to persuade the court that it is. (For completeness, I note that no point was taken whether, because the 1995 Act refers exclusively to the law of a 'country', the only foreign law that might arguably be applicable would be US Federal law, as to the content of which (as with New York law) neither side pleaded any case and I did not receive expert evidence.)

137. Whether considered under English law or under Connecticut law, it was common ground that: (i) the tortious interference claim required AIG Inc to have caused or procured AIG-FP to act in breach of contract, intending that outcome, with damage resulting to the claimants; (ii) if although AIG Inc caused or procured an outcome, intending that outcome, it did so honestly believing the outcome did not involve any breach of contract by AIG-FP, there would be no liability.

138. The issue arising, as to which there was room for debate whether Connecticut law is different to English law (depending on what I made of the expert evidence of Connecticut law), is whether there is some further requirement, and if so what it is, before there can be liability in the particular context of alleged tortious interference by a parent in the contract of a subsidiary. That in turn is or may be no more than a specific case of alleged tortious interference by a sole or controlling shareholder in the contract of his or its company.

139. The defendants submitted that Connecticut law required 'egregious conduct' comprising an 'improper motive' or 'improper means' on the part of the parent/shareholder, beyond the intentional inducement of a breach of contract by the subsidiary/company.

140. Under English law, the point does not appear to have the benefit of much authority. A claim was upheld on some rather unusual facts in *Stocznia Gdanska SA v Latvian Shipping Co et al. (No.3)* [2002] 2 AER (Comm) 768, but an observation of Males J's in *Moran Yacht & Ship Inc v Pisarev et al.* [2014] EWHC 1098 (Comm) voices, in my view, an important note of caution to inform any debate. *Moran Yacht & Ship Inc* involved an allegation of breach of contract by a company (Galaxias) said to have been procured by Mr Pisarev, its ultimate beneficial owner, and Males J said this at [115]:

> "*I would observe only that, even if Galaxias was in breach of contract for failing to pay commission, and even if Mr Pisarev knew this to be the case ..., it would remain a case where all that had happened was that a company ... had failed to make a payment which its ultimate beneficial owner, in accordance with whose instructions the company would act, knew to be due. To hold the beneficial owner liable in tort in such circumstances would appear to drive a fairly large hole through the principle of limited liability. However, it is on the facts of this case unnecessary to explore this point further.*"

Discussion

141. There is some real synergy, it seems to me, between Males J's note of caution and Mr Oudkerk QC's preference in closing for an *alter ego* analysis if his basic factual submissions found favour. If it is shown on the facts that a parent has procured its subsidiary to break its contract, intending that to be the result, but in circumstances where the law governing the piercing of corporate veils does not say the parent has assumed responsibility for the breach – the corporate veil remains intact – the imposition of liability on the parent by the law of torts requires careful justification and that surely means something more than that the subsidiary's breach was the parent's intended and procured outcome.

142. Putting the point the other way round, what would seem objectionable about AIG Inc's conduct, if the claimants' factual case were made out on the evidence, would be its abuse of the corporate structure, determining for AIG-FP that Plan balances were not to be paid, irrespective of Participants' entitlements, and then (in effect) hiding behind the corporate veil when Participants sought to enforce their rights, saying that that is a matter for AIG-FP, and not AIG Inc's responsibility. If an argument of that ilk is to found liability, it seems more satisfactory to categorise it after its substance – to call a spade a spade – by saying the veil is being pierced and liability is being imposed for an abuse of the privilege of creating separate corporate identities, rather than extending the notion of third party interference in contracts into this context.

143. Completing that circle neatly for this case, the experts on Delaware law were agreed that the *alter ego* claim brought by the claimants here would be treated in Delaware as one of 'first impression'. That is to say, whilst there is authority in Delaware on the principles, and from such authority there are illustrations of their application, there is no prior decision on substantially similar facts and the authorities as to the principles would not be regarded as dictating the result. But it was the view of former Chief Justice

Veasey, called by the claimants, that it would be a viable *alter ego* claim under Delaware law to allege that a parent overwhelmed any separate corporate will of its subsidiary, so as to dictate events and require the subsidiary to break its contract with a third party, if in doing so the parent was acting deliberately to prejudice that third party, who suffered harm as a result, with a view then to shielding itself behind the corporate structure. That would be an abuse of the privilege of separate legal identity, simultaneously taking the decision that the subsidiary's contract was to be broken whereby to injure the third party, without allowing the subsidiary any say in the matter, and intending if challenged to say it was the subsidiary's doing.

