

IN THE UNITED STATES COURT OF FEDERAL CLAIMS

STARR INTERNATIONAL COMPANY,
INC., on its behalf and on behalf of a class of
others similarly situated,

Plaintiff,

No. 11-00779C (TCW)

v.

THE UNITED STATES,

Defendant.

PLAINTIFFS' PROPOSED FINDINGS OF FACT

BOIES, SCHILLER & FLEXNER LLP

Robert B. Silver

Robert J. Dwyer

Alanna C. Rutherford

Julia C. Hamilton

Laura Harris

Ilana Miller

John Nicolaou

Matthew R. Shahabian

David L. Simons

Craig Wenner

575 Lexington Avenue

New York, NY 10022

Telephone: (212) 446-2300

Amy J. Mauser

Abby Dennis

William Bloom

James A. Kraehenbuehl

5301 Wisconsin Avenue, NW

Washington, DC 20015

Telephone: (202) 237-2727

February 19, 2015

BOIES, SCHILLER & FLEXNER LLP

David Boies

Attorney of Record

333 Main Street

Armonk, NY 10504

Telephone: (914) 749-8200

Fax: (914) 749-8300

Email: dboies@bsfllp.com

SKADDEN, ARPS, SLATE, MEAGHER &
FLOM LLP

John L. Gardiner

Four Times Square

New York, NY 10036

Telephone: (212) 735-3000

R. Ryan Stoll

Gregory Bailey

155 N. Wacker Drive

Chicago, IL 60606

Telephone: (312) 407-0700

*Attorneys for Starr International Company, Inc.
and for the Plaintiff Classes*

TABLE OF CONTENTS

1.0	IN SEPTEMBER 2008, THE UNITED STATES FACED THE MOST SEVERE FINANCIAL CRISIS SINCE (AND PERHAPS INCLUDING) THE GREAT DEPRESSION. CREDIT MARKETS FROZE AND EVEN SOLVENT COMPANIES WERE UNABLE TO BORROW FROM PRIVATE SOURCES TO MEET THEIR LIQUIDITY NEEDS.....	1
1.1	“September and October of 2008 Was the Worst Financial Crisis in Global History, Including the Great Depression.” (Bernanke: PTX 548 at 24; <i>see also</i> Bernanke: Trial Tr. 1959:8).	1
2.0	THE FINANCIAL CRISIS OF 2008 THREATENED THE VIABILITY OF VIRTUALLY EVERY MAJOR FINANCIAL FIRM.....	2
2.1	In Financial Crises Even Solvent Companies Become Illiquid and Fail.	2
2.2	In September 2008 Financial Markets Throughout the World Shut Down.	3
2.3	In September 2008, Financial Markets Deteriorated and Money Market Funds “Began to Face Runs”. (PTX 708 at 90; Bernanke: Trial Tr. 1966:1-5).....	4
2.4	As Money Market Funds Began To Face Runs “They in Turn Began to Dump Commercial Paper as Quickly as They Could. As a Result, The Commercial Paper Market Went into Shock.” (PTX 708 at 90; <i>accord</i> Bernanke Trial Tr. 1966:1-5; Willumstad: Trial Tr. 6511:10-12).	4
2.5	Financial Institutions Stopped Lending to Each Other, Even on a Secured Basis.....	4
2.6	During September 2008, “Even Companies That Were Solvent Were Not Able to Borrow the Liquidity That They Needed”. (Paulson: Trial Tr. 1204:3-5).....	4
2.7	In September 2008, the Financial Crisis and the Freezing of Credit Markets Threatened the Viability of Virtually Every Major Financial Institution.	5
3.0	THERE WERE MANY CAUSES OF THE FINANCIAL CRISIS, WHICH HAD ITS ORIGIN IN AN OVER EXTENSION OF CREDIT BOTH BY TRADITIONAL BANKS AND BY THE ALTERNATIVE BANKING SYSTEM, PARTICULARLY IN THE HOUSING MARKET.....	6
3.1	An Important Cause of the Financial Crisis Was That in the Years Prior to 2007 the Government Kept Interest Rates Artificially Low, Expressly in Part to Encourage Home Ownership, Which Resulted in the Over Extension of Credit and the Creation of a “Housing Bubble”.	6

3.2	Another Important Cause of the Housing Bubble, and the “Housing Correction” That Followed Was “That for Many Years There Had Been Bad Lending Practices by Banks and Financial Institutions” and “Borrowers Had Been Taking out Mortgages That They Couldn’t Afford”. (Paulson: Trial Tr. 1198:23 – 1199:8).	7
3.3	Another Important Cause of the Financial Crisis Was the “Originate-to-Distribute” Business Model Adopted by Commercial Banks, Investment Banks, and Broker Dealers.	7
3.3.1	Traditionally, lenders to homeowners (primarily banks and savings and loans) had an incentive to be sure the loans would be paid because they held the resulting mortgage.	7
3.3.2	Beginning in 2002 and accelerating in 2006 and 2007 mortgage originators would sell or transfer mortgages to a pool held by a special purpose vehicle (“SPV”). The SPV would in turn create a series or “tranches” of securities (collateralized debt obligations or “CDOs”) representing tiered rights to be paid from the revenue of the pool, which the SPV then marketed to investors and, in some cases, in part continued to hold.	7
3.3.3	The most senior CDO security or tranche had the right to be paid its principal and interest in full before any other CDO tranche received anything; the second most senior CDO tranche was then paid all of its principal and interest, and so on down the line. (Cragg: Trial Tr. 4956:1-22, 4958:15 – 4959:4).	8
3.3.4	The originate-to-distribute business model substantially increased the investors in, and the money available to originate, housing loans.	8
3.3.5	The originate-to-distribute business model also eliminated the incentive of mortgage originators to be careful that their borrowers could repay the amounts loaned because the mortgage, and risk of non-payment, had been transferred to others.	9
3.4	Another Important Cause of the Financial Crisis Was That “Many of the Subprime Mortgages That Originated in the 2001 to 2005 Period Had Floating Rates”. (Saunders: Trial Tr. 8380:14-19). When the Federal Reserve Started to Raise Interest Rates in 2006 “the Cost of Meeting Mortgage Commitments Rose to Unsustainable Levels for Many Low Income Households”. (Saunders: Trial Tr. 8380:7-19).	9
3.5	Another Important Cause of the Financial Crisis Was That Rating Agencies, upon Which Investors Relied to Evaluate the Riskiness of CDOs, Greatly Understated the Risks of Such Securities.	9

3.5.1	In significant respects the rating agencies misled investors by fraudulently overstating the safety of CDOs and related securities.	10
3.6	Another Important Cause of the Financial Crisis Was the Collapse of the Alternative Banking System.	11
3.6.1	In the years prior to 2007 an alternative or “shadow” banking system had developed which provided trillions of dollars of short-term liquidity to financial firms.	11
3.6.2	The alternative banking system consisted primarily of investment banks and broker dealers that extended credit in competition with traditional banks.	11
3.6.3	An important element of the alternative banking system was the so-called “repo” financing which in March 2008 provided \$4.5 trillion in financing, primarily to investment banks and broker dealers.	12
3.6.4	Repo financing was particularly vulnerable to a crisis of panic, loss of confidence, or uncertainty because it was overnight financing which had to be renewed every day.	12
3.6.5	The crash of the shadow banking system beginning in 2007 was an important cause of the liquidity crisis.	13
4.0	IN MARCH 2008, THE FEDERAL RESERVE SYSTEM RECOGNIZED THAT BECAUSE OF A LACK OF LIQUIDITY, “UNUSUAL AND EXIGENT CIRCUMSTANCES” EXISTED THAT JUSTIFIED IT FUNCTIONING AS A LENDER OF LAST RESORT TO COMPANIES OUTSIDE THE BANKING SYSTEM.	14
4.1	The Crisis in Financial Markets “Arrived in Force on August 9, 2007”. (Paulson: PTX 706 at 78).	14
4.2	Financial Markets Deteriorated Further from August 2007 to March 2008.	14
4.3	In March 2008, the Federal Reserve Concluded That There Were “Unusual and Exigent Circumstances” Caused by “Frozen Markets” and a “Lack of Liquidity” in the Marketplace.	15
4.4	In March 2008, the Federal Reserve Concluded That Because of Its Role As the Lender of Last Resort and the Existence of “Unusual and Exigent Circumstances” It Would Lend Outside the Banking System.	15
4.4.1	On March 14, 2008, the Federal Reserve authorized a 13(3) credit facility to help keep Bear Stearns out of bankruptcy.	

	(PTX 1201 at 2-3; <i>accord</i> Alvarez: Trial Tr. 127:5-16, 617:16-19).	15
4.4.2	On March 16, 2008, the Federal Reserve, again acting under Section 13(3), authorized FRBNY “to make a nonrecourse loan of up to \$30 billion that would be fully collateralized by a pool of Bear Stearns assets” to facilitate a merger between Bear Stearns and JPMorgan. (PTX 12 at 2-3).	16
4.4.3	On March 16, 2008, the Federal Reserve authorized a 13(3) credit facility for primary dealers. (PTX 693 at 4-5).	16
4.5	From March to September 2008 Financial Markets Deteriorated Even Further.	16
4.6	Financial Markets Continued to Deteriorate in Early September 2008.	17
4.7	When Lehman Brothers Filed for Bankruptcy Early in the Morning of September 15, Financial Markets Were Completely Disrupted.	17
5.0	NO ONE ANTICIPATED OR PREDICTED THE SEVERITY OF THE FINANCIAL CRISIS.	21
6.0	DESPITE THE FINANCIAL CRISIS, AND DESPITE THE FACT THAT AIG UNLIKE OTHER MAJOR FINANCIAL FIRMS HAD NOT HAD ACCESS TO GOVERNMENT CREDIT, AIG WAS ABLE TO MANAGE ITS LIQUIDITY NEEDS UNTIL THE SECOND WEEK IN SEPTEMBER 2008 WHEN LEHMAN BEGAN TO FAIL.	23
6.1	As Early as the End of 2005, AIG Stopped Offering CDS Protection for Mortgage-Backed CDOs.	23
6.1.1	AIG exited the CDS market for CDOs at a time when regulators were expressing views that mortgage-backed securities did not pose substantial risks and when banks and other firms were increasing their participation in the CDO market.	23
6.2	Until Lehman’s Failure, AIG Was Managing Its Liquidity Needs.	24
6.2.1	In 2007, “AIG recognized that there were possible liquidity issues and had begun work to try to make sure that AIG behaved in a prudent way”. (Willumstad: Trial Tr. 6477:13-17).	24
6.2.2	In 2007 AIG created a Liquidity Risk Committee and began to build liquidity.	24

6.2.3	Capital Raises.....	25
6.2.4	In August 2008 AIG’s auditors PwC concluded after an analysis of the company’s liquidity that “we did not think it rose to the level of concern that required disclosure”. (Farnan: Trial Tr. 4243:14-21).	26
6.3	Lehman’s Unexpected Failure, and the Resulting Collapse of Financial Markets, Made It Impossible for AIG to Continue to Meet Its Liquidity Needs from Private Sources.....	26
6.4	In the Absence of Lehman’s Failure AIG Would Have Been Able to Continue to Manage Its Liquidity Needs.....	28
7.0	ON SEPTEMBER 16, 2008, AFTER LEHMAN’S FAILURE, AIG, LIKE MANY FINANCIAL INSTITUTIONS, FACED A SEVERE LIQUIDITY CRISIS AND, WHILE SOLVENT, WAS UNABLE TO MEET ITS LIQUIDITY NEEDS FROM PRIVATE SOURCES.	29
7.1	On September 16, 2008, AIG Faced a Severe Liquidity Crisis as a Result of the Market-Wide Financial Crisis.....	29
7.2	The Freezing of Markets for Over-the-Counter Derivatives and Markets for Mortgage-Backed Securities Prevented AIG and AIGFP from Obtaining Realistic Valuations Based on Market Transactions.	31
7.2.1	By September 16, there were essentially no prices for subprime-backed securities and collateral calls could not be met from private sources because of the freezing of the credit markets.....	32
7.3	In 2008, AIG’s CDS Counterparties Made Collateral Calls That Took Advantage of the Subjectivity Involved in Valuing Illiquid Collateralized Debt Obligations (“CDOs”) in a Time of Crisis.....	34
7.4	As the Federal Reserve and Other Government Agencies Recognized, Because of Fear, Lack of Liquidity, and the Resulting “Unnaturally Strong Downward Market Pressures,” Reported Values for AIG’s Mortgage-Backed Securities, the CDOs Protected by AIGFP’s Multi-Sector CDS, and the AAA and Super Senior Tranches of RMBS Held by AIG’s Securities Lending Pool Did Not Reflect the Amount of Aggregate Proceeds That Would Be Received from Those Assets Over Time.....	36
7.5	AIG’s Securities Lending Operations Faced the Same “Run on the Bank” Pressures as Many Other Financial Firms.	36
7.6	The Freezing of Commercial Paper Markets Meant That AIG Was Not Able to Roll Over Its Commercial Paper as It Became Due.....	37

7.7	On September 15, 2008, AIG’s Counterparties Began Withholding Legitimately Owed Payments from AIG and Refusing to Transact with AIG, Even on a Secured, Short-Term Basis.	37
8.0	ON SEPTEMBER 16, 2008, DEFENDANT CONCLUDED THAT IN THE ABSENCE OF A 13(3) LOAN FROM THE FEDERAL RESERVE AIG WOULD HAVE TO FILE FOR BANKRUPTCY.....	38
9.0	DEFENDANT WAS NOT PREPARED TO LET AIG FILE FOR BANKRUPTCY BECAUSE OF THE “CATASTROPHIC” CONSEQUENCES AN AIG BANKRUPTCY WOULD HAVE HAD FOR OTHER FINANCIAL INSTITUTIONS AND THE ECONOMY, AND DEFENDANT CONCLUDED A \$85 BILLION 13(3) LOAN TO AIG WAS APPROPRIATE.....	39
9.1	“The Failure of AIG Would Have Been Catastrophic for a Financial System Already in Free Fall.” (PTX 563 at 15; Geithner: Trial Tr. 1421:16-23).....	39
9.2	Government Officials Concluded That They Did Not Have the Option of Letting AIG File for Bankruptcy.	42
9.3	Defendant Knew that Loaning Money to AIG Would Benefit the Major Financial Firms Which Would Have Been Harmed by an AIG Bankruptcy.....	44
9.4	Before Offering a 13(3) Loan the Federal Reserve Had Analyzed and Considered the Requirements for Such a Loan and AIG’s Need for It.	45
9.4.1	Defendant had monitored AIG starting in 2007 and continuing into early September 2008.	45
9.5	In the Summer of 2008, Defendant Recognized That AIG Was Facing Serious Liquidity Issues.....	46
9.6	In the Afternoon of September 16, 2008, With the Support of the Treasury Department, the Federal Reserve Concluded That It Was in the National Interest to Provide an \$85 Billion 13(3) Credit to AIG, and AIG Was Offered Such a Credit Later That Day.....	49
10.0	DEFENDANT’S REGULATORY FAILINGS AND RELATED POLICIES SUBSTANTIALLY CONTRIBUTED TO THE 2008 FINANCIAL CRISIS.....	50
10.1	The Financial Crisis Was “Linked to Regulation”. (Bernanke: Trial Tr. 2181:13-15).....	50
10.2	Defendant Kept Interest Rates Artificially Low in the Years Leading up to the Financial Crisis, Which Created a Housing Bubble That Began to Burst in 2007.....	51

10.3	Defendant Failed to Regulate the Subprime Mortgage Market.	51
10.4	Defendant Failed to Regulate the Banks for Which It Was Responsible.	51
10.4.1	FRBNY, under Geithner’s leadership, was responsible for monitoring and regulating the exposure of Citi and other banks to the housing market, yet it failed to understand that exposure, or ensure banks had adequate capital.	52
10.4.2	Long after AIG had stopped offering CDS protection for mortgage-backed CDOs, Citi and other firms regulated by the Defendant continued, and even increased, their marketing of such CDOs.	52
10.5	Defendant Failed to Regulate the Conduct of Ratings Agencies Until Long After the Financial Crisis Had Passed.	53
11.0	DEFENDANT TOOK A NUMBER OF ACTIONS AND MADE A NUMBER OF STATEMENTS THAT DIRECTLY DISADVANTAGED AIG COMPARED TO OTHER FINANCIAL INSTITUTIONS AND CONTRIBUTED TO AIG HAVING NO REASONABLE CHOICE OTHER THAN TO ACCEPT A LOAN FROM DEFENDANT.	54
11.1	Although Defendant Recognized That AIG Would Benefit from Financial Assistance of the Type Offered Other Financial Institutions (<i>see supra</i> § 4.4), Defendant Rebuffed AIG’s Repeated Requests for the Types of Assistance Offered to Others.	54
11.1.1	Beginning in the summer of 2008, AIG recognized that it would benefit from financial assistance of the type offered to other financial institutions and began seeking such assistance.	54
11.1.2	Defendant refused AIG’s initial requests for discount window access or other assistance.	55
11.1.3	Defendant again refused to act on AIG’s September 9, 2008 request for access to the PDCF.	56
11.2	Access to the PDCF Would Have Mitigated AIG’s Liquidity Needs.	57
11.2.1	As Defendant’s expert Anthony Saunders conceded, each of the insurance subs had enough PDCF-eligible collateral that, if they had access to the PDCF window, that would have solved their own liquidity needs, saving the parent company from having to downstream funds, an amount that before September was \$12 billion and would have grown thereafter. (Saunders: Trial Tr. 8333:4 – 8337:2).	57

11.2.2	AIG’s parent and insurance companies could have obtained over \$70 billion in liquidity if Defendant had granted them access to the PDCF.	58
11.3	Although Defendant Claims That AIG Could Not Have Accessed the PDCF Because Defendant Had Refused to Permit AIG to Become a Primary Dealer, Defendant Had the Ability to, and Did in Fact, Grant Non-Primary Dealers Access to the PDCF.....	58
11.4	Moreover, “The Decision to Limit the Primary Dealer Credit Facility to Primary Dealers Had Been a Decision that the Federal Reserve Board of Governors Had Made in Its Discretion” (Bernanke: Trial Tr. 2261:5-9) and It “Was a Decision that Could Be Changed in Its Discretion.” (Bernanke: Trial Tr. 2261:10-12).	59
11.4.1	Indeed, over the course of the Financial Crisis, the criteria and requirements for the PDCF changed a number of times.....	59
11.5	Defendant Refused AIG’s September 12 and 13, 2008 Renewed Requests for Access to the Discount Window, the PDCF, or a 13(3) Loan.	59
11.5.1	On September 12, 2008, AIG “explicitly asked” FRBNY “how to obtain an IPC 13-3 loan.” (PTX 42 at 2, 4).	59
11.5.2	“On September 13, 2008, Mr. Willumstad met with President of FRBNY Geithner and Secretary of Treasury Henry Paulson”, and “AIG executives asked Federal Reserve officials about obtaining an emergency loan”. (Agreed to Stipulations ¶¶ 79, 81; Def. Resp. to Pl. 1st RFAs No. 4.2).	61
11.5.3	On September 13, 2008, Kohn told Frenkel, in substance, that the Federal Reserve was not going to provide financial assistance to AIG. (Alvarez: Trial Tr. 410:15-20; <i>see also</i> JX 46 at 1).	61
11.6	Defendant Refused AIG’s Request to Become a Bank Holding Company.....	61
11.7	Defendant Refused AIG’s Proposal That It Provide AIG with a Guarantee.	61
11.7.1	During their September 13, 2008 call with the Federal Reserve (including Fed Vice Chair Kohn), Willumstad and AIG Vice Chair Frenkel told the representatives of the Federal Reserve that AIG was continuing to try to raise capital from private investors, but AIG “could need bridge financing or a guarantee from the government”. (Willumstad: Trial Tr. 6492:21 – 6493:1). By guarantee Willumstad was “talking about a credit guarantee that would guarantee the backing of asset sales”. (Willumstad: Trial Tr. 6493:2-5).	61

11.7.2	On September 13, “Mr. Kohn said to Mr. Frenkel, in substance” that “the Federal Reserve was not going to provide financial assistance to AIG.” (Alvarez: Trial Tr. 410:15-20).	62
11.7.3	During a meeting with FRBNY in the afternoon of September 13, 2008, Willumstad again told FRBNY that AIG “needed bridge financing or a guarantee to get beyond the ratings downgrade and allow” AIG “to sell assets in an orderly fashion”. (Willumstad: Trial Tr. 6493:6-21; <i>see also</i> Willumstad: Trial Tr. 6493:22 – 6494:1 (Willumstad “meant a guarantee that would back the sale of assets”)).	62
11.7.4	During that meeting, “Mr. Paulson and Mr. Geithner were quite clear that there was going to be no support from the government.” (Willumstad: Trial Tr. 6494:22 – 6495:3).	62
11.8	A Guarantee Would Have Alleviated AIG’s Liquidity Needs.	62
11.9	Defendant Discouraged Private Parties from Providing Liquidity to AIG by Telling Private Parties That Defendant Would Not Provide Any Assistance to AIG.	64
11.9.1	Defendant acknowledged that sharing the burden of a loan with the private sector “would have been a desirable thing to do”. (Bernanke: Trial Tr. 2017:8-18).	64
11.9.2	Bernanke was willing to lend to AIG as early as September 13, 2008.....	65
11.9.3	Geithner began to consider lending to AIG on September 14, 2008.....	66
11.9.4	Nevertheless, Defendant continued to tell private parties and the public, including as late as September 15, that there would be no federal assistance for AIG.	66
11.9.5	Defendant knew that asserting that there would be no Government assistance would discourage the private sector from providing liquidity to AIG.	67
11.9.6	The strategy of publicly refusing to support AIG until it was at the brink of bankruptcy was not a strategy that was considered or authorized by the Board of Governors.	68
11.10	Defendant Did Not Allow AIG Management or AIG’s Largest Shareholder to Participate in the September 15-16, 2008 Discussions Between Defendant, JPMorgan, and Goldman Sachs Concerning AIG.....	69

11.11	On September 17, 2008, Four Days Before AIG Approved the Credit Agreement, Defendant Declined a Proposal for Private Sector Participation in the Revolving Credit Facility Without AIG’s Knowledge or Participation.....	70
11.12	Defendant Directly Discouraged Sovereign Wealth Funds from Providing Liquidity to AIG.	71
11.12.1	Sovereign wealth funds, including the Government of Singapore Investment Corporation (“GIC”) and the China Investment Corporation (“CIC”) indicated they were prepared to invest in AIG. (Studzinski: Trial Tr. 4490:1-21, 4497:3-16).....	71
11.12.2	CIC was discouraged from investing in AIG prior to September 16, 2008:	74
11.13	On September 16, 2008, Defendant Discouraged the New York State Government from Assisting AIG.....	75
11.13.1	“Around noon on September 15, 2008, New York Governor David Paterson held a press conference at which he announced that he had directed the New York State Insurance Department to authorize AIG to access approximately \$20 billion in liquid assets from certain AIG insurance subsidiaries.” (Agreed to Stipulations ¶ 96).	75
11.13.2	On or around September 16, 2008, Dinallo proposed “providing liquidity to the AIG parent from assets in the related insurance subsidiaries that were considered excess”. (Geithner: Trial Tr. 1470:15 – 1471:4). Geithner believed the amount Dinallo proposed was “in the range of \$20 billion”. (Geithner: Trial Tr. 1471:5-8).	76
11.13.3	On September 16, FRBNY conveyed to “Mr. Dinallo that the New York Fed did not want to accept that proposal”. (Geithner: Trial Tr. 1471:16-21). It was “concluded that the Fed would consider making a loan and that the New York State Insurance Department’s efforts weren’t necessary”. (Geithner: Trial Tr. 1768:4-19).	76
12.0	THE SEPTEMBER 16 TERM SHEET DEMANDED WARRANTS EXERCISABLE FOR 79.9% OF AIG’S SHAREHOLDERS’ EQUITY AS A CONDITION OF THE CREDIT FACILITY.....	76
12.1	The Only Meeting of the Board of Governors to Approve the AIG Loan Occurred on September 16, 2008.....	76

12.2	The Only Term Sheet Approved by the Board of Governors Provided That Defendant’s 79.9% Equity Interest in AIG Would Be Non-Voting Warrants. (JX 63 at 5-10).....	77
12.2.1	The term sheet included in JX 63 “was the only AIG credit facility term sheet that the Federal Reserve Board of Governors ever reviewed”. (Alvarez: Trial Tr. 188:18-21).....	77
12.2.2	The term sheet approved by the Board of Governors states that the form of equity interest will be: “Warrants for the purchase of common stock of AIG representing 79.9% of the common stock of AIG on a fully-diluted basis”. (JX 63 at 6).	78
12.2.3	The term sheet approved by the Board of Governors required shareholder approval before stock was issued or voting control transferred.	79
12.2.4	The term sheet approved by the Board of Governors required the payment of an exercise price when the warrants it provided for were exercised.	79
12.3	Both Immediately Before and After the Board of Governors Meetings, Defendant Understood That the Form of Equity Would Be Non-Voting Warrants.	79
12.4	As of September 16, 2008, AIG Understood That Defendant’s AIG Equity Would Be Non-Voting Warrants.	86
12.4.1	The evidence from AIG and its auditors is consistent that on September 16 AIG understood that Defendant’s “equity” would be warrants.	86
12.4.2	Under New York Stock Exchange (“NYSE”) Listed Company Manual Rule 312.03, shareholder approval is required prior to the issuance of warrants exercisable into 20 percent or more of the voting power of a corporation’s common stock unless a company invokes an exception to Rule 312.03 that waives the requirement of a shareholder vote when: “(1) the delay in securing shareholder approval would seriously jeopardize the financial viability of the Corporation’s enterprise and (2) reliance by the Corporation on such exception is expressly approved by the Audit Committee of the Board”. (JX 75 at 2; <i>see also</i> JX 240 at 94-96).....	87
12.4.3	On September 16, 2008, the Audit Committee of the AIG Board approved the issuance of warrants without shareholder approval under Rule 312.05 of the NYSE Listed Company Manual. (JX 75 at 3; <i>see also</i> Shannon: Trial Tr. 3669:20-22).	87

12.5	As of September 17, 2008, AIG Understood That Defendant’s Equity Would Be Non-Voting Warrants.	88
12.5.1	On September 17, 2008, counsel for AIG and FRBNY discussed “insurance issues relating to the warrant”. (PTX 114 at 1).	88
12.6	As of September 18, 2008, AIG Understood That Defendant’s Equity Would Be Non-Voting Warrants.	88
12.6.1	On September 18, 2008, AIG filed a Form 8-K with the SEC announcing the terms of the proposed Credit Facility, that reported that “AIG issued a warrant to the Board of Governors of the Federal Reserve”, and that “the exercise of the warrant” was “subject to shareholder approval” (JX 96 at 2).	88
12.6.2	AIG’s September 18 Form 8-K filing was based on discussions with AIG board members, was reviewed by inside and outside counsel, and was “true and accurate” at the time of filing.	89
12.6.3	During a town hall speech to AIG employees on September 18, 2008, Liddy told employees that AIG would strive to “give the government some sort of a return on its warrants”. (PTX 173 at 9).	90
12.7	Published Reports Stated That AIG Would Issue Non-Voting Warrants to Defendant for 79.9% of the Common Equity of AIG.	90
12.7.1	No published report prior to the evening of September 23, 2008, stated that Defendant would receive voting preferred stock.	91
13.0	ON SEPTEMBER 16, 2008, DEFENDANT TOLD AIG THAT DEFENDANT’S TERMS, INCLUDING DEFENDANT’S DEMAND FOR 79.9% OF AIG SHAREHOLDERS’ EQUITY, WERE NON-NEGOTIABLE AND THAT IF AIG DID NOT AGREE, AIG WOULD NOT RECEIVE ANY LOAN OR OTHER ASSISTANCE FROM DEFENDANT AND WOULD HAVE TO FILE FOR BANKRUPTCY.	91
13.1	Geithner Knew “It Would Have Been Possible to Loan AIG Money on a Secured Demand Note Without Having Reached Agreement on The Term Sheet,” If “the Demand Note Allowed Us to Be Secured to Our Satisfaction.” (Geithner: Trial Tr. 1908:24 – 1909:4). In Fact, Defendant Lent to “AIG Based on a Secured Demand Note” on September 16, 17, 18, and 19 (Geithner: Trial Tr. 1909:5-7; JX 84).	91
13.2	Nevertheless, AIG Was Provided with a Very Limited Time Period with Which to Accept FRBNY’s Offer of Assistance.	91

13.3	The Offer Made to AIG by FRBNY on September 16, 2008 Was a Take-It-or-Leave-It Offer.	92
14.0	THE “FIRST TIME THAT AIG WAS OBLIGATED TO PROVIDE EQUITY TO THE GOVERNMENT” WAS “WHEN THE SEPTEMBER 22 CREDIT FACILITY WAS SIGNED”. (BAXTER: TRIAL TR. 765:2-5).	94
14.1	The Evening of September 16, 2008, AIG’s Board Passed Two Resolutions – a Resolution Authorizing the Negotiation of a Credit Agreement Between AIG and the Federal Reserve Based on the Terms of Defendant’s Offer, and a Resolution Authorizing AIG to Immediately Borrow Money from the Federal Reserve on a Secured Demand Note Basis.	95
14.2	The AIG Board Was Never Presented with the Version of the Term Sheet Defendant Claims Was Executed.	95
14.2.1	Willumstad was the only member of the AIG Board of Directors who saw a term sheet on September 16, 2008. On the afternoon of September 16, 2008, Willumstad received a two-page term sheet. (Willumstad: Trial Tr. 6515:10-13). But that term sheet was not shown to the AIG Board at its meeting later that day. (Willumstad: Trial Tr. 6515:14-16). In fact, the AIG Board was not shown any term sheet at its September 16 meeting. (Willumstad: Trial Tr. 6515:17-19).	96
14.2.2	The term sheet Willumstad saw on September 16 has not been produced in this litigation.	96
14.3	The September 16, 2008 Term Sheet Expressly Provides That It Is Not Legally Binding.	98
14.4	No Version of the September 16, 2008 Term Sheet Was Executed by Both Parties.	98
15.0	UPON THE AIG BOARD’S PASSING OF ITS SEPTEMBER 16 RESOLUTIONS, DEFENDANT ASSUMED CONTROL OF AIG.	99
15.1	When Funds Were Advanced on September 16, “the Government Had Immediate Control” (Offit: Trial Tr. 7938:7-15) and the “Latitude to Do Whatever It Wished” (Offit: Trial Tr. 7964:23 – 7965:9).	99
15.2	On September 16, 2008, Prior to Any Discussions with the AIG Board, Defendant Fired Willumstad as CEO of AIG and Replaced Him with a CEO of Defendant’s Own Choosing.	101
15.3	Liddy Began Functioning as AIG’s CEO Before He Had Even Met, Let Alone Been Approved by, the AIG Board.	103

15.4	The AIG Board’s Approval of Liddy on September 18, 2008 Was Only a Formality, Which the Board Understood They Were Obligated to the Government to Do.....	105
15.4.1	The AIG Board felt forced into accepting Willumstad’s resignation and accepting Liddy’s appointment.	106
15.4.2	The AIG Board accepted Liddy even though when Liddy became CEO of AIG he was a member of the Goldman Sachs Board of Directors, was Chairman of the Audit Committee of Goldman Sachs, and owned a “considerable amount of Goldman Sachs stock”.	106
15.5	On September 19, 2008, Defendant Required That AIG Adopt a Policy of Not Granting Dividends to Shareholders in Order to Preserve Capital. (JX 94 at 5-6).....	107
15.6	Both Defendant and Liddy Considered Liddy the Government’s Man at AIG.	107
15.6.1	Liddy viewed his role as CEO of AIG as a partnership with Defendant.....	108
15.7	On September 21, 2008, Liddy Knew That Goldman Sachs Was Going to Become a Bank Holding Company (“BHC”) but Did Not Explore This Possibility for AIG.....	109
15.7.1	When he was confirmed as Chairman and CEO of AIG on September 18, 2008, Liddy was “aware that Goldman Sachs was at least considering as one of its options becoming a bank holding company” (Liddy: Trial Tr. 3084:17-20). Yet Liddy never discussed “with anybody at AIG the possibility of AIG becoming a bank holding company” (Liddy: Trial Tr. 3084:7-9).	110
15.7.2	On September 21, 2008 at 4:45 p.m., Liddy attended a special meeting of the Board of Directors of Goldman Sachs, during which the Board deemed “it advisable and in the best interests of the Corporation that the Corporation become a BHC and, in connection therewith, that Goldman Sachs USA Holdings LLC, a subsidiary of the Corporation, also become a BHC” (JX 358 at 1).	110
15.7.3	Liddy left the special meeting of the Goldman Sachs Board on September 21 to attend a meeting of the AIG Board later that evening at which the Board accepted the Credit Agreement. (<i>Compare</i> JX 358 at 1 (Goldman Sachs meeting called on September 21, 2008 at 4:45 p.m.) <i>with</i> JX 103 at 1 (AIG	

	meeting called on September 21, 2008 at 8:00 p.m.)). At the AIG Board meeting, Liddy never disclosed that Goldman Sachs had been approved for bank holding company status even though it may have been significant to board members.	110
15.7.4	On the contrary, at the September 21 AIG Board Meeting at which the Credit Agreement was agreed to, Liddy advised the AIG Board that there was “urgency” in approving the Credit Agreement “because there were indications that” FRBNY “was not going to come to the aid of other troubled issuers and turmoil was expected.” (JX 103 at 2).....	110
15.7.5	However, Liddy knew that “permitting Goldman Sachs and Morgan Stanley to become bank holding companies was coming to the aid of Goldman Sachs and Morgan Stanley”. (Liddy: Trial Tr. 3083:18-22). “Becoming a bank holding company permitted Goldman Sachs to borrow more money at more attractive terms than it would have been able to do without becoming a bank holding company”. (Liddy: Trial Tr. 3075:18 – 3076:3).....	110
15.8	As of September 16, 2008, Defendant Began to Control AIG’s Business Operations, Including by Installing a Permanent On-Site Monitoring Team at AIG.....	111
15.8.1	Federal Reserve Vice Chairman Kohn: On “September 16, the government in the form of the Federal Reserve, working with the Treasury, became very deeply involved in the overall strategy of the company.” (PTX 449 at 15-16).....	111
15.8.2	On September 16, Geithner appointed Dahlgren to head the AIG monitoring team, telling her in substance: “You’re going to take on AIG, we are going to make them a loan, and you are going to run it”. (Dahlgren: Trial Tr. 2601:4-21; <i>see also</i> Geithner: Trial Tr. 1565:21 – 1566:16 (“The Federal Reserve Bank of New York appointed a group of people to monitor and be present on the premises of AIG”)).	111
15.8.3	On September 18, 2008, FRBNY “instructed” AIG that going forward “all collateral calls that are not contractual” need to be “agreed” to by FRBNY before AIG posts, and that AIG “must not post on valuations before going through this process.” (PTX 141 at 1).	111
15.8.4	On September 16, 2008 FRBNY established “an on-site presence at AIG to monitor and protect our interests as lender	

	and equity stakeholder.” (PTX 102 at 1; McLaughlin: Trial Tr. 2397:17 – 2398:5).	111
15.8.5	Defendant’s AIG Monitoring Team included hundreds of government officials and outside advisors.	114
15.9	Several of the Advisory Firms That Defendant Used to Manage AIG Had Conflicts with AIG.	116
15.10	AIG Was Required to Reimburse FRBNY for All Expenses Incurred by FRBNY’s Advisors, but FRBNY Neither Set a Budget for Such Expenses Nor Reviewed with AIG How Much Money FRBNY Planned to Spend in Advance of Spending It. (Dahlgren: Trial Tr. 2606:7 – 2608:11).	117
15.11	Defendant Reviewed and Approved AIG Securities Filings, Press Releases, and Other Significant Public Statements.	118
15.12	Starting on September 17, 2008, Defendant Engaged in Significant Additional Conduct That It Knew Would Lead to Divergence from AIG Management Strategy and AIG Corporate Interests.	122
15.12.1	Starting on September 17, 2008, Defendant began to implement a liquidation plan for AIG.	122
15.12.2	Defendant continued to discourage and ignore offers from sovereign wealth funds and the private sector to participate in financing for AIG. (<i>See supra</i> §§ 11.9, 11.11-11.12).	122
15.13	The Government and Others Considered the Government the Owner of AIG.	123
16.0	FROM SEPTEMBER 17 THROUGH SEPTEMBER 22, DEFENDANT DRAFTED A BINDING CREDIT AGREEMENT, A SUMMARY OF TERMS OF WHICH WAS PRESENTED TO THE AIG BOARD FOR THE FIRST TIME THE EVENING OF SEPTEMBER 21.	123
16.1	Between September 16 and 22, 2008, Defendant Provided Liquidity to AIG Pursuant to Agreements in the Form of Secured Demand Notes.	123
16.1.1	The demand notes were “separate and distinct legal documentation from the legal documentation that was executed on September 22”. (Baxter: Trial Tr. 740:24 – 741:22).	124
16.2	Defendant Drafted the Credit Agreement.	124
16.3	Between September 17 and September 21, Defendant Refused to Negotiate Key Terms of the Credit Agreement.	125

16.4	Although Defendant Refused to Negotiate the Key Terms of the Credit Agreement with AIG, Defendant Unilaterally Changed the Key Terms of the Form of Equity and Shareholder Approval, and Voting Control.....	125
16.5	A Summary of the Credit Agreement Terms Was Presented to the AIG Board for the First Time the Evening of September 21.....	126
16.6	Prior to the Evening of September 21, the AIG Board Had Not Been Given Any Indication that Defendant Was Demanding Voting Preferred Stock as the Form of Equity.....	126
16.7	Even at the September 21 Board Meeting, the AIG Board Was Not Given a Copy of the Draft Credit Agreement.....	127
16.8	Defendant Continued to Make Changes to the Credit Agreement After the AIG Board of Directors Approved the Terms of the Agreement.	128
17.0	THE TERMS OF THE CREDIT AGREEMENT WERE MATERIALLY WORSE FOR AIG SHAREHOLDERS THAN THE TERMS DEFENDANT HAD OFFERED, AND WHICH THE FEDERAL RESERVE BOARD OF GOVERNORS HAD APPROVED, ON SEPTEMBER 16.....	129
17.1	The Credit Agreement Provided Defendant with Voting Preferred Stock That Had Not Been Agreed to, or Even Mentioned to AIG, on September 16 (<i>see supra</i> §§ 12.4, 14.2, 16.5-16.6).	130
17.2	There Are Material Differences Between Voting Preferred Stock and the Warrants in the Term Sheet Approved by the Board of Governors.	132
17.3	The Warrants in the Term Sheet Approved by the Board of Governors Were Non-Voting and Required a Shareholder Vote to Be Exercised, While Voting Preferred Stock Gave Defendant Immediate Control over AIG.	133
17.4	The Warrants in the Term Sheet Approved by the Board of Governors Required the Payment of an Exercise Price to Be Converted to Stock, Which Payment Was Avoided by Immediately Issuing Preferred Stock.	134
17.5	The Form of Equity Was Material to AIG.....	134
17.6	Changing the Form of Equity from Non-Voting Warrants to Voting Convertible Preferred Stock in Order to Obtain Immediate Control of AIG Was Important to Defendant.	136
17.7	Defendant Wanted Immediate Control of AIG to Prevent AIG's Common Shareholders from Having a Chance to Reject the Terms of the Credit Agreement.....	138

17.8	Defendant Was Obsessed with the Danger That AIG Shareholders Might Object to the Deal and Use Their Right to Vote to Block or Revise It.....	140
17.9	Defendant Changed the Form of Equity from Non-Voting Warrants to Voting Convertible Preferred Stock in Order to Avoid Payment of a Strike Price of a Minimum of \$29.343 billion.	143
17.9.1	Warrants have an exercise price. (Def. Resp. to Pl. 2nd RFAs No. 558; Offit: Trial Tr. 7939:13-15; Liddy: Trial Tr. 3090:22 – 3091:2).	143
17.9.2	The exercise price for warrants for AIG common stock would have been at least \$2.50 per share, absent the AIG common shareholders voting as a class to decrease the par value.....	143
17.9.3	To receive 79.9% of AIG’s common shares, Defendant would be required to exercise warrants for 11.737 billion shares (79.9% of 14.69 billion shares per PTX 375 at 21), which at \$2.50 per share would be approximately \$29.343 billion.....	144
17.9.4	Defendant wanted to avoid paying more than a “nominal price” for the AIG equity it acquired.....	145
18.0	THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE NEVER APPROVED THE CREDIT AGREEMENT NOR THE CHANGES MADE TO THE TERMS OF THE \$85 BILLION 13(3) LOAN TO AIG AS APPROVED BY THE BOARD OF GOVERNORS ON SEPTEMBER 16 (12 U.S.C. §§ 343, 357 (2006)).....	145
18.1	The Board of Governors Must Authorize the Terms in Order for FRBNY to Extend a Loan Under Section 13(3), and so FRBNY Needed Authorization from the Board of Governors to Extend a Loan to AIG.	145
18.2	The Board of Governors Authorized a 13(3) Loan to AIG Based on a Term Sheet That Called for Non-Voting Warrants and Did Not Mention Preferred Shares (Voting or Otherwise), and Did Not Leave the Form of Equity “To Be Determined” (JX 63 at 5-10).	146
18.2.1	The Board of Governors did not discuss or consider requiring AIG to issue voting convertible preferred stock or leaving the form of equity “to be determined” (JX 63).	146
18.3	The Board of Governors Authorized a 13(3) Loan Based on a Term Sheet That Required Shareholder Approval for Defendant to Obtain Voting Stock or Voting Control (JX 63 at 6, 10).	146

18.3.1	There was no discussion or vote at the September 16, 2008 Board of Governors meeting about obtaining voting stock or voting control without a shareholder vote. (JX 63).	146
18.3.2	The only term sheet approved by the Board of Governors includes a “Summary of Terms of Warrants” which states that “Shareholder Approval” was “Required to issue stock above authorized by unissued shares”. (JX 63 at 10).	147
18.4	The Board of Governors Authorized a 13(3) Loan Based on a Term Sheet That Required Defendant to Pay an “Exercise Price” (JX 63 at 10).	147
18.4.1	There was no discussion about acquiring stock without paying an exercise price. (JX 63).	147
18.4.2	The term sheet provides when “The warrants may be exercised” and discusses the warrants’ “Exercise Price”. (JX 63 at 10).	147
18.5	The Board of Governors Authorized a 13(3) Loan Based on a Term Sheet That Did Not Mention a Trust.	147
18.5.1	The term sheet considered by the Board of Governors did not mention the creation of a Trust to hold voting convertible preferred stock (JX 63 at 5-10), and there was no discussion about, or vote concerning, a Trust (JX 63 at 1-3).	147
18.6	“The Federal Reserve Board Did Not Have Any Involvement in the Structure of the Credit Facility Trust Agreement.” (Def. Resp. to Pl. 2nd RFAs No. 563).	148
18.7	The Board of Governors Did Not Vote to Approve the Credit Agreement.	149
18.8	The Board of Governors Did Not Even Learn That FRBNY Would Demand Voting Convertible Preferred Stock or That FRBNY Would Create a Trust Until After September 16, 2008.	149
18.9	Contemporaneous Documents Indicate That the Board of Governors Had Reservations About the Change from Non-Voting Warrants to Voting Convertible Preferred Stock.	150
18.9.1	Defendant did not, however, limit its voting control over AIG because, as Treasury attorney Stephen Albrecht noted on January 16, 2009 regarding a proposal by the Board of Governors to limit Defendant’s voting control over AIG: “there is real risk that this could in some way open the door for the existing shareholder who are currently engaged in litigation	

over the deal, and seek to gain control of the company” (PTX 3308 at 1). 151

19.0 ON SEPTEMBER 21, 2008, DEFENDANT TOLD AIG’S OFFICERS AND DIRECTORS THAT IF THEY DID NOT APPROVE THE CREDIT AGREEMENT AS PROPOSED BY DEFENDANT, INCLUDING WITH THE CHANGES DEFENDANT HAD UNILATERALLY MADE, DEFENDANT WOULD CALL ITS SECURED DEMAND NOTES AND AIG WOULD BE REQUIRED TO FILE FOR BANKRUPTCY..... 152

19.1 From September 16 to 19, AIG Had Given FRBNY Several Demand Notes Totaling \$37 Billion Which Obligated AIG to Repay FRBNY for Any Principal and Interest “On Demand”. (JX 84 at 1-4). 152

19.2 At the September 21, 2008 Meeting, Liddy Told the Board: “the Corporation Will Be Required by the Bank and the Treasury Department to Finalize the Documentation and Sign the Credit Agreement Before the Opening of the Market the Following Day.” (JX 103 at 2). 152

19.3 Defendant Threatened to Cut Off Funding for AIG by Calling the Secured Demand Notes if the AIG Board Did Not Approve the Credit Agreement as Drafted by Defendant. 152

19.4 If Defendant Had Called the Demand Notes and Not Continued to Fund AIG, “That Would Have Had a Disastrous Effect on AIG” (Offit: Trial Tr. 7941:10-16)..... 152

20.0 FACED WITH DEFENDANT’S NON-NEGOTIABLE DEMANDS, ITS THREAT TO CALL ITS SECURED DEMAND NOTES, AND THE OPINION OF AIG COUNSEL THAT A DECISION TO FILE FOR BANKRUPTCY WOULD NO LONGER BE PROTECTED BY THE BUSINESS JUDGMENT RULE, AIG HAD NO REALISTIC CHOICE BUT TO ACCEPT DEFENDANT’S LOAN ON DEFENDANT’S TERMS. (PTX 195 AT 4)..... 153

20.1 AIG’s Outside Counsel, Rodgin Cohen of Sullivan & Cromwell LLP, Advised the Board During the September 21, 2008 Meeting That “Bankruptcy Was a Considerably Worse Alternative Now Than It Was Previously,” and That “if the Board Accepted the Bank Transaction, the Board Would Have Properly Exercised Its Business Judgment,” but That “if the Board Chose to File for Bankruptcy, He Was Not Prepared to Render a Similar Opinion to the Board”. (JX 103 at 5-6). 153

20.1.1 The AIG Board was advised that its constituencies included not just its shareholders, but also its creditors and employees. (JX 103 at 4). 153

20.2	By Contrast, During the September 16, 2008 AIG Board Meeting, Cohen Advised the Board That It “Could Accept Either Option” of the Proposed Credit Facility or Filing for Bankruptcy. (JX 74 at 5).	154
20.3	AIG’s Board Had “No Choice” but to Accept Defendant’s Offer on Defendant’s Terms.	155
20.3.1	The Board believed it had no choice even though it believed the terms were “exorbitant”.	156
20.4	In September 2008, Bankruptcy “May Have Been a Legal Option,” but “It Was Not a Realistic or Viable Option”. (Herzog: Trial Tr. 7031:5-12).	156
20.5	AIG’s Obligation to Issue to Defendant Voting Preferred Stock Representing 79.9% of the Shareholders’ Equity and Voting Control Was Fixed as of the Execution of the Credit Agreement Even If Defendant Later Unilaterally Substituted a Different Financing Structure. (JX 107 at 46-47, 63 (§§ 5.11, 8.17)).	157
20.5.1	AIG’s outside auditor PwC “concluded the Company’s obligation to issue a fixed number of shares of its preferred stock represents a prepaid forward sales contract” which “should be classified as permanent equity” for the third quarter of 2008. (JX 151 at 23-24).	158
20.5.2	The Credit Agreement was signed by Liddy on behalf of AIG on the morning of September 23, 2008, with an effective date of September 22, 2008. (JX 110 at 1, 3, 66).	158
20.6	Plaintiffs Did Not Participate in, or Approve, the Decision to Provide Defendant with 79.9% of Their Equity and Voting Control.	159
20.6.1	The Credit Agreement became effective without any vote or other expression of approval by the Plaintiffs.	159
20.6.2	Neither Plaintiffs nor the public generally were ever informed that AIG was being asked to provide voting preferred stock until after the Credit Agreement was executed.	159
20.7	Defendant Deliberately Prevented a AIG Shareholder Vote (see <i>supra</i> §§ 17.6-17.8) and Even Concealed the Plan to Issue Voting Preferred Shares Until After the Credit Agreement Was Signed.	160
21.0	ON SEPTEMBER 16, 2008, AND CONTINUING THROUGH JANUARY 2011, AIG HAD SUFFICIENT ASSETS TO FULLY SECURE THE CREDIT PROVIDED TO IT BY THE FEDERAL RESERVE.	160

21.1	Defendant’s Officials Repeatedly Concluded That the Federal Reserve’s Loans to AIG Were “Fully Secured” and, Indeed, “Overcollateralized”.	160
21.2	Because the AIG Loan Was Fully Secured, Defendant Believed It Did “Not Run the Risk of Losing Money”.	163
21.3	AIG Was Solvent at All Times.	163
21.3.1	AIG management concluded AIG was solvent.....	166
21.3.2	As late as September 14, 2008, Citibank concluded AIG had more than \$10 billion of “repoable” assets worth lending against.	167
21.4	AIG’s Valuable Insurance Subsidiaries Were Stable and Secure.....	167
21.5	The Credit Facility Was Secured by Substantially All of AIG’s Assets.	172
21.5.1	The Federal Reserve has not extended a loan that was not fully secured and the AIG loan was no exception.....	173
21.5.2	Section 13(3) does not permit the Federal Reserve to take risk or to “lend into a run.”	174
21.5.3	Defendant conservatively valued the collateral pledged by AIG.	174
21.5.4	The value of the collateral was determined by doing a conservative valuation of the assets, then applying a 25% haircut to them.	175
21.5.5	Despite the high quality of AIG’s collateral, the 25% haircut applied by FRBNY was higher than the haircut applied to any other 13(3) eligible collateral. (PTX 5361).....	176
21.6	AIG Pledged Collateral That Defendant’s Advisors Ernst & Young and Morgan Stanley at All Times Valued at More Than \$85 Billion.	176
21.6.1	The “maximum amount that AIG drew against the credit facility” was “\$72 billion.” (Kothari: Trial Tr. 4531:6-17; Agreed to Stipulations ¶ 217; PTX 5200).....	178
21.6.2	The pledged collateral was revalued periodically and always determined to fully secure the Credit Facility.....	178
21.7	Defendant Recognized Immediately that the Credit Facility Was Likely to Be a Highly Profitable Loan Rather than a Risky Loan.	179

21.8	Defendant’s Experts’ Proffered Testimony That the Credit Facility Was a High Risk Loan Has No Basis in Fact and Is Contrary to Defendant’s Contemporaneous Conclusion That the Credit Facility Was Fully Secured and with Low, if Any, Risk (see <i>supra</i> §§ 21.1-21.2, 21.6-21.7).	180
21.8.1	The testimony of Defendant’s expert, Dr. Anthony Saunders, that the Credit Facility was comparable to an unsecured loan has no basis in fact and should be disregarded.	181
21.8.2	Defendant’s experts erroneously and misleadingly rely on bond yields and CDS spreads for unsecured AIG bonds as indicators of the credit risk of the fully secured Credit Facility.	185
21.8.3	Dr. Mordecai’s and Dr. Saunders’ opinions concerning the credit risk are also flawed because they rely on bond yields and CDS spreads from September 16 – nearly a week before the Credit Facility was even established. Had Dr. Mordecai and Dr. Saunders relied on CDS spreads or bond yields from September 22, 2008 – the day the Credit Facility was actually established – they would have found that the interest and commitment fees associated with the Credit Facility provided fair market compensation for the risk assumed by Defendant, without considering the value of the 79.9% equity and voting interests taken by Defendant.	187
21.8.4	Dr. Saunders has no basis for claiming the credit risk of lending to AIG was “extremely high” (Saunders: Trial Tr. 8177:12-16). Although there are many widely accepted, objective ways of estimating credit risk, Dr. Saunders did not use any of them to measure the risk of the Credit Facility.	188
21.9	Senior Government Officials Have Repeatedly Testified that AIG Had Pledged “good” or “high-quality” Collateral to Secure the Credit Facility.....	188
22.0	AIG WAS THE ONLY 13(3) BORROWER IN HISTORY WHOSE SHAREHOLDERS’ EQUITY AND VOTING CONTROL WERE DEMANDED AS CONSIDERATION FOR A 13(3) LOAN.	189
23.0	DEFENDANT UNDERSTOOD THAT NEITHER THE FEDERAL RESERVE NOR TREASURY HAD THE AUTHORITY TO ACQUIRE EQUITY AS A CONDITION OF MAKING A 13(3) LOAN.	190
23.1	Defendant Understood That Section 13(3) Did Not Authorize the Federal Reserve to Acquire or Hold Equity as Consideration for a 13(3) Loan.....	190
23.2	Defendant Recognized That 13(3)’s Provision That the Consideration for a 13(3) Loan Was to Be a “Rate” Limited Such Consideration to an Interest Rate.	196

23.3	Recognizing That These Limitations Prevented It from Taking an Equity Interest in AIG, Defendant Discussed Amending Section 13(3) to Create the Authority to Demand or Receive Equity in Exchange for Emergency Credit.....	196
23.4	Defendant Understood That FRBNY’s Legal Position Concerning Its Authority Under Section 13(3) Was Aggressive “Loophole Lawyering” and Inconsistent with the Board of Governors’ Position.	197
23.5	In September 2008, Treasury Had No Authority to Purchase or Hold Equity.	198
23.5.1	Recognizing Treasury’s lack of authority, Board of Governors legal staff drafted proposed legislation on September 16, 2008 that would have allowed Treasury to acquire “any type of equity interest” in a troubled financial institution (PTX 3368 at 2).	199
23.5.2	Even though Congress provided Treasury with authority to purchase equity in EESA, that authority was still far more limited than the taking and/or illegal exaction provided for by the Credit Agreement. (12 U.S.C. §§ 5211, 5223).	199
23.6	Defendant Was Explicitly Aware That Diluting AIG Shareholders Raised Concerns Under The Takings Clause of The Constitution.	201
24.0	PRIOR TO THE EXECUTION OF THE CREDIT AGREEMENT, NEITHER THE BOARD OF GOVERNORS NOR ANY OTHER GOVERNMENT OFFICIAL UNDERTOOK ANY INVESTIGATION OR ANALYSIS, OR MADE ANY FINDINGS, OR ALLOWED AIG OR PLAINTIFFS ANY MEANINGFUL OPPORTUNITY TO BE HEARD AS TO WHAT PERCENTAGE OF EQUITY OR VOTING CONTROL WAS APPROPRIATE TO DEMAND.	201
25.0	THE AIG CREDIT FACILITY TRUST DID NOT CURE DEFENDANT’S LACK OF AUTHORITY.	202
25.1	Regardless of Whether the Trust Ultimately Held the AIG Shares, FRBNY Initially Acquired the Shares.	202
25.1.1	“FRBNY was the settlor of the Trust” (Def. Resp. to Pl. 2nd RFAs No. 767; Baxter: Trial Tr. 985:15-19; JX 172 at 4).	202
25.1.2	The only payment made to AIG for AIG’s Series C Preferred Stock was \$500,000 in loan forgiveness that FRBNY provided to AIG in September 2008 (JX 107 at 37-38 (§ 4.02(e)), 137).	203

25.1.3	When FRBNY provided the \$500,000 in loan forgiveness to AIG in September 2008, the Trust did not exist. (<i>See</i> Def. Resp. to Pl. 2nd RFAs No. 726 (“The Trust did not exist until the AIG Credit Facility Trust Agreement was signed on January 16, 2009.”)).....	203
25.1.4	“The corpus of the Trust consisted entirely of the Series C Preferred Stock.” (Def. Answer to 2nd Am. Compl. ¶ 85; <i>see</i> <i>also</i> PTX 515 at 9-19).....	203
25.2	The Series C Preferred Shares Were Received as “the Quid Pro Quo” for the Fed’s Loan to AIG (PTX 4004).	203
25.3	Defendant Established the Trust in an Attempt to Circumvent the Limitations on Its Authority.....	203
25.3.1	Sometime between September 16th and September 22nd, Baxter conceived of the idea of having a trust own the equity interest in AIG and proposed that concept to Geithner. (Baxter: Trial Tr. 791:10-22).	203
25.3.2	Because Defendant did not want to give up the equity interest, it attempted to circumvent the limits on its authority (which prevented the Government from owning an equity interest in AIG) by placing the AIG shares in a trust.	203
25.4	The Use Of a Trust to Hold Equity in AIG for the Benefit of the United States Was Unprecedented.....	206
25.4.1	Baxter’s current explanation for creating the Trust is pretextual.....	206
25.4.2	Various provisions of the Trust Agreement—the Trustees’ “bible” (Feldberg: Trial Tr. 3341:23-25)—ensured Defendant’s control.	207
25.5	FRBNY Selected the Trustees for Their Close Ties to the Federal Reserve System.....	210
25.5.1	FRBNY recruited the individuals who served as Trustees. (Def. Resp. to Pl. 2nd RFAs No. 765, 766; JX 172 at 5, 14, §§ 1.02, 3.02(a)).	210
25.5.2	Each trustee had a significant connection to the Federal Reserve:.....	210

25.5.3	The Trustees “are, first and foremost, Treasury’s representatives,” as noted by the Federal Reserve’s General Counsel. (PTX 484 at 1).	212
25.6	The Trust Was Nothing More Than a Legal Shell for Defendant.	213
25.6.1	Defendant was always the beneficiary of AIG equity in all its forms.	214
25.6.2	The Trust Agreement gives away AIG rights despite AIG’s lack of involvement in the negotiation and drafting of the Agreement.	215
25.6.3	Despite its lack of authority to exercise control of the stock held by the Trust, Defendant – not the Trustees – managed the Trust and exercised the Trust’s ownership rights in AIG.	215
25.7	The Trustees Expressed Concern Over Their Independence.	216
25.7.1	Defendant argued to state insurance regulators and foreign governments that the Trust was a federal instrumentality.	218
25.7.2	FRBNY was the principal source of information about AIG for the trustees.	219
25.7.3	The trustees did not participate in matters affecting the Trust’s ownership rights in AIG.	222
25.7.4	The Trustees “engaged an investment advisor for the first time after” the Trustees “understood that there was going to be a recapitalization plan earlier than” the Trustees “might have anticipated” (Feldberg: Trial Tr. 3350:19-24).	224
25.7.5	Defendant reviewed and commented upon drafts of the written statement submitted by the Trustees to Congress. (PTX 3352 at 1-2).	224
25.8	The Board of Governors Never Authorized the Trust. (<i>See supra</i> §§ 18.5-18.6)	224
26.0	THE TERMS OF THE CREDIT AGREEMENT, INCLUDING THE REQUIREMENT THAT AIG’S SHAREHOLDERS SURRENDER 79.9% OF THEIR EQUITY, HAD THE PURPOSE AND EFFECT OF PENALIZING AIG SHAREHOLDERS.	225
26.1	Defendant Asserts That There Are Virtually No Limits on the Terms and Consideration The Federal Reserve Could Demand for a Section 13(3) Loan.	225

26.2	The Terms of Defendant’s Loan to AIG Were Intentionally Designed to Be Punitive, and Defendant Described Them as Punitive at the Time.	225
26.2.1	The “Government effectively nationalized AIG” and “effectively wiped out the equity holders” (Geithner: Trial Tr. 1445:16-19, 1449:2-18).	227
26.2.2	Defendant penalized AIG for political reasons.....	227
26.3	“The Only Purpose of an Equity Component Was to Minimize a Windfall”. “The Taxpayers Could Share in the Upside.” (Bernanke: Trial Tr. 1986:17-22).	229
27.0	EVEN IF THE TERM “RATE” IN SECTION 13(3) COULD SOMEHOW BE CONSTRUED TO INCLUDE THE ACQUISITION OF EQUITY AND VOTING CONTROL AS CONSIDERATION FOR A 13(3) LOAN, THERE WAS NO BASIS FOR DEFENDANT’S DEMAND.	230
27.1	The Federal Reserve Was Required to Fix Rates for 13(3) Credit “with a View of Accommodating Commerce and Business.” (Alvarez: Trial Tr. 385:21-25).	230
27.2	The Rates for Other 13(3) Credit Facilities Were Fixed “with a View of Accommodating Commerce and Business”. (12 U.S.C. § 357).	230
27.3	The Rate for the AIG 13(3) Credit Facility Was Several Times the Rate for Other 13(3) Facilities and Was Not Set “with a View of Accommodating Commerce and Business.”.....	230
27.3.1	There was nothing in writing that set forth the rationale for the interest rate on the AIG Revolving Credit Facility	232
27.4	Defendant Charged AIG a Punitive 14% in Interest Rate and Fees on the Loan Contrasted with the Primary Credit Rate Initially Recommended by Federal Reserve Board of Governors Staff.	233
27.4.1	Federal Reserve Board of Governors staff initially recommended lending to AIG at the primary credit rate.	233
27.4.2	FRBNY later proposed an interest rate and fees amounting to 14% to the Board of Governors, and the Board of Governors did not ask anyone from FRBNY what the basis for those terms was at the September 16, 2008 meeting authorizing the loan to AIG (Bernanke: Trial Tr. 1976:18-24, 1977:13-17; <i>see also</i> Bernanke: Trial Tr. 2001:13-20).	234
27.4.3	Bernanke understood “on September 16, 2008 that the interest rate for a 13(3) credit facility had to be approved by five	

	members of the Federal Reserve Board of Governors”. (Bernanke: Trial Tr. 2110:23 – 2111:2).....	234
27.4.4	Bernanke did not “know who drafted the resolution that was presented to the Board of Governors meeting on September 16” and could not say whether he had “any discussions with them about the drafting the resolution”. (Bernanke: Trial Tr. 2149:19 – 2150:3).....	234
27.4.5	The interest rate of 14% provided to AIG in the Credit Agreement was recognized to be “loan sharky”.	235
27.4.6	Defendant’s terms were “substantially more expensive” than the draft private sector term sheet, which was already at a high interest rate. (PTX 715 at 10).....	236
27.4.7	No “analysis or consideration” was “done or given by the United States to the question of whether the interest rate that the banks were asking for in the discussions was a reasonable interest rate”. (Alvarez: Trial Tr. 398:6-20).....	237
27.4.8	Alvarez: “private banks were not instructed by Congress to set their interest rates with a view towards accommodating commerce and business.” (Alvarez: Trial Tr. 398:24 – 399:4). Yet, the rate contemplated by the private sector consortium was still lower than the rate offered by Defendant in the Credit Agreement.....	238
27.4.1	The terms in the JPMorgan draft term sheet were never shown to the private sector (apart from JPMorgan and Goldman Sachs) or to AIG.	238
27.5	As the Terms of the Credit Agreement Became Known to the Public, Third Parties Characterized the Terms as Onerous and Punitive.	239
27.6	The Defendant’s Punitive Terms Hurt, Rather Than Stabilized, AIG.....	239
27.6.1	AIG faced being downgraded by the rating agency because of the market’s reaction to Defendant’s punitive terms.	240
27.6.2	Defendant’s punitive terms destabilized the market generally.	241
27.6.3	Defendant understood its loan should be restructured into more stable long-term funding.....	243
27.7	Despite the Unprecedentedly High Interest Rate, Defendant Took 79.9% of Plaintiffs’ Equity and Voting Control as “Additional Compensation” for the Loan.	243

27.8	FRBNY Was Not Only “Fully Repaid” for the Money Lent Under the Credit Agreement but Received \$6.7 Billion in Interest and Fees Paid by AIG.	245
27.8.1	AIG fully repaid its loan.	245
27.8.2	“FRBNY received \$6.7 billion in interest payments and fees in connection with the Credit Facility.” (Agreed to Stipulations ¶ 216).	246
27.9	The Government Had No Significant Risk of Loss on its Loan to AIG.	246
27.9.1	FRBNY’s loan to AIG was fully secured (<i>see supra</i> §§ 21.1-21.6).	246
27.9.2	FRBNY’s risk of loss was further limited by the fact that FRBNY had the unilateral right to deny funding to AIG if, at the time of the borrowing request, FRBNY was not satisfied with AIG’s collateral.	246
27.9.3	FRBNY’s risk of loss was further reduced by the numerous covenants imposed upon AIG by the Credit Agreement.	247
27.9.4	The covenants in the Credit Agreement gave Defendant the power to control AIG’s “corporate governance”.	249
28.0	DEFENDANT DELIBERATELY DEPRIVED PLAINTIFFS OF AN OPPORTUNITY TO VOTE ON THE CREDIT AGREEMENT, THE ISSUANCE OF EQUITY, THE ISSUANCE OF VOTING PREFERRED STOCK, OR THE REPLACEMENT OF PREFERRED STOCK WITH COMMON STOCK.	249
28.1	Defendant Changed the Form of Equity from Non-Voting Warrants to Voting Convertible Preferred Stock to Avoid the Shareholder Vote that Would Have Been Required to Exercise the Warrants and Obtain Voting Control.	249
28.2	Defendant Required AIG to Invoke a Waiver to NYSE Rules to Avoid the Shareholder Vote that Would Otherwise Have Been Required for the Issuance of Preferred Stock Representing More than 20% of a Company’s Voting Control.	251
28.2.1	Under NYSE Rule 312.03(c)(1), shareholder approval is required prior to the issuance of securities convertible into or exercisable for common stock if: (1) the common stock has, or will have upon issuance, voting power equal to or in excess of 20 percent of the voting power outstanding. (JX 240 at 94).	251

28.2.2	Defendant demanded that AIG invoke a waiver of the NYSE rule requiring shareholder approval.	251
28.2.3	Defendant asked AIG not to disclose the fact that NYSE rules provided a 10-day waiting period prior to issuance of the preferred shares because they did not “want to give a roadmap for someone to seek an injunction.” (PTX 251 at 8).	253
28.2.4	A company is only permitted to invoke a waiver of a shareholder vote if “the delay in securing stockholder approval would seriously jeopardize the financial viability of the enterprise”. (PTX 207 at 1).	254
28.2.5	There was no legitimate basis for waiver required by Defendant since the AIG preferred stock was not issued until March 2009, and there was more than enough time in the interim to have a shareholder vote.	255
28.3	Even Though the Change to Voting Convertible Preferred Stock Gave Defendant Voting Control Without a Shareholder Vote, the Equity Term Sheet That Became Exhibit D to the Credit Agreement Assumed That There Would Be a Shareholder Vote on Amendments to the AIG Charter That Would Allow Conversion of the Preferred Shares into Common Stock. (JX 107 at 137-38).	255
28.3.1	Defendant initially believed that the holder of convertible voting preferred could vote on the charter amendments required for conversion.	255
29.0	PRIOR TO THE EXECUTION OF THE CREDIT AGREEMENT ON SEPTEMBER 23, 2008, DEFENDANT DID NOT UNDERTAKE ANY INVESTIGATION OR ANALYSIS, MAKE ANY FINDINGS, OR HOLD ANY HEARING CONCERNING WHETHER AIG OR ITS SHAREHOLDERS SHOULD BE PENALIZED AND, IF SO, HOW.	257
29.1	Prior to the Execution of the Credit Agreement, Defendant Had No Basis to Determine Whether AIG or Its Shareholders Should Be Penalized or, if so, How.	257
29.1.1	The Federal Reserve did not have regulatory or internal guidelines for pricing a loan.	258
29.2	The Federal Reserve Did Not Even Determine, or Attempt to Determine, How Much Compensation It Was Demanding From AIG or What the Basis for Such Compensation Was.	259

29.2.1	The Board of Governors did not discuss the basis of the proposed interest rate prior to authorizing the RCF to AIG at the September 16, 2008 meeting.....	259
29.2.2	The Board of Governors did not discuss the purpose of the 79.9% equity demand prior to authorizing the RCF to AIG at the September 16, 2008 meeting.....	259
29.2.3	No “estimate was made as to how much additional compensation the equity component provided”. (Bernanke: Trial Tr. 1983:24 – 1984:3).	260
29.2.4	In determining how much compensation to require for the AIG loan, Bernanke did not take into account or give any consideration to “whether or not AIG had engaged in excessive risk taking”. (Bernanke: Trial Tr. 2131:14-24).....	260
30.0	BETWEEN NOVEMBER 2008 AND JANUARY 14, 2011, DEFENDANT RESTRUCTURED THE TERMS OF ITS EXTENSION OF LIQUIDITY TO AIG.	260
30.1	“According to Both FRBNY Officials and AIG Executives, It Was Apparent at the Time the Revolving Credit Facility Was Offered That Restructuring Would Be Necessary”. (PTX 641 at 128-129).....	260
30.1.1	On November 9, 2008, FRBNY modified the terms of the Credit Agreement by lowering the interest rate and increasing the maturity period for repayment.	260
30.1.2	The changes to the Credit Facility “were prospective only. That is, neither the principal amount of the Facility nor any interest accrued prior to the modification was forgiven by the terms of the modification.” (JX 387 at 3). The “modification of the Facility occurred contemporaneous with and in contemplation of the Treasury’s decision to purchase \$40 billion in preferred stock and warrants issued by” AIG. (JX 387 at 3).	261
30.1.3	On November 25, 2008, Treasury purchased \$40 billion of AIG’s Series D Preferred Stock, a newly created class of preferred that had terms far more onerous than other classes of preferred equity purchased by Treasury under TARP. (JX 158 at 2).	262
30.1.4	The \$40 billion purchase price paid by Treasury for the Series D Preferred Stock was immediately “used to pay down the current outstandings on the Fed loan”, also reducing the maximum borrowing limit under the RCF was reduced from	

	\$85 billion to \$60 billion. (Dahlgren: Trial Tr. 2875:19 – 2876:17; PTX 622 at 34; PTX 5200).....	262
30.1.5	On November 25, 2008, FRBNY established Maiden Lane III LLC (“ML III”), which subsequently purchased certain CDOs protected by AIGFP-written CDS for par value, at the expense of AIG. (JX 188 at 41).	263
30.1.6	On December 12, 2008, Maiden Lane II LLC (“ML II”), another FRBNY-controlled LLC, purchased RMBS with a par value of \$39.3 billion from certain AIG insurance subsidiaries for \$19.8 billion, causing the subsidiaries to suffer a permanent loss of \$19.5 billion on the RMBS in exchange for limited upside in ML II. (JX 188 at 41, 250).	264
30.1.7	AIG’s participation in ML II and ML III crystallized losses at the bottom of the market for AIGFP’s multi-sector CDS portfolio and AIG’s securities lending program. (PTX 578 at 3; <i>see infra</i> §§ 34.4, 34.9).	266
30.1.8	In 2009, Defendant further restructured its extension of liquidity to AIG.....	266
30.2	The January 14, 2011 Recapitalization Transaction Was Not in the Best Interests of AIG’s Existing Common Shareholders.....	267
30.2.1	As part of the Recapitalization transaction, FRBNY received full repayment on the principal borrowings from the Credit Facility plus \$6.7 billion in fees and interest payments.....	267
30.2.2	As a result of the January 2011 Recapitalization of AIG, Defendant acquired 92.1% of AIG’s common stock.	267
30.2.3	Defendant’s 92.1% ownership stake in AIG was well in excess of the ownership stakes it took in other financial institutions during the financial crisis.....	268
30.2.4	Existing AIG common shareholders were not given the opportunity to vote on the Recapitalization transaction.	268
30.2.5	The exchange of the Series E and F Preferred Stock for common stock with a value equal to their liquidation preferences diluted existing common shareholders by giving Defendant common stock that was tens of billions of dollars more valuable than the preferred stock returned to AIG.	269

30.2.5.1	AIG also recognized that the Series E and F Preferred Stock were far less valuable than their liquidation preferences.	270
30.2.6	The warrants shareholders received as part of the Recapitalization transaction did not offset the losses suffered by AIG’s existing shareholders as a result of Defendant’s conduct.	270
30.3	As a result of the Recapitalization and Defendant’s subsequent sale of AIG common stock, Defendant received a \$23 billion profit on its extension of liquidity to AIG.	271
31.0	MANY FINANCIAL INSTITUTIONS ENGAGED IN MUCH RISKIER AND MORE CULPABLE CONDUCT THAN AIG.	272
31.1	Financial institutions that originated and marketed subprime mortgage-backed securities made representations and disclosures that Defendant has concluded were false and misleading.	272
31.1.1	Citi:	272
31.1.2	Bank of America (and its acquired assets of Merrill Lynch and Countrywide):	273
31.1.3	Goldman Sachs:	274
31.1.4	JPMorgan:	274
31.1.5	Morgan Stanley:	275
31.1.6	No claims of fraud or other misconduct have been brought by the DOJ against AIG regarding AIG’s actions in the years leading up to or during the financial crisis. (Paulson: Trial Tr. 1236:17-24).	275
31.2	The Ratings Agencies that reviewed and rated CDS products and mortgage-backed securities misled investors and other market participants, like AIG.	275
31.2.1	“AIG did not itself originate or package or market subprime backed securities”. (Paulson: Trial Tr. 1236:25 – 1237:2). Instead, “What AIG did was sometimes purchase those and sometimes offer to kind of protection that we’ve loosely referred to as insurance or credit default swaps”. (Paulson: Trial Tr. 1237:3-7).	277

31.3	AIG, like other investors and like the Federal Reserve, also relied on the ratings given subprime mortgage-backed securities by ratings agencies.	277
31.3.1	Between 2004 and 2007, AIG, together with many global investors, including other financial institutions and insurance companies, relied on third-party credit ratings in making decisions to invest in the AA and AAA rated tranches of subprime RMBS and ABS CDOs.	277
31.4	AIG, like other investors and like the Federal Reserve itself, relied on the representations and disclosures of the financial institutions that originated and sold the subprime mortgage-backed securities for which AIGFP offered protection and in which AIG's securities lending business invested.	279
31.5	AIG, like other investors and like the Federal Reserve, relied on the expected liquidity of subprime mortgage-backed securities in making decisions.	279
31.5.1	These third-party credit ratings later proved to be inaccurate and led to eventual downgrades by the ratings agencies.	280
32.0	MANY FINANCIAL INSTITUTIONS THAT ENGAGED IN MUCH RISKIER AND MORE CULPABLE CONDUCT THAN AIG RECEIVED GOVERNMENT ASSISTANCE WITHOUT THE PUNITIVE EQUITY CONFISCATION REQUIRED OF AIG.	281
32.1	AIG experienced liquidity issues due to the market-wide liquidity crisis, not because of irresponsible <i>ex ante</i> risk-taking.	281
32.1.1	Due to the market-wide financial crisis, AIG was forced to recognize tens of billions of dollars in accounting losses in 2007 and 2008 due to the application of mark-to-market accounting rules, even though AIG's mortgage backed securities were still "performing" and AIGFP's CDS contracts had not "sustained an actual loss." (PTX 649 at 26; PTX 625 at 4).	281
32.1.2	Before the worsening of the market panic in 2008, AIG had sufficient liquidity.	282
32.1.3	After the market panic began to worsen in 2008, AIG began to experience liquidity issues due to the absence of reliable market prices on the CDOs protected by AIGFP's multi-sector CDS.	282
32.1.4	As late as September 2008, the mortgage-backed securities held by AIG were still "performing," and the multi-sector	

	CDOs protected by AIGFP’s CDS portfolio had not “sustained an actual loss.” (PTX 449 at 26; PTX 625 at 4).....	283
32.1.5	The collateral calls AIGFP was facing were based on artificially depressed prices driven in part by lack of information, which in turn led to indiscriminate liquidity flight and market failure.	284
32.1.6	Compared to other financial firms, AIG was not highly leveraged.	286
	32.1.6.1 Many systemically important institutions were highly leveraged.	286
	32.1.6.2 From 2005-2007, AIG’s leverage ratio was lower than other systemically important financial institutions. (PTX 2856 at 298, Table 44 (Cragg Expert Report)).	287
32.1.7	Independent estimates of the intrinsic or fair market value of securities protected by AIG showed that collateral already posted exceeded the reasonable collateral requirements created by these securities.	288
32.1.8	In fact, AIG did not take excessive risk from an <i>ex ante</i> standpoint.	289
	32.1.8.1 AIGFP’s CDS portfolio was diversified.	290
	32.1.8.2 AIGFP’s CDS portfolio was a small part of its overall exposure.	290
	32.1.8.3 AIGFP’s CDSs were written to a no-loss standard even under recessionary scenarios.	291
	32.1.8.5 AIGFP only sold CDS on super senior CDOs.	292
	32.1.8.6 Defendant’s expert had no basis for opining on the risk of AIG’s multi-sector CDS portfolio and securities lending program.	293
	32.1.8.7 AIG’s revenues on its securities lending business show on an <i>ex ante</i> basis that AIG did not take excessive risk:	294
	32.1.8.8 AIG was well capitalized and properly reserved throughout 2007:	294

32.1.9	Defendant overstates the ex ante risk of AIGFP’s super senior multi-sector CDS portfolio.	295
32.1.10	AIG began addressing potential liquidity issues as early as 2007 and continued to do so throughout 2008.	295
32.1.10.1	In 2007, “AIG recognized that there were possible liquidity issues and had begun work to try to make sure that AIG behaved in a prudent way”. (Willumstad: Trial Tr. 6477:13-17; <i>see also</i> DX 939 at 99 (AIG 2007 10-K); <i>see also</i> DX 1361 at 130 (AIG 10-Q for 3Q 2007); Cragg: Trial Tr. 5014:2-16; PTX 5327 (Cragg demonstrative)).	295
32.1.10.2	In 2008, AIG was “aware of the liquidity, the severity, beginning in January of 2008, which resulted in our going to the open market to raise some \$20 billion in equity capital”. (Offit: Trial Tr. 7338:15 – 7339:4).	296
32.1.11	AIGFP had stopped making commitments to provide CDS protection by the end of 2005, before underwriting standards declined precipitously and the quantity of subprime mortgages exploded.	298
32.1.12	By contrast, at just that time, major commercial and investment banks – many of which the Federal Reserve regulated – did the precise opposite and increased volume as quality decreased, leading ultimately to indiscriminate liquidity flight and the crash.	300
32.1.13	AIG’s liquidity issues in September 2008 were not unique to AIG.	300
32.2	In contrast to its treatment of AIG, Defendant provided non-punitive assistance to numerous other companies, including those most responsible for causing the financial crisis.	303
32.2.1	The Federal Reserve, following Bagehot’s advice, used Section 13(3) a number of times in the 2008 financial crisis to lend to institutions against collateral.	303
32.2.2	In March 2008, the Federal Reserve provided assistance on significantly more favorable terms than then existing market rates to many primary dealers that had contributed to the financial crisis.	304

32.2.2.1	The terms of the PDCF included an interest rate at the primary credit rate with “very small” fees, no equity component and no monitoring.....	306
32.2.2.2	Defendant attempted to distinguish the treatment of AIG and primary dealers at trial based on the supervision agreed to as a result of receiving PDCF funding, but all the same supervision and monitoring activities were put in place for AIG. (<i>See supra</i> § 15.8).....	307
32.2.2.3	The credit extended to primary dealers under the PDCF was targeted, long-term assistance.	308
32.2.2.4	The Federal Reserve continued to provide assistance to primary dealers even after they or their parent companies experienced significant financial distress.....	309
32.2.3	In September 2008, the Federal Reserve expanded the range of collateral that borrowers could pledge at the PDCF. (PTX 696 at 2-3; PTX 59 at 2-3).	310
32.2.3.1	Borrowings pursuant to the PDCF increased dramatically and the interest rate charged decreased after FRBNY broadened the eligible collateral criteria.....	312
32.2.4	The primary credit rate FRBNY charged as compensation for credit at the PDCF decreased after the range of eligible collateral was expanded to include non-investment grade securities. (Cragg: Trial Tr. 5081:4-14; PTX 5360 (Cragg demonstrative)).	313
32.2.5	Although FRBNY provided 13(3) lending to many institutions in 2008 and 2009, FRBNY did not take an equity stake in any of those institutions, including Citigroup, Bank of America, Bear Stearns or JPMorgan, Morgan Stanley or Goldman Sachs.	313
32.2.6	In March 2008, Defendant provided non-punitive assistance to the failing investment bank, Bear Stearns.....	314
32.2.6.1	Defendant set the interest rate for the Bear Stearns facility with a view towards accommodating commerce despite the “substantial risk relative to the size of the facility.”	315

32.2.6.2	Defendant allowed Bear Stearns shareholders to reject the offer on the table, ultimately allowing them to receive more favorable terms for their share dilution.	316
32.2.7	Defendant did not demand equity as additional consideration for its loan to Bear Stearns despite concerns with moral hazard.	317
32.2.8	The Board of Governors authorized FRBNY to extend a loan under 13(3) to Fannie and Freddie, if needed, at the primary rate on July 13, 2008. (PTX 696 at 1).....	317
32.2.9	In September 2008, Defendant provided emergency assistance to money market funds.....	318
32.2.9.1	The Federal Reserve created the AMLF to finance the purchase of commercial paper from money market mutual funds.	318
32.2.9.2	Defendant provided for a temporary guaranty program for investments in money market mutual funds through Treasury’s Exchange Stabilization Fund.	319
32.2.10	In September 2008, Defendant provided additional non-punitive assistance to Morgan Stanley and Goldman Sachs.....	320
32.2.10.1	On September 18-19, 2008, Defendant concluded that Morgan Stanley and Goldman Sachs would fail without additional assistance.....	320
32.2.10.2	After learning that Morgan Stanley and Goldman Sachs were likely to fail, Defendant provided immediate non-punitive assistance, including by allowing them to become bank holding companies.	322
32.2.11	On October 3, 2008, the Emergency Economic Stabilization Act (“EESA”) was enacted (P.L. 110-343, Oct. 3, 2008, 122 Stat. 3765). EESA authorized Defendant to purchase up to \$700 billion in troubled assets through the Troubled Asset Relief Program (“TARP”). (PTX 2156 at 14).	327
32.2.12	In 2008 and 2009, Defendant provided non-punitive assistance to Citigroup.	327
32.2.13	In 2008 and 2009, Defendant provided non-punitive assistance to Bank of America.	331

32.2.14	Defendant permitted institutions such as American Express to become bank holding companies on an expedited basis throughout the fall of 2008.	331
32.2.15	In 2008 and 2009, Defendant provided non-punitive assistance to a major insurance company.	332
33.0	DEFENDANT CONTINUED TO CONTROL AIG THROUGH THE TIME OF THE REVERSE STOCK SPLIT AND THROUGH COMMENCEMENT OF THIS ACTION.	332
33.1	Senior Government officials acknowledged that Defendant controlled AIG.	333
33.1.1	Defendant concluded that from a corporate governance perspective, the Credit Agreement covenants reflected a change in control over AIG.	335
33.2	Defendant continued to prevent AIG from pursuing alternative funding options.	336
33.3	The Defendant recruited and influenced new management for AIG.	338
33.4	Defendant controlled AIG’s CEO and senior management.	339
33.4.1	Defendant attended and participated in AIG Board of Directors meetings.	341
33.4.2	Defendant recruited directors for AIG.	344
33.4.3	Defendant decided which directors would stay and which would be replaced.	346
33.5	Defendant controlled AIG executive compensation decisions.	350
33.5.1	The restrictions on compensation that Defendant imposed upon AIG went “far beyond the EESA requirement”. (PTX 3243 at 2).	351
33.5.2	Defendant worked on a compensation package for Liddy. (PTX 3363).	351
33.5.3	Defendant directed Liddy to reduce Stephen Bensinger’s compensation.	351
33.5.4	In February and March 2009, Defendant intervened when controversy erupted over payment of bonuses to AIGFP executives that FRBNY had previously approved.	352

33.6	In the spring of 2009, Bernanke advocated for a “reset” on AIG requiring “a perceived and actual break in the governance regime.”	355
33.7	All outside accountants recognized that Defendant controlled AIG.	355
33.8	Defendant controlled AIG’s operations.	358
33.8.1	The Credit Agreement empowered Defendant to stop funding the credit facility at any time.	359
33.8.2	The Credit Agreement required that FRBNY “be reasonably satisfied in all respects with the corporate governance of the Borrower”. (JX 107 at 36 (§ 4.01(e)).	359
33.8.3	The Credit Agreement included numerous affirmative and negative covenants.	360
33.9	Defendant’s control over AIG was so complete that every major or even minor AIG decisions were subject to review and approval by Defendant.	364
33.9.1	Defendant required that AIG curtail its lobbying activities, including the submission of comments to the proposed TARP legislation. (PTX 3345 at 3-4).	364
33.9.2	Defendant communicated directly with the credit rating agencies regarding AIG.	365
33.9.3	Defendant communicated directly with AIG’s lead insurance regulator, the New York State Insurance Department (“NYSID”).	367
33.9.4	Defendant reviewed and delayed AIG’s proxy filing.	367
34.0	DEFENDANT’S CONTROL OVER AIG IS EVIDENCED THROUGH THE MAIDEN LANE II AND III TRANSACTIONS	370
34.1	Without AIG’s Knowledge or Input, Defendant Discussed and Created Solutions for AIG’s CDS Portfolio Beginning on September 17, 2008.	370
34.2	Despite Discussing Options That Would Have Had Lower Costs and May Have Been More Favorable for AIG, Defendant and Its Advisors Chose ML II and ML III. (JX 381).	372
34.2.1	FRBNY considered guaranteeing AIGFP’s entire CDS portfolio.....	372
34.2.2	Defendant considered buying all or part of AIG FP’s CDS portfolio.....	376

34.3	Defendant Was Aware That AIG’s Assets Were More Valuable Than Counterparties Claimed.	376
34.4	Defendant Knew That Maiden Lane II and III Would Cause AIG to Give Up at Least \$50-\$100 Billion in Upside.	378
34.4.2	The formation of Maiden Lanes II and III crystallized losses at the bottom of the market for AIGFP’s multi-sector CDS portfolio and AIG’s securities lending program. (PTX 578 at 3).	380
34.5	Defendant’s Control over AIG Is Evidenced by Defendant’s Decision to Pay AIG’s ML III Counterparties Par Without AIG’s Knowledge or Consent.	381
34.5.1	On October 31, 2008, Defendant directed AIG to cease any attempt at negotiating concessions from counterparties.	381
34.5.2	Defendant sought to create a “paper trail” after the fact to suggest that AIG asked Defendant to negotiate with the counterparties rather than Defendant telling AIG to stop.	382
34.5.3	On November 9, 2008, the AIG Board of Directors authorized AIG to terminate AIGFP’s CDS transactions with the expectation there would be concessions from the counterparties.	384
34.5.4	Defendant decided not to pursue discounts or concessions from AIG’s counterparties.	386
34.5.5	Defendant only attempted to negotiate concessions for approximately 24 hours.	387
34.6	Defendant’s Payment of Par Value and Legal Releases Given to AIG Counterparties Constituted a “Backdoor Bailout”.	388
34.6.1	In connection with the ML III transactions, AIG’s counterparties received payment equivalent to the par value of the CDOs without any discount.	390
34.6.2	FRBNY’s motivation in dealing with AIG’s CDS issues was to provide assistance to other financial institutions which it supervised.	391
34.6.3	In connection with the Maiden Lane III transactions, AIG’s counterparties received complete releases from AIG for all legal action, including any potential fraud or misrepresentation claims.	392

34.6.4	AIG received nothing in exchange for the mutual releases because its counterparties, who were paid in full, had no viable claims to release.	393
34.6.5	The legal releases provided to AIG’s counterparties had substantial value.	393
34.7	Defendant’s Control over AIG Is Evidenced by Its Control over Information Concerning the Maiden Lane Structures.	394
34.8	Defendant’s Control over AIG Is Evidenced by Defendant’s Direction to AIG to Conceal the Maiden Lane III Backdoor Payments from Public Disclosure.	394
34.9	Knowing That There Was Substantial Value in the Portfolios, AIG Attempted to Buy Back the Underlying CDOs from Maiden Lane II and III but Defendant Refused.	401
34.10	Defendant Retained a Disproportionate Share of the Residual Interests of ML II and III.	402
34.10.1	Defendant retained a disproportionate share of the residual interest in Maiden Lane III.	403
34.10.2	Defendant split the residual interest in ML III with AIG 67% to 33% in Defendant’s favor.	404
34.10.3	Defendant retained a disproportionate share of the residual interest in Maiden Lane II.	405
35.0	AIG’S COMMON SHAREHOLDERS WERE NEVER GIVEN AN OPPORTUNITY TO APPROVE OR DISAPPROVE DEFENDANT’S TAKING OR EXACTION OF AN EQUITY INTEREST IN AIG, AND DEFENDANT ACTED TO AVOID SUCH A VOTE FROM OCCURRING.	406
35.1	Defendant at All Times Intended to Convert Its Series C Preferred Stock into More Liquid and Thus More Valuable Common Stock.	406
35.1.1	Because Defendant’s goal was always to convert the preferred shares into common shares, Defendant made that goal one of the primary responsibilities the Trustees were required to undertake. (JX 172 at 9 (§ 2.04(c))).	407
35.1.2	Under the original warrant structure approved by the Board of Governors, Defendant understood that a shareholder vote was required to increase the number of authorized AIG shares and decrease the par value in order for Defendant to obtain a 79.9% equity interest in AIG. (<i>See also supra</i> § 12.2.3).	408

35.1.3	Defendant initially demanded that AIG pay a Periodic Commitment Fee of 2.5% prior to shareholder approval of the increase in authorized shares needed to grant Defendant 79.9% of the company in order to coerce shareholders' approval of the transaction.	408
35.1.4	The Credit Agreement called for a stockholder's vote to amend AIG's Certificate of Incorporation to increase the number of authorized shares to enable the conversion of Defendant's preferred stock into common stock. (JX 107 at 138 (Exhibit D)).	409
35.2	AIG Also Understood That a Shareholder Vote Was Required to Enable Defendant to Obtain Common Stock.	410
35.3	As a Result of the <i>Walker</i> Lawsuit (<i>Walker v. AIG, Inc.</i> , Case No. 4142-CC, Del. Chancery Court, November 4, 2008), the Credit Agreement Was Revised to Represent that Defendant's Preferred Stock Would Not Be Converted into Common Stock Without Approval by a Majority Vote of the Common Shareholders Voting as a Separate Class.	411
35.3.1	Defendant participated in devising AIG's response to the <i>Walker</i> lawsuit.	411
35.3.2	The <i>Walker</i> lawsuit explicitly sought a ruling that the "conversion feature of the Super Voting Preferred is invalid and unenforceable in the absence of an uncoerced, affirmative vote of the holders of a majority of the common shares, voting as a class, to amend the Restated Certificate of Incorporation to increase the number of authorized common shares and [to] decrease the par value of the common shares." (PTX 344 at 19).	415
35.3.3	AIG, with Defendant's agreement, represented on November 7, 2008 that "there's no dispute between the parties" on the question of whether a separate class vote of the common stock shareholders would be required to amend the certificate of incorporation to increase the number of authorized shares or to change the stock's par value (JX 143 at 7), which was reflected in the Consent Order issued by the court (JX 176 at 2).	415
35.3.4	On November 9, 2008, as a result of the <i>Walker</i> lawsuit, Defendant amended the Credit Agreement to note that "common stockholders voting as a separate class" will vote on "amendments to AIG's certificate of incorporation to (a) reduce the par value of AIG's common stock to \$0.000001 per	

	share and (b) increase the number of authorized shares of common stock to 19 billion”. (JX 147 at 9; JX 150 at 193).	417
35.3.5	AIG understood that the <i>Walker</i> lawsuit confirmed the common shareholders’ right to a class vote before the conversion of Defendant’s preferred stock into common stock.	419
35.4	AIG and Defendant Did Not Hold a Separate Common Shareholder Class Vote Because They Knew a Vote That Would Dilute the Common Stock Would Fail.	420
35.4.1	Without a guarantee that Defendant could win the shareholder vote, the vote was repeatedly delayed pending a resolution that would not necessitate a separate common shareholder vote.....	422
36.0	BECAUSE DEFENDANT’S PREFERRED SHARES COULD NOT BE CONVERTED INTO COMMON STOCK WITHOUT A SHAREHOLDER VOTE THAT DEFENDANT KNEW IT WOULD LOSE, DEFENDANT ATTEMPTED TO CIRCUMVENT A SHAREHOLDER VOTE BY HAVING AIG “EXCHANGE” THE PREFERRED STOCK FOR COMMON STOCK.	423
36.1	Defendant Coerced AIG To Delay The Separate Class Vote On The Amendments Necessary To Permit Conversion Of The Series C And To Amend The Credit Agreement To Remove The Provision Requiring The AIG Board To Call A Shareholder Vote On Conversion.	423
36.2	Neither Defendant Nor AIG Ever Told Common Shareholders Or The <i>Walker</i> Court About The Decision Not To Hold A Vote.	425
36.3	After Issuance of the Voting Convertible Preferred, Defendant Knew That “the Only Vote the Trust or Treasury Doesn’t Control Is the Class Vote of the Common Stockholders That’s Required to Permit the Convertible Preferred to Convert into Common Stock”. (JX 156 at 1).....	428
36.4	Defendant Developed The Reverse Stock Split As An Alternative Means Of Circumventing The Shareholder Vote Requirement.	429
36.4.1	Initially, Defendant believed that it could convert the preferred without the votes of the common shareholders.....	429
36.4.2	Once Defendant realized that it could not convert the preferred into common without winning a vote of the common shareholders, it began implementing a plan to avoid such a vote.....	429

36.4.3	Defendant still needed AIG to authorize enough common shares to satisfy Defendant’s desire to exchange its AIG preferred stock for AIG common stock.	431
36.5	The Reverse Stock Split Was Coercive And Deceptive.	432
36.5.1	Defendant caused AIG to engage in a 20 to 1 reverse stock split (“RSS”) that applied only to issued shares and not authorized shares. (JX 197 at 2; JX 201 at 5; JX 218 at 4, 9).	432
36.5.2	The only reason not to apply the reverse stock split to authorized shares, and the only reason for a ratio as high as 20-to-1, was to avoid a separate class vote of the common shareholders.	433
36.5.2.1	The timing of the origin of the 20-to-1 ratio suggested that its purpose was to avoid a common shareholder vote.	433
36.5.2.2	AIG’s concerns over delisting do not explain either the 20:1 exchange ratio or the reverse stock split’s application only to issued shares.	434
36.5.2.3	The effect of the reverse stock split was to allow Defendant to exchange its Preferred Shares for common shares without a vote of the common shareholders.	436
36.6	The Reverse Stock Split Was Also Deceptive And Misleading In That It Falsely Represented “AIG Currently Has No Plans For These Authorized But Unissued Shares Of AIG Common Stock Other Than Those Shares Previously Reserved For Issuance Under AIG’s Equity Units, The Warrants And AIG’s Employee Benefit Plans.” (JX 221 at 70).	439
36.7	After The Reverse Stock Split, Defendant Exchanged Its Series C, E, And F Preferred Shares, With The Purpose Of Avoiding A Class Shareholder Vote While Accomplishing “The Same Result As Converting Would Have Accomplished”. (Langerman: Trial Tr. 7216:17 – 7217:11).	441
37.0	THE PAYMENT MADE BY DEFENDANT FOR THE 79.9% OF EQUITY AND VOTING INTERESTS TAKEN FROM PLAINTIFFS ON SEPTEMBER 22, 2008 WAS AT LEAST \$35 BILLION LESS THAN THE FAIR MARKET VALUE.	442
37.1	The Fair Market Value Of The 79.9% Equity And Voting Control Defendant Acquired On September 22, 2008 Was Approximately \$35.4 Billion.	442

37.1.1	The fair value of a firm's equity is the price that reflects the underlying fundamental intrinsic value of the firm.	442
37.1.2	The appropriate method to measure damages is a market-based valuation approach.	442
37.1.3	Defendant, AIG, KPMG, and Deloitte used the same market-based approach to calculate the value of Defendant's 79.9% equity and voting interest in AIG as Plaintiffs' damages expert Dr. Kothari. (PTX 5203; PTX 5204).	443
37.2	Defendant, AIG, And Their Respective Consultants Calculated Defendant's 79.9% Aig Equity To Be Worth At Least \$23 Billion Using The Market-Based Valuation Methodology.	444
37.3	AIG's Market Capitalization Between September 22 And September 24, 2008 Reflects The Fair Value Of The 79.9% Equity Interest Taken Or Exacted From Plaintiffs By Defendant.	448
37.3.1	September 22, 2008 is an appropriate valuation date for the property taken from the Credit Agreement Class because the Credit Agreement's final terms were neither determined nor became effective until September 22, 2008.	448
37.3.2	September 23, 2008 is an appropriate valuation date for the property taken from the Credit Agreement Class because the Credit Agreement was executed and announced on September 23, 2008. (Kothari: Trial Tr. 4568:21-23; PTX 5207).	449
37.3.3	September 24, 2008 is the best valuation date for the property taken from the Credit Agreement Class because that is the date the market learned all the material terms of the Credit Agreement.	449
37.3.4	The market recognized that the newly announced terms were material.	450
37.3.5	The terms of the Credit Agreement were worse than expected and the market reacted on September 24 when AIG's stock price fell by 33%.	451
37.4	Using A Market-Based Valuation Approach, The Value Of The 79.9% Equity And Voting Interest In AIG Taken From Plaintiffs As Of September 22, 2008 Is Between Approximately \$35.4 Billion And \$53.4 Billion. (PTX 5211).	452

37.4.1	Dr. Kothari made several conservative assumptions in his damages calculation, including not adjusting for a control premium or liquidity discount.....	455
37.4.2	The market value of AIG as of September 22-24, 2008 represents a restoration of AIG's intrinsic value from immediately before the onset of AIG's liquidity crisis.....	456
37.4.3	Plaintiffs were deprived of the benefit of the restoration of AIG's intrinsic value by Defendant's acquisition of a 79.9% equity and voting interest.....	458
37.5	September 16 And 17, 2008 Are Not Appropriate Valuation Dates For The Fair Value Of Plaintiffs' Property Because The Date Of The Taking Was September 22.	459
37.5.1	The taking occurred on September 22, not September 16, because Defendant had no obligation to issue equity until the September 22 Credit Agreement was agreed upon. (<i>Supra</i> §§ 14.0-14.4, 37.3.1).....	460
37.5.2	On September 16 and 17, 2008, the market did not understand all the material terms of the Credit Agreement.....	460
37.5.3	Prior to the evening of September 23, 2008, market information indicated that the form of the equity would be warrants.....	461
37.5.4	The market price of AIG common stock on September 16, 2008 understated the intrinsic value of AIG.....	466
37.5.5	AIG and other market participants recognized that AIG's stock price in early and mid-September 2008 did not reflect AIG's intrinsic value.....	468
37.5.6	The market price of AIG stock on September 16, 2008 understated the fair value of AIG due to the market-wide panic that had an overwhelmingly negative impact on stock prices.	469
37.5.7	Defendant's experts did not consider or control for the fact that AIG's market price as of September 16, 2008 did not reflect its intrinsic value.....	470
37.6	Defendant Initially Paid Only \$500,000 In Loan Forgiveness For 79.9% Of AIG's Shareholders' Equity.	470
37.6.1	AIG acknowledged that paying \$500,000 for 79.9% of AIG was the same as essentially paying nothing.....	471

37.6.2	The Trust ultimately reimbursed FRBNY for the payment of the \$500,000 credit given to AIG after the Trust was created. (JX 107 at 37-38; PTX 1635 at 1; JX 388 at 2).....	471
37.7	Although AIG Received Access To The Credit Facility As Part Of The Credit Agreement, AIG’s Promise To Pay The Principal, Interest And Fees Associated With The Credit Facility More Than Compensated Defendant For The Risks Associated With Defendant’s Loan, Even Without Counting The Value Of The 79.9% Equity And Voting Interests Acquired By Defendant. (Kothari: Trial Tr. 4876:19 – 4878:24).....	471
37.8	Defendant Ultimately Sold Its 79.9% Equity Interest for the Depressed Price of \$18.3 Billion. (Kothari: Trial Tr. 4535:18-21; PTX 685 at 89-90; Mordecai: Trial Tr. 7762:22 – 7763:12 (discussing DX 1875 (Mordecai Report, Exhibit 13))).....	472
37.8.1	Defendant reduced the value of the common stock it received in exchange for the Series C Preferred Stock by its decision to liquidate when and how it did.	472
37.8.2	“Between fiscal years 2011 and 2013, the Department sold all of its 1.7 billion AIG common shares held by the General Fund and TARP together, on a pro-rata basis, in the open market.” (PTX 685 at 89).	472
37.8.3	From May 24, 2011 through December 14, 2012, Defendant sold 1,655,037,962 shares of AIG common stock at prices ranging from \$29 to \$32.50 per share for a total of \$51,610,497,475. (PTX 2852 at 65 n.197).	473
37.8.4	Assuming that the common shares received in exchange for Series C Preferred are treated as being sold pro rata with common shares received in exchange for Series E and F Preferred, the amount received for the common shares received in exchange for the Series C Preferred would be \$17.6 billion. (PTX 2852 at 65, n.197).	473
37.9	The Prices At Which Defendant Sold Its AIG Common Shares Were Reduced By The Damage Done To AIG’s Business, Operations, And Assets As The Result Of Defendant’s Control Over AIG.	473
37.9.1	Defendant reduced the value of AIG common shares by giving up value to counterparties through the ML II and ML III transactions. (<i>See supra</i> §§ 30.1.5, 30.1.6, 34.6).	473
37.9.2	Defendant reduced the value of AIG common shares by not negotiating discounts from ML III counterparties and by giving such counterparties 100% par value plus releases of claims that	

	had substantial value to AIG. (<i>See</i> Baxter: Trial Tr. 1069:19 – 1071:16; Alvarez: Trial Tr. 342:12-23).	473
37.9.3	Defendant diluted the value of the common stock it received in exchange for its Series C Preferred Stock by using its control of AIG to exchange its Series E and Series F Preferred Stock for common stock at inflated values. (<i>See supra</i> § 30.2.5).	473
38.0	THE RIGHT TO EXCHANGE DEFENDANT’S SERIES C, E & F CONVERTIBLE VOTING PREFERRED STOCK FOR COMMON STOCK HAD ECONOMIC VALUE.	474
38.1	The Right to Approve the Conversion or Exchange of Defendant’s Preferred Shares into Common Stock, Embodied in Particular by the Right to Vote on Whether to Increase the Number of Authorized Shares, Was a Right Which AIG Shareholders Viewed as Important.	474
38.2	The Stock Split Class’s Right to Prevent Defendant from Increasing the Number of Authorized Common Shares Necessary to Exchange the Series C, E & F Preferred Stock for AIG Common Stock Had Economic Value.	475
38.2.1	As a result of the Reverse Stock Split, Defendant was later able to exchange its Series C Preferred Stock for 562,868,096 shares of AIG common stock, which were transferred immediately by the Trust to the Treasury Department as part of the January 14, 2011 Recapitalization of AIG . (JX 314 at 3).	475
38.2.2	As a result of the Reverse Stock Split, Defendant was later able to exchange its Series E Shares for 924,546,133 shares of AIG common stock and some of its Series F Shares for 167,623,733 shares of AIG common stock as part of the Recapitalization of AIG on January 14, 2011. (JX 314 at 3).	476
38.3	Defendant Exchanged the Series C Preferred Shares for Common Stock Before Exchanging the Series E And F to Maximize the Total Amount of Common Stock Obtained by Defendant.	477
38.3.1	The conversion ratio for the Series C Preferred Stock was capped at 79.9%.	477
38.3.2	In its prior restructurings, Defendant honored the agreed-upon conversion ratio by reducing the percentage ownership represented by the Series C Preferred Stock to accommodate the issuance of warrants associated with the purchase of the Series D and Series F Preferred Stock.	478
38.3.3	In the Recapitalization, Defendant ignored the contractual cap on conversion of the Series C.	478

38.3.4	Defendant was only able to circumvent the contractual cap on its ownership through its control of AIG. (<i>See also supra</i> § 33.0).	480
39.0	THE FAIR VALUE OF THE RIGHT TO EXCHANGE DEFENDANT’S SERIES C VOTING PREFERRED STOCK FOR COMMON STOCK PER THE REVERSE STOCK SPLIT WAS A MINIMUM OF APPROXIMATELY \$339 MILLION.	483
39.1	The Value Of The Series C Reverse Stock Split Claim Is “Based On The Payment That The Government Would Have Made To AIG Shareholders To Increase The Number Of Authorized Shares, Which Is In Turn Based On The Value Of The Benefit That The Government Would Receive From Converting Its Illiquid Series C Preferred Stock Into More Liquid AIG Common Stock.” (PTX 2852 at 89, ¶ 124).	483
39.1.1	Instead, by using the reverse stock split to circumvent common shareholders’ right to vote, Defendant was able to exchange “less liquid preferred shares into more liquid, more valuable common shares” without paying for that benefit. (Kothari: Trial Tr. 4601:21 – 4602:24).	483
39.1.2	The value of the payment Defendant would have had to make to AIG’s common shareholders to induce them to vote to increase the number of authorized shares to enable the conversion or exchange of the Series C Preferred Stock is at least \$339 million.	484
40.0	THE FAIR VALUE OF THE RIGHT TO EXCHANGE DEFENDANT’S NON-CONVERTIBLE, NON-VOTING SERIES E AND SERIES F PREFERRED STOCK FOR AIG COMMON STOCK PER THE REVERSE STOCK SPLIT WAS A MINIMUM OF APPROXIMATELY \$4.33 BILLION.	485
40.1	The Value of the Series E and Series F Stock Split Claims Is a Minimum of \$4.33 Billion.	485
40.1.1	The fair value of the Series E and F Preferred Stock was significantly below their liquidation preferences.	488
40.2	AIG Received Fairness Opinions for the Exchange of the Series E and F Preferred Shares, but Those Opinions Tautologically Assumed That the Fair Value Was Equal to the Liquidation Value. (JX 284 at 3; JX 307 at 217).	489
40.2.1	The fact that the Series E and F were exchanged for their liquidation value rather than market value is evidence of Defendant’s control over AIG.	490

41.0	PREJUDGMENT INTEREST SHOULD BE AWARDED AT A COMPOUNDED AND ANNUALIZED RATE OF 7% FOR THE CREDIT AGREEMENT CLASS AND 20.1% FOR THE REVERSE STOCK SPLIT CLASS. (WAZZAN: TRIAL TR. 4442:18 – 4443:1; PTX 2841; PTX 2854 AT 16 (WAZZAN REPORT ¶ 28)).	491
41.1	Prejudgment Interest in a Takings Case Is an Element of Just Compensation, Required in Order to Put AIG Common Shareholders in the Same “Financial or Pecuniary Position That He or She Would Have Occupied Had a Payment Coincided with the Taking.” (Wazzan: Trial Tr. 4421:1-7; <i>see also</i> Neuberger: Trial Tr. 5603:21-25).	491
41.2	The “Appropriate Prejudgment Interest Rate in This Matter Is Best Determined By the Return on a Synthetic Portfolio Comprised of” Dow Jones “Industry Indices Representative of AIG’s Operations.” (PTX 2854 at 20, ¶ 37; <i>see also id.</i> at 14-16, ¶¶ 26-28).	491
41.2.1	Had Plaintiffs been compensated at the time of the takings, they would have sought to reinvest the sums received in investments similar to AIG common stock.	491
41.2.2	To determine what the Plaintiffs would have done had they received cash compensation at the time of the takings, Wazzan created “four portfolios,” which are “four ways” Wazzan thinks “are appropriate for someone to replicate an AIG asset”. (Wazzan: Trial Tr. 4424:24 – 4425:5).	492
41.2.3	The Dow Jones indices portfolio most closely tracked AIG’s operations.	494
41.2.4	For the Dow Jones indices average, Wazzan calculated an annualized return of 7 percent for the 2008 taking and 20.1 percent for the 2009 taking. (Wazzan: Trial Tr. 4442:18 – 4443:1; PTX 2841).	494
41.3	The Methodology for Calculating Prejudgment Interest Should Be Independent of the Date the Takings Occurred.	495
41.4	Plaintiffs’ and Defendant’s Experts Agree That the Interest Should Be Compounded.	495
41.5	The Synthetic Portfolio Method Is More Appropriate Than Other Methodologies Considered for Calculating an Appropriate Prejudgment Interest Rate.	495
42.0	RELEVANT ENTITIES AND PERSONNEL	498
42.1	Plaintiff and the Plaintiff Classes.	498

42.2	American International Group (“AIG”).....	499
42.2.1	AIG consultants and advisors	501
42.3	Defendant the United States of America (the “Government”) and its agents.....	503
42.3.1	The Department of the Treasury	503
42.3.2	The Federal Reserve System.....	505
42.3.3	The Federal Reserve Board of Governors	505
42.3.4	Federal Reserve Bank of New York (“FRBNY”).....	507
42.3.5	The AIG Credit Facility Trust.....	511
42.3.6	Defendant’s agents and advisors.....	511
42.4	Expert witnesses testifying on behalf of the Plaintiffs.....	513
42.5	Expert witnesses testifying on behalf of the United States	514
42.6	Other relevant actors	514

PLAINTIFFS' PROPOSED FINDINGS OF FACT

1.0

IN SEPTEMBER 2008, THE UNITED STATES FACED THE MOST SEVERE FINANCIAL CRISIS SINCE (AND PERHAPS INCLUDING) THE GREAT DEPRESSION. CREDIT MARKETS FROZE AND EVEN SOLVENT COMPANIES WERE UNABLE TO BORROW FROM PRIVATE SOURCES TO MEET THEIR LIQUIDITY NEEDS.

1.1 “September and October of 2008 Was the Worst Financial Crisis in Global History, Including the Great Depression.” (Bernanke: PTX 548 at 24; *see also* Bernanke: Trial Tr. 1959:8).

(a) “In the fall of 2008, the United States economy was suffering its most severe financial crisis since the Great Depression.” (Agreed to Stipulations (Dkt. 258) ¶ 70).

(b) Executive Office of the President: “The American economy had not faced such a severe economic downturn since the Great Depression.” (PTX 680 at 10).

(c) Bernanke: In September 2008, “the country at that time was in the most severe financial crisis since the Great Depression.” (Bernanke: Trial Tr. 1958:21-25).

(d) Geithner: September and October 2008 was the “worst financial crisis since the Great Depression”. (PTX 709 at 10).

(e) Bernanke: “The financial crisis that began in August 2007 has been the most severe of the post-World War II era and, very possibly—once one takes into account the global scope of the crisis, its broad effects on a range of markets and institutions, and the number of systemically critical financial institutions that failed or came close to failure—the worst in modern history.” (PTX 2179 at 2).

(f) Bernanke: “Over the past 2 years, our Nation, indeed the world, has endured the most severe financial crisis since the Great Depression, a crisis which in turn triggered a sharp contraction in global economic activity.” (PTX 553 at 11).

(g) Geithner: By September 12, “the broader financial system in the U.S. and around the world was under – was undergoing a run, a classic run and a classic panic.” (Geithner: Trial Tr. 1747:24 – 1748:6).

(h) Bernanke: “The crisis of 2008-2009 was a classic financial panic but in a different institutional setting: not in a bank setting but in a broader financial market setting.” (PTX 708 at 78).

(i) Geithner: “So, September 2008, as you all know, the world was really at the edge of the abyss. It was the worst financial shock in more than a century—significantly worse than the shock that caused the Great Depression. Just as an example, the initial loss of household wealth in the United States in the fall of ’08 was five times the initial shot to household wealth in the Great Depression.” (PTX 671 at 2; *accord* Geithner: Trial Tr. 1694:22 – 1695:1 (Geithner continues to believe this statement to be true); PTX 709 at 10, 14, 23).

(j) Geithner: “There hadn’t been a crisis this severe in seventy-five years, and never in a financial system this complex.” (PTX 709 at 14).

(k) Cragg: “there’s just simply no doubt that the financial crisis was the worst ever.” (Cragg: Trial Tr. 4938:16-17).

2.0

THE FINANCIAL CRISIS OF 2008 THREATENED THE VIABILITY OF VIRTUALLY EVERY MAJOR FINANCIAL FIRM.

2.1 In Financial Crises Even Solvent Companies Become Illiquid and Fail.

(a) Geithner: In “a panic, even the solvent institutions become illiquid, and if they are caught up in the run, even the strongest will not survive”. (PTX 663 at 11; *accord* Geithner: Trial Tr. 1445:9-15).

(b) Geithner: “Among the defining features of a panic is the fact that markets become less discriminating—more likely to run from everyone rather than try to figure out whose fundamentals seem strong. At a time when creditors were pulling back loans, counterparties were demanding more margin, and investors were fleeing for safety, not even the relatively strong institutions were safe.” (PTX 709 at 168).

(c) Geithner: “a company may fail because it needs additional capital that it can’t get, even if the company is still solvent”, because “it would become illiquid.” (Geithner: Trial Tr. 1556:8-17).

(d) Cragg: In a liquidity crisis firms are forced to sell off assets in a fire sale, which brings asset “prices down below their long-run value, which then harms everybody else’s ability to borrow against assets. And then, as that cycle begins to become self-reinforcing, fear sets in and people with liquidity are no longer willing to extend that liquidity and instead hoard that liquidity, and that creates a big contraction simply because of emotional concerns as opposed to . . . rational economic ones.” (Cragg: Trial Tr. 5422:21 – 5425:10; *see also* PTX 537).

2.2 In September 2008 Financial Markets Throughout the World Shut Down.

(a) Defendant’s expert, Dr. Anthony Saunders: “During the economic crisis of 2007 to 2009, financial markets throughout the world shut down”. (Saunders: Trial Tr. 8310:9-17).

(b) Geithner: In September 2008, “private markets had frozen”. (Geithner: Trial Tr. 1438:11-13).

(c) Geithner: In September 2008, the economy was essentially “in free fall.” (PTX 563 at 15).

(d) Herzog: In September 2008, the capital markets “were not functioning”. (Herzog: Trial Tr. 6955:5 – 6956:3).

2.3 In September 2008, Financial Markets Deteriorated and Money Market Funds “Began to Face Runs”. (PTX 708 at 90; Bernanke: Trial Tr. 1966:1-5).

(a) Cragg: Starting on September 15, 2008, there was “kind of a great sucking sound as the money, you know, got sucked out of the money market mutual funds and commercial paper markets, and you know, over the course of a few days, several hundred billion dollars, you know, just vaporized.” (Cragg: Trial Tr. 5060:12 – 5061:3).

(b) Geithner: “The Reserve Fund debacle discouraged risk taking by other money funds, which meant even less buying of commercial paper and less lending through repo, which meant an even more intense liquidity crisis for banks and other institutions. Basically, short-term financing—whether secured by collateral or not—was vanishing.” (PTX 709 at 211).

2.4 As Money Market Funds Began To Face Runs “They in Turn Began to Dump Commercial Paper as Quickly as They Could. As a Result, The Commercial Paper Market Went into Shock.” (PTX 708 at 90; accord Bernanke Trial Tr. 1966:1-5; Willumstad: Trial Tr. 6511:10-12).

2.5 Financial Institutions Stopped Lending to Each Other, Even on a Secured Basis.

(a) Geithner: “short-term financing—whether secured by collateral or not—was vanishing. No collateral, no matter how safe historically, was viewed as truly liquid, because there was simply no liquidity in the system to buy it. This would have been the textbook definition of a panic, except no textbook had recorded anything like it.” (PTX 709 at 211-12; *see also* Agreed to Stipulations ¶ 52).

2.6 During September 2008, “Even Companies That Were Solvent Were Not Able to Borrow the Liquidity That They Needed”. (Paulson: Trial Tr. 1204:3-5).

(a) Cragg: “it’s I think an undisputed fact among scholars and financial practitioners that in that period of time the liquidity crisis affected everybody. You know, it affected solvent firms tremendously.” (Cragg: Trial Tr. 5030:18 – 5031:8; PTX 5334 (Cragg demonstrative)).

2.7 In September 2008, the Financial Crisis and the Freezing of Credit Markets Threatened the Viability of Virtually Every Major Financial Institution.

(a) Offit: All “financial institutions were being put under pressure”. (Offit: Trial Tr. 7920:20-22). The “whole financial climate was under severe strain”. (Offit: Trial Tr. 7920:23-25). The “marketplace generally was frenzied”. (Offit: Trial Tr. 7921:1-3). The “banks themselves were under tremendous stress”. (Offit: Trial Tr. 7921:4-6).

(b) Bernanke: “during September and October of 2008, 12 of the 13 most important financial institutions in the United States had either failed or were at risk of failure.” (Bernanke: Trial Tr. 1960:7-20).

(c) Saunders: “In September of 2008, as a result of the deteriorating conditions in the financial markets, the financial condition of virtually every financial institution was fragile” and “there was uncertainty about the solvency and long-term viability of a wide range of financial institutions”. (Saunders: Trial Tr. 8402:25 – 8403:8).

(d) Geithner: “Of the twenty-five largest financial institutions at the start of 2008, thirteen either failed (Lehman, WaMu), received government help to avoid failure (Fannie, Freddie, AIG, Citi, BofA), merged to avoid failure (Countrywide, Bear, Merrill, Wachovia), or transformed their business structure to avoid failure (Morgan Stanley, Goldman).” (PTX 709 at 271-72).

3.0

THERE WERE MANY CAUSES OF THE FINANCIAL CRISIS, WHICH HAD ITS ORIGIN IN AN OVER EXTENSION OF CREDIT BOTH BY TRADITIONAL BANKS AND BY THE ALTERNATIVE BANKING SYSTEM, PARTICULARLY IN THE HOUSING MARKET.

(a) Bernanke: “The principal cause of the financial crisis and economic slowdown was the collapse of the global credit boom and the ensuing problems at financial institutions.” (PTX 553 at 129).

(b) In March 2008, the President’s Working Group on Financial Markets (which included Secretary Paulson) reported to President Bush that “Soaring delinquencies on U.S. subprime mortgages were the primary trigger of recent events. However, that initial shock both uncovered and exacerbated other weaknesses in the global financial system.” (PTX 11 at 3).

3.1 An Important Cause of the Financial Crisis Was That in the Years Prior to 2007 the Government Kept Interest Rates Artificially Low, Expressly in Part to Encourage Home Ownership, Which Resulted in the Over Extension of Credit and the Creation of a “Housing Bubble”.

(a) Paulson: Prior to the financial crisis, “interest rates had been held at artificially low levels, which resulted in the overstimulation of the housing market.” (Paulson: Trial Tr. 1198:23 – 1199:12).

(b) Saunders: The “roots” of the financial crisis are traceable to when “interest rates were lowered after 9-11 and then there was a buildup of subprime mortgages.” (Saunders: Trial Tr. 8379:14 – 8380:6).

(c) FCIC Report: “At a congressional hearing in November 2002, Greenspan acknowledged—at least implicitly—that after the dot-com bubble burst, the Fed cut interest rates in part to promote housing.” (PTX 624 at 116). “In the view of some, the Fed simply kept rates too low too long. John Taylor, a Stanford economist and former under secretary of treasury for

international affairs, blamed the crisis primarily on this action. If the Fed had followed its usual pattern, he told the FCIC, short-term interest rates would have been much higher, discouraging excessive investment in mortgages.” (PTX 624 at 131).

3.2 Another Important Cause of the Housing Bubble, and the “Housing Correction” That Followed Was “That for Many Years There Had Been Bad Lending Practices by Banks and Financial Institutions” and “Borrowers Had Been Taking out Mortgages That They Couldn’t Afford”. (Paulson: Trial Tr. 1198:23 – 1199:8).

(a) Paulson: “The over-stimulation of the housing market caused by government policy was exacerbated by other problems of that market. Subprime mortgages went from accounting for five percent of total mortgages in 1994 to twenty percent by 2006.” (PTX 583 at 8).

(b) Bernanke: “Broadly speaking, the crisis was triggered by the bursting of the housing bubble and the related rise in defaults and delinquencies among lower-quality mortgages.” (Bernanke: Trial Tr. 2179:3-5; *see also* PTX 599 at 5 (“Although a number of developments helped to trigger the crisis, the most prominent was the prospect of significant losses on subprime mortgage loans that became apparent shortly after house prices began to decline.”)).

3.3 Another Important Cause of the Financial Crisis Was the “Originate-to-Distribute” Business Model Adopted by Commercial Banks, Investment Banks, and Broker Dealers.

(a) As housing prices soared in the early to mid-2000s, mortgage originators, including commercial banks, and investment banks, began to rely more heavily on the so-called “originate-to-distribute” business model, whereby originators would transfer mortgages to other entities instead of holding them until maturity. (PTX 624 at 117-19, 130-154).

3.3.1 Traditionally, lenders to homeowners (primarily banks and savings and loans) had an incentive to be sure the loans would be paid because they held the resulting mortgage.

3.3.2 Beginning in 2002 and accelerating in 2006 and 2007 mortgage originators would sell or transfer mortgages to a pool held by a special purpose vehicle (“SPV”). The SPV would in turn create a series or “tranches” of securities (collateralized debt obligations or

“CDOs”) representing tiered rights to be paid from the revenue of the pool, which the SPV then marketed to investors and, in some cases, in part continued to hold.

(a) Between 2004 and 2007, “nearly all” of the adjustable rate subprime mortgages written were packaged into residential mortgage-backed securities (“RMBS”), and “a large share of the subprime RMBS were purchased by managers of CDOs of asset-backed securities (ABS), so-called ABS CDOs.” (PTX 11 at 10; *see also* Agreed to Stipulations ¶ 37).

3.3.3 The most senior CDO security or tranche had the right to be paid its principal and interest in full before any other CDO tranche received anything; the second most senior CDO tranche was then paid all of its principal and interest, and so on down the line. (Cragg: Trial Tr. 4956:1-22, 4958:15 – 4959:4).

3.3.4 The originate-to-distribute business model substantially increased the investors in, and the money available to originate, housing loans.

(a) Paulson: “But this ‘originate to hold’ approach began to change with the advent of securitization, a financing technique developed in 1970 by the U.S. Government National Mortgage Association that allowed lenders to combine individual mortgages into packages of loans and sell interests in the resulting securities. A new ‘originate to distribute’ model allowed banks and specialized lenders to sell mortgage securities to a variety of different buyers, from other banks to institutional investors like pension funds. Securitization took off in the 1980s, spreading to other assets, such as credit card receivables and auto loans. By the end of 2006, \$6.6 trillion in residential and commercial mortgage-backed securities (MBS) were outstanding, up from \$4.2 trillion at the end of 2002.” (PTX 706 at 84).

3.3.5 The originate-to-distribute business model also eliminated the incentive of mortgage originators to be careful that their borrowers could repay the amounts loaned because the mortgage, and risk of non-payment, had been transferred to others.

(a) Bernanke: “Serious problems with the structure of incentives also emerged in the application of the so-called originate-to-distribute model to subprime mortgages. To satisfy the strong demand for securitized products, both mortgage lenders and those who packaged the loans for sale to investors were compensated primarily on the quantity of ‘product’ they moved through the system. As a result, they paid less attention to credit quality and many loans were made without sufficient documentation or care in underwriting.” (PTX 607 at 11).

(b) Cragg: Unlike the traditional banking system, in which a bank has a “very intimate relationship with the risk of its clients” and derives revenue from “spread income,” i.e., the difference between the interest received on a loan and the interest paid on bank deposits, in the parallel banking system “that link is broken” by the originate-to-distribute model. “In the parallel banking system, what was most important was the ability to do deals, because it was fees that generated profits.” (Cragg: Trial Tr. 4946:14 – 4947:16).

3.4 Another Important Cause of the Financial Crisis Was That “Many of the Subprime Mortgages That Originated in the 2001 to 2005 Period Had Floating Rates”. (Saunders: Trial Tr. 8380:14-19). When the Federal Reserve Started to Raise Interest Rates in 2006 “the Cost of Meeting Mortgage Commitments Rose to Unsustainable Levels for Many Low Income Households”. (Saunders: Trial Tr. 8380:7-19).

(a) The “confluence of falling house prices, rising interest rates and rising mortgage costs lead to a wave of mortgage defaults in the subprime market and foreclosures and only reinforced the downward trend in housing prices”. (Saunders: Trial Tr. 8380:20-25).

3.5 Another Important Cause of the Financial Crisis Was That Rating Agencies, upon Which Investors Relied to Evaluate the Riskiness of CDOs, Greatly Understated the Risks of Such Securities.

(a) FCIC Report: “The Commission concludes that the credit rating agencies abysmally failed in their central mission to provide quality ratings on securities for the benefit of investors”. (PTX 624 at 240).

(b) Paulson: The rating agencies “didn’t perform well”. (Paulson: Trial Tr. 1199:18-20; *accord* PTX 11 at 3).

3.5.1 In significant respects the rating agencies misled investors by fraudulently overstating the safety of CDOs and related securities.

(a) FCIC Report: “The business model under which banks issuing securities paid for their rating seriously undermined the quality and integrity of those ratings; the rating agencies placed market share and profit consideration above the quality and integrity of their ratings.” (PTX 624 at 240).

(b) Defendant filed suit against Standard & Poor’s (“S&P”), alleging that, “beginning at the latest in or about September 2004 and continuing through at least in or about October 2007, . . . S&P, knowingly and with the intent to defraud, devised, participated in, and executed a scheme to defraud investors in RMBS and CDO tranches, including federally insured financial institutions, as to material matters, and to obtain money from these investors by means of material false and fraudulent pretenses, representations, and promises, and the concealment of material facts.” (PTX 661 at 3 (Complaint, *United States v. McGraw-Hill Cos., Inc. & Standard & Poor’s Financial Services LLC*, No. cv 13-00779, ¶ 7 (C.D. Cal. Feb. 4, 2013) (“S&P Complaint”))).

(c) Defendant asserted that, in “carrying out the scheme to defraud, S&P falsely represented that its credit ratings of RMBS and CDO tranches were objective, independent, uninfluenced by any conflicts of interest that might compromise S&P’s analytic judgment, and

reflected S&P's true current opinion regarding the credit risks the rated RMBS and CDO tranches posed to investors." (PTX 661 at 3 (*S&P Complaint* ¶ 8)).

(d) Defendant has stated that, "S&P's desire for increased revenue and market share in the RMBS and CDO ratings markets led S&P to downplay and disregard the true extent of the credit risks posed by RMBS and CDO tranches in order to favor the interests of large investment banks and others involved in the issuance of RMBS and CDOs who selected S&P to provide credit ratings for those tranches." (PTX 661 at 3-4 (*S&P Complaint* ¶ 9)).

3.6 Another Important Cause of the Financial Crisis Was the Collapse of the Alternative Banking System.

3.6.1 In the years prior to 2007 an alternative or "shadow" banking system had developed which provided trillions of dollars of short-term liquidity to financial firms.

(a) Cragg: The parallel or alternative banking system was "not regulated in the same way that thrifts and commercial banks were that are part of the traditional banking system. And most importantly, that alternative banking system was growing faster and eventually grew to overtake the size of the traditional banking sector." (Cragg: Trial Tr. 4941:19 – 4942:10).

3.6.2 The alternative banking system consisted primarily of investment banks and broker dealers that extended credit in competition with traditional banks.

(a) Cragg: "the traditional banking sector, it's composed of commercial banks and thrifts. In the other part of the banking system, it's composed of a variety of different institutions that are originating loans, that are packaging those loans into securities, that are then creating institutions that will buy those securities, that – you know, institutions that will distribute those securities to investors. At the heart of the alternative banking system are the investment banks, the broker-dealers, because they're really the ones that are making the markets that are – you know, that allow for the transformation of loans into securities that can be, you know, acquired

and utilized in the business of others.” (Cragg: Trial Tr. 4943:1-17; PTX 5302 (Cragg demonstrative)).

(b) Cragg: The broker dealers and investment banks at “the heart of the alternative banking system” are “putting together the special-purpose vehicles. They’re creating the securities that come out of those special-purpose vehicles. They’re selling those to – at least the – on the far right, you would have sales of the higher quality RMBS being sold to pension insurance companies.” (Cragg: Trial Tr. 4949:5-12; *see also* PTX 2856 at 15-18; PTX 5305 (Cragg demonstrative)).

3.6.3 An important element of the alternative banking system was the so-called “repo” financing which in March 2008 provided \$4.5 trillion in financing, primarily to investment banks and broker dealers.

(a) Bernanke: In the repo market, companies obtain “funding through repurchase agreements where the investment banks would put out assets overnight and use that as collateral”. Repo financing was thought to be a “pretty much foolproof form of short-term funding.” (PTX 548 at 13).

(b) For broker-dealers, “the repo market is extremely important”, as “half of their funding, half of their balance sheet was supported by repo and – and they’re highly leveraged”. (Cragg: Trial Tr. 5005:19 – 5006:5).

3.6.4 Repo financing was particularly vulnerable to a crisis of panic, loss of confidence, or uncertainty because it was overnight financing which had to be renewed every day.

(a) Paulson: “Most of this money was lent overnight. That meant giant balance sheets filled with all kinds of complex, often illiquid assets were poised on the back of funding that

could be pulled at a moment's notice. This hadn't seemed like a problem to most bankers during the good times that we'd enjoyed until the previous year. Repos were considered safe.

Technically purchase and sale transactions, they acted just like secured loans. That is to say, repos were considered safe until the times turned tough and market participants lost faith in the collateral or in the creditworthiness of their counterparties—or both. Secured or not, no one wanted to deal with a firm they feared might disappear the next day. But deciding not to deal with a firm could turn that fear into a self-fulfilling prophecy.” (PTX 706 at 115-16).

(b) Bernanke: “Once the crisis began, repo lenders became increasingly concerned about the possibility that they would be forced to receive collateral instead of cash, collateral that would then have to be disposed of in falling and illiquid markets. In some contexts, lenders responded by imposing increasingly higher haircuts, cutting the effective amount of funding available to borrowers. In other contexts, lenders simply pulled away, as in a deposit run; in these cases, some borrowers lost access to repo entirely, and some securities became unfundable in the repo market. In either case, absent sufficient funding, borrowers were frequently left with no option but to sell assets into illiquid markets. These forced sales drove down asset prices, increased volatility, and weakened the financial positions of all holders of similar assets. Volatile asset prices and weaker borrower balance sheets in turn heightened the risks borne by repo lenders, further boosting the incentives to demand higher haircuts or withdraw funding entirely. This unstable dynamic was operating in full force around the time of the near failure of Bear Stearns in March 2008”. (PTX 650 at 12-13).

3.6.5 The crash of the shadow banking system beginning in 2007 was an important cause of the liquidity crisis.

(a) Cragg: “when the housing market reached its peak in the third quarter of 2006, the shadow banking system crashed, falling from, you know, a magnitude of \$13 trillion down to \$8 ½ trillion within a three-year period. And that shock resonates throughout the system, . . . ultimately that shock to the shadow banking system . . . caused the liquidity crisis”. (Cragg: Trial Tr. 4942:17-25).

(b) The overall size of the repo market collapsed in March 2008, falling 20% from \$4.5 trillion in March 2008 to approximately \$3.5 trillion by September 2008 and down to \$2.5 trillion by December 2008. (Cragg: Trial Tr. 5006:6-15; PTX 5323 (Cragg demonstrative)).

4.0

IN MARCH 2008, THE FEDERAL RESERVE SYSTEM RECOGNIZED THAT BECAUSE OF A LACK OF LIQUIDITY, “UNUSUAL AND EXIGENT CIRCUMSTANCES” EXISTED THAT JUSTIFIED IT FUNCTIONING AS A LENDER OF LAST RESORT TO COMPANIES OUTSIDE THE BANKING SYSTEM.

