

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

LAWRENCE E. JAFFE PENSION PLAN, ON)
BEHALF OF ITSELF AND ALL OTHERS SIMILARLY)
SITUATED,)

Plaintiffs,)

- against -)

HOUSEHOLD INTERNATIONAL, INC., ET AL.,)

Defendants.)

Lead Case No. 02-C-5893
(Consolidated)

Judge Ronald A. Guzman

**HOUSEHOLD DEFENDANTS’ MOTION FOR
LEAVE TO FILE *INSTANTER* MEMORANDUM
OF LAW IN EXCESS OF FIFTEEN PAGES IN SUPPORT
OF DEFENDANTS’ *DAUBERT* MOTION TO EXCLUDE
THE “EXPERT” TESTIMONY OF DANIEL FISCHEL**

Defendants Household International, Inc., Household Finance Corp., William F. Aldinger, David A. Schoenholz, and Gary Gilmer (“Defendants”), by and through their attorneys, hereby move this Court for leave to file their 47-page Memorandum of Law in Support of Household Defendants’ *Daubert* Motion to Exclude the “Expert” Testimony Daniel Fischel, attached hereto as Exhibit A. In support of their application to exceed the 15-page limit, Defendants state as follows:

1. The accompanying Memorandum of Law identifies fundamental flaws in the methodology employed by Plaintiffs’ loss causation expert, Daniel Fischel.

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2. Defendants have attempted to address these issues fairly and completely as efficiently as possible, and any further reduction would impact the quality and clarity of the presentation made to the Court.

WHEREFORE, for the reasons stated above, Defendants respectfully request that they be granted leave to file a Memorandum of Law in excess fifteen pages.

Dated: January 30, 2009

Respectfully submitted,

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EXHIBIT A

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

LAWRENCE E. JAFFE PENSION PLAN, ON) BEHALF OF ITSELF AND ALL OTHERS SIMILARLY) SITUATED,) Plaintiff,) - against -) HOUSEHOLD INTERNATIONAL, INC., ET AL.,) Defendants.)	Lead Case No. 02-C5893 (Consolidated) CLASS ACTION Judge Ronald A. Guzman Magistrate Judge Nan R. Nolan
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**MEMORANDUM OF LAW IN SUPPORT OF HOUSEHOLD
DEFENDANTS' DAUBERT MOTION TO EXCLUDE THE
"EXPERT" TESTIMONY OF DANIEL FISCHER**

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This Memorandum is respectfully submitted on behalf of Defendants Household International, Inc., (“Household”), William F. Aldinger, David A. Schoenholz and Gary Gilmer (the “Individual Defendants” and, collectively with Household, the “Household Defendants” or “Defendants”), in support of their motion to preclude the testimony of Daniel R. Fischel.

PRELIMINARY STATEMENT

The opinion of Plaintiffs’ loss causation and damages expert reflects a preordained result built upon on unsupportable and unwarranted assumptions. Plaintiffs retained Professor Daniel Fischel ostensibly to provide his opinion about the cause of Plaintiffs’ alleged losses from fraud. The opinion was to serve as Plaintiffs’ proof of loss causation in this case. What they actually instructed him to do, however, and what Professor Fischel has provided here, is something different and ultimately useless to prove loss causation.

To prove loss causation “plaintiffs must show both that defendants’ alleged misrepresentations artificially inflated the price of the stock and that the value of the stock declined once the market learned of the deception.” *Ray v. Citigroup Global Markets, Inc.*, 482 F.3d 991, 995 (7th Cir. 2007). Rather than perform an independent analysis to support the requirement of this Circuit that the claimed loss be *actually caused* by the alleged fraud, Professor Fischel admitted that he simply made assumptions that these requirements were met and offered his opinion that Household’s stock price’s “long-term relative underperformance *is consistent with Plaintiffs’ claim.*” (August 15, 2007 Report of Daniel R. Fischel (“Fischel Report” or “Report”) at ¶ 29)¹ (emphasis added). Professor Fischel offers no indication of any kind that alternative non-

¹ Attached as Ex. 1 to the Declaration of Thomas J. Kavalier, dated January 30, 2009 (“Kavalier Decl.”)

fraud explanations are not also “consistent” with the evidence he considered -- a requirement to establish loss causation.

Professor Fischel readily admits that he assumed (with no analysis) that Defendants made “actionable” misrepresentations. He admits that he assumed on Plaintiffs’ instruction that Household’s stock price was inflated by fraud as of the first day of the Class Period. He admits that he assumed that “corrective disclosures” (which he did not analyze) revealed new truthful information about the assumed misrepresentations, that the assumed inflation “leaked” out of the stock price over eleven months, and that the inflation was zero on the last day of the Class Period. Having assumed every aspect of Plaintiffs’ loss causation burden, Professor Fischel provides no helpful insight into the loss causation issue.

It is not enough for an expert to conclude that evidence is “consistent with” a party’s claims. The expert must also conclude that the evidence is inconsistent with “obvious alternative explanations.” Fed. R. Evid. 702 advisory committee’s note (2000). The mere fact that a company’s stock price underperformed the market does not establish loss causation because “that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price.” *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 342-43 (2005). As the Supreme Court has recognized, many companies “underperform” the market at any time. Because it only narrowly relies on the absence of an *increase* in the stock price to support its “consistent with” opinion, Professor Fischel’s opinion is useless.

Professor Fischel’s “inflation” models which arise from this limited and faulty opinion are likewise inadmissible. His “leakage” model attributes all declines in Household’s stock price over an eleven-month period to the alleged fraud, although he freely admits that this

quantification includes stock price declines caused by non-fraud events. (Kavaler Decl. Ex. 2 (Transcript of the March 21, 2008 Deposition of Daniel R. Fischel (“Fischel Tr.”)) at 57:12-16).

The alternative “specific disclosure” model is no better. Although Professor Fischel identified particular disclosures that coincide with stock price declines, he “cherry-picked” those incidents from dozens of possibilities and ignored contradictory instances that showed that the events he purported to measure had no consistent or quantifiable effect on Household’s stock price. Even the purported quantification of Professor Fischel’s models undercuts Plaintiffs’ allegations of fraud. Belying Professor Fischel’s opinion that his analysis is not inconsistent with Plaintiffs’ claims, his opinion actually shows that the dozens of misrepresentations claimed by Plaintiffs did not actually introduce inflation into Household’s stock price.² These defects require the exclusion of both the opinion and the models from which it is derived.

BACKGROUND

On August 15, 2007, Plaintiffs served the Report of Daniel R. Fischel. In section two of the Report, Professor Fischel states that Plaintiffs asked him to determine whether the economic evidence is “consistent with” their claims of securities fraud and, if so, to “analyze the amount of alleged artificial inflation in Household’s stock price during the Class Period attributable to such claims.” (Kavaler Decl. Ex. 1 (Fischel Report) at 6). Professor Fischel is clear that the contents of his report are based upon a series of assumptions: (1) that Defendants made “actionable” misrepresentations (Kavaler Decl. Ex. 2 (Fischel Tr.) at 127:18-24); (2) that “artificial inflation” existed in Household’s stock price on the first day of the Class Period (*Id.* at 184:3-7);

²

This particular opinion by Prof. Fischel is, *inter alia*, fatal to a claim for securities fraud and a subject of Defendants’ pending motion for summary judgment.

(3) that the truth of the assumed fraud “leaked” into the market in 2001 and 2002, which dissipated the inflation (*Id.* at 138:14-18); and (4) that the amount of “artificial inflation” in Household’s stock price was zero on the last day of the Class Period. (*Id.* at 202:17-20).

In section three of the Report, Professor Fischel claims to explore “The Relationship Between Plaintiffs’ Allegations and Investors’ Losses.” (Kavaler Decl. Ex. 1 (Fischel Report) at 6). This section substantially consists of an eleven page recitation of various articles published between November 15, 2001 and October 11, 2002 regarding (1) self-styled consumer advocates’ characterizations of Household’s lending practices as “predatory” and (2) analysts’ expressions of interest in knowing additional details about Household’s “re-age” practice.³ Apart from the inclusion of news reports on subjects chosen by Plaintiffs, Professor Fischel ignores all other news released during the time period about Household and the consumer finance industry. Professor Fischel’s analysis then concludes that “the Company’s stock price underperformed the [S&P Financials and S&P 500] indexes during this period” (as did almost half of all companies) and that “this long-term underperformance is consistent with Plaintiffs’ claim.” (*Id.* at ¶ 29). Of course, this “opinion” is essentially axiomatic and could be offered with respect to any “underperforming” company. It does not analyze, much less reject, alternative non-fraud causes for the “underperformance.”

