

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,	.	
	.	
Plaintiff,	.	Docket No. CA99-02496
	.	
v.	.	
	.	
PHILIP MORRIS USA, et al.,	.	Washington, D.C.
	.	May 10, 2005
	.	
Defendants.	.	
.	

VOLUME 102
MORNING SESSION
TRANSCRIPT OF BENCH TRIAL PROCEEDINGS
BEFORE THE HONORABLE GLADYS KESSLER,
UNITED STATES DISTRICT JUDGE

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Proceedings reported by machine shorthand, transcript produced
by computer-aided transcription.

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1 MORNING SESSION, MAY 10, 2005

2 (9:44 a.m.)

3 THE COURT: All right, everybody. Good morning. This is
4 United States versus Philip Morris, CA 99-2496. We have a number
5 of preliminary matters, and I gather there's something that
6 Mr. Frederick wants to address. I indicated in an order I
7 issued, I think on Friday or Saturday, that I would put on the
8 record in some detail this morning the reasons for my decision in
9 terms of admitting Dr. Bazerman's testimony and I will do that.
10 But unless there's some problem with going forward, I would like
11 to actually begin our day with the testimony of Dr. Gruber. I
12 believe there will be direct testimony and I think you're going
13 to take an hour for that, or am I wrong about that?

14 MR. GETTE: Your Honor, James Gette for the United States.
15 I think we'll be somewhat shorter than an hour, actually.

16 THE COURT: All right.

17 MR. GETTE: I'm not exactly sure, 35 to 45 minutes is my
18 guess.

19 THE COURT: And then my recollection is there's going to
20 be very extensive cross?

21 MR. BIERSTEKER: I expect about three, four hours, Your
22 Honor.

23 THE COURT: Oh. All right. For some reason I thought
24 longer, but that's fine. Then let's call him in, please.

25 (JONATHAN GRUBER, Ph.D., GOVERNMENT'S WITNESS, SWORN)

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1 DIRECT EXAMINATION OF JONATHAN GRUBER, Ph.D.

2 BY MR. GETTE:

3 Q. Good morning, Your Honor. Again, James Gette on behalf

4 of the United States. Good morning, professor, could you please

5 introduce yourself to the Court.

6 A. My name is Jonathan Gruber. I'm a Professor of Economics

7 at MIT.

8 Q. Professor Gruber, in front of you is a document entitled

9 "United States Written Direct Examination of Jonathan Gruber,

10 Ph.D." Do you recognize that document?

11 A. Yes, I do.

12 Q. And what is that document?

13 A. That's my direct testimony in this case.

14 Q. Do you have any changes or corrections that you need to

15 make to that testimony?

16 A. No, I do not.

17 Q. Then, do you adopt that written direct examination as

18 your testimony in this case?

19 A. Yes, I do.

20 MR. GETTE: Your Honor, I would ask that Professor

21 Gruber's written testimony be accepted into evidence.

22 THE COURT: Any objection at this point?

23 MR. BIERSTEKER: Only subject to the objections that we

24 filed.

25 THE COURT: It may be admitted at this time.

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1 MR. GETTE: Your Honor, also, based on that, we would like
2 to move Professor Gruber to be recognized as an expert in
3 economics.

4 MR. BIERSTEKER: No objection, Your Honor.

5 THE COURT: All right. He may definitely be recognized as
6 an expert in economics.

7 MR. GETTE: Thank you, Your Honor.

8 BY MR. GETTE:

9 Q. Professor Gruber, have you developed a remedy for the
10 Court to consider in this case?

11 A. Yes, I have.

12 Q. Okay. Can you, just to get us started, briefly explain
13 that remedy for the Court?

14 A. Certainly. What I developed is a forward-looking,
15 outcome-based remedy that's designed to remove the financial
16 incentive for the defendants to undertake any RICO violating
17 activities that make their products appealing to youth. In
18 summary, the way that this forward-looking remedy works is that
19 there's a set of reduction targets that are laid out. These
20 reduction targets are based on the targets proposed themselves
21 by the defendants as part of the 1997 Proposed Resolution. If
22 they meet these targets, then there's no assessment on the
23 defendants. If youth smoking, however, is not reduced to these
24 target levels, then there is an assessment of \$3,000 for each
25 youth by which the targets are missed.

1 Q. Now, starting with targets and the timelines for those
2 targets, did you prepare a demonstrative exhibit to demonstrate
3 the different timelines and targets related to the
4 forward-looking remedy that you have proposed to the Court?

5 A. Yes, I did.

6 Q. Okay. Charles, if you could pull up U.S. Exhibit 18255.
7 Can you explain this graph to the Court?

8 A. Certainly. So, the blue line at the bottom of this graph
9 shows the path of youth smoking reductions that was proposed
10 under the 1997 Proposed Resolution. That resolution gave those
11 reduction targets in terms of years from enactment. So I
12 assumed for purposes of this demonstrative that the resolution
13 was enacted in 1998. If the resolution was enacted in 1998, the
14 reductions would have been a 30 percent reduction in youth
15 smoking by 2003, or five years after enactment; a 50 percent
16 reduction in youth smoking in 2005, or seven years after
17 enactment; and a 60 percent reduction in youth smoking by 2008,
18 or ten years after enactment.

19 What the red line shows is the time path of youth
20 reduction that is suggested under my proposed forward-looking
21 remedy. Under this remedy, the defendants would receive credit,
22 in essence, for the youth smoking reduction already achieved,
23 the roughly 30 percent reduction youth smoking that we've
24 already seen from that proposed baseline. Therefore, they would
25 start from that lower level and they would gradually step down

1 to that same ultimate reduction of roughly a 60 percent decline
2 in youth smoking. However, the pattern would be much slower.
3 Now that reduction would be achieved by 2013 rather than by
4 2008.

5 Q. You mentioned certain rates off a --

6 THE COURT: Let me just be clear on something. It would
7 be achieved by 2013 because defendants were getting credit for
8 the reduction which had already been achieved by the start of the
9 calculations; is that right or is that wrong?

10 THE WITNESS: Well, those are related. They would be
11 getting credit, but also it's designed to phase in somewhat more
12 slowly. We could have given credit and still -- I could have
13 given credit and still have it be achieved at the same time, but
14 this is the idea here, was to recognize the credit and to allow a
15 somewhat slower path of reductions to achieve that same level.

16 BY MR. GETTE:

17 Q. Let's just make sure we understand the credit you're
18 talking about for that already achieved.

19 You mentioned a baseline. What was the baseline that the
20 1997 Proposed Resolution was built off of?

21 A. The 1997 Proposed Resolution proposed reduction targets
22 in youth smoking relative to the average youth smoking rate from
23 1986 to 1996. That's the baseline for that proposed resolution.

24 Q. Now, has there been already some reduction from that 1986
25 to 1996 baseline that has been achieved as of 2003?

1 A. Yes, there has been.

2 Q. Okay. And what is that reduction?

3 A. By 2003, youth smoking had fallen by about 30 percent or
4 what the proposed resolution had suggested a target for that
5 year.

6 Q. And is it that reduction that you're suggesting to the
7 Court the defendants would get credit for under your proposed
8 forward-looking remedy?

9 A. Yes, that is true.

10 Q. Now, let's talk about the timelines. Under your
11 forward-looking remedy, when would the proposed reductions reach
12 the full target reduction of 60 percent?

13 A. Under my timeline, that full target reduction of
14 60 percent, rather than being achieved in 2008 as under the
15 proposed resolution, would be achieved five years later in 2013.

16 Q. Now, if the Proposed Resolution had taken effect in 1998,
17 would defendants have faced any monetary assessment in the most
18 recent complete year of 2004?

19 A. No, they would not have, because youth smoking by 2004
20 had fallen by more than 30 percent from its 1986 to 1996
21 baseline.

22 Q. Now, so far this morning you've talked about a 60 percent
23 targeted reduction. In your written direct testimony you also
24 talk about a 42 percent reduction. Can you explain the
25 relationship between those two percentages?

1 A. Certainly. The 60 percent reduction was off the 1986 to
2 1996 baseline. The proposed forward-looking remedy that I
3 designed is relative to a 2003 baseline. As I mentioned, youth
4 smoking had already fallen by 2003 to about 70 percent of its
5 1986 to 1996 level. Reducing by the remaining 30 percent off
6 that 70 percent base amounts to 42 percent reduction, or in
7 other words, if there was a hundred smokers in '86 to '96, those
8 had already fallen to 70. To reduce it to 40 is a 42 percent
9 reduction from 70.

10 Q. Now, I'd like to talk for a moment about what the
11 reduction means in terms of real kids. Have you prepared a
12 demonstrative to show the meaningfulness of your targets in
13 terms of the reductions in youth smoking in this country?

14 A. Yes, I have.

15 Q. Charles, let's look at U.S. Exhibit 18256.

16 Can you explain this chart to the Court?

17 A. Certainly. This is a -- what I call an illustrative
18 example because the numbers are rounded a bit to make it easier
19 to follow, but in 2003 there were roughly 5 million youth
20 smoking in the U.S. Under the reduction target proposed, which
21 is once again a 42 percent reduction from that level, or which
22 is equivalent to a 60 percent reduction from the old '86 to '96
23 level, that would fall to about 2.9 million for reduction of
24 about 2 million youth smokers.

25 Q. Are the targets that you set in your forward-looking

1 remedy achievable?

2 A. Yes, they are.

3 Q. What is the basis for your opinion that these targets are
4 achievable?

5 A. I base my opinion on three factors. First, these are
6 targets which were suggested by tobacco manufacturers, including
7 the defendants themselves, as part of the 1997 Proposed
8 Resolution. Second, as plaintiff's other experts have testified
9 on repeated occasions, there are a number of marketing/promotion
10 activities that defendants can undertake to make their products
11 appealing to youth and, therefore, by discontinuing those
12 activities, it would be possible to move at least part way
13 towards meeting these goals. And finally, as has been shown
14 repeatedly in the health economics literature, youth are very
15 price sensitive in their smoking decisions, so these targets can
16 also be met by increasing prices to reduce youth smoking.

17 Q. What amount -- how do you calculate an amount by which
18 defendants would be required to raise their prices to meet the
19 targets that you propose under your forward-looking remedy?

20 A. No, I haven't calculated that amount because, as I said,
21 they can meet it through a mix of price and non-price-based
22 approaches. Indeed, one thing I view as a great merit of this
23 outcome-based remedy is it lets defendants choose the mix that
24 most efficaciously meets these targets, choose the mix of price
25 and non-price. So I can't say exactly how much price is going

1 to go up to meet the targets.

2 THE COURT: Did you do any calculations about what the
3 amount of price increase would be if defendants under your
4 proposal chose to reach the target rates only by raising prices?

5 THE WITNESS: Yes, I did.

6 THE COURT: And what would that amount be? I think it's
7 in your direct.

8 THE WITNESS: I estimate that would require a 42 percent
9 increase in prices over the seven-year period to -- if -- in an
10 extreme case, which I don't expect to happen, but if they had to
11 do it only through prices, I estimate that would require a
12 42 percent price increase over this sort of seven-year period.

13 BY MR. GETTE:

14 Q. And Professor Gruber, can you explain how you reached
15 that 42 percent figure?

16 A. Certainly. Once again, as I want to emphasize, this is
17 an extreme case to only do it through price. I presume, as I
18 said, there will be some mix of non-price and price activities
19 that are used to meet this target. But if it was only done
20 through price, I used the best estimate available of the
21 sensitivity of youth to price in their smoking decisions, which
22 is an elasticity of minus one; that is, for every 10 percent
23 increase in price, youth are 10 percent less likely to smoke.
24 That suggests that a 42 percent increase in price would be
25 required for a 42 percent reduction in the level of youth

1 smoking.

2 THE COURT: And, of course, if defendants chose that
3 method of complying, the price increases would apply to everyone,
4 not just youth, right?

5 THE WITNESS: That's correct.

6 THE COURT: And have you -- and maybe I'm getting into the
7 defendants' cross so I think this will be my last question, have
8 you made any calculations as to what amount of the market
9 defendants would lose -- what amount of the adult market
10 defendants would lose by those price increases?

11 THE WITNESS: There's -- I have not. There's not really
12 very good evidence of which I'm aware of the -- what we call the
13 cross price elasticity, the sensitivity of the market of
14 particular manufacturers to their particular prices. We don't
15 really have good evidence on that.

16 THE COURT: That surprises me, but okay, go ahead.

17 BY MR. GETTE:

18 Q. Related to that, Professor Gruber, have you analyzed if
19 in fact defendants chose to meet this purely by price, based on
20 historical information, whether or not defendants could, in
21 fact, achieve the targeted reductions?

22 A. Yes, I have. Indeed, recent history, in recent history,
23 say from 1997 to 2002, defendants raised their prices by much
24 more than 42 percent, by about 60 percent, and in that case
25 moreover that was an increase in prices that was going largely

1 to pay off settlement payments, and despite the larger increase
2 in price, and despite the fact that they didn't get to keep a
3 lot of the proceeds from that price increase, the industry
4 remains profitable today.

5 Q. Just so I understand that historical price increase that
6 you looked at, was that more or less than the percentage
7 increase that would be required if the defendants chose to meet
8 your targets purely through price?

9 A. Once again, in the extreme case, which I don't expect to
10 happen, where they choose to meet it purely through price, that
11 would be much less of a price increase than we've actually seen
12 over the 1997 to 2002 period, which is about 60 percent.

13 THE COURT: Do you happen to know, does that price
14 increase that you've referred to in your direct testimony and
15 this morning, does that account for the 30 percent drop in youth
16 smoking or were those events at two different times?

17 THE WITNESS: That's a very good question. I'm a strong
18 believer that it's hard to take two time series and causally
19 relate them when many other things are going on. I feel -- my
20 opinion is that that price increase had a lot to do with the
21 reduction in youth smoking we've seen over this past period, but
22 I can't -- I can't claim there's a one-for-one correspondence,
23 but certainly it had a lot to do with it.

24 BY MR. GETTE:

25 Q. Let me just conclude this area of testimony by asking

1 you, would you expect these defendants to meet the targets
2 purely by raising price 42 percent?

3 A. No, no, I don't expect that. Once again, the idea of
4 this remedy is to let them choose the most efficacious way to
5 meet the targets. I doubt purely raising price would be that
6 method.

7 Q. And is there a reason why you determined that it would be
8 most efficacious for defendants to have the ability to choose
9 their method of meeting the targets?

10 A. Yes. Defendants are the ones who know best how to appeal
11 to youth smokers, so rather than my telling them how to reduce
12 youth smoking, I want to set up an incentive for them to choose
13 the method that's best.

14 Q. Let's move on from targets now and talk about
15 assessments, Professor Gruber. Earlier you mentioned
16 assessment, and what is the assessment amount that you propose
17 in your remedy?

18 A. Once again, if defendants meet the targets, there's no
19 assessment amount under the remedy, but if they do not meet the
20 targets, then the proposed assessment amount is \$3,000 per youth
21 smoker by which the targets are missed.

22 Q. And what does that assessment amount represent?

23 A. That assessment amount represents an estimated upper
24 limit on the financial benefit to a defendant from attracting a
25 youth smoker to their product.

1 THE COURT: All right. I want to focus in on that, and
2 again, I don't usually tread on other people's -- or other
3 parties' cross or questioning, but I need to understand that,
4 your testimony.

5 In your direct you use a term repeatedly and that term is
6 "proceeds". What do you mean by that term "proceeds"? Are you
7 talking about gross income, are you talking about net profits,
8 are you talking about before tax profits, after tax profits?
9 What is your definition of that term within the context of your
10 testimony.

11 THE WITNESS: That's a good question. Let me answer it in
12 two ways, sort of one conceptually and then one in more detail.
13 Conceptually the idea of this calculation is to ensure that on no
14 youth smoker is there financial benefit for the defendants. The
15 idea of this is to say on that last youth smoker they might
16 appeal to, what is the money they'll make on that marginal last
17 youth smoker. That's going to be the revenue, the net revenue
18 from selling the cigarette to that youth smoker minus the direct
19 cost of producing that cigarette.

20 So, the concept of --

21 THE COURT: Well, that's what net revenue would be in any
22 event minus the direct costs.

23 THE WITNESS: Minus the direct costs, exactly. So -- and
24 in particular, what's done is the -- we take the net revenue
25 minus the direct costs and that's used on the after tax basis.

1 That's the last part of your question because, obviously, what
2 matters to them is their after tax proceeds. So that's the
3 concepts used. It's the concept of what is the benefit to them
4 of that last cigarette sold. It's the net revenue minus the
5 direct cost after tax.

6 BY MR. GETTE:

7 Q. Let's step through each of the steps that you used to
8 arrive at your assessment amount to make sure that everyone
9 understands how we get there, because it's a fairly long
10 process. Have you prepared some demonstratives to walk us
11 through that?

12 A. Yes, I have.

13 Q. Okay. Let's start with U.S. Exhibit 18257.

14 A. This --

15 Q. So starting with this, can you just give us the overview
16 of the flow of your calculation of your assessment?

17 A. Absolutely. So this provides, as you said, an overview
18 of how I calculate this estimated upper limit on the financial
19 benefit to defendants from making their product appealing to
20 youth.

21 The first step is to say, given that someone is a youth
22 smoker, what is the odds that they're still alive and smoking at
23 each future age. So I'm going to go through at age 21, 22, et
24 cetera, and say given that you smoked as a youth, what are the
25 odds you're still alive and smoking at each of those future

1 ages?

2 The second step is to say, well, then if you are alive and
3 smoking at each of those future ages, how many cigarettes are you
4 smoking per year as a smoker?

5 The third step is to ask what the proceeds are, referring
6 to the Judge's earlier question, to calculate the proceeds on
7 each of those cigarettes that are consumed at each future age by
8 these former youth smokers.

9 Finally, those three are put together to get the key
10 concept, which is if someone's a youth smoker, what is the
11 expected proceeds that's earned on them in each future year, in
12 each future year as they age.

13 And then finally, since those proceeds are in future
14 dollars and what defendants care about is present value dollars,
15 those are discounted back to today and added to get to \$3,000.

16 Q. Okay. Now, let's take each of those steps individually
17 and make sure I understand them. And if you'll pull up,
18 Charles, U.S. Exhibit 18258.

19 Professor Gruber, can you explain how you determine the
20 first step of your estimation, the future likelihood of being
21 alive and smoking?

22 A. Yes, certainly. Once again, the goal here is to ask,
23 given that someone smoked as a youth, what is the likelihood
24 they're alive and smoking at each future age. So to do that, I
25 first calculate what is the odds that if they're alive they're

1 still smoking. To do that, I use age specific quit rates among
2 those who started smoking as a youth. These age specific quit
3 rates are calculated from the 2001 on to 2003 National Health
4 Interview Survey, which is the largest national representative
5 most commonly used survey on smoking in the U.S. I then want to
6 say, okay, we also need to compute what is the odds that they're
7 alive at each future age given they were a youth smoker. To do
8 that I take age specific mortality rates from the Social
9 Security Administration, adjust those for the fact that smoker
10 mortality is much higher, using data from Dr. Timothy Wyant, to
11 get an age-specific smoker -- smoker-specific mortality rate at
12 each future age. Putting those two together, I attain the odds
13 that someone who smoked as a youth is still alive and smoking at
14 age 21, 22, and so on up through age 65.

15 Q. And is it accurate that your estimations are based on an
16 assumption that the individuals have been smoking as a youth?

17 A. Yes. The quit rate adjustments are; the mortality rate
18 adjustments are not. The mortality rate uses the age-specific
19 mortality from Social Security Administration with smoker-
20 specific relative risks that's not conditioned on having been a
21 youth smoker, but the quit rates are.

22 Q. Let's move on to your second step. If we can look at
23 U.S. Exhibit 18259.

24 Can you explain the second step of your calculation,
25 Professor Gruber, for the Court.

1 A. Certainly. Having computed in step one the odds that
2 someone who was a youth smoker is alive and smoking at each
3 future age, in step 2, I then assess how many cigarettes they'd
4 be smoking as an alive smoker at each of those future ages.
5 Once again, using the 2001 to 2003 NHIS surveys, I calculate the
6 tip -- the average number of cigarettes smoked by smokers at
7 each age who were youth smokers.

8 Q. Let's move on to step 3 and we'll go slowly through this
9 step because it is a complex step relating to the proceeds
10 amount.

11 Pulling up U.S. Exhibit 18260, can you explain for the
12 Court this third step of your assessment calculation?

13 A. Certainly. So, in this third step -- Once again, through
14 steps one and two I've obtained numbers, if someone is a youth
15 smoker, what is the estimated number of cigarettes they'll be
16 smoking at each future age. The third step is to put a monetary
17 value on that, to multiply it by the proceeds that defendants
18 would earn from each of those future cigarette sales.

19 To do so, I start with a number for Philip Morris, which
20 is the largest and most profitable tobacco manufacturer
21 currently. Their real proceeds amount per cigarette in 1992,
22 which is their most profitable recent year, which is \$0.03.

23 Q. Let me ask you, why did you choose Philip Morris in 1992
24 for your assessment calculation?

25 A. I chose Philip Morris -- let me back up. It's important

1 to emphasize the goal here. The goal is to ensure that should
2 defendants not meet their targets, there will be no financial
3 benefit from making their product appealing to youth. That's
4 the sort of driving idea behind this remedy. To provide that
5 insurance, I need to account for what might happen to their
6 proceeds in the future. Right now, Philip Morris is the largest
7 and most profitable defendant; 50 years ago they weren't. In 10
8 or 15 years they may no longer be. So, I want to make sure that
9 should -- whoever is the largest and most profitable, that we
10 are charging an assessment large enough to recoup the financial
11 benefits that they could earn on -- the financial benefits they
12 would have from attracting a youth smoker. Likewise, Philip
13 Morris's proceeds have varied over time. They increased
14 dramatically during the '80s and early 1990s, peaking in 1992.
15 They've since fallen. Once again, since I don't know where
16 proceeds are going to be in the future, but I want to ensure
17 that should they get back to a level they've been demonstrated
18 to be achieved in the recent past, I want to ensure that there's
19 no financial benefit to attracting a youth smoker, I chose that
20 1992 level.

21 Q. Now, once you've established that 1992 level, did you
22 need to make adjustments to that proceeds amount?

23 A. Yes, I did.

24 Q. What adjustments were those?

25 A. First, I needed to adjust that 1992 number for inflation

1 to bring it to today's dollars. I used actual inflation to
2 bring it to 2004 dollars, which makes it about \$0.04 per
3 cigarette in real terms. I then assumed 3 percent inflation for
4 all future years.

5 Secondly, I include an additional adjustment to account
6 for the fact that defendants may achieve their youth targets by
7 raising price. Once again, I do not expect that the entire
8 42 percent reduction will be achieved by raising price, but it's
9 possible. And if they achieve those targets by raising price,
10 that will raise their proceeds and they will then earn -- they
11 will then, potentially, financially benefit from attracting
12 youth smokers. To ensure that even in that case, if they raise
13 prices by 42 percent, they don't financially benefit from
14 attracting youth smokers, I increased the proceeds by an
15 additional 50.4 percent over the 2007 to 2013 period.

16 Q. You've talked about a 42 percent price increase. If that
17 is the price increase that would be necessary to meet their
18 targets using only price, why is it that you have adjusted the
19 proceeds by 50.4 percent?

20 A. Once again, to motivate the idea of the analysis here,
21 the goal is to ensure that in any state of the world, there is
22 not -- to ensure -- to make my best estimate that any state of
23 the world there are not proceeds from attracting youth smokers.
24 One state of the world that I'm concerned about is the case
25 where they raise prices 42 percent to meet those targets. Then

1 the question becomes, well, how does a 42 percent increase in
2 price translate into proceeds, which is what I care about.
3 There's no theoretically right answer here. So I look to the
4 data. Nicely from 1993 to 2000, prices went up by almost the
5 same amount, by about 46 percent over that period. That's a
6 period over which I have proceeds data. That 46 percent
7 increase in prices from 1993 to 2000 translated to a 55 percent
8 increase in proceeds, suggesting a factor of 1.2 of translating
9 prices to proceeds. Applying that factor to the 42 percent, I
10 get my 50.4 percent increase in proceeds.

11 Q. Just to make sure I understand, is it accurate, then,
12 that once you've established the relationship between prices and
13 proceeds of 1.2, that you merely multiplied 42 percent by the
14 1.2 to get your 50.4 percent?

15 A. Yes, that's right.

16 Q. Okay. Now, did you --

17 THE COURT: Excuse me a minute. Well, what if the
18 companies, the defendants, chose your first option, or maybe it
19 was your second option, to take non-price related steps to reduce
20 youth smoking? What if they tried to do it all through marketing
21 efforts, obviously a change in marketing efforts? Wouldn't you
22 then have included a 50.4 percent increase that was
23 inappropriate?

24 THE WITNESS: Once again, the goal here is to ensure that
25 regardless of the actions they take they don't benefit. You're

1 right, if they didn't increase prices by 42 percent, then this
2 would be above the proceeds they could earn by attracting a youth
3 smoker. On the other hand, if they did increase price by
4 42 percent this would be a best estimate of those proceeds.

5 The goal here is to make sure that whichever route they
6 take, they don't financially benefit. You're exactly right that
7 if they take the route of non increasing price then this will be
8 higher than their financial benefit. Once again, if they meet
9 the targets they don't have to pay it, but the goal is to ensure
10 if they miss the targets they definitely do not benefit from
11 attracting that youth smoker.

12 BY MR. GETTE:

13 Q. Professor Gruber, in terms of the incentives for
14 defendants, what would occur if you didn't include this
15 adjustment?

16 A. If I didn't include this adjustment, let's say I didn't
17 do anything here, I didn't do -- I did zero instead of 50.4,
18 then to the extent that price was used at all to meet these
19 targets, then that would result -- that could result in proceeds
20 per youth smoker attracted above the \$3,000, which would mean
21 that there would now be the financial incentive to meet the
22 targets. They could still financially benefit from attracting
23 youth smokers.

24 Q. Professor Gruber, are there any additional adjustments
25 that you needed to make to your proceeds calculation?

1 A. Yes. There's a last step, which I mentioned earlier,
2 which is that what matters, of course, to the defendants are
3 their after tax proceeds, so I reduced this proceeds amount to
4 account for federal and state and local corporate tax rate of
5 40 percent.

6 THE COURT: But I thought you told me that your use of the
7 term "proceeds," and I don't know what the term "real proceeds"
8 means, but your use of the term "proceeds" was based on
9 calculations of after tax net income.

10 THE WITNESS: That's a good point. I meant that the
11 entire step accounted for taxes. That's a very good point. When
12 I used the word "proceeds" here, I mean before "tax." What I
13 meant to say earlier was that the tax adjustment does happen, it
14 just happens at the end. Sorry I wasn't clear on that.

15 BY MR. GETTE:

16 Q. And the term "real proceeds" as opposed to "proceeds" or
17 some other type of proceeds, why is it that you've used the
18 words "real proceeds" here?

19 A. Because what matters to defendants is the purchasing
20 power of their financial benefit from attracting youth smoker.
21 So those proceeds need to be put in constant dollars in terms of
22 what else they can buy with those goods, so I deflate them or
23 inflate them to put them in constant dollars.

24 Q. Can you explain how the word "real" equates with the
25 constant dollar?

1 A. Sure. For example, if Philip Morris proceeds was \$0.03 a
2 cigarette in 1992, in 2004 that same \$0.03 a cigarette, if that
3 \$0.03 a cigarette could buy them a certain bundle of goods, that
4 same bundle of goods was worth \$0.04 by 2004, so I need to
5 account for that by bringing the \$0.03 into today's dollars by
6 saying look, what was \$0.03 in 1992 is really worth \$0.04 today
7 because goods have gotten more expensive.

8 Q. Let's move on to the next step of your assessment
9 calculation. In looking at U.S. Exhibit 18261, can you explain
10 this step of your assessment calculation for the Court?

11 A. Sure. Step four is just putting the first three steps
12 together. So, once again, the goal here is to calculate the
13 expected proceeds amount per youth at each future age. We ask
14 three things. First, the probability that a youth smoker is
15 still alive and smoking at each future age, 21, 22 to 65; second
16 is the number of cigarettes they're smoking if they're still
17 alive and smoking; and third is the proceeds earned -- this
18 really should say after tax proceeds -- earned on each of those
19 cigarettes sold at each future age. Putting them together we
20 have a number for at each future age what is the expected
21 proceeds per youth smoker.

22 Q. Let's go on and finish up with the final step of your
23 estimation calculation. And looking at U.S. Exhibit 18262, can
24 you explain for us this final step of your assessment
25 calculation?

1 A. Certainly. The calculations I've described computes the
2 proceeds that could be expected to be earned at each future age
3 from attracting a youth smoker today, but it's important to
4 recognize that financial economics teaches us that proceeds
5 earned in the future are worth much less than proceeds earned
6 today. So, those proceeds in the future need to be discounted
7 to today's dollars to account for the fact that proceeds earned
8 when the youth is 40 are worth much less than the youth is 21.
9 I used the weighted average cost of capital for Philip Morris as
10 7.6 percent, roughly, to discount those future proceeds to
11 today's dollars.

12 Q. And why did you choose the weighted average cost of
13 capital for Philip Morris?

14 A. This is the best representation of what it costs Philip
15 Morris -- the time value of money to Philip Morris, what it
16 costs them to raise another dollar of financing, and since I'm
17 using their -- since I'm using Philip Morris's proceeds number I
18 thought it would be appropriate to use their time value of money
19 as well.

20 Q. Finally, let's talk just a little bit, Professor Gruber,
21 about the economic incentives of your proposed forward-looking
22 remedy. What economic incentives are created by your
23 forward-looking remedy?

