SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

THE PEOPLE OF THE STATE OF NEW YORK by ERIC T. SCHNEIDERMAN, Attorney General of the State of New York, Plaintiff, - against - MAURICE R. GREENBERG and HOWARD I. SMITH, Defendants.	Hon. Charles E. Ramos IAS Part 53 Index No. 401720/2005

PLAINTIFF'S PRE-TRIAL MEMORANDUM

ERIC T. SCHNEIDERMAN
Attorney General of the State of New York
120 Broadway, 23rd Floor
New York, New York 10271
(212) 416-8453

Counsel for Plaintiff

KARLA G. SANCHEZ
Executive Deputy Attorney General
for Economic Justice

DAVID N. ELLENHORN
Senior Trial Counsel

DAVID E. NACHMAN
Senior Enforcement Counsel

ARMEN MORIAN
Assistant Attorney General

of Counsel

<u>**TABLE OF CONTENTS**</u>

TABLE OF AUTHORITIES i

PRELIMINARY STATEMENT 1

I. THE GEN RE TRANSACTION WAS FRAUDULENT 4

The State's Proof 8

II. THE CAPCO TRANSACTION WAS FRAUDULENT 11

III. THE DEFENDANTS' PERSONAL LIABILITY 14

A. The Legal Standards 14

B. Gen Re 16

C. Capco 19

IV. MATERIALITY 22

Gen Re 23

Capco 27

V. REMEDIES 29

A. The State Is Entitled to Injunctive Relief 29

B. The State Is Entitled to Disgorgement, with Prejudgment Interest, of the Bonuses Defendants Received from AIG 33

CONCLUSION 36

TABLE OF AUTHORITIES

State Cases

Devito v. Feliciano,
22 N.Y.3d 159 (2013) 9

East Midtown Plaza Hous. Co. v. Cuomo,
20 N.Y.3d 161 (2012) 31

Hynes v. Iadarola,
221 A.D.2d 131 (2d Dep't 1996) 33

Marine Midland Bank v. Russo Produce Co.,
50 NY.2.d 31 (1980) 15

People v. American Motor Club,
179 A.D.2d 277 (1st Dep't 1992) 14

People v. Apple Health & Sports Clubs,
80 N.Y.2d 803 (1992) 15

People v. Ernst & Young LLP,
114 A.D.3d 569 (1st Dep't 2014) 33

People v. Fashion Place Assocs.,
224 A.D.2d 280 (1st Dep't 1996) 31

People v. Federated Radio Corp.,
244 N.Y. 33 (1926) 14

People v. Greenberg,
21 N.Y.3d 439 (2013) 30

People v. Greenberg,
95 A.D.3d 474 (1st Dep't 2012) 14, 15, 22

People v. Greenberg,
No. 401720/2005, 2010 N.Y. Slip Op. 33216(U)
(Sup. Ct. N.Y. County Oct. 21, 2010)....................16, 17

People v. Lexington Sixty-First Assocs.,
38 N.Y.2d 588 (1976) 14, 29, 31

People v. McCann,
3 N.Y.2d 797 (1957) 31

People v. Photocolor Corp.,
156 Misc. 47 (Sup. Ct. N.Y. County 1935) 15, 31

People v. Royal Secs. Corp.,
5 Misc. 2d 907 (Sup. Ct. N.Y. County 1955) 15

People v Sala,
258 A.D.2d 182 (3d Dep’t 1999) 14

People v. Tellier,
7 Misc. 2d 43 (Sup. Ct. N.Y. County 1956) 15

People v. World Interactive Gaming Corp.,
185 Misc. 2d 852 (Sup. Ct. N.Y. County 1999) 15

Riggs v. Palmer,
115 N.Y. 506 (1889) 35

State v. ASM Financial Funding Corp.,
No. 15485/2010 (Sup. Ct. Nassau County Jan. 10, 2011) 30

State v. Midland Equities of N.Y., Inc.,
117 Misc. 2d 203 (Sup. Ct. N.Y. County 1982) 30

State v. Rachmani Corp.,
71 N.Y.2d 718 (1988) 14, 22

Federal Cases

Blue Chip Stamps v. Manor Drug Stores,
421 U.S. 723 (1975) 30

Buckeye Co. v. Hocking Valley Co.,
269 U.S. 42 (1925) 30

Ganino v. Citizen Util. Co.,
228 F.3d 154 (2d Cir. 2000) 22

In re Global Crossing Ltd. Sec. Litig.,
322 F. Supp. 2d 319 (S.D.N.Y. 2004) 20

In re Vivendi, S.A. Sec. Litig.,
634 F. Supp. 2d 352 (S.D.N.Y. 2009) 26

Miller v. Asensio & Co., Inc.,
364 F.3d 223 (4th Cir. 2004) 26

Robbins v. Kroger Props., Inc.,
116 F.3d 1441 (11th Cir. 1997) 26

SEC v. Bankosky,
No. 12 Civ. 1012 (HB), 2012 U.S. Dist. LEXIS 70753 (S.D.N.Y. May 21, 2012) 31

SEC v. Black,
No. 04 C 7377, 2009 U.S. Dist. LEXIS 37309 (N.D. Ill. April 30, 2009) 33, 34

SEC v. First Pac. Bancorp,
142 F.3d 1186 (9th Cir. Cal. 1998) 31, 33

SEC v. First Jersey Securities, Inc.,
101 F.3d 1450 (2d Cir. 1996) 33

SEC v. Koenig,
532 F. Supp. 2d 987 (E.D. Ill. 2007)....................31, 33

SEC v. Lawbaugh,
359 F. Supp. 2d 418 (D. Md. 2005)....................33

SEC v. Lorin,
76 F.3d 458 (2d Cir. 1996)....................31

SEC v. Moran,
944 F. Supp. 286 (S.D.N.Y. 1996)....................33

SEC v. Patel,
61 F. 3d 137 (2d Cir. 1995)....................31

SEC v. Posner,
16 F.3d 520 (2d Cir. 1994)....................30, 34

SEC v. Razmilovic,
822 F. Supp. 2d 234 (E.D.N.Y. 2011)....................34

SEC v. Selden,
632 F. Supp. 2d 91 (D. Mass. 2009)....................32

TSC Indus., Inc. v. Northway, Inc.,
426 U.S. 438 (1976)....................22

United States v. American Soc'y of Composers, Authors and Publishers,
341 F.2d 1003 (2d Cir. 1965)....................30

United States v. Armour & Co.,
402 U.S. 673 (1971)....................30

United States v. Ferguson,
653 F.3d 61 (2d Cir. 2011)....................17

United States v. Ferguson,
553 F. Supp. 2d 145 (D. Conn. 2008)....................9

United States v. Fofanah,
765 F.3d 141 (2d Cir. 2014)....................18

United States v. MacDonald & Watson Waste Oil Co.,
933 F.2d 35 (1st Cir. 1991)....................18

United States v. Schiff,
602 F.3d 152 (3d Cir. 2010)....................26

Statutes and Regulations

Executive Law § 63(12).................... *passim*

The Martin Act, GBL § 352, *et seq.* .... *passim*

GBL § 352(1)....................14

GBL § 353(1)....................30, 31

GBL § 353-a 29

C.P.L.R. 5004..33

Sarbanes-Oxley Act of 2002, July 30, 2002, P.L. 107-204, Title III, § 304, 116 Stat. 778, codified at 15 USCS § 7243, *et seq*. 35

Dodd-Frank Act of 2010, July 21, 2010, P.L. 111-203, Title IX, Subtitle E, § 954, 124 Stat. 1904, codified at 15 USCS § 78j-4, *et seq*. 35

Other Authorities

SEC Staff Accounting Bulletin No. 99 .... *passim*

FASB Emerging Issues Task Force Topic D-14...22

New York Evidence Handbook 2d Ed. § 4.5.2.1 9

Weinstein-Korn-Miller, N.Y. CIV. PRAC. P. 5001.06 33

Wyndham Robertson, *Nobody Tops A.I.G. in Intricacy – or Daring*, TIME, May 22, 1978 11

PRELIMINARY STATEMENT

Since this Court rendered its 83-page decision on the cross-motions for summary judgment, the fundamental structure and overwhelming strength of the State's case against defendants Maurice Greenberg and Howard Smith has not changed.

In its decision, the Court reviewed essentially the same testimony and same documents that (with the exception of expert reports) will occupy the trial. The Court found that because no risk was transferred to AIG by Gen Re in the Gen Re reinsurance transaction, there was no proper basis for AIG to book $500 million in reserves. Accordingly, the Court found that the Gen Re Transaction was a "fraudulent or deceitful practice that tended to mislead the investing public as to the true financial health of AIG." The Court also found that the transaction was material, for the many reasons spelled out in the decision. As for Capco, the Court found that the transaction was fraudulent because AIG concealed hundreds of millions of dollars of underwriting losses by "converting" them into investment losses through a sham reinsurance transaction with Capco, an off-shore entity secretly controlled and financed by AIG.

So where does this leave us? With essentially the same factual record that was before the Court on summary judgment, and with ample basis for the Court to conclude, after trial, that the State has proven its case by a preponderance of the evidence. The State will offer testimony, both live and by deposition, from several witnesses whose testimony was at the heart of the Court's rulings as to the fraudulent nature of the Gen Re and Capco Transactions. They will include Richard Napier,[1] whose testimony is entirely unrebutted, as well as Greenberg and

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[1] The heart of Napier's testimony concerns conversations he had with Christian Milton, Greenberg's "point man" on the Gen Re Transaction, in which Napier and Milton negotiated the terms of the transaction, subject to approval by Greenberg and Ronald Ferguson, the former CEO of Gen Re. Napier's testimony is substantiated by a plethora of

Smith, who will be called by the State.[2] The few fact witnesses defendants will call have nothing new or relevant to add. They include two who impugn the motives of former Attorney General Spitzer in bringing this case, and two former AIG board members who proclaim their personal belief in Greenberg's "integrity." Such testimony is both inadmissible and irrelevant.