In section four of his Report — “Quantification of Alleged Artificial Inflation,” Professor Fischel purports to “quantify the alleged artificial inflation in Household’s stock price during the Class Period.” Professor Fischel, however, offers no opinion as to whether Household’s stock price ever actually was inflated or whether any inflation ever dissipated. Rather, he *assumes* the existence of the fraud, *assumes* the inflation, and *assumes* that the *assumed* inflation

³ Professor Fischel relegates his discussion of Household’s August 14, 2002 restatement of earnings to one paragraph. (Kavaler Decl. Ex. 1 (Fischel Report) at ¶ 27).

dissipated by the end of the Class Period. Professor Fischel's analysis is, therefore, limited to a calculation of certain stock price movements, purporting to quantify the amount of the *assumed* "artificial inflation" in Household's stock price. (Kavaler Decl. Ex. 2 (Fischel Tr.) at 88:18-20). Professor Fischel presents two models for quantifying the alleged inflation (assuming it ever existed), his "Quantification Including Leakage" ("Leakage Model") and his alternative "Quantification Using Specific Disclosures" ("Specific Disclosure Model").

In his Leakage Model, Professor Fischel purports to control for general market movements between November 15, 2001 and October 11, 2002. Having shown only that Household stock performed worse than the market measure he uses, Professor Fischel nevertheless concludes that the incremental stock price decline (the "residual" decline) over this eleven-month period can be entirely attributed to the alleged fraud once the fraud is assumed to exist. Professor Fischel concedes, however, that the residual includes price declines that are not connected to the alleged fraud.

The Specific Disclosure Model actually attempts to exclude these admittedly non-fraud residual price declines, but suffers from other defects. To make the connection to Plaintiffs' claims that cannot be claimed by the Leakage Model, Professor Fischel selects certain disclosures which he says coincide with "statistically significant" residual stock price declines and which relate in some way to the general subject matter of the alleged fraud. In making this connection, however, Professor Fischel ignores indistinguishable incidents where an increase (or lack of a significant change) in Household's stock price contradicts Plaintiffs' allegations of fraud. (Kavaler Decl. Ex. 1 (Fischel Report) at ¶¶ 34-37; Ex. 3 (February 1, 2008 Rebuttal Report of Daniel R. Fischel) ("Fischel Rebuttal") at note 14). Although he acknowledges that only new information can impact the stock price, Professor Fischel makes no effort analyze or determine whether any of the information in the selected disclosures was actually new. Professor Fischel also does not discuss any other firm specific information that was released on these days

that may also have affected Household's stock price. (Kavaler Decl. Ex. 1 (Fischel Report) at ¶¶ 34-37).

On this basis, he concludes that the sum of his selected declines could be an alternative measurement of inflation in Household's stock price, if a fraud existed. He emphasizes that neither calculation is a quantification of the amount of inflation that *actually existed* in Household's stock price at any time.⁴ (Kavaler Decl. Ex. 2 (Fischel Tr.) at 84:10-17). Professor Fischel provides neither a calculation of damages nor any method by which damages could be calculated.

ARGUMENT

Federal Rule of Evidence 702 states that,

[i]f scientific, technical or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

In *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993), the Supreme Court interpreted Rule 702, clarifying the standards governing the admissibility of expert testimony. Under *Daubert*, a district court is required to act as a "gatekeeper" to keep out improper expert advocacy and ensure that the trier of fact considers only proper expert testimony. *Id.* at 589. In order to fulfill this role, the court must engage in a two-step process. The court first considers

⁴

Significantly, in both models, Professor Fischel concludes that the alleged misleading statements made during the July 30, 1999 to October 11, 2002 Class Period (more than 80) introduced **zero** inflation into Household's stock price. (Kavaler Decl. Ex. 1(Fischel Report) at Ex 53, 56). The implications of this issue are discussed below. *See infra* pp. 18-21.

the *reliability* of the technique or method employed, and then examines the *relevance* of the evidence or testimony to the facts of the case. *Id.*

Under the reliability prong, the district court is “both authorized and obligated to scrutinize carefully the reasoning and methodology underlying” the expert’s opinion. *Claar v. Burlington Northern R.R.*, 29 F.3d 499, 501 (9th Cir. 1994) (cited in Fed. R. Evid. 702 advisory committee’s note). A court must look at multiple factors when determining the reliability of an expert’s testimony. These factors include: (1) whether an expert’s “testimony is based upon sufficient facts or data” (Fed. R. of Evid. 702); (2) “[w]hether the expert has adequately accounted for obvious alternative explanations” (Fed. R. Evid. 702 advisory committee’s note (2000)); (3) whether the expert’s theory or technique can be tested; and (4) whether the expert’s testimony can assist the trier of fact. *Chapman v. Maytag Corp.*, 297 F.3d 682 (7th Cir. 2002).

The admissibility of expert testimony regarding stock price movement is governed by substantive legal principles and also by principles of economics and finance. *See In re Williams Securities Litigation*, 496 F. Supp. 2d 1195, 1266 (N.D. Okla. 2007); *see* Federal Judicial Center, *Reference Manual on Scientific Evidence* 22 (2d ed. 2000) (“some opinions have held that the ‘fit’ prong of the *Daubert* test and the helpfulness standard of Rule 702 require courts to exclude a plaintiff’s expert testimony that does not satisfy the plaintiff’s substantive burden of proof on an issue”) (citing *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 43 F.3d 1311 (9th Cir. 1995)). In this case, the two sets of principles are tightly intertwined. Therefore, a discussion of the substantive law is informative as it has influenced many recent rulings excluding putative loss causation and damages experts. *See In re Northern Telecom Ltd. Securities Litigation*, 116 F. Supp. 2d 446, 460-61 (S.D.N.Y. 2000) (finding plaintiffs’ causation expert’s testimony “fatally deficient” because “[t]estimony of a hypothetical nature must be evaluated especially carefully to ensure that conclusions concerning price ‘maintenance’ rule out

causes for that maintenance other than the defendants' purported failure to disclose certain information").

The Supreme Court, in *Dura Pharmaceuticals, Inc. v. Broudo*, established that a plaintiff in a securities fraud action must demonstrate loss causation, *i.e.*, a causal connection between the alleged material misrepresentation and the plaintiff's loss. 544 U.S. 336, 341-42 (2005). This means that "plaintiffs must show both that the defendants' alleged misrepresentations artificially inflated the price of the stock and that the value of the stock declined once the market learned of the deception." *Ray v. Citigroup Global Markets, Inc.*, 482 F.3d 991, 995 (7th Cir. 2007). It is not enough for Plaintiffs to demonstrate that the company's stock price underperformed the market or even that Plaintiffs sold their shares at a lower price after the "truth" was revealed. *See Dura*, 544 U.S. at 342-343. Rather, Plaintiffs must prove that it was the revelation of the alleged fraud that caused the company's stock price to decline. *Id.* As the Supreme Court explained in *Dura*:

If the purchaser sells later after the truth makes its way into the marketplace, an initially inflated purchase price *might* mean a later loss. But that is far from inevitably so. When the purchaser subsequently resells such shares, even at a lower price, that lower price may reflect, not the earlier misrepresentation, but *changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions*, or other events, which taken separately or together account for some or all of that lower price. . . . Given the tangle of factors affecting price, the most logic alone permits us to say is that the higher purchase price will *sometimes* play a role in bringing about a future loss.

Id. at 342-43 (emphasis added).

The substantive loss causation analysis articulated in *Dura* dovetails with Rule 702's requirement that an expert must rule out obvious alternative explanations for the loss. In fraud-on-the-market securities cases, industry-specific and firm-specific non-fraud "bad news" are obvious alternative explanations for why any company's stock price might decline. An ex-

pert's failure to consider and exclude such factors renders his opinion inadmissible. Fed. R. Evid. 702 advisory committee's notes, (citing *Claar v. Burlington Northern R.R.*, 29 F.3d 499, 509 (9th Cir. 1994) (excluding expert testimony where the expert failed to consider other obvious causes for the plaintiff's condition)).

I. Professor Fischel's Purported Causation Analysis is Not Useful to the Fact Finder

A. Professor Fischel Did Not Evaluate Any Causal Connection

To determine that an alleged fraud caused a loss, one must first identify the alleged fraud. Professor Fischel acknowledges that he knows neither what facts Defendants allegedly misrepresented to the market to inflate the stock price nor when (if ever) the truth of any such misrepresentation was revealed. Rather than analyze Plaintiffs' position, Professor Fischel *assumed* that all of Household's public filings between July 30, 1999 and November 14, 2001 were misrepresentations (Kavaler Decl. Ex. 2 (Fischel Tr.) at 127:18-128:4) and *assumed* those misrepresentations were corrected (*Id.* at 138:14-18). Having *assumed* the misrepresentations and corrective disclosures, Professor Fischel then simply measured Household's stock price movement on each day. Without evaluating whether the alleged disclosures "corrected" the previous statements, Professor Fischel admits that he cannot conclude that the alleged fraud caused Plaintiffs' losses. (*Id.* at 135:19-21 ("I haven't made any independent analysis of the adequacy of disclosures at any point in time.")).