24 A. This forward-looking remedy creates incentives for the
25 defendants to disengage in any RICO violating activities that

1 make their products appealing to youth.

2 Q. And let me ask you this very directly, will this remedy
3 provide an economic incentive for defendants to discontinue
4 committing RICO violations?

5 A. Yes, it will.

6 MR. GETTE: We have no further questions for Professor
7 Gruber at this point, Your Honor.

8 THE COURT: All right. We're ready to begin cross,
9 please.

10 CROSS-EXAMINATION OF JONATHAN GRUBER, Ph.D.

11 BY MR. BIERSTEKER:

12 Q. Thank you, Your Honor. Peter Biersteker from Jones Day
13 on behalf of R.J. Reynolds Tobacco Company. Good morning,
14 professor.

15 A. Good morning.

16 Q. You say in your written direct examination, and you just
17 reiterated at the end of your oral examination, that you were
18 asked to develop a forward-looking remedy to reduce the
19 defendants' economic incentives to engage in future RICO
20 violations that make their products appealing to youth. Do you
21 remember that?

22 A. Yes, I do.

23 Q. All right. Now, when counsel for the government
24 contacted you to work on this case, it was about February,
25 right?

Scott L. Wallace, RDR, CRR
Official Court Reporter

- 1 A. Yes.
- 2 Q. And counsel for the government told you that the
3 government was considering an outcomes-based measure of the
4 performance of the tobacco industry in reducing youth smoking,
5 correct?
- 6 A. I'm not sure if those are the exact words, but the idea
7 was to consider an outcome-based remedy, yes.
- 8 Q. Well, do you want to take a look at your deposition to
9 refresh your memory on this?
- 10 A. Certainly.
- 11 Q. All right. Why don't we take a look at your deposition
12 from April 21st of this year. And professor, if you would turn
13 to page 736, we're going to look at lines 9 through 23. And I
14 basically asked you, well what were you asked to do by counsel
15 for the United States, and you said that they got in touch with
16 you in February, talked about the D.C. Circuit ruling, and they
17 said they were "considering other remedies and one remedy we are
18 considering is a sort of outcomes-based measure of the
19 performance of the tobacco industry in reducing youth smoking."
20 Does that refresh your recollection that counsel for the
21 government told you that they were considering an outcomes-based
22 measure of the performance of the tobacco industry in reducing
23 youth smoking?
- 24 A. Yes, it does.
- 25 Q. Okay. And in fact, that's what the government asked you

1 to help out on, right?

2 A. That's right.

3 Q. Now, when you were preparing your expert report in this
4 case, your purpose was to devise a remedy to combat youth
5 smoking, correct?

6 A. My purpose was to devise a remedy to provide financial
7 incentives to cause the defendants to not want to make their
8 products appealing to youth smokers.

9 Q. Well, why don't we take a look again at your deposition,
10 page 737, this time lines 11 to 16. And I asked you
11 specifically, sir, "In preparing your report, I take it it was
12 your purpose to devise a remedy to combat youth smoking; is that
13 right?"

14 And you answered, "Yes." Was that answer truthful, sir?

15 A. Yes, it was.

16 Q. And is it also truthful that you had no other purpose?

17 A. Yes, that's right.

18 Q. Okay. So, at the time you devised the remedies in your
19 2005 expert report in this case, you did not have as one of your
20 purposes reducing defendants' economic incentives to commit RICO
21 violations of any or all stripes, correct?

22 A. No, that's not correct.

23 Q. You did not have as a purpose, is it not true, to devise
24 an assessment that would compensate the government for any harm
25 caused by defendants' future RICO violations?

- 1 A. That's true, that was not part of the motivation.
- 2 Q. All right. Well, let's turn from the purpose of your
3 remedy to its effect.
- 4 Isn't it true that you simply do not know whether or not
5 your proposed remedy will be effective in preventing defendants
6 from committing future RICO violations?
- 7 A. No, that's not true.
- 8 Q. All right. Let's take a look at your deposition, again,
9 at 745 lines 9 through 14.
- 10 I first bungled the beginning of the question, after, I
11 say "that's fine," I say, "is the remedy described in your
12 April 2005 expert report effective in preventing defendants from
13 committing RICO violations in the future?"
- 14 And you said, "I don't know."
- 15 Then you went on to say you're not an expert on what
16 drives firms to commit RICO violations. Was that truthful
17 testimony, sir?
- 18 A. It is true that I'm not an expert, it's also -- and I'm
19 not certain. It is true, however, at the same time that I
20 believe strongly that this puts financial incentives in place to
21 stop them from engaging in those violations.
- 22 Q. Your answer was you didn't know if it was going to be
23 effective, correct, sir?
- 24 A. Yes.
- 25 Q. All right. Thank you. Now, you are an expert in

- 1 economics, right?
- 2 A. Yes.
- 3 Q. Now, from a textbook economic perspective, isn't it true
4 that one can prevent future RICO violations by giving defendants
5 economic incentives not to commit them?
- 6 A. Yes.
- 7 Q. Isn't it true that requiring defendants unconditionally
8 to pay money, for example, for a smoking cessation program, is a
9 payment that defendants cannot avoid regardless of their future
10 behavior?
- 11 A. Yes.
- 12 Q. And because it has to be paid, regardless of the
13 defendants' future behavior, it is what is sometimes referred to
14 in economics as a sunk cost, correct, S-U-N-K?
- 15 A. That's correct.
- 16 Q. And sunk costs do not influence marginal decisions, do
17 they?
- 18 A. In -- it depends on the context. In standard textbook
19 economics they do not; in other context sunk costs can matter
20 for many decisions. It depends on what you call the marginal
21 decision.
- 22 Q. Isn't it true that an unconditional payment of money
23 would not directly affect the costs and benefits to defendants
24 in the future of engaging in RICO violations?
- 25 A. No, that's not true. It depends on what you mean by

- 1 "directly." I don't really understand the question.
- 2 Q. Well, if they have to pay it anyway, regardless of
- 3 whether they commit a future RICO violation, isn't it true that
- 4 they get no benefit -- they can't avoid the cost and so
- 5 therefore whether they have to pay it or not doesn't enter into
- 6 a cost benefit analysis of the decision to commit a future RICO
- 7 violation?
- 8 A. No, that's not true. If the defendants are trying to
- 9 decide whether to commit a future RICO violation, part of that
- 10 calculation is going to be an expectation that they will
- 11 ultimately pay a penalty if they do. Whether the penalty in the
- 12 past has been imposed will affect that calculation.
- 13 Q. That's what we referred to in your deposition as an
- 14 indirect effect, correct?
- 15 A. That's the words you chose for it, yes.
- 16 Q. And you agree that that was a fair characterization?
- 17 A. I thought that was a fine word to use in the deposition.
- 18 Q. All right. Let's talk about that indirect effect.
- 19 Basically, what you're saying is that if defendants are required
- 20 to pay money on account of having committed past RICO
- 21 violations, that could affect their future behavior to the
- 22 extent that it affects their assessment that in the future if
- 23 they commit a RICO violation there will be a replay of the
- 24 litigation and they'll have to pay again, correct?
- 25 A. Yes.

1 Q. That would be true of any conceivable remedy for a past
2 RICO violation in varying degrees, correct?

3 A. Correct.

4 Q. In fact, that is one of the rationales that Professor
5 Fisher advanced as to why he thought his disgorgement remedy
6 prevented and restrained future RICO violations, isn't it?

7 A. I don't recall.

8 Q. Do you know if that's a rationale that the United States
9 advanced in their briefing before the D.C. Circuit?

10 MR. GETTE: Objection, Your Honor.

11 THE COURT: Sustained, sustained.

12 BY MR. BIERSTEKER:

13 Q. Let's explore how your remedy affects defendants'
14 economic incentives to take or to not take actions in the
15 future. Your remedy is focused on achieving the targeted
16 reductions in smoking of defendants' brands by what you call
17 youth, correct?

18 A. That's correct.

19 Q. And if the number of youth smokers of a particular
20 defendant's cigarettes exceeds the target, that defendant will
21 have to pay the \$3,000 assessment that you propose, correct?

22 A. If they miss the target. For each youth smoker they miss
23 the target they would have to pay the \$3,000.

24 Q. Okay. And so your remedy would give the defendant
25 cigarette manufacturers an economic incentive to achieve the

- 1 targeted reductions in youth smoking of their brands, correct?
- 2 A. Correct.
- 3 Q. For purposes of your remedy, I think you characterized it
- 4 this way in your written direct: "Achieving the targeted
- 5 reductions in youth smoking is the outcome of ultimate
- 6 interest," correct?
- 7 A. I don't recall the exact words I used, but that sounds
- 8 right.
- 9 Q. Well, would you agree with that?
- 10 A. It depends. It depends on the context. I don't know,
- 11 you know, it could be the ultimate outcome of interest. It
- 12 depends on the context.
- 13 Q. Let's try it this way. To the extent that focusing on
- 14 achieving the targeted reductions in youth smoking gives the
- 15 defendants economic incentives not to commit RICO violations in
- 16 the future, depends upon the degree to which youth smoking is
- 17 effective or determined by the commission of future RICO
- 18 violations, correct?
- 19 A. Yes, it does.
- 20 Q. Now, in your written direct, you, on pages 10 to 11 --
- 21 but you don't have to look -- but on pages 10 to 11 you list a
- 22 long list of actions that Dr. Chaloupka told you defendants
- 23 might take to make their cigarettes appealing to youth. Do you
- 24 remember that?
- 25 A. Yes, I do.

1 Q. Now, you don't believe that all of those activities
2 constituted RICO violations, do you?

3 A. As you pointed out to me in my deposition, I'm not an
4 expert on exactly what does or doesn't constitute a RICO
5 violation. So I can't tell you exactly which on the list do or
6 do not. I believe that, you know, at least some of them do, but
7 I can't tell you which ones.

8 Q. Based on the understanding of what constitutes a RICO
9 violation that was reflected in your expert report in this case,
10 there is certainly, certainly a difference between giving the
11 defendants an economic incentive to achieve the targeted
12 reductions in youth smoking on the one hand and on the other
13 hand removing any economic incentives for defendants to commit
14 RICO violations in the future, correct?

15 A. Yeah, in the perfect world those are two different
16 things, I agree.

17 Q. And in fact, back when you were the Deputy Assistant
18 Secretary for Economic Policy at the Treasury Department, as you
19 note in your written direct, you worked on youth smoking issues,
20 correct?

21 A. Correct.

22 Q. And in fact, while you were at the Treasury Department
23 you explicitly recognized there was a difference between giving
24 cigarette manufacturers an economic incentive to follow the
25 rules and giving them an economic incentive to reduce youth

1 smoking, right?

2 A. I don't recall.

3 Q. Why don't we take a look at JD 068057. This is a
4 memorandum dated August 7th, 1997 from you to then Treasury
5 Secretary Rubin and Deputy Secretary Summers, correct?

6 A. Yes, that's correct.

7 Q. All right. And the title of it is called "Principles,
8 Meeting on Tobacco - revised," right?

9 A. Yes.

10 Q. And back in 1997, that's when the proposed resolution was
11 pending, correct?

12 A. That's when it was being debated inside the
13 administration.

14 Q. All right. And if you'll turn -- the pages aren't
15 numbered, so you have to go with the Bates numbers, Doctor.

16 A. Okay.

17 Q. But it ends in Bates numbers 2834. So if you could turn
18 to that page.

19 A. Okay.

20 Q. And if you'll take a look -- hang on just a minute --
21 20843, I'm sorry, I got the wrong page. Thank you. That's
22 where I want to be.

23 You wrote, starting with the stuff that's highlighted in
24 yellow -- are you with me?

25 A. Yes.

1 Q. "In general, there's a trade off between motivating firms
2 to follow the rules and motivating them to promote lower
3 smoking."

4 And then you go on to say, "a substantial abatement would
5 offer strong incentives to follow the rules but would limit
6 incentives to consider innovative means of reducing youth
7 smoking."

8 Does that refresh your recollection about what you told
9 Secretary Rubin and Deputy Secretary Summers about there being a
10 difference between motivating tobacco companies to follow the
11 rules versus lowering youth smoking?

12 A. I need one minute to just read the context here. Yeah,
13 this is really a different -- I agree, you're quoting my words
14 correctly. This is a very different context. This is about a
15 particular partial abatement mechanism that was included in the
16 proposed resolution youth look back provisions, and so I don't
17 really know how it relates to what we're talking about here.
18 This is just a very different context. I would have to go back
19 and remind myself how I was thinking about that particular
20 mechanism.

21 Q. Maybe I can help. Let's ask a couple additional
22 questions. Isn't it true that the 1997 Proposed Resolution
23 would have required cigarette manufacturers to pay a penalty if
24 youth smoking exceeded a certain targeted level in the
25 aggregate?

- 1 A. Yes.
- 2 Q. And on the other hand, the 1997 Proposed Resolution
- 3 provided for a rebate or abatement of the penalty that a
- 4 cigarette manufacturer would pay if the cigarette manufacturer
- 5 could come forward and show that it had not targeted teens to
- 6 smoke its cigarettes, correct?
- 7 A. Correct, yes, now I remember.
- 8 Q. Okay. And you believed, did you not at the time, that it
- 9 would be easy, easy for the tobacco industry to show that it did
- 10 not explicitly target youth, correct?
- 11 A. I don't remember.
- 12 Q. All right. Why don't we take a look at another document,
- 13 JD 068058. This is a memorandum that you wrote to Treasury
- 14 Secretary Rubin, Deputy Secretary Summers and Assistant
- 15 Secretary Wilcox in May of 1998; is that right?
- 16 A. That's correct.
- 17 Q. And it's entitled: Youth Lookback Penalties. That's
- 18 what we're talking about here, right?
- 19 A. That's what we were working on in 1998.
- 20 Q. All right. And in fact, if you'll turn, again we have to
- 21 use the Bates numbered pages -- maybe I can do better this
- 22 time -- to the second page of the document, Bates number 0197,
- 23 Doctor.
- 24 A. Okay.
- 25 Q. And I'm looking for the third bullet point here. You

1 said "the burden of proof for the abatement was on the
2 government; it would be fairly easy for the industry to show
3 that it didn't explicitly target teens and therefore to avoid
4 75 percent of the penalty." Does that refresh your recollection
5 about what you told Secretary Rubin, Deputy Secretary Summers
6 and Assistant Secretary Wilcox in May of 1998?

7 A. Yes, it does.

8 Q. And so, what you were saying was, look, we're going to
9 assess a penalty if targeted reductions in youth smoking are not
10 achieved, but we're going to give the tobacco industry back some
11 money if they can show that, basically, they didn't take
12 affirmative steps to cause youth smoking to exceed the targets,
13 right?

14 A. What I was referring to was that the original proposed
15 resolution did that, to give back most of the money.

16 Q. 75 percent, right?

17 A. Right.

18 Q. Okay. And you believe that that mechanism, where they
19 got this 75 percent rebate of the penalty, gave the cigarette
20 manufacturers an incentive to follow the rules but what it
21 didn't do was it didn't give them an economic incentive to go
22 out and try to reduce youth smoking, right?

23 A. That's what I wrote. I believe, if you read the context
24 of this later memo, the idea is to follow the rules meant to
25 show -- to basically be able to defeat any government efforts to

1 show that they didn't follow the rules. That's different than
2 saying they actually followed the rules; it's just saying they
3 could defeat any effort to show they didn't.

4 Q. Okay. And when you were at the Treasury Department, you
5 thought that the Proposed Resolution was not hard enough on the
6 tobacco industry, right?

7 A. That's correct.

8 Q. And one of the reforms that you wanted to make to change
9 the Proposed Resolution in 1997 was to do away with this rebate
10 or abatement of any penalty if the industry could show that they
11 had not explicitly targeted teens, right?

12 A. I don't exactly recall. I mean, certainly I'm critical
13 of it here. I don't recall whether I proposed to get rid of it
14 all together or whether to adjust it.

15 Q. Well, I can show you a document and refresh your
16 recollection if you would like. It's the same one, I think we
17 were looking at, JD 068057, the memorandum dated August 7th,
18 1997 from you to Secretary Rubin and Deputy Secretary Summers,
19 and now we want to go to the same page. Just a minute. The
20 same section we highlighted, basically you said "eliminating the
21 abatement would require -- would provide an incentive to firms
22 to figure out how to lower youth smoking but offer no penalty
23 for not following the rules,"right?

24 A. I see that.

25 Q. Okay. And isn't that what you wanted to do?

1 A. Well, but then if you look at what I say next, I clearly
2 wasn't proposing to get rid of the abatement but just proposing
3 to make sure there was a nondebatable penalty which was large
4 enough.

5 Q. You wanted to add a nondebatable penalty, right?

6 A. Exactly.

7 Q. Now, the assessment that you propose in this case would
8 be levied whenever a defendant exceeds its youth smoking target,
9 correct?

10 A. Correct.

11 Q. And under the remedy that you propose in this case, it
12 doesn't matter why, it doesn't matter why a defendant cigarette
13 manufacturer failed to meet its youth smoking target, correct?

14 A. That's correct.

15 Q. And specifically, it doesn't matter at all whether or not
16 a cigarette manufacturer exceeded its youth smoking target in
17 the future because it committed a RICO violation in the future,
18 correct?

19 A. Once again, the other plaintiff's experts have suggested
20 that RICO violations are important determinants of youth
21 smoking, so I'd imagine they're related, but no, you are correct
22 that I don't tie it specifically to RICO-violating activities.

23 Q. Okay. And so let's try to explore this maybe a little
24 more fully with some hypotheticals.

25 Assume that a defendant cigarette manufacturer is above

1 its target, even though it committed no RICO violations in the
2 future. Isn't it true that under the remedy that you're
3 suggesting to this Court, that defendant must pay \$3,000 for
4 each youth smoker in excess of its target?

5 A. Once again, if it's above its target, I think it's very
6 hard, if not impossible, to determine whether it's because or
7 not because of RICO-violating activities. In your hypothetical,
8 it's true, but I don't know how you would exactly tell if that
9 was because or not because of RICO-violating activities.

10 Q. So the answer is yes, if a defendant cigarette
11 manufacturer exceeds its youth target, even though it committed
12 no RICO violations in the future, under the remedy you propose
13 to the Court they will be assessed \$3,000 for every youth in
14 excess of that target, correct?

15 MR. GETTE: Objection, Your Honor, asked and answered.

16 THE COURT: Well, we can just get a yes or no.

17 THE WITNESS: Correct.

18 THE COURT: But isn't it also true that such remedy
19 involving an assessment would only be imposed because there had
20 been a finding of liability about past RICO violations?

21 THE WITNESS: That's my understanding, yes.

22 BY MR. BIERSTEKER:

23 Q. Moreover, isn't it true that to the extent that there are
24 RICO violations that tend to decrease, decrease youth smoking,
25 your proposed remedy actually encourages the defendant cigarette

1 manufacturers to commit them in the future?

2 A. Well, first of all, I don't know what those activities
3 would be. Hypothetically, if some activities like that existed,
4 there'd be a host of considerations that defendants would want
5 to undertake in thinking about whether to take those activities,
6 of which this would be one, yes.

7 Q. All right. So, for example, let's try an example, and we
8 discussed this at your deposition, so let's go through it.
9 Making an explicit health claim for a product in cigarette
10 advertising might diminish youth's perceptions of the long term
11 health risks of smoking, correct?

12 A. That's certainly possible.

13 Q. Okay. And to the extent that you've perceived that the
14 long term health risks of smoking are lower because of this new
15 product and its advertising, that might encourage more youth to
16 smoke, right?

17 A. I'm not aware of the evidence on how youth smoking
18 depends on their perceived health risks. It's certainly
19 possible it could go that way.

20 Q. It's certainly possible. All right. So in other words,
21 suppressing accurate health information about a potentially
22 safer product could result in fewer youth smoking, correct?

23 A. In the hypothetical you've described, that is correct.
24 Once again, I don't know what the evidence is to support either
25 step of that hypothetical, but that's correct in your

1 hypothetical.

2 Q. All right. And so your remedy, by focusing exclusively
3 on youth smoking targets, actually gives the defendants an
4 incentive not to market potentially safer cigarettes as safer to
5 the extent they believe that that might lead more youth to
6 smoke, right?

7 A. That's not necessarily right. If -- even if they believe
8 it might lead more youth to smoke, if the other advantages of
9 marketing in that way are large enough, they still might do it
10 and then undertake other activities to reduce youth smoking.

11 Q. Sure. Let me try the question this way. Isn't it true
12 that your remedy would give defendants additional incentives to
13 suppress explicit health claims for potentially safer
14 cigarettes, compared to the world as it exists today, if they
15 thought that might increase youth smoking?

16 A. What -- once again, I don't think so because they have a
17 whole host of activities they can do to reduce youth smoking, so
18 even if that health information might increase youth smoking,
19 they still might want to do it and then undertake some other
20 activity to reduce youth smoking that offsets it so as to meet
21 their targets. That still might be the right thing to do.

22 Q. You're not an expert on what defendants can do to reduce
23 youth smoking, are you?

24 A. Well, I have done a lot of research on youth smoking,
25 so --

1 Q. But didn't you rely on Dr. Chaloupka for your list of
2 things that defendants could do to reduce youth smoking?

3 A. I'm not an expert on the non-price sort of aspects of
4 those activities, that's true.

5 Q. Let's try another variation on this theme. Let's say
6 that a defendant cigarette manufacturer is below its youth
7 smoking target and it commits RICO violations in the future.
8 Under your proposed remedy, that defendant would pay nothing,
9 correct?

10 A. If -- as long as they remain below the reduction target
11 in the future, there's no assessment.

12 Q. And in fact, if a defendant is below it's targeted youth
13 smoking level, that defendant would still have an economic
14 incentive to attract youth to its products, at least up to the
15 targeted level, correct?

16 A. Well -- first of all, the economic -- it's true that the
17 economic incentive that was there before would be unchanged
18 except for the fact that they -- there could be a concern that a
19 particular activity actually bumps the defendants into the range
20 where they are paying an assessment. If they could be sure that
21 some activity will for sure leave them below the target level,
22 then the incentive from before is unchanged by my remedy. I
23 understand the government has proposed other remedies that might
24 affect that but from my remedy. But if they can't be sure that
25 it might bump them into the range to pay assessments, then it

1 would reduce the incentive.

2 Q. You just mentioned other remedies that you understand the
3 government has proposed in this case. Are you suggesting that
4 those other remedies adequately prevent future RICO violations
5 that your proposed remedy either encourages or does not address
6 at all?

7 MR. GETTE: Objection, Your Honor. There's no foundation
8 in the cross that this expert has considered the other remedies
9 that are being offered by the experts in this case.

10 THE COURT: And at least at this point there's no
11 foundation that he really knows what they are. Now, you
12 certainly can try to elicit a foundation.

13 BY MR. BIERSTEKER:

14 Q. All right. Well, let me try it this way. What are the
15 other remedies with which you are familiar?

16 A. I understand that there are to be some funds for smoking
17 cessation. I think there is two; that's the one I'm familiar
18 with.

19 Q. Well, are you suggesting, then, by referring to other
20 remedies in your testimony, that this National Smoking Cessation
21 Program would address potential RICO violations that the remedy
22 you propose either would encourage or not address?

23 MR. GETTE: Objection, Your Honor. The question suggests
24 that the testimony has indicated that his proposed remedy would
25 encourage certain violations if they were below the target, when

1 in fact, I believe his testimony was exactly to the contrary.

2 MR. BIERSTEKER: No, no, no, you're confusing --

3 THE COURT: The objection's overruled. Let's get it clear
4 on the record. I think you should repeat the question, though.

5 BY MR. BIERSTEKER:

6 Q. By mentioning other remedies, I guess the National
7 Smoking Cessation Program, are you suggesting that that remedy
8 addresses defendants' incentives to commit future RICO
9 violations that your proposed remedy doesn't address at all
10 because the manufacturer is below its target, let's say, or that
11 your remedy encourages, apropos the safer cigarette hypothetical
12 that we just went through?

13 A. I have to give two qualifiers to my answer. First of
14 all, as I said I don't believe it necessarily encourages any
15 RICO violations. Second of all, even below the targeted, I
16 think there's still a disincentive, as I mentioned a moment ago.
17 With those two caveats, I believe -- once again I don't know a
18 lot about this other remedy, but I believe it could be a useful
19 compliment to what I'm proposing here.

20 Q. To the extent that that remedy you think is adequate, do
21 you?

22 A. Adequate for what?

23 MR. GETTE: Your Honor --

24 BY MR. BIERSTEKER:

25 Q. The National Smoking Cessation program.

1 MR. GETTE: Your Honor, the foundation now is that he
2 doesn't know much about that remedy.

3 THE COURT: Have you even read the expert testimony of any
4 government witness who is going to be testifying about a National
5 Cessation Program?

6 THE WITNESS: No, I haven't.

7 THE COURT: Or have you read the expert witness report on
8 that subject?

9 THE WITNESS: No, I haven't.

10 THE COURT: There's no foundation.

11 BY MR. BIERSTEKER:

12 Q. If a defendant is below its youth smoking target and it
13 could attract additional youth smokers to its brands by
14 committing future RICO violations, your proposed remedy would
15 not alter its economic incentives to commit those future RICO
16 violations except to the extent that they happen to overshoot
17 the target, right?

18 A. I'll repeat to make sure I understand. You're saying, to
19 the extent they're below and they're going to take an action
20 which they can be sure will not cause them to exceed the target,
21 then my specific remedy does not alter from today their
22 financial incentives? Yes, that's true.

23 Q. Okay. And in fact, if they exceed the target, but just
24 by a little bit, in other words, they attract more youth
25 smokers, you know, twice as many youth smokers as -- if they

1 exceed -- let me try it this way. If they exceed their youth
2 smoking target by one smoker but pick up hundreds or thousands
3 below the target, in that case they will still have an economic
4 incentive to commit the RICO violation even though they were
5 going to over shoot, right?

6 A. No. Once they exceed the target at all, coming back to
7 your way of thinking about things, relative to today, once they
8 exceed that target at all, there's now less of a financial
9 incentive to engage in those activities. So whatever their
10 calculus was before, should I do it or not do it, now there's
11 another thing on the don't do it side of the scales. Now, if
12 it's only one smoker it's a small other thing, it's only \$3,000,
13 but it's still there in that calculation.

14 Q. That's fair. Thank you. An injunction that prohibited
15 defendants from committing RICO violations in the future would
16 be forward-looking, correct?

17 A. Yes.

18 Q. Okay. And such an injunction could be targeted
19 specifically at the commission of RICO violations in the future
20 by these defendants, correct?

21 A. I -- I don't really know what the injunction would look
22 like. It's hard to say, I think there's a lot of problems -- as
23 I layout in my direct testimony, there's a lot of problems with
24 trying to use that approach.

25 Q. We're going to get there. Let's try it first just sort

1 of in principle. Would you agree that if penalties were imposed
2 for the violation of an injunction, that that would reduce
3 defendants' economic incentives to commit RICO violations in the
4 future?

5 A. To the extent that they think they will get caught, yes.

6 Q. Okay. And depending upon the size of the penalty, they
7 can either reduce their incentive to do on it or eliminate them
8 or give them an affirmative incentive not to commit them,
9 correct?

10 A. It depends on the size and the odds that they will
11 actually get caught doing it.

12 Q. And as you just said, an injunction coupled with
13 penalties large enough to at least remove any incentive to
14 commit future RICO violations would effectively prevent the
15 commission of those RICO violations in the future provided,
16 provided that the violations are measurable and you can target a
17 penalty to their occurrence, correct?

18 MR. GETTE: Objection, Your Honor, that misstates his
19 testimony.

20 MR. BIERSTEKER: I'll just ask the question without the
21 lead in.

22 THE COURT: All right, you may answer.

23 THE WITNESS: So, can you ask the question again?

24 BY MR. BIERSTEKER:

25 Q. Sure. Provided that an injunction coupled with penalties

1 removes any incentive to commit future RICO violations because
2 the penalty would be big enough, it would be effective in
3 preventing and restraining future RICO violations if, if --
4 here's your if -- if the RICO violations can be detected and
5 their occurrence subjected to the penalty, right?

6 A. Once again, it's not that easy. So, for example, let's
7 say there is some RICO violation that can be detected and
8 subject to the penalty. Let's say there's another one that they
9 haven't been doing yet but they can do that can't be subjected
10 to the penalty, then yes, it could reduce the incentive to
11 violation A but it could introduce an incentive to commit
12 violation B. So it's not clear on net that your statement is
13 correct.

14 Q. All right. Well, let's take a look at what you said in
15 your deposition by turning to page 769 to 770 starting on line
16 22, and 769. I asked, "would an injunction" -- are you with me,
17 Doctor?

18 A. You said the page numbers kind of fast.

19 Q. Yeah, 769 starting on line 22.

20 A. Okay.

21 Q. And then continuing down on page 770 through line 6. Are
22 you with me?

23 A. Okay.

24 Q. Okay. I asked the following question: "Would an
25 injunction with penalties large enough to at least remove any

1 incentive for committing future RICO violations be effective at
2 preventing the commission of future RICO violations?"

3 And you said, answer, "I mean, you're describing that. I
4 don't know how you'd do that because I don't know -- there's this
5 difficulty of measuring the RICO violations themselves, but
6 presuming that those are measurable and presuming that you can
7 actually target a penalty to their occurrence, then, yes."

8 Is that truthful testimony, sir?

9 A. That was truthful. I'm just -- I'm adding some
10 subtleties to my answer here.

11 Q. Okay. And let me just wrap it up, maybe on the theory,
12 and then we'll move to your practical reality. In theory, if a
13 RICO violation in the future were measurable and you could
14 actually target a penalty to their occurrence, then there
15 wouldn't be any need for any further relief beyond an injunction
16 in this case, correct?

