

People v Greenberg

2010 NY Slip Op 33216(U)

October 21, 2010

Sup Ct, NY County

Docket Number: 401720/05

Judge: Charles E. Ramos

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

Index Number : 401720/2005

PART 53

CUOMO, ANDREW M.

vs.

GREENBERG, MAURICE R.

INDEX NO. 401720/05

SEQUENCE NUMBER : 040

MOTION DATE _____

SUMMARY JUDGMENT

MOTION SEQ. NO. 40

MOTION CAL. NO. _____

The following papers, numbered 1 to _____ were read on this motion to/for _____

PAPERS NUMBERED

Notice of Motion/ Order to Show Cause – Affidavits – Exhibits ...

Answering Affidavits – Exhibits _____

Replying Affidavits _____

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

_____ is decided in accordance with
accompanying memorandum decision and order.

FILED

OCT 21 2010

NEW YORK
COUNTY CLERK'S OFFICE

Dated: 10/21/2010

CHARLES E. RAMOS ^{J.S.C.}

Check one: FINAL DISPOSITION

NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST

REFERENCE

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE
FOR THE FOLLOWING REASON(S):

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION

-----X

THE PEOPLE OF THE STATE OF NEW YORK by
ANDREW M. CUOMO, Attorney General
of the State of New York,

Plaintiffs,

- against -

Index No. 401720/05

MAURICE R. GREENBERG and HOWARD I. SMITH,

Defendants.

-----X

Charles Edward Ramos, J.S.C.:

In this action for civil penalties under the Martin Act, the Attorney General of the State of New York (NYAG), Andrew M. Cuomo, alleges that Maurice R. "Hank" Greenberg, the former chairman and chief executive officer (CEO), and Howard I. Smith, the former chief financial officer (CFO) of American International Group (AIG), personally initiated, negotiated and structured two sham reinsurance transactions that misled the investing public as to AIG's true financial condition.¹

AIG's revelation of the transactions forced it to restate its financial statements for the years 2001 through 2004, and resulted in the criminal indictment of a former AIG executive and four former General Reinsurance Corp. (Gen Re) executives as a result of their involvement in one of the transactions, in which defendants herein were characterized as "unindicted co-

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¹ The original complaint alleged that Defendants, including AIG, engaged in or authorized seven fraudulent transactions. On January 18, 2006, the NYAG settled with AIG when it agreed to pay \$1.6 billion in damages and penalties. In September 2006, the NYAG served an amended complaint (Complaint), dismissing three transactions. A fourth transaction was subsequently dropped by agreement of the parties.

NEW YORK COUNTY CLERK'S OFFICE

conspirators." In the criminal action (Criminal Action), two of the defendants pled guilty, and a federal jury convicted the remainder of the defendants, who are appealing (*United States v Ferguson*, 553 F Supp 2d 145 [D Conn 2008]).

In motion sequence 040² and 042, Greenberg and Smith (together, defendants) move for summary judgment dismissing the action in its entirety as against them.

In motion sequence 041, the NYAG moves for partial summary judgment as to liability against defendants.

Background³

Defendants are former executives of AIG, the world's largest insurance company. Greenberg ran AIG as its chairman and CEO for thirty-eight years. In 1996, Smith became AIG's CFO. They both resigned on March 15, 2005, shortly after AIG issued a press release admitting that the two transactions, discussed below, were improper. According to the NYAG, their resignation and the subsequent restatement of AIG's financial statements reduced its

² Motion sequence numbers 040, 041, and 042 are consolidated for disposition.

In motion sequence 043 and 044, Defendants moved and cross-moved to file over-sized memoranda of law in support of their motions and in opposition to the NYAG's motion, which were granted without opposition.

In motion sequence 045, non-party Jeffrey J. Haas, a professor of New York Law School, and five law students moved by order to show cause to file an amicus curiae brief in support of Greenberg, which was denied for the reasons set forth in this Court's record (Tr 4/20/10).

³ The facts set forth herein are taken from the parties' Rule 19-A Statements.

stockholder equity by \$3.5 billion, and caused an immediate and substantial decline in AIG's stock price, resulting in the loss of billions of dollars to investors.

The Gen Re Transaction

On October 26, 2000, AIG reported its financial results for the third quarter of 2000 (Exhibit 10, annexed to the Smith Aff.). The financial statements show that AIG's loss reserves decreased by approximately \$59 million from the previous quarter, while its net premiums increased by 8.1% (*Id.*). That same day, the price of AIG's stock dropped six percent from the prior day's close (Exhibit 11, annexed to the Smith Aff.).

According to Charlene Hamrah, AIG's head of investor relations, the day that the results were released, she received several calls from analysts commenting on the results and drop in AIG's stock price (Exhibit 9, annexed to the Hamrah Trial Testimony⁴ (Tr Tes) 243:16-24, 248:11-25, 249:4-10, 18). Hamrah testified that Greenberg also called her several times that day and was "unhappy" (*Id.*). According to Hamrah, "we all knew [the third quarter of 2000 loss reserve numbers] was going to be a problem [in] that the reserves had declined that quarter, and that it was going to be an issue that I'd have to deal with on

⁴ Defendants generally dispute citations to testimony from the Criminal Trial, in addition to all depositions conducted by the NYAG pursuant to Martin Act subpoenas, documentary exhibits to those depositions, AIG's financial statements, e-mails, handwritten notes by employees, and interview notes taken by AIG's outside counsel, Paul, Weiss, Rifkind, Wharton & Garrison LLP (Paul Weiss) on the grounds that they constitute inadmissible prior testimony or hearsay (Defendants' Response to NYAG's Rule 19-A Statement).

the phone calls with the analysts and investors after we announced this - after we reported this quarter" (*Id.*).

At the time, several insurance industry stock analysts attributed the drop in AIG's stock price to the decline in AIG's loss reserves, and investor fears that AIG was releasing loss reserves into income so that it could meet its projected income numbers (see e.g. Exhibit 12, 14, annexed to the Smith Aff.).

Several days later, on October 30, 2000, out of concern over the decline in AIG's stock price, Greenberg telephoned Ronald Ferguson, the CEO of Gen Re. Greenberg told Ferguson that AIG was interested in acquiring or borrowing between \$200-500 million in reserves from Gen Re through a "loss portfolio" transfer in exchange for a fee to Gen Re for accommodating the request (NYAG's Rule 19-A Statement, ¶ 27, Greenberg Dep Tr 9:14-21, 33:2-6, 40:3-9, 42:9-14, 46:6-18, 53:22-23, 102:8-11). According to contemporaneous notes and e-mails between Gen Re executives and Ferguson, Greenberg requested claims on "long tail" business⁵ for six to nine months.

After speaking with Greenberg, Ferguson designated Nick Napier, a senior Gen Re executive, as the Gen Re "point person" on the transaction, while Greenberg appointed Chris Milton, a senior vice president at AIG and head of reinsurance, to "work

⁵ Long Tail "refers to the length of time between a claim causing incident and the settlement of the resultant claim" (Exhibit 35, annexed to the Smith Aff.).

out the details" and report back to him as to its status (NYAG's Rule 19-A Statement, ¶¶ 28-29).

A "Non-Risk Deal"

Greenberg and Ferguson spoke for a second time by telephone in mid-November 2000. Greenberg confirms that this second telephone conversation with Ferguson took place, and that he had contemporaneous discussions with Milton, Ferguson and Smith concerning the proposed Gen Re transaction (Exhibits A; 33, annexed to the Smith Aff., Greenberg Dep Tr at 65:13-14, 75:16-21, Interrogatory No. 11).).

Over the next several weeks, Milton and Napier spoke several times concerning the details of the proposed Gen Re transaction, and Napier met with Gen Re executives (NYAG's Rule 19-A Statement, ¶¶ 31-36, 39).

Deposition testimony and Napier's notes from these meetings show that there were discussions about the possibility of structuring a "non-risk deal" with AIG, to the extent that "there would not be any risk in the reinsurance transaction" (Exhibits 30, 37 annexed to the Smith Aff., Napier Deposition Tr 63:14-25, 64:2, 14-19, 25, 65:2-25, 66).

According to Napier, Ferguson initially instructed him to call Milton and inquire whether AIG would consider a no-risk deal (Exhibits 25, 30, annexed to the Smith Aff., Napier Dep Tr 67:24-68:6; Napier Tr Tes 739-40). Napier testified that Milton indicated that he would check and get back to him, and later that day, Milton called Napier and indicated that, after speaking with

Greenberg, a non-risk transaction "was something they [AIG] would like to take a look at" (*Id.*, 68:24-69:4-8).

Napier testified that Ferguson and Greenberg orally agreed at this time that AIG would not bear any "real risk" in the transaction (Exhibits 25, 27, 41, 185, annexed to the Smith Aff., Napier Dep Tr 609:11-13, 17-24, 649-652, 655-658). In any event, according to the NYAG, it was highly unlikely that any claims on "long tail" business would be submitted in a short, six to nine month period, and thus, there was no risk that AIG would actually incur losses.

At the time, Ferguson wrote an e-mail to Napier, copied to several other Gen Re executives, regarding the details of the "AIG transaction." Ferguson admonished that "the circle of people involved in this [should be kept] as tight as possible" (Exhibit 166, annexed to the Smith Aff.). Following this, Napier wrote in the same e-mail exchange to Gen Re executives that Milton indicated that AIG "want[ed to proceed ... in accordance with REF's [Ferguson's] conversation with MRG [Greenberg]" (Exhibit 48, annexed to the Smith Aff.). According to Napier, the "conversation" referenced in this e-mail was Greenberg's and Ferguson's telephone call where they agreed that the transaction would be structured without involving risk transfer.

The Payment Arrangement

The meetings and exchanges between AIG and Gen Re executives produced two sham reinsurance agreements between Cologne Re Dublin (Cologne Re), a subsidiary of Gen Re, and National Union

Fire Insurance Company of Pittsburgh, P.A. (National Union), a subsidiary of AIG. On their face, these reinsurance agreements, that became known as the Gen Re transaction (Gen Re Transaction), made it appear as if AIG was reinsuring Gen Re for \$600 million in liabilities in exchange for a \$500 million premium (NYAG's Rule 19-A Statement, ¶¶ 54-55, Exhibits 52-3, annexed to the Smith Aff.). The \$500 million total premium was charged on a 98% funds withheld basis, and thus, Cologne Re paid National Union \$10 million, instead of the entire \$500 million.

However, according to John Houldsworth, the CEO of Cologne Re (who eventually pled guilty to his participation in the scheme), \$350 million of the \$500 million that was subject to these reinsurance agreements was already reinsured. Houldsworth testified:

"[W]e've already bought insurance to cover those reserves effectively ... [I]f you take out the reserves that are already reinsured, ... there would be no possibility or virtually impossible that the remaining contracts could ever add up to 500 million let alone \$600 million ... **We [Cologne Re] weren't transferring any risk to them [AIG]**" (emphasis added) (Exhibit 187, annexed to the Smith Aff., Houldsworth Tes Tr 2286-2293).

This fact is reflected in a November 15, 2000 e-mail that Houldsworth sent to Napier and Elizabeth Monrad, Gen Re's CFO, entitled "Loss Portfolio Request for A[IG]." Attached to the e-mail, in which Houldsworth explains that there would be no risk transferred in the Gen Re transaction, is a "draft term sheet":

'Can CRD [Cologne Re] provide a retrocession contract transferring approximately \$500m of reserves on a funds withheld basis to the client **with the intention that no real risk is transferred and that this may well be commuted or**

gradually reduced in a few years' ... Contract we provide must have Statutory risk transfer (GAAP as well?) ... Contract we provide must give A[IG] a potential upside in entering the transaction. **Given that we will not transfer any losses under this deal it will be necessary for A[IG] to repay any fee plus the margin they give us for entering this deal** (emphasis added) (Exhibit 39, annexed to the Smith Aff.).

The difference between the \$600 million limit of liability and the \$500 million premium created the false appearance of a possible \$100 million loss. It was agreed that, for accommodating AIG in its request to structure the transaction as no-risk, Gen Re would be paid a \$5 million fee, and the \$10 million premium payment was secretly returned to Gen Re through the commutation of certain unrelated agreements (NYAG's Rule 19-A Statement, ¶¶ 54-55; Exhibits 49-50, 182, annexed to the Smith Aff.).

This payment arrangement was reflected in Cologne Re's payment to National Union of \$15 million instead of the entire \$500 million premium, while the \$10 million premium payment was to be returned to Gen Re through the commutation of certain unrelated agreements at a subsequent point in time (*Id.*). According to the NYAG, in order to help conceal the fraud, a deceptive paper trail was created to make it appear as if Gen Re had asked AIG to purchase reinsurance, rather than AIG initiating the deal (*Id.*).

This secret pay-back arrangement between AIG and Gen Re was the subject of several e-mails between Ferguson, Milton, and Napier, and several other Gen Re executives between November 2000

and January 2001 (Exhibits 66, 166, annexed to the Smith Aff.). In a January 2001 e-mail, Napier writes to Milton that the "details to be worked out" regarding Cologne Re is "how to recover the fee we advance" (*Id.*).

The following month, Monrad writes in an e-mail to Napier and Houldsworth, that "Milton [of AIG] has had the opportunity to talk with [defendant] Howie Smith regarding the most efficient way to transfer the funds ... [AIG] intends for us to reinsure the cover back to AIG. AIG would then novate the agreement and leave GRC [Cologne Re] with \$15m [million]" (Exhibit 67, annexed to the Smith Aff.).

In a subsequent e-mail, Napier writes that under the payment structure suggested by Milton to fund the transaction, "we [Gen Re] will retain \$15m [million] which will be used to fund the Dublin [Cologne Re Dublin] transaction (including our fee for that transaction)" (Exhibit 68, annexed to the Smith Aff.).

Accounting for the Transaction

As to the accounting of the Gen Re Transaction, AIG was advised at a meeting held in late November or early December 2000 at its headquarters, and attended by Milton, Smith, Michael Castelli, AIG's controller,⁶ and several Gen Re executives, including Napier, that Gen Re was going to account for the transaction as a deposit (Exhibit 167, annexed to the Smith Aff., Napier Tes Tr 952-956).

⁶ Castelli reports directly to Smith (NYAG's Rule 19-A Statement, ¶¶ 57-58).

According to the NYAG, Smith directed that the Gen Re Transaction be booked as insurance for GAAP purposes, in order to increase AIG's loss reserves in accordance with Greenberg's motivation for initiating the transaction (NYAG's Rule 19-A Statement, ¶ 62).