Professor Fischel did not evaluate whether the alleged corrective disclosures related to the alleged misleading statements, presumably because he does not know which, if any, of Household's statements introduced artificial inflation. Rather, he simply assumed that any disclosure that even mentioned "re-aging," "predatory lending," or the "restatement" contained some facts that were previously unknown. (*Id.* at 138:14-18 ("I am *assuming* that the informa-

tion that came out during the period about these three different areas was something that the company did not disclose during the class period beginning from the first day of the class period.”) (emphasis added)). By forgoing any analysis of whether there is any connection between the facts allegedly misrepresented and the facts disclosed in the alleged “corrective disclosures,” Professor Fischel undercut his ability to provide any opinion related to causation. *Dura* 544 U.S. at 342 (loss causation is the “connection between the material misrepresentation and the plaintiff’s loss”).

Putting aside for the moment his failure to connect the information contained in the “corrective disclosures” to any prior statements, Professor Fischel did not evaluate whether the information contained in these “corrective disclosures” was even new to the market. He *assumed* that as well. (Kavaler Decl. Ex. 2 (Fischel Tr.) at 138:14-18). However, according to the efficient market hypothesis upon which Professor Fischel’s analysis is based, old information does not affect the stock price because such information would already have been incorporated into the market price when investors first learned of it. As Professor Fischel has previously testified:

there is an extensive economic literature and a very well established methodology for analyzing the effect of particular events on stock prices, and what the literature shows, and therefore what the methodology reflects, is that *stock prices react quickly to new information*, and therefore you can look in the period immediately after a particular event to analyze how market participants, buyers and sellers in the marketplace, value the consequences of that particular event.

(Kavaler Decl. Ex. 4 (Testimony of Daniel R. Fischel, *Glendale Federal Bank, FSB v. United States*, United States Court of Federal Claims, September 3, 1997) at 3) (emphasis added). In his Report, Professor Fischel states that “the change in the price of a stock when new information becomes available measures the value of the new information to investors.” (Kavaler Decl. Ex. 1 (Fischel Report) at ¶ 31).

This Court has recognized that efficient markets only respond to new information. *Kriendler v. Chemical Waste Management, Inc.*, 877 F. Supp. 1140, 1150 n.8 (N.D. Ill. 1995) (Castillo, J.) (“Upon publication of the information, the market immediately reacts, adjusts and incorporates the new information into the stock price.”) (citing *Roots Partnership v. Lands’ End, Inc.*, 965 F.2d 1411, 1419 (7th Cir. 1992)). Old or “stale” information cannot influence a company’s stock price in an efficient market. *See Eckstein v. Balcors Film Investors*, 8 F.3d 1121, 1130 (7th Cir. 1993) (failure of a stock to decline in price following the revelation of the truth demonstrates that the information is either not material “or that investors had fully taken this fact into account”); *West v. Prudential Securities, Inc.*, 282 F.3d 935, 939 (7th Cir. 2002) (market prices are not affected by actions or statements that do not convey new information).

Professor Fischel violates this fundamental tenet of economics, law, and logic by failing to evaluate whether the information released on any day he analyzed was new to the market. For example, Plaintiffs allege that the truth regarding Household’s predatory lending scheme was first revealed to the market on November 15, 2001 when “the *Associated Press* and *Los Angeles Times* reported that the California Department of Corporations sued Household for \$8.5 million, alleging the Company engaged in predatory lending practices.” (Kavaler Decl. Ex. 5 (Lead Plaintiffs’ Third Amended Objections and Responses Defendants’ [Fifth] Set of Interrogatories to Lead Plaintiffs, 02/01/2008), at 13). By then, that information was a week old. The details of the lawsuit had been reported on November 9, 2001, a day when Household’s stock price actually increased. (Kavaler Decl. Ex. 6 (*Abusive Lending*, City News Service, Nov. 9, 2001)). Moreover, the November 2001 allegations by the California Department of Corporations were not the first allegations of “predatory lending” leveled against Household. When confronted with evidence that the “corrective disclosures” he identified actually contained no new facts, Professor Fischel acknowledged that he had made no attempt to determine if the disclosures were stale. Instead, he *assumed* all the information was new.

Q: If the company is accused of being a predatory lender . . . and you are trying to analyze the movements of that stock price in response to allegations about predatory lending, doesn't it matter whether some of the things that are being criticized were known to the marketplace or not? (Kavaler Decl. Ex. 2 (Fischel Tr.) at 196:11-18).

A: [M]y analysis under both my quantification of specific disclosures and my leakage method of quantification focuses on changes in stock price. . . . [A] determination that something was or was not disclosed in a securitization prospectus wouldn't have any obvious effect on any of my opinions. (*Id.* at 196:21- 197:18).

An expert must rely upon "sufficient facts or data" in order to satisfy the requirements of Fed. R. Evid. 702. The very foundation of the fraud-on-the-market doctrine is that only new information can cause a company's stock price to decline. Professor Fischel's reliance on unwarranted assumptions in favor of actual economic analysis renders his opinion inadmissible. *See Korte v. Exxonmobil Coal USA, Inc.*, 164 Fed. Appx. 553, 557 (7th Cir. 2006) (finding a doctor's testimony inadmissible because his opinion was based on the assumption that defendant's coal dust caused the plaintiffs' injuries, and yet he had failed to test the dust); *Gayton v. McCoy*, 521 F. Supp. 2d 841, 850 (C.D. Ill. 2007) ("But general scientific truths . . . cannot be reliably applied to an individual case . . . without first establishing the facts or factual assumptions upon which that application is based.")

B. Professor Fischel Has Assumed His Conclusion, Making His Opinion Regarding Causation Useless to the Fact Finder

As discussed above, rather than proceeding on the basis of independent analysis, Professor Fischel relied on unwarranted assumptions that have produced a useless and tautological opinion. Specifically, Professor Fischel made the following assumptions:

- Professor Fischel *assumed* that Household's stock price was artificially inflated prior to the start of the Class Period. (Kavaler Decl. Ex. 2 (Fischel Tr.) at 84:3-7; Ex. 3 (Fischel Rebuttal) at ¶ 36).

- Professor Fischel *assumed* that “all public statements from the beginning of the Class Period contained material nondisclosures.” (Kavaler Decl. Ex. 2 (Fischel Tr.) at 127:18-24).
- Professor Fischel *assumed* that certain disclosures revealed the alleged (and assumed) fraud to the market. (*Id.* at 138:14-18).
- Professor Fischel *assumed* that these disclosures revealed new information. (*Id.*).
- Professor Fischel *assumed* that any stock price movements coinciding with these disclosures was artificial inflation leaving the stock price. (*Id.* at 133:24-134:3).
- Professor Fischel *assumed* that there remained zero inflation on the last day of the Class Period after the last alleged (and assumed) disclosure. (*Id.* at 202:17-20).

Professor Fischel made it clear that he is not giving any opinion as to what information (if any) caused investors’ losses or Household’s stock price to decline. Rather, Professor Fischel *assumed* all elements of securities liability as a basis for his conclusion. (*Id.* at 88:18-20 (“[C]ertainly there would have to be an adjudication that there were disclosure defects for my analysis to be meaningful.”); *id.* at 50:1-7 (“The claim that there is legal liability for misrepresentations or omissions — that may or may not be correct.”); *id.* at 103:3-4 (“I’m *assuming* that there were actionable non-disclosures on the first day of the class period”)) (emphasis added).

Specifically, Professor Fischel can offer no useful testimony regarding the introduction or dissipation of inflation. To prove loss causation “plaintiffs must show both that the defendants’ alleged misrepresentations artificially inflated the price of the stock and that the value of the stock declined once the market learned of the deception.” *Ray v. Citigroup Global Markets, Inc.*, 482 F.3d 991, 995 (7th Cir. 2007). However, the introduction and dissipation of inflation is what Professor Fischel explicitly assumed.

“In order for their [sic] to be artificial inflation, there has to be an actionable disclosure defect. I’m *assuming* the existence of action-

able disclosure defects.” (Kavaler Decl. Ex. 2 (Fischel Tr.) at 133:24-134:3) (emphasis added).

“My analysis is premised on my *assumption* that artificial inflation in Household’s stock price began on July 30, 1999 or no later than August 16, 1999.” (Kavaler Decl. Ex. 3 (Fischel Rebuttal) at ¶ 36) (emphasis added).

“I am *assuming* that the information that came out during the period about these three different areas was something that the company did not disclose during the class period beginning from the first day of the class period.” (Kavaler Decl. Ex. 2 (Fischel Tr.) at 138:14-18) (emphasis added).

“[B]ecause it’s the last day of the class period, I’m *assuming* that full disclosure occurred as of that date, meaning that there is no further inflation to measure after that date.” (*Id.* at 202:17-20) (emphasis added).

