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.
Monday, November 17, 2014
9:30 a.m.
Trial Volume 32

BEFORE: THE HONORABLE THOMAS C. WHEELER

Josett F. Whalen, RMR-CRR, Reporter

APPEARANCES:

ON BEHALF OF THE PLAINTIFFS:

DAVID BOIES, II, ESQ.
Boies, Schiller & Flexner, LLP
333 Main Street
Armonk, New York 10504
(914) 749-8201
dboies@bsfllp.com

and

AMY J. MAUSER, ESQ.
ABBY L. DENNIS, ESQ.
Boies, Schiller & Flexner, LLP
5301 Wisconsin Avenue, N.W.
Washington, D.C. 20015
(202) 237-2727
amauser@bsfllp.com
adennis@bsfllp.com

APPEARANCES: (continued)

ON BEHALF OF THE PLAINTIFFS:

ROBERT J. DWYER, ESQ.
ALANNA C. RUTHERFORD, ESQ.
Boies, Schiller & Flexner, LLP
575 Lexington Avenue, 7th Floor
New York, New York 10022
(212) 446-2300
rdwyer@bsfllp.com
arutherford@bsfllp.com

and

JOHN L. GARDINER, ESQ.
Skadden, Arps, Slate, Meagher & Flom LLP
4 Times Square
New York, New York 10036
(212) 735-2442
john.gardiner@skadden.com

APPEARANCES: (continued)

ON BEHALF OF THE DEFENDANT:

KENNETH DINTZER, ESQ.
BRIAN A. MIZOGUCHI, ESQ.
CLAUDIA BURKE, ESQ.
JOSHUA GARDNER, ESQ.
SCOTT AUSTIN, ESQ.
JOHN TODOR, ESQ.
JOHN H. ROBERSON, ESQ.
MATTHEW SCARLATO, ESQ.
RENÉE GERBER, ESQ.
MARIANO TERESA ACEVEDO, ESQ.
VINCENT D. PHILLIPS, ESQ.
ZACHARY SULLIVAN, ESQ.
U.S. Department of Justice - Civil Division
Post Office Box 480
Ben Franklin Station
Washington, D.C. 20044
(202) 305-3319
brian.mizoguchi@usdoj.gov

APPEARANCES: (continued)

ON BEHALF OF AIG:

SUNNY J. THOMPSON, ESQ.
Weil, Gotshal & Manges LLP
1300 I Street, N.W. - Suite 900
Washington, D.C. 20005-3314
(202) 682-7142
sunny.thompson@weil.com

I N D E X

WITNESS:	DIRECT	CROSS	REDIRECT	RECROSS	VOIR
MORDECAI	7427				7445
	7457	7599			

EXHIBITS	FOR ID	IN EVID
Plaintiffs'		
(none)		
Defendant's		
Number449		7498
Number560		7504
Number866		7595
Number1736		7500
Number1863		7589
Number1874		7460
Number1875		7460
Number1875-A		7428
Number2601-2625		7598
Number2626-A		7598
Number2627-2639		7598
Joint		
(none)		

P R O C E E D I N G S

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

THE COURT: We're on the record this morning for day 32 in the trial of Starr International Company versus the United States.

Mr. Gardner.

MR. GARDNER: Your Honor, before we call our next witness, just a very few housekeeping matters if we could.

THE COURT: Sure.

MR. GARDNER: You had asked, at the end of the day on Friday, about what the government's intention was with respect to calling Mr. Greenberg. I think you had indicated the clerk's office was particularly interested.

I think the clerk's office will be happy to know that the government does not intend to call Mr. Greenberg in its case in chief.

THE COURT: Okay. Thanks for letting me know.

MR. GARDNER: Sure.

The second issue is, as the Court may be aware, we all learned Friday afternoon that Mr. Offit had a funeral that he had to attend to, and that is why he cannot be here today.

I asked counsel for Mr. Offit, Mr. Curnin, when he could be available again. He's an out-of-town witness. And they indicated that he could be available to testify Wednesday morning.

THE COURT: Okay.

MR. GARDNER: So what the government intends to do -- and you know, this is pretty consistent I think with how we've operated throughout trial in terms of flexibility -- the government will present whatever witnesses it has Monday and Tuesday, but we may need to interrupt Tuesday's witness somewhat to get Mr. Offit on and off. I don't expect that we have much more testimony on the direct.

THE COURT: So he'll be back Wednesday morning; is that right?

MR. GARDNER: Wednesday morning at 9:30.

And then that will be followed by another short witness, Ms. Suzanne Nora Johnson, another AIG board member.

THE COURT: All right.

MR. GARDNER: Then we would continue on with the rest of the witnesses in order.

The only other thing I would mention is, the government intends to call Howard Smith, an employee from Starr International. The plaintiffs have indicated that his only date of availability is this Tuesday, tomorrow, and that's fine with the government. But I think what that means is, whoever is on the stand Tuesday may need to be interrupted somewhat to put Mr. Smith on. Again, that's a fairly short witness, so I don't think that should be too disruptive, but to accommodate plaintiffs' scheduling issues, that's fine with the government as well.

THE COURT: All right. Well, I'll leave it to you and Mr. Boies to orchestrate all of this, but it sounds like it's a workable plan.

MR. GARDNER: I think so.

And the government's intention still is to rest its case in chief this Friday. Obviously we can't predict how long cross-exams will be, but I think that is a workable goal.

We will file the proffer that we discussed last week today. The one issue there, Your Honor, is, because the proffer does implicate the equities of a third party, AIG, we wanted to make sure that if we were going to publicly file this that AIG wasn't going to have a concern that somehow there had been a broad waiver, even though I'm not sure the Department of Justice can waive AIG's privilege.

And one thing AIG had asked us or requested of us, or inquired I should say, is whether or not it would be appropriate to file this under seal, not ex parte.

From the Department of Justice's view, you know, obviously we do not like to file things under seal. We believe that court proceedings should be public. On the other hand, because of the uniqueness of this privilege issue, I'm not sure the government feels strongly one way or the other.

It certainly -- we don't think it should be ex parte. Obviously the plaintiffs should have the opportunity to see what it is we file, but because of the impending or burgeoning privilege issue, there was a thought that perhaps it did make sense under this limited circumstance to file this under seal for the Court's review, and so I mentioned -- I told Mr. Carangelo that we would at least explore that with the Court and take the Court's view.

THE COURT: The other option it seems to me would be to share it with AIG's counsel and --

MR. GARDNER: We did.

THE COURT: -- plaintiffs' counsel. You did.

MR. GARDNER: Well, we shared it with counsel for AIG to get a sense from them whether or not they felt that there was a need on their part to file it under seal, understanding that the government's position was we are reluctant to file things under seal because for all the reasons I just mentioned.

But my sense is that AIG will ask the Court to file it under seal, and the government doesn't really have a position on whether that's appropriate or not because it's really a third-party issue.

THE COURT: All right.

MR. GARDNER: And then the final thing, just to give you the entire schedule, given that the government is resting on Friday or we anticipate resting on Friday, we've heard several times throughout this case, as early as plaintiffs' case in chief, that plaintiffs have a desire to put on a rebuttal case.

And as this Court knows, you know, at least in the Court of Federal Claims, there's no entitlement or right to a rebuttal case. Typically you have to make a showing of need and that the testimony one wishes to present was not reasonably anticipated in their case in chief.

And what we would ask this Court to do, because of the logistics of next week being Thanksgiving, is that if there is going to be a rebuttal case that we know about it earlier rather than later. As you can imagine, mobilizing a large group of attorneys and consultants and things like that is somewhat of a logistical nightmare.

And it seems that the best approach may be to inquire of plaintiff what their need is, to proffer what they are -- what it is that they are rebutting, who they intend to use for that purpose, and then to come up with a schedule because I know Your Honor had mentioned previously you do not wish to have court next week during Thanksgiving, which, frankly, would be very helpful for me logistics-wise. But, you know, obviously we can be flexible and do what the Court wishes.

THE COURT: Well, I'm going to hear from Mr. Boies about this.

It's been my objective since the beginning to try to wrap this case up in about 34 trial days. Now, if we're two days off and it goes through Friday, that's not too bad. But it would be my strong desire to finish on Friday if we can. Because I'm not sure what the solution is if we don't finish on Friday.

MR. GARDNER: And the one thing I would request, Your Honor, is that if we do go further than Friday and if we don't go into the week of Thanksgiving, which I would strongly urge the Court not to for personal reasons, if we do go that following week, if we don't start on the Monday just because of the holiday weekend and I think many people are going to be tied up in traveling and things like that, that we start maybe on that Tuesday to the extent the Court concludes that a rebuttal case even is appropriate, which again I haven't heard a reason from the plaintiffs why it would be.

But again, I just think that now that we're getting close to the end, it may make sense now to try to start thinking about these issues and working through them.

THE COURT: I mean, I'll just emphasize again, I would like everybody to be thinking in terms of Friday.

MR. GARDNER: Understood, Your Honor.

THE COURT: Because after that, it gets complicated.

MR. GARDNER: Agreed, Your Honor.

THE COURT: Mr. Boies, I'd like to hear from you.

MR. BOIES: We do contemplate a rebuttal case, but as I have said to the Court before, I think it's going to be very short. My expectation is that my own testimony that I would be eliciting would not be more than four hours.

And obviously if we could do that this week, that would be ideal for all of us. I think that if we could finish on Thursday and we just split Friday up between my rebuttal and their cross of my rebuttal, we could make it work.

But it is a little hard to define exactly what we're going to do because, although there are a few things that we need to rebut now, a lot is going to come out of their experts.

THE COURT: Sure.

MR. BOIES: And so one of the things we have standing by are our experts in case we need to rebut something.

And for example, I suspect that something may come out of the witness today.

Now, we don't have any problem in identifying those things as we come up with them, and what we can do is overnight try to identify what we now know that we need to rebut.

Some of it -- it is conceivable to me that some of it we could do by stipulation. And I'd be certainly open to seeing if we could do that as well.

Now, in terms of if we don't do it, if we're not able to do it on Friday, obviously Thanksgiving week is not an ideal time to do it, but we probably could get it done on Monday. As I say, I think this is really a one-day thing, both cross and direct.

If we are not able to do it on Monday and it goes over to the following week, I would share counsel's desire not to do it on Monday because I have a hearing in Dallas, Texas in another matter on Monday that was scheduled when I thought this would be over by then. But if that didn't -- if it had to be on Monday, I would call the Court and try to get that postponed if I could.

THE COURT: Well, another consideration is that we can't continue to occupy this courtroom with all of the notebooks and such without using the courtroom. We can't just hold up and prevent other parties from using the courtroom.

Again, Friday is the goal here. But if we have to go over that, it's probably going to be next Monday. And then hopefully that's going to be it.

MR. BOIES: Yes.

MR. GARDNER: Understood, Your Honor.

MR. BOIES: Thank you, Your Honor.

THE COURT: Yes.

MR. GARDNER: Oh, I'm sorry.

And most importantly, the government calls as its next witness Dr. Mordecai.

THE COURT: All right. Very well.

Please come forward, sir.

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Whereupon --

DAVID K.A. MORDECAI

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

THE COURT: Good morning, Mr. Austin.

MR. AUSTIN: Good morning, Judge.

THE COURT: Please go ahead.

MR. AUSTIN: Thank you, Your Honor.

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DIRECT EXAMINATION

BY MR. AUSTIN:

Q. Good morning, Dr. Mordecai.

A. Good morning.

Q. Dr. Mordecai, where are you currently employed?

A. I have three professional affiliations currently.

I am the president of Risk Economics, Inc., a firm I cofounded in 1998.

I am a senior advisor and member of the advisory committee of Compass Lexecon.

And I have some affiliations at New York University. I'm senior research scholar of computational economics, law, commerce and geopolitics at the Stern School of Business. I'm also visiting scholar and adjunct professor at the Courant Institute of Mathematical Sciences at NYU.

Q. Dr. Mordecai, you should find two binders in front of you. And if you look in the larger of the two binders, if you could please turn to a document that has been marked as DX 1875-A and if you could identify this document for us.

A. Yes. It's the current version of my CV.

Q. Does your CV accurately reflect your training and experience?

A. To the best of my recollection, yes.

MR. AUSTIN: Your Honor, I would move to admit DX 1875-A.

MR. BOIES: No objection, Your Honor.

THE COURT: Defendant's Exhibit 1875-A is admitted.

(Defendant's Exhibit Number 1875-A was admitted into evidence.)

BY MR. AUSTIN:

Q. Dr. Mordecai, what is Risk Economics, Inc.?

A. Risk Economics, Inc., as I mentioned, is a firm I cofounded in 1998. It is a New York-based advisory firm that specializes in application of data analytics to a wide range of risk issues and valuation issues and other issues and across diverse industries and a diverse client base.

Q. What is Compass Lexecon?

A. It is an economic consulting firm that specializes in economic consulting for litigation and regulatory matters.

Q. And what do you do at Compass Lexecon?

A. I am a senior advisor and on the advisory committee, and in that capacity I apply my professional experience, my formal academic training, as either an expert testifying or as a consultant on a number of different kinds of matters, mostly relating to economics, financial economics, across different industries, across different issues.

Q. And what are your current roles at New York University?

A. At New York University I am an adjunct professor and course director for the NYU Center for Data Science. I'm on their advisory committee.

I am a principal scientist and lead investigator in the Risk Econ Lab for Decision Metrics at Courant. And I also have some advisory committee roles, and I'm a fellow for the mathematical finance program, a master's program at Courant.

Q. Can you please describe your previous positions at New York University.

A. Yes.

I started out as a guest lecturer in around

2005-2006 in the risk management course in Courant for the financial mathematics program. I subsequently was appointed as an advisory committee member, a member of the advisory board, of that same program and a fellow of that program.

I taught a course as -- in applied mathematics as a lecturer in spring of 2012 on advanced statistical computational models for socioeconomic and geopolitical phenomena basically or systems.

Q. Are you on any working groups for NYU?

A. I am. I am on the working group for the NYU Center for Data Science. I've been on that for -- since its inception.

Q. Do you serve on any committees within New York University?

A. I do. I am -- particularly a senior advisory role for the advisory committee or the steering committee made up of faculty and executives for the AIG-NYU global research partnership for innovation in global resilience.

Q. What courses have you taught at New York University?

A. I mentioned my guest lecturing at the risk management program for the master's of science in financial mathematics. I -- as I mentioned, the spring 2012 course, which was an advanced topics course in applied math focused on computational statistical modeling of geopolitical and socioeconomic systems.

I am also currently the course director for the NYU Center for Data Science capstone course, which is an applied project course for the data science students, master's students.

Q. Do any of these courses deal with the subject matter of your testimony in this case?

A. Yes.

Q. In what way?

A. The risk management course certainly applies statistical methods, modeling methods, various kinds of studies to a wide range of risk domains, commercial risk domains, financial markets domains. The same is true with the advanced topics course.

And even in the capstone course, a number of the projects being pursued, a number of the sponsored projects, are related to financial markets.

Q. Can you briefly describe your educational background.

A. Yes.

I got my bachelor's degree from The King's College in computational -- I'm sorry -- comparative religion and philosophy.

I got my master's or my MBA in finance from NYU -- at the time, it wasn't called Stern, but the Stern School of Business.

And then I got my Ph.D. in econometrics, statistics, industrial organization economics from the University of Chicago.

Q. Turning to your curriculum vitae that we identified earlier, DX 1875-A, on the first page of your CV, under Professional Experience, is that an accurate listing of the places that you have been employed during your 30-year career?

A. It is.

Q. And could you give us first a broad overview of the areas your professional career has focused upon.

A. I think the kind of unifying theme of my professional career has been corporate finance and options and asset pricing related to a wide range of transactions, including highly leveraged transactions, nonrecourse lending, distressed lending, a range of corporate finance in highly leveraged transactions, loan origination, loan structuring, derivatives and hybrid securities, commercial risk analysis.

So it's basically all been related to applying economics coupled with commercial credit and financial statement analysis to look at corporate transactions and the creditworthiness of either originators and other kinds of financial counterparties.

Q. I'm not going to --

A. As well as asset valuation.

Sorry.

Q. I'm not going to take the time to go through all of your past roles, but I would like to ask you some questions about a few of them.

Can you briefly describe what your role was at Fitch IBCA that's about halfway down the listing there?

A. Certainly.

So first I'll start out by explaining what Fitch -- at the time, it was called Fitch IBCA; now it's just called Fitch Ratings. At the time I was there, Fitch had been -- had acquired a European ratings organization called IBCA.

So Fitch is what's called a nationally recognized statistical rating organization or NRSRO, and it is one of the agencies that assigns creditworthiness grades, if you will, to both financial transactions as well as to issuers of debt.

And my role was as a lead analyst on a number of practices. I assigned ratings or participated in rating committees to assign ratings on a wide range of structured transactions as well as issuers.

Q. Did you do any work at Fitch with respect to insurance derivatives and insurance-linked securities ratings?

A. I ran three ratings practices at Fitch or co-ran three ratings practices at Fitch. One was insurance derivatives and insurance-linked securities. Another was structured notes. And the third is called commercial esoteric asset-backed securities.

Q. Your curriculum vitae indicates you were employed at AIG from 1998 to 2001.

Can you briefly describe what your duties were when you were employed by AIG.

A. I had a wide range of and scope of responsibilities during my time at AIG. I worked with global investments. I was a financial engineering vice president and principal finance vice president.

I was on the executive committee of AIG Risk Finance, where insurance -- basically where insurance and capital markets met, that intersection. I advised senior management on both private equity transactions we were involved in as well as acquisitions that AIG engaged in.

Q. Why did you leave AIG in 2001?

A. I was recruited to join a very large asset management platform, Clinton Group, as a managing director, and I ran 50 percent of the recorded assets under management after leaving AIG.

Q. Can you explain what Clinton Group is?

A. Yes. A diversified asset manager. At the time, it was the largest fixed-income arbitrage hedge fund in -- hedge fund manager in the space, so they ran diversified platforms that included hedge funds as well as various kinds of other investment vehicles.

And my role was commercial oversight of the structured credit vehicles as well as some new vehicles that were being structured around managed assets.

Q. And what did you do in your capacity as managing director of structured products at Clinton Group?

A. In my role, focusing on commercial oversight of structured credit and other structured products, I analyzed and evaluated many of different kinds of collateral. I structured and negotiated many forms of collateralized financing on behalf of the firm.

I day to day was involved in evaluating collateral portfolios, negotiating with rating agencies, negotiating with banks and investors, making decisions with regard to various types of vehicles, looking at everything from municipal finance securities through repackagings of various kinds of loan pools, credit enhancement. I've negotiated with the monolines for financial guarantees, a wide range of things.

Q. Looking at your CV, it indicates that you worked at Swiss Re Financial Markets from 2007 to 2008.

What is Swiss Re?

A. Swiss Re was one of the three largest reinsurance companies in the world. It actually still is. And at the time, it was the largest of the three, the other two being Munich Re and Zurich Re.

And I worked for senior management and executive committee, the head of financial services globally, first as a senior advisor and then as the managing director of a global group I helped organize called Relative-Value Market Strategies.

Swiss Re had about $35 billion in revenue at the time that I was there. About 50 percent of those were written in the U.S. and the remainder was written around the world. Not as large an enterprise as AIG, but certainly one of the major players in insurance and reinsurance.

Q. What is reinsurance? What does that mean?

A. Reinsurance is insurance that is bought by insurers to hedge themselves against exposure, reduce their exposure to certain kinds of risk.

Reinsurers also sell reinsurance directly to large commercial players who need direct access to the

reinsurance markets.
Q. While you were at Swiss Re, did you have any involvement with Lehman Brothers in any respect?
A. Yes. I had daily access -- and actually I sat on the trading desks of Swiss Re in New York, and so I had daily input into evaluating market conditions, and I would often be asked to provide technical oversight or provide technical advice to senior management around market developments.
And so during the Lehman Brothers issues, we shall call them, I was asked to assess and provide input on what the implications were for the broader financial markets and specifically for Swiss Re's own exposures.
Q. While you were at Swiss Re, how regularly were you engaged with, you know, capital market desks?
A. Daily. Daily they would try to -- the Swiss Re personnel, Swiss Re group, Swiss Re decision makers would ask for my input or my advice or, you know, tap into my experience around what kinds of decisions to make and what are some of the broader issues and implications for those decisions.
Also I was overseeing a number of strategic initiatives for Swiss Re that involved the intersection between insurance, their insurance liabilities and their investments.

Q. And what is meant by "capital market desks"?

A. Everything from swaps, repo -- they had a $65 billion investment grade corporate repo book that had to be managed on a daily basis. We ran structured investment vehicles at Swiss Re. We provided credit enhancement across a wide range of things. We financed asset management platforms.

So it was a pretty diverse, fully developed capital markets operation.

Q. Now, you left Clinton Group in 2003, and you didn't join Swiss Re until 2007.

Can you briefly explain what you did in that interim between 2003 and 2007.

A. Certainly.

My activities were mostly focused around Risk Econ, Risk Economics, Inc., at that time. I performed a number of consulting and advisory assignments. I provided advice to a number of agencies, federal agencies, multilateral agencies.

So as I said, I structured some portfolios for folks, I did a number of consulting assignments, and I provided advice to a number of governmental or quasi governmental agencies during that time.

Q. During your career, have you had opportunities to evaluate and estimate economic gains and losses?

A. Yes.

Q. How often, and can you describe what you've done?

A. Well, it's the foundation of credit analysis, which I've been involved in since 1983-84. Credit analysts are very much focused on credit exposure and gains and losses as they affect the valuation of assets, as they affect the creditworthiness of instruments of loans, of bonds, capital structures.

As a rating agency analyst, it is fundamental to ratings assignments to think of -- to consider and measure and estimate likelihood or probability of default and then losses conditional or given those defaults.

It's a big part of insurance and reinsurance. It's a central -- probably most central focus in my reinsurance roles, everything from work I'd done with looking at event risks under directors and officers insurance, financial guarantee programs, what would be called financial lines, so things like political risk insurance.

Many of these are focused on using things like event study and other estimation models and estimation methods.

A lot of the advice I provided to director of national intelligence, National Academy of Sciences, the International Monetary Fund's Financial Stability Unit, the International Organization of Securities Commissions, all of those roles -- the shadow regulatory committee as the crisis was developing, all of those advisory insights that I provided or was asked to provide involved that, that -- very much that focus.

Q. Have you written any book chapters or articles?

A. Yes. I've written perhaps a dozen or more articles, case studies, working papers, book chapters on distress, distressed lending, causes and sources of distress, default, operational risk, volatility and how volatility affects creditworthiness and leverage.

My dissertation at the University of Chicago focused on the interaction or intersections between leverage and market volatility.

Yeah.

Q. Do your book chapters or articles correspond to similar topics to those arising in this case?

A. Yes.

Q. In what way?

A. As I said, my -- typically my writing and my work and my speaking all overlap in the following way: understanding the nature of financial conditions of firms, how those interact with business conditions in markets, understanding sources and causes of financial distress, economic implications of that distress, how that affects valuation, how that affects relative value between instruments that are more or less similar to each other.

It is really the coupling of economic basic first principles, industry practice and real-world settings and conditions and thinking about those in a consistent, coherent way that is as comprehensively factual as one can be.

Q. Have you participated in the editing of any academic journals?

A. Yes.

Q. Could you describe them.

A. I have sat or sit on a number of journal committees. I was on the Journal of Alternative Investments. I've served on some other journal advisory boards.

I founded the -- as the first editor in chief of the Journal of Risk Finance, which was an Institutional Investor Euromoney journal currently owned and run by Emerald, a very large journal publisher. And it's a peer-reviewed industry journal that focuses at the intersection between financial markets and reinsurance and insurance markets.

And so I was editor in chief for some seven years, and in that capacity I edited and was responsible for content and oversight of every single article published in that journal.

Q. Do you continue to have a role with respect to the Journal of Risk Finance?

A. Yes. I sit in a senior capacity on their advisory -- on their editorial advisory board.

Q. You mentioned briefly your previous lectures, but have you lectured on topics that are relevant to the testimony that you will be proffering in this case?

A. Yes. And many of the topics I have lectured on to both industry groups as well as academics as well as governmental agencies overlap with both my industry practice as well as with my writing.

Q. You mentioned earlier that you've had some consulting with government and regulatory bodies, but have you ever served in an advisory capacity on economic issues to any government agencies or regulatory bodies?

A. Yes. And I may have mentioned those a bit before.

I was approached, after leaving Clinton Group, then prior to joining Swiss Re and then also while I was at Swiss Re and subsequent to Swiss Re, to work with the IMF Financial Stability Unit, which looks at global risks and how those affect global financial markets.

The -- what's called the IOSCO, which is the

International Organization of Securities Commissions, which includes the SEC, the FSA and their counterparts throughout the G8, European -- the various European countries, the Federal Reserve Board of Governors, the regional Federal Reserve Banks, particularly the Atlanta Fed, the Philadelphia Fed. I have had interactions with the Chicago Fed and the Boston Fed.

I would also say the Commodity Futures Trading Commission has had me work on some things with them and provide advice to the commissioners.

There are others, but I -- I guess the director of national intelligence I mentioned as well, right, so...

Q. Have you ever previously testified as an expert in a court of law?

A. Yes.

Q. And have you ever testified as an expert in an arbitration?

A. Yes.

Q. In what areas have you provided expert testimony in arbitration or what forums?

A. In an international arbitration matter I remember, the focus was on merger -- merger dispute, where fixed-income valuation was a critical component of that.

I have testified in U.S. arbitrations on collateralized financing terms.

I've testified in a U.S. arbitration on auction rate securities and implications of market conditions on liquidity in auction rate securities markets.

I think that's -- that's some of the arbitration roles I've had.

Q. Has any Court or arbitrator ever determined that you were not qualified as an expert witness?

A. No. Not to my knowledge.

Q. And Dr. Mordecai, could you just briefly summarize why you believe your education and professional experience qualify you to render expert opinions in this case.

A. Yes. This is something I think I've alluded to a little bit, but I'll just try to, you know, draw a firm line under it because I think it's important.

So my entire career has been about coupling -- and maybe it comes out of my philosophy background, but my entire career has been coupled on taking economic principles, fundamental economic principles that come out of my academic training, coupling those with consistent application of market practices, either accepted or in many cases best practices. Industry conventions have to be considered. Sometimes particular standards have to be taken into account and applying those in real-world settings in as comprehensively factual manner as I can to the actual transactions being considered, the actual parties being considered, what the circumstances are.