The only new material the Court will receive is expert testimony: ten defense experts and four experts for the State (three on rebuttal). As a whole, the testimony of defendants' ten experts is sound and fury signifying nothing. A few of defendants' experts offer the unremarkable opinion that the CEO of a large public company cannot know about every transaction done by the company, and has to rely on subordinates. Such generic testimony has nothing to do with the facts of this case, in which Greenberg and Smith originated, negotiated and approved the two fraudulent transactions with knowledge of their improper purpose and structure. Defendants also put forward an array of expert testimony designed to suggest that numerous incriminating facts surrounding the Gen Re Transaction could be consistent with a legitimate, risk-transferring deal. This testimony is theoretical and again unrelated to the actual facts. Two accounting experts called by defendants contend that the rules governing consolidation of Capco and AIG were not entirely clear when the Capco deal was arranged. That is both false and non-responsive; the rules were clear, and Smith and Greenberg were well aware of them. The illegality of the Capco Transaction, moreover, does not turn on a debate over technical consolidation rules. The very nature of the Capco arrangement, designed as it was to

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emails, tape recordings and other evidence, and has not been challenged by Milton, who was on defendants' trial witness list until shortly before his deposition was to be taken, at which point defendants suddenly withdrew him.

[2] The State also will call fact witnesses Charlene Hamrah, the former head of investor relations at AIG, AIG actuary Jay Morrow, AIG finance executive Lawrence Golodner, and, if necessary, former AIG CFO Steven Bensinger. In addition, the State will introduce the deposition testimony of eight current or former employees of AIG or its subsidiaries, and one prominent stock analyst, Alice Schroeder, all of whom are unavailable to appear in person.

hide AIG's underwriting losses, was inherently fraudulent. Finally, defendants' experts will argue that the Gen Re and Capco Transactions were not material, despite overwhelming evidence to the contrary.

At defendants' request, there will be only one trial encompassing both liability and remedies. Accordingly, the State also will produce evidence regarding the need for, and the propriety of, injunctive relief and disgorgement. In determining whether to issue injunctive relief, the Court may consider a variety of factors, including the seriousness of the securities violations, defendants' role in those violations, defendants' knowledge and willfulness, whether the violations were isolated or part of a pattern, and whether the defendants have acknowledged their wrongdoing. Applying these factors, the case for injunctive relief is powerful. The Gen Re and Capco Transactions were major frauds. They were personally engineered by Greenberg and Smith. Despite AIG's acknowledgement of the accounting frauds, defendants continue to deny any personal or corporate wrongdoing; in fact, Greenberg has aggressively touted his innocence, and brought baseless attacks against both the Court and government attorneys prosecuting the case. With respect to disgorgement, it is well-settled that courts may compel corporate officials who have committed securities fraud to disgorge their ill-gotten gains, including performance-based compensation. Greenberg and Smith received $24,500,000 million and $3,065,000 million, respectively, in bonuses for the years 2000 through 2004 (and in Smith's case, for early 2005), to which they are not entitled in light of the frauds they engineered. This and substantial other evidence will amply support the State's request for injunctive relief and for an award of disgorgement by Greenberg and Smith of the bonuses they received from 2000 through 2005, together with prejudgment interest.

I. THE GEN RE TRANSACTION WAS FRADULENT

Despite hitting analysts' estimates for the third quarter of 2000, the value of AIG's stock dropped dramatically on October 26, 2000, immediately following AIG's announcement that its loss reserves had decreased by $59 million. In response, certain prominent stock analysts expressed the view that the decline in AIG's loss reserves, at a time when its premium income was increasing, could be interpreted as a sign that AIG was "managing earnings," particularly if the loss reserves continued to decline in future quarters.

Acutely sensitive to how analysts viewed AIG and its stock price,[3] Greenberg called Ron Ferguson, CEO of Gen Re, from which AIG ordinarily was a major *buyer* of reinsurance, to initiate a loss portfolio transfer. Greenberg asked Ferguson to provide AIG with $250 million to $500 million in loss reserves for a period of six to nine months by entering into an agreement with AIG. The request was not designed to provide actual reinsurance for Gen Re (which did not seek it), but rather solely as a device for manipulating AIG's loss reserves and thus to assuage the stock market's concerns about AIG's declining reserves.

Some two weeks later, on November 17, 2000 (after Christian Milton, head of reinsurance at AIG, and Richard Napier, senior vice president of Gen Re, had various discussions about the proposed deal), Greenberg and Ferguson spoke again. As Greenberg testified, the call was a "CEO-to-CEO" discussion to pin down the agreement and reach a "deal." The evidence, including uncontradicted deposition testimony from Napier, extensive e-mails and corporate documents from AIG, contemporaneous notes and recorded telephone conversations,

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[3] As Warren Buffett put it at his deposition, Greenberg "was very sensitive to what people said about him and – and AIG. AIG was his baby. And he had – had various conversations where he indicated he was – which indicated a fairly thin skin, which was sort of counter to his public persona. … [H]e cared about analysts." Buffett Dep. Tr. Apr. 15, 2009, 112-13.

admissions by Greenberg, and other testimony, establishes the parties' explicit understanding that Gen Re would make no claims on AIG for reinsurance payments. AIG had no risk of any loss, no less the "reasonable possibility" of a "significant" loss, which, under applicable accounting standards, was required for AIG to properly book loss reserves under the agreement. Nevertheless, at the end of the fourth quarter of 2000 and the first quarter of 2001, at Smith's direction, AIG booked an increase in loss reserves in two tranches, totaling $500 million, treating this arrangement as a genuine finite reinsurance agreement.

In return for Gen Re accommodating Greenberg's request for this transaction, AIG agreed to, and did, fund a $10 million premium payment made by Gen Re for the alleged reinsurance and, in addition, paid Gen Re $5 million for doing the deal. To conceal this fraud, Gen Re sent AIG a fictitious letter making it appear that Gen Re had sought reinsurance when, in fact, it was Greenberg who initiated the deal.

The Gen Re reinsurance arrangement was a sham. When one company insures or reinsures the risks of another, it gets paid for assuming those risks. Here, however, the parties agreed that because AIG did not undertake the risk of paying claims and Gen Re was only providing an accommodation to AIG, it was Gen Re, not AIG, that had to be paid for its efforts. To state that openly on paper would be an obvious give-away that this was not a legitimate reinsurance transaction, so the real payment terms were concealed.

On paper, the Gen Re Transaction was structured as follows.[4] In return for a premium of $500 million, Gen Re purportedly transferred to AIG the responsibility to pay losses on six

[4] The Gen Re Transaction was a single deal negotiated all at once, but executed in two tranches of $250 million each, reflected in two reinsurance agreements and sets of documentation with nearly identical terms. The transaction was initiated at the end of October 2000, and the terms were finalized by the end of December 2000. One of the $250 million tranches was booked in the fourth quarter of 2000, the other in the first quarter of 2001.

insurance portfolios, up to $600 million. Gen Re retained the responsibility to administer and pay claims on those losses, and its payments would be made from an "experience account" that was to be prefunded by Gen Re's premium – that is, of the $500 million premium nominally due to AIG, $490 million was "funds withheld," meaning the cash stayed with Gen Re to pay claims on the underlying policies, and $10 million was to be paid in cash to AIG. This $10 million payment to AIG was a fiction, however – pursuant to the parties' side deal, AIG agreed to reimburse Gen Re the $10 million premium it was supposed to pay, and pay Gen Re an additional $5 million. The covert mechanics for arranging these payments were left to Milton and Smith, which was ultimately accomplished in December 2001, when AIG required a newly-acquired subsidiary, Hartford Steam Boiler, to take about $15 million less than it would have otherwise have received on the commutation (or termination) of an unrelated deal with Gen Re.

The fact that Greenberg agreed to have AIG *pay* Gen Re to enter into the loss portfolio transfer, when it was Gen Re that supposedly was *buying* reinsurance, is solid, but by no means the only, proof that this was not a genuine risk-transferring transaction. Further demonstrating the fraudulent nature of the Gen Re deal, AIG did not perform *any* actuarial or underwriting analysis of the insurance portfolios it supposedly was reinsuring. Such analysis is the standard practice at all insurance companies, and certainly at AIG, where Greenberg's insistence on strict underwriting discipline was legendary. As defendants have conceded, there was no way to tell from the barebones documents generated in connection with this half-a-billion dollar transaction what types of risk, or the extent of risk involved, or, indeed, whether AIG was assuming any risk at all. In addition, over the four-year life of the transaction, Gen Re did not provide a single experience account report to AIG. There was no need to do so, because Gen Re would never

present any claims to AIG, and AIG would never have to pay any. In fact, AIG never received a claim from Gen Re, and never paid one.

The little documentation that was prepared in connection with the deal was itself bogus. Not only did the term sheet presented to AIG omit the crucial side agreement to repay Gen Re's $10 million cash premium and pay it another $5 million, but it was accompanied by a concocted cover letter designed to make it appear that Gen Re had approached AIG for help with its reinsurance needs, when it was Greenberg himself who had initiated this transaction purely to achieve a different purpose – to add reserves to his company's balance sheet.

By entering into the Gen Re Transaction, and characterizing it as insurance, AIG avoided reporting additional declines in its loss reserves in the two quarters following the third quarter of 2000, when its reported $59 million decline in loss reserve unnerved the market. Thus, AIG reported a $106 million *increase* in loss reserves for the fourth quarter of 2000. If not for the inclusion of the $250 million of loss reserves from the first tranche of the Gen Re Transaction, AIG would have reported a *decrease* of approximately $144 million in its loss reserves, and a second straight quarter of declining reserves. With the inclusion of the $250 million in loss reserves from the second tranche, AIG likewise was able to report a $63 million *increase* in loss reserves for the first quarter of 2001; without it, AIG would have reported a *decrease* of approximately $187 million of reserves, and a third straight quarter of declining reserves.

