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IN THE UNITED STATES COURT OF FEDERAL CLAIMS

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

Courtroom 4

Howard T. Markey National Courts Building
717 Madison Place, N.W.
Washington, D.C.
Thursday, October 23, 2014
9:30 a.m.
Trial Volume 18

BEFORE: THE HONORABLE THOMAS C. WHEELER

Josett F. Whalen, RMR-CRR, Reporter

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	I N D E X				
	WITNESS :	DIRECT	CROSS	REDIRECT	RECROSS
1					
2					
3	ZINGALES		4039	4057	4136
4	FARNAN	4160	4200		
5					
6					
7					
8	EXHIBITS	FOR ID	IN EVID		
9	Plaintiffs'				
10	Number86		4101		
11	Number284		4190		
12	Number332		4199		
13	Number347		4177		
14	Number350		4187		
15	Number364		4171		
16	Number366		4123		
17	Number444		4181		
18	Number699		4170		
19	Number1066		4193		
20	Number1583		4101		
21	Number1650		4179		
22					
23					
24					
25					

	EXHIBITS	FOR ID	IN EVID
1			
2	Defendant 's		
3	Number175		4244
4	Number572		4232
5	Number626		4234
6	Number637		4220
7	Number675		4223
8	Number688		4247
9	Number756		4268
10	Number2131		4159

11

12 Joint

13 (none)

14

15

16

17

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

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

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

2 - - - - -

3 (Proceeding called to order, 9:31 a.m.)

4 THE COURT: We're on the record this morning for
5 day number 18 in the trial of Starr International Company
6 versus United States.

7 Good morning, Dr. Zingales.

8 THE WITNESS: Good morning.

9 THE COURT: You understand that you are still
10 under oath in these proceedings?

11 THE WITNESS: I do.

12 THE COURT: All right. Let's go ahead.

13 MR. DINTZER: Thank you, Your Honor.

14 - - - - -

15 Whereupon --

16 LUIGI ZINGALES

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

20 CROSS-EXAMINATION (continued)

21 BY MR. DINTZER:

22 Q. Sir, did you speak with anybody about your
23 testimony from the time we left court yesterday?

24 A. No.

25 Q. And sir, we talked a little bit about the credit

1 agreement yesterday.

2 The credit agreement had a corporate governance
3 provision; is that right?

4 A. Yes.

5 Q. And the provision -- it's in article 4.01. I
6 don't know if you recall that.

7 But the provision did not kick in until after AIG
8 issued the preferred stock; is that right?

9 A. I don't remember on the specific, but I trust your
10 words.

11 Q. And I'd be happy to show you in your report where
12 you say that.

13 A. Okay.

14 Q. If you could look at your report at page 34, sir,
15 and just let me know when you're there.

16 A. Where do I find it? Sorry. In which binder?

17 Q. I'm sorry. There should be a binder up there with
18 your report in it. If not, we can get you a copy.

19 A. I don't see it.

20 Q. Do you see the other binders that we did -- we
21 talked with yesterday?

22 A. Is this (indicating)?

23 Q. That could be, sir, if you could take a look.

24 A. And that would be?

25 Q. Of your original report at page 34.

1 A. Yeah, but what is the exhibit of the report?

2 Q. Oh, the exhibit number? It's -- I don't think
3 we -- DX 2150.

4 Oh, I'm sorry. May I approach, Your Honor?

5 THE COURT: Sure.

6 MR. DINTZER: Okay. Here it is, sir (indicating).

7 THE WITNESS: 652?

8 MR. DINTZER: No. I've got it for you, sir.

9 Does the Court have one?

10 THE COURT: I have it in the black binder from
11 yesterday. It doesn't have an exhibit number because we
12 were going to do that later I think, but I do have it.

13 MR. DINTZER: Okay. Thank you, Your Honor.

14 And so we're just directing the witness to
15 page 34.

16 THE COURT: Right. I have it.

17 THE WITNESS: Okay.

18 BY MR. DINTZER:

19 Q. And sir, at paragraph 54, you write, "At the
20 September 28, 2008 AIG Board Meeting, the AIG board was
21 advised that 'within ten days after the issuance of the
22 Convertible Preferred Stock, the corporate governance
23 provisions of the agreement will require that AIG have a
24 board composition satisfactory to the trust.'"

25 Do you see that?

1 A. Yes.

2 Q. And so the corporate governance provisions didn't
3 kick in until after AIG issued the preferred stock; is
4 that right?

5 A. Yes.

6 Q. And the preferred stock shares weren't issued
7 until March 2009; is that right?

8 A. Just one second.

9 Q. Sure.

10 (Pause in the proceedings.)

11 A. If you sort of would -- the thing that I was a
12 little bit confused at the beginning, the corporate
13 governance provision or you're saying sort of the board
14 composition satisfactory to the trust.

15 If you read the next sentence, which is again from
16 the minutes of the 28, the composition of the board after
17 the issuance of convertible preferred is unknown, but the
18 Treasury does want to make certain that the board
19 includes directors with whom they are comfortable.

20 Q. And my only question, sir, is that the provisions
21 of the corporate governance requirement under the credit
22 agreement didn't kick in until ten days after the
23 issuance of the stock.

24 A. If I read this, it's saying that the agreement
25 will require that the AIG have a board composition

1 satisfactory to the trust ten days after the issuance of
2 the convertible.

3 Q. And that was in -- the convertible was then issued
4 in March of 2009.

5 A. Yeah. As I said in my I think slides, the fact
6 that they didn't even need to issue the convertible
7 suggests that the goal, which is stated here, to have a
8 board with whom they are comfortable was realized
9 earlier, because it's pretty clear here that they had
10 this goal. Treasury has a goal to have directors who --
11 with whom they are comfortable, and so the fact that they
12 don't -- they have the right to do -- to issue whenever
13 they wanted after 45 days. They didn't, so it's pretty
14 clear that they achieved their objective because
15 otherwise it would not explain why they didn't.

16 Q. Or maybe they were just trying to figure out how
17 they were going to do this or maybe they were in such a
18 hurry to have the trust take control because it wasn't
19 that important to them, because there's a lot of reasons
20 that could explain. I understand that --

21 A. No, no, because they said -- sorry. But they said
22 here it's clearly very important to them. They state
23 here, literally report what the Treasury said. And there
24 are indications that they're pretty aggressive in getting
25 what they want, so the fact that they don't feel the need

1 I interpreted -- I -- you know, I -- I'm not a lawyer, so
2 I don't look at intent, but I look at action and infer
3 sort of an objective from action. And the action is,
4 they don't do it, not because it was complicated. I
5 don't think that that's a legitimate -- it could be an
6 alternative. It doesn't seem to me a legitimate
7 alternative. It's because they don't need it.

8 Q. And sir, for whatever reason, they didn't issue
9 the stock until March of 2009; is that right?

10 A. Yeah.

11 Q. And so the corporate governance provisions -- and
12 this is my question -- the corporate governance
13 provisions didn't kick in until March 2009, yes or no,
14 sir?

15 A. What I read here is that the corporate governance
16 provision of the agreement will require that AIG have a
17 board composition satisfactory to the trust.

18 Q. Right.

19 And the trust didn't exist until 2009; right?

20 Right?

21 A. Yes.

22 Q. Okay. Okay. No further questions on that
23 document, sir.

24 Sir, do you know who Mr. Swagel is?

25 Phillip Swagel?

1 A. Yeah. I think he's a guy who -- if I remember
2 correctly the name, he's a guy who was at the Treasury
3 under the Bush administration during this period.

4 Is that correct?

5 Q. I'll show you something.

6 May I approach, Your Honor?

7 THE COURT: Yes.

8 THE WITNESS: Yeah.

9 BY MR. DINTZER:

10 Q. And what we're looking at here, sir, this is --
11 this actually is a multipart article; is that right?

12 A. This is an article that Phillip Swagel wrote for
13 the Brookings Institute, and there were after a
14 discussion. I was one of the discussant. And then there
15 was an open discussion of the floor.

16 If that's what you mean with "multipart article,"
17 yeah.

18 Q. Yes.

19 And so -- so part of the way this worked is, is
20 Mr. Swagel wrote something and then you read it and then
21 part your job as a discussant was to comment on it and
22 to disagree with it if you disagreed with it; is that
23 right?

24 A. Yeah.

25 Q. Okay. And --

1 A. To -- in general, what the discussant -- it's not
2 just a question of disagreement. It's also a question of
3 pointing out what are the weak argument in a reasoning,
4 so it's not necessarily an issue of disagreement. It's
5 more pointing out -- and this is I could or I could not
6 disagree depending on the situation. But the job of a
7 discussant is not simply to say what you disagree with;
8 it's also to point out the weakness in arguments.

9 Q. And if you could turn to page 42, and you can
10 satisfy yourself that 42 is still Mr. Swagel's analysis
11 and we haven't turned to the discussant portion yet.

12 A. Okay. So I look at page 42. Okay.

13 Q. Okay. And what Mr. Swagel is doing in this
14 article, he's talking about all -- basically the things
15 that led to Fannie and Freddie and to AIG and the like;
16 is that right?

17 A. He talks about entire period after the goals
18 are -- if I remember correctly, from the March 2008 to I
19 would guess sort of the general 2009 when the Bush
20 administration steps down and so he leaves.

21 Q. Okay. And in the middle of page 42, he starts
22 writing, "In sum, AIG was larger" -- do you see where I'm
23 reading?

24 A. Yes.

25 Q. -- "more interconnected and more 'consumer facing'

1 than Lehman. There was little time to prepare for
2 anything but pumping in money -- and at the time only the
3 Fed had the ability to do so for AIG. Eventually the AIG
4 deal was restructured, with TARP funds replacing Fed
5 lending, to give AIG a more sustainable capital structure
6 and avoid a rating downgrade that would have triggered
7 collateral calls. As time went on, it became clear that
8 AIG was a black hole for taxpayer money, and perhaps a
9 retrospective analysis will demonstrate that the
10 cost-benefit analysis of the action to save AIG came out
11 on the other side. But this was not apparent at the
12 time."

13 Do you see that?

14 A. I do see that.

15 Q. And this is being written in I think 2009; is that
16 right? Yes, it says "Spring 2009" at the top. Is that
17 right?

18 A. Yeah. I think so.

19 Q. And then you write in the discussant portion, and
20 you don't say anything to disagree with the point that
21 AIG was a black hole for taxpayer money, that that was
22 the thinking in spring 2009; right?

23 A. I don't remember all my discussion. If you are --
24 if you want me to read all my discussion and say I didn't
25 say, I'm happy --

1 Q. Well, let me -- sir, let me just ask you, sir.

2 A. Yeah.

3 Q. In spring 2009, did you have any reason to
4 disagree with the idea that the taxpayer would lose money
5 on AIG? At that point in time, did you believe that the
6 taxpayer would lose money?

7 A. Actually I don't remember what I was thinking in
8 2009 vis-à-vis AIG. This is the -- yeah, I don't
9 remember.

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

12 But if you did disagree with this, you would have
13 written it in there. Would you agree with me on that?

14 A. Not necessarily.

15 Q. Okay.

16 A. If I have to write everything I disagree with in
17 there, my discussion would be very often very long.

18 Q. Now, within a few days after AIG was -- received a
19 loan from the New York Fed, you at that point in time --
20 because I understand your opinion has changed over
21 time -- at that point in time, you were very against the
22 loan, right, within the week, week and a half?

23 A. I think that I was and I am against a bailout to
24 insolvent firms, so to the extent I thought that AIG was
25 insolvent, I was against bailing out an insolvent firm,

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1 yes.

2 Q. And at the time in September 2008, you viewed the
3 extension of the safety net to AIG to be an enormous
4 broadening of the too-big-to-fail idea, at that time.

5 A. Again, I think that the issue is not a broadening
6 of the safety net in that I think that the Fed has a
7 responsibility in providing liquidity not just to bank
8 but to the system.

9 So if AIG was solvent, it should have been --
10 should have received access to the discount window like
11 the primary dealers received earlier. And I think was a
12 mistake of the Fed not to do it, a mistake that probably
13 is due to the cultural attitude of the Fed because the
14 Fed deals with bankers most of the time and not with
15 other kind of companies, so the fact that the Fed did not
16 extend -- the Fed understanding that AIG was solvent did
17 not extend I think was a mistake.

18 If AIG was insolvent, which is what I thought at
19 the time, not understanding the details -- and I said in
20 an article that I couldn't understand the details of AIG
21 because were too complex -- if AIG was insolvent, should
22 not have received the money from the Fed like any
23 insolvent firm should not have received the money of the
24 Fed.

25 So it's nothing in term of enlarging or

1 restricting the safety net, should not be a safety net.
2 The words "safety net" I think is wrong, is liquidity
3 provision, liquidity provision for solvent firms and no
4 provision for insolvent firms.

5 Q. Yes or no, sir. In September 2009, you believed
6 that the AIG loan dramatically extended the Fed's role as
7 lender of last resort, yes or no?

8 A. I think I cannot answer that yes-or-no question.
9 I think that --

10 Q. Okay. Let me show you something. Maybe it will
11 make it easier.

12 A. Okay.

13 Q. Sir, let me show you what we have here. We
14 have -- and this is DX 2135. We have an article that you
15 wrote in Italian September 20, 2008. Those are the last
16 two pages.

17 Do you see that?

18 A. I see that.

19 Q. And then we have a translation, which are the
20 first two pages, and then the middle page is the
21 affidavit of accuracy from the translator.

22 Do you see that?

23 A. Okay. So the last two pages is the Italian
24 version, this is the affidavit of the accuracy, and this
25 is the translation. Okay. I see that.

1 Q. Okay. And this is an article you wrote; right?
2 A. Yeah.
3 Q. And you wrote it in Italian; right?
4 A. Yes.
5 Q. And the title is Now Nothing Will Ever Be the
6 Same; is that right?
7 A. Yeah.
8 Q. Okay. And you were talking about nothing will
9 ever be the same after the AIG bailout.
10 A. Being written 20th of September, probably that's
11 the case. I don't remember verbatim my article, but...
12 Q. And so if you go to the second page, in the
13 middle --
14 A. Uh-huh.
15 Q. -- it says, "The AIG bailout also dramatically
16 extends the Fed's new role as last-resort investor."
17 Do you see that?
18 A. Yes.
19 Q. And you believed that when you wrote it; right?
20 A. Of course I believed that when I wrote it.
21 Q. Okay. And then farther down, in the middle --
22 A. Sorry. Can I point out one thing --
23 Q. Please.
24 A. -- because if the position is correct -- and I
25 have no reason to believe it is not -- they say

1 "last-resort investor," so not lender of last resort.

2 Before, the question, if I understood correctly, was a
3 lender of last resort, so --

4 Q. Do you want to look and see if you agree with the
5 translation, if you have any question with it?

6 Because the next four or five words are "the
7 structure of the loan," so...

8 A. Yeah, the translation in this part is correct.

9 Q. Okay. Did you believe that the AIG --

10 A. But -- sorry -- again, the question you asked me
11 earlier I think was characterized as lender of last
12 resort, not investor of last resort.

13 Q. Okay. And so let me be clear.

14 Do you believe that the AIG bailout dramatically
15 extended the Fed's role as lender of last resort, yes or
16 no -- did you believe that in September 2008, yes or no?

17 A. Again, I think I answer the same way I answered
18 before. To the extent that --

19 Q. I need a yes or no and then you can explain, sir.

20 A. Do I have to reply a yes or no?

21 Q. Or "I don't know." I think those are the ground
22 rules.

23 THE COURT: Sir, when you get a question that
24 calls for a yes or no answer, that's the preferred way to
25 do this. But -- and then Mr. Dintzer will give you an

1 opportunity to explain.

2 THE WITNESS: Okay.

3 BY MR. DINTZER:

4 Q. Would you like to hear the question again?

5 A. Yes, please.

6 Q. Okay.

7 Do you believe -- or did you believe on
8 September -- in September 2008 that the AIG bailout
9 dramatically extended the Fed's role as the lender of
10 last resort, yes or no?

11 A. Yes, I did -- I did believe so to the extent I
12 thought that AIG was insolvent at the time.

13 Q. And you didn't write -- like the next line isn't
14 "to the extent that AIG is insolvent at the time." In
15 fact, you don't say anything about their solvency or
16 insolvency, do you, in the next sentence or anywhere
17 here, do you?

18 A. Then I need to read all the articles. If you give
19 me time, I'm happy to read it all.

20 Q. I have absolute confidence that if you mention
21 insolvency in here that your counsel will let us know
22 about it when he gets up shortly.

23 But let me show you, at the end of that page, the
24 paragraph beginning "Joseph Schumpeter."

25 Do you see that?

1 A. "Schumpeter." Yeah.

2 Q. I'm sorry. "Schumpeter."

3 A. Uh-huh. Yes.

4 Q. In the middle, it says, "The AIG bailout -- and
5 the implicit guarantee the emergency decision extends to
6 all major companies -- will not only block the
7 destructive forces of capitalism for decades, but also
8 freeze its driving forces. It means the end of
9 capitalism as we have known it to date."

10 Do you see that?

11 A. Yeah.

12 Q. Do you remember believing that the assistance to
13 AIG in September 2008 -- that you believed that that was
14 the end of capitalism as it was known to date? Just yes
15 or no, sir, and then you can explain.

16 A. No. The answer is no, because if you read in
17 context, I say that the failure of obsolete business
18 models creates space for new companies which introduce
19 innovation and progress. The AIG bailout and the
20 implicit guarantee the emergency decision extend to all
21 major companies will not only block the destructive force
22 of capitalism for decades but also freeze its driving
23 forces, so here I'm talking about failure of businesses
24 that need to fail because they are insolvent, so I
25 precisely say what I said earlier, which is I don't think

1 that the Fed should bail out failed businesses. That
2 would be terrible.

3 I don't think and I don't think Schumpeter -- even
4 if I cannot infer, but I don't think Schumpeter would
5 have said that because you are illiquid, you have to
6 fail. I think that that's not what capitalism is about.
7 That's not what good innovation is about. And that's
8 what I believed then. That's what I believe now.

9 Q. You didn't write all that in the article about --

10 A. I beg your pardon?

11 Q. About insolvency. It doesn't say anywhere there
12 about insolvency; right? Just -- you can read the rest
13 of that paragraph. You just went on, but I just want to
14 make sure. I don't see the word "insolvent" there.
15 Right?

16 A. So --

17 Q. Yes or no?

18 A. Then I have to read all the article.

19 Q. Okay. Let me ask you this.

20 Clearly, doing this, the end of capitalism, it's
21 big. It's important. You have real concerns in
22 September 2008.

23 A. Uh-huh.

24 Q. Okay?

25 Will you agree with me that it was a difficult

1 decision for the Fed to make, to provide any assistance
2 to AIG, that they recognized, like you recognized, that
3 this was a big step and they had to consider it
4 carefully? Would you agree with me on that?

5 A. Yes.

6 MR. DINTZER: Okay. And with that, Your Honor, I
7 pass the witness.

8 THE COURT: All right. Thank you, Mr. Dintzer.

9 MR. DINTZER: And actually, I would like to move
10 the demonstratives into evidence as demonstratives.

11 MR. BOIES: Have we numbered them?

12 THE COURT: All right. Well, why don't you make
13 reduced copies perhaps.

14 MR. DINTZER: Absolutely, Your Honor.

15 THE COURT: And then you can submit them to us.

16 MR. DINTZER: Okay. Thank you very much,
17 Your Honor.

18 MR. BOIES: And no objection to the admission of
19 demonstrative exhibits as demonstrative exhibits.

20 THE COURT: Sure. I think we'll officially
21 identify them and receive them once you have the reduced
22 copies.

23 MR. DINTZER: Excellent, Your Honor.

24 And there is that one thing -- and we'll be happy
25 to deal with it at the end of the witness. We had an

1 exhibit -- I believe it's 6- -- 669, which was the exact
2 same as one of the demonstratives that I handed up, but
3 it had been chopped off, and we were going to ask to swap
4 in the cleaner un- -- and so I'll do that at the end of
5 the witness.

6 THE COURT: I remember that. Sure.

7 MR. DINTZER: Okay.

8 And I would ask counsel, do you want us to swap
9 back in your board?

10 MR. BOIES: I don't need it now.

11 MR. DINTZER: Okay.

12 MR. BOIES: Maybe we can do that at the break.

13 - - - - -

14 REDIRECT EXAMINATION

15 BY MR. BOIES:

16 Q. Good morning, Professor Zingales.

17 A. Good morning.

18 Q. Let me begin with what counsel for the
19 United States was just talking to you about, and that's
20 Defendant's Exhibit 2135.

21 And he said that if there was anything in here
22 about insolvency, I would probably point it out to you.
23 Do you recall that?

24 A. Yes, I remember.

25 Q. And do you recall that he asked you to look for

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1 the word "insolvency" in here?

2 A. I remember he asked, yes.

3 Q. Let me ask you to look beginning with the sentence
4 that he directed your attention to, which is the second
5 page of the article, where it says, "The AIG bailout also
6 dramatically extends the Fed's new role as last-resort
7 investor."

8 Do you see that?

9 A. Yes.

10 Q. And what did you mean by "last-resort investor"?

11 A. I used the term "investor" instead of a lender of
12 last resort in a very concerted way because in the case,
13 for example, of Bear Stearns, what they did, the Fed
14 ended up buying some -- de facto buying some assets of
15 Bear Stearns to facilitate the merger, which was not
16 simply a liquidity provision, was a taking, owning
17 de facto some assets. And I think that the idea of
18 owning some assets is -- again, I'm not a lawyer -- but
19 is beyond what the role of the Fed is about.

20 Q. And what significance, if any, does the reference
21 to "new role as last-resort investor" have to do with the
22 issue as to whether or not you assumed at that point in
23 time that AIG was or was not insolvent?

24 A. So the term "new" refers to the fact that my
25 understanding at the time and my understanding today is

1 that this is not a role of the Fed to buy assets from the
2 private sector. I think that my understanding of the
3 statute is not and also my understanding, most
4 importantly, my understanding of economic theory, it's
5 not a good idea for the Fed to start buying assets.
6 There are some people who claim this is a good idea, but
7 I'm not among those.

8 Q. The next sentence, which counsel did not direct
9 your attention to, says, "The structure of the loan
10 imitates private equity fund takeovers of bankrupt
11 companies."

12 Do you see that?

13 A. Yes, I do.

14 Q. And what significance, if any, does that
15 observation have to whether or not you assumed at this
16 time, back in 2009, that AIG was insolvent?

17 A. I think that the clear reference to bankrupt
18 companies suggests that at the time I was thinking that
19 AIG was bankrupt. Otherwise, I would not have written
20 that.

21 Q. Let me go down to the bottom of that page, where
22 there was a discussion of the great Australian --
23 Austrian economist, whose name I will not try to
24 pronounce, and the failure of obsolete business models?

25 A. Yes.

1 Q. What is the significance of that reference?

2 A. Clearly, from what we have seen now, AIG was not
3 an obsolete business model, so I think that the fact that
4 I say "the failure of obsolete business models" suggests
5 that I talk about, number one, failure, so is -- failure
6 means bankruptcy, and obsolete business model relates to
7 the fact that a business is not able to compete, is not
8 able to produce enough income to sustain its liabilities.
9 It is an insolvent business.

10 Q. You have said a number of times, in response to
11 various questions that counsel for defendant asked you,
12 that you assumed in 2008-2009 that AIG was insolvent.

13 What is the significance of that assumption; that
14 is, what is the significance in your analysis as to
15 whether or not AIG was or was not insolvent?

16 A. I think is an enormous importantly -- enormously
17 important assumption because that distinguish between two
18 states of the world. The good lender of last resort sort
19 of a doctrine, which I subscribe to -- and maybe it's
20 good because I subscribe to, but -- and the one I believe
21 is that follow the Bagehot principle, which is, you
22 should lend freely to solvent institution because in this
23 way the government is not substituting itself through the
24 private sector in taking sort of a risk and in making
25 decision where to allocate the money.

1 The moment the government starts to pick winner
2 and losers, we move closer to a socialist economy than to
3 a capitalist economy, and that's what my sort of end of
4 capitalism warning here is -- refers to.

5 On the other hand, we have learned over the
6 years -- and I think this is -- this is important, is
7 we've learned over the years that financial markets can
8 become illiquid, that panic do exist.

9 I actually I don't want to bother you with this,
10 but I recently wrote a paper showing how risk aversion
11 sort of jumped during this period and that sudden shift
12 in risk aversion creates illiquidities in the market, and
13 these illiquidities in the market need to be addressed by
14 an intervention of the central bank.

15 So I think that it's crucial to distinguish and I
16 know and I -- when counsel asked me is this a difficult
17 decision, I completely agree that the Fed had a difficult
18 decision to sort of determine which state of the world
19 you are in.

20 And I have all my sympathy for the people who made
21 this decision. The point here is not to say these people
22 are bad because they made the wrong decision. My
23 understanding -- and again, I'm not a lawyer, but my
24 understanding, here we are in determining the proper
25 allocation of property rights with the time, with the

1 benefit of the time that they did not have at the time.

2 So they made a decision in a hurry and that now we
3 are here to determine not whether they are right or wrong
4 but whether they -- what's the allocation of the property
5 rights.

6 Q. At the time that you were writing these articles
7 in 2008 and 2009, had you done an investigation as to
8 whether or not AIG was or was not solvent?

9 A. No, I did not do an investigation. And in fact, I
10 quoted -- I think it's in my -- I don't remember whether
11 it was sort of a letter to Mr. Geithner or Plan B. Maybe
12 it was my Plan B article, where I do say that I sort of
13 devised strategy for most of the problems that were
14 arising. I never devised strategy for AIG because I did
15 not understand AIG.

16 Q. Were you aware in 2008 and 2009 of the work that
17 the Federal Reserve had done to assess whether or not AIG
18 was solvent?

19 A. No.

20 Q. Let me ask you to turn to a subject that counsel
21 for the defendant asked you a lot about, which was
22 warrants, and in that connection I'd like to hand up a
23 book with some documents.

24 Do you recall yesterday counsel for the
25 United States asked you a number of questions about

1 warrants, including whether you'd seen a document that
2 conveyed a term sheet based on warrants to AIG? Do you
3 recall that?

4 A. Yes, I do remember.

5 Q. And I think you said you had not seen such a
6 document?

7 A. Yes.

8 Q. But you nevertheless told him that you had
9 concluded that AIG's expectation -- I think you said
10 clear expectation -- was that there would be warrants.
11 Do you recall that?

12 A. Yes, I do.

13 Q. Let me ask you to look at some of these documents
14 that are in this binder and ask you what significance, if
15 any, they have to the conclusion that you reached.

16 A. Okay.

17 Q. First, Plaintiffs' Trial Exhibit 86, which is
18 behind tab 1.

19 A. Okay.

20 Q. And is this a document that you reviewed in
21 connection with your work?

22 A. Yes, it is.

23 Q. Let me ask you -- and this is a term sheet that is
24 sent around by somebody from Davis Polk September 16 at
25 2:5 p.m.

1 Do you see that?

2 A. Yes.

3 Q. And if you go to page 3 of the exhibit, where the
4 heading says "Facility," do you see that?

5 A. Yes, I do.

6 Q. And do you see the second sentence there that
7 says, "In consideration of the Commitment," referring to
8 the credit commitment, "AIG will issue to [U.S. Treasury]
9 upon entering into the Agreement the Warrants described
10 below"?

11 A. You're looking at page 3.

12 Q. Page 3 of Exhibit -- Plaintiffs' Trial Exhibit 86.

13 A. Yes.

14 Q. Do you see the heading that says "Facility"?

15 A. Oh, yes. Okay, so sure.

16 Q. And do you see the second sentence?

17 A. Yeah. "In consideration of the Commitment, AIG
18 will issue to [U.S. Treasury] upon entering into the
19 Agreement the Warrants described below."

20 Q. And the reference to U.S. Treasury is in brackets;
21 correct?

22 A. Yes.

23 Q. But there's no brackets around "Warrants";
24 correct?

25 A. That's correct.

1 Q. And if you look in the next page, opposite the
2 heading Warrants, do you see the reference to "Warrants
3 for the purchase of common stock of AIG representing
4 79.9 percent of the common stock of AIG on a fully
5 diluted basis"?

6 A. Yes, I do see that.

7 Q. And what was the significance of this in terms of
8 your conclusions?

9 A. The significance is, when I respond to counsel, I
10 said I don't remember, and I think that this, this
11 document, is something sent by a lawyer of -- at Paul --
12 Davis Polk, so somebody who's working for the government,
13 to I think a bunch of people to -- and which described
14 clearly that there was a -- the term sheet included a
15 warrant and wasn't form to be determined, but it's
16 warrant.

17 Q. If you look at Joint Exhibit 64 that is behind
18 tab 2, you'll see this is a series of e-mails. The last
19 one is from Thomas Baxter to Scott Alvarez, September 16
20 at 2:15 p.m., and the subject is Revised AIG Term Sheet.

21 Do you see that?

22 A. Yes, I do.

23 Q. And did you know who Mr. Baxter and Mr. Alvarez
24 were during the time that you were doing your work?

25 A. Yes. Baxter and Alvarez are counsel for the

1 New York Fed.

2 Q. And what Mr. Baxter writes Mr. Alvarez is "Here it
3 is," referring to the revised AIG term sheet.

4 Do you see that?

5 A. Yes, I do.

6 Q. And if you turn to page 3, opposite the heading
7 Facility?

8 A. Sure.

9 Q. Do you see the same language that we saw before?

10 A. Yes. With the same bracket around "U.S. Treasury"
11 and no brackets around "the Warrants."

12 Q. And if you look at page 4 opposite the heading
13 Warrants, do you see the same language that we saw in the
14 earlier term sheet?

