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Rebuttal Economic Analysis of Receivables Transactions Involving McKesson Canada Corporation and McKesson International Holdings III S.ar.l.: Fiscal Year 2003

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McKesson Canada Transfer Pricing Rebuttal Report

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McKesson Canada Transfer Pricing Rebuttal Report

I. Assignment & Overview

A. Assignment and Valuation Issues

McKesson Corporation, a multinational healthcare company, primarily distributes pharmaceuticals and other healthcare products throughout North America.[1] In 2003, McKesson's operations principally focused in the United States and Canada. With headquarters in the United States, McKesson operates as the leading provider of pharmaceuticals and other healthcare products in Canada through its Canadian subsidiary, McKesson Canada Corporation ("MCC").

During the 2003 fiscal year, MCC engaged in two interrelated intercompany transactions with McKesson International Holdings III S.ar.l. of Luxembourg ("MIH"). In particular, MCC transferred its existing and future (for five years) eligible accounts receivables[2] and related assets to MIH. In addition, MIH appointed MCC as its servicing agent for these receivables.[3] MCC proposed that it sell these receivables at face value of approximately $2.2 billion[4] less a *net* discount of 2.075 percent (or 207.5 "basis points"[5]), based most directly on analyses by TD Securities. See **Tables 1A-1B**.

In its original analyses, the taxpayer set its prices in two steps. First, it targeted the receivable price to be equivalent to the arm's length price at which MCC sold to its customers. See **Table 1A**. As the receivables would not be collected immediately—that is, equivalent to cash—the taxpayer made adjustments to this market price for differences in the form of a "discount" rate. See **Table 4**. Its net discount of 207.5 basis points represented the total of six components (see **Table 1B**).[6]

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1 McKesson Corporation. (6 June 2003). Form 10-K for the Fiscal Year Ended March 31, 2003, p. 3.

2 A small portion of MCC's receivables including those defined as "Arrangements and Inter-Co Receivables" were not transferred. Canada Revenue Agency. (10 January 2008). Taxpayer Response to Audit Query No. T119-11.

3 McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement."; and McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Servicing Agreement."

4 All dollars are in Canadian dollars unless specified otherwise.

5 A "basis point" is equivalent to 1/100 of a percentage point. That is, 1.00 percent would be equivalent to 100 basis points.

6 In point of fact, the taxpayer computed both a servicing fee discount and a service fee. Netting out these two factors creates a single "Net Discount" as opposed to having both a "Gross Discount" and a servicing fee.

The Department of Justice Canada ("DOJ") engaged Precision Economics, LLC in 2009 to analyze the two intercompany transfers described above. In particular, I was hired to critically analyze these transfer prices and the taxpayer's submissions thereon to determine whether the reported transfer prices were consistent with arm's length expectations. I completed that assignment on April 4, 2011 in a report entitled, "Economic Analysis of Receivables Transactions Involving McKesson Canada Corporation and McKesson International Holdings III S.ar.l.: Fiscal Year 2003" ("BECKER AFFIRMATIVE REPORT").

The BECKER AFFIRMATIVE REPORT performed analogous two-step approaches to the valuation. For the primary pricing issue, the BECKER AFFIRMATIVE REPORT agreed with the taxpayer that the best initial indicator of the receivables' arm's length value would be the price at which MCC sold to its customers—approximately $2.2 billion. See **Tables 1A & 4**. The BECKER AFFIRMATIVE REPORT, however, (principally)[7] disagreed over the quantum of three of the *components to the adjustment* to this uncontrolled price (see **Table 1B**):

- The BECKER AFFIRMATIVE REPORT did not find that MCC would be paid any premium (the taxpayer originally computed a premium of 51.8 basis points) above the cost of servicing as a discount to fund the servicing operation.
- The BECKER AFFIRMATIVE REPORT did not find that MIH would need to provide more cash (45.6 basis points) to MCC based upon MIH's risk profile. That is, MCC would be indifferent to the risk profile of the company purchasing its receivables.
- The BECKER AFFIRMATIVE REPORT computed the loss discount (percent of time when MCC's customers do not pay) at average historic levels of 4.4 basis points as opposed to the higher value (23.0 basis points) originally advanced by the taxpayer.

In total, these differences represented more than 120 basis points. After incorporating an additional approach to discounting using a factoring agreement for MCC, the BECKER AFFIRMATIVE REPORT determined an arm's length net discount of 83.9 basis points as an adjustment to be subtracted from the receivables price.[8] See **Table 2**. In dollar terms, the opinion of arm's length prices was (see **Tables 3-4**):

- A receivables price of $2.2 billion (agreement with the taxpayer).

[7] There were other relatively modest differences seen in **Table 1B**.

[8] This rate was arrived at through a consideration of an adjustment to the receivables price, as well as an adjustment to the discount rate in a factoring agreement between McKesson's Canadian operations and a third party.

- Less net adjustments to this uncontrolled price of $18.3 million ($27.0 million lower adjustments than the taxpayer had proposed).

Following the BECKER AFFIRMATIVE REPORT, the DOJ has engaged Precision Economics to analyze certain topics addressed within the expert reports filed by the taxpayer on April 11, 2011 (the “LIPSON REPORT,” the “FRISCH REPORT,” and the “REIFSNYDER REPORT”).[9] First, I was asked to determine whether my opinions in the BECKER AFFIRMATIVE REPORT changed after reviewing these reports. I can state that my opinions on the arm’s length prices have not changed.

Second, the DOJ asked me to provide an opinion on the issues in the taxpayer’s April 2011 reports that overlapped with the topics addressed in the BECKER AFFIRMATIVE REPORT. I have completed the details of this second assignment in Chapters II and III of this report and summarized those results in the section below.

In general, only the REIFSNYDER REPORT provided a valuation that could be compared with the taxpayer’s actual payments (and original submissions) and/or the BECKER AFFIRMATIVE REPORT.[10] In particular, the REIFSNYDER REPORT estimated a receivables arm’s length price equivalent to that of the taxpayer’s original submissions and that of the BECKER AFFIRMATIVE REPORT—approximately $2.2 billion. See **Tables 1A & 4**.

The REIFSNYDER REPORT adjusted the arm’s length receivable price with discount “components” of different magnitude than either the taxpayer’s original submissions or the BECKER AFFIRMATIVE REPORT. The REIFSNYDER REPORT “corrected” two of the three *non*-arm’s length values used in the original taxpayer computations of a discount rate identified in the BECKER AFFIRMATIVE REPORT. That is, the REIFSNYDER REPORT did *not* compute: (i) a premium of the servicing discount rate above the servicing fee; *or* (ii) a cost of capital discount. See below and **Table 1B**.

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[9] Lipson, Jonathan C. (8 April 2011). “Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP.”; Frisch, Daniel J. (7 April 2011). “Transfer Pricing Methods and Intercompany Receivables Sale between McKesson Canada Corporation and McKesson International Holdings III S.a.r.l.” Horst Frisch Incorporated.; and Reifsnyder, Jeremy E. (7 April 2011). “Expert Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP.” TLD Partners LLC.

[10] I provide further detail of the other two reports later in this document, but those reports generally do not offer a valuation nor do they generally comment on the approaches/data used in the BECKER AFFIRMATIVE REPORT.

Comparison of Differences in Net Discount Rate Computations

Component of Discount Rate (Basis Points)	**Taxpayer**	**BECKER AFFIRMATIVE REPORT**	**REIFSNYDER REPORT**
Servicing Discount Rate Above Servicing Fee	51.8	0.0	0.0
Cost of Capital Discount	45.6	0.0	0.0
Loss Discount	23.0	**4.4**	**125.6**

While the REIFSNYDER REPORT corrected two of the three non-arm's length values, it *accentuated* the other *non*-arm's length value the taxpayer had originally set for the loss discount. In particular, the REIFSNYDER REPORT inflated the (already greater than arm's length) loss discount from 23.0 to *125.6* basis points.[11] See **Table 1B** and above.

In making its credit risk calculation, the REIFSNYDER REPORT chose to ignore the direct internal comparable[12]—actual losses for MCC for the *same* types of receivables in the immediately preceding time periods. Rather, the REIFSNYDER REPORT chose indirect external comparables in the form of returns to junk bonds, various calculations in a nine-step process, and approximately two dozen assumptions. This multi-step process resulted in a rate that was almost 30 times the historical losses seen by MCC. See below and **Tables 6 & 8A-8B**.

MCC's Historical Losses As a Percent of Sales: 2000-2003

Losses (Basis Points): 2000-2003	**Consolidated Write-Off As Percent of Sales**
Minimum	2.5
Average (Applied by BECKER AFFIRMATIVE REPORT)	**4.4**
Maximum	6.6
Level Applied by REIFSNYDER REPORT	**125.6**

The order of magnitude increase to actual historic losses proposed by the REIFSNYDER REPORT can be better understood with an example. In the case of these receivables, the losses would quickly grow if an MCC customer simply chose to withhold *all* payments. This would be

[11] The REIFSNYDER REPORT refers to this loss discount as "credit risk" and computes a range. Unless otherwise stated, I will refer to its middle scenario ("B"). Reifsnyder, Jeremy E. (7 April 2011). "Expert Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP." TLD Partners LLC, p. 16.

