Leveraging Expert Testimony: Navigating Daubert Standards, Strategies for Direct and Cross Examination of Experts

TUESDAY, SEPTEMBER 22, 2015

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today’s faculty features:

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I. DAUBERT STANDARDS APPLY TO ACCOUNTANTS, ECONOMIC EXPERTS, AND FINANCIAL EXPERTS.

The United States Court of Appeals for the Eleventh Circuit has confirmed in its published decisions that the principles articulated in Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579 (1993), apply to accountants, economics experts, and financial experts.

In Club Car, Inc. v. Club Car (Quebec) Import, Inc., 362 F.3d 775 (11th Cir. 2004), the Eleventh Circuit confirmed that Daubert applies to expert testimony by accountants. The case involved claims and counterclaims by a Georgia manufacturer of golf carts and a Quebec distributor of golf carts. 362 F.3d at 780. The appellate court affirmed the district court’s decision to exclude the testimony of the counterclaimant’s accountant who testified that the counterclaimant had suffered lost profits in excess of $10 million. Id. The accountant admitted that he had not factored in expenses which the counterclaimant would normally incur in generating income and sales. Id.
The Eleventh Circuit held that the district court did not abuse its discretion in striking the accounting expert’s testimony. The Eleventh Circuit stated that “[t]he trial court reasonably concluded his lost profit calculation was based on flawed methodology that was unaccepted in the accounting community.” Id., citing Daubert, supra, at 593-94.

In Maiz v. Virani, 253 F.3d 641 (11th Cir. 2001), the Eleventh Circuit confirmed that Daubert, supra, applies to expert testimony by an economist. In Maiz, defendants defrauded plaintiffs, who were solicited to invest in a Georgia real estate venture. Defendants took hidden profits on land sales, claimed unauthorized expense reimbursements, and used plaintiffs’ contributions to pay for the defense of the lawsuit. Defendants argued that plaintiffs’ expert was not qualified to offer an opinion on lost value damages. The expert based his damage calculations on the return plaintiffs would have earned if they had invested in a broad-based REIT index rather than investing with defendants. 253 F.3d at 664.

The Eleventh Circuit affirmed the district court’s refusal to exclude the economist’s expert testimony. The Court held that the expert had a Ph.D. in economics from Yale, extensive experience as a professional economist, and a substantial background in estimating damages. 253 F.3d at 665. The Court held that the expert satisfied the requirements of Daubert because “(1) the expert is qualified to testify competently regarding the matters he intends to address; (2) the methodology by which the expert reaches his conclusions is sufficiently reliable; and (3) the testimony assists the trier of fact, through the application of scientific, technical, or specialized expertise, to understand the evidence or to determine a fact in issue.” Id. at 665.
The Eleventh Circuit noted that the U.S. Supreme Court held in *Daubert* that “[t]he inquiry envisioned by Rule 702 is, we emphasize, a flexible one.” *Id.* at 665, quoting *Daubert*, 509 U.S. at 594. The Eleventh Circuit also quoted the following statement by the U.S. Supreme Court in *Daubert*: “Many factors will bear on the inquiry, and we do not presume to set out a definitive checklist or test.” *Id.*, quoting *Daubert*, 509 U.S. at 593.

Those last two points are important. *Daubert* identified four general inquiries in the context of a pharmaceutical case which may or may not always apply in the context of testimony by an accountant or economist. Those inquiries as to an expert’s theory have been summarized as follows: (1) whether it can be tested; (2) whether it has been subjected to peer review and publication; (3) what its known or potential rate of error is, and whether standards controlling its operation exist; and (4) whether it is generally accepted in the field. 509 U.S. at 593-594.

However, in the context of a business litigation case, it may be very difficult for an accountant to state whether his expert testimony has been "tested" in the same type of case or whether his testimony “has been subjected to peer review and publication.” It may also be difficult for the accountant to testify “what [the theory’s] known or potential rate of error is, and whether standards controlling its operation exist.” It is accurate that the reliability and relevance of expert testimony by an accountant, economist, or financial expert must be critically examined. However, it should be noted that the language contained in the factors identified above may not be easily used in the context of assessing a lost profits analysis by an accountant, economist, or financial expert.
Expert financial testimony is typically admitted after the proponent establishes that the testimony is based upon an accepted methodology used by other financial experts. See, e.g., Conwood Co., L.P. v. U.S. Tobacco Co., 290 F.3d 768, 793 (6th Cir. 2002) (Court admitted testimony based on regression analyses, a “yardstick” test, and a before-and-after test because all three methods are generally accepted methods for calculating antitrust damages). Expert financial testimony not based on an accepted methodology will likely be excluded. See, e.g., LifeWise Master Funding v. Telebank, 374 F.3d 971, 929 (10th Cir. 2004).

II. PRACTICE POINTERS FOR SATISFYING DAUBERT STANDARDS WHEN PRESENTING DAMAGES EXPERT WITNESS TESTIMONY.

My advice in conducting a direct examination of a damages expert witness in a Daubert hearing is to prepare a detailed outline of questions in advance of the hearing. It is difficult to memorize the factors stated in Daubert, and it is important to ensure that you have covered all requirements. Furthermore, to the extent that you can ask the expert witness to come down from the stand and show the trial judge charts and graphs to explain his or her testimony, it is helpful to the trial judge in understanding the expert testimony and performing the court's "gate-keeping" function.
As the Eleventh Circuit stated in its application of Fed. R. Evid. 702, entitled Testimony by Expert Witnesses: “Expert testimony may be admitted into evidence if: (1) the expert is qualified to testify competently regarding the matters he intends to address; (2) the methodology by which the expert reaches his conclusions is sufficiently reliable as determined by the sort of inquiry mandated in Daubert; and (3) the testimony assists the trier of fact, through the application of scientific, technical, or specialized expertise, to understand the evidence or to determine a fact in issue.” City of Tuscaloosa v. Harcros Chemicals, Inc., 158 F. 3d 548, 562 (11th Cir. 1998).

The proponent of expert testimony bears the burden of proof pursuant to Fed. R. Evid. 104(a) of proving admissibility by a preponderance of the evidence. Daubert, 509 U.S. at 593. That is also true under Georgia law. Butler v. Union Carbide Corporation, 310 Ga. App. 21, 712 S.E.2d 537 (2011).

In presenting damages expert witness testimony, it is important to show that the damages expert’s qualifications and testimony fit the issues, that the Daubert reliability standard is satisfied, that the expert’s opinions are based upon valid data and information, that the expert’s assumptions are reasonable, and that the expert has shown that he has ruled out alternative causes of alleged damage in his analysis.

Attached to this memo are two documents: (i) the outline of my direct examination of Marc Vellrath, Ph.D., an economist engaged in the study of financial economics who performs event studies and regression analyses for securities fraud cases; and (ii) the redacted transcript of my direct examination of Dr. Vellrath at the Daubert hearing before Fulton County State Court Judge
Susan Forsling in June, 2007, in a common law fraud action involving public securities.

We called Dr. Vellrath as an expert witness to render opinions as to causation and calculation of damages. As Dr. Vellrath explains in his testimony, he performed an "event study," which is an analytical tool which courts have held is necessary to ascertain damages in fraud cases involving publicly traded securities. It is a regression analysis which is designed to differentiate between fraud factors and non-fraud factors which affect the decline of stock prices over time.

After Dr. Vellrath testified, Judge Forsling determined that Dr. Vellrath was qualified to render his opinions, that his analyses were the product of reliable principles and methods which were applied reliably in the case, and that his opinions were relevant. Therefore, Judge Forsling concluded that Dr. Vellrath's testimony was relevant on the issue of damages and admissible.

The outline that is attached to this memo provides you with a template that I give you permission to use in structuring direct examinations of your own damages expert witnesses.

III. PRACTICE POINTERS FOR OPPOSING DAMAGES EXPERT WITNESS TESTIMONY UNDER DAUBERT.

Keep in mind that we attorneys specialize in words; that is how we make our living. Accountants, economists, and financial experts, on the other hand, specialize in numbers, algorithms, financial statements, balance sheets, profit and loss statements, regression analyses, and other mathematical models.
Unless you are an accountant or possess financial expertise, the best way to begin the process of rebutting an opposing damages expert is to retain your own damages consultant to help you understand the opponent’s analysis and develop methods for challenging or rebutting that analysis. An accounting or financial consultant can identify analytical gaps and flaws in an opposing expert’s valuation or lost profits analysis that we attorneys may not be able to identify or understand without the consultant’s guidance.

Fed. R. Evid. 702, entitled Testimony by Expert Witnesses, provides a built-in blueprint to help you organize your angle of attack for deposing or cross-examining the opposing expert. Rule 702 states:

A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if:

(a) the expert’s scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;

(b) the testimony is based on sufficient facts or data;

(c) the testimony is the product of reliable principles and methods; and

(d) the expert has reliably applied the principles and methods to the facts of the case.

1. **Attack assumptions.** A good starting point is to attack the opposing expert’s assumptions. Try to show that the opposing expert’s assumptions are contrary to or not supported by the evidence. What assumptions is he making about the business, the personnel of the business, the intellectual property belonging to the business, the “shelf life” of its products, the industry, the level of competition, the level of market penetration, the discount rate, the impact of technological advances in competitive products, and other economic factors relating to his valuation determination or lost profits calculation?

If you can establish that the opposing expert’s assumptions are flawed, then you can successfully move to exclude the expert’s testimony on the ground that it is not “based on sufficient facts or data.” Fed. R. Evid. 702; O.C.G.A. § 24-7-702. *See, e.g., American Southern Ins. Group v. Goldstein,* 291 Ga. App. 1, 10, 660 S.E.2d 810, 818 (2008) (economist’s testimony regarding damages based upon insufficient data). Alternatively, even if the expert used reliable data, his testimony can be excluded if he has over-extrapolated from that data to reach unsupported conclusions. *General Electric Co. v. Joiner,* 522 U.S. 136 (1997).

2. **Question the validity of the data and information relied upon by the expert.** Try to show that the expert’s opinions are based upon speculation or conjecture rather than upon sufficient facts or data. For example, is the opposing expert using actual revenue, income, and expenses for his valuation of a business or the determination of lost profits, or is he using “budgeted” revenue and net income? If he is using “budgeted” data, why is he not using actual financial results when they are available?
In *American Southern Ins. Group v. Goldstein, supra*, the Georgia Court of Appeals affirmed the trial court’s exclusion of testimony by the plaintiff’s expert economist, which it claimed would show its financial injury as to its tortious interference claim. The defendant noted that the “expert had reviewed no American Southern tax return, balance sheet, expense statement, or any other accounting or financial record reflecting the company’s actual profits and losses.” 291 Ga. App. at 10. Instead, ... “the expert had extrapolated American Southern’s economic loss primarily from Wilson’s commission statement for part of one year.” *Id.* The defendant ... “argued that the partial sales history of a single agent, along with a letter referencing annualized premiums from the sale of only certain life insurance policies and unsupported representations by Buckley, did not provide an adequate basis for the expert’s opinion ....” *Id.* The trial court agreed, noting that the plaintiff “had not preserved pertinent financial reports” and that the expert’s extrapolation of limited information was “unconscionable.” *Id.* at 11.

3. **Question the validity of the methodology relied upon by the expert.**

   In *Club Car, Inc. v. Club Car (Quebec) Import, Inc., supra*, the Eleventh Circuit stated that the methodology used by the expert must be “sufficiently reliable.” 362 F.3d at 780. The Court elaborated:

   To ensure that a proper foundation is made, the trial court must screen expert testimony to determine if it is relevant and reliable. *Daubert*, 509 U.S. at 589. Expert testimony must be excluded if the reasoning or methodology underlying the opinion is scientifically invalid, or if the methodology cannot properly be applied to the facts. *Id.* at 592.
The Eleventh Circuit stated:

Ryan testified that CCQ's damages in the form of lost profits exceeded $10 million. But, as the trial court found, that estimate was based on gross sales and gross profit figures. Ryan admitted he had not factored in expenses CCQ would normally incur in generating income and sales. To recover lost profit damages in Georgia, “one must show the probable gain with great specificity as well as expenses incurred in realizing such profits. In short, the gross amount minus expenses equals the amount of recovery.” Shaw v. Ruiz, 207 Ga. App. 299, 428 S.E.2d 98, 103 (1993) (citations omitted). Ryan failed to follow this rule. The trial court reasonably concluded his lost profit calculation was based on flawed methodology that was unaccepted in the accounting community. See Daubert, 509 U.S. at 593-94 (degree to which experts in the field accept technique relevant to admissibility). The court did not abuse its discretion in striking the testimony.

What methodology is the opposing expert using to justify his opinion about the value of a business or his determination of lost profits? Is the methodology reliable, or is it speculative, unreliable, and misleading? These are questions to address with your consultant as you develop your challenge to the opposing expert’s damages opinion.

4. Certification by CPA or other financial expert; adherence to GAAP standards. Note that in certain instances, an opposing party may present you with an “executive summary” of a damages analyses prepared by an accounting firm. If you are presented with such a summary, demand that the party present you with a written report signed and certified by the accountant who ostensibly prepared the summary. If an accountant is purporting to present his expertise or specialized knowledge to assist a party in a mediation or settlement negotiation,
then he should be willing to sign his firm name to whatever document is attributed to him. Of course, such a report will not be admissible into evidence unless the accountant actually signs and certifies the report.

Also, consult with your own consultant as to whether the opposing CPA has adhered to Generally Accepted Accounting Principles ("GAAP") in presenting his accounting report or damages analysis to you. GAAP is the “common set of accounting principles, standards and procedures that companies use to compile their financial statements. GAAP are imposed on companies so that investors have a minimum level of consistency in the financial statements they use when analyzing companies for investment purposes. GAAP cover such things as revenue recognition, balance sheet item classification and outstanding share measurements.” Investopedia (March, 2015) (www.Investopedia.com). Discuss with your consultant to what extent, if any, you can rebut an opposing accounting expert’s analysis on the ground that it does not adhere to GAAP.


An expert’s failure to rule out reasonable alternative causes of alleged damage or contrary evidence can be used as a basis for excluding expert testimony. Shiver v. Georgia & Florida Railnet, Inc., 287 Ga. App. 828, 652 S.E.2d 819 (2007), cert. denied, (2008) (expert testimony is admissible only if it is both relevant and reliable; physician failed to rule out all other possible causes of employee’s medical condition after considering his complete medical history).
An example of a federal circuit court decision in which an economist’s testimony was excluded because he failed to consider alternative evidence is *Blue Dane Simmental Corp. v. American Simmental Association*, 178 F.3d 1035 (8th Cir. 1999). In that case, the Eighth Circuit upheld the federal district court’s exclusion of testimony by an agricultural economist, Dr. Baquet, who was to testify that the claimed wrongful introduction of a certain breed of cattle into the fullblood Simmental cattle market in the United States caused the market value of all American Simmentals to drop substantially. The district court determined that the methodology employed by Dr. Baquet was not reliable and that his analysis was “simplistic.” 178 F.3d at 1040.

The Eighth Circuit noted that the economist attributed the entire difference in market price within the United States and Canada to the introduction of only nineteen Risinger animals into the fullblood Simmental market and that “at least one other independent variable contributed to the falling cattle markets, as it was undisputed that both the Canadian and American markets were falling prior to the introduction of the Risinger animals.” *Id.* at 1040. The Eighth Circuit also noted that Dr. Baquet admitted in his deposition that various factors contribute to particular cattle breeds losing market value and “that generally an economist would attempt to identify and evaluate all of the independent variables significantly affecting changes in the value of a breed.” *Id.* The appellate court noted that the economist “acknowledged that he had neglected to consider any variables other than the introduction of the Risinger fullbloods.” *Id.*
In affirming the trial court’s exclusion of the expert testimony, the Eighth Circuit stated:

This case is analogous to *Kumho*. Although Dr. Baquet utilized a method of analysis typical within his field, that method is not typically used to make statements regarding causation without considering all independent variables that could affect the conclusion. We find no evidence in the record that other economists use before-and-after modeling to support conclusions of causes of market fluctuation. *See, e.g.*, *Kumho*. *See also Jaurequi*, 178 F.3d at 1081 & n. 3 (quoting *General Electric Co. v. Joiner*, 522 U.S. 136 (1997) (finding that the scientific validity of a methodology is the key to admissibility, and noting that “[a] court may conclude that there is simply too great an analytical gap between the data and the opinion proffered”). Nor do plaintiffs cite to any articles or papers that would support Dr. Baquet’s approach. *See Kumho*. Accordingly, we conclude that the district court did not abuse its discretion by excluding Dr. Baquet’s testimony.

*Id.* at 1041.

6. “Analytical gap” between expert’s opinion and underlying data.

In *General Electric Co. v. Joiner*, 522 U.S. 136 (1997), the U.S. Supreme Court reversed the Eleventh Circuit’s reversal of U.S. District Judge Orinda Evans’ exclusion of scientific testimony. The Supreme Court stated:

“But nothing in either *Daubert* or the Federal Rules of Evidence requires a district court to admit opinion evidence that is connected to existing data only by the *ipse dixit* of the expert. A court may conclude that there is simply too great an *analytical gap* between the data and the opinion proffered.” *See Turpin v. Merrell Dow Pharmaceuticals, Inc.*, 959 F.2d 1349, 1360 (C.A. 6), cert. denied, 506 U.S. 826 (1992). That is what the District Court did here, and we hold that it did not abuse its discretion in so doing.”

