

BATUS-GROUP -- FAX TRANSMITTAL SHEET
Topeka, Kansas

JUL 12 1988

F.A.B.

Date

7/12/88

Number of Pages

(including cover sheet)

SENT

TO

Tony Burke

FAX NUMBER

502/581-8084

CONFIRMING NUMBER

FROM

Terry Chambers

OPERATOR INITIALS:

TIME:

If you have any problem receiving these pages, please call
(913) 233-5885 ext. 334 immediately. Thank you.

Comments:

Kansas Transcript 7/12 PM

LWA & DAS rec'd in Kansas
Filed to Lardox

LWA Alex Exam - pg 305
LWA Cross Exam - pg 310

162.5M

CC: HFF

681612232

GROUP STATUS - BATUS GROUP

BEFORE THE COMMISSIONER OF INSURANCE
OF THE STATE OF KANSAS

In the Matter of the Proposed) Docket No.
Acquisition of Control of) 1270-H
Farmers Group, Inc. and Farmers)
Insurance Company, Inc., by B.A.T.)
Industries P.L.C., Batus, Inc., and)
Batus Financial Services, Inc.)

TRANSCRIPT OF PROCEEDINGS
VOLUME IV

Topeka, Kansas

1:35 p.m.

July 12, 1988

Sowers, Johnson, Beovich, Kirk & Co.

State of Kansas

1001 SW Fifth Avenue Suite 808
Portland, Oregon 97204
Telephone: 503-222-1200

681612233

07.12.88 08:38PM - BATUS GROUP

P R O C E E D I N G S (Resumed)

HEARING EXAMINER TODD: Everybody looks like they're ready, so let's go back on the record, and we'll continue with the direct examination of Mr. Arentsen.

DIRECT EXAMINATION (Resumed)

BY MR. MILLSON:

Q. Mr. Arentsen, I'd like you to look at Exhibit 18 again and go back to page 4699. Can you very briefly tell me what this chart shows?

A. This is the projections for BATUS consolidated, which consolidates the previous projections of Farmers and then of BATUS excluding Farmers, so this consolidates BATUS with Farmers.

Q. This chart is simply a combination of A4695 and 4697?

A. It's a consolidation.

Q. And what it shows is that the combined consolidated group, after paying back the debt, the entire acquisition debt, will have nearly \$2.8 billion in excess cash, excess funds, at the end of 1998; is that correct?

A. Yes. It shows that in 1998, that over that period the consolidated group will generate excess cash of

681612234

40000 00000 00000 00000 00000 00000 00000 00000 00000 00000

1 2.751 billion. The bottom figure which shows in the
2 lower right-hand corner, which takes into account the
3 initial cash balance and the in effect initial
4 payment, shows an ending balance of actual
5 investments of \$2,690,000,000.

6 This is -- as I mentioned earlier, does not
7 include roughly 350 million of beginning excess cash
8 and investments that Farmers currently has which
9 would be added to that.

10 Q. While we were talking about Farmers, will you go back
11 to page A4695 for a second?

12 A. Yes.

13 Q. Now, there's been some reference in these hearings to
14 using this chart to show that SATUS would in here,
15 one, get approximately a seven percent return. Are
16 you familiar with that testimony?

17 A. Yes, I'm generally familiar with that testimony,
18 right.

19 Q. And the testimony looks only at the return in the
20 first year: is that correct?

21 A. I believe that's what it is. It's taking our
22 investment of 4.5 billion, in round figures, and
23 comparing it to Farmers' current income and saying
24 that that represents approximately a seven percent
25 return based on its current income.

681612235

1 Q. Do you believe that that comparison is a realistic
2 way to look at this transaction?

3 A. Well, I think it's an arithmetic exercise that -- it
4 shows a seven percent return in year one, which is --
5 you can't argue with arithmetic on that calculation,
6 but it totally misses the point if it's intended to
7 say, why would BAIUS buy a business that gets a seven
8 percent return?

9 Now, obviously, in buying any business, you not
10 only look at the current earnings, but, much more
11 importantly, you look at the future prospects of the
12 business, and the seven percent return is like a 14
13 times price earnings multiple, which is in the range
14 of what many U.S. companies sell for, so there's
15 nothing unusual about buying into a business that was
16 set at initially a seven percent return.

17 In fact, seven percent return, with the cost of
18 financing and the tax deduction on financing,
19 actually would show, you know, positive net income
20 effect or close to a breakeven in the year one.

21 Q. Okay. In looking at the debt on this chart,
22 obviously, page 4695 obviously shows the payment of
23 the debt. What would happen, in your view, if for
24 some unexpected reason Farmers couldn't finance this
25 debt to BAIUS in quite the way that was shown on this

681612236

BAIUS GROUP - 1985-1986 - 1987-1988 - 1989-1990

1 chart?

2 A. Well, I think your question is, what if there's some
3 unforeseen shortfalls in Farmers and/or Farmers
4 needed additional funds.

5 BATUS would meet with Farmers. They would
6 discuss it with Farmers. We'd work out an
7 arrangement.

8 Obviously, depending on the circumstances, we
9 would need to know what the situation is, but there
10 is no way that we would put Farmers in any financial
11 difficulty on repaying intercompany debt. I'll say
12 once again, that's totally ridiculous.

13 We would either provide additional capital
14 contribution or defer the debt or make whatsoever
15 arrangements were necessary under the circumstances
16 to assist Farmers with its finances.

17 Q. Does BATUS have the funds to be able to do what you
18 just described?

19 A. Yes, we do. We -- as shown on the BATUS schedules,
20 we have significant funds, including borrowing
21 capacity, as does B.A.T.

22 We also have -- even in these projections,
23 there's a lot of dividends, there's a lot of
24 discretionary spending, and we believe that these
25 projections are conservative, so a combining of all

681612237

1 those factors, I cannot see any -- foresee any
2 problems in Farmers being able to operate under this
3 financial structure, or BATUS, for that matter.

4 Q. What advantage do you think that Farmers can achieve
5 from the financial strength of BATUS?

6 A. Well, the financial strength is considerable, not
7 only in BATUS but in B.A.T., and I think that can only
8 enhance the security to the policyholders and enhance
9 Farmers' growth prospects in the sense that financial
10 resources are there and are available.

11 Q. Now, we've spent a day and a half here, your giving
12 testimony about this acquisition. Are these merely
13 your personal views?

14 A. No. I speak for -- I speak for BATUS and I speak for
15 the management of B.A.T.

16 Q. Is there anybody else in either BATUS or B.A.T. who
17 knows more about this transaction than you do?

18 A. No. I'm -- I've been the project leader on the
19 project. I've spent the most time. I've been
20 involved in all aspects of the transaction. I've
21 worked closely with the people at BATUS and the
22 people at B.A.T., including the chairman's policy
23 committee, and I don't know of anybody that would
24 have any more information than I do.

25 MR. MILLSON: Thank you very much. Mr.

681612238

NOV 13 1988 10:21 AM BATUS GROUP

1 Arentsen.

2 I have no further questions.

3 HEARING EXAMINER TODD: Do the attorneys for
4 Farmers have any questions of this witness?

5 MR. SMITH: We have one or two. I believe that
6 Mr. Karic also has some questions on behalf of the
7 Exchanges.

8

9

CROSS-EXAMINATION

10 BY MR. SMITH:

11 Q. Dealing with the -- first, with the exhibit that you
12 have in front of you, Exhibit 16, Mr. Arentsen,
13 you've indicated that -- well, let's turn to page
14 4695, the page that deals with the Farmers Group,
15 Inc. projection of sources and uses of cash.

16 You indicated that you chose 15 percent as the
17 growth factor for 1988 and 10 percent for '89 through
18 '98 because you believe those to be conservative. Is
19 that correct?

20 A. That's correct.

21 Q. Have you done these calculations on this page using
22 any other growth factors?

23 A. I think as a result of a question that came out of
24 the Illinois hearing, we used an eight percent growth
25 factor. The hearing officer requested us to run

681612239

1 these numbers using an eight percent growth factor.

2 Q. Prior to the question from the Illinois hearing
3 officer, had you run these figures on page 4695 using
4 any growth rates other than the ones set forth on
5 this page?

6 A. No, not for purpose of these projections.

7 Q. How did you decide that 10 percent was the correct
8 conservative number rather than nine percent or 11
9 percent or 8.5 percent or any other number?

10 A. Well, as I explained earlier today and yesterday, we
11 looked at the research work that had been done by our
12 consultants, we looked at Farmers' past history,
13 which showed growth rates of 15-plus percent over
14 extended periods of time, we looked at comments that
15 were made by Farmers publicly regarding their outlook
16 for the business, that that past growth rate would
17 continue in the future, and based on all these
18 factors, we believe that the 10 percent growth rate
19 was very conservative.

20 I mentioned the 15 percent in '88 includes
21 reduction of tax rates, so it's really a combination
22 of different factors.

23 Q. While you have explained again why 10 percent is
24 conservative, you really haven't answered my
25 question. Why did you pick 10 percent as a

681612240

END

GROUP - STATUS - 00:00:00

- 1 conservative rate rather than nine percent or 11
2 percent or eight percent? How did you decide that 10
3 percent was the magic number you would pick?
- 4 A. Well, I think I answered that. We looked at all
5 those factors and we felt that 10 percent was very
6 conservative.
- 7 Q. You don't need to repeat your last answer. Was there
8 anything in those numbers that indicated that 10
9 percent was the right number for you to choose?
- 10 A. I think in order to be very conservative, we believe
11 that 10 percent was the best number.
- 12 Q. Well, would eight percent have been more
13 conservative?
- 14 A. Eight percent would be more conservative than 10
15 percent.
- 16 Q. So what made 10 percent the correct conservative
17 number?
- 18 A. It was the correct conservative number in our
19 opinion. Obviously, we wanted to be conservative.
20 We wanted to provide, in effect, a cushion against
21 unforeseen circumstances and did not feel that there
22 was a need to use a lower growth rate.
- 23 Q. Why did you decide 10 percent was the correct
24 conservative number rather than 12 percent?
- 25 A. Well, the actual results may well be 12 percent.

681612241

GROUP STATUS - 08/08/80 12:00

1 Q. Would 12 percent be a conservative number to use in
2 these projections?

3 A. It would not be as conservative as 10 percent.

4 Q. But in preparing these projections, you did not, as
5 you sketched out these numbers, try out any other
6 growth rate factors just to see what they would do
7 rather than simply picking the 10 percent and
8 sticking with it?

9 A. Well, as was explained yesterday, we did several
10 sensitivities back in September and we looked at
11 different growth rates, ranging from ten and a half
12 percent premiums written to 15 percent. We looked at
13 different sensitivities on several different factors,
14 and based on all the subsequent information, we
15 believed that the -- that 10 percent is a reasonable
16 figure. It's a conservative figure and one that we
17 have full confidence that Farmers will be able to
18 achieve.

19 Q. Did you -- let me phrase that a different way. The
20 projection that is here on page 4695, do we have here
21 on this page the first cut that you made of this
22 projection?

23 A. I'm sorry. What do you mean, "first cut"?

24 Q. Well, did you do this in working papers? Did you do
25 this on a computer? I mean, how did you lay these

681612242

GROUP STATUS - 08:00 PM 09/01/90

1 numbers out physically?

2 A. This was done on a computer terminal.

3 Q. And would any calculations run on the computer that
4 showed any of these numbers on this page differ from
5 what we now have on this page?

6 A. Not that I'm aware of. We agreed on the assumptions
7 to be used and the numbers were run on the computer
8 and this was a result.

9 There may have been some corrections by the, you
10 know, people that actually processed it on the
11 computer, but to the best of my knowledge, these are
12 the numbers that were prepared on the computer.

13 Q. So once you agreed on the assumptions, you never
14 changed any of those assumptions at all?

15 A. As I said, none that I'm aware of, unless there were
16 some corrections of errors.

17 Q. But you did not intentionally change any of the
18 assumptions because you decided that your original
19 assumption was not the correct one?

20 A. That's right.

21 Q. And you were never curious to run these numbers with
22 any different assumptions, different sensitivities,
23 to see whether the results would change?

24 A. Well, obviously, I studied the numbers. We had done
25 several sensitivities earlier, as I explained, with

681612243

2025 RELEASE UNDER E.O. 14176

1 different growth rates. We --

2 Q. Were you ever curious to see whether the numbers on
1 — ~~this model would change if you ran sensitivities with~~

4 different assumptions?

5 A. Well, the major assumption here is the growth rate in
6 net income; and as I said, we have run -- looked at
7 different sensitivities on that.

6 Q. On a different model, correct?

9 A. Yes.

10 Q. Were you ever curious to see what would happen on
11 this model if you ran these numbers with a different
12 growth rate?

13 A. No. I looked at this and I saw the cash build-up and
14 the sensitivities with respect to differences in
15 interest rates. We felt very comfortable with the
16 acquisition costs. We felt very comfortable with the
17 cash used for operating investments, which is in
18 excess of what Farmers has spent and is in excess of
19 what they said they are going to spend.

20 We explained earlier how the dividends and debt
21 service payments were calculated, so we felt very
22 comfortable with these figures.

23 Q. Now, the only thing that you did change at the bottom
24 of this is you determined what would happen to the
25 accumulation of short-term investments if the life

681612244

1 company earnings were all retained; is that correct?

2 A. That's correct.

3 Q. Why did you want to study the question of the effect
4 on the cumulation of available short-term investments
5 if the life earnings were retained?

6 A. Well, we didn't know what Farmers' opinion was with
7 respect to the payment of the life company to the
8 management company, which owns the life company, and
9 so --

10 In the last two or three years, at least,
11 Farmers has not paid dividends out of the life
12 company. They have substantial funds that build up
13 in the life companies, and until the tax law change,
14 there was a tax advantage to leaving money down in
15 the life companies.

16 I don't know if that's why they left the money
17 down there, but it might be. We just need the
18 opportunity to review that with Farmers.

19 Q. Would you turn to page 4697, Mr. Arentsen, of the
20 BATUS projection. Did you study -- excuse me. Did
21 you run any --

22 Did you run this study using any other
23 assumptions other than those set forth in this
24 document?

25 A. Yes. We initially for the first time, the net income

681612245

2025 RELEASE UNDER E.O. 14176

1 from operations, used the actual figures from our
2 five-year plan, and then it was agreed among the
3 parties that we would not disclose our internal
4 plans, so we changed the numbers from our actual
5 numbers in the five-year plan from net income to the
6 15 and 10 percent figures, which are more
7 conservative than our five-year plan.

8 Q. Have you looked at what would happen to this BATUS
9 projection on page 4697 if you lowered the growth
10 rate?

11 A. Now, here again, in our planning process, we look at
12 different sensitivities, and we felt very comfortable
13 that the 10 percent was a conservative figure.

14 Q. Are you aware that in one of the earlier hearings,
15 Mr. Faulwell testified that he ran these numbers at
16 an eight percent growth rate and that this projection
17 ended up with a cash shortfall?

18 A. I don't remember that testimony.

19 Q. You indicated you ran the Farmers projections on page
20 4695 at an eight percent growth rate. Is it your
21 testimony that you have not similarly run the BATUS
22 projections on page 4697 with an eight percent growth
23 rate?