4.1 The Crisis in Financial Markets “Arrived in Force on August 9, 2007”. (Paulson: PTX 706 at 78).

(a) “Foreclosures rose in 2007, as many borrowers could not pay their mortgages.” (Agreed to Stipulations ¶ 44).

4.2 Financial Markets Deteriorated Further from August 2007 to March 2008.

(a) Geithner: “By December 2007, market conditions were deteriorating again. Credit spreads were widening, and liquidity was draining away . . . the National Bureau of Economic Research would later peg the start of the Great Recession to that month.” (PTX 709 at 156).

(b) “Disruptions in the domestic housing and credit markets impacted AIG’s fourth quarter 2007 financial results.” (Agreed to Stipulations ¶ 46).

(c) “The U.S. residential mortgage market continued to worsen in the first quarter of 2008, expanding into the broader U.S. credit markets and resulting in greater volatility, less liquidity, widening of credit spreads, and a lack of price transparency.” (Agreed to Stipulations ¶ 50).

(d) Alvarez: “financial conditions had deteriorated markedly between mid-January 2008 and mid-March 2008” and there “had been an escalation in haircuts for a variety of types of collateral”. (Alvarez: Trial Tr. 130:3-10; *see also* JX 13 at 7).

4.3 In March 2008, the Federal Reserve Concluded That There Were “Unusual and Exigent Circumstances” Caused by “Frozen Markets” and a “Lack of Liquidity” in the Marketplace.

(a) In March 2008, the Federal Reserve concluded there were “frozen markets” and a “lack of liquidity” in the marketplace. (Alvarez: Trial Tr. 81:2-9).

(b) Baxter: “The Board of Governors of the Federal Reserve System, which is the governing body in the Federal Reserve, first determined that there were exigent and unusual circumstances in March of 2008” and the Federal Reserve “never concluded that there had been an end to unusual and exigent circumstances from March 11th, 2008, through the end of that year”. (Baxter: Trial Tr. 656:2-8, 659:8-12).

4.4 In March 2008, the Federal Reserve Concluded That Because of Its Role As the Lender of Last Resort and the Existence of “Unusual and Exigent Circumstances” It Would Lend Outside the Banking System.

(a) Geithner: “we considered finding ways to lend outside the banking system” under Section 13(3) of the Federal Reserve Act “beginning probably towards the end of 2007” and decided to do it in March of 2008. (Geithner: Trial Tr. 1390:8-15, 1391:23 – 1392:2).

4.4.1 On March 14, 2008, the Federal Reserve authorized a 13(3) credit facility to help keep Bear Stearns out of bankruptcy. (PTX 1201 at 2-3; *accord* Alvarez: Trial Tr. 127:5-16, 617:16-19).

(a) Geithner: The Federal Reserve's March 14 loan was "a short-term loan" designed to "give Bear enough liquidity to survive the weekend, so we would have a couple of days to seek a more permanent solution." (PTX 709 at 167-168).

(b) Report Pursuant to Section 129 of the EESA of 2008: "On March 14, the FRBNY made an overnight discount window loan of \$12.9 billion to JPMC Bank on a non-recourse basis and took as collateral assets of Bear Stearns with a value of \$13.8 billion. The rate of interest on this loan was the rate for primary credit extended by the Reserve Banks, or 2.25 percent." (PTX 2554 at 3; PTX 12 at 2 (BOG authorization, confirming the interest rate)).

4.4.2 On March 16, 2008, the Federal Reserve, again acting under Section 13(3), authorized FRBNY "to make a nonrecourse loan of up to \$30 billion that would be fully collateralized by a pool of Bear Stearns assets" to facilitate a merger between Bear Stearns and JPMorgan. (PTX 12 at 2-3).

4.4.3 On March 16, 2008, the Federal Reserve authorized a 13(3) credit facility for primary dealers. (PTX 693 at 4-5).

(a) "The Federal Reserve established the Primary Dealer Credit Facility ('PDCF') on March 16, 2008." (Agreed to Stipulations ¶ 51; *accord* PTX 12 at 3-4 (March 16, 2008 Board of Governors minutes: "the Board authorized the New York Reserve Bank to establish a facility to extend credit to primary securities dealers."))).

(b) In March 2008, the Federal Reserve loaned as much as \$40 billion a night under the PDCF program. (*See* PTX 728 at 5).

4.5 From March to September 2008 Financial Markets Deteriorated Even Further.

(a) Alvarez: From "March until the beginning of September of 2008 . . . Liquidity was becoming difficult to get with any kind of haircut on a secured basis, and unsecured credit was becoming all but unavailable". (Alvarez: Trial Tr. 136:21 – 137:5).

4.6 Financial Markets Continued to Deteriorate in Early September 2008.

(a) Offit: “between September 5 and September 12 it was obvious that the markets were deteriorating”. (Offit: Trial Tr. 7920:16-19).

(b) On September 6, 2008, the Federal Housing Finance Agency (“FHFA”) placed the two Government-Sponsored Entities (“GSEs”), Federal Home Loan Mortgage Corporation (“Freddie Mac”) and the Federal National Mortgage Association (“Fannie Mae”), into Conservatorship. (Agreed to Stipulations ¶ 71).

(c) Email from Hayley Boesky, a market analyst at FRBNY to Meg McConnell and other FRBNY officials on September 11, 2008: “On a scale of 1 to 10, where 10 is Bear-Stearns-week-panic, I would put sentiment today at a 12. People are expecting full-blown recession.” (PTX 41 at 1-2; *see also* Mosser: Trial Tr. 1283:7-15 (“The level of concern throughout the financial markets” “was exceptionally high on the 11th of September”)).

4.7 When Lehman Brothers Filed for Bankruptcy Early in the Morning of September 15, Financial Markets Were Completely Disrupted.

(a) Around 12:30 a.m. on September 15, Lehman Brothers announced it would file for bankruptcy (Agreed to Stipulations ¶ 93), an event Geithner describes as “the most destabilizing financial event since the bank runs of the Depression.” (PTX 709 at 228).

(b) Bernanke: The financial crisis “had stages. It became distinctive in August of 2007. There was an upsurge in March 2008, around the Bear Stearns episode. And then it became extremely severe after Lehman failed” in September of 2008. (Bernanke: Trial Tr. 1958:5-11).

(c) Bernanke: The Lehman bankruptcy “was an enormous shock that affected the whole global financial system.” (PTX 708 at 88; *see also* Bernanke: Trial Tr. 1963:6-9 (affirming the statement as true)).

(d) Bernanke: The failure of Lehman “worsened the financial crisis that was already under way enormously”. (Bernanke: Trial Tr. 1963:6-12). It “created a huge loss of confidence in other financial firms and created pressure on a wide variety of other financial firms, including investment banks and others”. (Bernanke: Trial Tr. 1963:13-17).

(e) Paulson: “By the middle of September, right after Lehman failed, the country was plunged into . . . the most wrenching financial crisis since the Great Depression”. (Paulson Trial Tr. 1200:25 – 1201:4).

(f) Paulson: The liquidity markets had “been freezing up for a long time, but they really froze up” during the week of September 16. (Paulson: Trial Tr. 1203:23 – 1204:2).

(g) “The Financial Crisis: Five Years Later” A Report From The Executive Office of the President (September 2013): After Lehman’s bankruptcy: “Key regulators feared that nearly all of the nation’s major financial institutions were at risk of failure within a period of a week or two”. (PTX 680 at 16). “Reflecting these developments, bank credit spreads widened to all-time highs and the funding markets began to shut down.” (PTX 680 at 16).

(h) Herzog: “financial markets were in a crisis condition and essentially not functioning”. (Herzog: Trial Tr. 7032:20-25).

(i) The period after Lehman Brothers’ failure “was a period the likes of which” Offit “had never seen before”. (Offit: Trial Tr. 7926:15-23).

(j) Baxter: September 16, 2008 was “the day after Lehman Brothers filed for bankruptcy and the week after the government-sponsored enterprises Fannie and Freddie were put into conservatorship, so everything is accelerating in a vicious downward spiral with respect to the American economy.” (Baxter: Trial Tr. 860:20 – 861:19).

(k) Bernanke: One effect of the Lehman bankruptcy was that there was “a very intense bank run or, in this case, a money market fund run, in which investors in these funds began to pull out their money just as quickly as they could.” (PTX 708 at 88). In the days immediately following the bankruptcy, “one hundred billion dollars a day was flowing out of these funds.” (PTX 708 at 89; *see also* Bernanke: Trial Tr. 1963:18-21 (affirming the intense run on money market funds)).

(l) “At midday on September 16, 2008, the Reserve Primary Fund, a \$65 billion dollar money market fund, reported a share value of less than a dollar, which meant that investors were at risk of losing money. This was only the second time in history that a money market fund had ‘broken the buck’.” (Agreed to Stipulations ¶ 113).

(m) Bernanke: In “the days immediately following the Lehman bankruptcy,” “there were substantial outflows” from money market funds. (Bernanke: Trial Tr. 1963:22 – 1964:1).

(n) Bernanke: “Following the Lehman collapse and the ‘breaking of the buck’ by a money market mutual fund that held commercial paper issued by Lehman, both money market mutual funds and the commercial paper market were also subject to runs.” (PTX 650 at 12-14).

(o) Geithner: In the aftermath of the failure of Lehman, regulators “had two death spirals” that they “needed to stop immediately: the run on money market funds, which was killing the market for the commercial paper that provided America’s top corporations with short-term operating loans, and the run on investment banks, which was threatening to ignite two more Lehman-style explosions.” (PTX 709 at 218).

(p) Mosser: Following the Lehman bankruptcy, “very large numbers of financial institutions basically had severe problems borrowing dollars”. (Mosser: Trial Tr. 1280:19-22). Indeed, financial institutions “were refusing to lend to one another, in some cases because they

were concerned about the direct financial health of the firm that they were lending to, in some cases because they were concerned that no one else was lending to each other, so why should I lend because I might not get it back. Therefore, there was a sort of round-robin going on.” (Mosser: Trial Tr. 1284:9-25). And this resulted “in a broad group of firms not being able to fund themselves because of the pullback in liquidity”. (Mosser: Trial Tr. 1284:9 – 1285:11).

(q) The Congressional Oversight Panel: “In addition, at midday on September 16, the assets of a money-market mutual fund that had exposure to Lehman fell below \$1 per share, a rare occurrence known as ‘breaking the buck,’ which further stoked investors’ fears; that week, money-market mutual funds were subjected to enormous withdrawals, especially by institutional investors.” (PTX 589 at 60).

(r) Email from Hayley Boesky, a market analyst at FRBNY to Meg McConnell and other FRBNY officials on September 16, 2008: “Head of citi fx just called to tell me that unsecured funding market is shut down. Major banks have stopped giving quotes to each other. And some have stopped picking up their phones.” (DX 397 at -779; *see also* McConnell: Trial Tr. 2520:1 – 2522:2 (DX 397 is the kind of information that McConnell was receiving at that time)).

(s) Baxter: “in the several days after the Lehman Brothers filing, credit markets began to freeze, and even solvent institutions began to be unable to get the liquidity that they needed”. (Baxter: Trial Tr. 663:20 – 664:15).

(t) Cragg: The effect of the Lehman bankruptcy can also be seen in the increase in AIG’s credit default swap (“CDS”) spread. (Cragg: Trial Tr. 5033:11-22). PTX 5338, a demonstrative used by Dr. Cragg, demonstrates that the “failure of Lehman and Merrill Lynch and, frankly, the other investment banks over that week have an enormous impact on the market

overall, which has an enormous impact on AIG” and also the “feedback between all of these events.” (Cragg: Trial Tr. 5033:11-22).

(u) Cragg: The “events around that period and specifically the failure of Lehman, which also coincided with the effective failure of Merrill Lynch because it was taken over by B of A that weekend, that caused enormous disruption in an already fragile market. And it – it affected every – every major financial firm.” (Cragg: Trial Tr. 5029:10-18).

5.0

NO ONE ANTICIPATED OR PREDICTED THE SEVERITY OF THE FINANCIAL CRISIS.

(a) Paulson: The crisis in financial markets “came from an area we hadn’t expected—housing—and the damage it caused was much deeper and much longer lasting than any of us could have imagined.” (PTX 706 at 78).

(b) Alvarez: “In September, it became clear that the financial system had become more fragile than anyone, including regulators, had realized”. (Alvarez: Trial Tr. 138:19-22).

(c) Geithner: “We weren’t expecting default levels high enough to destabilize the entire financial system. We didn’t realize how panic-induced fire sales and radically diminished expectations could cause the kind of losses we thought would happen only in a full-blown economic depression.” (PTX 709 at 153; *accord* PTX 709 at 118 (“I took too much comfort in analyses downplaying the risk of large nationwide declines, which hadn’t happened in the United States since the Depression.”); *see also* Geithner: Trial Tr. 1454:4-21).

(d) Bernanke: “I did not anticipate a crisis of this magnitude and this severity.” (PTX 553 at 33).

(e) Paulson: Beginning in late April 2007 and continuing “for another couple of months”, Paulson had stated “that subprime mortgage problems were ‘largely contained.’” He later confessed, “We were just plain wrong.” (PTX 706 at 83).

(f) Bernanke (October 20, 2005 congressional testimony): “House prices have risen by nearly 25 percent over the past two years. Although speculative activity has increased in some areas, at a national level these price increases largely reflect strong economic fundamentals, including robust growth in jobs and income, low mortgage rates, steady rates of household formation, and factors that limit the expansion of housing supply in some areas.” (PTX 974 at 11).

(g) Bernanke (May 2007 speech): “given the fundamental factors in place that should support the demand for housing, we believe the effect of the troubles in the subprime sector on the broader housing market will likely be limited, and we do not expect significant spillovers from the subprime market to the rest of the economy or to the financial system.” (PTX 1041 at 6; *see also* Cragg: Trial Tr. 5507:22 – 5509:11 (Bernanke’s statement shows that “the financial crisis wasn’t – and its magnitude wasn’t anticipated or foreseeable”)).

(h) Bernanke (November 17, 2009 FCIC testimony): “so, again, I fully admit that I did not forecast this crisis.” (PTX 548 at 48-49; *accord* PTX 553 at 129).

(i) Alvarez: “We have a system—a whole system that I think was much more fragile than we realized, and I don’t just mean just the regulators. I mean everybody. The regulators, investors, bank regulators, securities regulators, you know, the CFTC, others. A system that was more fragile than we realized.” (PTX 572 at 9; *accord* Alvarez: Trial Tr. 424:22 – 425:10).

(j) Cragg: “The risks that materialized were unanticipated by both the market as well as regulators.” (Cragg: Trial Tr. 5498:7-10).

6.0

DESPITE THE FINANCIAL CRISIS, AND DESPITE THE FACT THAT AIG UNLIKE OTHER MAJOR FINANCIAL FIRMS HAD NOT HAD ACCESS TO GOVERNMENT CREDIT, AIG WAS ABLE TO MANAGE ITS LIQUIDITY NEEDS UNTIL THE SECOND WEEK IN SEPTEMBER 2008 WHEN LEHMAN BEGAN TO FAIL.

6.1 As Early as the End of 2005, AIG Stopped Offering CDS Protection for Mortgage-Backed CDOs.

(a) “In December 2005, AIGFP made the decision to stop writing credit protection on multi-sector CDOs.” (Agreed to Stipulations ¶ 42). “By December 2005, AIG ceased committing to new transactions providing credit protection on CDOs containing subprime RMBS exposure.” (Agreed to Stipulations ¶ 43).

(b) Defendant’s expert Dr. Anthony Saunders: AIGFP stopped writing CDS protection on subprime mortgage-backed securities “as of the end of 2005.” (Saunders: Trial Tr. 8081:12 – 8082:3).¹

(c) Cragg: “AIG left the market in 2005.” (Cragg: Trial Tr. 4964:22 – 4965:19).

(d) Polakoff, Acting Director of Supervision, OTS: “AIG halted these activities while the housing market was still going strong”. (PTX 449 at 12; *see also* PTX 587 at 76).

6.1.1 AIG exited the CDS market for CDOs at a time when regulators were expressing views that mortgage-backed securities did not pose substantial risks and when banks and other firms were increasing their participation in the CDO market.

¹ Saunders opined that AIGFP’s Multi-Sector CDS portfolio exposed AIG to significant liquidity risk because it was unhedged. DX 2703; Saunders: Trial Tr. 8074:8 – 8075:18; DX 2705. However, in light of his concession that AIG “stopped writing new CDSs as of the end of 2005” and his acknowledgement that “empirical evidence shows there was a relaxation of guidelines for underwriting mortgage loans in 2006 as reflected in much higher default rates for those mortgages” (Saunders: Trial Tr. 8081:12 – 8082:25), it is unclear how he could maintain that AIG did nothing to hedge against risk. There could be no better hedge against risk than to cease participation in the market. Yet, Saunders never accounts for this in his opinion.

(a) Bernanke: “In and after 2005 when AIG stopped accepting additional CDS risks, there were still a number of people who were expressing views that mortgage-backed securities did not pose substantial risks”. (Bernanke: Trial Tr. 2136:17-21; *see also supra* § 5.0(a)–(j); Bernanke: Trial Tr. 2142:5 – 2143:18 (Bernanke’s statement that the Fed does “not expect significant spillovers from the subprime market to the rest of the economy or to the financial system” was made “some considerable period of time after AIG had stopped accepting additional CDS risks”).).

(b) After 2005, “as the market is exploding, as we can see, and the housing bubble is rising and the quantity of subprime debt that’s out there is, you know, starting, you know, to take over, taking over – you know, a quarter of all mortgages are subprime, AIG’s left the market before all of that’s happened.” (Cragg: Trial Tr. 4965:13-19; PTX 5308 (showing that most CDO issuance was in 2006 and 2007 after AIG stopped offering CDS protection on CDOs with subprime collateral); *see also* PTX 5309 – PTX 5313 (Cragg demonstratives showing a dramatic increase in cumulative default rates on subprime mortgages issued after 2005)).

6.2 Until Lehman’s Failure, AIG Was Managing Its Liquidity Needs.

6.2.1 In 2007, “AIG recognized that there were possible liquidity issues and had begun work to try to make sure that AIG behaved in a prudent way”. (Willumstad: Trial Tr. 6477:13-17).

(a) In 2007, AIG “proactively started to tell its investors, its clients where it was exposed to subprime risk and how it was managing that risk”. (Cragg: Trial Tr. 5014:2-16; PTX 5327 (Cragg demonstrative)).

6.2.2 In 2007 AIG created a Liquidity Risk Committee and began to build liquidity.

(a) AIG 2007 10-K: “As a result of market disruption in the credit markets, AIG took steps to enhance the liquidity of its portfolios. Cash and short-term investments increased in all

of AIG's major operating segments. In addition, AIG created an interdisciplinary Liquidity Risk Committee to measure, monitor, control and aggregate liquidity risks across AIG." (DX 939 at 99).

(b) Willumstad: "AIG established a company-wide liquidity risk committee" in an effort "to try to build liquidity starting in 2007". (Willumstad: Trial Tr. 6477:13-24).

(c) On August 5, 2008, AIG's accountants at PwC noted that over "the course of the last nine months, AIG has been building liquidity – as of June 30, 2008, cash and short-term investments, including within the Securities Lending Pool, was \$82.2 billion." (DX 175 at -233).

6.2.3 Capital Raises

(a) In 2008, AIG began to undertake efforts to raise additional capital from the private market. (Cragg: Trial Tr. 5016:6-18; PTX 5327).

(b) "In May 2008, AIG raised approximately \$20 billion in new capital by issuing a mix of common stock, equity units, and junior subordinated debentures." (Agreed to Stipulations ¶ 56). That "was the largest private capital raise in history as of that time". (Willumstad: Trial Tr. 6481:15-22; *accord* PTX 587 at 113-14 (Willumstad: "Going back in May of 2008, AIG raised \$20 billion of capital which at the time I think was the largest capital raise ever done.")).

(c) Despite this liquidity cushion, "through July and August of 2008", Willumstad "and AIG worked to further strengthen AIG's balance sheet to be prepared in case a crisis arose" in addition to raising an additional \$3 to \$4 billion in capital (Willumstad: Trial Tr. 6483:11-16). Among other things, AIG undertook to "identify certain nonstrategic businesses, retain financial advisors and begin the process of selling those businesses to raise cash". (Willumstad: Trial Tr. 6483:11-20). "To conserve cash," AIG also decided to "stop discussion relating to a number of acquisitions" that it had been contemplating. (Willumstad: Trial Tr. 6483:21-24). AIG also

started to “develop and implement an aggressive plan to further reduce expenses”. (Willumstad: Trial Tr. 6483:25 – 6484:2).

(d) “On August 18, 2008, AIG raised \$3.25 billion through the issuance of 8.25% Notes Due 2018.” (JX 188 at 3, 56; *see also* Agreed to Stipulations ¶ 66).

(e) “In late August 2008, AIG hired JPMorgan Chase to help develop funding options” and “approached Berkshire Hathaway about providing a \$5 billion backstop to AIG’s guaranteed investment contracts (GICs)”. (Agreed to Stipulations ¶¶ 67, 69).

(f) In September of 2008, AIG began “to attempt to negotiate transactions with other private parties to raise additional capital or liquidity.” (Willumstad: Trial Tr. 6484:3-6).

(g) By September 2008, AIG had reduced its securities lending balances “down about 25% from its peak”. (PTX 625 at 4).

6.2.4 In August 2008 AIG’s auditors PwC concluded after an analysis of the company’s liquidity that “we did not think it rose to the level of concern that required disclosure”. (Farnan: Trial Tr. 4243:14-21).

(a) In early August 2008, PwC knew that AIG was “looking at liquidity, but we did not think it rose to the level of concern that required disclosure”. (Farnan: Trial Tr. 4243:14-21). In an August 5, 2008 PwC workpaper on “Liquidity”, PwC noted: “it appears that the Company has the appropriate persons involved to evaluate the liquidity issue”. (DX 175 at -235; *see also* Farnan: Trial Tr. 4243:6-13 (PwC did not think that there was a going concern risk for AIG as of the first half of August 2008)).

6.3 Lehman’s Unexpected Failure, and the Resulting Collapse of Financial Markets, Made It Impossible for AIG to Continue to Meet Its Liquidity Needs from Private Sources.

(a) Alvarez: “The failure of Lehman ended any chance of securing a private sector solution for AIG . . . Investors became extremely concerned about their own financial well being

and chose not to use their resources to acquire or assist a struggling firm during this period of economic and financial turmoil. Indeed, there was widespread pull-back from any risky investment and even from safe, fully collateralized lending by the private sector.” (PTX 587 at 28-29; *see also supra* §§ 4.5-4.7).

(b) Baxter: Following the Lehman bankruptcy, financial institutions were trying to “protect their own balance sheets” and would “not make credit available that they would have under other circumstances”. “And the effects of financial institutions being unwilling to make credit available were severe”. (Baxter: Trial Tr. 663:20 – 664:15).

(c) Offit: “AIG got caught in the cauldron of the Lehman debacle, and that’s what – in effect, everything became a financial crisis right after because AIG was then frozen out of the commercial paper market. And once you’re frozen out of the commercial paper market, then in effect all liquidities sort of – outside liquidity disappears.” (Offit: Trial Tr. 7339:10-21; *see also* Offit: Trial Tr. 7917:14-24 (Once “you went into a period where you had a paralyzed bond market, where mortgage securities trade, and you had in effect the cauldron effect of the Lehman, and so forth, and a frenzied marketplace, then you really had the crisis.”)).

(d) Studzinski: “I believe that the bankruptcy of Lehman had such an onerous impact on world financial markets and U.S. financial markets that it had a direct implication on the trading in all securities of AIG.” (Studzinski: Trial Tr. 4495:21 – 4496:5).

(e) Offit: “On September 16, the marketplace was in extremis”. (Offit: Trial Tr. 7927:15-17). “The entire market was in complete disarray”. (Offit: Trial Tr. 7927:18-20). “Markets, particularly debt markets, were freezing up”. (Offit: Trial Tr. 7927:21-23). “Companies were unable to finance externally”. (Offit: Trial Tr. 7927:24 – 7928:1). “And with the deterioration of the market each day you had a new set of circumstances”. (Offit: Trial Tr.

7928:2-4). “And by virtue of the financial climate, AIG’s liquidity shortfall kept increasing”. (Offit: Trial Tr. 7928:5-7).

(f) Willumstad: “AIG did not face significant cash demands from securities lending counterparties until on or around Monday, September 15 or possibly Friday, September 12”. (Willumstad: Trial Tr. 6489:25 – 6490:4). What was happening on September 15 was “a tidal wave disrupting the financial markets generally” (Willumstad: Trial Tr. 6511:16-19), and “AIG’s counterparties were not honoring their obligations to AIG”. (Willumstad: Trial Tr. 6511:13-15).

(g) Between September 15 and 22, 2008, the liquidity outflow from collateral posting and postings related to AIG’s downgrade was \$25 billion. (Cragg: Trial Tr. 5033:23 – 5036:1; PTX 5341 (Cragg demonstrative)).

6.4 In the Absence of Lehman’s Failure AIG Would Have Been Able to Continue to Manage Its Liquidity Needs.

(a) Baxter: “had Lehman not filed for bankruptcy, private sector financing for AIG could have been secured”. (Baxter: Trial Tr. 675:8-11).

(b) “Mr. Baxter added, again, that over the course of the weekend, the highest levels of large financial institutions told him that they would take care of AIG’s liquidity needs. There was nothing over the weekend in terms of the information flow to the Fed that would lead officials to question those assurances. The turning point for the financial institutions that made those assurances, however, was Lehman Brothers’ bankruptcy filing. Had Lehman not filed for bankruptcy, private sector financing for AIG could have been secured.” (PTX 632 at 13).

(c) Without “the Lehman crisis and the related issues, it would seem that AIG” in September 2008 would have been able to raise capital in the private sector. (Cragg: Trial Tr. 5039:6-23; PTX 5340 (Cragg demonstrative)).

(d) Cragg: “on September 15, the total cash flow impact or liquidity impact on AIG of the downgrade as well as the run that by this point was occurring on its securities lending portfolio, as well as other wholesale funding for AIG, that that day required an outflow of \$14.3 billion.” (Cragg: Trial Tr. 5025:20 – 5026:18; PTX 5339-A (Cragg demonstrative)). Between September 1 to 11, AIG had only had a net outflow from collateral postings and securities lending of \$900 million, of which “\$700 million flowed out on September 11.” (Cragg: Trial Tr. 5027:16 – 5028:15; PTX 5339-A (Cragg demonstrative)). “On September 12, \$1.7 billion flowed out of AIG on that day.” (Cragg: Trial Tr. 5028:16; PTX 5339-A (Cragg demonstrative)). AIG’s collateral postings from AIGFP and returns from its securities lending program on September 15, 2008 were \$14.3 billion. (Cragg: Trial Tr. 5029:4-7; PTX 5339-A (Cragg demonstrative)). Another \$7 billion flowed out of AIG on September 16. (Cragg: Trial Tr. 5029:8-9; PTX 5339-A (Cragg demonstrative)).

7.0

ON SEPTEMBER 16, 2008, AFTER LEHMAN’S FAILURE, AIG, LIKE MANY FINANCIAL INSTITUTIONS, FACED A SEVERE LIQUIDITY CRISIS AND, WHILE SOLVENT, WAS UNABLE TO MEET ITS LIQUIDITY NEEDS FROM PRIVATE SOURCES.

7.1 On September 16, 2008, AIG Faced a Severe Liquidity Crisis as a Result of the Market-Wide Financial Crisis.

(a) Willumstad: “the overriding factor” that caused AIG’s financial problems that led to the government assistance in September of 2008 “was the decline in the housing market and the state of the U.S. economy at that time.” (Willumstad: Trial Tr. 6500:15-22).

(b) Liddy: On September 18, 2008, “I thought the company faced a very complex liquidity squeeze, in line with that which was affecting many other financial institutions.”

(Liddy: Trial Tr. 3183:23 – 3184:13; *see also* Liddy: Trial Tr. 3191:2-17 (As of September 18, 2008, “the company was in an acute liquidity crisis.”)).

(c) Offit: “liquidity need is really a function of the condition of the marketplace, so the marketplace started to freeze up, and the dealers weren’t dealing. And that’s the whole concept of a fixed-income market. If the dealers choose not to deal, then in effect you have a nonfunctioning marketplace or better expressed as a paralyzed marketplace.” The “paralyzed marketplace” “shuts off the company from accessing the market for additional liquidity.” (Offit: Trial Tr. 7339:22 – 7340:14).

(d) Offit: “Once a company is frozen out of the commercial paper market, you can’t roll over commercial paper, which is the primary instrument in short-term liquidity, then it looks to its backup lines. But the backup lines really are not going to be existent either, so you in effect have this liquidity crisis. And it’s short-dated. The company may have solvency over time, but in the meantime your liquidity crisis is the primary reason for bankruptcies.” (Offit: Trial Tr. 7371:25 – 7372:24).

(e) Email from FRBNY Research Officer Adam Ashcraft to McConnell on September 15, 2008, regarding AIG: “Very solvent lots of capital but no liquidity”. (PTX 60; *see also* McConnell: Trial Tr. 2549:18 – 2550:13).

(f) During a speech at AIG’s annual shareholder meeting on June 30, 2009, Liddy stated that “in September, just after the collapse of Lehman”, although “solvent, AIG suddenly faced an acute liquidity crisis.” (PTX 2109 at 4).

(g) Schreiber: “The root cause” for AIG’s need to raise capital at the end of August of 2008 “was continued volatility in the markets that was causing a significant liquidity drain on AIG.” (Schreiber: Trial Tr. 6535:8-16).

(h) The Board of Governors' report to Congress: On September 16, 2008, "short-term funding markets had come under severe stress during the months prior to September 2008, with very high spreads between lending rates and the target federal funds rate and very illiquid trading conditions in term money markets. Those stresses intensified in late August and early September 2008, and these developments had led to a considerable impairment of a broad range of other financial markets. These events placed significant liquidity pressures on AIG in the period leading up to September 16, 2008, as declines in the prices of mortgage-related assets required AIG to post additional collateral in connection with its CDO² and other mortgage-related derivative exposures and as AIG experienced difficulty in raising additional funding in the markets." (PTX 339 at 2-3).

7.2 The Freezing of Markets for Over-the-Counter Derivatives and Markets for Mortgage-Backed Securities Prevented AIG and AIGFP from Obtaining Realistic Valuations Based on Market Transactions.

(a) Financial Crisis Inquiry Commission Report: In the second half of 2008, transactional activity in the over-the-counter derivatives market "would undergo an unprecedented contraction, creating serious problems for hedging and price discovery." (PTX 624 at 328). "The market for nonconforming mortgage securitizations (those backed by mortgages that did not meet Fannie Mae's or Freddie Mac's underwriting or mortgage size guidelines) had also vanished in the fourth quarter of 2007." (PTX 624 at 329).

(b) As a result, market participants, including AIG and AIGFP, found it difficult to derive fair market values for their securities based on market transactions. (PTX 221 at 4; *see* Herzog: Trial Tr. 7031:23 – 7032:19 ("what was happening with the attempts to mark assets to

² "A Collateralized Debt Obligation (CDO) is a debt security backed by a pool of assets (cash or synthetic) that can be comprised of a mix of various assets such as leveraged loans, bonds, residential mortgage backed securities, credit default swaps, etc. A CDO security will earn either a fixed or floating periodic coupon payment from the cash flow proceeds received from the pool of assets." Agreed to Stipulations ¶ 36.

market . . . when there aren't markets can sometimes be challenging"); Willumstad: Trial Tr. 6484:10 – 6485:8 (“the problem is that the market was not functioning, and so there really wasn't a mark-to-market price”).

(c) Schreiber: In early September 2008, “Liquidity generally in the market was declining, meaning there was more volatility. The bid-ask on securities was widening. Prices were coming down. There was far – it was far more difficult to sell securities and raise liquidity at that point in time.” (Schreiber: Trial Tr. 6554:23 – 6555:4).

7.2.1 By September 16, there were essentially no prices for subprime-backed securities and collateral calls could not be met from private sources because of the freezing of the credit markets.

(a) Offit: “financial institutions have to mark-to-market their inventory, so the marks on mortgage securities were all over the place. On any one day you could have three dealers bidding on bonds and one would bid 50, another bid 70 and another bid 80, and you had to take the lesser of the – or the two of the three. I forget. But you had to basically mark it on the lowest price. And that is what is reflected in your assets and your bond holdings, so that's why I say you're in effect eroding the value of your assets every day because you have a paralyzed bond market. There's no action. And nobody knew where the bonds would trade because the marks were so erratic, which drove me out of my mind, I must say.” (Offit: Trial Tr. 7377:24 – 7379:19).

(b) Cragg: “The market circumstances created a, you know, broad-spread panic. They affected AIG by creating a run on it. They affected AIG through creating fire – you know, through creating marks that impacted the CDS collateral calls in a very artificial manner.” (Cragg: Trial Tr. 5122:3-8).

(c) Cragg: “And you can see that during the crisis week, when Lehman, Morgan Stanley, Goldman Sachs, Merrill Lynch, when the money market mutual funds, the commercial paper market, when AIG, when all of those events were happening at the same time, the overnight LIBOR spread skyrocketed and hardly surprising because nobody wanted – everyone was hoarding their liquidity. They were all, you know, in fear of failure, because of liquidity.” (Cragg: Trial Tr. 5031:9 – 5032:7; *see also* PTX 5335 (Cragg demonstrative showing jump in overnight LIBOR-OIS spread)).³

(d) Cragg: PTX 5336 summarizes “the series of market impacts that were happening to AIG. So at the beginning of the year you have downgrades on the CDO portfolio. Those are the securities underlying it. The counterparties demand collateral for those contracts. It turns out that that is right in the middle of this mad cow period. I call this the run – actually, Gary Gorton, who I think – who presented this theory to the Federal Reserve Board in August, where they have a retreat every August. He presented this, called it the run on repo. So the run on repo is happening. That leads to negative valuation adjustments. That leads to collateral call drains. Eventually the credit rating agencies get concerned about AIG’s liquidity. That of course caused more liquidity problems and that ultimately then leads to a run on AIG. So that whole process is happening because of these market events which are driving AIG’s problems.” (Cragg: Trial Tr. 5036:16 – 5037:11).

(e) Cragg: PTX 5341 “shows the cumulative liquidity outflow from AIG over the course of 2008, so I’m taking a longer snapshot over time. And if you look at the beginning of

³ The “difference between overnight LIBOR, which is the London interbank offer rate, so it’s the rate at which banks lend to each other, subtracted for the – from the OIS spread, which is the expected return on Treasuries for that same day, so it’s the difference between, you know, the risk-free rate and then the rate that banks charge each other. And that spread is used in a lot of research as a way of analyzing when financial events happen.” Cragg: Trial Tr. 5031:15-24.

the year, on December 31, 2007, AIG had posted only \$2.7 billion of collateral. It had no problems rolling its commercial paper at that point. There was no – it had no issues of liquidity. And then over the course of the – up through the summer and even up to August 31, 2008, AIG is steadily posting more collateral on its CDS contracts. You know, it's raised money during this period. It's raised \$23 billion during this period. But there's this, you know, crazy mismatch between the true value of the CDOs that it had insured and, you know, the way they were being marked. During that first week of September, so going from August 31 to September 8, as your chart reflects there, there's no change in the amount of cash outflow from AIG. And then as your chart indicated as we looked at it more closely, the run on AIG begins to start. And by 'run' I mean counterparties getting nervous about AIG and its ability to repay short-term funding. And then that takes off with the failure of Lehman, and so on. So on the day – over the course of Friday to Monday, September 15, when the Lehman bankruptcy occurred, and then to the end of the week, AIG in one day posts an additional 15 or so billion dollars". (Cragg: Trial Tr. 5033:23 – 5035:9).

7.3 In 2008, AIG's CDS Counterparties Made Collateral Calls That Took Advantage of the Subjectivity Involved in Valuing Illiquid Collateralized Debt Obligations ("CDOs") in a Time of Crisis.

(a) "On September 16th, AIG, the largest multidimensional insurance company in the world, which had been selling credit insurance, came under enormous attack from people demanding cash either through margin requirements or through short-term funding." (PTX 708 at 80; *see also* Bernanke: Trial Tr. 1968:25 – 1969:12 (affirming the statement as true and accurate)).

(b) Offit: The marketplace was "paralyzed" and "marks on mortgage securities were all over the place". (Offit: Trial Tr. 7926:24 – 7927:10, 7377:24 – 7379:19).

(c) A September 22, 2008 Ernst & Young document describing the market at the time refers to a “Lack of liquid quotes from market participants” and the “Subjectivity involved in pricing” for AIG’s collateral calls. (PTX 221 at 4; Symons: Trial Tr. 3592:18 – 3595:2 (with credit default swaps, “oftentimes counterparties have disagreements on what the instruments are worth”)).

(d) Cragg concluded that the collateral calls that were being made by counterparties deviated from the intrinsic values of the underlying CDS contracts and their underlying CDO security: “my primary conclusion is that the amount of collateral that AIG was required by its counterparties to post way exceeded any reasonable estimate of the actual risk of nonpayment on the CDS contracts. You know, if you look at the – you know, the underlying CDO contracts that AIG was insuring, the risk there was very small and the risk had not actually been really realized.” (Cragg: Trial Tr. 5016:22 – 5017:24).

(e) Cragg: In the base case of expected losses on AIG’s multi-sector CDS portfolio as of September 2008, “BlackRock estimates that the value of that portfolio is not 77.1 billion but is only 69.8 billion” which “would imply a \$7.3 billion loss.” (Cragg: Trial Tr. 5020:7-25). In “the stress case, they estimated that there would be a \$15.2 billion loss so that the portfolio was only really worth \$61.9 billion”. (Cragg: Trial Tr. 5021:1-10). With “respect to the collateral postings,” “AIG had already posted \$36.9 billion” which “implied that the portfolio was only worth 40.2 billion.” “That is that there would be a loss of 36.9 billion on it.” (Cragg: Trial Tr. 5021:11-22; *see also* PTX 5328 (Cragg demonstrative); PTX 1675 at 4 (September 29, 2008 BlackRock presentation: the “Collateral posted to counterparties under the CDS in the [AIGFP multi-sector] portfolio is over \$29 billion, far in excess of the projected net cash flows in BlackRock’s stressed case”)).

7.4 As the Federal Reserve and Other Government Agencies Recognized, Because of Fear, Lack of Liquidity, and the Resulting “Unnaturally Strong Downward Market Pressures,” Reported Values for AIG’s Mortgage-Backed Securities, the CDOs Protected by AIGFP’s Multi-Sector CDS, and the AAA and Super Senior Tranches of RMBS Held by AIG’s Securities Lending Pool Did Not Reflect the Amount of Aggregate Proceeds That Would Be Received from Those Assets Over Time.

(a) Board of Governors Report to Congress: “Because the collateral assets for the loans to ML-II and ML-III are expected to generate cash proceeds and will be sold over time, the current reported fair values of the net portfolio holdings of ML-II and ML-III do not reflect the amount of aggregate proceeds that the Federal Reserve could receive from payments on the assets over time or from the sale of the assets of these entities over time. The collateral will be sold over time in an orderly manner that is not affected by the unnaturally strong downward market pressures that have been associated with the recent liquidity crisis.” (PTX 393 at 10).

7.5 AIG’s Securities Lending Operations Faced the Same “Run on the Bank” Pressures as Many Other Financial Firms.

(a) Bernanke: “Whenever there was doubt about a firm, as in a standard bank run, the investors, the lenders, and the counterparties would all pull back their money quickly for the same reason that depositors would pull their money out of a bank that was thought to be having trouble.” (PTX 708 at 79).

(b) Deloitte & Touche: “Because of the significant market turmoil caused by the Lehman bankruptcy filing, [AIG] experienced severe financial distress due to liquidity requirements at one of its subsidiaries and its inability to maintain its securities lending relationships.” (JX 387 at 2).

(c) Between September 15 and 22, AIG’s cumulative liquidity outflow from collateral postings, securities lending balance outflows, and downgrades totaled \$25 billion. (Cragg: Trial Tr. 5033:23 – 5036:14; PTX 5341 (Cragg demonstrative)).

(d) On September 12, 2008, Mosser sent an e-mail to Geithner and others at FRBNY stating: “Markets are also punishing AIG.” “Some banks are already pulling away; some banks are even turning down AIG in the secured (repo) borrowing markets”. “AIG’s repo book is all investment grade, mostly structured mortgage products. . . . Things that have, in the past, been used as repo collateral. . . . but the combination of being perceived as a weak counterparty and risky, illiquid collateral is resulting in counterparties stepping away Securities lending (mostly out of the insurance companies) – about \$69B in liabilities, and the holding company has only enough cash to fund ½ of that, if sec lending counterparties turn away from the AIG name.” (PTX 42 at 1-2 (ellipses in original)).

7.6 The Freezing of Commercial Paper Markets Meant That AIG Was Not Able to Roll Over Its Commercial Paper as It Became Due.

(a) “On September 12, 2008, two of AIG’s non-insurance subsidiaries, International Lease Finance Corporation (‘ILFC’) and American General Finance (‘AGF’) were unable to roll over their commercial paper. As a result, AIG advanced loans to these subsidiaries to meet their commercial paper obligations.” (Agreed to Stipulations ¶ 74).

(b) On September 12, AIG “had difficulty rolling its commercial paper programs” and believed it would “face pressure to roll its commercial paper facilities on Monday, September 15th”. (DX 296 at -683 to -684; *see also* DX 1503 at -917 (“since mid September there has been no capacity to issue commercial paper”)).

(c) Herzog: “if we weren’t able to roll the commercial paper, we . . . had to basically refund the cash”. (Herzog: Trial Tr. 7031:23 – 7032:8).

7.7 On September 15, 2008, AIG’s Counterparties Began Withholding Legitimately Owed Payments from AIG and Refusing to Transact with AIG, Even on a Secured, Short-Term Basis.

(a) AIG 2008 10-K Filing: “the downgrades, combined with a steep drop in AIG’s common stock price to \$4.76 on September 15, 2008, had resulted in counterparties withholding payments from AIG and refusing to transact with AIG even on a secured short-term basis.” (JX 188 at 4).

(b) Willumstad: “we had counterparties on many transactions, and – where they legitimately owed AIG money, and they were refusing to – to honor those claims.” (Willumstad: Trial Tr. 6396:18 – 6397:4).

8.0

ON SEPTEMBER 16, 2008, DEFENDANT CONCLUDED THAT IN THE ABSENCE OF A 13(3) LOAN FROM THE FEDERAL RESERVE AIG WOULD HAVE TO FILE FOR BANKRUPTCY.

(a) Alvarez: “the Federal Reserve believed that the only alternative for AIG other than a 13(3) loan was bankruptcy”. (Alvarez: Trial Tr. 357:11-16).

(b) Paulson: “either there was going to be federal assistance for AIG or AIG was going to file for bankruptcy”. (Paulson: Trial Tr. 1205:24 – 1206:7; *see also* JX 82 at 1 (Paulson told the Federal Reserve in a September 16, 2008 meeting that “either AIG goes down or Fed helps”)).

(c) Geithner: “AIG would fail unless it received assistance from the Fed”. (Geithner: Trial Tr. 1421:12-15).

(d) Bernanke: “AIG did not have any alternative other than bankruptcy, except for a 13(3) loan”. (Bernanke: Trial Tr. 1969:13-17).

9.0

DEFENDANT WAS NOT PREPARED TO LET AIG FILE FOR BANKRUPTCY BECAUSE OF THE “CATASTROPHIC” CONSEQUENCES AN AIG BANKRUPTCY WOULD HAVE HAD FOR OTHER FINANCIAL INSTITUTIONS AND THE ECONOMY, AND DEFENDANT CONCLUDED A \$85 BILLION 13(3) LOAN TO AIG WAS APPROPRIATE.

9.1 “The Failure of AIG Would Have Been Catastrophic for a Financial System Already in Free Fall.” (PTX 563 at 15; Geithner: Trial Tr. 1421:16-23).

(a) Defendant admits: “The failure of AIG could easily have led to a worldwide banking run and a severe financial meltdown, devastating millions of people financially along the way.” (Def. Resp. to Pl. 2nd RFAs No. 206).

(b) Defendant admits: “The Federal Reserve made its decision to lend based on a judgment that a failure of AIG would cause dramatically negative consequences for the financial system and the economy, consequences worse than what occurred in the aftermath of the failure of Lehman Brothers.” (Def. Resp. to Pl. 2nd RFAs No. 233).

(c) Baxter: On September 16, Geithner, Bernanke and Paulson “all concluded that if AIG filed for bankruptcy, that would have catastrophic effects for financial markets”. (Baxter: Trial Tr. 676:16-22). “AIG was a financial firm that was systemically important to the financial markets”. (Baxter: Trial Tr. 680:21 – 681:5).

(d) Geithner: “The U.S. financial system seemed even more exposed to AIG than it had been to Lehman. Europe and Asia were also more exposed to AIG. And not only was AIG larger than Lehman, with a more complex derivatives book, its decline had been much swifter, which would be even scarier to markets. ‘If they default, you’ll see default probabilities explode on all financial firms,’ I said. In other words, mass panic on a global scale.” (PTX 709 at 208; *see also* Geithner: Trial Tr. 1431:21 – 1432:1).

(e) Geithner: “In late 2008, AIG faced the prospect of default and bankruptcy, which would have had catastrophic consequences for the economy. AIG was the largest provider of conventional insurance in the world, with approximately 75 million individual and corporate customers in over 130 countries. If AIG had failed, the crisis would have almost certainly spread to the entire insurance industry. The government took action to prevent AIG’s failure and to protect the financial system. This included helping restructure the credit default swap contracts that AIG had entered into with various counterparties.” (PTX 563 at 3; *see also* Geithner: Trial Tr. 1425:14 – 1426:7).

(f) Geithner: the failure of AIG would have been “even more damaging” than the failure of Lehman. (Geithner: Trial Tr. 1429:6-10).

(g) Bernanke: “AIG’s demise would be a catastrophe”. (PTX 599 at 77; *see also* Bernanke: Trial Tr. 1958:16-20).

(h) Bernanke: “In our estimation, the failure of AIG would have been basically the end. It was interacting with so many different firms. It was so interconnected with both the U.S. and the European financial systems and global banks.” (PTX 708 at 92; *see also* Bernanke: Trial Tr. 1969:18 –1970:7; Bernanke: Trial Tr. 2190:20-25).

(i) Bernanke: “AIG, again, we felt that its failure would threaten the stability of the global financial system. Among other things, they had as counterparties many of the world’s largest bank financial institutions, many of the world’s largest banks. The uncertainty in the markets about the financial impact of the collapse of AIG on so many large financial institutions in this period of intense crisis already, plus the impact on insurance markets, et cetera, et cetera.” (PTX 548 at 26-27; Bernanke: Trial Tr. 1969:18-21).

(j) Bernanke: AIG was “a case where action was necessary”. (Bernanke: Trial Tr. 1970:11-17).

(k) Paulson: AIG’s collapse “would have buckled our financial system and wrought economic havoc on the lives of millions of our citizens.” (PTX 564 at 142).

(l) Paulson: “An AIG failure would have been devastating to the financial system and to the economy.” (PTX 564 at 141).

(m) Paulson: “it would be catastrophic if AIG filed for bankruptcy”. (Paulson: Trial Tr. 1206:4-10). While “the system could withstand a Lehman failure, if AIG went down, the country faced a real disaster”. (Paulson: Trial Tr. 1206:11-17).

(n) Paulson: “If AIG had failed – this was a huge financial organization, interconnections throughout the economy. If it had failed, with the system as fragile as it was, I believe it would have taken down the whole. . . . I believe it would have taken down the whole financial system and our economy. It would have been a disaster.” (PTX 564 at 147; *see also* Paulson: Trial Tr. 1207:2-6 (“if AIG had failed, it would have taken down the whole financial system and our economy, it would have been a disaster”)).

(o) On September 16, Paulson received a message from the prime minister of Australia in which the PM stated that “AIG is deeply entwined in the Aussie finan[ce] system (and he thinks with the UK and others).” (JX 67 at 1). Paulson received similar calls from the finance ministers of Germany and France, who also expressed their grave concerns regarding AIG. (*See* PTX 706 at 266; JX 66 (“worried about AIG”); JX 70 (“great concern about AIG”)).

(p) Paulson: “Tim, Ben and I reviewed our options with great care in an hour-long conference call at 8:00 a.m.,” on September 16, 2008, “that included Fed vice chairman Don

Kohn and governors Kevin Warsh and Elizabeth Duke. Whatever else happened, we could not let AIG go down.” (PTX 706 at 262; *see also* Def. Resp. to Pl. 2nd RFAs No. 235).

(q) Alvarez: On September 16, the Federal Reserve believed that an AIG bankruptcy would have been “catastrophic for a financial system already in free-fall” (Alvarez: Trial Tr. 357:23 – 358:4).

(r) Alvarez: May 26, 2010 testimony before the Congressional Oversight Panel: “In the Board’s judgment and given the fragile economic conditions at the time, an AIG default during this period would have posed unacceptable risks for our economy as well as to the millions of individuals and businesses that were counterparties to AIG, including individuals who were insurance policyholders, state and local governments, workers with 401(k) plans, money market mutual fund holders, and commercial paper investors, as well as banks and investment banks in the United States and worldwide.” (PTX 587 at 25; *see also* Alvarez: Trial Tr. 358:13 – 359:13 (“It’s a statement I believed at the time and I believe today.”)).

(s) Alvarez: “With the financial system already teetering on the brink of collapse, the disorderly failure of AIG, the world’s largest insurance company, would have undoubtedly led to even greater financial chaos, further contractions in the flow of credit to businesses and consumers, and a far deeper economic slump than the very severe one we are experiencing today.” (PTX 587 at 25; *see also* Alvarez: Trial Tr. 359:14 – 360:1).

9.2 Government Officials Concluded That They Did Not Have the Option of Letting AIG File for Bankruptcy.

(a) Defendant admits that given “the unusual and exigent circumstances at the time, the potentially far-reaching consequences of a potential AIG bankruptcy compelled policymakers to take decisive action to intervene.” (Def. Resp. to Pl. 1st RFAs No. 12.6).

(b) Geithner: “We did not have the option of bankruptcy; we did not have the option of defaults; we did not have the option of selective haircuts. It would have been catastrophic to let the institution fail.” (PTX 564 at 139; *see also* Geithner: Trial Tr. 1424:4 – 1425:3).

(c) Geithner: “Letting AIG fail seemed like a formula for a second Great Depression. It was essential that we do everything in our power to try to avoid that.” (PTX 709 at 209).

(d) Geithner: An AIG “Default was not an option, unless we wanted a global stampede that could have made the aftermath of Lehman look relatively mild.” (PTX 709 at 261).

(e) Geithner: “The Federal Reserve and the Treasury determined that it was in the best interests of the United States to rescue AIG in order to stop the panic and prevent further damage to the economy. Without assistance, AIG would have been forced to file for bankruptcy protection, resulting in default of over \$100 billion of debt, as well as trillions of dollars of derivative contracts. The failure of AIG would have been catastrophic for a financial system already in free fall.” (PTX 563 at 15).

(f) Bernanke: “In the case of AIG, there was really not much doubt in our minds. This was a case where action was necessary, if at all possible.” (PTX 708 at 101).

(g) Bernanke: “We were then forced—we had no choice but to try to stabilize the system because of the implications that the failure would have had for the broad economic system. We know that failure of major financial firms in a financial crisis can be disastrous for the economy. We really had no choice.” (PTX 447 at 25).

(h) Baxter: “At no point did we believe that we should let AIG file” for bankruptcy. (PTX 2211 at 12).

(i) On the morning of September 15, 2008 Paulson told President Bush: “With luck . . . the system could withstand a Lehman failure, but if AIG went down, we faced real disaster.

More than almost any financial firm I could think of, AIG was entwined in every part of the global system, touching businesses and consumers alike in many different and critical ways.” (PTX 706 at 256).

(j) “Q. And you believed that in part because the system was as fragile as it was, if AIG had failed, it would have taken down the whole financial system and our economy, it would have been a disaster; correct?

A. Yes.

Q. There then came a point where you concluded that you could not let AIG fail; correct?

A. Yes.” (Paulson: Trial Tr. 1207:2-9).⁴

9.3 Defendant Knew that Loaning Money to AIG Would Benefit the Major Financial Firms Which Would Have Been Harmed by an AIG Bankruptcy.

(a) “The United States admits that, on September 16, 2008, Henry Paulson told President George W. Bush, in substance, that Mr. Paulson believed that, if AIG were to fail, several other financial institutions would likely also fail”. (Def. Resp. to Pl. 2nd RFAs No. 228).

(b) Bernanke: “An AIG bankruptcy would have severe adverse effects on AIG’s counterparties, including many of the world’s largest bank and financial institutions”. (Bernanke: Trial Tr. 1969:22 – 1970:1).

⁴ Defendant’s contention in this litigation that it would have refused to provide assistance to AIG and forced AIG to file for bankruptcy if the AIG Board had not accepted the terms of Defendant’s proposed loan is contradicted by virtually every contemporaneous statement government officials made regarding the loan to AIG. Moreover, a refusal to provide assistance to AIG would also be contrary to the mission and purpose of the Federal Reserve, which is to prevent and mitigate the very systemic risk Defendant states that AIG posed. Geithner: Trial Tr. 1703:5-8 (“The Fed’s role is to take actions within its authority to try to mitigate the effects of a financial crisis on the broader economy.”); Bernanke: PTX 708 at 10 (it is the “mission” of central banks “to maintain financial stability” and “prevent or mitigate financial crises”); PTX 553 at 48 (one of the four duties of the Fed is “containing systemic risks that may arise in the financial markets”).

(c) Dahlgren: “An AIG bankruptcy would have had damaging impact on U.S. counterparties.” (Dahlgren: Trial Tr. 2980:9-15). Some “of the most significant U.S. counterparties that would have been damaged by an AIG bankruptcy filing” were Goldman Sachs, JPMorgan, Citi, and Morgan Stanley. (Dahlgren: Trial Tr. 2980:16 – 2981:19).

(d) On September 16, 2008, FRBNY conducted an “impact analysis” detailing the exposures of banks to AIG. Goldman and Deutsche Bank were identified as the banks with the most exposure. (JX 73 at 1, 2). FRBNY estimated that Goldman Sachs had between \$7.54 billion and \$14.4 billion economic exposure to AIG – the second largest among selected financial institutions. (JX 60 at 3-4).

(e) COP Report: “Goldman Sachs was one of AIG’s largest counterparties until November 2008, when the government took steps to close out the exposure that Goldman and other large financial institutions had to AIG.” (PTX 589 at 76).

9.4 Before Offering a 13(3) Loan the Federal Reserve Had Analyzed and Considered the Requirements for Such a Loan and AIG’s Need for It.

9.4.1 Defendant had monitored AIG starting in 2007 and continuing into early September 2008.

(a) “The United States admits that on October 24, 2007, in response to a request from FRBNY President Timothy Geithner for reports from a private research firm concerning a financial institution other than AIG, FRBNY President Timothy Geithner received a report which also contained analysis and estimates of AIG losses in residential mortgage-backed securities, CDOs, and CDSs.” (Def. Resp. to Pl. 2nd RFAs No. 114).

(b) September 2011 GAO Report: On October 25, 2007, “Federal Reserve Bank of New York (FRBNY) staffer sends market update to FRBNY President and other FRBNY officials,

citing decline in AIG stock price on rumors of multi-billion dollar write-down stemming from subprime mortgage-related assets.” (PTX 641 at 19; *see also* Geithner: Trial Tr. 1409:1-11)).

(c) Geithner “looked several times during the day at a list of indicators” “that tried to capture the perceived default risk in a range of financial institutions”. (Geithner: Trial Tr. 1405:4-15). AIG was added to the list “sometime in ‘08”. (Geithner: Trial Tr. 1406:17 – 1407:2).

(d) On May 21, 2008, Alex Cohen wrote to Geithner: “Just to follow up on AIG, their CDS is 13bps wider on the day to a level of 133 basis points.” (PTX 2717 at 1; *see also* Geithner: Trial Tr. 1407:21 – 1408:9 (Geithner explaining that the CDS spread is an indication of the market’s perception of AIG’s default risk)).

(e) On May 29, 2008, Kevin Coffey sent Geithner and other Federal Reserve personnel an email the subject of which was “Update on Financial Guarantor Negotiations; AIG CDS-related margin call impact.” (PTX 17 at 1). This would “have been one of a series of such reports that” Geithner would have received around this time. (Geithner: Trial Tr. 1410:11 – 1411:6).

(f) “On July 8, 2008, President of FRBNY Timothy Geithner initiated a meeting with Mr. Willumstad.” (Agreed to Stipulation ¶ 62).

9.5 In the Summer of 2008, Defendant Recognized That AIG Was Facing Serious Liquidity Issues.

(a) On the morning of August 7, 2008, FRBNY examiner Kevin Coffey emailed McConnell: “AIG’s liquidity position has been an issue”. (PTX 24 at 1).

(b) On the evening of August 7, 2008, Coffey wrote to McConnell: “sounds like AIG needs to do an additional, large capital raise.” (PTX 27 at 2; *see also* PTX 26 (McConnell forwarding Coffey email in PTX 27 to Geithner)).

(c) McConnell periodically received materials on AIG from Kevin Coffey in August of 2008. (McConnell: Trial Tr. 2507:14-19; *see, e.g.*, PTX 1449).

(d) During an August 7, 2008 meeting, the FRBNY Markets Group discussed AIG, including the fact that “AIG posted a steeper-than-expected quarterly loss of \$5.36 billion due to massive write-downs related to the credit collapse.” (PTX 25; *see also* Dahlgren: Trial Tr. 2635:21 – 2636:5 (Dahlgren likely received “other similar types of updates with respect to AIG in August and early September of 2008”)).

(e) On August 8, 2008, FRBNY began checking which major banks had exposure to AIG. (PTX 27 at 1). FRBNY was checking for “‘top-10’ exposure status at the banks” to AIGFP and considering expanding the analysis “to a full exposure analysis” if it could be done “reasonably quietly.” (PTX 27 at 1).

(f) On August 11, 2008, FRBNY staff met with the OTS’s AIG team “to open a dialogue with them about AIG and its operations”. (PTX 44 at 1; *see also* PTX 715 at 1; Agreed to Stipulations ¶ 64 (“On August 11, 2008, FRBNY staff members met with the Office of Thrift Supervision to discuss AIG.”)).

(g) On August 14, 2008, Coffey sent McConnell and other senior FRBNY executives “a short note summarizing some of the key drivers of potential earnings, capital and liquidity issues at AIG and various subsidiaries.” (PTX 34 at 2).

(h) On August 14, 2008, FRBNY analyst Kevin Coffey sent a note to various FRBNY officials, which was forwarded to Geithner on September 4 and 6, 2008, concluding that “Despite raising \$20 billion of capital in May 2008, AIG is under increasing capital and liquidity pressure. The firm appears to need to raise substantial longer term funds to address the impact of

deteriorating asset values on its capital and available liquidity as well as to address certain asset/liability funding mismatches.” (PTX 37 at 2).

(i) On August 14, 2008, Brian Peters wrote to FRBNY executives: “Anyone taking bets on AIG?” (PTX 29 at 1). That same day, Peters wrote to Sarah Dahlgren: “Oh, and did I mention neither AIG nor Citi can raise sufficient term money at decent rates?” (PTX 29 at 1).

(j) On August 19, 2008, FRBNY included AIG on a list of institutions posing “systemic risk”. (PTX 30 at 2-3).

(k) Defendant admits that Paulson asked Treasury contractor Ken Wilson “in August or September 2008 to gather information about AIG,” and that “Mr. Wilson reported back to Mr. Paulson.” (Def. Resp. to Pl. 2nd RFAs No. 125).

(l) On September 4, 2008, in preparation for a September 5, 2008 meeting of the Committee on Regulatory Reform, McConnell forwarded Coffey’s August 14, 2008 summary of potential liquidity and capital issues at AIG: “I think it gives you some useful background detail on how the liquidity situation for an institution like this could erode.” (PTX 37 at 1).

(m) On September 6, 2008, Geithner emailed senior FRBNY executives: “cld you put someone on AIG”. (PTX 38 at 2; *see also* Geithner: Trial Tr. 1417:23 – 1418:4 (Geithner believes his request was complied with)).

(n) On September 6, 2008, in response to Geithner’s email, McConnell again forwarded Coffey’s August 2008 memo to Geithner with the note: “It distresses me to think that you may not read everything I send you, but attached below is a relatively recent write-up by Coffey on AIG.” (PTX 37 at 1).

(o) Geithner: Prior to September 12, 2008, “the Federal Reserve was aware of general concerns regarding the financial health of AIG through ongoing interaction with market

participants and banking organizations that it supervised, as well as press reports and other public materials.” (PTX 563 at 12).

(p) Geithner: “The Federal Reserve was first notified of the extent of the impending liquidity crisis at AIG on Friday, September 12, 2008, by officials of AIG. On that date, AIG officials met with senior officials at the Federal Reserve Bank of New York and the Board to discuss the company’s liquidity position.” (PTX 563 at 12).

(q) “On the evening of September 12, 2008, FRBNY sent a team to AIG to attempt to evaluate AIG’s liquidity needs and financial situation.” (Agreed to Stipulations ¶ 77).

(r) “On September 13, 2008, AIG CEO Robert Willumstad informed Treasury Secretary Henry Paulson that AIG was facing a liquidity crisis and would run out of money within a week.” (Def. Resp. to Pl. 2nd RFAs No. 180).

(s) “Over the weekend of September 13-14, 2008, FRBNY President Geithner requested data on the direct exposure of domestic and international banks to AIG in the event of a default by AIG as part of his assessment of the potential systemic effects of an AIG failure.” (Agreed to Stipulations ¶ 83).⁵

9.6 In the Afternoon of September 16, 2008, With the Support of the Treasury Department, the Federal Reserve Concluded That It Was in the National Interest to Provide an \$85 Billion 13(3) Credit to AIG, and AIG Was Offered Such a Credit Later That Day.

⁵ Although Geithner has repeatedly claimed that prior to Lehman Weekend, the Federal Reserve did not have access to AIG’s confidential company data (*see* PTX 563 at 12; Geithner: Trial Tr. 1728:1-23, 1719:17 – 1720:4), beginning on August 11, 2008, FRBNY staff met with the OTS staff, AIG’s lead regulator, “to open dialogue” about AIG and discuss issues facing the company. PTX 715 at 1; PTX 24 at 1-2. The OTS did have access to AIG’s confidential, non-public data and documents, and it shared some of that information with Defendant. *See* PTX 44 at 1-2 (internal FRBNY email from Kevin Coffey summarizing FRBNY meeting with OTS, including specific information on AIG’s capital raising strategies and liquidity management, on AIGFP-specific issues, and noting that the “OTS team was very open, sharing their views on AIG’s operations, OTS’s oversight program, etc.”).

(a) “Given the unusual and exigent circumstances, the Board authorized the Federal Reserve Bank of New York under section 13(3) of the Federal Reserve Act to extend credit to AIG or any of its subsidiaries, in an amount up to \$85 billion”. (JX 63 at 2).

10.0

DEFENDANT’S REGULATORY FAILINGS AND RELATED POLICIES SUBSTANTIALLY CONTRIBUTED TO THE 2008 FINANCIAL CRISIS.

10.1 The Financial Crisis Was “Linked to Regulation”. (Bernanke: Trial Tr. 2181:13-15).

(a) Bernanke: The origin of the financial crisis was “linked to regulation.” (Bernanke: Trial Tr. 2181:13-15). “There were large gaps in the regulatory oversight.” (Bernanke: Trial Tr. 2181:15-17). “There were also obviously mistakes made by regulators in terms of enforcing sufficiently tough standards of risk management on some firms, and so yes, there were regulatory failures and regulatory problems in terms of the structure of the financial regulatory system.” (Bernanke: Trial Tr. 2181:18-23).

(b) Paulson: Leading up to the Financial Crisis, “the regulators really didn’t do their job”. (Paulson: Trial Tr. 1199:21-23).

(c) Paulson (FCIC Testimony): “many mistakes were made by all market participants, including financial institutions, investors, regulators and the rating agencies, as well as by policy makers.” (PTX 583 at 6).

(d) Geithner: “you can lay responsibility for regulatory failure on various arms of the government”. (Geithner: Trial Tr. 1713:15-24).

(e) Bernanke: “there were mistakes made all around, including other regulators, the private sector, Congress, and so on, in the area where we had responsibility in the bank holding

companies, we should have done more. We should have required more capital, more liquidity. We should have required tougher risk management controls.” (PTX 553 at 32-33).

10.2 Defendant Kept Interest Rates Artificially Low in the Years Leading up to the Financial Crisis, Which Created a Housing Bubble That Began to Burst in 2007.

(a) Paulson: Prior to the financial crisis, “interest rates had been held at artificially low levels, which resulted in the overstimulation of the housing market”. (Paulson: Trial Tr. 1198:23 – 1199:12).

(b) Paulson: “The over-stimulation of the housing market caused by government policy was exacerbated by other problems of that market. Subprime mortgages went from accounting for five percent of total mortgages in 1994 to twenty percent by 2006.” (PTX 583 at 8).

10.3 Defendant Failed to Regulate the Subprime Mortgage Market.

(a) When asked by the FCIC whether the Fed’s failure to regulate the subprime mortgage market during the housing boom was “a very significant failure” on the part of the Federal Reserve, Bernanke responded: “It was, indeed. I think it was the most severe failure of the Fed in this particular episode.” (PTX 599 at 27).

(b) Bernanke: “The Fed had authority to provide some protections to mortgage borrowers that, if used effectively, would have reduced at least some of the bad lending that occurred during the latter part of the housing bubble. But for a variety of reasons that was not done to the extent it should have been.” (PTX 708 at 57-58).

(c) Saunders: “The roots” of the financial crisis are traceable to when “interest rates were lowered after 9-11 and then there was a buildup of subprime mortgages”. (Saunders: Trial Tr. 8379:14-25).

10.4 Defendant Failed to Regulate the Banks for Which It Was Responsible.

10.4.1 FRBNY, under Geithner's leadership, was responsible for monitoring and regulating the exposure of Citi and other banks to the housing market, yet it failed to understand that exposure, or ensure banks had adequate capital.

(a) Geithner: "There was plenty of blame to go around, some of it mine." (PTX 709 at 268).

(b) Geithner: "As Citi's supervisors and regulators, the New York Fed, the OCC, and the SEC had missed what Citi's leadership, creditors, and shareholders also missed: Its dramatic exposure to an increase in mortgage defaults and even more dramatic declines in the price of mortgage securities." (PTX 709 at 153; *see also* Geithner: Trial Tr. 1454:4-21).

(c) Geithner: "we vastly underestimated the riskiness of its AAA-rated mortgage assets." (PTX 709 at 151-52).

(d) Geithner: "Bob Rubin's presence at Citi surely tempered my skepticism as well. Even though he had no management responsibility or authority, he sat on the board, and he probably gave Citi an undeserved aura of competence in my mind." (PTX 709 at 151).

10.4.2 Long after AIG had stopped offering CDS protection for mortgage-backed CDOs, Citi and other firms regulated by the Defendant continued, and even increased, their marketing of such CDOs.

(a) Goldman Sachs: Goldman Sachs' "CDO issuance going from 2005 to 2006 doubled" (Cragg: Trial Tr. 4987:1-8; PTX 5314 (Cragg demonstrative)), from \$12.6 billion in 2005 to \$25.4 billion in 2006 (Cragg: Trial Tr. 4987:9-14; PTX 5314 (Cragg demonstrative)). Goldman Sachs' "total issuance was almost \$50 billion" by 2007. (Cragg: Trial Tr. 4987:15-21; PTX 5315 (Cragg demonstrative)).

(b) Merrill Lynch: In 2005, Merrill Lynch “issued \$14 billion worth of these types of CDOs and then in 2006 its issuances almost tripled”. (Cragg: Trial Tr. 4987:22 – 4988:1; PTX 5316 (Cragg demonstrative)). “Merrill Lynch issued \$40.9 billion worth of CDOs in 2006”. (Cragg: Trial Tr. 4988:2-4; PTX 5316 (Cragg demonstrative)). Merrill Lynch’s “cumulative CDO issuance increased going from 2006 to 2007 so that in 2007 its combined issuance was \$83 billion.” (Cragg: Trial Tr. 4988:5-13; PTX 5317 (Cragg demonstrative)).

(c) Citigroup: In 2005, Citigroup “issued \$11.1 billion worth of these types of CDOs, and then in 2006 its issuance more than doubled to \$26.3 billion.” (Cragg: Trial Tr. 4988:19-24; PTX 5318 (Cragg demonstrative)). In 2007, Citi issued \$28.3 billion of these types of CDOs (PTX 2856 at 191, App’x 5, Table 16 (Cragg Expert Report); Cragg: Trial Tr. 4988:25 – 4989:8; PTX 5319 (Cragg demonstrative)), for a cumulative CDO issuance through 2007 of \$65.7 billion. (Cragg: Trial Tr. 4989:9-20; PTX 5320 (Cragg demonstrative)).

10.5 Defendant Failed to Regulate the Conduct of Ratings Agencies Until Long After the Financial Crisis Had Passed.

(a) FCIC Report: “The Commission concludes that the credit rating agencies abysmally failed in their central mission to provide quality ratings on securities for the benefit of investors. They did not heed many warning signs indicating significant problems in the housing and mortgage sector. Moody’s, the Commission’s case study in this area, continued issuing ratings on mortgage-related securities, using its outdated analytical models, rather than making the necessary adjustments. The business model under which firms issuing securities paid for their ratings seriously undermined the quality and integrity of those ratings; the rating agencies placed market share and profit considerations above the quality and integrity of their ratings.” (PTX 624 at 240).

11.0

DEFENDANT TOOK A NUMBER OF ACTIONS AND MADE A NUMBER OF STATEMENTS THAT DIRECTLY DISADVANTAGED AIG COMPARED TO OTHER FINANCIAL INSTITUTIONS AND CONTRIBUTED TO AIG HAVING NO REASONABLE CHOICE OTHER THAN TO ACCEPT A LOAN FROM DEFENDANT.

11.1 Although Defendant Recognized That AIG Would Benefit from Financial Assistance of the Type Offered Other Financial Institutions (*see supra* § 4.4), Defendant Rebuffed AIG's Repeated Requests for the Types of Assistance Offered to Others.

11.1.1 Beginning in the summer of 2008, AIG recognized that it would benefit from financial assistance of the type offered to other financial institutions and began seeking such assistance.

(a) On July 29, 2008, "Willumstad meets with Geithner, asks if government assistance would be available in crisis; discusses possible AIG access to discount window." (PTX 620 at 2; *accord* Agreed to Stipulations ¶ 63; Def. Resp. to Pl. 1st RFAs No. 1.2).

(i) Willumstad "wanted to discuss with him, if AIG were ever to be in a liquidity crisis, that—I wanted to know if we would have the availability of going to the Fed window and borrowing." (Willumstad: Trial Tr. 6343:7-12).

(ii) "I told him I had been doing some planning and doing some stress testing of AIG's portfolios, and one of the conclusions I came to is if there were a liquidity crisis, particularly in the securities lending program, that that would require a lot of liquidity in a short period of time, potentially, and I thought that the New York Fed would be able to provide some support in that area." (Willumstad: Trial Tr. 6343:13-24).

(iii) "I had asked him that since the Fed had previously allowed nonbanks to have access to the discount window, whether AIG could be one of those institutions that could have access to the discount window." (Willumstad: Trial Tr. 6345:2-12; *accord*

PTX 587 at 96 – “since the Fed had made the Fed window available to – after Bear Stearns to Lehman and Goldman Sachs and Morgan Stanley, institutions that they traditionally had not regulated, would it be possible, if need be, could the Fed make its Fed window available in a time of crisis to AIG”).

(b) Talking Points for Willumstad’s September 2, 2008 Meeting with Geithner to Request Access to the PDCF:

(i) “The very availability of access to additional liquidity as a primary dealer under various Federal Reserve programs is likely to help prevent liquidity pressures from arising”. (JX 42 at 2; *see also* Willumstad: Trial Tr. 6503:4-17 (Willumstad agreed “with that as of September of 2008”)).

(ii) “Even if the Fed’s current programs are revised or terminated next year, we would expect that AIG’s status as a primary dealer should help in maintaining market confidence”. (JX 42 at 2; *see also* Willumstad: Trial Tr. 6504:12-19 (Willumstad agreed with that statement); Willumstad: Trial Tr. 6504:20 – 6505:1 (maintaining market confidence was important because “the rating agencies, the market in general, the availability to raise capital was based on market confidence that AIG would eventually be able to repay any liquidity requirements”)).

(c) September 2, 2008 AIG presentation, “Talking Points to the Fed”: “1. Becoming a **primary dealer** will boost our reputation, support & expand our current business in US government and Federal agency securities, and offer liquidity benefits.” (DX 1919 at 1 (emphasis in original)).

11.1.2 Defendant refused AIG’s initial requests for discount window access or other assistance.

(a) Geithner told Willumstad that he would not allow AIG to access the discount window. (PTX 587 at 96; *accord* Geithner: Trial Tr. 1721:24 – 1722:5).

11.1.3 Defendant again refused to act on AIG’s September 9, 2008 request for access to the PDCF.

(a) Geithner’s Written Response to GAO Questions: On September 9, 2008, Willumstad met with Geithner “to inquire about discount window access by means of becoming a primary dealer.” (PTX 715 at 1; *accord* PTX 641 at 19; *see also* Geithner: Trial Tr. 1418:22 – 1420:14).

(i) Willumstad spoke with “much more urgency in his voice” and “emphasized that major Wall Street institutions had hedged their risks through credit default swaps and other insurance contracts with AIG.” (PTX 709 at 192).

(ii) Following this meeting, at Geithner’s request, FRBNY staff “intensified their focus on the deteriorating financial conditions of AIG and what that might mean for the financial system.” (Geithner: Trial Tr. 1725:15 – 1726:5).

(b) Willumstad told Geithner that “the purpose of my meeting was to seek approval to become a primary dealer.” (Willumstad: Trial Tr. 6370:3-12). In support of that request, Willumstad told Geithner “that AIG was already a significant player in the U.S. rates market” and that “AIG had counterparties across its business lines that included virtually every major financial institution in the world.” (Willumstad: Trial Tr. 6506:3-11; *see also* DX 228 at -775 (talking points left with Geithner stating that AIG was already “a significant player in the U.S. rates market” and had “counterparties across its business lines that included virtually every major financial institution in the world”)). The talking points Willumstad left with Geithner also

explained that AIG's assets were "Larger than several existing primary dealers". (DX 228 at - 776; *see also* Willumstad: Trial Tr. 6371:10-13).

(c) At the end of the meeting, Geithner said "he would get back to me" (Willumstad: Trial Tr. 6370:13-20), but Geithner never did. (Willumstad: Trial Tr. 6506:12-16; *see also* PTX 641 at 19 (September 2011 GAO Report: "FRBNY President says he will get back to him, but no follow-up, according to AIG CEO"))).⁶

11.2 Access to the PDCF Would Have Mitigated AIG's Liquidity Needs.

11.2.1 As Defendant's expert Anthony Saunders conceded, each of the insurance subs had enough PDCF-eligible collateral that, if they had access to the PDCF window, that would have solved their own liquidity needs, saving the parent company from having to downstream funds, an amount that before September was \$12 billion and would have grown thereafter. (Saunders: Trial Tr. 8333:4 – 8337:2).

(a) Saunders: "Q. You knew that each of these AIG insurance subsidiaries had PDCF-eligible collateral, correct? A. Correct. Q. And you knew they had enough of that collateral that if they had been able to exchange it for liquidity, that would have solved their securities lending problem, correct? A. Each single one? Q. Yes. A. Individually? Q. Yes. A. Yes." (Saunders: Trial Tr. 8336:16 – 8337:2).

⁶ Defendant has argued that AIG did not file a formal application to become a primary dealer. But that was because Geithner had not gotten back to Willumstad and Willumstad believed that if it became known that AIG "had applied to become a primary dealer but had been turned down that that would have a negative market reaction." Willumstad: Trial Tr. 6505:2-14; *see also* JX 42 at 2 (AIG did "not want to file an application that would not be approved and we would not want to proceed much further with the process if there would not be receptivity at the Fed"). Defendant may also argue that Sullivan & Cromwell "advised AIG that it would take about two months to become a primary dealer." Willumstad: Trial Tr. 6361:9-12. However, Defendant responded overnight to Bear Stearns' need for assistance and put the original PDCF facility in place over a matter of days. There was no reason a credit facility with PDCF terms could not have been made available to AIG quickly. Moreover, Defendant could have granted AIG access to the PDCF itself even before it became a primary dealer. *See infra* § 11.3.

11.2.2 AIG's parent and insurance companies could have obtained over \$70 billion in liquidity if Defendant had granted them access to the PDCF.

(a) If Defendant had allowed the AIG parent company to access the PDCF, the parent company could have obtained \$12.6 billion in liquidity. (Cragg: Trial Tr. 5073:7-13; PTX 5355 (Cragg demonstrative)).

(b) If Defendant had allowed AIG's domestic life insurance companies that participated in the securities lending program to access the PDCF, they could have obtained \$58.5 billion above the amount needed to cover the demands of the securities lending program. (Cragg: Trial Tr. 5073:7 – 5074:6; PTX 5354; PTX 5355).

11.3 Although Defendant Claims That AIG Could Not Have Accessed the PDCF Because Defendant Had Refused to Permit AIG to Become a Primary Dealer, Defendant Had the Ability to, and Did in Fact, Grant Non-Primary Dealers Access to the PDCF.

(a) On September 21, 2008, Defendant granted certain non-primary dealers emergency access to the PDCF, including the foreign subsidiaries of Morgan Stanley, Goldman Sachs, and Merrill Lynch. (PTX 198).

(b) Non-primary dealers made considerable use of PDCF-like funding. For example, on September 30, Morgan Stanley-London borrowed \$25.5 billion, Goldman Sachs-London borrowed \$6.5 billion, and Merrill Lynch-London borrowed \$6.7 billion. (PTX 728 at 11).

(c) Cragg: “the rules were changed on the PDCF” by the Federal Reserve “instantaneously” to allow Morgan Stanley, Goldman Sachs and Merrill Lynch “to also access the PDCF from their foreign affiliates.” (Cragg: Trial Tr. 8713:16 – 8714:2).

(d) Cragg: From an economic standpoint, there was no “reason for the Federal Reserve not to have given financial institutions other than primary dealers access either to the PDCF or a facility that had the same qualities” and “various economists at the Federal Reserve Bank of New York had already noted that.” (Cragg: Trial Tr. 5493:15-22).

11.4 Moreover, “The Decision to Limit the Primary Dealer Credit Facility to Primary Dealers Had Been a Decision that the Federal Reserve Board of Governors Had Made in Its Discretion” (Bernanke: Trial Tr. 2261:5-9) and It “Was a Decision that Could Be Changed in Its Discretion.” (Bernanke: Trial Tr. 2261:10-12).

(a) “When the Federal Reserve set up credit facilities for primary dealers, the Federal Reserve could have set up similar or the same credit facilities for other individuals, partnerships, or corporations”. (Geithner: Trial Tr. 1888:19-25).

11.4.1 Indeed, over the course of the Financial Crisis, the criteria and requirements for the PDCF changed a number of times.

(a) The PDCF originally had a requirement that it would take structured asset-backed securities as collateral only if the securities had publicly available prices. (Mosser: Trial Tr. 2048:9-18; *see also* Mosser: Trial Tr. 2047:14 – 2048:8 (“there was a restriction on that particular class of collateral, because of the severe illiquidity in the markets, that in order for the collateral to be acceptable, that there had to be a third-party price or price available for the particular security that was being pledged”)). Effective September 14, 2008, the scope of eligible collateral was expanded beyond investment grade securities (PTX 696 at 2-3; McLaughlin: Trial Tr. 2441:22 – 2442:5), and, during the week of September 16, 2008, the requirement of a third-party price was removed. (Mosser: Trial Tr. 2050:2-17).

11.5 Defendant Refused AIG’s September 12 and 13, 2008 Renewed Requests for Access to the Discount Window, the PDCF, or a 13(3) Loan.

11.5.1 On September 12, 2008, AIG “explicitly asked” FRBNY “how to obtain an IPC 13-3 loan.” (PTX 42 at 2, 4).

(a) On September 12, 2008, Mosser was told that AIG wanted to discuss plans to become a primary dealer. (Mosser: Trial Tr. 1317:19 – 1318:5). Later that day, Mosser reported to Geithner that AIG asked FRBNY about “about how to obtain an IPC 13-3 loan”, noting that the company was “very willing to open their books to us, and give us a better sense of their risk

profile, the complexity of their book and detailed liquidity profile as soon as possible (ie this weekend.)”. (PTX 42 at 2, 4; *see also* PTX 709 at 197 (Geithner received Mosser’s email)).

(b) September 2011 GAO Report: On September 12, 2008 Willumstad spoke with Geithner “again about the company’s liquidity problems, saying that although the company was pursuing private financing, any solution would require assistance from the Federal Reserve System.” (PTX 641 at 27; *see also* Alvarez: Trial Tr. 403:19-25 (“I believe it to be true because it’s in the GAO report.”); Geithner: Trial Tr. 1726:6-15 (confirming the September 12th discussion with Willumstad)).

(c) On September 12, 2008, “Federal Reserve System officials and AIG executives held a meeting, during which the company provided details about its liquidity problems and actions it was considering to address them. . . . One option discussed at that meeting was whether AIG could borrow from the discount window through its thrift subsidiary.” (PTX 641 at 27; *see also* Alvarez: Trial Tr. 405:1-24 (Alvarez testified “with the best memory and recollection and honesty and completeness” that he could when he agreed as the Defendant’s 30(b)(6) representative that that statement was accurate)).

(i) “In September 2008, AIG owned a small thrift that was a depository institution with access to the Federal Reserve’s discount window. AIG’s thrift had about \$2 billion in assets.” (Agreed to Stipulations ¶ 160).⁷

(d) Early in the morning on September 13, 2008, Brian Madigan advised Bernanke: “Staff participated in a call yesterday evening in which AIG further briefed us on the firm’s situation. The firm is requesting a loan from the Federal Reserve. We are in the office this

⁷ Defendant may argue that AIG’s thrift only had \$2 billion in assets so that its borrowing from the discount window would have been limited. However, just as Goldman Sachs transferred tens of billions of assets to its bank immediately after becoming a bank holding company, AIG could have done the same. *See* PTX 202 at 2.

morning analyzing the situation. We will brief you soon.” (PTX 45 at 1; *see also* Bernanke: Trial Tr. 2018:24 – 2019:17 (confirming Bernanke learned early in the morning on September 13, 2008 that AIG was seeking a 13(3) loan)).

11.5.2 “On September 13, 2008, Mr. Willumstad met with President of FRBNY Geithner and Secretary of Treasury Henry Paulson”, and “AIG executives asked Federal Reserve officials about obtaining an emergency loan”. (Agreed to Stipulations ¶¶ 79, 81; Def. Resp. to Pl. 1st RFAs No. 4.2).

(a) September 2011 GAO Report: “Leading up to the weekend of September 13-14, 2008, AIG made renewed attempts to obtain discount window access while also initiating efforts to identify a private-sector solution.” (PTX 641 at 26; *see also* Alvarez: Trial Tr. 400:2-9 (Alvarez agreed that AIG made those attempts)).

(b) On September 13, 2008, Willumstad and AIG Vice Chairman Jacob Frenkel also telephoned Federal Reserve officials to request Federal Reserve credit. (Alvarez: Trial Tr. 460:6-14; Alvarez: Trial Tr. 470:24 – 471:1).

11.5.3 On September 13, 2008, Kohn told Frenkel, in substance, that the Federal Reserve was not going to provide financial assistance to AIG. (Alvarez: Trial Tr. 410:15-20; *see also* JX 46 at 1).

11.6 Defendant Refused AIG’s Request to Become a Bank Holding Company.

(a) Defendant admits that “an AIG representative discussed with a representative of FRBNY the possibility of AIG becoming a bank holding company.” (Def. Resp. to Pl. 1st RFAs No. 10.0).

11.7 Defendant Refused AIG’s Proposal That It Provide AIG with a Guarantee.

11.7.1 During their September 13, 2008 call with the Federal Reserve (including Fed Vice Chair Kohn), Willumstad and AIG Vice Chair Frenkel told the representatives of the

Federal Reserve that AIG was continuing to try to raise capital from private investors, but AIG “could need bridge financing or a guarantee from the government”. (Willumstad: Trial Tr. 6492:21 – 6493:1). By guarantee Willumstad was “talking about a credit guarantee that would guarantee the backing of asset sales”. (Willumstad: Trial Tr. 6493:2-5).

11.7.2 On September 13, “Mr. Kohn said to Mr. Frenkel, in substance” that “the Federal Reserve was not going to provide financial assistance to AIG.” (Alvarez: Trial Tr. 410:15-20).

11.7.3 During a meeting with FRBNY in the afternoon of September 13, 2008, Willumstad again told FRBNY that AIG “needed bridge financing or a guarantee to get beyond the ratings downgrade and allow” AIG “to sell assets in an orderly fashion”. (Willumstad: Trial Tr. 6493:6-21; *see also* Willumstad: Trial Tr. 6493:22 – 6494:1 (Willumstad “meant a guarantee that would back the sale of assets”)).

11.7.4 During that meeting, “Mr. Paulson and Mr. Geithner were quite clear that there was going to be no support from the government.” (Willumstad: Trial Tr. 6494:22 – 6495:3).

11.8 A Guarantee Would Have Alleviated AIG’s Liquidity Needs.

(a) Cragg: A guarantee of AIG’s CDS contracts from Defendant “would have required counterparties to return billions of dollars to AIG in collateral already posted,” “would have obviated any need for the posting of additional collateral,” and “could have stopped the run.” (PTX 5528; *see also* Cragg: Trial Tr. 5486:15-23 (a guarantee by the Federal Reserve “would have had the impact of reducing the collateral risks associated with the credit default swaps and would have therefore led to a return of collateral from AIG’s counterparties to AIG”)).

(b) Cragg: “the idea of a guarantee is that it will deal with the crisis of confidence which has led to the market not providing liquidity to a solvent institution. A guarantee is designed to create confidence and would have had a direct impact on both the market’s perception of AIG’s liquidity as well as, from a practical perspective, it would have led to the

return of collateral under AIG's CDS contracts, and as well as, in my view, would have stopped the run on the securities lending business.” (Cragg: Trial Tr. 8717:20 – 8718:10; *see also* PTX 5529 (illustrating how AIG's collateral calls could have been reduced through a government guarantee); Cragg Trial Tr. 8719:2-9 (“there would be no reason to have collateral posted on these contracts, and that would lead to a decrease of \$23.7 billion or return of collateral of \$23.7 billion on September 15th and a higher amount of \$34.3 billion on September 22nd”)).⁸

(c) Huebner: “Had the government directly guaranteed the CDOs with a replacement CDS, presumably AIG would have been let off the hook on its CDS.” And “that would have meant that it would have not had to put additional collateral postings because of a decrease in credit quality of the CDOs” and “AIG would have had no further obligations of any kind.” (Huebner: Trial Tr. 6217:15-25).

(d) The Federal Reserve participated in providing guarantees to companies other than AIG. (Cragg: Trial Tr. 5102:4-6). Guarantees were “used in the week of the Lehman failure as a way of stemming the outflow from the money market mutual funds. As well, the FDIC used guarantees as a way of keeping an outflow from the institutions that it oversaw. And then as

⁸ Defendant has suggested that in order to provide a guarantee of AIG's CDS portfolio there would have to be a novation of the CDS agreements. *See, e.g.*, Cragg: Trial Tr. 5373:8-15. However, one does not need a novation to provide a guarantee. Cragg: Trial Tr. 5486:9-11; *see also* Huebner: Trial Tr. 6219:6-18 (admitting that he never read the agreements and he did not believe a novation would have to occur).

well, there were guarantees created for Bank of America and Citibank later that – later in 2008.”
(Cragg: Trial Tr. 5102:4-24).⁹

11.9 Defendant Discouraged Private Parties from Providing Liquidity to AIG by Telling Private Parties That Defendant Would Not Provide Any Assistance to AIG.

11.9.1 Defendant acknowledged that sharing the burden of a loan with the private sector “would have been a desirable thing to do”. (Bernanke: Trial Tr. 2017:8-18).

(a) Bernanke: A partnership between the Federal Reserve and the private sector to rescue AIG “would be better than what we had.” (Bernanke: Trial Tr. 2016:25 – 2017:7).

Specifically, if FRBNY “could have found a private sector group that was prepared to put up half of the money that was required” and “to share *pari passu* in the compensation that AIG was paying,” “that would have been a desirable thing to do”. (Bernanke: Trial Tr. 2017:8-18).

(b) Bernanke: It “would have been a desirable thing to do” because it “would have reduced the perception that this was a bailout, because the private sector would be playing a role and would be taking on some of the risk”. (Bernanke: Trial Tr. 2017:8-24).

⁹ Defendant has argued that a guarantee was not within the scope of the Federal Reserve’s authority. *See, e.g.*, Geithner: Trial Tr. 1820:6-23. However, the contemporaneous documents, including documents that predate AIG’s September 2008 request for a guarantee, demonstrate the contrary: that the Federal Reserve believed that such a guarantee was within their authority and that Defendant considered providing one to AIG. *See* PTX 589 at 142 & n.543 (Congressional Oversight Panel conversations with Alvarez regarding capped guarantees for AIG where “the amount of the guarantee would be ‘capped’ by the value of available or unencumbered assets that could be posted as collateral”); PTX 277 at 11 (discussing option of either FRBNY replacing AIG parent as guarantor of AIG FP’s multi-sector CDO portfolio or guaranteeing FP); Dahlgren: Trial Tr. 2730:1-25 (“I remember there were conversations” with Blackrock and AIG, “and I think that they covered something like a guarantee”); Dahlgren: Trial Tr. 2732:24 – 2733:7 (PTX 277 discusses both “a guarantee of FP” and “a guarantee of the multisector CDO portfolio”); Dahlgren: Trial Tr. 2984:4-12 (“options that were presented to the New York Fed and its financial advisors on September 30, 2008” “included guarantees of different kinds”); Baxter: Trial Tr. 1058:4-7 (“There were lots of alternatives considered. I remember there were people who proposed that the Fed should be the party that takes over the obligations of AIG and becomes the insurer.”); *see also* PTX 3156 at 1 (“FRBNY and DPW had worked up the presentation below on how an guarantee program might work that would protect the intrinsic value of AIG’s investment portfolio.”).

(c) Geithner: “if it’s serious and real and involved a credible commitment of large sums of money that would take risk off our hands, then we would have been made aware of that and would have had every incentive to pursue it.” (Geithner: Trial Tr. 1510:15-18).

(d) Geithner: “in concept, as I said, if there was a credible proposal out there to take some of the risk off our hands, on conditions that wouldn’t undermine what we were trying to achieve, then we were open to that and would have welcomed that.” (Geithner: Trial Tr. 1512:10-14).¹⁰

11.9.2 Bernanke was willing to lend to AIG as early as September 13, 2008.¹¹

(a) On September 13, 2008, Bernanke emailed Geithner, Kohn and Warsh: “I would be willing to consider lending to them against good collateral if we have explicit and public commitments regarding the actions they will take to wean themselves and restore stability.” (DX 286; *see also* Bernanke: Trial Tr. 2021:16-25; PTX 706 at 262 (Paulson: “Tim Geithner called,” on September 16, 2008, “to tell me that he had talked with Ben Bernanke, who was amenable to asking the Fed board to make a bridge loan if the executive branch and I stood behind him”))).

¹⁰ Huebner testified that while he was aware of “several preliminary meetings” with private parties concerning a loan to AIG, “there was never a follow-up meeting where any party presented any credible refinancing or financing proposal that could have in fact taken out the Fed loan.” Huebner: Trial Tr. 6005:6-20. Huebner admitted, however, that he was not aware of all of the approaches from the private sector to the Government to invest in AIG. *See, e.g.*, Huebner: Trial Tr. 6185:19-22 (“Q. Did anyone ever tell you that there had been a proposal to have \$40 billion of the \$85 billion credit facility taken over by a private group? A. I don’t believe so.”).

¹¹ Bernanke’s testimony that he “was holding open the possibility of making a 13(3) loan” but was “certainly not” “making a decision here to lend” on September 13, 2008 (Bernanke: Trial Tr. 2196:21 – 2197:14; *see also* Bernanke: Trial Tr. 2206:4-11) is consistent with the evidence establishing that there was willingness to lend, despite Defendant’s repeated statements that there would be no assistance to AIG. *See, e.g.*, JX 46; DX 318; PTX 706 at 250-251. Moreover, Bernanke’s testimony that his hesitation in lending to AIG was due to uncertainty over the company’s plans and/or ability to repay the loan (Bernanke: Trial Tr. 2202:13-22) ignores the evidence that AIG informed Defendant repeatedly over the weekend of September 13, 2008 that any private sector solution depended upon Defendant’s support. *See supra* § 11.7.1.

(b) Bernanke: “I was holding open the possibility of making a 13(3) loan. And the requirements would be first good collateral to satisfy the law and my own view of how these loans should be made.” (Bernanke: Trial Tr. 2197:6-9).

11.9.3 Geithner began to consider lending to AIG on September 14, 2008.

(a) Email from Mosser to Latorre on September 14, 2008, at 10:32 a.m., re: “Aig meeting with Christine”: “Tim wants a note on pros and cons of lending to them byu early afternoon.” (DX 303).

(i) Latorre: “My understanding was that then-President Geithner wanted to understand what the impact would be, particularly on the financial system, of lending to AIG.” (Latorre: Trial Tr. 2300:7-12).

(b) At 3:48 p.m. on September 14, 2008, Latorre emailed Geithner and others a document outlining a small group of FRBNY staff’s thoughts on the “Pros and Cons on AIG lending”. (DX 307 at -644; *see also* Latorre: Trial Tr. 2300:25 – 2301:6 (regarding the list in DX 307: “we debated and deliberated internally, among the team, what were the most relevant or salient issues that we wanted to bring to the attention of then-President Geithner”); Mosser: Trial Tr. 1344:23 – 1345:7 (the list in DX 307 was the product of a “joint effort of a lot of different individuals”)).

(c) “At 11:30 am on September 15, 2008, Mr. Willumstad, New York State Insurance Department Superintendent Eric Dinallo, FRBNY President Geithner, Treasury contractor Dan Jester, and certain Government officials, as well as representatives of Morgan Stanley, JPMorgan, and Goldman Sachs attended a meeting at FRBNY.” (Agreed to Stipulations ¶ 95).

11.9.4 Nevertheless, Defendant continued to tell private parties and the public, including as late as September 15, that there would be no federal assistance for AIG.

(a) Latorre: At some point over the weekend of September 14, Geithner told Latorre that “we should not do anything to signal to AIG that we would, in fact, consider making a loan, that the New York Fed would consider making a loan.” (Latorre: Trial Tr. 2307:12 – 2308:8).

(b) Lee: “Tim had been very clear that there was no government solution here, so in our discussions, that was the – those were the instructions that we were given.” (Lee: Trial Tr. 7087:5-8).

(c) Willumstad: “I went to the Fed on Saturday and . . . asked for both a bridge loan and/or a guarantee that I could take back to the lenders and the private equity investors that would give them some assurance that AIG would be viable after they put up this capital. I was told that was not going to happen. There would be no government solution for AIG, and we went back to work on Sunday trying to find more capital.” (PTX 587 at 114-15).

(d) On September 15, 2008, Willumstad met at the Fed with representatives of JPMorgan, Goldman Sachs, and the Fed. (Willumstad: Trial Tr. 6391:17 – 6392:5). “Geithner appeared for a short period of time and, again, reiterated that there would be absolutely no government support for AIG and that was going to have to be a bank/financial industry solution.” (Willumstad: Trial Tr. 6392:6-14; *see also* Herzog: Trial Tr. 6964:25 – 6965:11 (Geithner told the JPMorgan and Goldman Sachs representatives, “You need to find a private sector solution to this” and “there will be no public money involved”).

11.9.5 Defendant knew that asserting that there would be no Government assistance would discourage the private sector from providing liquidity to AIG.

(a) Geithner: “I didn’t mind no-bailouts as a negotiating stance, as long as we understood that, ultimately, private money wasn’t going to defuse a global panic on its own.” (PTX 709 at 195).

(b) On September 13, 2008, Willumstad informed Geithner and Paulson that AIG could raise approximately \$30 billion in liquidity, but the raise would require Government assistance. Geithner and Paulson responded that “that was not going to happen.” (PTX 587 at 114-15).

(c) Willumstad: on September 13 it “was made very clear to me and I think the others that were there that the Fed and/or Treasury would have no interest in providing any liquidity, line of credit, loan, backstop to the company.” (Willumstad: Trial Tr. 6382:14-22).

(d) Willumstad: After it was clear Lehman was failing, at a September 14, 2008 meeting at FRBNY, Willumstad told FRBNY representatives that “there was not going to be a private solution without some action by the government.” (Willumstad: Trial Tr. 6495:23 – 6496:2). Geithner responded “that there was going to be no government assistance.” (Willumstad: Trial Tr. 6496:3-5).

(e) In the early afternoon of September 14, Willumstad told FRBNY “that we had determined that we were going to be unable to raise any capital from – from investors. And, again, just extended the request for – for government assistance.” (Willumstad: Trial Tr. 6389:23 – 6390:8). In response, Willumstad received: “A very stern, ‘There’s no interest and there will be no support from the Fed or the Treasury.’” (Willumstad: Trial Tr. 6390:9-12).

11.9.6 The strategy of publicly refusing to support AIG until it was at the brink of bankruptcy was not a strategy that was considered or authorized by the Board of Governors.

(a) Bernanke: There was no “formal motion or action” by the Board to “authorize the Federal Reserve Bank of New York or anyone to tell AIG whether or not the Federal Reserve would or would not make credit available to AIG,” nor was there any “statement by the Board as a board” as to what anyone “should or should not say to AIG about the availability or unavailability of credit from the Federal Reserve”. (Bernanke: Trial Tr. 2023:1-16).

(b) Bernanke did not “recollect talking with” Geithner on the issue of “what, if anything” Geithner “was telling or should tell AIG”. (Bernanke: Trial Tr. 2024:1-5).

11.10 Defendant Did Not Allow AIG Management or AIG’s Largest Shareholder to Participate in the September 15-16, 2008 Discussions Between Defendant, JPMorgan, and Goldman Sachs Concerning AIG.

(a) On September 15 and 16, 2008, “AIG did not participate in” and “was not invited” to the September 15, 2008 meeting between the Government, JPMorgan, and Goldman Sachs, concerning potential financing arrangements for AIG. (PTX 620 at 7).

(b) Willumstad: On the evening of September 14, 2008, FRBNY asked AIG’s bankers and a few lawyers to come to FRBNY for a meeting. (Willumstad: Trial Tr. 6496:6-12). AIG’s business executives “were specifically not invited” to that meeting. (Willumstad: Trial Tr. 6496:13-18). In fact, they “were told not to come.” (Willumstad: Trial Tr. 6496:19-20). Willumstad questioned the decision, but he never received “any rational explanation” for why he and other AIG executives were being excluded from the meeting. (Willumstad: Trial Tr. 6946:21 – 6947:1; *accord* PTX 587 at 116).

(c) Willumstad also had no role in organizing the discussions between AIG, JPMorgan and Goldman Sachs concerning a potential private sector solution for AIG and no role in choosing its leaders other than giving his consent to Geithner’s request. (Willumstad: Trial Tr. 6497:24 – 6498:3).¹²

(d) Defendant intentionally excluded Greenberg and Starr – the largest individual shareholder and former CEO of AIG, who was very familiar with all aspects of the company, and

¹² Willumstad’s clear testimony that he had no role in organizing the discussions on September 15, 2008 or choosing its leaders contradicts Geithner’s assertions that Defendant “together with AIG” initiated the discussions on September 15, 2008 and that Geithner asked Willumstad “who should we ask to lead that.” (Geithner: Trial Tr. 1574:4 – 1575:16; *see also* Geithner: Trial Tr. 1744:17 – 1745:1).

the largest institutional shareholder – from the meetings hosted by FRBNY on September 15 and 16, 2008. (Geithner: Trial Tr. 1642:7-15 (agreeing that “the Federal Reserve Bank of New York declined to offer” Greenberg “a seat at the table”); Smith: Trial Tr. 7727:15 – 7728:2 (Greenberg “offered to – to both Mr. Geithner and Mr. Paulson, he was attempting to get a seat at the table on that so-called Lehman weekend”, but he was unsuccessful in his efforts); PTX 109).

(e) In a September 17, 2008 email to Michael Silva, Geithner’s chief of staff, Charles Duffy (FRBNY) states that Greenberg is on “PBS’s Charlie Rose show” asserting that “he called and spoke to Tim, asking to be afforded a seat at the discussion table, based on his being so familiar with all aspects of the company as a former CEO and being he is one of the largest shareholder in the company.” Silva responded, “Yes, he did call. We declined to offer him a seat at the table. **And he should have said he WAS one of the largest shareholders in the company. The Federal Reserve is now the largest shareholder in the company.**” (PTX 109 (emphasis added)).

(f) Geithner: Geithner was aware that Greenberg, on his own behalf and on behalf of Starr International, “wanted to participate in any discussions that related to what was going to happen to AIG”. (Geithner: Trial Tr. 1545:13-17). But Geithner “declined to have him participate”. (Geithner: Trial Tr. 1545:18-20).

11.11 On September 17, 2008, Four Days Before AIG Approved the Credit Agreement, Defendant Declined a Proposal for Private Sector Participation in the Revolving Credit Facility Without AIG’s Knowledge or Participation.

(a) On September 17, 2008, Geithner instructed his staff to forward an email from Laurence Meyer, a former Federal Reserve Board Governor, which proposed a consortium of private investors who “would be able to participate with the Fed in the \$85 billion AIG loan facility in size and on a pari pasu basis” to “purchase about \$40 billion of the loan that is being provided to AIG” to Dan Jester, a Treasury contractor. (PTX 129 at 2). Geithner concluded that

he “could not judge, based on the email, if it was a credible alternative” but did not recall ever following up with Dr. Meyer to try to determine whether it was. (Geithner: Trial Tr. 1508:17-22, 1509:24 – 1510:22).

11.12 Defendant Directly Discouraged Sovereign Wealth Funds from Providing Liquidity to AIG.

11.12.1 Sovereign wealth funds, including the Government of Singapore Investment Corporation (“GIC”) and the China Investment Corporation (“CIC”) indicated they were prepared to invest in AIG. (Studzinski: Trial Tr. 4490:1-21, 4497:3-16).

(a) As of September 12, 2008, the Chinese had advised Blackstone in sum and substance that the “Government of China has big investment in United States, saw AIG as an important financial institution and would try to be constructive.” (Studzinski: Trial Tr. 5673:20 – 5674:6).

(b) “CIC had an interest in the situation for a number of days, even while the number of real options started to run out, because they obviously found the Asian assets very attractive as investments.” (Studzinski: Trial Tr. 5677:1-16).

(c) On September 15, 2008, Studzinski wrote to Schreiber: “Chinese Government moving fast.” (PTX 63).

(i) “the Chinese Government had had conversations with my colleague, Antony Leung, as a separate matter and indicated a willingness to be supportive in any way, shape or form.” (Studzinski: Trial Tr. 4497:3-16).

(d) Email exchange between Stephen Schwartzman, Chairman and CEO of Blackstone, John Studzinski, and others at Blackstone on September 16, 2008: “I received a call last night at home at 11:15 p.m. from Chairman Lou Jiwei of China Investment Corporation.” “Chairman

Lou said that CIC had a very serious interest in AIG and, in effect, wanted to have a road map in terms of what was going on.” (JX 69 at 1-2).¹³

(e) On September 16, 2008, Taiya Smith, Secretary Paulson’s deputy chief of staff and executive secretary, informed Paulson’s chief of staff Jim Wilkinson and Treasury under secretary for International Affairs David McCormick that CIC was “prepared to make a big investment in AIG, but would need Hank to call Wang Qishan.” (PTX 89 at 1; *see also* PTX 423 at 16).

(f) Defendant admits that “in September 2008, Taiya Smith met with Zhu Guangyao, Assistant Minister of Finance of China, and Zheng Quan, Deputy Director of the Office of International Affairs of the Ministry of Finance of China, and five or six subordinates who were also employees of the Ministry of Finance of China.” (Def. Resp. to Pl. 2nd RFAs No. 494).

(g) Taiya Smith heard from Virginia Kamski, an advisor to American businesses in China, that CIC was interested in investing in AIG and “they were actually willing to put up a little bit more than the total amount of money required for AIG”. (PTX 423 at 16; *see also* Paulson: Trial Tr. 1211:8 – 1212:24 (Paulson had “no reason to doubt” that the Chinese “were actually willing to put up a little bit more than the total amount of money required for AIG”)).

(h) Studzinski: “I obviously had specific conversations with people like Kok Song Ng, the Governor of Singapore in Singapore, because they’re one of the largest sovereign wealth funds in the world, and I knew that they had a long-standing respect for AIG”. (Studzinski: Trial Tr. 5661:23 – 5662:10).

¹³ Offit testified that, in his opinion, sovereign wealth funds would not have invested in AIG on short notice. Offit: Trial Tr. 7383:11 – 7385:15 (discussing JX 74 at 8). However, on cross-examination Offit admitted that he had never seen PTX 253, a September 26, 2008 email from Studzinski to Liddy stating that the “Chinese remain interested in a large investment and writing a large check” and “are talking about writing a check of about \$50 billion.” PTX 253 at 2; Offit: Trial Tr. 7950:22 – 7952:10.

(i) Several different, independent versions of an AIG deal were discussed with potential Chinese investors. First, there was a deal with CIC either in conjunction with J.C. Flowers or through Goldman Sachs or Deutsche Bank (Studzinski: Trial Tr. 4490:1-10; *see also* JX 353 (Goldman Sachs: “We need to have team ready to . . . Go in with Chinese . . . They say they are signing confi with AIG . . . Deutsche will be there at ‘opening’ as CIC’s advisor . . . We are invited as ‘co-investor’”. (ellipses in original))). Second, a standalone CIC investment was discussed on September 16, 2008 (JX 69 at 1-2), potentially large enough “to put up a little bit more than the total amount of money required for AIG.” (PTX 423 at 16). Finally, there were discussions with “China, Inc.” – the Chinese Government – concerning an asset purchase deal to purchase various assets in Asia (including AIA and perhaps real estate) for \$50 billion. (Studzinski: Trial Tr. 4503:10 – 4504:8; PTX 253 at 2). The number of times the Chinese expressed interest – and the diversity of the deals in which they expressed interest – underscores the significance of the opportunity for AIG Defendant squandered.

(j) Over the weekend of September 12-14, 2008, Studzinski spoke with Ng regarding Singapore’s Sovereign Wealth Fund’s interest in investing in AIG. Mr. Ng’s position at that time “was open-minded, not unconstructive”. (Studzinski: Trial Tr. 5667:10-13). Mr. Ng did not express an upper limit that GIC would be interest in committing, and Studzinski discussed an investment “based on 20 billion”. (Studzinski: Trial Tr. 5668:11-16).

(k) On September 14, 2008, Studzinski wrote to Schreiber: “You should know if Buffett comes in GIC will match him dollar for dollar with little due diligence.” (PTX 56; *see also* Studzinski: Trial Tr. 4495:13-20 (Mr. Ng “was very clear that in his judgment they would

certainly be at the same level as Warren Buffett if Warren Buffett was making an investment in ILFC”).¹⁴

11.12.2 CIC was discouraged from investing in AIG prior to September 16, 2008:

(a) Despite knowing that the Chinese “were actually willing to put up a little bit more than the total amount of money required for AIG” (PTX 423 at 16-17), Paulson “never talked with the Chinese that I can recall about AIG” (Paulson: Trial Tr. 1216:11-16) and “never ever said” to his staff “would you talk to them about an AIG investment.” (Paulson: Trial Tr. 1217:13-14).¹⁵

(b) David McCormick told Taiya Smith that he had spoken to Paulson, and that Paulson “did not want the Chinese coming in at this point in time on AIG.” (PTX 423 at 17).

(c) Defendant did not tell AIG of its discussions with CIC.

(i) No one from Treasury or the Fed ever told Willumstad on September 16 “that they had been informed that CIC was prepared to make a big investment in AIG”. (Willumstad: Trial Tr. 6508:17-20).

¹⁴ In Studzinski’s judgment, although AIG might have sold real estate assets to GIC that weekend, GIC would have needed two weeks to perform due diligence. *See* DX 262; Studzinski: Trial Tr. 5671:13 – 5672:10; *see also* JX 74 at 8 (“Mr. Studzinski stated that two large sovereign wealth funds, CIC and GIC, were consulted over the weekend regarding potential equity investments and that both stated that they could not act for at least 5 to 10 business days.”). A bridge loan from the Federal Reserve that extended until the GIC deal was complete could have significantly aided AIG in resolving its liquidity issues in September 2008.

¹⁵ Although Paulson stated that he “was a hundred percent certain that the Chinese weren’t going to come in and do something of the size that would save this company without getting assurances that” he “couldn’t give” (Paulson: Trial Tr. 1217:1-18), he admitted no one ever told him “that China or CIC was looking for any government guarantee or assurances from the United States in order to make an investment.” Paulson: Trial Tr. 1216:11-16. In fact, as noted above, Paulson “never talked with the Chinese” about AIG. Paulson: Trial Tr. 1216:15-16.

(ii) No one from the government ever told Willumstad “that the Chinese had indicated that they were willing to put up a little bit more than the total amount of money required for AIG.” (Willumstad: Trial Tr. 6510:15-19).

(d) Zingales: “on the day of the 16th, the Chinese expressed an interest to then Secretary Paulson, but Paulson said that they couldn’t proceed in this respect and did not even communicate this information to AIG”. (Zingales: Trial Tr. 3816:9-17).

(e) Zingales: “I think that if the Chinese had intervened, was part of the solution to the problem, I think that there was a line of credit, as was seen, that was partly drawn down, that could have been drawn down more. There was the possibility of upstreaming some of the collateral from the assets of the overcapitalized subsidiaries to the parent company. And so as of the 16th, before the market became even worse, et cetera, I think that there could have been an alternate solution with all these pieces together.” (Zingales: Trial Tr. 4000:11-24).

(f) Zingales: “The important point, in my view, is not so much whether CIC had decided to invest that moment. The important point is that the Treasury blocked that possibility, and so that stop indicates two things. One, indicates that the government intervened heavily in the process. And two, this news traveled fast. If the government stopped the Chinese, probably also from Singapore people will not have wanted to invest, so other sovereign wealth funds will be less interested in even trying because of that.” (Zingales: Trial Tr. 4108:4-17).

11.13 On September 16, 2008, Defendant Discouraged the New York State Government from Assisting AIG.

11.13.1 “Around noon on September 15, 2008, New York Governor David Paterson held a press conference at which he announced that he had directed the New York State Insurance Department to authorize AIG to access approximately \$20 billion in liquid assets from certain AIG insurance subsidiaries.” (Agreed to Stipulations ¶ 96).

11.13.2 On or around September 16, 2008, Dinallo proposed “providing liquidity to the AIG parent from assets in the related insurance subsidiaries that were considered excess”. (Geithner: Trial Tr. 1470:15 – 1471:4). Geithner believed the amount Dinallo proposed was “in the range of \$20 billion”. (Geithner: Trial Tr. 1471:5-8).

11.13.3 On September 16, FRBNY conveyed to “Mr. Dinallo that the New York Fed did not want to accept that proposal”. (Geithner: Trial Tr. 1471:16-21). It was “concluded that the Fed would consider making a loan and that the New York State Insurance Department’s efforts weren’t necessary”. (Geithner: Trial Tr. 1768:4-19).¹⁶

12.0

THE SEPTEMBER 16 TERM SHEET DEMANDED WARRANTS EXERCISABLE FOR 79.9% OF AIG’S SHAREHOLDERS’ EQUITY AS A CONDITION OF THE CREDIT FACILITY.

12.1 The Only Meeting of the Board of Governors to Approve the AIG Loan Occurred on September 16, 2008.

(a) Alvarez: On September 16, 2008, “there were two sessions of the board, one when the FOMC broke for lunch, which was somewhere between 12:00 and 12:30, in that area, and I believe that session lasted for something on the order of 40 minutes or so And then they reconvened the FOMC meeting, and then there was another session – brief session of the Board

¹⁶ Defendant might argue that the \$20 billion was not in itself enough to cover the potential needs that AIG identified. Geithner: Trial Tr. 1768:16 – 1769:18. Such an argument misses the point that the upstreaming from New York State could have been part of a package of options that could have been provided to AIG to meet its liquidity needs. *See generally supra* §§ 11.2, 11.6-11.8, 11.12; PTX 5355 (demonstrating how AIG’s parent and insurance companies could have obtained over \$70 billion in liquidity through the Paterson plan and PDCF borrowing). On September 14, 2008, AIG also “got a ‘firm commitment’ from Citi for \$10 billion in repo financing, based on a list of about \$60 billion in unencumbered assets.” PTX 620 at 5; Schreiber: Trial Tr. 6798:19 – 6799:10. AIG also had “overall \$15 billion credit lines divided between the parent company and some subsidiaries”. Zingales: Trial Tr. 8612:4 – 8613:11.

after the FOMC meeting.” (Alvarez: Trial Tr. 509:13 – 510:3; *see also* Agreed to Stipulations ¶¶ 105, 114).

(b) Bernanke: The “September 16th, 2008, Board of Governors meeting was the only meeting of the Board of Governors that was held prior to the time that the credit agreement was actually executed”. (Bernanke: Trial Tr. 1974:22 – 1975:3).

12.2 The Only Term Sheet Approved by the Board of Governors Provided That Defendant’s 79.9% Equity Interest in AIG Would Be Non-Voting Warrants. (JX 63 at 5-10).

12.2.1 The term sheet included in JX 63 “was the only AIG credit facility term sheet that the Federal Reserve Board of Governors ever reviewed”. (Alvarez: Trial Tr. 188:18-21).

(a) Bernanke: The “Board of Governors only saw one term sheet related to the AIG credit facility”. (Bernanke: Trial Tr. 1974:18-21; *see also* Bernanke: Trial Tr. 2025:12-17 (the only term sheet brought to the Board of Governors for approval was JX 63)).

(b) Geithner: The JX 63 term sheet was sent to the Board of Governors “because they were considering whether we should propose to AIG a loan with conditions, and if we were going to do that under Section 13(3), we needed the approval of five governors.” (Geithner: Trial Tr. 1476:6 – 1477:7).

(i) With respect to the conditions set forth in the JX 63 term sheet, Geithner was directly involved in the decision setting the “amount, the interest rate, the equity” and “the term”. (Geithner: Trial Tr. 1477:8-24). He was “deeply involved in the decision to propose an interest rate that was set at 850 basis points above three-month LIBOR”. (Geithner: Trial Tr. 1478:4-13).

(ii) Geithner attended the September 16, 2008 meeting of the Board of Governors by telephone. (Geithner: Trial Tr. 1471:22-25).

12.2.2 The term sheet approved by the Board of Governors states that the form of equity interest will be: “Warrants for the purchase of common stock of AIG representing 79.9% of the common stock of AIG on a fully-diluted basis”. (JX 63 at 6).

(a) The Board of Governors did not discuss or authorize taking AIG equity in any form other than non-voting warrants. (JX 63).¹⁷

(b) Geithner: “As originally contemplated at the time of the Board of Governors meeting on September 16th, the equity consideration that the Federal Reserve was going to receive was in the form of warrants”. (Geithner: Trial Tr. 1491:7-15).

(c) Bernanke: The term sheet considered by the Board of Governors on September 16 “provided that there would be warrants that would be made available in connection with the credit facility”. (Bernanke: Trial Tr. 1975:4-9).

¹⁷ Several government witnesses testified that as of September 16, 2008, the form of equity had yet to be agreed upon and the form of equity was yet to be determined. *See, e.g.*, Geithner: Trial Tr. 1493:13-18; Baxter: Trial Tr. 815:2-12; Alvarez: Trial Tr. 190:1 – 191:1. This testimony is inconsistent with the term sheet attached to the meeting minutes that was unanimously approved by the Board of Governors, which clearly states that the form of equity is “warrants”. JX 63 at 10. As the Federal Reserve’s General Counsel concedes, nowhere do the minutes “use the words ‘to be determined.’” Alvarez: Trial Tr. 205:3-8. Moreover, subsequent to the Board of Governors’ approval that evening, BOG staff understood the authorization to be for warrants. For example, hours after the Federal Reserve Board meeting, a draft press release circulated to several government officials, including Geithner, at 6:44 p.m. on September 16 stated that “The Federal Reserve will receive **warrants** to acquire up to 79.99 percent of the firm’s equity.” DX 416 at -346 to -347 (emphasis added). Geithner responded a few minutes later, “Good.” DX 416 at -346. At some point in the following two hours, Alvarez and the FRBNY public affairs officer Michelle Smith agreed to a request from FRBNY to remove the reference to warrants in the press release. *See* DX 393; Alvarez: Trial Tr. 525:21 – 527:9. At 9:15 p.m., however, staff at the Federal Reserve still believed the Government would receive warrants and briefed the press on the details of the agreement as including warrants. *See, e.g.*, PTX 2736 at 1 (“Fed staffers, who briefed reporters at 9:15 tonight, don’t even want us to say the government will control A.I.G. The government will name new management, and will have veto power over all important decisions. And it will have a warrant allowing it to take 79.9 percent of the stock whenever it wants. But they contend there is no control until the warrant is exercised.”).

12.2.3 The term sheet approved by the Board of Governors required shareholder approval before stock was issued or voting control transferred.

(a) The term sheet approved by the Board of Governors includes a “Summary of Terms of Warrants” which states that “Shareholder Approval” was “Required to issue stock above authorized by unissued shares”. (JX 63 at 10).

(b) Bernanke: “understood that the warrants would not have a vote until they had been exercised”. (Bernanke: Trial Tr. 1975:13-15).

(c) Baxter: The “term sheet that was considered by the Board of Governors provided that there would be shareholder approval of the increase in authorized shares necessary to permit the exercise of the warrants”. (Baxter: Trial Tr. 816:10-15).

12.2.4 The term sheet approved by the Board of Governors required the payment of an exercise price when the warrants it provided for were exercised.

(a) The term sheet provides when “The Warrants may be exercised” and discusses the warrants’ “Exercise Price”. (JX 63 at 10).

(b) Bernanke: “understood that those warrants would have an exercise price”. (Bernanke: Trial Tr. 1975:4-12).

12.3 Both Immediately Before and After the Board of Governors Meetings, Defendant Understood That the Form of Equity Would Be Non-Voting Warrants.

(a) On September 16, 2008 at 12:43 a.m., GC of Treasury Robert Hoyt sent an email to Geithner and Alvarez describing various possible options for the New York Fed to extend credit to AIG (PTX 70 at 2). There “is no reference in this document under any of the alternative options to any form of equity other than warrants” (Alvarez: Trial Tr. 194:22 – 196:17).

(b) As of the morning of September 16, 2008, Defendant’s advisor Morgan Stanley understood that the form of the equity would be warrants, and drafted a press release stating, “As

consideration for providing this facility, AIG will grant to the Federal Reserve warrants to purchase [79.9] percent of the common stock of AIG at an exercise price of [XXXX] per share.” (PTX 76 at 2 (brackets in original); *see also* J. Head: Trial Tr. 3718:4 – 3719:5 (acknowledging that PTX 76 indicates the equity is in the form of warrants)).

(c) On September 16, 2008, McConnell took notes of possible responses to certain questions. (McConnell: Trial Tr. 2559:25 – 2561:7). The following question and response are on the third page of her notes: “Any plans to dispose of the stake? No current plans to sell the warrants.” (PTX 105 at 3).

(d) On September 16, 2008, at 2:05 p.m., Davis Polk circulated a term sheet time-stamped 1:44 p.m. to various FRBNY and Treasury officials. (*See* PTX 86 at 1). The term sheet stated: “In consideration of the Commitment,” referring to the credit commitment, “AIG will issue to [U.S. Treasury] upon entering into the Agreement the Warrants described below.” (PTX 86 at 3 (brackets in original); *see also* Zingales Trial Tr. 4064:12-25 (“the reference to U.S. Treasury is in brackets” while “Warrants” is not)).

(i) The term sheet also stated: “Warrants: Warrants for the purchase of common stock of AIG representing 79.9% of the common stock of AIG on a fully-diluted basis”. (PTX 86 at 4; *see also* Huebner: Trial Tr. 6259:24 – 6260:4 (the 1:44 p.m. term sheet “contemplated warrants”)).

(e) On September 16, 2008 at 2:15 p.m., Baxter sent Alvarez a term sheet providing for “Warrants for the purchase of common stock of AIG representing 79.9% of the common stock of AIG on a fully-diluted basis”. (JX 64-A at 1, 4, 8; *see also* Alvarez: Trial Tr. 262:7-17 (confirming JX 64-A was sent to him at 2:15 p.m., “shortly before the second session of the Board of Governors meeting on September 16”); Baxter: Trial Tr. 695:4-16 (confirming JX 64-A

was sent to Alvarez around 2:15 p.m. on September 16); *accord* Baxter: Trial Tr. 902:11-20).

Like the PTX 86 term sheet, the JX 64-A term sheet has the same brackets around “U.S. Treasury” and no brackets around “Warrants”. (*See* JX 64-A at 3).

(f) Alvarez: The JX 64-A term sheet “attached and referred to in the minutes” “only reference warrants, they do not reference preferred.” (Alvarez: Trial Tr. 264:13 – 265:9).

(g) Email from Jeremiah Norton at the Department of Treasury on September 16, 2008 at 3:21 p.m. circulating a term sheet that, like JX 64-A and PTX 86, provides for “Warrants for the purchase of common stock of AIG representing 79.9% of the common stock of AIG on a fully-diluted basis” (JX 378 at 3). The term sheet further stated: “The warrants may be exercised in whole or in part at any time during the period commencing on the date of issuance and ending on the 10th anniversary” (JX 378 at 7).

(i) JX 378 also includes a blacklined version of the term sheet that shows the changes from earlier drafts. (JX 378 at 8-12; Zingales: Trial Tr. 4068:10 – 4069:23 (“Clearly on the 16th there was some refining of terms during the day, and the fact that other terms had been refined but ‘warrants’ remains there validates the clear expectation of management that this will be warrant.”)).

(h) A September 16, 2008 draft Federal Reserve press release that reflects a “DPW mark-up” as of 3:43 p.m. provided: “As part of the consideration for providing this facility, AIG will grant to the Federal Reserve Bank of New York warrants to purchase [79.9] percent of the common stock of AIG at an exercise price of [\$XXX] per share.” (PTX 3279 at 1-2) (brackets in original).

(i) On September 16, 2008 at 6:50 p.m., several hours after the completion of the Board of Governors meeting, Geithner received a draft Federal Reserve press release stating that “The

Federal Reserve will receive warrants to acquire up to 79.99 percent of the firm's equity.” (DX 416 at -347). Geithner responded, “Good.” (DX 416 at -346). At the time Geithner responded, he “knew that Fed staffers were going to brief the press” (Geithner: Trial Tr. 1487:12 – 1490:1). And he “wanted to be sure that both the press release and what Fed staffers said to the press and the public was accurate” (Geithner: Trial Tr. 1490:2-5).¹⁸

(j) On September 16, 2008, Alvarez asked Rich Ashton and Mark Van Der Weide to prepare a memorandum analyzing the Federal Reserve's authority to take warrants in connection with an extension of credit under 13(3). (Alvarez: Trial Tr. 446:20 – 447:8; *see generally* DX 484). The “memo was written in terms of warrants because the memo was assigned on September 16, and that was at a time when warrants were the – referenced in the term sheet.” (Alvarez: Trial Tr. 448:7 – 451:23).

(k) FRBNY attorney Catherine Kung on September 17, 2008 to Davis Polk attorneys Marshall Huebner and Bradley Smith: “We would like to schedule a call today to discuss the following: . . . Equity Warrants – our business/accounting folks need to understanding exactly what that is and the accounting implications.” (PTX 3252 at 1). FRBNY attorney HaeRan Kim responds: “My understanding is that Treasury will get the warrants, and Wactell is representing Treasury and working on the agreement relating to warrants.” (PTX 3307 at 1).

¹⁸ Geithner claimed at trial that his response of “good” was not necessarily in response to the attached draft press release for which comments were being solicited but rather to Michelle Smith's (Head of Public Affairs for the Board of Governors) statement in the email that if everything falls through, in the alternative they would release a statement saying: “The Federal Reserve stands ready to employ the full range of its liquidity tools to support the orderly functioning of financial markets in the wake of the announcement by American International Group.” DX 416 at -346; *see* Geithner: Trial Tr. 1488:1 – 1489:4. However, the emails to which Geithner was responding asked the recipients to “Please comment asap on the attached draft press release.” DX 416 at -346. Moreover, he made no other comment on the language of the press release which continued to refer to warrants.

(l) A September 17, 2008 “Guidance” distributed to presidents of the Federal Reserve Banks at 4:20 p.m., copying Governors Donald Kohn, Randall Kroszner, Elizabeth Duke, and Kevin Warsh, directed the recipients to be “Be mindful/avoid the following”, including “The U.S. government does not ‘own’ 79 percent of the company – it has warrants, as you know.” (PTX 122 at 1, 3).

(i) Zingales: PTX 122 is significant for two reasons: “One it that, again, here it’s the 17th late in the afternoon and the government thinks that they’re going to issue warrants. The second is that had they not received warrants, they will feel like they own the company, so I think that I can infer that the U.S. government must be thinking that if it had preferred shares or anything else as equity participation, they might own the company.” (Zingales Trial Tr. 4081:15 – 4083:18).¹⁹

(m) On September 17, 2008, at 8:55 p.m., Helen Mucciolo sent an email to Dahlgren and others in response to a query as to whether FRBNY would be “getting the warrants” because “Treasury can’t”, stating, “I thought we couldn’t take them under the FRA”. (PTX 127 at 1-3; *see also* Dahlgren: Trial Tr. 2791:6-20 (“‘them’ refers to warrants” and “‘FRA’ is the Federal Reserve Act”)).

(i) Zingales: The emails in PTX 127 are significant because “they’re all talking about warrants.” There “was a clear understanding that they were issuing warrants, but

¹⁹ Alvarez testified at trial that PTX 122 was not “consistent with” his “understanding of the form of equity as of 4:20 in the afternoon on September 17th, 2008”. Alvarez: Trial Tr. 200:9-22. However, he never sent an email or any other written information correcting the allegedly inaccurate “guidance” referencing warrants sent to “all of the members of the Board of Governors” and “all the presidents of the individual Federal Reserve Banks”. Alvarez: Trial Tr. 200:9 – 201:14. Moreover, Alvarez admits as General Counsel of the Fed, if he knew the top officials were getting inaccurate information and “If I thought it was material” and “important to be corrected” he “would have felt a responsibility to correct it to them”. Alvarez: Trial Tr. 203:5-12.

they started to find problems about who will own the warrants and how.” (Zingales: Trial Tr. 4083:19 – 4084:16).

(n) On September 17, 2008, Federal Reserve officials continued to discuss whether Treasury or FRBNY would own “the warrant that will be issued for 79.9% equity interest in AIG”. (PTX 1583).

(o) On September 17, 2008, FRBNY official HaeRan Kim wrote to Baxter: “You mentioned that Treasury will get warrants. Has this been finally decided? I’m on a call with Davis Polk and our business people, and they seem not to know.” Baxter responded: “Lots of issues. I’m in Tim’s office, but **there are many legal problems with Treasury owning AIG.**” (PTX 116 (emphasis added)).

(p) On September 17, 2008, Alvarez met with Federal Reserve Board accounting personnel and economists to determine how the Federal Reserve would report the AIG transaction on its financial statements. During that conversation, Alvarez talked to them about an equity interest in the form of a warrant. (PTX 130; Alvarez: Trial Tr. 207:14 – 208:1). The accounting notes concerning the conversation with Mr. Alvarez state:

(i) “Under the agreement, the FRBNY receives the right to 80 percent of the equity interest in AIG through an ‘equity participation note’ (warrant). This right can only be exercised when the note is sold.” (PTX 130).

(ii) “At this point, details on the structure of the warrant (equity participation note) is being worked out; however, such warrants are common and can likely be priced using an options pricing model.” (*Id.*).

(iii) “Value of the warrant will appear on the balance sheet as an asset.” (*Id.*).

(q) On September 18, 2008, Huebner participated in a conference call with Baxter, representatives of the Treasury Department and other lawyers from Davis Polk. (*See* PTX 148 at 1; Huebner: Trial Tr. 6227:6-18). During that call, Huebner asked, “Does Fed care who gets benefit of warrant: Fed or Treasury?” (PTX 148 at 1).²⁰

(r) Email between FRBNY personnel on September 18, 2008: “my initial reaction when I heard that interest rate was “huht?!” it seems totally unnecessary given the warrant for 79.9% ownership. I understand LIBOR + (maybe 200?) as an incentive to expedite asset sales but LIBOR +850?!!” (PTX 142 at 2).

(s) On September 19, 2008, BOG counsel forwarded to another Board of Governors employee a copy of the September 16 term sheet noting “This should be close to the one Scott had.” The term sheet provided for “Warrants for the purchase of common stock of AIG representing 79.9% of the common stock of AIG on a fully diluted basis”. (PTX 3367 at 1, 3).

(t) September 19, 2008 FRBNY Memorandum re: “Accounting for the AIG Transaction” discussing accounting treatment for the warrants, noting that the “strike price and duration of the warrants are unknown.” (JX 384 at 2).

(u) On September 21, 2008 Baxter sent an email to Alvarez stating that “We will either go ‘AIG Credit Facility Trust’ or warrants exercisable after sale.” (DX 527 at -762; *see also* Alvarez: Trial Tr. 627:18 – 628:4 (“There’s no mention of preferred stock there”)).

²⁰ Huebner asserted at trial that “from the 16th to the 21st the form of equity was not known. And in general, the clients and the professionals working on the deal I believe tried to be and I certainly tried to be careful not to use the term ‘warrant’ or the term ‘preferred’ or any other specific term because it wasn’t known. There were many communications and e-mails during this period. It’s entirely possible somebody shorthanded it or said it. I don’t know.” Huebner: Trial Tr. 6226:7-22. In this particular case, he is recorded as having used the phrase “warrants”. *See* PTX 148 at 1; Huebner: Trial Tr. 6228:2-13 (“I remember asking this question because this question was important to me in figuring out, structuring it, whether ultimately all funds flowed to the taxpayer, but whether I said ‘who gets the warrant’ I have no idea.”).

(v) On September 21, 2008, Board of Governors staff sent an email to Alvarez with the subject line “Are you aware that AIG ‘Warrants’ are turning into preferred shares?” (PTX 192 at 1; PTX 191 at 1 (same)).

