IN THE UNITED STATES COURT OF FEDERAL CLAIMS

STARR INTERNATIONAL COMPANY, )
INC., Individually and on )
Behalf of All Others )
Similarly Situated, )
Plaintiffs, ) Case No. 11-779C
vs. )
UNITED STATES OF AMERICA, )
Defendant. )
----------------------------------)

Courtroom 4
Howard T. Markey National Courts Building
717 Madison Place, N.W.
Washington, D.C.
Tuesday, October 28, 2014
9:30 a.m.
Trial Volume 21

BEFORE: THE HONORABLE THOMAS C. WHEELER

Susanne Bergling, RMR-CRR-CLR, Reporter

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I N D E X

| EXHIBITS | FOR ID | IN EVID |
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| Plaintiff's | | |
| Number2822 | | 4920 |
| Number2823 | | 4920 |
| Number2849 | | 4922 |
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| Defendant's | | |
| Number425 | | 4918 |
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| DXX | | |
| NumberDXX 004-011 | | 4919 |
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| Joint | | |
| None | | |

*All exhibits premarked for identification prior to trial.

*See full attached list of admitted exhibits following transcript.

P R O C E E D I N G S

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(Proceeding called to order, 9:30 a.m.)

THE COURT: Good morning.

ALL COUNSEL: Good morning, Your Honor.

THE COURT: Please be seated. We are on the record for day 21 in the matter of Starr International Company versus United States.

Good morning, Mr. Todor.

MR. TODOR: Good morning, Your Honor.

THE COURT: Good morning, Dr. Kothari.

Do you understand that you're still under oath in these proceedings?

THE WITNESS: Yes, sir.

THE COURT: Let's go ahead.

Whereupon --

S.P. KOTHARI

a witness, called for examination, having previously been duly sworn, was examined and testified further as follows:

CROSS EXAMINATION (cont.)

BY MR. TODOR:

Q. Good morning, Dr. Kothari.

A. Good morning.

Q. Yesterday when we left off we were discussing some analyst reports from September 24th, and just to orient you, could you please turn to PTX 5208 in your demonstrative binder.

A. Okay.

Q. And your first item, you have a business flyer item on the left side from September 23rd, 2008, correct?

A. Yes.

Q. Okay. Would you please turn, in the demonstrative and additional exhibits binder we have handed to you, to PTX 236.

A. Okay. PTX 236, okay. Yes.

Q. And do you recognize this as a Company Focus Report from Citi dated September 23rd, 2008?

A. Yes.

Q. And is this a document that you relied upon in preparation of your opinions in this matter?

A. Okay.

MR. TODOR: Your Honor, we move the admission of PTX 236 for the purposes of illustrating the basis for the expert's opinion and market impact.

MR. BOIES: No objection, Your Honor.

THE COURT: Plaintiffs' Trial Exhibit 236 is admitted for the stated purpose.

(Plaintiffs' Exhibit Number 236 was admitted into evidence.)

BY MR. TODOR:

Q. And in the first bullet -- okay, so first, the description of the report is "Deal or No Deal?" Correct?

A. Yes.

Q. And the first bullet says, "Laconic and Conflicting Information," correct?

A. Yes.

Q. And Citi is stating, "Little information has been provided to date regarding the $85 billion credit facility offered by the Federal Reserve to AIG. Complicating this is that some of the statements and disclosures seem to be conflicting. This, along with news that shareholders are attempting to find an alternative to the credit facility, has raised speculation regarding the possibility that the government will not take a dilutive equity stake in AIG."

Do you see that?

A. I do.

Q. You referred in your analysis to a run-up in the price of AIG's stock as you documented on PTX 5209, correct?

A. PTX 5209, yes. From when to when, sir?

Q. As of September 23rd, the open -- well, the close was $5 a share, correct?

A. Yes.

Q. And that was up from $4.72 a share on 9/22, correct?

A. Yes.

Q. And dramatically higher than the $2.05 a share on September 17, correct?

A. So -- okay, so we are talking now about 5/17 -- I mean September 17 to September 23, you are saying it went from $2 and a few cents to $5, and that is a dramatic --

Q. Yes.

A. Yes, I would say that is a --

Q. And that's almost 250 percent.

A. Okay.

Q. You haven't done an analysis as to whether the speculation regarding the possibility that the Government will not take a dilutive equity stake in AIG was a reason for the increase in the share price from $2.05 to $5 as of September 23rd, correct?

A. So, first of all, to be clear, other than the date on the 24th when there is a negative price reaction, and luckily, over a couple days, there was some positive price reaction, I haven't tried to parse out, on a day-by-day basis, what was going on. That's number one.

Number two, the overall tenor of the price movement, as I observe it, is that the provision of liquidity facility did lead to an increase in the share price and over and above what was the 80 percent equity, which has to be factored into the overall value of AIG, okay? Those are the two observations I'm making, and that information arrival did not complete by any 17th or 18th. It continued, some ups and downs, some of those here -- we are observing here, and then it concluded by 24th.

Q. But you have not done an analysis stating the reason why the stock price went from $2.05 on the 17th to $5 on the 23rd, correct?

A. Not a detailed, day-by-day analysis, no. I have not done that, if that was the question.

Q. I direct your attention back to PTX 5208, please.

A. Okay.

Q. And on September 24th, 2008, you cite a Bloomberg News article.

A. Yes.

Q. And that is cited as PTX 1658, correct? Could you -- is -- correct?

A. Oh, okay. Yes, yes.

Q. I'm just asking what you cited on your demonstrative at this point.

A. Oh, okay. For a minute I was not sure. Okay.

Q. Could you please turn to PTX 1658.

A. Yes.

Q. And you cited page 2 of that document in your demonstrative. I'd like to direct your attention to page 1 of that document.

A. Okay.

Q. The title of the article is "AIG Falls on Concern U.S. Loan Will Force Liquidation," correct?

A. Yes.

Q. And the first paragraph states, "American International Group, the insurer that agreed to a U.S. takeover to avert collapse, fell 34 percent in New York trading on concern the company may have to sell all its units to repay an $85 billion loan."

Correct?

A. Yes.

Q. The need to or the concern the company may have to sell all its units to repay an $85 billion loan was not one of the items that you mentioned as new market information in PTX 5207, correct?

A. I did not mention that.

Q. The next -- and then next you discuss a Morgan Stanley analyst report we discussed yesterday. You also, during your direct examination, were asked about JX 114. So, please turn to JX 114.

A. This is in my binder or --

Q. I believe it's in both your binder and -- but it is in the demonstrative and additional exhibits binder we handed up to you.

A. JX 114 I have. I see that here, okay.

Q. The -- this is a Credit Suisse report of September 24, 2008, correct?

A. Yes.

Q. The title is "Deal with the Fed Finalized," correct?

A. Yes.

Q. The first bullet states, "Last night AIG announced that it had signed a definitive agreement with the Fed on the previously announced $85b liquidity facility. There had been speculation that AIG could seek a private sector solution and thus avoid the government dilution, but the company indicated that this deal with the Fed represents its best option given the market turmoil."

Do you see that?

A. I do.

Q. You did not refer to speculation that AIG could seek a private sector solution and thus avoid the government dilution being deflated as one of the factors you referred to in PTX 5207, correct?

A. No. I mean, this is -- these are just excerpts, and I have not. I also would say that, you know, AIG perhaps did try some private solutions, and it accepted the government one. We also have to remember that by then, Mr. Liddy, a government representative, was CEO. So, I don't know, I mean, how to take statements such as this, that this is the best option. This is pretty much a government spokesperson who has been installed as CEO making these statements.

Q. And AIG's board also voted unanimously to accept the credit agreement, correct?

A. It's -- I'm not disputing that. All I'm saying is whether this is best option or not, I'm -- I'm just pointing out to the possibility that these things -- once the Government starts to have 79 percent ownership and installs the CEO, whether the statements are entirely independent, at least that doubt creeps into my mind.

Q. Well, turning your attention to the third bullet --

A. Okay.

Q. -- on JX 114.
A. Um-hum.
Q. There's a statement that Credit Suisse states, "We would expect a pullback in the stock following recent strength as we think it was bid up in the hopes of avoiding dilution of the government's equity stake. With that prospect now off the table, our sum of the parts analysis suggests that our $3 price target (after considering the net effect of repaying the government loan and net of AIG corporate debt) is a fairly optimistic assessment of the value of AIG equity."
A. True.
Q. Again, you did not refer to a pullback in the stock following recent strength on September 24th as being potentially caused by the stock having been bid up in the hopes of avoiding dilution of the Government's equity stake, correct?
A. See, part of the dilution was coming from warrants, which compared to preferred stock, there's a difference. So, I do not know what they are referring to, because there were clearly indications that the Government might take 79.9 percent equity. That started prior to this 23rd.
And intervening, the only point throughout my report I have been making is that there was uncertainty

about the terms, about whether the deal will go through or not, how much are the fees, warrants versus preferred equity, and my analysis is aimed at trying to get to the conclusion of that information flow process and then assess the valuation of different components, including the credit facility.

Q. And, Dr. Kothari, just, again, for clarity of the record, my question I believe was whether you had referenced to whether the stock was bid up in the hopes of avoiding dilution of the Government's equity stake as one of the factors that would have been resulting in a change in AIG's stock price on September 24th.

A. I had not explicitly referenced that.

Q. Turning your attention back to PTX 5207, you have a series of points in your fourth bullet point under "September 16, 2008 is not the proper date to value the taking."

A. I do.

Q. Isn't it true that none of the sub-bullets you have here were things that were public information between September 16 and September 24th?

A. That the term sheet was nonbinding and those things?

Q. All of the bullets here under -- we can go through them one by one, but isn't it true that none of these were public information between the 16th and the 24th?

A. Well, if -- if they were -- just for the sake of argument here, if -- let me assume that none of those were public, right, as you are saying. In that case -- but if, in fact, those bullets were true, not public but were true, then all the more reason why September 16th would not be the appropriate date, because it does not accord with facts.

Q. Okay. I'm not -- again, I -- I hear your explanation. Just for the purposes of my question, do you have an understanding as to whether these items were public or nonpublic between September 16 and September 24?

A. Sitting here, I cannot say with hundred degree confidence that -- you know, I have reviewed a number of documents, and my understanding was some of these at least were public, people were finding it out, but with that said, I cannot here offer one way or other exactly whether some of this information was public and when it became public.

Q. Referring back to the items that you list as key terms that were not fully disclosed in the second bullet, PTX 5207 --

A. Okay.

Q. -- the 8.5 percent fee on undrawn funds you mention --

A. Yes.

Q. -- that was only in effect for, what, six weeks?

A. Ex post, it might have been for six weeks, but ex ante, I do not know if it was for six weeks. And what matters on that date is what the market anticipated. It wasn't stated that it will be six weeks.

Q. To your knowledge, was that 8.5 percent fee ever actually paid by AIG?

A. Well, all the fees and interest, those were being added to the principal, and all the principal amount in the end was paid -- paid out and --

Q. This --

A. -- once again, here, what matters is whether these terms, as were stated by AIG, by the Fed, what the market perceived those to be, that is relevant.

Q. You just said, with respect to the term sheet being nonbinding and the other items under the "September 16th is not the proper date," that even if the market had known about it, that would be further proof that September 16 was not the date for the 8.5 percent fee on undrawn funds. You're saying even if that turned out to be inaccurate, what matters is what

is known ex ante. So, isn't that contradictory?
A. I didn't say that.
MR. BOIES: Object to the form of that question, Your Honor.
THE COURT: Sustained.
BY MR. TODOR:
Q. Do you know whether the 8.5 percent fee on undrawn funds was amended as a part of AIG's November 2008 restructuring of the credit agreement?
A. I'm aware that several terms were amended, and one of those was this one.
Q. And wasn't it true that the 8.5 percent fee was amended to, I believe, 0.75 percent?
A. That's my recollection, yes.
Q. I'll turn your attention, please, to PTX 5217. In this chart, you show AIG's market value, including equity units, through October 7, 2008?
A. Yes.
Q. And you have a dotted line in the middle --
A. Yes, I do.
Q. -- that shows you had skipped over the dates from September 17 to September 23, correct?
A. Yes.
Q. In the middle, if you had included those dates, wouldn't the equity value on your red bars for, say,

September 23 be much higher than any of the red bars in your chart?

A. On which date, on 23rd?

Q. September 23.

A. Yes. In some other charts, I have shown the value at September 23, as well as September 22.

Q. It is your opinion that the comparison of AIG's stock price on the opening of September 16, 2008, to its stock price on September 22, 2008, is flawed and ignores the effect of the worsening financial crisis and the related worsening of AIG's liquidity issues, correct?

A. Well, the 16th price, that was the last day when the liquidity crisis was adversely affecting AIG. From 12, 15 -- 11, 12, 15, 16, those were the dates. And then from 16th onwards, discussion about liquidity provision started to reach the market, and the price started to return to its intrinsic value or the valuation of AIG started to return to its intrinsic value.

Q. And is this what you're referring to in PTX 5216, sir?

A. Let me look at that. Yes.

Q. One of the factors that you believe makes a comparison between September 16 and September 22 flawed is the worsening financial crisis affecting the markets as a whole, correct?

A. From 16 to 22, that's not what -- I don't believe that's what I'm saying, because it was 12 to 15, 16 -- because Lehman went bankrupt on the 15th, and then liquidity provision to AIG was -- started to be discussed from 16, and then things started to come out of the hole in some ways. They started to return to a less crisis-prone period, if you will, and by 22nd, the discussion about the credit facility, that, you know, in fact it became effective, 23rd it was signed, and 24th, everyone learned about it.

Q. Could you please turn to your rebuttal report, sir.

A. Okay.

Q. It is in the expert reports and exhibits binder we handed you, stickered as DX 2251. I'm not sure if it's in one of the binders that Plaintiffs' counsel handed to you.

A. DX 2251, correct?

Q. Yes, sir.

A. Okay, um-hum.

Q. Could you turn to paragraph 27 of that document, please. It is on page 15.

A. Okay.

Q. In the last sentence of that paragraph, you state, "The comparison of AIG's stock price on the opening of September 16, 2008 to its stock price on September 22, 2008 is flawed and ignores the effect of the worsening financial crisis and the related worsening of AIG's liquidity issues that I document in the previous section."

Correct?

A. Yeah, yeah. This sentence is accurate. There is nothing wrong here.

Q. And one of the factors you're mentioning here is the worsening financial crisis affecting the markets as a whole, correct?

A. Okay. So, let me make sure that, you know, at least my understanding is communicated here, so whether you have the same or not with me, I don't know.

But here I'm saying on 16th, the price was adversely affected because of worsening financial crisis. That cannot be compared to a price on 22nd, by which time liquidity provision had restored the valuation of AIG to certain extent. That's -- that's what this sentence is stating.

It's not stating that the financial crisis was worsening between 16th and 22nd. You cannot compare the price on 16th, which is affected by financial crisis, that cannot be compared with your price on 22nd when it's coming out of that crisis.

Q. Now, on PTX 5216, you are -- you have a bar for September 11, 2008, right?

A. That's correct, um-hum.

Q. If it is true that the financial crisis worsened between September 16, 2008, and September 22nd, 2008, isn't it also true that the financial crisis worsened between September 11, 2008, and September 24, 2008?

A. Okay. So, first of all, the first half of your sentence, I did not say that the financial crisis worsened from 16th to 22nd. What I'm -- the main point is -- that's made is before September 11th, there wasn't the onset of financial crisis for -- liquidity crisis for AIG. The 11th through 16th, it was horrendous, and we have seen the precipitous decline in the price of AIG.

It hit the bottom around 16th, and then it started to come out in part because of the provision of liquidity via the credit facility, but that process didn't complete overnight. It took three, four, five days, whatever, and by 24th, it was firmly in place and the market capitalization of AIG returned to its precrisis level, which I have taken it to be September 11.

Q. Isn't it true that between September 11 and

September 16, Lehman Brothers declared bankruptcy?
A. Yes.
Q. And that is a worsening of the financial crisis affecting the markets as a whole, correct?
A. Yes.
Q. And so in that sense, the financial conditions on September 16 were not the same as they were on September 11.
A. Yes. Absolutely.
Q. And between September 16 and September 24, Morgan Stanley and Goldman Sachs were reorganized as bank holding companies, correct?
A. Yeah. The market was convulsing, I mean, there is no question about it. But as far as AIG is concerned, it was coming out of the woods because it had -- you know, they had negotiated the credit facility.
Q. Turning your attention back to paragraph 27 of your rebuttal report, sir.
A. Okay.
Q. In the third sentence of that paragraph, you state, "The Mordecai report ignores the affect of AIG's worsening liquidity issues on September 11 through September 16, 2008 on AIG's stock price that I document in the previous section of this report," correct?

A. Yes.
Q. So, AIG's own liquidity situation was getting worse between September 11 and September 16, correct?
A. Well, I agree entirely with that, yeah. I've all along maintained that.
Q. Turn your attention, please, to paragraph 28 of your rebuttal report.
A. Okay.
Q. You state in this paragraph, "On September 22, 2008, AIG was able to resolve its immediate liquidity issues through the Credit Agreement," correct?
MR. BOIES: I think it says "needs," but --
BY MR. TODOR:
Q. "Liquidity needs," yes.
Then you state, "As expected and as I document in the previous section, the market capitalization of AIG's common stock bounced back to the levels of September 11, 2008 after the relevant information about the Credit Agreement was disclosed."
Correct?
A. Yes, I do.
Q. And that relevant information included both the $85 billion credit facility and the 79.9 percent equity term, correct?
A. Yes.

Q. Then you state, "As discussed in the Initial Kothari Report, if the Government had not taken and/or illegally exacted 79.9% of AIG common equity, the share price as of the date of the taking would have been $16.47, which would have reflected the bounce back in AIG's stock price."

You said that, yes?

A. Yes, I do.

Q. And what you were measuring is -- as a loss is what the shareholders would have got if the Government had not had the 79.9 percent equity stake, correct?

A. Well, this is -- you know, this is not the usual counterfactual way, we don't observe some price or something. Here it is -- everyone agrees that the Government took 79.9 percent equity. If they had not taken -- I mean, this is not at all any complicated model that I have to build to demonstrate that the value that shareholders would have had would have been equal to that -- the red portion on that chart that I have, and if you just divide by 264 million shares, and adding the -- I'm not -- I'm sorry, not 264, 2.6 billion shares, and add to that equity units, you will get a price that I have calculated.

Q. And by what -- the chart you're referring to, PTX 5216, sir?

A. Yes.
Q. And what you're measuring there in the red bar is what you're saying shareholders would have got if the Government had not received the 79.9 percent equity stake, correct?
A. Well, yes, and all I'm trying to say here is that the shares existed in the sense that nobody is disputing what the total value is, 80 percent the Government has taken. So, this is -- in many other analysis, when we say the counterfactual, one has to really go through an elaborate analysis to demonstrate that the price would have been something else.
Here, it is simply that the market capitalization, everyone agrees, we know, and expose these shares to the Government sold, also. So, it's -- it's right there.
Q. Now, turning your attention back to paragraph 28 of your rebuttal report, sir.
A. Okay.
Q. You state in the last sentence, "As I also document in the previous section, the effect of the bounce back is that AIG's market capitalization reflected a value for AIG that was consistent with the quality of its assets when not encumbered by AIG's immediate liquidity needs."

Correct?
A. Yes.
Q. And the thing that removed that encumbrance was the $85 billion credit facility, correct?
A. That certainly was part of it, yes.
Q. You're not identifying any other source of liquidity that AIG received between September 16 and September 24, correct?
A. I'm not -- I'm not performing that kind of analysis, no.
Q. Turning your attention back to PTX 5216, you have a blue bar for September 24 of 8.9 billion, correct?
A. Yes.
Q. And that represents the value of the common shares that were held by the pre-September 16 shareholders?
A. Yes.
Q. And it's your opinion that as of September 24, the market had absorbed all relevant information about the credit facility and the 79.9 percent equity stake and all of the other terms you believe that were relevant, correct?
A. Yeah. That's the -- that's the assumption I have made, yes.

Q. And it took the good and the bad, and the market concluded that in terms of the value of the common shares, this was a net benefit to the common shareholders compared to the value of those same common shares at the market open on September 16, correct?

A. Well, in terms of mathematically, if you take that share and ask what was the value, one might say what -- what you just said, that -- that there was a net benefit or an increase in the value of those shares, but that misses the economic point here, which is that the shareholders owned all of AIG before, and then they suffered 80 percent dilution. So, the value it restored to its precrisis level, but 80 percent was taken away.

So, what we are measuring is the remaining 20 percent, what you just said, that blue bar. Now, if you ignore the 80 percent, well, that is a loss to shareholders. Regardless of whether that remaining 20 percent is larger than what the amount was on 16th, the reality is that they lost that red portion.

Q. And 20 percent of AIG on September 24th was worth more than 100 percent of AIG at the market open on September 16, correct?

A. That is -- in terms of -- you know, those are numbers, and that is exactly right. There's no question about it. But, again, the price on 16th was adversely affected. The market valuation on 16th was adversely affected by liquidity crisis. So, in my opinion, the relevant comparison is preliquidity crisis, September 11 amount, and in which case the statement you just made is simply not true.

Q. And -- but many shareholders bought in on September 16, correct?

A. And that is true.

Q. And they may have very different expectations for their equity having purchased on the 16th as opposed to purchasing on the 11th, correct?

A. Well, all shareholders, they buy and sell with different expectations. Yes, that's true.

Q. Yesterday, I believe we discussed what the market value of the common shares was on September 16th, correct?

A. Yes.

Q. And I believe the -- we agreed that the market cap on -- for 100 percent of AIG at the market open on September 16th was just shy of $5 billion, correct?

A. Yeah. It was about that.

Q. And you calculate $8.9 billion for September 24th, for that same equity, correct?

A. Not the same equity. It's -- that's the point I'm trying to make here, sir, that it is not the same equity in the sense that it -- you know, economic dilution is that -- that dilution is an economic phenomenon. I don't think we can just brush that aside.

Q. You had 2.689 billion shares on September 16. Those same 2.689 billion shares were worth 8.9 billion on September 24th, correct?

A. They are not the same, because now the overall market capitalization is being divided among 14-point-some billion shares. So, in that sense, economically they are not the same. They have suffered 80 percent dilution.

Q. If you owned one share of AIG at market open on the 16th, that share was worth $1.85, correct?

A. That is correct.

Q. If you owned one share of AIG at market close on September 24, that share was worth $3.31, correct?

A. My answer continues to be the same, that mathematically or just by way of if you are quoting me the share price, I would naturally agree with you on that, but I would also maintain that an important economic event in the intervening period took place, which was 80 percent dilution, and for any shareholder value, I do not think that we can ignore 80 percent dilution.

Q. Please turn to PTX 5219.

A. Okay.

Q. You had some discussion of target prices that you looked at in analyst reports, correct?

A. Yes.

Q. Isn't it true that all of the target prices that you're referring to here are target prices where analysts were including both the effect of the $85 billion credit facility and the 79.9 percent equity stake?

A. Yes.

Q. Please turn to PTX 5220.

A. Okay.

Q. And here you refer to a control premium and a liquidity discount, correct?

A. I do.

Q. You did not calculate the -- what the size of either of those would have been for AIG, correct?

A. The control premium, I did not; I have ignored it. And the liquidity discount, I have gone through some analysis and offered my conservative estimate of the improvement in liquidity for preferred -- Series C preferred shares that the Government would exchange for common shares, and that estimate is 5 percent.

Q. And for clarity's sake, on PTX 5220, you refer to a liquidity discount that you did not adjust the

credit agreement class for, correct?
A. That is correct.
Q. And on PTX 5223, you refer to a liquidity discount that you do apply as a measure of what compensation is due for the Series C preferred stock, correct?
A. Yes.
Q. But you do not deduct the liquidity discount amount from the Series C from your credit agreement class calculation.
A. There is no need to do that. I have explained that, and I am happy to explain it again if you would like.
Q. You don't deduct the liquidity discount when it would have reduced your calculation for the credit agreement class, but you do include it when it increases the stock split calculation.
A. Okay. So, let us go through this so that I would -- I can explain it. So, in the first case, what did the Government take? The Government took 80 percent of equity, right, that otherwise was in the hands of common shareholders. Common shares, they were publicly traded, they were -- AIG, on New York Stock Exchange, liquid stock. So, what did those shareholders lose?
Those shareholders lost 80 percent of liquid,

publicly traded shares. So, I applied the valuation of liquid, publicly traded shares to calculate what was taken away from shareholders as a result of the credit agreement. And in that I also explained that I also have chosen to ignore control premium, that someone who tries to wrest control from minority shareholders would have otherwise paid.

