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(212) 318-6405
patrickshea@paulhastings.com

March 16, 2009

Thomas C. Baxter, Jr.
General Counsel
Federal Reserve Bank of New York
33 Liberty Street
New York, New York 10045

Re: AIG Financial Products Corp.'s Employee Retention Plan

Dear Mr. Baxter:

We were retained by AIG Financial Products Corp. ("AIGFP") and American International Group, Inc. ("AIG") months ago to, among other things, conduct an extensive legal review and analysis of AIGFP's compensation plans, including the AIGFP Employee Retention Plan ("ERP") adopted in early 2008. In particular, we have analyzed whether the Guaranteed Retention Awards ("GRAs") under the ERP constitute a legally enforceable contractual obligation of AIGFP and AIG, as well as the risks associated with a failure to pay GRAs under the Connecticut's Wage Act ("Wage Act") and the availability of expedited relief to remedy any such failure.

We believe that there is a clear contractual obligation on the part of AIGFP -- which is guaranteed by AIG -- to pay GRAs to participants who have not been terminated for cause, resigned without good reason, or (with respect to the GRA for 2009) been terminated for failure to meet performance standards in calendar year 2008. The failure to pay GRAs would expose AIGFP and AIG to double damages and attorneys fees under the Wage Act. Further, in the event of a breach, expedited relief would likely be available to participants in four of the five jurisdictions where AIGFP employees work.¹

ANALYSIS

Breach of Contract Claims

Under Connecticut common law, which governs the ERP (Section 4.08), the ERP would be considered a unilateral contract enforceable according to its terms. *Torosyan v. Boehringer Ingelheim Pharmaceuticals, Inc.*, 234 Conn. 1, 13 n.4 (1995) (a unilateral contract in an employee handbook is one in which the offeror invites acceptance of his promise not by a reciprocal promise, but by performance); *Schreiber v. Connecticut Surgical Group, P.C.*, 96 Conn.App. 731, 738 n.5 (Conn. App. 2006) (termination letter stating that salary and

¹ Such relief would likely be available in the United States, the United Kingdom, France and Japan, but not likely in Hong Kong.

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benefits would continue until end of 90-day notice period constituted a complete and unambiguous express unilateral contract, which the employee accepted by performance); *Feilbogen v. AIG Trading Group, Inc.*, No. 3:03CV1624 (DJS), 2006 U.S. Dist. LEXIS 29184, at *17-26 (D. Conn. May 15, 2006) (no dispute at summary judgment stage that oral promise of guaranteed retention bonus satisfied prima facie elements of a contract claim). Moreover, in this case, the plan was distributed to all participants in early 2008 and participants were asked to execute confirmations acknowledging and agreeing to the terms of the ERP, which all participants did. Further, management confirmed to employees in writing, on multiple occasions, that the company would honor its contractual commitments under the ERP.

Under the ERP there is a clear and unambiguous obligation to pay participants the GRAs unless a participant is 1) terminated for cause, 2) resigns without good reason, or 3) with respect to the GRA for 2009, is terminated for failure to meet performance standards during calendar year 2008.² Except for terminated participants in these three categories, the obligation to pay participants is mandatory. See ERP Sections 3.04 and 3.05. The ERP also prohibits any amendments that would reduce or delay required payments. See ERP Section 4.03.

The obligation to pay the GRAs is expressly guaranteed by AIG pursuant to the AIG General Guarantee Agreement. ERP Section 3.03. The terms of that guarantee extend to any "monetary obligation or liability [of AIGFP]." On its face, this would include the obligation to pay GRAs.

We have considered whether the defense of impossibility and/or illegality would be available in the event of a failure to pay. Recent executive compensation pay cap legislation does not appear to apply to the ERP. Section 111 of the Emergency Economic Stabilization Act, as amended, ("EESA") provides that such restrictions do not apply to bonus payments required to be paid pursuant to a written employment contract executed on or before Feb. 11, 2009. 12 U.S.C. § 5221. Based on the plain language of the statute, the ERP falls within this exception because each of the requirements specified in the statute is satisfied by the ERP.³ We do not believe there is a basis for asserting a defense of illegality or impossibility.

² Cause means "intentional wrongdoing, fraud, dishonesty, gross negligence, material breach of the AIG Code of Conduct or other policies of AIGFP or AIG, or conviction of or entry of plea of guilty or no contest to a criminal offense." ERP Section 3.04(b). Good reason means "a material reduction in base salary, a material reduction in title, duties or responsibilities, or transfer to a geographic location that is more than 50 miles from the Covered Person's current location." ERP Section 3.04(a).

