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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.
Friday, October 31, 2014
9:30 a.m.
Trial Volume 24

BEFORE: THE HONORABLE THOMAS C. WHEELER

Susanne Bergling, RMR-CRR-CLR, Reporter

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1 I N D E X

2

3 WITNESS:	DIRECT	CROSS	REDIRECT	RECROSS	VOIR
4 CRAGG			5464	5519	
5 NEUBERGER	5549	5601	5636	5644	
6 STUDZINSKI	5651				

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9 EXHIBITS	FOR ID	IN EVID
10 Plaintiff's		
11 Number6		5503
12 Number262		5628
13 Number1051		5501
14 Number1291		5497
15 Number1472		5518
16 Number1474		5493
17 Number2182		5474
18 Number2565		5518
19 Number2850-2857		5544
20 Number5001		5547
21 Number5004		5544
22 Number5006		5544
23 Number5007-A		5544
24 Number5011		5544
25 Number5012		5544

1	Number5100	5544
2	Number5390	5544
3	Number5391	5544
4	Number5045-5050	5545
5	Number5052-5056	5545
6	Number5058-5059	5546
7	Number5061-5067	5546
8	Number5069	5546
9	Number5200-5226	5545
10	Number5366-A	5518
11	Number5339-A	5518
12	Number5352-A	5518
13		
14	Defendant 's	
15	NumberDXX 020 -	5543
16	DXX 035	
17	Number247	5681
18	Number262	5681
19	Number1880	5560
20	Number1881	5560
21	Number2261	5542
22	Number2402-2418	5601
23		
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1 Joint

2 None

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22 *All exhibits premarked for identification prior to
23 trial.

24 *See full attached list of admitted exhibits following
25 transcript.

1 P R O C E E D I N G S

2 - - - - -

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

4 THE COURT: Thank you. Please be seated.

5 We are on the record in Starr International
6 Company versus the United States, trial day number 24.

7 Good morning, Dr. Cragg.

8 THE WITNESS: Good morning.

9 THE COURT: You understand you are still under
10 oath, I'm sure.

11 THE WITNESS: I still realize that.

12 THE COURT: All right.

13 Good morning, Mr. Boies.

14 MR. BOIES: Good morning, Your Honor.

15 THE COURT: Let's go ahead.

16 MR. BOIES: Thank you, Your Honor.

17 Whereupon --

18 MICHAEL CRAGG

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

22 REDIRECT EXAMINATION (cont.)

23 BY MR. BOIES:

24 Q. Good morning, Dr. Cragg.

25 A. Good morning.

1 Q. During your examination by counsel for the
2 United States, you were asked whether you agreed with a
3 position that Mr. Thornton had articulated that the
4 lender of last resort's primary responsibility is to the
5 market or the general interests and not to the
6 individual bank, and you said that you did agree, and
7 you said, "I do think that's the primary objective," and
8 then you went on to say, "I think from a social welfare
9 perspective, the Government or lender of last resort
10 eliminating negative externalities, where it can, is a
11 good thing."

12 A. Yes.

13 Q. What did you mean by eliminating negative
14 externalities?

15 A. Well, during a period of panic or crisis, when
16 solvent firms are unable to get liquidity, that creates
17 unnecessary losses, and so providing liquidity to
18 solvent firms is an important corrective mechanism that
19 the lender of last resort can play.

20 Q. Are there objectives of a lender of last resort
21 other than to the market, as described by Mr. Thornton?

22 A. Yes, providing liquidity to solvent firms is a
23 general doctrine which is valuable.

24 Q. Does providing liquidity to solvent firms have
25 any objectives, other than contributing to a mitigation

1 of a general crisis?

2 A. Well, there's -- it's a self-reinforcing policy
3 in the sense that you're correcting the impact of crisis
4 on specific firms, but at the same time it's doing that,
5 that reinforces the broader objective of mitigating the
6 overall crisis. So, it's a cycle -- it's a policy that
7 is self-reinforcing.

8 Q. Is there anything in the history -- the economic
9 history of the Federal Reserve in the United States that
10 illustrates the goal of protecting solvent institutions
11 and not merely the market?

12 A. Well, my testimony from a couple days ago
13 identified circumstances during the 1930s when the
14 Federal Reserve was lending to a variety of different
15 types of institutions.

16 Q. And did those institutions all have what has
17 been referred to in this Court as systemic importance?

18 A. No.

19 Q. You also testified that it is okay for the Fed
20 to treat different borrowers differently based on their
21 financial status. Do you recall that, generally?

22 A. Yes.

23 Q. What did you mean by "financial status" in that
24 answer?

25 A. Well, there I was -- I had in mind the

1 differentiation between solvent and insolvent
2 institutions. So, that's a financial status which
3 differentiates potential borrowers, and it's a -- it's
4 a, you know, fairly bright line.

5 Q. From an economic standpoint, do you believe that
6 it is sensible economic policy to treat different
7 solvent borrowers differently once the Fed decides to
8 make a 13(3) loan?

9 A. In general, the lender of last resort -- the
10 implementation of that policy and the description of how
11 to do that by a variety of different authors has
12 emphasized the importance of anonymity of the borrower.
13 So long as collateral is posted, the actual
14 circumstances of a particular borrower shouldn't matter.
15 That policy of nondiscrimination, you know, should have
16 obvious impacts for any observer in the sense that -- I
17 think it should be self-evident, the picking of winners
18 and losers is not a policy that creates broad confidence
19 but, rather, can actually be quite undermining.

20 Q. Let me ask you to look at Defendant's Exhibit
21 2202. That was an article by Mr. Thornton that counsel
22 for Defendant showed you. Do you still have that up
23 there in a convenient place?

24 A. Yes.

25 Q. And do you recall counsel for the United States

1 asking you some questions about this document?

2 A. Yes.

3 MR. DINTZER: Your Honor, and just -- not to
4 interrupt, just so that the record's clear, the author's
5 name is Mr. Humphrey. I believe he quoted Mr. Thornton,
6 but I wanted to make sure the record was clear.

7 THE COURT: I was just noticing that.

8 MR. BOIES: Thank you. That's exactly right.

9 BY MR. BOIES:

10 Q. The portion, I think, that counsel for the
11 United States directed your attention to in this article
12 by Mr. Humphrey was where he was quoting Mr. Thornton.
13 Do you recall that, generally?

14 A. Yes.

15 Q. I'd like to direct your attention to page 349 of
16 this article.

17 A. Yes.

18 Q. Seven lines up from the bottom of the page, do
19 you see a sentence that begins (as read): "By accepting
20 good collateral from any source whatsoever, the lender
21 of last resort avoids favoritism and the channeling of
22 aid to privileged borrowers. Here is the element of
23 anonymity that Forrest Capie (1998) sees as essential to
24 impartiality in the granting of last-resort aid. The
25 LLR need not, and indeed cannot, see the identity of the

1 applicant if, for example, the discount window is made
2 of one-way glass. The LLR simply says, 'We don't know
3 who you are. Just shove your good collateral under the
4 window and pay the penalty rate and we will lend you the
5 amount you request.'"

6 How, if at all, does that principle relate to
7 what you were just saying with respect to the goal of
8 central bank or lender of last resort lending being not
9 to discriminate against solvent borrowers?

10 A. Well, that is a rearticulation of the principle
11 I was enumerating, and it's -- scholars and central
12 bankers have used the metaphor of the frosted glass
13 as -- the frosted glass at the discount window to
14 capture the principles that are laid out here in the
15 quote that we just listened to.

16 Q. The Department of Justice also asked you whether
17 reasonable scholars could disagree with certain central
18 bank decisions. Do you recall that?

19 A. Yes.

20 Q. What are the basic choices that a central bank
21 needs to make in terms of implementing its lender of
22 last resort responsibilities?

23 A. Well, I guess they have to decide who, when -- I
24 guess who, whether, when, and under what terms to
25 provide liquidity to institutions.

1 Q. Um-hum. With respect to the decision as to when
2 to lend, that is, whether there are unusual and exigent
3 circumstances, is that a decision about which reasonable
4 scholars could, under some circumstances, differ?

5 A. Yes.

6 Q. With respect to the decision as to whom to loan,
7 whether it is every solvent business or only
8 systemically important firms or everyone, is that a
9 decision or choice about which, at least under some
10 circumstances, reasonable scholars could differ?

11 A. I think there's been debate about that topic,
12 yes.

13 Q. With respect to the terms of lender of last
14 resort loans or credits, that is, how they are
15 structured, is that something that you believe that it
16 is a question about which reasonable scholars could
17 differ?

18 A. I think unlike the first two questions, there
19 really has been a very uniform approach to answering
20 that particular question, that as the quote that we
21 looked at earlier suggests, lending against good
22 collateral at a penalty rate is really the dominant
23 paradigm for answering that last question that we've
24 been discussing.

25 Q. Are you aware of any central bankers or any

1 central banking scholar who, prior to 2008, advocated
2 requiring the shareholders of a borrower who was being
3 lent to by a lender of last resort to surrender a
4 majority of the borrower's equity and voting control as
5 consideration for a loan?

6 A. No. This is -- as far as I'm aware, this is
7 really a unique circumstance that arose, that that
8 decision is different than any other that I've observed
9 and that scholars have observed.

10 Q. Let me ask you to now turn to the subject of
11 assets eligible to be pledged for the revolving credit
12 facility.

13 A. Yes.

14 Q. Do you recall that you were asked some questions
15 about that?

16 A. Yes.

17 Q. Now, do you have an understanding, one way or
18 the other, as to whether or not AIG's charter initially
19 prevented pledging all or substantially all of AIG's
20 assets without shareholder consent?

21 A. Yes. As I mentioned yesterday, there was a
22 limitation on that.

23 Q. And how, if at all, was that addressed, as you
24 understand it, in connection with the Federal Reserve's
25 revolving credit agreement?

1 A. I believe there was an addition to the proxy
2 vote that was made in June 2009 which addressed that
3 question.

4 Q. And as you understand it, was there any
5 obligation that AIG had undertaken to change that
6 shareholder provision?

7 A. I'm not sure what you mean by --

8 MR. DINTZER: Objection, Your Honor. This is
9 beyond the scope of my cross. I didn't ask anything
10 about this.

11 THE COURT: Mr. Boies?

12 MR. BOIES: Well, he asked about what assets
13 were eligible to be pledged, and he asked the witness
14 whether or not all of AIG's assets were eligible to be
15 pledged or not. And, in fact, at one point in time you
16 could not pledge all or substantially all of the assets,
17 but that was something that the company was obligated to
18 use its efforts to change in the guarantee and pledge
19 agreement. That's the only point I'm trying to make.

20 THE COURT: I think that's right, Mr. Dintzer.

21 MR. DINTZER: That's fine. We will withdraw our
22 objection based on that.

23 THE COURT: All right, thank you.

24 BY MR. BOIES:

25 Q. And if I can, with counsel's permission, lead

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1 the witness just to close this out. Is it your
2 understanding that there were such provisions in the
3 guarantee and pledge agreement?

4 A. Yes.

5 Q. Now, you were asked whether the collateral that
6 was used to secure the credit agreement was at least in
7 substantial part illiquid. Do you recall that?

8 A. Yes.

9 Q. First, was the illiquidity of that collateral
10 significantly different from other collateral that was
11 being used for 13(3) loans?

12 A. In general, during this period of time, you
13 know, the whole objective of what the Federal Reserve
14 was doing was dealing with the illiquidity of a whole
15 range of different types of assets and collateral. As I
16 described a couple days ago, when you look at what
17 happened in the repo market, there was a -- you know, an
18 enormous run there that was a result of concern about --
19 about, you know, for instance, RMBS as adequate
20 collateral, and that's what all of the facilities that
21 the Federal Reserve was creating during this period of
22 time were designed to address.

23 So, you know, the PDCF, for instance, accepted
24 all kinds of different collateral at a penalty rate
25 because they were illiquid.

1 Q. Let me hand you a document that has been marked
2 as Plaintiffs' Trial Exhibit 2182. This is very, very
3 similar to a document that we previously admitted, but
4 the dates it provides information for I believe are
5 different.

6 I would offer Plaintiffs' Trial Exhibit 2182.

7 MR. DINTZER: Your Honor, we don't have any
8 problem with this coming in under 703 if the witness
9 wants to rely on it.

10 MR. BOIES: That's satisfactory for the present
11 purposes. This is from the Federal Reserve's Web site,
12 but we can establish that later, and we can, for the
13 present purposes, just use it for 703.

14 THE COURT: Plaintiffs' Trial Exhibit 2182 is
15 admitted with a Rule 703 restriction.

16 (Plaintiffs' Exhibit Number 2182 was admitted
17 into evidence.)

18 BY MR. BOIES:

19 Q. Is this a document that you relied on,
20 Dr. Cragg?

21 A. Yes.

22 Q. And what does this document show?

23 A. It is a -- you know, it's titled "Collateral
24 Margins for the Primary Dealer Credit Facility." I've
25 been using the word "haircuts," which is a synonym for

1 collateral margins.

2 Q. And does this also show the kind of collateral
3 that the primary dealer credit facility was accepting at
4 various points in time?

5 A. It does, yes.

6 Q. And does it show whether or not, after September
7 14th, 2008, the PDCF was, for example, accepting
8 noninvestment grade CDOs?

9 A. Yes, it does.

10 Q. At that point in time, were noninvestment grade
11 CDOs liquid?

12 A. No.

13 Q. Let me ask you to turn to a subject about due
14 diligence, and you were asked, when the Fed had entered
15 into the September 16th agreement, the Federal Reserve
16 had not had the opportunity for due diligence.

17 And you answered, "In terms of the amount of due
18 diligence that they could do, obviously, it was a rush
19 to transaction. So, it was limited."

20 Do you recall that?

21 A. Yes.

22 Q. First, what types of due diligence had the
23 Federal Reserve been able to do on or prior to September
24 16th?

25 A. Well, going back to the summer, there were, you

1 know, obviously discussions at the highest levels of
2 both the Federal Reserve Bank as well as AIG. There
3 were also task forces at the Federal Reserve Bank that
4 had considered AIG, its circumstances, and its potential
5 access to, for instance, the PDCF, the merits of that.

6 We heard with Ms. Dahlgren conversations that
7 she and others had, as well as Mr. Geithner had with
8 various regulators who oversaw various parts of the --
9 of AIG, like the OTS, Mr. Dinallo and other regulators.
10 Also, Mr. LaTorre -- or LaTorre, I can't remember how
11 his name is pronounced -- but he described his
12 participation in a couple of teams that were focused on
13 analyzing AIG over the course of the previous week
14 before the loan was -- you know, loans were ultimately
15 extended.

16 And then if you look at -- I think one of my
17 trial demonstratives shows an extract from the GAO
18 report, which has the timeline of interactions between
19 AIG and the Federal Reserve Bank of New York.

20 Q. Is that Plaintiffs' Trial Exhibit 5350?

21 A. Let me -- I have to find it, so...

22 Q. That would be in your demonstrative exhibits
23 binder.

24 A. No, I had to find the binder. I have got
25 several here. Exactly.

1 MR. DINTZER: Your Honor, we are going to
2 object. This was a slide that was not used, as I
3 believe, in Plaintiffs' initial case. We did not
4 address it in our cross, and to address it now in their
5 rebuttal or their redirect is clearly beyond the scope
6 since it wasn't addressed during the cross. I don't --

7 THE COURT: You did ask about due diligence.
8 Doesn't that cover this?

9 MR. DINTZER: We have no problem with him asking
10 about due diligence, but to use any line of questioning
11 we have to leverage in slides that they didn't use in
12 the first round of questioning, Your Honor, seems like
13 it's allowing them to exceed the scope.

14 THE COURT: I think it's all right. Let's go
15 ahead.

16 MR. BOIES: I actually don't have any more
17 questions on that.

18 THE COURT: Okay.

19 MR. BOIES: I just wanted to identify for the
20 record what he was referring to when he referenced
21 communications or contacts or whatever word he used.

22 BY MR. BOIES:

23 Q. Subsequent to September 16th but after or
24 before, rather, the credit agreement was signed, that
25 is, in the period between September 16th and September

1 23rd, in the morning, did the Federal Reserve have an
2 opportunity for additional due diligence?

3 A. Yes, they did.

4 Q. And can you give me some examples of what kind
5 of due diligence the Federal Reserve did and had an
6 opportunity to do between September 16th and the morning
7 of September 23rd?

8 A. So, I can, you know, quickly think of three
9 examples. One was the team that Ms. Dahlgren led. I
10 think she, you know, described there being a couple of
11 dozen Federal Reserve Bank of New York employees that
12 were deployed for monitoring and supervisory purposes.

13 During that week as well, the Federal Reserve
14 Bank of New York engaged I think it was Ernst & Young
15 and Morgan Stanley to assist them in doing due
16 diligence.

17 Q. Let me ask you to turn next to the November
18 restructuring, the November 2008 restructuring. Counsel
19 asked you whether the November restructuring was meant,
20 in part, to address credit agency concerns. Do you
21 recall that?

22 A. Yes.

23 Q. And I think you said that it was. Is that
24 right?

25 A. Yes.

1 Q. Was that, as you understand it, the primary
2 motivation for the November restructuring?

3 A. Well, I think there's several motivations for
4 why the restructuring was initiated. There -- you know,
5 several witnesses have identified that the terms were
6 onerous -- Mr. Liddy did so, as well as Mr. Paulson --
7 and by onerous, they meant that -- in part that the
8 structure of the loan was not a -- you know, wasn't
9 supportable, that the terms were so exacting as to
10 actually threaten the viability of AIG, you know, an
11 observation that the rating agencies themselves made in,
12 you know, numerous conversations that they had with
13 Mr. Liddy and Ms. Dahlgren. So, there's, you know,
14 obvious recognition that what was put in place was, you
15 know, overly exacting.

16 As well -- so, just, you know, from a straight,
17 you know, economics perspective, you know, looking at
18 the viability of the firm, but second, you know, put in
19 the context of all of the other programs that were
20 either already initiated or were subsequently being
21 initiated, you know, the terms were, you know, so
22 anomalous as to warrant some change.

23 Q. Let me ask you to look at Joint Exhibit 387 --

24 A. Thank you.

25 Q. -- which is a joint exhibit and is already in

1 evidence.

2 Is this a document that you relied on in the
3 course of your analysis?

4 A. Yes.

5 Q. Let me ask you to look at page 10.

6 A. Just before the section titled "Accounting
7 discussion"? Is that -- there's a missing "G" there, so
8 it's kind of got that southern ring to it.

9 Q. The sentence at the very top is a carryover from
10 page 9, at the very bottom.

11 A. Yes.

12 Q. Which says, "As represented by the engagement
13 team in the FACTS section above, A's" -- and do you
14 understand that "A's" refers there to AIG?

15 A. Yes.

16 Q. -- "AIG's creditworthiness did not deteriorate
17 after the issuance of the original instrument on
18 September 22, 2008."

19 Do you see that?

20 A. Yes.

21 Q. And what is the original instrument that is
22 referred to there?

23 A. The RCF.

24 Q. It then continues, "On the contrary, considering
25 the fact that AIG was threatened with imminent

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1 bankruptcy prior to the extension of the original
2 Facility by the Federal Reserve Bank, it appears that
3 the financial condition of AIG either remained the same
4 or improved, as the threat of imminent bankruptcy did
5 not exist on the eve of the modification transaction."

6 Do you see that?

7 A. Yes.

8 Q. Then, if you go down to the last sentence of
9 that paragraph, it begins, seven lines up from the
10 bottom of that paragraph, where it begins, "At such
11 time..." Do you see that?

12 A. Yes.

13 Q. And the exhibit there states, "The Federal
14 Reserve Bank and the United States Treasury determined
15 that establishing lending terms in a manner that
16 encouraged rapid sales of assets did not, in the current
17 economic environment, adequately represent the Federal
18 Reserve Bank's public policy mission and could in fact
19 further destabilize the potential markets (as opposed to
20 the individual Facility borrowers, such as AIG) by
21 adding general uncertainty as to whether entities
22 seeking financing from the Federal Reserve Bank would be
23 forced to conduct fire sales into a market with reduced
24 liquidity."

25 Do you see that?

1 A. Yes.

2 Q. And what significance, if any, do those
3 statements have to your analysis?

4 A. Well, one of the four concerns of the Federal
5 Reserve throughout 2008 was that one of the factors that
6 led to the continued downward spiral of panic was the
7 need to, in the absence of credit being extended, that
8 in that absence, in order to repay loans, that could
9 lead to -- you know, asset sales under fire sale
10 conditions, and that would then compound the existing
11 problem related to the illiquidity of collateral.

12 So, having the structure of the RCF the way it
13 was, what's being said here is that the terms of it, and
14 kind of the rapid disposal of AIG's assets that were
15 forced by those terms, wasn't good public policy.

16 Q. Let me ask you to look in the next paragraph at
17 the second sentence, where it says, "Because the Federal
18 Reserve Bank's motivation to modify the Facility was not
19 the result of a deterioration in, or for that matter
20 specific to, AIG's creditworthiness but rather a change
21 in the manner in which the Federal Reserve Bank and the
22 U.S. Treasury chose to carry out their own public policy
23 mission, we do not believe the modification represents a
24 TDR within the scope of FAS 15. Rather, we believe that
25 the modification reflects a resetting of the terms of

1 the Facility to be consistent with changes in the
2 Federal Reserve Bank and the U.S. Treasury's public
3 policy mission."

4 Do you see that?

5 A. Yes.

6 Q. Now, first, can you identify what FAS 15 and TDR
7 are referring to?

8 A. They relate to whether the asset should be
9 treated as a -- or the change in terms should be -- lead
10 to the loan being treated as a distressed debt. I can't
11 remember what the specific -- we can look earlier here,
12 what the specific acronym TDR stands for, but this whole
13 memo's about the topic of whether this should be treated
14 as distressed.

15 Q. Now, before going on to the next sentence, for
16 context, I want you to go back to page 7 of this
17 document.

18 A. Yes.

19 Q. And it's the first full paragraph. It's in the
20 bottom half of the page. It begins, "Consistent..." Do
21 you see that?

22 A. Yes.

23 Q. It says, "Consistent with the excerpt above,
24 although independent of each other, the U.S. Treasury
25 and the Federal Reserve Bank have acted in concert with

1 each other and the U.S. Government in (a) extending the
2 original Facility in September, 2008, (b) modifying the
3 terms of the Facility in November, 2008 and (c)
4 executing the overall strategy...for dealing with the
5 unprecedented financial crisis gripping the United
6 States (and its impact on individual entities)."

7 Do you see that?

8 A. Yes.

9 Q. And somewhere in here there is a reference to
10 extension of credit to G and C, which is what is
11 described in page 10 of the joint exhibit and which I
12 wanted to direct your attention to for context.

13 May I have just a moment, Your Honor?

14 THE COURT: Yes.

15 (Pause in the proceedings.)

16 BY MR. BOIES:

17 Q. Would you turn to page 4, the third bullet, it
18 says, "In December 2008 (i.e. subsequent to the
19 modification of the terms of the Facility), the U.S.
20 Treasury extended debt financing to G and C, two
21 entities unrelated to AIG that, absent receiving funding
22 from the Treasury, were threatened with imminent
23 bankruptcy."

24 Do you see that?

25 A. Yes.

1 Q. Now I want to turn you back to page 10 and the
2 sentence that immediately follows the material on page
3 10 that we had directed your attention to before, and
4 that's the last portion of this first full paragraph on
5 page 10. Do you see that?

6 A. Yes.

7 Q. It states, "While the extension of credit by the
8 U.S. Treasury to G and C occurred subsequent to the
9 modification transaction, given the coordinated actions
10 of the U.S. Treasury and the Federal Reserve Bank in
11 addressing the financial crisis, we believe that the
12 fact that the terms of G and C's financing arrangements
13 were similar to the modified terms of the Facility
14 extended by the Federal Reserve Bank serves to confirm
15 the overall shift in the Federal Reserve Bank and U.S.
16 Treasury's strategy for providing assistance to entities
17 impacted by the financial crisis."

18 Do you see that?

19 A. Yes.

20 Q. And what significance, if any, does that have to
21 your conclusion that you testified to a few minutes ago
22 that there were a number of reasons, other than dealing
23 with rating agencies, that motivated the Federal Reserve
24 in undertaking the restructuring?

25 A. Well, this is consistent with the statement I

1 made regarding the AIG terms being so anomalous.

2 Q. Now, let me turn to another subject. You were
3 asked by counsel for the United States, in connection
4 with your testimony about the possibility of a guarantee
5 for the transactions that went into Maiden Lane III,
6 whether or not the counterparties might not want a
7 novation. Do you recall that?

8 A. Yes.

9 Q. Do you need a novation in order to give a
10 guarantee?

11 A. No.

12 Q. Do you need the counterparty's agreement to give
13 a guarantee?

14 A. No.

15 Q. What would the effect have been if the Federal
16 Reserve had given a guarantee?

17 A. Well, it would have had the impact of reducing
18 the collateral risks associated with the credit default
19 swaps and would have therefore led to a return of
20 collateral from AIG's counterparties to AIG.

21 Q. And would that have been a significant return of
22 collateral?

23 A. Yes.

24 Q. Let me turn to another subject. You were asked
25 whether it was true that every dollar that the Federal

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1 Reserve lends to one borrower is a dollar that cannot be
2 lent or used for some other purpose, and you were asked
3 to respond yes or no. Do you recall that?

4 A. Yes.

5 Q. And you said that that was not necessarily true.
6 Do you recall that?

7 A. Excuse me. Yes.

8 Q. What did you mean when you said it was not
9 necessarily true that every dollar lent meant you could
10 not have money for other purposes?

11 A. Well, you're obviously using funding, you know,
12 for one entity instead of another, so that substitution
13 is there, but the broader point that I was trying to
14 make when I said it's not necessarily the case is that
15 the Federal Reserve has the ability to expand the size
16 of its balance sheet, which it did throughout the
17 financial crisis.

18 If you look at the overall size of the Federal
19 Reserve balance sheet, it almost doubled in size from,
20 you know, a couple trillion dollars in assets to, you
21 know, between 3 and 4 trillion. I'm sorry, and assets
22 in this context are loans to -- to others, either in the
23 form of holding security or directly extending credit.

24 Q. Let me turn to another subject. You were
25 directed to Plaintiffs' Trial Exhibit 549, which is the

1 SIGTARP report dated November 17th, 2009. I believe
2 that was one of the documents that was handed up to you.
3 Do you have that in a convenient place?

4 MR. DINTZER: It should be in his binder. I
5 believe it should be in his binder, just to help out,
6 the white binder.

7 MR. BOIES: Thank you.

8 THE WITNESS: Yes.

9 BY MR. BOIES:

10 Q. Would you turn to page 12 of the exhibit, which
11 was a page that counsel for the United States directed
12 your attention to.

13 A. Yes.

14 Q. And the top of the page says, "Table 1: AIG
15 Collateral Postings from December 31, 2007." Do you see
16 that?

17 A. Yes.

18 Q. Counsel directed your attention to the last
19 paragraph, and particularly first to the second
20 sentence, in which there's a reference to President
21 Geithner spearheading an effort to encourage a private
22 solution to AIG's liquidity crisis. Do you see that?

23 A. Yes.

24 Q. And then six lines down, he directed your
25 attention to the next-to-last sentence in the paragraph

1 that says, "The group developed a loan term sheet, but
2 an analysis of AIG's financial condition revealed that
3 liquidity needs exceeded the valuation of the company's
4 assets, thus making the private participants unwilling
5 to fund the transaction."

6 Do you see that?

7 A. Yes.

8 Q. And I should have -- I should have probably
9 read, for context, the immediate preceding sentence --
10 two sentences, that it was referring to a JPMorgan Chase
11 vice chairman noting various things. Do you see that?

12 A. Yes.

13 Q. Then the report in the immediately following
14 sentence says, "FRBNY officials told SIGTARP that, in
15 their view, the private participants declined to provide
16 funding not because AIG's assets were insufficient to
17 meet its needs, but because AIG's liquidity needs
18 quickly mounted in the wake of the Lehman bankruptcy and
19 the other major banks decided they needed to conserve
20 capital to deal with adverse market conditions."

21 Do you see that?

22 A. Yes.

23 Q. What significance, if any, does that information
24 have to your analysis?

25 A. Well, as I recall, when was asking -- answering

1 Mr. Dintzer's question, I had responded to his question
2 regarding the statement, you know, prior to this, that I
3 hadn't seen any evidence that the group didn't extend
4 credit because AIG's liquidity needs exceeded the
5 valuation of the company's assets. That's what I was
6 asked about. I responded saying I hadn't seen evidence
7 of that being true.

8 You know, this later sentence that follows is
9 consistent with the evidence that I've seen of what
10 banks were doing during this period of time and why they
11 wouldn't extend the so-called private solution to AIG.

12 Q. Let me turn your attention very briefly to your
13 demonstrative 5354 that's in your demonstrative book.

14 A. Yes.

15 Q. And do you recall that counsel for Defendant
16 asked you to compare certain information that you had in
17 that chart with certain information that was in
18 Plaintiffs' Trial Exhibit -- I think 1502. Do you
19 recall that?

20 A. Yes.

21 Q. And that -- that document is dated December
22 31st, 2007. Is that correct?

23 A. I'm sorry. The --

24 Q. Do you have the 1502?

25 A. I do have 1502. What was the date that you

1 mentioned?

2 Q. The data is as of the end of the year of 2007.

3 A. Oh, yes, it is. Yes. So, the data that we were
4 looking at exactly is from the end of 2007. The actual
5 data on the document, however, is September 5th, 2008.
6 That was my confusion. Sorry.

7 Q. Now, is that the document that you used for the
8 data that is reflected in Plaintiffs' Trial Exhibit
9 5354?

10 A. No.

11 Q. Do you know, without looking at something, what
12 the source of the data was for your Plaintiffs' Trial
13 Exhibit 5354?