15 A. I do.

16 Q. Let me ask you to look next at Joint Exhibit 378.

17 A. Okay.

18 Q. Which is behind tab 3.

19 And this is from a Jeremiah Norton at the
20 Department of Treasury.

21 Do you see that?

22 A. I do see that.

23 Q. And it is dated September 16, 2008 at 3:21 p.m.

24 Do you see that?

25 A. I see that, sir.

1 Q. And if you turn to page 2 of the exhibit.

2 A. Yes.

3 Q. Opposite the word "Facility"?

4 A. Yes.

5 Q. You see the same language that we've seen in the
6 other two term sheets.

7 A. That's correct.

8 Q. And if you go to page 3, opposite the heading
9 Warrants, do you see the same language that we've seen
10 before?

11 A. Yes, I do.

12 Q. Now, if you turn to page 7.

13 A. Yes.

14 Q. Where you see Summary of Terms of Warrants?

15 A. Yes.

16 Q. Do you see the heading Shares Issuable Upon
17 Exercise?

18 A. Yes.

19 Q. And then you see down two items later Exercise
20 Terms?

21 A. Yes.

22 Q. And it says, "The warrants may be exercised in
23 whole or in part at any time during the period commencing
24 on the date of issuance and ending on the tenth
25 anniversary."

1 Do you see that?

2 A. That's correct.

3 Q. And what significance did this document, at least
4 the portion that I've shown you so far, because I want to
5 show you some additional portions, have in terms of your
6 analysis?

7 A. Again, that there are a lot of discussions and
8 term sheets sent back and forth indicating that the
9 government is intending to ask for warrants.

10 Q. Now, attached to the portion that I have just
11 shown you is what is sometimes referred to as a redlined
12 or blacklined version of an earlier term sheet beginning
13 at page 8 of this exhibit.

14 Do you see that?

15 A. Yeah.

16 Q. And what did you understand this document
17 beginning at page 8 to be?

18 A. My understanding is that this is sort of a draft
19 where they're making changes, so that's the reason why
20 it's sort of with the, let's say, cancellation mark.

21 Q. That is, certain portions are crossed out --

22 A. Yes, crossed out. Yeah.

23 Q. -- and other portions are added, and the portions
24 that are added are indicated by something -- by the
25 portion being underlined; is that correct?

1 A. That's correct.

2 Q. Now, if you go to the term "Facility"?

3 A. Yes.

4 Q. Do you see that the language "In consideration of
5 the Commitment, AIG will issue to [U.S. Treasury] upon
6 entering into the Agreement the Warrants described
7 below," that language is not changed?

8 A. Yes. It's not been crossed out at all.

9 Q. And if you go to the second page of this earlier
10 draft, which is page 9 of Joint Exhibit 378, do you see
11 up -- the language opposite the heading Warrants?

12 A. Yes, I do.

13 Q. And was it your understanding that that had or had
14 not been changed?

15 A. This has not been changed at all as far as I can
16 see.

17 Q. And what significance, if any, did this document
18 have to your analysis?

19 A. Clearly on the 16th there was some refining of
20 terms during the day, and the fact that other terms had
21 been refined but "warrants" remains there validates the
22 clear expectation of management that this will be
23 warrant.

24 Q. Now, let me ask you to look at Joint Exhibit 63,
25 which counsel for the defendant referenced in his

1 examination of you.

2 A. Okay.

3 Q. That's behind tab 4?

4 A. Yes.

5 Q. And what did you understand this to be?

6 A. These are the minutes of the Federal Reserve Board
7 meeting that approved the 13(3) facility.

8 Q. And if you go to page 5 of the exhibit, opposite
9 the heading Facility?

10 A. Yes.

11 Q. Do you see the same language that we've talked
12 about before about AIG issuing warrants?

13 A. That's correct.

14 Q. And if you go to page 6 of the exhibit, opposite
15 the heading Warrants, do you see again the same language
16 that we had seen in the earlier drafts of the press
17 release -- or the earlier drafts of the term sheet
18 concerning this heading?

19 A. Yes, that's correct.

20 Q. In your analysis, did you reach a conclusion one
21 way or the other as to whether the Board of Governors of
22 the Federal Reserve ever considered any other term
23 sheet?

24 MR. DINTZER: Objection, Your Honor. That can't
25 be an economic conclusion, about whether a body created

1 to manage the federal fisc considered something? I mean,
2 either they did or they didn't. That seems to be a
3 factual question, but to ask an expert witness whether
4 they reached a conclusion about that seems to be beyond
5 the scope.

6 MR. BOIES: Your Honor, I --

7 THE COURT: Beyond the scope?

8 MR. DINTZER: Beyond the scope of his expertise.

9 THE COURT: Oh. I think that he's exhibited a
10 very good grasp of the facts, and I think your
11 cross-examination obviously put this issue in play, so I
12 think it's a fair question.

13 MR. DINTZER: If I could, Your Honor, just ask
14 that it not be stated as a conclusion but as -- as
15 whatever observation, but that is not -- or at least that
16 the record reflect that it's not --

17 THE COURT: I think maybe you can rephrase and --

18 MR. BOIES: Your Honor, I think there may be a
19 misunderstanding as to what my question was.

20 THE COURT: Okay.

21 MR. BOIES: My question was: "In your analysis,
22 did you reach a conclusion one way or the other as to
23 whether the Board of Governors of the Federal Reserve
24 ever considered any other term sheet?"

25 So I wasn't asking for the Board of Governors'

1 conclusion. I was asking for his conclusion about what
2 the board had or had not considered.

3 THE COURT: All right. Go ahead.

4 THE WITNESS: In my analysis, my conclusion was
5 that the Fed did not analyze any other thing except
6 warrants.

7 BY MR. BOIES:

8 Q. And was that significant to you in reaching the
9 conclusion that you testified about that the clear
10 expectation of people involved in the process was that
11 the equity participation would be warrants?

12 A. Yeah. It was an important element in since
13 everything seems to point in the same direction. The Fed
14 approves warrants. These documents seem to indicate that
15 they're working with warrants. The audit committee
16 approved warrants. The outside counselor approved an SEC
17 release talking about warrants. And then the 21st when
18 there is the next meeting, the board is surprised that
19 they're not warrants.

20 So it seems to me that all point in the same
21 direction.

22 Q. Let me ask you next to go to Joint Exhibit 75,
23 which is behind tab 5.

24 And this is a document that counsel for the
25 defendant showed you, and he directed your attention to

1 the top of the page, where there's a reference to
2 Mr. Reeder, who has been identified I think as a lawyer
3 at Sullivan & Cromwell, is said to have requested that
4 the committee consider taking action pursuant to the
5 rules of the New York Stock Exchange to enable AIG to
6 issue, without shareholder approval, the warrants thought
7 to be contemplated in connection with a secured revolving
8 credit facility to be entered into between the
9 corporation and the Federal Reserve Bank of New York.

10 Do you see that?

11 A. Yes.

12 Q. Now, counsel for defendant suggested to you that
13 the phrase "thought to be contemplated" was somehow --
14 indicated an uncertainty as to whether the equity would
15 or would not be warrants.

16 Do you recall that?

17 A. I do recall his question, yeah.

18 Q. Let me direct your attention to the second whereas
19 clause that you did not have an opportunity to look at
20 during your earlier examination.

21 A. Uh-huh.

22 Q. Do you see that?

23 A. Yes, I do.

24 Q. And this is part of a resolution that the minutes
25 say was duly made, seconded and unanimously carried.

1 Do you see that?

2 A. Yes, I do.

3 Q. And that says, "Whereas, the Board" -- and do you
4 see by looking at the first whereas clause that
5 "the Board" is the board of directors of AIG?

6 A. Yes, I do.

7 Q. It says, "Whereas, the Board of Directors of AIG
8 has deemed it desirable and in the best interests of the
9 Corporation to enter into a secured credit facility," and
10 it describes that facility and then goes on and says "and
11 in connection therewith to issue warrants convertible
12 into 79.9 percent of the Corporation's common stock."

13 Do you see that?

14 A. I do see that.

15 Q. Did you believe that there was anything ambiguous
16 or uncertain about that resolution?

17 A. No. The resolution is clear in only one
18 direction.

19 Q. Now, in connection with the work that you did, did
20 you investigate whether, immediately after the
21 transaction became public, whether the public reports
22 referenced warrants or not?

23 A. Yes. I remember there was several articles, one
24 in particular in New York Times, mentioning warrants.

25 Q. Now, counsel for defendant showed you two press

1 releases, Defendant's Exhibit 419 which was the
2 Federal Reserve press release and Joint Exhibit 79 which
3 was the AIG press release the evening of September 16.
4 Do you recall that?

5 A. I do recall that.

6 Q. And he asked you whether the term "warrants"
7 appeared in either of those press releases. Do you
8 recall that?

9 A. I do remember that.

10 Q. Now, you may need to look at these to answer this
11 question. If you do, we'll find them.

12 A. Okay.

13 Q. But I just want to know whether you can answer
14 this from your memory or not.

15 Do you remember whether the press release, either
16 of those press releases, said anything about preferred
17 stock?

18 A. I don't remember that at all.

19 Q. Let me ask you to look at Defendant's Exhibit 419,
20 which is in the white book that counsel --

21 A. Sorry.

22 Q. -- for the United States gave you.

23 A. Maybe I mischaracterized my answer.

24 I -- I -- I don't -- I -- as far as I remember, I
25 didn't see that at all. That was -- "I don't remember

1 that at all" is -- meant I did not -- as far as I
2 remember, I don't remember it mention -- I don't see -- I
3 don't remember any term of preferred, but anyway.

4 Q. Okay. I think that may have been a language
5 issue.

6 A. Yeah.

7 Q. And do you recall whether or not either of those
8 press releases says "form to be determined"?

9 A. As far as I remember, no, there was no form to
10 be -- to -- form to be determined.

11 Q. Now, you mentioned a New York Times article.

12 Would you look at Plaintiffs' Trial
13 Exhibit 2736 that is behind tab 6.

14 A. Yes.

15 Q. And I would direct your attention to the second
16 paragraph, the next to last sentence, where it says, "The
17 government will have a warrant allowing it to take
18 79.9 percent the stock whenever it wants"?

19 A. Yes, I see that.

20 Q. Is this the article that you were referring to?

21 A. Yes, it is.

22 Q. Let me skip to tab 9 in the interest of time,
23 which is Joint Exhibit 355.

24 A. Yes.

25 Q. Is this one of the documents that you saw as part

1 of your analysis?

2 A. To be completely honest, I don't remember having
3 seen this particular where some of my associate look at
4 it.

5 Q. Let me pass this document then.

6 Let me just ask you, do you know who Chris Cole
7 is, the person who is writing the e-mail at the bottom of
8 the page?

9 A. In this moment it doesn't come to mind.

10 Q. Okay. Let me ask you to look next at Plaintiffs'
11 Trial Exhibit 1583.

12 Is this a document that you considered as part of
13 your analysis?

14 A. Yes.

15 Q. And this is a series of e-mails. The e-mail at
16 the top is an e-mail from Robert Pofsky at the
17 Federal Reserve to other people, also at the
18 Federal Reserve, dated September 16 -- dated
19 September 17, 2008 at 9:20 in the morning, and the
20 subject is September 16, 2008 AIG Announcement.

21 Do you see that?

22 A. Yes, I do.

23 Q. And this is after those two press releases that
24 counsel for defendant showed you had already gone out;
25 correct?

1 A. Yeah.

2 Q. And Mr. Pofsky writes, "I confirmed with
3 Stephanie Heller that while the Federal Reserve Bank of
4 New York has made the loan that is collateralized with
5 AIG assets, the warrant that will be issued for
6 79.9 percent equity interest in AIG will be owned by the
7 Treasury and not the Bank, so I don't feel we have a
8 consolidation issue."

9 Do you see that?

10 A. I do see that.

11 Q. And what was the significance of this in terms of
12 your analysis as to whether or not the clear expectation
13 of the parties was that the equity participation would be
14 in the form of warrants?

15 A. It's twofold. One, in -- if there was any
16 disagreement of the Fed with the fact that the previous
17 day there was an article about -- or no -- I think the
18 newspaper of that date there was an article about
19 warrants on The New York Times, they would have gone and
20 disconfirmed that. And second, the fact that even after
21 the 16th there's still an understanding of everybody
22 involved that the form of equity participation is a
23 warrant.

24 Q. Let me ask you to look at Joint Exhibit 86, which
25 is behind tab 11.

1 And is this a document that you considered as part
2 of your analysis?

3 A. Again, I don't remember having personally seen
4 that.

5 Q. Okay. Let me pass that then.

6 Let me ask you to look next at Plaintiffs' Trial
7 Exhibit 114 and in particular the e-mail at the bottom of
8 the first page of this exhibit, and I would ask you
9 whether that is an e-mail that you considered as part of
10 your analysis.

11 A. Yeah.

12 Q. And this is an e-mail chain that includes both
13 people representing AIG from Sullivan & Cromwell and
14 people representing the government; correct?

15 A. Yes, that's correct.

16 Q. And in the e-mail at the bottom, which is on
17 September 17, 2008 at 11:44 a.m., Mark Welshimer from
18 Sullivan & Cromwell writes to Bradley Smith and a number
19 of other people, "Brad, on a different subject (the voice
20 mail I left you regarding the insurance issues relating
21 to the warrant), Andy Rowen here heads our insurance
22 practice and has looked into this."

23 Do you see that?

24 A. I do see that.

25 Q. And what was the significance of this to your

1 analysis of whether there was a clear expectation on the
2 part of the parties that the equity participation would
3 be warrants?

4 A. I think this is quite important because here we
5 are on the 17th and we keep talking actively about
6 warrant, there's no other discussion of any other form of
7 equity, let alone of preferred shares.

8 Q. If you turn to tab 13 and Plaintiffs' Trial
9 Exhibit 116, is this a document that you considered as
10 part of your analysis?

11 A. Yes.

12 Q. And there is an e-mail at September 17, 2008 at
13 1:44 p.m. from HaeRan Kim to Mr. Baxter.

14 A. Yes, I do see that.

15 Q. That begins, "You mentioned that Treasury will get
16 warrants."

17 Do you see that?

18 A. Yes, I do.

19 Q. And then "Has this been finally decided? I'm on a
20 call with Davis Polk and our businesspeople, and they
21 seem not to know."

22 And then Mr. Baxter replies, "Lots of issues. I'm
23 in Tim's office, but there are many legal problems with
24 Treasury owning AIG."

25 Do you see that?

1 A. Yes.

2 Q. And what was the significance of this to your
3 conclusion that there was a clear expectation on the part
4 of the parties that the equity participation would be
5 warrants?

6 A. The fact that there is this e-mail exchange
7 reflects the fact that the Treasury and the Fed -- the
8 government was trying to issue warrants, but there were
9 some legal problems, so not only this sets an issue --
10 sets some evidence regarding the fact that the clear
11 expectation of everybody was warrants, but also starts to
12 point out the fact of one of the reason why maybe this
13 has been changed that there was some legal issue with the
14 warrants.

15 Q. Let me ask you to look at tab 14, Plaintiffs'
16 Trial Exhibit 122. And this is an e-mail and then there
17 is guidance attached to it.

18 Is this a document that you considered as part of
19 your analysis?

20 A. Yes.

21 Q. And this is, on the first page, a cover e-mail
22 dated September 17 at 4:20 p.m.

23 Do you see that?

24 A. I do.

25 Q. And it goes to a wide variety of Federal Reserve

1 people.

2 Do you see that?

3 A. Yes.

4 Q. And as part of your analysis, are there people
5 there that you can identify?

6 A. Yes.

7 Eric Rosengren is the head of the Boston Fed.

8 Charles Plosser is the head or I think of the --
9 one of the -- the Philadelphia Fed.

10 Jeffrey Lacker is the head of the Richmond Fed.

11 Thomas Hoenig is the head of maybe the Kansas Fed.

12 James Bullard is the head of the San Francisco
13 Fed.

14 Richard Fisher is the head of the Texas Fed.

15 Sandra Pianalto, I don't know who is she.

16 Janet Yellen, of course we know who she -- and she
17 must be at the time the head of the San Francisco Fed.

18 And then Donald Kohn was a vice chairman.

19 Alvarez was the legal counselor.

20 Randy Kroszner, by the way, is my colleague, was a
21 governor at the time.

22 And Elizabeth Duke and Kevin Warsh are two other
23 governor at the time.

24 Q. And the subject of this is Guidance on AIG
25 Announcement.

1 Do you see that?

2 A. Yes.

3 Q. And then if you turn to page 3 of this exhibit,
4 the last sentence, it says, "The U.S. government does not
5 'own' 79.9 percent of the company -- it has warrants, as
6 you know."

7 Do you see that?

8 A. I do see that.

9 Q. And what was the significance of that to your
10 conclusion?

11 A. Actually has two significances. One is that,
12 again, here it's the 17 late in the afternoon and the
13 government thinks that they're going to issue warrants.

14 The second is that had they not received warrants,
15 they will feel like they own the company, so I think that
16 I can infer that the U.S. government must be thinking
17 that if it had preferred shares or anything else as
18 equity participation, they might own the company.

19 Q. Let me ask you to turn next to Plaintiffs' Trial
20 Exhibit 127, which is behind tab 15.

21 A. Yes.

22 Q. Is this a document that you considered as part of
23 your analysis?

24 A. Yes.

25 Q. And this is a series of e-mails beginning from

1 Maria Grace Ambrosio on the second and third pages and
2 then continuing, and all of these e-mails are on
3 September 17, 2008; correct?

4 A. Yes.

5 Q. And can you tell the Court what significance, if
6 any, you attached to this series of e-mails?

7 A. Oh, this series of e-mail, they're all talking
8 about warrants. In fact, the heading of some are -- is
9 regarding warrants. And then there is a discussion of
10 whether they can take warrant, who can take warrant.

11 So one sentence is "I heard that there are problem
12 with Treasury taking warrants, but I don't know what the
13 final decision is," so this is in the spirit of what I
14 was saying earlier. There was a clear understanding that
15 they were issuing warrants, but they started to find
16 problems about who will own the warrants and how.

17 Q. Let me ask you to look next at Plaintiffs' Trial
18 Exhibit 130, which is behind tab 16.

19 Is this a document that you considered as part of
20 your analysis?

21 A. Yes.

22 Q. And what did you understand this document to
23 represent?

24 A. These are notes of a meeting with the counselor of
25 the Fed and this is sort of what they -- the conversation

1 was about.

2 Q. And the counselor of the Fed that you're referring
3 to there is Mr. Scott Alvarez; is that correct?

4 A. That's correct.

5 Q. And if you would just look at the bottom bullet
6 where it says, "Value of the warrant will appear on the
7 balance sheet as an asset," do you see that?

8 A. I do see that.

9 Q. And then it goes on to say, "The warrant likely
10 will be revalued quarterly"?

11 A. Yes.

12 Q. What was the significance of that?

13 A. So this is the Fed trying to cope with the legal
14 and accounting issues that the ownership of warrants will
15 bring to the table, and so if they are spending so much
16 time and resources to do so must mean that they're
17 thinking this is the outcome, that they were going to get
18 warrants.

19 Q. Behind tabs 17 and 18 we have some publications
20 that have been marked as Plaintiffs' Trial Exhibits 131
21 and 1593. In the interest of time, let me skip those
22 and direct your attention to Plaintiffs' Trial
23 Exhibit 142 that's behind tab 19.

24 A. Okay.

25 Q. Is this a document that you considered as part of

1 your analysis?

2 A. Yes.

3 Q. And if I can direct your attention to page 2,
4 where there is an e-mail, and this one is dated
5 September 18 at a little bit after noon.

6 Do you see that?

7 A. Yes.

8 Q. And this is a reply to an e-mail that
9 Scott Sherman had sent; correct?

10 A. Yes.

11 Q. And the -- Mr. Sherman had sent an e-mail on the
12 pricing of the AIG loan; correct?

13 A. Yes.

14 Q. And in particular with respect to the interest
15 rate; correct?

16 A. Yes.

17 Q. And the reply says, "Nice Scott, unfortunately
18 this makes sense. My initial reaction when I heard that
19 interest rate was 'huh?!' It seems totally unnecessary
20 given the warrant for 79.9 percent ownership. I
21 understand LIBOR plus (maybe 200?) as an incentive to
22 expedite asset sales but LIBOR plus 850?!! Who did that?
23 And why?!"

24 What did -- what significance, if any, did this
25 have to your conclusion about warrants?

1 A. So clearly the fact that here we are on the 18th
2 and at the beginning of the afternoon on the 18th and the
3 presumption is still that they are using warrant.

4 But can I add one thing?

5 Q. If it's relevant to my question.

6 A. Okay. Then I pass.

7 Q. And I don't mean in any way to cut you off, but
8 we've got a lot of ground to cover and I'd like to just
9 proceed as directly as I can.

10 Let me ask you to look at Plaintiffs' Trial
11 Exhibit 148, which is behind tab 20?

12 A. Yes.

13 Q. Is this a document that you considered as part of
14 your analysis?

15 A. Yes.

16 Q. And what did you understand this to be?

17 A. These are the minutes -- the actual minutes of a
18 board -- no. Actually this is a conference call that AIG
19 had.

20 Q. Over on the left-hand column, do you see the
21 identification of the participants?

22 A. Yes. There is -- there are a bunch of people from
23 Davis Polk, Ethan James, Randy -- I don't remember the --
24 that spelling -- and then a bunch of people at Treasury.
25 And "TB" should be Tom Baxter.

1 Q. And one of the Davis Polk lawyers that you
2 identified was Ethan James. Do you recall that?

3 A. Yes.

4 Q. If you look at the second note on the first page
5 that says --

6 A. Yes.

7 Q. -- "Ethan:"?

8 A. Uh-huh.

9 Q. "May be issues with warrants at AIG." And then
10 there's a little arrow and it says "may need shareholder
11 approval." And then there's another arrow and it says
12 "convertible preferred shares."

13 Do you see that?

14 A. Yes, I do.

15 Q. And then down at the bottom, there's a reference
16 from Marshall Huebner.

17 Do you see that?

18 A. Yes.

19 Q. And it says "does Fed care who gets benefit of
20 warrant: Fed or Treasury?"

21 Do you see that?

22 A. Yes.

23 Q. What was the significance, if any, to your
24 analysis of this?

25 A. So, again, we are the 18th and the conversation

1 focuses mostly on warrants and now for the first time the
2 word "convertible preferred" appears as a potential
3 solution to sort of some legal issues.

4 Q. Now let me ask you to look at page 21 -- or
5 tab 21, Joint Exhibit 96.

6 And is this the 8-K that you identified in your
7 testimony with respect to counsel for the United States?

8 A. Yes.

9 Q. And as you understand it, when was this 8-K filed?

10 A. So my recollection is that this 8-K was filed --

11 Q. Rather than trying to have you draw that from
12 memory, I can direct your attention to the third page
13 that indicates the date it was filed.

14 A. Okay. But I -- okay.

15 So the date is the 18th.

16 Q. And if you look on page 2, the third paragraph,
17 where it says, "In connection with the revolving credit
18 facility, AIG issued a warrant to the Board of Governors
19 of the Federal Reserve that permits the Federal Reserve,
20 subject to shareholder approval, to obtain up to
21 79.9 percent of the outstanding common stock of AIG," do
22 you see that?

23 A. Yes, I do.

24 Q. What was the significance, if any, of this
25 document to your conclusion that there was a clear

1 understanding among the parties that the equity component
2 would be warrants?

3 A. SEC filings are important -- very important
4 documents. People can be sued if they declare something
5 that is incorrect, so a lot of attention is put in having
6 this document formally and substantially correct.

7 And to issue this, I imagine that the top-level
8 corporate lawyers inside the firm and the outside counsel
9 got together and drafted and reviewed this document, so
10 the fact that in this document they mention warrants
11 suggests that this was clearly the understanding of all
12 the parties involved, because it would have been safer to
13 keep it more vague if there was any understanding that it
14 was something other than warrant.

15 Q. Now, you are aware that another 8-K was filed the
16 following day; correct?

17 A. Yes, I'm aware of that.

18 Q. And counsel for the United States asked you, if
19 you file an 8-K that is erroneous, do you need to correct
20 it, and you said of course you do.

21 A. Yes. I remember that.

22 Q. And you also said that the 8-K that is
23 Joint Exhibit 96 was erroneous to the extent it said that
24 a warrant had been issued as opposed to would be issued.

25 Do you see that?

1 A. Yes, I do.

2 Q. Now, when the new 8-K was filed on September 19,
3 did that 8-K simply correct that issue, or did it go
4 further than that?

5 A. No, it went further than that.

6 Q. In what way?

7 A. So it was not simply saying that, oh, has not been
8 issued, was basically retracting on the fact that the
9 form of participation will be a warrant.

10 Q. Let me ask you to look at a document behind
11 tab 22 that is Plaintiffs' Trial Exhibit 160.

12 Do you see that?

13 A. Yes, I do.

14 Q. And is this a document that you reviewed as part
15 of your analysis?

16 A. Yes.

17 Q. And this is an e-mail chain going from
18 Robert Pofsky of the Federal Reserve System to a variety
19 of other Federal Reserve personnel.

20 Do you see that?

21 A. Yes, I do.

22 Q. And the subject is Summary of AIG Accounting
23 Meeting.

24 Do you see that?

25 A. In the next page, yeah.

1 Q. And indeed on the cover e-mail page, the subject
2 of the e-mail.

3 A. Yeah. Subject, yeah.

4 Q. And the e-mail says, "Attached is a summary of
5 what was discussed at the September 18 meeting."

6 Do you see that?

7 A. Yes, I do.

8 Q. And if you turn to the summary itself, do you see
9 under Accounting Considerations?

10 A. Yes.

11 Q. (as read) Treatment of the loan and related fees,
12 originated -- origination costs, accounting for the
13 warrants, and most importantly whether this transaction
14 can be accounted for simply as a loan or as a "business
15 combination" with consolidated financial statement
16 implications now or upon exercise of the warrants if that
17 occurs.

18 Do you see that?

19 A. Yes, I do.

20 Q. And then if you go to the next page, the third
21 bullet, where it says, "If ownership, upon exercise of
22 the warrants, is less than a majority interest, the
23 investment in AIG could be accounted for based on the
24 equity method."

25 Do you see that?

1 A. Yes, I do.

2 Q. And down at the bottom of the page, the last
3 bullet says, "The warrants should be recorded at fair
4 value."

5 Do you see that?

6 A. Yes, I do.

7 Q. What significance, if any, did this document have
8 to your conclusion that initially the clear contemplation
9 of the parties was that the equity for the loan would be
10 warrants?

11 A. So, again, here we are on the 19th and the Fed is
12 working out the accounting issues that the issuance of a
13 warrant will generate, so that means that the expectation
14 was still that warrants will be issued.

15 Q. Let me ask you to look next behind tab 23 at
16 Plaintiffs' Trial Exhibit 173.

17 A. Yes.

18 Q. And is this a document that you considered as part
19 of your analysis?

20 A. Yes.

21 Q. And this is a transcript of an AIG town hall
22 presentation that Mr. Liddy made at noon on September 18,
23 2008; correct?

24 A. Yes.

25 Q. And let me direct your attention to page 9 at the

1 top, the second full sentence, where Mr. Liddy says, "We
2 can restore that provided we can get through, pay off the
3 revolver, give the government some sort of a return on
4 its warrants, and then have a company that emerges from
5 this that really is fit to fight."

6 Do you see that?

7 A. Yes, I do.

8 Q. And if you look at page 11, in the middle of the
9 page there's a paragraph that begins, "So I'd like to
10 tell you that within reason."

11 Do you see that?

12 A. Page 11.

13 Q. Page 11, middle of the page.

14 A. Yes.

15 Q. The last couple of sentences in that paragraph, it
16 says, "That's why they lent us the money. I think they'd
17 like nothing better than to make \$20 billion or
18 \$30 billion or \$40 billion on the warrants that they
19 have."

20 Do you see that?

21 A. Yes, I do.

22 Q. And this was after Mr. Liddy was the chief
23 executive officer of AIG; correct?

24 A. Yes.

25 Q. And what was the significance, if any, of this

1 document to your analysis?

2 A. I think several important points. The first one
3 is, Liddy as of September 18 noontime still has the
4 belief, the clear expectation, that warrants will be
5 issued, and that's why that is communicated to -- to
6 employees, and so on.

7 The second point is, the call from the U.S.
8 government regarding the wrong filing had already took
9 place at that time, so the -- in spite of the correction,
10 Liddy insists that this is warrants, so this suggests
11 that the -- he felt he made a mistake on saying issued,
12 but he didn't make a mistake on warrants, otherwise will
13 have corrected here.

14 Q. Let me ask you to look last in this chain of
15 documents at tab 24, Joint Exhibit 103.

16 A. Yes.

17 Q. And if you look on page 3 -- and this is the
18 minutes of the AIG board of directors meeting on
19 September 21, 2008; correct?

20 A. Yes. I do recognize them, yes.

21 Q. And nine lines down from the top on the third
22 page, do you see a sentence that begins "It was noted?"

23 A. Yes.

24 Q. And these are the minutes of the AIG board of
25 directors meeting when they approved the credit

1 agreement; correct?

2 A. That's correct.

3 Q. And it says, "It was noted that although the Board
4 had originally been led to believe that the form of
5 equity participation by the Treasury Department would be
6 warrants, the form of equity participation to be issued
7 in connection with the Credit Agreement is now proposed
8 to be convertible preferred stock, the terms of which
9 were reflected in a term sheet delivered to Board members
10 prior to the meeting."

11 Do you see that?

12 A. Yes, I do.

13 Q. And then there's a sentence that says, "Mr. Reeder
14 also noted that there had been significant negotiations
15 with the Bank and its counsel."

16 And then the minutes say the "Members of the Board
17 noted that the change from warrants to preferred stock
18 would give the Bank current voting rights and would not
19 require shareholder approval to the issuance."

20 Do you see that?

21 A. Yes, I do.

22 Q. What was the significance, if any, of these
23 minutes to your conclusion that initially there was a
24 clear understanding that the agreement for equity was an
25 agreement for warrants?

1 A. So I think this is very important.

2 First of all, the counsel say "the Board had
3 originally been led to believe," so not only the board
4 believed but had been led to believe, so means that the
5 counterparty gave sign that that was what they wanted and
6 that was the understanding.

7 So the board had operated in the decision on the
8 16th on the basis that was warrant, and now the board
9 noted that the change from warrant to preferred stock
10 would be -- would be materially different. In spite of
11 what Ed Liddy said, it was materially the same, the board
12 noted that it makes a difference because it would give
13 the bank voting rights immediately and would not require
14 shareholder approval to the issuance.

15 So those are two of the points I raised in even my
16 exhibits, in my demonstrative, because the board itself
17 noticed that at the time.