In short, Professor Fischel assumed that unspecified pre-Class Period statement artificially inflated Household’s stock price, that the artificial inflation was present in Household’s stock price on the first day of the Class Period, that between November 15, 2001 and October 11, 2002, certain articles and analyst reports contained some unspecified “corrective” information relating to the subject matters at issue that caused the artificial inflation to “leak” out of Household’s stock price, and that on the last day of the Class Period the artificial inflation was zero. An expert cannot avoid a challenge to the admissibility of his testimony by simply substituting assumptions for reliable testing to arrive at his conclusion. *See, e.g., Clark v. Takata Corp.*, 192 F.3d 750, 757 (7th Cir. 1999) (finding expert’s opinion unhelpful because expert assumed the very fact he had been hired to prove). By the very terms of Professor Fischel’s assumptions, any testimony that he provides would not assist the trier of fact in determining the very liability he has assumed.

Moreover, by assuming that a fraud introduced inflation into Household’s stock price before the Class Period began and that the identified disclosures revealed that fraud, Pro-

fessor Fischel has explicitly not considered non-fraud alternative explanations as required under *Daubert*, *Dura*, and Rule 702. In *In re Williams Securities Litigation*, the court held that plaintiffs' loss causation expert's methodology was neither relevant nor reliable where he simply assumed that the truth was revealed to the market because "[i]n securities litigation, non-fraud causes of a loss in value are 'obvious alternative explanations,'" which he failed to address. 496 F. Supp. at 1267.

Professor Fischel has previously acknowledged that when an expert makes assumptions of this nature, his methodology is fundamentally flawed. In *In re Blech*, Professor Fischel criticized a loss causation expert for using the same methods that Professor Fischel employed here, concluding,

Dr. Nye's report does not analyze the alleged manipulative transactions or present any evidence which establishes which, if any, of the alleged manipulative transactions caused any price inflation. In fact, Dr. Nye merely assumes (as his report states) that the alleged manipulative transactions caused the prices of the Blech Securities to be artificially inflated.

(Kavaler Decl. Ex. 7 (Report of Daniel R. Fischel in *In re Blech Securities*, No. 94 Civ 7696 (RWS)) at 2). This is exactly what Professor Fischel has done here. He has performed no independent analysis of the alleged misleading statements, the alleged "corrective disclosures," or any economic "connection" between the two as required by *Dura*. Instead he has merely assumed that the alleged misleading statements caused Household's stock price to be artificially inflated.

C. Professor Fischel's Conclusion That There is Economic Evidence "Consistent With" Plaintiffs' Allegations is Inadmissible

Having assumed the fraud, the inflation, and its dissipation, Professor Fischel cannot fairly conclude that the alleged fraud actually "caused" Plaintiffs' losses (as *Dura* re-

quires). Instead, he concludes only that there is economic evidence “consistent with” Plaintiffs’ allegation.⁵ Professor Fischel reaches this conclusion based upon no more than the fact that Household’s stock price underperformed the market during 2002. (Kavaler Decl. Ex. 1 (Fischel Report) at ¶ 29). The opinion doesn’t even claim to establish loss causation, and implicitly asserts only the absence of a preclusive *increase* in the stock price during the Class Period. It is therefore facially insufficient to survive a Rule 702 challenge.⁶ *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 261, 270 (5th Cir. 2007) (denying class certification because “[t]he plaintiff’s expert report did not establish loss causation”); *In re Omnicom Group, Inc. Securities Litigation*, 541 F. Supp. 2d 546, 554 (S.D.N.Y. 2008) (granting summary judgment for the defendant because plaintiffs’ expert’s event study failed to demonstrate loss causation).

It is not enough for an expert to analyze only whether the evidence is “consistent with” plaintiffs’ allegations. An expert must also be able to rule out alternative explanations. Fed. R. Evid. 702 advisory committee’s note (2000); *see also Claar v. Burlington Northern R.R.*, 29 F.3d 499, 502 (9th Cir. 1994) (testimony excluded where the expert failed to consider other obvious causes for the plaintiff’s condition). For a loss causation opinion, the rules provide a bright line that can be easily applied. For an opinion regarding loss causation to be admissible, it must not only conclude that the company’s stock price underperformance is “consistent with” a

⁵ Lacking any analysis that might support a causal connection, Professor Fischel does not even establish a statistical correlation between the economic evidence and Plaintiffs’ allegations. Of course, even a statistical correlation is insufficient in this Circuit as a basis to prove a causal relationship. *See, e.g., Sheehan v. Daily Racing Form, Inc.*, 104 F.3d 940, 942 (7th Cir. 1997) (excluding an expert’s testimony in an age discrimination case because “his equating a simple statistical correlation to a causal relation . . . indicates a failure to exercise the degree of care that a statistician would use in his scientific work, outside of the context of litigation”).

⁶ As a matter of pure logic, if one assumes all elements of an alleged claim then that person would find the claims themselves to be “consistent with” what he had assumed.

theory of fraud, but also that the underperformance is *inconsistent* with non-fraud explanations, which are obvious alternative explanations that an expert must rule out. *In re Williams Securities Litigation*, 496 F. Supp. 2d at 1266; *Malletier v. Dooney & Burke, Inc.*, 525 F. Supp. 2d 588, 669 (S.D.N.Y. 2007) (rejecting a regression analysis “because [plaintiff] has not set forth any credible testimony from a knowledgeable witness that the obvious alternatives were considered, analyzed and ruled out”); *see also Dura* 544 U.S. at 342-43.

Mere underperformance of a company’s stock price is not enough because, as the Supreme Court stated, the “lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price.” *Dura*, 544 U.S. at 342-43. Professor Fischel makes no conclusion that Household’s underperformance is inconsistent with non-fraud explanations.

In his deposition, Professor Fischel emphasized that the economic evidence he considered could not support an opinion that the alleged fraud *caused* Household’s stock price to become artificially inflated and later *caused* Household’s stock price to decline when the truth was revealed. Professor Fischel stated:

I’m not expressing an opinion on whether there were in fact misrepresentations or omissions. *The economic evidence that I’ve looked at does not allow me to express an opinion on that subject.* I can express an opinion as to whether the economic evidence is consistent with those allegations, but *does not establish* that the allegations themselves are true.

(Kavaler Decl. Ex. 2 (Fischel Tr.) at 49:11-26) (emphasis added). The unhelpful opinion that there is evidence “consistent with” Plaintiffs’ theory will not “assist the trier of fact to understand the evidence or to determine a fact in issue” as required by Rule 702. The fact finder is completely capable of determining whether the economic evidence, once provided, is consistent

with Plaintiffs' claims. *Sheehan v. Donlen Corp.*, 173 F.3d 1039, 1046 (7th Cir. 1999) ("The jurors, and they alone, are to judge of the facts, and weigh the evidence. . . . [T]hey are better calculated to judge of motives, weigh probabilities, and take what may be called a 'common-sense view' of a set of circumstances, involving both act and intent, than any single man, however pure, wise, and eminent he may be.").

Moreover, Professor Fischel does not identify the criteria (if any) that he used to determine whether the evidence was consistent, inconsistent or neutral as to Plaintiffs' allegations. Therefore his method is also not "reproducible" or "verifiable." Fed. R. Evid. 702. Allowing an "expert" to opine on what evidence is consistent with Plaintiffs' claims without an articulated criterion by which to evaluate that conclusion would prejudice Defendants, especially considering the diminutive probative value that such a vague conclusion would add. Fed. R. Evid. 702; Fed. R. Evid. 403; *See also United States v. Brown*, 7 F.3d 648, 655 (7th Cir. 1993) ("we recognize that in a close case the danger of unfair prejudice may be heightened by the 'aura of special reliability' that often surrounds expert testimony, and that jurors may tend to give such testimony undue weight") (citation omitted).

In *Thompson v. City of Chicago*, 472 F.3d 444, 458 (7th Cir. 2006), the Court of Appeals affirmed the District Court's exclusion under Rule 403 of the testimony of two expert witnesses on whether an officer used excessive force, stating that such a determination "is a fact-intensive inquiry turning on the reasonableness of the particular officer's actions in light of the particular facts and circumstances" and that "[w]hat is reasonable under any particular set of facts is 'not capable of precise definition or mechanical application.'" *Id.* (citation omitted). The Court held the experts' testimony "would have been of little value except as to possibly causing confusion and bore a substantial risk of prejudice." *Id.* The Court held that the jury was perfectly capable of determining whether the officer's conduct was reasonable based on the facts

and the introduction of expert testimony on the subject would have caused the jurors to automatically adopt the expert's opinion rather than develop their own conclusions. *Id.*

Here, Plaintiffs propose to introduce Professor Fischel's opinion that "[u]nder the facts and circumstances of this case, [Household's] long-term relative underperformance is consistent with Plaintiffs' claim." Like the standard of "reasonableness" discussed in *Thompson*, whether facts are "consistent with" Plaintiffs' claims is "not capable of precise definition or mechanical application." *Id.* (citation and internal quotation marks omitted). Indeed, Professor Fischel admits that his determination turned on the particular "facts and circumstances," just like in *Thompson*. (Kavaler Decl. Ex. 2 (Fischel Tr.) at 88:18-20). Putting aside the actual requirements of loss causation, jurors are perfectly capable of evaluating whether Household's stock price decline from November 15, 2001 through October 11, 2002 is "consistent with" Plaintiffs' claims. Professor Fischel's "two cents" is of little value but is cloaked in the "aura of special reliability," creating a substantial risk of prejudice.