From 2001 through 2004, as CEO and CFO, Greenberg and Smith certified AIG's financial statements knowing they reflected the fraudulently inflated reserves derived from the Gen Re Transaction. In May 2005, however, AIG's Board commissioned an extensive internal investigation by Paul Weiss and Simpson Thatcher. Following that investigation, an expanded scope audit by PricewaterhouseCoopers ("PwC"), review by AIG's new management, and

review by the company's Audit Committee and Board, AIG restated its annual and quarterly financial statements for the years ended December 31, 2000, 2001, 2002, and 2003, the quarters ending March 31, June 30 and September 30, 2003 and 2004, and the quarter ending December 31, 2003 ("the Restatement"). The Restatement covered numerous transactions; as to Gen Re, AIG admitted that its financial statements had improperly booked the Gen Re deal as reinsurance, because no risk was intended to be conveyed to AIG in the transaction.

As the truth about Gen Re emerged, the consequences were immediate and substantial. On February 14, 2005, AIG reported that the SEC and NYAG were investigating AIG's use of finite reinsurance deals, whereupon AIG's stock price immediately declined, causing huge investor losses. Greenberg transferred over $2 billion in AIG stock to his wife (a transfer he rescinded shortly thereafter), and he refused to testify in the SEC and NYAG investigations, well aware that by failing to cooperate he would have to relinquish his role as CEO of AIG with which he had been so closely associated for decades. On March 14, 2005, Greenberg and Smith were forced to relinquish their executive positions at AIG, and AIG's stock declined again. Upon leaving AIG, Greenberg and Smith, along with Milton, became engaged in managing C.V. Starr, a large private insurance company which they continue to manage to this day.

The State's Proof. The State will submit both live and deposition testimony concerning the Gen Re Transaction. Charlene Hamrah, former head of investor relations for AIG, will explain the circumstances under which Greenberg initiated the transactions, testimony which Greenberg himself has confirmed. Alice Schroeder, an insurance stock analyst whom Greenberg regarded as preeminent among her peers, will testify, by deposition, as to the importance of loss reserves, the effect the Gen Re Transaction had on AIG's reserves, as well as conversations she

had with Greenberg in 2001 about such matters. Richard Napier, by deposition,[5] will describe how the deal developed, including several critical conversations he had with Milton, leading to the telephone call between Greenberg and Ferguson in which the key terms of the deal were agreed. Napier will testify that he and Milton explicitly discussed the concept of a no risk deal; that after checking its acceptability, Milton explicitly confirmed to Napier that it was acceptable; and that shortly thereafter Ferguson confirmed to Napier that he and Greenberg had agreed to the terms of the deal, including that no "real risk" would be transferred and that Gen Re would be compensated for doing the deal. Jay Morrow, a former AIG executive and senior actuary, will testify about the lack of underwriting and other suspicious aspects of the Gen Re deal, and the role of Smith in booking the reserves. Lawrence Golodner, an assistant controller of AIG, will provide similar testimony.

The State will also introduce testimony, by deposition, from several former AIG officials, including Saul Basch and William Heckles, former senior executives of AIG subsidiary Hartford Steam Boiler, who will explain how AIG, at Smith's and Milton's direction, used a circuitous route to funnel some $15 million to Gen Re subsidiaries, to fulfill the arrangements Greenberg made with Ferguson to return the $10 million premium and pay Gen Re its $5 million fee.

[5] Defendants have attacked the testimony of Napier, pointing to comments by the Second Circuit when it reversed the Gen Re convictions on other grounds, in which the Court questioned certain testimony by Napier at the criminal trial. That testimony in no way bears on the Gen Re deal itself, or on Greenberg's role, but on the role of one or another of the Gen Re defendants. District (now Second Circuit) Judge Christopher F. Droney, who presided over the criminal trial, specifically found Napier to be a trustworthy witness whose testimony is corroborated by contemporary e-mails, documents and tape recordings of conversation among the co-conspirators. *United States v. Ferguson*, 553 F. Supp. 2d 145, 157 n.18 (D. Conn. 2008) ("The Court notes … that Napier's testimony was strongly corroborated by other witness testimony and exhibits, and that the Court found his testimony credible.").

Napier was deposed in this case and cross-examined for three days by Greenberg's counsel. When the Court evaluates his testimony, it will find Napier to be a reliable witness. If defendants had genuine grounds to contest Napier's testimony, they would call Milton, the person who negotiated the deal with Napier. Milton works for Greenberg, is within his control, and was on defendants' witness list as late as November 17 of last year. Three weeks before Milton's scheduled deposition, defendants removed him from their witness list. That decision gives rise to, and the State will seek, an adverse inference. *See* New York Evidence Handbook 2d Ed. § 4.5.2.1; *Devito v. Feliciano*, 22 N.Y.3d 159, 165 (2013) ("strongest inference that the opposing evidence permits").

On its case in chief, the State will call as an expert witness Jane Nettesheim, a recognized damages and materiality expert who analyzed the effect of the Gen Re transaction on AIG's stock price, one important, but by no means exclusive, measure of materiality. Ms. Nettesheim will explain that the Gen Re Transaction, and its consequences for AIG's top management, were material to AIG investors, analysts, and the stock market, as evidenced by their contemporaneous reactions to the fraud, and the negative impact revelation of the transaction had on AIG's stock price on February 14, March 14 and March 15, 2005.

On rebuttal, in response to defense experts Professor David Babbel, Debra Roberts, and Mark Bridges, the State will offer testimony from Dr. Christopher Culp, a leading expert on finite risk insurance and reinsurance. Dr. Culp will explain why the defense experts' efforts to explain away the multiple suspect features of the Gen Re Transaction are either unpersuasive or absurd. To provide context, he will trace the history of finite risk deals and the potential for abuse of such transactions, including by AIG itself in the 1998 "Brightpoint" scheme. AIG assisted Brightpoint, Inc. to disguise major losses through a no-risk "retroactive" insurance transaction falsely structured to look like traditional insurance.[6] Dr. Culp also will testify that AIG could not have profited from the Gen Re transaction, and there was no reason for AIG to do the Gen Re deal other than to "borrow" loss reserves in order to facially bolster its financials.[7]

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[6] The Brightpoint matter arose from AIG's development and marketing, beginning in 1997, of non-traditional finite reinsurance products. A "White Paper" circulated within the company stated that AIG's "non-traditional" effort could provide "[i]ncome statement smoothing" to AIG's clients, and instructed AIG executives to structure deals to make them look like traditional "insurance," by, among other things, creating the appearance of risk transfer; omitting from deal documents any terms that might reveal the true nature, purpose and effect of the transaction; maintaining essential terms of the deals in oral side agreements; and setting the limit of the policy above the premium. Importantly, the White Paper cautioned that these tactics might *not* be acceptable in the context of *reinsurance*, where the accounting standards were more stringent and fully elaborated. Eventually, after a customer used this product to manipulate its reported earnings, the SEC investigated AIG's role, leading AIG to pay a $10 million penalty for its part in the fraud and for refusing to produce key documents, including the White Paper.

[7] Defendants tender still more expert reports from a number of academics and others, including Professors David Teece, Jonathan Macey, and Patrick Kenny, who give the generic opinion that top executives of a large company

II. THE CAPCO TRANSACTION WAS FRAUDULENT

It was a basic credo at AIG that the company and its core insurance operations were to be judged on its underwriting results. As Greenberg put it, "underwriting profits are the god we cherish." Wyndham Robertson, *Nobody Tops A.I.G. in Intricacy – or Daring*, TIME, May 22, 1978. Not surprisingly, Greenberg was highly irritated by the underwriting results of an auto warranty insurance program initiated by Evan Greenberg, his son, which by 1999 was a disaster, with AIG anticipating hundreds of millions of dollars in losses. Greenberg took personal and direct control of this "major loser," and enmeshed himself, to an extraordinary degree (even for him), in every aspect of the problem and how the losses could be mitigated. Greenberg received, or wrote, more than two dozen memos with AIG staff about the program. He was in constant communication (including weekend calls) with subordinates who were responsible for improving the claims-handling and other operational aspects of the program, and who were instructed to report directly to Greenberg. Eventually, it became clear that no matter what steps were taken to mitigate the losses, AIG was going to suffer a loss of major proportions from a single line of insurance, exposing its vaunted underwriting abilities to public criticism and re-examination.

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such as AIG are entitled to rely on subordinates to whom they delegate responsibilities. Such testimony from any expert, much less three, is unnecessary and of no assistance to the Court. The opinion of these experts is irrelevant and speculative, and should either be rejected or given no weight whatsoever. *See* Memorandum of Law in Support of Plaintiff's Motion *In Limine*, Motion Seq. No. 52, dated Jun. 13, 2014, at 15-20.

Another of defendants' experts, Prof. Arnold, discusses the role of PwC as an auditor of AIG and concludes that PwC had knowledge of certain aspects of the Gen Re transaction. Besides being irrelevant, he cites no evidence that PwC was aware of the fraudulent, no risk, oral side agreement between Gen Re and AIG, and other fraudulent aspects of the transaction.

Defendants also will call Deborah Roberts, an insurance executive who has opined that the term "no real risk," as used by Ferguson and Greenberg in their November 17, 2000 conversation, actually might have meant real risk within the jargon of "insiders" in the finite reinsurance field. Roberts concedes that neither Greenberg nor Ferguson were "insiders" in that field as she uses the term, and that she has no knowledge of what they actually meant.

