

## **Refining Litigation as an Instrument of Tobacco Control Annotated Expert Testimony on Punitive Damages**

### ***INTRODUCTION***

Tobacco industry conduct has been the focus of extensive judicial scrutiny. Numerous individual and class-action lawsuits have also been filed and many more lawsuits are expected both in this country and elsewhere.

Judges and juries rely on expert witnesses to untangle complex scientific and technical questions in tobacco litigation. The admission of tobacco documents and articles from scientific journals is not enough. Experts are needed to provide a context for interpreting the particular facts of each case.

The following annotated expert testimony focuses on the assessment of punitive damages. Punitive damages are warranted in tobacco litigation. The Oregon Supreme Court stated “Philip Morris, with others, engaged in a massive, continuous, near-half-century scheme to defraud the plaintiff and many others, even when Philip Morris always had reason to suspect -- and for two or more decades absolutely knew -- that the scheme was damaging the health of a very large group of Oregonians -- the smoking public -- and was killing a number of that group. In the case *Henley v. Philip Morris Inc.*, the judge allowed a punitive damage award, finding that “Philip Morris over the course of decades has avoided, concealed, suppressed and failed to disclose information known to it concerning the addictive and harmful properties of its product, and that it has done so in combination with other cigarette manufacturers.”

Without the opportunity to receive punitive damages, individual plaintiffs are unlikely to recover anything for the harm they have suffered. Internal documents describe an industry willing to use its enormous wealth and aggressive tactics to scare off lawyers from representing potential plaintiffs. The prospect of punitive damages provides sufficient incentives to induce talented plaintiffs’ attorneys to bring these cases.

The following excerpts of expert witness testimony are selected from various cases. A brief description is provided at the beginning of each excerpt along with a citation. “Focus points” are included throughout the excerpts providing insight into the questioning attorney’s motivations for asking particular questions, comments on the expert’s testimony and overall trial strategy. The cited transcripts as well as others are available at the Deposition and Trial Testimony Archive (DATTA) housed at the *Legacy Tobacco Documents Library*. DATTA contains 4,850 transcripts of depositions and trial testimony, including a total of about 820, 000 transcript pages. ([www.legacy.library.ucsf.edu](http://www.legacy.library.ucsf.edu))<sup>1</sup>

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<sup>1</sup> The commentary and annotations are for educational purposes only. They do not necessarily represent the opinions of the testifying expert or other parties involved in the litigation. This work is funded by a grant from the American Legacy Foundation.

**ANNOTATED TESTIMONY**

**The plaintiff's counsel inquires into his expert's educational background, work experience and other qualifications. Direct Examination of Robert Johnson (Plaintiff), *Boeken v. Philip Morris Inc., et al.*, April 25, 2001, Pp. 3582-86, 3587-89.**

Q. Good morning.

A. Good morning.

Q. Tell us your occupation, please.

A. I am a forensic economist.

Q. What is that?

A. Basically a forensic economist is an economist who would use the standard techniques of economic analysis and statistics to assist in the calculation or framing of damages. For example, if I was doing the injury to somebody who was working, I would talk about their lost ability to work, their wages, their benefits, future medical expenses. When we deal with issues such as punitive damages, we talk about the financial health, wealth and economic status of the defendants.

*Focus Point: Punitive damages are awarded in addition to damages meant to compensate plaintiffs for the harm they have suffered. Punitive damages are awarded when the wrongful conduct is egregious. The goal of punitive damages is not to run a defendant out of business. Instead, the goal is to punish the defendant in hopes that the defendant as well as other similarly-situated, potential defendants will discontinue the conduct in question. Accordingly, financial experts help place a value on the defendant so that the jury can decide on an appropriate punitive damage award; an award that is sufficient to discontinue the type of the conduct in question, but not so high as to bankrupt the defendant.*

A. I have a Bachelors degree in business administration with a major in economics from the Baruch College of the City University of New York. I have a masters degree in business administration with a major in finance and investments from Stanford university, graduate school of business and post-graduate training with the Strategic Planning Institute and the American Management Association.

\* \* \*

Q. Thank you. Now, I would like to you please tell the jury your occupational background?

A. Sure.

Q. Your work history learning up until now that allows you to give the type of opinions you are going to give?

A. Well, I worked on Wall Street as an investment analyst with the firm Donaldson, Lufkin & Jenrette. Our clients were the top 100 financial institutions in the United States, like Bank of America, Wells Fargo, the California state retirement system. I worked for American Express investment management company as an analyst and portfolio manager. We managed about 700 million dollars of mutual funds. I also was assistant director -- assistant to the director of strategic planning for a division of the Singer Corporation, H.R.B. Singer. Our division did signal intelligence work for various agencies of the department of defense and I was in charge of the mergers and acquisitions

area. Also, I worked as assistant to the director of finance and the controller of FMC Corporation in California, San Jose. That's about a three billion dollar division. We are probably best known for the Bradley fighting vehicle used in Operation Desert Storm. Since 1981 I have been taking my academic training and my real world experience and using them together in the fields of forensic economics.

Q. Since 1981, where have you been working from, geographically?

A. Geographically, my home base has been the Palo Alto area up in northern California.

Q. Since 1981, have you been your own boss or have you worked for other people also giving your opinion?

A. I worked for about a year with, for one company as a consultant. But since 1982, I have had my own company.

Q. What's the name of the company?

A. Robert J. Johnson and associates.

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Q. And also before we get too deeply into the subject matter here, I want to just talk about a couple of representative types of cases you have done. Can we do that?

A. Sure. Let's see, some of the cases that I have --

Q. Can I lead you?

A. Yes, you can.

Q. Because I have a list here and I will pick the ones I like. Okay?

A. Sure.

Q. There was a DC-10 that crashed in Chicago sometime ago and unfortunately killed 273 people. Were you one of the economists chosen by the defense on that case when many, many, many wrongful death claims were filed as a result of that?

*Focus Point: The frequency with which an expert testifies will be discussed. Under the decision, Daubert v. Merrell Dow Pharmaceuticals, 509 U.S. 579 (1993), courts scrutinize testimony offered by professional expert witnesses more so than experts who maintain a career related to their testimony outside of the courtroom. The examining attorney may try to portray the opposing side's expert as a hired gun, calling into question the expert's independence. In this excerpt of testimony, the plaintiff's counsel dispels this perception by pointing out that his expert has testified on behalf of defendants as well as plaintiffs.*

A. Yes, I was.

Q. There was a fire in the M.G.M. Grand Hotel in Las Vegas, and again, unfortunately, resulted in a lot of deaths. Were you involved in litigation between the M.G.M. Grand and Lloyd's of London that arose out of that?

A. Yes, I did. I represented Lloyd's.

Q. How about Becks versus Trans World Airways, a case like that?

A. Yes, that was a case I did represent the defense in that case.

Q. T.W.A.?

A. Yes.

Q. Have you worked for my law firm before?

A. I think this is the first case that we have done to the point of trial.

**The plaintiff's counsel has his expert introduce his testimony. Direct Examination of Robert Johnson (Plaintiff), *Boeken v. Philip Morris Inc., et al.*, April 25, 2001 Pp. 3589-90, 3612-13, 3591-95.**

Q. Now, let's go to the financial condition of Philip Morris. What in their economic, their final report, what do you call it again, the thing they turn into the shareholders?

A. Well, there are two of them. There's one that's called the standard annual report and then there's another one that's called the 10-k. And the 10-k is an expanded annual report that's required by the S.E.C. and so you have the annual report which goes out to all the shareholders and then you have this larger volume, more detailed report generated by the company called the 10-k. The only other third piece that they would send to the shareholders which would be for voting would be the proxy statement.

Q. Okay. You deal with this stuff all the time and so the initials just slip off your tongue. What's S.E.C.?

A. S.E.C. is the Securities and Exchange Commission.

Q. Are all corporations or just some corporations supposed to file these 10-k's with the S.E.C.?

A. That's correct. That would be the, what we call publicly traded, in other words, if they are traded on the stock exchange, they have to file a specific series of documents with the S.E.C. according to their rules.

Q. What was it in either of those documents, if anything, that was of significance to you in order to determine the financial condition of Philip Morris, Inc., which is the domestic, U.S.A. tobacco, please?

A. Specifically within those documents, we were able to determine, and those documents, as I said, are prepared by the company, signed off by the senior management and also signed off by their accountants, their auditors who audit the financial authenticity of the numbers that are in the document.

*Focus Point: Note that the plaintiff's counsel points out that the data used by his expert comes from SEC filings, the veracity of which the defendant's counsel will not challenge. To do so could trigger scrutiny by the SEC or shareholders. Note that the plaintiff's expert also uses data generated by the defendant's recent acquisition of three cigarette brand names from another manufacturer. The defendant's counsel has a hard time challenging this data as well because the defendant itself purchased the brands in an arms-length transaction.*

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Q. I am going on to a third example now, figuring out the financial condition of Philip Morris, Inc. Does it have to do with an acquisition made by Philip Morris, Inc.?

A. Yes, it does.

Q. Explain, please.

A. Well, in 1998, '99, Philip Morris, Inc., the domestic tobacco company, purchased the trade marks, the brand names, et cetera, of three cigarette brands. Those are L&M, Lark and Chesterfield. So they have bought the rights to manufacture cigarettes under those names. The price they paid was 300 million dollars. So they paid –

Q. Let me stop you, please, and I apologize. Let's be sure what they paid for. Aside from the ability to use the name, did they get anything else?

A. No. This bought them the right to the brand, the trademarks.

Q. Okay, sorry to interrupt?

A. They paid 300 million dollars. Now, these brands represented, in terms of unit volume, unit sales, two-tenths of a percent of the entire domestic tobacco market.