18 Q. Let me turn to a related subject that comes off of
19 your last comment.

20 And counsel for the United States asked you a
21 number of questions about the fact that the shares of
22 stock were not actually issued until March of 2009 and
23 the trust was not formed until January of 2009. Do you
24 recall that?

25 A. Yes, I do.

1 Q. Did the right of the government to have the
2 preferred stock as an economic matter, in your judgment,
3 effect control prior to the time the stock was actually
4 issued?

5 A. Yes. Absolutely.

6 Q. Why is that?

7 A. Because if you have the right to receive voting
8 rights at your discretion is as if, for all practical
9 purposes, unless there is explicit vote, for all
10 practical purposes is the same.

11 Q. Let me turn next --

12 THE COURT: Is this a good time for a morning
13 break?

14 MR. BOIES: Yes, it is, Your Honor.

15 THE COURT: All right. Let's reconvene at 11:15.

16 (Court in recess.)

17 THE COURT: Let's go ahead.

18 MR. BOIES: Thank you, Your Honor.

19 BY MR. BOIES:

20 Q. Professor Zingales, would you turn to
21 Joint Exhibit 107, which I believe is in the white book
22 that you were given by counsel for the United States.

23 A. Okay.

24 Q. Now, do you recall that counsel for the
25 United States suggested to you that the requirement that

1 AIG's corporate governance be satisfactory only came into
2 being once the shares of preferred stock had been issued?
3 Do you recall that?

4 A. I do.

5 Q. And if you look at page 138 of Joint Exhibit 107,
6 it says next to Governance -- Joint Exhibit 107 page 138.

7 A. Yes.

8 Q. It says, "AIG and its board will work in good
9 faith with the trustees of the Trust to ensure corporate
10 governance arrangements satisfactory to the trustees."

11 Do you see that?

12 A. Yes, I do.

13 Q. Now, that assumes that there are trustees;
14 correct?

15 A. Yes.

16 Q. But it does not condition this on the issuance of
17 the stock.

18 Do you see that?

19 A. Yes.

20 Q. Now, in addition to the obligation to work with
21 the trustees, I'd like to direct your attention to
22 page 36 of the credit agreement.

23 A. Okay.

24 Q. And section 4.01(e)?

25 A. Uh-huh.

1 Q. And these are conditions of lending; correct?

2 A. Yes.

3 Q. And the Federal Reserve Bank does not have to
4 lend, is that your understanding, if the conditions are
5 not met?

6 A. That's correct.

7 Q. Let me ask you to look at section 4.01(e) where it
8 says, "The Lender shall be reasonably satisfied in all
9 respects with the corporate governance of the Borrower
10 after giving effect to the Transactions then
11 consummated."

12 Do you see that?

13 A. Yes, I do.

14 Q. What significance, if any, does that have to your
15 conclusions?

16 A. It suggests that the requirement of the credit
17 agreement regarding corporate governance is not
18 conditional on the issuance of the preferred stock. It
19 is conditional on the transaction being consummated.

20 MR. BOIES: I'm going to turn to another subject,
21 but before I do, I have been told, Your Honor, that
22 Plaintiffs' Trial Exhibit 86 and Plaintiffs' Trial
23 Exhibit 1583 -- Plaintiffs' Trial Exhibit 86 is at tab 1
24 and Plaintiffs' Trial Exhibit 1583 is at tab 10 of the
25 binder that I handed out -- those two documents I'm told

1 have not yet been admitted into evidence, and I would
2 offer those two.

3 THE COURT: Tell me the tab again for
4 Joint Exhibit --

5 MR. BOIES: Tab 1 is Plaintiffs' Trial Exhibit 86.

6 THE COURT: Oh, 86.

7 MR. BOIES: And tab 10 is Plaintiffs' Trial
8 Exhibit 1583.

9 THE COURT: All right.

10 MR. DINTZER: We're looking, Your Honor. We
11 believe that -- whoop. Oh, okay. I take that back.

12 To PTX 86 we have no objection, Your Honor.

13 With -- tab 10; is that right, counsel?

14 MR. BOIES: Yes.

15 MR. DINTZER: We have no objection, Your Honor.

16 THE COURT: All right. Without objection,
17 Plaintiffs' Trial Exhibits 86 and 1583 are admitted.

18 (Plaintiffs' Exhibit Number 86 was admitted into
19 evidence.)

20 (Plaintiffs' Exhibit Number 1583 was admitted into
21 evidence.)

22 BY MR. BOIES:

23 Q. Let me turn next to a series of questions that
24 counsel for the United States asked you about whether the
25 AIG board had a duty to use their best judgment to decide

1 whether to go with a Federal Reserve loan or bankruptcy.

2 Do you recall those questions generally?

3 A. Yes, I do.

4 Q. Does the question of the board's duty to use its
5 best judgment and the extent to which the board fulfilled
6 that duty -- is that relevant to the question of
7 effective economic control?

8 A. No, it's not relevant.

9 Q. Why not?

10 A. For two reasons.

11 First of all, in situation in which you have only
12 one choice, whether this is the best choice, the worst
13 choice, is the only choice, so you exercise your best
14 judgment, sure. If the only choice, you exercise your
15 judgment and you make that choice, so in those situation
16 clearly doesn't make a difference.

17 Now, even in another situation, if I -- if there
18 is a party with a veto power, I know that I'm trying to
19 do my best conditional on the veto power.

20 So if I am a congressman and I know that the
21 president will veto a law, I use my best judgment in
22 trying to pass the law which it get -- does not get
23 vetoed by the president, so does it mean that I don't
24 exercise my best judgment because I don't vote for the
25 law that in principle will be the best one? No. Because

1 I do my best conditional on the constraint I have.

2 So if there are some outside constraint, for
3 example, the power of the lender, then I exercise my best
4 judgment, but that doesn't mean that the other side does
5 not have some control over me.

6 Q. In that connection, you mentioned that there had
7 been a counsel for AIG that had given an opinion that the
8 business judgment rule would no longer protect a choice
9 of bankruptcy as of September 21. Do you recall that?

10 A. Yes, I do recall that.

11 Q. What significance, if any, does that have to the
12 question of choice and the question of effective economic
13 control?

14 A. Both as a scholar and as a board member, I would
15 say that if you are told that you cannot be protected by
16 the business judgment rule in making a decision, you
17 should not go down that territory since the potential
18 liability for you is so large that basically that makes
19 it an unfeasible choice from your point of view.

20 Q. Now, with respect to the issue of bankruptcy,
21 counsel for the United States showed you Mr. Willumstad's
22 deposition. Do you recall that?

23 A. I do.

24 Q. And he showed you -- I think he showed you
25 pages 260 and 261 of his deposition. Do you still have

1 that up there?

2 It was a pretty thick --

3 A. This one (indicating).

4 Q. Because I think he gave you the entire --

5 A. Yes, I do.

6 Q. My recollection is that this was not marked as an
7 exhibit, and just so that we have a way of identifying it
8 in the record -- what's our next exhibit number? -- I
9 would mark it as Plaintiffs' Trial Exhibit 2859.

10 Now, if you look at the pages of the deposition --
11 I'm going to use the pages of the deposition, not the
12 pages of the exhibit -- if you look at pages 260 and 261,
13 are those the pages that counsel for the defendant
14 directed your attention to?

15 A. Yes.

16 Q. And you see the question begins:

17 "QUESTION: What did he," Mr. Geithner, "say when
18 you told him you were planning on filing for bankruptcy?"

19 "ANSWER: I don't remember specifically what he
20 said." And then Mr. Willumstad goes on to say what he
21 does remember.

22 A. Yes.

23 Q. And counsel for the United States asked you
24 whether there was anything there where Mr. Willumstad
25 said that he had been asked not to file for bankruptcy.

1 A. I remember that.

2 Q. And he directed your attention to an earlier
3 version of a chart that you had prepared, not one you
4 testified about but an earlier version, in which you had
5 said, "Defendant tells Willumstad not to draw down on
6 credit lines, not to file for bankruptcy"?

7 A. I do remember that.

8 Q. And counsel for the defendant then suggested that
9 you didn't have any basis for saying that Mr. Willumstad
10 had been told not to file for bankruptcy. Do you recall
11 that?

12 A. I do recall that.

13 Q. Let me hand up Exhibit 709. This is
14 Mr. Geithner's book. And I'm going to just hand up a --
15 one page from that book. If anybody wants you to have
16 additional pages, we'll furnish them. I've got the
17 entire book here.

18 A. You even got the autographed copy.

19 Q. Yeah. No extra charge.

20 A. There was also a dedication?

21 Q. No.

22 If I can direct your attention to page 194 of the
23 book, where Mr. Geithner is talking about that, and he
24 says, "While we were considering whether to act, we
25 learned that AIG was preparing to file for bankruptcy. I

1 immediately called Willumstad. 'Don't do that yet,' I
2 said."

3 Do you see that?

4 A. Yes, I do.

5 Q. And what significance, if any, does that have to
6 the material that you had on your superseded chart that
7 you were asked about?

8 MR. DINTZER: Objection, Your Honor. I don't have
9 a problem with counsel asking the witness the question,
10 but I would like -- he hasn't asked the witness if the
11 witness actually saw this and relied on this before he
12 made his chart or when he -- actually when he came to his
13 conclusion in the case.

14 THE COURT: Or if he was aware of the statement.

15 BY MR. BOIES:

16 Q. First let me ask, were you aware personally of
17 this statement in the -- Mr. Geithner's book?

18 A. Yeah. I read the relevant chapter of
19 Mr. Geithner's book and I thought were very interesting.

20 Q. Let me ask you to turn next to the subject that
21 counsel asked you about --

22 A. Sorry. So the previous question about the
23 relevance is -- is not --

24 Q. Thank you. I let myself get distracted by the
25 objection.

1 What is the relevance or significance, if any, to
2 your analysis of the exchange between Mr. Geithner and
3 Mr. Willumstad that Mr. Geithner reflects?

4 A. So in this statement it's clear indicated that
5 Geithner told explicitly Willumstad not to -- not to
6 file. In his testimony, he sort of did not remember
7 clearly one way or another, and Geithner does remember
8 clearly and he writes in his book, so I took in my slides
9 this as a fact that I could rely upon.

10 And it's indicative because over the day of the
11 16th we have seen that there are several intervention of
12 the government that tends to limit the outside option.
13 And remember, had they filed for bankruptcy on the 16th,
14 the first 14 billion would have not gone out, and so
15 there was a compelling reason to file for bankruptcy to
16 stop the bleeding of cash during that period.

17 Q. And how much additional cash had bled, to use your
18 term, by the time the board considered the credit
19 agreement draft the evening of September 21?

20 A. 37 billion.

21 Q. Now let me turn to the subject of the
22 Chinese Investment Corporation. And counsel for
23 defendant asked you a number of questions. I think he
24 drew a picture of a plane and suggested to you that you
25 had not seen any evidence that someone in absolute

1 authority at CIC had made a decision. Do you recall
2 that?

3 A. I do remember that.

4 Q. What is the significance, if any, of that fact to
5 your analysis? That is, whether you had seen any
6 evidence that someone in absolute authority at CIC had
7 made a decision.

8 A. The important point, in my view, is not so much
9 whether CIC had decided to invest that moment. The
10 important point is that the Treasury blocked that
11 possibility, and so that stop indicates two things. One,
12 indicates that the government intervened heavily in the
13 process. And two, this news traveled fast.

14 If the government stopped the Chinese, probably
15 also from Singapore people will not have wanted to
16 invest, so other so and well funds will be less
17 interested in even trying because of that.

18 Q. Counsel also asked you whether AIG had been
19 prevented from contacting the Chinese directly. Do you
20 recall that?

21 A. Yes, I do.

22 Q. As you understood it, did the government pass on
23 to AIG any information about the expression of interest
24 by the Chinese in CIC?

25 A. To my understanding, it didn't.

1 Q. And what is the significance, if any, of that to
2 the conclusions you've reached?

3 A. Again, as I said yesterday, information is an
4 important resource. The government had this information
5 and use it in a way that cut off outside option for AIG
6 rather than trying to build outside options.

7 Q. Let me turn to another point that was discussed
8 with counsel for defendant.

9 You were asked whether in unusual and exigent
10 circumstances there will be some monopoly power with
11 respect to the lender of last resort. Do you recall
12 that?

13 A. Yes, I do.

14 Q. And you said that there was; correct?

15 A. Yes.

16 Q. Does the degree of monopoly power vary with the
17 circumstances?

18 A. Absolutely.

19 Q. In what way?

20 A. I will say that the more unusual and more exigent
21 the circumstances are, the bigger is the monopoly power,
22 so if there is a slight friction in the marketplace, the
23 lender of last resort can benefit, but not tremendously.
24 If there is a total collapse like we have seen during
25 that week, then you're really the only game in town and

1 the alternatives are not there, so the result is that
2 your power is very strong.

3 Q. And when you say "like we have seen during that
4 week," what week are you referring to?

5 A. I'm referring to the week of from the 16th to the
6 21st of September 2008.

7 Q. You also told counsel for the defendant that
8 refusing to negotiate by itself does not always show
9 effective economic control. Do you recall that?

10 A. Yes, I do.

11 Q. What does show effective economic control?

12 A. Again -- sorry -- in my distinction between input
13 and output, you want to look at the output and not at the
14 input; right?

15 Q. Let's do both, but do it in whatever order you
16 think makes the most sense.

17 A. Okay. So in term of input is -- the thing is more
18 clear-cut because you look at whether you have control
19 over a resource which is crucial to the organization.

20 So in this case, is liquidity important? Yes. Do
21 you have a monopoly on liquidity? Yes. So do you have
22 control? Yes.

23 In term of an output is the ability to extract
24 most of the surplus or all the surplus in a negotiation,
25 and so the ability to make a take-it-or-leave-it offer

1 might be a sign. Now, people can in some situation bluff
2 and make a take-it-or-leave-it offer when they can't, so
3 by itself, the take-it-or-leave-it offer is not a proof
4 that you are in control, but it's certainly consistent
5 and one of the indicia of control.

6 Q. Did you consider the question of the extent to
7 which, if any, the government considered whether or not
8 it was acceptable to allow AIG to file for bankruptcy?

9 A. From the statements I review, and certainly
10 Geithner in his book goes out of the way in saying that,
11 they say that would be terrible for the overall system if
12 AIG were to go bankrupt.

13 Q. What significance, if any, does that have to the
14 question of whether a take-it-or-leave-it offer or
15 refusal to negotiate is a demonstration of effective
16 economic control?

17 A. So it depends on the information set of the other
18 side in the sense if the other side knew that the
19 government felt -- if -- to be precise, if AIG knew that
20 the government was -- or the AIG board -- that the
21 government would not have let this happen, I think that
22 the AIG board should have behaved in a different way.

23 And if I remember correctly, I think
24 Stephen Bollenbach raised this potential issue the 21st.
25 And I think that at the time, the board had just seen

1 Lehman go under, and so they thought that the government
2 was credible when they said: We don't negotiate. This
3 is a take-it-or-leave-it offer. If you don't say yes,
4 we're going to let you go under.

5 Q. To what extent, if any, is it important to
6 consider a refusal to negotiate in the context of other
7 criteria of effective economic control?

8 A. So one of the characteristic of effective economic
9 control is to be in a monopoly power. If you have
10 monopoly power, you dictate the rule.

11 If you are in a market transaction, then you
12 negotiate a transaction, unless like it's a fully
13 competitive market where you take prices given. But in a
14 relationship like this one, in a one-to-one relationship,
15 if you have viable alternative, you should see some
16 negotiation taking place. It is only if you are
17 completely controlled by the other party that you take
18 the terms without even trying to modify them in any way.

19 Q. Let me turn to the subject of Maiden Lane III.

20 A. Yes.

21 Q. And first, in connection with Maiden Lane III, I
22 want to talk about the issue of concessions or haircuts
23 to be negotiated from the counterparties. And do you
24 recall counsel for the United States asking you about
25 that?

1 A. Yes, I do remember.

2 Q. And you were asked whether you had attempted to
3 quantify the concessions that would have been achievable.
4 Do you recall that?

5 A. Yes, I do.

6 Q. Is a quantification of the concessions that would
7 have been achievable important to your conclusion as to
8 whether or not the government had effective economic
9 control over AIG?

10 A. No. I think what is crucial is the fact that
11 there wasn't a serious attempt at negotiating, which was
12 consistent with a goal of the government to stabilize the
13 economy but was not consistent with a goal of a party
14 trying to maximize the value of a AIG -- the value of
15 AIG.

16 And I -- I'm not in a position to say today, today
17 how much they would have given up. That's very hard to
18 determine, but the fact that they didn't try is
19 inconsistent with maximizing the value of AIG.

20 Q. Let me ask you to look at Plaintiffs' Trial
21 Exhibit 549, which I will hand out.

22 A. Sorry. I don't have it?

23 Q. You do not have it.

24 A. Okay.

25 Q. Which I am told is already in evidence.

1 A. Thank you.

2 Q. And again, this is an excerpt, and if you need to
3 see the full document, we can furnish that to you.

4 Is this a document that you saw in connection with
5 your analysis?

6 A. Yes.

7 Q. Let me ask you to look at the top of page 30.

8 And if you look at page 29, you will see that this
9 has to do with whether the Federal Reserve sought to
10 benefit AIG's counterparties?

11 A. Uh-huh.

12 Q. And then at the top of page 34 of Plaintiffs'
13 Trial Exhibit 549, this report states, "Questions have
14 been raised as to whether the Federal Reserve
15 intentionally structured the AIG counterparty payments to
16 benefit AIG's counterparties -- in other words that the
17 AIG assistance was in effect a 'backdoor bailout' of
18 AIG's counterparties. Then-FRBNY President Geithner and
19 FRBNY's general counsel deny that this was a relevant
20 consideration for the AIG transactions. Irrespective of
21 their stated intent, however, there is no question that
22 the effect of FRBNY's decisions -- indeed, the very
23 design of the federal assistance to AIG -- was that tens
24 of billions of dollars of Government money was funneled
25 inexorably and directly to AIG's counterparties."

1 Do you see that?

2 A. Yes, I do.

3 Q. What significance, if any, does that have to the
4 point that you were making earlier concerning maximizing
5 the value of AIG as opposed to acting with a government
6 goal of stabilizing the economy?

7 A. I think it's important to notice that it's not
8 only me but also the government itself in the -- in sort
9 of the role in this case of SIGTARP that notices that not
10 only the effect, so it's not only an unintended
11 consequence, but the very design is designed to provide
12 resource to the counterparties.

13 This, as I said earlier, this in sharp contrast
14 with what the government had done in other situations, so
15 when it came to General Motors and Chrysler, the
16 government was not shy of asking important concession to
17 bondholders, so it's really striking the difference here.

18 Q. Now, in this connection, counsel for the
19 United States also directed your attention to
20 Joint Exhibit 144 that is in your white binder, and I
21 would also like to direct your attention to that.

22 A. Okay.

23 THE COURT: Mr. Boies, did you say whether
24 Plaintiffs' Trial Exhibit 549 is in evidence or not?

25 MR. BOIES: I believe it is in evidence.

1 THE COURT: Okay. Thank you.

2 MR. BOIES: Thank you.

3 BY MR. BOIES:

4 Q. And this discussion arose in the context of one of
5 the slides that you had prepared. And in that
6 connection, would you just look for a minute at
7 Plaintiffs' Trial Exhibit 5061, which is one of the
8 slides, so that we can see the context of the
9 examination.

10 A. Yeah.

11 Q. And one of your bullets or one of your points was
12 that AIG had no involvement with the decision to pay the
13 ML III counterparties par.

14 Do you see that?

15 A. Yes, I do.

16 Q. And you cited Mr. Liddy there?

17 A. Yes, I do.

18 Q. And then the third point from the top, you also
19 said, "When the AIG Board approved the ML III transaction
20 on November 9, 2008, it was led to believe that the
21 Government would seek concessions from AIG's
22 counterparties," and you there cited JX 144 at
23 page 45 and Mr. Liddy again; correct?

24 A. Yes.

25 Q. Now, in his examination, counsel for the

1 government did not direct your attention to any of those
2 citations but instead directed your attention to a
3 portion of the document on page 53. Do you recall that?

4 A. I do recall that.

5 Q. Now let me ask you to look at the materials that
6 you actually did cite for this proposition, first
7 beginning with Joint Exhibit 144 on page 45.

8 A. Yes.

9 Q. And do you see near the bottom of the page the
10 heading Termination Agreement?

11 A. Yes.

12 Q. And do you see where the -- there's a reference to
13 termination price?

14 A. Yes.

15 Q. That says that the termination price together with
16 the purchase price and the amount of any concession
17 deducted from the purchase price equals such percentage
18 of the par value of such CDO pool as set forth in
19 Appendix A for the relevant seller.

20 Do you see that?

21 A. Yes.

22 Q. And what is the significance, if any, of that
23 statement to what you said in Demonstrative Exhibit 5061?

24 A. It's pretty clear here that they intend at least
25 to try to obtain concessions, and that's what provided

1 support to the bullet that I -- my third bullet there.

2 Q. And was it your understanding that this
3 is what the board was presented with at the
4 November 9, 2008 meeting?

5 MR. DINTZER: Objection. Leading.

6 THE COURT: Sustained.

7 BY MR. BOIES:

8 Q. What, as you understood it, was presented to the
9 AIG board at the November 9, 2008 meeting?

10 A. So these are nexus, are attached to the board
11 minutes, and so my understanding is that it was part of
12 the material that was given to the board when they made
13 that decision.

14 Q. Now, on page 45, there's a reference to
15 Appendix A.

16 Do you see that?

17 A. Yes.

18 Q. And it says that the termination price together
19 with the purchase price and the amount of any concession
20 deducted from the purchase price equals such percentage
21 of the par value of such CDO pool as set forth in
22 Appendix A for the relevant seller; correct?

23 A. Correct.

24 Q. Now, if you turn to page 52 of this document, do
25 you see Appendix A1?

1 A. Yes, I do.

2 Q. And six lines down do you see where it says "Sum
3 of Purchase Price and Termination Price: [9_] percent of
4 CDO Pool par value"? Do you see that?

5 A. Yes, I do.

6 Q. What significance, if any, does that have to the
7 conclusion that was reflected on Plaintiffs' Trial
8 Exhibit 5061 that when the AIG board approved the ML III
9 transaction, it believed that the government would seek
10 concessions from AIG's counterparties?

11 A. The fact that there is the first digit and the
12 first digit is a 9 and then there is a blank is that the
13 expectation was that they will negotiate a discount that
14 clearly was not above 10 percent, because if it was,
15 there wouldn't be a 9 in the first digit. But it was a
16 discount; otherwise, it will be 100 percent or would not
17 even sort of -- it would just say CDO par value.

18 Q. Let me try next to ask you to look at the portions
19 of Mr. Liddy's trial testimony that you cited here. And
20 in that connection, I will hand up excerpts from
21 Mr. Liddy's trial testimony.

22 Now, I have handed up pages 311 through 318 of the
23 trial transcript together with the cover page for that
24 day, which was October 17, 2014.

25 Do you see that?

1 A. Yes, I do.

2 Q. And this excerpt includes those portions of
3 Mr. Liddy's trial testimony that you had cited in
4 Plaintiffs' Trial Exhibit 5061; correct?

5 A. Correct.

6 Q. And let me look -- or let me ask you to look first
7 at trial transcript 3113 at line 21.

8 A. Yes.

9 So when the board approved the Maiden Lane III
10 transaction, is that the part?

11 Q. Yes.

12 And what you rely on in what you have provided in
13 Plaintiffs' Trial Exhibit 5061 is from line 21 of
14 page 3113 through line 3 of 3114.

15 Do you see that?

16 A. Yes.

17 Q. And that says:

18 "QUESTION: When the board approved the
19 Maiden Lane III transaction on November 9, you expected
20 that the Federal Reserve would continue to try to
21 negotiate concessions below par with respect to the CDSs
22 that were the subject of Maiden Lane III; correct?

23 "ANSWER: That was my expectation. To the extent
24 AIG had attempted to do that, I presumed the
25 Federal Reserve would do the same thing."

1 Do you see that?

2 A. Yes, I do.

3 Q. And what was the significance of that to the
4 conclusion that you reached as to what the AIG board
5 believed when it approved the ML III transaction?

6 A. Actually I was present here when your counsel
7 deposed Mr. Liddy, so that's the reason why I added to
8 the bullet here. It just strengthened what was my
9 opinion even before, that the expectation of the board in
10 this case, even of the CEO, was that the government will
11 try to get some concession from the counterparties.

12 Q. And when you were examined about this point
13 before, you also were not given an opportunity to look at
14 transcript page 3117 lines 4 through 7 that you cite on
15 Plaintiffs' Trial Exhibit 5061. I'd like to give you
16 that opportunity now, and would you look at lines 4
17 through 7:

18 "QUESTION: The decision to pay the
19 counterparties 100 percent of par was a decision that
20 the Federal Reserve made entirely on its own; correct?

21 "ANSWER: Yes."

22 Do you see that?

23 A. Yes, I do.

24 Q. And what was the significance of that?

25 A. This is further evidence that AIG was expecting

1 that the Fed did a concession and delegated that decision
2 to the Fed under that assumption.

3 Q. Let me ask you to look at the next ten lines
4 beginning at line 8:

5 "QUESTION: That is a decision that you and AIG
6 did not participate in in any way; correct?

7 "ANSWER: That's my recollection.

8 "QUESTION: And it is something that you had no
9 say in and no control over; correct?

10 "ANSWER: Correct.

11 "QUESTION: In dealing with the Federal Reserve in
12 connection with ML III and generally, you trusted the
13 Federal Reserve to do what was in AIG's interests;
14 correct?

15 "ANSWER: I did, yes."

16 What significance, if any, does that testimony
17 have to the conclusions that you've set forth on
18 Plaintiffs' Trial Exhibit 5061 that counsel for the
19 United States asked you about?

20 A. I think it's important to understand that Liddy
21 perceives the Federal Reserve as a partner -- it says so
22 in the next line -- and trusts the Federal Reserve
23 completely to work in AIG interest and, as such, finds it
24 not -- okay to delegate this decision to the Fed,
25 thinking that the Fed had only the AIG interests in mind

1 in making those decisions.

2 Q. Let me ask you to look at Plaintiffs' Trial
3 Exhibit 366.

4 Is this a document that you considered as part of
5 your analysis?

6 A. Yes, I did.

7 Q. What was the significance of this document, and in
8 particular the November 10, 2008 e-mail from David Herzog
9 that is at the top of the first page, what was the
10 significance of that to your analysis?

11 A. Just one second so that I refresh my memory with
12 all the...

13 MR. BOIES: While the witness is looking at that,
14 Your Honor, I'm told that this is not yet in evidence,
15 and I would offer it.

16 MR. DINTZER: No objection, Your Honor.

17 THE COURT: All right. Plaintiffs' Trial
18 Exhibit 366 is admitted.

19 (Plaintiffs' Exhibit Number 366 was admitted into
20 evidence.)

21 THE WITNESS: So this is an e-mail from the CFO of
22 AIG that is sort of saying, I understood the Fed to be
23 negotiating the purchase of the CDOs, and the trade was
24 to happen as far below par as possible, so as any CFO in
25 that situation, he's trying to act in the interest of

1 AIG, which is to get the best price for what they're
2 buying, and he understood that the Fed is doing that.

3 BY MR. BOIES:

4 Q. Let me turn next to Mr. Bagehot.

5 And you had mentioned Mr. Bagehot a number of
6 times in your answers to counsel for the defendant's
7 questions, and do you recall that counsel for the
8 defendant asked you whether Mr. Bagehot wrote 150 years
9 ago?

10 A. Yes, I do remember that.

11 Q. And that is approximately when he wrote; is that
12 correct?

13 A. It's 1873, if I'm not mistaken.

14 Q. In your economic analysis, is Mr. Bagehot
15 out-of-date or irrelevant because of when he originally
16 wrote?

17 A. In general, I don't think that just the age or the
18 time when something is written makes it outdated.
19 Otherwise, the gospel would be outdated because it was
20 written 2000 years ago.

21 But most importantly for this case, I think that
22 Bagehot was very -- first of all, he builds on previous
23 work, but he was very insightful and to this day has been
24 considered the reference for all the major central banks,
25 so the fact that it's an old rule doesn't mean it's not

1 up-to-date.

2 Q. Let me hand you up a binder of materials.

3 A. Just in case I don't have enough?

4 Q. I apologize.

5 A. Do I beat Mr. Liddy on the number of binders or
6 not?

7 THE COURT: Boy, I think you do.

8 BY MR. BOIES:

9 Q. You beat him on the number of binders. I'm not
10 sure on the volume of paper.

11 A. Thank you.

12 Q. These are some materials that I want to ask you
13 about in connection with Mr. Bagehot, and some of these
14 may not be materials you're familiar with because we had
15 to prepare these last night when we were not able to talk
16 to you, so I'm going to be asking you some background
17 questions with respect to these materials.

18 A. Sure.

19 Q. First, with respect to behind tab 1, there's
20 Plaintiffs' Trial Exhibit 15, which is in evidence, and I
21 would ask you whether this is one of the materials that
22 you relied on in connection with your preparation.

23 A. Yes.

24 Q. And this is a speech given by Chairman Bernanke
25 May 13, 2008; correct?

1 A. Yes.

2 Q. And in his second paragraph, the first sentence,
3 Chairman Bernanke says, "In my remarks today, I will
4 begin by reviewing the principles that should guide
5 central banks' actions to support market liquidity."

6 Do you see that?

7 A. I do see that.

8 Q. And then at the beginning of the next paragraph
9 that's headed The Principles Behind Central Bank
10 Liquidity Provisions, Mr. Bernanke says, "The notion that
11 a central bank should provide liquidity to the banking
12 system in a crisis has a long intellectual lineage.
13 Walter Bagehot's Lombard Street, published in 1873,
14 remains one of the classic treatments of the role of the
15 central bank in the management of financial crises."

16 Do you see that?

17 A. Yes, I do.

18 Q. And what is the significance, if any, of that to
19 your analysis as to whether the Bagehot principles
20 continue to be important in terms of the economic
21 analysis of crises?