*Id.* at 146. (Emphasis added.)
Therefore, a federal district court is authorized to conclude that an opinion derived from valid data is unreliable because the “analytical gap” between the opinion and the data is too great. That is what the federal district court did in *Blue Dane Simmental Corp. v. American Simmental Association, supra.* Because of the analytical gap, the district court excluded the expert’s testimony, and the Eighth Circuit affirmed its decision.

IV. CONCLUSION.

The principles articulated in *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993), apply to accountants, economics experts, and financial experts. If you are offering expert witness testimony, carefully outline your direct examination to ensure that you satisfy the principles articulated in *Daubert* and the requirements of Fed. R. Evid. 702 if you are in federal court or the requirements of O.C.G.A. § 24-7-702 if you are in a Georgia state or superior court. If you are attempting to oppose expert testimony by an accountant, economics expert, or financial expert, retain a consultant to assist you in rebutting the opponent’s expert testimony and employ one or more of the tips contained in this memo to exclude or rebut the expert testimony.
OUTLINE OF DIRECT EXAMINATION OF MARC VELLRATH, PH.D.

I. General.
1. Please introduce yourself to the Court.
2. Where do you work?
3. What do you do?
4. Please describe your firm and what it does.
5. Who contacted you to do work in this case?
6. When?

II. Educational background.
1. Please tell us about your educational background, beginning with college.
2. What degrees have you obtained?
3. From which schools and when?

III. Employment background, including teaching positions and expert witness assignments; qualifications to serve as expert witness.
1. Please tell the Court about your employment background, beginning with your first position after obtaining your last degree.
2. Discuss chronology of positions held by Dr. Vellrath, including teaching positions.
3. Discuss expert witness and consulting assignments carried out by Dr. Vellrath, including his work for Enron as to Jeff Skilling and other matters.
4. Previous qualification as an expert witness.
5. Service as a consulting economist.

IV. Event studies and regression analyses.
1. In the course of your work, have you performed event studies and regression analyses?
2. What is an event study?
3. What is a regression analysis?
4. Have you personally done event studies?
5. How many event studies have you done?
6. Have you personally done regression analyses?
7. How many regression analyses have you done?
8. Have you also supervised the preparation of event studies and regression analyses by others? How many?
V. Assignment in this case.

1. What have you been asked to do in this case?
2. What you have done?
3. Discuss purposes of assignment on Pages 2 and 3 of report.
4. Have you prepared a written report?
5. Tender written report as an exhibit.
6. Identify and authenticate the written report.

VI. Discussion of opinions.

1. Opinion as to value of McKesson HBOC Stock as represented on January 12, 1999.
   a. Discussion of McKesson HBOC common stock trading in a semi-strong efficient market. What does that mean?
   b. Best indication of the value as represented is closing price of McKesson HBOC stock on January 12, 1999.
   c. Value of McKesson HBOC securities as represented on January 12, 1999, was $85.13 per share.

   b. He conducted an independent analysis of the actual value of McKesson HBOC stock on January 12, 1999, and the amount of artificial inflation in the price of McKesson HBOC stock on January 12, 1999, using regression analysis and an event study.
   c. Review of others’ event studies; discussion of factors which he considered.
   d. Discussion of “disentangling” the effects of fraud, effects of market conditions, industry conditions, and non-fraud-related events at McKesson HBOC during relevant period.
e. Discussion of direct effects of fraud and real business effect of fraud.

f. Discussion of impact of fraud at McKesson HBOC during three different time periods—pre-announcement period, announcement period, and post-announcement period.

g. Methodology and analysis.
   1. Discussion of regression-based event study of the determinants of the price of (and returns on) McKesson HBOC common stock.
   2. Discussion of “abnormal returns.” Use the variability of the data to assess the abnormality of the price movements.
   3. Discussion of two-factor model of the observed returns on McKesson HBOC stock.
   4. Discussion of charts used by Dr. Vellrath.

h. Discussion of four factors to determine whether you have used valid and reliable principles in reaching your conclusions (Daubert; Kumho Tire Co. cases).
   1. Whether the theories and principles that you are using are capable of being tested and have in fact been tested?
   2. Whether the theories have been subjected to peer review and publication?
   3. Whether the theories are generally accepted in the economic community?
   4. What is the rate of error associated with the theories? How does that relate to standard deviation theory? (In effect, have you considered and accounted for alternative explanations for the data?)
3. Review, analysis, and critique of Professor Benston’s methods and conclusions.
   
   a. Discussion of Benston’s methods and analysis.

4. Review, analysis, and rebuttal of Professor Fischel’s opinion.
   
   a. Discussion and rebuttal of Fischel’s two opinions.
   
   
   c. Note that Professor Benston defines the value as represented as the value the stock would have had if the representations made by defendants regarding the stock had been accurate.
   
   d. Paragraph 46 of Report—Benston’s analysis and approach are correct.
THE WITNESS: MY NAME IS MARC VELLRATH.

MARC VELLRATH, PH.D.

HAVING BEEN FIRST DUTY SWORN, TESTIFIED AS FOLLOWS:

DIRECT EXAMINATION

BY MR. FELLOWS:

Q. DR. VELLRATH, BY WHOM ARE YOU EMPLOYED?

A. I AM THE PRESIDENT OF A SMALL CONSULTING FIRM, A START-UP CONSULTING FIRM, MY OWN CONSULTING FIRM.

Q. WHERE IS IT LOCATED?

A. OUR OFFICES ARE IN EMERYVILLE, CALIFORNIA. THAT'S
JUST EAST OF SAN FRANCISCO.

Q. WHAT DO YOU AND YOUR FIRM DO?

A. WE PROVIDE ECONOMIC AND FINANCIAL CONSULTING
PRIMARILY IN LEGAL MATTERS BUT OTHER MATTERS AS WELL.

Q. WHO CONTACTED YOU TO DO WORK IN THIS CASE, SIR?

A. I BELIEVE I RECEIVED A CALL FROM YOU AND MR. SCHKLAR
TOGETHER.

Q. HOW LONG AGO?

A. APPROXIMATELY TWO MONTHS AGO.

Q. PLEASE TELL THE COURT ABOUT YOUR EDUCATIONAL
BACKGROUND.

A. I LIVE IN CALIFORNIA. I GREW UP IN PENNSYLVANIA AND
MUCH OF MY EDUCATION WAS IN PENNSYLVANIA. AS AN UNDERGRADUATE
I ATTENDED THE UNIVERSITY OF PENNSYLVANIA IN PHILADELPHIA. I
HAVE A BACHELOR'S OF ART FROM THE UNIVERSITY OF PENNSYLVANIA.
I HAVE A M.B.A. DEGREE, A MASTER'S OF BUSINESS ADMINISTRATION,
FROM THE UNIVERSITY OF WASHINGTON IN SEATTLE.

I THEN RETURNED TO PENNSYLVANIA AND ATTENDED
CARNEGIE-MELLON UNIVERSITY. I HAVE A MASTER'S IN ECONOMICS AND
A PH.D. IN ECONOMICS FROM CARNEGIE-MELLON UNIVERSITY.

I ALSO HAVE PROFESSIONAL CERTIFICATION. I COMPLETED
THE 3-YEAR TRAINING PROGRAM OF THE INSTITUTE OF CHARTERED
FINANCIAL ANALYSTS, SO I'M A CFA, CHARTERED FINANCIAL ANALYST.
THE INSTITUTE OF CHARTERED FINANCIAL ANALYSTS IS THE LEADING
INTERNATIONAL ORGANIZATION OF SECURITIES ANALYSTS AND PORTFOLIO
MANAGERS.

Q. WHEN DID YOU COMPLETE THAT TRAINING?
A. THAT WOULD HAVE BEEN ABOUT 1986 OR SO.

Q. PLEASE TELL THE COURT ABOUT YOUR EMPLOYMENT
BACKGROUND, INCLUDING EXPERT WITNESS ASSIGNMENTS, ANY TEACHING
POSITIONS AND SERVICES AS A CONSULTANT.

A. YES. MY FIRST POSITION AFTER LEAVING CARNEGIE-MELLON
WAS WITH NEW YORK UNIVERSITY. I LIVED IN NEW YORK AND TAUGHT
AT NEW YORK UNIVERSITY FOR FIVE YEARS; THAT WAS AT THE BUSINESS
SCHOOL.

Q. DURING WHICH YEARS?
A. THAT WAS FROM 1977 TO 1983, FIVE OR SIX YEARS I WAS
AT NYU. FOR ONE YEAR I WAS THE VISITING ASSISTANT PROFESSOR AT
THE UNIVERSITY OF WASHINGTON.

THE COURT: IN SEATTLE?
THE WITNESS: IN SEATTLE.

A. AFTER LEAVING NYU, I RETURNED TO THE UNIVERSITY OF
WASHINGTON TO TEACH IN THE SAME PROGRAM WHERE I GOT MY M.B.A.
FOR ANOTHER TWO YEARS. SO A TOTAL OF EIGHT YEARS I WAS A
FACULTY MEMBER AT NEW YORK UNIVERSITY AND THE UNIVERSITY OF
WASHINGTON.

WHILE I WAS A FACULTY MEMBER I STARTED DOING
CONSULTING WORK AND FOUND THAT I ENJOYED THAT VERY MUCH. I WAS
BETTER AT THAT THAN ACADEMIC RESEARCH, AND SO AFTER EIGHT YEARS
OF TEACHING I TOOK A POSITION AS A CONSULTANT WITH ERNST &
YOUNG, THE INTERNATIONAL CONSULTING AND ACCOUNTING FIRM.

Q. (BY MR. FELLOWS) IN WHICH YEAR?
A. THAT WOULD HAVE BEEN JANUARY OF '86.
Q. CONTINUE.
A. THAT WAS USEFUL FOR ME AS AN ECONOMIST AND PROVIDED ME WITH AN UNDERSTANDING OF WHAT ACCOUNTING FIRMS DID AND HOW AUDITS WERE PREPARED. I WAS NOT AN AUDITOR, BUT I WORKED UNDER AN AUDITOR AND CAME TO UNDERSTAND THE CONTENT AND THE IMPORTANCE OF FINANCIAL STATEMENTS.

AFTER FIVE YEARS AT ERNST & YOUNG I LEFT TO JOIN AN ECONOMIC CONSULTING FIRM, ONE VERY MUCH LIKE LEXECON, THE ONE MR. FISCHER RUNS, A FIRM CALLED ANALYSIS GROUP HEADQUARTERED IN BOSTON. THAT WAS WHEN I STARTED DOING LITIGATION-RELATED WORK AND SOME OTHER CONSULTING WORK. I SPENT FIVE YEARS AT ANALYSIS GROUP AND THEN LEFT TO FORM MY OWN FIRM. MY CURRENT FIRM IS MY SECOND START-UP.

I STARTED A FIRM IN 1996 AS WELL. I GREW THAT FIRM TO ABOUT 30 PEOPLE; AND THEN I SOLD IT TO A LARGE NATIONAL CONSULTING FIRM, ERS GROUP. I WAS EMPLOYED BY ERS GROUP FOR THREE YEARS. I CONTINUED TO BE AN AFFILIATE OF ERS GROUP, BUT IN JULY OF LAST YEAR I RESIGNED MY APPOINTMENT RELATIONSHIP TO START MY CURRENT FIRM, FINANCE SCHOLARS GROUP.

Q. PLEASE TELL THE COURT ABOUT SOME OF THE EXPERT WITNESS ASSIGNMENTS YOU'VE HAD DURING THE PAST FIVE YEARS.
A. I'VE WORKED ON A VARIETY OF CASES, MANY OF THEM -- I
WOULD SAY MOST OF THEM DEALING WITH FINANCIAL MARKETS OR
FINANCIAL INSTITUTIONS. I WORKED ON THESE CASES ON MY OWN AND
ALSO WITH CLOSE COLLEAGUES IN THE ACADEMIC COMMUNITY.

AMONG THE CASES THAT I HAVE WORKED ON RECENTLY WERE
THE ENRON CRIMINAL TRIALS. I WAS RETAINED BY THE ENRON TASK
FORCE AT THE U.S. DEPARTMENT OF JUSTICE TO EXAMINE DAMAGES
ISSUES IN THE THREE CRIMINAL TRIALS. IN THE FIRST OF THOSE
TRIALS MY COLLEAGUE AND CO-OWNER OF MY FIRM, PROFESSOR ANTHONY
SAUNDERS OF NEW YORK UNIVERSITY, TESTIFIED AS TO DAMAGES. IN
THE SECOND AND THIRD CRIMINAL TRIALS I PREPARED AN EXPERT
REPORT THAT WAS USED FOR SENTENCING PURPOSES IN BOTH OF THOSE
TRIALS.

I HAVE DONE A VARIETY OF ASSIGNMENTS IN THE
SECURITIES AREA, SECURITIES FRAUD AREA, PRIMARILY FEDERAL
SECURITIES FRAUD MATTERS. I HAVE PREPARED PLANS FOR
DISTRIBUTION IN SECURITIES MATTERS THAT HAVE BEEN ACCEPTED BY
THE U.S. DISTRICT COURT IN NORTHERN CALIFORNIA. I PREPARED A
PLAN OF DISTRIBUTION RECENTLY FOR THE SECURITIES AND EXCHANGE
COMMISSION THAT WAS REVIEWED BY THE SEC STAFF AND ADOPTED AS I
HAD WRITTEN IT.

ANOTHER MAJOR MATTER THAT I HAVE BEEN INVOLVED IN FOR
THE LAST THREE OR FOUR YEARS IS THE ALLEGED WRONGDOING IN THE
MUTUAL FUND INDUSTRY RELATED TO BAIT TRADING AND MARKET TIMING.
SO A BROAD RANGE OF ISSUES PRIMARILY IN FINANCIAL MARKETS AND
FINANCIAL INSTITUTIONS.
Q. WHAT DOES THE TERM "FINANCIAL ECONOMICS" MEAN?
A. IT IS THAT AREA OF ECONOMICS THAT CONCENTRATES ON MARKETS FOR FINANCIAL INSTRUMENTS, WHETHER THEY BE STOCKS OR BONDS, DERIVATIVES SUCH AS FUTURES. IT WOULD INCLUDE BANKING INSTITUTIONS, INVESTMENT BANKS, MUTUAL FUNDS. THAT FINANCIAL SECTOR OF THE ECONOMY IS THE FOCUS OF FINANCIAL ECONOMICS -- HOW DO THOSE MARKETS WORK, HOW DO THOSE INSTITUTIONS MAKE DECISIONS.

Q. PLEASE TELL THE COURT WHETHER, BASED ON YOUR EXPERIENCE, YOU CONSIDER YOURSELF AN EXPERT IN THAT FIELD OR DISCIPLINE.
A. I DO BOTH BY TRAINING, BY EXPERIENCE, BY MY PROFESSIONAL CERTIFICATION IN THE AREA AS A SECURITIES ANALYST. I DO CONSIDER MYSELF AN EXPERT IN FINANCIAL ECONOMICS.

Q. IN THE COURSE OF YOUR WORK, DR. VELLRAH, AND I'M CALLING YOU DOCTOR. DO YOU HAVE A PH.D.?
A. I DO HAVE A PH.D.

Q. IN WHAT SUBJECT?
A. IN ECONOMICS.

Q. IN THE COURSE OF YOUR WORK, DR. VELLRAH, HAD YOU PERFORMED EVENT STUDIES AND REGRESSION ANALYSIS?
A. YES, I HAVE MADE EXTENSIVE USE OF BOTH EVENT STUDIES WHICH IS ONE APPLICATION OF REGRESSION AND OF REGRESSION MORE GENERALLY BOTH IN EVENT STUDIES AND OTHER CIRCUMSTANCES AS WELL.
Q. WHAT IS AN EVENT STUDY?

A. AN EVENT STUDY IS AN ANALYSIS OF THE RETURNS ON A PARTICULAR ASSET OR THE PRICE MOVEMENTS OF A PARTICULAR ASSET. AN EVENT STUDY SEeks TO IDENTIFY BOTH THE NORMAL RETURNS ON AN ASSET, THE NORMAL PRICE MOVEMENTS ON AN ASSET AND ABNORMAL OR UNUSUAL MOVEMENTS IN THE PRICE OF AN ASSET AND TYPICALLY FOCUSES ON PARTICULAR EVENTS OF INTEREST TO ACCESS WHETHER OR NOT THERE WAS AN ABNORMAL AND UNUSUAL MOVE ASSOCIATED WITH A PARTICULAR EVENT.

Q. WHEN YOU USE THE TERM "ASSET," DOES THAT INCLUDE STOCKS AND SECURITIES?

A. YES, IT DEFINITELY INCLUDES SECURITIES; AND EVENT STUDIES ARE PROBABLY MOST OFTEN USED WITH RESPECT TO STOCK AND STOCK PRICES.