Q. One-fifth of one percent?

A. Yes. It's 0.2 percent. So they paid 300 million dollars so they could have the right to name cigarettes. That was worth two-tenths of a percent of the whole market. If we take and say, if they are willing to spend, in their mind, 300 million dollars to buy two-tenths of a percent, effectively, of the domestic market, and what does that say about how they value -- this isn't anybody else that paid 300 million. They paid 300 million. They valued the entire domestic market. Well, if two-tenths of a percent is worth 300. You just do the math, and you come up with a figure that says the whole market is worth approximately 150 billion dollars. And when you do it from that perspective and you say if the whole market is worth 150 billion, what share of the market does Philip Morris U.S.A., domestic tobacco have? Well, they have 49.6 percent of the entire market. So if the whole market is worth 150 billion, they -- and they have 49.6 billion, then their share of the whole market, according to what they are willing to pay, is approximately 75 billion dollars. So if you are going to do a valuation based on what they're willing to take out of their pocket and buy a share of the market comes out to be approximately 75 billion dollars.

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Q. Why don't we start off, please, by discussing the difference between Philip Morris' Companies, Inc., and Philip Morris, Inc. Can you do that?

A. Sure. Basically, Philip Morris Companies, Inc., is a, what we call a holding company. It has other companies underneath it, one of them being Philip Morris, Inc., which is the domestic tobacco company. There are a number of other subsidiaries that they have but it is the holding company, it's sort of like the umbrella. And underneath the umbrella are all of these other companies that are under its corporate total ownership. And so you are looking at Philip Morris, Inc., is the domestic tobacco. By domestic, I mean, just U.S.A. in fact, it's called Philip Morris U.S.A. sometimes. The domestic arm of Philip Morris Companies. It's one portion, one segment.

Q. Is there a place you can go in either of the documents that you have mentioned to report annual report of the 10-k and find, because this is what I am looking for, the bottom line, ultimately what I am looking for, quote, the financial condition, close quotes, of Philip Morris, Inc., in other words, the tobacco company?

A. Yes. There are places where you can go and find out information about the financial condition inside the annual reports and 10-k. There are some charts and graphs and some tables that talk about their operating revenue, their sales, talk about the operating income, that talk about what they spend, in other words, capital expenditures, how much you are able to spend for a new plant and equipment and major operations and how much they are able to afford to be able to pay their leader, the C.E.O. of their company.

Q. Okay. Is there ever, within the 10-k, or is there ever within the annual financial report, a bottom line where it's broken out what the financial condition of the subsidiary U.S. tobacco company is or do you have to do a little calculation in order to get there?

*Focus Point: The plaintiff's expert provides the jury with a basic operating knowledge of some accounting terms and the corporate structure of the defendant. This introduction helps jurors understand how to value a company from its SEC filing and preempts the defendant's counsel from defining the same accounting terms in a manner that favors the defendant.*

A. Yes. There's an item called operating income. And they do, within Philip Morris, segregate out each element, the major elements, like Philip Morris Tobacco -- excuse me, Philip Morris, Inc., U.S. tobacco, into the different segments of what's called the operating income.

Q. Okay. Let's start with that. Right now, right now, I am interested only in Philip Morris, Inc., which is the U.S. domestic tobacco company?

A. Yes.

Q. And that's all I want to talk about right now. All right?

A. Yes.

Q. I have got a couple graphs here that I am going to show in while, but for now I am not. What is revenue? What is revenue and then I am going to ask you what's income and what's the difference?

A. Sure. Revenue is the amount of dollars that a company collects for the sale of its goods or services. So if somebody goes in and buys a pack of cigarettes at the retail level, whatever they pay for that is considered the revenue that the company gets. So in other words, that is the company's revenue, that would be the, quote, unquote, the revenue to the store. Whatever the store winds up paying to Philip Morris, sort of the wholesale price, that's Philip Morris's revenue. So we are talking about revenue, we are talking about what goes into Philip Morris's cash register. Their gross income, their gross sales of their product, not what the retail establishment may get. But what the retail establishment, the wholesaler, would pay to Philip Morris. That's their revenue coming in the door.

Q. What's income, what's the difference between Philip Morris domestic tobacco, income, I am not looking for numbers now, just concept, and revenue?

A. Okay. Revenue is generally what you take in. Income, particularly operating income, is after you have taken out and deducted all of the expenses. So, for example, for cigarettes, that would basically be the cost of manufacturing, the cost of advertising, the cost of any tax items that you may have had to pay, any payments, settlement payments, all of that is deducted and you are left with your, what's called your operating income. The only thing you still have to pay is some general corporate overhead charges for having the corporation do what it does to facilitate the business. But basically, you are looking just about at the bottom line before any interest payments. So it's just about that bottom, bottom line figure.

Q. Income is always going to be less than revenue?

A. Yes.

**The plaintiff's counsel has his expert provide a general overview of the financial condition of company. Direct Examination of Robert Johnson (Plaintiff), *Boeken v. Philip Morris Inc., et al.*, April 25, 2001, Pp. 3595-3601, 3605-3608, 3609-3611.**

Q by Mr. Piuze: have you seen a smaller version of that?

A. Yes, I have.

Q. What does that mean?

A. That chart is the operating revenues of Philip Morris Tobacco U.S.A., also known as Philip Morris, Inc. And that's their sales, it starts in 1998 at 15.31 billion dollars and by

the year 2000 it has increased to 22.658 billion dollars, close to a 50 percent increase, 47.99 percent.

Q. Just so we can have completeness, where this line crosses the 1999 -- where were we?

A. At 19.596 billion dollars.

Q. Okay. So over the course of, between '98 and 2000, the sales went up close to 50 percent?

A. Correct.

*Focus Point: The plaintiff's counsel's discussion of the financial condition of the defendant provides a context for some very big numbers coming later in his direct examination. It also shows that the defendant has more than enough resources to continue the status quo unless the jury sends a strong message to the defendant in the form of a large punitive damage award.*

*In this case, the plaintiff's expert extrapolates the value of the defendant from its parent holding company. Note that the defendant is a corporation wholly owned by the trans-national holding company known as Philip Morris Companies, Inc, which had recently changed its name to Altria, Inc. In at least on other case, however, the defendant's counsel has successfully blocked the plaintiff's counsel from discussing the value of Altria on the grounds that the enormous value of Altria would prejudice the jury against the defendant.*

Q. Now, we have heard in this trial that fewer people are smoking nowadays, if the sales went up by 50 percent, I guess, does that mean national cigarettes are more expensive nowadays?

A. Well, when you have a volume decrease, in other words, the number of units that are sold drops and you still have an overall increase in total revenue, and revenue you can typically define when you sell a product is the unit costs of the revenue times how many of those units you sold, that will give you your total revenue. When the unit number drops, but the total revenue increases, that increase comes because the price has gone up significantly. And that's exactly what has happened. The price of cigarettes has increased significantly over those years, such that you are able to see that specific type of revenue increase.

Q. Have you done analyses similar to what we are doing here today in other types of other cases in other types of companies and products?

A. Sure.

Q. Is a 50 percent increase, I don't want you to name any companies now, I don't want to do that, but is a 50 percent increase in sales in a two-year period or a three-year period, depending on how you look at it, is that a pretty healthy jump?

A. That's really good. That's very good.

Q. So whether or not there are fewer people out there smoking, the money coming in to Philip Morris is increasing dramatically?

A. Significantly.

Q. Here's [Exhibit] 10,006. I guess I should officially say, is this out of their company's official documents to the shareholders and to the U.S. government?

A. Yes, those numbers there, that are represented on that chart, do match identically the numbers from the annual report and the 10-k and the documents prepared and sent to the securities exchange commission. These are Philip Morris numbers.

Q. This is 10,006. Now, this one isn't revenue, this one isn't income. Tell us, for openers, please, what's operating income?

A. Well, basically, the operating income is the income after all of the costs, the goods, advertising, all of the expenses have been taken out, typically, with the exception of interest, corporate overhead, any appropriate, what they call minority interest items, before they have been deducted. So basically what you are looking at when they say operating income is what does it cost to get the product out the door, sold, take care of almost all of your expenses. It's just about the big number before the bottom line.

Q. You have seen a smaller version of that one, haven't you?

A. Yes, I have.

Q. So I guess it doesn't matter if you can actually see that or not now. But over the course of the three-year period, '98 to 2000, does this chart accurately show how much the operating income has gone up?

A. Yes, it does. It shows it going from 1 billion, 489 million in '98 to 4 billion, 865 million in '99 to 5 billion, 350 million in the year 2000.

Q. Now, I'd like to draw your attention and everybody's attention to these numbers up here where we are talking about the increase over the period of '98 to 2000. Before I do, though, I have been sort of stammering on whether this is a three-year period or whether this is a two-year period. Why don't you just tell me what period it is so I won't have to be giving alternatives any more.

A. They are the periods from 1998 to 2000. So you have got a total of three calendar years with two interval years.

Q. So what's the right thing for me to say, two-year increase or three-year increase?

A. It's over -- both are correct. It's over a three-year period from '98 and 2000. The intervals are two years.

Q. Well, having solved that, why -- withdraw "why." what is the significance of the fact that although the revenue curve has gone way up, 50 percent, the other one is way beyond that, almost 260 percent?

A. Well, the reason for the significant increase in the operating revenue -- excuse me -- the operating income versus the operating revenue is one -- is a gross figure, one for higher base, number 1, and the second is when we go to the operating revenue, you will pick up any additional cost that may be in there. For example, if somebody raises their prices but their costs go up, then you would not expect the revenue -- the costs to go up as much. But the biggest reason we are starting from a much smaller base on that basis. If you look at the operating income, that's a base of 1 -- almost 1.5 billion and the other one you are starting from a base of 15 billion. So the increase will significantly appear greater.