Under GAAP accounting rules, set forth in the Statement of Financial Accounting Standards (FAS 113), in order to be booked as reinsurance, the transaction must involve a transfer of risk from the cedent (the company that transfers the risk) to the reinsurer (Exhibit 7, annexed to the Smith Aff.). Under FAS 113, if there is insufficient risk transfer or no intention to transfer risk, the transaction must be booked as a deposit, not as insurance (*Id.*). However, booking the transaction as a deposit does not affect loss reserves (*Id.*).

Thus, under GAAP accounting rules, without any risk of loss, the Gen Re transaction did not qualify, and should not have been booked, as insurance. Rather, it should have been booked as a "deposit," which would not have increased AIG's loss reserves.

The NYAG cites to an e-mail drafted by Frank Douglas, the chief actuary of AIG's domestic brokerage group (DBG), to Milton where he states that Smith, the senior authority on GAAP accounting, would have to decide how to book the Gen Re Transaction. Douglas also raised the possibility that there might be issues with booking the Gen Re Transaction as insurance (Exhibits 55-56, annexed to the Smith Aff.). This sentiment was echoed by Jay Morrow, another DBG senior actuary, who indicated

that it would have to be addressed by Smith (Exhibits 18, 197, annexed to the Smith Aff., Morrow Tr Tes 1917:9-12; Morrow Dep Tr 72).

During Paul Weiss' internal AIG investigation of the transaction, it was recorded that Smith stated in an interview that he understood the Gen Re Transaction was to "look like" risk was being transferred, and that "If deposit accounting had been required ... AIG would [not] have done the deal" (Exhibit 28, annexed to the Smith Aff.).

Lack of Underwriting

It was AIG's general business practice that, the larger the deal, the more actuarial involvement was required (Exhibit 19, annexed to the Smith Aff., Morrow Dep Tr 282-283). Nonetheless, no underwriting analysis was performed for the Gen Re Transaction.

Morrow, who testified that the Gen Re Transaction was one of the largest loss transfer portfolios that he had encountered in his twenty-seven years of experience at AIG, also stated that Milton did not request an actuarial review of the Gen Re Transaction (Exhibit 18, annexed to the Smith Aff., Morrow Tr Tes 1949:12-16, 1950:9-11). In Milton's interview with Paul Weiss, it was recorded that he indicated that there "isn't much more" by way of documentation for the deal (Exhibit 29, annexed to the Smith Aff., at 2).

Napier testified that, before acquiring the loss portfolio from Gen Re, AIG did not request any information relating to the

lines of business to be reinsured, the loss experience of the specific policies that AIG would be reinsuring, or any other facts, and thus, from his perspective, no underwriting analysis was performed (Exhibits 185-186, annexed to the Smith Aff., Napier Dep. Tr. 141:12-143:11; Napier Tr Tes 1787-89).

As a result of the Gen Re Transaction, AIG booked \$250 million in loss reserves for the fourth quarter of 2000 and another \$250 million for the first quarter of 2001, totaling \$500 million of fictitious reserves (NYAG's Rule 19-A Statement, ¶ 63). The transaction enabled AIG to conceal a trend of decreases in its loss reserves, that would have totaled \$187 million for the first quarter of 2001, and avert any further drops that might occur in the Company's stock price (*Id.*). By the end of the first quarter of 2001, AIG announced that its loss reserves had increased by approximately \$63 million (Exhibit 64, annexed to the Smith Aff.).

In a February 2001 AIG press release, Greenberg was quoted as boasting of the increase of \$106 million to AIG's general insurance net loss and loss adjustment reserves for the fourth quarter of 2000 and first quarter of 2001 (Exhibit 58, annexed to the Smith Aff.).

The increase in AIG's loss reserves was the subject of commentary and praise amongst an industry analyst, who noted that "AIG put to rest a minor controversy from last quarter by adding \$106 million to reserves" (Exhibits 60-63, annexed to the Smith Aff.). Greenberg cited the increase in AIG's loss reserves on a

call with Morgan Stanley analyst, Alice Schroeder, who testified both in this action and the Criminal Action (Exhibits 57, 62, 63, annexed to the Smith Aff., Schroeder Dep Tr 316:20-317:17, 319:1-9; Trial Tr 473, 475). According to Schroeder, AIG's 2001 press release and Greenberg's comments to her, in part, led Morgan Stanley to upgrade AIG's stock (*Id.*).

Commuting the Gen Re Transaction

Throughout 2002 to 2004, Gen Re and AIG executives discussed when to commute the Gen Re Transaction (NYAG's Rule 19-A Statement, ¶¶ 80-85). According to the deposition testimony of Douglas and Jacobson, the CFO of DBG, Greenberg was directly involved in discussions in 2003 and 2004 about disclosure issues that would have resulted from the commutation of the Gen Re Transaction (Exhibits 87, 88, annexed to the Smith Aff., Jacobson Dep Tr 156:7-23; Douglas Dep Tr 302:7-303:3; 319:4-320:8; 324:7-325:14; 324:21-325:25).

Although Gen Re had the unilateral right to commute the transaction all at one time (Exhibit 1, annexed to the Dwyer Supp Aff., Greenberg Dep Tr 90:19-22), it agreed to commute in two tranches. In late 2004, one tranche of the Gen Re Transaction was commuted, that reduced premiums and reserves for losses and loss expenses by \$250 million in the fourth quarter of 2004, that is reflected in an internal AIG memo written by Morrow to defendant Smith (Exhibit 93, annexed to the Smith Aff.).

AIG Restates its Financial Statements

In February 2005, AIG received subpoenas from the Office of the Attorney General (OAG) and the Securities and Exchange Commission (SEC) relating to investigations of non-traditional insurance products and reinsurance transactions, including the Gen Re Transaction (Exhibit 96, annexed to the Smith Aff.). It was at this time that AIG retained Paul Weiss to perform an internal investigation into the Gen Re Transaction, and requested that PricewaterhouseCoopers (PwC) conduct an expanded audit.

According to a senior auditor for PwC, when he began to examine the Gen Re Transaction in 2005, Greenberg, in an "argumentative tone" tried to convince him to ignore or downplay the deal, suggesting that it was "much ado about nothing" (Exhibit 95, annexed to the Smith Aff., Winograd Dep Tr 423:7-14, 427:12-25, 428:10-14).

In early March 2005, AIG issued a press release, and stated that it had concluded that the "Gen Re transaction documentation was improper and, in light of the lack of evidence of risk transfer, these transactions should not have been recorded as insurance" (Exhibit 96, annexed to the Smith Aff.).

On March 11, 2005, Greenberg transferred 41,399,802 shares of AIG common stock to his wife, valued at the time in excess of \$2 billion. Greenberg admits to the transfer, but insists that it was done for estate planning purposes, and that it was later reversed (Greenberg's Response to NYAG's Rule 19-A Statement, ¶ 91).

Several days later, defendants resigned as AIG's CEO and CFO, respectively, and AIG terminated Milton's employment. Subsequent to their resignation, defendants went on to lead C.V. Starr & Co., Inc., a global insurance and investment holding company, where Milton was offered employment within days of his termination.

Defendants' explanation for the events surrounding their departure from AIG is merely to contend that Greenberg retired as Chairman and CEO of AIG as the result of public attacks by then New York Attorney General Eliot Spitzer.

On April 12, 2005, Greenberg appeared for an examination as part of the OAG's investigation, but refused to answer substantive questions concerning the Gen Re Transaction and invoked his Fifth Amendment privilege, a decision that his counsel publicized in an open letter to the Wall Street Journal (Exhibit 100, annexed to the Smith Aff.). Smith refused to answer questions relating to both the Gen Re and CAPCO Transactions.

On May 31, 2005, AIG restated its financials for the years 2000 through 2004, in which it revisited and reversed certain accounting decisions, including with respect to the Gen Re and CAPCO Transactions (NYAG's Rule 19-A Statement, ¶ 89; Exhibit 11, annexed to the Dwyer Opp Aff).

During the course of discovery in this action, defendants invoked their Fifth Amendment privilege and refused to testify with respect to the Gen Re Transaction. Subsequent to the close

of discovery and after the parties fully briefed competing summary judgment motions, defendants sought to revoke their previous invocations and testify, after the statute of limitations on certain parallel investigations against them had lapsed, which was granted by this Court on consent of the NYAG (Exhibit 5, annexed to the Dwyer Supp Aff).

In their depositions, both defendants deny having any knowledge that the Gen Re Transaction did not involve sufficient risk transfer, or was structured in such a manner as to boost reserves on AIG's books (Exhibit 2, annexed to the Dwyer Supp Aff, Greenberg Dep Tr 226:12-14, 30:10-32:2, 32:10-22, 48:24-49:3, 118:15-119:19, 77:10-16, 81:20-82:15; Exhibit 2, annexed to the Sama Opp Aff, Smith Dep Dr 36:3-9;116:9-117:9; 117:10-118:6).

Settlements with Regulatory Agencies and the Gen Re Criminal Trial

In January 2006, AIG settled fraud allegations made by the OAG and the SEC concerning, among others, the Gen Re Transaction, and agreed to pay \$800 million in fines and penalties.

The following month, Ferguson, Gen Re's CEO, Graham, Gen Re's former assistant general counsel, Monrad, Gen Re's former CFO, Garand, Gen Re's former senior vice president and chief underwriter, Houldsworth, Cologne Re's CEO, Napier, and Milton, AIG's former senior vice president and head of reinsurance, were indicted on charges that they committed conspiracy, securities fraud, making false statements to the SEC, and wire and mail

fraud in connection with the Gen Re Transaction (Exhibits 8, 101, annexed to the Smith Aff.) (*U.S. v Ferguson*, 584 F Supp 2d 447 [D Conn 2008]).

Houldsworth and Napier both pled guilty to participating in a conspiracy to commit securities fraud for their role in the Gen Re transaction.

On February 25, 2008, Milton and all four of the former Gen Re executives were convicted on all counts. They are currently appealing their sentences.

In early 2010, Gen Re settled with the SEC for \$12.2 million, and with the Department of Justice for \$19.5 million. In its settlement, Gen Re admitted that it had assisted AIG to commit fraud⁷ (Exhibit F, annexed to the Smith Aff.).

The CAPCO Transaction

The second transaction at issue in this case involves defendants' attempts to fraudulently conceal over \$200 million in

⁷ In the settlement, Gen Re stated:

"[As] an accommodation to AIG, one of its largest purchasers of reinsurance, [Gen Re] agreed to undertake a transaction [that] . . . nominally exposed AIG to \$600 million in potential loss for a premium of \$500 million. . . . In truth . . . (1) **AIG's management did not seek to bear any real risk under the LPT** [loss portfolio transaction]; (2) **AIG in fact would not and did not bear any real reinsurance risk under the LPT**; (3) AIG would and did [return] the premium through an apparently unrelated transaction; (4) ...; and (5) AIG would and did provide Gen Re with an accommodation fee of \$5 million, also via an apparently unrelated transaction, that was not documented in the sham formal LPT contract" (emphasis added) (*Id.*).

underwriting losses that AIG incurred in an auto warranty insurance program.

Beginning in the early 1990s, various AIG subsidiaries wrote auto insurance (NYAG's Rule 19-A Statement, ¶ 105). In late 1999, an actuarial consultant retained by AIG to analyze projected losses in the program concluded that AIG was facing an underwriting loss ratio of 265% (*Id.*, ¶ 108).

At the time, Greenberg directed that an internal AIG audit division undertake a special review of the auto warranty business, and explored ways to mitigate projected losses (NYAG's Rule 19-A Statement, ¶ 114; Greenberg's Response to NYAG's Rule 19-A Statement, ¶ 116). Greenberg himself described the auto warranty program as a "major loser," with "horrendous results," which was "poorly administered, [and] poorly thought through" (Exhibits 110, 117, annexed to the Smith Aff., Greenberg Dep Tr 38:4, 103:6-10, 297:19-21).

In an internal AIG memorandum, Greenberg cautioned that "[r]einsuring the [auto warranty] book to get it off our back is not a solution. No one is going to reinsure it at terms that would be satisfactory ... there are better ways of handling it than a simply reinsurance approach. [C]ontinue to pursue every avenue of recovering excess losses" (Exhibit 119, annexed to the Smith Aff.).

According to the NYAG, the "better approach" conceived of by defendants was to hatch a plan to conceal the debacle of the auto warranty program by converting the underwriting losses into a

capital loss, and was purportedly outlined in a December 1999 memo authored by Smith to another AIG executive (Exhibit 120, annexed to the Smith Aff.).⁸

In the memo, Smith proposes:

"[To] swap this [auto warranty] book of business for investments of a Japanese Company which are in an unrealized loss position of \$210 million. The investments could be removed from the Japanese entity's books upon reaching an agreement with us while the warranty loss could be absorbed over a longer period of time. We could conceivably give the entity a note in payment for the investments and the payout terms of the note could roughly correspond to the warranty loss payouts" (Exhibit 120, annexed to the Smith Aff.).

Smith concludes the memo by stating that "[d]iscussion of this deal should be limited to as few people as possible" (*Id.*).

While Smith does not deny authoring this memo, he contends that the plan outlined therein was never effectuated. However, according to the NYAG, this memo outlines the plan that became known as the CAPCO transaction (CAPCO Transaction).

According to the testimony of Joseph Umansky,⁹ senior vice president of AIG and president of AIG reinsurance advisors, Smith designated him to be the "point man" to execute the proposition

⁸ According to the NYAG, underwriting and capital investments are two distinct measures of financial performance with different implications to the operations of an insurance company. Underwriting measures the profitability of a general insurance company in its core business operation -- writing insurance. Over the years, AIG repeatedly told investors that underwriting performance was "the true measure of the performance of ... a general insurance company." Capital losses, in contrast, were not deemed to be "integral" to AIG's operations (NYAG's Rule 19-A Statement).

⁹ Umansky appeared for a deposition prior to the filing of the Complaint, pursuant to a Martin Act subpoena.

outlined in Smith's memo (Exhibit 122, annexed to the Smith Aff., Umansky Dep Tr 72:11-25, 73:2-25).

Umansky outlined his proposed plan to defendants in an April 2000 memo, and asked for his reaction before he proceeded (Exhibit 123, annexed to the Smith Aff.). The memo contemplates AIG's formation of an offshore single purpose entity and relies upon the same auto warranty loss projections set forth in Smith's December 1999 memo:

"Our objective was to convert an underwriting loss into a capital loss ... AIG forms an off-shore reinsurer and reinsures the warranty book into that wholly-owned subsidiary. AIG then sells the subsidiary through a series of partial sales, thus recognizing a capital loss. As the warranty losses emerge they are recognized in this off-shore company that is not consolidated as part of AIG ... The accounting is aggressive and there will be a significant amount of structuring required in order to address all the legal, regulatory and tax issues"¹⁰ (*Id.*).