So I think that if you think about distressed lending, highly leveraged institutions, leveraged transactions, how those things affect valuation of firms, how those things affect valuation of instruments, all in a relative -- what means relative value means that you're comparing apples to apples, you're comparing oranges to oranges, and you're making those kinds of assessments. I think that's particularly relevant here.

MR. AUSTIN: Your Honor, I tender Dr. David Mordecai as an expert in financial economics, fixed income and credit markets, credit default swap markets, and distressed lending.

THE COURT: All right. Let me just get that down. I'm looking at the transcript here.

(Pause in the proceedings.)

All right. Mr. Boies, voir dire?

MR. BOIES: Thank you, Your Honor.

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VOIR DIRE EXAMINATION

BY MR. BOIES:

Q. Good morning, Dr. Mordecai.

A. Good morning.
Q. We haven't met before. My name is David Boies, and I suspect they've told you I represent the plaintiffs here.
A. Yes.
Q. Does the CV that was marked as Defendant's Exhibit 1875-A accurately reflect the book chapters and articles that you have written and the teaching that you've done?
A. To the best of my recollection, yes.
Q. When it says there that you were a guest lecturer, does that mean that you taught the course or that you were a lecturer in a course taught by somebody else?
A. A guest lecturer typically means you're lecturing in a course that someone else is responsible for the students.
Q. Now, you've never held a tenured teaching position; correct?
A. I never held a tenured teaching position.
Q. And indeed you've never taught full-time; is that correct?
A. I've never been a full-time professor, career professor. Correct.
Q. You're not a CPA; correct?

A. I am not a CPA.

Q. Have you ever worked for an insurance company that was in or contemplating bankruptcy?

A. I had an advisory role at Mutual Benefit Life back in around 1992. It was a short-term consulting advisory role.

Q. And did Mutual Benefit Life file for bankruptcy?

A. I recall they had a distressed situation. I don't recall whether bankruptcy was an outcome of that.

Q. How long did you do that?

A. I was with them for -- the assignment was maybe six or nine months long I think.

Q. And it's your testimony that you don't recall whether they actually filed for bankruptcy or not?

A. I don't recall.

Q. Other than that short-term consulting advisory role with Mutual Benefit Life back in around 1992, have you worked for or advised any insurance company that was in or contemplating bankruptcy?

A. Not that I specifically recall, with a caveat.

The caveat is, I've been involved in a lot of lending transactions, and to the extent that you're acting as a loan structurer and a deal structurer, depending on how you're defining "advice," there certainly is a lot of professional input and judgment that I would provide to the deal team as a member of the deal team.

Q. And were there deal teams that you were a member of that were advising an insurance company that was in or contemplating bankruptcy?

A. I do not directly recall that at this time.

Q. Okay. Have you ever testified as an expert in court with respect to Federal Reserve lending?

A. No.

Q. Have you ever taught a course about Federal Reserve lending?

A. No.

Q. Have you ever written a peer-reviewed article about Federal Reserve lending?

A. No.

Q. Have you ever taught a course about central bank theory or practice?

A. I've never taught such a course.

Q. Have you ever written a peer-reviewed article about central bank theory or practice?

A. No.

Q. Have you ever testified in court or in arbitration as an expert about central bank theory or practice?

A. No.

Q. Have you ever taught a course about the use of event studies in connection with damage calculations?
A. Elements of my courses have dealt with event study and market responses to events, specific events, and so I would say my courses have contained lectures along those lines.
Q. You know what an event study is.
A. I certainly do.
Q. And you know that event studies are sometimes used, as experts, including yourself, have done in this case, in connection with damage calculation; correct?
A. I've actually done that in court before.
Q. And when did you do that in court before?
A. The Bayer CropScience cases, which is around four years of litigation, MDL, involving the market -- European market's foreclosure on GMO rice coming out of the U.S.
The focus of my testimony was actually on event studies to assess damages to farmers, U.S. farmers, based on that market foreclosure. It was entirely event study.
Q. This was an event study that related to damages to a crop from contamination; is that correct?
A. This was damages to the farmers' business, right, as commercial enterprises, given market foreclosure in

Europe to imports of U.S. rice. And we used futures markets on rice to assess what the market damage calculation should be, and it was actually done using event study.

Q. Other than using futures markets on rice to assess market damage for contamination, have you ever used an event study for purposes of damages?

A. Yes.

Q. In what case?

A. One of the initiatives at Swiss Re that I was actually in charge of and initiated was the use of event study to assess M&A insurance risks, business interruption risks.

Q. Is this someplace you testified?

A. No. I thought you said have I ever used -- you didn't ask about testimony. You asked have I ever used it.

Q. Perhaps there was a confusion. What I was asking was whether you've ever testified in court or in arbitration as an expert about the use of event studies for damage calculations, and I think you indicated that you had with respect to this rice crop damage.

A. That's correct.

Q. Was there any other instance in which you've testified as an expert in court about that?

A. We conducted event studies for the API versus Zurich matter, which involved both a total return swap on their credit portfolio as well as other corporate transactions related to that reinsurance package. We did conduct event study. I do not recall -- I did -- I was deposed on the matter. I do not recall -- to my recollection, I do not recall whether in fact the exact questioning and answering ended up focusing on any of the event studies that we conducted in that analysis.

Q. And I just want to be sure that your answer is meeting the question.

Was that testimony in court?

A. It was not. It was on a case that settled.

Q. Have you ever taught a course about the use of event studies in connection with damage calculations?

A. I have never taught a course where the specific focus of the course was on event study as used for damage calculations in court.

I have taught courses where the use of event study was used to understand insurance loss or some other credit loss or financial loss, some of which ultimately ends up being decided as a result of court deliberations.

Q. What course was that?

A. As I mentioned, the courses --

Q. Just identify the course.
A. Okay.
So my advanced topics course on geopolitical and socioeconomic systems often focused on reinsurance or insurance transactions and how one would analyze those. Some of the lectures were certainly about that.
Q. Have you ever taught a course about valuing insurance companies?
A. I have never taught a course about valuing insurance companies.
Q. Have you ever written a peer-reviewed article about valuing insurance course?
A. I've never written a peer-reviewed article about valuing insurance companies.
Q. Have you ever testified in court or in arbitration as an expert about the valuation of an insurance company?
A. It was an element of the API versus Zurich matter.
Q. What insurance company were you valuing?
A. We were valuing the American Home -- not American Home. Sorry -- Home Insurance, which was the cedant of asbestos liability cover to a set of trusts, and Zurich was providing excess of loss reinsurance as well as preferred stock and common equity, and valuation

in terms of understanding the surplus contributions, the fairness opinions, the valuations provided by various investment banks were all key to that testimony and key to my own analysis and my own report.

Q. So what you're saying is that you testified in court?

A. No.

Q. That was my question.

My question was, have you ever testified in court or in arbitration as an expert about the valuation of an insurance company?

A. I have not.

That was at deposition. I apologize for misunderstanding your question.

Q. That's okay.

And the insurance company that you were valuing was the Home Insurance Company?

A. It was Home Insurance in runoff and the trusts associated with the settlements around those asbestos litigations.

Q. And what you were doing is you were there evaluating an insurance company that was in runoff?

A. I was -- I was evaluating the benefits of the reinsurance and the various investments to the surplus provided to that company by Zurich based on or in

conjunction with --
Q. I just want to be clear.
A. Uh-huh.
Q. When you were valuing whatever you were valuing in the Home Insurance case, were you valuing the insurance company or were you valuing certain benefits of certain reinsurance and investments?
A. I'm having a difficult time answering your question because to me those are so intrinsically linked that you need to do both in order to do that. You have to have a baseline on the value of the company. You then have to look at the way in which that value gets adjusted by this new capital and new capacity, and so I'm having a difficult time separating those things in my own professional experience.
I'd love to answer the question if you could clarify it further.
Q. Were you trying to value the Home Insurance Company as a whole?
A. No.
Q. Okay. And the Home Insurance Company with respect to what you were doing, whatever valuation work you were doing, that was a company in runoff; is that correct?
A. Home Insurance was in runoff.

Q. And could you just explain very briefly, if you can, what an insurance company in runoff is.

A. The company had ended up in such financial distress from its liabilities that it was basically in the process of being liquidated. And part of the purpose of this capital coming from Zurich was to help make the liquidation as orderly as possible under the circumstances and provide support for the policyholders that remained.

Q. Home Insurance was not an operating insurance company at that time going out and writing new business; correct?

A. It was -- the aspects that I was focused on certainly were not on the writing of new business. I can't really say specifically whether there were no new policies that were being rewritten, because there was some -- actually, I take that back.

There was a lot of replacement policies being rewritten, and those would often involve new forms of cover replacing old forms of cover, so depending on how you define new policies being written, there actually were. That was part of the benefit that Zurich was bringing to the table with their additional capacity and their additional capital.

Q. Have you ever written any peer-reviewed article concerning government assistance to private companies during the financial crisis?

A. I have not.

Q. Or taught a course about that?

A. I have not.

Q. Or testified in court or in arbitration as an expert about that?

A. I have not.

Q. And would your answers be the same if I asked you about the causes of the financial crisis of 2008?

A. And you said specifically courses.

Q. Peer-reviewed articles.

A. Peer-reviewed articles.

Q. Or testimony in court or in arbitration.

A. In none of those forums have I discussed causes of the financial crisis.

I have talked about credit in certain policy domains, and so forth, but more from the commercial markets and commercial reasonability standpoint.

MR. BOIES: Your Honor, Dr. Mordecai is clearly an expert in certain areas. We don't think he is an expert in some of the areas for which they are going to offer opinions.

When they offer him as an expert, for example, in financial economics, that's a very broad area, and there are certain areas within that that we think perhaps some of the credit valuations that he's done would fall. But with respect to what he's going to be testifying to here, which is Federal Reserve lending and the various opinions that he's given in his report, we don't think that his expertise covers that.

Now, that may be a subject for cross-examination, but I wanted to alert the Court to our view on that.

THE COURT: Yes. I think in a bench trial the option is always available to hear an expert witness to see if it provides aid in evaluating all of the issues in the case, and if I don't think it's logical, I don't have to accept it. But I think under the circumstances, I think there's certainly a potential there for assisting the Court in analysis of the issues, so I will accept him as an expert witness in the areas proffered.

MR. BOIES: Thank you, Your Honor.

THE COURT: And then we'll see how things go.

MR. AUSTIN: Thank you, Your Honor.

THE COURT: Yes.

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DIRECT EXAMINATION (resumed)

BY MR. AUSTIN:

Q. Dr. Mordecai, you were hired by the Department of Justice on behalf of the government to serve as an expert witness in this matter; is that right?

A. Yes, that's correct.

Q. And what was the assignment that you were given?

A. My assignment was twofold. First was to use market evidence or examine market evidence to see the degree to which plaintiffs' claim that they were harmed by the rescue package or the rescue transaction or transactions instituted or that AIG accepted is at all valid based on, as I said, market evidence and then secondly to assess claims of certain or evidence and support provided by certain plaintiffs' experts in that regard.

Q. And what documents or other materials did you review for the purpose of preparing for your expert testimony today?

A. Documents?

Q. Documents and other materials.

A. Oh, okay.

So I started with market prices in equity markets and various debt markets, both bonds as well as what are called credit default swaps written against -- specifically against AIG debt, also looked at credit default swaps of other financial institutions, evaluated or examined market commentary contemporaneous with the events and with the market prices that I was examining, also looked at certain documents associated with the events in the case, as well as some of the testimony in this case.

Q. And when you say "testimony," you're referring to the trial testimony?

A. Trial testimony as well as depositions.

Q. Can you briefly explain how you approached your assignment.

A. I always try to approach my assignments -- and that holds in this assignment as well -- in the same way I approach my professional activities.

So I take my previous experience. I take all my previous training. I couple my understanding of academic -- my academic training in economics. I combine it with my understanding and my past experience around deals transactions in a number of situations, and I try to apply it to the circumstance at hand. And that's very much what I did here.

Q. Now, based on the work that you've done in this case, did you form any opinions to a reasonable degree of certainty?

A. I did.

Q. Directing your attention again back to the larger of the two binders in front of you, could you please turn to two documents that are within that binder, specifically DX 1874 and DX 1875.

A. Yes.

Q. Can you please identify what these two documents are.

A. DX 1874 is my signed report in this matter, and DX 1875 are my exhibits to that report and my appendices as well.

Q. Do DX 1874 and DX 1875 contain the opinions that you're prepared to testify about today?

A. They do.

MR. AUSTIN: Your Honor, we would move to admit DX 1874 and DX 1875 as Dr. Mordecai's expert report and exhibits, subject to the Court's guidelines in this case.

THE COURT: Yes. I have previously explained my approach to receiving expert reports, but under those criteria, is that acceptable?

MR. BOIES: Absolutely, Your Honor.

THE COURT: All right.

Defendant's Exhibits 1874 and 1875 are admitted as expert reports and exhibits.

(Defendant's Exhibit Number 1874 was admitted into evidence.)

(Defendant's Exhibit Number 1875 was admitted into evidence.)

MR. AUSTIN: Thank you, Your Honor.
BY MR. AUSTIN:
Q. Dr. Mordecai, to assist the Court in presenting your testimony today, have you prepared a set of demonstratives?
A. I have.
Q. And have you prepared a demonstrative that summarizes your broad opinions in this case?
A. Yes.
Q. And is that summary document DX 2601?
A. It is.
Q. Could you please list the points set forth in your -- in DX 2601, your summary of opinions.
A. Absolutely.
The first is that the initial rescue did not result in an economic loss to AIG's shareholders. "Initial rescue" I can explain.
The second is that without the equity return participation granted by AIG to the government, the revolving credit facility, RCF for short, did not provide a return to adequately compensate for the significant risk of lending to AIG.
The third is that plaintiffs' expert Professor Kothari's estimate of the alleged harm suffered by the credit agreement class is fundamentally

flawed.

And then the fourth is that Professor Kothari's estimate of the alleged harm suffered by the stock split class is fundamentally flawed.

Q. And you mentioned that you would explain what you mean by "initial rescue."

What do you mean by the term "initial rescue" in your first opinion there?

A. I mean the revolving credit facility of $85 billion agreed to on 9-16 with the acceptance by AIG of the term sheet proffered by the government and the associated equity return participation.

Q. Let's turn to your first opinion, that the initial rescue did not result in an economic loss to AIG's shareholders.

What is your opinion based upon?

A. It's based upon my review of market evidence.

Q. And when you say "market evidence," what are you referring to?

A. I'm referring to stock prices, bond prices, credit default swap prices written on AIG debt. I'm looking at contemporaneous market commentary associated with the events in question. I'm also looking at evidence in terms of documents produced or generated at the time by various participants.

Q. Why do you want to evaluate market prices in this case?

A. Because they're the best available value measures or value indicators that we can observe, that an objective party can observe.

Q. Do you have an opinion as to whether market prices, generally speaking, are a reliable indicator of value?

A. I do.

Q. And what is your opinion?

A. My opinion is that they're reliable and they're the most reliable indicators of value we have.

Market prices are the result of orders, buy and sell orders by a wide range of participants. And as a result of those buy and sell orders, the forces of supply and demand result in an equilibrium price that we observe that reflects the aggregate beliefs, the expectations, and basically the costly expectations to the participants as to what they really think about the value of the firm.

Q. Do market prices provide information in a timely manner?

A. They are contemporaneously good sources of new information as to how that affects value.

Q. In connection with your evaluation of whether the initial rescue resulted in any economic loss to AIG's shareholders, what were the first market prices that you specifically evaluated?

A. Stock prices.

Q. Do you have an opinion as to whether AIG's stock price specifically was a reliable indicator of value at or around the time of the initial rescue?

A. I do have an opinion on that.

Q. And what is your opinion?

A. And my opinion is that they were a very reliable indicator of the market's response and valuation responses to news at the time.

Q. Did you review plaintiffs' expert Professor Kothari's trial testimony in this case?

A. I did.

Q. And let me ask you to look at some testimony from Dr. Kothari that we'll put up on the board from pages 4868-20 -- line 20 to line 24 of the transcript, just those few lines, and do you see where that Dr. Kothari testified that the stock price on September 16 of AIG's stock did not reflect the intrinsic value of AIG's stock?

A. Okay.

Q. Do you agree with that testimony from Dr. Kothari -- Professor Kothari?

A. No, I don't.

Q. Could you explain why you do not agree with it.
A. Yes.
From my examination and based on my experience, the markets were and market participants were very much concerned about both AIG, its exposure to market conditions as well as market conditions themselves, and as a result, the stock reflected that.
There's a misperception sometimes in common knowledge about what it means for a market to be informationally efficient. Just because prices are volatile or because prices trade down does not mean the markets are not functioning.
If you have actively traded markets where there's a lot of stock volume or a lot of bond volume moving, those market prices reflect by both the volatility as well as their direction what the aggregate belief is with regard to value.
And so I don't agree with what I've seen of Dr. Kothari's testimony. I do not agree with his position. They were in fact reliable.
Q. Okay. Let's turn now to the performance of AIG's stock price in the September 2008 time period.
Dr. Mordecai, did you prepare demonstratives that illustrate what occurred with respect to AIG's stock price in the time period immediately leading up to and

following the initial rescue in September of 2008?
A. Yes, I have.
Q. And are those demonstratives DX 2602 and DX 2603?
A. That's correct.
Q. Let's start with DX 2602.
Could you please explain to the Court what is illustrated in DX 2602.
A. DX 2602 is a graph or plot of market prices for AIG stock starting at the beginning of September 15 through the end of September 16. And what it actually shows is the fact that AIG's stock price fell on public bankruptcy concerns and then subsequently rose once news of a rescue alleviated those concerns of bankruptcy. And when I say "bankruptcy" here, I mean costly bankruptcy.
Q. And looking at some of the specifics on DX 2602, what does it indicate was the closing price of AIG's stock on 9-15?
A. The closing price was $4.76.
Q. And what happened after the close of the market on September 15 but before the market opened up on the morning of September 16 with respect to -- that was relevant to AIG's stock?
A. It was announced that all three rating agencies had downgraded AIG upon concerns about AIG's solvency as

well as AIG's ability to fund its immediate obligations coming due.

Q. And then what happened -- what was the opening price, according to DX 2602, of AIG's stock in the -- when the market opened on the morning of September 16?

A. $1.85.

Q. So how did that compare to the closing price on the 15th?

A. It was less than half.

Q. And then what happened subsequently that day on the 16th with respect to AIG's stock?

A. It immediately started -- it immediately started trading down to a low of $1.25.

Q. And what happened after that?

A. After that, there was news leaking out to the possibility of a government rescue.

Prior to that, there was a fair bit of commentary saying if AIG did not get something in the neighborhood of 75 billion or more of capital funding that they would most likely head to bankruptcy court. And then there was news leaking out of the possibility of a deal, of a government deal.

Q. Is that the entry you have on DX 2602 of the 10:52 a.m. CNBC report?

A. That's right.

And you'll notice that the price starts marching up to that point when finally CNBC says, Look, we're hearing news circulating in the markets of the possibility of a deal. We've gotten that information from folks close to the firm and close to the situation.

And then you'll see the stock price rally as a result of that news, and in fact it continues to drift upward throughout the day, closing at $3.75 at the end of the day.

Q. So how did the closing price of the stock on September 16 compare to the opening price of the stock that morning?

A. The stock doubled, more than -- more than doubled actually.

Q. Let's now turn to DX 2603.

What is demonstrated in DX 2603?

A. It takes the same graph and extends it through the end of the month.

Q. So the beginning of the chart on 2603 is basically a condensed version of what you have on 2602?

A. Yes. Except it focuses on the open -- it starts at the open of 9-16 and doesn't have 9-15. However, it extends all the way to the end of the month.

Q. An what is illustrated in DX 2603 that is relevant to your opinions?

A. First of all, the demonstrative is called AIG's Stock Price Rose Following News of the Initial Rescue. And what it illustrates is the stock price responded to the news of rescue, moving up from its opening price and up from the low. The -- it closed at 3.75.

The news was confirmed in aftermarket hours with press releases announcing the terms of the $85 billion revolving credit facility, and the stock price remained above the 9-16 open throughout this period. In fact, it remained above the 9-16 open throughout subsequent periods I examined.

Q. Now, you have a red dotted line in the middle of DX 2603.

What does that red dotted line illustrate?

A. That horizontal red dotted line is the open, the $1.85 9-16 opening price.

Q. And the blue lines are all AIG's stock?

A. That's all AIG stock prices.

Q. So what is the significance, if any, in your opinions of the fact that the blue lines from 9-16 through 9-29 are all above the red dotted line?

A. You see that there are still volatility and uncertainty in markets and volatility and uncertainty in the stock, but nonetheless, the price of AIG's stock is now trading at a new equilibrium. That equilibrium incorporates the benefits of the rescue and the mitigated or diminished risk of a costly bankruptcy for AIG.

So basically it means it's good news.

Q. Focusing for a moment on a specific time period that is in -- illustrated in DX 2603, and I'm going to look at the period from September 19 through September 24, can you tell us, you know, just visually what happened to the stock price in that 19th through 24th time period?

A. Certainly.

Just for sake of context, so, as we said, on 9-16 there is an accepted and announced revolving credit facility term sheet. There's funds that are being advanced under demand notes throughout the time leading up to 9-23 intermittently or periodically.

At 9-19 there's rumors that start to circulate in the market that results in speculative bidding on the stock, and those rumors are that there may be a new or different private sector deal, now that the government's initial rescue has created room and time for AIG relative to a bankruptcy situation, that a new deal may come in and substitute that may offer even more flexible terms to AIG and hence to all the stakeholders in AIG, so that results in the stock being bid up.

At 9-23, once AIG announces that it has entered into the finalized credit agreement with the government and that there's no new other alternative, you know, deal in there, a lot of that speculative upward pressure diminishes and it settles into this equilibrium that I discussed before, which is government assistance, government deal.

Q. And throughout this period from September 19 when the stock price goes up and then drops again on the 24th after the white knight is no longer available, how do those stock prices of AIG stock compare to the red line, the dotted red line in DX 2603?

A. It's still well above the dotted red line.

Q. Let me ask you to turn in your larger binder to JX 114.

A. You said JX?

Q. JX 114.

A. Yep, I'm there.

Q. And first of all, can you identify what JX 114 is?

A. Yes. It's a Credit Suisse Equity Research market report, and it's focused on -- it's coming out of what's called the multiline insurance group. It's a research group in the equity division of Credit Suisse.

Q. And it's dated September 24, 2008?

A. Correct.

Q. And I'm going to highlight for you the first full paragraph under the first bullet point there.

And does the portion highlighted there both in that paragraph -- and then I'd also ask that the third paragraph be highlighted. I'm not going to read that information, but does that, those two paragraphs, address some of the market commentary you mentioned concerning the stock price response to the hopes of a private sector deal on more favorable terms than the government offered in the initial rescue?

A. Correct. It does.

Q. Okay. And turning away from JX 114 and going back to demonstratives 2602 and 2603 --

A. Yes.

Q. -- can you summarize what conclusions you drew from your analysis in demonstratives 2602 and 2603.

A. The conclusion is that the initial rescue, the market's assessment and the market evidence of the initial rescue, that it was positive for AIG and therefore positive for the shareholders and that this was reflected in the new equilibrium market price that persisted being above the 1.85 price throughout the period following the market becoming aware of the rescue package.

Q. And do you have an opinion as to whether what you see in DX 2602 and DX 2603 reflects a market that is performing functionally or dysfunctionally?

A. It reflects a market that is performing functionally, right. You're seeing differences in volatility regimes. You're seeing a lot of liquidity in these markets. You're seeing movement responding to news events very rapidly.

So what I see is definitely two things, good news from the marketplace and review of the marketplace and, secondly, informationally efficient and reliable prices.

Q. Did you conduct any further analysis to verify your conclusion that the initial rescue did not result in an economic loss to AIG's shareholders?

A. I did.

Q. And is that analysis described in DX 2604?

A. It is.

Q. Can you please list the analyses that you have set forth in DX 2604.

A. Yes.

In DX 2604, it summarizes two general steps that I took next, which is I performed an event study to verify that in fact AIG's stock price did not underperform the market and industry but in fact showed positive gains, in fact outperformed the market and industry, and then I reviewed the market commentary contemporaneous to these movements just to see whether market commentary by participants involved were consistent with my own.

Q. Let's take your two analyses one at a time.

And with respect to the first one concerning event studies, could you please explain for the Court what an event study is used for.

A. An event study is a statistical equation, and it's -- or a model. And what that model does is it controls for general market movements as well as movements of specific industries in which the company being studied is active. And by adjusting for and controlling for those other movements, it's able to isolate specific movements of that firm that are specific to news events about that firm to see how the market responds.

So it's like taking -- looking at movements of a body of water, you know, an ocean, and then looking at movements in specific parts of that ocean and taking those out to understand a specific boat or set of boats and how those are going to move.

Q. Now, before we get into the details of the event study you did with respect to AIG, could you describe for the Court how commonly are event studies used in your expert field of financial economics.

A. They're extremely common. They're extremely common in economics generally and extremely common in financial economics particularly.

Q. Have you prepared a demonstrative that explains how event study methodology works?

A. Yes.

Q. And is that DX 2605?

A. It's DX 2605.

Q. Could you please list and explain what is shown with respect to how an event study works in DX 2605.

A. Yes.

So as I mentioned before, these are extremely common. They're used by industry practitioners in event -- in event-driven investment. They're used in court. They're used in academics. They're used in regulatory analyses. And what they basically do is the following.

So it starts from a fundamental set of interrelationships between markets, industries and firms, and it looks at the firm's stock price in terms of those relationships.

So a particular firm's stock price corresponds to three interrelationships: price changes related to overall market conditions, overall business conditions for the entire economy; price changes related to conditions specific to an industry or group of industries in which that particular firm you're studying operates; and then thirdly, price changes specific to that firm related to business and economic developments to which that firm is specifically exposed.

And so the steps --

Q. Before you go to the steps, though, so what is the goal of the event study in terms of the three interrelationships that you just mentioned?

A. The goal -- and this is a very important point -- is to isolate movements specific to that firm's news, that firm's particular situation, from other general movements having to do with industries and other industry players that that firm may be involved with and then general movements in the economy. And it's about really trying to separate out or filter out that movement and that movement's contributing factors from all the others.