Q. I asked you before about other cases, other analysis and other companies as far as an increase in revenues are concerned. I am going to ask you the same question, again, caution you not to mention the companies or the industries, but over a period of three reporting years, is an increase in profits of about 260 percent common?

A. No.

Q. Is that, like if you were grading that on a performance, A, B, C, D, double A or triple A or whatever, where does that fall?

A. For most Fortune 500 companies that is extremely good. That's, I'd call that A plus.

Q. In order to figure out the financial condition of the company, can you use some of the

other numbers in those reports in order to come up with what you believe may be reasonable prices for the company?

A. Yes, you can. You can use some of the data that's inside the report to sort of frame valuations of the company.

Q. How?

*Focus Point: The plaintiff's counsel has his expert introduce the concept of market capitalization, which is share price multiplied by the number of outstanding shares. Market capitalization provides a valuation of Philip Morris Companies, Inc. The expert then extrapolates the value of Philip Morris Companies, Inc., which are carried out under the wholly own corporate subsidiary known as Philip Morris USA Inc, the defendant in this case. This extrapolation is necessary because Philip Morris USA Inc. is not a publicly traded company.*

A. Well, one of the ways you can do it is by looking at the sales of that segment as a portion of the sales of the entire company and look at what the entire company is, what we call the market capitalization of the company, in other words, the parent company which is traded on the stock exchange, you can see how much that company is worth. Because you look at the number of shares times the price per share and that will give you the total value in terms of the, what the stock market says the company is worth. And then you can say, well, if this segment of the company is, let's say, half of it, then one can take and frame and say, well, if half -- if the part of the company that generates half the sales could be worth half of what the stock market value is. And so that's one way of looking and valuing the company as a percent of sales relative to its market capitalization.

Q. Now, if Mr. Boeken or anyone who read the Wall Street Journal or the stock pages of the newspaper went to look up what a share is trading at, would a person be able to ever see what a share of Philip Morris Tobacco U.S.A. is trading at?

A. No.

Q. And I know this is just my shorthand to you, would anyone be able to look up and find out what a share of Philip Morris, Inc., that's the official name for the domestic tobacco company, would anyone be able to find out what Philip Morris, Inc., is trading at?

A. No, they would not.

Q. Would a person only be able to find out what a share of the parent company is trading at?

A. That is correct. Yes, that's the only thing that would be traded.

Q. And that would be Philip Morris Companies, Inc.?

A. That is correct.

Q. Well, how do you know how much shares of Philip Morris, Companies, Inc., are out there?

A. You look in the annual report and they tell you what is the number of shares outstanding.

Q. You have done that?

A. Yes, I have.

Q. And if you look in the newspaper and figure out how much one share of stock is selling for, and you multiply it by all those shares out there, what does that get you? What's that called?

A. That's called the market capitalization.

Q. What does that mean?

A. Again, that simply means if you take the price per share times the number of shares outstanding, that gives you the total market capitalization of the value of the company as measured by the stock market.

Q. So if someone had a really big checkbook and went out and bought up all of the shares for what they are trading at today, it would cost "x"; right?

A. That is correct.

Q. What's "x"?

A. "x," as of the 23rd of April, was, and this is "x" for Philip Morris, Inc., or "x" for Philip Morris Companies.

Q. Philip Morris Companies, Inc., the thing that you can actually look up in the report and on the stock market?

A. That would be approximately 105 billion dollars.

\* \* \*

Q. So knowing what the parent or umbrella company, company's capitalization is, how does that help us figure out the financial condition of Philip Morris, Inc., the domestic tobacco company?

*Focus Point: Using the market capitalization of Philip Morris Companies, Inc., the expert offers two valuation models. The expert also discusses a third valuation model using information generated by the defendant's recent acquisition of three cigarette brand names from another manufacturer. The first model values the defendant by multiplying the percentage of Philip Morris Companies, Inc.'s sales that occur in the United States (33%) by Philip Morris Companies, Inc.'s market capitalization (\$105 Billion) yielding a total value of the defendant (\$35 billion).*

*Although any one of the models offered by the expert would appear to provide an accurate valuation of the defendant, the plaintiff's counsel provides three approaches in hopes that at least one will click with each juror. There is the potential for confusion in discussing all three models. However, the plaintiff's counsel probably wanted to be the first to frame these models for the jurors.*

A. Well, in terms of looking at a way of framing its value, since there is a percent of the total company sales that represents the tobacco segment, and you can look and say, well, what percentage of the total company's sales represents the tobacco, take that tobacco percentage and apply that against the market capitalization. And that's what we call value based on a percent of sales basis.

Q. Are you going to, in response to -- let me withdraw that. Are you prepared to, in response to my series of questions here now, give several different methods that you believe are valid in showing the financial condition of Philip Morris, Inc.?

A. Yes.

Q. Is this the first?

A. This is the first.

Q. Okay, so we are talking about total revenue now; right?

A. That is correct.

Q. Here's (exhibit 10,008, blowup, marked for I.D.)

Q. by Mr. Piuze: you have seen that before?

A. Yes, I have.

Q. What does it mean, please?

A. This is Philip Morris Companies, and basically what it says is it has all the different divisions and it says that if you look at Philip Morris Tobacco, U.S.A. Philip Morris, Inc., it's 28.2 percent of the total revenue of Philip Morris Companies, which is the 22.658 billion dollars.

Q. What's the total revenue of the parent company, please.

A. 80 billion.

Q. Here's (exhibit 10,007-a, blowup, marked for I.D.)

Q. Is that sort of the same information in a slightly different form?

A. Yes, it is. It is the 2000 revenues from the annual report, the Philip Morris Companies, it's total revenue of 80.356 billion with the Philip Morris, Inc., the tobacco domestic section, at 28.2 percent of the total revenue for Philip Morris, Companies.

Q. That 80 figure at the top, your number, my number, Philip Morris's number?

A. Philip Morris's number.

Q. So what? So we know that the sales of the U.S. tobacco -- we know that the sales of the U.S.A. tobacco is 28 percent of the sales of the big parent company.

A. That is correct.

Q. What are you going to do with that?

A. Well, the next step is we take that and multiply it by that 28.2 percent and multiply it by the total market capitalization that we spoke about earlier, the 105 billion dollars. And that gives us a net figure of approximately 30 billion dollars.

Q. So if you were to -- thank you. If you were to value the domestic tobacco company based on its percentage of sales, to the parent company, if you chose that method of valuation, the domestic tobacco company is worth 30 billion dollars?

A. That is correct.

Q. And just remind us, please, as of when, what date did those numbers come out of the newspaper, the stock quotes?

A. April 23rd, 2001.

Q. Monday?

A. That is correct.

*Focus Point: Using the second valuation model, the expert values the defendant based on operating income. Operating income is the income after most business operation expenses are deducted, such as salaries, equipment and manufacturing, but not including general corporate expenses. The plaintiff's expert multiplies the percentage of the operating income from the Philip Morris Companies, Inc.'s domestic tobacco sales (28.2%) by its total market capitalization (\$105 Billion) yielding the defendant's value (\$30 Billion).*

*Note that in the beginning of his direct examination, the plaintiff's counsel had the expert define some basic accounting terms, and then, used the terms in a hypothetical visit to the local convenience store. The hypothetical is simple to understand because nearly everyone can relate to it. If the plaintiff's counsel feels that the jurors are confused during any part of the testimony, he will have his expert answer the question in the context of the hypothetical store.*

Q. Now, can you do the same thing, not based on sales, but based on income?

A. Yes, you can.

Q. How?

A. Well, you go through the same process. You look at the total operating income for Philip Morris Companies and then you look at what is the operating income for Philip Morris, Inc., that tobacco section. You do the same proportional analysis of the tobacco to the whole of the company and you can apply that against the market capitalization as we get closer to the bottom line, seeing exactly what the ratio is, again, getting a market valuation of the company based on its operating income.

Q. Here's (exhibit 10,009, blowup, marked for I.D.)

Q you have seen that one before?

A. Yes, I have.

Q. I can do the work of one easel. Go ahead explain that, please.

A. Sure. The operating income that we have here for Philip Morris Companies basically breaks down the total figures for Philip Morris Companies which is approximately about -- is the 5.350 billion of the -- which is tobacco, or approximately 32.97 percent.

Q. Let me interrupt you now. You said tobacco. I am interested in domestic tobacco, U.S.A. tobacco.

A. This is only U.S.A. tobacco. So it's -- there's no international. This is Philip Morris, Inc., also known as Philip Morris, U.S.A., only domestic tobacco.

Q. So the ratio or -- let's talk percentage. The percentage of Philip Morris Inc.'s, that's the domestic tobacco company, profits, to the parent corporation, is what?

A. Approximately 33 percent, 32.97 percent.

Q. And here's (exhibit 10,009-a, illustration, marked for I.D.)

Q Does that, in real simple form, show the percentage of profits of the domestic tobacco company to the parent?

A. Yes, it does.

Q. I will ask you again, so what? So we know it's a third, what about it? How does that help us figure out the financial condition of Philip Morris, Inc., the domestic tobacco company, please.

A. Well, now if you are going to value the company, based on its -- what portion does the domestic tobacco consist of, the total market capitalization, you would take that 32.97 percent, approximately 33 percent and apply that against the 105 billion dollar market capitalization, give you a market value of approximately 35 billion dollars, as to the market value of Philip Morris, Inc.

Q. Doing it that way, 30 billion, doing it that way, 35 billion?

A. That is correct.

Q. I am showing 10,008 now. Doing it that way, 30 billion?

A. Correct. Based on revenue.

Q. Doing it that way.

A. Based on income, 35 billion.

**The witness offers a third valuation model based on the defendant's recent acquisition of three cigarette brand names from another manufacturer. Direct Examination of Robert Johnson (Plaintiff), *Boeken v. Philip Morris Inc., et al.*, April 25, 2001 Pp. 3611-3616.**

A. No. They are both different ways of looking at the valuation. From an investor's standpoint, it depends what you are going to do with the company as to which one may or may not be most appropriate. Also, there are other methods of doing evaluations that don't include sort of an outside valuation of the company that can be derived from internal valuation of the company.