With defendants' mandate, Umansky learned that Western General Insurance Ltd. (West Gen), an insurance company that frequently did business with AIG, was planning on liquidating its subsidiary, CAPCO Reinsurance Company (CAPCO) (Exhibit 122, annexed to the Smith Aff., Umansky Dep Tr 49:2-12). Umansky approached the president of West Gen, who agreed to sell CAPCO to AIG (*Id.*).

¹⁰ Umansky described to Defendants in a confidential memo in November 2000 the structure of the CAPCO transaction, that is "designed to cover \$210 million of losses through a unique structure. The cash has been transferred into the structure and is shown on our balance sheet as assets; nothing has yet been charged to expense. The expectation is that as the losses developed and are recovered from the reinsurer, a capital loss will be recognized" (Exhibit 173, annexed to the Smith Aff.).

As reflected in a July 2000 letter addressed to West Gen's president, John Marion, West Gen agreed to purchase \$1 million of CAPCO common stock as a non-affiliated purchaser, and for compensation for its "continued participation in Capco." Meanwhile, AIG agreed to make a "market value adjustment" of \$1,030,000 for the commutation of a separate reinsurance treaty between AIG and West Gen (Exhibit 131, annexed to the Smith Aff.).

At Greenberg's suggestion, Umansky then contacted the president of AIG Private Bank, Eduardo Leemann, to assist in identifying investors to purchase the remainder of CAPCO's common stock (Exhibits 110, 122, annexed to the Smith Aff., Umansky Dep Tr 41:7-12; Greenberg Dep Tr 187: 24-28, 188: 2).

Shortly thereafter, Smith authorized AIG subsidiary, American International Reinsurance Company (AIRCO), to purchase \$170 million of CAPCO preferred stock (8,500 shares) (Exhibits 124-25, annexed to the Smith Aff.). CAPCO then agreed to reinsure National Union, an AIG subsidiary, as lead for the auto warranty pool on AIG's auto warranty business, pursuant to an "aggregate loss ratio agreement" (Exhibit 128, annexed to the Smith Aff.).

According to the NYAG, AIG's control of CAPCO was masked by the use of three strawman investors that Leemann identified, whose equity interests in CAPCO were entirely financed on a non-recourse basis by an AIG subsidiary, AIG Capital Corp., pursuant to a promissory note (Exhibit 134, annexed to the Smith Aff.).

In exchange for their investment in CAPCO, AIG agreed to pay the three investors "consulting/advisory fees" of \$100,000 payable in proportion to each investors' ownership of CAPCO common stock, as reflected in an e-mail from Umansky to Leemann (Exhibit 135, annexed to the Smith Aff.). The subscription agreement between CAPCO, West Gen and the three Swiss investors prohibited CAPCO from engaging in any other business other than reinsuring National Union (Exhibit 136, annexed to the Smith Aff.).

AIG "invested" enough funds in CAPCO, through AIRCO's purchase of the entirety of CAPCO preferred stock, in order to cover AIG's projected auto warranty underwriting loss, which CAPCO, in turn, "reinsured" for a nominal premium (NYAG's Rule 19-A Statement, ¶¶ 140, 142, 148).

Without the funds invested by AIG through AIRCO, which represented approximately eighty-nine percent of CAPCO's total capitalization, CAPCO would not have had enough assets to pay the loss reinsured by CAPCO (*Id.*). As CAPCO paid claims under the reinsurance agreement,¹¹ AIG reported an underwriting gain that offset the auto warranty underwriting losses that CAPCO assumed.

AIG gradually sold off its interest in CAPCO for a fraction of the value of its investment, leaving CAPCO, a shell company,

¹¹ For the year ending December 31, 2000, National Union ceded a \$73,184,000 auto warranty loss to CAPCO (Exhibit 137, annexed to the Smith Aff.). In March 2002, National Union ceded a \$55,432,000 auto warranty loss to CAPCO (Exhibit 141, annexed to the Smith Aff.).

with the underwriting losses and AIG with a purported capital loss.¹²

According to the NYAG, for the year ending December 31, 2000, AIG booked a purported \$83,729,000 underwriting gain as the result of the CAPCO transaction (NYAG's Rule 19-A Statement, ¶ 170). For the year ending December 31, 2001, AIG realized a capital loss of \$66 million (NYAG's Rule 19-A Statement, ¶ 189).

In September 2002, Umansky sent defendants a memo indicating that "CAPCO will be liquidated by year-end, AIG contracts in CAPCO will be commuted or novated." Several weeks later, National Union and CAPCO cancelled the agreement between them for a \$130 million settlement (Exhibits 152-153, annexed to the Smith Aff.). This cancellation released CAPCO from any further obligation to reinsure the auto warranty business (*Id.*).

Several months later, AIG released the three Swiss investors from the promissory note that they had executed (Exhibit 156, annexed to the Smith Aff.). The Swiss investors never made a single payment to AIG on the notes (NYAG's Rule 19-A Statement, ¶ 199).

The NYAG asserts that the CAPCO Transaction had no economic substance or purpose other than to conceal underwriting losses incurred by AIG in the auto warranty program, while still

¹² For instance, in late December 2000, AIRCO sold 1,600 shares of CAPCO preferred stock to West Gen for \$2 million, which had been purchased several months earlier for \$32 million (Exhibits 139-40, annexed to the Smith Aff.). West Gen immediately bought back the shares for \$2,010,000 (Exhibits 179-80, annexed to the Smith Aff.).

remaining liable to pay such losses, by converting the underwriting losses into investment losses, which the stock market would perceive as less serious.

Revelation of the structure and purpose of the CAPCO Transaction caused the lead engagement partner for PwC involved in AIG's audit to call it "one of the sleaziest" (Exhibit 95, annexed to the Smith Aff., Winograd Dep Tr 324:20).

When AIG restated its financials in 2005, it acknowledged that the CAPCO Transaction "involved an improper structure created to recharacterize underwriting losses related to auto warranty business as capital losses" (Exhibit 11, annexed to the Dwyer Opp Aff).

Defendants do not dispute many of the key details of the CAPCO transaction. In fact, both defendants defend their approval of the CAPCO Transaction, testifying that Umansky assured them that the transaction would be structured properly to comply with all legal, accounting and regulatory guidelines (Exhibits 1, 3, annexed to the Dwyer Aff., Exhibit 2, annexed to the Sama Supp Aff Off, Greenberg Dep Tr 218:8-20; Smith Dep Tr 113:20-21, 263:25-264:8, 248:7-24, 264:9-25, 265:2-23, 290:16-23, 313:2-10, 18-24, 314:6-13, 339:6-22, 318:22-319:7).

Analysis

The NYAG moves for partial summary judgment as to liability against defendants on its claims for violations of the Martin Act and Executive Law § 63 (12). According to the NYAG, the evidentiary record establishes defendants' participation and

actual knowledge to the bona fides of the fraudulent Gen Re and CAPCO Transactions, for which they should be found personally liable.

In opposition and in support of their own motions for summary judgment, defendants assert that the transactions were immaterial as a matter of law. In addition, they argue that there is no admissible evidence that they were involved in, or had knowledge of any impropriety with respect to the Gen Re and CAPCO Transactions, and reasonably believed that the transactions were proper.

Preemption

Plaintiffs assert that federal securities laws preempt any state securities laws that lack scienter, which the Court will address at the outset.

The Martin Act, Article 23-A of the General Business Law (GBL), New York's Blue Sky Law, makes it unlawful for any person to engage in misleading or fraudulent practices in connection with the promotion or sale of securities (GBL § 352-c). The Martin Act authorizes the NYAG to investigate and bring a civil enforcement action in the name of, and on behalf of, the people of the State of New York to protect the investing public as a whole, and to redress harm suffered by investors as the result of statutory violations (*People v Coventry First LLC*, 13 NY3d 108, 114, *rearg denied* 13 NY3d 758 [2009]; *State v 7040 Colonial Road Assocs. Co.*, 176 Misc 2d 367, 369-370 [Sup Ct, NY County 1998]).

Under the Executive Law, the NYAG is authorized to bring a claim against any person or entity that engages in repeated or persistent fraudulent or illegal acts in the carrying on of the transaction of business (*State v First American Corp.*, 76 AD3d 68 [1st Dept 2010]).

Under both the Martin Act and Executive Law § 63 (12),¹³ the NYAG is not required to demonstrate scienter in order to sustain civil liability for a violation, although the test for fraud differs slightly under both statutes (*State v Rachmani Corp.*, 71 NY2d 718, 725 fn 6 [1988]; *People v General Electric Co.*, 302 AD2d 314, 314-15 [1st Dept 2003]; *State v Sonifer Realty Corp.*, 212 AD2d 366, 367 [1st Dept 1995]; *People v Apple Health and Sports Clubs, Ltd., Inc.*, 206 AD2d 266, 267 [1st Dept], *lv dismissed, lv denied* 84 NY2d 1004 [1994]).

In order to establish a violation under the Martin Act, the NYAG is required to demonstrate that the challenged act or practice was misleading in a material way (*Id.*; *People v Sala*, 258 AD2d 182, 193 [3d Dept 1999], *lv granted* 94 NY2d 799, 94 NY2d 925, *affirmed* 95 NY2d 254 [2000]; Cons Laws of NY, Book 19, General Business Law Art. 23-A, 32-33). The elements of a claim under Executive Law § 63 (12) are nearly identical to a Martin Act claim (see *State v Interstate Tractor Trailer Training, Inc.*, 66 Misc 2d 678, 682 [Sup Ct, NY County 1971]; see also *People*, 302 AD2d at 314).

¹³ Defendants argue that the claim under the Executive Law is derivative of the claim under the Martin Act, and otherwise, treat the claims as equivalent.

The NYAG asserts that defendants are personally liable under the Martin Act and Executive Law based upon evidence that they personally initiated, approved and implemented the Gen Re and CAPCO Transactions that were structured in such a manner as to deceive the investing public about AIG's reserves (Gen Re), and the extent of its underwriting losses (CAPCO).

Defendants assert that, unless the NYAG's claims incorporate scienter as an element of liability, the claims for violations of the Martin Act and the Executive Law are expressly preempted by the National Securities Markets Improvement Act of 1996 (NSMIA). Moreover, defendants contend that the structure and purpose of federal securities laws demonstrates a congressional intent to entirely dominate the area and to dictate the terms and conditions of liability in the field.

In opposition, the NYAG maintains that, in adopting the NSMIA, Congress did not intend to affect state Blue Sky laws. Further, the NYAG asserts that, even assuming that defendants are correct, the record supports an inference that defendants had sufficient access to information to establish actual knowledge of the fraud.

In determining whether federal law preempts a state statute, a court's sole task is to ascertain the intent of Congress (*California Fed. Sav. & Loan Assoc. v Guerra*, 479 US 272, 280 [1987]; *Balbuena v IDR Realty LLC*, 6 NY3d 338, 356 [2006]). To discern the existence and scope of congressional intent to preempt a state law, a court must look to the statutory language

and legislative framework, in addition to the structure and purpose of the statute as a whole (*Caprotti v Town of Woodstock*, 94 NY2d 73, 82 [1999], *cert denied* 529 US 1108 [2000]).

In the absence of an express congressional command, state law is preempted if the law actually conflicts with federal law, or where federal law so thoroughly occupies a legislative field "as to make reasonable the inference that Congress left no room for the States to supplement it" (*Balbuena*, 6 NY3d at 356).

The NSMIA, codified at 15 USC § 77r (a) (2) (B), expressly preempts any state law that "directly or indirectly prohibit[s], limit[s], or impose[s] any conditions upon the use of ... any proxy statement, report to shareholders, or other disclosure document relating to a covered security" registered under 15 USC §78o-3.

The purpose of the NSMIA is to preempt state Blue Sky laws which require issuers to register securities with state authorities prior to marketing in the state, in recognition of the redundancies and inefficiencies inherent in such a system, and to preclude states from requiring issuers to register or qualify certain securities with state authorities (House Report of Committee on Commerce, HR Rep 104-622, 104th Cong, 2d Sess at 16 [1996]).

In order to accomplish this objective, the NSMIA precludes states from imposing disclosure requirements on prospectuses, traditional offering documents, and sales literature relating to

covered securities (*Zuri-Invest AG v Natwest Finance, Inc.*, 177 F Supp 2d 189, 192 [SD NY 2001]).

Nonetheless, the savings clause contained in the NSMIA is quite clear in its direction that Congress did not intend to supplant the police power of states in regulating fraudulent conduct in the field of securities:

"Consistent with this section, the securities commission (or any agency or office performing like functions) of any state shall retain jurisdiction under the laws of such State to investigate and bring enforcement actions with respect to fraud or deceit, unlawful conduct by a broker or dealer, in connection with securities or securities transactions" (emphasis added) (15 USC 77r [c]).

The legislative history of the NSMIA confirms the conclusion that Congress did not intend to supplant state enforcement actions in the realm of securities.

According to the Conference Committee,

"This preservation of authority [contained in the savings clause] is intended to permit state securities regulators to continue to exercise their police power to prevent fraud and broker-dealer sales practice abuses, such as churning accounts or misleading customers. It does not preserve the authority of state securities regulators to regulate the securities registration and offering process through the commenting on and/or imposing requirements on the contents of prospectuses or other offering documents" (Conference Report, H.R. Conf. Rep. 104-864, 104th Cong., 2d Sess. at 40 [1996], reprinted in 1996 USCCAN 3920, 3921).

The House Report of Committee on Commerce stated:

"[Congress] did not intend ... that the extension of the prohibition to indirect actions by State regulators restrict or limit their ability to investigate, bring actions or enforce orders, injunctions, judgments or remedies based on alleged violations of State laws that prohibit fraud and deceit ... in connection with securities or securities transactions ... [R]ather than being burdened with the time-consuming task of conducting a second review of investment company offering and sales materials, State regulatory

authorities will be free to spend more time investigating customer complaints, broker-dealer sales practice problems, and related issues ... It is also the Committee's intention not to alter, limit, expand, or otherwise affect in any way any State statutory or common law with respect to certain securities offerings" (emphasis added) (House Report of Committee on Commerce, HR Rep 104-622 at 30-31, 34).

In light of this exploration of the NSMIA's statutory language and legislative purpose, the Court rejects outright defendants' assertion that the NYAG's claims are expressly preempted. Defendants can point to no language in the NSMIA that indicates an intent to preempt the authority of states to bring enforcement actions under state Blue Sky laws that do not seek to impose disclosure requirements in prospectuses, offering documents and sales literature relating to covered securities (accord *Houston v Seward & Kissel, LLP*, 2008 WL 818745, *4-5 [SD NY 2008]; *Zuri-Invest AG*, 177 F Supp 2d at 194; *State v McLeod*, 12 Misc 3d 1157[A], *14 [Sup Ct, NY County 2006]; *State v Justin*, 3 Misc 3d 973, 998-1004 [Sup Ct, Erie County 2003]).