Greenberg stated that there was no way AIG could get the problem "off our books" through legitimate reinsurance, because no one would reinsure such an obviously disastrous program. Instead, Greenberg and Smith launched a scheme to hide the losses by converting them into capital or investment losses – by Greenberg's own publicly professed standards, a less important metric for measuring AIG's performance.[8]

Initially, Smith tried to effectuate the scheme himself, through an associate in Japan. When that did not work, Smith and Greenberg assigned Joseph Umansky, AIG's head of "special insurance," to handle the matter. Umansky developed a plan for AIG, in effect, to reinsure itself with its own money. Under this plan, AIG would invest nearly $210 million to capitalize a supposedly independent offshore entity, which in fact would be controlled by AIG. The offshore entity, which existed solely to pay the warranty claims, would enter into a reinsurance agreement with AIG covering the auto warranty losses, with its payments on those losses financed with the money coming from AIG. As this entity made reinsurance payments to AIG on the warranty claims, AIG would reduce its underwriting losses, but the value of its investment in the offshore reinsurer would progressively diminish, thus generating investment losses. Through this circular alchemy, AIG would conceal the full extent of its underwriting losses by transforming them into investment losses.

In April 2000, Greenberg and Smith met with Umansky and reviewed a memo Umansky gave them that clearly and concisely laid out this scheme. In the memo, Umansky expressly asked for Greenberg's "reaction to the proposed structure." Greenberg reviewed the memo, but nevertheless approved the deal, even though he knew it would have to be consolidated if (as was

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[8] A statistical study performed by Dr. Zmijewski, one of defendants' own experts, has confirmed Greenberg's view that the stock market is more concerned with an insurer's underwriting results than its investment performance.

obviously the case) AIG controlled the offshore entity. Greenberg also referred Umansky to the president of an AIG-controlled private bank in Switzerland, who could find three "investors" who would act as straw-man investors in the off-shore reinsurer, and whose equity interests would be financed on a non-recourse basis by another AIG subsidiary.

The Capco scheme was implemented over a three-year period from 2000 to 2003, enabling AIG to avoid $163 million of underwriting losses by recharacterizing the losses as realized capital losses, until the scheme was uncovered in 2005, when AIG restated the transaction to reflect its economic realities. Defendants have never attempted to rebut AIG's admission, reflected in the Restatement, that the Capco Transaction was improper. Rather, they have argued that they "assumed" the transaction would be implemented legally, and that it is not material. Defendants will call Charles Lundelius, a certified public accountant, who claims that it was not clear in 2000 and 2001 that Capco's financial statements had to be consolidated with AIG's for financial reporting purposes and, in this regard, that the key issue was whether the three "independent" investors in Capco had "voting control" of the entity. The State will present a rebuttal report by Douglas Carmichael, former Chief Auditor and Director of Professional Standards of the Public Company Accounting Oversight Board ("PCAOB"), establishing that under applicable accounting rules then in effect, the results of a controlled special-purpose entity like Capco had to be consolidated with those of its sponsor, AIG.

This is not simply a matter of expert testimony. The evidence will include contemporaneous AIG memoranda establishing that Smith, himself a leading accounting expert on special purpose entities, and Greenberg, both knew that under the applicable standards Capco could not be regarded as an independent company. And, of course, they had to know that

regardless of the technical rules of consolidation, concealing AIG's underwriting results from the public was inherently misleading.[9]

III. DEFENDANTS' PERSONAL LIABILITY

A. The Legal Standards. The Martin Act makes it illegal for any person to employ "any deception, misrepresentation, concealment, suppression, fraud, false pretense or false promise," and "to engage in any practice or transaction or course of business relating to the purchase, exchange, investment advice or sale of securities … which is fraudulent or in violation of law and which has operated or which would operate as a fraud." GBL § 352(1). Executive Law § 63(12) includes "virtually identical language" to the Martin Act. *State v. Rachmani Corp*., 71 N.Y.2d 718, 721 n.1 (1988).

The Attorney General need not prove *scienter* or intent to defraud in a civil claim under either statute. *Rachmani*, 71 N.Y.2d at 725 n.6; *see also People v. Lexington Sixty-First Assocs*., 38 N.Y.2d 588, 595 (1976) ("the terms 'fraud' and 'fraudulent practices' . . . embrace all deceitful practices contrary to the plain rules of common honesty, including all acts, even though not originating in any actual evil design to perpetrate fraud or injury upon others, which do tend to deceive or mislead"); *People v. Greenberg*, 95 A.D.3d 474, 482-83 (1st Dep't 2012); *People v Sala*, 258 A.D.2d 182, 193 (3d Dep't 1999); *People v. American Motor Club*, 179 A.D.2d 277, 283 (1st Dep't 1992); *People v. Federated Radio Corp*., 244 N.Y. 33, 39-41 (1926).

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[9] Defendants have suggested that the Capco Transaction was an appropriate way for AIG to "signal" to the public that it was going out of the auto warranty insurance business, and that the associated losses were non-recurring. The argument is not a serious one. Not only was the Capco Transaction concealed entirely, but the losses from the auto warranty business were not separately broken out in AIG's financial statements, and no investor could have known that AIG was exiting the business. Far from "signaling" anything to the public, the purpose and effect of Capco was to hide and mislead.

The Martin Act is aimed at those who have meaningfully participated in a fraudulent securities transaction. Liability therefore attaches to any party who participates in a transaction and who either knows, or should have known, it was fraudulent. *See People v. Tellier*, 7 Misc. 2d 43, 48 (Sup. Ct. N.Y. County 1956) (defendant liable under the Martin Act for false representations where he "*was or reasonably should have been aware of*" the conditions of the company) (emphasis supplied); *People v. World Interactive Gaming Corp.*, 185 Misc. 2d 852 (Sup. Ct. N.Y. County 1999) (Ramos, J.).

As the First Department has stated, in this litigation, "[o]fficers and directors are liable for a corporation's fraud where they either personally participate in the fraud or have actual notice of its existence." *People v. Greenberg*, 95 A.D.3d at 483 (*citing Marine Midland Bank v. Russo Produce Co*., 50 NY.2.d 31, 44 (1980); *accord People v. Apple Health & Sports Clubs*, 80 N.Y.2d 803, 807 (1992); *see also People v. Royal Sec. Corp*., 5 Misc. 2d 907, 911 (Sup. Ct. N.Y. County 1955) (underwriters and their directors are under a duty to make a reasonable investigation concerning the truth and accuracy of the statements contained in the offering circulars and other sales literature before they are issued to the general public) (*citing Federated Radio*, 244 N.Y. at 41). Martin Act liability is satisfied by conscious avoidance or willful indifference to fraud perpetrated by the executive's company:

> A corporate director may not sit idly by where he knows or should know that securities of the corporation are being fraudulently offered for sale to the public, where misrepresentations are being made and false prospectuses issued, and expect that his obliviousness, supineness, or dereliction of duty shall serve as his protection.

People v. Photocolor Corp., 156 Misc. 47, 50 (Sup. Ct. N.Y. County 1935).

Here, Greenberg and Smith did not sit by passively; they personally initiated, approved and implemented both the Gen Re and Capco Transactions, which were designed to deceive the

investing public about AIG's reserves and its underwriting losses. They did so either knowing that these transactions were fraudulent or, at the very least, willfully "oblivious" to the fraud.

B. Gen Re. Greenberg's own admissions place him at the heart of the unlawful conspiracy to falsify AIG's books, a conspiracy that – as this Court has held – included Milton, Napier, Ferguson, and Greenberg. *People v. Greenberg*, No. 401720/2005, 2010 N.Y. Slip Op. 33216(U) at *53, 60 (Sup. Ct. N.Y. County Oct. 21, 2010). Greenberg admits he initiated the Gen Re deal seeking an enormous loss portfolio transfer for a limited duration, with no specification of the portfolios involved, and for no apparent business purpose. Neither Greenberg nor Napier could recall another reinsurance deal for such a stated and limited period.

As Gen Re officials struggled to put together a portfolio that would meet AIG's objectives, they concluded that the easiest way was to have an explicit, albeit off-the-record, arrangement, whereby Gen Re would not transfer any risk and would make no claims for payment under the reinsurance treaty. On or about November 13, 2000, Napier proposed this arrangement to Milton who, apparently after consulting Greenberg, told Napier it would be acceptable. To seal the deal, on November 17, 2000, Greenberg and Ferguson had a discussion designed, in Greenberg's own words, to "determine whether they had found and could do a loss portfolio and what the terms would be." Greenberg and Ferguson explicitly agreed on a $500 million loss portfolio deal for which Gen Re would receive a $5 million fee, AIG would fund the $10 million premium that it would receive from Gen Re for issuing the reinsurance, and the deal would involve "no real risk." This and other evidence led this Court to conclude on summary judgment that "[t]here is ample proof [to] warrant the conclusion that Greenberg was a participant, and likely spearheaded, an illicit arrangement between Gen Re and AIG to effectuate

a transaction to artificially inflate AIG's loss reserves." *Greenberg*, 2010 N.Y. Slip Op. 33216(U) at *46.[10]

Smith's role in the Gen Re deal was indispensable. Along with Milton, Greenberg appointed Smith as a "point person" to implement the deal. On November 20, 2000, Smith received and marked up a copy of an email from Napier to Milton, which set forth the fundamentals of the deal, including the return of the premium to Gen Re and the payment of an additional commission to Gen Re on top. And on December 21, Frank Douglas, the chief actuary of AIG's Domestic Brokerage Group ("DBG"), and others exchanged e-mails stating that "Howie [Smith] would have to OK any treatment on a GAAP basis. …" and, "[t]here may also be issues with booking it for GAAP purposes, but that would have to be addressed by H. Smith." According to Robert Jacobson, Chief Financial Officer of DBG, Smith made the decision to book the reserves because the transaction "was executed by the parent company." Further, Smith was involved in arranging the return of the $10 million premium paid by Gen Re to AIG.