14 A. Well, I used a spreadsheet which is from -- the
15 date is at the end of August 2008, the data for that. I
16 believe it's somewhere around the 26th or the 28th.

17 Q. Let me ask you to look at Plaintiffs' Trial
18 Exhibit 1475, which is already in evidence, which I
19 think we've handed out earlier. Do you have up there
20 Plaintiffs' Exhibit 1475?

21 A. I don't, but I remember those being distributed
22 because of their unique size.

23 Q. And is this the document that you used as a
24 source for your chart 5354?

25 A. It is. Just -- I -- I have never used a paper

1 version of this. I've always used a spreadsheet, but I
2 can recognize this bucket two and bucket three and the
3 list of assets here as -- in the columns as
4 corresponding to the spreadsheet that I used.

5 Q. And as you understood it, that spreadsheet had
6 data as of what date?

7 A. The end of August 2008.

8 Q. All right.

9 A. As -- as I -- I think this is attached -- now
10 you are straining my memory, but I think it's attached
11 to an email which identifies when the -- when exactly
12 the file is from.

13 Q. Let me --

14 A. So, just to be clear -- I guess to be a little
15 clearer, PTX 5354, which is the exhibit or the
16 demonstrative I used, identifies that the -- the
17 balances are as of August 26th, 2008.

18 Q. Let me ask you to look at Plaintiffs' Trial
19 Exhibit 1474, and I would ask you whether this is the
20 email that you were referring to.

21 A. Yes.

22 MR. BOIES: Your Honor, I would offer this
23 subject to a 703 limitation.

24 MR. DINTZER: No objection, Your Honor.

25 THE COURT: Plaintiffs' Trial Exhibit 1474 is

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1 admitted with a Rule 703 restriction.

2 (Plaintiffs' Exhibit Number 1474 was admitted
3 into evidence.)

4 THE WITNESS: And I guess just in terms of how I
5 inferred the date, the file is called "Liquidity Risk
6 Analysis 082608 Repo Buckets," and that's August 26th,
7 2008.

8 BY MR. BOIES:

9 Q. Let me ask you to turn next to the subject of
10 the primary dealer credit facility and primary dealers.
11 Do you recall counsel for the United States elicited
12 from you that AIG was not a primary dealer?

13 A. Yes.

14 Q. Do you recall that?

15 From your analysis, can you say from an economic
16 standpoint -- I'm not asking a legal question -- but
17 from an economic standpoint, was there any reason for
18 the Federal Reserve not to have given financial
19 institutions other than primary dealers access either to
20 the PDCF or a facility that had the same qualities?

21 A. No, and, you know, various economists at the
22 Federal Reserve Bank of New York had already noted that.

23 Q. Would making a facility such as the PDCF --
24 either the PDCF itself or a comparable facility --
25 available to financial institutions other than primary

1 dealers have been consistent with central banking
2 principles?

3 A. Yes.

4 Q. The Department of Justice also asked you
5 whether, while all primary dealers are broker-dealers,
6 most broker-dealers are not primary dealers, and you
7 said that was true, correct?

8 A. Yes. Hopefully, I passed the PSAT question.

9 Q. Now, are all or substantially all of the biggest
10 broker-dealers primary dealers?

11 A. Yes.

12 Q. Can you give me some examples?

13 A. Goldman Sachs, Merrill Lynch, Morgan Stanley,
14 Citi.

15 Q. Now, you were also asked by counsel for the
16 Defendant whether soundness and liquidity was required
17 to be a primary dealer. Do you recall that?

18 A. Yes.

19 Q. In 2008, did any primary dealers fail?

20 A. Yes.

21 Q. Can you give me some examples?

22 A. Well, Lehman's the most obvious. You know, Bear
23 Stearns and Merrill Lynch were taken over. Then Goldman
24 and Morgan Stanley received extraordinary assistance to
25 make it through the financial crisis.

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1 Q. The Department of Justice also asked whether
2 primary dealers had a special relationship with the Fed.
3 Do you recall that?

4 A. Yes.

5 Q. From an economic standpoint -- again, I'm not
6 asking for any legal conclusions -- but from an economic
7 standpoint, is it consistent to -- under central banking
8 lender of last resort principles, to discriminate in
9 favor of institutions that have a special relationship
10 with the Federal Reserve?

11 A. No. I mean, I think when we had first started
12 speaking this morning, I, I think, described the issues
13 that arise with applying a favoritism or I think I used
14 the phrase choosing -- you know, picking winners and
15 losers, but that type of selectivity doesn't -- it
16 doesn't enhance confidence.

17 Q. Let me turn to another subject. With respect to
18 AIG's ceasing to write multisector CDSs at the end of
19 2005, you were asked by counsel for the Defendant
20 whether AIG continued to get paid to maintain the CDS
21 contracts that had already been written. Do you recall
22 that?

23 A. Yes.

24 Q. Approximately how much was AIG paid for those
25 CDS contracts?

1 A. The average payment was about 11 basis points
2 per dollar of notional amount outstanding, which, you
3 know, on an \$80 billion portfolio is about 88 million a
4 year.

5 Q. And just to be clear, when you say 11 basis
6 points, is that eleven-hundredths of 1 percent?

7 A. Yes.

8 Q. And that was the annual charge?

9 A. Yes, the average annual charge.

10 Q. The average annual charge.

11 While we're on the area of revenues, the other
12 area that you've identified that contributed to AIG's
13 liquidity issues was securities lending. Do you recall
14 that?

15 A. Yes.

16 Q. And approximately what were AIG's revenues from
17 securities lending in the 2005, 2006, 2007 period?

18 A. Well, it's a similar order of magnitude. As I
19 recall, it ranges from about 10 to 20 basis points per
20 dollar outstanding.

21 Q. Let me ask you to look at Plaintiffs' Trial
22 Exhibit 1291. Is this a document that you have relied
23 on in connection with your work?

24 A. Yes.

25 MR. BOIES: Your Honor, I would offer

1 Plaintiffs' Trial Exhibit 1291 for the 703 purposes that
2 we've previously described.

3 MR. DINTZER: No objection, Your Honor.

4 THE COURT: Plaintiffs' Trial Exhibit 1291 is
5 admitted with a Rule 703 restriction.

6 (Plaintiffs' Exhibit Number 1291 was admitted
7 into evidence.)

8 BY MR. BOIES:

9 Q. Let me ask you to turn to page 11. Does this
10 set forth, as you understand it, AIG's revenues from its
11 security lending businesses during the period 2002 to
12 2007?

13 A. Yes. As is identified here in the last line,
14 the spread to AIG is -- you know, ranges from, you know,
15 a high of 15 basis points to a low of nine basis points
16 in 2007, and, you know, when applied to the average
17 assets on loan, which is the top line, you can see, in
18 the line below that, what the net investment income
19 earned is.

20 Q. What significance, if any, does your testimony
21 concerning the revenue that AIG received from
22 multisector CDSs and from securities lending have to
23 your conclusion as to whether AIG engaged in ex ante
24 risky conduct?

25 A. Well, on a -- on an ex ante basis, the -- you

1 know, the pricing of these transactions reflects the
2 level of risk that was being taken, which on an ex ante
3 basis -- was small. Now, obviously, on an ex post
4 basis, as we all know, with the financial crisis,
5 completely unexpected risks materialized and, you know,
6 obviously had devastating costs for -- for everybody.

7 Q. Were those risks, from your investigation,
8 recognized generally by the market in 2005 and 2006?

9 A. No. The risks that materialized were
10 unanticipated by both the market as well as regulators.

11 Q. When you say the risks were unanticipated by the
12 regulators, can you give me an example?

13 A. Well, certainly various congressional testimony
14 and presentations from, you know, for instance, Chairman
15 Bernanke, you know, talked about the strength of the
16 housing market right around the period that it actually
17 peaked. I believe in 2007, he talked about the first
18 half, that this -- the repercussions of the -- the down
19 climb in housing prices wasn't going to be, you know, a
20 significant event. You know, Alan Greenspan, when he,
21 you know, testified after the fact expressed his, you
22 know, great surprise and how it really caused him to
23 question his -- the view of the world that he was going
24 to carry forward and that he had had in the past.

25 Q. With respect to securities lending, counsel for

1 the United States asked you whether AIG was jumping into
2 the RMBS mortgage pond just as AIGFP was starting to
3 climb out of that pond. Do you recall that?

4 A. Yes. And then we had a -- some further
5 discourse about how the leapfrog that was described
6 there wasn't accurate.

7 Q. Was, in your economic judgment, it inconsistent
8 for AIG to continue to invest in RMBSs after ceasing to
9 issue CDSs for CDOs?

10 A. No. I believe I described that yesterday, that
11 there are different types of securities with different
12 types of transactions with different pricing executed by
13 different business units.

14 Q. Let me go back to the demonstrative PTX 5390,
15 and you described, when we prepared this, how RMBSs were
16 separated into a number of tranches, and we've listed
17 several here, super senior, Aaa, A, Bbb, and you said
18 there were other tranches, including Aa. Do you recall
19 that?

20 A. Yes.

21 Q. Now, when AIG, in its securities lending
22 business, invested in RMBSs, which of these tranches did
23 AIG invest in?

24 A. Well, it's typically the higher grade tranches,
25 the Aa, Aaa.

1 Q. And I am going to put in a Aa tranche just
2 because you've mentioned that a couple of times.

3 Let me ask you to look at Plaintiffs' Trial
4 Exhibit 1051.

5 A. Thank you.

6 Q. Is this a document that you have used in
7 connection with your analysis?

8 A. Yes.

9 MR. BOIES: And, Your Honor, I would offer
10 Plaintiffs' Trial Exhibit 1051 subject to the 703
11 limitation.

12 MR. DINTZER: Your Honor, if we can just get a
13 clarification, did counsel ask the witness if he used
14 this with his analysis? It's -- cross-checking on the
15 documents relied upon list a little cumbersome, but if
16 we can just get a representation that this is a document
17 that the witness relied upon, then we wouldn't have an
18 objection.

19 THE COURT: All right. Do we have such a
20 representation?

21 THE WITNESS: That I relied on it?

22 MR. BOIES: I will have to ask the witness.

23 THE COURT: Okay.

24 BY MR. BOIES:

25 Q. Is this -- is this a document that you have

1 relied on in the work that you've done?

2 A. Yes. I saw this in a color PowerPoint
3 presentation. So, I only looked at it as an electronic
4 document.

5 MR. BOIES: Your Honor, I would offer
6 Plaintiffs' Trial Exhibit 1051 for the purposes
7 indicated.

8 MR. DINTZER: No objection, Your Honor.

9 THE COURT: Plaintiffs' Trial Exhibit 1051 is
10 admitted with a Rule 703 limitation.

11 (Plaintiffs' Exhibit Number 1051 was admitted
12 into evidence.)

13 BY MR. BOIES:

14 Q. And I am told that this is cited in Dr. Cragg's
15 report at footnote 240, for the record.

16 A. We just got that from Barnes & Noble, the
17 representative is here.

18 Q. Now, could you turn to page 22 of this document.
19 Do you have that?

20 A. Yes.

21 Q. What does this document show, as you understand
22 it?

23 A. Well, it's explaining to investors the
24 investments by the securities lending business and the
25 structure of that portfolio.

1 Q. And what does it show in terms of which tranches
2 of RMBSs AIG's securities lending business had invested
3 in?

4 A. Well, it shows the dominance of Aaa investments
5 from the 2005 and 2006 period.

6 Q. Now, by contrast -- and let me go to Plaintiffs'
7 Trial Exhibit 5391. When you were describing CDOs, you
8 described CDOs as representing a pool of securities that
9 included a wide variety of securities, including Bbb
10 RMBSs. Do you recall that?

11 A. Yes.

12 Q. What is the significance, if any, to that in
13 terms of your conclusion that it was consistent, from an
14 economic standpoint, for AIG to continue in the
15 securities lending business, even when it stopped
16 writing CDSs?

17 A. Well, the CDO pool -- I mean, they're called
18 multisector CDOs, and as I was describing, it's really a
19 collection of different types of assets, and that
20 collection or that creation of a portfolio has the
21 impact of diversifying the risk. So, when some assets
22 are up, others are down, you know, some sectors are up,
23 other sectors are down. And so that diversification has
24 the benefit of reducing the overall risk of a more
25 diversified CDO.

1 And one of the factors that was occurring with
2 the structure of the multisector CDOs is that they were
3 becoming more concentrated in RMBS, and, in particular,
4 they were becoming more concentrated in lower quality
5 RMBS at a time when default rates were beginning to rise
6 on those. So, as a result, they were riskier.

7 Q. Let me ask you to look at Plaintiffs' Trial
8 Exhibit 6.

9 A. Thank you.

10 Q. Is this a document that you have relied on in
11 your analysis?

12 A. Yes.

13 MR. BOIES: Your Honor, I would offer
14 Plaintiffs' Trial Exhibit 6 with a 703 limitation.

15 MR. DINTZER: No objection, Your Honor.

16 THE COURT: Plaintiffs' Trial Exhibit 6 is
17 admitted with a Rule 703 restriction.

18 (Plaintiffs' Exhibit Number 6 was admitted into
19 evidence.)

20 BY MR. BOIES:

21 Q. This is a February 28, 2006, email from Gene
22 Park to Joseph Cassano, with copies to a variety of
23 other people, correct?

24 A. Yes.

25 Q. And the subject is, "CDO of ABS Approach Going

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1 Forward." Do you see that?

2 A. Yes.

3 Q. And what is ABS?

4 A. ABS is an acronym that stands for asset-backed
5 securities. So, it's -- it's a -- you know, it's a
6 synonym for multisector -- these -- it's a general
7 description of what CDOs are that are asset-backed.

8 Q. To repeat our standardized test formulation, is
9 it the case that all RMBSs are ABSs, but not all ABSs
10 are RMBSs?

11 A. Yes.

12 Q. And the ABSs would include things that are on
13 our Demonstrative 5391, like credit cards, securities,
14 and the like?

15 A. Yes.

16 Q. Let me ask you to look at the first sentence of
17 the second paragraph, where it's stated, "We feel that
18 the CDO of ABS market has increasingly become less
19 diverse over the last year or so and is currently at a
20 state where deals are almost totally reliant on
21 subprime/nonprime residential mortgage collateral."

22 Do you see that?

23 A. Yes.

24 Q. What significance, if any, does that have to
25 your analysis?

1 A. Well, it's consistent with or reflects the
2 discussion from a couple of days ago where I had shown
3 how the composition of the asset-backed security market
4 had become more concentrated in RMBS as the private
5 label securitization market for mortgages had really
6 taken off. And as a result, that meant that the assets
7 that were available to create multisector CDOs were
8 becoming more concentrated in RMBS.

9 Q. And the next sentence says, "Given current
10 trends in the housing market, our perception of
11 deteriorating underwriting standards, and the potential
12 for higher rates we are no longer as comfortable taking
13 such concentrated exposure to certain parts of the
14 nonprime mortgage securitizations."

15 Do you see that?

16 A. Yes.

17 Q. And let me read one more sentence. "On the
18 deals that we participate on we would like to see a
19 significant change in the composition of these deals
20 going forward -- i.e., more diversification into other
21 non-correlated asset classes."

22 Do you see that?

23 A. Yes.

24 Q. And what's the significance of that to your
25 analysis?

1 A. Well, to create a diversified portfolio, the --
2 you know, you want to have declines in the asset value
3 of some parts of your portfolio, offset by increases and
4 returns on other parts of your portfolio. And that
5 offsetting movement in returns is called negative
6 correlation and, ideally, they would be noncorrelated,
7 ultimately.

8 If your portfolio consists of a -- you know, a
9 set of assets which are correlated, then they all go up
10 in price at the same time and they all go down in price
11 at the same time, and that -- that is not a diversified
12 portfolio. It's risky.

13 Q. Let me go to the very last paragraph, the first
14 sentence, where they say, "We realize that this is
15 likely to take us out of the CDO of ABS market for the
16 time being..."

17 Do you see that?

18 A. Yes.

19 Q. And what's the significance of that to your
20 analysis?

21 A. Well, they're recognizing that this will mean
22 that their participation in this particular market will
23 decline, which it did.

24 Q. Now, let me go to the last sentence of the
25 second paragraph. The sentence immediately precedes

1 what we were just talking about. Do you see where it's
2 stated, "We are still comfortable with our current
3 modeling of tranches related Aa3/AA- or higher on
4 nonprime mortgage deals tranches..." Do you see that?

5 A. Yes.

6 Q. What significance, if any, does that have to
7 your analysis that it was consistent for AIG to stay in
8 the securities lending business, investing in what it
9 invested in, at the same time that it was stopping
10 writing CDSs?

11 A. I think it reflects a confidence in their
12 ability to price higher tranche RMBS assets, that the
13 models that they are using they felt warranted comfort,
14 but in terms of modeling the risks and pricing the
15 risks -- so, modeling and pricing and measuring risk are
16 all related to each other. So, their confidence in that
17 modeling of lower tranche, more concentrated portfolios
18 didn't have the -- they didn't have the same confidence
19 in their ability to -- to price that type of security
20 and, you know, felt it -- it didn't warrant there
21 being -- therefore bearing that kind of risk.

22 Q. You mentioned a moment ago a statement that you
23 attributed to Chairman Bernanke, and with the Court's
24 permission, I am going to ask you to look on the screen
25 at a document that's already admitted in evidence, which

1 is Plaintiffs' Trial Exhibit 1041, of which I have only
2 a copy that has marks on it.

3 And I want to direct your attention to page 6 of
4 that document and, in particular, the middle paragraph.

5 I've got one clean copy, Your Honor.

6 THE COURT: I can see it fine.

7 MR. BOIES: You can see it?

8 BY MR. BOIES:

9 Q. You'll see at the beginning of that paragraph,
10 Chairman Bernanke talks about the increase in subprime
11 mortgages and the fact that, as a result, you're likely
12 to see further increases in delinquencies and
13 foreclosures. Do you see that?

14 A. Yes.

15 Q. He then goes on to say, "All that said, given
16 the fundamental factors in place that should support the
17 demand for housing, we believe the effect of the
18 troubles in the subprime sector on the broader housing
19 market will likely be limited, and we do not expect
20 significant spillovers from the subprime market to the
21 rest of the economy or to the financial system."

22 Do you see that?

23 A. Yes.

24 Q. And this was a speech made by him on May 17th,
25 2007. Is that correct?

1 A. Yes.

2 Q. And what is the significance of that to your
3 conclusion as to whether it was reasonably foreseeable
4 that these products that AIG was investing in would have
5 substantial risk?

6 A. Well, this reflects that comment that I was
7 making earlier about the foreseeability of the financial
8 crisis by both the market and by regulators, that it was
9 an event that -- you know, the financial crisis
10 wasn't -- and its magnitude wasn't anticipated or
11 foreseeable.

12 Q. Let me ask you to turn to another subject. You
13 were asked whether the value of collateral can change
14 after a loan is made. Do you recall that?

15 A. Yes.

16 Q. And you said it could, and you were asked
17 whether in a changing market, what was reliable
18 collateral one day could be unreliable or insufficient
19 the next day, and you said yes, and you gave an example
20 of a margin call where somebody has to put up more
21 margin. Do you recall that?

22 A. Yes.

23 Q. First, in your work, did you examine whether the
24 Federal Reserve was constantly updating its evaluations
25 of the collateral that AIG had posted?

1 A. I'm not sure what you mean by "constantly," but
2 it did, over time, have valuations executed on its
3 behalf of the underlying collateral for the loan.

4 Q. Did the Federal Reserve, as you understand it,
5 have any other protection against a possible change in
6 the value of the AIG collateral?

7 A. Well, it was using a policy that it used with
8 all of its collateral, which is to create a buffer
9 through the amount of haircut that it used regarding the
10 value of the collateral and the loan that it was willing
11 to extend against that collateral. And in all of the
12 loans that the Federal Reserve made through this period,
13 it dealt with that risk through the magnitude of the
14 haircuts that were used.

15 So, in AIG's case, there was a 25 percent
16 haircut, and when I looked at the relationship between
17 the amount of the loan outstanding and the valuations
18 that were being done by, for instance, Morgan Stanley,
19 that cushion, that haircut -- there was always a lot of
20 excess value there. So, it was always fully secured as
21 has been stated by many, many government officials.

22 Q. Let me turn to the subject of AIG's downgrades
23 and losses prior to September of 2008.

24 THE COURT: Before we get into that subject,
25 shall we take our break?

1 MR. BOIES: Yes, Your Honor.

2 THE COURT: All right. We will reconvene at
3 11:15.

4 (Court in recess.)

5 THE COURT: Thank you. Please be seated.
6 All right, let's go ahead.

7 MR. BOIES: Thank you, Your Honor.

8 BY MR. BOIES:

9 Q. Dr. Cragg, just before the break, I was
10 directing your attention to the issue of AIG's
11 downgrades and losses prior to September of 2008. Do
12 you recall that, generally?

13 A. Generally, yes.

14 Q. And do you recall that counsel for the United
15 States showed you various criticisms that Mr. Greenberg
16 and others had made of AIG's losses and downgrades
17 earlier in 2008? Do you recall that?

18 A. Yes.

19 Q. And do you have any understanding as to whether,
20 at that period in 2008, Mr. Greenberg and Starr
21 International and AIG had litigation against each other?

22 A. Yes. I believe they did.

23 Q. Now, with respect to the losses and collateral
24 calls and the like that occurred in 2007 and early 2008,
25 did that adversely affect AIG's stock price?

1 A. The stock price would have reflected whatever
2 information was publicly available in the market, and
3 that information was at the time.

4 Q. And was AIG able to deal with the issues raised
5 by Mr. Greenberg and others in the period prior to
6 September 2008 without threatening its survival?

7 A. Well, AIG did post collateral, if required, and
8 it did raise money prior to the full onset of the
9 financial crisis.

10 Q. Now, when you say AIG did raise money, what
11 money did AIG raise in 2008?

12 A. 20 billion at the beginning of the summer and
13 then another 3 billion at the end of the summer.

14 Q. And how was this \$23 billion raised?

15 A. Well, it was from the public markets, through a
16 combination of different types of security claims.

17 Q. Let me turn to the question of the substitution
18 of later RMBSs into CDOs. Do you remember counsel for
19 the United States asking you about that?

20 A. Yes.

21 Q. And just for context, what -- what are we
22 talking about here?

23 A. Well, there are several places in the agreements
24 where collateral substitution can occur. It can occur
25 with regards to -- you know, with some swaps; it could

1 be with regards to the CDO; it could also be with the
2 underlying collateral to the CDO. So, there are
3 different places where a collateral substitution could
4 occur.

5 Q. Going to our demonstrative, PTX 5391, and if you
6 look at the circle that represents the pool of
7 securities, can you tell me what kind of substitutions
8 might be made?

9 A. Well, for instance, you could substitute a --
10 say a 2007 RMBS of the same rating for a previous
11 vintage RMBS, as an example, as long as it had the same
12 rating.

13 Q. And when you said it has to have the same
14 rating, was that specified in the CDS contract?

15 A. It's described more as the security of similar
16 quality.

17 Q. Similar quality. And if the collateral that was
18 substituted in was, in fact, of similar quality, would
19 there be any harm?

20 A. No, as long as it's similar, but as we know,
21 later vintage securities which on their face appeared
22 similar were, in fact, not similar.

23 Q. And were there later statements that you have
24 reviewed and relied on by the United States concerning
25 the role that rating agencies had in that?

1 A. Yes. I mean, the structure of AB -- the
2 structured rating of asset-backed securities over this
3 period was often -- and increasingly so -- done on a
4 collaborative basis with the rating agencies, as opposed
5 to more of an arm's length basis.

6 Q. Now, both in your testimony with me and in your
7 prior testimony to counsel for the United States, you've
8 talked about the term "fully secured," and you testified
9 to counsel for the United States that you had not done a
10 solvency analysis but had relied on what others had
11 done. Do you recall that?

12 A. Yes.

13 Q. When you say that you relied on what others had
14 done, can you explain what you meant?

15 A. I mean in a couple of different ways. One is
16 that there are, you know, a variety of valuations that
17 were done of the collateral that was provided by AIG.
18 So, you know, various different professional services
19 firms evaluated that using, you know, standard methods
20 that I'm familiar with, and, you know, upon my review of
21 their analysis, I relied on it.

22 As well, there are, you know, a large number of
23 statements made by, you know, a variety of different
24 actors regarding the adequacy of the AIG collateral.

25 Q. When you say there were a variety of valuations

1 that were done of the collateral that was provided by
2 AIG, can you give me some examples of those that you
3 relied on?

4 A. Well, those by Morgan Stanley, Ernst & Young,
5 are the two that come to mind.

6 Q. And when you say that there were also a large
7 number of statements by a variety of different actors
8 regarding the adequacy of the AIG collateral, can you
9 give me some examples of who you're talking about?

10 A. So, statements to Congress were made by
11 Mr. Geithner, Mr. Bernanke. I also recall joint
12 testimony that included Mr. Baxter, as some examples.

13 Q. Let me turn to what I hope is the last subject.
14 You told counsel for the United States, in response to
15 his question, that you did not know whether AIG had a
16 plan of how they would pay the CDS contracts if the CDOs
17 all collapsed. Do you recall that?

18 A. Yes.

19 Q. Did that, in fact, happen? Did all the CDOs
20 collapse?

21 A. No.

22 Q. As far as you have been able to determine, did
23 anyone have any reasonable expectation that that would
24 happen in the period leading up to September 16th?

25 A. No.

1 MR. BOIES: Your Honor, I would offer four
2 exhibits, all subject to the 703 limitation. The first
3 is Plaintiffs' Exhibit 1472, which is in the big binder
4 and which we referred to earlier in, I believe,
5 Mr. Cragg's testimony.

6 And the other three are Plaintiffs' Trial
7 Exhibits 5366-A --

8 THE WITNESS: Thank you.

9 MR. BOIES: -- 5339-A and 5352-A.

10 For the record, each of the last three exhibits
11 are demonstrative exhibits that the witness prepared and
12 utilized. The "A" versions correct three issues.
13 Plaintiffs' Trial Exhibit 5366-A differs from 5366 in
14 that the number in the middle column for the amount
15 posted collateral by AIG, AIG's equity, and CDO interest
16 and principal proceeds is shown as 37.8, which is the
17 correct number. On the prior chart, it was 37.5.

18 THE COURT: Okay.

19 MR. BOIES: With respect to Plaintiffs' Trial
20 Exhibit 5352-A, in the September 29, 2008, column that
21 shows the PDCF collateral, the section related to
22 unrated debt securities was right in terms of its size
23 as shown on the chart, but the number was listed as 2
24 billion as opposed to 29 billion.

25 And with respect to Plaintiffs' Trial Exhibit

1 5339-A, we had the opposite issue. All of the numbers
2 are right, but the size of some of these bars didn't
3 quite match with the -- with the numbers.

4 THE COURT: Okay.

5 MR. BOIES: And then I'm reminded we still have
6 the 2365 spreadsheets -- 2565 spreadsheet.

7 MR. DINTZER: So, if I may, Your Honor, do them
8 one at a time. The three -- the three "A" documents
9 that amend the PowerPoint deck that the witness used,
10 counsel has moved these for 703, but for clarity,
11 those -- we don't object to those coming in as
12 demonstratives --

13 MR. BOIES: That's what I meant.

14 MR. DINTZER: -- as a replacement for the
15 earlier demonstratives.

16 THE COURT: Okay, that's clear.

17 MR. DINTZER: The PTX 1472, we do not object to
18 that coming in under 703.

19 And the last one, if I could ask for a
20 clarification, that is only offered for 703, the 2365
21 spreadsheet.

22 MR. BOIES: Yes, only 703.

23 MR. DINTZER: And then we don't object to that.

24 THE COURT: All right, very well.

25 Therefore, Plaintiffs' Trial Exhibits 1472 and

1 2565 are admitted subject to a Rule 703 restriction; and
2 Plaintiffs' Trial Exhibits 5366-A, 5339-A, and 5352-A
3 are admitted as demonstrative exhibits.

4 (Plaintiffs' Exhibit Number 1472 was admitted
5 into evidence.)

6 (Plaintiffs' Exhibit Number 2565 was admitted
7 into evidence.)

8 (Plaintiffs' Exhibit Numbers 5366-A, 5339-A, and
9 5352-A were admitted into evidence.)

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

11 THE COURT: All right. Thank you.

12 MR. DINTZER: If we could just have -- good
13 morning, Your Honor. If we could just have one moment,
14 we are going to swap out some of the hardware. Thank
15 you.

16 (Pause in the proceedings.)

17 MR. DINTZER: If I may, Your Honor?

18 THE COURT: Yes. Please go ahead.

19 MR. DINTZER: Okay, thanks.

20 (Pause in the proceedings; technical
21 difficulty.)

22 THE COURT: All right, we will go off the
23 record, and we will just kind of stay here, but it's a
24 five-minute break.

25 (Court in recess.)

1 THE COURT: Okay, I think we're ready. Let's go
2 back on the record.

3 MR. DINTZER: May I, Your Honor?

4 THE COURT: Yes, please. Thank you.

5 RECROSS EXAMINATION

6 BY MR. DINTZER:

7 Q. Good morning.

8 A. Good morning.

9 Q. We're going to start with PTX 6, the email that
10 I believe counsel handed up to you, and let me know when
11 you've found it.

12 A. PTX 6 you said?

13 Q. PTX 6. It's the email from Gene Park.

14 A. Oh, yes. Yes.

15 Q. And this is an email to a number of people. One
16 of them is Gary Gorton. Do you see that?

17 A. Yes.

18 Q. Do you know who he is?

19 A. I do.

20 Q. Who is he?

21 A. He's now a professor at Yale.

22 Q. And you talked about the modeling here that was
23 done. Do you know that he's the person who was doing
24 the modeling?