*Focus Point: The defendant's acquisition provides a value on a particular percentage of the defendant's sales. From this percentage, the expert then extrapolates what the defendant would pay for 100 percent of its domestic sales (or in other words, the value of all its brand names combined). This model is very persuasive because the plaintiff points out that the defendant valued itself in an arms-length business transaction. Additionally, this model undercuts the defendant's counsel's use of its net worth as an accurate valuation. Net worth does not include the intangible value of brand names. Indeed, the defendant's counsel will repeatedly de-emphasize the value its brand names. By focusing on this acquisition, the jurors are reminded of the incredible value of cigarette brand names.*

Q. I am going on to a third example now, figuring out the financial condition of Philip Morris, Inc. Does it have to do with an acquisition made by Philip Morris, Inc.?

A. Yes, it does.

Q. Explain, please.

A. Well, in 1998, '99, Philip Morris, Inc., the domestic tobacco company, purchased the trade marks, the brand names, et cetera, of three cigarette brands. Those are L&M, Lark and Chesterfield. So they have bought the rights to manufacture cigarettes under those names. The price they paid was 300 million dollars. So they paid --

Q. Let me stop you, please, and I apologize. Let's be sure what they paid for. Aside from the ability to use the name, did they get anything else?

A. No. This bought them the right to the brand, the trademarks.

Q. Okay, sorry to interrupt?

A. They paid 300 million dollars. Now, these brands represented, in terms of unit volume, unit sales, two-tenths of a percent of the entire domestic tobacco market.

Q. One-fifth of one percent?

A. Yes. It's 0.2 percent. So they paid 300 million dollars so they could have the right to name cigarettes. That was worth two-tenths of a percent of the whole market. If we take and say, if they are willing to spend, in their mind, 300 million dollars to buy two-tenths of a percent, effectively, of the domestic market, and what does that say about how they value -- this isn't anybody else that paid 300 million. They paid 300 million. They valued the entire domestic market. Well, if two-tenths of a percent is worth 300. You just do the math, and you come up with a figure that says the whole market is worth approximately 150 billion dollars. And when you do it from that perspective and you say if the whole market is worth 150 billion, what share of the market does Philip Morris U.S.A., domestic tobacco have? Well, they have 49.6 percent of the entire market. So if the whole

market is worth 150 billion, they -- and they have 49.6 [percent], then their share of the whole market, according to what they are willing to pay, is approximately 75 billion dollars. So if you are going to do a valuation based on what they're willing to take out of their pocket and buy a share of the market comes out to be approximately 75 billion dollars.

Q. I asked you before, when I had these two up here, using a percentage of revenues, I think the number was 30?

A. That is correct.

Q. Using a percentage of profits, excuse me, income, am I doing that right? Yeah, income, I believe it's 35 billion?

A. Yes.

**The plaintiff's counsel has the expert describe why "net worth" is a poor valuation model. Direct Examination of Robert Johnson (Plaintiff), *Boeken v. Philip Morris Inc., et al.*, April 25, 2001, Pp. 3616-3621.**

Q. Are you familiar with the concept or the term "net worth"?

A. Yes.

Q. What does that mean, net worth?

A. Basically, net worth is an accounting designation that says if you take the reported assets, the book value of the assets and you take the liabilities and you subtract all the liabilities from the assets, you will have what's called the net worth. In publicly traded companies, it is sometimes called the stockholders equity.

Q. Okay. I am going to ask you, I will do it right now, is there a published figure for the net worth of either Philip Morris, Inc., which is the domestic tobacco company, or Philip Morris Companies, Inc., which is the parent umbrella company?

A. There is only a figure for Philip Morris, companies, Inc., in other words, the parent, the umbrella. There is no published figure that I have been able to find in any of these S.E.C. documents, the publicly available documents, regarding Philip Morris, Inc., domestic tobacco.

Q. What are the published figures for the, let me get this right now, net worth of the parent company?

A. As of their first quarter, in other words, march 31 reporting, that would be 15 billion, 140 million.

*Focus Point: The net worth of the defendant is much less than the value arrived at using the three valuation models discussed by the plaintiff's expert in this case. The primary reason for this difference is that net worth does not account for the value of brand names.*

*In this excerpt, the plaintiff's counsel knows that the defendant's counsel will push net worth as the best valuation model. Part of trial advocacy is articulating your case. But just as important is knowing what the opposing side is going to argue and having a response. The expert witness is often involved in both parts of trial advocacy. The expert assists the attorney by providing scientific or technical testimony and by helping to figure out what the other side might say in response. In this case, net worth would have become Philip Morris' position on valuation as opposed to the manner in which the plaintiff's counsel describes it: an ineffective measure of business value.*

Q. So watch this. If we take that number and do the same math, putting 28 percent on 15 billion, that's going to give you a net worth to the domestic tobacco company of less than 5 billion dollars; right?

A. Just under 5, that is correct.

Q. And if we do this, and look at the income, and the parent has a 15 billion dollar net worth, this is almost right on the button, a third, 5 billion dollar net worth for the domestic tobacco company?

A. That will be correct, yes.

Q. These are way smaller numbers than we have been talking about, obviously?

A. That is correct.

Q. So you told us what net worth is. Let's talk about it some more. And I also want to know what net worth isn't. Are you ready? A. Sure.

Q. If net worth is assets minus liabilities, what goes into the asset column?

A. What's called, typically, it's called the lower of cost or market. Let me explain that. In the asset column you would line up all of the assets. For example, if you got a plant, it would be the plant that you have, less the depreciation. It would be any of the active items that you have as part of your production facility, the land, all of those items would be included in the assets that are measurable. And they are usually calculated, typically, at what's called the lower of cost of market.

Q. Okay. So assets, if Philip Morris owns someplace, a Ford Econoline van, is that an asset?

A. Yes, it is.

Q. And if Philip Morris, someplace, still has to pay out an extra \$7,822.00 which is left on the payment schedule for that Econoline van, is that a liability?

A. That is a liability, that is correct.

Q. If Philip Morris owns some big old factory some place that's worth a lot of money, is that an asset?

A. Yes, it would be an asset.

Q. If Philip Morris has a mortgage on that big old factory someplace, and has to pay off that mortgage, is that a liability?

A. The mortgage is the liability that is correct.

Q. If Philip Morris has a pension plan someplace and they have to be paying pensions to the people, that would be for the corporation, is that a liability?

A. That is also a liability.

Q. If Philip Morris owns some tobacco field someplace or some other property that's somewhere, is that an asset?

A. That is an asset.

Q. Okay, so these are pretty straightforward things to understand?

A. That is correct.

*Focus Point: The plaintiff's counsel picks very good examples of brand names that every juror probably knows, including Marlboro and Coca Cola. Note also that the plaintiff refers back to the three brand names that were used in the expert's third valuation model. Linking arguments with key works and concepts in this manner is a very effective technique of trial advocacy.*

Q. Let me ask you this: have you ever heard of Marlboro?

A. Sure.

Q. Have you ever heard of Coca-Cola?

A. Yes, I have.

Q. Is there someplace in the Philip Morris balance sheet, the assets and the liabilities, where they lead up to the net worth where someone says, the name Marlboro, let's forget the factory and the Econoline and the tobacco fields, the name Marlboro is worth "x."

A. No.

Q. So if we look at the net worth, and this is the point I am trying to make, if we look at the net worth of the company that's published in those documents someplace, and we are thinking about factories and machines and cars and trucks and pension plans and everything else, that are easy to grasp, so far we haven't taken into account the value of the name Marlboro, is that true?

A. That's correct, we don't have whatever the current market value is.

Q. From your point of view, I am not looking for any kind of a number now, just conceptually, from your point of view, is owning the name Marlboro worth a couple bucks?

A. Definitely.

Q. What were the names of those three brands that Philip Morris paid 300 million dollars for?

A. L&M, Chesterfields and Lark.

**The defendant's counsel focuses on the plaintiff's expert's work in preparing for the trial. Direct Examination of Robert Johnson (Plaintiff), *Boeken v. Philip Morris Inc., et al.*, April 25th, 2001 Pp. 3624-3628.**

Q. Good morning, Mr. Johnson.

A. Good morning.

Q. Just start off, I think we can agree that Philip Morris, Inc., is a profitable company; right?

A. That's every indication, yes.

Q. And it is probably worth billions of dollars?

A. Yes.

Q. Okay. What I'd like to do is just talk a little bit more about the specific valuations, the way you got to the specific valuations you told us about this morning. All right.

A. Sure.

Q. When were you first contacted by Mr. Piuze in this case?

A. Oh, that would have been back in the end of last year, beginning of this year.

Q. And this is what you do for a living, work up numbers like this and testifying in court?

A. I don't have a lot of punitive damages cases. But if you are asking me do I do economic testimony for matters of litigation, yes, that's all we do.

Q. And the first thing you did for Mr. Piuze was to work up an evaluation of Philip Morris Companies, Inc.; right?

A. That was the first part, correct.

Q. And then you gave a deposition in this case, didn't you?

A. Correct.

Q. That was in March?

A. Correct.

Q. Middle of March?

A. Correct.

Q. And at that point, you had done this net worth evaluation of Philip Morris Companies, isn't that right?

A. I had done a net worth evaluation of Philip Morris Companies and I was awaiting information regarding Philip Morris, Inc.

Q. So the first thing you did was to do a net worth analysis?

A. That was one of the items that we looked at. We did an analysis. Did we look at net worth? Yes. That was one of the items we looked at.