12.4 As of September 16, 2008, AIG Understood That Defendant’s AIG Equity Would Be Non-Voting Warrants.

12.4.1 The evidence from AIG and its auditors is consistent that on September 16 AIG understood that Defendant’s “equity” would be warrants.²¹

(a) Liddy: “it was the clear expectation of AIG’s management as of the 16th that the form of equity would be warrants” (Liddy: Trial Tr. 3142:13-20); as of September 16, 2008, “the clear expectation of AIG management was that there would be warrants with no vote” (Liddy: Trial Tr. 3135:14 – 3136:11).

(b) Offit: At the September 16, 2008 AIG Board meeting, Offit’s “understanding at that time was that the form of equity was going to be warrants”. (Offit: Trial Tr. 7931:5-9).

(c) Farnan: PwC was aware that “AIG’s expectation on September 16 and for some days thereafter was that the equity component would be warrants,” and that, “originally warrants were planned and that was later changed.” “I was aware of their expectations because they told

²¹ At trial Mr. Liddy testified: “I believe the original term sheet, which the board approved on the 16th, had ‘TBD’ when it came to the equity piece.” Liddy: Trial Tr. 3135:18-20. However, Mr. Liddy was not present at that Board meeting, his testimony is contrary to the testimony of those who were present, and his testimony is contrary to the contemporaneous documents (*see, e.g., supra* ¶¶ 12.4.1(b)-(c), *infra* §§ 12.4.2-12.7.1).

us in a memo that originally it was expected to be warrants.” (Farnan: Trial Tr. 4162:19 – 4163:19).²²

12.4.2 Under New York Stock Exchange (“NYSE”) Listed Company Manual Rule 312.03, shareholder approval is required prior to the issuance of warrants exercisable into 20 percent or more of the voting power of a corporation’s common stock unless a company invokes an exception to Rule 312.03 that waives the requirement of a shareholder vote when: “(1) the delay in securing shareholder approval would seriously jeopardize the financial viability of the Corporation’s enterprise and (2) reliance by the Corporation on such exception is expressly approved by the Audit Committee of the Board”. (JX 75 at 2; *see also* JX 240 at 94-96).

12.4.3 On September 16, 2008, the Audit Committee of the AIG Board approved the issuance of warrants without shareholder approval under Rule 312.05 of the NYSE Listed Company Manual. (JX 75 at 3; *see also* Shannon: Trial Tr. 3669:20-22).

²² Defendant may continue to assert that AIG never received the term sheet approved by the Board of Governors that states that the form of equity is warrants (JX 63 at 5-10), but rather received a version of the term sheet that describes the equity participation as “equivalent to 79.9 percent of the common stock of AIG on a fully diluted basis. Form to be determined.” JX 83 at 17; DX 392 at -808; Baxter: Trial Tr. 909:2-16; Huebner: Trial Tr. 5945:16 – 5946:10. Baxter, however, admitted that he had no knowledge of “what exactly was provided to AIG’s board” on September 16, 2008. Baxter: Trial Tr. 984:11-16. Even assuming that AIG did in fact receive a term sheet stating the form of equity was “to be determined”, that would simply mean that there was no agreement between the parties on September 16, 2008 for at least one very important reason: the only version of the term sheet approved by the Board of Governors would not match the version of the term sheet approved by AIG. *See supra* § 12.2. Furthermore, although Defendant offered an exhibit purporting to show that AIG’s outside counsel Rodgin Cohen received a term sheet describing the equity participation as “Form to be determined” prior to AIG’s 9/16 Board Meeting (DX 436 at -001, -003), there is no evidence that Mr. Cohen ever actually saw this term sheet – or that any member of the AIG Board ever saw it. In fact, Zingales relied in part on Mr. Cohen’s prior deposition testimony in reaching his conclusion that AIG understood that the equity would be in the form of non-voting warrants. *See* Zingales: Trial Tr. 3903:22 – 3904:2 (“Rodgin Cohen said that he did not read this before the board meeting.”).

Perhaps most important, any contention by Defendant that AIG never received a term sheet referencing warrants flies in the face of the consistent, contemporaneous documentation that shows AIG was convinced that Defendant’s “equity” would be in the form of warrants.

(a) On September 16, 2008, the Audit Committee voted to waive the NYSE requirement and passed a resolution which states that the AIG Board has agreed “to issue warrants convertible into 79.9 percent of the Corporation’s common stock (the ‘Warrants’).” (JX 75 at 2-3).

(b) Shannon believed that the drafter of the resolution “was probably Sullivan & Cromwell”, because with respect to “resolutions relating to the credit facility,” all the “original drafts were done by outside counsel”. (Shannon: Trial Tr. 3667:21 – 3668:7).

12.5 As of September 17, 2008, AIG Understood That Defendant’s Equity Would Be Non-Voting Warrants.

12.5.1 On September 17, 2008, counsel for AIG and FRBNY discussed “insurance issues relating to the warrant”. (PTX 114 at 1).

(a) At 11:44 a.m. on September 17, counsel for AIG emailed counsel for FRBNY, referencing a “voice mail” concerning “the insurance issues relating to the warrant” and noted that counsel for AIG “has looked into this.” (PTX 114 at 1).

(b) Zingales: Discussing PTX 114, “I think this is quite important because here we are on the 17th and we keep talking actively about warrant, there’s no other discussion of any other form of equity, let alone of preferred shares.” (Zingales: Trial Tr. 4079:6 – 4080:7).

12.6 As of September 18, 2008, AIG Understood That Defendant’s Equity Would Be Non-Voting Warrants.

12.6.1 On September 18, 2008, AIG filed a Form 8-K with the SEC announcing the terms of the proposed Credit Facility, that reported that “AIG issued a warrant to the Board of Governors of the Federal Reserve”, and that “the exercise of the warrant” was “subject to shareholder approval” (JX 96 at 2).

(a) Concerning the terms of the FRBNY loan, AIG’s September 18, 2008 8-K stated: “In connection with the revolving credit facility, AIG issued a warrant to the Board of Governors

of the Federal Reserve (‘Federal Reserve’) that permits the Federal Reserve, subject to shareholder approval, to obtain up to 79.9% of the outstanding common stock of AIG (after taking into account the exercise of the warrant). AIG anticipates calling a special meeting for such purpose as promptly as practicable.” (JX 96 at 2).

(b) Liddy: “on the 19th, Stasia Kelly, the general counsel of AIG, would have told” Liddy “that the reason that the original 8-K had been filed the way it was was that it was the clear expectation of AIG’s management as of the 16th that the form of equity would be warrants.” (Liddy: Trial Tr. 3142:13-20).

(c) Zingales: Discussing JX 96, “SEC filings are important – very important documents. People can be sued if they declare something that is incorrect, so a lot of attention is put in having this document formally and substantially correct. . . . it would have been safer to keep it more vague if there was any understanding that it was something other than warrant.” (Zingales: Trial Tr. 4089:24 – 4090:14).

12.6.2 AIG’s September 18 Form 8-K filing was based on discussions with AIG board members, was reviewed by inside and outside counsel, and was “true and accurate” at the time of filing.

(a) Shannon signed AIG’s Form 8-K dated September 18, 2008 on behalf of AIG. (JX 96 at 3; Shannon: Trial Tr. 3646:10-15). She believed it to be “true and accurate” at the time she signed it. (Shannon: Trial Tr. 3648:4-7).

(b) Before signing AIG’s September 18, 2008 Form 8-K, Shannon “would have consulted with people who were present” at the September 16, 2008 AIG Board meeting “to be sure that what was being stated was accurate”. (Shannon: Trial Tr. 3647:3-9).

(c) Indeed, as a general matter, to ensure the accuracy of a Form 8-K, Shannon “would consult with everyone – anyone that I thought was appropriate to determine that they agreed that the document was – was correct and ready to be filed.” (Shannon: Trial Tr. 3646:16-25).

(d) Shannon: “this 8-K was in fact prepared by outside counsel”, specifically “Sullivan & Cromwell”, and “Mr. Reeder was one of the partners that would have been involved in overseeing the preparation of it.” (Shannon: Trial Tr. 3647:18 – 3648:3).

12.6.3 During a town hall speech to AIG employees on September 18, 2008, Liddy told employees that AIG would strive to “give the government some sort of a return on its warrants”. (PTX 173 at 9).

12.7 Published Reports Stated That AIG Would Issue Non-Voting Warrants to Defendant for 79.9% of the Common Equity of AIG.

(a) On September 16, 2008, the *New York Times* reported: “Fed staffers, who briefed reporters at 9:15 tonight, don’t even want us to say the government will control A.I.G. The government will name new management, and will have veto power over all important decisions. And it will have a warrant allowing it to take 79.9 percent of the stock whenever it wants. But they contend there is no control until the warrant is exercised.” (PTX 2736 at 1).

(b) On September 17, 2008, the *New York Times* reported: “Under the plan, the Fed will make a two-year loan to A.I.G. of up to \$85 billion and, in return, will receive warrants that can be converted into common stock giving the government nearly 80 percent ownership of the insurer, if the existing shareholders approve.” (PTX 131 at 3).

(c) A publication by A.M. Best dated September 17, 2008, headed “American International Group, Inc., A Quick Look at the 6-Month Numbers,” stated: “Current AIG shareholders will see their equity diluted 79.9% by the issuance of warrants to the federal government, which also retains the right to veto dividend payments.” (PTX 1593 at 3; *see also*

Colannino: Trial Tr. 5770:18 – 5771:2 (PTX 1593 was consistent with Colannino’s understanding on or about September 17, 2008)).

12.7.1 No published report prior to the evening of September 23, 2008, stated that Defendant would receive voting preferred stock.

(a) AIG first disclosed to the public that the form of the equity would be voting preferred stock at 9:59 p.m. on September 23, 2008. (PTX 234 at 1).²³

13.0

ON SEPTEMBER 16, 2008, DEFENDANT TOLD AIG THAT DEFENDANT’S TERMS, INCLUDING DEFENDANT’S DEMAND FOR 79.9% OF AIG SHAREHOLDERS’ EQUITY, WERE NON-NEGOTIABLE AND THAT IF AIG DID NOT AGREE, AIG WOULD NOT RECEIVE ANY LOAN OR OTHER ASSISTANCE FROM DEFENDANT AND WOULD HAVE TO FILE FOR BANKRUPTCY.

13.1 Geithner Knew “It Would Have Been Possible to Loan AIG Money on a Secured Demand Note Without Having Reached Agreement on The Term Sheet,” If “the Demand Note Allowed Us to Be Secured to Our Satisfaction.” (Geithner: Trial Tr. 1908:24 – 1909:4). In Fact, Defendant Lent to “AIG Based on a Secured Demand Note” on September 16, 17, 18, and 19 (Geithner: Trial Tr. 1909:5-7; JX 84).

13.2 Nevertheless, AIG Was Provided with a Very Limited Time Period with Which to Accept FRBNY’s Offer of Assistance.

(a) Geithner: “I get on the phone with Willumstad and basically said we’re going to send you a term sheet, you’re not going to like it, but you have an hour to get your Board to approve it, two hours, we gave them a deadline, and you are not going to be running the

²³ Defendant’s expert Mordecai testified at trial that through an event study he has established that by the opening of the market on September 17, 2008, the market was aware that the form of equity was either preferred shares or a form to be determined, which he asserts was reflected in AIG’s stock price. Mordecai: Trial Tr. 8011:21 – 8013:10. Not only does all of the aforementioned evidence contradict Mordecai’s purported analysis (*see* Mordecai: Trial Tr. 7862:1 – 7872:23), so does the testimony of Defendant’s other damages expert, Dr. Saunders, who testified that with respect to the form of equity, such an analysis “isn’t possible, because it’s – the stock price is showing the confluence of different opinions as to what it might be.” Saunders: Trial Tr. 8268:7 – 8270:15.

company.” (PTX 673 at 24; *see also* Geithner: Trial Tr. 1533:6-17). Defendant “admits that Mr. Geithner had a telephone call with Mr. Willumstad in the afternoon of September 16, 2008 in which he informed Mr. Willumstad that AIG would be receiving a term sheet and that there was limited time for AIG’s Board to approve FRBNY’s offer to extend credit to AIG.” (Def. Resp. to Pl. 2nd RFAs No. 349).²⁴

13.3 The Offer Made to AIG by FRBNY on September 16, 2008 Was a Take-It-or-Leave-It Offer.

(a) Baxter: The offer was a “take-it-or-leave-it offer and the Federal Reserve made clear to AIG that nothing could be negotiated,” the Fed “told AIG that that was the only offer AIG was going to get”. (Baxter: Trial Tr. 761:2-10; PTX 126 at 1 (“AIG was told this was ‘take it or leave it’. Nothing could be negotiated.”)).

(b) Geithner: After Willumstad called back to ask if the terms could be negotiated, Geithner “made it clear that we would not consider alternative terms to what we proposed” (Geithner: Trial Tr. 1535:4-15). Geithner “made it clear this was the only offer they were going to get” (Geithner: Trial Tr. 1535:16-18). AIG could either accept the offer as Geithner had made it with the terms that he had given “or there was going to be no offer of assistance from the Federal Reserve” (Geithner: Trial Tr. 1535:19-24). Geithner “said no” when Willumstad “asked if we would be willing – open to changing some of the terms,” including the amount of equity that was demanded (Geithner: Trial Tr. 1533:18-25).

²⁴ Geithner testified at trial that AIG was given a deadline because “we couldn’t keep the Fedwire, which is the mechanism we would make that payment and they would make payments to their counterparties, we couldn’t keep that open indefinitely” and it usually closed “in the 6:00 p.m. range”. Geithner: Trial Tr. 1799:10 – 1800:2. However, Geithner admitted that there was still the option of providing funding to AIG through a separate demand note, which is what Defendant ultimately did after the AIG Board accepted the Government’s terms. Geithner: Trial Tr. 1908:24 – 1909:7.

(c) Baxter: During a call on September 16, 2008, Geithner told Willumstad that there was no “give in the equity” demanded by FRBNY and AIG could not “negotiate a fiduciary out.” (Baxter: Trial Tr. 911:20 – 912:10 (“it was a take-it-or-leave-it principle that Mr. Geithner was articulating to Mr. Willumstad”); JX 52-U at 20 (Baxter’s handwritten notes from that September 16th call acknowledging that Geithner refused these requests); Baxter: Trial Tr. 922:20 – 923:19 (confirming Geithner’s denial of Willumstad’s requests)).

(d) 2011 GAO Report: The “AIG board’s view was that the terms of the government’s offer were unacceptable, given a high interest rate and the large stake in the company—79.9 percent—the government would take at the expense of current shareholders. AIG executives telephoned FRBNY officials during the AIG board meeting in an effort to negotiate terms of the Revolving Credit Facility, but the FRBNY officials said the terms were nonnegotiable and that the company had no obligation to accept the offer.” (PTX 641 at 42-43).

(e) Willumstad: Geithner told Willumstad that FRBNY’s terms were “take-it-or-leave-it.” (Willumstad: Trial Tr. 6520:18 – 6521:11).

(f) Willumstad: On September 16, AIG and its lawyers were given a term sheet (Willumstad: Trial Tr. 6411:25 – 6413:5). Geithner “indicated that the terms that had been sent over were the only terms that we were going to get and that he expected us to be prompt in responding to those terms.” (Willumstad: Trial Tr. 6414:18 – 6415:3).

(g) Willumstad: In the middle of the September 16 AIG Board meeting, Willumstad, acting at the direction of the AIG Board, called Geithner to ask if the terms could be negotiated. (Willumstad: Trial Tr. 6429:21 – 6430:8). “Geithner said there was no negotiations to be had over the terms.” (Willumstad: Trial Tr. 6430:9-11).

(h) Willumstad also asked Geithner whether FRBNY “would agree that if AIG could raise capital to repay whatever AIG had borrowed from the government in a short period of time whether the government would unwind the credit facility”. (Willumstad: Trial Tr. 6521:12-17). Geithner essentially refused to agree to give back the equity even if AIG was able to raise money from private sources in a short period of time. (Willumstad: Trial Tr. 6521:18 – 6522:10).

(i) Offit: The Board understood on September 16 that the Government’s terms were “nonnegotiable.” (Offit: Trial Tr. 7395:10-21).

(j) Zingales: “It was a take-it-or-leave-it offer from the Government, which indicates all the bargaining power was on the side of the Government.” (Zingales: Trial Tr. 3817:6 – 3818:11).

14.0

THE “FIRST TIME THAT AIG WAS OBLIGATED TO PROVIDE EQUITY TO THE GOVERNMENT” WAS “WHEN THE SEPTEMBER 22 CREDIT FACILITY WAS SIGNED”. (BAXTER: TRIAL TR. 765:2-5).

(a) Alvarez: “the first time that AIG was under a contractual obligation to abide by the terms of this term sheet” was “When the actual contract was signed September 22.” (Alvarez: Trial Tr. 309:14 – 312:10).²⁵

²⁵ Although some witnesses made the “assumption” that the funding that was provided on September 16, 2008 was a result of a binding agreement (*see, e.g.*, Offit: Trial Tr. 7969:12-16; Bernanke: Trial Tr. 2034:4-8; Willumstad: Trial Tr. 6436:14 – 6437:24, 6440:2-5), it is clear that counsel for the parties were contemporaneously aware that funding was extended pursuant to secured demand notes and not a binding term sheet agreement or an executed Credit Agreement. *See* JX 83; JX 84; *see also* Baxter: Trial Tr. 919:13 – 920:1 (“no credit had been extended to AIG on the basis of” a term sheet on September 16; rather, the credit that was extended on September 16 “was on the basis of different legal documentation”).

14.1 The Evening of September 16, 2008, AIG’s Board Passed Two Resolutions – a Resolution Authorizing the Negotiation of a Credit Agreement Between AIG and the Federal Reserve Based on the Terms of Defendant’s Offer, and a Resolution Authorizing AIG to Immediately Borrow Money from the Federal Reserve on a Secured Demand Note Basis.

(a) On September 16, 2008, the AIG Board of Directors approved a resolution that authorized AIG:

(i) “to enter into a transaction with the Federal Reserve Bank of New York (the ‘Lender’) to provide a revolving credit facility of up to \$85 billion on terms consistent with those described at this meeting”. (JX 74 at 13); and

(ii) “to enter into a \$14 billion demand note with the Lender” and to “enter into such additional demand notes” “as any Authorized Officer determines is necessary or appropriate to meet the liquidity needs of the Corporation prior to the execution of definitive documentation of the Credit Facility.” (JX 74 at 14).

14.2 The AIG Board Was Never Presented with the Version of the Term Sheet Defendant Claims Was Executed.²⁶

²⁶ Despite Huebner’s testimony that hard copies of a term sheet referring to the equity as “form to be determined” were given to Michael Wiseman, a Sullivan & Cromwell attorney representing AIG, at the Fed, before Wiseman left for the September 16, 2008 AIG Board meeting (Huebner: Trial Tr. 5973:21 – 5974:18, 5976:11-14), Offit and Willumstad—who both attended the September 16 meeting—testified that the Board was not shown a term sheet at that meeting. *See* Willumstad: Trial Tr. 6515:14-22; Offit: Trial Tr. 7936:12-14.

(a) Offit did not see a term sheet on September 16, and did not see one until “the term sheet that was delivered to board members on September 21.” (Offit: Trial Tr. 7936:12-14, 7937:19-22).²⁷

14.2.1 Willumstad was the only member of the AIG Board of Directors who saw a term sheet on September 16, 2008. On the afternoon of September 16, 2008, Willumstad received a two-page term sheet. (Willumstad: Trial Tr. 6515:10-13). But that term sheet was not shown to the AIG Board at its meeting later that day. (Willumstad: Trial Tr. 6515:14-16). In fact, the AIG Board was not shown any term sheet at its September 16 meeting. (Willumstad: Trial Tr. 6515:17-19).

14.2.2 The term sheet Willumstad saw on September 16 has not been produced in this litigation.

(a) The version of the term sheet that Willumstad saw on the afternoon of September 16 has not been produced in this litigation. (PTX 681 (“FRBNY has not been able to locate the two-page term sheet described by Robert Willumstad during his October 15, 2013 deposition, or any document fitting Mr. Willumstad’s description.”); PTX 683 (Letter from counsel for the Department of Justice: “We have not located any document meeting Robert Willumstad’s description during his October 15, 2013 deposition of a two-page term sheet.”)).

(b) Defendant asserts that a “draft of the term sheet was handed to Michael Wiseman (Sullivan & Cromwell LLP) sometime before the 5:00 p.m. start of the AIG Board of Directors meeting held on September 16, 2008” (Def. Resp. to Pl. 3rd Interrogatories No. 2), but

²⁷ Despite Offit’s testimony that the AIG Board received adequate advice, considered its options, and had “sufficient time to fully discuss and consider the government’s terms” on September 16, 2008 (Offit: Trial Tr. 7388:7 – 7390:11, 7399:7-10), Offit admitted on cross-examination that he did not see a term sheet on September 16 and that his understanding at the September 16 Board meeting was that “the form of equity was going to be warrants”. Offit: Trial Tr. 7931:5-9, 7936:12-14.

Defendant has not identified the draft handed to Mr. Wiseman and the document with bates stamp DPWSTARR_00051939, identified by Defendant in its response to Plaintiffs' interrogatory, does not contain a copy of the term sheet handed to Wiseman. (*See* JX 76).

(c) After the AIG Board of Directors meeting on September 16, 2008, Willumstad signed a single signature page that had nothing attached (JX 76 at 1-2; *see also* Willumstad: Trial Tr. 6438:1 – 6439:1, 6441:20 – 6442:3), a copy of which was faxed to Baxter at 8:44 p.m. (PTX 94 at 1-2) and subsequently appended to a copy of a term sheet Willumstad had not seen (Willumstad: Trial Tr. 6439:5-14 (“I don’t know that I ever saw the document while I was CEO.”)).²⁸

(d) Defendant admits that the “final version” of the term sheet was sent at “8:51 pm” – after Defendant received the signed signature page. (Def. Resp. to Pl. 3rd Interrogatories No. 2 (identifying DX 437 (STR_SC_00000024) as the “final version” of the term sheet)).

(e) Three separate copies of the same signature page that Defendant claims were attached to a term sheet on September 16, 2008 were also inexplicably produced by FRBNY as attachments to a series of documents including the September 16, 2008 Demand Note and Security and Pledge Agreement. (JX 83 at 15, 21-24).

(i) McLaughlin: “I’m not sure I would have had an understanding of exactly how these specific pages related to the credit agreement.” (McLaughlin: Trial Tr. 2478:11-18).

²⁸ Baxter testified at trial that on September 16, 2008 he received Willumstad’s signature page attached to a term sheet. However, he admitted that he did not “know whether that term sheet was faxed with this signature page” in PTX 94 “or whether it was attached, if it was, by someone else”. Baxter: Trial Tr. 754:11-16. Moreover, Defendant could not locate and did not produce any term sheet that, like Willumstad’s signature page in PTX 94, contains a fax line on it. Counsel for Defendant: Trial Tr. 756:23 – 757:9 (“There is no other document that has the fax line on it, the actual term sheet or the credit agreement or anything like that – or the demand note I mean.”).

14.3 The September 16, 2008 Term Sheet Expressly Provides That It Is Not Legally Binding.

(a) The term sheet attached to the September 16, 2008 Board of Governors meeting minutes, and every other term sheet prior to the Credit Agreement, expressly states at the top: “This Summary of Terms **is not intended to be legally binding on any person or entity**, nor is it intended to be a comprehensive list of all relevant terms and conditions of the transactions contemplated herein. Any binding agreement with respect to the matters referred to herein shall be evidenced by appropriate documentation, executed by the applicable parties. This Summary of Terms shall not constitute an offer to sell, nor the solicitation of an offer to buy, any security or instrument referred to herein.” (JX 63 at 5 (emphasis added); *see also* JX 64-A at 3 (same)).

(b) Baxter: “the term sheet in and of itself was not legally binding.” (Baxter: Trial Tr. 764:6-11). “The term sheet itself says that it’s nonbinding.” (Baxter: Trial Tr. 763:6). The “term sheet itself did not have the binding – the same binding effect as the executed revolving credit agreement on September 22.” (Baxter: Trial Tr. 763:11-14).²⁹

14.4 No Version of the September 16, 2008 Term Sheet Was Executed by Both Parties.

(a) Baxter: The term sheet was not “signed by the Federal Reserve System, the Board of Governors or the Federal Reserve Bank of New York.” (Baxter: Trial Tr. 764:19-23; *see also* Baxter: Trial Tr. 764:24 – 765:1 (agreeing that “ordinarily when you have a binding contract, it’s signed by more than one party”)).

(b) Defendant’s counsel circulated a signature page with the intention that it would be signed but it never was:

²⁹ Offit testified that he believed AIG entered into “a contractual arrangement with the U.S. government” on September 16, 2008. Offit: Trial Tr. 7973:24 – 7974:14. However, he never saw such an agreement and he admitted that “on September 16 everybody contemplated it would be warrants”. Offit: Trial Tr. 7973:9-12.

(i) On September 16, 2008, at 5:57 p.m., an attorney from Davis Polk emailed AIG's counsel at Sullivan & Cromwell a signature page with signature lines for both AIG and FRBNY saying: "Attached please find the heads of agreement for the term sheet" (JX 76 at 2). A few minutes later, an attorney from S&C replies all: "Brian - was your intention to circulate only a signature page with the attached email, or are there additional pages coming?" (JX 76 at 2). The Davis Polk attorney responds: "I only intended to circulate the signature page at this time." (JX 76 at 2). A second Davis Polk attorney, Brad Smith, adds: "The idea of course is to staple it to the Term Sheet." (JX 76 at 1).

(ii) The signature page signed by Willumstad and faxed to Baxter at 8:44 p.m. contained only a single signature line for AIG. (PTX 94 at 1-2).

(iii) At 8:51 p.m., an attorney from Davis Polk emailed the "final" version of the term sheet to AIG's counsel, with a signature page attached titled "Heads of Agreement" with signature lines for both FRBNY and AIG. (DX 437 at -024, -030). This attachment was different than the signature page Willumstad signed. (Huebner: Trial Tr. 6171:15 – 6175:12). This attachment was never signed. (Huebner: Trial Tr. 5980:9 – 5981:12).

15.0

UPON THE AIG BOARD'S PASSING OF ITS SEPTEMBER 16 RESOLUTIONS, DEFENDANT ASSUMED CONTROL OF AIG.

15.1 When Funds Were Advanced on September 16, "the Government Had Immediate Control" (Offit: Trial Tr. 7938:7-15) and the "Latitude to Do Whatever It Wished" (Offit: Trial Tr. 7964:23 – 7965:9).

(a) Offit: "I believe the government had immediate control upon the lending of money under the facility." And that control began "when the government began to advance funds on September 16" (Offit: Trial Tr. 7938:7-15). "The government succeeded to an 80 percent

interest, approximate 80 percent interest in AIG. Certainly the government had latitude to do whatever it wished in that respect.” (Offit: Trial Tr. 7964:23 – 7965:9; *accord* Offit: Trial Tr. 7968:1-10).

(b) On September 16, 2008 Sarah Dahlgren of FRBNY prepared “an immediate punch list for taking control of AIG” based on a discussion with a group she “had interacted with in supervision who were around that day, including Steve Manzari, Paul Whynott, and others, who ended up helping us through that period.” (Dahlgren: Trial Tr. 2640:25 – 2641:13).³⁰

(c) Zingales: “I concluded that Defendant exercised control over AIG starting at least from September 16, 2008, until at least 2011.” (Zingales: Trial Tr. 3800:12-16; *see also* PTX 5047 – 5053 (Zingales demonstratives); Zingales: Trial Tr. 3815:10 – 3828:15 (further discussion of Defendant’s exercise of control)).

(d) Zingales: Pursuant to the “Fed Policy Statement on Control”, control is present either when there is “an equity ownership above 25 percent or the ability to select directors or a number of indicia of control or influence over management. And what I want to stress is, number one, these are either/or, so one of the three is sufficient to indicate control; and two, again, these are what theory would predict regardless of the Fed policy.” (Zingales: Trial Tr. 3810:14 – 3811:17; *see also* PTX 2579 at 1 (Fed Policy Statement laying out these three disjunctive criteria for control); PTX 5045 (Zingales demonstrative)).

(e) Zingales: From September 17-23, 2008, the indicia of the Government’s effective control over AIG “are pretty powerful” (Zingales: Trial Tr. 3819:1 – 3820:16).

³⁰ Later, during examination by counsel for the United States, Dahlgren claimed not to understand what she meant by “taking control”. Dahlgren: Trial Tr. 2916:18-25 (“What I meant by ‘taking control’ I don’t know.”). However, this is particularly difficult to credit when she told a group of high-level AIG executives on September 17, 2008 we “are here, you’re going to cooperate.” PTX 581 at 2; *see also* Dahlgren: Trial Tr. 2817:22 – 2818:15.

(f) Zingales: “the Government is able to tell Willumstad, the then CEO, that he was out. Not only that, the Government go out and recruit a new CEO and call him and say you are in, even before contacting anybody on the board. So, from a de facto point of view, the Government acts like it is in control.” (Zingales: Trial Tr. 3815:10 – 3817:5; *see also* PTX 5047 (Zingales demonstrative on “Examples of the Sources of the Government’s Power to Control AIG (September 16, 2008)”)).

(g) Zingales: “The government-appointed CEO shows up on the premises of AIG before the board even have the ability to decide whether to appoint him, let alone to even do the due diligence. The situation is such that the government appointee, Sarah Dahlgren, is sort of showing up and saying we are – you are going to cooperate, talk to the employees, you are going to cooperate. At the same time, we have the Government still sort of discouraging potential private solution. . . . as of the end of the day on the 16th, there is a temporary secure lending done by the Fed to AIG, which is drawn down in a significant way, so that by the 21st, we’re down to 37 billion in that secure lending that will expire on September the 23rd. So, remember, the Fed policy is saying that a contractual lender can get a disproportionate amount of controlling influence as a result of being in a situation where he is the monopoly lender, and this is exactly what happens, because if the situation was bad on the 16th, it only got worse afterward.”

(Zingales: Trial Tr. 3819:1 – 3820:16).

15.2 On September 16, 2008, Prior to Any Discussions with the AIG Board, Defendant Fired Willumstad as CEO of AIG and Replaced Him with a CEO of Defendant’s Own Choosing.

(a) “Mr. Geithner and Mr. Willumstad had a telephone conversation on September 16, 2008, during which Mr. Geithner told Mr. Willumstad that FRBNY and the Department of the Treasury expected Willumstad to be replaced as CEO of AIG following AIG’s acceptance of the Term Sheet.” (Def. Resp. to Pl. 1st RFAs No. 7.5).

(i) “neither the Government nor FRBNY had any conversations with any representative of AIG about Edward Liddy potentially becoming CEO of AIG prior to September 16, 2008.” (Def. Resp. to Pl. 1st RFAs No. 24.0).

(ii) “neither the Government nor FRBNY had any conversations with any representative of AIG about any potential candidates to replace Robert Willumstad as CEO prior to September 16, 2008.” (Def. Resp. to Pl. 1st RFAs No. 24.1).

(iii) “The Board of Governors of the Federal Reserve System did not vote on whether to remove Robert Willumstad as AIG’s CEO” or on “whether to appoint Edward Liddy as AIG’s CEO.” (Def. Resp. to Pl. 1st RFAs Nos. 29.1, 29.2)

(b) On September 16, 2008, “before discussions with AIG regarding Mr. Willumstad’s removal”, and without discussing “the selection of Mr. Liddy with the AIG Board or AIG management Secretary Paulson called Edward Liddy and asked whether Mr. Liddy would be interested in accepting the position of CEO of AIG.” (Def. Resp. to Pl. 2nd RFAs Nos. 383 – 385).

(c) Paulson: On the morning of September 16, 2008, “I worked on finding a new CEO for the company. We had less than a day to do it—AIG’s balances were draining by the second. I asked Ken Wilson to drop everything and help. Within three hours he had pinpointed Ed Liddy, the retired CEO of Allstate”, and Paulson “immediately called Ed Liddy and offered him the position of AIG chief on the spot” (Paulson: Trial Tr. 1227:15 – 1228:14; *accord* PTX 706 at 263).

(d) Paulson: Paulson “sealed the deal” to name Ed Liddy CEO “before” he “removed Willumstad.” (Paulson: Trial Tr. 1228:10-21).

(e) Liddy was first asked to become the CEO of AIG by Christopher Cole, who was

then the Chairman of Goldman Sachs' investment banking division, in the early morning of September 16, 2008. (Liddy: Trial Tr. 3024:1 – 3025:17). Later that day, he was asked again by Ken Wilson, who “had worked for many years at Goldman Sachs” and had been a “senior executive at Goldman Sachs”, but was now an advisor to Secretary Paulson at the Treasury Department. (Liddy: Trial Tr. 3026:17 – 3028:14). After telling Wilson that he would accept the position, Liddy received a call from Paulson around “3:00 or 4:00” in the afternoon during which Paulson told him that he hoped Liddy “would feel the need to help the country”, to which Liddy answered that he would. (Liddy: Trial Tr. 3028:5 – 3029:3).

15.3 Liddy Began Functioning as AIG's CEO Before He Had Even Met, Let Alone Been Approved by, the AIG Board.

(a) Dahlgren: On September 16, 2008, Dan Jester (Treasury) told Dahlgren that Liddy is “the person who is going to be the new CEO of AIG”. (Dahlgren: Trial Tr. 2639:16-25; Def. Resp. to Pl. 2nd RFAs No. 409).

(b) Dahlgren: That same day, at Liddy's request, Dahlgren and others “prepared some bullet points that we thought he should focus on in his initial interactions with the company.” (Dahlgren: Trial Tr. 2645:8-13; *see also* Dahlgren: Trial Tr. 2917:25 – 2918:16 (“Ed had asked us, the night before when I was on the phone with him with Dan Jester, to prepare for him some talking points that he might be able to use in his first interactions with the company.”)).

(c) On the morning of September 17, 2008, Liddy met with Dan Jester (Treasury) at Liddy's hotel to prepare for the meeting with AIG senior managers. (Dahlgren: Trial Tr. 2640:12-22).

(i) McConnell's notes from September 16, 2008 state: “Ed Liddy, CEO designate, is coming to the Ritz.” (PTX 105 at 3).

(ii) Liddy testified that he “was staying at the Ritz in Battery Park” and presumes he had breakfast with Jester there. (Liddy: Trial Tr. 3029:14-22; *see also* Liddy: Trial Tr. 3029:4-13 – the morning of September 17, 2008 Liddy “had a meeting or maybe a breakfast with Dan Jester, who was an ex Goldman Sachs employee and was working in some capacity for Secretary Paulson”).

(d) Dahlgren and Manzari also met with Liddy at AIG’s offices on the morning of September 17, 2008. (Dahlgren: Trial Tr. 2641:14-23).

(e) Dahlgren gave the Government’s talking points to Liddy on the morning of September 17. (Dahlgren: Trial Tr. 2645:8-18; *see also* Dahlgren: Trial Tr. 2917:25 – 2918:16; Dahlgren: Trial Tr. 2646:5-12 (confirming PTX 112 is the talking points prepared for Liddy)).

(i) Zingales: “The fact that the Government provides to the new CEO the talking points indicates who was running the agenda.” (Zingales: Trial Tr. 3825:4-18).

(f) Later that morning, Dahlgren met with Liddy and other AIG senior managers, “including the CFO, the chief risk officer, the general counsel”. (Dahlgren: Trial Tr. 2641:24 – 2642:9; Def. Resp. to Pl. 2nd RFAs No. 414).

(i) Liddy “was clearly the one in charge” during that meeting. (Dahlgren: Trial Tr. 2643:1-16 (deposition testimony that Liddy was “clearly the one in charge” was accurate)).

(ii) At the meeting, the message was conveyed to AIG senior managers that “The Fed is coming in and now we are going to talk about what we are going to do.” (Dahlgren: Trial Tr. 2644:5-19).

(iii) AIG senior management attending the meeting were “shell-shocked and at other times terrified”. (Dahlgren: Trial Tr. 2644:21-24).

(g) Dahlgren also prepared for Liddy an “immediate punch list for taking control of AIG.” (Dahlgren: Trial Tr. 2640:25 – 2641:3). Dahlgren prepared the “immediate punch list for taking control of AIG” in consultation with “a group of people that I had interacted with in supervision who were around that day, including Steve Manzari, Paul Whynott, and others, who ended up helping us through that period.” (Dahlgren: Trial Tr. 2640:25 – 2641:13).

15.4 The AIG Board’s Approval of Liddy on September 18, 2008 Was Only a Formality, Which the Board Understood They Were Obligated to the Government to Do.

(a) The night before the September 18 board meeting, Liddy told AIG’s Lead Director Bollenbach that Liddy “would step into” the dual role of Chairman and CEO at AIG. (Liddy: Trial Tr. 3040:18 – 3041:1; Offit: Trial Tr. 7930:10-20 – Offit was informed on September 18, 2008 that Liddy, the Department of the Treasury, and FRBNY expected Liddy to assume the dual role of CEO and Chairman).

(b) At the September 18 meeting the AIG Board was informed that Liddy “expected, and he understood the Department of the Treasury and Federal Reserve Bank of New York to expect, that Mr. Liddy would be both Chief Executive Officer and Chairman.” (JX 94 at 2).

(c) At the Board meeting, the Board’s counsel “Mr. Beattie explained that these are uncharted waters for any board, but that Mr. Liddy was accepted as Chief Executive Officer as part of the agreement to accept government financing on September 16 and that the Board was acting in accordance with its duties to formally implement that agreement by appointing Mr. Liddy as Chief Executive Officer.” (JX 94 at 2; *see also* Offit: Trial Tr. 7929:9 – 7930:9 (Offit believed that on September 18, 2008)).

(d) Paulson “assumed the board would approve” Liddy’s installation. (Paulson: Trial Tr. 1228:10-21).

15.4.1 The AIG Board felt forced into accepting Willumstad's resignation and accepting Liddy's appointment.

(a) Offit: "the government goofed" on conditioning its assistance on Willumstad's resignation. Offit "would have been happy to" have Willumstad stay on. (Offit: Trial Tr. 7928:22 – 7929:8).

(b) AIG Board Member James Orr "voiced concern that Mr. Liddy didn't have the level of experience that it would take to run AIG". (Willumstad: Trial Tr. 6524:3-12). In fact, Orr said "Something like" "that if you were looking for a CEO for AIG, not only would Mr. Liddy not have been on the short list, he wouldn't have been on the long list". (Willumstad: Trial Tr. 6524:13-17).

(c) Willumstad: Asked whether he believed that "Liddy had the level of experience to meet the criteria to be CEO of AIG", Willumstad answered that "given the – again, the breadth of complexity of AIG's businesses, based on his experience at Allstate, I didn't think they matched very well." (Willumstad: Trial Tr. 6523:20 – 6524:2; *see also* Willumstad: Trial Tr. 6523:15-19 (Allstate's "lines of business would be a small piece of what AIG is"))).

15.4.2 The AIG Board accepted Liddy even though when Liddy became CEO of AIG he was a member of the Goldman Sachs Board of Directors, was Chairman of the Audit Committee of Goldman Sachs, and owned a "considerable amount of Goldman Sachs stock".

(a) At the time Liddy was confirmed as Chairman and CEO of the AIG board on September 18, 2008, he held a "considerable amount of Goldman Sachs stock". (Liddy: Trial Tr. 3032:21-24). Liddy "continued to hold that Goldman Sachs stock throughout the period of time that" he was CEO and Chairman of AIG. (Liddy: Trial Tr. 3032:25 – 3033:4).

(b) Liddy continued to serve on both the Goldman Sachs Board of Directors and its Audit Committee after he became AIG CEO and Chairman.

(i) On September 21, 2008, Liddy was still serving as “chairman of the Goldman Sachs audit committee.” (Liddy: Trial Tr. 3071:5-7; *see also* JX 358 at 1 (noting Liddy’s attendance at a special meeting of the Board of Directors of Goldman Sachs on September 21, 2008)).

(ii) Mr. Liddy only “resigned from the Goldman Sachs Board of Directors on September 23, 2008”, after the Credit Agreement had been executed. (Def. Resp. to Pl. 2nd RFAs No. 71).³¹

15.5 On September 19, 2008, Defendant Required That AIG Adopt a Policy of Not Granting Dividends to Shareholders in Order to Preserve Capital. (JX 94 at 5-6).

15.6 Both Defendant and Liddy Considered Liddy the Government’s Man at AIG.

(a) Liddy: “I came out of retirement to help my country. At the government’s request, I have had the duty and the extraordinary challenge of serving as Chairman and Chief Executive Officer of American International Group or AIG.” (PTX 471 at 61; Liddy: Trial Tr. 3006:1-20; *see also* Liddy: Trial Tr. 3003:4 – 3004:9).

(b) Davis Polk attorney Beverly Chase on November 7, 2008: “we (the usa) hired ed to fix this mess” (PTX 3216 at 2).

³¹ Liddy testified at trial that he drafted his letter of resignation from the Goldman Sachs Board of Directors on September 21, that he sent it to Goldman Sachs on September 22, and that it was received by Goldman Sachs on September 23. *See* Liddy: Trial Tr. 3063:6 – 3064:23. Goldman Sachs did not announce Liddy’s resignation from its Board until September 26, however, and Liddy could not proffer a convincing explanation for why it would delay doing so. *See* Liddy: Trial Tr. 3064:24 – 3065:10; *see also id.* 3069:12-20 (acknowledging his awareness that the date of his resignation from the Goldman Sachs Board would be an issue at trial but that he nevertheless made no effort to document it). Nor could Liddy explain why his recollection of his resignation at trial was more precise than it was five years earlier, when he testified before Congress months after the same events and was asked the same question. *See* Liddy: Trial Tr. 3066:9 – 3069:11 (discussing PTX 516 at 57).

(c) Beginning the week of September 17, 2008, “Mr. Liddy and FRBNY employees Sarah Dahlgren and Steve Manzari had a standing daily meeting scheduled.” (Def. Resp. to Pl. 2nd RFAs No. 431).

(d) Dahlgren: “initially I would meet quite frequently with Ed, and, you know, when things were either stressful or we were leading up to restructuring, like November and March, it would be more frequent.” (Dahlgren: Trial Tr. 2824:11-18).

(i) Dahlgren acknowledged that she shared her views with Liddy on corporate matters. For example, Dahlgren admitted that she may have instructed Liddy that “most of the existing members of the AIG board should be replaced by new directors” (Dahlgren: Trial Tr. 2695:3-12); told him “in substance” that she “believed that Mr. Bollenbach should be replaced as the director” (Dahlgren: Trial Tr. 2688:3-22); and had “a number of conversations about compensation” decisions with Liddy in which she expressed FRBNY’s concerns. (Dahlgren: Trial Tr. 2665:4-13).

(ii) Liddy’s ultimate decisions “often reflected the concerns” that FRBNY “had expressed”. (Dahlgren: Trial Tr. 2665:14 – 2666:6).

(e) Liddy “weighed every decision” that he made “with one priority in mind, will this action help” AIG’s “ability to repay monies back to the government or hurt it.” (Liddy: Trial Tr. 3016:8-13).

15.6.1 Liddy viewed his role as CEO of AIG as a partnership with Defendant.

(a) Liddy testifying before Congress on March 18, 2009: “I very much view the relationship as a partnership. We do not do a single thing of strategic import without making certain that we have talked to the Federal Reserve about it and we have given them an opportunity to weigh in on it.” (PTX 471 at 75; *see also* Liddy: Trial Tr. 3006:21 – 3007:16,

3008:10 – 3009:3, 3010:15-24).

(i) “In general,” Liddy “didn’t do anything without reviewing it with the Federal Reserve and Treasury” while he was Chairman and CEO of AIG. (Liddy: Trial Tr. 3008:10-13).

(ii) Liddy “treated the Federal Reserve as a partner”. (Liddy: Trial Tr. 3117:19-21).

(iii) While Liddy was Chairman and CEO of AIG, he “worked closely with people from the Federal Reserve and Treasury”. (Liddy: Trial Tr. 3006:21-24).

(iv) “I made the decision we would treat them as a full partner. We would invite them under the tent, so to speak.” (Liddy: Trial Tr. 3215:22 – 3216:3).

(b) “In dealing with the Federal Reserve in connection with ML III and generally,” Liddy “trusted the Federal Reserve to do what was in AIG’s interests”. (Liddy: Trial Tr. 3117:14-18).

(c) Liddy “believed that the Federal Reserve had invested in AIG and owned 79.9 percent of the equity”. (Liddy: Trial Tr. 3117:22-25).

(d) Zingales: The fact that Liddy viewed Defendant as a full partner is an indicia of Defendant’s control over AIG. (Zingales: Trial Tr. 3833:17 – 3834:15 (“It’s very important that the CEO feels a partnership with a major investor. So, he felt he was completely aligned with the Government”); *see also* PTX 5049 & PTX 5054 (Zingales demonstratives)). The “combination of lending and intermingling in the day-to-day affairs, to the point that Mr. Liddy is saying that I don’t do anything without reviewing, suggests a very strong control over the affairs of the corporation.” (Zingales: Trial Tr. 3821:23 – 3822:12).

15.7 On September 21, 2008, Liddy Knew That Goldman Sachs Was Going to Become a Bank Holding Company (“BHC”) but Did Not Explore This Possibility for AIG.

15.7.1 When he was confirmed as Chairman and CEO of AIG on September 18, 2008, Liddy was “aware that Goldman Sachs was at least considering as one of its options becoming a bank holding company” (Liddy: Trial Tr. 3084:17-20). Yet Liddy never discussed “with anybody at AIG the possibility of AIG becoming a bank holding company” (Liddy: Trial Tr. 3084:7-9).

15.7.2 On September 21, 2008 at 4:45 p.m., Liddy attended a special meeting of the Board of Directors of Goldman Sachs, during which the Board deemed “it advisable and in the best interests of the Corporation that the Corporation become a BHC and, in connection therewith, that Goldman Sachs USA Holdings LLC, a subsidiary of the Corporation, also become a BHC” (JX 358 at 1).

15.7.3 Liddy left the special meeting of the Goldman Sachs Board on September 21 to attend a meeting of the AIG Board later that evening at which the Board accepted the Credit Agreement. (*Compare* JX 358 at 1 (Goldman Sachs meeting called on September 21, 2008 at 4:45 p.m.) *with* JX 103 at 1 (AIG meeting called on September 21, 2008 at 8:00 p.m.)). At the AIG Board meeting, Liddy never disclosed that Goldman Sachs had been approved for bank holding company status even though it may have been significant to board members.

15.7.4 On the contrary, at the September 21 AIG Board Meeting at which the Credit Agreement was agreed to, Liddy advised the AIG Board that there was “urgency” in approving the Credit Agreement “because there were indications that” FRBNY “was not going to come to the aid of other troubled issuers and turmoil was expected.” (JX 103 at 2).

15.7.5 However, Liddy knew that “permitting Goldman Sachs and Morgan Stanley to become bank holding companies was coming to the aid of Goldman Sachs and Morgan Stanley”. (Liddy: Trial Tr. 3083:18-22). “Becoming a bank holding company permitted Goldman Sachs to

borrow more money at more attractive terms than it would have been able to do without becoming a bank holding company”. (Liddy: Trial Tr. 3075:18 – 3076:3).

15.8 As of September 16, 2008, Defendant Began to Control AIG’s Business Operations, Including by Installing a Permanent On-Site Monitoring Team at AIG.

15.8.1 Federal Reserve Vice Chairman Kohn: On “September 16, the government in the form of the Federal Reserve, working with the Treasury, became very deeply involved in the overall strategy of the company.” (PTX 449 at 15-16).

15.8.2 On September 16, Geithner appointed Dahlgren to head the AIG monitoring team, telling her in substance: “You’re going to take on AIG, we are going to make them a loan, and you are going to run it”. (Dahlgren: Trial Tr. 2601:4-21; *see also* Geithner: Trial Tr. 1565:21 – 1566:16 (“The Federal Reserve Bank of New York appointed a group of people to monitor and be present on the premises of AIG”)).

15.8.3 On September 18, 2008, FRBNY “instructed” AIG that going forward “all collateral calls that are not contractual” need to be “agreed” to by FRBNY before AIG posts, and that AIG “must not post on valuations before going through this process.” (PTX 141 at 1).

15.8.4 On September 16, 2008 FRBNY established “an on-site presence at AIG to monitor and protect our interests as lender and equity stakeholder.” (PTX 102 at 1; McLaughlin: Trial Tr. 2397:17 – 2398:5).

(a) “On September 17, 2008, FRBNY established an on-site team at AIG led by FRBNY employee Sarah Dahlgren to help FRBNY understand and monitor the company.” (Def. Resp. to Pl. 2nd RFAs No. 416).

(b) Baxter: “We had a team that we sent to AIG to monitor AIG on a continuous basis.” (Baxter: Trial Tr. 935:8-11).

(c) “The team spent an enormous amount of time over at AIG.” (Dahlgren: Trial Tr. 2602:13-17). The Federal Reserve also “had people who spent much of their time at AIGFP up in Connecticut.” (Dahlgren: Trial Tr. 2602:13-17).

(d) Dahlgren and the AIG Monitoring Team “on an average day would spend at least part of that day at AIG”. (Dahlgren: Trial Tr. 2603:19-22). Dahlgren “spent at least part of every day at AIG” during the early stage of the Federal Reserve’s monitoring of AIG. (Dahlgren: Trial Tr. 2603:1-3).

(e) After September 17, “I and my team continued to interact with key people within the organization” “to understand how things were running.” (Dahlgren: Trial Tr. 2825:22 – 2826:10). These key people included “the CFO, the chief risk officer, the chief restructuring officer, general counsel, head of strategy.” (Dahlgren: Trial Tr. 2826:11-15). The frequency of these meetings “would be intense around periods of stress or quarter-end or coming into a restructuring. It became, you know, more regular as things settled down a bit, but that was probably later in 2009.” (Dahlgren: Trial Tr. 2826:16-22).

(f) Defendant admits that “on February 20, 2009, AIG CEO Edward Liddy asked, in words or in substance, whether going forward AIG should contact Treasury staff directly, and that Treasury Secretary Timothy Geithner suggested to Mr. Liddy, in words or in substance, that AIG should continue to coordinate through FRBNY and pointed at Sarah Dahlgren, who was in the room.” (Def. Resp. to Pl. 2nd RFAs No. 831).

(g) Zingales: “When we talk about source of power, one important source of power is information So, if you have some monopoly power to information, you have a large degree of control over an institution. So, here, what the Government does is gets a direct source of information that bypass the board and the CEO and direct access to the company’s information.”

In combination with other indicia, “that’s a very strong indication of the degree of control of the Government.” (Zingales: Trial Tr. 3822:13 – 3823:5; PTX 5049 (Zingales demonstrative)).

(i) Government officials “were going to daily meetings with key corporate managers. They had multiple daily interactions with the CEO. They had frequent dialogue. They discussed both high-level and tactical issues at the corporate level. They decided what assets to be disposed. They spent an enormous amount of time, and they had a pretty large team.” (Zingales: Trial Tr. 3835:3 – 3836:2; PTX 5055 (Zingales demonstrative)).

(ii) “sometimes you have some outside monitors to a board. So, if you are a company and you are convicted of a serious violation of the Foreign Corrupt Practices Act, sometimes the DOJ imposes a monitor to your corporate – to your boards to make sure that you don’t do it again. Those monitors tend to be very sort of passive. That’s not the case for the AIG monitoring team led by the Fed.” (Zingales: Trial Tr. 3835:3-15; *see also* PTX 5054 – 5055 (Zingales demonstratives)).³²

³² Defendant’s witnesses testified at trial in conclusory terms that they did not “have any role in the day-to-day management of AIG” or direct AIG to take any particular business action. Dahlgren: Trial Tr. 2827:16-18; Symons: Trial Tr. 3606:5-9. However, Defendant’s witnesses also admitted to attending AIG board meetings, management meetings, and having daily meetings with the CEO and other senior management (Dahlgren: Trial Tr. 2653:9 – 2654:16 (discussing PTX 293 at 13-21), 2657:3 – 2660:2 (discussing PTX 612 at 16)); conceded that AIG never took any actions inconsistent with their expressed thoughts on any issue (Dahlgren: Trial Tr. 2665:21 – 2666:6 (AIG’s decisions “often reflected the concerns that we had expressed”); Liddy: Trial Tr. 3010:15-24 (affirming that AIG did “not do a single thing of strategic import without making certain that” he had “talked to the Federal Reserve about it and we have given them an opportunity to weigh in on it”)); and stated that as the majority shareholder and largest lender that they would expect a certain degree of deference. *See, e.g.*, PTX 581 at 2 (Dahlgren told senior AIG managers “we [the NY Fed] are here, you’re going to cooperate”); Baxter: Trial Tr. 994:5 – 995:24 (noting that FRBNY “felt we should express” its view “to our trustees, who as majority shareholder might be able to influence the company”); Pl. Prop. Concl. § 12.2.

15.8.5 Defendant's AIG Monitoring Team included hundreds of government officials and outside advisors.

(a) Dahlgren: The AIG Monitoring Team was "assisted by both Federal Reserve personnel and by personnel from other professional organizations" that the Federal Reserve retained. (Dahlgren: Trial Tr. 2602:1-5).

(i) Professionals "from Ernst & Young, from Morgan Stanley and from Davis Polk, and those three were the primary outside firms that assisted" the AIG Monitoring Team. (Dahlgren: Trial Tr. 2603:23 – 2604:4; *see also* PTX 524 (a "working group list" including team members from FRBNY, AIG, Morgan Stanley, Davis Polk, Blackstone, and Ernst & Young)).

(b) "From September 18 through September 29, 2008, representatives from AIG and its consultant AxiPartners met each weekday with representatives from FRBNY and/or representatives from Ernst & Young." (Agreed to Stipulations ¶ 163).

(c) Morgan Stanley had approximately "a hundred individuals throughout the firm in different disciplines" who worked on the AIG engagement "on behalf of" FRBNY. (J. Head: Trial Tr. 3722:13-17). Morgan Stanley had "a core team of individuals" on-site either at AIG or FRBNY "practically every day". (J. Head: Trial Tr. 3722:18-22).

(d) The scope of Morgan Stanley's work at AIG on behalf of the Government was very broad and encompassed virtually every important decision and activity (*see, e.g.*, JX 222 at 3-4; PTX 303 at 1, 8).

(e) Morgan Stanley even "oftentimes reviewed the earnings press releases, which was a primary element of interaction with the investors, so there was a – material aspects of the press

releases and things like that we usually were asked for our opinion.” (J. Head: Trial Tr. 3726:4-11).

(f) There were “probably upwards of a hundred people from E&Y” who were assisting the AIG Monitoring Team. (Dahlgren: Trial Tr. 2605:5-21).

(g) On September 19, 2008, Defendant retained E&Y to perform services for Defendant in connection with Defendant’s loan to AIG, including: the “quality of collateral posted,” “cash flow projections,” “divestiture support,” “regulatory,” “covenant monitoring,” “financial reporting,” “tax considerations,” and “program management.” (PTX 169 at 5-10; *see also* Symons: Trial Tr. 3601:23-25 (Ernst & Young was engaged by FRBNY with respect to the AIG loan “around September 18-19, 2008.”)).

(h) One of the key objectives of the E&Y engagement was “To understand the extent of FRBNY credit exposure by performing valuations of the entities posted as collateral.” (PTX 169 at 5; *see also* PTX 221 at 2-8 (detailing “Meetings completed” and “Next Steps” for work on Maiden Lane II and “purchase inquiry on ILFC”, and preparations for “NAIC Meeting”)).

(i) Ernst & Young was also tasked with ensuring that any potential AIG subsidiary IPOs did not conflict with FRBNY’s goals. Explicitly acknowledged as a “Potential issue” as part of E&Y’s engagement on this task was that: “The Company’s plans for taking certain businesses public may not coincide with the FRBNY’s goals.” (PTX 551 at 6).

(j) Ernst & Young provided “people to help us develop the kinds of MIS [Management Information System] we needed to monitor; they provided additional expertise in funding and liquidity; they provided us with additional expertise in derivatives up at Financial Products. We also leveraged their expertise in the real estate area, and they provided us obviously with the deep insurance expertise that we needed.” (Dahlgren: Trial Tr. 2812:14-23).

(k) BlackRock worked to value AIG assets (JX 379 at 2) and to devise, structure, and manage Maiden Lane II and Maiden Lane III. (Dahlgren: Trial Tr. 2647:9-13; *see also* J. Head: Trial Tr. 3743:25 – 3744:12; JX 382 at 1, 25).

(i) As early as September 18, 2008, Defendant already had a copy of BlackRock's September 9 analysis of AIGFP's CDS portfolio, and Defendant had a meeting with BlackRock on September 18 to walk through BlackRock's analysis of the portfolio without AIG's knowledge. (JX 379 at 2; *see also* JX 379 at 1 (email from David Saks (AIG) to Joseph Chalom (BlackRock) re: "Fed meeting": "In the future, to the extent possible, we would appreciate if you gave us advance notice of the meetings with the Fed so we could opt to have an AIG person present.")).

(l) Approximately ten to twenty Davis Polk lawyers were working with Dahlgren on AIG. (Dahlgren: Trial Tr. 2606:4-6).

(i) Davis Polk was hired by Defendant after Davis Polk obtained permission from JPMorgan. (*See* Huebner: Trial Tr. 5933:13-25 (describing Davis Polk's request to "be released" from its representation of JPMorgan)).

(m) The financial advisory firm "Houlihan Lokey was brought in when we were doing AIA and ALICO" in March 2009. (Dahlgren: Trial Tr. 2646:13-24; *see also* Langerman: Trial Tr. 7168:4-19).

15.9 Several of the Advisory Firms That Defendant Used to Manage AIG Had Conflicts with AIG.

(a) Morgan Stanley had a conflict of interest due to its counterparty exposure to AIG. (PTX 66 at 2-3; *see also* PTX 589 at 116 ("Morgan Stanley received \$1.2 billion as a CDS and securities lending counterparty.")).

(b) Dahlgren: “with respect to at least Ernst & Young and BlackRock, and perhaps some other others, there were conflicts that had to be resolved” due to those firms’ ongoing relationships with AIG. (Dahlgren: Trial Tr. 2648:2-5; *see also* PTX 1609 at 1).

(i) FRBNY waived a conflict for Ernst & Young. The September 21, 2008 Ernst & Young conflicts waiver letter stated: “FRBNY has requested that certain EY personnel who are currently performing, or who have previously performed, services for AIG (‘EY Personnel’) serve on the EY engagement team performing the Services for FRBNY (the ‘FRBNY Team’), and may request additions to the FRBNY Team from among the EY Personnel.” (PTX 204 at 1-2 (providing that all confidential information related to the E&Y engagement shared by AIG may be provided to FRBNY, but information provided by FRBNY to E&Y shall not be provided to AIG); *see also* Symons: Trial Tr. 3589:21 – 3590:5 (PTX 204 is a “conflicts waiver letter” dated September 21, 2008 from E&Y to FRBNY and AIG)).

(ii) Dahlgren was asked to waive BlackRock’s conflict of interest due to its simultaneous work on valuing RMBS and CDS for AIG and its work for FRBNY on the Maiden Lane II and III transactions. (PTX 301-U at 5; *see also* Dahlgren: Trial Tr. 2649:18 – 2650:12 (Dahlgren did not know whether AIG was consulted on the preparation of the draft letter from BlackRock but acknowledged that AIG was not included on the email chain.)).

15.10 AIG Was Required to Reimburse FRBNY for All Expenses Incurred by FRBNY’s Advisors, but FRBNY Neither Set a Budget for Such Expenses Nor Reviewed with AIG How Much Money FRBNY Planned to Spend in Advance of Spending It. (Dahlgren: Trial Tr. 2606:7 – 2608:11).

(a) Geithner: There was “No budget” for all of the personnel and firms helping the Federal Reserve with respect to AIG, but it was “Very expensive”. (Geithner: Trial Tr. 1569:2-12).

(b) AIG 2009 10-K: “AIG is contractually obligated to reimburse or advance certain professional fees and other expenses incurred by the FRBNY and the trustees of the AIG Credit Facility Trust, a trust established for the sole benefit of the United States Treasury (Trust). . . . Future reimbursement or advancement payments to the FRBNY and the trustees cannot reasonably be estimated by AIG.” (JX 251 at 316-17).

15.11 Defendant Reviewed and Approved AIG Securities Filings, Press Releases, and Other Significant Public Statements.

(a) After AIG filed an 8-K on September 18, 2008 referencing warrants and shareholder approval, Defendant required AIG to amend its 8-K, and to submit its future securities filings and other significant releases to FRBNY’s lawyers for review prior to filing. (PTX 155 at 1; *see also supra* § 12.6.1).

(b) On September 19, 2008, AIG General Counsel Anastasia Kelly and Dahlgren “agreed going forward that all securities filings, press releases, and any other significant releases or communications would be run past our lawyers (DPW) in advance of anything issued.” (PTX 155 at 1; *see also* Dahlgren: Trial Tr. 2700:22 – 2701:6 (“Stasia had agreed to share with us securities filings and other press releases and things like that.” And that included not just securities filings, but “a lot of the communications.”)).

(c) Email from Charlton to Huebner on September 19, 2008: “Sarah Dahlgren and I called AIG’s GC this morning at 7:15 to alert her to the problem. She or their lawyers will be in contact with you asap. We also told her that future SEC filings, press releases, and other significant communications should be run by DPW first.” (JX 97).

(d) January 25, 2010 Committee on Oversight and Government Reform Report: “In September 2008, after its first round of bailouts from the FRBNY, AIG agreed to submit all of its filings to the Securities and Exchange Commission (‘SEC’), press releases, and other ‘significant’ communications to the FRBNY’s counsel, Davis Polk & Wardwell.” (PTX 562 at 7; *see also* Alvarez: Trial Tr. 333:13 – 334:17 (30(b)(6) deposition testimony that he had “no reason to doubt” above-quoted statement was accurate when he gave it and “it’s accurate testimony today”)). “Moreover, AIG’s SEC disclosure became a government group project: the FRBNY and Davis Polk shared draft filings with the Treasury Department as well.” (PTX 562 at 7-8).

(e) On September 22, 2008, Shannon emailed Huebner: “As we discussed on Friday, we would like to come up with a framework to share our significant filings and press releases with you and the Federal Reserve prior to filing or issuance. We wish to emphasize that we view the Fed as our partner in this process, and we intend to cooperate fully with their request.” (PTX 1638; Dahlgren: Trial Tr. 2800:14 – 2801:17 (“AIG provided us and cooperated fully.”)).

(f) On September 22, 2008 AIG’s Legal Counsel Ted Yau sent Huebner “a copy of the draft press release for clearance with the Fed.” (PTX 212 at 1).

(g) On September 23, 2008, Shannon emailed the AIG senior management team: “Although we had originally hoped to file the Form 8-K with definitive documents today, the Fed and their counsel have delayed our filing until later in the week.” (PTX 238).

(h) On September 24, 2008, Ethan James of Davis Polk sent AIG and FRBNY “Communications protocols” relating to AIG: “Here are the basic concepts, sent to all of you at the same time to facilitate speedy resolution:

1. '34 Act filings: all filings by parent and subs except for a) Section 16 filings, b) filings by Transatlantic Holdings, Inc. and c) Form 8K filings limited to press releases already cleared through or exempt from these protocols.
 2. Written communications with regulators, counterparties and employees not in the ordinary course of business. Communications regarding the lending arrangements or the Fed's involvement with AIG will be eligible for grandfathering: if a passage has been vetted, it can be used in subsequent communications w/out a repeat review. Communications regarding distress situations (economic, regulatory or other) will have to be addressed on an ad hoc basis, and we will work with you to grandfather these as well, as context permits.
 3. Press releases by AIG parent regarding significant corporate events, transactions of changes in senior management, but not including announcements of new insurance products or other ordinary course matters.
- [Consider adding a list of things that clearly don't require clearance as further reassurance of the troops.]" (PTX 244 at 1 (brackets in original)).

(i) On October 2, 2008, Dahlgren and Davis Polk "spent two hours with Ed Liddy and his team on the substance of the investor call tomorrow." (PTX 275 at 1). Dahlgren conveyed her view to Liddy that "it was not wise to release the PowerPoint deck" the company had planned to release, and "the company decided not to do it." (Dahlgren: Trial Tr. 2698:10 – 2699:11).

(j) The record is replete with other examples of Defendant's review, comment, and approval of AIG filings and releases. For example:

(i) In October 2008, Defendant reviewed and commented upon a draft letter from Ed Liddy to Secretary Paulson. (PTX 3344).

(ii) On October 16, 2008, Dahlgren approved a draft AIG press release announcing the elevation of David Herzog to AIG CFO. (PTX 1777; *see also* Dahlgren: Trial Tr. 2697:11-15 (“this email chain has to do with the Federal Reserve Bank of New York’s approval of a press release concerning a new CFO for AIG.”)).

(iii) On October 27, 2008, Defendant approved the timing of the release of AIG’s earnings statements. (PTX 327; *see also* Dahlgren: Trial Tr. 2697:24 – 2698:4).

(iv) Dahlgren and her team “would meet with the company leading up to big events, including quarterly earnings.” (Dahlgren: Trial Tr. 2699:12-16).

(v) On December 9, 2008, Anastasia Kelly (AIG) sent Sarah Dahlgren and James Hennessy (FRBNY) a draft of a speech that Liddy was scheduled to give on December 11, 2008 to the American Chamber of Commerce & Hong Kong General Chamber of Commerce for review and comment. (PTX 387 at 1, 3). Hennessy provided comments on the draft a short while later. (PTX 387 at 1; *see also* Dahlgren: Trial Tr. 2917:1-24 (Dahlgren reviewed the speech because “It referenced interactions in the relationship with the New York Fed and the Treasury, and in that regard we would want to make sure that it was accurate.”)).

(k) The Series C Stock Purchase Agreement, executed on March 1, 2009, contained a provision that required any AIG proxy statement that included the amendments necessary to either convert the Series C preferred shares into common shares or to list the Series C preferred shares be “reasonably acceptable to the” AIG Credit Facility Trust, and that AIG “shall not file”

any such proxy statement “with the SEC unless so directed by the Trust.” (JX 185 at 7 (§ 6.2(c))).³³

15.12 Starting on September 17, 2008, Defendant Engaged in Significant Additional Conduct That It Knew Would Lead to Divergence from AIG Management Strategy and AIG Corporate Interests.

15.12.1 Starting on September 17, 2008, Defendant began to implement a liquidation plan for AIG.

(a) On September 21, 2008, Paulson went on the television show “Meet the Press” with Tom Brokaw and said “that the government planned to liquidate AIG.” (Paulson: Trial Tr. 1229:10-16). Paulson admits that he referred to the AIG loan as a “liquidating loan.” (Paulson: Trial Tr. 1248:16 – 1249:15).

(b) Bernanke: “Throughout the restructuring, we have tried to do everything we can to make sure that the main focus of the company – we are not trying to make this company profitable again for the benefit of shareholders. Every objective we have is to make the company viable enough that it can sell itself off, sell off its non-core businesses, and repay the taxpayers as soon as possible. And that has been our objective.” (PTX 447 at 29-30).

15.12.2 Defendant continued to discourage and ignore offers from sovereign wealth funds and the private sector to participate in financing for AIG. (*See supra* §§ 11.9, 11.11-11.12).

³³ Dalhgren testified at trial that Defendant “reviewed a lot of materials, but I don’t believe we reviewed every security filing, press release, et cetera” (Dahlgren: Trial Tr. 2831:2-13), and that “we reviewed securities filings, press releases, and other things that referenced the – either the loan or the relationship with the Federal Reserve Bank of New York and/or the Treasury” (Dahlgren: Trial Tr. 2831:14-18). However, the testimony and documents referred to in § 15.11(a)–(k) above indicates some of the actual breadth of Defendant’s participation in AIG’s operations. Moreover, it is worth noting that every securities filing and many other key public statements referenced “either the loan or the relationship with the Federal Reserve Bank of New York and/or the Treasury” until the date the loan was repaid.

15.13 The Government and Others Considered the Government the Owner of AIG.

(a) On September 19, 2008, prior to execution of the Credit Agreement, Joseph Sommer (FRBNY) recommended that Dahlgren attend the National Association of Insurance Commissioners Conference, “Now that you are the proud new owner of an insurance company.” (PTX 1607-U at 1; *see also* Dahlgren: Trial Tr. 2789:9-21 (Dahlgren and Charlton attended that meeting)).

(b) Zingales: “It was pretty clear that the directors were serving at the will of the Government.” (Zingales: Trial Tr. 3832:19 – 3833:16).

16.0

**FROM SEPTEMBER 17 THROUGH SEPTEMBER 22,
DEFENDANT DRAFTED A BINDING CREDIT
AGREEMENT, A SUMMARY OF TERMS OF WHICH WAS
PRESENTED TO THE AIG BOARD FOR THE FIRST TIME
THE EVENING OF SEPTEMBER 21.**

16.1 Between September 16 and 22, 2008, Defendant Provided Liquidity to AIG Pursuant to Agreements in the Form of Secured Demand Notes.

(a) On September 16, 17, 18, and 19, 2008, Defendant lent to AIG pursuant to fully secured demand notes. These demand notes were separate agreements that were cancelled on September 23, 2008, after the execution of the Credit Agreement. (*See* JX 107 at 12, 23, 38-39, 74-75; JX 84 (the September 16-19, 2008 Demand Notes)).

(b) Baxter: “between September 16 and September 22, the Federal Reserve Bank extended additional credit to AIG” pursuant to “Demand notes and security pledge agreements”. (Baxter: Trial Tr. 761:15-22).

(c) Liddy: On September 16 through September 18, “money was flowing from the Federal Reserve to AIG pursuant to secured demand notes that covered each funding”. (Liddy: Trial Tr. 3044:3-6).

(d) On September 17, 2008, AIG and FRBNY executed an “Amended and Restated Pledge Agreement”, whereby AIG pledged equity interests in five subsidiaries to secure its demand note borrowing. (JX 92 at 1, 13).

(e) “These advances against the demand notes of AIG were entered into between September 16, 2008, and September 19, 2008, in an aggregate amount of \$37 billion.” (PTX 339 at 4).

(f) “Under the Demand Notes, AIG had an obligation to pay the principal, fees and interest on the demand of FRBNY or on September 23, 2008, whichever came earlier”. (Agreed to Stipulations ¶ 150; *see also* JX 84).

16.1.1 The demand notes were “separate and distinct legal documentation from the legal documentation that was executed on September 22”. (Baxter: Trial Tr. 740:24 – 741:22).

16.2 Defendant Drafted the Credit Agreement.

(a) Davis Polk was responsible for drafting Exhibit D to the Credit Agreement. (Brandow: Trial Tr. 5887:13-20).

(b) Baxter: “Ultimately I was responsible” for drafting the Credit Agreement along with “Davis Polk and lawyers who work in the legal group at the New York Fed.” (Baxter: Trial Tr. 935:22 – 936:3).

(c) At AIG’s September 18, 2008 Board meeting, “Mr. Litzky noted that a number of directors had raised questions regarding the process by which the various agreements with the Federal Reserve and Treasury would be approved. Mr. Wiseman explained the process in detail,

and noted that the documents were still being drafted by counsel for the Federal Reserve and that counsel for the Corporation hoped to receive them shortly.” (JX 94 at 6).³⁴

16.3 Between September 17 and September 21, Defendant Refused to Negotiate Key Terms of the Credit Agreement.

(a) Liddy: AIG “had several discussions with Sarah” Dahlgren “about the terms of . . . the term sheet before the 21st.” (Liddy: Trial Tr. 3293:12-16). In response, Liddy was told that “there was not going to be any change” (Liddy: Trial Tr. 3293:23-25).

(b) Dahlgren: Between September 17th and September 21st, “I know that there was back-and-forth through the lawyers on things that Ed was expressing concern about.” (Dahlgren: Trial Tr. 2779:8-21). Liddy “expressed unhappiness with respect to the equity piece of the deal between September 16th and September 21st”. (Dahlgren: Trial Tr. 2779:22 – 2780:4).

(c) Minutes of the September 21, 2008 AIG Board of Directors meeting: “Concern was raised about the Corporation’s inability to conduct further negotiations with the Bank”. (JX 103 at 6; *see also* PTX 195 at 7 (handwritten notes to the Board Meeting: “Fed gets it both ways not purely negotiated”)).

16.4 Although Defendant Refused to Negotiate the Key Terms of the Credit Agreement with AIG, Defendant Unilaterally Changed the Key Terms of the Form of Equity and Shareholder Approval, and Voting Control.

(a) Defendant changed the form of equity from warrants to voting preferred stock (*see* § 17.0-17.2, *infra*), which avoided an exercise price (§ 17.9, *infra*), and gave Defendant immediate voting control of AIG without a shareholder vote (§§ 17.3, 17.6-17.8, *infra*) – without ever presenting a proposal for voting preferred stock to AIG until the afternoon of the September 21 Board meeting (§ 16.5, *infra*).

³⁴ Although AIG’s counsel, Sullivan & Cromwell, provided comments on the Credit Agreement (*see* PTX 214-A at 3-4; Huebner: Trial Tr. 6098:17-21), their substantive comments were largely rejected. *Compare* PTX 214-A at 3-4 *with* JX 107 at 137-39.

16.5 A Summary of the Credit Agreement Terms Was Presented to the AIG Board for the First Time the Evening of September 21.

(a) As of 9:27 a.m. on September 21, AIG GC Anastasia Kelly was still advising: “We have not yet received the equity piece, which is the most important.” (PTX 182 at 1).

(b) At 3:03 p.m. on September 21, 2008, Eric Litzky (AIG Special Counsel and Secretary to the Board of Directors) emailed the AIG Board: “Attached is a summary of the draft Credit Agreement to be presented at the AIG Board meeting tonight. [REDACTED] **The terms of the equity participation have not yet been received.** A summary of those terms will follow as soon as possible” (PTX 189 at 1 (redaction in original) (emphasis added)).

(c) At 6:31 p.m. on September 21, 2008, Litzky emailed the AIG Board: “Attached is a summary of the terms of the Convertible Participating Serial Preferred Stock, which represents the United States Government equity participation. The terms of the Preferred Stock will be presented to the AIG Board at the Board meeting tonight.” (PTX 196 at 1).

(d) The summary of terms describes the form of equity as “Convertible Participating Serial Preferred Stock” that “will vote with the common stock on all matters submitted to AIG’s shareholders” and will be entitled to control “79.9%” of the vote. (PTX 196 at 3).

16.6 Prior to the Evening of September 21, the AIG Board Had Not Been Given Any Indication that Defendant Was Demanding Voting Preferred Stock as the Form of Equity.

(a) At 12:34 a.m. on September 21, Davis Polk lawyer Ethan James circulated a draft term sheet which referenced convertible participating preferred shares (JX 100 at 1-2). This draft was not sent to anyone at AIG (Brandow: Trial Tr. 5870:1 – 5871:6), and “as of this time, no one at AIG had been sent any term sheet that referenced convertible preferred shares or preferred shares of any kind”. (Brandow: Trial Tr. 5871:7-10; *accord* Def. Resp. to Pl. 2nd RFAs No. 568).

(b) At the September 18, 2008 AIG Board Meeting, “A number of questions were raised regarding the price and voting rights of the equity interest that was included in the term sheet approved on September 16. Mr. Wiseman stated that those details would be part of the documents that counsel for the Corporation expected to receive shortly, and that until those documents were completed it was not possible to answer the Board’s questions on the specifics of the equity interests.” (JX 94 at 6).

(c) At 2:52 p.m. on September 21, Baxter authorized Huebner to send the equity term sheet to Sullivan & Cromwell. (PTX 190 at 1-2; *see also* Baxter: Trial Tr. 819:12 – 821:8).

(d) The first time “that a copy of the equity term sheet mentioning preferred stock went to any counsel for AIG” was at 3:22 p.m. on September 21. (Brandow: Trial Tr. 5876:14 – 5877:6; DX 522 (email from Davis Polk lawyer Michel Beshara to Robert Reeder on September 21, 2008 at 3:22 p.m. attaching “the term sheet for the equity issuance”)).³⁵

(e) The Minutes of the September 21, 2008 AIG Board meeting state that “the Board had originally been led to believe that the form of equity participation by the Treasury Department would be warrants”. (JX 103 at 3).

16.7 Even at the September 21 Board Meeting, the AIG Board Was Not Given a Copy of the Draft Credit Agreement.

³⁵ Huebner testified at trial that he thinks it is more likely than not that he told Kathleen Shannon on September 19 that the form of equity was likely to be preferred stock. However, he does not “have a specific recollection of it” (Huebner: Trial Tr. 6029:1-21); there is no evidence that Huebner told Shannon the equity would be preferred stock; Defendant chose not to ask Shannon if she had been told by Huebner that the equity would be preferred stock (*see* Shannon: Trial Tr. 3702:20 – 3712:14); Huebner’s testimony is contradicted by record evidence that suggests that as of September 19, there was still internal debate about the form of equity (*see generally, e.g.*, PTX 183; JX 376-U); and by Defendant’s own binding admission “that the afternoon of September 21, 2008 was the first time that a draft equity term sheet was sent to AIG containing language proposing a specified form for the equity participation to be issued in connection with the Credit Agreement, and that the specified form was convertible preferred stock.” Def. Resp. to Pl. 2nd RFAs No. 448.

(a) Minutes of the September 21, 2008 AIG Board meeting: “Mr. Reeder reviewed a summary of the **principal terms** of the facility that had been prepared for review by the members” (JX 103 at 2 (emphasis added)).

(b) Offit did not see a draft of the Credit Agreement. (Offit: Trial Tr. 7965:14-24). Offit “never saw anything other than” the term sheet referenced in the September 21 AIG Board minutes. (Offit: Trial Tr. 7965:18 – 7966:15).

(c) Defendant’s expert Robert Daines: “as a matter of good corporate governance”, it is generally “preferable” “for a board to have a copy of the agreement that they are being asked to approve”. (Daines: Trial Tr. 8529:17-22).

(d) Defendant’s expert Daines: “if a board is to fulfill its obligations, it must have knowledge of all of the material terms of the transaction that it is being asked to approve”.

(Daines: Trial Tr. 8523:17 – 8524:1).³⁶

16.8 Defendant Continued to Make Changes to the Credit Agreement After the AIG Board of Directors Approved the Terms of the Agreement.

(a) Brandow: “in between the evening of September 21st and the morning of September 23rd, there continued to be changes to the credit agreement and to the equity term sheet that was attached to it”. (Brandow: Trial Tr. 5878:1-5).

³⁶ Daines testified at trial that “it’s perfectly acceptable to rely on summaries and it’s quite common to rely on summaries from outside or inside advisors,” even where the agreement the board is going to approve “is going to transfer 79.9 percent of the equity of their company to a party.” Daines: Trial Tr. 8529:17-24, 8530:7-16. However, he admitted that he did not investigate “whether the AIG board received full disclosure of all the material details of the proposed transaction for the September 16 meeting” or whether “the board was given any more information about the terms of the credit agreement other than what is set forth in the minutes and in the resolution” (Daines: Trial Tr. 8525:6-11, 8531:23 – 8532:3). Also, Defendant continued to make changes to the Credit Agreement after the AIG Board meeting (§ 16.8 (a)-(c), *infra*).

(b) At 9:37 p.m. on September 22, 2008, Davis Polk sent a draft of the Credit Agreement “requesting that all parties review and sign off within the hour” and adding to Section 5.11, “Trust Equity”, language providing: “The Borrower shall use best efforts to cause the composition of the board of directors of the Borrower to be, on or prior to the date that is 10 days after the formation of the Trust, satisfactory to the Trust in its sole discretion.” (PTX 1645 at 2, 49-50).

(c) At 10:26 p.m. on September 22, 2008, Brandow sent Treasury and FRBNY a revised equity term sheet. (DX 543). The blacklines in DX 543 “mostly go to the two issues I talked about before, the sort of details for how you would convert the percentage 79.9 percent into a number of shares, and then changes that AIG requested under equity issues to permit the issuance of common stock as part of employee benefit plans without the consent of the holders of Series C preferred.” (Brandow: Trial Tr. 5884:25 – 5885:18). Brandow does not know when this version was sent to Sullivan & Cromwell. (Brandow: Trial Tr. 5878:25 – 5879:10).

17.0

THE TERMS OF THE CREDIT AGREEMENT WERE MATERIALLY WORSE FOR AIG SHAREHOLDERS THAN THE TERMS DEFENDANT HAD OFFERED, AND WHICH THE FEDERAL RESERVE BOARD OF GOVERNORS HAD APPROVED, ON SEPTEMBER 16.

(a) Zingales: “I concluded there were significant economic differences between” the credit facility terms approved by the Federal Reserve Board of Governors on September 16, 2008, and the terms presented to the AIG Board on September 21, 2008. (Zingales: Trial Tr. 3800:17 – 3801:2; *see also* PTX 5052 – PTX 5053 (Zingales demonstratives comparing the terms approved by the Federal Reserve Board of Governors with the terms presented to the AIG

Board); Zingales: Trial Tr. 3826:12 – 3828:15 (affirming the statement as true and accurate and providing further details on PTX 5052)).

(b) Cragg: The terms of the Credit Facility changed significantly from those initially approved by the Board of Governors. (Cragg: Trial Tr. 5106:11 – 5109:24; PTX 5373 (Cragg demonstrative); *see also* PTX 2857 at 67-73 (Cragg Rebuttal Report); JX 63 at 1, 6, 10 (9/16/2008 Minutes of the Board of Governors of the Federal Reserve System); JX 107 at 137 (9/22/2008 Credit Agreement)).³⁷

17.1 The Credit Agreement Provided Defendant with Voting Preferred Stock That Had Not Been Agreed to, or Even Mentioned to AIG, on September 16 (*see supra* §§ 12.4, 14.2, 16.5-16.6).

³⁷ Defendant's expert Prof. Daines testified at trial that there was not an "economically meaningful change between the equity participation term approved by the board on September 16 and the credit agreement" (Daines: Trial Tr. 8480:24 – 8481:3). However, this testimony was based on the assumption, contrary to all the evidence, that there was no discussion of warrants on September 16, and he conceded that "there would be a difference between what" the AIG Board "knew on the 16th and what they approved on the 21st" had there been a discussion of warrants on the 16th. *Id.* 8550:15 – 8551:5.

Daines also admitted that he based his entire opinion on "just comparing the board resolutions", rather than examining what AIG's Board was told or believed about the terms of the equity. Daines: Trial Tr. 8533:7-15, 8534:25 – 8535:8, 8580:3-5; *see also id.* 8540:8-14 ("I don't have an opinion about whether the board – about what the board expected at what time."); *id.* 8542:4-6 ("I'm comparing two resolutions. I'm not comparing the terms."); *id.* 8543:10-14 ("I don't have an opinion as to whether or not the resolution is accurate."). Moreover, Daines' opinion ignores the portion of the September 16th AIG Board resolution stating that the Board agreed to "terms **consistent with those described at this meeting**". JX 74 at 13 (emphasis added). Indeed, on cross-examination, Prof. Daines conceded that "the words of the board resolution from September 16, relate to terms consistent with those described at the board meeting of that day" and that "the terms that were described at the meeting that day that are referred to in this board resolution **are terms that referenced warrants**". Daines: Trial Tr. 8535:16-24 (emphasis added).

As both the AIG Board minutes and other documents reflect, as of September 16, 2008, the AIG Board did, in fact, believe that Defendant's equity participation would be in the form of warrants. JX 103 at 3 ("although the Board had originally been led to believe that the form of equity participation by the Treasury Department would be warrants, the form of equity participation to be issued in connection with the Credit Agreement is now proposed to be convertible preferred stock"); JX 75 at 3 ("the Audit Committee hereby determines that the delay in securing shareholder approval for the issuances of the Warrants"); *see also supra* § 12.4.

(a) Minutes of the September 21, 2008 AIG Board meeting: Although “the Board had originally been led to believe that the form of equity participation by the Treasury Department would be warrants, the form of equity participation to be issued in connection with the Credit Agreement is now proposed to be convertible preferred stock, the terms of which were reflected in a term sheet delivered to Board members prior to the meeting.” (JX 103 at 3).

(b) Liddy: “We had been anticipating that it would be warrants. It was, in fact, preferred stock. So, it was a change from what was anticipated.” (Liddy: Trial Tr. 3129:13 – 3130:2; *see also* Liddy: Trial Tr. 3136:6-11 (“the clear expectation of AIG management was that there would be warrants with no vote” but the final credit agreement “provided preferred stock with a 79.9 percent vote”)).

(c) Prior to the September 21 Board meeting, Liddy “did not have any source of information as to the form of the equity, other than through Stasia Kelly.” (Liddy: Trial Tr. 3133:21 – 3134:25).

(d) Zingales: the fact that AIG’s board learned “only at the last minute that the Government had changed those terms into preferred equity” is an example of the Government’s control because “the difference between a normal contract and a contract with a person who is in

control is that the person in control dictate the terms and make it basically impossible to negotiate.” (Zingales: Trial Tr. 3824:12 – 3825:3).³⁸

17.2 There Are Material Differences Between Voting Preferred Stock and the Warrants in the Term Sheet Approved by the Board of Governors.

(a) Defendant’s expert Daines: “preferred stock is materially different from the warrants that AIG could issue on September 16”. (Daines: Trial Tr. 8544:1-4).

(b) Alvarez: “One of the differences between warrants which are limited to exercise on transfer and voting preferred is that with voting preferred the United States gets both an economic interest and voting control, whereas with warrants they would get the economic interest but not voting control.” (Alvarez: Trial Tr. 261:3-10).

(c) Zingales: “there are two major differences between a warrant and a convertible voting preferred stock, as was finally approved. The first one is that the convertible voting preferred stock has voting right from the moment they are issued. The warrant has voting right only after the warrant is exercised”. (Zingales: Trial Tr. 3826:24 – 3827:7). “And second, in order to exercise the warrant, you have to pay a strike price.” (Zingales: Trial Tr. 3827:10-11; *see also* PTX 5052).

³⁸ Liddy testified at trial that the change from warrants to preferred stock did not affect the “financial ramifications of the credit agreement” (Liddy: Trial Tr. 3294:9-12). His testimony, however, is belied by the AIG Board meeting minutes and notes of the discussion of the meeting which make clear that the AIG directors considered the change to be significant (see JX 103 at 3; PTX 195 at 2, 5); by the actual facts of its financial significance (§ 17.2, *supra*), including the fact that the change from warrants to preferred stock had the plainly substantial financial ramification of not requiring Defendant to pay an additional \$29.343 billion to AIG before acquiring voting control of AIG (see *infra* § 17.9); and by admission, “I did not concentrate on this whole area of warrants or preferred stock.” Liddy: Trial Tr. 3092:8-10; *see also* Liddy: Trial Tr. 3090:22 – 3092:8.

It is also important that independent of any “financial ramification” the change from warrants to preferred stock gave Defendants immediate control of AIG (§§ 17.6-17.8, *infra*).

(d) Kothari: “they are very different kind of securities. Warrants don’t have voting stocks, and you have to pay a certain amount to convert the warrant into shares, with the approval of existing shareholders, whereas convertible preferred, it has different set of rights, dividend and voting rights. So, the two are quite different.” (Kothari: Trial Tr. 4824:4-14).

17.3 The Warrants in the Term Sheet Approved by the Board of Governors Were Non-Voting and Required a Shareholder Vote to Be Exercised, While Voting Preferred Stock Gave Defendant Immediate Control over AIG.

(a) Defendant’s expert Daines: “If warrants had been issued, the Federal Reserve could not have gained control of . . . AIG without a shareholder vote”. (Daines: Trial Tr. 8560:8-11).

(b) “Members of the Board noted that the change from warrants to preferred stock would give the Bank current voting rights and would not require shareholder approval to the issuance.” (JX 103 at 3).

(c) Mr. Beattie of Simpson Thacher, counsel for AIG’s Board, “pointed out that the transaction gave the Federal Government voting control of the Corporation and that shareholder approval of the issuance of the preferred stock was not required.” (JX 103 at 5).

(d) “In response to a director query, Mr. Wiseman stated that the government had decided that the preferred stock could be held through a trust that would hold 79.9 percent of the voting power and would be able to control the Board and the governance of the Corporation.” (JX 103 at 6-7).

(e) Geithner acknowledged that the draft term sheet shown to the Board of Governors on September 16, 2008 states that the contemplated warrants did not have voting power until they were exercised. (Geithner: Trial Tr. 1491:7 – 1492:4).

(f) Offit: “One of the differences between preferred stock and warrants was that with preferred stock, the government was able to elect all of AIG’s directors”. (Offit: Trial Tr.

7961:14-18). A “warrant would not have any rights until it converts”. (Offit: Trial Tr. 7939:8-12).³⁹

17.4 The Warrants in the Term Sheet Approved by the Board of Governors Required the Payment of an Exercise Price to Be Converted to Stock, Which Payment Was Avoided by Immediately Issuing Preferred Stock.

(a) Zingales: “the warrant could not have been exercised at a strike price below 2.5 dollars a share. Now, given that in order to give 80 percent of equity to the Government upon exercising of the warrant, you had to issue roughly 12 billion shares. Twelve billion times 2.5 dollars per share is roughly 30 billion. So, it would have cost the Government 30 billion to achieve those voting rights that they were receiving right away in the convertible voting preferred.” (Zingales: Trial Tr. 3827:17 – 3828:2; *accord* Cragg: Trial Tr. 5107:16 – 5108:7; PTX 5373 (Cragg demonstrative)).

17.5 The Form of Equity Was Material to AIG.⁴⁰

(a) AIG General Counsel and Chief Compliance and Regulatory Officer Anastasia Kelly emailed AIG executives and staff on September 21, 2008, at 9:27 a.m. regarding the

³⁹ Although Offit testified that the terms presented on September 21 were “consistent” with those presented on September 16 (Offit: Trial Tr. 7900:10-16), and that he believed the Board acted in the best interests of AIG and its shareholders on September 21 (Offit: Trial Tr. 7903:10-13), on cross-examination Offit admitted that on September 21 he believed that the preferred stock the Government received would *not* have voting rights prior to conversion. Offit: Trial Tr. 7935:19 – 7936:11. This mistaken belief calls into question both Offit’s opinion that the terms on the 21st were consistent with those on the 16th, and also the thoroughness of the Board’s consideration of the Credit Agreement. *See, e.g.*, JX 103 at 13 (describing the immediate voting rights of the Preferred Stock).

⁴⁰ Messrs. Liddy, Offit, and Schreiber suggested at trial that the change from warrants to preferred stock was not significant to the agreement (see Liddy: Trial Tr. 3135:1-4; Offit: Trial Tr. 7899:8-14; Schreiber: Trial Tr. 6612:14-20), there is significant contemporaneous evidence that the AIG Board considered it a material term at the time. However, that suggestion is inconsistent with the undisputed differences (*see supra* §§ 17.2-17.4), the importance AIG gave to the form of equity (*see infra* § 17.5(a)-(b)), and the concern expressed about the change (*see infra* § 17.5(c)-(d)).

forthcoming Credit Agreement: “We have not yet received the equity piece, which is the most important.” (PTX 182 at 1).

(b) Farnan: “PwC considered the form of equity that AIG was to provide to the trust in the credit agreement to be a material term of the credit agreement from an accounting perspective”. (Farnan: Trial Tr. 4404:1-5).

(c) The Board minutes reflect the Board’s concern about the change from non-voting warrants to preferred stock. “It was noted that although the Board had originally been led to believe that the form of equity participation by the Treasury Department would be warrants, the form of equity participation to be issued in connection with the Credit Agreement is now proposed to be convertible preferred stock, the terms of which were reflected in a term sheet delivered to Board members prior to the meeting” (JX 103 at 3; *see also supra* § 16.3).

(d) The handwritten notes of Kathleen Shannon, who drafted the September 21 meeting minutes, are also replete with specific comments from various AIG Board directors and their advisors concerned about the change. For example:

(i) “ET don’t particularly understand equity”. (PTX 195 at 2; *see* Shannon: Trial Tr. 3652:5-17 (“ET” refers to Edmund Tse)).

(ii) “GM would like to understand duties . . . in accepting facility w/ Fed altho did not know form of equity”. (PTX 195 at 3; *see* Shannon: Trial Tr. 3653:15 – 3656:1 (“GM” refers to George Miles)).

(iii) “RB gov’t getting vote now . . . shh do not have to approve issuance of preferred”. (PTX 195 at 5; *see* Shannon: Trial Tr. 3653:15 – 3658:14 (“RB” refers to Richard Beattie)).

(iv) “MW . . . will hold 79.9% of voting power + will be able to control BOD and governance of co”. (PTX 195 at 8; *see* Shannon: Trial Tr. 3653:15 – 3654:11 (“MW” refers to Michael Wiseman)).

17.6 Changing the Form of Equity from Non-Voting Warrants to Voting Convertible Preferred Stock in Order to Obtain Immediate Control of AIG Was Important to Defendant.

(a) “FRBNY considered whether it should seek equity in the form of warrants, but concluded that, among other shortcomings, this approach would not be consistent with all of its objectives because the warrants would not carry voting rights until exercised.” (Def. Resp. to Pl. 2nd Interrogatories No. 2).

(b) Baxter: “Between September 16 and September 22, the form of equity that was going to be provided changed from warrants to convertible voting preferred stock”. (Baxter: Trial Tr. 765:6-9). Warrants “did not have a vote that could be used to control AIG”. (Baxter: Trial Tr. 765:18-20).

(c) Geithner: “There came a time when the Federal Reserve wanted to be sure that it had equity that would provide it with voting control” and “in pursuit of that, ultimately, what the Federal Reserve required as consideration for the credit facility was voting preferred stock.” (Geithner: Trial Tr. 1492:19 – 1493:1).

(d) On September 19, 2008, Huebner sent a memorandum to Treasury and FRBNY officials at the request of Defendant on the pros and cons of two different equity structures, Option A (non-voting warrants and preferred stock with very limited voting rights) and Option B (“Super-voting convertible preferred shares”), noting under Option B, “Voting is controlled by voting trust from day one”, which allowed for the advantage of the “Ability to realize control premium”. Baxter responded: “I actually like Option B better.” (PTX 159-U at 1, 6-7).

(e) Huebner to Baxter on September 19, 2008: “I feel even more strongly about my long vm to you about structure preference after I learned that the board is not staggered and has only 1 year terms.” (PTX 154 at 1).

(i) AIG’s Board was at a “relatively high risk of being fired all in one shot by a possible constituency” (Huebner: Trial Tr. 6055:3-5), and that “presented incremental risk, especially in a distressed situation in a company with a greatly declined stock price”. (Huebner: Trial Tr. 6055:7-10).

(ii) Having voting preferred stock as compared to warrants protected FRBNY against this risk because it gave FRBNY “a vote equal to 79.9 percent of the common and economic rights equal to 79.9.” (Huebner: Trial Tr. 6058:9-14).

(f) In a November 9, 2008 email between Ashton and Stephen Albrecht (a lawyer in the General Counsel’s office at Treasury), Ashton notes that some Board members had policy concerns about the Government having full voting rights: “We checked again last night the issue of voting versus limited voting for the stock to be held by the Trust. Our policy people, including some Board members, are against the convertible preferred having full voting rights while it is in the Trust. It will be more difficult for us to insulate ourselves from the perception of having full voting power if we have to set up the Trust and select the trustees and perhaps fund expenses. . . . While in the trust the preferred could vote in limited circumstances when it is necessary, like when there is a contested vote for directors or when necessary to call a special shareholders meeting to respond to problems that would threaten the government’s interest.” (PTX 359 at 1).

(i) Zingales: PTX 359 is significant to an analysis of control because it shows that despite being “concerned about perception of being too much in control,” Defendant

believed the need for voting rights was so important that it went ahead believing that voting rights were “instrumental for the Government to implement what the Government wanted to do.” (Zingales: Trial Tr. 8618:1 – 8619:2).

(g) Cragg: The fact that the “terms of the credit facility approved by the Board of Governors required shareholder approval before stock could be issued and the final terms of the credit facility provided that the voting preferred shares would be issued without further shareholder approval” has economic significance because “it’s a change in the degree of control that the existing shareholders would have relative to the government,” and “creates a cascade of impacts from that change of control.” (Cragg: Trial Tr. 5109:8-20; PTX 5373 (Cragg demonstrative)). For example, “decisions about board members, management, financing. You know, a wide range of things could be impacted by that.” (Cragg: Trial Tr. 5109:21-24).

(h) Defendant’s outside counsel at Wachtell on September 16: “We think voting control from day 1 is extremely important.” (PTX 3278 at 1).

17.7 Defendant Wanted Immediate Control of AIG to Prevent AIG’s Common Shareholders from Having a Chance to Reject the Terms of the Credit Agreement.

(a) Davis Polk’s Ethan James on September 17: “avoiding a SH vote we don’t control is a primary goal.” (PTX 3272 at 1).

(b) Treasury Counsel Stephen Albrecht to Treasury personnel regarding “AIG preferred stock – Fed credit agreement”: “We originally pushed for voting rights to help fend off the shareholder attempts to ‘reclaim’ the company.” (PTX 349 at 1).

(c) On September 21, 2008, in an email from FRBNY attorney Charles Gray to Dahlgren: FRBNY Counsel “Rich Charlton just came up and shared with Tom your concern about whether the terms of the equity investment will adequately protect us against shareholder activism among minority shareholders at AIG. I can say that this issue has been a key focus of

both Tom and the Davis Polk lawyers drafting the Term Sheet, and the Davis Polk lawyers think the proposed plan will protect us.” (PTX 184 at 1).

(d) Huebner to Baxter on September 19, 2008: “I don’t see how we can leave this asset at risk of minority shareholder takeover.” (PTX 154 at 1).

(e) Defendant’s counsel Wachtell: AIG “will need to authorize at least another 8 billion shares (perhaps more) to be able to issue common representing 79.9% Warrant confers no governance rights or vote – a third party could try to accumulate existing common and hold up the vote to authorize additional common, perhaps demanding compensation or concessions in exchange for the vote. . . . May be no viable remedy for failure to get the shareholder vote.” (PTX 98-U at 4).

(i) Convertible participating preferred stock, compared to warrants, “could ensure shareholder approval of charter amendment to authorize additional common and eliminate par value. It would also prevent third party or parties from accumulating controlling interest in common (or running a successful proxy fight), because the preferred would carry 79.9% of voting power.” (PTX 98-U at 5).

(f) Davis Polk on September 16, 2008: “The Fed wants the entire board to resign and be replaced. The Fed believes the board will agree to this, but is there a way to get the directors the government wants without getting lock-ups from a majority of shareholders and getting the shareholders to vote?” (PTX 3290).

(i) Zingales: PTX 3290 is significant to his opinion because “this is really the moment in which the Government is designing the initial facility for AIG, and it’s clear from this document that they want to control the vote, and they want to do it in a way that

is the least controversial and creates less problems with existing shareholders, but they do want to control the vote.” (Zingales: Trial Tr. 8619:24 – 8620:8).

(g) On September 19, 2008, McConnell, Geithner’s Deputy Chief of Staff, sent Geithner a *Bloomberg* article reporting that AIG “rose 44 percent in New York trading on speculation shareholders may try to derail a government takeover by helping to repay a federal loan to the company.” (PTX 161 at 1).

(h) Geithner “was generally aware” of the “possible risk” that investors would derail the takeover and that his colleagues had concerns that dissident shareholder actions “might jeopardize what we were trying to do” and “were exploring ways of dealing with that risk” (Geithner: Trial Tr. 1500:16-21, 1528:14-19).

17.8 Defendant Was Obsessed with the Danger That AIG Shareholders Might Object to the Deal and Use Their Right to Vote to Block or Revise It.

(a) Baxter: On September 21, 2008, Baxter told Alvarez that he wanted to keep the process of drafting the equity term sheet moving and send it to AIG “because of a concern there will be shareholder action.” (PTX 183 at 1).

(b) Baxter: Baxter was concerned that Rodgin Cohen, AIG’s lawyer who had previously represented Bear Stearns, “would try to renegotiate the terms of the deal so that they would be less favorable to the New York Fed and more favorable to AIG.” (Baxter: Trial Tr. 781:19-25; *see also* Baxter: Trial Tr. 780:1-7 (acknowledging that one part of the deal that changed in the Bear Stearns transaction was that Cohen renegotiated the deal “from \$2 a share to \$10 a share for the shareholders”)).

(c) Once the Credit Agreement was executed, Baxter was no longer concerned that the terms would be renegotiated in a manner less favorable to Defendant and more favorable to AIG because Baxter “had a binding agreement at that point in time with the protections that I had

been looking for” including “convertible preferred stock that had an immediate vote . . . by the trustees.” (Baxter: Trial Tr. 783:11 – 784:3).

(d) Between September 16 and 24, 2008, there were several news reports around this time of shareholders possibly banding together to avoid a Government takeover of AIG.

(i) *Bloomberg News* on 9/19/08: “American International Group Inc. rose 44 percent in New York trading on speculation shareholders may try to derail a government takeover by helping to repay a federal loan to the company.” (PTX 161 at 1).

(ii) *Wall Street Journal* on 9/20/08: “Major shareholders are trying to help pay off the federal government’s loan to American International Group Inc. in time to avoid having Washington take an 80% stake in the company”. “AIG shareholders are seeking to pay off the loan quickly so a government takeover of the company could be averted.” (PTX 179).

(iii) Citigroup Report on 9/23/08: “news that shareholders are attempting to find an alternative to the credit facility, has raised speculation regarding the possibility that the government will not take a dilutive equity stake in AIG.” “shareholders have formed a committee against the government claim”. (PTX 236 at 1).

(iv) MarketWatch on 9/24/08: “Some big AIG shareholders have reportedly been trying to raise capital in private markets to avoid the government seizing control of the company.” (PTX 242 at 1).

(e) Huebner on September 22 to senior Treasury officials and a FRBNY attorney: “I would give a lot to find a way to take the stock before the shareholder war machine moves.” (PTX 3249 at 1).

(f) Davis Polk attorney Ethan James on September 22: “we want to make sure that the CA leaves the company no choice but to issue the equity, even (especially) in the face of concerted efforts to prevent that issuance.” (PTX 3277 at 1).

(g) A September 22, 2008 email chain among Davis Polk lawyers shows that Defendant considered requiring AIG to issue the equity in 30 days in order to avoid a situation in which “Boies convinces a significant regulator” to withhold approval. (PTX 3282 at 1).

(h) Huebner: On September 23, 2008, after the credit facility had been agreed to, AIG representatives met with certain AIG shareholders and their financial advisor. (PTX 3120 at 2). At that meeting, the AIG “shareholder representatives” stated in sum and substance that: “They are ‘very concerned’ about the 79.9% equity interest, and are focused on the ‘ability to claw it back should the facility be repaid in a reasonable time.’ They articulated a belief that adding an ‘equity clawback’ to the deal would provide substantial incentive to help both the taxpayers and AIG, and was synergistic to all. (Despite that fact that we, of course, find this statement incorrect, I said nothing.)”. (PTX 3120 at 2).

(i) On September 19, 2008, Huebner wrote in an email to several FRBNY and Treasury officials, referencing a September 18 *Wall Street Journal* article which reported that AIG’s directors were “stunned” by Defendant’s “‘onerous’ proposal”; “bristled at what they considered Washington’s heavy-handed treatment”; and “felt ‘violated’”: Preferred shares “may well be critically necessary given the very public winging (pronounced in this case winzhing) going on by certain board members (see below), the annual non-staggered risk of having a known board voted out, and the ability of anyone (and there are several logical candidates) to have/acquire big stock positions and make much trouble for us.” (PTX 159-U at 1-2).

(i) This relates to the concern “that absent having voting rights available to the 79.9 percent equity that was promised, you know, anybody could or could buy into this and in one swoop call a shareholders vote and fire the whole board, fire the whole management and install people who might be decidedly hostile, including to AIG, by the way.” (Huebner: Trial Tr. 6077:24 – 6078:25).

(j) Ethan James on September 19: “Form 8K Item 1.01 requires the disclosure of material contracts, but it does not require that the actual contract be filed with the form. We should consider going this route, particularly to show less of a hand to Greenberg on the equity issuance (ideally we should have the pref issued before they realize that we are going to do it w/out a SH vote).” (PTX 3242 at 1).

17.9 Defendant Changed the Form of Equity from Non-Voting Warrants to Voting Convertible Preferred Stock in Order to Avoid Payment of a Strike Price of a Minimum of \$29.343 billion.

17.9.1 Warrants have an exercise price. (Def. Resp. to Pl. 2nd RFAs No. 558; Offit: Trial Tr. 7939:13-15; Liddy: Trial Tr. 3090:22 – 3091:2).

17.9.2 The exercise price for warrants for AIG common stock would have been at least \$2.50 per share, absent the AIG common shareholders voting as a class to decrease the par value.

(a) As of September 21, 2008, AIG’s Certificate of Incorporation provided that par value of AIG common stock was \$2.50 per share. (PTX 3 at 1).

(b) Baxter: “if there were warrants, when those warrants were exercisable, the price would have to be at least the par value of the common stock into which they were being converted,” which Baxter knew “was in the neighborhood of \$2.50 a share” for AIG. (Baxter: Trial Tr. 789:16-20, 790:22-24).

(c) On September 21, 2008, Liddy understood from his “experience at Goldman Sachs” that “the exercise of a warrant required a price at least equal to the par value.” (Liddy: Trial Tr. 3138:25 – 3139:6; *see also* Liddy: Trial Tr. 3140:21 – 3141:7).

(d) Farnan: It was PwC’s “understanding” that, “as long as the par value of the stock was \$2.50, the strike price for any warrant to be exercised had to be at least \$2.50”. (Farnan: Trial Tr. 4185:19-22). “If the Charter Amendment to reduce the par amount is not passed, the strike price remains at \$2.50”. (PTX 444 at 9).

17.9.3 To receive 79.9% of AIG’s common shares, Defendant would be required to exercise warrants for 11.737 billion shares (79.9% of 14.69 billion shares per PTX 375 at 21), which at \$2.50 per share would be approximately \$29.343 billion.

(a) Defendant’s outside counsel at Wachtell on September 16: “Based on 2.7 billion shares outstanding, would need to issue about 10.8 billion new shares to get to 79.9% – that number will probably be a bit higher to reflect dilution from existing options, etc.” (PTX 98-U at 4).

(b) On September 22, Defendant’s outside counsel at Davis Polk circulated a chart which presented a base case requiring 11.791 billion shares for full conversion of Defendant’s equity interest. (DX 543 at -058).⁴¹

⁴¹ Although Huebner testified that it was not contemplated that FRBNY would have to pay “any strike price” for the warrants (Huebner: Trial Tr. 5995:11– 5998:12), his testimony runs counter both to basic principles of corporate finance that were known to the relevant actors as well as to evidence that shows that Defendant and its counsel were aware of AIG’s par value and the need for a shareholder vote (which would have been controlled by the existing common shareholders) to reduce par value if the Government wanted to avoid paying the strike price. *See* Baxter: Trial Tr. 789:16-790:1 (Baxter knew “that if there were warrants, when those warrants were exercisable, the price would have to be at least the par value of the common stock into which they were being converted”).

17.9.4 Defendant wanted to avoid paying more than a “nominal price” for the AIG equity it acquired.

(a) Defendant’s outside counsel at Wachtell on September 16, 2008: “current par value is \$2.50 per share, so will need to amend charter to eliminate par value in order to permit exercise for nominal exercise price.” (PTX 98-U at 4).

18.0

THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE NEVER APPROVED THE CREDIT AGREEMENT NOR THE CHANGES MADE TO THE TERMS OF THE \$85 BILLION 13(3) LOAN TO AIG AS APPROVED BY THE BOARD OF GOVERNORS ON SEPTEMBER 16 (12 U.S.C. §§ 343, 357 (2006)).

18.1 The Board of Governors Must Authorize the Terms in Order for FRBNY to Extend a Loan Under Section 13(3), and so FRBNY Needed Authorization from the Board of Governors to Extend a Loan to AIG.

(a) Baxter: “my interpretation of Section 13, subparagraph (3), is that the Board of Governors, which would be the equivalent of a principal, has to authorize the lender, which would be the equivalent of an agent, before the lender can – can have the power to lend. And so the question, apart from the statutory authority question, is had the Board of Governors authorized the lending Reserve Bank to make a loan of a particular kind.” (Baxter: Trial Tr. 1112:4-12). “If we hadn’t – if we hadn’t, Mr. Boies, then we would have been taking action that was not authorized in the same sense that a principal authorizes an agent, and if an agent acts without the authority of the principal, then the agent could have responsibility or liability for its action.” (Baxter: Trial Tr. 1112:14-19).

(b) Baxter: “in order for the New York Fed to be authorized to make the loan,” FRBNY “must receive authorization from” the “Board of Governors,” and “that authorization, broad or

narrow, must be within the statutory authority of the Board of Governors” and the “the Reserve Bank”. (Baxter: Trial Tr. 1114:5-13 (“We both have to abide by the statutory limits.”)).

(c) Baxter: “The issue with authority related to the authorization that section 13 subparagraph (3) requires the Board of Governors to offer to the lending Reserve Bank so it could make the loan. And the issue with respect to the authorization was always, with respect to the equity, who could hold the equity. And the feeling, at least as I understood it, from the Board of Governors is that we, the New York Fed, were not authorized by the authorization given to us by the Board of Governors to hold the equity.” (Baxter: Trial Tr. 720:25 – 721:15).

(d) Geithner: “Five governors would have to concur or vote to approve any use of” 13(3) authority. (Geithner: Trial Tr. 1704:24 – 1705:6).

18.2 The Board of Governors Authorized a 13(3) Loan to AIG Based on a Term Sheet That Called for Non-Voting Warrants and Did Not Mention Preferred Shares (Voting or Otherwise), and Did Not Leave the Form of Equity “To Be Determined” (JX 63 at 5-10).

18.2.1 The Board of Governors did not discuss or consider requiring AIG to issue voting convertible preferred stock or leaving the form of equity “to be determined” (JX 63).

(a) Alvarez: Nowhere in the materials from the September 16, 2008 meeting of the Federal Reserve Board of Governors, “not the minutes, not the term sheet, not the resolution, is there any reference to any other specific form of equity other than warrants”. (Alvarez: Trial Tr. 191:12-16).

(b) The September 16 minutes “does not say that the form of equity is to be determined, that’s correct.” (Alvarez: Trial Tr. 205:3 – 206:4).

18.3 The Board of Governors Authorized a 13(3) Loan Based on a Term Sheet That Required Shareholder Approval for Defendant to Obtain Voting Stock or Voting Control (JX 63 at 6, 10).

18.3.1 There was no discussion or vote at the September 16, 2008 Board of Governors meeting about obtaining voting stock or voting control without a shareholder vote. (JX 63).

18.3.2 The only term sheet approved by the Board of Governors includes a “Summary of Terms of Warrants” which states that “Shareholder Approval” was “Required to issue stock above authorized by unissued shares”. (JX 63 at 10).

(a) Bernanke: The term sheet approved by the Board of Governors “contemplated shareholder approval” and the Board of Governors never approved a provision “for the issuance of preferred stock without shareholder approval”. (Bernanke: Trial Tr. 2026:20 – 2027:19).

(b) Bernanke: “understood that the warrants would not have a vote until they had been exercised”. (Bernanke: Trial Tr. 1975:13-15).

(c) Baxter: The “term sheet that was considered by the Board of Governors provided that there would be shareholder approval of the increase in authorized shares necessary to permit the exercise of the warrants”. (Baxter: Trial Tr. 816:10-15).

18.4 The Board of Governors Authorized a 13(3) Loan Based on a Term Sheet That Required Defendant to Pay an “Exercise Price” (JX 63 at 10).

18.4.1 There was no discussion about acquiring stock without paying an exercise price. (JX 63).

18.4.2 The term sheet provides when “The warrants may be exercised” and discusses the warrants’ “Exercise Price”. (JX 63 at 10).

(a) Bernanke: “understood that those warrants would have an exercise price”. (Bernanke: Trial Tr. 1975:4-12).

18.5 The Board of Governors Authorized a 13(3) Loan Based on a Term Sheet That Did Not Mention a Trust.

18.5.1 The term sheet considered by the Board of Governors did not mention the creation of a Trust to hold voting convertible preferred stock (JX 63 at 5-10), and there was no discussion about, or vote concerning, a Trust (JX 63 at 1-3).

(a) “The Board of Governors of the Federal Reserve System did not vote on whether to create a Trust for the purpose of holding the equity interest in AIG.” (Def. Resp. to Pl. 1st RFAs No. 29.3).

(b) “The Board of Governors of the Federal Reserve System did not vote on whether the Series C Preferred Shares should be issued to and held by the Trust.” (Def. Resp. to Pl. 1st RFAs No. 29.5).

(c) Bernanke: “the provision for a trust” was never “presented to the Board of Governors for approval,” and he could not recall if there was “any presentation of information to the Board of Governors concerning the trust between September 16th and September 22nd.” (Bernanke: Trial Tr. 2028:16-25)

(d) Baxter: The Board of Governors term sheet “dealt with warrants,” there “was no mention of trust,” whereas “the credit facility on 9/22” “had preferred stock” and “it had a trust.” (Baxter: Trial Tr. 1109:20 – 1110:4).

18.6 “The Federal Reserve Board Did Not Have Any Involvement in the Structure of the Credit Facility Trust Agreement.” (Def. Resp. to Pl. 2nd RFAs No. 563).

(a) United States 30(b)(6) (Greenlee), *Murray v. Geithner*, Dep. 32:15-20: “Q. So is it your testimony here today, Mr. Greenlee, that after September 16th none of the individual board members – and that includes Chairman Bernanke – had any further involvement in the decision as to how to structure the credit facility, how much to provide, when to provide it? A. Yes.” (PTX 545 at 32).

(b) United States 30(b)(6) (Greenlee), *Murray v. Geithner*, Dep. 29:17-21: “Q. So your testimony here today is that the Federal Reserve Board took no decision regarding that particular structure versus any other structure that the Federal Reserve Bank of New York might have used? A. Yes.” (PTX 545 at 29; *see also* Bernanke: Trial Tr. 2026:20 – 2027:14).

18.7 The Board of Governors Did Not Vote to Approve the Credit Agreement.

(a) The “United States admits that the Credit Agreement was not presented to the Board of Governors for a formal vote.” (Def. Resp. to Pl. 2nd RFAs No. 550).

(b) The Board of Governors “did not hold a meeting or vote to consider the terms of the Credit Agreement separate and apart from the two-part meeting on September 16, 2008”. (Def. Resp. to Pl. 3rd Interrogatories No. 5).

(c) Bernanke: The Credit Agreement was never brought to the Board of Governors for approval. (Bernanke: Trial Tr. 2025:6-11). The only “draft of the credit agreement” brought to the Board is the term sheet included in JX 63. (Bernanke: Trial Tr. 2025:12-17).

(i) Bernanke: “the requirement that AIG provide voting equity as opposed to nonvoting warrants” was never “brought to the Federal Reserve Board of Governors for approval”. (Bernanke: Trial Tr. 2025:22-25).⁴²

18.8 The Board of Governors Did Not Even Learn That FRBNY Would Demand Voting Convertible Preferred Stock or That FRBNY Would Create a Trust Until After September 16, 2008.

⁴² Defendant’s witnesses have sometimes suggested that the September 16th authorization by the Board of Governors provided FRBNY sufficient flexibility to alter the terms as they were ultimately agreed in the Credit Agreement (Alvarez: Trial Tr. 573:16 – 574:23; Geithner: Trial Tr. 1792:22 – 1794:8; Bernanke: Trial Tr. 2111:7 – 2112:6), and that subsequent conversations with former Fed Chairman Bernanke or Vice Chairman Kohn were sufficient to provide authorization for the changes. *See* Baxter: Trial Tr. 976:2-20 (referring to DX 528 at -883 (“Based on conversations with the Chairman and Vice Chairman, we are O.K. if any stock we get goes to a trust of which Treasury is the sole beneficiary, as long as we never get any equity ourselves.”)); *see also* Alvarez: Trial Tr. 574:24 – 576:14; Bernanke: Trial Tr. 2029:1-11.

None has explained, however, how these interpretations are consistent with the acknowledged statutory requirement that the Board of Governors approve the terms of all 13(3) loans (12 U.S.C. § 343 (2006)); Defendant’s belief that the Board had not authorized FRBNY to take equity despite the “flexibility” in setting the terms, which led to the creation of the Trust (Baxter: Trial Tr. 721:5-15); why they thought it might be “preferable” to ask for the Board of Governors’ approval after the change in the form of equity from warrants to preferred shares was made (*see* PTX 1816 at 6); or why they thought purported “conversations” with the Chairman and Vice Chairman were sufficient in light of the statutory requirement of five votes (*see also infra* ¶ 27.5.3).

(a) Bernanke: “Q. When was the first time you were informed that the September 22nd credit agreement included a trust? A. Mr. Alvarez came to see me sometime later that week, I’m not quite sure what day, and – to check with me about the change in the equity component and the trust”. (Bernanke: Trial Tr. 2029:1-6).

(b) Bernanke could not recall “any presentation of information to the Board of Governors concerning the trust between September 16th and September 22nd, even if no formal approval was required”. (Bernanke: Trial Tr. 2028:21-25).

18.9 Contemporaneous Documents Indicate That the Board of Governors Had Reservations About the Change from Non-Voting Warrants to Voting Convertible Preferred Stock.

(a) Board of Governors attorney Rich Ashton on November 9, 2008 to Treasury attorney Stephen Albrecht: “Our policy people, including some Board members, are against the convertible preferred having full voting rights while it is in the Trust. It will be more difficult for us to insulate ourselves from the perception of having full voting power if we have to set up the Trust and select the trustees and perhaps fund expenses. We think the interests of the Government in having the loan repaid and protecting the Treasury’s beneficial equity stake by having the stock in the trust be generally nonvoting preferred that would be convertible to voting when sold to a third party.” (PTX 359 at 1).

(b) On November 5, 2008,⁴³ in a memorandum regarding whether there is legal authority for the Reserve Bank to pay expenses of the AIG Credit Facility Trust, there was still a concern being raised by Federal Reserve counsel about whether the Board of Governors had actually given FRBNY permission to acquire preferred shares: “To avoid any ambiguity arising from the transformation of the ‘warrants’ mentioned in the term sheet to the preferred shares in

⁴³ This is the correct date based upon the metadata and the court reporter reflected the correct date in the transcript. Trial Tr. 1190:13-14.

the AIG Credit Facility documentation, it might be preferable to request that the Board amend the Resolution to refer to the issuance of the preferred shares to the Trust, and to specifically authorize the Reserve Bank to pay the expenses (or, alternatively, to advance funds for the expenses, *see infra*).” (PTX 1816 at 6).

(c) November 21, 2008 Memo from the Legal Division of the Board of Governors to the Treasury Department, regarding “Voting Rights for AIG Preferred Shares Issued to AIG Credit Facility Trust”: “The Federal Reserve believes that a variety of protections can be built into the Preferred Stock of AIG to fully protect the Government’s interest while maintaining the public nature of the company. In particular, significant protections can be secured by allowing the trustees to have voting powers for the Preferred Stock **in a few specified circumstances** when voting would be necessary to prevent actions by the existing common shareholders that could impair AIG’s repayment of the Federal Reserve loan or the value of the Treasury’s equity interests. Thus, **the Preferred Stock would not need to have full voting rights with the common shares generally while it was held by the Trust nor would it have to be converted into common shares until sold.** This would materially dispel the perception that AIG is no longer a public company and that the Government has the power and influence of a controlling shareholder over AIG.” (JX 162 at 2 (emphasis added)).

(d) Treasury attorney Stephen Albrecht on January 13, 2009 to other Treasury officials: “The Fed Board has had a lingering concern that these shares should be changed from full voting to limited voting.” (PTX 3244 at 1).

18.9.1 Defendant did not, however, limit its voting control over AIG because, as Treasury attorney Stephen Albrecht noted on January 16, 2009 regarding a proposal by the Board of Governors to limit Defendant’s voting control over AIG: “there is real risk that this

could in some way open the door for the existing shareholder who are currently engaged in litigation over the deal, and seek to gain control of the company” (PTX 3308 at 1).

19.0

ON SEPTEMBER 21, 2008, DEFENDANT TOLD AIG’S OFFICERS AND DIRECTORS THAT IF THEY DID NOT APPROVE THE CREDIT AGREEMENT AS PROPOSED BY DEFENDANT, INCLUDING WITH THE CHANGES DEFENDANT HAD UNILATERALLY MADE, DEFENDANT WOULD CALL ITS SECURED DEMAND NOTES AND AIG WOULD BE REQUIRED TO FILE FOR BANKRUPTCY.

19.1 From September 16 to 19, AIG Had Given FRBNY Several Demand Notes Totaling \$37 Billion Which Obligated AIG to Repay FRBNY for Any Principal and Interest “On Demand”. (JX 84 at 1-4).

19.2 At the September 21, 2008 Meeting, Liddy Told the Board: “the Corporation Will Be Required by the Bank and the Treasury Department to Finalize the Documentation and Sign the Credit Agreement Before the Opening of the Market the Following Day.” (JX 103 at 2).

19.3 Defendant Threatened to Cut Off Funding for AIG by Calling the Secured Demand Notes if the AIG Board Did Not Approve the Credit Agreement as Drafted by Defendant.

(a) AIG’s outside counsel, Michael Wiseman of Sullivan & Cromwell LLP, advised the Board during the September 21, 2008 meeting that “based on his conversations with the General Counsel of the Bank, he believed that if the Board did not approve the transaction that evening, the likely result would be that the Bank would refuse to fund the Corporation the next day” (JX 103 at 4) and that the Bank “would call Note” (PTX 195 at 3; *see also* Shannon: Trial Tr. 3655:12-20 (Shannon interprets her notes to indicate that Wiseman was “saying that, according to Mr. Baxter, if there was not board of directors approval, the Federal Reserve would likely not fund and would likely call whatever note was then outstanding.”)).

19.4 If Defendant Had Called the Demand Notes and Not Continued to Fund AIG, “That Would Have Had a Disastrous Effect on AIG” (Offit: Trial Tr. 7941:10-16).

20.0

FACED WITH DEFENDANT'S NON-NEGOTIABLE DEMANDS, ITS THREAT TO CALL ITS SECURED DEMAND NOTES, AND THE OPINION OF AIG COUNSEL THAT A DECISION TO FILE FOR BANKRUPTCY WOULD NO LONGER BE PROTECTED BY THE BUSINESS JUDGMENT RULE, AIG HAD NO REALISTIC CHOICE BUT TO ACCEPT DEFENDANT'S LOAN ON DEFENDANT'S TERMS. (PTX 195 AT 4).

20.1 AIG's Outside Counsel, Rodgin Cohen of Sullivan & Cromwell LLP, Advised the Board During the September 21, 2008 Meeting That "Bankruptcy Was a Considerably Worse Alternative Now Than It Was Previously," and That "if the Board Accepted the Bank Transaction, the Board Would Have Properly Exercised Its Business Judgment," but That "if the Board Chose to File for Bankruptcy, He Was Not Prepared to Render a Similar Opinion to the Board". (JX 103 at 5-6).

(a) Daines: In his experience in the area of corporate governance, Daines is not "aware of any instance in which board members have taken action that their counsel advised them would not be protected by the business judgment rule." (Daines: Trial Tr. 8573:18-23).

(b) Zingales: Between the 16th and 21st, "the situation had changed quite a bit, and so much so that Rodgin Cohen, the outside counselor, sort of was not prepared to extend the opinion that filing for bankruptcy was protected under the business judgment rule. So, at that time, clearly it was no feasible option for the board members." (Zingales: Trial Tr. 3924:8-22).

(c) Zingales: "Both as a scholar and as a board member, I would say that if you are told that you cannot be protected by the business judgment rule in making a decision, you should not go down that territory since the potential liability for you is so large that basically that makes it an unfeasible choice from your point of view." (Zingales: Trial Tr. 4103:6-19).

20.1.1 The AIG Board was advised that its constituencies included not just its shareholders, but also its creditors and employees. (JX 103 at 4).

(a) September 21, 2008 AIG Board meeting minutes: “It was pointed out that at the prior meeting, the directors had been instructed on their duties to creditors, shareholders and employees, and they should weigh their duties and the actions described at the prior meeting as they considered the matters at this meeting.” (JX 103 at 4).

(b) Offit considered that advice in making his decision. (Offit: Trial Tr. 7374:11-23).

(c) The possibility of “AIG personnel leaving to work for other companies if AIG had filed for bankruptcy” “certainly was a very important part of my personal consideration”. (Offit: Trial Tr. 7375:17-23). Offit was concerned about AIG personnel suffering reputational harm due to the “taint of bankruptcy.” (Offit: Trial Tr. 7376:2-15).

(d) The AIG Board “took into consideration the best interests of all the stakeholders of AIG”, meaning its shareholders, creditors, customers, and employees, when entering into the credit facility. (Willumstad: Trial Tr. 6432:7-16).

20.2 By Contrast, During the September 16, 2008 AIG Board Meeting, Cohen Advised the Board That It “Could Accept Either Option” of the Proposed Credit Facility or Filing for Bankruptcy. (JX 74 at 5).

(a) Cohen on September 16, 2008: “In response to questions from the Board, Mr. Cohen replied that the Board could accept either option if the Board believed in good faith that that option was in the best interests of the constituencies to whom the Board now owes it duties.” (JX 74 at 5; *see also* Offit: Trial Tr. 7945:18 – 7946:1 (Offit has no reason “to believe that the minutes are inaccurate” with respect to Cohen’s statement)).

(b) On September 16, 2008, AIG Board counsel Rodgin Cohen advised the AIG Board that it had “a duty to creditors as well as equity holders”. (JX 74 at 10). Cohen “explained that in a bankruptcy, equity holders would receive nothing unless all creditors were first paid in full.” (JX 74 at 10).

20.3 AIG's Board Had "No Choice" but to Accept Defendant's Offer on Defendant's Terms.

(a) Geithner: "I get on the phone with Willumstad and basically said we're going to send you a term sheet, you're not going to like it, but you have an hour to get your Board to approve it, two hours, we gave them a deadline, and you are not going to be running the company. . . . His Board, which had no option at that point, calls back and says we will take it." (PTX 673 at 24-25).

(b) The minutes of the September 21 AIG Board meeting report: "Several of the directors commented that they did not feel as though they had any choice". (JX 103 at 5).

(c) Shannon's handwritten notes of the September 21 AIG Board meeting state:

(i) "GM doesn't think we had choice" (PTX 195 at 4; *see also* Shannon: Trial Tr. 3655:25 – 3656:1 ("GM" refers to George Miles)).

(ii) "VR don't have choice." (PTX 195 at 4; *see also* Shannon: Trial Tr. 3657:16-24 ("VR" refers to Virginia Rometty); Shannon: Trial Tr. 3657:12-15 (confirming what she wrote in her notes)).

(iii) "EL [Ed Liddy] agree with discomfort of everyone in the room." (PTX 195 at 5).

(iv) "MO don't see why we need to do it tonight." (PTX 195 at 5; *see also* Shannon: Trial Tr. 3660:13-15 ("MO" refers to Morris Offit); Shannon: Trial Tr. 3660:16-19 (confirming notes)).

(v) "MO Fed gets it both ways not purely negotiated – extremely uncomfortable." (PTX 195 at 7; *see also* Shannon: Trial Tr. 3662:19 – 3663:1 (confirming notes)).

(d) Offit: Offit did not feel as though he had “any choice but to approve the transaction because bankruptcy would have such a bad effect on the company.” (Offit: Trial Tr. 7943:21 – 7944:4). Offit recalled that several other directors expressed the same view. (Offit: Trial Tr. 7944:5 – 7945:12).⁴⁴

20.3.1 The Board believed it had no choice even though it believed the terms were “exorbitant”.

(a) Willumstad: On September 16, 2008, “the board reaction was that they were very onerous terms.” (Willumstad: Trial Tr. 6517:24 – 6518:2). In fact, Willumstad and “other members of the board believed that they were exorbitant”. (Willumstad: Trial Tr. 6518:3-5).

20.4 In September 2008, Bankruptcy “May Have Been a Legal Option,” but “It Was Not a Realistic or Viable Option”. (Herzog: Trial Tr. 7031:5-12).

(a) On September 22, 2008, Jacob Frenkel, Vice Chairman of AIG and a former Governor of the Bank of Israel, wrote that the Board’s approval of the Credit Agreement “should not be confused with approval of the robbery – the government stole at a gunpoint 80 percent of the company”. (PTX 228 at 1).

⁴⁴ While a few witnesses testified at trial to the conclusion or characterization that the Credit Agreement was entered into “voluntarily” and without coercion (*see* Offit: Trial Tr. 7904:14-22), this testimony disregards these same witnesses’ testimony (as well as the testimony of other witnesses and contemporaneous documents) that they had “no choice” and that by September 21, 2008 when the AIG Board was asked to approve the Credit Agreement, the AIG Board: (1) had been advised that “if the Board did not approve the transaction that evening,” FRBNY would call in the \$37 billion in outstanding loans the next day (JX 103 at 4); (2) owed fiduciary duties to its creditors – of which the United States Government, who was seeking to call in its loan, was now one of the largest and had a loan which had priority; (3) was advised that the alternative of filing for bankruptcy was not really an option on the table because its counsel would not agree that the option was protected by the business judgment rule (*id.* at 4-6); (4) regarded Defendant as AIG’s controlling lender as of September 16, 2008, five days before they approved the Credit Agreement (Offit: Trial Tr. 7938:10-15; *see supra* §§ 15.1, 15.8, 15.13); and (5) was chaired by Liddy, who viewed himself as the Government’s man. *See supra* §§ 15.2-15.4, 15.6.

(i) Zingales: PTX 228 is significant to his analysis because “this is an indication of at least some high-level employees of AIG felt that the Government was in full control, and this was obtained, as he said, at gunpoint.” (Zingales: Trial Tr. 8620:18 – 8621:7).

(b) Daines: “as a lender of last resort to AIG, the government was a monopolist regarding the terms of the loan.” (Daines: Trial Tr. 8470:1-8).

(c) Zingales: “If there is a total collapse like we have seen during that week, then you’re really the only game in town and the alternatives are not there, so the result is that your power is very strong.” (Zingales: Trial Tr. 4109:16 – 4110:2).

(d) Zingales: “the lender of last resort ability was the only game in town, and if this was true on the 16th, it became even more true in the period from the 16th to the 22nd.” (Zingales: Trial Tr. 3823:6 – 3824:3; *see also* PTX 5049 (“The private credit markets remain frozen with many firms (including Morgan Stanley and Goldman Sachs) dependent on Government assistance for survival.”)).⁴⁵

20.5 AIG’s Obligation to Issue to Defendant Voting Preferred Stock Representing 79.9% of the Shareholders’ Equity and Voting Control Was Fixed as of the Execution of the Credit Agreement Even If Defendant Later Unilaterally Substituted a Different Financing Structure. (JX 107 at 46-47, 63 (§§ 5.11, 8.17)).