Q. So please go on to explain the steps in an event study.

A. And these steps effectively -- so step one is how the equation establishes benchmark relationships between the company's stock price and contemporaneous changes in both the market and the industry or industries in which that company is active.

Those benchmark relationships are used, as I said before, to filter out the effects of the market and industry so you can isolate and measure the particular firm's price movement.

And then that measurement is a by-product of that, and then you can use diagnostics to evaluate those firm-specific price changes over particular event windows, what are called event windows or particular periods of time that need to be studied.

Q. And directing your attention to that third step where you measure and evaluate the firm-specific price change over the event windows, have you prepared a demonstrative that explains what event window or windows you analyzed?

A. I have.

Q. And is that DX 2606?

A. It is.

Q. Could you please explain what you have set forth in DX 2606.

A. Yes.

So DX 2606 is an articulation or an illustration of the six event windows that I analyzed around the initial rescue for the event study. And each and every one of them begins at the open of 9-16 when the markets are already concerned about the issues with the rating downgrades and the risk of bankruptcy, and then the information comes out as to a possible government rescue.

So they all start on 9-16, and then they proceed to try to capture periods of time after 9-16 when information would be flowing into the marketplace related to the government rescue and the terms of the deal of this initial government rescue.

So I've got two windows that capture the news effects or attempt to capture the news effects immediately following the CNBC report, both by the end of the day and leading into the 9-17 open and then take 9-17 into account.

So you've got -- the first one captures from the open of 9-16 to the open of 9-17. The second one also takes into account the full trading day of 9-17 to cover the close.

The next two windows basically pick up the window or -- after AIG confirms that it's entered into the formal credit agreement, so it goes from 9-16 all the way to the open of 9-24 and then also captures with another window all the way from 9-16 to the close of 9-24, so it's now picking up the 9-24 trading day.

And then the last two see if there's any information that trickles in upon the formal filing of the 8-K which had attached to it the final credit agreement in its entirety, so those two start on 9-16 and go all the way to the end of the month basically, to the 9-29 open and then to the 9-29 close.

Q. So why do you have six different ending points in your event windows?

A. The reason is, is the measurement of event windows, how long it's going to take for information to fully be captured as information leaks out, is a matter of judgment, so one of the things you want to do is come up with reasonable alternative windows and test whether in fact they make any difference to your results.

Q. Now, you also mentioned that each of your six event windows has the same starting point, specifically the opening of the market on September 16.

Did you consider using any other starting points?

A. I actually did.

Q. And have you prepared a demonstrative that explains your decision to use the same starting point of the open of September 16 for all of your event windows?

A. Yes.

Q. And is that DX 2607?

A. That's correct.

Q. Could you please explain what you've illustrated in DX 2607.

A. DX 2607 is meant to illustrate as viscerally and tangibly as I could, as concretely as I could, why it's improper to use a different starting point, why 9-16 is the right starting point.

Q. The 9-16 open.

A. The 9-16 open is the right starting point.

And so I try to show what two alternative window starting points would do or fail to do.

So, for example, if you take the first alternative, alternative number one, if you started before the 9-16 open and started at the close of 9-15, for example, and included therefore that $4.76 price in there, what you're doing is you're taking in what we would call a confound.

What I mean by "a confound" is you're taking in another effect that's likely to blur what it is you're trying to study because it's other information that is different from what it is you're trying to study that really doesn't incorporate what you're trying to study.

And so if in fact you start too early, you end up including in the market response a rating agency downgrade. Now, what we're not trying to study -- we're trying to study the rescue package, not the rating agency downgrade, so by including the rating agency downgrade you're basically taking out all the signal and you're putting all this background noise in that is basically making it hard for you to read that signal, and so you don't want that in there. Okay.

The second alternative is one that starts too late, and that would be having a window that starts at the close of 9-16, right, once the market has already started receiving news of the rescue and the prices have responded, so all the action around the initial news that, hey, guess what, this company is not going to bankruptcy court right now, right, you're leaving it out. Why does that make any sense?

So if you need to -- if you were trying to isolate an event, it would be like a doctor looking at you, understanding that there's an issue in your shoulder, and he looks everyplace else except your shoulder or he incorporates other things that don't belong there with regard to something about your shoulder. It's not -- it's not the -- you know, not the thing you're trying to study.

Q. So looking at the first alternative, one that you rejected, why is it improper to use an event window that includes the market's response to rating agencies' downgrades on the 15th after the market is closed?

A. Could you repeat the question.

Q. Yeah.

Why is it improper to use an event window that includes the market's response to rating agency downgrades on September 15 that occurred after the market closed? What's the problem with doing that?

A. Because I'm not studying rating agency downgrades, and it will obscure the thing I'm trying to study.

Q. And then again why is it improper, with respect to your alternative two, to use an event window that excludes the market's response to news of a possible government rescue that came out during the trading day on September 16?

A. Because you're leaving out the thing you're trying to study. It's like looking for your keys not where you lost it but someplace else.

Q. Let's now discuss the results of your event study.

Have you prepared a demonstrative that demonstrates these results?

A. Yes, I have.

Q. Is that DX 2608?

A. That's DX 2608.

Q. Can you explain what you've demonstrated in DX 2608.

A. These are the six event windows and the results from my event study with regard to those six event windows. It -- it basically -- as the title says, "Event Study Results Show that AIG's Stock Price Did Not Decline Over Any of the Six Event Windows."

So as you recall, I said you use different event windows to see whether your results are different and whether it changes one's opinion of what the event study says, and you can see I had a consistent result throughout.

So if you look across each of the rows, you'll see the event window open or event window start and you'll look up and down that column A. It's 9-16 in every instance.

When you go to column B, as I described previously, I've got a 9-17 open, 9-17 close, 9-24 open, 9-24 close, 9-29 open, 9-29 close, as I illustrated earlier.

Q. So these are the same event windows in columns A and B that you described earlier in DX 2606 describing your event windows.

A. Correct.

Q. Please continue.

A. So column C actually shows what we would call the raw return, so it's AIG's actual return over that window. And in each instance what you see is a positive return, varying magnitudes but nonetheless positive returns. But this is the raw return that includes, you know, market movements. It includes industry movements. It has not yet isolated out the AIG-specific movement.

So in my footnote I describe the market and industry proxies or the stock baskets that are used to find those other interrelationships and filter them out.

And what you'll see is I've got a broad market index. I've got a property and casualty index for the property and casualty line of AIG or that industry. I've got a North American life insurance index which filters out the life insurance industry. I've got a world airlines index for the aircraft leasing industry that AIG is involved with. And I've got an investment management index for the asset management industry, an index of monoline financial guarantors which proxies for the capital markets division activities around credit default swap summary portfolios and things like that. And then I've got a consumer finance related index.

And so once you extract or filter those out, you're left with what's called a residual AIG return on a percentage basis, which is column D. And that's AIG isolated so that we're only focused on news events and market effects of news events on AIG's specific stock, not those other movements.

And so you see there we've got residual returns of AIG, gains, percentage gains ranging from 16 percent all the way to 116-117 percent.

Then column E converts that into dollars, from percentages into dollars.

So column E represents AIG-specific changes in its market capitalization, its equity market capitalization, in billions of dollars.

So if you look at the first row, column E, that's a $790 million gain, then below that a $940 million gain, and then below that a $7.4 billion gain, below that a $2.7 billion gain, a $3.09 billion gain and then a $1.17 billion gain.

So column F now says are these negative stock price reactions, and the answer in each case is no.

Q. Can you please explain how column F relates, if at all, to plaintiffs' claims.

A. If plaintiff claims were valid, you would expect negative stock price reactions over these windows. There are no negative stock price reactions over these windows.

And so plaintiff -- to put it plainly, this market evidence does not support plaintiff claims. The market does not view this as a negative.

Q. And looking back at column E, what does column E tell you with respect to how the initial rescue affected AIG --

A. Share value --

Q. -- and its shareholders?

A. Share values went up. They went up over the entire period. And it's similar to the graph with the red line. It stayed above that horizontal red line.

Q. Now, comparing columns C and D, it appears that sometimes the figure in column C is higher than the figure in column D, and at least on one occasion it's the opposite.

Could you please explain that. What does that mean?

A. You know, as per the earlier explanation, column D factors out or filters out industry and broad market movements, so what it's basically saying is, look, sometimes the market goes up, sometimes the market goes down, sometimes industries in which it's involved go up, sometimes they go down. At the end of the day what we know is this, is that AIG outperformed the market and its industry groups throughout this period. The news was positive for AIG throughout this period even taking those into account.

MR. AUSTIN: Your Honor, would this be a good time to take a morning break?

THE COURT: Sure. Let's take a morning break. Let's reconvene at 11:20.

(Court in recess.)

THE COURT: Let's go ahead, Mr. Austin.

MR. AUSTIN: Thank you, Your Honor.

BY MR. AUSTIN:

Q. Dr. Mordecai, we were talking about DX 2608, but before we move off of that, I just wanted to ask you one question to make sure something is clear.

When we compare columns C and D, you mentioned that you're filtering things out to get to column D from column C.

What do you mean by "filtering out" and what's the goal of filtering things out?

A. If what you're trying to study is a specific stock price reaction to news, you want to understand how that news affected that particular company's condition and stock and how did markets respond, how did buyers and sellers of stock in this case respond to news over that event window that's isolating that company's buy and sell decisions, company-related buy and sell decisions, and given that company's sensitivity to that news.

The raw return includes in it the general market reactions and movements during the day. It includes lots of industry-related news effects.

And so by building out this equation, statistical equation, you're controlling for those other effects, so you can identify and isolate and then measure the specific effect for that company.

And so column C takes -- here's how AIG's stock responded over the window or here's how it behaved over the window.

In between C and D effectively there's a -- well, here's how all these other things behaved, right, in that equation along with the stock, and so these other coefficients basically, if you will, extract those other movements so you can just see that one movement by itself, right. It takes out any of the noise obscuring that movement so that you can then just observe that movement.

So, you know, you'll sometimes see these things on TV where there's lots of people talking in a room, and you know, they'll do something with the computer and they'll isolate that one guy talking in the room because you've taken out the background noise. That's what we're doing here.

Q. In column D you're isolating the effect of the initial rescue on AIG's stock.

A. Exactly.

Q. Now, do you recall from Professor Kothari's testimony whether he performed an event study?
A. I do.
Q. And did he?
A. Yes, he did.
Q. And what event window did Professor Kothari use in his analysis?
A. I seem to recall he used September 11 to September 15.
Q. Do you have an opinion as to whether the event window used by Professor Kothari starting on September 11 and ending on the 15th provides useful information for determining whether AIG's shareholders suffered an economic loss as a result of the initial rescue?
A. I do have an opinion.
Q. And what is your opinion?
A. It's irrelevant. It's too early.
Q. Why is it too early?
A. He's studying something other than the news of the rescue. He seems to be studying the decline in AIG culminating in the rating downgrade as a result of its solvency concerns. That's not what my event study studied. He's studying everything leading up to the ultimate decline of the stock on September 16 and the

response of the stock to the government rescue packages.
Q. Is there -- Dr. Mordecai, is there any methodological or economic reason why Professor Kothari's event study cannot be modified to the time period covering your event windows to determine the effect of the initial rescue on AIG's stock price?
A. Nothing at all. All you'd have to do is you could use the same specification and just shift the time window over to focus on the 16th onward.
Q. Have you done such a modification?
A. I have.
Q. And have you prepared a demonstrative showing the results of that analysis?
A. I have.
Q. Is that DX 2609?
A. It is.
Q. Can you explain what you have illustrated in DX 2609.
A. DX 2609 takes Professor Kothari's model specification, his event study methodology, and applies it over the same six windows I use, so it's his identical methodology.
He uses different proxies for the market and industry. He uses three, and he uses S&P related ones. Okay. Other than that, all -- so I haven't changed that.

I'm still using his model. I'm still using his equation, if you will. What I've done now is focused on the windows that in my previous study I consider relevant.

And so if you look at the slide 2609, it -- you look at column A and all of these regression -- these event study regressions or event study equations are looking at an event start of 9-16 open. They reflect then the closing prices that I used in my own event study.

And what you'll notice on column C, the AIG raw return is identical to the one in my event study because that's how AIG performed on that day.

The residual return once you extract market and industry factors are different. And they're different because he uses different filters, if you will, or uses a different number of filters and he uses different filters, but the principle is the same.

And so you see in column D the residual percentage return controlling for movements other than AIG now range from 16.7 percent to 158.6 percent.

And then when you convert those into dollars, you get capital gains for AIG's stock over all of these windows as you did with my version of the model.

In fact, you get larger AIG-specific residual returns on a percentage basis with Professor Kothari's model, and you get larger market cap gains, market capitalization gains to equity, with Professor Kothari's model.

So if you were to compare those, not only are his positive in terms of company-specific reactions to the news of rescue, they're more positive than my own.

Q. And so what does your column F indicate?

A. My column F indicates there's still no negative stock price reactions from the market. The market still views the rescue package as good news for shareholders. There is no damage to shareholders according to Professor Kothari's own model when applied to the actual event date when the news got out.

Q. And what does the -- what do the figures in column E demonstrate in DX 2609?

A. The figures in column D --

Q. E.

A. D as in dog?

Q. No. E.

A. Oh, E. I'm sorry.

It shows increased value, increased wealth for shareholders.

Q. As a result of what?

A. As a result of the initial rescue package announcement.

Q. If you look at the note on DX 2609, you're referring to Dr. Kothari's event study and the three factors he used there.

What are you indicating there? As -- in terms of his filtering mechanism.

A. His filtering mechanism uses fewer portfolios, fewer proxies. It's still a reasonable approach. He hasn't tried to do what I did, which is I took all of the -- this is something that's consistent with how I would analyze financial statements and companies from my professional career.

You would try to look at the balance sheet and income statements of those companies, find their primary or principal businesses, and say okay, here are the places where this company's business is related to an industry or a set of industry activities and then try to say, based on the bulk of this firm's activity, how is that firm going to behave, so you create your filters that way.

He's used far fewer. He's used a financial index, he's used an insurance index, and he's used a general market index. It's still fine.

Q. Right.

But when you modified Dr. Kothari's to a later

period in DX 2609, you used the same --
A. Exact same ones that he did.
Q. You didn't use yours; you used his.
A. No. As I said previously, this is Dr. Kothari's model. Only change that's been made is that I've shifted him from 9-11 to 9-15, his model, to 9-16 to the windows that I looked at. Everything else is the same as the model, to the best of my understanding, as was explained in his own work.
Q. Going back to DX 2604, you indicated there that you had two analyses. Your second analysis involved review of the market -- contemporaneous market commentary.
Did you prepare any demonstratives setting forth this market commentary?
A. I did.
Q. And are those 2610 and DX 2611?
A. That's correct.
Q. First, could you explain to us what is demonstrated in DX 2610.
A. DX 2610 provides a couple of examples of the kind of market commentary and the attributions that were being granted by market participants on the morning of September 16, 2008 and specifically those relating to AIG's imminent risk of bankruptcy in the absence of any

financial assistance.

So the first one is a CNBC note, which was available on Bloomberg as well. And it essentially says that AIG needs to raise an enormous amount of capital on the 16th, that day, or it would file for bankruptcy on the 17th.

So they had looming liabilities, they had looming obligations to pay, they did not have sufficient capital to meet those, and they were headed for bankruptcy court, was the CNBC account that morning.

And then there's a second account from the former CEO of AIG, Hank Greenberg, also a Bloomberg documented statement, where the insurer is struggling to raise funds and will go bankrupt without outside help from either the U.S. government or other investors.

Q. Now, you had indicated earlier that the price opened at 1.85, and then what happened to it immediately after that?

A. It declined to 1.25 as this kind of conversation was taking place in the market.

Q. The kind of conversation about the possibility of bankruptcy?

A. Possibility of bankruptcy if they didn't raise -- I think I saw some accounts that said at least 75 billion or maybe more.

Q. Now, can you explain what's demonstrated in DX 2611.

A. Certainly.

So this is an example of the kind of market commentary that was typical once news started circulating of possible resources available for rescue.

And later that morning, one of the news items was that American International's stock price jumps over a dollar a share on a CNBC report that government assistance was on the table and that the broader market then spiked the session highs. But remember, my event study takes those broader market spikes out and focuses on the AIG-specific. But generally good news.

The second one, that stocks turned higher Tuesday after the CNBC reported that the government was considering extended aid to troubled AIG insurer, so there's yet another -- another such announcement that came out on 9-16.

Q. And what do these announcements indicate?

A. The announcements indicate that the markets were attributing the improvement in price to the news of a rescue, of available rescue resources, and the fact that the firm now was at less at risk for really costly and painful bankruptcy.

Q. Can you summarize your opinion as to the significance of the commentary that we saw set forth in DX 2610 and DX 2611 to your opinions.

A. Relief. Markets were relieved. Prices -- downward pressure on prices were relieved. Markets basically evaluated the risk of bankruptcy to be alleviated.

Q. Well, that's with respect to the market commentary in 2611.

A. In 2611.

2610 said, when the markets had no sense that there was such relief, that the firm was likely going to end up in a very negative place, bankruptcy was highly likely and loss given default or losses in the event of bankruptcy were going to be significant.

MR. AUSTIN: Your Honor, I'd like to move into evidence DX 449, which is cited on -- as a source for DX 2611, and I would move it into evidence pursuant to Federal Rule of Evidence 703 as the basis for Dr. Mordecai's opinion.

MR. BOIES: As I understand it, DX 449 is being moved in pursuant to rule 703?

MR. AUSTIN: That's correct.

MR. BOIES: No objection, Your Honor.

THE COURT: All right. Defendant's Exhibit 449 is admitted with a rule 703 limitation.

(Defendant's Exhibit Number 449 was admitted into evidence.)

BY MR. AUSTIN:

Q. Now, Dr. Mordecai, if you turn briefly back to DX 2602?

A. Yes.

Q. And do you see the reference there to the CNBC announcement at 10:52 a.m. in the middle of the page there?

A. Yes.

Q. And also in DX 2611 you also referred to the CNBC announcement; is that right?

A. Correct.

Q. And that was the news of a possible government rescue on the morning of the 16th?

A. Correct.

Q. And have you prepared a short video clip of that CNBC announcement?

A. I have.

Q. And is that -- not that you know this, but Your Honor, this is DX 1736.

Dr. Mordecai, I'd like to play this short video clip, and then I'm going to ask you a question about it.

But first, as we watch the video clip that you prepared, is there anything in particular we should look

for as we watch the clip?
A. Yes. There's a stock ticker that's playing in the -- on the screen as the commentary is taking place. I would watch that stock ticker because it shows not just the market's response to the news as it's happening, but it shows the rapidity with which the market is responding to the news in real time.
And so that highlights something I mentioned earlier, which is, not only do we have a response, but we also have evidence of the degree to which markets are contemporaneous and informationally efficient at this time incorporating news into prices rapidly.
Q. We'll go ahead and play the video.
(Whereupon, the video, DX 1736, was played.)
A. So you could see the way that he said "unwinding," but we got covered, boom, back up, right.
Q. What, if anything, does this CNBC video, DX 1736, demonstrate that is relevant to your opinion concerning whether the initial rescue resulted in an economic loss to AIG's shareholders?
A. It reinforces for me that market prices were reliable incorporating news, and what those market prices indicated was that the rescue, the initial rescue package, was of benefit to the firm and benefit to the shareholders and that the shareholders gained as a

result of the rescue package from the market's assessment.

MR. AUSTIN: Your Honor, we would move DX 1736 into evidence pursuant to Federal Rule of Evidence 703.

MR. BOIES: And as a 703 exhibit, we have no objection, Your Honor.

THE COURT: All right.

Defendant's Exhibit 1736 is admitted with a rule 703 restriction.

(Defendant's Exhibit Number 1736 was admitted into evidence.)

BY MR. AUSTIN:

Q. Now, Dr. Mordecai, let's go back to your summary of opinions which we've produced here as DX 2612 and discuss your second opinion, that without the equity component, the revolving credit facility, the RCF, did not provide a return to adequately compensate for the significant risk of lending to AIG.

Have you conducted an evaluation of the risks of lending to AIG?

A. I have.

Q. And what did you do to evaluate those risks?

A. I looked at bond prices and I looked at credit default swap on AIG debt, and I looked at the valuations and the spreads related to credit default swap prices written against AIG debt or debt issued by AIG.

Q. And you looked at the market evidence of those bonds and credit default swaps?

A. This was all about market evidence. Yes.

Q. Please turn to DX 560, which is in your large binder.

A. Yes.

Q. Have you seen this document before?

A. Yes.

Q. Can you tell us what it is.

A. This is another form of market evidence. This is actually market commentary from the time. This is September 24, 2008, market commentary from a firm called Fox-Pitt Kelton Cochran Caronia and Waller, which is an investment banking firm specializing in insurance and reinsurance markets.

Q. Let me direct your attention to the second page of DX 560, and I'd first draw your attention to the highlighted portion in the fourth paragraph beginning with the words "The downside risk" and just up to "so far." Just highlight up to the words "so far."

It says there that "The downside risk is that the value of the entities, which is dissipating each day, become insufficient to replace the government loan or real economic losses from the derivative portfolio grow significantly from the current $26 billion in mark-to-market losses so far."

Do you see that?

A. Yes.

Q. And how is this paragraph of DX 560 relevant to your opinion two?

A. This is a clear example or illustration of the kinds of commercial risks, underlying commercial risks, that a lender to AIG would be facing, and in this particular case the government, by extending a loan to AIG.

Q. What does it show you with respect to whether or not the market recognized that risk?

A. Well, it was out in the market. Market participants were clearly discussing it.

Q. And let me then direct your attention two paragraphs down to under First Step: Stabilizing the Insurance Operations.

And it says there that "AIG's insurance businesses are losing value by the day, due to competitors, distributors, and/or customers working to move business away from AIG. In commercial lines, brokers and risk managers of larger accountings are opting to move their business as soon as possible, even canceling and rewriting with other carriers."

How, if at all, is this statement relevant to your opinion concerning the risk of lending to AIG?

A. This kind of statement is consistent with my thirty years as a commercial credit analyst, as a financial statement analyst, as a transactor in these markets.

And what this is saying is it's looking at the underlying competitive position of the firm, its actual business franchise value, and then it's saying that these are very much under risk and they're actually at risk of deterioration and decline on a prolonged basis. And that's a risk that a lender to AIG would be assuming or facing in terms of the ability to -- for AIG to ultimately repay over time.

Q. And then finally, in the next paragraph, the short paragraph there, it says, "The largest risk is people. Bonus plans, deferred compensation and other financial incentives that kept employees in place no longer have material value. It is a reasonable choice to take the opportunity to move to another company, given the remaining uncertainties on the long-term position of AIG's insurance companies."

And is this another example of market commentary concerning the risk of lending to AIG at this time?

A. Yes. The first was around the viability of one's customer relationships. This is now about the viability of one's employee base to serve those customers, so those are very real commercial risks at the fundamental level of the company's operations.

MR. AUSTIN: Your Honor, I would move DX 560 into evidence pursuant to rule 703.

MR. BOIES: No objection, Your Honor.

THE COURT: Defendant's Exhibit 560 is admitted with a rule 703 limitation.

(Defendant's Exhibit Number 560 was admitted into evidence.)

BY MR. AUSTIN:

Q. Now, Dr. Mordecai, did any of the risks that we just read that were listed in DX 560 actually materialize in the real world?

A. Yes.

Q. Could you please explain.

A. There were situations in which AIG lost -- you know, business moved away from AIG. There were difficulties in disposition of assets that they were relying on in order to restructure the business. There were additional ratings -- negative watch and downgrades associated with that. It was -- there continued to be issues.

Q. In addition to looking at market commentary, did you do any other analysis to evaluate the risk of lending to AIG?
A. Yes.
Q. What did you do?
A. Well, I looked at bond prices and I looked at credit default swaps written against AIG-issued debt.
Q. Do you have an opinion as to whether AIG's debt and credit default swap prices that referenced AIG debt were a reliable indicator of value at or about the time of the initial rescue?
A. I do.
Q. And what is your opinion?
A. My opinion is they were very reliable indications of AIG value and AIG creditworthiness at that time.
Q. Does your direct experience have anything to do with that?
A. Absolutely. I was involved with credit markets since '84. I did credit statement analysis, loan structuring, loan -- I've been involved with credit markets, commercial credit markets since 1984, formally trained as a credit analyst. And since then, I've done credit analysis, loan structuring, loan trading, loan repackagings, reorganization.
I looked at -- I've been involved with credit

default swap markets since their inception in the mid-'90s. And I've had to do relative value analysis across credit default swaps, underlying bonds, loans, pools like in CDOs, whole loan purchases, so yes.

Q. Let's focus on AIG debt first.

Is there a market where AIG debt is actively traded?

A. There is.

Q. And where is that?

A. It's an over-the-counter market. It's between dealers and large financial institutions mostly, very sophisticated players. It's a very active market, and in fact the bulk of financial claims that are traded are actually -- bond and credit claims are the largest markets in the world as far as capital markets are concerned.

Q. Who trades in that market?

A. Institutions mostly. Large, sophisticated banks. Mutual funds. Pension funds. Insurance companies. Finance companies. Hedge funds. Asset management platforms of all kinds.

Q. Did you prepare a demonstrative to show what happened to AIG's bond prices in the September 2008 time period?

A. Yes.

Q. Is that DX 2613?
A. It is.
Q. Can you please tell us what this demonstrative demonstrates.
A. Certainly.
So this demonstrative demonstrates the response of bond markets to both impending news of AIG's imminent bankruptcy risk and then the news of availability of initial rescue, so this chart basically starts on the 2nd of September and rolls all the way to the end of the month.
It uses volume-weighted average price, so it captures the degree to which a large number of bonds were trading. That would have a greater impact on the average price than a small number of bonds trading to make sure that we're getting an accurate reflection of how the market was actually trading this day.
And it takes prices as a percentage of par, so in other words, cents on the dollar is another way to think about that, so, you know, if you think about a bond being worth $100, it would basically tell you how many dollars of price there was in a $100 bond.
And so we have three bonds from AIG's capital structure, one bond that's representative of two-year instruments, another bond that's representative of

five-year instruments, and then another bond that's representative of ten-year instruments, all issued by AIG itself.