Q. HAVE YOU PERSONALLY DONE EVENT STUDIES?

A. I HAVE PERSONALLY DONE EVENT STUDIES, SAD TO SAY I THINK LAST SATURDAY I WAS AT HOME DOING AN EVENT STUDY.

THE COURT: I WAS AT HOME READING THIS.

THE WITNESS: I KNOW.

A. SO, YES, I HAVE PERSONALLY DONE EVENT STUDIES. I SHOULD SAY THAT I HEARD PROFESSOR FISCHEL'S TESTIMONY THAT IT'S SIMPLY A MATTER OF PUSHING A BUTTON ON THE COMPUTER. I REALLY MEAN SOMETHING BROADER THAN THAT. I MEAN, THINKING ABOUT HOW YOU STRUCTURE THE EVENT STUDY AND WHAT'S THE RIGHT DATA TO USE. I HAVE DONE ALL OF THAT PERSONALLY.
Q. (BY MR. FELLOWS) WELL, THAT'S MY NEXT QUESTION.

PLEASE EXPLAIN TO THE COURT WHAT GOES INTO PREPARING AN EVENT
STUDY AND IDENTIFYING THE DIFFERENT FACTORS.

A. IT IS TRUE THAT THE ACTUAL NUMBER CRUNCHING THESE
DAYS IS DONE BY A COMPUTER BUT MUCH MORE THAN THE COMPUTATIONS
GOES INTO PREPARING A GOOD EVENT STUDY. I THINK ONE NEEDS TO
LOOK AT THE ISSUES AND DETERMINE WHAT TIME PERIOD IS
APPROPRIATE, WHAT DATA IS AVAILABLE AND ONE NEEDS TO LOOK AT
THE DATA TO MAKE SURE IT'S GOOD-QUALITY DATA. THAT'S ALL A
PREMISE TO STARTING YOUR EVENT STUDY.

ONCE YOU'VE ADDRESSED THOSE ISSUES YOU NEED TO -- I'M
GOING TO USE A LITTLE BIT OF JARGON HERE; I'LL TRY TO AVOID TOO
MUCH OF IT -- SPECIFY A MODEL. YOU HAVE TO WRITE OUT THE
REGRESSION EQUATION THAT YOU WANT TO ESTIMATE. YOU NEED TO
DECIDE IS IT GOING TO BE A ONE-FACTOR MODEL THAT TAKES INTO
ACCOUNT JUST THE MARKET OR WILL IT BE A TWO-FACTOR MODEL THAT
TAKES INTO ACCOUNT BOTH THE MARKET AND THE INDUSTRY. HOW AM I
GOING TO MEASURE THE MARKET. HOW AM I GOING TO MEASURE THE
PARTICULAR INDUSTRY. SO THERE'S A LOT OF JUDGMENT THAT GOES
INTO IMPLEMENTATION OF AN EVENT STUDY. NOW, THERE'S A GENERAL
AGREEMENT ON HOW THESE ARE DONE; THESE ARE NOT MAJOR
DIFFERENCES, BUT ONE DOES HAVE TO THINK ABOUT HOW TO IMPLEMENT
THE EVENT STUDY.

Q. AND YOU GAVE SOME DIFFERENTIATION AS TO A REGRESSION
ANALYSIS. CAN YOU EXPLAIN WHAT A REGRESSION ANALYSIS IS AND
WHAT GOES INTO PREPARING ONE.

A. YES. REGRESSION IS REALLY A STATISTICAL TECHNIQUE
THAT CAN BE APPLIED TO LOTS OF DIFFERENT KINDS OF DATA. IT
COULD BE APPLIED TO MEDICAL DATA, ENGINEERING DATA, IN
CIRCUMSTANCES OTHER THAN AN EVENT STUDY.

THE MOST COMMON USE OF THAT PARTICULAR STATISTICAL
TECHNIQUE IN FINANCE IS IN AN EVENT STUDY, SO THAT'S REALLY ONE
OF THE STATISTICAL UNDERPINNINGS FOR AN EVENT STUDY. IT
BASICALLY LOOKS FOR CORRELATIONS IN THE DATA.

Q. HAVE YOU PERSONALLY DONE REGRESSION ANALYSES?
A. YES. WHEN YOU DO AN EVENT STUDY YOU DO ONE, BUT I'VE
USED REGRESSION ANALYSIS IN OTHER KINDS OF STUDIES AS WELL.

THE COURT: BUT THEY ARE -- AM I CORRECT THEY ARE A
NECESSARY COMPONENT FROM WHAT I'VE HEARD OF AN EVENT
STUDY? REGRESSION ANALYSES IS NECESSARY --

THE WITNESS: YES, YOUR HONOR, THAT'S RIGHT.

THE COURT: BUT WHAT FACTORS GO IN IS MORE THE
QUALITATIVE ANALYSIS THAT THE EXPERT WOULD DO?

THE WITNESS: YES, YOUR HONOR.

THE COURT: ALL RIGHT. I'M CLEAR ON THAT. THANK
YOU.

Q. (BY MR. FELLOWS) HOW MANY EVENT STUDIES HAVE YOU
DONE, DR. VELLRATH?
A. WELL, I HAVE DONE LOTS OF THEM. I WOULD SAY IN TERMS
OF FORMAL ASSIGNMENTS/ENGAGEMENTS IN WHICH I USED EVENT STUDY
ANALYSIS, I WOULD SAY AT LEAST 15 OR 20 DIFFERENT ENGAGEMENTS.

Q. AND AS TO SECURITIES CASES, INCLUDING CLASS ACTION
   CASES, APPROXIMATELY HOW MANY TIMES HAVE YOU PROVIDED WRITTEN
   REPORTS OR GIVEN TESTIMONY IN SUCH CASES?

A. MOST OF THOSE EVENT STUDIES -- IN FACT, PROBABLY ALL
   OF THOSE EVENT STUDIES WERE FOR SECURITIES LITIGATION
   MATTERS.

Q. LET ME ASK YOU AS WE'RE GOING ALONG AS TO WHAT YOUR
   ASSIGNMENT WAS IN THIS CASE.

   THE COURT: ARE YOU GOING TO ASK HIM THE PERFUNCTORY
   DAUBERT QUESTIONS OF EVENT STUDIES?

   MR. FELLOWS: YES.

   THE COURT: ALL RIGHT.

   IS AN EVENT STUDY A TECHNIQUE THAT CAN BE TESTED?

   THE WITNESS: YES.

   THE COURT: HAS IT BEEN SUBJECT TO PEER REVIEW?

   THE WITNESS: YES, THOSE STUDIES ARE USED EXTENSIVELY
   IN THE ACADEMIC LITERATURE AND VIRTUALLY ALL OF THAT
   LITERATURE IS SUBJECT TO PEER REVIEW.

   THE COURT: IS THERE A KNOWN OR ACCEPTED RATE OF
   ERROR IN SUCH STUDIES?

   THE WITNESS: ONE OF THE NICE THINGS ABOUT REGRESSION
   ANALYSIS AND EVENT STUDIES IS THAT THE STATISTICAL
   UNDERPINNINGS PROVIDES STATISTICS THAT LET YOU ASSESS THE
   ERROR IN EACH ITEM THAT YOU'RE ESTIMATING. SO IF YOU
ESTIMATE A COEFFICIENT, YOU CAN DETERMINE DO I HAVE A GOOD
ESTIMATE OR A WEAK ESTIMATE.

THE COURT: A HIGH RATE OF ERROR OR A LOW RATE OF
ERROR?

THE WITNESS: YES, THAT'S RIGHT.

THE COURT: AND THAT CAN BE IDENTIFIED?

THE WITNESS: IN THE REGRESSION ANALYSIS AND THE
EVENT STUDY.

THE COURT: AND THEN FINALLY, I THINK I KNOW THE
ANSWER TO THIS, BUT I WANT TO ASK IT ANYWAY. HAS THIS
THEORY OF EVENT STUDIES AND REGRESSION ANALYSIS IN THE
CONTEXT THAT YOU'RE USING IT FOR THIS LITIGATION ATTAINED
A GENERAL ACCEPTANCE WITHIN THE SCIENTIFIC COMMUNITY,
BEING FINANCIAL ECONOMISTS IN THAT GENRE?

THE WITNESS: IT IS WIDELY ACCEPTED, WIDELY USED; AND
I DON'T THINK THERE'S ANY DISAGREEMENT AMONG ANY OF THE
ECONOMISTS HERE ABOUT THAT.

THE COURT: JUST DOING MY HOMEWORK, MR. FELLOWS.

EXCUSE ME FOR INTERRUPTING YOU.

MR. FELLOWS: WELL, I WAS GOING TO COVER THOSE,
TOO.

THE COURT: OH, YOU WERE? I WOULD SAY THAT NOW IF I
WERE YOU, TOO.

Q. (BY MR. FELLOWS) HERE WERE THE OTHER QUESTIONS I
WANT TO COVER PRIMARILY WITH YOU AS THE COURT ASKED YESTERDAY
AS WELL.

HAVE ANY OF THE STUDIES THAT YOU HAVE DONE INVOLVED PUBLICLY-TRADED STOCK WHERE THE ALLEGATIONS OR THAT THE PRICE OR PRICE CHANGES WERE CAUSED BY FRAUD?

A. YES. FOR EXAMPLE, THE TWO REPORTS THAT I HAVE PREPARED IN THE ENRON MATTERS INVOLVED FRAUD IN A PUBLICLY-TRADED COMPANY.

Q. THE NEXT QUESTION: IS THERE A DIFFERENCE IN DOING AN EVENT STUDY WHERE THE MARKET IS RESPONDING TO FRAUD AND DOING A STUDY WHERE THE MARKET IS REACTING TO COLLUSIVE FACTORS OR OTHER FACTORS?

A. I DON'T THINK SO. THE EVENT STUDY METHOD IS THE SAME IN BROAD TERMS. REALLY, NO MATTER WHAT THE SETTING, THE WAY YOU IMPLEMENT THE STUDY MAY VARY A LITTLE BIT DEPENDING ON THE PARTICULAR ISSUES YOU'RE LOOKING AT, BUT THERE'S A GENERALLY ACCEPTED FRAMEWORK FOR CONDUCTING AN EVENT STUDY.

Q. WHAT DO YOU CONSIDER YOUR TRAINING, EXPERIENCE AND BACKGROUND TO BE TO QUALIFY YOU AS AN EXPERT WITNESS IN FINANCIAL ECONOMICS AND IN PARTICULAR, GIVING EXPERT WITNESS OPINIONS IN THIS CASE?

THE COURT: YOU'RE GOOD, MR. FELLOWS. THOSE ARE VERY QUESTIONS THAT I ASKED.

GO AHEAD.

A. TWO THINGS. I THINK, AS I SAID EARLIER, MY TRAINING AND EDUCATION AND EXPERIENCE IN GENERAL PROVIDE THE BACKGROUND,
BUT I CAN REMEMBER TEACHING ABOUT EVENT STUDIES IN PARTICULAR AS EARLY AS 1978-1979, TEACHING STUDENTS HOW TO DO AN EVENT STUDY, THE IMPORTANCE OF EVENT STUDIES, HOW TO DRAW CONCLUSIONS FROM EVENT STUDIES.

Q. AND DOES THAT ALSO INCLUDE YOUR STATUS AS A CHARTERED FINANCIAL ANALYSIS?

A. CHARTERED FINANCIAL ANALYST, YES. AS I MENTIONED, THAT TRAINING FOCUSES ON ANALYSIS OF SECURITIES AND ANALYSIS OF FINANCIAL STATEMENTS. THE PEOPLE WHO PREPARE THE KIND OF SECURITY ANALYST REPORTS THAT WE DISCUSSED YESTERDAY ARE TYPICALLY CFA'S. THAT'S THE TRAINING THAT THOSE FOLKS HAVE.

Q. NOW, WHEN YOU'RE DOING AN EVENT STUDY FOR A CASE SUCH AS THIS, HOW DO YOU MAKE DECISIONS AS TO WHETHER TO ANALYZE INDIVIDUAL STOCK MOVEMENTS OR COMBINED STOCK MOVEMENTS OR LOOK AT INDICES? HOW DO YOU MAKE THOSE DECISIONS?

A. I THINK YOU MAY BE REFERENCING A PARTICULAR ISSUE IN THIS CASE WHICH IS GIVEN THAT YOU WANT TO TAKE INTO ACCOUNT MARKET FACTORS AND YOU ALSO WANT TO TAKE INTO ACCOUNT INDUSTRY FACTORS. HOW DO YOU DO THAT IN PARTICULAR WITH RESPECT TO THE INDUSTRY FACTORS BECAUSE THERE'S BEEN SOME DISCUSSION ABOUT IT AND SOME DIFFERENCE ABOUT THAT. AND JUST FOR CLARITY, IS THAT WHAT YOU WERE ASKING ME TO COMMENT ON?

Q. YES.

A. AND I'LL ANSWER THAT. THIS MAY BE AN EXAMPLE OF HAVING THREE ECONOMISTS IN A ROOM AND GETTING FOUR OPINIONS,
BUT I HAVE A SLIGHTLY DIFFERENT TAKE FROM BOTH PROFESSOR 
FISCHEL AND PROFESSOR BENSTON. AGAIN, I THINK WE'RE ALL IN 
THAT BROAD FRAMEWORK OF DOING EVENT STUDIES. 

I PERSONALLY LIKE TO MEASURE THE INDUSTRY FACTOR BY 
TAKING A READY MADE PUBLISHED INDEX THAT'S AVAILABLE IN THE 
MARKETPLACE, SUCH AS AN S&P INDEX. AND, IN FACT, IN MY EVENT 
STUDY I DID USE STANDARD & POOR'S HEALTHCARE INDEX. OTHERS 
PREFER TO CONSTRUCT THEIR OWN INDEX, AND THAT'S APPROPRIATE. 
EITHER OF THOSE METHODS IS FULLY ACCEPTABLE IN MY VIEW. 

IT IS CLEARLY THE CASE, THOUGH, THAT IN THOSE STUDIES 
MOST ECONOMISTS USE AND RELY ON AN INDEX, WHETHER TAKEN FROM 
THE MARKETPLACE OR CONSTRUCTED THEMSELVES FROM A SAMPLE OF 
STUDIES. IT'S VERY UNUSUAL TO HEAR SOMEBODY SAY, AS PROFESSOR 
FISCHEL DID, YOU SHOULDN'T LOOK AT THE INDEX, YOU SHOULDN'T LOOK 
AT THE INDIVIDUAL UNDERLYING STOCK. 

Q. WHY DO YOU SAY THAT? 
A. YES, YOU SHOULD LOOK AT THEM AND BE AWARE OF THEM, 
BUT TO INCORPORATE THEM INTO A GOOD EVENT STUDY IT'S 
APPROPRIATE TO USE AN INDEX THAT WEIGHTS THOSE INDIVIDUAL 
STOCKS AND TAKES THEM ALL INTO ACCOUNT. 

THE COURT: WHAT DO YOU MEAN BY WEIGHTING THEM? 
THE WITNESS: WELL, ONE NEEDS SOMEHOW TO COMBINE THE 
DIFFERENT PRICE MOVEMENTS. YOU CAN SIMPLY ADD THEM UP AND 
USE A STRAIGHT AVERAGE, A SIMPLE AVERAGE, OR YOU CAN SAY 
SOME OF THESE COMPANIES ARE LARGER THAN OTHERS AND I WANT
TO RECOGNIZE THAT SO THAT A SMALL COMPANY DOESN'T DRIVE
THE INDEX AND I WANT TO PUT SOME ADDITIONAL WEIGHT ON
THOSE COMPANIES THAT ARE BIGGER AND MORE REPRESENTATIVE OF
THE MARKET, SO SOME KIND OF WEIGHTING ACCORDING TO SIZE, I
THINK, IS TYPICALLY APPROPRIATE.

Q. (BY MR. FELLOWS) NOW, TURNING TO YOUR ASSIGNMENT IN
THIS CASE, DR. VELLRAITH, WHAT HAVE YOU BEEN ASKED TO DO?
A. THERE WERE THREE PARTS OF MY ASSIGNMENT. I WAS ASKED
TO REVIEW AND ANALYZE AND RESPOND TO PROFESSOR FISCHEL'S
REPORT. I WAS ASKED TO REVIEW AND ANALYZE AND CRITIQUE THE
METHODS AND APPROACH OF PROFESSOR BENSTON; AND I WAS ALSO ASKED
TO DO AN INDEPENDENT ANALYSIS, DO ANYTHING I THOUGHT WAS
NECESSARY TO MAKE MY OWN ASSESSMENT AS TO THE AMOUNT OF
ARTIFICIAL INFLATION IN THE PRICE OF MCKESSON HBC stock ON
JANUARY 12, 1999.

