14-4067-cv(L)

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

In Re AMERICAN INTERNATIONAL
GROUP, INC. SECURITIES LITIGATION

Appeal from the United States District Court
For The Southern District Of New York
Case No. No. 04 Civ. 8141(DAB), The Honorable Deborah A. Batts, Presiding

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BRIEF OF AMICUS CURIAE AMERICAN BENEFITS COUNCIL
IN SUPPORT OF APPELLANT AIG RETIREMENT PLANS

SEYFARTH SHAW LLP
James R. Napoli
Christopher M. Busey

American Benefits Council
Janet M. Jacobson

Attorneys for Amicus Curiae American Benefits Council

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INTEREST OF AMICUS CURIAE

The American Benefits Council (the "Council") is a broad-based nonprofit organization dedicated to protecting and fostering privately sponsored employee benefit plans under ERISA.[1] The Council's approximately 400 members include large employer sponsors of employee benefit plans, as well as organizations that provide services to employers of all sizes regarding their employee benefit programs. Collectively, the Council's members either directly sponsor or provide services to ERISA plans covering more than 100 million Americans. The Council regularly participates as amicus curiae in court actions implicating issues that affect employee benefit plan design or administration.

The Council and its members have a substantial interest in this case, which presents the issue of whether an ERISA-governed retirement plan is an "affiliate" of the plan's sponsoring employer as that term is defined under federal securities law.

[1] No party or counsel for a party authored this brief in whole or in part. No party, counsel for a party, or person other than amicus curiae, its members, or its counsel made a monetary contribution intended to fund the preparation or submission of the brief. Both parties have consented to the filing of this brief.

INTRODUCTION

The Council believes that the District Court erred in concluding that the Plans[2] constitute "affiliates" of AIG because the company possesses "control" over them through its power to appoint fiduciaries or terminate the Plans. This conclusion lacks a basis in either securities law or ERISA. While Appellants touch on several arguments demonstrating the District Court's error, the Council believes it necessary to highlight two others that further indicate that the District Court misapplied securities law and ignored the ERISA context completely. First, the District Court's reasoning would preclude recovery by all employees of AIG. The company assuredly exhibits at least as much – and likely more – "control" over its employees as it does over the fiduciaries appointed to manage its benefit plans, since fiduciaries, once appointed, are bound by ERISA to act solely in the interest of plan participants and not the company. Second, and critical to the Court's understanding of this issue, the Plans should not be excluded even under the security law definitions applied by the District Court. Appellants creditably argue that ERISA law should define those terms, but the District Court erred even if this Court borrows the definitions of "affiliates" and "control" from securities law. As such, the District Court's opinion should not stand.

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[2] The use of the term "Plans" reflects its use in Appellants' brief. *See* Brief and Special Appendix of Appellants, Dkt. No. 61 at Corporate Disclosure Statement.

We have decided to provide our views to the Court because the implications of the Court's decision of the issues raised in this appeal are far-reaching and unwelcome. We must begin with the simple premise that ERISA encourages, but does not require, employers to provide benefit plans to their employees; and Congress provided important incentives to induce employers to sponsor such plans. *See* Tax Reform Act of 1976, Pub. L. No. 94-455, § 803 (Oct. 4, 1976) ("The Congress, in a series of laws . . . has made clear its interest in encouraging employee stock ownership plans."). In other words, the statutory scheme erected by Congress is wholly voluntary.

While the Council has repeatedly expressed concern about frivolous ERISA lawsuits against Employee Stock Ownership Plan ("ESOP") fiduciaries, we also believe that Congress intended that participants saving in retirement vehicles and investing in equities of companies would be protected by the securities laws. We are aware of no evidence that Congress intended to provide less protection to Americans buying equities in their employment-based 401(k) and other plans.

The District Court's ruling could also have unexpected and concerning implications for the relationship between plan fiduciaries and the employers that establish and maintain retirement plans. Plan fiduciaries do not act as if the employee benefit plan they administer and manage is an "affiliate" of the plan sponsor – doing so would violate their most basic duties under ERISA. Thus, the

Council and its members are concerned that the District Court's ruling could be inconsistent, and could have significant negative effects, if applied in other contexts. To take a simple example: ERISA prohibits myriad transactions between a plan and certain "parties-in-interest," which include the plan sponsor and certain of the plan sponsor's affiliates. *See* 29 U.S.C. §§ 1102(14); 1106(a). The District Court's ruling suggests that the plan is its own "party-in-interest" – a conclusion that would make plan administration impossible.