25 A. He was one of the people there, yes.

1 Q. And you described their confidence in the
2 modeling. That was one of the things you discussed.

3 A. My confidence?

4 Q. No, no, no; AIG's confidence in the modeling.

5 A. Oh, yes.

6 Q. I take it you did not review their modeling
7 techniques.

8 A. I have not, no.

9 Q. Okay. And do you know that the -- that the
10 modeling that they used on the CDO contracts was
11 incomplete?

12 A. You'll have to be clearer --

13 Q. Sure.

14 A. -- by either what you or whoever means by
15 "incomplete."

16 Q. Sure.

17 May I approach, Your Honor?

18 THE COURT: Yes.

19 THE WITNESS: Thank you.

20 BY MR. DINTZER:

21 Q. Sir, I've handed you what's been marked as
22 DX 2260.

23 A. Yes.

24 Q. It's a newspaper article. You can just tell me
25 if you've seen it before.

1 A. I have.

2 Q. You have?

3 A. But it's been a long time since I've looked at
4 it.

5 Q. Okay. And so the -- the first page -- let me
6 see if I can get this right now. Great.

7 So, the first page here discusses actually that
8 gentleman, Gary Gorton, right?

9 A. Yes.

10 Q. A 57-year-old finance professor. And in the
11 second paragraph, it notes that -- in the second
12 sentence, that "he also has a lucrative part-time job --
13 part-time gig: devising computer models used by the
14 giant insurer to gauge risk in more than \$400 billion of
15 devilishly complicated deals called credit-default
16 swaps."

17 Do you see that?

18 A. Yes.

19 Q. And that's your understanding, right, sir?

20 A. That he worked at AIG as -- at AIGFP as a
21 consultant?

22 Q. Did modeling for them?

23 A. He is part of the team that did modeling.
24 That's my understanding.

25 Q. Okay. And then the next sentence, "AIG relied

1 on those models to help figure out which swap deals were
2 safe." That's your understanding, too, right?

3 A. Yes.

4 Q. "But AIG did not anticipate how market forces
5 and contract terms not weighed by the models would turn
6 the swaps, over the short term, into huge financial
7 liabilities." Do you see that?

8 A. Yes.

9 Q. "AIG didn't assign Mr. Gorton to assess those
10 threats, and knew that his models didn't consider them."
11 Do you see that?

12 MR. BOIES: Your Honor, I am going to object to
13 just the reading of a document that is not in evidence
14 and will never come into evidence.

15 MR. DINTZER: I'm about to ask him a question.
16 He did discuss modeling specifically with Plaintiffs'
17 counsel.

18 THE COURT: All right. Let's go ahead,
19 Mr. Dintzer.

20 MR. DINTZER: Thank you, Your Honor.

21 BY MR. DINTZER:

22 Q. Were you aware, when you reached your
23 conclusions in this case, that AIG had modeling that did
24 not anticipate how the market forces would measure the
25 CDO contracts? Were you aware of that?

1 MR. BOIES: Objection to the form of the
2 question. The question assumes a fact, doesn't ask the
3 witness a question about the fact but assumes the fact.

4 THE COURT: I think that's true. Can you
5 rephrase?

6 MR. DINTZER: Yes, Your Honor.

7 BY MR. DINTZER:

8 Q. Are you -- are you -- do you have any knowledge,
9 one way or the other, as to whether AIG's models models
10 for the collateral risk or the risk of posting
11 collateral?

12 A. I didn't look at the AIG models specifically.

13 Q. You didn't look at them at all?

14 A. In terms -- I have not examined the workings --
15 the inner workings of those models, no.

16 Q. Okay. Are you aware or were you -- at any --
17 let me put it this way.

18 Are you aware or did you consider, when reaching
19 your conclusions in this case, that AIG's models that
20 they used at the time that they did the CDS deals, when
21 they entered into those contracts, that those models
22 didn't model for the possibility of posting collateral?

23 A. I don't know whether the models did or didn't
24 anticipate that.

25 Q. That's something you didn't look at.

1 A. No.

2 Q. Will you agree if their models, when they were
3 writing the CDS contracts, 2006, 2007, did not model for
4 the possibility that they would have to post collateral,
5 that that would be a mistake?

6 A. With hindsight, we can say all kinds of things,
7 what are things -- mistakes in hindsight, but the
8 question is, on an ex ante basis, were the models
9 reasonable? I haven't looked at that.

10 Q. Okay. No further questions on that document,
11 sir.

12 Now I'm going to ask you to turn to JX 387, a
13 document Plaintiffs' counsel handed you. And just let
14 me know when you're there. It's the Deloitte document,
15 sir, just in case.

16 A. I just got it as you mentioned it.

17 Q. Now, do you know what -- briefly, do you know
18 what accounting issue this memo is trying to address?

19 A. As I described earlier, as I recall, it was
20 dealing with whether the loan should be treated as a
21 distressed debt.

22 Q. All right. And I'm going to take you to page 4
23 of the document, and the heading is, "Changes to
24 Strategy of U.S. Government for Dealing with Financial
25 Crisis." Do you see that?

1 A. Yes.

2 Q. And the first bullet, "In making its decision to
3 extend the original facility to AIG, the Federal Reserve
4 Banks understood that a failure to do so would result in
5 AIG's immediate declaration of bankruptcy." Do you see
6 that?

7 A. Yes.

8 Q. Do you agree with that?

9 A. I think I testified yesterday that when exactly
10 a bankruptcy might emerge and under what circumstances,
11 I hadn't developed an opinion about that.

12 Q. Okay. The next sentence is, "Although it is
13 widely understood that AIG continues to experience
14 financial difficulty, the Federal Reserve Bank does not
15 believe that AIG's financial condition has deteriorated
16 since the extension of the original facility."

17 Now, this document is dated February 18th, 2009.
18 Is that right?

19 A. Yes.

20 Q. And do you agree with that conclusion?

21 A. I'm sorry, I got derailed looking at the front.
22 The sentence beginning "Although"?

23 Q. Yes.

24 A. I think, you know, the Federal Reserve says what
25 it believes and --

1 Q. And I'm asking you, sir, do you agree with their
2 position right there? Yes, no, or I don't know.

3 A. I don't know what their -- what exactly they're
4 responding to there, but it was widely understood by me
5 and others that the terms were onerous, but AIG's actual
6 underlying businesses were performing.

7 Q. So, my only question, sir, is do you -- yes or
8 no -- do you agree with the statement that AIG's
9 financial condition has not deteriorated since -- from
10 the -- between the time of the extension of the original
11 facility until the writing of this document, February
12 18th, 2009? Yes, no, or I don't know.

13 A. I don't know.

14 Q. The next sentence says, "Practically speaking,
15 short of actually filing for bankruptcy, further
16 deterioration in the financial condition of AIG is
17 improbable, if not impossible." Do you see that?

18 A. Yes.

19 Q. Do you agree with that?

20 A. As -- again, I haven't analyzed the specificity
21 of what's being called for here.

22 Q. You didn't look at this document that carefully?

23 A. No, I did. I didn't analyze whether I agreed --
24 sorry. I didn't conduct an analysis which would allow
25 me to definitively agree or disagree with each of these

1 statements.

2 Q. Okay. If we can go down to the fourth bullet,
3 the same page, "The Federal Reserve Bank agreed to
4 modify the terms of the original facility because of a
5 change in its strategy through dealing with troubled
6 financial institutions." Do you see that?

7 A. Yes.

8 Q. And one of the changes -- there were others, but
9 one of them was that TARP was passed and they were able
10 to do assistance in a different way, is that right, or
11 at least the Treasury was?

12 A. Yes.

13 Q. Yes? Is that right?

14 A. Yes.

15 Q. And then if you would skip a sentence, it says,
16 "These terms were also" -- well, actually, let me not
17 skip.

18 "At the time the facility was originally
19 extended, the Federal Reserve Bank was seeking to
20 facilitate a process whereby AIG could sell certain of
21 its assets in a rapid but orderly manner. These terms
22 were also designed to reduce moral hazard, a key
23 consideration at the time."

24 Do you see that?

25 A. Yes.

1 Q. And do you have any reason to doubt that,
2 according to this document, that the terms were also
3 designed to reduce moral hazard, that that was the
4 intent -- that that was a key consideration at the time?

5 A. I think I've spoken to that previously, that I
6 don't see the relationship between the design of the
7 terms and their link to moral hazard.

8 Q. But you'll agree with me, sir, that at least in
9 February 2009, that is one of the reasons identified by
10 the Federal Reserve, right?

11 A. Yes. That's what's identified in the document.

12 Q. Okay. No further questions on that document,
13 sir.

14 Sir, you mentioned Lehman and its filing for
15 bankruptcy. Just to be clear, Lehman itself, that
16 wasn't a broker-dealer. Is that right? Were they a
17 broker-dealer?

18 A. You mean the company?

19 Q. Yes.

20 A. They had a broker-dealer subsidiary.

21 Q. And Lehman filed for bankruptcy. Do you know if
22 their broker-dealer filed for bankruptcy?

23 A. I don't recall whether it did or it didn't.

24 Q. PTX 549 at page 12. I think that's in my white
25 binder, the white binder we handed up. And just to be

1 clear, it's at exhibit page 12, not document page 12.
2 Just let me know when you're there, sir. It's in the
3 white binder.

4 A. Yes.

5 Q. So, Plaintiffs' counsel went through that
6 paragraph -- and I'm not going to go through it again --
7 but that second paragraph on page 12. Do you see it?
8 The one that begins "On Monday"?

9 A. Yes.

10 Q. Okay. And the only thing I wanted to direct you
11 to is, "The group developed a loan term sheet, but an
12 analysis" -- and you talked about this with counsel,
13 about how they couldn't get funding because of the
14 Lehman bankruptcy, right?

15 A. Yes. They couldn't get funding. As it says at
16 the end here, "the other major banks decided they needed
17 to conserve capital to deal with adverse market
18 conditions."

19 Q. And that term sheet, the group developed a loan
20 term sheet, that's the term sheet we've been talking
21 about in this case. Is that right?

22 A. I presume so.

23 Q. And that term sheet -- that loan term sheet
24 called for 79.9 percent equity as part of the terms of
25 the loan. Is that correct?

1 A. I believe warrants were part of that term sheet.

2 Q. But 79.9 percent, fully diluted, correct?

3 A. I would have to look back at the document to --
4 but I believe that's right.

5 MR. DINTZER: May I approach, Your Honor?

6 THE COURT: Yes.

7 THE WITNESS: Thank you.

8 BY MR. DINTZER:

9 Q. Sir, I have handed you what's been marked as
10 JX 65. Please tell me if you recognize the document.

11 A. It's an email with an attachment called
12 "Indicative terms and conditions."

13 Q. Okay. And if you could turn to the -- and do
14 you recognize this as the private term sheet that you
15 said you thought you saw?

16 A. Yes.

17 Q. Okay. And if you could turn to the second page,
18 it's dated September 16th. Is that right, sir?

19 A. You mean the second page of the terms?

20 Q. No, I'm sorry. The third page of the document,
21 the first page of the terms.

22 A. Yes.

23 Q. And this shows that the borrower was AIG. Is
24 that right?

25 A. Yes.

1 Q. And the syndication strategy was that they'd
2 look for 15 underwriters at \$5 billion each. Is that
3 right?

4 A. Yes.

5 Q. And if you go down farther, the warrant
6 allocation is penny warrants on common shares
7 representing up to 79.9 percent of the company. Is that
8 right?

9 A. That's what it says, yes.

10 Q. Okay. And so if the funding had been available
11 that we were looking at, PTX 549, if that funding had
12 been available and it had funded that term sheet, the
13 deal would have been at least estimated at 79.9 percent
14 of the company. Is that correct?

15 A. That's what this document says, yes.

16 Q. Okay. No further questions on that, sir.

17 Now we're going to turn back to Mr. Bagehot. Do
18 you remember that you looked at an article with
19 Plaintiffs' counsel by Mr. Madigan?

20 A. Yes.

21 Q. Okay. And before we go to that article, do you
22 remember that -- and maybe I can do this without the
23 document -- that Mr. Madigan, he worked for the Board of
24 Governors during the AIG -- during the time the AIG loan
25 was made, correct?

1 A. Yes.

2 Q. And he wrote a memo in that time period. Is
3 that right?

4 A. Yes.

5 Q. And in that memo he recommended -- at least in
6 the initial version of the memo, he recommended against
7 making the loan to AIG. Is that correct?

8 A. He and the other authors.

9 Q. Yes. And one of the reasons they gave was moral
10 hazard, correct?

11 A. Yes.

12 Q. Okay. Now, let's go to PTX 537, which is Tab 2
13 of the Bagehot binder. Just let me know when you have
14 that, sir.

15 A. Here we go.

16 Q. Okay.

17 A. You said Tab 2?

18 Q. Yes, sir.

19 And so this is Mr. Madigan's speech, and just
20 for reference, it's August 21st, 2009, so almost a full
21 year after AIG's initial loan. Is that right?

22 A. Yes.

23 Q. Okay. And he writes about Bagehot, and you
24 discussed that with Plaintiffs' counsel. I'd like you
25 to go to page 3 of the exhibit and a little beyond

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1 halfway down, the sentence that begins, "In lending."
2 Just let me know when you're there.

3 A. Yes.

4 Q. Okay. So, this says, "In lending under the PDCF
5 and TSLF, the Federal Reserve's actions are quite
6 consistent with the principles attributed to Bagehot."
7 Do you see that?

8 A. Yes.

9 Q. "The Fed lends to firms that are judged to be
10 solvent; by applying haircuts to the market value of
11 securities, it ensures that lending against good
12 collateral; and particularly under the PDCF the Fed
13 extends credit at interest rates that would be
14 above-market in more routine circumstances."

15 Do you see that?

16 A. Yes.

17 Q. And he talks about Bagehot, he talks about those
18 facilities, but he doesn't mention AIG. Is that -- at
19 least in that paragraph. Is that correct?

20 A. Correct.

21 Q. Okay. Now, you go to -- and right before that
22 paragraph, there is endnote 8, and that's where I'm
23 going to take you to, sir. In endnote 8, he writes,
24 "Although the Federal Reserve found it necessary, in the
25 interests of financial stability, to lend to support the

1 acquisition of Bear Stearns and later to prevent the
2 disorderly failure of AIG -- in both cases with the full
3 support of the Treasury Department -- the Federal
4 Reserve and Treasury have both noted that a superior
5 arrangement would be for the Congress to establish by
6 statute a regime for the resolution of systemically
7 important nonbank financial firms."

8 Do you see that?

9 A. Yes.

10 Q. Okay. So, in the paragraph here where he's
11 talking about AIG, he's not talking about Bagehot at
12 all. Is that correct?

13 A. Not in this paragraph. He's talking about
14 asking Congress for permission to do something that
15 they're not allowed to do.

16 Q. Exactly. What he's looking for is -- it's
17 something that they would have preferred to have, which
18 is if an AIG comes through the door next time, they want
19 to hand them off for resolution, resolution of
20 systemically important nonbank financial firms. That
21 means instead of getting a loan, like under Bagehot,
22 they're going to be put in for resolution.

23 Do you know what "resolution" means sort of in
24 the FDIC context, sir?

25 A. Yes.

1 Q. What does that mean in the FDIC context?

2 A. That you'll rehabilitate the -- the bank and it
3 would then emerge as a stronger institution.

4 Q. Or be put into bankruptcy and taken apart and
5 sold off for creditors.

6 A. It would depend on the circumstances.

7 Q. Yes. So -- but he -- in this article, he does
8 not connect Bagehot and AIG. Is that correct? And if
9 you don't know, you can just say I don't know.

10 A. Okay, I'm trying to -- so, we started with the
11 memos and now we're looking at the article, okay. So,
12 now what are we trying to do?

13 Q. The next question I have for you, sir, is on
14 page 4, and we'll go to the last paragraph on that page.
15 Mr. Madigan writes, "Despite Bagehot's advice to lend
16 broadly, practicability requires that central banks not
17 lend to all firms, or even all financial institutions,
18 either in routine circumstances or in a crisis."

19 Now, I know you disagree with that, don't you,
20 sir?

21 A. I -- that's a very broad statement, so parts I
22 might agree with and other parts I wouldn't agree with,
23 so...

24 Q. Okay. The next thing Mr. Madigan writes is (as
25 read): "Rather, central banks generally need to

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1 establish eligibility for their facilities using some
2 sharp defined criteria -- for example, a banking
3 charter, designation as a primary dealer, and so on --
4 in order to avoid an untenable" -- untenable --
5 "situation in which it may appear that individual firms
6 are arbitrarily allowed or denied access."

7 Do you see that?

8 A. Yes.

9 Q. Will you agree with me, whether you like it or
10 you don't like it, the primary dealer credit facility
11 had sharply defined criteria? Either you're a primary
12 dealer or you're not, right?

13 A. It did. The -- I think what he's calling for
14 here is an announcement of what the rules of the game
15 will be and not to change them in an ad hoc manner along
16 the way.

17 Q. With sharply defined criteria, right, sir? That
18 is what he says.

19 A. So, this article is about a couple of different
20 topics, but one is the need to announce before a crisis
21 what you're going to do, which 13(3) actually does.
22 Then, if you don't like the outcome that happens in a
23 crisis, to go back and establish new regulations, which
24 Treasury did in March through the -- through the
25 blueprint, and which Congress did, you know, later,

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1 through the passage of various new laws.

2 But, you know, doing things that are like
3 resolution obviously go past the legal constricts that
4 the Federal Reserve was acting under. I think that
5 article recognizes that.

6 Q. No further questions on that document, sir.

7 A. Well, I hadn't finished, but...

8 Q. Please.

9 A. So, the other point that's made with this
10 article as well as a series of other articles that
11 started coming forward from the Board of Governors is a
12 need for maximum prudential regulation and an entirely
13 new approach to the way federal regulation of the
14 financial sector would work given the problem that
15 emerged during this period of time by essentially
16 allowing a large section of the financial services
17 sector to go unregulated under the nose of the
18 regulators. So, I think there's a recognition starting
19 before September 2008 that the regulatory environment
20 was broken and that something would have to be done in
21 the future.

22 And then in terms of the memo that you're
23 talking about that Mr. Madigan and others actually wrote
24 about moral hazard, that memo went through several
25 iterations. The one we were just speaking about,

1 Mr. Bernanke actually chided Mr. Madigan for not
2 actually having presented any evidence for what he was
3 saying regarding moral hazard and other of the
4 recommendations about not lending to AIG.

5 And as we know, later on, without knowing what
6 he was really resolved to think about moral hazard,
7 Mr. Bernanke actually, you know, cast a vote to support
8 the RCF without actually having a well-established
9 position on moral hazard at that point in time, as we
10 know from what he said in the FOMC meetings an hour
11 before he cast his vote.

12 Q. Okay, sir?

13 A. Yes.

14 Q. If you could now turn to the Humphrey article,
15 DX 2202, the one titled, "Lender of Last Resort: What
16 It is, Whence It Came, and Why the Fed Isn't It."

17 A. Yes.

18 Q. In the bottom paragraph on 359, Mr. Humphrey --
19 do you know that -- what role Mr. Humphrey -- and it
20 says that on the first page. He was a senior economic
21 and policy advisor from the Federal Reserve Bank of
22 Richmond. Is that right?

23 A. Yes.

24 Q. Do you know Mr. Humphrey?

25 A. I don't.

1 Q. And on the last paragraph there, he writes, "The
2 truth is that the Fed has set a dangerous precedent by
3 bailing out Citigroup and AIG. Not only do the bailouts
4 intensify systemic hazard (the very hazard Fed policy is
5 supposed to alleviate) by creating incentives for other
6 firms to take excessive risks so that they can become
7 big and be rescued if their risks go sour, they also
8 open the door to baneful possibilities of a political
9 nature."

10 Do you see that?

11 A. Yes.

12 Q. And my only question for you is, is it your
13 understanding that different scholars have taken
14 different positions about whether AIG should or
15 shouldn't have been assisted and based on the concern of
16 moral hazard? That's it.

17 A. Yes.

18 Q. Okay. No further questions on that document,
19 sir.

20 If you could go to PTX 5350, that is the GAO
21 timeline that is in your set. Just let me know when
22 you're there, sir.

23 A. Yes.

24 Q. Okay. Under September 12th, over to the right,
25 the second paragraph under that, do you see that? And

1 it's really small print, but it says, "AIG" -- the
2 second sentence or the second clause says, "AIG presents
3 application to become primary dealer."

4 Do you see that?

5 A. Yes.

6 Q. Have you ever -- I mean, is it your
7 understanding that they actually presented a physical
8 application?

9 A. I haven't seen a physical application.

10 Q. Have you seen any document or anything that
11 refers to a physical application?

12 A. No.

13 Q. Okay.

14 A. Other than this one.

15 Q. Okay. That's -- what?

16 A. Other than this, I haven't seen an official
17 application or reference to it.

18 Q. Okay. No further questions on that document,
19 sir.

20 The Texas Insurance Commissioner was concerned
21 with AIG's securities lending program in 2006. Is that
22 right?

23 A. AIG, you know, discussed the management of its
24 securities lending portfolio with the Texas Insurance
25 Commissioner, amongst others.

1 Q. And the New York Commissioner?

2 A. And the New York Commissioner, yes.

3 Q. And the New York and Texas Commissioners had
4 some concerns about what AIG was doing in its securities
5 lending, correct?

6 A. Yes. They agreed to reduce the size of that
7 portfolio.

8 Q. Okay.

9 Pardon me, Your Honor, just one moment.

10 THE COURT: Sure.

11 (Counsel conferring.)

12 MR. DINTZER: May I approach, Your Honor?

13 THE COURT: Yes.

14 THE WITNESS: Thank you.

15 MR. DINTZER: Your Honor, this has been marked
16 as DX 2261. It is not on our exhibit list. What it is,
17 is it -- when the Federal Reserve Bank of New York
18 handed over pieces of the Doomsday Book a few days back,
19 this was one of the memos in the set, and Plaintiffs'
20 counsel has moved a number of those into evidence,
21 which -- without our objection.

22 I didn't realize that this one wasn't part of
23 that group, and that's on me, Your Honor, but we would
24 ask, for the sake of completeness, that DX 2261 be --
25 2261 be moved into evidence to complete the set of the

1 memos.

2 MR. BOIES: No objection, Your Honor.

3 THE COURT: All right. Defendant's Exhibit 2261
4 is admitted.

5 (Defendant's Exhibit Number 2261 was admitted
6 into evidence.)

7 BY MR. DINTZER:

8 Q. And, sir, it's unlikely that you have, but I at
9 least want to ask you. Have you seen this document
10 before?

11 A. I haven't looked at it.

12 Q. It's not something you've seen -- I just want to
13 be sure I understand your answer. It's not something --

14 A. Oh, no, I haven't -- I don't recognize it.

15 Q. Okay. Did you look at any of the Doomsday
16 memos?

17 A. I don't recall them, the Doomsday memos. I
18 actually don't know what that collection is. I know of
19 the Doomsday Book. I've looked at various things which
20 I think are part of what's called the Doomsday Book, but
21 I haven't actually, you know, done the exercise of, you
22 know, matching what's in and not in that book.

23 Q. Okay. Then no further -- no questions on the
24 document, sir.

25 May I have a moment, Your Honor?

1 THE COURT: Sure.

2 (Counsel conferring.)

3 MR. DINTZER: I have no further questions, Your
4 Honor. I would like to move in a set of the slides that
5 I created with the witness as demonstratives, if I can
6 just find the folder, or maybe I'll do that next time,
7 Your Honor. Oh, okay.

8 May I approach, Your Honor?

9 THE COURT: Yes.

10 MR. DINTZER: Your Honor, we move for the
11 admittance as demonstratives DXX 020, 021, 022, 023,
12 024, 025, 026, 027, 028, 029, 030, 031, 032, 033, 034,
13 and 035.

14 MR. BOIES: No objection, Your Honor.

15 THE COURT: All right. The Defendant's
16 demonstratives just recited by Mr. Dintzer are admitted
17 as demonstrative exhibits.

18 (Defendant's Exhibit Numbers DXX 020-DXX 035
19 were admitted into evidence.)

20 MR. DINTZER: Thank you, Your Honor.

21 Thank you, sir.

22 THE WITNESS: You're welcome.

23 THE COURT: All right.

24 Dr. Cragg, thank you very much for your
25 testimony in this matter.

1 THE WITNESS: Thank you.

2 THE COURT: You are excused.

3 MR. BOIES: That was our last witness, Your
4 Honor.

5 THE COURT: Okay.

6 MR. BOIES: I have a few documents to offer.
7 First, we would offer Plaintiffs' Trial Exhibits 2850
8 and 2851, which are Professor Zingales' expert report
9 and expert rebuttal report; Plaintiffs' Trial Exhibit
10 2852 and 2853, which are Professor Kothari's expert
11 report and rebuttal expert report; Plaintiffs' Trial
12 Exhibit 2854 and 2855, which are Dr. Wazzan's expert
13 report and expert rebuttal report; and Plaintiffs' Trial
14 Exhibit 2856 and 2857, which are Dr. Cragg's expert
15 report and expert rebuttal report, each being offered
16 for the purpose that the Court previously identified.

17 MR. DINTZER: No objection, Your Honor.

18 THE COURT: All right. Plaintiffs' Trial
19 Exhibits 2850 through 2857 are admitted as expert
20 reports under the criteria that I stated earlier in the
21 trial.

22 (Plaintiffs' Exhibit Numbers 2850-2857 were
23 admitted into evidence.)

24 MR. BOIES: Next, Your Honor, I would offer
25 Plaintiffs' Trial Exhibits 5200 to 5226 as demonstrative

1 exhibits. These are the slides from Dr. Kothari's
2 testimony. And I would offer Plaintiffs' Trial Exhibits
3 5045 through 5050, 5052 through 5056, 5058 and 5059,
4 5061 through 5067, and 5069, which are the charts from
5 Professor Zingales' testimony.

6 I have skipped charts that I did not use or
7 refer to. I would be prepared to offer them if counsel
8 for the Defendant wishes, but my offer is simply for the
9 demonstratives that I did use or refer to.

10 MR. DINTZER: And with that, Your Honor, we're
11 not going to run all these down. We will take counsel's
12 representation. We will reserve our right, if we see
13 that any of these were not actually used, to ask the
14 Court to withdraw them, but otherwise we have no
15 objection to them coming in as demonstratives.

16 THE COURT: All right. Without objection, the
17 demonstrative exhibits identified by Mr. Boies are
18 admitted.

19 (Plaintiffs' Exhibit Numbers 5200-5226 were
20 admitted into evidence.)

21 (Plaintiffs' Exhibit Numbers 5045-5050 were
22 admitted into evidence.)

23 (Plaintiffs' Exhibit Numbers 5052-5056 were
24 admitted into evidence.)

25 (Plaintiffs' Exhibit Number 5058-5059 were

1 admitted into evidence.)

2 (Plaintiffs' Exhibit Numbers 5061-5067 were
3 admitted into evidence.)

4 (Plaintiffs' Exhibit Number 5069 was admitted
5 into evidence.)

6 MR. BOIES: And we would offer Plaintiffs' Trial
7 Exhibit 2868, which is a transcript of the portions of
8 Mr. Studzinski's deposition that we played during our
9 case, and I believe that this includes both the portions
10 that we designated and the counter-designations of the
11 Defendant.

12 MR. DINTZER: Without having looked at this,
13 Your Honor, we don't have any objection. Because the
14 tape is -- the part for the Plaintiffs is -- has already
15 and our part will be actually played in Court and put on
16 the transcript, it's totally at the Court's pleasure,
17 but this will just duplicate what will ultimately fall
18 into the transcript, as I understand it.

19 MR. BOIES: Is this in the transcript?

20 MR. DINTZER: Yes. So, this will just be played
21 in Court, right, so it will be captured --

22 MR. BOIES: Your Honor, I didn't realize that it
23 had actually been incorporated in the transcript. If it
24 has, we may not need to put this in.

25 MR. DINTZER: When we played it, did the court

1 reporter --

2 THE COURT: Yes, that's what was happening, and
3 I can confirm that.

4 MR. BOIES: So, then, Your Honor, subject to the
5 right to re-offer this at some point if we can think of
6 a reason that we need to, I will withdraw that offer for
7 the present time.

8 THE COURT: All right, very well.

9 MR. BOIES: I would then offer as demonstrative
10 exhibits Plaintiffs' Trial Exhibits 5001, 5004, 5006,
11 5007-A, 5011, 5012, 5100, 5390, and 5391, which are
12 demonstrative exhibits that I prepared on the flip-chart
13 paper and we have reproduced them in all their confusion
14 in small versions.

15 THE COURT: Okay.

16 MR. DINTZER: No objection, Your Honor.

17 THE COURT: All right. The demonstrative
18 exhibits identified by Mr. Boies are admitted.

19 (Plaintiffs' Exhibit Numbers 5001, 5004, 5006,
20 5007-A, 5011, 5012, 5100, 5390, and 5391 were admitted
21 into evidence.)

22 MR. BOIES: With the Court's permission, we will
23 hand up a copy and we will give the Clerk a copy once
24 we've collated them.

25 THE COURT: Sure.

1 MR. BOIES: With that, Your Honor, the
2 Plaintiffs rest.

3 THE COURT: All right. Thank you, Mr. Boies.

4 MR. DINTZER: Your Honor, we're prepared to call
5 our first witness. I don't know if you would rather
6 seat the witness right now or if you would rather --
7 whatever is the Court's pleasure.

8 THE COURT: You know, we are just a short time
9 before our usual lunch break, so maybe we can have a
10 clean break, have lunch now, and start the Defendant's
11 case after lunch.

12 MR. DINTZER: We are fine with that, Your Honor.

13 THE COURT: We will reconvene at 1:30.

14 (Lunch recess, 12:24 p.m. to 1:30 p.m.)

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1 AFTERNOON SESSION

2 (1:30 p.m.)

3 THE COURT: Thank you. Please be seated.

4 MR. DINTZER: Your Honor, for our first witness,
5 the Government calls Jonathan Neuberger, and he will be
6 presented by Ms. Gerber.