Q. HAVE YOU DONE THOSE THINGS?
A. YES, I HAVE DONE ALL THREE OF THOSE.
Q. HAVE YOU PREPARED A WRITTEN REPORT IN CONNECTION WITH
YOUR WORK?
A. I DID PREPARE A WRITTEN REPORT.
Q. LET ME SHOW YOU WHAT'S BEEN PREVIOUSLY MARKED AS
EXHIBIT 38. THAT IS IN THE BLUE BINDER THAT EVERYONE HAS.
THE COURT: IT SHOULD BE THERE.
Q. (BY MR. FELLOWS) AND I'LL ASK YOU TO TURN TO TAB 38
AND ASK YOU IF YOUR WRITTEN REPORT IS ATTACHED TO THAT?
A. YES, THIS IS A FILING THAT CONTAINS MY REPORT.
Q. DOES THE REPORT CONTAIN THE ATTACHMENTS AND THE
INDICES THAT YOU LOOKED AT?
A. IT INCLUDED MY RESUME AND INCLUDES THE RESULTS OF THE
REGRESSION ANALYSIS THAT I PERFORMED. I DID NOT ATTACH THE
DATA TO THE REPORT. IT WAS AVAILABLE ON THE DAY OF MY
DEPOSITION, FOR EXAMPLE. I CAN'T RECALL WHETHER IT'S BEEN
PROVIDED. I'M SURE IF IT'S BEEN REQUESTED IT'S BEEN PROVIDED
TO THE DEFENDANTS; I JUST DON'T KNOW.

MR. FELLOWS: YOUR HONOR, AT THIS TIME WE WANT TO
TENDER EXHIBIT 38 INTO EVIDENCE.
THE COURT: ANY OBJECTION?
MR. MANNING: NO OBJECTION.
THE COURT: ALL RIGHT. THANK YOU. LET PLAINTIFF'S
38 BE ADMITTED WITHOUT OBJECTION.
(PLAINTIFF'S EXHIBIT NO. 38 ADMITTED)

Q. (BY MR. FELLOWS) NOW, DR. VELLRATH, NOW TO MOVE
THINGS ALONG, FEEL FREE TO LOOK AT YOUR REPORT AS I'M ASKING
THOSE QUESTIONS. I'M GOING TO ASK YOU WHAT OPINIONS YOU'VE
REACHED IN THIS CASE AND ON PAGE 6 YOU HAVE A HEADING STATING
"SUMMARY OF OPINIONS" AND IT'S PARAGRAPH 15 AND THEN OVER ON
THE NEXT PAGE YOU BEGIN WITH YOUR FIRST OPINION WHICH IS ON
PAGE 7. SO LET'S START WITH THAT.

PLEASE TELL THE COURT WHETHER YOU HAVE AN OPINION AS
TO THE VALUE OF MCKESSON HBOC STOCK AS REPRESENTED ON JANUARY
12TH OF 1999 AND PLEASE EXPLAIN WHAT YOU MEAN BY THAT TITLE OF
THAT OPINION --

A. YES.

Q. -- ON THAT PAGE.

A. YES. I DO HAVE AN OPINION AS TO THE VALUE OF
MCKESSON HBOC STOCK AS REPRESENTED. AND WHAT I MEAN BY THAT
TERM, IS WHAT WAS THE VALUE OF THE COMPANY AS IT WAS DESCRIBED
AND REPRESENTED IN THE FINANCIAL STATEMENTS THAT WERE AVAILABLE
AS OF THAT DATE, NOT THAT THEY WERE PREPARED AS OF THAT DATE OR
THAT THAT WAS THE DATE OF THE ACCOUNTING, BUT ON JANUARY 12TH
BASED ON THE INFORMATION THAT WAS AVAILABLE AND THE COMPANY AS
IT WAS REPRESENTED IN THAT INFORMATION, WHAT WAS THE VALUE.

MY OPINION IS THAT THE MARKET PRICE IS THE BEST
INDICATOR OF THE VALUE AS THE COMPANY WAS REPRESENTED IN THOSE
FINANCIAL STATEMENTS AND OTHER AVAILABLE INFORMATION. THE
MARKET PRICE ON THAT DAY, BASED ON THE CLOSING PRICE, WAS
$85.13 PER SHARE; AND I BELIEVE THAT IS THE BEST INDICATOR OF
THE VALUE OF THE FIRM AS REPRESENTED.

Q. WHY DO YOU SAY THAT?

A. WELL, THIS STOCK TRADED ON THE NEW YORK STOCK
EXCHANGE. IT IS WIDELY-RECOGNIZED STOCK ON THE NEW YORK
EXCHANGE TRADING IN AN EFFICIENT MARKET AND IN A PARTICULAR
KIND OF EFFICIENT MARKET, AGAIN, TO USE SOME JARGON, A
SEMI-STRONG FORM EFFICIENT MARKET.

WHAT THAT MEANS IS THAT THE PRICE OF MCKESSON HBOC
REFLECTED ALL OF THE PUBLICLY AVAILABLE MATERIAL INFORMATION ABOUT THE COMPANY. THERE ARE ENOUGH TRADERS IN THE MARKETPLACE, THERE ARE ENOUGH ANALYSTS FOLLOWING THE STOCK, THERE ARE ENOUGH SOPHISTICATED INVESTORS WHO SEEK OUT INFORMATION. THOSE PEOPLE TRADING IN THE MARKETPLACE DRIVES THE PRICE — SOME OF IT — FULLY REFLECTS THE INFORMATION THAT'S AVAILABLE IN THE MARKETPLACE. THOSE INCLUDE THE REPRESENTATIONS AND FINANCIAL STATEMENTS AND OTHER THINGS, INCLUDES THEM WHETHER THEY'RE TRUE OR FALSE. THOSE WHO USE THAT INFORMATION DON'T KNOW WHETHER THAT INFORMATION IS TRUE OR FALSE; IT GETS IMPOUNDING INTO THE PRICE IN A SEMI-STRONG FORM EFFICIENT MARKET.

Q. AND YOU EXPLAINED THIS TO SOME EXTENT, BUT PLEASE DEFINE WHAT IS A SEMI-STRONG EFFICIENT MARKET.

A. JUST TO BACK UP A LITTLE BIT. THE EFFICIENCY OF A MARKET HAS TO DO WITH HOW QUICKLY AND FULLY SECURITY PRICES REFLECT INFORMATION, AND THERE ARE DIFFERENT TYPES OF INFORMATION. ONE KIND OF INFORMATION IS SIMPLY HISTORICAL PRICES OF SECURITIES. SOME PEOPLE THINK THEY CAN LOOK AT PAST MOVEMENTS IN THE STOCK PRICE AND BASED ON THAT ALONE PREDICT WHICH DIRECTION THE PRICE IS GOING TO GO IN THE FUTURE. TO MOST FINANCIAL ECONOMISTS THAT IS NOT VERY LIKELY IN MOST MARKETS.

A MARKET WHERE PAST MOVEMENTS IN THE PRICE ALONE ARE REFLECTED IN SECURITIES PRICES IS WEAK FORM EFFICIENT.
SEMI-STRONG FORM EFFICIENT SAYS SOMETHING MORE THAN THAT. IT SAYS NOT ONLY THE PAST PRICE BUT WHATEVER HAS BEEN MADE AVAILABLE PUBLICLY BY THE COMPANY, COMMENTS BY ANALYSTS, INFORMATION ABOUT OTHER COMPANIES, ALL OF THAT IS VERY QUICKLY REFLECTED IN SECURITIES PRICES. THAT MEANS WHEN THERE'S A NEW MAJOR ANNOUNCEMENT THAT PROVIDES NEW INFORMATION EITHER POSITIVE OR NEGATIVE THERE'S ALMOST AN IMMEDIATE PRICE RESPONSE, SOMETIMES VERY QUICK, WITHIN HOURS, BUT GENERALLY WE MEAN WITHIN A DAY OR AT MOST TWO DAYS AND THAT'S WHAT WE OBSERVE ON THE NEW YORK STOCK EXCHANGE, THAT WHEN THERE'S A RELEASE OF NEW INFORMATION ABOUT A COMPANY, A BIG SURPRISE THAT EARNINGS ARE MUCH BETTER THAN EXPECTED, MUCH WORSE THAN EXPECTED, THE PRICE RESPONDS VERY QUICKLY.

Q. TURNING TO PAGE 8 OF YOUR REPORT, DO YOU HAVE AN OPINION AS TO THE ACTUAL VALUE OF MCKESSON HBC'S STOCK ON JANUARY 12TH OF 1999?

A. YES, I DO.

Q. WHAT IS YOUR OPINION?

A. I CONDUCTED AN EVENT STUDY. I EXAMINED THE FACTS HERE. I CONSIDERED PROFESSOR BENSTON'S STUDY. I CONSIDERED PROFESSOR FISCHEL'S CRITIQUE. I ALSO LOOKED AT REPORTS RELEVANT TO THIS ISSUE BY OTHER FINANCIAL ECONOMISTS WHO HAVE EXAMINED MCKESSON HBC IN OTHER MATTERS. BASED PRIMARILY ON MY EVENT STUDY AND ON OTHER ANALYSES AS WELL, I CONCLUDED THAT ALL OF THE DROP IN MCKESSON HBC'S PRICE FROM JANUARY 12TH, 1999
THROUGH MARCH OF 2000 IS ATTRIBUTABLE TO THE FRAUD.

AND THE CONCLUSION ONE DRAWS FROM THAT IS THAT THE
ACTUAL VALUE OF MCKESSON -- FREE OF ANY FRAUD, TAKING OUT THE

Q. PLEASE EXPLAIN THE STEPS YOU TOOK TO REACH THAT
OPINION.

A. YES. THE FIRST AND MOST IMPORTANT STEP WAS TO
CONSTRUCT MY OWN EVENT STUDY. I TALKED EARLIER ABOUT EXAMINING
THE ISSUES AND THE CONTEXT. I DID THAT. I PERSONALLY DECIDED
TO USE A BROAD MARKET INDEX TO CAPTURE MARKET FACTORS. I USED
THE STANDARD & POOR'S HEALTHCARE INDEX TO CAPTURE INDUSTRY
FACTORS. I RAN THE REGRESSION. I IDENTIFIED NORMAL EXPECTANT
RETURNS, NORMAL PRICE MOVEMENTS BASED ON THOSE FACTORS; AND
THEN I EXAMINED A LONG SEQUENCE OF EVENTS AS WELL IN ASSESSING
HOW MUCH OF THE PRICE DECLINE WAS RELATED TO THE FRAUD AND HOW
MUCH OF IT WAS RELATED TO OTHER ISSUES -- IN OTHER WORDS, I
FOLLOWED STANDARD PROCEDURES TO DISENTANGL THE EFFECTS OF THE
MARKET, THE EFFECTS OF THE INDUSTRY AND THE EFFECTS OF EVENTS
OTHER THAN THE FRAUD TO IDENTIFY AND ISOLATE THE EFFECTS OF THE
FRAUD ON MCKESSON HBOC'S STOCK PRICE.

Q. LET ME ASK YOU THIS: YESTERDAY WE HEARD DISCUSSION
ABOUT LOOKING AT THE AGGREGATE EFFECT VERSUS THE SPECIFIC EVENT
EFFECTS ON SPECIFIC DAYS. CAN YOU PLEASE EXPLAIN TO THE COURT
YOUR UNDERSTANDING AND EXPERIENCE IN DEALING WITH THOSE
CONCEPTS.
A. YES, I THINK THE CRITICAL ISSUE HERE IS THE AGGREGATE EFFECT OVER THE ENTIRE TIME PERIOD AND IF YOU CARE TO LOOK AT SHORTER TIME PERIODS, FOR EXAMPLE, THE PRE-ANNOUNCEMENT TIME PERIOD, BUT THE QUESTION IN MY MIND IS TO, FOR EXAMPLE, FOCUS ON THE PRE-ANNOUNCEMENT PERIOD. DID THE MARKET MOVEMENT TEND TO INCREASE MCKESSON HBOC'S PRICE DURING THAT PERIOD OR DECREASE IT.

THE ANSWER IS INDISPUTABLY THE MARKET ROSE, MCKESSON HBOC TENDED TO RISE WITH THE MARKET SO THE MARKET FACTOR DURING THE PRE-ANNOUNCEMENT PERIOD SHOULD HAVE DRIVEN UP THE PRICE OF MCKESSON HBOC.

Q. AND LET ME ASK YOU THIS... WILL YOU PLEASE COME DOWN FROM THE STAND AND I'D LIKE YOU TO USE THE CHART THAT WAS USED YESTERDAY AND ACCORDING TO THESE TIME PERIODS I'M GOING TO ASK YOU A SERIES OF QUESTIONS AND YOU CAN CONTINUE ANSWERING THEM LOOKING AT THE JUDGE, BUT I'D LIKE FOR YOU TO DO IT BY REFERENCING THIS CHART.

THE COURT: YOU DON'T HAVE TO LOOK AT ME. AS LONG AS I CAN HEAR YOU, THAT'S FINE BUT FEEL FREE TO DO SO. I HAVE A COPY OF THE CHART.

BUT BEFORE WE GET THERE, I WANT TO MAKE SURE I'M CLEAR WHAT WE'RE ADDRESSING. I RAISED INQUIRIES YESTERDAY ABOUT THE ANALYSIS PROBABLY ON THE CROSS-EXAMINATION BY MR. MALKO WHERE HE TRIED TO SAY, WELL, HERE'S AN EVENT ON SUCH AND SUCH DATE. WHAT HAPPENED TO THE STOCK PRICE ON
THAT DAY.

AND MY THEORY WAS, WELL, DOES IT MAKE SENSE TO DO IT THAT WAY OR DOES IT MAKE SENSE TO LOOK AT IT AS A CONTINUUM. ARGUABLY EVEN IF YOU TAKE -- I KNOW THEY DISPUTE YOUR CONTINUUM DATE, BUT EVEN PRETERMITTING THAT QUESTION, YOUR ARGUMENT OR YOUR OPINION, I SHOULD SAY, IS THAT YOU DO LOOK AT IT AS A CONTINUUM AND YOU ARE ABOUT TO EXPLAIN WHY.

THE WITNESS: YES, THAT'S RIGHT.

THE COURT: I WANT TO MAKE SURE I'M FOLLOWING YOU.

GO AHEAD, MR. FELLOWS.

Q. (BY MR. FELLOWS) AND LET ME ADDRESS THAT WITH RESPECT TO THE PREANNOUNCEMENT PERIOD IN PARTICULAR.

THE COURT: RIGHT.

Q. (BY MR. FELLOWS) AND FOR PURPOSES OF THE RECORD, PLEASE TELL THE COURT WHAT ARE YOU INDICATING IS THE PRE-ANNOUNCEMENT PERIOD BY REFERENCE OF THE DATES?

A. IT'S THIS FIRST PERIOD HERE FROM JANUARY 12, 1999 THROUGH APRIL 27 OF 1999. THAT'S WHAT I USED AS THE PRE-ANNOUNCEMENT PERIOD AND I THINK THAT'S WHAT -- WELL, THAT'S WHAT DEFENDANTS' CHART IDENTIFIES AS THE PREANNOUNCEMENT PERIOD.

Q. AND WHAT PREANNOUNCEMENT ARE YOU REFERRING TO?

A. FROM THE MERGER TO THE FIRST ANNOUNCEMENT OF A RESTATEMENT -- FIRST IN A SERIES OF ANNOUNCEMENTS.
Q. AND A RESTATEMENT OF WHAT?

A. A RESTATEMENT OF FINANCIALS OF MCKESSON HBOC.

SO LET'S FOCUS ON THIS PERIOD AND TO ADDRESS EXACTLY THAT ISSUE AS TO WHETHER WE SHOULD FOCUS ON AN INDIVIDUAL DAY OR SHOULD WE LOOK AT THE FULL-TIME PERIOD.

THERE ARE CERTAINLY DAYS IN HERE WHEN, FOR EXAMPLE, A MARKET FACTOR WENT DOWN AND YOU COULD FIND THOSE DAYS AND YOU COULD MAKE A BIG STORY ABOUT, GEE, THE MARKET FACTOR WENT DOWN AND MCKESSON WENT DOWN BECAUSE THE MARKET WENT DOWN, DID YOU TAKE THAT INTO ACCOUNT.

THE MORE RELEVANT AND THE MORE IMPORTANT INQUIRY IS OVER THIS TIME PERIOD WE KNOW THAT THE MARKET WENT DOWN SOME DAYS AND UP SOME DAYS. IN THE AGGREGATE OVER THAT TIME PERIOD DID IT GO UP OR GO DOWN AND THE MARKET IN GENERAL -- THE STOCK MARKET IN GENERAL -- WENT UP. BASED ON INDICES THAT I CITED IN MY REPORT, IT WENT UP BY ABOUT 9.3 PERCENT. DURING THIS SAME TIME PERIOD THE INDUSTRY MEASURED BY THE STANDARD & POOR'S HEALTHCARE INDEX WENT UP BY 7 1/2 PERCENT. AGAIN, THERE WERE DAYS WHEN IT DROPPED AND THERE WERE DAYS WHEN IT WENT UP, BUT THE IMPORTANT INQUIRY IS, OVER THIS TIME PERIOD WERE THOSE FACTORS TENDING TO INCREASE THE PRICE OF MCKESSON HBOC OR DO THEY EXPLAIN THE DOWNWARD TREND IN THE PRICE OF MCKESSON HBOC. AND THE SIMPLE AND INDISPUTABLE ANSWER, IN MY OPINION, BASED ON THE REGRESSION ANALYSIS IS THAT THOSE FACTORS TENDED TO INCREASE THE PRICE OF MCKESSON HBOC. THEY DO NOT EXPLAIN THE
DECLINE.

