IN THE UNITED STATES COURT OF FEDERAL CLAIMS

FRANK P. SLATTERY, JR., et al.,	)	
	)	
Plaintiffs,	)	
	)	
v.	)	**No. 93-280C**
	)	**(Senior Judge Smith)**
	)	
THE UNITED STATES,	)	
	)	
Defendant.	)	

DEFENDANT'S POST-TRIAL RESPONSES TO THE COURT'S QUESTIONS WITH RESPECT TO DAMAGES

Pursuant to this Court's Order of October 17, 2003, defendant, the United States, respectfully submits the following post-trial responses to the Court's questions regarding damages. We request that the Court deny plaintiffs' damages claims for the reasons set forth below, in our post-trial brief, and at trial, including the record evidence.

I. Forseeability

1. Was it foreseeable that Meritor would convert from a mutual to a stock form at the time of the 1982 deal?

RESPONSE: No. In 1982, Meritor had been a state-chartered mutual savings bank since 1816. DX 392 at 3.[1] No internal documents suggested a change from mutual to stock form before September 1982. DX 1358; DX 1357 at CSL124 0157-63; DX 1359; Tr. 212, 215 [Brumbaugh]; DX 432 at 4. The wide-spread conversion of mutual savings banks to stock occurred after the PSFS-Western merger, Tr. 1633 [Gough], and was not discussed in 1982. Tr. 1672 [Gough]. A May 1983 memorandum by Mr. Nocella noted that 19 other thrifts had converted to stock form since October 14, 1982. DX 94 at 132.

"The effect of independent business decisions on foreseeability is discussed in Myerle v. United States, 33 Ct. Cl. 1 (1897). 'For damage to be direct there must appear no intervening incident. . . . other independent and collateral undertakings, . . . [make damages] too uncertain and remote.'" California Fed. Bank, FSB v. United States, 54 Fed. Cl. 704, 713 (2002). Plaintiffs' alleged damages here – the consequence of independent, collateral undertakings – are, indeed, too remote and uncertain to warrant recovery. See Tr. 820-21 [Brummett] (decision to convert was business decision).

"Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made." RESTATEMENT OF

[1] The following abbreviations will be used throughout these responses and the accompanying brief: "DX__" refers to Defendant's Exhibits; "PX___" refers to Plaintiffs' Exhibits; "JE___" refers to Joint Exhibits; "Tr. (L) ___" refers to transcript citations from the trial on liability; "Tr. ___" refers to transcript citations from the trial on damages; "IMA"refers to the Income Maintenance Agreement entered into by the FDIC and PSFS; "IRR" refers to interest rate risk; and "IPO" refers to an Initial Public Offering, usually referring to that of Meritor in 1983.

CONTRACTS (SECOND) § 351 (1981)) (emphasis added). See also Def. Response Nos. 18, 32; Wells Fargo Bank, N.A. v. United States, 88 F.3d 1012,1023-24 (1996), cert. denied, 520 U.S. 1116 (1997). Meritor's conversion and the loss of the stock market value created in 1983 were not foreseeable in 1982 as the probable result of a future breach.

2. Was it foreseeable in April 1982 that Meritor would sell off all of the discounted Western assets so rapidly and, as a consequence, choose to forego the $512 million in accretion of purchase discount represented in Mr. Brummett's model as a "cost of performance?"

RESPONSE: No. Before the merger, PSFS had analyzed its ability to sell the Western assets, but had not shared its plans for sale with FDIC personnel. Tr. (L) 99-100 [Nocella]; Tr. (L) 289 [Cooke]. Although the FDIC expected Meritor to restructure through asset sales eventually, Mr. Isaac did not foresee Meritor selling the Western assets until interest rates had fallen, automatically increasing the value of those assets. Tr. (L) 1512, 1522-23, 1525-26, 1534-35 [Isaac]. The IMA was intended to "try to get them through this high rate climate on that portfolio." Tr. (L) 1517, 1527 [Isaac]; Tr. (L) 2707 [Gough].

The FDIC's Regional Director, Paul Fritts, emphasized that the Western asset sales were "a really dumb move" by PSFS. Tr. (L) 2960 [Fritts]. When he learned of the sales, Mr. Fritts told PSFS that their business judgment in selling the Western assets, after only a small amount of appreciation, and in a high interest rate environment, was "really, really bad" because it eliminated the accretion income that would have otherwise offset the goodwill amortization. Tr. (L) 3031-32 [Fritts]; DX 510 at 9 ("any advantages [of the Western merger] . . . were eliminated through management's decision to immediately sell off the acquired assets and deplete the accretion accounts."); DX 3 at CSL002 0346; Tr. 652-54 [Brummett]. Meritor's sale of approximately $2.1 billion in assets and the resultant $512 million of foregone accretion was unforeseeable in both magnitude and how rapidly the assets were sold.

II. Expectancy Damages

3. Do Meritor's operating losses from 1982 to 1992 render plaintiffs calculation of expectancy damages unreliable?

RESPONSE: Yes. Expectancy damages are too speculative as a matter of law when the they cannot be reconciled with historical performance. Suess v. United States, 52 Fed. Cl. 221, 226-27 (2002) (rejecting expectancy damages, in part, because of plaintiff's track record); Travellers Int'l A.G. v. Trans World Airlines, Inc., 41 F.3d 1570, 1572, 1579 (2d Cir. 1994); Palmer v. Connecticut Ry. & Lighting Co., 311 U.S. 544, 561-62 (1941); Eleven Line, Inc. v. North Texas Soccer Assoc., 213 F.3d 198, 206-07 (5th Cir. 2000); McClaran v. Plastic Indus., Inc., 97 F.3d 347, 356-57 (9th Cir. 1996) (same); Kidder Peabody & Co. v. IAG Int'l Acceptance Group, 28 F. Supp. 2d 126, 134-35 (1998); RTC v. Stroock & Stroock & Lavan, 853 F. Supp. 1422, 1426 n.3 (S.D. Fla. 1994) (same); Lindheimer v. Illinois Bell Tel. Co., 292 U.S. 151, 164 (1934).

Dr. Finnerty's 1988 damage calculation ignores Meritor's historical performance because it assumes the loss of every dollar of Meritor's pre-1988 breach value was the result of the breach instead of the myriad of economic and continued operational problems afflicting the institution from 1988 to 1992. Tr. 2509-10 [Hamm]; Tr. 1435-55 [Thakor]; Tr. (L) 4123-24, 4134-35, 4147, 4163-64, 4169-70, 4172-73, 4180-83, 4203-04, 6018-21 [Epstein]; DX 1699A at 4-43; DX 1959A-O. See also Tr. 1739-40 [Epstein] (citing DX 3026 at 13); Tr. (L) 488-91, 494-95 [McCarron]. Despite these non-breach factors, he also implausibly assumes a value 61 percent higher than the August 1, 1988 market value. Dr. Finnerty merely makes this assumption without any modeling or analysis. Tr. 1435 [Thakor]. Plaintiffs' other expert concludes Dr.

Finnerty is woefully incorrect. PX 541A, Ex. 1, p.2 [Goldstein] ($400 million in losses between 1989-91 absent breach).

That Meritor's pre-breach performance was horrendous, and declined precipitously between 1984 and 1987, cannot be seriously contested. Tr. (L) 3132-36, 3139-40 [Lutz]; Tr. 1437-51 [Thakor]; DX 3302; Tr. (L) 5589 [Brumbaugh]; see Def. Response No. 17. Its operating losses both before and after the 1988 MOU were the result of non-breach issues, including Meritor's "massive" growth, pre-breach investment decisions, and external economic conditions (i.e., real estate recessions). Tr. 1451-55, 1436-45 [Thakor]; Tr. 2509-10 [Hamm]; DX 1909 at CSL055 0438-0443; Tr. (L) 1032-34 [High]; Tr. (L) 3132-36, 3139-40 [Lutz]; Tr. (L) 5618, 5635 [Brumbaugh]; DX 8 at 1-4 (volume of non-earning assets presented a "crushing burden," threatening viability); DX 7 at CSL001 1091-1099; Tr. 1453-55 [Thakor]; DX 3307 (similarly situated non-breach thrifts decline); see also Tr. 3237-38 [Finnerty] (citing PX 1118).

4. **Given Meritor's loss of regulatory capital during the period 1-1-88 to 12-31-89, how much asset shrinkage would have been necessary for the thrift to remain in compliance with the standard minimum capital requirements (*i.e.*, 5.5%/6.0%)? How much shrinkage would have been necessary to maintain a 0.5% regulatory capital cushion?**

RESPONSE: Meritor failed the minimum capital requirements notwithstanding divestitures. DX 50 at FSL011 0604 (June 1989 10Q); PX 9 at 0281; Tr. 766, 769 [High]; Tr. (L) 708 [Hillas]; Tr. 1489-91 [Thakor]. Meritor would have failed the minimum capital requirements by a greater margin had they retained the divested assets. Tr. 770-71, 786-87 [High].

Meritor, assuming it was unwilling to raise capital, indisputably would have shrunk absent the breach to the same extent it actually did in the real world – and, thus, sell every asset it in fact sold as part of its restructuring plan in 1987, 1988 and 1989 – to meet the minimum regulatory capital requirements applicable to the industry. See Tr. 1075-77, 1118 [Finnerty] (admitting $10 billion shrinkage); PX 541A, Ex. 1, p. 1-3 (Goldstein) (shrinkage by $10 billion); Tr. (L) 720-21 [Hillas]; Tr. 1363-65 [Hillas]; Tr. 1489-91 [Thakor]; Tr. 2617-29, 3122-25 [Hamm] (citing DX 3365, DX 3366); DX 68 at 2. Dr. Finnerty's model, withdrawn because it showed capital failure, asserted that Meritor would have shrunk by even more absent the breach. Tr. 1075-77 [Finnerty].

Plaintiffs' reliance upon Dr. Goldstein's model is misplaced because: (1) Dr. Goldstein's model shows more shrinkage in the but for scenario at year end 1989, compare PX 541A, Ex. 1 at p.1 ($11.4 billion) with PX 9 at CSL019 0259 ($12.6 billion); (2) Dr. Goldstein's model violates Meritor's internal capital cushion policies, compare Pl. Response No. 4 (5.71 percent primary and 6.03 percent total) and DX 1365 at 13 (requiring 6.0 percent and 6.25 percent

respectively); (3) neither Dr. Goldstein nor plaintiffs explained the unfounded claim that they would have shrunk absent the breach by $10 billion in two years without selling assets; and (4) Dr. Goldstein's model, in addition to being speculative, was riddled with uncorrected errors. See Def. Response No. 128.

5. What non-breach-related factors, if any, could have caused Meritor's share-price to decline relative to the NASDAQ Bank Index during the periods (a) January 1, 1986 – April 30, 1988, (b) May 1 – August 1, 1988, and (c) August 2, 1988 – December 11, 1992?

RESPONSE:

(a) Meritor's declining profitability between 1986 and 1988; its enormous reported loss in 1987; its massive, and increasing, credit problems; its increasingly high risk profile; its negative interest margin, as well as other factors – all of which were reflected in Meritor's declining stock price. Tr. 1434-49 [Thakor]; DX 3304A; Tr. 2508-10 [Hamm]; DX 3384; Tr. (L) 5589 [Brumbaugh]; Tr. (L) 3136, 3139-40 [Lutz]; DX 736 at 2; Tr. (L) 777 [Hillas]; DX 228 at 9-11; DX 241 at 2-3; DX 7 at CSL001 1088-89. See also Def. Response Nos. 4, 9.

(b) Meritor's continuing non-breach financial problems outlined above. Tr. 1132-33 [Finnerty] (PX 727) (Meritor suffers from "cancer"); Tr. 1437-55 (Thakor). Dr. Finnerty's "leakage" theory is without merit. The publications upon which he and plaintiffs rely say nothing about an impending MOU, and discuss Meritor's numerous non-breach problems. PX 727; PX 868; Tr. 1515-16 [Thakor]; see also DX 3129; PX 731; Tr. 1131-38 [Finnerty]; Tr. 2510-11, 2516-19, 2522 [Hamm]. PX 867 demonstrates that an MOU was not made public, and that non-breach problems were. Tr. 1134 [Finnerty]; DX 46, published May 13 – and, thus, irrelevant to Finnerty's stock price analysis based upon May 19, 1988 as the disclosure date – mentions numerous non-breach problems. See also Def. Response Nos. 9, 23, 24.

(c) Massive continuing losses and non-breach problems. Tr. 2522-28 [Hamm]; DX 3385; Tr. 1451-55 [Thakor]; Tr. (L) 5618, 5635 [Brumbaugh]; DX 736 at 1-2; DX 71 at CSL062 0015-17; see also Def. Response Nos. 3, 6. There was also a general downward trend in the stock

market for "comparable" thrifts. PX 1118 (Tr. 3237-38 [Finnerty]). Dr. Finnerty conceded that Meritor's profitability was below that of the "comparables." Tr. (L) 2483-84, 2495 [Finnerty]; see also Tr. 1454-55 [Thakor]; DX 3307. Contrary to plaintiffs' claim, the court did not decide causation. E.g., Tr. 1332-33 [Hillas].

6. Did Meritor face financial problems unrelated to the breach during the May 1, 1988 - December 11, 1992 period?

RESPONSE: Yes. See Def. Response Nos. 3, 5. Meritor reported massive losses during this period. Tr. 1451-55 [Thakor]; Tr. 2522-28 [Hamm]; DX 3385; DX 736 at 1-2; DX 71 at CSL062 0015-16; see also Tr. (L) 5618, 5635 [Brumbaugh]; Tr. (L) 1033-34 [High]; Tr. (L) 621-23, 714-16 [Hillas]. In addition, Meritor was crippled by "enormous impediments," including high-costing liabilities, vacant office space, costly hedges that needed to be closed out, non-performing assets, and goodwill amortization. Tr. (L) 1102-1103, 5187-88 [High]; Tr. 1451-52 [Thakor]; DX 241 at 10-12; Tr. (L) 714-16 [Hillas]; Tr. (L) 2868-69 [Valinote]. Meritor also suffered from external economic conditions that caused the performance of other banks to deteriorate as well. Tr. 1454-55 [Thakor]; DX 3307; Tr. (L) 2483-84, 2495 [Finnerty]; PX 1114 (Tr. 3232 [Finnerty]); PX 1118 (Tr. 3237-38 [Finnerty]). Finally, Meritor faced non-breaching regulatory problems, including the 1989 retirement of over $250 million in capital notes, as well as its failure to meet minimum regulatory capital requirements. Tr. 1489-91 [Thakor]; Tr. 2617-29, 3123-25 [Hamm]; Tr. (L) 4608 [Hammer]; Tr. (L) 3146 [Lutz].

Plaintiffs' contention that the breaches were the "substantial factor" in Meritor's demise after 1988 is baseless. Plaintiffs' argument also fails because: (1) "substantial factor" is not the proper causation test, see Def. Response No. 19; (2) even if it were, plaintiffs have not met their burden, see Def. Response No. 19; e.g., Tr. 2833-35 [Hamm]; DX 3370; DX 3023 at 85-87 [Hamm]; (3) Meritor, to meet minimum regulatory capital requirements, would have undergone massive shrinkage by at least $10 billion even absent the breach and, thus, would have sold all the assets it did sell up to the April 1990 branch sale, see Def. Response No. 4; (4) Meritor's

CEO agrees that Meritor would have sold at least 27 of the 54 branches to Mellon absent the breach, see Tr. (L) 720-21 [Hillas]; and (5) the 1991 Written Agreement had no effect upon Meritor's operations. Tr. (L) 1118-1120 [High] (no action required).

7. From what source(s) would the increased expected earnings needed to justify a control premium have come in August 1988 (after Mr. Hillas was hired)?

RESPONSE: A control premium reflects the synergies, and resulting enhanced cash flows, that an acquiring company might enjoy and thus pay for. Tr. 1491-1502 [Thakor]. Finance academic research is unanimous in concluding that a control premium cannot be assumed outside an acquisitions context. Tr. 3448-72 [Thakor]; DX 3534; Tr. 2529-34 [Hamm]; Dr. Finnerty explicitly assumed no acquisitions context. Tr. 1019-20, 1157 [Finnerty]; Tr.1493 [Thakor].

The academic research has identified essentially four sources of gains in which transfer of control may increase cash flow and enhance value: (1) "synergies," or efficiencies from more effective use of resources; (2) more efficient management, such that new management can do a better job; (3) excess perquisite consumption; and (4) tax benefits that the acquiror can take advantage of. Tr. 3462-64 [Thakor]; DX 3539. Dr. Finnerty did no analysis of any of these factors. Id.

The June 1988 Hillas arrival – and plaintiffs' deification of him – demonstrates that even if an acquisition scenario were proffered, any gains to be realized were already embedded in Meritor's stock price as of August 1, 1988. Tr. 3457-58 [Thakor].

That other institutions received control premiums – in an acquisitions context given specifically-identified synergies – is to no avail for plaintiffs. Tr. 3520-21 [Thakor]. Dr. Finnerty's sample represents only consummated mergers in which premiums were realized and thus was not a random sample. Id.; see also Tr. 2536-38 [Hamm]; Def. Response No. 21.

Finally, it is undisputed that any control premium inures to the benefit of the selling shareholders, not to the firm, precluding recovery as a matter of law in this derivative suit. Tr. 1499-1500 [Thakor]. See Phillip Morris, Inc. v. Comm'r, 96 T.C. 606, 629 (1991); Foltz v. U.S. News & World Report, Inc., 865 F.2d 364, 369 (D.C. Cir. 1989).

8. How did Meritor's pre-breach operating problems affect the damages calculated by Dr. Finnerty?

RESPONSE: Dr. Finnerty's expectancy damage calculations assumes causation and thus did not account for Meritor's pre-1988 breach operating problems. See Def. Response Nos. 3, 5; Tr. 1435, 1448-49 [Thakor]. Notwithstanding Meritor's financial deterioration before August 1988, Dr. Finnerty admitted that he merely assumed, without independent analysis, that Meritor's market value decline after the 1988 breach was attributed entirely to the breach. Tr. 1113, 1115-1117 [Finnerty]; see also Tr. 2509-10 [Hamm]; Tr. 1435, 1448-49 [Thakor]. It is implausible to assume causation given the numerous non-breach factors affecting Meritor's financial performance leading up to the 1988 breach. Tr. 1436-55 [Thakor]; DX 3302; DX 3304A; Tr. 2509-10 [Hamm].

Meritor's market valuation as of August 1988 did reflect past operating losses. But Dr. Finnerty ignores Meritor's historical performance and the myriad of economic and continued operational problems that impacted Meritor from 1988 to 1992 when positing his ex post causation assumption – that the loss of every dollar of Meritor's value was the result of the breach. Dr. Finnerty not only assumes away these terminal obstacles, he implausibly poses a valuation for Meritor that exceeds its actual August 1, 1988 market capitalization by 61 percent. Moreover, plaintiffs elsewhere concede that no-breach Meritor would have sustained over $400 million in additional operating losses after 1988. See PX 541A, Ex. 1, at p.2 (Goldstein Model).

Dr. Finnerty's inflated 1992 valuation based upon historical book values does not capture economic losses; Meritor's market valuation does. E.g., Tr. 1521-23, 1527-31, 1475-76 [Thakor].

9. Did Meritor's shedding of Western's assets proximately cause, or was it just a contributing factor, to Meritor's problems in 1988?

RESPONSE: Meritor's shedding of Western's assets resulted in gains, which boosted its regulatory capital by approximately $200 million in 1982-84 (DX 65 at 3; DX 64A at 37), as well as creating tax losses in the approximate amount of the foregone discounts. See Tr. 2347-49 [Hargett]. While the imbalance thus created between the foregone discount accretion and amortization of $53-54 million per year of goodwill could have conceivably contributed to Meritor's need to downsize further from 1988 to 1992, Meritor asserted it did not. See Def. Response No. 38. Meritor's more pressing problems in 1988 included the massive unrealized losses in its asset portfolios ($812 million as of September 30, 1987), DX 7 at 2-e-4, DX 69 at 32-33, 37, which included no Western assets, PX 854 at 3. As to income problems, Mr. Hammer had coined the term "financial anchors" to describe the four primary earnings problems Meritor suffered from. These "anchors," totalling $170 million per year, DX 481 at 2, included the amortization of goodwill (approximately $53 million/year), interest rate swaps, several billion dollars of assumable fixed-rate mortgages, and the EPIC problem. Tr. (L) 4612-17 [Hammer]. Using the figure cited by Mr. Hammer and assuming - contrary to plaintiffs' admission (see Def. Response No. 38) - an imbalance resulting from forgone discount accretion, the early sale of the Western assets could have created less than a third of Meritor's annual income problem, with additional asset, capital, liquidity and other problems creating the balance.

10. What were PSFS/Meritor's expectations at the time of the contract regarding the impact on earnings of the Western acquisition?

RESPONSE: The merger was perceived as strengthening Meritor, allowing it to restructure, and likely to enhance earnings. Def. Response No. 40; Tr. (L) 307, 311-12 [Cooke]; Tr. (L) 191-92 [Nocella]; Tr. (L) 4580-81, 4684 [Hammer]; Tr. 1671-73 [Gough]; Tr. 2210-11 [Hargett] (citing DX 502 at CSL012 1460); Tr. 2666, 2767-68 [Hamm]; DX 1358 at 2; DX 3001; DX 63 at 6 (CSL017 1249); DX 1883 at CSL100 0123-24. In fact, PSFS had concluded it needed to broaden its operations in order for the institution to survive. Tr. (L) 297 [Cooke]. See also Tr. (L) 297-98, 302 [Cooke]; DX 392 at 19; DX 1357 at CSL124 0158.

Meritor's pre-bid analysis concluded that $400 million in assistance would make the former Western's economic earnings break-even for 8-10 years with no growth in deposits. Tr. 2176-77 [Hargett]; DX 1357 at CSL124 0161; DX 1062 at CSL085 0043 (assistance valued at $552 million excluding credit guarantees). Mr. Nocella and Mr. Cooke considered the amount of the Western goodwill as equivalent to the value received by PSFS as part of the transaction, which included the Income Maintenance Agreement and the transferred value of the Western franchise. Tr. (L) 109-10, 233-34 [Nocella]; Tr. (L) 303-04 [Cooke]; DX 502 at 2. As a result of the level of assistance received from the FDIC as part of the transaction, the ongoing losses Western was suffering at the time of the merger had no material effect on the results of PSFS's operations immediately after the merger, and PSFS enjoyed significant upside potential once interest rates fell. Tr. (L) 207-08 [Nocella]; DX 392 at 56; DX 63 at 18; DX 64A at 35; DX 65 at 39.

11. Were changes in market interest rates after the Western acquisition sufficient to restore the acquired assets to their par value?

RESPONSE: Yes. The entire thrift industry, including PSFS and Western, was insolvent on a market basis in early 1982. Tr. (L) 189-90 [Nocella]; DX 62 at CSL089 0024-25, 0036; DX 64A at CSL089 0120; see Def. Response Nos. 15, 40; Tr. (L) 297 [Cooke]. Had PSFS held the discounted assets acquired from Western to term, the entire amount of the discount would have been received back by PSFS, minus those related to any assets that became non-performing, but PSFS desired to sell some early due to other considerations. Tr. (L) 205-06 [Nocella]; Tr. (L) 310-11 [Cooke]; Tr. 644 [Brummett]; Tr. 2190, 2192 [Hargett] (citing DX 3502); Tr. 751 [High]. Pre-merger, PSFS had estimated that an interest rate decline of 367 basis points would produce break-even earnings for Western. PX 15 at CSL 124 0089-90; Tr. 2768-69, 2774-76 [Hamm]; DX 3345. Interest rates fell approximately 700 basis points from 1982 until the interest rate spike in 1987. Tr. 643-44 [Brummett]; DX 3023 at 106. Plaintiffs concede that the Western assets, if retained, would have returned to par value within five years. Pl. Response No. 11, 47. More importantly, all refinanced or repaid loans paid off at par value. See also Def. Response No. 38.

12. Was the IMA designed to essentially insulate the assets and liabilities that were acquired from Western against interest rate risk ("IRR")during the 1982-1992 period, as long as Meritor did not exercise its option to terminate the agreement?

RESPONSE: Yes. The IMA was intended to protect Meritor for ten years against interest rate risk with respect to the assets and liabilities acquired from Western. The IMA fully hedged and insulated the Western portfolio from rising interest rates and assured that the portfolio would break-even with a lot of upside potential. Tr. 2774-76 [Hamm]; DX 3345; Tr. 2175-76 [Hargett]; Tr. 2178-79 [Hargett] (citing DX 3498); Tr. 3542-44 [Hamm]; DX 3066, page 21; Tr. 1444-45 [Thakor]. Meritor's own documents demonstrate that the IMA essentially converted the fixed-rate portfolio that had been acquired from Western into a variable-rate portfolio and largely insulated it from IRR. Tr. 2193-94 [Hargett] (citing DX 1062 at CSL085 0037, DX 1357 at CSL124 0162); DX 1883 at CSL100 0123-24.

The Western liabilities were more interest-sensitive than were the assets, so when interest rates rose during this period, the spread would narrow, but the FDIC payments would increase accordingly. If interest rates fell, the spread would increase, the FDIC payments would decrease, and the value of the Western assets would have risen simultaneously. See Tr. 2211-12 [Hargett]; DX 3506; Tr. 2182 [Hargett] (citing DX 3498 & 3501); Tr. 2192-93 [Hargett] (citing DX 3498); Tr. 2220 [Hargett] (citing DX 3508); Tr. 2302-03, 2199-2200 [Hargett]; Tr. 866-67, 869 [Brummett]; DX 1357 at 0162; DX 3140 at 60.

13. Was the FDIC assistance package that was provided to Meritor in connection with the Western transaction structured so as to essentially guarantee Meritor against loss with respect to the assets and liabilities acquired from Western?

RESPONSE: Yes. The "guarantee against loss" provided in the assistance agreement (DX 386 at 2) meant that the FDIC would guarantee the surviving bank from incurring material losses in the acquired portfolio, but this guarantee would not apply to independent business decisions of PSFS, including reinvestment decisions. Tr. 1650-51 [Gough]; Tr. 3537-38 [Hamm]; Tr. 2170-71 [Hargett] (quoting DX 3029 at CSL009 0105); Tr. 2169-70 [Hargett] (citing DX 3491); Tr. 2172, 2175 [Hargett]; Tr. 2214-16 [Hargett] (citing DX 3507 & 3502); Tr. 2424 [Hargett]; Tr. 714 [High].

Net interest margin: Meritor's IMA served two critical functions: (1) provide enough immediate assistance to eliminate the negative net interest margin on the acquired assets and liabilities; and (2) thereby eliminate IRR on Western's portfolio. Tr. 2181-83 [Hargett] (citing DX 3498 and 3501); Tr. 2189, 2192-94 [Hargett]; Tr. 2194-96 [Hargett] (citing DX 3509); Tr. 2197 [Hargett] (citing DX 392 at CSL020 1130); Tr. 2220 [Hargett] (citing DX 3498, DX 3501 & DX 3508); Tr. 2222-23 [Hargett]; Tr. 2302-03 [Hargett]; DX 1883 at CSL100 0123-24; DX 1357 at CSL124 0162; DX 1062 at CSL085 0037; Tr. 2181-91, 2403-04 [Hargett] (citing DX 3501); Tr. 1348, 1441-42, 1954 [Thakor]; Tr. (L) 2706-07 [Gough]; Tr. (L) 1527 [Isaac]; Tr. 708-09, 749, 753, 785 [High]; Tr. 502, 641-51, 801, 803-05, 866-67, 869 [Brummett]; DX 1357 at CSL124 0089-90; Tr. 2775 [Hamm] (citing DX 3345); Tr. 2783-86 [Hamm] (citing DX 3342); Tr. 2797-98, 2847-48, 3537-38, 3540, [Hamm].

Credit risk: Meritor reserved only $15.8 million for estimated credit losses on the acquired Western portfolio in 1982, reflecting every dollar of probable non-covered losses. Tr.

2415-17 [Hargett]; DX 63 at 20 (CSL017 1263); DX 65 at CSL089 0201. Western had suffered only $15 million in net loan charge-offs from 1976-81. PX 606 at 1; PX 612 at 1; PX 607 at 2; see also PX 15 at 24; Tr. 2892 [Hamm]; PX 24 at 2. The private placement issues were generally protected. See PX 15 at 27; PX 21 at 11-12. PSFS immediately sold Western's residential mortgages, bond and stock portfolios despite considering them of relatively good quality. PX 15 at 25-26, 28; DX 63 at CSL017 1249.

G&A expense: Meritor estimated in 1982 that annual incremental operating expenses for Western would total 0.58 percent of average deposits. Tr. 2249-50 [Hargett] (citing DX 3522); Tr. 2821-23 [Hamm]; DX 3024 at ¶¶ 69-72 & Ex. K; DX 1357 at CSL124 0155. By design, such expenses were covered by the earnings from the $112 million note contributed by the FDIC. See Tr. 3540 [Hamm]; Tr. 2363 [Hargett].

Liquidity: See DX 63 at 8.

Meritor was at break even from the start. Tr. 2775-77 [Hamm]; DX 3345; Tr. 2783-86 [Hamm]; DX 3342; Tr. 2171-74 [Hargett]; DX 63 at CSL017 1261; Tr. 2174-75 [Hargett] (citing DX 3497); Tr. 2197-98 [Hargett]; DX 3497; Tr. 720-21 [High].

14. Did the "Loss (from par value) on investments and loans sold" from Mr. Brummett's Income Statement reflect cash disbursements by Meritor?