In fact, a plain reading of the statute and exploration of legislative history demonstrates that the NSMIA's preemption of state Blue Sky laws is quite limited. Its savings clause embodies a congressional intent to preserve states' traditional authority to prosecute fraudulent conduct in securities transactions.

Further, where Congress expressly defines a statute's preemptive reach and the definition provides a "reliable indicium" of congressional intent as to what should be left to state authority, there is a "reasonable inference" that Congress

did not intend to preempt matters beyond that reach (*Freightliner Corp. v Myrick*, 514 US 280, 288 [1995]). This is based upon the well-established principle of *expressio unius est exclusio alterius*: the mention of one thing implies the exclusion of the other (*Cipollone v Liggett Group, Inc.*, 505 US 504, 517 [1992]; *Zuri-Invest AG*, 177 F Supp 2d at 194).

Thus, Congress' silence as to the definition of fraud and deceit in the NSMIA does not infer any intent on its part to restrict the scope of state Blue Sky laws' definition of fraud, but rather a deliberate choice as to what lies beyond preemptive reach, with which the courts should not interfere.

In addition, the structure and purpose of federal securities laws do not demonstrate a federal intent to entirely dominate the field, in which Congress has chosen not to include broad preemptive language, particularly with respect to state enforcement actions.

For instance, in 1998, Congress passed the Securities Litigation Uniform Standards Act (SLUSA) in order to preempt private securities class action lawsuits involving nationally traded securities, while expressly preserving the enforcement powers of State securities regulators to investigate and bring enforcement actions (PL 105-353).

While the purpose of SLUSA is to stem the shift in private securities class-action litigation from federal to state courts, and to prevent certain state private securities class action lawsuits alleging fraud from being used to frustrate the

objectives of the Private Securities Litigation Reform Act, its application is limited to holders, purchasers and sellers of securities (*RGH Liquidating Trust v Deloitte & Touche LLP*, 71 AD3d 198 [1st Dept 2009]; see generally *Merrill Lynch, Pierce, Fenner & Smith Inc. v Dabit*, 547 US 71, 82 [2006]; *Lander v Hartford Life & Annuity Ins. Co.*, 251 F 3d 101, 107-08 [2d Cir 2001]; *Houston*, 2008 WL 818745 at *5).

In 2002, Congress enacted the Sarbanes-Oxley Act (SOX Act), after a series of "celebrated accounting debacles." The SOX Act introduces tighter regulation of the accounting industry by increasing the criminal penalties for securities fraud, changes the Bankruptcy Code to make judgments and settlements based upon securities law violations non-dischargeable, extends the limitations period for discovery of facts constituting a Rule 10b-5 claims, and provides for a private remedy for terminated whistle-blower employees (see generally *Free Enterprise Fund v Public Co. Accounting Oversight Board*, US, 2010 WL 2555191 [2010]¹⁴).

As with the NSMIA and SLUSA, nothing in the text, legislative history, or structure of the SOX Act demonstrate an intent on Congress' part to occupy the entire legislative field with respect to the scope of state Blue Sky laws aimed at

¹⁴ The Supreme Court recently ruled that portion of the SOX Act that created a regulatory board appointed by the SEC to investigate and discipline members is unconstitutional to the extent that the President is deprived of adequate control over the board (*Id.*).

remedying fraudulent conduct (see S Rep 107-146 [2002]; 148 Cong. Rec. S7418-01, S7419).

In sum, Congress and the courts, including the Supreme Court, have repeatedly recognized state authority to regulate and enforce its own fraud statutes in the securities realm independent of federal law (see *Stoneridge Investment Partners, LLC v Scientific-Atlanta, Inc.*, 552 US 148, 163-167 [2008]).

Otherwise, there is no conflict between the federal securities scheme and the NYAG's application of the Martin Act, in this regard. Rather than undermining the purpose and effect of the NSMIA or interfering with its regulatory mandate, New York's enforcement of the Martin Act is entirely consistent with, and actually reinforces the remedial purpose of federal securities laws, including the NSMIA, which is to deter fraudulent practices in the securities realm (see *People v Landes*, 84 NY2d 655, 661-62 [1994]; *All Seasons Resorts v Abrams*, 68 NY2d 81, 86-7 [1986]).

Therefore, the Court rejects defendants' contention that federal law preempts the NYAG's claims under the Martin Act and Executive Law to the extent that the claims do not contain the element of scienter.

Admissibility

A critical part of defendants' arguments in opposition to the NYAG's motion for partial summary judgment and in support of their own motions for dismissal is that testimony and evidence from other proceedings, including the Martin Act interviews

conducted by the NYAG before the Complaint was filed, and testimony from the Criminal Trial cannot be relied upon by the NYAG in support of its motion for summary judgment. Defendants specifically take issue with the use of the deposition of Umansky, President of AIG Reinsurance Advisors, who was interviewed in May 2005 by the OAG pursuant to a Martin Act subpoena prior to the commencement of this action (Exhibit 122, annexed to the Smith Aff.).

Defendants assert that testimony adduced from those proceedings is inadmissible as prior testimony or hearsay, and is not properly considered as proof on a motion for summary judgment. Defendants point out that they were not parties charged with a criminal offense in the Criminal Action, and were not afforded the opportunity to cross-examine the witnesses whose testimony is being used against them. This Court disagrees.

Depositions and documents obtained by the Attorney General in the course of a Martin Act investigation are allowable as supporting proof on a motion for summary judgment (see *State v Metz*, 241 AD2d 192, 198-201 [1st Dept 1998]).

First, Umansky provided testimony under penalty of perjury, upon being advised of his right to invoke the privilege against self incrimination, and of his right to have counsel present (Exhibit 265, annexed to the Smith Aff., Umansky Dep Tr3:24-25, 4:2-25). To this extent, his testimony is, as is testimony given in the Criminal Trial, "arguably far more reliable than an affidavit" (*Metz*, 241 AD2d at 200).

Indeed, the First Department in *Metz* (*Id.*) specifically held that depositions obtained pursuant to Martin Act subpoenas were clearly admissions of those deponents and allowable as supporting proof on a motion for summary judgment under CPLR 3212 [b] (*Metz*, 241 AD2d at 199).

Additionally, it must be noted that, although they deposed numerous other witnesses over the course of four years of discovery in this action, many of whom who had only marginal connection to the Gen Re or CAPCO transactions, defendants chose not to depose Umansky. Thus, it certainly cannot be said that defendants did not have an adequate opportunity to confront him regarding his testimony. In any event, the statement of an unexamined witness, including Umansky, can be countered by submitting opposing affidavits or other proof (*Id.*), which defendants have attempted.

Notwithstanding clear First Department precedent on the issue, federal courts similarly and consistently permit the use of interview transcripts, depositions, and documentary exhibits obtained in the course of an SEC investigation as proof on motions for summary judgment on the same basis as other competent deposition or affidavit testimony (*see e.g. Securities and Exchange Commission v Research Automation Corp.*, 585 F 2d 31, 33-34 [2d Cir 1978]; *Securities and Exchange Commission v Lowery*, 633 F Supp 2d 466, 477 [WD Mich 2009] ["in ruling on summary judgment, it is entitled to consider sworn testimony given by (defendant) and others in the course of the SEC's investigation

on the same basis as other competent deposition or affidavit evidence"]; see also *Securities and Exchange Commission v Phan*, 500 F 3d 895, 912-13 [9th Cir 2007]).

Therefore, the Martin Act deposition of Umansky is properly considered. In addition, under some circumstances, sworn testimony from prior proceedings that involve different parties may be offered as supporting proof on a summary judgment motion.

First, it is undisputed that defendants had the opportunity to cross-examine the witnesses concerning the testimony that they gave at the Criminal Trial, with the exception of one witness, John Houldsworth, and that defendants themselves were questioned about the substance of the testimony that these witnesses gave¹⁵ (see *DiGiantomasso v City of New York*, 55 AD3d 502, 502-03 [1st Dept 2008]).

Further, with the exception of Houldsworth, testimony from the Criminal Trial is being offered by the NYAG largely to substantiate the testimony that these identical witnesses have already given in this action.¹⁶ Defendants extensively deposed these witnesses and numerous others during the course of discovery in this action.

¹⁵ For instance, Greenberg was specifically questioned at his deposition concerning Napier's testimony at the Criminal Trial (Exhibit A, annexed to the Smith Aff., Greenberg Dep Tr 45:5-25, 46:2-18).

¹⁶ Incidentally, Defendants themselves affirmatively rely on testimony from the Criminal Trial and other purported hearsay documents, including e-mail correspondence, memos and AIG's financial statements (See e.g. Smith's Opp Br at 6, 8, 9, 13, 16, 19-21, 24-25, 29).

For instance, counsel for defendants examined Napier, whose testimony was characterized by Judge Droney as "credible and critical in the convictions of the five defendants,"¹⁷ for over four days, while Napier was subject to cross-examination on the same subject matter for numerous days in the Criminal Action.

Defendants' reliance on *Crawford v Washington* (541 US 36 [2004]) in opposition is misplaced. *Crawford* involved the admissibility of an out-of-court recorded statement at trial under a defendant's Sixth Amendment right to be confronted by adverse witnesses in a criminal proceeding. It did not involve the use of prior deposition or affidavit testimony submitted as proof on a motion for summary judgment. The Supreme Court did not discuss the proof that is properly considered on motions for summary judgment. Nor did the Supreme Court, as defendants erroneously suggest, hold that a summary judgment motion may only be supported by deposition or affidavit testimony when a defendant has cross-examined the witness.

Moreover, our courts have recognized that proof which may be inadmissible at trial may, nevertheless, be considered on a motion for summary judgment (*Metz*, 241 AD2d at 198). Thus, even if deemed to be inadmissible as hearsay as to defendants at trial, the testimony of prior proceedings is properly considered on the parties' competing summary judgment motions, along with the admissible deposition and affidavit testimony from this action that corroborates it, so long as it is not the sole basis

¹⁷ Exhibit 263, annexed to the NYAG's Reply Brief, 20:24-21:12.

for the Court's determination (*DiGiantomasso*, 55 AD3d at 502-03; *In re New York City Asbestos Litig.*, 7 AD3d 285, 285-86 [1st Dept 2004]; *State*, 241 AD2d at 197; *Navedo v 250 Willis Ave. Supermarket*, 290 AD2d 246, 247 [1st Dept 2002]; see also *Josephson v Crane Club, Inc.*, 264 AD2d 359, 360 [1st Dept 1999]).

In the absence of being accompanied by other direct evidence, hearsay evidence may be considered on a motion for summary judgment if it falls within a hearsay exception (see e.g. *Commercial Ins. Co. of Newark, New Jersey v Popadich*, 68 AD3d 401, 402 [1st Dept 2009] [statements made by a witness after his arrest, which were signed to and made under penalty of perjury, were admissible against another individual as a declaration against interest, which may be introduced by or against any one]; *Jara v Salinas-Ramirez*, 65 AD3d 933, 933-34 [1st Dept 2009] [testimony was admissible on summary judgment motion that fell under "present sense impression" exception to hearsay rule]; *Buckley v J.A. Jones/GMO*, 38 AD3d 461, 462 [1st Dept 2007] [accident report that may be admissible at trial as a business record may be considered as proof on a summary judgment motion]; *Fruit and Vegetable Supreme, Inc. v The Hartford Steam Boiler Inspection and Ins. Co.*, 28 Misc 3d 1128 [Sup Ct, Kings County 2010] [government reports had sufficient independent indicia of reliability to justify its admission on a motion for summary judgment as a business record]).

Defendants also argue that AIG's revision of its earlier financial statements (the "Restatement") for the years 2000

through 2004, issued in May 2005, in which AIG acknowledged the fraudulent Gen Re and CAPCO transactions (by revisiting and reversing many of its wrongful accounting decisions), cannot be used to support a motion for summary judgment, because it does not qualify as a business record that can be admitted under CPLR 4518. Greenberg also argues, somewhat surprisingly, that the Restatement is not "relevant" to the NYAG's fraud claim.

In support of his opposition, Greenberg cites one relevant case, although it is hardly persuasive. In the unreported case of *S.E.C. v Todd* (2006 WL 5201386 [SD Cal 2006]), the California Court, upon one of many motions in limine before trial, held that certain restatements and re-restatements were not reliable nor probative enough to be admitted into evidence, but relevant testimony regarding the restatements were. The court's only discernable reason for the exclusion was that the existence of a 2003 re-restatement was some indication that an earlier 2001 restatement was unreliable.

Here, there was no re-restatement on the part of AIG. Furthermore, financial statements and revisions of financial statements are routinely admissible under CPLR 4518 as a business record prepared in the regular course of business, and thus, are properly considered as supporting proof as a motion for summary judgment (see e.g. *Niagara Frontier Transit Metro Sys., Inc. v County of Erie*, 212 AD2d 1027 [4th Dept 1995]; *International Systems, Div. of Interedec Inc. v Delcrete Corp.*, 103 AD2d 1008, 1009 [4th Dept 1984] [financial statements which were prepared by

the corporate defendants in the regular course of business were admissible as business records under CPLR 4518]; see also *DeLeon v Port Authority of New York and New Jersey*, 306 AD2d 146, 146-47 [1st Dept 2003]).

Greenberg does not, and cannot, take a credible position that AIG's 2005 Restatement is unreliable, unduly prejudicial, or not reasonably probative and relevant to the falsity or materiality of the previously filed statements, discussed below. Additionally, Greenberg fails to point out with any detail how this Restatement does not fall squarely within the CPLR's definition of a business record. Accordingly, this Court is provided with no reasonable basis to disregard the Restatement in considering the NYAG's summary judgment motion.

Conversely, this Court has more than a sufficient basis to rely on AIG's 2005 Restatement because it is a business record under CPLR 4518. In New York, numerous cases have held that a company's restatements are admissible as a business record and indeed, are highly probative of fraud. For example, in *In re WorldCom, Inc. Securities Litigation* (388 F Supp 2d 319, 327 [SD NY 2005]), District Court Judge Cote held that the class action plaintiffs could introduce evidence of a similar restatement which, she held, "was clearly highly probative of the issues being tried," and clearly admissible as a business record (*Id.* at 327).

Judge Cote later reasoned that the restatement was a business record because it was a report made at or near the time

of the accounting review, that the restatement was created by those with knowledge of [the company's] books, and was required to comply with GAAP (*In re WorldCom, Inc. Sec. Litig.*, 2005 WL 375313, *5-9 [SD NY 2005]). Further, the restatement was created and kept in the course of the company's regular business practice and the company had a duty not only to issue restated financials, but to file restated statements with the SEC (*Id.*). Judge Cote went on to hold that the restatement was highly relevant, and that "the Company's admission of what its financial statement should have been in prior years is highly probative of whether the previously filed documents were false. The magnitude of the corrections speaks directly to the issue of materiality" (*Id.* at 23).