24 A. To the best of my knowledge, it only applied to the
25 Farmers projections.

681612246

GROUP - BATUS - 1980-1981

- 1 Q. So you don't know whether these projections on page
2 4697 work or not with an eight percent growth rate?
3 Is that your testimony?
- 4 A. Well, the point is that even with an eight percent
5 growth rate for BATUS, there are excess funds
6 building up, and BATUS also --
- 7 Q. Let's start with my question, Mr. Arentsen. Does
8 this projection on page 4697, does it work? Does it
9 show a positive build-up of cash if one uses an eight
10 percent growth rate?
- 11 MR. MILLSON: I believe the witness was
12 answering that question when you interrupted him.
- 13 MR. SMITH: I don't believe he was.
- 14 Q. But can you answer that question?
- 15 A. I don't know what the cash figure would be. What I
16 was trying to explain, Mr. Smith, is that the
17 transaction is financeable and BATUS can repay the
18 debt with an eight percent growth rate.
- 19 Q. How do you know that?
- 20 A. Well, because we build up substantial equity here.
- 21 Q. What happens to that equity if the growth rate is
22 only eight percent?
- 23 A. Will you let me answer the question, Mr. Smith?
- 24 Q. Well, if you answer my questions, yes.
- 25 A. I'm trying to. Would you repeat your question and

681612247

BATUS - 1980-1981 - 1982-1983 - 1984-1985 - 1986-1987 - 1988-1989 - 1990-1991 - 1992-1993 - 1994-1995 - 1996-1997 - 1998-1999 - 2000-2001 - 2002-2003 - 2004-2005 - 2006-2007 - 2008-2009 - 2010-2011 - 2012-2013 - 2014-2015 - 2016-2017 - 2018-2019 - 2020-2021 - 2022-2023 - 2024-2025 - 2026-2027 - 2028-2029 - 2030-2031 - 2032-2033 - 2034-2035 - 2036-2037 - 2038-2039 - 2040-2041 - 2042-2043 - 2044-2045 - 2046-2047 - 2048-2049 - 2050-2051 - 2052-2053 - 2054-2055 - 2056-2057 - 2058-2059 - 2060-2061 - 2062-2063 - 2064-2065 - 2066-2067 - 2068-2069 - 2070-2071 - 2072-2073 - 2074-2075 - 2076-2077 - 2078-2079 - 2080-2081 - 2082-2083 - 2084-2085 - 2086-2087 - 2088-2089 - 2090-2091 - 2092-2093 - 2094-2095 - 2096-2097 - 2098-2099 - 2100-2101 - 2102-2103 - 2104-2105 - 2106-2107 - 2108-2109 - 2110-2111 - 2112-2113 - 2114-2115 - 2116-2117 - 2118-2119 - 2120-2121 - 2122-2123 - 2124-2125 - 2126-2127 - 2128-2129 - 2130-2131 - 2132-2133 - 2134-2135 - 2136-2137 - 2138-2139 - 2140-2141 - 2142-2143 - 2144-2145 - 2146-2147 - 2148-2149 - 2150-2151 - 2152-2153 - 2154-2155 - 2156-2157 - 2158-2159 - 2160-2161 - 2162-2163 - 2164-2165 - 2166-2167 - 2168-2169 - 2170-2171 - 2172-2173 - 2174-2175 - 2176-2177 - 2178-2179 - 2180-2181 - 2182-2183 - 2184-2185 - 2186-2187 - 2188-2189 - 2190-2191 - 2192-2193 - 2194-2195 - 2196-2197 - 2198-2199 - 2200-2201 - 2202-2203 - 2204-2205 - 2206-2207 - 2208-2209 - 2210-2211 - 2212-2213 - 2214-2215 - 2216-2217 - 2218-2219 - 2220-2221 - 2222-2223 - 2224-2225 - 2226-2227 - 2228-2229 - 2230-2231 - 2232-2233 - 2234-2235 - 2236-2237 - 2238-2239 - 2240-2241 - 2242-2243 - 2244-2245 - 2246-2247 - 2248-2249 - 2250-2251 - 2252-2253 - 2254-2255 - 2256-2257 - 2258-2259 - 2260-2261 - 2262-2263 - 2264-2265 - 2266-2267 - 2268-2269 - 2270-2271 - 2272-2273 - 2274-2275 - 2276-2277 - 2278-2279 - 2280-2281 - 2282-2283 - 2284-2285 - 2286-2287 - 2288-2289 - 2290-2291 - 2292-2293 - 2294-2295 - 2296-2297 - 2298-2299 - 2300-2301 - 2302-2303 - 2304-2305 - 2306-2307 - 2308-2309 - 2310-2311 - 2312-2313 - 2314-2315 - 2316-2317 - 2318-2319 - 2320-2321 - 2322-2323 - 2324-2325 - 2326-2327 - 2328-2329 - 2330-2331 - 2332-2333 - 2334-2335 - 2336-2337 - 2338-2339 - 2340-2341 - 2342-2343 - 2344-2345 - 2346-2347 - 2348-2349 - 2350-2351 - 2352-2353 - 2354-2355 - 2356-2357 - 2358-2359 - 2360-2361 - 2362-2363 - 2364-2365 - 2366-2367 - 2368-2369 - 2370-2371 - 2372-2373 - 2374-2375 - 2376-2377 - 2378-2379 - 2380-2381 - 2382-2383 - 2384-2385 - 2386-2387 - 2388-2389 - 2390-2391 - 2392-2393 - 2394-2395 - 2396-2397 - 2398-2399 - 2400-2401 - 2402-2403 - 2404-2405 - 2406-2407 - 2408-2409 - 2410-2411 - 2412-2413 - 2414-2415 - 2416-2417 - 2418-2419 - 2420-2421 - 2422-2423 - 2424-2425 - 2426-2427 - 2428-2429 - 2430-2431 - 2432-2433 - 2434-2435 - 2436-2437 - 2438-2439 - 2440-2441 - 2442-2443 - 2444-2445 - 2446-2447 - 2448-2449 - 2450-2451 - 2452-2453 - 2454-2455 - 2456-2457 - 2458-2459 - 2460-2461 - 2462-2463 - 2464-2465 - 2466-2467 - 2468-2469 - 2470-2471 - 2472-2473 - 2474-2475 - 2476-2477 - 2478-2479 - 2480-2481 - 2482-2483 - 2484-2485 - 2486-2487 - 2488-2489 - 2490-2491 - 2492-2493 - 2494-2495 - 2496-2497 - 2498-2499 - 2500-2501 - 2502-2503 - 2504-2505 - 2506-2507 - 2508-2509 - 2510-2511 - 2512-2513 - 2514-2515 - 2516-2517 - 2518-2519 - 2520-2521 - 2522-2523 - 2524-2525 - 2526-2527 - 2528-2529 - 2530-2531 - 2532-2533 - 2534-2535 - 2536-2537 - 2538-2539 - 2540-2541 - 2542-2543 - 2544-2545 - 2546-2547 - 2548-2549 - 2550-2551 - 2552-2553 - 2554-2555 - 2556-2557 - 2558-2559 - 2560-2561 - 2562-2563 - 2564-2565 - 2566-2567 - 2568-2569 - 2570-2571 - 2572-2573 - 2574-2575 - 2576-2577 - 2578-2579 - 2580-2581 - 2582-2583 - 2584-2585 - 2586-2587 - 2588-2589 - 2590-2591 - 2592-2593 - 2594-2595 - 2596-2597 - 2598-2599 - 2600-2601 - 2602-2603 - 2604-2605 - 2606-2607 - 2608-2609 - 2610-2611 - 2612-2613 - 2614-2615 - 2616-2617 - 2618-2619 - 2620-2621 - 2622-2623 - 2624-2625 - 2626-2627 - 2628-2629 - 2630-2631 - 2632-2633 - 2634-2635 - 2636-2637 - 2638-2639 - 2640-2641 - 2642-2643 - 2644-2645 - 2646-2647 - 2648-2649 - 2650-2651 - 2652-2653 - 2654-2655 - 2656-2657 - 2658-2659 - 2660-2661 - 2662-2663 - 2664-2665 - 2666-2667 - 2668-2669 - 2670-2671 - 2672-2673 - 2674-2675 - 2676-2677 - 2678-2679 - 2680-2681 - 2682-2683 - 2684-2685 - 2686-2687 - 2688-2689 - 2690-2691 - 2692-2693 - 2694-2695 - 2696-2697 - 2698-2699 - 2700-2701 - 2702-2703 - 2704-2705 - 2706-2707 - 2708-2709 - 2710-2711 - 2712-2713 - 2714-2715 - 2716-2717 - 2718-2719 - 2720-2721 - 2722-2723 - 2724-2725 - 2726-2727 - 2728-2729 - 2730-2731 - 2732-2733 - 2734-2735 - 2736-2737 - 2738-2739 - 2740-2741 - 2742-2743 - 2744-2745 - 2746-2747 - 2748-2749 - 2750-2751 - 2752-2753 - 2754-2755 - 2756-2757 - 2758-2759 - 2760-2761 - 2762-2763 - 2764-2765 - 2766-2767 - 2768-2769 - 2770-2771 - 2772-2773 - 2774-2775 - 2776-2777 - 2778-2779 - 2780-2781 - 2782-2783 - 2784-2785 - 2786-2787 - 2788-2789 - 2790-2791 - 2792-2793 - 2794-2795 - 2796-2797 - 2798-2799 - 2800-2801 - 2802-2803 - 2804-2805 - 2806-2807 - 2808-2809 - 2810-2811 - 2812-2813 - 2814-2815 - 2816-2817 - 2818-2819 - 2820-2821 - 2822-2823 - 2824-2825 - 2826-2827 - 2828-2829 - 2830-2831 - 2832-2833 - 2834-2835 - 2836-2837 - 2838-2839 - 2840-2841 - 2842-2843 - 2844-2845 - 2846-2847 - 2848-2849 - 2850-2851 - 2852-2853 - 2854-2855 - 2856-2857 - 2858-2859 - 2860-2861 - 2862-2863 - 2864-2865 - 2866-2867 - 2868-2869 - 2870-2871 - 2872-2873 - 2874-2875 - 2876-2877 - 2878-2879 - 2880-2881 - 2882-2883 - 2884-2885 - 2886-2887 - 2888-2889 - 2890-2891 - 2892-2893 - 2894-2895 - 2896-2897 - 2898-2899 - 2900-2901 - 2902-2903 - 2904-2905 - 2906-2907 - 2908-2909 - 2910-2911 - 2912-2913 - 2914-2915 - 2916-2917 - 2918-2919 - 2920-2921 - 2922-2923 - 2924-2925 - 2926-2927 - 2928-2929 - 2930-2931 - 2932-2933 - 2934-2935 - 2936-2937 - 2938-2939 - 2940-2941 - 2942-2943 - 2944-2945 - 2946-2947 - 2948-2949 - 2950-2951 - 2952-2953 - 2954-2955 - 2956-2957 - 2958-2959 - 2960-2961 - 2962-2963 - 2964-2965 - 2966-2967 - 2968-2969 - 2970-2971 - 2972-2973 - 2974-2975 - 2976-2977 - 2978-2979 - 2980-2981 - 2982-2983 - 2984-2985 - 2986-2987 - 2988-2989 - 2990-2991 - 2992-2993 - 2994-2995 - 2996-2997 - 2998-2999 - 3000-3001 - 3002-3003 - 3004-3005 - 3006-3007 - 3008-3009 - 3010-3011 - 3012-3013 - 3014-3015 - 3016-3017 - 3018-3019 - 3020-3021 - 3022-3023 - 3024-3025 - 3026-3027 - 3028-3029 - 3030-3031 - 3032-3033 - 3034-3035 - 3036-3037 - 3038-3039 - 3040-3041 - 3042-3043 - 3044-3045 - 3046-3047 - 3048-3049 - 3050-3051 - 3052-3053 - 3054-3055 - 3056-3057 - 3058-3059 - 3060-3061 - 3062-3063 - 3064-3065 - 3066-3067 - 3068-3069 - 3070-3071 - 3072-3073 - 3074-3075 - 3076-3077 - 3078-3079 - 3080-3081 - 3082-3083 - 3084-3085 - 3086-3087 - 3088-3089 - 3090-3091 - 3092-3093 - 3094-3095 - 3096-3097 - 3098-3099 - 3100-3101 - 3102-3103 - 3104-3105 - 3106-3107 - 3108-3109 - 3110-3111 - 3112-3113 - 3114-3115 - 3116-3117 - 3118-3119 - 3120-3121 - 3122-3123 - 3124-3125 - 3126-3127 - 3128-3129 - 3130-3131 - 3132-3133 - 3134-3135 - 3136-3137 - 3138-3139 - 3140-3141 - 3142-3143 - 3144-3145 - 3146-3147 - 3148-3149 - 3150-3151 - 3152-3153 - 3154-3155 - 3156-3157 - 3158-3159 - 3160-3161 - 3162-3163 - 3164-3165 - 3166-3167 - 3168-3169 - 3170-3171 - 3172-3173 - 3174-3175 - 3176-3177 - 3178-3179 - 3180-3181 - 3182-3183 - 3184-3185 - 3186-3187 - 3188-3189 - 3190-3191 - 3192-3193 - 3194-3195 - 3196-3197 - 3198-3199 - 3200-3201 - 3202-3203 - 3204-3205 - 3206-3207 - 3208-3209 - 3210-3211 - 3212-3213 - 3214-3215 - 3216-3217 - 3218-3219 - 3220-3221 - 3222-3223 - 3224-3225 - 3226-3227 - 3228-3229 - 3230-3231 - 3232-3233 - 3234-3235 - 3236-3237 - 3238-3239 - 3240-3241 - 3242-3243 - 3244-3245 - 3246-3247 - 3248-3249 - 3250-3251 - 3252-3253 - 3254-3255 - 3256-3257 - 3258-3259 - 3260-3261 - 3262-3263 - 3264-3265 - 3266-3267 - 3268-3269 - 3270-3271 - 3272-3273 - 3274-3275 - 3276-3277 - 3278-3279 - 3280-3281 - 3282-3283 - 3284-3285 - 3286-3287 - 3288-3289 - 3290-3291 - 3292-3293 - 3294-3295 - 3296-3297 - 3298-3299 - 3300-3301 - 3302-3303 - 3304-3305 - 3306-3307 - 3308-3309 - 3310-3311 - 3312-3313 - 3314-3315 - 3316-3317 - 3318-3319 - 3320-3321 - 3322-3323 - 3324-3325 - 3326-3327 - 3328-3329 - 3330-3331 - 3332-3333 - 3334-3335 - 3336-3337 - 3338-3339 - 3340-3341 - 3342-3343 - 3344-3345 - 3346-3347 - 3348-3349 - 3350-3351 - 3352-3353 - 3354-3355 - 3356-3357 - 3358-3359 - 3360-3361 - 3362-3363 - 3364-3365 - 3366-3367 - 3368-3369 - 3370-3371 - 3372-3373 - 3374-3375 - 3376-3377 - 3378-3379 - 3380-3381 - 3382-3383 - 3384-3385 - 3386-3387 - 3388-3389 - 3390-3391 - 3392-3393 - 3394-3395 - 3396-3397 - 3398-3399 - 3400-3401 - 3402-3403 - 3404-3405 - 3406-3407 - 3408-3409 - 3410-3411 - 3412-3413 - 3414-3415 - 3416-3417 - 3418-3419 - 3420-3421 - 3422-3423 - 3424-3425 - 3426-3427 - 3428-3429 - 3430-3431 - 3432-3433 - 3434-3435 - 3436-3437 - 3438-3439 - 3440-3441 - 3442-3443 - 3444-3445 - 3446-3447 - 3448-3449 - 3450-3451 - 3452-3453 - 3454-3455 - 3456-3457 - 3458-3459 - 3460-3461 - 3462-3463 - 3464-3465 - 3466-3467 - 3468-3469 - 3470-3471 - 3472-3473 - 3474-3475 - 3476-3477 - 3478-3479 - 3480-3481 - 3482-3483 - 3484-3485 - 3486-3487 - 3488-3489 - 3490-3491 - 3492-3493 - 3494-3495 - 3496-3497 - 3498-3499 - 3500-3501 - 3502-3503 - 3504-3505 - 3506-3507 - 3508-3509 - 3510-3511 - 3512-3513 - 3514-3515 - 3516-3517 - 3518-3519 - 3520-3521 - 3522-3523 - 3524-3525 - 3526-3527 - 3528-3529 - 3530-3531 - 3532-3533 - 3534-3535 - 3536-3537 - 3538-3539 - 3540-3541 - 3542-3543 - 3544-3545 - 3546-3547 - 3548-3549 - 3550-3551 - 3552-3553 - 3554-3555 - 3556-3557 - 3558-3559 - 3560-3561 - 3562-3563 - 3564-3565 - 3566-3567 - 3568-3569 - 3570-3571 - 3572-3573 - 3574-3575 - 3576-3577 - 3578-3579 - 3580-3581 - 3582-3583 - 3584-3585 - 3586-3587 - 3588-3589 - 3590-3591 - 3592-3593 - 3594-3595 - 3596-3597 - 3598-3599 - 3600-3601 - 3602-3603 - 3604-3605 - 3606-3607 - 3608-3609 - 3610-3611 - 3612-3613 - 3614-3615 - 3616-3617 - 3618-3619 - 3620-3621 - 3622-3623 - 3624-3625 - 3626-3627 - 3628-3629 - 3630-3631 - 3632-3633 - 3634-3635 - 3636-3637 - 3638-3639 - 3640-3641 - 3642-3643 - 3644-3645 - 3646-3647 - 3648-3649 - 3650-3651 - 3652-3653 - 3654-3655 - 3656-3657 - 3658-3659 - 3660-3661 - 3662-3663 - 3664-3665 - 3666-3667 - 3668-3669 - 3670-3671 - 3672-3673 - 3674-3675 - 3676-3677 - 3678-3679 - 3680-3681 - 3682-3683 - 3684-3685 - 3686-3687 - 3688-3689 - 3690-3691 - 3692-3693 - 3694-3695 - 3696-3697 - 3698-3699 - 3700-3701 - 3702-3703 - 3704-3705 - 3706-3707 - 3708-3709 - 3710-3711 - 3712-3713 - 3714-3715 - 3716-3717 - 3718-3719 - 3720-3721 - 3722-3723 - 3724-3725 - 3726-3727 - 3728-3729 - 3730-3731 - 3732-3733 - 3734-3735 - 3736-3737 - 3738-3739 - 3740-3741 - 3742-3743 - 3744-3745 - 3746-3747 - 3748-3749 - 3750-3751 - 3752-3753 - 3754-3755 - 3756-3757 - 3758-3759 - 3760-3761 - 3762-3763 - 3764-3765 - 3766-3767 - 3768-3769 - 3770-3771 - 3772-3773 - 3774-3775 - 3776-3777 - 3778-3779 - 3780-3781 - 3782-3783 - 3784-3785 - 3786-3787 - 3788-3789 - 3790-3791 - 3792-3793 - 3794-3795 - 3796-3797 - 3798-3799 - 3800-3801 - 3802-3803 - 3804-3805 - 3806-3807 - 3808-3809 - 3810-3811 - 3812-3813 - 3814-3815 - 3816-3817 - 3818-3819 - 3820-3821 - 3822-3823 - 3824-3825 - 3826-3827 - 3828-3829 - 3830-3831 - 3832-3833 - 3834-3835 - 3836-3837 - 3838-3839 - 3840-3841 - 3842-3843 - 3844-3845 - 3846-3847 - 3848-3849 - 3850-3851 - 3852-3853 - 3854-3855 - 3856-3857 - 3858-3859 - 3860-3861 - 3862-3863 - 3864-3865 - 3866-3867 - 3868-3869 - 3870-3871 - 3872-3873 - 3874-3875 - 3876-3877 - 3878-3879 - 3880-3881 - 3882-3883 - 3884-3885 - 3886-3887 - 3888-3889 - 3890-3891 - 3892-3893 - 3894-3895 - 3896-3897 - 3898-3899 - 3900-3901 - 3902-3903 - 3904-3905 - 3906-3907 - 3908-3909 - 3910-3911 - 3912-3913 - 3914-3915 - 3916-3917 - 3918-3919 - 3920-3921 - 3922-3923 - 3924-3925 - 3926-3927 - 3928-3929 - 3930-3931 - 3932-3933 - 3934-3935 - 3936-3937 - 3938-3939 - 3940-3941 - 3942-3943 - 3944-3945 - 3946-3947 - 3948-3949 - 3950-3951 - 3952-3953 - 3954-3955 - 3956-3957 - 3958-3959 - 3960-3961 - 3962-3963 - 3964-3965 - 3966-3967 - 3968-3969 - 3970-3971 - 3972-3973 - 3974-3975 - 3976-3977 - 3978-3979 - 3980-3981 - 3982-3983 - 3984-3985 - 3986-3987 - 3988-3989 - 3990-3991 - 3992-3993 - 3994-3995 - 3996-3997 - 3998-3999 - 4000-4001 - 4002-4003 - 4004-4005 - 4006-4007 - 4008-4009 - 4010-4011 - 4012-4013 - 4014-4015 - 4016-4017 - 4018-4019 - 4020-4021 - 4022-4023 - 4024-4025 - 4026-4027 - 4028-4029 - 4030-4031 - 4032-4033 - 4034-4035 - 4036-4037 - 4038-4039 - 4040-4041 - 4042-4043 - 4044-4045 - 4046-4047 - 4048-4049 - 4050-4051 - 4052-4053 - 4054-4055 - 4056-4057 - 4058-4059 - 4060-4061 - 4062-4063 - 4064-4065 - 4066-4067 - 4068-4069 - 4070-4071 - 4072-4073 - 4074-4075 - 4076-4077 - 4078-4079 - 4080-4081 - 4082-4083 - 4084-4085 - 4086-4087 - 4088-4089 - 4090-4091 - 4092-4093 - 4094-4095 - 4096-4097 - 4098-4099 - 4100-4101 - 4102-4103 - 4104-4105 - 4106-4107 - 4108-4109 - 4110-4111 - 4112-4113 - 4114-4115 - 4116-4117 - 4118-4119 - 4120-4121 - 4122-4123 - 4124-4125 - 4126-4127 - 4128-4129 - 4130-4131 - 4132-4133 - 4134-4135 - 4136-413