⁴⁵ Professor Zingales testified at trial that the AIG Board that voted on the Credit Agreement was “independent” because the Board was elected in May 2008, before Defendant’s extension of credit. *See* Zingales: Trial Tr. 3888:9-12, 3889:18 – 3890:6. Zingales also testified that his analysis is not designed to determine whether AIG’s directors acted in shareholders’ best interests, and that he had no reason to believe that AIG’s Board failed to satisfy its “duty” to use its “best judgment” during the week of September 16, 2008. Zingales: Trial Tr. 3900:2-6, 3916:18 – 3917:6.

Rather, Zingales explained that the issue of board independence or judgment is “not relevant” “to the question of effective economic control” or when “you have only one choice, . . . if there are some outside constraint, for example, the power of a lender, then I exercise my best judgment, but that doesn’t mean that the other side does not have some control over me.” Zingales: Trial Tr. 4102:4 – 4103:5; *see also* §§ 19.1-19.4.

(a) Section 8.17 provides that “If, following the Closing Date, the Lender identifies to the Borrower an alternative financing structure which provides benefits to the Borrower equivalent to those provided to under this Agreement without material detriment to the Borrower,” then “the Borrower will, and will cause its Subsidiaries to, take such steps as the Lender may reasonably request to implement such alternative structure.” (JX 107 at 63, § 8.17).

(b) Section 8.02 of the Credit Agreement, “Survival of Agreement”, provides that AIG’s obligation to issue the equity under Section 5.11 “shall remain operative and in full force and effect regardless of the expiration of the terms of this Agreement, the consummation of the transactions contemplated hereby, the repayment of any of the Loans, the termination of the Commitment, the invalidity or unenforceability of any term or provision of this Agreement or any other Loan Document or any investigation made by or on behalf of the Lender.” (JX 107 at 57, § 8.02; *see also* JX 177 at 6 (AIG draft presentation on federal funds provided to AIG states: “The Series C preferred stock remains outstanding even if the Fed credit facility is repaid in full or otherwise terminates.”)).

20.5.1 AIG’s outside auditor PwC “concluded the Company’s obligation to issue a fixed number of shares of its preferred stock represents a prepaid forward sales contract” which “should be classified as permanent equity” for the third quarter of 2008. (JX 151 at 23-24).

(a) As a November 5, 2008 AIG Accounting Policy Memorandum explained, “The only thing keeping AIG from” issuing the preferred stock “is awaiting the government to establish the Trust that will physically hold the preferred stock.” (PTX 347 at 64).

20.5.2 The Credit Agreement was signed by Liddy on behalf of AIG on the morning of September 23, 2008, with an effective date of September 22, 2008. (JX 110 at 1, 3, 66).

(a) Davis Polk attorney John Brandow testified that the Credit Agreement was not signed until September 23, 2008. (Brandow: Trial Tr. 5877:17-25).

20.6 Plaintiffs Did Not Participate in, or Approve, the Decision to Provide Defendant with 79.9% of Their Equity and Voting Control.

20.6.1 The Credit Agreement became effective without any vote or other expression of approval by the Plaintiffs.

(a) On September 21, 2008, the AIG Board, without shareholder input or approval, passed a resolution which stated: “RESOLVED, that the Corporation is authorized to enter into a revolving credit agreement (the ‘Credit Agreement’) with the New York Fed on substantially the terms and conditions set forth on Annex A hereto, and to issue preferred stock reflecting a 79.9 percent common stock equivalent interest in the Corporation (the ‘Preferred Stock’).” (JX 103 at 7).

(b) September 21, 2008 AIG Board minutes: “Members of the Board noted that the change from warrants to preferred stock would give the Bank current voting rights and would not require shareholder approval to the issuance.” (JX 103 at 3).

(c) September 21, 2008 AIG Board minutes: “Mr. Beattie . . . pointed out that the transaction gave the Federal Government voting control of the Corporation and that shareholder approval of the issuance of the preferred stock was not required.” (JX 103 at 5).

(d) On September 21, 2008, the Audit Committee of the AIG Board approved the issuance of the preferred shares, which represented over 20% of the aggregate voting power of the Corporation’s shareholders, without shareholder approval under Rule 312.05 of the NYSE Listed Company Manual. (JX 104 at 2-3).

20.6.2 Neither Plaintiffs nor the public generally were ever informed that AIG was being asked to provide voting preferred stock until after the Credit Agreement was executed.

(a) Bloomberg News on September 24, 2008: “AIG said Sept. 18 it would give the U.S. warrants The company yesterday said the Treasury will instead get preferred shares with voting rights, guaranteeing the U.S. will control the outcome of any shareholder vote.” (PTX 1658 at 2).

20.7 Defendant Deliberately Prevented a AIG Shareholder Vote (see *supra* §§ 17.6-17.8) and Even Concealed the Plan to Issue Voting Preferred Shares Until After the Credit Agreement Was Signed.

(a) Davis Polk attorney Ethan James on September 22: “we want to make sure that the CA leaves the company no choice but to issue the equity, even (especially) in the face of concerted efforts to prevent that issuance.” (PTX 3277 at 1).

(b) Davis Polk’s Ethan James on September 19: “Form 8K Item 1.01 requires the disclosure of material contracts, but it does not require that the actual contract be filed with the form. We should consider going this route, particularly to show less of a hand to Greenberg on the equity issuance (ideally we should have the pref issued before they realize that we are going to do it w/out a SH vote).” (PTX 3242 at 1).

21.0

ON SEPTEMBER 16, 2008, AND CONTINUING THROUGH JANUARY 2011, AIG HAD SUFFICIENT ASSETS TO FULLY SECURE THE CREDIT PROVIDED TO IT BY THE FEDERAL RESERVE.

21.1 Defendant’s Officials Repeatedly Concluded That the Federal Reserve’s Loans to AIG Were “Fully Secured” and, Indeed, “Overcollateralized”.

(a) U.S. 30(b)(6) witness (Millstein), AIG v. Brookfield): “when systemic risk determination was made under 13.3, the Treasury Department, Secretary Paulson concluded that the government was **overcollateralized** on the \$85 billion of loans that could be extended under that facility, and I don’t think there’s anything that I’m aware of that suggested we ever thought

that – we ever reached a different conclusion, that the government was undercollateralized on that 85 billion.” (PTX 4003 (emphasis added)).

(b) Bernanke: “The credit facility was **fully secured** by assets that AIG was able to pledge under the associated Guarantee and Pledge Agreement and that had an estimated value in excess of the maximum size of the credit facility.” (PTX 561 at 5 (emphasis added)).

(c) Bernanke: With respect to the AIG loan, Bernanke “said on a number of occasions that that loan was **fully secured**.” (Bernanke: Trial Tr. 2285:11-13 (emphasis added)).

(d) Bernanke “concluded that because the AIG credit could be secured by valuable, available collateral, including shares of stock of profitable insurance companies and other businesses, that that credit was **fully secured**”. (Bernanke: Trial Tr. 2009:13-20 (emphasis added)).

(e) Bernanke (December 3, 2009 Congressional Committee Testimony): “The revolving credit facility is **fully secured** by all the unencumbered assets of AIG, including the shares of substantially all of AIG’s subsidiaries.” (PTX 553 at 141 (emphasis added)).

(f) Bernanke (to the FCIC): “because the AIG insurance assets were in a separate business that had a lot of going concern value and did have a lot of assets, that the loan was **fully secured**”. (Bernanke: Trial Tr. 2010:4-9 (emphasis added); *see also* Bernanke: Trial Tr. 2010:10-12 (statement to the FCIC “was truthful, complete, and accurate testimony”); *see also* Bernanke’s “assessment that AIG had plenty of collateral to repay the Federal Reserve loan” (Bernanke: Trial Tr. 2009:23 – 2010:3)).

(g) Baxter and Dahlgren: “To be clear, we were not making an investment in AIG; we were making a **fully secured loan**” (PTX 587 at 55 (Joint Written Testimony of Baxter and Dahlgren to the Congressional Oversight Panel) (emphasis added); *see also* PTX 587 at 53

(Under 13(3), FRBNY “had the ability to provide liquidity to AIG by making a **fully secured** loan.”) (emphasis added)).

(h) Baxter: The lending staff informed Baxter that, during the period from September 16 to 22, 2008, “the lendable value of the collateral **fully secured** us with respect to the amounts that we had extended” (Baxter: Trial Tr. 737:20 – 738:19 (emphasis added)).

(i) Baxter: “sometime on or before September 22, 2008, the loans and credit staff of the Federal Reserve Bank of New York” concluded that “the lendable value was there” for the \$85 billion credit facility. The FRBNY legal department further concluded that the loan was “**fully secured**” (Baxter: Trial Tr. 739:25 – 740:11 (emphasis added)).

(j) Baxter (Statement to FCIC on September 1, 2010): “Unlike the naked guarantee needed to facilitate the merger of Barclays and Lehman, our committed credit to AIG on September 16, 2008 was **fully secured** by good collateral, namely, AIG’s sound retail insurance businesses. In fact, before any money was disbursed to AIG on September 16, AIG delivered share certificates to the New York Fed that we continue to hold as collateral in our vaults. These shares **fully secured** every penny we lent to AIG on September 16, 2008. And today, the credit extended to AIG by the New York Fed remains **fully secured**.” (PTX 598 at 11 (emphasis added); *see also* Baxter: Trial Tr. 735:9-16 (confirming the statement was “as accurate and honest” as was possible for him); Baxter: Trial Tr. 924:13-16 (confirming that FRBNY’s loan to AIG was “**fully secured**”) (emphasis added); Alvarez: Trial Tr. 430:5-15 (agreeing with Baxter’s statement in PTX 598 except to note that the collateral was not limited to the retail insurance business)).

(k) Alvarez: The credit facility to AIG was “**fully secure**”. (Alvarez: Trial Tr. 360:13-18 (emphasis added); *see also* Alvarez: Trial Tr. 613:12-22 (the Federal Reserve had a secured interest in “a substantial amount” of AIG’s assets)).

(l) Alvarez: The “credits were each **fully secured** at the time they were made. . . . We expect the Federal Reserve will be fully repaid on each extension of credit involving AIG” (PTX 587 at 25 (emphasis added)).

(m) Dahlgren and Baxter “told Congress that AIG had enough high-quality collateral to permit the Federal Reserve to make the loans that it made, provide the liquidity to the firm that it provided, and that the Federal Reserve was **fully secure**” (Dahlgren: Trial Tr. 2783:12-18 (emphasis added); *see also* PTX 587 at 55).

21.2 Because the AIG Loan Was Fully Secured, Defendant Believed It Did “Not Run the Risk of Losing Money”.

(a) Alvarez: “The Fed believed that it could secure a loan with AIG’s insurance subsidiaries, which could be sold off to pay any borrowing, and not run the risk of losing money.” (Alvarez: Trial Tr. 601:1-19 (affirming 30(b)(6) deposition testimony on behalf of Defendant)).

(b) Bernanke to FCIC on September 2, 2010: “So unlike Lehman, which didn’t have any going-concern value, or not very much, AIG had a very substantial business, a huge business, more than a trillion dollars in assets and a large insurance business that could be used as collateral to borrow the cash needed to meet Financial Products’ liquidity demands. So that’s a very big difference. And indeed, the Federal Reserve will absolutely be paid back by AIG.” (PTX 599 at 37).

21.3 AIG Was Solvent at All Times.

(a) Office of Thrift Supervision Director Scott Polakoff: “It is critically important to note that AIG’s crisis was caused by liquidity problems, not capital inadequacy.” (PTX 449 at 53).

(b) Baxter: Notes of Interview with Congressional Oversight Panel on May 11, 2010: “AIG was balance sheet solvent, had more assets than liabilities.” (PTX 2211 at 6).⁴⁶

(c) Paulson: The Federal Reserve believed that “it could make a loan to help AIG because we were dealing with a liquidity, not a capital, problem.” (PTX 706 at 262; *see also* Paulson: Trial Tr. 1226:22 – 1227:2 (“clearly my view at the time that loan was made” was that the Fed could make a loan “to help AIG, unlike Lehman Brothers, because with AIG you were dealing with a liquidity, not a capital, problem”); Alvarez: Trial Tr. 362:14 – 364:1, 366:18 – 367:5 (affirming that his 30(b)(6) testimony on behalf of the United States agreeing with Paulson’s statement in PTX 706 was truthful and accurate)).

⁴⁶ James Lee of JPMorgan testified at trial that as part of the private sector consortium, he concluded that the current value of AIG “was dwarfed by the size of the liquidity need, even at the low end of the liquidity need, so our sense was that it might be 50-60 billion dollars, that kind of zone, to the best of my recollection.” Lee: Trial Tr. 7075:9-17.

However, “FRBNY officials told SIGTARP that, in their view, the private participants declined to provide funding not because AIG’s assets were insufficient to meet its needs, but because AIG’s liquidity needs quickly mounted in the wake of the Lehman bankruptcy and the other major banks decided they needed to conserve capital to deal with adverse market conditions.” *See* PTX 549 at 12 (SIGTARP Report); *see also* Cragg: Trial Tr. 5489:13 – 5490:11 (this sentence “is consistent with the evidence that I’ve seen of what banks were doing during this period of time and why they wouldn’t extend the so-called private solution to AIG”); Baxter: Trial Tr. 675:8-11 (“had Lehman not filed for bankruptcy, private sector financing for AIG could have been secured”); PTX 632 at 13 (Baxter: “The turning point for the financial institutions that made those assurances, however, was Lehman Brothers’ bankruptcy filing. Had Lehman not filed for bankruptcy, private sector financing for AIG could have been secured.”).

Moreover, Lee contacted Defendant immediately after the Credit Agreement was executed still asking about potential syndication of the loan. PTX 3227 at 3 (Huebner on September 25, 2008: “Jimmy Lee called last week to ask whether we would be interested in syndicating.”); PTX 3152 at 1 (notes to a September 18, 2008 “Call with Marshall Huebner/Jeremiah Norton”: “Jimmy Lee – partially syndicated – mkt appetite”).

(d) On September 15, 2008, FRBNY Research Officer Adam Ashcraft reported to McConnell, Geithner's Deputy Chief of Staff, concerning AIG: "Problem is that bankruptcy option is very attractive for the firm **very solvent** lots of capital but no liquidity" (PTX 60 (emphasis added); *see also* McConnell: Trial Tr. 2549:23 – 2550:13 ("I think it's probably AIG" that "he's referring there to.")).

(e) Bernanke: "But AIG had a completely separate business, an ongoing business, that had a going-concern value. It had a lot of shareholder equity . . . it was our assessment that **they had plenty of collateral to repay our loan**--because it was in a separate business that did have a lot of going-concern value and did have a lot of assets." (PTX 599 at 60 (emphasis added)).

(f) Bernanke: "Now, fortunately, from the perspective of lender of last resort theory, although AIG was taking a lot of losses in its financial products division, underlying those losses was the world's largest insurance company. So **AIG had lots and lots of perfectly good assets**. Therefore, it had collateral that it could offer to the Fed to allow us to make a loan to provide the liquidity it needed to stay afloat." (PTX 708 at 92 (emphasis added)).

(g) Bernanke: "AIG was an effective, sound company, with a lot of value, and that was the basis on which the Fed made its loan". (Bernanke: Trial Tr. 2016:20-24).

(h) Bernanke (to FCIC on September 2, 2010): "So unlike Lehman, which didn't have any going-concern value, or not very much, AIG had a very substantial business, a huge business, more than a trillion dollars in assets and a large insurance business that could be used as collateral to borrow the cash needed to meet Financial Products' liquidity demands." (PTX 599 at 37).

(i) According to handwritten notes taken by Alvarez on the Board of Governors meeting held September 16, 2008, Geithner indicated that "with proper management wld be able

to realize positive net value in sale of company over time.” (JX 80 at 1; *see also* Geithner: Trial Tr. 1473:20 – 1474:7 (“at least for the part I read, I did not see anything that I did not believe to be accurate”)).

(j) September 15, 2008 Memorandum to the Board of Governors: “Staff estimates that **AIG is solvent** in the sense that the firm appears to have positive economic net worth”. (PTX 64 at 1 (emphasis added)).⁴⁷

21.3.1 AIG management concluded AIG was solvent.

(a) Liddy at June 30, 2009 Annual Meeting of AIG Shareholders: “It is important to note that, throughout this crisis and right up to today, our principal insurance businesses have been fundamentally sound”; “Although solvent, AIG suddenly faced an acute liquidity crisis.” (PTX 2109 at 4; *see also* Liddy: Trial Tr. 3017:19 – 3019:22 (agreeing that that statement was truthful, accurate, and complete)).

(b) Liddy: There was never a time when Liddy “believed it might be necessary for AIG to sell all of its businesses in order to repay the government” (Liddy: Trial Tr. 3021:6-11).

(c) Schreiber to various AIG executives on September 21, 2008: “**AIG’s break-up value/underlying franchise value is far in excess of the 85b fed line**. Independent research

⁴⁷ Certain of Defendant’s witnesses at trial questioned whether it was certain that AIG had sufficient collateral to repay the loan. This issue is a red herring for several reasons. First, as shown in §§ 21.1-21.2, *supra*, those questions were answered by Defendant’s contemporaneous documents and statements. Second, Section 13(3) requires that loans be adequately secured. 12 U.S.C. § 343. Third, each time a new disbursement of the 13(3) facility was made, the collateral was secured and verified to support the amount being lent. McLaughlin: Trial Tr. 2421:1-4, 2422:2-6; Symons: Trial Tr. 3638:13-24. Fourth, the manner in which the Credit Agreement was drafted permitted FRBNY to stop disbursing the remainder of the facility at any time whether adequately secured or not. JX 107 at 36; PTX 339 at 6; PTX 612 at 6. Finally, Defendant has admitted that the onerous terms, including the interest rate, the equity terms, and the exertion of control by Defendant, were among the issues that led ratings agencies to consider further downgrades against AIG in the fourth quarter of 2008 and that led to further financial problems in 2009 for the company. Baxter: Trial Tr. 826:15-18, 1019:3-14, 1052:16-25; Dahlgren: Trial Tr. 2770:8-20, 2842:8-17, 2843:1-5.

from Merrill, Wachovia and CS value AIG in excess of 123 bn. AIG's internal analysis as well as that of our advisor Blackstone is far in excess of the 85b too. It is AIG's goal not to draw down the entire facility." (PTX 186 at 1 (emphasis added); *see also* Schreiber: Trial Tr. 6813:18 – 6814:3 ("that was accurate as of September 21, 2008")).

(d) Schreiber: "Our view, supported by Blackrock's analysis is that the rmbs and cds portfolios are high quality and that realizable value will be significantly higher than current market values." (PTX 186 at 1; *see also* Schreiber: Trial Tr. 6815:4-11 (this was Schreiber's view as of September 21, 2008)).

(e) "Underlying business values significantly exceed current market capitalization". (DX 233 at -834; *see also* Schreiber: Trial Tr. 6783:17 – 6784:6 ("this is something that" he "believed on or about September 11"))).

21.3.2 As late as September 14, 2008, Citibank concluded AIG had more than \$10 billion of "repoable" assets worth lending against.

(a) Schreiber: Citi "offered to provide" "\$10 billion of repo capacity" "around 5:00 p.m. or 6:00 p.m. on Sunday, the 14th". Though that was their limit, "Citi believed that there was at least another \$20 billion or more of repo-able assets". (Schreiber: Trial Tr. 6798:19 – 6799:10).⁴⁸

(b) "AIG got a 'firm commitment' from Citi for \$10 billion in repo financing, based on a list of about \$60 billion in unencumbered assets." (PTX 620 at 5).

21.4 AIG's Valuable Insurance Subsidiaries Were Stable and Secure.

⁴⁸ A repo facility is one in which the debtor pledges certain securities ("repoable assets") in exchange for access to a line of liquidity. *See* Schreiber: Trial Tr. 6584:19 – 6585:3.

(a) Willumstad: “As of September 16, AIG’s insurance subsidiaries were strong and well-capitalized”. (Willumstad: Trial Tr. 6512:6-8).⁴⁹

(b) Geithner: AIG “had hugely profitable, pretty stable earnings power in their insurance businesses. And we could lend against those businesses” (PTX 668 at 47); “we were lending against a pretty profitable business” (PTX 668 at 48).

(c) Geithner was not aware of “any risks in connection with its insurance subsidiaries” in September 2008. (Geithner: Trial Tr. 1675:18-24).

(d) FRBNY estimated the value of the AIG insurance subsidiaries (Geithner: Trial Tr. 1870:3-15). And the value of the AIG insurance subsidiaries estimated by FRBNY never fell “below the outstanding balance of the September 22nd credit facility”. (Geithner: Trial Tr. 1870:16 – 1871:1).

(e) Bernanke: The “core operations of AIG were viable and profitable insurance companies.” (PTX 616 at 15).

(f) Bernanke: “the problems with AIG didn’t relate to weaknesses in their insurance businesses, it related very specifically to the losses of the Financial Products Division. The rest

⁴⁹ At trial Defendant’s expert Dr. Saunders asserted that the value of the equity in AIG’s insurance companies was “nearly perfectly correlated” with an AIG default. DX 2737 (Saunders demonstrative). However, that assertion is flatly inconsistent with the contemporaneous evidence and other testimony set forth in this section. Moreover, the stability of AIG’s insurance subsidiaries’ operations is not contradicted by Defendant’s assertion that AIG’s credit rating downgrades would have had “qualitative effects” on its reputation resulting in a run. *See* Schreiber: Trial Tr. 6601:2 – 6603:17. The panicked runs described in DX 383, for example, are just the type of irrational behavior taking place at the height of the financial crisis that created liquidity problems for solvent companies like AIG and its subsidiaries. This is well evidenced by Defendant’s estimated sale prices for AIG’s insurance subsidiaries of AIA at between \$16.5 billion and \$20.5 billion, and ALICO at between \$9 billion and \$12 billion in April 2009 (PTX 508 at 3), compared to the significantly greater sale prices obtained by AIG when it sold its insurance subsidiaries, receiving close to \$35 billion and over \$16 billion, respectively, for AIA and ALICO. Schreiber: Trial Tr. 6802:14 – 6803:6; *see also* JX 294 at 2 (AIG November 4, 2010 8-K announcing that “total consideration” for the sale of ALICO was “approximately \$16.2 billion”).

of the company was, as far as we could tell, was an effective, sound company with a lot of value, and that was the basis on which we made the loan.” (PTX 599 at 61).

(g) Bernanke: “knew that AIG’s foreign subsidiaries were very well capitalized and there were a lot of potential buyers for those subsidiaries”. (Bernanke: Trial Tr. 2257:11-14).

(h) Paulson: AIG’s insurance subsidiaries were “more stable because of the strength of their businesses and their stand-alone credit ratings, which were separate from the AIG holding company’s ratings and troubles.” (PTX 706 at 262).

(i) Paulson: was aware that “the primary collateral for the loan, the primary collateral for the credit facility, was AIG’s insurance businesses” (Paulson: Trial Tr. 1226:5-8); “these retail insurance businesses of AIG had independent credit ratings” (Paulson: Trial Tr. 1226:9-12); and “they were the kind of collateral that the Federal Reserve was looking for” (Paulson: Trial Tr. 1226:13-15).

(j) Alvarez: “Dinallo had said that the AIG insurance subsidiaries were appropriately capitalized.” (Alvarez: Trial Tr. 611:16-19; *see also* Alvarez: Trial Tr. 518:7-23 (Dinallo “indicated his belief that the insurance subsidiaries were holding up okay and they were appropriately capitalized and that they had substantial value.”)).

(k) A September 16, 2008 Press Release of the National Association of Insurance Commissioners: “We have a very strong message for consumers: If you have a policy with an AIG insurance company, they are solvent and have the capability to pay claims.” (PTX 2762 at 1; *see also* Geithner: Trial Tr. 1679:3-25 (“this is a judgment of reinsurance by the insurance – by the National Association of Insurance Commissioners that” “the individual AIG insurance subsidiaries were stable and properly capitalized”); Willumstad: Trial Tr. 6513:3-11 (PTX 2762 is consistent with Willumstad’s understanding as of September 16, 2008)).

(l) Liddy: “the quality of the Corporation’s underlying insurance businesses is very high”. (JX 94 at 5).

(m) Liddy: “I knew AIG’s insurance operations well. They were incredibly compelling and powerful businesses. They were a little damaged by the security lending that went on within them, but they were still very strong.” (Liddy: Trial Tr. 3184:23 – 3185:10).

(n) Liddy (November 10, 2008): “Reported earnings are not indicative of the underlying core earnings power of our insurances businesses, which remain solidly capitalized. Retention of our customers remains strong and reflects the support and loyalty of our long-term partners, intermediaries and sponsors.” (JX 149 at 4).

(o) Liddy (March 2, 2009): “AIG’s underlying businesses remain strong, well-capitalized, and competitive. Moreover, policy holders, regulators, agents and business partners around the globe can be confident that policies written by any AIG company are sound”. (JX 187 at 18).

(p) Mosser: Following an “analysis of the solvency of several subsidiaries of AIG” by FRBNY staff, they concluded that “the property and casualty subsidiaries, insurance subsidiaries, of AIG, had a significant amount of excess capital”. (Mosser: Trial Tr. 1287:9 – 1288:25).

(q) Mosser spoke with Eric Dinallo, Superintendent of the New York State Insurance Department, twice on September 13 and 14. (Mosser: Trial Tr. 1292:17-24). Mosser ultimately concluded that “the AIG property and casualty companies in New York and Pennsylvania had very large capital cushions”. (Mosser: Trial Tr. 1293:25 – 1294:18).

(r) A.M. Best (Colannino): agreed with a statement from a September 29, 2008 *Washington Post* article, where Andrew Edelsberg, an A.M. Best vice president in the life/health division, is quoted as follows: “At this point, the insurance subsidiaries have an excellent ability

to pay claims, AIG's life insurance companies are still highly rated, as most of the issues are at the holding company. We believe that policyholders will be paid in the long term." (Colannino: Trial Tr. 5767:16 – 5768:20).

(s) A.M. Best (Colannino): also agrees with a statement in that same *Washington Post* article from Tom Rosendale, an A.M. Best Assistant Vice President, that "AIG's insurance subsidiaries 'weren't even close to being at that level' even before the government bailout of the holding company." (Colannino: Trial Tr. 5768:25 – 5769:14 ("being at that level" refers to "being in a situation in which the company became insolvent"))).

(t) At the height of AIG's liquidity crisis in September 2008, the Financial Strength Rating ("FSR") of both AIG's life and retirement services and its property/casualty subsidiaries was "A", which indicates that A.M. Best deemed the financial strength of the companies to be "Secure" and "Excellent". (DX 331 at -024; DX 1552 at x). A company A.M. Best rates as "secure" – as AIG was rated throughout the Financial Crisis and is so rated today – "has the financial strength to pay its claims" and has "a good ability to engage in future business." (Colannino: Trial Tr. 5699:7-16).⁵⁰

⁵⁰ Although Colannino testified that A.M. Best believed that AIG's insurance subsidiaries might potentially have lost franchise value due to financial troubles at the holding company level or in the event that the holding company declared bankruptcy, the record demonstrates that despite those difficulties materializing, they did not substantially affect AIG's insurance subsidiaries. For example, despite concerns that the subsidiaries would confront problems writing new business and retaining talented employees, throughout the financial crisis, AIG subsidiaries retained their "secure" ratings (which Colannino testified and A.M. Best states indicate "a good ability to engage in future business") and Colannino could not identify any "management" or "talent" who left any AIG subsidiary in 2008. Colannino: Trial Tr. 5732:22 – 5733:13, 5738:3-13, 5774:21 – 5775:9.

(u) Studzinski: “we were advised by a number of lawyers that the insurance companies of AIG all were perfectly financially standalone viable”. (Studzinski: Trial Tr. 7115:15-22).⁵¹

21.5 The Credit Facility Was Secured by Substantially All of AIG’s Assets.

(a) Bernanke: “the loan the Fed made was a senior lien on the entire value of the entire company” (PTX 447 at 30).

(b) U.S. 30(b)(6) witness Jon Greenlee, *Murray v. Geithner*: “the Federal Reserve Bank of New York received as collateral an interest in all of AIG’s subsidiaries as well as all other unencumbered assets of the corporation.” (PTX 545 at 83).

(c) “To draw on the Credit Facility, AIG would submit a borrowing request to FRBNY. Each time AIG made a borrowing request, Ernst & Young would update its valuations for collateral that had been previously posted and value any new collateral that AIG had pledged in support of its new borrowing request. FRBNY would then determine whether the collateral was adequate to secure AIG’s new borrowing request.” (Agreed to Stipulations ¶ 169).

Defendant also has raised the risk of a potential run or “contagion effect” on the insurance businesses, particularly in Asia (*see* DX 383; DX 1451). However, there were also “indications of interest on various parties of buying certain AIG assets” as “AIG owned some of the most attractive insurance assets in the world.” Cragg: Trial Tr. 5105:2-16; PTX 5372 (Cragg demonstrative); PTX 512 at 17-18; PTX 253 at 2; JX 69; JX 98; JX 353; Willumstad: Trial Tr. 6408:22 – 6409:3 (“AIG had a number of different insurance entities in Asia. They were strong, robust businesses that generated a lot of income for the company.”); Studzinski: Trial Tr. 5676:21 – 5677:16 (“CIC had an interest in the situation for a number of days, even while the number of real options started to run out, because they obviously found the Asian assets very attractive as investments.”); Studzinski: Trial Tr. 7135:3-4 (“Mr. Greenberg was right in that the company had great assets and they should be fundable.”).

⁵¹ Although the minutes to the September 16, 2008 AIG Board of Directors meeting state that Herzog advised the Board that “regulators made clear that if AIG made use of insurance company assets to pay the securities lending liabilities without the permission of the regulators, the regulators would seize the insurance companies” (JX 74 at 8), he also testified, regarding a hypothetical AIG bankruptcy, “What would have happened I don’t know. It would be speculation on my part what various regulators, state regulators or regulators around the world, might have done.” Herzog: Trial Tr. 6986:8-13. Herzog testified that the regulator he spoke with on September 16, 2008 allowed AIG to utilize \$4.5 billion of insurance company liquidity to satisfy the needs of the securities lending program (Herzog: Trial Tr. 6971:8 – 6974:3).

(d) AIG and FRBNY entered into a Guarantee and Pledge Agreement dated September 22, 2008, which provided for AIG to pledge sufficient collateral to secure its borrowings. (JX 108 at 1, 4-5).

(i) The schedules attached to the Guarantee and Pledge Agreement reflect the various subsidiaries pledged as collateral by AIG as of September 22, 2008. (*See* JX 108 at 47-49, 55-56, 59-60).

(e) FRBNY memorandum titled “AIG Collateral Analysis Third Quarter 2009”: “AIG’s loan balance from the FRBNY credit facility is collateralized by all subsidiaries with assets greater than \$50 million.” (PTX 541 at 2). “Noteworthy other assets included in the Bank’s collateral package include: the aircraft collateral pledged by ILFC that secures their current \$3.7 billion intercompany loan from AIG, AIG’s equity interest in Maiden Lane III, real estate assets, assets securing the asset-backed commercial paper programs (Curzon and Nightingale), and several other smaller subsidiaries.” (PTX 541 at 3).

21.5.1 The Federal Reserve has not extended a loan that was not fully secured and the AIG loan was no exception.

(a) Board of Governors staff: The Federal Reserve Act “does not authorize a Reserve Bank to lend to an IPC on an **unsecured** basis.” (PTX 3267 at 5 n.4 (emphasis in original)).

(i) “Section 13(3) extensions of credit are generally fully secured.” (PTX 3267 at 6).

(b) FRBNY Senior Vice President McLaughlin: “the Federal Reserve is not allowed to lend on an uncollateralized basis” (McLaughlin: Trial Tr. 2420:4-6). Each time the Federal Reserve extended credit to AIG, “there was collateral that had to be pledged that was sufficient to support the credit extended” (McLaughlin: Trial Tr. 2421:1-4).

21.5.2 Section 13(3) does not permit the Federal Reserve to take risk or to “lend into a run.”

(a) Geithner: “we were the central bank of the United States, and we weren’t going to defy our own governing law to lend into a run. We could make loans to solvent institutions against solid collateral.” (PTX 709 at 203).

(b) Domsday Book Version 4.1 (6/19/2006): “[REDACTED]

[REDACTED]” (PTX 7 at 36).

(c) Under 13(3), the Fed could conceivably lend to a nonbank we deemed solvent, but only if it was in such deep trouble that no one else would lend to it, and even then only if we could secure collateral that could plausibly cover our exposure.” (PTX 709 at 91).

21.5.3 Defendant conservatively valued the collateral pledged by AIG.

(a) McLaughlin: FRBNY was “interested in being conservative” when valuing AIG’s assets. (McLaughlin: Trial Tr. 2496:1-5).

(b) McLaughlin: When FRBNY was confronted with a situation in which it had two values for an AIG asset, FRBNY “took the lower of the two values”. (McLaughlin: Trial Tr. 2496:6 – 2497:7).

(c) McLaughlin: At the time E&Y valued AIG’s “pledged assets” at \$104.7 billion, FRBNY used a collateral value of \$80.55 billion. (McLaughlin: Trial Tr. 2423:6-23; *see also* PTX 1636 at 1).

(d) Defendant’s valuations of the equity in AIG’s insurance companies did not attribute any value to certain assets held by AIG which had substantial value. “Certain assets included in FRBNY’s collateral packages were not reflected in MS’s valuation report. Such assets include,

but are not limited to, the aircraft collateral pledged by ILFC that secures their current \$3.9 billion intercompany loan from AIG, AIG's equity interest in Maiden Lane III, real estate, and several other smaller subsidiaries." (PTX 592 at 17, n.5; *see also* PTX 630 at 11 n.7 (same)).

(e) McLaughlin: When FRNBY was valuing the collateral for AIG, the \$104.7 billion value "excluded the value of certain AIG assets". (McLaughlin: Trial Tr. 2494:20 – 2495:7).

(f) Ernst & Young: E&Y's September 21, 2008 valuations "pertain to a relatively large portion, but not all, of the AIG enterprise" (JX 111 at 2). Nevertheless, E&Y's September 21, 2008 mid-point "Market Approach" valuation for AIG overall was \$110 billion (JX 105 at 13).

21.5.4 The value of the collateral was determined by doing a conservative valuation of the assets, then applying a 25% haircut to them.

(a) Baxter: To determine the "lendable value" Defendant does "a valuation of the collateral. Then we haircut the valuation of the collateral, and that gives us a lendable value." Defendant wanted "the lendable value to always equal or exceed the actual amount of dollars extended to the borrower." (Baxter: Trial Tr. 738:20-25).

(b) Defendant applied a 25 percent haircut to the value of the collateral pledged by AIG. (Baxter: Trial Tr. 740:12-16; McLaughlin: Trial Tr. 2460:2 – 2461:2, 2481:8-12; Dahlgren: Trial Tr. 2821:19 – 2822:3; PTX 257 at 4 (showing haircut of 25 percent)).

(c) Cragg: The Federal Reserve had protection against a possible change in the value of the AIG collateral. In "AIG's case, there was a 25 percent haircut, and when I looked at the relationship between the amount of the loan outstanding and the valuations that were being done by, for instance, Morgan Stanley, that cushion, that haircut – there was always a lot of excess value there. So, it was always fully secured as has been stated by many, many government officials." (Cragg: Trial Tr. 5510:4-21).

21.5.5 Despite the high quality of AIG’s collateral, the 25% haircut applied by FRBNY was higher than the haircut applied to any other 13(3) eligible collateral. (PTX 5361).

(a) Cragg (referring to PTX 5361): “So you can see for the RCF the haircut was 25 percent, and as we go from left to right, for equities in the PDCF the haircut was 6 percent, for non-investment grade corporate bonds it was 6 percent, non-investment grade mortgage-backed securities it was 9 percent for non-investment grade CDOs it was 12 percent. And then for Lehman, when it was in bankruptcy, the haircut that was on average used was 16 percent. And then the maximum amount that was applied to Countrywide was 17 percent.” (Cragg: Trial Tr. 5082:6-25; *see also* PTX 2182 (collateral margins for the PDCF)).

(b) “Q. First, was the illiquidity of that collateral significantly different from other collateral that was being used for 13(3) loans? A. In general, during this period of time, you know, the whole objective of what the Federal Reserve was doing was dealing with the illiquidity of a whole range of different types of assets and collateral. As I described a couple days ago, when you look at what happened in the repo market, there was a – you know, an enormous run there that was a result of concern about – about, you know, for instance, RMBS as adequate collateral, and that’s what all of the facilities that the Federal Reserve was creating during this period of time were designed to address. So, you know, the PDCF, for instance, accepted all kinds of different collateral at a penalty rate because they were illiquid.” (Cragg: Trial Tr. 5473:9-25).

21.6 AIG Pledged Collateral That Defendant’s Advisors Ernst & Young and Morgan Stanley at All Times Valued at More Than \$85 Billion.

(a) Morgan Stanley was “involved in helping to value that collateral to make sure” that “the loan met the requirements that the Federal Reserve had to do a secured loan.” (J. Head: Trial Tr. 3739:7-17; *see also* PTX 290 (an MS valuation); PTX 508 (another MS valuation)).

(b) Morgan Stanley valued AIG's collateral "pretty close" to every month. It was "a constant throughout the entire engagement." And on "a quarterly basis, MS prepares a business valuation report for the primary AIG entities included in the Bank's collateral package." (J. Head: Trial Tr. 3741:6-21; PTX 630 at 4; *see also* J. Head: Trial Tr. 3742:22 – 3743:8 ("yes, we did that throughout the – on a quarterly basis"); J. Head: Trial Tr. 3739:18-20 (AIG's "assets met the requirements of the Federal Reserve to provide a secured loan"))).

(c) A Morgan Stanley valuation from October 8, 2008 valued AIG at approximately \$127 billion. (PTX 290 at 2).

(d) A Morgan Stanley valuation from April 22, 2009 concluded that "the FRB Facility – both on a drawn and undrawn basis – is projected to remain secured by collateral of greater value" (PTX 508 at 2). "At each stage of the restructuring, the FRB Facility is secured by collateral of greater value" (PTX 508 at 4; *see also* PTX 541 at 2; PTX 592 at 5; PTX 630 at 2, 5).

(e) On September 21, 2008, Ernst & Young set the median value of AIG at \$104.7 billion. (JX 105 at 10; *see also* Dahlgren: Trial Tr. 2819:9 – 2820:9 (identifying JX 105 as E&Y's preliminary valuation)). Ernst & Young's \$104.7 billion valuation excluded the value of certain AIG assets. (McLaughlin: Trial Tr. 2494:20 – 2495:7; Symons: Trial Tr. 3626:21 – 3627:6 ("There would certainly be companies in AIG that were not included in" the \$104.7 billion median valuation.); Symons: Trial Tr. 3627:17-23 ("there are other companies in AIG that are not included in this total")).⁵²

⁵² There was some testimony at trial that the initial valuation was performed on a rushed basis without the benefit of full information. *See* Symons: Trial Tr. 3616:14 – 3617:10; Dahlgren: Trial Tr. 2819:20 – 2820:9. However, as the contemporaneous documents note, by the time the valuation was performed, Ernst & Young had "already received" "reams of info" from AIG (DX 521 at -381), including the various spreadsheets and filings listed as being relied upon in the valuation (JX 105 at 15). Moreover, each subsequent valuation confirmed that the AIG loan was over collateralized (*see* § 21.6, *supra* and ¶ 21.6.2, *infra*).

(f) “In each one of these cases, Ernst & Young or Morgan Stanley would give” FRBNY “what they thought was their best judgment.” (Dahlgren: Trial Tr. 2967:12 – 2968:2). “And in each case, Ernst & Young or Morgan Stanley’s best judgment was that the outstanding balance was fully secured”. (Dahlgren: Trial Tr. 2968:3-6).

(g) Deloitte & Touche, the independent auditor of the Federal Reserve, found that Morgan Stanley’s mid-point valuation of “four key business units” of AIG of \$98.95 billion as of December 31, 2009 was reasonable. (JX 391 at 4-5; *see also id.* (finding that Houlihan Loukey’s valuation analysis of the same four AIG units on behalf of FRBNY as of November/December 2009 with a mid-point value of \$101.30 billion was also reasonable)).

21.6.1 The “maximum amount that AIG drew against the credit facility” was “\$72 billion.” (Kothari: Trial Tr. 4531:6-17; Agreed to Stipulations ¶ 217; PTX 5200).

21.6.2 The pledged collateral was revalued periodically and always determined to fully secure the Credit Facility.

(a) Symons: “each time AIG made a borrowing request, Ernst & Young would update its valuations for the collateral that had been previously posted and value any new collateral that AIG had pledged in support of its new borrowing request”, and “the Federal Reserve Bank then would determine itself whether it believed that the collateral was adequate to secure AIG’s new borrowing request”. (Symons: Trial Tr. 3638:13-24).

(b) Morgan Stanley and Ernst & Young continued to give FRBNY analyses of the collateral in late 2008 and in 2009 and 2010. (Dahlgren: Trial Tr. 2661:7-18, 2966:22 – 2968:6; *see, e.g.*, JX 113 (collection of regular valuations of AIG’s collateral); PTX 508 (April 22, 2009 Morgan Stanley valuation of AIG’s collateral); PTX 541 (Third Quarter 2009 FRBNY memo on the value of AIG’s collateral); PTX 592 (Second Quarter 2010 FRBNY memo on the value of

AIG's collateral); PTX 630 (Fourth Quarter 2010 FRBNY memo on the value of AIG's collateral); PTX 612 at 17-19 (describing periodic valuations of the collateral securing the Credit Facility)).

(c) Cragg: The Federal Reserve took steps to confirm that it had adequate collateral at all times. For example: "early on in the loan there was very active monitoring of the collateral value by Ernst & Young. Then over time, there was a focus on a quarterly basis for reporting purposes of what the value of the collateral was. Outside third parties would value the collateral and report back what they found. I mean, at all times, as you go into the future, the actual valuations are well in excess of the amount of credit extended. In addition, of course, the Federal Reserve had a team on-site, as well as its legal teams and accounting teams, to help with the monitoring and management of AIG. So, it was very well informed as to what was going on." (Cragg: Trial Tr. 8704:13 – 8705:3).⁵³

21.7 Defendant Recognized Immediately that the Credit Facility Was Likely to Be a Highly Profitable Loan Rather than a Risky Loan.

(a) Davis Polk attorney Marshall Huebner on September 23, 2008 to FRBNY General Counsel Thomas Baxter: "The real joy comes when we get back the \$85, with \$10 + + + in fees and interest, and make the treasury tens of billions it deserves (and needs!) on the equity." (PTX 3228 at 1).

(b) FRBNY staffer, Michael Holscher, on September 17, 2008: "we took almost no credit risk in extending a loan equal for about 8% of the total assets, which is secured by a senior

⁵³ There was a suggestion at trial that declining values of the AIG companies acting as collateral for the RCF in late 2008 and early 2009 resulted in the RCF becoming less than fully secured (*see* Schreiber: Trial Tr. 6617:3-9, 6629:23 – 6631:5). However, as Schreiber made clear on cross examination, the declines discussed in the December 9, 2008 finance committee minutes (DX 711) are "equity market prices generally and not the value of any of AIG's assets" (Schreiber: Trial Tr. 6730:4 – 6731:25; *see also* DX 233 at -834 ("Underlying business values significantly exceed current market capitalization")).

claim on 100% of the assets. Nonetheless, we extended the loan at an exceptional high penalty rate of L + 850bps and took nearly all the upside in our equity position. In sum: minimal risk, huge reward, disincentivising equity investment.” (PTX 119 at 1).

(c) Geithner: “the weird thing of our authority at that time was AIG—we could legally take their business, lend against their entire business. And they had a business that was very substantial earning power.” “So we could legally lend against that without taking that much risk.” (PTX 672 at 59; *see also* Geithner: Trial Tr. 1685:5-22).

(d) Notes of September 16, 2008 Meeting of the Federal Reserve Board of Governors: “TG. AIG - with proper management would be able to realize positive net value in sale of company over time.” (JX 80 at 1; *see also* Geithner: Trial Tr. 1760:3-17 (that was consistent with Geithner’s belief on September 16, 2008). “Positive net value” meant that FRBNY “would in effect be able to recover, either because the firm would repay us or we’d be able to sell the assets of the firm over time or someone else would take us out of our position, that we’d be able to recover funds sufficient to offset or match the funds we provided.” (Geithner: Trial Tr. 1760:18-25).⁵⁴

21.8 Defendant’s Experts’ Proffered Testimony That the Credit Facility Was a High Risk Loan Has No Basis in Fact and Is Contrary to Defendant’s Contemporaneous Conclusion That the Credit Facility Was Fully Secured and with Low, if Any, Risk (see *supra* §§ 21.1-21.2, 21.6-21.7).

(a) Cragg: “Q. Let me turn to another potential explanation that certain people have raised, and that is that the punitive terms of the AIG credit facility were necessary to protect

⁵⁴ A number of Defendant’s witnesses testified that the AIG loan was not “risk-free”. *See, e.g.*, Alvarez: Trial Tr. 519:5-15; Baxter: Trial Tr. 927:15-23; Geithner: Trial Tr. 1756:11 – 1759:21; Geithner: Trial Tr. 1815:22 – 1816:3; Bernanke: Trial Tr. 2236:8-25. However, this is inconsistent with the contemporaneous documents (see § 21.6) and contemporaneous testimony of these same witnesses (see §§ 21.1-21.2). *See, e.g.*, Geithner: Trial Tr. 1848:1 – 1849:5 (acknowledging the inconsistency between his trial testimony and Baxter’s FCIC testimony).

against the risk of the loan. Do you recall seeing that? A. Yes. Q. Did you evaluate whether that justification made any economic sense? A. I did. That was a relatively recent explanation that's been forwarded. And again, it's an explanation that I don't think is economically supportable. And the reason is that, first off, the loan was, you know, fully collateralized, so from a risk perspective, it was on the same footing as many of the other institutions. And in particular, it was collateralized with assets which were better quality than were being pledged in, let's say, to the PDCF. So that's one reason. The other is, when you look at the terms that were being charged for the loan, there's no concordance between the credit quality or the – of this loan versus others that had been entered into by alternative institutions, so there's – from a credit quality perspective, it's – it's I think very difficult to – well, I think it's impossible to justify the terms that way.” (Cragg: Trial Tr. 5114:4 – 5115:5).

21.8.1 The testimony of Defendant's expert, Dr. Anthony Saunders, that the Credit Facility was comparable to an unsecured loan has no basis in fact and should be disregarded.

(a) Defendant's expert, Dr. Saunders, incorrectly compares the Revolving Credit Facility (RCF) to an unsecured loan (Saunders: Trial Tr. 8193:17 – 8194:4), but the Federal Reserve did not make, and had no authority to make, an unsecured loan. (12 U.S.C. § 343; *see also* PTX 2825 at 3 (“it seems clear that the Reserve Bank must be satisfied that the loan will be repaid in due course, either by the borrower or by resort to such security.”)).

(b) Although Dr. Saunders asserted that the collateral pledged by AIG was unusually risky (DX 2737 (Saunders demonstrative); Saunders: Trial Tr. 8190:24 – 8192:12),⁵⁵ he did no analysis of the collateral pledged by AIG and did not know basic facts about the collateralization of the Credit Facility.

(i) He did not “do a study of the credit quality of the assets that were pledged by AIG”. (Saunders: Trial Tr. 8304:16-18).

(ii) He did not do any analysis of the calculations of value of the collateral pledged by AIG. (Saunders: Trial Tr. 8346:17 – 8348:1).

(iii) He could not remember what happened with FRBNY’s “collateral evaluation” after September 16, 2008 and could not even remember what the collateral was for the demand notes that preceded the September 22, 2008 Credit Agreement. (Saunders: Trial Tr. 8301:17 – 8302:2).

(iv) He did not know whether Ernst & Young was retained to help value AIG’s collateral prior to the execution of the Credit Agreement (Saunders: Trial Tr. 8299:18-21), when, in fact, Ernst & Young provided FRBNY with the \$104.7 billion collateral valuation, which FRBNY relied upon, on September 21, 2008 – the day before the Credit Agreement was signed. (*See* JX 105 at 1, 10; JX 111 at 2; McLaughlin: Trial Tr. 2422:16 – 2423:19; PTX 1636).

⁵⁵ This is, again, inconsistent with Defendant’s contemporaneous testimony and documents. Dr. Saunders did not “investigate at all what the Federal Reserve or Treasury said to Congress after September 16th about whether the loan to AIG was or was not risky” (Saunders: Trial Tr. 8295:21 – 8296:4). Moreover, Defendant accepted equity as collateral from many borrowers, not just AIG. As of September 30, 2008, over 40% of the collateral pledged at the PDCF was equity. (PTX 293 at 7). Historically, the Federal Reserve has accepted a wide range of items as collateral for 13(3) loans, such as marble shipments, common stock in a brewing company, and barrels of brandy and rum. PTX 2816 at 6.

(v) He did not know that FRBNY had the right to stop lending to AIG under the Credit Facility if FRBNY later decided that it was not satisfied with AIG's collateral.

(*Compare* Saunders: Trial Tr. 8281:11 – 8283:1 *with* JX 107 at 36 (§ 4.01(d)); PTX 612 at 6; *see also* Saunders: Trial Tr. 8301:3-16).

(vi) He could not remember if the Federal Reserve “had in its sole discretion the decision as to whether the collateral was or was not sufficient” each time AIG drew on the facility. (Saunders: Trial Tr. 8282:20 – 8283:1; *see also* Saunders: Trial Tr. 8301:3-16).

(vii) He did not know what percentage of AIG's collateral was composed of stock in AIG's insurance subsidiaries and conceded that “assets like repo collateral and cash and other securities” would not be so correlated with the performance of AIG's insurance subsidiaries. (Saunders: Trial Tr. 8320:13 – 8321:18).

(viii) He only read “the front end” of the Credit Agreement. (Saunders: Trial Tr. 8300:11-23). The September 22, 2008 Guarantee and Pledge Agreement, which contains many of the most important provisions concerning the collateralization of the Credit Facility, is contained in the latter half of the Credit Agreement. (*See* JX 107 at 71-136).

(c) Although Saunders inexplicably testified that it is not appropriate to “take into account the effect on the borrower of receiving the loan” when analyzing credit risk (Saunders: Trial Tr. 8277:3-9), Board of Governors staff recognized that, “in considering the value of AIG's assets supporting the existing and new lines of credit, FRBNY could take into account any increase in the value of AIG's assets that is expected to occur because of the new extension of credit.” (PTX 3267 at 7).

(d) Dr. Saunders did not assess how the credit risk of the Credit Facility compared with the credit risk of the Defendant's assistance to other financial institutions. (Saunders: Trial Tr. 8403:9-15).

(e) Although Dr. Saunders asserted that state regulators would have likely seized AIG's insurance subsidiaries in the event of an AIG bankruptcy (Saunders: Trial Tr. 8192:13-25), Saunders could not give "an example of one" time when a holding company bankruptcy led to seizure of insurance subsidiaries (Saunders: Trial Tr. 8323:18 – 8324:6). Furthermore:

(i) He did not know that Conseco's insurance subsidiaries were not seized upon its bankruptcy. (Saunders: Trial Tr. 8324:7-17);⁵⁶ and

(ii) He was unaware that a September 15, 2008 conversation between FRBNY and the NY State Insurance Department clarified that "If parent files for bankruptcy, it does not force the insurance regulators to do anything as long as the insurance subsidiaries remain financially healthy and solvent." "Solid P&C companies with sufficient capital which would be walled off from the insolvency proceeding" such that they can "continue to run". (PTX 1553 at 1-2; see also Saunders: Trial Tr. 6810:8 – 6812:14).

(f) As Dr. Cragg explained, "When you do look at the relationship between the collateral and the businesses of the parent, which actually undertook the loan, there are many reasons why you wouldn't think that they're actually correlated. Both the regulators have the

⁵⁶ Schreiber testified similarly to Dr. Saunders that, in the case of bankruptcy, the subsidiaries' "franchise value would decline dramatically, and we would lose potentially employees, customers, and whatever franchise value that we had in the business" (Schreiber: Trial Tr. 6612:21 – 6613:6). On cross examination, however, it became clear that Schreiber had no basis for this belief, admitting that he was not an expert in insurance regulation, "had not personally been involved in any discussions with regulators with respect to the insurance subsidiaries", and was not "involved in any discussions at AIG planning for bankruptcy" (Schreiber: Trial Tr. 6799:22 – 6800:18).

interest of maintaining the value of the subsidiaries that serve as collateral, as do the shareholders, as do the – as does the Federal Reserve in its position as a lender.” (Cragg: Trial Tr. 8699:6 – 8700:4).

21.8.2 Defendant’s experts erroneously and misleadingly rely on bond yields and CDS spreads for unsecured AIG bonds as indicators of the credit risk of the fully secured Credit Facility.

(a) Defendant’s experts Dr. Saunders and Dr. Mordecai rely on CDS spreads and bond yields on AIG unsecured debt to measure the risk of the fully secured Revolving Credit Facility, (*see* Saunders: Trial Tr. 8179:10-19, 8181:17-24; Mordecai: Trial Tr. 7823:12-17), but:

(b) Dr. Saunders: “unsecured debt has a higher yield than secured debt”. (Saunders: Trial Tr. 8306:24 – 8307:1);

(c) Dr. Saunders: during the fall of 2008, “the price of liquidity (the liquidity risk premium) soared” which causes the estimate of credit risk based on bond yields to be “biased upward.” (Saunders: Trial Tr. 8310:9 – 8311:23); and

(d) Dr. Mordecai: “the vast majority of the parent’s assets were, in fact, pledged” as security for the RCF (Mordecai: Trial Tr. 7822:13-17), and “generally speaking”, “secured debt would, to the extent that there was any value in its security, be expected to trade at a lower yield than the unsecured debt of the same company” (Mordecai: Trial Tr. 7821:1 – 7822:5).

(e) CDS spreads and bond yields on AIG unsecured debt overstate the credit risk of the fully secured Credit Facility. “AIG understands that the observable CDS spread is on AIG’s senior unsecured debt which has a higher risk than the risk on the Credit Facility because the Credit Facility is secured by the assets and operations of AIG” (JX 137 at 6 (AIG “Valuation on Preferred Shares”)).

(f) KPMG did not rely upon the CDS spread approaches to value the Credit Facility, instead concluding that market-based methodologies “were the most reliable indicators of value”. (PTX 375 at 21; *see also* Farnan: Trial Tr. 4228:3-5).

(g) AIG’s independent auditor, PwC, reviewed the KPMG valuation and found the CDS valuation methodologies used by KPMG were not reliable, noting:

(i) “The sub-prime lending crisis and the credit crunch, which resulted in Company seeking the credit facility from FRBNY, also triggered a widespread financial contagion that impacted inter-bank lending rates, overnight borrowing rates, and LIBOR among other measures. As of the Valuation Date, given the spikes broadly observed in measures such as LIBOR, default probabilities (specifically for entities in financial services), we believe the magnitude of CDS observed or change in CDS observed between pre- and post-transaction levels for the Company were influenced by factors not solely limited to the placement of the credit facility agreement between the Company and FRBNY.” (JX 140 at 3).

(ii) “The use of CDS spreads to value the Credit Facility has “inherent limitations, specific to the facts and circumstances of this transaction, therefore producing results that are less or not reliable.” (JX 140 at 3; *see also* DX 675 at -520 (“the CDS spread approach is considered to be less direct approach due to the nature of the quotes (i.e. based on AIG Inc.’s unsecured senior debt which is different from the terms of the credit facility) and that the CDS spread might be influenced by other market indicators (e.g. LIBOR rates and etc) which were not specific to this situation.”); Farnan: Trial Tr. 4227:12 – 4228:5 (the KPMG methods to value the Credit Facility using credit default spreads “were less reliable than the market approaches using the stock price”)).

21.8.3 Dr. Mordecai's and Dr. Saunders' opinions concerning the credit risk are also flawed because they rely on bond yields and CDS spreads from September 16 – nearly a week before the Credit Facility was even established. Had Dr. Mordecai and Dr. Saunders relied on CDS spreads or bond yields from September 22, 2008 – the day the Credit Facility was actually established – they would have found that the interest and commitment fees associated with the Credit Facility provided fair market compensation for the risk assumed by Defendant, without considering the value of the 79.9% equity and voting interests taken by Defendant.

(a) Cragg: “accepting Dr. Mordecai's method – which I don't necessarily do – the date that he would want to make that analysis would be on the 24th, because that's the point at which the market is fully aware of the RCF terms. And why that matters is that Dr. Mordecai is using market rates as a way to measure credit risk associated with the RCF. So, if he's going to do that, then he needs to do that as of a date which is appropriate.” (Cragg: Trial Tr. 8700:20 – 8701:3).

(b) Cragg: “I calculated the value of the loan using Dr. Mordecai's method on the 22nd and found that the fair market value of the loan was higher than the par value of the RCF.” (Cragg: Trial Tr. 8745:2-8).

(c) Kothari: Using CDS spreads on AIG's unsecured debt as of September 22, 2008, Dr. Kothari calculates that the fair value of the Credit Facility without considering the equity and voting control component was over \$88 billion, even without adjusting for the lower credit risk of secured debt relative to unsecured debt (Kothari: Trial Tr. 4875:5 – 4878:19). Had Dr. Kothari adjusted the discount rate he derived based on CDS spreads on AIG's unsecured debt, he would have found the fair value of the Credit Facility was still higher. (Kothari: Trial Tr. 4878:10-24).

21.8.4 Dr. Saunders has no basis for claiming the credit risk of lending to AIG was “extremely high” (Saunders: Trial Tr. 8177:12-16). Although there are many widely accepted, objective ways of estimating credit risk, Dr. Saunders did not use any of them to measure the risk of the Credit Facility.

(a) Dr. Saunders did not conduct a net present value analysis of the Credit Facility (Saunders: Trial Tr. 8304:19 – 8305:2).

(b) Dr. Saunders did not use the Black-Scholes-Merton model to value the Credit Facility. (Saunders: Trial Tr. 8305:6-11; *see also* Farnan: Trial Tr. 4168:19 – 4169:2 (the Black-Scholes model is “a well-accepted methodology for valuing certain instruments that incorporates inputs such as volatility, strike price and time to calculate a value”)).

(c) Dr. Saunders did not use a reduced form model to value the Credit Facility. (Saunders: Trial Tr. 8305:12-17).

21.9 Senior Government Officials Have Repeatedly Testified that AIG Had Pledged “good” or “high-quality” Collateral to Secure the Credit Facility.

(a) Geithner: “Some have asked why Lehman went bankrupt, while AIG received extraordinary assistance that prevented default. The answer is that AIG presented a very different case. AIG had enough **high-quality collateral** to permit the Federal Reserve to extend a loan sufficient to stabilize the firm—largely the profitable insurance businesses that were relatively insulated from the firm’s losses on complex financial transactions.” (PTX 2206 at 176 (emphasis added); *see supra* §§ 21.1-21.2).

22.0

**AIG WAS THE ONLY 13(3) BORROWER IN HISTORY
WHOSE SHAREHOLDERS' EQUITY AND VOTING
CONTROL WERE DEMANDED AS CONSIDERATION
FOR A 13(3) LOAN.**

(a) Defendant admits that no “federal reserve bank has required any company other than AIG to provide equity in that company to any person or entity (including but not limited to the U.S. Treasury, the Trust, or any government agency) as a condition for the extension of credit under Section 13(3)” or any other statute. (Def. Resp. to Pl. 1st RFAs Nos. 19.0, 19.2).

(b) Baxter: In 2008, FRBNY established emergency credit facilities under 13(3) to provide liquidity to markets, including such general facilities as the PDCF, the TSLF, the money market investor funding facility, the commercial paper funding facility, TALF, and special facilities for AIG, Bear Stearns, Citigroup, and Bank of America. With the exception of AIG, FRBNY “got interest and fees but no equity” in all of those facilities. (Baxter: Trial Tr. 1083:9 – 1085:24).

(c) Cragg: is not “aware of any central bankers or any central banking scholar who, prior to 2008, advocated requiring the shareholders of a borrower who was being lent to by a lender of last resort to surrender a majority of the borrower’s equity and voting control as consideration for a loan.” (Cragg Trial Tr. 5470:25 – 5471:9). Moreover, the economic theory of the Lender of Last Resort does not include “the use of equity kickers in the same way that is does with commercial lending . . . to distressed institutions”. (Cragg: Trial Tr. 8716:22 – 8717:16).

23.0

DEFENDANT UNDERSTOOD THAT NEITHER THE FEDERAL RESERVE NOR TREASURY HAD THE AUTHORITY TO ACQUIRE EQUITY AS A CONDITION OF MAKING A 13(3) LOAN.

23.1 Defendant Understood That Section 13(3) Did Not Authorize the Federal Reserve to Acquire or Hold Equity as Consideration for a 13(3) Loan.

(a) November 1, 2008 memo from the Legal Division of the Board of Governors to the Board of Governors regarding “Ownership of equity interests in IPCs”: “The Federal Reserve Act authorizes the Federal Reserve Banks to extend credit in various forms and under certain conditions. **No provision of the Federal Reserve Act expressly authorizes the Federal Reserve to acquire the equity of any entity.** Section 13(3) authorizes a Reserve Bank, in unusual and exigent circumstances and with the authorization of a super-majority of the Board of Governors, to discount notes of any individual, partnership or corporation.” (PTX 336 at 1 (emphasis added)).

(b) U.S. 30(b)(6) witness James Millstein, *Murray v. Geithner*: “Q. So when you refer to the Federal Reserve could not own the equity, you mean the Federal Reserve Bank of New York? A. Yes.” (PTX 4004 (U.S. 30(b)(6) (Millstein), *Murray v. Geithner* Dep. 50:15 – 51:6); *see also* PTX 4006 (U.S. 30(b)(6) (Hsu), *Murray v. Geithner* Dep. 53:12 – 54:5) (“the Fed does not have authority to hold equity as a legal – doesn’t have the legal authority to do that”)).

(c) U.S. 30(b)(6) witness Jon Greenlee, *Murray v. Geithner*: “The Federal Reserve is only, by statute only allowed to extend credit to organizations. It is not empowered to make any type of investments or equity injections.” (PTX 545 at 82:14-16).

(d) Davis Polk attorney Randall Guynn on September 17, 2008: “There is no express authority, which is one of the reasons Treasury and the Fed discussed their actions with congressional leaders of both parties. Maybe it’s an implied power of setting the conditions for

lending money under 13(3) of the federal reserve act, but the govt is on thin ice and they know it. But who's going to challenge them on this ground?" (PTX 3263 at 1). He forwards the email to Huebner, adding: "I'll be interested in how creative the treasury and fed lawyers become on this issue." (PTX 3283 at 1).

(e) FRBNY's independent auditor Deloitte: FRBNY "is prohibited by law from holding equity securities in a commercial enterprise." (JX 386 at 3).

(f) Deloitte: "FRBNY cannot legally control a commercial company, and therefore it is not appropriate for them to consolidate an entity it cannot legally own." (JX 388 at 6).

(g) Baxter (FRBNY Notes of Interview with COP on May 11, 2010): "Neither the Fed nor the treasury had authority to hold the shares. When we saw equity on term sheet- problem of legal ownership and the conflict. Maybe strike that and not take equity. But then thought of taxpayer. Create a trust, put shares in trust. For benefit of American people. We had to decide that right away." (PTX 2211 at 10).

(h) Baxter (to Alvarez on October 23, 2008): "we agree that there is no power" for the Federal Reserve "to hold AIG shares". (PTX 320-U at 1).

(i) Handwritten notes of Alvarez of a September 18, 2008 conference call among attorneys from FRBNY, BOG, Treasury and Davis Polk, attributed to "Tom B" (Baxter), the

following comments: “signif issues w/ Fed controlling AIG”; “legal, conflicts, regulatory, etc”; “don’t have statutory authority to control”. (PTX 148 at 1 (emphasis in original)).⁵⁷

(j) The handwritten notes of FRBNY attorney Greg Cavanaugh, dated September 17, 2008 state: “Fed can’t hold warrants.” (PTX 3153 at 7-8).

(k) Legal Division to BOG: The Fed “Can’t acquire equity” (PTX 336 at 2).

(l) The Federal Reserve is “prohibited from acquiring and holding stock as an equity kicker in connection with a loan by the Bank, as are commercial banks.” (PTX 370-A at 2)).⁵⁸

(m) Bernanke: “The Federal Reserve is authorized under the Federal Reserve Act to extend credit in various forms, but is not authorized to purchase equity securities of financial institutions” (PTX 363 at 2).

(n) Bernanke: never received “any legal advice or opinion as to whether the Federal Reserve could hold AIG stock”, nor asked “for any such opinion”, nor received “any legal advice

⁵⁷ Despite his own contemporaneously documented statements that the Federal Reserve did not have the authority to hold equity, Baxter testified at trial that in his view, “there was no question that the Federal Reserve Bank of New York had the authority to receive equity as consideration for a section 13(3) lending” (Baxter: Trial Tr. 804:22 – 805:9; *see also* Baxter: Trial Tr. 944:8-15 (“I believe that under the Federal Reserve Act we had full statutory authority to own the equity and hold it.”)). He later reframed the issue as one of authorization, claiming that it was his belief that Alvarez’s view was that “the Federal Reserve Bank of New York did not have the authorization of the” Federal Reserve Board of Governors “to hold the equity in its name,” although Baxter acknowledged that he had never seen anything in writing attributing that view to Alvarez. Baxter: Trial Tr. 829:14 – 830:23. Baxter also had not seen anything in writing stating precisely “Alvarez’s view as to whether the New York Fed could or could not hold equity in its name was related to what the authorization was from the Federal Reserve Board of Governors.” Baxter: Trial Tr. 830:24 – 831:5. Furthermore, just as the documentary evidence does not support the claim that Alvarez’s concern was the distinction between statutory authority to take equity and the authorization by the Board of Governors to take equity, Alvarez’s own trial testimony does not support Baxter’s claim (*see infra* n.59), and such a claim ignores the many other contemporaneous admissions that the Federal Reserve did not have the statutory authority to take or hold equity (*see* § 23 above).

⁵⁸ Although Alvarez testified that he disagreed with this conclusion (Alvarez: Trial Tr. 300:7 – 303:17), his handwritten note on the memorandum simply stated that he believed it was “politically sensitive”. PTX 370-A at 1.

or opinion as to whether the Federal Reserve could acquire AIG stock”, nor ever asked “for such advice or opinion” (Bernanke: Trial Tr. 2156:16 – 2157:1).

(o) Geithner: “Under section 13(3) of the Federal Reserve Act, the Fed is prohibited from taking equity or unsecured debt positions in a firm. At its core, this restriction reflects the importance of maintaining the line between the responsibilities and authorities of the fiscal authority, and those of the monetary authority.” (PTX 409 at 177).

(p) Geithner to Baxter on May 5, 2008: “I recall a sentence in my written testimony saying we did not have the authority to acquired an equity stake in an inst we were lending to. And I thought we have these broad prohibitions in what we can purchase” (DX 118 at -015 to -16).⁵⁹

⁵⁹ Baxter responded: “Tim, You said ‘We did not have the authority to acquire an equity interest in either Bear or JPMorgan Chase, nor were we prepared to guarantee Bear’s very substantial obligations.’ The context for this quoted part of your statement was taking an equity interest in Bear that was an alternative to Section 13(3) lending. By contrast, in the LLC lending we have committed to, we will take a kind of ‘equity kicker’ in the residual, should there be any. But this ‘kicker’ is incidental to the Section 13(3) lending, which is within our express authority, and the kicker is incidental to that express authority.” DX 118 at -015. However, Baxter acknowledged during trial that he “knew that there could be criticism of taking an equity kicker in this context” because his interpretation of FRBNY’s authority to take a so-called “equity kicker” was at odds with the interpretation of others who did not view FRBNY’s powers so broadly. Baxter: Trial Tr. 876:15 – 878:8; *see also* DX 118 at -015 (“we in New York read much into the incidental powers clause of Section 4 of the Act. And, we don’t always succeed in convincing our colleagues to the South. And, there are many who see our interpretive conduct as ‘loophole lawyering’. In this regard, I do pause and think when I see descriptions like ‘barely legal’ (Krugman in today’s NYT), ‘toes to the line’ (Volcker), or even ‘creative’ (Dudley). Hope this is responsive to your question, and there is another issue that is important. If we were not saddled with a statute that is nearly 100 years old, and requires liberal interpretation to fit the way business is done now, we would not be in this position.”).

(q) Alvarez (to Baxter on September 21, 2008): “Just to confirm, ownership of stock along the lines in this term sheet will not work for the Fed – trust or no trust. It’s fine if Treasury takes the stock, which I thought from the discussion last week was foreclosed.” (PTX 183 at 1). “I still haven’t gotten an answer to my question about why we can’t have warrants for voting preferred that are limited to exercise on transfer.” (PTX 183 at 1).

(i) Baxter testified during his deposition that when Alvarez wrote in PTX 183 ““ownership of stock along this line in this term sheet will not work for the Fed, trust or no trust””, this is referring to ““Scott’s view that we couldn’t take equity in AIG, ‘we’ being the Federal Reserve Bank of New York.”” His deposition testimony was “complete, truthful and accurate testimony” at the time it was given and remains so today. (Baxter: Trial Tr. 817:5 – 818:7).

(r) Email from Alvarez to Geithner, Bernanke and Baxter on March 1, 2009: “Nice try on the preferred stock investments! We still don’t have that authority.” (PTX 443 at 1).

(s) Internal Wachtell Lipton email on September 16, 2008: “Scott alvarez apparently nixed that idea” that the Fed has the “ability to hold AIG’s equity”. (JX 370 at 1-2; *see also* JX 370 at 1 (Richard Kim of Wachtell writes: “Looks like it’s Treasury unless we can find another

More specifically, lawyers for the Board of Governors have maintained that it is *not* within the scope of a Federal Reserve Bank’s express or incidental powers to take an equity kicker in connection with a loan (*see, e.g.*, PTX 336 at 2 (the Fed “Can’t acquire equity”); PTX 370-A at 2 (the Federal Reserve is “prohibited from acquiring and holding stock as an equity kicker in connection with a loan by the Bank, as are commercial banks”); PTX 2737 at 1 (“the legislative history of the Act says Congress didn’t want us to buy equities (hence the non-appearance of such authorization in sections 13 and 14)”); that the Federal Reserve’s incidental powers to “carry on the business of banking” are “more restricted than the comparable National Bank Act provision” (PTX 2738 at 13); and that, although the incidental powers of national banks are broader than those of Federal Reserve Banks, even national banks may not acquire equity in connection with a loan (PTX 336 at 2 (“Even accepting FRBNY argument that it can engage in all activities ‘incidental to the business of banking’ national banks may not make equity investments in companies in connection with a loan (may have equity kickers as inducements, but not acquire equity).”)).

home for the equity” to which David Neill of Wachtell responds: “The Fed question is mooted--it has to be Treasury.”)).

(t) Alvarez: there were “legal reasons why it was decided not to have the New York Federal Reserve Bank hold the equity participation that was required for the extension of the Federal Reserve Bank credit” (Alvarez: Trial Tr. 265:21 – 267:8).⁶⁰

(u) In response to an email which states: “Treasury can’t take this so we are”, Helen Mucciolo (FRBNY) sent an email to Dahlgren and others on September 17, 2008 stating, “I thought we couldn’t take them under the FRA.” (PTX 127 at 1; *see also* Dahlgren: Trial Tr. 2791:6-20 (“‘them’ refers to warrants” and “‘FRA’ is the Federal Reserve Act.”)).

(v) Davis Polk attorney Randall Guynn on September 18 to Alvarez: “I understand that one of the issues to be discussed is whether the Fed’s power to make advances under Section 13(3) of the Federal Reserve Act includes the power to acquire an equity interest in AIG as an incident to the lending power. I also understand someone at DOJ is raising questions based on what has been described to me as a 1940’s statute restricting control of corporations and the Fed’s ‘gift’ powers” (PTX 3280 at 2). Guynn later stated that he thought DOJ “may be talking about Youngstown Sheet & Tube Co. v. Sawyer (the Steel Seizure Cases), where the Supreme Court affirmed an injunction against President Truman’s executive order seizing control of the

⁶⁰ At trial, Alvarez offered multiple theories in an attempt to explain away his past statements concerning the Federal Reserve’s lack of authority to hold equity. He explained that there is a distinction between the Federal Reserve’s ability to purchase equity directly (which they cannot do) and take equity in satisfaction of a loan (which he argued could be done). *See* Alvarez: Trial Tr. 578:6 – 580:20; *see also* 580:3-11 (“The difference is the acceptance of stock in satisfaction of the debt that we had previously contracted, the \$85 billion credit, was a natural way of paying off the debt and then selling the assets in satisfaction of that debt. That’s what we were doing, and that was different than being an investor that invests stock – invests cash in a company as a way of acquiring an equity interest in the company, which we were not doing.”).

Even if Alvarez’s new-found theory could be credited, it fails to account for the fact that FRBNY did not take the equity in satisfaction of AIG’s debt because even after AIG repaid the FRBNY loan, Defendant still retained the equity interest in AIG for its own benefit.

steel mills throughout the country on national security grounds, without any express Congressional authorization” (PTX 3288 at 1).

23.2 Defendant Recognized That 13(3)’s Provision That the Consideration for a 13(3) Loan Was to Be a “Rate” Limited Such Consideration to an Interest Rate.

(a) Bernanke: Asked whether “rate” as used in Section 13(3) includes equity, Bernanke answered, “I normally think of rates as interest rates.” (Bernanke: Trial Tr. 2005:6-19).

(b) Bernanke: The equity component was “not a rate on a loan, no. It was a piece of the compensation, yes.” (Bernanke: Trial Tr. 2004:22 – 2005:2).

(c) Bernanke neither asked for nor received an opinion on whether the term “rates,” as used in Section 13(3), includes equity. (Bernanke: Trial Tr. 2006:6-22, 2007:23 – 2008:5).

23.3 Recognizing That These Limitations Prevented It from Taking an Equity Interest in AIG, Defendant Discussed Amending Section 13(3) to Create the Authority to Demand or Receive Equity in Exchange for Emergency Credit.

(a) On September 18, 2008, Alvarez sent Geithner a list of proposed “Simple legislative changes to improve emergency powers.” (PTX 132 at 1-2). Alvarez explained that the “change to section 13(3) would allow the Reserve Bank, in unusual and exigent circumstances, to provide any type of funding to an IPC—including any type of equity or debt funding. It would also clarify that the Reserve Bank may impose any condition in connection with providing funding to an IPC. That would include accepting any inducement, such as warrants, and requiring any type of remedial action, such as changing management or cutting dividends.” (PTX 132 at 2-3).

(b) Geithner admitted that the proposed changes were “designed to broaden the authority of the Federal Reserve to extend 13(3) credit and to provide the scope of what the Federal Reserve can receive in exchange for those credits.” (Geithner: Trial Tr. 1589:22 – 1590:3).

(c) On September 18, 2008, at Geithner's request, Baxter also drafted proposed changes to Section 13(3). The Alvarez and Baxter edits differ by one sentence. (*Compare* PTX 132 at 2 (Alvarez's version replacing "discount for" with "provide funding to" any individual, partnership or corporation) *with* PTX 136 at 3 (Baxter's version replacing "discount for" with "provide funding by means of a loan, capital contribution, commitment, guarantee, letter of credit or the like" to any individual, partnership or corporation)). Baxter explained that the change to section 13(3) would allow the Reserve Bank, in unusual and exigent circumstances, to accept "any inducement, such as warrants, and requiring any type of remedial action, such as changing management or cutting dividends" (PTX 136 at 3-4).

23.4 Defendant Understood That FRBNY's Legal Position Concerning Its Authority Under Section 13(3) Was Aggressive "Loophole Lawyering" and Inconsistent with the Board of Governors' Position.

(a) Geithner was aware "that there was a difference of view between the lawyers at the Federal Reserve Bank of New York and the Board of Governors lawyers in terms of the authority of the Federal Reserve Bank of New York to hold equity". (Geithner: Trial Tr. 1687:21 – 1688:1).

(b) Baxter: "we don't always succeed in convincing our colleagues to the South" (referring to Federal Reserve Board of Governors) and there "are many who see our interpretive conduct as 'loophole lawyering'." (DX 118 at -015; *see also supra* n.58).

(c) Version 5.0 of the Doomsday Book (updated in 2012): "[REDACTED]

[REDACTED]" (PTX 651 at 38).

(d) Howard Hackley (former General Counsel to the Board of Governors and Federal Open Markets Committee): "By stating that a Federal Reserve Bank may exercise 'all powers specifically granted by the provisions of this Act' and such incidental powers as shall be

necessary to carry on the business of banking ‘within the limitations prescribed by this Act’, the Federal Reserve Act provision suggests a scope more restricted than the comparable National Bank Act provision. Moreover, it may be persuasively argued that a broad construction of the ‘incidental powers’ of a private corporation is not likely to have any substantial effect on the public interest, but that particular care should be taken to avoid enlargement of the important governmental powers of a governmental corporation in a manner beyond the intent of Congress.” (PTX 2738 at 13-14; Alvarez: Trial Tr. 643:17 – 644:21).

(e) Federal Reserve Board staff attorney Heatherun Sophia Allison: “it seems we are basically arguing that ‘incidental powers’ means we can buy a little bit of equities **even though the legislative history of the Act says Congress didn’t want us to buy equities (hence the non-appearance of such authorization in sections 13 and 14).**” (PTX 2737 at 1 (emphasis added)).

23.5 In September 2008, Treasury Had No Authority to Purchase or Hold Equity.

(a) Board of Governors Legal Division memorandum dated November 2008: “We understand that the Treasury lacks the legal authority to hold directly voting stock of AIG”. (PTX 370 at 3).

(b) Treasury’s external counsel at Wachtell Lipton on September 17, 2008: “Treasury legal is telling as, per doj, that they cannot hold voting shares.” (JX 373-U at 1).

(c) Email from FRBNY counsel (who reported to Baxter) to Federal Reserve Board officials on September 17, 2008, concerning “Issues with regard to the NY Fed/Treasury’s equity participation in AIG”: Treasury “consider themselves legally unable to assume ownership. This leaves the NYFed as Treasury’s place to house the equity position.” (PTX 143 at 1-2).

(d) On September 17, 2008, Baxter notes that “there are many legal problems with Treasury owning AIG” (PTX 116 at 1).

(e) October 3, 2008 draft of the AIG Credit Facility Trust Agreement: With respect to the “Perpetuities Savings Language” provision, a FRBNY comment states: “DPW provided this language except it had the property going to FRBNY. Not sure why FRBNY and not Treasury (neither of us can take stock so we both have the same problem).” (PTX 278 at 20).

(f) September 26, 2008 draft of the AIG Credit Facility Trust Agreement: “I think we have a drafting problem. We need specific termination events for the trust but since the Treasury cannot own the stock upon termination the Trustees need to be able to liquidate – this could take time and the Trust is terminated.” (PTX 260 at 21).

(g) October 8, 2008 email from Stephen Albrecht (a Treasury attorney) discussing a draft of the Trust Agreement: Treasury “cannot take stock that confers control.” (PTX 288-U at 2).

(h) Prior to any decision to loan to AIG, Federal Reserve and Treasury Department officials held a conference call on September 15, 2008 to discuss the “powers we wld want” from Congress. (PTX 65 at 1-2). Those powers included the power to “buy any stock, preferred or common, and any debt”. (Alvarez: Trial Tr. 162:2-8).

23.5.1 Recognizing Treasury’s lack of authority, Board of Governors legal staff drafted proposed legislation on September 16, 2008 that would have allowed Treasury to acquire “any type of equity interest” in a troubled financial institution (PTX 3368 at 2).

(a) Paulson: “before we had the TARP we didn’t have the ability to put in capital.” (Paulson: Trial Tr. 1247:5-6).

23.5.2 Even though Congress provided Treasury with authority to purchase equity in EESA, that authority was still far more limited than the taking and/or illegal exaction provided for by the Credit Agreement. (12 U.S.C. §§ 5211, 5223).

(a) Baxter: “The Emergency Economic Stabilization Act gave authority to the Treasury Department to invest in common equity, and of course it did in the TARP program, but that was not authority that the statute extended to the Federal Reserve.” (Baxter: Trial Tr. 798:7-11).

(b) Even after EESA was passed, Treasury had no authority to acquire voting stock. The equity provided under TARP was “nonvoting stock”. (Geithner: Trial Tr. 1397:5-10).

(c) FRBNY attorney Stephanie Heller: “under the TARP legislation Treasury is prohibited from getting voting rights” (PTX 3350 at 1); “perhaps Congress should have passed a law that actually allowed the Treasury to get voting rights in connection with TARP money” (PTX 3351 at 1).

(d) Heller concerning AIG: “I do not see how the use of the stock works unless the argument is that the fact that Treasury turned over its right to vote to the trustees satisfies the requirement that for voting shares Treasury gives up its right to vote. I am concerned about relying on such an argument because in this case Treasury is giving the right to vote to trustees who are obligated to vote in the interest of the Treasury and acting in a fiduciary capacity to the Treasury.” (PTX 3360 at 1).

(i) “There were questions at that time which continue today as to whether the Treasury or the FRBNY have authority to ‘own’ voting shares of a company. As I mentioned, the TARP legislation (section 113(d)) suggests that Treasury cannot have voting control.” (PTX 2067 at 1).

(e) The AIG preferred shares purchased pursuant to TARP (Series E and Series F) had only limited voting rights. (*See* JX 208 at 16-17 (Series E voting rights limited to election of two directors in the event that AIG failed to pay dividends for four quarterly periods and to matters affecting the rights and obligations of the preferred shares); JX 209 at 17-19 (same for Series F)).

23.6 Defendant Was Explicitly Aware That Diluting AIG Shareholders Raised Concerns Under The Takings Clause of The Constitution.

(a) A February 25, 2009 memorandum from a Board of Governors attorney: “Based on our discussions with Scott, we think there is some political benefit to having the Government some visible additional control for the new money it is putting in and not giving the existing shareholders a windfall. We are trying to do some quick legal research to see if there are possible takings problems with further dilution” (PTX 3159 at 1).

24.0

PRIOR TO THE EXECUTION OF THE CREDIT AGREEMENT, NEITHER THE BOARD OF GOVERNORS NOR ANY OTHER GOVERNMENT OFFICIAL UNDERTOOK ANY INVESTIGATION OR ANALYSIS, OR MADE ANY FINDINGS, OR ALLOWED AIG OR PLAINTIFFS ANY MEANINGFUL OPPORTUNITY TO BE HEARD AS TO WHAT PERCENTAGE OF EQUITY OR VOTING CONTROL WAS APPROPRIATE TO DEMAND.

(a) SIGTARP: FRBNY “did not conduct an independent analysis regarding the appropriate terms for Government assistance to AIG”. (PTX 549 at 15).

(b) Before deciding to take a 79.9% equity interest in AIG and to charge 14% in interest and fees on its loan to AIG, the Government did not perform any “documented analysis . . . regarding the type and amount of consideration” (Def. Resp. to Pl. 1st Interrogatories No. 3).

(c) Defendant admits that it “is not aware of any attempt by the Board of Governors or FRBNY to estimate the value of the Series C Preferred stock” (Def. Resp. to Pl. 3rd Interrogatories No. 18).

(d) Defendant admits that when it offered to lend to AIG, “the United States and/or FRBNY did not estimate the cash value of the 79.9% equity” stake in AIG (Def. Resp. to Pl. 2nd RFAs No. 546).

(e) Bernanke: As of September 16, no estimate was “made as to how much additional compensation the equity component provided” (Bernanke: Trial Tr. 1983:24 – 1984:3).

(f) Bernanke was not “aware of any attempt to make an estimate of how much additional compensation was being provided as a result of the equity component of the proposed term sheet on September 16th” (Bernanke: Trial Tr. 1985:20-24, 1986:6-12).

(g) Geithner was “not aware of a single document . . . that compared the amount of risk in the AIG credit facility to the Citi credit facility or the Bank of America credit facility or the Bear Stearns credit facility” or to the PDCF. (Geithner: Trial Tr. 1882:22 – 1883:15).

(h) Baxter had “never focused on the precise amount, 79.9 percent” until he saw it “in the private sector term sheet” on September 16, 2008. (Baxter: Trial Tr. 905:10-17).⁶¹

25.0

THE AIG CREDIT FACILITY TRUST DID NOT CURE DEFENDANT’S LACK OF AUTHORITY.

25.1 Regardless of Whether the Trust Ultimately Held the AIG Shares, FRBNY Initially Acquired the Shares.

25.1.1 “FRBNY was the settlor of the Trust” (Def. Resp. to Pl. 2nd RFAs No. 767; Baxter: Trial Tr. 985:15-19; JX 172 at 4).

⁶¹ Baxter testified that while no formal calculation was done of the equity FRBNY had taken from AIG, he and Geithner had a conversation “On or around September 16” in which they ultimately agreed that the equity could be “worth a substantial amount.” Baxter: Trial Tr. 745:10-22, 748:10-24; Baxter could not recall whether he shared his “estimate” of the value of FRBNY’s equity holdings in AIG. Baxter: Trial Tr. 747:15 – 748:4 (confirming his 30(b)(6) deposition testimony on behalf of the United States that no one made “any effort to make an estimate of the value of the 79.9 percent equity, other than saying that it was somewhere between zero and a very substantial amount.”); *see also id.* 750:21 – 751:7.

25.1.2 The only payment made to AIG for AIG's Series C Preferred Stock was \$500,000 in loan forgiveness that FRBNY provided to AIG in September 2008 (JX 107 at 37-38 (§ 4.02(e)), 137).

25.1.3 When FRBNY provided the \$500,000 in loan forgiveness to AIG in September 2008, the Trust did not exist. (*See* Def. Resp. to Pl. 2nd RFAs No. 726 ("The Trust did not exist until the AIG Credit Facility Trust Agreement was signed on January 16, 2009.")).

25.1.4 "The corpus of the Trust consisted entirely of the Series C Preferred Stock." (Def. Answer to 2nd Am. Compl. ¶ 85; *see also* PTX 515 at 9-19).

25.2 The Series C Preferred Shares Were Received as "the Quid Pro Quo" for the Fed's Loan to AIG (PTX 4004).

25.3 Defendant Established the Trust in an Attempt to Circumvent the Limitations on Its Authority.

25.3.1 Sometime between September 16th and September 22nd, Baxter conceived of the idea of having a trust own the equity interest in AIG and proposed that concept to Geithner. (Baxter: Trial Tr. 791:10-22).

25.3.2 Because Defendant did not want to give up the equity interest, it attempted to circumvent the limits on its authority (which prevented the Government from owning an equity interest in AIG) by placing the AIG shares in a trust.

(a) U.S. 30(b)(6) witness James Millstein, *Murray v. Geithner*: "my understanding is the Federal Reserve generally cannot own an equity security, and so the trust was established to hold the equity security that . . . was part of the quid pro quo for the loan. Since AIG had failed to be able to muster private financing on its own and was forced to come to the Federal Reserve Bank as a lender of last resort to meet its liquidity needs in September of 2008, the penalty for that was to . . . suffer the substantial dilution associated with the issuance of the Series C preferred stock; and since the Federal Reserve could not own the equity security, a trust was

established for the benefit of the treasury to hold that security.” (PTX 4004 (U.S. 30(b)(6) (Millstein), *Murray v. Geithner* Dep. 50:15-51:6)).

(b) U.S. 30(b)(6) witness James Millstein, *Murray v. Geithner*: “Q. The Series C preferred shares were transferred to the beneficial interest of the US Treasury; correct? A. The trust agreement says that . . . beneficial interest in the trust is held by the US Treasury. Q. And as I understand your earlier testimony, that was because the Federal Reserve Bank of New York could not own equity? A. That’s my understanding.” (PTX 4005 (U.S. 30(b)(6) (Millstein), *Murray v. Geithner* Dep. 80:1-8)).

(c) Alvarez: “The creation of the Trust is necessary . . . because neither the Reserve Bank nor the Treasury Department has the legal authority to hold the equity in the form of preferred or common stock directly.” (PTX 368 at 3).⁶²

(d) Board of Governors attorneys Ashton and Meyer: “Had the equity ‘kicker’ been in the form of warrants, as originally contemplated, there would have been a stronger argument that the Reserve Bank or the Treasury could hold them, and there would not have been a need for a separate, independent trust.” (PTX 1816 at 3 n.2).

(e) FRBNY attorney Stephanie Heller: “One of the reasons we set up that the shares would be issued to the trust was an authority concern”. (PTX 3217 at 1).

(f) Baxter Interview with FCIC on April 30, 2010: ““We didn’t have the legal authority to own shares, we didn’t want to control the company. That’s why the credit facility trust and

⁶² During trial, Alvarez disclaimed authorship of PTX 368 (Alvarez: Trial Tr. 372:4-6). He could not, however, identify any other document that purported to be a final document from him to other people that he had never seen (Alvarez: Trial Tr. 372:22 – 375:16). Moreover, five days earlier he had received a memo from Board of Governors attorneys Ashton and Meyer which said “The Trust is necessary to hold the preferred shares, because neither the Reserve Bank, nor the Treasury has explicit statutory authority for stock to be owned directly the Reserve Bank or the United States government” (PTX 1816 at 3).

the equity participation went to trust - legal ownership was in the trust, which has three independent trustees, so there's no control in Treasury or the Fed.'" (PTX 580 at 3; *see also* PTX 580 at 4 ("we had learned many things in September, and one was that we didn't have the ability to own shares before.)); *see also* Baxter: Trial Tr. 797:8-11 (acknowledging that he has never suggested any corrections to PTX 580)).

(g) FRBNY Notes of Interview with COP on May 11, 2010: Baxter: "**Neither the Fed nor the treasury had authority to hold the shares.** When we saw equity on term sheet- problem of legal ownership and the conflict. Maybe strike that and not take equity. But then thought of taxpayer. Create a trust, put shares in trust. For benefit of American people. We had to decide that right away." (PTX 2211 at 10 (emphasis added)).⁶³

(h) The Congressional Oversight Panel: "Because neither Treasury nor the Federal Reserve had the authority to own these shares, the terms were written so that the shares would be held by the U.S. Treasury." (PTX 589 at 72 n.265).

(i) Deloitte & Touche, FRBNY's auditor: "As neither the Federal Reserve Board nor the FRBNY has explicit authority to directly hold equity securities, the Preferred Stock and any common stock into which it is converted are held in a trust (hereinafter, the 'Trust') created by FRBNY for the benefit of the U.S. Treasury." (JX 388 at 2; *see also* JX 386 at 3 ("In consideration for F's extension of credit under the Senior Revolving Credit Facility, A concurrently agreed to issue 100,000 shares of Series C Preferred Stock ('Series C Preferred

⁶³ Baxter claimed at trial that he does not remember ever saying what is in the recorded notes of either his FCIC or COP interviews (*see* Baxter: Trial Tr. 801:19 – 802:13, 722:24 – 723:10). However, in addition to the interview notes of two separate congressional investigative committees, the contemporaneous documentary evidence from Baxter and other Government officials at the Fed at the time of the taking/exaction was that there was no authority to acquire equity. *See* PTX 320-U at 1; *see generally supra* § 23.0.

Stock’) to a trust (the ‘Trust’). It should be noted that F is prohibited by law from holding equity securities in a commercial enterprise.”)).

25.4 The Use Of a Trust to Hold Equity in AIG for the Benefit of the United States Was Unprecedented.

(a) Email from Huebner to FRBNY and Treasury officials on September 23, 2008:

“This is a very very odd animal. A state law trust where the grantor is the NY Fed and the beneficiary is the US Treasury. We know of no precedent”. (PTX 235-U at 1).

25.4.1 Baxter’s current explanation for creating the Trust is pretextual.⁶⁴

(a) Baxter told the Trustees that the hope was the trust would resolve his concern about “the potential appearance of conflict of interest if the Government itself voted the stock.” (Feldberg: Trial Tr. 3398:2-21; *see also* Feldberg: Trial Tr. 3398:22 – 3399:3 (confirming the primary purpose for creating the trust was to deal with the “appearance or actual conflict of interest”)).

(b) Email from Baxter to Huebner on September 17, 2008: “Treasury is now focused on the myriad legal issues arising from the equity participation. Consequently, I have been asked to reconsider my position that the Federal Reserve Bank of New York, which technically is not a

⁶⁴ Baxter testified that the Trust had to be created because “at the senior levels of the Federal Reserve Bank of New York we had individuals who had knowledge of the most sensitive financial information that is available within the government,” and “to have people who have that sensitive information also in a position to control the largest financial institution in the world presented a conflict that needed to be resolved” (Baxter: Trial Tr. 800:24 – 801:18), and because of the trustees’ relative expertise in risk management (Baxter: Trial Tr. 771:17-22, 943:25 – 944:7). However, Defendant continued to control AIG by virtue of the controls it placed in the Trust Agreement (*see infra* § 25.4.2), by selecting Trustees with close ties to the Federal Reserve System (*see infra* § 25.5), by managing the Trust and the Trust’s ownership rights in AIG (*see infra* § 25.6.3) and by being the principal source of information about AIG for the Trustees (*see infra* § 25.7.2).

part of the United States Government, may hold the participation. Of course, control is the key issue. We cannot have control.” (JX 88-U at 1).⁶⁵

25.4.2 Various provisions of the Trust Agreement—the Trustees’ “bible” (Feldberg: Trial Tr. 3341:23-25)—ensured Defendant’s control.

(a) “Section 1.01. *Creation of Trust*.”: The Trust Agreement provides that FRBNY established the Trust “for the sole benefit of the Treasury.” (JX 172 at 5, § 1.01).

(b) “Section 1.02. *Appointment and Acceptance of Trustees*.”: FRBNY has the power, in consultation with Treasury, to appoint the trustees of the trust. (JX 172 at 5, § 1.02).

(c) “Section 1.03. *Trust is Irrevocable*.”: The “Board of Governors may terminate or amend its authorization pursuant to Section 13(3) of the Federal Reserve Act, thereby revoking or amending the Trust”. (JX 172 at 6, § 1.03).

(d) “Section 2.04. *Exercise of Trust Stock Voting Rights*.”: “In exercising their discretion hereunder with respect to the Trust Stock, the Trustees are advised that it is the FRBNY’s view that (x) maximizing the Company’s ability to honor its commitments to, and repay all amounts owed to, the FRBNY or the Treasury Department and (y) the Company being

⁶⁵ At trial, Baxter testified that when he said “we cannot have control,” he “meant the Federal Reserve Bank of New York cannot have control.” FRBNY could not have control “Because it wasn’t consistent with the authorization granted to us by the Board of Governors and because of the conflict issues that I testified about earlier” (Baxter: Trial Tr. 938:8-25). As noted above, that is contrary to the contemporaneous evidence, including from Baxter himself (*see supra* n.63).

managed in a manner that will not disrupt financial market conditions, are both consistent with maximizing the value of the Trust Stock.” (JX 172 at 9-10, § 2.04(d)).⁶⁶

(e) “Section 2.07. *Control of Trust Litigation.*”: “The FRBNY shall . . . control the defense of any actual or threatened suit or litigation of any character involving the Trust” and the Trustees “may not make any admissions of liability . . . or agree to any settlement without the written consent of the FRBNY”. (JX 172 at 13, § 2.07(a)-(b)).

(f) “Section 3.02. *Number, Resignation, Succession and Disqualification of Trustees.*”: FRBNY, in consultation with Treasury, had the power to remove a trustee. (JX 172 at 14, § 3.02(d); *see also* Foshee: Trial Tr. 3575:11-22).

(g) “Section 3.03. *Standard of Care and Indemnification of Trustees.*”: The Standard of Care required the Trustees to act “in or not opposed to the best interests of the Treasury”. (JX 172 at 15, § 3.03(a)(i)).⁶⁷

⁶⁶ Defendant’s witnesses testified that FRBNY’s views expressed in Section 2.04(d) did not create any conflict or constrain the Trustees’ judgment. *See, e.g.,* Foshee: Trial Tr. 3516:14-25; Baxter: Trial Tr. 1151:1-12 (the views were intended to be “precatory or suggestive”); Foshee: Trial Tr. 3517:1-18 (perceiving no conflict “between maximizing the company’s ability to honor its commitments to and repay all amounts owed to the FRBNY or the Treasury Department and maximizing the value of the trust stock”); Langerman: Trial Tr. 7163:21 – 7164:1 (“I felt certainly that we had discretion to do what we thought was appropriate.”).

However, both the contemporaneous record and testimony elicited at trial evidences the opposite. At the time of drafting, FRBNY staff expressed concern that “we are asking the Trustees to do things that may be fundamentally in conflict.” (PTX 260 at 12). Moreover, at the time the Trustees approved the recapitalization, the Trustees took into account “the total value for all three preferred stock series”, not just the Series C for which they were responsible. Feldberg: Trial Tr. 3436:8-21; *see also* DX 859 at -125 (Minutes of Meeting of Trustees from September 29, 2010, discussing “the maximization of overall value to the beneficiary of the Trust” and “the estimated range of combined value of the common stock to be received by the Trust for the Series C Preferred Stock and the Treasury Department for the Series E and F Preferred Stock pursuant to the Recapitalization Plan”).

Moreover, the statement of the FRBNY’s views in the Trust Agreement was obviously intended to influence the Trustees or it would not have been included – particularly over the objections that had been voiced.

(i) Alvarez: “The Trustees, when they were selected, had fiduciary duties to the Treasury Department”. (Alvarez: Trial Tr. 320:24 – 321:1).

(ii) Feldberg “understood from the trust agreement that” the Trustees “had a fiduciary duty to the Treasury.” (Feldberg: Trial Tr. 3442:15-17).⁶⁸

(h) “Section 3.05. *Additional Rights and Obligations of Trustees.*”: Where the Trustees were uncertain about the Trust Agreement, the Trustees were to apply to FRBNY for clarification, and if FRBNY provides such clarification, then the “Trustees shall act in accordance with such written instructions.” (JX 172 at 19-20, § 3.05(g); *see also* Foshee: Trial Tr. 3577:10-19).

(i) “Section 6.07. *Remedies.*”: Defendant had the right to seek specific performance from the Trustees for compliance with their obligations. (JX 172 at 23, § 6.07).

(j) Geithner: “we were integral to constructing the trust which held the shares, the voting rights that were held on behalf of the Treasury, so we had a set of interests and obligations that we had to try to protect.” (Geithner: Trial Tr. 1809:4-11).

⁶⁷ Baxter testified at trial that this language “created a duty on the part of the trustees to act in a manner that benefited all shareholders, Treasury and non-Treasury alike.” (Baxter: Trial Tr. 1152:10 – 1153:5). However, there is no mention of “shareholders” in this provision. Moreover, in response to the question of whether “it would have been satisfactory to substitute the word ‘AIG shareholders’ for the word ‘Treasury’ in Section 3.03(a),” Baxter’s only response was that he did not “remember ever thinking of that in the course of this discussion of the trust agreement” Baxter: Trial Tr. 1155:8-12. Finally, Baxter’s trial testimony directly conflicts with his emails (originally withheld on grounds of privilege and produced only after Geithner’s testimony) during the drafting of the Trust Agreement in which he stated that he saw the “**trustees as protectors of the Federal equity stake in AIG**” and that the “**trustees should not care about the AIG minority shareholders.**” PTX 3286 at 1 (emphasis added).

⁶⁸ Foshee believed that the reference in Section 3.03(a)(i) to “Treasury” meant that he “was working for the benefit of the U.S. taxpayer and not for the – not for the Department of the Treasury” (Foshee: Trial Tr. 3510:10-16), but Foshee acknowledged that the word “Treasury” appears in many provisions throughout the Trust Agreement and at times refers to “the Treasury Department” not the U.S. taxpayer. Foshee: Trial Tr. 3569:6 – 3570:15.

(k) Zingales: “the Government really controlled the trust, and through the trust, AIG.” (Zingales: Trial Tr. 3840:17-22; *see also* PTX 5059 (Zingales demonstrative); Zingales: Trial Tr. 3838:17 – 3840:22 (comparing the level of Government control of the AIG trust with the degree of separation between the Government and the trust created in the BCCI case)).

(l) Huebner did not believe that the Trustees “had separate duties to the common shareholders. They were the representative of the owner of the preferred.” (Huebner: Trial Tr. 6272:22 – 6273:15).

(m) Baxter viewed the “trustees as protectors of the Federal equity stake in AIG” and believed that the “trustees should not care about the AIG minority shareholders” (PTX 3286 at 1).

25.5 FRBNY Selected the Trustees for Their Close Ties to the Federal Reserve System.

25.5.1 FRBNY recruited the individuals who served as Trustees. (Def. Resp. to Pl. 2nd RFAs No. 765, 766; JX 172 at 5, 14, §§ 1.02, 3.02(a)).

(a) Baxter: “The trustees were chosen by the Federal Reserve Bank of New York, which consulted with the United States Treasury Department” and Baxter “was the most senior officer of the Federal Reserve Bank of New York responsible for selecting the trustees.” (Baxter: Trial Tr. 986:11-19).

(b) Alvarez: “So, the trustees were selected through a search done by the New York Reserve Bank, and there was consultation with the Treasury about the names of the trustees before they were finally installed.” (Alvarez: Trial Tr. 578:2-5; *see also* Alvarez: Trial Tr. 318:9-12 (confirming FRBNY’s participation in the selection of the trustees)).

25.5.2 Each trustee had a significant connection to the Federal Reserve:

(a) Feldberg previously worked at FRBNY for 36 years, and he “had a close relationship with many Federal Reserve employees and officials” (Feldberg: Trial Tr. 3334:12 –

3335:5). He knew Kohn “well” (Feldberg: Trial Tr. 3335:6-8), had “worked closely with Mr. Baxter for many years” (Feldberg: Trial Tr. 3335:9-11; *see also* Baxter: Trial Tr. 987:18 – 988:1 (“Chet Feldberg and I had worked with for a long time at Federal Reserve. He ultimately became the head of our supervision function”)), and Dahlgren had worked for Feldberg “for a while” (Feldberg: Trial Tr. 3335:20-3336:1). Additionally, before he was approached about becoming a trustee, Feldberg had been asked by Baxter to serve as a consultant to the “investment committee for the Federal Reserve Bank of New York in connection with the Bear Stearns Maiden Lane facility” (Feldberg: Trial Tr. 3337:22 – 3338:2).

(b) Jill Considine, among other things, “had chaired the audit and risk committee of the board of directors of the Federal Reserve Bank” (Baxter: Trial Tr. 988:18 – 989:3). Prior to serving as a Trustee of the AIG Credit Facility Trust, she completed a six-year term as a member of the Board of the Federal Reserve Bank of New York (Def. Resp. to Pl. 2nd RFAs No. 770).

(c) During the entire time he was a Trustee of the AIG Credit Facility Trust, Douglas Foshee was chair of the Board of Directors of the Federal Reserve Bank of Dallas, Houston Branch, and Central Houston, Inc. (Def. Resp. to Pl. 2nd RFAs No. 772; *see also* Foshee: Trial Tr. 3453:17-21 (confirming that while he was a trustee he was also chairman of the Houston Branch of the Federal Reserve Bank of Dallas)).

(i) On November 16, 2008, Alvarez wrote to Baxter on the subject of the “AIG trustees” to ask “Did you end up selecting a 3rd trustee for the AIG trust?” and was it the person that the President of the Federal Reserve Bank of Dallas Richard Fisher had recommended? Baxter responded: “It looks like ‘yes’. His name is Doug Foshee, and he is Chief Executive Officer of El Paso Natural Gas. He also sits on the Houston branch board of directors.” (PTX 372 at 1).

(ii) Foshee was first contacted about becoming a trustee by Tom Baxter.

(Foshee: Trial Tr. 3454:3-4; *see also* Baxter: Trial Tr. 989:7-25; PTX 298 at 1-2).

(iii) Foshee was later contacted by James Millstein, Treasury's Chief Restructuring Officer, about succeeding Liddy as CEO of AIG. (Foshee: Trial Tr. 3562:8-25).⁶⁹

(d) Board of Governors staff recognized that the nomination of Trustees with close ties to Defendant raised "an issue as to the perception of independence of the trustees." (PTX 3295 at 2).

25.5.3 The Trustees "are, first and foremost, Treasury's representatives," as noted by the Federal Reserve's General Counsel. (PTX 484 at 1).

(a) Alvarez: was aware that the trustees of the Trust "were going to be first and foremost Treasury's representatives". (Alvarez: Trial Tr. 318:5-8).

(b) Feldberg "understood from the trust agreement that" the Trustees "had a fiduciary duty to the Treasury." (Feldberg: Trial Tr. 3442:15-17).⁷⁰

(c) Huebner did not believe that the Trustees "had separate duties to the common shareholders. They were the representative of the owner of the preferred." (Huebner: Trial Tr. 6272:22 – 6273:15).

⁶⁹ Defendant called Langerman to testify at trial because he did not "have any prior relationship with either the New York Fed or the Federal Reserve" when he became a trustee for the AIG Credit Facility Trust. Langerman: Trial Tr. 7158:22 – 7159:2. Langerman was appointed as a Trustee on February 26, 2010 (DX 843 at -567) – long after most of the key events at issue took place, including the Reverse Stock Split, ML II & III, the *Walker* lawsuit, and the replacement of a majority of directors.

⁷⁰ Foshee believed that the reference in Section 3.03(a)(i) of the Trust Agreement to "Treasury" meant that he "was working for the benefit of the U.S. taxpayer and not for the – not for the Department of the Treasury" (Foshee: Trial Tr. 3510:10-16), but Foshee acknowledged that the word "Treasury" appears in many provisions throughout the Trust Agreement and at times refers to "the Treasury Department" not the U.S. taxpayer. Foshee: Trial Tr. 3569:6 – 3570:15.

(d) Baxter to Alvarez on November 16, 2008: “Both Jill and Chet realize that they are not to function like an uber-board of directors, but to vote the shares in the interest of the beneficial owner, i.e., the Treasury.” (PTX 372 at 1).

(e) Baxter to Huebner on October 28, 2008: “the issue to whom the trustees owe a duty is a key substantive point. We need to ensure the trust is drafted with clarity on that key point. Now, it is lacking in my view. I see the trustees as protectors of the Federal equity stake in AIG, and that is different than the duties of an AIG director. The trustees should not care about the AIG minority shareholders - they have no interest in the trust.” (PTX 3286 at 1; *see also* PTX 3286 at 2 (noting that the Trust Agreement “narrows the duties of the trustees, under the trust, to the trust beneficiary.”)).

(f) BOG counsel Richard Ashton and Stephen Meyer to Alvarez on November 17, 2008: “It is also uncertain as to whether the Trust would be sufficiently independent from the Government to qualify as a ‘partnership’ or ‘corporation’ that can borrow under section 13(3). The Trust’s entire beneficial interest belongs to the Treasury and the Trust would be set up by the Reserve Bank, which would select the trustees, in consultation with the Treasury.” (PTX 373 at 6).

25.6 The Trust Was Nothing More Than a Legal Shell for Defendant.

(a) As Deloitte, the Federal Reserve’s independent auditor, stated: “We observed that a legal shell (the Trust) was inserted into the transaction structure, and concluded that the introduction of this shell does not impact the conclusions reached above.” (JX 386 at 16).

(b) Wachtell attorney Lawrence Makow on a draft provision of the Trust Agreement that would make the Trust revocable at FRBNY’s discretion: “If we go this route, we might as well do away with the charade of having a voting trust altogether, because in my view this would destroy any hope we might otherwise have of avoiding change-in-control triggers. Then, it’s hard

for me to see the value of the voting trust other than pure optics for the market or the Fed's own fantasies about their lack of control." (PTX 3260 at 3).

(c) The final Trust Agreement gave the Board of Governors the power to revoke or amend the Trust by terminating or amending its Section 13(3) authorization. (JX 172 at 6, §1.03).

(d) During his congressional testimony, Liddy responded to the question of "Did you ever see or hear from these trustees? Were they at the board meetings? Were they there?" with the following: "You know, I have met with the trustees on a number of occasions. They were just appointed approximately the middle of February or so. I don't remember the exact date. Again, we have reviewed these with the Federal Reserve, and **the Federal Reserve is the repository gatekeeper, if you will, of the relationship with AIG.**" (PTX 471 at 84 (emphasis added)).

25.6.1 Defendant was always the beneficiary of AIG equity in all its forms.

(a) After reviewing the Treasury Department's financial statements, GAO "concluded that the U.S. Treasury, and the Department on behalf of the U.S. Treasury, is the constructive owner of the AIG stock" and believed "that the AIG stock should be recorded as a non-entity asset on Treasury's books." (PTX 3364 at 1). Consistent with the GAO's views, the Treasury Department ultimately recorded the value of its beneficial interest in AIG's stock in its financial statements. (PTX 2156 at 75, 94; Def. Resp. to Pl. 2nd RFAs Nos. 658, 659, 748, 752).

(b) The Trust dissolved on January 14, 2011 without having ever held or sold any AIG Common Stock. (Def. Resp. to Pl. 2nd RFAs Nos. 740, 745-747).

(c) The Recapitalization Plan resulted in the direct transfer of AIG common stock exchanged for the Series C Preferred Stock to Defendant. (Def. Resp. to Pl. 2nd RFAs No. 740).

While Defendant directly held this stock, it exercised the associated voting rights. (Def. Resp. to Pl. 2nd RFAs No. 742).

25.6.2 The Trust Agreement gives away AIG rights despite AIG's lack of involvement in the negotiation and drafting of the Agreement.

(a) Baxter: AIG was not involved in drafting the Trust Agreement and Defendant "generally believed it was empowered to draft the trust agreement and select the trustees without consulting AIG". (Baxter: Trial Tr. 841:22 – 842:3)

(b) AIG's outside counsel Robert Reeder to the AIG Board of Directors at their March 1, 2009 meeting: The "Trust Agreement contains a broad waiver of corporate opportunities by AIG with respect to the Trustees and AIG did not expressly agree to be bound by this waiver" (JX 184 at 11).

(c) Among other things, the Trust Agreement contained an undertaking through which AIG was required to reimburse all Trust expenses. (JX 173 at 1; JX 184 at 11 (AIG is required "to pay the Trust expenses, including indemnification expenses of the Trustees, to the extent the Trust lacks available funds.")).

(i) This occurred after Defendant determined that it had no Section 13(3) authority to pay the Trust's expenses (*see* PTX 368 at 5-7).

25.6.3 Despite its lack of authority to exercise control of the stock held by the Trust, Defendant – not the Trustees – managed the Trust and exercised the Trust's ownership rights in AIG.

(a) Huebner to Baxter on September 21, 2008: "you guys have said on every call that you - not the trustees - control disposition decisions. This is a rather big way in which the Fed is 'involved.'" (PTX 190 at 2).

(b) Board of Governors attorney Stephen Meyer on October 3, 2008: “I think that we cannot say that we do not intend to control the Company stock, when we do intend (at least in part) to control its disposition.” (PTX 3357 at 1).

(c) Under Section 2.05(a)(iii) of the Trust Agreement, the Trustees could not divest the Trust’s stock without FRBNY’s approval. (JX 172 at 11, § 2.05(a)(iii); *see also* Foshee: Trial Tr. 3566:22 – 3567:4 (affirming the statement as true and accurate)).

(d) Feldberg: The Trustees “were not able to sell or dispose of the trust stock, except with the prior approval of the Federal Reserve Bank of New York.” (Feldberg: Trial Tr. 3442:4-9).

(e) An attorney at Davis Polk who helped draft the Trust Agreement “thought our trustees simply wanted to be told exactly how they need to vote” (PTX 3231 at 4-5).

(f) Langerman: “I understood and we understood that ultimately the Fed could approve or disprove – disapprove what we might otherwise be proposing.” (Langerman: Trial Tr. 7190:24 – 7191:17).

(g) The “trustees consulted with the New York Fed prior to voting on matters and prior to selecting directors for AIG” (Baxter: Trial Tr. 842:25 – 843:5; *see also* Def. Resp. to Pl. 2nd RFAs No. 797 (“The Trustees consulted with representatives of FRBNY before voting on issues as majority shareholder of AIG”)).

(h) As the Proxy Statement for AIG’s 2009 Annual Meeting summarized, “As a result of the arrangements described above, AIG is controlled by the Trust, which is established for the sole benefit of the United States Treasury.” (JX 221 at 15).

25.7 The Trustees Expressed Concern Over Their Independence.

(a) The trustees, through counsel, sent a memo to Baxter entitled “Topics for Discussion at the Meeting on October 30, 2008” which stated under a heading “Independence of

the Trustees”: “We would like clarification with respect to the independence of the Trustees.”

“there is Section 2.04(d) of the Trust Agreement which sets forth two ‘views’ of the FRBNY to be taken into account by the Trustees in exercising their discretion. First, the view that ‘maximizing potential value for all stockholders of the Company will require managing the Company so as to maximize its ability to repay advances under the Credit Agreement’. Second, the view that ‘management of the Company in a manner that will not disrupt financial market conditions is in the best interests of the stockholders of the Company’. **Is it intended that the Trustees are to be independent or not? If they are to be independent, we would respectfully suggest deleting Section 2.04(d).** There are two problems we see with it. First, we wonder whether, from the perspective of stockholders (the perspective of the Trustees), it is in fact necessarily correct to say (i) that potential value for all stockholders of the Company is maximized by maximizing the ability of the Company to repay its lender or (ii) that it is in the best interests of the stockholders of the Company not to disrupt financial market conditions. Second, we are concerned that the expression of these ‘views’ in the Trust Agreement compromises (and certainly confuses) the independence and discretion that the Trustees are supposed to have.” (DX 630 at -312 to -313 (emphasis added)).

(b) Despite the trustees’ stated desire to delete Section 2.04(d) because it “compromises (and certainly confuses) the independence and discretion that the Trustees are supposed to have” (DX 630 at -313), Defendant refused to delete this section (*see* JX 172 at 10, § 2.04(d)).

(c) Baxter: “We felt it was important for the New York Fed and the Federal Reserve more generally to state its views”. “One broad objective was to avoid the systemic consequences to the U.S. economy that would result from an AIG bankruptcy, and so we felt we should express that view as well to our trustees, who as majority shareholder might be able to influence the

company to file a petition in bankruptcy, for example. So, we wanted to articulate clearly our view on that.” (Baxter: Trial Tr. 994:11 – 995:12).⁷¹

25.7.1 Defendant argued to state insurance regulators and foreign governments that the Trust was a federal instrumentality.

(a) FRBNY managed the Trust’s communications with AIG’s regulators, including the process for complying with change-of-control rules under applicable state insurance laws and regulations. (*See, e.g.*, PTX 407 at 1; PTX 435 at 1; PTX 408 at 1).

(b) Defendant invoked supremacy clause and sovereign immunity, claiming that the Trust was an instrumentality of the United States not subject to state law regulation. (Def. Resp. to Pl. 2nd RFAs Nos. 728, 729; *see also* PTX 208 (email from Alvarez to Baxter suggesting that Baxter “call the states and argue supremacy”); Alvarez: Trial Tr. 324:14-19).

(c) On February 20, 2009, Dahlgren wrote a letter to state insurance regulators claiming that the Trust was a federal instrumentality and therefore immune from state insurance department regulations governing the change-in-control regulations concerning insurance companies. (PTX 427 at 2; *see also* Dahlgren: Trial Tr. 2759:17 – 2760:3 (Dahlgren believes she sent a letter similar to PTX 427 “to other insurance commissioners or departments around the country”); PTX 2037 (Dahlgren’s February 20, 2009 letter to Dinallo); Dahlgren: Trial Tr. 2760:12-18).

⁷¹ Baxter downplayed the significance of the provision. Baxter: Trial Tr. 995:20-24 (“All that said, those were the Fed’s views, and we knew we couldn’t control the discretion of our independent trustees. We wanted them to know what our views were at the outset, but in the end, they were going to vote their judgment and not necessarily ours”). However, as the aforementioned evidence demonstrates, because the Trustees’ information about AIG came from Defendant and the Trustees’ goal was to act in Defendant’s best interests, the Trustees’ actions were necessarily circumscribed based on their duties and knowledge. *See also supra* nn.66, 67.

(d) Baxter admitted to taking the position with state insurance commissioners that the trust was an instrumentality of the United States. (Baxter: Trial Tr. 842:4-9; *see also* JX 183 at 1 (February 27, 2009 NAIC letter to Baxter expressing concern over the February 20th letter from Dahlgren asserting the trust was “an instrumentality of the United States exempt from State law”); Baxter: Trial Tr. 842:10-24 (explaining that he took this position to avoid state or foreign regulation of the trust)).

(e) PTX 435 is an information statement sent by FRBNY counsel on behalf of Dahlgren to state insurance regulators summarizing the terms of the Series C Preferred Stock and the restructuring, and attaching the AIG Credit Facility Trust agreement. (*See generally* PTX 435; *see also* Dahlgren: Trial Tr. 2761:2-22 (the information statement also included a section that directed any questions to be sent to “AIG Credit Facility Trust, c/o James R. Hennessy, Federal Reserve Bank of New York.” Hennessy was part of the AIG monitoring team)).

25.7.2 FRBNY was the principal source of information about AIG for the trustees.

(a) The Trustees relied on the FRBNY Monitoring Team and other Government officials for information about AIG. As Baxter conceded, “representatives of the New York Fed provide the trustees with information concerning AIG.” (Baxter: Trial Tr. 1006:5-8; *see, e.g.*, PTX 429 at 1-3; PTX 441 at 1-2 (Email from David Gross (FRBNY) attaching the agenda for the February 27, 2009 Trust meeting held at FRBNY which includes updates provided by and discussions with Dahlgren and Baxter); PTX 453 at 1-2 (email from Dahlgren to trustees providing an update from that week’s events and asking for input on a list of names provided by Morgan Stanley as potential “senior advisors” in connection with AIA and ALICO transactions); PTX 515 at 39-45 (AIG Credit Facility Trust meeting minutes for Feb. 17, 2009 with

representatives of FRBNY; meeting minutes for Feb. 24, 2009 discussing upcoming meetings at FRBNY; and meeting minutes for Feb. 29, 2009 held at FRBNY)).

(b) The Trustees sought out guidance from Defendant. (PTX 484 at 1 (Email from Alvarez to Kohn: “Tom Baxter called on behalf of the three trustees for the Treasury trust that holds the AIG stock. They would like to visit someone senior at the board to discuss their plans and get guidance.”); *see also* Alvarez: Trial Tr. 318:20 – 319:7 (acknowledging the statement)).

(c) The Trustees did not attend AIG board or committee meetings. (PTX 516 at 49-50).

(d) Baxter met with the trustees “approximately once a month” because “I wanted them to feel comfortable that they were getting all the information that they needed.” (Baxter: Trial Tr. 1005:22 – 1006:4).

(e) Baxter: “the trustees consulted with the New York Fed prior to voting on matters and prior to selecting directors for AIG” (Baxter: Trial Tr. 842:25 – 843:5).

(f) Dahlgren: “we met with them periodically to provide them information updates on what we were doing at the company, what we were seeing at the company, again, just giving them sort of a broad brush, bringing them up to speed. And then as things were occurring, we would provide them information. So leading up to the restructuring in March, for example, we would have interactions with them to let them know both how things were going but what the set of solutions were intended.” (Dahlgren: Trial Tr. 2898:21 – 2899:7).

(g) Dahlgren: FRBNY met with the Trustees between February 27, 2009 and May 1, 2009 “more than three and fewer than 15” times (Dahlgren: Trial Tr. 2764:4-12). “There may have been one meeting” in which someone from AIG was present (Dahlgren: Trial Tr. 2764:13-17).

(h) On February 27, 2009, Dahlgren met with the Trustees at FRBNY's offices; there were no AIG representatives in attendance while Dahlgren was present at the meeting. (Dahlgren: Trial Tr. 2762:6-25; *see also* PTX 441 at 2 (agenda for the February 27, 2009 meeting indicates that Dahlgren and Baxter will "discuss developments from the last two weeks" and that Dahlgren will discuss "corporate governance issues"))).

(i) Minutes of March 27, 2009 meetings of the Trustees and FRBNY: "The trustees met in a closed door session with Sarah Dahlgren and Tom Baxter of the FRBNY to discuss issues relating to the overall strategic plan for AIG and the composition of the board of directors of AIG going forward." (PTX 515 at 61; *see also* Dahlgren: Trial Tr. 2932:23 – 2933:10 (affirming that is "an accurate description of what happened"))).

(j) On April 21, 2009, Dahlgren emailed Dudley "to bring Mr. Dudley up to speed with respect to a meeting or a conversation that" she had had with the Trustees the previous evening. (Dahlgren: Trial Tr. 2764:23 – 2765:8 (affirming the statement as true and accurate); PTX 2088 at 1). Dahlgren does not recall "anyone from AIG present" on her call with the Trustees on April 20, 2009. (Dahlgren: Trial Tr. 2765:9-22).

(k) Defendant also provided email updates to the Trustees of its activities. For example:

(i) On February 21, 2009, Dahlgren emailed the trustees to provide an "Update on week's events – AIG". "Chet, Doug and Jill – thought it would be helpful to provide you with an update of all of the things that happened over the balance of the week and how we see things playing out over the coming days". (PTX 429 at 1).

(ii) On March 8, 2009, Dahlgren wrote to the three Trustees: "I met separately with each of Ed and Paula about how things would work going forward – about our

deeper level of involvement going forward, in particular on various of the transactions (AIA, ALICO, etc...) I was pleased with both discussions – and that both Ed and Paula were clearly committed to the new direction (and new life) that the company has... I also mentioned to both of them that we (the USG) would do what we could to identify potential senior management candidates for the company and would work with them to get additional support/help for the company.” (PTX 453 at 2 (ellipses in original); *see also* Dahlgren: Trial Tr. 2796:21 – 2797:5 (Dahlgren gave the Trustees “regular updates such as this”)).

(iii) On April 17, 2009, Sarah Dahlgren emailed the Trustees with an “Update on Proxy Issue and UST concerns”, describing an “emergency call from UST indicating that they didn’t want the company to file its preliminary proxy tomorrow” and that “In all likelihood, this means a June shareholders meeting” (PTX 503 at 1-2).

(iv) On April 26, 2009, Foshee emailed Dahlgren regarding the “Proxy” and asked Dahlgren if she had “any updated info on when company wants to file and when Treasury will let them file?” (PTX 2731 at 1).

(v) On April 28, 2009, Baxter wrote to Foshee, copying Dahlgren, on the subject of the “New Board” relaying his conversation with Wiseman of Sullivan & Cromwell about the “Appointment of New Board” for AIG (PTX 510 at 3-4). Dahlgren later that day describes to Foshee her conversation with Liddy about “the timing issues” and the “Bollenbach issue” (PTX 510 at 1).

25.7.3 The trustees did not participate in matters affecting the Trust’s ownership rights in AIG.

(a) Feldberg first learned of the reverse stock split “Shortly before the proxy was issued” (Feldberg: Trial Tr. 3364:15-22; *see also* Feldberg: Trial Tr. 3373:10-16 (Feldberg doesn’t “recall hearing about reverse stock splits until we were close to the annual shareholders meeting.”); Feldberg: Trial Tr. 3374:9-17 (“I do not remember knowing about the reverse stock split issue until the context of the – the final proxy in June.”)).

(b) As of February 5, 2009, the date of the stipulated dismissal of the Walker lawsuit (JX 176 at 4), Feldberg did “not recall knowing that there was a lawsuit outstanding at that point in time” (Feldberg: Trial Tr. 3375:18-25). In fact, to the best of his recollection, Feldberg did not “ever have any discussions with anyone from or representing the Federal Reserve concerning the Walker lawsuit” (Feldberg: Trial Tr. 3376:17-20).

(c) Feldberg was not “aware of amendments to the AIG credit agreement that were done while” he was a trustee, including amendment number 3 (Feldberg: Trial Tr. 3387:14-24).

(d) Feldberg does not remember approving the restructuring discussed in AIG’s March 2, 2009 8-K. (JX 187 at 20; Feldberg: Trial Tr. 3395:7-21 (“I do not remember approving this restructuring. In fact, I do not remember this restructuring.”)).

25.7.4 The Trustees “engaged an investment advisor for the first time after” the Trustees “understood that there was going to be a recapitalization plan earlier than” the Trustees “might have anticipated” (Feldberg: Trial Tr. 3350:19-24).⁷²

25.7.5 Defendant reviewed and commented upon drafts of the written statement submitted by the Trustees to Congress. (PTX 3352 at 1-2).

25.8 The Board of Governors Never Authorized the Trust. (*See supra* §§ 18.5-18.6)

⁷² Langerman testified at trial that the trustees “participated actively” in the recapitalization negotiations (*see, e.g.*, Langerman: Trial Tr. 7164:7-7165:1). However, Schreiber, the AIG manager in charge of the recapitalization negotiations, could not recall if the trust participated in those negotiations (Schreiber: Trial Tr. 6668:15-17), and contemporaneous emails indicate that the trustees had at most a cursory role. *See* PTX 2836 at 1 (September 28, 2010 email exchange between Millstein (Treasury) and Casarella (Treasury) stating that the trustees “are back in line” following a series of requests from the trustees for the recapitalization that were rejected by Defendant). Furthermore, when asked to “identify the persons involved in the structuring of the Government’s acquisition of AIG common stock in connection with the Series C Preferred as an ‘exchange’ rather than a ‘conversion’ and the nature of each person’s role,” Defendant identified Treasury officers and Davis Polk attorneys but did not identify any of the Trustees or their counsel and advisors. *See* Def. Resp. to Pl. 2nd Interrogatories No. 8 (“Persons involved in structuring the exchange of the Series C, E, and F preferred shares for common stock include James Millstein and Tom Casarella of Treasury, as well as John Brandow, Paul Kingsley, William Chudd, Ethan James, and John Knight of DPW.”).

26.0

THE TERMS OF THE CREDIT AGREEMENT, INCLUDING THE REQUIREMENT THAT AIG'S SHAREHOLDERS SURRENDER 79.9% OF THEIR EQUITY, HAD THE PURPOSE AND EFFECT OF PENALIZING AIG SHAREHOLDERS.⁷³

26.1 Defendant Asserts That There Are Virtually No Limits on the Terms and Consideration The Federal Reserve Could Demand for a Section 13(3) Loan.

(a) Bernanke: “13(3), as I understand it, does give wide discretion to the lender, to the Fed” (Bernanke: Trial Tr. 2267:24 – 2268:9). “All I knew was that our authority was broad” (Bernanke: Trial Tr. 2269:7 – 2270:1). If punishing AIG “for its past conduct . . . was the desire of one of the board members, I don’t think that would be in any way inconsistent with the law”. (Bernanke: Trial Tr. 2227:1-7).

(b) Alvarez: The “Reserve Bank has the discretion to enter into the credit and . . . there’s no limitation on how it designs that credit other than the ones that I just mentioned, other than the limitation on obtaining evidence and the limitation that the rate – the rate that’s actually charged be set in a certain way” (Alvarez: Trial Tr. 435:22 – 437:22).

(c) Baxter: There is no “kind of property belonging to a potential borrower” that “the Federal Reserve System is not authorized to demand, other than contraband” (Baxter: Trial Tr. 1128:9-14).

26.2 The Terms of Defendant’s Loan to AIG Were Intentionally Designed to Be Punitive, and Defendant Described Them as Punitive at the Time.

⁷³ At trial, certain of Defendant’s witnesses suggested that nothing in the Federal Reserve Act constrains Defendant from setting whatever conditions or terms, whether punitive or not, it wishes for a Section 13(3) loan. Such an interpretation ignores the clear instruction in 12 U.S.C. § 357 that the rate for a Section 13(3) loan be set with a “view of accommodating commerce and business” (12 U.S.C. § 357) and the fact that no government agency can enact punitive measures without explicit legal or regulatory authority, some sort of hearing or tribunal, and clearly set forth guidelines. *See* Pl. Prop. Concl. §§ 6.2-6.3.

(a) Millstein: “FRBNY took nearly 80% of AIG’s fully diluted common equity to provide additional compensation to taxpayers for their assistance, and to penalize the shareholders of the Company for the fact that the Company had no alternative but to ask the government for extraordinary assistance.” (PTX 587 at 205, 212).

(b) Paulson: The terms of the credit facility with AIG were “punitive” and even “too punitive.” (Paulson: Trial Tr. 1230:25 – 1231:6). Defendant “basically killed the shareholders” of AIG. (PTX 706 at 316).

(c) Paulson: The Credit Agreement “did indeed punish the shareholders.” (Paulson: Trial Tr. 1243:16 – 1244:2).

(d) Geithner: “We forced losses on shareholders proportionate to the mistakes of the firm. And we made it clear in the GSEs and AIG that they would be dismembered, not allowed to live on as independent entities with the scope and reach they had before the crisis.” (PTX 648 at 8; *see also* Geithner: Trial Tr. 1669:23 – 1670:1; Geithner: Trial Tr. 1670:14-25 (“I’m referring specifically to the GSEs, which, Your Honor, is Fannie and Freddie, Fannie Mae and Freddie Mac, and AIG, but at times I have used that similar language like that to describe the strategy we adopted with respect to the major banks as well.”)).⁷⁴

(e) According to Alvarez’s September 16, 2008 hand-written notes of a conference call, Geithner stated, in substance, that “conditions need to be punitive” with regard to AIG. (JX 80 at 2; Alvarez: Trial Tr. 369:2 – 370:2 (affirming the statement as true and accurate)).

⁷⁴ Geithner’s testimony that Defendant similarly forced losses on Citi’s and Morgan Stanley’s shareholders proportionate to the mistakes that those banks made was “only in the sense” that Defendant required the banks to raise capital (Geithner: Trial Tr. 1671:1-22, 1672:14-23) and ignores that unlike AIG’s shareholders, those banks’ existing shareholders benefitted from the additional capital raised (Geithner: Trial Tr. 1841:3-7).

(f) Deloitte: The “original terms of the Facility were intentionally designed to be punitive”. (JX 387 at 4).

(g) Liddy: “there were pieces of that loan arrangement that were particularly harsh. Boy, they were particularly harsh.” (Liddy: Trial Tr. 3085:21 – 3086:11).

26.2.1 The “Government effectively nationalized AIG” and “effectively wiped out the equity holders” (Geithner: Trial Tr. 1445:16-19, 1449:2-18).

(a) Geithner: “By that point we had already effectively nationalized the GSEs and AIG, and could decide how to carve up, dismember, sell or restructure those institutions.” (PTX 663 at 14; *see also* Geithner: Trial Tr. 1446:4-13 (confirming he wrote that statement)).

(b) Geithner: “There were institutions like the GSEs or AIG or GMAC that we put into a type of conservatorship or quasi nationalization, using special authority provided by the Congress. In these cases, we changed management and the boards, effectively wiped out equity holders”. (PTX 663 at 15).

(c) Paulson: “what happened with AIG” was “nationalization”; “when the government owns more than 50 percent, it’s a nationalization.” (Paulson: Trial Tr. 1231:12-17; *see also* PTX 105).

(d) During discussion of the March 2009 Restructuring, Bill Dudley (FRBNY President) wrote to Donald Kohn, copying Dahlgren: “I got an email from Sarah last night indicating a strong preference at Treasury and at FRBNY not to increase AIG ownership share from the current 79.9 pct as part of the restructuring. Believe it sends the wrong message publicly–creeping nationalization–and to the BoD, management and employees.” (PTX 438).