RESPONSE: No. See Pl. Response No. 14. This line reflected the amount of the "paper" purchase discount not recovered at sale. PX 854 at Exh. A. As the discounted assets were sold, Mr. Brummett placed the cash proceeds into a hypothetical account he referred to as "Intercompany receivable (payable)." See PX 854 at 7. For example, on Exh. B of PX 854, Mr. Brummett shows that Western's discounted investments were reduced from April 3, 1982 to Dec. 31, 1982 from $731 million to $193 million, and its mortgages from $491 million to $363, while its Intercompany receivable increased from zero to $863 million. Thus, the "Cash loss" of $386.7 million for 1982 shown in Mr. Brummett's exh. A.1 did not reflect a cash disbursement in that amount, rather Western generated upwards of $863 million in cash for PSFS to invest in 1982, by Mr. Brummett's own calculations. Plaintiffs' absurd attempt to characterize the $386 million figure for 1982 as a cash loss reflects their untenable underlying assumption that PSFS assumed $796 million of net liabilities when it acquired Western and that this was the equivalent to a cash expenditure. See Def. Response No. 115. The "losses" that Mr. Brummett has Meritor incurring in the first nine months of the contract are three and a half times the income it reported for the preceding five years. Tr. 2789-91 [Hamm]. See also Tr. 2806-07 [Hamm]; DX 3352.

III. 1988 Value

15. What was Meritor's value immediately prior to the 1982 merger with Western?

RESPONSE: PSFS needed to broaden its operations in order for the institution to survive. Tr. (L) 297 [Cooke]. PSFS was insolvent on a mark-to-market basis immediately prior to the 1982 merger with Western. See Def. Response Nos. 11, 40. PSFS's investment portfolio alone contained unrecognized losses of over $723 million at the end of 1981 and over $413 million at the end of 1982, while surplus and retained earnings totaled only about $388 million at the end of 1981 and about $429 million at the end of 1982. The average yield earned on its loan portfolio in the first quarter of 1982 was 9.49 percent versus a weighted average rate of 10.95 percent paid on liabilities for the same period. DX 392 at 14, 27; DX 63 at 15.

Western's conventional mortgages had average book yields between 9.76 and 9.625 percent, virtually identical to those of Meritor, and were marked to market in 1982 using a market rate of 17 or 17.5 percent, which reduced their market value by almost half of book value. DX 510. Marking PSFS's loan portfolios to market at the same interest rates used for the Western portfolio would have created discounts proportionate to Western's. Tr. (L) 189-90 [Nocella]. Given the larger size of PSFS, it was likely insolvent by billions of dollars in April 1982.

16. What was the closing price of Meritor's stock on the day it was offered to the public in 1983? How much was raised by that offering?

RESPONSE: The stock closed at $11.4375 per share on September 15, 1983. DX 3025 at Ex. 7 & 8 [Thakor Report]. Meritor reported raising a net amount of approximately $369 million in the 1983 stock offering. DX 64A at 4, 33.

1988 Value

17. Did Meritor's market value decline by 60% before the 1988 MOU?

RESPONSE: Yes. Between the IPO in September of 1983 through December 1987, 6 months before first breach, Meritor lost approximately 60 percent of its stock market value. Tr. 1447 [Thakor]; DX 3304A; accord Pl. Response No. 17.

This decline – and Meritor's overall historical performance – is highly relevant as a matter of fact and law in assessing how Meritor might have performed between 1988 and 1992 absent the breach. Def. Response Nos. 3, 5(a), 8; e.g., Suess, 52 Fed. Cl. at 226-27. Plaintiffs assert that we provided no "substantive analysis" demonstrating that Meritor's historical decline would have informed its performance in the no breach world. They are incorrect. Tr. 1436-51 [Thakor]; DX 3302; DX 3304A; DX 3305; Tr. 2508-10 [Hamm]. Meritor's historical performance also apparently informed their own experts. PX 541A, Ex. 1, p.2 (Goldstein Model asserting that, consistent with history, Meritor would have sustained over $400 million in losses between 1989 and 1991 absent the breach); Tr. 2473 [Finnerty]; Tr. (L) 5618, 5635 [Brumbaugh].

18. Did Meritor lose all of its value as a result of the government's breaches?

RESPONSE: No. Meritor suffered from substantial non-breach operating problems both before and after the breach, all of which resulted in significant net losses. Def. Response Nos. 3, 5, 6, 8, 17, citing Tr. 1437-55 [Thakor]; Tr. 2509-10, 2522-28 [Hamm]; DX 3385; DX 736 at 1-2; DX 71 at CSL062 0015-17; see also Tr. (L) 5618, 5635 [Brumbaugh]; Tr. (L) 1032-1034 [High]; Tr. (L) 621-22, 714-16 [Hillas]; Tr. (L) 1102-1103, 5187-88 [High]; DX 241 at 11; Tr. (L) 2868-69 [Valinote]; Tr. 1454-55 [Thakor]; DX 3307; Tr. (L) 2483-84, 2495 [Finnerty]; PX 1114 (Tr. 3232 [Finnerty]); PX 1118 (Tr. 3237-38 [Finnerty]); Tr. 2509-10 [Hamm]; DX 1909 at CSL055 0438-0443 (High Presentation); Tr. (L) 3132-36, 3139-40 [Lutz]; DX 8 at 1-4.

Irrespective of the breach, the need for Meritor to meet minimum regulatory capital requirements would have forced major restructuring, assuming Meritor was unwilling to raise capital. Tr. 1075-77, 1118 [Finnerty]; PX 541A, Ex. 1, p.1-3 [Goldstein]; Tr. (L) 3146 [Lutz]; Tr. (L) 720-21 [Hillas]; Tr. 1363-65 [Hillas]; Tr. 1489-91 [Thakor]; Tr. 2617-29, 3123-25 [Hamm]; DX 3406; DX 3365; DX 3366; DX 68 at 2.

Undisputed empirical evidence further demonstrates that neither the breaches, nor the 1990 branch sales, resulted in the total diminution of Meritor's value, Tr. 1456-1472 [Thakor], nor to the foreseeable loss of the entirety of Meritor's value. Tr. 1456-61 [Thakor]. If thousands of sophisticated market participants could not, "in the ordinary course of events," foresee such a loss at the time of the breach, it necessarily follows that regulators could not have foreseen such a loss at the time of contract formation. E.g., Landmark Land Co. v. United States, 256 F.3d 1365, 1378 (Fed. Cir. 2001) (citing RESTATEMENT OF CONTRACTS (SECOND) § 351(2) and 5 A. Corbin, Corbin on Contracts, § 1012 at 88 (1964)).

Plaintiffs assert that shrinkage resulted in total lost equity value, but plaintiffs' witnesses agree that Meritor would have undergone massive shrinkage and branch divestitures absent the breach. Tr. (L) 720-21 [Hillas]; Tr. 1363-65 [Hillas]; PX 541A, Ex. 1, p.1 [Goldstein]; Tr. 1075-77 [Finnerty]. Contrary to plaintiffs' claim, Dr. Goldstein clearly <u>did not</u> prove "prosperity" at no-breach Meritor. PX 541A, Ex. 1, p.2; <u>see</u> <u>also</u> Tr. 1436-55 [Thakor]; <u>accord</u> Tr. (L) 5635, 5618 [Brumbaugh]. Contrary to plaintiffs' claim, Dr. Hamm agreed only that the bank could control <u>growth</u> through rates and runoff, not execute a massive shrinkage of $10 billion within two years by doing so. Tr. 2829-30, 3538 [Hamm].

19. Have plaintiffs established causation with respect to the claimed loss of the "total equity" of Meritor as of August 1, 1988?

RESPONSE: No. Dr. Finnerty merely assumed causation without analysis. Tr. 1435 [Thakor]; Tr. 1113, 1115-17, 1124 [Finnerty]. Meritor's value declined substantially for a myriad of non-breach reasons. Def. Response Nos. 3, 5, 6, 8, 18; accord Tr. (L) 5618, 5635 [Brumbaugh]; PX 1114 (Tr. 3232 [Finnerty]); PX 1118 (Tr. 3237-38 [Finnerty]); see also Tr. (L) 2483-84, 2495 [Finnerty]; Tr. 1454-55 [Thakor]; DX 3307; see also Tr. 1456-1472 [Thakor]; DX 3304A.

The causation test in this Circuit requires that plaintiffs prove that the claimed damage "was attributable solely to, and was therefore directly caused by, the [breach]." J.D. Hedin Constr. Co. v. United States, 456 F.2d 1315, 1330 (Ct. Cl. 1972); see also Myerle v. United States, 33 Ct. Cl. 1, 27 (1897). The "substantial factor" test is a tort standard used to analyze concurrent cause cases, Keeton, et al., Prosser And Keeton On The Law of Torts, 266-68 (5th ed. 1984), and is only applied if it "generally yields identical results." Abbott Labs. v. Brennan, 952 F.2d 1346, 1352-53 (Fed. Cir. 1992).

Plaintiffs fail even the "substantial factor" test given numerous non-breach problems afflicting Meritor, and because the breach alone was insufficient to cause the claimed harm (total lost equity value). Shyface v. Secretary of Health and Human Services, 165 F.3d 1344, 1352-52 (Fed Cir. 1999) (quoting RESTATEMENT (SECOND) OF TORTS § 433); Menne v. Celotex Corp., 861 F.2d 1453, 1461 (10th Cir. 1988); Point Productions A.G. v. Sony Music Entertainment, Inc., 215 F. Supp.2d 336, 344 (S.D.N.Y. 2002); see also Greater Rockford Energy and Technology Corp. v. Shell Oil Co., 998 F.2d 391, 401-02 (7th Cir. 1992).

Even assuming that "regulatory capital constraints," as opposed to operating problems, caused Meritor's decline, DX 3370 (Tr. 2833-35 [Hamm]) proves that the breach did not cause those alleged constraints. See also DX 3023 at 85-87.

Meritor could have raised capital, but chose not to. Tr. 1462-68 [Thakor]; DX 1909 at 0445; Tr. (L) 1071:2-16 [High]; Hughes Communications Galaxy, Inc. v. United States, 271 F.3d 1060, 1071 (Fed. Cir. 2001) (independent business decisions break causation chain); Wells Fargo Bank v. United States, 88 F.3d 1012, 1022-23 (Fed. Cir. 1996).

That no institution was seized with positive capital before FDICIA is irrelevant because: (1) plaintiffs' point fails to address the causes of Meritor's decline, 1988-1992, before seizure; (2) FDICIA ushered in a stricter, non-breach regulatory regime, requiring seizure for non-compliance, Tr. 2016 [Thakor]; and (3) Meritor projected capital failure at the end of 1992 including goodwill, DX 420 at 9. See also Tr. (L) 1134-37 [High]; Tr. 2018 [Thakor]. Plaintiffs' claim that Dr. Goldstein shows shrinkage through "runoff" without divestitures is unfounded. Def. Response Nos. 4, 18, 73, 74.

20. Is Dr. Finnerty's use of the average stock price for the 30 days before May 19, 1988 to value Meritor as of August 1, 1988, reasonable?

RESPONSE: No. At trial, Dr. Finnerty's "leakage" theory was proven baseless because the articles upon which he relied did not mention any forthcoming MOU. See Def. Response Nos. 5(b), 23; see also PX 868; PX 727; DX 3129; PX 731; Tr. 1515-16 [Thakor]; Tr. 1128-30, 1132-38 [Finnerty]; see also 1139-40, 1142-43 [Finnerty] (no need for "leakage" adjustment in prior reports). Instead, other non-breach financial concerns – including non-breaching regulatory capital constraints (i.e., retirement of $250 million in notes; minimum regulatory requirements) were discussed. Id. Dr. Finnerty made no attempt to separate out non-breach disclosures. Tr. 1138 [Finnerty]; Tr. 1515-16 [Thakor].

Dr. Thakor conceptually agreed that one needs to account for informational "leakage" to determine Meritor's pre-breach value. Tr. 1503 [Thakor]. However, he rejected Finnerty's analysis because: (1) there was no demonstrable disclosure of a forthcoming MOU in the publications Dr. Finnerty relies upon, Tr. 1515-16 [Thakor]; (2) even if there were, Dr. Finnerty made no attempt to control for non-breach disclosures in the same publications, id.; Tr. 1138 [Finnerty]; and (3) he made no effort to establish the one-to-one correlation between the NASDAQ Bank Index and Meritor's stock price he assumes, see Def. Response No. 24; Tr. 1502-14, 3472-83 [Thakor]; DX 3543.

21. Is a control premium justified here?

RESPONSE: No. A control premium reflects the enhanced cash flows from efficiencies that an acquiring company might pay for. Def. Response No. 7; Tr. 1491-1502 [Thakor]. The academic literature is unanimous in concluding that a control premium is recognized only in an acquisitions context after identifying the sources of gains an acquiror would pay for. Tr. 3448-72 [Thakor]; DX 3537; DX 3539; Def. Response No. 7. Dr. Finnerty assumes no acquisitions context, Tr. 1019-20, 1156-58 [Finnerty]; Tr.1493 [Thakor]; and has not evaluated the sources of a control premium. Tr. 3462-64 [Thakor]; see also Tr. 2528-49 [Hamm].

That other institutions received control premiums – in an acquisitions context – does not support one here. Tr. 3520-21 [Thakor]; Tr. 2111 [Epstein]. Dr. Finnerty's sample only represents consummated mergers in which premiums were realized and is thus not a random sample. Id.; see also Tr. 2542-46 [Hamm]; DX 3395. That no potential acquirors offered to buy Meritor, is prima facia evidence that investors did not believe Meritor's value was underpriced in the market. Tr. 2536-40 [Hamm]; DX 3071; see also Def. Response No. 22.

Plaintiffs also confuse "control" premiums and "franchise" premiums when contending the realization of a substantial premium justifies a gross up of Meritor's market capitalization; any franchise value was already embedded in Meritor's stock price. E.g., Tr. 2541-42 [Hamm]; see Def. Response No. 25.

Plaintiffs contend that a theoretical gain in market share supports a control premium, Pl. Response No. 21, but again fail to provide an acquiror, and analysis of this source.

Finally, any control premium is legally unrecoverable as it inures to the benefit of shareholders, not the firm. Tr. 1499-1500 [Thakor]. See Phillip Morris, Inc. v. Comm'r, 96 T.C. 606, 629 (1991); Foltz v. U.S. News & World Report, Inc., 865 F.2d 364, 369 (D.C. Cir. 1989)

22. What evidence supports the claim that Meritor might have been a takeover target in 1988?

RESPONSE: Recognizing the overwhelming academic research in finance conclusively demonstrating that control premiums cannot be assumed outside an acquisitions context, e.g., Tr. 3449-51 [Thakor]; DX 3534; Tr. 2539-40 [Hamm]; DX 3071;, plaintiffs, during surrebuttal, switched course, contending (based upon comments by CEO Hammer in 1987) that Meritor might have been acquired. Tr. 3470-72 [Thakor]. CEO Hammer merely referred to hostile "takeover possibilities," PX 128 at CSL016 0017, and that management was attempting to fight off such efforts so that it could resolve its problems first. See PX 129 at 7; Tr. 3471 [Thakor].

No evidence suggests that any potential acquiror was actually extant, let alone an acquiror who was willing to offer 50 percent above market value – presumptive evidence against a control premium. Tr. 2536-41 [Hamm]; accord Tr. 1157-59, 1162-63 [Finnerty]; see also Tr. (L) 1085 [High]; DX 1067 at 24 (Mellon branch sale designed to make Meritor more attractive to buyers). If there were such a willing buyer at 50 percent above market, Meritor surely would have jumped at the opportunity.

Plaintiffs claim that assessment of a control premium without evaluating the sources of such a premium in an acquisitions context is permissible, relying in part upon Dr. Epstein and case law. Pl. Response No. 22. Their citations do not support the proposition, and see Def. Response Nos. 7, 21; e.g., Tr. 3465-67 [Thakor] (responding to IRS, real estate appraisal, and other examples where observable market value not present).

23. In valuing Meritor as of August 1988, is it appropriate to make an adjustment for the possible impacts on Meritor's share price from breach-related publicity prior to the date the MOU was signed?

RESPONSE: No, because Dr. Finnerty has failed to establish public disclosure of the breach before August 1, 1988. Tr. 1515-16 [Thakor]; Tr. 1129-38 [Finnerty]; see PX 727; PX 868; DX 3129; PX 867 (demonstrating that an MOU was not discussed at the shareholder meeting); Def. Response Nos. 5(b), 20. Even if there were disclosure of the breach, Finnerty failed to control for all the non-breach disclosures in these publications of Meritor's severe operating problems negatively affecting its stock price. Tr. 1138 [Finnerty]; Tr. 1515-16 [Thakor]. In addition, he made no effort to establish that the NASDAQ Bank Index was a valid proxy for movement of Meritor's stock price during the "leakage" period, May 19-August 1, 1988. See Def. Response No. 24.

Plaintiffs cite DX 46 at FSL011 0864 for disclosure of the breach. This reliance fails because: (1) DX 46 merely speaks of a plan to raise Meritor's primary capital "to a level that would exceed the specified regulatory minimums" which is consistent with Meritor's pre-breach goal to raise its capital ratios, see Tr. (L) 313-15 [Cooke]; Tr. (L) 4562-63 [Hammer]; DX 482 at CSL076 0379-80; DX 376 at 3; and (2) discusses numerous non-breach operating problems of Meritor which Finnerty failed to control for. See DX 46 at FSL011 0864; Tr. 1138 [Finnerty]; Tr. 1515-16 [Thakor]. Plaintiffs contend that non-breach problems were previously disclosed, but Meritor's new reported losses for the quarter and deepening credit quality problems – to name a few – clearly were not.

24. Does Meritor's stock price positively correlate with the NASDAQ Bank Index?

RESPONSE: Yes, but not in the manner Dr. Finnerty assumes, and only to a limited degree that provides no predictive power. Dr. Finnerty asserted a one-to-one relationship between the NASDAQ Bank Index and Meritor's stock price without offering any regression analysis to support this conclusion. Tr. 1503, 1505-06 [Thakor]; see also Tr. 1751-60 [Epstein].

Professor Thakor, noting Dr. Finnerty's failure to run a regression analysis to prove the relationship he assumed, performed his own regression, concluding that the NASDAQ Bank Index and Meritor's stock were not positively correlated. Tr. 1513-14, 3473-74 [Thakor]; DX 3542. In running this analysis, he took all of Dr. Finnerty's assumptions as given. Tr. 1514, 3472-74, 3476-78 [Thakor].

During rebuttal, still failing to provide his own analysis proving his one-to-one relationship, Dr. Finnerty performed a regression analysis and chastised Professor Thakor's regression for failing to account for "autocorrelation" – the phenomenon that the best predictor of Meritor's stock price today is its stock price yesterday. Tr. 3474-78 [Thakor]. Doing so reestablishes positive correlation, however, the positive correlation is statistically meaningless.

Dr. Finnerty's invocation of "autocorrelation" refutes the one-to-one relationship he assumed, and proves that Meritor's own stock price and other variables, not NASDAQ, best predict Meritor's future stock price. Tr. 3474-82 [Thakor]; DX 3543. Dr. Finnerty never offered a predictive model incorporating other explanatory variables he now concedes weigh more heavily upon Meritor's stock price. Tr. 3479-82 [Thakor].

25. What is the relevance of the premium Mellon paid for Meritor in 1990 to the 1988 valuation of Meritor?

RESPONSE: None, because the premium received by Meritor was based upon the sale of only a portion of the bank – excluding the severely troubled asset portfolio, high cost liabilities, etc. See Tr. 2541-42 [Hamm]; Tr. 3515-16 [Thakor]. It is an apples–to-oranges comparison: control premiums and franchise value/premiums are two different economic concepts. Id.

Moreover, Meritor retained the $336 million premium paid by Mellon in exchange for the branches and, thus, one would have expected Meritor's stock price to skyrocket at the time of the sales – by 336 percent according to Pl. Response No. 25 – if the $336 million reflected a value previously unrecognized by the market. There was no such increase (or decrease), Tr. 1474-75 [Thakor], thus proving: (1) Meritor's market price already had embedded within it the franchise value ultimately paid for by Mellon; and (2) the branches were sold at fair market value causing no foreseeable economic harm. Tr. 2541-42 [Hamm]; Tr. 1471-81, 1458-60, 3515-16 [Thakor]; Tr. 1289:4-11 [Finnerty].

Similarly, it is erroneous to suggest that the $181 million premium received by the FDIC receivership for the sale of a "clean bank" to Mellon reflected the value of the total bank in 1992. Tr. 1522-23 [Thakor]; see also Def. Response No. 27.

That no institution was interested in acquiring the entire bank after 1988 – notwithstanding Meritor's efforts to position the bank for sale, DX 1067 at p.24; Tr. (L) 1085 [High], Tr. (L) 991-92, 1003-05 [High] – further proves Meritor was not undervalued by the market.

IV. 1992 Value

26. How do you reconcile the $112 million damage claim at seizure with Meritor's market capitalization value of $15 million in December of 1992?

RESPONSE: Dr. Finnerty's damage claim at seizure cannot be reconciled with Meritor's open market valuation in December 1992 or with the market's historical valuation of Meritor. Average market capitalization remained far below $100 million for the previous three years. Tr. 1097-98 [Finnerty]; Tr. 2564-65, 2567 [Hamm] (citing DX 3379); Tr. 1528 [Thakor] (citing DX 3304A). The market valued Meritor at $14 million day before the receivership was established; $29 million on October 13, 1992, the day before press speculation identified by Dr. Finnerty concerning Meritor's ability to count goodwill as tangible capital; $31 million on September 25, 1992, the day before FDIC published its rule on implementation of FDICIA; and $22 million on December 18, 1991, the day before FDICIA became law. Tr. 2565-67 [Hamm]; DX 3379; Tr. 1529-31 [Thakor]; DX 3304A. The contemporaneous FDIC estimate of the receivership results was $40 million, assuming Mellon absorbed $170 million in losses. DX 1022 at 16-18; PX 502B at 48276.

Moreover, Dr. Finnerty's inflated figure is further unreconcilable with the fact that Dr. Finnerty concluded that prior to the 1991 Written Agreement, Meritor was worth $50 million. Tr. 1093. Dr. Finnerty's 1992 valuation implies, implausibly, that Meritor's value increased by more than 100 percent notwithstanding the imposition of the 1991 Written Agreement, which plaintiffs claim was harmful. Tr. 1529-30 [Thakor]; see also Def. Response Nos. 27, 28.

27. What is the relevance of the premium Mellon paid for Meritor in 1992 to the 1992 valuation of Meritor?

RESPONSE: The premium has no direct relevance, and, in fact, indicates that Meritor's true market value was much less than Dr. Finnerty's 1992 valuation. See Tr. 1523 [Thakor]. First, the premium merely reflected the value of the particular assets and liabilities selected by Mellon and was inflated by the FDIC's loss sharing agreement. Mr. Frank Francisco, review examiner for Meritor, recalled payments to Mellon of $120 million under the loss sharing agreement in the first six months of the receivership. Tr. (L) 3726-28 [Francisco]. The premium did not reflect the massive problems in the assets and liabilities left in the receivership. Tr. 1523 [Thakor]. As described by Mr. Dennis Fitzgerald, examiner-in charge for the July 1992 examination, the level of Meritor's adversely classified assets were "horrendous" and unprecedented in his career. Tr. (L) 1593 [Fitzgerald]; DX 841. He expected continued deterioration in the commercial real estate portfolio, Tr. (L) 1593-94 [Fitzgerald]; DX 841, and did not believe that Meritor's real estate loans would improve if the economy improved. Tr. (L) 1595 [Fitzgerald]. In fact, Meritor's own management conceded in October 1, 1992, that: "Meritor . . . has a relatively high volume of nonperforming assets, ... it is too early to conclude that problems in the real estate portfolio have peaked . . ." DX 1788 at 6-7; see PX 845 at 7 (total gain or loss on disposition of assets was $274 million out of receivership's loss on operations of about $320 million).

28. Are the values assigned by Dr. Finnerty in his 1992 valuation reasonable?

RESPONSE: No. His disparate 1992 valuation conclusions and associated errors render his conclusions uncertain. See Tr. 1080 [Finnerty] ($336 million); Tr. 1081-82, 1085 [Finnerty] ($242 million); Tr. 1092 [Finnerty] ($226 million); Tr. 1092 [Finnerty] ($211 million); Tr. 1085 [Finnerty] ($195 million); Tr. 1092-93 [Finnerty] ($102 million); Tr. 1086-92 [Finnerty] (conceding multiple valuation errors).

Dr. Finnerty's use of the "asset approach" fails to measure the actual market value of Meritor's equity. Tr. 2560-61 [Hamm]; DX 3377; see also Tr. 1226 [Finnerty] (made no "sense to rely just on one valuation technique"). Dr. Finnerty implausibly assumes that book values reflect market values and, consequently, he grossly overstates Meritor's true economic value. Tr. 2570-71 [Hamm]; Tr. 3530-31 [Hamm]; Tr. 1521-23 [Thakor]. Moreover, his sporadic and unscientific adjustments intended to convert certain book values to market values are arbitrary and woefully inadequate in assessing the market value of Meritor's equity. See Tr. 1031-32 [Finnerty]. In the liability trial, he made $122 million in negative adjustments to book value. Tr. 1208, 1220 [Finnerty]. Were the same adjustments taken here, in combination with his $109 million increase to the loan loss reserve for asset quality issues, Tr. 1033-34 [Finnerty], his estimate of the 1992 equity would fall to zero. Tr. 1223 [Finnerty].

Also, Dr. Finnerty's use of Washington Federal's loan loss reserve ratio bears no logical connection to Meritor's reserve requirements. Tr. 2571-73 [Hamm].

Dr. Finnerty also did not determine the market value of Meritor's liabilities and, thus, significantly understated the economic burden of Meritor's high-cost liabilities, which was

significantly higher than book value in December 1992, thus overstating Meritor's equity value. Tr. 2577-82 [Hamm] (citing DX 3380); Tr. 3530-31 [Hamm]; see Def. Response No. 29.

29. Did the high cost of Meritor's liabilities undermine Dr. Finnerty's analysis?

RESPONSE: Yes. Approximately $661 million of the liabilities retained by the receivership had above-market rates and $25 million had below market rates. DX 3023 at 152. Dr. Finnerty ignores this evidence by valuing Meritor's liabilities at book value, significantly understating the economic burden of the liabilities owed by the remainder of Meritor, and thereby artificially boosting his December 11, 1992 equity value by the amount of the understatement. DX 3023 at 152; Tr. 2577-82 [Hamm] (citing DX 3380). The economic burden of Meritor's remaining liabilities was significantly higher than the book value. Tr. 2577-82 [Hamm] (citing DX 3380); see Tr. 2583 [Hamm] (citing DX 632 at 17) (Meritor's liabilities imposed heavier burden than Dr. Finnerty allows). If Dr. Finnerty had properly determined the market value of liabilities and deducted them from the market value of the assets, his asset valuation of $112 million would have come down accordingly. Tr. 2582 [Hamm].

Dr. Finnerty's assertion that Meritor's assets were so impaired at the time that they could not have supported liabilities with a market value greater than book value is irrelevant to the valuation of the liabilities. Tr. 1035-36 [Finnerty]. The market does not care what assets are worth when it comes to valuing liabilities; the market only cares about the terms of the liabilities. Tr. 3530-31 [Hamm]. The issue is whether the economic value of Meritor's liabilities were greater than or less than book value, which Dr. Finnerty ignores. Tr. 3530-31 [Hamm].

V. Market Efficiency

30. Was there a difference between Meritor's actual stock price on the exchange and what its "real value" was? In other words, was its stock severely undervalued by the market because of factors irrelevant to its prospects?

RESPONSE: No, and plaintiffs concede this. Pl. Response No. 30. Plaintiffs also do not dispute that Meritor's stock price shortly after the breaches incorporated the foreseeable effect of the breaches; plaintiffs' only contention is that Meritor's market capitalization purportedly would have been higher absent the breaches. Id.; see Tr. 1456-61 [Thakor]. Indeed, plaintiffs, in contending that public capital markets would have accurately gauged the valuation effects of an announcement by FDIC discounting goodwill, see Pl. Response No. 30, concede that the market accurately assessed the effect of the first breach by August 1988; the MOU was the public announcement manifesting the first breach in this case. Tr. 1960-64 [Thakor].

Perhaps no doctrine in the field of financial economics is more accepted than the "efficient markets" hypothesis for the public securities market: market values reflect true values, and the market provides the best judgement about the value of future cash flows. Tr. 1475-76 [Thakor]; Tr. 2522-25 [Hamm]. For these reasons, economists trust market prices, and so do courts absent proof to the contrary. See Tr. 1475-76 [Thakor]; accord Basic, Inc. v. Levinson, 485 U.S. 224, 246 (1988).

Dr. Finnerty tacitly relied upon the efficient markets doctrine in proffering his "leakage" theory – a theory which argues that the market accurately assessed the foreseeable effects of the breach upon public disclosure of it. Tr. 1517 [Thakor]. We agree with his underlying thesis, but explained there was no leakage. Def. Response Nos. 5(b), 20, 23.

31. Did the public/capital markets have complete information about Meritor between 1988-92?

RESPONSE: Yes. Meritor was required to fully and truthfully disclose its financial condition every quarter. Tr. 1473-74, 2025-27 [Thakor]; accord Tr. 732-33 [High].

Plaintiffs suggest that the public markets might not have had complete information because: (1) In August 1988, the market could not foresee the future breaches; (2) the market was unaware of regulatory commentary purportedly discounting goodwill; and (3) Meritor withheld the negative effects of the branch sales to prevent panic.

First, Dr. Thakor, in observing Meritor's de minimus stock price decline after the 1988 MOU, assessed the effects of 1988 MOU and the plausibility of Dr. Finnerty's 1988 damage claim. Tr. 1456-62 [Thakor]. To assess the cumulative effects of each breach, he evaluated the market values before and after each breach, isolating each breach's effect, which showed no substantial drop in value. Id.; DX 3304A.

Plaintiffs' second point is confusing because the public manifestation of regulatory treatment of goodwill – the actual breaches found by the Court – were the higher capital requirements imposed by the 1988 MOU and 1991 Written Agreement. Tr. 1960-64 [Thakor]. Again, plaintiffs concede that the markets capture the effects of public announcements. Pl. Response Nos. 31, 30.