17 A. The only qualification still in the theory that is
18 implicit in any answer, but I agree isn't stated, is you've got
19 to actually -- they've got to actually perceive they'll be
20 caught. It depends is the probability that they'll be caught.

21 Q. Let's talk about the adequacy of injunctive relief in
22 practice. It would not be difficult, would it, for the
23 defendants to monitor -- for the Court, rather, to monitor
24 defendants' future public statements about their marketing, the
25 health risks of smoking or any other topic, correct?

1 MR. GETTE: Objection, Your Honor, I don't think there's
2 any foundation that this expert has expertise on how the Court
3 operates or what it considers in reaching its opinions.

4 MR. BIERSTEKER: Your Honor, he found a way to answer the
5 question at his deposition.

6 THE COURT: You may answer the question.

7 THE WITNESS: So the question again, sir, is?

8 BY MR. BIERSTEKER:

9 Q. Yeah. It would not be difficult, would it, for the Court
10 to monitor the defendants' future public statements about
11 marketing or about the health risks of smoking or any other
12 topic, correct?

13 A. It depends. Certainly if those public statements were
14 put out on billboards the size of buses, you're right, it
15 wouldn't be hard to monitor. There may be other public
16 statements hard to monitor. I'm not an expert on the ability to
17 the Court to know exactly what they're saying in every forum.

18 Q. All right. And isn't true that all of the RICO
19 violations that you describe in all of your expert reports in
20 this case involve allegedly fraudulent public statements?

21 A. I'm sorry, can you say that again?

22 Q. You set forth your understanding of the alleged RICO
23 violations in your expert report in this case, correct?

24 A. Yes, I believe that's correct.

25 Q. And isn't it true that the RICO violations that you

1 identified in your expert report in this case all concerned
2 allegedly fraudulent public statements by the defendants?

3 A. I'd have to see my expert report to see what you're
4 referring to.

5 Q. Okay. Well, why don't we look at it then. Your report
6 from April 13th, 2005. I think it's JD 068059. And we can put
7 it up on the screen, I guess, but it's page 7 paragraph 20,
8 Doctor? And there you describe what the United States alleges
9 in this case and they both -- both of the RICO violations you
10 chose to highlight in your expert report involve fraudulent
11 public statements, correct?

12 A. Yes, that's correct.

13 Q. And isn't it true that every work day Courts and juries
14 in this country determine whether or not statements made by one
15 party to a lawsuit is true or false?

16 MR. GETTE: Objection, Your Honor. Again, foundation.

17 THE COURT: Sustained, sustained.

18 BY MR. BIERSTEKER:

19 Q. Isn't it true that your reservation is you're not sure
20 that Courts get it right?

21 MR. GETTE: Objection, Your Honor. I mean, a follow-on
22 question that there was something there was no foundation for in
23 the first instance.

24 THE COURT: Sustained. If you're changing topics, we can
25 take our morning recess. Dr. Gruber, may step down for

1 15 minutes. Mr. Frederick, let's address the issue you wanted
2 to.

3 MR. FREDERICK: Thank you, Your Honor. Tom Frederick, for
4 the record for Philip Morris.

5 Your Honor, I wanted to raise an issue relating to Order
6 Number 944, an issue related yesterday to Dr. Healton's
7 testimony. Part of the order granted our objection to a portion
8 of Dr. Healton's testimony where she discusses the Foundation's
9 shortfall in funding. Just so the government and Court are not
10 surprised, we certainly intend to explore that area in connection
11 with her testimony as part of our bias cross of Dr. Healton, and
12 to the extent that -- because it goes to her motive for
13 testifying here, so to the extent that's deemed to have opened
14 the door to that issue, we would withdraw the objection to that
15 portion of her testimony.

16 MS. EUBANKS: Your Honor, I'll make it simple. If the
17 objection is withdrawn and the testimony comes in, then we
18 wouldn't oppose -- would, in fact, consent to an order that
19 reversed the circumstances of that, because we did look at that,
20 as well, and note that in -- with respect to a couple of the
21 orders that the Court entered on summary judgment, that we
22 believe that striking that testimony gave rise to some questions
23 regarding remedies and approach that the Court had stated in
24 earlier orders with respect to remedies and the MSA. So we're
25 perfectly fine with that for an order.

Scott L. Wallace, RDR, CRR
Official Court Reporter

1 THE COURT: I'm not sure what the government is referring
2 to. I do know what Mr. Frederick is referring to. He is
3 withdrawing his objection, so therefore the testimony will be
4 admitted, and it's fair game for everybody to ask questions
5 about.

6 MS. EUBANKS: Your Honor, on another matter, when we were
7 last here we discussed getting some information from defendants
8 which we have not yet received with respect to whether
9 Dr. Wittis, or Ms. Wittis, I don't remember, would testify and
10 whether it would be Dr. Wecker. We were supposed to receive that
11 information yesterday, we have not received it. We also were
12 supposed to find out as of Friday whether Brickley would actually
13 testify and we received none of that information from defendants
14 in terms of follow-up as we discussed with the Court.

15 THE COURT: Mr. Bernick?

16 MR. BERNICK: Yes. We're prepared to make a report to the
17 Court on the status of our thinking concerning witnesses. I was
18 prepared to do that this morning first thing.

19 THE COURT: All right. Let's do it now.

20 MR. BERNICK: You want to do it now? Okay. That's fine.
21 With respect to Dr. --

22 THE COURT: You did promise to get this information to the
23 government earlier than today, though.

24 MR. BERNICK: We promised to get information with respect
25 to Ms. Ivey and Ms. Beasley yesterday.

1 THE COURT: And whether it was going to be Dr. Wecker or
2 somebody else.

3 MR. BERNICK: Dr. Wecker. If we did, then I apologize,
4 Your Honor. We really met on this last night as part of our
5 overall list of witnesses.

6 Dr. Wecker will not be testifying. It will be Dr. Wittis.
7 We also have other witnesses that we know that we're at this
8 point in time not going to call. Those would be Mr. Orlowsky.

9 THE COURT: Who you are or are not?

10 MR. BERNICK: Are not.

11 THE COURT: All right.

12 MR. BERNICK: Mr. Orlowsky, Ms. Ivey and Ms. Beasley.
13 There are two additional witnesses that we'll be able to report
14 on later on this afternoon. That would be Mr. Prentice, the
15 Oxford Don and Dr. Brickley.

16 THE COURT: Dr. Brickley?

17 MR. BERNICK: I'm sorry, yes. And then Liggett is going
18 to determine whether they do intend to call Dr. -- or
19 Mr. Bernstein, I'm not sure which one it is -- so that's still
20 outstanding.

21 With respect to Mr. Parrish, Mr. Parrish we really can't
22 determine whether he needs to appear until after Mr. Myers
23 testifies. Remember, Mr. Myers is going to be testifying about
24 the 1997 Proposed Resolution. We may or may not need to call
25 Mr. Parrish, but we're really not going to know until that

1 testimony is done, so we really can't provide any further input
2 with respect to Mr. Parrish until that time.

3 Likewise, with respect to Dr. House, whether he appears or
4 not depends upon the testimony of Dr. Fiore at trial next
5 Tuesday. So, Parrish is a question mark depending upon Myers.

6 THE COURT: And Mr. Myers will be testifying Wednesday.

7 MR. BERNICK: Wednesday, that's correct. Dr. House is a
8 question mark depending upon Dr. Fiore. And then finally,
9 Mr. Szymanczyk we are still going to keep on the list. If he
10 does testify, it will be at the very end of our case. We don't
11 know whether or not that's going to happen. It really depends
12 upon what emerges concerning really, you know, in the sense of
13 the current state of play in the industry. There's going to be a
14 lot of talk, discussion from our experts about the state of play
15 in the industry generally, and Mr. Szymanczyk -- Mr. Szymanczyk
16 therefore will remain on our list, but at the very, very end.

17 So, we've made, I think, substantial progress in
18 identifying people that we're not going to call, and I think that
19 what I've set forth as a sequence that we're going to use to
20 determine whether the list can be pruned even more, and we do
21 hope to be able to report to the Court concerning Mr. Prentice
22 and Dr. House -- I'm sorry, Dr. Brickley, later on today.

23 THE COURT: And you may have told me this, but who will
24 your first three witnesses be?

25 MR. BERNICK: Our first witness will be Dr. Rubin.

1 THE COURT: He'll be next Monday?

2 MR. BERNICK: Yeah, he'll be next -- I think it's
3 actually -- it's not next Monday, it will be a week from Tuesday
4 because we don't have Court on the 23rd.

5 THE COURT: That's right. That's right.

6 MR. BERNICK: And then following him, if he appears, will
7 be Mr. Prentice. Following him would probably be Mr. Fischel on
8 the 27th. Now, I know that Your Honor has suggested that you
9 might be able to have Court on the 27th. Mr. Fischel cannot
10 appear on the 26th, and what we would like to do is to call him
11 on the 27th. On the 26th we would otherwise have a dark day or
12 if Mr. -- Dr. Brickley is going to testify, we would have
13 Dr. Brickley testify that day.

14 THE COURT: You can't get Mr. Fischel here on the 26th?

15 MR. BERNICK: I don't believe that we can. That's the
16 difficulty. Now, we're still trying to pin down his schedule,
17 and we will probably have some further information on that later
18 on today as well.

19 THE COURT: All right. Now, the 27th is a ways away. I
20 will be rearranging some things that are set, and many statuses
21 fall through at the last minute, but certainly by the 24th you
22 should give me some idea of how long Mr. Fischel's testimony will
23 be, whether that will be a whole day or less than a whole day.

24 MR. BERNICK: Sure, we'll have -- I think we'll -- we'll
25 have information that's more definite information with respect to

1 Mr. Fischel long before that. I think that we can provide Your
2 Honor with information long in advance of that.

3 And let me also give the Court and the government other
4 dates. We expect that Dr. Weil will testify on the 31st. We
5 expect that Dr. Wittis will testify on the 1st. We expect that
6 Dr. Carlton will testify on the 2nd. Now, again, there's --
7 Dr. -- Mr. Fischel and Dr. Carlton, we're trying to determine
8 which one is going to be in the week of the 23rd and which one is
9 going to be in the week of the 30th. That's just part of our
10 problem, and again, that's what we expect to know fairly soon.

11 And I think that gives all the dates that we have so far,
12 and again, I think even yet today we'll have more information
13 with respect to Mr. Prentice and Dr. Brickley. I think there's
14 some reasonable prospect that we're going to end up having, as
15 you can see, a fairly short case, and literally as the decisions
16 are being made we're reporting them. I don't expect we'll have
17 anymore information this week with respect to Dr. House and
18 Mr. Parrish for the reasons that have been indicated, and
19 Mr. Szymanczyk, I think, will remain for the indefinite future
20 kind of at the end of the list and we'll see what Liggett has to
21 say about Dr. Bernstein.

22 THE COURT: All right. Ms. Eubanks.

23 MS. EUBANKS: Thank you, Your Honor. This is a little bit
24 disturbing about the testimony of Prentice. That's scheduled for
25 deposition tomorrow, and when we were here on Thursday, the Court

1 instructed counsel to let us know on Friday whether to expect
2 Prentice's testimony or not, which was tied to the question of
3 whether Dr. Bazerman's testimony would come in or not. After we
4 received the order on Friday, we called defense counsel.

5 THE COURT: I did that purposely. I knew people had all
6 sorts of obligations, I knew the government had to -- not had to,
7 but wanted to file some kind of brief that I didn't need, and
8 that there were other preparations going on, so I wanted to let
9 you all know.

10 MS. EUBANKS: I think -- and my problem right now is, Your
11 Honor, I have someone in the office preparing to take the
12 deposition of Prentice, which you had said we should know on
13 Friday, and now we're hearing that sometime later today, while
14 this person is spending time on preparation, that the defendants
15 may or may not call Prentice. I think we need a time certain for
16 knowing that information because it does involve preparation to
17 take the deposition and as a courtesy, that would be nice.

18 MR. BERNICK: 3:00 this afternoon.

19 MS. EUBANKS: Now, with respect to the question that
20 Mr. Bernick --

21 THE COURT: I will say this. If possible, earlier.

22 MR. BERNICK: We're not -- Your Honor, I'm not -- I'm
23 certainly not delaying that, and we really have been -- we didn't
24 anticipate Your Honor was going to rule with respect to
25 Dr. Bazerman until some time early this week. So, that's just

1 the fact of the matter.

2 THE COURT: I try to rule in such a way to make life a
3 little bit easier for everybody.

4 MR. BERNICK: I'm not being critical, obviously, with Your
5 Honor. I'm just saying in terms of making communications, that
6 came -- Your Honor ruled very promptly. We appreciate that,
7 we've been following up over the weekend, but it just was not
8 possible to pin that down with respect to Mr. Prentice. We
9 expect to have that this afternoon.

10 THE COURT: 3:00 at the latest, earlier in possible.
11 Ms. Eubanks, did you have something else?

12 MS. EUBANKS: Your Honor, I should say that Prentice is
13 coming from Great Britain, so we've got -- if he's -- he's either
14 on the plane or not on the plane. He's either here or he's not.
15 It would seem to me that the defendants have made this decision.
16 The Court ordered on Thursday that we should know on Friday. And
17 now it's Tuesday. The same with respect to Brickley, we were
18 supposed to know with certainty on Friday. I mean, I have the
19 transcript. This is what was established. We did receive two
20 letters with respect to Ms. Ivey and Ms. Beasley, and we
21 appreciate receiving that information. The most recent
22 information came in last night where defendants had conditions
23 upon the fact that they would not testify, so it's good to hear
24 the definitive.

25 THE COURT: Let's focus on what's outstanding. Prentice

1 is going to be at 3 p.m. Have you made a decision on Prentice?

2 MR. BERNICK: It's not my witness, Your Honor, these are
3 communications that are taking place with London. I just --

4 THE COURT: Let me hear from BATCo.

5 MR. CONRAD: Yes, Your Honor.

6 THE COURT: Is he on his way over here?

7 MR. CONRAD: He is here, but --

8 THE COURT: Here.

9 MR. CONRAD: -- but we're in negotiations with the client
10 as to whether he will be appearing for trial or not.

11 THE COURT: 3:00 today or he's not going to testify.

12 MR. CONRAD: Absolutely, Your Honor.

13 THE COURT: Now, Dr. Brickley, whose witness is that?

14 MR. BERNICK: Dr. Brickley is a Philip Morris witness.

15 But with respect to Dr. Brickley, again, there was no commitment
16 that was made to the government to do it by today. We are still
17 in the process of analyzing the implications of Your Honor's
18 determination, and I don't know whether his deposition is
19 scheduled to take place.

20 MR. FREDERICK: Sunday.

21 MR. BERNICK: So it's -- Your Honor, I could -- and I
22 won't -- go through chapter and verse of similar problems that
23 we've had with the testimony of the government's witnesses where
24 a lot of people spent a lot of time kind of chasing down rabbit
25 holes and it's just not worth, I think, our time here in Court.

1 I can report to the Court that we are promptly meeting to discuss
2 all of these developments. I've just announced that we're
3 truncating our witness list dramatically and we'll continue to
4 work on it. There is no desire on our part to delay reporting to
5 the government.

6 THE COURT: Do you think you can get a decision on
7 Dr. Brickley by Wednesday?

8 MR. BERNICK: I think -- as I indicated, I think we'll
9 have that decision about Dr. Brickley this afternoon.

10 THE COURT: All right, good.

11 MR. BERNICK: So there really won't be -- by the time we
12 close -- by 3:00 this afternoon, or before the end of the day,
13 5:00 this afternoon with respect to Dr. Brickley, the only
14 outstanding issues will be issues that basically depend upon
15 testimony going forward. For example, the response of Dr. Fiore,
16 do we need Dr. House to respond to Dr. Fiore? Do we need
17 Mr. Parrish to respond to Mr. Myers, and do we need
18 Mr. Szymanczyk at the end? Otherwise, all matters will have been
19 determined and we therefore are reporting to the Court everything
20 that we can based upon the evidence that's come in so far.

21 MS. EUBANKS: Well, Your Honor, in so far as the evidence
22 that's has come in so far, perhaps Mr. Bernick is aware of this,
23 but the United States has filed all of its written direct so they
24 have Mr. Myers' testimony and they have the written direct of
25 Dr. Fiore. Insofar as those decisions are tied, or their

1 decisions whether or not to call Dr. House and Mr. Parrish are
2 tied to that, the written directs --

3 THE COURT: We're going to get them at 3:00 this
4 afternoon, everybody, and it isn't just the direct that counts.
5 Presumably cross-examination bears some fruit, after all, a lot
6 of work goes into it. So, I think by the end of today there will
7 only be three witnesses in question. Mr. Szymanczyk, at best, is
8 going to be the star closing witness, and Dr. Crouse and
9 Mr. Parrish will turn on government witnesses Mr. Myers and -- I
10 don't remember who Dr. Crouse turns on.

11 MR. BERNICK: It's Dr. House, Your Honor, and there's one
12 other thing I have to say is Bernstein where Liggett is
13 determining what they have to do.

14 THE COURT: Correct. When is Liggett going to make a
15 decision about Mr. Bernstein?

16 MR. STRAUB: Your Honor, can we have until Thursday first
17 thing in the morning?

18 THE COURT: All right, everybody, 15 minutes, please.

19 (Thereupon, a break was taken from 11:18 a.m. until
20 11:32 a.m.)

21 THE COURT: All right, Mr. Biersteker, please.

22 MR. BIERSTEKER: Thank you, Your Honor.

23 BY MR. BIERSTEKER:

24 Q. I wanted to just kind of see if we could tie up with a
25 bow the topic we were discussing earlier this morning and,

1 notwithstanding my messy penmanship, I scrawled on the flip
2 chart. And I had the thought when we set the actions of the
3 defendants in the future over here and the consequence under the
4 remedy that you propose.

5 And would you agree with me that ideally, what we would
6 like to do is if in the future the defendants commit a RICO
7 violation, we would want there to be some sort of penalty?

8 A. Yes.

9 Q. Okay. And would you agree with me that ideally, what we
10 would like to do in the future, if we're aimed at preventing
11 future RICO violations, is when a defendant does not commit a
12 RICO violation in the future, we don't want there to be a
13 penalty?

14 A. If we had this perfect world where we could do that, then
15 that's what we would want.

16 Q. And in a perfect world that's what an injunction would
17 do, right?

18 A. I don't know if it's possible in reality, but in a
19 perfect world, that's what it would do.

20 Q. Now, in the circumstance that we explored before the
21 break where a defendant cigarette manufacturer is under its
22 targeted youth smoking level in your remedy and commits a RICO
23 violation, it gets off Scott free without a penalty, correct?

24 A. Once again, it's not correct in two senses. First of
25 all, if that RICO violation pushes it above the target level, it

1 will face an assessment. Second of all, once again, there's
2 this effect you labeled the "indirect effect," which is by
3 putting this remedy in place, then it may raise concerns among
4 defendants that those RICO violations could lead to future
5 penalties against them.

6 Q. Let me try it this way: Let's just focus on your remedy
7 and that the defendant is under its target. Even though it
8 commits a RICO violation, it pays no assessment or no penalty,
9 correct?

10 A. Under my remedy, as long as it remains under the targets,
11 there's no assessment; that's correct.

12 Q. All right. And we also explored another hypothetical,
13 which was if a defendant is over its target despite the fact
14 that it committed no RICO violation, the assessment will be
15 imposed, correct?

16 A. Once again, I -- this is a hypothetical. I don't know
17 why they're over the target. It seems likely that being over
18 the target would involve some RICO violations, based on other
19 testimony. But under your hypothetical, that's correct.

20 Q. Okay. So under my hypothetical, a cigarette manufacturer
21 who is over its target and who in the future commits no RICO
22 violation will nonetheless pay the assessment, correct?

23 A. In the hypothetical, that's correct.

24 Q. And in this circumstance, in that hypothetical, isn't it
25 true that effectively, what your remedy does is impose a penalty

1 for past violation of RICO? Your remedy is imposed because of
2 the past violations, right?

3 A. I don't see how you draw that conclusion.

4 Q. Well, your remedy would be imposed if the court finds
5 that the --

6 THE COURT: I think the question to a nonlawyer may have
7 been unclear.

8 MR. BIERSTEKER: Let me maybe try to clear it up. I don't
9 know if I'll be able to.

10 BY MR. BIERSTEKER:

11 Q. But in a situation where your remedy is imposed because
12 the Court finds that past RICO violations have been committed
13 and are likely to be committed again in the future, but in fact
14 no future RICO violations do occur in the future, yet the
15 defendants exceed the targeted youth smoking level, they get
16 penalized, right?

17 A. If -- yes; that's right.

18 Q. Thank you. And wouldn't that mean, therefore, that the
19 assessment in those circumstances constitutes a penalty for past
20 conduct?

21 A. I don't know. I don't know what that necessarily means,
22 that term.

23 Q. Why would you think it wouldn't mean that?

24 A. I don't know what -- you're using a legal term, "penalty
25 for past conduct." I don't know what that means.

1 Q. You don't know what "past conduct" is?

2 A. I know what "past conduct" is.

3 Q. What is it that you don't understand?

4 MR. GETTE: Objection, Your Honor. This is argumentative

5 as well as --

6 MR. BIERSTEKER: It's not argumentative. I'm trying to

7 understand --

8 THE COURT: Sustained. Again, as we all know, terms like

9 "penalty" have different meanings in ordinary English and

10 lawyer-speak.

11 MR. BIERSTEKER: All right.

12 BY MR. BIERSTEKER:

13 Q. If I use the word "assessment," does that help you?

14 That's the word you used?

15 A. So --

16 MR. GETTE: Your Honor, at this point if the witness could

17 have a full question.

18 THE COURT: Yes.

19 MR. BIERSTEKER: Fine. Let me try it again.

20 BY MR. BIERSTEKER:

21 Q. In the circumstance where the court finds there's been

22 past violations that are likely to be future violations; there

23 are no future violations, but defendants exceed the targeted

24 level of youth smoking for reasons that have nothing to do with

25 their having committed RICO violations in the future; isn't it

1 true that your assessment basically is being levied because of
2 past conduct?

3 A. I'm sorry. I don't -- the assessment is being levied
4 based on where your smoking is off the targets. I'm not --
5 there's nothing in my report or remedy that says why it's being
6 assessed in particular. I don't assign a certain reason for it
7 being assessed in some circumstances than others. They missed
8 the target so there's an assessment.

9 Q. And isn't it true that the circumstances that we put up
10 here where you can have assessments even though there is no RICO
11 violation in the future and you can avoid assessments even if
12 there might be RICO violations in the future is a consequence of
13 your having focused on an outcome-based remedy?

14 A. I think the important point is that there is no perfect
15 answer here. But you're right; the consequence of an
16 outcome-based remedy is that those hypotheticals are possible.

17 Q. All right. Let's turn now to some of the details of your
18 proposed remedy and let's start with the targets themselves,
19 okay?

20 A. Okay.

21 Q. Fine. Isn't it true that you do not know what the
22 prevalence of youth smoking would be if the defendants commit no
23 RICO violations in the future?

24 A. That's true.

25 Q. And you don't claim that your targets reflect the

1 prevalence or the number of youth smokers that would obtain in
2 the future if the defendants commit no future RICO violations,
3 correct?

4 A. That's true.

5 Q. Instead, as I think you said earlier this morning and
6 also certainly in your written direct, the targeted reductions
7 for youth smoking that you use for your remedy come from the
8 1997 Proposed Resolution, correct?

9 A. Yes.

10 Q. And one of the reasons that you said that you thought
11 that those targets were achievable or reasonable, both in your
12 written direct and earlier today in your oral testimony, was
13 that the defendants had agreed to them as part of the 1997
14 Proposed Resolution, correct?

15 A. That's correct.

16 Q. Now, let me ask you: Isn't it true that the defendants
17 might have agreed to the targeted reductions in youth smoking in
18 1997 Proposed Resolution even though they did not think they
19 could achieve them?

20 A. I don't know what was in the defendants' mind when they
21 signed that proposed resolution, but it's certainly possible.

22 Q. And in fact merely because the targeted reductions in
23 youth smoking were agreed to in the proposed resolution does not
24 mean -- does not mean that the targeted reductions were
25 achievable, correct?

1 A. Once again, I don't know -- I wasn't in the room when
2 they signed that so I don't know why those particular levels
3 were chosen.

4 Q. Well -- but you did study the proposed resolution,
5 correct?

6 A. Yes.

7 Q. And in fact, isn't it your view that the 1997 Proposed
8 Resolution was attractive to the cigarette manufacturers because
9 it afforded them significant protection from civil liability in
10 the future?

11 A. Yes.

12 Q. And I don't mean to test your memory and we can look if
13 you like, but let's just explore briefly a couple of those
14 provisions. One of the provisions would have barred punitive
15 damages for past conduct, correct?

16 A. I believe that's right.

17 Q. It would have permitted only individual lawsuits to go
18 forward, barring class actions and joinders and aggregations,
19 consolidations -- suits like this one, correct?

20 A. I don't remember the exact details, but I do know it
21 would have barred a class of group actions.

22 Q. And in fact that limitation permitting only individual
23 actions to proceed for smoking and health damages was one that
24 would have applied both to past conduct as well as to future
25 conduct, correct?

- 1 A. I don't remember.
- 2 Q. Isn't it true that the defendants under the proposed
3 resolution had to make certain annual payments?
- 4 A. Yes.
- 5 Q. Isn't it true that those annual payments were reduced by
6 80 percent of the amount that they paid in future damages in
7 individual actions?
- 8 A. It's ringing a bell, but I don't remember exactly.
- 9 Q. You don't remember the exact percentage or you don't
10 remember the offset?
- 11 A. I don't remember the offset.
- 12 Q. Okay. And as we discussed, even the lookback penalties
13 that are akin to what you're proposing here, the defendants were
14 entitled to a rebate if they could show they had not explicitly
15 targeted youth, right?
- 16 A. Correct.
- 17 Q. Okay. Isn't it possible that the protections afforded to
18 this industry by the 1997 Proposed Resolution were valuable
19 enough that they might be willing to agree to reductions in
20 youth smoking that they didn't think they could achieve?
- 21 MR. GETTE: Objection, Your Honor; it calls for
22 speculation.
- 23 MR. BIERSTEKER: I said, "Isn't it possible?"
- 24 BY MR. BIERSTEKER:
- 25 Q. That's exactly --

1 THE COURT: You may answer if you can.

2 THE WITNESS: I wasn't in the room; I don't know what the
3 motivations were. It certainly is possible. It was part of a
4 package deal and it certainly is possible, but I don't know if
5 it's probable or what the thinking was.

6 BY MR. BIERSTEKER:

7 Q. Isn't it true that when you were at the Treasury
8 Department, you assessed whether or not defendants would be able
9 to achieve the targeted reductions in youth smoking contained in
10 the 1997 Proposed Resolution?

11 A. I don't think that's true.

12 Q. All right. Let's take a look.

13 If I could have JD 053441, please. Do you want the
14 number again, Jamey?

15 This is a memorandum that you wrote in September of 1997
16 to Secretary Rubin and Deputy Secretary Summers, right?

17 A. Right.

18 Q. And it says "Tobacco Settlement Analysis." This is at
19 the time that the proposed resolution was pending, correct?

20 A. Once again, when the administration was analyzing it,
21 yes.

22 Q. Okay. Fine. And you say on the first page that
23 "Economic Policy" -- and that's when you were the Assistant
24 Deputy Secretary, right?

25 A. Right.

1 Q. Okay. "Economic Policy has been working closely with the
2 Council of Economic Advisers, the Office of Management and
3 Budget and Bruce Reed of the White House to analyze the proposed
4 tobacco settlement as negotiated by the states Attorneys General
5 and the major firms of the tobacco industry."

6 That's what you were doing, correct?

7 A. Correct.

8 Q. And if you turn to the second page of the document, you
9 talk there under the heading "Revising the Youth Lookback
10 Surcharge" -- do you see that heading?

11 A. Yes.

12 Q. And in fact, isn't it true that you said: "Our current
13 price and use projections indicate that the targets would
14 not" -- your emphasis, in italics -- "be met"?

15 A. That's what it says there, yes.

16 Q. Does that refresh your recollection about what you told
17 Secretary Rubin and Deputy Secretary Summers back in 1997 about
18 whether these targeted reductions in youth smoking were
19 achievable?

20 A. What -- there's an important distinction in what you're
21 asking and what this says. What this says is they would not be
22 met. What that meant was based on the annual payments that the
23 tobacco -- we expected the tobacco companies to make, given the
24 increase in price that would be induced by those annual
25 payments, that would not be enough to reduce youth smoking by

1 60 percent.

2 This has nothing to do with whether they could or could
3 not do it. It's a "would," not a "could."

4 Q. Well, in fact, as I think you testified earlier today,
5 prices have gone up by 60 percent, right, since the MSA?

6 A. That's true, yes.

7 Q. And I think you also said today that in roughly the same
8 time period, youth smoking declined by 30 percent; that's the
9 credit you're going to give these defendants, right?

10 A. Correct.

11 Q. Okay. And yet you tell the Court that every percent
12 increase in price results in a one-for-one reduction in youth
13 smoking, correct?

14 A. Correct.

15 Q. But that didn't happen in the real world when prices
16 increased by 60 percent and youth smoking declined by 30,
17 correct?

18 A. As I've already testified earlier this morning, it's
19 dangerous to try to infer causality from two corresponding time
20 trends. Price went up; youth smoking went down. As I responded
21 to the judge earlier, I think price played some role. But there
22 are many other factors going on over time.

23 The elasticity of minus one comes from a careful
24 econometric study that attempts to control for those other
25 factors, not from simply comparing corresponding time series.