1 we'll go back to it.

2 Q. How do you know that BATUS can finance the
3 transaction with an eight percent growth rate if you
4 haven't done any calculations at eight percent?

5 A. I know because, for one thing, these projections
6 provide for a significant amount of dividends to
7 B.A.T. They provide for, I think, between four and
8 five billion dollars worth of dividends, and,
9 obviously, if there was a shortfall in paying our
10 debt payments to B.A.T, the first thing would be, we
11 would reduce dividends.

12 Beyond that, there are significant investments
13 in here, operating investments, another four to five
14 billion, which we've deducted. Beyond that, we have
15 substantial amounts of equity that build up and no
16 new debt, so there is a borrowing capacity.

17 And beyond that, we have the financial strength
18 of B.A.T. behind us.

19 Q. The question that I asked you initially, Mr.
20 Arentsen, which I still don't believe you answered,
21 does this projection on page 4697 develop a positive
22 cash build-up if one uses an eight percent growth
23 rate instead of the 10 percent growth rate which you
24 project?

25 A. With that narrow question for me to answer that, we

681612248

BATTLES GROUP

1 would have to run the numbers, Mr. Smith.

2 Q. So you don't know?

3 Now, you indicated that there is cash you've
4 shown coming out of here to go into operating
5 investments. Do you believe that if you eliminate
6 those operating investments, you can still show the
7 same growth rate that you've projected?

8 A. No. If you eliminate the operating investments, you
9 cannot show the same growth rate, but, obviously,
10 there is discretion as to timing of capital
11 expenditures.

12 Q. What percentage of the income, net income, that you
13 project has historically come from BATUS's tobacco
14 operations?

15 A. Well, that's -- if I can use the figures from the
16 last three years on operating income as shown on page
17 33 of our annual report, in '85, tobacco provided
18 61.5 percent, in '86 it was 61.9, and in '87, 67.4
19 percent.

20 Q. Have you done any study as to how BATUS could handle
21 the acquisition debt if its income from its tobacco
22 businesses was to be substantially reduced?

23 A. There was a question that came, I believe, from the
24 hearing officer in Ohio along those lines, and we
25 prepared a response to that.

681612249

2000 01 10 10:00 AM - BATUS GROUP

1 Q. And what was the response?

2 A. Well, there's a document to that effect.

3 Q. Did you prepare the document?

4 A. I participated in the preparation of it.

5 Q. Do you know what it says?

6 A. Well, it's a lengthy document. In general, it says

7 that BATUS and B.A.T have plenty of financial

8 resources, even in the event that there was a

9 significant shortfall in Brown & Williamson's

10 earnings.

11 Q. Does Brown & Williamson have any reserves on its

12 books for potential tobacco products liability

13 judgments?

14 A. No.

15 Q. Does Brown & Williamson have any insurance for

16 tobacco products liability judgments?

17 A. No.

18 Q. Does Brown & Williamson have any insurance coverage

19 for the costs of defense of tobacco products

20 liability suits?

21 A. Not that I'm aware of.

22 Q. Has Brown & Williamson ever done any studies as to

23 its potential exposure from tobacco products

24 liability suits?

25 A. Not that I'm aware of.

281612250

1 Q. Hasn't Brown & Williamson agreed to hold harmless all
2 of its wholesale tobacco distributors from any
3 tobacco products liability suits?

4 A. I don't know the answer to that.

5 Q. Are you familiar with the National Association of
6 Tobacco Distributors?

7 A. I know there is a national association, yes, but I'm
8 not very familiar with it.

9 Q. Haven't they extracted from -- excuse me. Haven't
10 they obtained from Brown & Williamson a hold harmless
11 agreement with respect to potential liability from
12 tobacco products liability suits as a condition of
13 continuing to distribute Brown & Williamson products?

14 A. I don't know.

15 Q. Who would know?

16 A. That's obviously somebody at Brown & Williamson;
17 somebody in their legal department, I imagine.

18 Q. You will not expect someone at BATUS to know of such
19 a hold harmless agreement?

20 A. I think that's a tobacco operating company issue,
21 and, as I said, I'm not aware of it.

22 Q. You don't see any potential financial impact on BATUS
23 from such a hold harmless agreement?

24 MR. MILLSON: I wonder if we're getting very
25 speculative given the fact the witness says he

681612251

GROUP - BATUS GROUP

1 doesn't know about it.

2 HEARING EXAMINER TODD: I believe the witness
3 answered your question.

4 MR. SMITH: I'll move on.

5 Q. Mr. Arentsen, you testified earlier today with
6 respect to page 4695, the Farmers projections,
7 Exhibit 15, that the term "short-term investments" on
8 this page are not intended -- or the term is not
9 intended to mean investments held for a period of
10 less than one year. Is that correct?

11 A. That's correct.

12 Q. And that you do not intend to in any fashion change
13 Farmers' investment policy as between what Farmers
14 would call short-term and longer-term investments?

15 A. That's correct.

16 Q. How is the reader of this document and this page to
17 know what definition you give "short-term
18 investments"?

19 A. Well, I guess it depends how knowledgeable the reader
20 is of the document. In BAUS, when we put together
21 projections of this nature, the purpose of it is to
22 -- at least in these projections, is to come up with
23 the amount of cash that's available after you have
24 identified all the specific needs in the business.
25 And that balance, which we do call increase in

681612252

GROUP STATUS + NEEDS 98 10 100

10 at

1 investments?

2 A. Short-term investments in an accounting sense
3 generally mean investments that can be turned into
4 cash in the short-term; and, normally, the
5 investments would generally have maturity in less
6 than a year.

7 Q. This is the first hearing, is it not, in which you
8 have testified that the term "short-term investments"
9 on this page means something other than what one
10 would commonly understand it to mean?

11 A. Well, it's the first hearing in which we have gotten
12 into this issue because I guess it wasn't raised
13 until Professor Buser in Ohio brought up the issue.
14 At least, it was always clear in my mind and at SATUS
15 what it meant, but, obviously, he did not understand
16 it.

17 Q. When you stated it was clear what it meant in your
18 mind, you don't dispute, do you, that what you are
19 now saying it means is something different from the
20 commonly understood meaning of the term "short-term
21 investment"?

22 A. What I'm saying is that it means investments that
23 could be converted into cash in the short-term.
24 Investments may be a longer-term bond or common
25 stocks, but they would be marketable securities that

681612254

2025 RELEASE UNDER E.O. 14176

1 could be sold in the short term, and that was the
2 context in which we used it, which is a business
3 point of view context, not necessarily the technical
4 accounting context of investments having a maturity
5 in less than one year.

6 Q. As you know, Mr. Arentsen, we've talked a lot in
7 various of the proceedings about what documents were
8 retained and not retained and what was shredded and
9 wasn't shredded.

10 Were these projections, Exhibit 18, the April 7,
11 1988 projections, prepared without the assistance of
12 any work papers whatsoever?

13 A. I'm not aware of any work papers. It was all done on
14 the computer.

15 Q. And nothing on the computer screen beyond what we see
16 in this Exhibit 18 was printed out in hard copy?

17 A. This is a hard -- a copy of the hard copy.

18 Q. But there was no earlier hard copy printed out when
19 you first put the numbers in to see if they came out
20 correctly? You had no trial runs?

21 A. I'm not aware of any, unless there were -- people
22 that were running the runs made corrections and that
23 sort of thing.

24 The assumptions at the back were typed on a word
25 processor, and I think the narrative at the front was

681612255

CONFIDENTIAL - BATUS GROUP

BROWN & WILLIAMSON
1994 - 95 COLLECTION

ARCHIVE VARIANCE FORM

THE NUMBER (RANGE) 681612256 IS

() MISSING

() MISSING IN ALL SETS

() MISSING IN CLOSED AND REVIEW SETS

() DELETED

() CHANGED TO _____

() DELETED AND CHANGED TO _____

(☒) NOT USED

() OTHER

() ADDED

DATE OF CHANGE

CLOSED SET 8-2-96

REVIEW SET 8-2-96

- 1 typed on a word processor.
- 2 Q. I'm really talking about the numerical schedules and
3 tables, and those, you think you put into the
4 computer, got them right and made one single printout
5 and we have that one here? Is that your testimony?
- 6 A. Well, as I mentioned, before that, we ran the numbers
7 using BATUS five-year plan figures and then we
8 adjusted BATUS to use the 15 and 10 percent growth
9 rates, but I'm not aware of any --
- 10 Q. But all of that was on a different model, correct?
- 11 A. Pardon?
- 12 Q. All of the use of different growth rates is on a
13 different model?
- 14 A. No. When I said the BATUS figures, where we used the
15 five-year plan --
- 16 Q. I see.
- 17 A. -- income, we used the same model, but we just put in
18 the five-year plan income figures as opposed to the
19 10 percent growth figures.
- 20 Q. And that projection has never been approved?
- 21 A. No. It was agreed that we would not produce our
22 actual plan figures.
- 23 MR. MILLSON: I believe the projection is being
24 produced with the plan figures masked out, Mr. Smith.
- 25 Q. Have you heard of the firm Wentz-Nealy, Mr. Arentsen?

681612257

APPROVED FOR RELEASE BY NSA/CSS

- 1 A. The name sounds familiar, but I can't recall what it
2 is.
- 3 Q. Do you know of a Louisville, Kentucky public
4 relations firm that has at least in the past done
5 work for Brown & Williamson by that name?
- 6 A. There may be. I don't know whether they've done any
7 work for Brown & Williamson.
- 8 Q. Have you ever seen a booklet put out by Brown &
9 Williamson and distributed to senior and mid-level
10 management explaining how to respond to questions
11 about the relationship between smoking and health?
- 12 A. I have seen information of that nature that Brown &
13 Williamson has put out.
- 14 Q. Do you know whether the firm of Wentz-Neely prepared
15 such a booklet for Brown & Williamson?
- 16 A. No. As I said, I don't know that.
- 17 Q. Have you read that -- have you read the booklet that
18 you did refer to that you were aware of that Brown &
19 Williamson had put out?
- 20 A. Well, I said I have read the information of that
21 nature from Brown & Williamson. I don't know if it's
22 the booklet you are referring to.
- 23 Q. When did you see that booklet?
- 24 MR. MILLSON: Can I have the question back? I'm
25 just not sure that it matches with his prior

681612258

1 testimony.

2 Q. The information that you saw, what format was it in?

3 A. Question and answer format.

4 Q. And was it a pamphlet or a booklet that contained a
5 series of questions and answers?

6 A. I think I did see something of that nature, yes.

7 Q. And when did you last see that booklet?

8 A. Oh, on -- it must have been at least several months
9 ago.

10 Q. Have you reviewed it since the start of these
11 administrative proceedings?

12 MR. HILLSON: I'm not sure what the relevance of
13 this whole line of questioning is. I'm not sure of
14 what -- the relevance of whether he has reviewed
15 something since the start of this administrative
16 proceedings.

17 Maybe this is the time where I can just note out
18 continuing objection to the relevance of these, what
19 farmers' chairman has called the socio-political
20 issues.

21 HEARING EXAMINER TOBBS: Mr. Smith, I was going
22 to ask -- and this is probably a good time. I
23 understand both values of the business, though these
24 before I haven't been privy to, but remember,
25 earlier, when we had the discussion about the

681612259

2025 RELEASE UNDER E.O. 14176

1 relevancy of this kind of thing, I did make the
2 ruling that I would just wait and see what the
3 questions were going to be.

4 Can I assume you have some point of direction
5 you are heading here, to lay the groundwork as to the
6 relevancy of these things? If you could educate me
7 on what it is, I think we might be able to feel a
8 little more comfortable about it.

9 MR. SMITH: Well, of course, the problem with an
10 interruption as counsel has made and as counsel knows
11 in the middle of cross-examination requires me to
12 explain the point of these questions for the witness
13 before we get the questions out, but I will do so.

14 The point is that we've asked a number of people
15 issues about the relationship between smoking and
16 health in these hearings, and we believe we're
17 getting a series of pat answers that have been
18 prepared by various individuals within Brown &
19 Williamson and that this --

20 What I'm trying to inquire about is as to
21 whether or not this witness has read the pamphlet
22 which tells him how to respond to these questions and
23 is now repeating for us the standard answers that
24 they are told to give.

25 HEARING EXAMINER TODD: How about just asking

681612260

8222

GROUP - STATUS - 08/13/88

1 and answers on the relationship between smoking and
2 health, when did you read that booklet?

3 A. I'm not sure it was in pamphlet form. I remember
4 reading something of that nature. I don't remember
5 exactly when I read that, Mr. Smith. It was sometime
6 within the last three, four months I remember seeing
7 something, you know, some question and answers from
8 Brown & Williamson.