[12] Internal comparable in transfer pricing generally refers to an arm's length transaction involving one of the parties to the intercompany transaction at issue. Similar terminology is defined in the FRISCH REPORT. Frisch, Daniel J. (7 April 2011). "Transfer Pricing Methods and Intercompany Receivables Sale between McKesson Canada Corporation and McKesson International Holdings III S.a.r.l." Horst Frisch Incorporated, p. 9.

accentuated in an extreme case where, for example, that customer: (a) was a major customer of MCC (say one percent of MCC's receivables); and (b) was not "cut off" by MCC for a relatively long time (say three months). The *mathematical* impact of such a significant event on the discount rate would, however, only be *5 basis points*.[13] Put another way, for MCC to have the poor fortunes implied by the REIFSNYDER REPORT, it would need to expect that it would experience the bad luck to witness *25* significant customers refusing to pay anything for three months apiece. By contrast, MCC's historic losses suggest that it did not suffer any such significant customer non-payments in recent years.[14]

Outside of the loss discount valuation component, the REIFSNYDER REPORT's result is essentially consistent with arm's length expectations. See **Table 1B**. Incorporating this non-trivial non-arm's length loss discount, however, the REIFSNYDER REPORT incorrectly implies that MCC would sell an asset *worth* 99.96 for only 98.74. See **Table 7**. Similarly, it would incorrectly imply that MIH would receive an (economically non-existent) "free lunch"—that is, pay 98.74 for an asset known to be worth 99.96.

B. Materials Reviewed

I analyzed the MCKESSON CANADA transfer prices using publicly available documents and documents supplied by MCKESSON CANADA as part of this dispute. Some of the documents reviewed are listed below:[15]

- "Letter from Barbara Hooper to McKesson Canada Corporation and Blake Cassels & Graydon, LLP, December 16, 2002";
- "Letter from Barbara Hooper to McKesson Canada Corporation and Blake Cassels & Graydon, LLP, April 25, 2003";
- "PriceWaterhouseCoopers, McKesson Canada Corporation, Factoring Review, December 14, 2005";
- Case briefings by DOJ and the taxpayer as referenced below;
- MCC, MIH, and McKesson Corporation financial statements;
- McKesson Corporation Forms 10-K, 2002-2004;

[13] That is, 1% × 3/60 months = 0.05 percent, or five basis points.

[14] There is no documentation that MCC experienced any problems near this magnitude in the years leading up to the RSA, and its total losses translated to less than five basis points. See **Table 5**.

[15] Appendix B contains a complete listing of the documents I relied upon in these analyses.

- Lipson, Jonathan C. (8 April 2011). "Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP." ("LIPSON REPORT");

- Frisch, Daniel J. (7 April 2011). "Transfer Pricing Methods and Intercompany Receivables Sale between McKesson Canada Corporation and McKesson International Holdings III S.a.r.l." Horst Frisch Incorporated. ("FRISCH REPORT");

- Reifsnyder, Jeremy E. (7 April 2011). "Expert Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP." TLD Partners LLC. ("REIFSNYDER REPORT");

- BECKER AFFIRMATIVE REPORT; and

- Intercompany agreements between MIH and MCC.

C. Qualifications

My name is Brian C. Becker. I am the founder and President of Precision Economics. A copy of my current curriculum vitae, which includes a complete listing of my publications, teaching experience, and expert testimony, is attached to this report as Appendix A.

I have been employed as a consulting economist for more than 18 years. Prior to founding Precision Economics in 2001, I gained experience with several consulting firms. My primary areas of focus in these positions were in transfer pricing, business valuation, international trade, intellectual property, and financial damages.

In the transfer pricing/valuation area, I have testified as an expert witness, published more than twenty articles, and spoken to a number of industry/government groups. In total, this experience includes more than 400 transfer pricing reports for taxpayers, law firms, and tax authorities. Among my primary areas of focus in these analysis has been financial products and risk analysis. This has included the determination of arm's length credit ratings/credit worthiness (probability of payback), guarantee fees, and interest rates.

I have provided expert testimony in various venues, including The Administrative Appeals Tribunal (Australia), The Canadian International Trade Tribunal, The Federal Court of Australia, The Tax Court of Canada, The U.S. International Trade Commission, The U.S. Supreme Court, and U.S. Tax Court. Among recent assignments that are a matter of public record, I served as a transfer pricing economic expert for the U.S. Internal Revenue Service in its 2006 dispute with GlaxoSmithKline involving tangible goods and intangible property. In 2008 and 2009, I served as a transfer pricing economic expert for the Australian Government Solicitor and the Australian Taxation Office in Australia's first two major transfer pricing trials (Roche and SNF) involving the inbound purchases of tangible goods. In 2009, I served as a transfer pricing economic expert for the Department of Justice Canada and the Canada Revenue Agency in a transfer pricing dispute with General Electric involving financial guarantees. In 2010, I testified as an expert witness in a U.S. Tax Court transfer pricing matter involving intercompany services with Weekend Warrior Trailers, Inc.

My academic background includes teaching positions at four universities and a variety of published research. Most recently, at Johns Hopkins University, I taught Corporate Finance and Derivative Securities to MBA students where the topics focused on the quantification of risk and return. I have published more than two dozen articles and book chapters, including in the *Tax Management Transfer Pricing Report*, *Corporate Business Taxation Monthly*, *Business Valuation Review,* and *Business Valuation Digest.* This research includes the incorporation of risk/return with regards to discount rates as well as the arm's length accounting for receivables (and payables and inventory) in comparing profits across companies.

I received my B.A. in Applied Mathematics and Economics from the Johns Hopkins University. I received my M.A. and Ph.D. in Applied Economics from the Wharton School of the University of Pennsylvania.

D. Organization of Report

I organize this report into three chapters, supporting tables, and various appendices. This first chapter outlines the scope of the project and summarizes the conclusions. Chapter II summarizes the approach and results in the three taxpayer reports submitted on April 11, 2011. Chapter III critically analyzes the three taxpayer reports, and describes their impact (or lack thereof) on the opinions in the BECKER AFFIRMATIVE REPORT. Tables and appendices follow the text.

II. Summary of Taxpayer Expert Reports

A. Overview

The taxpayer submitted three expert reports on or around April 11, 2011. Each report answered a different question(s) regarding the receivables sales, by professionals with different backgrounds. As described in more detail below:

- The LIPSON REPORT defined a securitization transactions based upon the expertise of a law school professor.[16] Using this definition, the LIPSON REPORT also opined that the MCC/MIH receivables sale at issue was *not* a securitization.[17]

- The FRISCH REPORT first provided a transfer pricing Ph.D. economist's[18] review of the allowable transfer pricing calculation methods explicitly specified/named under Canadian tax law—principally those based on transactional and profitability data from arm's length transactions. The FRISCH REPORT then opined that it could *not* apply any of the specified methods to the data/transactions/approaches that it considered. Finally, the FRISCH REPORT concluded that its author, Dr. Daniel J. Frisch, did not have the experience/expertise with financing transactions to value the receivables sale at issue.[19]

- The REIFSNYDER REPORT determined an arm's length price for the receivables sale at issue, based upon the opinion of an MBA-trained

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[16] Mr. Lipson's education includes a B.A. in History and Philosophy prior to his J.D. In addition to serving as a Professor, Mr. Lipson previously served as a law firm Associate and Senior Associate for approximately nine years. Lipson, Jonathan C. (8 April 2011). "Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP," p. 28.

[17] Lipson, Jonathan C. (8 April 2011). "Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP," p. 2.

[18] Dr. Frisch preceded his Ph.D. in Economics with M.A. and A.B. degrees in Economics. His experience includes government, research, and academic positions in addition to his transfer pricing work. Frisch, Daniel J. (7 April 2011). "Transfer Pricing Methods and Intercompany Receivables Sale between McKesson Canada Corporation and McKesson International Holdings III S.a.r.l." Horst Frisch Incorporated, Appendix A.

[19] Frisch, Daniel J. (7 April 2011). "Transfer Pricing Methods and Intercompany Receivables Sale between McKesson Canada Corporation and McKesson International Holdings III S.a.r.l." Horst Frisch Incorporated, pp. 2, 49.

banker.[20] The REIFSNYDER REPORT applied the same type of two-step approach as in the original taxpayer analysis and the BECKER AFFIRMATIVE REPORT. See **Table 4**. The REIFSNYDER REPORT agreed with the first step of the BECKER AFFIRMATIVE REPORT by targeting the price ($2.2 billion) of the sales made by MCC to its customers as the basis to price the receivables sale to MIH.[21] See **Table 1A**.

On the discount (adjustments) to this price, the difference between the REIFSNYDER REPORT and the BECKER AFFIRMATIVE REPORT is essentially[22] *isolated on the loss discount component*. The REIFSNYDER REPORT performed a nine-step, indirect, external comparable approach using approximately two dozen assumptions in arriving at its estimate of 125.6 basis points (leading to a total discount of 206.3 basis points). See **Tables 1B & 8A-8B**.

B. Detailed Summary of REIFSNYDER REPORT

The REIFSNYDER REPORT set the price of the receivables as equivalent to the price charged by MCC to its customers, less a net discount adjustment. As seen in **Tables 1A-1B & 4**, the REIFSNYDER REPORT agreed with the results of the BECKER AFFIRMATIVE REPORT on the receivables price, but differed on the adjustment.

The REIFSNYDER REPORT employed a component addition methodology to determine the appropriate arm's length discount to apply to the (agreed upon) receivables "base" price. The components fall into three categories. See **Table 1B**. First, there exist components where the taxpayer's original report, the BECKER AFFIRMATIVE REPORT, and the REIFSNYDER REPORT all largely agree (and/or differ by a relatively modest number of basis points): yield rate, prompt payment discount, accrued rebate dilutions discount, and option on increased funding discount. Second, the REIFSNYDER REPORT quantified two discounts that were

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[20] The REIFSNYDER REPORT does not include a resume or a list of corporations for whom its author worked, although it does provide details on Mr. Reifsnyder's education and a broad summary of his work experience. Mr. Reifsnyder's MBA followed earlier M.A. and B.A. degrees in East Asian Studies and Political Science. Reifsnyder, Jeremy E. (7 April 2011). "Expert Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP." TLD Partners LLC, p. 3.