Therefore, the Restatement will be treated as a business record in accord with CPLR 4518 for the purposes of the NYAG's motion for summary judgment.

Finally, Defendants argue that the notes, e-mails, and transcripts of recorded telephone calls of Gen Re employees are inadmissible hearsay. The NYAG counters that declarations contained therein are admissible against Defendants because they were uttered by coconspirators in furtherance of a conspiracy. Defendants do concede that such evidence would be admissible against them once it is established that they were members of the conspiracy.

Insofar as the declarations at issue are not duplicative of other admissible evidence, the NYAG has established by prima

facie proof, and without resort to the declarations sought to be introduced, the existence of a conspiracy linking Greenberg, Milton, Ferguson and Napier and thus, their statements contained in notes and e-mails constitute competent proof on summary judgment (*see People v Sanders*, 56 NY2d 51, 62, *rearg denied* 57 NY2d 674 [1982]).

The declarations of one coconspirator made in the course of and in furtherance of a conspiracy are admissible at trial against all other coconspirators as an exception to the general rule against hearsay (*Id.*). Before evidence can be admitted against a defendant under the exception, the plaintiff must establish by prima facie proof the existence of a conspiracy between the declarant and the defendant "without recourse to the declarations sought to be introduced" (*Id.*). The coconspirators' exception is predicated primarily on the theory of vicarious admission: parties engaged in an illicit partnership are bound by one another's declarations to the same extent that a principal is bound by the declarations of his agent (*Id.*).

The declarations at issue include statements made in handwritten notes,¹⁸ e-mails¹⁹ and recorded telephone calls.²⁰

¹⁸ The handwritten notes at issue were all drafted by Napier, which was his common practice (Exhibit 36, annexed to the Smith Aff., Napier Tr Tes 651:18-22). In the first, dated the same day that Greenberg first called Ferguson to initiate the Gen Re Transaction, he includes a reference to a "loss portfolio transaction" with AIG for a six to nine month duration (Exhibits 23, 27, 37-8 annexed to the Smith Aff.). The second note references Ferguson's suggestion of Cologne Re's involvement, Smith's and Milton's designation as point persons on AIG's side, and states that "AIG would not bear real risk" (*Id.*). In the third, undated, Napier states that it is a "non risk deal," and

The record reveals that Greenberg, by his own admission and motivated in part over analysts' concerns over AIG's declining

in the fourth, dated mid-November 2000, Napier describes the details of the proposed transaction, the repayment arrangement, while referencing the need for "confidentiality" and a "side deal" (*Id.*).

¹⁹ The second category of statements are contained in e-mails between Ferguson, Napier, Monrad, Houldsworth and other Gen Re executives where they discuss the structure and details of the transaction, including "the intention that no real risk is transferred" (Exhibits 24, 26, 32, 39, 41, 47-8, 66-8, 75, 81-3). In addition are e-mails between Napier and Milton the date of the second telephone call between Greenberg and Ferguson where Napier writes that Ferguson and Greenberg decided that Milton, Smith, Napier, and Monrad "have been appointed to work out the details" of the transaction (*Id.*). Further, there are e-mail exchanges between Ferguson, Milton, Napier and other Gen Re executives referencing the structure, pay-back arrangement, and short-term duration of the Gen Re Transaction, and e-mails between Napier and Milton referring to Smith's involvement in the funding of the transaction and knowledge of the structure.

²⁰ The third category of declarations are transcripts of recorded telephone calls between Houldsworth and Gen Re employees and executives that refer to Greenberg's initiation of the transaction". Houldsworth describes the terms of the deal and Greenberg's involvement as follows:

"They're [AIG] trusting us not to give 'em a hundred million loss ... there's a 500 million premium for a 600 million limit ... we're gonna give 'em ... ten million up front as a fee. At the same time, they'd have to give us back ten million ... plus our margin ... another five million ... they [AIG] shouldn't care whether we commute or not 'cause they get their fee and no risk ... Ron's [Ferguson] the only one [talking to the client]. Hank's [Greenberg] phoning him every day to ask how its going ... according to Betsy [Monrad] ... [W]e don't really want to have too many e-mails and things flying around the place" (Exhibits 21-2, 34, 40, 46 annexed to the Smith Aff.).

Two weeks later, Houldsworth, in a recorded telephone conversation with another Gen Re executive, states, "Hank [Greenberg] said it's a deal so that means it's a deal as far as everybody's concerned," and goes on to describe the pay-back arrangement (*Id.*).

reserves, initiated the Gen Re Transaction with Ferguson in two telephone conversations in late-October and mid-November 2000, thereby personally involving himself in a matter usually delegated to others, which was highly unusual because, as Greenberg himself acknowledged, he "didn't get involved in the day-to-day reinsurance of AIG" (Exhibit 1, annexed to the Dwyer Supp Aff., Greenberg Dep Tr 31-33, 39-40, 42-44, 53-54, 65:13-14, 75:16-25, 77:24-25; Exhibit 33, annexed to the Smith Aff., Interrogatory No. 11).

In addition, Greenberg admits to appointing Milton to be the "point person" on the transaction, to "follow-up and handle it," and was aware that Napier had been designated as the contact on the Gen Re side, while conceding to having contemporaneous discussions with Milton, Ferguson and Smith concerning the Gen Re Transaction (*Id.*).

After the implementation of the Gen Re Transaction that artificially inflated AIG's loss reserves, Greenberg made public statements boasting of the increased reserves in AIG's earnings press releases for the fourth quarter 2000 and first quarter 2001, and on a call with Morgan Stanley analyst Alice Schroeder (Exhibits 62-63, annexed to the Smith Aff., Schroeder Dep Tr 316:20-317:17, 319:1-9; Schroeder Tr Tes 473).

Moreover, New York permits the testimony of admitted coconspirators, and other witnesses or participants regarding defendant's involvement in establishing a prima facie case of conspiracy (*People v Wolf*, 98 NY2d 105, 118 [2002]). Napier, an

admitted participant in the scheme, testified to an "unwritten side agreement" that was borne out of the conversations between Greenberg and Ferguson, and effectuated through their subordinates and designated point persons, Milton and Napier.

According to Napier's testimony, Ferguson indicated to him that Greenberg requested a loss portfolio transaction with Gen Re of a specified number of reserves for six to nine months, and that Napier was to follow-up with Milton as to the details of the transaction as per Greenberg's instructions (Exhibits 25, 30, 31, 36, 185, annexed to the Smith Aff., Napier Dep Tr 19:16-25, 21-22, 35-6, 51:16-18, 64:14-25, 64:2, 66:11-16, 68:4-23, 69:6-80, 89:14-15, 90:2-6, 610:20-24; Napier Tr Tes 816, 1523-24).

Napier also testified as to his frequent discussions with Milton following Greenberg's and Ferguson's communications, and that Milton confirmed that AIG was requesting the transaction in order to address criticism by analysts (*Id.*) Napier testified that he was directed to inquire with Milton if AIG would approve a non-risk deal; Milton responded in the affirmative (*Id.*).

Beyond this, in Milton's interview with Paul Weiss, Milton, who Greenberg concedes was designated to oversee and effectuate the transaction, confirmed that Greenberg was looking for a loss portfolio deal when he contacted Ferguson, and that Napier laid out the terms of the deal (Exhibit 29, annexed to the Smith Aff., at 2). As to the lack of documentation, as far as Milton knew, there was no underwriting or analysis undertaken, and stated that there "isn't much more" in terms of documentation

(*Id.*). This was confirmed by senior DBG actuary, Morrow, who testified that Milton did not request an actuarial review of the Gen Re Transaction (Exhibit 18, annexed to the Smith Aff., Morrow Tr Tes 1949:12-16, 1950:9-11).

Further, Douglas, DBG's chief actuary, testified that he personally attended several meetings with both Defendants in 2003 and 2004 where the issue of commutation of the Gen Re Transaction was discussed. At the meetings, Douglas states that he expressed concern that commuting the entire transaction at one time would have been problematic (Exhibit 88, annexed to the Smith Aff., Douglas Dep Tr 302:16-23, 303:2, 319-21, 323-25).

Finally, when PwC began to examine the Gen Re Transaction in 2005, Greenberg tried to convince it to ignore or downplay the deal, suggesting it was "much ado about nothing," according to a senior PwC auditor who personally spoke with Greenberg (Exhibit 95, annexed to the Smith Aff., Winograd Dep Tr 423:7-14, 420:2-4, 421:5-7, 427:20-22 and 428:10-14).

The NYAG has demonstrated that the declarations made by Milton, Ferguson and Napier in the course of and in furtherance of the conspiracy constitutes competent proof under the coconspirators' exception to the hearsay rule, and will be considered accordingly. There is ample proof, exclusive of the e-mails and notes, which 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.

Otherwise, in addition to the fact that the evidence as a whole against Greenberg is overwhelming, much of the so-called hearsay declarations are duplicative of other evidence in the record that is undoubtedly admissible, and to this extent, is properly considered (see *People v Jones*, 305 AD2d 264, 265 [1st Dept], *lv denied* 100 NY2d 643 [2003]).

Nonetheless, the declarations contained in the recorded telephone calls are not admissible under the coconspirator exception to the hearsay rule, in the absence of a showing of the existence of an illicit arrangement between those declarants and Defendants.

On the other hand, exclusive of the notes, e-mails and telephone recordings sought to be considered, there is not enough direct evidence at this stage to warrant the conclusion that Smith was a member of the illicit scheme to artificially inflate AIG's loss reserves.

By his own testimony, Smith indicates that Milton advised him in November 2000 as to the "broad terms of the transaction," and he admits to "having communications concerning aspects of the Gen Re transaction with Mr. Greenberg and Chris Milton" (Exhibit 1, annexed to the Sama Supp Aff., Smith Dep Tr 45:6-8; Exhibit 165, annexed to the Smith Aff., No. 8). Further, he admits that it was his understanding that entering into the Gen Re Transaction would result in the increase in premiums and loss reserves (Exhibit 165, annexed to the Smith Aff., No. 12).

Undergirding this testimony is that of Napier, an admitted participant in the scheme, that Ferguson advised him that Greenberg had also designated Smith as AIG's point person on the transaction, and that he was personally present at a meeting in which Smith was advised that Gen Re was accounting for the transaction as a deposit (Exhibit 25, 84, 167, Napier Tr Tes 816:19-21, 952:3-24, 954:16-17, 955:13-22, 956:4-7, 1267, 1271-73). However, Napier also testified that he did not work with Smith at all in connection with the Gen Re Transaction (Exhibit 3, annexed to the Sama Supp Aff., Napier Dep Tr 817:22-818:9).

Despite testimony concerning his general awareness of the Gen Re Transaction, and ample evidence that he was involved in the improper accounting for the transaction, discussed below, there is little more in the way of direct proof that Smith was a participant or member in the initial illicit scheme.

Materiality

Defendants next argue that the Gen Re and CAPCO Transactions were immaterial as a matter of law, which is a sufficient basis to deny the NYAG's motion for summary judgment and dismiss the claims against them.

Materiality is a necessary element of a Martin Act claim (*State*, 71 NY2d at 726-27; *People v World Interactive Gaming Corp.*, 185 Misc 2d 852, 864 [Sup Ct, NY Co 1999] [Ramos, J.]). Determining materiality is generally a mixed question of law and fact, in which the finder of fact must speculate as to both the inferences a reasonable investor would draw from the postulated

disclosure and the significance the finder of fact would assign to those inferences (*TSC Industries, Inc. v Northway, Inc.*, 426 US 438, 450 [1976]).

Nevertheless, materiality may be disposed of as a matter of law on summary judgment where the omission or misrepresentation is so obviously important to an investor that reasonable minds cannot differ (*Id.*; see e.g. *In Monster Worldwide, Inc. Securities Litig.*, 549 F Supp 2d 578, 582 (SD NY 2008); *State*, 12 Misc 3d 1157[A] at *6-8; *People*, 185 Misc 2d at 864).

New York courts appropriately look to federal courts interpreting securities laws to establish the standard for materiality in Martin Act prosecutions (*State*, 71 NY2d at 726-27).

Where the Martin Act claim is based upon a defendant's failure to disclose, an omitted fact is material if it would have assumed actual significance in the deliberations of a reasonable investor, or there must be 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 (*State*, 71 NY2d at 726-27; see also *Gebhardt v ConAgra Foods, Inc.*, 335 F 3d 824, 829-30 [8th Cir 2003]).

Where the violation involves a misstatement contained in a company's financial statements, the Second Circuit has "consistently rejected a formulaic approach to assessing the materiality of an alleged misrepresentation" (*Id.*). Federal

courts weighing the materiality of such misstatements often cite to SEC Staff Accounting Bulletin (SAB) No. 99, which is "persuasive guidance for evaluating the materiality of an alleged misrepresentation" (*Id.*).

According to SAB 99, with respect to financial statements, materiality concerns the significance of an item to users of a registrant's financial statements²¹ (SAB 99, 64 FR 45150-01). On the one hand, an intentional misstatement of even immaterial items in a financial statement may be an unlawful act and thus, material (*Id.*). "Among the considerations that may render material a quantitatively small misstatement of a financial statement" are the following: 1) "whether the misstatement masks a change in earnings or other trends;" 2) "whether the misstatement hides a failure to meet analysts' consensus expectations;" and 3) "whether the misstatement changes a loss into income or vice versa" (*Id.*).

Thus, while clearly the magnitude of the corrections to a financial statement speaks directly to the issue of materiality (*In re WorldCom, Inc. Sec. Litig.*, 2005 WL 375313, *5-9 [SD NY 2005]), various "qualitative factors may cause misstatements of quantitatively small amounts to be material" (*Ganino v Citizens Utils. Co.*, 228 F 3d 154, 162-63 [2d Cir 2000]).

Ultimately, there is no bright-line rule that a restatement is conclusive admission of wrongdoing. Nonetheless, it is possible

²¹ A reasonable investor is presumed to have knowledge of information that has already been disclosed or is readily available (*State*, 71 NY2d at 726-27).

for a court to conclude that the mere fact that financial results were restated is itself a sufficient basis to find that the restatement constitutes an admission that the financial statements were false when made, and that the errors were material, particularly where there are separate corroborating admissions that the financial statements contained errors (see *In re Atlas Air Worldwide Holdings, Inc. Securities Litig.*, 324 F Supp 2d 474, 486 [SD NY 2004]; see also Kitchens & Pennington, Restatement As Admission § 11:5.2, PLIREF-SECLIT, 11-31 [2009]).

Materiality of the Gen Re Transaction

As a result of the Gen Re transaction, AIG was able to artificially boost its loss reserves for the fourth quarter of 2000 and for the first quarter of 2001 by a total of \$500 million, and to conceal a trend of decreasing reserves.