1 Q. So the 30 percent reduction in youth smoking that we have
2 observed during the time period when there has been a 60 percent
3 increase in price might be in part due to factors other than
4 price, correct?

5 A. Part of that reduction might may be due to factors other
6 than price. At the same time, there may be other factors other
7 than price which would have pushed it up, absent the price
8 increase. There are other things going on in the background
9 over time. That's why it's dangerous to infer an elasticity
10 just from that time series correspondence.

11 Q. And that nonprice behavior is something that you're not
12 an expert in, correct?

13 A. No, I'm not an expert in nonprice behavior.

14 Q. Thank you. Let's turn to another document that you wrote
15 when you were back at the Treasury Department, JD 068062. And
16 this is something that was faxed to you in care of Bruce Reed.
17 Bruce Reed was an very senior White House advisor, was he not?

18 A. Yes, he was.

19 Q. Was he the Domestic Policy Advisor to President Clinton?

20 A. I believe that was his title.

21 Q. Okay. And this was just a couple days after the memo we
22 just looked at. This one's on September 11th, 1997.

23 And if we could go to the first page of the document,
24 please, after this fax cover sheet. No, that's not it at all.
25 There we go.

1 What you have is a draft of a "Revised Youth Lookback
2 Surcharge," right?

3 A. Yes.

4 Q. Okay. And the first page of this analysis, both in the
5 text and in the graph --

6 If we could maybe bring out the graph. Thank you very
7 much, Jamey.

8 -- clearly shows, doesn't it, that the targeted
9 reductions in youth smoking would not be achieved even with the
10 company-specific fines that you were then considering, correct?

11 A. Yes. That shows our estimates, that even with the new
12 lookback that we were contemplating early on in
13 September 1997 -- that remain above the target levels.

14 Q. Right. And just to make it clear, the top line there --
15 first of all, the steps show the targeted reductions from the
16 proposed resolution, correct?

17 A. Correct.

18 Q. All right. And the very top line, which says "Original
19 Path From Settlement" -- that's the reduction in youth smoking
20 that you were projecting at the time would be achieved under the
21 1997 Proposed Resolution, correct?

22 A. I believe so, yes.

23 Q. And the 1997 Proposed Resolution, as we discussed,
24 imposed penalties on the entire industry, not on specific
25 companies, correct?

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- 1 A. Correct.
- 2 Q. All right. And the folks in the administration were
3 considering a new lookback penalty that would have had part of
4 it imposed on the industry as a whole and part of it imposed on
5 specific firms, correct?
- 6 A. Correct.
- 7 Q. All right. And the remedy that you proposed in this case
8 is one that imposes your assessment on specific firms --
9 specific companies, correct?
- 10 A. Correct.
- 11 Q. Okay. And even with the new lookback which includes the
12 company-specific penalties -- that's the dotted line, right?
- 13 A. Correct.
- 14 Q. Okay. And it's well above, is it not, the targeted
15 reductions?
- 16 A. Once again, the new lookback that we're proposing there
17 is -- may be structurally similar to what I'm discussing today,
18 but it's not necessarily the same. I wouldn't want to imply
19 that it's the same amounts or anything.
- 20 But certainly our projections at that time were that it
21 would remain -- even with the new lookback, it would remain
22 above the targets.
- 23 Q. You examined the issue of the achievability of the
24 smoking reductions that were targeted in 1998, did you not?
- 25 A. I don't recall.

1 MR. BIERSTEKER: All right. Well, why don't we take a
2 look at JD 068061.
3 BY MR. BIERSTEKER:
4 Q. And this is an e-mail from you to, among others, Deputy
5 Secretary Summers, correct?
6 A. Correct.
7 Q. And it's dated June 10th, 1998, correct?
8 A. Correct.
9 Q. And it's entitled "Youth Lookback Revenue Estimates,"
10 correct?
11 A. Correct.
12 Q. And as you explained, Mr. Reed had asked the Treasury
13 Department apparently to prepare an estimate of the revenues
14 that you estimated would be raised by a new lookback provision
15 prepared by Durbin over 25 years, correct?
16 A. Yes.
17 THE COURT: And Durbin -- was that a U.S. Senator?
18 THE WITNESS: Senator Durbin from Illinois.
19 THE COURT: That's what I thought.
20 MR. BIERSTEKER: I'm sorry. I should have made that
21 clear.
22 BY MR. BIERSTEKER:
23 Q. And what you tell Deputy Secretary Summers and others in
24 the last sentence of that first paragraph is: "The results are
25 that we raise no money over 5, since we meet our targets, 5

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1 billion over 10 and 62 billion over 25 in real dollars."
2 Right?
3 A. Right.
4 Q. Okay. And in order for there to be any money raised from
5 the new lookback scheme being proposed by Senator Durbin, that
6 meant that the targeted reductions in youth smoking were not
7 achieved, correct?
8 A. That's correct. Once again, I don't remember what
9 Durbin's targets were or what his penalties were, but certainly
10 under the basic structure if there was any money raised, it
11 meant Durbin's targets weren't achieved.
12 Q. And you note -- going down to the last paragraph, you
13 say: "It is worth noting that McCain" --
14 Senator McCain, right?
15 A. Yes.
16 Q. Okay.
17 -- "has requested a similar score of the youth" -- excuse
18 me -- "of lookback payments from JCT."
19 Is "JCT" the Joint Committee on Taxation?
20 A. Yes, it is.
21 Q. Okay. And you go on to relate that while you've not yet
22 heard the outcome, "they appear to model youth smoking as
23 falling substantially less than we do."
24 Is it fair to say that what you thought the Joint
25 Committee on Taxation was projecting was that youth smoking

1 would fall even less than you, the folks at Treasury, thought it
2 was going to fall?

3 A. That's what's implied there, yes.

4 Q. And so what's implied there is that they thought the miss
5 in terms of the youth smoking targets was going to be even
6 greater than the 62 billion over 25 years?

7 A. Once again, whatever those targets were and whatever the
8 penalty was, yes, they thought it would be greater.

9 Q. All right. Let's go to the middle section of this
10 e-mail.

11 "Mr. Reed reports to me that these figures are for
12 internal use only for now. Your views on whether we should ever
13 allow these to be public as opposed to maintaining our public
14 line that targets will definitely be met in all circumstances
15 would be appreciated."

16 Do you see that?

17 A. Yes, I do.

18 Q. And in fact, isn't it true that the estimates that you
19 were generating internally at the Treasury Department and that
20 apparently the Joint Committee on Taxation was in the midst of
21 preparing were at odds with the publicly taken position of the
22 administration that the youth targets would definitely be met?

23 A. That's what that implies. I don't remember exactly what
24 the public position of the administration was, but certainly
25 that's what's implied.

1 Once again, let me emphasize this is for a very
2 different -- I don't remember what Durbin's structure was. This
3 is for a potentially different structure.

4 I should also emphasize that the literature on the
5 sensitivity of youth smoking to prices advanced enormously since
6 1998, so this is just a very different world that you're
7 comparing here.

8 Q. Let me ask you this: When you were privately advising
9 Clinton administration officials, you were trying to give them
10 your honest, best advice, weren't you?

11 A. Absolutely.

12 Q. Okay. And can you identify a single time in any of the
13 documents that have been produced to us where you said, "Well,
14 of course they're achievable; the industry agreed to them"?

15 MR. GETTE: Objection, Your Honor. There's no foundation
16 that this witness even knows what the universe of documents that
17 were produced to the defendants were.

18 THE COURT: No, objection's overruled.

19 THE WITNESS: So can you repeat the question?

20 BY MR. BIERSTEKER:

21 Q. Yeah. Did you ever advise Secretary Summers or Mr. Read
22 at the White House or any other senior administration official
23 that "Of course we don't have to do all this analysis; these
24 targets are achievable because the defendants agreed to them in
25 the 1997 Proposed Resolution"?

- 1 A. No, I don't think I did, but I can't say for sure.
- 2 Q. Now, you asserted earlier this morning and also in your
3 written direct examination that you thought the targeted
4 reductions in youth smoking could be achieved if the defendants
5 simply raised their prices by 42 percent?
- 6 A. Yes, that's correct.
- 7 Q. And that's a 42 percent increase in real dollars,
8 correct?
- 9 A. Yes.
- 10 Q. And that means that it's a 42 percent increase over and
11 above the rate of inflation, right?
- 12 A. That's correct.
- 13 Q. Okay. Let's talk about that, too. We touched on it
14 briefly when we talked about real world experience after the
15 MSA, but let's talk about what you did when you were at the
16 Treasury Department. And as we discussed, the proposed
17 resolution would have imposed these -- the "penalties" is what
18 they were referred to -- for failing to achieve youth smoking
19 reduction targets upon the entire industry, right?
- 20 A. Yes.
- 21 Q. And that's an important difference because industrywide
22 penalties are likely to be passed through to consumers in the
23 form of higher prices, correct?
- 24 A. The industrywide penalties are likely to pass through in
25 the form of higher prices; that's correct.

1 Q. And indeed historically, that's what's happened, for
2 example, when the federal excise tax has been increased; the
3 increase in the excise tax has been passed through to consumers
4 in the form of higher prices, right?

5 A. Correct.

6 Q. And excise taxes apply, of course, to every manufacturer
7 of cigarettes, correct?

8 A. Correct.

9 Q. In contrast, textbook economic theory at least teaches us
10 that it would be impossible for an individual firm to pass
11 through to consumers a company-specific penalty that applied
12 only to it, correct?

13 A. If there's a company-specific penalty that applies only
14 to one firm in a competitive market, it would be impossible to
15 pass it on; that's right.

16 Q. And the U.S. cigarette industry is not a perfectly
17 competitive market, correct?

18 A. Correct.

19 Q. But even in the United States cigarette industry, it
20 would be difficult, would it not, for an individual company to
21 pass through to consumers a company-specific penalty that it
22 alone faced?

23 A. You know, "difficult" is a hard word to interpret. It
24 certainly would not be as natural as if it was an industrywide
25 penalty. The extent to which they could pass it through the

1 price is hard to ascertain in this industry.

2 Q. All right. Well, let's look at your deposition, page
3 861, line 23 to 862, line 7.

4 I asked you: "And you're saying, recognizing that this
5 industry does not exactly mirror perfect competition as we see
6 in economic textbooks, it may be possible for a company-specific
7 levy to get passed through to consumers in the form of higher
8 prices, but you agree it would be very difficult, correct?"

9 And you answered: "I don't know if I'd add the qualifier
10 'very,' but it would be difficult."

11 And I say -- "Question: It would be difficult?"

12 And you said: "Yes."

13 That's your testimony, sir?

14 A. Yes.

15 Q. Do you stick by it?

16 THE COURT: Under your proposal, would the companies or
17 the industry be attempting to pass through to consumers the
18 amount of the assessment they had to pay for failing to meet the
19 target or would they be attempting to pass through to smokers --
20 and I should have said "smokers" rather than "consumers"
21 before -- the increase in price that they thought would get them
22 to meet their target?

23 THE WITNESS: That's a good question and there's no right
24 answer to that. Certainly to the extent that they decide to try
25 to meet the target by price, that will be passed on to consumers.

1 As I said, if -- and if they meet their targets, then we're done,
2 but if we don't meet the targets, then there is an assessment on
3 them.

4 To the extent that that assessment is levied similarly on
5 several manufacturers -- let's say they all miss -- then it seems
6 likely that at least some of that could be passed under price.

7 To the extent only one -- to come to Mr. Biersteker's
8 example, to the extent only one manufacturer misses and the
9 others don't, it might be difficult for that manufacturer to pass
10 it on to price.

11 BY MR. BIERSTEKER:

12 Q. And that would be true, would it not -- wouldn't that be
13 true regardless of whether or not there was a company-specific
14 levy or if that particular firm alone decided to try to meet its
15 youth smoking reduction targets by raising its price?

16 A. Yes.

17 Q. Okay. And in fact, isn't it true that when you were at
18 the Treasury Department, you were of the view that
19 company-specific assessments of the kind that you are proposing
20 in this case would not be passed through to consumers in the
21 form of higher prices?

22 A. I certainly was of the view that it was unlikely.

23 Q. And the reason you thought that it was unlikely was you
24 thought that any price differential between companies would
25 dramatically affect their market share, correct?

1 A. Once again, we have to distinguish between a part that's
2 common to many companies, which I think can largely be passed
3 under price, and one that's specific to only one company.

4 For the most part, if it's specific to only one company,
5 as you say, textbook theory tells us it will be difficult to
6 pass that on to price.

7 Q. And the remedy you're proposing here is company-specific
8 as opposed to industrywide, correct?

9 A. Yes; correct.

10 MR. BIERSTEKER: Why don't we just pull up JD 068063,
11 please.

12 BY MR. BIERSTEKER:

13 Q. This, unfortunately, is not dated, but your name appears
14 at the top. It's from you to a Mr. Wolin. Do you see that?

15 A. Yes.

16 Q. Okay. And you talk about "tougher lookback surcharges"
17 and you say there that the companies -- and you're talking about
18 company-specific surcharges here, correct?

19 A. Yes. Once again, I can't verify that I authored this.
20 It looks like I passed it on to him, but I don't know -- I can't
21 verify that I actually authored it as opposed to just passing it
22 to him from someone else.

23 Q. If you thought it was worthless, you wouldn't have passed
24 it on, correct?

25 A. Yes.

1 Q. Okay. All right.

2 "The companies will not be able to pass these

3 company-specific surcharges on to price because any price

4 differential between companies will dramatically affect their

5 share of the adult market." Correct?

6 A. That's what it says.

7 Q. And in fact we've seen that occur, haven't we?

8 A. I don't know.

9 Q. Isn't it true that there was a period of time when my

10 client's cigarettes, Reynolds' cigarettes, were just a few cents

11 more per pack than Philip Morris's and my client lost

12 significant market share after that price differential existed?

13 A. I don't know.

14 Q. All right. Well, let's see if we can refresh your

15 memory.

16 If I could have JD 0605- -- excuse me -- 068058.

17 Which I think you already have in front of you. It's the

18 May 1998 "Youth Lookback Penalties Overview" memo that you

19 wrote. And if you could turn to the page marketed 200 on the

20 bottom. It's about halfway through the document. I think it's

21 page number 5 at the top.

22 Are you with me?

23 A. Okay.

24 Q. And I'm looking at the first full bullet point on the

25 page, the last sentence.

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1 A. Okay.

2 Q. You write there: "Firms are reticent to have any price
3 differential between premium brands," and then you have a
4 parenthetical. "Just a few cent differential between Philip
5 Morris and RJR a few years ago led to a five percent reduction
6 in RJR's market share."

7 Do you see that?

8 A. Yes, I do.

9 Q. Okay. Here's the point. If an individual defendant
10 cigarette manufacturer in this case attempted to achieve the
11 targeted reductions in youth smoking that you propose in your
12 remedy by increasing their prices not by a few cents, but by
13 42 percent in real dollars, isn't it true that they get killed
14 if their competitors didn't follow along?

15 A. Once again, I don't remember the evidence behind this
16 memo. It looks like when I wrote it I was making the same
17 mistake I've described twice this morning of trying to attribute
18 a time series change to another time series change.

19 I don't actually know -- once again, as I have, I think,
20 mentioned to you before, I did not do much research on tobacco
21 before I worked on this in government. I subsequently have done
22 a lot of research in tobacco.

23 I don't actually know of any convincing evidence of a
24 cross-price elasticity across manufacturers; that is, I don't
25 really know of good evidence about the extent to which a rise in

1 price by one manufacturer leads to a shift in demand for another
2 manufacturer's product. You would think it would be something
3 we would know, but in fact there's not good evidence on that of
4 which I'm aware.

5 Q. Certainly it's not your testimony that if -- well, let's
6 just pick a number. Let's say that the price of cigarettes is
7 \$4 now, I don't know what it is, but let's just say it's \$4.
8 And if my client, Reynolds, increased the price of its
9 cigarettes by 42 percent, so say a little less than \$6 per pack
10 for its cigarettes, and Philip Morris did not, is it your
11 testimony that under those circumstances R.J. Reynolds Tobacco
12 Company wouldn't bleed adult smokers share the market to Philip
13 Morris?

14 A. I don't know the definition of the word "bleed", but
15 certainly it's true that at that price differential I imagine
16 there would be considerable switching away from it. If the
17 differential is that large, I would imagine there would be
18 considerable switching. As I said, despite growing tuition to
19 that effect, there's actually not good evidence I'm aware of of
20 how fair those price switching decisions are.

21 Q. If you don't know what would happen, is it fair to say
22 that you cannot testify that an individual defendant cigarette
23 manufacturer in this case could realistically increase its
24 prices by 42 percent in real terms in order to achieve the
25 targeted reductions in youth smoking without facing dire

1 competitive consequences in the market, including the adult
2 market?

3 A. I have to have two qualifiers to that. First of all, as
4 I said repeatedly, I don't expect that these goals are met
5 purely by increasing price by 42 percent. Second of all, you
6 asked if a given manufacturer increased price, if a given
7 manufacturer alone increased price by 42 percent and no one else
8 increased price at all, that would, I would imagine, have very
9 serious negative consequences. I don't see how that could
10 possibly ever be the case. Clearly, to the extent there's any
11 commonness across manufacturers, many would be rising prices
12 simultaneously. So that seems a very extreme hypothetical.

13 Q. Well, there are a whole bunch of cigarette manufacturers
14 who are not defendants in this case, correct?

15 A. Correct.

16 Q. Are you suggesting that it would be a good thing if these
17 defendants colluded to raise prices in lockstep?

18 A. No.

19 Q. How else is a uniform price increase of the kind you're
20 suggesting something to occur?

21 A. They don't have to collude to raise -- for prices to
22 increase together. If they all face a common incentive to
23 reduce youth smoking, then by raising prices then prices can
24 raise without collusion.

25 Q. They would have to tacitly collude, correct?

1 A. I don't know the definition of tacit collusion, I'm
2 sorry.

3 THE COURT: Isn't it true that there has been a very
4 substantial change in the configuration of the cigarette market
5 in that the companies that are non defendants in this case have
6 an increasing share of the market even though it's still not --
7 my recollection is nowhere near a majority share of the market,
8 but an ever increasing share of the market. Am I correct about
9 that?

10 THE WITNESS: Yes. I don't know the exact numbers, but
11 certainly the major tobacco manufacturers which used to control
12 about 97 percent of the market now I think if you include the
13 defendants in this case control around 85, 84 percent of the
14 market. That's true.

15 THE COURT: And therefore, if your remedy was implemented
16 and these defendants reacted economically, if you will, and let's
17 say they all decided to increase prices, wouldn't that result in
18 a dramatic windfall, if you will, to the non defendant tobacco
19 companies in terms of their obtaining an increase in the market
20 share, in the fair market share?

21 THE WITNESS: Once again, I hate to sound like a broken
22 record, but it's hard to infer that lesson from what we've seen
23 in the past. It's true that we've seen since 1997 prices have
24 gone up and these other actors have gained a share of the market,
25 but there may be other reasons that that happened. For example,

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1 there's been an increased taste for generic products in society
2 in general. There has -- the defendants in this case may have
3 decided in the wake of the 1993 price war to basically seed the
4 discount market, these other manufacturers. We can't -- once
5 again, without reliable evidence outside of these time series
6 correlations on how price sensitive people's decisions are
7 between switching now between this group of major products and
8 this totally different kind of product, this discount kind of
9 product, without good evidence on that, I can't say what's going
10 to happen with another 42 percent increase. Yes, it's true that
11 these others have grown, but we can't really say why at this
12 point. There's just not been a good study of that,
13 unfortunately.

14 BY MR. BIERSTEKER:

15 Q. Certainly economic theory would suggest that if these
16 defendants were to increase their prices while other cigarette
17 manufacturers did not, they will lose market share, correct?

18 A. Yes, that's correct.

19 Q. You said something about seed the discount market. Isn't
20 it true, for example, that my client, and I think Brown &
21 Williamson as well, have a significant presence in the value
22 cigarette or discount cigarette market?

23 A. Traditionally it had, yes.

24 Q. Isn't it true that that, as you know it, I think in your
25 written direct, in the wake of the Master Settlement Agreement,

1 as these defendants started to lose market share, they
2 increasingly started to discount the prices of their cigarettes
3 through price promotions?

4 A. That's different than having discount cigarettes. What I
5 meant was they offered price reductions on their premium --
6 well, on all their brands.

7 Q. On all their brands. That is not seeding the market, is
8 it?

9 A. Once again, I'm not an expert in this area, but I
10 understand that they're -- that there's been less effort put
11 into promoting these kinds of discount lines as opposed to
12 trying to more aggressively promote and market the premium lines
13 of cigarettes.

14 Q. Would you agree with me that the increasing report to
15 price related promotions in the wake of the MSA, the initial
16 price increases, and then subsequent loss of market share, is a
17 means by which these defendants compete with smaller cigarette
18 manufacturers on price?

19 A. I don't know if they're competing with each other or with
20 smaller cigarette manufacturers. Certainly there is more
21 competition going on -- you know, price competition certainly
22 picked up in terms of using price discounts.

23 Q. Let's talk about a little bit more about the effect of
24 price on youth smoking daily initiation. We talked a little bit
25 about real world experience after the MSA with the 60 percent

1 price increase and the 30 percent reduction. But I want to talk
2 a little bit about what you said was the best evidence, and you
3 are referring there, are you not, sir, to a paper written by a
4 fellow named Tauras, T-A-U-R-A-S, I believe.

5 A. Yes, a paper he wrote with Jonathan O'Malley.

6 Q. And that was a paper that appeared in 2001 in the
7 National Bureau of Economic Research Working Paper Series,
8 correct?

9 A. Correct.

10 Q. Now, in their 2001 Working Paper, Tauras and his
11 coauthors recognized that there were two unpublished and two
12 published studies that attempted to address the issue of the
13 effect of price on youth smoking initiation, correct?

14 A. I don't recall the exact number, but they did review the
15 literature.

16 Q. Okay. And isn't it true that all of those other studies,
17 whether they were for or not, conclude that there were economic
18 factors such as cigarette prices and excise taxes were
19 insignificant determinants of youth smoking initiation?

20 A. I don't recall.

21 Q. Why don't we take a look. JD 068070. This is the NBER
22 Working Paper, correct?

23 A. Correct.

24 Q. All right. And I'm looking at the language that appears
25 on page 5. It's in the middle of the page, the first full

1 paragraph.

2 A. Okay.

3 Q. And here they talk about prior studies and they say two
4 published and two unpublished. Do you see that?

5 A. Yes.

6 Q. And they say that "all four studies concluded that
7 economic factors such as cigarette prices and excise taxes were
8 insignificant determinations of youth smoking initiation." Do
9 you see that?

10 A. Yes, I do.

11 Q. Does that refresh your memory?

12 A. That's what they -- they wrote -- they then review the
13 articles thereafter.

14 Q. Yes, they do. And in fact, one of the articles they
15 review thereafter, I may be mispronouncing this, but was a paper
16 by DeCicca and others published in 1999?

17 A. Yes.

18 Q. Okay. And --

19 THE COURT: Of course, the question they examined was
20 youth smoking initiation; isn't that right?

21 THE WITNESS: Yes.

22 THE COURT: Not just -- I don't mean just, but not youth
23 smoking as a whole.

24 THE WITNESS: You know, you raise a good point in some
25 sense what the paper I really would have liked to use here, if it

1 was written, is what is the effect of higher prices in the long
2 run on youth smoking as a whole. Not just initiation. This
3 paper, I think, forms the best approximation to that ideal, but
4 that ideal paper doesn't exist. The one I would have used would
5 be the effect on daily smoking in the long run of increasing
6 prices. The effective initiation should proximate that.

7 THE COURT: And if you know, isn't it correct that the
8 studies show that most youths start their smoking by being given
9 cigarettes by peers or friends or even family?

10 THE WITNESS: I don't know.

11 THE COURT: Okay.

12 BY MR. BIERSTEKER:

13 Q. Doctor, in the four years since 2001, the NBER Working
14 Paper by Tauras et al has not appeared in a peer-reviewed
15 literature, has it?

16 A. I don't know.

17 Q. However, the DeCicca paper that they reference has
18 appeared in the peer-reviewed literature, correct?

19 A. Correct.

20 Q. It was in the Journal of Political Economy?

21 A. Correct.

22 Q. And that is peer-reviewed. Is it a respected journal?

23 A. It's one of the best journals in economics, yes.

24 Q. And if we could take a look at that peer-reviewed
25 article, it's U.S. Exhibit 78,803. And if we go just to the

1 abstract, sir.

2 A. Okay.

3 Q. What they find is "we find weak or nonexistent tax
4 effects in the models of the onset of smoking between 8th and
5 12th grades." Do you see that?

6 A. Yes, I do.

7 Q. In English that basically means they don't find, in
8 effective, price differentials due to tax differences in
9 different states on the rates of smoking initiation among 8th
10 and 12th graders, correct?

11 A. Correct.

12 Q. All right. And this paper, if you look down a little
13 bit, the authors among the individuals who are thanked for their
14 contributions to this article are none other than Dr. Chaloupka,
15 Dr. Harris, Dr. Mulholland among others, correct?

16 A. Correct.

17 Q. Have you looked to see whether or not Tauras has another
18 paper out since 2001 that addresses the same topic --

19 A. Yeah, there's a related paper in 2003, I think.

20 Q. Actually, I think it's 2004, the one I have in mind. Why
21 don't we take a quick look at it. It's JD 068064.

22 And it's, as I understand it, it's dated December 2004.
23 Do you see that?

24 A. Yes, I do.

25 Q. But it was to be presented earlier this year, in 2005, at

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1 a professional meeting, correct?

2 A. That's what it says.

3 Q. Okay. And if we'll turn to page -- this is entitled:

4 Body Weight, Cigarette Prices, Youth Access Laws and Adolescent

5 Youth Smoking Initiation, correct?

6 A. Correct.

7 Q. And if we turn to the third page, in this more recent

8 paper Tauras and his coauthors first note that "the results from

9 initiation studies that use longitudinal data are mixed."

10 Right?

11 A. Right.

12 Q. Do you disagree that the results concerning the effect of

13 price on smoking initiation using longitudinal data are still

14 mixed as of December 2004?

15 A. I -- in my opinion, they are -- the best paper is the one

16 I used, but certainly there are papers that come to different

17 conclusions.

18 Q. Okay. And if you follow on in the same paragraph,

19 "Tauras here refers to his 2001 paper upon which you rely, and

20 it concluded that cigarette prices are strongly negatively

21 correlated with the probability of transition to daily smoking,"

22 right?

23 A. Correct.

24 Q. Okay. And then he goes on to note, "however, the effect

25 of price on the probability of transition to smoking any

1 quantity of cigarettes is not statistically significant." And
2 he cites DeCicca in the published article in 2002, correct?

3 A. You make an incorrect inference. That sentence refers
4 back to his article, not to the DeCicca article.

5 Q. Yes, you're right. Fair enough.

6 A. But what they did in their article is they looked at two
7 things, the effect of smoking at all, including those who smoke
8 casually, and the effect of smoking daily and they found very
9 small effects on the effects of smoking at all, like smoking
10 once a month, but very significant affects on the effects of
11 smoking daily.

12 Q. But then he cites DeCicca and says they didn't find any
13 significant relationship between differences in cigarette excise
14 taxes and the onset of smoking, correct?

15 A. If you write an article in literature, you're supposed to
16 cite those that have gone before whether you agree with them or
17 not.

18 Q. Let's see what Tauras does in this 2004 paper. So if we
19 could turn to page 7. He starts off by saying "we're going to
20 look at three measures of smoking initiation." And I can read
21 what's there, but let me see if I can paraphrase it and cut
22 through it a little bit. The first one is whether you've ever
23 smoked a cigarette. The second one is if you smoke at least
24 once a week. And the third is if you smoke 5 to 6 times a week,
25 right?

- 1 A. Right.
- 2 Q. And he's going to take a look at the effect, among other
3 things, price on those three measures of smoking initiation.
4 Which of those three measures, Doctor, more closely approximates
5 the daily smoking initiation measure that you're using in this
6 cases?
- 7 A. The third.
- 8 Q. The third?
- 9 A. It doesn't exactly equal it because "daily" means you're
10 smoking every day five or six times a week is somewhat
11 different, but it's the closest of the three.
- 12 Q. Okay. Why don't we turn to page 12 of the article and
13 take a look at what Tauras reports for results. He says:
14 "Cigarette prices have little effect on the initiation decision
15 of adolescent girls." Do you see that?
- 16 A. Yes.
- 17 Q. Okay. And as to adolescent boys further down on the
18 page, the next paragraph, he says "the results for adolescent
19 boys differ considerably from the results for girls." Do you
20 see that?
- 21 A. Yes.
- 22 Q. And then he goes on to talk about it, and he says with
23 respect to his first measure of initiation, and if you remember,
24 Doctor, will you agree with me that the first measure of
25 initiation was having ever smoked a cigarette?

1 A. That -- presumably he didn't mess up his order, that's
2 what he means.

3 Q. And he found the price was negatively and statistically
4 significantly related to having ever smoked a cigarette,
5 correct, among the adolescent boys?

6 A. Correct.

7 Q. Okay. If we go to the top of the next page, 13, isn't it
8 true that what Taurus now reports in 2004 is that for boys price
9 matters for having ever smoked a cigarette, but the initiation
10 of heavier smoking is driven by non-price considerations?

11 A. That's what he's written. I don't know what that
12 implies, is the actual -- driven by non-price may mean he found
13 strong non-price effects. I don't know what he found for price
14 effects for this population.

15 THE COURT: Well, he's also looking at body mass index,
16 which so far as I can figure out, is not related to this lawsuit,
17 so go ahead, Mr. Biersteker.