144. Former Justice Holland, called by the defendants, was not asked to comment directly on that view, but he did not express any contrary specific view; and nothing in his evidence as to the principles in play or the way they have been applied in Delaware suggested to me it would not be the view taken if the matter came to be tested. The defendants contended, at least in opening, that *alter ego* liability under Delaware law required a finding that the subsidiary was a 'sham' or 'façade', generating a side-debate as to whether that meant generally or in respect of a particular transaction or action; and that it required fraud or something similar on the part of the parent, generating a side-debate as to what might be meant by 'fraud' in this context and what might be similar. I do not think former Justice Holland's evidence actually supported either contention, and in any event I was persuaded by and accept former Chief Justice Veasey's rejection of both. The two former judges agreed in their joint memorandum the following formulation of principle and I do not accept that for this case any further gloss needs to be or should be put upon it:

> "*In a parent/subsidiary context, the parent corporation may be liable as the "alter ego" of its subsidiary where each of the following factors has been established at trial:*
>
> *(i) complete domination and control of the subsidiary by the parent; and*
>
> *(ii) a misuse or manipulation of the corporate structure; and*
>
> *(iii) an element of fraud or injustice (or similar) by the parent on an innocent third party has resulted; and*
>
> *(iv) the misuse or manipulation of the corporate structure results in fraud or injustice (or similar), which is distinct from the underlying alleged wrong, such as breach of contract.*"

<u>Conclusions as to Applicable Law</u>

145. In the result, I conclude that:

    i) *if* AIG Inc, overwhelming any separate corporate will of AIG-FP in the matter, dominated and controlled the operation of the Plans in or after late 2008, deliberately requiring AIG-FP to break its contract with the claimants with a view then to shielding itself behind the separate corporate identity of AIG-FP as subsidiary, *then* under Delaware law AIG Inc's conduct would be actionable in tort at the suit of the claimants in respect of their resulting loss;

ii) otherwise, at least on the facts of this case, no possibility of *alter ego* liability arises;

iii) *if* AIG Inc overwhelmed any separate corporate will of AIG-FP so as to dominate and control the operation of the Plans, and though it did so understanding and intending the operation of the Plans in the manner it dictated to be unfavourable to the claimants, yet if it acted upon an honest view (albeit mistaken) that no breach of the Plans on the part of AIG-FP would be involved, *then* (a) no *alter ego* liability would arise under Delaware law and (b) no tortious interference liability would arise under Connecticut law; and

iv) nor would any tortious interference liability arise under English law, if applicable, were it shown that AIG Inc controlled events, if it did, in the honest, but mistaken, belief that what it was requiring did not involve AIG-FP in any breach of contract.

146. As will be seen below, those propositions are sufficient to resolve the claims made against AIG Inc. Therefore, it is not necessary to decide whether under the 1995 Act (if applicable) the tortious interference claim would be governed by Connecticut law, the case for which comes down to whether the fact the Plans are contracts governed by Connecticut law is a factor of overriding strength, or therefore to grapple with whether the events giving rise to damage occurred before or after 11 January 2009 (or whether, perhaps, the correct analysis might be that, strictly, a number of separate torts were committed, if any were committed at all, both before and after that date).

Judgment on Tort Claims

147. The senior (former) AIG executive called by the defendants as a witness to the decision making said by the claimants to give rise to their tort claims was William ("Bill") Dooley. He was an AIG 'lifer', employed throughout his long career (from July 1978 to December 2015) by AIG Inc. Mr Dooley was first appointed to the Board of AIG-FP in September 1998 and became Chairman in November 2005. When Mr Cassano left AIG-FP at the end of March 2008, Mr Dooley was appointed interim President and CEO. In the event, he held those roles (President and CEO of AIG-FP) until the end of September 2015, three months before he retired from AIG. Mr Dooley also sat on the Board of Banque AIG as permanent representative of AIG-FP on that Board between the end of September 2008 and late October 2015.

148. That said as to Mr Dooley's various roles, without doubt and as he accepted in his evidence, at the material times he was, first and foremost, Senior Vice President (Financial Services) at and of AIG Inc. His Board roles at AIG-FP and in consequence at Banque AIG were incidents of that primary function.

149. By letter dated 3 October 2008 addressed to "*AIG FP employees*", writing as AIG Inc Senior V-P (Financial Services), Mr Dooley thanked them for their high standards of professionalism and customer service over the preceding, and challenging, 13 months, and called for their continued support as the "*wind-down process*" of "*unwinding FP's complex portfolio*" began, a process he recognised would require the specialised skills and unique knowledge that the existing workforce possessed. The letter acknowledged that details of the "*unwind plan*" were still being worked out and that it would involve

"*headcount reductions*" in 2008. He sought to reassure the addressees as to one aspect of their bonus arrangements, in the following terms:

> "*Although many issues remain to be resolved, I can tell you that AIG will live up to its commitment in honoring your retention guarantees under the terms of the ERP.*"

150. Given its context, its author and the important conversation with Mr Liddy to which I refer below, in my judgment that was, and was intended by Mr Dooley to be, reassurance only that AIG Inc stood by its commitments built into the ERP (*cf* paragraph 113 above). In practical terms, that was reassurance only that irrespective of the winding down of AIG-FP's operations, AIG Inc would ensure that Participants received the cash (non-deferred) portion of ERP Guaranteed Retention Awards. It said nothing, one way or the other, as to the impact of AIG-FP's difficulties and the unwinding of its portfolio on whether or when the deferred portion of those Awards would ever be paid. Nor did it say anything about existing (i.e. non-ERP) DCA balances or SIP Account balances.