26.2.2 Defendant penalized AIG for political reasons.

(a) Paulson (referring to AIG): “And it certainly was a scapegoat for . . . Wall Street and all the bad practices that people were angry about.” (Paulson: Trial Tr. 1254:22 – 1255:2).

(b) Paulson: AIG was “incredibly unpopular” on September 16-18 (Paulson: Trial Tr. 1254:12-21).

(c) Paulson told Presidential candidates John McCain and Barrack Obama that “they shouldn’t be unhappy about the AIG credit because the AIG shareholders were being treated very harshly”. (Paulson: Trial Tr. 1256:4-13).

(d) Geithner: “There was intense pressure on us to punish the Wall Street gamblers who had gotten us into this mess”. (PTX 709 at 15). “Wall Street in that definition – it depends who was using it – could include anybody, any bank, any financial firm. It certainly could have included AIG.” (Geithner: Trial Tr. 1894:12-24). “In people’s perceptions, it would have included the whole lot of them,” including “AIG and Goldman Sachs and Citi”. (Geithner: Trial Tr. 1894:25 – 1895:2).

(e) Geithner acknowledged that, prior to September 2008, FRBNY had been criticized for failing to adequately take into account moral hazard “With respect to the loans that were made to banks and investment banks and primary dealers”. (Geithner: Trial Tr. 1890:23 – 1891:5). Geithner called the people leveling those criticisms “moral hazard fundamentalists.” (Geithner: Trial Tr. 1891:10-18; *see also* McConnell: Trial Tr. 2583:25 – 2585:20 (acknowledging that she thought that providing emergency credit to AIG would subject the Federal Reserve to renewed criticism similar to the criticism expressed in the wake of the assistance given to Bear Stearns)).

(f) Bernanke: “In September of 2008 at the time of the AIG credit facility,” Bernanke, Secretary Paulson and President Geithner “were concerned with the political implications of any loan to AIG” that the Federal Reserve might make. (Bernanke: Trial Tr. 2150:5-10).

(i) This is confirmed in Alvarez’s handwritten notes of a September 16, 2008 conference call concerning AIG between Geithner, Bernanke, and Paulson, attributing to Geithner the following comments on the call: “ other risks: political.” (JX 82 at 3).

(g) U.S. 30(b)(6) witness James Millstein, *Murray v. Geithner*: “The government is not a – is not a speculative investor in institutions, in private companies. It’s a – this was a – to the extent that equity value was being preserved by the making of the loan, it was preventing the shareholders of AIG from having a windfall from the extraordinary credit being provided to the company.” (PTX 4002 (U.S. 30(b)(6) (Millstein))).

(h) Bernanke: “if it appeared to the public or to Congress that AIG was being treated lightly, that could cause political problems”. (Bernanke: Trial Tr. 2150:21 – 2151:2; *see also* Bernanke: Trial Tr. 2233:11-19).

(i) After TARP passed, Paulson was reluctant to extend TARP aid to AIG because the company still was politically unpopular. “AIG was systemically important and could not be allowed to fail, but I was distressed at the prospect of using TARP money. . . . it would enflame public resentment of bailouts and make it harder to get Congress to release the final \$350 billion of TARP when we needed it.” (PTX 706 at 409).

26.3 “The Only Purpose of an Equity Component Was to Minimize a Windfall”. “The Taxpayers Could Share in the Upside.” (Bernanke: Trial Tr. 1986:17-22).

27.0

EVEN IF THE TERM “RATE” IN SECTION 13(3) COULD SOMEHOW BE CONSTRUED TO INCLUDE THE ACQUISITION OF EQUITY AND VOTING CONTROL AS CONSIDERATION FOR A 13(3) LOAN, THERE WAS NO BASIS FOR DEFENDANT’S DEMAND.

27.1 The Federal Reserve Was Required to Fix Rates for 13(3) Credit “with a View of Accommodating Commerce and Business.” (Alvarez: Trial Tr. 385:21-25).

(a) “In order to set a rate for the AIG 13(3) credit facility, a determination had to be made as to what rate would accommodate commerce and business”. (Alvarez: Trial Tr. 389:15-18).

27.2 The Rates for Other 13(3) Credit Facilities Were Fixed “with a View of Accommodating Commerce and Business”. (12 U.S.C. § 357).

(a) Credit extended through the PDCF, including to Morgan Stanley, was at the primary credit rate. (*See* PTX 12 at 4; Alvarez: Trial Tr. 420:3-6, 381:6-11).

(b) The interest rate for the Citigroup ring-fencing facility “was something on the order of one of the overnight indexes”, perhaps “LIBOR or the overnight index swap rate – plus 300 basis points.” (Alvarez: Trial Tr. 384:24 – 385:4). The interest rate for the Bank of America ring-fencing facility “was the same rate as the Citigroup ring fencing rate.” (Alvarez: Trial Tr. 385:15-20).

(c) The discount rates for Maiden Lane I, the AMLF, the TSLF, the PDCF, and the Citicorp and Bank of America ring-fencing facilities were all “set” with “a view of accommodating commerce and business”. (Alvarez: Trial Tr. 385:21 – 387:24).

27.3 The Rate for the AIG 13(3) Credit Facility Was Several Times the Rate for Other 13(3) Facilities and Was Not Set “with a View of Accommodating Commerce and Business.”

(a) Bernanke: “Generally, the Federal Reserve lent at rates above the normal rates for the market but lower than the rate prevailing in distressed and illiquid markets”. (Bernanke:

Trial Tr. 1999:25 – 2000:4). That means “that the Federal Reserve would generally be lending at a rate that was less than the rate that participants could get from private sources in a crisis situation”. (Bernanke: Trial Tr. 2000:5-9).⁷⁵

(b) Bernanke: The AIG interest rate was “significantly higher than the interest rate that the Federal Reserve generally used in providing liquidity during the crisis” (Bernanke: Trial Tr. 1999:19-24).

(c) Alvarez: The interest rate charged to AIG “was the highest interest rate” charged to any 13(3) recipient (Alvarez: Trial Tr. 395:14 – 396:1).

(d) In fact, the interest rate on the Revolving Credit Facility (“RCF”) was 200% to 500% the rate the Federal Reserve charged on other 13(3) facilities. (Cragg: Trial Tr. 5078:24 – 5079:20; PTX 5359; *see also* PTX 2856 at 272, 287 (Cragg Report, Table 39 & Fig. 36); *see generally* PTX 2563 at 6-57 (Term Auction Facility (TAF)); PTX 2564 (Term Securities Lending Facility (TSLF) and TSLF Options Program (TOP)); PTX 2565 (TSLF data); PTX 728 at 5-26 (Federal Reserve PDCF data); PTX 2329 (Single Tranche Term Repurchase Agreements data); PTX 1214 at 1 (“Summary of Terms and Conditions Regarding the JPMorgan Chase Facility,” FRBNY (Mar. 24, 2008)); PTX 2735 at 2 (“Summary of Terms of USG/Citigroup

⁷⁵ Bernanke attempted to distinguish Defendant’s rate-setting for facilities with broad-based eligibility like the PDCF from its rate-setting for the five “one-off loans” Defendant made under Section 13(3) – namely, the loan in connection with JPMorgan’s acquisition of Bear Stearns and the loans to the Government-Sponsored Enterprises, AIG, Citi, and Bank of America – on the basis that lower rates were necessary in the former case to encourage borrowing and reduce stigma, but in the latter case the Federal Reserve “very, very much did not want to make those loans.” *See* Bernanke: Trial Tr. 2171:13 – 2172:21, 2177:19 – 2178:8, 2245:8 – 2246:11. Bernanke’s testimony, even if credited, however, does not explain why AIG was charged interest and fees several times higher than the interest charged to the other recipients of “one-off loans”, why AIG was the only firm required to transfer equity to Defendant, or why the primary credit rate charged to borrowers under liquidity facilities with broad-based eligibility was not raised as the crisis intensified and stigma decreased. *See infra* §§ 22.0, 32.0. Moreover, as Dr. Bernanke conceded, “Section 13(3) does not make a distinction between” “multifirm or broad-based facilities” and “single-firm bailouts” (Bernanke: Trial Tr. 2275:7-11; *see also supra* § 27.2).

Loss Sharing Program,” Citigroup); PTX 2726 at 2 (“Summary of Terms Eligible Asset Guarantee,” Bank of America (Jan. 15, 2009))).

27.3.1 There was nothing in writing that set forth the rationale for the interest rate on the AIG Revolving Credit Facility

(a) Nothing was ever prepared in writing describing the rationale for the interest rate given to AIG. (Geithner: Trial Tr. 1583:5 – 1584:14).

(b) There were no “written materials submitted to the Board of Governors concerning what rate would accommodate commerce and business for the AIG 13(3) credit facility.” (Alvarez: Trial Tr. 390:18-21).

(i) The only information distributed concerning the interest rate was conveyed orally. (Alvarez: Trial Tr. 390:18 – 391:20). When asked to highlight the portions of his handwritten notes that reflected the Board of Governors discussion concerning the interest rate, Alvarez marked portions of the discussion that, while relevant to a discussion of an AIG loan, shed no light on why the interest rate was set the way it was. (See JX 80-A; JX 82-A; Alvarez: Trial Tr. 394:3 – 395:13).⁷⁶

(c) Alvarez could not recall whether any analysis was done to determine whether the Government’s objectives could be accomplished with a lower interest rate (Alvarez: Trial Tr. 623:16-22), and he did not know whether anyone had ever even asked “to have such an analysis done.” (Alvarez: Trial Tr. 623:23 – 624:2). Yet, he maintained that the interest rate charged on

⁷⁶ McLaughlin testified at trial that Defendant “didn’t really have a theory about pricing of emergency lending” and that there “wasn’t anything in writing and there were no established guidelines” establishing “how to price a 13(3) loan” (McLaughlin: Trial Tr. 2491:16 – 2492:12). However, it is clear that Defendant’s pricing for the AIG loan represented a drastic departure from Section 13(3)’s mandate to “accommodate commerce and business” and from Defendant’s own *practice* in pricing other 13(3) loans, all of which were at rates far less than the rate on the AIG loan. See, e.g., PTX 5359 (Cragg demonstrative collecting citations); see also *supra* § 27.4.

the AIG loan was set with a view to accommodating commerce and business because it helped “AIG remain in business” and therefore prevented further disruption of the markets. (Alvarez: Trial Tr. 517:10-21). Nonetheless, Alvarez conceded that it was possible those objectives “would have been accomplished if the interest rate were half what was charged AIG.” (Alvarez: Trial Tr. 623:16-19).⁷⁷

27.4 Defendant Charged AIG a Punitive 14% in Interest Rate and Fees on the Loan Contrasted with the Primary Credit Rate Initially Recommended by Federal Reserve Board of Governors Staff.

27.4.1 Federal Reserve Board of Governors staff initially recommended lending to AIG at the primary credit rate.

(a) Between September 15, 2008 and September 29, 2008, the primary credit rate was 2.25%. (Def. Resp. to Pl. 2nd RFAs No. 668).

(b) September 15, 2008 memo from the Federal Reserve Board of Governors Staff to the Board of Governors: “The moral hazard consequences could be limited somewhat by lending at an elevated and escalating rate. However, the lending rate could not be so high that it would add to the problem, and it **might be difficult to charge substantially more than the rate on the PDCF, the primary credit rate.**” (PTX 64 at 10 (emphasis added)).

⁷⁷ Defendant contends that the interest rate on the AIG loan was set to discourage moral hazard and accommodate commerce and business. *See* Alvarez: Trial Tr. 516:15 – 517:21; *see also* Geithner: Trial Tr. 1712:1-17. However, this testimony is inconsistent with the facts: (1) it was the only 13(3) loan given such a high interest rate – close to five times higher than others, including the PDCF rate charged to Lehman even the week after it declared bankruptcy, Citibank (which Defendant concedes was on the edge of failure), and Morgan Stanley (*see* PTX 5359 (Cragg demonstrative collecting citations); *see also infra* § 32.2); (2) the loan was fully secured by assets more than sufficient to protect Defendant’s loan even after taking into account a conservative valuation and a 25% haircut (*see infra* § 21.5); (3) there is no written documentation of how the rate for the AIG loan was determined; and (4) there was no Board of Governors analysis of what rate was appropriate. *See* JX 63; *see also infra* § 27.5.2 (the Board of Governors did not ask anyone from FRBNY the basis for the 14% rate).

(c) On September 16, 2008, at 11:56 a.m., Alvarez sent Geithner and Baxter a draft Board of Governors resolution that recommended extending a loan to AIG at the “primary credit rate”. The draft resolution stated: “The Board approves the recommendation of the Reserve Bank of New York that the credit to AIG be extended at the primary credit rate.” (PTX 80 at 2).⁷⁸

27.4.2 FRBNY later proposed an interest rate and fees amounting to 14% to the Board of Governors, and the Board of Governors did not ask anyone from FRBNY what the basis for those terms was at the September 16, 2008 meeting authorizing the loan to AIG (Bernanke: Trial Tr. 1976:18-24, 1977:13-17; *see also* Bernanke: Trial Tr. 2001:13-20).

27.4.3 Bernanke understood “on September 16, 2008 that the interest rate for a 13(3) credit facility had to be approved by five members of the Federal Reserve Board of Governors”. (Bernanke: Trial Tr. 2110:23 – 2111:2).

27.4.4 Bernanke did not “know who drafted the resolution that was presented to the Board of Governors meeting on September 16” and could not say whether he had “any discussions with them about the drafting the resolution”. (Bernanke: Trial Tr. 2149:19 – 2150:3).

(a) Bernanke “did not have any participation in the drafting of the resolution that was ultimately adopted by the Board of Governors”. (Bernanke: Trial Tr. 2149:6-10).

(b) Bernanke did not know whether the Board of Governors had “ever given discretion to a Federal Reserve Bank to change the terms of a 13(3) loan” before. (Bernanke: Trial Tr.

⁷⁸ Alvarez testified that PTX 80 reflected the Board of Governors staff’s recommendation as of the morning of September 16, which he forwarded on but did not include his input. *See* Alvarez: Trial Tr. 527:15-18, 528:14-19. He admits that when he forwarded it on to Geithner and Baxter, while he did input an amount for the loan as \$85 billion, he did not change the interest rate from the primary credit rate and has no record of conversations he says took place later that day to change the rate from the primary rate. Alvarez: Trial Tr. 624:3 – 625:23.

2256:3-7.) Yet, he contended FRBNY was entitled to such latitude: “My understanding was that we were giving the Federal Reserve Bank of New York latitude to make adjustments to the term sheet as necessary, and I didn’t have a strong view as to whether the interest rate was one of the things that could be adjusted.” (Bernanke: Trial Tr. 2111:7-17). FRBNY would have latitude to make changes in the interest rate, if “the change had been modest and explained, if there had been a good reason for it.” (Bernanke: Trial Tr. 2111:18-25).

27.4.5 The interest rate of 14% provided to AIG in the Credit Agreement was recognized to be “loan sharky”.

(a) FRBNY General Counsel Baxter described the interest rate on the AIG Revolving Credit Facility as “loan sharky.” (PTX 279 at 1).

(i) FRBNY Notes of Interview with COP on May 11, 2010: Baxter: “Interest rate was not a Fed interest rate. More of a loan shark.” (PTX 2211 at 10).

(b) Baxter told SIGTARP “that the interest rate was too high, and that FRBNY recognized the need to restructure the deal by making it less onerous to AIG soon after the agreement was signed.” (PTX 549 at 15-16; *see also* Geithner: Trial Tr. 1693:15 – 1694:4 (testified that in his “judgment,” Baxter’s was “an accurate statement”)).

(c) McLaughlin: In September 2008, the nominal rate on the AIG facility was “four times higher” than the rate that was being charged borrowers under the PDCF. (McLaughlin: Trial Tr. 2493:22 – 2494:3).

(d) Dahlgren learned “early on” “that there were people at the Federal Reserve Bank that believed that the interest rate charged AIG was too high”. (Dahlgren: Trial Tr. 2769:24 – 2770:7).

(e) Geithner: “I believe” that “the reference to this crazily high rate” in PTX 318, an October 22, 2008 email from McConnell, “is a reference to the interest rate initially charged on the AIG credit facility.” (Geithner: Trial Tr. 1691:16-19; *see also* Geithner: Trial Tr. 1692:2-11 (“My sense, but it would only be my sense, is that she’s referring to people of course outside of the Federal Reserve Bank of New York, and in this case she must be referring to people at either the Board of Governors or at the Treasury.”)).

27.4.6 Defendant’s terms were “substantially more expensive” than the draft private sector term sheet, which was already at a high interest rate. (PTX 715 at 10).

(a) The Government Accountability Office (“GAO”) concluded that the Federal Reserve’s terms were “substantially more expensive” than the draft private sector term sheet. (PTX 715 at 10).

(b) Geithner did not dispute the GAO’s assertion that “the Federal Reserve’s terms are substantially more expensive.” (PTX 715 at 10; *see also* Geithner: Trial Tr. 1580:5 – 1582:4 (confirming that the rate was “significantly higher” and that he set it, despite not having any knowledge of how the private sector term sheet’s interest rate was chosen apart from it being “a reasonable set of conditions” in the banks’ judgment)).

(c) The JPMorgan draft term sheet called for:

(i) Warrants instead of preferred stock, which would have required a shareholder vote and an exercise price;

(ii) An interest rate of LIBOR plus 6.5% for drawn funds that was 200 basis points lower than the interest rate for drawn funds in the Credit Agreement at LIBOR plus 8.5%;⁷⁹ and

(iii) No interest on undrawn funds whereas the Credit Agreement called for an interest rate on undrawn funds of 8.5%. (*Compare* JX 65 at 3 with JX 107 at 26-27, 137-39).

(d) James Lee, Vice Chairman of JPMorgan, who Defendant tasked with arranging for a private sector consortium, testified that the interest rate called for by the JPMorgan draft term sheet was “quite a high interest rate”. The rates “would have been indexed against a series of very high-risk loans,” meaning “high-yielding loans”. (Lee: Trial Tr. 7090:21 – 7091:4, 7106:6-9; *see also* Lee: Trial Tr. 7091:7-14 (Lee gave “complete, honest and accurate testimony” at his deposition where he made these statements)).

(e) Geithner: The interest rate on the 13(3) loan to AIG was “substantially higher” than the interest rate in the private sector draft term sheet because FRBNY “wanted to make the conditions tough enough that they were not viewed as attractive by firms at the time in a similar circumstance or firms in the future that might face financial difficulties.” (Geithner: Trial Tr. 1772:23 – 1773:10).

27.4.7 No “analysis or consideration” was “done or given by the United States to the question of whether the interest rate that the banks were asking for in the discussions was a reasonable interest rate”. (Alvarez: Trial Tr. 398:6-20).

⁷⁹ Although James Head of Morgan Stanley testified that he recalled the private sector recommending an interest rate of “LIBOR plus 850” (J. Head: Trial Tr. 3749:3-16), Defendant has admitted that “the private consortium term sheet contemplated” an interest rate of “3-month LIBOR + 650 bps”. Def. Resp. to Pls. 2nd RFAs No. 542; *see also* JX 65 at 3 (private sector term sheet indicating interest rate of LIBOR plus 650 basis points); Baxter: Trial Tr. 906:12-21 (testifying that Defendant “raised” the interest rate compared to the private sector term sheet).

27.4.8 Alvarez: “private banks were not instructed by Congress to set their interest rates with a view towards accommodating commerce and business.” (Alvarez: Trial Tr. 398:24 – 399:4). Yet, the rate contemplated by the private sector consortium was still lower than the rate offered by Defendant in the Credit Agreement.

27.4.1 The terms in the JPMorgan draft term sheet were never shown to the private sector (apart from JPMorgan and Goldman Sachs) or to AIG.

(a) Lee: As far as he is aware, no one ever showed “a draft of what has been marked as Joint Exhibit 65 or any other term sheet to any employee, officer, director, attorney or other representative of AIG”. (Lee: Trial Tr. 7103:4-9).

(b) Lee: “I don’t remember discussing any of these terms with anyone at AIG.” (Lee: Trial Tr. 7102:24 – 7103:3).

(c) Lee: does not remember ever discussing “the proposed terms in any term sheet with anyone outside of JPMorgan or Goldman Sachs”. (Lee: Trial Tr. 7103:10-13).

(d) Willumstad believed that the private sector consortium organized by Geithner never prepared a term sheet (Willumstad: Trial Tr. 6498:4-9). No one from AIG ever told him that they had seen such a term sheet (Willumstad: Trial Tr. 6498:10-12).

(e) Herzog did not recall “having seen a specific term sheet” from JPMorgan or Goldman Sachs or “seeing a tangible piece of paper” concerning terms considered by JPMorgan or Goldman Sachs for a potential loan to AIG. (Herzog: Trial Tr. 6966:7-19; *see also* PTX 620 at 7 (GAO Record of Interview Memorandum stating, “The AIG executives did not know the extent to which the FRBNY used terms developed by the private effort as the basis for the terms of the RCF”)).

(f) GAO memorandum summarizing interview of AIG executives, discussing a meeting of financial institutions on September 15, 2008: “The banks, however, did not put any terms on the table for AIG. They may have been exchanging terms among themselves, but AIG did not know. When the banks came to AIG, they spent time with Mr. Schreiber, sizing up how much would be needed and what the future draws on a facility would be” (PTX 620 at 7; Schreiber: Trial Tr. 6829:21 – 6830:7 (this is “consistent with what AIG executives told the GAO when” Schreiber was present)).

(g) Geithner does not “know whether any term sheet ever prepared by JPMorgan and/or Goldman Sachs had ever been shared with AIG” (Geithner: Trial Tr. 1578:5-12). Geithner also does not know whether the interest rate under consideration by JPMorgan and Goldman Sachs was ever shared with AIG (Geithner: Trial Tr. 1578:13-18).

27.5 As the Terms of the Credit Agreement Became Known to the Public, Third Parties Characterized the Terms as Onerous and Punitive.

(a) Davis Polk advised Defendant that there was an “existing perception that the Fed loan’s terms are already too expensive.” (PTX 3295 at 1).

(b) Bloomberg Report: The Credit Agreement was “hugely punitive.” (PTX 1658 at 1).

(c) Morgan Stanley analyst report: “The terms of the offering are more punitive than we originally expected”. (PTX 246 at 1).

(d) A.M. Best: “the cost of drawing this facility is exorbitant and could impede profitability going forward.” (DX 490 at -027; *see also* Colannino: Trial Tr. 5772:10-16 (DX 490 is consistent with Colannino’s view on or about September 18, 2008)).

(e) FBR Capital Markets analyst report: “AIG essentially nationalized, in our opinion.” (PTX 1654 at 1).

27.6 The Defendant’s Punitive Terms Hurt, Rather Than Stabilized, AIG.

(a) One of the reasons Paulson thought the loan terms “were too punitive were that they were actually having a deleterious effect on the company’s financial stability”. (Paulson: Trial Tr. 1231:3-11). “The loan’s high cost strained interest coverage, and its short, two-year duration created pressure to sell assets quickly in a soft market.” (PTX 706 at 426).

(b) Liddy: The Federal Reserve “concluded that the terms were so onerous on AIG that it was actually counterproductive and was imperiling their ability to get repaid”. (Liddy: Trial Tr. 3087:12-19).

(c) On October 21, 2008, Mickey Kantor (former Secretary of Commerce) to Dan Jester (Treasury): the AIG loan “severely reduces upside potential to common shareholders thereby making it impractical to raise new equity capital,” at odds with Defendant’s recent approach in TARP. Kantor wrote, “To improve the chances of recovering its funds, to attract the private capital needed to enable AIG to avoid liquidation, and to extend to those whose retirement funds are invested in AIG the same treatment afforded to shareholders of other financial institutions, the government should – together with an infusion of substantial new private capital into AIG – replace the existing Facility with terms consistent with those of the TARP Capital Purchase Program.” (PTX 315 at 1-2).

27.6.1 AIG faced being downgraded by the rating agency because of the market’s reaction to Defendant’s punitive terms.

(a) Baxter: “the rate was so high that it was causing the credit rating agencies to consider a downgrade of AIG, and that downgrade threatened our principal objective, which was to avoid the systemic consequences of an AIG bankruptcy”. (Baxter: Trial Tr. 825:8 – 826:7).

(b) Dahlgren: “One of the concerns clearly expressed by the rating agencies in our discussions was the interest rate and the ability of the company to continue to service the debt”, a concern that Dahlgren “shared” (Dahlgren: Trial Tr. 2770:8-20).

(c) On November 1, 2008, Dahlgren wrote to Treasury personnel under the subject line “Update on rating agencies”: “The RMBS and CDO portfolio solutions (the FRBNY SPVs) lock in losses, forcing the company to absorb a substantially greater loss relative to what Moody’s expected the ultimate losses on this portfolio to be.” (DX 639 at -750; *see also* McConnell: Trial Tr. 2572:19 – 2573:4 (McConnell had no “reason to disagree with that” email in November 2008)).

27.6.2 Defendant’s punitive terms destabilized the market generally.

(a) Email from Michael Holscher (FRBNY) to McConnell on September 17, 2008: “Just wanted to put in my two cents on the AIG deal and other thoughts. In sum: We are exacerbating distressed market pricing at a vulnerable time when we should be trying to stabilize market prices.” (PTX 119 at 1; *id.* (McConnell forwards the email to FRBNY EVP Terrence Checki with the note “This is interesting.”); *see also* Mosser: Trial Tr. 1179:4 – 1180:11) (“I interpret this sentence as being Michael’s opinion that the AIG deal was, as he puts it – and I assume by that he means the loan – was pushing asset prices down and credit spreads wider.”)).

(b) On September 18, 2008 FRBNY trade analyst Scott Sherman reported that he had heard “several market participants” contend “that the pricing of the AIG loan has increased uncertainty in LIBOR, credit space. the most important thing about the AIG deal is the terms of the loan, which are three-month libor +850bp. If the Fed, who now run the company and can influence its outcome deem that taxpayers deserve 850 bp over libor to lend to a solvent institution with liquidity gaps, then why would any bank worldwide argue with their pricing?”

(PTX 138; Mosser: Trial Tr. 1180:21 – 1181:18 (Mosser confirming that she forwarded the email to McLaughlin, Dahlgren, and Sandy Krieger)).

(c) McLaughlin: “Unforeseen consequence..but could have been avoided if business had had input on the rate. We should have been charging 3.5% (pre crisis secondary credit rate today), not 12%....and should not have viewed libor as reference...it is wrong that this was done w/o lender’s input”. (PTX 145 (ellipses in original); *see also* McLaughlin: Trial Tr. 2416:17-22 (“business” refers to the “discount window staff”)).⁸⁰

(d) FRBNY analyst in a September 23, 2008 email to Mosser, Latorre, and other FRBNY staff: “The current policy response is to obliterate existing stockholders and AIG’s bonds are trading at distressed levels because folks now believe every part of the capital structure is behind the \$85 billion Federal Reserve loan.” “Fear of getting whipped out by a government intervention is one reason I have heard from some of my equity market contacts as to why the capital markets are slow to invest new funds into financial firms.” (PTX 232; *see also* Mosser: Trial Tr. 1271:17-21). Dr. Mosser remembers this subject “being raised by one other analyst” as well. (Mosser: Trial Tr. 1272:10-25).

(e) Deloitte: “the Federal Reserve Bank and the US Treasury determined that establishing lending terms in a manner that encouraged rapid sales of assets did not, in the current economic environment, adequately represent the Federal Reserve Bank’s public policy mission and could in fact further destabilize the financial markets (as opposed to the individual

⁸⁰ McLaughlin testified at trial that when she wrote this email, she was “behind I think in my understanding of the terms,” and that the AIG terms were “pretty representative of how risky loans were being price in the market in that period in 2008.” McLaughlin: Trial Tr. 2449:8-20, 2450:1-5. However, by September 18, 2008, when PTX 145 was written, McLaughlin had already reviewed and discussed draft terms of the Credit Agreement and the demand notes, and she was also responsible for reviewing the adequacy of the collateral AIG posted (*see* McLaughlin: Trial Tr. 2395:3 – 2396:4, 2420:16 – 2421:4, 2421:24 – 2422:6; 2456:25 – 2457:20; JX 92 at 12; DX 411; PTX 126 at 2, 4).

Facility borrowers, such as A[IG]) by adding general uncertainty as to whether entities seeking financing from the Federal Reserve Bank would be forced to conduct fire sales into a market with reduced liquidity” (JX 387 at 10).

27.6.3 Defendant understood its loan should be restructured into more stable long-term funding.

(a) On or around October 4, 2008, Dan Jester (Treasury) asked FRBNY to “rethink the terms of the deal; deal was onerous”. (PTX 279 at 2).

(b) Geithner: “FRBNY recognized the need to restructure the deal by making it less onerous to AIG soon after the agreement was signed.” (PTX 549 at 16; *see also* Geithner: Trial Tr. 1693:15 – 1694:4 (statement is accurate)).

(c) A November 6, 2008 memo by Board of Governors staff proposes restructuring the loan due to rating agencies’ concerns, including that the “current interest rates payable on the September Facility may be unsustainable by the company and significantly weaken the company’s interest coverage ratio, which is a key metric used by the rating agencies” (DX 660 at -594).

(d) Baxter: “We had that very high interest rate, Your Honor, which was also contributing to the debt service problem. So, in some ways we were part of the problem by setting that very high rate. So, the other aspect of the restructuring – and it sounds so simple now – is reduce the rate and make it a lower rate, and that lower rate, the lower debt, will alleviate the debt problems and avoid further downgrades of AIG.” (Baxter: Trial Tr. 1019:3-14).

27.7 Despite the Unprecedentedly High Interest Rate, Defendant Took 79.9% of Plaintiffs’ Equity and Voting Control as “Additional Compensation” for the Loan.

(a) Baxter: “in addition to the interest rate specified in the September 22 credit facility, that credit facility required, as additional compensation for the facility, the issuance of convertible preferred stock”. (Baxter: Trial Tr. 743:18-22).

(b) Report of the Board of Governors to Congress: “As additional compensation to the U.S. government for the Credit Facility, AIG will issue 100,000 shares of a new series of perpetual, non-redeemable convertible participating serial preferred stock (the Preferred Stock) to a trust that will hold the Preferred Stock for the benefit of the U.S. Treasury Department.” (PTX 339 at 7).

(c) Federal Reserve Vice Chairman Kohn: “Importantly, the Revolving Credit Facility was (and remains) secured by a pledge of a substantial portion of the company’s assets, including AIG’s ownership interests in its domestic and foreign insurance subsidiaries. **As additional compensation for the Revolving Credit Facility**, AIG agreed to issue to a trust for the benefit of the Treasury, preferred stock convertible into 79 percent of AIG’s outstanding common stock.” (PTX 449 at 50 (emphasis added)).

(d) Baxter: “On September 16, 2008 the Board of Governors authorized the New York Fed to lend up to \$85 billion to AIG through a secured revolving credit facility (‘Fed Facility’). The Fed Facility was (and remains) secured by a pledge of a substantial portion of AIG’s assets, including ownership interests in the company’s domestic and foreign insurance subsidiaries. **As additional compensation for this Facility, AIG issued, to a trust for the benefit of the**

Treasury, preferred stock convertible into approximately 78 percent of AIG’s outstanding common stock.” (PTX 564 at 190-91 (emphasis added)).⁸¹

(e) Baxter: “if we succeeded with the rescue, the equity could be worth a substantial amount. There was upside potential there”. (Baxter: Trial Tr. 748:22-24).

(f) Huebner: “This was not a purchase of equity. This was a grant of equity as part of the consideration for a rather breathtaking extension of credit.” (Huebner: Trial Tr. 5998:10-12).⁸²

27.8 FRBNY Was Not Only “Fully Repaid” for the Money Lent Under the Credit Agreement but Received \$6.7 Billion in Interest and Fees Paid by AIG.

27.8.1 AIG fully repaid its loan.

⁸¹ Baxter and other Defendant witnesses misleadingly refer to Defendant’s 79.9% equity interest in AIG as an “equity kicker”. *See* Baxter: Trial Tr. 742:21 – 743:3. Even if 79.9% of a company’s equity and voting control were fairly described as an “equity kicker”, it would still have been unauthorized. The statute is clear that the only authorized compensation for a 13(3) loan is an appropriate interest rate. Moreover, equity kickers “tend to be of a modest proportion, between 4 percent and 10, 12 percent.” Zingales: Trial Tr. 8621:24 – 8622:2. “They’re generally structured as a warrant that does not have voting right at the moment the warrant is issued. It might acquire a voting right after the warrant is exercised, but not necessarily”; “Because the warrant, it is generally structured with a strike price which is above the current market price. So, if the company does well, then the lender receives an extra return, but if the company does not do well, there is no additional collateral or guarantee. So, it’s not something that protects on the downside; it’s something that helps the lender share some of the upside.” Zingales: Trial Tr. 8622:3-20. That Defendant’s 79.9% equity interest in AIG is not an “equity kicker” typical of commercial transactions is also clear from the advice Defendant received from its counsel on September 23, 2008: “No standard practice has yet evolved” for disclosure “for credit deals pursuant to which the lender gets 80% of the company.” PTX 3300 at 1.

⁸² First, this presumption completely disregards the analyses of FRBNY loan officers, Ernst & Young, and Morgan Stanley, and the various government officials reviewing their work who repeatedly found that the Credit Facility was fully secured. *See supra* §§ 21.1,-21.2, 21.6. Second, although “loans made by the Federal Reserve Banks bear interest, they are made not for profit but for a public purpose”. PTX 742 at 18. Third, it ignores 13(3)’s mandate; Defendant’s expert admits he “did not study 13(3) lending at all” (Mordecai: Trial Tr. 7848:20 – 7849:12), but rather sought to impose what would be acceptable terms in private lending. *See* Mordecai: Trial Tr. 7537:6 – 7538:20. However, lender of last resort and private lending are two very different things with different histories and functions. *See supra* § 27.1; Cragg: Trial Tr. 8716:5 – 8717:16; *see also* PTX 5520 (Cragg demonstrative).

(a) FRBNY website: “AIG fully repaid the facility on January 14, 2011.” (PTX 720 at 1 n.1).

(b) Bernanke: “sometime before today AIG paid back not only the Federal Reserve, but every other government agency that advanced it credit for every dollar received”. (Bernanke: Trial Tr. 2013:14-18).

(c) Schreiber: The government received “all of the money they put into AIG back plus a profit of approximately 23 billion.” (Schreiber: Trial Tr. 6684:19 – 6685:1).

27.8.2 “FRBNY received \$6.7 billion in interest payments and fees in connection with the Credit Facility.” (Agreed to Stipulations ¶ 216).

(a) Alvarez: The Federal Reserve earned a profit on the AIG 13(3) credit facility, earning approximately \$6.7 billion of interest and fees on the credit facility. (Alvarez: Trial Tr. 611:23 – 612:5).

27.9 The Government Had No Significant Risk of Loss on its Loan to AIG.

27.9.1 FRBNY’s loan to AIG was fully secured (*see supra* §§ 21.1-21.6).

27.9.2 FRBNY’s risk of loss was further limited by the fact that FRBNY had the unilateral right to deny funding to AIG if, at the time of the borrowing request, FRBNY was not satisfied with AIG’s collateral.

(a) The Credit Agreement states: “All Borrowings. On the date of each Borrowing: . . .
(d) The Lender shall be satisfied in its sole discretion with the Collateral (including the value of such Collateral) securing the Obligations at the time of such Borrowing.” (JX 107 at 36 (§ 4.01)).

(b) FRBNY executives (to GAO): “The RCF credit agreement is not structured as a standard commercial credit agreement. FRBNY took a number of precautions during the drafting process. Section 401 of the credit agreement requires each AIG borrowing to be secured

to FRBNY's satisfaction. This gives FRBNY discretion towards the nature and volume of the collateral. The agreement gives broad power for FRBNY to cut off its commitment at any time. AIG used the credit line to manage its cash flow, and the credit line could stop at any time if FRBNY was not reasonably satisfied with either collateral or corporate governance measures." (PTX 612 at 6).

(c) The Board of Governors (to Congress): "Importantly, under the terms of the Credit Agreement, FRBNY's agreement to provide advances under the Credit Facility is specifically conditioned on FRBNY being satisfied in its sole discretion with the nature and value of the collateral securing AIG's obligations at the time of the advance." (PTX 339 at 6).

(d) Cragg: "at each point in time that AIG sought to draw down on the RCF, these covenants or these conditions of lending in Article 4 allow for the Federal Reserve Bank of New York to evaluate the existing collateral and the new collateral to determine that the loan remains fully secured. And so . . . the RCF and the – shouldn't be thought of as an open-ended extension of credit but one where the Government at each point in time has the ability to ensure the adequacy of its security." (Cragg: Trial Tr. 8702:13 – 8703:8).

27.9.3 FRBNY's risk of loss was further reduced by the numerous covenants imposed upon AIG by the Credit Agreement.

(a) FRBNY (to GAO): "The breadth for negative covenants was unusually wide because the agreement was drafted in only a week's time and FRBNY did not have time to fully understand the situations at AIG. The agreement was customized to reflect the nature of the AIG's business, but did not 'give slack in the leash' to AIG. By embedding more negative covenants than in standard commercial agreements, AIG had to come to FRBNY for consent more often." (PTX 612 at 6-7).

(b) AIG presentation: “The FRBNY Facility has much stronger covenants than a typical bank facility; AIG is constantly in need of waivers”. (PTX 609 at 16).

(c) AIG presentation: “FRBNY Facility has more restrictive covenants than a private market credit facility”. (PTX 609 at 79).

(d) AIG presentation: AIG had to seek “More than 1,000 waivers” under the Credit Facility. (PTX 2248 at 28).

(e) Negative covenants required AIG to obtain prior written consent to enter any agreement involving “Asset sales if consideration received is less than 90% in cash”, “Prepayment or repurchase of indebtedness”, and “Sale and lease-back transactions”. (JX 271 at 17).

(f) FRBNY (to GAO): “One of the most important negative covenants is section 604. Under Section 604, AIG cannot contribute capital or make loans to outside loan party groups without FRBNY consent. This provision prevents outside loan parties from drawing upon FRBNY’s resources and moving the resources out of the collateral pools. For example, AIG’s regulated insurance company subsidiaries are considered outside loan parties and any loans or capital injections from the AIG parent to these subsidiaries would require FRBNY consent.” (PTX 612 at 7).

(g) “As a **negative covenant**, AIG will not make capital expenditures of more than \$10 million if the Reserve Bank objects, after the Reserve Bank has been given ten days notice.” (PTX 3160 at 3 (emphasis in original)).

(h) “As a **negative covenant**, AIG will not . . . without Reserve Bank approval, make an asset sale, unless it is a fair market sale, at least 90% of the consideration is in cash, and the funds are used to pay down the Reserve Bank’s loan.” (PTX 3160 at 3 (emphasis in original)).

(i) “As a **negative covenant**, AIG will not (without Reserve Bank permission) increase its indebtedness, permit new liens, and enter into sale and lease-bank transactions (with various exceptions).” (PTX 3160 at 3 (emphasis in original)).

(j) “As a **negative covenant**, AIG will not permit aggregate liquidity to be less than \$15B.” (PTX 3160 at 4 (emphasis in original)).

27.9.4 The covenants in the Credit Agreement gave Defendant the power to control AIG’s “corporate governance”.

(i) “It is a **condition** to each borrowing that the Reserve Bank be reasonably satisfied in all respects with the corporate governance of the Borrower after giving effect to the Transactions then consummated. In other words, the Reserve Bank does not have to lend any more funds, if AIG’s corporate governance is not satisfactory.” (PTX 3160 at 2) (emphasis in original).

28.0

DEFENDANT DELIBERATELY DEPRIVED PLAINTIFFS OF AN OPPORTUNITY TO VOTE ON THE CREDIT AGREEMENT, THE ISSUANCE OF EQUITY, THE ISSUANCE OF VOTING PREFERRED STOCK, OR THE REPLACEMENT OF PREFERRED STOCK WITH COMMON STOCK.

28.1 Defendant Changed the Form of Equity from Non-Voting Warrants to Voting Convertible Preferred Stock to Avoid the Shareholder Vote that Would Have Been Required to Exercise the Warrants and Obtain Voting Control.

(a) At the September 16, 2008 AIG Board meeting: “Counsel explained that if the equity interest took the form of warrants, then a shareholder vote would be necessary to authorize additional shares of common stock sufficient to meet the requirements of the warrant.” (JX 74 at 12).

(b) Defendant's outside counsel at Wachtell explained on September 16 that AIG "will need to authorize at least another 8 billion shares (perhaps more) to be able to issue common representing 79.9% current par value is \$2.50 per share, so will need to amend charter to eliminate par value Warrant confers no governance rights or vote – a third party could try to accumulate existing common and hold up the vote to authorize additional common". (PTX 98-U at 4).

(c) Email from Baxter to Davis Polk on September 18, 2008: "from NY Fed perspective, I could see the New York Fed: (a) hold warrants exercisable on transfer, which has the draw back of a shareholder vote (any way out of that?), or (b) establish a voting trust for shares, where trustee (preferably a third party) is directed to vote with management. I have done no research and this is off the cuff." (PTX 1601 at 2; *see also* Baxter: Trial Tr. 788:5-16 (acknowledging that he "must have had that concern at the time" that one of the drawbacks of warrants was that they required a shareholder vote)).

(d) During a conference call on September 18, 2008 with attorneys from FRBNY, the Federal Reserve Board, Treasury, and Davis Polk, Davis Polk advised: "warrants require s/h because not enough shares authorized" (PTX 148 at 2), and "consider voting preferred w/ 79% voting w/ common." (PTX 148 at 2; *see also* Alvarez: Trial Tr. 223:3-15 (PTX 148 reflects notes Alvarez "took of a September 18, 2008, conference call among lawyers")).

(e) During a noon conference call on September 21, 2008, Defendant decided that it was going to take equity in AIG in the form of Convertible Participating Serial Preferred Stock to be issued to an AIG Credit Facility Trust, established for the benefit of Treasury (JX 101 at 1-3).

28.2 Defendant Required AIG to Invoke a Waiver to NYSE Rules to Avoid the Shareholder Vote that Would Otherwise Have Been Required for the Issuance of Preferred Stock Representing More than 20% of a Company's Voting Control.

28.2.1 Under NYSE Rule 312.03(c)(1), shareholder approval is required prior to the issuance of securities convertible into or exercisable for common stock if: (1) the common stock has, or will have upon issuance, voting power equal to or in excess of 20 percent of the voting power outstanding. (JX 240 at 94).

(a) NYSE Listed Company Manual Rule 312.03(c), "Shareholder Approval": "Shareholder approval is required prior to the issuance of common stock, or of securities convertible into or exercisable for common stock, in any transaction or series of related transactions if: (1) the common stock has, or will have upon issuance, voting power equal to or in excess of 20 percent of the voting power outstanding before the issuance of such stock or of securities convertible into or exercisable into common stock". (JX 240 at 94).

28.2.2 Defendant demanded that AIG invoke a waiver of the NYSE rule requiring shareholder approval.

(a) "the United States admits that the Credit Agreement executed by AIG and FRBNY obligated AIG to 'take all actions necessary or expedient,' including actions required of the AIG Audit Committee to take advantage of the exemption to NYSE Section 312.03(c)(1) under NYSE Section 312.05." (Def. Resp. to Pl. 2nd RFAs No. 465; *see also* JX 107 at 139).

(b) Davis Polk attorney Ethan James on September 18, 2008: "Let's discuss building the NYSE's 'financial viability in jeopardy' exception into the loan doc. IE, if their AC doesn't make the determination req'd by nyse rules, we turn off the tap – a self-fulfilling condition." (PTX 3281 at 1).

(c) Email from Tanya Hoos (NYSE) to Shannon on September 17, 2008: "As you know, we've been trying to reach you to set up a call this morning to discuss last night's news.

As one of the discussion topics will be our shareholder approval policy (in light of the >20% equity issuance to the government), we wanted to share with you the attached materials in advance of the call.” (PTX 115 at 1). Attached to Hoos’ email is the text of NYSE Listed Company Manual Section 312.03. (PTX 115 at 9; *see also* Shannon: Trial Tr. 3671:2-13 (the attached materials contained the shareholder approval policy of the NYSE)).

(d) On September 22, 2008, Davis Polk attorney Ethan James informed FRBNY and Treasury that “Section 312.03 of the NYSE listed company manual requires shareholder approval for the issuance of securities having more than 20% of the vote” but that “Section 312.05 provides an exception to this limitation” when ““(1) the delay in securing stockholder approval would seriously jeopardize the financial viability of the enterprise and (2) reliance by the company on this exception is expressly approved by the Audit Committee of the Board.”” (PTX 207 at 1).

28.2.3 Defendant asked AIG not to disclose the fact that NYSE rules provided a 10-day waiting period prior to issuance of the preferred shares because they did not “want to give a roadmap for someone to seek an injunction.” (PTX 251 at 8).⁸³

(a) On September 25, 2008, Shannon wrote to Glenn Tyranski of the NYSE that AIG had “all intentions of complying with the ‘waiting period’ but I was told ‘they don’t want to give a roadmap for someone to seek an injunction’.” (PTX 251 at 8). At trial, Ms. Shannon indicated that she was not told that by “outside counsel for AIG”; “I believe it’s the counsel for the New York Fed that is referred to previously that that’s who the – the – would have given me that advice.” (Shannon: Trial Tr. 3673:15 – 3674:14).

(b) Email from John Brandow of Davis Polk to Shannon on September 25 at 5:24 p.m., attaching “proposed revisions to the Press Release and Letter to Shareholders”: “The point of the new language is to track the Credit Agreement provision for when the Preferred Stock will be issued and to avoid any suggestion that the shareholders have a ten day period within which to try to prevent the issuance.” (PTX 249 at 1).

⁸³ Davis Polk attorney John Brandow testified that disclosure of the issues arising from Defendant’s handling of the applicable NYSE rules would not “provide a roadmap to shareholders to seek an injunction” (Brandow: Trial Tr. 5801:16-23). However, documents produced after Defendant’s intentional waiver of privilege show that his then-partner, Ethan James, disagreed. *See* PTX 3246 at 4 (“What about filing the CA etc but w/out schedules? This is done all the time in m+a so shouldn’t raise eyebrows ... but wld also ... remove the roadmap to why we don’t need a SH vote in the equity TS, which is the biggest issue”); PTX 3246 at 3 (“The one piece I’d like to leave out is the specific reference to the nyse provisions that highlight the path to no SH vote. If it is clear that we are getting 80% in the near future I don’t think that part is material.”); PTX 3276 at 1 (“the parts of the equity TS that could tip someone off that we expect to get the equity w/out a SH vote won’t need to be disclosed, I would think (anyone disagree?). On the other hand, the timing for the EoD will be a message that we have something up our sleeve, which increases the pressure for someone at our client to have the necessary discussion with the NYSE – recall that the NYSE was a big battleground in the [redacted] deal, where similar issues were at play.”); *see also* PTX 98-U at 5 (Defendant’s outside counsel at Wachtell on September 16: “immediate issuance of preferred stock with full voting rights may violate NYSE rules unless a waiver is obtained.”).

(c) On September 25, 2008, Shannon sent Tanya Hoos (NYSE) AIG’s “proposed press release and letter to shareholders” with respect to the waiver of the NYSE rule requiring shareholder approval. (PTX 251 at 11-12; *see also* Shannon: Trial Tr. 3671:22 – 3672:8 (confirming same)). Later that day, Shannon advised Hoos that “Counsel for the NY Fed has requested that we not mention the 10 days in the letter or release.” (PTX 251 at 9; *see also* Shannon: Trial Tr. 3672:21 – 3673:5 (“I believe it’s a reference to the letter to shareholders and the press release which are required as part of the rule, the Stock Exchange rule, and what you have to do in connection with using the exigent circumstances exception to the rule.”)).

(d) Shannon: The NYSE ultimately required “that the ten-day waiting period be referred to in the letter to shareholders.” (Shannon: Trial Tr. 3674:15-18; *see also* JX 119; Brandow: Trial Tr. 5804:4-12).

28.2.4 A company is only permitted to invoke a waiver of a shareholder vote if “the delay in securing stockholder approval would seriously jeopardize the financial viability of the enterprise”. (PTX 207 at 1).

(a) NYSE Listed Company Manual Rule 312.05, “Exceptions”: “Exceptions may be made to the shareholder approval policy in Para. 312.03 upon application to the Exchange when (1) the delay in securing stockholder approval would seriously jeopardize the financial viability of the enterprise and (2) reliance by the company on this exception is expressly approved by the Audit Committee of the Board.” (JX 240 at 96).

(b) Liddy: As of September 26, 2008, when AIG sent a letter to shareholders (JX 119), Liddy understood that the only way AIG “could get an exception to the New York Stock Exchange’s rule requiring shareholder approval to issuance of the preferred stock was to bring” AIG “within an exception that depended on a finding that the delay involved in securing that

approval could seriously jeopardize the company”. (Liddy: Trial Tr. 3306:12-21; *see also* Liddy: Trial Tr. 3309:15-18 (Liddy “did understand that you couldn’t come within this exception of avoiding shareholder votes unless you didn’t have time to have a shareholder vote”)).

28.2.5 There was no legitimate basis for waiver required by Defendant since the AIG preferred stock was not issued until March 2009, and there was more than enough time in the interim to have a shareholder vote.

(a) Shannon’s “expectation is that it would probably take four to six weeks to get through – to give the requisite notice that was required and then to ... get through the preliminary proxy process with the SEC and then have the required notice time thereafter before the shareholder meeting could be held.” (Shannon: Trial Tr. 3679:22 – 3680:8).

(b) Brandow: “There was time . . . between the signing of the agreement and the issuance of the securities for there to have been stockholder approval.” (Brandow: Trial Tr. 5881:8-14). There was “enough” time. (Brandow: Trial Tr. 5881:16-20).

(c) Liddy: There “was time between September 22nd, 2008, and 2009 to have a shareholder vote on the issuance of the preferred stock”. (Liddy: Trial Tr. 3308:7-11).

(d) Offit: “I’m saying there certainly could be a vote, a formalized vote. Certainly that’s in accordance with appropriate governance.” (Offit: Trial Tr. 7956:10-19).

28.3 Even Though the Change to Voting Convertible Preferred Stock Gave Defendant Voting Control Without a Shareholder Vote, the Equity Term Sheet That Became Exhibit D to the Credit Agreement Assumed That There Would Be a Shareholder Vote on Amendments to the AIG Charter That Would Allow Conversion of the Preferred Shares into Common Stock. (JX 107 at 137-38).

28.3.1 Defendant initially believed that the holder of convertible voting preferred could vote on the charter amendments required for conversion.

(a) Wachtell on September 17 concerning draft language for the convertible voting preferred stock: “Please note that we did not include any penalties for failure to obtain

shareholder approval for the charter amendments on the assumption that the holder would have voting rights.” (PTX 3215 at 1).

(b) Davis Polk attorney Ethan James at 11:38 p.m. on September 16: “Once those voting rights arise, they should be sufficient to control any SH vote, as your term sheet suggests. At that point we could amend the par value of the common stock, which would address consideration issues related to the conversion of the preferred shares (if that is what we will use), and the number of authorized shares.” (PTX 3219 at 2). Wachtell attorney Steven Rosenblum responds: “agree that once we have the voting rights, we can approve the necessary charter amendment.” (PTX 3219 at 1).

(c) Ethan James on September 22: “No warrants means no need for SH approval to get the equity”. (PTX 3256 at 1).

(d) November 6, 2008 legal memo from Board of Governors staff regarding the *Walker* litigation: “we understand that Davis Polk has said that it had reviewed the lawsuit and is confident that the trust structure still works, presumably including the provision that will allow the trust to vote the preferred shares to increase the number of authorized common shares and decrease their par value.” (PTX 3221 at 2-3).

(e) Board of Governors attorney Rich Ashton to Alvarez on December 20, 2008: “The way it was initially, the common holders and the preferred holders voted together on whether to increase the number of common shares, so that the preferred holders could dictate the result.” (PTX 3225 at 1).

29.0

PRIOR TO THE EXECUTION OF THE CREDIT AGREEMENT ON SEPTEMBER 23, 2008, DEFENDANT DID NOT UNDERTAKE ANY INVESTIGATION OR ANALYSIS, MAKE ANY FINDINGS, OR HOLD ANY HEARING CONCERNING WHETHER AIG OR ITS SHAREHOLDERS SHOULD BE PENALIZED AND, IF SO, HOW.

29.1 Prior to the Execution of the Credit Agreement, Defendant Had No Basis to Determine Whether AIG or Its Shareholders Should Be Penalized or, if so, How.

(a) Paulson did not believe “Treasury or the Federal Reserve or in fact anyone in connection with the government” undertook “any investigation or analysis or made any findings concerning whether AIG had engaged in any excessive risk taking or other misconduct” prior to September 22, 2008 (Paulson: Trial Tr. 1236:5-11).

(b) Bernanke could not identify anyone, through the period of September 22, 2008, “who had reached any conclusion concerning whether or not AIG has mismanaged its business or taken on excessive risks”. (Bernanke: Trial Tr. 2134:17 – 2135:1).

(c) Bernanke could not “identify anyone at the Federal Reserve or in government” that he “believed reached a conclusion, in September, that AIG had mismanaged its business or taken on excessive risks” (Bernanke: Trial Tr. 2135:2-8).

(d) Geithner: No one within the government tried “to determine whether the management decisions that AIG had made were bad management decisions at the time they were made” (Geithner: Trial Tr. 1653:18-22, 1652:23 – 1653:6).⁸⁴

(e) Latorre: At no time through September 16 “did anyone identify any specific poor risk management practice that they believed that AIG had engaged in”. (Latorre: Trial Tr. 2057:13-20). And there was no “effort made to assess whether AIG’s risk management practices” were “better or worse than other companies that were in financial distress”. (Latorre: Trial Tr. 2058:13-17).

29.1.1 The Federal Reserve did not have regulatory or internal guidelines for pricing a loan.

(a) McLaughlin: In September 2008, “there wasn’t anything in writing and there were no established guidelines” on how to price a 13(3) loan (McLaughlin: Trial Tr. 2492:9-12).

(b) Mosser: Criteria for which financial institutions should be given access to Fed borrowing facilities were never developed (Mosser: Trial Tr. 1314:10-18).

⁸⁴ Geithner claimed at trial that he “had a reasonable basis for judgment that, in a relative sense, [AIG] had taken imprudent risks.” Geithner: Trial Tr. 1655:2-13. But he admitted that this conclusion was based solely on “comparing the consequences or needs that AIG faced with the consequences or needs” of other financial institutions in mid-September. Geithner: Trial Tr. 1658:22 – 1659:4. In reaching that conclusion, he did not consider the government assistance provided to those other financial institutions prior to the worsening of the Financial Crisis in September 2008 or that at various points, including throughout September 2008, the borrowings of Morgan Stanley and AIG from Defendant were largely the same size. *See* PTX 728 at 10-11 (Morgan Stanley borrowed \$24 billion on September 18, 2008 alone, and its UK subsidiaries borrowed an additional \$21.23 billion on September 29, 2008); Cragg: Trial Tr. 5075:20 – 5077:5 (As of September 29, 2008, Morgan Stanley had borrowed \$97.3 billion, whereas AIG had borrowed \$55 billion) (discussing PTX 5356). Moreover, he admitted at trial that he and others at the Fed had “no basis for having any direct knowledge of the nature of the risks they were taking, so I don’t think we could have made that judgment” that AIG’s risk taking was excessive. (Geithner: Trial Tr. 1659:20 – 1661:13).

(c) To the extent legal advice was required on the AIG loan and its terms, there is nothing in writing indicating any such advice. Although Bernanke admitted that it was important to have legal advice in writing where possible, he never asked for any legal advice in writing with respect to the AIG credit facility (Bernanke: Trial Tr. 2270:9-18).

29.2 The Federal Reserve Did Not Even Determine, or Attempt to Determine, How Much Compensation It Was Demanding From AIG or What the Basis for Such Compensation Was.

29.2.1 The Board of Governors did not discuss the basis of the proposed interest rate prior to authorizing the RCF to AIG at the September 16, 2008 meeting.

(a) Bernanke did not “know what the basis was for the Federal Reserve Bank of New York proposing” the interest rate provided for in the term sheet (Bernanke: Trial Tr. 1976:18 – 1977:3), and does not recall anyone asking what the basis was for the drawn interest rate at the Board of Governors meeting. (Bernanke: Trial Tr. 1977:13-17).

(b) Bernanke does not recall “any attempt made” at the September 16 meeting “to determine what the total interest rate that AIG would be paying to the Federal Reserve would be”. (Bernanke: Trial Tr. 2130:18-22). Nor was there any discussion “prior to the Board of Governors meeting, as to what interest rate would be provided for any loan extended to AIG pursuant to section 13(3)”. (Bernanke: Trial Tr. 2147:25 – 2148:4).

29.2.2 The Board of Governors did not discuss the purpose of the 79.9% equity demand prior to authorizing the RCF to AIG at the September 16, 2008 meeting.

(a) The minutes of the September 16, 2008 Federal Reserve Board of Governors meeting approving the terms of the AIG 13(3) RCF do not indicate any discussion or consideration of the purpose of the 79.9% equity demand. (JX 63).

(b) Bernanke could not recall any discussion at the September 16, 2008 Board of Governors meeting as to why the warrants were for 79.9% of AIG shareholders' equity, as opposed to some other percentage. (Bernanke: Trial Tr. 2002:2-7).

29.2.3 No "estimate was made as to how much additional compensation the equity component provided". (Bernanke: Trial Tr. 1983:24 – 1984:3).

29.2.4 In determining how much compensation to require for the AIG loan, Bernanke did not take into account or give any consideration to "whether or not AIG had engaged in excessive risk taking". (Bernanke: Trial Tr. 2131:14-24).

30.0

BETWEEN NOVEMBER 2008 AND JANUARY 14, 2011, DEFENDANT RESTRUCTURED THE TERMS OF ITS EXTENSION OF LIQUIDITY TO AIG.

30.1 "According to Both FRBNY Officials and AIG Executives, It Was Apparent at the Time the Revolving Credit Facility Was Offered That Restructuring Would Be Necessary". (PTX 641 at 128-129).

(a) Dahlgren: "the terms of the AIG credit facility were viewed by the rating agencies – and ultimately, by" Dahlgren "as being too onerous and counterproductive". (Dahlgren: Trial Tr. 2772:10 – 2773:2).

(b) On or around October 4, 2008, Dan Jester of Treasury asked FRBNY to "rethink the terms of the deal; deal was onerous." (PTX 279 at 2). Shortly thereafter, on October 15, 2008, FRBNY and Board of Governors staff met to discuss "the way forward" with regard to restructuring the deal. (PTX 297).

30.1.1 On November 9, 2008, FRBNY modified the terms of the Credit Agreement by lowering the interest rate and increasing the maturity period for repayment.

(a) The interest rate on funds drawn from the Credit Facility was reduced by 5%, from 8.5% plus the three-month LIBOR (with a 3.5% floor) to 3% plus the three-month LIBOR (with a 3.5% floor) and the maturity period for repayment of the Credit Facility was increased from two years to five years. (*Compare* JX 107 at 7, 15, 17, 26, *with* JX 147 at 2). The undrawn commitment fee was also reduced from 8.5% to 0.75% (JX 147 at 2).

30.1.2 The changes to the Credit Facility “were prospective only. That is, neither the principal amount of the Facility nor any interest accrued prior to the modification was forgiven by the terms of the modification.” (JX 387 at 3). The “modification of the Facility occurred contemporaneous with and in contemplation of the Treasury’s decision to purchase \$40 billion in preferred stock and warrants issued by” AIG. (JX 387 at 3).

(a) Deloitte (FRBNY’s auditor), concerning the November 2008 modification to the Credit Agreement: “the Federal Reserve Bank and the US Treasury determined that establishing lending terms in a manner that encouraged rapid sales of assets did not, in the current economic environment, adequately represent the Federal Reserve Bank’s public policy mission and could in fact further destabilize the financial markets (as opposed to the individual Facility borrowers, such as A[IG]) by adding general uncertainty as to whether entities seeking financing from the Federal Reserve Bank would be forced to conduct fire sales into a market with reduced liquidity.” (JX 387 at 10; *see also* PTX 489 at 7 (“The decrease in the effective borrowing rate was part of the overall arrangement to be more equitable to AIG in light of other financial

institution's similar difficulties and to better meet the Federal Reserve's public policy considerations.")).⁸⁵

30.1.3 On November 25, 2008, Treasury purchased \$40 billion of AIG's Series D Preferred Stock, a newly created class of preferred that had terms far more onerous than other classes of preferred equity purchased by Treasury under TARP. (JX 158 at 2).

(a) The Series D Preferred Stock had an annual dividend rate of 10%. (JX 158 at 10). The dividends owed under the Series D Preferred Stock were cumulative (JX 158 at 2, 11), which meant that dividends owed under the Series D Preferred Stock accumulated until AIG made the payment. (Liddy: Trial Tr. 3245:18-22).

(b) In contrast, the \$125 billion in preferred stock purchased by Treasury under the Capital Purchase Program from "eight of the country's largest financial institutions" had an annual dividend rate of only 5%. (PTX 622 at 30; *see also* PTX 422 at 57-59).

30.1.4 The \$40 billion purchase price paid by Treasury for the Series D Preferred Stock was immediately "used to pay down the current outstandings on the Fed loan", also reducing the

⁸⁵ Defendant suggested at trial that the restructuring was necessary because of AIG's deteriorating finances. However, contemporaneous with the restructuring, Defendant rejected the idea that the restructuring was based on AIG's deteriorating financial condition. *See* PTX 489 at 7 ("Based on the above, we do not believe that AIG's financial condition had deteriorated from September 22 to November 10."); Dahlgren: Trial Tr. 2945:5-10 (acknowledging the statement). FRBNY's auditor, Deloitte also recognized with respect to the November 2008 restructuring, "the threat of imminent bankruptcy did not exist on the eve of the modification transaction." (JX 387 at 9-10; *see also* PTX 489 at 10 ("Although it is widely understood that" AIG "continued to experience financial difficulty," the Fed "does not believe that A[IG]'s financial condition has deteriorated since the extension of the original facility."); PTX 489 at 7 ("In addition, we believe that the FRBNY did not modify their line of credit with AIG due to deterioration in AIG's financial condition.")).

Defendant's suggestion is contrary to facts set forth in Section 30.1. Moreover, to the extent AIG was experiencing problems, the onerous terms imposed in September were materially responsible (*see supra* §§ 27.5-27.6).

maximum borrowing limit under the RCF was reduced from \$85 billion to \$60 billion.

(Dahlgren: Trial Tr. 2875:19 – 2876:17; PTX 622 at 34; PTX 5200).

30.1.5 On November 25, 2008, FRBNY established Maiden Lane III LLC (“ML III”), which subsequently purchased certain CDOs protected by AIGFP-written CDS for par value, at the expense of AIG. (JX 188 at 41).

(a) “ML III borrowed approximately 24.3 billion from” FRBNY, and “AIG provided an equity contribution of \$5 billion to ML III.” (PTX 2800 at 34; PTX 2540 at 2). As part of the transaction, AIG’s counterparties “were allowed to keep the \$35 billion in collateral that had been posted by AIG prior to the transaction in exchange for tearing up the associated credit default swap contracts.” (PTX 549 at 9).

(b) FRBNY was “the managing member and the controlling party of ML III” (PTX 2800 at 34).

(c) FRBNY’s senior loan was “fully collateralized by all of the assets of ML III.” (PTX 2800 at 34).

(d) Under FRBNY and AIG’s agreements with ML III, FRBNY’s senior loan was to be repaid in full before AIG received any payment on its equity contribution. Once FRBNY’s loan was repaid, AIG was entitled “to receive repayment of its equity contribution plus interest”. After ML III repaid FRBNY’s “senior loan and AIG’s equity contribution equity contribution in full,” FRBNY was “entitled to receive 67 percent of any additional net proceeds by ML III . . .

and AIG” was “entitled to receive 33 percent of any net proceeds received by ML III” (PTX 2800 at 34-35; *see also* PTX 2540 at 2).⁸⁶

(e) Between November 25 and December 31, 2008, ML III “purchased from AIGFP’s counterparties a total of \$62.1 billion in par amount of CDO securities, and the associated credit default swaps had been terminated.” (JX 188 at 41).

(f) The CDOs purchased by ML III were later “sold through a series of auctions culminating on August 23, 2012.” (PTX 2540 at 1).

(g) Saunders: “On June 14, 2012, the FRBNY announced that the ML III loan had been completely repaid with interest. By July 16, 2012, AIG’s equity contribution to ML III had been repaid plus interest. On August 23, 2012, the FRBNY announced that it had sold the remaining securities in the ML III portfolio, resulting in an overall net gain to the benefit of the public of approximately \$6.6 billion, including \$737 million in accrued interest.” (DX 1883 at App’x C, ¶ 29 (Saunders Expert Report); *see also* PTX 2540 at 1).

(h) Although AIG contributed \$35 billion in collateral payments towards ML III’s purchases of the multi-sector CDOs and \$5 billion in equity to ML III (PTX 549 at 9), AIG received only \$8.5 billion in payments from ML III, including interest and residuals. (PTX 2540 at 2).

30.1.6 On December 12, 2008, Maiden Lane II LLC (“ML II”), another FRBNY-controlled LLC, purchased RMBS with a par value of \$39.3 billion from certain AIG insurance

⁸⁶ Although Defendant and many of Defendant’s documents refer to a “profit” derived from the ML III residual interest (*see, e.g.*, Latorre: Trial Tr. 2331:4-10; Dahlgren: Trial Tr. 2984:21-23; PTX 2540 at 2), this purported “profit” is an accounting convention designed to deal with the residual interest in AIG, which as explained later ignores approximately \$35 billion in assets AIG contributed to Maiden Lane III. *See supra* § 34.10 & nn.117-18.

subsidiaries for \$19.8 billion, causing the subsidiaries to suffer a permanent loss of \$19.5 billion on the RMBS in exchange for limited upside in ML II. (JX 188 at 41, 250).

(a) FRBNY 2010 Annual Report: “Concurrent with the November 2008 restructuring of the its financial support to AIG,” FRBNY established Maiden Lane II LLC (“ML II”). (PTX 2800 at 34). “ML II borrowed \$19.5 billion” from FRBNY “and used proceeds to purchase nonagency RMBS that had an approximate fair value of \$20.8 billion as of October 31, 2008 from AIG’s domestic insurance subsidiaries.” (PTX 2800 at 34).⁸⁷

(b) FRBNY was “the sole and managing member and the controlling party of ML II”. (PTX 2800 at 34).

(c) Under the terms of the ML II agreements, after “ML II has first paid the Bank’s senior loan, including accrued and unpaid interest, and then the fixed deferred purchase price in full, including accrued and unpaid interest, any net proceeds will be divided between the Bank, which is entitled to receive five-sixths, and the AIG subsidiaries, which are entitled to receive one-sixth.” (PTX 2800 at 34).

(d) Saunders: “On March 30, 2011, the New York Fed announced that it would begin selling securities in the Maiden Lane II LLC (‘ML II’) portfolio The portfolio was sold through a series of auctions culminating on February 28, 2012. Net proceeds from sales of all the securities as well as cash flow the securities generated while held by ML II enabled the full repayment of its liabilities to the New York Fed and AIG while also providing a total gain of approximately \$2.8 billion to the New York Fed for the benefit of the U.S. public.” (PTX 2539 at 1; *see also* DX 1883, Saunders Report, App’x C, ¶ 28).

⁸⁷ Although the agreed upon purchase price was \$19.8 billion, \$19.5 billion represented the amount payable by ML II on the closing date after certain adjustments, including payments on RMBS for the period between the transaction settlement date of October 31, 2008, and the closing date of December 12, 2008. (JX 188 at 250).

(e) FRBNY ML II disclosure: For RMBS with a par value of \$39.3 billion and its investment in ML II, AIG received only a total of \$21.059 billion in proceeds from ML II.⁸⁸ (PTX 2539 at 2).

30.1.7 AIG's participation in ML II and ML III crystallized losses at the bottom of the market for AIGFP's multi-sector CDS portfolio and AIG's securities lending program. (PTX 578 at 3; *see infra* §§ 34.4, 34.9).

30.1.8 In 2009, Defendant further restructured its extension of liquidity to AIG.

(a) On March 2, 2009, AIG and Defendant announced an agreement in principle to further restructure Defendant's extension of liquidity to AIG. (JX 186).

(b) On April 17, 2009, the Credit Agreement was amended to remove the 3.5% LIBOR floor associated with the interest rate on funds borrowed from the Credit Facility. (JX 207 at 3).

(c) On April 17, 2009, Treasury exchanged its Series D Preferred stock for Series E Preferred Stock. (PTX 589 at 96-98). Unlike the Series D Shares, the Series E Preferred Stock was noncumulative, meaning unpaid dividends did not accumulate for later payments. (Feldberg: Trial Tr. 3392:16-19 ("the Series E preferred stock was noncumulative preferred stock"); PTX 589 at 96-98).

(d) Noncumulative preferred stock "more closely resembles common stock and is, therefore, more favorably looked upon by the credit rating agencies." (PTX 589 at 96).

(e) Like the Series D Preferred Stock, the Series E Preferred Stock had a dividend rate of 10% per year. (JX 208 at 3).

⁸⁸ \$21.059 billion is the sum of the \$20.493 billion purchase price paid to AIG for its RMBS and the \$0.566 billion additional proceeds received from interest and profits on ML II. (PTX 2539 at 2).

(f) On April 17, 2009, Treasury established an equity facility, under which Treasury committed for five years to provide up to \$30 billion to AIG in exchange for shares of Series F Preferred Stock. (JX 209 at 3). The Series F Preferred Stock was non-cumulative and had an annual dividend rate of 10%. (JX 209 at 3).

(g) On June 25, 2009, FRBNY reduced the outstanding principal on the Credit Facility by \$25 billion in exchange for preferred interests in two SPVs which would hold 100% of the common stock in two AIG insurance subsidiaries, ALICO and AIA. (JX 241 at 2; PTX 5200). The transactions were closed on December 1, 2009. (JX 241 at 2).

30.2 The January 14, 2011 Recapitalization Transaction Was Not in the Best Interests of AIG's Existing Common Shareholders.

30.2.1 As part of the Recapitalization transaction, FRBNY received full repayment on the principal borrowings from the Credit Facility plus \$6.7 billion in fees and interest payments.

(a) AIG Form 8-K (Jan. 14, 2011): On January 14, 2011, as part of the so-called "Recapitalization," "AIG paid FRBNY \$21 billion in cash, representing complete repayment on all amounts owing under the Credit Facility, and the Credit Facility was terminated." (JX 314 at 2).

(b) Alvarez: The Federal Reserve earned a profit on the AIG Credit Facility, earning approximately "\$6.7 billion of interest and fees" (Alvarez: Trial Tr. 611:23 – 612:5; *see also* Kothari: Trial Tr. 4533:10-24 (Defendant received \$6.7 billion in interest and fees on the Credit Facility); PTX 720 (FRBNY reporting \$6.7 billion in interest and fees earned from the Credit Facility)).

30.2.2 As a result of the January 2011 Recapitalization of AIG, Defendant acquired 92.1% of AIG's common stock.

(a) “As part of the January 2011 recapitalization, Treasury ultimately received 562.9 million shares of common stock in exchange for the Series C preferred shares held by the AIG Credit Facility Trust and exchanged the Series E and Series F preferred shares for 1.09 billion shares of common stock, resulting in an aggregate 92.1% equity stake.” (Agreed to Stipulation ¶ 212).

30.2.3 Defendant’s 92.1% ownership stake in AIG was well in excess of the ownership stakes it took in other financial institutions during the financial crisis.

(a) AIG Presentation: Treasury’s “ownership stake in AIG is well in excess of its stake in other financial services institutions which received US Governments support”. (PTX 578 at 3).

(b) Schreiber: “I am sensitive to the Govt’s view, but its not reality, just politics. **Other institutions were toast as well yet their past, present and future shareholders are not being punished this way.** We are meeting all of our public and private obligations and the Govt is making a huge profit – that is why this is unlike other restructurings and why they shouldn’t be as hung up on a reinforcing transaction as they seem to be.” (PTX 601 at 1 (emphasis added); *see also* Schreiber: Trial Tr. 6691:10 – 6692:7).

30.2.4 Existing AIG common shareholders were not given the opportunity to vote on the Recapitalization transaction.

(a) The “United States admits that, on December 7, 2010, the Trustees submitted their written consent to the Recapitalization plan as part of AIG’s Schedule 14C filing with the SEC, in lieu of a special meeting of shareholders.” (Def. Resp. to Pl. 2nd RFAs No. 1119; JX 307 at 17-19).

(b) Offit: “There came a time when AIG exchanged Series C, E and F preferred stock for common stock”. (Offit: Trial Tr. 7964:3-6). “And that was done by the government on consent, written consent, because the government controlled more than a majority of the votes”. (Offit: Trial Tr. 7964:7-17). “And the government could not have done that if all they held were warrants”. (Offit: Trial Tr. 7964:19-22).

30.2.5 The exchange of the Series E and F Preferred Stock for common stock with a value equal to their liquidation preferences diluted existing common shareholders by giving Defendant common stock that was tens of billions of dollars more valuable than the preferred stock returned to AIG.⁸⁹

(a) Saunders: “economic dilution or lost value occurs when shares are issued to a new shareholder for less than reasonably equivalent value.” (DX 1882 ¶ 66 (Saunders Expert Report)).

⁸⁹ Although AIG received fairness opinions from Bank of America and Citi concerning the exchange of the Series E and F Preferred Stock, those opinions were invalid tautologies because AIG had instructed Bank of America and Citi to assume that the fair value of each of the Series E and Series F Preferred Stock was equal to the liquidation value thereof, \$41.6 billion and \$7.5 billion. JX 284 at 3; JX 307 at 215, 217; *see also* PTX 5509 (Zingales demonstrative). That assumption is highly questionable in light of the testimony of Brian Schreiber – the AIG executive responsible for the provision of information to Citi and Bank of America – that he knew Defendant valued the Series E and F Preferred Stock at less than their liquidation values and that the “Series E preferred stock was an instrument that would have almost no value in the marketplace”. Schreiber: Trial Tr. 6735:7 – 6736:10, 6732:22 – 6733:3; *see also* Kothari: Trial Tr. 4782:15-18 (“the fair value of Series E and F preferred stock was far less than the liquidation preference value” and “that is in the opinion of the Government itself”); PTX 622 at 19 (Defendant reported that, as of September 30, 2009, the Series E and F were worth \$13.2 billion, and that, as of September 30, 2010, the Series E and F were worth \$26.1 billion—significantly less than the liquidation value of those securities of more than \$43 billion in 2009 and \$47.6 billion in 2010); PTX 5224 (Kothari demonstrative showing that the fair value of the Series E and F Preferred was \$23.547 billion lower than its liquidation preference as of June 30, 2009).

(b) The common stock AIG provided to Defendant in exchange for the Series E and F Preferred Stock had a value equal to the \$49.1 billion liquidation preference of the Series E and F Preferred Stock. (PTX 2248 at 7; Langerman: Trial Tr. 7282:10-20).

(c) Defendant's own valuation, however, shows the Series E and F Preferred Stock had a fair value of \$26.1 billion as of September 30, 2010. (PTX 622 at 19).

30.2.5.1 AIG also recognized that the Series E and F Preferred Stock were far less valuable than their liquidation preferences.

(a) Schreiber: even though the Series E stock "was an instrument that would have almost no value in the marketplace," the government received a number of common shares in exchange for Series E stock equal to "\$40 billion" divided by "\$45" as "part of the overall recapitalization." (Schreiber: Trial Tr. 6692:17 – 6695:1; *see also* Zingales: Trial Tr. 8610:14-22; PTX 5506 (Zingales demonstrative); PTX 5508 (same)).

(b) Had Defendant exchanged the Series E and F Preferred Stock for common stock with a value equal to the fair value of the Series E and F and exchanged the Series C Preferred Stock after exchanging the Series E and F, Defendant would have only acquired 80.3% of AIG's common stock. (Zingales: Trial Tr. 8608:10 – 8609:2; *see also* PTX 5505).

30.2.6 The warrants shareholders received as part of the Recapitalization transaction did not offset the losses suffered by AIG's existing shareholders as a result of Defendant's conduct.

(a) On January 19, 2011, as part of the Recapitalization, AIG issued 10-year warrants with a strike price of \$45 to existing shareholders. Each shareholder as of the Record Date received a number of warrants equal to the number of shares held of record multiplied by 0.533933. (JX 311 at 3).

(b) Schreiber to then AIG EVP and current CEO Peter Hancock on September 5, 2010: Discussing “the issuance of warrants to existing shareholders as a way to” “sweeten the exchange offer” (Schreiber: Trial Tr. 6690:14-21), Schreiber writes, “Its also hard to argue its a windfall for old shareholders when even at that value we are taking under \$4/sh in aggregate value pre reverse split. I am sensitive to the Govt’s view, but its not reality, just politics. Other institutions were toast as well yet their past, present and future shareholders are not being punished this way. We are meeting all of our public and private obligations and the Govt is making a huge profit – that is why this is unlike other restructurings and why they shouldn’t be as hung up on a reinforcing transaction as they seem to be.” (PTX 601).

(c) The warrants were only provided to shareholders of record at the time of the recapitalization, but that would not, in general, compensate the two classes, many of whom likely sold their AIG holdings prior to January 2011. (*See* PTX 2852 at 126, Ex. I-1 (Kothari Expert Report, showing significant trading volume in AIG stock from June 30, 2009 through the Recapitalization); *see also* Mordecai: Trial Tr. 7581:5-8 (following the reverse stock split, “the liquidity of AIG common stock” and the “average trading volume increased”)).

30.3 As a result of the Recapitalization and Defendant’s subsequent sale of AIG common stock, Defendant received a \$23 billion profit on its extension of liquidity to AIG.

(a) December 12, 2012 Treasury Press Release: “Today, the U.S. Department of the Treasury announced that it has agreed to sell all of its remaining 234,169,156 shares of American International Group, Inc. . . . Giving effect to today’s offering, the overall positive return on the Federal Reserve and Treasury’s combined \$182 billion commitment to stabilize AIG during the financial crisis is now \$22.7 billion.” (PTX 658).

(b) Bernanke: The return to Defendant “on all of the assistance that was given to AIG, whether it was from the Federal Reserve or TARP or some other place,” was \$23 billion.

(Bernanke: Trial Tr. 2014:3-14).

(c) Bernanke: “sometime before today AIG paid back not only the Federal Reserve, but every other government agency that advanced it credit for every dollar received”. (Bernanke: Trial Tr. 2013:14-18).

(d) Schreiber: The government received “all of the money they put into AIG back plus a profit of approximately 23 billion.” (Schreiber: Trial Tr. 6684:19 – 6685:1).

31.0

MANY FINANCIAL INSTITUTIONS ENGAGED IN MUCH RISKIER AND MORE CULPABLE CONDUCT THAN AIG.

31.1 Financial institutions that originated and marketed subprime mortgage-backed securities made representations and disclosures that Defendant has concluded were false and misleading.

(a) Cragg: “So one of the critical issues during this period of time was the representations and warranties that were being made on both – on the collateral at all levels. And as it turns out, many of those reps and warranties were violated because of fraud in the underwriting process, and so this – this exhibit [PTX 5321] summarizes the results of litigation related to these issues. Q. And this relates to litigation brought against Bank of America, Citigroup, JPMorgan, and involving Merrill Lynch and Countrywide; is that correct? A. Yes. Exactly.” (Cragg: Trial Tr. 4996:3-24).

(b) The DOJ charged many firms with fraud related to the financial crisis. (PTX 5321 (Cragg demonstrative quoting DOJ press releases: PTX 2734 (Bank of America); PTX 2527 (Citigroup); PTX 2473 (JPMorgan); PTX 2872 (Merrill Lynch and Countrywide)).

31.1.1 Citi:

(a) Paulson: The DOJ “has brought claims against a number of other companies, including Citi, alleging that these companies had engaged in fraudulent conduct that caused the financial crisis”. (Paulson: Trial Tr. 1236:17-21).

(b) Defendant said on July 14, 2014, ““after collecting nearly 25 million documents relating to every residential mortgage backed security issued or underwritten by Citigroup in 2006 and 2007, our teams found that the misconduct in Citigroup’s deals devastated the nation and the world’s economies, touching everyone””. (PTX 2527 at 2).

(c) Geithner concluded that Citicorp had taken excessive risks. (Geithner: Trial Tr. 1675:9-11).

31.1.2 Bank of America (and its acquired assets of Merrill Lynch and Countrywide):

(a) On or about March 26, 2014 Bank of America agreed to pay \$9.3 billion to settle claims brought by the Federal Housing Financing Agency under its statutory mandate to recover losses incurred by Fannie Mae and Freddie Mac accusing the bank (and subsidiaries Merrill Lynch and Countrywide) of “misrepresenting the quality of loans underlying residential mortgage-backed securities purchased by the two mortgage finance companies between 2005 and 2007.” (PTX 2504 at 1).

(b) On August 21, 2014, Bank of America paid \$16.65 billion (approximately 10% of its market capitalization) to settle a U.S. Department of Justice probe related to the bank’s misconduct (including the misconduct of subsidiaries Merrill Lynch and Countrywide) in originating mortgage securities. The settlement was “the largest civil settlement with a single entity in American history” and Bank of America “acknowledged that it sold billions of dollars of RMBS without disclosing to investors key facts about the quality of the securitized loans. . . .

The bank has also conceded that it originated risky loans and made misrepresentations about the quality of those loans”. (PTX 2734 at 1).

(c) The Southern District of New York has held, in a case brought by Defendant, that Countrywide Financial engaged in conduct that “was from start to finish the vehicle for a brazen fraud by the defendants, driven by a hunger for profits and oblivious to the harms thereby visited, not just on the immediate victims but also on the financial system as a whole.” (*United States ex rel. O’Donnell v. Countrywide Home Loans, Inc.*, – F. Supp. 2d –, 2014 WL 3734122, at *1, 6 (S.D.N.Y. July 30, 2014)).

(d) Attorney General Eric Holder: Merrill Lynch and Countrywide “knowingly, routinely, falsely, and fraudulently marked and sold these loans as sound and reliable investments.” (PTX 2872 at 1).

31.1.3 Goldman Sachs:

(a) In July 2010, Goldman Sachs settled with the SEC, “paying a record \$550 million fine. Goldman ‘acknowledge[d] that the marketing materials for the ABACUS 2007-AC1 transaction contained incomplete information. In particular, it was a mistake for the Goldman marketing materials to state that the reference portfolio was “selected by” ACA Management LLC without disclosing the role of Paulson & Co. Inc. in the portfolio selection process and that Paulson’s economic interests were adverse to CDO investors.’” (PTX 624 at 221).

31.1.4 JPMorgan:

(a) On or about November 19, 2013, the Department of Justice announced a \$13 billion settlement of claims brought by the United States “in which JPMorgan acknowledges that it regularly represented to RMBS investors that the mortgage loans in various securities complied with underwriting guidelines. Contrary to those representations, as the statement of facts

explain, on a number of different occasions, JPMorgan employees knew that the loans in question did not comply with those guidelines and were not otherwise appropriate for securitization, but they allowed the loans to be securitized – and those securities to be sold – without disclosing this information to investors. This conduct, along with similar conduct by other banks that bundled toxic loans into securities and misled investors who purchased those securities, contributed to the financial crisis.” (PTX 2473 at 1).

31.1.5 Morgan Stanley:

(a) On or about February 4, 2014, Morgan Stanley “agreed to pay \$1.25 billion to the Federal Housing Finance Agency to resolve claims that it sold shoddy mortgage securities to Fannie Mae and Freddie Mac.” “According to the agency’s lawsuit, Morgan Stanley sold \$10.58 billion in mortgage-backed securities to Fannie and Freddie during the credit boom, while presenting ‘a false picture’ of the riskiness of the loans.” “Many of the loans involved were originated by subprime lenders, like New Century and IndyMac, bundled into bonds and sold to Fannie and Freddie. One group of loans had default and delinquency rates as high as 70 percent, according to the lawsuit.” (PTX 2485 at 1).

(b) Geithner concluded that Morgan Stanley had taken excessive risks. (Geithner: Trial Tr. 1675:4-8).

31.1.6 No claims of fraud or other misconduct have been brought by the DOJ against AIG regarding AIG’s actions in the years leading up to or during the financial crisis. (Paulson: Trial Tr. 1236:17-24).

31.2 The Ratings Agencies that reviewed and rated CDS products and mortgage-backed securities misled investors and other market participants, like AIG.

(a) The Financial Crisis Inquiry Commission: The “rating process involved many conflicts, which would come into focus during the crisis.” (PTX 624 at 146-47).

(b) Bernanke: “Rating agencies’ ratings of asset-backed securities were revealed to be subject to conflicts of interest and faulty models.” (PTX 650 at 8).

(c) Geithner: “Since the issuers rather than the purchasers of securities paid them, they had some incentive to give generous ratings that kept issuers happy. Moody’s revenue from rating structured products such as CDOs had risen 800 percent in a decade.” (PTX 709 at 152).

(d) Defendant agrees that, between 2004 and 2007, Standard & Poor’s, one of the major credit rating agencies, “knowingly and with the intent to defraud, devised, participated in, and executed a scheme to defraud investors in RMBS and CDO tranches, including federally insured financial institutions, as to material matters, and to obtain money from these investors by means of material false and fraudulent pretenses, representations, and promises, and the concealment of material facts. . . . S&P’s desire for increased revenue and market share in the RMBS and CDO ratings markets led S&P to downplay and disregard the true extent of the credit risks posed by RMBS and CDO tranches in order to favor the interests of large investment banks and others involved in the issuance of RMBS and CDOs who selected S&P to provide credit ratings for those tranches.” (PTX 661 at 3-4).

(e) Defendant filed a civil complaint against Standard & Poor’s on February 4, 2013, seeking civil penalties for fraud. (PTX 661 at 1).

(f) Defendant has entered into a \$1.375 billion settlement agreement with Standard & Poor’s (and 19 states and the District of Columbia) to resolve its claims. (Press Release, Dep’t of Justice, “Justice Department and State Partners Secure \$1.375 Billion Settlement with S&P for Defrauding Investors in the Lead Up to the Financial Crisis,” *available at* <http://www.justice>.

gov/opa/pr/justice-department-and-state-partners-secure-1375-billion-settlement-sp-defrauding-investors)).⁹⁰

(g) In late 2014 and early 2015, the Department of Justice “met with multiple former executives of Moody’s Investors Service to discuss ratings of complex securities before the crisis”. State and federal law-enforcement officials have said “they weren’t necessarily stopping with S&P and were weighing potential action against Moody’s, too.” (Timothy Martin, “U.S. Probes Moody’s On Precrisis Ratings,” Wall Street Journal (February 1, 2015), *available at* http://www.wsj.com/article_email/SB21202435268869774069104580435980906993308-1MyQjAyMTE1MjAwMjIwNDIzWj).

(h) Cragg: The rating agencies played a role in the collateral substitution of later vintage RMBSs into the CDOs that AIG insured because “the structured rating of asset-backed securities over this period was often – and increasingly so – done on a collaborative basis with the rating agencies, as opposed to more of an arm’s length basis.” (Cragg: Trial Tr. 5513:23 – 5514:5; *see also* PTX 5391 (Cragg demonstrative)).

31.2.1 “AIG did not itself originate or package or market subprime backed securities”. (Paulson: Trial Tr. 1236:25 – 1237:2). Instead, “What AIG did was sometimes purchase those and sometimes offer to kind of protection that we’ve loosely referred to as insurance or credit default swaps”. (Paulson: Trial Tr. 1237:3-7).

31.3 AIG, like other investors and like the Federal Reserve, also relied on the ratings given subprime mortgage-backed securities by ratings agencies.

31.3.1 Between 2004 and 2007, AIG, together with many global investors, including other financial institutions and insurance companies, relied on third-party credit ratings in

⁹⁰ Plaintiffs respectfully request that the Court take judicial notice of Defendant’s settlement discussions with Standard & Poors pursuant to Federal Rule of Evidence 201.

making decisions to invest in the AA and AAA rated tranches of subprime RMBS and ABS CDOs.

(a) Defendant in its Report on behalf of the President's Working Group on Financial Markets: "The subprime RMBS and the ABS CDOs were structured in tranches and a very large share of the total value of the securities issued was rated AA or AAA by the credit rating agencies." (PTX 11 at 10; Agreed to Stipulations ¶ 38). "Many of the global investors in the AA or AAA tranches relied heavily on the ratings in making investment decisions or in communicating risk appetites to their investment managers". (PTX 11 at 10; *see also* PTX 583 at 34 (Paulson making a substantially similar statement)).

(b) AIG's securities lending cash collateral investment policy required that 95% of its asset backed securities be invested in transactions that were rated AAA or Aaa. (Schreiber: Trial Tr. 6815:22 – 6817:18).

(c) The Financial Crisis Inquiry Commission: "The rating agencies were essential to the smooth functioning of the mortgage-backed securities market. Issuers needed them to approve the structure of their deals; banks needed their ratings to determine the amount of capital to hold; repo markets needed their ratings to determine loan terms; some investors could buy only securities with a triple-A rating; and the rating agencies' judgment was baked into collateral agreements and other financial contracts." (PTX 624 at 146).

(d) Bernanke: "At the end of the chain were investors who often relied mainly on ratings and did not make distinctions among AAA-rated securities." (PTX 650 at 8).

(e) New York Insurance Superintendent Eric Dinallo: AIG's securities lending "program was invested almost exclusively in the highest-rated securities. Even the few securities that were not top rated, not triple A, were either double A or single A". (PTX 449 at 62).

31.4 AIG, like other investors and like the Federal Reserve itself, relied on the representations and disclosures of the financial institutions that originated and sold the subprime mortgage-backed securities for which AIGFP offered protection and in which AIG's securities lending business invested.

(a) 72% of the CDOs that were placed in Maiden Lane III were listed in Defendant's fraud prosecutions and settlements. (Cragg: Trial Tr. 5100:8-12; PTX 5365 (Cragg demonstrative)).

(b) 60% of the RMBS securities placed in Maiden Lane II were listed in Defendant's fraud prosecutions and settlements. (PTX 5365; *see also* PTX 2734 at 83-113 (Annex 4 to DOJ and Bank of America Settlement Agreement (8/21/2014)); PTX 2527 at 52-60 (Annex 3 to DOJ and Citigroup Settlement Agreement (7/14/2014)); PTX 2473 at 44-57 (Annex 3 to DOJ and JPMorgan Settlement Agreement (11/19/2013))).

31.5 AIG, like other investors and like the Federal Reserve, relied on the expected liquidity of subprime mortgage-backed securities in making decisions.

(a) Cragg: "The other big impact was that the fall in housing prices filtered throughout the securities that were created to package up the loans for distribution, and that had an impact on both those who were buying those securities for the long term, but most importantly, those securities were playing the role of money. So, they were – they actually were being traded back and forth between investment banks and commercial banks, as well as their clients, and they were being treated as money. The fact that they changed from being money ultimately caused great angst in the world of investment banking, because it caused a great deleveraging and a – you know, a flight to quality that sucked the liquidity out of the system." (Cragg: Trial Tr. 4943:18 – 4944:25).

(b) The President's Working Group on Financial Markets (March 2008): "The seizing up of structured credit markets and the contraction of ABCP markets imposed significant liquidity pressures on many of the largest U.S. and European financial institutions. These firms

were the leading underwriters of non-agency RMBS and of ABS CDOs. When the structured credit markets shut down, the firms were left holding mortgages and RMBS that could not be sold off.” (PTX 11 at 11).

31.5.1 These third-party credit ratings later proved to be inaccurate and led to eventual downgrades by the ratings agencies.

(a) Geithner: “The AAA label ended up being very misleading. The rating agencies were not exceedingly competent. Their ratings typically lagged cycles in finance, staying too optimistic too long.” (PTX 709 at 152).

(b) Bernanke: The rating agencies also “bear some blame for rating these structured credit products AAA even though they turned out to be bad.” (Bernanke: Trial Tr. 2181:24 – 2182:19).

(c) Defendant in its report from the President’s Working Group on Financial Markets concluded that:

(i) “Credit rating agencies contributed significantly to the recent market turmoil by underestimating the credit risk of subprime RMBS and other structured credit products”. (PTX 11 at 16).

(ii) A cause of turmoil in the financial markets was “flaws in credit rating agencies’ assessments of subprime residential mortgage backed securities (RMBS) and other complex structured credit products, especially collateralized debt obligations (CDOs) that held RMBS and other asset backed securities (CDOs of ABS)”. (PTX 11 at 3).

(iii) “Faulty assumptions underlying rating methodologies and the subsequent re-evaluations by the credit rating agencies (CRAs) led to a significant number of

downgrades of subprime RMBS, even of recently issued securities. Downgrades were even more frequent and severe for CDOs of ABS with subprime mortgage loans as the underlying collateral.” (PTX 11 at 4).

(d) Defendant’s expert Saunders conceded that “institutional investors who invested in residential mortgage-backed securities relied on credit ratings” “up to the crisis”. (Saunders: Trial Tr. 8382:16-20). There “came a time when people concluded that the rating agencies’ ratings were not reliable”, “I think after they started to lose a lot of money on the RMBSs they decided that the rating agencies had overrated the securities.” (Saunders: Trial Tr. 8382:16 – 8383:1). “And that loss of confidence in the rating agencies’ ratings caused still greater uncertainty about the value of the RMBS-backed securities”. (Saunders: Trial Tr. 8383:15-18).⁹¹

32.0

MANY FINANCIAL INSTITUTIONS THAT ENGAGED IN MUCH RISKIER AND MORE CULPABLE CONDUCT THAN AIG RECEIVED GOVERNMENT ASSISTANCE WITHOUT THE PUNITIVE EQUITY CONFISCATION REQUIRED OF AIG.

32.1 AIG experienced liquidity issues due to the market-wide liquidity crisis, not because of irresponsible *ex ante* risk-taking.

32.1.1 Due to the market-wide financial crisis, AIG was forced to recognize tens of billions of dollars in accounting losses in 2007 and 2008 due to the application of mark-to-market accounting rules, even though AIG’s mortgage backed securities were still “performing” and AIGFP’s CDS contracts had not “sustained an actual loss.” (PTX 649 at 26; PTX 625 at 4).

⁹¹ Although Saunders criticized the investment decisions of AIG, he did not know with “respect to the RMBSs purchased by the securities lending program at AIG,” “how many of those securities were later charged by the United States government as having been marketed fraudulently”. (Saunders: Trial Tr. 8390:3-9). Nor did he look into whether AIG “made some claims” “against a number of underwriters regarding fraudulent underwriting.” (Saunders: Trial Tr. 8390:10 – 8391:1).

32.1.2 Before the worsening of the market panic in 2008, AIG had sufficient liquidity.

(a) AIG had “exceptionally good results” in 2006 and early 2007. (Willumstad: Trial Tr. 6481:6-10).

(b) “As of December 31, 2007, AIG’s market capitalization was more than \$147 billion.” (Agreed to Stipulations ¶ 48).

(c) AIG reported approximately \$100 billion in revenue from its insurance operations in 2006 and \$105 billion in 2007. Its non-insurance operations reported \$13 billion and \$5 billion in those same years, respectively. (Agreed to Stipulations ¶ 24).

(d) AIG 3Q 2008 10-Q (filed November 10, 2008): “Through June 30, 2007, AIGFP had not received any collateral calls related to this credit default swap portfolio.” (JX 150 at 129; *accord* Agreed to Stipulations ¶ 45).

(e) November 7, 2007 PWC Audit Team Memo: “Based on the portfolio to date, AIGFP has never paid out on any Super Senior transactions.” (PTX 1066 at 10; *see also* Farnan: Trial Tr. 4195:6-19 (affirming that this statement was consistent with PwC’s understanding)).

32.1.3 After the market panic began to worsen in 2008, AIG began to experience liquidity issues due to the absence of reliable market prices on the CDOs protected by AIGFP’s multi-sector CDS.

(a) Toward the end of 2007, “when the market for the underlying bonds that were protected by CDSs that AIG had issued froze, the accounting rules required AIG to ‘mark-to-market’ the value of its swaps”. (Willumstad: Trial Tr. 6484:15 – 6485:1). There was no market at that time, so the accounting rules were being applied in an “unprecedented situation”. (Willumstad: Trial Tr. 6485:2-8). “And applying the accounting rules in this unprecedented

situation forced AIG to recognize tens of billions of dollars in accounting losses” in the “first two quarters of 2008 and the last quarter of 2007”. (Willumstad: Trial Tr. 6485:9-21; *see also* Willumstad: Trial Tr. 6485:22 – 6486:1 (“the reason that AIG was forced to recognize these tens of billions of dollars in accounting losses was the application of the mark-to-market accounting rules to AIG’s business”)).⁹²

(b) Smith: “AIG recognized significant mark-to-market losses, which, again, I think was a major issue for AIG and everybody else who was, in my opinion, using mark-to-market accounting inappropriately at that point in time.” (Smith: Trial Tr. 7697:7-13).

(c) But in 2008 transactional activity in the over-the-counter derivatives market and the markets for RMBS and mortgage-backed securities “would undergo an unprecedented contraction, creating serious problems for hedging and price discovery.” (PTX 624 at 328). As a result, market participants, including AIG and AIGFP, found it difficult to derive fair market values for the securities. (PTX 624 at 300; PTX 221 at 4).

(d) Offit: “Well, you had, as I said, a marketplace in complete disarray, something that hadn’t happened certainly during my lifetime and I’ve been in the business for 55 years.... As to the bond market, dealers don’t have to deal.” (Offit: Trial Tr. 7378:11-24).

32.1.4 As late as September 2008, the mortgage-backed securities held by AIG were still “performing,” and the multi-sector CDOs protected by AIGFP’s CDS portfolio had not “sustained an actual loss.” (PTX 449 at 26; PTX 625 at 4).

⁹² The ‘mark-to-market’ is the key phrase here because under FASB they – the – as you’re familiar with that, the financial institutions have to mark-to-market their inventory, so the marks on mortgage securities were all over the place. On any one day you could have three dealers bidding on bonds and one would bid 50, another bid 70 and another bid 80, and you had to take the lesser of the – or the two of the three. I forget. But you had to basically mark it on the lowest price. And that is what is reflected in your assets and your bond holdings, so that’s why I say you’re in effect eroding the value of your assets every day because you have a paralyzed bond market.” (Offit: Trial Tr. 7378:11 – 7379:16).

(a) Indeed, at the time AIG was forced to recognize tens of billions of dollars in losses, “the vast majority of securities underlying those swaps were still paying and still rated investments grade or better by the rating agencies”. (Willumstad: Trial Tr. 6486:2-10).

(b) Thus, despite its accounting losses, AIG announced in its February 28, 2008 8-K that: “Based upon its most current analyses, AIG believes that any credit impairment losses realized over time by AIGFP will not be material to AIG’s consolidated financial condition, although it is possible that realized losses could be material to AIG’s consolidated results of operations for an individual reporting period.” (JX 9 at 5; *see also* Offit: Trial Tr. 7917:25 – 7918:20 (“That’s an accurate portrayal. Absolutely.”)). “AIG expects AIGFP’s unrealized market valuation losses to reverse over the remaining life of the super senior credit default swap portfolio.” (JX 9 at 5; *see also* Willumstad: Trial Tr. 6489:4-11 (that is something that Willumstad “and the AIG Board believed was true at the time that JX 9 was filed”); Offit: Trial Tr. 7918:21 – 7919:4 (“Fair statement.”)).

(c) Likewise, “BlackRock believed that if AIG continued to hold its positions to maturity, AIG would be financially better off than if it sold them at the then current market prices”. (Willumstad: Trial Tr. 6489:4-19).

32.1.5 The collateral calls AIGFP was facing were based on artificially depressed prices driven in part by lack of information, which in turn led to indiscriminate liquidity flight and market failure.

(a) AIG Meeting Notes, September 12, 2008 from Mosser to Geithner, Madigan, Dudley, Dahlgren, McConnell, Baxter, and others: “One of the challenges they are already facing is very aggressive marks from counterparties and strategic unwinding of ‘in the money’

positions, and this will likely accelerate in coming days adding to the cash drain.” (PTX 42 at 2).

(b) Farnan: “At this particular time, the markets were in – were challenged, shall we say, so the ability – you couldn’t go find similar transactions in the marketplace, you certainly couldn’t pick up the Wall Street Journal, so there’s a lot of judgments in determining the individual values of individual securities.” (Farnan: Trial Tr. 4197:15 – 4198:8).

(c) PwC memo: “As discussed in PwC’s report to the Audit Committee on ‘Accounting and Valuation Considerations Relating to AIG’ dated October 4, 2007, **the estimation of the fair value of these CDS is highly judgmental.** Specifically, the customized nature of each CDS (i.e., no two transactions are alike) and **the limited amount of reliable observable market information to similar transactions at December 31, 2007 have posed significant challenges for market participants.**” (DX 100 at -080 (emphasis added)).

(d) Paulson: “Like a tainted food scare, a relatively small batch of deadly products secured by subprime mortgages led to fear and panic in the markets for many mortgage securitizations, driving down the price of assets which triggered huge losses and severe liquidity problems.” (PTX 583 at 9-10).

(e) Geithner: “As the crisis escalated, markets continued to run from mortgage assets that looked toxic, and as investors shunned them, they became toxic”. (PTX 709 at 154).

(f) The September 19, 2008 SEC Short Selling Ban Press Release: “At present, it appears that unbridled short selling is contributing to the recent, sudden price declines in the securities of financial institutions unrelated to true pricing valuation. Financial institutions are particularly vulnerable to this crisis of confidence and panic selling because they depend on the confidence of their trading counterparties in the conduct of their core business.” (PTX 168 at 1;

see also Cragg: Trial Tr. 5137:14-23; PTX 5331 (Cragg demonstrative) (PTX 168 is “a clear statement about where the market was in September, and it also is a synthesis of the downward spiral that I’ve talked about where you have fire sale prices, you know, I should say collateral calls leading to fire sales prices leading to more collateral calls, and so on, that cycle is one of the hardest to stop in a panic, and that’s what started back at the beginning of the year and that the government was struggling to bring to – bring to a close.”)).

(g) Cragg: “my primary conclusion is that the amount of collateral that AIG was required by its counterparties to post way exceeded any reasonable estimate of the actual risk of nonpayment on the CDS contracts.” (Cragg: Trial Tr. 5016:22 – 5017:10).

(h) Absent the artificially depressed prices evidenced by BlackRock’s projections, as of the end of September 2008, the amount AIG would have had to post as collateral would have been lower by approximately \$19 billion based on BlackRock’s stress-case projections. (*See* PTX 266 at 3 (BlackRock intrinsic-value projections from 9/29/2008); PTX 2857 at 92-94, App’x B, ¶ 108 & Table 5 (Cragg Rebuttal Report, calculating a \$12.6 billion stress-case collateral posting based on BlackRock’s intrinsic-value estimation); PTX 2856 at 320, Table 53 (Cragg Expert Report, demonstrating AIG’s collateral posts as of 9/29/2008 were \$31.45 billion)).

32.1.6 Compared to other financial firms, AIG was not highly leveraged.

32.1.6.1 Many systemically important institutions were highly leveraged.

(a) The Financial Crisis Inquiry Commission: “In the years leading up to the crisis, too many financial institutions, as well as too many households, borrowed to the hilt, leaving them vulnerable to financial distress or ruin if the value of their investments declined even modestly. For example, as of 2007, the five major investment banks – Bear Stearns, Goldman

Sachs, Lehman Brothers, Merrill Lynch, and Morgan Stanley – were operating with extraordinarily thin capital. By one measure, their leverage ratios were as high as 40 to 1, meaning for every \$40 in assets, there was only \$1 in capital to cover losses. Less than a 3 % drop in asset values could wipe out a firm.” (PTX 624 at 19; *see also* PTX 5306).

(b) Dr. Mosser agreed with the assessment of her colleague at FRBNY in PTX 2727 that in January 2009 Bank of America Corp.’s (“BAC”) “loss coupled with Citigroup’s loss (announced this morning) brings the banking system to an uncomfortable intersection of size and leverage: the two largest balance sheets accounting for roughly 40% of the industry’s assets are also the two most levered from a tangible common equity perspective (BAC at 2.6%, Citigroup below 2%).” (PTX 2727; *see also* Mosser: Trial Tr. 1273:25 – 1274:12 (agreeing “that both Bank of America and Citigroup’s capital ratios were low, very low, and that they were in quite dire straits in terms of how much capital they had”); PTX 2727 (Referring to the “insufficient bank equity” at Bank of America and Citigroup, Mosser responds that the Federal Reserve might nationalize the banks); Mosser: Trial Tr. 1275:2-8)).

32.1.6.2 From 2005-2007, AIG’s leverage ratio was lower than other systemically important financial institutions. (PTX 2856 at 298, Table 44 (Cragg Expert Report)).

(a) Cragg: “For AIG, in 2005, 2006 and 2007 – so I’m looking at this on, you know, an ex ante before basis, before the financial crisis occurs – it’s, you know, 4.3, 4.7 and 6.4 in 2007. When you compare that to a variety of other financial institutions, you know, large conglomerate financial institutions, it has a, you know, *lower leverage than, let’s say, Bank of America, Citigroup, Goldman Sachs, JPMorgan, Lehman Brothers or Morgan Stanley.*” (Cragg: Trial Tr. 5037:16 – 5038:8 (emphasis added); PTX 5337 (Cragg demonstrative)). AIG

“looked like, you know, very much like a, you know, traditional bank or insurance company.”
(Cragg: Trial Tr. 5037:12-15).

32.1.7 Independent estimates of the intrinsic or fair market value of securities protected by AIG showed that collateral already posted exceeded the reasonable collateral requirements created by these securities.

(a) According to BlackRock, an independent advisor working on behalf of AIG: “Collateral posted to counterparties under the CDS in the portfolio is over \$29 billion, far in excess of the projected net cash flows in BlackRock’s stressed case.” (PTX 266 at 3; *see also* PTX 1675 at 4 (same)). BlackRock estimated that AIG’s projected net cash flows for the life of the CDS contracts, discounted at LIBOR, ranged between negative \$7.3 billion in a base case and negative \$15.2 billion in a stress case. (PTX 266 at 3; PTX 1675 at 4 (same)).

(b) Cragg: Ex-post cash flow data confirms the accuracy of BlackRock’s projections. (Cragg: Trial Tr. 5021:23 – 5023:9; PTX 5329 (Cragg demonstrative)). “When you compare that to the cash flow projections that BlackRock made, so their base case is slightly below that, they expected the cash flow projections to be about \$15.7 billion short of what the bonds were contracted to pay. And then in their stress scenario, the shortfall cash that’s being generated by the CDOs relative to their contract amounts is \$23.5 billion. So it turns out that BlackRock, you know, did a very impressive job of projecting what the actual cash flows have looked like.” (Cragg: Trial Tr. 5022:15 – 5023:9; PTX 5329 (Cragg demonstrative)). Cragg determined that CDS cash flows based on actual CDO performance from August 2008 through December 2013 was \$16.6 billion dollars. (Cragg: Trial Tr. 5022:5-18; PTX 5329 (Cragg demonstrative)).

(c) Cragg: At the end of September 2008, “The notional value of the AIG multi-sector CDO CDS portfolio was at this point in time \$77.1 billion”. (Cragg: Trial Tr. 5020:9-12; PTX 5328 (Cragg demonstrative)). In its base case, BlackRock, an investment management service hired by AIG, then eventually FRBNY, estimated the value of AIG’s CDS portfolio at \$69.8 billion, implying a \$7.3 billion loss in the event AIG was required to purchase all the bonds from its counterparties. (Cragg: Trial Tr. 5020:19-25; PTX 5328 (Cragg demonstrative)). In its stress case, BlackRock estimated that AIG’s CDS portfolio would be worth \$61.9 billion, implying a \$15.2 billion loss. (Cragg: Trial Tr. 5021:1-6; PTX 5328 (Cragg demonstrative)). By September 2008, “AIG had already posted 36.9 billion dollars” in collateral (Cragg: Trial Tr. 5021:11-14; PTX 5328 (Cragg demonstrative)), and “that implied that the portfolio was only worth 40.2 billion” (Cragg: Trial Tr. 5021:11-17; PTX 5328 (Cragg demonstrative)), such “that there would be a loss of 36.9 billion on it.” (Cragg: Trial Tr. 5021:18-22; PTX 5328 (Cragg demonstrative)).

(d) BlackRock’s estimates were not optimistic, with actual cash outflows on AIG’s multi-sector CDS to date approximately equal to BlackRock’s base case and substantially lower than BlackRock’s stress case. (PTX 2857 at 95-98, 117-136, App’x B, ¶¶ 111-113, & Ex. R-1 (Cragg Rebuttal Report)).

(e) Cragg: “if you look at, for instance, AIG’s stock price during this period, it was very much that uncoupling of intrinsic value from panic pricing.” (Cragg: Trial Tr. 5137:24 – 5138:18; PTX 5331 (Cragg demonstrative)).

32.1.8 In fact, AIG did not take excessive risk from an *ex ante* standpoint.

(a) Scott Polakoff, Acting Director, Office of Thrift Supervision: “AIGFP’s role was not underwriting, securitizing, or investing in subprime mortgages.” (PTX 449 at 58).

(b) Polakoff: “AIG’s credit default swaps were protecting against credit losses on the highest rates, super-senior, AAA-rated tranche of collateralized debt obligations. This segment of the securitization poses the least credit risk. In fact, as of September 30 of 2008, there have been no actual realized credit losses from the underlying CDOs.” (PTX 449 at 12).

32.1.8.1 AIGFP’s CDS portfolio was diversified.

(a) AIGFP’s overall CDS portfolio “is diversified. It’s not all invested in multi-sector CDS.” (Cragg: Trial Tr. 5012:2-12; PTX 5325 (Cragg demonstrative); PTX 5326 (Cragg demonstrative)).

(b) Willumstad: “Approximately \$400 billion” of AIGFP’s \$500 billion CDS portfolio “was against European banks, and there was about \$80 billion of credit default swaps that were written against mortgage-backed securities.” (Willumstad: Trial Tr. 6329:15 – 6330:11).

(c) Cragg: “The largest portion of the CDS portfolio was for what are called regulatory capital arbitrage CDS. And when you look at the history of that and the corporate arbitrage portfolio, neither of those had, you know, substantial losses. Through September 2008, both those – you know, the major part of AIG’s CDS portfolio had lost \$400 million. Q. Now, \$400 million sounds like a lot of money, but that compares to regulatory capital of \$307 billion; is that correct? A. Yes.” (Cragg: Trial Tr. 5012:13-5013:8).

32.1.8.2 AIGFP’s CDS portfolio was a small part of its overall exposure.

(a) As of September 2008, AIGFP’s Multi-Sector CDS Portfolio accounted for approximately 3% of the notional value of AIGFP’s total credit and non-credit derivatives exposure, and less than 20% of AIGFP’s total credit derivatives portfolio. (PTX 589 at 31-32).

(b) AIGFP's multi-sector CDS portfolio "was limited to 20 percent of the overall notional value" of AIGFP's overall CDS portfolio. (Cragg: Trial Tr. 5012:2-16; PTX 5325 (Cragg demonstrative); PTX 5326 (Cragg demonstrative)).

(c) "the overall portfolio that AIGFP held was \$411 billion and the multi-sector CDOs represent \$80 billion of that total portfolio of 18 percent." (Cragg: Trial Tr. 5012:17-22; PTX 5325 (Cragg demonstrative); PTX 5326 (Cragg demonstrative)).

32.1.8.3 AIGFP's CDSs were written to a no-loss standard even under recessionary scenarios.

(a) OTS Acting Director Scott Polakoff: "AIGFP's procedures required modeling based on simulated periods of extended recessionary environments (i.e., ratings downgrade, default, loss, recovery). Up until June 2007, the results of the AIGFP models indicated that the risk of loss was a remote possibility, even under worst-case scenarios. The model used mainstream assumptions that were generally acceptable to the rating agencies, PwC, and AIG." (PTX 449 at 59).

(b) Cragg: AIG had constructed its "portfolio so that it was a low-risk portfolio. It was designed so that it wasn't going to, you know, make payments even looking at the most stressed of scenarios over the last half century. And in fact, it didn't actually have any, you know, events of default until well into 2008. And then perhaps most importantly, it wasn't until September 30, 2007 did you have any collateral calls that were being made on the CDS contracts. And so even though there was concern about the pricing of the underlying bonds, you know, as the financial crisis started, it wasn't until into 2008 that AIG had to start making – posting collateral on these contracts." (Cragg: Trial Tr. 5013:9 – 5014:1; PTX 5325 (Cragg demonstrative)).

32.1.8.5 AIGFP only sold CDS on super senior CDOs.

(a) November 7, 2007 PWC Audit Team Memo: “AIGFP as a core part of its business writes credit default swaps on portfolios of reference obligations to a variety of market counterparties on a second loss basis. These transactions have levels of subordination as noted by management that are designed to never suffer economic loss even under recessionary scenarios.” (PTX 1066 at 1; *see also* Farnan: Trial Tr. 4367:22 – 4369:2 (PwC would have “examined management’s assertion to see whether there was evidence to the contrary” “in the context of valuing these securities at fair value.”)).

(b) Cragg: “AIG only sold CDS on super senior CDOs. So, you couldn’t get insurance on a AAA bond or a single A bond from – from AIG.” (Cragg: Trial Tr. 4965:2-4). The monoline insurers “were willing to insure lower quality CDOs than AIG was.” (Cragg: Trial Tr. 4964:22 – 4965:7).

(c) Cragg: AIG did two things when negotiating its CDS contracts to limit its risk: “One is, it, you know, tried to ensure that the cushion that lay below the super senior CDO was large, so it was trying to make the share of the cash flows that go to the super senior – you now, just making that share smaller so that any losses get suffered in the tranches below.” (Cragg: Trial Tr. 5008:3-22). “In negotiating the attachment point, AIG was stressing the cash flows so that in all but the most extreme circumstances, using the post-war period, that in all those circumstances AIG would not lose money”. (Cragg: Trial Tr. 5008:25 – 5009:9); PTX 1066 at 2 (“stressed to be set at the worst post World War II recessionary scenario”). AIG’s CDS contracts also contained additional provisions to mitigate AIGFP’s exposure. (Cragg: Trial Tr. 5010:8 – 5011:15; PTX 5325 (Cragg demonstrative)).

32.1.8.6 Defendant's expert had no basis for opining on the risk of AIG's multi-sector CDS portfolio and securities lending program.

(a) "In January 2006 and continuing throughout 2006," "for the AAA and the super senior tranche of subprime mortgage-backed securities, the market in 2006 was a highly liquid market". (Saunders: Trial Tr. 8381:1-20).

(b) Saunders never looked "for the volume or the degree of liquidity for senior and AAA tranches of residential mortgage-backed securities". (Saunders: Trial Tr. 8382:10-15).

(c) Saunders did not know that "as of September 30, 2008, there had been no actual realized credit losses from the underlying CDOs that were the subject of AIG-issued swaps". (Saunders: Trial Tr. 8384:4-10).

(d) "Up until June of 2007, the results of AIGFP's models indicated that the risk of loss was a remote possibility even under worst-case scenarios". (Saunders: Trial Tr. 8384:11-14).

(e) AIG September 29, 2008 Report: "Through week of 9/10/2008, AIG's securities lending program operated normally while building significant cash position." (PTX 1679 at 7). Saunders had not seen the report prior to being shown on cross-examination. (Saunders: 8389:1-18).

(f) Saunders did not know "With respect to the RMBSs purchased by the securities lending program at AIG," "how many of those securities were later charged by the United States government as having been marketed fraudulently." (Saunders: Trial Tr. 8390:3-9). Nor did he look into whether AIG "made some claims" "against a number of underwriters regarding fraudulent underwriting." (Saunders: Trial Tr. 8390:10 – 8391:1).

32.1.8.7 AIG's revenues on its securities lending business show on an *ex ante* basis that AIG did not take excessive risk:

(a) Cragg: "the pricing of these transactions reflects the level of risk that was being taken, which on an *ex ante* basis – was small." (Cragg: Trial Tr. 5497:20 – 5498:6). AIG's revenues from securities lending in the 2005, 2006, 2007 period were ranged "from about 10 to 20 basis points per dollar outstanding." (Cragg: Trial Tr. 5496:11-20).

32.1.8.8 AIG was well capitalized and properly reserved throughout 2007:

(a) In 2007, when Willumstad first became aware of the possibility of counterparty collateral calls with respect to AIG's CDS business, Willumstad and the AIG Board considered "it a relatively small issue relative to the size of AIG". (Willumstad: Trial Tr. 6480:23 – 6481:5). Willumstad believed "that AIG was well-capitalized and properly reserved" at this time. (Willumstad: Trial Tr. 6481:11-14).

(b) At the time AIG began to raise capital in 2008, Offit believed that "AIG was prudently managing its liquidity and capital needs". (Offit: Trial Tr. 7917:4-13).

(c) October 23, 2007 AIG credit risk committee memo: "Collateral pool cash on hand accounted for 15% of the overall pool as of September 19, 2007. It currently stands at 19% and is projected to reach 20% in the near future. The absolute level of overnight cash investments increased from over \$2 billion at August 1, 2007 to \$18 billion as of September 28, 2007." (PTX 1060 at 1).

(d) "AIG survived longer without liquidity support than other financial institutions," including Citigroup, Goldman Sachs, Lehman Brothers, and Morgan Stanley. (Cragg: Trial Tr. 5061:6 – 5062:15). As of September 30, 2008, AIG was receiving less government support than Bank of America, Citigroup, JPMorgan and Morgan Stanley. (Cragg: Trial Tr. 5062:16 –

5063:4; PTX 5352-A (Cragg demonstrative); *see also* PTX 2857 at 43, 152-71, Ex. R5 & Table 2 (Cragg Rebuttal Report)).

32.1.9 Defendant overstates the ex ante risk of AIGFP’s super senior multi-sector CDS portfolio.

(a) Although Saunders, relying on DX 1356, testified that \$64 billion of AIGFP’s \$79 billion super senior multi-sector CDS portfolio had exposures to “mixed collateral including subprime” (Saunders: Trial Tr. 8074:8 – 8075:18), Saunders omitted the fact that the document he relied upon shows that the portfolio was exposed to only \$26.3 billion of subprime collateral. (*See* DX 1356 at 29; DX 2705).

32.1.10 AIG began addressing potential liquidity issues as early as 2007 and continued to do so throughout 2008.

32.1.10.1 In 2007, “AIG recognized that there were possible liquidity issues and had begun work to try to make sure that AIG behaved in a prudent way”. (Willumstad: Trial Tr. 6477:13-17; *see also* DX 939 at 99 (AIG 2007 10-K); *see also* DX 1361 at 130 (AIG 10-Q for 3Q 2007); Cragg: Trial Tr. 5014:2-16; PTX 5327 (Cragg demonstrative)).

(a) AIG formed a liquidity risk committee to “prepare for stress scenarios in the current marketplace”. (Cragg: Trial Tr. 5014:21 – 5015:8; PTX 5327; *see also* Willumstad: Trial Tr. 6477:13-24 (“AIG established a company-wide liquidity risk committee” in an effort “to try to build liquidity starting in 2007”); DX 939 at 99; DX 1361 at 130 (AIG 10-Q for 3Q 2007)).).

(b) Starting in the third quarter of 2007, AIG worked with state insurance regulators to reduce the size of its securities lending portfolio “in a gradual manner” (PTX 500 at 1-2; *see*

also Willumstad: Trial Tr. 6480:9-22). AIG “started to reduce the size of its securities lending portfolio that had been invested in RMBS” (Cragg: Trial Tr. 5015:24 – 5016:1; PTX 5327).

(c) AIG began to undertake efforts to raise additional capital from the private market. (Cragg: Trial Tr. 5016:6-18; PTX 5327).

(d) In AIG’s 2007 10-K, it informed investors and the market: “As a result of market disruption in the credit markets, AIG took steps to enhance the liquidity of its portfolios. Cash and short-term investments increased in all of AIG’s major operating segments. In addition, AIG created an interdisciplinary Liquidity Risk Committee to measure, monitor, control and aggregate liquidity risks across AIG.” (DX 939 at 99).

32.1.10.2 In 2008, AIG was “aware of the liquidity, the severity, beginning in January of 2008, which resulted in our going to the open market to raise some \$20 billion in equity capital”. (Offit: Trial Tr. 7338:15 – 7339:4).

(a) AIG 10-Q for 3Q 2008: “In light of the ongoing significant effects the disruption in the U.S. housing and credit markets is having on AIG’s results, AIG is planning to raise additional capital to fortify its balance sheet and increase financial flexibility.” (JX 21 at 42).

(b) AIG 8-K filed May 8, 2008: “the continuation of the weak U.S. housing market, the disruption in the credit markets, as well as equity market volatility, had a substantial adverse effect on its results for the first quarter ended March 31, 2008.” (JX 19 at 5).

(c) “In May 2008, AIG raised approximately \$20 billion in new capital by issuing a mix of common stock, equity units, and junior subordinated debentures.” (Agreed to Stipulations ¶ 56); *see also* Willumstad: Trial Tr. 6481:15-18 (“As part of the attempt to increase potential liquidity reserves, AIG raised \$20 billion in capital in May of 2008”); Willumstad: Trial Tr. 6340:7-11 (AIG raised “Slightly over \$20 billion” in private capital in

May of 2008); Cragg: Trial Tr. 5016:15-18 (“In May 2008, AIG raised \$20 billion and then again on August 18, 2008, AIG raised another \$3.25 billion”); PTX 5327 (Cragg demonstrative)). That “was the largest private capital raise in history as of that time”. (Willumstad: Trial Tr. 6481:15-22; *see also* PTX 587 at 113-14 (Willumstad: “Going back in May of 2008, AIG raised \$20 billion of capital which at the time I think was the largest capital raise ever done.”)).

(d) As of July 16, 2008, “Approximately \$12.3 billion remains from the capital raise and, when combined with other sources of liquidity, provides a cushion except in the most extreme scenarios.” (PTX 1408 at 2; Willumstad: Trial Tr. 6482:6 – 6483:2 (that is what Willumstad and the AIG Board believed as of the middle of July 2008)).

(e) Despite this liquidity cushion, “through July and August of 2008”, Willumstad “and AIG worked to further strengthen AIG’s balance sheet to be prepared in case a crisis arose”. (Willumstad: Trial Tr. 6483:11-16). “On August 18, 2008, AIG raised \$3.25 billion through the issuance of 8.25% Notes Due 2018.” (JX 188 at 3, 56; *see also* Agreed to Stipulations ¶ 66; *accord* Willumstad: Trial Tr. 6349:20 – 6350:1). Among other things, AIG undertook to “identify certain nonstrategic businesses, retain financial advisors and begin the process of selling those businesses to raise cash”. (Willumstad: Trial Tr. 6483:11-20). “To conserve cash,” AIG also decided to “stop discussion relating to a number of acquisitions” that it had been contemplating. (Willumstad: Trial Tr. 6483:21-24). AIG also started to “develop and implement an aggressive plan to further reduce expenses”. (Willumstad: Trial Tr. 6483:25 – 6484:2).

(f) In early August 2008, PwC knew that AIG was “looking at liquidity, but we did not think it rose to the level of concern that required disclosure”. (Farnan: Trial Tr. 4243:14-

21). In an August 5, 2008 PwC workpaper on “Liquidity”, PwC noted: “We have been in discussions with Bob Willumstad and with other Board members on the liquidity concerns and strategy” and “it appears that the Company has the appropriate persons involved to evaluate the liquidity issue”. (DX 175 at -235; *see also* Farnan: Trial Tr. 4243:6-13 (PwC did not think that there was a going concern risk for AIG as of the first half of August 2008)).

(g) On August 5, 2008, AIG’s accountants at PwC noted that over “the course of the last nine months, AIG has been building liquidity – as of June 30, 2008, cash and shortterm investments, including within the Securities Lending Pool, was \$82.2 billion.” (DX 175 at -233).

(h) “In late August 2008, AIG hired JPMorgan Chase to help develop funding options” and “approached Berkshire Hathaway about providing a \$5 billion backstop to AIG’s guaranteed investment contracts (GICs)”. (Agreed to Stipulations ¶¶ 67, 69).

(i) In September of 2008, AIG began “to attempt to negotiate transactions with other private parties to raise additional capital or liquidity.” (Willumstad: Trial Tr. 6484:3-6).

(j) By September 2008, AIG had reduced its securities lending balances “down about 25% from its peak”. (PTX 625 at 4).

32.1.11 AIGFP had stopped making commitments to provide CDS protection by the end of 2005, before underwriting standards declined precipitously and the quantity of subprime mortgages exploded.

(a) “In December 2005, AIGFP made the decision to stop writing credit protection on multi-sector CDOs.” (Agreed to Stipulations ¶ 42). “By December 2005, AIG ceased committing to new transactions providing credit protection on CDOs containing subprime

RMBS exposure.” (Agreed to Stipulations ¶ 43; *see also* Saunders: Trial Tr. 8081:12 – 8082:3).⁹³

(b) “AIGFP made an internal decision to stop origination of these derivatives,” meaning CDS credit protection on subprime CDOs, “in December 2005,” when “mortgage underwriting standards were declining for loans packaged for securitization.” (PTX 587 at 76). “AIG halted these activities while the housing market was still going strong.” (PTX 449 at 12).

(c) Bernanke: “In and after 2005 when AIG stopped accepting additional CDS risks, there were still a number of people who were expressing views that mortgage-backed securities did not pose substantial risks”. (Bernanke: Trial Tr. 2136:17-21; *see also* Bernanke: Trial Tr. 2142:5 – 2143:18 (Bernanke’s statement that the Fed does “not expect significant spillovers from the subprime market to the rest of the economy or to the financial system” was made “some considerable period of time after AIG had stopped accepting additional CDS risk.”)).

(d) Cragg: After 2005, “as the market is exploding, as we can see, and the housing bubble is rising and the quantity of subprime debt that’s out there is, you know, starting, you know, to take over, taking over – you know, a quarter of all mortgages are subprime, AIG’s left the market before all of that’s happened.” (Cragg: Trial Tr. 4965:13-19; PTX 5308 (showing that most CDO issuance was in 2006 and 2007 after AIG stopped offering CDS protection on CDOs with subprime collateral); *see also* PTX 5309 – PTX 5313 (Cragg demonstratives

⁹³ Saunders opined that AIGFP’s multi-sector CDS portfolio exposed AIG to significant liquidity risk because it was unhedged. DX 2703; Saunders: Trial Tr. 8074:8 – 8075:18; DX 2705. However, in light of his concession that AIG “stopped writing new CDSs as of the end of 2005” and his acknowledgement that “empirical evidence shows there was a relaxation of guidelines for underwriting mortgage loans in 2006 as reflected in much higher default rates for those mortgages” (Saunders: Trial Tr. 8081:12 – 8082:25), it is unclear how he could maintain that AIG did nothing to hedge against risk. There could be no better hedge against risk than to cease participation in the market. Yet, Saunders never accounts for this in his opinion.

showing a dramatic increase in cumulative default rates on subprime mortgages issued after 2005)).

32.1.12 By contrast, at just that time, major commercial and investment banks – many of which the Federal Reserve regulated – did the precise opposite and increased volume as quality decreased, leading ultimately to indiscriminate liquidity flight and the crash.

(a) Goldman Sachs’ “CDO issuance going from 2005 to 2006 doubled”. (Cragg: Trial Tr. 4987:1-8; PTX 5314), from \$12.6 billion in 2005 to \$25.4 billion in 2006 (Cragg: Trial Tr. 4987:9-14; PTX 5314 (Cragg demonstrative)). Goldman Sachs’ “total issuance was almost \$50 billion” by 2007. (Cragg: Trial Tr. 4987:15-21; PTX 5315 (Cragg demonstrative)).

(b) In 2006, Merrill Lynch “issued \$14 billion worth of these types of CDOs and then in 2006 its issuances almost tripled”. (Cragg: Trial Tr. 4987:22 – 4988:1; PTX 5316 (Cragg demonstrative)). “Merrill Lynch issued \$40.9 billion worth of CDOs in 2006”. (Cragg: Trial Tr. 4988:2-4; PTX 5316 (Cragg demonstrative)). Merrill Lynch’s “cumulative CDO issuance increased going from 2006 to 2007 so that in 2007 its combined issuance was \$83 billion.” (Cragg: Trial Tr. 4988:5-13; PTX 5317 (Cragg demonstrative)).

(c) In 2005, Citigroup “issued \$11.1 billion worth of these types of CDOs, and then in 2006 its issuance more than doubled to \$26.3 billion.” (Cragg: Trial Tr. 4988:19-24; PTX 5318 (Cragg demonstrative)). Citigroup’s cumulative CDO issuance in 2007 was \$65.7 billion. (Cragg: Trial Tr. 4989:9-20; PTX 5320 (Cragg demonstrative)). Citigroup increased its origination of subprime mortgages 85% in 2006. (PTX 2856 at 189, App’x 5, Table 13 (Cragg Expert Report)).

32.1.13 AIG’s liquidity issues in September 2008 were not unique to AIG.

(a) From September through November 2008, every major financial institution was the recipient of extraordinary financial support from Defendant. (PTX 624 at 382, 389-90, 401-04, 414).

(b) Executive Office of the President: “In the autumn of 2008, the American financial system was teetering on the edge, with numerous banks and other financial institutions failing, auto companies struggling, the housing market in free fall, and the economy in a severe downturn.” (PTX 680 at 10).

(c) Willumstad: As of the week of September 9, “I would say while the capital markets were still there, they were getting particularly difficult, not just for AIG but for many financial companies.” (Willumstad: Trial Tr. 6367:14-19). The “crisis that required AIG to seek assistance from the Federal Reserve was not limited to AIG; it was a market-wide crisis of confidence that affected the entire financial industry and the American and global economy”. (Willumstad: Trial Tr. 6490:20-25).

(d) On September 18, 2008, FRBNY lent \$92.4695 billion through the PDCF, including \$47.942 billion to Barclays Capital, \$5 billion to Goldman Sachs, \$5.1 billion to Merrill Lynch, and \$24 billion to Morgan Stanley. (PTX 728 at 10).

(e) Saunders: “In September of 2008, as a result of the deteriorating conditions in the financial markets, the financial condition of virtually every financial institution was fragile” and “there was uncertainty about the solvency and long-term viability of a wide range of financial institutions”. (Saunders: Trial Tr. 8402:25 – 8403:8).

(f) Cragg: If you compare AIG with financial peer companies like Bank of America, Morgan Stanley, Goldman Sachs, and Citigroup, “AIG was suffering the same types of wholesale funding restrictions that they did. The – you know, the collapse of the triparty repo

market and the withdrawing of using residential real estate as acceptable collateral, that was no longer the case after March and was particularly not the case in September. Those are the very problems that both the investment banks as well as AIG faced”. (Cragg: Trial Tr. 8721:13 – 8722:2).⁹⁴

⁹⁴ Defendant’s expert Anthony Saunders has asserted that the “deterioration in AIG’s financial condition and risk profile were primarily caused by factors unique to AIG, not market-wide forces as Dr. Cragg claims.” DX 2709. A review of his support for this proposition demonstrates its invalidity.