And so you see that at the beginning of the month, these bonds are somewhere between 85 and 100 cents on the dollar, the two-year bond being at 100, at par, as they would say.

And then as the month progresses, particularly as we approach the 15th and the morning of the 16th, these bonds begin to substantially decline in value until all three bonds now are trading at 40 cents on the dollar, which is the industry standard for a default situation with only a 40-cents-on-the-dollar recovery for senior creditors, senior unsecured creditors in the company.

And then -- so that says, Hey, headed to the courthouse for bankruptcy, you're not going to get all your money back, is the general view of the marketplace.

Then on the 16th it responds and the bonds recover. They still aren't riskless. They're still way below par, but they're substantially better than 40 cents on the dollar.

So the likelihood of bankruptcy has been diminished, but you still have a bond that's basically -- the market's best estimation is, depending upon whether you're holding a two-year, five-year or ten-year, on an indicative basis you're somewhere between call it 60 and 70 cents on the dollar.

Q. Now, in general, what does it mean when a bond trades as far below par as we see at the 40 or below mark on September 16? What does that mean generally?

A. The expression in the industry and among market participants is: The bond is trading at close to its floor. And what that means is the bond was trading at close to a liquidation value for the firm.

Interest rate profiles matter less. What really matters now is what's this bond going to get on liquidation. It's not good news for the firm. It's not good news for the debt holders. The debt holders will not recover the full amount that they've extended to the company.

Q. Relating to AIG and its situation specifically as in DX 2613, what specifically do these bond prices shown in DX 2613 indicate about the risk of extending credit to AIG on September 16?

A. It indicates that there is substantial risk of lending to AIG, substantial risk of not even getting one's principal back.

Q. In your experience, Dr. Mordecai, would a lender who is considering making a loan to AIG on September 16, 2008 want to take into account the fact that current debt holders were pricing in an expectation of not being repaid in full on their loans?

A. In my opinion, any commercially reasonable lender who's both prudent, responsible and proficient at their job would absolutely take these prices into account.

Q. Now, you mentioned earlier and I want to come back to credit default swaps referencing AIG debt that you mentioned a moment ago. The Court has heard a significant amount of testimony about AIG's credit default swap business.

How is AIG's credit default swap business different from the credit default swap contracts referencing AIG debt that you're addressing here in your analysis?

A. Both contracts are generally similar; however, they reference very different things. And this is very, very important.

AIG's credit default swap business is about AIG writing protection to another party in the marketplace on some pool of assets -- and they wrote their stuff on asset pools, not individual credits -- on some pool of assets, whether that be a pool of corporate loans, a tranche of a -- senior tranche of a CDO or collateralized debt obligation, which is a pool of corporate credits, loans, bonds, other credit default swaps, or residential mortgage-backeds.

So that's the AIG Financial Products business in terms of the credit default swaps. It's credit default swaps, written to another party by AIG, providing protection payments on some pool of assets that is not issued by AIG but has pooled other things, may include a little AIG in it, but it's not AIG.

The credit default swaps that I analyze here are credit default swaps that specifically reference debt issued by AIG, and it's usually -- and it is between market participants -- the contract is written between market participants that are not AIG.

So those are two very different things. You've got a business where AIG is writing credit protection to third parties on some pool that they've agreed upon, okay, that's got nothing to do with debt issued by AIG necessarily, okay, versus I am now -- "I" meaning some financial institution out there is writing credit protection to some other financial institution on debt AIG has issued, right, their -- AIG obligations.

Q. Can you briefly explain specifically how credit default swaps referencing AIG debt work.

A. Sure.

A credit default swap specifically referencing AIG debt would involve a protection buyer and a protection seller.

The protection buyer may be pension fund, life insurance company. I could think of other folks that basically want to purchase protection against a default or other credit event like bankruptcy or reorganization, costly reorganization, around AIG-issued debt.

The credit protection seller is providing that protection, those protection payments, in the event of a credit event.

So the credit protection buyer makes a series of periodic payments to the credit protection seller. That's the cost of purchasing this protection. And that's related to spreads on the total face amount of that debt, okay, the hundred cents on the dollar, right, typically speaking.

The credit protection seller receives those payments, which now obligate that credit protection seller, if a credit event happens, to provide compensation, payments, protection payments, okay, to offset or immunize the credit protection buyer from the losses associated with that credit event.

And so you have either physical settlement where the credit protection buyer turns over the defaulted bond, you know, to the credit protection seller and gets paid par as opposed to whatever the market price is, 40 cents, whatever it happens to be, or they do a cash settlement that just makes up the difference between where those bonds are trading in default or in the credit event and par.

Q. So --

A. Those things are the same. Whether it's physical or cash, you basically end up in the same place.

Q. The periodic payments that the credit protection buyer makes to obtain credit protection are -- they are referred to as the credit default swap spread?

A. That's correct. It's a spread over LIBOR that the this contract references.

Q. Did you prepare a demonstrative to show what happened to the prices of these credit default swaps referencing AIG debt?

A. Yes.

Q. And is that DX 2614?

A. That's correct.

Q. Can you please tell us what DX 2614 demonstrates.

A. Well, it shows what the CDS spreads referencing AIG debt did over that window from September 1 to September 29 and a little beyond, say, end of the month.

And I'd like to sort of describe this a little bit to make it clear that when spreads are wider, bond prices are lower, okay, so this moves in sort of the opposite direction.

So you can think about the credit default swap spread as the cost of protection. Your cost of protection goes up as the company's fortunes are declining, okay, and the bond prices are going lower, right.

So this is -- these are called indicative par spreads. And what that means is, this is the indicative cost of buying protection against the full par amount of a bond, an AIG bond, and it is at the midpoint between bid and ask.

What bid and ask is, is this is where buyers and sellers of credit protection are either offering to purchase or offering to sell credit protection, and so that's your bid-offer or bid-ask differential. This is the average between that, so we can just track that midpoint and follow the cost of protection around.

That doesn't mean that bid and ask won't get wider or narrower based on, you know, how many bids and offers there are in the marketplace, but that's why you focus on the mid. That is an industry standard approach.

So what we see here is that at the beginning of the month, the AIG debt protection spread is below 500 basis points or 5 percent.

As you get closer to 9-15 and 9-16, by the time you get to 9-15, it's jumped to 20 percent, so you're paying 20 percent a year to protect yourself or 20 cents a year to protect yourself against a default on an AIG bond. Twenty percent of the value of the bond you're paying in protection every year on a five-year bond, so over five years at that level you're basically going to pay the full value of the bond just to protect yourself on the bond. It's pretty serious stuff.

It goes all the way up to 35 percent on the morning of 9-16, so you're paying now 35 percent of the total value of the bond every year for five years with this contract to protect yourself against a default, right.

And then when the news come out that there's a government rescue package, those spreads decline very precipitously. The cost of insurance -- oh, I don't like the word "insurance." The cost of credit protection on this goes down, way down. And you end up still not back where you were, but you end up with a new equilibrium through the end of the month someplace in the neighborhood of 700 or 800 to, you know, 1500 or 15 percent, 15 cents on the dollar effectively, so you're somewhere in that range significantly different from 35 percent of face.

Q. And what again is the relationship between credit default swap spreads referencing AIG debt and AIG's bond prices?
A. They're very closely linked. They're intrinsically linked.
If you had a significant disconnect between the credit default swap price referencing AIG debt and the AIG debt itself, you would end up with this weird world of what they call arbitrage opportunities which don't make any sense.
If you're protecting against the debt, then -- and the debt is trading down, your -- your cost of protection should go up. And in fact, there are other mechanisms in the market that require you to pay more and more and more of that protection payment up front to the protection seller because of the imminence of him having to pay out on protection.
Q. To give us some frame of reference here, how does the 3500-basis-point CDS spread on AIG debt that we observe -- that you observe in DX 2614 on September 16 compare to spreads that are commonly observed in the credit default swap market?
A. These are some of the highest spreads I've seen on credit default swaps, particularly -- well, particularly a financial institution credit default swap.

This is very close to high-yield bonds spreads and this is very close to firms that are sort of close to default or in default.

Q. So what, if anything, does a credit default spread -- credit default swap spread of 3500 basis points indicate about how the market viewed the possibility of an AIG bankruptcy on September 16, 2008?

A. It viewed bankruptcy as an imminent and highly likely outcome on September 16 and a very costly and prolonged one at that.

There's a sense in the market where we talk about -- in credit default swaps they talk about materiality, so if you have a technical default, it's a default that has no economic impact. You know, it doesn't show up in the credit default swap spread. When you have a real default that's going to be costly to bondholders, it certainly shows up in the credit default swap spread, and this is an example of that.

Q. In addition to pricing in a high likelihood of bankruptcy, does a spread of 3500 basis points on a credit default swap referencing AIG debt indicate anything with respect to the expected recovery rate if in fact the default occurs?

A. Yes. I actually mentioned this a little bit in the last exhibit of the three bond prices.

What you see is that despite the tenor or the length of the bond -- so you've got a two-year bond, a five-year bond and a ten-year bond -- when the risk of bankruptcy becomes imminent, what you see is all three of those bonds that previously had a difference between them that's related to time value, it disappears and they all start trading at what's called the bond floor.

That's the recovery value of the firm. That's what happens if you sold off the firm, right, and took the cash and tried to pay back the bondholders. You get 40 cents on the dollar, right.

And that's why you don't see a spread now related to time value and the interest rate differences, because as far as the market's assessment, the market's assessment is we're all heading to bankruptcy court and this is what's left.

Q. So it's describing not only the possibility of a bankruptcy but the expected recovery rate should that event happen.

A. The severity, which is also called loss given default, is also in there. It's incorporated into that spread and those bond prices.

Q. Do you have an opinion, Dr. Mordecai, as to whether a lender considering making a loan to AIG on September 16, 2008 would take into account the AIG credit risks that are reflected in DX 2614 when determining the terms of the loan?

A. Ever since the bank markets initiated -- well, first your question is whether I do; right?

Q. Do you have an opinion --

A. And my answer is yes.

Q. Yes. Okay.

Could you please explain why.

A. Ever since the bank markets initiated credit default swaps as a means of hedging their loan exposure among them, around 1994, credit default swaps have become increasingly a benchmark instrument throughout those markets.

Any commercially -- in my opinion, my professional opinion, any commercially reasonable lender or investor in a situation like this, right, if they're being prudent and diligent, would certainly incorporate these market indications into a lending decision.

Q. What, if anything, does a low expected recovery rate on AIG senior debt in bankruptcy indicate about the expected recovery rate for shareholders in bankruptcy?

A. What does it indicate?

Q. Yes.

A. If the senior claimants, the debt holders, are only seeing 40 cents on the dollar, maybe less, there's nothing left to pay shareholders as the junior claimants in the company. As the primary bearers of risk at inception, they're the first to face the fact that when the debt isn't paid off, there's nothing left over.

Q. Is it common for shareholders to receive nothing in bankruptcy?

A. It's very common for shareholders to receive nothing in bankruptcy.

Q. Have you prepared any data to illustrate what shareholders typically recover in bankruptcy?

A. I have.

Q. And is that DX 2615?

A. It is.

Q. Please explain what is shown in DX 2615.

A. DX 2615 is a panel -- there are two panels, actually, of outcomes on large company bankruptcies. The left panel is the largest public company bankruptcies in U.S. history, and the right panel are the largest insurance holding company bankruptcies in U.S. history.

The left panel, which is generally public company bankruptcies, shows the companies ranked by their asset size in terms of bankruptcy. And with the exception of a seven-cent-per-share recovery for equity holders in Washington Mutual, every other instance there's zero

recovery for equity holders.
When you move to the insurance industry example --
Q. Well, that's your left panel; right?
A. I said left panel. Of if I said something else, I misspoke.
Q. No. You said left panel.
A. Oh, okay.
Q. Now let's move over to the right panel, and tell us what is there.
MR. BOIES: Your Honor, I don't believe that the right-hand panel was in his expert report. Now --
MR. AUSTIN: It was.
THE WITNESS: Yes, it was. I can turn to it if you'd like me to.
MR. BOIES: No. I'll take the representation if you'd just tell me where it was.
MR. AUSTIN: The source there is Mordecai Report Exhibits 19 and 20 I believe. The right panel is Exhibit 20.
MR. BOIES: Okay.
BY MR. AUSTIN:
Q. Is that right, Dr. Mordecai?
A. Yes. It's right here (indicating).
Q. And what exhibit are you looking at?

A. Exhibit 20.

Q. Of what exhibit? What's the exhibit number?

A. Exhibit 20.

Q. No. The DX number.

A. Oh, I'm sorry. Oh.

DX 1875.

Q. Go ahead and turn over to the right panel.

A. Sure.

So the right panel, which is the one we were just looking at in my report, are basically the largest insurance holding company bankruptcies. I only list eight. I only list eight of those. I list the ones that were companies with book value of assets of a billion dollars or greater at the time of the bankruptcy filing. And of course, it is also now in the -- in order of asset size or book value.

And so it starts with Conseco, and you can see there that in every single instance shareholders received zero recoveries in bankruptcy.

Q. How, if at all, are the risks of lending to AIG that you've been discussing relevant to your opinion that without the equity component, the revolving credit facility did not provide a return to adequately compensate for the significant risk of lending to AIG?

A. Could you repeat the question.

Q. Sure.
Your second opinion --
A. Uh-huh.
Q. -- your second broad opinion is that without the equity component, the revolving credit facility did not provide a return to adequately compensate for the significant risk of lending to AIG.
How, if at all, are the risks of lending to AIG that we've been discussing relevant to that opinion?
A. Well, the market price indications at the time that the rescue package was being extended at the time that -- on the day, 19th, were such that the market was demanding 35 percent yield on any new credit, any new debt for that debt to be par, what we would call par debt or 100 cents on the dollar debt, because of the risks remaining in the firm.
So you have this risk of not getting your money back. You have this market required yield or hurdle rate of 35 percent, 35 cents on the dollar. And the -- to try to use a coupon payment or a current debt payment and have a company in distress service a 35 percent per year interest payment would just make things worse.
So the common thing that's done in restructuring situations, reorganizations, you know, in my experience and from my study, is you use an equity return

participation and something called payment-in-kind features to leave the company with sufficient flexibility to still provide the lender an adequate return to compensate for risk and leave the company with enough flexibility to work its way out of the debt and not be burdened by having to make that nut, if you will, you know, in every period come hell or high water.

Q. Is there a relationship between risk and return?

A. Absolutely.

Q. What is that relationship?

A. As risk goes up, return goes up.

Q. Did you conduct any analysis concerning whether the interest rate on the revolving credit facility was adequate considering your assessment of the risks involved, again, leaving aside the equity participation?

A. First, I misspoke. Let me be clearer.

When risk goes up, the required or expected return of the market goes up. If you end up with something opposite, you end up in a topsy-turvy world.

Could you ask the question again, please.

Q. Sure.

Did you conduct any analysis concerning whether the interest rate on the revolving credit facility was adequate considering your assessment of the risks involved, again, leaving aside the equity participation?

A. I did.
Q. And is that analysis set forth in DX 2616 and DX 2617?
A. Yes, it is.
Q. Can you describe first what is shown in DX 2616.
A. Certainly.
So DX 2616 uses a horizontal green line representing the revolving credit facility's associated coupon payment, if you will, periodic interest payment on a per annum basis, and compares it to correspond -- to corresponding debt yields, senior unsecured debt yields, on AIG securities at the time that it was being extended or -- and just prior in fact to its being extended.
So we have three dates here. We have 9-12, September 12, September 15 and September 16. And we have one to three-year maturity average bond yields for AIG debt, which are the blue bars, the vertical bars. And we have the average AIG bond yields for one to five-year maturities, which are the vertical red bars.
And as the title of the slide shows, the interest rate on the revolving credit facility was below AIG's contemporaneous debt yields both on the 16th when it was extended and even on the day before and four days before the actual announcement of the availability of the

revolving credit facility.

So you've got a 12 percent interest payment or coupon payment on the revolving credit facility which is a three-month LIBOR base rate which is -- with a 3.5 percent floor, so that says --

Q. Is that the green line that we see on --

A. That's the green line.

And as the yellow box pointing to the green line shows, 3.5 percent minimum on three-month LIBOR plus another 8.5 percent spread that yields 12 percent, and that's that horizontal green line.

What we see is, even on the 12th, that horizontal green line for a two-year facility is below the one to three-year maturity, which is the most comparable maturity, and is in the neighborhood of the five-year maturity.

And then as you move to the 15th, it's well below the contemporaneous debt yields at the one to three-year maturity level, which is the most comparable, which is 33 percent, is what the market is requiring, and for one to five-year, the market is requiring -- one to five-year maturities. Okay?

And then when you get to the actual day, when, you know, AIG is considered by the market to be close to bankruptcy, okay, and likely to file bankruptcy without some relief, the blue bar, the one to three-year maturities, the most comparable to the RCF, is at 58 percent, is what the market is requiring for new debt, 58 percent, and the one to five-year is at 42.5 percent.

Your Honor, one of the things that's going on here is the reason that the one to three-year required yield is higher than the one to five-year, this is typically called an inverted credit curve. And it's the market saying, Look, we are not sure the company is going to make it out the three years, right. We're much more focused on the risk in the short end than the risk in the long end. And that's why you see that yield getting bid up on the blue bar. But it's the most comparable to the two-year facility that the Fed has extended.

Q. Let me understand this a little bit better, Dr. Mordecai. On September 16, 2008, as you indicated, the blue bar is 58 percent and the red bar is 42.5 percent.

What does that mean as a market matter? What does that mean when those numbers are there?

A. As a market matter, it's basically -- because the market -- as we said, when risk goes up, the expected return or the required return is going to go up. And what the market is saying is this is what we need to get paid to take on this new risk and have an instrument that is sufficient in its return to compensate for this risk.

Q. How can those numbers be so high?

A. Because this company is that risky at this point.

Q. Risky in terms of what?

A. In terms of risk of default, risk of its inability to pay its own obligations and the implications of that for the ongoing concern, for the going concern value of the firm, for the commercial viability of the firm on an ongoing basis.

Q. Does it reflect anything not only with respect to the probability of default but with respect to the expected recovery rate in bankruptcy?

A. Yes. The 58 percent required yield is saying we don't think you're going to get more than 45 or 40 or 35 percent back on any new debt you put in. That's the market's assessment at that point. We need that much just to make us whole over the short run; otherwise, we think we're going to lose money.

Q. In addition to the 12 percent interest rate that is shown by the green line on DX 2616, are you aware that the government also received a 2 percent up-front commitment fee --

A. Yes.

Q. -- in addition to the 12 percent?
A. I am.
Q. If you had included this 2 percent fee in your analysis, how would that have affected your conclusions?
A. It wouldn't have changed my opinions or conclusions at all.
Commitment fees are fairly common in debt markets, particularly loan markets. And what one typically does is, if it's an ongoing annual fee, you add it to the rate and just sort of look at what it does. If it's a one-time fee over the life of the deal, you split it into equal parts and add it to each year.
My understanding is that the 2 percent up-front rate was a one-time fee, and so for a two-year deal, the industry standard is, you split it in half, you add a point to each year, which means you're now at 13 percent a year. It just doesn't move the needle at all.
Even if I went so far as to say let's pretend it's 2 percent a year, it's going to take you from 12 to 14 percent. It gets nowhere near what the market requires for a par loan, a loan that's worth a hundred cents on the dollar.
Q. Please turn to DX 2617, and can you please tell us what's demonstrated in DX 2617.
A. This is using credit default swap spreads

contemporaneous to the bond yields we just looked at.

Q. Referencing AIG debt?

A. Referencing -- no. It's credit default swap spreads referencing or written against AIG-issued debt. And I think, as you recall, I earlier said something about bond and credit default swap prices are -- pricings are very close together and intrinsically linked. They have to be because the credit default swaps reference the debt.

So here is a table, 2617, which shows that the interest rate spread on the revolving credit facility was below the comparable AIG contemporaneous credit default swap spread.

So embedded in the interest rate coupon being charged, which is that horizontal green line again, there is an 850-basis-point spread over LIBOR, which can be compared to the credit default swap spreads, which also subtract out LIBOR and just focus on spread.

And so what you see is, we use the same three dates, 9-12, 9-15 and 9-16 of '08. And we put that horizontal green line in to represent the revolving credit facility is a two-year facility made available on 9-16. And as you look, you see that on 9-12, four days before this even occurred, the 850-basis-point spread of the revolving credit facility is at or below the two-year credit default swap and five-year credit default swap spreads indicated in the marketplace.

When you get to 9-15 and AIG's credit condition and financial condition has deteriorated precipitously and they're looming on the downgrade, which did in fact happen by all three agencies, you now see that the credit default swap spread is almost three times higher than the spread built into the RCF payment, the coupon payment, at the two-year point, and at the five-year point it's more than double.

And then when you get to 9-16, the credit default swap markets are saying 43 percent or 4300, 4332, at the two-year mark and the 35 percent that we've already talked about at the five-year mark.

So yeah, that 12 -- that 850 basis points is nowhere near either of those.

Q. If you compare the green line on 2617, it refers to interest rate spread over three-month LIBOR of 850 basis points, and back on 2616, the green line is interest rate on the revolving credit facility equal to 12 percent.

Why are they different from each other?

A. It's about the way -- it's about the convention in how credit default swap spreads are cited and valued. They're economically the same.

So 8.5 percent is the same as 850 basis points of spread. The credit default swap markets do not explicitly focus on the LIBOR funding rate, right. They focus strictly on default spread or credit-related spread, so they're focusing on the 850.

And that 850 is then compared to the cost of protection, which, as I said on 2617, is, you know -- 9-16 is ranging between 35 percent at the five-year level and 43 percent -- more than 43 percent at the two-year level or two-year maturity.

So they are the same, 850 basis points is the same as 8.5 percent over LIBOR, right, and the comparable relationship between the debt yields and the CDS spreads are also able to be matched apples for apples and oranges for oranges.

Q. Now, focusing again on the credit default swaps referencing AIG debt on DX 2617, again, would your conclusions change if you had included the 2 percent up-front commitment fee in this chart?

A. No. The 2 percent is not going to take 850 basis points and make it 43 percent.

Q. Based upon your training and experience, Dr. Mordecai, do you have an opinion as to whether, when setting the interest rate on the loan, it is common practice by lenders to evaluate contemporaneous bond yields and credit default swap spreads as you have done in DX 2616 and 2617?

A. It's both commonly accepted practice and best practice for lenders and investors generally looking at investments, professional investors.

Q. Why do you compare the interest rate on the revolving credit facility to AIG's bond yields and to the spreads on credit default swaps referencing AIG debt as opposed to comparing them to the bond yields and credit default swap spreads of other firms or the rates that the government charged to other firms?

A. Because it only makes commercial sense, common sense, that you look at the risk and the spreads and the prices associated with the company you're lending to when you're looking to make that loan. If you're going to lend to AIG, why not look at AIG's prices and spreads and financial condition, not that of other firms, not in this context.

Q. Now, in DX 2616 and DX 2617, in both of those you show AIG bond yields and CDS spreads for the dates of September 12, September 15, and September 16; correct?

A. Correct.

Q. Why did you look at these dates in particular as opposed to some date after the news of the initial rescue had reached the market on September 16?

A. The dates after the news would incorporate the benefits of the rescue package, and so it's -- you can't -- no market participant has a crystal ball and is able to look into the future, right, so although you want to be forward looking, you want to be forward looking based on all the information you have at the time.

And market spreads at the time indicated what the risk of lending to AIG is for a lender, a commercially reasonable lender. Trying to look after the fact back at dates afterwards is not -- that's about once the benefits of the commercially -- you know, once the benefits have been put in place, you know, what the subsequent risk to the firm is, that's -- that's neither something that you can get at the time, right, that you're making the loan, nor is it a reasonable thing to think you can get at the time.

Q. Let me direct your attention back for a moment to DX 2616.

A. Uh-huh.

Q. And if you look at the bottom of the page there, you have a footnote that mentions that the bond yields you are demonstrating on this chart are yields on AIG senior unsecured debt.

A. Yes.

Q. Have you prepared a demonstrative to explain the comparison of AIG's senior unsecured debt prior to the rescue to the interest rate on the revolving credit facility?

A. Yes.

Q. Is that demonstrative 2618?

A. It is.

Q. Could you please explain demonstrative 2618 for the Court.

A. Demonstrative 2618 is meant to provide an intuitive and hopefully fairly tangible illustration or explanation of where the revolving credit facility fit into the capital structure of AIG once it was made available and extended to AIG and where it fit in relative to senior unsecured debt claims prior to it being included to show why those spreads at the time the decision was being made were reasonable proxies, right, and actually the most -- best available proxies for that, the risk of that loan.

So if you look at the pre-rescue AIG capital structure, which is on the left-hand side of the page, you see that senior unsecured debt claims were under other claims like insurance liabilities, life insurance book of business, secured, you know, security lending operation, you know, credit default swap business of AIG Financial Products, so it fits in there and above more junior claims like equity, any surplus notes, that kind of stuff.

And then once the revolving credit facility is put in place, it basically takes the place of those senior unsecured debt claims in the capital structure, just below those other insurance liabilities and trade claims, okay, and ahead of what -- now the senior unsecured debt claims, the old ones, have moved down, and of course the more junior claims have also moved down.

So what this shows is the revolving credit facility has the same seniority that the previous senior unsecured debt claims have. It's also backed by the same sources of repayment from the same assets as the senior unsecured debt claims were, right.

So as a result, they are comparable and in fact interchangeable in that economic sense with those senior unsecured debt claims from the perspective of expected return.

Q. So what's your bottom-line conclusion based on what you're setting forth in DX 2618?

A. That senior unsecured debt claim pricing, both in the bond markets and the credit default swap spread markets, are a reliable indicator of risk and reward for the RCF.

Q. Now, in your opinion, would a comparison to secured debt be appropriate in these circumstances?

A. A comparison to secured debt is not even feasible in these circumstances, and it certainly isn't industry standard or industry accepted.

Q. Are you aware that one of plaintiffs' experts attempted to adjust AIG's unsecured debt yields to secured yield equivalents?

A. Yes, I am.

Q. Does his analysis affect your opinion?

A. Not at all.

Q. Why not?

A. Well, first of all, as I mentioned, the kind of adjustments, ad hoc adjustments, being made were inconsistent with what I in my experience find to be industry accepted practice.