22 A. This, as many other speeches by Bernanke and other
23 central bankers, inform my opinion that Bagehot rule is
24 still a very highly regarded rule, in fact is the
25 doctrine that everybody follows, not just 150 years ago,

1 but even today.

2 Q. Let me direct your attention to page 2, the next
3 to last paragraph, where it says, "Bagehot defined a
4 financial crisis largely in terms of a banking panic --
5 that is, a situation in which depositors rapidly and
6 simultaneously attempt to withdraw funds from their bank
7 accounts. In the 19th century, such panics were a
8 lethal threat for banks that were financing long-term
9 loans with demand deposits that could be called at any
10 time."

11 Chairman Bernanke then says, "In modern financial
12 systems, the combination of effective banking supervision
13 and deposit insurance has substantially reduced the
14 threat of retail deposit runs. Nonetheless, recent
15 events demonstrate that liquidity risks are always
16 present for institutions -- banks and nonbanks alike --
17 that finance illiquid assets with short-term
18 liabilities."

19 Do you see that?

20 A. Yes, I do.

21 Q. And what significance, if any, does that have to
22 the issue of the applicability of the Bagehot principle
23 to nonbanks?

24 A. So it seems that Bernanke here was extremely
25 prescient because some people thought that the Bagehot

1 rule was outdated precisely because we have in the
2 United States deposit insurance. And what he points out
3 to -- points to here is that while this might be a good
4 safety net for commercial banks, it doesn't cover other
5 institutions, that can be banks or nonbanks alike, that
6 may be faced with what amounts to a bank run even if it
7 doesn't take the form of people lining up outside of a
8 bank teller.

9 And in particular, what he points to is that
10 institutions that finance themselves a lot with
11 short-term liabilities can be subject with solvent bank
12 run that takes the form of people not renewing their repo
13 agreement rather than withdrawing their deposit, but from
14 an economic point of view it's the same thing, and so
15 here he's saying the Bagehot rule is saying we should
16 intervene in this banking panic and we should intervene,
17 at least the way I read this, we should intervene not
18 only to preserve liquidity to commercial banks but also
19 to other nonbanks institutions that are faced with the
20 same kind of run.

21 Q. Let me ask you to skip to tab 7, which is
22 Plaintiffs' Trial Exhibit 684, and I would ask you
23 whether this is a document that you considered as part of
24 your analysis.

25 A. Yes.

1 Q. And this is a speech by Chairman Bernanke
2 December 16, 2013; is that correct?

3 A. I don't remember the exact date. Yeah,
4 December 16, yeah.

5 Q. And if you go to page 2 of the exhibit?

6 A. Uh-huh.

7 Q. The paragraph at the bottom of the page?

8 A. I see it.

9 Q. That says, "When the financial system teetered
10 near collapse in 2008 and 2009, we responded as the
11 19th century British essayist Walter Bagehot advised, by
12 serving as liquidity provider of last resort to stressed
13 financial firms and markets."

14 Do you see that?

15 A. I do.

16 Q. And what significance does that have, if any, to
17 your conclusions about the continued applicability of the
18 Bagehot principle in financial crises?

19 A. As far as the applicability, that says that it
20 should have applied to all institutions that were faced
21 with distress, the liquidity stress in financial market.

22 Q. Let me ask you to look at Plaintiffs' Trial
23 Exhibit 2844 that is behind tab 13.

24 Is this a document that you relied on in
25 connection with your analyses?

1 A. Yes.

2 MR. BOIES: This I think is not yet admitted.
3 It's a Federal Reserve document. I'm going to refer to
4 it and I would offer it, although I don't -- I don't need
5 it in the record. If there's an objection, I'll just use
6 it without it.

7 MR. DINTZER: Your Honor, we're going to object on
8 hearsay grounds.

9 MR. BOIES: Okay.

10 THE COURT: All right.

11 BY MR. BOIES:

12 Q. What do you understand this document to be, sir?

13 A. I understand this is a bunch of lectures written
14 by Chairman -- former Chairman Bernanke about the
15 financial crisis.

16 Q. I think -- I'm not sure I've got the right
17 document. I'm talking about 2844, which is at tab 13,
18 the one that's headed The Federal Reserve and the
19 Financial Crisis and a series of flip charts after that.

20 A. This is a series of lecture on the -- of the
21 Federal Reserve on the financial crisis.

22 Q. Okay. I didn't understand that's what it was.
23 But actually looking at the last page, I see you're
24 absolutely right.

25 Let me ask you to look at page 14 of the exhibit.

1 And what significance, if any, does that have to
2 your conclusion as to whether or not the Bagehot
3 principle continues to be a principle applied, at least
4 to the extent they say so, by the Federal Reserve?

5 A. So this is the Federal Reserve saying that the
6 Bagehot's dictum -- and in quotes it says "still
7 relevant," so despite it being 150 years old, it's still
8 relevant -- is to do exactly what I've sort of repeated
9 many times here, that during a bank panic you should lend
10 freely against good assets and at a penalty interest
11 rate, where they define in bracket what it is is to
12 discourage excessive use.

13 So what is important here is they don't say the
14 penalty rate should be a punitive rate to punish moral
15 hazard because in the middle of the panic people who have
16 all of a sudden need to be punished are in crisis, so
17 that's not the purpose of the Bagehot's dictum, but is to
18 discourage excessive use because you want it, as soon as
19 things get normal, people don't want to borrow that
20 anymore, so that the way it is to lend at the rate which
21 is a hundred basis points above generally or what would
22 have been the rate in a normal market.

23 Q. Let me ask you to look next at Plaintiffs' Trial
24 Exhibit 2846, which is behind tab 15.

25 A. 2846, yes.

1 Q. And is this a document that you relied on in
2 connection with your analysis?

3 A. Yes.

4 Q. And what is this, as you understand it?

5 A. It's a speech given by then Vice Chairman Kohn,
6 Vice Chairman of the Fed Kohn, Don Kohn.

7 Q. Let me ask you to look at the second to last
8 paragraph on the first page, the third sentence that
9 begins "In designing our liquidity facilities."

10 Do you see that?

11 A. "The liquidity measures" -- no. Before? It's
12 before "The liquidity measures"?

13 Q. Yes. It's -- yeah, it is that paragraph before.
14 It is the third sentence in that --

15 A. Oh, yes. Okay.

16 Q. Where it says "In designing our liquidity
17 facilities"?

18 A. "We were guided by the time-tested" --

19 MR. DINTZER: I'm sorry, Counselor. It's just
20 that it's not on the screen, so I can't catch it. I
21 can't find -- where are we?

22 (Pause in the proceedings.)

23 Thank you, Your Honor.

24 BY MR. BOIES:

25 Q. What significance, if any, did that have to your

1 analysis?

2 A. So this is the vice chairman of the Fed saying
3 that in designing the -- all the liquidity facilities
4 they designed, they were following a principle
5 attributed to Bagehot that calls time-tested, doesn't
6 call it old or outdated but time-tested, which I take it
7 as a compliment, that sort of lasted, resisted the time,
8 so...

9 Q. Let me ask you to look at the next sentence after
10 that that begins "Those precepts hold that central
11 banks."

12 Do you see that?

13 A. Yes.

14 Q. What significance, if any, did that statement by
15 Vice Chairman Kohn have to your analysis?

16 A. I think that's very important because here Kohn is
17 saying what I think is the right thing, so that the
18 central bank can and should ameliorate financial crises
19 by providing ample credit to a wide set of borrowers. It
20 doesn't say we should provide lending only to commercial
21 banks or only to sort of primary dealers, but to a
22 wide -- to a wide set of borrowers, as long as -- so
23 that's also very important -- as long as the borrowers
24 are solvent and the loans are provided against good
25 collateral and a penalty rate is charged.

1 So that's exactly what Bagehot said, and that's
2 exactly what I think should have taken place.

3 Q. Let me ask you to look at the next sentence that
4 begins, "Such lending addresses discontinuities in
5 investor behavior."

6 Do you see that?

7 A. Yes.

8 Q. Can you explain from an economic standpoint what
9 principle Mr. Kohn is referring to here.

10 A. So I think that this is very important because at
11 least part of the recent economic literature thinks in
12 term of rational markets all the time, so if markets are
13 rational all the time, there are not, what Kohn said,
14 discontinuities in investor behavior in a crisis.

15 And in reality -- and this is what -- why Bagehot
16 was sometimes wiser than some recent commentators --
17 Bagehot saw that in some situation the withdrawal of
18 investor passed the limit of what is sort of,
19 quote-unquote, rational given the situation and
20 transformed itself in panic.

21 And in this panic, the purpose of the Fed is to
22 stop the panic by providing ample liquidity. It's not to
23 rescue insolvent firms. It is to provide ample liquidity
24 to firm which are solvent but are faced by a liquidity
25 crisis due to that panic.

1 MR. BOIES: Your Honor, I pass the witness.
2 THE COURT: All right. Thank you, Mr. Boies.
3 Mr. Dintzer, recross?
4 MR. DINTZER: Yes, Your Honor.
5 THE COURT: If any.
6 MR. DINTZER: If I could just have a moment,
7 Your Honor, to get --
8 THE COURT: Sure.
9 MR. DINTZER: -- move some materials around.
10 THE COURT: Yes.
11 (Pause in the proceedings.)
12 MR. DINTZER: Your Honor, I fear I'm suffering
13 from binder overload, so I'm going to ask if I could just
14 have the Court's indulgence for one moment. I want to
15 make sure I've got the binders that I'm going to need up
16 here.
17 (Pause in the proceedings.)
18 THE WITNESS: So much for saving trees.
19 MR. DINTZER: The electronic age. We do need to
20 have both.
21 THE COURT: I wonder if AIG has thought about
22 going into the binder business.
23 MR. DINTZER: There is fortune to be made,
24 Your Honor, in a bed of binders.
25 THE WITNESS: They have to ask permission to the

1 Fed.

2 - - - - -

3 RECROSS-EXAMINATION

4 BY MR. DINTZER:

5 Q. Sir, I'm going to start right where you left off
6 with Mr. Kohn's or Vice Chairman Kohn's article, if you
7 could just go to the second page there.

8 A. Yes.

9 Q. And -- and I'm not -- and at the top -- let me see
10 here -- do you see that?

11 A. Yes.

12 Q. And he writes, "In the case of the TALF, we are
13 backstopped by the Treasury. In addition, the terms and
14 conditions of most of our facilities are designed to be
15 unattractive under normal market conditions, thus
16 preserving borrowers' incentives to obtain funds in the
17 market when markets are operating normally."

18 Do you see that?

19 A. I do.

20 Q. "Apart from a very small number of exceptions
21 involving systemically important institutions" -- that
22 would include AIG; right?

23 A. I don't know.

24 Q. Okay. A very small number of exceptions -- how
25 many systemically important institutions received their

1 own individual rescues? Do you know? As opposed to
2 facilities.

3 A. How many you mean targeted?

4 Q. Yes.

5 A. 13(3)?

6 Q. Yes.

7 A. But you seem to be equating targeted 13(3) as sort
8 of a -- in systemically important institutions. Is it
9 sort of an automatic? I don't think so.

10 Q. Okay. I'm just saying -- I'm reading here, "Apart
11 from a very small number of exceptions involving
12 systemically important institutions, such features have
13 limited the extent to which the Federal Reserve has taken
14 on credit risk."

15 Do you see that? Do you -- do you see that, sir?

16 A. Yes.

17 Q. Do you understand that one of the systemically
18 important institutions which did involve the
19 Federal Reserve taking on credit risk was AIG? Yes or
20 no?

21 MR. BOIES: I object to the form of that question,
22 Your Honor. I think that misstates what the document
23 says.

24 THE COURT: Overruled. I'll allow the answer.

25 THE WITNESS: I would be shocked if it includes

1 the AIG because I've seen -- in all the documents I've
2 seen, they say clearly that all the facilities were with
3 adequate -- collateralized to the satisfaction of the
4 Federal Reserve, so I -- probably he's talking about
5 Bear Stearns, but I don't know what he's talking about
6 credit risk.

7 Q. Okay. No further questions on that document,
8 sir.

9 I'm going to direct you to the first binder that
10 plaintiffs' counsel gave you, the one with the warrants
11 material.

12 A. Okay.

13 Q. And just let me know when you've found it because
14 I assume you've got the same binder overload --

15 A. Yeah, that's a challenge.

16 Q. -- that I have.

17 A. Yeah, I think I've found it.

18 Q. And so the question that I had asked you, sir,
19 was had you seen any materials that actually
20 demonstrated that a warrants term sheet was actually
21 transmitted to AIG. Do you remember -- I'm not going to
22 review that, but you remember that conversation we had.

23 A. I do remember that conversation.

24 Q. And then plaintiffs' counsel gave you a binder,
25 and so -- and he talked a whole lot about it, and I'd

1 like to go back to that point.

2 And so the question is the term sheet. Okay?

3 And so the first document plaintiffs' counsel
4 showed you was -- was -- it's in tab 1. It's PTX 86;
5 right?

6 A. Yes.

7 Q. And it's at 2:05 p.m.

8 Do you see that?

9 A. I do.

10 Q. Okay. And it's on the 16th of course. All of
11 this is 9-16. Right?

12 A. Yes.

13 Q. And what he says here is: "Here is a revised
14 draft. We welcome any questions or comments."

15 Do you see that?

16 A. Yes, I do.

17 Q. Okay. So we can agree that at 2:05 p.m. with
18 respect to the term sheet, it's still being drafted;
19 right?

20 A. Yes.

21 Q. Okay. And this is from DPW. That's Davis Polk;
22 is that right?

23 A. That's my understanding, yes.

24 Q. And plaintiffs' counsel didn't ask you this, but
25 none of the people this is to are AIG.

1 And if you don't know, you can just say "I don't
2 know."

3 A. I don't know.

4 Q. Okay. And -- but we do know that there are people
5 from the Federal Reserve Bank. We know that there are
6 people at Treasury. And none of these indicate an AIG
7 e-mail. You'll give me that. It doesn't say like
8 ".AIG" or anything like that.

9 A. I don't see any ".AIG," but in the cc there are a
10 bunch of people where there is not the address.

11 So, for example, Ethan T. James is a counselor I
12 know.

13 Q. Okay. Not a problem, because my question to you
14 is had you seen anything. You don't know -- so nothing
15 you see here says that it's going to AIG; is that
16 correct? As far as you know.

17 A. I'm trying to remember what role Ethan T. James
18 played because was a counselor and I remember some
19 exchange between him and Joel Hollenberg I think, and
20 this was later in February and I'm trying to remember
21 what side they were playing.

22 Q. So why don't you turn to the next document, sir.

23 A. Uh-huh.

24 Q. And go all the way down the page. And we'll get
25 there. It's JX 64.

1 But do you see the e-mail Ethan T. James at
2 DavisPolk.com (sic) on the first page of the second
3 document?

4 A. The second -- the first page of the second --

5 Q. All the way down?

6 A. Okay. Yeah.

7 Q. Does that refresh your memory, sir?

8 A. Yeah.

9 Q. Okay. So then let's go back to PTX 86 and --

10 A. Uh-huh.

11 Q. -- so we're still at the question of, as far as
12 you know -- and if you don't know, I'm not asking -- this
13 is not a memory test, just as far as you know --

14 A. I'm glad.

15 Q. And it doesn't need to be.

16 As far as you know, PTX 86 didn't go to anybody at
17 the Federal Reserve Bank -- I mean, at AIG; is that
18 correct?

19 A. Can you ask the question again?

20 Q. Sure.

21 As far as you know, no one that PTX 86 was sent to
22 was AIG.

23 A. I cannot point any of these people as for sure as
24 AIG people here.

25 Q. Okay. So we know it's drafted, it's being

1 drafted, the term sheet, and can't identify AIG. Okay?

2 So that's at 2:05. Now let's go to the next
3 document.

4 Now, this is an e-mail that is from Mr. Baxter to
5 Mr. Alvarez and Mr. Ashton. And I think that's pretty
6 clear that those people all work for either the
7 Federal Reserve or Treasury; is that right? Or the
8 Board of Governors.

9 A. Yes.

10 Q. So this document, JX 64 -- and this is at -- at
11 2:15; is that right? On September 16?

12 A. Yes.

13 Q. Okay. So 2:16.

14 And let's go farther into the document.

15 A. Sorry. Can I point out the fact that in the
16 previous e-mail there was Morgan Stanley, and
17 Morgan Stanley was I think brought as an advisor to the
18 government, but they were playing sort of advisor
19 earlier -- I think that earlier were advisor to AIG, so
20 it's not obvious who they represent in this situation.

21 Q. Okay. And so -- and I'm not going to ask you --
22 you don't know one way or the other; right, sir?

23 A. I -- I assume that whatever is said to investment
24 banks, they let know everybody. That's my assumption by
25 experience.

1 Q. So you don't believe that investment banks keep
2 confidential information confidential?

3 A. No. I'm just saying that in -- in a deal like
4 this where they have multiple sources of commitment
5 because they play different roles, they easily say to act
6 as the transmitter of information.

7 Q. And so I'm asking you, sir, point blank, do you
8 have any information as to who Morgan Stanley was
9 working for on this e-mail and who they -- and whether
10 they provided this information to AIG, or are you -- are
11 you expressly stating that Morgan Stanley worked for
12 AIG?

13 A. I don't know in this e-mail who they were working
14 for.

15 Q. Okay. So let's go to Exhibit Number 2, and on the
16 second page, at the bottom, Bradley Smith from Davis Polk
17 writes, "Attached are the Clean and Blackline documents."

18 Do you see that?

19 A. Yes.

20 Q. Okay. And so this is sending along -- do you
21 understand what the term "blackline" means?

22 A. Yes.

23 Q. What does it mean, sir?

24 A. It's sort of a crossover with the changes.

25 Q. So it's part of the drafting process; right?

1 A. Yes.

2 Q. So we'll agree that JX 64, the document -- the
3 term sheet is still in the drafting stage; right?

4 A. Yes.

5 Q. Okay. And so then we go to tab 3.

6 This is at 3:21; is that right?

7 A. Yes.

8 Q. And -- and the e-mail on JX 378 says (as read):
9 Dear All, Here is a revised draft. We welcome any
10 comments -- questions or comments.

11 Do you see that?

12 A. Yes, I do.

13 Q. Okay. And can we agree that on September 16 at --
14 at -- now, the top one is 3:21, this one is at 2:05, but
15 the top e-mail is 3:21 -- at 3:21 the document was still
16 in the drafting stage?

17 A. Yes.

18 Q. And as far as you know, sir, JX 378 was not sent
19 to AIG or its counselors; is that right? And I'm not
20 going to ask you to account for everybody on the
21 document, just as far as you know.

22 A. Yes, as far as I know.

23 Q. Okay. And so -- so then we go to DX 436, which
24 was in the original binder I gave you, sir, and if you
25 could go there.

1 A. This is the binder you just gave me or the --

2 Q. No, no, no. The big white one that we started off
3 with.

4 And tell me when you get there, sir. This is a
5 document we looked at together before.

6 A. Yeah. Okay.

7 Q. Okay. So this is an e-mail --

8 A. Sorry. I found the binder.

9 Q. I'm jumping ahead of you, sir.
10 DX 436.

11 A. Yes.

12 Q. Okay. And we looked at this document before.

13 This is the e-mail from Treasury to Mr. Cohen,
14 the -- AIG's attorney; right?

15 A. Yes.

16 Q. And this is 4:06 p.m.; right?

17 A. Yes.

18 Q. So now we have 4:06 and we have copy sent to AIG's
19 attorney; is that right?

20 A. That's my understanding, yeah.

21 Q. Okay. And then everything else in this binder
22 that -- now, he did give you the -- he gave you the
23 Board of Governors minutes, and I think we agreed last
24 time, that was -- as far as you know, that was never sent
25 to AIG.

1 A. Yeah.

2 Q. Okay. And other than that, if we look at -- you
3 can look all the way through the binder counsel gave
4 you.

5 Nothing else there is actually a document
6 transmitting a term sheet with warrants to AIG; is that
7 right?

8 A. I think we discussed last time that the board did
9 not have a term sheet in its hands when it made the
10 decision.

11 Q. So my question here, sir, is, is that we still
12 haven't, you still haven't seen -- even after counsel had
13 a chance to go through the materials with you, you still
14 haven't seen a document transmitting a term sheet with
15 warrants to AIG on September 16; is that correct?

16 A. Yeah, that's correct.

17 Q. Okay. Now, I'm going to take you to JX 74, and
18 that's the resolution -- and that's the -- that's the --
19 the meeting minutes for AIG, and just let me know when
20 you have it there, sir.

21 A. I have it.

22 Q. Okay. And this time, sir, I'm going to take you
23 to page 13, and just let me know when you're there.

24 A. Yes.

25 Q. And these are the resolutions from the board;

1 right?

2 A. Yes.

3 Q. And it says, "The following resolutions were moved
4 at the meeting"; right?

5 A. Yes.

6 Q. "Resolved, that the Corporation be, and hereby is,
7 authorized to enter into a transaction with the
8 Federal Reserve Bank of New York (the 'Lender') to
9 provide a revolving credit facility of up to \$85 billion
10 on terms consistent with those described at this meeting,
11 including equity participation equal (sic) to
12 79.9 percent of the common stock of the Corporation on a
13 fully diluted basis (the 'Credit Facility')," do you see
14 that?

15 A. Yeah. It says "equivalent," not "equal," but
16 besides that, it's --

17 Q. Thank you, sir.

18 But it doesn't say warrants, does it?

19 A. It does not say warrants in this part.

20 Q. So the resolution calls for 79.9 percent common or
21 the equivalent of that; is that correct?

22 A. Can you give me time to read over the resolution?

23 Q. Absolutely, sir.

24 A. Okay.

25 (Pause in the proceedings.)

1 Yeah, this is inconsistent with what the audit
2 committee did afterwards, but yes.

3 Q. Okay. So the resolution of AIG's board was
4 79.9 percent common equivalent; right?

5 A. Yeah.

6 Q. Okay. On 9-21, the board met and voted on the
7 credit agreement; right?

8 A. Yes.

9 Q. And they gave 79.9 percent in preferred; is that
10 right? Yes or no, sir?

11 A. The -- they signed on the credit agreement that
12 will give in the future that, yes.

13 Q. Okay. The 79.9 percent of preferred stock that
14 was in the credit agreement is 100 percent consistent
15 with the resolution of 79.9 percent common equity; is
16 that right -- common equivalent; is that correct, sir?

17 A. It's not inconsistent. It is inconsistent with
18 the warrant decision made by the audit committee
19 immediately after that.

20 Q. Now, I can take you back to the -- to the term
21 sheet attached to the Rodgin Cohen e-mail, but that term
22 sheet said "form to be determined"; right?

23 A. Yeah. But I don't understand how somebody as
24 experienced as Rodge Cohen is present, as far as I
25 understand, at the audit committee and the audit

1 committee approves the issuance of warrants.

2 By the way, they had to approve because in order
3 to not to have a shareholders vote, you have to have a
4 compelling reason according -- if I remember correctly,
5 the NYSE said you have to have a compelling reason of
6 necessity to issue that instrument.

7 So they need to establish in that moment that
8 need. If they weren't sure what the equivalent form
9 would be, they should have either waited or issue a
10 generic decision.

11 Q. Okay. And so -- but the term sheet that was
12 attached to the Rodgin Cohen e-mail -- and again, I can
13 take you back there if you'd like --

14 (Admonition from the court reporter.)

15 BY MR. DINTZER:

16 Q. Let me try again.

17 The term sheet attached to the Rodgin Cohen
18 e-mail -- and I can take you back there if I need to --
19 it says common equivalent, form to be determined, doesn't
20 it, sir?

21 A. Yeah, it does say that, but that doesn't mean it's
22 not a warrant.

23 Q. And that's -- that's -- that's true.

24 A. Uh-huh.

25 Q. And so the fact that on the days after that there

1 are discussions about warrants and preferred and which
2 is better is fully consistent with the term sheet on
3 9-16 that says "form to be determined"; isn't that right,
4 sir?

5 A. But it's not consistent in the vote of the audit
6 committee.

7 Q. I need you to answer my question.

8 It's -- all the back-and-forth that you looked at
9 with plaintiffs' counsel is fully consistent with a
10 discussion about the form to be determined; isn't that
11 correct, yes or no?

12 A. Can you please ask the question again.

13 Q. Sure.

14 The back-and-forth of consideration, warrants and
15 preferred stock, all of that is consistent with an
16 understanding on 9-16 that the form of the equity
17 equivalent was to be determined; isn't that correct?

18 A. No. The back-and-forth is not.

19 MR. DINTZER: Okay. I have a little bit more,
20 Your Honor. If you'd like, I can -- but I am at a good
21 stopping point.

22 THE COURT: Let's break for lunch then.

23 We'll reconvene at 1:45.

24 (Whereupon, at 12:44 p.m., a lunch recess was
25 taken.)

1 Q. And Blackstone was representing AIG at this time?

2 A. Yes.

3 Q. And so what Mr. Schwarzman -- he's writing to his
4 colleagues, is that correct, including John Studzinski --
5 who will appear by video, Your Honor, at some point, I
6 feel assured.

7 And he writes, "I received a call last night at
8 home at 11:15 p.m. from Chairman" -- and I'm not even
9 going to try because I'm going to make a mess of it --
10 "of China Investment Corporation."

11 Do you see that?

12 A. Yes.

13 Q. "He was on the phone with a female translator. He
14 wanted to know, at the opening of the call, how
15 Blackstone was doing in the current unsettled
16 environment."

17 And this is September 16, 2008; right?

18 A. Yes.

19 Q. Okay. So if we go to the next page, and in the
20 middle of that second paragraph on that page, the writer
21 says, "I described the general background of the AIG
22 situation and its relatively short time dimension.
23 Chairman Lou said that CIC had a very serious interest
24 in" --

25 A. Sorry, sorry. I lost you. Where did you start

1 reading? This is the second page.

2 Q. It is, sir. It's on the screen to show you where
3 I'm reading. "I described" --

4 A. Okay. Sure. Okay.

5 Q. No. That's fine. I just want to make sure --
6 "said that CIC had a very serious interest in AIG and, in
7 effect, wanted to have a road map in terms of what was
8 going on."

9 A. Yeah.

10 Q. So just to be clear, CIC actually was talking to
11 AIG's representative on September 16.

12 A. Okay.

13 Q. Yes? That's a yes-or-no question, sir.

14 A. It appears that way.

15 Q. And so in the next paragraph, he writes (as read):
16 I probed with Chairman Lou as to how big CIC could be in
17 the AIG situation. Chairman Lou reiterated that CIC was
18 not interested in controlling or running any business but
19 operated with general -- with other general partners.

20 And then here's the part I want to emphasize: "He
21 said, of course, that \$75 billion was too much of CIC's
22 resources to invest in AIG."

23 Do you see that?

24 A. I do see that.

25 Q. Okay. Based on this e-mail, we can understand

1 that CIC, at least by itself, was not interested in
2 putting anywhere near enough money into AIG to provide
3 the liquidity it needed on September 16; right?

4 A. This is one piece of evidence that -- in that
5 direction.

6 Q. Okay. And then we go on (as read): I told him of
7 the current evaluation by JPMorgan and Goldman Sachs and
8 that they would be looking for commitments of between
9 five billion to ten billion apiece to lay off their
10 exposure if they reached an agreement with AIG on a loan
11 package.

12 Do you see that?

13 A. Yes.

14 Q. Okay. Do you have an understanding that that's
15 the private effort that took place on the 15th and the
16 16th, that that's what he's describing right there, the
17 effort by JPMorgan and Goldman Sachs?

18 A. Yeah. I was aware that during the weekend there
19 was sort of a contact with the CIC that they were trying
20 to organize something. Yes.

21 Q. But I'm talking about when President Geithner got
22 Goldman Sachs and JPMorgan together and said, I want you
23 to -- and AIG of course -- I want you to see if you can
24 try to find a private solution, and that was on the 15th.
25 Do you remember that, or are you aware of that?

1 A. Yeah, I'm aware of that. I remember that, yes.

2 Q. Do you understand that this here, this sentence,
3 is a reference to that? JPMorgan and Goldman Sachs, do
4 you see that?

5 A. Yeah. That's the private solution we're trying to
6 arrange --

7 Q. Yes.

8 A. -- so when they're saying sort of how much they
9 would want to invest, they are referring to that
10 arrangement.

11 Q. Okay. And then he writes, "Chairman Lou
12 reiterated that if they had enough time, they could be a
13 very significant investor, but they would have to go to
14 the State Council for approvals."

15 So you understand -- and we talked about this
16 earlier -- that the CIC even with Chairman Lou, who I --
17 without -- with his interest, that they still had to go
18 to see if the State Council would approve a loan; right?

19 A. It seems that way. Yes.

20 Q. You don't have any information to the contrary.

21 A. I don't have any information to the contrary. I
22 don't see why this is so important, but maybe you are
23 going to tell me later.

24 Q. What -- okay. CIC on September 16 was already in
25 contact with AIG. They had no interest in putting

Starr International Company, Inc. v. USA

1 anywhere near \$85 billion into -- into any investment in
2 AIG and --

3 A. Whoa, whoa, wait.

4 Q. Let me finish my question -- and even if they were
5 interested, they would have to get approvals before that
6 investment could be made; true?

7 A. No. What I read here is that they were not
8 interested in putting more than 75 million into the
9 private solution organized at JPMorgan and Morgan -- and
10 Goldman.

11 This does not deny the fact they might have an
12 interest in it going directly like the way I understood
13 the advance that they made through Treasury was not to go
14 through JPMorgan and Goldman, which was a private
15 solution where they would not have a direct
16 involvement -- firsthand involvement. This is a direct
17 involvement, which is something for which you would want
18 to have kind of an endorsement from the Treasury.

19 If they invest in a private solution as part of
20 something led by JPMorgan and Goldman Sachs, the
21 blessing -- sorry -- quote-unquote, blessing of the
22 Treasury is less important. If they do a direct
23 investment, the blessing become important.

24 So what I read here is that they are not
25 interested in putting more than 75 million in that

1 solution. That doesn't deny that they're interested in
2 putting more in a different solution.

3 Then they say they cannot do it overnight, and I
4 don't think I ever said that they would do it overnight,
5 and I don't think it is so crucial that they do
6 overnight because if -- this was part of a private
7 solution.