More significantly, the District Court's opinion, if applied to other plans, could have the perverse effect of encouraging employees not to participate in employer-sponsored plans, because it creates an artificial distinction under the securities laws between saving for retirement in ERISA-governed plans and saving outside the employment context. This would mean relinquishing significant advantages of ESOPs like employer matching contributions or favorable tax treatment that are not readily available outside of a tax-qualified ESOP. The Court may prevent this undesirable outcome by reversing the District Court and allowing the Plans to share in the settlement award available to all other AIG investors.

ARGUMENT

I. The District Court Erred in Ruling That The Plans Are "Affiliates" of AIG

In ruling that the Plans were "affiliates" of AIG, the District Court relied on two lines of legal reasoning. First, the District Court found that, "while the term ["affiliate"], in general, may be somewhat vague," the term "affiliate" as used in the Settlement Agreement is not. ECF No. 749 at 9. The District Court based this conclusion on the definition of the term "affiliate" in Black's Law Dictionary. *Id*. at 9-10. In the alternative, the District Court turned to federal securities law to define the term "affiliate" for purposes of the Settlement.

Under both the Black's Law Dictionary and federal securities law definitions of "affiliate," the level of "control" one party exerts over another is the gravamen of whether the other party is or is not an "affiliate" of the alleged controlling party. ECF No. 749 at 9-11. The District Court ruled that AIG's ability to appoint plan fiduciaries to the Plans as well as AIG's ability to terminate the Plans established the requisite level of "control" over the Plans such that the they were "affiliates" of AIG. *Id*. As such, the District Court further ruled that the Plans were excluded from enjoying any of the fruits of the Settlement. The District Court's ruling on this issue is in error, however, because the Court failed to properly apply the cited definitions to the case at hand. Specifically, the District Court failed to adequately consider the ramifications of extending its reasoning and the context within which the terms apply when dealing with ERISA-governed plans.

A. **<u>The District Court's Test for Determining "Control" Would Dictate That All Employees of AIG Who Purchased or Otherwise Acquired Securities to be Excluded from the Settlement, Not Only Those That Participated in the Plans</u>**

The District Court determined that the Plans should be classified as "affiliates" of AIG merely because it possessed "control" over the Plans through the authority to appoint members of the Plans' administrative committees. Taken to its logical conclusion, however, the District Court's reasoning proves too much. AIG undoubtedly retains "control," in the District Court's use of the word, over *all* its employees. All that is required to satisfy the District Court's definition of "control" is the "direct or indirect power to govern the management and policies of a person or entity" or the "power or authority to manage, direct, or oversee." ECF No. 749 at 9-10 (*quoting* Black's Law Dictionary (9th ed. 2009)). Among countless levers of control at its disposal, AIG has the ability to hire, fire, promote, and discipline all of its employees. Yet, the Settlement Agreement could not possibly have been intended to exclude AIG employees. Indeed, that result would preclude perhaps the most likely classes of securities plaintiffs from bringing suit and defy the most basic tenets of securities litigation. *See, e.g.*, *Burke v. Jacoby,* 981 F.2d 1372 (2d Cir. 1992) (permitting former employee to bring suit under

Securities Exchange Act of 1934, but entering judgment for defendant where plaintiff could not establish genuine issue of material fact).

Moreover, the District Court's decision creates an untenable dichotomy between plan participants and other shareholders. Two sets of employees, who are similarly situated but for the method by which they acquired shares of AIG, would be treated differently under the Settlement Agreement. Those that bought shares on the open market would benefit from the Settlement Agreement and have the harm suffered by the alleged fraud remedied. Those who participated in the Plans, through no fault of their own, would likely be left without a remedy unless they were able to pursue a separate recovery, incurring unnecessary and significant expenses in the process. This result finds no support in securities law or ERISA. Indeed, securities plaintiffs are often employees or former employees. *See, e.g.*, *Burke*, 981 F.2d at 1374. Moreover, it runs headlong into one of the goals of ERISA: encouraging employers to provide retirement benefit plans that invest in employer stock. *See Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459, 2468 (2014) (identifying "an attempt to promote employee ownership of employer stock" as "a goal that Congress views as important"); *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 54 (1987) (ERISA reflects a "careful balancing of the need for prompt and fair claims settlement procedures against the public interest in encouraging the formation of employee benefit plans"). The Supreme Court has repeatedly recognized that Congress favors ESOPs. *See, e.g., Dudenhoeffer*, 134 S. Ct. at 2465-66 (2014) (stating that Congress has "written into law its interest in encouraging" use of such plans).