So, if the Government was to take 80 percent of shares in an arm's length transaction, they would have had to pay the control premium. I ignored that. The net effect, even though liquidity discount was not needed to be applied, control premium was -- needed to be applied, I have ignored both of those.

And the only discussion I have also provided is even if I were to have applied liquidity discount, for whatever reason, still the net effect would have been control premium is greater than liquidity discount, okay? So, that's -- that's about it, so...

Q. You just said the net effect of the control premium would be greater than the liquidity discount, but didn't you just say that you didn't calculate what either one would have been?

A. Okay. So, that's -- that's a good point. So, let me explain that. I did not calculate it, but I can comment on the relative magnitudes on the basis of evidence that exists in the literature, and so my -- there is an extensive amount of evidence on control premium. This has been a topic that has been researched for more than a couple decades, and acquisition transactions even today, you see, control premium of 20 percent is not at all uncommon. In fact, that is the norm.

So, in that sense, control premium being considerably larger than liquidity premium -- liquidity discount is a well-accepted phenomenon in the financial economics literature.

Q. You don't put any calculation of what the control premium would have been in your reports, do you?
A. I do not.
Q. And we can -- and please refer to PTX 375 at 16.
A. Okay.
Q. And this is KPMG's analysis --
A. Sure, um-hum.
Q. -- of the value of the preferred stock, correct?
A. Right.
Q. And KPMG, in the second paragraph, in the next-to-last sentence, states, "In addition, the impact of change in control should be reflected in the stock price post-announcement." Correct? It's on page 16, sir.

A. Okay. That's what they state, yes.
Q. Turning your attention back to PTX --
A. The -- the -- may I explain, however, that the stocks that were traded after 16th were minority shares, so I don't know how they can make that statement. They have made the statement, I agree, but economic logic dictates that since the only shares that were traded were minority, without any control, so I don't see -- that's why I think we went through this yesterday.
They have not given the sign on that impact, positive or negative there. I'm -- I'm assuming that they haven't given that sign because it -- in their analysis, it could go negative, because what -- the shares that are publicly traded are minority shares, so...
MR. BOIES: Your Honor, I think the witness is exactly right. This same point, with this same document, with this same explanation was covered yesterday.
THE COURT: I think so. That's my recollection, too.
MR. TODOR: I was using it to point the witness to contrary evidence to what we were discussing on PTX 5220, which we were not discussing yesterday. Yesterday we were discussing it in the context of the

valuation opinion, but I will move on.
THE COURT: So, it was a different reason.
MR. TODOR: I will move on.
THE COURT: Okay.
BY MR. TODOR:
Q. Dr. Kothari, please turn to PTX 5221.
A. Yes.
Q. And this is your summary of opinion for the value of the stock split class claim, correct?
A. Yes.
Q. You put a value of a total of 4.668 billion, correct?
A. That is correct.
Q. And, again, that would be the value for all of the shares that could have been a member of the stock split class, correct?
A. That is correct.
Q. You do not have a calculation for how many shares actually opted into the stock split class and would be entitled to a total figure, correct?
A. I have not calculated that.
Q. And in your report, you estimated the total value of the stock split class as $1.74 per share, correct?
A. Yes.

Q. And of that, 13 cents per share is for the Series C stock, correct?
A. That is correct.
Q. And $1.61 is for the Series E and F stock claim, correct?
A. That is correct.
Q. And in your understanding, the Series C claim and the Series E and F claims are independent of one another?
A. I mean, the -- the economic source -- economic sources of those claims are different, and in that sense, they are independent. "Independent" is a statistical term, so that's why I hesitate whether it meets all that condition, but with that said, just as generally English term, using that, yeah, they -- they are distinct. I think so.
Q. AIG's share price as of June 30, 2009, was $1.16 per share, correct?
A. That is correct.
Q. And you would agree that a voting right on share votes that would occur for common stock class only votes is just one of the bundle of rights that comes with share ownership.
A. That is correct.
Q. But you're valuing that one right at more than

100 percent of the total share value of AIG, correct?
A. That is correct.
Q. If the Government had physically seized 100 percent of the minority shares on June 30th, 2009, it only would have had to pay $1.16 per share, correct?
A. Again, you know, this analysis misses the point. You know, you keep bringing up the Government seizing the shares, you know, and I am getting a little bit worried about what the market -- what's in the mind of Government with that aside, you know?
But here, let me -- may I explain, you know, as to what -- why this is -- why this is in excess of $1.16 on the share price?
Q. Okay. So, you agree with the premise that if the Government had seized all the shares for $1.16, it could have done -- it could have done the same votes that you're talking about here, correct? Do you agree with that?
A. Not -- the economic -- if -- the economics here is a little bit different, okay? So, that's why it means I cannot agree with you on that statement.
Q. Okay. Why can't you agree or disagree with me --
A. So, let me -- that's right. So, let's take Series E and F, okay? Series E and F, the reason for

the claim is that the Government exchanged Series E and F shares, preferred shares, that were with a fair value of about 17.6 billion, and exchanged those for common shares that were worth about $41 billion. So, there's no question that the economic dilution took place, and that economic dilution is to the tune of about 23 or 24 billion dollars, 80 percent the Government itself had and 20 percent it did not. And the 20 percent is $4.3 billion, which translates into $1.61.

Now, let me get to your point, which you said that if it had ceased to hold all the shares, it would not have -- it would have gotten $1.16, but if you tell me, in that case, if they would have had all 100 percent shares, would they have been able to exchange less valued preferred shares for more valued common shares? Now you have all 100 percent, so it's -- everything will come out of your own pocket. So, in that sense, that analysis that you presented is flawed, okay?

Q. The event that occurred on June 30th, 2009, that you were asked to assume was the basis for liability, was the vote on the reverse stock split at AIG's annual shareholder meeting, correct?

A. That is correct.

Q. If the Government had seized 100 percent of the minority common shares, it would have been able to vote those shares in favor of the reverse split at that meeting, correct?

A. Yes, but --

Q. And that would have cost less than $1.74 per share, correct?

A. No, it would not have. That's the point I'm making, sir, because what it enabled them was to inflict economic dilution on 20 percent shares that resided in the hands of private individuals. Now, if you have all shares of yourself, how can you inflict dilution on yourself? You cannot. That's the point I'm trying to make here, okay?

Q. By inflicting dilution, what act are you saying is inflicting dilution?

A. Okay. They exchanged -- the fair value of Series E and F preferred stock was far less than the liquidation preference value, and that is Duff & Phelps, that is in the opinion of the Government itself, so that is unambiguous fact, that they would have valued, had -- I have generously valued them at around $17 billion. They were valued less than that, but let's ignore that -- anything less than that.

The liquidation preference value of Series E and F preferred stock was $41.15 billion. So, the economic dilution is to the tune of $23 billion. Twenty percent of that was borne by shareholders -- common shareholders, and that's giving rise to that claim of $4 billion, on a per share basis $1.61.

Your analysis is we buy all these shares, sure, go ahead and buy them, then you cannot -- just as the 80 percent economic dilution I have not included, now you have to exclude all 100 percent dilution. So, the Government, again, does not get that benefit of -- that it received, the benefit of exchanging less valuable Series E and F preferred shares for more valuable government shares.

Q. Let's focus on the Series C claim for a moment just to make sure I understand your position on that. On the Series C claim, what do you understand to be the act that is creating the 339-point -- 339 billion of compensation you believe is due?

A. Sure. In that, the reverse stock split denied -- the reverse stock split effectively took the right away from common shareholders by increasing the number of authorized shares.

Q. And that is something that I guess you were asked to assume for purposes of liability would require a majority vote of the common shares as opposed to the Series C preferred shares, correct?

A. That's my understanding, and I was asked to

assume that, yes.
Q. Okay. If the Government had seized 100 percent of these shares, the Government could have voted those shares in favor of that proposition, correct?
A. Yes. I mean, you know, that -- that -- again, it misses the economic point, but -- but -- I have answered your question in a limited fashion, answered it yes.
Q. You agree that since the Series C preferred stock was already the near equivalent of common shares, dilution, per se, was not an issue for that security.
A. That is accurate.
Q. And the only additional benefit you're saying that the Government got for the Series C claim was a liquidity premium for the ability to confirm -- convert those into more liquid common shares, correct?
A. That is correct.
Q. You estimate that liquidity discount at 5 percent here on PTX 5223, correct?
A. That is correct.
Q. And the reason why you have it at only 5 percent is because it is your understanding that the Government had alternate methods to monetize the Series C preferred stock that did not involve converting them into common shares, correct?

A. That is certainly an important reason, yes.

Q. Okay. What is your understanding of how the Government could have done that?

A. It could have listed that Series C preferred stock on an exchange, and that process would have led to a market for those shares. The quantity is large, the form is AIG, my guess is it would have become quite liquid. So, that's the process that I would have, and these things take time.

Q. And, in fact, that would have been pretty much by definition almost four-fifths of the total shares outstanding.

A. One are preferred and the other are common, but yes, the quantity is four times as much as the common.

Q. And you're awarding or you're calculating a Series C liquidity discount on the theory that the shareholders could have bargained to divide up the benefit to the Government from the Government being able to have more liquid common shares as opposed to preferred, correct?

A. I'm just applying standard economic theory that the Government stands to benefit, the shareholders had the right to deny that benefit, the two sides negotiate, split the baby in the middle. That's the kind of analysis that economic theory predicts.

Q. And turning back to PTX 5221, you had said the reverse stock split enabled Defendant to take shareholders' right to block dilution of their common shares, correct?
A. Yes.
Q. Now, with respect to the Series C preferred stock, there wouldn't be any additional dilution of the minority shares just because the Government had an additional liquidity benefit in the ability to market its shares.
A. The term "dilution" here is generically used, that in the sense of -- that shareholders in Series C, that they were deprived of some amount that they could have received, but it is not in the same spirit as Series E and F. Series E and F we discussed, it is dilution in the more traditional sense that -- when something of lesser value is exchanged for something of greater value.
Q. But with the Series -- as to the Series C, in particular, you're not saying that the shareholders actually lost any of the rights of their shares out of pocket on the Series C claim, correct?
A. Well, they did lose the right to prevent an increase in number of authorized shares, which had some follow-on implications.

Q. But at least in the way your calculation is structured, you haven't structured your calculation such that you are showing a loss of value of these -- of the minority shares.
A. Yes. That is correct.
Q. With respect to the Series C claim, you were describing the right to block dilution. Is what you're describing here valuing basically what the shareholders -- the value of their right to block the Government receiving a benefit would be?
A. Yes.
Q. Okay. Would that be what you call holdup value?
A. I -- I -- it -- perhaps, but I'm just calling it right to block.
Q. Let's turn your attention to the Series E and F claim.
A. Okay.
Q. I'll turn your attention to PTX 5224, please. This chart is your depiction of the fair value of the Series E and F preferred as of -- compared to the liquidation preference as of June 30, 2009, correct?
The reverse split did not change the liquidation preference of the Series E and F preferred, correct?
A. Not to my knowledge, no.
Q. The reverse split did not change the fair value

of the Series E and F preferred, correct?
A. That is also accurate.
Q. The liquidation preference is $40 billion, correct?
A. What, Series E and F together or --
Q. Well, Series E, and then for Series F, you say it's 1.15, right?
A. Yes, so the total is 41.15.
Q. And that's because the Government actually put cash of that amount into AIG, correct?
A. The Government did, by TARP funding, provide those $41.15 billion to AIG, but that's -- from the standpoint of this transaction, that is -- in my opinion, that is not relevant.
Q. The Government put in $40 billion into AIG and, in exchange, got some preferred stock, correct?
A. Yes.
Q. And now you're saying that for the Government to get its money back is a taking or illegal exaction from the common shareholders.
A. So, I will analyze that, at least to some extent, okay? The reason it is not relevant is because when the Government put in that money, it wanted AIG to do certain things. They were not -- not everything was dollar for dollar from the standpoint of the

shareholders of AIG. The Government had certain objectives that were not always perfectly aligned with the common shareholders. So, that's why, when the TARP money is put in, to say that, well, they can take it out in this fashion, I don't think that is -- from an economic analysis standpoint, that is appropriate here.

What is happening on June 30th is that something that was worth only $17 -- $17 billion was being exchanged for something that is worth $41 billion, regardless of what the preceding set of events that you have described.

Q. Please turn to JX 208.

A. This is in your folder?

Q. It is in our demonstrative and additional exhibits folder, sir.

A. Exhibit 208 you said, right?

Q. Yes, sir.

A. Yes. I'm there.

Q. Would you please turn to pages 3 and 4 of that document, sir.

A. Okay.

Q. And do you see at the bottom of page 3, there's a heading, "Series E Preferred Stock"?

A. Yes.

Q. And in the second sentence of that paragraph, it states, "The Series E Preferred Stock ranks senior to the Common Stock and, subject to the approval of the amendments to AIG's Restated Certificate of Incorporation described above, will rank senior to the Series C Preferred Stock and any other series of preferred stock subsequently issued by AIG to any person other than the Treasury Department with respect to the payment of dividends and amounts upon liquidation, dissolution, and winding up of AIG."

Correct?

A. Yes.

Q. So, AI -- the -- there was a liquidation preference for the Series E of $40 billion, correct?

A. Yes.

Q. And according to this disclosure, upon liquidation, this $40 billion is senior to any other equity, correct?

A. Yes.

Q. The next paragraph states, "AIG may redeem the Series E Preferred Stock at the Liquidation Preference, plus unpaid dividends for the then-current dividend period, at any time that the AIG Credit Facility Trust, a trust established for the sole benefit of the United States Treasury, or any successor entity, beneficially owns less than 30 percent of AIG's voting securities and no holder of the Series E Preferred Stock controls or has the potential to control AIG."

Correct?

A. Yes.

Q. You referred during your direct to the Series E and F not being puttable. Is that correct?

A. That is correct.

Q. What does "puttable" mean?

A. That means the holder of Series E can bring those shares to AIG or to a firm and ask for liquidation preference.

Q. So, by them not being puttable, the Government can't say to AIG, "Here's our stock, please give us our money back at a time of our choosing."

A. That's correct.

Q. When it says here that AIG may redeem the Series E preferred stock at its liquidation preference, does that mean that the Series E is callable by AIG?

A. Yes, sir.

Q. What does it mean for it to be callable?

A. That AIG could call them, and if in this case the Government says, "Okay, here are the shares," the Government could receive from AIG the liquidation preference amount.

Q. This means that AIG, because they're callable, has the option to say to the Government, "Here's your liquidation preference, please give us our shares back," at a time of AIG's choosing, correct?

A. Yeah.

Q. And that term says that they're callable only at the liquidation preference, correct?

A. That is true.

Q. And that liquidation preference for the Series E is $40 billion, not the fair value, correct?

A. That is correct. Now, may I just explain one thing here?

Q. Please do.

A. This entire -- it, again, misses the economics, because the Government controlled AIG. So, now, you know, you're -- this is what is called self-dealing. You can't -- you know, and I'm not -- again, I am offering valuation as a valuation expert, but when the Government itself controls AIG, I don't know what it means that AIG asks Government to, okay, call those shares and redeem those, but --

Q. Okay. But you haven't given any opinions in your report as to government control or noncontrol of AIG, correct?

A. The -- you know, as a valuation analysis, I have to examine that the statements about this being economic dilution, okay, do they -- are they reasonable? Just as in the other case, why September 26th -- 22nd, even though that is not the primary analysis, but as part of doing the valuation analysis, I examined the reasonableness.

Here it isn't the same, the fact that they're nonputtable, and then the moment I know that the Government owns 80 percent, I know that AIG on its own making decisions is -- that is not a very tenable kind of scenario, even though I'm not an expert in trying to -- on governance or control. But these are some basic attributes or facts about how control -- ownership and control are related, part of accounting it is, part of finance it is.

Q. In your report, you do not base your valuation opinions upon allegations of control or noncontrol of AIG by the Government, correct?

A. That is correct. My report focuses on the economic dilution suffered by 20 percent of the shareholders, and that is how the calculation is done.

Q. I'll turn your attention back to page 4 of JX 208.

A. Okay, um-hum.

Q. At the top paragraph, it states, "Holders of the Series E Preferred Stock will be entitled to vote for the election of the greater two additional members of the board and a number of directors, rounded upward, equal to 20 percent of the total number of directors of AIG, if dividends payable on the shares of the Series E preferred stock have not been paid for four or more dividend periods, whether or not consecutive."

That is an additional feature of the Series E preferred stock, correct?

A. Yes.

Q. And after the Series E preferred stock was exchanged for common, this feature no longer applied to AIG, correct?

A. Again, I -- you know, you read that, and, you know, that sounds about right, but I haven't analyzed or I haven't thought through that carefully. So, I can't answer yes or no, but -- and that wasn't a factor in my valuation analysis.

Q. You do not offset any of your valuation against benefits to AIG from escaping restrictions on AIG's operations that were imposed as part of the Series E and F preferred stock, correct?

A. Yeah. I don't do that.

Q. You also have an understanding that the Series E and F preferred stock contained other restrictions on AIG's operations in addition to the one we've just discussed.

A. It's possible, but I haven't reviewed that aspect.

Q. For example, they had -- restrictions on executive compensation were part of the Series E and F preferred stock, correct?

A. Again, I don't have -- I have reviewed it generally, but I don't recall that particular feature. That doesn't mean I disbelieve that. I just don't recall, sitting here.

Q. And, again, you don't offset any -- removal of any other restrictions against the valuation you put on your Series E and F stock split claims, correct?

A. That is correct.

Q. You did not analyze the effect on AIG's stock price, as of June 30th, 2009, of the announcement of the votes on Proposals 3 and 4 for AIG's annual shareholder meeting, correct?

A. I did not perform a stock price analysis of that vote that took place on June 30th. No, I did not.

Q. And you have not formulated an opinion as to what AIG's stock price would have been after June 30th, 2009, if there had been no reverse stock split.

A. I haven't performed that analysis. I wasn't asked to, and I haven't performed that analysis.

Q. You have not performed an analysis of what benefits the reverse stock split had for AIG.

A. The benefit that was discussed was listing that AIG's share was in the danger of being delisted on New York Stock Exchange and reverse stock split would have prevented that delisting. That was the benefit that was being, at least to the best of my understanding, that was the benefit that was being talked about. I considered that, and I -- I did not think that that -- that that was necessary to make an adjustment. I didn't think that was huge amount.

Q. You did not offset the benefit from -- to AIG's business from the reverse stock split against your valuations of the Series C or Series E and F stock split claims, correct?

A. Yeah, I considered those, but I did not make any adjustment. I didn't think those were particularly substantial.

Q. You have not calculated what, if any, magnitude the benefits from the reverse stock split had for AIG.

A. Once again, you know, my general understanding, expertise in finance, and understanding of the literature, and the fact that they could have done some other type of reverse stock split, some other meaning, not twenties-to-one, maybe fives-to-one or tens-to-one, and could have achieved the same objective of maintaining listing on New York Stock Exchange.

It's also the case that the stock was already listed on New York Stock Exchange and highly liquid. So, the incremental benefit of doing a reverse stock split to maintain it, I estimated that to be small, if not negligible.

Q. You don't issue an opinion in your report as to whether the magnitude of the benefits from the reverse split was too small to be considered, do you?

A. I -- I do not have a separate opinion on that. As I said, in any valuation analysis, one knows more about what they choose to include and -- in some ways, and they choose to not include certain other things, because -- if they are perceived to be not material.

Q. In your PTX 5224, you state that you are relying on PTX 422, correct?

A. Okay. Yes.

Q. And that is the Duff & Phelps report, correct?

A. Yes. So, to help you understand, I am referring to this, and you had another PTX, but we are still on the same chart?

Q. Yes.

A. Okay.

Q. This is the chart on 5224. One of your source

documents for this is the Duff & Phelps analysis, which is PTX 422, correct?
A. Yes, yes.
Q. Could you please turn to PTX 422.
A. Yes.
Q. And I'll refer you to page 22, which is the page you cite there on 5224.
A. Okay.
Q. And this chart is the valuation summary. This is what you were relying on for your figures, correct?
A. Yes.
Q. And the valuation date here is -- for AIG is November 10th, 2008, correct?
A. Correct.
Q. And that's the date that the TARP investment occurred, correct?
A. Yes.
Q. And so as of that date, that is the date that Duff & Phelps said that the Government had put in $40 billion and got back preferred stock that Duff & Phelps is estimating at 14.2 to 15.4 billion in value, correct?
A. Yes.
Q. Wasn't that a subsidy to AIG?
A. I don't know. The reason I say is because I don't know what they were expecting AIG to do with that.

They were asking them to pay off some counterparties or someone -- some other things, because the Government, as one could expect, has many objectives, not necessarily that objective is only to act in the best interests of shareholders.

So, in that sense, I'm not passing any judgment here, value judgment here as to what they should have done or not. All I'm stating is that this TARP investment, they were designed to further certain objectives, not necessarily to maximize the shareholders' wealth.

Q. Okay. You said what AIG did with 35 billion of that 40 billion in PTX 5200, didn't you?

A. They repaid the credit facility.

Q. Yes. So, the Government gave AIG 40 billion, which AIG then used to pay off the Government's loan with the Government's own money, right?

A. They did.

Q. And you were saying that it's a taking of $4 billion from common shareholders for the Government to get its money back.

A. I'm not doing that analysis on November 10th, and if the Government received that money back, that's not the relevant issue. There were CDO transactions that were taking place, and I -- frankly, I have not analyzed, other than saying that the funding that firms like AI -- especially AIG received, the objective of that was not simply to manage operations at AIG, but it was also to further some other objectives in the interest of systemic risk or some -- those considerations, and as a result, I cannot view this as a subsidy, okay? It may be, it may not be, but to me, it's not obvious.

In any case, the relevant analysis on June 30th that I'm conducting is to demonstrate unambiguously that something of lesser value was exchanged for something of higher value, and common shareholders suffered dilution.

Q. We discussed earlier the liquidation preference of 40 billion needing to be paid. Would that need to be paid before common shareholders would get anything in the -- in the event of a liquidation?

A. In the event of a liquidation, I would think so, but, again, I haven't studied that aspect carefully. But I -- given the -- what we read about the rights that Series E preferred had, I would think so.

Q. If it is true that the Series E and F were worth less than their liquidation preference, wouldn't it be true that in the event of a liquidation, if the Series E and F don't get paid, the common get nothing?

A. That hypothetical, yes, but I -- I would agree with that hypothetical, but I don't think that is relevant to the economic analysis being conducted here.

Q. You're saying that the day the Government gave AIG $40 billion, it got back something worth only 14.2 to 15.4 billion, correct?

A. Well, that's the valuation analysis. I haven't analyzed that, but that's what this analysis is showing.

Q. And that transaction would have a negative fair market value from the perspective of the Government, correct?

A. It depends upon what the Government is seeking to achieve from that activity. I mean, I haven't done that analysis of what -- because clearly the Government didn't get up and say, "Well, let me give a subsidy of $26 billion to AIG." It gave it certain objectives, and I haven't studied those objectives, and I haven't studied the consequence of those either. So, I cannot agree or disagree with the statement you are making.

Q. You reviewed the -- you stated that the agreement to the Series E and F provided certain benefits to the Government, correct?

A. I'm sorry. Can you repeat that?

Q. You stated that the Series E and F claims were based upon the Government receiving a benefit, correct?

A. That exchanging less valued series E and F preferred stock being exchanged for more valued common shares? Yes.

Q. That benefit did not occur until January of 2011, correct?

A. We always knew that the event took place on June 30th, 2009, and I'm valuing as of that date. Now, the exchange, if that's what you mean, the exchange didn't take place until January of 2011.