Q. AND BY THE WAY, WHAT WERE THE ANALYST REPORTS INDICATING DURING THAT PERIOD THAT YOU'RE DISCUSSING?

A. WELL, THE THIRD SET OF FACTORS THAT ONE NEEDS TO TAKE INTO ACCOUNT IS INDIVIDUAL INFORMATION ABOUT THE COMPANY AND HERE, AGAIN, WE KNOW THAT THERE WILL BE SOME DAYS WHEN THERE'S AN ANNOUNCEMENT THAT, GEE, WE LOST THIS CONTRACT; THERE ARE GOING TO BE OTHER DAYS WHEN WE GOT A NEW CONTRACT AND THERE WILL BE DAYS WHEN THE ANALYST COMES AND SAYS, THIS IS A GREAT BUY.

SO WHAT YOU NEED TO DO, IN MY OPINION, IS LOOK OVER THE COURSE OF THIS TIME PERIOD AND SAY, IN THE AGGREGATE DID THE ANNOUNCEMENT ABOUT THE COMPANY, THE INDIVIDUAL DAILY ANNOUNCEMENTS, TEND TO INCREASE THE PRICE OF MCKESSON HBOC OR DO THEY EXPLAIN THE DECLINE.

I'VE DONE THAT ANALYSIS, BUT PROFESSOR BENSTON DID EXACTLY THE SAME ANALYSIS AND AS AN APPENDICES TO HIS REPORT HE HAS, FOR EXAMPLE, A LIST OF THE ANALYST REPORTS THAT WERE ISSUED DURING THIS TIME PERIOD AND WE LOOKED AT THIS YESTERDAY. I THINK VIRTUALLY EVERY ONE OF THOSE SAID BUY HEALTH REFORM, BUY, BUY, BUY.

PROFESSOR BENSTON ALSO HAS A LIST OF THE ANNOUNCEMENTS RELATED TO THE COMPANY, NEW CONTRACTS AND SO ON, DURING THIS TIME PERIOD. HE HAS A CHRONOLOGY. IF YOU'LL READ THROUGH THAT CHRONOLOGY, YES, SOME OF THEM ARE NEGATIVE BUT
MOST OF THEM ARE POSITIVE. SO I BELIEVE WHEN YOU TAKE INTO
ACCOUNT THIS THIRD SET OF FACTORS, THE FIRM SPECIFIC FACTORS,
THEY ALSO ARGUE THAT BASED ON THOSE, THE PRICE OF MCKESSON HBC
SHOULD HAVE BEEN RISING DURING THIS TIME PERIOD AND THOSE
FACTORS DO NOT EXPLAIN THE DECLINE.

Q. ALL RIGHT. AND BY THE WAY, PROBABLY EVERYBODY IN THE
ROOM HAS HAD A BAD EXPERIENCE WITH STOCK PRICES GOING DOWN AND
STOCK BUBBLES. WHEN DID THAT FIRST BUBBLE OCCUR DURING THE
PAST SEVEN TO EIGHT YEARS, THE SO-CALLED TECH BUBBLE?

A. THE CRASH CAME, I THINK, AFTER THE END OF THIS
PERIOD.

Q. LATE MARCH OR EARLY APRIL OF 2000?

A. THAT'S WHAT I RECALL, YES.

Q. AND BACK TO THAT FIRST PERIOD -- AND IF YOU WANT TO
TAKE -- YOU CAN SIT DOWN OR EITHER STAY UP HERE.

A. I'LL SIT DOWN.

Q. WE'LL COME BACK TO THAT IN A MOMENT, BECAUSE I WANT
TO ASK YOU SOME MORE QUESTIONS ABOUT THIS PREANNOUNCEMENT
PERIOD.

IN THE COURSE OF YOUR WORK DID YOU HAVE OCCASION TO
READ THE SKADDEN REPORT THAT WE IDENTIFIED AS SKADDEN 1
YESTERDAY BUT DID NOT TENDER INTO EVIDENCE?

A. I DID REVIEW IT BRIEFLY, YES.

Q. LET ME HAVE YOU LOOK AT SKADDEN 1 JUST SO YOU CAN
TELL US IF THAT'S THE REPORT THAT YOU REVIEWED IN CONNECTION
WITH YOUR WORK?

A. YES, I HAVE SEEN THIS BEFORE; AND I HAVE REVIEWED
THIS QUICKLY, BUT I HAVE REVIEWED IT.

Q. NOW, THERE WAS DISCUSSION YESTERDAY ABOUT SALES OF
STOCK BY A TIMOTHY HEYERDAHL. DID YOU REVIEW THOSE SALES, AND
HOW DID THEY AFFECT YOUR ANALYSIS IN THIS CASE?

A. YES, I DID REVIEW THOSE SALES; AND I THINK THEY ARE
RELEVANT TO AN UNDERSTANDING OF WHAT WE JUST DISCUSSED.

Q. ARE HIS SALES CONSISTENT WITH A DROP IN PRICE DUE TO
FACTORS OTHER THAN THE ONES YOU WERE TALKING ABOUT?

YES, FULLY CONSISTENT WITH THAT AND I THINK SUGGEST
THE KIND OF ACTIVITY THAT CAUSED THE PRICE DECLINE. I CAN'T
PROVE THAT WITH EVIDENCE, BUT WE'VE SEEN THAT THE THREE KINDS
OF FACTORS THAT ECONOMISTS USE AND LOOK AT DO NOT EXPLAIN THAT
DECLINE, BUT CAN THAT DECLINE BE LINKED TO THE FRAUD WHILE THIS
IS A CIRCUMSTANCE WHERE WE HAVE THE PLEA AGREEMENT FROM
MR. HEYERDAHL WHICH IS AN EXAMPLE OF THE KIND OF ACTIVITY THAT
WOULD DRIVE THAT PRICE DOWN RELATED TO THE FRAUD.

THE COURT: WOULD IT HAVE TO HAVE BEEN KNOWN TO DRIVE
IT DOWN? I THINK THAT'S WHAT WE WERE TRYING TO ASSESS
YESTERDAY. I MEAN, WE KNOW IT WAS GOING ON, BUT WE
DIDN'T -- IT WASN'T -- WE KNOW NOW IT WAS GOING ON. THE
MARKET INVESTORS DID NOT KNOW AT THE TIME.

THE WITNESS: I THINK THERE ARE TWO THINGS.

MR. FELLOWS: IF I COULD BREAK THAT DOWN INTO SOME
FOUNDATION QUESTIONS.

THE COURT: SURE. ABSOLUTELY.

Q. (BY MR. FELLOWS) BASED ON YOUR EXPERIENCE IN FINANCIAL ECONOMICS AND WORKING IN SECURITIES CLASS ACTION CASES, PLEASE EXPLAIN TO THE COURT THE TYPE OF ACTIVITY THAT CAN OCCUR IN CONNECTION WITH INSIDER SALES.

A. WELL, INSIDER SALES, AS WE DISCUSSED YESTERDAY, HAS A NARROW MEANING AND A BROADER MEANING AS WELL, ESPECIALLY IN A CIRCUMSTANCE LIKE THE ONE WE'RE DEALING WITH HERE. IT'S NOT SIMPLY THE OFFICERS AT THE VERY TOP WHO MAY KNOW THAT THERE'S BEEN SOME WRONGDOING HERE, THAT THERE MAY BE A REASON FOR THE PRICE TO DECLINE AND THE PEOPLE IN THE ACCOUNTING DEPARTMENT MAY KNOW THEY'RE BEING TOLD TO BOOK CONTRACTS EARLY. A VARIETY OF PEOPLE MAY BE AWARE THAT THINGS ARE NOT RIGHT AT THIS COMPANY AND MIGHT BE ASKED TO SELL SOME SECURITIES SO --

THE COURT: LET ME STOP YOU THERE.

DID YOU LOOK AT SOME OF THOSE MEMOS, THAT THERE WAS A WOMAN -- AND I CAN'T REMEMBER HER NAME -- WHO WAS ADMONISHING PEOPLE ABOUT THE SIDE CONTRACT AND THINGS OF THAT NATURE. WOULD THAT BE AN EXAMPLE OF MAYBE OTHER PEOPLE KNOWING ABOUT WHAT'S GOING ON? I MEAN, WOULD THAT GIVE YOU AN INDICATION THAT THERE WAS MORE THAN A FEW PEOPLE WHO KNEW BECAUSE THESE WERE THE PEOPLE WHO WERE DOING THE SIDE CONTRACTS?

THE WITNESS: ABSOLUTELY, YOUR HONOR. THAT'S AN
EXAMPLE, PLUS THIS REPORT, I THINK, ESTABLISHES THAT THERE WAS --

THE COURT: I HAVEN'T SEEN THAT REPORT.

THE WITNESS: -- THERE WAS A PRETTY BROAD KNOWLEDGE OF PROBLEMS, SHALL WE SAY, AT THE COMPANY.

SO WHAT I WANTED TO MAKE, THOUGH, IS IT'S NOT ONLY THE TRADING BY HOWARD HEYERDAHL THAT I HAPPENED TO KNOW ABOUT BECAUSE THERE WAS A PLEA AGREEMENT HERE, BUT THERE'S CERTAINLY THE POTENTIAL FOR SIMILAR TRADING BY LOTS OF OTHER PEOPLE OF THE COMPANY, THE BROTHER OF SOMEBODY THAT WORKS AT THE COMPANY, LOTS OF OTHER PEOPLE.

CERTAINLY IF IT'S WIDELY KNOWN THAT THE FORMER VICE PRESIDENT OF FINANCE HAS SOLD ALL OF HIS SHARES, THAT TENDS TO MAKE THE SHARE MORE INFORMATIVE -- MAKE THE SALE MORE INFORMATIVE, BUT THAT'S NOT REQUIRED FOR THIS LEAKAGE STORY TO FULLY EXPLAIN WHAT'S GOING ON HERE.

Q. (BY MR. FELLOWS) SO IS IT A FUNCTION OF BOTH PEOPLE WITH KNOWLEDGE OF BAD EVENTS OR THINGS THAT ARE NOT GOOD AT A COMPANY IN ADDITION TO THE POSSIBLE KNOWLEDGE OF STOCK SALES?

A. YES.

Q. AND HAVE YOU OBSERVED THAT TYPE OF BEHAVIOR IN YOUR OTHER SECURITIES CASES YOU'VE WORKED ON INVOLVING FRAUD?

A. WELL, IT'S VERY DIFFICULT TO OBSERVE BECAUSE MOST OFTEN YOU DON'T HAVE THE CRIMINAL PROCEEDING OF FRAUD. WHAT WE DO KNOW IS THAT INSIDER TRADING BY A LEGALLY DEFINED INSIDER IS
A matter of great concern to the SEC, to the New York Stock Exchange and what we also know from finance studies is that there are movements in stock prices that appear to suggest the kind of leakage that we're talking about here.

Q. And if Mr. Heyerdahl sold some 66,000 shares as a block on one day during that period, what effect would that have at a brokerage firm?

Mr. Malko: Calls for speculation.

MR. FELLOWS: OKAY. I'LL WITHDRAW THAT QUESTION.

THE COURT: OKAY.

Q. (By Mr. Fellows) Let me ask you this: Please explain to the court what is a "tippee" in terms of the analysis of tippers and tippees when it comes to stock and securities information.

A. The tipper is someone who receives information and typically it's nonpublic information, it's already public, it's not worth much. But a tip -- in this context -- could be, physically means you've been given some inside information, some information that's not yet known to the public and it might allow you to sell stock before a price decline or buy stock before a price increase.

Q. And please define for the court what this "artificial inflation" means.

A. As I use that term generally and in this particular setting, artificial inflation is the difference between the
PRICE AS REPRESENTED — THE PRICE OF A SECURITY AS REPRESENTED
AND MEASURED BY THE MARKET PRICE AND THE ACTUAL VALUE OF THE
SECURITY.

Q. NOW, LET ME DIRECT YOUR ATTENTION TO PAGE 9. IN
PARAGRAPHS 23 AND 24 YOU DISCUSS THE IMPACT OF THE FRAUD AT
MCKESSON HBCO DURING THREE DIFFERENT TIME PERIODS; AND PLEASE
TELL THE COURT, DO YOU AGREE THAT THOSE ARE RELEVANT TIME
PERIODS TO LOOK AT OR WOULD YOU CONSIDER THEM IN A DIFFERENT
COMBINATION?

A. NO, I THINK IT'S USEFUL TO BREAK THE ENTIRE TIME
PERIOD — THE RELEVANT TIME PERIOD — UP IN THIS WAY. LOOK AT
THE PREANNOUNCEMENT PERIOD BEFORE THE FIRST ANNOUNCEMENT AND
LOOK AT THAT FIRST ANNOUNCEMENT THAT THERE WAS FRAUD AND THEN
LOOK AT THE EVENTS AFTER THAT FIRST ANNOUNCEMENT.

JUST TO BE CLEAR, THE DEFENDANTS' EXHIBIT LOOKS AT
THESE PERIODS A LITTLE BIT DIFFERENTLY. THEY HAVE IDENTIFIED A
YELLOW SWAT THERE THAT IS FROM THE FIRST ANNOUNCEMENT — THE
FIRST RESTATEMENT THROUGH THE LAST RESTATEMENT, THAT'S OKAY AS
WELL. I DON'T HAVE A PREFERENCE BETWEEN THOSE TWO WAYS OF
SLICING THE PIE IN HERE.

Q. AND TURNING TO PAGE 10 AND TO PARAGRAPH 25, WHAT DID
YOUR ANALYSIS OF THAT PREANNOUNCEMENT PERIOD INDICATE?

A. FOR THE REASONS I SUGGESTED EARLIER, ALL OF THE
DECLINE IN THAT PERIOD, $19.38, IN MY VIEW IS REASONABLY
ATTRIBUTED TO THE FRAUD, REASONABLY VIEWED AS PART OF THE
ARTIFICIAL INFLATION BASED ON EVENT STUDY, BASED ON THE
ANALYSIS OF THE ECONOMIC FACTS AND EVIDENCE HERE.

Q. NOW, TURNING TO THE SO-CALLED ANNOUNCEMENT PERIOD --
THE COURT: COULD I STOP YOU --

MR. FELLOWS: YES.

THE COURT: -- I HAVE A COUPLE OF PRO FORMA QUESTIONS
THAT I BELIEVE I NEED TO ASK UNDER DAUBERT ABOUT LEAKAGE,
AGAIN METHODOLOGY.

FIRST OF ALL, I GUESS THE CONCERN THE COURT HAS, WE
DON'T HAVE ANY ACTUAL EVIDENCE OF LEAKAGE AND WE'VE HAD
EXPLANATIONS, BUT THAT'S BECAUSE -- AND I KNOW BECAUSE I
DO CRIMINAL WORK -- BUT PEOPLE JUST DON'T COME AND SAY:
OH, BY THE WAY, TODAY I'M GOING TO GO OUT AND COMMIT A
CRIME. OKAY? SO WE KNOW THAT. BUT THERE'S A CONCERN OF
THE ABSENCE OF EVIDENCE OF LEAKAGE WHICH WOULD JUSTIFY A
CONCLUSION THAT LEAKAGE WAS WHAT WAS THE FACTOR THAT
CAUSED THE STOCK TO DECLINE.

SO WHAT I WANT TO KNOW ABOUT LEAKAGE, FIRST OF ALL,
IS THIS A THEORY -- THIS LEAKAGE THEORY -- THAT HAS
ATTAINED A GENERAL ACCEPTANCE WITHIN YOUR SCIENTIFIC
COMMUNITY; THAT IS, AS A FINANCIAL ECONOMIST?

THE WITNESS: YES, I WOULD SAY IT'S AN AREA OF
RESEARCH. IT IS VIEWED AS AN ANOMALY; THAT IS TO SAY --
THAT IS A PHRASE THAT PROFESSOR BENSTON USED -- IT'S A
TERM OF ART IN THE PROFESSION. THERE IS SOMETHING WE
OBSERVE AT CERTAIN TIMES IN STOCK PRICES THAT'S NOT FULLY
CONSISTENT WITH -- WELL, IT'S NOT CONSISTENT WITH THE
ABSENCE OF LEAKAGE.

AND SO IT'S AN ANOMALY. IT'S SOMETHING THAT WE
WOULDN'T EXPECT IF THERE WAS NO IMPROPER TRADING, AND SO
IT'S AN AREA OF RESEARCH. THE PHENOMENON HAS BEEN -- A
PHENOMENON HAS BEEN DEFINED.

THE COURT: ALL RIGHT.