18 MR. BIERSTEKER: I think Your Honor -- let me just ask the
19 witness.

20 BY MR. BIERSTEKER:

21 Q. Isn't one of the theories that gets bantered about is
22 that adolescent girls who perceive themselves to be over weight
23 are more likely to smoke?

24 A. Yeah.

25 Q. And that would be a reason for including a variable for

1 body mass index in a study such as this one, correct?

2 A. That's correct.

3 THE COURT: Well, let me just be clear. I didn't make
4 that comment to criticize the authors of the article who are
5 doing academic research but to keep us all focused on what's
6 before me in this case.

7 BY MR. BIERSTEKER:

8 Q. All right. Well, why don't we turn to the abstract of
9 this article, and Tauras reports finding clear gender
10 differences and he says "these gender-specific differences may
11 help explain the mixed evidence of the impact of price on
12 smoking initiation found in the previous literature." Do you
13 see that, first of all?

14 A. Yes.

15 Q. Okay. And what he's basically doing, is he not, is he's
16 suggesting that the results of his earlier 2001 non
17 peer-reviewed working paper upon which you rely, and the DeCicca
18 published article, the conflict between them might be due to the
19 fact that in neither of those studies where the effects of price
20 separately estimated by gender?

21 A. I don't know if that's exactly what he means. Once
22 again, the -- when you write an article like this you try to be
23 nice to the previous literature whether you actually agree with
24 it or not, but its certainly -- this article certainly suggests
25 there are gender-specific differences which are important.

1 THE COURT: Are you changing topics at this point?

2 MR. BIERSTEKER: I am, Your Honor.

3 THE COURT: All right, I'm going to let Dr. Gruber step
4 down. At this point, it's as good a time as any for me to put on
5 the record, as I promised counsel, my reasoning on the
6 Dr. Bazerman decision just so that, as I say, the record is
7 clear.

8 I always prefer, as I think counsel know, to have a
9 written opinion that can perhaps withstand closer scrutiny, but
10 there isn't time at this point, and it's important that this
11 decision have gotten made so that everybody can move on with
12 their choices as to selection of future witnesses.

13 As counsel know, joint defendants moved to strike the
14 testimony and accompanying exhibits of Dr. Max Bazerman for
15 failure to comply with the evidentiary standards set forth in
16 Daubert versus Merrel Dow Pharmaceuticals, Inc. 509 US 579, a
17 1993 Supreme Court case, and the subsequent case law in our
18 circuit.

19 The government presented Dr. Bazerman as an expert in the
20 field of behavioral decision research and in particular as that
21 discipline is focused in managerial organizational contexts,
22 namely corporations.

23 Joint defendants did spell out in their supplemental
24 memorandum their detailed arguments about the need to strike
25 Dr. Bazerman's testimony under the Daubert standards and under

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1 Federal Rule 702.

2 In reaching my decision to deny the motion, despite my
3 initial concerns, which I shared with counsel about whether the
4 Daubert criteria were satisfied, I am, of course, relying heavily
5 on the Daubert opinion itself, as well as cases in this circuit.
6 The leading one, at least in my view, is Ambrosini versus
7 Labarraque, 101 Fed 3d 129, and that's a D.C. Circuit opinion
8 from 1996.

9 Perhaps the most recent one, or one of the most recent
10 ones, is Meister versus Medical Engineering Corporation, 267 Fed
11 3d, 1123, D.C. Circuit of course, 2001.

12 There are a number of other Court of Appeals opinions on
13 application of the Daubert criteria, and there are also a number
14 of other District Court decisions discussing the Daubert issues.

15 I can't say I've read every single one, but I've read a
16 number of them. None of them were either inconsistent with my
17 present ruling now, and none were, in my view, more directly
18 applicable than Ambrosini where the Court of Appeals spelled out
19 its view of Daubert in great detail. First it must be
20 remembered, and Ambrosini points this out at page 133, quote,
21 that the Daubert standard involves a two-prong analysis that
22 centers on evidentiary reliability and relevancy, unquote.

23 As to relevancy, I'll take that first because it's so much
24 easier, there is no question that the testimony given was
25 extremely relevant to many aspects of remedies which I may have

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1 to address.

2 The question of whether the remedies and the procedures
3 recommended by Dr. Bazerman, and in particular his recommendation
4 as to the use of monitors and outside lawyers and outside
5 consultants, but the question as to whether those recommendations
6 are legally permissible under existing case law is a totally
7 separate issue from the merits of the recommendations, and that
8 issue is a legal question.

9 In other words, the legalities of the remedies suggested
10 is an entirely separate question from whether the testimony about
11 them may be admitted.

12 Consequently, there isn't, in my view, any merit to
13 defendants' argument that the testimony itself should be struck
14 on the grounds that the remedies suggested are not within the
15 legal authority of the Court. That, as I've said, is a separate
16 question. It will be determined later.

17 Next, it's important to remember that the Daubert inquiry
18 requires that in a jury trial the Judge, as gatekeeper, must play
19 a restricted and a carefully limited role, even though when that
20 Judge sits as a fact-finder in a bench trial, she always has a
21 bit more latitude. In admitting testimony, it certainly does not
22 follow that a Judge in a bench trial sitting as fact-finder
23 should be erring on the side of precluding testimony for failure
24 to meet the Daubert standard. Quite the contrary. In a bench
25 trial, a Judge should be erring, if at all, on the side of

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1 admitting testimony -- of course, we're talking about expert
2 testimony now -- because it's presumed that she will be able to
3 apply rigorous standards when weighing its merits.

4 The Daubert Court was well aware of the limits to the
5 gatekeeper role and instructed the trial Court to focus, quote,
6 solely on principles and methodology, not on the conclusions that
7 they generate, unquote, and that's 509 U.S. at 595.

8 By the same token, in a bench trial, the Court's initial
9 focus under Daubert must also be on principles and methodology,
10 not the Court's evaluation of the merits of evidence. While it's
11 true in this particular instance that the Court as fact-finder
12 has many doubts about the feasibility and the merits of
13 Dr. Bazerman's testimony, that does not justify me acting as
14 gatekeeper to preclude his testimony under Daubert if the Daubert
15 standards can be met.

16 In Ambrosini, as in Daubert, our Court of Appeals
17 recognized the specific and discreet gatekeeping role which is
18 assigned to the trial Judge. Our Court of Appeals has said in
19 Ambrosini that, quote, there is nothing in Daubert to suggest
20 that Judges, and in Ambrosini our Court of Appeals was speaking
21 in the context of a jury trial, not a bench trial, but it said
22 there's nothing in Daubert to suggest that Judges become
23 scientific experts, much less evaluators of the persuasiveness of
24 an expert's conclusion, rather, once an expert has explained his
25 or her methodology and has withstood cross-examination, or

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1 evidence suggesting that the methodology is not derived from the
2 scientific method, the expert's testimony, so long as it fits an
3 issue in the case, is admissible under Rule 702 for the trier of
4 fact to weigh.

5 In this case, of course, I am the trier of fact.

6 Ambrosini goes on to then describe the limited gatekeeper role
7 that Daubert envisions under the Federal Rules of Evidence.

8 Now, let's look at those particular standards. As I said
9 earlier, there are two prongs under Daubert, two prongs to focus
10 on and they are reliability and relevancy and I've already spoken
11 to the issue of relevancy.

12 As to reliability, there are four factors to be
13 considered, and again, Ambrosini spells out those four factors at
14 101 Fed 3d, 134 through -- I'm sorry, 134 through 135. The four
15 factors are very well known.

16 First, whether the theory or technique can be and has been
17 tested. Second, whether the theory or technique has been
18 subjected to peer review and publication. Third, the methods
19 known or potential rate of error, and fourth whether the theory
20 or technique finds general acceptance in the relevant scientific
21 community. I want to note that the third factor, the methods
22 known or potential rate of error, to my recollection that was not
23 addressed directly in either the direct or cross-examination.
24 There were possibly some questions that tangentially spoke to
25 that issue, but none directly.

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1 Let me speak about and let me evaluate the other three
2 factors, however. Dr. Bazerman testified extensively in his
3 written direct, in his cross by Mr. Webb, and in his redirect
4 about the methodology he followed. He indicated that he had
5 rigorously studied the scientific methods used as a general
6 matter that intended to follow them, that he himself based his
7 theories on empirical evidence, and those -- and that empirical
8 evidence was based on tightly controlled laboratory experiments
9 which he described in detail. He testified that there had been
10 literally hundreds of those experiments. He also testified that
11 he had extrapolated the results of those experiments, which were
12 conducted by students, mostly graduate students in a controlled
13 manner, as I've indicated, but that he had extrapolated the
14 results of those experiments to what he called executive
15 populations. Obviously, what he meant was groups of corporate
16 executives. He also testified in great detail about his many
17 many publications. He had contributed over 80 peer-reviewed
18 articles. He had written -- or co-written either one -- at least
19 six books. He also testified that his particular theories had
20 gained general acceptance in the relevant scientific community,
21 and he certainly pointed out the fact that in 1978 an economist
22 in his particular area of behavioral research had won the 1978
23 Nobel Prize and that a different economist had won it in 2002.

24 Based on that testimony and the failure of
25 cross-examination or any other evidence to really shake that

1 testimony or to undermine that testimony or to devalue that
2 testimony, it is clear to me that the basic methodological
3 principles that the Supreme Court set forth in Daubert have been
4 satisfied by Dr. Bazerman's testimony.

5 Again, I want to emphasize that Ambrosini warns us that
6 quote, Daubert instructs that the admissibility inquiry focused
7 not on conclusions, but on approaches, unquote, and that's at 101
8 Fed 3d at 140.

9 In reversing the District Court in Ambrosini, and I think
10 that was the second reversal in that case, District Court was
11 someone else, the Court of Appeals noted that, quote, by
12 attempting to evaluate the credibility of opposing experts and
13 the persuasiveness of competing scientific studies, the District
14 Court conflated the questions of the admissibility of expert
15 testimony and the weight appropriately to be accorded such
16 testimony by a fact-finder, unquote. And that's 101 Fed 3d at
17 141. That is precisely what the joint defendants' position would
18 lead to in this case. It would lead to a conflation of the
19 admissibility with the merits.

20 The issue in this present ruling is not the persuasiveness
21 or credibility of Dr. Bazerman's testimony. The issue is only
22 the preliminary issue of whether he has satisfied the
23 methodological requirements of Daubert. Given the expert
24 testimony about the fact that he has tested his theories many
25 times, that those theories have been subjected to peer review and

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1 publication, that his theories find general acceptance in the
2 relevant scientific community, and the absence of any evidentiary
3 record to the contrary, it would be clear error for the Court,
4 acting in its role as a Daubert gatekeeper, to preclude or strike
5 the testimony in its entirety. It will be the role of this Court
6 as a fact-finder to address the persuasiveness of that testimony,
7 and as I think I've made very clear, that's a very different
8 issue, everybody.

9 Mr. Bernick, yes.

10 MR. BERNICK: I don't want to trouble the Court, but I had
11 two questions that bear upon this because we are now in the
12 process of making a decision about who to call.

13 THE COURT: I understand that.

14 MR. BERNICK: If it's not appropriate to address the Court
15 about what Your Honor has said, I'm happy not to, but I think it
16 would be important for us to get a little bit of guidance, if
17 that's appropriate now or after the lunch break.

18 THE COURT: What are your questions?

19 MR. BERNICK: I've got two questions. One, with respect
20 to Dr. Bazerman, the Court will recall that he ended up
21 recommending, obviously, the appointment of these monitors, and
22 that there was also then a list of potential remedies or
23 recommendations that the monitors might make, so we have the
24 monitors and then we have the list of potential remedies. It's
25 of vital importance to us to know whether Your Honor has

1 determined that the Daubert or Rule 702 analysis that Your Honor
2 has just announced pertains to his recommendation of the
3 monitoring or whether it pertains to -- goes to the
4 methodological basis of the substantive recommendations that they
5 be considered. And the reason this is important is as follows:
6 We believe that all he really testified to as a recommendation
7 was the monitoring. If Your Honor -- I'm sorry.

8 THE COURT: Go ahead.

9 MR. BERNICK: Yeah.

10 THE COURT: He testified to a lot more, but go ahead.

11 MR. BERNICK: But this is why I ask the Court maybe to
12 give us a little bit of clarification. If Your Honor takes his
13 testimony as recommending the ultimate remedies that the
14 monitoring might embrace, for example, changing management and
15 the like, that in fact his testimony is taken to support one of
16 those or more of those possible remedies as opposed to simply
17 appointing the monitors, then we would have to consider
18 responding to all of those different potential remedies. I don't
19 know if I'm making myself clear --

20 THE COURT: I understand.

21 MR. BERNICK: -- to the Court. So if the Daubert analysis
22 applies to the monitoring and also applies to these individual
23 remedies, and Your Honor is taking his testimony as testimony in
24 support of those ultimate remedies, that has a strong bearing on
25 who we call to respond. Whereas, if his testimony is taken as a

1 recommendation of monitoring, then -- without being taken as a
2 recommendation of the ultimate remedies -- then that has a very
3 different impact on who we would call.

4 The second question that's built into it is that our
5 position was based on Daubert, but Daubert really isn't in the
6 sense the governing law here in the following way. The Daubert
7 decision itself was a gatekeeper decision with respect to a jury
8 trial, and obviously is subject to the limitations that Your
9 Honor has pointed out that emanate from the Ambrosini case. But
10 the Ambrosini case was decided before the rules were amended in
11 2000, I believe, to incorporate the substantive tests of Daubert
12 into Rule 702. And now that they've been incorporated into 702,
13 it's not really a gatekeeping function, per se, it is a rule of
14 admissibility regardless of who it is that's trying the case, the
15 Court or the jury.

16 So, really, it kind of really bears on the first question.
17 If Your Honor is determining that Rule 702 has been satisfied,
18 not just with respect to the monitoring recommendation, but also
19 with respect to the potential remedies that emanate --

20 THE COURT: I understand.

21 MR. BERNICK: -- then that has tremendous significance in
22 terms of who we call, not only substantively, but also to
23 complete the record that will bear upon the review of Your
24 Honor's determination under 702. Because we believe that the
25 record that's going to be relevant to the ruling on 702 includes

1 not only Dr. Bazerman's testimony, but also whatever we offer
2 through our own witnesses, and again, that's why we need guidance
3 there, too.

4 If Your Honor is, again, going to those ultimate remedies
5 and whether they're supported under Rule 702, then that's
6 something that we might have to call witnesses to respond to.
7 I'm sorry. If it's not appropriate to ask the question or to
8 stand up, I apologize, but that's the consideration that we're
9 going to be going through internally.

10 THE COURT: Ms. Eubanks.

11 MS. EUBANKS: Your Honor, I think that defense counsel is
12 asking this Court how it should put on its evidence. The Court
13 has given us a ruling with respect to the motions that were
14 pending, and the issues were thoroughly addressed in those
15 documents that were put before the Court. We appreciate the
16 Court's ruling on it expeditiously before the weekend very much,
17 and we think that the guidance given us, particularly with
18 respect to the reliance on Ambrosini and the Daubert case law, is
19 sufficient precedent not to invoke considerations of the
20 amendment of Rule 702 and so forth because there's been -- none
21 of this has been briefed. This goes to -- I think the Court's
22 remarks are clear how the Court will weigh that evidence. It's
23 up to counsel, based upon this ruling, which is from the motions
24 that were put before the Court, to decide how they might try
25 their case. I don't think offering further guidance without -- I

Scott L. Wallace, RDR, CRR
Official Court Reporter

1 don't think further guidance is necessary or appropriate under
2 these circumstances. It's basically asking the Court to engage
3 in what hopefully will be a determination that's made at the end
4 of these proceedings with regard to how that testimony might be
5 viewed should the Court have to make a determination on remedies.
6 We just don't think it's an appropriate inquiry to put before the
7 Court and certainly not at this status or this juncture, having
8 been given the full thought process that the Court went through.

9 THE COURT: Well, at a minimum, I'll think about it over
10 lunch. That doesn't mean I'll answer the questions. I will
11 leave it at that, everybody, and let's come back at 2, please.
12 Mr. Biersteker, is your estimate still the same in term of your
13 cross?

14 MR. BIERSTEKER: I think I'm pretty much on track.
15 According to my notes I used about an hour and three quarters and
16 I think I'm about halfway, so I'm about right.

17 THE COURT: We may finish cross this afternoon?

18 MR. BIERSTEKER: I would hope so, Your Honor.

19 THE COURT: All right. And then the government should get
20 an idea as to how much redirect it will have tomorrow.

21 MR. GETTE: Yes, Your Honor.

22 THE COURT: All right. 2:00.

23 (Thereupon, a luncheon recess was had beginning at
24 12:49 p.m.)

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C E R T I F I C A T E

I, Scott L. Wallace, RDR-CRR, certify that the
foregoing is a correct transcript from the record of proceedings
in the above-entitled matter.

Scott L. Wallace, RDR, CRR
Official Court Reporter

Scott L. Wallace, RDR, CRR
Official Court Reporter

1 I N D E X

2

3 Examinations Page

4

5 DIRECT EXAMINATION OF JONATHAN GRUBER, Ph.D. 20588
6 BY MR. GETTE

7 CROSS-EXAMINATION OF JONATHAN GRUBER, Ph.D. 20611
8 BY MR. BIERSTEKER

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9 E X H I B I T S

10 Description Page

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UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA,	:	CA No. 99-2496 (GK)
	:	May 10, 2005
Plaintiff,	:	
	:	2:02 p.m.
	:	
v.	:	Washington, D.C.
	:	
PHILIP MORRIS USA, et al.,	:	
	:	
Defendants.	:	
.	:	

VOLUME 102
AFTERNOON SESSION
TRANSCRIPT OF TRIAL RECORD
BEFORE THE HONORABLE GLADYS KESSLER
UNITED STATES DISTRICT JUDGE

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Proceedings reported by machine shorthand, transcript produced
by computer-aided transcription

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

2 THE COURT: Mr. Biersteker, let's continue with cross,
3 please.

4 MR. BIERSTEKER: Thank you, Your Honor.
5 JONATHAN GRUBER, Ph.D., Government's witness, RESUMES

6 CROSS-EXAMINATION (Cont'd.)

7 BY MR. BIERSTEKER:

8 Q. Every break I can't resist. I thought before we moved on to
9 the next topic it might be useful to try to frame things a
10 little bit, and it's up there in my chicken scratching again,
11 but basically this is called compliance pathways.

12 And the first pathway that I have to potentially comply
13 with the youth reduction targets is price, and I kind of want to
14 review where I think we are.

15 The first is that any price increase must stick in
16 order for it to have an effect on youth smoking initiation.

17 Correct?

18 A. What do you mean by must stick?

19 THE COURT: I certainly have the same question.

20 Q. What I mean is that the price increase is one that would
21 have to be maintained in the market; whereas, it would have to
22 be maintained in the market as opposed to something that turns
23 out not to be tenable, and a manufacturer who attempts to raise
24 his price has to reduce it again.

25 A. Yes, that's true.

1 Q. Okay. And as I understood your testimony, there is a
2 significant question about whether or not all of the defendants'
3 cigarette manufacturers in this case would in fact increase
4 their price in order to meet the target or at least would
5 increase it by the same amount; right?

6 A. Yes. That's true.

7 Q. And there's also a significant question about whether
8 others, cigarette manufacturers who are not a party to this
9 lawsuit, would follow along and raise their prices too; correct?

10 A. Correct.

11 Q. And if everybody doesn't follow along, isn't it true that
12 there's a significant question about whether or not the price
13 increase would stick or be capable of being maintained in the
14 marketplace?

15 A. Once again, I think it's an interesting question.

16 We do have some historical experience which bears on
17 this, which is there was a price increase larger than -- larger
18 than the one -- than the 42 percent upper bound I've been
19 discussing and it stuck and defendants continued to be
20 profitable businesses.

21 Q. But there was a difference, wasn't there?

22 A. I don't know. You tell me.

23 Q. Well, in the historical example you point to -- for example,
24 under the MSA -- virtually every cigarette manufacturer faced
25 roughly the same kind of increase in their costs; right?

1 A. In principal -- actually, not even in principal, no, that's
2 not true, because as we've discussed there were these
3 essentially loopholes in these escrow statute which allowed a
4 lot of nonparticipating manufacturers to not have an increase in
5 their costs.

6 Q. Loopholes which have been closed; right?

7 A. Recently closed.

8 Q. And excise taxes apply to everybody; right?

9 A. That's true.

10 Q. But here we're talking about these defendants or maybe even
11 a subset of them that might be tempted to raise their price in
12 order to come into compliance; correct?

13 A. That's correct.

14 Q. And, in fact, when you were at the Treasury Department,
15 didn't you view it as unrealistic, unrealistic, that price
16 differentials, even as large as 10 cents a pack, could exist in
17 the real world?

18 A. I may have written that one when I was in Treasury, yes.

19 Q. Do you adhere to that today?

20 A. I think that between -- if you're talking about similar
21 premium brands, I don't know if 10 cents is unrealistic or 20
22 cents or what is, but certainly I think premium brands have --
23 historically, the prices have been fairly similar. Certainly
24 we've seen variations as large as 10 or 20 cents, but not a
25 dollar or something like that.

1 Q. And the other thing that must obtain in order for price to
2 be a pathway to compliance is that the price itself, to the
3 extent that it's increased, must have an impact on youth smoking
4 initiation; correct?

5 A. On youth smoking levels, primarily working through
6 initiation.

7 Q. All right. Youth smoking levels.

8 And we reviewed just before lunch Tauras and -- DiCicca
9 and Tauras and there seems to be some significant question about
10 the effect that price has on smoking initiation, at least as
11 reflected in the literature; correct?

12 A. Yeah. My view is that the best article does find this price
13 elasticity. Frank Chaloupka, who is even more expert than I in
14 this area, shares that view, but certainly not everyone in the
15 literature agrees.

16 Q. Now, let's turn to the other potential compliance pathways.
17 Okay?

18 A. Okay.

19 Q. You wrote an article with -- excuse me, I seem to have a
20 tickle -- Cutler and others entitled, The Economic Impacts of
21 the Tobacco Settlement. Right?

22 A. Yes, that's right.

23 Q. And you and your coauthors observed in that article, did you
24 not -- I can give it to you if you can't remember, just let me
25 know -- observed in that article that the literature does not

1 exhibit a very strong consensus on the role of cigarette
2 advertising in effecting smoking; correct?

3 A. That's true.

4 Q. And for that reason, you assumed for purposes of your
5 analysis of the effect of the MSA and, in particular, the
6 restrictions that it imposed on defendants' marketing activity,
7 that those restrictions would not have any effect; correct?

8 A. I believe we assumed that antismoking activities would have
9 an effect, but the marketing restrictions for the purpose of
10 estimates we assumed did not have an effect.

11 Q. And you believe that that was a reasonable assumption to
12 make, given the uncertainty that you perceived in the
13 literature; correct?

14 A. That's correct.

15 Q. And, in fact, when you were at the Treasury Department you
16 did some analyses of advertising and advertising restrictions on
17 youth smoking, did you not?

18 A. I didn't do actual analysis, but we reviewed studies that
19 had been done.

20 Q. Okay. Why don't we take a look at that, one of those
21 documents, which is JD 068057. I think we looked at this
22 earlier. It's -- there we go. It's on the screen.
23 August 1997, memo from you to Treasury Secretary Rubin and
24 Deputy Secretary Summers?

25 A. Yes.

1 Q. And there's a series of attachments. If you turn to
2 attachment C, which I think starts on 2833. Maybe not. It
3 starts on 2831. Excuse me. That's entitled, An Economic
4 Analysis of the Tobacco Settlement; correct?

5 A. Correct.

6 Q. And then if you flip --

7 THE COURT: Is this the article that you wrote? No.

8 MR. BIERSTEKER: No. We are passed that, Your Honor.

9 A. This is a memo that I -- I don't know if I was the sole
10 author or worked on when I was in government.

11 Q. And if we turn two more pages in to Page 2833. Are you
12 there? I want to ask you about the highlighted bullet point.

13 You say there, "To the extent that the settlement
14 facilitates cooperative price fixing, it has language calling
15 for an antitrust exemption, discourages entry, reduces
16 advertising which largely leads to brand substitution and not
17 new smoking, and raises the costs of output expansion. It could
18 lead to price increases greater than the excise-tax equivalent
19 of the industry payment."

20 First of all, did I read that right?

21 A. Yes, you did.

22 Q. So you told Secretary Rubin and Deputy Secretary Summers,
23 did you not, that advertising largely leads to brand
24 substitution and not new smoking?

25 A. What I can't tell from the context is did I mean that it

1 reduces the set of advertising, which largely leads to brand
2 substitution and not new smoking, or did I mean that advertising
3 largely leads to brand substitution, not new smoking? You see
4 what I mean?

5 I don't remember what was in my mind eight years ago
6 when I wrote this and I can't exactly figure out which of those
7 I meant from the language there.

8 Q. You don't say "reduces some subset of advertising"?

9 A. No, I don't.

10 Q. You're referring to advertising, generally?

11 A. That's one way to read it. But once again, I don't know.
12 You could read it both ways and, unfortunately, I don't remember
13 which way I intended it.

14 Q. Let me ask you hypothetically.

15 If advertising largely leads to brand substitution and
16 not new smoking, doesn't it follow that changes in defendants'
17 advertising practices in response to the remedy that you propose
18 is unlikely to lead to reductions in youth smoking to the
19 targeted levels?

20 MR. GETTE: Objection, Your Honor. It's beyond the
21 scope of what was testified to in direct as well as the fact
22 that it's beyond the scope of what Dr. Gruber in fact has
23 indicated he has expertise in, in terms of price versus nonprice
24 marketing.

25 THE COURT: The objection is overruled.

1 A. Can you ask the question again?

2 Q. If advertising largely leads to brand substitution and not
3 to new smoking, isn't it true that changes in defendants'
4 advertising practices, should the court adopt the remedy you
5 propose, would be unlikely to achieve compliance with the
6 targeted youth smoking reductions?

7 A. Once again, even if overall, so even if reading this the way
8 you would like to, which is that advertising largely leads to
9 brand substitution, not new smoking, that could mean overall it
10 still could mean that among youth, which is a subset, a small
11 subset of cigarettes sold, it does lead to new smoking as well
12 as brand substitution.

13 So once again, it depends on -- if it's true that even
14 within youth it only leads to brand switching and not new
15 smoking, then you're right, but I don't know -- this sort of
16 refers to overall that it does that. The key question to what
17 extent within youth it promotes new smoking versus brand
18 switching.

19 Q. Let me -- we will get to this in a minute, but for purposes
20 of your remedy you've defined youth as someone under the age of
21 21; correct?

22 A. Yes.

23 Q. And do you know how frequently individuals 18 to 21 switch
24 brands and whether they do it more frequently than older
25 smokers?

1 A. First of all, the 18 to 20 that's relevant, and I don't know
2 the answer to that.

3 Q. It is -- you may take that down, Jamey. Thank you.

4 It is certainly true, isn't it, that other factors,
5 factors not within the exclusive control of these defendants,
6 have been associated with youth smoking initiation?

7 A. Yes.

8 Q. And, in fact, there's a large literature on it. I don't
9 know how much you know about it. But, for example, the 1994
10 Surgeon General's Report reviewed a number of factors such as
11 peer smoking and family smoking and youth access, et cetera;
12 right?

13 A. Yes, but things like peer smoking and family smoking are
14 affected by the defendants' actions.

15 Q. You would agree -- I'm sorry.

16 You would agree with me, would you not, that peer
17 smoking is not something within the exclusive control of the
18 defendants?

19 A. Not exclusive, no.

20 Q. Okay. And you believe that youth access is something that
21 could influence youth smoking, right?

22 A. Yes.

23 Q. Now, these defendants do not sell cigarettes directly to any
24 smokers, much less youth smokers; correct?

25 A. That's correct.

1 Q. How about movies?

2 Isn't it true that there's been recent literature
3 suggesting that as much as half of youth smoking is caused by
4 smoking being portrayed in a favorable light in movies?

5 A. I have no idea.

6 Q. Do you know whether or not defendants would ever -- first of
7 all, isn't it true that the MSA prohibits defendants from paying
8 movie makers in order to place their products in the movies?

9 A. I believe so.

10 Q. Do you know whether or not, if a movie maker decides to use
11 Camel cigarettes made by my client, R.J. Reynolds, in a movie,
12 whether or not Reynolds can stop them from doing it?

13 A. I don't know.

14 MR. GETTE: Objection, Your Honor, calls for
15 speculation.

16 THE COURT: Sustained. But he's indicated he doesn't
17 know.

18 MR. BIERSTEKER: I'm sorry. What, Your Honor?

19 THE COURT: I said sustained, but he's indicated he
20 doesn't know the answer.

21 BY MR. BIERSTEKER:

22 Q. I guess the point is that to the extent that factors that
23 are not entirely within the control of these defendants affect
24 youth smoking decisions, isn't it true that the targeted
25 reductions in youth smoking that you propose might not be met

1 for reasons that have nothing to do with defendants' conduct at
2 all?

3 A. I believe I testified earlier that that is -- that that is
4 certainly possible.

5 Q. In fact, you personally studied the increase in youth
6 smoking that occurred in the 1990s; right?

7 A. Yes.

8 Q. And in that period, I think it was '92 to '97, youth smoking
9 went up by approximately a third; correct?

10 A. That's correct.

11 Q. And by youth, what you were looking at specifically were
12 high school students; correct?

13 A. Yes.

14 Q. And you tried to explain that increase in youth smoking;
15 correct?

16 A. Yes.

17 Q. And you looked at price and you found that price reductions
18 that occurred during the 1990s, the earlier part of the 1990s,
19 accounted for about 30 percent of the increase in smoking by
20 high school seniors; correct?