Q. And the board of AIG agreed to the transaction that resulted in the Government receiving that benefit, correct?

A. Again, I'm not an expert in those governance issues or contract issues, those -- I haven't offered any opinion, but I do want to state that the Government owned 80 percent of AIG. So, I don't know where you draw the line about independence, but as far as any of the accounting standards, when we implement those, or analysis, that require that any time it is more than 50 percent ownership, control is with them.

So -- so, that's -- I just mention that because from my understanding of accounting and finance, the control is entirely with the Government. But, again, to repeat, I'm not an expert on governance matters.

Q. Just for clarity of the record, do you agree that AIG's board agreed to the transaction that closed in January of 2011?

A. I haven't reviewed that aspect, but I have no reason to question that. It is entirely possible that that's exactly what happened.

Q. Now, referring to the difference between the liquidation preference and the fair value --

A. Okay.

Q. -- the reverse split you say created there to be enough authorized but unissued shares ultimately to permit the exchange of the Series E and F for common without an increase in the number of authorized common shares, correct?

A. That is correct.

Q. The fact that there were more authorized but unissued common shares does not control how many of the Series E and F preferred shares would get exchanged for each common share, correct?

A. Yeah, that -- what the exchange ratio is, that is not determined by how many authorized and unissued shares there are, if that was the question you had asked.

Q. So, for example, if AIG had insisted on a different ratio of the number of E and F preferred shares to common shares, that would not be dictated by the fact that there was a reverse split that created a greater ratio of authorized but unissued shares to issued shares, correct?

A. Yes. I think that is --

Q. And the ultimate ratio was decided as a product of a negotiation among AIG, the Treasury, and the trust, correct?

A. At a mechanical level, that might be, but once again, the economic underpinning of it is that the Government -- it was -- it expected conversion at liquidation preference, so this started to become -- why it was not disclosed what the purpose of that reverse stock split was at the time, but the Government's practice certainly is consistent with the exchanging at liquidation preference.

Q. The negotiation over what the ultimate exchange ratio would be occurred after June 30th, 2009, correct?

A. A, I don't know exactly what negotiation. I did not review those, okay? But that said, all -- the point I'm making is that 41.15 billion, that the Government will receive that, that was a done deal early on. The ratio would depend upon what is the fair value then, right, at a subsequent date, because it is the difference that I am focusing on.

So, from that standpoint, on June 30th, I'm focusing on the difference between 41.15 billion and the fair value of those Series E and F preferred shares with the information that was best available at or around that time.

THE COURT: Mr. Todor, should we take our morning break?

MR. TODOR: Yes, Your Honor.

THE COURT: Let us reconvene at 11:15.

(Court in recess.)

THE COURT: Thank you. Please be seated.

Go ahead, Mr. Todor.

MR. TODOR: Thank you, Your Honor.

BY MR. TODOR:

Q. Dr. Kothari, please turn to JX 221 in your demonstratives and additional exhibits binder.

A. Yes.

Q. Do you recognize this as the proxy statement for AIG's 2009 annual shareholders meeting?

A. Yes.

Q. And this is a document you relied upon in preparation of your opinions in this matter, correct?

A. Yes.

Q. Please turn to page 67 of the document. It has the 64 in the small numbers.

A. Page 63, is that right?

Q. Page 67, sir.

A. Oh, I'm sorry. Okay. Okay.
Q. And this is the beginning of the Proposal 3, correct?
A. At the bottom?
Q. Yes.
A. Um-hum.
Q. And please turn your attention to page 68 of the document.
A. Yes.
Q. And do you see that there's a chart in the middle of that page, correct?
A. Yes, I do.
Q. And that chart in the -- it is stated that it describes the number of shares of AIG common stock that would be authorized, issued, reserved but unissued, and authorized but unissued and unreserved, in the following scenarios, correct?
A. Yes.
Q. And one is Proposal 3 is approved, but Proposal 4 is not, correct?
A. Yes.
Q. And one is Proposal 4 is approved, but Proposal 3 is not, correct?
A. Yes.
Q. And the last is if Proposals 3 and 4 are both

approved, correct?

A. Yes.

Q. And in reality, what happened was the second scenario, that Proposal 4 was approved, but Proposal 3 was not, correct?

A. Yes.

Q. And in this disclosure, it states that in that scenario, the number of authorized shares would be 5 billion, correct?

A. Yes.

Q. And that the number of issued shares would be 147,400,931, correct?

A. Yes.

Q. And the reserved but unissued would be 19,767,152, correct?

A. Yes.

Q. And this would leave the number of authorized but unissued and unreserved of 4,832,831,917, correct?

A. Yes.

Q. You agree that an investor reading this would be able to know that the result of Proposal 4 would be an increase in the number of authorized but unissued shares relative to the number of -- authorized but unissued relative to the number of issued shares, compared to what the effect would have been before the reverse

split, correct?
A. Yes, except that the rationale that was offered was about the stock would otherwise be delisted on -- on the New York Stock Exchange. So, the description of the other purposes, which eventually the Government did, they were not disclosed. So, there's -- so, it's not clear to me that from the approval of Proposal 4, it follows as to what the intent was.
Q. I'm just talking numerically now. Numerically, would you agree that an investor reading this would know that there would be enough authorized but unissued shares to execute a conversion or an exchange of the Series C preferred stock for common?
A. Numerically, yes.
Q. Okay. And to be clear, Proposal 4 did not change the par value of AIG common stock, correct?
A. Yes, that is my understanding. No.
Q. Therefore, there would still need to be an exchange, rather than a conversion, even following the reverse split, correct?
A. Yes.
Q. Similarly, would an investor looking at this disclosure have sufficient information to conclude numerically that there would be sufficient authorized but unissued shares following the reverse split to have

the exchange of the Series E and F preferred stock that you discuss in your opinions?

A. So, numerically, they exist. Whether they have knowledge and those things, I don't -- I just don't know. And what was disclosed and what was told the shareholder community was that the purpose is to have -- to avoid delisting. So, in that sense, I don't know what was in their mind. What I do know is that numerically, this number is sufficient to permit an exchange.

Q. I'll turn your attention, please, to page 69 of JX 221.

A. Okay.

Q. And I'll turn your attention to the next-to-last paragraph, and there's a statement that "The primary purpose of the reverse stock split is to increase the per share trading price of AIG Common Stock. AIG believes a reverse stock split will increase the price of AIG Common Stock, and thus allow a broader range of institutional investors to invest in AIG Common Stock, increase other investor interest in AIG Common Stock and help ensure the continued listing of AIG Common Stock on the New York Stock Exchange."

Correct?

A. Yes.

Q. Do you agree that a reverse split would be designed to increase the trading price of AIG common stock?

A. Well, it -- the increase in trading price from reverse stock split is almost automatic, and so from that standpoint, the statement is that it would increase, that is true. The benefit of this is small. Even the literature documents this benefit to be small.

Q. But being delisted, you would agree, would not be a good thing for AIG's common shareholders.

A. See, if the purpose was only to avoid delisting, they could have done fives-to-one, and that would have avoided delisting.

Q. Dr. Kothari, just for clarity of the record, do you agree that being delisted would not be a good thing for AIG's common shareholders?

A. Yeah. Other things equal, being delisted is not a good thing.

Q. Okay. Next, AIG states, "A reverse split would allow a broader range of institutional investors to invest in AIG Common Stock."

Isn't it true that there are rules for institutional investors on investing in what are called penny stocks?

A. Yes.

Q. And are penny stocks stocks that trade below a certain share price?

A. Yes.

Q. And in some cases that value could be $1, and in some cases that value could be $5, correct?

A. The definition of penny stock generally doesn't go to $5, but -- but institutional investors, some of them might have restrictions like nothing less than so and so dollars.

Q. Isn't it true that a reverse split would allow a broader range of institutional investors to invest in AIG common stock?

A. Yes. At the same time, this is not a firm who was hurting for institutional investors, that just as a matter of fact, that there were plenty of institutional investors, the number of shares traded was enormously high, so -- but with that said, other things equal, the reverse stock split would help more institutional investors.

Q. You did not do an analysis of whether -- what the institutional investor participation was in AIG at any point in time as part of your analysis in this case, right?

A. I have a general understanding, but I did not conduct a specific analysis.

Q. AIG was trading at $1.16 per share as of June 30, 2009, correct?

A. That's correct.

Q. And that value was below the threshold that many institutional investors would have for investing in a stock, even if that stock is listed on the Stock Exchange, correct?

A. That is correct.

Q. And AIG's stock had declined in value from the 3.31 that you showed on September 24, 2008, to $1.16 on June 30, 2009, correct?

A. Yes, that is correct.

Q. So, that's a decline of about 67 percent, correct?

A. I can't do it in my head that quickly, but that sounds about right.

Q. Turning your attention to the -- page 70 of JX 221.

A. Okay.

Q. The first full paragraph states, "The share price of AIG Common Stock has declined significantly since the third quarter of 2008, and, during February and March 2009, and occasionally since then, it has closed below $1.00 per share. With the shares trading at this level, small moves in absolute terms in the price per share of AIG Common Stock translate into disproportionately large swings in the price on a percentage basis."

Isn't it true that if the stock is trading at values on or around $1 per share, that small moves in absolute terms in the price per share translate into disproportionately large swings in the price on a percentage basis?

A. So, here it's -- one issue is one of simple mathematics and the other is one of economics. So, lower priced stocks generally are more risky, and, therefore, they tend to experience bigger percentage swings. The other reason is what is called mathematically, you know, discreteness in the movement in prices. I think that was less of an issue given the decimalization, changes in decimal points in pennies incrementing bigger spreads. It had become less of an issue, those discrete changes in prices resulting in big percentage stock price swings.

Q. By decimalization, are you referring to back in the days when stocks traded in an eighth or a sixteenth of a dollar as opposed to pennies?

A. Yes, yes.

Q. Even with decimalization, even a movement of a penny is the smallest move that you could have, and on a

$1 stock, that would be a 1 percent change, correct?
A. That is correct.
Q. Whereas if the same stock were trading at $20, a 1 cent change would be a much smaller percentage change, correct?
A. All I'm saying is that when -- empirically, when stocks are at $1, the economics is such -- not because it is $1, but fundamentally, that they tend to be more risky, and that accounts for more of the observed stock price changes, and that you cannot change simply by making it into a $20 stock, even with reverse stock, because the economics is not going to be any different.
And the second part is, which is what we refer to, the discreteness of prices, and that imparts an additional layer of volatility. But in my assessment, that additional layer of volatility is second order compared to the first order effect, which is the economics-based statement.
Q. And when you refer to stocks that trade for a dollar a share being more risky, what is your basis for that statement?
A. Well, I have conducted my own research over the years, I have read research, and price has a negative correlation with the volatility of stock returns, and part of that is because of the discreteness, but more

often it is because they're inherently more risky.
Now, there are exceptions to the rule, don't get me wrong, but as a general rule, that's -- that empirical fact is quite well established in what is called asset pricing literature in finance.
Q. AIG was trading for around a dollar a share as of June 30, 2009, correct?
A. Yes.
Q. Therefore, it would be your conclusion that AIG itself was a riskier stock as of June 30, 2009.
A. Yes. And the key point to take away from this is you cannot mask that risk just by doing stock split. It is what it is. So, that you cannot change, and it would be too easy otherwise in the world, "Hey, I'm more risky, let me do stock split and become less risky." It's just not going to happen. That is the key point that I want to make here.
Q. All right. Are you familiar with the concept of option value in security pricing?
A. Yes, I am.
Q. When a stock is trading at a very low share price, isn't it true that part of the share price includes an option value on some ability for the stock to turn around?
A. It is, again, by changing -- by doing a reverse

stock split, you cannot change that fact, that if -- if a particular stock -- a particular firm's market value is reflecting an option, as you are correctly saying, just because how it is sliced into more shares or fewer shares, that fact is unchanged.

Q. In the case of AIG, referring back to September 16, 2008, we saw that the -- the stock opened at $1.85 per share and traded at an intraday low of $1.25 per share, correct?

A. Yes.

Q. Isn't it possible that a considerable portion of that $1.85 or $1.25 consisted of an option value of -- rather than the fundamentals of the stock?

A. I wouldn't analyze that in this context. I haven't done that analysis.

Q. It may be possible, however?

A. I -- I cannot say yes or no, because -- so, I haven't conducted that analysis. And AIG was also quite different from -- AIG was not a typical firm in the sense that AIG had many insurance and some divisions that were strong, steady, well-functioning, solid businesses, and then it had this Financial Products, which they had taken certain investment decisions or certain trades that they had engaged in, and they were experiencing some liquidity needs as well as some losses.

So, it's a different kind of conglomerate business, if you will, and, therefore, it's even more difficult to make any statement without conducting a formal analysis, and, therefore, I'm -- I cannot offer you any opinion.

Q. I'll turn your attention back to page 70 of JX 221.

A. Okay.

Q. I'll turn your attention to the next-to-last paragraph before the bold heading. There's the statement that "An overall effect of the reverse stock split of the outstanding AIG Common Stock will be a reduction of the total number of outstanding shares of AIG Common Stock approximately in proportion to the one-for-twenty reverse stock split ratio and therefore an increase in authorized but unissued shares of AIG Common Stock."

Correct?

A. Yes.

Q. And that's the same numerical phenomenon we discussed in the context of the chart on page 68, correct?

A. That is correct.

Q. The next sentence states, "AIG currently has no plans for these authorized but unissued shares of AIG Common Stock other than those shares previously reserved for issuance under AIG's Equity Units, the Warrants and AIG's employee benefit plans."

Correct?

A. That is correct.

Q. You have not done any analysis as to these disclosures apart from your analysis of the valuation of the Series C, E, and F stock split claims, correct?

A. I'm sorry. You are going to have to repeat that question. I didn't quite fully understand it.

Q. You have not done any analysis of these disclosures, other than your valuation opinion for the Series C, E, and F stock split claims, correct?

A. Yeah. I haven't analyzed these disclosures in any fuller fashion, no.

MR. TODOR: Your Honor, may we have a moment?

THE COURT: Sure.

(Counsel conferring.)

MR. TODOR: No further questions on cross, Your Honor.

THE COURT: All right. Thank you, Mr. Todor.

Redirect, Mr. Boies?

MR. BOIES: Yes, Your Honor. Thank you.

THE COURT: Okay.

REDIRECT EXAMINATION

BY MR. BOIES:

Q. Good morning, Professor Kothari.

A. Good morning.

Q. We have handed a binder of documents up to you, which I will hand up to the Court as well. I apologize for the volume of materials that are up there.

Let me begin with the issue that you spent a lot of time talking about with counsel for the United States, which was the extent to which all of the information had been disclosed and internalized with the market prior to September 24th. Do you remember that, generally?

A. Yes.

Q. And do you recall that counsel showed you a number of documents that related to September 17th? They were documents that were mostly analyst reports describing what the market was understanding about the announcement. Do you recall that?

A. Yes.

Q. I'd like to ask you to look at those, and I'd like to ask you to begin to look -- and we can do this very quickly, I hope -- at the documents that they showed you.

A. Okay.

Q. And they started off by showing you, I think, Exhibit 1588, which is in the new binder that I handed you.

A. Yes.

Q. And that's a September 17th report by Credit Suisse. Is that correct?

A. Yes.

Q. And they pointed out to you that this referred to 80 percent equity interest?

A. Yes.

Q. Is there any reference here to preferred stock?

A. I don't see that. There isn't any reference to preferred stock.

Q. And is there any reference here to an undrawn fee?

A. I don't see that either.

Q. Is there any reference here to a LIBOR floor?

A. No, there isn't.

Q. Is there any reference here to a commitment fee?

A. I don't see that either.

Q. With respect to any of the reports that were shown to you from September 17th, did any of those reports reference preferred stock? If you recall.

A. I do not recall reference to preferred stock.

Q. Did any of those reports contain references to the other things that I've identified, an undrawn fee, a LIBOR floor, or a commitment fee?

A. I do not recall.

Q. And that's entirely understandable, so let me direct your attention to those. Look at Plaintiffs' Exhibit 1590. This is in the Defendant's book.

A. The demonstratives and additional exhibits?

Q. They have two books and --

A. Would this be PTX 1590?

Q. Yes.

A. Yes, I have that in front of me.

Q. So, take a look at that, and when you're ready to answer my question, let me know.

A. Okay.

Q. In this exhibit, is there any reference to preferred stock?

A. No.

Q. Any reference to an undrawn fee?

A. No.

Q. Any reference to a commitment fee?

A. No.

Q. Any reference to a LIBOR floor?

A. No.

Q. Since the documents are in evidence, I won't go through each one of those, but from your investigation, do you recall any reference on September 17th in any of the analyst reports to preferred stock?

A. My general recollection is that there was no reference to preferred stock on September 17.

Q. What about a reference to an undrawn fee?

A. There wasn't.

Q. What about a reference to a LIBOR floor with respect to the interest rate?

A. No, there wasn't.

Q. And what about a reference to a commitment fee?

A. I do not recall.

Q. Now, were there publications that you identified from your investigation in the period of September 17th through 23rd that expressed uncertainty or doubt about what the terms were?

A. Yes.

Q. Let me ask you to look at a document that Defendant's counsel asked you to look at, which is Defendant's Exhibit 1475, and this one is in the same book. It's right at the very front.

A. Oh, yes.

Q. If you look at page 2, which was a page that counsel for the Defendant directed your attention to, under the heading "How is the Fed Loan and Ownership Stake Structured?" Do you see that?

A. Yes.
Q. The first sentence underneath there says, "Unfortunately, there are very few details regarding the transaction at this stage, beyond what was in the press release from the Federal Reserve." Do you see that?
A. I do.
Q. And this is dated September 18th, 2008, correct?
A. Yes.
Q. How, if at all, does that affect your judgment as to whether all of the information -- all of the material information relating to the credit facility had been made known to the market prior to September 24th?
A. It reinforces my belief that all of the information was not available prior to September 24.
Q. Let me ask you to turn next to a series of documents that I want to ask you about. If you -- if you look at where we are now, the fourth sentence down says, "the Fed will receive warrants..." Do you see that?
A. Yes.
Q. Were there a number of other analyst reports that described what the Federal Reserve was going to receive as warrants?
A. Yes.
Q. Let me just -- let me go through some of those,

and for those I am going to use the volume that I just handed out to you.

A. Okay.

Q. And as a predicate matter, did you reach a conclusion as to whether the difference between warrants and convertible preferred voting stock was a material difference?

A. The two are -- yes, they are very different kind of securities. Warrants don't have voting stocks, and you have pay a certain amount to convert the warrant into shares, with the approval of existing shareholders, whereas convertible preferred, it has different set of rights, dividend and voting rights. So, the two are quite different.

Q. Let me ask you now to look at Plaintiffs' Trial Exhibit 103.

A. This is a -- yes, I have it.

Q. Okay. And is this one of the documents that you considered in connection with your investigation and opinions?

A. As I said, I have reviewed a large number of documents, but this seems to be one of those.

Q. And this is a publication of Dow Jones & Company, correct?

A. Yes.

MR. BOIES: Your Honor, I would offer Plaintiffs' Trial Exhibit 103, not for the truth of the matter asserted, but for evidence of what was available to the market and the market reaction.

MR. TODOR: No objection for the purposes of illustrating the basis for the expert's opinion, Your Honor.

THE COURT: All right. Plaintiffs' Trial Exhibit 103 is admitted with the restriction as stated.

(Plaintiffs' Exhibit Number 103 was admitted into evidence.)

BY MR. BOIES:

Q. If you look at page 1 of Plaintiffs' Trial Exhibit 103.

A. Okay.

Q. The third paragraph.

A. Um-hum.

Q. Do you see in the third line where it says, "The U.S. Government will effectively get a 79.9% equity stake in the insurer in the form of warrants called equity participation notes"?

A. I see that.

Q. Do you see that?

And this was as of a minute before midnight on September 16th, correct?

A. That is correct.
Q. Let me ask you to look at next Plaintiffs' Trial Exhibit 131, which is already in evidence, a New York Times article, dated September 17th, 2008.
A. Yes.
Q. If you go to page 3, the second full paragraph, do you see that?
A. "Under the plan"?
Q. Yes. "Under the plan the Fed will make a two-year loan to AIG of up to $85 billion and, in return, will receive warrants that can be converted into common stock giving the government nearly 80 percent ownership of the insurer, if the existing shareholders approve."
Do you see that?
A. I do.
Q. What significance, if any, do the statements with respect to warrants have with respect to your analysis as to whether the market knew and had absorbed all material information about the credit facility on September 16th, 17th, or 18th?
A. Clearly, since the subsequent form of equity taken by the Defendant was preferred -- convertible preferred shares with dividend and voting rights, that is at variance with the information that was available

on 16th, 17th, and 18th. So, my conclusion is that the process of market assimilating all of the information, that simply didn't happen until September 24th.

Q. And you also note that the issuance of stock here is said to be "if the existing shareholders approve." Do you see that?

A. I do.

Q. And what significance, if any, does that have to your analysis as to whether all of the material information about this transaction was available as of September 17th?

A. Well, this -- this is approval of shareholders, that seems to be an important right that was taken away eventually in the form of -- well, or at least that was being discussed and, at least to a certain extent, taken away in how AIG gets managed. So, this is, again, one more indication that -- that not all of the information existed prior to September 24.

Q. Let me ask you to look at -- next at Plaintiffs' Trial Exhibit 137.

A. Okay.

Q. A New York Times article dated September 18th, 2008. Do you see that?

A. I do.

MR. BOIES: And, Your Honor, I would offer this, again, not for the truth of the matter asserted but for the evidence of what the market had available to it and what the market reaction was.

MR. TODOR: No objection for the purpose of illustrating the basis for the expert's opinion.

THE COURT: Plaintiffs' Trial Exhibit 137 is admitted for the stated purpose.

(Plaintiffs' Exhibit Number 137 was admitted into evidence.)

MR. BOIES: Your Honor, I noticed in the last two offers and statements a mismatch between my offer and what he said, and I just want to -- if there is a confusion, I want to clear that up now. I am offering this with respect to the witness' testimony, but in that connection, I am offering it as evidence of what was available to the market and what the market reaction was, which was what they had offered a number of their documents for. I am not merely offering it for what the expert considered.

MR. TODOR: Then no objection for the purposes for which Plaintiffs' counsel submits the documents.

THE COURT: All right. Thank you, Mr. Todor. I think that straightens it out.

BY MR. BOIES:

Q. Let me direct your attention to the first page

of Plaintiffs' Trial Exhibit 137 --
A. Okay.
Q. -- which is dated September 18th, 2008, correct?
A. Yes.
Q. And the headline here is, "AIG: So Many Questions." Do you see that?
A. I do.
Q. And do you see in the second paragraph, it says, "Oddly, the documents and details of the transaction have yet to be fully disclosed. (Perhaps they are still negotiating them?) So some of what I've written below is speculation."
Do you see that?
A. I do.
Q. What significance, if any, does that have to your analysis as to whether or not all of the material information about the credit facility was available to the market on September 18th?
A. Well, it certainly doesn't appear to be available by September 18th.
Q. And if you turn to page 7, where the Times reports, "So, there will be a shareholder vote. But we still need to see the warrant to see when the government can exercise it." Do you see that?
A. Yes.

Q. And what significance, if any, does that have to your conclusions about when the market had available to it all material information?

A. My conclusion is that by 18th, the market didn't have all the information, and by 24th, as my analysis earlier has shown, the market learned the rest of the information.

Q. Let me ask you to look next at Plaintiffs' Trial Exhibit 179 --

A. Okay.

Q. -- which is dated September 20th, 2008, at 11:59 p.m. on that date. Do you see that?

A. I do.

MR. BOIES: Your Honor, I would offer Plaintiffs' Trial Exhibit 179 for the limited purpose of showing what was available to the market and what market reaction was.

MR. TODOR: No objection.

THE COURT: All right. Plaintiffs' Trial Exhibit 179 is admitted for the stated purpose.

(Plaintiffs' Exhibit Number 179 was admitted into evidence.)

BY MR. TODOR:

Q. If you -- do you see at the very first paragraph, it says, "Major shareholders are trying to help pay off the federal government's loan"? Do you see that?