Q. But you hadn't done any of the other methods of analysis that you talked about today, at that time in March?

A. That is correct.

Q. And you came up, and I think you told us today, with a net worth of Philip Morris Companies of about 15 billion dollars?

A. Correct.

Q. And you think, at that time, you were relying on your 2000 figure so it was a little less than the 15 billion, 140 million you told us today?

A. About 135 million.

Q. So that was the net worth of Philip Morris Companies?

A. Correct.

*Focus Point: This excerpt shows that the defendant's counsel has the right to explore the expert's preparation for the current case. The defendant's counsel may inquire by deposition or on cross examination during trial.*

*The defendant's focuses on the expert's admission in his deposition that he used "net worth" as part of his preparation for the case. The defendant is trying to rehabilitate the concept of "net worth" in the eyes of the juror after the plaintiff's expert described it as an ineffective way to value companies. The defendant's counsel wants the jury to use net worth when calculating punitive damages because it provides a much lower number than the other valuation models in this case.*

Q. Now, Philip Morris Companies own a number of subsidiaries, doesn't it?

A. Correct.

Q. That would include Philip Morris, Inc., that's one of them; right?

A. Correct.

Q. And the other subsidiaries it owns would include Kraft foods; right?

A. Sure.

Q. The international tobacco business?

A. Correct.

Q. There's a financial services subsidiary; right?

A. Correct.

Q. Miller beer?

A. Correct.

Q. And all of those subsidiaries are the assets of Philip Morris Companies?

A. Correct.

Q. And the value of those assets less the liabilities of -- less the liabilities, came out to about 15 billion dollars?

A. Book value, less liabilities, that is correct.

Q. And that's what you testified to at your deposition in March; correct?

A. Correct.

Q. Now, recently, you were re-contacted by Mr. Piuze and asked to do some more evaluation; right?

A. Correct.

*Focus Point: The defendant's counsel focuses on the fact that the expert valued the defendant several months before trial, and then again just a few days before the trial started. The defendant's counsel tries to portray the two valuations as inconsistent. The defendant's counsel is trying to undermine the credibility of the expert by making it appear that his conclusions were influenced by what the plaintiff's counsel wanted to hear.*

Q. And you did that evaluation or completed it at least just within the last few days, didn't you?

A. Correct.

Q. So the numbers you told us about today you finalized when?

A. 23rd, Monday.

Q. Monday of this week?

A. Correct.

Q. In response to a call from Mr. Piuze?

A. Correct.

Q. And then you gave a second deposition yesterday to talk about these numbers?

A. Sure.

Q. And now, based upon the numbers you told us today then, Philip Morris, Inc., a subsidiary of Philip Morris Companies, with a net -- Philip Morris Companies has a net worth of 15 billion, Philip Morris, Inc., may have a value of between 30 and 75 billion?

A. Those are the numbers I presented, correct.

**The defendant's counsel challenges the expert's use of the term capitalization under the argument that it is not money in the bank. Cross-Examination of Robert Johnson (Plaintiff), *Boeken v. Philip Morris Inc., et al.*, April 25, 2001, Pp. 3628-3637.**

Q. And the first two of them you used some percentage of the total market capitalization of Philip Morris Companies?

A. That is correct.

Q. Let's talk about market capitalization a bit. Market capitalization is the total value of all of the outstanding stock of a company; right?

A. Correct. Basically, it's the share price per share by the outstanding stock.

Q. And what were you looking at was the total value of the outstanding stock of Philip Morris Companies?  
A. What I was looking at was the --  
Q. To start with?  
A. What I was looking at was the products, share price times number of shares outstanding. That's all. That's market capital.  
Q. That was the 105 billion dollar number; right?  
A. That is correct.  
Q. Now, that 105 billion dollars isn't -- doesn't equate with money in the pocket of Philip Morris Companies, does it?  
A. No. They can be two different things.  
Q. They can be two different things?  
A. Sure.  
Q. And a publicly traded company,  
A company will sell a share of stock and it gets the money from the proceeds; right?  
A. Correct.  
Q. The value of that share of stock can go up and down?  
A. And it does.  
Q. And it does. We have seen that in the dot com world. But that doesn't result in a check being paid to the company that issued the stock, or a debit to its account if it goes down?  
A. Not unless they have issued the stock for the first time.  
Q. Right. After it sold the first time, it's not money in the bank for them?  
A. Correct.

*Focus Point: The defendant's counsel raised makes the point of "money in the bank" because he wants to argue that the defendant cannot pay a large punitive damage award. The question, however, appears ineffective in the face of the common understanding that shares in a company constitute part ownership of the company and have value.*

Q. What you have talked about then, in terms of the percentage of revenues method or the percentage of income method really has to do, doesn't have anything to do with the amount of money in the bank that Philip Morris, Inc., might have?  
A. Let me make sure I understand. You are asking me does the value of the company -- does the market capitalization value of the company have anything to do with the amount of cash they have in the bank?  
Q. Right.  
A. No.  
Q. It's possible. Now, the value that the market places on a company's stock is not just affected by the asset of that company, is it?  
A. Correct.  
Q. Might be affected by the liabilities of the company; right?  
A. Correct.  
Q. Might be affected by things called contingent liabilities; right?  
A. Correct.  
Q. Things that might happen in the future that haven't yet happened?  
A. Correct.  
Q. And the market tries to take that into account and figure it into what they are going to

pay for the stock of that company?

A. Correct.

Q. Contingent liabilities might include the risk of litigation, such as this; right?

A. Sure.

*Focus Point: The defendant's counsel brings up the concept of contingent liability in the form of potential litigation-related expenses. Bringing up the threat of litigation was a calculated risk, one which seems to have favored the plaintiff. In an excerpt of redirect testimony provided below, the plaintiff's counsel jumps on the defendant's counsel's position that the threat of litigation is significant, by implying that the defendant deserves it. Because the door was opened, the witness can even talk about how the defendant could settle these claims as a regular business matter. Lastly, the witness points out that despite the threat of litigation, the defendant is very profitable.*

*The scope of cross examination is limited to the subject matters discussed on direct examination, which are largely determined before trial. If, however, the direct examination strays into an area that the questioning attorney had the judge previously exclude from evidence, the witnesses will have "opened the door" for the opposing counsel to inquire on cross examination. Similarly, the defendant's counsel's cross-examination can open the door for redirect that goes beyond the direct testimony.*

Q. And do you have any idea how the market would factor that in to the value of Philip Morris, Inc., by itself?

A. If you are asking me how exactly did they factor any of the contingencies mentioned, and there is a section in the balance sheet that talks about contingencies for Philip Morris, there's no number there. There's just a section. But if you are asking me how the market would actually go about making the specific adjustment, I don't know. I do know they are aware of all of the contingencies as set forth by Philip Morris in their financial statements and they are making whatever adjustment they deem appropriate based on their interpretation of all of that publicly available information.

Q. For the whole umbrella entity?

A. Contingencies, all the contingencies, in all aspects of Philip Morris Companies, all of the different companies, not just tobacco but all of them.

Q. Have you done any research into how the market might evaluate Philip Morris, Inc., if it were traded separately?

A. No.

Q. You do know that that issue has been a topic of analysis in the investment press, don't you?

A. I haven't really looked at what the investment press are saying. No, I haven't – I mean, they talked about, when I was an analyst in the '80's, they talked about what would happen if the companies got split apart. In other words, the tobacco segments got split apart because Nabisco used to be owned by another company. But this is something that's been going on for a long time, so it is nothing new. So if you are -- they are talking about it again, okay.

Q. You pay attention to stock prices, you pay attention to investment analysts in the course of your business?

A. No. No, I don't. Stock prices for this case, yes. Do I pay attention to investment

analysts, no, not really. I do my own investing for myself. If I am asked to come in and evaluate the acquisition price or do a specific evaluation, then I will go out and look at what some investment advisors may be saying. But having been an investment adviser myself, I understand the financial pressures that they are under and I understand specifically what their role is.

Q. Do you get "Forbes" magazine?

A. Sure.

Q. February 19th of this year, did you happen to get it?

A. Probably, yeah. Subscription comes in regularly.

Q. Would it surprise you to hear that "Forbes" magazine said: "the upcoming sale of shares in its food business, once the Nabisco acquisition of combined with Philip Morris's Kraft will prove that the tobacco operations are valued near zero."

Does that surprise you?

A. What?

Q. That the tobacco operations on a market basis are valued near zero?

A. No, no, no. What you got there is one person's opinion as to what they think that valuation would be. Whether it's the market's opinion, I haven't seen it, on that basis. And you will have to wait and see whether or not "Forbes," there's no financial analyst that's 100 percent correct. So that's that person's opinion.

Q. Might be right, might be wrong?

A. Who knows?

Q. So when you say, in evaluating the proportion of the total market capitalization of Philip Morris Companies that should be attributed to Philip Morris, Inc., you are saying it should be 28 percent or 33 percent; right?

A. I am saying, if you use that tool, that way of measuring a value on an item that's not publicly traded, looking at it from a percentage of sales is a reasonable way. Looking at it from a percentage of operating income is a reasonable way. If you look at it from these perspectives, these are the numbers.

Q. And other than --

A. That's all.

Q. And other reasonable people, taking into account contingent liabilities, can conclude it's really close to zero?

A. Well, counsel, I just want to make sure that you understand that when we did market capitalization, market capitalization does take into effect contingent liabilities. So both of us took into effect contingent liabilities. We just did it differently.

**The defendant's counsel asks the plaintiff's expert about the net worth of a company. Cross-examination testimony of Lowell Bassett (Plaintiff), *Williams v. Philip Morris Inc., et al.*, March 11, 1999, Pp. 48-56.**

Q. Dr. Bassett, you are not an accountant; is that correct?

A. That is correct.

Q. You do not prepare audited balance sheets for corporations?

A. I do not.

Q. Your consultive work, is that primarily forensic?

A. Yes, it is.

Q. And by that, Doctor, forensic work means that your clients are not businesses or corporations generally, but rather attorneys. You are retained by attorneys to perform analysis for litigation primarily purposes, correct?

