Once Paid, AIG Bonuses will be Hard to Recover

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By Kathleen Pender
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President Obama pledged Monday to challenge $165 million in bonuses paid to American International Group employees in the division that was largely responsible for bringing the company down.

Some attorneys are asking why the government, which owns 80 percent of AIG, didn't pressure the company to withhold payments while it investigated ways to stop them.

"There wasn't any hurry to pay them out," says Miriam A. Cherry, an associate professor of contract law at the University of the Pacific. Cherry says it would have been better to force AIG employees to bring a case explaining why they were entitled to the bonuses.

Once in the hands of employees, those payments will be very hard to claw back. AIG reportedly told Treasury Secretary Timothy Geithner that if it didn't pay out the bonuses that were due on Sunday, it could wind up paying twice as much. Under a Connecticut law, employees can collect double damages plus attorneys fees if an employer withholds wages and the employee can prove bad faith. Cherry says she is not sure whether bonuses would qualify for wages under this law.

AIG paid additional bonuses to workers in other parts of its insurance empire, but they are not generating as much outrage as bonuses paid to employees of its Financial Products division, which wrote contracts that essentially guaranteed securities backed by pools of loans including subprime mortgages.

Losses on those securities grew so large that in September 2008, the Federal Reserve agreed to provide an $85 billion credit facility to AIG in exchange for nearly 80 percent of its stock. The government has injected a total of $173 billion into AIG, more than it has put into any other financial firm.

Neither AIG nor the Obama administration has disclosed which Financial Products division employees got bonuses and why. New York Attorney General Andrew Cuomo has said he will subpoena AIG to find out who got the money.

According to the Wall Street Journal, 400 employees were set to receive bonuses ranging from $1,000 to $6.5 million. The bonus pool included retention bonuses that AIG agreed to pay employees in early 2008 to prevent them from quitting.

It's hard to imagine how anyone in the division that drove AIG to the brink of bankruptcy could have earned a performance bonus for 2008.
"The dismal performance of the financial products unit was apparent in the earlier part of 2008," says Lucian Bebchuk, Director of the program on Corporate Governance at Harvard Law School.

"Similarly, it is hard to justify the bonuses as essential for retention, as they were not made contingent on executives' staying with the company. The executives who recently received the bonus payments are now free to leave AIG with the bonuses in their pockets," Bebchuk adds.

"To make its claim more credible," he says, the company should disclose the terms and dates of the contracts.

Without knowing the details, lawyers say it is hard to gauge AIG's chances of getting the money back.

"If the bonuses have been earned, I don't think there is any good contract remedy for getting them back," said Frank Snyder, a law professor with Texas Wesleyan University. "Some of my colleagues have suggested using a doctrine called changed circumstances or frustration of purpose" under the theory that things have changed so much the contract can be undone. "But that doesn't apply when one party has done all the things they have to do."

Snyder says that if AIG had been allowed to go bankrupt, the contracts might have been undone in bankruptcy court. But "the government didn't let them go under, so the company is stuck with the contracts it has."

Theoretically, AIG's nongovernment shareholders could try to sue the board for violating its duty of care, but "I'm sure AIG (like most companies) has a provision that says you can't sue directors for violating duty of care," he adds.

Snyder says AIG's best chance of getting back the money is through public pressure: "The government is capable of starting a criminal investigation to get money from people they think shouldn't have gotten paid."

**Bailouts, bonuses and outrage**

President Obama vowed to try to recover bonuses American International Group paid to employees in the company's Financial Products unit. This team was heavily involved in complex financial transactions that led to billions of dollars in losses.

Early 2008: AIG sets up a $450 million bonus pool to retain employees in its Financial Products unit.

Feb. 29, 2008: The head of the troubled unit, Joseph J. Cassano, resigns. It is later revealed that he was retained as a consultant for $1 million a month.

Oct. 15, 2008: Attorney General Andrew Cuomo of New York demands that AIG recover bonuses and other payments from former executives, including Cassano.
Oct. 22, 2008: AIG agrees not to make any payments from a $600 million deferred compensation and bonus pool for executives of the Financial Products unit. This is separate from the retention bonus program.

December 2008: AIG distributes about $55 million in retention bonuses to the Financial Products unit.

Jan. 27: AIG says it will pay retention bonuses as planned to the Financial Products unit, explaining that the program had been contracted months before the government provided aid.

March 13: AIG distributes a further $165 million in retention bonuses to employees in the financial products unit. Another payout of $230 million is scheduled for this year.

March 16: Cuomo says he will issue subpoenas to make AIG release a list of employees who received retention bonuses. The Treasury Department says it will try to block the company from making new bonus payments.