[21] In point of fact, the REIFSNYDER REPORT does not explicitly comment on its first step. However, it does state that the actual pricing (which first set the receivables price at the MCC sales price) was consistent with arm's length expectations. Reifsnyder, Jeremy E. (7 April 2011). "Expert Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP." TLD Partners LLC, p. 5.

[22] As seen in **Table 1B**, the reports differ in modest amounts on several other components of the discount rate.

equivalent to those in the BECKER AFFIRMATIVE REPORT, but differed from the taxpayer's original report: premium of servicing discount rate above servicing fee and cost of capital discount.

Comparison of Differences in Net Discount Rate Computations

Component of Discount Rate (Basis Points)	Taxpayer	BECKER AFFIRMATIVE REPORT	REIFSNYDER REPORT
Servicing Discount Rate Above Servicing Fee	51.8	0.0	0.0
Cost of Capital Discount	45.6	0.0	0.0
Loss Discount	23.0	**4.4**	**125.6**

The final category at issue—essentially the *only* place where the REIFSNYDER REPORT discount estimate differs from the BECKER AFFIRMATIVE REPORT—mathematically largely defines the entire difference between the REIFSNYDER REPORT and the BECKER AFFIRMATIVE REPORT. This loss discount, or credit risk, forecasts the portion of MCC's sales that will not be collected. The REIFSNYDER REPORT forecasts this non-payment probability using the following nine-step procedure (see **Table 8B**):

- Determination of the *long-term debt* ratings for the MCC customers. The REIFSNYDER REPORT assumed non-rated obligors to have long-term debt ratings below investment grade—or equivalent to junk bonds.

- Assumption that the obligors' probability of defaulting on short-term operating payments for products from MCC was equivalent to their (represented by junk bonds) probability of defaulting on long-term loan payments.

- Assumed a premium of 15 to 20 percent to reflect the fact that MCC's obligors were concentrated in the retail business.

- Assumed a premium of 10 to 15 percent to reflect MCC's obligors consisted of small companies.

- Assumed a subtraction of 15-30 percent to reflect the fact that some of the MCC customers were investment grade rated companies.

- Assumed a premium of 20 to 40 percent in that MCC's obligors could change over time and that some of the larger obligors were not rated.

- Assumed a premium of 5 to 15 percent to reflect the agreement's five year time period, exceeding the period in the Canadian junk bond index used by the REIFSNYDER REPORT.

- Assumed a 25 to 40 percent subtraction to reflect the lower risk in operating receivables than in long-term debt.

- Assumed a premium of 5 to 10 percent to reflect receivables' relatively lower value as collateral (compared to equipment).

This nine-step process of assumptions resulted in a value of 125.6 basis points for the loss discount/credit risk. See **Table 1B**.

III. Critical Analysis of Taxpayer Expert Reports

A. Primary Critical Analysis

The taxpayer expert reports in total offered certain opinions that resulted in valuations (discount rates) in excess of arm's length expectations. I restrict my analysis to my area of experience—economics/finance/valuation—and leave the remaining opinions (principally legal) to be considered by others. In this sense, I make no comment on the LIPSON REPORT's legal definition of a securitization transaction. That definition did not impact the BECKER AFFIRMATIVE REPORT in that I did not apply securitization transactions as comparables to non-securitization transactions.

The FRISCH REPORT does not offer an affirmative valuation opinion nor does it directly critique/negate any of the valuation approaches in the BECKER AFFIRMATIVE REPORT. As such, its overlap with the opinion in the BECKER AFFIRMATIVE REPORT is also limited.

The FRISCH REPORT's *assignment* focused on the entire RSA—that is, the price paid for receivables *and* the discount/adjustments to that price—but its *analysis* of the applicability of methods only focused on the valuation of the discount/adjustments.[23] While the arm's length price of the receivables (before discounts) does not appear to be a contentious valuation issue in this case (see **Table 1A**), it clearly makes up the bulk of the overall RSA valuation. Both the taxpayer and the BECKER AFFIRMATIVE REPORT price the receivables by reference to the prices at which *MCC* sold the *same product* to its obligors before making relatively minor adjustments for days to pay, prompt payment, etc. See **Tables 1A & 4**. This type of approach where the primary valuation is in the product price has been—in my experience—referred to as a CUP approach.[24]

The REIFSNYDER REPORT, as a valuation, provides the closest "apples to apples" comparison with the BECKER AFFIRMATIVE REPORT. Both reports use the MCC sale price to customers as the base receivables price before adjustments.[25] See **Tables 1A & 4**. As such, I offer no further commentary on this CUP-like price target.

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[23] Frisch, Daniel J. (7 April 2011). "Transfer Pricing Methods and Intercompany Receivables Sale between McKesson Canada Corporation and McKesson International Holdings III S.a.r.l." Horst Frisch Incorporated, p. 3.

[24] Whether such approaches would be classified by one name or another is ultimately a legal issue that has no impact on the valuation from an arm's length economic valuation perspective. While I have typically seen the CUP classification applied to analyses like this (by lawyers, accountants, and economists), I offer no opinion of its official "name" from a Canadian tax law perspective.

[25] In point of fact, the REIFSNYDER REPORT is tasked with determining whether the terms and conditions in the RSA are consistent with arm's length expectations, but its explicit opinion is isolated on the discount/adjustments. I assume that the REIFSNYDER REPORT's opinion that the terms and conditions of the RSA do not differ from

The adjustments/discounts to the receivables price in the BECKER AFFIRMATIVE REPORT and the REIFSNYDER REPORT are mathematically similar except for the loss discount/credit risk component. See **Table 1B**. This component—intended to reflect the probability of customers *not* paying MCC—would realistically need to consider that:

- In the years immediately preceding the RSA, MCC customers had defaulted on payment only 0.044 percent of the time—or 4.4 basis points. See **Table 5**.

- The historic non-payments of MCC customers varied by year. In the earlier years, the loss rate was as high as 6.6 basis points. Trending downward in more recent years, the loss rate reached a low of 2.5 basis points in 2002. See **Table 6**.

- Future loss projections would potentially be *lower* than historic figures in that the initial receivables would not include receivables in default.[26]

- MIH knew it would have an explicit upper bound on its loss ratio. That is, MIH could terminate the agreement if the loss rate reached 25.0 basis points. See **Table 9**.[27]

The REIFSNYDER REPORT chose not to set the loss ratio by reference to historic losses of 4.4 basis points—or to make adjustments to this figure—but rather to apply a figure of *125.6 basis points*.[28] See **Table 6**. Economic theory in general supports the use of historic data in

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arm's length expectations implies that it agrees with the RSA that the receivables should be priced at the MCC sales price to customers, *before* adjustments/discounts. Reifsnyder, Jeremy E. (7 April 2011). "Expert Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP." TLD Partners LLC, p. 5. See also, McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement," p. 8.

[26] McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement," p. 3.

[27] MIH could also terminate the agreement in three other cases that might trigger before the loss rate reaches 25.0 basis points. See **Table 9**.

[28] Ignoring historical results appears to be inconsistent with several points/themes in the REIFSNYDER REPORT. First, the REIFSNYDER REPORT considered the historic pattern of days sales outstanding when valuing the yield rate. Second, the REIFSNYDER REPORT considered the historic pattern of customers earning prompt payment discounts from MCC in forecasting the prompt payment discount. See **Table 1B**. While the REIFSNYDER REPORT acknowledges that historical information and past performance are indicators of expected future performance, it chose not to apply MCC's historic losses as the loss discount. Reifsnyder, Jeremy E. (7 April 2011).

projecting future performance—especially in the absence of major business changes and/or the contemporaneous existence of projections.[29] Standard & Poor's writes that in the case of trade receivable credit-related risk specifically, historical delinquency and write-off performance is generally the *best* indicator of portfolio credit quality.[30] To the degree projected losses were expected to differ from historical losses—that is, 4.4 basis points—a rationale for such predictions would be expected. The REIFSNYDER REPORT does not address why its projections would result in adjustments of nearly 30 times historical levels.

In addition to ignoring historical losses (and/or neglecting to offer rationales for significantly more pessimistic projections), the REIFSNYDER REPORT did *not* appear to regard the 25.0 basis point level as a trigger for MIH to terminate the agreement as an upper bound to the valuation. Rather, the REIFSNYDER REPORT chose a value of 125.6 basis points—or approximately *five* times the upper bound level where MIH could terminate the agreement.

The order of magnitude increase to actual historic losses proposed by the REIFSNYDER REPORT can be better understood with an example. In the case of these receivables, the losses would quickly grow if an MCC customer simply chose to withhold *all* payments. This would be accentuated in an extreme case where, for example, that customer: (a) was a major customer of MCC (say one percent of MCC's receivables); and (b) was not "cut off" by MCC for a relatively long time (say three months). The *mathematical* impact of such a significant event on the discount rate would, however, only be *5 basis points*.[31] Put another way, for MCC to have the poor fortunes implied by the REIFSNYDER REPORT, it would need to expect that it would experience the bad luck to witness *25* significant customers refusing to pay anything for three months apiece. By contrast, MCC's historic losses suggest that it did not suffer any such significant customer non-payments in recent years.[32]

The REIFSNYDER REPORT's non-arm's length loss discount is largely explained by its use of an indirect method requiring many assumptions. See **Tables 8A-8B** and below.

"Expert Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP." TLD Partners LLC, pp. 7, 9, & 13.