8 Most importantly, this avenue was not explored
9 because the government intervened, so in -- if this
10 path -- and I'm not saying the Goldman Sachs and
11 JPMorgan. I'm saying the direct intervention of CIC was
12 not explored because the government did not give its
13 blessing.

14 Q. Have you seen a single document, a single
15 document, from CIC or CIC's communication with anybody
16 that said that anything that happened when they were
17 talking with the woman who talked to the woman who talked
18 to somebody on a plane, that any of that had any actual
19 impact on anything that CIC did? Have you seen a single
20 document from CIC that said that affected them?

21 A. First of all, you -- I think you mischaracterized
22 my statement about a woman on plane with woman -- I think
23 that I said that there was not only that conversation and
24 hearsay. There was a meeting of a high-level official of
25 the U.S. Treasury and the Chinese government in

1 Southern California, if I remember correctly, where they
2 spend a day talking about AIG.

3 So it seems to me that it's true this is not a
4 document, but that's a pretty clear indication if you
5 spend a day talking about this, clearly they have no
6 interest in wasting time, so they were seriously
7 interested. That's what I sort of infer.

8 MR. DINTZER: We have no further questions for the
9 witness, Your Honor.

10 THE COURT: All right. Dr. Zingales, thank you
11 very much for your testimony in this matter. You are
12 excused.

13 THE WITNESS: My pleasure.

14 MR. DINTZER: Your Honor, we just wanted to take
15 care of some of the document issues.

16 So we have DX 669, which is on our exhibit list
17 and is cut off. And then we have what we passed out,
18 DX 2131, which is a substantively duplicate document,
19 but it is -- it has the full list of people who received
20 it, so we would like to add DX 2131, which we used with
21 the witness, to our exhibit list and to move it into
22 evidence.

23 THE COURT: Is that okay with you, Mr. Boies?

24 MR. BOIES: Was the other one in evidence?

25 MR. DINTZER: 669? We didn't proffer it.

1 Obviously we used it with the witness. We didn't
2 proffer -- this is the no concessions e-mail. We didn't
3 proffer it because we left a marker with the Court that
4 we wanted to swap it out with the one that --

5 MR. BOIES: No objection, Your Honor.

6 THE COURT: All right. With that explanation,
7 Defendant's Exhibit 2131 is admitted.

8 (Defendant's Exhibit Number 2131 was admitted into
9 evidence.)

10 MR. DINTZER: Thank you, Your Honor.

11 And we don't have those yet? Okay.

12 And we will get you the flip charts at some later
13 point and we would at that point ask the Court to admit
14 them as demonstratives.

15 THE COURT: Very well.

16 MR. DINTZER: Thank you, Your Honor.

17 MR. BOIES: Your Honor, we now call as our next
18 witness Donald Farnan.

19 (Pause in the proceedings.)

20 THE COURT: You may come forward, sir.

21 - - - - -

22 Whereupon --

23 DONALD FARNAN

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

1 DIRECT EXAMINATION
2 BY MR. BOIES:
3 Q. Good afternoon, Mr. Farnan.
4 A. Good afternoon.
5 Q. My name is David Boies. I don't believe we've met
6 before, but I think they've probably told you that I
7 represent the plaintiffs in this action.
8 A. Yes, sir.
9 Q. You are a partner at PricewaterhouseCoopers;
10 correct?
11 A. Yes.
12 Q. How long have you been a partner there?
13 A. Since 1998.
14 Q. And how long has PricewaterhouseCoopers been AIG's
15 independent auditor?
16 A. I'm not sure exactly, but several decades.
17 Q. And when did you start working on the AIG account?
18 A. The first time I worked on an AIG account, I was
19 in -- it was in -- I was in Japan at the time back in
20 1997, '95, '96, '97.
21 Q. And did you work on the AIG account from time to
22 time thereafter?
23 A. Yes, sir.
24 Q. Did there come a time when you began to work on
25 the AIG account as part of the AIG independent auditor

1 team?

2 A. Well, yes. Even when I was in Japan, I was
3 working on a subsidiary.

4 Q. And did there come a time when you worked on the
5 parent?

6 A. Yes.

7 Q. When was that?

8 A. 2006.

9 Q. How large was PwC's auditing team for AIG in 2006?

10 A. In New York, sir?

11 Q. Let's begin with that.

12 A. It varied over the year but could be as -- in
13 busiest times, meaning at year end, could be more than a
14 hundred people.

15 Q. And what about worldwide?

16 A. I don't -- everybody was not full-time, but I
17 think it was probably in the thousands.

18 Q. Now, I want to direct your attention to the period
19 2008.

20 You were still part of the team auditing the
21 parent AIG at that time?

22 A. Yes, sir.

23 Q. How long did you stay in that position?

24 A. I left the corporate team in the middle of 2011.

25 Q. While you were on the PwC independent auditing

1 team for AIG, did you become aware that AIG had retained
2 outside experts to value certain preferred stock that was
3 being transferred to the government?

4 A. Yes, I did.

5 Q. When did you become aware of that?

6 A. I don't remember the exact date, but certainly
7 by -- shortly after September 26 -- September 22, 2008,
8 after the series -- preferred stock had been issued.

9 Q. Were you familiar with the Federal Reserve credit
10 facility for AIG prior to September 22?

11 A. I believe the facility was signed on September 22,
12 so not in -- not that I recall.

13 Q. In connection with your auditing work at AIG, did
14 you come to learn when AIG first learned that it would be
15 required to provide preferred stock as a condition of the
16 Federal Reserve credit facility?

17 A. I don't remember the exact date, but along about
18 maybe slightly before September 22 of 2008.

19 Q. Was it your understanding that AIG's expectation
20 on September 16 and for some days thereafter was that the
21 equity component would be warrants as opposed to
22 preferred stock?

23 A. That at least there were points of view that, yes,
24 warrants was one potential form of equity that would be
25 issued.

1 Q. When you say it was one potential form of equity,
2 my question is whether PwC understood that AIG's
3 expectation was that that equity would be warrants.

4 A. Oh, I'm sorry. I don't -- I don't know P- --
5 AIG's expectation. I don't know what their expectation
6 was.

7 Q. Was that something that PwC looked into?

8 A. I'm sorry. May I add to my answer, sir?

9 Q. Sure.

10 A. I do think that at least in our work papers at
11 one point we were told that warrants -- originally
12 warrants were planned and that was later changed. I
13 think that is more responsive to your previous question.
14 I apologize.

15 Q. That's really what I was asking.

16 A. Yes.

17 So I mean, I was aware of their expectations
18 because they told us in a memo that originally it was
19 expected to be warrants.

20 Q. So AIG had conveyed to you that their original
21 expectation was that it would be warrants and then it was
22 changed sometime thereafter.

23 A. At least one member of management, yes --

24 Q. Told you that.

25 A. -- told us that.

1 Q. Who told you that?

2 A. Yes.

3 I don't remember. I remember it being in one of
4 the memos in our files. Could -- somebody from the
5 accounting group I'm sure.

6 Q. That is, the communication to you about AIG's
7 expectation that the equity would be warrants would have
8 come to you from somebody in AIG's accounting group; is
9 that what you're saying?

10 A. Yes.

11 Q. Okay. Did you have any discussions with the
12 person in AIG's accounting group that conveyed this
13 information to you as to what that person's source of
14 information was?

15 A. Not that I recall.

16 Q. Did you personally ever see a term sheet for the
17 Federal Reserve credit facility?

18 A. Not until I was shown one in preparation for this
19 case when Boies took -- Schiller took my deposition.

20 Q. Prior to your deposition, you had not seen it.

21 A. Not that I recall.

22 Q. Did you ever read the credit agreement that was
23 dated as of September 22?

24 A. Yes, I did.

25 Q. When did you do that?

1 A. Shortly after having received it around that same
2 particular time.

3 Q. Was that same particular time back in 2008 or in
4 connection with your deposition?

5 A. In September 2008, so between September 2008 and
6 October 15 probably of 2008.

7 Q. And you understood when you read the credit
8 agreement that the credit agreement provided for the
9 issuance of voting convertible preferred stock; correct?

10 A. Yes.

11 Q. And there came a time when you understood that
12 KPMG had been retained to value that; right?

13 A. Yes, sir.

14 Q. Did anyone ask for your advice or PwC's advice as
15 to how they should value the preferred stock?

16 A. Not that I remember.

17 Q. Did you recommend that given the circumstances of
18 the transaction that you believed it would be prudent for
19 AIG to retain an independent third party to review the
20 valuation?

21 A. Yes, we did.

22 Q. And to whom did you give that recommendation?

23 A. My recollection is Mr. Anthony Valoroso, who was
24 the head of accounting policy for AIG at the time.

25 Q. And did you encourage Mr. Valoroso and AIG to

1 retain an outside consultant to help value that preferred
2 stock?

3 A. Yes, we did.

4 Q. And did there come a time when you became aware of
5 what KPMG's valuation was?

6 A. Yes.

7 Q. And what was that valuation?

8 A. There were several methods used, but the amount
9 chosen by the company was \$23 billion.

10 Q. And I want to get the sequence right.

11 Because the company played a role, KPMG played a
12 role, and PwC played a role; am I correct?

13 A. Yes.

14 Q. And am I correct that PwC played the last role;
15 that is, PwC looked at it after the other two had reached
16 a conclusion?

17 A. I would say in the normal course, as a company is
18 completing their work or having an expert like KPMG
19 complete it, that we would have dialogues before the
20 finalization of an amount.

21 Q. But PwC's role would not have been to value it
22 themselves but rather to review the reasonableness of
23 the valuation that was done by somebody else; is that
24 fair?

25 A. That's absolutely correct, in our role as the

1 auditor of AIG.

2 Q. As you understood it, who was the first mover, was
3 it KPMG or was it AIG, in terms of coming up with this
4 valuation?

5 A. I think AIG originally made some estimates.

6 Q. And then KPMG would have reviewed those estimates;
7 is that correct?

8 A. KPMG -- I mean -- sorry -- AIG originally did
9 the -- some estimates. Then after discussing with us,
10 then they hired an expert -- at our recommendation, they
11 hired an expert. And then their process -- they followed
12 their process, and we came at the end as you described
13 earlier.

14 Q. And that expert would have been KPMG.

15 A. Yes, sir.

16 Q. Did there come a time when you were advised as to
17 what the conclusion was both of the company and of KPMG
18 as to the valuation of the Series C preferred stock?

19 A. Yes.

20 Q. And what was that valuation?

21 A. The amount was \$23 billion.

22 Q. And what did you do as the independent auditor to
23 determine whether that was a reasonable valuation or not?

24 A. So we -- keep in mind that this was in the third
25 quarter of 2008, so our responsibility is to review, not

1 to audit at that stage. But we had specialists -- so I'm
2 not a valuation specialist, but we have specialists that
3 are also expert in valuation -- look at KPMG's work and
4 the valuation methodologies. And then throughout the
5 course of 2008 we would have audited information in order
6 to -- to enable us to sign our opinion on the
7 2008 financials.

8 Q. You distinguished in your answer between reviewing
9 and auditing.

10 A. Yes.

11 Q. Did you do both a review and then an audit --

12 A. Yes.

13 Q. -- of this valuation?

14 A. Yes.

15 Q. And in both your review of the valuation and your
16 audit of the valuation, did you conclude that the
17 \$23 billion valuation was reasonable?

18 A. Yes, we did.

19 Q. Now, you're familiar with the Black-Scholes option
20 model; correct?

21 A. Yes. I'm not an expert in it.

22 Q. Nor am I.

23 But could you explain to the Court generally what
24 the Black-Scholes option model is.

25 A. It's a well-accepted methodology for valuing

1 certain instruments that incorporates inputs such as
2 volatility, strike price and time to calculate a value.

3 Q. You should have up there on the witness stand two
4 binders. One is a binder that contains your deposition
5 transcript. The other binder contains documents and
6 excerpts from documents.

7 In a number of cases where the documents are
8 voluminous, we've only included certain excerpts, but
9 anytime you'd like to see the entire document for
10 context, just let me know, and we'll furnish it to you.

11 A. Okay.

12 Q. I'd like to ask you to turn first to Plaintiffs'
13 Trial Exhibit 699.

14 And can you identify what this document is.

15 A. These are shadow calculations performed by the PwC
16 team as a rough estimate of a valuation of the preferred
17 stock.

18 Q. And when was this prepared?

19 A. At or around the same time as the KPMG -- well,
20 after KPMG had done some work although not finalized
21 their valuation, this work was performed by PwC.

22 Q. You referred to shadow calculations.

23 What do you mean by "shadow calculations"?

24 A. The main driver of the value was KPMG's valuation
25 and AIG's work with that. We called it shadow because we

1 were doing it for our own purposes.

2 MR. BOIES: Your Honor, I would offer
3 Plaintiffs' Trial Exhibit 699.

4 MR. ROBERSON: No objection, Your Honor.

5 THE COURT: Plaintiffs' Trial Exhibit 699 is
6 admitted.

7 (Plaintiffs' Exhibit Number 699 was admitted into
8 evidence.)

9 BY MR. BOIES:

10 Q. Can you explain what this document shows
11 concerning the approximate value of the Series C
12 preferred stock using the Black-Scholes model.

13 A. I'm using -- it shows amounts between 28 and
14 42 billion dollars based on the assumptions shown here.

15 Q. Let me ask you to look next at Plaintiffs' Trial
16 Exhibit 364.

17 Can you identify this document?

18 A. These are minutes of a meeting that Tim Ryan and I
19 attended in the context of the third quarter review of
20 AIG.

21 Q. And am I correct that that meeting was November 9,
22 2008?

23 A. No. That's the date it was written. I don't
24 exactly remember the date of the meeting unless it's
25 mentioned here.

1 Q. If you look at the very first line of the memo?

2 A. Yes. Sorry. Yes.

3 MR. BOIES: Your Honor, I would offer
4 Plaintiffs' Trial Exhibit 364.

5 MR. ROBERSON: Your Honor, he hasn't established
6 foundation in connection with this particular witness.

7 THE COURT: Mr. Boies?

8 MR. BOIES: Your Honor, he said this is the
9 minutes of a meeting that he personally attended.

10 THE COURT: I'll overrule the objection.

11 MR. ROBERSON: Thank you, Your Honor.

12 THE COURT: Plaintiffs' Trial Exhibit 364 is
13 admitted.

14 (Plaintiffs' Exhibit Number 364 was admitted into
15 evidence.)

16 BY MR. BOIES:

17 Q. At the very top, the first sentence says
18 (as read): Today, Don Farnan and I met with David Herzog
19 of AIG and Sarah Dahlgren of the New York Fed and
20 Ethan James of Davis Polk, counsel to the New York Fed,
21 to review the management representation letter in
22 connection with the filing of AIG's third quarter
23 financial statements.

24 Do you see that?

25 A. Yes, sir.

1 Q. And if I can direct your attention to the bottom
2 third of the page 1 of Exhibit 364, where you see
3 numbered paragraph 1?

4 A. Yes.

5 Q. The minutes state, "They had reviewed," and who is
6 the "they" there?

7 A. The New York Fed. Represented by Ms. Dahlgren and
8 Mr. James.

9 Q. And you say or the author says that it was asked
10 whether the New York Fed had reviewed the representation
11 regarding the valuation of the \$23 billion preferred
12 stock.

13 Do you see that?

14 A. Yes, sir.

15 Q. And it goes on to say, "Ethan and Sarah indicated
16 that they had and that they were aware of the Company's
17 process, including KPMG's involvement and they felt that
18 the Company's process was reasonable and that they
19 considered the representation as appropriate."

20 Do you see that?

21 A. Yes.

22 Q. And then it goes on to say that they had not
23 themselves made a determination of value.

24 Do you see that?

25 A. Yes.

1 Q. And is that an accurate summary of what was said
2 on that subject at this meeting?

3 MR. ROBERSON: Your Honor, he wrote -- he put in
4 the word "themselves." It says "they had." It didn't
5 say "they themselves had."

6 THE COURT: All right. I think we know what it
7 means.

8 The word "themselves" does not appear in the
9 quote, but I think you were saying that to emphasize who
10 the "they" was.

11 MR. BOIES: Exactly, Your Honor.

12 THE COURT: Okay.

13 THE WITNESS: Yes, it's an accurate summary.

14 BY MR. BOIES:

15 Q. Now, let me ask you to look at the last page of
16 Plaintiffs' Trial Exhibit 364, where Mr. Ryan of PwC
17 writes, "In performing the above," describing the work
18 that you were doing, "we believe that we have
19 appropriately considered the controlling share holder and
20 primary lenders views and knowledge in determining
21 whether or not it is appropriate to accept management's
22 representations."

23 Do you see that?

24 A. Yes.

25 Q. And who was the controlling shareholder and

1 primary lender whose views you were referring to?

2 A. Well, the primary lender was clearly the
3 New York Fed. I think we believed they were operating
4 and functioning as a controlling shareholder absent the
5 trust being set up and the Series C being issued to the
6 trust.

7 Q. Incidentally, going back to the question of
8 valuation, the KPMG valuation was done as of a particular
9 day; correct?

10 A. Yes.

11 Q. And the \$23 billion valuation came from what was
12 described as a market analysis or market approach;
13 correct?

14 A. There were multiple approaches used. Market was
15 one of them.

16 Q. And the market approach was one of the approaches
17 that led to a \$23 billion valuation; correct?

18 A. That's correct.

19 Q. And what is your view of the appropriateness or
20 inappropriateness of using a market approach for such
21 valuation?

22 A. We concluded that the market approach -- in fact,
23 approaches used by KPMG were reasonable.

24 Q. Now, with respect to the date that was picked, the
25 company and KPMG made a valuation as of a particular

1 date, and you obtained evidence to support their
2 assertion that that date was an appropriate date;
3 correct?

4 A. Yes.

5 Q. It would have been possible for there to be other
6 appropriate dates; correct?

7 A. I think it would have been possible.

8 Q. Did you investigate whether there were alternative
9 appropriate dates one way or the other?

10 A. Yes. We considered other dates, but the company
11 made an assertion, and we audited that assertion.

12 Q. Right.

13 Because your job is to audit what the company has
14 done; correct?

15 A. Yes.

16 Q. And what I'm asking is, as part of that, you would
17 determine that the date the company picked was
18 reasonable; correct?

19 A. That's correct. Based on evidence.

20 Q. Based on evidence.

21 Would you also have investigated one way or the
22 other as to whether there were other dates the company
23 could have picked that you would have also found to be
24 reasonable?

25 A. I believe we thought of other dates.

1 Q. Did you make any determination as to whether those
2 other dates would or would not have been reasonable if
3 the company had selected them?

4 MR. ROBERSON: Objection. Vague, Your Honor.

5 THE COURT: Do you understand the question?

6 THE WITNESS: Could you repeat it, please.

7 BY MR. BOIES:

8 Q. Sure.

9 Did you make any determination as to whether those
10 other dates that you looked at would or would not have
11 been reasonable if the company had selected them?

12 A. No, we did not.

13 Q. Let me ask you to look at Plaintiffs' Trial
14 Exhibit 347.

15 Can you explain what this document is?

16 A. This is a draft of AIG's accounting policy
17 memorandum addressing issues with respect to the
18 preferred stock.

19 Q. And who prepared this document, and for what
20 purpose was it prepared?

21 A. I'm not sure of an individual, but AIG's
22 accounting policy group prepared this memo. And because
23 there were a new security, they want to make sure all the
24 accounting issues were accounted for and properly
25 reported in the third quarter financial statements.

1 Q. And then this was sent to you and others at PwC;
2 correct?

3 A. Yes.

4 Q. What was the purpose of sending it to you and
5 others at PwC, as you understand it?

6 A. They would want our point of view on whether the
7 conclusions they were drawing were acceptable.

8 Q. And did you give them your opinion as to whether
9 the conclusions they had drawn were acceptable?

10 A. I believe we wrote our own memo answering --
11 answering all the questions we thought applicable. Yes.

12 Q. And did you ultimately conclude that the
13 positions that AIG took in this memorandum were in fact
14 acceptable?

15 A. This is a draft. Is there a -- I know we agreed
16 with their final memo. This says "draft" on it.

17 MR. BOIES: We'll try to find that as we go,
18 Your Honor.

19 In the meantime, I would offer Plaintiffs' Trial
20 Exhibit 347.

21 MR. ROBERSON: No objection, Your Honor.

22 THE COURT: Plaintiffs' Trial Exhibit 347 is
23 admitted.

24 (Plaintiffs' Exhibit Number 347 was admitted into
25 evidence.)

1 BY MR. BOIES:

2 Q. Do you recall receiving this document at the time
3 or at about the time that it's dated?

4 A. Yes. I remember getting their memo on the
5 issues.

6 Q. Now, in the second paragraph of the covering
7 e-mail, it says "the final terms of the preferred stock
8 are not yet available."

9 Do you see that?

10 A. Yes, sir.

11 Q. Did you have an understanding of why the final
12 terms of the preferred stock were not yet available as of
13 November 6, 2008?

14 A. I don't remember the detailed reasons or the
15 detailed terms that were not yet available.

16 Q. When were the final terms of the preferred stock
17 available?

18 A. I don't recall.

19 Q. Was it before the end of the year 2008, if you
20 recall?

21 A. I don't remember right now.

22 Q. Let me ask you next to look at Plaintiffs' Trial
23 Exhibit 1650, which again should be in your binder.

24 And this is talking about definitive documents for
25 the credit facility.

1 Do you see that?

2 A. Yes.

3 Q. And this is an e-mail from Mr. Valoroso to you,
4 September 24, 2008 at 9:59 in the morning; correct?

5 A. Yes.

6 MR. BOIES: Your Honor, I would offer
7 Plaintiffs' Trial Exhibit 1650.

8 MR. ROBERSON: No objection, Your Honor.

9 THE COURT: Plaintiffs' Trial Exhibit 1650 is
10 admitted.

11 (Plaintiffs' Exhibit Number 1650 was admitted into
12 evidence.)

13 BY MR. BOIES:

14 Q. And do you see the e-mail at the bottom of the
15 page from Kathleen Shannon, dated September 23, 2008 at
16 10:59 p.m.?

17 A. Yes.

18 Q. And it begins, "Although we had originally hoped
19 to file the Form 8-K with definitive documents today, the
20 Fed and their counsel have delayed our filing until later
21 in the week."

22 Do you see that?

23 A. Yes, sir.

24 Q. When, as you understand it, were the definitive
25 credit facility documents prepared?

1 A. I don't know of any information contrary to what's
2 stated there. Not earlier.

3 Q. Not earlier than this.

4 A. Right.

5 Q. And what I'm really asking is, do you have any
6 understanding as to how much later after this those
7 definitive documents were prepared?

8 A. I'm not aware that they were -- that the documents
9 were definitive after this.

10 Q. Were definitive documents for the credit facility
11 ever prepared, in your understanding?

12 A. I believe we had the definitive documents in our
13 audit files by the end of the year.

14 Q. Other than believing you had them by the end of
15 the year, do you have any better understanding as to when
16 between September 24 and the end of the year that those
17 were prepared?

18 A. I don't remember the -- I don't remember the date
19 when we first got what was represented to us as the
20 definitive documents.

21 Q. Did you have an understanding --

22 A. Excuse me. Other than this e-mail.

23 Q. Yes. Yes.

24 Did you have an understanding as to why the
25 preparation of the definitive documents had been

1 delayed?

2 A. Not that I remember.

3 Q. Let me ask you to look next at Plaintiffs' Trial
4 Exhibit 444.

5 Can you explain what this document is?

6 A. This first page and the accompanying document is
7 from our work papers in the year-end audit, the
8 12-31-2008 year-end audit.

9 Q. So this was prepared by PwC in connection with
10 their year-end audit for 2008 for AIG; is that correct?

11 A. That's correct.

12 MR. BOIES: Your Honor, I would offer
13 Plaintiffs' Trial Exhibit 444.

14 MR. ROBERSON: No objection, Your Honor.

15 THE COURT: Plaintiffs' Trial Exhibit 444 is
16 admitted.

17 (Plaintiffs' Exhibit Number 444 was admitted into
18 evidence.)

19 BY MR. BOIES:

20 Q. Let me ask you to turn to page 3 of this exhibit.

21 A. I'm sorry. Page 3?

22 Q. Yes, page 3 of the exhibit. Page 3 of
23 Plaintiffs' Trial Exhibit 444.

24 And this is a PricewaterhouseCoopers critical
25 matter memo; is that correct?

1 A. Yes.

2 Q. And it's dated January 19, 2009?

3 A. Yes.

4 Q. Were you the author of this memo?

5 A. Coauthor with Latasha Brown.

6 Q. And I apologize for not having the hierarchy
7 right, but where in the hierarchy does manager and
8 partner stand at PwC?

9 A. Latasha worked for me.

10 Q. Okay. Thank you.

11 Let me direct your attention to the first page of
12 your memo, which is page 3 of Plaintiffs' Trial
13 Exhibit 444, and the heading Facts and Circumstances.

14 Do you see that?

15 A. Yes.

16 Q. And it says here (as read): During the process of
17 evaluating the United States GAAP accounting treatment
18 for the Series C preferred shares, we understood it was a
19 forgone conclusion that the Charter Amendment (to
20 increase the Company's authorized common share count by
21 19 billion and to reduce the par value on the Company's
22 common stock from \$2.50 to a tiny fraction of a penny)
23 would pass as the amendment would benefit the preferred
24 shareholder who held a controlling voting interest of
25 77.9 percent in the Company.

1 Do you see that?

2 A. Yes, sir.

3 Q. And I take it that was your understanding at the
4 time this memorandum was prepared.

5 Correct?

6 A. Well, it's referring to what our understanding was
7 earlier in the year.

8 Q. I take your point.

9 A. I'm stating a fact that that was our understanding
10 at the third quarter.

11 Q. You're stating in January what your understanding
12 had been earlier in the third or fourth quarter of 2008.

13 A. Yes, sir, that's correct.

14 Q. And you go on to say, "It was our understanding
15 that these amendments were needed to ensure conversion of
16 the Series C preferred shares."

17 Do you see that?

18 A. Yes.

19 Q. And where would that understanding have come
20 from?

21 A. From the work that we did in connection with the
22 third quarter review in October and November of 2008.

23 Q. And that would have been in connection with AIG?

24 A. Yes.

25 Q. You then go on to say, "We now understand the

1 common shareholders (sic) must also approve the amendment
2 in order for it to pass. Accordingly, it is not a
3 forgone conclusion that the amendment will pass and, in
4 fact, it may never pass."

5 Do you see that?

6 A. Yes.

7 Q. And what was the source of that understanding that
8 is described in what I just read?

9 A. I believe that originally came from conversations
10 with the company.

11 Q. Let me ask you to go to page 5 of the exhibit, and
12 there is a heading on page 5 in your memo that says
13 "Conclusion/Considerations."

14 Do you see that?

15 A. Yes.

16 Q. And you write there, "We understand the class vote
17 provision was a requirement that, under Delaware law, had
18 to be included in the terms securities purchase
19 agreement. Because the existing common shareholders
20 would be materially adversely affected by the
21 Charter Amendment, they are given the right to vote to
22 approve the amendment."

23 Do you understand -- do you see that?

24 A. Yes.

25 Q. What was the source of that understanding?

1 A. I believe that came from a legal group at AIG.

2 Q. Let me ask you to look at page 8 of this exhibit.

3 But before I do that, let me go back to page -- or
4 forward to page 9, where you've got a heading that says
5 "Measurement/Valuation of the TARP Warrants."

6 Do you see that?

7 A. Yes, I do.

8 Q. And you write, on page 9 of Plaintiffs' Trial
9 Exhibit 444 (as read): The warrants will give the
10 holder the option to purchase prior to the expiration
11 date in ten years, 53,798,766 common shares at an
12 initial strike price of \$2.50 per share until the
13 amendment to reduce the par value of the Company's stock
14 to a tiny fraction of one cent. If the Charter Amendment
15 to reduce the par amount is not passed, the strike price
16 remains at \$2.50.

17 Do you see that?

18 A. Yes.

19 Q. And as long as the par value of the stock was
20 \$2.50, the strike price for any warrant to be exercised
21 had to be at least \$2.50; correct?

22 A. That was our understanding.

23 Q. And then on the same page, down at the bottom, the
24 first sentence of the last paragraph, it says,
25 "Management believes that there is an inherent economic

Starr International Company, Inc. v. USA

1 disincentive for shareholders to approve the amendment,"
2 referring to the charter amendment; correct?

3 A. Yes.

4 Q. And you continue, "As such, the valuation assumes
5 that the strike price stays at \$2.50"; correct?

6 A. Yes.

7 Q. And you go on to say that if the strike price of a
8 tiny fraction of one cent was used, the value of the
9 warrant would increase but be capped by the stock price
10 of the common shares on the measurement date; correct?

11 A. Yes.

12 Q. With respect to the conversion of either warrants
13 or preferred stock into common stock, did you have an
14 understanding as to why that was desirable from the
15 standpoint of the holder of those warrants or preferred
16 stock?

17 A. Ultimately to be able to have optionality to own
18 the company. Or stock of the company I should say.

19 Q. And in addition, is it true that the common shares
20 would be much more liquid than the preferred shares?

21 A. They would be more liquid -- I agree they would be
22 more liquid than the preferred shares.

23 Q. And would you also agree that generally liquid
24 shares have a higher market value than shares that are
25 not liquid?

1 MR. ROBERSON: Objection, Your Honor. It calls
2 for expert opinion at this stage.

3 THE COURT: Well, I think as a PwC partner he can
4 answer the question.

5 THE WITNESS: I think generally in most markets
6 there's a higher value to something that's liquid than
7 something that's not liquid.

8 BY MR. BOIES:

9 Q. Let me ask you to turn next to Plaintiffs' Trial
10 Exhibit 350.

11 And can you identify what this document is.

12 A. This is a memo from Mr. Tim Ryan on a meeting he
13 and I had with Mr. Herzog and Ms. Dahlgren on October 28.

14 Q. And am I correct that the meeting that this memo
15 records took place on October 28, 2008 and the memo
16 itself is dated November 6, 2008?