Finally, the suggestion that Meritor withheld negative information about the branch sales is troubling, and is belied by Meritor's own affirmative statements, market reaction, and Meritor's receipt of fair market value. Tr. (L) 761-62 [Hillas]; Tr. (L) 1439, 1459-60 [Slattery]; Tr. 5005-06 [Ketcha]; Tr. 1470-72, 1473-74, 2025-26 [Thakor]; DX 3310.

VI. Reliance

32. In proving reliance damages (cost of performance), who carries the burden of proof, and by what standard, with respect to establishing expenses incurred?

RESPONSE: Plaintiffs bear the burden of proving reliance damages. Landmark Land Co., Inc. v. United States, 256 F.3d 1365, 1378 (Fed. Cir. 2001); Castle v. United States, 301 F.3d 1328, 1341 (Fed. Cir. 2002) (plaintiffs "demonstrated no individual loss . . . caused by reliance on the contract"), reh'g & reh'g en banc denied, 2003 WL 21212568 (Fed. Cir. May 1, 2003), cert. denied, 123 S.Ct. 2572 (2003); Westfed Holdings, Inc. v. United States, 52 Fed. Cl. 135, 155 (2002), appeal docketed, Nos. 03-5131, 03-5145 (Fed. Cir. July 16, 2003); id. at 155 (plaintiff must prove it incurred expenditures and that it incurred them in reliance on the contract); id. at 155 ("burden . . . rests with plaintiff. . . .); Hansen Bancorp, Inc. v. United States, 53 Fed. Cl. 92, 99 & n.7 (2002), appeal pending, Nos. 03-5029, 03-5061 (Fed. Cir.).

As with other types of contract damages "[r]eliance damages are subject to the ordinary limitations upon contract remedies: causation, certainty, and foreseeability." California Fed. Bank, FSB v. United States, 43 Fed. Cl. 445, 450 (1999), aff'd in part, vacated in part, 245 F.3d 1342 (Fed. Cir. 2001), cert. denied, 534 U.S. 1113 (2002); Landmark, 256 F.3d at 1378; Bluebonnet Savings Bank, FSB v. United States, 266 F.3d 1348, 1355 (Fed. Cir. 2001); Energy Capital Corp. v. United States, 302 F.3d 1314, 1325 (Fed. Cir.), reh'g denied (Fed. Cir. 2002); Chain Belt Co. v. United States, 115 F. Supp. 701, 714 (1953); Westfed Holdings, Inc. v. United States, 55 Fed. Cl. 544, 549 (2003), appeal docketed, Nos. 03-5131, 03-5145 (Fed. Cir. July 16, 2003); Hansen, 53 Fed. Cl. at 99; Citizens Financial Servs., FSB v. United States, 57 Fed. Cl. 64, 70-71 & n.5 (2003); RESTATEMENT (SECOND) OF CONTRACTS §§ 344(b), 349, 351(1).

Plaintiffs must establish not only that its claimed damages were "foreseeable to the party in breach at the time of contract formation," but that "both the magnitude and type of damages were foreseeable" as well. Landmark, 256 F.3d at 1378 (citing RESTATEMENT OF CONTRACTS (SECOND) § 351); Northern Helex Co. v, United States, 524 F.2d 707, 714-15, 720 (Cl. Ct. 1975), cert. denied, 429 U.S. 866 (1976); Bank United of Texas, FSB v. United States, 50 Fed. Cl. 645, 654 (2001), aff'd in relevant part, rev'd in part, Nos. 02-5132, 02-5137, 2003 WL 22177282 (Fed. Cir. Sept. 22, 2003); California Fed. Bank, FSB v. United States, 54 Fed. Cl. 704, 713 (2002).

The traditional causation standard in this Circuit for breach of contract cases requires plaintiffs to prove that the claimed damage "was attributable solely to, and was therefore directly caused by, the [breach]." J.D. Hedin Constr. Co. v. United States, 456 F.2d 1315, 1330 (Ct. Cl. 1972). See also Ramsey v. United States, 121 Ct. Cl. 426, 433, 101 F. Supp. 353 (1951), cert. denied, 343 U.S. 977 (1952); Myerle v. United States, 33 Ct. Cl. 1, 27 (1897)); Wells Fargo Bank, N.A. v. United States, 88 F.3d 1012, 1022-23 (Fed. Cir. 1996); CalFed, 54 Fed. Cl. at 713. Plaintiffs must prove the reliance expenses claimed were "actually sustained as a result of the breach." Glendale Fed. Bank, FSB v. United States, 239 F.3d 1374, 1382 (Fed. Cir. 2001); Castle, 301 F.3d at 1341; LaSalle Talman Bank, FSB v. United States, 317 F.3d 1363, 1376 (Fed. Cir. 2003); Westfed, 52 Fed. Cl. at 161 ("expenditures must have been lost as a result of the breach").

Plaintiffs' alleged damages also must be reasonably certain and, therefore, may not be based on mere speculation or hypotheticals. Home Savings of America, FSB v. United States, 57 Fed. Cl. 694, 727 (2003), appeals pending, Nos. 04-5020, 04-5032 (Fed. Cir.); Franklin Fed.

Bank, FSB v. United States, 55 Fed. Cl. 108, 131 (2003); Willems Indus., Inc. v. United States, 155 Ct. Cl. 360, 295 F.2d 822 (1961); RESTATEMENT OF CONTRACTS (SECOND) § 352. Uncertainty as to the exact amount of damages will not necessarily preclude recovery, but only "if a reasonable probability of damage can be clearly established. . . ." CalFed, 54 Fed. Cl. at 714; California Fed. Bank, FSB v. United States, 245 F.3d 1342, 1350 (Fed. Cir. 2001).

33. In proving reliance damages (cost of performance), who carries the burden of proof, and by what standard, with respect to establishing offsetting benefits received?

RESPONSE: Like restitution, only net reliance expenditures may be recovered by a plaintiff. Charles T. McCormick, Damages, §142 at 584 (1935). Plaintiffs must deduct any benefit or value it received or retained from its claimed reliance expenditures. Westfed, 52 Fed. Cl. at 160 (citing Dan B. Dobbs, Law of Remedies, §12.3(1) at 51-52 (2d. ed. 1993) ("The reliance damages recovery is a recovery for net reliance loss, so the defendant is credited with any benefit the plaintiff receives from the expenditure in reliance.")); Anchor Sav. Bank, FSB v. United States, No. 95-39C, 2003 WL 22415878 (Fed. Cl. Sept. 29, 2003); Citizens Financial, 57 Fed. Cl. at 70-71 & n.5; E. Allen Farnsworth, Contracts § 12.16, at 929 (2d ed. 1990) ("loss avoided through salvage should be deducted from reliance expenditures"); L. Albert & Son v. Armstrong Rubber Co., 178 F.2d 182, 189 (2d Cir.1949). Netting plaintiffs' reliance damages in this manner is consistent with the governing rationale that damages in a contract action should not place a party in a better position than it would have occupied had there been no breach. Northern Helex, 634 F.2d at 563 (plaintiff may not profit from a breach).

Plaintiffs bear the burden of proving their net reliance expenditures. Franklin, 55 Fed. Cl. at 121 (plaintiff bears burden of establishing net costs for reliance damage claim based upon net liabilities assumed); Citizens Financial, 57 Fed. Cl. at 70-71 ("Thus, if Citizens can establish that it incurred an actual economic cost when it assumed the net liabilities of [two thrifts], and that the cost was not completely offset by the benefit it received from acquiring [the two thrifts], Citizens may be entitled to reliance damages.") (emphasis added); Allen, Heaton & McDonald v.

Castle Farm Amusement Co., 86 N.E.2d 782, 783 (1949) (plaintiff must prove no expenses saved by breach); Dan B. Dobbs, Law of Remedies, §12.3(1) at 51-52 (2d. ed. 1993).

34. In proving reliance damages (cost of performance), who carries the burden of proof, and by what standard, with respect to establishing whether the contract was a "losing" contract, and if this is established what if any impact does it have on the calculation of the plaintiffs' damages?

RESPONSE: This question is irrelevant. Despite plaintiffs' attempt to misrepresent Dr. Hamm's testimony, the Government is not asserting a losing contract defense, which, when proven, defeats a claim for lost profits, because the breach saves the plaintiff money. In that situation, the plaintiff, as an alternative to lost profits, may seek reliance expenditures "less any loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been performed." RESTATEMENT (SECOND) OF CONTRACTS § 349 & cmt. a.; See also L. Albert & Son, 178 F.2d at 189-90; United States v. Behan, 110 U.S. 338, 345 (1884).

Here, plaintiffs failed to carry their threshold burden of proving Meritor's alleged expenditures were foreseeable, required under the contract, and actually sustained due to the breach(es). See Def. Response No. 32. Plaintiffs' model shows enormous, pre-breach expenditures that (even assuming they were actually incurred) were unanticipated, independent business decisions – not required costs of contract performance. See Def. Response Nos. 1-2, 10-13, 15, 37, 41-46, 48-55, 58-61.

Given the way the assistance was structured, the Western acquisition and the accompanying FDIC assistance guaranteed that Meritor would not incur a material loss on the acquired portfolio. At worse, Meritor would break-even and, as rates fell, the bank would actually reap substantial gains. See Def. Response Nos. 10-13, 40-46, 48, 119; see also, e.g., Tr.

2666, 2767-68, 2775-77, 2783-88, 2852 [Hamm]; Tr. 2169-2213 [Hargett]. Other than transaction costs, plaintiffs admittedly paid nothing to acquire Western. Tr. 615 [Brummett].

See also Tr. 2169-70 [Hargett] (citing DX 3491); Tr. 2170-71 [Hargett] (citing DX 3029 at CSL009 0105); Tr. 2171-75 [Hargett] (citing DX 63 at CSL017 1261 and DX 3497); Tr. 2176-77 [Hargett] (citing DX 1357 at CSL124 0161-62); Tr. 2214-15 [Hargett] (citing DX 3507); Tr. 2405, 2407-08, 2311, 2410, 2413-14 [Hargett] (citing DX 1357 at CSL124 0142, 0161-62; DX 1883 at CSL100 0123-24); Tr. 2764-2766 [Hamm] (citing DX 3335); Tr. 2768-69, 2774-76, 2787-93 [Hamm]; Tr. 1650-51 [Gough]; Tr. (L) 109-110 [Nocella] (citing DX 502 at CSL012 1460); Tr. (L) 234 [Nocella]; Tr. (L) 297-299 [Cooke]; Tr. (L) 302-03 [Cooke]; Tr. (L) 304 [Cooke]; Tr. (L) 307 [Cooke]; Tr. (L) 307 [Cooke]; Tr. (L) 311-12 [Cooke]; DX 1902 at CSL027 0409; DX 1357 at CSL124 0158, 0161; DX 502 at CSL012 1460; DX 1062 at CSL085 0043.

35. In proving reliance damages (cost of performance), how if at all is the standard of proof altered by the fact that difficulties of proof are the result of the defendant's breach(es)?

RESPONSE: This question is irrelevant because plaintiffs' inability to prove its alleged reliance damages is not attributable to the breach(es).

Even if this question were somehow germane, we are unaware of any authority altering the standard of proof for reliance damages where "the difficulties in proof are the result of the defendant's breach(es)." At best, it would mean only that "when damages are hard to estimate, the burden of imprecision does not fall on the innocent party." LaSalle, 317 F.3d at 1374; Energy Capital, 302 F.3d at 1327; CalFed, 54 Fed. Cl. at 714. This is a long-standing principle of the "reasonable certainty" standard, not some new, "watered down" test.

Plaintiffs also neglect to mention that the precedent which "makes allowance for proof that is flawed merely as to the amount of damages does not displace the case law that requires proximity of cause and result." Fifth Third, 55 Fed. Cl. at 242 & n.8 (emphasis added). Indeed, "[i]n LaSalle[,] the Federal Circuit specifically noted that proximity, as contrasted with remoteness, is a critical factor in the damages analysis." Id. (citing LaSalle, 317 F.3d at 1371, and rejecting Dr. Brumbaugh's model on summary judgment as speculative and wholly unreliable). Thus, plaintiffs are not excused from fulfilling its burden of proving foreseeability, causation, and reasonable certainty – elements it failed to satisfy irrespective of the breach(es). See Def. Response Nos. 32 (discussing plaintiffs' burden), 39.

36. In proving reliance damages (cost of performance), how if at all is the standard of proof altered by the fact that relevant documentary evidence is unavailable as a result of the defendant's breach(es)?

RESPONSE: This question is irrelevant because the Government produced any relevant, non-privileged documents and, therefore, has not made any documentary evidence "unavailable as a result of the defendant's breach(es)."

Even if this question were somehow germane, the standard of proof might be altered only if plaintiffs had sought appropriate relief with the Court, such as by filing a motion for spoliation of evidence, and the Court determined the just sanction for the deliberate destruction or withholding of documentary evidence is drawing adverse factual inferences. Plaintiffs' prior attempt to obtain such inferences regarding documents that were eventually produced to plaintiffs well before trial was soundly rejected by the Court. Slattery v. United States, 46 Fed. Cl. 402, 405-06 (2000) ("long-standing presumption of good faith of public officials in performance of their duties" that may be reversed "only with irrefragable proof of animus, or specific intent to injure, the plaintiff"); id. at 405 ("facts here are far from scaling the required high threshold of proof". . . Moreover, the [G]overnment ultimately waived the privilege and produced all the materials, hardly a gesture of animus").

Realizing its proof of damages is lacking, plaintiffs revisit the low road by once again seeking adverse inferences. See Pl. Response No. 36. Plaintiffs' repeated attempts at lessening its burden speaks volumes about the baseless nature of its claims.

37. Was Meritor's decision to sell off virtually all of the discounted Western assets by mid-1986 a voluntary and independent business decision?

RESPONSE: Yes. Contrary to plaintiffs' evasive and non-responsive answer (see Pl. Response No. 37 ("Not in any legally meaningful sense.")), witnesses repeatedly testified that Meritor voluntarily and independently sold Western's assets irrespective of the contract or any regulatory supervision. Tr. (L) 310-11 [Cooke] ("Q: Isn't it true that it was PSFS's business judgment to sell most of Western assets at a market value or slightly above, instead of holding them to term? A: Yes."); Tr. (L) 209 [Nocella] ("Q: The decision as to whether . . . to sell off [Western's] assets was always in the hands of PSFS and its management, correct? A: Yes. Q: And that was a business decision? A: Yes."); Tr. (L) 288 [Cooke] (Meritor at liberty to handle Western assets as it chose; viewed merger as opportunity to restructure; sold Western assets to achieve this goal); Tr. (L) 310-11 [Cooke] (If Meritor had held Western assets to term, book value would have recovered excluding defaults. Management chooses whether to sell discounted assets or hold to term. Meritor chose to sell.); Tr. 820-21, 920-21, 3323, 3379-80 [Brummett] (selling Western assets was voluntary, independent decision); Tr. (L) 914-15 [High] (Meritor sold Western assets to restructure its balance sheet and improve IRR); Tr. 745-46, 748-49 [High] (same); Tr. 2217-18 [Hargett] (citing DX 3510); Tr. 2228 [Hargett]; Tr. 2229-32 [Hargett] (citing DX 3515); Tr. 2786-87 [Hamm] (citing DX 3342); Tr. 2791-92, 2794, 2797, 2847-48, 3545-46 [Hamm]; Tr. 1438-39 [Thakor]; Tr. 1646 [Gough] (Meritor decided whether to sell or retain Western's assets); Tr. 1631-32 [Gough]; Tr. (L) 2707, 2724 [Gough]; Tr. (L) 3029-32 (Fritts) (Western asset sales was independent "business judgment").

See also DX 3 at CSL002 0342, 0383, 0344-45; DX 4 at CSL009 0578; DX 65 at CSL089 0163, 0180, 0184; DX 930 at CSL009 0690-91; PX 855 at 39; DX 1902 at CSL027 0409; DX 1883 at CSL100 0123; DX 63 at CSL1017 1249, 1253; DX 2020 at CSL027 0039; DX 510 at CSL010 0506.

See also Def. Response Nos. 2, 9-10, 51-55.

38. Did Meritor reinvest the proceeds from the sale of the discounted Western assets in interest-earning assets carrying current market yields at the respective dates of sale, thus substantially offsetting the loss of discount accretion which would have been recorded in income had such assets been held to maturity?

RESPONSE: Meritor expressly admitted it reinvested the proceeds at market rates. The bank's 1986 offering circular states:

> By June 30, 1986, virtually all of Western's acquired assets had been sold. The proceeds from the sales of such assets were reinvested in interest-earning assets carrying current market yields at the respective dates of sale, thus substantially offsetting the loss of discount accretion which would have been recorded in income had such assets been held to maturity."

DX 3036 at ESL012 1019 (emphasis added). See also Tr. 535-37, 875-77 [Brummett] (Meritor presumably reinvested at market rates, and it disclosed in DX 3036 that it substantially offset lost accretion discount); Tr. 2243; 2247 [Hargett]; Tr. 2815 [Hamm] (DX 3036 is completely at odds with Mr. Brummett's model and entirely consistent with Dr. Hamm's opinions); DX 3023 at 53-58.

39. How would Meritor have recouped its pre-breach costs of performance, assuming Mr. Brummett's calculations to be accurate, if the FDIC had honored the contract?

RESPONSE: It would not have. The contract, as structured, would not have produced the types of losses described by Mr. Brummett. See Def. Response Nos. 10, 13, 14, 34, 40, 42, 46, 49, 62-63, 65, 67, 115, 117, 119. Causation is lacking because plaintiffs' alleged losses are unrelated to the contract or the breach, and the breach did not result in Meritor's failure to recoup the alleged costs. See Tr. 2214-17 [Hargett] (citing DX 3493, DX 3502 & DX 3507); Tr. 2786-87 [Hamm] (citing DX 3342); Tr. 2791-97, 2799-2802, 2847-49, 3133-35 [Hamm]. See also, e.g., Def. Response Nos. 1-2, 9, 51-55.

Nonetheless, assuming Mr. Brummet's calculations are correct (i.e., Meritor expended $630.14 million, or nearly 92 percent of plaintiffs' alleged cash loss, prior to the 1988 MOU (which we dispute)), then plaintiffs would have incurred these losses even if the FDIC had honored the contract. Tr. 910-11 [Brummett]; PX 854 at Ex. A.1. Dr. Goldstein's supposedly conservative "but for" model projects that Meritor would have suffered another $650.9 million in losses from 1988-91 and a net loss of $241.6 million by 1997. PX 541A at 2 ("Net Income" line).

Using certain generous assumptions, Dr. Hamm further demonstrated that Meritor, without Western, would have recouped only a small fraction of the costs estimated by plaintiffs, assuming Meritor was able to achieve in the no-breach world what it was unable to achieve in the real world – recurring operating income. Tr. 2835-52 [Hamm] (citing DX 3375, DX 3364A, DX 3372A, DX 1365 at 5); DX 113 at 2; Tr. (L) 682-84 [Hillas]. See also DX 3023 at 93-98.

Plaintiffs argue that Meritor's alleged pre-breach losses would have been recouped "[t]hrough earnings." Pl. Response No. 39. None of plaintiffs' citations show what Meritor's earnings would have been or how they would have been achieved.

40. Did the combination of the Western acquisition and the FDIC assistance package economically strengthen or weaken PSFS/Meritor?

RESPONSE: Strengthen. Meritor was severely impacted by high interest rates and needed Western to survive. E.g., Tr. (L) 198-90 [Nocella] (Meritor likely insolvent by billions on market basis); Tr. (L) 297 [Cooke] (restructuring needed for survival); DX 62 at CSL089 0025 (net worth declining from $423.9 million in 1980 to $388.7 million in 1981); DX 62 at CSL089 0024 (net income declining from $42.1 million in 1979 to $21.4 million in 1980 to negative $33.3 million in 1981; losses in 1981 prior to taxes and recognizing gains on sales over $61 million); DX 62 at CSL089 0036 (net interest spread for 1981 negative 0.60%); DX 64(a) at CSL089 0120 ($20.4 million loss for first three months of 1982).

Meritor acquired Western because it allowed management, at no cost, to halt losses and eventually improve Meritor's capital and earnings; rapidly restructure its balance sheet; improve its negative $1.9 billion gap position and poor IRR; eliminate competition; and obtain a valuable deposit franchise. The merger accomplished these objectives. See Def. Response Nos. 10-13, 15, 41-46, 48-55, 58-61; see also Pl. Response Nos. 9 & 40 (conceding enormous benefits).

See also DX 1883 at CSL100 0123-24 (benefits summary); DX 3 at CSL002 0383 (Western asset sales "strengthen[ed] [Meritor's] liquidity position"); DX 1902 at CSL027 0409; DX 432 at 4, ¶6; DX 1365 at CSL012 2266 (Western needed to restructure, grow, and prosper. Western immediately "strengthen[ed] PSFS' position in the Philadelphia market by adding nearly $2.0 billion in deposits"); DX 502 at CSL012 1460 (transaction strengthened Meritor); DX 1357 at CSL124 0158, 0161; DX 1062 at CSL085 0043; DX 63 at CSL017 1249, 1261; DX 1902 at 4;

DX 1883 at 2; DX 65 at 3; PX 855 at 39, lines 5-9; PX 25 at 1 (Western no burden given "massive aid").

See also Tr. (L) 76, 99, 109-10, 130-31, 191-92 [Nocella] (citing DX 1358 at 3); Tr. (L) 135 [Nocella] (citing DX 94 at CSL085 0056); Tr. (L) 288, 297-98 [Cooke]; Tr. (L) 302 [Cooke] (citing DX 1357 at CSL124 0158); Tr. (L) 303-04, 307, 311-12 [Cooke]; Tr. (L) 696 [Hillas]; Tr. 694, 927-28 [High]; Tr. (L) 2707, 2721-22 [Gough]; Tr. 1597-98 [Gough]; Tr. 1671-72 [Gough] (citing DX 3001); Tr. 1673 [Gough]; Tr. 502, 621-23, 655-57 [Brummett]; Tr. 862-63, 503-04 [Brummett]; Tr. 796-98, 864-65 [Brummett]; Tr. 745-46, 748-49 [High]; Tr. (L) 914-15 [High]; Tr. 2666, 2696 [Hamm]; Tr. 2767-68 [Hamm] (citing DX 3337); Tr. 2176-77 [Hargett] (citing DX 1357 at CSL124 0161); Tr. 2210 [Hargett] (citing DX 502 at CSL012 1460); Tr. 1444-45 [Thakor].

41. Given the structure of the FDIC assistance that was provided to Meritor in connection with the Western acquisition, is it meaningful to consider the assistance payments that were actually made to Meritor (on an ex post basis) without regard to the impact of falling interest rates on the actual assets and liabilities that were acquired?

RESPONSE: No. It is **meaningless** to consider the actual IMA payments in a vacuum. The FDIC used IMAs as a merger incentive by guaranteeing a market rate of return on the acquired assets. DX 3140 at 72-73 ("The FDIC paid the acquirer the difference between the yield on acquired earning assets and the average cost of funds for savings banks, thereby assuming [IRR]. If interest rates declined to where the cost of funds was below the yield on earning assets, the acquirer . . . [paid] the FDIC."); Tr. 3542-44 [Hamm] (citing DX 3066 at 21); Tr. 3546-47 [Hamm]; Tr. (L) 2706-07 [Gough]; Tr. (L) 1527 [Isaac]. See also Def. Response Nos. 12-13.

Meritor's IMA served two critical functions: (1) provide enough immediate assistance to eliminate negative net interest margin on the acquired assets and liabilities; and (2) thereby eliminate IRR on Western's portfolio. Tr. 2181-83 [Hargett] (citing DX 3498 and 3501); Tr. 2189, 2192-94 [Hargett]; Tr. 2194-96 [Hargett] (citing DX 3509); Tr. 2197 [Hargett] (citing DX 392 at CSL020 1130) ("IMA . . . substantially reduces [Meritor's] sensitivity to increases in interest rates. . . ."); Tr. 2220 [Hargett] (citing DX 3498, DX 3501 & DX 3508); Tr. 2222-23 [Hargett]; Tr. 2302-03 [Hargett]; DX 1883 at CSL100 0123-24; DX 1357 at CSL124 0162 (IMA protected Meritor for 10 years from "Western" IRR); DX 1062 at CSL085 0037 ("IMA . . . created to turn [Western's] fixed rate portfolio . . . into . . . variable rate portfolio."); Tr. 2181-91, 2403-04 [Hargett] (citing DX 3501); Tr. 1348, 1441-42, 1954 [Thakor]; Tr. (L) 2706-07 [Gough]; Tr. (L) 1527 [Isaac]; Tr. 708-09, 749, 753, 785 [High]; Tr. 502, 641-51, 801, 803-05,

866-67, 869 [Brummett]; DX 1357 at CSL124 0089-90; Tr. 2775 [Hamm] (citing DX 3345); Tr. 2783-86 [Hamm] (citing DX 3342); Tr. 2797-98, 2847-48, 3537-38, 3540, [Hamm].

Considering only the IMA's actual payments disregards: (1) the fact that, by 1985, Western's portfolio had fully recovered and was generating positive net interest income; (2) the IMA's "insurance policy" protection against rising interest rates; and (3) the FDIC's potential cost if rates had remained high. Tr. 3135-36 [Hamm]; Tr. 2768-69, 2774-75 [Hamm] (citing DX 3345); Tr. 2189-91 [Hargett] (citing DX 3502); Tr. 2291-93 [Hargett] (IMA not terminated until 1987 even though Meritor in paying position since 1985); Tr. 749, 751-52, 785 [High]; Tr. (L) 310 [Cooke]; Tr. 643-44 [Brummett]; Tr. 652-54 [Brummett] (citing, e.g., DX 3 at CSL002 0346); Tr. 804-05 [Brummett]; Tr. 807 [Brummett]; Tr. 864-65 [Brummett]. See also Def. Response Nos. 11-13.

VII. 1982 Deal at the time

42. What was the net cost of Western to Plaintiff?

RESPONSE: The net cost was zero, since Meritor gained control of Western without a material economic investment. Tr. 2764-66 [Hamm]. The assistance agreement provided an economic structure that virtually guaranteed Meritor would not lose money, and would likely profit, from ownership of Western's assets. In fact, given the precipitous drop in interest rates from 1982-1987, the acquired Western portfolio, in combination with the assistance package, was guaranteed to generate profits. Tr. 2765-88 [Hamm]. It is impossible, however, to quantify the cost to Meritor, if any, in the manner suggested by Mr. Brummett because Meritor's independent decision to sell the Western assets forever commingled the portfolios. Tr. 2216, 2228 [Hargett]. Further, the infirmities that plague his model render it utterly unreliable. Tr. 3555-57 [Hamm]. Regardless, as Mr. Brummett acknowledged, Meritor realized numerous obvious benefits from the Western transaction. The increase in the value of Western's assets due to falling rates enabled Meritor to record gains when it sold those assets, which increased Meritor's capital. Interest rates fell approximately 700 basis points from 1982 until 1987. Tr. 643-44 [Brummett]. As a result of the merger, Meritor reduced its interest rate risk by redeploying proceeds from the sale of Western's assets into shorter term instruments. Tr. 835-37 [Brummett]; Tr. 836 [Brummett] (citing DX 197 at CSL009 1105); Tr. 837 [Brummett] (citing DX 432 at CSL0085 0061); DX 1883 at CSL100 0123-24; Tr. 2194-96 [Hargett] (citing DX 1357 at CSL124 0162); DX 3509. Furthermore, divesting the branches generated more than $300 million in premiums for Meritor, DX 71 at 29-30.

43. Was a dollar value proven for the IMA? Explain both ex ante and ex post?

RESPONSE: Yes. Ex ante, Meritor identified and valued the various components of the values ascribed to the FDIC assistance and core deposits. DX 1062 at CSL085 0043; see Def. Response No. 50 (ex ante nature of Rapp memorandum). In 1982, the IMA had a value of $440 million, the branch franchise had a value of $194 million, and the FDIC's capital infusion had a value of $112 million. Id. Other benefits of the merger, such as the FDIC's credit guarantees, Meritor's increased liquidity, the reduction of its interest rate sensitivity and the economies of scale had a value of $50 million in 1982. Tr. 796-98 [Brummett]. See also Tr. 743, 739-40, 731 [High]. Tr. 1548-49 [Thakor]; Tr. 732, 738 [High]. Meritor solicited the First Boston valuation and had the Rapp memorandum prepared for the purpose of determining the appropriate write-off to its "value ascribed to acquired deposits and FDIC assistance." DX 1062. For Meritor's duty to accurately disclose such information, see Def. Response Nos. 31, 56.

Ex post, see Def. Response No. 41.

44. Could the IMA have been treated as an asset with an identifiable cash flow?

RESPONSE: Yes, as the IMA was an asset with an identifiable cash flow. As Mr. High testified, Meritor included the IMA in "value ascribed to FDIC assistance and branches acquired" Tr. 733 [High]; Tr. 659 [Brummett]. Meritor acknowledged that the $796 million asset included the value of the IMA, Western's core deposit intangible, the loan guarantees, and the FDIC's $112 million capital infusion, Tr. 663 [Brummett], and assigned specific values to the various components. DX 1062 at CSL085 0043. For example, the IMA had a value of $440 million in 1982. Tr. 796-98 [Brummett]. Mr. Nocella noted that Meritor used the terms "value ascribed to acquired intangibles" or "acquired deposits and FDIC assistance" to reflect the true cash value received from the IMA, the credit guarantees and the franchise value of Western. Tr. (L) 109-110 [Nocella]; Tr. 814 [Brummett]; Tr. (L) 234 [Nocella]; Tr. 811-13 [Brummett]; Tr. 2202-03 [Hargett]; DX 3503; DX 3492.

Importantly, at the time of the April 3, 1982 agreement, it was known, based on current conditions, that the IMA would provide approximately $8.0 million per quarter to Meritor, or $32.0 million, annualized. The nature of the IMA was that payments from the FDIC would be affected by future changes in interest rates; however, "[a]t the date the deal was done, it was basically an in the money issue." Tr. 2179 [Hargett].