Professor Fischel's analysis also contradicts his own "consistent with" conclusion, another defect which highlights the anticipated prejudice (and Plaintiffs' intended misuse) of that vague conclusion. The Court of Appeals has recently stated that "plaintiffs must show *both* that defendants' alleged misrepresentations artificially inflated the price of the stock *and* that the value of the stock declined once the market learned of the deception." *Ray v. Citigroup Global Markets, Inc.*, 482 F.3d 991, 995 (7th Cir. 2007) (emphasis added); *see also Semerenko v. Cendant Corp.*, 223 F.3d 165, 184-85 (3d Cir. 2000) (to prove loss causation a plaintiff must show both that he or she "purchased a security at a market price that was artificially inflated due to a fraudulent misrepresentation," and "that the artificial inflation was actually 'lost' due to the alleged fraud.") During discovery, Plaintiffs identified over 80 statements that they contend were

“affirmative misrepresentations made either by the Company or the Individual Defendants.” (Kavaler Decl. Ex. 8 (Plaintiffs’ Responses to Defendants Interrogatories Nos. 41-43)).⁷ Plaintiffs allege that these misrepresentations artificially inflated Household’s stock price. (AC at ¶ 349 (“the market prices had been artificially and falsely inflated by defendants’ misleading statements.”)).⁸

Purporting to evaluate whether the economic evidence is “consistent with” Plaintiffs’ claims of inflation, Professor Fischel calculated the amount of inflation present on every day of the Class Period as a result of these alleged misleading statements.

[T]he plaintiffs allege that all public statements from the beginning of the class period contained material nondisclosures relating to the three different areas that I discuss in my report, and what I’ve attempted to do is, based on that assumption, attempt to quantify the amount of inflation that resulted, and how that inflation varied over time as different disclosures occurred, which either increased or decreased inflation during the class period.

(Kavaler Decl. Ex. 2 (Fischel Tr.) at 127:18-128:4). Professor Fischel concluded that none of the alleged misleading statements introduced inflation into Household’s stock price. (*Id.* at 123:8-11 (“I didn’t find any statistically significant price increases that resulted in inflation from the beginning of the period, and through November 15, 2001.”)) Specifically, it is Professor Fischel’s opinion that artificial inflation was never introduced into Household’s stock between the first day of the Class Period (July 30, 1999) and the first alleged “corrective disclosure” which began revealing the alleged fraud (November 15, 2001). This question was put to Professor Fischel during his deposition:

⁷ On January 15, 2009, two years after fact discovery ended and two weeks before the pretrial Order (and this motion) was to be presented to the Court, Plaintiffs changed their position from 80 false statements to 47. They not only removed certain statements from their claims but also added new statements that they never previously identified during discovery. The analysis herein applies equally to Plaintiffs’ newly-minted position.

⁸ “AC” or “Complaint” refers to the [Corrected] Amended Consolidated Class Action Complaint.

Q: I want to understand in the sense that you use the words ‘to become inflated,’ how the stock price is becoming inflated on any of those days?

A: . . . [A]s a result of my quantification of what I am assuming to be a series of nondisclosures on the first day of the class period where the inflation *remained constant*, until there was a disclosure either increasing the amount of inflation or decreasing the amount of inflation which, based on my analysis, occurred on November 15th of 2001.

(*Id.* at 132:21-133:7) (emphasis added)).

To prove loss causation, Plaintiffs must demonstrate that the alleged misrepresentations or omissions introduced inflation into the stock price. *Ray*, 482 F.3d at 995; *Knapp v. Ernst & Whinney*, 90 F.3d 1431, 1438 (9th Cir. 1996) (to establish loss causation in a fraud-on-the-market case, a plaintiff must “show[] that the price on the date of purchase was inflated because of the misrepresentation”). Professor Fischel has found that the alleged misrepresentations caused zero inflation.⁹ Whatever unknown method Professor Fischel used to determine that the economic evidence was “consistent with” Plaintiffs’ allegations, it was clearly unreliable since

⁹ Professor Fischel also concluded that the economic evidence contradicted the cornerstone of Plaintiffs’ claim, *viz.*, that the fraud was revealed on the last day of the Class Period. Plaintiffs claim that “[i]t was only at the end of the Class Period, on 10/11/2002, when defendants announced that the company would pay \$484 million to settle predatory lending charges, that investors learned Household had been conducting its nationwide operations in direct violation of federal and state lending laws.” (AC at ¶ 23). However, Professor Fischel notes that “one would expect that [the settlement] would have *caused* the Company’s stock price to decline significantly. However, the stock price increased \$1.90 on October 11, 2002 after increasing \$5.30 on the previous day.” (Kavaler Decl. Ex. 1 (Fischel Report) at n.21) (emphasis added). In his deposition, Professor Fischel stated that he concluded that the announcement of the settlement was “good news.” (Kavaler Decl. Ex. 2 (Fischel Tr.) at 204:7-10). However, when confronted with the quotation from Plaintiffs’ Complaint that the alleged fraud was revealed on that day, Professor Fischel who had repeated several times that he had assumed that all of Plaintiffs’ claims were true for the purpose of his analysis, backtracked, stating “[w]ell, obviously, my report focuses on my analysis as opposed to the allegations in the complaint.” (*Id.* at 205:17-19). Professor Fischel cannot have it both ways. Either he assumed all of Plaintiffs’ claims were true and his opinions are tautological or he performed an independent analysis that contradicted Plaintiffs’ claims, because a revelation of a fraud cannot logically cause a \$7.20 (or 34.3%) increase in stock price.

his findings directly contradict what Plaintiffs must prove.¹⁰ Moreover, Professor Fischel's failure to determine that any inflation was introduced by any of the alleged misleading statements renders his opinion inadmissible. Where a plaintiff's case is "premised on misrepresentations and omissions" as it is here, "a valid loss causation methodology . . . must be able to analyze the inflationary effects of the alleged misrepresentations or omissions *and* the alleged corrective events." *Fogarazzo v. Lehman Bros.*, 232 F.R.D. 176, 189 (S.D.N.Y. 2005) (emphasis added).

II. Both of Professor Fischel's "Inflation" Models Should be Excluded

Having assumed the validity of all elements of Plaintiffs' claims, including loss causation and damages, in section four of his Report, Professor Fischel presents two "inflation" models that he claims could be used to quantify damages in the event liability were determined. As an initial matter, Professor Fischel makes clear that he has no opinion whether there was ever any inflation in Household's stock price and he does not claim that these models are measuring the amount of artificial inflation in Household's stock price at any time. Rather, these models assume all aspects of Plaintiffs' claims are true (misleading statements, materiality, reliance, sci-

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Plaintiffs offer a purported adjustment to their theory to accommodate this contradiction, now claiming that they are alleging fraudulent omissions rather than affirmative misrepresentations. Putting aside that this directly contradicts the Complaint and Plaintiffs' own contention in interrogatory responses, the new explanation is unavailing. Plaintiffs are conflating stock price *movement* with *inflation*. Securities law is only concerned with the latter. As Professor Fischel testified, the omission/misrepresentation distinction is irrelevant for purposes of measuring inflation. "[A] disclosure which contains an omission can create inflation even if there is no price reaction to it." (Kavaler Decl. Ex. 2 (Fischel Tr.) at 126:7-9). "Regression analysis [] can be used in this case to calculate the amount of artificial inflation resulting from an alleged omission on any day during the Class Period." (Kavaler Decl. Ex. 3 (Fischel Rebuttal) at ¶ 39). "[I]f I make the opposite assumption that plaintiffs claim particular statements of misrepresentations as opposed to omissions, and there is no statistically significant price reaction to them . . . I would still conclude that those statements would not be the basis of a material misrepresentation which would be included in my quantification of specific disclosures, because there is no statistically significant price reaction as a result. *So nothing really for my purposes turns on whether these statements are considered to be omissions or misrepresentations.*" (Kavaler Decl. Ex. 2 (Fischel Tr.) at 124:22-125:12 (emphasis added)).

enter, loss causation, and damages) (Kavaler Decl. Ex. 2 (Fischel Tr.) at 88:18-20 (“[C]ertainly there would have to be an adjudication that there were disclosure defects for my analysis to be meaningful.”)). These models are purported methods for measuring what (if any) inflation was present in Household’s stock price if the fact finder ultimately were to find that all aspects of Plaintiffs’ claims have been established by proof other than that offered by Professor Fischel.