At the outset, it is notable that the court in the Criminal Action determined that there was sufficient evidence to find that AIG's misstatements concerning its loss reserves were material, irrespective of whether it represented a quantitatively small amount when viewed in the larger context of AIG's business (*U.S.*, 553 F Supp 2d at 152-54).

Applying SAB 99 as guidance, the court considered relevant testimony concerning the importance that AIG's investors placed upon the amount of AIG's loss reserves, changes in the amount of its loss reserves, and the effect of declining loss reserves on earnings (*Id.*).

While the court focused on the presence of qualitative factors, it noted that a rational jury could have concluded that the potential quantitative effect on earnings stemming from the Gen Re Transaction was, in itself, material (*Id.*).

Similarly, the record before this Court contains ample evidence from which to conclude as a matter of law that the type of misstatements that AIG made concerning the Gen Re Transaction, purportedly at defendants' behest and contained in the financial statements, satisfies the materiality element to support an actionable claim under the Martin Act.

The NYAG submits extensive deposition testimony of two leading insurance industry analysts, Morgan Stanley's Alice Schroeder and Merrill Lynch's Jay Cohen, who testified that loss reserves are an extremely important measure for stock analysts and investors, in addition to the testimony of Charlene Hamrah, AIG's head of investor relations, who similarly testified (Exhibits 9; 189; 237; 239, annexed to the Smith Aff., Schroeder Dep Tr 300:16-23, 339:12-24, 340:1-9, 351:12-21; Cohen Dep Tr 213:8-12, 218:12-25, 219:1-5, Hamrah Tr Tes 309:10-25, 310:1-4). Schroeder and Cohen provided similar testimony at the Criminal Trial.

According to Schroeder, an insurer's loss reserves are the most important component of underwriting because it affects an insurer's quality of earnings (Exhibit 190, annexed to the Smith Aff., Schroeder Trial Tes 407-08).

Referring to his review of AIG's press release announcing its third quarter of 2000 results, Cohen testified that "typically

the first thing we'll [analysts] look at is the change in loss reserves" (Exhibit 235, annexed to the Smith Aff., Cohen Tr Tes 3555:9-11). Further, he testified that decreases in loss reserves for three consecutive quarters, at a time when premium income was increasing at an accelerating pace, "on its own, is what I would call a red flag" (Exhibit 239 to annexed to the Smith Aff., Cohen Dep Tr 234:1-10).

Hamrah, AIG's head of investor relations, stated that she frequently discussed loss reserves with analysts, and testified that analysts typically expected that a decline in net loss reserves would correspond to a drop in stock price, that also corresponds to premium growth (Exhibit 238, annexed to the Smith Aff., Hamrah Tr Tes 256:10-15, 257:10-25, 258:1-6, 264:19-25, 257).

Moreover, the misstatement as to AIG's loss reserves that resulted from the Gen Re Transaction masked a trend in declining reserves, and hid the failure to meet analysts' expectations. Schroeder testified that, after personally speaking with Greenberg after the release of AIG's fourth quarter 2000 press release, which Greenberg does not deny, she upgraded AIG stock. She states that she "certainly would not" have if she had known that AIG's loss reserves actually declined for three quarters in a row, and would have advised her clients to be more cautious about investing in AIG (Exhibits 62-3; 235; 237, annexed to the Smith Aff., Schroeder 496:4-16, 497:2-25, 498:7-8, 22-25, 499:1-

22, 269:1-9; Schroeder Dep Tr 350:18-23, 351:1-10; Cohen Tr Tes 3630-31, 3684).

In the Criminal Action, Judge Droney similarly found that "accurate information about loss reserves was important to investors, and that the type of misstatements AIG made about its loss reserves - disguising a three quarter decline in reserves during a corresponding period of premium growth as an isolated one quarter event - would have been particularly significant to investors, especially in light of the implications for the quality of AIG's earnings, a central concern for investors" (*U.S.*, 553 F Supp 2d at 155; see also SAB 99, 64 FR 45150-01 [masking change in loss reserves and other trends weighs in favor of materiality]).

Another relevant factor in the materiality analysis is the integrity of senior management, which is clearly of importance to investors, particularly if the conduct at issue is fraudulent, but also where the conduct involves obliviousness to their subordinates' malfeasance (*Gebhard*, 335 F 3d at 829-830; *In re Comverse Tech., Inc. Securities Litig.*, 543 F Supp 2d 134, 151 [ED NY 2008]; *U.S. v Ferguson*, 545 F Supp 2d 238, 240 [D CT 2008]).

For instance, executives who engage in fraudulent conduct may subject their employer to a risk of legal action and are likely to be terminated, which is plainly material to investors where those very executives are valuable to a company's continued success (*Id.*).

Similarly, Cohen and Schroeder testified that, if corporate management was involved in a transaction where the intent was to manipulate numbers, it speaks to the "credibility of management," and because "management is responsible for the accuracy of financial statements and ... if you believe that they are not doing so, then you don't have a basis for analyzing the stock," (Exhibits 239, 234, 235, annexed to the Smith Aff., Cohen Dep Tr 221:7-14; Schroeder Tr Tes 393:21-25, Cohen Tr Tes 3551:15-25, 3552:7-9, 3559-60).

The implication that defendants, AIG's senior management, assisted by the senior management of Gen Re, initiated and participated in a sham reinsurance transaction designed to artificially boost AIG's loss reserves and intentionally deceive analysts and investors would clearly be relevant to investors and analysts in evaluating the financial health and stability of the company. Consequently, defendants' participation in the scheme, if established, clearly provides support for the materiality of the Gen Re Transaction.

Moreover, the very fact that AIG restated its financial statements for the years 2000 through 2004, in which it recharacterized the Gen Re Transaction as a deposit rather than as insurance, is, itself, evidence of materiality.

According to AIG's Restatement:

"To recognize the cash flows under an insurance contract as premium and losses, GAAP requires the transfer of risk. If risk transfer requirements are not met, an insurance contract is accounted for as a deposit, resulting in the recognition of cash flows under the contract as deposit

assets or liabilities and not as revenues or expense. **AIG has concluded, based upon its internal review, that there was insufficient risk transfer to qualify for insurance accounting** for certain transactions where AIG subsidiaries either wrote direct insurance or ceded reinsurance, these transactions are now recorded using deposit accounting. **The changes resulting from the change to deposit accounting affect both the consolidated balance sheet and statement of income ...**

In December 2000 and March 2001, an AIG subsidiary entered into an assumed reinsurance transaction with a subsidiary of General Re Corporation (Gen Re) involving two tranches of \$250 million each. In connection with each tranche, consolidated net premiums written and consolidated incurred policy losses and benefits increased by \$250 million in the fourth quarter of 2000 (with respect to the first tranche) and third first quarter of 2001 (with respect to the second tranche). The first tranche of the transaction was commuted in November 2004, reducing premiums and reserves for losses and loss expenses by approximately \$250 million in the fourth quarter of 2004. **AIG has concluded that the [Gen Re] transaction was done to accomplish a desired accounting result and did not entail sufficient qualifying risk transfer. As a result, AIG has determined that the transaction should not have been recorded as insurance.** Such recharacterization had virtually no effect on net income or consolidated shareholders' equity but had the following effects on certain of AIG's consolidated statement of income and balance sheet accounts ..." (emphasis added) (Exhibit 94, annexed to the Smith Aff., at 308-09).

In a May 2005 press release that preceded the Restatement, AIG declared:

"The restatement corrected errors in prior accounting for improper or inappropriate transactions or entries that appear to have had the purpose of achieving an accounting result that would enhance measures important to the financial community and that may have involved documentation that did not accurately reflect the nature of the arrangements" (Exhibit 164, annexed to the Smith Aff.).

Under GAAP, previously issued financial statements should be restated only to correct material accounting errors that existed at the time the statements were originally issued (*In re Atlas*

Air Worldwide Holdings, Inc. Securities Litig., 324 F Supp 2d at 486-87).

Here, the fact that AIG elected to restate its financials with respect to the Gen Re Transaction is surely of interest to a reasonable investor (see *Gebhardt*, 335 F 3d at 829-30).

Plainly, investors, and analysts for that matter, review AIG's corporate filings relying upon their accuracy (Exhibit 63, annexed to the Smith Aff., Schroeder Dep Tr 269:23-4, 270:1-3). Corporate management is responsible for the accuracy of the financial statements (1 CCH AICPA Professional Standards, SAS No. 1, § 110.02 [1982]).

Thus, while it is not conclusive evidence in itself of an admission of wrongdoing, the Restatement strongly suggests that its financials contained material errors with respect to the Gen Re Transaction. Coupled with other qualitative factors discussed above, the Court concludes that the record unequivocally demonstrates that full disclosure as to the accuracy of AIG's loss reserves, and management's role in inflating those reserves, would have been viewed by the reasonable investor as having significantly altered the total mix of information made available (*State*, 71 NY2d at 726-27).

In opposition, defendants point to the Restatement itself that states that the Gen Re Transaction had a trivial effect on net income or shareholders equity. Further, they submit testimony of Steven Bensinger, formerly AIG's CFO, and Frank Douglas, DBG's chief actuary, who both testifies that the Gen Re Transaction was

"totally immaterial to net income and consolidated shareholder's equity" (Exhibits 37, 74, annexed, to the Dwyer Opp Aff., Bensinger Dep Tr 43:2-7, 53:5-17, 204:13-24; Douglas Dep Tr 287:17-20, 333:6-10, 334:17-25).

However, the small quantity of a misstatement contained in a financial statement, in and of itself, is not dispositive of the issue of materiality (*Gebhardt*, 335 F 3d at 830). Rather, it is but one factor to be weighed against qualitative factors that may render the relatively minor numerical value material, where, as here, the misstatement masks a change in earnings or other trends, hides a failure to meet analysts' consensus expectations, and implicates senior management in fraud (SAB 99, 64 FR 45150-01).

Finally, defendants' selected excerpts mischaracterize Douglas' testimony to the extent of the concerns he voiced regarding the size and accounting impact of commuting the Gen Re Transaction.

For instance, Douglas testified that, when discussions regarding commuting the entire transaction at one time were discussed in the beginning of 2003 with defendants, Douglas voiced concerns regarding the impact on the loss reserves tables. Unlike other contracts that AIG commuted in 2003, no statutory reserves had been booked in connection with the Gen Re Transaction. Thus, according to Douglas, commuting the entire transaction at one time would not be reflected in a development table in AIG's Schedule P, the annual statement filed with state

insurance regulators (Exhibit 88, annexed to the Smith Aff., Douglas Dep Tr 319:4-19; Ex. 91 at 410). In fact, he stated that the Gen Re Transaction "was so large, to me it was a more material impact on our reserve developments. It would be a significant percent of our overall reserve development, compared to the other transactions" (Exhibit 88, annexed to the Smith Aff., Douglas Dep Tr 320:9-320:13, 320:20-321:4).

Douglas further testified as follows:

Because the Gen Re Transaction was "much larger than other deals, that it's [recorded as] a GAAP reserve, and we have not, to my knowledge, reflected any significant prior year development from those GAAP reserves ... I wasn't comfortable taking a 500 million dollar adjustment to our reserve development for such a transaction that I didn't really have any familiarity to begin with" (Exhibit 88, annexed to the Smith Aff., Douglas Dep Tr 302:16-25, 303:2, 319:7-25, 323-325).

In addition, he testified that he was concerned over the discrepancy between the statutory accounting treatment of the transaction and the GAAP treatment, which might raise public scrutiny (Exhibit 88, annexed to the Smith Aff., Douglas Dep Tr 319:20-320:8).

Despite defendants' attempt to mischaracterize his testimony, Douglas' statements are in line with other testimony in the record concerning the materiality of the Gen Re Transaction, both from a qualitative and quantitative perspective.

Otherwise, defendants fail to rebut the extensive evidence in the record that establishes that accurate information concerning AIG's loss reserves was significant to investors and analysts, and that the misstatements contained in AIG's financial

statements sought to hide a potentially negative trend of declining loss reserves, that ultimately misled investors concerning the financial health of the company.

Materiality of the CAPCO Transaction

As for the CAPCO Transaction, defendants assert that it involved an immaterial amount of underwriting losses, and had no aggregate effect on net income or shareholders' equity in relation to the enormous size and structure of AIG.

In support, defendants cite to the testimony of AIG witnesses who participated in the CAPCO Transaction and the Restatement. According to defendants, the \$163 million in auto warranty underwriting losses that the Restatement reversed represented only 0.05% of the \$306 billion in assets AIG had at the time. Defendants cite to case law which unremarkably holds that the improper accounting treatment of 0.3%, 1% and 2% of a company's total assets is immaterial (e.g. *ECA, Local 134 IBEW Joint Pension Trust of Chicago v JP Morgan Chase Co.*, 553 F 3d 187, 204 [2d Cir 2009]; *Parnes v Gateway 2000, Inc.*, 122 F 3d 539, 547 [8th Cir 1997]; *Ferber v Travelers Corp.*, 802 F Supp 698, 708 [D CT 1992]).

However, as discussed above, numerical tests alone are not determinative of the issue of materiality, and must be weighed against qualitative factors (SAB 99, 64 FR 45150-01; *Ganino*, 228 F 3d at 162-63; *ECA, Local 134 IBEW Joint Pension Trust of Chicago*, 553 F 3d at 204; *Gebhardt*, 335 F 3d at 830).

In any event, evidence in the record establishes that defendants' stated objective in effectuating the CAPCO Transaction was not to improve AIG's assets, but to conceal from investors underwriting losses.

The NYAG submits evidence suggesting that the transaction did have a considerable impact on AIG's underwriting results. For instance, according to the NYAG's calculations, in the third quarter of 2000, when the CAPCO Transaction first appeared on AIG's books, it stripped out losses that should have been reported as part of AIG's total General Insurance underwriting profit and AIG's domestic General Insurance underwriting profits.

The NYAG submits an exhibit setting out the quarterly and yearly impact of the CAPCO Transaction on AIG's total General Insurance underwriting profits, Domestic General Insurance underwriting profits and, when available, DBG's²² underwriting profits that shows that CAPCO inflated AIG's reported General Insurance underwriting profits by 28.3% and its domestic insurance results by 40.7% (Exhibit 243, annexed to the Smith Aff.).

²² The auto warranty losses were incurred by DBG, which was a part of AIG's Domestic General Insurance operation. The transaction boosted the underwriting profits reported by DBG, the Domestic General Insurance segment, and the total General Insurance underwriting profits, at the expense of a capital loss that was reported separately.