45. What evidence supports the claim that Meritor believed the IMA was worth $440 million in 1982?

RESPONSE: The Rapp memorandum states that values were calculated individually in 1982 for the elements comprising the intangible asset that Meritor labeled "value ascribed to acquired deposits and FDIC assistance," but were recorded as an aggregated entry of $796 million, and then sets forth the amounts of those individual values at the time of the 1982 Western acquisition. Tr. 2208-09 [Hargett] (citing DX 3505); Tr. 1548-49 [Thakor]; DX 1062 at CSL085 0043. The IMA had a value of $440 million in 1982; the branch franchise had a value of $194M in 1982; the FDIC's capital infusion had a value of $112 million in 1982; and the other benefits of the merger, such as the FDIC's credit guarantees, Meritor's increased liquidity, the reduction of its interest rate sensitivity and the economies of scale had a value of $50 million in 1982. Id.; Tr. 796-98 [Brummett]. The valuations were prepared by, or on behalf of, Meritor. Tr. 2401 [Hargett] (citing DX 3505)

46. Would a reasonable bank management have understood the 1982 contract as a favorable contract for the bank?

RESPONSE: Yes. Meritor was severely impacted by high interest rates and needed Western to survive. E.g., Tr. (L) 198-90 [Nocella] (Meritor likely insolvent by billions on market basis); Tr. (L) 297 [Cooke] (merger needed for survival); DX 62 at CSL089 0025 (net worth declining in 1981); DX 62 at CSL089 0024 (net income declining – losses in 1981 prior to taxes and recognizing gains on the sales over $61 million); DX 62 at CSL089 0036 (net interest spread for 1981 negative 0.60%); DX 64(a) at CSL089 0120 ($20.4 million loss for first three months of 1982).

Meritor acquired Western because it allowed management, at no cost, to eventually improve Meritor's capital and earnings; rapidly restructure its balance sheet; improve its negative $1.9 billion gap position and poor IRR; eliminate competition; and obtain a valuable deposit franchise. The merger accomplished these objectives. See Def. Response Nos. 10-13, 15, 41-46, 48-55, 58-61; see also Pl. Response Nos. 9 & 40 (conceding enormous benefits).

See also DX 1883 at CSL100 0123-24; DX 3 at CSL002 0383; DX 1902 at CSL027 0409; DX 432 at 4, ¶6; DX 1365 at CSL012 2266; DX 502 at CSL012 1460 (transaction strengthened Meritor); DX 1357 at CSL124 0158, 0161; DX 1062 at CSL085 0043; DX 63 at CSL017 1249, 1261; DX 1902 at 4; DX 1883 at 2; DX 65 at 3; PX 25 at 1 (Western no burden given "massive aid"); PX 855 at 39, lines 5-9.

Other than transaction costs, plaintiffs admittedly paid nothing to acquire Western (Tr. 615 [Brummett]), and the assistance guaranteed that Meritor would not incur a material loss on the acquired portfolio. Meritor was immediately at break-even and, as rates fell, the bank would

actually reap substantial gains. See Def. Response Nos. 10-13, 40-46, 48, 119. See also Tr. 2169-70 [Hargett] (citing DX 3491); Tr. 2170-71 [Hargett] (citing DX 3029 at CSL009 0105); Tr. 2171-75 [Hargett] (citing DX 63 at CSL017 1261 and DX 3497); Tr. 2176-77 [Hargett] (citing DX 1357 at CSL124 0161-62); Tr. 2214-15 [Hargett] (citing DX 3507); Tr. 2405, 2407-08, 2311, 2410, 2413-14 [Hargett] (citing DX 1357 at CSL124 0142, 0161-62); DX 1883 at CSL100 0123-24; Tr. 2764-2766 [Hamm] (citing DX 3335); Tr. 2768-69, 2774-76, 2787-93 [Hamm]; Tr. 1650-51 [Gough]; Tr. (L) 109-110 [Nocella] (citing DX 502 at CSL012 1460); Tr. (L) 234 [Nocella]; Tr. (L) 297-99, 302-04, 307, 311-12 [Cooke]; DX 1902 at CSL027 0409; DX 1357 at CSL124 0158, 0161; DX 502 at CSL012 1460; DX 1062 at CSL085 0043.

Finally, no rational economic actor would enter into a transaction that would make it economically worse off than before the transaction. See Mancur Olson, The Logic of Collective Action 1-2 (1965). Paradoxically, plaintiffs assert that the Western merger included short term value to Meritor, Pl. Response No. 46, but advance Mr. Brummett's model indicating massive losses in the first few years of the contract. PX 854 at Ex. A.1. See also Tr. 2789-91 [Hamm].

47. Did Meritor need to leverage the goodwill to cover the cost of amortizing the goodwill?

RESPONSE: No. The accretion of the discount was actually greater than the amount of goodwill to amortize, so they should have roughly balanced out. As a result, the goodwill was largely self-financing without any further leverage. Tr. 2776 [Hamm]; Tr. 1445-46 [Thakor]. Despite Meritor creating an accounting imbalance between the accretion of the discount and amortization of the goodwill by selling the Western assets immediately, see Def. Response No. 9, Meritor asserted in 1986 that the reinvestment of the proceeds had substantially offset the lost accretion. Def. Response No. 38 (citing DX 3036). It was Meritor's own independent business decision to grow and leverage between 1982 and 1987. Tr. (L) 1023 [High]. In part, this was due to Mr. Cooke's view that PSFS had to broaden its operations in order for the institution to survive. Tr. (L) 297 [Cooke].

Amazingly, plaintiffs assert that the FDIC did not allow the goodwill to be leveraged, Pl. Response No. 47, perhaps because Mr. Brummett failed to give Western any credit for Meritor's ability to leverage the contractual capital. See Tr. 2234-38 [Hargett]; DX 3518-3521. The assertion is patently absurd. See DX 68 at 24 (Meritor's regulatory capital fully leveraged); DX 69 at 24; DX 70 at CSL006 2009; 1st Amen. Compl. ¶ 50 (FDIC calculated regulatory capital including goodwill until 1992); DX 7 at 1-1, 1-2, and 3; DX 8 at 1-1, 3.

48. Is Dr. Hamm correct that Meritor assumed no net liabilities because roughly $800 million of the liabilities assumed were not part of the basis for the Western assets acquired but were, instead, Meritor's basis for the intangibles associated with the merger (IMA and other assistance, core deposit premium, etc.)?

RESPONSE: Dr. Hamm is correct. Both Dr. Hamm and Mr Hargett opined that the identifiable intangible Meritor recorded for GAAP purposes reflected the fact that the benefits Meritor received roughly equaled the $796 million net liabilities created by the mark-to-market (the $796M mark to market value did not take into account the FDIC assistance or the value of the Western deposit base. Tr. 2281 [Hargett]). Tr. 2202-03 [Hargett] ($796 million asset "largely comprised of real assets with [related] identifiable cash flows"); DX 3503.

The record is replete with statements reflecting that Meritor assumed no net liabilities. The $796 million recorded on Meritor's balance sheet was labeled "value ascribed to acquired deposits and FDIC assistance." Tr. 659 [Brummett]. Meritor itself identified that the $796 million included the value of the IMA, the value of Western's deposit base, the loan guarantees, and the FDIC's $112 million capital infusion. Values for these identifiable assets were calculated in 1982, but were not recorded individually. Tr. 663 [Brummett]; Def. Response No. 50. There were numerous valuations of the FDIC assistance and the Western deposit base that were performed by or on behalf of Meritor during the 1980s. Even under the more conservative range of these valuations, the value of these identifiable assets effectively eliminated the majority of the $796 million of net liabilities. Tr. 2208-09 [Hargett] (citing DX 3505); see also DX 1062; DX 502 at CSL012 1460; Tr. 2401 [Hargett]. Tr. (L) 233:8 - 234 [Nocella]; Tr. 811-14 [Brummett]; Tr. (L) 109-110 [Nocella]; Tr. (L) 303-304, 307 [Cooke]; DX 502 at 2; DX 3001; DX 63 at 6

(CSL017 1249); Tr. (L) 207-08 [Nocella]; DX 392 at 56; DX 63 at 18; DX 64A at 35; DX 65 at 39.

49. If Dr. Hamm [and Mr. Hargett are] correct about the assumption of no net liabilities, what are the consequences for plaintiffs' cost of performance damage case?

RESPONSE: Dr. Hamm's and Mr. Hargett's demonstration that Meritor assumed no net liabilities extinguishes plaintiffs' cost of performance claim, since "[t]he reliance recovery is a reimbursement for losses the plaintiff suffers in reliance on the defendant's contractual promise." 3 DAN B. DOBBS, LAW OF REMEDIES § 12.3(1) (2d ed. 1993).

Plaintiffs characterize the sale of the Western assets as producing $512 million of cash losses to obfuscate the fact that Mr. Brummett treats the $796 million of net liabilities as the equivalent of a cash expenditure in 1982. See Def. Response No. 115. This analysis is baseless. Aside from transactions costs (which are not a component of plaintiffs' damage claims), Meritor did not incur any net cost of performance under the contract. Tr. 2787-88 [Hamm]. See generally Def. Response Nos. 42-45.

Plaintiffs also predicate their cost of performance claim upon events resulting from Meritor's independent business decisions. Tr. 2791-93 [Hamm]; DX 63 at 10; Tr. 2794-96 [Hamm]; see generally Def. Response No. 38. The sale of the Western assets was outside of the ambit of contract performance, and thus cannot serve as a basis for plaintiffs' cost of performance claim. See Fed. R. Evid. 702, Advisory Committee Notes (Dec. 2000) (on matters of causation, "[w]hether the expert has adequately accounted for alternative explanations"). Claar v. Burlington N.R.R., 29 F.3d 499 (9th Cir. 1994) (expert failed to consider alternative causes for the condition).

50. Does the Rapp memo contradict Mr. Brummett's model?

RESPONSE: Yes. The Rapp Memo valued all components of assistance and Western's franchise value and concluded they were worth $796 million. DX 1062. Plaintiffs' suggestion that this memo is irrelevant because it originated in 1987, after the 1982 merger, is without merit. The Rapp Memo indicates this analysis was performed in 1982, but recorded in 1987. Tr. 1548-49 [Thakor]; DX 1062 at CSL085 0043.

Mr. Brummett's model is predicated upon the erroneous assumption that Meritor assumed net liabilities of $796 million in connection with its acquisition of Western. The Rapp memo, which reflects Meritor's own internal estimates – estimates that were used as a basis for Meritor's 1987 write-off of intangibles, which was disclosed to the public under threat of criminal and civil penalties – definitively establishes that Meritor assumed no net liabilities when it acquired Western. Tr.732-33 [High]; DX 3007.

VIII. Asset Sales

51. Did the FDIC encourage Meritor to sell off Western assets for more interest rate protection or for any other reason?

RESPONSE: No. See Def. Response No. 2. Through the IMA, the FDIC provided an economic framework within which Meritor could manage Western's assets and liabilities. The assistance package provided Meritor a structure within which it could retain Western's assets until interest rates had fallen to the point where most or all of the par value had been regained. Tr. (L) 2706-07 [Gough] (purpose of the IMA was "[t]o allow the acquiring institution to maintain these assets at a profitable level for a period of time."); Tr. (L) 1517, 1527, 1512, 1522-23, 1525-26, 1534-35 [Isaac]. Of course, the FDIC did not mandate that Meritor retain these assets, and Meritor could exercise its own business discretion and divest itself of these assets to pursue broader objectives (e.g., moderating IRR in the non-Western portion of the balance sheet). From an economic perspective, whether or not Meritor sold the Western assets had no bearing whatsoever on the FDIC's financial obligations under the IMA.

Regardless, Mr. Brummett's model fails to capture what in effect was a wealth transfer from "Western" to PSFS, Tr. 3556-57 [Hamm], which forever commingled the portfolios of the two entities. Tr. 2216 [Hargett]; see Def. Response Nos. 37, 38.

52. Did Meritor suffer economic loss or gain when it sold off Western's assets?

RESPONSE: Meritor recognized an economic gain greater than $200 million, which increased its capital in the same amount. Having failed to explain how plaintiffs could realize an economic loss on something in which it made no economic investment, plaintiffs refer to a statement by Dr. Hamm in Suess, wherein he described a circumstance where some thrifts sold certain assets they acquired at below original book value. In this case, the facts and circumstances are completely different. When PSFS acquired Western, because of the way the assistance agreement was structured, there were no net liabilities. See Def. Response Nos. 40-49. The economic value of all of the assets obtained by Meritor equaled the economic value of the liabilities. As a consequence, the marked-to-market value of the assets is Meritor's economic basis in those assets and that is the basis from which gains or losses should be calculated. Tr. 3552-54 [Hamm].

Moreover, Mr. Brummett's model does not recognize the obvious economic gains realized by Meritor when Western's borrowers paid off their loans or a portion of their loans at par. Tr. 2811-12 [Hamm].

53. Has the government proven that Meritor derived benefits from the sale of the Western assets that Mr. Brummett has not accounted for?

RESPONSE: See Def. Response Nos. 9, 63, 67. First, the Government does not carry a burden of proving these benefits where Mr. Brummett has wholly ignored them. Second, these benefits are impossible to quantify because Meritor's decision to sell the Western assets forever commingled the portfolios. Tr. 2216, 2228 [Hargett].

As Mr. Brummett acknowledged, Meritor realized numerous obvious benefits from the sale of Western's assets: (1) the increase in the value of Western's assets due to falling rates enabled Meritor to record gains when it sold those assets, which increased Meritor's capital; (2) interest rates fell approximately 700 basis points from 1982 until 1987. Tr. 643-44 [Brummett]; (3) Meritor reduced its IRR by redeploying proceeds from the sale of these assets into shorter term instruments. Tr. 835-37 [Brummett]; Tr. 836 [Brummett] (citing DX 197 at CSL009 1105); Tr. 837 [Brummett] (citing DX 432 at CSL0085 0061); DX 1883 at CSL100 0123-24; Tr. 2194-96 [Hargett] (citing DX 1357 at CSL124 0162); DX 3509; Tr. 2195 [Hargett] (citing DX 392 at CSL020 1130) (moderated IRR profile reduced Meritor's pre-merger interest rate gap from negative 26 percent to less than 15 percent); (4) Meritor's own assets were "underwater" to a massive extent in 1982, and it needed to restructure to survive. Def. Response Nos. 15, 10, Tr. 3556-57 [Hamm]; see Def. Response No. 47 (Meritor used the sale of Western assets to address IRR problems inherent on the "non-Western" side of its balance sheet); (5) when interest rates fell, Meritor could sell Western assets and book gains, whereas selling PSFS assets would have produced losses. DX 65 at 3. See Def. Response No. 38; DX 3036 at ESL012 1019; Tr. 876-77 [Brummett].

54. Was the sale of Western's assets by Meritor from 1982-1987 a necessary, a sound, or a bad business decision?

RESPONSE: The sale of Western's assets was not necessary. As Dr. Hamm and Mr. Hargett explained, if Meritor had retained Western's assets, the IMA provided an economic structure which virtually guaranteed that Meritor would not lose money on those assets, and would likely profit from their retention. See Def. Response Nos. 40-46. The structure of the assistance – i.e., the "guarantee against loss" provided by the FDIC with respect to the acquired portfolio – assured Meritor that it would not incur a material loss from the acquired Western assets and liabilities. If COFI, as specified in the IMA, fell below the 8.50% benchmark rate – as it did by 1985 (DX 3502) – Meritor stood to make money on the acquired portfolio. However, Meritor's decision to sell the Western assets hopelessly commingled the Western portfolio with the overall institution, "particularly with respect to interest rate risk. . . ." Tr. 2216 [Hargett] (citing DX 3502). In short, by selling off Western's assets, Meritor relinquished this economic guarantee.

The immediate sale of Western's assets was a bad business decision. Tr. (L) 3032-33 [Fritts]; Tr. 1438-39 [Thakor]. More significantly here, however, is that Mr. Brummett improperly measures the cost of performance by counting the sales as losses, without recognizing the benefits of those sales to the non-Western portions of the balance sheet. Tr. 3555-57 [Hamm].

55. Since the sale of Western's assets occurred before the 1988 breach, doesn't that defeat Plaintiffs' "cost of performance" claim?

RESPONSE: Yes, because it unequivocally demonstrates there is no causation. Before the 1988 MOU took effect, according to Mr. Brummett's model, Meritor had already incurred approximately $640 million in losses as a result of the Western acquisition. Mr. Brummett testified that those losses were not associated with the breach and would have been incurred in the no-breach world. Tr. 2835-36 [Hamm]; Tr. 2213-14 [Hargett]; DX 3493; DX 3507. Dr. Goldstein's but-for model demonstrates that these costs would never have been recovered in the no-breach world. PX 541A, Ex. 1, p. 2. Plaintiffs' reliance claim is rendered unreliable as a result. See Fed. R. Evid. 702, Advisory Committee Notes (Dec. 2000).

Plaintiffs' cost of performance claim is a component of its reliance damage claim. See Acme Process Equip. Co. v. United States, 171 Ct.Cl. 324, 347 F.2d 509, 530 (1965), rev'd on other grounds, 385 U.S. 138 (1966); Landmark Land Co. v, United States, 256 F.3d 1365, 1372 (Fed. Cir. 2001). Because reliance damages are available for costs incurred both before and after the breach, Admiral Fin. Corp. v. United States, 57 Fed. Cl. 418, 424 (2003), plaintiffs' claim would not necessarily fail due to its inclusion of pre-breach costs. It fails because these costs are unrelated to contract performance.

IX. Conversion

56. Did Western have any franchise value at the time of the 1983 conversion?

RESPONSE: Yes. Meritor identified and valued the various components of the values ascribed to the FDIC assistance and core deposits. DX 1062 at CSL085 0043. Western's branch franchise had a **conservative** value of $194 million in 1982. Id.; see also id. at CSL085 0026 (Meritor noting "variation in the core deposit valuation of $194 to $372 [million]."); Tr. 796-98 [Brummett]; Tr. 2208-09 [Hargett] (citing DX 3505); Tr. 2401 [Hargett] (range of values on DX 3505 prepared by or for Meritor); DX 3424 at 20-21; Tr. 2686-88 [Hamm]. Meritor's external accountants, Peat Marwick, also estimated in 1982 that the value of the Western deposits ranged in value from $320 to $330 million based upon its own proprietary deposit valuation model. DX 1357 at CSL124 0142.

Plaintiffs concede that Meritor ascribed a value of $194 million to Western's "core deposit intangible." Pl. Response No. 56. Given the gravity of this concession, plaintiffs then remarkably argue that this valuation was merely a "plug number" to allow for the write-off of the goodwill in 1987 and 1990. Id. This is tantamount to saying that plaintiffs "cooked their books" by writing off goodwill without an economic justification, a suggestion that plaintiffs' own witnesses vehemently denied. Tr. 731 [High] (GAAP requires an economic justification for writing off goodwill); Tr. 732 [High] (In 1987, Meritor told its shareholders and investors that the 1987 valuations of the FDIC assistance and branch franchise were management's best estimates); Tr. 732-33 [High] (Meritor's public disclosures truthful, accurate, and within accounting rules).

57. What is the best method to allocate the 1983 IPO proceeds?

RESPONSE: There is no best method to allocate the IPO proceeds because any attempt to do so is inherently arbitrary and speculative. Although Mr. Brummett admits the IPO was successful because of the perceived value of Western's deposit franchise, he nonetheless allocated (in his February 2003 report) only $95 million of the $369 million net proceeds to Western, without analysis. Tr. 848-50 [Brummett]; DX 3115 at 10. Mr. Brummett subsequently reduced this allocation to $91.8 million, again, without analysis. Id.; PX 854 at 10. At trial, he remarkably claimed he "analyzed" several factors supporting this allocation. Tr. 498-501, 505 [Brummett] (citing PX 967). Source material for this superficial analysis (PX 968-71) includes material not considered by Mr. Brummett, which explains why plaintiffs' counsel deliberately skipped them. Tr. 857-60 [Brummett].

Mr. Brummett's superficial, undisclosed, and post-hoc analysis is belied by the contemporaneous evidence, which demonstrates that Meritor, standing alone, could not have successfully converted without Western. See Def. Response Nos. 40, 119. See also, e.g., Tr. (L) 311-12 [Cooke]; Tr. (L) 109-110 [Nocella]; Tr. (L) 135 [Nocella] (citing DX 94 at CSL085 0056); DX 432 at 4 ¶ 6; Tr. 164 [Brumbaugh] (Western positioned Meritor for successful IPO). Mr. Brummett's criteria are meaningless and misleading because they attempt to weigh, albeit incorrectly, the wrong question – i.e., whether Western could have converted. For instance, whether Western's management was poor is irrelevant because Meritor managed Western at the time of the conversion. Tr. 860-63 [Brummett]. The results of Mr. Brummett's supposed consideration of other criteria is simply erroneous. Tr. 860-63, 502-04, 864-67, 869 [Brummett];

Tr. 2257-58, 2373, 2375 [Hargett]; Tr. 2264 [Hargett] (citing DX 3529) (illustrating enormous impact of Brummett's arbitrary allocation).

58. Do contemporaneous statements from Meritor about financial results undercut the purported losses suggested by Mr. Brummett?

RESPONSE: Yes. See Def. Response Nos. 10, 13, 40, and 59.

The guarantee against loss concept is demonstrated by Meritor's 1982 annual report, which states: "Although Western sustained losses of $44,935,000 and $19,519,000 during the year ended December 31, 1981 and the period January 1, 1982 to April 3, 1982, respectively, [Meritor] does not believe that there would have been any material impact upon its results of operations had this acquisition taken place on January 1, 1981 or January 1, 1982 (assuming a similar level of assistance from the FDIC on such dates)." Tr. 2172-73 [Hargett] (citing DX 63 at CSL017 1261) (emphasis added)). This disclosure indicates that, despite having lost more than $19 million during early 1982 and $45 million in 1981, Western would have had no "material impact upon [Meritor's] results of operations" assuming similar assistance. Tr. 2172-74 [Hargett] (citing DX 63 at CSL017 1261) ("This isn't saying that those losses would not have actually happened, it's saying somebody else would have paid for them, and that somebody is the FDIC."). See also Tr. 2175 [Hargett]; DX 3497; DX 3029 at CSL009 0105.

Mr. Brummett's attempt to reconcile the disparity between Meritor's contemporaneous disclosures and his calculations by contrasting GAAP and cash basis reporting (see Def. Response No. 59) is unpersuasive and belied by the evidence and plaintiffs' own witnesses. Compare Tr. 561 [Brummett], with Tr. 840-46 [Brummett]. Plaintiffs' admission of short-term advantages, Pl. Response No. 58, also conflicts with Brummett's massive early "losses." See also Tr. 2170-71 [Hargett] (citing DX 3029 at CSL009 0105); Tr. 2172-74 [Hargett] (citing DX 63 at CSL017 1261); Tr. 721 [High] (citing DX 65 at CSL089 0199); DX 392 at CSL020 1181; DX 66

at CSL041 at 0203; DX 1357 at CSL124 0161; Tr. 303-04, 307 [Cooke]; Tr. 2707, 2721-22 [Gough]; DX 423 at 3.

59. How is Meritor's claim in its 1982 Annual Report that the transaction would have "no material impact" reconciled with Mr. Brummett's model?

RESPONSE: It cannot be reconciled. See Def. Response Nos. 58, 60-61.

Mr. Brummett's model shows a total cash loss of negative $386.7 million for 1982. PX 854, Ex. A.1; Tr. 561; 605; 3354-55 [Brummett]. Mr. Brummett claims that: (1) although Meritor suffered no harm on a GAAP basis in 1982, the Western asset sales resulted in a $357.3 million cash loss; and (2) although the Western asset sales were recorded as a financial statement gain of $212 million, Meritor nonetheless suffered an overall loss of $512 million due to the loss of the accretion discount used to offset the goodwill amortization. Tr. 514-20, 522, 561, 3312-15, 3357, 3354-55 [Brummett]; PX 953; PX 975. See also Tr. 2214-17 [Hargett] (citing DX 3502 & DX 3507).

To show a 1982 loss of $386.7 million, Mr. Brummett inappropriately treats Western's $796 million pre-assistance net liabilities as the equivalent of a 1982 cash expenditure. Tr. 3358 [Brummett]; Tr. 613-14 [Brummett]; Def. Response Nos. 14, 48, 49, 52, 115. Mr. Brummett's testimony that Meritor paid gross book value for Western's discounted assets when it assumed Western's liabilities rests upon a flawed premise. Tr. 3355-57 [Brummett]; see also Tr. 514-20, 522, 561, 3312-15, 3357, 3354-55 [Brummett]. Besides being legally foreclosed (see Def. Response No. 115), this flaw is obvious given that Meritor admittedly registered a gain from selling the Western assets in 1982, not a loss. See Def. Response Nos. 58, 60-61. Importantly, it is the bank's initial investment in a loan (rather than the loan's gross book value), relative to the sales price, that determines whether the bank experiences a cash (economic) gain or loss on sale.

Tr. 3355-57 [Brummett]. Meritor's initial investment is admittedly zero. Tr. 615 [Brummett].

See Def. Response No. 60.

60. Were the losses Mr. Brummett attributes to the sale of Western's assets disclosed in Meritor's annual reports?

RESPONSE: No. See Def. Response Nos. 58-59, 61.

Meritor reported a $221 million gain on the Western asset sales, not a cash loss or outflow of $512 million. See Def. Response Nos. 58-59; Pl. Response No. 9; PX 854 at Ex. A, line [e]; DX 3036 at ESL012 1019; DX 65 at 24; DX 68 at 14. Meritor's annual reports also do not show a negative "cash flow" or "cash loss" of $357.269 million on Western asset sales in 1982, or an overall loss of $386.7 million. Compare PX 854 at Ex. A.1. See also Tr. 721, 732-33 [High].

Plaintiffs claim that Meritor's annual reports "obfuscate" an alleged economic or tax loss on the Western asset sales. Pl. Response Nos. 59, 60. This argument of Enron-esque accounting is disingenuous and misleading. Under then-existing GAAP, the difference between the sales price and the net book value at the date of sale determined whether Meritor recorded a gain or loss. Tr. 870 [Brummett]. Any appreciation (due to declining interest rates) in the asset's value from its low market value in 1982 that was realized from the sale was treated as income. Tr. 870-71 [Brummett]. Meritor could not continue to accrete the discount on assets that were sold or prepaid, but it could take the gain from sale immediately into income. Tr. 871 [Brummett]. If a sold asset had a value less than its original book value, Meritor could take a loss for tax purposes at the same time it recognized an economic and accounting profit. Tr. 615, 871-72, 873, 451 [Brummett]; Tr. 2347-49 [Hargett]; Tr. 2734-35 [Hamm]; Tr. 2802-07 [Hamm] (citing DX 3351-3351). Reducing Meritor's taxable income was a substantial benefit. Tr. 871-73 [Brummet].

61. Does the fact that the alleged damages were not disclosed in Meritor's annual reports undermine Meritor's claims?

RESPONSE: Yes. See Def. Response Nos. 58-60.

It is inconceivable that the parties to this transaction so completely misjudged the impact of the acquisition, as Mr. Brummett's model implies. The FDIC and Meritor expected this to be at least a break-even deal for PSFS. See Def. Response Nos. 10, 13, 40, 46, 47. Mr. Brummett nonetheless contends that, after nine months, Meritor had already suffered a $385 million cash loss. Tr. 2789-91 [Hamm]. See also Def. Response Nos. 14, 115.

It also is implausible that Meritor could have suffered such an enormous cash loss and not acknowledged it in public disclosures. The losses that Mr. Brummett has Meritor incurring in the first nine months of the contract are three and a half times all of the income it reported for the preceding five years. Id.

Because Meritor could have calculated the losses from the Western asset sales, as alleged by Mr. Brummett, with exactitude, Mr. Brummett implies that Meritor elected to incur losses of $700 million – an unbelievable hypothesis. Id.; see also Def. Response Nos. 37, 52, 54-55, 58-60.

XI. Additional Specific Issues

62. Why did Mr. Brummett use 9.7% for earnings from the IPO instead of 13%?

RESPONSE: Mr. Brummett's decision to use the average yield on Meritor's assets as the reinvestment rate for the earnings from the IPO is inexplicable given that we know the bank's actual reinvestment rate was 13 percent, not 9.7 percent. Tr. 833 [Brummett]; PX 854 Ex. I, line [o]; PX 48 at 2 (bulk of IPO proceeds was used to acquire GNMA issues yielding 13%); Tr. 2242 [Hargett] (citing DX 3525); Tr. 2243, 2247 [Hargett] (citing DX 3036 at 1019); Tr. 2816-17 [Hamm] (citing DX 3358); Tr. 2818-19 [Hamm]; Tr. 2820-21 [Hamm] (citing DX 3358A). As Mr. Hargett and Dr. Hamm both made clear, Mr. Brummett's methodology is speculative, inconsistent, and implausible, and this is but one example of its lack of reliability. Tr. 2816-17 [Hamm]; DX 3358A.

The effect of using annual rates versus actual marginal rates in Mr. Brummett's model, particularly in the early years, is enormous. Tr. 2242-43 [Hargett] ("Another key thing to understand about his model . . . is if you are off by a dollar in 1982 or 1983," that dollar, because it compounds over the years "multiplies into $2.50" by 1992. "So these early decisions here in '82 and '83 that [Mr. Brummett] is making about marginal versus average yields are critical to what his result would be."); Tr. 2246 [Hargett] (The disparity in the early years between the average and marginal rates has a huge impact on Western's income within Mr. Brummett's model going forward); Tr. 2816-17 [Hamm] (citing DX 3358) (using Meritor's annual average rate biases the results in plaintiffs' favor and undercuts model's reliability); Tr. 2820-21 [Hamm].

63. Is it appropriate for Mr. Brummett to calculate Western's investment earnings by applying Meritor's cost of funds and average rate of return on interest-bearing investments?

RESPONSE: No. See Def. Response Nos. 62, 64.