But even if I were to allow them or accept them and say they were, they really don't move the needle. They don't take you -- they don't change the substance of the opinion or the economic -- ultimate economic opinion, doesn't get you to a market equivalent yield on the RCF, nowhere near it actually.

Q. Then going back to your broad opinion two set forth in DX 2612 that without the equity component, the revolving credit facility did not provide a return to adequately compensate for the significant risk of lending to AIG, can you explain how the conclusions you reach from your analysis of AIG bond yields and spreads on credit default swaps referencing AIG debt relate to that opinion.

A. They basically support that opinion. If the market is saying something in the neighborhood of 35 percent or 43 percent required yield for a new source of credit in order for that to be par credit, then I could not envision putting a 43 or 35 percent coupon on a distressed firm loan because the company couldn't possibly support that.

PIK debt or PIK features combined with equity return features are the usual substitute for such a high rate. And in fact, the reason for that is to provide better support for a par performance, you know, a hundred cents on the dollar performance, that's commensurate with market return to the extender of that new credit, a commercially reasonable lender, in which this case would be the government.

Q. What, if anything, does that tell you as to whether or not the equity component should be viewed as part of the consideration provided to the government for bearing the risk of lending to AIG?

A. It's exactly what it represents.

Q. Now, in your earlier answer, you referenced PIK features. Could you explain what that is.

A. A PIK feature -- and again, these are -- I've seen these throughout restructuring and reorganization transactions and, you know, exchange offers in a lot of these situations.

A PIK feature is payment in kind. And it's a feature built into a coupon payment for a distressed loan where what it's saying is, look, since the -- since the coupon is going to be high relative to the company's very variable cash flow prospects at the time, it means that the lender is going to be flexible as to when they get those payments, and so the payments are deferrable. If the company cannot make them, they're deferrable without the company ending up in a default situation. But ultimately they will be recouped, you know, or sought to be recouped by the lender.

Q. Did you conduct any analysis on what the government's actual return was on its various loans and investments in AIG?

A. Yes.

Q. Is that shown in DX 2619?

A. It is.

Q. Can you please explain what is demonstrated in DX 2619.

MR. BOIES: Your Honor, we're going to raise a relevancy objection. This doesn't have anything to do with what is at issue in this case, which is the RCF.

THE COURT: Mr. Austin?

MR. AUSTIN: Your Honor, Dr. Kothari has presented evidence of -- or Dr. Cragg -- I can't recall which -- as to the overall return on investment that he believes that AIG received, and this is simply responsive to that, so if their evidence is relevant on this question, Dr. Mordecai's evidence is also relevant.

THE COURT: I'll take his testimony.

MR. AUSTIN: Thank you, Your Honor.

THE COURT: Overruled.

THE WITNESS: So -- thank you, Your Honor.

So Exhibit 2619 is a calculation of the government's return across all the investments it made in AIG, so this includes both the $85 billion in the revolving credit facility commitment plus another 90 -- almost $90 billion of other resources and commitments provided.

So that includes the revolving credit facility, the securities lending facility, the Maiden Lane II and III transactions, which I'm sure there's been a lot of testimony about so far in this case, the special-purpose vehicles created around equity of AIA and ALICO, ALICO being one of the AIG life insurance companies, as well as all the preferred and common.

And so on all of that 182.3 billion, taking into account the timing of when the money came back -- so, you know, the way you calculate a percentage return on an annualized basis, you need to take into account when the money went out and the time when the money came back, how it came back and how much, what was the size of the repayments that came in.

On a plain, absolute basis, what the government earned back over what it extended was -- on 182 billion or 182.3 billion, was 22.7 billion. On an annualized basis, that rate of return, based on the timing as well as the magnitude of the payments, was 5.7 percent a year, under 6 percent a year.

And the annualized rate of return, if you remove the 79.9 percent equity return participation, was 1.2 percent a year, right, so below LIBOR. That says, as a market participant, to me, the government's return on $182.3 billion of taxpayer money was below what you'd get for LIBOR, basically the interbank's cost of funds.

Q. Turning back to your summary of opinions which we've -- is reproduced on DX 2620, let's start discussing your third opinion that Professor Kothari's estimate of the alleged harm suffered by the credit agreement class is fundamentally flawed.

Now, Dr. Mordecai, from your review of Professor Kothari's trial testimony, do you understand that Professor Kothari has proffered an opinion that the value of plaintiffs' credit agreement claims is equal to $35.4 billion?

A. Yes, I do.

Q. Have you prepared a demonstrative setting forth the bases for your opinion that Professor Kothari's estimate of the alleged harm suffered by the credit agreement class is fundamentally flawed?

A. Yes.

Q. And is that demonstrative 2621?

A. It is.

Q. Can you please list the flaws that are identified in demonstrative 2621.

A. Certainly.

First of all, a straightforward sanity check demonstrates that Professor Kothari's analysis produces illogical results.

Secondly, share dilution, which I can explain later, is not equal to economic loss. In fact, share dilution is common in the financing of distressed firms.

Third, Professor Kothari ignores that AIG's stock price increased as a result of the initial rescue announcement. And this demonstrates that the AIG shareholders did not suffer economic loss.

Fourth, Professor Kothari does not value losses to shareholders. Instead, he estimates the value of the government's 79.9 percent equity return participation on September 24, after the firm has benefited from the gain, and uses that -- and uses that value, and that value is entirely created by the initial rescue itself and therefore is not a loss to shareholders.

Baked into Professor Kothari's error here is an assumption that the initial rescue was a zero-sum game. And the initial rescue was not a zero-sum game. In fact, distressed lending as a matter of course are not distressed -- are not zero-sum transactions.

Q. Let's start with your first criticism in DX 2621 concerning your opinion about the results of a straightforward sanity check.

Have you prepared a demonstrative that explains the sanity check that you conducted on Professor Kothari's analysis?

A. I have.

Q. Is that DX 2622?

A. It is.

Q. Can you please explain your straightforward sanity check to the Court.

A. It's meant to really be common sense, a common-sense illustration.

So the slide shows that Professor Kothari's loss estimate substantially exceeds AIG's stock price just prior to the rescue.

So the horizontal dotted red line is representative in this slide of Professor Kothari's loss estimate of $13.16 a share.

The two blue boxes below show what the range of trading prices for the stock, AIG stock, were on the 15th and the 16th. And you see that the range is a maximum of 7.99 or $7.99 per share on the 15th with a low of $3.50, and then on the 16th the maximum share price is $5.24 with a minimum of 1.25.

Now, Professor Kothari is claiming they lost $13.16 when in fact on the relevant time period they never owned more than $7.99 worth of value, so how could you possibly have a loss greater than the value of what you owned. It doesn't fit this situation at all.

Q. Turning back to DX 2621, let's focus on your second criticism of Professor Kothari, that share dilution does not equal economic loss.

Can you please define "share dilution" for us.

A. Yes.

So share dilution is a common situation, particularly in distressed financing, where shareholders end up owning less of the -- on a per-share basis, fewer shares or a smaller percentage of shares, total shares, in the reorganized firm than they did before the reorganization or the financing.

Q. Did AIG's shareholders incur share dilution as a result of the initial rescue?

A. They did. They owned less on a percentage basis of the firm.

Q. What is the relationship, if any, between a shareholder incurring share dilution and that shareholder suffering economic harm?

A. If it's only about share dilution, there is no connection, right. The way in which a shareholder who's suffered share dilution or experienced share dilution has a loss or harm is only if the total value of the firm has not increased sufficient to compensate them.

So if I ended up with less of a firm but that what I end up with is worth more than what I started out with, I haven't been harmed at all. I've actually benefited.

Q. Have you prepared a demonstrative that explains this concept that you just described?

A. I have.

Q. Is that DX 2623?

A. It is.
Q. Could you please explain DX 2623 for us.
A. So this is meant to illustrate in as tangible and common-sense and sort of visceral way that I can, intuitive way that I can, the way in which share dilution is not equal to or equivalent to economic loss.
So in the example, the pre-dilution firm has an equity value of a hundred dollars in total, and the shareholders in that firm own a hundred percent of a hundred bucks.
After the dilution, if the value of the original equity or the value of the total firm goes up from $100 to $750, while the preexisting shareholders end up owning only 20 percent of the firm at its new value, that 20 percent is now worth $150 versus the 100 percent previously that was only worth $100, so the same shareholders now actually own an asset that's worth $50 more. Their holdings are worth $50 more or 50 percent more than it was.
So even though they own less of the total pie, the value of their slice is larger, so you can say, Well, I got a smaller slice of a bigger pie, but I got to eat more pie.
And that's what we see here, right. They're at $150 instead of $100. That's not harm. They just own

less of the firm.

Q. So what determines whether shareholder dilution leads to economic loss?

A. Value change, which is what I measured in my previous analysis.

Q. And how do you measure value change?

A. I measured value change by looking at where the per-share prices started out, where they ended up, and then multiply it times the number of shares that the shareholders have.

Q. Now, Dr. Mordecai, in your opinion, did share dilution resulting from the government's equity participation cause AIG's shareholders to suffer economic loss?

A. Absolutely not.

Q. Please explain why.

A. For the reasons that I just explained. They started out with stock worth something between a buck eighty-five at the open to a buck twenty-five at the low and ended up with stock worth substantially more than that throughout the rest of the period in question. They ended up gaining, not losing, on the value of the stock they held.

THE COURT: Mr. Austin, shall we take our lunch break?

MR. AUSTIN: That will be fine, Your Honor.
THE COURT: Let's reconvene at 1:45.
(Whereupon, at 12:44 p.m., a lunch recess was taken.)

A F T E R N O O N S E S S I O N

(1:46 p.m.)

THE COURT: You may go ahead, Mr. Austin.

MR. AUSTIN: Thank you, Your Honor.

BY MR. AUSTIN:

Q. Dr. Mordecai, how common is it for shareholders to be diluted in situations involving distressed lending or restructuring?

A. Extremely common.

Q. Why is that?

A. The reason is, is that as a company's financial condition deteriorates, as a company goes in decline and becomes in distress, the original equity capital gets eaten up by the deterioration and it leaves no forward, ongoing cushion against further risk for the firm.

So as new capital moves in senior to the original equity holders, they become the new risk bearers for the firm's ongoing operations, and so the previous equity holders end up forgoing their ownership because they can no longer provide this risk-bearing capacity.

Q. Have you prepared a demonstrative that explains why it is common for shareholders to be diluted in situations involving distressed lending or restructuring?

A. I have.

Q. And is that DX 2624?
A. It is.
Q. Can you please list and explain the first point on your demonstrative.
A. So as I was just mentioning, the shareholders of a distressed firm again have little or no equity value remaining in the firm. That gets eaten up, and the buffer that the equity provided to the ongoing operation of the firm is substantially diminished, and so the result would be or will be that the firm -- the equity holders lose ownership of the firm to creditors upon a default or bankruptcy.
So for that reason, distressed restructuring typically results in the reorganized firm redistributing equity to new and/or existing creditors as the primary risk bearers going forward. And that really leaves the equity holders with a diminished interest in the firm and the -- their original equity actually starts to reflect that prospect as you move closer to either the reorganization or the bankruptcy as two alternative outcomes.
Would you like me continue?
Q. No, no. Unless you have any -- do you have anything more on point one?
A. No.

Q. Okay. And on this case here, in AIG's case, and with respect to the initial rescue, did AIG's equity value decline substantially prior to the initial rescue?

A. It certainly did. We saw it go all the way to a low of $1.25, and in early in January of '07 AIG's stock was at $72 a share, something in that neighborhood.

Q. Okay. Could you please read or list and explain the second point that you've listed on DX 2624 as to the reasons that share dilution is common in distressed lending situations.

A. Certainly.

So there are two additional principles or themes I highlight here on this slide.

The first is that this equity return participation, loosely sometimes called an equity kicker, can serve as a substitute for a higher interest rate, is that, as I think we discussed a little bit before the break, too high an interest rate, even if it's actually appropriate for the risk of the firm, would tend to encumber too much of the distressed firm's cash flow and make it difficult for that firm to operate or remedy its situation, so instead you set a lower interest rate and you couple that with a more variable return to the lenders, which is this equity return participation or loosely referred to here as the equity kicker.

Now, that accomplishes something else as well, so not only does it enable the firm to be more flexible in its capital structure and its payment obligations going forward, the other thing it does is, by providing equity to a senior lender, that lender can be more patient in terms of its repayment.

So if all I have to rely on is a coupon, right, a fixed payment on a firm that's very risky, right, and the only way for me to get paid back is to charge a really high rate and try to rush to liquidate assets to get my money as soon as possible, once you add that variable coupon with the PIK feature, which means we're giving you flexibility on timing, on interest payments --

Q. And remind us again what a PIK feature means?

A. Payment in kind. It means that if I get to a point where I'm -- where the coupon is owed, but I don't have the money for the coupon, that coupon is just simply -- "payment in kind" means like an IOU gets set aside for future collection.

So you're getting this timing flexibility, as the borrower making the payments, in terms of the debt service, and you also then add this equity return participation which allows the lender or the investor to say, I don't just have to look to the coupon and the principal repayment, I can also look to how the firm's future prospects improve to recoup my investment, and I can therefore -- rather than rush to sell the firm, I can actually wait because I will -- I am now aligned with the rest of the equity owners in the firm.

Q. And that's the -- you just went on to the third point that's on --

A. Yes.

Q. -- DX 2624.

A. Yes.

Q. Going back to the second point about the equity kicker as a substitute, do you have an opinion as to whether the 79.9 percent equity participation resulted in a lower interest rate on the loan than would have been the case without the equity participation?

A. Absolutely. I do.

Q. What is your opinion?

A. In my opinion, it is absolutely a substitute for that higher rate. We had a 12 percent rate on something the market expected to be closer to 35, and that's exactly where I see this fitting in. It's consistent with many other deals I've either structured myself or evaluated on behalf of others or was involved in in other ways.

Q. Now, have you seen, from your review of the materials in this case, any examples of private sector proposals to rescue or to provide financial assistance to AIG that themselves contemplated shareholder dilution?

A. Absolutely.

Q. Okay. What do you recall in that respect?

A. I recall at least two such transactions and term sheets for those transactions. One was a J.C. Flowers-Allianz transaction, a term sheet that was contemplated. And the other was a syndicated loan where I believe JPMorgan Chase and Goldman Sachs were going to be the syndicate leaders for that.

Q. And what do you recall about those transactions with respect to equity participation?

A. They both had substantial equity participation components to them.

Q. Do you recall what those -- what they were?

A. Yeah.

I think the J.C. Flowers transaction for only $10 billion of new capital or financing was taking 60 percent of the firm. That's my general recollection.

And I recall that the term sheet for the syndicated loan was going to advance 75 billion for approximately the same amount of equity return participation. The coupon was a little lower, but the amount being advanced was also a little lower. And by "a little lower," I mean like one or two points.

Q. When you say "the same amount," you're referring to the same amount as the 79.9 percent?

A. That approximately is my recollection, around 79.9, for $75 billion of funds to be advanced with I think it was a 10 percent coupon and, as I said, 79.9 percent equity return participation.

Q. Turning back to DX 2621, I'd like to focus now on your third criticism of Professor Kothari's analysis with respect to your point that he ignores that AIG's stock price increased as a result of the initial rescue, which shows that there are no economic losses to shareholders resulting from the initial rescue.

Did you review Professor Kothari's testimony in which he provided an explanation that, in his view, all the information about the terms of the initial rescue were known to the market and incorporated into AIG's stock price by the close of trading on September 24, 2008?

A. Yes.

Q. And have you analyzed what happened to AIG's stock price through the close of trading on September 24, 2008?

A. Yes.

Q. And is that analysis shown in DX 2625?

A. It is.

Q. And just before you start your explanation, Dr. Mordecai, just so there's no confusion, is DX 2625 the same demonstrative we saw earlier concerning the analysis of your event studies?
A. Yes. It is the same analysis with my seven different controlling portfolios and the same six windows, all starting on 9-16 and extending onward.
Q. And that's at DX 2608 that we saw that --
A. Correct.
Q. Okay. Please, what is -- what are you illustrating in DX 2625?
A. As you mentioned, DX 2625 is the same as DX 2608 with one difference. I've highlighted the fourth window in my analysis, and it's the window that begins on 9-16 but extends all the way to 9-24 to capture the -- all of the information that would have come out over that window and the market reactions to that information over that window.
And what it shows is the actual return to AIG was 78.9 percent. The residual or excess return to AIG over the market and the industries that are used to control for that return, that excess return is 55.2 percent over the window, with a residual increase in the equity market capitalization for AIG in dollars, okay, so that's that excess performance in market cap, a gain of

$2.7 billion.

So what it actually shows is, if you extend -- start at 9-16 and extend all the way to the 24th, the closing price on the 24th, you don't actually get a negative stock price reaction, you get a positive stock price reaction and a positive gain in wealth to shareholders of $2.7 billion.

Q. Dr. Mordecai, do you have an opinion as to whether Professor Kothari properly accounted for the price increase demonstrated in your event window number 4 in DX 2625?

A. I do have such an opinion.

Q. And what is your opinion?

A. My opinion is that he did not.

Q. What did he fail to do?

A. He failed to actually account for the gain starting on 9-16 going all the way through to that end date, which was a positive gain.

Q. Turning back to DX 2621, could you please explain your fourth flaw that you identified with respect to Professor Kothari's analysis of the credit agreement claims.

A. My fourth analysis is that Professor Kothari does not value losses to shareholders, and then he calls it losses, but he doesn't value them as losses. He actually values something else.

He estimates the value of the government's equity return participation on September 24, which is, in other words, the value created by the government and its initial rescue package, and then calls that losses to shareholders, but that's not losses to shareholders.

And for the reason I mentioned earlier, this was not a zero-sum game. This was a game that was beneficial to both parties if you include the equity return participation as part of the overall package for the extension of credit.

Q. Have you created a demonstrative that illustrates why you believe that Professor Kothari measured value created by the initial rescue itself rather than economic losses to shareholders?

A. I have.

Q. And is that DX 2626-A?

A. It is.

Q. And could you please explain what you've demonstrated in DX 2626-A.

A. DX 2626-A is very similar to the share dilution/economic value exhibit or demonstrative that I created earlier, except now, instead of using a hypothetical $100 share price, I've now used the actual AIG valuations, so I've made that earlier demonstrative or earlier example specific to the actual values of AIG based on the record.

So you'll see that on the left-hand side we have the pre-rescue equity valued at the $1.85 price at the open on 9-16, and it basically shows preexisting shareholders with a $5 billion stake, equity stake in AIG.

Equity in bankruptcy, as we show, because the bankruptcy-dependent or bankruptcy-conditional value of debt for AIG was well below par -- it was 40 cents on the dollar, which means shareholders get zero, so I next show that equity in bankruptcy would have ended up with a value of zero, which is consistent with the evidence we have and with historical evidence on other bankruptcies.

And then we look at the post-rescue equity by comparison. What we see is, based on the 9-24-08 price or closing price of $3.31 used by Professor Kothari, the preexisting shareholders now own 20 percent of a much more valuable firm. That 20 percent stake is now worth $8.9 billion, $3.9 billion more than the $5 billion they originally had.

The total firm, okay, the new debt, if you look at the new debt of the firm and you look at, you know, how that all comes together, that is more valuable.

So the total equity package, the total -- or total equity holdings of the firm have gone up to 44.3 billion, of which the equity return participation is 35.4 billion.

Well, what Professor Kothari does is he says that 35.4 billion is shareholder losses. It's not shareholder losses.

Q. What is it?

A. It's value from the rescue package. It's value from the rescue package that was shared by the capital provider who created the value and the existing -- preexisting shareholders who benefit to the tune of $3.9 billion relative to what they had before.

Q. And the 3.9 billion is computed by subtracting the 8.9 billion post-rescue equity from the pre-rescue equity of 5 billion.

A. Exactly right. That's -- you know, that's more than a 50 percent increase.

Q. So if the post-rescue equity for the shareholders increased from 8.9 billion from the pre-rescue equity value of 5 billion, how were the shareholders harmed by the initial rescue?

A. They weren't.

Q. Now, you testified earlier about bond trading prices and what they review about the -- I'm sorry -- what they reveal about the market's view as to what AIG's

shareholders would likely receive in a bankruptcy. Do you recall your --
A. I do.
Q. -- testimony on that subject?
A. I do.
Q. Now, as you indicated earlier, DX 2626-A lists the value of AI shares under the heading Equity in Bankruptcy as being zero --
A. Correct.
Q. -- but then again the pre-rescue equity value as being $5 billion based upon the 9-16-08 open share price of $1.85 per share.
Can you explain how AIG's shares could have traded at $1.85 on opening on 9-16 if the market believed AIG was headed to bankruptcy.
A. I can explain it in two words, option value.
What I mean by "option value" is both the academic literature in this area as well as industry practice talks about the fact that when a firm is in extreme distress to the extent where the firm is going to either end up in bankruptcy or be liquidated, the stock still often ends up with a positive price, and that positive price is basically a representation of the chance that it averts or avoids that ultimate outcome.
So this is pure option value, and it is option

value on betting on maybe a government rescue is coming, maybe not, right, maybe another white knight will come in, maybe not, so all you're getting is the probability-weighted chance that the company avoids the ultimate negative scenario.

Q. So to what extent, if any, is the concept of option value applicable to AIG's pre-rescue market price on September 16?

A. That's really all the shareholders have.

Q. You mentioned previously that the transaction, the initial rescue, was not a zero-sum game.

Can you explain in greater detail what you mean by that it wasn't a zero-sum game.

A. A zero-sum game is a description from -- mostly from pure academic literature and something called game theory, where you're looking at the fact that one party's loss in a transaction results in another party having a gain, and any gain that one party gets must mean a loss for the other.

That is a particularly special case that does not apply to many economic transactions, maybe most economic transactions, and certainly not distressed lending transactions.

It's different from another economic principle which is called a Pareto optimal situation. And what that says is, when you see a transaction, the transactors agree to do the transaction because there are benefits for both, and they end up splitting something called the gains from trade. And that's opt- -- that's more optimal for both as opposed to the zero-sum game, which is, if you want it, I have to lose.

And that -- you know, that really doesn't apply to many, many economic transactions, certainly not distressed lending transactions, because if that were the nature of that transaction, you'd choose the outside option, you'd choose bankruptcy. Right?

Q. What was the term you used earlier, "parento" or --

A. Pareto optimal.

Q. Pareto optimal.

A. Yeah.

Q. Could you explain what that means.

A. Pareto optimal, P-A-R-E-T-O optimal, means -- and it's an economic principle. It's in the textbooks. And it basically means when two parties come together to make an exchange, okay, the reason they agree to finally make that exchange is because there are benefits to both sides or they wouldn't do it.

Q. Dr. Mordecai, do you recall Professor Kothari's trial testimony that you reviewed in which he testified that AIG was impacted by a liquidity crisis, and therefore, once its liquidity problems were resolved, AIG's stock price should be expected to bounce back to where it was on September 11, 2008, prior to these liquidity issues? Do you recall that testimony?

A. I do recall that testimony.

Q. And have you prepared a demonstrative that responds to that testimony?

A. I do. I have.

Q. Is that DX 2627?

A. It is.

Q. And could you please list and then explain the points that you have set forth in DX 2627.

A. My first point is that AIG's liquidity crisis was not temporary. The firm had already been in decline for a very long period of time. That decline accelerated and precipitated leading up to September 16, 2008. The risks that we saw manifesting themselves that we talked about earlier continued on a prolonged and protracted basis even with the funding.

The second thing that Professor Kothari's choice of the September 11, 2008 price is completely arbitrary. It's inconsistent with commercial lending practice. It's inconsistent with the economics of how financial decisions are made at the time that they're made.

And then Professor Kothari is -- as such, ignores both fundamental first principles of economics and also ignores the practice of -- commercial practice of distressed lending by commercially reasonable investors and lenders.

Q. And with respect to that third point, what do you mean that he ignores the economics and practice of distressed lending?

A. Well, by going back to September 11 and using that to try to justify a liquidity situation which is intrinsically linked to solvency and then suggest that the lender in that situation should lend at -- should accept terms or advance terms that somehow recoup shareholders is not how lending works. It's not how distressed investing works. Right?

When a lender comes into a distressed situation to do a reorganization financing or a workout financing or anything along those lines, the purpose is to preserve the going concern and enterprise value of the firm they're lending to. It is not to recoup or reimburse shareholders for past losses.

And by picking that September 11 point, he's basically suggesting they get a do-over in the credit deal, and that's nothing that I'm -- is consistent with what I've seen in my thirty years.

Q. With respect to your second point that the choice of AIG's September 11, 2008 share price is arbitrary, I mean, what's the basis for your conclusion that choosing that date is arbitrary?

A. It's a date that seems to give him the outcome he wants, but, you know, in the same way you asked me a question earlier and said what would a commercially reasonable lender look at and I said they'd look at AIG's yields and spreads at the time they're lending to it, not a bunch of other stuff, you know, unless they were trying to make some other decision other than am I lending to AIG, in the same way, they would look at what is AIG's market assessed risk and the expected return on the investment at the time I'm lending, September 16, not, well, what was it a year ago, three years ago.

You may consider that to say, well, where was the firm versus where it is today, but the deal you make at the time is going to be based on the prices at the time, not the prices, you know, ad hoc chosen from some other period in the past, unless you want to go back and lend to that other company in the past, which I don't think one can do.

Q. Okay. Do you also recall Professor Kothari's trial testimony in which he proffered testimony that the total principal, interest and fee payments that the government was to receive on the revolving credit facility after discounting those future payments to present value was greater than or equal to $85 billion?

A. That's a long question. Can you repeat it?

Q. Yeah.

Do you recall Professor Kothari's trial testimony in which he testified that the total principal, interest and fee payments that the government was to receive on the revolving credit facility after discounting to present value was greater than $85 billion?

A. I recall that, yes.

Q. And do you have an opinion as to whether the present value of the principal, interest and fee payments that the government was to receive on the revolving credit facility was greater than $85 billion?

A. I do have a view.

Q. And what is your opinion?

A. And are you talking with or without the equity return participation?

Q. This is without.

A. Without the equity return participation, without that equity return participation, my analysis actually shows what the market evidence is, and that is my opinion.