A. Yes.

Q. And then if you go down to the fifth paragraph, where it says, "Edward Liddy, who was named AIG's chief executive this past week as part of the deal with the government, said he had no knowledge of the shareholder effort and had no comment."

Do you see that?

A. Yes, I do.

Q. And then the next sentence says, "The effort became confused on Friday after AIG made a filing with the Securities and Exchange Commission about the deal with the government that said it was correcting errors in a filing it made on Thursday. In the Thursday filing, AIG said it had issued a warrant to the Federal Reserve Board letting it obtain 79.9% of AIG's common stock outstanding, 'subject to shareholder approval.'

"In the Friday filing, the 'shareholder approval' language was absent and AIG said 'the corporate approvals and formalities' needed to give the government its stake would depend on the form of that stake."

Do you see that?

A. I do.

Q. What significance, if any, does that have to the conclusions that you've reached?

A. Once again, I think the market was learning over time about what the terms of the credit facility and what form of equity interest was being given as part of the credit facility, and that process, at least by September 20th, had not come to a closure.

Q. The next paragraph of this document reports, "'We have not finalized all of the documents,' says a spokesman for the New York Fed, which is lending AIG the money, and had already given it $28 billion as of Wednesday."

Do you see that?

A. I do.

Q. And what's the significance, if any, of statements such as that?

A. The New York Fed, which is the party that is signing this or making this credit facility available, even they themselves are acknowledging that not all -- they have not finalized all documents, which is, again, consistent with my conclusion that information had not been fully disclosed until September 24th, and in this case, September 20th is evidence consistent with that conclusion.

Q. Let me ask you to look next to Plaintiffs' Trial

Exhibit 1587.

A. Okay.

Q. And this is a Citigroup analyst report, dated September 18th, 2008. Do you see that?

A. I do.

MR. BOIES: And, Your Honor, I would offer this document for the limited purpose of showing what was available to the market and what market reaction was.

MR. TODOR: Your Honor, may we have a brief voir dire on this document?

THE COURT: Sure.

VOIR DIRE EXAMINATION

BY MR. TODOR:

Q. Dr. Kothari, was this document one of your documents relied upon in the preparation of your opinions in this matter?

A. Once again, I have reviewed a number of documents, and analyst reports between 17th and 29th were part of my portfolio of documents. So, while I may not recall specifically, I expect that this was one of them, but we can verify that.

Q. Okay. Would you please refer to PTX 2494 at pages 15 and 16.

A. PTX what, 24? 5224?

Q. Okay. I think I see the issue. Item 6 there,

there's a document titled, "Citi, 'The Too-Big-to-Fail Thesis Prevails,'" which is dated September 17, 2008. This document is dated September 18, 2008. Was this a typo in your documents relied upon or is that a different document?

A. I can't answer that. I mean, unless I verify and look at it, you know, I cannot -- just off the top of my head I cannot answer that. I'm sorry.

Q. Okay.

Your Honor, based on the title of the document, we won't object, but we will check to see if there was, in fact, a different document that was in his documents relied upon.

THE COURT: All right, very well. Let's resume.

I think you had offered that into evidence, though. Is there no objection?

MR. TODOR: We have no objection.

THE COURT: All right. Plaintiffs' Trial Exhibit 1587 is admitted for the stated purpose.

(Plaintiffs' Exhibit Number 1587 was admitted into evidence.)

REDIRECT EXAMINATION (cont.)

BY MR. BOIES:

Q. I'd like to direct your attention to the first page, the heading "Government Action." Do you see that?

A. I do.
Q. And if you go eight lines down, do you see a reference to "In return, the government will receive warrants convertible into a 79.9% equity interest in AIG common stock"?
A. Yes, I do.
Q. And what is your understanding of the significance of statements like this, whether you saw this particular statement or not, as of September 18th, 2008, concerning the terms of the agreement as to your conclusion as to when the market knew and absorbed all the material information about the revolving credit agreement?
A. As of September 18th, the market expected something in the form of warrants, but eventually that didn't happen to be the case. So, the information set was changing, and the finality didn't take place until September 24th.
Q. Let me ask you to look next at Plaintiffs' Trial Exhibit 1593 --
A. Okay.
Q. -- which is an A.M. Best Company publication, published September 17th, 2008. Do you see that?
A. I do.
Q. And who is A.M. Best Company?

A. They are one of the analysts or a trader. I don't know exactly who they are.

Q. This is headed, "AIG, Inc.: A Quick Look at the 6-Month Numbers." Do you see that?

A. Yes.

MR. BOIES: Your Honor, I would -- I'd offer Plaintiffs' Trial Exhibit 1593 for the limited purpose of showing what was available to the market and what the market reaction was.

MR. TODOR: No objection for that purpose.

THE COURT: Plaintiffs' Trial Exhibit 1593 is admitted for the stated purpose.

(Plaintiffs' Exhibit Number 1593 was admitted into evidence.)

BY MR. BOIES:

Q. Let me ask you to look at the last page, the last paragraph, where it says, "Current shareholders will see their equity diluted 79.9% by the issuance of warrants to the federal government..." Do you see that?

A. I do.

Q. And does that have the same significance that you have previously described?

A. Yes, it does.

Q. Let me ask you to look next at Plaintiffs' Trial Exhibit 1595, which is a Dow Jones Newswire, which I would offer for the limited purpose of showing what was available to the market and the market reaction.

MR. TODOR: No objection for that purpose.

THE COURT: Plaintiffs' Trial Exhibit 1595 is admitted for the stated purpose.

(Plaintiffs' Exhibit Number 1595 was admitted into evidence.)

BY MR. BOIES:

Q. And do you see in the third paragraph, it says, "Under terms hammered out Tuesday night, the U.S. Federal Reserve will lend up to $85 billion to AIG, and the U.S. Government will effectively take a 79.9% equity stake in the insurer in the form of warrants called equity participation notes"?

Do you see that?

A. I do.

Q. And what is the significance of any of that statement?

A. Again, the market presumed one form of equity on September 17th, but the ultimate form of equity received by the Defendant was preferred shares. So, in that sense, the information about terms and form of equity, that continued to evolve through September 24th.

Q. Let me ask you to look next at Plaintiffs' Trial Exhibit 1598, a New York Times article dated September

27th, 2008 --
A. Yes.
Q. -- which I think we can pass, because this is simply a different format of Plaintiffs' Trial Exhibit 131, which we've already looked at.
Let me ask you next to look at Plaintiffs' Trial Exhibit 1606, which is a Reuters publication dated September 18th, 2008, which I would offer, again for the limited purpose of showing what was available to the market and what the market reaction was.
MR. TODOR: No objection for that purpose.
THE COURT: Plaintiffs' Trial Exhibit 1606 is admitted for the stated purpose.
(Plaintiffs' Exhibit Number 1606 was admitted into evidence.)
BY MR. BOIES:
Q. If you look at the first paragraph there, it says, "AIG said it will hold a shareholder vote as soon as possible on the agreement to issue warrants to the Federal Reserve for up to 79.9 percent of AIG's outstanding shares."
Do you see that?
A. I do.
Q. And what is the significance of that, if any?
A. Again, the information continued to come to the

marketplace and doesn't seem to change until September 24th.

Q. And let me ask you to look at Plaintiffs' Trial Exhibit 2736, which is already in evidence.

A. Okay.

Q. And I direct your attention to the second paragraph, beginning with the second sentence, where it says, "Fed staffers who briefed reporters at 9:15 tonight, don't even want to say the government will control AIG. The government will name new management, and will have veto power over all important decisions. And it will have a warrant allowing it to take 79.9 percent of the stock whenever it wants. But they contend there is no control until the warrant is exercised."

Do you see that?

A. Yes, I do.

Q. And what is the significance of that to your conclusion as to whether or not the market knew and had absorbed all of the material information about this transaction before September 24th?

A. The same as before, that the market didn't have all of the information on the 16th, late at night, it didn't have all of the information until September 24th, 2008.

Q. Let me now ask you to look at Plaintiffs' Trial Exhibit 246, which is one of the documents that Defendant's counsel asked you to look at earlier.

A. Is it in this new -- what is the number?

Q. It's 246, and it is in the same volume that you're looking at.

A. Okay.

Q. And this is already in evidence.

Do you see the second paragraph on the first page that's headed "What's new"?

A. Yes.

Q. And this is dated September 24th, 2008, correct?

A. Yes.

Q. And it says, "AIG announced that it has signed a definitive agreement with the Federal Reserve Bank under which it has secured an $85 billion, two-year line of credit."

And then it says, "The terms of the offering are more punitive than we originally expected," and then they list four items. Do you see that?

A. I do.

Q. First, what is the significance, if any, to your conclusion that the market had not absorbed all of the information about the revolving credit agreement until September 24th, that you draw from statements such as this by investment banking analysts on September 24th, 2008?

A. So, this confirms my conclusion that the process continued at least until September 24th, and the definitive agreement, those types of statements, and the listing of terms shows us that it did complete on September 24th, 2008.

Q. In the sentence that begins, "The terms of the offering are more punitive than we originally expected," there then are four items listed. One is an interest cost of 8.5 percent, plus three-month LIBOR on the outstanding balance. The second, an initial commitment fee of 2 percent. Three, an 8.5 percent annual commitment fee on the undrawn amounts. And four, the issuance of convertible preferred stock.

Do you see that?

A. Yes.

Q. And what is the significance of the identification of these items in this September 24th analyst report?

A. Well, it's in line with that the market expected somewhat more lenient terms and that these terms are more punitive and, therefore, I would expect a decline in market valuation as a result of that. I would also say that this is consistent with the information continuing to reach the marketplace until the 24th, when it reached closure.

Q. And the last sentence in that paragraph says, "This announcement effectively puts to rest the question as to whether other private alternatives would be available to common equity holders." Do you see that?

A. I do.

Q. And what's the significance, if any, of that to your conclusion as to when the market became aware of the material terms of the revolving credit agreement?

A. The last statement says that the discussion or speculation that was going around about private-party solution being put in place, that comes to an end, and in general, there is a closure of discussions surrounding whether or not the credit facility would be in place and the terms of the credit facility, and that closure took place on September 24.

Q. Let me ask you to look at Plaintiffs' Trial Exhibit 242, which is a Wall Street Journal Market Watch publication dated September 24th, 2008, at 4:05 in the afternoon. Do you see that?

A. I do.

MR. BOIES: Your Honor, I would offer Plaintiffs' Trial Exhibit 242 for the limited purpose of evidencing what was available to the market and what the market reaction was.

MR. TODOR: No objection for that purpose.

THE COURT: Plaintiffs' Trial Exhibit 242 is admitted for the stated purpose.

(Plaintiffs' Exhibit Number 242 was admitted into evidence.)

BY MR. BOIES:

Q. Would you read the first half of this document, down to the heading that says "Asset Sales Dilution," just read it yourself, and when you've finished, let me know.

A. (Document review.) Okay.

Q. What significance, if any, does this report have to your conclusion as to when the market first absorbed the material information concerning the revolving credit agreement?

A. Would you repeat that?

Q. Yes.

What significance, if any, does this report have to your conclusions as to when the market first absorbed the material information concerning the revolving credit agreement?

A. Well, certainly the market responded on the 24th. Whether it to some extent responded earlier, I cannot say from this.

Q. Have you finished your answer?
A. Yes.
Q. Where it says, at the beginning, "Some big AIG shareholders have reportedly been trying to raise capital in private markets to avoid the government seizing control of the company.
"But late Tuesday AIG said it had signed a definitive agreement with the Federal Reserve Bank of New York for a two-year, $85 billion revolving credit facility."
Do you see that?
A. Yes, I do.
Q. And do you see where, three paragraphs down, it says (as read): "The agreement leaves 'AIG essentially nationalized,'" an analyst wrote. "'Shareholder efforts to prevent the government from taking an equity stake in AIG will prove fruitless.'"
Do you see that?
A. Yes.
Q. What significance do those particular statements have to your conclusion with respect to whether or not the market had absorbed all of the material information prior to September 24th, 2008?
A. Well, clearly this suggests that material information came in on September 24th, and the market

did react to it on the 24th. So, it could not have reacted fully until September 24th.

Q. Now, let me ask you to look at Plaintiffs' Trial Exhibit 1665, and this is a UBS publication.

A. Where is this? This is in a different --

Q. This is -- oh, I apologize. I've switched binders on you. This is in the original witness binder we gave you. I apologize.

A. Okay. So, this is PTX 1665?

Q. Yes, PTX 1665. It is near the back of the binder that we gave you yesterday. And this is dated September 25, 2008.

A. I'm sorry. I'm still not there.

Q. Oh, I'm sorry.

A. Exhibit 1665, okay.

Q. Yes, 1665. Do you have that?

A. UBS. Okay, I'm there.

Q. And do you see at the top is -- the headline is, "Fed Stake Reversal -- Remote Probability"? Do you see that?

A. Yes.

Q. And it says, "On September 23, AIG signed an agreement with the Fed for a two-year, $85 billion credit facility. On top of a 2 percent upfront commitment fee, three-month LIBOR plus 850 basis points on borrowings, and 8.5% on untapped balances, the government also gets a 79.9% equity stake."

Do you see that?

A. I do.

Q. And what's the significance, if any, of that to your analysis as to when the market received and absorbed the material information with respect to the credit facility?

A. So, this is dated -- it was posted September 23rd, so it couldn't have happened before September 23rd. So, 23rd and 24th is when this information is assimilated -- processed and assimilated -- processed by analysts and assimilated into stock prices.

MR. BOIES: Your Honor, I would offer Plaintiffs' Trial Exhibit 1665 for the limited purpose of showing what was available to the market and market reaction.

MR. TODOR: No objection for that purpose.

THE COURT: Plaintiffs' Trial Exhibit 1665 is admitted for the stated purpose.

(Plaintiffs' Exhibit Number 1665 was admitted into evidence.)

BY MR. BOIES:

Q. Do you have up there the white volume that is headed "Demonstrative and Additional Exhibits"?

A. Yes.
Q. And in that connection, I want to ask you to look at Joint Exhibit 114.
A. Okay.
Q. And this was a document that counsel for the United States asked you about. Do you recall that?
A. I do.
Q. And let me go down to the third paragraph, where it begins with, "We would expect a pullback in the stock following recent strength as we think it was bid up in the hopes of avoiding dilution of the government's equity stake. With that prospect now off the table, our sum of the parts analysis suggests that our $3 price target (after considering the net effect of repaying the government loan and net of AIG corporate debt) is a fairly optimistic assessment of the value of AIG equity."
Do you see that?
A. I do.
Q. And what significance, if any, does this September 24th Credit Suisse report have on your analysis as to whether or not information had been previously fully absorbed by the market with respect to the revolving credit facility?
A. Well, this is inconsistent with the information

being available prior to September 24th.

Q. Let me ask you to look at Plaintiffs' Trial Exhibit 2884. Never mind. That's in a different volume, and I think it's cumulative anyway. Let me go on to another subject.

In addition to the various statements that we've seen about negative market reactions on the part of analysts to what was announced on September 23, did you analyze whether the market itself reacted negatively on September 24th?

A. Yes, I did.

Q. And what did you find?

A. I find that the stock price reaction on 24th is statistically significant, negative, in the ballpark of 30 percent negative.

Q. Now, did you analyze whether the drop in AIG stock price on September 24th could be attributed to factors other than AIG-specific information?

A. I considered whether market movements would explain the decline in stock market -- in stock price of AIG; specifically, I examined whether S&P 500 Index, performance of that, and S&P Financial Index, as well as S&P Insurance Index.

Q. And what did you conclude from those examinations?

A. I concluded that movements in those indices, meaning that by general marketwide movement, either the entire market or the financial services sector or the insurance sector, none of those movements would explain or would account for the substantial, statistically significant negative stock price reaction that AIG experienced. And, therefore, it implies it was firm-specific information about AIG that contributed to the vast majority of the negative stock price decline that was observed on September 24th.

Q. Now, let me turn to another subject. Do you recall that yesterday counsel asked you whether you could cite any statements by Mr. Baxter made back in September 2008 that there was no binding obligation to transfer equity until September 22nd? Do you recall that?

A. I do.

Q. And you had referenced Mr. Baxter's testimony in this trial. Do you recall that?

A. I do.

Q. And then counsel had asked you that question.

Let me ask you -- and I'm now going to ask you about some documents, again, that are in the binder that we just handed out.

A. Okay.

Q. Would you look at Joint Exhibit 63, which is in evidence.
A. Exhibit 63, okay.
Q. And do you recognize this document?
A. These are minutes of the board, right? Yes. I have, again, reviewed a number of documents, and I have a general recollection but not a specific one.
Q. This is the minutes of the Board of Governors of the Federal Reserve System, correct?
A. Yes.
Q. From a meeting on September 16th, 2008, correct?
A. Yes.
Q. And do you see that Mr. Baxter is present, if you look down two lines from the bottom?
A. Yes.
Q. And let me direct your attention to page 5 of the document.
A. Okay.
Q. And do you see where this is the term sheet that the Federal Reserve Board of Governors considered?
A. Yes.
Q. And if you turn to page 6, do you see the reference to warrants?
A. Yes.
Q. Now, let me ask you to turn back to page 5 of

this term sheet that the Federal Reserve Board of Governors considered on September 16th with Mr. Baxter present, and do you see, right at the top, in italics, it says, "This Summary of Terms is not intended to be legally binding on any person or entity, nor is it intended to be a comprehensive list of all relevant terms and conditions of the transactions contemplated herein"?

A. I do.

Q. And it says, "Any binding agreement with respect to the matters referred to herein shall be evidenced by appropriate documentation, executed by the applicable parties." Do you see that?

A. I do.

Q. When was the first time, insofar as you have been able to discover, that there was any documentation that both parties executed?

A. My recollection is September 23rd, 2008.

Q. I'd also like to direct your attention to a document that's been marked as Joint Exhibit 64, which I will hand up. Now, Joint Exhibit 64 is already in evidence.

Do you see that the -- at the top, it is an email from Mr. Baxter --

A. Yes.

Q. -- dated September 16th, 2008? Do you see that?
A. I do.
Q. It's to Scott Alvarez and other people at the Federal Reserve System?
A. I do.
Q. And the subject is "Revised AIG term sheet"?
A. I do.
Q. And then do you see that attached, at page 3 of the exhibit, is a revised term sheet?
A. Yes.
Q. And do you see in this term sheet that Mr. Baxter sends around, it says, "This Summary of Terms is not intended to be legally binding on any person or entity, nor is it intended to be a comprehensive list of all relevant terms and conditions of the transactions contemplated herein. Any binding agreement with respect to the matters referred to herein shall be evidenced by appropriate documentation, executed by the applicable parties"?
A. I do.
Q. What significance, if any, does this have to your conclusion as to whether Mr. Baxter considered the September 16th term sheet to be nonbinding?
A. Mr. Baxter was aware and he's communicating a term sheet that explicitly states that.

Q. Let me return to another subject. You were asked a number of questions about KPMG's analyses. Do you recall that?

A. I do.

Q. And you were asked a number of questions about alternative analyses that KPMG performed, that is, alternative to the market-based analysis that you had identified. Do you recall that?

A. I do.

Q. And you told counsel for the Defendant that you believed that those other methods were not reliable. Do you recall that?

A. The market-based were objective and reliable. The others were not.

Q. Now, in the course of your analysis, did you identify anyone else who reached the same conclusion that you did with respect to whether or not these alternative approaches to the market-based methodology were or were not reliable?

A. AIG itself, I think, concluded that. That's my recollection.

Q. Let me ask you to look at Joint Exhibit 140 --

A. Okay.

Q. -- which I may have to hand up to you. I'm told, if you go back to the very first binder that we gave you yesterday, you will find Joint Exhibit 140. And once you have that, would you let me know.

A. Yes, I do have it. Yes.

Q. And this is already in evidence. It's a PricewaterhouseCoopers memorandum dated October 31, 2008, to the AIG, Inc., audit workpaper files. Do you see that?

A. I do.

Q. And if you go to page 2 of the exhibit and under the heading "Key Issues/Resolutions."

A. Um-hum.

Q. Do you see that?

A. I do.

Q. And do you see paragraph number 1 says, "Methods A and B are based on changes in Company's common stock price before and after the transaction"? Do you see that?

A. I do.

Q. And then you can read whatever else in the paragraph that you want to for context, but the last sentence says, "We take no exception to these methods or the value implied under these methods." Do you see that?

A. I do.

Q. And then number 2 refers to Methods C, D, and E as being income approaches under valuations that rely on using the credit default spreads in fair valuing the credit facility offered by FRBNY. Do you see that?

A. I do.

Q. And then if you go over to the next page -- and, again, you can read whatever portions you want for context -- but six lines from the bottom, after a discussion, PwC writes, "As such, although we believe that Methods C, D and E may provide data points for concluding on the value of the Preferred Stock, these Methods have inherent limitations, specific to the facts and circumstances of this transaction, therefore producing results that are less or not reliable."

Do you see that?

A. I do.

Q. And what is the significance of that in terms of the conclusion you reached as to what the appropriate valuation methodology was?

A. The market risk methodology is a methodology that I have advocated for reasons that it is objective, it's nonjudgmental, it's readily observable, and the conclusion that PwC has offered is in line with my assessment of market-based valuation methodology. It -- so, that is a preferred methodology when a share of a security is publicly traded in a liquid market.

Q. Did you have an opportunity to review Mr. Farnan's trial testimony in this case?

A. I did read through that, you know, I have -- if you point me to a particular -- that would jog my memory, but I have read it.

Q. Do you recall that he discussed whether in his view the KPMG Methods C, D, and E were or were not reliable?

A. I have a general recollection of that.

Q. I thought I had a copy of that. We'll pass that issue for now, Your Honor, and come back -- and come back to that when we find it. Let me, in the meantime, turn to another subject.

First, you were asked some questions both yesterday and today about the subject of control premium. Do you recall that?

A. I do.

Q. And you talked about academic literature and findings that you and others in your profession had made with respect to control premiums. Do you recall that?

A. I do.

Q. Let me ask you to look at Plaintiffs' Trial Exhibit 774 --

A. This is in --

Q. -- which I will hand up.

A. Okay.
Q. Is this an article that you're familiar with?
A. Yes.
Q. And this is a publication called Managerial and Decision Economics. Do you see that?
A. I do.
Q. And what is that?
A. It's a financial economics -- it's a journal in financial economics, and decision economics, in particular, refers to the field of -- a subfield of economics.
Q. And let me ask you to look at the fourth paragraph of this, and I would ask you to read that to yourself, and when you've finished, let me know.
A. (Document review.) Okay.
Q. And what significance, if any, does that have to the conclusion you reached with respect to the significance of control premiums?
A. I have concluded that control premiums are substantial, they are significant, and here it gives a point estimate of 9 to 13 percent as to the control premium associated with purchases of blocks.
Q. Yes. And a purchase of a block is less than a purchase of majority control, correct?
A. Yes. I mean, when you purchase a block, you do

not necessarily get control, but in order to get control, you will have to purchase a block.

Q. And if you look at the next paragraph, it talks about the "premiums paid in purchases of blocks and those paid in repurchases of blocks are not significantly different." Do you see that?

A. Yes.

Q. And then it goes on, in the next paragraph, to discuss the extent to which premiums of the value for control, that constitute majority control and those that do not, are different. Do you see that?

A. Yes.

Q. And is that consistent with your understanding?

A. Yes.

Q. And which is greater?

A. Control is greater than just a block.

Q. And you were shown both yesterday and today a line from a document that was prepared by -- I think it was AIG or one of the AIG advisors, talking about control, and you said that it didn't make clear what direction he was talking about. Do you recall that?

A. Yes.

Q. Can you --

A. In fact, it was a statement by KPMG, I think, and there was one sentence that says that if the --

yeah, it -- it referred to it as "impact," without stating the direction.

Q. And that is Plaintiffs' Trial Exhibit 375, I believe, which is in your original witness binder, that is, the one that we gave you yesterday.

A. I have it in front of me.

Q. And if you turn to page -- I don't -- I don't remember -- I don't see the exact page, but if you have it in -- if you have it in mind, would you explain what you meant by the importance of considering the direction of the movement? Look at page 16.

