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Substance Over $37B in Form: Recharacterization, Equitable Subordination and the Limits of Independent Committees in '*In re AIG Financial Products*'

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Chief Bankruptcy Judge Mary F. Walrath recharacterized a $37.6 billion intercompany loan as equity after finding AIG advanced billions to its failing subsidiary without genuine expectation of repayment, proper documentation or board approval. Alternatively, the court equitably subordinated AIG's claim beneath former executives' deferred compensation claims, citing AIG's pattern of inequitable conduct including abandoning a 2010 recapitalization to avoid triggering $600 million in executive compensation obligations.

On Aug. 14, 2026, Chief Bankruptcy Judge Mary F. Walrath of the U.S. Bankruptcy Court for the District of Delaware issued a sweeping opinion recharacterizing a $37.6 billion intercompany loan as equity, and, in the alternative, equitably subordinating the claim to former executives' deferred compensation claims. See *AIG Financial Products v. Arthurs (In re AIG Financial Products)*, No. 22-11309 (MFW), 2026 WL 2408732 (Bankr. D. Del. Aug. 14, 2026). Walrath's opinion on recharacterization, equitable subordination, and independent committees provides guidance on insulating transactions from recharacterization and equitable-subordination attack, but also illustrates the limits of procedural safeguards when structural dominance remains unchecked.

BACKGROUND

AIG Financial Products Corp. (FP) was a wholly owned subsidiary of American International Group, Inc. (AIG). A critical feature of the parent-subsidiary relationship was AIG's unconditional guarantee of FP's counterparty obligations. When the 2008 financial crisis triggered collateral calls on FP's derivatives portfolio, and threatened cross-defaults at AIG, the Federal Reserve Bank of New York extended AIG an $85 billion loan which permitted arm's-length, unsecured intercompany loans to its subsidiaries, including FP, but restricted equity contributions. AIG immediately began advancing funds to FP to meet its collateral obligations and the advances ultimately exceeded $37 billion. These advances were not formally documented as a loan until two years after the first funds flowed and were never approved by FP's board. By 2010, both of FP's directors were AIG employees, while a special steering committee directed FP's wind-down.

FP also maintained two deferred compensation arrangements tying executive compensation to FP's performance.

The obligations were unsecured, not guaranteed by AIG, and contractually subordinated to all other creditors of FP in the event of bankruptcy. In 2010, AIG considered forgiving $35 billion of the federal revolver and applying a $18.5 billion tax receivable, which would have eliminated FP's negative equity. AIG abandoned the plan after being advised that restored solvency could trigger a potential $600 million liability under the compensation plans.

In January 2022, with FP's wind-down substantially complete and bankruptcy on the horizon, FP appointed a special committee (the committee) of its board consisting of two independent directors. Before the committee had an opportunity to retain its own counsel or form an independent assessment of FP's situation, AIG presented its view of the relevant facts, the intercompany transactions, and the proposed path to bankruptcy, including that deferred compensation claims would be expressly nonguaranteed, unsecured and subordinated. Acting on the recommendation of the committee, FP authorized a series of pre-bankruptcy transactions that dramatically restructured its balance sheet in AIG's favor. The committee approved pre-petition offsets and novations, but AIG, without committee approval, swept $127 million from FP's cash pool, leaving FP with approximately $10 million in liquid assets.

FP filed for bankruptcy in December 2022 reporting approximately $152 million in total assets against $37.9 billion in total liabilities. AIG's proposed plan contemplated converting AIG's $37.6 billion claim to equity and offering the former executives a pro rata share of $1 million in total distributions.

RECHARACTERIZATION: WHEN A $37.6 BILLION 'LOAN' IS REALLY EQUITY

The court concluded that the $37.6 billion loan was in economic substance an equity contribution by AIG to its failing subsidiary, notwithstanding the formal revolving-credit documents, promissory note, and contemporaneous references to the advances as "loans." The court's recharacterization analysis employed both the Third Circuit's *SubMicron* "economic reality" test and the Sixth Circuit's *Autostyle* 11-factor structured checklist as "reinforcing lenses" and both converged on equity treatment. See *Cohen v. KB Mezzanine Fund II (In re SubMicron Systems)*, 432 F.3d 448 (3d Cir. 2006). See also *Bayer v. MascoTech (In re AutoStyle Plastics)*, 269 F.3d 726, 749–50 (6th Cir. 2001).