My opinion is 12.5 -- a 12 percent coupon, okay, with or without the commitment fees, is not equal to an $85 billion present value to $85 billion extended because it is a subpar set of terms. It is not the same as the money going out.

So the market says it's not, and I agree with the market.

Q. So your view is that the risk-adjusted present value of future payments that the government was to receive was less than $85 billion.

A. Absolutely.

Q. Okay. And what do you mean, what are we talking about when we talk about a risk-adjusted present value, net value?

A. There are a couple of things I think we've mentioned earlier.

One of them is that risk and reward are intrinsically linked. When risk goes up, the expected return that a market would accept also goes up, so the required return also goes up.

That's the same thing as saying that if you kept the instrument with the same terms, as risk increases, the value of that instrument comparatively decreases, because it's paying even less now than the market would require.

Q. Now, do you also recall testimony that

Professor Kothari proffered in which he testified that if, if the present value of future payments the government was to receive on the revolving credit facility was more than 85 billion -- I know you disagree with that, but this is his testimony -- that if it was, that the government would have been fully compensated on its loan?

A. Do I remember that --

Q. Yes.

A. -- testimony?

Q. Do you remember that testimony from --

A. I do remember that testimony.

Q. Do you have an opinion as to whether any additional consideration above 85 billion would constitute economic loss suffered by the plaintiffs in that hypothetical situation that Dr. Kothari was describing?

A. I do have an opinion.

Q. And what is your opinion?

A. My opinion is that's not correct. It does not necessarily represent, because of that Pareto optimality concept I mentioned earlier, that general concept, it does not represent -- that gain does not represent an absolute necessary loss to shareholders. In fact, it often does not.

Q. And have you prepared a demonstrative that explains why this is the case?
A. I have.
Q. And is that DX 2628?
A. It is.
Q. And could you please explain what is demonstrated by DX 2628.
A. Yes.
This is an illustration, again, my attempt to be as intuitive and tangible as I can be and straightforward as I can be, to explain why a commercially reasonable transaction should occur at a risk-adjusted present value above 85 billion. And this is consistent with things I've said earlier in our discussion.
So we have a commercially reasonable lender, and that could be any commercially reasonable lender -- in this particular case, because the only deal that ultimately got consummated was the government's deal, we're talking about the government -- and a commercially reasonable borrower, in this case AIG.
And what this shows is -- it's from the bargaining literature and academia, but it also holds true in the economic context in deals as well. It shows that the amount that a lender would accept for a deal of this kind on a risk-adjusted present value basis is greater than

the $85 billion extended. Okay? Otherwise, a commercially reasonable lender would not lend.
Q. So that's zone 1 that would be --
A. That's zone 1.
Q. Okay.
A. And that's again forward looking at the time of the lending, that's the case.
Remember, this is risk-adjusted. Okay.
Zone 3 represents where a borrower would not accept the financing and it would instead choose bankruptcy and say, Look, I'm going to take my chances in court. I don't like the look of this deal. I don't like the terms of the deal.
And that occurs if the $85 billion extended on a risk-adjusted basis, if that deal ended up consuming more of the benefits of the lender than the borrower had hoped to get from the money. Okay?
So they're going to go no, not doing it, it's not worth it. Okay?
In between there's a zone of -- an area of potential agreement. The range of that area can vary based on the deal. But what it's basically saying is the borrower and lender split what I call the gains from trade. And as long as the benefits of the rescue are worth more than 85 billion between the parties, the deal

occurs and they split those benefits between them.

And that's why you can have an agreement with a greater risk-adjusted present value than 85 billion that the lender would accept and the borrower will accept, because those benefits, that increase in total firm value ends up being enough on the table that both folks can, you know, be happy with the situation. Right?

Q. Where did this deal end up, in what zone?

A. Well, it got done, so it ended up in the zone of potential agreement.

Q. Now, previously you explained that AIG's stock and bond prices rose following the initial rescue; is that right?

A. That's correct.

Q. Now, how, if at all, do those stock and bond prices increases inform you as to whether the initial rescue is situated within this zone 2, area of potential agreement?

A. So if you remember, I said that this RCF comes in over the existing senior creditors, right, and certainly over the more junior obligations which include the equity, right, so that new deal comes in.

When that new deal came in, bond markets improved, so basically bond prices of that preexisting senior debt, senior unsecured debt, increased. The senior unsecured debt junior to the revolving credit facility increased in value, became more valuable.

At the same time, the preexisting -- the stock also increased in value, okay, which says there were general benefits to the firm overall that even though these guys were more junior, their values went up. And that says --

Q. When you say "these guys," who are you referring to?

A. Meaning the preexisting senior unsecured creditors and the equity holders.

So they both managed to share in the benefits to the firm from the extension of credit, even though the new extension of credit was senior to what existed before, post-financing senior, right, as a -- as replacing the preexisting senior unsecured.

Q. According to your analysis of the terms of the revolving credit facility and referring to DX 2628 and leaving aside the equity consideration --

A. Uh-huh.

Q. -- where would the transaction have ended up on this chart, again assuming there was no equity participation?

A. Without equity participation, a commercially reasonable lender, based on my experience and training, would not have lent.

Q. So it's zone 1?

A. Zone 1.

Q. Let's turn back to your summary of opinions, which we have reproduced once again in DX 2629, and discuss your fourth opinion, that Professor Kothari's estimate of the alleged harm suffered by the stock split class is fundamentally flawed.

A. Yes.

Q. Have you prepared a demonstrative that lists what you believe to be the primary flaws in Professor Kothari's valuation of the stock split claims?

A. Yes.

Q. And is that DX 2630?

A. Yes.

Q. And could you please list the points that are set forth in your demonstrative DX 2630.

A. Certainly.

So the first one is that, once again, a straightforward sanity check demonstrates that Professor Kothari's analysis produces illogical results, nonsensical results.

The second is that Professor Kothari analyzes the wrong event. He actually analyzes the terms of the 2011 recapitalization, which took place subsequent, rather than the 2009 shareholder vote and reverse stock split.

And then finally, his analysis of the wrong event is nonetheless flawed and incomplete.

So he analyzes the wrong event, and then the analysis he does of that other event is flawed and incomplete.

Q. Now, before we go into these three points that you've pointed out in DX 2630, could you please explain to the Court what your understanding is of what plaintiffs' reverse stock split claims are.

A. The plaintiffs are claiming that as a result of the reverse stock split, plaintiffs were not allowed to vote as a separate class, and as a result of not voting as a estimate class, they were somehow harmed on the subsequent settlement of the reverse stock split and subsequent events.

Q. Okay. So let's focus on your first flaw listed in DX 2630.

Have you prepared a demonstrative to show that a straightforward sanity check demonstrates that Professor Kothari's analysis produces illogical results?

A. Yes.

Q. And is that DX 2631?

A. It is.

Q. Could you please explain your sanity check to the Court.

A. Certainly.

So this is similar to -- in spirit to another analysis that I'd done earlier and presented in an earlier demonstrative. Here, we're looking at a different part of the overall set of circumstances and events, and here we're looking at the reverse stock split announcement and vote, and so forth.

What you see is, this horizontal red dotted line is what Professor Kothari is claiming losses to be worth or losses to be equal to. And he's saying it's $1.73 a share. Okay?

But if you look at the range of trading prices on June 26, 2009 and the range of trading prices on June 29, 2009, keeping in mind that the shareholder vote approving the reverse stock split was reported to the public on June 30, 2009, such that June 26 and 29 were the two trading days immediately prior to this announcement -- so remember what we did before. We say okay, what did the stockholders actually have just before the news of this change, this vote.

What they had was stock worth something in the neighborhood of at most $1.47 per share, as little as $1.28 per share. But he's claiming they lost $1.73.

He's claiming they lost more than they had. It doesn't make sense.

Q. How can you lose more than you had?

A. Exactly.

Q. The second flaw you mentioned was that Professor Kothari analyzed the wrong event.

Have you prepared a demonstrative that explains that criticism?

A. I have.

Q. Is that DX 2632?

A. It is.

Q. Please list and explain the points that you have set forth in this demonstrative.

A. Certainly.

So Professor Kothari did not analyze the effect of the reverse stock split on the AIG shareholders, which became known to the public on the announcement of the vote. Instead, he analyzes the terms, the settlement, if you will, right, so it's -- there's a trade and then there's a settlement. He analyzed the terms of the ultimate recapitalization, so he analyzes a completely different event from the event -- from the news event around the vote.

The recapitalization was first announced in September 2010, which was 15 months after the reverse stock split vote and the reverse stock split, and that was at a time when AIG's common stock had more than doubled in value.

So you'll note from the footnote here that in my own report, Exhibit C-2, I show that between July 1, 2009 and September 30, 2010, right, so between the time that the vote took place on the reverse stock split and then the ultimate recapitalization was announced, you know, 15 months later, the stock price had more than doubled. Right?

So, you know, gains were baked in. Value benefits were baked in.

Then 93 percent of Professor Kothari's alleged reverse stock split losses, which are, as I said before, not about the reverse stock split but about where the recapitalization ended up, incorrectly relate to the fairness of the 2011 exchange of Series E and F preferred for common.

And I want to highlight that this was an exchange of preferred. Okay?

So the reverse stock split reduced the number of AIG common shares outstanding. His allegedly unfair common for preferred change ratio was not established by the reverse stock split at all but was established 15 months later as part of the recapitalization plan.

So the period in which the market learned about the reverse stock split was in '09, mid-'09. The stock price increased over the subsequent months, at which point an exchange ratio was established between the parties, okay, with the stock already at this much appreciated value relative to the original reverse stock split.

Q. Let me focus in on your second bullet point on DX 2632 first and put up on the screen a very short excerpt of Professor Kothari's testimony at the transcript on page 4803 lines 14 to 21.

And Professor Kothari is asked, "The fact that there were more authorized but unissued common shares does not control how many of the Series E and F preferred shares would get exchanged for each common share; correct?"

And Professor Kothari's answer: "Yeah, that -- what the exchange ratio is, that is not determined by how many authorized and unissued shares there are, if that was the question you had asked."

Now, how, if at all, does this testimony relate to that second point that you listed there on DX 2632?

A. It suggests that the thing he's claiming was an issue was delinked from the thing he calculated.

Q. And could you be more specific. Delinked from

what?
A. Right.
So he's pointing out that the exchange ratio is not determined by authorized and unissued shares, but the actual reverse stock split vote was exactly about that.
Q. On DX 2632, your first point was that Professor Kothari has done no analysis of the effect of the reverse stock split on AIG's shareholders; is that right?
A. That's correct.
Q. Now, did you conduct an analysis of the effect of the reverse stock split on AIG's shareholders?
A. I did.
Q. And is that set forth in DX 2633?
A. It is.
Q. Please list and explain what is shown in your demonstrative DX 2633.
A. DX 2633 actually lists the potential benefits for the reverse stock split as described in AIG's proxy statement circulated on June 5, 2009. And these three benefits are -- basically illustrate and demonstrate that there was no sound basis to conclude that the reverse stock split harmed AIG's shareholders.
So the three things are:

That the reverse stock split reduced the risk that AIG's common stock would be delisted. And a delisting of that common stock would have been problematic.

As a result of the reverse stock split, institutional holdings increased.

And furthermore, the liquidity of AIG common stock also increased. The average trading volume increased. And the differential between the bid and ask prices decreased, which was something we talked a little bit about in another context earlier today, that when you see a decrease in the prices that buyers and sellers are citing to the market or quoting to the market for bids and offers, that is indicative of a more liquid market for the asset.

Q. Now, DX 2633 is listing the benefits that were listed in the June 5, 2009 proxy statement.

A. Correct.

Q. Now, for point one, did in fact the reverse stock split prevent a delisting of AIG's stock?

A. It did.

Q. So let's focus on the second and third points that you have listed on DX 2633.

Have you prepared a demonstrative to explain your opinion that institutional holdings of AIG's stock increased?

A. I did.
Q. After -- I'm sorry. After the reverse stock split.
A. Yes.
Q. And is that DX 2634?
A. It is.
Q. Can you briefly explain what you have set forth in this demonstrative starting with the green bars first?
A. Certainly.
So I've got two bar charts on this, on this demonstrative, and they cover two different ways of looking at institutional holdings. Okay? One is actual shares held institutionally, and it's been adjusted from a post-split description in my report exhibit to a pre-split, pre-split basis.
And so what it shows -- to make sure we have apples-to-apples comparisons here.
So what it shows is the difference on a -- this is again the left-hand bar chart. It shows a difference between second quarter '09 and third quarter '09 institutional holdings of AIG stock.
So pre-reverse stock split, institutions held $760 million of AIG stock. After the reverse stock split, institutions went on to hold $870 million of AIG stock. That's a meaningful increase in institutional

holdings.

When you look at the right-hand chart, bar chart --

THE COURT: Is that dollars or shares?

THE WITNESS: That's in shares, millions of shares.

THE COURT: So not dollars.

THE WITNESS: Not dollars.

When you look at the right-hand-side analysis -- but if you recall, sir, if I may, the value of the stock was going up as the institutional holdings were also going up, so you end up with more value as well being held by the institutions.

So on the right-hand side you've got institutional share ownership increasing on a percentage basis of total common outstanding as well, so the second quarter of '09 pre-reverse stock split you're looking at 28.2 percent being held by institutions. And by March '09 -- I'm sorry -- third quarter '09 -- my mistake -- that has gone up by almost 4 percent to 32.3.

BY MR. AUSTIN:

Q. Let me back up to the green chart and clear up the question of dollars and shares.

We're talking about shares in the green bar?

A. And the numbers of shares.

Q. Okay. Now, are these numbers of shares both on a pre-split basis?
A. These are both on a pre-split basis.
Q. So the 20-to-1 change is not incorporated into that.
A. No.
Q. Now, focusing on your third point in DX 2633, that the liquidity of AIG stock, common stock, increased, have you prepared a demonstrative that explains the analysis that you conducted in support of that conclusion?
A. Yes.
Q. And is that DX 2635?
A. It is.
Q. And can you briefly explain what you have set forth in DX 2635 starting with the green bars first.
A. Certainly.
So this is a slide, a demonstrative, meant to illustrate or demonstrate the ways in which the AIG common stock liquidity increased after the reverse stock split.
And so what you see there is daily trading volume, which is a very well-established, generally accepted metric or measure of liquidity, shows that the reverse -- or that after the reverse stock split, daily

trading volume on a pre-split basis increased by 681 million shares a day.

So AIG's stock went from trading pre-reverse stock split about 119 million a day to 800 million a day post-stock split in trading.

Q. And these are both -- both of these bars are on a pre-split basis.

A. Both on a pre-split -- both a pre-split average -- or the pre-reverse split average and the post-reverse split average are both on a pre-split basis, so it's apples to apples.

What you're seeing is an almost 700 million share increase in average trading on a daily basis.

Q. And moving over to the chart on the right with the blue bars, what does that show?

A. That shows that that bid-ask differential we've talked about before, that difference between bidder prices and offering prices by sellers, narrows and it narrows by a substantial amount.

So pre-reverse split the average bid-ask differential is 2.8 basis points. That compresses by 2.23 basis points, by a substantial amount of the original differential, to being only 0.57 basis points.

Q. And what's the significance of that, a decrease in the bid-ask differential?

A. The narrowing of the posted prices by bidders and sellers has come much closer together, right. That zone of agreement between bidders and sellers has gotten smaller, at which point they were willing to kind of trade the stock, so that suggests much greater liquidity to the stock.

Q. Now, are the metrics that you've analyzed here in DX 2635, volume -- daily volume on the left bar and bid-ask differential on the right bar, commonly used metrics to evaluate the liquidity of a stock?

A. Extremely common.

Q. And where are they common in? Who does that?

A. Well, we're looking at stocks here. Stock market participants generally use it, not just academics but market participants all the time, floor traders, specialists, you know, institutions trading the stock, day traders, you know, individuals. This is a really well-established and longstanding metric.

Q. And so then to summarize DX 2635, what does the fact that trading volumes went up and bid-ask differentials narrowed following the reverse stock split indicate, if anything, with respect to the liquidity of AIG common stock following the reverse stock split?

A. AIG common stock liquidity clearly benefited from the reverse stock split based on this evidence.

Q. And was that one of the goals in the proxy?
A. Yes.
Q. Going back to DX 2630 for a moment?
A. Yes.
Q. The third flaw that you found in Professor Kothari's analysis of the stock split claims was that Professor Kothari's analysis was of the wrong event, and it was flawed and incomplete; is that right?
A. That's correct.
Q. And have you prepared a demonstrative that explains the basis for your criticism that his analysis of the wrong event was flawed and incomplete?
A. Yes.
Q. And is that DX 2636?
A. It is.
Q. And can you please just list the points that are laid out in DX 2636.
A. Well, the first one is that Professor Kothari ignores that AIG's shareholders received a valuable warrant as part of the recapitalization.
The second is that he completely ignores the market reaction to the recapitalization at the time it was announced and therefore ignores the fact that the recapitalization was beneficial to AIG and its shareholders, that market participants commented

favorably on the terms of the recapitalization and, finally, that AIG's stock price increased as a result of the recapitalization.

Q. Now, turning to your first point on DX 2636, have you prepared a demonstrative that explains the value of the warrant that you believe Professor Kothari incorrectly failed to include in his analysis?

A. Yes.

Q. And is that DX 2637?

A. Yes.

Q. Can you explain this demonstrative to the Court.

A. This is just one example of the kinds of commentary that were out as well as other evidence looking at the value of these warrants that Professor Kothari completely ignores in his calculations.

So this is the UBS analysts valuing the warrant at eight to nine dollars a share or $1.1 billion based on the shares outstanding at the time and they recommending a short-term buy rating to AIG because of the upside from the $75 million warrants distributed to shareholders.

And then the fact that each ten-year warrant with a $45 strike price would have a value of approximately $16, translating again to an eight to nine dollar per share, per AIG common share, existing AIG common share, value, that's a pretty solid on-point example.

MR. AUSTIN: Your Honor, we would move into evidence, under Federal Rule of Evidence 703, DX 1863, which is referenced in the demonstrative DX 2637.

MR. BOIES: No objection, Your Honor.

THE COURT: Defendant's Exhibit 1863 is admitted with a rule 703 restriction.

(Defendant's Exhibit Number 1863 was admitted into evidence.)

BY MR. AUSTIN:

Q. Now, going back to DX 2636 and again under the second flaw that you identified, "Professor Kothari ignores the market reaction to the recapitalization at the time it was announced," the first bullet point under that that you have there is that the recapitalization was beneficial to AIG and its shareholders.

Focusing on that specific point, in your large binder, would you please turn to PTX 2248, which again is in your large binder.

And Your Honor, this has been -- this document has been admitted into evidence.

And have you ever seen PTX 2248 before?

A. Yes.

Q. And could you just tell us what it is.

A. This is a presentation to the board of directors of AIG on September 29, 2010. It's a joint presentation by Bank of America Merrill Lynch and Citigroup, and it's an analysis of the recapitalization transaction, effectively a valuation and a fairness opinion.

Q. And what is a fairness opinion?

A. A fairness opinion is an analysis commissioned typically by senior management and directors of a firm to assess whether terms, conditions and prices of a transaction are fair for the assets or -- being transacted, whether fair value is being exchanged between the parties, an independent analysis that's relied upon by the board acting on behalf of the shareholders and other constituents of the firm.

Q. If you would please turn to page 28 of this document.

And I would ask you to focus on the highlighted portion there that appears under Capital Markets, the third block on the left?

A. Yes.

Q. Go ahead and highlight the whole language there. Thank you.

Does this paragraph have relevance to your opinion set forth in DX 2636 that Professor Kothari ignored that the recapitalization was beneficial to AIG and its shareholders?

A. These are benefits being highlighted by these two commissioned analyst groups in their joint presentation to the board. Yes.

Q. And is that relevant to that opinion?

A. Absolutely.

Q. Okay. Why?

A. It's relevant because it's a clear set of benefits that are going to help AIG as an ongoing firm and also going to help the owners of AIG, including the shareholders, in terms of realizing the return to their investment.

Q. And what are the benefits that are set forth there that are beneficial to AIG and its shareholders?

A. Well, this particular section is talking about AIG's current situation that needs to be addressed by the capitalization, so it's -- this is clearly entitled Status Quo, and they're focusing on a range of things that need to happen with regard in that box to capital markets.

So they're saying that currently bank credit providers are unwilling to provide new credit to AIG and be either subordinate to or pari passu -- "pari passu" means at the same level of seniority -- with the Federal Reserve's credit facility.

So that's something that they were saying needs to be addressed by a recapitalization, in particular this recapitalization under consideration.

Then they're also pointing out that the Series F preferreds are the exclusive source of equity for the company as equity and hybrid investors are unwilling to provide or support primary issuance prior to what's called a resolution of the capital structure.

What they mean by that is this capital structure is too complicated, too many moving parts to it. As a result, new investors are unwilling to come in and provide a diversified source of equity capital to this company, so you need to resolve that and make it something that's clearer and easier for new investors to assess to come in with new capital or -- and more diversified sources of capital.

So it's saying, you know, until you exchange the C, E and F preferred stock, you're making it difficult for new investors to come in to provide new equity.

Q. And did Dr. Kothari include these benefits in his analysis?

A. I didn't see it in his analysis, so -- and it's clearly relevant to the entire purpose behind the recapitalization, but I didn't see it in his analysis, no.

Q. Now, going back to DX 2636, again under the second bullet point, the second bullet point under number 2, it states that market participants commented favorably on the terms of the recapitalization.

Have you prepared a demonstrative that relates to this commentary?

A. I have.

Q. And is that DX 2638?

A. It is.

Q. Could you please explain the commentary that's set forth in this demonstrative.

A. Yes. DX 2638 are two examples of the kinds of analysis and the kinds of commentary that market participants involved in these markets were putting out at the time.

So you've got one from October 18, one from October 19.

The October 18, 2010 excerpt is from again UBS Investment Research and a research report and where they refer to the recapitalization as "the last concession from the U.S. government" and by concession to shareholders from the U.S. government.

And then the second point, they say: The preferred-to-common -- they called it a conversion. It was actually an exchange -- lifted our sum-of-the-parts value range for AIG common stock from -- to 38 to 39 dollars a share from 26 to 29 dollars per share, so they say their valuation as a result of this recapitalization has gone up by $10 a share as a result of the exchange of preferred for common, so this is a clear net benefit in that research, cited in that research.

The next day, Wells Fargo's report comes out and effectively says that the government has shown a willingness and in fact has forgone some of their value that they are -- embedded in their own stake in AIG and effectively subsidized returns to existing shareholders along the way, so they've given up some of these benefits from the financing for shareholders to have, although they were effectively entitled to them according to the terms of the deal.

So by lowering coupons on securities, forgiving interest and dividends payments, just letting them go away and not recouping them, by converting debt to preferred, so going down in capital structure -- so they've been deferring payments to themselves. They've gone down and become more subordinated. They've converted their preferred to common, okay, and granted warrants to the existing shareholders. All of these things have effectively given many of the benefits from this to which they were originally, as the commercially reasonable lender, fully entitled according to the terms of the deal -- they've said, Hey, you know what, guys, here's more for you.

And that's what that says, and that's why the Wells Fargo report is taking the position it is, and I would say, in my reasonable estimation, it's consistent with the UBS analysis.

MR. AUSTIN: Your Honor, we would move into evidence, under Federal Rule of Evidence 703, DX 866, which is referenced in DX -- demonstrative DX 2638.

MR. BOIES: No objection, Your Honor.

THE COURT: Defendant's Exhibit 866 is admitted with a rule 703 restriction.

(Defendant's Exhibit Number 866 was admitted into evidence.)

BY MR. AUSTIN:

Q. And finally, Dr. Mordecai, going back to DX 2636, your final bullet point under number 2, you state that AIG's stock price increased as a result of the recapitalization.

A. Yes.

Q. Did you prepare a demonstrative to explain the analysis you performed to support that conclusion?

A. I did.

Q. And is that DX 2639?
A. It is.
Q. And would you please explain DX 2639.
A. Yes.
So it's another event study, this time focusing on the dates around the announcement of the recapitalization and the subsequent transactions that were part of the recapitalization and the event dates around those.
So what you see is the initial announcement for the recapitalization was an AIG press release issued September 30, 2010 at 7:00 in the morning.
And this follows the same methodology that I used for my other event study, right, and though this is -- so basically you've got -- first of all, you've got a date for the announcement. You've got something describing the event associated with that date. That's basically column B.
And then you have four columns that we've seen before, the actual AIG raw return, the residual AIG return controlling for industry and market movements, and then you've got the change in market capitalization on a dollars basis related to this residual percentage return to AIG's stock.
And what you see is, on the day of the

announcement, there's $220 million of additional positive gain to the equity of AIG around that event announcement, so AIG actually shows a residual return of 4.3 percent.

You'll notice that the market and industry returns only shaved a tenth of a percent off of the raw return, so AIG really outperformed there.

And then when you look at as a whole the subsequent events and the announcements coming out, for the six days of the settlement of the trades -- so you have a trade announced on 9-30, and then you have a sequence of events around the settlement of that trade, right. For over those six pieces or elements, the total change for AIG's actual return of 11.8 percent, its residual or firm-specific return of 10.4 percent, the actual impact on the market cap, the equity market cap of AIG, is $1.52 billion of gain.

And so when we look at F, what we see is no negative stock price reaction when the recapitalization was announced and no negative stock price reaction cumulatively as you're executing and completing the announced transaction.

Q. And what does -- what do the negative stock price reactions in column F reflect, the nos?

A. They basically say that you had gains. You did not have negative stock price reactions.

Q. And what does this table show about whether the recapitalization harmed AIG's shareholders?

A. It shows no evidence of harm. That net-net, when the deal was announced, there was gain, and when the deal was finally completed, the net result was a gain.

MR. AUSTIN: Your Honor, at this time I would like to move in DX 2601 through DX 2625, DX 2626-A and DX 2627 through DX 2639, all as demonstrative exhibits pursuant to Federal Rule of Evidence 703.

MR. BOIES: No objection, Your Honor.

THE COURT: All right. The stated demonstrative exhibits are admitted pursuant to rule 703.

(Defendant's Exhibit Numbers 2601-2625, 2626-A, and 2627-2639 were admitted into evidence.)

MR. AUSTIN: Your Honor, if I haven't already done so, I would move in DX 808 under Federal Rule of Evidence 703, which is referenced in DX 2633.