³ The GRAs are "bonus" payments, "required" to be paid, pursuant to a "written employment contract" executed on or before February 11, 2009. The statute authorizes the Secretary of the Treasury to issue regulations and to make determinations as to what constitutes "valid employment contracts." Although the Secretary has not yet issued regulations, we do not see a basis for declaring that the executed written agreements with respect to the ERP fall outside this grandfathering provision.

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Because AIGFP is contractually obligated to pay the GRAs, its failure to do so would excuse further performance by the employee if such failure were deemed a material breach. *See Bernstein v. Nemeyer*, 213 Conn. 665, 672 (1990). A “material breach” affects the substantive rights of the parties, “touches the fundamental purpose of the contract and defeats the object of the parties in making the contract.” *Fishman v. Smartserv Online*, No. X05CV0172810S, 2003 Conn. Super. LEXIS 338, at *24 (Conn. Super. Ct. Feb. 11, 2003). If the GRAs were not paid, we believe this would constitute a material breach that would relieve participants of their obligation to perform (i.e., to continue their employment at AIGFP.) *Begley v. Pikula*, 33 Conn. Supp. 592, 595 (Conn. Super 1976) (finding that trial court did not err in determining that plaintiff had terminated his employment “justifiably” because the defendant refused to pay him a commission he had earned). Thus, in the event of a failure to pay, employees could resign and still sue to recover GRAs for both 2008 and 2009.⁴

The Connecticut Wage Act

Moreover, failure to pay GRAs would subject AIGFP and AIG to a substantial risk of double damages under the Wage Act, which provides for the recovery of double damages and attorneys fees when wages are improperly withheld. Conn. Gen. Stat. §31-72. Double damages are generally available in cases in which an employer's refusal to pay wages lacks a good faith basis. *Schoonmaker v. Lawrence Brunoli, Inc.*, 265 Conn. 210, 269 (2003) (double damages appropriate for “bad faith, arbitrariness or unreasonableness”).

The Wage Act defines the term “wages” as “compensation for labor or services rendered by an employee, whether the amount is determined on a time, task, piece, commission or other basis of calculation.” Conn. Gen. Stat. §31-71a. Courts have concluded that guaranteed bonuses constitute wages under the statute when “the payment is premised upon work or services the employee has performed as opposed to the general success of the company or the whim of management.” *Feilbogen*, 2006 U.S. Dist. LEXIS 29184, at *26-28 (denying summary judgment and finding that plaintiff might be able to prove that his guaranteed retention bonus constituted unpaid wages).

The GRAs for most participants represent a fixed amount that is a large portion of their compensation for 2008. In addition, the GRAs are guaranteed retention payments suggesting that the payments are related to participants’ contributions to the company. Viewed from this perspective, the GRAs appear to be “wages.” But GRAs are also payable to participants who resign for good reason or who are terminated without cause. In this sense, GRAs are more like severance payments, which Connecticut courts have

⁴ The ERP provision allowing resignation for good reason does not authorize a resignation based on a reduction in GRA payments. Conceivably, AIGFP could argue that this was intended as a matter of contract to supersede the material breach principles discussed above. However, the good reason provision covers only contingencies—material reduction in salary, title or job duties or relocation—that would not constitute a breach of the ERP. This would make it difficult to claim that this provision was also intended to insulate AIGFP from the established consequences flowing from a material breach of the ERP.

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generally found to fall outside the protection of the Wage Act.⁵ Thus, current employees have a potentially stronger claim than terminated employees that the GRAs are wages.

If the GRAs are deemed to be wages, it is unlikely that AIGFP could establish a good faith legal basis for withholding payment, and it would therefore likely be required to pay double damages.⁶

Expedited Remedies

In the event of a breach, plan participants will also likely successfully obtain expedited relief from courts in most of the various jurisdictions where they are employed.

a. **Connecticut:** In Connecticut, plan participants could seek a pre-judgment remedy to attach assets of AIG and AIGFP sufficient to satisfy any judgment. Such remedies are granted upon a showing of probable cause, which is not a high standard for plaintiffs to meet.⁷ Probable cause is a “*bona fide* belief in the existence of the facts essential under the law for the action and such as would warrant a man of ordinary caution, prudence and judgment, under the circumstances, in entertaining it.” *Three S. Development Co. v. Santore*, 193 Conn. 174, 175 (1984); *Amgimon v. Debis Fin. Servs.*, No. CV02391470S, 2003 Conn. Super. LEXIS 9, at *8-9 (Conn. Super. Ct. Jan. 3, 2003)