9 Q. And do you recall whether that question and answer
10 document included within -- strike that.

11 Did that document suggest how certain questions
12 about the relationship between smoking and health
13 should be answered by executives at Brown &
14 Williamson?

15 A. It was a document that listed questions and it listed
16 answers.

17 Q. Did it give pointers on how to answer certain
18 questions?

19 A. I don't remember that.

20 Q. Is one of the things that was indicated should be
21 indicated by the individual responding to questions
22 that they should always point out the individual
23 answering the question was neither a scientist nor a
24 doctor nor a medical person?

25 A. I don't remember that.

681612262

102

07.17.88 08:48PM *BATVS GROUP

1 Q. Do you recall that that was not in it?

2 A. I say, I don't remember that being in it.

3 Q. What do you recall about the information that was
4 suggested to be included in the answers to questions
5 about the relationship between smoking and health?

about to the

1 MR. MILLSON: Show him the pamphlet you've got.
2 Let's be direct about it.

3 MR. SMITH: I want to know what he recalls about
4 the pamphlet that he read.

5 Q. Do you recall anything about what it said?

6 HEARING EXAMINER TODD: Well, let me interrupt.
7 Can you show me the pamphlet?

8 MR. SMITH: I don't have a copy of the
9 pamphlet. I only know it exists. I know it was
10 prepared and it was distributed, but I don't have it,
11 and when we get it, we'll show it to him.

12 Your Honor, I'm sorry, but it's very difficult
13 because we have yet to get our first discovery order
14 which requires them to produce any documents, so what
15 we are doing is conducting the trial of these issues
16 based upon what we can discover through our own
17 initiative and through our own inquiries, and we're
18 finding out a wealth of information, but it's
19 difficult when we learn there is in existence such a
20 document, the witnesses are allowed to come and tell
21 us that they only have vague recollections of what
22 documents exist and no one orders them to produce
23 those documents.

24 We'd be happy to cut right through it. If your
25 Honor will order them to produce the pamphlet that

681612264

POB

07.12.88 08:48PM *STATUS GROUP

1 Mr. Arentsen is talking about, I will immediately
2 move to another subject, but it's very difficult when
3 no one will order them to produce any documents.

4 MR. MILLSON: I don't think the document you are
5 talking about has anything to do with this proceeding
6 whatsoever. I've objected to the whole line of
7 questioning, and now that it's come out, you don't
8 even have a document. You are just throwing things
9 in the air and seeing where will anything fall.

10 MR. SMITH: I think if we had the document, we
11 would see that the witness has patterned a number of
12 his answers based on what Brown & Williamson tells
13 their employees to say in response to these
14 questions.

15 MR. MILLSON: I think that is an irresponsible
16 statement, Mr. Smith, and I resent it strongly on the
17 witness' behalf.

18 MR. SMITH: I didn't say I didn't know anything
19 about what was in the document just because I don't
20 have it, counsel.

21 MR. MILLSON: If you are saying here that you
22 think the witness has patterned his testimony after a
23 document you don't even have and the witness has
24 testified inconsistently, I think that that's wrong,
25 just wrong.

681612265

POA

07.12.88 08:48PM *BATUS GROUP

1 MR. SMITH: Your Honor, I suggest that we can
2 resolve this by asking them to produce the document.

3 HEARING EXAMINER TODD: Does RATUS know what
4 document he's talking about?

5 MR. MILLSON: I don't know what document he's
6 talking about, and I think coming in here, saying
7 that there's a document that --

8 This witness has been on the stand two days here
9 and you can judge for yourself about this witness.

10 That this witness has used that document whose
11 existence I have no idea what he's talking about, he
12 just made it up; and saying that this witness, who
13 you have met and you've seen for two days, that he
14 has used that as a script, I think, is grotesquely
15 irresponsible and I really resent it very strongly.

16 MR. SMITH: Your Honor, the witness has
17 indicated he has read such a document.

18 MR. MILLSON: He has read a document. To say
19 that that's -- that he used that as a script to come
20 in here, and you haven't even asked him any questions
21 about this irrelevant topic, I think is just wrong.

22 MR. SMITH: Well, then let's produce the
23 document and we'll certainly know shortly.

24 HEARING EXAMINER TODD: Let's go off the record
25 a moment.

681612266

POS

07.12.88 08:48PM *RATUS GROUP

1 (A discussion was held off the record.)

2 HEARING EXAMINER TODD: Mr. Smith, again, we
3 certainly want to get everything in the record that
4 we possibly can that might be at all relevant to this
5 situation, but, again, I've tried to ask it several
6 different ways so you could explain to me what -- why
7 it is relevant about -- these questions about the
8 document. I don't yet understand your answers, but,
9 I would like --

10 The witness did mention he had seen some
11 document. I would like the witness to testify what
12 document he has and that you think he's talking about
13 and what was in it, and then I'd like to move on to
14 another subject.

15 THE WITNESS: As I said, I saw some information,
16 and I don't remember the form it was in, whether it
17 was pamphlet or just typed up on a -- I can't
18 remember, but it listed some commonly asked questions
19 and gave answers. And this is a common practice in
20 dealing with a lot of issues. I mean, that is not
21 unique to smoking and health.

22 Q. BY MR. SMITH: I will try not to beat this to death.
23 Can you be any more specific as to how lengthy the
24 document was and as to any of the information it was
25 about?

681612267

POB

07.12.88 08:48PM *STATUS GROUP

1 You said it had questions and answers. Can you
2 tell me anything about what it said?

3 A. As I said, I don't remember. It did -- dealt with
4 smoking and health, common questions that people may
5 ask employees or -- that's all I remember about it.

6 Q. And you don't remember any of the answers?

7 A. No.

8 Q. Mr. Arantsen, in the form A that you filed, you have
9 stated in item 3, which you discussed in a number of
10 hearings -- after stating that you currently intend
11 to operate the company substantially as at present,
12 the next sentence contains a reservation of rights to
13 alter a number of things subsequent to the
14 acquisition; is that correct?

15 A. I think the statement speaks for itself, Mr. Smith.

16 Q. Well, I didn't want to read the whole sentence, but I
17 will, if you insist. Paragraph 2 says, "The offeror
18 reserves the right, however, to review the company's
19 business assets, corporate structure, dividend
20 policy, capitalization, operations, properties,
21 business policies, articles of incorporation, bylaws,
22 management and personnel and, subject to applicable
23 state insurance regulatory requirements, to make any
24 changes that the offeror deems necessary in light of
25 such review or future developments."

681612268

FO7

07.12.88 08:48PM *STATUS GROUP

- 1 And I take it you are familiar with that
2 language, correct?
- 3 A. Yes.
- 4 Q. And you don't intend that any of your testimony here
5 retreat at all from that reservation of rights, do
6 you?
- 7 A. No. As I said, we have not had the opportunity to
8 meet with Farmers' management and review those issues
9 with them, and our plan is Farmers' plan, as best as
10 we can tell what it is from their public statements
11 and their indicated strategic direction.
- 12 Q. You agree with me that the consultants' reports that
13 you went through at some length contain a variety of
14 affirmative recommendations for Farmers' business?
- 15 A. I think they showed some opportunities.
- 16 Q. You view them as opportunities. Do you agree that
17 some of them were stated by the consultants as being
18 their recommendations?
- 19 A. I think you have to be more specific, Mr. Smith, as
20 to what ones you are talking about. You know,
21 there's a whole boxful of documents there.
- 22 Q. Let's stay with your term for a moment,
23 "opportunities." Do you agree that one of the
24 opportunities that has been identified by BATUS and
25 its consultant is an increased emphasis on Farmers'

681612269

1 life business?

2 A. I believe they said there was an opportunity to
3 increase the life business as well as the property
4 and casualty business.

5 Q. Do you know whether B.A.T has any intentions for
6 Farmers different from your and BATUS's intentions?

7 A. B.A.T has no different intentions than what BATUS
8 has.

9 Q. You were present, were you not, in California when
10 Mr. Garraway acknowledged that he has stated publicly
11 in England that B.A.T intends to drive more life
12 business through the Farmers agency force?

13 MR. MILLSON: I object to the form of that
14 question.

15 HEARING EXAMINER TODD: What?

16 MR. MILLSON: I believe it mischaracterizes the
17 witnesses' testimony, Mr. Garraway's testimony. If
18 they want to show him Mr. Garraway's testimony, I
19 think that's fine, but I think just paraphrasing it
20 like that is just not correct.

21 HEARING EXAMINER TODD: Is that basically what
22 the testimony was?

23 MR. SMITH: I believe that's what it was. I
24 think the witness can tell me he didn't hear Mr.
25 Garraway say that if he didn't.

681612270

POB

07.12.88 08:48PM *BATUS GROUP

- 1 HEARING EXAMINER TODD: If you were there, go
2 ahead and answer from what you thought it was.
- 3 A. I was there -- you are talking about California?
- 4 Q. Yes. Were you there when Mr. Garraway testified in
5 California?
- 6 A. Yes.
- 7 Q. Did you hear Mr. Garraway acknowledge that he has
8 stated publicly in England that B.A.T intends to
9 drive more life business through Farmers' agency
10 force?
- 11 A. I don't know if that's what he said.
- 12 Q. Do you recall he said that he admitted stating words
13 to that effect?
- 14 A. I remember that there was a quote, an article from
15 some newspaper article, I think, dealing with that
16 subject and you asked him about it, and I just don't
17 remember anything beyond that.
- 18 Q. Do you agree that the reservation of rights in item 5
19 reserves to BATUS and B.A.T the right to shift to an
20 increased emphasis on Farmers' life business after
21 the acquisition?
- 22 A. We reserve the right to review the business and
23 discuss it with management, and we have no intentions
24 of shifting the business.
- 25 Q. Do you reserve the right to shift the emphasis of the

681612271

P 10

07.12.88 08:48PM *BATUS GROUP

1 business if you decide to do so?

2 A. Well, I believe we would discuss it with Farmers and
3 determine what they wanted to do.

4 Q. What if they didn't want to and you thought it was a
5 good idea? Do you reserve the right to do it?

6 A. Well, the reason I'm hesitating is because I think
7 the question is so speculative, I don't --

8 I mean, the operation of the business, decisions
9 of that nature, would be made by Farmers, and we
10 would, obviously, be involved reviewing with them
11 what overall strategic direction they were taking
12 with the business, but I don't believe we would
13 impose a new strategic direction on Farmers.

14 I mean, there would be no reason to do that, Mr.
15 Smith. I don't understand what --

16 Q. At what level are strategic issues resolved within
17 the B.A.T structure?

18 A. Well, we have a decentralized management process
19 where operating companies prepare five-year plans and
20 annual budgets. Those plans and budgets are reviewed
21 in BATUS. They would be reviewed with the BATUS
22 Executive Committee. They would be consolidated into
23 overall BATUS' five-year plan and budget, and that
24 would be reviewed with B.A.T, the chairman's policy
25 committee, and they consolidate that into a review

681612272

P 11

07:12:56 08:48PM *BATUS GROUP

1 that's made to the B.A.T board.

2 Q. Would a shift of the emphasis of Farmers' business
3 toward the life business fall within a strategic
4 review process?

5 A. Well, I think the guidelines would say that if there
6 is a major strategic change in the business, clearly
7 that would be reviewed at the BATUS and B.A.T level.

8 I guess it depends on what you mean by "shift."

9 Q. Well, when I asked you the question a moment ago, you
10 said the strategic direction of the business --
11 excuse me, a shift in the -- strategic shift in the
12 business would be reviewed with Farmers, and that was
13 in response to my question about shifting the
14 emphasis of the business toward the life side. I'm
15 only trying to find out what you meant by that.

16 Is that or is that not a strategic shift of the
17 business?

18 A. Well, I guess it depends how we define "shift." If
19 "shift" is an increased marketing emphasis on life,
20 perhaps an increased advertising budget, some more
21 training with the life -- or with the sales force, if
22 they are perhaps going to add some variations in life
23 products, I would say that those sorts of issues
24 would be dealt with at the operating company level
25 and that would not require any higher approval.

681612273

P 12

07.12.88 08:48PM *BATUS GROUP

1 If, by the other hand, you are going to make a
2 much more dramatic shift to either eliminate the line
3 or substantially curtail it or add a major new line
4 of product, that would be a major strategic issue
5 which we would go for higher approval.

6 Q. Who is it that decides strategic issues within the
7 B.A.T framework?

8 MR. MILLSON: Are you asking who they would go
9 to for approval in the issues he was just talking
10 about?

11 Q. At what level are those strategic issues decided?

12 A. Well, I explained earlier that we have a process that
13 goes from the operating company to BATUS to the
14 chairman's policy committee and then to the B.A.T
15 board, and it really depends on the magnitude of the
16 change in the -- I guess you would say the magnitude
17 of the change.

18 Q. Was one of the opportunities that was identified in
19 the consultants' report the sale of additional
20 financial service products through the Farmers agency
21 force?

22 A. I think there was discussion on that, and it really
23 went both ways, and I think the conclusion was that
24 it may not be appropriate.

25 Q. Whose conclusion was that?

681612274

P 13

07.12.88 08:48PM *BATUS GROUP

- 1 A. I think that was in the Intermatrix reports.
- 2 Q. Do you know whether there are other reports that
- 3 indicate that it is advisable?
- 4 A. I don't remember. I do remember in a discussion with
- 5 some of the Cresap people, there were concerns as to
- 6 whether that was advisable. I think we just have to
- 7 get the reports out, Mr. Smith.
- 8 Q. Is the issue of whether or not Farmers' agency force
- 9 should be asked to sell other financial service
- 10 products a strategic issue?
- 11 A. I think it depends on what products you are talking
- 12 about.
- 13 Q. What products do you think the consultants were
- 14 talking about?
- 15 A. I'm not really that clear. I think -- I don't think
- 16 we really discussed specific products.
- 17 Q. Was the acceleration of geographic growth one of the
- 18 opportunities identified in your consultants'
- 19 reports?
- 20 A. I think there were opportunities for geographic
- 21 growth identified.
- 22 Q. Do you know whether B.A.T has any different
- 23 intentions from you and BATUS with respect to the
- 24 geographic growth of Farmers?
- 25 A. I'm sorry. Would you say that again.

681612275

P 14

07.12.88 08:48PM *BATUS GROUP

- 1 Q. Certainly. Do you know whether B.A.T has any
2 different intentions with respect to the geographic
3 growth of Farmers from those held by you and BATUS?
4 A. I don't know of any, and I would be surprised if
5 there were.
6 Q. Have you heard before the statement from Mr. Sheehy's
7 deposition, when he was asked about the benefits to
8 Farmers from the acquisition, when he said, "and to
9 Farmers' management and employees the possibility of
10 accelerated growth of the business"? You've heard
11 that before, haven't you?
12 A. I don't recall that, but if that's in his deposition
13 -- I don't know, Mr. Smith.
14 Q. Do you have any understanding of what accelerated
15 growth of the business Mr. Sheehy was talking about?
16 MR. MILLSON: "Possibility of accelerated
17 growth" was the phrase you read.
18 A. No, I don't know. I don't know, Mr. Smith.
19 Q. Was one of the other assumptions that was identified
20 by the consultants a possible disposal of Ohio State
21 Life and Investors Guaranty Life?
22 A. Yes.
23 Q. In fact, I think you said elsewhere that that
24 disposal perhaps moved from the area of opportunities
25 to the area -- to being called a working assumption;

681612276

P 18

07.12.88 08:48PM *BATUS GROUP

- 1 is that correct?
- 2 A. At one point, yes.
- 3 Q. And although I'm not sure "opportunities" is quite
4 the right phrase, was another of the opportunities
5 identified the elimination of Farmers' medical
6 malpractice line?
- 7 A. I don't know if that was an opportunity. I think
8 that was a concern that was raised by the Tillinghast
9 people.
- 10 Q. Was one of the opportunities identified the
11 opportunity to pay an extraordinary dividend to BATUS
12 out of Farmers?
- 13 A. Are you talking about from the consultants?
- 14 Q. Yes.
- 15 A. I don't remember that being in the consultants'
16 report.
- 17 Q. Was one of the opportunities that BATUS identified
18 during the course of the study the opportunity to pay
19 an extraordinary dividend?
- 20 A. I think we assumed back in the summer of '87, and as
21 included in the September board report, there was an
22 assumption that Farmers Group and the Farmers life
23 companies had excess cash, and for purposes of, let
24 me just say, running the numbers for the projection,
25 there was an assumption that cash would be offset

681612277

P 16

07:12:58 08:48PM *BATUS GROUP

1 against the purchase price.