At his deposition, Smith conceded that under the governing GAAP guidance, there had to be a "reasonable possibility" of a "significant loss" for AIG to properly book reserves in

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[10] On similar evidence in the Gen Re criminal case, the Second Circuit affirmed the District Court's conclusion that the conspiracy commenced with Greenberg's first call to Ferguson on October 31, 2000. *United States v. Ferguson*, 653 F.3d 61, 89 (2d Cir. 2011):

> Greenberg and Ferguson agreed to a highly unusual deal: The transaction was prompted predominately by stock market concerns; it inverted their customary commercial roles as cedant and reinsurer, even though there was no evidence that Gen Re wanted reinsurance; and AIG requested a specific dollar range of loss reserves for a specific term. … Even if Greenberg and Ferguson had hoped to accomplish their objectives legally, execution of a no-risk transaction was not unforeseeable. These very senior executives agreed to pursue specific parameters. And their objective predictably exerted pressure on their subordinates on the deal team to get the transaction done that way no matter what.

connection with the Gen Re deal. Smith and Greenberg both admitted that a review of the Gen Re reinsurance agreements on their face would not have sufficed to determine which risks, if any, existed – because the agreements said nothing "about the underlying insurance, the nature of the underlying insurance that was being ceded to AIG." The mere fact that AIG was *theoretically* assuming up to a $600 million payment for $500 million in premiums proved nothing, without a determination by AIG of the actual probability of a significant loss. That probability could not be determined without underwriting, which was never performed, [11] and Smith could not point to any basis for concluding that there was actual risk. Smith had no basis, therefore, to conclude that the GAAP requirements had been satisfied.

For four years, Greenberg and Smith continued to certify annual financial statements that reflected the Gen Re reserves, well aware that during these four years Gen Re never made a single claim under the reinsurance policy. As a matter of law, Greenberg and Smith had the responsibility to ascertain the facts before certifying financial statements containing a deal that put $500 million in reserves on AIG's books for four years.

It bears emphasis that while Greenberg and Smith can be held liable under willful blindness and conscious avoidance doctrines, [12] the evidence will support direct findings of their direction and involvement in the Gen Re fraud. Here, Greenberg admits that he initiated and

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[11] Defense expert Prof. Babbel has argued that AIG was entitled to rely in "utmost good faith" on Gen Re to put together a loss portfolio that transferred sufficient risk to meet the standards of FAS No. 113, and that this might, theoretically, explain why AIG did no underwriting. This theoretical testimony has nothing to do with the facts. Gen Re never represented to AIG that it was conveying risk; on the contrary, Napier and Ferguson conveyed the opposite. And AIG obviously would not take on the risk of a major loss – up to $100 million on the face of the agreements – in a deal in which *it paid Gen Re for taking on such risks*.

[12] Willful blindness can give rise to even *criminal* liability under statutes that have a *scienter* or specific intent requirement. S*ee*, *e.g*., *United States v. MacDonald & Watson Waste Oil Co*., 933 F.2d 35, 55 (1st Cir. 1991); *United States v. Fofanah*, 765 F.3d 141 (2d Cir. 2014). *A fortiori*, willful blindness and conscious avoidance are more than adequate predicates for *civil* liability under a statute like the Martin Act which has no *scienter* requirement, and which requires only that the defendant have participated in the fraud.

negotiated the Gen Re transaction and approved it after at least two conversations with Ronald Ferguson, CEO of Gen Re. Greenberg may deny remembering that he explicitly discussed the "no real risk" nature of the deal with Ferguson (or the return of the $10 million premium), but his denials are not credible. The absence of risk and the return of the premium were the very essence of the deal that he was concluding, and it defies reason to believe that AIG would have paid $5 million for a deal in which AIG supposedly was taking on up to $100 million in risk.

When not trying to shift blame to Gen Re (which worked hard to accommodate Greenberg's request), defendants may attempt to pin it on Milton. The notion that Milton, on his own, would fraudulently implement a major transaction requested by Greenberg is not remotely plausible. Indeed, Greenberg testified that if Milton had planned to modify the deal, "I'm sure he [Milton] would have come and talked to me about it." Any possible doubt that Milton followed Greenberg's instructions is put to rest by Greenberg's action in March 2005, when the Gen Re transaction came to light. Instead of cooperating with the investigation, Greenberg refused to testify, left AIG, and took Milton (and Smith) with him to C.V. Starr, where Milton continues to be a senior adviser to Greenberg. Equally telling is defendants' abrupt decision to pull Milton from this case as a witness, after listing him for years as a trial witness. Defendants' failure to call Milton, who was at the heart of the conspiracy, gives rise to the strongest possible adverse inference that his truthful testimony would confirm that Greenberg was aware of the no risk arrangement at the heart of the deal. (The State is filing a motion for that inference.)

C. Capco. Greenberg and Smith admit they approved the Capco Transaction after receiving a detailed written briefing that made clear its fraudulent purpose. They contend that they assumed the Capco deal would be handled legally by their subordinates. Such a "defense" is unsupported. Neither Greenberg nor Smith sought or received any legal or accounting advice

as to the propriety of the transaction. As two highly sophisticated insurance executives, they well knew that it was inherently fraudulent to conceal AIG's actual underwriting losses, and no lawyer ever would or could suggest otherwise. Further, Greenberg has acknowledged knowing that if AIG controlled Capco, as it did, Capco could not be treated as independent from AIG. As for Smith, he was the "house expert" and the last word at AIG on the subject of "special purpose entities" such as Capco, and he was intimately familiar with the specific accounting rules that required Capco's financial results to be consolidated with AIG's.

Umansky's memorandum demonstrated that Capco was controlled and financed by AIG, and that the "independent investors" were not independent at all. But even if the arrangement had technically complied with applicable accounting rules, which it did not, the transaction still would have been fraudulent, because its sole purpose and effect was to conceal some $200 million in losses incurred by AIG in the auto warranty program. It is well-established that even if a company's financial statements are consistent with specific technical accounting standards, which is not the case here, that does not mean that its financial statements are not fraudulent. "[U]nder both GAAP and the securities laws, business entities ... are required to provide whatever additional information would be necessary to make the statements in their financial reports fair and accurate and not misleading." *In re Global Crossing Ltd. Sec. Litig*., 322 F. Supp. 2d 319, 340 (S.D.N.Y. 2004) (Lynch, J.).

Greenberg and Smith lean heavily on the fact that certain attorneys and others at AIG worked on the papers needed to effectuate the Capco deal, and that at least some of them knew about the deal's purpose, *viz*., to convert underwriting losses into investment losses. However, defendants cannot explain how the fact that underlings lacked the moral strength to stop a fraudulent deal, created and approved by the top executives of AIG, is a defense. Moreover, a

number of AIG executives *did* express concern about various aspects of the deal, including Neil Friedman, vice president and controller of AIG Capital Corp., George Cubbon, president and CEO of AIRCO, Richard Krupp, vice president and treasurer of AIRCO, and Stan Young, an AIG tax attorney. All were disregarded.[13] Indeed, when Cubbon and Krupp e-mailed AIG headquarters their misgivings about how the investment losses on the Capco transaction were being accounted for, Smith pointedly instructed them not to put their qualms in writing, and to destroy the electronic and hard copies of their e-mails.

Furthermore, the abuse of special purpose entities and the accounting rules applicable to their consolidation were a live subject at AIG and for defendants at the very time of the Capco Transaction. In 2001 and early 2002, when the Capco deal was active, AIG created and marketed a product that purported to allow public companies to remove unwanted assets from their balance sheets by transferring those assets to special purpose entities created by AIG. In marketing this product, AIG represented to prospective customers that the special purpose entities would not, under GAAP, have to be consolidated on the client companies' financial statements – based on the very standards that it now argues did *not* apply to special purpose entities, such as Capco, during the very same time period. That is, it represented to prospective customers that because *AIG* would retain the "substantive risks and rewards of ownership," the customer would not have to consolidate the results of the special purpose entity with its own – showing that AIG fully understood that if the customer *did* retain the risks of ownership (just as it was AIG's money that was solely at risk in the Capco deal), consolidation *would* be required.[14]

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[13] Still other attorneys have testified that they simply prepared necessary papers for the deal, but never were asked to consider its propriety.

[14] The only customer that bought into AIG's special purpose entity product was PNC Financial Services Group, Inc. ("PNC"), which used it to remove a total of $762 million in loan and venture-capital assets from its balance sheet.

This experience also contradicts Smith's testimony in this case that he was only vaguely aware of the applicable standards governing consolidation.

IV. MATERIALITY

A representation or omission in a corporation's financial statements is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *accord State v. Rachmani Corp.*, 71 N.Y.2d 718, 726 (1988); *see also People v. Greenberg*, 95 A.D.3d 474, 483 (1st Dep't 2012) ("the alleged fraudulent transactions [are] be material [where] they have more than a trivial effect on net income or shareholder equity").

The SEC – whose views offer "persuasive guidance" here, *Ganino v. Citizen Util. Co*., 228 F.3d 154, 163 (2d Cir. 2000) – has stressed that the analysis of materiality must consider *both* quantitative factors, such as "the size in numerical or percentage terms of the misstatement," *and* qualitative factors, such as "the factual context in which the user of financial statements would view the financial statement item." SEC Staff Accounting Bulletin No. 99 ("SAB No. 99"). Even a quantitatively small misstatement is material when the misstatement:

AIG, however, had failed to retain sufficient "risks of ownership," and PNC was found by the SEC to have massively understated its liabilities because of its failure to consolidate. AIG did not escape responsibility for the fiasco it caused. On November 29, 2004, AIG entered into a consent judgment with the SEC in which it was ordered to pay disgorgement with interest of more than $46 million. Simultaneously, the two AIG subsidiaries, AIG-FP and AIG-FS, avoided indictment by entering into deferred prosecution agreements with the Justice Department, under which AIG agreed to pay $126 million in disgorgement and penalties. Both the SEC *consent* judgment and the deferred prosecution agreements with the Justice Department – including a statement of facts *agreed to* by AIG – explicitly recite that the standards for nonconsolidation applicable *in 2001* are the same accounting standards the State asserts in this action applied to, and required consolidation of, the Capco transaction Indeed, in support its marketing efforts, AIG obtained from Ernst & Young LLP an opinion letter expressing the view that the appropriate standards for the consolidation and non-consolidation of special purpose entities could be found in FASB Emerging Issues Task Force Topic D-14 (Transactions Involving Special Purpose Entities), a standard that defendants' experts now claim did not apply to an special purpose entity like Capco.