A. Page 16. "In addition, the impact of change in control should be reflected in the stock price post-announcement." But here, the Defendant received 79.9 percent equity and voting interest, and as a result, it received control. The remaining 20 percent shares were held by AIG shareholders, and they are publicly traded, and those are minority shareholders. So, they will not -- they do not have control any longer.

So, therefore, their share price would reflect lack of control, not existence of control, and that's the sense in which the impact could very well be negative on the traded share price of those AIG shareholders -- AIG stock, because it used to have control and doesn't have control any longer.

Q. Staying with this document, I want to turn to another subject.

THE COURT: Should we break for lunch here, do you think?

MR. BOIES: Yes, Your Honor.

THE COURT: All right. Let's reconvene at 1:50.

(Lunch recess, 12:51 p.m. to 1:50 p.m.)

AFTERNOON SESSION

(1:50 p.m.)

THE COURT: Thank you. Please be seated.

Before we get started, I have a matter that I wanted to raise probably just to give you a heads-up, and maybe we can talk about it further after the completion of this witness, but I was noticing one of the documents we were referring to recently was JX 64, which is an email with some term sheets attached to it from September 16th, and one of the term sheet drafts is completely redacted, and yet when I look at the dates when the documents were apparently produced, if the date and time is correct, the one that has been produced is from 3:50 a.m. on September 16th, and the redacted version is from 1:54 p.m., so it would be later in the day.

And I don't quite understand why this document needs to be treated as a privileged document, yet I see also that it's a joint exhibit, so you both apparently agreed to it at one point. I'd also note that I think today is the first day that Mr. Kiernan has missed, so when we could use him the most, he is not here, but I just wanted to note that issue, and if you want to converse about it on a break, that's fine, but I would just like to be notified, you know, why that draft needs

to be treated as a privileged document.
MR. BOIES: We will deal with that, Your Honor.
THE COURT: Okay, good. Let's go ahead.
MR. BOIES: Thank you, Your Honor.
BY MR. BOIES:
Q. Good afternoon, Professor Kothari.
A. Good afternoon.
Q. Just before the break we were talking about Plaintiffs' Trial Exhibit 375. Do you still have that in front of you?
A. Yes.
Q. And this was in the large white book entitled "Demonstrative and Additional Exhibits" that the Defendant's counsel gave you. And I'd like to direct your attention to page 14, where there's a heading that says, "Key Assumptions."
Do you see that?
A. Yes.
Q. And KPMG writes, right under the heading "Key Assumptions," that "Our analysis is based on the following key assumptions:" And the first one is, "Valuation date as of September 16th, 2008." Do you see that?
A. Yes.
Q. Is that consistent with your understanding of

what KPMG did?
A. Yes.
Q. Do you know whether KPMG did any investigation or made any attempt to determine whether September 16th, 2008, was the right valuation date?
A. I haven't seen anything to suggest that they conducted an analysis or why September 16th would be the right date.
Q. Let me ask you to look at Plaintiffs' Trial Exhibit 319, and that is in the binder that we handed out just today. It's headed "Rebuttal Documents."
A. Yes, um-hum.
Q. Plaintiffs' Exhibit 319.
A. Okay, I have it.
Q. And this is a statement of work signed by KPMG and AIG in October of 2008. Is that correct?
A. October 20th, 2008, yes.
Q. And this says "Statement of Work." Do you see that?
A. Yes.
Q. And the first numbered paragraph is "Services." Do you see that?
A. Yes.
Q. And it says (as read): "We understand that a valuation of the consideration in connection with the

AIG credit facility including the shares of convertible participating serial preferred stock issued by AIG to the Credit Facility Trust, a trust established for the benefit of the United States Department of Treasury, is required as of September 16, 2008 (the 'Valuation Date')."

Do you see that?

A. Yes.

Q. And is that consistent with your understanding as to what instructions KPMG had received?

A. Yes.

Q. Have you seen any analysis as to why AIG instructed KPMG to use September 16th, 2008, as the valuation date?

A. I don't know why they asked, if they wanted it as of September 16th for financial reporting purposes. I don't know, for a fact, why they suggested September 16th.

Q. Let me ask you to look at Joint Exhibit 188, which is in the same binder --

A. Okay.

Q. -- and if you will turn to page 294.

A. Okay.

Q. And do you see up at the top -- and this is talking about the valuation of the Series C preferred

stock, correct?
A. Yes.
Q. And do you see up at the top, it says, "The following significant assumptions were utilized in the valuation:" And the first one is, "The valuation date for the Series C Preferred Stock was September 16, 2008, the date AIG received the NY Fed's commitment to enter into the Fed Credit Agreement."
Do you see that?
A. Yes.
Q. And is that consistent with your understanding as to how AIG and KPMG came to use September 16th as the valuation date?
A. Yes.
Q. Let me turn to another related subject. You were asked a number of questions about comparing the stock price on September 22nd with the stock price on September 16th. Do you recall that?
A. I do.
Q. And you were asked to compare the closing stock price on September 22nd with the opening stock price on September 16th. Is that correct?
A. References were made to those two prices, yes.
Q. And do you have any understanding of any economic rationale why you would compare the opening

prices on September 16th as opposed to the closing price on September 16th?

A. The same date you are saying, opening --

Q. Yes, the same date.

A. That -- that would be because there would be some material information that came about during the day. If that is the case, then one might compare the opening price with the closing price.

Q. If there was material information that came out during the day, you'd want to compare the price that preceded the closing -- the introduction of the new information.

A. Yes.

Q. You were pointed to the fact that there is a liquidity discount taken with respect to the reverse stock split Series C but that there was not a liquidity discount taken with respect to the valuation of the Series C when it was initially acquired. Can you explain why that is?

A. So, let me begin with the credit agreement claims that arose as a result of the Defendant taking or acquiring 79.9 percent equity and voting interest in AIG. I note that those are -- that the Series C preferred stock, that is near economic equivalent of AIG common shares. So, I am valuing 80 percent equity interest acquired by the Defendant, and that was taken from AIG shareholders.

The AIG shareholders, their common shares are publicly traded, were publicly traded at the time in the New York Stock Exchange, highly liquid security. Those shares did not suffer from any liquidity discount. They lost 80 percent of those liquid shares. The value of those are determined to be the traded share price times the number of shares taken, and that is how I calculate, without any consideration for liquidity discount, in valuing the credit agreement claims.

Q. Okay.

A. Now, when I get to the stock split claims as they pertain to Series C, the economic basis for the claim is that the common shareholders had the right to block any increase in authorized shares that was necessary in order to exchange Series C preferred shares into common. The reverse stock split took that right away.

Now, what is the value of that right? The value of that right I determined to be 50 percent of the benefit that the Defendant received by exchanging less liquid, not publicly traded Series C preferred shares into liquid, publicly traded common shares.

The preferred shares that the Defendant held at the time suffered from a liquidity discount, and that liquidity discount I determined to be approximately 5 percent, which would be eliminated as they exchanged those shares into common.

Q. Are you offering any legal opinion as to whether the damages for the reverse stock split class with respect to the Series C dilution issue should be 5 percent or 50 percent of that 5 percent?

A. Did you say am I offering legal opinion?

Q. Yes, as to which is the relevant -- in other words, you've calculated the -- it both ways. Are you offering any legal opinion as to which is the appropriate measure?

A. My calculation is that the liquidity discount is 5 percent, and that would be split halfway, and that is how I get the 2 1/2 percent and $339 million. Maybe I did not fully understand the question, sir.

Q. I think it was probably a rhetorical question, so I think I can probably pass it.

With respect to the price and value of the Series C stock when it was taken, you have said that the stock market price on September 16th did not reflect the intrinsic value of AIG's stock. Do you recall that?

A. Yes, I do.

Q. Why is it your opinion that the stock market price on September 16th did not reflect the intrinsic value of AIG common stock?

A. The circumstances in the marketplace and, in particular, the circumstances facing AIG at the time were extraordinary. The financial crisis which started sometime around -- sometime, depending upon who you ask, you know, late 2007 or early 2008, somewhere around then, and the stock market, as did the AIG stock price, started to decline, it did decline, but it was steady decline. It was more or less in line with what was happening in the marketplace.

Then on -- around September 11 -- and by then, AIG's market capitalization was a little over $50 billion, Fannie Mae and Freddie Mac, they were taken into conservatorship, and it started to become pretty clear in the marketplace -- and there is plenty of information in the documents -- that AIG started to face liquidity needs.

As we know, AIG had several business lines, business segments, insurance being one of the most dominant, and that was the healthy part of AIG. It had large number of subsidiaries. It was -- it had large number of clients, regular stream of revenue from premiums, so on and so forth. So, that business was pretty solid.

Then they also had a financial products business, and there they had made use of some proceeds that they had received from securities lending to invest in risky products. They had issued credit default swap CDS insurance, as well as they had some exposure because of mortgage-backed securities. And as the housing market collapsed, they started entering losses, and what that means is that they started to receive these margin calls.

So, the margin calls are a function of what is the value of the underlying security, as well as what is the credit rating of the firm. So, they started to receive these margin calls, and now, all of a sudden, they were in need of liquidity.

Now, this was turning out to be in tens of billions of dollars, and this started around September 11th, in full force, and it is a bit of a bad equilibrium in the sense that you face some liquidity needs, you scramble, your credit rating gets reduced, then you have more margin calls, and so it's a bad cycle that you get into. And that's what happened with AIG.

And the stock price naturally started to collapse, so the market valuation of AIG from $50 billion, it lost about 75 percent in just four trading days. Important among those events was the bankruptcy of Lehman, which was over the weekend, and then 15th, Monday, the market learned about it, and then the next question was that AIG's liquidity needs are acute and the stock price took further hit, and as a result, by the time 16th, the stock valuation was only about 10, 12 billion dollars.

This, I referred, was unhinged from the intrinsic value at the time, which was reflected by the insurance business that AIG had, and if it had some sufficient liquidity, it could have incurred losses, but, nonetheless, it would not have at least have suffered from ability to continue its operating businesses without any encumbrance or lack of liquidity. So, that's the sense in which the stock price was considerably depressed with respect to the intrinsic value of AIG.

The provision of liquidity started -- that process began sometime after the close of 16th and 24th of September, and as a result, the market value of AIG could return to its preliquidity crisis level, the onset of -- onset of liquidity crisis, and it bounced back to about, you know, $50 billion.  And it is in this sense that September 16th represents the low point in the market capitalization and is indicative of the effect of liquidity crisis.

Now, I verify that the reason is liquidity by analyzing CDS spreads. CDS spreads are indicative of how likely is it that your debt will default within a year? And you default on debt because of lack of liquidity, you are not able to pay your obligations, and that -- my analysis of CDS spreads demonstrates that CDS spreads widened dramatically over those -- September 12th, 13th -- not 13th, 12th, 15th, 16th -- 11, 12, 15, 16, and the stock price declined by about 75 percent, so that is consistent with what theory would predict about a negative relation between these spreads and stock price movement.

And then when liquidity provision, that discussion started to reach the marketplace, market valuation started to return to its intrinsic value, and CDS spreads started to fall. So, it's not just on one side, but on the rebound, also, the evidence is entirely consistent.

Q. Let me turn back to the subject of the reverse stock split and this time talk about the preferred E and F, and you said that that was a different situation than the Series C.

A. Yes.

Q. And why was that a different situation than the Series C?

A. Well, Series E and F, that stock price dilution is the classic form of stock price dilution, right, or dilution suffered by in the sense that less valued securities were exchanged for more valued securities.

Q. Which were the less valued securities?

A. The fair value of Series E and F preferred stock was below the liquidation preference value. So, those Series E and F preferred stock were less valued security here.

Q. Now, counsel for the United States pointed out to you that the liquidation value was 40 billion for the Series E and 1 1/2 billion for the Series F.

A. 1.15, but we are in the right ballpark.

Q. 1.15.

A. Yes, yes.

Q. Now, how could the Government have realized that liquidation value, if at all?

A. In the event of liquidation, they would have at least attempted to realize that, or if the firm had called those securities, then they could have realized that.

Q. Now --

A. When you say "liquidation," you mean liquidation preference? Did I -- that's what I understood that to mean.

Q. Yes, that's what I meant.
A. Okay.
Q. And is it the case that the -- any liquidation would be at some time in the future?
A. Yes.
Q. And when you have an event in the future that is going to result in the receipt of cash, what do you have to do in order to figure out the net present value of that event?
A. In this case, you would have to discount to calculate the present value of that future payment.
Q. And when you discount that value, does that increase the value or decrease the value?
A. It will decrease the value today.
Q. Now, counsel for the Defendant pointed out that this liquidation value was the amount of TARP investment that had been made in AIG. Do you recall that?
A. Yes.
Q. Was there any difference between the recipient of the TARP money and the parties that were being deprived of anything with respect to the reverse stock split?
A. Yes.
Q. What was that difference?
A. The recipient was AIG, and the aggrieved party

here would be shareholders.

Q. When you say the recipient was AIG, that's the recipient of the TARP money?

A. Yes.

Q. Now, with respect to the credit agreement, you said, in response to one of the questions from counsel for the Defendant, that you had done a valuation of the credit facility where you had concluded that the credit facility was fully compensated. Do you recall that?

A. I do.

Q. Let me ask you to look at page 45 of Plaintiffs' Trial Exhibit 2853, which is one of your reports, and that is in a couple of different places, but it is in the white -- one of the white binders that the Government gave you.

A. Is it part of my expert reports and exhibits?

Q. Yes.

A. Okay.

Q. It's 2853.

A. I have that exhibit here, 2523. 2523, page 1 of 27.

Q. You have 2523?

A. Yes.

Q. Let's use that one, then.

A. It looks the same.

MR. BOIES: May I approach, Your Honor, just to be sure that I'm looking at the same document?

THE COURT: Sure.

THE WITNESS: 2523. This is from the Defendant.

THE COURT: It's 2853. I think you might be looking at one of your demonstrative exhibits.

MR. BOIES: It's 2853, and if you --

THE WITNESS: Okay. All right, let me --

MR. BOIES: -- maybe the easiest way to find it is turn to the binder that we gave you that's labeled "Demonstrative Exhibits and Reports."

THE WITNESS: Yes.

MR. BOIES: And do you see at the back, there is a 2853, page 45?

THE COURT: It's under a tab that says "Kothari Rebuttal Report."

THE WITNESS: Okay, yes.

BY MR. BOIES:

Q. Does this page have anything to do with your conclusion that the Federal Reserve was at least fairly compensated for the credit facility?

A. Yes.

Q. Can you explain how?

A. So, in this exhibit, I have calculated the present value of the $85 billion revolving credit facility, and I have used standard methodology. The standard methodology is that you receive interest and any other payments over time in exchange for the loan that you have received -- I'm sorry, I misspoke. You make payments of interest and any fees in exchange for the loan you have received. You also repay the borrowed amount or the principal at the conclusion of that credit facility, assuming you have -- here I am assuming an $85 billion loan, and the contractual terms of the credit facility specify the fees, the interest payments, as well as schedule of principal repayment.

Those future payments have to be discounted to today's. The discount rate I have used is two-year CDS spread for AIG. This is applicable for unsecured debt. The loan was fully secure, so I will return to the significance of that in a minute. That is the spread. The spread is over three-month LIBOR. LIBOR at that time was 3.2 percent. So, the total discount rate would be 11.8 percent.

Using that discount rate, I calculate the present value, and I determined the present value to be $88,151,000,000, which is in excess of the face value of the credit facility, which is $85 billion. When it is in excess, that means you are more than fairly compensated. The risk of extending that credit is reflected in the discount rate.

I said that I would come back to the significance of the fact that this was a discount rate CDS spread that is applicable to unsecured debt, and that significance implies that the appropriate discount rate to use would be that for secure debt, CDS spread for secure debt, and CDS spreads for secure debts or the risk of secure debts is necessarily lesser than the risk of unsecured debt.

And I am using the discount rate that is applicable to unsecured debt, and this is, again, a point that others also have recognized, and, therefore, the fair value here that is estimated is understated. So, my purpose in conducting this analysis was to demonstrate that the fair value of the credit facility is at least as large as $85 billion. So even using conservative assumptions, I demonstrate that appropriate assumptions would show that the fair value is still greater than the $88 billion here.

Q. If you used a lower discount rate, what would the effect of that be on the fair value of the credit facility, as you have identified it here, as $88,151,000,000?

A. It would be higher.

Q. Let me turn to Joint Exhibit 221, which is in

the volume that the Government gave you.
    A. I have it.
    Q. Do you recall that counsel for the United States asked you about the purpose of the reverse stock split and various statements in this proxy statement at pages 68, 69, and 70? Do you recall that?
    A. I do.
    Q. First you told counsel that there was a benefit to avoiding delisting. Do you recall that?
    A. I do.
    Q. Could that benefit have been achieved by a reverse stock split that affected both authorized and unissued shares?
    A. Yes.
    Q. Now, counsel, on page 70, directed your attention to the second full paragraph, and the third sentence there says, "While the New York Stock Exchange has temporarily suspended the minimum share price requirement, this suspension may be terminated at any time and, in any event, the suspension expires on June 30, 2009."
        Do you see that?
    A. I do.
    Q. And this was a proxy statement for a meeting to be held June 30, 2009, correct?

A. Yes.

Q. Did you analyze in any way the reason given for waiting until June 30, 2009, to have a vote related to trying to avoid delisting?

A. I did not analyze that.

Q. You said that and counsel directed your attention to the statement in the second-to-last full paragraph on page 70, where it says, "AIG currently has no plans..." Do you see that? It's the paragraph that begins, "An overall effect of the reverse stock split..."

A. Um-hum, I see that.

Q. And then the next sentence says, "AIG currently has no plans for these authorized shares -- authorized but unissued shares of AIG Common Stock other than those shares previously reserved for issuance under AIG's Equity Units, the Warrants, and AIG's employee benefit plans."

Do you see that?

A. I do.

Q. Was there anywhere in this proxy statement, insofar as you were aware, any statement that the company was considering using these additional authorized shares to effect an exchange of common for preferred stock for the Government?

A. I'm not aware of that. I did not see any reference to that.

MR. BOIES: Your Honor, I pass the witness.

THE COURT: All right.

Mr. Todor, any recross?

MR. TODOR: Yes, Your Honor.

RECROSS EXAMINATION

BY MR. TODOR:

Q. Good afternoon, Dr. Kothari.

A. Good afternoon.

Q. First you were asked some questions about PTX 375. Could you please return to that document, please.

A. That's the one with KPMG?

Q. KPMG, yes.

A. Okay.

Q. Counsel for Plaintiff asked you questions about the conclusion whether the market value-based approaches were considered to be more reliable by KPMG, correct?

A. I think that's what -- yeah.

Q. Okay. Could you please turn to page 21 of the document.

A. Okay.

Q. And there there's -- this is the "Conclusions" section, correct?

A. Yes.

Q. And there it states, "We determined that the market approaches under Methods A and B were the most reliable indicators of value, since: the stock price is an observable market input and the stock is actively traded." And the second bullet, "the preferred stock is readily convertible into common stock."

Correct?

A. Yes.

Q. Next, KPMG states that "The other methods we considered corroborate and support our final conclusion." Correct?

A. That's what it states.

Q. And one of those methods was Method C, which is one of the income-based approaches, correct?

A. Method C is -- well, it says income approach, but it is favorable financing, so they -- two labels are used.

Q. And Method C was the calculation where KPMG had determined that the fair value of the credit facility on September 16, 2008, was approximately $51.58 billion, whereas the fair value of the credit facility on September 17, 2008, was approximately $75.27 billion, correct?

A. Yeah, that's what it is. Yes.

Q. Method -- I direct your attention to page 17 of the document.
A. Okay.
Q. This is Method B. This is one of the two market value approaches, correct?
A. This -- Method D, this is -- this is the CDO method, right?
Q. Method B, as in boy.
A. Oh, Method B. Okay.
Q. Sorry if I was unclear.
A. No, no, no, that's fine.
Q. Are you with me?
A. Method B, as in boy?
Q. Now, Method B is an incremental market capitalization approach, correct?
A. That is correct.
Q. And that measures the difference between the closing stock price as of September 16, applied to 2.954 billion shares, compared to the opening share price on 9/17, applied to 14.697 billion shares, correct?
A. Yes.
Q. So, this is a before and after analysis.
A. Ah, yes, with two things --
Q. And KPMG found that the after, including the 14.697 shares and share equivalents, had a higher market

cap than the before calculation, correct?
A. That is correct.
Q. In your calculations in this matter, you did not do a before and after valuation, correct?
A. Right.
Q. Your valuation was similar to Method A that KPMG used, which was simply the closing price on a given date, correct?
A. That's correct.
Q. I'll turn your attention to Method A, which is page 16.
A. Okay.
Q. You were asked questions by counsel for Plaintiffs regarding the statement of work that -- between AIG and KPMG, correct?
A. Yes.
Q. And you were asked questions about the use of the date of September 16th for the valuation date, correct?
A. Yes.
Q. Even if the valuation was as of September 16, isn't it true that it would involve judgment on the part of KPMG as to what market data to use to come up with the valuation for September 16?
A. Yes.

Q. And here, on page 16, KPMG states that "we determined that the closing price of $2.05 on September 17, 2008, (the day after announcement) showed adequate trading volume to reflect all available information about the credit facility and 79.9% dilution," correct?

A. Yes.

Q. And that is an exercise of judgment on the part of KPMG, correct?

A. Well, with one very important caveat, right, that it -- the judgment was exercised with respect to whether or not the market had processed the information that became available on 16th or after the trading of 16th. It did not exercise any judgment as to what information -- was all the information revealed or not, and that is the judgment that I exercised in saying that 22nd, the valuation date, and then all the information about credit facility is available by 24th.

There is an important distinction here, that that judgment -- that they are keyed on 16th, but they did not ask, "Is 16th the appropriate date?" They said, "Given that 16th is the appropriate date, should they use price of 17th?" That's the only limited judgment they have used.

Q. You were asked questions by counsel for Plaintiffs regarding JX 140.

A. Yes.

Before we finish, may I offer one more observation about the credit that's -- the approach C?

THE COURT: Sure, go ahead.

THE WITNESS: The incremental on the CDS spread in that valuation, correct, that they have done that over there in Method C, so then the credit facility -- I suppose the introduction of that, at least some discussion of that, reduced the CDS spread, right? They have valued only the $95 billion, but the introduction of that reduced the risk of all of debt.

So, they haven't -- KPMG, this analysis is not -- that's the kind of reason why this is not reliable, that they did not focus on all of debt. Instead they focus on all of market value, right? That's the sense in which this is done only for the credit facility, but the benefit of -- if it did reduce the risk, it reduced on all of debt, and surely AIG had other debt, also.

Anyway, just I wanted to point out why this is not reliable.

BY MR. TODOR:

Q. And when you say reduce the risk for all of debt, are you talking about reducing the risk for all of AIG's debt?

A. Yeah.

Q. So, you are saying that the $85 billion credit facility, you're saying that that may have reduced the CDS spreads as it applied to the $85 billion loan itself, but it had also benefits on AIG's other debt. Is that what you're saying?

A. All I'm pointing out, that these kinds of methods are not that reliable. That's the point I'm making.

Q. Okay. And in response to my prior question, is it your opinion that the $85 billion loan, the fact that it was there had a beneficial effect on AIG's ability to repay other debts in terms of its CDS ratings?

A. I'm -- all I'm -- yes, to some extent, that is, and just the market value approach takes into account or to whom it belongs, that's the sense in which if you are interested in valuing the shareholder equity value, then the relevant approach is to focus on the market value of equity. That is the point, and that's why Method A captures that. Other methods do not.

Q. Would Method B also capture that?

A. Method B has the attractive element that to the extent that it is based on market capitalization of equity and it is based on objective methodology, it has the attractiveness of that. So, A and B, that's --

those are the two, and if one were to choose between A and B, it is A.
Q. You were asked questions about JX 140, which I'm currently trying to determine which of your binders it was in.
A. Which one is it in?
Q. I will let you know when I find out. It appears to be in the white binder marked "Demonstrative and Additional Exhibits" that we handed up to you earlier.
A. Okay.
Q. And you were asked questions by counsel for Plaintiff regarding this document, correct?
A. JX 140? Yes.
Q. And you were asked questions about page 2 of that document with the discussion of Methods A and B compared to Methods C, D, and E, correct?
A. Right.
Q. And, again, PwC is concluding that the Methods A and B are based on changes to the company's common stock price before and after the transaction, correct?
A. Right.
Q. And PwC states that it believes that these methods are reasonable since they rely on a market approach to implicitly value the preferred shares.
A. Yes.