2 It was also pointed out that the interest income
3 on that investment, if left in Farmers, would offset
4 the interest expense on the acquisition debt, so it
5 really didn't make that much difference as far as the
6 projections went, but it would have increased the
7 acquisition debt.

8 Q. There was -- the payment of an extraordinary dividend
9 out of Farmers also reached the stage that you
10 characterized it as a working assumption; isn't that
11 correct?

12 A. That's correct. I'm not sure we called it an
13 extraordinary dividend. I think we -- at least, we
14 viewed it as excess cash available in Farmers.

15 Q. Now, you've testified, I believe, on direct either
16 this morning or yesterday that you do not currently
17 intend to pay that dividend or extract that cash; is
18 that correct?

19 A. That's correct.

20 Q. You do, however, reserve the right to do so once you
21 have met with Farmers' management, do you not?

22 A. Well, I think one of the items on this list is the
23 dividend policy. Obviously, one of the questions we
24 will ask Farmers is, what are their needs, what are
25 their financial requirements and resources that are

681612278

P 17

07.12.88 08:48PM *STATUS GROUP

1 needed in the business.

2 Q. By each of these items we've identified as
3 opportunities, BATUS is reserving the right to
4 implement each of those after the acquisition if it
5 decides that those are appropriate; isn't that
6 correct?

7 A. I'm sorry. You say, each of these opportunities.
8 What are you referring to?

9 Q. You just identified a list of opportunities, shifting
10 or -- excuse me, increasing the emphasis on life,
11 accelerating geographic growth, sale of additional
12 financial services, the sale of Ohio State Life,
13 Investors Guaranty Life and the payment of a large
14 dividend to BATUS, and you've indicated that you
15 don't intend to do those items until you meet with
16 Farmers' management.

17 My question is, although you say you don't plan
18 to do those at this time, your reservation of rights
19 in item 5 reserves for you the right to implement
20 each of those opportunities upon the completion of
21 the acquisition, does it not?

22 MR. MILLSON: Object to the use of your word
23 "opportunity." The witness on several occasions has
24 not adopted that phrase of yours.

25 MR. SMITH: Well, I thought I eliminated from my

681612279

P 18

07.12.88 08:48PM *BATUS GROUP

1 list the ones he didn't consider an opportunity.

2 Q. Have you left out items?

3 A. I'm sorry. I have to write down the list here.

4 MR. MILLSON: Why don't you not use the word
5 "opportunity." Why don't you just list the items.
6 We're going about it in the longest possible way.

7 MR. SMITH: Well, I did that because that's the
8 word he has used and it saves listing them all every
9 time we talk about them.

10 If you would like to hear the list every time,
11 we will use the list.

12 Q. Isn't it correct, Mr. Arentsen, that you have
13 reserved the right to shift the emphasis of Farmers'
14 business, life -- let me start all over.

15 Isn't it correct that you and BATUS have
16 reserved the right to shift the emphasis of Farmers'
17 business to its life business, to accelerate
18 geographic growth, to sell additional financial
19 services products, to dispose of Ohio State Life and
20 Investors Guaranty Life and to pay a large dividend
21 to BATUS after the acquisition is completed?

22 A. Clearly, Mr. Smith, we have no intentions to do any
23 of that. Why we have reserved our rights is that we
24 haven't had a chance to meet with Farmers and
25 conditions change in the future, and we would expect

681612280

P 19

07:12:58 08:45PM *BATUS GROUP

1 Farmers to have a point of view and recommendations
2 on each of those items.

3 Generally, we have reserved rights as said in
4 point five to review the business, dividend policy,
5 the capitalization, the other items listed in there.

6 Q. Is there any written commitment anywhere on behalf of
7 BATUS or B.A.T not to do any of these items upon the
8 completion of the acquisition?

9 A. Well, there is sworn testimony on all of those
10 issues, Mr. Smith, under oath.

11 Q. Are you testifying here today that you will not do
12 any one of those items after the acquisition?

13 A. I'm testifying that we have no intent to do any of
14 those items. To do any of those items would come
15 within a planning cycle which would require a very
16 thorough study.

17 Our planning horizon is three to five years. I
18 mean, it would be foolish to try and say we won't do
19 anything forever. I mean, I don't think any
20 businessman would do that.

21 Q. Your testimony -- your sworn testimony is that you
22 have no intention sitting here today to do any of
23 those items; isn't that correct?

24 A. My testimony is that I have no intentions, BATUS has
25 no intentions and B.A.T has no intentions.

681612281

P 20

07.12.88 08:48PM *BATUS GROUP

1 Q. Just as you have no plans?

2 A. We do have plans. The plan is in the form A.

3 Q. And that plan in the form A states that you reserve
4 the right upon the completion of the transaction to
5 do each and every one of these items, does it not?

6 A. The form A says what it says.

7 Q. Do you disagree that you have reserved the right to
8 do each of these items that I have listed immediately
9 upon the acquisition if you so choose to do so?

10 MR. MILLSON: I believe that question has been
11 asked and answered at least twice. I think we're
12 just arguing with the witness now. He's said there's
13 sworn testimony, including by himself, as to what
14 their intentions are. I think it's just arguing with
15 the witness.

16 HEARING EXAMINER TODD: Well, I don't really
17 agree with that. I think the question he asked was a
18 little bit different. If I understood the question,
19 it was whether or not the witness agreed with what
20 you said, that they could change most anything they
21 have in the form A the next day after it was
22 acquired.

23 MR. SMITH: That's correct.

24 HEARING EXAMINER TODD: I see no reason why you
25 couldn't answer that one.

681612282

P 21

02.12.88 08:48PM *STATUS GROUP

1 A. Well, I'm not sure what the technical question --
2 answer to that is, Mr. Smith. I'm not a lawyer, but
3 clearly the spirit of the form A would not permit us
4 to make any of those drastic changes the day we
5 acquire the business.

6 Q. Can you tell me what language in the form A you refer
7 to, what section you refer to that has the spirit
8 that would not allow you to make those changes?

9 A. As I said, I think the form A speaks for itself.

10 Q. Well, it says that the offeror reserves the right to
11 review the company's business assets, corporate
12 structure, dividend policy, capitalization,
13 operations, properties, et cetera, et cetera, and to
14 make any changes that the offeror deems necessary.

15 Are you telling me that that reservation of
16 rights does not include items on the list that we
17 just went through?

18 A. No. What I'm -- your question, I thought, was, the
19 day we buy the business, would we make any of those
20 changes that you talked about, and I'm saying that
21 would not be within the spirit of what is in the form
22 A and we would not do that.

23 Q. Let me give you six months. Meet with Farmers'
24 management on the third day after the acquisition and
25 implement those changes any time within six months,

681612283

P 22

07.12.88 08:48PM *STATUS GROUP

1 from anywhere from one week to six months after the
2 acquisition. Haven't you reserved the right to do
3 each and every one of those things?

4 A. Well, we have reserved the right to do the items that
5 is set in the form A. We have no intentions to do
6 any of those items that you have talked about.

7 I would say that with respect to the tax issue
8 and the billion six of intercompany debt, that
9 obviously is an issue that we would want to review
10 very soon with Farmers, and if there were advantages
11 to not having that debt in Farmers, that would be an
12 issue that hopefully could be dealt with in a shorter
13 time frame than six months, but I would not expect
14 any strategic issues to change within the first six
15 months or first year or probably in the first two or
16 three years.

17 HEARING EXAMINER TODD: Mr. Smith, would this be
18 an appropriate time to take about a ten-minute
19 break?

20 MR. SMITH: Certainly.

21 HEARING EXAMINER TODD: Let's adjourn for ten
22 minutes.

23 MR. SMITH: Your Honor, either at this moment or
24 immediately after the break, could we talk about the
25 timing of further witnesses, because we may need to

681612284

222

07.12.88 08:48PM *STATUS GROUP

1 let some of our witnesses leave town if they're not
2 going to get on this week, and if we're definitely
3 going to have additional days later --

4 MR. MILLSON: If I could also have an estimate
5 of how much longer you are going to be with Mr.
6 Arentsen, that obviously drives the other questions.
7 Do you think you will be done with him today?

8 MR. SMITH: I don't know.

9 HEARING EXAMINER TODD: If you want to visit
10 while we're off the record, yeah, I have no objection
11 after the break talking about it.

12 (A recess was taken.)

13 HEARING EXAMINER TODD: Let's please go back on
14 the record now. Mr. Arentsen is still on the stand.

15 Oh, just a minute. I'm sorry. I forgot. I
16 promised counsel right after the break we would be
17 open for a discussion about witnesses.

18 Mr. Smith, would you want to repeat that.

19 MR. SMITH: Yes. What I was interested in, I
20 think it's clear, assuming that -- at least, the
21 first question, Messrs. Clark and Broughton will --
22 Messrs. Clark and Broughton will go on tomorrow and
23 take approximately the same length of time they have
24 in the past, or will their testimony expand as Mr.
25 Arentsen's?

681612285

P 24

07.12.88 08:48PM *STATUS GROUP

1 MR. MILLSON: My estimate is that Mr. Clark, as
2 in past hearings, will be on and off in an hour.
3 That's our direct and your cross. I don't believe
4 that we will take longer than that. Mr. Broughton, I
5 think, may take longer than prior hearings, but my
6 anticipation is that we would be done at the end of
7 tomorrow. Is that right?

8 MR. COLE: And before that, if Clark is on --

9 MR. SMITH: If you are going to be done any time
10 late -- I mean, any time tomorrow afternoon, I think
11 it's clear that we cannot get done by the end of the
12 week, so I think we would like, then, to let some of
13 our witnesses go home with the understanding that
14 your Honor will schedule some subsequent days in the
15 future, if that's agreeable.

16 HEARING EXAMINER TODD: It's beginning to look
17 like that might be necessary.

18 When we get to Farmers' direct testimony, can
19 you make an estimate as to how -- what are we talking
20 about there, a day or two days?

21 MR. SMITH: I think our best guess would be four
22 days with direct and cross.

23 HEARING EXAMINER TODD: Four days?

24 MR. MILLSON: We are never going to make this
25 week.

681612286

922

40000 08:48PM *STATUS GROUP

1 MR. SMITH: It seems like everybody has
2 expanded. In some of the early states, we had a
3 little trouble getting done in a week, and your case
4 was completed in a day, I think, the first time you
5 put it on.

6 HEARING EXAMINER TODD: I may as well mention at
7 this point, we're beginning to get several requests
8 -- Pam can tell me how many, maybe, of other
9 interested parties to testify.

10 Do you have any idea how many we're scheduled
11 for now?

12 What we've been, basically, trying to tell them
13 is that, since this was announced to be this week, is
14 that Friday would be open for that type of
15 testimony. I'm not saying I anticipate that to take
16 all day, but we had to have something to tell them as
17 to when to appear.

18 Now, one member of the legislature has requested
19 a brief time in the morning, and I had anticipated
20 that we would take that first. I don't anticipate
21 that to take very long.

22 MR. SMITH: We have often in other jurisdictions
23 interrupted a witness to have a member of the public
24 or a legislator come in and talk out of order in
25 order to accommodate their schedules. We certainly

681612287

P 28

07.12.88 08:48PM *STATUS GROUP

1 have no objection to that.

2 MR. MILLSON: We obviously have no objection.

3 HEARING EXAMINER TODD: I just thought I would
4 tell you that about Friday because I think we'll be
5 able to get some testimony in from either of the
6 groups here, but we'll be working around some things.

7 MR. SMITH: In terms of the overall timing, I
8 think that the parties returned to Ohio for two
9 additional days and it's beginning to look like
10 that's about what we're going to need here, I think.

11 HEARING EXAMINER TODD: What I might suggest --
12 and I don't have any idea about our own schedule
13 right now -- between now and tomorrow, all the
14 respective parties kind of check their own calendars
15 and let's see if we can maybe arrive at some possible
16 times.

17 As I understand, is all next week scheduled for
18 Washington?

19 MR. SMITH: Yes, your Honor.

20 HEARING EXAMINER TODD: Is that apt to run over
21 into the next week? Is this a practice run for that
22 one?

23 MR. MILLSON: I very much doubt that it will run
24 over a week in that the Washington department has
25 ruled that tobacco and South Africa are irrelevant

681612288

issues and, therefore, some of the witnesses that they would otherwise put on will not be testifying, so I don't believe that that will --

MR. SMITH: It's hard to say, your Honor. We, obviously, will readdress the relevancy ruling, and generally tobacco has not taken more than one day of the hearing time, so it could conceivably run over, although everyone has an interest in seeing that we get it done in a week.

HEARING EXAMINER TODD: Has there been any resolution between the parties as to the Dr. Green matter?

MR. ROLFE: We don't have an answer yet.
There's time change and difficulty in communicating.

HEARING EXAMINER TODD: You're still working on that?

MR. ROLFE: We're still working on that.

HEARING EXAMINER TODD: Bear in mind, on our pre-hearing hearing, we still have questions of what witnesses we may order following. As we previously ruled, we will wait until BATUS's direct testimony was completed and then we would be completed, so

1 Go ahead and proceed, Mr. Smith.

2 Q. BY MR. SMITH: I believe you testified previously,
3 Mr. Arentsen, that you did not establish a particular
4 target for a rate of return with respect to seeking a
5 United States financial services market acquisition;
6 is that correct?

7 A. Yeah, we did not quantify a rate of return.

8 Q. Are you aware that Mr. Sheehy testified in his
9 deposition that B.A.T had established a target rate
10 of return for an acquisition in the United States
11 financial services market?

12 A. I'm aware that he said that. And he also said he
13 didn't know what it was, and he was wrong, because I
14 sat in several meetings with him when we discussed
15 this with Mr. Garraway and Mr. Frigon.

16 Q. Well, did you sit in on every internal meeting that
17 B.A.T held?

18 A. I don't sit in on all B.A.T internal meetings, if
19 that's what you mean.

20 Q. And Mr. Sheehy --

21 A. I'm not aware of any meetings where this was
22 discussed where I wasn't present.

23 Q. Mr. Sheehy is the chairman of the board of B.A.T
24 Industries p.l.c., correct?

25 A. Yes, sir.

681612290

P 28

07.12.88 08:48PM *BATVUS GROUP

- 1 Q. And that is the ultimate parent in the B.A.T empire?
2 A. That's correct, reportable to the board of directors
3 of B.A.T and the shareholders of B.A.T.
4 Q. And he's also a member of the chairman's policy
5 committee, is he not?
6 A. That's correct.
7 Q. And there are three members of the chairman's policy
8 committee; is that correct?
9 A. Yes.
10 Q. And Mr. Garraway has described that as being, in
11 United States terms, like the office of the
12 chairman. Do you think that is an apt description of
13 that committee?
14 A. Yes, an executive committee.
15 Q. Do you attend meetings of the CPC?
16 A. I've attended meetings with the CPC. I don't attend
17 all their meetings.
18 Q. You attend when invited; is that correct?
19 A. That's correct.
20 Q. Has Mr. Sheehy ever told you that the establishment
21 of the rate of return for a U.S. financial services
22 acquisition was not discussed at any meetings outside
23 your presence?
24 A. I don't remember him saying that.
25 Q. One of the reasons you want to acquire Farmers is the

681612291

P 30

07.12.88 08:48PM *BATVS GROUP

1 quality of its management; is that correct?

2 A. Yes.

3 Q. You've learned quite a bit about Farmers' management
4 through your preacquisition analysis, haven't you?

5 A. Yes. There was quite a bit of research to that
6 effect.

7 Q. And have you learned more about Farmers' management
8 and the individuals in Farmers' management since the
9 tender offer was launched?

10 A. Yes, I think I've learned more things, yes.

11 Q. Has anything ever come to your attention during your
12 investigation of Farmers over the course of this --
13 your tender offer effort which has led you to
14 conclude that any aspect of Farmers' management is
15 not what you would expect from the management of a
16 company you are acquiring?

17 A. No. I -- the only thing I can think of is I don't
18 understand why they won't sit down and talk to us
19 about negotiating this transaction, but we've had
20 very little personal contact. I did meet Mr. Denlea
21 at the shareholders meeting. I shook his hand,
22 chatted with him for a few minutes.

23 During the course of these proceedings, I've
24 chatted with some of the people from Farmers that
25 have been witnesses or attending these meetings, but

681612292

P 31

07.12.88 08:48PM *STATUS GROUP

1 outside of that, I haven't had any involvement.

2 Q. Other than Farmers' resistance to your offer, have
3 you learned of anything that Farmers has or has not
4 done which you think is an example of less than good
5 management?

6 A. Well, I would want to be curious -- to know more
7 about their deliberations on the withdrawal from the
8 business of Ohio State Life, the manner in which they
9 did that. I think there's some litigation issues
10 that come up that, obviously, we would like to know
11 more about or discuss with Farmers, Farmers
12 litigation issues.