[29] Pratt, Shannon P., Alina V. Niculita. (2008). Valuing a Business: The Analysis and Appraisal of Closely Held Companies. 5th Edition. McGraw Hill Companies: New York, pp. 56-58.

[30] Standard and Poor's. (1999). Structured Finance: Trade Receivable Criteria, p. 9.

[31] That is, 1% × 3/60 months = 0.05 percent, or five basis points.

[32] There is no documentation that MCC experienced any problems near this magnitude in the years leading up to the RSA, and its total losses translated to less than five basis points. See **Table 5**.

Comparison of Approaches to Determine MCC's Projected Losses (Non-Payment)

	REIFSNYDER REPORT	BECKER AFFIRMATIVE REPORT
Consideration of MCC's Historic Losses (Non-Payment)	--	✓
Consideration of 25 Basis Point Upper Bound Limit in Receivables Agreement	--	✓
Steps Required in Valuation Methodology	9	1
Assumptions Required in Valuation Methodology	23	1

By contrast, in general, valuations relying on more direct approaches with fewer assumptions tend to result in more accurate opinions.[33]

To the degree that the loss discount in the REIFSNYDER REPORT was to be considered a proxy for an arm's length value, it incorrectly suggests that MCC would be willing to forego its receivables (worth 99.96) for a *smaller* payment (of only 98.74). See **Table 7**. Put another way, MCC would *not* sell an asset at a price *below* its value, at arm's length. The analysis is similarly flawed from MIH's perspective as well in that there is no "free lunch" in economics.[34] Thus, MIH would *not* be able to purchase assets worth 99.96 for only 98.74 at arm's length, as other companies would be willing to "bid up" the price to MCC—up to 99.96.

The REIFSNYDER REPORT reached this faulty conclusion on the loss discount through a multi-step analysis of indirect, external comparables with a large number of assumptions. See **Tables 8A-8B**. It begins with a faulty assumption of the likelihood of MCC's short-term receivables' non-payment—historically 4.4 basis points for MCC—being the same as the risk of non-payment for long-term Canadian junk (high yield) bonds—more than 100.0 basis points.[35] The additional assumptions are described in the section below.

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[33] See, for example, Feinschreiber, Robert. (2004). Transfer Pricing Methods. John Wiley & Sons, Inc: New Jersey, pp. 40-43; and Green, William H. (2005). U.S. Transfer Pricing Sourcebook. World Trade Executive, Inc: Massachusetts, p. 26.

[34] Friedman, Milton. (1975). There's No Such Thing as a Free Lunch. Open Court Publishing Company: Illinois.

[35] Reifsnyder, Jeremy E. (7 April 2011). "Expert Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP." TLD Partners LLC, pp. 16.

B. Secondary Points in Critical Analysis

The REIFSNYDER REPORT reached its conclusion of a 125.6 basis point loss discount as opposed to the actual historic losses of 4.4 basis points through a multi-step analysis of indirect, external comparables. This analysis required a large number of assumptions and adjustments, including:

- The receivables' payment risk focused on many obligors choosing to pay (or not) their *short-term cost of goods sold* (to MCC). That is, a risk that *MCC* (the receivables owner) would or would not generate cash in the short-term. The REIFSNYDER REPORT principally inflated this risk by equating short-term receivables' non-payment to long-term non-payment of loans. However, short-term receivable risk of non-payment for a rated company like McKesson is lower than long-term debt risk on junk bonds. This is logical in that the former includes only the risk of (short-term) non-payment of customers, while the latter includes the risks of customer non-payment, sales volume, changes in unit prices, cost escalations, and unexpected fees. That is, *all* risks that impact a company's ability to generate a profit.[36]

- The REIFSNYDER REPORT required approximately two dozen additional assumptions to complete its long-term debt approach. See **Table 8A**. While some of these assumptions were based in part (or wholly) on actual data, many of the assumptions received limited justification or citation.[37] All else being equal, analyses with fewer assumptions and less subjectivity are preferred to those with more assumptions and subjectivity.[38]

While the loss discount/credit risk largely defines the mathematical difference between the BECKER AFFIRMATIVE REPORT and the REIFSNYDER REPORT, the latter report also contains an additional component that had not previously been introduced. In determining an

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[36] See also, for example, Standard and Poor's. (1999). Structured Finance: Trade Receivable Criteria.; and Moody's Investors Service. (8 July 2002). Moody's Approach to Rating Trade Receivables Backed Transactions.

[37] The REIFSNYDER REPORT provides no quantitative support for its: (a) 10 to 15 percent "Size of Obligors" adjustment; (b) 25 to 40 percent "Obligation Type (Trade Receivables vs. Loans)" adjustment; or (c) 5 to 10 percent "Security for Obligations (Inventories)" adjustment. Reifsnyder, Jeremy E. (7 April 2011). "Expert Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP." TLD Partners LLC, pp. 16-18, 20-21.

[38] See, for example, Feinschreiber, Robert. (2004). <u>Transfer Pricing Methods</u>. John Wiley & Sons, Inc: New Jersey, pp. 40-43.

appropriate discount for what the REIFSNYDER REPORT defines as an "Option on Increased Funding," it states as fact that banks charge *0.4 to 0.5* basis points for taking the risk of additional investment. The REIFSNYDER REPORT finds the risk in this instance to be greater than that typically cited. Without a quantitative citation to this differential, the REIFSNYDER REPORT sets a value of *100.0* basis points, or at least *200 times* the level it previously cited as fact. See **Table 12**. While this broad concept of option value may be reasonable to consider, a relevant analysis would require some factual basis and quantitative rationale before increasing a value by an order of 200 or more times.[39]

The FRISCH REPORT also includes several topics that qualify as secondary points in this critical analysis:

- The FRISCH REPORT opined that a CUP approach would not apply to the adjustment/discount portion of the transaction at issue. Whether the type of *adjustments* to a primary price would themselves have a *name classification* was not explicitly stated in the FRISCH REPORT. In my experience, I have rarely seen receivables or similar price adjustments referred to as a CUP, TNMM, or any other commonly used/named transfer pricing methods. Rather, they are simply referred to as adjustments—to the main transfer pricing issue.

- In making an opinion that no CUPs exist to set the *discount rate*, the FRISCH REPORT did not explicitly apply the TD Factors agreement used as a comparable in the BECKER AFFIRMATIVE REPORT.[40]

- The FRISCH REPORT defines the service fees paid to MCC as "not in dispute."[41] The wide *differential* between the discount to cover service

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[39] Even with this multiple of 200 or more, the REIFSNYDER REPORT ultimately only assigns 3.7 basis points to this option component. As such, its importance pales in comparison to the loss discount/credit risk. Reifsnyder, Jeremy E. (7 April 2011). "Expert Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP." TLD Partners LLC, p. 21-23.

[40] The FRISCH REPORT includes a footnote stating that it knew of the existence of a potential internal (factoring) comparable between McKesson and TD Factors. The FRISCH REPORT states that it did not consider this agreement due to Dr. Frisch's understanding of several differences between the two agreements. Frisch, Daniel J. (7 April 2011). "Transfer Pricing Methods and Intercompany Receivables Sale between McKesson Canada Corporation and McKesson International Holdings III S.a.r.l." Horst Frisch Incorporated, p. 38. The BECKER AFFIRMATIVE REPORT adjusted the discount rate from this agreement for several differences from the RSA, including annual spread, differences in days outstanding, prompt payment discounts, and arrangement fees. See **Tables 9-11**.

[41] Frisch, Daniel J. (7 April 2011). "Transfer Pricing Methods and Intercompany Receivables Sale between McKesson Canada Corporation and McKesson International Holdings III S.a.r.l." Horst Frisch Incorporated, p. 5.

fees and the service fees themselves initially proposed by the taxpayer differed from the opinion in the BECKER AFFIRMATIVE REPORT. As described above, the REIFSNYDER REPORT appears to have eliminated this issue. See **Table 1B**.

- The FRISCH REPORT appears to conclude that a securitization agreement *cannot* be compared to a receivables sale agreement.[42] While that comment may have been intended to be case dependent, further clarification may be useful. In particular, the *consideration of any* uncontrolled transaction as a potential comparable is always case dependent—on the degree of comparability and on the availability of other arm's length data and methods. In that sense, there is always *a* CUP available that may range from the most direct/similar (same product, company, terms, time period, etc.) to the very dissimilar (*i.e.*, comparing a sow's ear to a silk purse). An economist's judgment centers on one's ability to *objectively* adjust for differences and assess how the precision/accuracy of those adjustments compares to other valuation approaches. In this case, I chose not to consider securitizations as baselines for my adjustments (discount rates), as other, more direct arm's length data were available, in my opinion. However, while I have not made such calculations in this case, it would potentially be mathematically/economically possible to adjust for those differences.[43]

C. Impact on Opinions in BECKER AFFIRMATIVE REPORT

The taxpayer reports did not cause me to change my opinions from the BECKER AFFIRMATIVE REPORT. That is, I found that arm's length parties would agree to a receivable price equal to: (a) the ($2.2 billion) sale price of the products from MCC to its customers; less (b) a net discount of 83.9 basis points ($18.3 million). See **Table 4**. This arm's length price would have resulted in MCC reporting $27.0 million more profit in Canada than it had proposed. See **Table 3** and below.

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[42] Frisch, Daniel J. (7 April 2011). "Transfer Pricing Methods and Intercompany Receivables Sale between McKesson Canada Corporation and McKesson International Holdings III S.a.r.l." Horst Frisch Incorporated, p. 30.

[43] In that sense, the differences between a securitization and factoring agreement would not likely rise to the level of differences between a sow's ear and a silk purse.