151. Mr Dooley sent another letter to "*AIGFP Employees*" on 9 October 2008 (but mis-dated 2009), again writing as AIG Inc Senior V-P (Financial Services). He referred to the earlier letter, saying he had there noted that "*AIGFP will live up to its commitment of honoring your retention guarantees under the terms of the ERP*". As I have just indicated, this was in fact a change of language that changed the meaning of what his first letter said. The letter went on to state, as was correct irrespective of the disputed issues that arose, that the large losses incurred by AIGFP would have a significant impact on Participants' DCAs and SIP Accounts. It then sowed the seeds of this litigation by stating that:

    i) Mr Dooley expected Plan accounts "*to have substantial negative balances at the end of the current compensation year*" and "*future deferrals under the terms of the ERP [to] be affected by the substantial negative balances*"; and

    ii) whilst the Plans provided for the adoption of a restoration plan, "*The formulation of a restoration plan will ultimately depend on decisions made as we wind down AIGFP*".

152. Mr Dooley's witness statement evidence in chief seemed to suggest that he believed, even as he sent that letter, that nothing would ever thereafter be paid in respect of bonus amounts deferred pursuant to the DCP or SIP. I do not think that can be right. It would have been thoroughly disingenuous of Mr Dooley to write as he did concerning the possibility of future restoration if in his own mind that possibility could already be ruled out. I find that, in keeping with the terms of his letter, in early October 2008 Mr Dooley understood that the Plans did provide for a restoration plan to be adopted, but that adopting any such plan was a matter for the future. I have held that to be incorrect if and to the extent it might mean not adopting a restoration plan at the time of and in conjunction with the reducing of Plan balances under Section 4.01(b)[1]. But that is a different point.

153. Both in his witness statement and in his oral evidence Mr Dooley sought to characterise his 9 October letter as a letter from him as President and CEO of AIG-FP. In my

judgment, it plainly was not such a letter, although no doubt its recipients would have known that he did occupy those roles at the time.

154. The fact that Mr Dooley wrote, as he did, not as AIG-FP, but from above AIG-FP as AIG Inc Senior V-P (Financial Services), is one of the features of the evidence leading Mr Oudkerk QC to submit that all relevant decision making was at and by AIG Inc, dominating and controlling the operation of the Plans irrespective of (and so overwhelming) any separate corporate will of AIG-FP in that regard. As a convenient shorthand I have already adopted (paragraph 132 above) from a phrase favoured by Mr Dooley himself, the issue as addressed at trial was whether there was "*good and separate corporate governance*".

155. At the outset, it should be noted that there was a plain conflict of interest, or at the very least a plain possibility of conflict of interest, between AIG Inc and AIG-FP. AIG Inc, bailed out by Federal funds, was under great public and political pressure to curb bonus payments at AIG-FP, irrespective of Participants' contractual entitlements. It therefore, at least potentially, might see it as advantageous for AIG-FP not to honour its Plan obligations (at all events where those obligations were not guaranteed by AIG Inc). On the other hand, if allowed good and separate corporate governance, AIG-FP might wish to honour its Plan obligations in full, even if doing so might create friction with its shareholder. Indeed, at a much more basic level, the Plans were multi-party contracts between (1) AIG-FP, (2) Participants and (3) AIG Inc, not contracts between AIG-FP and AIG Inc jointly, on the one hand, and Participants, on the other hand; and thanks to the bail-out facility, AIG-FP was in a position to fund restoration and payment effectively, if necessary, at AIG Inc's net expense. Any AIG Inc involvement in what should have been matters for AIG-FP under the Plans ought to have rung loud and immediate 'conflict' alarm bells.

156. Mr Dooley professed not to have seen at the time, and still today not to see, that there was or may have been any such conflict. I found that surprising, for a man of Mr Dooley's seniority and experience in business, but sincere. My assessment was that he was honest in his claim not now to think there was a conflict, and that supports the accuracy of his claim not to have thought that at the time. I therefore accept Mr Dooley's evidence on this point (i.e. on his own understanding at the time).