First, contrary to Prof. Saunders’ suggestion (Saunders: Trial Tr. 8092:4-25; DX 1882 at 138, ¶ 312), the size of AIG’s securities lending portfolio was not out of line with its peers. As Saunders concedes, MetLife “had a securities lending portfolio that was comparable to AIG in terms of relative size” of less than 8% of its total assets. Saunders: Trial Tr. 8093:1-12; DX 2712. Moreover, MetLife was the only insurance company analyzed by Saunders even remotely comparable in size to AIG and AIG was still almost two times larger. *Compare* DX 1399 at 6 (MetLife held approximately \$555 billion in assets as of June 30, 2008) *with* JX 41 at 3 (AIG held approximately \$1.05 trillion in assets as of June 30, 2008).

Second, Saunders claimed that AIG’s insurance peers “outperformed AIG based on multiple financial metrics despite being exposed to the same market forces as AIG”, suggesting that its problems were specific to the firm rather than to the market in general.” DX 2717. Saunders’ analysis of the ultimate performance of peer-company securities lending programs (DX 2715) is *ex post* and in addition, runs the risk of being a false comparison because AIG had substantially different lines of business than many of its insurance peers and was in fact more closely aligned to other financial institutions. *See* Cragg: Trial Tr. 8719:10-22, 8720:12-24 (“Professor Saunders seems to insist on using an *ex post* analysis of companies to determine what the risks were that they actually took,” and “he insists on comparing AIG to insurance companies as opposed to recognizing that, at this point in time, AIG was a much more complicated financial services company that was more similar in some ways to the investment banks that were engaged in the trading and selling of option contracts, as well as those banks entering into insurance-type activities. So, in my view, to sort of, you know, better capture the risk, you need to look at a broader peer group.”). Saunders himself acknowledges that “*Ex post* could be very different from *ex ante*” analysis of risk. Saunders: Trial Tr. 8293:10-22.

Third, it was established during trial that Saunders had failed to consider a host of factors that were necessary to make the comparison apt. Saunders was “unaware of any” of “AIG’s insurance company peers” that had “requested an individual Section 13(3) loan from the Federal Reserve in September of 2008”. (Saunders: Trial Tr. 8150:2-5). Furthermore, Saunders fails to control for the fact that his selected financial-institution peers already had access to sources of liquidity provided by Defendant, but that AIG had received no liquidity from Defendant prior to September 16. *See* Saunders: Trial Tr. 8391:8-18 (Saunders was unaware of any assistance to

32.2 In contrast to its treatment of AIG, Defendant provided non-punitive assistance to numerous other companies, including those most responsible for causing the financial crisis.

32.2.1 The Federal Reserve, following Bagehot's advice, used Section 13(3) a number of times in the 2008 financial crisis to lend to institutions against collateral.

(a) Bernanke: "The multiple instances of run-like behavior during the crisis, together with the associated sharp increases in liquidity premiums and dysfunction in many markets, motivated much of the Federal Reserve's policy response. Bagehot advised central banks – the only institutions that have the power to increase the aggregate liquidity in the system – to respond to panics by lending freely against sound collateral. Following that advice, from the beginning of the crisis, the Fed, like other major central banks, provided large amounts of short-term liquidity to financial institutions, including primary dealers as well as banks, on a broad range of collateral." (PTX 650 at 14-15).

(b) Bernanke: "And as I said, the crisis was like an old-fashioned bank crisis, but it happened to all different kinds of firms and in different institutional contexts. So the Fed had to go beyond the discount window. We had to create a whole bunch of other programs, special liquidity and credit facilities that allowed us to make loans to other kinds of financial institutions, on the Bagehot principle that providing liquidity to firms that are suffering from loss of funding is the best way to calm a panic." (PTX 708 at 84).

(c) Madigan: "In lending under the PDCF and TSLF, the Federal Reserve's actions are quite consistent with the principles attributed to Bagehot. The Fed lends to firms that are judged to be solvent; by applying haircuts to the market value of securities, it ensures that

AIG prior to September 16, 2008); Saunders: Trial Tr. 8396:23 – 8397:2 ("every one" "received Federal Reserve loan assistance prior to September 16, 2008"); *see also* Saunders: Trial Tr. 8403:9-15 (admitting he never assessed "the extent to which that risk, if any, was more or less or about the same as the risk taken in financial assistance given to AIG's peers on a consolidated basis").

lending against good collateral; and particularly under the PDCF the Fed extends credit at interest rates that would be above-market in more routine circumstances.” (PTX 537 at 3).

(d) Bernanke: “During the financial crisis, the Federal Reserve provided two basic types of liquidity support under section 13(3)—broad-based credit programs aimed at addressing strains affecting groups of financial institutions or key financial markets, and credit directed to particular systemically-important institutions in order to avoid a disorderly failure of those institutions. In both cases the purpose of the credit was to mitigate possible adverse effects on the broader financial sector and the economy. Liquidity facilities of the first type included the Primary Dealer Credit Facility (PDCF), the Term Securities Lending Facility (TSLF), the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), the Commercial Paper Funding Facility (CPFF), the Money Market Investors Funding Facility (MMIFF), and the Term Asset-Backed Securities Loan Facility (TALF). Liquidity support provided to particular institutions to avert a disorderly failure included credit provided through Maiden Lane LLC to facilitate the acquisition of Bear Stearns by J.P. Morgan Chase, and credit provided to American International Group (AIG) through a revolving credit line and through Maiden Lane II LLC and Maiden Lane III LLC. The Federal Reserve, acting with the U.S. Treasury and FDIC, also agreed to provide loss protection and liquidity support to Citigroup and Bank of America on designated pools of assets utilizing authority provided under section 13(3), but ultimately did not extend any credit to either of these institutions.” (PTX 616 at 10).

32.2.2 In March 2008, the Federal Reserve provided assistance on significantly more favorable terms than then existing market rates to many primary dealers that had contributed to the financial crisis.

(a) Term Securities Lending Facility (“TSLF”): The Federal Reserve’s first use of Section 13(3) during the Financial Crisis was the creation of the Term Securities Lending Facility, created in March 2008 to provide collateralized funding to primary dealers. (PTX 2564; PTX 2565; PTX 5345 (Cragg demonstrative)).

(b) The Single Tranche Open Market Operations (“ST OMO”): In March 2008, pursuant to Section 14 of the Federal Reserve Act, “the Federal Reserve created the single-tranche open market operations where it auctioned off liquidity to primary dealers as a Band-Aid for that week to get them through the resolution of Bear Stearns.” (Cragg: Trial Tr. 5045:6-21).

(c) Primary Dealer Credit Facility (“PDCF”): On March 16, 2008, the Federal Reserve Board authorized FRBNY to establish the PDCF to provide a source of liquidity to primary dealers, including Goldman Sachs, Morgan Stanley, Bear Stearns, and Lehman Brothers. (PTX 12 at 3-4; PTX 1202 at 1; PTX 693 at 4-5; *see also* Alvarez: Trial Tr. 83:5-23 (Alvarez: “we announced the PDCF” in March 2008)).

(d) The primary dealers were chosen as a group to be beneficiaries of the initial emergency lending facilities because the facilities “were set up on very short notice, the PDCF in fact in a matter of a couple of days; and therefore, the infrastructure, the legal agreements, all of the plumbing, if you like, to do lending existed for those primary dealer counterparties of the markets group of the New York Fed already, and given the speed with which they were set up, we needed to use the pipes and the legal agreements that we had in place.” The primary dealers were “large global financial intermediaries” who could get “liquidity out to the financial system.” (Mosser: Trial Tr. 1306:2 – 1307:3).

(e) Cragg: The PDCF was a “collateralized loan facility designed to address the – you know, as I’ve been calling it, the run on repo. And it did so by allowing primary dealers to borrow – in the tri-party repo market to borrow against collateral that included agency-backed RMBS.” (Cragg: Trial Tr. 5049:9-21).

32.2.2.1 The terms of the PDCF included an interest rate at the primary credit rate with “very small” fees, no equity component and no monitoring.

(a) “The interest rate on PDCF loans was equal to the primary credit rate, the interest rate the Reserve Banks charged on discount window loans to depository institutions through its primary credit program” and the fees “were very small.” (PTX 638 at 6; Baxter: Trial Tr. 1086:12-17).

(b) Federal Reserve press release dated March 16, 2008: “Credit extended to primary dealers under this facility may be collateralized by a broad range of investment-grade debt securities. The interest rate charged on such credit will be the same as the primary credit rate, or discount rate, at the Federal Reserve Bank of New York.” (PTX 1202).

(c) Bernanke: The primary credit rate, which was “somewhere on the order of 2 ½ to 3 percent”, was sufficiently high to act as a “penalty rate in the sense that the rate was higher than the normal market rate, and so as the situation normalized, firms stopped using those facilities because the penalty rate drove them out”. (Bernanke: Trial Tr. 1995:22 – 1996:5, 1996:24 – 1997:2, 1997:19 – 1998:11).

(d) During 2008, the primary credit rate was 50 basis points above the Fed funds rate. (McLaughlin: Trial Tr. 2434:25 – 2435:3; *see also* PTX 2568 at 1 (“Currently, primary credit is available ... at a rate 50 basis points above the Federal Open Market Committee’s (FOMC) target rate for federal funds.”)).

(e) The secondary credit rate was 50 basis points above the primary credit rate. (McLaughlin: Trial Tr. 2434:25 – 2435:6). *See also* PTX 2568 at 1 (secondary credit is extended “at a rate 50 basis points above the primary credit rate”).

(f) With respect to the PDCF, the Federal Reserve faced “significant” “risk in relationship to the size of the facility”. (Geithner: Trial Tr. 1882:3-7). But Defendant did not demand equity in exchange for PDCF lending. (PTX 12 at 3-4; *see also* Baxter: Trial Tr. 1085:14-24 (FRBNY “got interest and fees but no equity” in the PDCF facility)).

(g) The Federal Reserve provided assistance to primary dealers through the PDCF without monitoring the way the primary dealers were managed. (Baxter Trial Tr. 1093:9-16 (FRBNY “didn’t monitor the way the primary dealers were managed at all”; “we were treating primary dealers as counterparties, not as their supervisor”)).

(h) “The Federal Reserve Board did not impose a borrowing limit that applied to each individual primary dealer. The total amount a primary dealer could borrow from PDCF was limited by the amount of haircut-adjusted eligible collateral it had pledged to its clearing bank.” (PTX 638 at 5).

32.2.2.2 Defendant attempted to distinguish the treatment of AIG and primary dealers at trial based on the supervision agreed to as a result of receiving PDCF funding, but all the same supervision and monitoring activities were put in place for AIG. (*See supra* § 15.8).

(a) Geithner: “after the primary dealer credit facility was put in place, we did put teams from the New York Fed into those institutions so we could better monitor their liquidity, funding risk, how they were managing risk, and we did that in full cooperation with the SEC.” (Geithner: Trial Tr. 1898:12-17).

(b) Geithner: After a broker-dealer borrowed from the PDCF, FRBNY was “at that point, in effect, a creditor. As a creditor, you do have additional capacity to influence you would not have, and so in that context, yes, we had some additional ability to affect, but that is not the same as a legal authority as supervisor or regulator.” (Geithner: Trial Tr. 1899:5-16).

(c) Dahlgren: FRBNY “did monitor the activities of the primary dealers who borrowed from the” PDCF. (Dahlgren: Trial Tr. 2804:2-19). FRBNY “had a handful of people who were monitoring the liquidity of those broker-dealers who weren’t otherwise supervised by the Fed.” (Dahlgren: Trial Tr. 2804:17-19).

32.2.2.3 The credit extended to primary dealers under the PDCF was targeted, long-term assistance.

(a) The PDCF was not a “broad-based” facility. (Cragg: Trial Tr. 5052:5-11). The “first loan under the PDCF would have been on Monday March 17”. (Cragg: Trial Tr. 5051:13-15; PTX 5348 (Cragg demonstrative)). At that time, there were 20 firms that were eligible to use the PDCF. (Cragg: Trial Tr. 5051:16-24; PTX 5348 (Cragg demonstrative)). But the top 5 users of the PDCF received 85% of the loans extended by the PDCF. (Cragg: Trial Tr. 5051:25 – 5052:2; PTX 5348 (Cragg demonstrative); *see also* PTX 2856 at 227, 231, Tables 18 & 20 (Cragg Expert Report); PTX 728 (Primary Dealer Credit Facility (PDCF) Data); PTX 1211 (Collateral Margins for the Primary Dealer Credit Facility (March 17, 2008 to February 1, 2010))).

(b) The PDCF was not a “short-term facility,” “it was a very easy program to continue, and so I guess it was rolled over several times over the course of the financial crisis. And it had to be. I mean, it was – it was a lifeline.” (Cragg: Trial Tr. 5053:8-19). Moreover, each time the Federal Reserve extended the facility, they announced that it “would continue for

some number of months in the future”. (Cragg: Trial Tr. 5053:20 – 5054:2). “And the reason for that is, the presence of the PDCF was designed to create confidence. And taking away the PDCF at a time when there’s still uncertainty would have a negative impact on the market’s confidence.” (Cragg: Trial Tr. 5053:24 – 5054:6).

(c) Baxter: “even if you had used the PDCF 180 days in a row, your total charge, both interest rate and frequency-based fee,” “would be the primary credit rate plus 40 basis points.” (Baxter: Trial Tr. 1086:22 – 1088:7).

32.2.2.4 The Federal Reserve continued to provide assistance to primary dealers even after they or their parent companies experienced significant financial distress.

(a) Countrywide continued to be a primary dealer despite the fact that it was in “significant financial trouble”. (Baxter: Trial Tr. 1101:13-19).

(b) “Lehman Brothers continued to be a primary dealer until after the parent had gone into bankruptcy”. (Baxter: Trial Tr. 1101:24 – 1102:2).

(c) During the period of September 15th 2008 (the day that Lehman declared bankruptcy) through September 22nd, the Federal Reserve also made “liquidity available pursuant to 13(3) to the Lehman Brothers broker-dealer”. (Geithner: Trial Tr. 1403:19-23; *see also* Cragg: Trial Tr. 5065:21 – 5066:7 (“after Lehman’s bankruptcy, this primary dealer continued to borrow from the PDCF, so after the parent company went into bankruptcy, the primary dealer subsidiary actually was borrowing significant amounts over the course of that week”); PTX 5353 (Cragg demonstrative showing Lehman primary dealer borrowing additional \$28 billion from PDCF after Lehman parent filed for bankruptcy)). On September 15, Lehman’s primary dealer subsidiary had already borrowed \$46 billion from the Federal

Reserve (Cragg: Trial Tr. 5066:8-13), with the “majority of that from the Primary Dealer Credit Facility”. (Cragg: Trial Tr. 5066:14-16; *see also* Geithner: Trial Tr. 1403:24 – 1404:4).

(d) “Bear Stearns continued to be a broker-dealer even after” its “severe financial problems arose”. (Baxter: Trial Tr. 1103:4-7).

(e) “No broker – no primary dealer, which is the designation we assign, lost its primary dealer designation” during 2008, including Countrywide, Lehman Brothers and Bear Stearns. (Baxter: Trial Tr. 1104:13 – 1105:9).

32.2.3 In September 2008, the Federal Reserve expanded the range of collateral that borrowers could pledge at the PDCF. (PTX 696 at 2-3; PTX 59 at 2-3).

(a) “On September 14, 2008, the Federal Reserve Board expanded the list of eligible collateral for the PDCF to include any collateral that could be pledged in the triparty repo system of the two major clearing banks. Previously, PDCF collateral had been limited to investment-grade debt securities. Following this expansion, primary dealers could post certain non-investment grade securities and equity as collateral for PDCF borrowing.” (Agreed to Stipulation ¶ 86; *see also* PTX 696 at 2-3; Geithner: Trial Tr. 1403:2-8; Paulson: Trial Tr. 1234:18 – 1235:10 (Paulson was “aware that on September 14, 2008, the Fed had revised the collateral requirements for the PDCF so that people could post noninvestment grade bonds and equities”); McLaughlin: Trial Tr. 2400:6-20 (on September 14, 2008, FRBNY began accepting a “broader amount of collateral”); McLaughlin: Trial Tr. 2441:22 – 2442:5 (The range of eligible collateral “was expanded to include also non-investment-grade marketable, fixed-income securities and equities.”); PTX 59 at 2 (September 14, 2008 press release announcing the change)).

(b) The FCIC Report: “As it had on the weekend of Bear’s demise, the Federal Reserve announced new measures on Sunday, September 14, to make more cash available to investment banks and other firms. Yet again, it lowered its standards regarding the quality of the collateral that investment banks and other primary dealers could use while borrowing under the two programs to support repo lending, the Primary Dealer Credit Facility (PDCF) and the Term Securities Lending Facility (TSLF).” (PTX 624 at 382).

(c) “In September of 2008, the collateral that would be accepted for, for example, the PDCF included collateral that was represented by mortgage-backed securities and asset-backed securities”, and there “wasn’t very much trading” in either at that time. (Bernanke: Trial Tr. 2278:19 – 2279:5).

(d) On September 21, FRBNY further expanded the range of collateral that Morgan Stanley, Goldman Sachs and Merrill Lynch could pledge at the PDCF loan to include foreign currency denominated securities. (McLaughlin: Trial Tr. 2411:12 – 2412:1).

(e) The purpose of expanding PDCF-eligible collateral “was to permit people who had access to the primary dealer credit facility to use collateral that had not previously been acceptable to the Fed”. (Geithner: Trial Tr. 1403:2-13).

(f) “By expanding the PDCF’s eligible collateral, the Fed aimed to reassure repo lenders that if any investment bank counterparty ran into problems, it could get cash from the Fed for any collateral and use that to repay the triparty repo lender.” (PTX 706 at 251).

(g) Geithner: The new acceptable collateral included “noninvestment grade debt and included equity”. (Geithner: Trial Tr. 1403:2-18).

(h) Bernanke: “a lot of the collateral that the Federal Reserve lent against under 13(3) in 2008 and 2009 was not bank securities”. (Bernanke: Trial Tr. 2278:15-18).

(i) McLaughlin: “The new collateral had more risk.” (McLaughlin: Trial Tr. 2445:11-15).⁹⁵

32.2.3.1 Borrowings pursuant to the PDCF increased dramatically and the interest rate charged decreased after FRBNY broadened the eligible collateral criteria.

(a) Borrowings pursuant to the PDCF increased after FRBNY broadened the eligible collateral. (McLaughlin: Trial Tr. 2404:5-14). McLaughlin recalled seeing a chart showing an increase in PDCF borrowing after September 14 that looked a “little bit like a hockey stick, it just shot right up”. (McLaughlin: Trial Tr. 2404:10-20).

⁹⁵ Some Defendant witnesses fought the notion that the change in accepting equity or noninvestment grade collateral for the PDCF was a lowering of the standards of the discount window or meant that the collateral was less safe. *See* Alvarez: Trial Tr. 415:24 – 416:22 (it was still “a kind of collateral that others were lending against and we felt safe in lending against”); Alvarez: Trial Tr. 417:4-9 (“I do not agree that it’s,” meaning non-investment grade collateral, “less safe” than investment grade collateral); Bernanke: Trial Tr. 2278:15 – 2279:13 (acknowledging that the PDCF accepted mortgage-backed securities, although there wasn’t very much trading in the market). However, these same witnesses testified that the same type of collateral when accepted from AIG was in fact less safe. *See* Bernanke: Trial Tr. 2282:16 – 2283:12 (stating that FRBNY took shares of stock in AIG’s insurance subsidiaries that “were traded in the markets in normal times” but that the mortgage-backed securities held were not).

The assertion that PDCF lending or collateral posed substantially different risks from AIG collateral and lending does not withstand scrutiny. *First*, the assertion by some witnesses that PDCF collateral had a third-party or market price was inaccurate. Testimony by those most responsible for the day-to-day operation of the PDCF revealed that FRBNY suspended the requirement of a third-party price during the week of September 16, 2008. *See* Mosser: Trial Tr. 2048:3-2050:17; Bernanke: Trial Tr. 2278:19-25, 2282:16 – 2283:12. *Second*, the one-day maturity period for PDCF loans offered little protection against default in light of the fact that many of the largest PDCF borrowers, including Goldman Sachs and Morgan Stanley, had tens of billions of dollars in loans outstanding when they were facing severe runs and at risk of failure. *See supra* § 27.1; *infra* § 32.2.8; PTX 728 at 9-10. *Finally*, AIG collateral was subject to scrutiny and haircuts just like PDCF collateral, only the amounts of the AIG collateral were ultimately less, while the haircuts were significantly higher. *See supra* § 21.5.5; *see also* Geithner: Trial Tr. 1756: 14 – 1757:7.

(b) That chart shows that on September 18, 2008, FRBNY lent \$92.4695 billion through the PDCF, including \$47.942 billion to Barclays Capital, \$5 billion to Goldman Sachs, \$5.1 billion to Merrill Lynch, and \$24 billion to Morgan Stanley. (PTX 728 at 10). By September 29, 2008, the Federal Reserve lent \$155.7682 billion through the PDCF, including \$15 billion to Barclays Capital, \$10 billion to Goldman Sachs, \$5 billion to Goldman Sachs' London branch, \$29.694 billion to Merrill Lynch, \$6.589 billion to Merrill Lynch's London branch, \$40.0621 billion to Morgan Stanley, and \$21.23 billion to Morgan Stanley's London Branch. (PTX 728 at 11).

32.2.4 The primary credit rate FRBNY charged as compensation for credit at the PDCF decreased after the range of eligible collateral was expanded to include non-investment grade securities. (Cragg: Trial Tr. 5081:4-14; PTX 5360 (Cragg demonstrative)).

32.2.5 Although FRBNY provided 13(3) lending to many institutions in 2008 and 2009, FRBNY did not take an equity stake in any of those institutions, including Citigroup, Bank of America, Bear Stearns or JPMorgan, Morgan Stanley or Goldman Sachs.

(a) Baxter: FRBNY “got interest and fees but no equity” in all of the emergency credit facilities that the Fed established in 2008 pursuant to section 13(3). (Baxter: Trial Tr. 1083:9 – 1085:24).

(b) Bernanke: In the entire history of section 13(3) loans, only AIG was required to provide its equity as compensation for a section 13(3) loan. (Bernanke: Trial Tr. 1989:20 – 1990:1).

(c) Geithner: Neither the PDCF nor the 13(3) facilities approved for Bank of America and Citigroup did not require them to provide equity to FRBNY. (Geithner: Trial Tr. 1397:15-25, 1396:19 – 1397:4).

(d) The shareholders of Citigroup, Goldman Sachs, Bear Stearns and all the firms that had access to the PDCF got “a windfall as a result of government assistance”. (Geithner: Trial Tr. 1903:2-21).

32.2.6 In March 2008, Defendant provided non-punitive assistance to the failing investment bank, Bear Stearns.

(a) In addition to its lending through the PDCF, Defendant twice provided 13(3) credit to assist Bear Stearns in March 2008 (first through JPMorgan to Bear Stearns and second through the Maiden Lane I facility). (PTX 709 at 168-172; PTX 1201; PTX 12 at 4).

(b) On March 13, 2008, Bear Stearns’ liquidity had decreased from \$18 billion to \$2 billion. That night, Bear Stearns’ CEO Alan Schwarz called Geithner to let him know “that Bear planned to file for bankruptcy in the morning.” (PTX 709 at 163-65).

(c) One day later, on March 14, 2008, the Federal Reserve Board authorized FRBNY under Section 13(3) to lend to JPMorgan to facilitate JPMorgan’s acquisition of Bear Stearns. (PTX 693 at 4; PTX 1201 at 2-3; *see also* Alvarez: Trial Tr. 84:4 – 87:1 (the purpose of providing 13(3) assistance to Bear Stearns was to prevent its bankruptcy); *see also* PTX 2554 at 3).

(d) Minutes of the March 14, 2008 BOG Meeting: “Board members agreed that, given the fragile condition of the financial markets at the time, the prominent position of Bear Stearns in those markets, and the expected contagion that would result from the immediate failure of Bear Stearns, the best alternative available was to provide temporary emergency financing to Bear Stearns through an arrangement with JPMorgan Chase & Co., also in New York.” (PTX 1201 at 2).

(e) Geithner: FRBNY facilitated the merger between JPMorgan and Bear Stearns by taking “a pool of securities that were – had a face value at that point of roughly \$30 billion and take those off the balance sheet of both Bear Stearns and JPMorgan and funding them directly. And by reducing some of the risk to JPMorgan in that transaction, we made it – we made it more likely that the merger would be acceptable.” (Geithner: Trial Tr. 1716:22 – 1717:8; *see also* PTX 709 at 172 (“The New York Fed agreed to lend JPMorgan \$30 billion to facilitate the merger, backed by \$30 billion worth of Bear’s investment-grade assets.”)).

(f) Alvarez: FRBNY “provided emergency credit to aid the acquisition of Bear Stearns by JPMorgan, and that would have avoided Bear Stearns from going into bankruptcy.” (Alvarez: Trial Tr. 84:9-16; Alvarez: Trial Tr. 617:16-23 (confirming that “a loan was made by the Federal reserve in connection with the Bear Stearns/JPMorgan transaction”); PTX 693 at 5 (FRBNY timeline with link to the March 24, 2008 press release describing the deal)).

32.2.6.1 Defendant set the interest rate for the Bear Stearns facility with a view towards accommodating commerce despite the “substantial risk relative to the size of the facility.”

(a) Geithner: In the Bear Stearns case, “there was substantial risk relative to the size of the facility.” (Geithner: Trial Tr. 1881:13-23).

(i) The Treasury Department had to guarantee FRBNY against losses that could arise from the loan to Bear Stearns even though Paulson acknowledged that “To be honest, I wasn’t sure what, if any, legal authority Treasury might have had to indemnify the Federal Reserve, but I was determined to make it to the weekend.” (PTX 706 at 118).

(ii) The Federal Reserve provided “around \$29 billion” of credit to the Maiden Lane I facility, while JPMorgan only supplied “\$1 billion” in “subordinated debt” to that

facility. (Alvarez: Trial Tr. 411:5-10). The loan to the Maiden Lane I facility was “nonrecourse,” meaning the Federal Reserve could only get the \$1 billion JPMorgan had put into the facility in the event of any deficit. (Alvarez: Trial Tr. 411:11-24).

(b) Nevertheless, Defendant provided credit to JPMorgan at the primary credit rate. (PTX 1201 at 3; PTX 12 at 2). Beginning on March 18, 2008, the primary credit rate was 2.5% or lower. (PTX 692 at 1; PTX 2575; *see also* Alvarez: Trial Tr. 90:5-10 (no reason to doubt that PTX 2575 accurately records the primary credit rate on March 18, 2008 as 2.5%)).

32.2.6.2 Defendant allowed Bear Stearns shareholders to reject the offer on the table, ultimately allowing them to receive more favorable terms for their share dilution.

(a) On March 16, 2008, Paulson pressured JPMorgan “to keep the price low” for its acquisition of Bear Stearns (PTX 709 at 171; *see also* PTX 706 at 128-29), because he “knew that whatever deal was announced” would “need ultimately to be increased because the required shareholder vote would give Bear leverage”. (PTX 706 at 129). At Paulson’s urging, JPMorgan initially offered \$2 per share to acquire Bear Stearns. (PTX 706 at 129).

(b) Bear Stearns shareholders rejected the “extremely unattractive deal.” (PTX 709 at 173).

(c) Geithner: Jamie Dimon, CEO of JPMorgan, “told Hank and me he would raise his offer if he could be assured the merger would go through. That was fine with me. I didn’t much care what JPMorgan paid for Bear, as long as the deal got done and the system calmed down.” (PTX 709 at 173). “Hank had his own concerns. He was still uncomfortable allowing the shareholders of a failed firm to benefit from a government rescue. But Ben and I helped persuade him that allowing JPMorgan to offer a somewhat better deal to the shareholders of Bear Stearns mattered less than the stability of the financial system.” (PTX 709 at 173-74).

(d) Paulson: Bernanke persuaded Paulson to approve JPMorgan increasing its offer to \$10 per share even though Paulson felt “it was an unseemly precedent to reward the shareholders of a firm that had been bailed out by the government”. (PTX 706 at 137).

(e) Ultimately, JPMorgan increased its offer from \$2 to \$10 a share “because the Bear Stearns shareholders were able to make a decision whether or not to accept” JPMorgan’s \$2 price and JPMorgan became concerned that the Bear Stearns shareholder would not accept \$2. (Bernanke: Trial Tr. 2259:25 – 2260:9).

32.2.7 Defendant did not demand equity as additional consideration for its loan to Bear Stearns despite concerns with moral hazard.

(a) Report Pursuant to Section 129 of the EESA of 2008: “The FRBNY received no warrants or any other potential equity of either JPMC Bank or Bear Stearns in exchange for the loan.” (PTX 2554 at 3; *see also* Bernanke: Trial Tr. 2121:5-24 (confirming that it was his understanding at the time that FRBNY received no warrants)). In fact, at no point did Defendant even consider requiring Bear Stearns to surrender equity in exchange for Fed assistance. (Alvarez: Trial Tr. 92:2-4).

(b) Bernanke: The assistance extended to Bear Stearns resulted in moral hazard. (Bernanke: Trial Tr. 2187:10-12).

32.2.8 The Board of Governors authorized FRBNY to extend a loan under 13(3) to Fannie and Freddie, if needed, at the primary rate on July 13, 2008. (PTX 696 at 1).

(a) “Today, the Board considered a proposal to authorize the Federal Reserve Bank of New York to make advances, if it determines that such lending is necessary, to the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) under section 13(13) of the Federal Reserve Act.” “*The Board*

approved the recommendation of the New York Reserve Bank that advances be made at the primary credit rate. It was noted that the authorization was intended to supplement Treasury's authority to lend directly to Fannie Mae and Freddie Mac. Board members agreed that the authorization should only be used to provide backup liquidity to those companies and should only authorize loans to Fannie Mae and Freddie Mac.” (PTX 696 at 1 (emphasis added); *see also* Geithner: Trial Tr. 1573:2-20).

32.2.9 In September 2008, Defendant provided emergency assistance to money market funds.

(a) Paulson: “when the commercial paper market was under – under a lot of – a lot of pressure and the money markets were under pressure,” the Federal Reserve “announced a program to support the commercial paper market, buying bank paper” (Paulson: Trial Tr. 1201:10 – 1202:14).

32.2.9.1 The Federal Reserve created the AMLF to finance the purchase of commercial paper from money market mutual funds.

(a) On September 19, 2008, “The Federal Reserve Board announces the creation of the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF) to extend non-recourse loans at the primary credit rate to U.S. depository institutions and bank holding companies to finance their purchase of high-quality asset-backed commercial paper from money market mutual funds.” (PTX 693 at 8).

(b) The AMLF “was created in the week of – that Lehman and Merrill Lynch and AIG, Goldman and Morgan Stanley, that they were – during that week that they were all having trouble, there was a, you know, kind of a great sucking sound as the money, you know, got sucked out of the money market mutual funds and commercial paper markets, and you

know, over the course of a few days, several hundred billion dollars, you know, just vaporized. That program was created to stop the run in those markets.” (Cragg: Trial Tr. 5060:12 – 5061:5).

(c) “The AMLF was an effort to revive the market for high-quality asset-backed commercial paper, which had shut down after Lehman fell, while easing pressures on money funds, which began dumping the paper after the Reserve Fund broke the buck.” (PTX 709 at 218).

(d) Within two weeks, the AMLF “was financing \$152 billion worth of commercial paper, helping financial institutions and some of America’s largest companies make payroll and make investments.” (PTX 709 at 218).

(e) The U.S. Treasury’s announcement, combined with the Federal Reserve’s actions “to provide liquidity to the broader markets,” including the creation of the AMLF, “helped prevent other funds from breaking the buck.” (PTX 709 at 218-19).

(f) Baxter: FRBNY “got interest and fees but no equity” as compensation for loans extended under AMLF. (Baxter: Trial Tr. 1085:14-24).

32.2.9.2 Defendant provided for a temporary guaranty program for investments in money market mutual funds through Treasury’s Exchange Stabilization Fund.

(a) Later on September 19, 2008, “The U.S. Treasury announces a temporary guaranty program that will make available up to \$50 billion from the Exchange Stabilization Fund to guarantee investments in participating money market mutual funds.” (PTX 693 at 8). The “Treasury Department used the Exchange Stabilization Fund to guarantee the money markets.” (Paulson: Trial Tr. 1201:10-23).

(b) Paulson: “Guaranteeing the money markets was an inspired idea; the problem was how to do it. Shafran’s insight was crucial. Treasury had next to no funding power—with one exception. The Gold Reserve Act of 1934 had created the Exchange Stabilization Fund (ESF) to allow Treasury to intervene in the foreign exchange market to stabilize the dollar. The ESF had been used very selectively over the years, most controversially when President Bill Clinton tapped it in 1995 to extend up to \$20 billion in loans to Mexico. Now money market funds were being hit by massive redemptions, some of them from skittish overseas investors. A collapse of the money fund industry could easily lead to a run on the dollar.” (PTX 706 at 285-86).

32.2.10 In September 2008, Defendant provided additional non-punitive assistance to Morgan Stanley and Goldman Sachs.

32.2.10.1 On September 18-19, 2008, Defendant concluded that Morgan Stanley and Goldman Sachs would fail without additional assistance.

(a) “Prior to the weekend of September 19 and 20,” Paulson received “calls from the chief executive officers of both Morgan Stanley and Goldman Sachs expressing concern about the future of their companies”. (Paulson: Trial Tr. 1202:15-22).

(b) On September 18, 2008, Paulson received a phone call from Bob Scully, vice chairman of Morgan Stanley, who told him that “he was not sure Morgan Stanley was going to make it.” (PTX 706 at 283-84).

(c) On September 19, 2008, Paulson received a call from Goldman CEO Lloyd Blankfein “to express his concern for Morgan Stanley and what its troubles might mean—for the market and for his firm. The market was losing confidence in investment banks, he said, and although Goldman had a strong balance sheet, counterparties and funding sources were

scared. ‘I’ve never rooted so hard for a competitor,’ he said. ‘If they go, we’re next.’” (PTX 706 at 297).

(d) Geithner: On September, 18, 2008, Morgan Stanley, Goldman Sachs and other investment banks “were under siege.” (PTX 709 at 214). “Morgan Stanley’s clients pulled an astonishing \$32 billion out of the firm on Wednesday, more than the annual economic output of Panama or Jordan; its credit default swaps had tripled since Lehman fell. Even Goldman Sachs, the strongest of the investment banks, watched helplessly as half its \$120 billion in liquidity evaporated in a week.” (PTX 709 at 214-15). In short, “Goldman was getting killed.” (PTX 709 at 215). Indeed, “everyone on Wall Street knew that if Morgan went the way of Lehman, Goldman would be next.” (PTX 709 at 220).

(e) Meg McConnell took notes from a call among Geithner, Bernanke, Paulson and Chris Cox (SEC) on September 18, 2008, in which Geithner states: “TFG: We’re going in for two days to get legislation, so can we say through authority/moral suasion that they announce they’re deferring two days on the basis of what we’re working on. But if rating agencies say lower Morgan, GS, Merrill, then they don’t make it through the weekend and we’re doing AIG for all of them.” (PTX 147 at 1-2; *see also* McConnell: Trial Tr. 2529:4 – 2530:3 (“what Mr. Geithner is saying here is, if the rating agencies do downgrade Morgan Stanley, Goldman Sachs and Merrill Lynch, then they won’t make it through the weekend”); McConnell: Trial Tr. 2530:4-12 (McConnell understood “And we’re doing AIG for all of them” to mean “we’re bailing them all out”; “AIG is being used here as a model.”)).

(f) On Friday September 19, the Federal Reserve was told that Morgan Stanley “indicated they cannot open Monday” without more Government assistance and that if Morgan Stanley did not open Goldman Sachs was “toast”. (PTX 175, 174).

(g) Morgan Stanley called Geithner “late on September 19th, 2008, and indicated that they could not open on Monday”. Geithner was told “that Goldman Sachs now felt that if Morgan Stanley did not open, then Goldman Sachs was . . . ‘toast’”. (Geithner: Trial Tr. 1545:21 – 1546:24).

(h) Paulson: As of September 20, 2008, “liquidity was drying up very quickly for Morgan Stanley, and they were getting – getting close to the edge. I never had it expressed to me that they wouldn’t be able to open on Monday, but based upon the conversations I’d had throughout the week, that was my fear.” (Paulson: Trial Tr. 1203:5-22; *see also* Paulson: Trial Tr. 1214:9-12 (“Morgan Stanley on September 20 badly needed liquidity”)).

(i) Bernanke: “Morgan Stanley depended very heavily on the wholesale funding markets which were highly disrupted after the Lehman/AIG weekend, so we understood that they were having difficulty in the funding markets.” (Bernanke: Trial Tr. 2117:14-19). “It is possible certainly”, Bernanke conceded, “that without the liquidity provided by the 13(3) lending to Morgan Stanley, Morgan Stanley would not have been able to continue in business”. (Bernanke: Trial Tr. 2118:21-25).

32.2.10.2 After learning that Morgan Stanley and Goldman Sachs were likely to fail, Defendant provided immediate non-punitive assistance, including by allowing them to become bank holding companies.

(a) Geithner: On September 19, 2008, “the SEC temporarily banned the short selling of 799 financial stocks”. “The ban’s most immediate beneficiary appeared to be Morgan Stanley;” “Its liquidity pool had shrunk from \$130 billion to \$55 billion in a week; it was borrowing nearly \$70 billion from the Fed to make up the difference. Its stock price fell 60 percent before word of the short-selling ban leaked.” (PTX 709 at 219-20).

(b) On the weekend of September 20-21, 2008, Defendant attempted to find potential acquirers for Morgan Stanley and Goldman Sachs, but could not. (PTX 709 at 220-21; *see also* Paulson: Trial Tr. 1214:13 – 1215:17 (Paulson “discussed with President Bush the possibility of getting China to make an investment in Morgan Stanley”, but ultimately, it “was clear they didn’t have an interest.”)). On the morning of September 20, 2008, Geithner’s chief of staff Michael Silva reported to several senior officials at FRBNY that options being actively discussed for Morgan Stanley and Goldman Sachs included sovereign wealth capital injections, merger with or acquisition by a bank, or becoming a bank holding company. (PTX 174 at 1).

(c) Morgan Stanley first applied the weekend of September 20-21 to “become both a bank holding company and a financial holding company,” and they were “granted both such status that weekend.” (Baxter: Trial Tr. 672:20 – 673:1). The Federal Reserve waived the usual five-day waiting period to make these approvals. (PTX 220; *see also* Geithner: Trial Tr. 1548:15-19 (Morgan Stanley’s application was approved “very quickly.”)).

(d) Geithner: On September 21, 2008, FRBNY Executive Vice Presidents William Dudley and Terrence Checki told Geithner that they were unable to find buyers for Goldman Sachs and Morgan Stanley. They proposed the alternative that the Federal Reserve approve the conversion of both investment banks into bank holding companies like Citi and JPMorgan. The conversion “would create the impression that they were under the umbrella of Fed protection.” (PTX 709 at 221; *see also* Alvarez: Trial Tr. 632:2-13 (Morgan Stanley and Goldman Sachs believed that FRBNY approval of their applications to become bank holding companies “would provide some imprimatur that would help them in their relations with the market.”)).

(e) FRBNY subsequently told Morgan Stanley and Goldman Sachs that they should apply to become bank holding companies. (Geithner: Trial Tr. 1547:10-13; *id.* at 1549:3-6; *id.* at 1551:11-19 (“I believe that I called both John Mack and Lloyd Blankfein directly to suggest to them that path.”)).

(f) On September 21, 2008, the Federal Reserve announced that it had approved the applications of Goldman Sachs and Morgan Stanley to become bank holding companies. (PTX 198; PTX 200 at 1, 8; PTX 201 at 1, 9-10; *see also* Paulson: Trial Tr. 1202:5-10 (“both Morgan Stanley and Goldman Sachs became bank holding companies.”); PTX 696 at 7 (Board of Governors approving “the applications of Goldman Sachs and Morgan Stanley to become bank holding companies”)).

(g) An “example of the value of Goldman Sachs becoming a bank holding company” was in “moving assets around to create liquidity in the event that it needs to be able to draw on it.” (Cragg: Trial Tr. 8712:6 – 8713:15; *see also* PTX 202 at 2 (Goldman Sachs press release stating, “We are moving assets from a number of strategic businesses, including our lending businesses, into GS Bank USA. With over \$150 billion in assets, GS Bank USA will be one of the ten largest banks in the United States.”)).

(h) A market analyst at Buckingham Research Group covering the conversion of Morgan Stanley and Goldman Sachs into bank holding companies summarized: “The benefits are clear in that it brings permanent access to the Fed discount window – and the liquidity and funding advantages that brings.” (PTX 1630 at 2).

(i) Cragg: The importance of becoming a bank holding company “is the Fed expressing a level of confidence in the institution by which the markets could also make a similar inference.” (Cragg: Trial Tr. 5450:20-25).⁹⁶

(j) On September 21, 2008, the same day that Morgan Stanley and Goldman Sachs were granted bank holding company status, the Federal Reserve Board of Governors authorized the extension of 13(3) credit to foreign subsidiaries of Morgan Stanley, Goldman Sachs, and Merrill Lynch. (PTX 696 at 7 (Board of Governors authorizing FRBNY “to extend credit as described below, (1) to the U.K. broker-dealer subsidiaries of Goldman Sachs, Morgan Stanley, and Merrill Lynch and (2) to the primary-dealer subsidiaries of Goldman Sachs, Morgan Stanley, and Merrill Lynch”); Bernanke: Trial Tr. 2119:6-18).

(k) The “purpose of permitting Morgan Stanley’s foreign subsidiaries to have access to 13(3) credit” was to “facilitate borrowing against that collateral without having to make complex transfers between foreign and domestic branches.” (Bernanke: Trial Tr. 2119:19-24).

⁹⁶ Defendant claims that there was a requirement that Goldman Sachs and Morgan Stanley raise private capital to become bank holding companies. *See, e.g.*, Geithner: Trial Tr. 1779:24 – 1781:3. However, neither company was obligated to provide “anything in writing confirming that they believed that they would be able to raise private capital if they were given a bank holding company status.” *See* Geithner: Trial Tr. 1926:11-16. Becoming a bank holding company did help both companies raise private capital, and thus they were better able to weather the Financial Crisis. In the case of Goldman Sachs, Warren Buffet made a \$5 billion equity investment for warrants at an exercise price of \$115/share, which was vastly different from the secured lending and 79.9% equity obtained without compensation by Defendant in the case of AIG. *See* Cragg: Trial Tr. 5447:10-19, 5448:22 – 5449:4. Morgan Stanley was the largest recipient of federal funds and also raised \$9 billion in private capital from Mitsubishi in exchange for a 20% equity stake. (PTX 709 at 222). Furthermore, the PDCF borrowings of the British subsidiaries of both Morgan Stanley and Goldman Sachs after they obtained bank holding company status were larger than the amount of capital that was raised. (PTX 728 at 11 (as of September 30, 2008, Goldman Sachs London and Morgan Stanley London had \$6.5 billion and \$25.523 billion in PDCF loans outstanding) (native spreadsheet)).

(i) Goldman London – 9/22- \$250 million; 9/23 - \$250 million; 9/24 - \$1 billion; 9/25 - \$2 billion; 9/26 - \$4 billion; 9/29 - \$5 billion; 9/30 - \$6.5 billion. (PTX 728 at 10-11 (native spreadsheet)).

(ii) Morgan Stanley London – 9/22 - \$9.6 billion; 9/23 - \$10 billion; 9/24 - \$10 billion; 9/25 - \$11.6 billion; 9/26 - \$12.2 billion; 9/29 - \$21.2 billion; 9/30 - \$25.5 billion. (PTX 728 at 10-11 (native spreadsheet)).

(iii) Merrill London – 9/22 – n/a; 9/23 - \$1.3 billion; 9/24 - \$4.8 billion; 9/25 - \$4.9 billion; 9/26 - \$6.8 billion; 9/29 - \$6.6 billion; 9/30 - \$6.7 billion. (PTX 728 at 10-11 (native spreadsheet)).

(iv) FRBNY accepted collateral denominated in foreign currencies from these U.K. broker-dealers. (PTX 638 at 3).

(l) Geithner: The interest rate charged Morgan Stanley and Goldman Sachs on all of the credit facilities that were made available to them was the primary credit rate. (Geithner: Trial Tr. 1553:17 – 1554:4).

(m) The January 2011 FCIC Report: “The investment banks drew liberally on the Fed’s lending programs. By the end of September, Morgan Stanley was getting by on \$96.1 billion of Fed-provided life support; Goldman was receiving \$31.5 billion.” (PTX 624 at 382).

(n) Geithner testified that he “wouldn’t find it surprising” if Morgan Stanley had borrowed more from the Fed than AIG as of September 16, September 22 and September 29, as Morgan Stanley had borrowed a “substantial” amount from the various facilities available to it. (Geithner: Trial Tr. 1399:5 – 1401:10-15, 1553:17-22; Geithner: Trial Tr. 1402:18 – 1403:1 (the total amount of liquidity provided to Morgan Stanley by the Federal Reserve in September 2008 “could have been very substantial”); Geithner: Trial Tr. 1550:21 – 1551:8 (As of

September 20, 2008, at the same time the Fed was approving Morgan Stanley as a bank holding company, it “seemed likely” to Geithner that Morgan Stanley “had already borrowed billions of dollars pursuant to” the PDCF)). On September 29, 2008, Morgan Stanley’s outstanding borrowing from all federal loan facilities was approximately \$107 billion. (PTX 728 at 11 (Morgan Stanley had \$61 billion in loans outstanding from the PDCF) (native spreadsheet); PTX 2565 at 3-4 (Morgan Stanley had \$36 billion in borrowings outstanding from the TSLF, including \$1.5 billion from September 5, \$500 million from September 12, \$14 billion from September 18, \$5 billion from September 19, \$10 billion from September 25, and \$5 billion from September 26) (native spreadsheet); PTX 2329 at 5 (Morgan Stanley had \$10 billion in obligations outstanding under the ST OMO facility, including \$5 billion due on October 8, 2008 and \$5 billion due on October 15, 2008)).

(o) By way of comparison, as of September 16, 2008, AIG had received \$14B in assistance versus \$16.5B in assistance to Morgan Stanley. By September 22, 2008, AIG had received \$37B versus \$60.6B by Morgan Stanley. By September 29, 2008, AIG had received \$55B and Morgan Stanley had received \$97.3B. “And contrast all of the terms of the two – you know, the types of loans that the two institutions were getting and see, you know, dramatic difference.” (Cragg: Trial Tr. 5075:20 – 5077:5; PTX 5356 (Cragg demonstrative comparing amounts outstanding, interest rate, various fees, and equity terms)).

32.2.11 On October 3, 2008, the Emergency Economic Stabilization Act (“EESA”) was enacted (P.L. 110-343, Oct. 3, 2008, 122 Stat. 3765). EESA authorized Defendant to purchase up to \$700 billion in troubled assets through the Troubled Asset Relief Program (“TARP”). (PTX 2156 at 14).

32.2.12 In 2008 and 2009, Defendant provided non-punitive assistance to Citigroup.

(a) Geithner: “Certainly Citi and BofA were insolvent.” (PTX 678 at 61; Geithner: Trial Tr. 1555:22 – 1556:7 (Citigroup “needed additional capital on a substantial scale or they would fail”); Geithner: Trial Tr. 1562:5-14 (“they certainly needed substantial additional financial support in some form or they would fail.”); Geithner: Trial Tr. 1556:2-7 (“They were experiencing severely acute funding difficulties, and it was our judgment – my judgment at the time that without additional financial support, that they were at significant risk of failure.”); PTX 709 at 151-52).

(b) Paulson: “Citi would have failed if it had not been provided with government assistance”. (Paulson: Trial Tr. 1233:6-9). Citi “had become almost too complex to manage. In the boom years, Citi had built a substantial exposure to commercial mortgages, credit cards, and collateralized debt obligations tied to subprime mortgages. It carried more than \$1.2 trillion in assets off its balance sheet, half of these related to mortgages. I knew that Citi was the weakest of the major U.S. banks.” (PTX 706 at 436).

(c) Bernanke: “despite the fact that Citi had supervision, including from the Federal Reserve, Citi got itself into a position where, without emergency government assistance, it was going to fail”. (Bernanke: Trial Tr. 2259:20-24).

(d) On November 23, 2008, the Federal Reserve, Treasury, and the FDIC announced that they would provide a package of guarantees, liquidity access, and capital to Citigroup. Under the terms of the support package, Defendant guaranteed up to \$306 billion in assets pursuant to the Fed’s 13(3) authority. (PTX 379 at 1, 3; PTX 1843; PTX 696 at 27-29 (November 23, 2008 BOG minutes);

(e) Citigroup accepted “the first loss position with a deductible of \$29 billion plus existing reserves, for a total of \$37 billion.” (PTX 2297 at 30; *see also* Bernanke: Trial Tr.

2125:1-20 (Bernanke: “The government term sheet at the bottom” of PTX 2297 is “an accurate description of the terms of the \$306 billion guarantee given to Citicorp”)).

(f) Bernanke: “this was a guarantee that the Federal Reserve participated in pursuant to its 13(3) authority” (Bernanke: Trial Tr. 2123:4-16; Geithner: Trial Tr. 1557:10-18 (FDIC’s guarantee authority “would not have extended to the obligations of the broker-dealer or other nonbank affiliates of Citigroup”)).

(g) The interest rate charged to Citigroup might have been as low 3.5%. (Geithner: Trial Tr. 1565:9-20).

(h) Cragg: Defendant provided significant liquidity assistance to Citigroup under more favorable terms via a guarantee of a \$301 billion portfolio. (Cragg: Trial Tr. 5102:25 – 5103:10; PTX 5368 (Cragg demonstrative); *see also* PTX 2856 at 236, Fig. 31 (Cragg Expert Report); PTX 2297 at 26-27, 31-34, 36, 66 (“Extraordinary Financial Assistance Provided to Citigroup, Inc.,” SIGTARP, Jan. 13, 2011)). “It was designed to limit the losses on this portfolio so that investors and others would have confidence or more confidence in Citigroup.” (Cragg: Trial Tr. 5102:25 – 5103:10).

(i) Cragg: In fact, Citigroup received “a wide range of assistance from the government.” (Cragg: Trial Tr. 5103:11-15). In addition to the \$301 billion guarantee, Citigroup received tens of billions in other assistance from Defendant, including “FHLB advances of 89 billion, TSLF funding of 30 billion, PDCF funding of 22 billion, TAF funding of 16 billion and ST OMO funding of 3 billion.” (Cragg: Trial Tr. 5103:19-25; PTX 5369 (Cragg demonstrative); *see also* PTX 2857 at 25, Table 1 (Cragg Rebuttal Report); PTX 2856 at 227, Table 18 (Cragg Expert Report); PTX 2563 (Term Auction Facility (TAF)); PTX 2329 (Single-Tranche Term Repurchase Agreements, March - December 2008)).

(j) Even though providing 13(3) assistance to Citigroup created a risk of moral hazard, Defendant “made a decision that stability was more important than moral hazard” and therefore did not punish Citigroup’s shareholders. (Paulson: Trial Tr. 1253:1-8).⁹⁷

(k) Paulson: Defendant did not condition the 13(3) assistance it provided to Citigroup on a change in Citigroup’s management. (PTX 706 at 442).

(l) Paulson: Referring to AIG, Paulson stated “I certainly believed it was treated on – on harsher terms than – than a number of others, than – than the one comparable I would come up with, Citibank. I – Citicorp. I think that AIG had harsher terms”. (Paulson: Trial Tr. 1231:19 – 1232:4).

(m) Geithner: With respect to the assistance given to Citigroup, there was “significant” “risk in relationship to the size of the facility”. (Geithner: Trial Tr. 1881:24 – 1882:2).

(n) Paulson: “We agreed that Citi needed an equity investment from TARP, but I demurred when Ben raised the possibility of buying common stock; the idea was good corporate finance but bad public policy. Citi’s market value was only about \$21 billion, and I pointed out that if we invested any meaningful amount in common stock, we would not only

⁹⁷ Paulson stated that Citibank’s terms were not as harsh as those imposed on AIG because he was concerned that punishing Citibank’s shareholders would reward short sellers and create “a domino effect” by encouraging short sellers to turn on other banks. Paulson: Trial Tr. 1249:19 – 1250:20, 1253:1-8. Paulson explained that he “didn’t have that same worry with AIG” because he “didn’t see another insurance company” that had “the same systemic importance” as AIG. Paulson: Trial Tr. 1251:7-20. That explanation does not withstand scrutiny, however. Paulson does not explain why the nature of AIG’s main business would prevent short sellers who profited from the reduction in AIG’s stock price from turning to financial institutions as the foreseeable next victims of the financial crisis. Moreover, MetLife already had access to the discount window as a bank holding company in 2008, and more recently has been identified as a systemically important institution. *See* DX 1399 at 201 (Metlife 10-Q for 2Q 2008, “The Holding Company and its insured depository institution subsidiary, MetLife Bank, are subject to risk-based and leverage capital guidelines issued by the federal banking regulatory agencies for banks and financial holding companies.”); DX 1883 at Exhibit 9.1, p. 4 (Saunders Expert Report Exhibits, showing MetLife’s Federal Reserve facility borrowings from August to December 2008, including from the discount window).

dilute shareholder equity and reward the short sellers, but also leave the government owning a large part of the bank.” (PTX 706 at 446).

32.2.13 In 2008 and 2009, Defendant provided non-punitive assistance to Bank of America.

(a) On January 15, 2009, Treasury, FDIC, and the Federal Reserve agreed to provide Bank of America with assistance, including the purchase of “an additional \$20 billion in newly issued senior preferred stock of Bank of America” under TIP. (PTX 406 at 1, 3). The Defendant also agreed to provide an “Eligible Asset Guarantee” on a pool of assets up to \$118 billion. (PTX 406 at 6).

(b) Bank of America was insolvent at the time it received 13(3) assistance from Defendant. (PTX 678 at 61).

(c) When “Citi and Bank of America sold or transferred equity either to the Treasury under TARP or to private individuals, they were paid for that equity”. (Geithner: Trial Tr. 1841:3-7).

32.2.14 Defendant permitted institutions such as American Express to become bank holding companies on an expedited basis throughout the fall of 2008.

(a) On November 10, 2008, after determining “that emergency conditions exist that justify expeditious action” on American Express’s application to become a bank holding company, the Federal Reserve approved American Express as a bank holding company (PTX 1833 at 2; Bernanke Trial Tr. 2115:4-13 (PTX 1833 “relates to the approval of American Express as a bank holding company”)), which “had the effect of bringing the holding company under the supervision of the Federal Reserve.” (Bernanke: Trial Tr. 2115:18-21).

(b) The purpose of allowing American Express to become a bank holding company “was to try to provide additional measure of market confidence in the firm.” (Bernanke: Trial Tr. 2115:18 – 2116:3).

32.2.15 In 2008 and 2009, Defendant provided non-punitive assistance to a major insurance company.

(a) Geithner: “other insurance companies availed themselves of assistance under TARP” because they faced “financial needs at some point, a mix of liquidity and capital.” (Geithner: Trial Tr. 1663:22 – 1664:13).

(b) For example, MetLife’s subsidiary bank accessed the Term Auction Facility 19 times in 2008 and 2009 for a total of \$18.9 billion at interest rates ranging from 0.2% to 2.38%. (*See, e.g.*, PTX 2563 at 16, 18-21, 23-27, 30, 33, 35, 38, 40, 43, 45, 47, 49).

(c) MetLife was also given access to the discount window as a financial holding company in 2008. *See* DX 1399 at 201 (Metlife 10-Q for 2Q 2008: “The Holding Company and its insured depository institution subsidiary, MetLife Bank, are subject to risk-based and leverage capital guidelines issued by the federal banking regulatory agencies for banks and financial holding companies.”); DX 1883 at Ex. 9.1, at 4 (Saunders Expert Report, showing MetLife’s Federal Reserve facility borrowings from August to December 2008, including from the discount window).

33.0

DEFENDANT CONTINUED TO CONTROL AIG THROUGH THE TIME OF THE REVERSE STOCK SPLIT AND THROUGH COMMENCEMENT OF THIS ACTION.

(a) Zingales:

(i) “I concluded that Defendant exercised control over AIG starting at least from September 16, 2008, until at least 2011.” (Zingales: Trial Tr. 3800:12-16; *see also* PTX 5045 – 5050, PTX 5054 – 5056, PTX 5058 – 5059, PTX 5061 – 5067, PTX 5069 (demonstratives discussing control); Zingales: Trial Tr. 3834:16 – 3835:2 (on PTX 5055: “I am sort of pointing out to evidence I found in documents of actions that are consistent with not simply a arm’s length lending but a direct involvement of the lender, in this case the Federal Reserve Bank of New York, into the daily activities of the corporation.”); PTX 5511 (Zingales slide demonstrating that the government “was really concerned on getting control – voting control from day one” (Zingales: Trial Tr. 8614:22 – 8615:12))).

(ii) “as of September 23, after the credit agreement is signed, the Government has the right to ask – within 45 days, the right to have those preferred shares issued. So, we know also, economic logic but also the Fed policy says that if you have a nonvoting stock that can immediately, at will of the holder, be converted into voting stock, it is as if you had voting stock. So, in this case, the Government has the ability to convert into voting stock that will control 79.9 percent of the voting in AIG, and so that alone will grant the Government control. But in addition to that, there were other factors that will – that substantiate the point even farther.” (Zingales: Trial Tr. 3828:16 – 3829:13 (discussing demonstrative PTX 5054)).

(iii) “the right of the government to have the preferred stock as an economic matter” led to “control prior to the time the stock was actually issued” because “the right to receive voting rights at your discretion” “for all practical purposes is the same” as having voting rights. (Zingales Trial Tr. 4098:1-10).

33.1 Senior Government officials acknowledged that Defendant controlled AIG.

(a) Bernanke testimony to Congress on March 3, 2009: “AIG is effectively under our control.” (PTX 447 at 50).

(b) Kohn on September 23, 2008: the Fed is “definitely acting like we own the company. Will need to consolidate on our balance sheet.” (PTX 233).

(c) Dahlgren told S&P on October 1, 2008 that she was speaking on behalf of the “largest creditor and 80% equity holder of the company.” (PTX 270 at 2; *see also* Dahlgren: Trial Tr. 2676:9-23 (confirming that was an accurate description of what she told S&P)).

(d) McConnell’s handwritten notes from September 15, 2008 state: “loan comes with conditions, plan to run the company.” (PTX 68 at 14).

(e) On September 16, 2008 at 9:43 p.m., Christopher Calabia of FRBNY sent an email stating, “We own aig, essentially. I can’t believe it”. (PTX 97).

(f) On September 17, 2008, Michael Silva (Geithner Chief of Staff at FRBNY) wrote an email stating that Greenberg “should have said he WAS one of the largest shareholders in the company. The Federal Reserve is now the largest shareholder in the company.” (PTX 109).

(g) Davis Polk:

(i) On September 21, 2008, a Davis Polk lawyer writes to Huebner, Brandow, and other counsel: “We would not want the new corporate parent to have 80% vote and value because we would not want that corporate parent to meet the test for affiliation under the consolidated return rules. . . . in case they are worried that there might be an argument to the effect that notwithstanding the formal limit on vote to 79.9%, the Fed in fact has more than that in voting power.” (PTX 3229).

(ii) A week later on September 28, 2008, lead outside counsel Marshall Huebner puts the question to various FRBNY and Treasury personnel: “do we want to

correct message that there is no way to stop us from taking control – 80% is already given.” (PTX 3218 at 1).

(iii) October 24, 2008 email from Marshall Huebner to Thomas Baxter attaching “as requested,” “a suggested draft email”: “It must be remembered that the current shareholders have strong views that are decidedly hostile to our transaction. Assume that – as is eminently possible under the proposal – the current 20% stockholders took over the board, fired all of senior management and, with their new (possibly _____ team), began to act in a manner (x) adverse to our recovery and (y) otherwise against the public interest. How would we explain and justify that we voluntarily allowed all of this to happen by unilaterally disclaiming elements of control? One of the main reasons we have been able to persuade AIG to do some good things, and not to do some ill-advised things, is precisely because of this voting power.” (PTX 3238 at 1).

(h) On May 7, 2009, Congressman Towns of the House Committee on Oversight and Government Reform wrote a letter to Liddy noting that he was “unaware that the Federal Reserve Bank of New York was so heavily involved in the management of AIG.” (PTX 514 at 3).

33.1.1 Defendant concluded that from a corporate governance perspective, the Credit Agreement covenants reflected a change in control over AIG.

(a) Davis Polk attorney Bradley Smith on September 22, 2008 with regard to a proposed “corporate governance covenant”: “In general terms, this could be approached as either an approval right over any change in the board or as an approval right over action taken by the board Obviously either would be highly unusual. . . . I find this one a little troubling.” (PTX 3273 at 1). Davis Polk attorney Arthur Long responds: “it is a change in control to

‘exercise a controlling influence over management’ of a thrift hold co or to ‘direct management and policies’ of a thrift co. The latter is clearly problematic and I think the former is also worrisome as one rule of thumb on covenants that go to management is whether they are usual in loan financing – this seems highly unusual and is per se controlling influence on board make-up.” (PTX 3273 at 1).

(b) Defendant ultimately conditioned all draws on the Credit Facility upon FRBNY’s satisfaction with AIG’s corporate governance. (JX 107 at 36 (§ 4.01(e))).

33.2 Defendant continued to prevent AIG from pursuing alternative funding options.

(a) On September 17, 2008, United States Senator Hillary Clinton called Paulson “on behalf of Mickey Kantor, who had served as Commerce secretary in the Clinton administration and now represented a group of Middle Eastern investors. These investors, Hillary said, wanted to buy AIG. ‘Maybe the government doesn’t have to do anything,’ she said”. (PTX 706 at 279).

(b) On September 21, 2008, Defendant was aware that “AIG shareholders are seeking alternatives to the federal government’s loan”, led by “Mickey Kantor, a cabinet member under former President Bill Clinton”. (PTX 208 at 3-4). In response, Huebner wrote to Jester (Treasury), Baxter, and others that “the shareholder march continues” and that “Beat the clock may matter here.” (PTX 208 at 2).

(c) On September 23, 2008, existing AIG shareholders met with representatives of AIG and Defendant. Prior to the meeting, AIG was “quite concerned” about Defendant “hearing every word that was stated by both parties” at the meeting. (PTX 3120 at 2). At the meeting, shareholders were “‘very concerned’ about the 79.9% equity interest” and were “focused on the ‘ability to claw it back should the facility be repaid in a reasonable time.’” (PTX 3120 at 2). After the meeting, Defendant and AIG discussed a concern that “the shareholder group was

likely inclined to function as a ‘shadow board’ and second-guess every decision taken.” (PTX 3120 at 3).

(d) After the Credit Agreement was executed on September 26, 2008, Studzinski wrote to Liddy about the Chinese government’s continued interest in AIG: “Chinese remain interested in a large investment and writing a large check. I know you are busy but I need you to focus because this could be a silver bullet solution and afford the Company the strategic and timing flexibility it needs.” “They are talking about writing a check of about \$50 billion.” **“We need to have Paulson call Vice Premier Wang Qishan.** The Chinese will then move ahead quickly.” (PTX 253 at 2 (emphasis added); *see also* Studzinski: Trial Tr. 4502:15 – 4504:8 (“this is the Chinese Government. They have studied the whole situation and at the most senior level.” The Chinese “saw this as a potential win-win, that they could help stabilize the situation by coming up with – you know, they really put the number US\$50 billion on the table.”)).

(i) Liddy then “took it upon himself to have a conversation with the Treasury Secretary.” (Studzinski: Trial Tr. 4504:23-25). Following that conversation, Liddy advised Studzinski in sum and substance “that Secretary Paulson would get back to Wang Qishan, but he didn’t think that they would want the Chinese Government to undertake something like this.” (Studzinski: Trial Tr. 4505:1-6).

(ii) Dan Jester (Treasury) received a copy of Studzinski’s e-mail on September 26, 2008 (PTX 253 at 1), but Paulson had no memory of Jester discussing it with him. (Paulson: Trial Tr. 1240:25 – 1242:7).

(iii) As late as November 2008, “the Chinese were asking questions” about AIG. (PTX 512 at 17-19). John Thornton, a former colleague of Paulson’s at Goldman Sachs and the Chair of Brookings Institute (Paulson: Trial Tr. 1220:2-8), “was coming to me

and saying is there a way for them to buy it, or invest in AIG? AIG was an icon in China” and “Hank Greenberg was legendary there.” “AIG in China was the gold standard for excellence.” (PTX 512 at 17-18).⁹⁸

33.3 The Defendant recruited and influenced new management for AIG.

(a) Defendant solicited and received advice from Morgan Stanley on replacing top-level AIG executives:

(i) Ruth Porat, Morgan Stanley: “to the extent you want a new GC for AIG, the genworth financial gc is, in my opinion, quite good. i would be happy to phone him.” (PTX 166).

(ii) J. Head: “we often got asked to say if we knew anybody that would – could be, you know, almost a part of the search process as they were looking for new executives to bolster their staff.” (J. Head: Trial Tr. 3727:5-19).

(b) Davis Polk, acting as counsel to FRBNY, originally proposed Paula Reynolds for the position of AIG’s chief restructuring officer. (Dahlgren: Trial Tr. 2667:21-24; PTX 261 at 1; *see also* Agreed to Stipulations ¶ 182). After Reynolds started work at AIG, Dahlgren “met with her multiple times a day” “because she was one of Mr. Liddy’s chief lieutenants” and “she ran a good chunk of the company and was responsible for the disposition of assets for the restructuring of the company”. (Dahlgren: Trial Tr. 2669:14-23; *see also* Dahlgren: Trial Tr. 2827:2-8 (“Paula was one of Ed’s key people, and so she was also responsible for asset dispositions and for sort of the future strategy of the company. So, Paula and I would interact frequently on those topics,

⁹⁸ Although Studzinski testified that potential private investors may not have invested absent some involvement by Defendant, he explained that “Mr. Greenberg was right in that the company had great assets and they should be fundable.... Remember, you were doing it not today, when there’s 3.5 trillion in cash in the S&P 500, but you were doing it at a time when effectively the banks had no money and everybody was pretty much terrified of poor liquidity.” Studzinski: Trial Tr. 7133:8 – 7135:13.

plus she was also responsible for areas like real estate, and so we would interact occasionally on that as well.”)). Dahlgren and “Reynolds discussed the issues at the company that needed to be addressed, how the disposition process was going, what were the plans, what would the company look like at the end, how did they think they would get there, where would the company be in the future”. (Dahlgren: Trial Tr. 2669:24 – 2670:5).

(i) Paula Reynolds: “To keep the Federal Reserve and other regulators fully informed and up-to-date on AIG and our restructuring requires that we interact with them regularly and provide substantial amounts of complex information from multiple sources on an ongoing basis.” (PTX 381 at 1).

33.4 Defendant controlled AIG’s CEO and senior management.

(a) Representatives of Defendant met hundreds of times with AIG management. (*See* PTX 703 (AIG spreadsheet tracking meetings and conversations between Defendant and AIG management)).

(b) On September 24, 2008, Dan Jester of Treasury informed Dahlgren that he “spoke with Liddy and asked him for a series of meetings on Friday” concerning “liquidity”, “sec lending”, and “asset disposition program”. (PTX 243 at 1).

(c) GAO Interview with FRBNY Personnel:

(i) “FRBNY holds regular and frequent dialogue regarding the overall direction of AIG with AIG’s CEO, senior leaders and general counsel. They discuss both high level and tactical issues at the corporate level.” (PTX 612 at 16; *see also* Dahlgren: Trial Tr. 2657:3-14 (confirming that is an accurate statement of the work that she and the monitoring team were doing)).

(ii) “FRBNY meets frequently with the operating companies to understand their business performances, management problems, and staffing. There are recurring

meetings between FRBNY and AIG to cover the risky categories.” (PTX 612 at 16; *see also* Dahlgren: Trial Tr. 2657:15 – 2658:2 (confirming that this is “an accurate description of what was done”)).

(iii) “FRBNY sits in on the steering committee meetings to discuss the details of unwinding AIG and its subsidiaries. In addition, FRBNY meets with individual AIG operations on-site.” (PTX 612 at 16; *see also* Dahlgren: Trial Tr. 2658:3-21 (confirming that FRBNY sat in on steering committee meetings to discuss the details of unwinding AIGFP, which was the only steering committee of which Dahlgren was aware)).

(iv) “FRBNY directly participates in asset dispositions. For example, FRBNY was involved in meetings regarding AIA and ALICO. FRBNY staff went to analyst meetings in Asia and held regular contact with negotiators on AIA and ALICO. Drafts of the purchase and sales agreements were provided to lawyers as they were generated. FRBNY therefore understood the implications of the dispositions as a creditor and had the insights and information necessary to meet the Bank’s obligations under the credit agreement. FRBNY knew about the status of the operations and the responsibilities in guarding its creditor position.” (PTX 612 at 16; *see also* Dahlgren: Trial Tr. 2658:22 – 2659:16 (that is “an accurate description of what was done by the FRBNY monitoring team”)).

(v) Dahlgren: “the New York Fed monitored the loan until AIG paid the loan off and we had no more exposure to AIG”, which was in “January 2011.” (Dahlgren: Trial Tr. 2813:24 – 2814:5).

(d) The monitoring team was having “Hands-on interaction” with AIG; “Ongoing daily meetings with key corporate managers”; Continued on-site presence at Financial Products”;

“Multiple daily interactions with the CEO”, Liddy; and “Observer status at Board of Directors meetings”, “Including all committee meetings”. (PTX 293 at 19; Dahlgren: Trial Tr. 2653:9 – 2654:16 (confirming that Dahlgren prepared the section of the presentation related to AIG.)).

(e) June 10, 2010 COP Report: “FRBNY uses its rights as creditor to work with AIG management to develop and oversee the implementation of the company’s business strategy, its strategy for restructuring, and its new compensation policies, monitors the financial condition of AIG, and must approve certain major decisions that might reduce its ability to repay its loan.” (PTX 589 at 180-81 (quotations omitted)).

33.4.1 Defendant attended and participated in AIG Board of Directors meetings.

(a) FRBNY attorney James Hennessy: “Though we can exercise it with discretion and restraint, there is no escaping our influence, given that we are the only ones who have daily contact with the company, have a team on the ground, attend board meetings (including compensation committee meetings), etc.” (PTX 3305 at 1).

(b) Liddy:

(i) Liddy to the COP on May 13, 2009: The “Federal Reserve is present at every one of our strategic discussions at all of our board meetings and all of our committee meetings.” (PTX 516 at 29). The Federal Reserve was “a significant participant” at AIG “board meetings and in other significant meetings in terms of reviewing policy.” (Liddy: Trial Tr. 3008:24 – 3009:3).

(ii) The Federal Reserve “had the ability to weigh in either yea or nay on anything” that AIG decided. (Liddy: Trial Tr. 3008:14-23).

(iii) Liddy to the COP on May 13, 2009: “The Federal Reserve has delegates at every building meeting and every committee meeting.” (PTX 516 at 50).

(iv) Federal Reserve representatives attended AIG's "compensation committee meetings" (Liddy: Trial Tr. 3008:14-18), and attended "various meetings on strategy" held by AIG (Liddy: Trial Tr. 3008:19-20).

(v) Liddy to Congress on March 18, 2009: Asked by Congress whether the Federal Reserve had been a participant at AIG's board meetings and in other "significant meetings in terms of reviewing policy", Liddy answered: "Yes. Absolutely yes. And it goes well beyond that. It goes to participation in all the things that lead up to board meetings or committee meetings." (PTX 471 at 75; *see also* Liddy: Trial Tr. 3009:4 – 3010:14 (Liddy: "that was truthful, accurate and complete testimony")).

(vi) "Sarah and/or one of her people would sit in the board meetings, and we would conduct the board meetings the way they normally would. If they felt they wanted to get involved or ask a question, they would. They rarely did. If they had any – any

concerns or anything they wanted to follow up on, they would usually do it after the fact.” (Liddy: Trial Tr. 3216:25 – 3217:9).⁹⁹

(c) Dahlgren: “I sit in on all Board and committee meetings.” (PTX 581 at 3; *see also* Dahlgren: Trial Tr. 2834:24 – 2835:4 (“one of the provisions in the credit agreement was that the lender needed to be satisfied with the corporate governance of the borrower, and so one way to do that was for me to attend board meetings to observe the corporate governance in action.”)).

(d) At the AIG board meetings, if AIG turned to issues relating to its financial relationship with the New York Fed, Dahlgren claims she “was dismissed from the room or left.”

⁹⁹ Liddy cited to two “instances in which AIG advised the government that it planned to do something, the government objected, and AIG went ahead and did it anyway” in an attempt to demonstrate that Defendant did not control AIG. The first example was David Herzog’s promotion to CFO. Liddy: Trial Tr. 3011:10-19; *see also id.* 3216:22-24. However, the evidence suggests that Defendant never objected to his promotion but was only made aware of it after Liddy had already offered the promotion. *See* PTX 1777 at 2 (Dahlgren reviewed AIG’s press release announcing Herzog as CFO, and responded that she was “surprised to see David as CFO ... (had only heard Ed speak about him as EVP of Finance)” (ellipses in original)); *see also* Dahlgren: Trial Tr. 2697:8-15 (“this email chain has to do with the Federal Reserve Bank of New York’s approval of a press release concerning a new CFO for AIG”). Moreover, Defendant subsequently exerted direct control over the terms of Herzog’s employment as CFO. PTX 562 at 11-12. The second example Liddy gave was the continued service of Morris Offit as a board member. Liddy: Trial Tr. 3011:20 – 3012:3. While the trial record indicates that Liddy and Defendant discussed the issue, it was not a decision in AIG’s or Liddy’s discretion – it was always up to Defendant, who held the majority voting stock to reelect board members at their choosing. Finally, Liddy acknowledged that over a year earlier, during his deposition, he was unable to come up with either of these examples of purported differences in opinion where AIG did something contrary to what Defendant advised. *See* Liddy: Trial Tr. 3015:2 – 3016:7.

(Dahlgren: Trial Tr. 2836:3-6). But Liddy or Stasia Kelly would have briefed the Federal Reserve “on what was covered in the executive session”. (Liddy: Trial Tr. 3119:10-23).¹⁰⁰

33.4.2 Defendant recruited directors for AIG.

(a) Defendant admits that “FRBNY employees participated in the recruitment of new AIG board members”. (Def. Resp. to Pl. 2nd RFAs No. 806).

(b) Geithner:

(i) FRBNY monitoring of AIG did “include Federal Reserve Bank of New York employees participating in the recruitment of new AIG board members”. (Geithner: Trial Tr. 1634:10-13).

(ii) “I think it’s quite likely I spoke with Secretary Paulson” and “was aware of suggestions that Ken Wilson had” regarding replacing or adding board members to AIG’s Board. (Geithner: Trial Tr. 1626:6-21).

(iii) Geithner even acknowledged that “it’s also possible that I spoke to, at some point, potential candidates. For example, I think it’s possible that I had a conversation with Bill Thompson and perhaps with Dennis Dammerman.” (Geithner: Trial Tr. 1627:3-8; *see also* Geithner: Trial Tr. 1627:11-18 (“I think it’s likely that I did” have conversations with prospective AIG board members)).

(c) Dahlgren:

¹⁰⁰ Although Dahlgren and Offit testified that Defendant was not significantly involved in the Board’s decisionmaking and did not coerce the Board to vote a particular way (*see, e.g.*, Dahlgren Trial Tr. 2836:14-24; Offit: Trial Tr. 7905:14-25), as Professor Zingales explained, Defendant’s control position provided Defendant with a “strong veto power” such that the Board knew that it had to act “conditional on the veto power” constraint. Zingales: Trial Tr. 3964:10 – 3965:5, 4102:4 – 4103:5. This point was further reinforced by Liddy’s testimony that Defendant “had the ability to weigh in either yea or nay on anything” that AIG decided. Liddy: Trial Tr. 3008:14-23.

(i) “I was asked by Ed at one point to speak to a prospective director, Doug Steenland, in order to try to convince him to join the board.” (Dahlgren: Trial Tr. Trial Tr. 2682:16-23).

(ii) Dahlgren and Bill Dudley also had “conversations with Harvey Golub to try to persuade him to become the chair” of the AIG Board. (Dahlgren: Trial Tr. 2686:16-22).

(iii) On October 19, 2008, Dahlgren emailed Geithner about prospective board members: “are you okay with these three names? and do you have a preference for the next choice? (The first two in line are – Denis Dammerman and Jim Hance... and Ed has Fred Langhammer’s resignation already, Dick Beattie is talking with Marty Feldstein (or did this weekend), and Morris Offit is prepared to hand his resignation to Ed when he asks.” (PTX 310; *see also* Dahlgren: Trial Tr. 2694:9-21 (“that has to do with requests being made to the existing AIG board to resign”)).

(iv) On or about February 21, 2009, Dahlgren told Michael Hsu of Treasury that the Board of Governors “wanted FRBNY to have people lined up to replace the board of directors”. (PTX 428; *see also* Dahlgren: Trial Tr. 2683:14 – 2684:12 (“Following on discussions that we had about the upcoming restructuring, I would have communicated the feedback that I had received from the Governors, and that is what I’m doing here”)).

(v) On April 3, 2009, Dahlgren told Liddy that Treasury “would be recruiting two very high profile directors (‘wow factor’) in the immediate term”. (PTX 2077 at 1; *see also* Dahlgren: Trial Tr. 2684:18 – 2685:12 (confirming the April 3, 2009 email)). Reporting on her conversation with Liddy, Dahlgren noted that Liddy “indicated that he had received several calls from individuals that had been asked to serve on the AIG

Board of Directors.” Liddy “didn’t sound pleased.” (PTX 2077 at 1; *see also* Dahlgren: Trial Tr. 2685:20 – 2686:5 (confirming that was an “accurate description” of her discussion with Liddy)).

(d) In April 2009, Defendant planned to replace the Board of Directors and appoint two lead directors to serve as the “‘governmental’ face of” AIG. Defendant also planned to require the new directors to replace AIG management. (PTX 496 at 3).

33.4.3 Defendant decided which directors would stay and which would be replaced.

(a) Email from Huebner to Baxter and others on September 19, 2008: “we also are ready to advise on how the entire board can be replaced without a shareholder vote”. (PTX 154 at 2).

(b) Liddy:

(i) At “some point in time in the process, the government wanted to bring in new directors and remove some of the old ones.” (Liddy: Trial Tr. 3012:4-11).

(ii) Liddy and Dahlgren “had several conversations” “about replacing members of the AIG board of directors.” (Liddy: Trial Tr. 3014:3-6; *see also* Dahlgren: Trial Tr. 2695:3-7 (“I probably had a discussion that roughly said he needed new blood on the board.”)).

1. In fact, Dahlgren acknowledged that she may have instructed Liddy that “most of the existing members of the AIG board should be replaced by new directors”. (Dahlgren: Trial Tr. 2695:8-12).

(c) Dahlgren also spoke directly with existing AIG Board members about whether they should stay on the AIG Board. (Dahlgren: Trial Tr. 2687:1-9 (“I imagine I did have

conversations with Suzanne Nora Johnson at some point” about whether she should stay on the AIG Board)).

(d) Treasury attorneys were concerned about the implications for control that Defendant’s appointment of the AIG Board and AIG management would have: “Duane and Steve, are you staying on top of aig.? I wandered into matt kabaker’s office tonight and they were discussing changes to the board, management, and the trust. Has someone looked at the trust and considered the legal implications of exercising that much control? I have not been involved with AIG. I am concerned that this is being done without any legal review.” (PTX 3237).

(e) Baxter spoke with AIG’s outside counsel about replacing AIG directors without AIG’s knowledge or involvement. On April 28, 2009, Baxter wrote to Doug Foshee, copying Dahlgren, on the subject of the “New Board”: “As promised, I spoke last night with Michael Wiseman from Sullivan & Cromwell, which has long represented AIG on corporate matters. Michael is an old friend, and he agreed that our conversation would be kept very close. I will address the issues in sequence. (1) Appointment of New Board. It is not necessary to move the new board through the lead director. It is necessary to move it through the Nominating and Governance Committee of the board, but Michael believes this can be done very quickly, and it may be done telephonically. He promised to check this morning with Delaware counsel to confirm this view.” (PTX 510 at 3-4).

(f) Later that day, on April 28, 2009, Dahlgren told Liddy “in substance” that she “believed that Mr. Bollenbach should be replaced” as the lead director. (Dahlgren: Trial Tr. 2688:16-22). Dahlgren reported to Foshee and Baxter that Liddy had “asked whether it would be okay to put Mr. Bollenbach into the transition category rather than in the ‘out right now’

category”. (Dahlgren: Trial Tr. 2688:23 – 2689:9; *see also* PTX 510 at 1 (Email from Dahlgren to Foshee and Baxter: “on the Bollenbach issue, he described a process where Bollenbach would be considered in the ‘transition’ category, rather than the ‘out right now’ category and asked if I’d be okay with this”)). Dahlgren told Liddy that although she couldn’t speak for anyone else, from her perspective, that would be okay, but she also explained again what her concerns were about Bollenbach. (Dahlgren: Trial Tr. 2689:10-14; *see also* PTX 510 at 1).

(i) Bollenbach subsequently left the board. (Dahlgren: Trial Tr. 2689:15-17).

(g) At the June 30, 2009 annual meeting of AIG shareholders, six new directors were elected to AIG’s Board. All were selected by Defendant. (JX 251 at 22-23).

(i) Dahlgren said she thought that, prior to the proxy vote in June, “all of the directors who were going to be replaced had already agreed to resign”, but she did not “know for sure.” (Dahlgren: Trial Tr. 2934:13-20; *see also* PTX 310).

(ii) And “all of the directors that were going to replace the resigning directors had already been selected before the proxy was prepared”. (Dahlgren: Trial Tr. 2934:21-25).

(iii) Dahlgren: “At least two” directors had agreed to resign but not yet actually resigned prior to the time the trustees were selected. (Dahlgren: Trial Tr. 2935:7-12).

(h) In the period between September 16, 2008 and the end of June 2009, eight of the members of the AIG board – Willumstad, Langhammer, Rometty, Sutton, Bollenbach, Feldstein, Orr and Tse – had been replaced. (Offit: Trial Tr. 7962:18 – 7963:13). The “only three members of the board who had been members of the board in September of 2008 that stayed on the board were” Offit, Miles, and Nora Johnson. (Offit: Trial Tr. 7963:14-18).

(i) In 2010, Treasury appointed Donald H. Layton and Ronald A. Rittenmeyer to AIG's Board of Directors pursuant to its rights under the Series E and F Preferred Stock. (JX 256 at 2).

(i) The terms of the Series E and Series F stock did not impose any restrictions on Treasury's discretion in appointing directors. (*See* JX 208 at 4).

(j) Zingales: "I think that the Government was able to get, up to the new slate, some compliant or mostly compliant board members, and by 2009, a slate of directors they handpicked." (Zingales: Trial Tr. 3836:3 – 3837:24 (further detailing the Government "handpicking" AIG directors); *see also* PTX 5056 (demonstrative containing a timeline of events for this issue)).

(i) "as early as September 18, the Government's outside counsel said it was ready to advise how the entire board can be replaced without a shareholder vote. So, this seems to be an indication that they were actively thinking about replacing the board, and the combination of this threat plus sort of the constant monitoring of the board makes it very easy for the Government to get what they want." (Zingales: Trial Tr. 3836:8-15).

(ii) Fed Policy Statement on Control: "Importantly, controlling-influence determinations depend not just on the contractual rights and obligations of the investor and the banking organization; they also depend on the amount of influence the investor in fact exercises over the banking organization." (PTX 2579 at 15; *see also* Zingales: Trial Tr. 3811:18 – 3812:10 (describing this statement as "consistent with" his understanding "of economic theory"))).

(iii) "From an economic point of view, if you have a – 50 percent or more of the stock and you can replace the board – the board members at will, it's basically such strong veto power that you get your way whether you have the most independent

directors or you have Daffy Duck, to use a quote of Bollenbach.” (Zingales: Trial Tr. 3964:10 – 3965:5).¹⁰¹

33.5 Defendant controlled AIG executive compensation decisions.

(a) Huebner: “there were a series of conversations going on about what compensation for AIG senior executives should be. You know, the TARP limitations were one set, and then there were other conversations that were also going on at the time in light of, you know, a lot of public anger at AIG and otherwise.” (Huebner: Trial Tr. 6318:2-11).

(b) Treasury’s Michael Hsu on AIG compensation issues: “We need a dedicated person and process to track and manage these.” (PTX 3353 at 1).

(c) Dahlgren had “a number of conversations about compensation” decisions with Liddy, and in those conversations Dahlgren expressed FRBNY’s concerns. (Dahlgren: Trial Tr. 2665:4-13). Liddy’s ultimate compensation decisions “often reflected the concerns” expressed by FRBNY. (Dahlgren: Trial Tr. 2665:21 – 2666:6).

(d) By November 6, 2008, Liddy had become “upset” with the restrictions on compensation imposed by Defendant. Liddy “Feels he was brought in to save AIG and shouldn’t have hands tied.” (PTX 352 at 1 (“Ed is upset. Never thought ssfi or yet more would apply.”);

¹⁰¹ Professor Daines theorized that the fact that the AIG Board were elected by the common shareholders prior to accepting the Credit Agreement meant that the AIG Board was independent and free from control in all its subsequent decisions, including the Reverse Stock Split. *See* Daines: Trial Tr. 8450:20 – 8451:20, 8451:24 – 8452:14, 8453:17 – 8454:9 (on May 20, 2009, when the Board approved the reverse stock split, “five of the seven members who voted to propose this had been elected by shareholders or appointed to serve shareholder interest before the government came on the scene.”), 8454:10 – 8455:1; DX 2804 (Daines demonstrative on “Composition of AIG Board of Directors on Key Dates”). However, as Prof. Zingales explained, the purported “independence” of the Board is irrelevant when the Board only has one meaningful choice or is in a control situation. Zingales: Trial Tr. 3894:10-18, 3964:10 – 3965:5. Furthermore, by the time of the June 2009 proxy, 8 of the 11 directors had been replaced by Defendant. Offit: Trial Tr. 7962:18 – 7963:13.

see also Huebner: Trial Tr. 6316:13 – 6317:11 (“SSFI was a Treasury program” that included “some restrictions on compensation”)).

33.5.1 The restrictions on compensation that Defendant imposed upon AIG went “far beyond the EESA requirement”. (PTX 3243 at 2).

(a) Treasury counsel Stephen Albrecht: “we are applying the strictest exec comp rules”. (PTX 3243 at 1).

33.5.2 Defendant worked on a compensation package for Liddy. (PTX 3363).

33.5.3 Defendant directed Liddy to reduce Stephen Bensinger’s compensation.

(a) Sometime in late 2008, Dahlgren and Baxter met with Liddy to discuss Stephen Bensinger’s compensation. (PTX 472 at 1 (Baxter: “I seem to recall a meeting I had with Tim, when he was president, about Benziger. Sarah and I then went and met with Ed. Cuomo took credit for stopping his comp, but we actually did it in the meeting with Ed.”); *see also* Geithner: Trial Tr. 1629:11-21 (“I do not know who Mr. Benziger is, so I don’t recall being aware of that. But I do have a general recollection that at that time when I was still president, I was exposed to a bunch of concerns about some compensation issues at AIG. And I think it’s likely in that context that I spent some time talking to Mr. Baxter about how we might encourage them to address those concerns.”)).

(b) Dahlgren:

(i) At that time, “there was a lot of turmoil around the compensation that Steve was to receive after leaving the company.” (Dahlgren: Trial Tr. 2666:15-20).

(ii) During their meeting with Liddy, Dahlgren and Baxter “communicated a level of disbelief that Steve would be getting the level of compensation that he did based on the performance of the company.” (Dahlgren: Trial Tr. 2666:21 – 2667:2).

(iii) Following his meeting with Dahlgren and Baxter, Liddy reduced Bensinger's compensation. (Dahlgren: Trial Tr. 2667:3-7).

33.5.4 In February and March 2009, Defendant intervened when controversy erupted over payment of bonuses to AIGFP executives that FRBNY had previously approved.

(a) In February 2009, FRBNY reviewed and approved bonuses to be paid to certain AIGFP executives. "The bonuses were reviewed with the Federal Reserve Bank" before the bonuses became public, and "the Federal Reserve Bank of New York had indicated that the proposed bonus amounts are generally in an appropriate range". (Liddy: Trial Tr. 3119:24 – 3121:19; *see also* PTX 432 at 4 (Minutes of the February 24, 2009 AIG Compensation and Management Resources Committee meeting: "In response to Mr. Liddy's request, Mr. Hennessy commented that the representatives of the FRBNY believe that the proposed bonus amounts are generally in an appropriate range.")).

(b) In March 2009, Defendant asked AIG to "rethink" AIG's 2008 corporate bonus proposals. (DX 776 at -992). In response to that request, Liddy explained in a March 14, 2009 letter that: "The proposals AIG originally submitted to you are part of a deliberative process, recommended by me and supported by the independent compensation committee of AIG's board of directors. We started with the additional compensation limits that AIG had already committed to – limits that were more extensive than those at any other recipient of TARP funds at the time – and weighed a variety of considerations appropriate to the goal of repayment and AIG's unique circumstances. Nevertheless, in response to your request, we are now proposing further changes to the 2008 corporate bonus proposals for Senior Partners that will better align their interests with AIG's restructuring efforts and the goal of repayment." (DX 776 at -922; Liddy: Trial Tr. 3127:17 – 3128:22).

(c) On March 13, 2009, Hennessey emailed Liddy and others: “Tim and Ed have reached agreement on how to deal with the senior partners under the 2008 Bonus Program.” (PTX 464; *see also* Liddy: Trial Tr. 3123:6 – 3124:9 (“Senior partners was a term used at AIG for people who participated in other bonus plans” separate from AIGFP’s bonus plan, “and I think what this document is referring to was those people were due retention bonuses”)).

(i) The agreement Liddy and Geithner “reached was not merely to delay a portion of the bonus, but it was first to delay it and second to make those delayed payments conditional on the company making sufficient progress on its restructuring and repayment plans”. (Liddy: Trial Tr. 3125:13-21).

(d) After the AIGFP bonuses were published they became a “lightning rod” for controversy (Liddy: Trial Tr. 3119:24 – 3120:8), “there was a lot of outrage about the compensation particularly of individuals up at Financial Products, which was one of the big issues at AIG and where a lot of the losses were had, that anyone at Financial Products would get paid anything, much less the kinds of bonuses that were scheduled to be paid.” (Dahlgren: Trial Tr. 2910:16 – 2911:16). Liddy “asked the individuals who received those bonuses at FP to consider giving back 50 percent of the bonuses that they had received.” (Liddy: Trial Tr. 3122:9-25).

(e) On March 15, 2009, Bernanke wrote to Geithner (then Secretary of the Treasury): “Tim, you did a fine job intervening with Liddy on the bonuses and contained what would have been even worse damage. We will support your stance every way we can (let us know if there is something specific we can do). I gather that our lawyers are advising against litigation though I would tend to favor it even if it gets thrown out.” (PTX 466).

(f) Dahlgren:

(i) “leading into the spring of 2009, there were additional constraints, including the implementation at one point, at some point that spring, of a compensation czar at Treasury whose job was to basically approve compensation of the top, you know, 25 to 50 employees at AIG and other companies.” (Dahlgren: Trial Tr. 2911:17 – 2912:4).

(ii) Email from Dahlgren to senior FRBNY officials on March 29, 2009: Liddy “indicated that Doug Steenland is very much on the fence -- the key issue is the same issue that’s affecting all of the directors -- it’s unclear what role the board of directors really can play in this situation --- if it can’t make comp decisions or most other decisions, then what does the board really do? . . . and not to state the obvious, but the same is true for Ed...he has no decisionmaking authority – and is paralyzed at this point by the USG’s role.”(PTX 485 (ellipses in original); *see also* Dahlgren: Trial Tr. 2598:13 – 2599:6 (confirming that PTX 485 does “fairly reflect what Mr. Liddy had told” Dahlgren)).

(iii) “the directors and Ed were, you know, feeling like they didn’t have any decision-making because compensation decisions had essentially been – for the top officials at AIG had been taken out of their hands”. (Dahlgren: Trial Tr. 2912:5-21). “this was a really hard time for the company, a really hard time for Ed and for Ed personally, and the level of frustration, the – at this time, the lack of total clarity about what the – how the compensation decisions would be made by the government, so being paralyzed by not entirely understanding what the government was going to do and how it

was going to work, this is what I'm expressing here, is the, you know, Ed was extremely frustrated at this point." (Dahlgren: Trial Tr. 2913:1-21).¹⁰²

(g) Email from Bernanke to Alvarez on March 25, 2009: "Scott, this is the record of my call to Ed Liddy today. I sympathized with him about all the criticism he has received and thanked him for his public service under very trying circumstances. I encouraged him to check in with me periodically about the progress of the divestiture plan and any other important matters. He was pleased to have received the call and promised to communicate periodically." (PTX 482).

33.6 In the spring of 2009, Bernanke advocated for a "reset" on AIG requiring "a perceived and actual break in the governance regime."

(a) On April 1, 2009, then FRBNY President William Dudley sent a memo to Bernanke and others titled "Proposals to Separate AIG FP from AIG Inc" with the message: "Per our call earlier this week, here is a memo that briefly outlines the options of managing down/hiving off/winding down AIG FP with rough estimates of cost, residual exposure and risk. I would suggest a call tomorrow to discuss next steps. The broader 'Reset' plan needs to be implemented rapidly, esp given the issue of the Treasury's \$30 billion TARP commitment, which still has not settled." The memo outlines four proposals: (I), a wind-down with third-party managers; (II), a wind-down with a derivatives vehicle; (III), a sale of AIG FP; and (IV), a fire sale liquidation. (PTX 491 at 1, 2).

33.7 All outside accountants recognized that Defendant controlled AIG.

¹⁰² AIG Board and management's paralysis in decision-making was not just due to the restrictions imposed by TARP, as Defendant implies, but predates those restrictions, as noted above. *See supra* §§ 15, 33-34. Furthermore, it does not explain, nor was any explanation proffered at trial, why AIG was subject to the highest level of compensation restrictions under the TARP program. *See* PTX 3243 at 1 ("we are applying the strictest exec comp rules").

(a) FRBNY representatives Sarah Dahlgren and Ethan James “met before the quarter end with the outside accountants, together with – with David [Herzog] and AIG, before the issuance of every earnings release.” (Dahlgren: Trial Tr. 2702:3-12).

(b) On October 28, 2008, Donald Farnan and Tim Ryan of PwC met with Herzog, Dahlgren, and Ethan James of Davis Polk. In a November 6, 2008 memo memorializing the meeting, Ryan stated:

(i) “The purpose of the meeting was to discuss the management representation process and to specifically request that the Federal Reserve be involved in that process giving their credit facility and that there is now a controlling shareholder at AIG in Q3 (note while technically not the Fed - as the Trust is not formed - the Fed appears to be functioning in the role of controlling shareholder).” (PTX 350; *see also* Farnan: Trial Tr. 4188:14-25 (memo accurately reflects his understanding)).

(ii) “Specifically, we explained that in a ‘typical’ quarter - we would ask management for representation and after reviewing those representations and assessing them, we would accept those representations. We explained that - given the Federal Reserve role as the provider of the Credit Facility and the 79.9% interest that was given up by AIG in consideration of the facility and the fact that the Fed - in its role might have plans for Company assets or liabilities (or other items) which are inconsistent with management’s plans.” (PTX 350; *see also* Farnan: Trial Tr. 4189:1-14 (that was an issue PwC thought it was “useful to address at this time”)).

(iii) “We also indicated that we would like to meet with the Federal Reserve later in the quarter to confirm that they have read the letter and that there are no objections or inconsistencies in the representations.” (PTX 350; *see also* Farnan: Trial

Tr. 4189:15-25 (that is “an accurate description of what Ms. Dahlgren and Mr. James conveyed” to PwC).

(c) Dahlgren: PwC “asked to meet with us regularly, and in addition, before quarter end to understand, you know, what was going on in the company and our views.” (Dahlgren: Trial Tr. 2704:11-20). “They wanted to make sure that our views were consistent with what was characterized by management.” (Dahlgren: Trial Tr. 2706:17 – 2707:1).

(d) On October 7, 2008, AIG sent Farnan and others at PwC a draft “AIG Accounting Policy Memorandum” on the preferred stock AIG issued in connection with the credit facility. (PTX 284 at 2). That memo states: “The 100,000 shares of preferred stock provide the holder(s) with voting rights equivalent to up to 79.9% of the voting power of all equityholders. This provides the Treasury, as sole owner of the preferred shares, control over AIG.” (PTX 284 at 3; *see also* Farnan: Trial Tr. 4191:3-20 (that would have been “an accurate statement once the Trust was set up”)).

(e) Davis Polk attorney John Brandow on November 6, 2008 with regard to Ernst & Young: “AIG’s accountants raised an issue last night over the equity classification of the TARP preferred. Their concern relates to the redemption provisions in the draft term sheet. They explained that a right to redeem is usually viewed for accounting purposes as solely the company’s option. . . . In this case, however, AIG’s accountants are concerned that the relationship between UST and NYFRB is such that the government will be in a position to require the company to redeem the security when the company has the right to do so, effectively giving the preferred stockholders a put. . . . We have reviewed this analysis with E&Y, and we tried to persuade them that UST and FRBNY are sufficiently distinct that the TARP preferred should not be excluded from equity, but E&Y shares the company’s concern.” (PTX 3346 at 2).

(f) FRBNY attorney Charles Gray: “E&Y accountants are basically viewing the Treasury as having control over AIG’s decision to redeem the Senior Preferred through the actions of the Trust and the influence that the FRBNY exerts as lender.” (PTX 3346 at 1).

(g) PwC (Tim Ryan) on November 9, 2008: “we believe that we have appropriately considered the controlling share holder and primary lenders views and knowledge in determining whether or not it is appropriate to accept management’s representations.” (PTX 364 at 3).

(h) Farnan: FRBNY was “operating and functioning as a controlling shareholder absent the trust being set up and the Series C being issued to the trust”. (Farnan: Trial Tr. 4173:15 – 4174:6; *see also* Farnan: Trial Tr. 4366:14-24 (noting that a PwC team working for FRBNY undertook a related party analysis with respect to FRBNY and AIG, which stated that PwC “would support the view that AIG is a related party through indirect control or significant influence beyond the bank’s normal supervisory capacity.”)).

(i) Deloitte: FRBNY “has governance rights” in AIG “through its ability to appoint the Trustees of the Trust. However, such rights are required to be exercised in consultation with the Treasury.” (JX 386 at 14).

(j) On November 6, 2008, AIG sent Farnan and others at PwC a November 5, 2008 draft “AIG Accounting Policy Memorandum” stating that AIG understood that the Series C Preferred Stock gave the “Treasury, as sole owner of the preferred shares, control over AIG.” (PTX 347 at 62; *see also* Farnan: Trial Tr. 4176:13 – 4177:7 (AIG would have sent the memo to PwC to get their “point of view on whether the conclusions they were drawing were acceptable.”)).

33.8 Defendant controlled AIG’s operations.

(a) AIG executives to GAO in December 2010: “Given the FRBNY’s position as creditor, and the terms of the credit agreement with FRBNY, AIG has certainly not been an equal

partner in reality. But in practice, the FRBNY has not been arbitrary with AIG, and has worked collaboratively with the company, so that ‘it really felt like we were partners.’” (PTX 620 at 13).

33.8.1 The Credit Agreement empowered Defendant to stop funding the credit facility at any time.

(a) Section 4.01(d) of the Credit Agreement provides that a condition of funding is that FRBNY is “satisfied in its sole discretion with the Collateral (including the value of the Collateral)”. (JX 107 at 36).

(b) Zingales: Defendant’s power to stop funding AIG at any time gave Defendant control. (PTX 5054 (Zingales demonstrative); Zingales: Trial Tr. 3829:14 – 3830:6 (“the source of power for the Government was the control as the lender of last resort, because the Government was the only game in town in that situation. So, it is like I am the monopolist in providing water or electricity to this town and at my discretion, I can stop providing that electricity or that water, and that clearly sort of impair the ability of the town to operate.”)).

33.8.2 The Credit Agreement required that FRBNY “be reasonably satisfied in all respects with the corporate governance of the Borrower”. (JX 107 at 36 (§ 4.01(e)).

(a) The Credit Agreement provides that FRBNY’s agreement to lend money to AIG is conditioned on a requirement that “The Lender shall be reasonably satisfied in all respects with the corporate governance of the Borrower after giving effect to the Transactions then consummated.” (JX 107 at 36 (§ 4.01(e)).

(b) Report Pursuant to Section 129 of the Emergency Economic Stabilization Act of 2008: Secured Credit Facility Authorized for American International Group, Inc. on September 16, 2008: “FRBNY’s agreement to lend is conditioned on FRBNY being reasonably satisfied in

all respects with the corporate governance of AIG after giving effect to the transactions provided for in the Credit Agreement.” (PTX 339 at 5).

(c) Zingales: Section 4.01 of the Credit Agreement is a source of the Government’s control over AIG. (Zingales: Trial Tr. 3831:20 – 3832:18; PTX 5054 (Zingales demonstrative listing § 4.01 of the Credit Agreement as a source of the Government’s control)). Section 4.01 is significant because it “suggests that the requirement of the credit agreement regarding corporate governance is not conditional on the issuance of the preferred stock. It is conditional on the transaction being consummated.” (Zingales: Trial Tr. 4100:7-19).

33.8.3 The Credit Agreement included numerous affirmative and negative covenants.

(a) There are many affirmative and negative covenants in the Credit Agreement. (*See, e.g.,* JX 107 §§ 5.04, 5.05, 5.10(b), 6.01, 6.03-6.09, 6.11, 6.12; *see also* PTX 398 at 4-17 (January 2009 AIG report describing the affirmative and negative covenants under Sections 5 and 6 of the Credit Agreement)).

(b) PTX 304 is a “detailed list of all real estate owned by AIG and its Subsidiaries” provided to Dahlgren pursuant to Section 5.10(b) of the Credit Agreement. (PTX 304 at 1-2). It is an example of “one of the filings that AIG was required to make with the Federal Reserve Bank of New York under the revolving credit agreement”. (Dahlgren: Trial Tr. 2660:8-16).

(c) PTX 305 is an October 17, 2008 “Identification of Real Property Owned by AIG” pursuant to Section 5.10(b) of the Credit Agreement. (PTX 305 at 1). Dahlgren believes that she received periodic reports like this. (Dahlgren: Trial Tr. 2662:17 – 2663:1).

(d) Dahlgren:

(i) “pursuant to the credit agreement, there had to be a series of consents that would be requested by AIG, and if the Federal Reserve Bank of New York decided to do

so, consented to by the Federal Reserve”. (Dahlgren: Trial Tr. 2663:14-18; *see also* Dahlgren: Trial Tr. 2831:20 – 2832:11 (“AIG needed to come to the New York Fed to either get consent or to have provisions waived in order to do certain types of transactions”).

(ii) The transactions covered by FRBNY’s consent rights included “transactions like capital injections into other subsidiaries, the release of funds in a real estate transaction, or when an asset sale was accomplished and there were funds that needed to be held back in order to – for operating purposes and not pay down the loan, those are the types of things that we needed to waive certain provisions”. (Dahlgren: Trial Tr. 2832:20 – 2833:4).

(e) FRBNY employees, including Dahlgren, to GAO on October 14, 2010: “FRBNY has to authorize many of AIG’s activities, such as capital injections, asset sales, infrastructure upgrades, and other expenditures.” (PTX 612 at 16; *see also* Dahlgren: Trial Tr. 2659:17 – 2660:2 (that is an accurate description).

(f) Herzog:

(i) “there were provisions or covenants to the loan agreement that we were required to comply with, and so that would certainly have been part of their oversight as well.” (Herzog: Trial Tr. 6990:12-22; *see also* Herzog: Trial Tr. 7037:12-17 (“there were certain affirmative covenants that AIG was required to comply with in connection with the Federal Reserve credit facility”)).

(ii) “Well, we had waivers that were required to essentially seek permission to do certain things, principally related to moving capital or cash around or, you know, again, using it for specific obligations of the firm.” (Herzog: Trial Tr. 6990:24 – 6991:6).

(g) Email from Dahlgren to various FRBNY officials on October 17, 2008 re: “Consent Process”: “We told David Herzog today that this was coming and to notify Bob Lewis about his role he and Liddy were totally fine with this and agreed....” (PTX 3121 at 1 (ellipses in original); *see also* Herzog: Trial Tr. 7041:20 –7043:12 (PTX 3121 “related to the waiver process, the approval of the multitude of waivers, as I spoke about earlier, the thousand-plus waivers that we were having to get reviewed and approved. We would have to prepare them, document them, review them, get them signed off internally and then submit them to the Fed for review and approval.”)).

(h) AIG and FRBNY established a set of procedures by which AIG could seek consent and waivers under the Credit Agreement. (PTX 412 (“FRBNY/AIG Credit Agreement Consent Procedures”); Dahlgren: Trial Tr. 2663:10-13 (PTX 412 “sets forth the Federal Reserve Bank of New York and AIG credit agreement consent procedures”); PTX 413 (executed consent agreement permitting AIG and FRBNY to institute the Credit Agreement Consent Procedures); Dahlgren: Trial Tr. 2696:2-5 (PTX 413 “is further clarification on streamlined procedures for consent.”)).¹⁰³

¹⁰³ Although Dahlgren testified that FRBNY never withheld its consent and that its consent rights did not allow FRBNY to “direct operational decisions at AIG” (Dahlgren: Trial Tr. 2833:20-25, 2834:10-14), her testimony overlooks the critical fact that Defendant exercised a “strong veto power” over AIG. Zingales: Trial Tr. 3964:10 – 3965:5. Indeed, Dahlgren admitted she was sure that “AIG would have beefed up the analysis as necessary to meet the requirements” for the requested waivers following interactions with Defendant. Dahlgren: Trial Tr. 2970:17-25. Dahlgren’s testimony also ignores the myriad ways in which Defendant made critical AIG operational decisions without management including, for example, the design and implementation of the Maiden Lane III structure. *See, e.g.*, PTX 562 at 3-5; PTX 3251; Zingales: Trial Tr. 3841:24 – 3843:21 (Maiden Lane III, a “major strategic decision” for AIG, was “started and analyzed outside of AIG, before even AIG management is aware of that”, is evidence of control); PTX 471 at 75 (Liddy: “We do not do a single thing of strategic import without making certain that we have talked to the Federal Reserve about it and we have given them an opportunity to weigh in on it.”); Liddy: Trial Tr. 3010:15-24 (agreeing with statement in PTX 471).

(i) Over the duration of the Credit Agreement, to satisfy FRBNY's consent rights, AIG and FRBNY executed hundreds of letter agreements concerning various AIG business transactions. (*See* PTX 573; *see also* Dahlgren: Trial Tr. 2664:11-21 (discussing the list of letter agreements in PTX 573); PTX 574 (consent agreements under the Credit Agreement)).

(ii) Over the duration of the Credit Agreement, AIG had a "thousand-plus waivers" that they had to get reviewed and approved by FRBNY. (Herzog: Trial Tr. 7042:3 – 7043:12). "We would have to prepare them, document them, review them, get them signed off internally and then submit them to the Fed for review and approval." (Herzog: Trial Tr. 7043:10-12; *see also* Dahlgren: Trial Tr. 2832:12-19 ("we set up what we called a waiver process, so that when AIG needed to submit to us a waiver, we had a process internally where it would be reviewed by the team and reviewed by lawyers before it was approved.")).

(i) September 19, 2010 draft AIG presentation to the AIG Board on the recapitalization plan:

(i) "FRBNY refusal to grant a waiver could place AIG in a very difficult situation and could even force bankruptcy / liquidation". (PTX 609 at 16).

(ii) "The FRBNY Facility has much stronger covenants than a typical bank facility; AIG is constantly in need of waivers". (PTX 609 at 16).

(j) Zingales: In the Credit Agreement, "in addition to these standard negative covenants, you have a lot of so-called policy covenants, so – that get much more involved in the day-to-day operations." (Zingales: Trial Tr. 3831:20 – 3832:18). "the Fed says that lending by itself is not evidence of control, but in conjunction with very intrusive covenants, that is indicia

of control.” (Zingales: Trial Tr. 3832:15-18; PTX 5054 (Zingales demonstrative identifying the “many affirmative and negative covenants of the Credit Agreement”)).

33.9 Defendant’s control over AIG was so complete that every major or even minor AIG decisions were subject to review and approval by Defendant.

(a) On October 25, 2008, in response to a request by Defendant that AIG describe its “past and future efforts to identify and control expenses and non-critical events”, Dahlgren received a memo from AIG’s Chief Administrative Officer to all AIG employees indicating that approval was required for new consulting arrangements, use of corporate aircraft, the signing of any new leases, office renovations greater than \$100,000, relocation of offices or facilities, and all meetings and events over \$25,000. (PTX 325 at 2, 4).

(b) On November 4, 2009, Defendant reviewed and approved the sale of a single airplane from the fleet owned by AIG subsidiary ILFC. (PTX 3333 at 1-3).

(c) Schreiber: The Fed “reviewed all of our [AIG’s] planned asset sales and our overall sort of strategy and process for generating capital and liquidity going forward to pay the Fed off and to stabilize our capital structure and get AIG back on its feet.” (Schreiber: Trial Tr. 6614:22 – 6615:8).

33.9.1 Defendant required that AIG curtail its lobbying activities, including the submission of comments to the proposed TARP legislation. (PTX 3345 at 3-4).

(a) Geithner: After the execution of the Credit Agreement, Geithner or someone else directed Liddy to “shut down the lobbying stuff”. (Geithner: Trial Tr. 1624:23 – 1625:1). Geithner wanted Liddy to shut down the lobbying because “there were a range of people at the Fed and at the Treasury, the Fed in Washington and New York, that felt it was somewhat awkward, inappropriate, at a time when they had borrowed a huge amount of money from the

Fed, to be spending that money on lobbying the U.S. government.” (Geithner: Trial Tr. 1828:5-13).

(b) On October 19, 2008, Geithner asked Dahlgren: “Has Liddy shut down the lobbying stuff?” Dahlgren responded: “I’ve confirmed with Ed this evening that he has ‘shut everything down’ . . . all lobbying will be done only through industry trade groups and AIG won’t be doing its own lobbying.” (PTX 309 at 1-2 (ellipses in original)).

33.9.2 Defendant communicated directly with the credit rating agencies regarding AIG.

(a) Dahlgren:

(i) On October 1, 2008, Dahlgren made telephone calls to the rating agencies and “had an initial conversation with each of the agencies that did not include AIG on the phone”. (Dahlgren: Trial Tr. 2675:18-22; *see also* Dahlgren: Trial Tr. 2676:6-8 (Dahlgren’s October 1, 2008 calls to credit rating agencies were “made without AIG’s participation”). Following those calls, Dahlgren sent a report to Geithner, Baxter, and other FRBNY executives. (PTX 270 at 2-3; *see also* Dahlgren: Trial Tr. 2675:23 – 2676:2 (PTX 270 is a record that Dahlgren made of her October 1, 2008 calls to rating agencies)).

(ii) Dahlgren noted that Standard & Poor’s Managing Director said that S&P “doesn’t normally talk with governmental agencies about ratings decisions – and I politely reminded her that I was calling as the largest creditor and 80% equity holder of the company . . . she responded positively to that.” (PTX 270 at 2 (ellipses in original); *see also* Dahlgren: Trial Tr. 2873:5-19 (Dahlgren reiterating “in a shorthand way said I’m calling as the largest creditor and 80 percent equity holder, so I was trying to get her attention”)).

(iii) Dahlgren further noted that A.M. Best “asked that AIG provide in writing to them ‘permission’ to talk with us....I said I would have AIG do that.” (PTX 270 at 3 (ellipses in original); *see also* Dahlgren: Trial Tr. 2676:24 – 2677:8 (that is an accurate description of what she told A.M. Best)).

(iv) On October 2, 2008, Dahlgren sent an update to Geithner, Treasury contractor Jester, and Silva (Geithner’s chief of staff at FRBNY) on her discussions with S&P. Dahlgren noted that S&P had raised “two clarifying questions.” The first one was: “Over the course of the next two weeks, was I/my team speaking with the ‘authorization’ of the appropriate persons in Treasury and FRBNY to describe what we are planning and will be putting in place with AIG?” (PTX 274 at 1). Dahlgren reported that she had explained to S&P that “we had a rigorous process that involved many levels of vetting and sign-off across the agencies and that we would be moving forward on solutions only with the intent to execute the solutions that were legal and feasible (within whatever limitations we have). They seemed satisfied to know that we weren’t going to be presenting them with solutions that weren’t actually going to get signed off on by the appropriate authorities.” (PTX 274 at 1).

(v) AIG did not participate on Dahlgren’s October 2, 2008 call with S&P, either. (Dahlgren: Trial Tr. 2679:13-16 (“It does not look like AIG personnel were on this phone call, no.”). Moreover, even though this meeting took place, AIG executives

“were not aware of any bilateral dealings between only the FRBNY and the rating agencies”. (PTX 620 at 14).¹⁰⁴

(b) J. Head: “one member of our team actually participated in the discussions between AIG and the rating agencies as an observer. And the sole purpose of that was to help provide advice to AIG to put themselves in the best position so that it didn’t get downgraded.” (J. Head: Trial Tr. 3725:16-25).

33.9.3 Defendant communicated directly with AIG’s lead insurance regulator, the New York State Insurance Department (“NYSID”).

(a) Dahlgren:

(i) Email from Dahlgren to Michael Silva, Geithner’s chief of staff, on September 17, 2008: “we are going to have a direct conversation with NYSID (since the discussion so far have been with only their outside counsel)”. (DX 472-U at -317; *see also* Dahlgren: Trial Tr. 2673:15-18 (Dahlgren is referring to the NYSID’s outside counsel); Dahlgren: Trial Tr. 2674:1-5 (DX 472-U says that there had been discussions between FRBNY and the NYSID’s outside counsel before September 17, 2008)).

(ii) After September 17, 2008, Dahlgren communicated directly with the NYSID, including Dinallo. (Dahlgren: Trial Tr. 2673:19-25).

33.9.4 Defendant reviewed and delayed AIG’s proxy filing.

¹⁰⁴ Dahlgren acknowledged that she “had an initial conversation” with each of the rating agencies “that did not include AIG on the phone with me”, but claimed that subsequently she then “joined the company in future conversations”. Dahlgren: Trial Tr. 2675:14-22, 2677:9-14, 2874:1-19. However, Dahlgren continued to have calls with ratings agencies without AIG representatives present, claiming: “Most of the time it was because the agency had called me and so I was the only one on the phone as they were asking me questions.” Dahlgren: Trial Tr. 2874:22 – 2875:2; *see, e.g.*, Dahlgren: Trial Tr. 2679:13-16 (acknowledging no AIG personnel were on a call Dahlgren had with S&P on October 2, 2008).

(a) The March 1, 2009 Series C Stock Purchase Agreement expressly states that the “Company shall prepare (and the Trust will reasonably cooperate with the Company to prepare) and file with the SEC a preliminary proxy statement reasonably acceptable to the Trust.” The Purchase Agreement further required that AIG “not file it with the SEC unless so directed by the Trust”, “notify the Trust promptly of the receipt of any comments from the SEC”, and “supply the Trust with copies of all correspondence” between the SEC and AIG related to its draft proxy statement. (JX 185 at 7 (§ 6.2(c)). “The Company shall consult with the Trust prior to filing any proxy statement, or any amendment or supplement thereto, and provide the Trust with a reasonable opportunity to comment thereon.” (JX 185 at 8 (§ 6.2(c)).

(b) On April 2, 2009, AIG sent FRBNY and Treasury officials and Davis Polk a draft AIG proxy for their review and comment. (PTX 492-U; *see also* Dahlgren: Trial Tr. 2717:6 – 2718:4).

(c) On April 3, 2009, FRBNY, the Trustees, Davis Polk, and the Trustees’ outside counsel Arnold & Porter held a conference call to discuss the AIG “Proxy Material”. (PTX 493; *see also* Dahlgren: Trial Tr. 2720:2-4 (confirming that there were no AIG personnel on the invite list)).

(d) On April 16, 2009, Dahlgren wrote to Anastasia Kelly (GC of AIG) and Liddy: “We are talking with UST at the moment on the proxy... when you get a chance, I will want to fill you in (and if possible, I want UST to talk directly to you about their issues -- either tonight or first thing in the morning....)..... in the meantime, we are talking with Marc Trevino to elicit UST’s specific concerns to see if we can move ahead on any possible changes.” (PTX 501 (ellipses in original); *see also* Dahlgren: Trial Tr. 2721:16 – 2722:10 (describing the exhibit); Agreed to

Stipulations ¶ 198 (“Representatives from FRBNY and Treasury reviewed a draft of AIG’s proxy on April 16, 2009.”)).

(e) On April 17, 2009, Dahlgren emailed the Trustees and various FRBNY and Treasury officials, stating: “After our discussion at 5:30, we received a emergency call from UST indicating that they didn’t want the company to file its preliminary proxy tomorrow”. (PTX 503 at 1).

(f) Dahlgren then spoke to AIG and convinced Liddy to delay AIG’s issuance of the 2009 proxy “for the benefit of UST” after “he and his lawyers were able to work through their concerns and are conceding that the political environment just isn’t friendly and that the best thing for the company would be to heed the UST’s wishes”. (PTX 503 at 2; *see also* Dahlgren: Trial Tr. 2720:10 – 2721:3 (“the United States Treasury had indicated that they did not want the company, AIG, to file the preliminary proxy that it had been planning to file on April 17 through April 18”); Dahlgren: Trial Tr. 2721:4-6 (AIG ultimately agreed “to delay the proxy at the request of the United States Treasury”)).

(g) On April 26, 2009, Doug Foshee wrote to Dahlgren: “I’m trying to put together a process for getting us from where we are to a proxy filing. Do have any updated info on when company wants to file and when Treasury will let them file? I think we have six really strong candidates for the Board and we are going to try to get them finalized and in the boat quickly. But I want to make sure my timeline matches up with proxy filing.” (PTX 2731; *see also* Foshee: Trial Tr. 3486:22 – 3487:4 (“I know there were lots of discussions about when the proxy statement should be issued.”); Foshee: Trial Tr. 3487:11-14 (“I know there were discussions about the proper time to hold the proxy, to follow the proxy statement.”); Feldberg: Trial Tr.

3370:5-8 (Feldberg remembers that “there was a disagreement as to whether the proxy statement should be issued earlier than June or not”)).

(h) Defendant suggested revisions to AIG’s proxy statement for the June 2009 annual meeting. (*See* PTX 3274).

34.0

DEFENDANT’S CONTROL OVER AIG IS EVIDENCED THROUGH THE MAIDEN LANE II AND III TRANSACTIONS

34.1 Without AIG’s Knowledge or Input, Defendant Discussed and Created Solutions for AIG’s CDS Portfolio Beginning on September 17, 2008.

(a) Huebner wrote with regards to Maiden Lane II and III (“ML II and ML III”):
“Today’s comprehensive set of solutions have been in process literally since the morning of September 17.” (PTX 3347 at 1).

(b) Government advisors at Ernst & Young, Davis Polk, Morgan Stanley, and BlackRock participated in discussions that led to the transactions that became ML II and ML III, “aimed at creating a structure that first protected the Federal Reserve’s interest, but otherwise could eliminate liquidity pressure from collateral calls.” (JX 381 at 2-3).

(c) BlackRock GAO interview: “In trying to design an appropriate structure, the Federal Reserve had the lead in shaping the discussions at a high level and enunciating key principles; the Federal Reserve ran the process. The overarching principles were to meet requirements of the law and to treat everyone equally. Various parties put various features on the table, and BR ran many permutations.” (JX 381 at 3).

(d) On October 1, 2008, Amy Flynn emailed Dahlgren and Jester (Treasury) attaching documents laying out proposals for addressing AIGFP’s CDS portfolio. (PTX 272 at 5).

(e) Dahlgren: On or about October 1, 2008, Dahlgren participated in discussions with Jester and Geithner about options for addressing AIGFP's CDS portfolio. AIG, however, was "likely not" a participant in these discussions. (Dahlgren: Trial Tr. 2734:18 – 2735:14 (discussing PTX 272)).

(f) On October 2 and 3, 2008, Dahlgren and Kevin Warsh (BOG) exchanged a series of emails regarding a proposed "restructuring plan" for AIG. (PTX 277 at 5). Attached to these emails are documents analyzing "Maiden Lane II and III" structures and other proposals for addressing AIG's CDS and securities lending portfolios. (PTX 277 at 7-12).

(g) Dahlgren: these documents provided "various options for dealing with the AIFGP issues". (Dahlgren: Trial Tr. 2728:2-24).

(h) Dahlgren: "So, the question is whether this document, this two-page document was provided to AIG. I don't believe it was. It would have surprised me if it was. It looks like an internal document." (Dahlgren: Trial Tr. 2728:2 – 2729:25).

(i) Dahlgren to Treasury contractor Dan Jester on October 4, 2008: "AIG FP Restructuring Winddown Plan" was "provided to us last night – we had asked AIG to pull together its plan for winding down AIG FP.....it covers everything except the credit portions," which Dahlgren writes, "we are proposing to deal with through the Maiden Lane 3 structure, although the firm doesn't know of our alternative yet." (PTX 280 at 1; *see also* Dahlgren: Trial Tr. 2725:25 – 2727:19).

(j) On October 7, 2008, Mark Wiedman (BlackRock) wrote to Dahlgren and others at FRBNY, BlackRock, and Ernst & Young: “We are growing more keen on a MLNE 3 or a parallel idea as a way of protecting the Fed’s and the Treasury’s interests”. (PTX 287 at 1).¹⁰⁵

(k) Attorneys from Davis Polk, on behalf of the Defendant, prepared the initial draft of the Maiden Lane III master agreement. (Def. Resp. to Pl. 2nd RFAs No. 931).

(l) Davis Polk attorney Bjorn Bjerke on November 5, 2008: AIG “have not seen any [docs] on MLIII (nor has mliii been explained to them in full detail).” (PTX 3251 at 1).

(m) Zingales: “the Government sort of started to think about the ML III before even talking to AIG and did not disclose this. So, this is an indication that this is an important decision for AIG, is started and analyzed outside of AIG, before even AIG management is aware of that.” (Zingales: Trial Tr. 3841:24 – 3843:21; PTX 5061 (demonstrative showing chronological timeline of the government exercising control over AIG in relation to ML III)).

34.2 Despite Discussing Options That Would Have Had Lower Costs and May Have Been More Favorable for AIG, Defendant and Its Advisors Chose ML II and ML III. (JX 381).

34.2.1 FRBNY considered guaranteeing AIGFP’s entire CDS portfolio.

(a) SIGTARP: BlackRock “presented three options for FRBNY to consider:” “counterparties cancelling their credit default swaps and selling the underlying CDOs to a FRBNY-financed SPV, for total consideration of par, comprised of previously posted collateral, cash, and mezzanine note in the SPV;” transferring “the obligation to perform under the credit default swaps” “from AIG to an SPV guaranteed by the FRBNY;” and creation of an “SPV to

¹⁰⁵ Although Dahlgren initially testified that she did not know who developed Maiden Lane III (Dahlgren: Trial Tr. 2724:20 – 2725:19), upon examination by Defendant Dahlgren later claimed that AIG “originated” the idea for ML III (Dahlgren: Trial Tr. 2921:9-14). However, the overwhelming weight of the contemporaneous evidence collected here refutes her testimony. *See, e.g.*, PTX 3251 at 1 (as late as November 5, 2008, ML III had not yet “been explained to [AIG] in full detail”). Indeed, PTX 280 demonstrates that Dahlgren was well aware that Defendant developed ML III without AIG’s knowledge.

purchase the underlying CDOs from AIGFP's counterparties, in connection with a termination of the related credit default swaps." (PTX 549 at 17-18; *see also* JX 381 at 4 (BlackRock identifying same three options to GAO)).

(b) FRBNY considered guaranteeing either AIGFP or its CDO portfolio. (PTX 277 at 11; *see also* Dahlgren: Trial Tr. 2730:4 – 2731:4 ("I remember there were conversations" with BlackRock and AIG, "and I think that they covered something like a guarantee, yes."); Dahlgren: Trial Tr. 2732:20 – 2733:7 (PTX 277 discusses both "a guarantee of FP" and "a guarantee of the multisector CDO portfolio").

(c) Dahlgren: One of the "options that were presented to the New York Fed and its financial advisors on September 30, 2008" included "guarantees of different kinds". (Dahlgren: Trial Tr. 2984:4-12).

(d) Baxter: "There were lots of alternatives considered. I remember there were people who proposed that the Fed should be the party that takes over the obligations of AIG and becomes the insurer." (Baxter: Trial Tr. 1055:24 – 1058:7).

(e) GAO: In October 2008, Government "officials contemplated other options, including financial guarantees on the obligations of AIGFP and its CDS portfolio." (PTX 641 at 52).

(f) In 2009, Defendant received advice from Morgan Stanley on the use of asset guarantees as a "potential government tool to stem investment losses," and analysis "of investments potentially subject to guarantees." (JX 222 at 17; *see also* J. Head: Trial Tr. 3732:20 – 3733:21 (There were multiple discussions between MS and either FRBNY or Treasury about broad asset guarantees)).

(g) On September 30, 2008, Defendant discussed providing AIG with a guarantee “to preempt a downgrade” by the rating agencies. (PTX 269 at 2; Alvarez: Trial Tr. 421:13 – 422:21 (indicating that three possible guarantees for AIG were being considered at the time)).

(h) Dahlgren: “there are three kinds of guarantees proposed for consideration as options” in PTX 272, including “a guarantee of AIG,” “a guarantee of FP,” and “a guarantee of the CDS or CDO portfolio”. (Dahlgren: Trial Tr. 2733:13 – 2735:3).

(i) Baxter to Alvarez on September 30, 2008: “we may wish to issue a guarantee to protect our security interest” in AIG. (PTX 3335 at 1).

(j) FRBNY and BOG counsel had already opined that a guarantee to AIG would have been possible:

(i) A July 25, 2008 FRBNY legal memo: “In our opinion, a Bank may guarantee the obligations of a person to whom it is extending credit, when it reasonably believes, based on an evaluation of the facts and circumstances at the time, that the guarantee is needed to protect an emergency loan of the Bank’s. A bank may also have a more general guarantee power, particularly if extended in the form of a standby letter of credit.” (PTX 3326 at 2).

(ii) An October 2, 2008 draft legal memo from Board of Governors staff: “there are several ways that an extension of credit to AIG could be structured to support

or guarantee all, or some subset of, the obligations of AIG to third parties.” (PTX 3267 at 3).¹⁰⁶

(k) Congressional Oversight Panel: A guarantee “could have created a period in which markets could have stabilized, and the possibility of a private-sector solution could have increased.” (PTX 589 at 83-84).

(l) Defendant understood that a guarantee from a AAA-rated entity, like the United States, would have halted collateral calls on AIG because it would have eliminated any credit risk to the counterparties. (PTX 272 at 5). However, they were reluctant to provide such a guarantee because it would force AIG’s counterparties to return the collateral that had been posted to AIG. “Return of collateral constitutes a \$33 billion liquidity call on the financial system” “Some counterparties may have difficulty returning collateral.” (PTX 277 at 10).

(m) Cragg: If the Federal Reserve had given a guarantee, “it would have had the impact of reducing the collateral risks associated with the credit default swaps and would have therefore led to a return of collateral from AIG’s counterparties to AIG.” (Cragg: Trial Tr. 5486:15-20). That would have been a “significant return of collateral”. (Cragg: Trial Tr. 5486:21-23).

(n) Cragg: If FRBNY had guaranteed the CDOs instead of doing Maiden Lane III, the more than \$29 billion in payments to AIG’s counterparties would not have been made. (Cragg: Trial Tr. 5097:2 – 5098:8; PTX 5367 (Cragg demonstrative)).

¹⁰⁶ Dahlgren testified that a guarantee “was something that we could not do.” Dahlgren: Trial Tr. 2730:21 – 2731:12. But when asked to name a lawyer who told her what could or could not be done with respect to guarantees, she couldn’t recall one except to say that she “probably” had a conversation with Baxter. Dahlgren: Trial Tr. 2731:24 – 2732:11. Dahlgren further admitted that she did not recall seeing anything “in writing concerning what the Federal Reserve could or could not do with respect to guarantees”, and that she did not remember asking for any such analysis. Dahlgren: Trial Tr. 2732:12-19. As these memoranda demonstrate, counsel at the Federal Reserve had already advised that a guarantee was possible. Furthermore, the Federal Reserve guaranteed assets against losses of other firms during the height of the financial crisis. See PTX 562 at 3, n.17.

(o) Cragg: Additionally, with respect to the collateral that AIG had already posted, “because there would be no need for covering the credit risk associated with these CDS contracts given who the counterparty would then be – it would be the federal government backing these contracts – that would have released all of the collateral that AIG had posted.” (Cragg: Trial Tr. 5098:9-16). In other words, “the \$32 billion [AIG] already posted would have come back”. (Cragg: Trial Tr. 5098:17-20).

34.2.2 Defendant considered buying all or part of AIG FP’s CDS portfolio.

(a) Under the second proposed option, “Novation”, “the Federal Reserve could step into AIG’s position. Presumably, the counterparties would accept the Federal Reserve’s credit, and ease collateral posting.” (JX 381 at 4).

(b) Under a proposed “novation option”, Defendant considered having AIG assign and transfer its CDS contracts to a special purpose vehicle guaranteed by Defendant. (PTX 641 at 63).

34.3 Defendant Was Aware That AIG’s Assets Were More Valuable Than Counterparties Claimed.

(a) In September 2008, Ernst & Young informed Defendant that there was a “Lack of liquid quotes from market participants” from which the pricing of CDSs could be derived, and that there was “Subjectivity involved in pricing” collateral calls. (PTX 221 at 4; *see also* Symons: Trial Tr. 3592:20 – 3593:5 (PTX 221 was “prepared in connection with a presentation made to Federal Reserve Bank of New York personnel.”); Symons: Trial Tr. 3594:3-12 (““Lack of liquid quotes from market participants’ means that many of the financial institutions were not trading with one another, and as a consequence, it was sometimes difficult, but possible, to get quotes for securities that were traded in the public markets.”); Symons: Trial Tr. 3594:20 – 3595:2 (““subjectivity involved in pricing,’ this addresses an issue primarily around credit

default swaps in that the pricing for some of these instruments is not public pricing but is an over-the-counter market in certain situations, and that pricing is usually prepared through a modeling exercise, and oftentimes counterparties have disagreements on what the instruments are worth.”)).