17 A. Yes.

18 MR. BOIES: Your Honor, I'd offer
19 Plaintiffs' Trial Exhibit 350.

20 MR. ROBERSON: Again, Your Honor, there's no
21 foundation that he reviewed this, this document.

22 THE COURT: Overruled. I'm going to allow it.
23 Plaintiffs' Trial Exhibit 350 is admitted.

24 (Plaintiffs' Exhibit Number 350 was admitted into
25 evidence.)

1 BY MR. BOIES:

2 Q. Did you see this document at or about the time it
3 was prepared?

4 A. I believe I did.

5 Q. The beginning says, "On October 28, Don Farnan and
6 I met with David Herzog of AIG and Sarah Dahlgren of the
7 Federal Reserve (the lead Federal Reserve representative
8 assigned to AIG) and Ethan James of Davis Polk (the Fed's
9 attorneys)."

10 Do you see that?

11 A. Yes.

12 Q. And that was accurate; correct?

13 A. Yes.

14 Q. The memo goes on (as read): The purpose of the
15 meeting was to discuss the management representation
16 process and to specifically request that the
17 Federal Reserve be involved in that process giving their
18 credit facility and that there is now a controlling
19 shareholder at AIG in the third quarter (note while
20 technically not the Fed - as the trust is not formed -
21 the Fed appears to be functioning in the role of
22 controlling shareholder).

23 And does that accurately reflect your
24 understanding as of October 28, 2008?

25 A. Yes.

1 Q. The memo goes on to say, "Specifically, we
2 explained that in a 'typical' quarter - we would ask
3 management for representation and after reviewing those
4 representations and assessing them, we would accept those
5 representations. We explained that - given the
6 Federal Reserve role as the provider of the
7 Credit Facility and the 79.9 percent interest that was
8 given up by AIG in consideration of the facility and the
9 fact that the Fed - in its role might have plans for
10 Company assets or liabilities (or other items) which are
11 inconsistent with management's plans."

12 And was that an issue that you thought it was
13 useful to address at this time?

14 A. Yes.

15 Q. At the end of that first paragraph, you say, "We
16 also indicated that we would like to meet with the
17 Federal Reserve later in the quarter to confirm that they
18 have read the letter and that there are no objections or
19 inconsistencies in the representations. Sarah and Ethan
20 agreed that this was a reasonable request and that they
21 understood the need for it and indicated that they would
22 do this."

23 And is that an accurate description of what
24 Ms. Dahlgren and Mr. James conveyed to you?

25 A. Yes, it is.

1 Q. Let me ask you to look next at Plaintiffs' Trial
2 Exhibit 284.

3 And can you identify to me what this document is.

4 A. So this is an accounting policy memo from the
5 accounting policy office of AIG to us dealing with the
6 preferred shares issuance, a draft.

7 Q. Yes.

8 And this is -- I think this is described as the
9 company's first draft accounting memo on the preferred
10 stock; is that correct?

11 A. Yes, you're correct.

12 Q. And it was sent to you and to Latasha Brown on
13 October 7, 2008; correct?

14 A. Yes.

15 MR. BOIES: Your Honor, I would offer
16 Plaintiffs' Trial Exhibit 284.

17 MR. ROBERSON: No objection.

18 THE COURT: Plaintiffs' Trial Exhibit 284 is
19 admitted.

20 (Plaintiffs' Exhibit Number 284 was admitted into
21 evidence.)

22 BY MR. BOIES:

23 Q. If you go to the third page of the exhibit, the
24 second page of the AIG accounting policy memorandum, you
25 see that there are certain key terms associated with the

1 preferred stock that are set out there?

2 A. Yes.

3 Q. And the second term says, "The 100,000 shares of
4 preferred stock provide the holder(s) with voting rights
5 equivalent to up to 79.9 percent of the voting power of
6 all equityholders. This provides the Treasury, as the
7 sole owner of the preferred shares, control over AIG."

8 Do you see that?

9 A. Yes, I do.

10 Q. And was that your understanding as of October 7th
11 or 8th of 2008?

12 A. The -- yes. Except the trust had not yet been set
13 up nor had the trustees been identified that would
14 control the trust for the benefit of the Treasury, so
15 it's a -- kind of a short sentence to describe the real
16 facts.

17 Q. But this would have been, according to your
18 understanding, an accurate statement once the trust was
19 set up.

20 A. That's correct.

21 Q. Now, with respect to the issue of control, you're
22 familiar with the concept of a control premium; correct?

23 A. Yes.

24 Q. And could you explain for the record what a
25 control premium represents.

1 MR. ROBERSON: Your Honor, the fact that he's
2 familiar with the term doesn't mean he's expert in it,
3 and he appears to be eliciting expert opinion on the
4 subject.

5 THE COURT: Overruled. I'll take his
6 understanding.

7 THE WITNESS: So in general, if you buy one share
8 of stock, there's a value, and if you buy enough shares
9 to control a company, there's a view that there is an
10 additional amount you would pay to control a company.

11 BY MR. BOIES:

12 Q. Why is that, if you have an understanding?

13 A. Because if you control the company, you can direct
14 its activities.

15 Q. Let me ask you to look next at Plaintiffs' Trial
16 Exhibit 1066, which is not in your book and I'll have to
17 hand up to you.

18 Can you identify what Plaintiffs' Trial
19 Exhibit 1066 is.

20 A. It's the PricewaterhouseCoopers work paper dated
21 November 7 regarding the Super Senior CDS of AIG.

22 MR. BOIES: Your Honor, I would offer
23 Plaintiffs' Trial Exhibit 1066.

24 MR. ROBERSON: No objection, Your Honor. And just
25 for the record, he said "November 7." 2007.

1 THE COURT: The date here is 2007; right?

2 MR. BOIES: Yes.

3 THE COURT: Without objection, Plaintiffs' Trial
4 Exhibit 1066 is admitted.

5 (Plaintiffs' Exhibit Number 1066 was admitted into
6 evidence.)

7 BY MR. BOIES:

8 Q. And what was the issue to which this analysis was
9 directed?

10 A. A number of matters with respect to the
11 Super Senior CDS, which was a very large financial
12 instrument held by AIGFP of AIG, so it dealt with their
13 process, methodology, values.

14 Q. If you go to page 10, where it says "History of
15 losses," do you see that?

16 A. Yes.

17 Q. And it says, "Based on the portfolio to date,
18 AIGFP has never paid out on any Super Senior
19 transactions."

20 Do you see that?

21 A. Yes.

22 Q. And that was your understanding at the time this
23 memorandum was prepared?

24 MR. ROBERSON: Objection, Your Honor. There's no
25 foundation that he prepared this memorandum; so

1 therefore, there's no suggestion from this document that
2 he would have an understanding of this statement at that
3 time.

4 THE COURT: Sir, do you have an understanding of
5 super senior transactions at AIG Financial Products?

6 THE WITNESS: Some understanding, but this was
7 written by other members of our team.

8 BY MR. BOIES:

9 Q. Did you receive a copy of this?

10 A. I don't recall if I did in the
11 November 7, 2007 critical matter.

12 Q. What was your position on the audit team in
13 November of 2007?

14 A. So I worked on the corporate team responsible for
15 issues resolution, financial reporting, certain
16 centralized functions.

17 Q. And did that include auditing the AIG parent?

18 A. Yes, it did.

19 Q. And in order to audit the AIG parent, judgments
20 had to be made about the valuation of the AIGFP super
21 senior securities; correct?

22 A. To audit the consolidated entity, yes.

23 Q. So you needed to be aware of, if not this
24 particular memo, the issues that are addressed in it;
25 correct?

1 A. Yes. But to differing degrees depending --
2 for example, there was a partner who was in charge of
3 AIGFP.

4 Q. Who was that?

5 A. Henry Daubeney I believe at this time.

6 Q. Let me direct your attention again to page 10,
7 where the authors of this PwC memo write, "Based on the
8 portfolio to date, AIGFP has never paid out on any
9 Super Senior transactions."

10 Do you see that?

11 A. Yes, I do.

12 Q. Did you have an understanding one way or the
13 other in November of 2007 as to whether or not that was
14 true?

15 A. Yes. We talked about these type of issues as
16 teams, as a team.

17 Q. And you understood at that time that AIG had never
18 paid out on any super senior transaction; correct?

19 A. That was our outstanding.

20 Q. When, if ever, did AIGFP have to pay out on any
21 super senior transaction?

22 MR. ROBERSON: Objection. Vague as to the term
23 "pay out."

24 THE COURT: Overruled.

25 You can answer the question if you can.

1 BY MR. BOIES:

2 Q. And I mean to be using "paid out" the way it was
3 used in this PwC memo.

4 A. Well, so they paid out collateral, for example,
5 and ultimately these Super Senior CDS were put into a
6 vehicle as part of the restructuring of AIG and AIG lost
7 considerable amounts.

8 Q. When you say these were ultimately put into a
9 special-purpose vehicle and AIG lost considerable
10 amounts, are you referring to Maiden Lane III?

11 A. Yes, sir. If there were other payouts, I don't
12 know for sure.

13 Q. Okay. Other than posting collateral and the
14 Maiden Lane III transaction, are you aware of any
15 instances in which AIGFP had to pay out money because of
16 any super senior transaction?

17 A. I don't remember.

18 Q. As part of your audit, did PwC have to make a
19 determination of the fair value of AIG's assets?

20 A. No, we did not.

21 Q. Did PwC have to make a judgment as to whether the
22 fair value determined by AIG was reasonable?

23 A. Yes, we did.

24 Q. And did you determine that the fair value of AIG
25 assets as determined by AIG was reasonable for the

1 year 2007?

2 A. Yes. May I add, in the context of the overall
3 financial statements, we don't audit any individual asset
4 or liability.

5 Q. And was the same thing true for 2008?

6 A. Yes.

7 Q. And was the same thing true for 2009?

8 A. Yes.

9 Q. Did auditing the fair value of CDOs and CDSs pose
10 any particular difficulties for AIG or for PwC?

11 MR. ROBERSON: Objection. Compound.

12 MR. BOIES: I'll break it up.

13 THE COURT: Okay.

14 BY MR. BOIES:

15 Q. Did auditing the fair values of CDOs and CDSs pose
16 any particular problem or complication for PwC?

17 A. Yes.

18 MR. ROBERSON: Objection. Compound still,
19 Your Honor, CDOs and CDSs.

20 THE COURT: And he already answered, "Yes."

21 BY MR. BOIES:

22 Q. And what was that particular complication or
23 difficulty?

24 A. Well, in particular, the CDS were -- these were
25 all individually different, so the terms of many of them

Starr International Company, Inc. v. USA

1 were very different. That adds complexity.

2 At this particular time, the markets were in --
3 were challenged, shall we say, so the ability -- you
4 couldn't go find similar transactions in the
5 marketplace, you certainly couldn't pick up the
6 Wall Street Journal, so there's a lot of judgments in
7 determining the individual values of individual
8 securities.

9 Q. And when you say "this particular time," you're
10 talking about November 2007; is that correct?

11 A. Yes. Just because that's the period you pointed
12 me to. That's not the only period of challenge.

13 Q. Exactly.

14 And indeed, the challenge, as you describe it, got
15 progressively worse in 2008; correct?

16 A. That's correct.

17 Q. Let me ask you to look at Plaintiffs' Trial
18 Exhibit 332.

19 This is an e-mail dated October 30, 2008, from
20 Mr. Valoroso to Sarah Dahlgren, with copies to you and a
21 number of other people; correct?

22 A. Yes.

23 Q. And attached is a valuation on preferred shares
24 memorandum; correct?

25 A. A draft, yes.

1 Q. And did you receive this draft on or about
2 October 30, 2008?

3 A. Yes, I did.

4 Q. And what was the purpose of sending you this, as
5 you understood it?

6 A. To obtain our point of view on the analysis done
7 thus far by AIG on the value.

8 MR. BOIES: Your Honor, I would offer
9 Plaintiffs' Trial Exhibit 332.

10 MR. ROBERSON: No objection.

11 THE COURT: Plaintiffs' Trial Exhibit 332 is
12 admitted.

13 (Plaintiffs' Exhibit Number 332 was admitted into
14 evidence.)

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

16 THE COURT: All right. Thank you.

17 Cross-examination?

18 MR. ROBERSON: Thank you, Your Honor.

19 (Pause in the proceedings.)

20 John Roberson for the Department of Justice,
21 Your Honor.

22 THE COURT: Yes. Good afternoon.

23 MR. ROBERSON: Nice to see. We have some binders
24 we'd like to distribute.

25 (Pause in the proceedings.)

1 - - - - -

2 CROSS-EXAMINATION

3 BY MR. ROBERSON:

4 Q. Good morning, Mr. Farnan.

5 A. Good afternoon.

6 Q. I just want to clear up a few more things about
7 your -- about your -- your work experience just to try
8 and -- I know you said a few things there.

9 You graduated from college in 1983; is that
10 right?

11 A. Yes, sir.

12 Q. And what did you do immediately after college?

13 A. Went to work for PricewaterhouseCoopers --
14 Coopers & Lybrand at the time.

15 Q. Right. Okay.

16 And at a certain point in time Coopers & Lybrand
17 was acquired by Price Waterhouse? It was a merger?

18 A. It merged. Thank you. Yes.

19 Q. And could you just give us a brief description of
20 your work with Coopers & Lybrand. You graduated in '83,
21 you worked for Coopers & Lybrand, and then you went and
22 you were working in what part of the country?

23 A. In -- till 1989 I worked in the Kansas City,
24 Missouri office. I left PricewaterhouseCoopers for a
25 couple of years. I worked in Richmond, Virginia; Tokyo,

1 Japan; Washington, D.C.; New York.

2 Q. And tell us about your experience auditing
3 insurance companies and specifically for
4 Coopers & Lybrand.

5 A. Well, I began auditing insurance companies as an
6 intern, so even before I graduated I did two internships
7 with Price Water- -- Coopers & Lybrand at the time. And
8 I've done some work on insurance companies most of my
9 career, although not always full-time, probably since
10 2001 almost full-time just insurance company audits.

11 Q. Okay. 2003 which subsidiary of AIG were you
12 auditing as an engagement partner?

13 A. ALICO or American Life Insurance Company out of
14 Wilmington, Delaware.

15 Q. And what work were you doing for AIG, the parent
16 company, in 2004 and 2005?

17 A. I worked on -- I worked on the restatement of the
18 2004 and prior financial statements of AIG, Inc.

19 Q. Okay. And as you said, you in 2006 became part of
20 the AIG engagement team; is that right?

21 A. That's correct.

22 Q. And you're currently employed by PwC.

23 A. That's correct.

24 Q. In your experience as -- in auditing insurance
25 companies, have you been involved where there have been

1 rating downgrades of the insurance companies?

2 A. Yes, I have.

3 Q. Okay. And have you in your experience as an
4 auditor been involved where an insurance company has gone
5 into bankruptcy?

6 A. I've worked on one after it went into bankruptcy.
7 Yes.

8 Q. All right. I'm sorry. But the insurance
9 companies get seized. The parent company goes into
10 bankruptcy. I'm sorry.

11 A. That's correct.

12 Q. Yes. I'm sorry.

13 And I just want to ask you a little bit about the
14 structure of PwC's engagement at AIG.

15 Who was the engagement partner at AIG, the holding
16 company?

17 A. Tim Ryan.

18 Q. And can you share me or tell me about your
19 relationship with Mr. Ryan in terms of sharing
20 information and documents?

21 A. I sat right next to Mr. Ryan in our offices at AIG
22 and worked closely with him every single day as part of
23 his team.

24 Q. Would he share his work product with you?

25 A. Very often.

1 Q. And what was the purpose of his sharing the
2 documents with you?

3 A. Well, it was a complex, large engagement, and I
4 think Tim Ryan as a collaborative partner wants to make
5 sure he gets points of view, and he respected mine.

6 Q. I want to first begin by discussing the valuation
7 of the Series C preferred stock that the government
8 received as part of the federal facility transaction.
9 And what we're going to do is we'll first look at a memo
10 that PwC prepared with which you expressly concur. We'll
11 discuss it, and then we'll move to turn to other
12 documents as needed to support or further discuss the
13 issues that are discussed in your memo, so I'll give you
14 a road map of where we're heading here.

15 So if you would, could you please turn to JX 146.

16 And JX 146 is a November 9 formal consultation
17 memo from PwC, and you were the partner on this memo; is
18 that correct?

19 A. Yes, it is.

20 Q. And if you look at the last page of the document,
21 it says "Partner Concurrence." Here it says,
22 "Donald Farnan, Engagement Team Partner, was involved in
23 the consultation and concurs with the preliminary views
24 expressed above."

25 So you concur with this memo; is that what that's

1 suggesting?

2 A. Yes.

3 MR. ROBERSON: Your Honor, we move to admit -- I
4 guess we don't have to. It's already admitted, JX 146.

5 THE COURT: Yes. All the joint exhibits --

6 MR. ROBERSON: Right.

7 THE COURT: -- are admitted.

8 MR. ROBERSON: I apologize.

9 BY MR. ROBERSON:

10 Q. And as a general matter, do you recall working on
11 the issue of PwC's audit of AIG's accounting for its
12 Series C stock that it issued to the government?

13 A. Yes, I do.

14 Q. So let's take a look at the structure of this
15 memo.

16 On the first page, under the heading Facts and
17 Circumstances, PwC writes that the definitive agreement
18 between AIG and the Fed was signed on September 22, and
19 then there is a chart where PwC describes the pertinent
20 terms of the federal facility; right?

21 A. Yes.

22 Q. And then on page 5, if you look over there, the
23 memo lists accounting issues to be addressed in the memo.

24 At page 6, the memo notes the research you used to
25 guide PwC's opinion; right?

1 A. Yes.

2 Q. And then in the body of the memo, PwC proceeds to
3 pose specific questions to which it posts its
4 conclusions; is that a fair description of this
5 document?

6 A. Yes, it is.

7 Q. Now, turn to page 9.

8 And at the bottom of the page, at question 2, PwC
9 writes, "How should the preferred stock initially be
10 measured and reported? How should the preferred stock
11 subsequently be measured and reported?"

12 And your preliminary conclusion is that the
13 preferred stocks should be recorded at fair value,
14 subsequent changes in fair value of the preferred stock
15 should not be recognized as long as the preferred
16 continue to be classified as equity; is that correct?

17 A. Yes, it is.

18 Q. Now, turn to the following page. And at the end
19 of your discussion of question 2, which is obviously the
20 paragraph immediately above paragraph 3, you write, "The
21 company has engaged a third-party specialist to assist in
22 the valuation of the preferred stock. The value of the
23 preferred stock was estimated at \$23 billion as of
24 September 16, 2008."

25 Do you see that?

1 A. Yes.

2 Q. So I take it there's actually a fair amount of
3 information embedded in that statement, so I'm going to
4 ask you to unpack those two sentences for us.

5 So in the first sentence, what are the key -- what
6 are the key issues? It is that the company comes up with
7 a valuation and not PwC; is that correct?

8 A. Yes, it is.

9 Q. And do you recall the company that AIG retained to
10 assist in the valuation? I believe that came up in your
11 examination.

12 A. KPMG.

13 Q. So what you're using is AIG's valuation of
14 preferred which it determined in the first instance with
15 the help of KPMG; is that correct?

16 A. Yes.

17 Q. And the second sentence indicates that the fair
18 value was estimated as of September 16, 2008.

19 Do you see that?

20 A. Yes, I do.

21 Q. So I have a couple questions about that.

22 First, do you recall whether the 16th as a
23 valuation date was a date that AIG chose?

24 A. Yes, it was.

25 Q. Okay. And I have -- take it that PwC concurred

1 with the use of September 16 as the valuation date;
2 correct?

3 A. We concurred -- yes, we concurred it was
4 reasonable.

5 Q. Okay. Now, I'm going to ask you to explain how it
6 is that PwC concurred with KPMG's use of September 16,
7 2008 as a valuation date for the preferred despite the
8 fact, as it is acknowledged in the first page of the
9 memo, that the federal facility was executed on
10 September 22, 2008. And toward that end, just so we --
11 so telegraph this a little bit -- if you turn to
12 page 12 and the second paragraph of that page, about
13 halfway down that large paragraph, there's an explanation
14 for the use of the September 16 valuation date, so if you
15 would take a look at that and it refreshes your
16 recollection, if you could discuss that, the distinction
17 between the September 16 date and the September 22 date.

18 MR. BOIES: Objection, Your Honor. Leading.

19 THE COURT: It's also quite long. Maybe you can
20 break it up now that you've given the background.

21 MR. ROBERSON: Okay.

22 BY MR. ROBERSON:

23 Q. September 16 was the date that AIG chose, and PwC
24 concurred with that date as the valuation date for the
25 preferred; correct?

1 A. That's correct.

2 Q. The federal -- if you look at the first page here
3 of your memo, it says on September 22, 2008, they
4 signed -- AIG signed a definitive agreement; right?

5 A. Yes.

6 Q. So can you explain how, despite the signing of the
7 definitive agreement on the 22nd, PwC concurred with
8 AIG's choice of September 16 as the date for the
9 valuation of the preferred stock?

10 A. The company asserted that September 16 was the
11 date of an oral agreement between them and the third
12 party or the other party. They provided us evidence. We
13 asked a lot of questions to audit or review the selection
14 of September 16 and after looking at that evidence, all
15 of it together, concurred that September 16 was an
16 appropriate date.

17 Q. If you look at page 12, in the section that I just
18 indicated to you, which is the second full paragraph,
19 there's a statement. And it concurs with what you just
20 said. It says that "The agreement signed on
21 September 22, 2008 memorializes the terms of the oral
22 agreement established on September 16, 2008."

23 And then there's a piece of evidence I assume
24 you're referring to here. It says (as read): This is
25 supported by the fact that no other -- that no additional

1 consideration was required upon execution of the
2 definitive agreement. Accordingly, we determined that
3 the prepaid forward sales contract (presented in the
4 statement of the shareholder's equity as "Consideration
5 received for preferred stock not yet issued) was "fully"
6 prepaid on September 16, 2008.

7 Is that a correct assertion of PwC's position on
8 this?

9 A. Yes.

10 THE COURT: Mr. Roberson, why don't we take a
11 break.

12 MR. ROBERSON: Yes, Your Honor.

13 THE COURT: We'll come back at 3:30.

14 (Court in recess.)

15 THE COURT: Please proceed, Mr. Roberson.

16 BY MR. ROBERSON:

17 Q. Mr. Farnan, before the break, we were discussing
18 JX 146 at page 12. Do you remember that?

19 A. Yes, sir.

20 Q. What PwC is doing here is describing the economic
21 reality of the transaction from an accounting and
22 auditing point of view; is that a fair assessment?

23 A. We're evaluating this, yes, and drawing
24 conclusions about the accounting implications, yes.

25 Q. And this analysis described here on page 12 is the

1 rationale underlying PwC's analysis of the appropriate
2 valuation date; is that correct?

3 A. Yes.

4 Q. And there are other sources of evidence and
5 information that you looked at for that date, too; is
6 that correct?

7 A. That's correct.

8 Q. We'll turn to the 16th as a specific part of the
9 questioning later on, but -- so we'll sort of move off.
10 Now, if you -- focusing still on this memo, if we
11 turn to question 3 of the memo, so we're at -- we were
12 discussing question 2. Now we'll look at question 3 of
13 the memo. And it's on page 10.

14 The question is: "What is the 'offset' to the
15 recognition of the preferred stock? Should the issuance
16 of the preferred stock be recognized as a deferred
17 financing cost (an asset) or as an adjustment to
18 permanent equity?"

19 And what was PwC's preliminary conclusion in that
20 regard?

21 A. That it should be recorded as an asset.

22 Q. And why was that?

23 A. Well, there's judgment -- so first of all, the
24 balance sheet must balance, so you have to either
25 recognize an asset or something on the right-hand side of

1 the balance sheet or as a kind of equity. But in looking
2 at these facts and circumstances, we believed that it was
3 an asset.

4 Q. When you say "it was an asset," what exactly are
5 you talking --

6 A. The offset to the \$23 billion valuation of the
7 preferred stock.

8 Q. And the asset as described here is the deferred
9 financing cost; correct?

10 A. That's correct.

11 Q. And what is the deferred financing cost referred
12 to specifically?

13 A. There was an exchange of access to the Fed
14 facility for which the -- AIG gave up the preferred
15 stock, so that's the exchange. That's the financing, the
16 line of credit. And part of the cost of that was the
17 preferred stock that was issued to the trust.

18 Q. Okay. And if we were to re- -- restate that, it
19 would be at the bottom of page 10, last sentence,
20 "As stated in the draft preferred stock agreements, the
21 preferred stock is being issued as consideration for
22 (in exchange for) \$500,000, plus the lending commitment
23 from the Federal Reserve Bank"; is that correct?

24 A. Yes, that's correct.

25 Q. And that's consistent with what you just said; is

1 that right?

2 A. Yes. And -- yes.

3 Q. Okay. And this concept is -- is -- is discussed
4 again at page 12, which is just above the part of the
5 paragraph that we discussed earlier. And if you look at
6 the -- about the seventh or eighth line down, PwC writes
7 "we have concluded the Company's obligation to issue a
8 fixed number of shares of its preferred stock represents
9 a prepaid forward sales contract. We believe the
10 recognition of a forward contract is appropriate because
11 the shares were effectively 'purchased' (paid for) by the
12 Federal Reserve Bank prior to the end of the third
13 quarter by providing the Company with access to the
14 Credit Facility, but would not be delivered until after
15 the end of the third quarter when the trust is
16 established."

17 So to be clear, PwC considered the federal
18 facility to provide consideration for the Series C
19 preferred that it received from AIG; is that correct?

20 A. Yes.

21 Q. And PwC considered AIG's obligation to issue the
22 Series C in return for the Fed facility to constitute a
23 prepaid forward sales contract; correct?

24 A. I'm sorry. Could you repeat that.

25 Q. PwC considered AIG's obligation to issue the

1 Series C in return for the federal facility to constitute
2 a prepaid forward sales contract.

3 A. That's correct.

4 Q. Okay. Can you explain what a prepaid forward
5 sales contract is?

6 A. Well, the accounting rules -- since the
7 Series C had not been issued, but the company was
8 obligated to issue it, the accounting rules don't let you
9 recognize preferred stock on your balance sheet. But
10 clearly the company had committed something and had
11 received something in return, so some accounting
12 recognition needed to be given to that. And as we
13 considered what those possibilities were, a commitment to
14 issue those shares we considered a financial instrument
15 that could be recognized on the financials.

16 Q. And it was an asset?

17 A. An asset -- and we considered it to be an asset of
18 the company. That would be amortized over the life of
19 the line of credit.

20 Q. Okay. And what we're going to do now is focus on
21 that consideration that AIG received for the preferred
22 stock and as the value of that consideration.

23 Let's turn now to JX 150, which is the third
24 quarter 2008 10-Q. And I'll ask you to take a look at
25 page 6.

1 And if you look toward the bottom of the page --
2 and this is a -- this is a chart obviously, a table -- it
3 has "non-cash financing activities," and then there's a
4 line "consideration received for preferred stock not yet
5 issued."

6 A. Excuse me. Excuse me. This is page 6 of the
7 actual document or --

8 Q. I'm sorry.

9 A. -- at the bottom?

10 Q. Page 6 of the actual document. It's page 8 of
11 200. I apologize.

12 A. Thank you.

13 Could you repeat your question.

14 Q. I'm sorry. Let me do this. Actually I think
15 it -- yes.

16 So -- so the question is, there's a -- there's a
17 line here "consideration received for preferred stock not
18 yet issued."

19 And what is the figure there?

20 A. 23 billion.

21 Q. And is that the consideration we were just
22 discussing?

23 A. Yes, it is.

24 Q. Now, if you turn two pages before that to
25 page 6 of 200, there's a line in here, second sort of

1 bolded line, additional paid-in capital.

2 Do you see that?

3 A. Yes.

4 Q. And is the consideration listed there as well as
5 additional paid-in capital?

6 A. Yes.

7 Q. Okay. And what is that figure again?

8 A. \$23 billion.

9 Q. Okay. Now we're going to take a look at the body
10 of the 10-Q concerning this topic, so if you would turn
11 to page 28 of 200.

12 Do you see at the bottom third of the page there
13 are a series of paragraphs and the first one states, "AIG
14 received the consideration in the form of the
15 Fed Facility for the Series C Preferred Stock in the
16 third quarter of 2008 and recorded the fair value of the
17 Series C Preferred Stock, \$23 billion, as an increase to
18 additional paid-in capital. The value, net of the
19 \$500,000 cash portion of the consideration, was
20 recognized as an addition to the prepaid commitment fee
21 asset associated with the Fed Facility. The valuation of
22 the consideration received for the Series C Preferred
23 Stock that AIG agreed to issue was determined by AIG and
24 was primarily based on the implied value of 79.9 percent
25 of AIG indicated by AIG's common stock price after the

1 terms of the Fed Credit Agreement were publicly
2 announced"?

3 Does this statement comport with PwC's
4 understanding that the consideration AIG received under
5 the loan transaction with the FRBNY and the value of the
6 consideration AIG received through the loan transaction?

7 A. Yes, it does.

8 Q. And does this statement comport with PwC's
9 understanding that the consideration received by AIG was
10 recorded at fair value?

11 A. Yes.

12 Q. And just to be clear, the \$23 billion valuation
13 was determined after the terms of the federal credit
14 agreement were publicly announced.

15 Do you recall that as being part of the analysis?

16 A. Yes.

17 Q. So because it's a valuation after the terms of the
18 federal -- Fed credit agreement were publicly announced,
19 the valuation only occurs after the market knows that AIG
20 will receive the right to the \$85 billion line of credit
21 and thus won't face bankruptcy in the immediate future;
22 is that correct?

23 MR. BOIES: Objection. Leading.

24 THE COURT: Well, both sides have been doing a lot
25 of leading here. Do you want to make an issue of it

1 or...

2 MR. BOIES: No, Your Honor.

3 THE COURT: Okay.

4 MR. ROBERSON: I appreciate that, Mr. Boies.

5 THE COURT: Let's try to avoid blatant leading.

6 MR. ROBERSON: All right.

7 THE COURT: As opposed to modest leading.

8 MR. ROBERSON: Okay.

9 BY MR. ROBERSON:

10 Q. Could you -- we were talking about the fact that
11 the -- that because this valuation is after the credit
12 agreement was announced, it implied a recognition by the
13 market of certain factors.