7 THE COURT: All right. Please come forward,
8 sir.

9 Whereupon--

10 JONATHAN NEUBERGER

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

13 THE COURT: Thank you. Please be seated.

14 MS. GERBER: Your Honor, I have binders for you
15 and the Clerk. May I approach?

16 THE COURT: Terrific. Yes, please. Thank you.

17 DIRECT EXAMINATION

18 BY MS. GERBER:

19 Q. Good afternoon.

20 A. Good afternoon.

21 Q. Would you please state your name for the record.

22 A. Jonathan Neuberger.

23 Q. And for whom do you work?

24 A. I work for a consulting firm called Economists
25 Incorporated.

1 Q. And how long have you worked for them?

2 A. I have been with Economists, Incorporated for
3 approximately a little over 12 years.

4 Q. And what is your title?

5 A. I hold the title of principal.

6 Q. And what's a principal?

7 A. Well, in my firm -- in some firms, principal
8 denotes an ownership interest in the firm. That's not
9 the case with our firm, but principal is our most senior
10 professional classification or rank.

11 Q. And how long have you been a principal at
12 Economists, Incorporated?

13 A. About seven years.

14 Q. Please briefly summarize your educational
15 background, starting with college.

16 A. Yes. I have an undergraduate degree, a bachelor
17 of science, from Georgetown University School of Foreign
18 Service. I had a concentration or a major in
19 international economics. And then I also have master's
20 and Ph.D. degrees from Johns Hopkins University in
21 economics. My concentrations were finance and macro.

22 Q. And after graduating from Johns Hopkins, where
23 did you go to work?

24 A. After I finished my Ph.D., I went to work at the
25 Federal Reserve Bank of San Francisco as a member of the

1 economic research staff.

2 Q. And what did you do there?

3 A. Like all the economists at the Federal Reserve
4 Bank of San Francisco, I had three broad areas of
5 responsibility. First of all, I conducted research, so
6 I had a number of research projects that I pursued
7 during the years I was there. And then the intention is
8 that research will lead to research articles that are
9 subjected to a rigorous peer review process within the
10 Federal Reserve System, and then they appear in Federal
11 Reserve publications.

12 Secondly, I had policy responsibility to review
13 and conduct antitrust analyses of the competitive
14 consequences of proposed bank mergers and acquisitions.

15 And then thirdly, I gave briefings and talks to
16 our boards of directors and also to outside groups.

17 Q. And when did you leave the San Francisco Fed?

18 A. I left after -- oh, about 6 1/2 years at the
19 Fed, so I left there in 1994.

20 Q. And what have you been doing since you left the
21 Fed?

22 A. For the past 20 years I have worked for a couple
23 of different consulting firms, providing applied
24 microeconomic analysis for clients who consisted of
25 corporations, law firms, and government agencies.

1 Q. And can you tell me in a little more detail some
2 of the types of work you've done over the past 20 years?

3 A. Early on in my consulting career, I did a lot of
4 business planning, strategic planning, valuation work.
5 I helped clients in a broad range of industries deal
6 with any number of economic issues. I helped them to
7 value assets, divisions, activities, risks that they
8 bore, sometimes for purposes of an acquisition,
9 sometimes for purposes of a sale.

10 And I also helped a number of companies,
11 including a number of financial institutions, deal with
12 issues related to risk management, so identifying,
13 measuring, and then helping companies to manage the
14 risks that they faced.

15 Q. And have you also been involved in litigation
16 consulting?

17 A. Yes. For the past 15 years or so, my consulting
18 practice has focused on litigation consulting, so
19 providing applied economic analyses in the context of
20 commercial litigation.

21 Q. And what kinds of litigation cases have you
22 worked on?

23 A. It's spanned a pretty broad range of cases.
24 I've provided economic analysis in breach of contract
25 cases, in fraud cases, in securities cases, tax,

1 intellectual property, antitrust. So, a pretty broad
2 range of cases.

3 Q. About how many such cases have you worked on?

4 A. Over the past 15 years, I'd venture a guess of
5 about a hundred.

6 Q. And have you ever testified?

7 A. I have.

8 Q. About how many times?

9 A. I have written expert reports under my own name
10 probably 50 times. I've been deposed in various
11 proceedings maybe 40 times. And then I've offered trial
12 testimony on a couple of dozen -- I'd say two dozen
13 occasions.

14 Q. And have you ever been qualified as an expert in
15 court?

16 A. I have, yes.

17 Q. Where?

18 A. I've been qualified in federal courts. I've
19 been qualified in state courts. And then I've also been
20 qualified as an economics expert in arbitrations.

21 Q. How about in the Court of Federal Claims?

22 A. Many times, yes.

23 Q. About how many?

24 A. Gosh, I think maybe 15 to 20 of the 25 times
25 I've testified have been in the Court of Federal Claims.

1 Q. And in what areas have you been qualified as an
2 expert?

3 A. It's depended a little bit on the facts and
4 circumstances of the case and the assignment that I was
5 given in each of those cases, and I'll try to recall all
6 of them. I'm not sure it will be exhaustive.

7 I've been qualified as an expert in economics
8 generally, in financial economics, in corporate finance,
9 in economic modeling, in econometrics, in risk
10 management, in the economics of uncertainty. Also, a
11 lot of my testimony -- and I've been qualified as an
12 expert -- in quantifying economic harm, so in assessing
13 and developing damages estimates.

14 Q. Has a court ever concluded you were not
15 qualified as an expert in the areas for which you were
16 offered?

17 A. No.

18 Q. And has your work involved determining
19 appropriate interest rates to use in particular
20 settings?

21 A. Yes. As a financial economist, a lot of my work
22 has dealt with issues related to interest rates. So, in
23 some of the research I've done or some of the work that
24 I've done for consulting clients, I have evaluated
25 changes in interest rates and the effects on companies.

1 A lot of the risk management work that I've done
2 has been related to the impact of changes in interest
3 rates. In the context of other kinds of assignments,
4 valuation work always requires specifying an appropriate
5 interest rate to use to discount future cash flow
6 streams. So, interest rates are relevant there.

7 And then in a lot of my testimony, damages
8 analyses, I've done a lot of work with interest rates.
9 In some cases, involving financial institutions, the
10 damages themselves were related to interest rates. In
11 other cases, I've addressed a variety of issues related
12 to prejudgment interest, which also is about selecting
13 an appropriate interest rate for purposes of assessing
14 prejudgment interest.

15 Q. For about how many of the cases that you've
16 worked on have you presented an opinion relating to
17 prejudgment interest?

18 A. Probably ten, ten to 15.

19 Q. And are you a member of any professional
20 associations?

21 A. Yes. I've been a member for over 30 years of
22 the American Economic Association. I'm an associate
23 member of the American Bar Association. And I also
24 belong to a couple of risk management professional
25 associations.

1 Q. What documents or other materials did you use
2 for the purpose of preparing your testimony today?

3 A. I reviewed the expert reports of Dr. Wazzan,
4 both his original report and his rebuttal report. I
5 reviewed in great detail the spreadsheets and work
6 papers that accompanied those expert reports. I
7 reviewed a number of legal citations and opinions that
8 Dr. Wazzan cited in his reports.

9 I reviewed a number of economics textbooks and
10 finance treatises on the conceptual basis for
11 establishing prejudgment interest and what kinds of
12 things to think about in evaluating prejudgment
13 interest. I looked at some finance textbooks, went back
14 and looked at various treatises in finance on portfolio
15 theory and investment decision-making. And I think
16 that's about it.

17 Q. Were there any documents that you requested from
18 counsel that you did not receive?

19 A. No.

20 Q. And what was your assignment in this case?

21 A. My assignment was twofold. First of all, I was
22 asked to offer an affirmative opinion about the
23 appropriate prejudgment interest rate to be used in this
24 case; and secondly, I was asked to assess, from my
25 perspective as an economist, the approach, method, data,

1 and conclusions that were presented to the Court by
2 Dr. Wazzan.

3 Q. And how would you describe the methodology you
4 used in preparing your testimony?

5 A. I would describe it as application of the
6 fundamentals of economics and finance to the facts and
7 circumstances of the case. For my affirmative opinions,
8 that involved looking at the economic foundation, the
9 economic basis for prejudgment interest, and then using
10 my expertise as an economist to develop an affirmative
11 opinion about which interest rate should be used in this
12 case.

13 For Dr. -- for the part of my analysis, the part
14 of my assignment that was to assess Dr. Wazzan's
15 analysis, I subjected his methodology, his approach, his
16 arguments, his data, and his conclusions to basic
17 fundamental economic principles.

18 Q. And did the application of the methodology
19 you've just described allow you to reach certain
20 conclusions in this case?

21 A. They did, and those conclusions are described in
22 my expert report and are also the subject of my
23 testimony today.

24 MS. GERBER: At this time, Your Honor, I move to
25 have Dr. Neuberger qualified as an expert witness in the

1 area of financial economics, the quantification of
2 economic harm, and the determination of prejudgment
3 interest rates.

4 THE COURT: All right.

5 Any voir dire?

6 MR. DWYER: No voir dire, Your Honor, but his
7 report only involves prejudgment interest, and we would
8 object to the first two categories because he hasn't
9 submitted a report on anything other than prejudgment
10 interest or the critique of Dr. Wazzan.

11 MS. GERBER: May I ask a few questions of the
12 witness, Your Honor?

13 THE COURT: Well, do we need anything more than
14 a prejudgment interest expert?

15 MS. GERBER: I believe Dr. Neuberger has an
16 opinion -- has the opinion that the other areas relate
17 to his opinions that he has set forth in his report.

18 THE COURT: Okay. Give it to me again, the
19 areas that you want?

20 MS. GERBER: Financial economics, the
21 quantification of economic harm, and the determination
22 of prejudgment interest rates.

23 THE COURT: Well, I am going to accept him as an
24 expert, and, Mr. Dwyer, if we get into any areas that
25 you think are inappropriate, you can let us know through

1 an objection.

2 MR. DWYER: That's fine, Your Honor.

3 THE COURT: Okay. Let's go ahead.

4 MS. GERBER: Thank you, Your Honor.

5 BY MS. GERBER:

6 Q. Dr. Neuberger, in front of you you should have a
7 binder. Do you see that?

8 A. I do.

9 Q. And if you open it up, the first two tabs are
10 DX 1880 and 1881. Are these your expert report and the
11 exhibits to your report in this case?

12 A. Yes, that's correct. 1880 is the text of the
13 report, and then 1881 contains the exhibits.

14 Q. And does the report contain the opinions you are
15 prepared to testify about today?

16 A. It does, yes.

17 MS. GERBER: Your Honor, we -- I move to admit
18 DX 1880 and 1881 as expert reports subject to the
19 Court's prior discussion about what that would entail.

20 THE COURT: All right.

21 MR. DWYER: No objection, Your Honor.

22 THE COURT: All right. Defendant's Exhibit 1880
23 and 1881 are admitted as expert reports under the
24 guidelines being followed in this case.

25 MS. GERBER: Thank you.

1 (Defendant's Exhibit Number 1880 was admitted
2 into evidence.)

3 (Defendant's Exhibit Number 1881 was admitted
4 into evidence.)

5 BY MS. GERBER:

6 Q. Dr. Neuberger, have you prepared some
7 demonstrative exhibits to assist your explanation of
8 your testimony today?

9 A. I have, yes.

10 Q. And do your slides include a summary of the
11 opinions you're offering?

12 A. Yes. I have four summary slides that describe
13 the four opinions that I'm presenting today.

14 Q. All right. Let's turn to the first one,
15 DX 2402. Please describe for the Court your first
16 opinion.

17 A. Yes. The beginning -- the starting point for
18 this opinion -- and this is related to my affirmative
19 opinion about the appropriate prejudgment interest
20 rate -- is to consider the role that prejudgment
21 interest plays in a case -- in a takings case like this.
22 And the basic opinion is that prejudgment interest
23 serves the purpose of restoring a successful plaintiff
24 to the economic position it would have occupied had the
25 award been paid on the date of the taking.

1 So, potentially, economic harm in a takings case
2 could comprise two elements. One is the principal
3 damages award, the impact of the taking itself, and the
4 second reflects the economic impact of the delay between
5 the date of the taking and the date an award is made.

6 Prejudgment interest relates to the second of
7 those pieces -- that is to say, the delay in the
8 granting of the award -- and, therefore, that situation,
9 that requirement or that association of prejudgment
10 interest with the delay creates certain or establishes
11 certain economic principles that an appropriate
12 prejudgment interest rate should have.

13 Q. And just to stop you for a moment, are you
14 offering any opinions today about the economic harm
15 caused by any taking itself?

16 A. I am not, but I do recognize that harm could
17 arise from that taking, and I am differentiating or
18 distinguishing that from the economic impact associated
19 with the delay, which is the subject of my testimony,
20 and that is related to prejudgment interest.

21 Q. What, then, are the economic foundations of
22 prejudgment interest?

23 A. Well, since the delay relates to the passage of
24 time in a delayed award, one of the first things that
25 prejudgment interest should, at the most basic level,

1 address is what economists refer to as the time value of
2 money.

3 Q. And what is the time value of money?

4 A. The time value of money reflects the economic
5 proposition that any rational economic actor will prefer
6 an earlier payment of a particular amount of money to a
7 later payment of the same amount of money. The reason
8 is that that person could earn interest in the interim,
9 and we, therefore, must compensate that person for
10 waiting, for the delay, and that -- if you identify an
11 interest rate that will effectively make the person
12 indifferent to the timing of that payment, then you have
13 captured the time value of money.

14 Q. And are there other economic criteria for
15 determining prejudgment interest?

16 A. There are, and that relates primarily to the
17 notion of risk, that prejudgment interest, while it
18 should reflect the time value of money, should also
19 reflect the risks that the Plaintiff bore or that anyone
20 faced, really, during the delay.

21 So, that doesn't mean that you pile every risk
22 or capture every risk that could have existed between
23 two dates, but rather, the risks that were associated
24 with the delay itself; the risks that were specific to
25 the delay itself.

1 So, in that regard, prejudgment interest should
2 reflect the risks that were associated with that delayed
3 award. That's the second bullet point that I have here.

4 Q. And what about the third and fourth bullet
5 points?

6 A. Sure. I think the basic requirement or the
7 basic economic foundation for prejudgment interest leads
8 to a couple of other desirable characteristics that an
9 economically supportable prejudgment interest rate
10 should have. On the one hand, the prejudgment interest
11 rate should always preserve the principal award, right?
12 We're talking about delayed payment. That's separate
13 from the harm that arose from the taking, and as a
14 general or a practical rule, a sound prejudgment
15 interest rate should never reduce the principal award
16 but should always augment it. It should always preserve
17 it and then add to it.

18 So, in short, what that means is the prejudgment
19 interest rate, in whatever method you use to derive it,
20 should always produce positive numbers. It should
21 always be a positive interest rate.

22 Secondly -- and this kind of follows from the
23 previous one -- with a positive prejudgment interest
24 rate, the longer the delay, the more prejudgment
25 interest you will assess on a given award. So, longer

1 delay, you make someone wait longer, you pay them more.
2 You compensate them more for the longer delay.

3 Q. Thank you, Dr. Neuberger.

4 Let's move to your second opinion and DX 2403.
5 Would you please state your second opinion for the
6 Court.

7 A. Yes. And this relates specifically to my
8 affirmative opinion about the appropriate prejudgment
9 interest rate here, and this is also somewhat related to
10 the notion of risk. Now, the taking may have deprived
11 the Plaintiffs, the class members in this case, of the
12 value of the taken asset, but once that taking occurred,
13 Plaintiffs were relieved by the taking of any risks
14 associated with that asset.

15 So, AIG's stock, which as I understand it was
16 the taken asset or at least the allegedly taken asset
17 here, AIG's stock was risky. Anyone who held that stock
18 faced the probability or the possibility that the value
19 of that stock could increase or the value of that stock
20 could decrease, and, in fact, that's exactly what
21 happened in the period leading up to the first taking.

22 So, once the Plaintiff or the Plaintiffs have
23 been relieved of the risks associated with holding AIG's
24 stock, which happened after the taking, then an
25 assessment of the risks that Plaintiffs actually faced

1 during the delay leads me to the conclusion that they
2 actually faced no risk. The only risk that really was
3 specific to the delay was whether the Federal Government
4 would pay an award granted by the Court, and I think --
5 I doubt that anyone in the room would suggest that the
6 Government wouldn't pay an award.

7 So, in that regard, there's no payment risk;
8 there's no risk associated with the taken asset. The
9 only thing left is the time value of money, and the time
10 value of money is measured by a risk-free rate of
11 return, and in my view, an interest rate equal to the
12 risk-free rate of return is the appropriate economically
13 supportable prejudgment interest rate in this case.

14 Q. And just to clarify the record, you have
15 mentioned the taking or the alleged taking. Are you
16 offering any opinion about whether there has been a
17 taking in this case?

18 A. I am not. It's my understanding that a damages
19 award or a granting of prejudgment interest would only
20 arise if liability is established and the Court
21 determines that a taking actually occurred. So,
22 effectively, for my analysis, I simply assumed that the
23 taking occurred, and now I'm looking at, well, how do
24 you quantify prejudgment interest? What prejudgment
25 interest rate should apply, assuming a taking has

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1 occurred?

2 Q. Thank you.

3 Now, you mentioned the risk-free rate of return.
4 Does a security exist that gives a risk-free rate of
5 return?

6 A. There's probably no perfect risk-free security.
7 The risk-free rate of return is an economic concept, and
8 there's probably no perfect risk-free security; however,
9 economists typically quantify or proxy for a risk-free
10 rate of return by referring to the interest rates on
11 short-term government securities.

12 For this case, I've determined that the best
13 proxy among short-term government securities for a
14 risk-free return is the one-year Treasury bill rate, or
15 T-bill rate, and that's the recommendation that I've
16 made here. I think the risk-free rate of return is the
17 appropriate prejudgment interest rate and is best
18 proxied by a one-year T-bill rate.

19 Q. Now, you also on your demonstrative have listed
20 the five-year TIPS. What are TIPS?

21 A. TIPS refers to Treasury Inflation Protected
22 Securities, and they are relatively short -- well, there
23 is different maturities, but they are government bonds,
24 so they have the full faith and credit of the
25 Government. They are potentially, anyway, default

1 risk-free. There is really very little risk associated
2 with a TIPS.

3 But the TIPS also include an explicit
4 compensation for inflation. So, if the concern is that
5 the one-year Treasury bill rate doesn't have an explicit
6 compensation for inflation, I offer the TIPS rate as an
7 alternative to provide that explicit compensation.

8 Q. And do you have an opinion about which rate, the
9 one-year Treasury bill or the five-year TIPS, is more
10 appropriate in this case?

11 A. They actually serve different purposes. I think
12 they're both free of any default risk. I think as a
13 proxy for the risk-free rate of return, the one-year
14 Treasury bill rate is the right rate. But, again, if
15 the Court determines that compensation should be
16 provided explicitly for inflation, then the five-year
17 TIPS provides that explicit compensation.

18 Q. Thank you.

19 Let's now move to your third opinion in DX 2404.
20 Would you please describe your third opinion to the
21 Court.

22 A. Yes. The third opinion is the first part of my
23 assessment of Dr. Wazzan's analysis, and in my view, the
24 methodology that he has proposed is economically unsound
25 because it violates all of the basic precepts for an

1 appropriate prejudgment interest rate.

2 Dr. Wazzan looks at stock returns on
3 hypothetical portfolios that the Plaintiffs never
4 actually held, and returns on those stock portfolios
5 don't measure the time value of money, so they violate
6 the basic premise of prejudgment interest in the first
7 place.

8 There's been some references to opportunity
9 cost. Stock returns don't measure opportunity cost.
10 They don't reflect risks that were specific to the
11 delay. They present a whole different set of risks that
12 were unrelated to the delay and don't belong in
13 prejudgment interest rates.

14 Finally, the last two items there, stock returns
15 could be positive or negative. They may not preserve
16 the principal of the award under certain circumstances,
17 and they may not yield prejudgment interest rates or
18 prejudgment interest that is longer for a longer delay.

19 So, at a very basic level, Dr. Wazzan's
20 methodology simply violates all of the basic premises
21 for prejudgment interest and I believe is economically
22 unsound.

23 Q. And now let's turn to your fourth opinion, and
24 if you would turn to DX 2405. Dr. Neuberger, would you
25 please summarize your fourth opinion for the Court.

1 A. Yes. Dr. Wazzan has a -- has proposed an
2 approach that makes certain assumptions, what I believe
3 are speculative assumptions, about what class members,
4 Plaintiffs, would have done in the post-takings period.
5 He is using the returns on hypothetical investments to
6 suggest a particular set of prejudgment interest rates.

7 In my view, that notion of identifying lost
8 investment returns is only feasible, is only capable of
9 producing a realistic or reliable result if it's done on
10 a Plaintiff-by-Plaintiff, class member-by-class member
11 basis. Simply identifying a single hypothetical
12 portfolio that nobody ever owned and saying that that
13 somehow represents what a very diverse group of
14 Plaintiffs would have invested in ignores all of the
15 diversity in the classes, it ignores what economists
16 call heterogeneity, that is to say, different beliefs
17 and different attitudes about risk, different objectives
18 in investments, and as a consequence, I think the only
19 reliable way to carry out a lost investment returns
20 approach, should the Court adopt that approach, I think
21 is on a Plaintiff-by-Plaintiff basis.

22 I think that's the only way to make Dr. Wazzan's
23 methodology workable, and I think in this case it would
24 be a horrifically complicated and costly endeavor. So,
25 I think the methodology, as Dr. Wazzan has proposed it,

1 is not workable. I think it has to be done on a
2 Plaintiff-by-Plaintiff basis.

3 Q. Thank you, Dr. Neuberger.

4 I'd like to break down these opinions in just a
5 little more detail, and if you would please turn to
6 2406, which is about your first opinion. Would you
7 please explain the purpose of prejudgment interest and
8 the juxtaposition that it appears you are making in this
9 slide.

10 A. Sure. In thinking about economic damages or
11 economic harm, I think it's important to recognize that
12 there are potentially two sources of economic harm here
13 from the takings: those related to the takings itself
14 and those related to the delay in the payment.

15 As I understand it, the damages or the principal
16 damages amount is assessed as of the date of the taking
17 itself. So, you identify harm, you identify damages
18 based on what -- some valuation or some -- some
19 methodology as of the date of the taking, and then carry
20 that amount forward because there's a delay between when
21 the taking occurred and when the award is ultimately
22 made.

23 Prejudgment interest only applies to the second
24 of those pieces, to the delay, and, therefore, we have
25 to look at that delay and assess what interest rate

1 properly measures the effect of the delay. In that
2 regard, economists have a conceptual idea of the cost of
3 a delay or the cost of the passage of time, and that, as
4 I mentioned, is the time value of money. So, at a very
5 basic level, prejudgment interest should reflect and
6 compensate for the time value of money.

7 Ultimately, I think, as the economic basis,
8 prejudgment interest should be set at a level that makes
9 the Plaintiff indifferent to the actual timing of the
10 award, whether it's a month after the taking or six
11 years after the taking. Prejudgment interest should be
12 such that it makes the Plaintiff indifferent.

13 Q. And how do you determine what interest rate will
14 make people indifferent to the timing of the award?

15 A. Well, economics tells us a little bit about
16 that. So, there are treatises and there's discussion of
17 the time value of money and what interest rate reflects
18 that time value of money, but an important consideration
19 is risk. Any interest rate includes a component that is
20 what's called a risk-free rate of return plus a risk
21 premium.

22 So, in order to get someone to buy or hold a
23 particular bond or a particular security that pays
24 interest, you have to compensate them not only for the
25 passage of time but also for the risks that they bear,

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1 and those risks could be in many different forms;
2 default risk, interest rate risk, et cetera. So,
3 bringing in the concept of risk, we have to assess what
4 risks were imposed on the Plaintiffs by the delayed
5 award, and that's a very specific inquiry.

6 Q. Should there always be some compensation for
7 risk?

8 A. Not necessarily. If, in fact, the Plaintiff --
9 the Plaintiffs faced no risk during the period of the
10 delay, then there shouldn't be necessarily a risk
11 premium associated with the prejudgment interest rate.
12 If Plaintiffs were, indeed, relieved of all the relevant
13 risks, then I think a risk-free rate of return would be
14 appropriate.

15 Now, in the context of a taking and a delayed
16 award, there is some risk, probably somewhat greater
17 than zero -- although in this case I didn't think very
18 much greater than zero -- that the Plaintiff or that the
19 Defendant wouldn't pay. In private litigation, there is
20 always the possibility that a Defendant might not pay.
21 Here, I don't think that probability or possibility is
22 very great.

23 So, during the delay, if there are no risks
24 associated with the taken asset, then what are you left
25 with? Well, some infinitesimally small payment risk,

1 and really those are the only things that a proper
2 prejudgment interest rate in this case should represent,
3 the passage of time, the time value of money, and some
4 very small risk premium associated with nonpayment.

5 Q. And actually, if you would turn to DX 2407, does
6 that summarize what -- the conversation we just had?

7 A. It does. It establishes the notion that, yes,
8 Plaintiffs held a risky asset at the time of the taking,
9 but the taking relieved them of those risks. So,
10 whatever happened to AIG after the taking, the
11 Plaintiffs weren't exposed to that risk. So, what other
12 risks are left over?

13 Well, there's the small -- the small amount of
14 risk that the Defendant doesn't pay. You don't
15 compensate Plaintiffs, as a basic economic matter, for
16 risks they didn't bear. So, really we want to look for
17 an interest rate that reflects the risks that were
18 imposed by the delayed payment.

19 Q. I want to go back to this idea of making
20 Plaintiffs indifferent to the timing of the award, and
21 with that in mind, would you please turn to DX 2408.
22 Would the interest rate that accomplishes this be
23 different for every member of the class?

24 A. I don't think it should. If an award had been
25 made on the date of the taking, I think it's

1 uncontroversial, I think it's obvious that different
2 Plaintiffs would have done different things with the
3 money.

4 Some of the Plaintiffs would have probably put
5 the money back into AIG after the taking and once an
6 award had been made. Some of them may have chosen other
7 assets to invest in. A very risk-averse investor might
8 choose only a very safe investment. Someone more
9 tolerant of risk or willing to bear risk would invest in
10 riskier assets. I can even envision some Plaintiffs,
11 very risk-loving, taking an award and going to Las Vegas
12 and investing the proceeds at the roulette table.

13 But all of those choices are individual choices
14 that are unrelated to the risk that was imposed by the
15 taking and the delayed award. Those are individual
16 investment decisions. They aren't reflective of the
17 risks that the Plaintiffs faced because of the delayed
18 award. So, they're really irrelevant.

19 In contrast, if you look at the economic
20 situation that every Plaintiff was put in by the delayed
21 award, you can see that the duration of the delay will
22 be the same for everybody; the risks that the Plaintiffs
23 faced during that delay period will be the same.
24 Therefore, a single rate of return is appropriate for
25 every single Plaintiff because that reflects the same

1 conditions and risks that were imposed on the Plaintiffs
2 by the delay.

3 Q. Thank you, Dr. Neuberger.

4 Let's now turn to your second opinion, which is
5 at the top of DX 2409. Based on your assessment of the
6 economics of prejudgment interest, what rate do you
7 think should be used in this case?

8 A. After assessing the economic conditions of the
9 delay, it is my view that an interest rate equal to the
10 risk-free rate of return provides exactly the
11 appropriate compensation for the delayed award. The
12 risk-free rate of return is desirable. It's
13 economically supportable because it satisfies all of the
14 economic requirements for an appropriate prejudgment
15 interest rate. It has an explicit compensation for the
16 time value of money.

17 It doesn't compensate for risks that Plaintiffs
18 did not bear or were relieved of during the delay. It's
19 equally applicable to every member of the class. It's
20 not dependent on individual decisions, investment
21 decisions, or attitudes about risk. And as a result, I
22 think based on the conditions that were imposed by this
23 delay, the risk-free rate of return is the appropriate
24 prejudgment interest rate.

25 Q. Now, the last bullet point on this slide says,

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1 "It is not a measure of lost profits which do not belong
2 in prejudgment interest."

3 What do you mean by that?

4 A. That's a glancing reference, if you will, to
5 Dr. Wazzan's methodology in which purportedly foregone
6 investment returns are used as the basis for setting his
7 prejudgment interest rates. I think that's economically
8 incorrect.

9 Lost profits don't belong in prejudgment
10 interest. Prejudgment interest is compensation for a
11 delay in a payment. It's not an opportunity to capture
12 other profits or other lost investment returns that
13 could have been made but, in fact, weren't made.

14 Q. Now, let's turn to DX 2410. And why do returns
15 on hypothetical investments not belong in prejudgment
16 interest?

17 A. Well, I think in order to make the assertion
18 that hypothetical -- returns -- investment returns on
19 hypothetical portfolios of assets are relevant to
20 prejudgment interest, I think there's just a pile of
21 speculation that has to go on, that has to be made in
22 order to lead to any conclusion with respect to lost
23 investment returns.

24 To the extent that the forgone investments were
25 risky assets, they include risk premia that were

1 unrelated to the delay. So, you're providing
2 Plaintiffs -- by giving them lost investment returns,
3 you're providing them with compensation for risks they
4 never actually had to bear.

5 Moreover, referencing risky asset returns after
6 the fact, risky asset returns can be anything. They can
7 be positive, they can be negative over relevant periods
8 of time. So, a reliance on lost investment returns
9 won't satisfy the requirement that prejudgment interest
10 is positive and produces longer -- produces more
11 prejudgment interest for longer delays.