13 Q. Well, with respect to Ohio State Life, I believe you
14 testified that you were surprised that they didn't
15 attempt to sell the accident and health business
16 rather than terminate it; is that correct?

17 A. I don't know if those are my exact words. What I
18 would say is that one course of action would have
19 been to sell that accident and life business and
20 retain the policyholders' coverage and retain
21 employees' jobs as opposed to just closing it down.
22 Perhaps Farmers considered that and there were good
23 reasons not to do it, but --

24 Q. What makes you think --

25 A. I just don't have enough information, Mr. Smith, to

681612293

P 32

07.12.88 08:48PM *BATVS GROUP

1 speculate on it.

2 Q. What makes you think they didn't try to sell it?

3 A. They may have. I don't know. Mr. Denlea didn't --
4 you know, there's no public information about that
5 that I'm aware of.

6 Q. Now, with respect to the litigation issues that you
7 mentioned, you said you would like to have more
8 information from the information presently available
9 to you, are there any acts or failures to act of
10 Farmers' management that you can presently identify
11 as being less than good management?

12 A. With respect to -- I think that litigation and the
13 Ebony file and the destruction of documents goes back
14 to three or four years, to some prior management, and
15 I don't know or have reason to believe that the
16 current management was involved in that. I just
17 don't know.

18 Q. From what you know about the two matters that you
19 mentioned, would you retain current management if
20 they were involved in it?

21 A. I just don't know, Mr. Smith. I think you are asking
22 us to make judgments on totally incomplete facts.

23 Q. So you don't have enough information to determine
24 whether or not those two items would be reflective of
25 poor management on the part of Farmers' present

681612294

832

07.12.88 08:48PM *BATLIS GROUP

- 1 management? Is that your testimony?
- 2 A. That's correct.
- 3 Q. Do you believe from your present knowledge that those
- 4 events reflected poor management by the management
- 5 that was in place at the time of those events?
- 6 A. Well, I think the management that's in place
- 7 obviously is accountable for what goes on during
- 8 their watch, and who or what was involved, I just
- 9 don't know.
- 10 Q. Other than the Ohio State Life and the litigation
- 11 issues, are you aware of any other actions or
- 12 failures to act on the part of Farmers' management
- 13 that you think is an indication of anything other
- 14 than good management?
- 15 A. No, I'm not aware. As we've said repeatedly and our
- 16 research has shown, Farmers is believed to have good,
- 17 solid, strong management with depth.
- 18 Q. Would you have available, Mr. Arentsen, the documents
- 19 that you spent quite a bit of time with yesterday?
- 20 A. I think -- well, wait a minute. The box?
- 21 Q. The box.
- 22 MR. MILLSON: We'll get the box.
- 23 (A recess was taken.)
- 24 Q. BY MR. SMITH: Can you find the document that's
- 25 Exhibit 5080, please, Mr. Arentsen.

681612295

1 MR. MILLSON: This one here, "Agriculture
2 Critical Factors"?

3 MR. SMITH: Right, dated August 1987.

4 MR. MILLSON: I'm sorry. It's the thin one.
5 Okay.

6 A. Yes, I have it, Mr. Smith.

7 Q. Would you turn to page 6151, please, Mr. Arentsen.
8 Focusing on the statement -- the statements that are
9 underlined, "Agriculture's future depends on the
10 following factors: One, the company must become a
11 more efficient operator - narrow the policy
12 acquisition expense gap with State Farm; two,
13 maintain disciplined underwriting standards and
14 preserve surplus," is that a conclusion with which
15 you agree?

16 A. I don't remember the statement, but I think the point
17 is that what was shown in the research was that
18 Farmers was less efficient than State Farm and that
19 to narrow the gap, they'd have to be more efficient.
20 But in our view, in spite of that, Farmers was still
21 much more efficient than many of its other
22 competitors, and, obviously, being more efficient
23 would improve Farmers' future. Maintaining
24 discipline and other underwriting standards and
25 surplus, clearly Farmers' future would be in part

681612296

P 36

07.12.88 08:48PM *BATVUS GROUP

- 1 dependent upon that.
- 2 Q. Do you believe that Farmers is presently maintaining
3 disciplined underwriting standards and preserving
4 surplus?
- 5 A. I have no reason to believe that they are not doing
6 that.
- 7 Q. I notice, Mr. Arantzen, when we were going through
8 these documents yesterday -- I'll try to avoid going
9 back over every reference. I notice that your
10 consultants frequently refer to Farmers as having a
11 unique structure. Did you make that same observation
12 when you reviewed these various consultants' reports?
- 13 A. Yes. I think in our report to the B.A.T board we
14 referred to Farmers' structure as unique.
- 15 Q. You also indicated, I think, from your review of
16 these various reports, you did it -- the consultants
17 did identify two problems with respect to group
18 accident and health and potential underreserve; is
19 that correct?
- 20 A. That's correct.
- 21 Q. And at least with respect to those aspects of the
22 consultants' reports, you agree that those were
23 problems?
- 24 A. With respect to the group accident and health, we
25 agreed that that was a problem. With respect to the

681612297

P 38

07.12.88 08:48PM *STATUS GROUP

1 underreserving, we agreed that it had been a problem
2 in the past. There was some question during mid-1987
3 in the third quarter when we were doing most of this
4 work as to what current underreserving still existed
5 at Farmers.

6 Q. Now, with respect to the group accident and health,
7 you expressed concern for the profitability of that
8 business; isn't that correct?

9 A. I think the concern was that the business was not
10 doing well and that we assumed that the business was
11 operating at a breakeven. Farmers didn't break out
12 their figures as to the profitability. We weren't
13 sure what the profitability was, but we believed
14 there was a troubled segment of their business.

15 Q. Because of the reserving?

16 A. On the group accident and health?

17 Q. Yes.

18 A. No.

19 Q. What did you believe was troubled?

20 A. The business just wasn't doing well. Farmers had
21 recognized that it was a problem business. They were
22 trying to cope with it. It was unclear as to what
23 actions Farmers was going to take. They had -- this
24 was -- the time frame we're talking about now, I
25 assume, is back August, September '87, before they

681612298

- 1 announced what they were going to do.
- 2 Q. Correct.
- 3 A. Farmers had increased premiums substantially by major
4 amounts in an effort to improve their results in the
5 business. They had decided to walk away from
6 policies that had losses, poor loss experience, by
7 having large increases in the premiums beyond what
8 was competitive, so they were taking some actions,
9 and, obviously, those actions were in response to a
10 problem.
- 11 Q. Is that what led you to believe the business was
12 troubled, the fact that there were large premium
13 increases?
- 14 A. This was based on the assessment that was given to us
15 by Conning and, I believe, Tillinghast.
- 16 Q. Wasn't there also a concern about having connections
17 with health maintenance organizations?
- 18 A. Not with respect to Ohio State Life.
- 19 Q. Was there a concern about having connections with
20 HMOs with respect to some other aspect of Farmers'
21 business?
- 22 A. Well, in our previous work looking at different
23 segments of financial services, we came to the
24 conclusion that health maintenance organizations were
25 not an attractive business to be in, along with

681612299

07.12.88 08:48PM *STATUS GROUP

P 38

1 several other segments.

2 Q. And wasn't one of the concerns about health
3 maintenance organizations that statements about
4 smoking and health made by employees of those groups
5 might be attributed to B.A.T?

6 A. I think the major concern was the poor results and
7 the poor profitability and the unpredictable results
8 of the business from a financial point of view. That
9 was the major concern.

10 Q. Well, was what I stated also a concern?

11 A. It may have been, what I would say, a minor concern,
12 but not one that a decision was made on. I think
13 there was some discussion of that topic, but by and
14 large, we just didn't feel that was a good business
15 to be in. And I think subsequent history -- recent
16 results of several companies that are in that
17 business are having severe difficulties.

18 Q. Was it discussed in looking for an acquisition
19 candidate that if you acquired a life business that
20 included an HMO, that you might have to dispose of
21 the HMO?

22 MR. MILLSON: Your Honor, I just wonder what
23 HMOs have got to do with the domestic insurer in
24 Kansas. I just wonder if we're not a bit far
25 afield.

681612300

P 38

07.12.88 08:48PM *BATES GROUP

1 HEARING EXAMINER TODD: Would you like to --

2 MR. SMITH: Certainly.

3 HEARING EXAMINER TODD: -- guide us to where you
4 are going?

5 MR. SMITH: I'm trying to find out the extent to
6 which in their discussions they were concerned about
7 the acquisition of any businesses which would or were
8 making statements linking smoking to various Health
9 problems and the necessity for disposal of such
10 units, and, unfortunately, we don't have Mr. Garraway
11 here.

12 What I'm coming to is Exhibit 5196, and maybe
13 this is an appropriate time to come to it. It was
14 produced to us redacted on the grounds that there was
15 material in it that was irrelevant. That material
16 turned out to be, "Life businesses had problems for
17 us, that any connection with health maintenance
18 organizations would require a disposal for fear of
19 group employees being attributed with statements on
20 smoking and health. Such an eventuality could have a
21 serious legal impact."

22 That statement comes from a meeting stated to be
23 held on September 14, 1987 between Messrs. Garraway,
24 Ratcliff and Brewis, none of whom, unfortunately, are
25 intended to be called by B.A.T or BATUS, and my

681612301

P 40

07.12.88 08:48PM *BATUS GROUP

1 question of this witness is whether he participated
2 in discussions of that very same topic.

3 MR. MILLSON: Let me ask again what health
4 maintenance organizations have to do with the
5 domestic insurer in Kansas or, even if we're going to
6 get more broadly than that, with Farmers at all in
7 any way.

8 They don't own a health maintenance
9 organization. That sentence he read -- inaccurately,
10 I think, but is absolutely irrelevant.

11 MR. SMITH: I inaccurately read the sentence?

12 MR. MILLSON: I believe you left out a word.
13 The word "in" is there that you didn't read.

14 MR. SMITH: Not on the copy. There is a blank
15 on the copy.

16 MR. MILLSON: I think your copier just didn't do
17 it right, but in any event --

18 MR. SMITH: I won't quibble with that. I will
19 simply point out that our employees frequently make
20 such statements, and we will introduce evidence of
21 statements about smoking being made by various and
22 numerous Farmers employees.

23 HEARING EXAMINER TODD: Would you state what the
24 HMO part had to do with it? I'm not sure I heard all
25 that. Was it about whether or not it was an

681612302

07:12:08 08:48PM *STATUS GROUP

P 41

ALL INFORMATION CONTAINED HEREIN IS UNCLASSIFIED DATE 08-11-2010 BY 60322 UCBAW

1 acquirer?

2 MR. SMITH: The statement was if they acquired a
3 life business that had an HMO affiliated with it,
4 they would have to dispose of the HMO to -- quote,
5 "for fear of group employees being attributed with
6 statements on smoking and health."

7 HEARING EXAMINER TODD: Well, I see no reason
8 why you shouldn't go ahead and direct that to the
9 witness.

10 A. What was the question, Mr. Smith?

11 Q. BY MR. SMITH: The question, Mr. Arentsen, is whether
12 or not you participated in any discussions concerning
13 whether it would be necessary for B.A.T or BATUS to
14 dispose of any piece of a -- of an insurance business
15 which was acquired either because it was an HMO or
16 ~~because it contained any operations wherein its~~

18 and health which could be attributed to B.A.T or
19 BATUS.

20 A. Well, as I -- that's a long question, I think much

1 HMOs because some life insurance companies kind of
2 ventured into that area, I'll say, unsuccessfully,
3 and we came to the conclusion that that would be an
4 unattractive segment of financial services to get
5 into.

6 I don't remember having any discussions saying
7 that if we bought a company that had an HMO we would
8 have to sell the HMO.

9 Q. Do you recall anyone ever raising any question or
10 concerns about Farmers in light of its aggressive
11 marketing of nonsmoking discounts?

12 A. Well, we -- in our research, we were aware of
13 Farmers' nonsmoking discounts. We discussed it, Mr.
14 Frigon, Mr. Sheehy, Mr. Garraway and myself, and came
15 to the conclusion that there was no conflict with
16 nonsmoker discounts -- in fact, B.A.T.'s insurance
17 companies had nonsmoker discounts -- and that that,
18 in our view, did not present any problems.

19 Q. You gave me the conclusion. The question, Mr.
20 Arentsen, was, did you ever engage in any discussions
21 as to whether or not there was a conflict?

22 MR. MILLSON: I think he just answered that
23 question. Are you asking him for more details of
24 that conversation? I mean, he just answered those
25 that very question.

681612304

- 1 Q. Those conclusions were derived from conversations as
2 to whether or not Farmers' marketing of those
3 discounts constituted a conflict?
- 4 A. Yeah. The discussion came up in the course of our
5 review, and when it was pointed out from our
6 consultants Farmers was extensively involved with
7 nonsmoker discounts, we said, "Well" -- after some
8 discussion, "That's fine. We don't see any problem
9 with that."
- 10 Q. Did you discuss whether or not Farmers would be
11 allowed to continue to market those nonsmoker
12 discounts -- I mean, offer them. I mean, market
13 them.
- 14 A. We saw no reason why Farmers would not continue to
15 market nonsmoker discounts.
- 16 Q. Did you discuss whether or not statements made by
17 Farmers in the course of marketing nonsmoking
18 discounts might be attributed to BATUS or B.A.T with
19 respect to questions linking smoking to health
20 problems?
- 21 A. I don't remember any discussions specifically dealing
22 with that issue other than we did not see any problem
23 or conflict with marketing nonsmoker discounts.
- 24 Q. And I presume that at the time you had those
25 discussions, you were unaware of what's been marked

681612305

P 44

07.12.88 08:48PM *BATUS GROUP

1 as Exhibit 5001, "Facts about Smoking." I know the
2 brochure, you have seen before.

3 A. That's right. We were not aware of that until these
4 hearings started.

5 Q. Now, this brochure, as you know, states that,
6 "Statistical studies and periodic reviews confirm
7 that smoking contributes to earlier death." Does
8 BATUS agree with that statement?

9 A. Our point of view on that is that we don't know
10 whether that statement is true or not. We do believe
11 that smokers as a group are in a higher risk category
12 than nonsmokers, statistics show that, and that that
13 is the basis for the nonsmoker discounts, but that is
14 the statistical association and not the cause.

15 Q. So it's your testimony that you don't know whether
16 smoking contributes to earlier death, correct?

17 A. That's correct. I don't know whether it does or
18 doesn't.

19 Q. You are aware, are you not, that the Surgeon General
20 of the United States has concluded that smoking is a
21 cause of lung cancer?

22 A. I believe that's correct, what he just concluded.

23 Q. Does BATUS agree with the Surgeon General?

24 MR. MILLSON: I just wonder if this is the point
25 where I should start saying again that I don't think

681612306

P 45

07.12.88 08:48PM *BATUS GROUP

1 the Surgeon General's views on smoking are relevant
2 in this proceeding.

3 Q. BY MR. SMITH: Well, you are aware, are you not, Mr.
4 Arentsen, that the Surgeon General's conclusions are
5 stated in Exhibit 5001 that is distributed by
6 Farmers?

7 A. That's what the document says.

8 Q. Do you agree or disagree with the Surgeon General's
9 conclusion that smoking is a cause of lung cancer?

10 MR. MILLSON: I just leave -- maybe I should
11 just have a standing objection rather than complain
12 all the time.

13 HEARING EXAMINER TODD: Well, let the record
14 show that on that issue, we will consider a standing
15 objection. I see no reason why the witness couldn't
16 go ahead and answer that particular question. I'll
17 reserve ruling on the relevancy of any other kind.

18 Go ahead.

19 A. Mr. Smith, we, as I stated earlier, do not believe
20 that science has proven what causes cancer,
21 scientifically proven what causes cancer, and so that
22 is where we, in effect, would disagree with the
23 conclusion that there is a cause until it's
24 scientifically proven.

25 Q. Are you saying you don't know whether or not the

681612307

1 Surgeon General's conclusion is correct or not?

2 A. That's correct.

3 Q. What is B.A.T's position as to whether or not the
4 Surgeon General is correct, if you know?

5 A. It's the same position.

6 Q. Are you aware that both Mr. Sheehy and Mr. Garraway
7 testified that they believe the Surgeon General's
8 conclusion to be incorrect?

9 A. I think they said it was incorrect because they did
10 not know whether it's correct or not correct.

11 Q. Will BATUS allow Farmers to continue to distribute
12 Exhibit 5001?

13 A. No.

14 Q. Will Farmers -- excuse me. Will BATUS allow Farmers
15 to continue to market nonsmoking discounts with any
16 materials which link smoking to health problems?