Mr. Brummett's methodology, which inappropriately applies Meritor's average annual yield as a proxy for the marginal yield on new assets (Tr. 475-77, 536-39, 541 [Brummett]; PX 854, Ex. I), has a compounding, ripple effect that grossly overstates plaintiffs' alleged cost. In effect, he makes the implausible assumption that Meritor was unable to invest the Western cash at market rates.

The problem with using Meritor's average yields is that, during the early 1980s, these were depressed due to the presence of older assets and, thus, were significantly below then-current market yields. Tr. 2239-40 [Hargett]; Tr. 537 [Brummett]; Tr. 2816-17 [Hamm] (citing DX 3358); Tr. 2820-21 [Hamm].

The magnitude of this flaw is evident in Mr. Brummett's model. Exhibit L.1 shows that, after purchase accounting adjustments, Western's interest-earning assets were earning yields ranging from a minimum of 15.9 percent. However, in Exhibit I to his report, Mr. Brummett assumes the cash generated from the sale of certain of those assets during 1982 would effectively be reinvested at 9.8 percent. Tr. 2241-42 [Hargett] (citing DX 3524).

Although he has done no analysis (Tr. 884-85 [Brummett]), Mr. Brummett claims the differences between average and marginal yields disappear over time. Tr. 476; 541 [Brummett]. This argument is invalid because Meritor sold most of Western's assets by 1984 and the proceeds were reinvested at market rates at a time when the rate differential between average and marginal yields was the largest. Tr. 2245-46 [Hargett] (citing DX 3526).

64. Has the [G]overnment proven a more appropriate method for calculating Western's investment earnings?

RESPONSE: The Government does not bear the burden of proving a more appropriate method for calculating Western's investment earnings. That burden clearly lies with the plaintiffs. Def. Response Nos. 32-33. Using marginal rates is a more accurate method, however. For the year 1982, for instance, Mr. Hargett replaced the average yield figure of 9.81 percent with Meritor's actual yield of 13.29 percent on money market investments during that year, which more closely approximates the marginal yield that Western earned from redeploying the sales proceeds in that year. DX 3024 at ¶57 & Ex. G.

Dr. Hamm also attempted to correct some of the Brummett model's errors to isolate economic ramifications of the contract (as opposed to the profoundly irrelevant branch profitability analysis that Mr. Brummett purports to have performed). Tr. 2823-25 [Hamm] (citing DX 3360). Once these corrections are made, the results are consistent with the parties' expectations regarding the agreement. From 1982-84, Western is essentially at break-even (gains of $8 million and losses of $9 million); from 1985-87, after interest rates have fallen significantly and Meritor is able to increase its "Western" spread, Western's assets start generating a significant return. As Dr. Hamm explained, cash losses that Mr. Brummett characterizes as "costs of performance" are contrived. Once certain corrections are made to his model, these "costs" disappear. Tr. 2825-26 [Hamm].

65. Is Mr. Brummett's assumed ratio of general and administrative expenses reasonable?

RESPONSE: No. Mr. Brummett assumed Western's annual "G&A and other expense" was equal to 1.0 percent of average core deposits over 10 years. This assumption is arbitrary, unwarranted, and inconsistent with Meritor's contemporaneous estimates.

Meritor estimated in 1982 that incremental operating expenses for Western would total only slightly more than half of Mr. Brummett's estimate (i.e., 0.58 percent). Tr. 2249-50 [Hargett] (citing DX 3522); Tr. 2821-23 [Hamm]; DX 3024 at ¶¶ 69-72 & Ex. K; DX 1357 at CSL124 0155. By nearly doubling Meritor's contemporaneous estimate, Mr. Brummett overstates expenses and understates revenues which, in turn, inflates plaintiffs' alleged damages. Tr. 2821-23 [Hamm].

Mr. Brummett claims his 1.0 percent ratio is conservative. Tr. 3328-33 [Brummett] (citing PX 1075). He conceded, however, that his supporting demonstrative, PX 1075, is flawed and misleading. Tr. 3372-73 [Brummett]. The blue line on PX 1075 reflects the average ratio of G&A expenses (excluding FDIC insurance premiums) to average deposits for FDIC-insured institutions from 1985-94. PX 1075 does not reflect purely incremental non-interest expenses arising from acquisitions, it only reflects the ratios of a stand-alone institution with its own charter. PX 1075 also has not been adjusted for efficiencies that occur when stand-alone institutions are merged. Id. Meritor anticipated and, in fact, received economies of scale that reduced Western's operating expenses. Tr. 899-900 [Brummett]; DX 1357 at CSL124 0062, 0063, 0155, 0162; DX 1887 at 2, ¶3; DX 2019 at CSL009 0682; DX 2020 at 2, ¶5; DX 2021 at 3,

¶7. Lastly, the blue line on PX 1075 is significantly higher than the 0.58 percent incremental G&A ratio that Meritor estimated in 1982.

66. Has the [G]overnment proven a more appropriate method for calculating Western's ratio of general and administrative expenses?

RESPONSE: The Government does not bear the burden of proving a "more appropriate method for calculating Western's ratio of general and administrative expenses." Def. Response Nos. 32-33.

For purposes of comparability with Mr. Brummett's assumed 1.0 percent ratio, Mr. Hargett took Western's operating expenses, as projected by Meritor at the time, and shown them as a percentage of average deposits. Tr. 2249-51 [Hargett]; DX 3024 at Ex. K. Although it is reasonable to assume a small portion of incremental indirect expenses or Meritor's corporate overhead might be attributable to Western, Mr. Brummett's 1.0 percent ratio, relative to Meritor's actual contemporaneous estimate, implies, implausibly, that such overhead allocations would comprise 42% of Western's total "G&A and other expense." Tr. 2251 [Hargett]. See also Tr. 2823-25 [Hamm] (citing DX 3360, DX 3361); DX 3023 at 56, 59.

67. Has Mr. Brummett properly accounted for capital gains and losses on assets purchased by Meritor with the cash provided by Western?

RESPONSE: No. Mr. Brummett's approach to reconstructing Western is oversimplified and misrepresents what separate financial reporting for Western would have shown because, among other reasons, he unconditionally and admittedly excludes the capital gains/(losses) for replacement assets. Tr. 3363-64 [Brummett]; Tr. 2811-14 [Hamm] (citing DX 3351); Tr. 3023, 3549-50, 3573-74 [Hamm], Tr. 2248-49 [Hargett] (citing DX 3515, 3522). See also DX 3023 at 55-56; DX 3024 at 32-33.

Mr. Brummett credits the non-Western portion of Meritor with all capital appreciation realized on replacement assets because it is impossible to track the proceeds. Tr. 477-78, 535-36, 537, 3325-26, 3363-66, 3381-82 [Brummett]. Plaintiffs' concession fully demonstrates the model's overarching flaw – it is impossible to "unscramble the eggs" and create a separate Western due to Meritor's innumerable, commingling business decisions. Tr. 2395-96 [Hargett]; id. at 2395-96 (Court stating "any real categorization of Western assets after the time of the merger is artificial . . . except those assets that were the [original Western assets]. . . ."). See also Def. Response Nos. 37, 117, 118. Even if such an artificial apportionment could be made, Mr. Brummett's decision to give Meritor all capital appreciation for replacement assets is inconsistent with his allocation of the losses to Western from non-Western assets transferred to Mellon in 1990. Tr. 2811-13 [Hamm] (citing DX 3351); Tr. 3023, 3573-74 [Hamm], Tr. 2248-49 [Hargett] (citing DX 3515, 3522). See also DX 3023 at 55-56; DX 3024 at 32-33.

Plaintiffs contend any appreciation in the replacement assets is an "offsetting benefit" which we must prove. Pl. Response No. 68. Plaintiffs are wrong. See Def. Response No. 33;

Glendale III, 54 Fed. Cl. at 12-14 (plaintiff must provide accurate accounting of actual losses sustained in operating thrift, including deducting any cash received; demonstrating any net cash outlay; and not treating excess liabilities as a cost).

68. Has the [G]overnment proven a more appropriate method for calculating capital gains and losses on assets purchased by Meritor with the cash provided by Western?

RESPONSE: The Government does not bear the burden of proving "a more appropriate method for calculating capital gains and losses on assets purchased by Meritor with the cash provided by Western."

Plaintiffs admit it is impossible to track the gains and losses from the assets acquired with proceeds from Western asset sales. See Def. Response Nos. 62-64, 67, 117-18; Tr. 477-78, 535-37, 3325-26; 3381-82 [Brummett]. Mr. Brummett therefore allocates losses on second generation assets to Western, without allocating any gains. PX 854; Tr. 3363-64 [Brummett]; Tr. 2247-48 [Hargett] (citing DX 3522); Tr. 2248-49 [Hargett] (citing DX 3515); Tr. 3549-50 [Hamm].

Mr. Hargett and Dr. Hamm are critical of plaintiffs' methodology because it treats gains/(losses) on these second generation assets inconsistently when compared to allocations for other items, such as losses on the 1990 Mellon branch sale (PX 854 at Ex. J); credit losses arising from Meritor's disastrous growth and diversification strategy (PX 854 at Ex. E); and costs associated with the termination of hedging instruments implemented for non-Western assets. Tr. 895-98 [Brummett]; Tr. 2247-48 [Hargett] (citing DX 3522); Tr. 2253-54 [Hargett] (citing DX 3515); Tr. 2797-2802, 2816 [Hamm]; Tr. 2812-14 [Hamm] (citing DX 3357). Mr. Brummett's treatment of gains/(losses) substantially shortchanges Western in every instance because it allocates losses to Western from the disposition of non-original Western assets at that same time it unconditionally excludes other gains/(losses) on the sale of non-original Western assets. Thus,

the only consistency in this disparate treatment is Mr. Brummett's repeated inflation of plaintiffs' alleged cost. Id.

69. How many former Western branches were sold to Mellon in 1990? How many Meritor or PSFS branches were sold to Mellon in 1990?

RESPONSE: Of the 54 branches sold to Mellon in 1990, 22 were original Western branches (16 stand-alone and six of which that were merged into Meritor branches). Tr. 481-82 [Brummett]; PX 854 at Ex. C.1. Certain Western retirement accounts also were transferred. Id. The remaining 32 branches originated from Meritor.

70. What was the dollar volume of the assets transferred to Mellon in 1990 to fund the transfer of Western's deposits?

RESPONSE: Plaintiffs admit there are no separate historical records or financials for Western post-merger, and it is impossible to track Western's portfolio. Tr. 595-96, 437, 537 [Brummett]; Pl. Response No. 62 ("Without separate records, it is not possible to trace Western funds."); Pl. Response No. 38 ("because Meritor did not maintain separate books for Western, we cannot trace the proceeds of the asset sales"); see also DX 3146 at ESL005 0230 (Western's liabilities immediately absorbed into Meritor; deposit flows cannot be tracked); Tr. (L) 3029-31 [Fritts] (citing DX 510 at CSL010 0506) ("[M]anagement is trying to ascertain what PSFS's financial condition would have been without the merger. This has been difficult . . . since the liabilities of Western were immediately absorbed into PSFS and they were not able to track them."); Tr. 2874, 2990 [Hamm]; Tr. 2395 [Hargett]. Thus, it is impossible to "unscramble the egg" to determine "the dollar volume of assets transferred to Mellon . . . to fund the transfer of Western's deposits." Tr. 2232-33 [Hargett]; DX 3517.

Mr. Brummett's attempt at answering the unanswerable is not credible. In identifying the "Western" deposits, Mr. Brummett ignores the fact that countless independent business decisions hopelessly pollute any attempt to resurrect "Western." See Def. Response Nos. 37, 54, 114, 117-18. See also Tr. 2788-89 [Hamm] (citing DX 3347); Tr. 2791-93, 2799-2802, 3133-35, 3549-50 [Hamm]; Tr. 1444-45 [Thakor]; Tr. 2214-32 [Hargett] (citing DX 3493, DX 3506-15); Tr. 1651 [Gough]; Tr. 820-21; 3379-80 [Brummett]. Nevertheless, Mr. Brummett's quantification rests on a wholly unsupported, paper-thin assumption: The deposit premium paid by Mellon can be allocated across the sold branches based solely on the proportion of deposits transferred. See PX

854 at Ex. J. It is undisputed, however, that numerous factors affect a branch's value. See Tr. 2436, 2442-43, 2537, 2882 [Hamm].

71. How many former Western branches were sold to Mellon in 1992? How many Meritor or PSFS branches were sold to Mellon in 1992?

RESPONSE: A total of 13 Western branches were sold to Mellon in 1992 (four merged branches and nine branches that had not been merged). PX 854 at Ex. C.1. The balance of the 29 branches transferred to Mellon in 1992 (a total of 16) were Meritor branches. It is unclear from the record how many Meritor branches were transferred to Mellon in 1992, and plaintiffs have not cited any evidence supporting its claimed figures.

72. What was the dollar volume of the assets transferred to Mellon in 1992 to fund the transfer of Western's deposits?

RESPONSE: See Def. Response No. 70.

XII. Wounded Bank – Causation

73. If Meritor would have to sell some branches in the absence of the 1988 MOU (the non-breach world), how many branches would it have had to sell?

RESPONSE: Plaintiffs' witnesses agree that Meritor would have massively shrunk – including branch sales – even absent the breach to meet minimum capital requirements. See Tr. 1075-77, 1118 [Finnerty]; PX 541A, Ex. 1, p. 1-3 (Goldstein Model); Tr. (L) 720-21, 680-81 [Hillas]; Tr. 1320 [Hillas], Tr. 1363-65 [Brumbaugh]; Tr. 1489-91 [Thakor]; Tr. 2613-29, 2635, 3123-25 [Hamm]; DX 3406; DX 3365; DX 3366; DX 68 at 2; see also Def. Response No. 4. Indeed, notwithstanding the sale of assets and subsidiaries through March 1990 – which improved Meritor's capital position above what it otherwise would have been, Tr. 770-71 [High] – Meritor still failed the minimum capital requirements. DX 50 at FSL011 0604; PX 9 at 0281; Tr. 766, 769 [High]; Tr. 708 [Hillas].

Moreover, it is speculative to suggest that Meritor would have retained any of the branches it sold absent the breach. Faced with failure of capital minimums and structural problems, and acknowledging that it needed cash to restructure its balance sheet, Meritor packaged its 54 suburban branches for sale. See DX 1067. Meritor did not have the benefit of hindsight that its witnesses have to refashion reality – evidence insufficient as a matter of law. Interstate General Government Contractors, Inc. v. West, 12 F.3d 1053, 1059-60 (Fed. Cir. 1993); accord Argus Incorporated v. Eastman Kodak Co., 801 F.2d 38, 41-43 (2d Cir. 1986); H & B Equipment Co. v. International Harvestor Co., 577 F.2d 239, 247 (5th Cir. 1978); Midwestern Waffles, Inc. v. Waffle House, Inc., 734 F.2d 705, 714 (11th Cir. 1984); Glendale Federal Bank v. United States, 43 Fed. Cl. 390, 399-400 (1999); Three Crown Limited

Partnership, v. Salomon Brothers, Inc., 906 F. Supp. 876, 884-88 (S.D.N.Y. 1995) (same); Ryder Energy Dist. Corp. v. Merrill Lynch Commodities, Inc., 684 F. Supp. 27, 30 (S.D.N.Y. 1988); Cegers v. United States, 7 Cl. Ct. 615, 620-22 (1985); Pure Gold, Inc. v. Syntex, Inc., 739 F.2d 624, 626-27 (Fed. Cir. 1984).

Meritor also publicly expressed its satisfactions with the sales. Tr. 1473-74, 2025-26 [Thakor]; DX 3310. See also DX 1062 at 35; Tr. (L) 761-62 [Hillas]; Tr. (L) 1439 [Slattery].

Finally, Meritor clearly could not have "runoff" $10 billion in deposits within 2 years without sales, and without substantial costs; every dollar of"run-off" must be funded with one dollar's worth of assets. DX 68 (less than $1 billion in cash/money market liquidity). In any event, Meritor was free to shrink in this manner notwithstanding the breach, but did not because it is untenable. See Tr. (L) 681 [Hillas].

74. Was Mr. Hillas' testimony consistent on the branch sales?

RESPONSE: Although his testimony at the damages trial was somewhat opaque, Mr. Hillas testified that absent the breach, Meritor would have sold at least 27 branches. He acknowledged that in a no-breach world, Meritor would have reduced its size from $18-19 billion to approximately $10-12 billion, Tr. (L) 680-81 [Hillas], since in 1989, it would lose $252 million in capital from its balance sheet. Tr.1319-20 [Hillas].

> Court: "If you hadn't had the MOU at that time, would it have been necessary to adopt this capital plan?
>
> A: No. I think, your Honor, you could have gone halfway. Instead of 54 branches, you could have gone 27."
>
> Later, the Court confirmed this:
>
> "So in other words, . . .if the 1988 MOU requirement had not existed, you could have, for example, sold 27 branches and used that premium to clean up the balance sheet instead?
>
> A: Start the process."

Tr. (L) 721 [Hillas]. See also Tr. (L) 728-29 [Hillas].

At the damages trial, plaintiffs attempted to repair this. Mr. Hillas claimed to be confused as to the particular package of branches offered to Mellon. Tr. 1308 [Hillas]. This testimony was not only vague, it was not credible: at his deposition prior to the damages trial, Mr. Hillas testified that he did not wish to modify his trial testimony after having reviewed the transcript. Tr. 1360-65 [Hillas].

75. How many of the assets would have been sold under the 1987 Restructuring Plan vs. how many were sold under the 1988 MOU?

RESPONSE: The objective evidence demonstrates that Meritor would have needed to sell all the assets and subsidiaries it sold even absent the 1988 MOU in order to meet minimum capital requirements, and for other non-breach reasons. Def. Response Nos. 4, 75, 80; e.g., Tr. 1075-77, 1118 [Finnerty]; Tr. (L) 720-21, 680-81 [Hillas]; Tr. 1320 [Hillas], Tr. 1363-65 [Brumbaugh]; Tr. 1489-91 [Thakor]; Tr. 2613-29, 2532-2635, 3123-25 [Hamm]; DX 3365; DX 3366. Plaintiffs' Dr. Goldstein projected that, absent the breach, Meritor would have reduced its assets to $7.8 billion by December of 1990. PX 541A at PEX176 0011.

At the end of 1987, Meritor realized that over the next two years, it was going to have to undertake massive restructuring to remain in compliance with the regular capital requirements that apply to institutions that are fundamentally sound and have no major defects. Tr. 2617-19, 3123-25 [Hamm]; DX 3365; DX 1909 at 0443; PX 1909 at 0443; DX 736 at 2; DX 104 at 9. Meritor knew it would lose, at a minimum, (1) $252 million of its regulatory capital due to the maturity of the FDIC non-amortizing note, and (2) $106 million because of goodwill amortization at $53 million per year. Tr. 2620-22 [Hamm].

This inevitable loss of capital, as well as its revised business strategy, led Meritor to sell off several of its assets, including Meritor Credit Corporation, Tr. 2631-32 [Hamm], DX 3407A; DX 787 at 8, DX 68 at 8; Tr. 2630-31 [Hamm]; the student loan portfolio; DX 3407A; DX 3013 at 2, Tr. 2633-34 [Hamm]; its investment advisory business; DX 3013, DX 3407A; Tr. 2638-39 [Hamm]; and Meritor's retail branch offices in Virginia, D.C., and Maryland; DX 68 at 8.

76. In the absence of the MOU, was there a need to hire Bankers Trust?

RESPONSE: Yes. Mr. Hillas testified that even absent the 1988 MOU, Meritor would have hired Bankers Trust. Tr. 1312 [Hillas]. As Dr. Hamm observed, Meritor was confronted with fundamental problems that would have justified the retention of investment bankers. Dr. Hamm explained that, given Meritor's serious regulatory capital and operating problems at the end of 1987, Tr. 3123-24 [Hamm]; DX 3365 and 3366, it would have needed to hire investment bankers to help it deal with that significant pending shortfall in its regulatory capital position. Tr. 2640-44 [Hamm]; DX 3408. Upon reviewing the Bankers Trust engagement letters, Dr. Hamm concluded there is no reason to believe that Meritor would not have sought the identical services from Bankers Trust in the absence of the breach. See PX 215; DX 3150 at CSL060 0008; DX 3105. Tr. 2648-52 [Hamm].

[THERE ARE NO QUESTIONS 77-78]

79. Was it possible, with a reasonable chance of success, for Meritor to raise $200 million of new capital in the 1987-1988 time period?

RESPONSE: If Meritor had profitable opportunities as it now claims in litigation, it could have raised external capital to compensate for the 1988 MOU. Tr. 1462-68 [Thakor]. To suggest that new investors would not have been willing to invest in Meritor flatly contradicts Dr. Finnerty's 1988 damage claim – Meritor's future cash flows could not have been worth $171 million (before gross up) if investors were unwilling to infuse additional capital. Tr. 1465-66 [Thakor]. Plaintiffs cannot have it both ways; either the market accurately assessed Meritor's value at $171 million which investors would have been willing to participate in, or the market severely overstated Meritor's value and investors were unwilling to invest. Id.

Meritor never attempted to raise capital: it never prepared an offering circular and it never spoke to potential investors, Tr. 3153 [Lutz] (Meritor told Lutz it would talk to First Boston and prepare an offering, but never did), presumably because shareholders blocked such efforts, believing that balance sheet restructuring was the more profitable course. DX 1909 at CSL055 0445; Tr. (L) 1071 [High].

At a minimum, there is no dispute that Meritor could have raised capital from insiders and existing shareholders through a rights offering – even if new investors were not interested. Tr. 1466-68 [Thakor]; Tr. (L) 3260 [Lutz]; Tr. (L) 816 [Albertson]; JE 10 at 71-72, 209-10; DX 1292; DX 1908; DX 1386. They rejected the option, presumably because they did not believe in Meritor's prospects. Tr. (L) 1938-39 [Hargrove]; Tr. (L) 4634-35, 4639-40 [Hammer]; DX 430 at 20; DX 447 at 2; DX 1909 at CSL055 0445.

80. What aspects of the 1987 Restructuring Plan were carried out in the 1988 MOU?

RESPONSE: By late 1987, Meritor recognized that significant restructuring was necessary because it had virtually no prospects of returning to stable positive earnings as the bank was then structured, and needed to boost tangible capital for non-breach reasons. DX 68 at 2; DX 1909; Tr. (L) 855-56 [Albertson]; Tr. (L) 313-15 [Cooke]; DX 482 at CSL076 0379-80; DX 376 at 3. Thus, it began a restructuring program – including substantial shrinkage – by initially identifying several assets and subsidiaries for sale by late 1987. DX 68 at 8; see also PX 8 at 2, 8. The 1987 Restructuring Plan, known as the "Philadelphia Plan," was designed to divest all non-Delaware Valley entities. PX 8 at 2.

As massive credit quality problems and net operating losses mounted, and anticipating the loss of over $250 million in regulatory capital from the retirement of notes, Meritor accelerated its divestiture plan. Tr. 2613-29, 3123-26 [Hamm]; DX 3365; DX 3366; PX 8 at 2, 8. In short, Meritor knew that these problems, between 1988 and 1989, would lead to the loss of approximately $623 million – or half – of its regulatory capital, and needed to do something about it. See Id.

As a result of asset and subsidiary sales between 1987 and March 1990, Meritor improved its regulatory capital position above what it otherwise would have been had such sales not taken place. Tr. 770-71 [High]. Meritor's divestitures were necessary to meet minimum capital requirements. See Tr. 1075-77, 1118 [Finnerty]; PX 541A, Ex. 1, pp. 1-3 [Goldstein]; Tr. (L) 720-21, 680-81 [Hillas]; Tr. 1320 [Hillas], Tr. 1363-65 [Brumbaugh]; Tr. 1489-91 [Thakor]; Tr. 2613-29, 2635, 3123-25 [Hamm]; DX 3406; DX 3365; DX 3366; DX 68 at 2; see also Def. Response Nos. 4, 75; Tr. 2632 [Hamm]; Tr. 2633-34 [Hamm] (Hillas: DX 1303 at 2, student

loan portfolio and investment advisory business sold for non-breach reasons); Tr. 2654-55 [Hamm].

81. Is there documentary evidence to support a realistic distinction between restructuring done in the "real world" vs. the "no breach" world? In other words, what is the basis in evidence for showing what would have happened in the non-breach world?

RESPONSE: None. No documents suggest Meritor would have retained any of its subsidiaries absent the breaches. In fact, the objective evidence demonstrates that Meritor would have needed to sell all the assets and subsidiaries it sold even absent the 1988 MOU in order to meet minimum capital requirements, and for other non-breach reasons. Def. Response Nos. 4, 75, 80; e.g., Tr. 1075-77, 1118 [Finnerty]; PX 541A, Ex. 1, pp. 1-3 [Goldstein]; Tr. (L) 720-21, 680-81 [Hillas]; Tr. 1320 [Hillas], Tr. 1363-65 [Brumbaugh]; Tr. 1489-91 [Thakor]; Tr. 2613-29, 2532-2635, 3123-25 [Hamm]; DX 3365; DX 3366.

The only evidence offered to support the claim that Meritor would have retained some of its subsidiaries, and some of its branches, is hindsight-driven, self-serving testimony by former executives of the bank. Such evidence is insufficient, as a matter of law. Interstate General Government Contractors, Inc. v. West, 12 F.3d 1053, 1059-60 (Fed. Cir. 1993); accord Argus Incorporated v. Eastman Kodak Co., 801 F.2d 38, 41-43 (2d Cir. 1986); H & B Equipment Co. v. International Harvestor Co., 577 F.2d 239, 247 (5th Cir. 1978); Midwestern Waffles, Inc. v. Waffle House, Inc., 734 F.2d 705, 714 (11th Cir. 1984); Glendale Federal Bank v. United States, 43 Fed. Cl. 390, 399-400 (1999); Three Crown Limited Partnership, v. Salomon Brothers, Inc., 906 F. Supp. 876, 884-88 (S.D.N.Y. 1995); Ryder Energy Dist. Corp. v. Merrill Lynch Commodities, Inc., 684 F. Supp. 27, 30 (S.D.N.Y. 1988); Cegers v. United States, 7 Cl. Ct. 615, 620-22 (1985); Pure Gold, Inc. v. Syntex, Inc., 739 F.2d 624, 626-27 (Fed. Cir. 1984).

Plaintiffs attempt to rely upon two documents, PX 109 at CSL008 2000, and PX 138 at SL000027, contending that the "Philadelphia Plan" contemplated shrinkage by just $1-$2 billion. Plaintiffs told the Court otherwise. See Pl. Response No. 4 (acknowledging "but for" shrinkage from at least $19 billion to $11 billion); accord Tr. 1075-77, 1118 [Finnerty]; PX 541A, Ex. 1, p.1 [Goldstein]; Tr. (L) 680-81 [Hillas].

Incidentally, Meritor's 1987 plan to execute a $2 billion shrink through asset divestitures instead of "runoff" belies plaintiffs' assertion that Meritor could have, and would have, executed a $10 billion shrink in 2 years through "runoff." See also Tr. (L) 680-81 [Hillas].

82. Would the investment banking fees related to the sale of Meritor Savings, F.A. have been incurred in the absence of the breaches?

RESPONSE: A substantial percentage of these fees would no doubt have been incurred to help Meritor address its restructuring plans and capital problems. Meritor's sale of Meritor Savings, F.A., was a good strategic move for Meritor in seeking to restore profitability. Tr. (L) 2475-76 [Finnerty]; DX 1267 at 366; Tr. 1355-56 [Hillas]. Plaintiffs' experts acknowledge that Meritor would have dramatically downsized absent the breach: Dr. Goldstein projected Meritor would have shrunk to $7.8 billion by year-end 1990. PX 541A at PEX1760011; Dr. Finnerty testified that Meritor would have shrunk from more than $19 billion at the end of 1987 to $9.5 billion by year end 1991; Tr. 1075, 1066, 1069,1079 [Finnerty]. Plaintiffs' fact witnesses confirm Meritor's need to shrink at that time. Tr. (L) 1401 [Fitzgerald]; Tr. (L) 680-81 [Hillas].

As Dr. Hamm explained, the engagement letters reflect investment banking services that would have been required given this significant restructuring. Tr. 2613-14, 2617-19, 3123-25 [Hamm]; DX 3406; DX 3365; Tr.2620-25, 2627-28, 2632-34, 2638-39 [Hamm]; DX 3407A; DX 3013 at 2. These investment banking services would be required to help it either raise capital or identify items on its balance sheet that it could sell at a profit and thus increase its capital. Tr. 3123 [Hamm].

XIII. Wounded Bank – Measurement and Proof

83. What were the wounded bank damages? Were there any off-setting benefits from the wounded bank costs?

RESPONSE: This Court has characterized "wounded bank" damages as "costs incurred by the thrift because of its status as a "troubled" or under-capitalized institution – a status directly related to [the] mandated removal of goodwill from the thrift's regulatory capital." Southern California Federal Savings & Loan Association v. United States, 57 Fed. Cl. 598, 623 (2003), appeal docketed, Fed. Cir. No. 04-5036 (Dec. 10, 2003). Because wounded bank damages are a form of reliance damages, plaintiffs must prove elements of foreseeability, causation, and reasonable certainty. Landmark, 256 F.3d at 1378; Westfed, 52 Fed. Cl. at 154 (citing Laka Tool and Stamping Co. v. United States, 650 F.2d 270, 272 (Ct. Cl. 1981)).