157. That does not detract, though, from the obvious force of Mr Oudkerk QC's submission that, acting by its Board, or in certain respects more specifically by its Board deciding whether to approve proposals of the Plan Committee (AIG-FP's CEO, COO, CFO and Secretary), AIG-FP, and not AIG Inc, had responsibility for operating the Plans. Given that, given the amounts involved (even in the context of AIG-FP's financial situation), and given the obvious heat being generated in the US over executive bonuses, in my judgment it is perfectly extraordinary, if indeed good and separate corporate governance were being exercised, that there is no documentary evidence of it. There are no relevant AIG-FP Board minutes, Board notes or memoranda, no internal circulars and no correspondence (whether formal or informal, e.g. emails amongst the members of the Board or Committee). There was one relevant Banque AIG Board minute, for a Board meeting on 15 January 2009, chaired by Mauro Gabriele, then Chairman and CFO of Banque AIG. According to the minute, Mr Gabriele proposed, and the Board approved, the writing down of Plan balances to zero (<u>not</u> to 'negative balances') on the basis that under the terms of the Plans no payment other than the Q4 2008 interest payments were due, given the extent of 2008 losses. It follows from my

judgment on the contractual issues that this was either a correct operation of the Plans on their terms, or if it was incorrect then that is only in the rather subtle and proportionately marginal respect that some Participants (e.g. Mr Rosen) may have had new credits accruing only in January 2009 under bespoke terms of their employment contracts that should not have been being written down at that point. So this one Banque AIG Board minute also does not detract from the force of Mr Oudkerk's submission; moreover, as I mention below (paragraph 165) by his own account at the time, Mr Gabriele had not been involved in the relevant deliberations.

158. Mr Dooley gave what he said were examples of good and separate corporate governance in relation to unrelated matters. There was some issue concerning a pledge agreement and some point relating to Banque AIG where care had to be taken over what hats were being worn. Those unrelated matters, being unrelated, provide no support for the idea that there was good and separate corporate governance in relation to the operation of the Plans. Indeed, they suggest the contrary. On matters where there was good and separate corporate governance, that can be demonstrated, in just the way it cannot be demonstrated as regards the Plans.

159. That brings me to the conversation with Mr Liddy to which I referred in paragraph 150 above. Mr Dooley's evidence about it was intended to rebut the suggestion being put to him that AIG had caved in to the public and political pressure over AIG-FP bonuses. The conversation he related, and of which he claimed (and I believe) he still has a clear and vivid recollection, concerned precisely the issue of how AIG would cope with or respond to that pressure. Edward ("Ed") Liddy was the Chairman and CEO of AIG Inc for a relatively brief period in 2008-2009, brought in by or at the insistence of the Federal Reserve as an adjunct to the bailing out of the AIG group. He was, in Mr Dooley's memorable phrase, "*the CEO of everything*".

160. Mr Dooley's evidence concerned a discussion at AIG Inc concerning the cash portion of the ERP Guaranteed Retention Awards. Given Mr Liddy's relatively short tenure, Mr Dooley's recollection must be faulty as to when the conversation took place (he related it to the payment in 2010 of the 2009 ERP Awards). I do not think that matters, however. His evidence was as follows:

> "*A: … There were not too many people in AIG that wanted to pay those bonuses. As a matter of fact, they were very nervous that that could be a very harsh problem for AIG. I insisted that we pay those bonuses, and the simple reason I insisted that we pay those bonuses was because it was the full faith commitment of AIG to pay that. And the meeting took place in 70 Pine [AIG Inc's head office] on an executive floor and people were really upset. And Liddy said to me to stay behind because he didn't make the decision yet. The conversation went around: are you sure we have to pay the bonuses? And I said: Mr Liddy, we guaranteed the bonuses, we promised to pay.*
>
> …
>
> *A: … And he realised we came to terms with each other at that point in time …*
>
> *Q: … I think you said: "And Liddy said to me to stay behind because he didn't make the decision yet." That was actually what you said?*

A: He didn't make the decision yet.

Q: Exactly, and you are agreeing with me. It's only that on the transcript -- you can't see the transcript, but there was an error on the transcript. There was an "I" and it should be a "he".

A: He was the CEO of everything, right? So I wasn't getting called into Cuomo's office.

Q: The reality is that what you did was to give effect to Inc's decisions, ultimately?

A: I gave effect?

Q: Yes. Ultimately it was for Inc to make the decisions, and you may agree with them, you may disagree with them, you may even argue against them, but if that was the decision you gave effect to it?

A: The last guy to make a decision like that, that is going to cause the outpouring of negative news to AIG, had to be the CEO of AIG who happens to own the subsidiary company called AIG Financial Products. So I don't think that is a problem."

161. It was plain to me from that evidence, and I find, that: (a) decisions as to what was or was not going to be paid out of the Plans were being made above AIG-FP, by and at AIG Inc in New York, probably by Mr Liddy personally, at least ultimately; (b) AIG-FP was, via Mr Dooley in the first instance, expected just to implement those decisions; (c) there was indeed, as the claimants claim, no good or separate corporate governance as between AIG Inc as parent and AIG-FP as subsidiary in respect of the operation of the Plans in or after October 2008; and (d) the "*we*" to whom Mr Dooley was referring when recalling that he insisted to Mr Liddy that "*we pay those bonuses ... because it was the full faith commitment of AIG to pay ...*" was AIG Inc, not AIG-FP. That last was a reference to the fact that AIG Inc, first and foremost and above all else one of the great insurers whose word ought to be its bond, had guaranteed payment of the cash portion of the ERP Awards. In my judgment it had nothing to do with AIG-FP's Plan obligations that went beyond anything guaranteed by AIG Inc.