21 A. I think that's about right, yes.

22 Q. And your analysis looked at other factors besides price,
23 such as background characteristics of the youth, in an effort to
24 try and explain more of the increase; correct?

25 A. That's correct.

1 Q. But you were able to explain, at most, a small additional
2 amount of the remaining 70 percent of the increase that had
3 occurred in youth smoking even when you looked at those other
4 factors; correct?

5 A. That's correct, factors such as income and race and changes,
6 basically changes in those over time, couldn't really explain
7 much of the trend.

8 Q. We cannot at present today, looking back at that period
9 10 years ago, determine which candidate factors, if any, were
10 responsible for the increase in youth smoking above the
11 30 percent of the increase that you can account for with price;
12 correct?

13 A. Once against this keeps coming up. It's hard to explain
14 time series. A lots of things are going on, so it's hard to
15 really pin down which factor.

16 There's been some suggestions that it was changes in
17 advertising practice, such as the use of Joe Camel, but it's
18 hard to pin down what role that played.

19 Q. And if, as occurred in the 1990s, smoking were to blip up
20 after 2007, for reasons that we can't even identify, much less
21 say were under the defendants' control, the defendants would
22 still pay your assessment; correct?

23 MR. GETTE: Objection, Your Honor. Again, it's calling
24 for him to speculate.

25 THE COURT: Overruled.

1 A. Once again, we don't know what -- for sure what caused that
2 to rise in the 1990s, but there's certainly a lot of speculation
3 that it was due to industry actions.

4 If youth smoking rose again, it could very well be due
5 to industry actions as well. But I agree, I can't -- it might
6 be hard to pin down exactly what's causing it.

7 MR. BERNICK: Your Honor, the transcript is incomplete,
8 Your Honor. I don't know if this just in the court reporter's
9 system, but I can't read it. But I believe the witness said it
10 would be speculation and that was not picked up so far.

11 THE COURT: Well, what's your problem, that you can't
12 read the transcript?

13 MR. BERNICK: No, that's not my problem. It's like
14 reading on the screen it doesn't say "speculation." That's what
15 the witness said.

16 THE COURT: I see. Okay. And, Mr. Hawkins, you will
17 pick that up, please. Thank you.

18 BY MR. BIERSTEKER:

19 Q. If the defendants do raise prices and the targeted
20 reductions in youth smoking are not achieved, isn't it true that
21 you have no expert opinion to offer on what the defendants might
22 do to come into compliance with your proposed remedy?

23 A. It's true the area of my greatest expertise is on prices. I
24 can rely on other plaintiffs' experts who suggest there's a host
25 of other marketing promotion activities that they might

1 discontinue that could affect youth smoking, but I myself am not
2 an expert on those.

3 Q. And you've offered no opinions about that in either your
4 direct testimony or in your expert report; correct?

5 A. Only to rely on those other experts.

6 Q. Let's turn to something you talked about this morning which
7 are the steps in your calculation.

8 And if I could have U.S. Exhibit 18257, please.

9 THE COURT: Is that one of the demonstratives?

10 MR. BIERSTEKER: That's one of the demonstratives used
11 by the government earlier this morning, Your Honor.

12 BY MR. BIERSTEKER:

13 Q. This is where you identify the five steps to get to your
14 \$3,000 assessment; correct?

15 A. Correct.

16 Q. Before we even begin talking about these individual steps,
17 as we've talked about, you define "youth" as folks under the age
18 of 21; right?

19 A. That's correct.

20 Q. And you will allow, will you not, that individuals age 18,
21 19 and 20 in this country can do a lot of things. They can
22 vote, enlist in the military, and so forth; correct?

23 A. That's correct.

24 Q. They are allowed to purchase cigarettes; is that right?

25 A. In most states.

1 Q. Allowed to get married?

2 A. I don't know the age of legal marriage in most states, but I
3 presume usually they are.

4 Q. Isn't it true in your prior writings, you have used under 18
5 as a definition of youth?

6 A. Typically in my prior writings I was using the Monitoring
7 the Future data, which is high school students, and so as a
8 result I used sort of high school 8th, 10th and 12th graders as
9 the definition of youth.

10 Q. And while some high school seniors might be 18, most are --
11 most of the individuals in 8th, 9th and 10th -- excuse me --
12 8th, 10th, and 12th grade are under 18. Will you not agree?

13 A. That's true.

14 Q. Thank you.

15 Isn't it true that you have characterized the
16 definition of youth as those under the age of 18 as the common
17 definition?

18 A. I may have. I don't know.

19 Q. You don't disagree that the definition of youth as those
20 under the age of 21 is relatively uncommon; correct?

21 A. It depends on the context.

22 Q. In fact, isn't it true that you would regard it as
23 undesirable to impose assessments on companies for legal sales
24 of a legal product to a legal adult?

25 THE COURT: Let me be clear. Did you say illegal

1 sales?

2 MR. BIERSTEKER: No, legal sales. I meant legal.
3 Legal, legal, legal. Legal sales, legal product, legal adults.

4 THE COURT: Mr. Bernick, was that your concern?

5 MR. BERNICK: Yes.

6 MR. BIERSTEKER: Is he having trouble reading again?

7 THE COURT: No, not at all. He read it correctly.

8 BY MR. BIERSTEKER:

9 Q. Isn't it true that you would regard it as undesirable to
10 impose an assessment on companies for making legal sales of a
11 legal product to legal adults?

12 A. It depends on the context, I think.

13 Q. Well, in the context of evaluating tobacco policy when you
14 were at the Treasury Department, wasn't that your view?

15 A. It may have been. I don't recall.

16 Q. Let's see if I can refresh your memory. I don't know if you
17 have this one in front of you. I think you do. It's 068057.

18 A. Yep.

19 Q. August 7th, 97?

20 A. Yes.

21 Q. This is a memo again that you wrote to Rubin -- excuse me --
22 Secretary Rubin and Deputy Secretary Summers, and if you will
23 turn to Page 2844, please.

24 One of the points that you made to them was that,
25 quote, From a philosophical as well as practical standpoint, it

1 may be undesirable to penalize a private firm for making a legal
2 sale of a legal product to a legal adult.

3 Do you see that?

4 A. Yes, I do.

5 Q. Okay. And that is the advice that you gave to Secretary
6 Rubin and Deputy Secretary Summers; correct?

7 A. Yes, it is.

8 Q. And the effect of your having chosen to define youth as
9 people under the age of 21 as opposed to under the age of 18
10 would be to include legal sales of a legal product to legal
11 adults; correct?

12 A. As I wrote in my written direct testimony, I understand from
13 the government's position that the RICO violations occur all the
14 way through age 20.

15 The context of this was not RICO violations. The
16 context of this was the settlement. In the context of the RICO
17 violations it may be appropriate. I'm not really an expert on
18 that. I just know that that's the, you know, accusations that
19 are made in this case.

20 Q. Well, let me ask it this way.

21 The effect of using age 21 as the first age of
22 adulthood is to increase significantly, is it not, the total
23 assessment that defendants who are over their targets may have
24 to pay?

25 A. Once again, only if they are over their targets, yes.

1 Q. Okay. Let's go back to U.S. Exhibit 18257, please. Thank
2 you.

3 And the first step I want to talk about is the first
4 one, Determine the likelihood that a youth smoker will still be
5 alive and smoking at each future age.

6 And as part of that first step, what you did, sir, is
7 you estimated age-specific rates at which smokers quit smoking;
8 correct?

9 A. That's correct.

10 Q. And in order to do that -- so, for example, let's just so
11 it's clear.

12 For example, you estimated the probability that a
13 smoker who had smoked when he was under the age of 21 will quit
14 at age 22, at age 23, at age 24 and so on; correct?

15 A. Correct.

16 Q. And those estimates, as I believe you said in one of your
17 demonstratives and also in your written direct, came from the
18 National Health Interview Survey in 2001 through 2003; right?

19 A. Correct.

20 Q. And the effect of having based your estimate of age-specific
21 smoking cessation rates on the experience from 2001 until 2003
22 is that you're assuming that age-specific smoking cessation
23 rates are static or not changing in the future; correct?

24 A. All I'm saying is the best estimate from today's perspective
25 is where they are over that period.

1 Q. Well, you know that technology for smoking cessation has
2 improved dramatically over time; correct?

3 A. Yes, that's true.

4 Q. And your estimates of age-specific smoking cessation rates
5 go out well past 2050, do they not?

6 A. Let's see. Yes, past 2050.

7 Q. Do you have any idea whether or not the trend in improving
8 technology for smoking cessation is something that will continue
9 or not?

10 A. I don't know.

11 Q. You certainly cannot identify a time in recent memory, can
12 you, when smoking cessation rates at any particular age have
13 gone down?

14 A. No, I can't.

15 Q. To the extent that the trend over the course of the last
16 several decades in improvements in smoking cessation technology
17 continue into the future, isn't it true that the age-specific
18 smoking cessation rates that you use in step 1 will be too high?

19 A. Yes.

20 Q. Apart from improvements in smoking cessation technology,
21 isn't it true that smoking cessation rates in the future might
22 increase if existing smoking cessation technology were to become
23 more likely available?

24 A. Yes, they might.

25 Q. And, as I believe you testified earlier, you know that one

1 of the remedies that the government is requesting in this case
2 is a potential nationwide smoking cessation program; correct?

3 A. Correct.

4 Q. You then take the government's proposed National Smoking
5 Cessation Program into account in estimating the age-specific
6 smoking cessation rates well into the future; correct?

7 A. That's correct.

8 Q. Isn't it true that to the extent that the government's
9 proposed National Smoking Cessation Program were adopted and to
10 the extent that it increased age-specific smoking cessation
11 rates in the future, all else equal, your \$3,000 assessment
12 would be too high?

13 A. Once again, to emphasize the goal of the assessment was to
14 ensure that there's no financial benefit for appealing to youth
15 smokers. Under the circumstances you describe it might be too
16 high. If the government's remedy wasn't adopted or something
17 else changes, it might not be too high. My goal is to ensure
18 that it's high enough.

19 Q. You know, I guess the point of this line of cross-
20 examination is that in order to ensure it's high enough, you
21 ignored trends in smoking cessation and you ignored the
22 government's proposed national cessation program effectively
23 assuming implicitly that they have no effect; correct?

24 A. That's correct.

25 Q. Thank you. Now, there are some daily smokers aged 12 to 20

1 who, if they did not smoke now, would start smoking anyway at
2 age 21 and over; correct?

3 A. That's correct.

4 Q. And conceptually you agree that the expected lifetime
5 proceeds should be reduced to account for that fact.

6 A. The -- conceptually, the expected lifetime proceeds should
7 be reduced to account for the fact that someone who didn't start
8 smoking a given manufacturer's product began smoking that same
9 manufacturer's product after age 21.

10 Q. That's a little curious. Let me ask it this way.

11 You ignore switching; correct?

12 A. I don't -- I don't adjust the calculations for brand
13 switching.

14 Q. Okay. So you don't account -- you don't adjust the
15 calculations for brand switching, but when it comes to
16 reductions in the assessment to account for the fact that some
17 people who smoke under the age of 21 would smoke after the age
18 of 21, even if they hadn't smoked under the age of 21, then you
19 want to get brand specific; is that right?

20 A. No. I don't understand the parallel.

21 All I'm saying here is conceptually what one might want
22 to do is to account for the fact that even if they hadn't
23 attracted a youth to their product under 21, that youth may have
24 started smoking their product after 21. I agree conceptually
25 one might want to account for that. But the key words is their

1 product. You would have to account for the fact that they would
2 start smoking their product after 21, and we have no idea what
3 that number looks like.

4 Q. But you don't account for the fact, in calculating your
5 assessment, of the fact that some smokers switch products after
6 they start; right?

7 A. Right.

8 Q. Okay. So, for example, if the target for each of these
9 defendants -- let's make it simple -- was a hundred smokers.
10 Are you with me?

11 A. Yes.

12 Q. And everybody meets their target except for Philip Morris,
13 they are at 101. Okay?

14 A. Okay.

15 Q. Under your proposed remedy when that smoker is say age 18
16 and smoking the Philip Morris' product, Philip Morris would have
17 to pay \$3,000; right?

18 A. If, under that example where in a strange world where only
19 one misses by one smoker, yes.

20 Q. It's just a hypothetical to help us understand the problem.

21 Okay. So if the next year the count is done again and
22 it turns out that that one extra youth smoker, overall, switched
23 from say Marlboro to my clients product, Camel, under your
24 proposed remedy, my client would have to pay \$3,000; correct?

25 A. Yes, appropriately, they would.

1 Q. Okay. If in the following year at age 20 that smoker
2 switched again and he switched to one of Lorillard's products,
3 he switched to Newport, then Lorillard would have to pay \$3,000;
4 correct?

5 A. Once again, that's appropriate.

6 Q. So in calculating your assessment you don't take into
7 account the fact -- I mean, that would result in a payment of at
8 least three times what you call the expected lifetime proceeds;
9 correct?

10 A. In that particular example, that's right. Overall across
11 the manufacturers that would be the payment.

12 Q. And so you don't take into account the fact that just
13 because a smoker under the age of 21 reports smoking a
14 particular brand now, that doesn't mean that they are going to
15 continue to smoke it for the rest of their lives; correct?

16 A. No, I don't, nor should I.

17 Q. But when it comes to reducing the estimate because you
18 recognize that some people who start smoking under the age of 21
19 would have started smoking anyway at 21 and older, then you
20 insist that the adjustment be done by manufacturer; correct?

21 A. Well, I don't actually insist that. I don't do the
22 adjustment because that's the conceptually correct adjustment
23 and that data is just not available.

24 Q. Well, but you do know, because you estimated it in this
25 case, correct, the probability that individuals who are smoking

1 cigarettes at age 20 would have started smoking at age 21 or 22
2 or 23 had they not smoked at age 20; correct?

3 A. No, I don't know that.

4 Q. Didn't you estimate something called the intertemporal
5 correlation coefficient in this case?

6 A. I did.

7 Q. That is an estimate, is it not, of the proportion of smokers
8 under the age -- I'm not sure I'm going to get this right. Let
9 me try.

10 That is an estimate of the proportion of smokers at age
11 21 who you estimate smoke because they smoked at age 20; right?

12 A. What I estimated -- the intertemporal correlation
13 coefficient is an estimate of the set of smokers actually not a
14 specific age, but over ages, I believe it's 21 to 54 I
15 estimated, over that range who smoke because they smoked as
16 youth smokers. I then used a different factor to adjust that by
17 age.

18 Q. Right. But you ended up with an age-specific estimate;
19 correct?

20 A. Correct.

21 Q. Your age-specific estimate at age 21, I believe, was about
22 70 percent; is that right?

23 A. I don't recall.

24 Q. If you had made the adjustment -- not by brand or by
25 manufacturer, but just by smoking -- do you know whether or not

1 your estimate of the assessment would be about 30 percent lower
2 than it is?

3 A. It certainly would not be that much lower than it is.

4 Q. It certainly would not be?

5 A. It certainly would not be because that -- once again the
6 idea of this intertemporal correlation coefficient was to
7 capture two things.

8 One is the fact that if you smoke as a youth you might
9 quit when you get older. The other is the fact that if you
10 hadn't started as a youth you might start when you get older.

11 You're only referring to the second of those. This
12 coefficient captured both.

13 Q. I know, but if you look at your age-specific estimate at age
14 21, you will agree that there's very little quitting that goes
15 on between ages 20 and 21; correct?

16 A. Yes.

17 Q. Okay. And so if we look at the value that you estimated for
18 age 21, it's about 70 percent, that would suggest that your
19 assessment is 30 percent too high; correct?

20 A. No. Once again, I did not -- I did not set out to estimate
21 in this case the IC -- the intertemporal correlation coefficient
22 at age 21. I estimated overall the relationship.

23 I then, because I had to for other calculations,
24 determined how that changed over age. I did an adjustment to
25 set up a pattern by age. But I don't claim that that is the age

1 21 intertemporal correlation coefficient. At no point do I do
2 that.

3 Q. You presented separate intertemporal correlation
4 coefficients at each specific age from age 21 to 45; correct?

5 A. I presented separate adjustments for that intertemporal
6 correlation case which were based on the mean estimate I had,
7 then adjusted by age. But at no point -- and if I did, I'm
8 sorry, I didn't mean to -- at no point did I imply that that was
9 the actual intertemporal correlation coefficient at 21.

10 Q. But you applied that estimate to smokers at age 21, did you
11 not, in order to estimate the youth-addicted population in one
12 of its variations?

13 A. Yes, I did.

14 Q. Thank you.

15 Let's talk about another choice you made, and that's
16 your third step, determine the proceeds amount per cigarette.
17 And there you used as your starting point Dr. Fisher's
18 historical estimates of the proceeds per cigarette earned by
19 these defendants; correct?

20 A. That's correct.

21 Q. And you didn't pick the defendants' cigarette manufacturers'
22 average proceed per cigarette over the course of the last
23 50 years or some shorter period, did you?

24 A. No, I didn't.

25 Q. And you didn't pick each defendants' cigarette

1 manufacturers' highest proceeds in any year, did you?

2 A. No, I didn't.

3 Q. And, instead, you chose as your starting point the highest
4 real proceeds per cigarette earned by the most profitable
5 defendant and its most profitable year since 1954; right?

6 A. That's correct.

7 Q. And you used that estimate as your starting point for your
8 \$3,000 assessment for every defendant; correct?

9 A. That's correct.

10 Q. Do you know whether or not Dr. Fisher's estimates of the
11 highest real after-tax proceeds per cigarette for Philip Morris
12 is about 70 percent higher than the highest ever after-tax
13 proceeds per cigarette for Brown & Williamson?

14 A. I don't know.

15 Q. Now, you talked a little bit to the court this morning
16 during the course of your oral examination and I thought -- and
17 I may have misheard -- you say that proceeds are net after-tax
18 income per cigarette. Is that what you said?

19 A. Once again, as the Judge corrected me, proceeds as I used --
20 was before tax and then adjusted for tax at the end.

21 Q. But that aside, is it your testimony that proceeds are net
22 income?

23 A. No. Proceeds are the -- proceeds are the financial benefit
24 from selling that last cigarette.

25 Q. It's not net income; correct?

1 A. It's not net income.

2 Q. Net income and profits are total revenues minus total
3 expenses; correct?

4 A. I don't know whether you want accounting definitions or
5 economic definitions, but that's certainly a sensible definition
6 of profits.

7 Q. And proceeds, as defined by Dr. Fisher and as adopted by
8 you, are revenues less direct costs and as adjusted by youth
9 taxes; correct?

10 A. Correct.

11 Q. So the proceeds' estimates that you're using as the basis of
12 your calculation is not net of, or less the cost of advertising,
13 the cost of plant and equipment, the cost of managers, the cost
14 of offices and pen and papers and computers and other overhead;
15 correct?

16 A. This is -- once again, I'm not an expert on the -- all the
17 details of this calculation. I did get it from Dr. Fisher.

18 But my understanding is that some of those costs of
19 production, like plant and equipment and other things, are in
20 this measure, but that things like general overhead and
21 advertising are not.

22 Q. Isn't it true that estimates of proceeds per cigarette are
23 much higher than estimates of profits or net income?

24 A. I don't know about much, but they are certainly higher.

25 Q. Do you know how much?

1 A. No, I don't.

2 Q. You were asked why you chose to use proceeds instead of
3 profits in your written direct at Page 24. We don't have to go
4 there if you remember it. Do you remember that?

5 A. Yes.

6 Q. And you testified there that you thought proceeds was the
7 right way to go; right?

8 A. That's right.

9 Q. And your reason, basically, was that the costs of plant and
10 equipment and advertising and managers and so forth were not
11 relevant for that one extra youth smoker in a given year;
12 correct?

13 A. Once again, what's hard about proceeds -- and I don't really
14 know as much detail about this as Dr. Fisher -- is that some of
15 those costs of plant and equipment and things are in there.

16 Conceptually, though, that's the right concept. The
17 right concept that I'm after here is should they miss that
18 target by one smoker, what is the cost of producing the packs of
19 cigarettes for that one smoker? And that would just be the
20 revenues they earn, minus the direct costs of producing those
21 packs.

22 Q. And so direct costs, you mean things like -- I don't mean to
23 oversimplify things -- like tobacco, the cigarette paper and
24 filters; right?

25 A. Exactly.

1 Q. There's a difference in economics, is there not, between
2 short run and the long run?

3 A. Yes.

4 Q. And the difference is that in the short run more costs are
5 fixed; right?

6 A. That's the definition of the short run.

7 Q. So in the short run, next week, next month, the incremental
8 costs to these defendants of selling 5 percent more cigarettes
9 might basically be the costs that you've identified. The costs
10 of the tobacco and the cigarette papers and the filters; right?

11 A. Five percent cigarettes is a lot more cigarettes of
12 selling --

13 Q. How about 1 percent? It doesn't matter.

14 A. Selling a small number of increased cigarettes, that's
15 right.

16 Q. In the long run, however, a manufacturer that is faced with
17 a 1 percent or 5 percent increase in its sales is going to
18 consider more incremental costs, not just the direct costs that
19 you've considered; correct?

20 A. If the -- I imagine that the answer might depend if it's 1
21 or 5 percent.

22 So if it's very small, then the long run could look
23 very much like the short run. If it's larger, then it might
24 look different.

25 Q. But if, in viewing the long run, a manufacturer who faces a

1 change in the magnitude of the demand for its product is going
2 to look at all variable costs; correct?

3 A. They should examine all those costs in thinking about how to
4 most efficiently produce in the long run.

5 Q. And I suppose that then raises the question of whether or
6 not, in assessing proceeds per cigarette, we should be
7 interested in the long run or the short run. So let me ask you
8 this question.

9 Isn't it true that you are attempting to approximate
10 the lifetime gains to these defendants of each extra youth
11 smoker beyond their respective targets from 2007 into
12 perpetuity?

13 A. Actually, not into perpetuity; until they're age 65.

14 Q. Until each individual smoker is age 65, but there's always a
15 new cohort?

16 A. Exactly.

17 Q. The targets continue forever; correct?

18 A. Exactly.

19 Q. Let's turn to step number 4 which you said was to calculate
20 the expected proceeds amount per youth at each future age.

21 Isn't it true that, in addition to estimating past
22 proceeds, Dr. Fisher estimated defendants' future proceeds?

23 A. I believe so. I don't recall his report exactly.

24 Q. You did not use Dr. Fisher's estimates of the defendants'
25 future proceeds in order to do your step 4 in calculating the

1 assessment; correct?

2 A. No, I didn't.

3 Q. Isn't it true that Dr. Fisher estimated that in the future
4 Philip Morris's per cigarette proceeds were going to decline?

5 A. I don't recall.

6 Q. Do you know whether or not Dr. Fisher estimated that my
7 client's future per cigarette proceeds, Philip Morris's future
8 per cigarette proceeds, Lorillard's future per cigarette
9 proceeds, and Brown & Williamson's future per cigarette proceeds
10 were all going to decline in the future?

11 A. He may have. I don't know.

12 Q. Let me see if I can show you something that refreshes your
13 recollection. I don't know if you even looked at this, but let
14 me show it to you. JD 060873.

15 Doctor, this is just a computer printout from some of
16 the materials that Dr. Fisher produced earlier in this case, and
17 I don't know if it will refresh your recollection or not, but
18 let me just ask you.

19 Isn't it true that Dr. Fisher projects declines in
20 annual proceeds per cigarette for every defendant: Brown &
21 Williamson, Lorillard, Reynolds and Philip Morris, and a growth
22 for Liggett?

23 MR. GETTE: Your Honor, as I understand it, counsel is
24 try to refresh his recollection from a document that's produced
25 by defendants that there's no indication that the witness has

1 ever seen. Not produced by defendants, created by defendants.

2 BY MR. BIERSTEKER:

3 Q. Did you look at Dr. Fisher's estimates?

4 A. I've never seen this before.

5 Q. Never seen it. So you don't know what he estimated?

6 A. No.

7 Q. This doesn't help you?

8 A. No, I don't know where it comes from or what he estimated.

9 Q. Fine. In contrast your assessment of future proceeds per
10 cigarette has them growing by 3 percent every year for
11 inflation; correct?

12 A. That's correct.

13 Q. And then, as you discussed with the court, there's a period
14 of time from 2007 to 2013 where you have them increasing by
15 50 percent in real terms; correct?

16 A. That's correct.

17 Q. And that increase in proceeds, that 50 percent real increase
18 in proceeds amount per cigarette is a consequence of the
19 potential 42 percent increase in the real price of cigarettes;
20 correct?

21 A. Once again, the goal was to ensure that if they chose the
22 path of just increasing price to meet the target, that they
23 would not financially benefit, and so that was that sort of
24 insurance built into that possible course of action.

25 Q. In fact, you do not expect, do you, that defendants will

1 raise the real price of their cigarettes by 42 percent between
2 2007 and 2013; correct?

3 A. Well, let me be clear. I think that's an unlikely way for
4 them to meet these targets.

5 They may raise their price by 42 percent for lots of
6 reasons. I don't -- I don't know what else is going to go on.
7 But in terms of what I've studied, which is, is this likely to
8 be the way to meet the target, I think it is unlikely that they
9 do it purely through a price increase.

10 Q. I'm not sure if you answered. I'm sorry. I wasn't
11 listening hard enough, but let me try one more time.

12 You do not expect the defendants to increase the real
13 price of their cigarettes by 42 percent between 2007 and 2013
14 and to enjoy a 50-plus percent increase in the real proceeds per
15 cigarette, do you?

16 A. I don't know. I never have actually been asked to make
17 those projections, so I don't know what's going to happen.

18 Q. Do you have any expectation of whether they will increase
19 prices and, therefore, real proceeds per cigarette at all?

20 A. I don't -- I don't really know. It depends on a lot of
21 other things that change over time. I haven't really sat down
22 and made that projection.

23 Q. In fact, when I asked you in your deposition whether you
24 were assuming that defendants would increase their prices by
25 42 percent and enjoy growth in proceeds of over 50 percent, you

1 refused to make that assumption or to say that you were making
2 it; correct?

3 A. Yes. I'm not necessarily making that assumption.

4 Q. And yet when you presented to this court your step 4, you
5 said that you were calculating the expected proceeds; correct?

6 A. That's correct.

7 Q. That's not true, is it?

8 A. I mean, once again, it's the -- that's -- that's a fair
9 point. It's the sort of up -- once again, as I said in my
10 testimony, it's the estimated upper limit, and that probably
11 would have been a better choice of words for step 4 than expect
12 it would have been sort of estimated upper limit of the amount
13 of proceeds per youth. That's a good point.

14 Q. Thank you. Let's turn to step 5 just briefly.

15 In step 5, as you said, I think earlier today, what you
16 do is you take the stream of dollars over the future and you
17 expressed it in constant dollars. You happened to choose 207,
18 right? 2007, excuse me.

19 A. 2007 is the starting point.

20 Q. Right?

21 A. Yes.

22 Q. And to do that, let me just ask a general -- a general
23 point.

24 Isn't it true that the lower the discount rate you used
25 to bring those future dollars back to current or 2007 dollars,

1 the lower that discount rate is, the higher the estimate of the
2 present value will be?

3 A. That's right.

4 Q. And in order to do your calculation here, you said that you
5 used the estimate of the weighted average cost of capital for
6 Philip Morris; right?

7 A. That's correct.

8 Q. And that was the weighted average cost of capital that was
9 recorded by Bloomberg; right?

10 A. That's correct.

11 Q. Isn't it true that the weighted average cost for Philip
12 Morris, a very substantial company that has several
13 subsidiaries, because you looked at Altria, not the domestic
14 tobacco unit; right?

15 A. That's correct.

16 Q. Okay. That the weighted average cost of capital reported by
17 Bloomberg for every other defendant in this case is higher than
18 that for Philip Morris?

19 A. I don't know.

20 Q. Isn't it true that Dr. Fisher, during the course of his
21 estimates of disgorgement proceeds, estimated the weighted
22 average cost of capital for each defendant individually?

23 A. Yes, I believe he did.

24 Q. And isn't it true that the weighted average cost of capital
25 that you have chosen to use is lower than any of the estimates

1 Dr. Fisher made?

2 A. I don't know.

3 Q. Isn't it true that using a higher weighted average cost of
4 capital made Dr. Fisher's calculation of disgorgement proceeds
5 higher?

6 A. Well, what would affect his disgorgement proceeds would have
7 been the weighted average cost of capital for previous years.
8 Looking backwards, that would have been the more important, and
9 certainly the higher that was, the higher the disgorgement would
10 be.

11 Q. So, yes, the higher the weighted average cost of capital,
12 the higher Doctor Fisher's disgorgements estimates would be;
13 right?

14 A. That's correct.

15 Q. And the lower the weighted average cost of capital, the
16 higher your assessment is going to be; right?

17 A. That's correct.

18 Q. And Dr. Fisher -- I'm asking you to assume -- used a higher
19 weighted average cost of capital than you did, which is in turn
20 higher than the weighted average cost of capital that Bloomberg
21 estimates for any one of these defendants which makes your
22 estimate high; right?

23 A. Your description is right, but your -- the closing clause is
24 not -- I don't endorse.

25 I think the estimate is the appropriate one. Given

1 that I used Philip Morris's proceeds numbers, I should use their
2 weighted average cost of capital.

3 Q. Let's step back for a moment from the trees and take a look
4 at the forest. If I could have J-DEM 060658, please.

5 We've gone through a number of choices you made. You
6 had the choice of 21 versus 18, and either you, independently,
7 or because the Justice Department asked you to do so, chose 21
8 which increases the total exposure of these defendants to the
9 assessment; correct?