12 So, in my view, lost investment returns are
13 simply lost profits. They are calculated with the
14 benefit of hindsight. We're doing this after the fact
15 and looking back. I mean, that --

16 Q. How -- I'm sorry. How does that affect your
17 analysis?

18 A. Well, it gives Plaintiffs an opportunity -- it
19 creates some perverse incentives and gives Plaintiffs an
20 opportunity to pick a portfolio of assets that, in
21 retrospect, has the highest rate of return, and that's
22 not really -- you are not supposed to cherry-pick a
23 hypothetical investment and add it to a damages claim
24 through prejudgment interest. That's not the purpose of
25 prejudgment interest. So, in my view, lost profits,

1 lost investment returns, that's something different.
2 It's not prejudgment interest.

3 Q. Now, you've recommended a risk-free rate of
4 return as the economically correct prejudgment interest
5 rate. Is that right?

6 A. That's correct.

7 Q. So, is there a risk-free security that can be
8 used to set the rate?

9 A. Again, there is no perfect risk-free security,
10 but I think if you look at the next slide --

11 Q. Yes, let's do that. DX 2411.

12 A. Okay. And as I've noted here, yes, the
13 risk-free rate of return, I believe, is the economically
14 appropriate prejudgment interest rate, and economists
15 typically proxy for a risk-free rate of return through
16 short-term government securities.

17 And I've identified the one-year Treasury bill
18 rate as an appropriate proxy. It's sold on a discounted
19 basis, so you know exactly what you're going to earn
20 when you buy it. It's a -- excuse me, a short enough
21 term that you're not really subject to much interest
22 rate risk. The one-year Treasury bill rate is a very
23 good proxy.

24 Q. And what was the one-year Treasury bill rate for
25 the alleged takings in this case?

1 A. Well, in the period following the two takings,
2 one-year Treasury bills averaged 0.5 percent per year
3 after the first taking and 0.3 percent per year after
4 the second taking.

5 Q. And, again, you've referred to the TIPS on this
6 slide. Why do you refer to that security, again?

7 A. Again, I understand that interest rates on --
8 that interest rates generally, but especially short-term
9 interest rates and interest rates on government
10 securities, have been relatively low over the last
11 several years. That's a consequence of supply and
12 demand factors in competitive bond markets. So, there's
13 nothing nefarious about low interest rates. They've
14 just been very low.

15 And I recognize that those low interest rates
16 have actually been below the rate of inflation that
17 we've experienced since the takings, in the post-takings
18 era. So, if the Court feels that those rates don't
19 provide compensation for the actual inflation that has
20 occurred in the post-takings era, then I've offered the
21 TIPS rate, the five-year TIPS, as an alternative.

22 Q. And what were the five-year TIPS after the
23 alleged takings?

24 A. As I show on the slide here, the five-year TIPS
25 have averaged 2.9 percent per year after the first

1 taking and 3.2 percent per year after the second taking.
2 And, again, that's a -- that includes a specific or
3 explicit return for experienced actual inflation.

4 Q. Thank you, Dr. Neuberger.

5 At this time, I would like to turn to your
6 second two opinions, your opinions regarding and
7 responding to Dr. Wazzan.

8 First, can you quickly summarize Dr. Wazzan's
9 approach?

10 A. Yes. Dr. Wazzan identifies hypothetical
11 portfolios of stocks that he asserts were similar to AIG
12 as of the date of the takings. He then computes actual
13 realized returns, investment returns, on those
14 portfolios and suggests or asserts, concludes that those
15 returns should be used to generate prejudgment interest
16 in this case.

17 Q. So, let's turn to DX 2412, and what is your
18 third opinion in this case?

19 A. Well, it's a general assessment of Dr. Wazzan's
20 methodology, this notion that forgone investment returns
21 or really stock returns should be the basis for
22 prejudgment interest. As I mentioned in my summary,
23 that approach, that methodology violates every precept
24 or every purpose or every economic purpose that
25 prejudgment interest is intended to serve.

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1 Stock returns on hypothetical portfolios that
2 weren't owned by any of the Plaintiffs are totally
3 unrelated to the time value of money. They don't
4 measure the passage of time. They also don't reflect
5 the risks that the Plaintiffs had to bear during the
6 delay.

7 They reflect instead risks specific to stocks
8 and risks specific to the particular stocks that are
9 included in those portfolios. So, there are risk premia
10 in investment returns. Investors invest in risky assets
11 expecting to be compensated for bearing those risks, but
12 the returns on Dr. Wazzan's hypothetical portfolios are
13 unrelated to the risks that were imposed by the delay.
14 So, they are improper from that perspective.

15 Stock returns can be negative over substantial
16 periods of time, certainly on small portfolios of
17 stocks, and, in fact, they were negative during the
18 post-taking period for much of the post-taking period.
19 So, stock returns could be negative and they could --
20 that could lead to a prediction of negative prejudgment
21 interest rates that would reduce a principal award,
22 damages award. That's not consistent with the economic
23 purpose of prejudgment interest.

24 And stock returns are somewhat volatile.
25 They're arbitrary. There's no requirement that a stock

1 return over a longer period of time would necessarily be
2 greater than a stock return over a shorter period of
3 time. So, you could have -- you could violate the last
4 precept here that you should have more prejudgment
5 interest per dollar of award for a longer delay, and, in
6 fact, Dr. Wazzan's proposed rates show exactly that.

7 The rate that he recommends for the second
8 taking is three times larger than the rate he recommends
9 for the first taking. It makes no economic sense when
10 you think about the purpose of prejudgment interest.

11 Q. And have you analyzed what the prejudgment
12 interest rate Dr. Wazzan's approach would yield if a
13 trial and an award had occurred earlier than now or
14 around now?

15 A. Well, if the trial had occurred any time before
16 early 2013, Dr. Wazzan's approach would yield negative
17 prejudgment interest rates for both takings.

18 Q. And what, if anything, does that indicate about
19 whether Dr. Wazzan's methodology would make a Plaintiff
20 indifferent to the timing of the award?

21 A. I can't imagine a Plaintiff accepting a negative
22 prejudgment interest rate and having that prejudgment
23 interest rate used to reduce the damages award.

24 Q. And what incentives do you see that Dr. Wazzan's
25 methodology creates for a Plaintiff?

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1 A. Well, I talked a little bit about perverse
2 incentives. I think, you know, since you -- damages
3 analysis and prejudgment interest and analysis, by
4 definition, is done retrospectively, it's done after the
5 fact, that gives the Plaintiff the opportunity to look
6 and see, identify a portfolio that produces a nice
7 positive return, and it would produce that return, and
8 then you go to trial and you would know with certainty
9 that if you win, you would get a prejudgment interest
10 rate that was significantly positive.

11 So, I think there are some real perverse
12 incentives associated with litigation where you're
13 retroactively or retrospectively picking a portfolio
14 that could yield a very high interest rate, and that
15 would lead a plaintiff or create incentives for
16 plaintiffs to draw out litigation, make it longer, so
17 that you can apply that certain very high risky return
18 to a longer period of time.

19 Q. Let's turn to -- what, if anything -- I'm sorry.
20 Let's turn to a different topic.

21 Are you familiar with the concept of opportunity
22 cost?

23 A. I am, yes.

24 Q. And what is opportunity cost?

25 A. Opportunity cost is an economic concept that

1 basically reflects the cost of an alternative action.
2 So, for example, if you're given two investment choices,
3 the opportunity cost of each one is the cost or the
4 value of the other one. So it's an alternative course
5 of action. What would that cost? What would that be
6 worth?

7 Ideally, you want to pick the investment that
8 has the highest value and, therefore, earn more than the
9 opportunity cost. But opportunity cost is just a
10 concept -- an economic concept that reflects the cost
11 associated with some alternative course of action.

12 Q. And are you aware that Dr. Wazzan has asserted
13 that prejudgment interest rates should reflect both the
14 time value of money and Plaintiffs' opportunity cost?

15 A. I am aware that he has made that assertion, yes.

16 Q. And did you create slides summarizing your
17 response to Dr. Wazzan's assertion?

18 A. Yes. And that's the next slide, which is 2413.

19 Q. Yes. Let's turn there.

20 A. Okay.

21 Q. And please explain your response to the
22 assertion that prejudgment interest rates should reflect
23 Plaintiffs' opportunity cost.

24 A. Well, I have a couple of responses to that
25 assertion by Dr. Wazzan. First of all, his lost returns

1 or lost investment returns approach is inconsistent with
2 that assertion. Investment returns do not measure
3 opportunity cost. Opportunity cost is a concept that is
4 measured by, in this context, a Plaintiff's cost of
5 funds; so, how much would it have cost them to raise
6 funds to make an alternative investment. It's not
7 measured by the returns on investments that could have
8 been made by some Plaintiffs but weren't really made by
9 any of the Plaintiffs.

10 So, first of all -- now, if opportunity cost is
11 supposed to be included in a prejudgment interest rate,
12 Dr. Wazzan hasn't captured it, because lost investment
13 returns don't measure opportunity cost.

14 Q. And you have some other bullet points here.
15 What other additional responses do you have to
16 Dr. Wazzan's approach?

17 A. Well, if we want to consider Plaintiffs' lost
18 opportunity cost or opportunity cost more generally, I'm
19 led to the conclusion that given the diversity, the
20 heterogeneity in the classes in this case, every
21 Plaintiff is going to have a different cost of funds.
22 So, opportunity cost is measured by cost of funds.

23 We have individuals, we have hedge funds, we
24 have professional investment managers, we have pension
25 funds. Every single one of those Plaintiffs would face

1 a different cost of funds.

2 So, if we pursue opportunity cost or if the
3 Court decides to pursue opportunity cost as the basis
4 for prejudgment interest, it must do so on a
5 Plaintiff-by- Plaintiff basis. Again, costly
6 proposition, difficult to do, but that's really the only
7 way to apply opportunity cost.

8 Q. And are you aware if Dr. Wazzan has investigated
9 individual Plaintiffs' opportunity costs?

10 A. I reviewed the transcript from his testimony,
11 and he indicated that he didn't know anything about the
12 individual Plaintiffs, that he hadn't investigated their
13 cost of funds or much of anything else about those
14 Plaintiffs.

15 Q. Thank you, Dr. Neuberger.

16 Let's turn to DX 2414. Now, in one of your
17 earlier slides, you had a statement to the effect that
18 using a risk-free rate of return for prejudgment
19 interest was not a lost profit analysis, and I believe
20 you testified that this was a glancing reference to
21 Dr. Wazzan.

22 How is that earlier statement relevant to your
23 third opinion?

24 A. If that was the glancing statement, this is the
25 more direct one, I guess. So, Dr. Wazzan's approach is

1 to add purportedly lost investment returns to a damages
2 award and award both to the Plaintiff, but adding lost
3 investment returns during the post-takings period is
4 essentially shifting the goal post and computing damages
5 as of the date of the award.

6 The damages award itself, the principal award,
7 would reflect pretaking value, and then by calculating
8 investment returns on assets that were purportedly
9 similar to AIG as of the taking is essentially giving
10 them post-takings lost profits.

11 So, now we have an award that doesn't coincide
12 with what I understand to be the standard and the
13 economic standard for damages in a case like this, which
14 is to compute the damage to the principal award as of
15 the date of the taking and then add to it prejudgment
16 interest at an appropriate interest rate. Dr. Wazzan's
17 approach essentially takes the damages analysis, brings
18 it to the current date or to the award date, and then
19 adds pre- and post-taking profits.

20 Q. Now, you just said that Dr. Wazzan's approach
21 essentially takes a damage analysis and brings it to the
22 award date. Are you aware that Dr. Wazzan's approach
23 doesn't assume that AIG stockholders continued to hold
24 AIG stock but instead held portfolios of other stock?

25 A. I understand that rather than looking at returns

1 on AIG, which Dr. Wazzan said was not somehow
2 appropriate, that it was changed, it was managed
3 differently after the takings, he has identified
4 different investments that he claims are purportedly
5 similar to AIG as of the takings dates, and he measures
6 his prejudgment interest rates and effectively lost
7 profits on those other investments.

8 Q. And have you compared Dr. Wazzan's portfolios to
9 what actually happened to AIG's stock?

10 A. Yes. I believe in my report I had a couple of
11 slides that did just that.

12 Q. And let's turn to that, actually. If you can
13 turn to DX 1881, Exhibit 5 of your report. And if you
14 could just explain briefly for the Court what this graph
15 represents.

16 A. Yes. This -- this graph shows daily stock
17 prices for AIG and for several of the portfolios --
18 perhaps all of them, I'm not sure -- that Dr. Wazzan has
19 proposed as hypothetical proxies for AIG. When I
20 produced this slide, I thought the colors were a lot
21 more differentiable, so it's a little hard to see.

22 But the light blue line, which is high on the
23 left side and very low on the right side, is AIG's stock
24 price; and then the others, the green ones and kind of
25 the purple ones, the brown one, are all the hypothetical

1 portfolios that Dr. Wazzan has proposed, one of which is
2 his recommended one.

3 Q. And just to orient us a little bit, where do the
4 two alleged takings fall on this graph?

5 A. Right. The first taking corresponds to the
6 second thick vertical line, so that line is drawn in
7 September 2008; and then approximately halfway between
8 the hash mark for 2009 -- early 2009 and early 2010
9 would be the second taking.

10 Q. And looking at the right-hand side of the graph
11 after the first taking, what, if anything, does the
12 comparison between AIG's stock price and the indices
13 indicate to you about Dr. Wazzan's approach?

14 A. Well, Dr. Wazzan purports to identify portfolios
15 of stocks that were very similar to AIG, but they don't
16 act similar in the post-takings period. AIG's stock
17 declined rather dramatically prior to the first taking,
18 and it has stayed down at those low levels ever since.

19 In contrast, the other portfolios, after kind of
20 bouncing around for a while, have increased pretty
21 dramatically for the last couple of years.

22 Q. Let's turn back to DX 2414. I think we stopped
23 in the middle there.

24 In your second bullet point, you've referred to
25 an assertion by Dr. Wazzan. Can you please describe

1 that assertion?

2 A. Yes. I reviewed Dr. Wazzan's -- the transcripts
3 from Dr. Wazzan's testimony, and he asserted that -- he
4 acknowledged that his methodology could produce negative
5 prejudgment interest rates, negative rates of return,
6 that's always a possibility with risky assets, but that
7 if his methodology produced those returns in a
8 particular instance, that they should be ignored.

9 So, under certain circumstances that are
10 beneficial to Plaintiffs, Dr. Wazzan says to the Court,
11 "Use my methodology," but under other circumstances
12 which are not so beneficial to Plaintiffs, he says, "Oh,
13 ignore my methodology and just cut off prejudgment
14 interest at zero."

15 Q. And what is your response to Dr. Wazzan's
16 assertion?

17 A. I found that testimony to be astonishing.

18 Q. How so?

19 A. It has no economic basis whatsoever. It is
20 perfectly arbitrary, and it is a rather bald admission
21 that his methodology is perfectly capable of producing
22 nonsensical results that the Court should ignore. I
23 think that was the -- perhaps the strongest indictment
24 of his methodology that anyone could make.

25 So, use it under the best circumstances, ignore

1 it under all of the other circumstances that aren't
2 beneficial to my clients, and somehow that's supposed to
3 be a reliable methodology. I think Dr. Wazzan has
4 effectively admitted that it isn't.

5 Q. And in your opinion, does Dr. Wazzan's
6 methodology overcompensate, undercompensate, have no
7 effect on compensation for Plaintiffs' actual risks and
8 injuries during the prejudgment period?

9 A. I would say --

10 MR. DWYER: Objection, Your Honor. I think
11 that's both leading and -- and it kind of
12 mischaracterizes Dr. Wazzan's testimony.

13 MS. GERBER: I agree.

14 THE COURT: Let's try again.

15 MS. GERBER: Yes, let's.

16 BY MS. GERBER:

17 Q. How, in your opinion, does Dr. Wazzan's -- does
18 Dr. Wazzan's suggestion to cut off the prejudgment
19 interest at zero affect how the Plaintiffs are
20 compensated?

21 A. It's effectively an artificial truncation of the
22 distribution of possible outcomes. So, you have some
23 distribution of outcomes -- positive, negative, right?
24 We're dealing with risky assets. By artificially
25 truncating that distribution, you're almost assuring a

1 windfall to Plaintiffs. You will never pick a
2 prejudgment interest rate that is below the proper rate,
3 here a risk-free rate of return. Under many
4 circumstances, you will pick a prejudgment interest rate
5 that exceeds the proper prejudgment interest rate,
6 risk-free rate here.

7 So, on average and probability weighted, I would
8 have to conclude that his -- his proposal to
9 artificially truncate the distribution of outcomes from
10 his methodology leads to a windfall for Plaintiffs.

11 Q. Now, let's move to your fourth opinion, and with
12 that in mind, let's turn to DX 2415.

13 Could you please restate your fourth opinion for
14 the Court.

15 MR. DWYER: Your Honor, I -- I don't know that
16 it's a proper question to ask an expert witness to
17 restate his opinion. I think there might be a --
18 it's -- if the examiner's trying to get at something in
19 particular, okay, but otherwise, I think that would call
20 for an asked and answered objection.

21 MS. GERBER: I was just seeking to remind the
22 Court where we were with the fourth opinion.

23 THE COURT: Yes, that's -- you can ask the next
24 question, then, because we're at opinion four.

25 MS. GERBER: All right. Okay.

1 BY MS. GERBER:

2 Q. Dr. Neuberger, would you please explain why you
3 believe Dr. Wazzan's approach requires a Plaintiff-by-
4 Plaintiff analysis.

5 A. As I've explained, Dr. Wazzan's approach makes
6 certain assumptions about post-taking investment
7 decisions by the Plaintiffs, but Dr. Wazzan hasn't
8 evaluated what the Plaintiffs would actually have done.
9 He has instead created, based on speculation,
10 speculative assumptions, a unique single portfolio of
11 assets that he asserts is somehow relevant in this case.

12 But investment decisions are personal.
13 Investment decisions depend, at least in part, on
14 individual characteristics, including attitudes toward
15 risk, investment horizon, age, investment objectives,
16 all sorts of factors that are relevant to what you
17 invest in, when you invest in it, how long you hold that
18 investment, and when do you change that investment.

19 Dr. Wazzan has done none of the analysis
20 required to actually address Plaintiffs' post-takings
21 investment decisions. He has not investigated any of
22 the characteristics that would lead every Plaintiff to
23 do something different. If, in fact, the Court
24 determines that post-takings investment returns are
25 somehow relevant to prejudgment interest, then this must

1 be done on a Plaintiff-by-Plaintiff basis, because every
2 Plaintiff will act differently and will respond
3 according to their own specific characteristics.

4 Really, Dr. Wazzan can't show that any of the
5 Plaintiffs would have held the portfolio that he
6 recommends, much less that all of them would have held
7 it.

8 Q. Now, is it your understanding that Dr. Wazzan
9 testified that economic theory did support his approach?

10 A. He did testify to that regard, yes, specifically
11 with regard to modern portfolio theory.

12 Q. And let's turn to DX 2416. How does
13 Dr. Wazzan's approach violate modern portfolio theory?

14 A. Well, modern portfolio theory basically, for the
15 last 50 years, has governed the way we think about
16 investment decisions. Modern portfolio theory talks
17 about how an investor seeks to find an optimal --
18 so-called optimal or efficient portfolio. That means
19 that they invest in a portfolio of assets that yields
20 the highest return for a given level of risk or the
21 highest -- or, sorry, the lowest risk for a given level
22 of expected return.

23 Modern portfolio theory makes a number of
24 predictions that are consistent with what we observe
25 with investor behavior; namely, asset selection,

1 diversification, a number of other factors, rebalancing
2 of portfolios, and the like. So, modern portfolio
3 theory is a legitimate theory. It has governed the
4 economics of investments and finance for the better part
5 of 50 years, but it has some specific characteristics as
6 well or some specific recommendations or predictions.

7 One of those predictions is that investment
8 decisions are based on individual characteristics. The
9 optimal portfolio for one person isn't the same as the
10 optimal portfolio for another person. And yet Dr. --
11 under Dr. Wazzan's approach, every Plaintiff is somehow
12 assumed to buy the same set of assets and hold them
13 virtually indefinitely. That's not consistent with
14 modern portfolio theory.

15 Just because somebody held AIG as of the date of
16 the taking doesn't mean they would necessarily hold
17 something that maybe looked like AIG at that time in
18 perpetuity. That's simply not what modern portfolio
19 theory says. So, in that regard, Dr. Wazzan's
20 prediction or reliance on a single hypothetical
21 portfolio is inconsistent with the theory.

22 The other element is dynamics. Modern portfolio
23 theory predicts investor behavior in an environment of
24 uncertainty. Uncertain conditions change all the time.
25 As those conditions change, modern portfolio theory says

1 optimal portfolios change. People change based on what
2 they perceive in the market. They change based on
3 market performance. They change not only on the
4 performance of the assets in a part of their portfolio,
5 they change based on the performance of every asset in
6 the market. People's attitudes change over time.

7 We're talking about a period of time that was
8 characterized by a great deal of volatility. There was
9 tremendous uncertainty in the market. People changed
10 their investment behavior. But that's not what
11 Dr. Wazzan predicts. He instead predicts a portfolio
12 that never changes in the post-takings era. That's six
13 years. And given the changing conditions that we've
14 observed, I don't think that's realistic; it's not
15 consistent with the theory. So, once again, I think
16 Dr. Wazzan's predictions violate the very theory that he
17 says motivates his analysis.

18 Q. And how do these inconsistencies between the
19 theory and Dr. Wazzan's approach relate to your opinion
20 that a Plaintiff-by-Plaintiff analysis is required?

21 A. Well, given what we know -- and I think this is
22 on the next slide --

23 Q. Yes. Let's turn to DX 2417.

24 A. Given what we know about investor behavior and
25 given what modern portfolio theory tells us about

1 diversity of investment decisions, the only way to
2 address a lost investment returns approach in any kind
3 of meaningful or reliable way is to do it on a
4 Plaintiff-by-Plaintiff basis.

5 Dr. Wazzan referred to a generic investor.
6 There are no generic investors in the class. The
7 classes are very different. There are hedge fund
8 managers, there's individuals, there's pension funds,
9 all of which have different objectives, different -- and
10 hold different assets and hold them for different
11 periods of time.

12 So, I think a reliance on a generic investor
13 virtually assures that you're going to miss it, you're
14 going to get it wrong for every member of the class.
15 That's not desirable. Damages should be relevant to at
16 least some members of the class, and Dr. Wazzan's
17 analysis isn't.

18 So, I would argue that if you're going to carry
19 out lost investment returns as a way to determine
20 prejudgment interest rates, which I think is improper,
21 you've got to do it on a Plaintiff-by-Plaintiff basis.
22 That's really the only way to make it meaningful.

23 In contrast, what I've proposed, looking at the
24 conditions created by the delay, is the same rate of
25 return, a risk-free rate of return, proxied by the

1 one-year Treasury bill rate, applied equally to every
2 member of the class. I think that's consistent with
3 economics.

4 Q. And finally, Dr. Neuberger, do you have any
5 opinions regarding the specific portfolios that
6 Dr. Wazzan evaluated as part of his analysis?

7 A. Yes. And this is a point that relates to the
8 empirical analysis that Dr. Wazzan conducted, and this
9 is shown on my last slide, which is 2418. Dr. Wazzan
10 identified hypothetical portfolios of stocks based on
11 their purported similarity to AIG before the taking. To
12 establish that similarity, he looked at asset returns --
13 that is, stock returns -- in the period 2003 to 2007.
14 He stopped looking at the beginning of January 2008. He
15 only looked at the 2003 to 2007 period, and he looked
16 for assets that behaved like AIG.

17 So, on this chart, which is reproduced from
18 Exhibit 8 in my expert report, I show in blue, in the
19 blue bars, the results of Dr. Wazzan's correlation
20 analysis. These are monthly returns during that period,
21 and you can see they're all pretty high numbers.
22 They're all pretty high correlations. Correlations go
23 from minus one to plus one or minus 100 percent to plus
24 100 percent, and you can see all the blue bars are
25 significantly high. They are higher than 50 percent.

1 The highest one looks to be about 85 percent. That's
2 the recommended portfolio that Dr. Wazzan presented to
3 the Court, the returns on that portfolio, and you can
4 see he did that by picking the highest correlation.

5 Now, what Dr. Wazzan excluded from his analysis
6 was the period leading up to the first taking, which as
7 a matter of an efficient capital market or an efficient
8 investment market, investors would consider the most
9 recent behavior as being directly relevant to their
10 investment decisions. And you can see in the red bars
11 I've calculated those same return correlations for the
12 one year leading up to the first taking, so from
13 September '07 to September '08, and you can see that
14 those correlations fall apart. If anything, they are
15 either nonexistent or they are negative. For the
16 portfolio that he recommends, it's effectively zero.

17 So, the portfolios that Dr. Wazzan analyzed and
18 presented to the Court as reasonable proxies for AIG
19 are, in fact, or were, in fact, not good proxies for AIG
20 at the time of the taking. In fact, they didn't behave
21 anything at all like AIG in the period leading up to the
22 first taking, and the same would be true for the second
23 taking.

24 Q. Now, finally, just to clarify, do your critiques
25 of Dr. Wazzan's methodology overall apply only to the

1 specific portfolios or do they also apply to broader
2 investments that might be used to calculate prejudgment
3 interest?

4 A. My critique applies generally to using lost
5 investment returns on some portfolio of assets that
6 weren't actually held by the Plaintiffs. Dr. Wazzan at
7 least suggested that these portfolios shown in slide
8 2418, that they were like AIG as of the time of the
9 taking.

10 Once you move to broader indices, like an S&P
11 500, for example, or a broad stock market index, now
12 you're further and further away from the intended
13 purpose, which was to identify assets that looked like
14 AIG, and now you're just looking at some other asset
15 that may have no relationship to AIG. So, the critique
16 would apply, if anything, more strongly to broader
17 portfolios.

18 Q. Thank you, Dr. Neuberger.

19 I have no further questions, but I do move for
20 the admission as demonstratives of DX 2402 to 2418.

21 THE COURT: All right.

22 MR. DWYER: No objection, Your Honor, on the
23 basis that they're demonstratives.

24 MS. GERBER: Yes.

25 THE COURT: Yes, demonstrative exhibits,

1 Defendant's Exhibits 2402 through 2418, are admitted as
2 demonstratives.

3 (Defendant's Exhibit Numbers 2402-2418 were
4 admitted into evidence.)

5 MS. GERBER: Thank you, Your Honor.

6 MR. DWYER: Your Honor, we are going to hand out
7 our notebook, so there's probably some overlap. I know
8 we have his -- his expert report in there, I know we
9 have his slides in there, so --

10 THE COURT: That's fine.

11 MR. DWYER: -- but we prepared them in advance.
12 We have some other documents in there as well, so...

13 THE COURT: Okay.

14 THE WITNESS: Thank you.

15 MR. DWYER: May I proceed, Your Honor?

16 THE COURT: Yes. Please go ahead.

17 CROSS EXAMINATION

18 BY MR. DWYER:

19 Q. Good afternoon, Dr. Neuberger. My name is
20 Robert Dwyer. I'm one of the lawyers for the Plaintiffs
21 in the class.

22 A. Good afternoon, sir.

23 Q. We have never met, right?

24 A. Correct.

25 Q. Now, you said you've testified or given reports

1 about prejudgment interest about ten or 15 times,
2 correct?

3 A. I would say on ten -- ten to 15 occasions,
4 opinions that I've offered have included prejudgment
5 interest, yes, whether it was directly addressed or not.

6 Q. And you understand that this case, in terms of
7 your testimony in this case, you're discussing
8 prejudgment interest in the context of a takings case
9 under the Fifth Amendment, correct?

10 A. That's correct.

11 Q. Have you ever previously testified or offered an
12 opinion in a takings case about the appropriate
13 methodology for determining prejudgment interest?

14 A. No.

15 Q. Have you ever previously testified or offered an
16 opinion in a takings case about the rate that should be
17 used to determine prejudgment interest?

18 A. No.

19 Q. Have any of your publications had the
20 calculation of prejudgment interest as their primary
21 focus?

22 A. No.

23 Q. Over the past ten to 12 years, have you served
24 about 18 to 20 times as an expert witness for the
25 Government?

1 A. I could check to be sure, but yes, I think that
2 number's about right.

3 Q. During that same ten- or 12-year period, have
4 you ever testified against the Government?

5 A. I don't believe so. I've testified on behalf of
6 private plaintiffs, both plaintiffs and defendants, but
7 not against the Government directly.

8 Q. But in terms of -- I'm trying to not have us
9 stay here all afternoon.

10 A. Understood.

11 Q. So, if you could answer my questions directly.

12 A. I think I did.

13 Q. My question was, have you ever testified against
14 the Government? And I take it the answer to that is no,
15 right?

16 A. In the last ten or 12 years, that's correct.

17 Q. Now, are you -- you are providing -- are you
18 providing opinions in this action from an economic
19 perspective?

20 A. I am.

21 Q. And is it your view that an award of prejudgment
22 interest should restore a successful Plaintiff to the
23 position it would have occupied had the award been paid
24 on the date of the taking?

25 A. Yes.

1 Q. And would you agree that the Plaintiff in that
2 situation must be indifferent as to when it is
3 compensated, whether it's one month after the taking or
4 six years after the taking?

5 A. That's the purpose of prejudgment interest, yes.

6 Q. Do you really believe that the investors in AIG
7 common stock who had their property taken in 2008 and
8 2009 would be indifferent as to whether they had their
9 funds tied up in short-term treasuries for six or seven
10 years?

11 A. Based on the risks that they faced during that
12 period, yes.

13 Q. You really think that people who invested in
14 common stock in AIG and held that stock in 2008 and 2009
15 would have taken the proceeds that they got if the
16 Government had paid for those takings when it made the
17 takings, that they would have -- they would have put
18 that money in one-year Treasury bills and continued to
19 roll it over for six or seven years?