The District Court failed to consider the practical realities of its use of the terms "affiliate" and "control" in this case, and crafted a rule that, if taken to its logical end, would preclude all employees from participating in securities litigation involving securities of their employers within which the employees are invested. ERISA aside for the moment, this cannot possibly be the result intended under the federal securities law – the law upon which the District Court relies in rendering its ruling. Moreover, the District Court only applied its legal reasoning to one class of employee; namely, those who invested in AIG through the Plans. The District Court's treatment of the underlying issues has, thus, created a dichotomy between the manner with which investing employees are treated. This is reversible error.

B. Federal Securities Law Dictates That the District Court Account for ERISA in Determining Whether The Plans are Affiliates of AIG.

As stated earlier, we are concerned that the District Court's reasoning does not properly reflect the rules under which ERISA plans are governed. It appears that the District Court ignored the strictures ERISA places on plan fiduciaries, stating that "it is appropriate to look to the definition [of 'affiliate'] provided in regulations promulgated under the 1933 and 1934 Acts. ECF No. 749 at 10-11 (*quoting Waldman v. Riedinger*, 423 F.3d 145, 151 (2d Cir. 2005)). The District Court thus turns to the definitions of "affiliate" and "control" contained in the SEC regulations. *Id.* at 10. The District Court's conclusion, however, is not even supported by a fair reading of those applicable securities regulations, which define "affiliate" as "a person that directly, or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified." 29 C.F.R. § 230.405. In turn, "control" is defined as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." *Id.*

Conspicuously absent from the District Court's analysis, however, is the prefatory phrase to the definitions it cites. The definitions noted above apply "*unless the context otherwise requires*." 17 C.F.R. § 230.405 (emphasis added). The Supreme Court has interpreted this phrase to allow for consideration of the factual circumstances under which the definition is scrutinized. *See, e.g., Weaver v. Marine Bank*, 455 U.S. 551 (1982). In *Weaver*, the Court cited the same prefatory phrase in analyzing the definition of "security" under the Securities Exchange Act of 1934. *Id.* at 556. It then discussed the factual circumstances surrounding the certificate of deposit at issue, ultimately concluding that the instrument did not constitute a "security" under the law. *Id* at 560. The Court noted that "[e]ach transaction must be analyzed and evaluated on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole." *Id.* at 560 n. 11.

The Second Circuit has also analyzed the particular factual circumstances of financial transactions in defining terms under securities law. *See, e.g., Exch. Nat'l Bank of Chicago v. Touche Ross & Co.*, 544 F.2d 1126 (2d Cir. 1976); *In re Adelphia Commc'ns Corp Sec. & Derivative Litig.*, 398 F. Supp. 2d 244, 257-260 (S.D.N.Y. 2005) (analyzing the definition of "purchase or sale" under the specific factual circumstances of the case). The phrase "unless the context otherwise requires" limits the statutory definition, which "courts have shrunk from a literal reading" of the statute. *Id.* at 1133; *see also Chem. Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 936 (2d Cir. 1984) (same). In *Exchange National Bank*, the court set forth a litany of instances where a "note" would not constitute a "security" as would otherwise be required by the Act and stated that only notes "that do not bear a strong family resemblance to these examples" would be deemed to fall within the definition for securities. *Id.* at 1138. Since that ruling, the Second Circuit and its district courts have similarly looked to the factual circumstances of each case to determine if the context of the case requires a moderated definition under securities law. *See, e.g. Chem. Bank*, 726 F.2d at 936-

39 (analyzing the definition of "security" given in *Exchange National Bank* and noting that those examples are "not graven in stone"); *Adelphia Commc'ns*, 398 F. Supp. 2d at 257-60 (utilizing three factors to determine if a transaction qualified as a "purchase or sale" under securities law); *Equitable Life Assur. Soc'y of the United States v. Arthur Andersen & Co.*, 655 F. Supp. 1225, 1245 (S.D.N.Y. 1987) (finding that "the context otherwise requires the exclusion of the transaction from coverage of the 1934 Act").