(1) "changes a loss into income or vice versa"; (2) "involves concealment of an unlawful transaction"; (3) "masks a change in earnings or other trends"; or (4) "hides a failure to meet analysts' consensus expectations for the enterprise." Evidence of materiality is "particularly compelling where management has intentionally misstated items in the financial statements."

At trial, the State will introduce substantial evidence of the materiality of the Gen Re and Capco Transactions, including all the evidence relied upon by the Court at the summary judgment stage. The State will also call expert witnesses who will show that the revelation of the Gen Re Transaction caused a multi-billion decline in the price of AIG's stock, itself a powerful indication of materiality, as well as how both transactions satisfy many of the criteria for materiality set forth in SAB No. 99.

Gen Re. In its summary judgment opinion, the Court acknowledged the importance of loss reserves. This finding relied on the testimony of Alice Schroeder, a leading insurance industry equity analyst, and others, as well as the testimony of Charlene Hamrah, AIG's head of investor relations, who testified that in 2000 equity analysts were concerned about AIG's declining loss reserves. Their testimony will be introduced at the trial. The evidence at trial will also support two other elements the Court correctly relied upon in finding the Gen Re Transaction material, namely, (1) AIG's restatement of the loss reserves, and (2) the fact that the transaction was initiated and directed by Greenberg, calling into question the integrity of AIG's management.

The State will also introduce expert testimony. Applying well accepted event study methodologies, Jane Nettesheim has concluded that the price of AIG stock declined materially on February 14(-$1.73), and March 14(-$1.54) and 15(-$1.42), 2005 solely in reaction to news about Gen Re and the departures of Greenberg and Smith, which came about directly as a result

of the revelation of the fraud. The declines in AIG's stock price, which resulted in billions of dollars in investor losses, demonstrate the materiality of the Gen Re fraud.[15]

The State also will call David Ross, who will testify that Gen Re comfortably passes the materiality inquiry under the SEC's SAB No. 99, which sets forth a number of non-exhaustive "qualitative considerations" to be taken into account. These include:

*First, "the intent of management [to] … misstate[ ] items in the financial statements to 'manage' reported earnings." Defendants undertook the transaction well aware that it was illegal. Gen Re, while not directly involving earnings, was intended to misstate AIG's loss reserves, a metric significant to the markets in evaluating the quality of AIG's earnings.

*Second, the Gen Re transaction masked a trend in declining loss reserves, and therefore satisfies another qualitative consideration specified in SAB No. 99 – "whether the misstatement masks a change in earnings *or other trends*."

*Third, analysts viewed the decline in AIG's loss reserves in the third quarter of 2000 as a potential "hot button" issue for investors, and reacted favorably to the increases in reserves AIG reported in the next two quarters, a result only made possible by the Gen Re fraud. Gen Re thus satisfies another qualitative consideration of SAB No. 99 – "whether the misstatement hides a failure to meet analysts' consensus expectations for the enterprise."

*Fourth, because the accounting treatment of Gen Re concerned the property/casualty insurance business, one of the most important lines of business to AIG, Gen Re satisfied yet another qualitative consideration of SAB No. 99 – "whether the misstatement concerns a segment or other portion of the registrant's business that has been identified as playing a significant role in the registrant's operations or profitability."

*Fifth, Gen Re satisfies still another qualitative consideration specified in SAB No. 99 – "whether the misstatement affects the registrant's compliance with regulatory requirements," namely the regulatory requirements of the SEC, and the anti-fraud provisions of the Martin Act and the federal securities laws.

*Sixth, because AIG should not have recorded loss reserves, but a $250 million increase in other liabilities in two quarters, the amounts at issue are capable of precise measurement, and

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[15] Ms. Nettesheim's findings mirror those made by Judge Droney, who found in the Gen Re criminal trial that the revelation of the Gen Re fraud, on the same three dates identified by Ms. Nettesheim, caused shareholder damages of at least $544 million. *United States v. Ferguson*, 584 F. Supp. 2d 447, 456 (D. Conn. 2008). Judge Droney's damages calculation was based on the testimony of a different expert, who used the same methodology as Ms. Nettesheim. In fact, Judge Droney's calculation was understated because it dealt only with damages to a limited class of institutional stockholders. *Id.*

Gen Re satisfies yet another qualitative consideration specified in SAB No. 99 – "whether the misstatement arises from an item capable of precise measurement or … an estimate."

*Finally, SAB No. 99 states that "the demonstrated volatility of the price of a registrant's securities in response to certain types of disclosures may provide guidance as to whether investors regard quantitatively small misstatements as material." AIG's stock price demonstrated precisely that volatility in response to loss reserve and Gen Re-related disclosures. After AIG reported its $59 million loss reserve decline on October 26, 2000, AIG's shares declined significantly, as they did again in response to the Gen Re-related disclosures in February and March 2005.

Defendants' Experts on Materiality. In response to Ms. Nettesheim and Mr. Ross, defendants will proffer a report by their expert, Dr. Mark Zmijewski. Dr. Zmijewski agrees with Ms. Nettesheim's methodology and study, and in particular her conclusion that AIG's stock price declined by a "statistically significant" amount on February 14 and March 14 and 15, 2005, when investigations by the SEC and the NYAG of the reinsurance scheme, and Greenberg's and Smith's involvement, were made public. Dr. Zmijewski offers no alternative explanation for these declines, but argues feebly that the Gen Re fraud was not responsible for the *entire* multi-billion dollar loss in AIG's share value because the news articles and commentary that appeared on February 14, 2005 did not identify Gen Re *by name* and did not include all of the details about the transaction, and AIG's stock price declines in mid-March were attributable, at least in part, to Greenberg's and Smith's departures.[16] Yet Dr. Zmijewski acknowledges, as he must, that their departures were due largely to their roles in Gen Re.

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[16] Dr. Zmiewski notes that the media reports that appeared on February 15, 2005 about the SEC and NYAG subpoenas did not specifically mention Gen Re "in any way," and therefore he contends that the stock price decline in response to AIG's announcement of the subpoenas cannot be attributed to the Gen Re transaction. Because the subpoenas did, in fact, relate to the Gen Re transaction, and actually focused quite specifically on Gen Re by name, Dr. Zmijewski's contention is not persuasive. What the public was reacting to was the investigation of Gen Re, whether or not it was publicly identified by name at that moment in time. As for the disclosures of March 14 and 15, 2005, they widely publicized the fact that AIG continued to be under investigation for the Gen Re Transaction (by name), and that Greenberg and Smith had been terminated because of the transaction and their role therein. Dr. Zmijewski's only response is that some of the media reports the Gen Re Transaction was not the "sole" reason cited for the defendants' termination. As the Court will see, the overwhelming focus of the media's attention relating to the defendants' termination was their role in the Gen Re fraud.

Per Dr. Zmijewski, it is not possible to distinguish precisely how much of the decline in AIG's stock price was attributable to news about Gen Re, as distinct from news about what he terms "confounding" matters. Ms. Nettesheim disagrees that there was such "confounding" information. But this dispute hardly matters. To establish materiality, the State need not show that the Gen Re was the *sole* cause of the entire stock price decline, but only that there was a "causal link" between Gen Re and the price decline, or that Gen Re had some "appreciable negative effect" on the price decline. *See United States v. Schiff*, 602 F.3d 152, 173 (3d Cir. 2010) ("To use stock price drops as evidence of materiality, the Government must demonstrate that public disclosure of the misstatements charged in the indictment had an appreciable negative effect on the stock price.") (internal quotation marks omitted). The State need only show that Gen Re or Capco were "significant contributors" to the price decline. *See In re Vivendi, S.A. Sec. Litig*., 634 F. Supp. 2d 352, 365 (S.D.N.Y. 2009); *Robbins v. Kroger Props., Inc*., 116 F.3d 1441, 1447 (11th Cir. 1997) ("plaintiff need not show that the defendant's act was the sole and exclusive cause of the injury he has suffered; he need only show that it was 'substantial', *i.e.*, a significant contributing cause."); *Miller v. Asensio & Co., Inc*., 364 F.3d 223, 229 (4th Cir. 2004) (to satisfy proximate causation, courts "require only that the plaintiff show that the defendant's conduct was a substantial cause of its injury").

Defendants also will proffer testimony from Prof. David Babbel, who does not address Ms. Nettesheim's conclusions, and made no study of the effect of the disclosure of the Gen Re Transaction on the price of AIG's stock. Rather, Prof. Babbel opines generally about loss portfolio deals and, with no reference to the evidence or to the Restatement, "see[s] no support for a presumption that there was any intent on the part of AIG's management to deceive investors." Ignoring that evidence, he concludes that the Gen Re Transaction is a "tempest in a

teapot" by comparing the size of the Gen Re loss reserves, *i.e*. $500 million, to AIG's total loss reserves at the time of some $25 billion. Prof. Babbel's inapt comparison disregards evidence of: (a) the stock market's reaction to AIG's declining reserves in the period leading up to the Gen Re Transaction; (b) Greenberg's initiation of the transaction in response to the stock market reaction; (c) the reaction of analysts and others to the increase in AIG's reserves effectuated by the deal; and (d) what the role of AIG's senior management in the fraud said about their integrity, itself a key criterion of materiality. Prof. Babbel's analysis is flawed as well because he compares the magnitude of reserves associated with Gen Re to AIG's *total reserves,* while ignoring other relevant quantitative factors of more direct and demonstrated concern to analysts, such as *changes* in reported loss reserves during the reporting period, and the *ratio of losses paid to losses incurred*. Prof. Babbel's testimony should be given no weight.