20 A. That's a different proposition. Now you're
21 talking about investment decisions that the Plaintiffs
22 would have made, taking varying levels or varying --
23 assuming varying degrees of risk, but on a risk-adjusted
24 basis, I believe that a risk-free rate of return at
25 one-year T-bill rates will provide appropriate

1 compensation for all the Plaintiffs based on the fact
2 that they didn't face any risk from that investment.

3 Q. Well, that wasn't my question. I'd ask you to
4 listen -- once again, I'd ask you to listen to my
5 question.

6 My question was, do you really believe that
7 investors in AIG common stock, who had their property
8 taken in 2008 and 2009, who had self-selected into being
9 investors in AIG common stock, would have taken the
10 money, had the Government paid them when it took the
11 property, and put it in one-year T-bills and continued
12 to roll it over in one-year T-bills for six or seven
13 years in one of the great bull moments -- bull markets
14 of our time? Do you really believe that?

15 A. You've asked me to look at investment decisions.
16 So, do I think every investor in the class or every
17 member of the class would have invested in one-year
18 T-bills? No, of course not. But as I said from the
19 beginning, I don't believe investment returns are the
20 proper basis for prejudgment interest. I think
21 prejudgment interest must be levied based on the risks
22 that were imposed by the delay.

23 Now, you're asking me would they have invested
24 in one-year T-bills. I don't know. I don't know enough
25 about the members of the class to know what they would

1 have invested in, but I think those class members would
2 acknowledge that a risk-free rate of return for bearing
3 no risk is an appropriate rate of return.

4 Q. Well, I've sat here for the last hour and a
5 quarter listening to you express actually a view as to
6 what they would have done with the money, because
7 your -- you said -- you criticized Dr. Wazzan for saying
8 he -- he's making an assumption about what these people
9 would have invested in, but your calculation assumes,
10 doesn't it, that they would have invested in one-year
11 Treasury bills and held those investments for six or
12 seven years? Isn't that your assumption?

13 MS. GERBER: Objection, Your Honor.
14 Mischaracterizes testimony.

15 THE COURT: Overruled.

16 THE WITNESS: I think, in fact, you have
17 mischaracterized my testimony. I'm not saying that
18 investment returns are relevant to the determination of
19 prejudgment interest, especially investment returns on
20 risky assets. I'm instead looking at the conditions of
21 the delay and identifying an interest rate that
22 compensates for the risks that were imposed by that
23 delay.

24 I'm not saying anything about what investors --
25 what the Plaintiffs, what the class members would have

1 done with the money if they had been given it in -- and
2 taken various risks with it had they been given the
3 award on the date of --

4 BY MR. DWYER:

5 Q. So, you're not applying modern portfolio theory,
6 for example, to your analysis about the calculation of
7 damages.

8 A. As I've stated repeatedly, I'm not making any
9 assumptions or assertions about Plaintiffs' investment
10 decisions based on modern portfolio theory or any other
11 theory. I'm simply looking at the conditions of the
12 delay and identifying a rate of return that compensates
13 for those conditions.

14 Q. And the rate of return is based on the
15 assumption that there's a portfolio that was -- the
16 money that they got -- they should have gotten when
17 their property was taken was put into a portfolio that
18 consisted solely of one-year T-bills rolled over and
19 held for six or seven years. That's your assumption,
20 isn't it?

21 A. That's not my assumption.

22 Q. Well, that's your calculation, isn't it?

23 A. I calculated prejudgment interest based on
24 one-year Treasury bill rates, rolling those over,
25 compounding the interest, but I'm not asserting that

1 Plaintiffs would have made those investments had they
2 been given money at the date of the award.

3 Q. But you expressed -- when I asked you before,
4 you said that your view is that an award of prejudgment
5 interest should restore a successful plaintiff to the
6 position it would have occupied had the award been paid
7 at the date of taking, and that's from one of your
8 slides. I'm quoting from one of your slides.

9 A. Yes. That is what I said in my slide, and on a
10 risk-adjusted basis, that's exactly consistent with what
11 I'm saying.

12 Q. You're saying -- so, what you're saying is it's
13 your opinion that the Defendant here, the Government,
14 can take the Plaintiffs' property and essentially make
15 those Plaintiffs invest that money in a forced return of
16 one-year Treasury bills for six or seven years until
17 it's resolved. That's your testimony?

18 MS. GERBER: Objection, Your Honor.
19 Argumentative.

20 THE COURT: Overruled.

21 THE WITNESS: My testimony doesn't say anything
22 about investments by the Plaintiffs. I'm not suggesting
23 that the Government should take anybody's property
24 improperly. What I am saying is that in this situation,
25 under the conditions that were imposed by this delay,

1 and based on the risks that Plaintiffs faced as a result
2 of that delay, that a one-year T-bill rate provides the
3 appropriate rate of compensation.

4 BY MR. DWYER:

5 Q. Now, you said that you reviewed a number of
6 cases. What cases did you review in connection with
7 formulating your opinion?

8 A. Those were some prior takings cases, a couple of
9 which I believe Dr. Wazzan had testified in.

10 Q. Did you review the Kirby Forest case?

11 A. Yes.

12 Q. And you were not familiar with that case until
13 you saw it cited in Dr. Wazzan's report, correct?

14 A. I believe that's right.

15 Q. What other cases did you -- did you review?

16 A. I recall seeing several opinions and orders
17 related to the Tulare Lake case, and I also recall the
18 Biery case.

19 Q. And did you also review the Otay Mesa case?

20 A. I know that was a question that was asked in my
21 deposition. I don't recall whether I looked at it or
22 not. I'm sorry.

23 Q. Did you -- did you follow those cases or did you
24 disagree with any of those cases?

25 A. I thought the reliance on risky rates of return

1 when it was -- when -- so, one of those cases, I forget
2 exactly which one now at the moment, I believe it was
3 the second opinion or order in the Tulare Lake case, the
4 judge in that case recommended prejudgment interest at a
5 Moody's Aaa bond rate. Those Aaa bonds, despite their
6 rating, have risks that were unrelated to delay in that
7 case. So, I didn't agree that that was the appropriate
8 interest rate to use.

9 Q. So, you read the Tulare Lake case, but then you
10 rejected the judge's findings in that case. Is that
11 what you're saying?

12 A. I don't know that it's a direct rejection. I
13 noticed that the first time around the judge accepted
14 one-year Treasury bill rates and then reconsidered and
15 chose a rate that reflected risky asset returns,
16 not risk-free rate of return.

17 Q. And you disagreed with the final decision on
18 prejudgment interest in the Tulare Lake case, correct?

19 A. Yes. As a matter of economics, yes.

20 Q. And the opinion that you are rendering today is
21 not one that's consistent with the final opinion on
22 prejudgment interest in the Tulare Lake case. Is that
23 correct?

24 A. That's correct.

25 Q. And you said you read the Biery case.

1 A. Yes.

2 Q. And am I correct in assuming that you also
3 disagree with the result in the Biery case?

4 A. Yes.

5 Q. And --

6 A. But as a matter of economics. I understand that
7 judges can make decisions about prejudgment interest
8 based on any number of criteria. But strictly based on
9 the economics, yes, I disagree.

10 Q. And the opinion you're expressing here today
11 does not comport with the decision that was made in the
12 Biery case, correct?

13 A. Correct.

14 Q. And you said you may or may not have read the
15 Otay Mesa case?

16 A. I know a question was asked about it at my
17 deposition. I just don't recall it as I'm sitting here
18 right now, whether I reviewed that case or not.

19 Q. Um-hum. Let me read you something from the Otay
20 Mesa case. That case says, "This principle recognizes
21 the time value of money and the opportunity a Plaintiff
22 has to -- has lost to earn income on its damages award.
23 A delay in payment is also a delay in the use of the
24 money." And that's from Ote Mesa Property vs. United
25 States, 111 Fed. Cl. 422, 424 (2013).

1 Is that -- you heard me read that, correct?

2 A. Yes, I heard that.

3 Q. And you heard it was both time value of money
4 and the lost opportunity cost, correct?

5 A. Yes.

6 Q. And am I correct in understanding your testimony
7 that you also disagree with that -- with that decision?

8 A. Not necessarily. I think if the opportunity
9 cost is measured with the same basic risks that were
10 imposed by the delay, so if you risk-adjust the
11 opportunity cost, then you could come up with a number
12 that would be perfectly consistent with what I've
13 recommended.

14 Q. Well, do you remember -- you remember being
15 asked about that case at your deposition, correct?

16 A. I do.

17 Q. And you remember saying, "This particular judge
18 is apparently asserting that prejudgment interest should
19 include both of those things. I would respectfully
20 disagree"?

21 A. Certainly the way it was presented, I think --

22 MS. GERBER: Your Honor. We would ask that the
23 deposition be shown.

24 THE WITNESS: I have a copy of it here.

25 MR. DWYER:

1 Q. Yes, he has it there. It's page -- I started
2 reading from page 139, line 5.

3 MS. GERBER: Thank you.

4 BY MR. DWYER:

5 Q. Now, you see -- do you see when Mr. Gant asked
6 you -- you were deposed in the case, right?

7 A. I was.

8 Q. And Scott Gant from my firm was asking you
9 questions?

10 A. Correct.

11 Q. And you see Mr. Gant says, starting at 139, line
12 5:

13 "QUESTION: And the language I was reading
14 appears shortly thereafter, after the citation. In
15 fact, it's the next sentence after the citations, and it
16 says, 'This principle recognizes the time value of money
17 and the opportunity a plaintiff has lost to earn income
18 on its damages award.'

19 "A delay in payment" -- and then it continues,
20 "a delay in payment is also a delay in the use of the
21 money. Do you see that?

22 "ANSWER: I do.

23 "QUESTION: What do you understand -- how does
24 this description of the interest that should be awarded
25 for prejudgment interest, how does it relate to your

1 views?

2 There's an objection and then you say:

3 "ANSWER: Well, in some earlier questions you
4 apparently conflated the time value of money with this
5 opportunity a plaintiff has to -- has lost to earn
6 income. I would note that the sentence you just read
7 specifically differentiates those two things. It
8 discusses the time value of money and the opportunity a
9 plaintiff has lost."

10 Then you go on to say: "This particular judge
11 is apparently asserting that prejudgment interest should
12 include both of those things. I would respectfully
13 disagree. I think the time value of money is the time
14 value of money, and opportunity to earn lost income is
15 something completely separate and involves, on the most
16 part, risks. If, in fact, the plaintiff bore no risk,
17 they shouldn't be compensated for risky assets they
18 never hold."

19 Is it still -- is that the testimony you gave at
20 the time?

21 A. Clearly, you read it correctly.

22 Q. Is that still your testimony?

23 A. Yes.

24 Q. And you still believe that in calculating
25 prejudgment interest, you would disagree with the judge

1 in the Otay Mesa case that lost opportunity should be
2 considered as well as the time value of money?

3 A. As long as the lost opportunity involves taking
4 on risks that weren't borne, that -- risks that were
5 unrelated to the delay, yes, I stand by that testimony.

6 Q. And you still --

7 A. And that's exactly what my position is.

8 Q. And you still disagree with that judge?

9 A. I do.

10 Q. And so in considering your opinion that you've
11 expressed today in this case, you -- you are not trying
12 to fit into the legal standard that is established in
13 the Otay Mesa case.

14 A. That's correct. I am attempting to address this
15 question from my perspective as an economist, not from a
16 judge's perspective as a legal scholar or a judge.

17 Q. Okay. Now, in your demonstrative that was at
18 DX 2402, you identified what you believed to be the four
19 main components of economically correct prejudgment
20 interest. Let me ask you if the -- and you -- you list
21 those four things in your opinion, and you discussed
22 those in your direct testimony.

23 Does the Kirby Forest decision or any of the
24 other prejudgment interest cases dealing with a taking
25 that you've read specifically identify any of the four

1 components that you list on DX 2402?

2 A. Not to my knowledge, except for some references
3 to the time value of money, if they're in there, and
4 that would be appropriate.

5 Q. Well, let me ask you about that specifically.
6 You -- let me -- you -- in 2403, which is another of
7 your demonstratives, you express the opinion that a
8 prejudgment interest rate equal to the risk-free rate of
9 return provides appropriate compensation for the delayed
10 award.

11 Does the Kirby Forest decision or any other
12 decision you've read relating to prejudgment interest in
13 a takings context use the language "the risk-free rate
14 of return"?

15 A. Not to my knowledge.

16 Q. Is it -- one of the assumptions that you're
17 making in giving your opinion that the only thing that
18 the Court should consider in determining prejudgment
19 interest and calculating prejudgment interest is the
20 risk-free rate of return?

21 A. Not in all instances, but in this case, yes.

22 Q. That's the only thing you want the Court -- you
23 think the Court should consider in this case?

24 A. Plus some minor, minimal risk that the
25 Government will default and not pay the award, but

1 that's reflected in Treasury bill rates anyway. So,
2 risk-free rate plus some very small default award,
3 default risk.

4 Q. Now, you -- let me ask you, did you formulate
5 your opinions in this case based on economics, without
6 taking into account any legal principles?

7 A. Since I'm not a legal scholar, yes. I -- I am
8 an economist, and I approached the question from my
9 perspective as an economist. So, I didn't specifically
10 take into account legal standards. I instead approached
11 the issue from my perspective as an economist.

12 Q. Do you agree that an efficient portfolio is one
13 that provides the highest return for a given level of
14 risk?

15 A. Generally, yes, although modern portfolio theory
16 is stated on the basis of expected returns and risk
17 rather than actual returns and risk. So, yes, an
18 efficient portfolio is one that offers the highest
19 expected rate of return for a particular level of risk.

20 Q. Do you agree that under modern portfolio theory,
21 investors place themselves into portfolios that reflect
22 an efficient or optimal balance of risk and return
23 characteristics?

24 A. Generally, yes. Whether everyone is perfectly
25 efficient at every point in time, I don't know. I don't

1 think that's the case. But as a general proposition, I
2 would agree with your statement.

3 Q. In your report, you cite a treatise by Stephen
4 Ross, Randolph Westerfield, and Jeffrey Jaffe, called
5 Corporate Finance. Do you regard that treatise as an
6 authoritative work?

7 A. It's a textbook that I've used in corporate
8 finance classes that I've taught, and I think it's
9 widely respected, yes.

10 Q. And in your report you also cite a treatise by
11 Richard Brealey and Stewart Myers called Principles of
12 Corporate Finance. Do you regard that treatise as an
13 authoritative work?

14 A. Again, I have taught from that book. Yes, it is
15 authoritative. It is a commonly used textbook.

16 Q. Do those two treatises identify opportunity
17 costs as a fundamental economic principle that must be
18 considered in tandem with the time value of money when
19 evaluating investment opportunities?

20 A. I don't know off the top of my head. If you
21 want to show me something, I'm happy to respond to it.

22 Q. Well, let's look in the book at -- let's look at
23 Brealey first, PTX 2898 at page 4, which is in your
24 notebook, in the notebook I gave you.

25 A. And, I'm sorry, what page?

1 Q. It's at page 4.

2 Do you see where -- do you have page 4 in front
3 of you?

4 A. I do.

5 Q. So, at the bottom there's a subheader that says,
6 "Three Points to Remember about NPV." Then it says, "As
7 we look at these alternative criteria, it is worth
8 keeping in mind the following key features of the net
9 present value rule. First, the net present value -- the
10 NPV rule recognizes that a dollar today is worth more
11 than a dollar tomorrow, because the dollar today can be
12 invested to start earning interest immediately. Any
13 investment rule that does not recognize the time value
14 of money cannot be sensible. Second, net present value
15 depends solely on the forecasted cash flows from the
16 project and the opportunity cost of capital."

17 Is that a statement that -- with which you
18 agree?

19 A. Yes.

20 Q. Now, let's look at --

21 A. And I would note, it's in the context of capital
22 budgeting, right, making decisions between two different
23 investment projects. It's not in the context of
24 assessing prejudgment interest.

25 MR. DWYER: Your Honor, could you instruct the

1 witness to only answer my questions, not to go on?

2 THE COURT: Yes, let's try to answer the
3 questions that are asked, so if it's a yes or no type
4 question, then treat it that way first, if you will.

5 THE WITNESS: I will do my best, Your Honor.

6 BY MR. DWYER:

7 Q. Now, if you look at 2899, which is a selection
8 from the Ross/Westerfield/Jaffe book, and look at the
9 bottom of page 3, top of page 4. Do you see where it
10 says "Opportunity Costs"?

11 A. I do.

12 Q. And it says, "Your firm may have an asset that
13 it is considering selling, leasing, or employing
14 elsewhere in the business. If the asset is used in a
15 new project, potential revenues from alternative uses
16 are lost. Those lost revenues can meaningfully be
17 viewed as costs. They are called opportunity costs
18 because, by taking the project, the firm forgoes other
19 opportunities for using the assets."

20 Is that a statement with which you agree?

21 A. Yes.

22 Q. You can put those two aside.

23 Now, is it your position that prejudgment
24 interest is intended to compensate for the delay in
25 receiving an award, not for the harm, if any, caused by

1 the taking itself?

2 A. Yes.

3 Q. In calculating prejudgment interest, am I
4 correct in understanding that you did not attempt to
5 measure the economic harm to the property owners?

6 A. That's correct.

7 Q. Is it your position that in this case, as a
8 matter of economics, the prudent investor rule has no
9 place in setting prejudgment interest rates?

10 A. Yes.

11 Q. Is it is your position -- I'm turning to a
12 different subject now.

13 Is it your position that the prejudgment
14 interest rate is best quantified by the interest rate on
15 one-year Treasury bills or, in the alternative,
16 five-year TIPS?

17 A. In this case, yes.

18 Q. Is the -- is your use of the one-year Treasury
19 bill rate as a rate of prejudgment interest -- I'm
20 sorry, withdrawn.

21 Is the use of the one-year Treasury bill rate as
22 the rate of prejudgment interest that is specified in
23 the Declaration of Taking Act a reason that you cite as
24 support for your advocacy of that rate?

25 A. No, although I -- I did reference that in my

1 report and noted that the Defense of Takings Act -- I
2 believe that's what it's called -- includes specific
3 reference to the one-year Treasury bill rate.

4 Q. It's the Declaration of Takings.

5 A. Declaration, excuse me, sir. Thank you.

6 Q. "Defense of Takings" sounds like something the
7 Government would argue.

8 When you cited to that and you were asked about
9 it at your deposition, didn't you say that the only
10 portion of the Declaration of Taking Act that you read
11 or relied on was when you looked to see -- when you
12 looked at the interest rate, the one-year Treasury bill
13 interest rate?

14 A. The one year Treasury bill reference wasn't the
15 only thing I looked at when I looked at the Declaration
16 of Takings Act. I looked at the section on prejudgment
17 interest, which included a reference to one-year
18 Treasury bills.

19 Q. But the section on prejudgment interest was the
20 only portion that you referenced -- was the only portion
21 that you looked at in the DTA, correct?

22 A. That's correct.

23 Q. Now, when you -- when you looked at the DTA, did
24 you ever become aware that the Declaration of Takings
25 Act applied only in formal land condemnation proceedings

1 where the Government deposits just compensation with the
2 Court and the condemnee gets immediate access to the
3 deposited funds?

4 A. You are now beyond my expertise. I did not.

5 Q. And you would agree that in this case the
6 Government did not deposit an amount of money equal to
7 what the Plaintiffs are alleging was taken from them in
8 court and the Plaintiffs did not have immediate access
9 to those funds in a deposit made by the Government,
10 correct?

11 A. That sounds -- that sounds accurate. I don't
12 know that personally, but that's my understanding.

13 Q. Did you look at the one-year Treasury bill rate
14 in the period prior to the taking?

15 A. I'm sure I looked at it. I don't recall that
16 number or those numbers as I'm sitting here right now.

17 Q. Were the rates for Treasury bills higher in that
18 period of time than today?

19 A. Probably.

20 Q. And the same with regard to the five-year TIPS
21 rate, higher than it is today?

22 A. Probably, yes.

23 Q. Now, you said that low interest rates you
24 attributed to supply and demand. Do you remember that
25 testimony?

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1 A. Yes.

2 Q. Now, aren't the interest rates influenced -- are
3 the interest rates influenced at all by monetary policy
4 choices made by the Federal Reserve Board of Governors?

5 A. That's encompassed on the supply side. Sure.

6 Q. And, in fact, are you -- you are aware that over
7 the -- over the period of time since 2008, the Federal
8 Reserve Board of Governors has deliberately kept the
9 interest rates low in order to foster their own vision
10 of monetary policy, correct?

11 A. Interest rates have been low in the post-takings
12 period. Monetary policy has contributed to those
13 interest rates. Whether that was to pursue some Federal
14 Reserve agenda or not, I don't know.

15 Q. Well, have you looked at the Federal Reserve
16 Board of Governors pronouncements by Chairman Bernanke
17 and others as to why they've kept the rates low since
18 2008?

19 A. Generally, yes, but not specifically, and I
20 didn't specifically reference them here.

21 Q. So, you're not aware that there was a specific
22 monetary policy to keep -- to keep interest rates low
23 that was -- that was followed by the Federal Reserve
24 Board of Governors over the last six years?

25 A. I didn't say that. I am aware that the Federal

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1 Reserve has provided sufficient liquidity to the economy
2 to keep interest rates low.

3 Q. So, the low interest rates over the last six
4 years that you attributed to supply and demand, in fact,
5 the Defendant in this case, for whom you're arguing that
6 the -- that the interest rates should be low, for whom
7 you're expressing an opinion that the interest rates
8 should be low, that -- that Defendant is, in fact,
9 setting low interest rates as a matter of policy,
10 unrelated to this case. Is that what -- you're aware of
11 that, correct?

12 A. I'm aware that supply conditions have kept --
13 helped to keep interest rates low, but so have demand
14 conditions. Investors have demanded and held those
15 interest rates. Now, it -- the Fed just can't supply
16 liquidity to the market if nobody wants to hold it. So,
17 what my testimony was, that supply and demand conditions
18 in bond markets have produced low interest rates. Yes,
19 the Fed has contributed to that.

20 Q. Do you agree that -- I'm sorry.

21 Would you agree that the case in which you're
22 testifying today is a case in which a significant amount
23 of time has elapsed between the taking of the property
24 and the payment of just compensation?

25 A. I don't know exactly what you mean by

Starr International Company, Inc. v. USA

1 "significant," but, yes, over six years have taken
2 place.

3 Q. You don't think that -- you would agree that
4 that's a significant amount of time.

5 A. I don't know what criterion you're using for
6 "significant," but it's over six years.

7 Q. And is the length of time, the more than six
8 years -- I won't characterize it, I'll just use the
9 number. Is the more than six years between the date of
10 taking and the entry of a possible future judgment in
11 this action the reason you have offered the five-year
12 TIPS rate as an alternative method to calculate
13 prejudgment interest?

14 A. That was one consideration. I wouldn't
15 deliberately pick a prejudgment interest rate or a proxy
16 for a risk-free rate -- if that's what I determined was
17 appropriate, I wouldn't pick that rate from a security
18 that had a maturity significantly longer than the delay,
19 but I would say as a secondary matter, I picked the
20 shortest TIPS that I could, and that's the only --
21 that's the shortest one, maturity that's available, the
22 five-year, and that was not longer than the period of
23 the delay, so I felt that that was at least partly one
24 justification for choosing it.

25 Q. Now, you picked rates that were a little below

1 and a little above 3 percent for the TIPS, correct?

2 That's what you put in your report, correct?

3 A. That's what the calculations are, yeah.

4 Q. Now, are those simple interest calculations or
5 compound interest?

6 A. My calculations were compound.

7 Q. Okay. And how did you get -- where did you
8 start the -- you know, in terms of the calculation,
9 what -- what -- is it -- what numbers did you use to
10 start the -- the one that's a little below 3 percent and
11 how did you get to the one that's a little above 3
12 percent?

13 A. I looked at an investment or the -- the interest
14 rate on TIPS. That interest rate is paid periodically.
15 So, TIPS, unlike Treasury bills, pay coupons,
16 twice-a-year coupons. I took the coupon payments and
17 reinvested them at the same rate as the initial interest
18 rate on those bonds in order to determine or to provide
19 the benefit of compounding through the life of the
20 asset.

21 Q. So, you --

22 A. So, there was a particular interest rate that --
23 the coupon rate was set --

24 Q. At September 22nd, 2008, let's start there, and
25 I can -- in your book is first -- the first -- the first

1 item in your book is PTX 262. Do you see there's a --
2 do you see that?

3 A. I do.

4 Q. And you're familiar with H-15 in this document,
5 correct?

6 A. I am.

7 Q. And what is this document?

8 A. The Federal Reserve puts out I believe daily,
9 weekly, monthly and less often summaries of interest
10 rates that are available in the market on those dates.

11 Q. And you relied on this in the course of your --
12 your work, correct?

13 A. I do.

14 MR. DWYER: Your Honor, I would offer PTX 262.

15 MS. GERBER: No objection, Your Honor.

16 THE COURT: Plaintiffs' Trial Exhibit 262 is
17 admitted.

18 (Plaintiffs' Exhibit Number 262 was admitted
19 into evidence.)

20 BY MR. DWYER:

21 Q. Now, PTX 262 is the -- is the Federal Reserve's
22 statistical release of selected interest rates that was
23 issued on September 29th, 2008, correct?

24 A. Yes. It appears to be.

25 Q. Okay. And if you look at -- in the left-hand

1 column, it says "Instruments." Those are the possible
2 instruments that you could have -- those are the various
3 investment vehicles. Is that -- is that what I'm -- am
4 I correct on that?

5 A. Different securities that offer interest rates,
6 yes.

7 Q. And in terms of the interest rate we've been
8 talking about, one-year Treasury bills, is that -- is
9 that under "U.S. Government Securities, Treasury Bills,
10 Secondary Market, One Year"?

11 A. I used the constant maturity.

12 Q. You used the constant maturity. So, you used
13 under that one year, which is 2.06 percent?

14 A. Correct.

15 Q. And that was the rate as of September 22nd,
16 correct?

17 A. It -- it was, yes.

18 Q. Okay. And then under that, there's --
19 there's -- where does -- does the TIPS fall on this
20 somewhere?

21 A. It does. It's the next subcategory, which says
22 "Inflation Indexed."

23 Q. So, there's five-year, seven-year, ten-year, and
24 20-year, correct?

25 A. Correct.

1 Q. And the rates for those, as of September 22,
2 2008, were 1.6, 1.73, 1.85, and 2.27, correct?

3 A. Yes.

4 Q. And you picked five years because that was the
5 least amount of time that you could pick for TIPS,
6 correct?

7 A. Correct.

8 Q. Did you have any other reason for picking five
9 years?

10 A. No.

11 Q. Now, explain to me how you do the -- let's --
12 for each of your two -- for the five-year TIPS, how do
13 you do the calculation? You started with the 1.6?

14 A. Yes.

15 Q. And then what did you do with that?

16 A. Six months later, there was a coupon payment.
17 So, the -- the coupons, the periodic coupons that are
18 paid twice a year under any government bond, but
19 including under TIPS, they are applied to an indexed --
20 an inflation indexed principal amount that increases
21 every six months to account for inflation.

22 At the end of six months, I took the coupon, the
23 calculated coupon payment, and applied it back, added to
24 principal by that amount, and reinvested it at the
25 initial rate. And I carried -- continued doing that

1 based on every coupon payment through the end of the
2 period or in the maturity of the bond, and then I
3 assumed that all of the proceeds from the bond,
4 including the inflation indexing, was then reinvested.

5 I believe for the five-year TIPS, given the
6 term, I then reinvested them at one-year Treasury bill
7 rates, at the end of the bond, at the maturity of the
8 bond.

9 THE COURT: Shall we take an afternoon break?

10 MR. DWYER: Yes, Your Honor. Thanks.

11 THE COURT: We will come back at 3:30.

12 (Court in recess.)

13 THE COURT: Thank you. Please be seated.

14 MR. DWYER: May I proceed, Your Honor?

15 THE COURT: Yes. Please go ahead.

16 BY MR. DWYER:

17 Q. Dr. Neuberger, in your direct examination today,
18 you defined interest rate as including a risk-free rate
19 of return and a risk premium, and then you defined risk
20 premium to include default rate risk, interest rate
21 risk, and you said "et cetera." Is one of the elements
22 of "et cetera" the inflation risk?

23 A. Yes.

24 Q. Okay. And do you agree that the one-year
25 Treasury bill rate does not account for the risk of

1 inflation?

2 A. Not explicitly, yes.

3 Q. Well, when you say "not explicitly," would
4 you -- would you agree that because of the rate of
5 inflation since 2008, the real rate of return on a
6 one-year Treasury bill has been negative since 2009?

7 A. In real inflation-adjusted terms, that's
8 correct, yes.

9 Q. Now, you also -- you testified about
10 Dr. Wazzan's suggested rates of return, and are you
11 aware that -- you're generally aware of what the
12 ballpark was for his rates of return, correct?

13 A. Yes.

14 Q. And that -- you know that for the 2008 taking,
15 they were in the 7 to 10 percent range, and for the --
16 for the June 2009 taking, they were in the 15 to 20
17 percent range?

18 A. Yes.

19 Q. Is it your -- now, let's start with the -- the
20 September 2008 taking suggested rates of return from
21 Dr. Wazzan. Is it your opinion that any of the rates
22 that he suggested in the 7 to 10 percent range, measured
23 from that -- from September 2008, would become negative
24 between now and the date of a judgment in this action?

25 A. Between now and a judgment date? No.

1 Q. Okay. And would you say the same thing for --
2 for the June 2009 rates that he suggested? Would any of
3 them become negative in -- between now, as you sit here
4 today, and the date of an expected judgment in this
5 action?

6 A. I -- I wouldn't expect so.

7 Q. Now, in your report, which is DX 1880, you
8 calculate -- you mentioned calculations about
9 prejudgment interest, and you used as an example a
10 claimant who got a thousand dollar award. Do you
11 remember that?