Under *SubMicron*'s holistic "economic reality" inquiry, the court meticulously examined what the parties said about the transaction, what the parties actually did, and the economic reality of the arrangement when viewed as a whole. The court found that virtually every badge of genuine indebtedness was absent. While the documents called the revolver a credit facility, included a repayment promise, and contemporaneous communications used "loan" terminology, this evidence only nominally favored debt and was weakened by the two-year delay in documenting the funding. Walrath then catalogued a series of the parties' conduct was inconsistent with a bona fide lending relationship, including that: AIG advanced billions over that period without executed loan documents, AIG performed no due diligence or credit analysis before making the advances, FP's board never approved the borrowing, there were no meaningful negotiations over the terms of the revolver, FP pledged no security for the advances evidencing AIG had no genuine expectation of repayment, and the aborted 2010 recapitalization exposed the true intent behind the transaction.

Under *AutoStyle*, six of the eleven factors favored equity: no genuine expectation of repayment because the advances were made to prevent a systemic collapse, not to earn a return; inadequate capitalization; identity of interests between AIG as FP's sole shareholder, and the advances were made in AIG's capacity as parent, (iv) no security was pledged; the revolver was functionally subordinated to all of FP's external obligations; and there was no sinking fund or other mechanism to ensure the systematic retirement of the purported debt. The lack of a fixed maturity or repayment schedule, interest paid through new borrowings or in kind, inability to obtain outside financing during the crisis, and use of funds for collateral calls and wind-down rather than capital assets were neutral. Only nomenclature favored debt.

EQUITABLE SUBORDINATION: THE REACH OF INSIDER MISCONDUCT

Even if the FP Revolver were treated as debt rather than equity, Judge Walrath held in the alternative that AIG's $37.6 billion claim should be equitably subordinated beneath the former executives' approximately $600 million in deferred-compensation claims effectively eliminating AIG's prospect of any recovery. Because AIG was FP's sole shareholder, it was an insider, and the court applied the heightened standard of "rigorous scrutiny" applicable to insider claims.

The court found that AIG's domination and control of FP exceeded ordinary parent oversight. AIG installed its employees as FP's officers and directors and directed the wind-down through an AIG steering committee, using control for AIG's benefit and to FP's and its creditors' detriment. It also found a deliberate course of conduct designed to prevent restoration of the former executives' deferred-compensation accounts, including misleading them about whether their accounts would be restored. The court found that AIG's decision to abandon the 2010 recapitalization was itself an act of inequitable conduct. The delayed tax receivable was another discrete act of inequitable conduct not attributable to any legitimate accounting or regulatory constraint that only benefited AIG. Finally, the court found that the $127 million cash sweep likewise exemplified AIG's inequitable pattern of conduct in which AIG's interests were paramount.

THE SPECIAL COMMITTEE: A NUANCED TREATMENT OF QUALIFIED INDEPENDENCE

Walrath's treatment of FP's committee implicitly asks whether the committee's independence was robust enough to serve as a general-purpose shield or so fragile that it could protect only transactions that were themselves innocuous. The committee was neither a sham nor genuinely independent, and the court's assessment of its role varied with the specific transaction at issue.

On the side of robustness, the members were experienced professionals who understood their fiduciary duties and were willing to push back when AIG's interests diverged from FP's. The committee retained its own financial advisors and exercised independent judgment over the intercompany offsets and novations, relying on its advisors' analysis rather than simply accepting AIG's representations. Most tellingly, it objected to AIG's unilateral $127 million sweep. However, AIG's pre- and post-formation influence was pervasive and constrained what the committee could accomplish.

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