10 A. It only increases the total exposure if it doesn't make it
11 easier for them to meet the targets.

12 Q. Fair enough.

13 For current versus future quit rates, you decided to
14 use the current ones, and to the extent that smoking cessation
15 technology continues to improve and to become more widely
16 available, that will make your assessment higher; correct?

17 A. Once again, I don't -- the best estimate I think is where we
18 are today. Quit rates could go up, they could not. And so if
19 they do go up, then my estimate will be the estimate would go
20 down. But I saw no reason to make that assumption.

21 Q. But you know of no time in recent memory where quit rates
22 went down; correct?

23 A. Not in recent times, no.

24 Q. You had a choice between proceeds or profits and you chose
25 proceeds focusing on the short run, and the effect of that --

1 I'm just asking you -- the effect of that was to increase your
2 estimate; correct?

3 A. This is a false choice. The right thing to do is to use
4 proceeds. It's not like I had the choice of proceeds versus
5 profits.

6 The right concept here is what is the benefit to
7 getting the -- appealing to the last youth smoker. This was not
8 a choice. This was the right thing to do.

9 Q. Let me just ask you the question.

10 By using proceeds you end up with a higher estimate
11 than you would if you used profits. Yes?

12 A. That's right.

13 Q. You had a choice of using company-specific historic proceeds
14 and you didn't do that; instead, you used the highest amount of
15 proceeds for the most profitable company in its most profitable
16 year; correct?

17 A. That's correct.

18 Q. You had a choice of using the weighted average cost of
19 capital for each specific company or of using those estimated by
20 Dr. Fisher, and you chose to use the estimate of the weighted
21 average cost of capital for Altria Group, Inc., which is lower
22 than any other one and, if so, that would increase your
23 estimate; correct?

24 A. Once again, for both these last two -- I guess I just want
25 to once again quibble over the notion this is a choice.

1 The idea here was to set up a mechanism which would
2 ensure that no financial benefit was being made by attracting
3 youth smokers. To did so, I chose a number large enough to
4 provide that insurance. Given that I chose that number, which
5 is Philip Morris in 1992, then it was natural to use their
6 weighted average cost of capital.

7 Q. Let me put it this way.

8 Your \$3,000 assessment per extra youth smoker is
9 larger, larger, than the present discounted value of the amount
10 made from the sale of cigarettes over the lifetime of that extra
11 youth smoker, isn't it?

12 A. It's estimated to be an upper limit, yes.

13 Q. It is higher than any benefit that you expect the defendants
14 will actually receive from lifetime sales of cigarettes to each
15 smoker under the age of 21; correct?

16 A. It's once again estimated to be the upper limit, yes.

17 Q. And you purposely decided to do that because you wanted to
18 have insurance against the possibility that your estimate could
19 ever be too low; right?

20 A. Once again, I can't ensure against it ever being too low.
21 That's why I referred to it as an estimated upper limit as
22 opposed to a theoretical upper limit.

23 I can't ensure that there's no state of the world in
24 which there would end up being a financial benefit. This was
25 realistically, I thought, the best they could do in the

1 foreseeable future.

2 Q. It's the best that they could ever do realistically, you
3 thought?

4 A. Realistically, it's the best that I could see them doing in
5 the foreseeable future.

6 Q. How much of the \$3,000 is insurance?

7 A. I can't answer that.

8 Q. In preparing your expert report and your testimony in this
9 case, isn't it true that you did not consider the effect of the
10 remedy that you are proposing on competition in the cigarette
11 industry or on these defendants?

12 A. I didn't spend -- you know, it's not something that was the
13 focus of my preparation.

14 Q. Nor did you consider the effect of the remedy that you are
15 proposing on the defendants' shareholders, bondholders,
16 employees, suppliers, et cetera?

17 A. No, I didn't.

18 Q. And you don't know what the risk to these defendants of
19 bankruptcy might be if individually or collectively they were
20 required to pay not only the assessments that you propose but
21 the \$5.2 billion in annual payments for smoking cessation that
22 Dr. Fiore proposes and whatever else is going to get thrown into
23 the mix; correct?

24 A. I haven't done an estimate of that, no.

25 Q. You do know, however, that defendants are likely to be

1 bankrupted by remedies, the cost of which exceed the market
2 capitalization of the defendants; correct?

3 MR. GETTE: Objection, Your Honor. This is beyond the
4 scope of what Dr. Gruber has testified to in this case.

5 THE COURT: Sustained.

6 BY MR. BIERSTEKER:

7 Q. Assuming that any remedies imposed in this case would have
8 to be paid out of defendants' future profits, isn't it pretty
9 clear that the defendants wouldn't be able to pay 5.5 plus
10 billion dollars a year?

11 MR. GETTE: Objection, Your Honor. I think that's
12 really asking the same thing, slightly differently.

13 THE COURT: Well, it's a different question. I'll
14 allow the question if the witness can answer it.

15 A. Once again, I don't -- that's an extreme assumption that it
16 would come out of their profits. I don't remember the rest of
17 the question. I just remember thinking that was an extreme
18 assumption when you started the question. So if you could ask
19 it again.

20 Q. Well, if the defendants can't raise their price because the
21 remedies here apply only to them, so it doesn't stick, any price
22 increase, where is the money going to come from if it doesn't
23 come out of profits?

24 A. Well, first of all, I don't endorse it they can't raise
25 their price. They may be able to raise their price somewhat.

1 Second of all, even if they can't raise their price,
2 they may be able to lower costs in some way.

3 And the remainder that's not passed through to price or
4 come through lowering costs will come out of their profits.

5 Q. Isn't it true that when you were in the Treasury Department
6 you thought that annual profits in the entire cigarette
7 industry, not just these defendants in this country, and this is
8 before the MSA, were \$4.6 billion a year?

9 A. I don't remember.

10 Q. Let's see if we can refresh your memory. I think you've got
11 this one up there, Doctor. It's the May 29, 1998, Youth
12 Lookback Penalties and Overview Memo. If you turn to the third
13 page in -- actually, it starts on the bottom of the one before.
14 Page 197 on the bottom.

15 Do you need some help? Do you have it?

16 A. No, but I can see it.

17 Q. Do you want me to help you fish it out?

18 A. No. I can see it here.

19 Q. You said in this memorandum to Secretary Rubin and others
20 that the entire after-tax profits of the domestic tobacco
21 industry in 1998 before adoption of the MSA were about
22 \$4.6 billion. Do you see that?

23 A. Yes, I do.

24 Q. Does that refresh your recollection?

25 A. I see it there. I don't recall -- I still don't recall

1 writing the memo, but I see it right in front of me.

2 Q. Do you know -- you go on to talk about volume shrinking and
3 profits declining if there was a fairly substantial excise tax
4 of a dollar ten a pack. Do you see that?

5 A. Yes, I do.

6 Q. Do you remember that?

7 A. Once again, I see it in front of me.

8 Q. Okay. Do you know whether or not profits in this industry
9 have fallen in the wake of the MSA?

10 A. I believe overall industry profits -- I don't know for sure.
11 I don't know for sure what's happened.

12 Q. Isn't it true that in one year my client, R.J. Reynolds
13 Tobacco Company, reported a loss?

14 A. Yeah, that was in 2003 due to a special sort of accounting
15 quirk in that year, as far as I understand.

16 Q. With the fix in the -- I've forgotten what the term is --
17 the allocation for some of the nonparticipating manufacturers
18 that has been recently adopted; it's your assessment, isn't it,
19 that the MSA imposes a competitive disadvantage on the original
20 participating manufacturers who are at this table?

21 A. Yes, it does.

22 Q. But it is your estimate that it's not that big, basically 2
23 to 2-and-a-half cents a pack; right?

24 A. If these loopholes in the state escrow statutes are fixed,
25 then it would be about 2-and-a-half cents, let's see, yeah,

1 around 2 to 3 cents a pack, that's right.

2 Q. Do you have any idea how big a competitive disadvantage
3 would be imposed on these defendants if your remedy were adopted
4 in this case and they had to pay \$2 billion a year?

5 A. Well, you know, working with the numbers that we discussed
6 in my deposition, you told me at that time they sold about 14
7 billion packs, I think. So, 2 billion divided by 14 billion is
8 about 14 cents a pack.

9 Q. So about seven times greater than the disadvantage you
10 believe was imposed by the MSA once the loopholes are fixed?

11 A. Well, yeah. I mean, the loopholes haven't all been fixed.
12 But ultimately if all of those loopholes are fixed this would be
13 a greater difference.

14 Q. Do you know how much the cost disadvantage on these
15 defendants would be if Dr. Fiore's \$5.2 billion smoking
16 cessation program were adopted?

17 MR. GETTE: Objection, Your Honor. We've already
18 established that Dr. Gruber hasn't studied Dr. Fiore's proposed
19 remedy.

20 THE COURT: The question is pretty specific. We've got
21 the dollar in the record, so you may answer if you can.

22 A. Once again, you'd divide by the number of packs.
23 Understand, I don't do them in my head, but you would get some
24 amount that's larger.

25 Q. Do you know if it would be about 30, 35 cents a pack?

1 A. That sounds about right.

2 Q. Thank you.

3 If these defendants are either put out of business
4 altogether or significantly competitively disadvantaged, isn't
5 it true that their bondholders and shareholders will see the
6 value of their investments decline?

7 A. Certainly if they are put out of business. If their
8 business shrinks, it depends on the cost of business shrinkage
9 versus any benefit that bondholders or shareholders perceive
10 from perhaps reduced legal risks, from having a remedy imposed
11 instead of hanging over their heads, so that's a little bit more
12 complicated.

13 Q. Isn't it true that to the extent that these defendants do as
14 you suggest they might, increase prices, and smaller companies
15 that are not bound by the Master Settlement Agreement take the
16 market share from them, that the states' payments under the MSA
17 will be reduced?

18 A. Yes, that's true.

19 Q. Isn't it true that to the extent that these defendants
20 increase their prices and share is taken away from them by
21 cigarette manufacturers who are not signatory to the MSA, that a
22 greater proportion of the demand for cigarettes is likely to be
23 met by manufacturers who are not constrained in terms of
24 advertising on billboards, sampling, whatever that the MSA
25 imposes on its signatories?

1 A. Once again, as I testified earlier, we don't really have a
2 good estimate of the extent to which business would shift from
3 the signatories to the nonsignatories as their price increase --
4 as the price increases. To the extent it does shift, then
5 you're right, but we don't have a good estimate of that.

6 Q. And, in fact, you have written, have you not, in connection
7 with this very case that that kind of phenomena could undercut
8 the goals of antismoking advocates?

9 A. It's possible that to the extent that more business shifts
10 to nonsignatories, then that could have some negative effects on
11 some the restrictions in the MSA.

12 Q. You would agree with me that if prices are lower, all else
13 equal, more people are likely to smoke; right?

14 A. Yes.

15 Q. And if the defendants are bankrupted or competitively
16 harmed, the real price of cigarettes might -- I underscore
17 might -- decline; correct?

18 A. That's true.

19 Q. In the event that these defendants were harmed competitively
20 or certainly bankrupted, isn't it true that there would likely
21 be downsizing and employees would have to find other work?

22 MR. GETTE: Objection, Your Honor. There's been no
23 foundation for this witness having done this kind of analysis
24 that he's being asked about.

25 THE COURT: Sustained.

1 BY MR. BIERSTEKER:

2 Q. Do you know what effect competitively harming these
3 defendants or putting them out of business would have on
4 retirees?

5 A. It's not really something I've studied.

6 Q. Doctor, when you were at the Treasury Department, isn't it
7 true that you told Secretary Rubin and others that a system of
8 forced disclosure of research on potentially less hazardous
9 cigarettes would reduce defendants' incentives to innovate
10 compared to the current situation where they can obtain patents
11 on that research when they disclose it?

12 MR. GETTE: Objection, Your Honor. We are now into
13 less hazardous cigarettes. This expert has indicated no area of
14 expertise in that.

15 THE COURT: Well, I know it's way beyond the scope of
16 his direct. He didn't discuss that issue at all. So sustained.

17 MR. BIERSTEKER: Well he is here also as a fact
18 witness, Your Honor, as his expert report makes clear.

19 THE COURT: He's here as a fact witness, but your
20 cross-examination is limited by what's presented in his direct
21 testimony.

22 MR. GETTE: In fact, Your Honor, we are not presenting
23 him as a fact witness at all. He is here as an expert witness.

24 THE COURT: You're right. You're absolutely right
25 about that. I'm sorry. That's correct. Well, the objection is

1 sustained for both reasons, everybody.

2 Do you want to take a 10-minute break at this point,
3 Mr. Biersteker?

4 MR. BIERSTEKER: I may be almost finished, so yes, that
5 may help me make that determination.

6 THE COURT: We will take a 10-minute break.

7 (Recess began at 3:16 p.m.)

8 (Recess ended at 3:30 p.m.)

9 THE COURT: Mr. Biersteker.

10 MR. BIERSTEKER: Yes, Your Honor, just maybe, I hope,
11 three questions and I'm going to sit down.

12 BY MR. BIERSTEKER:

13 Q. Isn't it true, Dr. Gruber, that you don't know how much, if
14 any, increase in price the defendants might institute if your
15 remedy is imposed?

16 A. Yes. As I've testified, I don't know by how much they will
17 use price versus other means to meet their targets.

18 THE COURT: That's because they have a choice of what
19 to do in order to meet their targets; right?

20 THE WITNESS: Indeed. I view that as a strength of
21 what I'm proposing is that they choose the appropriate mix.

22 BY MR. BIERSTEKER:

23 Q. And you don't know what other means the defendants might
24 pursue?

25 You can't make a prediction about what other means the

1 defendants might pursue in order to comply with the youth
2 smoking reduction targets; correct?

3 A. Once again, I'm sort of relying on other plaintiffs' experts
4 to say that such avenues exist, but I'm not an expert to predict
5 which avenue they will use.

6 Q. If your memory is imposed you cannot predict what the
7 defendants' response will be; correct?

8 A. No, I can't predict exactly what their response will be.

9 MR. BIERSTEKER: Thank you very much. Nothing further.

10 THE COURT: Mr. Gette, are you going to be able to
11 finish your redirect today?

12 MR. GETTE: I believe so, Your Honor.

13 THE COURT: Okay.

14 REDIRECT EXAMINATION

15 BY MR. GETTE:

16 Q. Good afternoon, Professor.

17 A. Good afternoon.

18 Q. I'd like to start by talking to you a little bit about some
19 changes in youth smoking rates and some changes in price that
20 you were asked about during your cross-examination.

21 A. Okay.

22 Q. Do you recall being asked about a -- in fact, yourself
23 testifying in your direct testimony about a 60 percent price
24 increase that occurred from 1997 to 2002?

25 A. Yes, I do.

1 Q. First, I'd like to ask you a few questions about that before
2 including the issue of the youth smoking reductions as well.

3 But with respect to that 60 percent price, did that
4 analysis of price change include issues related to price
5 promotions and other pricing mechanisms that are used by
6 defendants to market their products?

7 A. Yes, it did. That was -- that price increase number came
8 from data that Dr. Chaloupka provided to me which accounts in
9 the best way he found able for price-based promotions which
10 lowered the net price that smokers pay for cigarettes.

11 Q. And similarly with respect to the 42 percent price increase
12 that you've indicated would be necessary were defendants to
13 choose to meet their targets purely by price. Did that
14 percentage account for price promotions that defendants could
15 use with respect to the marketing of their product?

16 A. Yes. The idea --

17 MR. BIERSTEKER: I object to the form of the question.
18 I just don't understand it.

19 THE COURT: Well, let me look at it. I had a little
20 trouble myself.

21 Well, I think I understand the question, but why don't
22 you clarify it for the witness's sake, please.

23 BY MR. GETTE:

24 Q. Does your 42 percent account for all avenues of pricing that
25 would be employed by defendants?

1 A. The 42 percent represents the net change in prices
2 accounting for not just changes in list prices, but promotions
3 and other things which lower the net price of their product.

4 Q. You were asked about whether price increases, if used by
5 defendants to meet your targets, would impact youth as well as
6 adults. Do you recall that?

7 A. I don't recall exactly.

8 Q. You were asked whether, if they were required to increase
9 their prices, whether that would necessarily implicate adults as
10 well in terms of the prices being charged to adults.

11 A. Yes.

12 Q. Do you recall that?

13 A. Yes, I do.

14 Q. I'd like to show you some testimony -- and you indicated
15 that you've talked several times to Dr. Chaloupka. Well, let me
16 ask you.

17 Have you had occasion to talk to Dr. Chaloupka in
18 preparation and presentation of your evidence -- I'm sorry -- of
19 your opinions in this case?

20 A. Yes, I have.

21 Q. Now, in his testimony Dr. Chaloupka was asked the following
22 question.

23 "If it's the goal of the tobacco companies to reduce
24 the cost of cigarettes to consumers, why not just simply set a
25 lower list price instead of going through this process as you

1 see up here of reducing cigarette prices through all of this
2 price-related marketing?"

3 And after some objections, which were overruled,
4 Dr. Chaloupka says, "I would agree with Dr. Dolan on the two
5 reasons that he cited earlier this afternoon. I call one of
6 them something slightly different than he does.

7 "There's a term in economics known as price
8 discrimination which essentially involves charging different
9 people different prices based on how price sensitive they are
10 with the idea being that lower prices will be charged to the
11 most price sensitive consumers, higher prices to the more -- or
12 to the less price sensitive consumers. That's I think one of
13 the issues that Dr. Dolan discussed."

14 Now, how does the concept of price discrimination in
15 economics play into whether price increases intended to meet
16 youth smoking targets would necessarily apply to adult smokers?

17 A. That's a -- that's a good question.

18 Basically, it depends in the extent to which tobacco
19 manufacturers can price discriminate specifically to youth
20 smokers.

21 If, for example, there are promotions -- price-based
22 promotions, which they know would only go to youth smokers, then
23 it's possible -- or conversely, price-based promotions that they
24 know would not go to youth smokers, then it's possible to price
25 separately for those two markets.

1 Q. So, let me ask this then very directly.

2 Is it possible that defendants can differentiate price
3 for different segments of the market through targeted price
4 promotions?

5 A. It's certainly possible, yes.

6 Q. Now, I got us a little bit off track because I said we were
7 going to talk about the comparison of the 60 percent to the
8 youth smoking reduction and I want to come back to that now.

9 When being asked about that, there was a suggestion
10 that in fact perhaps your elasticity estimates were inaccurate
11 because we saw a 30 percent reduction while we saw a 60 percent
12 increase in price. And let me ask you.

13 Are there reasons why these numbers are not a 1-for-1
14 correlation beside the claim that your elasticity calculation
15 may be incorrect?

16 A. Yes. As I've testified, there are many things going on over
17 time, so that there wouldn't necessarily be a 1-to-1
18 correspondence. The case could be changing for other reasons,
19 for example.

20 Q. And is it possible that actions by defendants in terms of
21 their marketing approaches may have been implicated in some way
22 in the youth smoking reduction and price increases that were
23 seen during that period?

24 MR. BIERSTEKER: Objection, leading, and calls for
25 speculation.

1 THE COURT: I'm going to sustain that. The question
2 was very unclear as well. Why don't you try rephrasing it,
3 please?

4 BY MR. GETTE:

5 Q. Professor Gruber, in your immediately preceding answer you
6 said there was a lot going on, and my question is simply this.

7 Is it possible that one of those other things that were
8 going on during that period was, in fact, marketing activities
9 being undertaken by defendants?

10 MR. BIERSTEKER: Objection, leading. Why doesn't he
11 just ask what other things were going on?

12 THE COURT: I'll allow the answer.

13 You may answer if you can.

14 A. Yes, that's certainly possible.

15 Q. Now, when you were being asked in cross-examination about
16 what would occur if you assumed that defendants were unable to
17 raise prices to meet their targets, and in your answer you said,
18 "Even if they can't raise their price, they may be able to lower
19 their costs in some way."

20 Do you remember that testimony?

21 A. Yes, I do.

22 Q. Is one way the tobacco companies could lower their costs --

23 THE COURT: Mr. Gette, again you're going to hear an
24 objection leading with the way you're phrasing it.

25 MR. GETTE: Well, I'm simply asking if this is one of

1 several options that would be possible.

2 THE COURT: That is a leading question. You will have
3 to ask it differently, please.

4 MR. GETTE: Thank you, Your Honor.

5 BY MR. GETTE:

6 Q. What would occur if defendants eliminated part or all of the
7 \$12 billion they spend annually on cigarette brand marketing?

8 A. Lots of things could occur.

9 I mean, first of all, the costs would fall. It could
10 lead to less brand switching. It could lead to less smoking.
11 I'd expect some of each. But, you know, it's a very broad
12 question.

13 Q. What are the options to defendants that you were referring
14 to in terms of their ability to lower cost?

15 A. Well, there's a very complicated cost structure for these
16 companies, as with any other big company, ranging from cutting
17 the compensation of the CEO to lowering wages to producing more
18 efficiently.

19 We know -- despite our textbook economics that says
20 that every company at every moment should be producing as
21 efficiently as possible -- we know in many contexts that when
22 corporations face particular cost stresses they often find ways
23 to save money that they weren't using before, and there's a wide
24 range of options for doing so.

25 Q. Does the knowledge that defendants have regarding those

1 options bear on the efficacy of the remedy that you have
2 suggested to the court?

3 A. Basically, I think that's in some sense -- the key to the
4 remedy is that, basically, defendants have knowledge about the
5 best way to meet these targets. And -- actually, you know, I
6 think I may be confused. Can you ask the question again?

7 Q. The question was: Does the knowledge that defendants have
8 regarding those options bear on the efficacy of the remedy that
9 you have suggested to the court?

10 A. When you say those options, what do you mean?

11 Q. Options with respect to cutting costs, for example.

12 A. Yes. Yeah. Okay, yes -- now I understand.

13 Certainly since they know about the best routes to cut
14 costs, it means that an option which assesses them for meeting
15 targets will be more easily met without reducing their
16 profitability.

17 Q. During your cross-examination in answer to one of
18 Mr. Biersteker's questions you also said that it was your
19 opinion that peer smoking is partially influenced by defendants.

20 A. Yes, absolutely.

21 Q. Could you explain that to the court?

22 A. Well, it's -- sort of common fallacy in thinking about youth
23 smoking is, Gee, kids get their cigarettes from their friends or
24 kids are influenced by their friends and that means that price
25 doesn't matter or other defendants' actions don't matter. But

1 that's not right because it just begs the question of where the
2 friends got the cigarettes and why the friends are smoking.

3 So, in substance, it doesn't really matter if it's a
4 peer influence or you should decide on your own. Either way
5 defendants' action which caused youth to smoke will affect you.
6 Whether it affects you directly or through your friends, it's
7 still affecting you.

8 Q. Much of the questioning that you addressed throughout the
9 day today had to do with the comparative merits effectively of
10 an input-based remedy versus an output-based remedy.

11 So, could you explain for the court, please, what you
12 see as the relative merits of those two options of remedies?

13 A. Yes, I'd be glad to. I mean, it's --

14 MR. BIERSTEKER: I think this is going straight out of
15 the written direct, Your Honor. I think that exact question was
16 asked.

17 THE COURT: The objection is overruled. You may
18 answer.

19 A. I'd be glad to.

20 Basically, as I think has come out today, there's no
21 absolutely perfect route for addressing these violations. As
22 you mentioned, there's two ways to go roughly speaking.

23 There's input -- what I label input-based approaches
24 which would be directly trying to regulate every avenue of RICO
25 violation, and then there's this outcome-based regulation which

1 says, let's look at the bottom line which is youth smoking.

2 My personal view since the time I was at Treasury is
3 that this outcome-based approach is superior for several
4 reasons.

5 First, there's such a wide variety of things that
6 defendants can do to make their product appealing to youth.
7 It's hard to regulate every single one of them.

8 Second of all, in trying to regulate them, there's an
9 information deficit that the court faces because there are --
10 the defendants know much more about these routes than the court
11 does. So even if it had a comprehensive list it would be hard
12 to actually find out about each of those inputs and regulate
13 them.

14 And finally, and perhaps most importantly, the
15 defendants are very good at shifting their efforts around from
16 regulated to unregulated sources of inputs.

17 So, the MSA is a great example of this; where, in the
18 wake of the MSA regulating specific marketing activities, we've
19 seen defendants shift their efforts from those specific
20 activities to other activities which are not regulated by the
21 MSA.

22 And for all those reasons, I think that while the
23 outcome-based approach may have some limitations that came out
24 today, it's still a much better approach than trying to regulate
25 each of these inputs.

1 Q. I'd like to talk a little bit about price elasticity because
2 that was the subject of some of your testimony this morning, and
3 in the course of that you were shown a document by defendants'
4 counsel, which is U.S. Exhibit 78803. If we can find it in your
5 stack. It is the DiCicca article.

6 A. Yes, I have that.

7 Q. Have you considered this article in the preparation of the
8 opinions that you provided to the court?

9 A. Yes, I have.

10 Q. And as part of that consideration did you discuss this with
11 any other experts for the United States in this case?

12 A. Yes, I did. I discussed this article with Dr. Frank
13 Chaloupka.

14 Q. And why did you discuss this with Dr. Chaloupka?

15 A. Because I've always had various concerns about this article,
16 but he is more expert than I in this area. I know has spent
17 more time thinking about it. So I wanted to understand his
18 concerns as well in helping form my thinking about this
19 particular study.

20 Q. What are the concerns that you have regarding the DiCicca
21 study?

22 A. There are really several.

23 First of all, my main concern -- well, really, to be
24 honest, my main concern is that they don't ever give what
25 elasticities they get. They mention they are not significant,

1 but the key thing here to remember with statistical study is
2 significance is a function both of the magnitude of the estimate
3 and the precision with which it is estimated.

4 Just saying something is not significant, they could
5 have an estimate of an elasticity of minus 2, but the standard
6 error is 4. So it's a huge elasticity, but it's not
7 significant.

8 I can't find what elasticity they actually estimate in
9 this article, so I don't know if it's insignificant because it's
10 substantively small or if it's insignificant because it's just
11 imprecise.

12 My second problem is I have a lot of reason to suspect
13 the latter, and that's because they are looking at one cohort of
14 youth over a period of time where there wasn't a lot of cross
15 state variation in cigarette prices. And, as a result, since
16 their model is statistically working off cross state variations
17 in cigarette prices, I don't imagine they can get a very precise
18 estimate over this narrow time period.

19 Once again, I'd like to tell you that they do or don't,
20 but I can't tell from their paper whether they do or don't, but
21 I have reason to be concerned because there wasn't a lot of
22 price variation across this narrow time period.

23 And, finally, these data have a lot of problems. In
24 particular, there's a lot of missing values. There was a
25 critique -- when this came out as a working paper, there was a

1 critique put out by Professor William Evans at University of
2 Maryland, who I respect a lot for his work in this area as well,
3 critiquing the handling of missing data. That was addressed to
4 some extent in the published paper but not to my mind fully.

5 And indeed, it's my understanding, although I can't
6 recall exactly, that even Dr. Heckman in his deposition
7 criticized the data used in this article.

8 Q. When you discussed this with Dr. Chaloupka, were your
9 opinions consistent with his with respect to the DiCicca
10 article?

11 A. Yes.

12 MR. BIERSTEKER: Objection, Your Honor.

13 THE COURT: Sustained.

14 MR. BIERSTEKER: Dr. Chaloupka is not here.

15 THE COURT: Sustained.

16 BY MR. GETTE:

17 Q. Did you conclude that there was some study available to you
18 that provided you with better information with respect to
19 reaching the opinions that you offered in this case?

20 A. Yes. Once I knew the important role that a price elasticity
21 could play I reviewed the literature but, more importantly, I
22 went to Dr. Chaloupka, who really has been much more focused on
23 this as a research area in recent years. And my reading the
24 literature and also his reading of the literature is that this
25 Taurus, Johnson, O'Malley paper to which I refer was, while, as

1 I said earlier, not the ideal estimate, the best available
2 estimate for what I want.

3 MR. BIERSTEKER: I object to the extent that the
4 testimony is about Dr. Chaloupka's views as opposed to the
5 witness's own views.

6 MR. GETTE: Your Honor, as an expert he's certainly
7 allowed to rely on information and opinions from other experts
8 in reaching his own opinion.

9 THE COURT: He is. The objection is overruled.

10 BY MR. GETTE:

11 Q. There was an additional article that you were shown this
12 morning, and this was another article that included Dr. Tauras
13 as an author. Do you recall this article?

14 A. I recall seeing it this morning, yes.

15 Q. Is there anything about this article that leads you to reach
16 a different conclusion than the one you had reached in
17 consultation with Dr. Chaloupka regarding the price elasticity
18 of youth?

19 A. No, there's not.

20 Q. Dr. Gruber, let me show you another document that was the
21 subject of your examination. This is JD 068061.

22 And if you will recall, this related to an analysis of
23 the Durbin lookback scheme. Do you recall being asked about
24 this?

25 A. Yes, I do.

1 Q. And were the targets and the assessments contemplated under
2 the Durbin lookback scheme the same as those provided in the
3 remedy that you're suggesting to the court?

4 A. I don't recall. I mean, I doubt it; but I don't recall
5 exactly.

6 Q. In relation to this and some other analyses that you were
7 doing at Treasury when you were there, you said "research on
8 youth sensitivity has changed greatly since that time."

9 Do you recall that?

10 A. Yes, I do.

11 Q. Can you explain that to the court?

12 A. Certainly. The literature youth smoking elasticity really,
13 hadn't really -- there hadn't been much work on this before the
14 early 1990s.

15 The bulk of the work has been perhaps motivated by the
16 excitement over the McKean legislation and the MSA and things.
17 The bulk of the research on this topic has really happened after
18 1997.

19 So when I was at Treasury we really only had a very
20 small slice of the literature that now exists to rely on in
21 forming our opinions.