MR. BOIES: May I have just a moment, Your Honor.

That's Defendant's Exhibit 808?

MR. AUSTIN: 808, yes.

MR. BOIES: I have no objection. I thought we already --

MR. AUSTIN: That may be true. I think we already did that, Your Honor.

Your Honor, I'll pass the witness at this time.
THE COURT: All right. Thank you, Mr. Austin.
Cross-examination?
MR. BOIES: Thank you, Your Honor.
- - - - -
CROSS-EXAMINATION
BY MR. BOIES:
Q. Good afternoon, Dr. Mordecai.
A. Good afternoon.
Q. Let me begin with the reverse stock split that counsel was just talking to you about.
As part of your work, did you examine whether the reverse stock split was necessary in order to accomplish the exchange of Series C, E and F preferred stock for AIG common stock as part of the recapitalization?
A. Could I -- did I examine whether it was necessary?
Q. Yes, sir.
A. Can you be more specific in your question.
Q. Let me try.
As part of your analysis and investigation, did you examine whether the recapitalization as it was done, which included the exchange of Series C, E and F preferred stock for common stock, could have been done without the reverse stock split?

A. I think my answer to that is, I didn't examine hypotheticals of other ways deals could have gotten done other than the ways in which this deal got done given the votes, and so forth, so the answer is, whether I looked at whether or not other possible permutations on the transaction were conceivable, the answer is no.

Q. I think there may be a confusion here.

You understand there was a reverse stock split.

A. I do.

Q. That was not a hypothetical. That happened; correct?

A. Yes.

Q. And my question is whether that reverse stock split was necessary in order to allow the recapitalization to take place.

A. I'm actually trying to refresh my memory on what I did in that regard or if I did anything in that regard, so your patience, please.

Q. Sure. Take your time.

(Pause in the proceedings.)

A. I think if I rely on the position or the statements made, to my recollection, in demonstrative 2633 where I highlight the benefits of the reverse stock split, the focus there is on benefits that the reverse stock split do facilitate or create.

Implicit in my actual report and analysis in my report, to the extent that the reverse stock split improved the liquidity and the ability for shareholders to monetize their investment in AIG and therefore realize a value to the stock, then the reverse stock split would have played a role or an element in the success of the recapitalization.

So did I explicitly study that? No. Are there implicit benefits to the recapitalization? Perhaps yes.

And so to the -- that's the best I can kind of recall and the best I can answer your question right now.

Q. Let me try and be clear. I'm not asking now about what the benefits were of the recapitalization or of the reverse stock split.

A. Uh-huh.

Q. What I'm asking is whether the reverse stock split was necessary in order to permit the exchange of Series C, E and F preferred stock for common stock that was part of the recapitalization.

Do you understand the question?

A. I think I understand the question.

And I haven't really looked at that.

Q. Okay.

A. And I don't explicitly remember whether I did.

I'd have to go carefully through my report, but I don't remember looking at that.
Q. Okay.
A. Explicitly.
Q. Now, did you, as part of the work you've done, review the trial transcript?
A. I've reviewed a lot of the trial transcript. Whether I can recall certain parts, we'll see.
Q. It's not a memory test.
A. Yeah. Right. Right.
Q. Who selected the portions of the trial transcript that you reviewed?
A. I did.
Q. And did you review the testimony of Mr. Brandow?
A. I don't remember who Mr. Brandow is. Memory is escaping me. My 53rd birthday was last month.
Q. Well, my 73rd was last March, so I know your issue.
Mr. Brandow was a partner at Davis Polk & Wardwell, who you may recall were counsel for the Department of Treasury and the Federal Reserve Bank of New York?
A. Yes, I remember.
Q. And he gave some testimony about the reverse stock split and as to whether or not it was a necessary step in

order to accomplish the recapitalization in the way the recapitalization was done.
Do you recall reading that testimony at all?
A. I don't specifically recall that. I recall reading his -- some parts of his testimony, but I just don't recall that specific detail at this time.
Q. Uh-huh.
Let me turn to the benefits of the reverse stock split that you identify on DX 2633.
The first benefit is that the reverse stock split reduced the risk that AIG's common stock would be delisted.
Do you see that?
A. Yes.
Q. Now, the reverse stock split was a split of the issued and outstanding shares of AIG; correct?
A. Yes. Correct.
Q. Did it also split the authorized shares of AIG stock?
A. I'm turning to my report, the relevant section in my report. And I'm referring to pages 39 through 41 of my report. I'm just going to take a minute to refresh my memory.
Q. Certainly. And when you've done so, just let me know.

(Pause in the proceedings.)

A. Okay. I have done so.

So could you re-ask the question, to make sure that I don't garble my review and your question.

Q. You've testified that the reverse stock split split the issued and outstanding shares of AIG.

My question is, did it also split the authorized shares of AIG stock?

A. The nature of the vote that took place involved two proposals.

Proposal four was approved, and that was a 1-for-20 reverse stock split, which reduced the number of outstanding shares.

Proposal three, which was not approved by a majority shareholder vote, would have increased the number of authorized shares, and that did not happen.

Q. I wasn't asking about increasing the number of authorized shares. Did you understand that?

A. Then maybe I didn't understand.

Q. Okay.

A. I think paragraph 66 of my report is probably my best answer to your question with the recollection I have. And it actually says the combined effect of the -- the combined effect of both proposals being approved by the shareholders would have increased the authorized shares to 5.2 billion from 5 billion. But in fact, proposal three did not get approved, and as a result, that increase did not occur in authorized shares.

That's my recollection.

Is that a different answer from the question you're asking? If so, I apologize.

Q. It is.

A. Okay.

Q. Because what you're talking about there is increasing the number of authorized shares.

A. Uh-huh.

Q. And that's a relevant area for us, but it's not what I'm asking about right now.

A. Okay.

Q. The reverse stock split --

A. Uh-huh.

Q. -- was a 20-for-1 reverse stock split; correct?

A. Correct.

Q. That meant that for every 20 shares that a stockholder had, they got one new share.

A. Correct.

Q. My question is, did that reverse stock split apply to authorized shares as well as issued shares, as you understand it?

A. Yes. I believe -- my recollection is that it

applied to issued shares, but I could be wrong.
Q. Only issued shares.
A. As far as I have a recollection. I'd have to refresh my memory otherwise. I don't remember.
Q. As part of your work, did you examine why the reverse stock split applied only to issued shares and not total authorized shares?
A. I did not examine why, to the best of my recollection.
Q. With respect to the benefits of the reverse stock split as shown on your Exhibit DX 2633, when you refer to reducing the risk that AIG's common stock would be delisted, do you see that?
A. Uh-huh.
Q. That advantage could have been achieved with a reverse stock split that split both authorized and issued shares; correct?
A. I would have to refresh my memory. I'm not positive right now. Off the top of my head I wouldn't want to answer or respond by speculating on that.
And as I said, I also don't recall specifically whether the facts that we've laid out -- I've accepted them -- as to whether they were actually what occurred because I don't remember looking at that.
Q. I will represent to you that the reverse stock

split split only issued and outstanding shares and did not split authorized and unissued shares.

A. I think that is consistent with my recollection, but I'm -- I'm putting in the caveat that I'm not a hundred percent sure, but I'm taking it for sake of your argument.

Q. Thank you.

Now, the way that AIG's common stock avoided the risk of delisting was by increasing the price of that stock; correct?

A. The delisting rules are related to whether or not -- there's a minimum value as one of the things I recall important to delisting.

Q. When you say here on your exhibit --

A. Or market capitalization may be another way -- market cap is really the important thing for delisting.

Q. Market cap?

A. Yeah. Equity market cap.

Q. Equity market cap is what's important for delisting?

A. Yeah. And again, I'm working completely now out of vague memory, so I'd want to be a little careful.

Q. A reverse stock split --

A. Uh-huh.

Q. -- would not affect market capitalization;

correct?
A. That is correct.
Q. So --
A. Not directly, no.
Q. So that to the extent that the risk that AIG's common stock would be delisted was the result of market capitalization, the reverse stock split wouldn't help; correct?
A. That's correct.
Q. When you on DX 2633 say, "The reverse stock split reduced the risk that AIG's common stock would be delisted," why did you think that the reverse stock split reduced the risk that AIG's common stock would be delisted, if you remember?
A. I don't remember all the reasons, but I mean, one of the -- I mean, this slide is basically a position on a proxy statement issued by the management of AIG and their financial advisors, their investment advisors, and so I can rely on that as I remember it here today on the stand as a review of evidence. Whether -- you know, all the different reasons that I may have thought about at the time I don't immediately recall.
Q. Was one of the reasons that you believed that a reverse stock split would reduce the risk that AIG's common stock would be delisted your belief that the

reverse stock split would increase the price of AIG's stock?

A. My evidence is not about my belief at all. I mean, what I'm looking at is whether the benefits as described in the evidence at the time, the views of management, the views of their advisors, my understanding of markets and what in fact the markets -- how in fact the results showed up, so I guess I'm struggling with your -- with your use of my belief, the term use of my belief.

I mean, I'm not bringing beliefs to the table here. I'm bringing my training and my experience to the table here and am attempting to interpret market evidence.

Q. Was one of the reasons that you concluded or formed an opinion that a reverse stock split would reduce the risk that AIG's common stock would be delisted your conclusion or opinion that the reverse stock split would increase the price of AIG's stock?

A. I'm trying to parse your question, so again I'm trying to think about --

Q. Take your time and let me know when you're done.

(Pause in the proceedings.)

A. Would you re-ask the question.

Q. Certainly.

You have concluded that the reverse stock split reduced the risk that AIG's common stock would be delisted; correct?

A. Yes.

Q. Was one of the reasons for that conclusion your conclusion or opinion that the reverse stock split would result in an increase in the price of AIG's stock?

A. I'm trying to separate the part of your question that says that this was about my thought process or conclusion coming to the hypothesis from the fact that the markets responded positively to the shareholder vote. That is in fact a market evidence result.

I didn't bring that conclusion to my analysis. It was a result of my study of market response to the news of a shareholder vote approving the reverse stock split. I mean, that's where I'm running into the challenge in answering your question.

My scope -- just to be clear, my scope of testimony is about what the markets did in response to news, and the market price did in fact go up. I didn't try to preassume that. And that's why I'm sort of struggling with your question.

Q. Let me approach it this way.

Following the reverse stock split, AIG's stock price went up somewhat; correct?

A. Correct.
Q. Approximately how much did it go up?
A. I can tell you in a second. I can look and tell you. I actually think I had it in my exhibits. We've talked about a lot of price movements today, so I need to straighten them out. I want to be careful.
(Pause in the proceedings.)
Here we are. It's Exhibit 29.
Q. Could we put that up on the screen.
This is -- this is to your report; correct?
A. This is in my report.
Q. So this is in the book that the defendant's counsel gave you?
A. Yes.
Q. This is Defendant's Exhibit 1875; is that correct?
A. Correct.
Q. And where do you find Exhibit 29 in here?
A. In my book? DX 1875, which is exhibits to the report.
Q. Yes.
All right. And then you just go through 1 and you come up to 29, and it says "AIG's Common Stock Price Reaction Surrounding the Shareholder Vote"; is that correct?

A. Correct.
Q. And when you say "returns," is that related to the stock price changes?
A. It is related to the stock price changes.
Q. And the fact that it has a minus sign there, does that mean that the stock price went down?
A. It does mean that the stock price went down, as did the broader market. It went down less than the broader market and the corresponding industries, but it did -- it did go down.
Q. And just to be clear, when it says "actual," that's what the actual decline is; correct?
A. That's what the actual decline is, including general market and industry declines as well.
Q. And when you say "residual," that is your calculation of how much the AIG stock declined not because of general market conditions but because of this shareholder vote; is that correct?
A. Because of the shareholder vote, that's correct.
Q. And so this shows that rather than the stock going up, the stock went down.
A. In that particular -- on those particular dates, the stock declined in terms of their residual relative to the market, so the market declined, the other industries declined in general, and the stock declined as

well.

Q. And indeed, your calculation is that the stock declined more than it would have declined just because of general market conditions; correct?

A. It declined --

Q. That's a yes-or-no question.

A. Yes. It declined more -- or it declined despite declines in general market conditions. It declined in an isolated manner. Yes. It had a residual decline, although not statistically significant.

Q. It had a decline over and above the decline attributed to the general market; is that fair?

A. That -- loosely, yes.

Q. Okay.

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

MR. BOIES: Yes, Your Honor.

THE COURT: Let's reconvene at 3:40.

(Court in recess.)

THE COURT: You may go ahead, Mr. Boies.

MR. BOIES: Thank you, Your Honor.

BY MR. BOIES:

Q. Before the break, we were talking about your demonstrative DX 2633. Do you recall that?

A. Right. And I referred to Exhibit 29 in my report, and during the break, I was able to locate the text in my report and footnotes related to that exhibit, which might help with the answer I was providing when we took the break.

Q. The answer that you were providing when we took the break was that on each of the days shown on Exhibit 29, the AIG stock price declined both absolutely and relative to general market indices; is that correct?

A. That is the -- that was what we were looking at on that table. I was able to turn to some text in my report relating to paragraphs specifically describing the evidence in that table and some footnotes, and I'm happy to share those if you'd like.

Q. Why don't you just tell us what the page and paragraph numbers are.

A. That's paragraph 163 on page 94 continuing to page 95 and specifically footnotes 335 and 336 on --

Q. 335 and --

A. Footnotes 335 and 336 on page 95. And those specifically relate to the notion of statistical significance of the result and particularly a term I used at the beginning in my direct around confounds and then provides a very specific analysis of how the stock price performed at the announcement of the shareholder vote results. It's in footnote 335 actually. And then confounding negative pressures on the company are articulated carefully in 335 and 336.

Q. Okay.

A. Those things tend to affect the net effect. And that's -- and also, in my opinion, contribute to why that negative effect is not statistically significant, as highlighted in paragraph 3 -- 163, where I point out the decline is not statistically significant, it's actually indistinguishable from zero, and therefore conclude no scientific basis to conclude that the shareholder vote or filing of the preliminary proxy or proxy resulted in an economic loss to AIG common shareholders.

And obviously the footnote talks a lot about short selling, why short seller activity increased, talked about substantial losses in the rate cap portfolio that were announced that day, and actually said at the bottom of 335 Dow Jones News Service reports about that.

And then it goes on where I illustrate the fact that AIG's common stock price increased from approximately $1.11 per share at 10:52 a.m. when the results of the shareholder vote were announced to a closing price of $1.33 on the same day, a 20 percent increase. That was immediately following bad news released, in which case the stock for the day declined.

So what you have in Exhibit 29 is a combination of bad news about AIG, really bad news around their very, very large credit default swap portfolio and rate cap, followed by good news with regard to the shareholder vote, and both are covered in my -- in that footnote on that page, which relates to Exhibit 29.

THE COURT: Dr. Mordecai, I want you to focus on listening to the question and responding to the question asked. Otherwise, you're going to be here all week.

THE WITNESS: Okay. Well, I like you. I choose to spend time with you, Judge. But I will follow your instructions, number one.

THE COURT: No comment.

BY MR. BOIES:

Q. As I was saying, focusing on your Exhibit 2633, the second potential benefit of the reverse stock split that you identify here is: "Institutional holdings increased."

Do you see that?

A. Yes, sir.

Q. And you testified that that is shown on Defendant's Exhibit 2634; correct?

A. I don't have exhibit numbers in front of me, but --

Q. They're the exhibit numbers that you went through --

A. Yes. Of course, well, yeah. I told you, last month, makes a big difference. Exactly. Yeah.

Q. Now, if you look at your exhibit here, this shows that institutional holdings of AIG stock increased after the reverse stock split.

Do you see that?

A. Yes, I do.

Q. With respect to the bars in the left-hand side of the page, the green bars?

A. Uh-huh.

Q. You start the axis at 700 and it goes to 880.

Do you see that?

A. Yes.

Q. Why did you start it at 700 as opposed to zero?

A. I don't really recall. I think it's just a way to get it all on the page without having to do strange things with the graphic. Yeah, I don't really recall.

Q. It has the effect of making it look like the third quarter '09 holdings were two or three times the size of the second quarter '09 holdings; correct?

A. I think one can just do the math and look at the numbers of 870 versus 760.

Q. Right.

A. So, I mean, I wasn't really focused on that. I was just focused on the fact that you take 870 and you subtract 760 and you get a number.

Q. Did you prepare this chart yourself? Did you make the choices as to what axis to use and the like yourself?

A. I had input. I own the chart. It's part of my report.

Q. Oh, I know you own the chart, sir.

A. Right. Yeah.

Q. My question is different. My question was whether this was a chart that you had prepared in terms of making the decision as to where the axis would start and the like or was that done by somebody else.

A. It may have been done by someone else. I don't recall. I had a team supporting me.

Q. Am I correct that you have concluded that institutional holdings of AIG stock increased not only after the reverse stock split but because of the reverse stock split?

A. I think a fair way to answer the question is, one of the objectives stated by management of AIG in their proxy statement was that the reverse stock split is intended to provide -- let me see exactly how I put it -- that a potential benefit would be an increase of institutional holdings and that in fact institutional holdings did increase.

That's about I think the best I can stay close to an answer that I think responds to the question you just asked.

Q. My question has to do with whether there's any causal relationship, in your view, to the increasing institutional holdings and the reverse stock split.

Do you understand what I'm asking?

A. I do. And I -- I -- as an empirical economist and as a businessperson, I think I would not try to overreach and insert causality. When we measure things econometrically or we do empirical analysis, we talk about what the evidence indicates. I'm not here to argue causal relationships that I cannot measure.

But I think a result that is observed that was clearly a result that was intended was an increase in institutional holdings.

And I'm basing that on a proxy that was circulated on June 5.

Q. To the extent, if any, that the reverse stock split resulted in an increase in institutional holdings, could that result have been achieved with a reverse stock split that affected authorized as well as issued shares?

A. It's an empirical question I think to some degree. It was not something I sort of carefully thought about. I'd have to think about it and think about all the factors involved.

Q. As you sit here now, can you think of any reason why institutional holdings of AIG stock would be increased more with a reverse stock split that only affected issued shares than a reverse stock split that affected both issued and authorized shares?

A. Over what time horizon? That's a long-run change, I mean, intermediate change, short-term change?

Q. Let's take each of them one by one.

A. Okay. I think in each case the time period for equilibrium may matter, but to figure out the exact answer, it's going to be an empirical question with lots of factors, and I'd need to think about it longer, and I'd need to consider it carefully as to whether there were other alternatives.

I analyzed the deal that happened. I didn't put a lot of time and effort into thinking about other deals that could have, might have, would have and could have happened that I didn't see evidence for.

Q. Analytically, as an expert in finance and economics, can you think of any reason why an increase in institutional holdings of AIG stock would be affected by whether authorized shares were split or not?

A. To avoid going into complicated transactions and structures I've worked on in the past that would confuse the forum here, I'm reluctant to try to speculate without carefully considering and thinking about all the various permutations, but there are a lot of different permutations that one would need to consider.

"Institutional holdings" includes institutions doing structured transactions or pipes deals or -- there are lots of different things out there. I don't want to bring that into this case because I don't want to muddy the waters.

Q. Those institutional differences don't have anything to do with whether splitting authorized as well as issued shares would affect institutional holdings, though, do they, sir?

A. Again, I don't want to try to speculate on that here without a full consideration of what would be involved in such a circumstance. There are lots of different factors involved here.

Q. Okay. Now, let me go to your third point on Defendant's Exhibit 2633, in which one of the potential benefits of the reverse stock split is increasing the liquidity of AIG common stock, and you identify two metrics there. One is the average trading volume and the other is the bid-ask differentials.

A. Yes.

Q. And if you turn to your chart, Defendant's Exhibit 2635, you see you head that chart Liquidity of AIG Common Stock Increased After the Reverse Stock Split.
Do you see that?
A. Yes.
Q. First let me ask you whether you mean to imply here that the liquidity of AIG common stock increased as a result of the reverse stock split.
A. I think again I would answer in the same way I answered the last time you asked a similar question.
Q. It's really yes or no or I don't know.
A. I'm not seeking to add an undue -- unduly causal relationship. I would say that this was consistent with its -- it's consistent with -- the effect is consistent with the anticipated result as described on 2663 -- 2633 in the proxy statement issued by management.
So management said, We anticipate this to happen, and then what we observe is that it in fact happened.
Q. My question is, other than saying this was anticipated and this occurred, are you purporting to say anything else, including are you purporting to say anything else about whether what occurred was the result of the reverse stock split?
A. I have no reason empirically, analytically or otherwise to say that it was not. It is consistent with

economic theory and it is consistent with what we observe and it is consistent with the anticipated effect as described by AIG management in their proxy, in their proxy statement.

Q. And does that mean that you have concluded, in your opinion, that liquidity of AIG stock increased as a result of the reverse stock split?

A. I tested the result and explicitly state in my report that the intended result was in fact what happened and therefore accept as -- in my opinions, as a person examining market evidence, that it is in fact consistent with the expectation and therefore related to the transaction as announced.

So the answer is, my opinion is that the intended result was in fact what was achieved, and so therefore, I have no reason to say that the reverse stock split did not contribute to that result, increased liquidity. I don't know of anything else that did other than that reverse stock split.

Q. Did you investigate whether there was anything else that was occurring at this time that would have increased the liquidity of the AIG common stock?

A. You mean like the improvement in the price of or the condition of AIG or some of the other things that were in the news?

Q. Well, any of those things.

A. I don't recall in my review seeing anything else other than this, so I think it's fair for me to -- as an analyst and as an empirical economist to attribute the effect to the transaction.

Q. I mean, for example, the first measure of liquidity that you set forth on Defendant's Exhibit 2635 is the daily trading volume; correct?

A. Correct.

Q. Are you aware of any reasons why the daily trading volume increased over the 90-day period that you are looking at here, other than the reverse stock split?

A. I can't off the top of my head recall any alternative reasons for increased daily trading volume.

I will, as part of my previous answer and this answer, point out that it is well-documented in the academic literature that reverse stock splits tend to have -- are done for liquidity reasons and tend to have liquidity effects consistent with the ones that I've outlined in my report and in my demonstrative.

Q. And is it documented in that literature that reverse stock splits have that effect when they split authorized as well as issued shares?

A. I don't recall. I'd have to -- I'd have to review the literature again to refresh my memory.

Q. Is there any reason that you can think of, as you sit here now, why the increase in liquidity of AIG common stock that you attribute to the reverse stock split would not have occurred if the reverse stock split had applied to authorized as well as issued shares?

A. Could you repeat that question.

Q. Is there any reason that you can think of, as you sit here now, why the increase in liquidity of AIG common stock that you attribute to the reverse stock split would not have occurred if the reverse stock split had applied to authorized as well as issued shares?

A. Typically what matters to economists --

Q. This is in the beginning a yes or no or I don't know question.

A. The answer would be -- could you repeat the question again.

Q. Certainly.

Is there any reason that you can think of, as you sit here now, why the increase in liquidity of AIG common stock that you attribute to the reverse stock split would not have occurred if the reverse stock split had applied to authorized as well as issued shares?

A. Off the top of my head, I can't recall anything right now.

Q. Okay. Counsel for the United States directed your attention to Plaintiffs' Trial Exhibit 2248 that is in the book they gave you.

A. Okay.

Q. And this is the presentation of Bank of America and Citigroup to the AIG board of directors on September 29, 2010; correct?

A. Yes.

Q. And you relied on this document as part of your work; correct?

A. Yes.

Q. And counsel directed you to page 28 and the third section there about capital markets. Do you recall that?

A. Yes. Correct.

Q. And he asked you whether that was relevant to your analysis and you said it was?

A. Yes.

Q. Let me ask you to look at the first item here next to Federal Reserve Bank of New York.

Do you see that?

A. Yes.

Q. And that says (as read): FRBNY may require concessions in exchange for operational waivers of the FRBNY Credit Facility. More than 1,000 waivers have been granted since the FRBNY credit facility was established.

Concessions could include fees, increases to coupon, or forced asset sales. No access to private credit facility while FRBNY facility is in place. And FRBNY facility has more restrictive covenants than a private market credit facility.

Do you see that?

A. I do.

Q. Was that relevant to your analysis?

A. Sure.

Q. Let me ask you to look at -- let me ask you, how is that relevant to your analysis?

A. Okay.

Q. What did that mean to you?

A. It meant that the fact that AIG, in order to avoid costly bankruptcy, agreed to those terms, that it was the most viable choice that management of the firm had. I -- also that the company -- the Federal Reserve Bank of New York as a creditor had continued to be flexible in the ongoing administration of the facility in granting waivers during the life of the facility.

And we actually -- as I pointed out in my own direct testimony, there were numerous places where concessions were made, benefits were -- additional benefits were provided, so that is actually quite consistent with what I observed.

So if you recall, I talked about the fact that there was a period before the final -- finalization of the credit agreement where the markets were speculating as to a deal with different covenants in it. That deal never materialized.

And so, you know, are there things called covenant-light loans and covenant-light bonds and covenant-light this and that and the other thing? Sure, there are. The fact is that those never came to pass. This was the deal they had as opposed to bankruptcy.

Q. Let me ask you to look at page 35 and the second section that's headed Series C.

Do you see that?

A. Yes.

Q. And the first thing that is stated there is that the Series C preferred stock was received by the United States Treasury for no financial consideration, merely to obtain governance rights until the FRBNY facility was repaid.

Do you see that?

A. I do.

Q. And was that something that was relevant to your analysis?

A. I considered it. I also considered the fact that they granted much more flexible terms on the restructuring and the refinancing of the RFC -- or the RCF. They replaced it with --

MR. BOIES: Your Honor, could --

THE WITNESS: You asked me how. I was answering how. You didn't ask me yes or no. I answered the yes or no. Then you asked me how.

BY MR. BOIES:

Q. I didn't ask you how, sir.

A. I'm sorry. What did you ask?

Q. I said, "And was that something that was relevant to your analysis?"

A. And I said yes, I considered it.

Q. And you then started out --

A. My apologies. I misheard.

Q. Okay.

Now, with respect to the Series C stock --

A. Yes.

Q. -- did you understand that there was a requirement of a shareholder vote before it could be converted into common stock?

A. Yes. I believe that's correct.

Q. And did you understand that that shareholder vote had to include a class vote of the common shareholders?

A. I believe that to be correct.

Q. And did you understand that the Federal Reserve believed that they could not win a class vote of the common shareholders?

