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Second Circuit Holds An Employer's ERISA-Regulated Benefit Plans Are Not "Affiliates" of the Employer-Sponsor for Class Settlement Purposes; Splits with Seventh Circuit

The Second Circuit's September 20 decision in *In re American International Group, Inc. Securities Litigation*, No. 14-4067(L) will likely have consequences in the negotiation of class action securities settlement agreements. The Court held that, because the Employee Retirement Income Security Act of 1974 ("ERISA") imposes strict limits on an employer's ability to control the management and policies of ERISA-regulated employee benefit plans it sponsors, those plans do not qualify as "affiliates" of the employer for purposes of determining whether they may share in the proceeds from a securities class action settlement agreement entered into by that employer. *Id.* at 5.

Background

This case arose out of the settlements of a class action alleging violations of federal securities laws by American International Group ("AIG") and other defendants.[1] *Id.* at 5-6. The agreements defined the "Settlement Class" broadly to include any investor who bought any publicly-traded AIG securities over a roughly five and a half-year period, but to *exclude* "any parent, subsidiary, *affiliate*, officer, or director of AIG." *Id.* at 6-7 (emphasis added). The settlement agreements did not, however, define the term "affiliate." *Id.* at 7.

Having acquired AIG securities during the defined class period, four AIG-sponsored ERISA-regulated employee benefit plans (collectively, "the Plans") submitted claims under the settlement agreements. *Id.* at 10-12. The settlement claims administrator, however, took the position that the Plans were ineligible to receive payments because, as AIG-sponsored employee benefit plans, they were "affiliates" of defendant AIG. *Id.* at 12, 14. The administrator also rejected the claims of three of the Plans on the grounds that the participant-level data they submitted did not reflect solely actual purchases of publicly traded AIG securities made by the Plans, because each Plan had matched individual participants' purchase and sale orders by intra-Plan settlement, and the Plans purchased (or sold) only the net amount of stock necessary to respond to participants' directions. *Id.* at 14-15.

When the lead plaintiffs moved for approval of the initial distribution of the settlement proceeds, the Plans filed a motion requesting that the district court direct the claims administrator to approve the Plans'

[1] Paul, Weiss served as counsel for AIG. The Plans had separate counsel.

claims and distribute proceeds from the settlements to the Plans. *Id.* at 16. The district court denied the Plans' motion, agreeing with the claims administrator that the Plans were affiliates of AIG. *Id.* The district court approved the initial distribution without the Plans' participation in the proceeds. *Id.*

The Court's Holding

The Second Circuit held that the Plans were not affiliates under the settlement agreements. In reaching this conclusion, the Second Circuit examined the *Black's Law Dictionary* definition of "affiliate" and rules promulgated by the Securities and Exchange Commission ("SEC"). *Id.* at 25-27. Finding the term "control" a key element in determining whether an entity is an affiliate of another, the Second Circuit concluded that the question of the Plans' status turns on whether AIG possesses the "direct or indirect . . . power to direct or cause the direction of the management and policies." *Id.* at 27 (internal quotations omitted).

In denying the Plans' motion, the district court relied on the Seventh Circuit's decision in *In re Motorola Securities Litigation*, 644 F.3d 511 (7th Cir. 2011) ("*Motorola*"). *Motorola* held, under circumstances nearly identical to those in *AIG*, that the defendant-corporation's 401(k) plan should be excluded from the class because it was an "affiliate." *Id.* at 28 (citing *Motorola*, 644 F.3d at 520). In deciding that the plan was an affiliate, the court in *Motorola* noted that the issuer appointed the plan's administrators who served "at the pleasure of [the issuer's] Board of Directors." *Id.* The Seventh Circuit thus concluded that the issuer had sufficient operational and administrative authority over the plan to make the plan an affiliate of the issuer. *Id.* Likewise, the district court in *AIG* found that the Plans were all sponsored by AIG, could be disbanded by AIG without reason, and were administered by AIG employees, including AIG officers and directors. *Id.* at 27-28.

The Second Circuit declined to follow the reasoning of *Motorola* and the district court, explaining that they failed to consider the role of ERISA in shaping the "contour and limits" on an employer's control of a sponsored plan. *Id.* at 29. As the Second Circuit explained, ERISA plans are designed to "insulate the trust from the employer's interest." *Id.* at 29. ERISA imposes strict fiduciary duties on the administrators to manage the funds in the interest of a plan's participants. *Id.* at 31. Looking through the "prism of ERISA's statutory goals and requirements," the Second Circuit found that the indicia of control relied upon by *Motorola* and the district court were insufficient to demonstrate the "power to direct the management and policies of the Plan." *Id.* at 35. The Court vacated and remanded the case for determination of whether the claim administrator's rejection of participant-level data from three of the plans was valid – a question the district court did not reach. *Id.* at 40-41.

Implications

As a result of this decision, securities class action settlement agreements in the Second Circuit that contain the standard "affiliate" language will by default include in the distribution-eligible group ERISA-

regulated employee benefit plans sponsored by the settling defendant. The Second Circuit's reliance on definitions for "affiliate" and "control" in SEC rules, however, raises the question whether courts will apply a similarly restrictive definition of "affiliate" in other contexts or whether conflicts will arise about how the term is defined.

The Second Circuit decision creates a split in how courts define the term "affiliate" in class action securities settlements, and settling defendants in other jurisdictions who desire to have employer-sponsored benefit plans included in any settlement distribution should consider negotiating language that explicitly excludes them from the "affiliate" definition. Excluding ERISA plans sponsored by the settling defendant from a settlement class may encourage additional litigation brought by plan fiduciaries who have the obligation to protect the rights of their participants. More broadly, the case illustrates that settling defendants should carefully consider whether other related entities, such as mutual funds or other investment vehicles that are sponsored by the settling defendant, should be expressly excluded from the "affiliate" definition given how broadly some courts have read the term. As an alternative to defining the term "affiliate" more narrowly, settling defendants should consider pressing for the elimination of the term completely, in favor of a more specific description of excluded entities, because its broad and ambiguous meaning may inadvertently exclude investors who had nothing to do with the challenged conduct from participating in the recovery of the class.

The lack of a decision regarding participant-level data for claims submitted by defined contribution plans also illustrates the uncertainty that remains in this area, and the issue should be watched closely in future litigation.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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