14 Can you recall what those factors would be?

15 A. They included that AIG had access to a very large
16 amount of support from the Federal Reserve Bank of
17 New York, as well as the amount of dilution that would
18 occur because they were going to issue a 79.9 percent
19 equity interest to someone else.

20 Q. And it also indicated that AIG wasn't facing
21 bankruptcy in the immediate future; correct?

22 A. I don't remember thinking, but you asked what I
23 thought about it at the time, and I don't remember
24 thinking about that, but --

25 Q. Fair enough.

1 And just by definition because it's a market
2 valuation, the market price reflecting the Fed facility
3 would not have been available until September 17; is that
4 correct?

5 A. The announcement -- I believe the announcement was
6 made after the market closed --

7 Q. Correct.

8 A. -- and so no earlier than the next morning.

9 Q. Right.

10 And is that consistent with your recollection that
11 the 17th was the date that KPMG used in coming up with
12 the \$23 billion figure?

13 A. They used multiple methods. One of those included
14 the closing price on September 17.

15 Q. All right. Let's turn to JX 188. And we have
16 portions here. It's a 553-page document, so we're just
17 looking at a few pages.

18 It's the 10-K for 2008.

19 If you turn to page 293, under the heading
20 Series C Perpetual, Convertible, Participating Preferred
21 Stock, the 10-K states, "As partial consideration for the
22 Fed Credit Agreement, AIG agreed to issue 100,000 shares
23 of Series C Preferred Stock to the Trust. AIG recorded
24 the \$23 billion fair value of the Series C Preferred
25 Stock not yet issued as a prepaid commitment fee asset

1 and an increase to additional paid-in capital."

2 And this is AIG's statement; correct?

3 A. That's correct.

4 Q. Which AIG -- which PwC audited and which -- to
5 which PwC concurred; correct?

6 A. That's correct.

7 Q. Now, PwC performed a review of AIG's quarterly
8 2008 financial statements and audited AIG's year-end
9 2008 financial statements; correct?

10 A. Yes.

11 Q. And is it correct that PwC understood that AIG was
12 reporting the value of the preferred stock to be issued
13 as equivalent to the value of the consideration received
14 by AIG through the Fed facility?

15 A. Yes. I would -- those were needed to be equal --

16 Q. Right.

17 A. -- from our point of view.

18 Q. And they need to be equal for what reason?

19 A. Because the balance sheet has to balance at the
20 end of the day.

21 Q. Okay. Counsel had already addressed the notion
22 that KPMG had been doing work in connection with the
23 valuation of the preferred; correct?

24 A. Yes.

25 Q. Now, if you'd turn to DX 637.

1 And DX 637 is an e-mail from Anthony Valoroso,
2 dated November 1, 2008, to several people, including
3 yourself.

4 Do you see that?

5 A. Yes, I do.

6 Q. And it includes an e-mail forwarding an attachment
7 from Carolyn Worth at KPMG.

8 Do you know who she is?

9 A. I don't remember -- she was one of the main
10 contacts at KPMG doing the valuation of the preferred
11 stock.

12 Q. And the attachment is a KPMG document entitled
13 American International Group, Incorporated, Valuation of
14 Series A Preferred Stock, Valuation Date: September 16,
15 2008; correct?

16 A. Yes.

17 MR. ROBERSON: Your Honor, we move to admit
18 DX 637.

19 MR. BOIES: No objection, Your Honor.

20 THE COURT: Defendant's Exhibit 637 is admitted.

21 (Defendant's Exhibit Number 637 was admitted into
22 evidence.)

23 BY MR. ROBERSON:

24 Q. Now, I just mentioned it to you that it was the
25 valuation of Series A preferred stock.

1 Did this become the valuation of the Series C
2 preferred stock?

3 A. Yes, it did.

4 Q. And the conclusion of the report is on the
5 following page; right?

6 It's a letter to Mr. Valoroso, dated October 31,
7 2008. It says (as read): Dear Mr. Valoroso: KPMG has
8 completed its valuation of the shares of Series A
9 Perpetual, Convertible, Participating Preferred Stock to
10 be issued by American International Group to AIG Credit
11 Facility Trust, a trust established for the benefit of
12 the United States Department of Trusts -- I mean,
13 Department of Treasury, effective as of September 16,
14 2008.

15 Then continuing, it says, "We estimated the fair
16 value (rounded) of the Preferred Stock as of the
17 Valuation Date to be as follows: \$23 billion"; right?

18 A. Yes.

19 Q. And Mr. Valoroso was again -- what was his
20 responsibility at AIG?

21 A. Mr. Valoroso was the head of accounting policy and
22 did special project work at AIG.

23 Q. And he was in charge, as far as you know, as of --
24 of AIG's project of valuing the preferred stock --
25 Series C preferred stock?

1 A. That's correct.

2 Q. Now, if you turn to the fourth page of the
3 report, there's a table of contents, and you can see that
4 there are five different methods, valuation methods;
5 right?

6 A. Yes.

7 Q. There's a common stock price, incremental market
8 capitalization, improvement in credit standing, residual
9 method without government support, and residual method
10 with government support; correct?

11 A. Yes.

12 Q. And KPMG concluded that an average of the first
13 two valuations listed there, which are both based upon a
14 stock market price, was the appropriate valuation metric;
15 correct?

16 A. That's correct.

17 Q. And PwC received KPMG's valuations with respect to
18 the use of these first two stock market price-derived
19 valuations, and what conclusion did PwC reach?

20 A. That those two methods were reasonable methods for
21 determining the fair value of the preferred stock.

22 Q. Okay. And just to tie this down, let's turn to
23 DX 675.

24 DX 675 is a memo, a PwC memo titled Valuation of
25 Preferred Stock. It says it was reviewed by you on

1 November 10, 2008.

2 Do you see that? At the top of the page?

3 A. Yes.

4 MR. ROBERSON: We move to admit DX 675,
5 Your Honor.

6 MR. BOIES: No objection, Your Honor.

7 THE COURT: Defendant's Exhibit 675 is admitted.

8 (Defendant's Exhibit Number 675 was admitted into
9 evidence.)

10 BY MR. ROBERSON:

11 Q. Now, at the second page, under the heading
12 Conclusion of KPMG and AIG -- I apologize for the small
13 print -- PwC writes, "AIG has performed their own
14 independent calculation based on the two approaches.
15 Management has considered the various approaches used by
16 KPMG and concluded that the estimate resulting from the
17 common stock approach should be weighted most heavily in
18 their triangulation process because it has the most
19 observability. As documented in their memo," and then
20 skipping, "management has concluded that \$23 billion was
21 a reasonable estimate."

22 And again, PwC agreed that this estimate was
23 reasonable?

24 A. Yes, we did.

25 Q. And in fact, there's an express statement to that

1 effect. If you go forward three pages to the Bates
2 ending 17 -- 1078522, you can see the overall
3 conclusions, and the statement is: "Based on procedures
4 performed above, we concluded that the estimated fair
5 value of the preferred stock of \$23 billion is
6 reasonable"; right?

7 A. Yes.

8 Q. Okay. And this document indicates some of the
9 analyses that PwC undertook in that regard; is that
10 right?

11 A. Yes, it does.

12 Q. I'm going to turn now to JX 140.

13 This is the PwC memo dated October 31, 2008;
14 correct?

15 A. Yes, it is.

16 Q. Now, the first paragraph of the document states
17 that the authors "assisted the audit engagement team in
18 reviewing the methodologies and assumptions used by KPMG
19 in its valuation of shares of Series A perpetual,
20 convertible, participating preferred stock (Preferred
21 Stock) to be issued by AIG to AIG Credit Trust under its
22 credit facility agreement with the Federal Reserve Bank
23 of New York ('FRBNY') as of September 16, 2008 (the
24 ('Valuation Date'))"; right?

25 A. Yes.

1 Q. So this states the purpose of the memo; right?

2 A. Yes, it does.

3 Q. Okay. Now, turn to page 2, and here PwC writes,
4 under Key Issues/Resolutions, "In our review of the five
5 different approaches used by KPMG in valuing the
6 Preferred Shares, we noted the following key issues, the
7 actions taken to address those issues and the basis for
8 conclusions reached"; right?

9 A. Yes.

10 Q. And in paragraph 1, the memo further states that
11 "Methods A and B are based on changes in Company's common
12 stock price before and after the transaction."

13 That's the 16th to the 17th reference?

14 A. Yes, it is.

15 Q. Okay.

16 "It assumes that the market incorporates the
17 impact of dilution in common shares upon conversion of
18 Preferred Shares to Company's common stock. The change
19 in Company's capitalization before the credit facility
20 agreement versus its capitalization assuming preferred
21 shares are converted to common, after the transaction, is
22 implied to be the value of preferred shares"; right?

23 A. Yes.

24 Q. Another kind of long way to say what we've been
25 talking about. It's that valuation between the 16th and

1 the 17th, which is the metric that's being used here in
2 terms of stock market price.

3 A. Yes, that's correct.

4 Q. Okay. And under -- go to page 3 under Conclusion.

5 PwC concludes that it is reasonable for AIG to
6 rely on KPMG's report in the recording of the value of
7 the preferred stock; is that correct?

8 A. Yes.

9 Q. And did AIG conclude that KPMG's stock market
10 valuation represented the market assessment of the value
11 of the Fed facility?

12 A. Yes, it did.

13 Q. Okay. And how did PwC --

14 A. I'm sorry. The market value of the preferred
15 shares.

16 Q. Well, my question was the market value of the Fed
17 facility.

18 A. I'm sorry. Could you repeat your question. I
19 apologize.

20 Q. Did AIG conclude that KPMG's stock market
21 valuation represented the market assessment of the value
22 of the Fed facility?

23 A. Yes.

24 Q. Can you -- you seemed a little bit -- like you
25 questioned -- you questioned my question. Could you

1 explain your confusion to us.

2 A. Well, we were looking at this as the valuation of
3 the preferred stock. Again, there was -- AIG received
4 access to the facility and gave preferred stock, so when
5 I think of this, I think of valuing what AIG gave up.

6 Q. But my question was with what AIG got, and
7 that --

8 A. Well, those would be -- in a transaction, what you
9 get and give up should be equal.

10 Q. So they received a \$23 billion asset.

11 A. That's correct.

12 Q. Okay. And how did PwC evaluate the assessment of
13 the value of the Fed facility by AIG?

14 A. Well, KPMG evaluated the value. We assessed their
15 methodologies and assumptions that they -- that they used
16 to calculate the values, concluded their market
17 approaches were reasonable. Some of the other
18 approaches, we gave them feedback in this memo in terms
19 of their value to that, to the overall selection of
20 amount.

21 Q. And the other -- the other methods, what was
22 your -- what was your general feedback, if you can
23 recall?

24 A. Well, we thought that the methods C, D and E were
25 less reliable than market -- methods A and B, which is --

1 methods A and B were the stock-based ones.

2 Q. Right.

3 A. Methods C, D and E used credit default spreads,
4 but we thought they were less reliable than the market
5 approaches using the stock price.

6 Q. Okay. And that's -- your less reliable
7 determination was with respect to all three methods that
8 remained on KPMG's plate there, C, D and E?

9 A. That's correct.

10 Q. Okay. All right.

11 Now, AIG determined and PwC concurred that the
12 \$85 billion line of credit was consideration for the
13 preferred stock; correct?

14 A. That's correct.

15 Q. Okay. Now, given that AIG agreed to issue the
16 preferred stock in partial consideration for the Fed
17 facility, can you please explain how AIG accounted for
18 the preferred stock to be issued.

19 A. They recognized a prepaid forward contract that
20 increased their equity and they set up an asset to
21 off- -- so that the balance sheet would balance.

22 Q. Okay. The preferred stock to be issued was
23 recorded by AIG as an increase in additional capital;
24 correct?

25 A. Yes. I'm sorry. As additional paid-in capital.

1 Q. Right.

2 A. I said equity, but I shortcut additional paid-in
3 capital as a component of equity.

4 Q. Okay.

5 And I think we've gone over this, but would it be
6 fair to say that AIG valued the preferred stock at an
7 amount equal to what was given for the stock?

8 A. Yes. For consideration that they received, yes.

9 Q. Now, if AIG had received only \$500,000 cash for
10 the preferred stock to be issued and the Fed facility had
11 not concurred -- conferred any additional value to AIG,
12 AIG could not have properly recorded the value of the
13 stock to be issued at \$23 billion. Would you agree with
14 that statement?

15 A. Well, I think so, but that's a hypothetical that
16 didn't -- didn't -- the company did not assert that they
17 only had \$500,000 for the preferred stock.

18 Q. We agree to that. I'm just saying, if they had
19 asserted that, recording the value of the stock to be
20 issued at \$23 billion would have been incorrect.

21 A. That seems unlikely to me that that would have
22 been our conclusion.

23 Q. Right.

24 Now, we've been talking -- we talked earlier about
25 the date of the valuation as September 16, so we're going

1 to spend some time on that right now.

2 First, PwC wasn't required to accept AIG's
3 assertion that September 16 was the appropriate valuation
4 date; is that correct?

5 A. That's correct.

6 Q. And why not?

7 A. In our role, it -- we're supposed to be objective
8 and independent for any key points, and so just because a
9 company asserts something doesn't mean we will agree with
10 it.

11 Q. Okay. Now, if PwC disagreed that September 16 was
12 the appropriate valuation date, it would have objected to
13 AIG's assertion; correct?

14 A. That's correct.

15 Q. And PwC gathered audit evidence that allowed PwC
16 to conclude that September 16 was the appropriate
17 valuation date; is that a fair assessment?

18 MR. BOIES: I'm going to object there on leading,
19 Your Honor, because I think that it is inconsistent with
20 what the witness said to me on my examination, and if
21 he's going to say something different, I would like to
22 have it in a nonleading response.

23 THE COURT: I think that's actually a fair
24 request.

25 MR. ROBERSON: Fair enough, Your Honor.

1 THE COURT: Rephrase it.

2 BY MR. ROBERSON:

3 Q. What activities did PwC undertake in connection
4 with its assessment of the September 16 valuation date as
5 appropriate?

6 A. Well, may I begin with, the company asserted that
7 that was the appropriate date. We looked at -- we knew
8 that the credit agreement was signed on September 22, so
9 we talked to a number of different people, not just the
10 company but the counterparty in this particular
11 transaction, the Fed. And after looking at that, as well
12 as information that we've seen in terms of the valuation,
13 we concluded that that was the appropriate date of
14 measurement for the exchange.

15 Q. Okay. Turn to DX 675.

16 This is -- has this been admitted?

17 THE COURT: Didn't we already cover this?

18 MR. ROBERSON: We may have. We may have.

19 THE COURT: It was admitted just a little while
20 ago.

21 MR. ROBERSON: Right.

22 BY MR. ROBERSON:

23 Q. Just turn to page 3 of the document because we're
24 really just focusing on the September 16 date.

25 Under the key assumptions on the third page of the

1 document, you see the measurement date. It says
2 "Measurement date - September 16, 2008 - which appears to
3 be appropriate given that this is the date when the Fed
4 intervention was announced" and "Transaction is entered
5 into as an arm's length transaction."

6 Do you see that?

7 A. Yes, I do.

8 Q. Okay. So this is a date that AIG used, the 16th;
9 correct?

10 A. Yes.

11 Q. Let's turn to DX 572.

12 This is an e-mail from Mr. Valoroso to you, dated
13 September 26, 2008, and enclosed is a document that's
14 entitled Fair Value Determination of 79.9 percent
15 Interest in AIG.

16 We move to admit, Your Honor.

17 MR. BOIES: No objection, Your Honor.

18 THE COURT: Defendant's Exhibit 572 is admitted.

19 (Defendant's Exhibit Number 572 was admitted into
20 evidence.)

21 BY MR. ROBERSON:

22 Q. And so this -- what do you understand this
23 document to be?

24 A. Initially, the company itself drafted their
25 estimated value of the preferred shares --

1 Q. Okay.

2 A. -- and provided that to us.

3 Q. And that's what this document --

4 A. That's what this document is.

5 Q. Okay. And I -- we see there's a method A, a
6 method B and a method C; right?

7 A. Yes.

8 Q. And the range of valuations on method A, which is
9 based on the common stock price, is what?

10 A. .1 billion to 2.7 billion.

11 Q. Okay. And what date is Mr. Valoroso undertaking
12 the valuation?

13 A. I believe he was using September 16.

14 Q. Okay. So in this method A, AIG is valuing the
15 79.9 percent preferred stock interest as of the 16th, and
16 it's determining that the value is as little as
17 \$100 million and as much as \$2.7 billion; correct?

18 A. Under method A, yes.

19 Q. Right.

20 And method A is a stock price just on the 16th;
21 correct?

22 A. That's correct -- that's correct.

23 Q. Okay. In fact, if we look here, he's got -- on
24 Tuesday, September 16, he's got AIG downgraded and has
25 AIG low stock price \$1.25. And then if you look at the

1 text, it says (as read): In valuing the 79 percent
2 preferred stock interest, the low price of the common
3 stock on Tuesday, September 16, 2008 (\$1.25) provides an
4 indication of the company's value in a near-bankrupt
5 state, prior to the market having any knowledge of
6 possible Fed intervention. The stock ended higher on the
7 16th as the Fed announced in the middle of the day that
8 it was reconsidering its decision to aid AIG. With \$2.7
9 billion -- with 2.7 billion shares outstanding, \$1.25 for
10 the common places a value of 80 percent of the company at
11 \$2.7 billion (before consideration of a blockage discount
12 or control premium); right?

13 A. Yes.

14 Q. Let's turn to DX 626.

15 And DX 626 is an AIG accounting policy memorandum
16 on -- and it was sent to you, among other individuals;
17 correct?

18 A. Yes.

19 MR. ROBERSON: Move to admit DX 626.

20 MR. BOIES: No objection, Your Honor.

21 THE COURT: Defendant's Exhibit 626 is admitted.

22 (Defendant's Exhibit Number 626 was admitted into
23 evidence.)

24 BY MR. ROBERSON:

25 Q. Now, as it states in the introductory text,

1 DX 626 is an accounting memo addressing the accounting
2 associated with the \$85 billion loan facility; correct?

3 A. Yes.

4 Q. And just look at a couple references to the
5 September 16 date in the memo.

6 At the top of the second page -- excuse me -- at
7 the top of the second paragraph, AIG writes, "AIG, Inc.
8 began borrowing from the Fed on 9-16-2008, following an
9 agreement in principle between AIG and the Fed."

10 Do you see that?

11 A. Yes, I do.

12 Q. And now turn to page 6.

13 At the top of that page, it says, "AIG borrowed
14 amounts from the Fed beginning on 9-16-2008, when AIG
15 agreed to accept the Fed's terms. The Credit Agreement
16 was signed on 9-22-2008."

17 And my question is whether these two passages I've
18 cited from this AIG memo sent to you serve as a part of
19 the evidence that PwC considered with respect to using or
20 determining that the September 16 was the proper date for
21 AIG to value the Fed facility.

22 A. Yes, this is part.

23 Q. Okay. Right. And there were other things, but
24 this was one part of it.

25 A. Yes.

1 Q. Okay. You know, I just want to ask you
2 quickly -- we just looked at that Valoroso memorandum,
3 the AIG memorandum with the low price of AIG on the 16th
4 being \$1.25.

5 Do you recall the statement on that document with
6 respect to AIG's assessment of what the value of the
7 stock would have been in a Chapter 11 bankruptcy?

8 A. I just noticed it a minute ago. I didn't
9 remember that. I remembered a very low valuation based
10 somehow on a bankruptcy scenario, but I don't remember it
11 in depth.

12 Q. Well, let's turn back to that document -- it's
13 DX 572 -- just to tie that issue down.

14 If you'll look at the low estimate -- so the high
15 estimate was the \$2.7 billion shares based on the low
16 price of \$1.25 that day on the 16th. He also goes in to
17 describe what the low estimate would be, which is the
18 \$100,000 figure.

19 And it says (as read): Arguably, if the company
20 declared Chapter 11, the common stock would most likely
21 have been nearly wiped out, corroborated by the 3200-plus
22 basis points spread on the CDS spreads observable on
23 September 16th. The recent bankruptcy of Lehman left
24 them with a market capitalization of less than
25 \$100 million immediately after filing for Chapter 11. As

1 a proxy, this would be the low end of the range.

2 Is this your understanding of what AIG was
3 considering its value in the context of a bankruptcy?

4 A. At the time, yes.

5 Q. And did you have any conversations with
6 Mr. Valoroso about that?

7 A. Well, not deep ones. We had -- about the
8 valuation of the -- of the preferred Series C, yes.

9 Q. Right.

10 A. But not in depth around that as a value because
11 the range in this memo was so wide, we suggested they
12 needed expert help.

13 Q. I see.

14 And so part of it was this -- this -- this --
15 this memo, you looked at it and you said, There is such
16 a wide range of valuations here that perhaps you should
17 retain another company to help you with your valuations?

18 A. That's correct.

19 Q. Okay. But you didn't have any reason to disagree
20 with his assessment of the Chapter 11 valuation of AIG,
21 did you?

22 A. No, I did not.

23 Q. Okay. And did you have any discussions with him
24 specifically about the valuation in bankruptcy?

25 A. Yes.

1 Q. And what were those?

2 A. But not deep ones as I -- you know, Mr. Valoroso I
3 remember saying to me, if the company went bankrupt, the
4 shareholders would get nothing, and under that scenario,
5 the stock is worth virtually nothing.

6 Q. Okay.

7 A. That's not a direct quote, by the way --

8 Q. No. I understand.

9 A. -- of our conversation.

10 Q. I understand.

11 I apologize, Your Honor. I'm trying to get
12 organized with the documents.

13 (Pause in the proceedings.)

14 Okay. I guess I want to tie down one other issue
15 that relates to this valuation on the 16th. Could you
16 turn back to JX 146.

17 And we may have touched on this, but I want to
18 just touch on this -- this -- a particular sentence. In
19 this area of that second paragraph that we've been
20 talking about, there's a statement about halfway down,
21 maybe a little bit past --

22 A. Excuse me. I lost the page.

23 Q. I'm sorry. It's page 12 of JX 146.

24 And I just want to read this and then -- and tell
25 me your understanding.

1 It says, "The Federal Reserve Bank's performance
2 obligation was completed ('fully' performed) on
3 September 16, 2008, when the Company obtained its first
4 loan, then incorporated into the terms of a
5 Credit Facility established on September 22, 2008."

6 What did you mean by that, that statement?

7 A. I don't remember the "'fully' performed" part,
8 but effectively the money had begun to flow to AIG from
9 the Fed, so clearly a transaction had occurred at that
10 time.

11 Q. The \$14 billion the evening of the 16th.

12 A. I didn't remember the amount, but that refreshes
13 my recollection, yes.

14 Q. Okay.

15 I want to turn to a different subject now, and
16 that is the notion of a going concern opinion.

17 And do you recall that there were a number of
18 going concern determinations that were made by AIG
19 beginning in the summer of 2008 and continuing through
20 the release of the 2009 10-K?

21 A. Yes, I do.

22 Q. Okay. Can you explain the dynamic of a
23 going concern determination and PwC's responsibilities in
24 auditing a company's going concern assessment, and you
25 can use AIG as the paradigm if you'd like. And I guess

1 just to get this going, that's what we're trying to
2 hedge, that general explanation, but can you explain what
3 a going concern determination means.

4 A. Well, the way I think of it is, there is a
5 presumption in a set of financial statements that a
6 company is a going concern. It's only when there's
7 evidence to the contrary does a company disclose certain
8 information and an auditor makes sure that that
9 information is seen to call an investor's attention to
10 it.

11 Q. Okay. So that's sort of -- you're giving me
12 the -- sort of the procedural. That's the first step.

13 A. Right.

14 Q. And then what happens when there is evidence that
15 might suggest that the company is not a going concern?
16 What is the role of the auditor and management at that
17 stage?

18 A. So if there's evidence that would indicate that
19 the company may not be able to continue as a going
20 concern, then the company needs to design plans to
21 mitigate whatever risks that are causing the concern in
22 the first place that they need to implement. They need
23 to borrow money. They need to -- any number of different
24 possibilities that a company might undertake to overcome
25 the concern about their ability to continue.

1 Q. Okay.

2 A. That's what a company does.

3 Q. Right. And that's what -- if you could continue
4 then to explain PwC's role in -- in assessing the
5 company's determination with respect to going concern.

6 A. So even if a company comes up with plans that can
7 overcome the concern, they're required to disclose that
8 information to investors.

9 Our role is to assess those plans first for, in a
10 review, whether the disclosures are appropriate to
11 investors but then second to make -- to either agree or
12 disagree with their conclusion about whether there is
13 substantial doubt about their ability to continue.

14 Q. Okay.

15 A. So we look at cash flow analysis. We look at
16 specific plans that they may have and their feasibility.
17 We speak with a number of different people. We look at
18 audit evidence to support their position or disagree with
19 their position as the case may be.

20 Q. And when you say -- when a firm says it is a going
21 concern, what window of time is that projection of a
22 going concern -- what -- what -- what period of time does
23 that relate to?

24 A. The auditing literature is specific that it's
25 12 months from the date of the financial statements.

1 Q. Okay. And PwC's role in assessing a company's
2 going concern determination, how often does that come
3 into play?

4 A. Well, each period, each quarterly period or
5 annual period, one of our responsibilities as the
6 auditor is to consider if there is evidence that's
7 contrary to the presumption that it is a going concern,
8 so every quarter we consider it. It's only when there
9 is evidence that would indicate that there's concern
10 that we would extend our procedures, as we did in the
11 case of AIG.

12 Q. Okay. And when you say extend your procedures,
13 what sort of procedures would you undertake when there's
14 evidence that suggests the firm might not be a going
15 concern?

16 A. Well, I think first we would ask the company to
17 do a lot of analysis, first, what is the degree of
18 concern, what's the root cause of the concern, is it
19 liquidity, is it capital. And then we would ask them
20 what their plans are for overcoming all of those
21 concerns.

22 To the extent they came up with plans, we would
23 ask for documentation and support of those plans, again,
24 as I say, their feasibility, their practicality, whether
25 they considered all of the potential issues. And we did

1 that in the case of AIG or I believe we did that in the
2 case of AIG.

3 Q. Okay. In an extended period of time here from
4 2008 through to 2009 10-K; right?

5 A. That's correct. I think -- yes.

6 Q. Okay. So I want to focus initially on the summer
7 of 2008 and ask you whether there were -- whether or not
8 PwC had -- what -- I guess whether or not there was any
9 consideration of whether, let's say as of -- give us
10 some -- a month -- as of the first half of August 2008,
11 whether PwC thought there was a going concern risk for
12 AIG.

13 A. No, we did not think there was.

14 Q. Okay. Did PwC consider AIG's liquidity situation
15 in early August 2008 to be an existential concern at that
16 point?

17 A. I don't know if I would use the word "existential"
18 for that.

19 They were certainly looking at liquidity, but we
20 did not think it rose to the level of concern that
21 required disclosure, for example.

22 Q. Okay. I'll just tie this down real quick.
23 DX 175.

24 DX 175 is a memo that you completed at about -- on
25 about August 6, 2008, and the -- concerns AIG. The title

1 is Liquidity, and then obviously the subject of it is
2 liquidity, and this is a memo that you authored; is that
3 correct?

4 A. Yes, it's correct.

5 MR. ROBERSON: Move to admit DX 175.

6 MR. BOIES: No objection, Your Honor.

7 THE COURT: Defendant's Exhibit 175 is admitted.

8 (Defendant's Exhibit Number 175 was admitted into
9 evidence.)

10 BY MR. ROBERSON:

11 Q. And just to be clear, this is -- this memo is
12 basically setting a high-level description of PwC's
13 understanding of AIG's liquidity situation at about this
14 time; correct?

15 A. That's correct.

16 Q. Now, there are some issues with respect to,
17 you know, liquidity, and if you look at page 2, you'll
18 see that AIG has identified four primary areas of the
19 most significant liquidity risk; right?

20 A. Yes.

21 Q. And those are commercial paper programs.
22 Potential exposure is \$15 billion; right?

23 A. Yes.

24 Q. AIGFP. Financial Products is \$28.7 billion
25 potential exposure?

1 A. Yes.

2 Q. Global securities lending was 84 -- 64 or 84? I
3 can't read it.

4 A. I believe that's 64.

5 Q. \$64.1 billion potential exposure on the securities
6 lending program?

7 A. Yes.

8 Q. Right. And then there's ALICO, but we're not
9 going to discuss that.

10 The memo notes that AIG's -- the memo notes AIG's
11 plans to deal with those potential liquidity issues;
12 right?

13 A. Yes.

14 Q. And nothing in this memo indicates that either AIG
15 or PwC understood AIG to be facing an urgent need for
16 funds at this time sufficient to call into question
17 whether AIG was a going concern; is that correct?

18 A. That's correct.

19 Q. All right. We can move off of that document.

20 Now I'm going to turn to the going concern issues
21 that faced AIG as it issued its third quarter 2008 10-Q.

22 And was AIG auditing a going concern determination
23 in connection with the issuance of the third quarter
24 10-Q?

25 A. Well, we were not auditing. We were reviewing.

1 But other than that, I agree with your statement.

2 Q. Just explain to me the difference between auditing
3 and reviewing in that context.

4 A. So a review, the primary objective of review --
5 the primary method used in review is inquiry and
6 observation, not tests of audit evidence.

7 Q. Okay.

8 A. So that's -- that's a very high level. That's the
9 biggest difference.

10 Q. Okay. Fair enough.

11 Did PwC recognize at the time of the third quarter
12 2008 10-Q that there were a number of factors indicating
13 that AIG would likely face significant stress in the
14 upcoming twelve-month period?

15 A. Yes.

16 Q. And do you recall what some of those stresses
17 were?

18 A. They included additional collateral calls on the
19 Super Senior CDS. They included market value declines in
20 the secured -- securities lending portfolio. They
21 included ratings -- potential ratings downgrades that
22 could have knock-on effects to the two items I mentioned
23 and others. There were -- those I think we -- the
24 company disclosed a number of them in the -- in their
25 third quarter 10-Q.