THE WITNESS: I WOULDN'T SAY THAT THE PROFESSION HAS
FULLY SETTLED ON EXACTLY WHY WE OBSERVE IT. IT IS THE
MOST ACTUAL EXPLANATION, THOUGH. FOR EXAMPLE, IF YOU
THINK ABOUT AN ACQUISITION WHERE A COMPANY IS GOING TO BE
PURCHASED AT A 30 PERCENT PREMIUM AND IF YOU OBSERVE IN
THE WEEK OR TWO OR THREE BEFOREHAND THAT THE PRICE STARTS
MOVING UP BEFORE THAT ANNOUNCEMENT.

THINKING ABOUT HOW MARKETS WORK AND KNOWING THAT
INDIVIDUAL INVESTORS SEEK OUT INFORMATION AND ACT ON
INFORMATION, THAT IS THE -- TO MY MIND, THE LOGICAL
EXPLANATION FOR WHAT WE OBSERVED THERE. IT'S THE SIMPLEST
EXPLANATION. MAYBE SOMETHING ELSE IS GOING ON, BUT THAT
IS THE SIMPLEST EXPLANATION FOR WHAT'S GOING ON.

AND THERE'S A FAMOUS PRINCIPLE IN ECONOMICS THAT SAYS
IF YOU HAVE TWO EXPLANATIONS, ONE OF WHICH IS COMPLICATED
AND ONE OF WHICH IS SIMPLE, THE SIMPLE ONE IS PROBABLY
RIGHT.
THE COURT: WE NEED TO ADOPT THAT MORE.

PART OF MY JOB IS TO TEST THE RELIABILITY OF ALL OF THESE PRINCIPLES AND THEORIES AS THEY'RE APPLIED HERE AND I'M LOOKING ON LEAKAGE NOW.

WHAT I HEAR YOU TELLING ME IS, THAT LEAKAGE IS SOMETHING THAT IS WRITTEN ABOUT, PEOPLE HAVE DIFFERENT OPINIONS ABOUT IT, BUT IT CERTAINLY IS A RECOGNIZED FACTOR -- CORRECT ME IF I'M WRONG -- BUT SOMETHING THAT CAN AFFECT STOCK PRICES IN SITUATIONS SUCH AS THIS.

THE WITNESS: I THINK THAT IS ACCURATE. I THINK A GOVERNMENT AGENCY HOLDS THAT VIEW STRONGLY; FOR EXAMPLE, THE SEC.

THE COURT: AND IT HAS BEEN SUBJECT TO SOME PEER REVIEW, I ASSUME, IN THE JOURNALS?

THE WITNESS: YES, THERE ARE PEER REVIEW ARTICLES IN THE LITERATURE THAT DEAL WITH THIS ISSUE.

THE COURT: IT DOESN'T SOUND LIKE A THEORY THAT COULD EVER BE SCIENTIFICALLY TESTED, AND I MAY BE WRONG ON THAT.

THE WITNESS: WELL, ECONOMISTS ARE PRETTY CREATIVE AND I THINK THERE'S --

THE COURT: WELL, I KNOW THAT.

THE WITNESS: -- I THINK THERE'S A GOOD DISSERTATION, AND SOMEBODY WILL PUBLISH IT SOME DAY. SO I WOULDN'T GO SO FAR AS TO SAY IT CAN'T BE TESTED. I'D SAY PEOPLE ARE
TRYING TO IDENTIFY THIS WITH MORE PRECISION THAN WE
CURRENTLY UNDERSTAND IT AND THERE MAY BE OPPORTUNITIES IN
THE FUTURE TO ESTABLISH THAT THIS KIND OF -- THIS THEORY
OF WHAT'S GOING ON IS, IN FACT, VALID AND EMPIRICALLY
JUSTIFIED.

THE COURT: BECAUSE ONE WAY TO TEST IT THEN WOULD BE
TO EXCLUDE WHAT YOU HAVE DONE, MARKET INDUSTRY AND COMPANY
SPECIFIC FACTORS?

THE WITNESS: YES, YOUR HONOR.

THE COURT: THAT'S ONE WAY OF TESTING IT AGAINST --

THE WITNESS: YES, IT DOES -- AND THAT'S THE PRIMARY
BASIS FOR MY OPINIONS. I CAN'T PROVE TO YOU THAT THE
REASON THIS DECLINE TOOK PLACE, DESPITE THOSE OTHER
FACTORS, WAS BECAUSE OF TRADING BY HEYERDAHL AND SIX OTHER
PEOPLE.

THE COURT: EMPIRICALLY YOU CANNOT PROVE THAT?

THE WITNESS: THAT'S RIGHT.

THE COURT: BUT THE LEAKAGE THEORY IS RECOGNIZED
AMONG LINES AND TOLD TO BE A VALID -- A FACTOR THAT MAY
HAVE CONTRIBUTED TO IT. AND, OF COURSE, ULTIMATELY IF
IT'S A RELIABLE METHODOLOGY AND ACCEPTED IN THE COMMUNITY,
WHEN WE GET TO THE TRIER OF FACT WHICH WOULD BE A JURY --

THE WITNESS: YES.

THE COURT: -- MY JOB IS ONLY TO DECIDE -- AND I HATE
THIS WORD, BUT IT'S OUT THERE IN THE LEGAL GENRE OF STUFF
CALLED "JUNK SCIENCE."

LET ME ASK YOU ONE MORE QUESTION. AND, AGAIN, THESE
ALL COME FROM THE LEGAL REQUIREMENTS THAT THE COURT HAS AS
A GATEKEEPER ON THIS ISSUE.

I HAVE TO DETERMINE WHETHER THE EXPERT, PROFESSOR
BENSTON, UNJUSTIFIABLY EXTRAPOLATED FROM ACCEPTED PREMISE
TO AN UNFOUNDED CONCLUSION. THE ACCEPTED PREMISE IS,
HEYERDAHL, COMPANY EXEC, DUMPED A BUNCH OF STOCK PRETTY
QUICKLY.

ONE CONCLUSION IS, WELL, THAT'S WHAT WE EXPECTED IN.
COMPANIES AFTER THEY LEAVE, THAT'S VERY NORMAL AND THERE'S
NOTHING ON THE MARKET.

THE OTHER CONCLUSION EXTRAPOLATED FROM THE VERY SAME
PREMISE IS THE ONE THAT YOU AND PROFESSOR BENSTON HAVE
ADOPTED. IF I WERE TO ASK YOU, IS THIS AN UNJUSTIFIABLE
EXTRAPOLATION FROM THAT PREMISE, WHAT WOULD YOUR RESPONSE
BE TO THAT?

THE WITNESS: I THINK WE ACTUALLY HAVE SOME EVIDENCE
FROM THAT. THE LARGEST SALE BY MR. HEYERDAHL, AS I
RECALL, TOOK PLACE ON FEBRUARY 12TH.

AND I AGREE COMPLETELY WITH THE TESTIMONY YESTERDAY
IN THE CASE, 68,000 SHARES IN TERMS OF THE TOTAL VOLUME IS
SMALL, VERY SMALL. INTERESTINGLY, IF YOU LOOK AT THAT
PARTICULAR DAY, ON THAT DAY A NEW BROKERAGE FIRM STARTED
COVERAGE -- MCKESSION HBC -- WITH A BUY RECOMMENDATION, AS
I REMEMBER, A POSITIVE. SO IF YOU LOOK AT THE PUBLIC
INFORMATION ON THAT PARTICULAR DAY, YOU WOULD HAVE
EXPECTED AN ABNORMAL INCREASE, AN UPTAKE. INSTEAD WHAT
YOU SEE IS A DOWNTAKE ON THAT PARTICULAR DAY OF
MR. HEYERDAHL'S LARGEST SALE. THAT TO ME IS ONE PIECE OF
EVIDENCE SUGGESTING THAT, YES, THE KIND OF SALE THAT WE'RE
TALKING ABOUT HERE AND HYPOTHESIZING HAD THE EFFECTS HERE,
THERE'S VALIDITY TO THAT STORY.

THE COURT: ALL RIGHT. OKAY.

I APOLOGIZE FOR TAKING YOU OUT OF YOUR SEQUENCE, MR.
FELLOWS.

MR. FELLOWS: THAT'S FINE.

Q. (BY MR. FELLOWS) AND TO ADD TO THOSE QUESTIONS,
LET'S BE CLEAR. HAVE YOU PERFORMED YOUR OWN INDEPENDENT
ANALYSIS IN THIS CASE --

A. YES, I HAVE.

Q. -- OF THE DETERMINATION OF A PRICE DROP?

A: YES. YES, I HAVE.

Q. AND IS IT IN YOUR PROFESSIONAL OPINION THAT THE
SO-CALLED LEAKAGE ISSUE IS JUNK SCIENCE?

A. NO, ABSOLUTELY NOT. TO USE A TERM THAT I HEAR
LAWYERS USE, IT'S NOT COMPLETELY SETTLED, BUT IT'S DEFINITELY
NOT JUNK SCIENCE; IT'S AN ISSUE THAT GETS TREATED IN REPUTABLE
JOURNALS.

Q. AND FOLLOWING UP, IS THE EXISTENCE OF LEAKAGE AND THE
FACT THAT IT IMPACTS STOCK PRICES WELL-RECOGNIZED BY FINANCIAL
ANALYSTS?

A. YES. I'D SAY THE ANALYST COMMUNITY AS OPPOSED TO THE
ACADEMICS ARE CONVINCED THAT THIS SORT OF THING HAPPENS.

Q. LET ME ASK YOU THIS QUESTION: YOU HAVE GONE INTO
SOME DETAIL ABOUT THE OTHER FACTORS. PLEASE STATE WHETHER IT
IS ACCURATE THAT THE LACK OF OTHER EXPLANATORY FACTORS TO
EXPLAIN THE PRICE DROP FROM ROUGHLY $85 A SHARE TO $65 A SHARE
FROM JANUARY 12TH OF 1999 TO APRIL 27TH OF 1999 HAVE BEEN
TESTED AND MEASURED?

A. THE ANSWER IS "YES"; THAT'S EXACTLY WHAT THE
REGRESSION ANALYSIS AND THE CORE OF EVENT STUDY DOES. IT
PROVIDES A BASIS FOR TESTING WHETHER THOSE FACTORS EXPLAIN THE
PRICE DECLINE AND HERE YOU CLEARLY PROJECT THAT HYPOTHESIS THAT
THE MARKET OR INDUSTRY EXPLAIN THAT DECLINE.

Q. LET ME PUT IT THIS WAY: IN EFFECT HAVE YOU RULED OUT
OTHER POSSIBLE EXPLANATIONS TO PROVIDE THE CAUSAL CONNECTION
BETWEEN WHAT WAS GOING ON AT MCKESSION HBC AND THE PRICE
DROP?

A. YES, I THINK SO, GIVEN THE AVAILABLE INFORMATION AND
THE FACTS HERE TO THE BEST THAT WE CAN, YES.

Q. LET'S GO TO THE NEXT PERIOD THAT YOU DISCUSS ON PAGE
10, AND I THINK WE'LL BE ABLE TO FINISH UP YOUR EXAM IN THE
NEXT 20 MINUTES OR SO HERE.

WOULD YOU COVER THE SO-CALLED ANNOUNCEMENT PERIOD
AND, AGAIN, IF YOU WANT TO COME DOWN FROM THE STAND YOU CAN OR
YOU CAN STAY WHERE YOU ARE.

   A. THIS IS JUST ONE DAY SO WE CAN HANDLE THAT FROM
   HERE.

   THIS WAS THE FIRST DISCLOSURE OF FRAUD. THERE WAS
SOME INKLINGS IN SOME ANALYSTS REPORTS EARLIER THAT, GEE, MAYBE
THERE'S SOME PROBLEMS AT HBC, BUT I DON'T KNOW IF IT WAS
CHARACTERIZED AS FRAUD AT THIS TIME OF A SIGNIFICANT
RESTATEMENT. THIS WAS THE FIRST ANNOUNCEMENT OF A SIGNIFICANT
RESTATEMENT, AND THAT'S A VERY SERIOUS ANNOUNCEMENT FOR ANY
STOCK IN MOST CASES.

   Q. ANNOUNCEMENT OF RESTATEMENT OF WHAT? REVENUES OR
   EARNINGS OR BOTH?

   A. A FINANCIAL STATEMENT AND IN THIS CASE IT WAS
   EARNINGS AND -- BOTH REVENUE AND EARNINGS, I BELIEVE.
   THE RESTATEMENT, I THINK, APPLIED BOTH TO THE
QUARTERLY INFORMATION THAT HAD JUST BEEN PROVIDED A FEW DAYS
EARLIER AS WELL AS TO EARLIER PERIODS. SO THERE WAS AN
ANNOUNCEMENT OF A SIGNIFICANT RESTATEMENT, BOTH THE QUARTER
THAT HAD JUST ENDED AND ALREADY HAD BEEN ANNOUNCED AND A
RESTATEMENT APPLYING TO EARLIER PERIODS AS WELL.

   Q. AND WHAT DID YOUR EVENT STUDY INDICATE AS TO THIS
   DROP?

   A. HERE THE EVENT STUDY -- LET'S JUST LOOK AT THE TOTAL
STOCK DROP ON THAT DAY WHICH WAS $31.25 AND ASSESS HOW MUCH OF
THAT MIGHT HAVE BEEN DUE TO MARKET FACTORS AND HOW MUCH OF IT
MIGHT HAVE BEEN DUE TO INDUSTRY FACTORS. IN FACT, VERY LITTLE
OF IT -- I THINK LESS THAN A DOLLAR OF THAT DECLINE -- WAS
RELATED TO MARKET FACTORS AND INDUSTRY FACTORS ON THAT DAY --
THE COURT REPORTER: WHAT KIND OF FACTORS?
THE WITNESS: INDUSTRY FACTORS. I APOLOGIZE IF I'M
SPEAKING TOO QUICKLY.
A. -- SO I USED THE EVENT STUDY TO IDENTIFY THE ABNORMAL
DROP ON THAT DAY, THE ABNORMAL RESPONSE TO THE ANNOUNCEMENT AND
I ATTRIBUTED ALL OF THAT TO THE RESTATEMENT. I INCLUDED ALL OF
THAT -- I THINK IT'S APPROPRIATE TO INCLUDE ALL OF THAT AS PART
OF THE ARTIFICIAL INFLATION.
Q. HOW MUCH WAS THAT?
A. THE DROP ITSELF IN RAW TERMS WAS $31.25, JUST
SLIGHTLY LESS THAN THAT WAS THE ABNORMAL PORTION.
Q. NOW, LET'S LOOK AT THE POST-ANNOUNCEMENT PERIOD WHICH
YOU DISCUSS IN PARAGRAPH 27; AND PLEASE TELL US WHAT ANALYSIS
YOU DID AS TO THAT?
A. YES. SO UNLIKE THE CHART WHICH HAS A YELLOW SWAT
THERE, I LOOK AT THE ENTIRE PERIOD AFTER THE DROP AND YOU SEE
THAT THE PRICE OF MCKESSON HBOC CONTINUES TO DECLINE AFTER THAT
FIRST ANNOUNCEMENT.

SOME OF THAT DECLINE IS CLEARLY RELATED TO ADDITIONAL
ANNOUNCEMENTS OF RESTATEMENTS AND WE CAN MEASURE ON EACH OF
THOSE DAYS THE AMOUNT OF THE ABNORMAL DECLINE ON EACH OF THOSE
DAYS.

THE MORE INTERESTING QUESTION HERE, I THINK, IS WHAT
ABOUT THE REST OF THE DECLINE THROUGH THAT TIME PERIOD THROUGH
MARCH OF 2000. CAN THAT BE EXPLAINED BY THE MARKET? CAN IT BE
EXPLAINED BY INDUSTRY FACTORS? CAN IT BE EXPLAINED BY
ANNOUNCEMENTS AND EVENTS THAT MCKESSON HBOC WAS UNRELATED TO
THE FRAUD? THOSE ARE THE ISSUES THAT WE NEED TO DEAL WITH, IN
MY OPINION.

THIS -- THAT PERIOD FROM 4/28, THE DAY AFTER THE
FIRST ANNOUNCEMENT, THROUGH MARCH OF 2000 IS A LITTLE MORE
INTERESTING THAN THE FIRST ONE. THE MARKET CLEARLY CONTINUES
TO GO UP. MEASURED BY THE INDEX I USED, THE MARKET WENT UP BY
18.4 PERCENT FROM MARCH 28TH -- I'M SORRY -- APRIL 28TH THROUGH
MARCH OF 2000.

BECAUSE MCKESSON HBOC PRICES POSITIVELY RELATED TO
THE MARKET, THAT SHOULD HAVE MOVED THE PRICE UP A LITTLE BIT.
IT TURNS OUT THAT THE HEALTHCARE INDEX THAT I LOOKED AT
ACTUALLY DECLINED DURING THIS TIME PERIOD BY 13.1 PERCENT. SO
HERE WE HAVE THESE TWO FACTORS SOMEWHAT MOVING AGAINST EACH
OTHER.