Further, the exhibit shows that for the year ending December 31, 2000, AIG improperly overstated its underwriting profits by \$83,729,000²³ as a result of the CAPCO Transaction, which accounted for 10.7% of AIG's total 2000 General Insurance underwriting profits and 18.6% of AIG's domestic insurance underwriting profits (*Id.*).²⁴ For the year 2001, CAPCO overstated the underwriting profit reported by AIG's entire General Insurance segment by 87.9% and understated the domestic underwriting loss by 19.7% (*Id.*).

In opposition, defendants contend that the NYAG's conclusion is counter to PwC's analysis, who conducted the audit that resulted in the Restatement. Defendants argue that AIG did not incur or cede to CAPCO \$163 million in underwriting losses in 2000, because the majority of the auto warranty losses that National Union would have ultimately ceded to CAPCO were merely future projected losses, and had not incurred. For this reason, defendants assert that less than half of the amount of losses that the Restatement reported had actually been incurred in 2000.

²³ Greenberg's calculations utilize \$73,184,000 for the year 2000 cession to CAPCO, as opposed to the higher number, \$83,729,000, utilized by the NYAG in its calculations and actually booked by AIG. According to the NYAG, even utilizing the lower number relied upon by Greenberg, the CAPCO Transaction still accounted for 9.3% of AIG's total General Insurance underwriting profit and 16.2% of AIG's domestic profit.

²⁴ Looking only at AIG's fourth quarter results, the CAPCO Transaction represented 19.1% of AIG's General Insurance underwriting profits and 32.7% of its domestic profit. For the year 2000, the CAPCO transaction accounted for 38.6% of DBG's total underwriting profit of \$217 million (Exhibits 107 and 138, annexed to the Smith Aff.).

Notwithstanding the competing evidentiary submissions concerning the quantitative impact that the CAPCO Transaction had on AIG's reported underwriting profits, defendants fail to rebut the numerous quantitative factors of materiality that are present in the record.

To the extent that defendants directly participated in structuring a transaction whose sole purpose was to fraudulently conceal "horrendous" auto warranty losses, this is plainly material to investors insofar as it implicates the integrity of AIG's top management, discussed above (*In Re Comverse Tech., Inc.*, 543 F Supp 2d at 151; *U.S.*, 545 F Supp 2d at 240).

Moreover, the very fact that AIG restated its financial statements with respect to the CAPCO Transaction²⁵ is itself evidence of materiality, and clearly would be relevant to an investor (*In re Atlas Air Worldwide Holdings, Inc. Securities Litig.*, 324 F Supp 2d at 486-87; *Gebhardt*, 335 F 3d at 829-30).

²⁵ In the Restatement, AIG stated:

"[the CAPCO Transaction] involved an improper structure created to recharacterize underwriting losses relating to auto warranty business as capital losses. That structure, which appears to have not been properly disclosed to appropriate AIG personal or its independent auditors, consisted primarily of arrangement between subsidiaries of AIG and Capco that require Capco to be treated as a consolidated entity in AIG's financial statements. The result of such consolidation is to reserve capital losses for the years 2000 through 2003 and recognize a corresponding amount of underwriting losses in 2000" (Exhibit 94, annexed to the Smith Aff.).

Plainly, the information was of significance to AIG's auditors. One senior PwC engagement partner who worked on the AIG audit in 2000, while testifying that the CAPCO Transaction was "quantitatively immaterial," stated that the transaction was, nevertheless, "sleazy" because of "the notion of structuring a transaction in a way to achieve an accounting result, but not disclose to the auditors all the nuances surrounding the different legs of the transaction" (Exhibit 95, annexed to the Smith Aff., Winograd Dep Tr 436:14-18; Exhibit 80, annexed to the Dwyer Opp Aff, Winograd Dep Tr 339:10-10-11, 340:14-15).

Another PwC partner who worked on the AIG audit testified that when he learned of the CAPCO Transaction, he was in "disbelief [and] shock," because it was "inappropriate" (Exhibit 200, annexed to the Smith Aff., Mayock Dep Tr 340:10-22, 349:3-10). He testified that the transaction was qualitatively material because "the impact on the financial statements had demonstrated or suggested that the company was not recognizing underwriting losses the way they should have been, but, instead, recharacterizing those losses as something other than underwriting which was Capco losses" (*Id.*).

Here, the qualitative effect of the misstatements, even if numerically small, renders material the CAPCO Transaction. It is undisputed that the transaction had no economic substance or purpose other than to get the underwriting loss off AIG's books, and its orchestration by AIG's senior management, which would plainly be material to investors.

Summary Judgment Under the Martin Act and Executive Law

Summary judgment is available under the Martin Act and Executive Law § 63 (12) (see e.g. *State*, 12 Misc 3d 1157[A]).

In order to obtain summary judgment under the Martin Act, the NYAG must show that defendants committed an intentional act constituting fraud or engaged in fraudulent practices. The elements of a claim under Executive Law § 63 (12) are virtually identical to those under the Martin Act, except for the requirement that the offending behavior be repeated or persistent (*State*, 3 Misc 3d at 993).

"Fraud" and "fraudulent practice" under the Martin Act and the Executive Law have been given a broad meaning (*Badem Bldgs. v Abrams*, 70 NY2d 45, 53-4 [1987]), and "include 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 the purchasing public" (*People*, 258 AD2d at 193; *People v Lexington Sixty-First Assocs.*, 38 NY2d 588, 595 [1976]).

A showing of a specific intent to defraud (scienter) is not required to establish a violation under Martin Act (*People v Barysh*, 95 Misc 2d 616, 620-21 [1978]). Corporate officers and directors may be held personally liable for violations if they participated in the deceptive practices or had knowledge of them (*People v Concert Connection, Ltd.*, 211 AD2d 310, 320 [2d Dept], *app dismissed* 86 NY2d 837 [1995]; *People v Apple Health and*

Sports Clubs, Ltd., 80 NY2d 803, 807 [1992]; *People v Telehublink Corp.*, 301 AD2d 1006, 1010 [3d Dept 2006]; *People v Frink America, Inc.*, 2 AD3d 1379 [4th Dept 2003]; *People v Court Reporting Institute, Inc.*, 245 AD2d 564 [2d Dept 1997]; see generally *Polonetsky v Better Homes Depot, Inc.*, 97 NY2d 46 [2001]).

Thus, to the extent that personal knowledge or participation is required in order to find corporate officers and directors personally liable, the Martin Act is clearly directed at acts or practices, and not at any particular mental state on the part of the actor (*People*, 95 Misc 2d at 621).

Gen Re Transaction

This Court has found that the NYAG has demonstrated the materiality of the Gen Re Transaction as a matter of law, and now finds that it constitutes fraudulent or deceitful practices that tended to mislead the investing public as to the true financial health of AIG for the same reasons (see *State*, 258 AD2d at 193; *State*, 12 Misc 3d at 8). The Gen Re Transaction contained insufficient evidence of risk transfer, and was booked as insurance in order to effectuate the purpose of its initiation: to artificially increase its loss reserves by \$250 million for the fourth quarter of 2000, and another \$250 million for the first quarter of 2001, thereby allowing AIG to conceal a negative trend of decreasing loss reserves.

The remaining issue is whether defendants had the requisite degree of personal knowledge or participation in the unlawful aspects of the Gen Re Transaction.

As for Greenberg, his own testimony establishes that he initiated a loss portfolio transaction by phoning Gen Re's Ferguson, that he designated Milton as the point person of the transaction and to "please follow-up and handle it," and that he was motivated in part with analysts' concerns over AIG's reserves (Greenberg Dep Tr 9:14-21, 33:2-6, 40:3-14, 42:9-14, 46:6-18, 53:22-23, 102:8-11). This phone call occurred immediately after AIG reported its third quarter financial results and AIG's stock price dropped by 6% after it had reported an unexpected decline in its loss reserves.

Greenberg denies requesting a no risk transaction with Gen Re, of being informed that the Gen Re Transaction had been structured so as not to contain adequate risk transfer, or that he had any involvement in the accounting of the transaction (Exhibit 1, annexed to the Dwyer Supp Aff.; Exhibit A, annexed to the Smith Aff., Greenberg Dep Tr 75, 211-12, 225-26, 228). Otherwise, he fails to recollect numerous other details, including whether he asked Ferguson for a loss portfolio transaction for a six to nine month duration and for a specific type of insurance (long tail), or expressing to Milton a sense of urgency concerning the consummation the transaction, as documentary and testamentary evidence shows (Exhibit A, annexed to the Smith Aff., Greenberg Dep Tr 33, 39, 46, 51-53).

Notwithstanding Greenberg's failure to recollect details surrounding the transaction or his denial that he had any knowledge that subordinates at AIG and Gen Re ultimately structured the transaction so as to not contain adequate risk transfer and of AIG's improper accounting of the deal, there is clearly evidence in the record that connects both defendants to the improper aspects of the Gen Re Transaction, and highly suggest their knowledge or participation.

As for Greenberg, Napier²⁶ testified that he personally called Milton and explicitly proposed that the companies structure a "no risk" deal, and that later the same day, Milton called Napier back and told him that a no risk transaction "was something they would like to take a look at" (Exhibits 30, 185, annexed to the Smith Aff., Napier Dep Tr 67-69, 610:20-24). In Napier's words, "Chris [Milton] did not care [about the no risk nature of the deal] because Chris told me the chairman [Greenberg] had made the decision and there is nothing else to talk about" (*Id.*).

Shortly after Milton confirmed that AIG would consider a no risk deal, Greenberg and Ferguson spoke by telephone in mid-November 2000. Napier made contemporaneous notes of what Ferguson told him had transpired in this second telephone conversation with Greenberg, which corroborate his testimony

²⁶ Incidentally, Judge Droney noted "the significance and usefulness of Mr. Napier's assistance; the truthfulness, completeness, and reliability of information and testimony provided by him; and the nature and extent of his assistance," and found his testimony was "credible" (Exhibit, 263, annexed to the Smith Aff.).

(Exhibit D, annexed to the Smith Aff., Napier Dep Tr 111-12). Napier's notes from this meeting with Ferguson, dated November 17, 2000, state the following:

- "1) REF [Ferguson] explained [Cologne Re] Dublin
- 2) REF [Ferguson] wants 1% fee (\$5m)
- 3) Two tranches
 - \$250 M 2000
 - \$250 M 2001
- 4) Howie [Smith] & Chris [Milton] point persons
- 5) How to perfect how to get fee
- 6) **AIG not bear real risk**" (emphasis added)
(Exhibit 27, annexed to the Smith Aff.).

In another note, Napier writes "Deposit liabilities from KRD [Cologne Re]" with an arrow pointing to AIG, and the phrase "non risk deal" (Exhibit 37, annexed to the Smith Aff.).

Napier then called Milton to inform him of the agreed upon terms (Exhibit D, annexed to the Smith Aff., Napier Dep Tr 111-12). That same day, in an e-mail to Milton, Napier sets forth the proposed structure of the transaction, as established by "Ron's [Ferguson] discussions with MRG [Greenberg]," that references the secret pay-back mechanism:

"You may want to divide the transaction into two parts-one for 2000 and one for 2001 ...

the fee to GCR [Cologne Re] will be 1% or \$5m.

We need to work out a mechanism for GCR to recover the 2% fee advanced to AIG under the agreement

you [Milton], Howie Smith ... and I have been appointed to work out the details"

(Exhibit 41, annexed to the Smith Aff.).

Thereafter, Gen Re and AIG, through their respective subsidiaries, Cologne Re and National Union, executed two separate reinsurance agreements under which AIG purported to

provide \$600 million in reinsurance for \$500 million in premiums, 98% of which was withheld by Gen Re to pay claims (Exhibit H, annexed to the Smith Aff.). On the basis of these agreements, AIG booked \$250 million in additional reserves for the fourth quarter of 2000, and \$250 million for the first quarter of 2001.

The transaction was implemented without any actuarial analysis having been performed, which Milton essentially confirmed (Exhibits 18-19, 29, 186, annexed to the Smith Aff., Morrow Tr Tes 1892-93; Morrow Dep Tr 265, 282:2-283:5; Napier Tr Tes 1787-1789). Plainly, actuarial analysis was not performed because the no risk feature of the transaction had already been agreed upon.

It is possible, as Greenberg urges, that Milton, head of AIG reinsurance, whom he personally appointed to be the point person on the transaction, and to oversee, effectuate and follow-up with him as to its status, went ahead with a transaction of this dimension (one of the largest reinsurance deals in AIG's history), that exposed AIG to a possible \$100 million loss (although no actuarial analysis performed), and potential criminal prosecution, without Greenberg's consent or at a minimum, knowledge.

At his deposition, Greenberg was asked, "Do you think that if he [Milton] was going to change or modify the deal in a significant manner that might expose AIG to criminal prosecution or fraud charges ... he [Milton] would withhold that information from you" (Exhibit A, annexed to the Smith Aff., Greenberg Dep Tr 102). Greenberg responded, "I'm sure he would have come to talk

to me about it" (*Id.*). However, according to Greenberg, Milton did not come to him to advise him of the no-risk nature of the deal or seek his consent.

The NYAG points out that it is simply inconceivable that Greenberg would not have approved a transaction of this magnitude without knowing its key terms, given that he personally initiated it, designated Milton to follow through with the deal and give him status reports, his unusual personal involvement in the transaction that he himself testified to, and his autocratic style of governing AIG.²⁷

There are additional facts that the NYAG points to that strongly suggest knowledgeable conduct on the part of Greenberg. For instance, after the first tranche of the transaction had closed, Greenberg made public statements boasting of the increased reserves flowing from the Gen Re Transaction in AIG's earnings press releases for the fourth quarter 2000 and first quarter 2001, and on a call with Morgan Stanley analyst Alice Schroeder, which he now claims he does not recall (Exhibits 57, 62-63, annexed to the Smith Aff., Schroeder Dep Tr 316:14-20, 317:17, 319:1-9; Schroeder Tr Tes 473, 475). For four years thereafter, from 2001 through 2004, these reserves were improperly reflected on AIG's financial statements, which were

²⁷ Greenberg has been described in a book by a former senior colleague at AIG as "an archetypal autocrat, one who knows every detail of the company's operations" (Shelp, *Fallen Giant*, [2009] p. 6). Greenberg has been described in a similar manner in numerous articles and other publications.

annually certified by Greenberg and Smith who, as CEO and CFO, signed each of AIG's 10-K reports filed with the SEC.

Further, according to deposition testimony, Greenberg was personally involved in discussions in 2003 and 2004 about disclosure issues that would have resulted from the commutation of the Gen Re Transaction (Exhibit 87-88, annexed to the Smith Aff., Douglas Dep Tr 302:7-303:3; 319:4-320:8; 324:7-325:14; 324:21-325:25; Jacobson Dep Tr 156:7-23; see also exhibits 79, 89, 90, 91, and 92).