Q. You were also asked questions by counsel for Plaintiffs regarding Methods C, D, and E, correct?

A. Yes.

Q. You were asked questions about the statement that "Although we believe Methods C, D, and E may provide data points for concluding on the value of the preferred stock, these methods have inherent limitations specific to the facts and circumstances of this transaction, therefore producing results that are less or not reliable."

A. Yes.

Q. And that is a conclusion with respect to the application of the change in CDS spreads to the value of the preferred stock, correct?

A. Can you repeat that, please?

Q. And that is an evaluation of the utility of the change in CDS spreads with respect to the value of the preferred stock.

A. Yeah. In this context, at least, that is one of the reasons.

Q. But PwC is not criticizing the calculation of the CDS spreads or their change in and of themselves, correct?

A. The purpose of KPMG was to calculate the value of preferred stock, and if the method cannot produce a reliable valuation of that preferred stock, then I don't see what use is it whether or not they used appropriate CDS spreads. I don't even know what it means in that context, because if the methods are not producing valuation of what it is designed to -- it is stated to produce, then -- at least reliably, at least, then I think it is -- it's a negative assessment of those three methods.

Q. And turning your attention, if you need to, back to page 18 of PTX 375.

A. Okay. Page what did you say? I'm sorry.

Q. Eighteen.

A. Eighteen. Okay.

Q. The methodology is coming up with an incremental value from government support based on a comparison of the fair value of the credit facility on the 17th versus the 16th, correct?

A. Yes.

Q. By saying that this calculation is usable as a data point, their -- PwC is referring to the incremental value, not the validity of the calculations of the fair value on the 16th and the 17th, correct?

A. You cannot get the value of any -- reliance on incremental value unless the neutral values are also reliable. I -- I -- unless -- I mean, I -- so, I don't -- I don't quite understand how they could say the difference is good but not -- they don't rely on the two valuations themselves.

Q. Turning your attention back to page 3 of JX 140.

A. Okay.

Q. PwC also states, "we believe the magnitude of CDS observed or change in CDS observed between pre and post-transaction levels for the company were influenced by factors not solely limited to the placement of the credit facility agreement between the company and FRBNY," correct?

A. Okay, you will have to tell me where you are. Which paragraph?

Q. It is -- I was starting in the middle of a sentence to avoid more reading. It is the second full sentence on page 3 of JX 140, starting, "As of the valuation date..." You can read that for yourself.

A. Okay. (Document review.) Okay. That's what this says, yes.

Q. Right.

A. Um-hum.

Q. In your analysis, you did not determine whether there were other factors, other than those solely limited to the placement of the credit facility, between the company and the New York Fed that may or may not have had an influence on credit default swap spreads, correct?

A. I did not explicitly look for other factors. I -- other than specifying the dates, 11, 12, 15, 16, and 17, it -- you know, that time period, and those were the five days on which CDS spreads exhibited a significant change, in addition to a sixth date, which was November 10th, 2008. So -- and the significant change correlated very well with my general reading of when was AIG experiencing liquidity crisis and when that started to get defused as a result of liquidity provision.

Q. And just for clarity, the dates 11, 12, 15, and 16, were those all dates when AIG's CDS spreads were getting statistically significantly worse compared to the market?

A. Worse meaning they were larger, yes.

Q. And on the 17th they got better relative to the market.

A. Yes.

Q. You did not conclude that the CDS spreads got statistically better relative to the market on September 24th.

A. No.

Q. And then November 10th, again, the -- they got

better relative to the market on the 10th, correct?
A. That is -- that's the event study. The magnitudes have changed. Some of these things have spilled over two or three days. Now, I haven't done sort of multidate windows to ascertain whether the change over market revenues is significant or not. This was -- I didn't want to play around with data. I just wanted to let the data inform, to some extent, was a detectable change in CDS spread associated with the events I generally understand, and it lined up pretty nicely, but there wasn't an additional significant change on single date, 24th, even though, compared to 17th, the total change in CDS spread from 17th to 24th was very substantial, from 1700 to 860. So, it declined almost 50 percent, but that is spread over several days, in part because news about the credit facility didn't come in one single day.
Q. You did not present in your analysis a statistically significant change on the 24th.
A. That is correct, yeah.
Q. And the change on November 10th, that was statistically positive because of the announcement of the November 2008 restructuring and TARP investment, correct?
A. I would attribute it to that significant event.

Again, I haven't looked at whether there are multiple other events, but I strongly suspect that it is because of that.

Q. Turning to another topic, you were asked by counsel for Plaintiff about JX 63.

A. Okay. This is in which --

Q. This is in your rebuttal documents binder.

A. Okay. JX 63, yes.

Q. The initial discussion on this was in relation to Mr. Baxter's trial testimony and whether any statements from Mr. Baxter would have been known to the market in September 2008, correct?

MR. BOIES: Objection, Your Honor. That's not what it was in relationship to. He's characterizing my examination here.

MR. TODOR: Well, if that was the case, the examination was beyond the scope of cross, since that was the initial topic of my cross on the topic.

THE COURT: Well, I think in JX 63, counsel and the witness simply referred to the preamble to the term sheet, which we can all read, so --

MR. TODOR: All right.

THE COURT: -- I think we have been over that a few times.

BY MR. TODOR:

Q. I'll simply ask this. Dr. Kothari, to your knowledge, this document was not available to the market between September 16 and September 24, 2008, correct?
A. I believe so, although I'm -- you know, that level of specificity, I do not have.
Q. Do you know whether the Fed had actually compiled its minutes for the 16th meeting prior to September 24th, 2008?
A. Probably not, so...
Q. I'll next direct your attention to JX --
A. All I'm saying is I don't know if the summary of terms, whether that document somehow was known to market or not. I simply don't know that.
Q. Okay. I'll turn your attention to JX 64. You were asked about this by counsel for Plaintiff as well.
A. Is it also in the same binder?
Q. It was a loose-leaf document that was handed up to you.
A. Okay, this one. Yes, yes, um-hum.
Q. To your knowledge, this document also was not known to the investing market in September 2008, correct?
A. I don't know one way or another.
Q. You stated that you -- on a different topic -- you stated that you performed an event study for the

effect on AIG's stock price following the announcement of the credit agreement terms on September 24th, 2008, correct?

A. Yes.

Q. You also performed an event study on AIG's stock price for the dates leading up to September 16, 2008, correct?

A. Yes.

Q. And AIG's stock price was negative in a statistically significant way relative to the market on September 12th, 2008, correct?

A. Well, I would have to go back and look at that, and what I had done was I had put in a variable that captured four days, and average return on those four days was, I believe, some minus 25 percent. So, compounded return over that four-day window was about minus 72 percent. So, about three-quarters of the market capitalization of AIG was -- declined over that four-day period.

Q. And to refresh your recollection, would you please turn to your rebuttal report.

A. Okay.

Q. And specifically to the exhibits.

A. Um-hum, yes.

Q. And it's actually Appendix B. So, it would be page 63 of PX 2853.

A. Yes.

Q. And my -- the specific part I'd ask you to look at to refresh your recollection is paragraph 16, which spans pages 70 and 71 of the document.

A. Okay, yes.

Q. And does this refresh your recollection that it is your opinion that negative and significant abnormal returns of negative 30.5 percent, negative 47.3 percent, and negative 29.4 percent were associated with September 12, 15, and 16, 2008, with T statistics of negative 5.6, negative 8.5, and negative 5.3?

A. Yes.

Q. And could you please explain what the significance is of a T statistic of negative 5.6, negative 8.5, or negative 5.3?

A. Okay, I will give a -- in somewhat general terms, and if need be, get more and more precise. A T statistic is a scientific means of assessing whether the observed phenomenon is actually attributable to chance or is it really unusual? So -- and T statistic of 2, either plus 2 or minus 2, it can be signed, implies that -- or 1.9, say -- would imply that it is less than 5 percent chance that such an event will occur. So, it is fairly rare, and that is used as a standard in the literature to test whether something is significant or not.

Now, T statistic for -- here they are minus 5 or minus 8 and minus 5 again, those imply that it is extraordinarily unlikely that -- that just in the normal course of things, this happens. This is highly unusual phenomenon that's taking place, that a firm experience like minus 30 percent return or minus 27 percent return. Those are -- a T statistic of minus 5 and minus 8 would imply -- it's like, you know, to use the term, one in a million type of thing. That is literally -- it would be the case.

Q. These confirm that AIG was doing much worse than the market as a whole to a very high degree of certainty as of September 12, 15, and 16, correct?

A. That is correct, yes.

Q. The market price on the morning of September 16th was $1.85, correct?

A. Yes.

Q. And you agree that AIG was a very liquid stock, a lot of shares traded, correct?

A. Yes.

Q. And you agree that the stock price during the day reflects the prevailing market information about the prospects of the firm.

A. Yes.
Q. Thus, the market's assessment of AIG's future prospects as of that morning was at $1.85, correct?
A. Given the liquidity challenges it was facing, that market had assessed its valuation to be at that level, which was considerably below its -- I would say its intrinsic value at the time.
Q. But the market's assessment of the value of AIG differed from what you believed to be its intrinsic value at the time, correct?
A. Yeah.
Q. Okay.
A. I mean --
Q. And one of the factors that the market was embedding into AIG's stock price was the risk that AIG would declare bankruptcy, correct?
A. I don't know for a fact, but that is -- it is possible.
Q. And your measurement of AIG's intrinsic value is premised on AIG receiving liquidity support sufficient to get through its liquidity needs, correct?
A. Yeah. I mean, my whole -- whole hypothesis or whole explanation is on the basis that -- and this is a -- actually, this is exactly what happened. It was at about $40 billion market -- $50 billion market

capitalization. It started to experience acute liquidity needs. The provision of liquidity restored its value. So, it's exactly that scenario that I have offered, and that's a narrative that is consistent with economic theory and also data.

Q. You'd agree that the intrinsic value measured would not necessarily have been AIG's value had AIG not received the liquidity support that it ultimately did receive.

A. I'm sorry. You will have to repeat the question.

Q. Okay. You would agree that the -- your assessment of AIG's intrinsic value would not necessarily have been AIG's value had AIG not received the liquidity support that it ultimately did receive.

A. That requires an analysis of a counterfactual that I did not entertain. I didn't conduct that analysis, and the counterfactual, as an aside, you know, and I have stated this before, was not something that was being contemplated as stated by various high-ranking government officials. So, that -- but that analysis, I have not performed.

Q. I'll direct your attention to the PX -- PTX 774, the academic article you were referred to by Mikkelson and Regassa.

A. Yes.
Q. This is an assessment of premiums paid in block transactions, correct?
A. Yes.
Q. These were not block transactions of companies that were experiencing liquidity difficulties, correct?
A. Not to my knowledge.
Q. Isn't it true that a company experiencing liquidity difficulties might have a much lower premium for a block share of its stock?
A. I -- so, let me answer that a little bit broader than that. This control premium and -- which is in excess of this, just the block premium, right, is an extraordinarily pervasive phenomenon, okay? This happen with many firms who have been taken over when they were experiencing difficulty, and even in those cases, acquirers have paid a substantial premium.
I mean, in general, the phenomenon is that premium gets paid to acquire some company, and so that's a sense in which, while I cannot point to a specific study right sitting here of whether it is lower or higher, but my general understanding of this phenomenon, how robust and pervasive this is, I'm inclined to say that -- that even under those circumstances, the premium is likely to be substantial.

Q. You can't point me to a study saying that premiums of companies that are experiencing liquidity difficulties are higher, lower, or the same as companies that are not experiencing liquidity difficulties.

A. Sitting here, I cannot point to a specific study, no.

Q. You referred to a premium being paid, and that is something that results in a gain to the person acquiring the control, correct?

A. If they pay the premium.

Q. You did not, however, analyze in your context of this case whether any individual shareholder of AIG had any control premium that it lost.

A. The -- the economic concept of this control premium, it is not at all necessary that ^ in usual shareholders have to enjoy that control to lose it. Collectively, the sellers receive the premium paid by the buyer who acquires that control.

Q. So, for example, if instead of acquiring 79.9 percent of shares, the Government only acquired 1 percent of AIG's shares, would you agree that there would be no control premium associated with that?

A. Yeah. Generally, I would not associate control premium with -- if someone acquires 1 percent, happens all the time in the marketplace, and that -- those transactions generally take place at prevailing market prices. Maybe there might be a little bit of bump in bigger spread or tick -- price tick might go up by a tick or two, but not 20, 30 percent for that.

Q. Here, what you were measuring is the gain to the Government, or saying they're conservative by not measuring, is the gain to the Government from acquiring a control premium rather than a loss to shareholders from losing a control premium that they already had. Isn't that true?

A. Well, I'm measuring the loss. I mean, I'm ignoring -- you know, if -- if somebody comes and say that I want 79.9 percent, you know, I would say that, hey, you know, you will have to pay a premium. That's what the going rate is. So, if today's share price is $10, you will have to pay me $12, 20 percent premium, and that's what market transactions in that -- you know, we observe.

So, instead, I am assuming, no, no, this is -- I am going to give you 80 percent shares without charging $12, valuing it at $10 itself. So, I'm doing a conservative valuation from the standpoint of seller. In this case, I'm assuming credit agreement class shareholders as the seller.

Q. You're talking about the credit agreement shareholders as a class. No one of those individual shareholders had a control premium that they lost. You're just saying that, as a whole, once the Government acquired that 79.9 percent, the Government ended up in a controlling position, correct?

A. That's how the world works. That's what I am trying to say. You are absolutely right, nobody -- and usually -- I haven't verified that, but even if they were all diffuse shareholders, acquisition of 79.9 percent in the real world would entail the acquirer paying a premium to the remaining 20 percent share.

Q. You were asked some questions during your redirect regarding news stories regarding -- some talking about the possibility of warrants being the form of equity as opposed to what ultimately resulted, correct?

A. Yes.

Q. You have not performed a valuation of what the 79.9 percent would have been worth if it were in the form of warrants as opposed to preferred stock, correct?

A. I -- I did not perform any analysis, the reason being that I wanted to view what actually happened when all the information came about, and what actually happened was that preferred stock was issued, and that's what I valued.

Q. Turning your attention to the stock split claims, you were asked questions about the cause of the block in dilution, correct?

A. Yes.

Q. What was your assessment of the percentage of the $1.16 value of AIG's common stock price as of June 30th, 2009, that was based on this blocking right?

A. This was incremental to that $1.16, I would say. They had the right, and here comes someone who says that, well, I want to exchange these less liquid stocks into more liquid stocks. And the existing shareholders, they know that they don't directly benefit if some other shares are becoming available as liquid shares, but they do recognize that without their consent, the other party cannot exchange those for more liquid common shares.

So, they recognize that they are sitting on something of value which is to grant permission to, in this case the Defendant, to exchange less valuable shares for more valuable liquid shares. And that's where the sharing of the benefit that is accruing to the Defendant, economic theory suggests would get split, and the common -- the split class shareholders would get that $339 million inducement from the Defendant.

Q. So, what percentage of the value of the $1.16 does that blocking right represent?

A. Well, in this case, by way of calculation, 13 cents as a percent of $1.16 on that date, but that's not the economic analysis. That is just mathematical calculation. That's not the basis by way of what percent is liquidity discount and that -- and that. That's not what I'm doing.

Q. And what percentage of the value of the $1.16 was represented by the right to block dilution with respect to the Series E and F preferred?

A. Once again, here, the only point I'm making is that on June 30th, I don't know what was said, whether already reflected or not reflected. What it is the case is that if someone exchanges less liquid stock into more liquid, they benefit, and common shareholders have the right to refuse that benefit unless they receive some payment, and that right to refuse was taken away on that day from common shareholders, that day meaning June 30th, 2009, and I am valuing that.

Q. You would agree that AIG's stock market price was a reliable measure of the value of AIG common stock on June 30, 2009, correct?

A. Yes, yes.

Q. You were asked questions on redirect about the liquidation preference involved in the Series E and F preferred, correct?

A. Yes.
Q. And you were asked questions about whether a benefit would occur at some point in the future and would need to be discounted back to the present in order to make that calculation, correct?
A. Yes.
Q. As of June 30th, 2009, there were no announced plans to have that exchange that ultimately occurred at any point in the future, correct?
A. That is correct.
Q. Therefore, there would be no applicable discount rate that could be used, because you don't have an end point for some point in the future you're tracing back to June 30, 2009, correct?
A. I mean, if you don't specify when the cash flow is, I cannot apply that. I don't know if there was any expectation on the part, but -- your statement, I -- I -- without the payment date, I have to agree that I cannot calculate it.
Q. And AIG had already gotten the benefit of receiving the $40 billion TARP investment for the Series E and the 1.15 billion investment for the Series F as of June 30th, 2009, correct?
A. They had received TARP money, and in exchange, they had issued some securities to the Government. So,

I didn't perform any analysis of what was given and what was taken, whether it was equal value or not. So, I haven't conducted that analysis.

Q. But AIG was able to use the TARP funds for repaying of the revolving credit facility and other purposes, as we discussed previously, at the time it received the cash, correct?

A. Yes.

Q. You also were asked questions during your redirect regarding whether the benefit of the cash was received by AIG as opposed to the shareholders. Did I get that correct?

A. Yes.

Q. AIG used the funds in part to pay off part of AIG's debts under the revolving credit facility to the New York Fed, correct?

A. Yes. So, credit facility -- yes.

Q. And it also used it to pay off some of AIG's other debts.

A. It -- it issued some new equity. So, this is called refinancing type of transaction that took place. So, this is -- on paper, I mean, you know, you pay off one entity and you owe to another entity. So, this is refinancing. This wasn't net financing as far as I can tell.

Q. And AIG's debts are debts owed by the company, AIG, correct?
A. Yes.
Q. And by doing so, doesn't that increase shareholder value for the company not to have that same level of debt?
A. Once again, you know, so it all depends upon to what purpose the money is used and what was given in exchange, right? So, this is a transaction. It's not like somebody wrote a check and nothing -- I don't expect anything back from you. So, in that sense, I haven't analyzed it, but what I do know is that something was given and something was taken, and there was some of that money that was given that was used to refinance. So, again, something was taken and something was given. So, net of all of these things, I haven't analyzed it, nor was I asked to analyze it.
Q. Have you done any analysis of whether the refinancing was on better terms than the original financing?
A. Again, you know, so that -- that also -- in terms -- it might be looked better, but on the other hand, you have to ask, what was the risk? Maybe the risk profile had changed by then. So, these things are not in a vacuum. You cannot just compare without

reference to what the underlying economic reality is.
Q. Would you agree that substituting preferred equity for debt would tend to improve AIG's debt-to-equity ratio?
A. In this case, no. There are two things that were happening. One is preferred is not usual equity. That's number one, okay?
Q. Okay.
A. It had -- second, if you look at -- if you are suffering that economic dilution as a result of that preferred equity with liquidation preference, then that's an onerous term, because you are -- you -- eventually, they lost about $25 billion on that preferred debt -- preferred equity, right?
So, in that sense, again, I cannot answer that unless I know what was given versus what was taken. Simple labeling something as debt versus preferred equity, that is only a small part of the overall picture here.
Q. You -- so, this is the Series E preferred stock, correct?
A. Yes, $40 billion.
Q. That was exchanged for the Series D preferred stock.
A. That is correct.

Q. And one of the features of the Series E preferred stock, that it had noncumulative payment of dividends as opposed to the Series D preferred stock, correct?

A. Yes.

Q. Isn't it true that having the noncumulative dividends, one aspect of that would be for that equity to appear more like equity and less like debt in the eyes of credit rating agencies or other people evaluating AIG's debt-to-equity ratio?

A. So, there again, you know, so limited answer to that, without reference to anything else, the answer is yes. The noncumulative is better than -- from the standpoint of shareholders than cumulative, but the picture is more complicated.

AIG was not being paying dividend to begin with, and then to the extent that the focus was on liquidation preference, if it was perceived that what you are on the hook is for liquidation preference, then I think -- I think the situation is somewhat different, especially because even at the inception, even Series D was only about 40 percent the face value of -- or liquidation preference value of that Series D, as we saw from Duff & Phelps valuation.

And, therefore, this whole thing was

complicated, that money was being -- TARP funding was given not just as an arm's length transaction of lending money, but there were some other focuses that the Government had.

Q. I'll direct your attention back to PTX 2853, to that page 45 you were directed to during your redirect.

A. That is the valuation of that at Exhibit 1? Is that --

Q. Yes.

A. Okay. Okay.

Q. Now, you were asked earlier about the valuation of the credit facility. This is not any kind of opinion as to whether there ought to be liability, correct?

A. Oh, in terms of from the credit agreement claims or those things?

Q. Yes.

A. No, I'm not offering any opinion on liability, no.

Q. And directing your attention to the fair value of the credit facility figure, you are valuing the credit facility as of September 22nd, 2008, correct?

A. Yes.

Q. And you are using the CDS spread and LIBOR as of September 22nd, 2008, correct?

A. Yes.

Q. All right. Isn't it true that the value -- the fair value you'd come up with for the credit facility would be lower than 85 billion if you kept everything else about this the same but used the figures from September 16, 2008?

A. So, that is, again, a very complicated analysis. The primary reason is the CDS spreads that I used are for unsecured debt, right, and I know that they are too high, that that number is too high, but my purpose was very limited. It was to show that even using a higher CDS spread rate, on the date that I believe is appropriate date, I wanted to ascertain whether the estimated value is in excess of 85 billion or not.

Now, if you change the goal post to September 16th, right, then at a minimum, if I am asked to value -- okay, I am asked to assume that credit facility is there on the 16th, which I may not agree with, but suppose I'm saying that, well, assume it is there, take the CDS spreads, then the appropriate CDS spread, because even on that day it was fully secure, so the appropriate rate to use would be the rate that is applicable to secure debt and to conduct that valuation and analysis.

I have not conducted that. Nobody has, okay? Some -- I take that back. Some people might have done that. I haven't done that, and the limited analysis that I have seen, some of the other written -- other experts from the Defendant that I have seen, they also use unsecured. And I comment in my rebuttal report that I disagree with their use of unsecured debt to calculate the fair value.

THE COURT: Shall we take a break, Mr. Todor?

MR. TODOR: Yes, Your Honor.

THE COURT: Unless you're almost finished. Are you?

MR. TODOR: The break is fine.

THE COURT: Okay. We will return at 3:35.

(Court in recess.)

THE COURT: Thanks. Please be seated.

Mr. Todor:

MR. TODOR: Thank you, Your Honor. We have no further questions for the witness on cross, and we thank him for his time.

THE COURT: At least we gave you a few minutes to think about it.

Dr. Kothari, thank you for your testimony in this matter. You are excused.

MR. MIZOGUCHI: Your Honor, you asked a question during the last break about that exhibit that was redacted.

THE COURT: Yes.

MR. MIZOGUCHI: I am prepared to address that if you like.

THE COURT: Is that okay with you, Mr. Boies? That would be great.

MR. BOIES: Yes, Your Honor.

MR. MIZOGUCHI: JX 64, Your Honor, noted that there was a term sheet time stamped 1:54 p.m. that is redacted. Yesterday -- well, I think during the examination of Zingales, there was an exhibit that was used that is PTX 86 that contains an unredacted copy of this same email chain, starting with Brad Smith, that includes an unredacted copy of the term sheet in question.

THE COURT: Tell me that number one more time.

MR. MIZOGUCHI: PTX -- Plaintiffs' Exhibit 86, and it was admitted into evidence with Professor Zingales.

THE COURT: Mr. Boies, does that comport with your understanding?

MR. BOIES: Let me see if I understand what counsel is saying. He's saying that the document that has been redacted in Plaintiffs' Exhibit 64 --

THE COURT: Joint Exhibit 64.