(b) On September 18, 2008, the Federal Reserve already had copies of BlackRock’s September 9 analysis of AIGFP’s CDS portfolio, which reflected BlackRock’s estimate of between \$7.3 billion and \$15.2 billion loss on the entire life of the CDS portfolio. (JX 379 at 2, 4).¹⁰⁷

(c) Huebner: “ML II and III” “are not actually loans to AIG at all, and in fact take no AIG credit risk. Rather, they are loans directly against thoroughly reviewed pools of third party assets (put into single purpose spvs with no other creditors) that have been exhaustively analyzed and valued. We fully intend to make money on those transactions. Because of the fed’s unique balance sheet, we are able to hold these performing assets to maturity, with blissful immunity to short term price fluctuations.” (PTX 3324 at 1).

(d) Zingales: “at the time of that transaction, the value of the CDOs and so the value of the CDS liability was already marked down quite aggressively, and the – what was put into Maiden Lane III was the value of the CDOs that were marked down very aggressively and, in addition, the – AIG put another 5 billion of equity cushion. And the Fed had a secure lending, which was senior to everybody else, on that value for less than the marked-down value of the

¹⁰⁷ BlackRock’s analysis provides vital context to Schreiber’s testimony that the assets put in ML II and ML III “would have continued to generate losses” for AIG if they had remained on AIG’s books. Schreiber: Trial Tr. 6627:20 – 6628:8. Once the market began to recover, BlackRock projected that the assets would generate between \$3.4 and \$4.9 billion in proceeds. PTX 1675 at 4. And, in fact, once the market recovered, the underlying CDOs that were part of ML II and ML III returned billions in proceeds to Defendant. See DX 1883 App’x C, ¶¶ 28-29 (Saunders Report).

CDOs, and there was a 5 billion equity cushion.... So, there was not really much risk that the Fed was taking in that transaction.” (Zingales: Trial Tr. 3846:21 – 3847:23).

34.4 Defendant Knew That Maiden Lane II and III Would Cause AIG to Give Up at Least \$50-\$100 Billion in Upside.

(a) On October 7, 2008, BlackRock advised FRBNY officials that the “tear-up price” on AIG’s Goldman swaps “ought to be \$4 billion - \$6 billion, while Goldman now holds \$9 billion in collateral and is asking for \$1 billion more”, and that “A tear up at a bad price – say \$9 billion – would cost AIG and the Fed \$3-5 billion for Goldman alone.” (PTX 287 at 1; *see also* Dahlgren: Trial Tr. 2740:8 – 2742:2 (admitting she would have received PTX 287, and that it “suggests that the advisors had views” that AIG’s counterparties were “demanding more than was appropriate given market prices”).

(b) On October 31, 2008, Alejandro Latorre, a member of the FRBNY monitoring team, circulated to other members of the monitoring team and Morgan Stanley an analysis “that quantifies how much upside AIG would be giving up by participating in the Maiden Lane II and III structures.” (PTX 334 at 1). The so-called “Give Up Analysis for AIG” circulated by Latorre forecasted that participation in Maiden Lane II and III would cause AIG to give up approximately \$94.6 billion, \$70.57 billion, and \$57.01 billion in upside in an optimistic, base, and stress case, respectively. (PTX 334 at 1-2).

(c) On November 1, 2008, Dahlgren provided an update on the status of her discussions with the rating agencies: “The RMBS and CDO portfolio solutions (the FRBNY SPVs) lock in losses, forcing the company to absorb a substantially greater loss relative to what Moody’s expected the ultimate losses on this portfolio to be. Over the weekend, we will be reviewing our options here, including the upside sharing arrangements in the structure. . . . The overall

conclusion from Moody's was that they are almost certainly not going to give AIG a stable outlook, and there is a good chance they will decide to downgrade." (DX 639 at -750).

(d) Dahlgren: Moody's was considering a ratings downgrade for AIG because what the Fed was proposing to do with ML II and III "would force AIG to absorb a substantially greater loss than what Moody's expected" "the ultimate losses to be on the portfolio over time". (Dahlgren: Trial Tr. 2752:11 – 2754:15).

(e) Baxter: AIG's maximum exposure on the CDSs terminated in connection with ML III could not have exceeded \$62.1 billion. (Baxter: Trial Tr. 1053:1-23).

(f) Baxter: At the time Defendant agreed to pay AIG's CDS counterparties par, AIG had already posted approximately \$38.8 billion in collateral on its potential \$62.1 billion obligation. (Baxter: Trial Tr. 1050:15 – 1051:4, 1053:23 – 1054:1 ("38.8 billion had already been given to them")). "That meant that the maximum remaining AIG exposure on the CDSs was 29.3 billion." (Baxter: Trial Tr. 1054:2 – 1055:3).¹⁰⁸

(g) Baxter: Defendant, however, did not consider putting \$29.3 billion into ML III and stating publicly that ML III would meet any further collateral calls or other obligations to pay on

¹⁰⁸ Although Baxter testified that the rating agencies would not necessarily have been satisfied by a solution that simply guaranteed payment of the remaining exposure AIG faced (Baxter: Trial Tr. 1056:24 – 1057:16), he admitted that his opinion was merely that of a "lawyer . . . out on a limb and suggest[ing] an accounting answer" even though he is "not an accountant". Baxter: Trial Tr. 1060:18 – 1061:9.

AIG's remaining CDS obligations in order to satisfy the rating agencies with respect to their concerns about AIG's CDS obligations. (Baxter: Trial Tr. 1056:24 – 1057:22).¹⁰⁹

34.4.2 The formation of Maiden Lanes II and III crystallized losses at the bottom of the market for AIGFP's multi-sector CDS portfolio and AIG's securities lending program. (PTX 578 at 3).

(a) AIG Presentation: "The formation of ML II & III at the bottom of the market crystallized losses on the underlying securities, leaving the preponderance of the upside to the U.S. Government." (PTX 578 at 3).

(b) AIG executives to GAO: "AIG 'got skinned' on ML III, with terms unfavorable to the company. ML III forced AIG to 'crystallize' a loss, which severely hurt existing shareholders. This is because they then had no chance of recovery, other than through AIG's minor participation in the structure. There was little upside to shareholders if asset values increased, because they had the first loss position, but little equity return; nearly all the upside went to the structure. Also, unrealized market value losses on the CDOs going into ML III became realized losses when the CDS were torn up. Further, collateral that AIG had posted went to the counterparties. 'It was a tough set of terms.'" (PTX 620 at 10).

(c) Rating agencies expressed "concerns that AIG was forgoing the upside in the – in committing to Maiden Lane III". (J. Head: Trial Tr. 3745:2-8).

¹⁰⁹ Defendant elicited testimony from Herzog that the Maiden Lane III structure "was effective at resolving the liquidity strains on the company" and was necessary for AIG's future. *See* Herzog: Trial Tr. 7009:13 – 7010:3; *see also* Latorre: Trial Tr. 2336:24 – 2337:10. However, such testimony ignores the existence of other viable alternatives and structures, detailed here, that may have been far more favorable for AIG. Given these alternatives, ML III's effectiveness is irrelevant to the question of whether Defendant's unilateral decision to design and implement ML III was in the best interests of AIG and its shareholders (as opposed to the interests of Defendant and AIG's counterparties). *See* PTX 620 at 10 ("AIG 'got skinned' on ML III, with terms unfavorable to the company. ML III forced AIG to 'crystallize' a loss, which severely hurt existing shareholders.").

34.5 Defendant's Control over AIG Is Evidenced by Defendant's Decision to Pay AIG's ML III Counterparties Par Without AIG's Knowledge or Consent.

34.5.1 On October 31, 2008, Defendant directed AIG to cease any attempt at negotiating concessions from counterparties.

(a) On October 20, 2008, Herzog emailed Dahlgren re: "Goldman discussions": "we need to talk about settlement parameters. They've asked for Collateral per our agreed upon protocol. We are discussing tear ups. I want to be in a position to agree with Goldman. I will get approval from Ed, but what about Fed approval?" (PTX 311 at 1; *see also* Herzog: Trial Tr. 7033:1 – 7034:15 ("Ed" refers to Ed Liddy)).

(b) BlackRock: "Goldman approached AIG in August to discuss tearing up the CDS contracts", "Goldman has expressed a willingness to negotiate tear-ups on additional trades", and Goldman would "likely accept a small concession". (PTX 1817 at 13).

(c) On October 31, 2008, Elias Habayeb of AIG advised Herzog that Steve Manzari of FRBNY had asked him "to stand down on all discussion with counterparties on tearing up / unwinding CDS trades on the CDO portfolio." (PTX 333 at 1; *see also* Herzog: Trial Tr. 6996:13-23 ("I am aware of some direction that was given as it related to some of the – to the wind-down activities of AIGFP when we were trying to wind down or tear up trades that we were – we were involved in, and one of my colleagues was instructed to stand down on trying to tear up the trades.")); Herzog: Trial Tr. 7003:16-21 (FRBNY got involved in counterparty

negotiations when AIG “was asked to stand down or to stop negotiating for the terminations.”).¹¹⁰

(d) On November 4, 2008, Michael Gibson, an officer in the Federal Reserve Board of Governors Research Division, advised members and other staff of the Federal Reserve Board of Governors: “Last Friday, FRBNY told AIGFP to stop all conversations with counterparties about tear-ups. The process was proceeding too slowly. NY has decided that the only way to push forward is to get senior management involved, both at FRBNY and the counterparties. FRBNY now plans to take a leading role itself in negotiating the tear-ups with AIG’s counterparties.” (PTX 2806 at 1; PTX 341 at 1; *see also* Dahlgren: Trial Tr. 2949:6-18 (“Last Friday” would have been on October 31); Alvarez: Trial Tr. 355:19 – 356:21 (the above-quoted statement was Alvarez’s understanding as of November 4, 2008)).

(e) Latorre: “I can say that we did not participate jointly with AIG in those counterparty discussions. So, AIG was not part of the discussions we had with counterparties over the time frame in which we had them.” (Latorre: Trial Tr. 2069:24 – 2070:8, 2072:25 – 2073:5).

34.5.2 Defendant sought to create a “paper trail” after the fact to suggest that AIG asked Defendant to negotiate with the counterparties rather than Defendant telling AIG to stop.

¹¹⁰ Dahlgren’s testimony that FRBNY encouraged AIG to negotiate on its own up until the first weekend of November 2008 and only after AIG requested FRBNY to take over negotiations (Dahlgren: Trial Tr. 2880:8-15, 2946:6-11, 2950:14-21), is inconsistent with the contemporaneous emails from late October 2008 showing that FRBNY instructed AIG to “stand down”. *See* PTX 333; PTX 2806; PTX 341. Dahlgren testified that she was not aware that such instructions had occurred (Dahlgren: Trial Tr. 2947:4-7, 2751:18 – 2752:7), but noted that looking at the face of Plaintiffs’ Exhibit 2806, “at least a week before that weekend, AIG had already been told to stop all conversations with counterparties about tear-ups”. Dahlgren: Trial Tr. 2951:1-6.

(a) After Defendant directed AIG to cease any attempt at negotiating concessions from counterparties, Defendant and Davis Polk undertook to create a “paper trail” that AIG had actually asked Defendant to take over the negotiations.

(b) Email from Bergin to Baxter on November 5, 2008: “my understanding is that FRBNY will have bilateral discussions with the counterparties w/o AIG. I asked Marshall Huebner whether he felt we should get some direction from AIG that we could have these conversations (I understand that you mentioned this idea to HaeRan). He felt that it was a good idea to get an email but he felt that we didn’t need anything more than that. His analysis was basically that we are already very pregnant, so lender liability concerns can’t be at the front of our concerns, but that some paper trail would be nice to have.” (PTX 2773 at 1).

(c) Email from Manzari (FRBNY) to James (DPW) on November 6, 2008: “Ethan, what do we have to do to paper the AIG authority to let us negotiate on their behalf for ML3?”; James responds: “I spoke to Stasia about this last night, she gets the point. I will follow up with her this morning, but don’t think that needs to slow you down.” (PTX 2774 at 1).

(d) Email from James to Baxter and Manzari on November 5, 2008: “I spoke to Stasia about getting authorization to talk to the FP counterparties; she will work w/Ed and Kathy to gin something up and will send it over.” (DX 652 at -425).¹¹¹

(e) Zingales: “in a normal situation, what the Government – what the AIG would have done and should have done is to negotiate with a counterparty for some kind of discount vis-à-vis

¹¹¹ Although Huebner testified that his then-partner Ethan James was “wrong” to say that the Fed needed to get authorization from AIG to take over counterparty negotiations because AIG had already asked for Fed assistance (Huebner: Trial Tr. 6116:17 – 6117:16), Huebner conceded that “there’s nothing here that says the Fed has been asked to step in by AIG.” Huebner: Trial Tr. 6297:23 – 6298:7 (discussing PTX 333); *see also* Huebner: Trial Tr. 6295:24 – 6297:22 (conceding the same vis-à-vis PTX 341, an email from Gibson to Kohn et al., stating, “Last Friday, FRBNY told AIGFP to stop all conversations with counterparties about tear-ups”).

the full notional value. And here, the Government interferes in this process by saying ‘stop negotiating with the counterparty.’” (Zingales: Trial Tr. 3841:24 – 3844:14; PTX 5061 (listing these events in chronological order); *see generally* Zingales: Trial Tr. 3847:24 – 3849:12 (reiterating that the Government told “AIG to stand down”); Zingales: Trial Tr. 3849:13-25 (further explaining the Government’s actions with regard to AIG counterparties); PTX 5062; PTX 5063; PTX 5064 (additional timelines listing this series of events in chronological order).

(f) Zingales: Maiden Lane III “was not a – done in an arm’s length transaction between the Government or AIG or between AIG and the counterparty, but the Government inserted itself even in negotiation with the counterparty, and sort of operated in a non-arm’s length way with AIG, even if the two had conflicted interests”. (Zingales: Trial Tr. 3842:10 – 3843:9; *see also* PTX 5061 – PTX 5065 (demonstratives)).

34.5.3 On November 9, 2008, the AIG Board of Directors authorized AIG to terminate AIGFP’s CDS transactions with the expectation there would be concessions from the counterparties.

(a) “On November 9, 2008, representatives of FRBNY attended the AIG Board meeting where the board voted on the Maiden Lane III transaction.” (Agreed to Stipulations ¶ 185).

(b) November 9, 2008 AIG Board Minutes: The Board approved Maiden Lane III with “the terms and conditions” as set forth in “Annex D”. (JX 144 at 11). Annex D provides that counterparties will be paid par value minus “the amount of any concession deducted” from it. (JX 144 at 45).

(c) November 9, 2008 AIG Board Minutes: “Under the Forward Purchase Agreement and the Termination Agreement described below, for the termination of the CDS transactions and the purchase of the Assets, Counterparty will be paid the notional amount for the CDS

Transactions, subject to certain adjustments described in the Forward Purchase Agreement.” (JX 144 at 53). Appendix A1 says that the “Sum of Purchase Price and Termination Price” will be “[9__]% of CDO Pool par value”. (JX 144 at 52) (brackets in original).

(i) Zingales: Appendix A1 supports his opinion that “when the AIG board approved the ML III transaction, it believed that the government would seek concessions from AIG’s counterparties” because it indicates “that the expectation was that they will negotiate a discount”. (Zingales: Trial Tr. 4117:5 – 4119:17 (discussing JX 144 at 52)).

(d) AIG’s CFO David Herzog November 10, 2008, after the transaction was announced: “I understood the Fed to be negotiating with the counter parties directly on the buy out of the CDO’s directly. The trade was to happen as far below par as possible.” (PTX 366 at 1).

(e) Liddy: “When the board approved the Maiden Lane III transaction on November 9,” Liddy “expected that the Federal Reserve would continue to try to negotiate concessions below par with respect to the CDSs that were the subject of Maiden Lane III”. (Liddy: Trial Tr. 3113:21 – 3114:3; Liddy: Trial Tr. 3116:4-19 (Liddy expected that the Federal Reserve “would negotiate hard and attempt to settle these at below par.”)).

(f) Zingales: “when the AIG board approved the Maiden Lane III transaction on November 9, 2008, it was led to believe that the Government would seek concessions from AIG’s counterparties.” (Zingales: Trial Tr. 3844:15 – 3845:5 (explaining that “candor on the side of the Government” was “assumed” and that AIG relied on “what the Government” said “even if the Government already decided that it would not do concessions”); PTX 5061 (demonstrative showing a timeline of Government’s actions concerning this topic); Zingales:

Trial Tr. 4117:5 – 4118:1 (JX 144 at 45 makes it “pretty clear here that they intend at least to try to obtain concessions”)).¹¹²

34.5.4 Defendant decided not to pursue discounts or concessions from AIG’s counterparties.

(a) On October 30, 2008, BlackRock believed it was possible to obtain concessions from AIGFP’s counterparties, as demonstrated by the fact that BlackRock advisors wrote to Davis Polk that it was “not correct” that the counterparties would receive par value in connection with Maiden Lane III. (PTX 3212 at 5).

(b) Of “the 16 AIGFP counterparties involved in ML III, the FRBNY contacted eight of them regarding concessions or discounts”. (Def. Answer to Second Amended Complaint ¶ 140).

(c) Blackrock believed that Goldman Sachs would negotiate because it was the “least risk averse counterparty,” and had already approached AIG to discuss termination of the CDS contracts. (PTX 1817 at 13-14; *see also* Latorre: Trial Tr. 2064:23 – 2067:8 (the materials were intended “to help inform” FRBNY’s attempt to negotiate concessions with or from AIG’s CDS counterparties)).

(d) FRBNY’s Paul Whynott: “Bank of America has expressed interest through BlackRock to have AIG offer them a price to take them out of the one CDS transactions that they have with AIG.” (PTX 348 at 1).

¹¹² Although Defendant tried to demonstrate that AIG’s Board was aware that there would not be any concessions when they approved Maiden Lane III (Zingales: Trial Tr. 4015:17 – 4023:4), Defendant merely cherry-picked two out of context statements in DX 2131 and JX 144, neither of which proves Defendant’s point. DX 2131 was an email that did not go to AIG’s Board, and Defendant did not offer any evidence that the Board (or any of the non-Board member AIG recipients) ever reviewed the email. The statement in JX 144 explicitly states that counterparty payments will be “subject to certain adjustments”. JX 144 at 53. The overwhelming weight of the evidence both from the Board Minutes and Liddy’s trial testimony demonstrates that AIG and its Board fully expected that Defendant would negotiate concessions. *See, e.g.*, JX 144 at 45, 52.

(i) Latorre: “I’m not aware” of anyone following up on Bank of America’s request that AIG “offer Bank of America a price to take Bank of America out of the CDS transaction that Bank of America had with AIG”. (Latorre: Trial Tr. 2375:17 –2376:10).

(e) Despite the willingness of at least some counterparties to engage in discussions about a potential haircut, Defendant developed a negotiating script that did not even ask counterparties to accept a haircut. (PTX 718). Rather, the Maiden Lane III negotiating script “stressed that participation in concession negotiations with FRBNY was voluntary.” (PTX 549 at 19). “Thus, the FRBNY essentially began the discussions with the counterparties with a disclaimer that they had no obligation whatsoever to agree to any concessions.” (PTX 562 at 4).

(f) Baxter: It is “fair to say that the deal that was done with counterparties that involved 100 percent par, plus the releases, was a deal that was negotiated by representatives of the New York Fed with the counterparties”. (Baxter: Trial Tr. 1071:11-16; *see also* Baxter: Trial Tr. 1076:25 – 1077:4 (it is Baxter’s understanding that “the only people that were negotiating directly with the counterparties over the terms of the ML III terminations were representatives of the New York Fed”)).¹¹³

34.5.5 Defendant only attempted to negotiate concessions for approximately 24 hours.

¹¹³ Schreiber’s suggestion that paying par was necessary because the counterparties “had a contractual right to par” (Schreiber: Trial Tr. 6626:2-21), is unpersuasive in light of the fact that at least three counterparties had offered or agreed to concessions. *See* Baxter: Trial Tr. 1028:20 – 1029:13 (UBS offered a concession); Latorre: Trial Tr. 2331:18 – 2332:8 (same); *see also* PTX 348 (“Bank of America has expressed interest through BlackRock to have AIG offer them a price to take them out of the one CDS transactions that they have with AIG”); PTX 1817 at 13 (Goldman Sachs). Furthermore, Schreiber’s suggestion that AIG was contractually obligated to pay par is rebutted by the fact that he admits to neither knowing the law nor receiving legal advice “concerning whether AIG’s counterparties has a contractual right to par”. *See* Schreiber: Trial Tr. 6724:2 – 6725:11.

(a) FRBNY did not even contact AIGFP's CDS counterparties until on or about November 6, 2008, and then "asked the counterparties to agree by the close of business Friday, November 7, 2008." (Def. Answer to Second Amended Complaint ¶ 140).

(b) Latorre only attempted to seek concessions for "approximately 24 hours." (Latorre: Trial Tr. 2346:24 – 2347:3).¹¹⁴

34.6 Defendant's Payment of Par Value and Legal Releases Given to AIG Counterparties Constituted a "Backdoor Bailout".

(a) SIGTARP: "Irrespective of their stated intent, however, there is no question that the effect of FRBNY's decisions – indeed, the very design of the federal assistance to AIG – was that tens of billions of dollars of Government money was funneled inexorably and directly to AIG's counterparties." (PTX 549 at 34). "Stated another way, by providing AIG with the capital to make these payments, Federal Reserve officials provided AIG's counterparties with tens of billions of dollars they likely would have not otherwise received had AIG gone into bankruptcy." (PTX 549 at 34).

(b) Zingales: "I think it's important to notice that it's not only me but also the government itself in the sort of role in this case of SIGTARP that notices that not only the effect, so it's not only an unintended consequence but the very design is designed to provide resource to the counterparties. This, as I said earlier, this is in sharp contrast with what the government had done in other situations, so when it came to General Motors or Chrysler, the government was not

¹¹⁴ Although Defendant claims that its efforts to seek concessions were stymied by a lack of "bargaining power" (*see, e.g.*, Baxter: Trial Tr. 1029:14-18; Dahlgren: Trial Tr. 2995:1-13; Huebner: Trial Tr. 6138:13 – 6139:4), the contemporaneous evidence suggests that Defendant never seriously pursued concessions. First, Defendant only contacted half of AIG's counterparties regarding concessions. Def. Answer to Second Amended Complaint ¶ 140. Second, Defendant only tried to seek concessions for approximately 24 hours. Latorre: Trial Tr. 2346:24 – 2347:3. And third, Defendant stressed in its negotiations that any concessions would be "voluntary". PTX 549 at 19; *see also* PTX 562 at 4; PTX 718.

shy of asking important concession to bondholders. So it's really striking the difference here.” (Zingales: Trial Tr. 4114:12 – 4115:17).

(c) Cragg: “Maiden Lane III was an asset swap and that provided tremendous liquidity to AIG’s counterparties.” (Cragg: Trial Tr. 5094:22 – 5095:4; PTX 5366-A (Cragg demonstrative)). “AIG put up a total of \$37.5 billion. The Federal Reserve Bank of New York put \$24.3 billion. And they used that to purchase the CDOs from the counterparties. So the CDOs – so the counterparties received additional liquidity against these illiquid securities.” (Cragg: Trial Tr. 5095:5-19; PTX 5366-A (Cragg demonstrative)).

(d) Cragg: If FRBNY had guaranteed the CDOs instead of doing Maiden Lane III, the more than \$29 billion in payments to AIG’s counterparties would not have been made. (Cragg: Trial Tr. 5097:2 – 5098:8; PTX 5367 (Cragg demonstrative); *see also* PTX 272 at 5 (chart prepared by Defendant stating that a guarantee would “Require that no further collateral be posted. Require counterparty to return collateral posting of \$41B for use in paying down existing credit facility”); PTX 277 at 10 (“Return of collateral constitutes a \$33 billion liquidity call on the financial system” “Some counterparties may have difficulty returning collateral”)).

(e) Cragg: Additionally, with respect to the collateral that AIG had already posted, “because there would be no need for covering the credit risk associated with these CDS contracts given who the counterparty would then be – it would be the federal government backing these contracts – that would have released all of the collateral that AIG had posted.” (Cragg: Trial Tr. 5098:9-16). In other words, the \$32 billion AIG already posted would have come back and “the counterparties would have lost \$61 billion of liquidity”. (Cragg: Trial Tr. 5098:17-20).

(f) Cragg: AIG’s CDS counterparties received par through ML III’s addition to AIG’s prior collateral payments. (PTX 5367 (Cragg demonstrative); *see also* Baxter: Trial Tr. 1071:11-

16; PTX 2856 at 116 (Cragg Report, Table 6); PTX 549 at 23-24 (“Factors Affecting Efforts to Limit Payments to AIG Counterparties,” SIGTARP, November 17, 2009)).

34.6.1 In connection with the ML III transactions, AIG’s counterparties received payment equivalent to the par value of the CDOs without any discount.

(a) FRBNY Presentation on ML III: “AIG’s counterparties: Receive par consideration”. (PTX 385 at 11).

(b) Baxter: “No concessions were negotiated” with AIG’s counterparties. (Baxter: Trial Tr. 1028:20-23; *see also* PTX 562 at 5 (“FRBNY compensated the counterparties at par – 100 cents on the dollar.”)).

(c) Alvarez: The “negotiations that the Federal Reserve Bank of New York did on behalf of AIG led to AIG paying the counterparties a hundred percent of par.” (Alvarez: Trial Tr. 342:12-19; *see also* Alvarez: Trial Tr. 355:3-12 (“there were no concessions”)).

(d) Dahlgren: “Ultimately, a decision was made to pay the ML III counterparties par value.” (Dahlgren: Trial Tr. 2754:16-18).

(e) Kieran Fallon of the Federal Reserve on November 7, 2008: “Here is a revised version of the PowerPoint, reflecting the fact (just learned on an ML III update call) that there will be no concessions on the CDOs, so they will be purchased at par from the counterparties.” (PTX 355 at 1).

(f) “After consulting with the Federal Reserve Board and Treasury, the FRBNY informed AIG of its decision.” (PTX 562 at 4). “The decision that’s being referred to there is the decision to purchase the underlying assets insured by the CDS contracts from AIG’s counterparties through funding provided by the Federal Reserve Bank of New York into a special-purpose vehicle called Maiden Lane III”. (Alvarez: Trial Tr. 337:19 – 339:1; *see also*

Alvarez: Trial Tr. 339:2 – 340:21 (affirming Alvarez’s 30(b)(6) deposition testimony that Defendant believes the statement in PTX 562 is accurate)).

(g) Liddy: “The decision to pay the counterparties 100 percent of par was a decision that the Federal Reserve made entirely on its own”. (Liddy: Trial Tr. 3117:4-7). It is a decision that “AIG did not participate in in any way”. (Liddy: Trial Tr. 3117:8-10). It is something that AIG “had no say in and no control over”. (Liddy: Trial Tr. 3117:11-13).

(h) Zingales: If AIG’s lack of involvement in the decision to pay the CDS counterparties par is “not evidence that the Government is in control, I don’t know what – I don’t what it is.” (Zingales: Trial Tr. 3845:6-20; *see also* PTX 5061 (demonstrative showing a timeline of the counterparty payment issue and related points)).

34.6.2 FRBNY’s motivation in dealing with AIG’s CDS issues was to provide assistance to other financial institutions which it supervised.

(a) On December 9, 2008, Kelly sent Dahlgren and Hennessy a draft of a speech that Liddy was scheduled to give on December 11, 2008 to the American Chamber of Commerce & Hong Kong General Chamber of Commerce for review and comment. (PTX 387 at 3). It stated, in part, “I can’t underscore enough the significance of the November 10 action. It reflects a profound understanding on the part of the fiscal and monetary officials of the US government that AIG is too significant to counterparties around the world to be allowed to fail.” (PTX 387 at 6).

(b) Baxter and Dahlgren to the Congressional Oversight Panel on May 26, 2010: “As a liquidity provider, we did not consider conditioning our lending to AIG on a requirement that the company obtain concessions from some of its major creditors. Conditioning our lending on AIG coercing certain creditors to agree to reduce the amounts due and owing from AIG would have

been to ensure failure. The tactic would have undercut our primary goal in providing AIG with necessary liquidity – enabling AIG to pay creditors, maintain consumer, regulator, and counterparty confidence, and avoid default. . . . Any attempt to condition our lending would have created further uncertainty in a time of panic as to which of AIG’s counterparties would get paid and which would be forced to take substantial losses.” (PTX 587 at 56).

(c) Societe Generale, UBS, Bank of America, Morgan Stanley, and Goldman Sachs were among the counterparties who received payment the equivalent of par value. (Baxter: Trial Tr. 1061:25 – 1062:11).

34.6.3 In connection with the Maiden Lane III transactions, AIG’s counterparties received complete releases from AIG for all legal action, including any potential fraud or misrepresentation claims.

(a) Baxter: The deal “negotiated by representatives of the New York Fed with the counterparties” “involved 100 percent par, plus the releases”. (Baxter: Trial Tr. 1071:11-16). “There were mutual releases” given between AIG and the counterparties. (Baxter: Trial Tr. 1067:24 – 1068:7).

(b) Liddy was not “aware before it happened that the Federal Reserve was going to offer counterparties releases”. (Liddy: Trial Tr. 3176:13-19).

(c) Zingales: Defendant giving AIG’s counterparties complete releases “is basically impossible to explain unless the Government is giving direction to do so, because we can discuss a lot of other things, but why a private party will give full release to the counterparty, in

exchange for no consideration?” (Zingales: Trial Tr. 3845:21 – 3846:13; *see also* PTX 5061 (demonstrative showing a timeline for this and other related points)).¹¹⁵

34.6.4 AIG received nothing in exchange for the mutual releases because its counterparties, who were paid in full, had no viable claims to release.

(a) Baxter: AIG’s “contractual obligation” on its CDSs was “limited at” their par value, or \$62.1 billion. (Baxter: Trial Tr. 1068:8-22).

(b) Baxter: “I didn’t know of any claims of the counterparties against AIG.” (Baxter: Trial Tr. 1069:14-15).

(c) Baxter has “no knowledge” of FRBNY ever attempting “to negotiate a deal where the counterparties would get their \$62.1 billion, AIG would get a release, but that the counterparties would not get a release for fraud”. (Baxter: Trial Tr. 1077:17-25).

(d) Alvarez: “I don’t know” “of any reason why AIG would be giving the counterparties that they were paying a hundred percent on the dollar for a release”. (Alvarez: Trial Tr. 343:3-6).

(e) Zingales: “So, they pay the full value to the other side, and they release the right to bring suits that ex post we know would have been worth a lot to AIG, but even at the time, there were sort of hints that there was something wrong with the CDOs, so AIG could have brought suit and made money. Now, why AIG would do that is sort of – I can’t explain.” (Zingales: Trial Tr. 3845:21 – 3846:13).

34.6.5 The legal releases provided to AIG’s counterparties had substantial value.

¹¹⁵ Defendant tried to justify the legal releases by stating that they were drafted by AIG’s outside counsel, Weil Gotshal. *See* Baxter: Trial Tr. 1072:12 – 1076:17; Latorre: Trial Tr. 2334:17 – 2335:12; DX 666 at -252 to -254. But Defendant failed to offer any possible reason why AIG, absent pressure from Defendant, would consent to these releases without receiving any consideration in exchange. Defendant also failed to offer any evidence that AIG knew the releases would be entered into absent below-par concessions.

(a) Liddy did not make any effort to determine “whether AIG had any claims against the counterparties for misrepresentations related to CDOs”. (Liddy: Trial Tr. 3176:20 – 3177:1).

(b) But at least by March or April 2009, FRBNY understood that “AIG had plausible claims against the counterparties”. (Baxter: Trial Tr. 1069:19 – 1070:10).

(c) Since then, “with respect to CDS transactions other than those covered by ML III where releases were granted, AIG has, in fact, sued CDS counterparties for misrepresentations in connection with the issuance of those CDS protections”. (Baxter: Trial Tr. 1070:22 –1071:2).

(d) AIG pursued claims against, for example, Bank of America, Merrill Lynch and Countrywide for “fraud in the bank’s packaging and selling of mortgages to investors during the housing bubble.” (PTX 2528 at 1). AIG alleged that Bank of America and its affiliated companies “misrepresented the quality of mortgage securities sold to investors” (PTX 2528 at 1), securities comparable to the securities that were the subject of ML II. In July 2014 AIG and Bank of America settled AIG’s claims against Bank of America for \$650 million and a share of an \$8.5 billion settlement of claims for “problematic mortgages” in a related suit. (PTX 2528 at 1-2).

34.7 Defendant’s Control over AIG Is Evidenced by Its Control over Information Concerning the Maiden Lane Structures.

(a) Dahlgren: “I don’t think we should disclose anything to AIG on the ML structures (until we are ready with our own disclosures) – as I don’t have confidence that the information could be kept confidential within the company, etc....” (PTX 460 at 1 (ellipses in original)).

34.8 Defendant’s Control over AIG Is Evidenced by Defendant’s Direction to AIG to Conceal the Maiden Lane III Backdoor Payments from Public Disclosure.

(a) Committee on Oversight and Government Reform Report (January 25, 2010):
“After the public announcement of the Maiden Lane III transactions, the FRBNY tried to cover

up the fact that AIG's counterparties were receiving par in exchange for the underlying assets.” (PTX 562 at 7).

(b) SIGTARP: “Despite having made the decision to pay the counterparties effectively par value, the Federal Reserve and FRBNY made an initial decision not to reveal the identities of AIG's counterparties or the amount of individual payments.” (PTX 549 at 25).

(c) Dahlgren: “there was a time when the Federal Reserve wanted to not release counterparty names and amounts”. (Dahlgren: Trial Tr. 2777:14-17).

(d) “On November 11, 2008, FRBNY Assistant Vice President Alejandro Latorre edited a draft request for proposals for banking services for the ML3 transactions. The draft request for proposals included a sentence revealing that the counterparties had received par. Latorre deleted the sentence and e-mailed his colleagues: ‘As a matter of course, *we do not want to disclose that the concession is at par unless absolutely necessary.*’ (PTX 562 at 7) (emphasis in original)).

(e) House Committee on Oversight and Government Reform Questions for the Record (January 27, 2010): “AIG and the New York Fed created Maiden Lane III on November 25, 2008. Sarah Dahlgren, a Senior Vice President at the New York Fed in charge of the New York Fed's dealings with AIG, told Davis Polk that she did not want AIG to report the transactions to the SEC that day, saying in an email that ‘I really don't want the ML III to go out today...is the company still aiming to try to issue this today?...’ Ethan James, a Davis Polk partner, responded to her email saying ‘we gotcha covered. You only need hear Kathy [Shannon]'s pathetic

voicemail to understand how well trained she is-at least for now!” (PTX 563 at 24 (ellipses in original); *see also* PTX 564 at 267 (same)).¹¹⁶

(i) Zingales: The November 25, 2008 exchange between Dahlgren and Davis Polk “seems to indicate that employees of AIG had been trained to say yes to higher authority, which is the authority of the Defendant.” (Zingales: Trial Tr. 3850:8-19; *see also* PTX 5064 (Zingales demonstrative citing PTX 564 and other exhibits that show Defendant’s direction to AIG to conceal information about the counterparties who received par value under ML III)).

(f) On December 1, 2008, as AIG prepared once again to report its transaction with ML III to the SEC, Davis Polk attorney Peter Bazos advised Stephen Albrecht of the Treasury Department: “Bjorn and I spoke with AIG’s outside counsel (Weil) and communicated that the MLIII 8-K should not be filed today. As suggested, we will be in touch with Alex, as well as with Weil to finalize the wording of the 8-K.” (PTX 384 at 1).

(g) “On December 2, 2008, AIG reported ML3’s formation and its first round of transactions, which had occurred seven days earlier.” (PTX 562 at 8).

(h) “AIG made a second filing on December 24, 2008, describing ML3’s second round of transactions.” (PTX 562 at 8).

¹¹⁶ This contradicts Huebner’s testimony that “The marching orders from the clients were very clear, which is, AIG is a public securities filer with experienced counsel. We were to make suggestions where appropriate but never had essentially a veto or an ability to command that they do anything. They were always in the guise of suggestions” and that AIG was “exclusively responsible for its own filings.” Huebner: Trial Tr. 6034:4 – 6035:25, 6043:23 – 6044:8; *see also supra* § 15.11. This dichotomy is encapsulated in Huebner’s testimony regarding PTX 563 at 24: “You would accept, would you not, that this email exchange is not consistent with your description of the relationship between Davis Polk and the New York Fed on the one hand and AIG on the other? Yes, no, I don’t know, or I don’t understand your question. A. This email is not consistent with my understanding of how the relationship worked and my involvement in that relationship. Q. Okay. A. It is an unattractive email with – that should not have been phrased that way.” Huebner: Trial Tr. 6277:19 – 6281:5.

(i) Prior to that filing, on December 23, 2008, Davis Polk extensively edited AIG's proposed ML III 8-K and related press release. "Davis Polk edited both the December 2 filing and the December 24 filing, and the press releases that AIG issued along with these filings. Some of Davis Polk's edits tended to obscure controversial details of the transactions. For example, the proposed December 24 filing included a sentence referring to par value: 'As a result of this transaction, the AIGFP counterparties received 100 percent of the par value of the Multi-Sector CDOs sold and the related CDS have been terminated.' Davis Polk attorneys crossed out this sentence." (PTX 562 at 8; *see also* PTX 390 at 4 (DPW markup of 8-K showing that DPW deleted the sentence referred to in PTX 562); JX 165 at 2-3 (filed 8-K reflecting DPW edits)).

(j) "AIG's filings on December 2, 2008, and December 24, 2008, included the agreements between AIG and ML3 but omitted Schedule A. At the end of 2008, the SEC objected to the absence of Schedule A from AIG's filings, and ordered AIG to either file Schedule A publicly or provide it to the SEC for review along with a request for confidential treatment." (PTX 562 at 8-9).

(k) Schedule A included "the names of the counterparties to which the bonds were acquired from." (Latorre: Trial Tr. 2073:12 – 2074:4). FRBNY sought to keep the entire schedule confidential. (Latorre: Trial Tr. 2074:5-8).¹¹⁷

(l) On January 14, 2009, Latorre wrote to James Bergin of FRBNY's legal group and Davis Polk: "if we can avoid disclosing, I agree with Jim we should pursue that as we would like

¹¹⁷ Despite Latorre's testimony that he was concerned about "prejudicing" AIG by the ML III disclosure (Latorre: Trial Tr. 2075:15 – 2076:23), Latorre admitted that this "was my personal view", and he "did not have any discussions with AIG surrounding the confidentiality of the counterparty names" and did not "recall any specific person who did." Latorre: Trial Tr. 2077:20-24, 2078:24 – 2079:6; *see also* Latorre: Trial Tr. 2343:5-16 (acknowledging that no one from AIG ever told him that disclosure would prejudice AIG and that he did not "ever see anything in writing from AIG that said that AIG believed that releasing the names would prejudice AIG from a business perspective").

to keep the entire schedule confidential.” (PTX 405 at 1; *see also* Latorre: Trial Tr. 2074:15-17 (“Mr. Bergin is in the Legal Department of the Federal Reserve Bank.”)).

(m) To that end, “the Federal Reserve Bank of New York directly intervened with the SEC to prevent information about the AIG counterparties becoming public from the SEC.” (Alvarez: Trial Tr. 347:9 – 348:15 (affirming that Alvarez was being “as complete and forthcoming” as he could be when he gave the above-quoted testimony as Defendant’s 30(b)(6) representative); *see also* PTX 562 at 9 (“When officials at the FRBNY learned of the SEC’s objection, they intervened directly with the SEC to try to avoid having to provide a copy of Schedule A”); PTX 3356 (January 9, 2008 email from James Bergin summarizing call from FRBNY to SEC to make sure they were aware of the “FRS and public interest in the requested information”)); *see also* JX 170 at 3-4 (January 14, 2009 AIG Form 8-K/A containing “the Shortfall Agreement between Maiden Lane III LLC and AIG Financial Products Corp., dated as of November 25, 2008, and amended as of December 18, 2008, containing Schedule A in redacted form.”)).

(n) In response to a March 5, 2009 email from Bernanke asking Alvarez whether he would “be willing to draft an opinion that releasing the info is illegal,” Alvarez responded: “the key to winning this debate seems to me to be a convincing argument that releasing the information will be damaging to the counterparties, AIG and anyone else that has gotten or might be suspected of getting USG capital or Fed funding.” (PTX 3365 at 1-2).

(o) “Members of Congress continued to try to obtain information about the counterparty payments.” (PTX 562 at 9). In March 2009, Vice Chairman Kohn testified before the Senate Banking Committee, “where Senators criticized the FRBNY’s decision to keep the names of the counterparties secret.” (PTX 562 at 9). On March 6, 2009, after Vice Chairman Kohn’s

testimony, Latorre wrote to FRBNY counsel and staff: “I wonder if there is a way to get them,” meaning Congress, “off the fixation on counterparty names.” (PTX 450 at 1; PTX 562 at 9-10).

(p) On March 12, 2009 at 7:25 p.m., Anastasia Kelly (AIG’s general counsel) sent Dahlgren an email indicating that “AIG planned to file materials relating to Maiden Lane III without redacting counterparty names and amounts”. (Dahlgren: Trial Tr. 2773:13-23 (discussing PTX 458); *see also* PTX 458 at 1, 18 (draft letter to SEC withdrawing request for confidential treatment)). Later that evening, Dahlgren emailed Heller and others: “I told Ed yesterday – and have also told Brian Schreiber, who drafted the presentation – that we would need to review what the company is planning to disclose in the presentation – and I agreed with Brian that we would take a pass at the deck today and discuss with him tomorrow what could or couldn’t be included in the deck.” (PTX 460 at 2).

(q) Ultimately, in March 2009, only “after a congressional uproar about keeping the counterparties’ identities confidential,” FRBNY decided to release the names of the counterparties and the amounts they received from ML III. (Alvarez: Trial Tr. 345:6-15 (“That was – in sequence, that’s correct”); *see also* Baxter: Trial Tr. 1033:17 – 1034:2 (Baxter explaining that they ultimately disclosed names because of the controversy); PTX 562 at 9 (“Public pressure finally forces FRBNY to permit names of counterparties to be disclosed in March 2009.”); Dahlgren: Trial Tr. 2777:22 – 2778:2 (A “couple of months” “passed from the time that the ML III transaction was signed up and the time that the counterparty names and amounts were released”)).

(r) “As an apparent result of FRBNY pressure,” however, AIG did not release an unredacted version of Schedule A. (PTX 562 at 10).

(s) On March 12, 2009, at 8:12 p.m., James Bergin (FRBNY counsel) emailed several FRBNY executives and Davis Polk attorneys: “Have we made the decision to release the entire schedule to the Shortfall Agreement? I thought we had decided to release counterparty names and amounts. I checked with Baxter and that was his impression too. As currently presented, this filing would disclose CUSIP/ISIN numbers and Tranches Names.” (PTX 459 at 3). Heller responds: “Sounds like we are trying to hold it back.” (PTX 459 at 1). Bergin replies: “Yes, we don’t intend to disclose that.” (PTX 459 at 1).

(t) On March 12, 2009, at 10:48 p.m., Bergin emailed Dahlgren and several other FRBNY executives: “The company was a little leery of not disclosing everything at this point – including CUSIP and tranches names – but are willing to redact that at our wishes.” (PTX 461 at 1; *see also* Dahlgren: Trial Tr. 2962:3-8 (“We did not want the CUSIPs and tranche names revealed, that’s correct.”)).

(u) Later on March 12, 2009, at 10:55 p.m., Shannon wrote to Kelly regarding “counterparties”: “In order to make only the disclosure that the Fed wants us to make, which we understand to be to not include the CUSIPs or Tranche names and give the amounts by counterparty on a total rather than a transaction by transaction basis, we need to have a reasonable basis for believing and arguing to the SEC that the information we are seeking to protect is not already publicly available.” (PTX 462 at 1; *see also* Dahlgren: Trial Tr. 2959:10 – 2961:2 (“At this point in time, the discussions were between the Fed and AIG, how much would be disclosed, and we were concerned about disclosure of the CUSIPs and the tranches, which it appeared that AIG may have wanted to disclose without understanding why they wanted to disclose it.”)).

(v) On March 13, 2009, at the request of FRBNY, Davis Polk reviewed and commented on AIG’s press release relating to the disclosure of AIG’s counterparties. (PTX 463; *see also*

Dahlgren: Trial Tr. 2713:6 – 2714:3 (PTX 463 reflects Dahlgren asking Davis Polk and several FRBNY executives to provide comments on AIG’s draft press release)).

(w) On March 16, 2009, AIG filed another 8-K/A providing the aggregate notional value and aggregate total collateral posted for each counterparty, but it kept other information confidential including the CUSIP/ISIN numbers and Tranche Names. (JX 195 at 2-3, 14-18).

(x) Zingales: “Filing reports is a duty of the company, an indication of control. So, if AIG cannot independently file the report and decide what to disclose, I think that’s a pretty strong indication on who felt control over the situation.” (Zingales: Trial Tr. 3847:24 – 3850:7; PTX 5064 (Zingales demonstrative illustrating Defendant’s direction to AIG to conceal information about the counterparties who received par value under ML III)).

34.9 Knowing That There Was Substantial Value in the Portfolios, AIG Attempted to Buy Back the Underlying CDOs from Maiden Lane II and III but Defendant Refused.

(a) Recognizing their value, AIG offered to buy back the CDOs underlying ML II and ML III as part of the 2010 restructuring but Defendant refused. (PTX 3366 at 1, 4 (handwritten notes of conference call among FRBNY, Treasury and Morgan Stanley, regarding valuation of ML III and attributing to Peter Juhas of Morgan Stanley: “consideration is hold-to-maturity v. sale to AIG”); Baxter: Trial Tr. 1067:7-17 (“there was interest on the part of AIG in purchasing them”, but the “decision was to have an auction of those securities”)).

(b) In April 2010, AIG sought to have “the gains in ML II and ML III from their [Defendant’s] residual interests toward a reduction in the principal amount outstanding of the TARP Series E and F” because ML II and ML III were formed at the “bottom of the market” which “crystallized some losses” for AIG. (Schreiber: Trial Tr. 6674:9 – 6676:2; *see also* PTX 578 at 3 (AIG TARP Exit Proposal stating: “Crediting ML II and ML III toward TARP

repayment allows TARP to remain unimpaired while returning value that rightly belongs to AIG shareholders and other stakeholders.”)).

(c) On March 10, 2011, AIG wrote to FRBNY “offering to repay the loan by the FRBNY to, and to purchase all of the assets of, Maiden Lane II LLC.” (JX 324 at 3). According to the letter, “Maiden Lane II was formed to help AIG alleviate liquidity challenges in its securities lending program.... Since then, the conditions that necessitated Maiden Lane II in the first place have been resolved.” “Since the original transaction was executed in December 2008,” “the value of the Maiden Lane II assets has increased. If the FRBNY accepts this offer, the loans that the FRBNY made to Maiden Lane II will be repaid in full, with interest, and the FRBNY will realize a profit of approximately \$1.5 billion on its residual equity interest in Maiden Lane II.” (JX 324 at 7).

(d) Dahlgren, in response to a question concerning AIG’s “view that the price at which they were being sold was less than what those CDOs were worth”: “I remember some back-and-forth at some point about AIG wanting to take back some of the ML III assets.” (Dahlgren: Trial Tr. 2969:19-24).

34.10 Defendant Retained a Disproportionate Share of the Residual Interests of ML II and III.¹¹⁸

¹¹⁸ Although some testimony and exhibits refer to the “profit” derived from the ML III residual interest (*see, e.g.*, PTX 2540 at 2), this is an inaccurate description of the disbursement of “residual interest” in AIG. As part of the ML III transaction, AIG’s counterparties also retained approximately \$35 billion in already-posted collateral. PTX 549 at 2, 9. This part of AIG’s contribution to ML III was never accounted for in the ML III structure. *See* PTX 2540 at 2 (“Summary of Maiden Lane III LLC (‘ML III’) Waterfall Allocation” indicating that the \$35 billion in already-posted collateral was not accounted for); Latorre: Trial Tr. 2376:16 – 2378:4 (acknowledging that the already-posted collateral was not accounted for in the ML III structure). In other words, when AIG’s true contribution to ML III is accounted for, “AIG’s net return from the CDS portfolio that was placed into Maiden Lane III was negative \$29.6 billion”. PTX 2856 at 183 (Cragg Report ¶ 209); *see also* PTX 5366-A (Cragg demonstrative: “AIG had previously posted \$32.5 billion in collateral and contributed \$5 billion in equity. Its proceeds were \$8.5 billion. Thus its net losses were around \$29 billion (\$32.5 + \$5 – \$8.5)”).

34.10.1 Defendant retained a disproportionate share of the residual interest in Maiden Lane III.

(a) FRBNY loaned ML III \$24.3 billion while AIG made a \$5 billion cash investment in ML III, in addition to the \$35 billion in collateral it had previously posted to the CDS counterparties. (PTX 589 at 92).

(b) “AIG’s \$5 billion equity investment in Maiden Lane III was subordinated to the Fed’s \$24.3 billion secured loan.” (PTX 564 at 196; *see also* Dahlgren: Trial Tr. 2956:22 – 2957:1 (“the \$24.3 billion loan that the Fed made, that loan sat in first position, that is, it got paid back first out of all of the proceeds from ML III”)).

(c) AIG received no credit for the \$35 billion in collateral it had already posted and that was given to counterparties in satisfaction of the CDS portfolio buyout. (PTX 2540 at 2; PTX 2856 at 183, ¶ 209).

(d) A December 5, 2008 FRBNY presentation states that “Investment Objective” of Maiden Lane III was to “Maximize value of the senior note”, meaning the Government’s interest. (PTX 385 at 15, 17).

(e) As early as March 18, 2009, merely four months after its creation, it was clear to both AIG and Defendant that the Maiden Lane structures would have significant returns. Liddy testified before the House of Representatives Committee on Financial Services that the Defendant was “able to acquire those assets at a discount at 40 or 50 or 60 cents on the dollar. They are currently performing. There have been no credit losses on them. And the Fed is a patient investor. They and the American public will do very well on that investment.” (PTX 471 at 72).

34.10.2 Defendant split the residual interest in ML III with AIG 67% to 33% in Defendant's favor.

(a) After repayment of FRBNY's loan and AIG's equity investment, any residual interests were split 67% to FRBNY and 33% to AIG. (Def. Resp. to Pl. 2nd RFAs No. 939; Dahlgren: Trial Tr. 2984:21-23 ("ML III split the profits two-thirds to the Fed and one-third to AIG."); Baxter: Trial Tr. 1066:9-16 (FRBNY received two-thirds of the residual interests on ML III); Cragg: Trial Tr. 5099:17-20 (Maiden Lane III residual interests were divided one-third/two-thirds between AIG and the Federal Reserve.)).

(b) The Government Accountability Office was perplexed by the split of residuals for Maiden Lane III, and asked a similar question to that posed by Plaintiffs at trial: "Based on our reviews, we noted that FRBNY asked BlackRock to see how much the ML III residuals could be stretched prior to breaching consolidation issues. BlackRock came back with a 55%/45% (Fed/AIG) split. Why did FRBNY choose the 67%/33% split, when there was the other split presented?" (PTX 3362 at 3).

(c) "On June 14, 2012, FRBNY announced that the ML III loan had been completely repaid with interest. By July 16, 2012, AIG's equity contribution to ML III had been repaid plus interest. On August 23, 2012, FRBNY announced that it had sold the remaining securities in the ML III portfolio, resulting in an overall net gain of approximately \$6.6 billion, including \$737 million in accrued interest." (Agreed to Stipulations ¶ 192; *see also* DX 1883, App'x C, ¶ 29 (Saunders Report); *see also* Baxter: Trial Tr. 1066:1-8 (Approximately \$6 billion in residual proceeds has been earned on ML III, not including interest)).

(d) Zingales: In deciding how to split the proceeds, "there is clearly a potential conflict of interest between the Government and AIG, because it's a related-party transaction, and in this,

basically the decision of the two-third/one-third split of the profits was a decision that the Fed made without any sort of – without following the rules that generally takes place in a related-party transaction.” (Zingales: Trial Tr. 3847:24 – 3848:17; *see generally* PTX 5062 – PTX 5064 (Zingales demonstratives showing the chronology of Defendant’s control over AIG through ML III)).

(e) Zingales: “the Federal Reserve Bank of New York appropriated two-thirds of the profits from Maiden Lane III even though it bore no significant risk and put up no new equity.” (Zingales: Trial Tr. 3846:14 – 3847:20; *see also* PTX 5061 (Zingales demonstrative timeline listing this event); Zingales: Trial Tr. 3846:21 – 3847:23 (“the value of the CDOs that were marked down very aggressively, and in addition, the – AIG put another 5 billion of equity cushion. And the Fed had a secure lending, which was senior to everybody else,” accordingly “there was not really much risk that the Fed was taking in that transaction.”)).¹¹⁹

34.10.3 Defendant retained a disproportionate share of the residual interest in Maiden Lane II.

¹¹⁹ Although Latorre, perhaps in an attempt to justify the disproportionate split of the residual interest, testified that “all” of AIG’s collateral postings to its Maiden Lane III counterparties had been borrowed from FRBNY after September 16, 2008 (Latorre: Trial Tr. 2378:21 – 2379:11), there is significant record evidence that he was simply wrong. Prior to FRBNY’s loan, well over \$20 billion in collateral had already been posted by AIG. *See, e.g.*, PTX 2856 at 320 (AIG posted \$23.35 billion in collateral by 9/16/08); Cragg: Trial Tr. 5023:10 – 5024:8 (by summer 2008, around \$20 billion in collateral had been posted by AIG); *see also* PTX 66 at 2 (showing that AIG had posted approximately \$20 billion in collateral to its CDS counterparties as of 9/12/08). In fact, Latorre himself authored a September 12, 2008 email which states that in the days preceding the loan AIG had “so far made about \$1B in collateral postings on derivatives over the past week.” DX 249 at -964. Other FRBNY executives also knew that AIG had posted billions of dollars to its CDS counterparties prior to September 2008. *See* PTX 27 at 1 (August 7, 2008 e-mail to various FRBNY executives stating that AIG’s “collateral posted to counterparties increased from month-end April thru July from 10 b to 16.5 b.”). Latorre subsequently admitted that he did not know whether “prior to getting any money from the Federal Reserve, AIG had posted collateral for the CDSs that were the subject of ML III”. Latorre: Trial Tr. 2384:10 – 2835:2.

(a) “The FRBNY began selling portions of ML II’s portfolio in April 2011 and continued to sell pieces on a weekly basis through June 2011. On February 28, 2012, the FRBNY sold the remaining assets in the ML II portfolio for an approximate net gain of \$2.8 billion, which included \$580 million in interest.” (Agreed to Stipulations ¶ 191; *see also* DX 1883 App’x C, ¶ 28 (Saunders Report)).

35.0

AIG’S COMMON SHAREHOLDERS WERE NEVER GIVEN AN OPPORTUNITY TO APPROVE OR DISAPPROVE DEFENDANT’S TAKING OR EXACTION OF AN EQUITY INTEREST IN AIG, AND DEFENDANT ACTED TO AVOID SUCH A VOTE FROM OCCURRING.

35.1 Defendant at All Times Intended to Convert Its Series C Preferred Stock into More Liquid and Thus More Valuable Common Stock.

(a) In an email to Baxter on September 18, 2008, Stephen Albrecht (Treasury counsel) noted that, “if the AIG charter were eventually amended to increase the amount of common that could be issued, the preferred would convert to 79.9% of common (with the thought being that common would be easier to sell when that became advisable.)”. (PTX 146 at 1). “The ability to obtain common stock was important to the Federal Reserve because that allowed it to be readily salable in the market at some point” (Alvarez: Trial Tr. 425:14-18).

(b) Geithner: “it was important to the Government that the preferred stock be convertible into common stock because common stock was much more liquid and could be transferred more easily and, hence, was more valuable”. (Geithner: Trial Tr. 1519:6-11).

(c) “In considering possible structures for the equity participation, FRBNY wished to facilitate the eventual sale of the equity to the general public, which it believed would be most likely if the equity, when it was being marketed, took the form of AIG common stock that could be purchased by any buyer, including general public buyers. The initial issuance of the equity

could not be made in the form of AIG common stock because, at the time of the execution of the credit agreement, AIG did not have a sufficient number of authorized but unissued shares to convey 79.9 percent of its equity.” (Def. Resp. to Pl. 2nd Interrogatories No. 2).

35.1.1 Because Defendant’s goal was always to convert the preferred shares into common shares, Defendant made that goal one of the primary responsibilities the Trustees were required to undertake. (JX 172 at 9 (§ 2.04(c))).

(a) Section 2.04(c) of the Trust Agreement requires the Trustees to “take any and all reasonable actions available to them and necessary” to effect an amendment of AIG’s charter to increase the number of authorized common shares and to reduce the par value of AIG common shares. (JX 172 at 9).

(b) Feldberg: Section 2.04(c) “would have to be attended to at some point” “because the credit agreement contemplated that the Government would receive effectively 80 percent of the common stock of the company as consideration for providing the financial support that it did to AIG, and in order to do that, it was necessary to – as I recall, to issue more common stock, and to issue more common stock required an amendment to the charter.” (Feldberg: Trial Tr. 3342:24 – 3345:2, 3359:1-13 (Section 2.04(c) required the Trustees to take “any and all reasonable actions available to them to cause this shareholder vote to take place”)).

(c) Feldberg: In order for the Series C convertible preferred stock “to be converted into common shares, a shareholder vote was required”. (Feldberg: Trial Tr. 3357:5-9). The Trustees “thought that conversion was the vehicle for being able to dispose of the stock and realize the benefit of the proceeds for the Government.” (Feldberg: Trial Tr. 3380:17 – 3381:6). “Our expectation going in was that at some point the convertible preferred we held would be converted into common stock to facilitate the disposition of that stock and the realization of the

proceeds on behalf of the U.S. Government.” (Feldberg: Trial Tr. 3380:17-24; *see also* Feldberg: Trial Tr. 3360:10-15 (in order to dispose of the Trust’s equity, “that equity had to be converted into common stock”)).¹²⁰

35.1.2 Under the original warrant structure approved by the Board of Governors, Defendant understood that a shareholder vote was required to increase the number of authorized AIG shares and decrease the par value in order for Defendant to obtain a 79.9% equity interest in AIG. (*See also supra* § 12.2.3).

(a) Bernanke: The term sheet that was approved by the Board of Governors on September 16 “provided for a shareholder vote of AIG’s shareholders”. (Bernanke: Trial Tr. 2260:10-14).

(b) During a conference call on September 18, 2008, with attorneys from FRBNY, the Federal Reserve Board, Treasury, and Davis Polk, Davis Polk advised: “warrants require s/h because not enough shares authorized”, “consider voting preferred w/ 79% voting w/ common”. (PTX 148 at 2 (emphasis in original); *see also* Alvarez: Trial Tr. 223:10-15 (PTX 148 are the notes Alvarez “took of a September 18, 2008, conference call among lawyers”)).

35.1.3 Defendant initially demanded that AIG pay a Periodic Commitment Fee of 2.5% prior to shareholder approval of the increase in authorized shares needed to grant Defendant 79.9% of the company in order to coerce shareholders’ approval of the transaction.

(a) On September 16, 2008, Treasury contractor Dan Jester observed that the Government “will need approval of AIG s/h; economic incentive; increase fees to encourage s/h approval”. (JX 82 at 2 (emphasis in original)).

¹²⁰ Foshee disputed that the trustees had a specific objective of “converting the preferred stock into common stock”, but admitted that to “the extent that that would maximize the long-term value for the taxpayers,” it would have been a goal. Foshee: Trial Tr. 3467:9-13, 3469:4-7.

(b) The term sheet approved by the Federal Reserve Board of Governors on September 16, 2008 included a periodic commitment fee to encourage the shareholder vote. (JX 63 at 6 (“Prior to Shareholder Approval of the increase in authorized shares, 2.5% payable in kind every 3 months after closing. After Shareholder Approval, 50bp every 3 months after closing.”)).

(c) Alvarez: “The purpose of the periodic commitment fee provision was to encourage AIG’s management to bring to the shareholders and the shareholders to approve the steps that would be necessary to allow the equity participation provision to be fulfilled.” (Alvarez: Trial Tr. 426:2-17 (confirming that this statement, given at Alvarez’s prior deposition as the United States’ 30(b)(6) witness, “was accurate testimony”)).

(d) Davis Polk attorney Bradley Smith on September 22, 2008: The periodic commitment fee “is tied to shareholder approval of warrants. When shareholder approval disappears so does this fee.” (PTX 3256 at 1).

(e) Huebner: The periodic commitment fee included in drafts of the term sheet was “a potentially quite large ticking fee to incentivize the shareholders”. (Huebner: Trial Tr. 6003:4 – 6005:2).

(f) Email from Bradley Smith to Huebner on September 22, 2008: The “periodic commitment fee” was not in the credit agreement because “it was only payable during the period prior to shareholder approval of the equity, necessarily assuming that shareholder approval was required. When the shareholder approval requirement went away, so did the rationale for this fee.” (PTX 217 at 1).

35.1.4 The Credit Agreement called for a stockholder’s vote to amend AIG’s Certificate of Incorporation to increase the number of authorized shares to enable the conversion of Defendant’s preferred stock into common stock. (JX 107 at 138 (Exhibit D)).

35.2 AIG Also Understood That a Shareholder Vote Was Required to Enable Defendant to Obtain Common Stock.

(a) At the September 16, 2008 AIG Board meeting, “Counsel explained that if the equity interest took the form of warrants, then a shareholder vote would be necessary to authorize additional shares of common stock sufficient to meet the requirements of the warrant.” (JX 74 at 12).

(b) At the September 18, 2008 AIG Board meeting, the Board discussed “the need for a shareholder meeting to approve the increase in the number of authorized shares of Common Stock and to change the par value, Mr. Reeder explained that the government would likely draft the documents such that there was a strong incentive for shareholders to approve. There was then discussion of the process Bear Stearns had gone through and the reasons the terms of that transaction had changed after the initial announcement.” (JX 94 at 6-7).

(c) At the September 28, 2008 AIG Board meeting, Reeder stated “that the new Convertible Preferred Stock should be issued within 45 days to avoid an event of default, and a special shareholders meeting will be required to increase the authorized capitalization to 19 billion shares.” (JX 124 at 3).

(d) As early as October 2, 2008, AIG had prepared a draft proxy statement recognizing that “the authorization of the additional shares of common stock necessary to permit the conversion of the Series C Preferred Stock into common stock would require ‘an affirmative vote of a majority of our outstanding common stock and preferred stock, voting as separate classes.’” (JX 181 at 2).

(e) “A draft proxy statement dated October 2, 2008 reflects AIG’s conclusion by that date that 8 Del. C. § 242(b)(2) requires a class vote by the holders of AIG’s common stock on any vote to amend AIG’s Restated Certificate of Incorporation to increase the number of

authorized common shares or to decrease the par value of the shares of common stock, and AIG's determination that any vote would be conducted in accordance with Delaware law." (JX 181 at 2).

(f) The cover letter to the draft proxy statement "brackets a proposed date of Wednesday, November 18, 2008 for the meeting." (Shannon: Trial Tr. 3683:3-10; *see also* JX 181 at 6).

(g) Shannon: The purpose of the proposal in AIG's draft October 2, 2008 proxy was "To have adequate shares for the conversion of the Series C preferred stock, it was the charter amendment that was – the charter amendment required prior to the stock becoming convertible." (Shannon: Trial Tr. 3683:11 – 3684:2).

(h) On October 15, 2008, Shannon informed Tanya Hoos of the New York Stock Exchange that "We will be preparing the proxy materials for the special meeting with my current expectation that the meeting will be held in early December". (PTX 299 at 1).

(i) As late as January 8, 2009, AIG continued to contemplate a special shareholders meeting to hold a vote on amending AIG's charter. Email from Anastasia Kelly to Marshall Huebner on January 8, 2009: "I wanted to get to you this week about the need to have the Special Shareholders Meeting. . . . I asked Kathy Shannon to put together possible timelines so we can see how this would play out. The timelines are attached, although Kathy believes that only the 'Suggested Timeline' will realistically work." (PTX 401-U at 1-2). The "Suggested Timeline" proposed February 25, 2009 as the "Date of special meeting". (PTX 401-U at 6).

35.3 As a Result of the Walker Lawsuit (*Walker v. AIG, Inc.*, Case No. 4142-CC, Del. Chancery Court, November 4, 2008), the Credit Agreement Was Revised to Represent that Defendant's Preferred Stock Would Not Be Converted into Common Stock Without Approval by a Majority Vote of the Common Shareholders Voting as a Separate Class.

35.3.1 Defendant participated in devising AIG's response to the *Walker* lawsuit.

(a) The “United States admits that Treasury had received a copy of the *Walker* complaint by November 5, 2008”. (Def. Resp. to Pl. 2nd RFAs No. 1016; *see also* PTX 344 at 1 (November 5, 2008 e-mail attaching *Walker* complaint and copying Dahlgren and Huebner)).

(b) On November 5, 2008, at 9:36 a.m., Michael Leahy, Associate General Counsel at AIG, forwarded the *Walker* complaint to AIG General Counsel Stasia Kelly and AIG’s outside counsel Weil Gotshal, stating: “Here is a copy of the new shareholder complaint filed last night in Delaware seeking, among other things, an order declaring that the Super Voting Preferred is not convertible into common stock absent a class vote by the common stock to increase the number of authorized shares”. (PTX 3259 at 1).

(c) Less than twenty minutes later, Davis Polk received the *Walker* complaint.

(i) At 10:14 a.m., after he received a copy of the *Walker* complaint from Davis Polk’s Martine Beamon, Huebner writes to Beamon: “this is potentially serious. Please also copy tom baxter, jim h, sarah and me and ethan.” (PTX 3259 at 1).

(ii) At 10:31 a.m., Beamon writes to Huebner and James: “Marshall mentioned to me last night that he would like to have a conversation with Baxter regarding the management of these various issues and our roles, so I wanted to confirm to whom we should be sending the document.” (PTX 3259 at 1).

(iii) At 10:37 a.m., Beamon writes to Dahlgren, Baxter, and Hennessy: “Please find attached a new complaint filed last night against AIG that has some potentially serious ramifications.” (PTX 343 at 1).

(iv) Before Defendant produced PTX 3259 to Plaintiffs, Huebner insisted that he could “not recall ever learning what she believed the potentially serious ramifications of the Walker lawsuit were”. (Huebner: Trial Tr. 6315:13-24).

(d) Defendant monitored the *Walker* lawsuit and received updates from AIG's outside counsel, Weil Gotshal, on the *Walker* lawsuit. (*See, e.g.*, PTX 377 at 1-2; PTX 3164 at 1-2; PTX 3302 at 1; PTX 3316 at 1-2; PTX 3223 at 1-2).

(e) "FRBNY and the Government received a copy of the complaint in the Walker Lawsuit, and may have had internal discussions about the lawsuit. In addition, outside counsel for FRBNY and Treasury discussed the lawsuit with outside counsel for AIG." (Def. Resp. to Pl. 2nd Interrogatories No. 9).

(f) Defendant admits "that there were communications between AIG and representatives of FRBNY concerning the *Walker* Lawsuit." (Def. Resp. to Pl. 1st RFAs No. 30.0).

(g) During trial, Baxter acknowledged his prior deposition testimony as the United States' 30(b)(6) witness that "Davis Polk was monitoring" the *Walker* litigation on behalf of the United States. (Baxter: Trial Tr. 1131:8-21).

(h) Defendant noted the potential impact the *Walker* lawsuit would have on its plans for AIG.

(i) On November 5, 2008, Baxter noted with regard to the *Walker* lawsuit: "This may change dialog about the Trust." (PTX 3304 at 1).

(ii) The next day, on November 6, 2008, Board of Governors legal staff authored a memo analyzing the *Walker* lawsuit and whether Delaware law would require AIG to hold a separate class vote on the charter amendments. (PTX 3221).

(i) Defendant made suggestions to AIG about how to litigate the *Walker* case.

(i) Huebner on November 7, 2008: “I asked them to – if they think it logical – point out to the plaintiffs that the lien claim is likely equally frivolous and should be dropped from any amended complaint.” (PTX 3164 at 2).

(ii) AIG counsel consulted with Defendant’s counsel about settling the lawsuit on November 20, 2008: “Plaintiff is prepared to drop the lawsuit, but we may have a fight with respect to legal fees. We would like to discuss with you before responding.” (PTX 3223 at 1-2). Davis Polk (Huebner) then forwarded the settlement proposal to Baxter. (PTX 3223 at 1; *see also* PTX 376 at 1; Baxter: Trial Tr. 1132:20 – 1133:4 (Baxter has no reason to doubt that he received PTX 376)).

(iii) Shortly after Huebner forwarded the proposal to Baxter, Huebner replied to AIG counsel at Weil, commenting on the proposal as “sort of clever” and asking for more information, including AIG’s draft October 2008 proxy and related email from AIG’s Delaware counsel to counsel for the *Walker* plaintiffs. (PTX 377 at 1).

(iv) Huebner wrote to Baxter and Dahlgren, concerning Allerhand’s email: “I am inclined to tell them that if the plaintiff’s counsel will settle for a small amount of fees (ie, less than it would cost to keep dancing with them in their quest for fees), fine. But that AIG certainly should not (incorrectly) admit that they were going to violate Delaware law but for being caught by the plaintiffs. Please advise so I can get back to Joe.” (PTX 3223 at 1).

(v) Defendant later discussed and provided approval to AIG to pay the *Walker* plaintiffs’ attorneys fees: “The original ‘ask’ by the plaintiffs was \$350,000, which has since been reduced to \$175,000. Weil believes that AIG should pay this amount, and that it would cost more to litigate the issue further. They said that they plan to do so ‘unless

the Fed objects.’ We haven’t previously, to my recollection, been asked to sign off on settlements of this nature, but I think that, given the circumstances, Weil wants us to run this past you.” (PTX 3128 at 2).

1. Baxter responded: “No objection to the compromise on atty fees.” (PTX 3128 at 1).¹²¹

2. Zingales: “this exhibit shows that there was an involvement of counselor of the Government in the way AIG answered to the Walker lawsuit.” (Zingales: Trial Tr. 8617:10-15 (discussing demonstratives PTX 5514 – 5515)).

35.3.2 The *Walker* lawsuit explicitly sought a ruling that the “conversion feature of the Super Voting Preferred is invalid and unenforceable in the absence of an uncoerced, affirmative vote of the holders of a majority of the common shares, voting as a class, to amend the Restated Certificate of Incorporation to increase the number of authorized common shares and [to] decrease the par value of the common shares.” (PTX 344 at 19).

35.3.3 AIG, with Defendant’s agreement, represented on November 7, 2008 that “there’s no dispute between the parties” on the question of whether a separate class vote of the common stock shareholders would be required to amend the certificate of incorporation to increase the number of authorized shares or to change the stock’s par value (JX 143 at 7), which was reflected in the Consent Order issued by the court (JX 176 at 2).

¹²¹ Both Baxter and Huebner testified that Defendant was not involved “in providing AIG positions it should take in the Walker litigation” or “drafting documents for use in the Walker litigation”. Baxter: Trial Tr. 1034:15 – 1035:3; Huebner: Trial. Tr. 6125:14 – 6126:4. As the aforementioned evidence demonstrates, however, Defendant and its counsel participated in multiple conversations about AIG’s strategy for the *Walker* litigation, settlement discussions, and received regular updates on the case. See Zingales: Trial Tr. 8617:6-25 (noting that, despite Huebner’s testimony to the contrary, Huebner received a copy of the complaint and insisted that it be sent on to Baxter, Hennessy, and Dahlgren of FRBNY, and Ethan James of Davis Polk); PTX 5514 – 5515 (Zingales demonstratives summarizing evidence that Defendant was directly involved in the *Walker* lawsuit).

(a) On November 7, 2008, counsel for AIG informed the court in the *Walker* lawsuit that: “It is AIG’s position that any amendment to its certificate of incorporation to increase the number of authorized shares of common stock or to change the par value of that stock requires a class vote of holders of record of a majority of the shares of common stock outstanding on the record date for that vote. I hope that’s clear enough; and I think in view of that representation, there’s no dispute between the parties.” (JX 143 at 7; *see also* JX 143 at 11 (the Court “understood” “that if there is going to be an increase in the number of authorized shares or in the par value of the shares, that there will be a class vote on that issue. You were very clear about that”)).

(b) Huebner sent an update on the November 7, 2008 *Walker* hearing to Baxter, Dahlgren, and Hennessy, stating “They had a very good day in delaware.” (PTX 3164 at 2).

(c) *Walker* Consent Order dated February 5, 2009: “WHEREAS, during a conference with the Court on November 7, 2008, AIG’s counsel stated that any amendment to the Restated Certificate of Incorporation to increase the number of authorized common shares or to decrease the par value of the common shares would be the subject of a class vote by the holders of the common stock, and, based on this representation, plaintiff’s counsel agreed that the plaintiff’s request for an order granting this relief is moot;

“WHEREAS, AIG publicly disclosed on November 10, 2008, in its Form 10Q filing for the third quarter of 2008, that the holders of the common stock will be entitled to vote as a class separate from the holders of the Series C Preferred Stock on any amendment to AIG’s Restated Certificate of Incorporation that increases the number of authorized common shares and decreases the par value of the common shares.” (JX 176 at 2).

35.3.4 On November 9, 2008, as a result of the *Walker* lawsuit, Defendant amended the Credit Agreement to note that “common stockholders voting as a separate class” will vote on “amendments to AIG’s certificate of incorporation to (a) reduce the par value of AIG’s common stock to \$0.000001 per share and (b) increase the number of authorized shares of common stock to 19 billion”. (JX 147 at 9; JX 150 at 193).

(a) A November 6, 2008 legal memo from Board of Governors staff titled “*Walker v. AIG*” concluded that “The face of the Delaware statute cited above seems to indicate that common shareholders would have the right to vote separately from the preferred shareholders both to increase the number of common shares and to decrease the common shares’ par value.” (PTX 3221 at 3).

(b) The November 9, 2008 amendment to the Credit Agreement was intended “to implement the representation that had been made to the Delaware court two days earlier.” (Brandow: Trial Tr. 5861:22 – 5862:23).

(c) On November 9, 2008, FRBNY attorney Stephanie Heller wrote to Baxter and other FRBNY attorneys: “I want to make sure that you are aware of two changes that DPW is making to exhibit D to the credit agreement both of which are clearly due to the current litigation. . . . (1) As revised it highlights the real possibility that AIG may not get the vote needed to increase the common stock. . . . I think it leaves us with voting/dividends on the preferred but probably makes it much harder to sell. (2) It makes me feel as though we have not received great counsel from DPW again”. (PTX 3119 at 1).

(d) Baxter acknowledged: “They made a mistake. Now, it is fixed. There is some risk, but I think it is manageable.” (PTX 3119 at 1).

(e) BOG attorney Stephen Meyer wrote on November 10, 2008 that “AIG conceded the point in a conference call with the Delaware Chancery court judge on Thursday”, and “Exhibit D was changed to reflect explicitly that the common shareholders vote as a class for increasing the number of authorized shares, etc. Davis Polk is apparently claiming that the documents were previously ambiguous and that this was always foreseen!” (PTX 3222 at 1; *see also* PTX 3341 at 1 (handwritten note by Meyer on an amendment to Exhibit D to the Credit Agreement sarcastically noting “Some frivolous lawsuit” in response to the changes)).

(f) On November 19, 2008, Davis Polk advised that the “only vote the Trust or Treasury doesn’t control is the class vote of the common stockholders that’s required to permit the convertible preferred to convert into common stock” and noted that “we have an alternative for the sale of the investment if the convertible preferred can’t be converted”. (JX 156 at 1).

(g) Board of Governors attorney Rich Ashton wrote to Alvarez on December 20, 2008 that, “After the suit was filed, AIG conceded, before there was a court ruling, that in agreeing to issue the preferred stock to the trust AIG had improperly under Delaware law sought to increase the number of common shares (and reduce the par value) without a separate vote of the existing common stockholding as a class. This result was consistent with our research.” (PTX 3225 at 1).

(h) Meyer wrote to Alvarez on March 2, 2009: “As you may recall, shortly after the TARP-related warrants were issued, it was learned that only the common shareholders are

entitled to vote on the proposed charter amendments that increase the amount of authorized common stock and greatly lower the par value.” (PTX 3348 at 2).¹²²

(i) Zingales testified that “the modification of the credit agreement and the statement by AIG makes the substantive point of the Walker suit irrelevant, because AIG seems to agree that they have to” allow the common stockholders to vote as a class separate from the holders of Series C preferred. (Zingales: Trial Tr. 3852:17 – 3853:20; PTX 5066 (Zingales demonstrative)).

35.3.5 AIG understood that the *Walker* lawsuit confirmed the common shareholders’ right to a class vote before the conversion of Defendant’s preferred stock into common stock.

(a) AIG’s November 10, 2008 quarterly report filed with the SEC states: “AIG will be required to hold a special shareholders’ meeting to amend its restated certificate of incorporation to increase the number of authorized shares of common stock to 19 billion and to reduce the par value per share” and that “holders of the common stock will be entitled to vote as a class separate from the holders of the Series C Preferred Stock on these changes.” (JX 150 at 28; *see also* Brandow: Trial Tr. 5863:14 – 5864:3 (“that’s reflecting the amendment number two to the credit agreement that had been made the day before”)).

(b) AIG’s December 19, 2008 draft proxy statement provides for a separate class vote of common shareholders on the conversion of Defendant’s preferred shares into common shares. (JX 164 at 4; *see also* Zingales: Trial Tr. 3853:21 – 3854:1 (“exactly what AIG said would be

¹²² The need to revise the Credit Agreement in the aftermath of the *Walker* lawsuit filing alerted Defendant to the fact that the advice that they had previously received from Davis Polk that there would be no need for a separate common shareholder vote may have been wrong. *See* PTX 3226 at 1 (“we have been unhappy with the advice to date from DPW” on Delaware law); PTX 3233 (“very concerned that DPW is covering their asses and revising history and giving self-interested advice”).

done, that is, a vote of the common shareholders on the conversion of the preferred shares”, was provided for in the December 19, 2008 draft proxy statement)).

(c) On January 22, 2009, AIG informed its global regulators: “At and prior to the next annual general meeting of AIG’s stockholders following the issuance of the Series C Preferred Stock, the stockholders, with the common stockholders voting as a separate class in the case of the matters in clause (i), will vote on, among other things, (i) amendments to AIG’s certificate of incorporation to (a) reduce the par value of AIG’s common stock to \$0.000001 per share and (b) increase the number of authorized shares of common stock to 19 billion”. (PTX 410 at 1, 16).

35.4 AIG and Defendant Did Not Hold a Separate Common Shareholder Class Vote Because They Knew a Vote That Would Dilute the Common Stock Would Fail.

(a) Liddy: “there never was a shareholders meeting at which the common stock, voting as a class, had an opportunity to vote on whether or not to reduce the par value of AIG’s common stock or increase the number of authorized shares.” (Liddy: Trial Tr. 3163:9 – 3164:1).

(b) On September 23, 2008, AIG representatives met with certain AIG shareholders and their financial advisor. At that meeting, the AIG “shareholder representatives” stated in sum and substance that: “They are ‘very concerned’ about the 79.9% equity interest, and are focused on the ‘ability to claw it back should the facility be repaid in a reasonable time.’ They articulated a belief that adding an ‘equity clawback’ to the deal would provide substantial incentive to help both the taxpayers and AIG, and was synergistic to all. (Despite that fact that we, of course, find this statement incorrect, I said nothing.)” (PTX 3120 at 2).

(c) Feldberg: “there was a concern as to whether” a vote of the then-existing common shareholders voting as a class “would be positive.” (Feldberg: Trial Tr. 3357:5 – 3358:2).

(d) The proposal at the June 2009 AIG annual meeting to increase the authorized shares of common stock from 5 billion to 9.225 billion failed “because even though there was a

majority vote in favor of it, there was not a majority of the outstanding common stock voting in favor of it”. (Feldberg: Trial Tr. 3368:4-20; PTX 2108 at 1).

(e) FRBNY attorney Stephanie Heller to Baxter and other FRBNY attorneys on November 9, 2008: there is a “real possibility that AIG may not get the vote needed to increase the common stock.” (PTX 3119 at 1).

(f) FRBNY attorney Charles Gray on November 21, 2008: “This appears to be somewhat of a scramble to cope with the fact that (contrary to the original understanding they gave us) we might lose the vote on increasing the authorized common.” (PTX 3224 at 1).

(g) In January 2009, PwC noted in an accounting memorandum concerning AIG:

(i) “We now understand the common stockholders must also approve the amendment in order for it to pass. Accordingly, it is not a foregone conclusion that the amendment will pass and, in fact, it may never pass.” (PTX 444 at 3; *see also* Farnan: Trial Tr. 4183:25 – 4184:10 (that understanding “originally came from conversations with the company”)).

(ii) “We understand the class vote provision was a requirement that, under Delaware law, had to be included in the terms of the securities purchase agreement. Because the existing common shareholders would be materially adversely affected by the Charter Amendment, they are given the right to vote to approve the amendment.” (PTX 444 at 5; *see also* Farnan: Trial Tr. 4184:16 – 4185:1 (that understanding “came from a legal group at AIG.”)).

(iii) “If the Charter Amendment to reduce the par amount is not passed, the strike price remains at \$2.50”. “Management believes that there is an inherent economic disincentive for shareholders to approve the amendment. As such, the valuation assumes

that the strike price stays at \$2.50.” (PTX 444 at 9; *see also* Farnan: Trial Tr. 4185:19-22 (“as long as the par value of the stock was \$2.50, the strike price for any warrant to be exercised had to be at least \$2.50”)).

35.4.1 Without a guarantee that Defendant could win the shareholder vote, the vote was repeatedly delayed pending a resolution that would not necessitate a separate common shareholder vote.

(a) Davis Polk attorney Ethan James on January 29, 2009: “consensus on our side now seems to be that we are not likely to be ready for issuance of the C’s on Feb 4 for a handful of reasons, and we are still working through a number of related issues, incl esp the SH vote issue”. (PTX 3239 at 3).

(b) FRBNY attorney Charles Gray on January 29, 2009: “This morning I had an hour-long call with John Brandow on the shareholder-vote issue, which seems potentially close to a resolution once we (and Treasury) have reached consensus on DPW’s favored approach which, as we discussed yesterday, involves delaying the votes on the Series-C related charter amendments until such time as disposition appears likely.” (PTX 3342 at 1).

(c) Gray to Davis Polk and FRBNY attorneys on February 3, 2009: “The internal FRBNY legal team is having a meeting with Tom Baxter at 4:15 today to discuss your memo. It would be very helpful if we could have a sense by that time of Joe Allerhand’s view of the effect (if any) that postponing the shareholder vote on the charter amendment that would allow full convertibility of the Series Cs will have on the Delaware litigation that was commenced last fall.” (PTX 3132 at 1).

(d) Gray to Baxter on February 10, 2009: “the ultimate passage” of the charter amendment to reduce the par value of AIG’s common stock “is complicated by the need for a

class vote of existing common (i.e., Greenberg et al.) on this issue. As we discussed at our meeting last week, Davis Polk is advising that this proposal should not be put up for a vote at the upcoming shareholder meeting. Since last week's meeting, we have gotten confirmation from Joe Allerhand that such a deferral would not pose problems under the existing Delaware litigation. John Brandow of Davis Polk has discussed the deferral idea with Steve Albrecht at Treasury, who seems to favor it but has not fully signed-off yet. We will want to speak with you briefly about this issue when you return from Washington." (PTX 3118).

(e) March 10, 2009 Treasury memo: "The plan had been to propose an amendment to AIG's organizational documents which would lower the exercise price to a fraction of a cent, which would give the warrants real economic value. However, such a reduction requires a vote of a majority of the shares not held by the government. Because of the current climate among AIG shareholders, there is a possibility that such a vote would not be successful, although there is some disagreement among our advisors and partners in this transaction about how strong that possibility is. If the minority shareholders don't approve the reduction in the strike price, UST's warrants are essentially worthless." (PTX 3241 at 2).

36.0

BECAUSE DEFENDANT'S PREFERRED SHARES COULD NOT BE CONVERTED INTO COMMON STOCK WITHOUT A SHAREHOLDER VOTE THAT DEFENDANT KNEW IT WOULD LOSE, DEFENDANT ATTEMPTED TO CIRCUMVENT A SHAREHOLDER VOTE BY HAVING AIG "EXCHANGE" THE PREFERRED STOCK FOR COMMON STOCK.

36.1 Defendant Coerced AIG To Delay The Separate Class Vote On The Amendments Necessary To Permit Conversion Of The Series C And To Amend The Credit Agreement To Remove The Provision Requiring The AIG Board To Call A Shareholder Vote On Conversion.

(a) AIG hoped to “move” the process of scheduling a special shareholder vote “forward quickly”, and suggested that the meeting take place as early as February 5, 2009, or as late as March 27, 2009. (*See* PTX 401-U at 2-7).

(b) Treasury “asked AIG to delay” the proxy “a number of times”. (Dahlgren: Trial Tr. 2768:3-9; *see also* Dahlgren: Trial Tr. 2720:10-2721:6, 2723:1-3).

(c) A February 2, 2009 Davis Polk memo to FRBNY attorneys: “You have asked us to describe the procedural steps that will be necessary to permit conversion of the Series C Preferred Stock if the Company does not hold a vote on the Common Stock Amendment Proposal at the annual meeting of the Company’s stockholders in May of 2009. Instead, it is contemplated that the Company would agree, pursuant to the Series C Purchase Agreement, that the Trustees will have the right, at any time and in their sole discretion, to direct the Company to hold a special meeting of the Company’s stockholders to vote on the Common Stock Amendment Proposal. Exhibit D of the Credit Agreement would have to be amended to reflect that understanding. If the Common Stock Amendment Proposal is not put up for stockholder vote at the Company’s next annual meeting, the Series C Purchase Agreement would be revised to include a requirement that the Company work with the Trustees to prepare a draft proxy statement relating to the Common Stock Amendment Proposal promptly after the issuance of the Series C Preferred Stock.” (PTX 3132-A at 2).

(d) On February 3, 2009, Davis Polk advised FRBNY and AIG’s counsel: “As an additional wrinkle, S&C has informed us that the company has a contractual obligation related to the convertible securities issued in May 2008 to put to SH’s a vote to increase the number of authorized common to facilitate the operation of those securities”. (PTX 420 at 4).

(e) The next day, on February 4, 2009, it was decided that a “separate class vote on ‘conversion’” would no longer take place at the AIG annual meeting. (PTX 420 at 1). AIG counsel Joseph Allerhand of Weil provided a “quick recap” to AIG, FRBNY, Davis Polk, and Simpson Thacher (counsel to AIG outside directors) of a conference call held that day: “We all continue to believe that it makes sense for a multitude of good reasons not to have a separate class vote on ‘conversion’ now at the annual meeting. And it also makes sense to amend the relevant agreements to change the provision requiring AIG to call a special meeting to a provision providing the discretion to the Trustees to decide when to ask AIG to call a meeting for the class vote on ‘conversion.’” (PTX 420 at 1).

(f) With the execution of the March 1, 2009 Series C Perpetual, Convertible, Participating Preferred Stock Purchase Agreement, AIG no longer controlled the circumstances of such a vote. Under that agreement, the company was obliged to prepare a proxy statement for the charter amendments required for the conversion of the Series C Preferred Stock that was “reasonably acceptable to the Trust” and not to “file it with the SEC unless so directed by the Trust.” (JX 185 at 7 (§6.2(c))).

36.2 Neither Defendant Nor AIG Ever Told Common Shareholders Or The *Walker* Court About The Decision Not To Hold A Vote.

(a) Shannon submitted an affidavit dated February 24, 2009 to the *Walker* court. Attached to the affidavit was a draft proxy statement dated October 2, 2008. (JX 181 at 5; *see also* Shannon: Trial Tr. 3681:12 – 3682:15).

(b) Proposal 1 in the October 2, 2008 draft proxy statement was “a proposal to amend the Restated Certificate of Incorporation, as amended, to (i) reduce the par value of AIG’s common stock from \$2.50 per share to \$0.000001 per share and (ii) increase the authorized

shares of common stock from 5,000,000,000 to 19,000,000,000 shares”. (JX 181 at 6; Shannon: Trial Tr. 3683:11-18).

(c) The purpose of Proposal 1 was “To have adequate shares for the conversion of the Series C preferred stock, it was the charter amendment that was – the charter amendment required prior to the stock becoming convertible.” (Shannon: Trial Tr. 3683:19 – 3684:2).

(d) The October 2, 2008 draft proxy statement contemplated a special meeting before the annual meeting. (Shannon: Trial Tr. 3684:8-10). It did not include a proposal for a reverse stock split. (Shannon: Trial Tr. 3686:8-11; Zingales: Trial Tr. 3854:2-18; JX 181 at 6).

(e) By February 4, 2009, however, the decision had been made not to have a special meeting. (PTX 420 at 1 (Allerhand: “We all continue to believe that it makes sense for a multitude of good reasons not to have a separate class vote on ‘conversion’ now at the annual meeting.”)).

(f) AIG’s Form 10-K filed in March 2009 does not disclose its agreement not to require a vote and, to the contrary, states “AIG will be required to hold a special shareholders’ meeting to amend its Restated Certificate of Incorporation to increase the number of authorized shares of common stock to 19 billion and to reduce the par value per share. The holders of the common stock will be entitled to vote as a class separate from the holders of the Series C Preferred Stock.” (JX 188 at 293).

(g) On April 17, 2009, AIG and FRBNY amended the Credit Agreement for the third time to no longer require the AIG Board to call a meeting of shareholders to vote on an amendment to the AIG Charter to increase the number of authorized shares. *Compare* JX 147 at 9 (Amendment No. 2, adding to the “Stockholder vote” provision that “AIG’s board will call a meeting of stockholders as soon as practicable after the issuance of the Preferred Stock” in which

the common stockholders would vote “as a separate class” on the amendments) *with* JX 207 at 17 (Amendment No. 3, eliminating the language requiring AIG’s Board to call a meeting of stockholders and instead granting the Trust the “right to cause AIG’s Board of Directors to call a special meeting” for a separate class vote on the amendments); *see also* Feldberg: Trial Tr. 3388:7-14 (agreeing that the amendment eliminated the requirement that the AIG Board call a shareholder vote, with the common shareholders voting as a class, as soon as practicable)).

(h) Shannon: The April 17, 2009 amendment “indicates that the trust will have the right to cause the board of directors” to have a common shareholder class vote to increase authorized shares and decrease par value. (Shannon: Trial Tr. 3695:1-22). In the absence of the trust making that decision, the April 17, 2009 amendment does not call for a class vote of the common shareholders. (Shannon: Trial Tr. 3695:23 – 3696:20).

(i) Brandow: “one of the things that changed in Exhibit D was this whole question of the stockholder vote and what it would be and when it would happen, and under the previous version of the credit agreement, the previous version of Exhibit D, AIG was obligated to put the question of the changes that would be necessary to permit conversion to the shareholders as soon as possible after the Series C was issued, and one of the things that this amendment did was give the trust the ability to control the timing of that vote.” (Brandow: Trial Tr. 5839:14 – 5840:20; *see also* Brandow: Trial Tr. 5840:21 – 5841:3 (the trust “wanted discretion to call a vote on these issues” because Defendant “knew it was going to be a difficult vote”)).

(j) The Series C preferred shares were ultimately exchanged for common shares. (Shannon: Trial Tr. 3701:17-21).

(k) Defendant’s choice not to have AIG issue convertible voting preferred shares until March 2009 evidences Defendant’s control over AIG.

(l) Zingales: “So, as of September 23rd, the Defendant had the right – there was a 45 days period – but has the right to ask for the issuance of voting – of preferred voting shares to an amount of 79.9 percent of the voting interests of AIG. And what is interesting here is the Defendant chooses not to exercise this right until basically proxy season comes along, which suggests that they did not feel the need to use their voting power because things were getting their way anyway. When there is the need for a vote, then those shares are issued, and those votes are exercised.” (Zingales: Trial Tr. 3837:25 – 3838:16; PTX 5058 (Zingales demonstrative)).

36.3 After Issuance of the Voting Convertible Preferred, Defendant Knew That “the Only Vote the Trust or Treasury Doesn’t Control Is the Class Vote of the Common Stockholders That’s Required to Permit the Convertible Preferred to Convert into Common Stock”. (JX 156 at 1).¹²³

(a) “The conversion rights accompanying the Series C preferred shares could not be exercised because the par value of the common stock into which the Series C preferred shares

¹²³ JX 156 goes on to state that “we have an alternative for the sale of the investment if the convertible preferred can’t be converted.” JX 156 at 1. Brandow testified that the “alternative” means of monetizing Defendant’s AIG holdings is the option of “listing the preferred” as a second class of voting securities. Brandow: Trial Tr. 5822:5 – 5823:1. That option did not require a separate class vote by AIG’s common stock (*see* Brandow: Trial Tr. 5824:7-12), underscoring the fact that, from the outset, Defendant was singularly focused on finding ways to liquidate its stock that would not require a shareholder vote it would be unable to control. *See also* Brandow: Trial Tr. 5824:25 – 5827:20 (testifying that he advised AIG that the option of listing the preferred would not be in their interest because it would result in a “very unusual capital structure” “because you’d have those two classes of securities, and the preferred would be the dominant class and the common stock would be kind of a rump class, would be the less liquid class of voting securities”). However, Zingales opined that registering and selling the Series C preferred was not truly a viable option because “it would be extremely hard to get any decent amount of money for a security that’s so complicated” that Schreiber was unable to understand. *See* Zingales: Trial Tr. 8673:25 – 8674:17; *see also* Schreiber: Trial Tr. 6680:18 – 6681:24 (“there was a lot of sort of ambiguity here because it was sort of unclear whether the Series C would get, you know, common shares issued to it for 79.9 percent of the company before or after the Series E and F were taken out”); *see also* Schreiber: Trial Tr. 6766:7-20 (when asked what “the Series C preferred stock would be – would have been entitled to under the documentation that existed”, Schreiber answered “That, I don’t know. I can’t answer that question”).

converts would have exceeded the aggregate par value of the Series C preferred shares, and therefore conversion was not available under Delaware law.” (Def. Resp. to Pl. 2nd Interrogatories No. 8).

36.4 Defendant Developed The Reverse Stock Split As An Alternative Means Of Circumventing The Shareholder Vote Requirement.

36.4.1 Initially, Defendant believed that it could convert the preferred without the votes of the common shareholders.

(a) On September 20, 2008, Ethan James of Davis Polk explained that there was no need to “get around the vote” to amend AIG’s charter to authorize additional preferred shares, as there was “Enough auth’d to issue the prefs” already, and that the “preferred will be able to vote to fix the charter” to solve the problem of “not enough” authorized common shares “for them to convert into common.” (PTX 3248 at 1-2).

36.4.2 Once Defendant realized that it could not convert the preferred into common without winning a vote of the common shareholders, it began implementing a plan to avoid such a vote.

(a) Email from FRBNY Counsel Charles Gray to Dahlgren on September 21, 2008: FRBNY Counsel “Rich Charlton just came up and shared with Tom your concern about whether the terms of the equity investment will adequately protect us against shareholder activism among minority shareholders at AIG. I can say this issue has been a key focus of both Tom and the Davis Polk lawyers drafting the Term Sheet, and the Davis Polk lawyers think the proposed plan will protect us.” (PTX 184 at 1; *see also* Brandow: Trial Tr. 5872:2-15).

(b) In October 2008, Defendant began contemplating transactions that would allow it to avoid a shareholder vote, including by subdividing preferred shares “so that each share of preferred acted like a share of common”. (*See* Brandow: Trial Tr. 5811:6 – 5812:5 (describing

the process); Brandow: Trial Tr. 5812:9 – 5813:15 (explaining that the amendment to the charter “would be approved because the trust had 79.9 percent of the voting power”); Brandow: Trial Tr. 5813:16 – 5814:2 (explaining that the trust would have controlled the outcome of a vote to “lower the par value of the preferred”); Brandow: Trial Tr. 5814:3-20 (explaining how the Series C could then be registered under the Securities Act); Brandow: Trial Tr. 5854:3-15 (the option of listing the preferred stock was first considered in October 2008)).

(c) On November 5, 2008, Brandow wrote to Huebner, James, and other Davis Polk attorneys: “A few points to make about the suit that was filed yesterday. Even if the plaintiffs are right that the charter amendments to increase the number of authorized shares and to lower the par value of the common stock require a vote of the common shareholders voting as a class in addition to a vote of all the stockholders, the DGCL section plaintiffs cite does not undermine the issuance of the preferred shares themselves.” (PTX 3129 at 7). “We succeeded in finding a structure that allows the trust to gain control of the company without a shareholder vote. If plaintiffs are right, that’s as much as we could do.” (PTX 3129 at 7).

(d) On November 6, 2008, Brandow wrote to Huebner, James and other Davis Polk attorneys to announce “a way to avoid the separate common stockholders’ vote” that “turns on the fact that, under Delaware law, the stockholder vote that is required for a merger (which is a vote of all stockholders entitled to vote and not a class by class vote) would also let us amend the charter. In this way we can avoid the separate class vote of the common.” The stockholder vote, “which we will control, will also let us amend the charter to change the number of authorized common shares and lower their par value. Sneaky but legal.” (PTX 3232 at 1).

(e) On November 9, 2008, Brandow wrote that his “focus from the start of this transaction was to find a way for the trust to acquire the power to control the company without

having to get the consent of the common stockholders.” (PTX 3211 at 1-2; *see also* PTX 5511 (Zingales demonstrative)).

(f) On November 19, 2008, Brandow wrote: We “have an alternative for the sale of the investment if the convertible preferred can’t be converted.” (JX 156 at 1).

(g) Davis Polk recommended to AIG counsel at S&C that the AIG Board recommend to the shareholders to vote in favor of conversion and the subdivision option. But S&C had advised that, as a business matter, the AIG Board did not want to recommend those votes to the shareholders. (JX 156 at 1; *see also* Brandow: Trial Tr. 5820:11 – 5821:5 (discussing JX 156)).

36.4.3 Defendant still needed AIG to authorize enough common shares to satisfy Defendant’s desire to exchange its AIG preferred stock for AIG common stock.

(a) FRBNY attorney Charles Gray on February 10, 2009: “the ultimate passage of that charter amendment is complicated by the need for a class vote of existing common (i.e., Greenberg et al.) on this issue. As we discussed at our meeting last week, Davis Polk is advising that this proposal should not be put up for a vote at the upcoming shareholder meeting.” (PTX 3118).

(b) Huebner to Baxter, Dahlgren, Albrecht (Treasury) and others on April 3, 2009: “Given that there is now a board meeting scheduled for Wednesday at 5 to approve the proxy, you/the trustees may want to consider telling them of the new plan on either Monday or, at the latest, Tuesday.” (PTX 3131 at 1). This was necessary because AIG was not “aware of the rationale for possibly delaying the meeting into the summer.” (PTX 3330 at 1).

(c) Zingales: AIG’s commitment in the *Walker* lawsuit “to have a vote on decreasing the par value that will take place by class” “creates a complication because this gives some blocking power to the Plaintiff, actually, and so they discuss – the Defendant and AIG discuss

how to go around this by engineering a reverse stock split that will achieve the same goal.”

(Zingales: Trial Tr. 8616:8 – 8617:5; *see also* PTX 5513 (Zingales demonstrative)).

36.5 The Reverse Stock Split Was Coercive And Deceptive.

(a) Defendant’s outside counsel recognized on November 6, 2008 that proposals that avoided a shareholder vote – described by one proponent as “Sneaky but legal” – were risky, and only to be employed if absolutely necessary: “given the identity of our client, whipping up structure (that does not otherwise fit the facts) for the sole purpose of disenfranchising common after having been sued for doing same is something I think we explore only if really need at some point that is not now. great idea, and wicked creative, but for the back pocket for sure”. (PTX 3312 at 1).

36.5.1 Defendant caused AIG to engage in a 20 to 1 reverse stock split (“RSS”) that applied only to issued shares and not authorized shares. (JX 197 at 2; JX 201 at 5; JX 218 at 4, 9).

(a) Proposal 4 of the final proxy statement AIG sent to shareholders on June 5, 2009 is a proposal to effect a reverse stock split of outstanding shares at a ratio of twenty to one. (JX 221 at 2; *see also* Brandow: Trial Tr. 5844:25 – 5845:5 (Proposal 4 “was a proposal to do a reverse stock split of the AIG common stock so that every 20 outstanding shares of common stock going forward would be represented by one share.”)).¹²⁴

¹²⁴ Although Herzog may have suggested using a reverse stock split to avoid de-listing (Herzog: Trial Tr. 7012:16-7013:5; JX 221 at 69-70), he had no role in designing the reverse stock split, setting the ratio of 20-to-1, or splitting only issued shares. Herzog: Trial Tr. 7023:10 – 7024:6. Furthermore, his proposal connects the reverse stock split to the authorization of additional “shares to accommodate the Fed’s 79.9 percent ownership”. PTX 424 at 1 (“We are going to have a shareholder meeting coming up, and were considering a reverse split. We were also going to authorize more shares to accommodate the Fed’s 79.9% ownership. Let’s put all this together with Kathy to see how we optimize our path and timing.”).

(b) Smith: An option “for splitting authorized shares as well as issued shares” was not presented to AIG shareholders. (Smith: Trial Tr. 7724:3-6).

(c) Defendant used its control of a majority of the voting equity in AIG to approve the Reverse Stock Split. (Def. Resp. to Pl. 2nd RFAs No. 798; PTX 2108 at 1).

(d) Foshee: “The trust voted in favor of proposal 4.” (Foshee: Trial Tr. 3529:20-21).

(e) Brandow: When common and preferred “vote together,” the “trustees of the trust” control the vote “because the trust had 79.9 percent of the voting power”. (Brandow: Trial Tr. 5813:2-15).

(f) Zingales: The structure of the reverse stock split caused the ratio of outstanding shares to authorized shares to “shrink dramatically”. Before the transaction, “the authorized but unissued shares represented only 40 percent of the total and after they represent 97 percent of the total. So, the effect was to disproportionately increase the number of authorized but not issued shares.” (Zingales: Trial Tr. 3850:23 – 3851:12).

36.5.2 The only reason not to apply the reverse stock split to authorized shares, and the only reason for a ratio as high as 20-to-1, was to avoid a separate class vote of the common shareholders.

36.5.2.1 The timing of the origin of the 20-to-1 ratio suggested that its purpose was to avoid a common shareholder vote.

(a) AIG was first informed that it might be delisted by the NYSE based on the trading price of AIG’s common stock in October 2008. (DX 601 at -438 to -439; *see also* Liddy: Trial Tr. 3299:19-22 (the NYSE letter “triggered the idea of having a reverse stock split”)).

(b) AIG began to prepare proxy statements calling for meetings to amend the charter beginning in October 2008 (JX 181 at 5-6) and had proposed holding a shareholder meeting in

February and May 2009 (PTX 401-U at 6; JX 197 at 2), but Defendant insisted on delaying the meeting each time. (PTX 503 at 1-2; PTX 420 at 1; *see also* Dahlgren: Trial Tr. 2768:3-9).

(c) The first time AIG “internally drafted a proposal for a twenty-to-one reverse stock split” was after November 7, 2008. (Liddy: Trial Tr. 3300:4-11).

(d) A December 19, 2008 draft AIG proxy statement received by Defendant includes votes on charter amendments necessary to enable conversion of the Series C Preferred Stock as well as a proposed reverse stock split of outstanding common stock at a ratio of one for ten. (JX 164 at 4; Def. Resp. to Pl. 2nd Interrogatories No. 5).

(e) The shareholder vote to approve the reverse stock split was held on June 30, 2009, the day the NYSE suspension of its minimum stock-price for listing standard expired. (JX 221 at 2, 70 (the NYSE’s “minimum share price requirement” “expires on June 30, 2009”)).

36.5.2.2 AIG’s concerns over delisting do not explain either the 20:1 exchange ratio or the reverse stock split’s application only to issued shares.¹²⁵

(a) Defendant admits: The “goal stated in Proposal 4 to ‘ensure the continued listing of AIG Common Stock on the NYSE’ could have been accomplished by a reverse stock split that applied to all shares.” (Def. Resp. to Pl. 1st RFAs No. 32.9).

¹²⁵ Although several witnesses testified that the sole purpose of the reverse stock split was to avoid delisting from the New York Stock Exchange (*see, e.g.*, Baxter: Trial Tr. 1035:18-23; Liddy: Trial Tr. 3163:21 – 3164:11; Schreiber: Trial Tr. 6639:8-19; Dahlgren: Trial Tr. 2768:20 – 2769:13), none of these witnesses were able to explain why the reverse stock split applied to issued shares only, since delisting could be avoided without depriving Plaintiffs of their right to block dilution if the reverse stock split applied to authorized shares as well as to issued shares. *See, e.g.*, Dahlgren: Trial Tr. 2931:1-5; Baxter: Trial Tr. 1140:15-19; Liddy: Trial Tr. 3164:20 – 3167:22; Liddy: Trial Tr. 3279:23 – 3280:10; Foshee: Trial Tr. 3560:5-12 (“whether or not the authorized shares were split would not affect the price of the issued shares if those were split”); Paulson: Trial Tr. 1230:6-10. Some witnesses, like Schreiber, also had conflicting prior testimony concerning their recollections of the purpose of the reverse stock split. *See* Schreiber: Trial Tr. 6778:19 – 6779:21 (confirming Schreiber’s deposition testimony was that he had no understanding as to why the reverse stock split was done).

(b) Dahlgren could not think of any reason “related to keeping the AIG stock listed that would be served by reverse-stock-splitting the issued shares but not the authorized shares.”

(Dahlgren: Trial Tr. 2931:1-5).

(c) Dahlgren and Ethan James of Davis Polk attended the February 10, 2009 meeting of the Finance Committee of the AIG Board of Directors at which the ratio for the proposed reverse stock split was discussed. (JX 178 at 1, 7).

(d) Glass Lewis, the proxy advisory service that provided the AIG Board of Directors with an analysis on June 18, 2009 of the proxy statement for the 2009 annual meeting of AIG shareholder, stated: “we would prefer that the number of authorized shares of the Company’s common stock be adjusted in proportion with the reverse stock split”. (PTX 528 at 67; *see also* Daines: Trial Tr. 8517:24 - 8518:1 (Glass Lewis gave “advice on how shareholders should vote”); Daines: Trial Tr. 8518:11-16 (“Glass Lewis’ analysis was that it would have been preferable if the number of authorized shares of the company’s stock was adjusted in proportion with the reverse stock split of the company’s issued common stock”)).

(e) Kothari: A 5-to-1 ratio was sufficient to achieve Defendant’s purported goal of preventing delisting from the New York Stock Exchange but would not have achieved Defendant’s goal of implementing its “exchange” of its Series C, E, and F preferred shares. (Kothari: Trial Tr. 4810:9-13 (“if the purpose was only to avoid delisting, they could have done fives-to-one, and that would have avoided delisting”)). The benefit of avoiding delisting could “have been achieved by a reverse stock split that affected both authorized and unissued shares”. (Kothari Trial Tr. 4879:8-14).

(f) Zingales: The goal of increasing the trading price of AIG to make sure that it would not be delisted would, “as a matter of economics, have been obtained if you had split both the

authorized and the issued shares”. (Zingales: Trial Tr. 3851:13-19; Zingales: Trial Tr. 3854:19 – 3855:6 (“I cannot think of any reason to have a reverse stock split to apply just to the issued shares and not to the authorized and unissued shares”)); *see generally* Zingales: Trial Tr. 3850:20 – 3855:6).

36.5.2.3 The effect of the reverse stock split was to allow Defendant to exchange its Preferred Shares for common shares without a vote of the common shareholders.

(a) The ratification of Proposal 4 made enough authorized but unissued shares of common stock available to enable Defendant to acquire 79.9% of the outstanding common stock. (Def. Resp. to Pl. 1st RFAs No. 32.3).

(b) Brandow: The “reverse stock split was necessary for the exchange.” (Brandow: Trial Tr. 5852:21-25). The reverse stock split “left AIG with enough authorized but unissued shares to permit the exchange”, which did not require a shareholder vote. (Brandow: Trial Tr. 5852:5-20).

(c) Daines: “By increasing in effect the number of authorized but unissued shares, the reverse stock split made it possible to do the exchange of shares that took place in the recapitalization”. (Daines: Trial Tr. 8517:14-18).

(d) Daines: “the reverse stock split was necessary in order to accomplish the exchange of shares that took place in the recapitalization”. (Daines: Trial Tr. 8515:14-19).

(e) Saunders: The Reverse Stock Split created sufficient authorized shares to allow for the exchange of the Series C into common stock. (Saunders: Trial Tr. 8243:7-11).

(f) On November 29, 2010, the SEC noted, in response to AIG’s preliminary information statement regarding the recapitalization, that “Section 11 of the Certificate of Designations of the Series C Perpetual, Convertible, Participating Preferred Stock appears to

imply that conversion of the Series C Preferred Stock into shares of common stock could not occur until the effective date of a 'Charter Amendment'.... Please provide us with an analysis supporting your apparent conclusion that you may proceed with the issuance of shares of common stock in exchange for the Series C Preferred Stock notwithstanding the fact that the Charter Amendment is not yet effective. Alternatively, please advise us as to when you will be soliciting common shareholders, other than the Trust, to obtain approval of the Charter Amendment.” (JX 302 at 4).

(g) AIG responded that the “outstanding shares of the Series C Preferred Stock are not being converted into shares of AIG common stock,” “Rather, all the outstanding shares of the Series C Preferred Stock are being exchanged for shares of AIG Common Stock pursuant to a contractual agreement between the holder of the Series C Preferred Stock and AIG. **As a result of the reverse stock split of AIG Common Stock in June 2009, AIG has a sufficient number of authorized shares of AIG Common Stock available to conduct the proposed exchange.**” (JX 302 at 8 (emphasis added)).

(h) Daines: In response to a question from the Court, Daines admitted that the “reason” for the reverse stock split could have been to allow for “exchange of the preferred stock”.

(Daines: Trial Tr. 8496:1-16; *see also* Daines: Trial Tr. 8489:18 – 8491:22).¹²⁶

(i) Zingales: “I concluded that the reverse stock split and, in particular, the fact that this reverse stock split was applied just to the issued shares and not to the authorized and nonissued shares was not explainable in any other way, other than the Government wanted to bypass a vote separate by common shareholders for a modification of the corporate statute.” (Zingales: Trial Tr. 3801:3-13; *see also* PTX 5065 – 5067 (Zingales demonstratives on the reverse stock split)).

¹²⁶ Daines’ cursory testimony about the design and effect of the reverse stock split is not persuasive. *See* Daines: Trial Tr. 8486:17 – 8487:2, 8494:15 – 8495:1. By his own admission, Daines did not “look into the origins of the reverse stock split.” “I just read the proxy and describe generally the reasons that are commonly given or used for a reverse stock split, but I don’t have any opinion about who thought of what when.” Daines: Trial Tr. 8504:5-15. Daines similarly testified that the *Walker* litigation is “not relevant to my opinions, so it’s not something I investigated about the chronology here.” Daines: Trial Tr. 8510:13-22. However, Daines was “aware of the representation that there would not be an increase in the authorized shares without a vote” (Daines: Trial Tr. 8509:8-23), and “understood that the credit agreement explicitly called for a shareholder vote on whether or not to increase the number of authorized shares” (Daines: Trial Tr. 8510:8-12), and “that there never was a common shareholder class vote on increasing the number of authorized shares”. Daines: Trial Tr. 8511:16-20. Daines further understood “that there was an amendment to the credit agreement that provided that the required vote to increase the authorized number of common shares would include a class vote for common shareholders” (Daines: Trial Tr. 8514:11-16), but that “the credit agreement was amended to allow for more flexibility in when there would be a vote if there was going to be a vote held.” Daines: Trial Tr. 8514:17 – 8515:3. Yet Daines purports not to have drawn any inferences from the timing of these amendments. Daines: Trial Tr. 8515:4-8. Daines’ testimony about AIG’s proxy statement disclosures and the fact that many shareholders voted in favor of the reverse stock split also ignores that shareholders had no choice because it was the only mechanism presented that would prevent delisting. *See supra* § 36.5.2.2. Moreover, it ignores the fact that the one proposal that failed to obtain shareholder approval at the June 30, 2009 AIG annual shareholders meeting was the proposal to increase the number of AIG’s authorized common shares. PTX 2108 at 1. The failure of this proposal indicates that common shareholders would *not* have voted in favor of the reverse stock split had they been aware that Defendant intended to utilize the additional authorized, unissued shares to exchange its Preferred Stock for common stock.

(j) Zingales opined that the terms of the reverse stock split – both the “large ratio” and “why it was applied only to the outstanding shares” – are explained by the fact that Defendant “realized that they made a mistake” in thinking there did not need to be a separate class vote to authorize the exchange of the preferred, “and so they are trying to find a way to achieve the same goal in spite of that”. (Zingales: Trial Tr. 8615:13 – 8616:7; *see also* PTX 5512 (collecting quotes)).

36.6 The Reverse Stock Split Was Also Deceptive And Misleading In That It Falsely Represented “AIG Currently Has No Plans For These Authorized But Unissued Shares Of AIG Common Stock Other Than Those Shares Previously Reserved For Issuance Under AIG’s Equity Units, The Warrants And AIG’s Employee Benefit Plans.” (JX 221 at 70).

(a) Even before deciding to execute the Reverse Stock Split, Defendant decided it wanted 92% of AIG. A February 26, 2009 email produced after Defendant’s intentional waiver of privilege shows that Defendant was considering increasing its share of AIG’s equity to 92% – the percentage it would obtain as a result of the January 2011 Recapitalization – shortly after the *Walker* lawsuit was dismissed in February 2009. (*See* PTX 3328). Defendant purposely concealed its consideration of this plan from AIG. (*See* PTX 3343 at 5 (section of a proposed term sheet concerning the plan to increase Defendant’s Series C Preferred Stock interests to 92% of AIG’s equity and voting interest was “TO BE REMOVED PRIOR TO DISTRIBUTION OF TERM SHEET TO AIG”)).

(b) Liddy could not answer whether the statement in the AIG proxy (JX 221) regarding AIG having “no plans” for the additional authorized shares was “an accurate and complete and truthful statement” because he purportedly could not “recall the statement”. (Liddy: Trial Tr. 3283:11-24). Liddy also could not recall whether, in May and June 2009, AIG “had any other plans for these authorized but unissued shares, other than AIG’s equity units, warrants, and AIG’s employee benefit plans.” (Liddy: Trial Tr. 3283:25 – 3284:5).

(c) Liddy acknowledged that “companies have to submit their proxies to the SEC before they can be sent to shareholders”. (Liddy: Trial Tr. 3168:10-13). “And the proxy statement that related to this reverse stock split was presented to the SEC”. (Liddy: Trial Tr. 3168:14-16). The SEC had required AIG to be more specific about what its plans were for the extra authorized but unissued shares of AIG common stock that would result from the reverse stock split. (PTX 523 at 3).

(d) Zingales concluded that the reverse stock split indicates the Government’s control over AIG in part based on a January 28, 2009 email in which Defendant’s counsel wrote that “omitting the shareholder vote might run afoul of the *Walker* court because ‘we told them that we needed a vote to make the pref’s convertible’”. (See PTX 5067 (Zingales demonstrative citing PTX 414); Zingales: Trial Tr. 3854:2-13 (explaining that this is an example of the Defendant’s control over AIG)).

(e) Zingales: Despite the statement that AIG “currently has no plans for these authorized but unissued shares” (JX 221 at 70), “it’s a little bit strange to believe there was no intended purpose.” “First, in February, there was an exchange of emails between, if I remember correctly, AIG counselor and the Government where they say that they sort of don’t think it’s necessary anymore to have a shareholders vote, but they need to talk. So, they go off email, then they resume. It seems that in the between, there’s been a phone call where they resolve a way to bypass the shareholders vote, because remember, until the amended credit agreement, there was a requirement to have the shareholders vote with the common voting by class. And so in the – in the – the fact that they maintained that assumption for a while, and then all of a sudden, they switch, and they say that this was not necessary anymore, and at exactly the same time, the reverse stock split with this very, very unusual feature of a reverse stock split on one part, not the

other, appear, is, in my view, an indication that that's a purpose." (Zingales: Trial Tr. 4025:14-25 (discussing JX 221 at 69), 4026:19 – 4027:17 (discussing PTX 420)).¹²⁷

36.7 After The Reverse Stock Split, Defendant Exchanged Its Series C, E, And F Preferred Shares, With The Purpose Of Avoiding A Class Shareholder Vote While Accomplishing "The Same Result As Converting Would Have Accomplished". (Langerman: Trial Tr. 7216:17 – 7217:11).

(a) In March 2009, Defendant exchanged Series D Preferred Shares for Series E Preferred Shares and structured the transaction as an exchange in order to avoid a shareholder vote to amend the charter. (PTX 2038 at 2; *see also* Brandow: Trial Tr. 5907:3 – 5908:8 (Brandow was "aware that one of the ways of avoiding an amendment to the AIG charter in terms of changing stock from one form to another was to do it by an exchange"))).

(b) Feldberg understood that "in order to permit the exchange of Series C into common, there had to be a shareholder vote although not a class vote of the common shareholders". (Feldberg: Trial Tr. 3382:19-23). He "understood that by voting in favor of this exchange, the effect would be that the common shareholders would not have a class vote on whether or not the Series C Preferred was going to be changed – into common stock" (Feldberg: Trial Tr. 3383:2-8), and that "changing the Series C preferred stock into common stock without a shareholder vote was related to what had been the issue in the Walker litigation". (Feldberg: Trial Tr. 3383:11-15).

(c) Feldberg acknowledged that it was only "in connection with considering this exchange proposal" that he "would have focused more closely on" the *Walker* litigation

¹²⁷ Although Brandow testified that he had no reason to believe the statement in the Proxy was untrue (Brandow: Trial Tr. 5850:9-23), or that the reverse stock split related to the Series C preferred stock (Brandow: Trial Tr. 5846:1-4), that testimony should not be credited in light of the substantial evidence reflecting Defendant's efforts (including by Brandow) to find a means of acquiring common stock absent a shareholder vote. *See, e.g.*, PTX 3211 at 1-2 (Brandow: "My focus from the start of this transaction was to find a way for the trust to acquire the power to control the company without having to get the consent of the common stockholders.")).

(Feldberg: Trial Tr. 3383:16-21), because “in order for the preferred stock – the Series C convertible preferred stock – to be converted into common shares, a shareholder vote was required”. (Feldberg: Trial Tr. 3357:5-9).

37.0

THE PAYMENT MADE BY DEFENDANT FOR THE 79.9% OF EQUITY AND VOTING INTERESTS TAKEN FROM PLAINTIFFS ON SEPTEMBER 22, 2008 WAS AT LEAST \$35 BILLION LESS THAN THE FAIR MARKET VALUE.

37.1 The Fair Market Value Of The 79.9% Equity And Voting Control Defendant Acquired On September 22, 2008 Was Approximately \$35.4 Billion.

37.1.1 The fair value of a firm’s equity is the price that reflects the underlying fundamental intrinsic value of the firm.

(a) Defendant’s expert, Dr. Anthony Saunders, admits that a “fair market price” of equity is a price that “reflects its underlying fundamental intrinsic value.” (Saunders: Trial Tr. 8416:8-11).

37.1.2 The appropriate method to measure damages is a market-based valuation approach.

(a) Because “the Series C Preferred Stock was economically equivalent to AIG’s common stock and AIG’s common stock was actively traded on the New York Stock Exchange, the market value per share of AIG’s common stock represented the best independent valuation available for valuing the government’s beneficial interest in the Trust.” (Def. Resp. to Pl. 3rd Interrogatories No. 18).

(b) Kothari: “Market-based valuation approach” uses the “price of the security that is publicly traded in a market that is very liquid. And it’s -- using that traded price of the security times the quantity of the security, you can get the market valuation of the interest taken.”

(Kothari: Trial Tr. 4543:15-24; *see also* Kothari: Trial Tr. 4543:25 – 4544:4 (this market-based method is “commonly used by valuation professionals”)).

37.1.3 Defendant, AIG, KPMG, and Deloitte used the same market-based approach to calculate the value of Defendant’s 79.9% equity and voting interest in AIG as Plaintiffs’ damages expert Dr. Kothari. (PTX 5203; PTX 5204).

(a) Kothari’s market-based methodology for calculating the value of Defendant’s 79.9% equity and voting interest in AIG is “identical” to the methodology used by Defendant, AIG, KPMG, and Deloitte, except that Kothari valued the interest as of September 22, 2008 rather than a week earlier. (Kothari: Trial Tr. 4551:15-20; *see also* PTX 5205 (Kothari demonstrative bar chart showing the valuation of the 79.9% equity and voting interest in AIG for each trading day from September 17 to 30, 2008) and PTX 5206 (same, excluding the equity units)).

(b) Although Defendant, AIG, and KPMG used other valuation methods in addition to a market-based approach to calculate the value of Defendant’s 79.9% equity and voting interest in AIG, both AIG and KPMG ultimately relied on a market-based approach because it was the most reliable method to value Defendant’s interest in AIG. (*See* JX 189 at 9; PTX 375 at 14, 16, 21; PTX 5204 (Kothari demonstrative); Kothari: Trial Tr. 4550:12 – 4551:11).

(c) Consistent with Dr. Kothari’s valuation, Defendant’s expert, Dr. Anthony Saunders, conceded that, if “the Government had made the revolving credit facility available for the same interest rate and the same fees and terms, except not required the 79.9 percent of the equity, then the entire \$27.9 billion of increased value [as of September 17, 2008] would be captured by the common shareholders.” (Saunders: Trial Tr. 8260:11-17).

37.2 Defendant, AIG, And Their Respective Consultants Calculated Defendant's 79.9% Aig Equity To Be Worth At Least \$23 Billion Using The Market-Based Valuation Methodology.

(a) “The United States admits that its financial statement reported that the value of the Government’s beneficial interest in the Trust was \$23.5 billion, based on the market value of the Trust’s AIG holdings on September 30, 2009”. (Def. Resp. to Pl. 2nd RFAs No. 658; *see also* PTX 2156 at 75, 94).

(b) Deloitte & Touche: On September 21, 2008, Deloitte & Touche, the independent auditor of the Federal Reserve System, calculated that Defendant’s 79.9% equity interest in AIG had a value of approximately \$24.478 billion, based on the September 17, 2008 opening market price for AIG’s common stock. (JX 385 at 1-2).

(c) A November 4, 2008 presentation by Morgan Stanley, a consultant working with Defendant, valued the “Preferred Equity” in AIG as of September 30, 2008 at \$23.0 billion. (PTX 2724 at 28). In the same document, Morgan Stanley projects a “value of 79.9% Treasury common equity stake of \$22.1 to \$28.5Bn” by the end of 2010. (PTX 2724 at 29).

(d) AIG:

(i) AIG in its 10-Q for the third quarter of 2008 reported that the obligation to issue the Series C Preferred Stock had a “fair value” of \$23 billion. (JX 150 at 28).

1. Draft AIG Valuation of Preferred Shares sent to Dahlgren and Farnan on October 30, 2008 (memo dated October 19, 2008): “AIG determined the valuation for the Preferred Shares at \$23 billion. AIG believes that the most direct and least judgmental method is the Common Stock Approach given the high trading volume, and the direct relationship between the Preferred Shares and the common stock price.” (PTX 332 at 8; *see also* JX 189 at 9 (AIG’s final valuation memo, reaching the same conclusion)). Using the “Common Stock Price Approach”,

AIG valued the Series C Preferred Stock at \$24 billion as of September 16, 2008, using the closing stock price on September 17, 2008. (PTX 332 at 3-4). AIG's \$23 billion valuation came from taking "the average between the Common Stock Approach and average of the other KPMG approaches". (PTX 332 at 8).

(ii) Defendant reviewed the valuation process at AIG's request and did not express the belief that the valuation was inaccurate. (*See* PTX 1795; Dahlgren: Trial Tr. 2712:14-25, 2784:7-23; *see also* PTX 332 (October 30, 2008 email from Valoroso to Dahlgren attaching AIG's valuation of the Series C Preferred Stock)).

(iii) FRBNY representatives Sarah Dahlgren and Ethan James told PwC that they had reviewed the statement in AIG's representation letter "regarding the valuation of the \$23b preferred stock" and that "they felt that the Company's process was reasonable and that they considered the representation appropriate." (PTX 364 at 1; Dahlgren: Trial Tr. 2707:15 – 2708:24, 2710:14 – 2711:6; *see also* Farnan: Trial Tr. 4170:15 – 4173:13 (Farnan confirming that these statements in PTX 364 were an accurate summary of what was said at the meeting)).

(iv) In a separate valuation, AIG valued Defendant's 79.9% equity as a \$23 billion asset to offset its access to the credit facility. (*See generally* Farnan: Trial Tr. 4210:10 – 4216:11, 4218:15 – 4229:22). This was because AIG had valued the preferred stock it had not yet issued at \$23 billion, and "the balance sheet has to balance at the end of the day." (Farnan: Trial Tr. 4219:11-20). According to Farnan, "in a transaction, what you get and give up should be equal", so the balance sheet recorded as the value of access

to the credit facility the value of the equity as estimated by AIG, KPMG, and PwC.

(Farnan: Trial Tr. 4226:20 – 4227:20).¹²⁸

(e) KPMG:

(i) KPMG, AIG's auditor hired to conduct the valuation of the Series C, determined that the fair market value of the Series C Preferred Stock as of September 16, 2008 was \$23 billion. (PTX 375 at 21).¹²⁹

(ii) KPMG determined that the "market approaches" were the "most reliable indicators of value" of the 79.9% equity and voting interest in AIG. (PTX 375 at 21).

(iii) Defendant reviewed KPMG's valuation of the Series C Preferred Stock and considered the valuation to be reasonable. (*See* PTX 375 (November 20, 2008 email from AIG to Dahlgren and others attaching KPMG's valuation report on the AIG preferred stock); Dahlgren: Trial Tr. 2712:11-25 (Dahlgren did not recall ever expressing the belief that KPMG's valuation in PTX 375 was inaccurate); PTX 337 (November 2,

¹²⁸ Kothari: "So this is nothing but debits have to equal credits, so they knew that they have issued equity, additional paid-in capital, so preferred stock, and they had valued it at \$23 billion. It was based on KPMG as valuation consultant, \$2.00 share price, number of shares received, so on, so forth, and they valued it at \$23 billion. Now, what would be the debit. That is a credit as we say, additional paid-in capital. So debit -- normally when you issue additional paid-in capital, normally you receive cash, so the debit is cash. Okay? Here, they didn't receive any cash. They received the credit facility that they had borrowed that was an obligation, the cash was received, and they were obligated to pay that". Kothari: Trial Tr. 4700:15 – 4701:7; *see also* Kothari: Trial Tr. 4701:8 – 4702:6.

¹²⁹ AIG and KPMG based the \$23 billion valuation on the closing stock price on September 17, 2008 because they "determined that the closing price of \$2.05 on September 17, 2008 (the day after announcement) showed adequate trading volume to reflect all available information about the credit facility and 79.9% dilution" and "the impact of change in control should be reflected in the stock price post-announcement." PTX 375 at 16; *see also* Kothari: Trial Tr. 4574:14 – 4575:20 (Even if one had chosen September 16, 2008 as the valuation date, "you want to look at prices beyond September 17" because the information about the Credit Facility "trickled over a period of time" and therefore was not reflected in AIG's stock price until that process was complete).

2008 draft KPMG report circulated by Dahlgren); Dahlgren: Trial Tr. 2711:7 – 2712:4 (acknowledging circulating PTX 337)).

(f) PwC:

(i) As AIG's independent auditor, PwC reviewed and audited the valuations performed by KPMG and AIG, and concluded that the market-based methods used by those entities to value the 79.9% equity and voting interest "were reasonable". (Farnan: Trial Tr. 4174:11-23; *see also* Farnan: Trial Tr. 4168:15-18 (concluding that both the market-based methodology and the \$23 billion value derived were reasonable)).

(ii) PwC performed its own "shadow calculations" under the Black-Scholes option model as a "rough estimate of a valuation of the preferred stock." (Farnan: Trial Tr. 4168:19 – 4170:1; *see also* Farnan: Trial Tr. 4168:23 – 4169:2 (explaining that the Black-Scholes option model is a "well-accepted methodology for valuing certain instruments that incorporates inputs such as volatility, strike price and time to calculate a value")). Those calculations resulted in a value for the Series C Preferred Stock at "amounts between 28 and 42 billion dollars." (Farnan: Trial Tr. 4170:10-14 (discussing PTX 699)).

(iii) PwC, in an October 31, 2008 memo entitled "AIG Inc. Valuation as of September 16, 2008," described income approaches based on credit default spreads as having "inherent limitations, specific to the facts and circumstances of this transaction, therefore producing results that are less or not reliable." (JX 140 at 3).

37.3 AIG's Market Capitalization Between September 22 And September 24, 2008 Reflects The Fair Value Of The 79.9% Equity Interest Taken Or Exacted From Plaintiffs By Defendant.¹³⁰

37.3.1 September 22, 2008 is an appropriate valuation date for the property taken from the Credit Agreement Class because the Credit Agreement's final terms were neither determined nor became effective until September 22, 2008.

(a) Baxter: the "first time that AIG was obligated to provide equity to the government, broadly defined, was when the September 22 credit facility was signed". (Baxter: Trial Tr. 765:2-5).

(b) Alvarez: "the first time that AIG was under a contractual obligation to abide by the terms of this term sheet" was "When the actual contract was signed September 22." (Alvarez: Trial Tr. 309:14 – 312:10).

(c) Kothari used September 22, 2008 as the valuation date because the Credit Agreement "became effective as of September 22, and I also note that – the Court rule that if the taking did take place then, it took place on September 22". (Kothari: Trial Tr. 4554:4-12; *see also* Kothari: Trial Tr. 4555:8 – 4556:13 (discussing Kothari demonstrative PTX 5207 and three reasons why he concluded that the Credit Agreement did not become effective until September 22, 2008)).

(d) AIG's independent auditor acknowledged that the form of the equity was not agreed upon until September 22, 2008. (Farnan: Trial Tr. 4403:18-20 (the "first time" Farnan was

¹³⁰ AIG justified its selection of the closing price on September 17, 2008 for its September 16th valuation because it believed that the next day was when the market would "reflect all available information about the credit facility and 79.9% dilution". PTX 375 at 16. This same logic is equally applicable to selecting September 24, 2008 to review the pricing as of the execution of the Credit Agreement. As explained below: "It would not be appropriate to use the price prior to the announcement as the market did not have any information on the Credit Facility, 79.9% dilution, and AIG's ability to continue as a going concern. The price movement after September 17th was attributable to external events and headline news not directly available or could be incorporated by both parties in the negotiation." PTX 332 at 4.