Capco. The most compelling evidence of Capco's materiality is the conduct of the defendants themselves. They went to elaborate lengths to effectuate the Capco Transaction *solely* for the purpose of getting hundreds of millions of dollars in underwriting losses off of AIG's books.[17] Greenberg wanted to conceal from the public a "disastrous" insurance program that was a blemish on his company's vaunted underwriting profits, which, in Greenberg's own words, "are the god we cherish [at AIG]." Greenberg and Smith would hardly have gone to the lengths they did to hide the losses if they themselves did not regard them as material. And there is objective, statistical evidence, furnished in Dr. Zmijewski's own work, that Greenberg's

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[17] Defendants have argued that the transaction was not unusual in view of AIG's decision to discontinue writing auto warranty insurance, and suggest that it was not inappropriate to recharacterize the losses because they would not be recurring. There is no contemporaneous evidence that this was the motive for Capco, and this justification does not explain why the losses were concealed by a sham transaction rather than dealt with in honest fashion – for example, with a footnote to AIG's financial statements noting that the losses were non-recurring. Defendants have argued also that the purported reinsurance agreement with Capco brought "finality" to the auto warranty program, but in fact it did nothing of the kind. AIG continued to administer the warranty program for years thereafter.

intuitive judgment was correct: the market *is* more concerned with underwriting losses than investment losses.

Dr. Carmichael and Mr. Ross, the State's rebuttal accounting and materiality experts, will show that Capco satisfied both the quantitative and qualitative standards for materiality under SAB No. 99. Capco enabled AIG to overstate the earnings of its core business divisions by a significant amount. In the first quarter of 2002, because of Capco, AIG overstated the underwriting profits of its general insurance business by 3.8%, its Domestic General Insurance business by 6.4%, and its Domestic Brokerage Group ("DBG") by 10.5%. The effect of recharacterizing $163 million of underwriting losses as realized capital losses in 2000 overstated AIG's underwriting profits that year by 21%. Thus, the misstatement resulting from the Capco transaction substantially exceeded the typical 5% "rule of thumb" quantitative materiality threshold the SEC staff put forward in SAB No. 99 as a starting point for a materiality assessment. And AIG, in its Form 10Ks, including for 2000 and the other years relevant to Capco, clearly represented that "underwriting profit is the true measure of the core business of a general insurance company," but also that this portion of its operation had to be assessed separately from its investment operations. Thus, Capco satisfies the qualitative factor identified by SAB No. 99 – "whether the misstatement concerns a segment or other provision of the registrant's business that has been identified as playing a significant role in the registrant's operations of profitability."

The Capco Transaction satisfied several other qualitative factor identified by SAB No. 99. It masked a change in the trend of AIG's underwriting profits. With Capco, the underwriting profits of DBG in 2000 showed an increasing trend from $531 million in 1998 to $669 million in 1999 to $785 million in 2000; without the $163 million Capco boost in 2000,

profit for that year would have been only $622 million, reversing the trend of increasing profits. Greenberg and Smith intentionally orchestrated an inherently deceptive transaction. And the Capco transaction violated not only the requirements of GAAP, but the agreements AIG had recently made with New York and Delaware regulators in the wake of its prior experience with Coral Re (another Barbados reinsurer covertly controlled by AIG), as well as the fundamental principle, embodied in those agreements, that no risk is transferred when a reinsurer is controlled by its reinsured.

V. REMEDIES

The State seeks and is entitled to: (1) injunctive relief consisting of an order barring the defendants from (a) violating the Martin Act and the Executive Law; (b) participating, directly or indirectly, in any capacity, in the securities industry; and (c) acting as officers and directors of a public company; and (2) disgorgement of the cash bonuses each received from AIG during the period of their frauds.[18]

A. The State Is Entitled to Injunctive Relief

Courts have the equitable power to order any and all appropriate relief for violations of the Martin Act. GBL § 353-a ("[i]n any action brought by the attorney-general as provided in this article the court may grant such other and further relief as may be proper"); *see also People v. Lexington Sixty-First Assoc.*, 38 N.Y.2d 588, 596-97 (1976) (affirming broad equitable relief). As under federal law, this power is inherent in a court's "broad equitable power" to "fashion

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[18] The State incorporates by reference the legal and factual arguments it made in its opposition to defendants' motions for summary judgment on remedies.

appropriate relief for violations of the [ ] securities laws." *SEC v. Posner*, 16 F.3d 520, 521 (2d Cir. 1994). Executive Law § 63(12) provides a further basis for equitable relief.[19]

Upon a finding of liability, the State is entitled to an injunction prohibiting defendants from violating the Martin Act and Executive Law § 63(12). Defendants do not dispute this, but have argued that an injunction against future violations of state law would be "superfluous and meaningless" because they are already subject to SEC injunctions prohibiting Greenberg, "as a control person," and Smith from engaging in "securities fraud." The Court of Appeals already has rejected this argument. *People v. Greenberg*, 21 N.Y.3d 439, 448 (2013). An injunction obtained in this case would be different from those obtained by the SEC in the consent judgments. The SEC injunctions enjoin Greenberg and Smith from violating specified sections of the federal securities laws. New York's Martin Act and Executive Law differ from the federal securities laws in substantial respects, and the State has its own sovereign interest in monitoring compliance with and enforcing its own injunctions in its own tribunals.[20]

The Attorney General also may obtain a permanent injunction barring a defendant from "selling or offering for sale to the public within this state, as principal, broker or agent, or otherwise, any securities issued or to be issued," where the evidence suggests that a defendant "actually has or is engaged in" a fraudulent practice. GBL § 353(1). The *only* required showing

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[19] Executive Law injunctions may prohibit defendants from engaging in specific businesses or entire industries. *See, e.g.*, *State v. ASM Financial Funding Corp*., No. 15485/2010, Short Form Order, at *4 (Sup. Ct. Nassau County Jan. 10, 2011) (defendants enjoined from "operating promoting or participating in any business related to financial services . . . or the offering or sale of any securities…"); *State v. Midland Equities of N.Y., Inc*., 117 Misc. 2d 203, 208 (Sup. Ct. N.Y. County 1982) (defendants enjoined "from engaging in the business of mortgage foreclosure consultation, from offering legal advice to consumers and from soliciting business for attorneys").

[20] A consent decree is enforceable only by the parties to the decree, *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 750 (1975) (*citing United States v. Armour & Co*., 402 U.S. 673 (1971) and *Buckeye Co. v. Hocking Valley Co*., 269 U.S. 42 (1925)), and a non-party cannot compel a governmental entity to enforce a consent decree. *United States v. American Soc'y of Composers, Authors and Publishers*, 341 F.2d 1003, 1008 (2d Cir. 1965). The State is not a party to the SEC consent decrees, and has no standing or authority to enforce them.

is that the defendant engaged in conduct in violation of the Act; there is *no* requirement that a threat of imminent harm or a likelihood of repeat conduct be established. GBL § 353(1); *Lexington Sixty-First Assocs.*, 38 N.Y.2d at 598; *see also State v. Fashion Place Assocs*., 224 A.D.2d 280 (1st Dep't 1996); *Photocolor Corp.*, *supra*, 156 Misc. at 52-53.[21]

Officer and director bars are an established remedy for securities fraud, including under the Martin Act. *See, e.g., People v. McCann*, 3 N.Y.2d 797 (1957); *SEC v. First Pac. Bancorp*, 142 F.3d 1186, 1993 (9th Cir. 1998); *SEC v. Koenig*, 532 F. Supp. 2d 987, 994 (N.D. Ill. 2007). Courts look to federal securities law for guidance in interpreting the Martin Act, s*ee, e.g.*, *East Midtown Plaza Hous. Co. v. Cuomo*, 20 N.Y.3d 161, 170 (2012), and in issuing officer and director bars, federal courts consider the following "*Patel*" factors: "(1) the egregiousness of the underlying securities law violation; (2) the defendant's repeat offender status; (3) the defendant's role or position when he engaged in the fraud; (4) the defendant's degree of *scienter*; (5) the defendant's economic stake in the violation; and (6) the likelihood that misconduct will recur." *SEC v. Patel*, 61 F.3d 137, 141 (2d Cir. 1995). The defendant's lack of contrition also is significant. *See*, *e.g*., *SEC v. Lorin* 76 F.3d 458, 461 (2d Cir. 1996); *SEC v. Bankosky*, No. 12 Civ. 1012 (HB), 2012 U.S. Dist. LEXIS 70753, at *7 (S.D.N.Y. May 21, 2012

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[21] Defendants have argued that a securities bar is unnecessary because they "do not personally engage in the offering for sale of securities or rendering advice to the public" and do not intend to do so. Yet Greenberg's and Smith's own affidavits reveal their connection with Starr Investment Holdings, LLC ("Starr Holdings"), a registered investment advisor subsidiary of C.V. Starr. Greenberg's personal registration with FINRA's Central Registration Depository reflects that Greenberg had associations with two additional firms, Loeb Arbitrage Fund and Erhlich Bober International Inc., which are described as investment-related. Defendants' assertion that they do not *personally* give investment advice or sell securities is irrelevant. The Court may enjoin a securities fraud violator from being engaged in the management of a company that participates in the sale of securities, even though the day-to-day work of selling, rendering investment advice, or other contact with the public may be left to employees. Indeed, any other reading would allow someone found liable of fraud to simply hire an intermediary between himself and the public, and continue to sell securities. That is not what the legislature intended. *See Photocolor Corp.*, 156 Misc. at 52.