Plaintiffs' wounded bank damages fail this standard because they include non-breach related phenomena. Tr. 2614-16, 2639 [Hamm]. Plaintiffs' expert and fact witnesses have testified that absent the breach, Meritor would have to sell off a significant number of its assets in the late 1980's. See Def. Response No. 75, ¶ 3; Tr. 1075, 1066, 1069, 1079 [Finnerty]; PX 541A at PEX176 0011; Tr. (L) 1401 [Fitzgerald]; Tr. (L) 680-81 [Hillas]. Dr. Hamm explained that investment banking services that would have been required for this restructuring. Tr. 2613-14, 2617-25, 3123-25 [Hamm]; DX 3406; DX 3365; Tr. 2627-28, 2631-34, 2637-39 [Hamm]; DX 3407A; DX 3013 at 2. Dr. Brumbaugh fails to distinguish between those costs caused by the breach, and those not caused by the breach. See, e.g., PX 541A at 7; DX 24 at 6; DX 3407A; DX 3408; Tr. 2637-39, 2654-55 [Hamm]. For example, he includes Bankers Trust fees, despite the fact that, Bankers Trust would have been engaged in the absence of the 1988 MOU. Tr.1312

[Hillas]. He includes $3 million as a cost of selling Meritor Credit Corporation, where that was sold pursuant to the 1987 restructuring plan. DX 787 at 8; Tr. 2629-32 [Hamm]. Since plaintiffs' wounded bank damage estimates do not account for these alternative causes of these actions, they are barred. Fed. R. Evid. 702, Advisory Committee Notes ¶ 4 (3) (Dec. 2000); Claar v. Burlington N.R.R., 29 F.3d 499 (9th Cir. 1994); Children's Broadcasting Corp. v. The Walt Disney Co., 245 F.3d 1008 (8th Cir. 2001).

84. Is there evidence to support the payment of all the investment banker fees?

RESPONSE: No. Dr. Hamm reviewed all the documents that discuss the scope of services, and could not identify any component of these fees linked to the breach of contract. Tr. 2639-59 [Hamm]. By contrast, Dr. Brumbaugh did not even read the engagement letters. Tr. 2659 [Hamm]. These fees were unrelated to the breach:

First Boston: the primary purpose of the investment banking fees in the one letter produced (DX 3056) was to assist Meritor in evaluating and implementing a range of strategies designed to enhance shareholder value, and to advise regarding with tender offers or hostile takeovers. Tr. 2642-44 [Hamm].

Furash and Co.: one engagement letter relates to strategic planning, the second to Meritor's work with regulators on the MOU. The MOU also addressed Meritor's significant regulatory problems unrelated to the breach – e.g., operating income, excessive interest rate risk, poor liquidity, credit quality problems. Tr. 2646-48 [Hamm].

Bankers Trust: Upon reviewing the engagement letters, Dr. Hamm concluded there is no reason to believe that Meritor would not have sought the identical services from Bankers Trust in the absence of the breach. See PX 215; DX 3150 at CSL060 0008; DX 3105; Tr. 2648-52 [Hamm].

Shearson Lehman Hutton: the engagement letter states that Shearson had collected data on Meritor's asset and liability portfolios for use on their modeling system, which thrifts commonly do in the regular course of business. DX 1661, Tr. 2657-59 [Hamm].

85. Does the Bankers Trust letter support wounded bank damages? Would these letters have been written in the no-breach world?

RESPONSE: The Bankers Trust letter does not support plaintiffs' wounded bank damages claim. Mr. Hillas testified that Meritor would have engaged Bankers Trust absent the breach. Tr. 1312 [Hillas]. Given Meritor's regulatory capital dilemma at the end of 1987, it would have needed to hire investment bankers to help it deal with the significant pending shortfall in its regulatory capital position. Tr. 3122-25, 2639-42 [Hamm]; DX 3408, DX 3365 and 3366; Tr. 1075, 1066, 1069, 1079 [Finnerty]; PX 541A at PEX1760011; Tr.(L)1401 [Fitzgerald]; Tr.(L)680-81 [Hillas].

No portion of the Bankers Trust investment banking fees are appropriate to consider as wounded bank damages without further information showing what the incremental effect of the MOU was on Meritor's need for investment banking services. Upon reviewing the Bankers Trust engagement letters, Dr. Hamm concluded there is no reason to believe that Meritor would not have sought the identical services from Bankers Trust in the absence of the breach. See PX 215; DX 3150 at CSL060 0008; DX 3105. Tr. 2648-52 [Hamm]. Because Meritor would have had a compelling need for these same services in the no-breach world, these expenditures cannot be deemed to be wounded bank damages. Tr. 2641-42 [Hamm]. Fed. R. Evid. 702, Advisory Committee Notes ¶ 4 (3) (Dec. 2000); Claar v. Burlington N.R.R., 29 F.3d 499 (9th Cir. 1994); Children's Broadcasting Corp. v. The Walt Disney Co., 245 F.3d 1008 (8th Cir. 2001).

XIV. Restitution

86. Who carries the burden of proof, and by what standard, with respect to the likelihood that Western would have been liquidated absent merger with PSFS?

RESPONSE: This question, suggested by plaintiffs, is a red herring, as it suggests that, rather than their saved cost of liquidation claim having uniformly been rejected by the Court of Appeals for the Federal Circuit in LaSalle Talman Bank, FSB v. United States, 317 F.3d 1363, 1376-77 (Fed. Cir. 2003), Glendale Fed. Bank, FSB v. United States, 239 F.3d 1374, 1382 (Fed. Cir. 2001), California Fed. Bank, FSB v. United States, 245 F.3d 1342, 1351 (Fed. Cir. 2001), cert. denied, 534 U.S. 1113 (2002); it is a mere matter of proof. However, as in those cases, the financial institution here never conferred any measurable benefits upon the deposit insurer (here, the FDIC), and the financial institution never incurred an economic cost when it claims to have assumed the cost of liquidating the liabilities of the acquired mutual savings bank.

While, as in Southern California Federal Sav. & Loan Ass'n v. United States, 57 Fed. Cl. 598, 627-28 (2003), appeals docketed, Nos. 04-5036, -5038 (Fed. Cir. Dec. 10, 2003); this Court allowed this claim to proceed to trial despite the prior rejection of the theory, the result should be the same as in that case, where the Court concluded: "In sum, like the several judges previously faced with this theory, we are simply not convinced that this is an appropriate concept of restitution damages in this case." Id.; see Citizens Federal Bank, FSB v. United States, 52 Fed. Cl. 561, 564-65 (2002); Hansen Bancorp, Inc. v. United States, 53 Fed. Cl. 92, 96 & n.4 (2002); Suess v. United States, 52 Fed. Cl. 221, 229 (2002); Granite Mgmt. Corp. v. United States, No. 95-515C, 2003 WL 22989008 at *5-6 (Fed. Cl. Dec. 16, 2003). The burden to persuade this

Court and the Federal Circuit to change the law would be plaintiffs' burden, undoubtedly by a very high standard.

87. Who carries the burden of proof, and by what standard, with respect to the availability and likely cost of alternatives to liquidation?

RESPONSE: See Def. Response No. 86. This question, proposed by plaintiffs, is a red herring. Plaintiffs simply ignore the evolution of the law with respect to its restitution claim. The Federal Circuit unequivocally rejected restitution claims premised upon liquidation costs purportedly saved by the Government because they did not reflect actual losses to the non-breaching parties. See Glendale Fed. Bank, FSB v. United States, 239 F.3d 1374, 1381-82 (Fed. Cir. 2001); California Fed. Bank, FSB v. United States, 245 F.3d 1342, 1350-52 (Fed. Cir. 2001), cert. denied, 534 U.S. 1113 (2002) (quoting Glendale). In addition to the many options other than liquidation available to the Government, Glendale, 239 F.3d at 1382, the Federal Circuit has noted that the deposit insurer's contingent liability over the newly combined institution defeated restitution claims premised upon saved liquidation costs. Glendale, 239 F.3d at 1382; CalFed, 245 F.3d at 1351 (finding contingent liability defeated plaintiffs' claim); Southern California Fed. Sav. & Loan Ass'n v. United States, 57 Fed. Cl. 598, 624 (2003) (same); Granite Mgmt. Corp. v. United States, No. 95-515C, 2003 WL 22989008 at *6-7 (Fed. Cl. Dec. 16, 2003) (same).

The Federal Circuit’s most recent pronouncement highlights that plaintiffs' claim is inappropriate:

> [T]he calculation of restitution damages based on the treatment of assumed "goodwill" liabilities as a cost of performance was generally resolved in Glendale, 239 F.3d at 1382-83, where this court held that damages are not properly keyed to "a liability that was at most a paper calculation." . . ., we agree with the Court of Federal Claims [that assumed liabilities] are not a usable measure of either cost to the thrift or benefit to the government, and thus not an appropriate threshold for restitution damages. See also Cal. Fed. Bank, 245 F.3d at 1351.

LaSalle Talman, 317 F.3d at 1376-77 (emphasis added).

88. Who carries the burden of proof, and by what standard, with respect to the savings realized by the government as a result of the merger?

RESPONSE: See Def. Response Nos. 86 and 87. If such a theory were not already foreclosed as a measure of restitution, it would be plaintiffs' burden by a preponderance of the evidence.

89. Who carries the burden of proof, and by what standard, with respect to the existence and quantum of benefits received by Meritor and/or costs incurred by the government?

RESPONSE: See Def. Response Nos. 86, 87. If such a theory were not already foreclosed as a measure of restitution, it would be the Government's burden by a preponderance of the evidence. We disagree with plaintiffs' assertion that any benefit bestowed on Meritor was "taken back" by the Government as a result of Meritor's seizure. Meritor obtained full receipt of the benefits of the 1982 transaction prior to the first breach. The Income Maintenance Agreement ("IMA") was fully performed by both parties before Meritor canceled it in 1987. Meritor also received the full benefit, if any, from leveraging the unamortized, contractual goodwill from 1982 to 1988, and at least a portion of the goodwill from 1988 to 1992. This fact is not overcome by plaintiffs noting that Meritor was seized in 1992. Rather, this highlights our contention that the Court is unable to "unscramble the egg" for restitution purposes. LaSalle Talman Bank, F.S.B. v. United States, 45 Fed. Cl. 64, 77 (1999), aff'd in relevant part, rev'd on other grounds, 317 F.3d 1363 (Fed. Cir. 2003).

90. Is an award to Meritor of the amount saved by the government as a result of the merger precluded by the Court of Appeals' prior decisions in Winstar damages cases?

RESPONSE: Yes. Binding authority bars plaintiffs' restitution claim based upon the alleged avoided "cost of liquidation" as a matter of law. See LaSalle Talman Bank, FSB v. United States, 317 F.3d 1363, 1376-77 (Fed. Cir. 2003); Glendale Fed. Bank, FSB v. United States, 239 F.3d 1374, 1382 (Fed. Cir. 2001); California Fed. Bank, FSB v. United States, 245 F.3d 1342, 1351 (Fed. Cir. 2001), cert. denied, 534 U.S. 1113 (2002). The cases in this Circuit have squarely rejected the assumption that an award of restitution may be based upon the "saved cost of liquidation." Glendale, 239 F.3d at 1381-82 ("[T]he action taken by the purchasing [Savings & Loan] in acquiring the failing thrift did not result in the Government, specifically FSLIC, saving the dollar value of the net obligations of the thrift."); California Fed. Bank, 245 F.3d at 1342 (quoting Glendale); LaSalle, 317 F.3d at 1376-77 (holding that the liabilities assumed by the acquiring thrift in that case "are not a usable measure of either cost to the thrift or benefit to the Government, and thus not an appropriate threshold for restitution damages"); see Citizens Federal Bank, FSB v. United States, 52 Fed. Cl. 561, 564-65 (2002); Hansen Bancorp, Inc. v. United States, 53 Fed. Cl. 92, 96 & n.4 (2002); Suess v. United States, 52 Fed. Cl. 221, 229 (2002); Granite Mgmt. Corp. v. United States, No. 95-515C, 2003 WL 22989008 at *5-6 (Fed. Cl. Dec. 16, 2003).

Moreover, plaintiffs' theory that its avoided costs of liquidation claim rests upon firmer evidentiary ground than the same claim in other cases does not overcome the second basis for the ruling in Glendale that restitution is not available where the insurer bore a contingent liability after the transaction. Glendale, 239 F.3d at 1382; California Fed. Bank, 245 F.3d at 1351

(finding contingent liability defeated plaintiffs' claim); Southern California Fed. Sav. & Loan Ass'n v. United States, 57 Fed. Cl. 598, 624 (2003) (same); Granite Mgmt. Corp. v. United States, No. 95-515C, 2003 WL 22989008 at *6-7 (Fed. Cl. Dec. 16, 2003) (same).

91. Did the FDIC bear the risk of a contingent liability in approximately the amount of the estimated liquidation cost for Western immediately after the merger of Western and PSFS, should PSFS have failed thereafter?

RESPONSE: Yes. At the time of the merger, the FDIC was the ultimate insurer of Western's and PSFS's deposits. Both institutions were insolvent on a mark-to-market basis at the time of their merger in April 1982. DX 392 at 14, 27; DX 63 at 15; DX 510; see Tr. (L) 189-90 [Nocella]. Given the larger size of Meritor, PSFS was likely insolvent by billions of dollars in April 1982. Tr. 2565-66, 2664, 2744-45 [Hamm]. After the merger, the FDIC continued to be the ultimate insurer of the combined bank's deposits. Tr. 2673-74 [Hamm]; Tr. 630-31 [Brummett]; Tr. 357 [Dr. Brumbaugh]. Thus, the FDIC's contingent liability that existed prior to April 3, 1982 continued after that date. Notably, because PSFS was insolvent, PSFS could not confer economic benefits on the deposit insurer. Tr. 2673-74, 2744-45 [Hamm]; Tr. 1545-46 [Thakor].

Plaintiffs' attempt to distort Glendale, 239 F.3d at 1382, by stating that there was no contingent liability here because Meritor was eventually closed, is unavailing. Plaintiffs' asserted ability to measure the cost of the resolution of Meritor in 1992 does not eliminate the FDIC's contingent liability as deposit insurer for the combined Meritor and Western from April 3, 1982, until the bank's closing in 1992. Consequently, contingent liability was present here, and plaintiffs cannot overcome Glendale's binding holding. See Def. Response No. 90.

92. Subsequent to April 3, 1982, who bore the risk associated with the former Western assets and liabilities – Meritor or the FDIC?

RESPONSE: As to a direct legal liability, the FDIC did for up to ten years after the acquisition. See Def. Response Nos. 12 & 13; Tr. 3542-44 [Hamm] (income maintenance agreement entered into with PSFS provided what amounted to a guarantee against interest rate risk); DX 3066 at 21 ("The FDIC paid the acquirer the difference between the yield on acquired earned assets and the average cost of funds for savings banks, thereby assuming the interest rate risk."); Tr. 2172-74 [Hargett], citing DX 63 at CSL017 1261; Tr. 2192-94 [Hargett] (interest rate risk related to the acquired Western portfolio was assumed by the FDIC by virtue of the income maintenance agreement); DX 3497; Tr. 1444-45 [Thakor] (the FDIC bore the interest rate and credit risk on the Western portfolio following the merger).

As a matter of practicality, the FDIC always bore the contingent risk associated with the former Western along with the risk of PSFS/Meritor's failing. See Def. Response No. 91.

93. Who ultimately absorbed the post-April 3, 1982 losses, if any, generated by the assets and liabilities that were acquired from Western – Meritor or the FDIC?

RESPONSE: The FDIC. The FDIC, through the IMA, fully subsidized and thus absorbed the negative net interest margin on the acquired assets and liabilities, and this continued even **after** Meritor opted to sell the assets. Tr. 2302-03, 2426 [Hargett]. Meritor may or may not have incurred losses on the replacement assets but that is irrelevant to the question of losses generated by the performance of the acquired assets and liabilities. Tr. 1444-45 [Thakor]. Pursuant to the Merger Assistance Agreement, DX 386, the latter losses were fully absorbed by the FDIC. See Def. Response 92. Ultimately, the fall in interest rates was such that the acquired assets and liabilities recovered their par value. See Def. Response No. 11. This was reflected by the fact that, by 1985, Meritor was making payments to the FDIC under the IMA. Tr. 2188-89 [Hargett] (citing DX 3502).

Moreover, the $112 million FDIC capital infusion was, in effect, a cash gift to Meritor that immediately reduced Western's net liabilities (before considering any other assistance or the value of the Western deposits). Tr. 2197-98 (citing DX 3497), 2204-05 [Hargett]. Likewise, the credit losses on the acquired assets were absorbed by (a) the FDIC as long as they were held by Meritor, and (b) by whoever acquired them from Meritor thereafter. Tr. 2198-99 [Hargett] (citing DX 3497). According to Mr. Brummett's model, Meritor incurred less than $1million in credit losses on the acquired Western assets. Tr. 2253 [Hargett]; DX 3468. See Def. Response No. 92.

94. Do the "net payments" claimed by plaintiffs correctly measure the cash flows between the Government and Meritor?

RESPONSE: No. Dr. Finnerty's conclusion that the massive financial assistance package that the FDIC provided to Meritor in connection with the Western transaction resulted in $67.4 million of net payments to the FDIC is implausible on its face.

Not surprisingly, Dr. Finnerty's calculation suffers from numerous maladies. For example, with respect to Western's pre-existing, $108 million debt to the Federal Reserve, this liability was simply replaced with a new liability to the FDIC, much like refinancing a mortgage loan. Tr. 1242-43 [Finnerty]. However, Dr. Finnerty illogically treats this $108 million "wash" as a windfall to the Government. Tr. 2680-82 [Hamm]; see DX 3100, Ex.19a, which excludes the original $108 million disbursement from Federal Reserve to Western, which Finnerty acknowledges was a cash outlay to the Government – Tr. 1245-46 [Finnerty]; other components to this transaction are at lines [4] (take ½), [6], and [7].) In addition, as part of the Western transaction, Meritor and the FDIC separately exchanged $108 million of "paper" that carried identical interest rates in order to increase Meritor's regulatory capital. Tr. 1247-48, 1249 [Finnerty]. This transaction was an economic "wash"; however, Dr. Finnerty implausibly concludes that this transaction, which had no economic substance, resulted in a benefit to the FDIC equal to $57.5 million ($359.2 million /2 - $122.1 million). Tr. 1248 [Finnerty]. Common sense tells us otherwise.

95. To what extent, if any, is it economically meaningful to compare an ex ante estimate of liquidation costs with an ex post estimate of the actual costs incurred by the FDIC in connection with Meritor's acquisition of Western?

RESPONSE: It is not economically meaningful to conduct such a comparison. Dr. Finnerty's attempt to do so, Tr. 1238-39 [Finnerty], is improper and cannot yield a reliable conclusion for several reasons. It is methodologically improper to compare an ex ante estimate with an ex post estimate, Tr. 1549-50 [Thakor], as even Dr. Finnerty concedes. Tr. 1239-40 [Finnerty] (an ex ante estimate is generally performed without including any actual events that occurred thereafter). Dr. Finnerty compares estimates in two very different interest rate environments and, thus, derives results that are meaningless as a matter of economics. Tr. 2677-79 [Hamm]. At the time the liquidation estimate was formulated, likely prior to April 3, 1982, interest rates were very high. Following the transaction, interest rates fell sharply. Thus, the actual cost of the FDIC's transaction with PSFS benefitted from the fall in interest rates, as would have any estimate related to a potential liquidation of Western. Dr. Finnerty's apples-to-oranges comparison guarantees meaningless results. Tr. 2678-79 [Hamm]

Dr. Finnerty also improperly compares a discounted number to an non-discounted number. The liquidation cost estimate reflects the present value of the expected cash flows from liquidation. The cost of the PSFS/FDIC transaction, however, uses non-discounted cash flows. This further compounds an apples-to-oranges comparison. Tr. 2679-80 [Hamm].

96. What is the probability that the FDIC would have liquidated Western by paying off its depositors if the PSFS acquisition had not occurred?

RESPONSE: Zero. During the early 1980's, FDIC policy had ruled out the liquidation of mutual savings banks, Tr. 2690-91 [Hamm]; Tr. 3130-31 [Hamm]; Tr. 1909 [Thakor]; see also Tr. 227 [Brumbaugh], which could undermine the confidence of depositors. Tr. 2688-90 [Hamm]. In fact, no insolvent mutual savings bank has been liquidated by the FDIC since 1938, Tr. 2695-96 [Hamm]; Tr. 225 [Brumbaugh], despite a number of mutual savings banks that failed during the thrift crisis of the 1980s. Tr. 2692 [Hamm]; see DX 3328; Tr. 1861 [Lutz].

Alternative resolution methods were available to the FDIC at the time in the absence of the PSFS bid. Tr. 2013 [Thakor]; see Def. Response Nos. 99-103, 107-09. Thus, it would have been irrational for the FDIC to liquidate Western. Tr. 2682 [Hamm]; Tr. 1542-43 [Thakor]; see Tr. 1851-52 [Lutz]; Tr. 1616 [Gough]. The problem affecting Western – the high interest spike – was viewed as temporary, thus a liquidation of Western – a permanent loss of capital in response to a temporary problem – made no sense economically. Tr. 2682-83 [Hamm]; DX 3325; Tr. 1542-43 [Thakor]. Additionally, as the most expensive method, liquidation would have resulted in two economic costs not found in other resolution strategies: (1) the loss of Western's franchise value, which Meritor valued at $194 million, DX 1062 at 3, or more, DX 1357 at CSL124 0142 (identifying a larger range); and (2) the administrative cost, estimated here at $4 million. Tr. 2685 [Hamm]. It would have been irrational for the FDIC to liquidate Western since it could very easily avoid those costs. Tr. 2686-88 [Hamm].

97. To what extent, if any, is the FDIC's liquidation cost estimate a reliable measure of what it would have actually cost the FDIC to liquidate Western if the PSFS acquisition had fallen through and the agency had decided to litigate [sic]?

RESPONSE: It is not a reliable measure of the actual cost of a liquidation. Initially, it cannot be validated as to whether or not it represents the FDIC's view as to what the liquidation costs were at the time of liquidation. Tr. 2721-22 [Hamm]. Further, if the agency had decided to liquidate the assets, it is not known whether they would have done so over time or in a purchase and assumption, or how quickly the liquidation would have been conducted under either scenario. Assuming that it was based upon prevailing interest rates, it also would not have anticipated the dramatic drop in interest rates that occurred after 1982 and in which environment the liquidation of Western likely would have taken place. Tr. 2721-22 [Hamm]; see Tr. 2678-79 [Hamm]. The value of Western's assets, if interest rates declined far enough, would approach and perhaps even exceed their book value or the unpaid principal balance of the assets. Tr. 2722-23 [Hamm]; see also Tr. 2728 [Hamm]; DX 3333; Def. Response No. 11, Pl. Response Nos. 47, 11. An ex ante estimate of what the cost to the FDIC of liquidating Western would have been does not serve as a reasonable proxy. Tr. 2723, 2726-29 [Hamm]; see also Tr. 222-23 [Brumbaugh] (the FDIC liquidation estimate was a "paper calculation").

XV. Out-of-State Merger

98. Did the FDIC have a preference for out-of-state commercial banks to acquire failing thrifts?

RESPONSE: Yes, but state regulators usually opposed this preference. Tr. (L) 2713, 2715 [Gough]. In this case, neither the FDIC nor the Pennsylvania Department of Banking had ruled out the possibility that an out-of-state or commercial bank could acquire Western. DX 3000. The FDIC was reserving the right to solicit out-of-state institutions depending upon whether acceptable bids were attained within the state. DX 3000; see PX 655 (reflecting FDIC's position at that time that it would not seek out-of-state bids as long as it had a viable in-state alternative); Tr. 1664 [Gough]. Up to the point of the Western transaction, however, the FDIC had not opened up the bidding process to out-of-state bidders. If it had done so, however, the FDIC would have put itself in a position to obtain better, more competitive bids both from in-state institutions and from out-of-state institutions. The FDIC was clearly aware by early April 1982 that it could achieve significant savings by opening up the bidding pool to out-of-state acquirers. Tr. 2707-09 [Hamm]; see DX 3136 at 2.

99. Is there substantial evidence that any out-of-state banks would have been interested in acquiring Western at a cost to the FDIC less than its projected cost of liquidating Western?

RESPONSE: The Court did not allow evidence to be presented on this point. Tr. 1669-71 [Gough]. The fact that the FDIC reserved the right to solicit such indicates that it considered such an acquisition to be a feasible alternative. See DX 3000; see also PX 655 (reflecting FDIC's position at that time that it would not seek out-of-state bids as long as it had a viable in-state alternative); Tr. 1664 [Gough]. However, because an in-state bid was received by the FDIC, it was unnecessary for the FDIC to pursue out-of-state bidders. As Mr. Robert Gough, the FDIC regulator in charge of a task force for resolving mutual savings bank problems, including Western, testified, because the FDIC received an in-state bid, in accord with the Pennsylvania Department of Banking's preference, "[w]e never got to the other scenarios of the other alternatives," such as pursuing out-of-state bidders or the Pennsylvania legislature considering a change in the law to allow an out-of-state acquisition. Tr. 1616 [Gough].

100. Was it probable that the Pennsylvania law prohibiting out-of-state mergers would have barred any out-of-state commercial bank from purchasing Western?

RESPONSE: It is unclear whether such a merger could take place under existing Pennsylvania law. However, once the institution was placed in an FDIC receivership, there is no evidence that the FDIC could not sell the assets and liabilities to any institution, regardless of location. See Tr. 1592 [Gough]. Moreover, even if state law would have barred an out-of-state commercial bank acquisition, it is unknown whether the Pennsylvania legislature would have considered a change in the law to allow an out-of-state acquisition in the event no other resolution alternatives existed, although there existed precedent for such legislative change. Tr. 1614-15, 1638-39 [Gough]. The state banking authority, Mr. McEnteer, advised the FDIC that he had no interest in changing state law to allow out-of-state acquisitions, as long as he had an in-state bid. Tr. 1615 [Gough]. As indicated, because the FDIC received an in-state bid, "[w]e never got to the other scenarios of the other alternatives," such as pursuing out-of-state bidders or the Pennsylvania legislature considering a change in the law to allow an out-of-state acquisition. Tr. 1616 [Gough].

XVI. Dollar

101. Did or would the FDIC reject Dollar's bid as not viable?

RESPONSE: No. Mr. Gough's reference to the Dollar bid being rejected meant that they were just focusing on the PSFS bid as the superior bid at that point in time. Tr. 1674-75 [Gough]. In the absence of the PSFS bid, they were not foreclosed from dealing with Dollar. Tr. 1645 [Gough]. The ratings on the FDIC's prospective bidders' list indicate that Dollar was rated comparable or higher than certain areas as compared with PSFS. PX 649; Tr. 1656-57 [Gough]. .

Additionally, Dollar's bid was subject to further negotiation. Tr. 259 [Brumbaugh]. Dollar was open to the possibility of an open-bank merger, DX 3149 at 2; Tr. 2700 [Hamm], although its revised bid proposed a closed-bank acquisition. See DX 436; Tr. 2701-02 [Hamm]. Further, Dollar's revised bid, which included some contingency payment provisions like PSFS's bid, was exactly the way the FDIC wanted to structure bids because it believed interest rates would decline. Tr. 2702-03 [Hamm]. The FDIC was not opposed to contingency payments, and it would have simply evaluated Dollar's bid in terms of its overall and immediate impact upon the insurance fund. Nothing suggests that, with subsequent negotiations, a viable alternative would have been pursued with Dollar absent the PSFS merger. Tr. 2704-05 [Hamm]. Lastly, Mr. Fritts would not have been involved in determining whether the FDIC had a viable bid or not, Tr. 1617-18 [Gough].

102. Was Dollar too small to merge with Western?

RESPONSE: No. The FDIC would not have solicited a bid from Dollar if it didn't regard a Dollar bid as potentially viable. Following Dollar's initial bid on March 26, 1982, the FDIC's request that Dollar improve its bid to lighten the initial burden on the deposit insurance fund, further suggests that the FDIC did not foreclose Dollar as a potential acquirer because of its size. Tr. 2698-99 [Hamm]. Mr. Gough's deposition testimony about Dollar being too small to acquire Western was merely his interpretation of what Don Pfeiffer was saying in his memo. Tr. 1683-84 [Gough]. Mr. Gough disagreed in principle that Dollar was not big enough to acquire Western;, he was aware of several other instances where smaller banks took over bigger ones. Tr. 1620 [Gough]. With regard to his deposition testimony about the possibility of Western's problems overwhelming a smaller bank like Dollar, Mr. Gough clarified at his deposition that a smaller thrift like Dollar might not be overwhelmed so much as it might take a great deal more assistance than PSFS would require. Tr. 1676-77 [Gough]].

103. Was Dollar's bid too expensive?

RESPONSE: The answer to this is unknown, as the FDIC never had the opportunity to negotiate further with Dollar, given the receipt of a better offer from PSFS. If the PSFS bid had not been accepted, the FDIC's alternative would have been to go to Dollar to see if it could negotiate an acceptable deal. Tr. 2696-97 [Hamm]; Tr. 1665-66 [Gough]. Neither party advanced any evidence of the actual cost of the second bid from Dollar, though Dollar estimated the present value cost of its first proposal at $358 million, PX 661, well within the FDIC's parameters. Indeed, Dollar's second proposed bid, revised pursuant to FDIC request, was restructured to reduce the immediate burden upon the deposit insurance fund. Tr. 2698-99 [Hamm]; Tr. 2702 [Hamm]; DX 3023 [Hamm report] at 180-81l; PX 662.

The contingency payment provisions in Dollar's revised bid, similar to PSFS's, were structured the way the FDIC preferred, and were not deal busters. Tr. 2702-03 [Hamm]. Nothing suggests that Dollar's bid, with subsequent negotiations, would not have been made a viable alternative. Tr. 2704-05 [Hamm]. Dr. Brumbaugh's opinion that Dollar revised bid would have cost more than the cost of liquidation is untenable. Tr. 108 [Brumbaugh]. Dr. Brumbaugh is unaware of any present value estimate of Dollar's revised bid for Western, and made no attempt to ascertain the present value estimate of Dollar's revised bid or of the assistance Dollar requested. Tr. 248-49 [Brumbaugh].