WELL, IT TURNS OUT THAT THE REGRESSION ANALYSIS THAT
WE DO IS PART OF THE EVENT STUDY PROVIDES A WAY FOR BALANCING
THOSE AND PUTTING THOSE TOGETHER. I CAN GO THROUGH TECHNICALLY
WHAT IT DOES AS YOU TAKE THE COEFFICIENTS AND MULTIPLY THEM AND
GET A PREDICTED CHANGE BASED ON THOSE UNDERLYING MOVEMENTS IN
THE MARKET AND IN THE INDEX.

AT MOST, EVEN TAKING INTO ACCOUNT THE 13 PERCENT
DECLINE IN THE INDUSTRY, THE REGRESSION ANALYSIS IN MY EVENT
STUDY WOULD EXPLAIN A DECREASE OF BETWEEN 1 PERCENT AND 2 1/2
PERCENT. WHAT WE ACTUALLY OBSERVED DURING THAT TIME -- THAT'S
ACROSS THE FULL TIME PERIOD. WHAT WE ACTUALLY OBSERVED IS 43.6
PERCENT DECLINE IN THE PRICE OF MCKESSON HBOC. SO THIS IS A
LITTLE BIT DIFFERENT THAN THE FIRST PERIOD WHERE BOTH INDICES
ARE TENDING TO PUSH THINGS UP, BUT WHEN YOU BALANCE THOSE TWO
BASED ON THE STATISTICS, YOU STILL DON'T GET ANY SIGNIFICANT
EXPLANATION FOR THE KIND OF DECLINE WE OBSERVED FROM THE MARKET
INDEX AND THE INDUSTRY INDEX. YOU EXPECT BASICALLY A FLAT
PRICE MOVEMENT HERE.

THAT LEADS US TO THE THIRD COMPONENT OF THE ANALYSIS.
LET'S LOOK AT THE EVENTS IN THE ANNOUNCEMENTS. LET'S LOOK AT
WHAT ANALYSTS WERE SAYING, LET'S LOOK AT WHAT THE COMPANY WAS
SAYING ABOUT ITS OUTLOOK. HERE IS SOME ROOM FOR JUDGMENT IN
READING THE ANALYST REPORTS, BUT I HAVE READ THOSE REPORTS AND
THE ANNOUNCEMENTS ON THOSE DAYS AND I AGREE WITH PROFESSOR
BENSTON THAT MOST OF THE NEGATIVE ANNOUNCEMENTS ARE
ATTRIBUTABLE TO AND RELATE TO THE FRAUD. THEY DON'T
NECESSARILY SAY BECAUSE OF THE FRAUD I'M REDUCING MY ESTIMATE,
BUT THEY SAY THERE IS ONGOING TURMOIL AT HBOC COMPONENT OF
MCKESSON HBOC, WE'RE HAVING TROUBLE WITH CUSTOMERS BECAUSE THEY
ARE UNSURE OF OUR RELIABILITY.
MY CONCLUSION HERE IS THAT IT'S REASONABLE, BASED ON
AN ANALYSIS OF THE ANNOUNCEMENTS AND ANALYST REPORTS, TO
ATTRIBUTE ALL OF THE DECLINE IN THIS PERIOD TO THE RESTATEMENTS
AND THE CONTINUING EFFECTS OF THE FRAUD AND SO THAT WAS THE
BASIS OF MY OPINION WITH RESPECT TO THIS PERIOD.

Q. TURNING TO PAGE 11 IN PARAGRAPHS 28 AND 29, PLEASE
TELL THE COURT WHAT IS THE AMOUNT OF ARTIFICIAL INFLATION AT
MCKESSION HBOC'S STOCK PRICE AS OF JANUARY 12TH, 1999 THAT YOU
CONCLUDED EXISTED.

A. BASED ON THE ANALYSIS I JUST DESCRIBED, I BELIEVE
THAT $65.67 IS THE PROPER ESTIMATE OF THE ARTIFICIAL INFLATION
IN THE STOCK PRICE ON JANUARY 12, 1999.

Q. ON A PER SHARE BASIS?

A. YES, ON A PER SHARE BASIS.

Q. AND THE NEXT PARAGRAPH YOU DISCUSS NETTING OUT THE
FULL EFFECTS OF THE FRAUD AT ISSUE IN THIS CASE. PLEASE
EXPLAIN THE SIGNIFICANCE OF THAT CONCEPT OF "NETTING OUT."

A. YES. THIS GOES TO WHAT WAS THE ACTUAL VALUE -- IN MY
OPINION, WHAT THE ACTUAL VALUE WAS OF $19.46. IT'S USEFUL AND
IMPORTANT, I THINK, TO REALIZE IN LARGE FRAUD, SUCH AS THIS
ONE, THERE ARE BOTH SORT OF ACCOUNTING AND NUMBER EFFECTS AND
ARE REAL EFFECTS. ONE CAN IMAGINE A FRAUD WHERE, "GEE, WE
OVERSTATED, WE MADE A MISTAKE." WE COME BACK AND SAY, "OUR
INCOME FOR THE LAST PERIOD WAS HIGHER THAN IT SHOULD HAVE BEEN.
WE HAVE TO RESTATE IT TO A LOWER NUMBER. IT HAS NO EFFECT ON
OUR OPERATIONS GOING FORWARD. OUR OPPORTUNITIES ARE THE SAME
AS EVER. IT'S NOT GOING TO REQUIRE A MAJOR REWORKING OF OUR
COMPANY."

THAT'S A PURE NUMERICAL -- A PURE ACCOUNTING ISSUE
WHERE THE NUMBERS ARE WRONG, WE GOT THEM RIGHT, IT DIDN'T
REALLY HAVE ANY REAL CONSEQUENCES FOR THE COMPANY.

THAT'S DEFINITELY NOT WHAT WE'RE DEALING WITH HERE.
HERE THE ACCOUNTING NUMBERS WERE SO -- SO FAR OFF AND THE
NATURE AND EXTENT OF THE FRAUD WAS SO LARGE, THAT IT WASN'T
SIMPLY A MATTER OF SAYING, WELL, WE JUST CLEANED UP THE
FINANCIAL STATEMENT.

THERE WERE CONTINUING ONGOING EFFECTS ON THE BUSINESS
UNDoubtedly --

THE COURT: IS IT WHAT WAS SAID YESTERDAY, YOU CAN
FIX THE PAPER, BUT YOU MAY NOT HAVE FIXED THE PROBLEM?

THE WITNESS: YES, HE DID DRAW EXACTLY THAT
DISTINCTION YESTERDAY.

THE COURT: AND I READ FROM THE ANNOUNCEMENT WHERE
THEY TALKED ABOUT THE NECESSITY TO RESTORE CREDIBILITY AND
INTEGRITY WITH CUSTOMERS AND MARKETS AND THAT IS AN
ONGOING PROCESS AND I HEAR YOU SAYING NOTWITHSTANDING THE
FACT THAT THE PAPER HAS BEEN FIXED.

THE WITNESS: YES, YOUR HONOR, THAT'S NOT THE END OF
THE STORY WHEN WE MAKE THE FINAL ANNOUNCEMENT AND SAY,
"WE'VE GOT THE ACCOUNTING STATEMENTS RIGHT NOW"; THAT'S
NOT THE END OF THE STORY. THERE ARE CONTINUING EFFECTS.
MOREOVER, IT'S HARD TO UNDERSTAND WHAT THOSE EFFECTS ARE
GOING TO BE, AND IT APPEARS THAT THEY WERE MORE
LONG-LASTING AND MORE SERIOUS THAN PERHAPS WERE
ANTICIPATED ON THE DATE OF THE LAST ANNOUNCEMENT.

THE COURT: THAT'S DUE TO THE NATURE OF THE PROBLEM
AND THE EXTENT OF THE PROBLEM?

THE WITNESS: YES, IN MY OPINION, YOUR HONOR.

THE COURT: BUT YOU CONTRAST THAT WHERE THERE WOULD
BE RECOGNIZED SITUATIONS WHERE THE FINANCIAL STATEMENTS
WOULD NEED TO BE RESTATEd, BUT THE RESTATEMENT WAS
NUMERICAL AND PERHAPS DIDN'T INVOLVE PROCESS THESE PEOPLE,
STRUCTURE AND THAT WOULD BE A DIFFERENT SCENARIO THAT
WOULD NOT ALLOW FOR YOU TO PROJECT OUT A LONGER RELEVANT
PERIOD.

THE WITNESS: YES, YOU'RE RIGHT. THAT'S EXACTLY WHAT
I WAS DESCRIBING, YOUR HONOR.

THE COURT: OKAY. BECAUSE YESTERDAY I HEARD
TESTIMONY THAT THE USUAL FUNCTION IS THAT THE MARKET WILL
ABSORB AN ANNOUNCEMENT IN A COUPLE OF DAYS. SO IF YOU
LOOKED AT THE LAST ANNOUNCEMENT BEING 7/14/99, OKAY, IT'S
OUR LAST ANNOUNCEMENT, THE PAPER'S FIXED. THEN YOU WOULD
EXPECT MAYBE 7/20 WOULD BE THE END OF THE RELEVANT PERIOD,
BUT TO JUSTIFY A RELEVANT PERIOD GOING FURTHER, WHAT
YOU'VE JUST TESTIFIED TO, YEAH, THE PAPER GOT FIXED AND
RESTATED, BUT THERE ARE FUNDAMENTAL PROBLEMS WITH THE
ORGANIZATION THAT NEED TO BE FIXED IN ORDER TO RESTORE THE
CREDIBILITY -- AND THAT'S MY WORD -- AND I THINK USED ALSO
IN THE RESTATEMENT THAT THE MARKET NEED IN ORDER TO HAVE
CONFIDENCE BACK IN THIS STOCK IN THIS COMPANY?

THE WITNESS: YES, YOUR HONOR, THAT'S EXACTLY RIGHT.

THE COURT: I'M UNDERSTANDING NOW.

ALL RIGHT. AND IS THAT RECOGNIZED, THAT THE MORE
SERIOUS THE PROBLEM IS, THE LONGER IT'S GOING TO TAKE AND
MORE THE MARKET IS GOING TO BE CAUTIOUS OVER A LONGER
PERIOD OF TIME BEFORE IT PUTS ENOUGH CONFIDENCE IN IT TO
BRING THE STOCK PRICES BACK UP?

THE WITNESS: YES, I THINK SO, YOUR HONOR. AND IF I
MAY, THERE WAS THAT DISCUSSION ABOUT THE ECONOMISTS
USUALLY ASSUME THAT THE PRICE RESPONSE IS IN THE ONE DAY
OR SO. I AGREE WITH THAT COMPLETELY. IT'S MISLEADING,
THOUGH, TO SUGGEST THAT LOOKING AT THE PERIOD UP TO MARCH
OF 2000 IS IN ANY WAY INCONSISTENT WITH THAT.

WHAT I BELIEVE HAPPENED HERE AND I THINK WHAT
PROFESSOR BENSTON BELIEVES HAPPENED HERE IS THAT
THROUGHOUT THAT TIME PERIOD, THE END OF 1999 AND INTO
2000, THE MARKET WAS LEARNING NEW THINGS ABOUT HOW SERIOUS
THE ADJUSTMENT WAS AT MCKESSON. SO I'M NOT SAYING THAT IT
TOOK NINE MONTHS FOR THE MARKET TO RESPOND TO THE
ANNOUNCEMENT ON JULY 17TH.
THE COURT: OKAY.

THE WITNESS: I'M SAYING NEW INFORMATION CAME OUT GRADUALLY IN SMALL BITS OVER THAT WHOLE TIME PERIOD. IT TOOK THAT LONG FOR THE MARKET TO FULLY DIGEST THE MAGNITUDE OF THE ADJUSTMENTS. SO THERE'S NO INCONSISTENCY HERE WHATSOEVER BETWEEN LOOKING AT A TIME PERIOD OUT TO MARCH 2000 AND WHAT VIRTUALLY ALL ECONOMISTS AGREE, MAINLY THAT IN A SEMI-STRONG FORM EFFICIENT MARKET THE RESPONSES TO THE INDIVIDUAL ANNOUNCEMENTS ARE IN A DAY OR TWO.

THE COURT: I ASKED ANOTHER EXPERT THIS QUESTION. THE PLEA WAS JANUARY 1ST OF 2001, CORRECT, IS THAT ABOUT RIGHT?

MR. MALKO: JANUARY --

THE COURT: '02 OR '01?

MR. MALKO: I THINK IT WAS AFTER THIS PERIOD.

THE COURT: YEAH.

MR. MALKO: OH, I'M SORRY.

THE COURT: JANUARY OF '01 WOULD BE AFTER THIS PERIOD, AND I THINK THAT'S RIGHT.

BUT WASN'T -- I MEAN, USUALLY THERE'S AN INVESTIGATION GOING ON BY THE POWERS THAT BE, WHETHER IT'S THE SEC, WHETHER IT'S THE U.S. ATTORNEY'S OFFICE, WHETHER IT'S SOME INJUNCTION. IS THAT THE KIND OF INFORMATION THAT WOULD HAVE BEEN PUBLIC IF THERE WAS AN INVESTIGATION AND MAYBE INFORMATION COMING OUT OF THAT? I MEAN, WOULD
AND THAT'S A CONVOLUTED QUESTION.

THE WITNESS: WELL, I THINK THE SEC AND THE NEW YORK STOCK EXCHANGE ARE PRETTY CLOSE TO THE INVESTIGATIONS SO THEY BOTH, I THINK, HAVE ALGORITHMS THAT PROVIDE WATCHING STOCK PRICES, WATCH TRADING AND SO ON, BUT I THINK THAT'S TYPICALLY NOT PUBLIC INFORMATION, IT'S --

THE COURT: OKAY. BECAUSE THAT WOULDN'T BE A FACTOR IN YOUR JUDGMENT?

THE WITNESS: IN MY OWN OPINION, DESCRIBING -- IT WOULD NOT BE.

THE COURT: I DON'T WANT TO GO OFF ON SOME TANGENTS HERE; I'M JUST WONDERING. OKAY.

MR. NEY: YOUR HONOR.

THE COURT: YES, SIR.

MR. NEY: IF I MAY, NOT WITH REGARD TO WHAT THIS WITNESS IS TESTIFYING ABOUT, BUT THERE ARE AND WERE IN THIS CASE AND WE CITE THEM IN OUR COMPLAINT AND IN OUR MOTION FOR SUMMARY JUDGMENT BRIEFS, PUBLIC ANNOUNCEMENTS RELATING TO THE SEC INVESTIGATION.

THE COURT: ALL RIGHT.

MR. MALKO: I'M SORRY, BUT I OBJECT TO MR. NEY
TESTIFYING ABOUT THAT WHILE THIS WITNESS IS THE STAND.

THE COURT: WELL, OKAY. HE'S ANSWERING A QUESTION;

I'LL ALLOW IT.

MR. NEY: I JUST WANT IT TO BE CLEAR TO YOUR

HONOR THAT --

THE COURT: OKAY. IT'S THERE. I DON'T WANT TO GO

OFF ON A TANGENT AND MAKE AN ASSUMPTION THAT IT'S OKAY TO

EXTEND THE RELEVANT TIME PERIOD BASED ON INFORMATION AND

I'M THINKING IT'S THE WRONG KIND OF INFORMATION AND THAT'S

ALL I'M TRYING TO DO IS CLEAR IT UP.

I TAKE YOUR POINT.

AND I TAKE YOUR POINT.

AND I HEARD YOUR POINT.

ALL RIGHT. GO AHEAD, MR. FELLOWS.

Q. (BY MR. FELLOWS) NOW, DR. VELLRAITH IN ADDITION TO

YOUR OWN INDEPENDENT ANALYSIS WHICH YOU'VE DESCRIBED, REALLY

FOR THE BETTER PART OF THE LAST HOUR, DID YOU HAVE OCCASION TO

REVIEW, ANALYZE AND CRITIQUE PROFESSOR BENSTON'S METHODS AND

CONCLUSIONS?

A. YES, I DID.

Q. AND IS YOUR ANALYSIS OF HIS CONCLUSIONS SUMMARIZED ON

PAGES 11 THROUGH 13 OF YOUR REPORT?

A. YES, THAT'S CORRECT, I JUST DESCRIBED HIS BASIC

FRAMEWORK AND DESCRIBED MY ASSESSMENT OF HIS APPROACH AND

METHODS.
Q. PLEASE SUMMARIZE YOUR ASSESSMENTS FOR THE COURT.

A. BASED ON MY OWN ANALYSIS, BASED ON READING HIS REPORT, I ALSO HAD HIS DEPOSITION AT THE TIME I WROTE THIS. IT IS MY OPINION THAT HIS CONCLUSIONS ARE WELL-SUPPORTED BY HIS OWN ANALYSIS, THAT HIS OPINIONS ARE FULLY CONSISTENT WITH THE ANALYSIS I DID INDEPENDENTLY, THAT HIS APPROACH AND METHODS ARE BASED ON SOUND ECONOMIC PRINCIPLES CONSISTENT WITH THE EVIDENCE IN THIS CASE AND, THEREFORE, REASONABLE AND APPROPRIATE.