Professor Fischel proposes two separate models for measuring inflation (assuming it ever existed) — a “Leakage Model” and a “Specific Disclosure Model.” In preparing both models, Professor Fischel compared Household’s stock performance to that of the general market, using the S&P 500 and S&P Financial indices. (Kavaler Decl. Ex. 1 (Fischel Report) at ¶ 29). He used this comparison to eliminate the effect of general market factors on Household’s stock price movement. The remaining stock price movement on a given day, which would be the result of all industry (consumer finance) specific and firm specific news, is known as the “residual return.” (*Id.* at ¶ 32).

In the Leakage Model, Professor Fischel assumed that the truth regarding the alleged fraud “leaked” into the market between November 15, 2001 and October 11, 2002 (*Id.* at ¶ 41) and that any residual decline on any given day during this eleven-month period was the result of the fraud being partially “leaked.” All residuals are then assumed to measure the artificial inflation “leaking” out of the stock price on that day. Based on these assumptions, he then summed the residual returns during the period, concluding that this process was “a quantification of alleged artificial inflation taking leakage into account.” (*Id.* at ¶ 42).

In his Specific Disclosure Model, after calculating the residual return on each day of the Class Period, Professor Fischel selected for further examination only those days in which the residual return was statistically significant, *i.e.*, where there was 95% likelihood that the observed stock price movement occurred because of some reason other than random fluctuations.

(Kavaler Decl. Ex. 3 (Fischel Rebuttal) at n.14; Ex. 1 (Fischel Report) at ¶ 33). If Professor Fischel observed a statistically significant residual stock price decline he would check to see if any disclosure by or about the company that day was related in any way to the three subject matters of fraud alleged by Plaintiffs. If there was such a related disclosure (and even if it was only one of many disclosure on various topics that day), Professor Fischel included that residual stock price decline in his measurement of artificial inflation. (Kavaler Decl. Ex. 3 (Fischel Rebuttal) at n.14). Professor Fischel did not evaluate whether the disclosures he selected revealed any previously unknown facts about the company.

As an initial matter, both of Professor Fischel's "inflation models" should be rejected because his regression analysis applies an unacceptable "one-tail" test to find statistically significant stock price movements. (Kavaler Decl. Ex. 2 (Fischel Tr.) at 53:15-17). Use of a one-tail test has been repeatedly rejected by this Court. "Unlike the more common 'two-tailed' standards, which assess the likelihood that any differences between two groups would occur by chance, a one-tailed standard assumes that any deviation from what might be predicted by chance will be in only one direction." *Dicker v. Allstate Life Insurance Co.*, No. 89 C 4982, 1997 U.S. Dist. LEXIS 4512, at *117 (N.D. Ill. Apr. 7, 1997) (Pallmeyer, M.J.). Thus, the "two-tail" test is objective, while the "one-tail" test is inherently biased because the analyst begins the exam with the assumption that the stock price will only move in one direction (in this case, decline). (Kavaler Decl. Ex. 2 (Fischel Tr.) at 147:20-23 ("using [the one-tail] test of statistical significance, you have a hypothesis of which direction stocks are going to move in response to a particular disclosure")). Thus, a one-tail test should be used only where there is a reason to expect a reaction in only one direction. Courts have universally rejected it in discrimination cases because discrimination can occur against either sex [or race], even though the possibility may be remote. *See, e.g., Palmer v. Shultz*, 815 F.2d 84, 95-96 (D.C. Cir. 1987) (in discrimination cases, a two-tail test, not one-tail test is appropriate); *Barnhill v. City of Chicago Police Department*,

142 F. Supp. 2d 948, 969 (N.D. Ill. 2001) (Pallmeyer, J.) (a one-tail test in a reverse discrimination case was inappropriate because it did not consider that discrimination can occur against other races); *EEOC v. Autozone, Inc.*, No. 00-2923, 2006 WL 2524093, at *5 (W.D. Tenn. Aug. 29, 2006) (stating, in a discrimination case, that “using the two-tail rather than the one-tail probabilities is appropriate because one must look for both under-and overrepresentation, rather than looking for underrepresentation only”).

A one-tail test is completely inappropriate when examining stock price movement because stock prices can increase or decrease on any given day. Indeed, Professor Fischel undertook to evaluate both inflation (increases) and deflation (decreases) in Household’s stock price. (Kavaler Decl. Ex. 2 (Fischel Tr.) at 127:23-128:4 (“[W]hat I’ve attempted to do is . . . to quantify the amount of inflation that resulted, and how that inflation varied over time as different disclosures occurred, which *either increased or decreased inflation during the class period.*”) (emphasis added)). Thus, a one-tail test is especially unacceptable in this case. *See Dicker v. Allstate Life Insurance Co.*, No. 89 C 4982, 1997 U.S. Dist. LEXIS 4512, at *117 (N.D. Ill. Apr. 7, 1997) (Pallmeyer, M.J.) (rejecting the use of a one-tail test, stating that “a one-tailed standard assumes that any differences in outcomes for white and black employees reflect more favorable outcomes for whites. Even if one assumes the truth of this assumption, this court is unwilling to relax the standards necessary for a showing of statistical significance. . . .”).

The reason that experts use one-tail tests is because they allow the expert to find statistically significant days where they otherwise would not if they used the objective two-tailed test. *EEOC v. Federal Reserve Bank*, 698 F.2d 633, 655-56 (4th Cir. 1983) (“Many investigators find it tempting to use a one-tailed probability level to facilitate obtaining “significant” results.”) (quoting Herbert Friedman, *Introduction to Statistics*, 146-47 (Random House, 1972)), *rev’d on other grounds*, 467 U.S. 867 (1984). For these reasons, one-tail tests have been described as “‘data mining’ per se,” *i.e.*, they are used for “‘manipulating data to prove a desired

result.” *Id.* at 655-56. (citing Gregory Harper, *Statistics as Evidence of Age Discrimination*, 32 *Hastings L.J.* 1347, 1355 n.65 (1981) (citing David Freedman, Robert Pisani & Roger Purves, *Statistics* 494-96 (1978))).¹¹ Professor Fischel’s reliance on this inherently biased and universally rejected analysis renders his regression analysis, which is the basis for both of his “inflation models,” inadmissible.

A. Professor Fischel’s Leakage Model Fails to Account for Obvious Non-Fraud Alternative Explanations for the Decline In Household’s Stock Price and is Not Accepted in the Scientific Community

An expert’s testimony will be excluded if he has not “adequately accounted for obvious alternative explanations.” Fed. R. Evid. 702 advisory committee’s notes (2000). When analyzing stock price movements and loss causation, non-fraud firm specific factors are “obvious alternative explanations” for a company’s decline in stock price. *In re Williams Securities Litigation*, 496 F. Supp. 2d at 1267. As the Supreme Court explained in *Dura*:

If the purchaser sells later after the truth makes its way into the marketplace, an initially inflated purchase price *might* mean a later loss. But that is far from inevitably so. When the purchaser subsequently resells such shares, even at a lower price, that lower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price. . . . Given the tangle of factors affecting price, the most logic alone permits us to say is that the higher purchase price will *sometimes* play a role in bringing about a future loss. . . .

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In addition to the *per se* inappropriateness of the one-tail test, the absurdity of its use is evident from Professor Fischel’s own illogical conclusions. On the last two days of the Class Period, October 10 and 11, 2002, the days on which Plaintiffs claim the predatory lending fraud was finally revealed to the market, Household’s stock price increased \$7.20. Professor Fischel acknowledged that this increase contradicted his expectations that the stock price would decline on that day. (Kavaler Decl. Ex. 1 (Fischel Report) at n.21). Such an outcome mandates a rejection of the one-tail test hypothesis that disclosures caused Household’s stock price to decline.

Dura Pharmaceuticals, Inc. v. Broudo, 544 U.S. 336, 342-43 (2005). Professor Fischel's Leakage Model is flatly inconsistent with *Dura* as it does not account for the influence of *any* firm specific factors on Household's stock price over the entire eleven-month period. Instead, the Leakage Model attributes all stock price declines that are not attributable to general market forces to the alleged fraud.