104. Are Dime and Wilmington comparable to Meritor? By what standard?

RESPONSE: No, these were fundamentally different institutions: Unlike Meritor, Wilmington had no goodwill on its balance sheet, Tr. 1041, and Dime had relatively little goodwill. Tr. 1042, 1063-64,1274 [Finnerty]. As Dr. Hamm explained, they were not comparable in terms of six criterion commonly used by economists and financial analysts to determine the viability of an institution: (1) net interest spread (Meritor:1.36 percent; Dime: 2.45 percent, Wilmington: 2.65 percent); DX 3398; Tr. 2594 [Hamm]; (2) interest-earning assets to interest-bearing liabilities (Meritor: 92 percent; Wilmington: 105 percent; Dime: 97 percent) DX 3399; Tr. 2594-95 [Hamm]; (3) Fee Income (Dime nearly 25 percent better than Meritor; Wilmington more than double Meritor's); DX 3400; Tr. 2595-96 [Hamm]; (4) operating expense ratios (Meritor: 3.32 percent; Dime: 2.72 percent; Wilmington 3.58 percent) DX 3401; Tr. 2596-97 [Hamm]; (5) nonperforming assets (Meritor: 8.24 percent; Dime: 10.98 percent; Wilmington 5.73 percent) DX 3402; Tr. 2597-98 [Hamm]; (6) tangible equity to total assets (Meritor: .48 percent; Dime: 2.82 percent; Wilmington 3.41 percent) DX 3403; Tr. 2598-99 [Hamm]; see also DX 3404; Tr. 2605-07 [Hamm]; Tr. 2608 [Hamm]; Tr. 3522-26 [Hamm].

Dr. Epstein looked at net interest, spread; yield; and the ratio of interest income to interest expense, the "central measures of any deposit-accepting financial institution." Tr. 1720:11-18 [Epstein]. Dime and Wilmington's net interest margin was significantly better than Meritor's from 1986-91. Tr. 1721–22 [Epstein]; DX 3026 at 6. Dime and Wilmington's net interest spread were "more than three times the spread of Meritor." Tr. 1723–24,1727-28 [Epstein]; DX 3026 at 6.

Dr. Finnerty's analysis uses an inadequate sample size. DX 3396; Tr. 2588-89 [Hamm]; see also Tr. 1048 [Finnerty].Tr. 1049 [Finnerty]. Tr. (L) 5666 [Brumbaugh]. Tr. (L) 5667 [Brumbaugh]; Tr. 2591-93 [Hamm]; Tr. 1234-35 [Finnerty]. See Atlantic Richfield Co. v. Farm Credit Bank of Wichita, 226 F.3d 1138 (10th Cir. 2000); cf. Ventura v. Titan Sports, Inc., 65 F.3d 725 (8th Cir. 1995).

XVII. Other alternatives

105. Of what significance is Admission #6: without merger the FDIC would have liquidated Western?

RESPONSE: No, or very little, significance. Dr. Brumbaugh relies upon a Government admission from 1996, that in the absence of a merger "in or about the Spring of 1982," that the FDIC "would have terminated Western's deposit insurance and that the State of Pennsylvania would have appointed a receiver. . . ." Tr. 104-05 [Brumbaugh]. This pre-fact discovery admission obviously could have been phrased more accurately – for example, by noting that terminating deposit insurance can take years, Tr. (L) 5988 [Zamorski], that actions of the state regulator could not be predicted, Tr. 1615-16 [Gough], and that the regulatory options considered then were unknown. Regardless, it does not support plaintiffs' case. This admission indicates that, had a merger partner not been found by June 21, 1982, almost three months after the Western merger, that some other action would ensue. Plaintiffs have not produced any contemporaneous evidence to support this liquidation theory.

Additionally, the Secretary of Banking would have to make the decision to close the bank. The state regulator usually has to close a bank when the bank is insolvent. Tr. 1657 [Gough]. Here the FDIC represented in April 1982 that Western was not yet insolvent on a book basis. DX 386 at 5-6. Moreover, the Secretary of Banking had indicated in February 1982 that he wanted Western to remain independent. PX 643 at 2-4; PX 644; PX 648.

106. Of what significance is the government's finding, under the Bank Merger Act, that absent the merger Western's failure was imminent?

RESPONSE: The use of this boilerplate language has little significance. At the time of the merger, the Bank Merger Act applied, which required the FDIC to get the opinion of certain sister agencies as to the anti-competitive effects of the merger. The responses were required within 30 days. In a semi-emergency situation, the other agencies had to respond in 10 days, but in an emergency situation, the FDIC could act immediately because they had less than 10 days to carry out the transaction. Tr. 1626-27 [Gough]. Here, the "emergency" was because they had an agreement in place with PSFS, and needed to accomplish it quickly. Mr. Gough was assigned to deal with Western Savings in late 1981. Western was in financial distress at the time, but on a list that the FDIC maintained from most distressed to least distressed mutual savings banks, Western was in the top 20, but not near the top of the list. Tr. 1568-69 [Gough]. Moreover, as we noted in Def. Response No. 105, there was no evidence that the Secretary of Banking would have been willing to close Western in the absence of a merger, and as Western was still solvent on a book basis, there was still time to find a merger partner. See PX 643 at 3-4; PX 644; PX 648.

107. Was direct open bank assistance to Western a viable alternative? Had the FDIC determined against direct assistance to Western?

RESPONSE: In 1981, FDIC personnel had recommended against providing long-term support for Western. However, by 1982, the FDIC faced a potential $100 billion in mutual savings bank insolvencies, with only $11 billion in its insurance fund. Tr. (L) 1526 [Isaac]. The goal of the FDIC was "to deal with these institutions, if we had to, at a much later date, when interest rates were much lower and these assets had come up in value." Tr. (L) 1534-35 [Isaac]. "So what we needed to do was to get through this period, and eventually rates would come down and a lot of these institutions would get a lot stronger." Tr. (L) 1522-23 [Isaac]. Rather than resolving Western immediately through liquidation, it would have been in the FDIC's interest to prop Western up in some manner at least temporarily, because the FDIC believe interest rates would decline and the value of assets automatically would rise. Tr. (L) 1535 [Isaac]. Indeed, the FDIC acknowledged that direct assistance for Western would have been less costly liquidation, and actually somewhat less than the cost of the PSFS/FDIC transaction. Tr. 2716-17 [Hamm]. However, as Mr. Gough testified "[w]e never got to the other scenarios of the other alternatives," one of which could have been propping up Western until a merger could have been arranged. See Tr. 1616 [Gough]. See also Def. Response Nos. 105, 106.

108. Was Meritor the lowest cost possible resolution for the FDIC? What was the next lowest cost?

RESPONSE: Meritor was the lowest cost possible merger for the FDIC, barring widening the bidding pool, with an estimated present value cost of assistance of $294 million. DX 515. The cost of temporarily propping up Western until interest rates dropped is unknown. The next lowest cost, again assuming no change in the bidding pool, would have been an alternative merger with Dollar, which would need to be negotiated. Tr. 2696-97 [Hamm]. Dollar estimated the present value cost of its first bid at $358 million, and submitted a second bid restructured to reduce the immediate burden upon the deposit insurance fund. Tr. 2698-99 [Hamm]; Tr. 2702 [Hamm]; DX 3023 [Hamm report] at 180-181; PX 662. A proposed acquisition by Dollar very likely would have been less costly than liquidation. Tr. 2696-97 [Hamm]. Another round of bidding could have yielded an acceptable resolution less costly than liquidation. Tr. 2013 [Thakor]. Another feasible alternative to liquidation was splitting Western into three parts for merger or sale, PX 634; Tr. 1669 [Gough], or seeking an interstate merger. See DX 3000; Def. Response Nos. 98, 99, 101, 103, and 107.

109. What would have been the cost of liquidating Western?

RESPONSE: The answer is unknown, as the technique and timing of such a hypothetical liquidation is unknown. Alternative sales of all or part of Western would likely be similar in cost to the PSFS merger. Girard Bank had expressed considerable interest in acquiring Western, even on an unassisted basis, prior to PSFS making an offer, and other commercial banks had also indicated interest in acquiring Western, Tr. 1579, 1617-18, 1637-38, 1659 [Gough]; PX 633, PX 637. However, the record indicates that FDIC personnel mistakenly informed a Western director and Girard's Chairman that no FDIC assistance was likely for a merger of Western with a commercial bank. Tr. 1644-45 [Gough]; PX 636. Moreover, merging Western in three separate transactions was considered feasible, albeit not preferred. Tr. 1669 [Gough]; PX 634 at 2-3. As to a straightforward liquidation of Western's assets and liabilities, there is no evidence as to how such a liquidation of a mutual savings bank, which the FDIC has not done since 1938, Tr. 2695-96 [Hamm]; Tr. 225 [Brumbaugh], would have been conducted or how quickly assets might have been sold, given the FDIC's expectation that interest rates would fall, raising the value of the assets. See Def. Response Nos. 97, 107; Tr. 2721-22 [Hamm]; see Tr. 2678-79 [Hamm]. Other alternatives more likely than liquidation, such as propping up Western temporarily or a merger with Dollar, were never negotiated. See Def. Response Nos. 101-103. The estimated liquidation cost of $696 million is unreliable. See Def. Response No. 97; Tr. 2721-22 [Hamm].

110. What were the government's investment earnings on any money saved as a result of the merger?

RESPONSE: The Bank Insurance Fund is funded with member assessments. If any money had been "saved" due to the Western merger with PSFS, then assessments on BIF-insured institutions would have been reduced in the same amount. See DX 515. Thus, any investment earnings would largely be upon the portfolios of those various institutions. Tr. 2736 [Hamm]; see Def. Response Nos. 92-93, 96.

Moreover, the underlying basis for Dr. Finnerty's calculation for Government's alleged investment earnings is fundamentally flawed. Dr. Finnerty inappropriately combines an ex ante estimate of cost savings with an ex post estimate, an apples-to-oranges comparison, that results in double counting. Tr. 2729-31 [Hamm]. Dr. Finnerty also overstates the alleged benefits conferred upon the Government by 60 percent because the 60 percent that he treats as an initial benefit to the Government is actually an initial benefit to the insured depositories, because they got larger rebates than they otherwise would have received. Tr. 2742 [Hamm]. Sixty percent of the cost of resolving a failed bank was charged against a rebate pool for premium-paying institutions, consequently the PSFS/Western merger was charged to that rebate pool. Tr. 2739-41 [Hamm].. The other 40 percent of alleged saved liquidation costs also would not qualify as a benefit conferred upon the Government as that 40 percent would have come out of the pockets of insured depositories. Tr. 2742-43 [Hamm].

111. Are the government's investment earnings the same thing as prejudgment interest?

RESPONSE: Yes. The claimed earnings of the FDIC upon the amounts "saved" due to the merger is the same as a claim for interest on those "saved" amounts. As the Supreme Court has noted:

> The force of the no-interest rule cannot be avoided simply by devising a new name . . . : "[T]he character or nature of 'interest' cannot be changed by calling it . . . any other term, because it is still interest and the no-interest rule applies to it."

Library of Congress v. Shaw, 478 U.S. 310, 321 (1986) (quoting United States v. Mescalero Apache Tribe, 207 Ct. Cl. 369, 389, 518 F.2d 1309, 1322 (1975)). Similar claims in the Winstar arena have been rejected on the same basis. E.g., California Fed. Bank, FSB v. United States, 43 Fed. Cl. 445, 455 (1999) (rejecting the plaintiff's "benefits conferred" restitution argument which sought to recover "investment income" the Government purportedly earned on the funds the FDIC retained as a consequence of CalFed's avoidance of liquidation costs), aff'd in part, vacated in part, 245 F.3d 1342 (Fed. Cir. 2001), cert. denied, 534 U.S. 1113 (2002); Citizens, 52 Fed. Cl. at 566 & n.8 ("because restitution for 'benefits conferred' is inappropriate[,]. . . so too is interest earned on such alleged benefits."); Suess, 52 Fed. Cl. at 229 n.8 ("Although not addressed squarely in the Federal Circuit's opinion, the Court of Federal Claims had disallowed the portion of Glendale's restitution claim which was based on the earnings generated from the FSLIC funds saved by avoiding liquidation . . . "); Statesman Savings Holding Corp., et al. v. United States, No. 90-773C, June 4, 1998, Transcript at 3372. The investment earnings that Dr. Finnerty adds to the estimated liquidation cost is the economic equivalent of time value of money, and is indistinguishable from prejudgment interest. Tr. 2731-32 [Hamm].

112. If Meritor received benefits under the merger assistance agreement, should their value be offset against any restitution award?

RESPONSE: Yes. As the this Court has held: "[r]estitution is permitted as an alternative remedy for breach of contract in an effort to restore the innocent party to its pre-contract status quo, and not to prevent the unjust enrichment of the breaching party." Acme Process Equipment Co. v. United States, 171 Ct. Cl. 324, 359, 347 F.2d 509, 530 (1965) (emphasis added), rev'd on other grounds, 385 U.S. 138 (1966). Moreover, restitution "typically requires unwinding the entire transaction." First Nationwide Bank v. United States, 51 Fed. Cl. 762, 765 (2002); appeal docketed, No. 03-5128 (Fed. Cir. July 14, 2003). In other words, the Court must be able to "'unscramble the egg' and return the parties to the position they would have been in absent the contract." LaSalle Talman Bank, F.S.B. v. United States, 45 Fed. Cl. 64, 77 (1999), aff'd in relevant part, rev'd on other grounds, 317 F.3d 1363 (Fed. Cir. 2003). Restitution "fits best when the breaching party wholly fails to perform and when the injured party has paid up front for that non-performance." First Nationwide, 51 Fed. Cl. at 765 (emphasis added); see also RESTATEMENT OF CONTRACTS (SECOND) § 373 (1981); RESTATEMENT OF CONTRACTS (SECOND) § 384, cmt. a (1981).

There is no doubt Meritor received cognizable benefits under the merger assistance agreement equal to or exceeding its "costs" from the merger, and notwithstanding its seizure in 1992. See Tr. (L) 109-10, 233-34 [Nocella]; Tr. (L) 303-04 [Cooke]; DX 502 at 2; DX 3001 ("arrangement is, in my judgment, good for PSFS" [Cooke]); DX 63 at 6 (CSL017 1249); Tr. 2664, 2734-35 [Hamm]. Accordingly, any restitution award must be reduced to account for these benefits. Any award to a plaintiff "must be reduced by the value of any benefits that it received

from the defendant under the contract, so that only the actual, or net, loss is compensated" to restore the plaintiff to its status quo ante. Landmark Land Co., Inc. v. United States, 256 F.3d 1365, 1373 (Fed. Cir. 2001); see also Hansen Bancorp, Inc. v. United States, 53 Fed. Cl. 92, 107 (2002) (citing, e.g., RESTATEMENT OF CONTRACTS (SECOND) § 384 cmt. a)), appeal pending, No. 03-5029 (Fed. Cir.).

113. What are the appropriate components of a restitution award?

RESPONSE: A proper restitutionary award for breach of contract places the non-breaching party in the status quo ante; it does not seek to make the breaching party disgorge any supposed benefits received as a result of the contract. See Def. Response 112; Acme Process Equipment Co. v. United States, 171 Ct. Cl. 324, 359, 347 F.2d 509, 530 (1965) (emphasis added), rev'd on other grounds, 385 U.S. 138 (1966). See also First Nationwide Bank v. United States, 51 Fed. Cl. 762, 765 (2002); LaSalle Talman Bank, F.S.B. v. United States, 45 Fed. Cl. 64, 77 (1999), aff'd in relevant part, rev'd on other grounds, 317 F.3d 1363 (Fed. Cir. 2003); RESTATEMENT OF CONTRACTS (SECOND) § 373 (1981); RESTATEMENT OF CONTRACTS (SECOND) § 384, cmt. a (1981).

Here, there are no recoverable components for an award of restitution. There is no evidence that Meritor has any restitution interest. Tr. 2676-77 [Hamm]; DX 3322. Dr. Finnerty's claim of a $3 billion restitution interest is baseless for several reasons. One, Dr. Finnerty did not measure the economic impact of the contract on Meritor and, thus, he cannot advise the Court how much money is needed to restore Meritor to its no-contract position. Two, Dr. Finnerty's contention that Meritor, with only $389 million of book net worth and somewhere between negative $1.1 billion and negative $2.2 billion of economic net worth, was able to confer $3 billion worth of benefits upon the Government, is simply unfounded and implausible. Three, the basis for Dr. Finnerty's opinion is an apples-to-oranges comparison as a matter of economics, and, thus, completely unreliable. Four, Dr. Finnerty overestimates the benefits conferred by Meritor. Five, any benefit conferred went to the banking system. Lastly, Dr. Finnerty ignores offsetting benefits. Tr. 2676-77, 2682, 2736, 2744 [Hamm].

XIX. Experts

114. Does Mr. Brummett's analysis reflect a standard method of evaluating the net financial contributions (or costs) of a branch (or branch network) that is commonly relied upon by bankers and bank analysts?

RESPONSE: No. Plaintiffs promulgate the myth that Mr. Brummett's model is a simple branch profitability study. Attempting to unravel Western's and Meritor's assimilated and commingled operations over a 10 year period is significantly more complicated, however. In fact, it is impossible without resorting to preposterous assumptions. See Def. Response Nos. 67-68, 70, 116-17; Pl. Response Nos. 38, 62.

"All a branch profitability study is[,] is an allocation of income, expense, asset and [liabilities] of an institution using some sort of methodology to assign them to specific branches. . . ." Tr. 2151-53 [Hargett]. Although they can be a useful internal tool, "you [have] to be careful about how you use them because, depending upon what your objective is, you can get . . . a wrong answer." Id.

Mr. Brummett has attempted the impossible – carving out a separate, stand-alone Western in a fictitious and implausible manner that ignores Meritor's real world, independent business decisions. Using an invented intercompany receivable assures that Western is polluted by the consequences of Meritor's strategic choices. Tr. 2229-32 [Hargett] (citing DX 3515). In 1986, for example, the model implies Western purchased or originated $1.469 billion in assets, while also implying it sold $859.8 million. In the real world, however, the remaining balance of original Western assets as of January 1, 1986, was only $52.8 million. Id.

For impact of independent business decisions, see Def. Response Nos. 9, 37, 53-54, 117-18; Tr. 2788-89 [Hamm] (citing DX 3347); Tr. 2788-89 [Hamm] (citing DX 3347); Tr. 2791-93,

2799-2802, 3133-35, 3549-50 [Hamm]; Tr. 1444-45 [Thakor]; Tr. 2214-32 [Hargett] (citing DX 3493, DX 3506-15); Tr. 1651 [Gough]; Tr. 820-21; 3379-80 [Brummett].

For methodology flaws, see Def. Response Nos. 41, 49-50, 55, 57, 62-63, 65, 67, 114, 116-17; Tr. 2169-70, 2202-03, 2213-14, 2231, 2255 [Hargett] (citing DX 3491-95); Tr. 2764-66 [Hamm] (citing DX 3335); Tr. 2788-89 [Hamm] (citing DX 3347); Tr. 2789-91, 2799-2802, 2806-08 [Hamm]; Tr. 2811-12 [Hamm] (citing DX 3351); Tr. 2812-14 [Hamm] (citing DX 3357); Tr. 2816-17 [Hamm] (citing DX 3358); Tr. 2820-21 [Hamm] (citing DX 3358A); Tr. 2821-23, 2848-49, 3133-35, 3555-56 [Hamm].

115. Does Mr. Brummett's report reflect a net liabilities assumed amount, or is it actual costs paid? Stated differently, can the assumption of liabilities be treated as an expenditure of cash under the law established by the Federal Circuit?

RESPONSE: Mr. Brummett's model admittedly reflects a foreclosed reliance damage claim because it treats the assumption of excess liabilities as an actual cost. See Def. Response Nos. 58-61, 116; see also, e.g., Glendale, 239 F.3d at 1380-82; LaSalle, 317 F.3d at 1376-77; CalFed, 245 F.3d at 1350; Glendale, 54 Fed. Cl. at 13; see also Anchor, 2003 WL 22415878 at *40; Southern Nat'l Corp. v. United States, 57 Fed. Cl. 294, 299 (2003); Fifth Third Bank of Western Ohio v. United States, 55 Fed. Cl. 223, 245-46 (2003); Suess, 52 Fed. Cl. at 231 n.11.

Mr. Brummett claims Meritor assumed Western's excess liabilities, which was the equivalent of a $796 million cash expenditure in 1982 because the liabilities used to fund the acquired assets were supposedly paid over time. Tr. 613-14, 616-17 [Brummett]. Mr. Brummett agreed that treating the assumed $796 million of excess liabilities as the equivalent of a cash payment is the underlying assumption which allows him to show a negative "cash flow" or "cash loss" of $386.7 million on Ex. A.1. Tr. 616-17 [Brummett]. See also Tr. 522, 3354-55, 3357-58 [Brummett]. Apart from transaction costs, however, Meritor paid no cash for Western. Tr. 615 [Brummett].

Plaintiffs' argument also is a red herring. Tr. 634 [Brummett] (unable to show Meritor fully paid Western's deposits); Tr. 448, 456 [Brummett] (Meritor did not "pay off" Western deposits sold to Mellon at a premium). Saying a bank assumed "net liabilities" on a mark-to-market basis is different than saying it paid deposit liabilities over time, which is an everyday function occurring whenever deposits mature or withdraw. Tr. 636-37 [Brummett]. Plaintiffs' argument fails to consider: (1) many Western depositors rolled their maturing deposits into new

ones; and (2) Western's pre-existing branches generated new deposits. Tr. 637-38, 639-41 [Brummett]; PX 48 at 1; DX 1062 at 0044 (same deposit base level in 1990 as 1982).

116. Does Mr. Brummett's cash flow analysis prove that his estimate of cost of performance reflects the payment, rather than the assumption, of liabilities?

RESPONSE: No. The only cash flow statement in evidence for substantive purposes is PX 854, Ex. A.1. Exhibit A.1 shows a total cash outflow or an actual cash loss of negative $385.2 million for 1982. Tr. 561, 605, 3354 [Brummett]. This alleged $385 million total cash outflow for 1982 includes a cash loss related to the sale of the Western assets equal to $357.3 million. Tr. 3355 [Brummett]. Mr. Brummett testified that the $357.3 million figure is the cash loss resulting from the sale of the Western assets in 1982 because Meritor's economic basis exceeded the cash receipt by $357 million – i.e., the amount owed by its borrowers exceeded the proceeds by $357 million. Tr. 3354-55 [Brummett]. This argument is baseless primarily because Meritor received a cash inflow and recognized a cash gain when it sold Western's assets, not vice-versa. See Def. Response Nos. 58-61, 115.

There is only a $7.3 million difference between Mr. Brummett's GAAP income and cash costs because, in creating his cash flow statement, Exhibit A.1, Mr. Brummett reversed out of "accounting" the original $822 million discount and the $796 million value ascribed to acquired deposits and FDIC assistance. Tr. 602-04 [Brummett]. Because Exhibit A.1 clearly exposes Mr. Brummett's canard, plaintiffs attempt to obfuscate it by relying exclusively upon demonstratives not in evidence for substantive purposes. See Pl. Response Nos. 58-61, 115.

117. Is categorization of assets post-merger too artificial to be reliable?

RESPONSE: Yes. Setting aside the fact that Mr. Brummett's model is contaminated and corrupted by Meritor's independent business decisions (see Def. Response Nos. 37, 54, 114, 118), his methodology is speculative and fundamentally inconsistent, and his categorization of irreversibly commingled assets and liabilities is overly simplistic, arbitrary, artificial, and/or implausible. Tr. 2228, 2231-54 [Hargett] (citing DX 3491, DX 3515, DX 3517-26); Tr. 2395 [Hargett]; id. (Court stating "any real categorization of Western assets after . . . the merger is artificial. . . "); Tr. 2788-89 [Hamm] (citing DX 3347); Tr. 2799-2802 [Hamm]; Tr. 2802, 2808, 2811-12, 2816, 2821-22 [Hamm] (citing DX 3351); Tr. 3555-56 [Hamm].

Mr. Brummett admits there are no separate financial statements or records for Western post-merger; Meritor did not maintain separate financial reporting for Western after the merger; and the regulators made clear shortly after the merger that it would be impossible to track the deposit liabilities because they were immediately absorbed into Meritor. Tr. 595-96 [Brummett] (citing DX 3146 at ESL005 0230). See also Tr. 437, 537 [Brummett]; Tr. (L) 3029-31 [Fritts] (citing DX 510 at CSL010 0506) ("[M]anagement is trying to ascertain what PSFS's financial condition would have been without the merger. This has been difficult for them to do since the liabilities of Western were immediately absorbed into PSFS and they were not able to track them."); Pl. Response No. 62 ("Without separate records, it is not possible to trace Western funds."); Pl. Response No. 38 ("we cannot trace the proceeds of the asset sales"); Tr. 2874, 2990 [Hamm]; Tr. 2395 [Hargett].

Thus, it is impossible to accurately complete the first step in Mr. Brummett's model – i.e., determining the activity in the assets, liabilities, and equity from April 1982 to December 1992. See PX 951; Pl. Response No. 117, ¶¶ 2-3 (conceding artificiality).

118. Is Mr. Brummett's categorization of assets post-merger conservative?

RESPONSE: No. Due to a lack of information (see Def. Response No. 117), Mr. Brummett's model is admittedly polluted with several layers of aggressive assumptions regarding reinvestment rates, allocation of gains/losses on second generation Western assets, and credit losses for non-Western assets arising from Meritor's disastrous growth and diversification strategy – all used to allocate income and expenses to Western over a 10-year period through a fictitious intercompany receivable. Id.; see also Tr. 2228, 2231-54 [Hargett] (citing DX 3491, DX 3515, DX 3517-26); Tr. 2788-89 [Hamm] (citing DX 3347); Tr. 2799-2802 [Hamm]; Tr. 2802, 2808, 2811-12, 2816, 2821-22 [Hamm] (citing DX 3351); Tr. 3555-56 [Hamm].

Among other things, Mr. Brummett's arbitrary and speculative assumptions include Western's G&A expense ratio (Tr. 455, 512, 545-46 [Brummett]); the basis for allocating IPO proceeds (Tr. 450, 496-97 [Brummett]); Western's deposit growth rates (Tr. 488 [Brummett]); the maturity rates of Western's CDs (Tr. 490 [Brummett]); the interest rate on Western's CDs (Tr. 492-93 [Brummett]); the ratio of Western's CDs to savings deposits (Tr. 491-92 [Brummett]); the rates of return for proceeds from the Western's asset sales (Tr. 475-78 [Brummett]); and the allocation of credit losses. Tr. 510 [Brummett]. See, e.g., Def. Response Nos. 38, 57, 62-68, 117.

Mr. Brummett acknowledged the sensitivity of each of these overly optimistic assumptions, and the profound ripple effect his allocations have on the total "cost" derived in his model. Tr. 502-03 [Brummett] (explaining impact of arbitrary IPO allocation); Tr. 2256-59 [Hargett] (demonstrating sensitivity of Mr. Brummett's overly-generous assumptions). Changing any of these assumptions has a compounding effect. Tr. 503 [Brummett]. These allocations also

are admittedly tainted by hindsight, including those reached through numerous conversations with Michael High, a highly-biased witness. Tr. 598-99 [Brummett]; Tr. (L) 1146-47 [High], Tr. 675, 774-77 [High].

119. Does Mr. Nocella's testimony/opinion undercut Mr. Brummett's model?

RESPONSE: Yes, on several points. Mr. Nocella testified that the approximately $800 million in goodwill reflected $800 million in value received by Meritor. Tr. (L) 234 [Nocella]; Tr. 811-13 [Brummett]. Meritor deliberately called the assistance and franchise value "value ascribed to acquired intangibles" or "acquired deposits and FDIC assistance" to reflect the "very real values" received from the IMA, the credit guarantees and the franchise value of Western. Tr. (L) 109-110 [Nocella]; Tr. 814 [Brummett]; DX 502 at CSL012 1460; PX 60 at 2. Plaintiffs' attempt at discounting Mr. Nocella's contemporaneous letter is both unavailing and absurd. See Pl. Response No. 119 (arguing that management was "distressed" and the letter was written in a "harrowing context").

Mr. Nocella also explained that, whether the FDIC assistance counted as an asset for regulatory capital purposes was not the real issue for them – the "hotly contested" question was the **amount** that would be recorded to ensure, on a net value basis and from a cash flow perspective, that the transaction would be a "good deal" for Meritor. Tr. (L) at 96-97 [Nocella].

Mr. Nocella also contradicted Mr. Brummett's opinion regarding the allocation of the IPO proceeds. According to Mr. Nocella, Meritor's management believed that the sale of Western's assets improved Meritor's ability to issue stock and, without the conversion to stock, Meritor would have been locked into a series of $40 - $60 million annual operating losses. DX 94 at 0056; Tr. (L) 135 [Nocella]; see also Tr. (L) 311-12 [Cooke]; Tr. (L) 4580-81, 4684 [Hammer].

120. Does Dr. Finnerty's testimony under oath at his deposition regarding the actions that the no-breach Meritor would have taken to achieve compliance with the standard capital requirements render the plaintiffs' wounded bank damage estimate unreliable?

RESPONSE: While Dr. Finnerty's deposition testimony that he believed the Meritor Credit Corporation and Student Loan Portfolio would have been sold in the but-for world is cited in Dr. Hamm's report, DX 3023 at 200-01, the Court excluded testimony by Dr. Finnerty on this subject. See offer of proof at Tr. 1269-70 [Finnerty].

What renders the wounded bank damage claim unreliable is that it is largely contradicted by other record evidence. E.g., Tr. 1312 [Hillas]; Tr. (L) 2475-76; 2655 [Finnerty]; Tr. 1355-56 [Hillas]; Tr. 2635 [Hamm]; DX 3407A. Even in a no-breach scenario, Meritor had to downsize massively by 1990 to match its available capital. PX 541A at 5, 7; Tr. (L) 680-81, 720 [Hillas]; Tr. 1071-72 [Finnerty]. Indeed, Dr. Goldstein projected no-breach Meritor shrinking by $10 billion from 1987 to 1990, with a regulatory capital ratio of 6.03 percent for $11.4 billion of assets at the end of 1989. PX 541A at Ex. 1, p. 1 & 3. The actual Meritor had $12.6 billion in assets then, and was out of capital compliance. Tr. (L) 708 [Hillas]; DX 241 at 6. DX 70 at 1. The wounded bank claim posits that Meritor would have retained Meritor Credit Corporation's $1.4 billion in assets and $350 million in student loans, which implies a $14.4 billion no-breach institution. PX 855 at 25; DX 70 at CSL006 2017; DX 69 at 2. Clearly, either those assets would have had to be sold anyway, or a number of branches instead.