Q. NOW, HAVE YOU ALSO HAD OCCASION TO REVIEW, ANALYZE AND ASSESS PROFESSOR FISCHEL'S OPINION?

A. YES, HIS REPORT. YES.

Q. AND DOES YOUR DISCUSSION ABOUT PROFESSOR FISCHEL'S OPINION, DOES THAT BEGIN ON PAGE 13 AND GO THROUGH PAGE 19?

A. YES, THAT'S CORRECT, SIR.

Q. PLEASE SUMMARIZE FOR THE COURT YOUR ASSESSMENT OF PROFESSOR FISCHEL'S WORK AND OPINIONS IN THIS CASE.

A. MUCH OF HIS WRITTEN REPORT, IN MY OPINION, DOES NOT RELATE TO PROFESSOR BENSTON'S REPORT OR MINE. IT DID NOT RELATE TO THE ISSUE OF WHAT WAS THE ARTIFICIAL INFLATION IN THE PRICE OF MCKESSON HBOC ON JANUARY 12TH.

IN FACT, IF I READ HIS REPORT TO TRY TO IDENTIFY SPECIFIC METHODOLOGICAL CRITICISMS, THERE ARE VERY FEW; AND IN MY OPINION THEY'RE RELATIVELY MINOR. I DISCUSS THE FACT THAT THERE'S SOME JUDGMENT INVOLVED IN IMPLEMENTING AN EVENT STUDY.
NONE OF THE ISSUES THAT PROFESSOR FISCHEL RAISES, IN MY MIND, ARE ANYWHERE CLOSE TO A FUNDAMENTAL CHALLENGE TO THE METHODOLOGY. THERE'S NOTHING THAT HE RAISES THAT IS -- I THINK HE USED THE PHRASE IN HIS REPORT "FUNDAMENTAL FLAW." THAT'S JUST WRONG. NOTHING HE RAISES IS A FUNDAMENTAL FLAW, IN MY OPINION. THERE IS SOME QIBBLING THAT HAPPENS AMONG ECONOMISTS ABOUT IMPLEMENTATION, BUT THAT IS -- IN MY VIEW -- THE PROPER CHARACTERIZATION OF THE POINTS THAT PROFESSOR FISCHEL RAISES HERE.

Q. AND YOU WERE PRESENT YESTERDAY DURING THE TESTIMONY BY PROFESSOR FISCHEL, CORRECT?

A. YES, I WAS, SIR.

Q. IS THERE ANYTHING IN THE TESTIMONY THAT HE GAVE YESTERDAY THAT CHANGES YOUR WRITTEN OPINION IN THIS REPORT AS TO PROFESSOR FISCHEL'S WORK?

A. NOT AT ALL. THERE WERE SOME THINGS THAT HE SAID THAT I DISAGREED WITH.

Q. PLEASE TELL US WHAT THOSE THINGS ARE, AND YOU CAN INCORPORATE THOSE INTO YOUR ANSWER.

A. FOR EXAMPLE, TOWARD THE END OF HIS TESTIMONY HE POINTED TO HIS EXHIBIT 6 OR EXHIBIT J AND K, I BELIEVE. THOSE WERE THE CHARTS THAT SHOW THE DIFFERENT STOCK PRICE MOVEMENTS; AND HE SAID SOMETHING TO THE EFFECT OF YOU SHOULDN'T LOOK AT INDEXES, YOU SHOULD LOOK AT THE INDIVIDUAL STOCKS.

YOU SHOULD LOOK AT THE INDIVIDUAL UNDERLYING DATA,
BUT IT'S ESSENTIAL TO USE INDICES AND TO WEIGHT INDIVIDUAL
STOCKS APPROPRIATELY. AND, IN FACT, THE REAL DANGER HERE AND I
THINK WE SAW IT YESTERDAY, IF YOU LOOK AT ONE GRAPH AND IT
GIVES A VERY MISLEADING IMPRESSION OF WHAT'S GOING ON, AS WE
DISCUSSED EARLIER, I LOOKED AT AN INDUSTRY PREPARED, A STANDARD
INDEX FOR THE HEALTHCARE INDUSTRY. IT SHOWS THE INDUSTRY GOING
UP OR AT MOST DECLINING A LITTLE BIT IN THE LAST TIME PERIOD,
10, 13 PERCENT.

MR. FISCHEL'S GRAPH IS A MISLEADING IMPRESSION OF
WHAT WAS GOING ON IN THE INDUSTRY, IN MY OPINION. HIS CLAIM
THAT ONE SHOULD LOOK AT THE INDIVIDUAL STOCKS AND NOT LOOK AT
THE INDEX, I THINK, IS INCONSISTENT WITH THE PRACTICE OF
FINANCIAL ECONOMISTS VIRTUALLY EVERYWHERE.

THE COURT: CAN I ASK A QUESTION ON THIS GRAPH,
PLEASE?

THE WITNESS: YES.

THE COURT: IT GOES TO THIS DAUBERT STANDARD, AND I'M
REALLY LOOKING AT THE ADVISORY COMMITTEE NOTE WHICH SORT
OF FLUSHES OUT THE DAUBERT STANDARD.

THE GRAPH THAT WE SAW YESTERDAY, THOSE WERE GRAPHS
THAT PROFESSOR FISCHEL PREPARED FOR THIS CASE, WERE THEY
NOT, HE PICKED SPECIFIC STOCKS AND CHARTED THEM FOR THIS
CASE; IS THAT RIGHT?

THE WITNESS: MY UNDERSTANDING IS THAT HE'S CHARTING
PROFESSOR BENSTON'S STOCKS -- I MEAN, SELECTED BY
PROFESSOR BENSTON BASED ON WHAT HE DESCRIBED.

THE COURT: RIGHT. THAT'S CORRECT. YOU MORE

PROPERLY STATED IT.

BUT WHAT YOU'RE SAYING IS THAT WHEN YOU LOOK AT AN
INDEX, THEN YOU'RE TESTIFYING ABOUT MATTERS THAT ARE OUT
THERE IN THE PUBLIC DOMAIN INDEPENDENT OF THIS PARTICULAR
LITIGATION AS OPPOSED TO SOMETHING THAT HAS BEEN UNIQUELY
DEVELOPED FOR PURPOSES OF THE DAMAGES AND OPINIONS HERE.
IN OTHER WORDS, THE INDEX IS THE INDEX OF STANDARD &
POOR --

THE WITNESS: RIGHT.

THE COURT: -- IT WASN'T CREATED IN ORDER TO ADDRESS
AN ISSUE IN THE MCKESSON LITIGATION?

THE WITNESS: THAT'S ONE POINT, AND THAT'S THE REASON
THAT I HAPPEN TO PREFER USING AN INDUSTRY INDEX, BUT
THERE'S A MORE IMPORTANT POINT --

THE COURT: WELL, THIS IS AN IMPORTANT POINT ON THIS
BECAUSE UNDER THE ADVISORY COMMITTEE NOTES TO THE FEDERAL
RULES, WHICH GEORGIA IS PRETTY MUCH TRYING TO FOLLOW THE
FEDERAL RULES WHICH IS INTERESTING DISCUSSION IN ITSELF,
ONE OF THE THINGS WE LOOK AT IS WHETHER EXPERTS ARE
TESTIFYING ABOUT MATTERS WHICH GROW NATIONALLY AND DIRECT
AND RESEARCH THAT HAVE BEEN CONDUCTED INDEPENDENT OF
LITIGATION VERSUS OPINIONS THAT ARE FORMED UNIQUELY ON THE
PARTicular FACTS OF THE CASE AND ARGUABLY WHAT'S MORE
RELIABLE IS STUFF THAT'S OUT THERE IN THE GENERAL WORLD OF RESEARCH ECONOMICALLY THAN SOMETHING THAT IS SORT OF PICK AND CHOOSE FOR THE PURPOSES OF CONVINCING A JURY OR A COURT. THIS WOULD -- INDEXES, IN YOUR JUDGMENT, WOULD BE MORE OF A FORMER AND PARTICULAR STOCK WOULD BE MORE TO THE LEFT. I GUESS THAT'S THE ONLY POINT I'M TRYING TO ADDRESS.

THE WITNESS: I THINK THE CLAIM THAT HERE -- ONCE YOU LOOK AT THE INDIVIDUAL STOCKS AND THE INDICES, IT'S CLEARLY DESIGNED FOR THIS PARTICULAR CASE AND IT'S NOT CONSISTENT WITH INDUSTRY PRACTICE. GRAPHS ARE MISLEADING -- THESE ARE EASILY MISLEADING.

THE COURT: BUT THAT'S WHY YOU DID BOTH?

THE WITNESS: YES.

THE COURT: ALL RIGHT. THANK YOU.

I APOLOGIZE FOR THAT, MR. FELLOWS.

MR. FELLOWS: THAT'S FINE.

Q. (BY MR. FELLOWS) AND SO DID PROFESSOR FISCHEL SHOW THE WEIGHTED AVERAGE OF THE STOCKS?

A. WELL, IT'S VERY INTERESTING. HE SHOWS THE WEIGHTED AVERAGE OF ONE SET OF STOCK; HE SHOWS THE WEIGHTED OF THE SECOND SET OF STOCK. IT'S INTERESTING TO LOOK AT THEM, BUT ONE OF THE THINGS HE EMPHASIZED IN THE DISCUSSION WAS EXHIBIT J WHICH WERE THE MCKESSON COMPARABLES AND THERE WAS A QUICK REFERENCE TO EXHIBIT K BUT NOT MUCH OF ONE.
Q. AND SO THAT THE RECORD IS CLEAR, YOU'RE HOLDING THIS UP FOR US, BUT THE COURT REPORTER CAN'T TAKE THAT DOWN. WHAT DO YOU MEAN BY THERE'S A REFERENCE TO EXHIBIT K AND WHAT'S THE SIGNIFICANCE OF YOUR POINT?

A. EXHIBIT J ARE THE COMPANIES THAT ARE COMPARABLE TO MCKESSON, THE OLD MCKESSON; EXHIBIT K ARE THE COMPANIES THAT ARE COMPARABLE TO THE OLD HBOC.

AND, YES, PROFESSOR FISCHEL DOES HAVE THE INDICES THAT PROFESSOR BENSTON COMPUTED HERE IN EACH OF THESE CHARTS. THEY ARE HARD TO SEE. THEY'RE THE THICKEST RED LINE IN EACH OF THE CHARTS, I BELIEVE. AND YOU CAN SEE THAT, INDEED, IN THE MCKESSON ONE, AT LEAST AFTER SOME TIME PERIOD STARTING ABOUT THE MIDDLE OF THIS TIME PERIOD, THAT INDEX STARTS TO DECLINE.

IN THE UNDER CHART —

THE COURT: YOU'RE TALKING ABOUT "K" NOW?

THE WITNESS: YES.

THE COURT: GO AHEAD.

A. THE INDEX FOR THE OTHER COMPANIES INCREASES THROUGH TIME, ESPECIALLY THROUGH THAT LATE TIME PERIOD.

I'LL ALSO NOTE THAT THE SCALES ARE A LITTLE BIT DIFFERENT HERE WHICH IS ALWAYS AN ISSUE WITH THE CHARTS, BUT REMEMBER THAT HBOC AT THE TIME OF THE MERGER AND CERTAINLY THROUGH THE FIRST QUARTER WAS ABOUT TWO-THIRDS OF THIS COMPANY, SO THE SECOND CHART IS THE MORE IMPORTANT ONE IN DETERMINING WHAT THE APPROPRIATE BENCHMARK IS FOR THE COMBINED COMPANY
CERTAINLY IN THE FIRST QUARTER OF 1999.

SO I BELIEVE THE EMPHASIS ON EXHIBIT J AND ON THE
INDIVIDUAL STOCKS IS MISLEADING AS FAR AS WHAT WAS TRULY GOING
ON HERE ABOUT WHAT THE APPROPRIATE BENCHMARK FOR MCKESSON HBOC
WAS.

Q. (BY MR. FELLOWS) BY CONTRAST, DID PROFESSOR BENSTON
USE A WEIGHTED AVERAGE ACCURATELY SHOWING THE PERFORMANCE OF
THE STOCK INDICES?

A. YES. WHAT PROFESSOR BENSTON DID WAS TO TAKE BOTH OF
THESE INDICES AND TO WEIGHT THEM TOGETHER AND USE A -- AGAIN,
SOME JARGON -- A WEIGHTED AVERAGE OF THE TWO INDICES WITH MORE
WEIGHT ATTACHED TO THE ONE THAT CONTRIBUTED MORE TO THE
COMBINED COMPANY.

Q. NOW, YOU EARLIER TESTIFIED THAT YOU LOOKED AT HEALTH
COMPANY INDICES AND I WILL ASK YOU, BASED ON YOUR EXAMINATION
OF THE HEALTH COMPANY INDICES, WAS YOUR ANALYSIS WITH PROFESSOR
BENSTON CONSISTENT?

A. YES, I THINK LARGELY CONSISTENT.

Q. AND VERY QUICKLY HERE TO WRAP UP, DO YOU AGREE OR
DISAGREE WITH PROFESSOR FISCHEL'S COMMENTS THAT ONE SHOULD
IGNORE THE STATISTICS AND LOOK AT THE PICTURE; THAT IS, A GRAPH
OF INDIVIDUAL STOCKS?

A. CERTAINLY IF IT'S A GENERAL STATEMENT THAT'S WRONG
AND WOULD BE REJECTED BY VIRTUALLY EVERYBODY IN THE
PROFESSION.
Q. WHICH PROFESSION?
A. THE ECONOMICS PROFESSION.
Q. NOW, EVEN THOUGH YOU SAY YOU PREFER TO USE A PUBLISHED INDEX, PLEASE STATE WHETHER YOU BELIEVE THAT PROFESSOR BENSTON'S USE OF THE COMPANIES IDENTIFIED BY MORGAN STANLEY WAS AN APPROPRIATE EXERCISE OF PROFESSIONAL JUDGMENT OF THIS WORK?
A. YES, VERY MUCH SO. I LIKED VERY MUCH THAT HE RELIED ON WHAT OTHERS WITHOUT AN INTEREST IN THIS MATTER HAD DECIDED AS A BASIS FOR HIS OPINION -- OR FOR HIS CONSTRUCTION OF THE INDEX.
Q. AND PLEASE TELL THE COURT WHETHER PROFESSOR BENSTON'S METHODOLOGY IS CONSISTENT WITH INDUSTRY PRACTICE IN YOUR INDUSTRY OF FINANCIAL ECONOMICS?
A. YES, IT'S CERTAINLY WITHIN THE RANGE OF PRACTICE. AS I SAID, I PREFER TO USE THE INDEX -- A READILY AVAILABLE INDEX; AND I THINK THAT'S PROBABLY A LITTLE MORE COMMON BUT THAT MAY HAVE MORE TO DO WITH THE FACT THAT IT'S EASIER THAN CONSTRUCTING YOUR OWN INDEX. CERTAINLY THERE ARE MANY ACADEMIC STUDIES WHERE SPECIALIZED INDICES ARE CONSTRUCTED FOR THE PURPOSE OF THE STUDY.
Q. AND PLEASE STATE WHETHER PROFESSOR FISCHEL'S METHODOLOGY WAS CONSISTENT WITH INDUSTRY PRACTICE IN YOUR INDUSTRY OF FINANCIAL ECONOMICS.
A. WELL, HE DIDN'T INCLUDE OR ATTACH AN EVENT STUDY IN
HIS REPORT -- I MEAN, REFERENCE THAT ONE HAD BEEN DONE IN EARLIER ASPECTS. SO I DON'T HAVE AN EVENT STUDY TO ASSESS. IF YOU'RE REFERENCING HIS ASSERTION THAT ONE SHOULD LOOK AT THE INDIVIDUAL STOCKS AND NOT LOOK AT AGGREGATE STATISTICS, I'VE ALREADY SAID IT'S NOT CONSISTENT WITH INDUSTRY PRACTICE -- ECONOMIC PROFESSIONAL PRACTICE.

MR. FELLOWS: NOTHING FURTHER, YOUR HONOR.

THE COURT: ALL RIGHT. THANK YOU. YOU MAY CROSS-EXAMINE. MR. MALKO, IS IT YOU?

MR. MALKO: YES, IT IS.

MR. MALKO: WOULD YOU MIND IF WE JUST TOOK A SHORT BREAK?

THE COURT: I DON'T MIND AT ALL.

RECESS FOR FIVE MINUTES.

(RECESS AT 11:30 A.M.)

THE COURT: HOW COME YOU ARE HERE.

MR. NEY: ON BEHALF OF THE HALL FAMILY WE HAD A FEW QUESTIONS AND MR. MALKO ALLOWED US TO GO FIRST.

THE COURT: FAIR ENOUGH.

DIRECT EXAMINATION

BY MR. NEY:

Q. DR. VELLRATH, WITH REGARD TO THE ACTUAL EVENT STUDY THAT YOU DID, I WANT TO ASK YOU QUESTIONS ABOUT YOUR METHODOLOGY AS OPPOSED TO DR. BENVSON'S METHODOLOGY AND YOUR PROFESSIONAL JUDGMENT AS TO WHICH IS MORE APPROPRIATE AND