162. The conclusions in the preceding paragraph are also supported by an emailed letter from Mr Liddy to all "*AIG Financial Products Employees*" dated 18 March 2009 in relation to the cash portion of the 2008 ERP Awards. Mr Liddy's letter, written in terms obviously designed to engender moral pressure, requested ERP participants who had received US$100,000 or more to pay back at least 50% of what they had received. Mr Liddy's letter played for the moral high ground by noting that "*we*" (by which in my judgment he meant AIG Inc) had made the payments in question because they were a legal commitment even though "*I personally didn't feel these payments were appropriate in light of our present situation*".

163. Mr Dooley's particular plea for the court to understand that he was not the man called into A-G Cuomo's office in late 2008 was absolutely in point. There is an important, separate, question upon which the claimants must succeed if they are to establish a claim against AIG Inc, namely whether those making the decisions (ultimately,

therefore, Mr Liddy) believed they were requiring AIG-FP to break its contract. An aspect of that is whether the 'agreement' (as it was reported at the time) between Mr Liddy and A-G Cuomo, that nothing would be paid out of the US$600m AIG-FP deferred bonus pool as it stood in October 2008, was an agreement by Mr Liddy to ensure payments were not made to which he believed Participants were or would become entitled, or rather confirmation Mr Liddy was happy to give to A-G Cuomo of his (Mr Liddy's) understanding of the contractual position that it suited Mr Liddy to allow A-G Cuomo to present as an 'agreement'. I shall come onto that. The immediate point however – as Mr Oudkerk QC rightly emphasised, and on the basis that Mr Liddy was indeed acting as 'CEO of everything' – is that Mr Liddy conducted all of his business with A-G Cuomo, publicly and privately, over what would or would not happen to AIG-FP deferred bonus amounts, without any reference whatsoever to (those who should have been) decision makers at AIG-FP.

164. To similar effect, senior individuals at AIG Inc, not relevant decision makers at AIG-FP, had extensive discussions with the Federal Reserve, including consideration of what would happen about AIG-FP bonuses.

165. That there was indeed no good and separate corporate governance is also confirmed by a body of evidence as to how matters appeared at the time, at AIG-FP. Mr Gabriele recorded in an email to Stephen Blake (AIG Inc (Financial Services Division), Head of HR) on 10 October 2008 that Mr Dooley's 9 October letter had had "*… quite an impact here, as you would expect … a number of people may well vote with their feet …* ***Not having been part of the deliberations here, there is not much I can tell people to reassure them***." (my emphasis). It was evident (to those at AIG-FP) that Mr Blake, Elias Habayeb (AIG Inc (Financial Services Division), CFO) and Brian Reilly (AIG Inc (Financial Services Division), V-P, Chief Accounting Officer & Controller) were then in charge of implementation and the fielding of employee concerns. Kathleen ("Kathy") Furlong, AIG-FP CFO, was evidently not involved and could do no more than provide the calculations and other detailed support required to implement the approach being taken by AIG Inc. Mr Balfan, whom I have mentioned already (paragraph 92 above), was Ms Furlong's predecessor as CFO at AIG-FP for 2006-2007 and became CFO again, taking over from Ms Furlong, from 2009-2017. His role was similarly limited, as he confirmed in his evidence at trial.

166. Kelley Kirklin, the other claimant (in addition to Mr Rosen and Mr Scheyd) who gave evidence at trial, said in his witness statement evidence in chief that "*'on the ground', our impression after the bailout was very much that AIG Inc was in control of AIGFP/Banque AIG's business, both generally and certainly in relation to remuneration. The key details of the day-to-day unwind were subject to approval by committees run by AIG Inc managers, together with staff from the Federal reserve.*" Mr Kirklin also referred to the fact that when pressure was placed on Participants in March 2009 to return even the cash portion of their 2008 ERP Awards, that came principally from AIG Inc and in particular from the very top (Mr Liddy), as I mentioned in paragraph 162 above. Too much should not be read into that evidence, given the cross-examination of Mr Kirklin as to the extent of his actual knowledge of matters and the evidence I had of revised decision making structures put in place for AIG-FP under Mr Liddy's stewardship to ensure, in general terms, proper corporate governance in relation to the winding down of AIG-FP's book. For this judgment, however, what is significant is the absence of evidence that decisions about the operation of the Plans and/or

Participants' entitlements thereunder went through any such decision-making structures. In my judgment, even if Mr Kirklin could not know exactly where decisions were being made, his evidence of feeling at the time that matters of remuneration and Plan entitlements in particular had been taken out of AIG-FP's hands had the ring of truth and bore witness to the fact that that is precisely what had happened. (Mr Scheyd also gave similar evidence.)