121. Was Dr. Thakor's expert opinion reliable and why?

RESPONSE: Dr. Thakor is one of the most respected financial economists in the world, and his specific area of expertise, for which he has been internationally recognized, is in the area of banking and financial intermediation. Tr. 1398-1411 [Thakor]. He served as head of the finance department at the University of Michigan, ranked fourth worldwide for research. Tr. 1405 [Thakor]. He is the founder and editor of the Journal of Financial Intermediation, the leading academic publication for financial economics in banking. Tr. 1401-02 [Thakor]. He was ranked second in the world for the number of learned articles in financial economics between 1990 and 1999. Tr. 1405 [Thakor]. He serves on the Nobel Prize Nominating Committee for Economics. Tr. 1406-07 [Thakor]. In short, Dr. Thakor's qualifications and integrity are beyond reproach.

Dr. Thakor's analysis is also reliable because his opinions are based upon well-accepted corporate finance principles, and decades of empirical study in finance. E.g., Tr. 1456-61, 1470-78, 1480-81 [Thakor]; DX 3304A. Moreover, his opinions are grounded upon objective economic criteria – namely Meritor's observable market values and Meritor's reported financial ratios. E.g., Tr. 1436-55 [Thakor]; DX 3302; DX 3306; DX 3307. Finally, Dr. Thakor's opinions rely upon contemporaneous documentation. E.g., DX 3305.

Plaintiffs attacks upon his credibility are groundless, and do not bear scrutiny. E.g., Tr. 3517-19 [Thakor] (explaining that one would need to know more about the potential acquiror in counsel's hypothetical, not just the target, to determine realizable synergies).

122. Was Dr. Epstein's expert opinion reliable and why?

RESPONSE: Yes. Based upon his impeccable credentials (Tr. (L) 4079-88; Tr. 1685-89 [Epstein]; DX 1699A at Appendix II & III; DX 3026 at Appendix II), Dr. Epstein was admitted in both phases as an expert in accounting, auditing, financial and statistical analysis and financial reporting. Tr. 1695, 1711 [Epstein]; Tr. (L) 4116-17 [Epstein]. See also Tr. 4112 (L), 4116 (L) [Epstein] (plaintiffs acknowledging that Dr. Epstein is a "world-class" and "first-class accountant" with abundant accounting and financial reporting expertise). Dr. Epstein has authored several accounting books, including a voluminous handbook containing over two hundred detailed pages on accounting principles as applied in the banking and thrift industries. Tr. (L) 4081-82, 4104-05, 4106 [Epstein].

In the damages phase, Dr. Epstein fully rebutted Dr. Finnerty's superficial analysis of a flawed control premium. E.g., Tr. 1737-39, 1741-42, 1802-03, 2101-02, 2111, 2114 [Epstein]; DX 3026 at 13-14. Dr. Epstein also explained why Dr. Finnerty's use of a general market index is inappropriate (e.g., Tr. 1751, 1753, 1756, 1759-60 [Epstein]; Tr. (L) 4456 [Epstein]), and why his reliance upon Dime and Wilmington as comparables to support his 1988 valuation claim is unavailing. E.g., Tr. 1720-24, 1727-35, 1751, 1775, 1781, 1792-93, 1795-97, 2100-02, 2106-07 [Epstein]; DX 3026 at 6-7. See also Def. Response Nos. 7, 21, 22, 30, 104, 131.

In the liability phase, Dr. Epstein statistically demonstrated that Meritor's financial performance was abysmal from 1979-92. Meritor never had positive core earnings from 1982-89; its losses were staggering in the latter years, its operating expenses (even excluding goodwill amortization) repeatedly exceeded net interest income plus fees; and it was on a clear downward death spiral with little prospect of recovery. Tr. (L) 4123-24, 4135, 4147, 4163-64, 4169-70,

4172-73, 4182-83, 4203-04, 4393, 4506 6018-20 [Epstein]; DX 1699A at 4-43; DX 1959A-O. See also Tr. 1739-40 [Epstein] (citing DX 3026 at 13).

Dr. Epstein also discredited Dr. Goldstein's flawed "but for" model (Tr. (L) 4402-03, 4408-16, 4426-44, 4819 [Epstein]; DX 1959P - DX 1959Y; DX 2015; see also Def. Response Nos. 128, 130) and Dr. Finnerty's ever-changing equity valuations. Tr. (L) 4446-53, 4456, 4459-60, 4475-82, 4486, 4787-4504, 6008 [Epstein]; DX 1959Z - DX 1959DD; see also Def. Response Nos. 26, 28-29, 125.

123. Was Dr. Hamm's expert opinion reliable and why?

RESPONSE: Dr. Hamm's opinions were completely consistent with the principles of reliability espoused by Federal Rule of Evidence 702. Dr. Hamm's opinions were drawn from his training as an economist, and from a wealth of practical experience in thrift management and thrift regulation: his five years experience as an operations officer at one of the country's largest and most successful thrifts, Tr. 2435-39 [Hamm], COO of the FHLB San Francisco, where he was responsible for "all financial and business operations of the bank," Tr. 2442 [Hamm], and where he was required to develop a comprehensive understanding of the FDIC's regulatory policies and practices, Tr. 2443 [Hamm]; as California's Legislative Analyst, where he provided legislative advice regarding the state's savings and loan and banking agencies, Tr. 2434, 2454 [Hamm], and with the Office of Management and Budget. Tr. 2432-33 [Hamm].

Dr. Hamm's opinions were drawn from his experience in economics and thrift management. Fed. R. Evid. 702, Advisory Committee Notes ¶4(1); see, e.g., Def. Response Nos. 29, 48, 82, 84, 104. Unlike plaintiffs' experts' opinions, which either completely or partially ignored contemporaneous evidence, Tr. 2659 [Hamm], Dr. Hamm's conclusions were based upon the entirety of the contemporaneous record. Fed. R. Evid. 702, Advisory Committee Notes ¶4(2) (Dec. 2000); General Elec. Co. v. Joiner, 522 U.S. 136, 146 (1997). Moreover, throughout his testimony, Dr. Hamm relied upon the principles commonly applied by economists engaged in similar analysis. Fed. R. Evid. 702, Advisory Committee Notes ¶4(4) (Dec. 2000); Kumho Tire Co. v. Carmichael, 119 S. Ct. 1167, 1176 (1999); see, e.g., Def. Response Nos. 29, 48, 64, 104. In sum, Dr. Hamm's opinion was reliable because he applied the principles of his profession to the facts and circumstances of the contemporaneous record.

124. Was [Mr.] Hargett's expert opinion reliable and why?

RESPONSE: Yes. In addition to his sterling accounting and regulatory credentials (see Tr. 2133-52 [Hargett], DX 3026 at Ex. A), Mr. Hargett, unlike the other experts in this case, personally reviewed and/or worked on five of the 11 IMAs ever used by the FDIC. Tr. 2143-44 [Hargett] (citing DX 3066 at 22). See also DX 3140 at 72-73. Thus, he is eminently qualified to offer his overall opinions, which fully refute plaintiffs' reliance damage claim. Tr. 2169-70, 2202-03, 2213-14, 2231, 2255 [Hargett] (citing DX 3491-95). See also DX 3490.

Mr. Hargett's opinion should be given considerable weight because it is consistent with the contemporaneous evidence (e.g., Def. Response Nos. 50, 58,); plaintiffs' own witnesses (see Def. Response Nos. 2, 10, 34, 37, 40, 46, 48, 51, 58, 112, 119); the Government's witnesses (see Def. Response Nos. 2, 9-14, 37-68, 70, 72, 114-18); and the law of this circuit. See Def. Response Nos. 32, 115.

125. Was Dr. Finnerty's expert opinion reliable and why?

RESPONSE: No. Dr. Finnerty's report lacked certainty as to the Dec. 11, 1992 valuation. As we showed in discussing various aspects of that valuation, Def. Response Nos. 26-29, Dr. Finnerty's various valuations as of this date changed almost continuously, and each time he corrected an error found by the Government he raised a new counter-adjustment that favored the plaintiffs.

As to his 1988 valuation, his testimony indicated no factual basis for attempting to use the valuation around May 19, 1988 to increase the stock market valuation from August 1988. Of the four articles or reports he had relied upon in setting May 19, 1988 as the first date of disclosure, plus PX 868 used at trial, not one mentioned the pending MOU, other than a report (PX 867) by Mr. Valinote which indicated that the MOU was not discussed at Meritor's annual shareholders' meeting. Tr. 1133 [Finnerty] (PX 727); Tr. 1134 [Finnerty] (PX 867, PX 868); Tr. 1136 [Finnerty] (DX 3129); Tr. 1136-38 [Finnerty] (PX 731); Tr. 1138 [Finnerty].

Dr. Finnerty testified that "never thought it made sense to rely just on one valuation technique," and yet used just one technique for his 1988 and 1992 valuations. Tr. 1226 [Finnerty] His attempted models of but-for Meritor failed and were withdrawn due to repeated serious errors. Tr. 1071-74 [Finnerty] (overstated goodwill by $266 million); Tr. 1075-77 [Finnerty] (shrank bank by $10 billion, but still failed capital requirement).

126. Was Dr. Brumbaugh's expert opinion reliable and why?

RESPONSE: No. Dr. Brumbaugh's restitution analysis concerning the alleged benefit supposedly enjoyed by the Government based upon the alleged "avoided cost of liquidation" is barred by existing precedent and fundamentally flawed. See Def. Response Nos. 4, 90, 91, 96, 97. Among other things, Dr. Brumbaugh has sketchy knowledge of and limited experience with the FDIC. Tr. (L) 5516-17, 5645-46; Tr. (L) 5645-46; see DX 72 at 25; Tr. (L) 5568-69; Tr. 398-99 [Brumbaugh] (unaware of 6.0% regulatory minimum for total capital ratio); Tr. 83-86 [Brumbaugh]. His opinion that, but for PSFS's acquisition of Western, Western would have been liquidated or disposed of in a manner even more costly than liquidation is implausible and contradicted by the record evidence. See Def. Response Nos. 99-103, 105-106, 108-109.

Dr. Brumbaugh's opinion concerning plaintiffs' cost of performance claim is speculative and uninformed. Tr. 86 [Brumbaugh] (admittedly not qualified to conduct Mr. Brummett's cost of performance model); Tr. 301 [Brumbaugh] (admittedly failing to analyze Meritor's capital levels in the absence of the breach). See Def. Response Nos. 53, 54, 55. Dr. Brumbaugh's opinion concerning alleged wounded bank damages is wholly unreliable and contradicted by the historical record. See Def. Response Nos. 73, 74, 75, 76, 80. Among other things, Dr. Brumbaugh fails to establish that these alleged costs would not have been incurred in the absence of the breach. Tr. 2613-14 [Hamm] (citing DX 3406); Tr. 2617-19 [Hamm]; Tr. 3123-25 [Hamm]; DX 3365; Tr.2620-23 [Hamm]; Tr. 2623-25 [Hamm]; Tr.2627-28 [Hamm]; Tr.2631-34 [Hamm]; Tr. 2638-39 [Hamm] (citing DX 3407A; DX 3013 at 2); Tr. 2639-40 [Hamm]; Tr. 2642-44 [Hamm]; Tr. 2646 [Hamm] (citing DX 2408); Tr. 2648-52 [Hamm]; Tr. 2657-58 [Hamm] (citing DX 1661 at CSL001 0834). See Def. Response Nos. 4, 18, 81, 82, 83, 84, 85.

127. Was Mr. Brummett's expert opinion reliable and why?

RESPONSE: No. As in CalFed, where Mr. Brummett's highly paid "fact" testimony was rejected because it was unreliable, unsupported, and hindsight-driven, see CalFed, 54 Fed. Cl. at 707, 711-13, Mr. Brummett's opinion in this case is highly unreliable and speculative, and his model was wholly undermined by the contemporaneous evidence (e.g., Def. Response Nos. 50, 58), plaintiffs' own witnesses (see Def. Response Nos. 2, 10, 34, 37, 40, 46, 48, 51, 58, 112, 119); the Government's witnesses (see Def. Response Nos. 2, 9-14, 37-68, 70, 72, 114-18); and the law of this circuit. See Def. Response Nos. 32, 115.

The fatal flaws in Mr. Brummett's model are too numerous to fully list here. Among other things, he ignores the fact that the FDIC assistance essentially guaranteed that Meritor would not incur a material loss on the acquired Western portfolio. Mr. Brummett also improperly treats the $796 million "value ascribed to acquired deposits and FDIC assistance," as the net liabilities assumed by Meritor which, in his view, was the equivalent of a cash expenditure. Mr. Brummett's attempt to quantify the separate financial results for Western also includes costs incurred by Meritor that were not and could not have been due to the breaches. Thus, his analysis is neither relevant nor meaningful to measuring Meritor's alleged expenditures. Mr. Brummett's methodology also is speculative and fundamentally inconsistent; certain of his assumptions are overly simplistic, arbitrary, and/or implausible; and his quantification is highly dependent upon these flawed assumptions. Tr. 2169-70, 2202-03, 2213-14, 2231, 2255 [Hargett] (citing DX 3491-95); Tr. 2764-66 [Hamm] (citing DX 3335); Tr. 2775-77 [Hamm]; Tr. 2783-86 [Hamm] (citing DX 3342); Tr. 2788-89 [Hamm] (citing DX 3347); Tr. 2789-91, 2799-2802, 2806-08 [Hamm]; Tr. 2811-12 [Hamm] (citing DX 3351); Tr. 2812-14 [Hamm] (citing DX

3357); Tr. 2816-17 [Hamm] (citing DX 3358); Tr. 2820-21 [Hamm] (citing DX 3358A); Tr. 2821-23, 2848-49, 3133-35, 3555-56 [Hamm].

128. Was Dr. Goldstein's expert opinion reliable and why?

RESPONSE: No. His investigation was cursory at best. See Tr. (L) 1662, 1707, 1708, 1711, 1714-15, 1725, 1742-43, 1745-47, 1748-49 [Goldstein]. His model exhibited numerous errors and overly optimistic assumptions. See Tr. (L) 1722, 1751-55, 1730-31 (unable to explain model's excess $99.9 million in goodwill in 1997), 1738-40, 5748, 5762 [Goldstein]; PX 541A at Ex. 1, p. 1, 4; Tr. (L) 4402-03, 4408-09, 4410, 4427-28, 4434, 5882 [Epstein]; Tr. (L) 3946-47, 3944-46 [Clark]; DX 2048; DX 2047; DX 1067 at 8. Dr. Epstein's sensitivity analysis showed vast changes in the results when industry data was used instead of the model's overly optimistic assumptions. DX 1959Q-1959Z. As to Dr. Goldstein's positive growth assumptions (4.23 percent annualized growth in real estate loans, 1.91 percent annualized growth rate in deposits), of the "surviving" Philadelphia area thrifts, four out of five had negative annualized loan growth rates for the period studied. Tr. (L) 6002-04 [Zamorski]; PX 587, pp. 2-3; see DX 2076A The only two of these Philadelphia "survivors" even vaguely comparable to Meritor in size were Beneficial MSB (FDIC # 15697) and Firstrust Savings Bank (FDIC # 26647). PX 587, pp. 4-5, 8-9. Beneficial had an annualized compound loan growth rate for 1990-97 of -4.66 percent while Firstrust's comparable growth rate was -1.78 percent. Id. at 2-3. As to deposits, Beneficial had an annualized compound growth rate for 1990-97 of 0.08 percent while Firstrust had an equivalent rate of 0.82 percent. Id. at pp. 6-7. All of these growth rates for larger Philadelphia-area institutions were far below those assumed by Dr. Goldstein. PX 587 at 1.

XX. Meritor's Survivability Absent the Government's Breaches

129. Which party bears the burden of showing whether Meritor would have survived absent the government's breaches, and by what standard must it be shown?

RESPONSE: It cannot be seriously contested that a plaintiffs bear the burden for proving each and every element of their expectancy damages, including the "but for" scenario. E.g., Energy Capital Corp. v. United States, 302 F.3d 1314, 1324-25 (Fed. Cir. 2002) (to recover expectancy damages, "plaintiff must establish by a preponderance of the evidence" "proximate cause," foreseeability, and reasonable certainty).

Dr. Finnerty claims that Meritor's pre-seizure value in 1992 was $112 million, to which plaintiffs are entitled. Thus, Dr. Finnerty posits, had the Government not deducted goodwill from capital in 1992, Meritor would not have been seized in the but-for world.

Dr. Finnerty made the assumption that Meritor would not have failed, and would not have been seized, absent the breach without providing any model or analysis. As set forth below, Meritor itself believed that it was not economically viable as of February 1992 standing alone, and that, in addition, it would have failed the minimum capital requirements absent the 1992 breach, thereby subjecting it to withdrawal of insurance and seizure. See Def. Response No. 133.

Moreover, even if Meritor had survived, plaintiffs have failed to prove causation with respect to their "costs of performance." See Tr. 2832-46 [Hamm]; PX 541A, Ex. 1, p.2 (showing net losses of over $250 million after 1987).

130. Does Dr. Goldstein's model show that, absent the government's breaches, Meritor would likely have survived and prospered?

RESPONSE: No. Dr. Goldstein's model's assumptions are too overly optimistic for it to demonstrate anything other than that Meritor would have lost money from 1987-97. See Def. Response No. 128. Among these defects, Dr. Goldstein's original model mistakenly overstated Meritor's cumulative net income by $240 million. Tr. (L) 1722 [Goldstein]. Also, despite the requirement to amortize off all of the 1982 Western goodwill by 1997, Dr. Goldstein's model projects that Meritor still would have $99.9 million in unamortized goodwill at the end of 1997. PX 541A at Ex. 1, p. 1. This remaining $99.9 million in goodwill is the result, in part, of Dr. Goldstein's decision to reduce the amount of goodwill that amortizes annually after 1991 in his model. Tr. (L) 1731 [Goldstein]. Yet Dr. Goldstein literally could not explain the basis for his adjustment to the amount of amortizing goodwill. Tr. (L) 1730-31 [Goldstein].

Dr. Goldstein's no-breach model shows that Meritor would suffer total losses of $650.9 million from 1988-91, and total earnings of $409.3 million from 1992-97, a net loss of $241.6 million from 1988-97. PX 541A at Ex. 1, p. 2. While the Government agrees that Meritor would have had net losses from 1988-97 in the absence of any breaches, and thus would not recover any claimed "costs of performance," no further valid conclusions can be drawn from this study. See also Tr. (L) 4402-03, 4408-16, 4426-44, 4819 [Epstein]; DX 1959P - DX 1959Y; DX 2015; Def. Response No. 128.

131. What does the performance of Dime and Wilmington tell us about Meritor's likely prospects absent the FDIC's breach in December, 1992?

RESPONSE: Nothing. As to the comparison with Dime and Wilmington, in his report, PX 853 at 21-23, and in his testimony, Tr. 1065-66 [Finnerty], Dr. Finnerty failed to assert any reasoned basis for why these were the two most comparable thrifts to Meritor, other than the fact that they suffered some similar problems in the early 1990s and survived. Neither had any significant amount of goodwill, and neither had any supervisory goodwill. Tr. 1274 [Finnerty]. In his liability report, Dr. Finnerty had hand-picked eight "comparable" institutions - WSFS was not one of those. DX 1699F at 24. Moreover, Dime was one of only two surviving large institutions out of the ten largest thrifts that Dr. Finnerty found comparable, and the other had been acquired by Dime. DX 3025 at Ex. 12; Tr. 1232-34 [Finnerty]. WSFS was second to last in size among this group. Tr. 1234 [Finnerty]. Moreover, using a sample size of two is not reliable. Tr. 1234-35 [Finnerty]; Tr. 2591-92 [Hamm]; Tr. 2498-2501 [Hamm].

Finally, in many ways, the long-term and short-term performance of these thrifts was very different from that of Meritor. Tr. 2593-2607 [Hamm]; DX 3023 at 152-59; DX 3398; DX 3399; DX 3400; DX 3401; DX 3402; DX 3403; DX 3404; DX 3405; Tr. 1720-29, 1731-35, 1781, 1795-96, 2100-04, 2106-09 [Epstein]; DX 3026. Dr. Finnerty claimed only that "it is certainly possible that Meritor's share price could have exhibited a similar sort of pattern. I can't prove that, but it's at least suggestive" Tr. 1063 [Finnerty].

132. Does the totality of the evidence establish that, absent the government's breaches, Meritor more likely than not would have survived?

RESPONSE: No. There is no question that no-breach Meritor would have had to massively downsize from 1988 onwards. PX 541A at 7, Ex. 1, p. 1; Tr. (L) 680-81 [Hillas]; see also Tr. 1118-23 [Finnerty]. Whether Meritor would have survived this is unknown. See Def. Response Nos. 130-31; PX 1118 (Dr. Finnerty's chart of the stock prices of 9 "comparable" troubled thrifts shows that all of them lost most of their stock value from 1988 to 1992, with only three recovering their 1988 value by 1995 and four never doing so); Tr. (L) 2484, 2495, 2483 [Finnerty] (Meritor's profitability concerns considerably worse than "comparables").

Dr. Finnerty agreed that it would be very difficult for a savings bank to be profitable at Meritor's 1992 net yield of 1.56 percent. Tr. (L) 2499-2500 [Finnerty]. He believed that Meritor needed to achieve a net yield of at least 2.0 percent and reduce its expense ratio to 2.0 percent to achieve profitability. Tr. (L) 2501-02 [Finnerty]. Dr. Finnerty was not aware that Mr. Fitzgerald had calculated that Meritor's net interest margin would drop to 0.97 percent of average assets if the Florida subsidiary were excluded. Tr. (L) 2502-04 [Finnerty]; DX 13 at p. 1-4. Furthermore, when Florida operations were sold in late 1992, the operating expense ratio rose to 3.0 percent. Tr. (L) 5802-03 [Epstein]. Meritor's history of losses would raise a question as to its ability to survive and to earn a profit. Tr. (L) 2473 [Finnerty]. See also DX 420 at 1; Tr. (L) 1130-31 [High]; DX 1043 at 10; Tr. (L) 1385, 1817, 1839 [Fitzgerald]; Tr. (L) 2507 [Finnerty] ("[Meritor] was not a blue chip institution."); Tr. (L) 2474-75 [Finnerty]; Tr. (L) 4123-24, 4135, 4147, 4163-64, 4169-70, 4172-73, 4182-83, 4203-04, 4393, 4506 6018-20 [Epstein]; DX 1699A

at 4-43; DX 1959A-O. See also Tr. 1739-40 [Epstein], citing DX 3026 at 13; Def. Response Nos. 6, 18-19, 130-31.

133. In a hypothetical no-breach world, would Meritor have been out of capital compliance at any time prior to December 1992?

RESPONSE: Yes. In the actual world, Meritor failed the minimum capital requirements in 1989 and the first quarter of 1990, with the goodwill counted. E.g., Def. Response No. 4. Had they not sold the assets and subsidiaries they did between 1987 and 1990 – which they now assert they would not have done – they would have failed the regulatory capital minimums by an even greater amount. Tr. 770-71 [High].

As the evidence demonstrates, failing regulatory capital minimums in 1989 and 1990 would have subjected Meritor to the potential for a number of regulatory sanctions, including the imposition of MOUs, the withdrawal of insurance, and seizure. Tr. 2015 [Thakor]; Tr. 1074 [Finnerty] (admitting management would have acted to avoid failure of minimums); Tr. 767 [High].

It is also clear, according to Meritor's own judgement, that it would have failed the minimum non-breaching capital requirements under FDICIA even absent the breach the 1992 breach. DX 420 at 11, 9 (showing risk-based under 8 percent); DX 1043 at 10 (same); Tr. (L) 1008, 1130-31, 1136-37 [High].

Contrary to plaintiffs' claims, Dr. Goldstein's hindsight-driven model is unreliable for numerous reasons, see Def. Response No. 128, 130, and, in any event, shows massive continuing losses in 1988-1992, massive shrinkage, and failure of Meritor's internal capital guidelines – absent the breach. Def. Response No. 4; PX 541A, Ex. 1, pp. 1-3.

134. In a hypothetical no-breach world, would Meritor have been at risk of closure or of FDIC insurance withdrawal at any time?

RESPONSE: Yes. As the undisputed evidence shows, Meritor would have failed the minimum non-breaching capital requirements in 1989 and 1990, even absent the breaches. E.g., Def. Response No. 4. Such capital failure would have subjected Meritor to imposition of higher capital requirements through MOUs, withdrawal of deposit insurance, and seizure. Tr. 2015 [Thakor]; Tr. 1074 [Finnerty]; Tr. 767 [High].

In addition, even absent the 1992 breach, Meritor would have failed the new capital requirements under FDICIA, subjecting it to withdrawal of insurance and seizure. DX 420 at 11, 9; DX 1043 at 10; Tr. (L) 1008, 1130-31, 1136-37 [High].

Moreover, Meritor and its regulators concluded by early 1992 that Meritor was no longer economically viable, irrespective of whether goodwill was included as part of regulatory capital under FDICIA. Tr. (L) 991-92, 1003-04 [High]; PX 455. Indeed, FDIC cited Meritor's non-viability as one reason why it determined action under section 8(a) as the necessary course of action. Tr. (L) 4868, 5067, 4931, 4931-34, 4891, [Ketcha]; JE 3 at 114; DX 547; DX 841 at A-2; DX 1445; see also JE 3 at 286-87. FDIC had the authority to withdraw insurance and seize an institution that was in capital compliance – although Meritor projected capital failure even with goodwill included in capital – for unsafe and unsound conditions, as well as the inability to report earnings.

Plaintiffs arguments are incorrect because even if no institution was seized with positive capital before FDICIA, FDICIA ushered in a more stringent regulatory regime, and permitted

insurance withdrawal and seizure for failure of capital minimums, which Meritor was projecting. DX 420 at 11, 9; DX 1043 at 10 (same); Tr. (L) 1130-31 [High]; Tr. 2015 [Thakor].

XXI. Receivership

135. Was there a receivership deficit or surplus at the time of seizure?

RESPONSE: The FDIC had projected that the receivership would result, after anticipated losses absorbed by the receivership and Mellon (to the extent of $170 million), in a positive $40 million result. DX 1022 at 16-18; PX 502B at 48275. As the anticipated losses had not yet occurred, the receivership was in a positive mode after receiving the Mellon premium.

136. Why should Meritor be entitled to recover the amount of the receivership deficit?

RESPONSE: It should not be. This Court has already concluded that any claim for the receivership deficit belongs to the relevant insurance fund, not the bank or even the receiver. "Because any damage suffered as a result of the receivership deficit has been suffered by the FRF [here the BIF], not Statesman Bank, this element of plaintiff FDIC's claim must be dismissed." Statesman Sav. Holding Corp. v. United States, 41 Fed.Cl. 1, 12 (1998); see also Castle v. United States, 48 Fed.Cl. 187, 198 (2000) ("the various components of the receivership deficit--the payment to the depositors, the interest on that amount, and the subsequent expenses incurred in resolving the receivership estate--are ultimately claims against the bank, not claims belonging to the bank"), aff'd in part, rev'd in part on other grounds, 301 F.3d 1328 (Fed. Cir. 2002). See also Bailey v. United States, 341 F.3d 1342, 1345-47 (Fed. Cir. 2003) (rejecting claim for receivership deficit); 12 U.S.C. § 1821(a)(5)(C) (FDIC allowed to use the BIF "with respect to [BIF] members"); 12 U.S.C. § 1821(a)(7)(C)(i) (requires the FDIC to allocate "personnel, administrative, or other overhead expenses" to the BIF if "incurred directly as a result of the [FDIC's] responsibilities solely with respect to [BIF] members."); 12 U.S.C. § 1821(g) (subrogation of FDIC to depositor's interest where depositor has been paid off).

This claim does not belong to Meritor.

137. To what extent was the receivership deficit due to Meritor's asset quality problems that existed pre-seizure?

RESPONSE: To an enormous extent. Plaintiffs offer no evidence or testimony that the losses in the receivership were due to anything other than the poor quality of the assets received from Meritor. Mr. Fitzgerald, Meritor's final examiner-in charge, considered the level of adversely classified assets to be "horrendous" and unprecedented in his career. Tr. (L) 1593 [Fitzgerald]; DX 841 at A-2. He expected continued deterioration in the real estate portfolios, even if the economy improved. Tr. (L) 1593-95, 1401-03 [Fitzgerald]; DX 841 at A-2. In fact, in October 1992 "Meritor agree[d] that . . . it is too early to conclude that problems in the real estate portfolio have peaked" DX 1788 at 7; Def. Response No. 27.

As noted above, the FDIC originally estimated that the receivership would yield $40 million for the shareholders, based upon an extensive Asset Valuation Review and various assumptions. DX 1022 at 1648; PX 502B at 48276. That the receivership is currently almost $42 million in deficit does not indicate that the receivership performed poorly, merely that this 1992 estimate for a receivership that disposed of over $3.5 billion in assets was off by approximately $82 million, or a mere 2.34 percent of the original assets, consistent with the vast uncertainty involved in the quality of Meritor's assets as of December 11, 1992. Plaintiffs have provided no factual predicate for any award of the receivership deficit.

CONCLUSION

For the foregoing reasons, we respectfully request that the Court deny plaintiffs' damages claims.

Respectfully submitted,

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December 29, 2003

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CERTIFICATE OF SERVICE

I certify under penalty of perjury that on this 29th day of December 2003, I caused to be placed in the United States mail, postage prepaid) and transmitted by email copies of "DEFENDANT'S POST-TRIAL RESPONSES TO THE COURT'S QUESTIONS WITH RESPECT TO DAMAGES" addressed as follows:

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