A. That is correct, but the attorneys frequently represent corporations.

Q. Doctor, isn't it's true that the most common basis by which accountants, certified public accountants, in this country, use to quantify the financial condition of a corporate entity is what accountants call net worth?

A. Yes.

Q. And isn't it true that certified public accountants, in order to reach net worth, as established by generally accepted accounting principles, utilize a balance sheet approach?

A. Yes.

Q. Explain for the jury what a balance sheet is.

A. A balance sheet would list the assets that the company owns based on the prices that they paid for those assets, so, for instance, if you bought a piece of equipment for \$10,000, that would go on the balance sheet as an asset valued at \$10,000, so each thing that the company has bought that hasn't been used up is listed. And then the liabilities would be the amounts that the company owes, so they might have some accounts payable, they would have money that they borrowed perhaps from the bank or they could have bonds that represent IOUs to bond holders, and they list those liabilities. They subtract the assets -- excuse me, the liabilities from the assets to arrive at what's called book net worth, or book value.

*Focus Point: The defendant's counsel would prefer to have the jury use the net worth of a company over other valuation models when deciding on punitive damages. Net worth does not include the value of brand names and other related good will, and therefore, yields a much lower value than those methodologies discussed above in Boeken v. Philip Morris Inc.*

*Note that in this case, the defendant's counsel successfully objected to any discussion of the market capitalization of the defendant's holding company, which is now known as Altria, Inc. The basis of the objection was that the enormous value of the holding company would prejudice the jury against the defendant. This pre-trial determination by the judge prevented the plaintiff's expert from using some of the valuation methodologies used by the plaintiff's counsel in Boeken v. Philip Morris Inc.*

Q. And when a corporation needs financing and it goes to, a large lending institution in an attempt to acquire a large loan for major capital improvements, the lending institution would want an audited balance sheet, an audited financial statement prepared by a certified public accountant, that in all likelihood, if not in all probability, the method by which the balance sheet or the financial sheet or the financial statement would be prepared would be pursuant to general accounting principles?

A. Certainly that would be a start. The bank would want that before they would do anything else, but that wouldn't be the only thing that the bank would look at.

Q. The bank would want an audited balance sheet prepared in general form as you have just outlined, correct?

A. Correct.

Q. Doctor, you testified that when you're retained by counsel, you reviewed some material, correct?  
A. Correct.  
Q. Okay. Did you review a balance sheet of Philip Morris Incorporated, yes or no?  
A. No.  
Q. Did you request a balance sheet of Philip Morris Incorporated?  
A. I requested whatever information counsel had.  
Q. Okay. Did counsel advise you that Philip Morris Incorporated has a balance sheet three billion four hundred and thirteen million six hundred thousand?  
A. No.  
Q. You weren't aware of that when you gave your opinion of 17 billion, here you?  
A. Well, I was aware of it because you have been discussing it while I was here in court, but I wasn't aware of it when I prepared my opinion as to the market value.  
Q. And are you aware that Philip Morris Incorporated has publicly announced its balance sheet as of the end of the year 1998 of being three billion four hundred and thirteen million six hundred thousand?  
A. No, but I'm not surprised.  
Q. Now, Doctor, when an economist or accountant gives an opinion regarding net worth, particularly current net worth, isn't it generally true that the accountant will attempt to utilize the most current financial information available?  
A. The accountant will, yes.  
Q. And in reaching your opinion here today, Doctor, did you review the most current financial information of Philip Morris Incorporated?  
A. I reviewed the most up to date that I could find.  
Q. And what was that doctor?  
A. I reviewed the information that was available on the corporation web site on the Internet.  
Q. And what was the most current information that you had to available to you, Doctor?  
A. 1998.  
Q. Year end?  
A. Yes.

\* \* \*

Q. All right. Plaintiff's Exhibit 171. Doctor, you listed net profit of Philip Morris Incorporated for 1997 of one billion six hundred seven million dollars, correct?  
A. Correct.  
Q. What was the net profit of Philip Morris Incorporated as of year end 1998?  
A. Approximately four billion dollars.  
Q. Doctor, isn't it's true that the 1998 earnings of Philip Morris Incorporated is seven hundred six million dollars?  
A. That's after extraordinary charges.

*Focus Point: The defendant's counsel is implying that his client has already paid out enormous sums of money in defending lawsuits and that further punitive damages are not needed. The defendant's counsel is hoping that the jury will not interpret these expenses as evidence of the defendant's culpability. Note that they would not be admitted into evidence for a determination of culpability and the defendant's counsel may ask for a jury instruction on this point..*

*The defendant, however, actually has paid relatively little to plaintiffs. Cigarette manufacturers aggressively defend private lawsuits as part of a strategy of intimidating plaintiff's lawyers from suing tobacco manufacturers. Guardino, Friedman & Daynard, Remedies for Document Destruction: Tales from the Tobacco Wars, 12 Va. J. Soc. Pol'y & L. 1 (2004).*

Q. Doctor, we don't need to get into the nature of extraordinary charges. The fact of the matter is the reported earnings of Philip Morris Incorporated year end 1998 is seven hundred six million dollars, correct?

A. Only after extraordinary charges.

Q. You so testified a few moments ago in a hearing outside the presence of the jury, correct?

A. Correct, after the extraordinary charges, it's about seven hundred million dollars.

Q. The earnings of Philip Morris Incorporated in 1998 were less than half of the earnings in 1997, correct, Doctor?

A. Only because of those extra charges that we're talking about.

Q. Those charges were real, weren't they, Doctor?

A. Well, they're accrued charged. They're not cash charges if that's what you mean.

Q. Now, Doctor, correct me if I am wrong, you utilized, in response to Mr. Thomas' -- one of his last questions, that the 17 billion reflects the, quote, value of Philip Morris Incorporated as an ongoing business, correct?

A. Correct.

Q. What, in essence, you're talking about Doctor, is the market value of Philip Morris Incorporated?

A. Yes, I am.

Q. All right. Which in simple, general terms, is what, in your opinion, Philip Morris Incorporated might gather on the open market if it was sold, correct?

A. Correct.

Q. Okay. Philip Morris Incorporated does not have assets 17 billion dollars, does it?

A. Oh, assets are larger than 17 billion.

Q. After liabilities, Doctor?

A. No. But you asked about assets, not about after liabilities.

Q. Net assets, Doctor.

A. Net worth on the books is about what you said, three billion dollars.

Q. All right. In terms of providing some helpful information to these ladies and gentlemen of the jury, in terms of determining the actual financial condition of Philip Morris Incorporated, you get to the 17 billion dollars, only if Philip Morris Incorporated is sold, correct, Doctor?

A. No. I mean, that's what you could get if it was sold, but you don't have to sell it to access some of that value.

*Focus Point: The expert deftly explains why the defendant's counsel is wrong. The defendant's counsel wants the expert to admit that his valuation would be realized only if the company is sold. Such an admission would allow the defendant's counsel to argue the defendant can only pay a punitive damage award by selling part of the business. The expert responds that the value may be accessed simply by borrowing against it.*

Q. Philip Morris Incorporated is not sold, is it, Doctor?

A. No but they can borrow against the value that they have. It is not any different than if I own stock and it's worth \$17,000. I wouldn't just take the price that I paid for it, I would look for what the current market says it's worth.

Q. 17 billion dollars, in fact, Doctor, is about a factor of five times the actual net worth of Philip Morris Incorporated, isn't it?

A. No, because I believe 17 billion is the actual net worth. The book value decided by accountants does not reflect the value of the brands and the income that those brands produced for the company.

Q. And those valuations could be obtained only if the company was really, in essence, sold?

A. No. You could borrow against that value.

**The plaintiff's counsel asks his expert to provide an example that shows the limitations of using net worth. Redirect testimony of Lowell Bassett (Plaintiff), *Williams v. Philip Morris Inc., et al.*, March 11, 1999, Pp. 57-58.**

Q. Is there an example that we can use to illustrate how -- what an accountant puts on a balance sheet and what the financial condition of a company, how they're different?

A. Well, I think the best example is a personal example. If an accountant was looking at your historical personal financial data as an accountant looks at a company, if you bought a house for \$100,000, 20 years ago, the accountant would have it on the balance sheet as having a value of \$100,000. But if your house has appreciated as it frequently has in both Portland and Seattle, it may well be worth \$300,000 today, and that is not going to be reflected in historical data on the balance sheet, so you could have a mortgage of \$50,000, and the accountant would have \$50,000 as a liability, and \$100,000 as the historical cost of your house, and your net worth would be \$50,000; but in actuality, your house is worth \$300,000, you have a \$50,000 mortgage, and your net worth is \$250,000.

Q. Is it fair, in terms of evaluating the real financial condition of a company or an individual, to limit value to what somebody may have paid for, something 10, 20 years ago, without taking into account what it's really worth now in 1999?

A. I don't believe so.

**The defendant's counsel has the plaintiff's expert work through the defendant's balance sheet. Cross Examination Testimony of George Mundstock (Plaintiff), *Engle v. R.J. Reynolds Tobacco Co. et al.*, June 7, 2000, Pp. 12-26**

Q. Okay. Now, in reviewing these statements, you didn't see anywhere on these statements that Liggett has cash or cash equivalents on hand or current assets that approach 900 million or \$1.8 billion, did you?

A. No, I did not.

Q. In fact, you looked at Liggett's balance sheet -- I'm not very good with this, but I'm trying. You saw that at the end of December 31st -- at the end of the year, December 31st, 1999, Liggett had cash and cash equivalents on hand that's less than -- not billion, but that's less than \$3 million; is that right?