It is not enough, however, to demonstrate that Household's stock price simply underperformed the market. Instead, Plaintiffs must establish that it was the revelation of the fraud that caused the company's stock price to decline. *Dura*, 544 U.S. at 342-43. Professor Fischel's failure to account for obvious alternative explanations for some or all of Household's stock price decline such as headline risk, the general downturn of the consumer finance market, or any of the company-specific non-fraud-related bad news that was released over this period, renders his Leakage Model inadmissible. Rule 702; *In re Williams Securities Litigation*, 496 F. Supp. 2d 1195, 1266-67 (N.D. Okla. 2007).¹²

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Professor Fischel's eleven-month "leakage" window is unacceptable also because it does not evaluate the effect of a particular event on Household's stock price as required by any proper "event study". See *In re Initial Public Offering Securities Litigation*, 399 F. Supp. 2d 261, 265 (S.D.N.Y. 2005) ("in material misstatement and omission cases, a court cannot presume dissipation of the inflationary effect; a plaintiff must explicitly allege a disclosure or some other corrective event") (citation and internal quotation marks omitted). As the name suggests, an event study is used to "measures the impact of a specific event on the value of a firm." Craig MacKinlay, *Event Studies in Economics and Finance*, 35 J. of Econ. Lit. 13 (1997). Fischel's Leakage Model (and his eleven-month "event window") does not measure the impact of any specific event. Rather, it only measures how much Household underperformed the market from November 15, 2001 to October 11, 2002, without reference to a particular event that caused that particular decline. Such a "leakage" or "dissipation" analysis is contrary to what the law requires and must be excluded. See *In re World Access, Inc. Securities Litigation*, 310 F. Supp. 2d 1281, 1298 n.10 (N.D. Ga. 2004) (an event study is "a statistical regression analysis that examines the effect of an event, such as an allegedly fraudulent statement or omission, on a dependant variable, such as a company's stock price") (citing *In re Imperial Credit Industries, Inc. Securities Litiga-*

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Professor Fischel explicitly acknowledged that his Leakage Model attributed residual stock price declines to the alleged fraud even though they had nothing to do with Plaintiffs' allegations. (Kavaler Decl. Ex. 2 (Fischel Tr.) at 57:12-16 (“Q: So there are a bunch of stock price movements that were significant under your regression analysis that were not attributable to fraud related disclosures? A: Correct.”)). According to his own regression analysis, Professor Fischel identified 26 days during the eleven-month period where Household's stock price experienced a statistically significant stock price decline that he did not attribute to any “corrective disclosure” regarding the alleged fraud. However, Professor Fischel included these movements in his quantification of inflation. For example, Professor Fischel identifies July 9 and 10, 2002 as statistically significant residual declines, however, he identifies no information regarding Household or even the consumer finance sector being released between July 2 and July 10. The Leakage Model improperly attributes these declines to the alleged fraud nonetheless.

Equally inappropriately, Professor Fischel's Leakage Model attributes to the alleged fraud all residual stock price declines on every day even if the movement was not statistically significant. As Professor Fischel has acknowledged in his own writing, it is a well accepted tenet of economics that one can only attribute stock price movements to an event (fraud) if the stock price movement is statistically significant. Daniel R. Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 Bus. Law. 1, 19 (1982) (“If the difference between the actual return and the predicted return is not statistically significant, investors were not injured. . . .”). Professor Fischel's Leakage Model violates this

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tion, 252 F. Supp. 2d 1005, 1014 (C.D. Cal. 2003)); *In re Williams Securities Litigation*, 496 F. Supp. 2d at 1266-67 (excluding loss causation expert who measured inflation over a 21-month period).

principle. According to Professor Fischel's own analysis, 171 out of 228 trading days between November 15, 2001 and October 11, 2002 were statistically *insignificant*. For example, on June 14, 2002, Professor Fischel found that Household's stock price experienced a residual decline of \$.06 which would be "statistically significant" only if the confidence level was 6.37%. This means that there is a 93.63% likelihood that this size movement would simply be because of normal fluctuations in Household's stock price and not because of any firm specific news, whether fraud related or not. According to Professor Fischel's own report, absolutely no industry or firm specific information was released on either June 13 or 14, 2002. Despite the lack of any relevant disclosure on either day and an economic principle that mandates his exclusion of such a date, Professor Fischel's Leakage Model still attributed this decline to the fraud. This is unacceptable. *See, e.g., In re Imperial Credit Industries, Inc. Securities Litigation*, 252 F. Supp. 2d 1005, 1014-15 (C.D. Cal. 2003) ("[a] proper measure of damages in the securities context . . . requires elimination of that portion of the price decline or price difference which is unrelated to the alleged wrong"), *aff'd sub nom. Mortensen v. Snavely*, 145 Fed. Appx. 218 (9th Cir. 2005).

Professor Fischel's Leakage Model also fails to account for the fact that all of Household's competitors were experiencing similar losses. During the Class Period, the price of Household's common stock fell amidst an entire bundle of negative information that substantially decreased the value of publicly traded securities throughout the consumer finance sector. "Of course, if the loss was caused by an intervening event, like a general fall in the price of Internet stocks, the chain of causation will not have been established." *Emergent Capital Investment Management, LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 197 (2d Cir. 2003). Where there is both an industry-wide debacle (*e.g.*, "a marketwide phenomenon causing comparable losses to other investors," *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 174 (2d Cir. 2005) (citation and internal quotation marks omitted)), accompanied by an abundant flow of bad news about both the industry and the company in question, the non-fraud "contributing forces must be

isolated and removed.” *Robbins v. Koger Properties, Inc.*, 116 F.3d 1441, 1447 n.5 (11th Cir. 1997) (rendering judgment as a matter of law for defendant accounting firm).

In *Ray v. Citigroup Global Markets, Inc.*, No. 03 C 3157, 2005 U.S. Dist. LEXIS 24419 (N.D. Ill. Oct. 18, 2005) (Kennelly, J), the court granted summary judgment for the defendants even though Citigroup’s stock price declined following a corrective disclosure, because by the time the “truth” was revealed, the stock price had already declined significantly and the company’s competitors suffered similar declines during the same period. In affirming the district court’s decision, the Court of Appeals held that *Dura* requires a plaintiff to prove that “[the defendant’s] stock declined just when the alleged misrepresentations were revealed.” 482 F.3d at 995 (7th Cir. 2007).

Although Household’s stock price declined 58.37% between the Class Period high on July 18, 2001 and the end of the Class Period on October 11, 2002, over the same period, the Consumer Finance Index, which contains consumer finance coded companies, fell by 54.53% as regulation in the consumer finance market increased and consumer advocates criticized sub-prime lending as “predatory.” (University of Chicago’s Center for Research in Security Prices). The stock price of many of Household’s direct competitors, the members of the Consumer Finance Index, declined substantially during this time as indicated in Chart A:

COMPARISON OF STOCK PRICE CHANGES FOR CONSUMER FINANCE COMPANIES

Period Start Date: 11/14/2001
Period End Date: 10/11/2002

% Change During the Period

	Household	-52.70%
Consumer Finance Companies	1 Americredit	-71.98%
	2 Capital One	-43.63%
	3 Cash America	-14.60%
	4 Countrywide	6.25%
	5 MBNA	-20.92%
	6 Provident	19.56%

Note:

"Consumer Finance Companies" are members of Standard and Poor's Consumer Finance Index, which includes companies that belong to the S&P Supercomposite 1500 Index and are classified as "consumer finance companies" according to their GICS code (GICS code of 40201010).

Source:

University of Chicago's Center for Research in Security Prices (CRSP)

Professor Fischel's Leakage Model completely ignores this general industry downturn in the consumer finance business — an obvious alternative explanation for Household's stock price decline. Instead, he attributes all "residual returns," 82% of the decline in Household's stock price during the 11-month period, solely to the alleged fraud. Such a methodological failure is fatal. Where "plaintiffs' expert does detail[ed] event studies supporting a finding that [the stock] reacted to the *entire bundle* of negative information . . . this reaction suggests only market efficiency, not loss causation, for there is no evidence linking the *culpable* disclosure to the stock-price movement." *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 487 F.3d 261, 271 (5th Cir. 2007) (emphasis in original).

In *In re Williams Securities Litigation*, the court rejected a "leakage model" identical to Professor Fischel's. Plaintiffs' expert, Dr. Nye, attributed all residual returns of a telecommunications company over a 21-month period to the alleged fraud even though the company's competitors experienced similar losses. The court found the model insufficient under Rule 702 and *Daubert*. "*Dura* leaves no room for doubt that even where a securities fraud plaintiff proceeds on a 'leakage' theory of corrective disclosure, he must still establish that the lower

price reflects the fraud-related inflation and not ‘changed economic circumstances, changed investor expectations, new-industry specific facts, conditions or other events, which taken separately or together account for some or all of that lower price,’” 496 F. Supp. 2d at 1266-67 (internal citation omitted). The court noted that the expert “fail[ed] to differentiate between losses rooted in causes cognizable under loss causation doctrine, on one hand, and, on the other hand, losses attributable to industry-specific stresses, the meltdown in the telecommunications sector, and other negative developments unrelated to the alleged fraud.” *Id.* at 1266. Most significantly, the court held that a leakage model that attributes all residual returns not explained by general market forces to inflation “collides directly with loss causation doctrine” because such a model “does not even purport . . . to have removed the effects of ‘[n]onfraud company-specific information.’” *Id.* at 1266.