12 A. Vaguely, yes.

13 Q. So, if you look at -- if you look at paragraph
14 31, which is on page 12 of DX 1880. And in paragraph
15 31 -- I'll just run through the calculation here for the
16 September 2008 taking. You said in paragraph 31 that
17 applying the rates of return to the award, for every
18 thousand dollars allegedly taken on September 22nd,
19 2008, Plaintiffs would be compensated \$24 in prejudgment
20 interest through December 31st, 2013.

21 A. Yes.

22 Q. And that's still your testimony, right?

23 A. Yes. Well, it's in my report. I haven't redone
24 those -- well, I have -- I have looked at those
25 calculations through last week, but I certainly stand by

1 the numbers in the report.

2 Q. Right. And in -- with regard to that
3 calculation, \$24 between September 22nd, 2008, and the
4 end of 2013, is less than \$5 a year, correct?

5 A. Yes.

6 Q. Okay. And now for -- if you turn to paragraph
7 90 of your report, you -- you looked at Dr. Wazzan's
8 calculation, and there you made the same calculation but
9 using his suggested rate, and you used -- and your
10 calculation in paragraph 90 for the -- the claimant who
11 received a thousand dollar award through the end of last
12 year, using Dr. Wazzan's 7 percent rate, you said it --
13 at the end of that paragraph, you said, "This rate
14 yields prejudgment interest awards that are \$406" -- I'm
15 just reading for the September one -- "above the
16 interest payments using the one-year T-bill rate for
17 every \$1,000 in compensation."

18 So, am I correct in understanding that your
19 calculation, using Dr. Wazzan's 7 percent rate for the
20 September taking, is you would take the \$24 that you
21 calculated and then you would add to it \$406, so that
22 your calculation of interest for the thousand dollar
23 claimant for that 5 1/4 year period would be \$430?

24 A. I think that's right. I didn't calculate
25 Dr. Wazzan's numbers starting from my numbers. I -- I

1 saw in his report that he had calculated those numbers.
2 I then calculated the numbers for the interest rates
3 that I was proposing, and I have the -- they're an
4 exhibit, Exhibit 9 of my report, and the difference is
5 the number that I reported there, the 406.

6 Q. The difference between your \$24 and his number
7 is 406.

8 A. Correct. That's my recollection.

9 Q. So, based on your calculations and analysis,
10 the -- the bid and ask is you offering \$24 in interest
11 and he's offering \$430 in interest.

12 A. I believe that's correct.

13 Q. And that's about \$82 a year for his calculation?

14 A. I'll accept your representation. I don't have a
15 calculator right here in front of me.

16 Q. Now, in paragraph 29 of your report, if you go
17 back to that, which is on page -- it begins on the
18 bottom of page 11, goes over to the top of page 12.
19 You -- you describe "the fundamental requirement" of a
20 prejudgment interest calculation is "to make Plaintiffs
21 indifferent between receiving compensation at the time
22 of the alleged takings and receiving compensation at the
23 time of the award."

24 A. Correct.

25 Q. Is it your testimony that a class member with a

1 \$1,000 award would be indifferent as to receiving a
2 thousand dollars on September 22nd, 2008, as opposed to
3 \$1,024 at December 31st, 2013, 5 1/4 years later?

4 A. Yes, based on the risks that they were -- that
5 they faced as a result of this delay in award.

6 Q. So, it's your testimony that a class member with
7 a thousand dollar award would be indifferent as to only
8 getting less than \$5 a year in prejudgment interest for
9 that award for the 5 1/4 year period that you calculated
10 and that's during one of the great bull markets of all
11 time?

12 A. Well, again, you're conflating two very
13 different things, but yes, my testimony is that I have
14 identified an interest rate that, adjusted for risk,
15 properly compensates Plaintiffs and would make them
16 indifferent to the timing of the award. That's exactly
17 correct.

18 MR. DWYER: I pass the witness, Your Honor.

19 THE COURT: All right, thank you.

20 Any redirect, Ms. Gerber?

21 MS. GERBER: Briefly, Your Honor, yes.

22 THE COURT: Okay.

23 MS. GERBER: The binders keep proliferating.

24 Okay.

25 REDIRECT EXAMINATION

1 BY MS. GERBER:

2 Q. Good afternoon.

3 A. Good afternoon.

4 Q. I have just a few follow-up questions, and I
5 will try to let you know when I'm changing topics, but
6 if you get confused, let me know.

7 Earlier you testified that you are not opining
8 that Plaintiffs would have rolled over their money into
9 Treasury bills. Why not?

10 A. In my view, making speculation or speculating
11 about investments that the class members would have made
12 is just that. It's speculation. It's an exercise in
13 attempting to determine after the fact decisions that
14 individuals would have made several years ago.

15 Rather than attempting to peg prejudgment
16 interest to some hypothetical investment, I think it's
17 more appropriate to look at the conditions imposed by
18 the delay and to determine an interest rate that would
19 compensate for those conditions. That's what I've done.
20 So, I've attempted to divorce prejudgment interest,
21 because I think that's the appropriate framework, from
22 investment decisions.

23 Dr. Wazzan's approach is to look at alternative
24 investments -- and, I would note, very risky alternative
25 investments -- and to somehow conflate them with a

1 period of time when Plaintiffs were deprived of any
2 risks associated with this particular asset or similar
3 risky assets. So, I'm not making any investment
4 predictions. I'm attempting instead to look at the
5 conditions of the delay and find an interest rate that
6 compensates for that -- those conditions.

7 Q. Now, you also testified earlier, I believe, that
8 the risk-free rate of return might not always be the
9 appropriate prejudgment interest rate. Why -- why not?

10 A. Well, as I mentioned, you have to look at the
11 conditions that were imposed by the delay and the risks
12 that were associated with that delay. So, if, for
13 example, we were in private litigation and there was
14 some harm that was imposed by a private corporation that
15 was a risky corporation, perhaps faced a nonzero
16 probability of bankruptcy during the period of the
17 litigation, well, then, I would want to add a risk
18 premium that reflects the likelihood of default of that
19 company to any risk-free rate of return.

20 So, I'm not saying categorically that it's
21 always the risk-free rate of return and nothing else,
22 but in this case, given the very small probability that
23 the Government will default on a judgment in this case,
24 I think the appropriate rate is the risk-free rate of
25 return.

1 Q. Thank you.

2 Now, I'd like to turn to the black binder that
3 you received from Plaintiffs' counsel and turn to
4 PTX 2898, page 4, which you were directed to in your
5 cross examination. And you mentioned in your testimony
6 that this was in the context of capital budgeting. Is
7 that right?

8 A. Correct.

9 Q. And what does that mean?

10 A. Capital budgeting is an aspect of finance where
11 you are attempting to evaluate projects that you could
12 invest -- "you" being in this instance or in most
13 instances a corporation -- could invest in. So, you
14 could invest in a new piece of equipment for your
15 factory, for example, or you could invest in an entirely
16 new factory. Those are two choices that you face.

17 Capital budgeting provides a series of
18 procedures and methods that enable you to compare those
19 two very different investments and determine what their
20 value is to your company.

21 Q. And does that apply to your computation of
22 prejudgment interest?

23 A. I don't think the -- although some of the
24 concepts are similar, so the time value of money is
25 similar, this notion of opportunity cost is a similar

1 kind of concept, but the criteria that you use for
2 evaluating capital projects for purposes of capital
3 budgeting is a different setting than the one in which
4 you evaluate prejudgment interest rates.

5 Q. And then turning to PTX 2899 and specifically at
6 the bottom of page 3 to the top of page 4, discussing
7 opportunity costs, what's the context for this
8 discussion?

9 A. It's the exact same context. If you look back
10 on page 2 of 5, you see that heading for the chapter,
11 "Making Capital Investment Decisions." That's capital
12 budgeting.

13 Q. All right. And similarly would your response be
14 the same for whether it applies to prejudgment interest
15 calculations?

16 A. Same response.

17 Q. Thank you.

18 Okay. Switching topics, you testified earlier
19 that you wouldn't pick a security with a maturity
20 significantly longer than the delay at issue in a case.
21 Do you recall that?

22 A. I do.

23 Q. And why is that?

24 A. Well, there's -- there's interest rate risk
25 associated with long-term government securities or

1 really any long-term bond. As interest rates in the
2 market change relative to the interest rates on your
3 particular instrument, the value of that security will
4 change, and then you introduce a new form of risk into
5 the computation of prejudgment interest.

6 So, rather than incorporating interest rate risk
7 that's unrelated to the delay, I think it's more
8 appropriate to look at a risk-free rate of return or a
9 shorter term security that is less than the period of
10 the delay.

11 Q. Now, you also testified that the one-year
12 Treasury bill rate on a real inflation-adjusted basis
13 had a negative rate of return during the period of the
14 alleged takings to now. How does that comport with your
15 testimony that an interest rate -- a prejudgment
16 interest rate should preserve the principal award?

17 A. Well, that's in nominal terms. So, in nominal
18 terms, one-year Treasury bill rates are and have been
19 throughout this period positive. They're not negative
20 numbers. So, even though they're relatively small
21 numbers, even though they may not keep up with
22 inflation, a thousand dollar award will become more than
23 a thousand dollars by applying a positive prejudgment
24 interest rate.

25 Now, in real terms, that may not be -- that

1 award may not hold its real purchasing power, its value,
2 once you've taken into account inflation, but that's a
3 different proposition. That's a completely different
4 set of considerations.

5 Moreover, I've offered the TIPS to explicitly
6 address that issue. If the Court determines that
7 putting the principal award in jeopardy in the sense
8 that you might actually get less in real value,
9 inflation-adjusted value, the Court -- I've offered to
10 the Court an interest rate that will preserve the
11 principal award both in nominal terms and in real terms.

12 Q. Thank you.

13 When you were asked by Plaintiffs' counsel
14 whether a Plaintiff would be, in fact, indifferent, you
15 said yes, adjusted for risk. Why did you make that
16 qualification?

17 A. Well, I suspect if you ask Plaintiffs if they
18 would be happy or indifferent to a prejudgment interest
19 rate that's 0.5 or 0.3 percent, that they would probably
20 say no, but they would not have properly accounted for
21 the risks that they were asked to face during that
22 period. So, they would compare -- I think a typical
23 person would compare, oh, I could have gotten a 10
24 percent rate of return or a 20 percent rate of return,
25 using Dr. Wazzan's second takings number, and that's the

1 basis on which I'm going to make the comparison and tell
2 you whether I'm indifferent or not. That's not the
3 proper basis.

4 You've got to do that on a risk-adjusted basis.
5 So, confronting the risk that you actually confronted,
6 do you think this is an appropriate rate of return?
7 That's a very different question from just asking a
8 basic question, saying, "Well, would you be indifferent
9 to an award that's -- that provides half a percent of
10 prejudgment interest?" So, I think you have to look at
11 it on a risk-adjusted basis; otherwise, you're comparing
12 apples and oranges.

13 Q. Now, do you know how many years Plaintiffs
14 waited to file their case between the alleged taking
15 and -- or takings and filing a complaint in this Court?

16 A. I'm sorry. I don't know offhand.

17 Q. And how is the Plaintiffs' ability to choose a
18 filing date related to your analysis of prejudgment
19 interest?

20 A. Well, I'm sure there's some statute of
21 limitations that applies, but within that period, if you
22 observe -- if you know that you're going to claim
23 prejudgment interest at, let's say, some market rate of
24 return, and there's been a tremendous bull market during
25 that period, that certainly gives you some incentive to

1 wait until those returns are sufficiently high so that
2 you can file your claim.

3 As I mentioned, you know, damages analysis and
4 assessing prejudgment interest is always a retrospective
5 exercise. So, you have the benefit of hindsight to look
6 back and say, "Oh, what portfolio would I choose? Well,
7 I'm going to choose the one that's going to give me the
8 highest rate of return." Those are the perverse
9 incentives that I talked about.

10 Q. And finally, do you have any reason to believe
11 that the Government had a monetary policy to keep
12 interest rates low in order to affect Plaintiffs'
13 prejudgment interest rate?

14 A. I wouldn't think it would -- those things would
15 be related at all. I think the Government had other
16 concerns. The Fed had other concerns in the way it set
17 monetary policy.

18 Q. Thank you.

19 No further questions, Your Honor.

20 THE COURT: All right.

21 Anything further, Mr. Dwyer?

22 MR. DWYER: Just a few questions, Your Honor.

23 THE COURT: Okay.

24 RE CROSS EXAMINATION

25 BY MR. DWYER:

1 Q. Dr. Neuberger, are you aware that the -- with
2 regard to the interest rates that Dr. Wazzan concluded
3 were the interest rates that he would -- he would opine
4 that the Court should consider, that he, in fact, did
5 not pick the highest interest rates of the four
6 synthetic portfolios or the S&P 500 or the Wilshire 5000
7 indices that he looked at? Are you aware of that?

8 A. I remember there were some -- one or more of the
9 portfolios may have offered a marginally higher return
10 than the one he recommended. I don't remember
11 specifically what those numbers are.

12 Q. Well, we can look at those numbers. They're in
13 your book. His charts are in your book. It's 28 --
14 2841 and 2842, if you would look at those PTXs.

15 MS. GERBER: I don't believe those are in the --

16 THE WITNESS: Those are not in my binder, sir.

17 MR. DWYER: Oh, I'm sorry. Well, the record
18 will be what it is.

19 BY MR. DWYER:

20 Q. But you agree that he didn't pick the highest --
21 you agree that he didn't pick the highest numbers?

22 A. I think that's right.

23 Q. Now, you said several times -- and I'm trying to
24 quote this, but I'm -- you know, I'm not doing it
25 from -- I'm not necessarily accurate, but you said

1 something like that there's no risk that the Government
2 will default on the judgment, and that's -- that -- and
3 that played a role in your analysis of the risk -- what
4 the risk-free rate should be. Do you remember saying
5 something along those lines?

6 A. It affected my conclusion that the risk-free
7 rate of return was the right number. In proxying for
8 that risk-free rate of return, I used a one-year
9 Treasury bill rate, which does include a premium
10 associated with the likelihood that the Government will
11 default.

12 Q. So, is it your testimony and your opinion that
13 prejudgment interest is based on who the Defendant is
14 and the risk that the Defendant will default on the
15 award?

16 A. In part, yes.

17 Q. And so you're substituting the risk
18 characteristics of the Defendant's ability to pay for
19 the opportunity cost of the Plaintiffs. Is that your
20 testimony?

21 A. I don't know that I'm substituting that for the
22 opportunity cost of the Plaintiffs. I haven't directly
23 addressed the opportunity cost of the Plaintiffs, but I
24 did consider that the small likelihood that the
25 Government would not pay the award, I did factor that

1 into my -- into my calculus, into my calculations.

2 Q. So, you factored into your calculation of what
3 the appropriate rate of prejudgment interest should be
4 the risk profile of the Defendant rather than what the
5 Plaintiff is likely to do with the money. Is that -- is
6 that fair?

7 A. I think that's fair.

8 MR. DWYER: Nothing further, Your Honor.

9 THE COURT: All right. Thank you very much,
10 Mr. Dwyer.

11 Dr. Neuberger, thank you very much for your
12 testimony in this matter. You are excused.

13 THE WITNESS: Thank you, Your Honor.

14 MR. DINTZER: Your Honor, for the next witness,
15 we will be calling the remainder of the presentation of
16 Mr. Studzinski's videotape, and so we will be showing
17 that.

18 THE COURT: How long is that?

19 MR. PHILLIPS: Approximately 2 1/2 hours, Your
20 Honor.

21 THE COURT: Well, we are not going to watch it
22 all today.

23 MR. DINTZER: Well, as much as we can get in.

24 Just as a way of explanation, Your Honor, for
25 the perhaps a bit unorthodox start with prejudgment

Starr International Company, Inc. v. USA

1 interest and a videotape, just in case the Court is
2 wondering, we had reached an agreement with Plaintiffs
3 that they would try to close their case Wednesday and we
4 would start Thursday, and had that happened, we would
5 have started with actual fact witnesses. I don't mean
6 to lay any blame on them for this, it was what it was,
7 but for the convenience of witnesses, this is how it
8 just ended up. But we will be starting Monday with fact
9 witnesses.

10 THE COURT: Yes, it is a little bit unorthodox,
11 but I understand the reasons behind it.

12 By the way, as you probably know, in the course
13 of the Plaintiffs' case, they sent me each Friday a copy
14 of their notification letter to you about who was going
15 to appear and in what order.

16 MR. DINTZER: Yes, Your Honor.

17 THE COURT: Can you all do the same?

18 MR. DINTZER: We absolutely will.

19 THE COURT: That's kind of a valuable piece of
20 information.

21 MR. DINTZER: We will, and I believe that that's
22 a 5:00 thing, but whenever it goes, we will send it to
23 your chambers.

24 THE COURT: Sure. And you can send it to my law
25 clerk, Elyse.

1 MR. DINTZER: Absolutely.

2 THE COURT: All right.

3 MR. DINTZER: Thank you, Your Honor.

4 THE COURT: Um-hum.

5 Whereupon --

6 JOHN STUDZINSKI

7 a witness, called for examination, having been duly
8 sworn, was examined and testified, via videotaped
9 deposition testimony, as follows:

10 Q. Could you state your name for the record,
11 please?

12 A. John Studzinski.

13 MR. DINTZER: We are going to back it up. Wait
14 just one second. We have binders of documents that the
15 witness saw as part of the deposition.

16 THE COURT:

17 MR. BOIES: Your Honor, there are some
18 objections to some of this testimony, but rather than
19 interrupt the playing of the tape, what we would
20 propose, if it's acceptable to everybody, is after it's
21 played, we can -- if there's something in context that
22 we decide we want to stand with our objections, we will
23 just make a motion to strike.

24 MR. DINTZER: That will be fine. I mean, if
25 that's okay with the Court.

1 THE COURT: Sure.

2 MR. PHILLIPS: One moment on the binders, Your
3 Honor.

4 THE COURT: Where was this deposition taken, by
5 the way?

6 MR. PHILLIPS: This was taken in London,
7 December of last year, Your Honor, because the witness
8 resides there.

9 THE COURT: All right, thank you.

10 MR. PHILLIPS: Your Honor, there are two issues.
11 During the course of the video, would you prefer we stop
12 the video and tell you what document will be discussed
13 in the deposition?

14 THE COURT: Well, because in the deposition, the
15 numbers will be different, right?

16 MR. PHILLIPS: Yes.

17 THE COURT: So, yes, why don't you do that.

18 MR. PHILLIPS: And there's one other issue, Your
19 Honor, there are two documents used in the deposition
20 that are not on either party's list. Those documents
21 are not being offered, but for context for the Court,
22 would you like us to pass you those two documents as
23 well and point out to the Court when those documents are
24 used, for the context?

25 THE COURT: I suppose that would be useful.

1 MR. PHILLIPS: Okay.

2 (On video.)

3 DIRECT EXAMINATION

4 Q. Could you state your full name for the record,
5 please?

6 A. John Joseph Studzinski.

7 Q. I would like to turn to your background. Could
8 you state your educational history for us, starting with
9 college?

10 A. I attended Bowdoin College in Brunswick, Maine.
11 I have a double major in biology and sociology. I
12 graduated in June of 1978 and following that I got an
13 MBA from the University of Chicago, which I completed in
14 June of 1980.

15 Q. And could you list for us your work experience
16 after you received your MBA?

17 A. I started, I believe it was on August 4, 1980,
18 at -- in the Mergers and Acquisitions Department at
19 Morgan Stanley. I remember because I was the first
20 person who arrived in my class; it was a Monday morning.
21 And I was at Morgan Stanley until, I think, 2003. And
22 then after -- so I was at Morgan Stanley for
23 approximately 23 years.

24 Then after that I moved to HSBC in London where
25 I was on -- joined the Management and Executive

1 Committee that was responsible jointly for the corporate
2 investment banking and markets business, which I did for
3 three years until 2006. And then in October of 2006 I
4 joined the Blackstone Group, and here we are in December
5 2013 and I continue to work at the Blackstone Group.

6 Q. Thank you.

7 Sir, if we could just go back to your time at
8 Morgan Stanley, and I know you were there for a number
9 of years. Could you very briefly describe what you did
10 at Morgan Stanley, a broad overview, maybe focused on
11 the latter part, of what your role was or your duties
12 included?

13 A. Well, my class at Morgan Stanley was the first
14 class they took directly into -- so it was a bit like
15 the marine reserves -- they took directly into the
16 Mergers and Acquisitions Department. So prior to that
17 people coming into Morgan Stanley and Wall Street
18 generally spent two years in corporate finance, but my
19 class was seen to be a very strong class so they put us
20 right into the deep end of mergers and acquisitions. So
21 from day one I was actually involved -- I mean literally
22 from day one -- in a fairly intense M&A advisory
23 environment.

24 I continued in that role for a couple of years
25 and I did well in my job. I was promoted and I played

1 an operating management role in the department. I was
2 ultimately asked if I would move to London to start our
3 European investment banking business in -- I think if I
4 had to recall exactly, it may not be the exact month,
5 but I think it's probably February of 1983 -- and I then
6 worked towards building the M&A practice and the
7 investment banking practice of Morgan Stanley throughout
8 that whole period.

9 So my job remained very much focused on M&A,
10 investment banking and on the client advisory side,
11 really through my whole period up until 2003.

12 Q. What about your time at HSBC?

13 A. My time at HSBC was -- it was actually quite
14 interesting because I was able to take my investment
15 banking background, which was very focused on investment
16 banking, corporate finance, M&A, and broaden it to have
17 responsibility not only for investment banking, M&A
18 markets, but also wholesale and corporate lending, and
19 it also gave me an extraordinary exposure in management.
20 I had over 65,000 people reporting to me who gave me the
21 responsibility of understanding wholesale and corporate
22 lending and a whole range of other banking-related
23 services such as custody in the trade services and what
24 have you. So it was a very good broadening of both my
25 responsibility and my own orientation.

1 And lastly, of course, it gave me a very good
2 understanding of emerging markets, particularly Asia,
3 China, India and the Mid East as well as Latin America,
4 whereas prior to going to HSBC my focus really had been
5 very European centric.

6 Q. Sir, I would like to move now to your time at
7 Blackstone. Your current position, I believe, is Senior
8 Managing Director and Global Head of Blackstone Advisory
9 Partners, correct?

10 A. That is correct.

11 Q. Turning to the AIG situation, did you first
12 become involved with AIG on or about September 12, 2008?

13 A. I would be grateful if you could re-define or
14 ask the question again. "First became involved?" What
15 do you mean by "involved"?

16 Q. The issue in this case centers around,
17 ultimately, a loan made to AIG in September 2008. So
18 when I say "involved," were you aware of the issues in
19 September 2008 that AIG was having with liquidity?

20 A. That is a very general question. We --
21 Blackstone was engaged as an adviser that weekend.
22 Detailed conversations began on Friday evening about the
23 likelihood that AIG would retain a financial adviser to
24 assist in procuring capital for its own perceived
25 short-term needs.

1 I think I would distinguish your question
2 because there's a difference, as you know, in saying
3 "liquidity" versus "capital." One is a balance sheet
4 issue and one is a market trading counter-party issue,
5 and they are very different. But there was clearly a
6 short-term funding need that we were asked to begin to
7 assess on Friday evening, and we began assessing it in
8 detail, really, the following day on Saturday.

9 Q. As of September 2008 Blackstone was engaged in
10 advisory services for capital raising. Could you
11 explain what that role was in this capital-raising
12 engagement?

13 A. It was very specific. It was -- actually we
14 were asked to -- we were asked as to whether we could
15 identify sources of investment capital of approximately
16 US\$20 billion over a very short time frame to deal with
17 perceived pending capital shortfall needs over the
18 course of that weekend.

19 Q. Who at AIG asked you to identify the sources of
20 capital for this approximately \$20 billion shortfall?

21 A. Brian Schreiber.

22 Q. And were you working with Mr. Schreiber
23 directly?

24 A. Yes.

25 Q. This advisory relationship, were you dealing

1 with anyone other than Mr. Schreiber at AIG?

2 A. AIG is a big company. There are many
3 professionals. I can't recall specifically if I was
4 dealing just with Mr. Schreiber. I believe, based on my
5 recollection today, that I also would have had
6 conversations at the onset of that weekend with
7 Mr. Willumstad about the importance of this project as
8 well.

9 Q. In identifying sources of capital, what did you
10 or other members of the Blackstone Group do to identify
11 entities or parties that might be able to lend or
12 provide money to fill that \$20 billion shortfall?

13 A. Well, as a professional matter we had to do a
14 number of things.

15 Number one, we had to understand the situation,
16 which we spent most of Saturday doing. I physically did
17 not arrive --

18 My team, which consisted of four other partners
19 from Blackstone, and then a cascade of junior people
20 below them, but they began focused on this on Saturday
21 morning. So we (a) needed to define and understand the
22 nature of the client's request, (b) we had to understand
23 the time frame needed, (c) we needed to understand the
24 types of investors or the types of sources of funding
25 that would be acceptable or not acceptable. And we did

1 that early on Saturday.

2 Q. First, sir, who was on that team from
3 Blackstone? You identified four senior people, I
4 believe. What were their names?

5 A. They were Martin Alderson Smith, Larry Nath
6 (N-A-T-H), Tom Stoddard (S-T-O-D-D-A-R-D) and Anthony or
7 Tony Steains (S-T-E-A-I-N-S). That was the core of the
8 partners at that time. Later on in the weekend, on
9 Sunday, I had also consulted with another partner of
10 mine, Art Newman (Arthur Newman), as well.

11 Q. And were each of these five individuals given
12 any particular task? Were these particular individuals
13 given a particular task and, if so, what tasks was each
14 individual given? I'll break it up into two, sir.

15 Were the five individuals that you identified
16 given particular tasks in regard to this particular
17 engagement that started on September 12, 2008?

18 You can answer the question, sir.

19 A. They were... They all... They were made aware
20 on Saturday that there was a very short time frame where
21 US\$20 billion needed to be raised, namely that time
22 frame was approximately 24 to 48 hours, and that we were
23 targeting a sort of -- an intent to raise that amount of
24 money in two days, which is, you could argue among sane
25 people, is probably in the category of fantasy.

1 Each of the four, really, were there with
2 respect to their specific area of expertise and yet,
3 because of the short time duration and the fluidity of
4 the weekend and the number of sources of capital that we
5 were having parallel discussions with, I would say that
6 while they all had a primary focus, their different
7 roles overlapped, because there was a long list of
8 things they were doing to (a) understand the balance
9 sheet of AIG in terms of issues relating to capital
10 needs, solvency, and liquidity; (b) trying to understand
11 the issues of certain assets that were there, such as
12 ILFC, which was the aircraft leasing business which
13 Martin Alderson Smith is particularly knowledgeable
14 about; (c) there was also the need to understand the
15 holding company, which Larry Nath took responsibility
16 for; and (d) Tom Stoddard, whose expertise is really
17 that of being an insurance specialist; namely life, P&C
18 and what have you. His focus really was understanding
19 the insurance operations -- operating operations of AIG,
20 what their capital issues were, but also whether there
21 was any sources of capital for AIG among the global
22 insurance sector.

23 Q. How about Mr. Steains or Mr. Newman?

24 A. Mr. Steains, he is based in Hong Kong. He was
25 not physically in New York that weekend. And he became

1 relevant because a large portion of the AIG operations
2 and -- asset operations and assets are in Asia, and
3 therefore his knowledge of the liquidity issues and
4 solvency issues, regulatory issues from a Hong Kong and
5 other Asian perspective was relevant as well as we
6 started to think about sources of capital that weekend.

7 Mr. Newman, when he was consulted on Sunday, to
8 my recollection his focus, of course, is on insolvency
9 and issues to deal with solvency, liquidity and that
10 broader category of that practice within our advisory
11 area of Blackstone.

12 Q. Going back to the three points you raised, which
13 were -- I believe you said you needed to identify the
14 extent of the issue with AIG, then focus on a time
15 frame, and then determine what sources were acceptable.

16 Focusing on your first point, how were you and
17 the other members of Blackstone learning about the
18 extent of the issues on AIG on the weekend of September
19 12 through September 16, 2008?

20 A. I think it's important that I be clear. We were
21 told there was a perception by AIG that there was a
22 problem. We had no basis to believe there was a problem
23 other than what we were told. We had no ability to
24 verify/analyze ourselves (a) because of the short
25 duration and (b) because of the management information

1 system in AIG, which is slightly somewhere between the
2 abacus and some variation thereof, and therefore it was
3 limited in our ability to do other than be, at that
4 point, told the perception was that this was the
5 shortfall. And therefore, rather than analyze it and
6 say -- as much as we wanted to analyze it, and we tried,
7 we had to accept what the AIG client team led by Brian
8 Schreiber told us was the specific need of US\$20
9 billion.

10 Q. Focusing on your third point, determining what
11 sources were acceptable, how did you or the Blackstone
12 team go about determining whether sources were
13 acceptable to provide money to AIG?

14 A. Well, it's called professional judgment. And
15 you try to -- three equations, three unknowns: Short
16 time frame, try to identify what type of assets AIG had
17 that could be seen to be either saleable in the course
18 of the weekend, which gets into the fantasy land
19 category, or which assets can be identified as
20 collateral that weekend and, thirdly, who do you have
21 the ability to speak to over the weekend at the most
22 senior decision-making levels on the planet who will (a)
23 take your call and (b) be interested in this situation.

24 So, it was a -- it was not science, it was more
25 of an art. It was more, end of the day, as I said, a

1 judgment based on my 30 years of what we described
2 earlier of being at Morgan Stanley, HSBC, and then at
3 Blackstone. It became an issue of corporate finance
4 meets a specific situation meets a short time frame
5 meets a global source of investors for this particular
6 very defined situation.

7 And lastly, if you recall that weekend was
8 already a dramatic weekend in what was going on in
9 financial services because the whole world was focusing
10 on a number of other financial institutions that were
11 already having problems. So there was a great deal of
12 scrutiny placed on issues of liquidity and the valuation
13 of financial assets.