In addition, shortly after his departure from AIG, Greenberg transferred nearly all his AIG stock to his wife, then worth over \$2 billion. Finally, days after Milton's termination and Greenberg's resignation from AIG, Greenberg, in an apparent reward to his former subordinate, hired Milton as a high-ranking officer at C.V. Starr & Co. (where Greenberg became CEO after his departure from AIG), and where Milton is employed to this day, despite being found guilty and sentenced to four years in prison in the Criminal Action.

However, in the absence of direct testimony as to Greenberg's knowledge or participation in the structuring of the transaction without adequate risk transfer from the other participants in the illicit scheme, namely, Milton or Ferguson, or others who clearly facilitated the scheme, including Monrad and Houldsworth, the evidence against Greenberg is too remote to find liability against him as a matter of law, when confronted with his blanket denials. Thus, on the basis of this record, determinations of

Greenberg's credibility and the drawing of legitimate inferences from the facts must be made. These are functions for the trier of fact, and cannot be resolved on a motion for summary judgment (*Forrest v Jewish Guild for the Blind*, 3 NY3d 295, 315 [2004]).

As for Smith's role in the Gen Re Transaction, the NYAG asserts that he was primarily responsible for improperly accounting for it as insurance, an election that, in part, led AIG to restate its financial statements in order to reflect "that there was insufficient risk transfer to qualify for insurance accounting" (Exhibit 94, annexed to the Smith Aff.).

Other than being informed as to its broad terms, Smith denies having any role in structuring, implementing, or accounting for the Gen Re Transaction, or having any knowledge that it did not involve sufficient risk transfer (Exhibit 3, annexed to the Dwyer Supp Aff., Smith Dep Tr 25-36, 88-91, 116, 98-99). According to Smith's testimony, the GAAP loss reserves reported in AIG's 10-K were provided by DBG actuaries (*Id.*).

Senior DBG actuaries deny this, testifying that Smith was responsible for booking the Gen Re Transaction as insurance for GAAP purposes because it was initiated at the parent (AIG) level, rather than the DBG level (see Exhibits 18, 194-95, Tr Tes Morrow 1917-18; Jacobson Dep Tr 69:3-18, 80:9-10, 172:5-9, 176:13-177:5, 517:6-518:13, 518:21-519:3, 525:9-14; Beier Dep Tr 259:2-14).

Otherwise, AIG was advised at a meeting held in late November or early December 2000 at its headquarters, and attended by Smith, his direct subordinate, Castelli, Milton, and several Gen

Re executives, including Napier, that Gen Re was going to account for the transaction as a deposit (Exhibit 167, annexed to the Smith Aff., Napier Tr Tes 952-956). Smith claims he has no recollection of attending this meeting, and denies being advised that Gen Re was accounting for the transaction as a deposit (Exhibit 1, annexed to the Sama Supp Aff., Smith Dep Tr 46:10-13, 136:18-137:4).

The NYAG points out that Smith helped arrange for AIG to surreptitiously return to Gen Re a purported \$10 million premium payment that Gen Re had paid AIG, and to pay Gen Re a \$5 million fee for accommodating AIG in the Gen Re Transaction, through the commutation of unrelated reinsurance agreements (Exhibits 45, 74, annexed to the Smith Aff.).

Finally, during an interview with Paul Weiss in the midst of its internal AIG investigation of the transaction, it was recorded that Smith stated that he understood that the Gen Re Transaction was to "look like" risk was being transferred, and that "If deposit accounting had been required ... AIG would [not] have done the deal" (Exhibit 28, annexed to the Smith Aff.).

However, in light of the facts in dispute, and the credibility determinations that must be made regarding Smith's testimony concerning accounting treatment for the Gen Re Transaction, summary judgment as to his liability under the Martin Act must also be denied (*Forrest*, 3 NY3d at 295).

CAPCO Transaction

The Court found that the NYAG has demonstrated the materiality of the CAPCO Transaction as a matter of law, and finds that it constitutes fraudulent or deceitful practices that tended to mislead the investing public as to the true financial health of AIG for the same reasons. Moreover, no genuine issue of material facts remain that both defendants were indisputably aware of the transaction, the deceptive function that it was intended to achieve, and, in fact spearheaded it.

In the CAPCO Transaction, AIG shifted underwriting losses from its auto warranty program to an offshore company that was supposedly independent, CAPCO, but was, in fact, controlled by AIG. AIG's control of CAPCO was masked by the use of three strawman investors located in Switzerland whose equity interests in CAPCO were entirely financed on a non-recourse basis by AIG. AIG then "invested" enough money in CAPCO to cover the projected auto warranty underwriting loss and CAPCO "reinsured" AIG for the loss for a nominal premium. As CAPCO paid claims under the reinsurance agreement, AIG reported an underwriting gain that offset the auto warranty underwriting loss. AIG gradually sold off its interest in CAPCO for a fraction of the value of its investment, leaving the shell company with the underwriting loss and AIG with a purported capital loss.

In the Restatement, AIG recognized that the CAPCO Transaction involved an "improper structure," that involved an arrangement whereby CAPCO was to be treated as a consolidated entity on AIG's

financials that permitted AIG to reserve capital losses for the years 2000 through 2003 and recognize underwriting losses in 2000 (Exhibit 94, annexed to the Smith Aff.).

First, Greenberg admits in his interrogatory responses and his deposition to knowing that the CAPCO transaction was designed to remove the underwriting loss from AIG's books by "reflect[ing] the losses as capital losses rather than as underwriting losses" (Exhibits 33, 110 annexed to the Smith Aff., Greenberg Dep Tr Dep. Tr. 190:4-7).

In addition, Umansky, who was the designated point person on the deal, testified that both defendants approved the plan to convert auto warranty losses by purchasing CAPCO and making it appear as if it were not controlled by AIG (when, in fact, it was controlled by AIG), which was laid out in an April 2000 memo that Umansky authored and sent to defendants (Exhibit 122, annexed to the Smith Aff., Umansky Dep Tr 73:3-24).

At his deposition, Greenberg acknowledged reading at least the first two pages of Umansky's memo (Exhibit 110, annexed to the Smith Aff., Greenberg Dep Tr 169:22-23, 195:8-13, 195:19-196:8). Greenberg even admitted that it "would have been a logical thing for me to have inquired [with Umansky] if CAPCO was controlled or a non-controlled entity that he was proposing," because he understood that if CAPCO was a controlled entity it would have to be consolidated with AIG (Exhibit 110, annexed to the Smith Aff., Greenberg Dep Tr 195:19-196:8, 411:11-412:7). In short, Greenberg understood every aspect of the deal.

In addition, Greenberg admits that he directed Umansky to AIG Private Bank, located in Switzerland, to locate the "Non Affiliated Purchasers" called for by Umansky's plan (Exhibit 110, annexed to the Smith Aff., Greenberg Dep Tr 185:23-186:7). When asked why he directed Umansky to look to Switzerland to locate investors, rather than investors based in the U.S., Greenberg testified that Switzerland "just came off the top of my head" (Exhibit 110, annexed to the Smith Aff., Greenberg Dep Tr 187:24-188:3).

According to Umansky, he continued to brief both defendants on the CAPCO Transaction as it unfolded and sent them a number of memos as to the status of the transaction (Exhibits 122, 150, 152, 168, 172, annexed to the Smith Aff., Umansky Dep Tr 73:17-19, 75). For instance, on November 16, 2000, Umansky explained to defendants that CAPCO involved a "unique structure" and that the "cash has been transferred into the structure and is shown on our balance sheet as assets ... The expectation is that as the losses develop and are recovered from the reinsurer, a capital loss will be recognized" (Exhibit 173, annexed to the Smith Aff.).

On December 16, 2002, Umansky e-mailed Smith stating, "the Capco liquidation is underway. \$22.3M will be distributed to us tomorrow. The capital loss will be \$47M rather than the \$54M in the for[e]cast" (Exhibit 176, annexed to the Smith Aff.).

Smith, who first outlined a transaction that would convert the underwriting loss into a capital loss, confirms Umansky's

testimony that he personally instructed him to devise a transaction to convert the auto warranty loss into a capital loss (Exhibit 122, annexed to the Smith Aff., Umansky Dep Tr 72:24-73:3; Exhibit 2, annexed to the Sama Supp Opp Aff, Smith Dep Tr 263:10-264:17; 276:7-9).

Further, Smith personally arranged for the financing of CAPCO by AIG by authorizing AIRCO to invest \$170 million in CAPCO and signed the forms required to transfer the \$170 million capital contribution to fund AIRCO's investment in CAPCO and the \$19 million capital contribution to fund Cap. Corp.'s loan to the purported "Non-Affiliated Investors" (Exhibits 124, 127, 133, annexed to the Smith Aff.).

In an interrogatory response, Smith admitted understanding that "if the projected auto warranty losses developed to the maximum limit under the reinsurance agreement, AIRCO's preferred share investment in CAPCO would probably be worthless and would need to be written off as a capital loss" (Exhibit 165, annexed to the Smith Aff., Interrogatory Nos. 11-12).

When faced with concerns from AIRCO executives regarding the accounting for the CAPCO Transaction and certification for the SOX Act that were set forth in an e-mail, Smith, in an "upset" and "aggressive tone," directed them to destroy the e-mail and any other e-mails or hard-copies on the subject (Exhibits 146, 148, annexed to the Smith Aff., Krupp Dep Tr 74:17-22, 75-6; Cubbon Dep Tr 93-96).

Shockingly, both defendants defend their approval of the CAPCO Transaction, testifying that Umansky assured them that the transaction would be structured properly to comply with all legal, accounting and regulatory guidelines (Exhibits 1, 3, annexed to the Dwyer Aff., Exhibit 2, annexed to the Sama Supp Aff., Greenberg Dep Tr 218:8-20; Smith Dep Tr 113:20-21, 263:25-264:8, 248:7-24, 264:9-25, 265:2-23, 290:16-23, 313:2-10, 18-24, 314:6-13, 339:6-22, 318:22-319:7). Further, they attempt to deny culpability on the basis of one sentence in Umansky's April 2000 memo that stated "The accounting is aggressive and there will be a significant amount of structuring required in order to address all the legal, regulatory and tax issues" (Exhibits 110, 123, annexed to the Smith Aff., Greenberg Dep Tr 169:22-70:7).

However, Greenberg has admitted that he never asked for, or received, any legal opinion that would form the basis of such a defense (Exhibit 110, annexed to the Smith Aff., Greenberg Dep Tr 181:5-19).

The Court concludes that the NYAG has demonstrated that defendants' involvement and knowledge of the CAPCO Transaction constitutes a violation of the Martin Act for which there are no genuine issues of material fact in dispute. Defendants' assertions that they were under the impression that the transaction was proper is not a defense to Martin Act and Executive Law claims, which are concerned with an actor's

personal knowledge or participation, and not with any particular mental state (*People*, 95 Misc 2d at 621).

The Court's conclusion is based upon the largely undisputed evidence, including defendants' testimony, regarding their repeated and persistent personal involvement and knowledge of the CAPCO Transaction, and its stated purpose, to convert underwriting losses into capital losses by masking AIG's control of a supposedly independent offshore company to assume the loss.

Accordingly, the Court finds that the NYAG is entitled to summary judgment as to liability against defendants for violating the Martin Act and Executive Law § 63 (12) as a result of their knowledge of and participation in facilitating the CAPCO Transaction.

Damages

Finally, defendants move for summary judgment to dismiss the complaint on the ground that the NYAG is unable to establish any damages or reliance in this action. According to Greenberg, because he did not sell any AIG stock during the relevant time period, he was not "unjustly enriched" by the alleged improper aspects of these transactions and there are no "profits" that could form the basis for a restitution claim. Further, because there is no ongoing "fraud," and defendants do not currently serve in any executive capacity at AIG, there is no basis for injunctive relief.

Defendants' arguments are meritless. Proof of actual damages, injury or reliance are not a required element for liability to

accrue under the Martin Act. Under the statute's terms, where a person engages in any prohibited act, that person is guilty "regardless of whether issuance, distribution, exchange, sale, negotiation or purchase resulted" (GOL 352-c; see also *State*, 212 AD2d at 367; *People*, 258 AD2d at 193; *People v Royal Securities Corp.*, 5 Misc 2d 907, 909 [Sup Ct, NY County 1955]). Moreover, both the Martin Act and Executive Law authorizes "restitution and damages" as the result of a violation.

In any event, defendants fail to demonstrate that the transactions caused no damage to AIG's shareholders. Extensive expert testimony was considered in the Criminal Action and Judge Droney rejected the same argument as to damages made by the criminal defendants. In the Criminal Action, it was determined that the Gen Re Transaction caused damages in the range of \$450 and \$500 million to the shareholders of AIG.

To rebut this finding, defendants submit an expert report that concludes that the Gen Re Transaction caused no damages, thereby conflicting with Judge Droney's conclusion. In response, the NYAG indicates that it is prepared to submit a report at a damages hearing from the Stanford Consulting Group demonstrating that the Gen Re transaction actually caused some \$3 billion in damages to AIG shareholders. Clearly, the issue of damages caused by the Gen Re Transaction cannot be resolved at the summary judgment stage.

As to the purported damages caused by the CAPCO Transaction, the issue has yet to be litigated. In any event, defendants fail to demonstrate as a matter of law that it did not cause damage.

Accordingly, it is

ORDERED that defendant Maurice R. Greenberg's motion (040) for summary judgment is denied in its entirety; and it is further

ORDERED that the motion of the plaintiff State of New York by Attorney General Andrew M. Cuomo, acting on behalf of the People of the State of New York (041) is denied, in part, to the extent of the "Gen Re Transaction," and is otherwise granted in favor of the plaintiff against defendants, Maurice R. Greenberg and Howard I. Smith, to the extent of granting the plaintiff partial summary judgment on the issue of liability regarding the "CAPCO Transaction," with the amount of money damages due, if any, to be resolved at a separate hearing; and it is further

ORDERED that Howard I. Smith's motion (042) for summary judgment is denied in its entirety, and it is further

ORDERED that defendants Maurice R. Greenberg's and Howard I. Smith's motions (043, 044) to file over-sized memoranda of law is granted without opposition; and it is further

ORDERED that the motion by non-party Jeffrey J. Haas (045) to file an amicus curiae brief in support of Greenberg is denied; and it is further

ORDERED that a copy of this order with notice of entry be served upon the Clerk of the Trial Support Office (Room 158), who is directed, upon the filing of a note of issue and a statement

of readiness and the payment of proper fees, if any, to place this action on the trial calendar.

Dated: October 21, 2010

ENTER:



A handwritten signature in black ink, consisting of a large, stylized initial 'J' followed by a horizontal line extending to the right.

J.S.C.

FILED

OCT 21 2010

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COUNTY CLERK'S OFFICE