22 Q. And in relation to that, in JD 068062, you were shown a
23 graph from a document that was from the time period when you
24 were at the Department of the Treasury. Do you remember this
25 document?

1 A. Yes, I do.

2 Q. And would the additional research that you've just testified
3 about impact this sort of analysis had it been known at the time
4 you were at Treasury?

5 A. Yes, it certainly would have.

6 Q. Can you explain that to the court?

7 A. Well, at the time I was at Treasury I don't recall exactly
8 the price elasticity we were using, but I know my belief at that
9 time was that youth are less price sensitive than I believe now
10 based on the developments in the literature since that time
11 researched by myself and by others.

12 Therefore, I know that if I used the price elasticity I
13 now believe is right, which is the minus 1, these curves, the
14 dotted curve and the solid line, would fall more steeply over
15 time.

16 Q. From another one of the documents that you were shown this
17 morning, this is JD 068063, and if you look at the end of the
18 first bulleted item there you were asked about some language
19 there that says, "The companies will not be able to pass these
20 company-specific surcharges on to price, because any price
21 differential between companies will dramatically affect their
22 share of the adult market."

23 Do you see that?

24 A. Yes, I do.

25 Q. Have you gained information since the time you were at the

1 Department of Treasury that would alter to some extent the
2 analysis that is reflected in this language?

3 A. Yes, I have.

4 Q. Can you explain that to the court?

5 A. Well, a couple of things.

6 First, to emphasize this really only matters to the
7 extent that there's differentials across companies. If there's
8 a common increase in price, then it can be passed on without
9 necessarily affecting the adult market.

10 In terms of specific company price differentials, my
11 belief at the time I was at Treasury was that they couldn't
12 exist at all.

13 Now I know that there can be some modest differentials
14 between the prices of cigarettes in the market and still, you
15 know, both be sold even at the same store, even 20 cents a pack
16 between say two premium brands.

17 Q. Are defendants required under your proposed remedy to
18 increase prices to meet their targets?

19 A. No, they are not.

20 Once again, the strength I view of my proposed remedies
21 is they can choose the set of actions that most efficaciously
22 meet those targets.

23 Q. And how do you consider the issue of whether, based on
24 historical information, defendants could meet their targets
25 through price increases without unduly damaging their share of

1 the market?

2 A. Yes, I have.

3 Q. And what did you conclude?

4 A. I concluded that, based on our experience from '97 to 2002,
5 that a price increase of 42 percent would be not only feasible
6 but would not necessarily even be bad for industry profits.

7 After all, from '97-2002, as I've mentioned, prices
8 went up by more than that. Most of that was paid to state
9 governments and yet the industry remains very profitable today.

10 Q. Again, was the resulting increase more or less than what is
11 anticipated, even assuming all the target is met exclusively
12 through price -- let me ask that a little more clearly.

13 Was the increase from 1997 to 2002 more or less than
14 what is anticipated if defendants choose to meet their targets
15 purely through price?

16 MR. BIERSTEKER: Objection. This is straight out of
17 both the written direct and the oral direct this morning.

18 THE COURT: Sustained.

19 BY MR. GETTE:

20 Q. Despite those increases from 1997 to 2002, are defendants
21 still in business and still profitable?

22 A. Yes, they are.

23 THE COURT: Well, they are here and paying their legal
24 bills, presumably, so I think they are still in business.

25 Go ahead, please.

1 BY MR. GETTE:

2 Q. And at the time of the MSA and the payments required by
3 defendants under the MSA, were there participants in the market
4 other than defendants in this case?

5 A. Yes, there were.

6 Q. Now, in his questioning Mr. Biersteker used a figure of
7 \$2 billion as a potential assessment amount under your remedy.

8 What would be required for that \$2 billion assessment
9 to be incurred?

10 A. That \$2 billion assessment figure would be incurred only if
11 youth smoking did not fall at all from its levels today.

12 That is, if the 30 percent reduction we've seen
13 suddenly halted and there was no further reduction, then at its
14 peak the annual payments would be almost \$2 billion, 1.92 or
15 something. They would then fall again after that. They would
16 sort of rise to that peak and then fall again because of this
17 double counting adjustment I have that ensures they don't pay
18 twice for the same smoker.

19 Q. How do you consider the issue of whether defendants could
20 pay those assessments of approximately \$2 billion without
21 raising their prices?

22 A. Yes. I mean, that is once again partly -- I'm not saying
23 they would meet it this way, but they could by either cutting
24 cost or by just lowering profits. That's less of the
25 profitability of the industry. That once again is only the peak

1 in that one year. So certainly they could borrow or something
2 to make that one peak payment.

3 Q. There was something in your answer that I'm not sure came
4 out clearly and so I just want to ask it.

5 Did you say that the amount of 2 billion is less than
6 the profitability of the industry?

7 A. Yes.

8 Q. There was substantial discussion this morning about loss of
9 market share. Do you recall those discussions?

10 A. Yes, I do.

11 Q. Are there reasons why the defendants may have lost market
12 share aside from price increases resulting from the MSA?

13 A. Yes, there are.

14 Q. Could you explain those to the court?

15 A. As I mentioned earlier, there was at the same time a price
16 increase and a loss of market share, those two aren't
17 necessarily causally related. I just threw out a couple of
18 reasons why.

19 One is we, in general, saw a loss of market share of
20 premium brands to discount brands in a variety of goods over
21 this time period.

22 Second of all, in the wake of Marlboro Friday in 1993
23 it became clear that at least some manufacturers were more
24 focused on making sure they retained their premium share of the
25 market, even if it meant ceding the discount share of the

1 discount market to new manufacturers, and even before the MSA.

2 Q. Dr. Gruber, assuming that an individual defendant alone
3 faces an assessment, is it possible that other manufacturers --
4 let me give you a second assumption.

5 The first assumption is that a single individual
6 defendant faces an assessment.

7 The second assumption is that that defendant chooses to
8 pass that assessment on to price.

9 Do you understand the two conditions?

10 A. Yes, I do.

11 Q. With those conditions is it possible that other
12 manufacturers who do not face assessments may raise prices as a
13 competitive response nonetheless?

14 A. Yes. I think that's probably actually likely to some extent
15 that they would raise prices as a competitive response.

16 Q. Can you explain that a little more fully for the court?

17 A. Sure. If one -- if, once again, under the assumption that
18 one defendant does raise its price to deal with these
19 assessments, then as we said that's not necessary, but if they
20 did, then other defendants had two choices.

21 They can keep their prices the same and potentially
22 gain market share at one extreme. They could raise their price
23 just as much and make a lot more profits on their existing
24 market share at the other extreme.

25 Presumably, they will choose some mix of those two, of

1 gaining some market share, but also the optimal thing to do
2 would be raise their price some to take advantage of this sort
3 of new competitive advantage they've been given.

4 Q. Now, I'd like to ask you about an incentive, that it wasn't
5 quite clear from the testimony whether some incentive would be
6 created by your proposed remedy. Let me just ask it this way.

7 As compared to today without your remedy, is there any
8 instance in which imposing your remedy creates an incentive to
9 violate RICO that already doesn't exist today?

10 A. No. I mean, there's no way in which this could create a new
11 incentive to violate RICO.

12 Q. Does that hold true even if the defendants find themselves
13 under the targets that your assessment sets?

14 A. Yes.

15 Q. Can you explain that to the court?

16 A. I think -- let me qualify my earlier answer I shouldn't have
17 said. It's -- it's unlikely that it would create any new
18 incentive.

19 But I think the more specific answer to come to your
20 second question, certainly the fact they are below creates no
21 new incentive. In the extreme case if they are below and they
22 can be sure that a RICO violating activity doesn't push them
23 above, then it doesn't change their incentive, but there's no
24 way it creates a new incentive.

25 Q. I want to come back to your qualification on your first

1 answer.

2 You were asked some questions this morning about
3 whether your remedy would create an incentive to commit RICO
4 violations to the extent that a RICO violation would reduce
5 youth smoking. Do you recall that?

6 A. Yes, I do.

7 Q. In that context are you aware of any RICO violations from
8 your work in this case that would lead to a reduction in youth
9 smoking?

10 A. No, I'm not.

11 Q. If there was such a thing as a RICO violation that reduced
12 youth smoking, would defendants be required to commit that RICO
13 violation under your forward-looking remedy?

14 A. No, they certainly would not.

15 Q. How is that?

16 A. Well, once again, if there was such a thing as a RICO
17 violation that lowered youth smoking, defendants would weigh the
18 costs and benefits of committing that violation.

19 This would be on net a new benefit to them of
20 committing that violation, it's true, because they would be less
21 assessments, but they still would have to weigh that against the
22 costs. And even if they found this was a benefit, they might
23 still decide there's other ways to reduce smoking that aren't
24 RICO violations that are better.

25 Once again, the goal of this is that they choose the

1 most efficacious way to meet those targets.

2 Q. Dr. Gruber, I've put on the monitor J-DEM 060658. Do you
3 recall seeing this demonstrative in your cross-examination?

4 A. Yes, I do.

5 Q. And do you see that Mr. Biersteker down in the right-hand
6 column in each case has put the words "increased estimate"?

7 A. Yes, I do.

8 Q. Do you have an opinion with respect to whether in each
9 instance that is an appropriate implication of your remedy?

10 A. Well, once again, I guess the problem I have with this
11 demonstrative is not so much that the answers aren't
12 appropriate, but the questions are inappropriate.

13 This is not -- yes, it's true if I -- for example, if I
14 truly wasn't different between using proceeds and profits as a
15 measure, if it was matter of well either one is okay, had I
16 chose proceeds that would increase the estimates, I can't argue
17 with Mr. Biersteker's conclusion there. But that's not the
18 situation. The right thing to use is proceeds.

19 So, it's sort of irrelevant to say it increases the
20 estimates relative to profits because profits is not the right
21 thing to use, proceeds is.

22 THE COURT: But you would agree that's not true of the
23 decision you made to use 21 rather than 18 and current rather
24 than future quit rates?

25 THE WITNESS: Well, we can discuss each.

1 21 versus 18, to be honest, is not really my decision.

2 I was --

3 THE COURT: That was given to you.

4 THE WITNESS: That was given to me.

5 So once again, it's not really a decision I made to
6 increase the estimate. It was given to me.

7 Current versus future quit rates is a hard one. I
8 agree that was more of a choice. In that case, given that I
9 didn't really have the ability to project what would happen to
10 future quit rates, I thought that the best insurance was
11 provided by using current.

12 If the court in its wisdom saw the quit rates continued
13 to go down by 2007 and wanted to adjust this for that, that's
14 not something I would have a problem with because I agree that's
15 a sort of hard distinction.

16 I felt that that was the conservative thing to do to
17 make, to provide this insurance, but I don't really feel super
18 strongly about that versus using a future number if the court
19 decided that that was more appropriate down the road.

20 THE COURT: Would it be more accurate, instead of using
21 the word conservative, would it be more accurate to say that we
22 know what the current quit rates are and we can only speculate,
23 whether reasonably or unreasonably, about what the future quit
24 rates would be?

25 THE WITNESS: That would be a very good way to put it.

1 If I build in that speculation, I'm losing some
2 insurance, and so the idea was not to build in that speculation.
3 That's why I said if it was revealed to be true by 2007, then I
4 think it should be built in, but I don't want to build it in now
5 not knowing where we are going.

6 BY MR. GETTE:

7 Q. Just one last question, Dr. Gruber, which is with respect to
8 instances where you had a choice, how does the concept of
9 insurance play into the choices you made?

10 A. That's very important.

11 The basic idea here was when I was considering factors
12 over which the defendants do not have much control, over which
13 they are not really primary determinants, I tried to get the
14 best estimate I could today: Quit rates, intensity, mortality.

15 But when I was using factors over which defendants have
16 a lot of control, such as their reported proceeds, then the idea
17 of providing insurance was to choose a number large enough so
18 that they would not financially benefit from attracting youth
19 smokers.

20 MR. GETTE: Thank you, Professor Gruber.

21 That's all, Your Honor.

22 THE COURT: Thank you, Professor Gruber. You may step
23 down.

24 And before we leave Dr. Gruber's testimony, I want to
25 make sure that we cover the objections of which there are not

1 too many.

2 Let's see now. I'm going to come back to issue number
3 1 in a moment.

4 Issue number 2 is just the objection is overruled.
5 That is not true.

6 All of his testimony was how the remedies he was
7 proposing in his view could prevent and restrain any future
8 misconduct, and obviously he was focusing on reduction of youth
9 smoking. Those are the two issues presented.

10 Now, the first issue which regards the 1997 proposed
11 resolution testimony, in addition to the objection from the
12 defendants, I also have a formal motion in limine. I do not
13 have, because the time period had not passed, an opposition from
14 the government.

15 Given the way the testimony actually went, everybody,
16 Mr. Biersteker, are you still maintaining that objection since
17 you cross-examined the witness very, very closely on the 1997
18 proposed resolution? That's number one.

19 And two, I must say when I read the objections in
20 advance and the direct testimony I couldn't imagine how this
21 person could testify and how the defendants could cross-examine
22 without bringing in testimony about the 1997 proposed
23 resolution.

24 MR. BIERSTEKER: Let me just say this. Yeah, I think
25 the objection still stands for the following reason, Your Honor.

1 The witness explicitly, both in his written direct and
2 in his testimony here today on direct examination, said --
3 inferred from the fact that defendants agreed to certain
4 targeted reductions in the proposed resolution.

5 THE COURT: He did.

6 MR. BIERSTEKER: That those reductions were achievable.

7 I don't think that follows as a matter of logic, and I
8 pursued that in my cross-examination even though I had these
9 objections, but I do think that that is legally improper.

10 THE COURT: Just a minute, everybody. There is a
11 visitor on my desk.

12 Go ahead.

13 MR. BIERSTEKER: An unwelcomed visitor, I take it.

14 THE COURT: No.

15 MR. BIERSTEKER: But I guess my point would be I think
16 that's a legally inappropriate inference to draw, and I think
17 the objections are well-founded with respect to that aspect of
18 his testimony.

19 THE COURT: No. The objection is overruled.

20 This is an interesting area. I did a fair amount of
21 research trying to find helpful case law. I found very little
22 that was really on point -- well, actually nothing that was on
23 point, very little that was even helpful.

24 The Sixth Circuit case you all cited to my knowledge is
25 the only circuit case holding as it did, and what is more, I

1 have just recently learned, in discussing this with other
2 judges, that Judge Bates of our court issued an opinion just a
3 few days ago coming out the other way on the existence of a
4 discovery privilege. Now, of course, he's not the Court of
5 Appeals, but he certainly is very well respected.

6 But, in any event, that issue goes to whether there is
7 a 408 privilege for discovery, not for actual testimony. When I
8 said a 408 privilege, I think everybody understands what I'm
9 saying -- or what I'm referring to.

10 Number one, the testimony certainly wasn't being used
11 for liability. No question about that.

12 408 says that it can be admitted if used for other
13 purposes. The other purpose for which the government was
14 offering it was to show, whether convincingly or not -- and that
15 was the purpose of cross-examination -- but to show whether the
16 remedy being proposed was economically feasible or not. He had
17 his reasons. He was subjected to full and adequate
18 cross-examination.

19 Number three, as I understand it from everybody's
20 papers -- in fact, there was an incredible amount of discovery
21 on this issue, and actually, I know that from a number of R&Rs
22 that came through me. So I'm well aware that there was an
23 enormous amount of discovery on the issue.

24 Fourth, again, I don't think this witness's testimony
25 could have been presented in a comprehensible form nor

1 cross-examined at all effectively without reference to his work
2 on and reference back to the 1997 proposed resolution.

3 The testimony is not inadmissible under the
4 Norr-Pennington Doctrine for the simple reason that that
5 doctrine covers evidence relating -- well, let me say it
6 differently. That doctrine says that liability cannot be
7 premised upon activity pertinent to dealings with -- I'm stating
8 it very broadly -- but dealings with either the Executive Branch
9 or the Judicial Branch. And again the testimony wasn't being
10 offered for liability.

11 And in terms of inadmissibility pursuant to Federal
12 Rule of Evidence 403, that's without any merit whatsoever.

13 So the objections are being overruled, although I
14 certainly took them very seriously when I read them. I think
15 those are the only objections with Dr. Gruber, and we can move
16 on from him.

17 Now, I want to raise one other thing in the
18 five minutes we've got left, and I do want to end on time
19 because I think we can. 3:00 o'clock has come and gone,
20 Mr. Bernick. These are yes or no questions now.

21 Are you going to be using Dr. Brickley? And if so,
22 when?

23 MR. BERNICK: We will not be using --

24 THE COURT: I know you're laughing. I did used to do
25 cross-examination, everybody, a lifetime ago.

1 MR. BERNICK: But if I give you yes or nos, can I raise
2 a scheduling issue within my five minutes?

3 THE COURT: In your five minutes. Go ahead.

4 MR. BERNICK: That's fine. The answer to Dr. Brickley
5 is that no, we will not be calling him.

6 And with respect to Mr. Prentice, I slipped a note to
7 Ms. Eubanks at 2:30 indicating that we would not be calling
8 Mr. Prentice either.

9 THE COURT: So both of them are out.

10 Mr. Bernstein we're going to hear about on Thursday.

11 And Dr. Kraus, Mr. Parrish and Mr. Szymancyck we don't
12 know about yet.

13 MR. BERNICK: That's correct.

14 THE COURT: One thing I wasn't clear on from my own
15 notes. Who is your first witness? Is it Dr. Rubin?

16 MR. BERNICK: Dr. Rubin.

17 THE COURT: For the 24th?

18 MR. BERNICK: For the 24th.

19 THE COURT: Your second witness is either Dr. Wittis or
20 Dr. Carlton?

21 MR. BERNICK: The second witness is probably going to
22 be Mr. Fischell, now that we have decided not to proceed with
23 Mr. Prentice, and the question is whether Mr. Fischell can be
24 here either on the 26th or on the 27th. But right now we don't
25 really -- we don't have a witness for the 25th because we don't

1 have a witness for the 25th.

2 THE COURT: All right. When is Dr. Wittis testifying?

3 MR. BERNICK: Dr. Wittis, I think I indicated this
4 morning that Dr. Weil would be on the 31st, which is the
5 following week, and Dr. Wittis would be on the 1st, which is the
6 day after that. And then Dr. Carlton or Mr. Fischell would be
7 the following day, which is the 2nd.

8 And then depending upon what happens with respect to
9 Bernstein, Parrish, and Szymancyck, that will be Ann House,
10 House is also open. That would be it. But we just -- we just
11 can't answer those questions right now.

12 THE COURT: What was the scheduling question you wanted
13 to raise?

14 MR. BERNICK: Your Honor indicated that the government
15 had not filed a response to our motion in limine with respect to
16 the issue of the 1997 resolution beyond Dr. Gruber. That's an
17 issue that doesn't just relate to Dr. Gruber. A huge part,
18 60 percent of the testimony of Mr. Myers also relates to the
19 proposed resolution, and that's why we raised it, not simply by
20 way of an objection to Dr. Gruber, but also by way of a motion
21 in limine.

22 And Your Honor also before you a motion that we have
23 filed for further discovery of Mr. Myers because of his
24 extensive reliance on the 1997 resolution.

25 So I wanted to alert the court to that and see if we

1 can't develop an appropriate briefing schedule because there are
2 discovery issues. There are cross-examination issues. There
3 are also response issues in terms of Mr. Parrish, although
4 obviously those will come into more light when we hear from
5 Mr. Myers.

6 But I didn't want to have the court simply wait to
7 hear, see our issue objections with respect to Mr. Myers'
8 testimony, and we've received that testimony.

9 THE COURT: Well, the ruling I made as to Dr. Gruber --
10 well, obviously, I looked at all the applicable law, in many
11 ways that ruling may have been very witness specific. I don't
12 know. But I spelled out my thinking about that.

13 MR. BERNICK: I understood it that way and that's why I
14 restrained myself.

15 THE COURT: Am I going to hear from the government on
16 this motion in limine, which I must admit, for some reason, I
17 didn't focus on Matt Myers, but it definitely covers Matt Myers.

18 MR. BRODY: Your Honor, our memorandum in opposition to
19 the motion in limine is due on Monday, the 16th of May.

20 THE COURT: What are we going to do about Matt Myers?
21 That's going to be after his testimony.

22 MR. BRODY: No. He will probably testify on the 18th.

23 THE COURT: Have I got my days and weeks mixed up? I
24 do. So yours is going to come in on the 16th?

25 MR. BRODY: That's correct.

1 MR. BERNICK: The motion for discovery obviously will
2 be pretty much moot by then.

3 THE COURT: I've looked at that motion.
4 You can't get it in any earlier, Mr. Brody?

5 MR. BRODY: On the discovery, we can.

6 On the motion in limine, no, given the number of
7 motions that are pending right now and have been filed. But we
8 can and do plan to file a memorandum in opposition to the motion
9 on discovery on Thursday.

10 THE COURT: It seems to me they are closely
11 interrelated. There are either four or five motions pending at
12 this time. Am I right?

13 MR. BRODY: It is, I think, four.

14 THE COURT: All right. And you still can't get that
15 opposition in, say by Friday, at least for me to look at?

16 MR. BRODY: I don't think so, Your Honor, given the
17 totality of what is coming up and due.

18 I think that all three of the lengthier ones, the
19 memorandum in opposition, are all due on Monday, and so we are
20 pressed on the same time schedule on all of them. And if --
21 Your Honor, I don't know if you've looked at any of them.

22 THE COURT: I've looked at them all.

23 MR. BRODY: A couple of them --

24 THE COURT: The Rule 702(1) will probably take a fair
25 amount of work. I would rather get your opposition on the 1997

1 one by Friday in exchange for your getting another day on the
2 702(1). The 702(1) doesn't need to be decided instantly.

3 MR. BRODY: Could we get that to Your Honor on Saturday
4 just to make sure that we have time to address everything that
5 we need to address on that?

6 THE COURT: Wait. How are you going to get it to me on
7 Saturday? You always hand deliver, and it's hard to do it in
8 the court.

9 MR. BRODY: We could e-mail a copy of that brief to
10 your law clerk to make sure that it gets to the court.

11 THE COURT: All right. That's fine.

12 And you should by Friday give an approximate date when,
13 what time you're going to e-mail it so nobody spends their day
14 sitting inside.

15 MR. BRODY: We can do that.

16 MS. EUBANKS: Your Honor, if we can get in on Friday we
17 will do that and get it hand delivered to the court and notify
18 your clerk so she doesn't have to come in unnecessarily.

19 We will aim for Friday. What Mr. Brody is saying is it
20 may not be possible with all of the discovery that's going on at
21 the same time, but we will try to get in on Friday.

22 MR. BERNICK: If the government is going to turn in
23 their memo on the discovery issues on Thursday, we are just
24 really focused on the passage of time.

25 Would there be a way to reserve at least a little bit

1 of time Thursday afternoon -- I think Dr. Heaton's
2 cross-examination is not going to last the full day -- would
3 there be a way to reserve at least a little bit of time on
4 Thursday afternoon so Your Honor is at least familiar with what
5 the discovery issues are so that maybe when you take up the
6 motion in limine you've got everything before you?

7 Otherwise, we're in the position where if Your Honor is
8 to determine that the motion would be denied is an effective
9 matter unless Mr. Myers' testimony is to be postponed, there's
10 no time to conduct the discovery.

11 THE COURT: What day does he testify next week?

12 MR. BERNICK: He's testifying on Wednesday. He's the
13 last -- I believe the last witness the government has.

14 MR. BRODY: He is the last witness of the remedies
15 phase, Your Honor.

16 We would oppose doing sort of oral argument on
17 something where my anticipation is that the response on the
18 discovery motion will be undergoing final review before filing
19 after the conclusion of court on Thursday.

20 I find it -- it wasn't our expectation that by saying
21 that we could get that in on Thursday, we would get it in in
22 time for the court to review it and to have oral argument
23 Thursday afternoon on the motion for additional discovery.

24 THE COURT: I haven't read Mr. Myers' testimony. I
25 believe you filed it. You just filed it.

1 MR. BERNICK: Yes.

2 THE COURT: And I don't want a lengthy response, but
3 again, Dr. Gruber's testimony was very focused and very
4 specific. Let me put it this way.

5 What is the nature of Mr. Myers' testimony about the
6 1997 proposed resolution? I'll just leave it at that for now.

7 MS. EUBANKS: Your Honor, he was the sole person from
8 the public health community who was involved in those
9 discussions and negotiations, so he has personal knowledge of
10 what went on in terms of the remedies that were discussed and
11 that would address some of the same issues that the court is
12 confronted with.

13 He was involved in those discussions at the behest of
14 the White House and attended them with defendants. As you
15 probably know, the United States Government wasn't a part of
16 those discussions themselves. We were not parties to the actual
17 proposed resolution that came out of those agreements. That's a
18 part of what it is that he's testifying to.

19 But he's also testifying to matters that he undertook
20 while he was at the Federal Trade Commission and some of the
21 work that he did on tobacco there.

22 He's appearing as a fact witness and he was deposed on
23 all of these subjects. At his deposition, he very specifically
24 stated what he understood the nature of his testimony to be
25 because we had asked that he do that so that there would be no

1 hidden agenda in terms of what it was that he intended to offer,
2 and we offered up the documents that we intended to use in the
3 written direct before the deposition.

4 So, all of that has occurred and now there are motions
5 that are pending before you. And I was handed a letter from
6 Mr. Bernick about even more discovery regarding Mr. Myers'
7 testimony that they are interested in with, I think it's 8 or 10
8 items on it.

9 THE COURT: Well, I'm not going to have oral argument
10 on Thursday. I do realize the crunch in testimony and in the
11 schedule and it may be that I will set a conference call on
12 Friday, obviously with everybody in their respective offices and
13 it will have to work around matters that I have set. But at
14 that point I will have the government's opposition. I don't
15 know whether I will have read his testimony or not at that
16 point. I'll will try to have. I don't know.

17 MR. BERNICK: That's fine, Your Honor.

18 I don't want to get into responding to what Ms. Eubanks
19 said, but there really is a very extensive story here. I think
20 also that when we file our objections to Mr. Myers' testimony,
21 there will be relevant material there as well.

22 THE COURT: And they come in Friday?

23 MR. BERNICK: No. They come in tomorrow. So that --

24 THE COURT: That would be helpful.

25 MR. BERNICK: That would be before Your Honor tomorrow.

1 With respect to the letter I did send Ms. Eubanks, that
2 was prompted by the receipt of the written direct examination
3 yesterday. But you will find that Mr. Myers' testimony is very
4 extensive.

5 THE COURT: It's not that long.

6 MR. BERNICK: It is about 50 pages and it covers almost
7 every issue in the case.

8 Mr. Myers -- literally, Mr. Myers is going to be
9 testifying to a wide variety of matters, but it all points, his
10 baseline is what he thinks was the public health consensus
11 reflected in the 1997 resolution, and then he judges our conduct
12 in more recent years by reference to that benchmark and then
13 proposes a series of remedies, again all driven by the 1997
14 resolution. So it is the central feature of his testimony.

15 And Your Honor doesn't have to take -- you can judge by
16 what you see in the papers, but this is a substantial, a
17 substantial matter. I don't think it issues, or tees up
18 additional issues of law. I know Your Honor is very familiar
19 with those. It really is a question of what Mr. Myers is
20 getting into on the facts.

21 THE COURT: Final issue is on the question or the
22 guidance that Mr. Bernick asked for this morning, Dr. Bazerman's
23 testimony is what it is, and it should be read and evaluated by
24 counsel in view of the opinion I gave, and I don't think it's
25 appropriate to provide sort of ad hoc advice. No, that's not

1 right.

2 Okay, everybody 9:30 tomorrow, please.

3 MR. BRODY: It's going to be Thursday, as I think we
4 advised the court last week. Dr. Heaton is not available to
5 testify until first thing Thursday morning.

6 THE COURT: We have a free day tomorrow?

7 MR. BRODY: I think we do.

8 MS. EUBANKS: I don't know if you call it free. We
9 just won't be here.

10 THE COURT: Everybody, you're not the only ones who
11 have desks and desks full of work. Well, I guess we thought
12 Dr. Gruber would go over.

13 MR. BRODY: We did and --

14 THE COURT: Okay. It's a good thing you reminded me of
15 that, Mr. Brody, even though I tried to cut you off.

16 MR. BRODY: The only minor scheduling point. When
17 Mr. Bernick was addressing certain scheduling matters before the
18 lunch break, he referenced a Tuesday start date for Dr. Fiore's
19 testimony.

20 Your Honor, I'm sure, has not reviewed Dr. Eriksen's
21 testimony, and we don't have the cross for that, but given the
22 length of his testimony it wouldn't surprise me if his testimony
23 is completed by midday on Monday.

24 We will have Dr. Fiore available to begin after lunch
25 on Monday with the thinking being that his testimony might carry

1 on into Tuesday, and then we would be ready to start Mr. Myers
2 first thing Wednesday morning.

3 THE COURT: Other than another 12:00 o'clock conference
4 call on Thursday, the 19th, I don't have any interferences with
5 the schedule next week, and nothing with Thursday either. So we
6 will have full days of testimony during that time.

7 All right, everybody, thank you.

8 (Proceedings concluded at 4:41 p.m.)

9 INDEX

10 WITNESS: PAGE:

11 JONATHAN GRUBER, Ph.D.

12 CROSS-EXAMINATION BY MR. BIERSTEKER 20706
13 REDIRECT EXAMINATION BY MR. GETTE 20755

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CERTIFICATE

18 I, EDWARD N. HAWKINS, Official Court Reporter, certify
19 that the foregoing pages are a correct transcript from the
record of proceedings in the above-entitled matter.

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Edward N. Hawkins, RMR

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