167. So far so good for the claimants' claims against AIG Inc. However, in my judgment, on balance, they fail at the next stage.

168. Starting again with Mr Dooley's evidence, his witness statement evidence in chief included the following:

i) "*... my understanding was and is that any Restoration Plan was only to be adopted after [AIG-FP] stopped sustaining losses and the expected cash flows which formed the basis for Distributable Income became positive again, and ... when [AIG-FP] returns to a position where the making of a Restoration Plan would not prejudice its ability to pay its other creditors.*" In my judgment, although Mr Dooley may not have seen it this way, there is nothing in the latter point. It goes all the way back to paragraph 55 above: so long as AIG-FP had the benefit of the bail-out facility, restoring and paying Plan balances would have done nothing to prejudice its ability to pay other creditors; if AIG Inc did not want Plan balances to be restored and paid, and for that reason withdrew the support of the bail-out facility, formal insolvency would follow and different considerations would arise. Be that as it may, the first of Mr Dooley's claimed views, if held by those making the decisions that matter, would preclude the finding the claimants require that those decision makers appreciated that they were getting AIG-FP to break its contract (or did not care one way or the other);

ii) "*... I did not consider that we had any obligation to pay the notional amounts in the DCP and the SIP that had been reduced by the losses applied to the deferred compensation accounts. These sums were clearly at risk and subject to reductions for losses. ... the losses were so significant that it was obvious to me that no monies would be paid under the Plans.*" This is the evidence to which I have already referred (paragraph 152 above) as seeming to suggest that was Mr Dooley's belief even in early October 2008, a proposition I rejected. To the extent Mr Dooley's own understanding matters, the question now becomes whether his witness statement is merely confused as to when he came to that view or inaccurate in reporting that he ever did.

169. I put that last observation in deliberately careful terms. In my assessment of him, Mr Dooley was honest in his evidence to the court. Indeed, the honesty of his belief in the truth of the evidence he gave was not challenged squarely or (I think) really at all so as potentially to make it fair to him, or to the defendants, to consider the contrary. However, that Mr Dooley honestly believes that he was materially always of the view that the Plans were operated in accordance with their terms does not necessarily mean he was. Furthermore, it follows from my conclusions as to where the power lay and decisions were made, founded in part on Mr Dooley's own evidence, that Mr Dooley's view at the time, whatever it was, is not the real question.

170. That said, nonetheless it would be a strong thing to find that Mr Dooley is mistaken in the belief he now has as to what he thought at the time. Even allowing fully for the general frailty of human memory, and the real danger in a case like this of someone in Mr Dooley's position persuading himself of the truth of a favourable version of events, even without realising he is doing so, the events in question will have been amongst the most memorable of Mr Dooley's working life; and what he thought about the Plans and how they operated will have exercised him very considerably at the time, even if ultimate decisions were with others, in particular Mr Liddy himself. Further, if I accept Mr Dooley's evidence as to his own contemporaneous understanding, in my judgment it is then unlikely that Mr Liddy had any different understanding without that becoming apparent and being equally memorable to Mr Dooley.

171. There is no contemporaneous documentary evidence contradicting Mr Dooley's evidence on this point, or demonstrating that Mr Liddy believed that AIG-FP was being caused to do anything other than operate the Plans in accordance with their terms. As to Mr Liddy, I do not find that his 'agreement' with A-G Cuomo evidences an appreciation that Participants were being denied contractual entitlements, and there is documentary evidence supporting the proposition that the view that deferred bonus amounts became irretrievably wiped out, under the terms of the Plans rather than improperly, existed contemporaneously. In my judgment, Mr Liddy's 'agreement' with A-G Cuomo is at least as consistent with his having just reassured A-G Cuomo that the deferred bonus pool was 'wiped out', that being what Mr Liddy believed, as with his having promised A-G Cuomo to wipe it out irrespective of the Participants' contractual rights (which is what the claimants' case comes to). It is also relevant that, as I assess his evidence, and whilst his role was only to implement the Plans, Mr Balfan, an impressive, careful and transparently reliable witness, did not find surprising or untoward the manner in which he was asked to do so. That rather suggests there was room for intelligent, senior AIG executives to think the Plans were being correctly operated, even if I have held, ultimately without any great hesitation, that they were not.

172. I have found above that there was at least a degree to which Mr Liddy (and Mr Dooley) had a primary focus on AIG Inc and what commitments it had itself underwritten. It is not perhaps a huge leap from there to suppose that he might therefore have been at least careless as to whether AIG-FP was keeping to its Plan commitments not so underwritten. But it is still something of a leap and, on balance, it is not one I think it right to make.