A. I do not necessarily understand that, no.

Q. Did you see any evidence of that in your investigation?

A. I don't recall if -- I don't recall that actually. I recall -- no, I don't recall anything directly at this point in time.

Q. Do you recall a Mr. Huebner?

A. I remember Mr. Huebner testified. Yes.

Q. And do you remember any documents that Mr. Huebner wrote about his dubiety as to whether they would be able to win a vote of the common shareholders?

A. I don't recall that, no.

Q. Do you have an understanding as to whether there ever was a vote of the common shareholders?

A. You mean with regard to the Series C?

Q. Yes. The conversion of the Series C.

A. I believe the Series C was exchanged for Series D, so that would tell me that they never actually converted the C. Instead, they -- I think they exchanged it for -- I think they -- well, I'm now getting a little fuzzy.

I -- well, I think the simple answer is I do not -- there was -- I do not recall a conversion of the

Series C.

I recall an exchange that took place, but I don't recall an actual conversion of Series C.

Q. I will represent that there was not an actual conversion of the Series C.

But my question was whether there was ever a vote of the common shareholders to permit a conversion of the Series C.

A. Not to my recollection.

Q. Do you know why that was?

A. I'm sorry?

Q. Do you know why that was?

A. Not off -- not to my immediate recollection.

Q. Did you investigate why that was?

A. Again, not to my immediate recollection.

Q. Now, you said earlier that the Series C was exchanged for Series D, and I want you to think about that, and I suggest to you that the Series C was not exchanged for the Series D but was in fact exchanged for common stock.

A. And I misspoke. All right. Because D was -- is exchanged for other series. The C was ultimately exchanged, not converted, that's correct.

Q. And it was exchanged for common stock; correct?

A. That's correct, to the best of my recollection.

Q. Now, with respect to the Series D preferred stock, is it your recollection -- and I suggest to you that this is what happened -- that the Series D was exchanged for Series E stock?

A. That is consistent with my memory, that it was exchanged for Series E and then there was an additional F granted as well for additional funding.

Q. And in the recapitalization, the Series E and the Series F stock were exchanged for AIG common stock; correct?

A. That is correct.

Q. And the value of the common stock that was received in exchange for the Series E and Series F stock was equal to the liquidation value of the Series E and Series F stock; correct?

A. Liquidation value or liquidation preference?

Q. You tell me, sir.

A. Are you asking me a yes-or-no answer? I'm just trying to ask you to clarify.

Q. Yes. Let me ask you the question I asked you.

Was the value of the common stock that was received in exchange for the Series E and Series F stock equal to the liquidation value of the Series E and Series F stock?

(Pause in the proceedings.)

A. How are you using the term "liquidation value" here?

Q. Is "liquidation value" a term that you're familiar with?

A. I'm familiar with it in terms of talking about liquidation value of a firm. I'm familiar with it in terms of the liquidation -- contractual liquidation preference in the agreement that was negotiated between AIG and the government.

So I'm really asking, so I can answer your question, how you're using the word "liquidation value of the stock."

Q. Are you familiar --

A. Do you mean the market price?

Q. Are you familiar with the term "liquidation value" as applied to preferred stock?

A. Ahh.

Given the fact that this stock had no explicit rights, as I say in my report, it's perpetual preferred and had no maturity date, then there was the -- AIG's option to pay an optional redemption price equal to a hundred percent of the liquidation amount, which is an amount equal to all declared but unpaid dividends plus the -- it's a liquidation amount. And that phrase "liquidation amount" is from the annex to the purchase agreement.

And so I think here, the terms allowed them to either pay that liquidation preference or negotiate another deal with the government.

Q. My question to you, sir --

A. Uh-huh.

Q. -- is simply, as somebody who has the background and experience that you have, are you familiar with the term "liquidation value" as applied to preferred stock?

A. I am familiar with the terms associated with liquidation of preferred stock -- liquidating preferred stock or -- yes.

Q. And is one of those terms that you're familiar with the term "liquidation value"?

A. It's one of the terms that's commonly used.

Q. Okay. Now, using "liquidation value" in the way that it's commonly used, let me ask my question again.

Was the value of the common stock that was received in exchange for the Series E and Series F stock equal to the liquidation value of the Series E and Series F stock?

A. Equal at the time of the exchange?

Are you asking at the time of the exchange, sir?

Q. Was the value of the common stock that was received in exchange for the Series E and Series F stock

ever at any time equal to the liquidation value of the Series E and Series F stock?
A. At the time of the exchange --
Q. When was the time --
A. At the time of the announcement of the exchange --
Q. When was the time of the exchange?
A. I'd have to refresh my memory on the exact dates, but at the time --
Q. Approximately when was the time of the exchange?
A. Do you mean the announcement or the final settlement of the exchange?
Q. I mean the time of the exchange, the time when you exchanged the Series E and F stock for common stock.
A. I don't recall the exact date of the exchange. What I can tell you is that the date of the announcement --
Q. Let me deal with my question --
A. Okay.
Q. -- first and then I do want to come to the date of the announcement.
A. Okay.
Q. But since you raised the issue of the time of the exchange, I would like to have your best understanding when the time of the exchange was.

A. I don't really recall specifically when the stock actually got exchanged. I'm sorry. Not as I sit here.

Q. Approximately when was it?

A. Well, the recapitalization took place -- well, let's put it this way. It was certainly after September 30, 2010, because that's when it was announced.

Q. Can you be any more specific as to when it took place other than saying it was after it was announced?

A. I would also presume that it took place --

Q. What are you reading just so we can --

A. Well, I'm looking at my report page 99. And I can tell you that they announced the completion of the recapitalization on January 14, 2011, that on December 8, 2010 they filed an 8-K regarding the master agreement.

So I -- again, I don't specifically recall when the -- as we'd say in the parlance, the trade actually settled, all of the pieces of the trade.

I do know that the recapitalization, which included the terms of the exchange as well as the issuance of warrants to existing common stockholders, was announced before the open of the market on September 30 and that the stock --

Q. You don't have to read from your report. We've got the report here.

A. Okay.
Q. If you could just try to focus on the question I'm asking.
A. Okay.
Q. You already told me your best understanding of when the exchange took place; fair?
A. Yes.
Q. And --
A. At this time, yes.
Q. At the time the exchange took place, recognizing that you are not able to identify exactly when that was, was the value of the common stock that was received in exchange for the Series E and F stock equal to the liquidation value of the Series E and F stock?
A. The stock price rose and converged after the announcement to the -- to approach the liquidation preference value as described in the actual preference -- preferred share agreement.
That's the closest I think I can come to try and answer that question.
Q. At the time the exchange took place, are you saying that the value of the common stock that was received in exchange for the Series E and F stock was more than the liquidation value of the Series E and F stock?

A. No, I'm not saying that.
If what you mean by "liquidation value" is the agreed liquidation preference, then the common stock was not more, if I understand your question.
Q. Let me ask the question this way.
A. Uh-huh.
Q. What, as you understand it, is the liquidation value or liquidation preference of the Series E and F stock in total?
A. It's $49 billion of liquidation preference according to the actual E and F -- there was a contractual agreement of 45 --
Q. What are you reading from?
A. Again, it's my report.
Q. I know, but I'm just -- if you're going to read from the report, if you'd just tell us what page and paragraph you're doing it.
A. I'm sorry. Page 97 and 98 of my report, paragraphs 165 through 167. And I'm using that to supplement my own memory.
Q. Now, when you say that the liquidation value or preference of the Series E and F stock was approximately $49 billion, what are you relying on?
A. I direct you to --
Q. No. Just what are you relying on?

A. AIG's 10-Q for September 30, 2010 is a reference I cite in my report.
Q. Well, you do cite that in footnote 345.
A. That's correct.
Q. But are you saying that that is a statement that the Series E and F stock had a total liquidation preference at the time of the exchange of $49 billion?
A. What I'm saying is that that was the liquidation preference for the deal. For the -- for the -- as stated in the transaction, in the deal.
Q. Was the liquidation preference of the Series E and F stock different at the time the deal was announced and at the time the stock was exchanged?
That's a yes, no, or I don't know question.
A. Would you re-ask the question, please. I'm trying to parse the use of your words.
Q. Sure.
Was the liquidation preference of the Series E and F stock different at the time the deal was announced compared to the time the stock was actually exchanged?
A. Yes.
Q. And --
A. You said was the liquidation preference amount or the actual value of the stock, which -- I -- the answer is yes if you're talking about the value of the stock.

Q. By "the value of the stock" you're talking about the value of the Series E and F stock?

A. No. I'm talking about the underlying common that's part of the exchange.

Q. I'm not asking about the common stock.

A. Okay. So please ask the question again.

Q. Was the liquidation preference of the Series E and F stock different at the time the deal was announced compared to the time the deal was actually executed in terms of exchanging the stock?

A. I don't know the answer to the question as you're asking it as I sit here.

Q. Okay. Is it the case that the $49 billion figure that you used was the amount of the liquidation preference at the time the recapitalization was announced?

A. That 49 billion was at the time the recapitalization was announced, that is correct.

Q. Now, at the time that the recapitalization was announced, how many shares of common stock were going to be exchanged for the Series E and F stock?

A. I don't recall the specific breakdown between the C, E and F.

Q. The Series C stock was treated differently than the Series E and F stock; correct?

A. Correct.
Q. So focusing just on the Series E and F stock, how many shares of common stock were going to be exchanged for the Series E and F stock as of the announcement date of the recapitalization?
Does approximately 1.1 billion shares sound right?
A. I'd say 1.092132.
Q. And where does that come from?
A. The Citibank/Merrill Lynch pro forma shares outstanding analysis, the columns for E and F. This is page 11 of 44, PTX 2248. And it's the allocation, pro forma allocation of shares, so it's the allocation of 1.09.1 million shares based on the $45.00 implied exchange price.
Q. 1.09?
A. 2132.
Q. Billion shares.
A. 1.092 billion, yes -- no. 1.092 million shares.
Q. No. It's over a billion shares, sir.
A. I'm sorry. I'm taking my commas and turning them into periods. That's right. 1.092 billion shares, that's correct.
Q. And it also shows the Series C on the same page; right?

A. It does.
Q. And what was the Series C?
A. 562.9 million approximately.
See, that time I got the commas and the periods right.
Q. And these were shares before or after the effect of the reverse stock split?
A. These were shares after, I believe, the reverse stock split.
Q. Do you know what the government estimated the fair value of the Series E and F stock were at the time that the recapitalization was announced?
A. I don't recall the government's valuation of that, no.
Q. Do you recall approximately?
A. The government's valuation?
Q. Yes.
A. I can't recall off the top of my head, but --
Q. Did you investigate that?
A. I saw a lot of different valuation analyses conducted. I don't remember specifically the government's valuation, no.
Q. Whose valuation analyses did you see other than the government's?
A. Again, I don't recall off the top of my head.

There were a lot of numbers flying around. I don't recall whose numbers were whose, so...

Q. Do you recall any of the sources of valuations, even though you may not be able to identify what the valuation was?

A. Not off the top of my head. I don't want to overreach on my memory here.

Q. Let me ask you to look at Plaintiffs' Trial Exhibit 622, which I will hand up.

This is a document that's already in evidence.

Do you recognize this document, sir?

A. I don't -- not off the top of my head. I may have looked at it, but I don't remember it right now.

Q. As part of your investigation, did you look at the TARP annual reports?

A. I can't recall specifically if I did. I know I looked at a lot of things, but I don't specifically recall if I looked at those.

Q. You understood that the Series E and F stock were TARP stocks; correct?

A. Yes.

Q. If you --

A. They were part of the TARP program I think or associated with the TARP program.

Q. Do you distinguish between being part of the TARP

program and being associated with the TARP program?
A. No.
Q. Let me ask you to turn to page 19 of Plaintiffs' Trial Exhibit 622.
And do you see on the right-hand side of the page table 4 that is headed Summary of TARP Direct Loans and Equity Investments?
A. You said page 19?
Q. Page 19 of Plaintiffs' Trial Exhibit 622.
A. Oh, I see.
Yes, sir.
Q. And do you see the line that says "AIG Investment Program"?
A. Yes.
Q. And do you see that in the far right-hand corner or column there is an estimated value as of September 30, 2009 of $13.2 billion?
A. Yes, I do.
Q. And do you understand that that is the government's estimate of the value of the Series E and F stock as of September 30, 2009?
A. In order to answer that question, I need to look at the associated footnote, so I'm just trying to do that, make sure I don't misspeak.
(Pause in the proceedings.)

From what I can tell looking at pages 24 -- well, page -- pages 34 and 35 of 114, which I believe is the cite listed at the bottom of that table, there are quite a few elements to this total investment program under TARP here.

So I can't really tell from that number what actually is in that, in that estimated value of 13 billion, 13.2 billion.

Q. You understand that this is the AIG TARP investment program; correct?

A. Yes. And in trying to look at that, there seems to be a lot of discussions of different parts of that, so I can't tell what specifically the 13.2 refers to.

Q. Was there any TARP investment in AIG other than preferred stock, as you understand it?

(Pause in the proceedings.)

Could you identify for the record just what you're reading just so --

A. I'm looking at pages 34 of 114 and 35 of 114, which has a broad discussion of a number of elements that they're calling the AIG restructuring plan and taxpayer exit, and they're identifying a lot of -- so what I'm trying to do is parse what you're referring to as TARP -- since the focus of my testimony was not on studying TARP, I'm trying to parse what you're referring to as TARP versus this specific valuation here on this particular table that doesn't have any detailed footnotes to it or any detailed reference pages to see if I can answer your question.

Q. And just to be clear, I'm not asking you to research this report right now. I'm simply asking whether you have an understanding one way or the other as to whether there was any TARP investment in AIG other than the Series E and Series F stock at this time.

A. Specifically -- specifically TARP, not anything else, just TARP?

None of the other revolving credit facility, none of the rest of that, just TARP.

Q. Yes, just TARP. Because this is a TARP report.

A. Okay.

Q. Just TARP.

A. Right.

So I do recall that, as I said in my previous testimony, that over time the government continued to subordinate their credit facility in AIG in exchange for preferred shares, lower subordination, more deferred, so what you describe is not inconsistent with my understanding of what the government ultimately ended up with prior to exchanging preferred for equity.

Q. I want to focus just on Series E and Series F right now.

A. Okay.

Q. And do you understand that Series E and Series F stock were preferred stock that was issued under the TARP program?

A. I hadn't really focused on the TARP designation in my analysis because I was focused strictly on -- that was not -- the focus of the policy measures, the focus of how -- how things were defined or designated by what government -- I really did not focus on that, so you're asking me to answer a question on which I had not focused on until right now. And I focused on capital. I focused on the economics of that capital. I focused on the market transactions. I didn't focus on what people decided to call it.

Q. Is it fair to say -- and this is not a criticism in any way, but is it fair to say that as of now, you just don't have a view as to whether Series E and Series F preferred stock were or were not issued under the TARP program?

A. I -- I know that there was some mention of TARP and that some of the remedies or resources being granted to AIG by the government were part of the TARP program.

I don't know that I can strictly say Series E and F are specifically TARP related, especially since the way that these transactions worked, which I did study, was that the government continued to be repaid on their original issuance out of proceeds from these subsequent transactions.

So as an economist, but as a deal guy, I'm having a difficult time since I didn't specifically try to parse out this is TARP, this is this, this is that, this is that. I looked at cash flows in and out.

So I'm having a hard time trying to say this was TARP or that wasn't TARP or this other thing wasn't TARP or this thing was something over here. I'm looking at the money and I'm looking at the returns on the money and I'm looking at the economics and how they affected the firm.

Q. And let me just try to focus on that for a minute.

A. Okay.

Q. When you say you were looking at the money, you're talking about all of the money that the government, broadly defined, provided to AIG in 2008-2009; correct?

A. I'm looking at the capital --

Q. That's a yes, no, or I don't know question.

A. Generally speaking, I looked at all of it. Yes.

Q. And for example, if we could turn for a second to your demonstrative exhibit that talked about what the government's return was, Defendant's Exhibit 2619?

A. Yes.

Q. This is, as you say, all of the government's investments in AIG; is that correct?

A. Correct.

Q. Did you investigate what the government earned as a return on the revolving credit facility by itself?

A. Are you saying -- asking that question as the revolving credit facility as originally covenanted or with or without the equity return participation?

Q. I'd be interested to know whether you did it with the equity participation or without the equity participation or both.

Do you understand what I'm asking?

(Pause in the proceedings.)

And again, I don't have any objection to your referring to your report, but when you do, if you could just tell me what you're looking at.

A. I'd be happy to once I find it.

Q. What are you looking for?

A. I'm looking at the exhibits to my report right now and looking at some of the footnotes to see if I actually discuss that specific thing you're asking me about, the RCF and what the cash flows to the RCF were in some hypothetical or whether there's any other evidence that I may have referred to, just to make sure.

Q. All I'm really asking now is whether you made any effort to estimate what the Federal Reserve Bank of New York earned as a return on its revolving credit facility.

A. I think, as I recall sitting here, given the fact that --

Q. That's a yes, no, or I don't know question, sir.

Do you need to have the question again?

A. Yes, please.

Q. Did you make any effort to estimate what the government earned as a return on the Federal Reserve Bank of New York's revolving credit facility?

A. I did observe and examine cash flows associated with the RCF given that the RCF -- yes, I did consider that. I did review that. I did examine that.

Can I tell you what the outcome of that examination is? Would you like to know?

Q. What I would like to know is what is the return the government earned on the Federal Reserve revolving credit facility, if you know.

A. It is a difficult question to answer because the government continued to modify the revolving credit facility terms, defer and subordinate their claims on cash with the PIK features and everything else, and so although I looked at it, it was difficult to come up with a return absent of the calculation I did here, which is the 5.7 percent on everything.

If you're -- actually, here's the way I think I can ask it. If you're asking me what the return of the government would have been --

Q. No, I'm not asking you what the return would have been. I'm not asking a hypothetical question.

A. Okay.

Q. You understand that the Federal Reserve Bank entered into a revolving credit agreement with AIG; correct?

A. Yes, correct.

Q. You understand, pursuant to that revolving credit agreement, the Federal Reserve Bank loaned money to AIG; correct?

A. Yes, correct.

Q. And you understand that AIG repaid the principal of that loan?

A. All of the funds extended got ultimately repaid as AIG sold its common stock into the marketplace.

Q. Sir, all I'm asking -- this is really simple.

AIG borrowed money from the Federal Reserve Bank; correct?

A. Correct.
Q. And AIG repaid that money to the Federal Reserve Bank; correct?
A. Using proceeds from additional preferred stock.
Q. I'm not asking you what the source of it was.
A. Correct.
Q. I'm just saying that they repaid it. Correct?
A. Correct.
Q. And they repaid that with interest; correct?
To the Federal Reserve Bank of New York?
A. I do not recall whether there was interest associated with those repayments. I know that there were PIK features and money -- the interest was deferred. And I do know that the government ultimately got repaid on all the funds it extended, but it's the art- -- it's the parsing that you're asking me for that I'm not sure I can answer.
Q. I want to be sure that I'm not parsing something because I mean to be asking a really simple question.
The Federal Reserve Bank of New York lent AIG money.
A. Correct.
Q. And AIG repaid the amount of money that it borrowed; correct?
A. Ultimately. Ultimately the government got

repaid.

Q. Ultimately, yes.

A. Ultimately the government got repaid.

Q. And as you understand it, in addition to repaying the principal, did AIG pay the Federal Reserve Bank of New York interest on the money that AIG had borrowed from the Federal Reserve Bank?

A. Ultimately --

Q. Just yes or no, please, sir.

A. I cannot answer the question in the way in which you're asking it because it depends on what you mean by the ultimate repayment of that interest given that there were PIK features to the transaction and that the original credit facility was retired using the proceeds from the issuance of preferred stock, which then ultimately was exchanged for common, which was then sold in the market, so I'm trying to understand the question.

MR. BOIES: Your Honor, I want to get out of here tonight. I'm just trying to finish this line. Could you ask the witness to please be responsive.

THE COURT: We're going to take one more try at this if we may, and then we're going to adjourn for the day, so focus on the question and see if you can answer it.

THE WITNESS: I will do the best I can,

Your Honor.

THE COURT: Thank you.

BY MR. BOIES:

Q. Did AIG pay the Federal Reserve Bank of New York any interest on the money that the AIG company borrowed from the Federal Reserve Bank of New York?

Yes, no, or I don't know?

A. I don't immediately recall as I sit here what component of the cash flows that the government received were actual interest payments.

MR. BOIES: Okay.

THE COURT: All right. Let's reconvene at 9:30 tomorrow morning.

MR. GARDNER: Your Honor, before we convene, I was asked by Weil Gotshal if they could present to you a letter about the filing under seal request. The government, as I understand it, is prepared to file the proffer on the record, and Weil Gotshal wanted to submit to the Court a letter -- Ms. Thompson is here to provide it -- asking -- requesting that the Court receive the filing under seal.

THE COURT: Sure.

MR. GARDNER: And as I mentioned earlier today, the government really takes no position one way or the other, but we would like to know tonight --

THE COURT: I'll accept the letter, but why don't you go ahead and file it under seal, and if there's going to be some adjustment to that, we can take care of it tomorrow.

MR. GARDNER: That's fine, Your Honor. Thank you.

THE COURT: I'll have your letter.

Thank you.

MS. THOMPSON: Thank you, Your Honor.

MR. BOIES: Your Honor, one related housekeeping matter since we have counsel for AIG here.

The Court will recall that I mentioned there was one document on the AIG privilege log that we would like to have the Court look at in camera because it mentioned notes of the September 16 meeting.

THE COURT: Yes.

MR. BOIES: And I wonder if we could arrange that, to have that done before we have the AIG witnesses testify, so that if the Court concludes that it is appropriate for us to have it, we can have it for our examination.

THE COURT: Ms. Thompson, do you have an objection to that?

MS. THOMPSON: I do, Your Honor.

We do not believe that AIG's privilege has been implicated by the testimony thus far in the matter, and that's one of the reasons why the Department of Justice is filing the proffer for Mr. Reeder's testimony, and we don't think it's appropriate to have any of the AIG privilege log documents reviewed by Your Honor.

THE COURT: Were these notes prepared by an attorney?

MS. THOMPSON: They were notes prepared by an attorney. I believe it was Mr. Gamble of the Simpson Thacher firm. I believe Mr. Curnin spoke about that on Friday.

THE COURT: Right.

MR. BOIES: And Your Honor, our point in having the Court look at it is not because we are asserting a waiver of attorney-client privilege. It is to determine whether this is in fact privileged, because what has happened is they've produced the minutes themselves but not the underlying notes. We have the notes for the September 21 meeting.

THE COURT: One question, though, Ms. Thompson, is, if we're just talking about notes of an AIG board meeting that otherwise is in the record, why would it necessarily be privileged just because the notetaker was a lawyer?

MS. THOMPSON: You're correct, Your Honor. The document I believe Mr. Boies wants Your Honor to look at I believe is an e-mail between Mr. Gamble and AIG about the board minutes, not the notes themselves.

MR. BOIES: About the notes. It says "notes" in the -- the one I'm talking about says it's -- it is an e-mail about the notes.

MS. THOMPSON: Just to back up a little bit, Your Honor, when AIG agreed to produce unredacted copies of these board minutes, it was as a result of a negotiated stipulation with counsel for plaintiffs and the Department of Justice. And we understood that -- and this might be something that Mr. Boies and other counsel could talk about off the record, Your Honor, privately.

But we understood that nobody was going to assert that -- nobody was going to assert that AIG had waived anything as a result of producing those notes and that it was going to be acceptable for trial as well as for discovery, and so we're, frankly, a little bit surprised that here we are this far into the trial and this is coming up.

THE COURT: I'm just wondering in this one instance, just talking about this one document, why would it necessarily be a privileged document if it just happened to be a lawyer who took the notes.

MS. THOMPSON: I don't -- Your Honor, first of all, I actually am not familiar with the document itself we're talking about, but my understanding is that it is a communication about the notes at the board meeting the day before. I believe this is an e-mail from September 17.

MR. BOIES: Yes.

MS. THOMPSON: And I think it's an attorney-client communication between AIG's internal lawyers and outside counsel, Mr. Gamble. And I can't represent to Your Honor what the minutes say because they're privileged, but -- I'm sorry -- what the e-mail says, but we feel that it's justifiably privileged. It is an attorney-client communication.

And the minutes are what the minutes are. They have been produced unredacted. And we don't think it's appropriate to be changing the deal at this time in the trial, when AIG is not a party and we feel like we've been --

THE COURT: Well, maybe you can talk off-line about it a little bit and see if you can reach some agreement. If not, we can take it up tomorrow morning I suppose.

MS. THOMPSON: Thank you, Your Honor. We'll be prepared to do so.

MR. BOIES: Thank you, Your Honor.

THE COURT: Okay. Good night. 9:30 tomorrow.

(Whereupon, at 5:05 p.m., the proceedings were concluded.)

CERTIFICATE OF TRANSCRIBER

I, Josett F. Whalen, 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: NOVEMBER 18, 2014

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JOSETT F. WHALEN, COURT REPORTER

ADMITTED EXHIBITS

DX	PAGE	DESCRIPTION
449	7498	ARTICLE, STOCKS RISE ON REPORT OF GOVERNMENT AID FOR AIG, AP BUSINESS WRITER, SEPTEMBER 16, 2008, BY TIM PARADIS
560	7504	NEWS ARTICLE LIMITED OR UNCLEAR UPSIDE DOWNGRADING TO IN LINE, US PROPERTY AND CASUALTY, 24 SEPTEMBER 2008
866	7595	ARTICLE, AIG WALKING THROUGH RESTRUCTURING OF GOVT SUPPORT LOWER EST, EQUITY RESEARCH, WELLS FARGO, OCTOBER 19, 2010
1736	7500	CNBC VIDEO: HTTP://VIDEO.CNBC.COM/GALLERY/?VIDEO=857908766
1863	7589	UBS ANALYST REPORT, "STAYING NEUTRAL BUT WITH SHORT-TERM BUY," 10/18/10
1874	7460	DAVID K.A. MORDECAI EXPERT REPORT
1875	7460	DAVID K.A. MORDECAI APPENDICES AND EXHIBITS
1875-A	7428	Mordecai CV
2601	7598	Mordecai Demonstrative
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