MR. BOIES: -- Joint Exhibit 64, the email that has been redacted in Joint Exhibit 64 is the same as what is attached beginning with some page number, like page number 9, in Plaintiffs' Trial Exhibit 86?

MR. MIZOGUCHI: Ah, yes. Correct.

MR. BOIES: I have no reason not to accept counsel's representation. It seems to me that since the document is already available, I think what makes sense is to substitute a complete copy of Joint Exhibit 64 so we have it, so we have the document later.

MR. MIZOGUCHI: There is one difference between JX 64 and PTX 86. PTX 86 begins with the Brad Smith email that is at the bottom of JX 64. So, the one thing you would lose by substituting PTX 86 is the top email from Tom Baxter that says, "Here it is."

MR. BOIES: I'm inclined to have both documents in. I was just saying it did not seem to me that since -- the only reason for a redaction is if there's some kind of privilege or confidentiality. Since there obviously isn't, since this is now part of the public record, I just thought we would -- I wasn't trying to take out PTX 86, although I --

MR. MIZOGUCHI: No, I mean JX 64.

THE COURT: I think the question is whether JX 64 ought to be substituted with PTX 86, or should we just leave them both -- see, I think we should leave them both in the record, because there's been references throughout the trial --

MR. BOIES: Right.

THE COURT: -- to both exhibits. But I think with this explanation, we can be confident that we have the redacted document from JX 64 elsewhere.

MR. BOIES: Yes. And all I was suggesting is that we -- with respect to JX 64, so we don't have all those black pages, we just add in what had been blacked out.

THE COURT: If you can accomplish that, I guess that would be fine.

MR. MIZOGUCHI: There may even be a simpler alternative. DX 425 is another copy of JX 64, but it's unredacted.

MR. BOIES: Okay.

MR. MIZOGUCHI: I just thought I would refer to the one you used with Mr. Zingales.

THE COURT: So, DX 425 is the same document --

MR. MIZOGUCHI: Yes, Your Honor, but it has not been admitted into evidence.

THE COURT: Oh. Should we take care of that now?

MR. BOIES: I have no objection.

THE COURT: By stipulation, Defendant's Exhibit

425 is admitted.

(Defendant's Exhibit Number 425 was admitted into evidence.)

MR. MIZOGUCHI: Thank you.

THE COURT: I trust that you will get a copy for the Court?

MR. MIZOGUCHI: Yes, Your Honor.

THE COURT: Okay, very good.

MR. BOIES: Because of the fact that there have been references, since DX 425 hasn't been admitted yet but we're just admitting it now, would it make sense simply to substitute in the record the document that is DX 425 for JX 64? If it's exactly the same document, we would just apply the joint exhibit number to that document, and we would have it.

THE COURT: That might be the best solution of all, perhaps.

MR. MIZOGUCHI: That's fine, Your Honor.

THE COURT: Okay. Well, again, just furnish a copy that is unredacted and we will call it JX 64.

MR. DINTZER: Your Honor, a second housekeeping matter. With Professor Zingales, we created some demonstratives on the flip chart, and the Court asked us to shrink them down, and before the experts get too far ahead of me, I would like to go ahead and move those into evidence.

THE COURT: Sure, that's fine.

MR. BOIES: We have no objection.

MR. DINTZER: This is a little precarious.

THE COURT: Thank you.

MR. DINTZER: And, Your Honor, I'll just read these numbers into the record and move them, just to make sure we have it.

THE COURT: Sure.

MR. DINTZER: We have DXX 004, DXX 005, DXX 006, DXX 007, DXX 008, DXX 009, DXX 010, and DXX 011 that we would move into evidence, and all were used as demonstratives with Professor Zingales.

MR. BOIES: No objection, Your Honor.

THE COURT: Okay. These exhibits are admitted as Defendant's demonstrative exhibits.

MR. DINTZER: Thank you, Your Honor.

(Defendant's Exhibit Numbers DXX 004-011 were admitted into evidence.)

MR. BOIES: While we are doing housekeeping matters, Your Honor, we have six of the Doomsday memoranda that have been produced to us that we would now like to offer in evidence.

THE COURT: Sure.

MR. BOIES: And we have been assured that with respect to these particular memoranda that have been produced to us, these do not have to be under seal.

THE COURT: All right.

MR. BOIES: And these are Plaintiffs' Trial Exhibits 2813, 2814, 2817, 2818, 2822, 2823. I have copies for everybody.

MR. DINTZER: Your Honor, I -- Mr. Kiernan is not here, as the Court has noted, and he was the person with particular interest in -- in the sealing or not sealing of these. We will take counsel's representation, of course, and based on that representation, we will not oppose and not ask for sealing.

MR. BOIES: And if there's any question, what we could do, just to be absolutely certain, is we could just -- nobody distribute these until Mr. Kiernan has a chance to be heard.

THE COURT: All right.

MR. DINTZER: We would appreciate that.

THE COURT: That's fine. So, without objection, the Court admits Plaintiffs' Trial Exhibits 2813, 2814, 2817, 2818, 2822, and 2823.

(Plaintiff's Exhibit Numbers 2813, 2814, 2817, 2818, 2822 and 2823 were admitted into evidence.)

MR. BOIES: When these do become public, if they do, people will be very disappointed in the dryness. After the name "Doomsday Book," if you're expecting something very exciting, some of this is very pretty slow going.

THE COURT: It suggests a retitling of the book, "Not So Doomsday."

MR. BOIES: Your Honor, we now call Dr. Michael Cragg to the stand.

THE COURT: Yes. Please come forward, sir. I believe I remember you from a prior case.

THE WITNESS: Likewise.

THE COURT: Nice to see you.

Could you raise your right hand, please.

Whereupon--

MICHAEL CRAGG

a witness, called for examination, having been first duly sworn, was examined and testified as follows:

THE COURT: Please be seated.

THE WITNESS: Thank you.

MR. BOIES: I'm handing up two binders, and I must say, it may be good that we're coming to the end of our case, because the binders keep getting larger. I apologize for that.

THE COURT: This is the biggest one yet.

MR. BOIES: Yes.

DIRECT EXAMINATION

BY MR. BOIES:

Q. Good afternoon, Dr. Cragg.

A. Good afternoon.

Q. What is your present position?

A. I'm currently an employee at The Brattle Group, where I'm a principal in the company.

Q. In the larger binder that we gave you, the first tab is Plaintiffs' Trial Exhibit 2849. Would you look at that. It's the very first tab.

A. Oh, the very -- I see. Got it, yes.

Q. And can you identify this document?

A. This is my CV.

MR. BOIES: Your Honor, we would offer Plaintiffs' Trial Exhibit 2849 as Dr. Cragg's CV.

MR. DINTZER: No objection, Your Honor.

THE COURT: All right. Plaintiffs' Trial Exhibit 2849 is admitted.

(Plaintiff's Exhibit Number 2849 was admitted into evidence.)

BY MR. BOIES:

Q. Would you describe what The Brattle Group is?

A. The Brattle Group is an economic consulting firm. We specialize in doing research for a variety of different types of clients. We have offices in both

Europe and the United States. In Europe, we have offices in London, Madrid, and Rome; and then in the United States, we have Washington, New York, Cambridge, where I'm from, and San Francisco.

Q. Could you give the Court a brief summary of your educational background.

A. Sure. I was an undergraduate major at Princeton where I did a double major in architecture and engineering. I graduated with a bachelor of science in engineering. After that, I did a master's degree at the University of British Columbia, where I'm -- I'm from Vancouver, so I went back home to do that. After that, I immediately went to Stanford to do a Ph.D. in economics and finance and graduated from there in 1993.

Q. What did you do after graduating from Stanford?

A. So, my first job was with Columbia University, where I was in the Economics Department, and I also had a joint appointment in the School of International and Public Affairs. And then my teaching was across those two schools and the business school.

Q. How long were you on the faculty of Columbia University?

A. Just over five years.

Q. During that period of time, did you teach anywhere other than Columbia?

A. I did. I visited at Eton, which is the premier university in Mexico City, and then I also was out at the Anderson School of Business at UCLA.

Q. What were your primary responsibilities when you were teaching economics?

A. I had a variety of responsibilities. Of course, teaching, I taught undergraduate courses and graduate courses in corporate finance, finance, public finance, and econometrics. I also led a couple of senior theses seminars.

And then at the graduate school level, I taught public finance as well as econometrics. And then at the MBA level, I also taught MBA students a variety of different subjects in economics and finance.

And then, finally, I also had teaching responsibilities in a World Bank training program that we ran, which brought students, from midlevel kind of people who were coming through the ranks quickly, from a variety of different countries around the world.

Q. Have you published articles in peer-reviewed economics journals relating to your research?

A. Yes. I've published a variety of articles in kind of a -- in a range of different areas, in corporate finance, finance, valuation, public finance. So, I've also done research in environmental economics, is something that interests me.

Q. Have you done any research on the financial crisis?

A. Yes. When I -- so, I left -- I had my own firm for about eight years with a couple of colleagues, and when my fourth daughter was born, it was January of 2008, and so I was thinking of doing something different than what I was at the time. And as we all know, the financial crisis came along at that point, and I actually joined The Brattle Group right around the exact period that we focused on.

When I -- when I joined, I was -- it was a very interesting time, and I immediately started doing research with a variety of colleagues, both at Brattle as well as outside of the company. So, at Brattle, I was working with a fellow named George Oldfield and Jehan deFonseka, who is here, also. And then outside of the company, I was also doing a number of projects with Joe Stiglitz, who's a -- I think many people know is a well-known macroeconomist.

Q. Have you published any articles or other publications with respect to the financial crisis?

A. Yes. We were -- at that time, 2008, 2009, and even 2010, as the events were happening, there wasn't a great -- you know, people had trouble understanding what was going on. I put out a -- you know, a number of articles which were designed to educate smart people who were looking for primers on the issues that we were all experiencing. And then I also did a couple of pieces with Joe as well as with others on the financial crisis.

One of the other activities I was involved in during this period was explaining what I was learning, and I did that through professional seminars for lawyers. I was giving CLE courses at the IRS and the Department of Justice, as well as private law firms. And then I gave guest lectures at a couple of different places, at the University of Toronto, for instance, where there's, you know, an executive MBA program for the banking sector there.

Q. In addition to your work at Brattle and in addition to your teaching and academic work, have you had other experience in the field of economics?

A. Yes. You know, aside from the two that we've spoken about, when I left -- my path out of academia was first transitioning through a couple of think tanks. So, the first one I worked at was at Rand Corporation, which for the most part specializes in government contract research, and then after that, just a total coincidence that right down the street was a think tank that specialized in financial markets that Michael

Milken was funding. So, I then spent a little over a year there working with colleagues focused purely on finance-related topics.

After that, I -- you know, my wife wanted to move back to the East Coast, and so I joined a consulting firm, first with A.T. Kearney doing management consulting, and then eventually I joined an economic consulting firm called analysis Group, and that's how I got into the line of work I'm involved in now.

Q. Have you ever testified as an expert witness before?

A. I have, yes.

Q. In what courts have you testified?

A. In Federal District Court; as His Honor noted, the Court of Federal Claims; and then in Tax Court.

Q. On what subjects have you testified?

A. Most of the areas that I've testified in have been around topics related to structured finance, valuation, financial failure, and then the -- you know, how the system as a whole functions, whether it is in the United States or in Europe and also Latin America.

Q. And you have been retained by the Plaintiffs in this case to serve as an expert. Is that correct?

A. Yes.

Q. Are you being compensated for your work?

A. I am.

Q. Is your compensation contingent in any way either on how you testify or on the ultimate result of the case?

A. No.

MR. BOIES: Your Honor, we would offer Dr. Cragg as an expert witness in the fields of economics and financial markets.

THE COURT: All right.

Any voir dire, Mr. Dintzer?

MR. DINTZER: Yes, Your Honor.

VOIR DIRE EXAMINATION

BY MR. DINTZER:

Q. Good afternoon, sir.

A. Good afternoon.

Q. So, sir, you've been a consultant for about 15 years?

A. I think that's about right, yes.

Q. And about how much of your time has been spent working on litigation-type issues as opposed to other issues?

A. I would guess about three-quarters.

Q. Three-quarters litigation?

A. Yes.

Q. And just roughly, what percentage of your annual income comes from the litigation side as opposed to the other side?

A. So, in terms of the income, my compensation from Brattle doesn't differentiate between those two types of activities. And then work that I do outside of Brattle isn't compensated. So, as a general editor, for instance, I don't get compensation for that, or if I write academic articles, I'm not compensated for that.

Q. Am I right, sir, that you have never worked for a Central Bank?

A. That's right.

Q. And you have never worked for any entity in the Federal Reserve System?

A. That's right.

Q. And I've looked at your résumé -- and I'm happy to put the list in, and I know you have it in front of you -- but just roughly, your consulting and litigation projects have included the following:

The valuation of various brands owned by multinational food distributors. Is that right?

A. Yes.

Q. And an analysis and evaluation of metals distributors. Is that right?

A. I'm not sure which -- what you're referring to,

but I'll just take -- yeah.
Q. I'm looking -- I pulled these off your résumé.
A. Yeah, I understand.
Q. Evaluation of real estate holdings in San Francisco?
A. Yes.
Q. You analyzed the drug development process for drugs in various stages of clinical progress?
A. Yes.
Q. You analyzed complex border/cross-border lease transaction documents?
A. Yes.
Q. You've analyzed 12,000 coal contracts?
A. Yes.
Q. You've evaluated malpractice damages in a celebrity divorce representation, which sounds fascinating.
A. It was.
Q. You've determined the mitigation value of land that could be restored to wetlands.
A. Yes.
Q. You've analyzed competition at Chicago O'Hare Airport.
A. Yes.
Q. And you've determined the appropriate royalty

rate in pharmaceutical disputes involving cancer drugs and other treatments.

A. Yes.

Q. And you've talked about tax. How many times have you testified in tax cases?

A. I'm guessing like six or seven times in court perhaps.

Q. Is that about half of your litigation practice?

A. It varies -- it's varied over time, so --

Q. Roughly.

A. -- at times it's been half of it, yes.

Q. Okay. So -- and none of those deal specifically with central banking. Is that right?

A. No, that's not true.

Q. Just the ones that I've mentioned, sir.

A. Yes. So, for instance, in structured finance, much of those -- in the tax cases you just mentioned, often banking and investment banking are at the core of those cases, and then the types of risks that are present in the analysis do relate to the general activities of the Central Bank and how financial markets in general function.

Q. Okay. And in general -- I probably asked you too broad of a question, but in those cases, you haven't specifically opined about the function of a Central

Bank, have you?

A. Not directly.

Q. Okay. And so can we agree, sir, that you've done a lot of very interesting things, but your résumé does not suggest a single-minded focus on central banking issues. Is that right?

A. I think you're mischaracterizing it somewhat. The areas of both public finance and finance in general and economics, central banking is a -- you know, a -- you know, a core area. You can't -- you cannot be an economist, and in particular, you can't really do public finance or finance in general, and not have a -- a very strong understanding and knowledge about research and how these -- the impact of central banks on markets in general.

Q. Okay. And I could go down this list, sir, but can you agree with me, at least, that 13(3) and Mr. Bagehot have not come up in the cases that I've discussed, specifically?

A. I -- well, let me just address that. 13(3) has not. The principles of Bagehot have come up in cases that I've done which relate to the Irish banking crisis and the Latin American banking crisis, so -- crises. So, those are concepts which have been or those concepts have been core to the work that I did there.

Q. Okay. And, sir, I noticed that you said you were a student at Stanford. Is that right?

A. Yes.

Q. And was that when Chairman Bernanke was a professor there?

A. No. The macroeconomists who you might know that were there then, I had John Taylor as a professor, Joe Stiglitz, Bob Hall, who heads the MBR committee that determines when recessions occur, Tom Sargent, who won a Nobel Prize in economics.

Q. And if I could get you to hone in on my question, I just asked you about Chairman Bernanke. He was a professor at roughly the same time you were there as a student, right?

A. No, he wasn't.

Q. Is that right?

A. No, no. He, I think, arrived at Princeton just after I left there.

Q. And actually I was talking about Stanford.

A. No, I know.

Q. Okay.

A. So, I think we just missed each other.

Q. Okay. You received your Ph.D. in economics in '93. Is that right, sir?

A. Yes.

Q. And have you ever held a tenured teaching position?
A. No.
Q. Okay.
And with that, Your Honor, we have no objection to his being qualified as an expert in the two subjects identified by counsel.
THE COURT: Very well, then. We will accept Dr. Cragg as an expert in economics and financial markets.

DIRECT EXAMINATION (cont.)

BY MR. BOIES:
Q. Let me turn to your testimony. Did you prepare some slides in connection with your testimony today?
A. Yes, I did.
Q. Did you prepare a slide or a chart summarizing the opinions that you're offering in this case?
A. I did, yes.
Q. And can you identify that for the record?
A. It's here in -- I was going to say the smaller black binder. It's labeled PTX 5300.
Q. And this would be in the binder labeled "Demonstrative Exhibits and Transcripts," correct?
A. Yes.
Q. Would you turn to Plaintiffs' Trial Exhibit

5300.

A. Okay.

Q. And would you go down these opinions that you say are a summary of your work and go through them one by one.

A. All right. So, in general, I was investigating, you know, questions related to, you know, the terms and conditions around -- and the circumstances that surrounded AIG, its liquidity crisis, and entering into the RCF and how that impacted the company; and then what are the explanations for the set of circumstances and events that happened.

I came to five conclusions. The first one is that the liquidity crisis at AIG was caused by the market forces that basically affected every major financial institution over the course of 2008, 2009, and beyond. The events that occurred then, which really is -- many have described as the worst financial panic in world history, swept AIG up.

The second conclusion I have is that the punitive terms imposed by the Federal Reserve on AIG's shareholders included an onerous interest rate, the taking of equity. Those were inconsistent with, first, how the Federal Reserve, in general, functions as a lender of last resort, what it -- you know, its role in the economy and in society, and then second, it was inconsistent with the way the Federal Reserve used its powers during the financial crisis to assist others and to, you know, try to tame the crisis that was under way.

The third conclusion that I have is that the reason that the Federal Reserve was able to impose punitive terms on AIG's shareholders is that, as the lender of last resort, it had monopoly power, and it was able to use that monopoly power or misuse the monopoly power to expropriate AIG shareholder equity. And in doing that, it was doing it in a way that was inconsistent with generally how economists think about economic policy as it relates to the lender of last resort and without a strong economic rationale behind it.

The fourth conclusion I have is that there are a variety of justifications that the Government and others have forwarded for why AIG was treated the way it was, and I have, you know, analyzed those, and I don't see an economically compelling reason for why those are good explanations. You know, the idea that AIG should have been punished, the idea that there was moral hazard that would justify the terms that were used, the idea that you needed to prevent a windfall, the relatively new idea that the Government had to be compensated for taking credit risk, there just isn't a strong economic rationale for any of those.

When I went through and looked at all the rationales that have been forwarded, there's only one that stood out in the end, and that is that there's a reason for the Government to abuse its power, and it's -- you know, it really -- it's because of the timing of what was happening in the world at that time, but it was expedient to treat AIG as a political scapegoat. And we've heard testimony about that, and I think it's a -- it's understandable within the context of what was happening in the financial crisis, that that was why -- that's what explains the terms that were ultimately selected for the RCF.

Q. Let me turn to those opinions one at a time. First, you referred to a financial crisis. How did you reach the conclusion that this was, I think as you indicated, an extremely severe financial panic?

A. Well, I was hoping that when we initially started talking, that I was conveying a sense of enthusiasm for understanding what was happening. I -- I mean, it was both a scary time but also it was a fascinating time, and I -- for me, it was a -- I thought it -- you know, had a passion for exploring what was happening at the time, and I was very lucky that a lot of the cases and -- my colleagues and the activities that I was able to engage in allowed me to explore those activities, whether it be through doing research, doing education, writing. And, you know, I think one of the things I was most lucky about, that I was able to interact with some of the most important policy commentators in the world at that time. So, it was a very -- for me, it was a very natural thing to be exploring that.

You know, five years later, when I look at, you know, the -- you know, my bookcase in my library, you know, my wife complains about, you know, the volume of -- she uses some pejorative words for the books that I've collected, but I think it's been -- you know, it's always been fascinating.

So, anyways, there's just simply no doubt that the financial crisis was the worst ever. We've heard, you know, plenty of testimony at this trial that have, you know, identified a variety of both transcript quotes here as well as, you know, quotes from other trial exhibits that, you know, anywhere you looked in the Government, anywhere you looked in academic economics, and just as importantly, if you looked out in what was happening in Europe, there was, you know, this incredible financial crisis that was occurring, and it was global.

Q. Have you collected some of the evidence from this case that you rely on for your opinion that the financial crisis was a very severe one?

A. Yes. I mean, there's -- I look at the wall of binders over there. There's an incredible amount of information about, you know, the institutions that, you know, suffered through the financial crisis. One of the exciting things about this case is actually being able to see inside these institutions.

Q. And did you prepare a demonstrative exhibit listing some of the examples of the evidence that you relied on?

A. I have. There's a number of different pieces of evidence that I've put forward, which I hope will serve to be educational and provide help in understanding what were the set of events that occurred and how ultimately they impacted AIG and the Federal Reserve.

Q. Now, let me take you through some of those. Is one of those Plaintiffs' Trial Exhibit 5301?

A. Yes. So, this is a quick summary of what various witnesses have said at this trial, as well as what others have said as it relates to the financial crisis. So, Mr. Bernanke, who we were talking about earlier, you know, an incredible scholar of the

Depression, and it will be fascinating to see his analysis of the crisis when it's completed, but he said that this was -- that September and October of 2008 was the worst financial crisis in global history, and that's including the Great Depression, which I think most of us in this room actually, you know, probably didn't suffer the way most people did during the Great Depression, but, you know, ultimately, when you look at how devastating the impact was to financial markets, I think that statement is justified.

Secretary Paulson, you know, obviously a central figure in American finance, said, "By the middle of September, right after Lehman failed, the country was plunged into...the most wrenching financial crisis since the Great Depression." You know, when I read Mr. Paulson's book about the -- I mean, how gut-wrenching -- literally gut-wrenching it was during this period, you know, it's -- it's -- I think it's very visceral.

Secretary Geithner said, "So September 2008, as you all know, the world was really at the edge of the abyss." And that's one of the things that really resonates in the record here. "It was the worst financial shock in more than a century -- significantly worse than the shock that caused the Great Depression."

You know, the Office of the President said similar things. And I think, you know, when you think about AIG's liquidity crisis, what the issues were, as Mr. Geithner said in September 2008, "Private markets had frozen," and, you know, "under the unusual circumstances that existed at the time, even solvent institutions become illiquid, and if they are caught up in a run, even the strongest will not survive."

And when you read what people were writing who were in the markets at that time and how they were experiencing it, it was, you know, a real fear about would we have the liquidity that's necessary to get through the next day, the next week, and so on.

Q. I'd like to explore how the financial crisis came about, and have you prepared some demonstrative exhibits to illustrate that?

A. I have, yes.

Q. And what are they?

A. Well, the first, if we could look at 5302, so PTX 5302, it's a -- so, this is a -- a graph that's taken from the Financial Crisis Inquiry Commission, and in a way it captures a snapshot of what really happened at the time, which was that there were two banking systems that were growing along with each other, you know, parallel with each other, the traditional banking system and then what's been known as the shadow banking system, the alternative banking system, the parallel banking system. There's a bunch of different ways that this other system has been described, and it's called an "other system" because it's not regulated in the same way that thrifts and commercial banks were that are part of the traditional banking system.

And most importantly, that alternative banking system was growing faster and eventually grew to overtake the size of the traditional banking sector. So, if you, you know, think about household credit, which, you know, stands at a little over 20 trillion, a huge fraction of that is actually coming through the parallel banking system, and much of the parallel banking system represents loans to households that have been aggregated and put together into securities.

And as you can see, in 2007, just after the fall of -- you know, when the housing market reached its peak in the third quarter of 2006, the shadow banking system crashed, falling from, you know, a magnitude of $13 trillion down to $8 1/2 trillion within a three-year period. And that shock resonates throughout the system, and it's a -- you know, it's ultimately that shock to the shadow banking system which caused the liquidity crisis that we've been hearing about.