⁵ See *Stoddard v. WBM Plaza, LLC*, No. CV054007856, 2006 Conn. Super. LEXIS 895, at *13 (Conn. Super. Ct. Mar. 20, 2006) (“The statutory definition of ‘wages’ as used in § 31-72 is limited on its face and makes no mention of severance pay.”); *Mangiofico v. McKelvey*, No. CV044000609S, 2005 Conn. Super. LEXIS 1075, at *8-9 (Conn. Super. Ct. Apr. 18, 2005) (finding that the severance pay promised to the plaintiffs did not constitute wages for the purposes of § 31-72); *Justin v. AMA, Ltd.*, No. CV92 29 33 60, 1993 Conn. Super. LEXIS 1516, at *6 (Conn. Super. Ct. June 8, 1993) (Conn. Super. 1993) (finding that any agreement between the parties concerning the payment of severance pay to the plaintiff would not be an agreement “for payment of wages” within the meaning of § 31-72); *Wuerth v. Sebott Electronics, Inc.*, No. CV91 03 64 06S, 1992 Conn. Super. LEXIS 846, at *3 (Conn. Super. Ct. Mar. 12, 1992) (“The Connecticut Supreme Court and the United States District Court for Connecticut have both held that severance pay does not constitute wages. . . . severance is an additional payment above and beyond compensation for labor or services rendered.”) (citations omitted).

⁶ In the alternative, in the event that the GRAs are not found to be “wages,” participants could bring claims of intentional breach of contract. Connecticut courts recognize an “intentional breach of contract” where the conduct underlying the breach of contract was “wanton and malicious” or displayed a reckless disregard for the plaintiff’s rights. *Tamborino v. Velocity Express, Inc.*, No. FSTCV0505000234S, 2008 Conn. Super. LEXIS 1527, at *28-29 (Conn. Super. Ct. June 6, 2008). Such a claim would subject AIGFP and AIG to punitive damages, which under Connecticut law are limited to the participants’ attorneys’ fees. *Id.*

⁷ An applicant for a pre-judgment remedy is not required to plead exigent circumstances to show why the funds for an award might not be available by the time of judgment. Connecticut courts have opined that the purpose of § 52-278 is simply to “put teeth” behind a plaintiff’s power to sue. See *Town of New Hartford v. Conn. Res. Recovery Auth.*, No. X02CV040185580S, 2007 Conn. Super. LEXIS 749, at *10-11 (Conn. Super. Ct. Feb. 22, 2007) (“If the plaintiffs have the power to sue, they should have the power to attach. The prejudgment remedy statute does not exempt such an attachment. If this court were to rule otherwise, the power to sue [a defendant] would be reduced to the legal equivalent of a paper tiger.”).

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(granting pre-judgment remedy to secure claim for short-term incentive compensation in amount of \$1,250,000.00 after finding that plaintiff presented sufficient evidence to establish probable cause that defendant failed to deal with him in good faith when it fired him and ended his opportunity to participate in the long-term incentive plan); *Nofs v. Gemini Network, Inc.*, No. CV020818599S, 2003 Conn. Super. LEXIS 316, at *23-28 (Conn. Super. February 4, 2003) (granting pre-judgment remedy for amount of lost wages and a bonus, a third of the restricted shares which had vested and an attachment for a third of plaintiff's outstanding stock where plaintiff showed probable cause of wrongful discharge).

b. **United Kingdom:** In the United Kingdom, participants could seek summary judgment from the High Court, and in the absence of any substantial defense could likely be awarded judgment as early as eight to ten weeks after the filing of the complaint (any appeal from such a judgment would not automatically stay the obligation to pay). Even if no summary judgment was awarded, the court could order an expedited trial which could be heard and determined within six months of filing of the complaint. If an expedited trial was ordered, there would be a substantial risk that AIGFP would be required to pay a sum into court equal to the potential liability as a condition of allowing it to defend the claim; alternatively, participants could secure some other interim remedy, such as a freezing injunction restraining AIGFP from dealing with assets.

c. **France:** In France, participants could initiate a summary proceeding that could result in an award in their favor in as little as two months from the filing of the complaint.

d. **Japan:** In Japan, participants could seek a provisional attachment similar to the remedies available elsewhere. A complaint may be heard in as little as three to four months, but an appeal would take much longer, and there is no obligation to pay until the appeal is resolved.

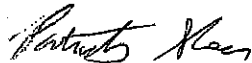
e. **Hong Kong:** In Hong Kong there is no provision for expedited hearings and disputes can take years to resolve.

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Conclusion

7 There is a clear contractual obligation on the part of AIGFP -- which is guaranteed by
AIG --to pay GRAs to participants who have not been terminated for cause, resigned
without good reason, or (with respect to the GRA for 2009) been terminated for failure to
meet performance standards in calendar year 2008. The failure to pay GRAs would
expose AIGFP and AIG to double damages and attorneys fees under the Wage Act.

Sincerely,



Patrick W. Shea
of PAUL, HASTINGS, JANOFSKY & WALKER LLP

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