Although the party asserting that "the context otherwise requires" bears the burden of making that showing, that burden is easily met here. *Chem. Bank*, 726 F.2d at 939. As in *Weaver* and *Exchange National Bank*, the present case requires a limiting interpretation of the term "affiliate." First, the general purposes of the Settlement Agreement indicate that the Plans are not affiliated with AIG. The agreement was struck "to ensure that those who perpetrated, or otherwise profited from, the alleged fraud would not benefit from the settlement." *Waldman v. Riedinger*, 423 F.3d 145, 153 (2d Cir. 2005). "Rather than profiting from the alleged fraud, as an affiliate might have done," the Plans – and, by extension, the innocent participant-shareholders of the Plans – were victimized by it. *Id.*; *see also Exch. Nat'l Bank*, 544 F.2d at 1134 ("The Act is for the protection of investors, and its provisions must be read accordingly.") (citation omitted).

Further, the Council and its members have significant experience in ERISA and the relationship between an employer (typically called the plan sponsor), who establishes the plan, and the fiduciaries, who administer the plan. Nothing could be more inconsistent with ERISA to say that the plan sponsor "controls" the fiduciaries – in fact a key reason Congress enacted ERISA was to separate the plan sponsor from the plan fiduciary.

ERISA states that each plan must have "one or more named fiduciaries who jointly or severally shall have the authority to control and manage the operation and administration of the plan." 29 U.S.C. § 1102(a). Each plan must also have a trustee or trustees, who, with certain exceptions not relevant here, must have the "exclusive authority and discretion to manager and control the assets of the plan." 29 U.S.C. § 1103(a).

Once appointed, the fiduciaries must act with strict loyalty to plan participants and beneficiaries. *See* 29 U.S.C. § 1104(a)(1)(A)(i). This cannot be undermined by the plan's governing documents. *See Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014) ("[T]rust documents cannot excuse trustees from their duties under ERISA."); *see also* 29 U.S.C. § 1104(a)(1)(D) (fiduciaries must act "in accordance with the documents and instruments governing the plan *insofar as such documents and instruments are consistent with the provisions of this subchapter*.") (emphasis added). In fact, if the plan fiduciaries use plan assets to benefit the plan sponsor, or let the plan sponsor "control" the plan in a way to benefit the plan sponsor, this would violate a host of ERISA provisions and the federal tax code. *See*, e.g., 29 U.S.C. § 1106(a); 26 U.S.C. § 401(a)(2). Put simply, when an ERISA plan holds employer securities, those assets are no longer under the "control" of the plan sponsor but must be used exclusively by the plan's fiduciaries to provide benefits under the plan. This is further evidenced by the fact that many retirement plan participants direct their own investment choices. In most cases, if fiduciaries override participant decisions, such actions would again result in ERISA violations as well as fiduciary liability.

Simply stated, the context otherwise required that the District Court account for the Plans' relationship with AIG under ERISA as well as ERISA law itself in determining whether AIG retained sufficient "control" over the Plans to render them securities law "affiliates" of AIG. The District Court did not so consider the Plans' relationships to AIG, nor did the Court consider ERISA law in any real manner. That lack of inquiry was reversible error.

CONCLUSION

For the foregoing reasons, the Court should vacate the Order of the District Court and remand with instructions to direct the settlement administrator to approve the Plans' claims and to distribute settlement funds to the Plans.

DATED: March 26, 2015

Respectfully submitted,

Attorneys for Amicus Curiae American Benefits Council

By /s/ James R. Napoli

James R. Napoli
Seyfarth Shaw LLP
975 F Street, NW
Washington, DC 20004
202-828-3593
Fax 202-641-9193

Christopher Busey
Seyfarth Shaw LLP
131 South Dearborn Street
Suite 2400
Chicago, IL 60603
(312) 460-5234

CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared using Microsoft Word in a proportionally spaced typeface (Times New Roman, 14 point). I further certify that this brief complies with the type-volume limitation set forth in Fed. R. App. P. 32(a)(7)(B) and contains _________ words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

Dated: March 26, 2015

By: /s/ James R. Napoli
James R. Napoli

Attorney for Amicus Curiae American Benefits Council

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By: /s/ James R. Napoli
James R. Napoli

Attorney for Amicus Curiae American Benefits Council