Q. Who were the primary participants in this alternative or shadow banking system?

A. So, if you think about the -- you know, the traditional banking sector, it's composed of commercial banks and thrifts. In the other part of the banking system, it's composed of a variety of different institutions that are originating loans, that are packaging those loans into securities, that are then creating institutions that will buy those securities, that -- you know, institutions that will distribute those securities to investors.

At the heart of the alternative banking system are the investment banks, the broker-dealers, because they're really the ones that are making the markets that are -- you know, that allow for the transformation of loans into securities that can be, you know, acquired and utilized in the business of others.

Q. Now, this chart on 5302 that you've taken from the Financial Crisis Inquiry Commission report shows a decrease in the parallel banking system over about three years of how many trillions of dollars?

A. So, it's a fall of almost 5 trillion, so from a peak of -- of about 13 trillion down to approximately 8 1/2 trillion in 2010.

Q. And what were the consequences of that?

A. Well, ultimately, the consequences filtered through the system in a complicated set of relationships. First off, the availability of credit to both households and businesses became much tighter; in particular, that part of the housing market, which has been known as kind of the subprime or Alt-A financed residential homes, that part of the market froze, and that part of the market actually relied on a continual process of financing. So, that had an enormous impact on households and then ultimately on regional prices.

The other big impact was that the fall in housing prices filtered throughout the securities that were created to package up the loans for distribution, and that had an impact on both those who were buying those securities for the long term, but most importantly, those securities were playing the role of money. So, they were -- they actually were being traded back and forth between investment banks and commercial banks, as well as their clients, and they were being treated as money.

The fact that they changed from being money ultimately caused great angst in the world of investment banking, because it caused a great deleveraging and a -- you know, a flight to quality that sucked the liquidity out of the system.

Q. Let me ask you to look at Plaintiffs' Trial Exhibit 5303, and can you explain what the role of this demonstrative is?

A. Yes. So, this gives a little more specificity to how the parallel banking system, you know, 2003, 2004, 2005, 2006, you know, was increasing at an exponential rate. So, it was following -- following the rise in housing prices and fueling the rise in housing prices. Ultimately, as we all know with hindsight, that there was a housing bubble, and, you know, these two forces were working together to both create the credit as well as create the demand for housing.

When the bubble burst in 2006, the parallel banking system contracted. It -- you know, literally all of this -- this money, all these loans got sucked out of the system over the next three years. There was no ability to refinance subprime mortgages, and that eliminated, for instance, the supply of lower-quality, private-label RMBS. RMBS stands for residential mortgage-backed securities.

Q. You mentioned a couple of other phrases. Subprime, which may be obvious, but the other one was Alt-A?

A. Yeah, so that stands for -- yeah, the A is alternative, and it's a regulatory designation. So, you have prime mortgages where they're well documented, the -- the income and value underlying the mortgages is stable and well identified. Those are called prime mortgages, typically linked to the prime rate.

The next layer of mortgages are called Alt-A because there are either documentation weaknesses or underwriting weaknesses. There's less information, but they're -- they're still decent quality loans.

And then the layer below that ultimately are called subprime mortgages, so obviously self-explanatory, but the -- the documentation, the income, and the value underlying the collateral, the houses themselves, are all much weaker.

Q. How does the parallel banking system differ from the traditional banking system?

A. Well, the most important is that in the traditional banking system, the link between the borrower and the lender is very tight. You, as the lender, know the person that you're extending credit to. You, as the borrower, know who your -- who your bank is. The bank, therefore, has a very intimate relationship with the risk of its clients.

In the parallel system, however, that link is broken, and you ultimately -- the way the banking system made money in the traditional system was very different than it was in the parallel banking system. In the traditional system, most of the income is being generated through what's called spread income, which is the difference between the cost of money coming in to the banks versus -- you know, from either -- from deposits or lenders versus the interest that they're able to charge on mortgages and other loans. So, that spread income is what drives the profitability of traditional banking.

In the parallel banking system, what was most important was the ability to do deals, because it was fees that generated profits. And so the -- one of the kind of core issues during this period and that led to problems in the parallel banking system was the utilization of what's called the originate to distribute model.

Q. Do you have some demonstratives that help explain that?

A. I hope so. So, 5304 here is just a simple picture of the relationship between a mortgage bank and its sources of financing and its uses of financing. So, the mortgage bank extends -- at the bottom here, to the right, we have cash going over to households, and they're providing mortgage obligations in return to the bank. The bank finances those mortgages by extending

IOUs either through deposits or through loans, and in return to its creditors, it gets cash back from them. So, that's how the traditional system works. It's, you know, very tight.

If we turn to the next demonstrative, which is how the parallel banking system worked, you can see that it's much more complex, and, you know, I struggled on how to actually reduce the complexity to something somewhat simple. So, even though this looks -- I think it looks complex, it is actually a vast simplification of the way the parallel banking system works.

So, you can see at the top, money is coming out of firms and households, it's going into a large range of different facilities, different types of investors, whether it be broker-dealers who buy securities, CDOs are a type of security, hedge funds obviously are investors, pension insurance companies are one of the biggest consumers of -- or investors in mortgage-backed securities. So, money goes into those vehicles, into those different savings institutions, and then filters its way down ultimately to the mortgage bank.

At the middle, at the center are special-purpose vehicles, and they're special purpose in the sense that you could think of them as a bathtub. You fill up the bathtub with mortgages, and then out of there comes a security which is then sold to one of these variety of different types of institutions. So, it's -- so, you know, the special-purpose vehicle is for collecting loans together against which a security will be created.

At the heart of this system, as we talked about earlier, are the broker-dealers. They're the investment banks. They're putting together the special-purpose vehicles. They're creating the securities that come out of those special-purpose vehicles. They're selling those to -- at least the -- on the far right, you would have the sales of the higher quality RMBS being sold to pension insurance companies. They can only invest typically in AAA securities. Then over to the left here in this diagram, the lower quality securities coming out of the special-purpose vehicles get sold. So, in a simple way, that's how the system is working.

Q. You talked about leverage. Can you look at Plaintiffs' Trial Exhibit 5306 and is that a demonstrative that you prepared?

A. It is, yes.

Q. And what is that designed to show?

A. Well, one of the hallmarks of this period of history is that the institutions that were at the core of this system were -- while they were thriving on the creation of fees, they were, you know, competing heavily against each other. And in the financial services sector, when there's a lot of competition, the way to magnify your returns is through leverage.

And as you can see here on this graph, which on the horizontal axis we have time, on the vertical axis we have the ratio of assets to equity for primary dealers, you can see from, you know, 1998 up to the first quarter of 2008 a dramatic increase in the leverage of these institutions. And so they were taking on more risk to amplify their returns in an evermore competitive environment.

And I was struck by Mr. Geithner's testimony on this. I thought he captured well what the economic forces were that were at play. And he said, "Risk gradually migrated from where it was constrained by things like capital requirements, leverage requirements..." So, he's talking about the commercial banking system, the traditional banking system, and that risk migrated "...to where those constraints did not exist." And where the constraints were, that was in the traditional banking system. Where they weren't was in this parallel system. And so there's a dramatic -- a really dramatic increase in leverage.

And the other thing that was going on at the same time was that not only was -- were the broker-dealers highly levered, but they were funded overnight, in some cases 50 percent with repo deals. So, their financing isn't long-term financing. It was overnight, short-term -- short-term funding. So, they would enter into a repo contract which would then terminate the next day, and they would have to roll that repo day after day after day, which was fine as long as markets stayed in a normal condition.

Q. Now, you've talked about the leverage. What risk did the primary dealers have as this process continued in 2006 and 2007, in particular?

A. Well, one of the core risks was that markets would stay in a -- in a normal situation where the securities that were being used for repo contracts would remain, kind of like light money, because, you know, ultimately, that was a critical dimension of the system.

Q. How large was the mortgage origination in the subprime market?

A. Over this period? It reached about $2 trillion.

Q. Do you have a demonstrative that shows that?

A. I do. At PTX 5307 is a demonstrative that summarizes well, I think, the way the subprime mortgage market was changing over this period of time.

Q. And what does this show?

A. So, there -- the graph itself has three components to it. So, the bars here represent the amount of subprime originations in any given year. So, you can see that, you know, 2001, 2002, subprime originations were less than $200 billion. Over the next four years, subprime originations tripled in size. So, that's one thing that the graph shows.

The second thing that the graph shows is that there are two types of subprime mortgage originations. There's ones that are put into a securitization vehicle and then they're sold as -- in a package on an RMBS, and then there are others that stay on the balance sheet of the originator. So, the fraction -- so, the black part of these bars represent originations that weren't securitized, and then the light gray portion represents the share that was securitized.

And you can see that the -- again, if we look at, for example, 2001, you know, on the order of half of mortgages were -- subprime mortgages were being put into securitizations, but until we get to 2005 and 2006, the fraction that are being securitized is enormously different. So, you know, the -- the thing that's driving this increase is the ability to originate a mortgage, put it into a special-purpose vehicle from which RMBS are sold. And that's what's driving this -- the financing of this.

And then the last component of this graph is the line, and the line represents the share of the entire mortgage market that subprime originations represent, and as you can see, in 2000, subprime mortgages represented 10.1 percent, and then over the next five years, grows to represent almost a quarter of all mortgage originations in the United States.

Q. Now, in 2000, so that I'm reading this chart right, subprime mortgages represented 10.1 percent of the total mortgage market. Is that right?

A. Yes, exactly.

Q. And then fell to 7.6 percent in 2001, 7.4 percent in 2002, 8.3 percent in 2003?

A. Yes, exactly.

Q. And then it jumps to 29 -- 20.9 percent in 2004, 22.7 percent in 2005, and 23.5 percent in 2006?

A. Yes. People were -- in the financial services sector were working hard.

Q. Now, the black portion of this bar, the nonsecuritized subprime mortgages, am I correct that those would be mortgages -- if you go back to Exhibit 5304, those would be mortgages where the mortgage bank puts out the mortgage and holds it and ultimately collects on it? Is that correct?

A. Exactly.

Q. And the gray securitized portion is what you were showing on 5305, which was the parallel banking system. Is that correct?

A. Exactly. So, the mortgages that were securitized would go into a special-purpose vehicle, and from the special-purpose vehicle, it would be -- those would be financed by a bond, whose acronym is, you know, RMBS, residential mortgage-backed security.

Q. And those RMBSs would then be marketed to pension insurance companies, hedge funds, CDOs, broker-dealers, and others?

A. That's right.

Q. Now --

A. And by the way, one of the big "others" here are the GSEs, Freddie -- Freddie Mac and Fannie Mae. They -- they're a big entity that absorbs a lot of the RMBS.

Q. Now, back on 5305, there is a box called "CDOs," and some of the RMBSs are going into CDOs. Can you explain what a CDO is?

A. Well, a CDO is just another special-purpose vehicle, but instead of mortgages going into them, it's just bonds of various different types. So, they include -- they could include just about anything, any type of security. RMBS can go into them, corporate bonds can go into them, credit card-backed -- asset-backed securities can go into them. So, they're just another way of collecting together a bunch of securities into a portfolio.

They play an important role in the system, though, because as I was describing, the RMBS that are AAA, those can be put into pensions and insurance companies. The low-quality ones that come out of the special-purpose vehicle go into things like CDOs.

Q. There's been reference to multisector CDOs. Can you explain what a multisector CDO is?

A. It's what I just described, would be a multisector CDO. It would contain mortgage-backed bonds, corporate bonds, you know, could be other types of asset-backed securities that go into it.

Q. Did the CDO market grow at the same time that the subprime mortgage market was growing?

A. Yes.

Q. Do you have some demonstratives to demonstrate how that happened?

A. Yes. 5308 is a -- is a summary of what happened with the CDO market overall. So, CDOs play an important role in the creation of RMBS, and I guess I realize, it's probably valuable to describe the tranching of a special-purpose vehicle.

So, the way that a financial engineer will put together a successful RMBS issue is to take a bunch of mortgages, combine them all together, and then they will cleave off the cash flows, you know, waterfall. So, you can think of it as the first part of the cash flows from the mortgages go into the AAA bonds, the second layer goes into the single A bonds, and then there are BBB, and then eventually there's a little layer of equity. So, there's this hierarchy that come out of any single SPV.

Above that AAA bond that I just described, there's something that's called super senior, and it's a super senior bond because there's a layer of AAA securities that buffer the risk of the super senior bonds. So, you've got this hierarchy of security qualities that are -- a hierarchy of securities which are created out of any single securitization, and those ones that are at the bottom of that hierarchy, those often go into a CDO. And then the CDO does exactly the same thing I just described. So, you've got a bunch of, you know, low-grade RMBS, but then you pull some AAA out of there and so on.

Q. Given all of your demonstratives --

A. Do you want me to -- if you want, I can draw on something if that would be helpful, or you can try.

Q. I was going to say, I -- I am going to try.
A. All right.
Q. First, with respect to an RMBS, there are a lot of mortgages here that create that. Is that right?
A. Yes.
Q. There's a pool of mortgages.
A. That's the bathtub that I described earlier.
Q. Yeah. And then the RMBS has tranches?
A. The SPV has tranches, and each tranche corresponds to a different bond, so a different RMBS.
Q. A different RMBS.
A. Exactly.
Q. So, the pool of mortgages, the SPV, would have a -- do they have super senior RMBSs?
A. Yes.
Q. Okay. You'd have a super senior RMBS, AAA?
A. Yep. So, the triple -- so, the super senior is also AAA, but it happens to have another AAA below it.
Q. Okay. And then --
A. Yeah, single A, BBB, and then some equity, let's say.
Q. Equity.
A. So, those five layers of securities we have there, the money from those are used to purchase the pool of mortgages.

Q. So, you would have an -- this would be an RMBS?

A. Yep.

Q. And another RMBS, another one, another one?

A. Yep.

Q. And people would buy these, and then the money would go to pay for the mortgages.

A. Exactly. And then over time, the money that's being paid by the homeowners gets then cycled back to each of those RMBS.

Q. And am I right that as money comes out of the mortgages --

A. Yeah.

Q. -- it goes first to the super senior RMBS?

A. Yes.

Q. And only after the super senior RMBS has been paid everything that's owed them, it then goes to the remaining AAA?

A. Why don't we think of it that way. It's actually a lot more complicated than that, but that's a -- I think that's a great metaphor for how the risk gets distributed.

Q. And then after the AAA people are paid, then single A RMBS would be paid, and then after the single A RMBS gets paid, then the BBB RMBS would be paid, et cetera.

A. Yeah. Yeah, and the reason I call it a bathtub is you have got all the mortgages sitting in there like water, you pull the plug, and the water starts coming out into these different layers of this waterfall.

Q. Now --

A. Now, the reason I say it's complicated, just to give you a sense of what's going on in academic physics at this point, all of the physics majors who are good at computer programming are going into making RMBS. There's, like, a massive diversion of talent that happens at the same time.

Q. What is so complicated about creating an RMBS?

A. So, you're worried about -- in the pool of mortgages, these are all different kinds of people. There are -- you know, there are old lady -- you know, people like me sitting there with their family and they're sitting -- you know, they are going to be in their house for another 20 years. You know, there are people getting close to retirement who are going to get out of their house in the next couple years. There are people who can't afford their house and so they need to refinance it every couple of years with another subprime mortgage.

So, that pool of mortgages has all these different kinds of people, and you need to predict how much money is going to be produced by them over time, and then you've got to modify the rules of the layers so that, you know, you actually meet the requirement that it be AAA, that it meet the requirement that it be, you know, single A. So, you have got this relationship between the investment banks who are working with the rating agency to get the structure of these things such that the rating agency can label it as AAA or, you know, single A and so on.

So, it's the -- you know, the complication is predicting what's going on to come out of -- the flow of cash out of the pool of mortgages and then setting up the rules so that the risk matches the rating agency requirements.

Q. And do I understand that these RMBSs, the super senior RMBSs, the AAA RMBSs, and all the other RMBSs, are then sold to these people who you were identifying?

A. Yes. So, there are lots of people who wanted super senior and AAA.

Q. And that's what I want to focus on. When they -- when the SPV sells these RMBSs, am I correct they get more money for the super senior than the rest of the AAA, the money for the AAA, and then the A and B and so on?

A. Well, a hundred dollar bond is a hundred dollar bond. They get a lower rate of interest on them because they are less risk.

Q. Lower risk. So, the -- these would all be bonds, and the thing that would distinguish them would be the rate of interest. Is that right?

A. Yeah.

Q. So, you'd get a relatively low rate of interest for a super senior RMBS bond?

A. Exactly.

Q. Now, I want to focus on CDOs.

A. Okay.

Q. Okay. Now --

A. So, you want to create another SPV.

Q. Okay. You have another SPV.

A. Yep. And now put some of those BBB RMBS into there.

Q. Okay. So --

A. Because nobody wants those, right?

Q. Right.

A. And as it turns out, for good reason.

Q. Yeah. And they would also have a lot of other bonds and securities, right?

A. Yeah, they -- exactly. You would have corporate bonds. You might have some credit card-backed bonds and so on.

Q. Now --
A. Now, the --
Q. -- now, does this have the same super senior, AAA, B --
A. Exactly, it does.
Q. So, the CDO now, what do you call the things that they issue? In other words --
A. You call those CDOs.
Q. CDOs.
A. So, you have the super senior CDOs, you have AAA CDOs below those.
Q. Okay. And then AAA, and just like before, right?
A. Exactly. Now you've got a problem, right? You've still got these BBB bonds.
Q. Down here?
A. Yeah.
Q. Yes.
A. So --
Q. And just before I go on to that, am I correct that the same thing basically happens here? All the money comes into this pool --
A. Yeah.
Q. -- and first the super senior CDOs get paid, then the second -- the AAA people get paid, then the A

people, then the BBB people?
A. Exactly.
Q. And --
A. And so the way you -- by the way, the way you solve your problem that you have got BBB CDOs, you can do a couple things. One is you can create another CDO, that's called a CDO squared, or you can kind of stash it off balance sheet in a -- just a -- you know, an off-balance-sheet special-purpose vehicle that you might fund with commercial paper, for instance. So, that's -- you know, asset-backed commercial paper could be used for stashing the BBB CDOs.
Q. And whoever's running this SPV is making money on fees when they're selling these various CDOs?
A. Yeah. So, the fees are happening on the mortgage origination, the structuring, the sales, the management. Those are, you know, the -- the big steady income flows that come out of this system.
Q. Thank you.
Now, I had asked you -- before I diverted you, I asked you whether CDO issuance was increasing, and you said it was?
A. It was, yes.
Q. And do you have some demonstratives on that?
A. So, Figure -- I'm sorry, not Figure, but Exhibit

PTX 5308 is a -- is a summary of what happened to the -- so, these are multisector CDOs. So, multisector CDOs represented about half of the total CDO market in this period of time. So, these are multisector CDOs, and each of these blue bars is the cumulative amount of CDOs outstanding. So, you can see 2007, there are 641 outstanding. There are fewer outstanding in 2006 and so on. But you can see that the CDO market rose rapidly from 1999, where there weren't any.

In 2008, there were no new CDO issuances. So, once we get into the financial crisis, this parallel banking machine that we just described came to a grinding halt. And I've labeled here, you know, when AIG actually stopped participating in the -- in this market.

Q. And AIG wrote CDSs for CDOs, right?

A. Yes.

Q. And a CDS or a credit default swap would, in effect, protect the owner of the CDO from a default of that CDO?

A. Yes.

Q. So, if I had a BBB CDO and I was worried about it defaulting --

A. Yes.

Q. -- could I go and get a CDS that would protect

me against a default?
A. Not from AIG. AIG only sold CDSs on super senior CDOs. So, you couldn't get insurance on a AAA bond or a single A bond from -- from AIG.
I'm not sure if you could from the monoline insurers, also, but certainly they were willing to insure lower quality CDOs than AIG was.
Q. Now --
A. And they did that in two ways. One is they would, for instance, insure the AAA tranche of a CDO, so that was one way to -- monoline insurers would take on greater risk, but they also continued writing CDSs after AIG left the market in 2005. So, as the market is exploding, as we can see, and the housing bubble is rising and the quantity of subprime debt that's out there is, you know, starting, you know, to take over, taking over -- you know, a quarter of all mortgages are subprime, AIG's left the market before all of that's happened.
Q. When AIG stopped writing CDSs for CDOs, did that inhibit the growth of the CDO issuance?
A. No. And the reason for it is --
Q. That's what I was going to ask you. Why not?
A. Oh. Well, one of the interesting things about the subprime mortgage market is that the mortgages were

self-reinforcing. So, they were structured so that for the first two years, they would have what's called a teaser rate. So, you -- you could get into your mortgage with a rate that you could afford, but after two years, the teaser rate would go away, and the mortgage rate would pop up at that point, and that would actually force a refinancing.

So, that subprime -- that first mortgage would come to an end, and then you would have to refinance and get a new mortgage because you could no longer afford your original mortgage. So, that process is happening and that dynamic is allowing the total volume of subprime mortgages to rise, to increase.

As well, there's another class of investors that's entering into the residential real estate market, which is people who are looking to make money on the -- you know, ride the housing prices up, and so you had a big class of investors who were buying -- they were called second homes, but they were really investment properties. So, that was the other kind of big driving force behind the subprime market.

THE COURT: Maybe we can adjourn there for today?

MR. BOIES: Yes, Your Honor.

THE COURT: We will reconvene tomorrow morning at 9:30.

(Whereupon, at 4:58 p.m., the proceedings were adjourned.)

CERTIFICATE OF TRANSCRIBER

I, Susanne Bergling, court-approved transcriber, certify that the foregoing is a correct transcription from the official digital sound recording of the proceedings in the above-titled matter.

DATED: 10/29/2014 ________________________________

SUSANNE BERGLING, RMR-CRR-CLR

ADMITTED EXHIBITS

| PX | PAGE | DESCRIPTION |
|---|---|---|
| 103 | 4825 | Matthew Karnitschnig et. Al, "U.S. to Take Over AIG in $85 Billion Bailout; Central Banks Inject Cash as Credit Dries Up," Wall St. J. (Sept. 16, 2008) |
| 137 | 4828 | "AIG: So Many Questions," New York Times Dealbook Article (September 18, 2008) |
| 179 | 4830 | Liam Plevin, "The Financial Crisis: AIG Shareholders Seek to Help Pay Off Loan From Fed," Wall Street Journal (9/20/2008) |
| 236 | 4749 | Citigroup Analyst, "American International Group Inc (AIG): Deal or No Deal?" (Semtepber 23, 2008) |
| 242 | 4843 | "AIG slumps after signing up for $85 billion Fed loan: Insurer effectively 'nationalized' after failing to raise capital in private market," MarketWatch (September 24, 2008) |
| 1587 | 4834 | Citi Analyst Report, “The Too-Big-To-Fail Thesis Prevails” (September 17, 2008) |
| 1593 | 4836 | A.M. Best Company “American International Group, Inc.: A Quick Look at the 6-Month Numbers” (9/17/2008) |

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| 1595 | 4837 | “DJ Australia’s Swan: Welcomes Federal Reserve Bailout of AIG,” Dow Jones Newswires (9/17/2008) |
| 1606 | 4838 | Reuters “AIG to hold shareholder vote on Fed bailout” (9/18/2008) |
| 1665 | 4846 | UBS Analyst Report, “Fed Stake Reversal - Remote Probability” (September 25, 2008) |
| 2813 | 4920 | Doomsday memoranda |
| 2814 | 4920 | Doomsday memoranda |
| 2817 | 4920 | Doomsday memoranda |
| 2818 | 4920 | Doomsday memoranda |
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| 2849 | 4922 | Dr. Cragg's CV |

| DX | PAGE | DESCRIPTION |
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| 425 | 4918 | EMAIL AND ATTACHMENTS FROM THOMAS BAXTER TO SCOTT ALVAREZ RE: REVISED AIG TERM SHEET, ATTACHMENTS SEP 16 2008, 3:50 AM REVISED AIG SR BRIDGE TERM SHEET AND SEP 16 2008, 1:54 AM REVISED AIG SR BRIDGE TERM SHEET, ATTACHMENTS |

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