Applying these factors, an officer and director bar against both defendants is amply warranted. Greenberg and Smith engaged in a fraud giving rise to billions of dollars in shareholder damages; they occupied the top leadership positions at AIG, and it was precisely their senior roles that led AIG to commit the Gen Re and Capco frauds; they certified AIG's financial statements knowing that they were false and misleading, when, as CEO and CFO, it was their responsibility to assure that the financials were accurate and not misleading; and while *scienter* is not an element under the Martin Act, the defendants acted with *scienter*. Gen Re and Capco, moreover, were only two among several frauds committed by AIG under Defendants' leadership.[22] And Greenberg not only has insisted that he committed no wrong, but has done so in a highly aggressive and public way, proclaiming his lack of responsibility in a recently published autobiography, and in numerous public fora, all the while orchestrating a public relations campaign designed to impugn the bona fides and motives of the State's continued prosecution, as well as the role of this Court. Moreover, Greenberg and Smith continue to be actively involved in the insurance industry. Greenberg controls C.V. Starr, and there is nothing to stop him from taking it public and appointing himself and Smith officers and/or directors. Assurances to the contrary are not sufficient to defeat a request for a bar. *SEC v. Selden*, 632 F. Supp. 2d 91, 99 (D. Mass. 2009).

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[22] Defendants' wrongful conduct, it is important to stress, was not isolated. Leaving aside their orchestration of not one, but two, nearly simultaneous frauds (Capco and Gen Re), Greenberg also supervised from 1985 through 1997 the creation and misuse of Coral Re, which, like Capco, was a Barbados-based reinsurer covertly controlled by AIG. The Coral Re structure was found by the insurance regulators of several states, including New York, to be improper and not to convey risk to any third party. It resulted in an agreement – violated by Greenberg and Smith when they developed the Capco scheme – not to engage in similar transactions in the future. As also noted *supra*, at pp. 25-26, AIG abused the accounting rules applicable to the consolidation of special purpose entities in the PNC matter, resulting in both a civil settlement and a criminal deferred prosecution. Shortly before the Gen Re Transaction, AIG also facilitated the abuse of finite insurance in the Brightpoint matter, discussed *supra*, at n. 8 and accompanying text.

Once liability is determined and defendants fail to acknowledge their wrongdoing, the Court may conclude that defendants' past conduct is a predictor of their future conduct. *See*, *e.g.*, *SEC v. First Pac. Bancorp*, 142 F.3d 1186, 1193-94 (9th Cir. 1998) (finding "likelihood of future violations" where defendant "had failed to assume any responsibility . . . or recognize the wrongful nature of his conduct"); *SEC v. Koenig*, 532 F. Supp. 2d 987, 994 (N.D. Ill. 2007) (finding "a reasonable likelihood of future violations" in light of overwhelming evidence and refusal to acknowledge culpability); *SEC v. Lawbaugh*, 359 F. Supp. 2d 418, 426 (D. Md. 2005) (granting bar where, without expression of remorse, court concluded there was a strong "likelihood of recurrence").

B. The State Is Entitled to Disgorgement, with Prejudgment Interest, of the Bonuses Defendants Received from AIG

The State is entitled to disgorgement of the bonuses Greenberg and Smith were paid by AIG during the period of the fraud, plus pre-judgment interest.[23] With interest, the total amount for Greenberg is approximately $49,835,000, and the total amount for Smith is $6,269,900.[24]

Disgorgement is an available remedy under the Martin Act and the Executive Law. *People v. Ernst & Young LLP*, 114 A.D.3d 569, 570 (1st Dep't 2014). A corporate officer's entire compensation may be ordered disgorged if the official would have been terminated earlier

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[23] While the State may be entitled to disgorgement of *all* the compensation Greenberg and Smith were paid during the period of their fraud, *see*, *e.g.*, *SEC v. Black*, No. 04 Civ. 7377, 2009 U.S. Dist. LEXIS 37309 at *5 (N.D. Ill., Apr. 30, 2009), including not only their cash bonuses, but also their salaries and the value of the stock options awards at the time of issue (whether or not such options were exercised), the State has limited its disgorgement claim to the cash bonuses defendants were paid.

[24] "Public policy favors awarding interest in equity actions." *Hynes v. Iadarola*, 221 A.D.2d 131, 135 (2d Dep't 1996) (*citing* Weinstein-Korn-Miller, N.Y. CIV. PRAC. P. 5001.06). An award of prejudgment interest is appropriate for the "entire period from the time of defendants' unlawful gains to the entry of judgment." *SEC v. First Jersey Sec.*, 101 F.3d 1450, 1477 (2d Cir. 1996); *SEC v. Moran*, 944 F. Supp. 286, 295 (S.D.N.Y. 1996) (to do otherwise would allow the defendants to obtain "the benefit of what amounts to an interest free loan procured as a result of illegal activity"). Greenberg's 2000-04 cash bonuses totaled $24,500,000; non-compounded interest on that amount at the statutory 9% rate specified in C.P.L.R. 5004 is approximately $25,335,000. Smith's cash bonuses from 2000 through the first quarter of 2005 totaled $3,005,000; his interest figure is approximately $3,204,900.

had the unlawful conduct been exposed. *SEC v. Black*, No. 04 Civ. 7377, 2009 U.S. Dist. LEXIS 37309 at *5 (N.D. Ill. Apr. 30, 2009); *see also Razmilovic*, 822 F. Supp. 2d at 255; *SEC v. Posner*, 16 F.3d 520, 522 (2d Cir. 1994).

The compensation Greenberg and Smith were paid by AIG was established by AIG's Board of Directors, through its Compensation Committee. On February 8, 2005, before the Gen Re fraud was revealed, the Committee met and approved the salary and performance-based compensation payable to Greenberg and Smith for 2004. The Committee increased Greenberg's bonus from $6.5 million in 2003 to $8 million in 2004, the maximum amount permitted under the 2004 CEO Plan, as amended. In March 2005, the Board compelled Greenberg to resign as CEO of AIG after it was presented with evidence of his involvement in the improper financial transactions that led to AIG's restatements, and Greenberg declined to cooperate in the investigations of those transactions. The Board terminated Smith's employment as CFO for the same reasons. On June 20, 2005, the Committee unanimously approved its annual report on executive compensation for 2004, for inclusion in AIG's 2005 Proxy Statement. That report included the following language:

> The Committee made determinations regarding Mr. Greenberg's 2004 compensation as Chairman and Chief Executive Officer of AIG at its meetings on December 16, 2004 and February 8, 2005. In each case, the determinations were based on the Committee's understanding at such time of Mr. Greenberg's activities and accomplishments during 2004 in relation to the strategic plans and goals of AIG, and were not made with the benefit of the information gained in the course of AIG's subsequent internal review. …
>
> If the Committee had the information gained In the course of the AIG's Internal review available to it at the time of its compensation evaluation with respect to Mr. Greenberg, the

> Committee believes that it would have arrived at materially different determinations.[25]

The Court should order disgorgement of the cash bonuses Greenberg and Smith were paid by AIG during the period of the fraud. This outcome is supported by federal precedent and by the record of what happened when the frauds were exposed in 2005, and would represent the application of an important public policy articulated by the Court of Appeals:

> No one shall be permitted to profit by his own fraud, or to take advantage of his own wrong, or to found any claim upon his own iniquity, or to acquire property by his own crime. These maxims are dictated by public policy, have their foundation in universal law administered in all civilized countries, and have nowhere been superseded by statutes.

Riggs v. Palmer, 115 N.Y. 506, 511-12 (1889). The same principle is embodied in the executive compensation "claw-back" provisions of the Sarbanes-Oxley Act of 2002, July 30, 2002, P.L. 107-204, Title III, § 304, 116 Stat. 778, codified at 15 USCS § 7243, *et seq*., which, broadly, calls for the claw-back of performance-based compensation paid to the CEOs and CFOs of public companies that issue restatements of their financial statements as a result of misconduct.

Affirming this public policy is especially appropriate where, as here: (1) AIG restated its financial statements; (2) defendants orchestrated the events giving rise to the Restatement; (3) AIG's Board was unaware of defendants' involvement in the improprieties giving rise to the Restatement at the time they were awarded their bonuses and stock option grants; (4) the Board terminated both defendants from their executive positions upon learning of their fraudulent conduct; and (5) AIG's Compensation Committee unanimously expressed its belief that it would not have awarded Greenberg the same compensation in 2004 had it known then the information

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[25] Report of the Compensation Committee on Executive Compensation, Annex A to Compensation Committee Minutes, June 20, 2005The published version of AIG's 2005 Proxy Statement, dated June 27, 2005, included the first paragraph quoted above, but omitted the second.

revealed by the internal review that led to the Restatement. Of course, had the AIG Board and Committee known *in 2000* that Greenberg and Smith had engineered two material frauds that could bring upon AIG the reputational and shareholder injury that ultimately ensued, there can be little doubt what would have happened: as actually occurred in 2005, defendants would have been ousted, and would never have received the bonuses they should now be made to disgorge.

CONCLUSION

The evidence at the trial of this action will establish that defendants Greenberg and Smith violated the Martin Act and Executive Law § 63(12), and entitle the State to the injunctive relief and disgorgement it has requested.

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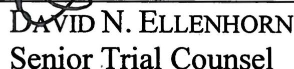
ERIC T. SCHNEIDERMAN
Attorney General of the State of New York
120 Broadway, 23rd Floor
New York, New York 10271
(212) 416-6388

By: 
DAVID N. ELLENHORN
Senior Trial Counsel

Counsel for Plaintiff

KARLA G. SANCHEZ
Executive Deputy Attorney General
for Economic Justice

DAVID E. NACHMAN
Senior Enforcement Counsel

ARMEN MORIAN
Assistant Attorney General

of Counsel