14 So, it was a period of enormous, I would say,
15 activity and the only positive out of that was the
16 ability to access very senior people who were prepared
17 to talk and be constructive was very real.

18 Q. Speaking about global sources and access to the
19 people, did you personally have any contact with any
20 global sources of investment during the weekend of
21 September 12 through September 16, 2008?

22 A. Yes.

23 Q. With whom did you either talk or communicate
24 that weekend?

25 A. Well, I have -- to the best of my recollection I

1 think I spoke to more people that weekend than I can
2 recall today. I obviously had specific conversations
3 with people like Kok Song Ng, the Governor of Singapore
4 in Singapore, because they're one of the largest
5 sovereign wealth funds in the world, and I knew that
6 they had a long-standing respect for AIG and I knew that
7 Singapore would be -- has been very focused on the
8 financial stability of Asia, because that's, of
9 course -- that's where they're situated. So I did speak
10 to Kok Song Ng.

11 And of course there are a number of other
12 financial players that were in dialogue with that
13 weekend who had either put their hand up and approached
14 AIG based on market rumors, whether it was Chris Flowers
15 or Deryck Maughan of KKR or people at financial
16 institutions, such as Axa and Allianz, just to name a
17 few. I cannot recall all the individuals and all the
18 institutions but I would say there was a large number of
19 them.

20 Q. Did you speak with anyone from CIC during that
21 weekend?

22 A. I did not directly speak to anybody from CIC
23 that weekend. Did Blackstone have conversations that
24 weekend with the entity CIC? I believe there were
25 conversations with one of my partners in Asia and I also

1 believe that, to the best of my recollection, Deutsche
2 Bank had surfaced as being a possible adviser to CIC and
3 they had contacted a number of my colleagues. I think
4 Larry Nath and Tom Stoddard and Martin Alderson Smith
5 had made their interest known as to being a possible
6 investor.

7 Q. What do you recall of your discussions with
8 Mr. Maughan?

9 A. I recall two or three things.

10 Number one, I recall that KKR was approaching us
11 in a very professional way; that they were sincere and
12 earnest of trying to establish a position of
13 understanding which would allow them to make an
14 investment.

15 I recall that Mr. Maughan also, given he's a
16 senior person in financial services and a grown-up,
17 understood the complexity of making this type of
18 decision under this time frame, namely that it was, to
19 use my word, a fantasy and almost impossible.

20 And, number three, I recall that he also, on
21 Sunday, began to raise a number of very astute, astute,
22 astute observations about the financial issues
23 surrounding the company's position which, while it
24 didn't discourage KKR, made it very clear that any
25 proposal they were going to make was going to be

1 caveated or subject to a number of other, what we call
2 in the trade, conditions precedent.

3 Q. What were some of Mr. Maughan's astute
4 observations?

5 A. His astute observations were that -- the concern
6 about understanding the actual nature of the liquidity
7 or solvency shortfall and concerns about lack of
8 collateral and that one could get in such a short time
9 frame; concerns about not being able to construct -- I
10 think this is probably the best comment I would make --
11 in a model that would reflect on a dynamic basis, on an
12 ongoing concern basis, the ongoing funding needs under
13 these circumstances. And I don't recall the details of
14 it, but he --

15 You know, during these periods of time where you
16 have to assess investor credibility there are a lot of
17 people who are completely off with the fairies and
18 pretend that they're going to write a check in 24 to 48
19 hours and they try to put forward a --

20 Derrick Maughan was very thoughtful but at the
21 same time, very realistic about the fact that KKR wanted
22 to make a thing but they had a lot of concerns. And the
23 more time they spent on Sunday, quite frankly, the more
24 articulate they were about their concerns and for the
25 most part they were all reasonable if not justifiable.

1 Q. You just stated that Mr. Maughan raised a
2 concern about a difficulty in identifying the ultimate
3 funding need. Could you elaborate on that any more?

4 A. I can elaborate on it only by re-stating it, and
5 that is that he was concerned that there was uncertainty
6 as to whether the objective put forward by AIG in the
7 form of Mr. Schreiber's request of a 20 billion capital
8 investment be dealt with. And I think the view was
9 there was uncertainty as to where that number came from
10 and whether that number was actually the real number or
11 whether the number was more. But there was -- again,
12 this is a judgment, it is not black and white, and it
13 certainly wasn't black and white that weekend given the
14 time frame and given the amount of -- given the sort of
15 inconsistent information that was made available.

16 Q. I would like to turn your attention back to your
17 discussions with individuals in Singapore. I believe
18 you mentioned that you spoke with Mr. Ng about that?

19 A. Well, his Christian name, Peter Ng, Peter as in
20 sort of "on this rock I will build my church," but the
21 Chinese name is Kok Song Ng.

22 Q. Could you spell that for the court reporter,
23 please, if you know?

24 A. Of course I know. K-O-K, new word, S-O-N-G, Ng,
25 N-G.

1 Q. I didn't mean to cut you off. You were --

2 A. No.

3 But in Chinese it would be Ng Kok Song. I don't
4 know whether you are going to have this transcript in
5 Mandarin, so I --

6 Q. So, you were saying that you had spoken to him.
7 What were you two talking about?

8 A. Well, first of all, my relationship with Peter
9 is very close, number one. So the ability to pick up
10 the phone on Saturday or Sunday and have multiple
11 conversations with the head of the Investment Authority
12 at the Government of Singapore is, in itself, something.

13 We basically talked about -- I was very clear.
14 I said that Blackstone had been asked by the Board of
15 AIG, through the form of Brian Schreiber, to see whether
16 or not that weekend we could identify one or two
17 investors who would be interested in investing
18 approximately US\$20 billion and making that sort of
19 complete by Sunday evening.

20 Q. And what was Mr. Ng's response?

21 A. Well he knew, because he's a very savvy guy and
22 he knew what was going on in the world, that there was
23 obviously a problem.

24 He knew, of course, that Singapore is an
25 important leg in the AIG portfolio and therefore the

1 government of Singapore, similar to other governments in
2 Asia, wanted to make sure that the AIG situation was
3 taken seriously and was stabilized if there was an issue
4 of instability or perceived instability. He also asked
5 specifically what could he invest in. Because
6 obviously, you know, he's not in the position to sort of
7 make a charitable contribution of \$20 billion, he
8 actually has to make an investment. So that's all we
9 discussed.

10 Q. And what was Mr. Ng's position on making any
11 investment in AIG at that time?

12 A. I would say, based on my recollection, that it
13 was open-minded, not unconstructive. I would say that
14 it was obviously caveated on the basis of the
15 investment. So we tried to identify what I call
16 "tangible assets" as opposed to flakey or sort of
17 operational assets that were not identifiable, but
18 tangible assets such as real estate that could be
19 invested in or used as collateral that weekend,
20 basically within 24 hours.

21 Q. Was Mr. Ng only interested in assets such as
22 real estate?

23 A. I think he was interested and open-minded in
24 anything I could propose that was tangible. Obviously
25 one could also talk about the -- any of the Asian

1 insurance operations of AIG at that time. But, again,
2 it gets down to this quid pro quo of having to identify
3 hard funding. I mean cash in hand -- and I'm talking
4 about cash in hand -- by a Sunday evening. And there
5 are a number of assets, therefore real estate is
6 tangible. There are a number of other assets in Asia,
7 such as the crown jewel AIA, which of course is based in
8 Hong Kong, and that was also discussed. But, again,
9 that -- there was nothing more tangible than real
10 estate.

11 Q. Did Mr. Ng express any upper limit that GIC
12 would be interested in investing?

13 A. I don't recall. I don't think so. No, I think
14 the reality is we didn't -- I didn't go -- the
15 discussion I had with him was based on 20 billion, I
16 don't recall a discussion beyond that.

17 Q. Was he willing to invest 20 billion or less?

18 A. We were in -- we were dealing with hypotheticals
19 until we actually could identify a tangible asset to
20 discuss.

21 (Video off.)

22 MR. PHILLIPS: Your Honor, at this point, DX 262
23 will be discussed.

24 (Video on.)

25 Q. You have been handed what's been marked as, with

1 the Bates stamp of BXStarr448. It's a 9/12/2008 email
2 at 7 p.m. that you sent to members of your Blackstone
3 team regarding GIC?

4 A. Right.

5 Q. Sir, I would like to focus on the third line
6 down where you wrote: "Not sure they will move by
7 Sunday or Monday." What did you mean by that?

8 A. Well, I think it's very clear English. I think
9 it means that having spoken to Peter Ng, as I said in my
10 earlier part of this discussion, they have every
11 intention of being helpful and constructive and, as I
12 also say here, would prefer to buy outright real estate.
13 But by "move" I would say I meant that they would be
14 able to have funding in place, which was our objective,
15 by Sunday or Monday.

16 Q. So GIC was unable to have that funding in place
17 in the short time frame that we've been discussing --
18 that you've been discussing -- the 24 to 48-hour period?

19 A. I think it was my judgment at that time that
20 they were not prepared to necessarily commit that
21 weekend. And as I say further, I see now "could"
22 commit -- conditional, "could" commit -- up to 10
23 billion, but would need two weeks.

24 Q. So, focusing on that sentence, "could commit,"
25 do you understand --

1 A. Actually, this is a quite good email, it sort of
2 summarizes it very well.

3 Q. Do you recall writing this email at the time?

4 A. No one else writes my emails, so this is my
5 email.

6 Q. And would this email have been contemporaneous
7 with your phone calls with Mr. Ng?

8 A. Yes.

9 Q. Do you believe that what you wrote in here would
10 have been an accurate summary of your discussions with
11 him?

12 A. Yes.

13 Q. So, when you -- and I would like to focus on
14 that "could commit up to 10 billion." So, do you
15 understand --

16 Looking at this document now, do you believe
17 that GIC may not have had the ability to put in \$10
18 billion right away or wasn't even committed to doing
19 that yet?

20 You can answer the question, sir.

21 A. I think you have to remember GIC is an investor.
22 They were very willing to commit. As I say here, "could
23 commit up to 10 billion," but they would need to do
24 their own due diligence and verify the underlying assets
25 in which they were investing. They are, effectively, a

1 fiduciary and they have to exercise fiduciary
2 prerogative over any investment decision.

3 Q. Fair enough, sir. I understand.

4 So, you understood at the time that GIC would
5 need more time than the two days that were available to
6 it to be able to complete its due diligence review to be
7 in a position to make any investment in AIG?

8 You can answer the question, sir.

9 A. Well, I think the reality is -- well, repeat
10 your question because I think this is not that
11 complicated, really.

12 Q. I agree. Do you -- fair enough, sir.

13 You understood at the time that GIC would need
14 more than two days time in which to evaluate and have
15 money on the table to invest in AIG?

16 A. I think, as I say here, they would prefer to buy
17 the real estate outright. And if I could have sold them
18 real estate that weekend -- maybe I should elaborate on
19 this just to be helpful.

20 If I could have sold them real estate that
21 weekend totaling US\$20 billion, we could have done that.
22 When we actually went to identify AIG's real estate,
23 it's not all in one place, it's actually across the
24 whole portfolio of insurance companies. So I was
25 unable, from the standpoint of harnessing or accessing

1 liquidity, to put one's finger on it in a short
2 duration.

3 It was my judgment that they would need two
4 weeks because they would have to conduct their own
5 protocol. I mean Mr. Ng was not in a position to write
6 a check for 10 billion or 20 billion. He was in a
7 position to say that this was urgent, that GIC felt they
8 should try to be constructive and helpful to the
9 company's short-term needs, but he was certainly not
10 prepared to do more than I say in this email.

11 Q. I would like to turn back to the questions about
12 CIC, and I would like to show you a few documents.

13 (Video off.)

14 MR. PHILLIPS: Your Honor, at this point, DX 247
15 will be discussed.

16 (Video on.)

17 Q. Sir, you have been handed what has been marked
18 as Exhibit 2. This is a 9/12/2008 email with a Bates
19 stamp BXStarr473. It is an email that you sent to
20 Mr. Schreiber at AIG. Do you recall this email, sir?

21 A. Well, of course I do. I mean, I'm not -- I
22 don't recall this sort of -- it's the first time I've
23 seen it printed out, but I recall -- it's bad English,
24 though, in the third paragraph. I don't normally write
25 bad English.

1 Q. Okay. I would like to focus on the second
2 paragraph where you start with:

3 "We discussed thoroughly tonight with Beijing
4 what the Chinese CIC would or would not do and we can be
5 useful here."

6 I would like to focus in on the clause "what the
7 Chinese CIC would or would not do."

8 Do you recall anything surrounding that
9 statement, do you have any recollection of what in
10 particular CIC was prepared or willing, as you say,
11 would or would not do as of the date of this email?

12 A. Well, yes, I recall -- although I have to
13 confess, I do not recall that much detail because, first
14 of all, I did not speak to CIC directly. Let me be very
15 clear about that, zero conversation with CIC directly.
16 I do recall my colleague spoke to CIC, and that was
17 Anthony Leung (L-E-U-N-G) to try to ascertain whether
18 CIC would have an interest in this sort of weekend
19 investment opportunity.

20 Q. And did you have discussions with Mr. Leung
21 about his calls with CIC?

22 A. I don't recall talking to him directly. I know
23 a number of my colleagues did, including Mr. Steains,
24 who is referred to at the top of the email, tracking
25 down Tony. But I know the -- I know the gist of what

1 was said, which was no more than: Government of China
2 has big investment in United States, saw AIG as an
3 important financial institution and would try to be
4 constructive. They gave what I thought was a
5 politically positive encouragement, but with no specific
6 financial commitment at all to doing anything.

7 Q. Did they -- did you understand the gist of this
8 conversation had put any sort of dollar figure in CIC's
9 mind?

10 A. I don't recall with respect to this
11 conversation.

12 Q. With respect to a later conversation?

13 A. No. But if you -- what I said earlier was that
14 they were very focused on there being a problem, and if
15 someone wanted to engage them they would try to sit down
16 and be constructive. That could be a bigger number, it
17 could be a smaller number. What I'm saying is that they
18 were not tying it to the 20 billion, I recall, that
19 weekend.

20 Q. What were they tying it to then?

21 A. They were tying it to the fact that AIG was a
22 big company and that there was a broader set of things
23 that they would want to do.

24 I think you have to -- I think you're asking
25 very good questions, but if you were there that weekend,

1 there was a short-term Band-aid that had to be dealt
2 with and the Band-aid on the whole kept getting -- the
3 perception was that the situation was worsening by the
4 hour. That is a strong situation.

5 As a financial adviser talking to people outside
6 of that microcosm, you cannot create the appearance of
7 any financial instability that would be bad behavior and
8 it would be professionally inappropriate. So, when you
9 are talking to people, people are assuming they're going
10 to have one, two, three, four, five weeks to make a
11 decision, and particularly the Chinese, and particularly
12 CIC, would take time. They would not write a check
13 in -- my judgment again. This is my judgment. They
14 would not write a check in 24 hours.

15 Q. So were these discussions with CIC more
16 preliminary in nature?

17 A. Preliminary is -- we were canvassing the market,
18 full stop.

19 Q. And in "canvassing the market," do you mean you
20 were looking for potential interest in the market?

21 A. We were asked by the Board of AIG to assess
22 sources of funding for a 48-hour window and we were
23 canvassing the market.

24 Q. Did you have any understanding that CIC could
25 not be a source of funding in that 48-hour window?

1 A. We could not eliminate CIC but we couldn't
2 necessarily say that they would be a source of funding,
3 either. We could nor eliminate nor confirm.

4 Q. Sir, I'm going to have a few more questions
5 about CIC, so I'm going to give you another document
6 here. While you're reading, I'll just -- this is a
7 two-page document with Bates stamps --

8 (Video off.)

9 MR. PHILLIPS: Your Honor, at this point JX 69
10 will be discussed.

11 (Video on.)

12 Q. -- series of three emails dated 9/16/2008, the
13 top one from Mr. Alderson Smith and to Mr. Studzinski
14 and others. It is Exhibit 3 in this case.

15 A. So, let me read this backwards here.

16 Q. Sir, this string of emails, you received each of
17 the three emails. Do you recall having received this
18 document -- this email at the time?

19 A. I recall these conversations and I recall -- I
20 recall -- I guess I do recall these emails.

21 Q. Which conversations do you recall?

22 A. I recall the fact that CIC had a general
23 interest in the situation but they couldn't be more
24 specific than that in terms of the amount of money or
25 the timing.

1 Q. And when you say "they couldn't be more specific
2 about the amount of money or the timing," what are you
3 referring to?

4 A. Well, as I think as is referenced in this email,
5 they were looking -- they had -- Chairman Lou then
6 brought up CIC's potential interest in AIG. They had an
7 interest in AIG but it was never ever -- and this was
8 Tuesday or Monday. I can't -- these email timings -- I
9 can't recall the timing of these conversations because
10 you have to remember that these conversations, Chairman
11 Lou was in China, we were in New York and there's a
12 12-hour time difference there and these were -- but all
13 I recall is that CIC had an interest in the situation
14 for a number of days, even while the number of real
15 options started to run out, because they obviously found
16 the Asian assets very attractive as investments.

17 Q. So, you understood that CIC was only looking at
18 potentially purchasing Asian assets of AIG?

19 Did you understand that CIC was only looking to
20 purchase Asian assets that AIG held?

21 A. I understood that they had a general interest
22 and that their interest stemmed from the fact that their
23 knowledge of AIG was based on their knowledge of AIG's
24 Asian operations. In Asia AIG is perceived as an Asian
25 financial institution, even though they are domiciled in

1 New York.

2 Q. Okay.

3 Looking back at the first email, which is the
4 Bates stamp 260, and that's the number at the bottom of
5 the page there, Stephen Schwarzman was at the time the
6 chairman and CEO of Blackstone, wasn't he?

7 A. He was and still is.

8 Q. And were you having any conversations with
9 Mr. Schwarzman at the time -- and I'm referring to
10 September 12 through September 16, 2008 -- about the AIG
11 situation?

12 A. Is the Pope Catholic? Yes.

13 Q. Is it fair to say that you and Mr. Schwarzman
14 were talking frequently about this situation?

15 A. Yes.

16 Q. So that any information he may have had he would
17 have relayed to you and vice versa?

18 A. Yes.

19 Q. So what Mr. Schwarzman is communicating in this
20 email you understood to be the position of CIC?

21 A. I have no other reason to think that this is not
22 the position of CIC.

23 Q. So just focusing on a couple sentences in here.
24 If you turn to page 260, the second page of this
25 document. I just want to read the third paragraph down,

1 where Mr. Schwarzman writes:

2 "I probed with Chairman Lou as to how big CIC
3 would be in the AIG situation. Chairman Lou reiterated
4 that CIC was not interested in controlling or running
5 any business, but operated with other general partners.
6 He said, of course, that 75 billion was too much of
7 CIC's resources to invest in AIG."

8 So, was it your understanding at the time that
9 CIC would not be looking to put an amount of money
10 anywhere near 75 billion into AIG?

11 A. Well, I was not part of this conversation so I
12 cannot interpret Chairman Lou in any way other than this
13 conversation. And also, if you noted, Chairman Lou had
14 a translator, and this was the result of the
15 translation.

16 Q. But did you understand Mr. Schwarzman to be
17 expressing to you and the other recipients of this email
18 that CIC was not looking to put that much money into
19 AIG?

20 A. The number 75 billion, I do not know where that
21 comes from. The number 75 billion is an interesting
22 number, but it's one of many numbers. I do not know
23 where CIC's attitude about investment was because it
24 would be tied ultimately to the underlying assets.

25 Q. When you say their interests would be tied to

1 the underlying assets, what do you mean by that?

2 A. I mean that CIC's interest as investors would be
3 tied to what they actually would be investing in in the
4 vehicle of their investment, whether they were investing
5 in a specific insurance operation in Asia, whether they
6 were investing in other asset classes within the AIG
7 portfolio.

8 Q. Just focusing again on this second email. If
9 you look at one, two, three, four paragraphs down,
10 Mr. Leung writes:

11 "He also asked how much time they would have.
12 Told him things were moving very fast. If they want to
13 be involved now, it would be a couple of days."

14 Was it your understanding at the time -- and I
15 think this is what you have testified -- that CIC would
16 not have been able to provide funding within that very
17 short 24 to 48-hour time frame you were looking at over
18 the weekend of the 12th to the 16th?

19 You can answer the question, sir.

20 A. I think, based on our experience and my
21 experience, it would have been unprecedented for an
22 entity such as CIC -- it's not impossible, but
23 unprecedented based on my experience -- for that weekend
24 for them to come up with funding by Sunday night or
25 Monday morning. It's a judgment.

1 (Video off.)

2 THE COURT: Mr. Phillips, can we call it a day
3 at that point?

4 MR. PHILLIPS: Yes, Your Honor. I think that's
5 a logical place to stop.

6 One other point, Your Honor. There were two
7 documents that we used in this part of the video that
8 have not been entered into evidence. So, we would move
9 DX 247 and DX 262 into evidence.

10 THE COURT: Who's speaking on the Plaintiffs'
11 side? Okay, Mr. Boies?

12 MR. BOIES: Barely, Your Honor. No objection.

13 THE COURT: All right. Defendant's Exhibits 247
14 and 262 are admitted.

15 (Defendant's Exhibit Number 247 was admitted
16 into evidence.)

17 (Defendant's Exhibit Number 262 was admitted
18 into evidence.)

19 THE COURT: Have a good weekend. We'll see you
20 all on Monday morning at 9:30.

21 ALL COUNSEL: Thank you, Your Honor.

22 (Whereupon, at 4:55 p.m., the proceedings were
23 adjourned.)

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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: 11/1/2014 /S/ Susanne Bergling
SUSANNE BERGLING, RMR-CRR-CLR.

1	ADMITTED EXHIBITS		
2	PX	PAGE	DESCRIPTION
3	6	5503	Email (2/28/2006) From: Gene Park
4			To: Joseph Cassano, cc: Andrew Forster, Alan
5			Frost, Gary Gorton, Sheridan Teasel, Tom
6			Fewings, Adam Budnick re: CDO of ABS Approach
7			Going Forward - Message to the Dealer
8			Community
9	262	5625	Federal Reserve Statistical Release - H.15
10			(519) Selected Interest Rates for use at 2:30
11			p.m. Eastern Time (September 29, 2008)
12	1051	5501	AIG Slide Deck - Residential Mortgage
13			Presentation (Financial Figures as of June 30,
14			2007) (August 9, 2007 - Revised as to slide
15			29)
16	1291	5497	AIG Slide Deck "AIG Domestic Securities
17			Lending: A Presentation to State Insurance
18			Departments" (April 4, 2008)
19	1472	5514	Attachment to AIGSTARR00116202: Slides - Net
20			liquidity benefits of primary dealer
21	1474	5493	Email (8/27/2008) From: John Grace
22			To: Jens Berding re: Fw: SL & Ins. Co 's
23			Collateral
24			
25			

1	2182	5474	Collateral Margins for the Primary Dealer
2			Credit Facility (March 17, 2008 to February 1,
3			2010)
4	2565	5514	Federal Reserve Board of Governors Website
5			"Term Securities Lending Facility (TSLF) Data"
6			(spreadsheet, available at
7			http://www.federalreserve.gov/newsevents/files
8			/tslf.xls)
9	2850	5541	Professor Zingales' Expert Report
10	2851	5541	Professor Zingales' Expert Rebuttal Report
11	2852	5541	Professor Kothari's Expert Report
12	2853	5541	Professor Kothari's Rebuttal Expert Report
13	2854	5541	Dr. Wazzan's Expert Report
14	2855	5541	Dr. Wazzan's Expert Rebuttal Report
15	2856	5541	Dr. Cragg's Expert Report
16	2857	5541	Dr. Cragg's Expert Rebuttal Report
17	5001	5444	Cragg Demonstrative Exhibit
18	5004	5444	Cragg Demonstrative Exhibit
19	5006	5444	Cragg Demonstrative Exhibit
20	5007-A	5444	Cragg Demonstrative Exhibit
21	5011	5444	Cragg Demonstrative Exhibit
22	5012	5444	Cragg Demonstrative Exhibit
23	5045	5442	Chart From Professor Zingales' Testimony
24	5046	5442	Chart From Professor Zingales' Testimony
25	5047	5442	Chart From Professor Zingales' Testimony

1	5048	5442	Chart From Professor Zingales' Testimony
2	5049	5442	Chart From Professor Zingales' Testimony
3	5050	5442	Chart From Professor Zingales' Testimony
4	5052	5442	Chart From Professor Zingales' Testimony
5	5053	5442	Chart From Professor Zingales' Testimony
6	5054	5442	Chart From Professor Zingales' Testimony
7	5055	5442	Chart From Professor Zingales' Testimony
8	5056	5442	Chart From Professor Zingales' Testimony
9	5058	5442	Chart From Professor Zingales' Testimony
10	5059	5442	Chart From Professor Zingales' Testimony
11	5061	5442	Chart From Professor Zingales' Testimony
12	5062	5442	Chart From Professor Zingales' Testimony
13	5063	5442	Chart From Professor Zingales' Testimony
14	5064	5442	Chart From Professor Zingales' Testimony
15	5065	5442	Chart From Professor Zingales' Testimony
16	5066	5442	Chart From Professor Zingales' Testimony
17	5067	5442	Chart From Professor Zingales' Testimony
18	5069	5442	Chart From Professor Zingales' Testimony
19	5100	5544	Cragg Demonstrative Exhibit
20	5200	5542	Slide From Dr. Kothari's Testimony
21	5201	5542	Slide From Dr. Kothari's Testimony
22	5202	5542	Slide From Dr. Kothari's Testimony
23	5203	5542	Slide From Dr. Kothari's Testimony
24	5204	5542	Slide From Dr. Kothari's Testimony
25	5205	5542	Slide From Dr. Kothari's Testimony

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1	5206	5542	Slide From Dr. Kothari's Testimony
2	5207	5542	Slide From Dr. Kothari's Testimony
3	5208	5542	Slide From Dr. Kothari's Testimony
4	5209	5542	Slide From Dr. Kothari's Testimony
5	5210	5542	Slide From Dr. Kothari's Testimony
6	5211	5542	Slide From Dr. Kothari's Testimony
7	5212	5542	Slide From Dr. Kothari's Testimony
8	5213	5542	Slide From Dr. Kothari's Testimony
9	5214	5542	Slide From Dr. Kothari's Testimony
10	5215	5542	Slide From Dr. Kothari's Testimony
11	5216	5542	Slide From Dr. Kothari's Testimony
12	5217	5542	Slide From Dr. Kothari's Testimony
13	5218	5542	Slide From Dr. Kothari's Testimony
14	5219	5542	Slide From Dr. Kothari's Testimony
15	5220	5542	Slide From Dr. Kothari's Testimony
16	5221	5542	Slide From Dr. Kothari's Testimony
17	5222	5542	Slide From Dr. Kothari's Testimony
18	5223	5542	Slide From Dr. Kothari's Testimony
19	5224	5542	Slide From Dr. Kothari's Testimony
20	5225	5542	Slide From Dr. Kothari's Testimony
21	5226	5542	Slide From Dr. Kothari's Testimony
22	5366-A	5515	Cragg Demonstrative Exhibit
23	5339-A	5518	Cragg Demonstrative Exhibit
24	5352-A	551	Cragg Demonstrative Exhibit
25	5390	5544	Cragg Demonstrative Exhibit

1	5391	5544	Cragg Demonstrative Exhibit
2			
3			
4	DX	PAGE	DESCRIPTION
5	247	5678	EMAIL FROM JOHN STUDZINSKI TO BRIAN SCHREIBER
6			RE: HELLO, (ROLE IN RAISING CAPITAL)
7	262		EMAIL FROM JOHN STUDZINSKI TO MARTIN ALDERSON
8			SMITH RE: GIC IMPRESSIVE
9	1880	5557	Dr. Neuberger Expert Report
10	1881	5557	Dr. Neuberger Expert Rebuttal Report
11	2261	5598	Doomsday Book Memorandum
12	2402	5598	Dr. Neuberger Slide
13	2403	5598	Dr. Neuberger Slide
14	2404	5598	Dr. Neuberger Slide
15	2405	5598	Dr. Neuberger Slide
16	2406	5598	Dr. Neuberger Slide
17	2407	5598	Dr. Neuberger Slide
18	2408	5598	Dr. Neuberger Slide
19	2409	5598	Dr. Neuberger Slide
20	2410	5598	Dr. Neuberger Slide
21	2411	5598	Dr. Neuberger Slide
22	2412	5598	Dr. Neuberger Slide
23	2413	5598	Dr. Neuberger Slide
24	2414	5598	Dr. Neuberger Slide
25	2415	5598	Dr. Neuberger Slide

1	2416	5598	Dr. Neuberger Slide
2	2417	5598	Dr. Neuberger Slide
3	2418	5598	Dr. Neuberger Slide
4			
5	DXX	PAGE	DESCRIPTION
6	020	5540	Dr. Cragg Demonstrative Exhibit
7	021	5540	Dr. Cragg Demonstrative Exhibit
8	022	5540	Dr. Cragg Demonstrative Exhibit
9	023	5540	Dr. Cragg Demonstrative Exhibit
10	024	5540	Dr. Cragg Demonstrative Exhibit
11	025	5540	Dr. Cragg Demonstrative Exhibit
12	026	5540	Dr. Cragg Demonstrative Exhibit
13	027	5540	Dr. Cragg Demonstrative Exhibit
14	028	5540	Dr. Cragg Demonstrative Exhibit
15	029	5540	Dr. Cragg Demonstrative Exhibit
16	030	5540	Dr. Cragg Demonstrative Exhibit
17	031	5540	Dr. Cragg Demonstrative Exhibit
18	032	5540	Dr. Cragg Demonstrative Exhibit
19	033	5540	Dr. Cragg Demonstrative Exhibit
20	034	5540	Dr. Cragg Demonstrative Exhibit
21	035	5540	Dr. Cragg Demonstrative Exhibit
22			
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