BECKER AFFIRMATIVE REPORT Single Point Estimate Compared to Taxpayer's Proposed Prices

Adjustment ($ million, basis points)	BECKER	Taxpayer	Difference	Formula
MCC's Sale of Net Accounts Receivables	$2,187.0	$2,187.0	--	A
Net Discount Rate	83.9	207.5	123.6	B
Net Discount on Sale of Receivables	$18.3	$45.4	$27.0	C = A*B

McKesson Canada Transfer Pricing Rebuttal Report

TABLES

Summary of BECKER AFFIRMATIVE REPORT: Tables 1A-3

Table 1A:

Comparison of Taxpayer Original Analysis, BECKER AFFIRMATIVE REPORT, and the REIFSNYDER REPORT Arm's Length Receivables Price (CAD Million)

	Original (TD STUDY)	**BECKER AFFIRMATIVE REPORT**	**REIFSNYDER REPORT**
Arm's Length Receivables Price Pre-Discount	$2,187.0	$2,187.0	$2,187.0
Benchmark for Receivables Price	MCC Sale Price to Customers	MCC Sale Price to Customers	MCC Sale Price to Customers /1/

Note:
/1/: The REIFSNYDER REPORT agrees with the pricing in the RSA, but does not specify a comparable for the receivable price.

Sources:
(1) **Table 3**.
(2) Reifsnyder, Jeremy E. (7 April 2011). "Expert Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP." TLD Partners LLC, p. 5.

Table 1B:

Comparison of Taxpayer Original Analysis, BECKER AFFIRMATIVE REPORT (Build-Up), and the REIFSNYDER REPORT Net Discount Rate to Arm's Length Receivables Price

Component of Discount Rate (Basis Points)	Original (TD STUDY)	BECKER AFFIRMATIVE REPORT	REIFSNYDER REPORT	Formula
Components of Overall AGREEMENT				
Yield Rate	24.2	23.1	21.4	a
Prompt Payment Discounts /1/	60.0	53.2	55.6	b
Accrued Rebate Dilutions Discount	2.4	0.0	0.0	c
Option on Increased Funding	0.0	0.0	3.7	d
Components of Becker and Reifsnyder AGREEMENT				
Premium of Servicing Discount Rate Above Servicing Fee	51.8	0.0	0.0	e
Cost of Capital Discount	45.6	0.0	0.0	f
Component of DISAGREEMENT				
Loss Discount	**23.0**	**4.4**	**125.6**	g
Total	**207.2**	**80.7**	**206.3**	h = sum(a:g)
Actual Payment	**207.5**			i

Note:
/1/: Quebec's discounts were removed from the prompt payment discount calculation as the face value of receivables sold was net of Quebec discounts.

Sources:

(1) Becker, Brian, "Economic Analysis of Receivables Transactions Involving McKesson Canada Corporation and McKesson International Holdings III S.ar.l.: Fiscal Year 2003," April 4, 2011, Tables 6 & 10.

(2) Reifsnyder, Jeremy E. (7 April 2011). "Expert Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP." TLD Partners LLC, pp. 7, 9, 13, & 23.

Table 2:

BECKER AFFIRMATIVE REPORT Single Point Estimate of Net Discount Rate in Audit Period

Discount Rate (Basis Points)	**Percent of Accounts Receivable**
Build-Up CUP Approach	80.7
TDF CUP Approach	87.0
BECKER AFFIRMATIVE REPORT Single Point Estimate of Net Discount Rate	**83.9**

Source:

(1) Becker, Brian, "Economic Analysis of Receivables Transactions Involving McKesson Canada Corporation and McKesson International Holdings III S.ar.l.: Fiscal Year 2003," April 4, 2011, Table 15.

Table 3:

BECKER AFFIRMATIVE REPORT Single Point Estimate Compared to Taxpayer's Proposed Prices: 2003 (CAD Million)

Post-RSA 2003	**BECKER**	**Taxpayer**	**Difference**	**Formula**
MCC's Sale of Net Accounts Receivables	$2,187.0	$2,187.0	**--**	a
Net Discount Rate Applied (Basis Points)	83.9	207.5	123.6	b
Net Discount on Sale of Receivables	$18.3	$45.4	**$27.0**	c = a*b
Reported Taxable Income			**-$8.8**	d
Arm`s Length Taxable Income			**$18.2**	e = c+d

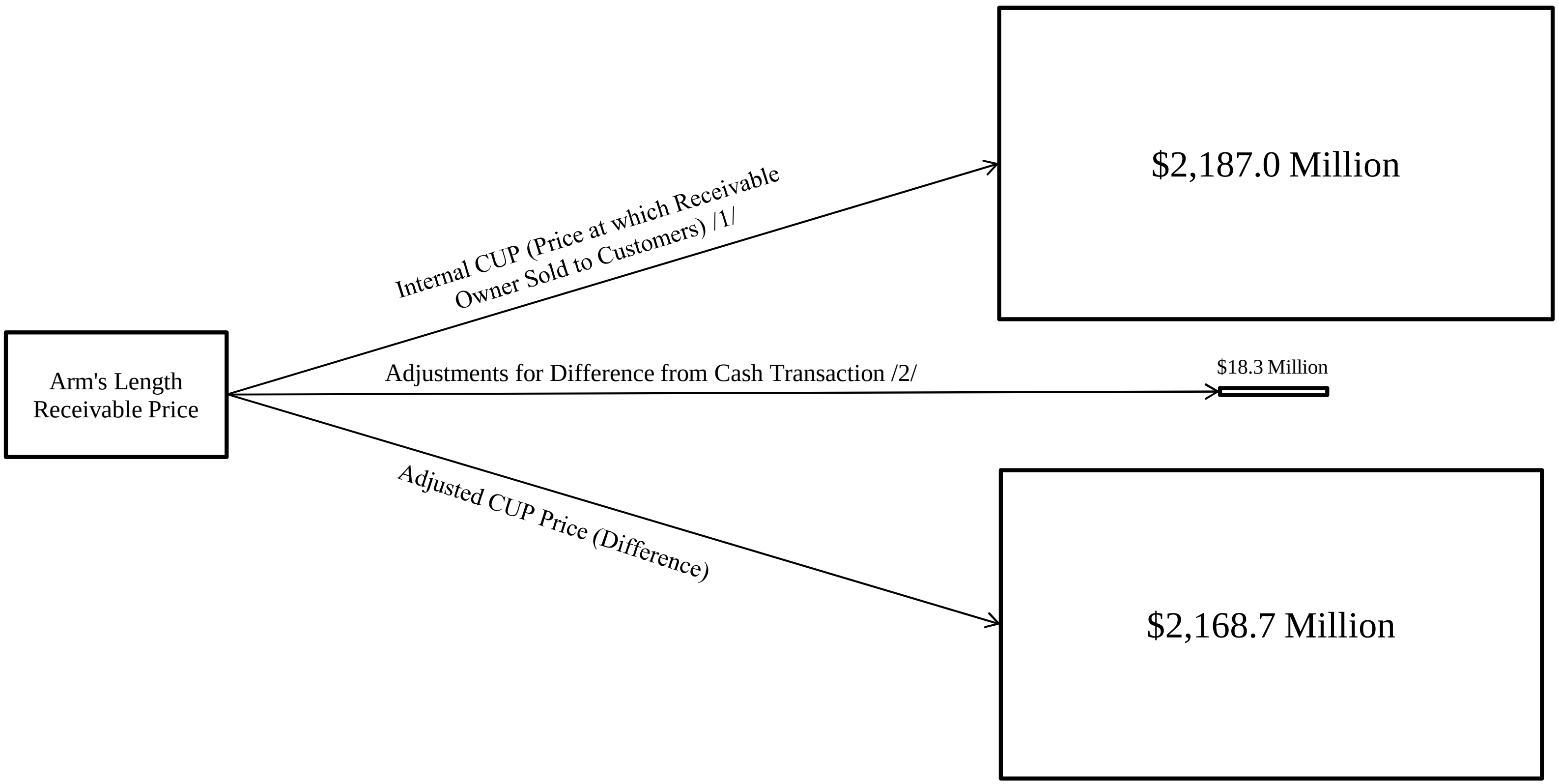
Source:

(1) Becker, Brian, "Economic Analysis of Receivables Transactions Involving McKesson Canada Corporation and McKesson International Holdings III S.ar.l.: Fiscal Year 2003," April 4, 2011, Table 16.

Analysis of Taxpayer Expert Reports: Tables 4-12

Table 4:

CUP Determination of an Arm's Length Price for Receivables



Notes:
/1/: The taxpayer and the BECKER AFFIRMATIVE REPORT agree on this uncontrolled price.
/2/: The REIFSNYDER REPORT supports the taxpayer's proposed adjustment of $45.4 million.

Source:
(1) **Tables 1A-1B & 3**.

Table 5:

MCC's Historical Losses As a Percent of Sales: 2000-2003

Fiscal Year	**Consolidated Write-Off As Percent of Sales (Basis Points)**
2000	6.4
2001	6.6
2002	2.5
2003 /2/	2.5
Losses (Discounts)	
Minimum	2.5
Average (Weighted)	**4.4**
Maximum	6.6
Level Applied by REIFSNYDER REPORT	**125.6**

Notes:

/1/: Consolidated write-off includes all write-offs, adjustments made for bad debt provision, and other recoveries.

/2/: YTD P09 2003.