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1 Q. And do you recall that AIG undertook a review of
2 the assumption that AIG was a going concern at this point
3 in time?

4 A. Yes.

5 Q. Okay. Let's turn to DX 688.

6 And DX 688 is a document, PwC document, with
7 respect to AIG for the period end 9-30-2008, and the
8 title is Q3 Going Concern Analysis.

9 And if you look on the second page of the
10 document, you will see your name, reviewed by
11 Donald Farnan, and you also see you're listed as an
12 editor of this document. Is that correct?

13 A. Yes, it is.

14 MR. ROBERSON: We move to admit DX 688,
15 Your Honor.

16 MR. BOIES: No objection, Your Honor.

17 THE COURT: Defendant's Exhibit 688 is admitted.

18 (Defendant's Exhibit Number 688 was admitted into
19 evidence.)

20 BY MR. ROBERSON:

21 Q. And just to be clear, this document was completed
22 on November 10, 2008; correct?

23 A. Yes.

24 Q. And what's the significance of November 10, 2008
25 relative to the third quarter 10-Q?

1 A. I don't remember off the top of my head, but very
2 close to the final date on which you could file your 10-Q
3 to the SEC.

4 Q. Okay. Turn to page 3 of the document or page 1 of
5 the memo and look at the first two paragraphs.

6 And just tell me, does the description here set
7 forth the general dynamic that we've just discussed
8 concerning the process of auditing or reviewing a
9 company's going concern opinion? I'll just leave you a
10 moment to look over that and see if it's consistent,
11 those first two paragraphs.

12 (Pause in the proceedings.)

13 A. Yes, it is.

14 Q. Okay. And if you look at the bottom of this page,
15 there is a section II that is entitled The Series of
16 Events that Led Up to the Fed Intervention.

17 Do you see that?

18 A. Yes.

19 Q. And then if you look at the next page, the memo
20 continues by describing the events that created doubt
21 about AIG's financial condition; is that right?

22 A. And its liquidity position.

23 Q. Right.

24 In the fourth paragraph of page 2 -- or actually
25 the third -- fourth paragraph of this section but third

1 paragraph of page 2, you write -- or PwC writes, "These
2 above events as well as the risk factors discussed later
3 in this memo, when taken in the aggregate, create doubt
4 about AIG's ability to continue as a going concern for
5 the next twelve-month period. In partnership with the
6 Fed, Management has been working on solutions that could
7 mitigate the effect of such conditions or events."

8 Do you see that?

9 A. Yes, I do.

10 Q. And having reached that conclusion, what
11 obligation did PwC have with respect to the consideration
12 of the mitigating factors?

13 A. Sorry. Could you repeat that.

14 Q. So here you -- you -- you say that the -- there
15 are factors that create doubt about AIG's ability to
16 continue as a going concern; right?

17 A. Yes.

18 Q. And I thought when you -- earlier you said that
19 when there's evidence to the effect that there's some
20 doubt, substantial doubt or doubt about whether a firm is
21 a going concern, then it is incumbent upon PwC to
22 consider the mitigating events; right?

23 A. That's correct.

24 Q. Okay. So the memo then goes on to describe the
25 mitigating factors which provide evidence that AIG had

1 the capacity to continue as a going concern for the next
2 year; is that a fair view of the rest of the -- of this
3 portion of the memo? In fact, you can see it says
4 "Management Plans and Mitigating Factors." And then it
5 lists -- there's several headings. There's the
6 Federal Reserve credit facility as a mitigating factor,
7 the revised Federal Reserve credit facility on (b), the
8 preferred equity investment by the U.S. Treasury pursuant
9 to TARP. There's the Commercial Paper Funding Facility.

10 Continuing on, there's the securities lending
11 agreement with the Fed. And then there's the sale of
12 RMBS assets included in the domestic securities lending
13 pool, the terminations of the multi-sector CDS
14 transactions and sale of underlying CDOs, the asset
15 disposition plan, the Troubled Asset Relief Program.

16 A series of mitigating steps that PwC was then
17 looking at to see if, with these additional steps, AIG
18 could represent that it was a going concern for the next
19 twelve months; is that a fair characterization?

20 A. Yes, it's correct.

21 Q. Okay. Now, these were all self-explanatory and
22 for the record what each of these are, but I want to ask
23 you about one other -- it's the last factor. It says
24 "(j) Other Mitigating Factors."

25 And it says here -- this is on page 5, the top of

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1 page 5, factor (j) -- "In addition to the above
2 Management plans, there is a significant mitigating
3 factor which is that the Fed has been significantly
4 involved in devising above plans and has provided
5 significant support to the Company. As the above plans
6 indicate, the Fed is working with the Company in
7 addressing the risk associated with the Company's
8 business."

9 Can you tell me what is being referenced here in
10 this Other Mitigating Factors section and the importance,
11 if any, of this factor in the going concern conclusion
12 that PwC reached.

13 A. Well, this -- so this is a more general
14 reference -- these are all specific actions described
15 hopefully clearly in our memo (indicating). This is more
16 general in that each of these individual, previously
17 described items included help from the Fed to design the
18 solution and to in some cases be a counterparty to some
19 of those transactions.

20 So we viewed that as generally supporting the
21 company to try to reduce its risk to avoid a ratings
22 downgrade, and that support was very important. The
23 company was dependent on that support to -- to continue
24 as a going concern.

25 Q. Okay. Now, turn to page 21 of this document. And

1 you just touched on this, which is the credit rating
2 agencies' assessment of AIG.

3 And if you look here under E, it's Rating Agency
4 Credit Downgrades. It says, "AIG is currently rated
5 A-minus with Credit Watch Negative. Credit downgrades
6 will impact the business in a very significant way
7 particularly regarding cash outlays relating to the FP
8 business. Below we considered each of the significant
9 implications of such a downgrade." All right?

10 And this is an area that you had expertise in
11 because you worked in insurance your -- the majority of
12 your professional life; correct?

13 A. That's correct.

14 Q. Okay. Can we just -- I'd just like to march
15 through some of these effects of the credit rating
16 downgrade that PwC was recognizing at this stage.

17 A. May I add something to my previous statement?

18 Q. Absolutely.

19 A. I've done insurance most of my career, as I
20 mentioned. These potential issues were not my only
21 brainchild. We had a great number of partners and others
22 trying to assess what the potential issues were --

23 Q. Okay.

24 A. -- so I didn't do it on my own.

25 Q. Fair enough.

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1 The PwC team was --

2 A. That's correct.

3 Q. -- recognizing these potential effects with a
4 credit rating downgrade of AIG.

5 A. That's correct.

6 Q. Okay. Fair enough.

7 First issue is, if there was a credit rating
8 downgrade, termination rights and underlying CDO
9 purchases relating to the FP business. It says
10 (as read): A rating downgrade at AIG would permit
11 counterparties on certain over-the-counter and CDS
12 contracts to elect early termination rights -- early
13 termination of contracts. This has the following
14 implications:

15 And the first bullet is: Unrealized losses on
16 such contracts could crystallize causing liquidity needs.
17 As of September 30, 2008 -- this is after the federal
18 transaction -- there is approximately \$9 billion of
19 unrealized losses net of collateral posted on the OTC/CDS
20 and other derivative books.

21 So that was one of the determinations that PwC
22 recognized as a risk with the credit rating downgrade;
23 correct?

24 A. Yes.

25 Q. If you look at the second page, page 22, the first

1 full paragraph says, "Hence a downgrade by two notches
2 could result in \$11.9 billion of cash outflows, while a
3 downgrade by three notches could result in \$12.6 billion
4 of cash outflows. Of the \$12.6 billion, \$6.4 billion
5 relates to the multi-sector CDOs and \$4.3 billion relates
6 to the Credit Support Agreements ('CSAs') on the
7 remaining derivative portfolios."

8 That's giving a scope of the multibillion-dollar
9 effect just on the -- that single portfolio from a credit
10 rating downgrade; correct?

11 A. That's correct.

12 Q. If you look at the bottom of this section, it
13 says, in italicized text, "As discussed above, since
14 there is a Fed solution to the multi-sector CDSs, this
15 risk is mitigated to the extent the plan can be
16 executed"; correct?

17 A. Yes.

18 Q. And that's your responsibility at that stage, when
19 you see something that's a potential -- it's evidence of
20 a potential going concern risk, to look at what could
21 potentially mitigate; is that --

22 A. That's correct.

23 Q. And the mitigation factor here you're saying was
24 the Fed solution; is that right?

25 A. Yes, that's right.

1 Q. And what was that Fed solution? Do you recall?

2 A. This was Maiden Lane III.

3 Q. Okay.

4 A. Or what became Maiden Lane III.

5 Q. The next issue on the credit rating downgrade is
6 termination rights relating to insurance contracts. It
7 says, "In order to address the general market concern
8 about AIG's situation, we understand that CI management
9 added an endorsement on certain contracts that allows the
10 contract holder to terminate their contract pro rata
11 (that is, standard cancellation clauses would be more
12 onerous on the insured) if CI has another rating
13 downgrade. It is not clear at this stage what
14 percentages of contracts contain such an endorsement and
15 whether the contract holders would exercise such rights
16 and terminate their contract. At September 30, 2008
17 there is approximately \$14 billion of UPR at CI."

18 Can you tell me what "CI" means?

19 A. That was the commercial insurance group of AIG.

20 Q. And what's UPR there?

21 A. Unearned premium revenue.

22 Q. So the risk here on the termination rights on the
23 insurance contracts is up to \$14 billion; is that
24 correct?

25 A. Yes.

1 Q. Okay. The third factor that could result from a
2 credit rating downgrade was an increase in surrender
3 rates and reduction in new business production.

4 Again, this is referring to the insurance
5 companies; is that right?

6 A. The life insurance companies.

7 Q. Okay. So it says, "A downgrade in an insurance
8 company's financial strength can impact the Company's
9 business significantly. As a result of the September
10 downgrades, AIG insurance subsidiaries have begun to lose
11 policyholders in certain distribution channels
12 (particularly bank and broker network)."

13 Continuing to the last sentence, it says, "Lastly,
14 as a result of the high surrender levels and low new
15 business production, the value of the businesses may be
16 significantly negatively impacted"; correct?

17 A. Yes.

18 Q. Then there's a section on surrenders. And here it
19 says, under the Life and Retirement Services (as read):
20 Surrenders peaked in most regions of the world following
21 the press coverage of the events of September, that is --
22 I mean, for example, annuity surrenders -- for example,
23 annuity surrenders at ALICO Japan were initially four
24 times higher than normal levels. Management reviews the
25 surrender activity on a daily basis. We under that since

1 September, surrenders declined to more normal levels.
2 However, a new downgrade could cause the surrenders to
3 peak again.

4 So again, if AIG were to face another credit
5 rating downgrade, it would face the potential for
6 surrenders of its life and retirement contracts; is that
7 correct?

8 A. That's what we believed, yes.

9 Q. And you also believed here with respect to new
10 business production at the bottom of the page, it says,
11 "Life and Retirement Services - Following the events of
12 September, new business production for the life and
13 retirement services businesses has been impacted
14 significantly. Management indicated that there has been
15 an approximately 30-40 percent of reduction in the level
16 of new business."

17 That would have been exacerbated if there had been
18 a credit rating downgrade; is that correct?

19 A. I think that's likely.

20 Q. Now, the next page, there's italicized text.

21 And here, PwC is noting that the rating agencies
22 had given AIG's management an assurance that it would
23 give AIG until the end of the year before making changes
24 to AIG's credit rating; right?

25 A. Yes.

1 Q. And here, PwC is noting that the Fed was involved
2 in the negotiations with the agencies and was attempting
3 to find solutions to potential issues that could give
4 rise to a ratings downgrade; is that what was being
5 communicated there?

6 A. Yes.

7 Q. And based on these factors, PwC was able to
8 conclude that a near-term ratings downgrade was not
9 likely; is that correct?

10 A. That's correct.

11 Q. Now, at the bottom of this page, there's -- under
12 the Conclusion section, the last paragraph, it says,
13 "Management has developed a plan to address the liquidity
14 issues it faces. This plan has been developed with
15 significant involvement and support from the New York
16 Federal Reserve and incorporates amendments to the
17 existing federal agreement and additional transactions
18 with New York Federal Reserve. Management and the Fed
19 representatives indicated to PwC that the agreements in
20 principle announced on November 10th were specifically
21 structured to address rating agency concerns in order to
22 avoid a near-term downgrade of AIG's ratings."

23 And then it concludes, "Based on all the factors
24 discussed in this memo and work performed discussed in a
25 separate memo, Management have concluded and we agree

1 that although doubt exists, these are alleviated by
2 Management's plans, changes in the Fed facility and the
3 solutions found for the multi-sector CDO and Domestic Sec
4 lending."

5 That's PwC's conclusion here; right?

6 A. Yes, it is.

7 Q. And the reference to the domestic sec lending, was
8 that the Maiden Lane II project?

9 A. Yes, it was.

10 Q. And again, the multi-sector CDOs, that was
11 Maiden Lane III.

12 A. That is correct.

13 Q. Now, in connection with your work on the third
14 quarter 2008 -- for AIG in the third quarter of 2008, can
15 you -- can you describe the procedures you undertook to
16 determine if AIG could properly be considered a going
17 concern by the end of the third quarter?

18 A. First, management showed us their own assessment
19 of their ability to pay their obligations as they come
20 due.

21 So we talk about going concern, but in its
22 simplest form, it's can a company pay its obligations as
23 they come due without substantial liquidation of the
24 company.

25 So they asserted they had enough cash, including

1 all these various plans, so we -- we spoke with a lot of
2 people. This is a review, so inquiry and observation,
3 but we also obtained documents where appropriate. We met
4 with the Fed itself. We considered other potential
5 sources of liquidity issues as we just went through in
6 the last few minutes, asked the company to assess those
7 potential cash drains on the company, because if -- to
8 determine -- so we pushed back. Oh, we pushed back. We
9 didn't audit, but we asked for a lot of evidence to
10 support their assertion and did our own testing as we
11 felt appropriate in the circumstance.

12 Q. Okay. And do you recall what aspects of AIG's
13 businesses you focused on in making the going concern
14 determination?

15 A. Well, I think I mentioned before the largest two
16 sources of liquidity to that point had been
17 Maiden Lane III and Maiden Lane -- or sorry -- the
18 super senior -- multi-sector Super Senior CDS and
19 securities lending.

20 And keep in mind, these solutions were announced
21 but not yet done, so there was execution risk, so we
22 considered in this context what that means, a company's
23 ability to continue as a going concern when there's still
24 execution risk to getting the deal done.

25 We looked at the general insurance. We tried to

1 consider every conceivable potential source of negative
2 cash flow to the company.

3 Q. Okay. If AIG could not have been determined to
4 be a going concern at the end of the third quarter of
5 2008, what effects would that have had on AIG? Do you
6 know?

7 A. Well, at the time, we had understood from the
8 company and from the Fed that one of the potential
9 impacts was a ratings downgrade.

10 Q. And what sort of an effect would that have had
11 as -- I think we discussed it a little bit in this memo,
12 but if you could --

13 THE COURT: Haven't we been over that?

14 MR. ROBERSON: Okay. Fair enough, Your Honor. I
15 think that's fair.

16 BY MR. ROBERSON:

17 Q. Without the additional government funding sources,
18 TARP, Commercial Paper Funding Facility, the
19 establishment of ML II and ML III, restructuring of the
20 Fed facility, how likely would it have been that PwC
21 could have concluded that AIG could have continued as a
22 going concern as of the time of the release of AIG's
23 2008 third quarter 10-Q?

24 A. We believed it was unlikely.

25 Q. And why is that?

1 A. Because there were still large amounts of risk as
2 we just went over that could drain liquidity from the
3 company so that in the next twelve months it would be
4 unable to pay its obligations as they came due.

5 Q. Okay. I'm going to switch now and we're going to
6 talk about the release of the 2008 10-K.

7 And do you recall approximately when that 10-K was
8 issued?

9 A. End of February, beginning of March.

10 Q. Of 2009.

11 A. Of 2009, yes.

12 Q. Do you have -- recall having discussions with
13 AIG's management in January of 2009 concerning the
14 possibility that AIG could be downgraded by the credit
15 rating agencies despite all the assistance AIG had
16 received from the government up to that point in time?

17 A. Yes.

18 Q. And can you tell me who -- with whom you had those
19 discussions?

20 A. We certainly -- so at the company, people like
21 David Herzog, who was the CFO at the time. At the Fed,
22 people like Sarah Dahlgren -- well, as a representative
23 of the Fed, Sarah Dahlgren.

24 Q. Okay. And can you tell me what Mr. Herzog and you
25 talked about with respect to the possibility that AIG

1 could be downgraded in January 2009?

2 A. Well, I think we -- we believed it was a real
3 possibility that sometime over the next -- again, we're
4 talking about twelve months, right, twelve months from
5 the date of the financial statements, so that would be
6 between January 1, 2009 and December 31, 2009.

7 So we think given all -- we thought -- and I
8 believe Mr. Herzog agreed with us -- that there was a
9 very real possibility that absent government support,
10 continuing support, that the company would not be a going
11 concern.

12 Q. And do you recall the issues that AIG was facing
13 in -- at that point in time, specific issues?

14 A. There were a lot of them. I still think there
15 were potential for collateral calls on certain
16 securities. The company had -- I don't -- I know we
17 wrote a memo, an extensive memo, and I don't remember as
18 I sit here right now, but --

19 Q. Sure.

20 A. But a number of potential issues that could --
21 for example, a part of the plan was to be able to repay
22 the Fed facility with sales of the company -- sales of
23 various subsidiaries, but some of those subsidiaries were
24 struggling, and so whether the value they could get from
25 those companies was declining or not was a potential

1 issue.

2 Q. And in fact, generally the market had declined
3 significantly even since September of 2008 as we go into
4 January 2009; correct?

5 A. Yes, that's correct.

6 Q. So the value of the assets that AIG -- of AIG's
7 assets had declined significantly.

8 A. Yes.

9 Q. Right. Okay.

10 And would you agree that AIG's management
11 expressed to PwC sufficient concerns that it was clear
12 that there was substantial doubt about AIG's capacity to
13 make a going concern determination in connection with the
14 2008 10-K?

15 A. That's my recollection from at the time.

16 Q. And as we discussed earlier what the process is,
17 given that presentation, AIG was obligated to pursue a
18 remediation plan in order to avoid a finding that there
19 was substantial doubt about AIG's capacity to continue as
20 a going concern; is that fair?

21 A. That's correct.

22 Q. And when there is substantial doubt, so, for
23 instance, if PwC disagrees with whatever mitigating steps
24 might be taken, is there a formal statement that PwC
25 makes in disclosures such as the 10-K that it would

1 indicate a disagreement or an assessment different than
2 the company?

3 A. No. But let me explain.

4 There's a statement that gets made in the opinion
5 that refers to substantial doubt, but it's done in the
6 case of when the company believes that and we agree and
7 if we would disagree -- or if we would disagree.

8 Q. Okay.

9 A. So that the statement is put there when there is
10 substantial doubt about a company's ability to continue
11 as a going concern whether we agree with the company or
12 disagree with the company.

13 Q. Okay. Now, did AIG begin designing solutions in
14 early 2009 to address what was then effectively a
15 continuing going concern doubt?

16 A. Sorry. Could you repeat the question.

17 Q. Sure. I probably added too much to it.

18 Did AIG begin designing solutions in early 2009 to
19 address the going concern doubt?

20 A. Yes. The company was -- the company was working
21 on solutions almost constantly it seemed like to me, so
22 you said early 2009, but that was ongoing I believe
23 between the Fed, the Treasury and AIG.

24 Q. And can you describe your understanding of how
25 AIG worked with the Fed and Treasury in designing

1 solutions to the going concern issue, you know, in the
2 2009 period.

3 A. I think they tried to ascertain the biggest
4 issues, so in the first instance agreeing with the Fed
5 and the company about what the biggest issues were and
6 then how do you mit- -- just like they did on designing
7 Maiden Lane II and Maiden Lane III, how could you design
8 something to mitigate that -- mitigate that risk to
9 overcome the issue.

10 Q. Let's turn to JX 188.

11 And if you look at page 321 of 553, and if you
12 look at the bottom of the page under Subsequent Events,
13 it says, "March 2009 Agreements in Principle. On
14 March 2, 2009, AIG, the New York Fed and the
15 United States Department of the Treasury announced
16 agreements in principle to modify the terms of the
17 Fed Credit Agreement and the Series D Preferred Stock and
18 to provide a \$30 billion equity capital commitment
19 facility."

20 Do you see that?

21 A. Yes, I do.

22 Q. And then if you look at the next page, 322 to 323,
23 the 10-K explains these additional activities that were
24 undertaken; is that a fair assessment?

25 A. Sorry. When you say "undertaken" --

1 Q. Undertaken by AIG and here with respect to --
2 well, let me just ask you, are these the activities that
3 were taken to mitigate the risk of a going concern
4 determination at this stage?

5 A. The reason I'm struggling with your "taken" is
6 because if you look at this, I don't believe the
7 securitization, which is the last item on here, actually
8 happened, but at the time, it was expected to.

9 Q. Okay. So there was a -- these are -- this was a
10 plan to mitigate because there was a continued going
11 concern; right?

12 A. That's correct.

13 Q. And certainly the 10-K is describing the steps
14 that were planned at that stage.

15 A. Yes.

16 Q. Of which the modification to the Series D
17 preferred stock occurred; is that correct?

18 A. Yes.

19 Q. And the equity capital commitment facility, that
20 took place; right?

21 A. That was the 30 billion we just discussed.

22 Q. Right.

23 A. Yes.

24 Q. The allowment of the repayment of the Fed
25 facility with subsidiary preferred equity, do you see

1 that?

2 A. Yes. There were -- two special-purpose vehicles
3 were established.

4 Q. Okay. And then there is on the -- on page 323 --
5 you say that the securitizations didn't occur, but on
6 page 323 there's the modification to the Fed facility.

7 And do you recall that the Fed facility was
8 modified with the purpose again of easing the liquidity
9 burden that AIG might have faced?

10 A. Yes, sir.

11 Q. Now, let's get a little bit more detail on this.
12 Let's turn to DX 756.

13 DX 756 is a document that says it was completed by
14 you, reviewed by Tim Ryan on March 10, 2009. You
15 completed it by -- on March 2, 2009. It's with respect
16 to AIG, and the title is Going Concern.

17 Your Honor, we move to admit DX 756.

18 MR. BOIES: No objection, Your Honor.

19 THE COURT: Defendant's Exhibit 756 is admitted.

20 (Defendant's Exhibit Number 756 was admitted into
21 evidence.)

22 BY MR. ROBERSON:

23 Q. So turn to page 1 of the memorandum, which should
24 be about, what, three pages, four pages in, where it
25 says -- the top of the page is Overview?

1 A. Yes, I have it.

2 Q. Okay. The second paragraph, there's a description
3 here of the factors that were having a negative effect on
4 AIG during that fourth quarter period.

5 It says, "During the fourth quarter, as the market
6 deteriorated even further, AIG experienced significant
7 losses on its investment portfolio, saw the value of the
8 businesses that it is trying to sell decline and was
9 required to make further capital contributions to its
10 insurance companies. Also, AIG was hit with residual
11 losses associated with its multi-sector Super Senior" --
12 that's SS; right?

13 A. Yes.

14 Q. -- "CDS book (that is, ML3 was done late in the
15 quarter and as such AIG was exposed prior to the
16 cancellation of swaps and sale of the underlying CDOs
17 into ML3) and its securities lending portfolio (similar
18 to ML3, ML 2 was not done until December and as such AIG
19 was exposed during the quarter and thus suffered further
20 from the market decline)."

21 Is that sort of a succinct description of the
22 negative factors that was -- that were contributing to
23 the going concern issue as of March of 2009?

24 A. Yes, it is.

25 Q. Okay. Now, if you look at page 2, at the first

1 full paragraph, continuing through the quoted text, take
2 a moment to look at that.

3 (Pause in the proceedings.)

4 A. Okay.

5 Q. Would you agree that the text here is describing
6 the importance of not only the specific transactions
7 agreed to between AIG and the government that we just
8 discussed that were disclosed in the 2008 10-K but also,
9 more generally, the general commitment of the government
10 to AIG's orderly restructuring over time?

11 A. Yes.

12 Q. Okay. And in fact, after that quoted text, you
13 write, "We understand from management that the
14 combination of the above was such that each of the four
15 major rating agencies confirmed during the week of
16 February 23 that they would not downgrade AIG,
17 Incorporated after the announcement of their Q4 results
18 and record loss of approximately \$62 billion"; right?

19 A. Yes.

20 Q. So the notion with the 10-K was that AIG was going
21 to be disclosing perhaps the world's largest quarterly
22 loss in history, something to that effect?

23 A. Yes.

24 Q. And the credit rating agencies were effectively at
25 the door ready to downgrade after this catastrophic loss;

1 right?

2 A. We were concerned that was the case, as was the
3 company.

4 Q. Right.

5 And so a big part of the backstop to keep that
6 credit rating from happening -- downgrade from happening
7 was the general commitment of the United States
8 government to AIG at that stage; is that correct?

9 A. Yes. The company believed that and we agreed.

10 Q. Okay.

11 THE COURT: Mr. Roberson, how much more
12 examination do you have of this witness?

13 MR. ROBERSON: Your Honor, my guess is an hour,
14 hour and a half.

15 THE COURT: All right. We're going to break for
16 today, and I'm thinking maybe overnight you can figure
17 out a way to do a little less reading of documents.
18 There's been just a lot of blanket reading of exhibits
19 and then basically asking the witness "isn't that right"
20 or "isn't that correct" or something like that.

21 Maybe you can just refer him to the section of the
22 document you're referring to and figure out a way -- a
23 shorter way to ask your question.

24 MR. ROBERSON: Will do, Your Honor.

25 THE COURT: I think that will help things speed up

1 a little bit.

2 MR. ROBERSON: Will do.

3 THE COURT: We'll reconvene at 9:30 tomorrow
4 morning.

5 (Whereupon, at 4:59 p.m., the proceedings were
6 adjourned.)

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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: OCTOBER 24, 2014

s/Josett F. Whalen

JOSETT F. WHALEN, COURT REPORTER

1			ADMITTED EXHIBITS
2	PX	PAGE	DESCRIPTION
3	86	4101	Email (9/16/2008) From: Bradley Smith
4			To: Jeremiah Norton, Robert Scully, Ruth
5			Porat, Daniel Simkowitz, Kevin Ryan, Peter
6			Juhas, Helen Ayala, Marshall Huebner, Donald
7			Bernstein, Ethan James, Robert Heckart, Jason
8			Kyrwood, Brian Resnick re: Revised AIG Term
9			Sheet Attaching Draft Term Sheet
10	284	4190	Email (10/7/2008 4:24 pm) From: Frank Reda
11			To: Donald Farnan, Latasha Brown, cc: Anthony
12			Valoroso re: Preferred stock - draft memo
13			Attaching Draft Memo from Frank Reda to Jesus
14			Zaragoza, Elaine Chu, Greg Budd, Michael
15			Reilly, Robert Gender, Fernando Melon, Tal
16			Kaissar, David Junius, Don Farnan re:
17			"Preferred shares issued to Fed (9/2008)"
18	332	4199	Email (10/30/2008 6:50 pm) From: Anthony
19			Valoroso To: Sarah Dahlgren, cc: Vijay
20			Raghavan, Ken Lau, Donald Farnan re: Preferred
21			Units1.doc Attaching valuation memo
22			(10/29/2008)
23	347	4177	Email (11/6/2008 1:58 pm) From: Frank Reda
24			To: Jesus Zaragoza, Elaine Budd, Michael
25			Reilly, Tal Kaissar, Donald Farnan, Latasha

1 Brown, cc: Anthony Valoroso, Lesley Mercado
2 re: Preferred stock memo in support of 3Q
3 accounting Attaching Preferred stock_3Q memo
4 350 4187 Memo to the Files (November 6, 2008) re: T.
5 Ryan & D. Farnan meeting with D. Herzog, S.
6 Dahlgren and E. James on October 28
7 364 4171 Memo to the Files (November 9, 2008) re: T.
8 Ryan & D. Farnan meeting with D. Herzog, S.
9 Dahlgren and E. James
10 366 4123 Email (11/10/2008 12:57 pm) From: David Herzog
11 To: Elias Habayeb re: RE: Inquiry
12 444 4181 PwC Review of "Critical matter: Assess the
13 impact of the Charter Amendment on the
14 accounting conclusions reached for the Series
15 C preferred shares and Evaluate the accounting
16 for the Series D Preferred Stock and Warrant"
17 699 4170 Shadow Calculations: Approximate value of
18 preferred shares under BSM
19 1066 4193 PwC Memo (11/7/2007) From: PwC audit team
20 To: AIG work paper files re: AIG07 SS00 PwC
21 3Q07 Critical Matter - Super Senior CDS
22 1583 4101 Email (9/17/2008) From: Robert Pofsky
23 To: Edward Murphy, cc: Leon Taub, Maria
24 Ambrosio re: Re: Fw: September 16, 2008 AIG
25 Announcement

1 675 4223 PRICE WATERHOUSE COOPERS AIG INC. VALUATION AS
2 OF SEPTEMBER 16, 2008 PREFERRED STOCK
3 VALUATION REVIEW MEMO
4 688 4247 REPORT, AMERICAN INTERNATIONAL GROUP, INC.,
5 RE: Q3 ANALYSIS OF GOING CONCERN ASSUMPTION,
6 PARENT LINK: Q3 GOING CONCERN ANALYSIS,
7 COMPLETED WITH ATTACHMENTS, PERIOD END:
8 09/30/2008, BY: SAMIYE YILDINM, REVIEWED BY:
9 TIM RYAN 11/10/2008
10 756 4268 EMAIL AND ATTACHMENT FROM DONALD FAMAN TO FILE
11 RE: AIG LIQUIDITY, ATTACHMENT GOING CONCERN
12 CRITICAL ISSUES MEMO
13 2131 4159 EMAIL AND ATTACHMENT FROM PAUL ANDERSON TO
14 OFER ELDAR RE: ML III - COUNTERPARTY TERM
15 SHEET ATTACHMENT DRAFT COUNTERPARTY TERM SHEET
16
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