17 MR. MILLSON: Are you saying -- let me make sure
18 I understand the question. Are you asking the
19 witness whether BATUS will permit Farmers to market
20 nonsmoking discounts with materials that state that
21 smoking causes cancer?

22 MR. SMITH: Or any other disease, yes.

23 A. If the question deals with whether there's a
24 statement that there's a cause, that is where I think
25 we would not agree because we don't know whether

681612308

1 there's a cause or not.

2 If the material shows a statistical association
3 or facts of that nature, we don't necessarily
4 disagree with that. I think we just have to look at
5 the material, Mr. Smith.

6 Q. Will BATUS allow Farmers to engage in any marketing
7 activities which include encouraging people to stop
8 smoking?

9 A. I don't know. I think we'd have to see if -- I mean,
10 the issue is if Farmers says, "If you stop smoking,
11 then you are entitled to a nonsmoker discount," we
12 don't see a problem with that. If they say, "Smoking
13 causes disease," then we would have a problem with
14 that.

15 Q. Were you present in Oregon and California when Mr.
16 Garraway stated that B.A.T could not and would not
17 allow Farmers to proselytize an anti-smoking program?

18 A. Yes.

19 Q. Did you agree with that?

20 A. Yeah, I think that's in the context of what I've
21 said.

22 HEARING EXAMINER TODD: Mr. Smith, could you
23 repeat that question again. I just didn't hear it.

24 MR. SMITH: Certainly.

25 HEARING EXAMINER TODD: I heard the answer, but

681612309

878

07.12.88 08:48PM *BATUS GROUP

1 I didn't hear --

2 MR. SMITH: The statement was that Mr. Garraway
3 testified in Oregon and California that B.A.T could
4 not and would not allow Farmers to proselytize an
5 anti-smoking program.

6 HEARING EXAMINER TODD: Thank you.

7 MR. MILLSON: If I could just come back to --
8 the tactic that Mr. Smith uses frequently of saying
9 to a witness, do you remember testimony given
10 somewhere else, I really think that that's not the
11 best way and the fairest way to do that.

12 If he wants the witness to hear the testimony --
13 there's been a lot of hearings now. This is not
14 apropos, this particular question.

15 I'm just concerned that the tactic seems to be,
16 you remember someone -- you know, Mr. Sheehy saying
17 this or someone saying that. I think that he should
18 just read the witness' testimony -- or not even
19 bother to read the witness' testimony. It says what
20 it says, and I think it's unfair to the witness, as
21 he sits here the end of his second day, to be
22 expected to remember a whole bunch of things and
23 nuances, and I would just make that request to Mr.
24 Smith.

25 MR. SMITH: I'm trying to make things move

681612310

049

07.12.88 08:48PM *BATUS GROUP

1 rapidly, your Honor.

2 HEARING EXAMINER TODD: Do you have any
3 objection to that?

4 Q. BY MR. SMITH: BATUS and B.A.T have also taken the
5 position, have they not, Mr. Arentsen, that if after
6 the acquisition Farmers' board of directors insists
7 on continuing to market nonsmoking discounts by
8 making statements linking smoking to disease, that
9 the board of directors of Farmers will be rearranged
10 to give BATUS a majority on the board? Is that
11 correct?

12 MR. MILLSON: That's the exact problem I just
13 asked him. There is testimony by Mr. Garraway who
14 was asked by Director Kulongoski in Oregon, in fact,
15 on this specific pamphlet Mr. Smith has there on
16 Exhibit 5001. I just object to characterizations
17 that are not quite right, and I wonder why we can't
18 just read the testimony, if that's what he wants to
19 do -- or I don't know why we need to read it to this
20 witness.

21 Whether he remembers this or not doesn't make
22 any difference. If Mr. Garraway said that, then Mr.
23 Garraway said it. I don't see the use of asking Mr.
24 Arentsen whether he remembers that. That doesn't
25 have anything to do with this proceeding.

681612311

P 50

07.12.88 08:48PM *BATUS GROUP

1 HEARING EXAMINER TODD: Let me ask Mr. Smith a
2 question.

3 Is that testimony or transcript in Oregon -- was
4 that it? -- is it going to be part of the record in
5 this hearing?

6 MR. SMITH: Your Honor, if we go back to the
7 question before, we certainly intend to mark the
8 portion of the transcript that I was citing.

9 The last question I asked -- and, you know,
10 we're slowing proceedings down tremendously with
11 these objections.

12 The last question I asked, if counsel had
13 listened to it, had nothing to do with any prior
14 testimony. I asked him, wasn't that BATUS's
15 position, isn't that the position that BATUS has
16 taken. I'm asking the witness to tell me, is that or
17 is that not BATUS's position.

18 MR. MILLSON: I may have misheard. I believe
19 that you referred to the Oregon testimony. In any
20 event, that testimony is in the record. I mean, they
21 can put in --

22 MR. SMITH: May we have the reporter read the
23 last question.

24 MR. MILLSON: If I'm wrong, I apologize.

25 HEARING EXAMINER TODD: Well, why don't we just

681612312

198

07.12.88 08:48PM *BATUS GROUP

1 have the witness answer the question that you asked
2 last.

3 MR. SMITH: I'll restate it.

4 THE WITNESS: Thank you.

5 Q. BY MR. SMITH: Mr. Arentsen, isn't it BATUS's
6 position that if Farmers' management after the
7 completion of an acquisition by BATUS continues to
8 market nonsmoking discounts by making statements
9 linking smoking to various diseases, that the board
10 of directors of Farmers will be rearranged so to give
11 BATUS a majority of the board?

12 A. Our position on that, Mr. Smith, is that, in the
13 first instance, we would want to review in great
14 detail with Farmers their marketing with respect to
15 what you have referred to, discuss with them their
16 reasons, get a good understanding of what you are
17 referring to.

18 With respect to this pamphlet, this pamphlet is
19 one that is not by any means a major portion of
20 Farmers' marketing program. It is a very minor
21 portion, as we understand it. They send out enough
22 so that one agent gets one of those pamphlets every
23 two months, and I don't have any idea how many get to
24 their possible customers.

25 In fact, many of Farmers' witnesses have -- some

681612313

292

07:12:08 PM *BATUS GROUP

1 Farmers' witnesses have not even been aware of that
2 pamphlet. We would disagree with that pamphlet.

3 Q. Are you eventually going to answer the question, Mr.
4 Arentsen?

5 A. I think it's necessary to put that question in the
6 proper context, Mr. Smith, if you don't mind.

7 Q. Can you now answer it?

8 A. Yes, I'm answering the question.

9 After we've had an opportunity to review that
10 issue, to discuss it with Farmers' management to get
11 an understanding of their position on it, if Farmers'
12 board insisted that they had to continue with that
13 pamphlet, and then I think, as Mr. Garraway stated in
14 Oregon, if they continue with that pamphlet and
15 continued with a marketing program built on
16 associating smoking as a cause of disease, then we
17 would feel that that would be irresponsible of -- for
18 us to have one corporate point of view and to allow a
19 subsidiary to do something totally inconsistent with
20 that.

21 Given all that, if they still insisted on that,
22 then, yes, we would rearrange the board.

23 Q. Do you believe it is irresponsible for Farmers to
24 distribute a brochure which states that smoking
25 causes lung cancer?

681612314

P 53

07.12.88 08:48PM *STATUS GROUP

I would say it would be irresponsible for us if we

2 owned Farmers to allow them to distribute that
3 pamphlet.

4 Q. Is it irresponsible for Farmers to distribute that
5 brochure?

6 A. I don't know. I'd have to talk with Farmers and find
7 out why they were distributing that pamphlet and what
8 their beliefs are.

9 Q. Would BATUS allow Farmers' employees to say publicly
10 that cigarette smoking causes a higher death rate?

11 A. I think we would not allow them to say it causes a
12 higher death rate. Here again, there's a difference
13 between cause and a statistical association.

14 Q. Are you aware that Thomas Welch, a Farmers employee,
15 has testified that based upon the studies conducted
16 by Farmers New World Life, Farmers has concluded that
17 cigarette smoking does cause a higher death rate?

18 A. I haven't seen that testimony, so I'm not aware of
19 that.

20 Q. Would BATUS allow Farmers to engage in advertising
21 which states, "You can quit. We can help you" --
22 excuse me, "We can help. There are a million reasons
23 why you can't quit smoking right now and a million
24 more why you should. The best reason of all, it will
25 save your life"?

1 MR. MILLSON: I just wonder whether it's
2 appropriate to keep this witness on the stand asking
3 him about brochures, et cetera. I think the general
4 thrust of his testimony is clear, that BATUS would
5 not permit Farmers to put out advertising material
6 that says smoking causes cancer.

7 I think getting more than that by reading a
8 variety of different pamphlets is merely cumulative,
9 and I would ask that we limit the examination in that
10 regard.

11 HEARING EXAMINER TODD: In regard to what Mr.
12 Millson just said, is there some way you could
13 shorten it up by listing the pamphlets or something?

14 MR. SMITH: Your Honor --

15 HEARING EXAMINER TODD: I do agree with him that
16 the answers are fairly clear.

17 MR. SMITH: Well, and I agree with that, as
18 well. There are two answers to Mr. Millson's
19 objection. The first is that, when I asked the
20 witness whether or not they would rearrange the
21 Farmers board to prevent the distribution of that
22 material, he went on at great length to explain that
23 this brochure is not widely distributed, so I think
24 it is important to relate to at least one -- one or
25 two additional advertisements to show that they would

681612316

P 55

07.12.88 08:48PM *BATUS GROUP

1 also disallow those advertisements; and my other
2 response to Mr. Millson's objection is that this is
3 the last one that I'm planning to ask him about, so
4 if he could answer that question, we can move on.

5 HEARING EXAMINER TODD: Okay. That may be the
6 simplest solution.

7 Go ahead.

8 A. I'm sorry. Could we have the question reread or
9 repeat it, please.

10 Q. Why don't I just read it. Would you allow Farmers to
11 engage in advertising which states: "You can quit.
12 We can help. There are a million reasons why you
13 can't quit smoking right now and a million more why
14 you should. The best reason of all, it will save
15 your life"?

16 A. I don't think we would allow that, Mr. Smith.

17 HEARING EXAMINER TODD: Is that last one going
18 to be an exhibit?

19 MR. SMITH: It will be an exhibit. We just got
20 these today and they haven't been marked yet, but
21 they will be.

22 HEARING EXAMINER TODD: That's all right. Thank
23 you.

24 MR. MILLSON: I don't know how many other
25 exhibits they just got today, but I would hope that

681612317

1 we would get a revised exhibit list if we're going to
2 have a lot of other exhibits coming in.

3 HEARING EXAMINER TODD: I think that's a valid
4 suggestion. Do we have another box like we had this
5 morning or yesterday?

6 MR. SMITH: We're not going to spring a new box
7 on you, your Honor. These are the only two new
8 exhibits that I know of.

9 MR. ROLFE: Hot off the press?

10 MR. MILLSON: If you could send us copies of
11 both of them with a revised exhibit list, I would be
12 most grateful.

13 MR. SMITH: Fortunately, a copy for you is
14 available right now, as soon as you -- I'm sure you
15 can hardly wait to read it.

16 MR. MILLSON: Thank you.

17 Q. BY MR. SMITH: Can you from your box, Mr. Arentsen,
18 find Exhibit 5127, please.

19 A. Yes, I have it, Mr. Smith.

20 MR. MILLSON: It's a document dated August 25th,
21 1987.

22 Q. BY MR. SMITH: First of all, would you turn to page
23 6194, Mr. Arentsen.

24 A. Yes, I have it.

25 Q. I think this is a fairly simple question. Is that

681612318

PS 7

07.12.88 08:48PM *BATUS GROUP

- 1 your handwriting?
- 2 A. Yes.
- 3 Q. Could you read that for us, please.
- 4 A. It says -- this is an exhibit dealing with
- 5 compensation and bonuses for Farmers' management, and
- 6 it says: "Strong incentive to drive up short-term
- 7 earnings. Incentive formula tied to EPS," earnings
- 8 per share of growth. "Have not" -- I think it's
- 9 "surpassed," but I'm not sure of my own writing here,
- 10 "have not surpassed targets by large amounts driven
- 11 by one-year incentive program."
- 12 Q. I'm having trouble with the same words. Would you
- 13 turn back to page 5176, please.
- 14 A. Yes, I have it.
- 15 Q. The third bullet says: "To maintain the current
- 16 management fee level, capital shortfall of
- 17 approximately \$2 billion within the next ten years
- 18 will need to be addressed."
- 19 What is your understanding of what that
- 20 statement means?
- 21 A. This was a summary of a report from Tillinghast. I
- 22 think it dealt with their assessment of the
- 23 underreserving, and if you extrapolated that out, I
- 24 think that's the context of it. I'd have to go back
- 25 and --

681612319

P 55

07.12.88 08:48PM *BATUS GROUP

1 Q. It's a \$2.7 billion shortfall in the reserves of the
2 Exchanges?

3 MR. MILLSON: I think, Mr. Arentsen, if you do
4 need to go back and look -- you said you might have
5 to do that -- I would do that rather than just answer
6 the question.

7 Your Honor, I don't know if you would like just
8 to have Mr. Arentsen look at the document more
9 overnight since it doesn't seem Mr. Smith is going to
10 finish by five o'clock, anyway, and we can return to
11 this answer in the morning -- or, Wayne, what is your
12 pleasure on that?

13 MR. SMITH: I'd be happy to let him review the
14 document overnight, and I'll go on to something else
15 now because I don't want to --

16 MR. MILLSON: Are you going to finish tonight?

17 MR. SMITH: No.

18 HEARING EXAMINER TODD: Why don't we go ahead
19 and hold up the question for him to answer tomorrow.

20 Q. BY MR. SMITH: Mr. Arentsen, when we were looking at
21 one of the exhibits that included some calculations
22 with respect to Farmers' surplus ratio, you said, I
23 believe -- and correct me if I'm wrong -- BATUS is
24 committed to a surplus ratio no worse than 3.2 to one
25 and we want to have a better ratio. Was that a

681612320

882

07.12.88 08:48PM *BATUS GROUP

1 correct summary of your testimony?

2 MR. MILLSON: Did you say, 3.2?

3 MR. SMITH: I'm sorry.

4 Q. BATUS is committed to a surplus ratio no worse than
5 three to one, three colon one.

6 A. Yes. We're committed to maintaining a ratio of three
7 to one, which has been what Farmers has typically
8 maintained, although they have exceeded that slightly
9 in the past.

10 I believe in 1986, they exceeded it
11 significantly before they put the 200 million capital
12 contribution in which brought them back to a three to
13 one ratio, but we would be committed to maintaining
14 the ratio at three to one.

15 MR. SMITH: Your Honor, I don't mean to be
16 picky, but I hope when people start complaining about
17 how long the cross-examination has gone, that the
18 extra information contained in the answers be kept in
19 mind.

20 I asked what BATUS's commitment was and I got a
21 little dissertation on Farmers' history along with
22 it. I don't mind that, but it's taking significantly
23 longer than it otherwise would to complete the
24 cross-examination.

25 MR. MILLSON: I haven't complained yet, Wayne.

68161222

1 I would rather the witness give full and fair
2 answers.

3 Q. Did you also state, Mr. Arentsen, that it would be
4 BATUS's intention to have a surplus ratio better than
5 three to one?

6 A. I think we would prefer having a surplus ratio better
7 than three to one. I think, obviously, that's better
8 for the business.

9 Q. How do you intend to achieve a surplus ratio of
10 better than three to one?

11 A. Well, we would have to review that with Farmers'
12 management to get their opinion on it. They may have
13 good reasons to say that three to one is better than
14 something more stronger than three to one.

15 Other things being equal, we would prefer to
16 have a stronger ratio than three to one, but I'm also
17 saying that there's nothing wrong with three to one.

18 Q. What plans does BATUS have to fulfill its commitment
19 to maintain a surplus ratio no worse than three to
20 one?

21 A. Well, we would have capital available to Farmers.
22 And as Farmers has done in the past with surplus
23 contributions to the Exchanges in the form of capital
24 surplus notes, if that were appropriate, then that's
25 one of the things that we would do.

681612322

P 61

07.12.88 08:48PM *BATUS GROUP

1 I would also point out that Farmers seems to
2 have been able to manage their business within a
3 three to one ratio with the exception of 1986, when
4 they had a 20 percent premium growth rate, and that
5 may well have been an unusual situation.

6 Q. Do you have a projection for the Exchanges which goes
7 with Exhibit 18 and which demonstrates that you will
8 be able -- or, excuse me, that the Exchanges will be
9 able to maintain a three to one surplus ratio under
10 the growth plan set forth in Exhibit 18?