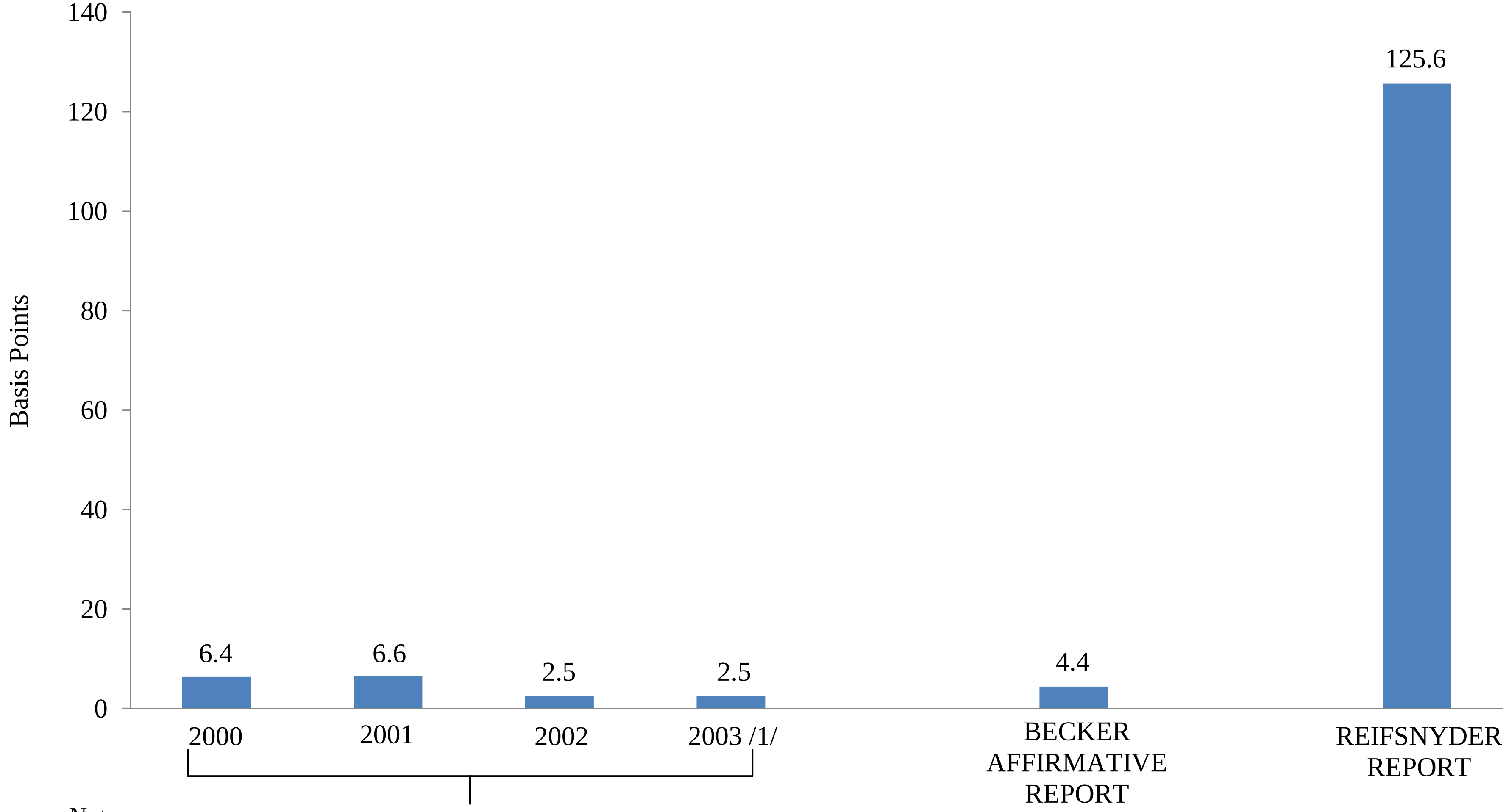
Sources:

(1) Becker, Brian, "Economic Analysis of Receivables Transactions Involving McKesson Canada Corporation and McKesson International Holdings III S.ar.l.: Fiscal Year 2003," April 4, 2011, Table 7.

(2) Reifsnyder, Jeremy E. (7 April 2011). "Expert Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP." TLD Partners LLC, p. 16.

Table 6:

MCC's Actual Historic Losses Compared To Loss Discounts Projected in BECKER AFFIRMATIVE REPORT and REIFSNYDER REPORT

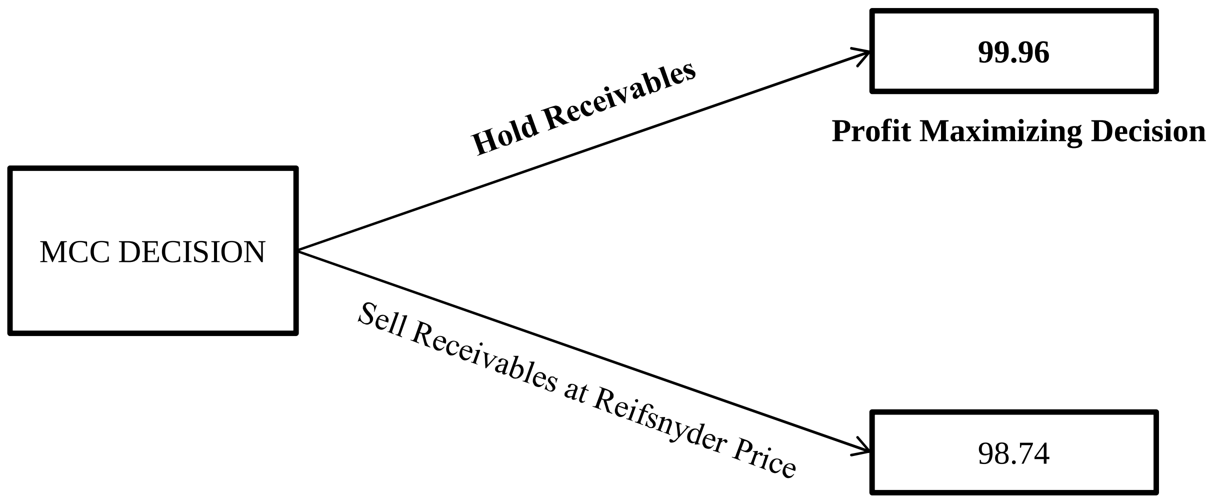


Note:
/1/: YTD P09 2003

Source:
(1) **Table 5**.

Table 7:

Irrationality for MCC to Sell Receivables at Price Adopted in the REIFSNYDER REPORT



Note:
/1/: The prices reflects a percentage of customer sale price, *after* accounting for yield and prompt payments.

Table 8A:

Assumptions Required in REIFSNYDER REPORT and BECKER AFFIRMATIVE REPORT in Computing Loss Discounts

Assumptions	Number of Assumptions Required: REIFSNYDER REPORT	Number of Assumptions Required: BECKER AFFIRMATIVE REPORT
Base for Loss Discount		
Average Historic MCC Losses Best Predictor for Future Losses	--	1
Long-Term Debt Risk Equivalent to Short-Term Receivables Risk	1	--
Non-Rated Obligors' Risk Equivalent to Risk on Junk Bonds	1	--
Subtotal	2	1
Differences Between Receivables and Long-Term Debt		
Obligors' Industry 15-20% More Risky than Economy as a Whole	3	--
Smaller Obligors 10-15% More Risky than Economy as a Whole	3	--
Rated Obligors Less Risky than Junk Bonds Implies 15-30% Decrease	3	--
Larger Obligors Not Rated, Could Take Up Larger Share in Future Implies 20-40% Premium	3	--
Length of Junk Bonds in Index Fund Shorter than Five Years of RSA Implies 5-15% Premium	3	--
Short-Term Receivables 25-40% Faster Turnover than Long-Term Debt	3	--
Receivables as Collateral 5-10% More Risky than Equipment	3	--
Subtotal	21	--
Total Assumptions	**23**	**1**

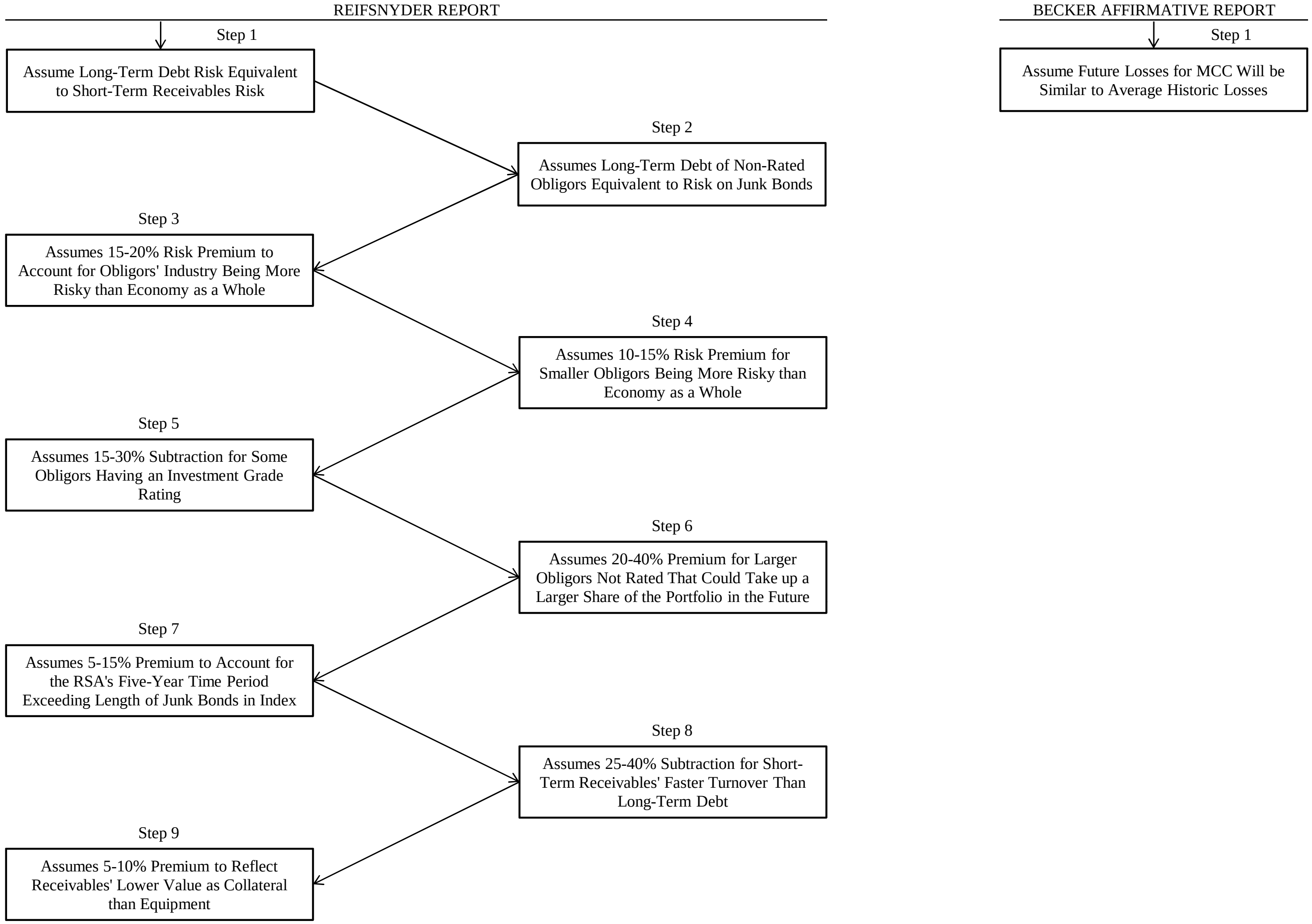
Sources:

(1) Reifsnyder, Jeremy E. (7 April 2011). “Expert Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP.” TLD Partners LLC, pp. 14-21.

(2) Becker, Brian, “Economic Analysis of Receivables Transactions Involving McKesson Canada Corporation and McKesson International Holdings III S.ar.l.: Fiscal Year 2003,” April 4, 2011, Tables 7 & 10.

Table 8B:

Loss Discount Valuation Approaches in the REIFSNYDER REPORT and BECKER AFFIRMATIVE REPORT



Source:
(1) **Table 8A**.

Table 9:

Comparison of the TDF Agreement and RSA Terms

Characteristics	TDF Agreement	RSA
Transactions		
Intercompany Transaction at Issue	Sale of MCC Receivables	Sale of MCC Receivables
Intercompany Transaction at Issue	Servicing of MCC Receivables	Servicing of MCC Receivables
Closing Date of Agreement	1996	December 16, 2002
Recourse	None	None
Facility Limit	$99 Million	$900 Million
Collection Agent/Servicer	MCC	MCC
Term of Agreement/Historical Results (DSO) /1/	14-22 days	30.2 days
Historical Prompt Payment Discount (Basis Points)	N/A	53.2
Large Customers (Obligors) Include	Pharma Plus, Loblaws, Zellers, & Safeway	Pharma Plus, Loblaws, Zellers, & Safeway
Termination Events for Agreement Include (Basis Points)		
Delinquency Ratio Greater Than	N/A	250.0
Loss Ratio Greater Than	N/A	25.0
Seller's Parent Company Rating Below	N/A	BBB-
Adverse Material Event	N/A	Yes
Definition of Discount Rate Per Agreement (Basis Points)		
Yield Rate Based on	Banker's Acceptance	--
Additional Annual Yield (Spread)	37.5	--
Arrangement Fees	3.2	--

Note:

/1/: Under the TDF Agreement, the term of the sale of receivables was set upon each sale of receivables. The examples of receivable sales under the TDF Agreement showed terms of 14 to 22 days.

Source:

(1) Becker, Brian, “Economic Analysis of Receivables Transactions Involving McKesson Canada Corporation and McKesson International Holdings III S.ar.l.: Fiscal Year 2003,” April 4, 2011, Table 11.

Table 10:

BECKER AFFIRMATIVE REPORT Arm's Length Net Discount (Potentially Exclusive of Prompt Payment) for MCC Receivables Transferred to MIH based on TDF Agreement Terms

2003	Percent of Accounts Receivable (Basis Points)	Formula
Annual Yield Rate Based on Banker's Acceptance /1/	279.0	a
Annual Spread	37.5	b
Combined Annual Yield	316.5	c = a+b
Term (Days Sale Outstanding)	30.2	d
Yield Over the DSO	26.2	e = c*d/365
Loss Discount	4.4	f
Arrangement Fees	3.2	g
Net Discount Rate (Potentially Exclusive of Prompt Payment)	**33.8**	h = e+f+g

Note:
/1/: Banker's Acceptance as of 10 December 2002.

Source:
(1) Becker, Brian, "Economic Analysis of Receivables Transactions Involving McKesson Canada Corporation and McKesson International Holdings III S.ar.l.: Fiscal Year 2003," April 4, 2011, Table 12.

Table 11:

BECKER AFFIRMATIVE REPORT Arm's Length Total Net Discount Rate Based on TDF Agreement CUP

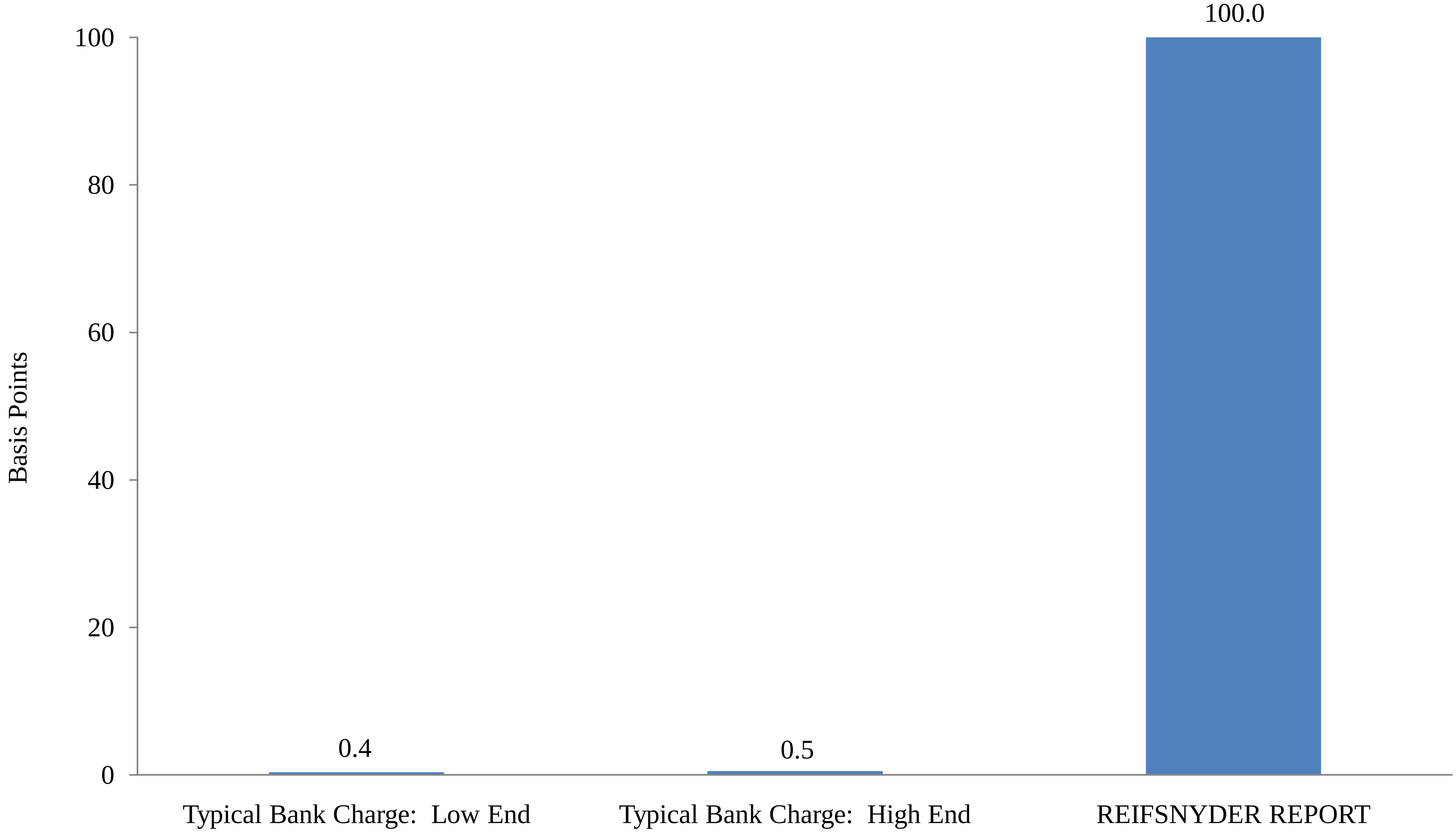
Discount Rate	**Percent of Accounts Receivable (Basis Points)**	**Formula**
Net Discount Rate (Potentially Exclusive of Prompt Payment)	33.8	a
Prompt Payment Discount	53.2	b
Total Non-Recourse Net Discount Rate	**87.0**	c = a+b

Source:

(1) Becker, Brian, "Economic Analysis of Receivables Transactions Involving McKesson Canada Corporation and McKesson International Holdings III S.ar.l.: Fiscal Year 2003," April 4, 2011, Table 14.

Table 12:

Typical Bank Charges to Commit Incremental Funding Compared to Estimate Applied in the REIFSNYDER REPORT



Source:
(1) Reifsnyder, Jeremy E. (7 April 2011). "Expert Report on Behalf of McKesson Canada Corporation Prepared for Blake, Cassels & Graydon LLP." TLD Partners LLC, pp. 21-22.