“aware of preferred stock being agreed to is September 22nd”); Farnan: Trial Tr. 4399:5-7 (the form of equity had not been agreed upon as of September 16, 2008)).

(e) The interest rate had not been agreed to as of September 16, 2008. (Farnan: Trial Tr. 4396:7-16).

37.3.2 September 23, 2008 is an appropriate valuation date for the property taken from the Credit Agreement Class because the Credit Agreement was executed and announced on September 23, 2008. (Kothari: Trial Tr. 4568:21-23; PTX 5207).

37.3.3 September 24, 2008 is the best valuation date for the property taken from the Credit Agreement Class because that is the date the market learned all the material terms of the Credit Agreement.

(a) Kothari: September 24, 2008 is the “best” date to use because “information about the credit facility, the terms of the credit facility and the form of equity interest taken by the defendant, all of that information became known and there was time for the investment community to assimilate that information, process that information, by the close of September 24, and that is the reason for using the close of September 24 as the most appropriate price.” (Kothari: Trial Tr. 4573:23 – 4574:9).

(b) AIG first disclosed the form of the equity, the 8.5% annual fee on undrawn funds, and the 2% commitment fee at 9:59 p.m. on September 23, 2008. (PTX 234 at 1).¹³¹

(c) No September 17, 2008 analyst reports reference preferred stock (Kothari: Trial Tr. 4820:21-24); an undrawn fee (Kothari: Trial Tr. 4822:5-6); a LIBOR floor with respect to the interest rate (Kothari: Trial Tr. 4822:7-9); or a commitment fee (Kothari: Trial Tr. 4822:10-11).

¹³¹ AIG did not disclose that the interest rate on drawn funds was subject to a 3.5% LIBOR floor until September 26, 2008. *See* JX 121 at 4, 20 (AIG Form 8-K disclosing Credit Agreement, defining “LIBO Rate”).

37.3.4 The market recognized that the newly announced terms were material.

(a) On September 24, 2008, Bloomberg published a report that AIG stock fell “on Concern U.S. Loan Will Force Liquidation.” (PTX 1658 at 1 (describing the interest rate as “hugely punitive” and observing that “AIG has essentially been nationalized”).

(b) Morgan Stanley on September 24, 2008:

(i) **“What’s new:** AIG announced that it has signed a definitive agreement with the Federal Reserve Bank”; “The terms of the offering are more punitive than we originally expected,” listing as reasons: (1) an interest cost of 8.5 percent, plus three-month LIBOR on the outstanding balance; (2) an initial commitment fee of 2 percent; (3) an 8.5 percent annual commitment fee on the undrawn amounts; and (4) the issuance of convertible preferred stock. (PTX 246 at 1; Kothari: Trial Tr. 4841:8 – 4842:2 (confirming that this is “in line with that the market expected somewhat more lenient terms”)).

(ii) “The terms are even more punitive than we originally expected, making us question the risk-reward profile of the company.” (PTX 246 at 1).

(c) Credit Suisse on September 24, 2008:

(i) “We would expect a pullback in the stock following recent strength as we think it was bid up in the hopes of avoiding dilution of the government’s equity stake. With that prospect now off the table, our sum of the parts analysis suggests that our \$3 price target (after considering the net effect of repaying the government loan and net of AIG corporate debt) a fairly optimistic assessment of the value of AIG equity.” (JX 114 at 1).

(ii) “the added costs related to the undrawn part of the facility will be material (extra \$4.7 billion of annualized interest expense for current \$55b of undrawn line).” (JX 114 at 1).

(d) September 24, 2008 FBR Capital Markets analyst report:

(i) “We view last night’s news as an additional negative. We are lowering our earnings estimates and reducing our price target to \$5.30 from \$6.25.” (PTX 1654 at 1).

(ii) “AIG must pay an initial gross commitment fee of 2% of the total facility (\$1.7 billion) at the closing and an annual commitment fee on the undrawn portion of the facility of 8.5%.” (PTX 1654 at 1).

37.3.5 The terms of the Credit Agreement were worse than expected and the market reacted on September 24 when AIG’s stock price fell by 33%.

(a) Kothari:

(i) Once the terms were finally disclosed “the stock price of AIG did fall about 33 percent I believe on September 24”. (Kothari: Trial Tr. 4557:12 – 4558:3). In other words, once the terms were disclosed, “the market had an opportunity to understand what the final terms were, compare those against their expectations and process that surprise, if you will, and have that reflected in the stock price as the shares traded on that date, so that negative information is assimilated into the stock price of AIG as of the closing of September 24.” (Kothari: Trial Tr. 4567:25 – 4568:9; *see also* Kothari: Trial Tr. 4567:7-24 (discussing PTX 5205 (showing a \$20 billion drop in AIG’s stock price on September 24, 2008) and PTX 5206 (same, excluding the equity units))).

(ii) “I considered whether market movements would explain the decline in stock market – in stock price of AIG” by examining the S&P 500 Index, the S&P

Financial Index, and the S&P Insurance Index and concluded that none of the movements in those indices “would account for the substantial, statistically significant negative stock price reaction that AIG experienced. And, therefore, it implies it was firm-specific information about AIG that contributed to the vast majority of the negative stock price decline that was observed on September 24th.” (Kothari: Trial Tr. 4848:16 – 4849:10).

37.4 Using A Market-Based Valuation Approach, The Value Of The 79.9% Equity And Voting Interest In AIG Taken From Plaintiffs As Of September 22, 2008 Is Between Approximately \$35.4 Billion And \$53.4 Billion. (PTX 5211).

(a) Kothari: Using a market-based valuation approach, Defendant acquired equity and voting interests in AIG worth approximately \$38.9 billion (using the closing price on September 24 of \$3.31), \$55.4 billion (using the closing price on September 22 of \$4.72) or \$58.7 billion (using the closing price on September 23 of \$5.00). (PTX 5210 (Kothari demonstrative); Kothari: Trial Tr. 4572:24 – 4573:12).

(i) The actual amount due to the Credit Agreement Class must be adjusted for equity unit holders who owned approximately 9 percent (or 264 million shares) of AIG and who are not part of the Credit Agreement Class.¹³² (Kothari: Trial Tr. 4540:5 – 4541:17; *see also* PTX 5202 (Kothari demonstrative summarizing the value of the equity and voting interests Defendant acquired); Kothari: Trial Tr. 4542:2-16 (“So to be conservative, I’m treating those as if they have been issued and making adjustment for those equity units in calculating the claims of the class.”)).

(ii) After adjusting for the equity unit holders, the amount due to the Credit Agreement Class is reduced to approximately \$35.4 billion (using the closing price on

¹³² The equity units consist of an ownership interest in AIG junior subordinated debentures that obligate the holder of an equity unit to purchase shares in AIG at a future date and pre-specified prices. AIG had agreed to sell those shares to the equity unit holders prior to September 2008 and had reserved 264 million shares for the equity unit holders. (Kothari: Trial Tr. 4541:25 – 4542:13).

September 24 of \$3.31), \$50.4 billion (using the closing price on September 22 of \$4.72) or \$53.4 billion (using the closing price on September 23 of \$5.00). (PTX 5211 (Kothari demonstrative)).

(iii) The amount due to the Credit Agreement Class will be further reduced based on only those class members who have actually opted into the Class as opposed to the entire potential class. (Kothari: Trial Tr. 4542:20 – 4543:12; *see also* PTX 5202 (“Class members are due at least $\$35.378B \times (\text{shares held by member} \div \text{total common shares outstanding})$.”)).

(b) Kothari: September 24, 2008 is the “best” valuation date to value the Credit Agreement Claims not only because the market had assimilated all of the material terms by that date, but also because the stock price on that date is the lowest of any other prices from September 22-24, 2008 and is therefore “conservative.” (Kothari: Trial Tr. 4573:23 – 4574:13; *see also* PTX 5209 (demonstrating that the closing stock price on September 24, 2008, was AIG’s lowest stock price from September 22 through September 24, 2008)).

(c) Under the market-based approach, and using the September 24, 2008 closing stock price as an example, the value of 79.9% equity and voting interests taken from common shareholders as of September 22, 2008 is calculated as follows:

(i) To ascertain the value of 100% of AIG’s equity interests, AIG’s closing stock price of September 24, 2008 (\$3.31) is multiplied by the number of AIG common shares outstanding and equivalents (*i.e.*, equity units) (14.691 billion). The value of 100% of AIG’s equity interests equals \$48.626 billion. (Kothari: Trial Tr. 4576:19 – 4577:16; PTX 5212).

(ii) The value of 100% of AIG's equity and voting interests is then multiplied by the 79.9% taken by Defendant. The value of the interest acquired by Defendant equals \$38.852 billion. (Kothari: Trial Tr. 4577:17-22; PTX 5212).

(iii) This value is then adjusted to exclude the equity units (approximately 9%). The resulting value of the equity and voting interests taken from AIG common

shareholders equals \$35.378 billion using the closing stock price on September 24, 2008.

(Kothari: Trial Tr. 4577:23 – 4578:5; PTX 5212).¹³³

37.4.1 Dr. Kothari made several conservative assumptions in his damages calculation, including not adjusting for a control premium or liquidity discount.

¹³³ Saunders opined that the “rescue transaction did not result in an economic loss to the Credit Agreement Class.” DX 2739 (Saunders demonstrative). While there was no disagreement between Plaintiffs’ and Defendant’s experts that the “correct framework for analyzing economic dilution requires a calculation of the value of AIG’s common equity prior to and after the ownership interest dilution” (Saunders: Trial Tr. 8203:10-18), Plaintiffs dispute Saunders’ conclusion that common shareholders received a net gain of \$1.2 billion. Saunders: Trial Tr. 8203:19 – 8206:19; DX 2744; DX 2745. Saunders’ analysis is flawed for multiple reasons, most fundamentally because the paradigm that Saunders uses disregards the facts of this case. *First*, as Zingales explained, the statement that ownership dilution does not necessarily imply economic dilution “is correct but is relevant to the point only in which fair consideration is provided in exchange for ownership dilution. And there is no evidence I’m aware of that any monetary consideration was provided and no evidence that I’m aware of that fair financial consideration was provided.” Zingales: Trial Tr. 8613:12-25; *see also* PTX 5510 (“When a new shareholder does not provide consideration for its shares (or does not provide consideration equal to the proportionate value of its shares), ‘ownership dilution’ is equal to ‘economic dilution’”). Saunders himself acknowledges that if Defendant had extended credit without diluting the ownership stake of AIG’s shareholders by 79.9%, AIG’s shareholders would have retained ownership of \$27.9 billion in value, measured by the price of AIG common stock on September 17, 2008. Saunders: Trial Tr. 8260:11-17. *Second*, although Saunders conceded that “Any economic losses suffered by the Credit Agreement Class due to an ownership percentage dilution would be reflected in a lower stock price, which did not occur,” (DX 2749), he continued to rely on September 16th as the relevant date for his analysis (Saunders: Trial Tr. 8204:5-17), which, as demonstrated above, is fundamentally flawed and predetermines the valuation result. *See supra* § 37.3. Saunders also acknowledged that on September 23 and 24, when one corrected his analysis to account for when the Credit Agreement was actually executed and the market became aware of the terms, there was a decline in price that he did not study. Saunders: Trial Tr. 8264:21-8265:5 (Saunders conceded that “price on September 16th at the close was higher than the price either on the 16th opening or the 17th opening” and that he did not form an opinion or conclusion as to why the price declined). *Finally*, Saunders had no “opinion or a conclusion as to what the marketplace believed the form of equity would be” as of “the morning of September 17th.” Saunders: Trial Tr. 8268:7-10. And, after taking “as much time as” he needed to review documents, Saunders could not find any reports—which he testified existed—stating on the morning of September 17th that the form of equity was still to be determined. Saunders: Trial Tr. 8271:25 – 8273:5. He later acknowledged that he may have been mistaken about what the reports said – “Perhaps not the form to be determined, but a 79.9 percent equity stake.” Saunders: Trial Tr. 8273:6-14.

(a) Kothari did not adjust his valuation for a control premium or a liquidity discount resulting in a more conservative valuation. (PTX 5220).¹³⁴

(i) “Control premium is the additional amount a buyer would pay above the minority equity interest in order to obtain control of a company” because “by virtue of control then you are able to make decisions for the company” and “that is perceived to be valuable by acquirers, and they are willing to pay that premium”. (Kothari: Trial Tr. 4590:17 – 4591:18; *see also* Kothari: Trial Tr. 4657:1-7 (a “control premium is routinely paid even when the target shareholders individually do not have control, but collectively they do”)).

(ii) Farnan: “if you buy enough shares to control a company, there’s a view that there is an additional amount you would pay to control a company” because “if you control the company, you can direct its activities.” (Farnan: Trial Tr. 4191:21 –4192:14).

(iii) “Liquidity discount is the inability to sell an asset at the time the owner wants, immediately, without selling it at a discount.” (Kothari: Trial Tr. 4591:23 – 4592:1).

(iv) “Scientific evidence in the literature demonstrates that control premium is larger than liquidity discount. In fact, it is – it swamps liquidity discount. And as a result, if I were to make an adjustment for both, then the net effect would still be that that control premium would be larger than liquidity discount.” (Kothari: Trial Tr. 4592:2-14).

37.4.2 The market value of AIG as of September 22-24, 2008 represents a restoration of AIG’s intrinsic value from immediately before the onset of AIG’s liquidity crisis.

¹³⁴ The other entities that valued the 79.9% equity and voting interest in AIG (*i.e.*, Defendant, AIG, KPMG, and Deloitte) also did not adjust for a control premium or liquidity discount. Kothari: Trial Tr. 4592:19-22.

(a) Kothari: On September 11, 2008 “AIG’s shareholders had market capitalization of \$47.2 billion, and the equity unit holders, their valuation was about \$4.6 billion on September 11 for an aggregate market capitalization of \$51.8 billion.” (Kothari: Trial Tr. 4582:18 – 4583:6 (regarding PTX 5215)). This value is consistent with the value of AIG’s equity prior to the onset of its liquidity crisis beginning around September 11, 2008. (Kothari: Trial Tr. 4584:8-20 (regarding PTX 5213 (demonstrating that the market value of AIG was around \$60-80 billion throughout August and early September 2008) and PTX 5214 (same, excluding the value attributable to the equity unit holders))).

(b) Kothari: “The point to recognize is, the valuation on September 16 was depressed or adversely affected by lack of liquidity, so the intrinsic value of AIG is the September 11, and provision of liquidity enabled AIG to bring its value back to its intrinsic level.” (Kothari: Trial Tr. 4676:22 – 4677:7).

(c) Kothari: The “provision of liquidity brought its valuation back to the pre-liquidity crisis levels.” (Kothari: Trial Tr. 4583:8-12). As demonstrated, for example, in PTX 5215, “the total market valuation of AIG using the market-based approach is \$48.626 billion on September 24,” which is approximate to AIG’s market capitalization of \$51.822 billion on September 11, 2008, prior to the onset of its liquidity crisis. (Kothari: Trial Tr. 4583:13-16; *see also* PTX 5217 (showing that AIG’s equity value remains in the range of \$45 to \$55 billion dollars following the provision of liquidity); PTX 5218 (same, excluding the value attributable to the equity unit holders))).

(d) Cragg: AIG’s stock price “over the period . . . September 8th through to September 16th reflects that liquidity crisis whereby the market is very worried about AIG’s ability to continue as a going concern without liquidity support. When there is the announcement of the

Federal Reserve's provision of liquidity, immediately afterwards you see the market capitalization, as reflected in the markets, come back, and the impact of the RCF is to ultimately correct the externality, the negative externality of panic that was driving investors away from AIG. When the confidence returned, so did its market cap, reflecting that over this period, the intrinsic value of AIG didn't change or the intrinsic value of its assets didn't change, but rather, the stock price reflected a crisis of confidence which was then corrected." (Cragg: Trial Tr. 8724:12-8725:13; *see also* PTX 5527 (Cragg demonstrative showing changes in AIG's market capitalization throughout September 2008)).

(e) Kothari: Analysts recognized that AIG's value had "returned to its pre-liquidity crisis levels" following the infusion of liquidity. (Kothari: Trial Tr. 4586:24 – 4587:18).

(i) From September 17-29, 2008, analysts reported "target prices" for AIG (*i.e.*, twelve-month "estimates of what the firm's [stock] price would be") with an average of \$4.52, approximately 45% higher than AIG's closing price on September 24, 2008 of \$3.31. (Kothari: Trial Tr. 4589:1-15; PTX 5219).

(ii) These target prices provide "corroborative evidence" that market participants thought that the provision of liquidity had restored the value of AIG to its pre-liquidity crisis levels. (Kothari: Trial Tr. 4587:11-18, 4589:6-20).

37.4.3 Plaintiffs were deprived of the benefit of the restoration of AIG's intrinsic value by Defendant's acquisition of a 79.9% equity and voting interest.

(a) Kothari: After the provision of liquidity, "the ownership of common shareholders declined from \$47.1 billion to only about \$8.9 billion afterward", whereas Defendant acquired \$38.852 billion of the equity and voting interest in AIG. (Kothari: Trial Tr. 4583:8-22; PTX 5215; *see also* PTX 5216 (same, but excluding the value attributable to the equity unit holders)).

(b) Kothari: “The same shareholders, had the government not taken 80 percent, would have had claim on the value of AIG, and that claim on the 24th would have been 40 to 50 billion dollars. It’s just that four-fifths of that claim was taken away by the government.” (Kothari: Trial Tr. 4640:23 – 4641:7; *see also* Kothari: Trial Tr. 4641:8-18 (“I’m taking the facts as they occurred, that liquidity was provided and the value did bounce back. The share – AIG fully compensated the government for the provision of liquidity. The 80 percent taking was over and above the full compensation for liquidity provision.”)).

37.5 September 16 And 17, 2008 Are Not Appropriate Valuation Dates For The Fair Value Of Plaintiffs’ Property Because The Date Of The Taking Was September 22.¹³⁵

¹³⁵ Although PwC had previously indicated that it had reviewed a variety of information in concluding that September 16, 2008 was the correct valuation date (*see* Farnan: Trial Tr. 4231:3-14; JX 146 at 12 (“The agreement signed on September 22, 2008 memorializes the terms of the oral agreement established on September 16, 2008.”)), PwC’s engagement partner for the AIG account Donald Farnan admitted at trial that he had incorrectly understood that AIG had “access” to the \$85 billion credit facility on September 16. Farnan: Trial Tr. 4391:24 – 4392:14, *id.* 4393:4-21 (indicating “that was a basis for concluding that the September 16, 2008, valuation date was a reasonable one”). He has since reviewed other documents and evidence such as “some demand notes during” his deposition that were issued in connection with loans that were made to AIG “prior to September 22nd”. Farnan: Trial Tr. 4392:18 – 4393:3 (“I don’t recall having seen those demand notes before I was shown them” in “my deposition”).

Furthermore, Farnan acknowledged that “it would have been possible” for there to “be other appropriate dates” than the September 16, 2008 valuation date used by AIG and KPMG. Farnan: Trial Tr. 4174:24 – 4175:7. However, PwC did not “make any determination as to whether those other dates” “would or would not have been reasonable if the company had selected them.” Farnan: Trial Tr. 4176:9-12; *see also* Farnan: Trial Tr. 4384:17-20 (“PwC did not conclude, one way or another, as to whether there were other reasonable valuation dates.”). Not only did the taking/exaction not occur until September 22, but the market was unaware of the terms of the Credit Agreement before September 23, 2008, as demonstrated in the next section.

KPMG also did not conduct an independent analysis of whether September 16, 2008 was an appropriate valuation date but rather used it as an assumption provided by AIG. *See* Farnan: Trial Tr. 4206:22-24 (AIG chose the valuation date of September 16, 2008); Kothari: Trial Tr. 4863:3-8 (“I haven’t seen anything to suggest that [KPMG] conducted an analysis or why September 16th would be the right date.”).

37.5.1 The taking occurred on September 22, not September 16, because Defendant had no obligation to issue equity until the September 22 Credit Agreement was agreed upon. (*Supra* §§ 14.0-14.4, 37.3.1).

(a) Defendant's loans prior to September 22 are not relevant to the valuation of the 79.9% equity and voting interests because those loans did not require the transfer of equity to Defendant. (*See* JX 84 (demand notes)).

(b) Kothari: Beginning on September 16, 2008, Defendant provided financing to AIG in the form of demand notes, which were "separate contractual documents", that were "due on September 23", with a "fixed interest rate of 12 percent" and that did not have equity attached to them. (Kothari: Trial Tr. 4558:20 – 4559:12).

(c) Kothari: "defendant understood the term sheet was nonbinding" and the "term sheet itself says that it is nonbinding." (Kothari: Trial Tr. 4558:16-19).

(d) Farnan, an AIG independent auditor from PwC, acknowledged that the form of equity as preferred stock had not been agreed to as of September 16, 2008. (Farnan: Trial Tr. 4399:5-7)

(e) Defendant's expert, Robert Daines, admitted that there is a material difference between the warrants AIG could have issued on September 16, 2008 and preferred stock contemplated in the September 22, 2008 Credit Agreement. (Daines: Trial Tr. 8544:1-4).

37.5.2 On September 16 and 17, 2008, the market did not understand all the material terms of the Credit Agreement.

(a) Under a market-based approach using securities prices, it is important to wait until market participants "have all the relevant information" so that "prices will reflect the economic import of the information contained in that contract." (Kothari: Trial Tr. 4562:7-18).

(b) Kothari: The economics of the Credit Facility were not fully known on September 16, 2008. (Kothari: Trial Tr. 4558:7 – 4559:12; *see also* Kothari: Trial Tr. 4558:13-15 (“the first indication of any information about credit facility, that happened after the close of the 16th”)).

(c) With respect to the news and analyst reports dated September 17, 2008, there was “no reference to preferred stock” (Kothari: Trial Tr. 4821:24 – 4822:4); or to an undrawn fee (Kothari: Trial Tr. 4822:5-6); or to a LIBOR floor with respect to the interest rate (Kothari: Trial Tr. 4822:7-9); or to a commitment fee (Kothari: Trial Tr. 4822:10-11).

37.5.3 Prior to the evening of September 23, 2008, market information indicated that the form of the equity would be warrants.

(a) *New York Times* on September 16, 2008 (11:10 p.m.): “Fed staffers, who briefed reporters at 9:15 tonight, don’t even want us to say the government will control A.I.G. The government will name new management, and will have veto power over all important decisions. And it will have a warrant allowing it to take 79.9 percent of the stock whenever it wants. But they contend there is no control until the warrant is exercised.” (PTX 2736 at 1; Kothari: Trial Tr. 4839:18-25).

(b) *Wall Street Journal* on September 16, 2008 (11:59 p.m.): “the U.S. government will effectively get a 79.9% equity stake in the insurer in the form of warrants called equity participation notes.” (PTX 103 at 1; Kothari: Trial Tr. 4825:10 – 4826:1).

(c) *Dow Jones Newswire* on September 17, 2008 (1:08 a.m.): “the U.S. government will effectively take a 79.9% equity stake in the insurer in the form of warrants called equity participation notes.” (PTX 1595 at 1).

(d) A.M. Best Company, September 17, 2008: “Current AIG shareholders will see their equity diluted 79.9% by the issuance of warrants to the federal government, which also retains

the right to veto dividend payments.” (PTX 1593 at 3; Kothari: Trial Tr. 4836:13-23 (acknowledging PTX 1593)).

(e) *New York Times*, September 17, 2008: the Fed “in return, will receive warrants that can be converted into common stock giving the government nearly 80 percent ownership of the insurer, if the existing shareholders approve.” (PTX 131 at 3; Kothari: Trial Tr. 4826:2-16 (acknowledging the statement)).

(f) Citigroup analyst report, September 18, 2008: “In return, the government will receive warrants convertible into a 79.9% equity interest in AIG common stock.” (PTX 1587 at 1; Kothari: Trial Tr. 4834:20 – 4835:6 (acknowledging the statement)).

(g) Reuters on September 18, 2008: AIG “said it would hold a shareholder vote as soon as possible on the agreement to issue warrants to the Federal Reserve for up to 79.9 percent of AIG’s outstanding shares.” (PTX 1606 at 1).

(h) *New York Times* on September 18, 2008: “AIG: So Many Questions.” “So, there will be a shareholder vote. But we still need to see the warrant to see when the government can exercise it.” (PTX 137 at 7).

(i) *Wall Street Journal* on September 20, 2008 (11:59 p.m.): “Major shareholders are trying to help pay off the federal government’s loan to American International Group Inc. in time to avoid having Washington take an 80% stake in the company”. (PTX 179 at 1).

(i) “‘We have not finalized all of the documents,’ says a spokesman for the New York Fed, which is lending AIG the money”. (PTX 179 at 1).

(ii) “The effort became confused on Friday after AIG made a filing with the Securities and Exchange Commission about the deal with the government that said it was correcting errors in a filing it made on Thursday. In the Thursday filing, AIG said it had

issued a warrant to the Federal Reserve board letting it obtain 79.9% of AIG's common stock outstanding, 'subject to shareholder approval.'" (PTX 179 at 1).

(j) Market information prior to September 23, 2008, confirms that there was substantial uncertainty concerning the terms of the Credit Agreement. (Kothari: Trial Tr. 4822:12-16 (discussing publications that "expressed uncertainty or doubt about what the terms were"))).

(i) *New York Times* on September 18, 2008: "AIG: So Many Questions." "Oddly, the documents and details of the transaction have yet to be fully disclosed. (Perhaps they are still negotiating them?) So some of what I've written below is speculation." (PTX 137 at 1; Kothari: Trial Tr. 4828:25 – 4829:20 (acknowledging the statement)).

(ii) Morgan Stanley analyst report, September 18, 2008 : "Unfortunately, there are very few details regarding the transaction at this stage, beyond what was in the press release from the Federal Reserve." (DX 1475 at -099; Kothari: Trial Tr. 4822:17 – 4823:14 (acknowledging statement in DX 1475)).

(iii) On September 19, 2008, AIG filed an amended 8-K concerning the agreement that stated the form of equity the "corporate approvals and formalities necessary to create this equity interest will depend upon its form." (JX 99 at 2; Kothari: Trial Tr. 4691:19 – 4692:9 (acknowledging statement in 8-K/A)).

(iv) September 23, 2008 "Company Focus" on AIG by Citi: "Little information has been provided to date regarding the \$85 billion credit facility offered by the Federal Reserve to AIG. Complicating this is that some of the statements and disclosures seem to be conflicting. This, along with news that shareholders are attempting to find an alternative to the credit facility, has raised speculation regarding the possibility that the

government will not take a dilutive equity stake in AIG.” (PTX 236 at 1; Kothari: Trial Tr. 4749:25 – 4750:21 (acknowledging the statement)).

1. The September 23, 2008 Citi analyst report continues: “The laconic and opaque amendment to the 8-K combined with the actual extension of credit and draw down from it raise a number of questions regarding the government’s equity position in AIG:

“Has a credit facility agreement between the company and the government, fully detailing the terms and provisions, been signed?

“Were warrants issued by AIG to the Federal Reserve and if so, under what circumstances can the warrants be exercised?

“If warrants were issued but shareholder approval is required, when will a shareholder meeting be called? If shareholder approval is not obtained retroactively, what recourse could shareholders seek now that the credit line has already been extended and drawn down? Could the agreement between the government and AIG be terminated or nullified without the government receiving an equity stake in AIG? In such a case, could the government seek recourse against the company if and if so, would it be interested in seeking recourse?

“If warrants have not been issued yet, would the government be willing to forego its equity stake in AIG should the company be able to repay the loan and raise

enough cash through the disposition of assets? What bearing would shareholder objection to the issuance of warrants have with the loan de-facto in place?

“What forms of shareholders’ equity, other than warrants or common shares, could the Federal Reserve end up with?” (PTX 236 at 4).

(k) 35.5.2.1.1 The market recognized that the change of the form of the equity had the significant effect of ending shareholders’ ability to prevent dilution of their voting rights.

(l) *Wall Street Journal* on September 24, 2008: “Some big AIG shareholders have reportedly been trying to raise capital in private markets to avoid the government seizing control of the company. But late Tuesday AIG said it signed a definitive agreement ‘Shareholder efforts to prevent the government from taking an equity stake in AIG will prove fruitless.’” (PTX 242 at 1).

(m) Bloomberg on September 24, 2008: “AIG said Sept. 18 it would give the U.S. warrants entitling the government to get common shares equal to a 79.9 percent stake. Some investors surmised that the U.S. might hold onto the warrants long enough for them to find enough new cash to make the government takeover unnecessary. Preferred Shares. The company yesterday said the Treasury will instead get preferred shares with voting rights guaranteeing the U.S. will control the outcome of any shareholder vote.” (PTX 1658 at 2).

(n) Morgan Stanley on September 24, 2008: “This announcement effectively puts to rest the question as to whether other private alternatives would be available to common equity holders.” (PTX 246 at 1; Kothari: Trial Tr. 4842:3-17 (discussing PTX 246 (“closure took place on September 24” about private negotiations))).

(o) Credit Suisse on September 24, 2008: “Last night AIG announced that it had signed a definitive agreement with the Fed on the previously announced \$85b liquidity facility. There had been speculation that AIG could seek a private sector solution and thus avoid the government dilution, but the company indicated that this deal with the Fed represents its best option given the market turmoil.” (JX 114 at 1).

(p) UBS on September 25, 2008: “Shareholder group attempting to reverse/amend onerous Fed agreement”. (PTX 1665 at 1).

37.5.4 The market price of AIG common stock on September 16, 2008 understated the intrinsic value of AIG.

(a) Kothari: AIG’s stock price on September 16, 2008 was “considerably below its – I would say its intrinsic value at the time.” (Kothari: Trial Tr. 4898:17 – 4899:11).

(b) Kothari: Until about September 11, 2008, the value of AIG “was 50 to 60 billion dollars, and that is – that is the time period before the onset of liquidity crisis. September 11, after Fannie Mae and Freddie Mac being put under conservatorship, in the overall marketplace, liquidity – credit markets started to freeze and liquidity became an issue. In particular, it was a severe issue for AIG. And what you observe is that September 12, 15, 16, market capitalization of AIG dropped precipitously because it was suffering from liquidity crisis. And this is entirely as expected by economic theory. Economic theory suggests that a firm that is facing liquidity crisis, it will have its stock market valuation to go down.” (Kothari: Trial Tr. 4579:3-17; *see also* Kothari: Trial Tr. 4580:5-14 (noting that September 12 is the last business day before Lehman went bankrupt on the morning of September 15)).

(c) Cragg: In “normal times, market prices do reflect the intrinsic value of assets; they do reflect the fair market value of assets, that the securities that are written against those assets

reflect their value. In this period of time, that was not the case”. (Cragg: Trial Tr. 8729:18 – 8730:7; *see also* PTX 5523 (“Market prices only reflect intrinsic or fair market value where markets are orderly and functioning.”))).

(i) “when markets are not functioning, when there are other issues that are present, you can have the situation arise where the market price of a – of a security deviates from the fair value of the underlying assets which are generating, you know, ultimately the value of owning those shares.” (Cragg: Trial Tr. 8730:8-19).

(d) Cragg: AIG’s “share price had fallen on September 16th because of the run on AIG that was coming from the general, overall liquidity crisis. There were mark-to-market losses that were being generated, there were the collateral calls, which altogether led to a downgrade of AIG as the – the rating agencies saw this crisis of confidence. It meant that AIG’s intrinsic value was not reflected in its stock price, and that’s, you know, ultimately why, in the days after the RCF, you see the rebound in its – in its stock price.” (Cragg: Trial Tr. 8728:11 – 8729:1; *see also* PTX 5523 (Cragg demonstrative explaining why AIG’s intrinsic value was not reflected in its opening market price on September 16, 2008)).

(e) Cragg: “it’s important to analyze what are the underlying sources of information that go into determining what the stock price is. Now, obviously, one of those is intrinsic value, but in this case, if he had dug further beyond just looking at the stock price, which is all he did, if he had done the analysis to see what the market commentary was, to look at what was happening with the CDS spreads, to look at the pattern of how the stock price fell and why, the source of liquidity stress on AIG, I think the only conclusion that you’d come to is that this market – what happened over this period of time was not that the market reflected the intrinsic value of AIG’s assets, but rather, there was a temporary crisis of confidence.” (Cragg: Trial Tr. 8726:16 –

8727:11; *see also* PTX 5523; PTX 5524 (“AIG’s opening stock market price on September 16, 2008 was not a reliable measure of AIG’s intrinsic or fair market value”)).

(i) For example, the SEC understood that “like many financial institutions at the time, AIG’s share price was affected by artificial collateral calls and mark-to-market losses, that there was a disrupted market, that there was a liquidity crisis that was affecting all financial institutions.” (Cragg: Trial Tr. 8727:12 – 8728:10; PTX 5522 (Cragg demonstrative)).¹³⁶

37.5.5 AIG and other market participants recognized that AIG’s stock price in early and mid-September 2008 did not reflect AIG’s intrinsic value.

(a) Willumstad: On September 8, 2008, AIG’s stock price was “trading meaningfully below its intrinsic value”. (Willumstad: Trial Tr. 6498:13-24).

(b) Citi on September 9, 2008: “Reiterate Buy – There are still options available to AIG, and the stock trades meaningfully below intrinsic value.” (PTX 40 at 1).

(c) On September 16, AIG executives estimated that AIG’s equity was worth \$67.6 billion, which was well in excess of the \$5 billion market capitalization implied by the September 16, 2008 opening price. (DX 1450 at 1, 3).

¹³⁶ Saunders did not “agree with Dr. Kothari’s opinion about AIG’s stock price not reflecting its intrinsic value on September 16th, 2008.” Saunders: Trial Tr. 8217:20-23. “I think the relevant metric on the 16th was \$1.85, based on the – and that in the investors’ belief about the intrinsic value of the firm”, and “on the 16th, the intrinsic value of the firm was \$1.85.” Saunders: Trial Tr. 8217:23 – 8218:8. But again, Saunders bases the assumption on the idea that the \$85 billion revolving credit facility was available to AIG as of the evening of September 16th. *See* Saunders: Trial Tr. 8218:9-17. Moreover, as Prof. Zingales pointed out, Prof. Saunders’ analysis does not work because “to assess what is there, Professor Saunders uses the market valuation at the time; however, the market does not assess what is there but what it expects to be there.” Zingales: Trial Tr. 8625:10 – 8626:2.

37.5.6 The market price of AIG stock on September 16, 2008 understated the fair value of AIG due to the market-wide panic that had an overwhelmingly negative impact on stock prices.

(a) Geithner: “If AIG had been forced to mark all its assets to their depressed market prices during a selling frenzy, then sure, it would’ve been insolvent. Just about every financial firm would’ve been insolvent. But we thought that once the crisis passed and asset prices once again reflected some notion of their true underlying value, there was a reasonable chance AIG’s assets would be worth more than its liabilities.” (PTX 709 at 222).

(b) On September 18, 2008, Defendant temporarily banned short selling on numerous institutions, including AIG, because it recognized that stock prices were dropping artificially based on the market-wide panic. (PTX 152; PTX 3209 at 5).

(i) The SEC on September 18, 2008: “The Commission is aware of the continued potential of sudden and excessive fluctuations of securities prices and disruption in the functioning of the securities markets that could threaten fair and orderly markets. . . . we are concerned about the possible unnecessary or artificial price movements based on unfounded rumors regarding the stability of financial institutions and other issuers we have become concerned about sudden and unexplained declines in the prices of securities. Such price declines can give rise to questions about the underlying financial condition of an issuer, which in turn can create a crisis of confidence without a fundamental underlying basis.” (PTX 152 at 1).

(ii) “there continues to exist the potential of sudden and excessive fluctuations of securities prices generally and disruption of the securities markets that could threaten fair and orderly markets.” (PTX 152 at 2).

(iii) “Our concerns, however, are no longer limited to just the financial institutions that were the subject of the July Emergency Order. Recent market conditions have made us concerned that short selling in the securities of a wider range of financial institutions may be causing sudden and excessive fluctuations of the prices of such securities in such a manner so as to threaten fair and orderly markets.” (PTX 3209 at 1).

37.5.7 Defendant’s experts did not consider or control for the fact that AIG’s market price as of September 16, 2008 did not reflect its intrinsic value.

(a) Dr. Saunders agreed that “other than looking at the price at which AIG’s stock was trading on September 16”, he did not “undertake any investigation or analysis to determine . . . the true value or fair market value of AIG’s common stock”. (Saunders: Trial Tr. 8416:17 – 8417:14).

37.6 Defendant Initially Paid Only \$500,000 In Loan Forgiveness For 79.9% Of AIG’s Shareholders’ Equity.

(a) The only payment made to AIG for AIG’s Series C Preferred Stock was \$500,000 in loan forgiveness that FRBNY provided to AIG in September 2008. (JX 107 at 37-38 (§ 4.02(e)), 137).

(b) Series C Stock Purchase Agreement: The Trust shall purchase the Series C stock from AIG “at the purchase price of \$500,000 (five hundred thousand dollars)”. (JX 185 at 2).

(c) FRBNY paid \$500,000 for the Series C Preferred Stock at the closing of the Credit Agreement (PTX 1635 at 1), for which it would be reimbursed by the Trust. (JX 185 at 2 (§ 2.1)).

(d) AIG recorded the fair value for the Series C as \$23 billion. (JX 188 at 293-94; Kothari: Trial Tr. 4700:10-25).

37.6.1 AIG acknowledged that paying \$500,000 for 79.9% of AIG was the same as essentially paying nothing.

(a) As AIG's Senior Vice President Brian Schreiber on January 13, 2010 told the AIG Board of Directors: The "Treasury Department's priority is the repayment of the Series E and Series F Preferred Stock, as the Series C was *essentially received for nothing*." (PTX 584 at 17 (emphasis added)).

(b) A presentation to the AIG Board of Directors by Bank of America and Citi on September 29, 2010: "Series C was received by UST for *no financial consideration*; merely to obtain governance rights until FRBNY Facility repaid". (PTX 609 at 86 (emphasis added); PTX 2248 at 35 (same)).

(c) In an April 2010 TARP Exit Proposal, AIG explained that the Series C should be cancelled for some consideration to the Treasury because the Series C was "Overly Punitive", constituting "a punitive measure granting the U.S. Government 79.8% ownership of AIG (at the time the FRBNY Facility was established) for *no additional monetary consideration*". (PTX 578 at 3 (emphasis added)). That same proposal explained that "U.S. Treasury considers Series C to have a *negligible value*". (PTX 578 at 7 (emphasis added)).

37.6.2 The Trust ultimately reimbursed FRBNY for the payment of the \$500,000 credit given to AIG after the Trust was created. (JX 107 at 37-38; PTX 1635 at 1; JX 388 at 2).

37.7 Although AIG Received Access To The Credit Facility As Part Of The Credit Agreement, AIG's Promise To Pay The Principal, Interest And Fees Associated With The Credit Facility More Than Compensated Defendant For The Risks Associated With Defendant's Loan, Even Without Counting The Value Of The 79.9% Equity And Voting Interests Acquired By Defendant. (Kothari: Trial Tr. 4876:19 – 4878:24).

(a) A present value analysis of the Credit Facility indicates that the fees, interest and principal repayments due fully and fairly compensated Defendant for its loan to AIG:

(i) Under a conservative present value analysis of the Credit Facility as of September 22, 2008, the fair value of the Credit Facility was \$88.151 billion, which is greater than the \$85 billion face value of the loan. (PTX 2853 at 45; *see also* Kothari: Trial Tr. 4877:20 – 4878:1 (when the present value is in excess of the face value of the loan “that means you are more than fairly compensated”)).

(ii) This present value analysis is understated because it uses a discount rate for unsecured debt, whereas the Credit Facility was fully secured. In other words, a discount rate based on secured debt would have resulted in an even *higher* present value than \$88.151 billion for the Credit Facility. (Kothari: Trial Tr. 4878:2-24).

37.8 Defendant Ultimately Sold Its 79.9% Equity Interest for the Depressed Price of \$18.3 Billion. (Kothari: Trial Tr. 4535:18-21; PTX 685 at 89-90; Mordecai: Trial Tr. 7762:22 – 7763:12 (discussing DX 1875 (Mordecai Report, Exhibit 13))).

37.8.1 Defendant reduced the value of the common stock it received in exchange for the Series C Preferred Stock by its decision to liquidate when and how it did.

(a) Kothari: Defendant had a choice as to when it liquidated the common stock it received in exchange for the Series C preferred stock. (Kothari: Trial Tr. 4539:12-15).

(i) The value of the common shares Defendant received in exchange for the Series C Preferred Stock on January 14, 2011, was \$24.3 billion. (Kothari: Trial Tr. 4534:8-17).

(ii) “If the government had chosen to liquidate at the end of 2013, it would have received approximately \$28 billion. And if it had waited till just this past September, I think the amount would have been about \$30 billion.” (Kothari: Trial Tr. 4539:16-25).

37.8.2 “Between fiscal years 2011 and 2013, the Department sold all of its 1.7 billion AIG common shares held by the General Fund and TARP together, on a pro-rata basis, in the open market.” (PTX 685 at 89).

37.8.3 From May 24, 2011 through December 14, 2012, Defendant sold 1,655,037,962 shares of AIG common stock at prices ranging from \$29 to \$32.50 per share for a total of \$51,610,497,475. (PTX 2852 at 65 n.197).

37.8.4 Assuming that the common shares received in exchange for Series C Preferred are treated as being sold pro rata with common shares received in exchange for Series E and F Preferred, the amount received for the common shares received in exchange for the Series C Preferred would be \$17.6 billion. (PTX 2852 at 65, n.197).

37.9 The Prices At Which Defendant Sold Its AIG Common Shares Were Reduced By The Damage Done To AIG's Business, Operations, And Assets As The Result Of Defendant's Control Over AIG.

37.9.1 Defendant reduced the value of AIG common shares by giving up value to counterparties through the ML II and ML III transactions. (*See supra* §§ 30.1.5, 30.1.6, 34.6).

37.9.2 Defendant reduced the value of AIG common shares by not negotiating discounts from ML III counterparties and by giving such counterparties 100% par value plus releases of claims that had substantial value to AIG. (*See* Baxter: Trial Tr. 1069:19 – 1071:16; Alvarez: Trial Tr. 342:12-23).

37.9.3 Defendant diluted the value of the common stock it received in exchange for its Series C Preferred Stock by using its control of AIG to exchange its Series E and Series F Preferred Stock for common stock at inflated values. (*See supra* § 30.2.5).

(a) Kothari: The amount Defendant received for its sales of AIG common shares “is understated as a result of the dilution” that occurred when Defendant exchanged Series E and F preferred stock, which was an exchange of less valued preferred shares for more valuable common shares, and caused all shares to suffer economic dilution as a result. (Kothari: Trial Tr. 4538:22– 4539:6).

(i) It is his understanding that “the common shares derived from the Series C preferred shares” were sold together with the TARP shares. (Kothari: Trial Tr. 4539:7-11).

(b) Although they were empowered to do so (*see* JX 172 at 12 (§ 2.05(a)(iv)), the Trustees “did not” obtain a fairness opinion for the exchange of the Series C preferred shares for common shares. (Langerman: Trial Tr. 7192:11-16; Feldberg: Trial Tr. 3355:4-6). The Trustees also did not “ever ask to see a copy of the fairness opinions” for the exchange of the Series E and F preferred shares for common shares produced by Citi and Bank of America. (Langerman: Trial Tr. 7299:1-13; *see also* Feldberg: Trial Tr. 3355:7-18 (having no recollection of either the Trustees or their advisors reviewing fairness opinions)).

(c) The Trustees never discussed with Treasury or the Federal Reserve what their “duties were to the minority shareholders”, nor is there any written record of advice received from the Trustees’ own lawyers. (Langerman: Trial Tr. 7214:2-15).

38.0

THE RIGHT TO EXCHANGE DEFENDANT’S SERIES C, E & F CONVERTIBLE VOTING PREFERRED STOCK FOR COMMON STOCK HAD ECONOMIC VALUE.

38.1 The Right to Approve the Conversion or Exchange of Defendant’s Preferred Shares into Common Stock, Embodied in Particular by the Right to Vote on Whether to Increase the Number of Authorized Shares, Was a Right Which AIG Shareholders Viewed as Important.

(a) Defendant’s expert, Prof. Saunders conceded that one “of the fundamental rights assigned to common stock is voting rights”. (Saunders: Trial Tr. 8378:2-4). The “value of a stock is the sum of the economic value of the underlying stock value plus the value of the voting right, and it’s hard to decompose.” (Saunders: Trial Tr. 8378:8-19).

(b) On November 4, 2008, an AIG shareholder filed a class-action complaint seeking “an order declaring that the Super Voting Preferred is not convertible into common stock absent a class vote by the common stock to increase the number of authorized common shares”. (PTX 344 at 6, ¶ 6).

(c) A week after the complaint was filed on November 10, 2008, AIG stated in its 3Q 2008 Form 10-Q filing: “After the Series C Preferred Stock is issued, AIG will be required to hold a special shareholders’ meeting to amend its restated certificate of incorporation to increase the number of authorized shares of common stock to 19 billion and to reduce the par value per share. The holders of the common stock will be entitled to vote as a class separate from the holders of the Series C Preferred Stock on these changes to AIG’s Restated Certificate of Incorporation.” (JX 150 at 28).

38.2 The Stock Split Class’s Right to Prevent Defendant from Increasing the Number of Authorized Common Shares Necessary to Exchange the Series C, E & F Preferred Stock for AIG Common Stock Had Economic Value.

(a) Kothari: “The reverse stock split enabled defendant to take shareholders’ right to block that dilution of their common shares” that would have resulted through an increase in authorized shares. Dr. Kothari’s damages calculations “value that right to block dilution of common shares.”¹³⁷ (Kothari: Trial Tr. 4593:15-20).

(b) Bradow: The 2009 Reverse Stock Split was necessary for the exchange in 2011 because it “left AIG with enough authorized but unissued shares to permit the exchange.” (Bradow: Trial Tr. 5852:16-25; *see also* PTX 5507 (Zingales demonstrative)).

38.2.1 As a result of the Reverse Stock Split, Defendant was later able to exchange its Series C Preferred Stock for 562,868,096 shares of AIG common stock, which were transferred

¹³⁷ While Saunders stated that Kothari’s valuation made “no economic sense” (DX 2759), he made no “effort to determine what the fair value of the Series E and F preferred stock was as of either June 30, 2009, or January 14th, 2011”. (Saunders: Trial Tr. 8253:21-24).

immediately by the Trust to the Treasury Department as part of the January 14, 2011 Recapitalization of AIG . (JX 314 at 3).

(a) Kothari: “In the absence of a reverse stock split that applied only to issued shares but not authorized shares,” there would not “have been enough existing authorized shares to do the exchange of preferred stock for common stock”. (Kothari: Trial Tr. 4596:24 – 4597:3; PTX 5222 (demonstrative)).

38.2.2 As a result of the Reverse Stock Split, Defendant was later able to exchange its Series E Shares for 924,546,133 shares of AIG common stock and some of its Series F Shares for 167,623,733 shares of AIG common stock as part of the Recapitalization of AIG on January 14, 2011. (JX 314 at 3).

(a) Schreiber: The Series E was “illiquid”, had “no sort of exchange or conversion features”, was a “perpetual zero-coupon capital instrument”, and as a result had “almost no value in the marketplace”. (Schreiber: Trial Tr. 6692:24 – 6693:4; *see also* Zingales: Trial Tr. 8610:14-22; PTX 5506 (Zingales demonstrative); PTX 5508 (demonstrative)).

(b) Saunders: The Reverse Stock Split was the only means of authorizing the number of shares needed to effectuate the exchange of the Series E and part of the Series F. (Saunders: Trial Tr. 8243:25 – 8244:6; *see also* 8243:7-11).¹³⁸

(c) Zingales: “The particular way in which the reverse stock split was done created enough authorized but not issued shares to make convertible not only the shares that – the

¹³⁸ Although Saunders testified that the Series C could have been monetized in ways that did not require payment of a liquidity premium to the common stockholders, he did not opine that any of the other approaches he suggested were legally permissible. (Saunders: Trial Tr. 8255:10-23).

preferred shares that the Defendant got in the credit facility of September 22nd, but also the Series E and F preferred.” (Zingales: Trial Tr. 3855:13-18).¹³⁹

38.3 Defendant Exchanged the Series C Preferred Shares for Common Stock Before Exchanging the Series E And F to Maximize the Total Amount of Common Stock Obtained by Defendant.

38.3.1 The conversion ratio for the Series C Preferred Stock was capped at 79.9%.

(a) The conversion ratio of the Series C Preferred Stock did not allow for the Government’s percentage ownership of outstanding AIG common stock to exceed 79.9% as a result of the conversion of the Series C Preferred Stock. (*See* JX 185 at 22 (§ 11), 30-31 (defining conversion ratio)).

(b) August 2010 presentation on “Summary of Preferred Stock and the Trust” to the AIG Government Repayment Committee by AIG outside counsel: The Series C Preferred Stock is entitled “to 79.8% minus all other shares owned by or to which the Department of the Treasury is entitled to receive upon conversion or exchange”. (JX 282 at 10).

(c) Board of Governors Attorney Steven Meyer to Alvarez: The formula for the percentage ownership represented by the Series C Preferred Stock “contains escape hatches so

¹³⁹ Although Saunders claims that redenominated preferred shares would be as liquid as common stock, Defendant has previously admitted that the eventual sale of its equity stake to the public would be “most likely if the equity, when it was being marketed, took the form of AIG common stock that could be purchased by any buyer, including general public buyers.” Def. Resp. to Pl. 2nd Interrogatories No. 2. Saunders’ opinion is also belied by the fact that he did not know the mechanics or legality of alternate means of monetizing the Series C stock (Saunders: Trial Tr. 8256:13-22) and did not investigate whether it “would have been legally permissible . . . to redenominate the Series C preferred shares into smaller par values”. Saunders Trial Tr. 8257:8 – 8258:7. Furthermore, an email chain produced as a result of Defendant’s deliberate privilege waiver during trial shows there were “certain potential complications with using the depository structure”, so much so that Davis Polk attorney John Brandow did “not believe that this should be an option that is presented to” FRBNY. PTX 3271 at 3. Nor would registering the Series C have yielded the same return; given the complexity of the capital structure and the instrument, it was not likely to “be appreciated by the market” or be valued as highly. Zingales: Trial Tr. 8671:6-12; *see also* Zingales: Trial Tr. 8674:15-17 (“So, I think that the answer is could you get some money? Sure. Could you get a decent amount of money? I doubt it.”).

that the government's overall voting and common stock interest **will stay the same**, even if more warrants are issued.” (PTX 3348 at 1 (emphasis added)).

(d) Zingales: Referring to the Series C, “there is an adjustment to ensure that if the Government achieve other equity before the moment of the conversion, it will never exceed 79.9 percent as a result of the conversion.” (Zingales: Trial Tr. 8602:16 – 8063:8; PTX 5502 (Zingales demonstrative)).

38.3.2 In its prior restructurings, Defendant honored the agreed-upon conversion ratio by reducing the percentage ownership represented by the Series C Preferred Stock to accommodate the issuance of warrants associated with the purchase of the Series D and Series F Preferred Stock.

(a) In the November 2008 restructuring, Defendant and AIG agreed that in “connection with the issuance of the Warrant, the number of shares into which the Series C Preferred Stock will be convertible will be reduced to 77.9 percent of the outstanding shares of Common Stock.” (JX 158 at 3; *see also* PTX 3291 at 1 (Alvarez to Bernanke: “In order to accommodate the requirement that the TARP get warrants, the 79.9% voting interest associated with the existing Treasury preferred will be reduced to 77.9% and the Treasury will take warrants convertible into 2% of the common voting shares.”)).

(b) In connection with the issuance of warrants associated with the Series F Preferred Stock, Treasury attorney Ronald Ferlazzo advised: “Please go with the de minimis warrants. You had drafted in 100 common per 1B preferred earlier, which is fine by us as long as it keeps the USG under 80 percent total.” (PTX 3340 at 1).

38.3.3 In the Recapitalization, Defendant ignored the contractual cap on conversion of the Series C.

(a) AIG's Peter Hancock on August 24, 2010, discussing a conversation with Treasury's Jim Millstein: "We are much further apart than I thought. He is still hung up on the C being worth 4 times the public float in addition to whatever E and F is exchanged." (JX 281 at 1).

(b) Zingales: "On conversion the Series C Preferred shares were entitled to a fixed number of common shares (566 million, or 3.9751244 times 142 million, including common shares related to equity units) **less warrants, common shares and exchangeable or convertible securities held by Defendant**. Consequently, if the Series E and F preferred shares were exchanged for common **before** the Series C exchange, the shares to which the Series C shares were entitled would be reduced by the number of shares received by Defendant for its Series E and Series F Preferred." (PTX 5502 (Zingales demonstrative) (emphasis added); Zingales: Trial Tr. 8602:22 – 8603:8 (explaining that the Stock Purchase Agreement included the 79.9% cap on ownership because Defendant "was afraid to be forced to consolidate AIG in the Fed balance sheet.")).

(c) If the United States had exchanged the Series E & F first, it would have held 1,092 shares of AIG common stock prior to converting the Series C. (PTX 5503-5504). The fixed number of common shares into which the Series C would then be convertible (566 million less 1,092 billion common shares held by Defendant) would be zero. (PTX 5504).

(d) Using the 1,092 billion shares already converted by exchanging the Series E & F before the Series C "at most would have led to an 88.5" percent ownership, "assuming that the Series E and F were exchanged pursuant to the Recapitalization Plan at \$45 per share divided

into the Series E and F full liquidation value.” (Zingales: Trial Tr. 8601:3 – 8608:9; PTX 5501; *see also* PTX 5502 – PTX 5504 (Zingales demonstratives)).¹⁴⁰

(e) Instead, Defendant was able to exchange its Series C preferred stock for 563 million shares of AIG common stock. Adding that amount to the common shares exchanged for the Series E and F, Defendant ended up owning 92.1 percent of AIG’s common shares as “the result of the recapitalization as it was done.” (Zingales: Trial Tr. 8603:9 – 8606:18, 8608:3-7).

(f) This additional stock was never contemplated by the contractual formula. (Zingales: Trial Tr. 8602:4-6).

38.3.4 Defendant was only able to circumvent the contractual cap on its ownership through its control of AIG. (*See also supra* § 33.0).

(a) Zingales: These calculations are “very significant, because the Government could not have converted Class E and Class F without the reverse stock split, and – or with a shareholders vote that – separate by class, so with common voting separately, which probably not would take place, because Plaintiff had a significant stake in that. So, it shows two things: It shows how crucial it was for the Government to have voting control of AIG during this period Number two, the fact that it was used to favor the Government at the expense of AIG’s shareholders, in the sense that the management of AIG told Citigroup that was evaluating the

¹⁴⁰ However, even this 88.5 percent ownership stake would have been greater than the ownership stake Defendant would have received had it exchanged the Series E and F by using the fair market value of the shares, as measured by the Department of the Treasury, rather than the full liquidation value: if it had used the fair market value instead, it would have ended up with only 80.3 percent of AIG. Thus, as Prof. Zingales explained, the 88.5% ownership stake “was not guaranteed,” as “the Government itself valued in some documents the Class E and F as at fair market value, much below liquidation value. The liquidation value was 49.1 [billion], and, in fact, the fair value, as estimated by the Government, is only 26.1 [billion].” Zingales: Trial Tr. 8608:10-20. “[I]f we use the 26.1 number rather than the 49.1, . . . the result is that the Government would receive 80.3 percent of AIG common stock.” Zingales: Trial Tr. 8608:22 – 8609:2 (discussing demonstrative PTX 5505).

fairness of the recapitalization to maintain that the value of the Class E and F should be computed at the liquidation preference. . . . I think this shows that control is valuable, that the Government actually pursued control and used it to the detriment of AIG's shareholders." (Zingales: Trial Tr. 8609:3-8610:6; Zingales: Trial Tr. 8614:14-21 ("because control is nonlinear, . . . if you have 51 percent of the votes, you get more than 51 percent of control, you get all control").

(b) Zingales: "This was by all means a related-party transaction, because the Government had the majority of the stock", had "influence upon the CEO and influenced the board", and yet "the Government was also counterparty." The common shareholders, on the other hand, "were not at the table discussing and bargaining. So, this was not an arm's length transaction at all." (Zingales: Trial Tr. 8688:16-24).

(c) Daines: "as a matter of good corporate governance, in a transaction between a majority shareholder and the firm, the transaction should be judged by the entire fairness doctrine." (Daines: Trial Tr. 8521:16-19). The "relevant question in an entire fairness transaction is not whether the transaction was potentially beneficial to the firm, but whether the price and process adopted were, in the end, entirely fair to minority shareholders." (Daines: Trial Tr. 8522:17-8523:5).¹⁴¹

¹⁴¹ Both Langerman and Schreiber proffered testimony that conflicted with the evidence that was presented at trial. Langerman asserted that the Trustees treated minority shareholders fairly and, indeed, the minority shareholders may have been treated better than the Trust. *See* Langerman Trial Tr. 7203:17-19; 7203:4-16; 7187:1-16; 7203:21-23 ("the minority got what the majority got plus on top of thought [*sic*]; They did better than we did."). The Trustees concede that although empowered to, the Trustees did not obtain a fairness opinion on the recapitalization (Langerman: Trial Tr. 7192:11-16; Feldberg: Trial Tr. 3355:4-6); they never asked to see a copy of the fairness opinions for the Series E & F shares, (Langerman: Trial Tr. 7299:11-13; *see also* Feldberg: Trial Tr. 3355:7-18 (having no recollection of either the Trustees or their advisors reviewing fairness opinions)); and they never discussed with Treasury or the Federal Reserve what their "duties were to the minority shareholders", nor is there any written record of advice

(d) Neither AIG nor Defendant obtained a fairness opinion concerning the exchange of the Series C Preferred Stock. (Def. Resp. to Pl. 2nd RFAs No. 1121; JX 307 at 6).¹⁴²

received from the Trustees' own lawyers. Langerman: Trial Tr. 7214:2-15. Moreover, neither Langerman nor any other Defendant witness explained how Defendant got around the contractual cap on ownership.

Schreiber testified that someone in the government (he could not recall who) took the position that Defendant's exchange of the Series C before the Series E and F constituted a concession because it would have received 99 percent of AIG if the Series E and F had been exchanged before the Series C. (Schreiber: Trial Tr. 6681:8-24, 6768:13 – 6768:20, 6683:1-7). Both these assertions are false. Schreiber understood "that there was a Series C preferred stock purchase agreement and a Series C certificate of designation." (Schreiber: Trial Tr. 6767:11-15). He also understood "that those documents would define what shares of common stock the Series C preferred stock would be entitled to and under what circumstances." (Schreiber: Trial Tr. 6767:16-21). However, he doesn't recall ever reviewing "what common shares the Series C preferred stock were entitled to under the purchase agreement and the Series C certificate of designation." (Schreiber: Trial Tr. 6767:22 – 6768:2). After the reverse stock split, minority shareholders already owned 3% of all outstanding stock, so Defendant's total holdings could not exceed 97%. (See PTX 5222 ("AIG's 20:1 reverse stock split decreased the percentage of authorized shares that were already issued from 60% to 3%)). After reviewing various provisions of the Series C Purchase Agreement (JX 185 at 22), Schreiber was unable to answer whether he could confirm his testimony that the Defendant would have received more shares if Series E & F had been exchanged before Series C or, rather, Defendant would actually have received less. (Schreiber: Trial Tr. 6774:20 – 6776:17).

¹⁴² Although AIG's "Government Repayment Committee did not deem it necessary to receive a fairness opinion regarding" the exchange of the Series C Preferred Stock "because the number of shares of AIG Common Stock received by the Trust for the Series C Preferred Stock was derived from a previously agreed upon formula" for the conversion (rather than the exchange) of the Series C (JX 307 at 6), as explained above, there are questions as to whether the conversion ratio relied on by AIG permitted Defendant's total percentage ownership to exceed 79.9% (a point which AIG itself argued during the negotiations). See PTX 578 at 3 ("To avoid consolidating AIG results, the UST cannot own greater than 80% of AIG common stock"); Schreiber: Trial Tr. 6673:14 – 6674:22. Moreover, as explained above (*see supra* § 38.3.3), even if the formula is applied correctly, Defendant's total holdings based on the conversion of the Series E and F before the Series C Preferred Stock should not have exceeded 88.5%, and thus it says nothing about the fairness of structuring the exchange of the Series C Preferred Stock to allow Defendant to hold 92% of AIG's common stock.

39.0

**THE FAIR VALUE OF THE RIGHT TO EXCHANGE
DEFENDANT'S SERIES C VOTING PREFERRED STOCK
FOR COMMON STOCK PER THE REVERSE STOCK
SPLIT WAS A MINIMUM OF APPROXIMATELY \$339
MILLION.**

39.1 The Value Of The Series C Reverse Stock Split Claim Is “Based On The Payment That The Government Would Have Made To AIG Shareholders To Increase The Number Of Authorized Shares, Which Is In Turn Based On The Value Of The Benefit That The Government Would Receive From Converting Its Illiquid Series C Preferred Stock Into More Liquid AIG Common Stock.” (PTX 2852 at 89, ¶ 124).

(a) Kothari: “The reverse stock split enabled defendant to take shareholders’ right to block that dilution of their common shares” that resulted through an increase in authorized shares. (Kothari: Trial Tr. 4593:15-19). Kothari values “that right to block dilution of common shares.” (Kothari: Trial Tr. 4593:19-20).

39.1.1 Instead, by using the reverse stock split to circumvent common shareholders’ right to vote, Defendant was able to exchange “less liquid preferred shares into more liquid, more valuable common shares” without paying for that benefit. (Kothari: Trial Tr. 4601:21 – 4602:24).

(a) Farnan: From the standpoint of the holder of either preferred stock or warrants, it was desirable to be able to convert into common stock “to be able to have optionality to own the company. Or stock of the company.” (Farnan: Trial Tr. 4186:12-18). In addition, common stock “would be more liquid than the preferred shares” and “generally in most markets there’s a higher value to something that’s liquid than something that’s not liquid.” (Farnan: Trial Tr. 4186:19 – 4187:7).

(b) PwC in January 2009: “We acknowledge that because the conversion rights are not guaranteed the preferred shares are dissimilar from the common shares in that there is no available market to dispose of such shares (liquidity).” (PTX 444 at 7; *see also* Farnan: Trial Tr.

4347:6-13; JX 185 at 4 (The Series C Preferred Stock was not “registered under the Securities Act or under any U.S. federal or state securities laws”).

39.1.2 The value of the payment Defendant would have had to make to AIG’s common shareholders to induce them to vote to increase the number of authorized shares to enable the conversion or exchange of the Series C Preferred Stock is at least \$339 million.

(a) In calculating the damage to the Stock Split Class, Kothari first determined the market value of Defendant’s Series C Preferred Interest as of June 30, 2009 by multiplying AIG’s June 30, 2009 closing stock price (\$1.16) by the number of Defendant’s Series C Preferred Shares (in common share equivalents) (11.680 billion). The total value of Defendant’s Series C Preferred Interest as of June 30, 2009 equals \$13.549 billion. (Kothari: Trial Tr. 4597:16 – 4598:2, 4598:21-25; PTX 5223 (Kothari demonstrative)).

(b) Because Defendant’s Series C Preferred Stock was not as liquid as AIG common stock, Kothari applied a liquidity discount of 5% to the “aggregate valuation of \$13.549 billion” in order to determine the value of the “benefit received by the defendant by exchanging less liquid preferred shares for highly liquid common shares of AIG.” The value of that benefit is \$677 million. (Kothari: Trial Tr. 4598:5-19; PTX 5223 (Kothari demonstrative)).¹⁴³

(c) Kothari then applied a 50% bargaining outcome to the \$677 million benefit taken by Defendant to reflect the fact that AIG common shareholders had the right to deny that benefit. (Kothari: Trial Tr. 4602:10-16; PTX 5223; *see also* Kothari: Trial Tr. 4602:4-9 (“Now, if the government were to have acknowledged that right of the shareholders to block that, then it would have been a situation where the government could have paid an inducement to common

¹⁴³ A 5% liquidity discount is a “conservative estimate” based on academic literature and Kothari’s own analysis of restricted stock studies. Kothari: Trial Tr. 4599:7-4600:10; *see also* PTX 2852 at 89-94, ¶¶ 132-45.

shareholders to allow an increase in authorized shares so that Series C preferred can be converted into or exchanged for common.”)).

(d) After applying the 50% bargaining outcome, the value of the Stock Split Claims with respect to the Series C is approximately \$339 million. (Kothari: Trial Tr. 4602:14-16; PTX 5223).¹⁴⁴

40.0

THE FAIR VALUE OF THE RIGHT TO EXCHANGE DEFENDANT’S NON-CONVERTIBLE, NON-VOTING SERIES E AND SERIES F PREFERRED STOCK FOR AIG COMMON STOCK PER THE REVERSE STOCK SPLIT WAS A MINIMUM OF APPROXIMATELY \$4.33 BILLION.

40.1 The Value of the Series E and Series F Stock Split Claims Is a Minimum of \$4.33 Billion.

(a) Kothari: The value of the Series E and Series F Stock Split Claims is based on the fact that the “reverse stock split enabled the Government to receive common stock that had a value that was billions of dollars higher than the value of Series E and F Preferred Stock that was exchanged. This exchange directly diluted the common shareholders and reduced the value of

¹⁴⁴ Mordecai opined that Kothari’s estimate of the alleged harm suffered by the Stock Split Class is fundamentally flawed because the damages to the Stock Split Class exceed the value of AIG’s stock price as of the date of the reverse stock split. *See* Mordecai: Trial Tr. 7576:2 – 7577:2 (“What they had was stock worth something in the neighborhood of at most \$1.47 per share, as little as \$1.28 per share. But he’s claiming they lost \$1.73. He’s claiming they lost more than they had.”); DX 2601; DX 2631. However, Mordecai did not examine whether the exchange of Series C, E and F could have been done without the reverse stock split. Mordecai Trial Tr. 7599:21 – 7602:3. Mordecai was largely unable to describe the liquidation value of Series E & F vis-à-vis the Exchange (Mordecai Trial Tr. 7632:13 – 7643:9); did not know whether Series E and F “are specifically TARP related” (Mordecai Trial Tr. 7647:24 – 7648:5); did not “try to estimate the value of the Series E and F preferred stock prior to the recap” (Mordecai: Trial Tr. 7797:15-18); and did not have any understanding “as to what the estimates of value of the Series E and F preferred stock were by the Government itself prior to the recapitalization.” Mordecai: Trial Tr. 7805:9-11.

their equity interest in AIG.” The value of this right is a minimum of \$4.33 billion. (PTX 2852 at 79, ¶ 111; Kothari: Trial Tr. 4594:10-18, 4780:14 – 4781:9).

(b) Kothari: “the source of economic dilution from the exchange of Series E and F preferred into common shares arose because the fair value of Series E and F preferred shares was about 23.5 billion less than the liquidation preference value of those shares.” (Kothari: Trial Tr. 4603:17 – 4604:1; *see also* PTX 5224 (demonstrative); Kothari: Trial Tr. 4604:2-19 (explaining that Defendant had no right to exchange its preferred stock into common stock at liquidation preference – the shares were “not puttable” – meaning that “in an arm’s length transaction you will only receive fair value”)).

(c) To calculate the fair value of the Series E and F Preferred Stock, Kothari relied upon a valuation of the Series D Preferred Stock (the predecessor to the Series E) done by Duff & Phelps for the Government’s Congressional Oversight Panel as of November 10, 2008.¹⁴⁵ (Kothari: Trial Tr. 4607:11-23; PTX 422 at 14).

(i) Duff & Phelps determined that the fair value of the Series D was equal to approximately 36% to 38% of the liquidation preference of that security, or 39% to 42% without accounting for a 5 to 10% discount for reduced marketability. (Kothari: Trial Tr. 4607:24 – 4609:6; PTX 422 at 21-22).

(ii) Kothari applied the highest percentage – 42% – to the liquidation preference of the Series E and F Preferred Stock to estimate the fair value of those securities.

¹⁴⁵ Kothari relied upon the Duff & Phelps valuation of the Series D Preferred Stock for two reasons: 1) “because it is the last valuation of the Government’s preferred stock in AIG issued under TARP before June 30, 2009”; and 2) because “Duff & Phelps valued the predecessor to the Series E Preferred Stock, the Series D Preferred Stock” which was more valuable than the Series E Preferred Stock because “the Series D Preferred Stock had a cumulative dividend preference while the Series E Preferred Stock did not . . . thus, my valuation is conservative.” PTX 2852 ¶ 112, at 80-81 (Kothari Expert Report).

(Kothari: Trial Tr. 4607:24 – 4609:6; *see also* Kothari: Trial Tr. 4609:7-15 (if Kothari had applied the lower percentage of 36% to 38%, the estimated fair value of the Series E and F would have been lower, resulting in a higher valuation for the Series E and F Stock Split Claims)). 42% percent of the liquidation preference of the Series E and F Preferred Stock of \$41.150 billion results in a fair value of approximately \$17.6 billion. (Kothari: Trial Tr. 4609:16-20).

(iii) Accordingly, by exchanging the Series E and F Preferred Stock for common stock, Defendant was able to receive common stock that was \$23.5 billion more valuable than the fair value of those preferred shares. (PTX 5224 (Kothari demonstrative calculating the difference between the liquidation preference of the Series E and F Preferred Stock of \$41.150 billion and the fair value of the Series E and F Preferred Stock of \$17.6 billion, which equals \$23.547 billion)).

(d) The damage to the Stock Split Class with respect to the Series E and F Preferred Stock is calculated as follows:

(i) As described above, Kothari first calculated the liquidation preference in excess of fair value acquired by Defendant of \$23.547 billion. (PTX 5225 (Kothari demonstrative summarizing damage calculation); *see also* PTX 5224 (calculating the liquidation preference in excess of fair value)).

(ii) The value of \$23.547 billion is then multiplied by 20% to obtain the value taken by Defendant from the remaining shareholders, and is then further adjusted to exclude the equity unit holders. (Kothari: Trial Tr. 4615:19 – 4617:9; PTX 5225).

(iii) After the adjustments, the value of the Stock Split Claims with respect to the Series E and F Preferred Stock equals \$4.329 billion as of June 30, 2009. (Kothari: Trial Tr. 4594:10-12; PTX 5225).

(e) Kothari: The value of the right that was taken away from common shareholders to block the dilution as a result of “the Series E and F exchange” is \$4.329 billion. (Kothari: Trial Tr. 4594:10-12; PTX 5221 (Kothari demonstrative)).¹⁴⁶

40.1.1 The fair value of the Series E and F Preferred Stock was significantly below their liquidation preferences.

(a) Consistent with Dr. Kothari’s valuation, Defendant reported that the Series E and F was worth tens of billions less than the outstanding balance of the loan.

(i) Defendant reported that, as of September 30, 2009, the Series E and F were worth \$13.2 billion, even though the then-outstanding balance of the loan was \$43.2 billion. (PTX 622 at 19).

(ii) Defendant reported that, as of September 30, 2010, the Series E and F were worth \$26.1 billion, even though the then-outstanding balance of the loan was \$47.6 billion. (PTX 622 at 19).

¹⁴⁶ There is no dispute that the value of the Series E and F shares on the day they were obtained were worth less than the \$40 billion TARP capital injection. *See* PTX 622 at 19 (Dept. of Treasury Office of Financial Stability Agency Financial Report for Fiscal Year 2010: “Estimated Value of Investment as of September 30, 2010” listed as \$26.1 billion, compared to \$47.6 “Outstanding Balance as of September 30, 2010); Langerman: Trial Tr. 7291:16 – 7292:10 (acknowledging that the outstanding balance in PTX 622 is “amount that they put in or the so-called liquidation value.”); Kothari: Trial Tr. 4801:3-7. Part of a normal capital injection process, however, is accepting the risk that the stock received in exchange could ultimately be worth more or less than the value initially invested. *See* Alvarez: Trial Tr. 455:10-23 (“An injection of capital is typically taking a direct speculative position in the company where you provide funds to the company without the expectation of being repaid for those funds by that company. It is an injection into the company as a way of sharing in the profits and sometimes the losses of the company itself.”).

(b) Although he did not conduct his own valuation, Defendant's expert, Dr. Anthony Saunders, conceded that preferred stock with the characteristics of the Series E and F would generally trade below their liquidation preferences. (Saunders: Trial Tr. 8248:5 – 8250:12, 8253:1-24; *see also* Saunders: Trial Tr. 8246:12-16 (“Unless the company calls the shares in, the Series E and F stock is going to have a fair market value of less than its liquidation value”); *id.* at 8250:4-12 (the fair value would be expected to be lower than the liquidation value “regardless of whether the company was solvent or not”).

(c) Zingales: “In the process of converting, the Government took the face value of this preferred, the liquidation value So, by doing that, by the very government calculation, the Government basically benefitted almost \$20 billion in this transaction.” (Zingales: Trial Tr. 3855:8 – 3856:2 (discussing PTX 5069, a Zingales demonstrative showing the \$21.4 billion difference between Defendant's reported fair value of the Series E and F and their liquidation preference)).

(d) Zingales: “as a matter of economics, if you have preferred stock that is noncumulative” the liquidation preference will “not as a general term” equal the fair value of the stock. (Zingales: Trial Tr. 3856:23 – 3857:6).

40.2 AIG Received Fairness Opinions for the Exchange of the Series E and F Preferred Shares, but Those Opinions Tautologically Assumed That the Fair Value Was Equal to the Liquidation Value. (JX 284 at 3; JX 307 at 217).

(a) AIG received fairness opinions from Bank of America and Citi with regard to the exchange of the Series E and Series F Preferred Stock for common stock (*see* JX 307 at 6); however, at AIG's instruction, each fairness opinion recites that in forming their opinions, the banks were asked by AIG to assume that the fair value of each of the Series E Preferred Stock and Series F Preferred Stock is equal to the liquidation value thereof, or \$41.6 billion and \$7.5 billion, respectively. (JX 284 at 3; JX 307 at 215, 217; PTX 2248 at 7).

(b) Schreiber: Despite knowing that what Defendant “was reporting at that time as the fair value of the Series E preferred stock was substantially below its liquidation value” and that “the Series E preferred stock was an instrument that would have almost no value in the marketplace”, Schreiber “gave Citi and Bank of America instructions that rather than them trying to figure out what the fair value was, they should assume that the fair value of the Series E stock was equal to its liquidation value”. (Schreiber: Trial Tr. 6735:25 – 6736:16).¹⁴⁷

(c) Zingales: “if you’re giving a fairness opinion that is composed of multiple aspects and one aspect is unfairly sort of valued, then the entire fairness opinion falls apart.” (Zingales: Trial Tr. 8653:5-16).

40.2.1 The fact that the Series E and F were exchanged for their liquidation value rather than market value is evidence of Defendant’s control over AIG.

(a) Zingales: Concerning the Series E and F exchange, “And this shows the importance of control, because whoever is in charge calls the shots and is able to make those decisions, and this decision made by AIG management was very detrimental to the common shareholders of AIG.” (Zingales: Trial Tr. 8611:16 – 8612:3). “This is evidence that control is very valuable. The Government would not have been able to convert a class of shares, like Class E and F, that were worth, by its own words, only 26.1 billion, convert into liquid stock worth, de facto, 49.1 billion. So, the Government was able to appropriate a large amount of money just

¹⁴⁷Schreiber testified that a fairness opinion was not necessary for the recapitalization. Schreiber: Trial Tr. 6701:18 – 6702:9. Even Defendant’s expert Robert Daines acknowledged that “transactions between a control shareholder and the firm pose a high risk to minority shareholders” (Daines: Trial Tr. 8520:10-15), which is exactly why one would get a fairness opinion. *See* Pl. Prop. Concl. § 10.4-10.5; *see also* PTX 2850 at 59 (Zingales Expert Report: “Naturally, an exchange based on an overvaluation of the Government’s Series E and F Preferred Stock was not in the best interest of AIG’s common shareholders and thus, it would not have occurred in this way had the Government not had effective economic control of AIG.”).

because it was in control. Had it not been in control, it would not have been able to do that.” (Zingales: Trial Tr. 8616:23 – 8617:5 (discussing PTX 5513 (Zingales demonstrative))).

41.0

PREJUDGMENT INTEREST SHOULD BE AWARDED AT A COMPOUNDED AND ANNUALIZED RATE OF 7% FOR THE CREDIT AGREEMENT CLASS AND 20.1% FOR THE REVERSE STOCK SPLIT CLASS. (WAZZAN: TRIAL TR. 4442:18 – 4443:1; PTX 2841; PTX 2854 AT 16 (WAZZAN REPORT ¶ 28)).

41.1 Prejudgment Interest in a Takings Case Is an Element of Just Compensation, Required in Order to Put AIG Common Shareholders in the Same “Financial or Pecuniary Position That He or She Would Have Occupied Had a Payment Coincided with the Taking.” (Wazzan: Trial Tr. 4421:1-7; *see also* Neuberger: Trial Tr. 5603:21-25).

41.2 The “Appropriate Prejudgment Interest Rate in This Matter Is Best Determined By the Return on a Synthetic Portfolio Comprised of” Dow Jones “Industry Indices Representative of AIG’s Operations.” (PTX 2854 at 20, ¶ 37; *see also id.* at 14-16, ¶¶ 26-28).

41.2.1 Had Plaintiffs been compensated at the time of the takings, they would have sought to reinvest the sums received in investments similar to AIG common stock.

(a) Wazzan: Because Plaintiffs were “all invested in AIG stock”, it is “reasonable to assume that they would have taken the cash and tried to replicate that holding” in their portfolios. (Wazzan: Trial Tr. 4423:8 – 4424:11).

(b) Wazzan: “portfolio theory tells us that investors hold efficient portfolios, and what this means is for a given level of risk, they attempt to maximize return, and for a given level of expected return, they attempt to minimize the risk, and they do this by holding diversified portfolios of assets. So, someone who holds a portfolio of assets, one of those assets is AIG. If that asset is displaced, it’s natural that these investors would try to replace that asset and get back to, you know, an efficient portfolio.” (Wazzan: Trial Tr. 4424:1-11; *see also* PTX 2854 at 9-11, ¶¶ 18-21; PTX 2855 at 3-4, ¶ 4).

(c) Defendant’s prejudgment interest expert, Dr. Neuberger: “an efficient portfolio is one that offers the highest expected rate of return for a particular level of risk.” (Neuberger: Trial Tr. 5617:12-19; *see also* Neuberger: Trial Tr. 5617:20 – 5618:2 (agreeing that “under modern portfolio theory, investors place themselves into portfolios that reflect an efficient or optimal balance of risk and return characteristics”)).

(d) Wazzan: The portfolio approach is “consistent with the prudent investor rule” (Wazzan: Trial Tr. 4433:13-16) used by some courts, which “asks ‘how a reasonably prudent person would have invested the funds’” recovered as just compensation “‘to produce a reasonable return while maintaining safety of principal.’” (PTX 2855 at 7, ¶ 12 (quoting *Tulare Lake Basin Water Storage Dist. v. United States*, 61 Fed. Cl. 624, 626 (2004)); *see also* Wazzan: Trial Tr. 4433:7-12).¹⁴⁸

41.2.2 To determine what the Plaintiffs would have done had they received cash compensation at the time of the takings, Wazzan created “four portfolios,” which are “four ways” Wazzan thinks “are appropriate for someone to replicate an AIG asset”. (Wazzan: Trial Tr. 4424:24 – 4425:5).

¹⁴⁸ Neuberger’s methodology—the equivalent of a coerced loan to the government—would not meet the objectives of a rational, prudent investor, because his theory supposes that Plaintiffs would make a loan to the Government notwithstanding their financial condition or ability to gain a better return from an alternative investment. For example, a person with outstanding debt at a high interest rate would not lend to a third party at less than 1%, the current Treasury bill yields. PTX 2854 at 17-18, ¶¶ 29-32; *see also* Neuberger: Trial Tr. 5635:25 – 5636:5 (unpersuasively testifying that “a class member with a \$1,000 award would be indifferent as to receiving a thousand dollars on September 22nd, 2008, as opposed to \$1,024 at December 31st, 2013, 5 ¼ years later”). Neuberger also conceded that his recommended approach was inconsistent with the analysis in several takings cases that awarded prejudgment interest (*see* Neuberger: Trial Tr. 5610:9-24 (as to *Tulare Lake*); Neuberger: Trial Tr. 5611:2-9 (as to *Biery*); Neuberger: Trial Tr. 5611:19 – 5615:16 (as to *Otay Mesa*)), and that he did not know of any takings case dealing with prejudgment interest that identified any of the four factors he identified as the proper components of prejudgment interest or that discussed a “risk-free rate of return.” Neuberger: Trial Tr. 5615:17 – 5616:15; DX 2402 (Neuberger demonstrative identifying the four factors).

(a) Synthetic portfolios “are commonly used to control for a common set of risk/return characteristics when calculating expected returns for subject companies.” (PTX 2855 at 15, ¶ 29).

(b) Wazzan used multiple portfolios to give him “a level of confidence that” he was not “finding some strange result” or “a one-off.” (Wazzan: Trial Tr. 4429:21 – 4430:8).¹⁴⁹

(c) Wazzan’s synthetic portfolios contained firms which “a) AIG lists in its SEC filings as peers; b) AIG lists in its financial models as peers; and c) have the same Standard Industrial Classification (“SIC”) codes as AIG.” The fourth portfolio included “exchange-listed indexes,” meaning Dow Jones indices, “in the same industry sectors in which AIG operates.” (PTX 2854 at 11, ¶ 21).

(d) Wazzan calculated “a rate of return for each of the four portfolios that” he “constructed.” (Wazzan: Trial Tr. 4425:6 – 4426:7).¹⁵⁰

(i) For the synthetic portfolio based on the Dow Jones exchange-listed indices,

Wazzan calculated the annualized return based on a “weighted average” of several Dow

¹⁴⁹ Although Neuberger asserted that the synthetic portfolios “don’t act similar” to AIG common stock “in the post-takings period” (Neuberger: Trial Tr. 5589:10-21; *see also* DX 1881, Ex. 5 (Neuberger demonstrative showing daily prices for AIG and various Dow Jones indices)), Neuberger does not account for the fact that the value of AIG’s common stock post-takings was adversely affected by the takings themselves and by Defendant’s subsequent actions. *See* Wazzan: Trial Tr. 4457:22 – 4458:9 (“I satisfied myself that AIG was not being run as a profit-maximizing firm, and, therefore, I didn’t think it was appropriate to put the cash back into AIG in this context.”).

¹⁵⁰ Neuberger contends that the synthetic portfolios are a poor proxy for AIG because Wazzan’s opening report did not analyze the correlation between AIG’s performance and Wazzan’s synthetic portfolios in 2008. Neuberger: Trial Tr. 5598:4 – 5599:23 (Wazzan “stopped looking at the beginning of January 2008”). However, Wazzan explained that he “left out 2008” in considering AIG’s revenues in his report because he “didn’t have full-year data as of the time of the first taking” (Wazzan: Trial Tr. 4467:4-17), and his rebuttal report, which updated his correlation summary to use data from 2008—“a short time period with high market volatility” (PTX 2855 at 15, ¶ 31 and 21 (Ex. 3))—concluded that the updated data did not have “much of an impact at all.” Wazzan: Trial Tr. 4479:14 – 4480:20.

Jones indices “that correspond to the lines of business that AIG is in,” *i.e.*, the “Dow Jones Life Index, the Dow Jones Nonlife Index, and the Dow Jones Financial Services Index.” (Wazzan: Trial Tr. 4427:13 – 4428:7; *see also* PTX 2854 at 14-16, ¶¶ 26-27).

(ii) To convert an index to an annual return, “you can just observe the market price at a starting point, and then you can move forward in time and find the market price at an end date, and then you just compute the percentage change between the starting price and the ending price, and that generates a return for the entire period. And then you can take that return and annualize it”. (Wazzan: Trial Tr. 4426:19 – 4427:5).

41.2.3 The Dow Jones indices portfolio most closely tracked AIG’s operations.

(a) Wazzan concluded that although “all four are good in that these are based on sort of standard, accepted methodologies . . . the Dow Jones indices average most closely tracked AIG.” (Wazzan: Trial Tr. 4432:14 – 4433:3).

41.2.4 For the Dow Jones indices average, Wazzan calculated an annualized return of 7 percent for the 2008 taking and 20.1 percent for the 2009 taking. (Wazzan: Trial Tr. 4442:18 – 4443:1; PTX 2841).

(a) The Dow Jones portfolio was conservative relative to the other portfolios in that it produced the lowest interest rate for the reverse stock split class taking, and close to the lowest interest rate for the credit agreement class taking. (PTX 2854 at 16 n.39; PTX 2841 (Wazzan demonstrative showing that the other three synthetic portfolios produced a range of 6.9% to 9.0% for the 09/22/08 taking, and a range of 21.5% to 24.8% for the 06/30/09 taking)).

(b) The prejudgment interest rate resulting from Wazzan’s calculations is larger for the June 2009 taking than for the September 2008 taking because “The stock market was lower in June of 2009 than it was in September of 2008.” (Wazzan: Trial Tr. 4431:7-23).

41.3 The Methodology for Calculating Prejudgment Interest Should Be Independent of the Date the Takings Occurred.

(a) Wazzan's methodology is "independent of the date on which the takings occurred" and accounts "for the length of time between the takings and the judgment". (Wazzan: Trial Tr. 4422:8-16).¹⁵¹

41.4 Plaintiffs' and Defendant's Experts Agree That the Interest Should Be Compounded.

(a) Both Wazzan and Neuberger agree that compounding is appropriate. (Wazzan: Trial Tr. 4443:14-21; Neuberger: Trial Tr. 5627:4-6).

41.5 The Synthetic Portfolio Method Is More Appropriate Than Other Methodologies Considered for Calculating an Appropriate Prejudgment Interest Rate.

(a) The rates for the other equity indices Wazzan considered and the synthetic portfolios "are very close." (Wazzan: Trial Tr. 4435:24 – 4436:3).

(b) Wazzan considered other equity indices because "the subject of the taking here is stock" and "equity." (Wazzan: Trial Tr. 4433:17 – 4435:7; *see also* PTX 2842).

(i) For the S&P 500 index, Wazzan calculated an annualized return of 10.8 percent for the 2008 taking and a 19.3 percent return for the 2009 taking. (Wazzan: Trial Tr. 4435:16-21). And, for the Wilshire 5000 Index, Wazzan calculated an annualized return of 9.2 percent for the 2008 taking and 17.8 percent for the 2009 taking. (Wazzan: Trial Tr. 4435:21-23).¹⁵²

¹⁵¹ Wazzan's analysis uses December 31, 2013 as the end date because that was the most recent data available when he prepared his reports. (Wazzan: Trial Tr. 4427:6-12). However, the end date for the calculation should be the date that the judgment is issued. (Wazzan: Trial Tr. 4442:7-13).

¹⁵² The S&P 500 is an equity index relying on 500 publicly traded companies grouped by Standard & Poor's. Wazzan: Trial Tr. 4438:8-14. The Wilshire 5000 is an index of roughly 6500 publicly traded firms. Wazzan: Trial Tr. 4434:15-23.

(c) Moody's AAA long-term bond rate: Wazzan calculated a bond rate using Moody's AAA long-term bond rate of "about 5 to 6 percent for both of the takings." (Wazzan: Trial Tr. 4436:4-20). The Moody's AAA long-term bond rate was not as appropriate because "the asset in question is AIG stock, which is not a debt instrument. So, in my opinion, the – if a stock is taken, I think an investor would replicate it with a stock holding, not a debt instrument." (Wazzan: Trial Tr. 4438:21 – 4439:6).

(d) Short-term Treasury bills: Wazzan concluded that a market actor would demand a rate higher than the rate for one-year T-bills to reflect the approximately 6-year delay in this case. (Wazzan: Trial Tr. 4440:10 – 4441:9; PTX 2855 at 7, ¶ 12).¹⁵³

(i) An "investment in one-year Treasury bills does not provide for meaningful capital appreciation." (PTX 2854 at 20, ¶ 36; *see also* Wazzan: Trial Tr. 4440:22 – 4441:9 (a one-year Treasury bill "doesn't even protect from inflation")).

¹⁵³ Neuberger argues, incorrectly, that Plaintiffs do not deserve a higher interest rate because they bore no risk during the delay and because the Defendant is the U.S. government, which has the money to pay damages. *See, e.g.*, Neuberger: Trial Tr. 5572:6-14; DX 2407 (Neuberger demonstrative stating: "While the taking may have deprived plaintiffs of the value of the taken asset, it also relieved them of the risks of holding that asset."). Prejudgment interest is not based on Defendant's good standing, however, but in the delay in returning what rightfully belongs to Plaintiffs. *See* Wazzan: Trial Tr. 4421:1-7; *see also* Neuberger: Trial Tr. 5603:21-25. Neuberger also ignores that his proposed rate does not involve "no risk"; Plaintiffs, under his scenario, faced risks such as opportunity costs (Wazzan: Trial Tr. 4454:19 – 4455:6 ("in the taking – in the analysis here, you've taken away their opportunity to take on a risk")); liquidity risk (PTX 2854 at 19, ¶ 33 (plaintiffs "cannot trade or sell their claims against the U.S. government, and consequently, they hold illiquid positions" for which they should be compensated)); inflation risk (Neuberger: Trial Tr. 5632:3-8 (acknowledging that "the real rate of return on a one-year Treasury bill has been negative since 2009" in "real inflation-adjusted terms")); and that "a plaintiff may not be able to diversify away from (*i.e.*, hedge) risks which arise in connection with the substitution of the seized asset for a claim against the government" (PTX 2854 at 11 n.30). Neuberger does not explain why he would compensate Plaintiffs for the "minimal risk that the Government will default and not pay the award", but not compensate Plaintiffs for these other risks. Neuberger: Trial Tr. 5616:16 – 5617:3.

(ii) “It is highly unlikely that a reasonably prudent investor would invest in one-year Treasury bills over a long period of time. These instruments are typically used by large institutions and banks for short-term liquidity reasons. A prudent investor would be more likely to invest in a diversified, efficient portfolio, and attempt to get back to that portfolio if displaced from a particular investment.” (PTX 2855 at 7, ¶ 12; *see also* Wazzan: Trial Tr. 4441:6-8 (“It’s a one-year instrument, whereas the length of the taking here is now stretching into five years.”)).

(iii) Neuberger admitted that interest rates are “influenced” by Defendant, as the rate is set as part of the “monetary policy choices made by the Federal Reserve Board of Governors”. (Neuberger: Trial Tr. 5624:2-5; Neuberger: Trial Tr. 5624:6-14 (“Interest rates have been low in the post-takings period. Monetary policy has contributed to those interest rates. Whether that was to pursue some Federal Reserve agenda or not, I don’t know.”); Neuberger: Trial Tr. 5624:21 – 5625:2 (testifying that he was “aware that the Federal Reserve has provided sufficient liquidity to the economy to keep interest rates low”)).

(iv) Neuberger implicitly acknowledged that his advocacy of one-year Treasury bills to determine the pre-judgment interest rate was inappropriate when he proposed using 5-year inflation adjusted Treasury Inflation-Protected Securities (“TIPS”) rate as an alternative. (DX 1880 at 14-15, ¶¶ 36-37; DX 2411 (Neuberger demonstrative stating “Returns on five-year Treasury Inflation Protected Securities (“TIPS”) provide an alternative rate that compensates for actual inflation.”); Neuberger: Trial Tr. 5579:5-21 (recognizing that the rates on one-year Treasury bills “have actually been below the rate of inflation” and offering the five-year TIPS as an alternative); Neuberger: Trial Tr.

5641:11 – 5642:11 (“If the Court determines that putting the principal award in jeopardy in the sense that you might actually get less in real value, inflation-adjusted value, the Court – I’ve offered to the Court an interest rate that will preserve the principal award both in nominal terms and in real terms.”)).¹⁵⁴

(e) The Treasury Inflation-Protected Securities (“TIPS”) rate would yield “about 3 percent for both of the dates.” (Wazzan: Trial Tr. 4439:14-18). However, the TIPS rate is not the most appropriate comparison because “the asset in question here is stock. The TIPS rate is a debt instrument. The – the TIPS rate specifically does not compensate for the opportunity cost that Plaintiffs were forced to bear.” (Wazzan: Trial Tr. 4439:21 – 4440:9).

42.0

RELEVANT ENTITIES AND PERSONNEL

42.1 Plaintiff and the Plaintiff Classes

(a) Plaintiff Starr International Company, Inc. (“**Starr International**”) is a privately held Panama corporation with its principal place of business in Switzerland.

(b) Maurice R. “Hank” Greenberg (“**Greenberg**”) is the Chairman of Starr International.

(c) Until 2005, Howard Smith (“**Smith**”) was chief financial officer and chief administrative officer of AIG. (Smith: Trial Tr. 7673:19 – 7674:6). He now serves as vice

¹⁵⁴ Although Neuberger criticizes Wazzan’s approach on the ground that the assumptions made by Wazzan require a plaintiff-by-plaintiff analysis to determine an appropriate interest rate (*see, e.g.,* Neuberger: Trial Tr. 5568:23 – 5570:2, 5593:2 – 5595:21; DX 2416 (“Under Dr. Wazzan’s approach, a plaintiff-by-plaintiff analysis will be required to determine appropriate prejudgment interest rates.”)), such criticism is disingenuous given that the assumptions underlying Neuberger’s approach would also require the calculation of interest on a plaintiff-by-plaintiff basis (*see* Neuberger: Trial Tr. 5605:3 – 5606:3 (“do I think every investor in the class or every member of the class would have invested in one-year T-bills? No, of course not.”))).

chairman of finance of C.V. Starr and as a director of Starr International. (Smith: Trial Tr. 7673:9-13).

(d) The **Credit Agreement Class** is the class of persons and entities injured by the taking and/or illegal exaction of a 79.9% equity interest in AIG pursuant to the Credit Agreement. The Credit Agreement Class consists of “All persons or entities who held shares of AIG Common Stock on or before September 16, 2008 and who owned those shares as of September 22, 2008, excluding Defendant, any directors, officers, political appointees, and affiliates thereof, as well as members of the immediate families of Jill M. Considine, Chester B. Feldberg, Douglas L. Foshee, and Peter A Langerman.” (Opinion and Order Regarding Class Certification (Dkt. 100) at 9).

(e) The **Reverse Stock Split Class** is the class of persons and entities injured by the events and actions resulting in the Reverse Stock Split. The Reverse Stock Split Class consists of “All persons or entities who owned shares of AIG Common Stock on June 30, 2009 and were eligible to vote those shares at the annual shareholder meeting held on that date, excluding Defendant, any directors, officers, political appointees, and affiliates thereof, as well as members of the immediate families of Jill M. Considine, Chester B. Feldberg, Douglas L. Foshee, and Peter A. Langerman.” (Opinion and Order Regarding Class Certification (Dkt. 100) at 9).

42.2 American International Group (“AIG”)

(a) “AIG was incorporated as a holding company for various general life and insurance businesses in 1967.” (Agreed to Stipulations ¶ 22).

(b) At all relevant times, AIG has been a Delaware corporation with its principal executive offices located in New York City. (Agreed to Stipulations ¶ 20).

(c) “In 2008,” AIG Financial Products (“**AIGFP**”) “was a separate, wholly-owned subsidiary of the AIG parent company.” (Agreed to Stipulations ¶ 49). “AIG guaranteed all of

AIGFP's obligations, and, prior to March 2005, AIGFP benefited from AIG's AAA rating." (Agreed to Stipulations ¶ 41).

(d) From 2004 to 2009, Jacob Frenkel ("**Frenkel**") was AIG's Vice Chairman and Vice Chairman of AIG's Global Economic Strategies Group. (Bernanke: Trial Tr. 2189:5-9; JX 188 at 20).

(e) From July 2005 through October 2008, David Herzog ("**Herzog**") served as Comptroller of AIG. (Herzog: Trial Tr. 6955:2-4). Since October 2008, Herzog has been the Chief Financial Officer of AIG. (Herzog: Trial Tr. 6953:15-18).

(f) In 2008, Anastasia ("Stasia") Kelly ("**Kelly**") served as General Counsel and Vice Chairman of AIG. (Huebner: Trial Tr. 6115:22-24; JX 188 at 20). Kelly left AIG on December 30, 2009. (JX 251 at 523-28).

(g) During the relevant time period, Paula Reynolds ("**Reynolds**") served as Vice Chairman and Chief Restructuring Officer of AIG. (Liddy: Trial Tr. 3250:20-22; Herzog: Trial Tr. 7036:5-8; JX 188 at 20).

(h) In 2008, Brian Schreiber ("**Schreiber**") served as Senior Vice President for Strategic Planning at AIG. (Schreiber: Trial Tr. 6533:16-20). Schreiber currently serves as AIG's Deputy Chief Investment Officer. (Schreiber: Trial Tr. 6533:5-15).

(i) In 2008 and 2009, Kathleen Shannon ("**Shannon**") served as Deputy General Counsel, Senior Vice President and Corporate Secretary for AIG. (Shannon: Trial Tr. 3646:1-3). As Deputy General Counsel, Shannon was the senior securities and corporate finance lawyer at AIG. (Shannon: Trial Tr. 3646:1-3).

(j) During the relevant time, Anthony Valoroso ("**Valoroso**") served as head of accounting for AIG. (Farnan: Trial Tr. 4165:23-24).

(k) On June 15, 2008, Robert Willumstad (“**Willumstad**”) replaced Martin Sullivan as CEO of AIG. Willumstad served as CEO of AIG until September 16, 2008. (PTX 589 at 59, 72). From December 2006 until September 16, 2008, Willumstad was Chairman of the AIG Board of Directors. (Willumstad: Trial Tr. 6328:19 – 6329:10).

(l) On September 22, 2008, AIG’s Board of Directors comprised Stephen F. Bollenbach (“**Bollenbach**”), Martin S. Feldstein (“**Feldstein**”), Suzanne Nora Johnson (“**Nora Johnson**”), Fred H. Langhammer (“**Langhammer**”), Edward Liddy (“**Liddy**”), George L. Miles Jr. (“**Miles**”), Morris W. Offit (“**Offit**”), James F. Orr III (“**Orr**”), Virginia M. Rometty (“**Rometty**”), Michael H. Sutton (“**Sutton**”), and Edmund S.W. Tse (“**Tse**”). (JX 103 at 1).

(i) Liddy joined AIG’s Board of Directors after September 18, 2008, upon being named Chairman and CEO. (JX 94 at 2-3; AIG’s Response to Def. RFA No. 11). Liddy was recruited for the position by Christopher Cole, then chairman of Goldman Sachs’s investment banking division, and Ken Wilson, a former Goldman Sachs banker who then worked for Paulson at Treasury. (Liddy: Trial Tr. 3024:1 – 3027:19).

42.2.1 AIG consultants and advisors

(a) BlackRock (“**BlackRock**”) served as an outside financial adviser for AIG. “AIG retained BlackRock in June 2008 to value its credit default swap portfolio.” (Agreed to Stipulations ¶ 57; *see also id.* ¶ 157). “In October 2008, FRBNY engaged BlackRock to evaluate various issues surrounding AIG’s CDS exposure.” (*Id.* ¶ 156).

(b) Blackstone Advisory Partners LLP (“**Blackstone**”) was hired as AIG’s advisor the weekend prior to September 12, 2008; it remained AIG’s advisor and was the sole advisor when the Board discussed the credit agreement proposed by FRBNY. (Studzinski: Trial Tr. 4500:8-

21). John Studzinski (“**Studzinski**”) led Blackstone’s work for AIG in September 2008. (*See* JX 74 at 17).

(c) KPMG (“**KPMG**”) was retained by AIG in October 2008 to conduct a valuation of the Series C Preferred Stock. (PTX 375 at 3).

(d) PricewaterhouseCoopers LLC (“**PwC**”) has served as AIG’s independent auditor for “several decades.” (Farnan: Trial Tr. 4160:14-16).

(i) During the relevant time period, Donald Farnan (“**Farnan**”) was the primary accountant on the PwC team serving AIG. (Farnan: Trial Tr. 4298:3-15).

(e) Simpson, Thacher & Bartlett LLP (“**Simpson Thacher**”) “served as outside counsel to the AIG Board of Directors in 2008.” (Agreed to Stipulations ¶ 31).

(i) Richard Beattie (“**Beattie**”) of Simpson Thacher advised AIG’s Board of Directors during the time periods relevant to this case. (*See, e.g.*, JX 94 at 1).

(ii) James Gamble (“**Gamble**”) of Simpson Thacher advised AIG’s Board of Directors during the time periods relevant to this case. (*See, e.g.*, JX 94 at 1).

(f) Sullivan & Cromwell LLP (“**Sullivan & Cromwell**”) served as outside counsel to AIG in 2008. (*See, e.g.*, JX 74 at 1).

(i) Rodgin Cohen (“**Cohen**”) was Chairman of Sullivan & Cromwell LLP in 2008. (PTX 706 at 26). Cohen advised not only AIG, but also “just about every other firm that got in trouble during the crisis,” including Fannie Mae, Lehman Brothers, and Bear Stearns. (PTX 709 at 163).

(ii) Michael Wiseman (“**Wiseman**”) of Sullivan & Cromwell advised AIG during the time periods relevant to this case. (*See, e.g.*, JX 74 at 1).

(iii) Robert Reeder (“**Reeder**”) of Sullivan & Cromwell advised AIG during the time periods relevant to this case. (Reeder: Trial Tr. 6851:18-22).

(g) Weil, Gotshal & Manges LLP (“**Weil**”) “served as one of AIG’s outside counsel, including from 2008 through the present.” (Agreed to Stipulations ¶ 30).

(i) Joseph Allerhand (“**Allerhand**”) of Weil Gotshal advised AIG during the time periods relevant to this case. (*See, e.g.*, JX 74 at 1-2).

42.3 Defendant the United States of America (the “Government”) and its agents

42.3.1 The Department of the Treasury

(a) The Department of the Treasury (“**Treasury**”) is part of Defendant the United States. (Def. Answer to Second Amended Complaint ¶ 29).

(b) Treasury is an executive agency of Defendant. (Def. Resp. to Pl. 2nd RFAs No. 3). The Secretary of the Treasury is appointed by the President of the United States and is an official of the United States Government. (Def. Resp. to Pl. 2nd RFAs Nos. 1-2).

(c) In 2008, the Office of Thrift Supervision (“**OTS**”) was part of Treasury. (Def. Resp. to Pl. 2nd RFAs No. 4). In 2007 and 2008, OTS supervised AIG at the holding company level. (Def. Resp. to Pl. 2nd RFAs No. 5).

(d) During the relevant time period, Stephen Albrecht (“**Albrecht**”) was an attorney in the General Counsel’s office at Treasury. (Alvarez: Trial Tr. 568: 11-12).

(e) From January 26, 2009 through January 25, 2013, Timothy F. Geithner (“**Geithner**”) was Secretary of the Treasury. (Def. Resp. to Pl. 2nd RFAs No. 46). Prior to his service as Secretary of the Treasury, Geithner served as President of the Federal Reserve Bank of New York. (*See infra* § 42.3.4(l); Def. Resp. to Pl. 2nd RFAs No. 56).

(f) In August 2008, Dan Jester (“**Jester**”), a former Goldman Sachs executive, was recruited by Paulson to join Treasury as a contractor in 2008. (PTX 706 at 190-191). Both

Jester and another Treasury contractor, Ken Wilson (“**Wilson**”) had worked for Paulson at Goldman Sachs. (Def. Resp. to Pl. 2nd RFAs Nos. 48-51, 717). On September 16, 2008, Paulson tasked Wilson with finding “a new CEO for AIG”. (Paulson: Trial Tr. 1227:15 – 1228:9). Neither Jester nor Wilson was required to publicly disclose their personal financial holdings. (Def. Resp. to Pl. 2nd RFAs No. 718). In late September or October of 2008, “all contact” between FRBNY and Jester was “cut off”, and Dahlgren “was told he was no longer our contact point” due to “some conflict that was not desired.” (Dahlgren: Trial Tr. 2681:1 – 2682:5).

(g) Beginning in October 2008, James Lambright (“**Lambright**”) was the Chief Investment Officer of the Troubled Asset Relief Program (“**TARP**”). (PTX 706 at 419).

(h) David McCormick (“**McCormick**”) served as Undersecretary for International Affairs during Paulson’s tenure as Secretary of the Treasury and, during the Financial Crisis, spoke regularly with the Chinese government. (Paulson: Trial Tr. 1212:6-12).

(i) From May 2009 through February 2011, James Millstein (“**Millstein**”) was Treasury’s Chief Restructuring Officer. (Def. Resp. to Pl. 2nd RFAs No. 52).

(j) From July 10, 2006 to January 20, 2009, Henry “Hank” Paulson (“**Paulson**”) was the United States Secretary of the Treasury. (Def. Resp. to Pl. 2nd RFAs No. 45). Prior to becoming Secretary of the Treasury, Paulson worked at Goldman Sachs Group Inc. for more than 20 years, including serving as its CEO from 1999 to May 2006. (Def. Resp. to Pl. 2nd RFAs Nos. 47; PTX 706 at 46-49).

(k) Taiya Smith (“**Smith**”) served as deputy chief of staff to Paulson during his tenure as Secretary of the Treasury. (PTX 706 at 99).

(l) James Wilkinson (“**Wilkinson**”) was Paulson’s Chief of Staff during Paulson’s tenure as Treasury Secretary. (PTX 706 at 25).

42.3.2 The Federal Reserve System

(a) The Federal Reserve System (“**Federal Reserve**” or the “**Fed**”) is the central bank of the United States. It was founded by Congress in 1913. (Def. Resp. to Pl. 2nd RFAs Nos. 29, 30).

(b) “The Federal Reserve System is comprised of the Board of Governors and 12 regional Federal Reserve Banks.” (Agreed to Stipulations ¶ 1).

(c) “The Federal Open Markets Committee (“**FOMC**”) is responsible for conducting open market operations—the purchase and sale of securities by the central bank. The Federal Reserve uses open market operations to adjust the supply of reserve balances to manage the federal funds rate (the rate at which banks lend reserve balances overnight). The FOMC consists of the members of the Board of Governors, the President of the Federal Reserve Bank of New York, and four of the remaining Reserve Bank presidents, who rotate through one-year terms.” (Agreed to Stipulations ¶ 13 (emphasis added); *see also id.* ¶ 14).

42.3.3 The Federal Reserve Board of Governors

(a) The Board of Governors of the Federal Reserve System (“**Board of Governors**”) “is an agency of the United States. The Board of Governors supervises and regulates the operations of the Federal Reserve Banks.” (Agreed to Stipulations ¶ 2).

(i) “The Board of Governors is responsible for, among other things, regulating and supervising (1) banks that are members of the Federal Reserve System, (2) bank holding companies, and (3) international banking facilities in the United States.” (Agreed

to Stipulations ¶ 11; Def. Resp. to Pl. 2nd RFAs No. 13 (“The Governors of the Federal Reserve Board are United States government officials.”)).

(b) “The Board of Governors is composed of up to seven members, called ‘Governors.’ Governors are appointed by the President of the United States and confirmed by the U.S. Senate. The Chairman and the Vice Chairman of the Board are Governors who are also appointed by the President and confirmed by the Senate. The nominees to these posts must already be members of the Board or must be simultaneously appointed to the Board. The terms for these positions are four years. Members of the Board of Governors are officials of the United States.” (Agreed to Stipulations ¶ 3).

(c) From February 1, 2006 through January 31, 2014, Ben Bernanke (“**Bernanke**”) was the Chairman of the Federal Reserve. (Def. Resp. to Pl. 2nd RFAs No. 53).

(d) From June 23, 2006 through June 23, 2010, Donald Kohn (“**Kohn**”) was Vice-Chairman of the Federal Reserve. (Def. Resp. to Pl. 2nd RFAs No. 54).

(e) During the relevant period, Bernanke, Elizabeth Duke (“**Duke**”), Kohn, Randall Kroszner (“**Kroszner**”), and Kevin Warsh (“**Warsh**”) were members of the Board of Governors. (JX 63 at 1; Alvarez: Trial Tr. 510:7-15).

(f) “Members of the Board of Governors are in continual contact with other policy makers in government. The Board has regular contact with members of the President’s Council of Economic Advisers and other key economic officials. The Chairman also meets from time to time with the President of the United States and has regular meetings with the Secretary of the Treasury.” (Agreed to Stipulations ¶ 4).

(g) “Federal Reserve Banks operate under the general supervision of the Board of Governors.” (Agreed to Stipulations ¶ 7).

(h) The Board of Governors' employees are known collectively as "Board of Governors Staff" or, colloquially, "BOG staff" or "Board staff". (Def. Resp. to Pl. 2nd RFAs Nos. 14-15).

(i) Since 2004, Scott Alvarez ("**Alvarez**") has been the General Counsel for the Federal Reserve. (Alvarez: Trial Tr. 79:20 – 80:7).

(j) During the relevant period, Richard Ashton ("**Ashton**") was deputy general counsel in the Legal Division at the Board of Governors and reported directly to Alvarez. (Alvarez: Trial Tr. 300:18-24).

42.3.4 Federal Reserve Bank of New York ("**FRBNY**")

(a) The Federal Reserve Bank of New York ("**FRBNY**") is one of the twelve regional Federal Reserve Banks. Among other functions, FRBNY performs fiscal agency functions for the U.S. Treasury, certain federal agencies, and other entities. (Def. Resp. to Pl. 2nd RFAs Nos. 28-29). FRBNY and other Federal Reserve Banks process Federal payments and deposits to Treasury's account and service Treasury securities. (Def. Resp. to Pl. 2nd RFAs No. 35).

(b) FRBNY is "required by the Federal Reserve Act to serve as fiscal agent and depository of the United States Government. By statute, the Department of the Treasury has appropriations to pay for these services." (Def. Resp. to Pl. 2nd RFAs No. 31).

(i) "During the years ended December 31, 2008 and 2007", FRBNY "was reimbursed for substantially all services provided to the Department of the Treasury as its fiscal agent." (Def. Resp. to Pl. 2nd RFAs No. 32).

(ii) When FRBNY and other Federal Reserve Banks receive earnings that exceed statutory amounts of surplus, those earnings are paid to Defendant and are recognized as non-exchange revenue. Those earnings totaled \$32.0 billion and \$33.6

billion for the years ended September 30, 2008, and 2007, respectively. (Def. Resp. to Pl. 2nd RFAs No. 36).

(c) In responding to the financial crisis of 2007-2009 in general, and with regard to assistance to AIG in particular, FRBNY was acting as the agent of the United States. (Discovery Order No. 6 (Dkt. 182) at 12-13).

(i) Deloitte & Touche, the independent auditor for the Federal Reserve, concluded that Treasury and the Federal Reserve were related parties for accounting purposes. (*See* JX 386 at 9).

(d) “On September 17, 2008, FRBNY established an on-site team at AIG” (the “**Monitoring Team**”) “led by FRBNY employee Sarah Dahlgren to help FRBNY understand and monitor the company.” (Def. Resp. to Pl. 2nd RFAs Nos. 416). The Monitoring Team represented the interests of the Federal Reserve as the lender to AIG, to ensure compliance with the terms of the Credit Agreement, and to supervise the company’s decision-making. (PTX 516 at 50).

(i) The Monitoring Team kept the Federal Reserve Board of Governors informed of its monitoring of AIG. The Monitoring Team acted under the direction and supervision of the Federal Reserve Board. (Def. Resp. to Pl. 2nd RFAs No. 420; PTX 581 at 4).

(ii) The Monitoring Team included as many as 20 members. (Def. Resp. to Pl. 2nd RFAs No. 418).

1. Defendant has identified the following FRBNY officers and employees who were members of the Monitoring Team: Michael Alix, Christina Anzalone, Marilyn Arbuthnott, Susan Ballinger, Sarah Bell, Shannon Bozelli, Jennifer Brett,

Nick Brophy, Christina Celi, Ajla Cico, Sarah Dahlgren, Hampton Finer, Amy Flynn, Susan Goldberg, Katherine Ivanova, Bin Lang, Alejandro Latorre, Jeff Levine, Danielle (Vicente) Lima, Clint Lively, Fatima Madhany, Jim Mahoney, Steve Manzari, Helen Mucciolo, Kay Naraine, Alon Neches, Robert Patalano, Jonathan Polk, Robert Rinaldi, Clay Saylor, Steve Schoen, Roseann Stichnoth, Vivian Sung, Cathy Voigts, Eleanny Wernecke, Tamra Wheeler, and Paul Whynott. (Def. Resp. to Pl. 2nd Interrogatories No. 10 & Schedule A).

(e) Thomas Baxter (“**Baxter**”) has served as General Counsel of FRBNY for “nearly twenty years.” (Baxter: Trial Tr. 796:19-21).

(f) During the relevant period, James Bergin (“**Bergin**”) was an attorney at FRBNY. (Baxter: Trial Tr. 719:4-5).

(g) During the relevant period, Christopher Calabria (“**Calabia**”) was a Vice President in the Bank Supervision Group at FRBNY. (Def. Resp. to Pl. 2nd RFAs No. 63; Dahlgren: Trial Tr. 2637:1-3).

(h) Since 2006, Terrence Checki (“**Checki**”) has been an Executive Vice President in the Emerging Markets and International Affairs Group at FRBNY. (Def. Resp. to Pl. 2nd RFAs No. 60).

(i) During the relevant time, Kevin Coffey (“**Coffey**”) worked in financial institution supervision at FRBNY. (Baxter: Trial Tr. 682:3-9).

(j) Beginning on September 16, 2008, Sarah Dahlgren (“**Dahlgren**”) was the Vice President in charge of FRBNY’s AIG Relationship Monitoring Team. (Def. Resp. to Pl. 2nd of RFAs No. 59; *see also* Dahlgren: Trial Tr. 2601:4-9 (Dahlgren stating “I was responsible for the AIG monitoring team, which was responsible for monitoring the loan that was made to AIG and

ensuring that we got paid back.”)). Dahlgren is “currently the head of the financial institution supervision group at the Federal Reserve Bank of New York.” (Dahlgren: Trial Tr. 2603:10-13).

(k) In 2008, William Dudley (“**Dudley**”) “was Executive Vice President of the Markets Group at FRBNY. From January 27, 2009, through the present, Mr. Dudley was the President of FRBNY.” (Agreed to Stipulations ¶ 16). Before joining FRBNY, Dudley was an economist and Goldman Sachs managing director. (PTX 709 at 113).

(l) From November 17, 2003 through January 26, 2009, **Geithner** was President of FRBNY. (Def. Resp. to 2nd RFAs No. 56). After his service as President of FRBNY, Geithner served as Secretary of the Treasury. (*See supra* § 42.3.1(e); Def. Resp. to Pl. 2nd RFAs No. 46).

(m) During the relevant period, Stephanie Heller (“**Heller**”) was an attorney at FRBNY. (Baxter: Trial Tr. 996:17-18; Latorre: Trial Tr. 2344:4-6).

(n) In 2008, Alejandro Latorre (“**Latorre**”) was an Assistant Vice President working on FRBNY’s Open Market Desk, the “monetary policy implementation arm of the Federal Reserve System”. (Latorre: Trial Tr. 2080:25 – 2081:17, 2082:16-18). Latorre also was a member of the AIG Monitoring Team (Def. Res. to 2nd Interrogatories No. 10 & Schedule A), where his responsibilities included work related to Maiden Lane III. (*See* Latorre: Trial Tr. 2318:20-22).

(o) From July 2007 to 2011, Margaret McConnell (“**McConnell**”) was the FRBNY President’s Deputy Chief of Staff for Policy (McConnell: Trial Tr. 2506:16 – 2507:1; Def. Resp. to Pl. 2nd RFAs No. 58). McConnell is currently Senior Vice President and Director of Financial Stability and Regulatory Policy. (McConnell: Trial Tr. 2506:13-15).

(p) In September of 2008, Susan McLaughlin (“**McLaughlin**”) was the “senior officer with oversight responsibility for the discount window, leading a function that was called financial management and discount window.” (McLaughlin: Trial Tr. 2394:13-17). McLaughlin

is currently Senior Vice President and Senior Policy Advisor in the Markets Group.

(McLaughlin: Trial Tr. 2394:10-12). McLaughlin had responsibility for, among other things, “managing the pledge of collateral” from AIG and other 13(3) borrowers, (McLaughlin: Trial Tr. 2395:3-13), meaning ensuring that FRBNY “had a valuation for the collateral and were applying haircuts and that we had enough lendable value of collateral to make the loan” (McLaughlin: Trial Tr. 2395:21 – 2396:4).

(q) From December 2006 through 2008, Patricia Mosser (“**Mosser**”) was a Senior Vice President in the Markets Group at FRBNY. (Mosser: Trial Tr. 1159:21-1160:2; Def. Resp. to Pl. 2nd RFAs No. 62).

(r) During the relevant period, Michael Silva (“**Silva**”) was a Senior Vice President at FRBNY and served as Chief of Staff to FRBNY President Geithner. (Def. Resp. to Pl. 2nd RFAs No. 57).

(s) During the relevant period, Joseph Sommer (“**Sommer**”) was an attorney at FRBNY who reported to Baxter. (Baxter: Trial Tr. 880:4-5).

42.3.5 The AIG Credit Facility Trust

(a) On January 16, 2009, FRBNY, as Settlor, and Jill M. Considine (“**Considine**”), Chester B. Feldberg (“**Feldberg**”) and Douglas L. Foshee (“**Foshee**”) (collectively the “**Trustees**”) as Trustees entered into the AIG Credit Facility Trust Agreement (the “**Trust Agreement**”), which created the AIG Credit Facility Trust (the “**Trust**”). (JX 172 at 4).

(b) Peter Langerman (“**Langerman**”) became a Trustee on February 26, 2010, following Foshee’s departure. (Langerman: Trial Tr. 7158:22-24; Foshee: Trial Tr. 3453:3-6; DX 843 at -567).

42.3.6 Defendant’s agents and advisors

(a) Beginning on September 16, 2008, Davis, Polk & Wardwell LLP (“**Davis Polk**” or “**DPW**”) served as legal counsel to Defendant in connection with the drafting and execution of the terms of the AIG Credit Agreement and the related agreements, including the AIG Credit Facility Trust Agreement and Stock Purchase Agreement. (Agreed to Stipulations ¶¶ 109, 110). In addition, Davis Polk provided advice and counsel to FRBNY and Treasury concerning a variety of issues related to AIG. (Def. Resp. to Pl. 3rd Interrogatories No. 25).

(i) Counsel from Davis Polk who advised Defendant included partners John Brandow (“**Brandow**”), Marshall Huebner (“**Huebner**”), and Ethan James (“**James**”). (See, e.g., Brandow: Trial Tr. 5790:8-14, 5868:21 – 5869:10; Huebner: Trial Tr. 5933:13-25).

(b) From 2008 through 2012, Deloitte & Touche LLP (“**Deloitte**”) was the independent auditor for the Board of Governors and FRBNY. The Board of Governors also contracted with Deloitte beginning in 2008 to provide independent audit services to Maiden Lane II and Maiden Lane III, for which those entities reimbursed the Board. (Def. Resp. to Pl. 3rd Interrogatories No. 25).

(c) On September 19, 2008, FRBNY retained Ernst & Young (“**E&Y**”) to perform services for FRBNY in connection with Defendant’s loan to AIG. (Def. Resp. to 3rd Interrogatories No. 25).

(i) Marc Symons (“**Symons**”) was the engagement partner for E&Y in connection with its retention by FRBNY. (Symons: Trial Tr. 3588:2-6).

(d) **Morgan Stanley** began advising FRBNY on the morning of September 15, 2008 regarding AIG. (J. Head: Trial Tr. 3714:6-12). In addition, “Morgan Stanley provided advice to FRBNY in connection with the drafting of the terms of the Credit Agreement.” (Agreed to

Stipulations ¶ 35). Morgan Stanley was formally engaged in October 2008 to assist FRBNY in connection with “strategic alternatives” for AIG. (PTX 303 at 1; J. Head: Trial Tr. 3720:25 – 3721:11).

(i) James Head (“**Head**”) has worked at Morgan Stanley for twenty years in mergers and acquisitions and was a member of the Morgan Stanley team advising Defendant on matters related to AIG. (J. Head: Trial Tr. 3713:25 – 3714:5).

(e) In 2008 and 2009, the Board of Governors retained **PwC**, and PwC provided accounting expertise and resources to the Board of Governors’ accounting staff. (Def. Resp. to Pl. 3rd Interrogatories No. 25; Def. Resp. to Pl. 2nd RFAs No. 756).

(f) Wachtell, Lipton, Rosen & Katz (“**Wachtell**”) provided legal services to Treasury relating to AIG, including assisting Treasury in drafting the terms of Defendant’s loan to AIG, beginning on or around September 14, 2008 through September 19-20, 2008. The United States never memorialized its retention of Wachtell for services rendered to AIG, and Wachtell never sought compensation for such services rendered. (*See* Def. Resp. to Pl. 3rd Interrogatories No. 25; PTX 98-U at 3; JX 85 at 1; JX 376-U at 1, 3-7; Alvarez: Trial Tr. 290:4-8).

(i) In September 2008, Wachtell represented Morgan Stanley in its successful efforts to become approved by the Federal Reserve as a bank holding company. (JX 377 at 1-2).

42.4 Expert witnesses testifying on behalf of the Plaintiffs

(a) Dr. Michael Cragg (“**Cragg**”) was offered by the Plaintiffs and admitted by the Court as an expert “in the fields of economics and financial markets.” (Cragg: Trial Tr. 4928:7-9, 4934:8-10).

(b) Dr. S.P. Kothari (“**Kothari**”) was offered by the Plaintiffs and admitted by the Court as an expert in “the fields of accounting and finance.” (Kothari: Trial Tr. 4525:25 – 4526:2, 4529:3-4).

(c) Dr. Christopher Paul Wazzan (“**Wazzan**”) was offered by the Plaintiffs and admitted by the Court as an expert in prejudgment interest. (Wazzan: Trial Tr. 4416:7-8, 4420:5-9).

(d) Professor Luigi Zingales (“**Zingales**”) was offered by the Plaintiffs and admitted by the Court as an expert in the fields of “economics and corporate governance.” (Zingales: Trial Tr. 3796:6-8, 3799:18-19).

42.5 Expert witnesses testifying on behalf of the United States

(a) Professor Robert Daines (“**Daines**”) is a law professor offered by the United States and admitted by the Court as an expert in “corporate governance, corporate finance, and the economic analysis of corporate control.” (Daines: Trial Tr. 8425:6-10; 8432:19 – 8433:13).

(b) Dr. Jonathan Neuberger (“**Neuberger**”) was offered by the United States and admitted by the Court as an expert in “the area of financial economics, the quantification of economic harm, and the determination of prejudgment interest rates.” (Neuberger: Trial Tr. 5557:24 – 5559:1).

(c) Dr. David K. A. Mordecai (“**Mordecai**”) was offered by the United States and admitted by the Court as an expert in “financial economics, fixed income and credit markets, credit default swap markets, and distressed lending.” (Mordecai: 7445:13-16, 7457:9-16).

(d) Professor Anthony Saunders (“**Saunders**”) was offered by the United States and admitted by the Court as an expert in the “field of financial economics.” (Saunders: Trial Tr. 8067:19 – 8068:1).

42.6 Other relevant actors

(a) In 2008, **Bank of America** was a large financial institution with a significant commercial banking business. (*See, e.g.*, PTX 706 at 392). The weekend of September 13 through 15, 2008, it purchased Merrill Lynch in a deal brokered by Defendant. (PTX 709 at 201, 204, 292). It subsequently received from Defendant billions in aid and a guarantee on a pool of assets up to \$118 billion. (PTX 406 at 1, 3, 6).

(b) “**China Inc.**” refers to commercial and financial entities owned by the Chinese government. (*See, e.g.*, Studzinski: Trial Tr. 4503:16 – 4504:8).

(c) The China Investment Corporation (“**CIC**”) is the sovereign wealth fund of China. (PTX 706 at 301).

(d) Citigroup Inc. (“**Citigroup**” or “**Citi**”) is a large financial institution with a significant commercial banking business. (*See, e.g.*, PTX 706 at 392; PTX 379 at 1). On November 23, 2008, the Federal Reserve, Treasury, and the FDIC announced that they would provide a package of guarantees, liquidity access, and capital to Citigroup, including a guarantee of up to \$306 billion in assets under the Federal Reserve’s Section 13(3) authority. (*See* PTX 379 at 1, 3-4; PTX 1843).

(e) The **Committee on Oversight and Government Reform** is the main investigative committee in the U.S. House of Representatives. (PTX 562 at 22).

(f) In November 2008, Congress appointed the Congressional Oversight Panel (“**COP**”) to review the current state of financial markets and the regulatory system and to report on Treasury’s Troubled Asset Relief Program (“**TARP**”), which was enacted in October 2008 as part of the Emergency Economic Stabilization Act (“**EESA**”). (*See* 12 U.S.C. § 5233; PTX 589 at 326). On June 10, 2010, the COP released a report titled “The AIG Rescue, Its Impact on

Markets, and the Government's Exit Strategy", which addresses the events at issue in this litigation. (*See generally* PTX 589).

(g) Under TARP, Congress also established the Special Inspector General for TARP ("**SIGTARP**"), a law enforcement agency charged with preventing and reporting fraud, waste and abuse in the program. (*See* 12 U.S.C. § 5231). On November 17, 2009, SIGTARP released a report titled "Factors Affecting Efforts to Limit Payments to AIG Counterparties". (*See generally* PTX 549).

(h) A credit rating agency ("**rating agency**") is an entity that assesses the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments. (*See, e.g.*, PTX 624 at 71-72; PTX 689 at 3 (A.M. Best's credit ratings aim "to provide an opinion of the rated entity's ability to meet its senior financial obligations"))).

(i) "During the relevant period, Standard & Poor's [("**S&P**")], **Moody's**, **Fitch**, and **A.M. Best** were ratings agencies, which published credit ratings on AIG." (Agreed to Stipulations ¶ 25 (emphasis added)).

(ii) During the relevant time period, A.M. Best was a rating agency specializing in ratings for the insurance industry. (Colannino: Trial Tr. 5696:10-22). Since 2005, Andrew Colannino ("**Colannino**") has been a Vice President in the Ratings Division at A.M. Best. (Colannino: Trial Tr. 5697:1-11).

(i) During the relevant time period, Eric Dinallo ("**Dinallo**") was the Superintendent of the New York State Insurance Department ("**NYSID**"). (*See* Agreed to Stipulations ¶ 95). NYSID was one of the lead regulators of AIG's insurance subsidiaries. (PTX 628 at 2).

(j) J.C. Flowers ("**Flowers**") is an investor who runs a large private equity fund. (Alvarez: Trial Tr. 467:25 – 468:3).

(k) The Federal Home Loan Mortgage Corporation (“**Freddie Mac**”) and the Federal National Mortgage Association (“**Fannie Mae**”) are Government-Sponsored Entities (“**GSEs**”) that “owned or guaranteed more than \$5 trillion in residential mortgages and mortgage-backed securities – about half of all those in the country.” (PTX 706 at 20). On September 6, 2008, the Federal Housing Finance Agency (“**FHFA**”) placed both Fannie Mae and Freddie Mac into conservatorship. (*See* Agreed to Stipulations ¶ 71).

(l) In 2009, Congress established the Financial Crisis Inquiry Commission (“**FCIC**”) to ““examine the causes of the current financial and economic crisis in the United States.”” (PTX 624 at 11). After a two-year investigation, the Commission published its findings (the “**FCIC Report**”) in January 2011. (PTX 624 at 11).

(m) The Government of Singapore Investment Corporation (“**GIC**”) is the sovereign wealth fund of Singapore. (Studzinski: Trial Tr. 5666:20 – 5667:4, 5668:11-12).

(n) The Government Accountability Office (“**GAO**”) is “the audit, evaluation, and investigative arm of Congress.” (PTX 539 at 101). At the request of Congress, the GAO conducted investigations into Defendant’s assistance to AIG. (PTX 539 at 9).

(o) Goldman Sachs Group, Inc. (“**Goldman Sachs**”) is a large financial institution with a significant investment banking business. (PTX 706 at 392). Before becoming Secretary of the Treasury, Henry Paulson served as CEO of Goldman Sachs. (PTX 706 at 46-49). On September 21, 2008, Goldman Sachs’s application to become a bank holding company was approved by the Federal Reserve. (PTX 200 at 1, 8).

(p) JPMorgan Chase & Co. (“**JPMorgan**”) is a large financial institution that provides commercial and investment banking services, among other services. (*See* PTX 706 at 392). AIG hired JPMorgan to help develop funding options in late August 2008. (*See* Agreed to

Stipulations ¶ 67). Geithner then requested that JPMorgan (along with Goldman Sachs) coordinate a private sector solution for AIG the weekend of September 13-15, 2008. (*See* PTX 709 at 208).

(i) James Lee (“**Lee**”) has served as vice chairman of JPMorgan for ten years. In that capacity, he is the bank’s senior investment banker. (Lee: Trial Tr. 7067:22 – 7068:11).

(q) In 2008, Merrill Lynch & Co., Inc. (“**Merrill Lynch**”) was a large financial institution with a significant investment banking business. (PTX 706 at 392). The weekend of September 13 through 15, 2008, it was purchased by Bank of America in a deal brokered by Defendant. (PTX 709 at 201, 204, 292).

(r) The National Association of Insurance Commissioners (“**NAIC**”) is a “voluntary organization of the chief insurance regulatory officials of the 50 states, the District of Columbia and five U.S. territories.” (PTX 2762 at 2).

(s) The **President’s Working Group on Financial Markets** is “an interagency group of regulators and policy institutions” “who discussed regulatory and other financial policy matters on a regular basis.” (Mosser: Trial Tr. 1165:6-12). The President’s Working Group drafted reports and recommendations for the President. (*See e.g.*, PTX 11).

Dated: February 19, 2015
Armonk, New York

Respectfully submitted,
BOIES, SCHILLER & FLEXNER LLP

By /s/ David Boies

David Boies
Attorney of Record
333 Main Street
Armonk, NY 10504
Telephone: (914) 749-8200
Fax: (914) 794-8300
Email: dboies@bsfllp.com

SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP

John L. Gardiner
Four Times Square
New York, NY 10036
Telephone: (212) 735-3000

R. Ryan Stoll
Gregory Bailey
155 N. Wacker Drive
Chicago, IL 60606
Telephone: (312) 407-0700

BOIES, SCHILLER & FLEXNER LLP

Robert B. Silver
Robert J. Dwyer
Alanna C. Rutherford
Julia C. Hamilton
Laura Harris
Ilana Miller
John Nicolaou
Matthew R. Shahabian
David L. Simons
Craig Wenner
575 Lexington Avenue
New York, NY 10022
Telephone: (212) 446-2300

Amy J. Mauser
Scott E. Gant
Abby Dennis

William Bloom
James A. Kraehenbuehl
5301 Wisconsin Avenue, NW
Washington, DC 20015
Telephone: (202) 237-2727

*Counsel for Plaintiff Starr International Company,
Inc. and for the Plaintiff Classes*