A. Yes.

Q. And total current assets which would include accounts receivable, inventories, that was only about \$81 million?

A. Yeah.

Q. Is that right?

A. Again, in an industry that generates the kind of cash flow that this -- that may be low cash for some industries, say -- investing in real estate can be quite frightening; that low numbers of current cash in a business like tobacco, where they generate huge cash flows are less telling indicators of a company liquidity. I mean, as you know, tobacco is one of the industries known for its ability to just generate cash, cash, cash.

Q. But you're not doubting the accuracy of this statement?

A. Oh, absolutely not.

Q. Okay. Thank you.

On the other side of the ledger, you saw current liabilities of \$49 million, correct?

A. Give me a second.

Q. I believe it's the next page.

A. Yes.

Q. And we saw the stockholders' equity, which you agreed yesterday was equal to total assets minus total liabilities, and under generally accepted accounting principles, something called book value, net worth, of a little bit under \$34 million; isn't that right?

A. Yeah. Again, they use the more -- the correct -- other companies it was shareholders' equity; here it's stockholders' equity.

Q. Again, you have no reason to doubt that Liggett's stockholders' equity at the end of 1999 was shy of \$34 million; is that correct?

A. No, I do not.

Q. Now, Professor, as I understand your testimony correctly, despite the fact that Liggett's stockholders' equity, according to generally accepted accounting principles, is somewhere around \$34 million at the end of 1999, it is nevertheless your opinion that there is some sort of transaction or transactions that can be performed whereby Liggett's assets could be used to raise \$900 million, \$1.8 billion, for paying a punitive damage verdict in this case?

A. As I discussed what is now two days ago -- it seems like yesterday -- that everyone knows these are balances in accounts; these aren't values. Your ability to raise money today is based on your value. Your ability to raise money over time is based on your ability to get your hands on cash.

Q. Okay.

A. These numbers are based on the history. Eve does not appear on these numbers. I don't know what the value of Eve is; probably not that great because you don't have that many brands. But nowhere on these numbers, because you expense -- you treat it as money thrown out the door: All your advertising building up the Eve name, all the customer relations associated. You also, if I remember correctly, have one big customer.

The relationship with that customer does not appear here. It's been filled; it's been nourished over the years. None of that value appears on those numbers.

Q. Professor, I assure you, we'll get to that. What you had said was the higher numbers based on Liggett's ability to get cash, right? Your number is based on their ability to get cash. And through a transaction --

A. Right.

Q. -- presumably what you said yesterday, a dead offering, something to that effect?

A. Accessing the equity markets -- the capital markets.

Q. Accessing the capital markets. Now -- correct me if I'm wrong -- yesterday, when the lawyer for Philip Morris, Mr. Lerman, was questioning you, you stated that you don't know, you're not privy to information as to whether any of these companies have had any problems recently in accessing the capital markets; is that correct?

A. Well --

Q. That's not what you said?

A. My understanding from the public records is they've not even thought about accessing the equity markets. Whether they've had trouble getting a bank loan, I don't know.

Q. Okay. Professor, I want to talk to you about what sort of access Liggett may have to the capital markets, because that's what your valuation is really about, right?

A. Yes.

Q. Now, from looking at the company's financial statements that you were provided, you already know that one of Liggett's parent companies already has a significant amount of debts on its books?

A. Oh, yeah.

Q. That's correct, right?

A. Oh, yes.

Q. In fact, it was something called senior secured notes outstanding --

A. Right.

Q. -- that are payable by the company in time in about six months, January 31st, 2001?

A. I'm sorry. Which company?

Q. It's by one of Liggett's parent companies. I think it's called BGLS. Did you see that? Brooke --

A. I know you renamed your companies. I would have to check the chart. I know you have a great deal of debt.

Q. You have no reason to disbelieve what I just told you?

A. No.

Q. And the principal amount of that is somewhere around \$80 million?

A. 80 million.

Q. 80 million. Not \$800 million?

A. Not Philip Morris numbers.

Q. Not Philip Morris numbers. 80 million. And not even your numbers, right? 80 million is not 900 million. It's not \$1.8 billion. It's 80 million?

A. Right.

Q. Do you know what the term "senior secured notes" means?

A. Presumably that they are the most secured against nonsenior, but perhaps better secured than even more senior.

Q. When notes are secured -- correct me if I'm wrong --

A. Not secured. Their order of priority on distribution. They may not actually be secured. Let me back up. Some of these companies -- one that comes to mind is RJR. They don't just borrow money; they borrow money in layers. Because lenders, particularly in the public capital markets, have different degrees of risk. Some people, like myself, are very conservative and just put their money in the bank or in really good -- or invest by taking back notes from very conservative corporations because we don't want risk. We're willing to not have big interest rates in exchange for not taking risk. I'm risk adverse. Why did I become a tax lawyer. Good question.

Q. My question --

A. Let me just finish this answer.

Q. Do you want me to sit down?

A. Yes, but putting that aside -- What happens is they -- the companies borrow in layers, so that their most risky debt plays a higher interest rate; next less risky debt pays a lower interest rate. Therefore, they come in layers like a cake, where the most senior is -- has the first right to the assets and pays the lowest interest rate. As you get less senior, they pay a higher interest rate, but it's riskier. It has to stand in line after the other debt.

Q. What you just said, the most senior pays the lowest interest rate --

A. That is correct.

Q. And a secured note means that it's collateralized?

A. Well, it means that under the law, the lenders not only can go against -- fight with other lenders for the assets of the company, but they've got specific legal interest and specific properties that enables them to get the assets before anybody else, so they're the most safe.

Q. So they have first priority on those assets?

A. Yes.

Q. Before tort claimants?

A. In general.

Q. Now, the senior secured notes, BGLS-senior secured notes, whatever you want to call them, they are collateralized by Liggett's parent company's interest in Liggett?

A. Right.

Q. They are secured by the stock in Liggett; isn't that correct?

A. I don't know that for a fact. That's a common structure.

Q. So these secured noteholders --

A. Uh-huh.

Q. -- according to you --

A. Yeah.

Q. -- would have first priority on the stock, the assets of Liggett?

A. If they are the only people with a security interest --

Q. Assuming that's correct.

A. Yes.

Q. So, Professor, just the existence of these senior secured notes, that have a priority position as to Liggett's assets, just their existence alone likely would have a negative impact on Liggett's ability to raise further capital for the purposes of paying --

A. So you're piercing the veil the other way now?

Q. I'm not suggesting any sort of piercing the veil. If Liggett's assets --

A. You told me I couldn't look at the corporate structure for valuing companies. Now you're looking at the corporate structure for valuing companies the other way.

Q. This is a very simple question.

THE COURT: Listen to the question. He raised the question. You give him the answer.

BY MR. MARKS:

Q. I'm just looking at Liggett.

A. Yes.

Q. The fact that Liggett's assets, that someone already has a senior priority --

A. Are the assets pledged or the stock pledged?

Q. The stock is pledged.

A. Right, so the assets are not pledged.

Q. That's correct. I'm going to move on. Professor -- actually, I'm going to stick with the notes for a second. Professor, do you know what the interest rate is that Liggett's parent pays on those notes?

A. No.

Q. It's in the 10-K. 15.75 percent interest?

A. That's the stated rate.

Q. What is the difference?

A. Yield is what the economic effect is. I did not check the yield.

Q. Do you think that Liggett pays less than 15.75 percent? Do you have any reason to believe they pay less?

A. I have no reason to believe.

Q. That's a remarkably high interest rate, isn't it?

A. In the current economic climate.

Q. What is the prime rate today?

A. It's like 7 something.

Q. So they're paying more than double of prime; is that right?

\* \* \*

Q. I'm correct, am I not, that you have not done any analysis or study, surveying the investment community, the capital markets, to determine what further funds, what further cash Liggett or its affiliates could access through issuance of bonds or notes, taking on other debt, to fund the transactions that you contemplate this company would have to undertake to raise the sort of funds that you're talking about?

A. I'm sorry, I -- lost -- I have not --

Q. You have not -- I will shorten it up. You haven't done any study, you haven't done any analysis, you haven't done any survey of the investment community, the capital markets, to figure out whether Liggett can fund the sort of transaction that you're talking about?

A. That is correct.

**The defendant's counsel asks the plaintiff's expert how the defendant would tap into the value in the brand names it owns. Cross Examination Testimony of George Mundstock (Plaintiff), *Engle v. R.J. Reynolds Tobacco Co. et al.*, June 7, 2000, Pp. 31-34.**

A. I mean, for example, if I understand your financial statements correctly, it appears that transaction costs were 5 million of the 300 million.

Q. For the Liggett brand sale?

A. For the Liggett brand sale.

Q. But, Professor --

A. That's a big number.

Q. That's a big number. But, Professor, we're talking about -- the Liggett brand sale was a transaction between two corporations. You didn't have, in the Liggett brand sale, to go out to the capital market --

A. But it was --

Q. -- and attract investors, right?

A. But you had --

Q. You didn't have investment bankers?

A. But you had absolute state-of-the-art tax planning in there that I'm sure you paid Price Waterhouse, your, quote, "independent auditors," a small fortune to do.

Q. Professor, the sort of transaction you're talking about is not between two companies; it's between a company and whatever capital you can get from the vast capital market?