11 MR. MILLSON: What do you mean, goes with 18? I
12 don't understand that.

13 Q. Do you understand the question, Mr. Arentsen?

14 A. I'm not sure, Mr. Smith.

15 Q. Do you have a projection for the Exchanges which
16 demonstrates that under the growth plan set forth in
17 Exhibit 18, the Exchanges will be able to maintain a
18 surplus ratio no worse than three to one?

19 A. As we've stated in previous testimony, we have done
20 projections of the Exchanges. That was not part of
21 these projections. Those projections dealt with the
22 valuation of the business, and those projections, as
23 agreed, have not been produced.

24 MR. MILLSON: Let me say, with one exception,
25 there was the board report that you took them through

681612323

07.12.88 08:48PM *BATLIS GROUP

1 yesterday, right? There were projections of the
2 surplus to the Exchanges?

3 THE WITNESS: Right. And as shown in that board
4 report, at different growth rates, the Exchanges were
5 able to maintain a three to one ratio. I think that
6 the ratios were laid out in that sensitivity. I
7 would have to go back to that document to --

10 or not you have done a projection for the Exchanges
11 which matches the assumptions and growth rates in
12 Exhibit 18 and which demonstrates that Exhibit 18 is
13 achievable while, at the same time, the Exchanges are
14 maintaining a reserve ratio no worse than three to
15 one.

16 A. Well, as I said earlier, the Exchanges' projections
17 were done separately from these projections, and if
18 you would allow me to go back to the September board
19 report, I could look that up for you.

20 Q. And do any of the projections in the September board
 report contain the same assumptions as set forth in

1 Exchanges, so we really have two different sets of
2 projections.

3 Q. Well, do you have a set of projections for the
4 Exchanges which backs up the business growth shown in
5 Exhibit 18 and shows that the Exchanges, the
6 underlying insurance business, can support the growth
7 in Exhibit 18 under the assumptions in Exhibit 18
8 without exceeding a three to one surplus ratio?

9 A. And what I've stated is that the Exchange projections
10 that are summarized in the September board report
11 show that.

12 Q. They do?

13 A. Yes, sir.

14 Q. One of the assumptions in the September board report
15 assumes the growth rate under the same assumptions
16 that are set forth in Exhibit 18; is that your
17 testimony?

18 A. Well, the growth rate in Exhibit 18 deals with a net
19 income growth rate of Farmers Group, does not deal
20 with the premium growth rate, and that includes a
21 life company and it includes investment income and it
22 includes a lot of other things.

23 With respect to the Exchanges, the sensitivities
24 on the Exchanges in the board report deal with
25 different growth rates in premiums, so it's a

681612325

792

07.12.88 08:48PM *BATVUS GROUP

- 1 question of whether or not you are talking about net
2 income growth rates or premium growth rates.
- 3 Q. The projections that are contained in Exhibit 18 are
4 not the projections upon which you based your
5 decision to proceed with the hostile tender offer; is
6 that correct?
- 7 A. The projections to proceed with the acquisition of
8 Farmers is in the board report dated September '87.
- 9 Q. And --
- 10 A. Those other projections were done in April '88.
- 11 Q. And the September '87 projections assume that OSL and
12 IGL will be sold, correct?
- 13 A. Yes.
- 14 Q. And they also assume that \$750 million will be paid
15 out of Farmers post-acquisition, correct?
- 16 A. They assume the cash availability of that, including
17 the proceeds from the two sales you referred to.
- 18 Q. My question is whether when you came down to March 3,
19 1988, you had some other set of projections, neither
20 those contained in the board report nor those
21 contained in, obviously, the subsequently prepared
22 Exhibit 18, which supported your decision to launch
23 the tender offer on March 3, 1988.
- 24 MR. MILLSON: I'm not sure what you mean by
25 "support." He's already testified that they got

681612326

- 1 approval from the board in September based on some
2 projections, and you are asking whether there were
3 other projections that went to the board? Is that
4 what you are saying?
- 5 Q. Did someone make a decision on March 3 or shortly
6 before to launch the tender offer?
- 7 A. Yes.
- 8 Q. And were any projections prepared in connection with
9 that decision?
- 10 A. I was at that meeting and there were no projections
11 reviewed at that meeting.
- 12 Q. Were any --
- 13 A. In other words, there was information presented by
14 Goldman, Sachs dealing with valuation.
- 15 Q. Dealing with valuation wholly or in part, was the
16 information that Goldman, Sachs presented at that
17 meeting different from the projections which BATUS
18 had prepared for Farmers business?
- 19 A. Well, it was information that Goldman, Sachs had
20 prepared dealing with valuation.
- 21 Q. My point is that the Goldman, Sachs valuation
22 information did not include the BATUS projections for
23 Farmers' business; is that correct?
- 24 A. I think that's correct. I think they may have had
25 some of their own projections.

681612327

FEE

07.12.88 08:48PM *BATUS GROUP

- 1 Q. Now, did BATUS prepare a set of projections which
2 supported or justified offering \$63 per share for
3 Farmers' stock?
- 4 A. Are we getting into information we're not supposed to
5 talk about, valuations?
- 6 Q. It's just a yes or a no.
- 7 A. We prepared several sets of projections dealing with
8 valuation, if that's your question.
- 9 Q. Do you have a set of projections for Farmers'
10 business which relates to the \$63 price which has
11 been offered?
- 12 MR. MILLSON: You are asking, in addition to the
13 September board report, which you have?
- 14 MR. SMITH: Yes.
- 15 A. We have projections that deal with valuation and at
16 different price levels, and these projections here
17 deal with the \$63 specific price.
- 18 Q. Which projections are "these projections here"?
- 19 A. The April 7th.
- 20 Q. Do you have projections on the same format of Exhibit
21 18, the April 7 projections, which deal with
22 different prices?
- 23 A. No.
- 24 Q. Do you have projections on the other format which
25 relates specifically to the \$63 price?

681612328

P 67

07.12.88 08:48PM *BATUS GROUP

- 1 A. I don't recall, Mr. Smith. I'd have to go back and
2 look. I know we looked at different prices. I don't
3 recall a \$63 price being one of those, but I'd have
4 to check it to make sure.
- 5 Q. Was the \$60 price that was initially offered on March
6 3 one of the prices that is set forth or included in
7 one of the projections that you did?
- 8 MR. MILLSON: Wayne, you said 60 on March 3?
- 9 MR. SMITH: Yes.
- 10 MR. MILLSON: I don't recall 60 being offered.
- 11 Q. Well, what was the price offered on March 3 when the
12 tender offer was initially launched, Mr. Arentsen?
- 13 A. I believe that was the \$63 price.
- 14 Q. Wasn't there earlier an offer of \$60 a share?
- 15 A. There was a proposal, but not a tender offer, but at
16 \$60 a share.
- 17 Q. It is not your recollection that the tender offer was
18 launched at \$60 a share and then amended upward
19 thereafter?
- 20 A. I think it was at 63, which was an increase of the
21 prior proposal, which was at 60.
- 22 Q. Do you have a set of projections which relate to the
23 \$60 which was included in the earlier projection?
- 24 A. I think we may have included \$60, yes.
- 25 Q. And what is the growth rate that is assumed for

681612329

07.12.88 08:48PM *BATUS GROUP

P88

1 Farmers in the \$60 projection?

2 MR. MILLSON: I'm going to object to any.
3 valuation information. We have a clear deal that, to
4 quote Mr. Smith's partner, Mr. Fairbank, "I think a
5 quantitative answer and the pricing value fits within
6 that agreement." We have a clear deal that they
7 can't ask for pricing information, and I don't
8 know --

9 MR. FAIRBANK: May we see the whole text of
10 that? I'll be glad to talk about it in that context,
11 but don't quote me for two or three words out of
12 that.

13 MR. MILLSON: Do you recall -- the question
14 was: "Do you recall of your own personal knowledge
15 any of the projections in that computer valuation
16 model that related to the Exchanges' performance?"

17 I objected. There was several pages of
18 colloquy. You can look at it overnight, if you
19 like. Maybe that's the most efficient thing to do.
20 It's page 212, and following those on, it goes on for
21 to page 216, and I think --

22 HEARING EXAMINER TODD: Perhaps I could save you
23 a little time.

24 MR. FAIRBANK: I think he's proven my point.

25 HEARING EXAMINER TODD: I really don't see any

681612330

07.12.88 08:48PM *BATUS GROUP

288

1 relevancy of valuation proposals.

2 MR. SMITH: Your Honor --

3 HEARING EXAMINER TODD: I'll tell you why. That
4 used to be in our act because we had to approve the
5 price. It was taken out by our legislature, so
6 unless you can convince me otherwise, I see no
7 purpose of continuing on that line.

8 MR. SMITH: Your Honor, the whole -- the clear
9 agreement that Mr. Millson states and which has never
10 been --

11 HEARING EXAMINER TODD: Well, I'm not talking
12 about the agreement.

13 MR. SMITH: I say, it's never been an
14 agreement. The reason -- what we agreed to
15 initially, to the extent we agreed -- we made an
16 argument before the Arizona Commissioner.

17 What we agreed was that the issue of price was
18 not relevant vis-a-vis the standards of fairness to
19 the shareholders. That, indeed, used to be a
20 criterion in a number of states, and in those states
21 which had not removed that criteria subsequent to the
22 Williams Act, we agreed that it was inappropriate for
23 commissioners to determine whether or not the price
24 offer was fair to shareholders.

25 What we're talking about here is something

681612331

07.12.88 08:48PM *BATVS GROUP

P70

1 entirely different, which is, we have a set of
2 projections which have been prepared expressly and
3 exclusively for the regulatory proceeding that are
4 not part of any business-making work that the company
5 did, that were not used to form the basis for any
6 decision that they made, but, rather, they have some
7 wholly separate set of projections with wholly
8 different assumptions which relate to what it is that
9 they really intend for Farmers' business to do.

10 And what we've been trying to show is that one
11 must find out -- to get through the superficial,
12 "There is no plans," one must get to the documents to
13 show what they have really projected for Farmers
14 business.

15 We have always agreed that they can blank out
16 any portion of those documents which would show the
17 actual price that they are willing to pay, and I'm
18 not asking Mr. Arentsen to tell me what price they're
19 willing to pay. I'm asking him about two
20 projections: One, is \$60 a share -- the present
21 offer is 63. He said they did prepare a set of
22 projections at 60, he will have to look to see if
23 they prepared one at 63.

24 The only question I have asked is the growth
25 rate assumed in those projections because I think

681612332

07.12.88 08:46PM *BATUS GROUP

P 71

1 that that will tell us whether or not the growth rate
2 that is in Exhibit 18 bears any relationship to what
3 they really project for this business, and that's the
4 purpose of the question.

5 I'm not trying to get at what price they really
6 want to pay or the fairness of the price.

7 MR. MILLSON: If I could just respond to that
8 briefly, I believe that your Honor is the sixth or
9 maybe the seventh state -- I can't remember now --
10 that has made this precise same ruling.

11 I would say that Mr. Smith asked this question
12 in Illinois about these same projections. Mr. Smith
13 stood up and said, "Those projections have not been
14 produced and they have never been ordered produced."
15 The Illinois department said they weren't interested
16 in the projections. They are clear of valuation
17 data.

18 When he says that he wants to know the
19 information on which the board made the business
20 decision, he has that information and he can examine
21 Mr. Arentsen about --

22 Mr. Arentsen has on several occasions here
23 during this very afternoon suggested to Mr. Smith
24 that maybe he should get out the board report to
25 answer some of Mr. Smith's questions, but Mr. Smith

681612333

07.12.88 08:48PM *BATUL GROUP

P 72

1 doesn't want to hear that for some reason, and I just
2 think this is a fishing expedition into our valuation
3 data.

4 The witness has testified several times that it
5 is valuation data. It has been ruled now in six or
6 seven states, as I say, that that's irrelevant, and I
7 just --

8 And I also disagree with Mr. Smith's statement
9 that there was not a deal on this. And you can see,
10 we submitted a document -- I've forgotten what day it
11 is -- yesterday where we described the numerous
12 occasions on which Mr. Smith, Mr. Karic, Mr. Fairbank
13 and others have said there was a deal, and I just
14 don't think that here, in the seventh state, they
15 should even try to waltz on it, but your Honor has
16 ruled it's irrelevant. I shall say no more.

17 MR. SMITH: Your Honor, I must respond to that.
18 First of all, the document that they filed which uses
19 the word "agreement" is an example of contorting
20 words out of context just as here. I said I have
21 agreed and I agreed sitting here when we were arguing
22 with the hearing officers that certain areas of
23 information should not be produced.

24 That is then extrapolated into some kind of a
25 global, quote, unquote, deal from which no one can

1 ever renege. It's clear we never had that deal
2 because Mr. Millson is correct that we have requested
3 -- not in all of the previous states, but we have
4 requested elsewhere that some of these projections be
5 produced.

6 We have never, to the best of my recollection,
7 requested that rather than have the projections
8 produced, that they merely tell us what growth rate
9 is assumed in those projections.

10 MR. MILLSON: Wayne, I have to tell you, twice
11 you have done that. You personally did that in
12 Illinois and Mr. Ziegler did it in Ohio. On each
13 occasion, the hearing officer overruled that.

14 And I remember in Illinois saying to you that --
15 I believe at Mr. Schultz' deposition, where we
16 accidentally or whatever asked about the assumptions
17 in your plan, your people took the position that if
18 you knew what the assumptions were, you can -- anyone
19 could stick it into a computer. That's what the key
20 element is, is the assumption.

21 MR. SMITH: I have given you the courtesy of not
22 interrupting you. I would appreciate if I could
23 finish my statement.

24 MR. MILLSON: I apologize.

25 MR. SMITH: And as I said, to the best of my

681612335

07.12.88 08:48PM *STATUS GROUP

P 74

1 recollection, and I stand on that, we have not asked
2 the specific question, produce the growth rate
3 without the document, and I said to the best of my
4 recollection.

5 I was not in Ohio. I don't know what Mr.
6 Ziegler asked, and if I asked it in Illinois, then
7 maybe this proves -- I hope will prove the adage that
8 if you don't succeed at first try, try, try again.

9 I do believe it is appropriate that we have that
10 information. Mr. Millson says that the witness has
11 told us several times to go to the projections in the
12 September board report, and that highlights the exact
13 problem that we have, because if I go to the
14 projections in the September board report, I find
15 assumptions wholly inconsistent with Exhibit 18, I
16 find assumptions that are wholly inconsistent with
17 the form A.

18 And I told the witness, your board of directors
19 approved this transaction based on assumptions wholly
20 inconsistent with what you want the regulatory bodies
21 to believe you are going to do with this business,
22 and the witness tells me, well, all of those
23 assumptions changed; that between the September board
24 meeting and the launching of the hostile tender
25 offer, we have changed all of our assumptions.

681612336

07.12.88 08:48PM *BATV5 GROUP

P 75

1 Now that I want to know what the new assumptions
2 are, they say, why don't you go back to the September
3 board meeting assumptions. Well, they can't have it
4 both ways.

5 MR. MILLSON: Wayne, I'll get you the Illinois
6 transcript where you asked for the assumptions and
7 the judge overruled you. I'll show it to you
8 tonight.

9 I would say that the witness has been asked on
10 two assumptions, I believe, that they changed since
11 September. One was the sale of the Ohio State Life
12 and the other was the extraordinary dividend. I
13 asked him about that. There is a board report that
14 says that they're not going to do that. The witness
15 testified about that at length in -- I've lost the
16 state -- Ohio.

17 There is also testimony from Mr. Garraway and
18 others that that is not what they intend to do, and I
19 just -- I don't see that --

20 By the way, the Ohio Life company and the
21 extraordinary dividends don't have anything to do
22 with the Exchanges. They are utterly irrelevant to
23 the Exchanges. The dividend comes out of the
24 management company and Ohio State Life is not a P & C
25 company.

681612337

07.12.88 08:48PM *BATUS GROUP

P 78

1 HEARING EXAMINER TODD: I think I understand,
2 really, where both sides are coming from on this, but
3 because -- for the reason I stated earlier, we won't
4 allow the way it was asked, at least, price
5 information to be instituted in this proceeding tied
6 to those projections.

7 If you want to get through to projections
8 separated from the price, perhaps there's some other
9 way to do it, but this current way would not be
10 permissible.

11 This appears to be a very good time to stop for
12 this evening, and we'll now adjourn and convene again
13 at nine in the morning.

14 MR. MILLSON: Thank you, your Honor.

15 HEARING EXAMINER TODD: Thank you.

16 (PROCEEDINGS ADJOURNED)
17
18
19
20
21
22
23
24
25

681612338 -

07.12.88 08:48PM *STATUS GROUP

P 77