173. The claimants placed heavy reliance on an email from Mr Reilly to Dennis Cody (AIG Inc (Financial Services Division), V-P (Financial Planning & Analysis)) dated 7 September 2010. The subject was AIG-FP's capitalisation. The email recommended setting off an inter-company liability of AIG Inc's to AIG-FP for c.US$18.5 billion against AIG-FP's bail-out facility indebtedness to reduce AIG-FP's balance sheet and its ongoing inter-company interest expense. The AIG Inc liability related to a tax credit generated for it by the losses in AIG-FP. The evidence I had of the level of the bail-out facility indebtedness from time to time evidenced that that set off was in due course effected. Mr Reilly's email contrasted that proposed "*measured step*" with a plan that appears to have been being mooted, to recapitalise AIG-FP by substituting equity for debt, the detail of which was not in evidence (whatever it was), although there is an obvious echo there of the point I addressed in paragraph 91 above.

174. Mr Reilly appears to have understood, and to have regarded as a disadvantage, that the proposed equity-for-debt recapitalisation, if implemented, would or might cause AIG-FP to generate a surplus out of which it would be obliged to fund a restoration plan under the DCP and SIP. Mr Oudkerk QC invited me to say from this that AIG Inc was dead set against the idea of Plan balance restoration and therefore to infer that in directing how the Plans were operated it knew full well that, or did not care whether, AIG-FP was caused to be in breach. I do not think Mr Reilly's email assists the claimants. In fact, it supports the defendants' case (at all events as things stood in September 2010) that AIG Inc understood there to be no requirement to restore (let alone pay) the balances that had been wiped out by losses. The tenor of Mr Reilly's relevant comment is not that AIG-FP had done or was doing anything wrong, it was that the mooted recapitalisation, if implemented, might require AIG-FP to do something it had not been and was not presently required to do. Of course, Mr Reilly's evident view, that causing AIG-FP to become obliged to restore and pay previously reduced Plan balances was a disadvantage of the mooted recapitalisation, speaks to AIG Inc being happy that there had been and was no such obligation, as things stood. But that is a quite different point.

175. Mr Oudkerk QC also, perfectly fairly, prayed in aid the fact that the defendants did not call evidence from Mr Liddy, or Mr Reilly, or anyone else at AIG Inc (apart from Mr Dooley) who was or may have been privy to or close to the making of the key decisions. He rightly submitted that the absence of such evidence was not explained.

176. If the evidence I do have pointed more strongly to the positive finding the claimants require, the absence of evidence from the horse's mouth, or from witnesses additional to Mr Dooley who heard it speak, may have tipped the balance in the claimants' favour. As it is, however, and bearing fully in mind all the matters relied on by Mr Oudkerk QC, I am not persuaded it is more probable than not that in directing as it did how the Plans would be operated, in and since late 2008, AIG Inc thought it was causing AIG-FP to act in breach of its obligations or did not care whether or not it was doing so.

177. Unhappy though AIG Inc's conduct may have made the claimants, and correct though I have held them to be that AIG-FP broke its contract with them, their claims that AIG Inc is liable to them in respect of that conduct do not succeed.

Conclusions

178. To the extent indicated in this judgment, but no further, the claimants' claims in contract succeed. There will be judgment against AIG-FP for damages to be assessed in respect of the restoration limb of the reduction / restoration scheme.

179. To the extent the claimants claimed in debt in respect of their 2008 opening Plan balances or amounts credited to their DCAs under the ERP, their claims fail and are dismissed. In respect of those amounts, the claimants' claims against Banque AIG, to the extent such claims were made, fail and are dismissed.

180. There may be some good claims, in debt or damages against AIG-FP and/or in debt against Banque AIG, in respect of bespoke credits to DCAs under individual claimants' particular contracts (e.g. the specific credits to which Mr Rosen was entitled related to Deutsche Bank entitlements he had foregone). I shall ask for the parties' assistance about this aspect when this judgment is handed down.

181. The claimants' claims against AIG Inc fail and are dismissed.

CL-2014-000921

Tobias Gruber et al. v AIG Management France, S.A. et al.