A. Right. So you can't do the kind of tax planning that was done on the brands transaction.

Q. Professor, if your testimony is accepted and judgments for punitive damages are entered against each of these five defendants in the order of magnitude that you've been talking about, all of the companies likely would be going to this capital market at or about the same time; is that right? I'm not asking when; but at some point --

*Focus Point: The defendant's counsel will emphasize the hurdles involved in extracting liquidity from the value of the defendant's brand names. Ideally, the defendant's counsel wants the jury to believe that the only way to extract such value is to sell the brand name. Much of the value of cigarette companies is in their brand names. So, selling brand names hits their bottom line hard. Because the goal of punitive damages under the law is not to force a defendant out of business, the defendant's counsel may be preparing to argue at closing that the value of brand names should play only a small role for the jury in calculating punitive damages.*

*Note that selling brand names is obviously not the only way to extract cash from them. The defendant's can use the brand name as collateral in borrowing cash or the defendant can simply raise prices, as some manufactures did to make payments under the 1998 Master Settlement Agreement payments.*

A. Well, you know, again, I can't tell you. I mean, that -- at what point you decide to start pricing or deal -- or whether you're going to hold your breath until the process is over and then all panic at the last minute, living in denial, I mean, I can't tell you that. But if

you all hold your breath, wait until the absolute last minute and then suddenly realize you have to pay money and it's required that you pay it all at once, which doesn't seem realistic, yeah, that's right.

Q. Professor, if there's a verdict in this case, the capital market will know --

A. It's --

Q. -- the capital market will know that everyone of these five companies is -- at some point is going to be going to the capital market, right? So even if Liggett goes today and Philip Morris goes a year and a half from now, the market is going to know that Philip Morris is going to be there eventually?

A. But to the extent liquidity is a concern in the capital market, if you spread it over time and don't all go at once, it's not -- there's -- the simple -- I mean, the simple reality of moving this kind of money all on one day is absolutely unprecedented. So that effect is considerably larger than the effect of all of you raising capital tactically, properly planned, over whatever period you have from when you decide you might need it to when you actually have to pay it. And more to the extent that you can then further pay it over time, again, it has less effect on the total liquidity on the market.

Q. So what you're saying is if these five companies came up with some sort of tactical plan, maybe they could work something out?

A. The assumption that they would be self-destructive and all wait and all try to pay a lump sum, the fact that the Court will make them pay, all of them pay on the same day -- even though that's stupid for everybody involved -- it's --

MR. ROSS: Objection, Your Honor.

THE COURT: Well, yeah. I think we are really going into an area that --

MR. MARKS: I'm going to move off this, Your Honor.

THE COURT: Okay. I'll sustain the objection, if you're going to move on.

BY MR. MARKS:

Q. Professor, of these five companies, right, going to the capital market, Liggett would be the least attractive of the five, for an institutional investor?

A. For an institutional investor, absolutely.

**The plaintiff's expert describes the impact of the 1998 Master Settlement Agreement. Direct Testimony of Joe Cherner (Plaintiff), *Engle v. R.J. Reynolds Tobacco Co. et al.*, May 31, 2000, Pp. 38-55.**

Q. Have you figured out -- well, since the tobacco companies voluntarily entered into the Master Settlement Agreement, where they obligated themselves to pay some \$246 billion, have they raised their prices?

*Focus Point: The defendant's counsel would like to argue that the 1998 Master Settlement Agreement provided sufficient impetus for the tobacco industry to change its ways, and thus, punitive damages are no longer necessary. That impetus, according to the tobacco industry, is in the form of the Agreement's marketing restrictions and the obligation to remit settlement payments to states. The plaintiff's counsel rebuts this argument by showing that the tobacco industry has made the settlement payments with very little disruption to their bottom line.*

A. Absolutely. The way that the tobacco industry is able to pay a sum as enormous as \$246 billion, which sounds to us like an enormous number -- actually, it isn't very difficult for them to raise at all. There are 50 million smokers. And there are trillions of cigarettes sold each year. So, for the tobacco industry, in order to raise large sums of money, all they have to do is simply raise prices. So, what the tobacco industry did, approximately, in order to pay for the \$250 billion settlement that they agreed to pay to the attorneys general, under a different lawsuit, they simply raised the price of cigarettes approximately four and a half cents a cigarette, which turns into about 80-some cents a pack. There's 20 cigarettes in a pack. Approximately 90 cents a pack. A little bit less than that. That's all they had to do. They raised cigarette prices by approximately -- it was 85 cents a pack, and then they're able to pay this agreement, where they're paying approximately \$10 billion a year to the states around the country. That's how they're able to raise that money, just by simply raising the price of cigarettes.

Q. Did you calculate, if they raise the price of cigarettes by about 85 cents a pack, how many billions of dollars is raised by doing that; for example, if you've got 50 percent of the market or 25 percent of the market?

A. Yes, sir. Actually, I did it a little bit easier, by using five cents a pack, because the numbers are just rounder and it's easier. And I would suggest, if the tobacco industry wasn't in need to pay off an amount of money for any reason, whether it be the Master Settlement Agreement or any other penalty that they were found to be -- to have to pay, if they were to raise the price of cigarettes by five cents a cigarette, which is a dollar a pack, by raising the price of cigarettes a dollar a pack -- and I have a chart. Am I allowed to use it? I don't know.

\* \* \*

Q. With that price rise?

A. Yes. If the tobacco industry was to raise cigarettes by five cents per cigarette, which is a dollar per pack of 20, they would raise an additional 20 -- almost \$21 billion a year, assuming there was no decrease in consumption. If there was a decrease in consumption, which we have seen from after the Master Settlement Agreement in 1998, when they agreed to pay 250 billion -- they raised the price of cigarettes by approximately 85 cents a pack, and we did see a decrease in consumption. So there will most likely be somewhat of a decrease in consumption. But if there were, for example, a 10 percent decrease in consumption of cigarettes because they raised the price a dollar a pack --

*Focus Point: The marketing restrictions in the 1998 Master Settlement Agreement appear to have had very little effect on industry conduct. Tobacco manufacturers often tout the efficacy of the Agreement and argue punitive damages are not necessary. However, public health professionals have generally concluded that the Agreement is largely ineffective. Additionally, in the Federal Government's lawsuit against the tobacco industry under the federal Racketeering Influenced and Corrupt Organization Act, Judge Kessler determined that the Agreement "has not sufficiently altered [the tobacco industry's] conduct to justify not imposing appropriate remedies" in this case. In short, the judge found that more was needed to deter the tobacco industry from future wrongdoing.*

\* \* \*

A. If they -- if there was to be, for example, a 10 percent decrease in consumption, then instead of raising \$21 billion, they would raise approximately \$19 billion a year. Not one time, but a year. And that's extremely significant. It's per year, \$19 billion per year forever.

Q. So what you're saying is, when they raise the prices by a substantial sum, like five cents a cigarette, that there are a certain number of smokers who drop out of the market; they won't pay the higher price, but looking at the big picture and taking all of that into account, are you saying that, in spite of cigarette consumption going down in terms of the number of smokers, the profits to the tobacco companies go up?

A. Absolutely.

\* \* \*

Q. Is the tobacco industry today, in spite of the Master Settlement Agreement and its obligations under the Master Settlement Agreement, from your standpoint with your financial background, are they doing well?

A. They're doing very well.

Q. In your opinion, in the foreseeable future, do you expect that they will continue to do well, financially and economically?

A. Yes, sir. They will do even better financially and economically in the foreseeable future.

**The defendant's counsel discusses the defendant's accounting with its controller. Direct Testimony of Richard Adams (Non-Expert Witness for Defendant), *Whitely v. Raybestos-Manhattan, Inc. et al.*, March 23, 2003, Pp. 5986-88.**

Q. And from an accounting perspective, how does that difference between the purchase price of the company and the previous net book value of the company get reflected in the balance sheet?

*Focus Point: The defendants in tobacco litigation rarely introduce expert witnesses on punitive damages. Rather, they have employees testify about the defendants' financial records.*

A. Well, when it gets put on the balance sheet, it's called goodwill. And at the time, the goodwill was -- it was about \$14 billion. I mean, it was an enormous sum of money.

Q. Is there anything improper from an accounting perspective in characterizing this premium that was paid for R.J.R. Nabisco above its net book value as goodwill?

A. No. On the other hand, it's entirely proper and there's lots of accounting literature that directs you as to how to do it and what to call it.

Q. And how has that goodwill been treated on the financial records, and in particular, the balance sheet of R.J.R. Nabisco, and now R.J. Reynolds Tobacco Holdings, Inc., over the course of time?

A. Well, once it's established, the way that you account for goodwill is to expense it periodically over a period of years. And that period of years is -- at the time, the rules were not more than 40 years. So each year, they would expense 1/40th of that \$14 billion into their profit and loss statements.

Q. So you simply take the difference between the purchase price of the company and its net book value at the point in time of the purchase, then take that difference, put it into goodwill, and then amortize that over time on a gradual basis, reducing the number?

A. That's right.

Q. Do I have that right?

A. That's right. It's just like depreciation on fixed assets.

Q. Was there anything else about the LBO transaction that had an effect on the balance sheet of the company other than this goodwill entry?

A. Well, yes. I mean, we had to value our trademarks. That's also the thing that happens in a purchase transaction or a leveraged buyout. And so values were assigned to our trademarks, Winston, Salem and other cigarettes and some of the other brands that were present for the other companies.

Q. And how was that valuation accomplished?

A. An independent appraiser is hired, and they look at the information at that point in time and try and determine some future value for the brands. I mean, I'm not an appraiser. I can't tell you exactly how they do it. The appraisals were to be independent and values were assigned.

Q. So those values are entered as values under trademarks on the balance sheet. And are they amortized over time as well?

*Focus Point: This testimony is in response to the plaintiff's expert's valuation of cigarette brand names. Excerpts of testimony by Robert Johnson provided above show how the plaintiff's counsel values the defendants' brand names based on the defendant's purchase of brand names from other tobacco manufacturers. In this line of questioning, the defendant's controller would have the jury believe that the value of the brand names started decreasing the moment they were purchased. .*

A. They are. It's the same 40-year period. The concept is identical, 1/40th every year.