APPENDICES

APPENDIX A

PRECISION ECONOMICS, LLC
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BRIAN C. BECKER, Ph.D.

EDUCATION

The Wharton School of the University of Pennsylvania, Philadelphia, PA

- Ph.D., Applied Economics (1993)
- M.A., Applied Economics (1991)

The Johns Hopkins University, Baltimore, MD

- B.A., Applied Mathematics, Economics (1988)

PRESENT POSITION

PRECISION ECONOMICS, LLC, Washington, DC, 2001 - present
President

- Prepared more than 400 transfer pricing reports for taxpayers, the IRS, the Australian Taxation Office, and the Canada Revenue Agency on a variety of issues, including tangible property, cost sharing, intangible property, intercompany loans, guarantee fees, and service fees.
- Served as a lead transfer pricing economic expert for the IRS in the largest tax dispute and settlement on record, GlaxoSmithKline Holdings (Americas) v. Commissioner of Internal Revenue.
- Provided expert witness testimony—supporting two written reports—in the Tax Court of Canada in the transfer pricing dispute of General Electric Capital Canada Inc. v. Her Majesty the Queen.
- Served as an economic expert witness in the first two major transfer pricing trials in Australia: Roche Products Pty Limited v. Federal Commissioner of Taxation and SNF (Australia) Pty Limited v. The Commissioner of Taxation of the Commonwealth of Australia.
- Submitted an expert witness report and provided testimony in United States Tax Court in a transfer pricing dispute.
- Prepared and defended expert reports quantifying damages and valuations in the contexts of anti-trust, patent infringement, trade secrets, executive compensation, and tax shelters.
- Provided testimony and economic reports involving catfish, various steel products, and pineapples in hearings before the U.S. International Trade Commission.
- Provided written and oral expert valuation testimony in U.S. Tax Court involving minority interests in a privately held publishing business.

EXPERT TESTIMONY, SUBMISSIONS AND HEARINGS

"Brief of Dr. Brian C. Becker, Dr. Sara Fisher Ellison, and Dr. Joseph R. Mason as *Amici Curiae* in Support of Petitioners," In the Supreme Court of the United States, No. 10-1173, April 25, 2011.

"Valuation of Nortel Networks U.K. Limited and Nortel Networks Corporation as of June 30, 2008," In the Matter of a Plan of Compromise or Arrangement of Nortel Networks Corporation, et. al., Application Under the Companies' Creditors Arrangement Act, R.S.C. 1985, C. C-36, As Amended, Ontario Superior Court of Justice, Court File No. 09-CL-7950, Toronto, Canada, November 30, 2010.

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"Arranging for Intercompany Transfers of Intangible Property," BNA CITE: U.S. International Transfer Pricing Update, New York, NY, July 18, 2011 (forthcoming).

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"Fundamentals of Transfer Pricing," Conference Chair, IIR Seminar, London, UK, October 29, 2008.

"Fundamentals of Transfer Pricing," Speaker on Transfer Pricing Methods, IIR Seminar, London, UK, June 11, 2008.

"Transfer Pricing," Guest Lecturer at The George Washington University Law School, March 26, 2008.

"Economics of Private Student Loans," Speaker on the 2008 National Council of Higher Education Loan Programs Leadership Conference: As the Dust Settles, Sarasota, FL, January 9, 2008.

"Economists in Transfer Pricing: Intangibles, Audits, and APAs," Council for International Tax Education, Inc.: U.S. Transfer Pricing Planning and Controversies, Houston, TX, October 15, 2007.

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"Economics of Mass Tort: Lead Paint," Gerson Lehrman Group Seminar, New York, NY, November 16, 2005.

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"Maximizing Revenue, Minimizing Taxpayer Burden," Emcee and Speaker for Discussion of "Revenue Matters," National Press Club, Washington, DC, June 7, 2005.

"Intangible Valuation in Transfer Pricing," Transfer Pricing Roundtable: Best in Class Practices for Companies, Infonex Seminar, New York, NY, May 25, 2005.

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"Probability and Statistics," Digital Sandbox Risk Analysis Seminar Series, Reston, Virginia, October 14, 2004.

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"Transfer Pricing Workshop," Workshop Chair and Speaker, IIR Ltd., London, UK, April 21, 2004.

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"Profitability Analysis of NYSE Trading Specialists," American Enterprise Institute Seminar Series, Washington, DC, October 8, 2003.

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"Pricing Cost Sharing Buy-Ins and Other Intercompany Transfers," Council for International Tax Education: U.S. Transfer Pricing Planning & Compliance, New York, NY, November 15-16, 2001.

"Pricing Cost Sharing Buy-Ins and Other Intercompany Transfers," ATLAS Intermediate U.S. International Tax Update, Cleveland, Ohio, November 5, 2001.

"Cost Sharing Buy-Ins: Market Capitalization, Declining Royalty, and Other Methods," Internal Revenue Service Annual Economist Convention, Washington, DC, July 25, 2001.

"The Relative Values of Early and Late Stage Research & Development," presentation to Shaw Pittman, McLean, Virginia, March 28, 2001.

"Valuation Concepts in Family Limited Partnerships," two hour presentation to Internal Revenue Service Northeast Engineers, Fort Monmouth, New Jersey, August 30, 2000.

"The Discounted Cash Flow Method and Other Valuation Concepts," two hour presentation to IRS Kansas and Missouri District Estate & Gift Tax attorneys and managers, Kansas City, Kansas, October 4, 1999.

"The Discounted Cash Flow Method and Other Valuation Concepts," presentation to IRS New York District Estate & Gift Tax attorneys and managers, New York, NY, August 16, 1999.

"Business Valuation," national closed circuit televised broadcast for Internal Revenue Service Estate Tax Agents, September 23, 1997 (with J. Murphy).

"Valuation and Finance Principles Applied to Transfer Pricing," a presentation to IRS and Treasury Department economists, Washington, DC, September 11, 1997 (with T. Reichert).

"The Peculiar Market for Commercial Property: An Economically Irrational Situation," Southwestern Economics Association Annual Meeting, Houston, Texas, March 23, 1996.

"The Robin Hood Bias: A Study of Biased Damage Awards," Southwestern Economics Association Annual Meeting, Houston, Texas, March 22, 1996.

"Quantifying Comparability for Applications in International Trade and Intercompany Transfer Pricing: The Weighted Distance Method of Analyzing Comparability," Southwestern Economics Association Annual Meeting, Houston, Texas, March 21, 1996.

"Some Economic Issues in Transfer Pricing," World Trade Institute: Tax Aspects of Intercompany Transfer Pricing, New York, NY, November 9-10, 1995.

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Inclusion in Euromoney's "Expert Guide to the World's Leading Transfer Pricing Advisors," 2010.

Bloomberg Television Interview, New York Stock Exchange Trading Specialists, October 8, 2003.

"Valuation Evaluation: How to Determine the Size of Interest in an LLC," CFO.com, Ask the Experts, August 31, 2001.

CONSULTING EXPERIENCE

CRITERION FINANCE, L.L.C., Washington, DC, 2001 - 2001
Partner and Senior Vice President

- Authored expert reports and articles on various transfer pricing topics, including cost sharing buy-ins.
- Wrote an expert report and provided deposition testimony estimating damages to a music database corporation from the anti-competitive acts of a competitor.

LECG, LLC, Washington, DC, 1999 - 2001
Senior Managing Economist

- Served as an economic expert in a pharmaceutical patent dispute regarding the relative values of early and late stage compounds.
- Submitted expert report on the process used to determine financial viability for state certified transportation services.

ECONOMIC CONSULTING SERVICES INC., Washington, DC, 1995 - 1999
Senior Economist (promoted from Economist)

- Analyzed transfer prices for corporations in a number of industries, including oil products, pharmaceuticals, consumer products, and software.
- Testified as an economic expert in international trade matters before the Canadian International Trade Tribunal and the U.S. International Trade Commission.

ARTHUR ANDERSEN, L.L.P., Washington, DC, 1994 - 1995
Manager, Economics Group

- Directed more than 20 transfer pricing studies.
- Submitted an expert witness report on executive compensation in Tax Court.

DELOITTE & TOUCHE NATIONAL TAX OFFICE, Washington, DC, 1992 - 1994
Senior Consultant, Economics Group

- Performed numerous tax economic analyses, primarily transfer pricing.
- Participated in seminars regarding transfer pricing and international taxation.

PROFESSORIAL EXPERIENCE

THE JOHNS HOPKINS UNIVERSITY, Washington, DC, 1997 - 2002
Visiting Professor of Finance

- MBA level Corporate Finance and Derivative Security courses.

MARYMOUNT UNIVERSITY, School of Business, Arlington, VA, 1993 - 1995
Visiting Professor of Statistics

- MBA and undergraduate level Statistics courses.

THE GEORGE WASHINGTON UNIVERSITY, School of Business and Policy Management, Washington, DC, 1992 -1993
Visiting Professor of Management Science

- MBA level Productions and Operations Management course.

UNIVERSITY OF PENNSYLVANIA, The Wharton School, Decision Sciences Department, Philadelphia, PA, 1988 - 1990
Instructor

- Undergraduate level Computer Applications courses.

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APPENDIX B

McKesson Canada Transfer Pricing Rebuttal Report

Appendix B: List of Documents Relied Upon

1. Becker, Brian, "Economic Analysis of Receivables Transactions Involving McKesson Canada Corporation and McKesson International Holdings III S.ar.l.: Fiscal Year 2003," April 4, 2011.

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