Appendix to Judgment dated 9 November 2018

Section 4.01 of the DCP:

4.01 AIGFP's Liability.

(a) **[1]** The benefits payable hereunder shall constitute an unsecured debt of [AIG-FP] to the Participants … and to AIG and **[2]** shall not have the benefit of any guarantee by AIG of payment obligations of [AIG-FP] **[3]** For the avoidance of doubt, notwithstanding anything else contained herein to the contrary, (i) the payment of benefits payable hereunder to each of the Participants … and to AIG shall be made only ~~from~~ from the general funds of [AIG-FP], (ii) [AIG-FP] shall not segregate or earmark any of its assets nor hold any assets in trust or in any special account for this purpose, and (iii) none of the Participants … or AIG shall have any legal or equitable interest in, lien on, or claim to, any particular asset of [AIG-FP] by virtue of this Deferred Compensation Plan. **[4]** If [AIG-FP] shall become the subject of any bankruptcy or insolvency case or proceeding, or shall make an assignment for the benefit of creditors, or shall become the subject of a reorganisation whether or not pursuant to bankruptcy laws, or if any other relief should be granted to [AIG-FP] generally from the rights of creditors, then any such event (a "Bankruptcy/Insolvency Event") the obligations under this Deferred Compensation Plan to Participants … and to AIG shall be subordinate and junior in right of payment and otherwise, to the prior payment in full of all of the other obligations of [AIG-FP], whether now existing or hereafter incurred, except to the extent payment of any such obligations is expressly made subordinate to or *pari passu* with the payment obligations hereunder~~, and the Participants … and AIG shall not be entitled to participate or share, ratably or otherwise, in the distribution of the assets of [AIG-FP] as a result of this Deferred Compensation Plan, and shall not receive payment of any benefits hereunder, until all claims~~. **[5]** If, in connection with a Bankruptcy/Insolvency Event, the claims (collectively "Creditors' Claims") of all other present and future creditors of [AIG-FP], other than those claims that are expressly made subordinate to or *pari passu* with claims for benefits payable hereunder, ~~have been~~can be immediately fully satisfied, or adequate provision ~~has been made therefor.~~ made for them, payments will be made at the times specified in this Plan. **[6]** If, in connection with a Bankruptcy/Insolvency Event, Creditors' Claims cannot be immediately satisfied or provision made for them, then during the period prior to such condition being satisfied ("the Delay Period"), the following special rules shall apply: **[6A]** [AIG-FP] will try to satisfy or provide for Creditors' Claims as soon as reasonably practicable so as to minimize Delay Period restrictions. **[6B]** During the Delay Period, no benefit payments shall be made. **[6C]** For the calendar year in which the Delay Period ends, (1) any payments that first became due during that calendar year will be paid by the end of that year or, if later, within 75 days after the date they first became due, and (2) any payments that first became due in an earlier calendar year will be paid to the extent doing so would not violate Internal Revenue Code Section 409A (e.g., because paying them in any earlier year in the Delay Period would have jeopardized [AIG-FP]'s ability to continue in business as a going concern). **[6D]** The right to any other payment that first became due during the Delay Period shall lapse except to the extent [AIG-FP] determines that it may amend the Plan to provide for its payment without violating Internal Revenue Code Section 409A.

(b) **[1]** The outstanding balance credited to the Deferred Compensation Accounts of each Participant and of AIG shall be subject to reduction, from time to time, to the extent of any losses incurred (i) by AIGFP (excluding AIGTG) or (ii) by AIGTG resulting from transactions entered into on or after January 1, 2003, which losses in the case of (i) and (ii) for any year in the aggregate exceed the outstanding market and credit reserves and current-year income of AGIFP (excluding outstanding market and credit reserves relating to transactions entered into by AIGTG before January 1, 2003), but before base capital of AIGFP (for the avoidance of doubt including AIGTG, and consisting of equity, retained earnings, if any, and subordinated debt). **[2]** Such reductions shall be made among the Participants … and AIG on a pro rata basis. **[3]** [AIG-FP] shall be obligated subsequently to restore amounts so deducted from Participants' and AIG's account balances, plus accrued interest thereon at the interest rate determined in accordance with Section 3.03 and **[4]**, in connection therewith, the Board shall adopt a plan (which shall not be subject to the approval of AIG or the Participants) setting forth a schedule under which [AIG-FP] shall restore amounts deducted from Participants' and AIG's account balances (plus accrued interest thereon). **[5]** Any such restoration plan shall provide that any restored amounts shall be paid in 2013; **[6]** to the extent amounts have not been restored by December 31, 2013, all restoration rights shall permanently lapse except to the extent [AIG-FP] determines that it may amend the Plan to provide for payment of restored amounts without violating Internal Revenue Code Section 409A. **[7]** Notwithstanding the terms of any such plan, in a bankruptcy or insolvency of [AIG-FP] each Participant … and AIG shall have an unsecured claim, subordinated and junior in payment and subject to the limitation on rights and interests to the extent provided in [*Section 4.01(a)*], against [AIG-FP] for the amount, if any, by which the balance is credited to their Deferred Compensation Account were reduced and not subsequently restored (plus credit for accrued interest thereon), in addition to such claims as are described in [*Section 4.01(a)*]. **[8]** For the avoidance of doubt, if [AIG-FP] consolidates or amalgamates with, or merges with or into, or transfers all or substantially all of its assets to, another entity, then the resulting, surviving or transfer re-entity shall assume all of the obligations of [AIG-FP] hereunder.