Professor Fischel’s Leakage Model is indistinguishable from the leakage model rejected in *In re Williams* and, therefore, must be excluded. *See also United States v. Ferguson*, 584 F.Supp. 2d 447 (D. Conn. 2008) (rejecting plaintiff’s expert’s “leakage event study” which was “an estimate of the total decline in [defendant’s] stock price for that thirty-day period, after controlling for market and industry factors” because “the leakage study attributes all non-market and non-industry related declines in [defendant’s] stock price to the [] fraud without accounting for other factors that may have contributed to that decline. . .”).¹³

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Not only is Professor Fischel’s Leakage Model deficient on its face but it is also inadequate to support Professor Fischel’s vague conclusion that the economic evidence is “consistent with” Plaintiffs’ allegations. All that the Leakage Model shows is that Household’s stock price underperformed the S&P 500 and Financials during the 11-month period. However, by definition of the S&P being an average of all companies’ performance, at any given time any company will underperform or over perform the market as a whole. Any time a company underperforms the market that underperformance is “consistent with” an allegation of fraud being revealed. However, such an opinion is so weak and devoid of substance that the prejudice that would occur by it coming from an “expert” would substantially outweigh its probative value, which is miniscule. *See United States v. Brown*, 7 F.3d 648, 655 (7th Cir. 1993) (“[W]e recognize that in a close case

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Looking to create an exception to the variety of cases rejecting leakage models, Professor Fischel claims that his Leakage Model is nevertheless acceptable because the way he has done it in this case it falls within the definition of an “event study” as articulated in the 1990 article by Bradford Cornell and R. Gregory Morgan, *Using Finance Theory to Measure Damages in Fraud on the Market Cases*, 37 UCLA L. Rev. 883, 905 (1990). (Kavaler Decl. Ex. 1 (Fischel Report) at ¶ 41) (“I quantified the amount of artificial inflation in Household’s stock price including the leakage of information related to the alleged fraud using the ‘event study approach’ described by Cornell and Morgan”). This paper is the sole source cited in Professor Fischel’s Report in his section on the Leakage Model. With no other support for his model, Professor Fischel exclusively and repeatedly cites this lone article more than ten times in his Report to validate his Leakage Model as a proper event study.

First, as explained above, dubbing a model an “event study” does not anoint it proper expert methodology. Not all event studies are performed in a manner up to the high evidentiary standards imposed by the Federal Rules of Civil Procedure, which is evidenced by courts’ repeated rejection of similar “event study” models. Second, Doctor Bradford Cornell, the co-author of the article upon which Professor Fischel exclusively relies for the validation of his Leakage Model, rejects Professor Fischel’s insistence that his Leakage Model is an event study as described in the Cornell article. (Kavaler Decl., Ex. 9 (Affidavit of Bradford Cornell, dated October 30, 2008 (“Cornell Aff.”) at 3).¹⁴ To the contrary, Professor Cornell reviewed Professor

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the danger of unfair prejudice may be heightened by the ‘aura of special reliability’ that often surrounds expert testimony, and that jurors may tend to give such testimony undue weight.”); Fed. R. Evid. 403; Fed. R. Evid. 702.

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Doctor Cornell has earned a master’s degree in Statistics and a PhD in Financial Economics from Stanford, is a Professor of Finance at California Institute of Technology, has authored numerous works in economics and has served as a consultant and expert witness for plaintiffs and defen-

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Fischel's Leakage Model and concluded that "[a]lthough Prof. Fischel refers to his leakage model as an event study approach, citing my paper with Mr. Morgan as support, I do not agree. Instead, it is what Mr. Morgan and I refer to as a comparable index approach." (*Id.* at 3-4). Doctor Cornell explains that this is more than a matter of semantics:

Whether Prof. Fischel's approach is called an event approach or a comparable index approach, it still suffers from the problem that Mr. Morgan and I discuss on page 903 of our paper. There we say, 'The trouble with the comparable index approach, . . . is that it attributes any decline in the security price that is not due to movements in the market or the industry to disclosure of the fraud. If the disclosure of the fraud is associated with the release of other company-specific news, the comparable index approach will overestimate the true damages.' The recognition of this problem with the comparable index approach is not unique to Mr. Morgan and me. It has been widely documented in the academic literature, including published work by Prof. Fischel.

Applying this common sense logic to this case, Professor Cornell explains:

For companies like Household over a period as long as the alleged leakage period [11 months], there are hundreds, if not thousands, of news items. Assuming the model employed by Prof. Fischel properly nets out market and industry related effects, there are still hundreds of news items that deal with Household itself. Prof. Fischel's leakage model assumes, without demonstrating, that all the news items that affect Household's stock price are related to the fraud. In my opinion as an economist, that assertion does not provide adequate evidence, indeed it really provides no evidence, that the stock price decline was caused by leakage of fraud related information rather than disclosure of other firm specific news. . . . Although Prof. Fischel's model could take account of market and industry factors, assuming it is properly specified, it does not take account of firm specific factors, Therefore, any estimate of inflation produced by this model cannot be relied upon.

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dants alike in a variety of securities, regulatory and commercial lawsuits. His background and qualifications are described more fully in his attached affidavit and curriculum vitae. (Kavaler Decl., Ex. 9 (Cornell Aff.) at 1-2, Ex. 1).

(*Id.* at 5).

Even if Professor Fischel's Leakage Model were an event study that measured the effect of an identifiable event on Household's stock price (which it is not), and even if Professor Fischel had accounted for firm specific non-fraud news that affected Household's stock price (which he did not), the sheer size of his "event window" (the period of time after the event that is analyzed) mandates its exclusion.

As the name suggests, an event study is used to "measure[] the impact of a specific event on the value of a firm." Craig MacKinlay, *Event Studies in Economics and Finance*, 35 J. of Econ. Lit. 13 (1997). Because the cornerstone of the efficient market hypothesis is that the market incorporates all information immediately, the generally accepted size of an "event window" is one or two days. *See, e.g., Goldberg v. Household Bank, F.S.B.*, 890 F.2d 965, 966-67 (7th Cir. 1989) ("[Plaintiff] sought \$3.75 per share, the amount the stock declined on the date the truth came out. . . . When markets are liquid and respond quickly to news, the drop when the truth appears is a good measure of the value of the information. . .") (citing *Flamm v. Eberstadt*, 814 F.2d 1169, 1179-80 (7th Cir. 1987) and Daniel R. Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 Bus. Law. 1, 12-13 (1982)); *Short v. Belleville Shoe Manufacturing Co.*, 908 F.2d 1385, 1392 (7th Cir. 1990) ("the market price of the securities after the news is released. . . is fixed within days after the trading, sometimes within hours").

Professor Fischel's proposed event window is not one or two days. It is *eleven months*. A window of this size is facially deficient. *See In re Williams Securities Litigation*, 496 F. Supp. 2d at 1266-67 (excluding loss causation expert who measured inflation over a 21-month period); *United States v. Ferguson*, 584 F.Supp. 2d 447 (D. Conn. 2008) (rejecting loss causation expert's "leakage event study" which used a 30 day window) Once again, the only

support for this unprecedented event window size that Professor Fischel offers is his claim that Doctor Cornell's article blesses it as an "event study" approach. This is false. Once again, Professor Fischel has mischaracterized Doctor Cornell's academic work for his own gain. Doctor Cornell explicitly commented on Professor Fischel's use of an eleven-month window in this case:

There is one final issue that arises when regression models are applied over long periods to predict returns as Prof. Fischel does in his leakage model. No regression model perfectly accounts for market and industry factors. Nonetheless, if the models are used to calculate residual returns over intervals of no more than a few days, the errors are generally minor. However, when a model is used to predict returns over periods hundreds of days long the errors compound. Such compounding, in turn, can produce significant errors in measured inflation. This is another reason to be skeptical of the results produced by the comparable index approach.

(Kavaler Decl., Ex. 9 (Cornell Aff.) at 5-6).

Doctor Cornell's words speak for themselves. Not only does Professor Fischel's Leakage Model fail to meet the high standards for admissible expert testimony set by *Daubert* and its progeny because of its failure to account for non-fraud, company-specific news as alternative explanations for the decline in Household's stock price, but in the course of his employment for Plaintiffs, Professor Fischel (an attorney who holds no degree in statistics, economics or finance) has mischaracterized his model as an accepted method in the field, misrepresenting Doctor Cornell's work to further Plaintiffs' goal. The sole academic that Professor Fischel relies on to validate his model has explicitly rejected it. With no support in the scientific community for his Leakage Model, Professor Fischel's testimony on this subject must be excluded. Fed. R. Evid. 702 advisory committee's note (2000) (identifying as a *Daubert* factor "whether the technique or theory has been generally accepted in the scientific community"); see *Daubert*, 509 U.S. at 592-93.

B. Professor Fischel's Specific Disclosure Model Must Be Excluded Because He Engaged in "Cherry-Picking"

Professor Fischel also puts forth his Specific Disclosure Model as an alternative measure of the assumed inflation in which he selects 10 disclosures from his Leakage Model that coincide with statistically significant declines in Household's stock price. Assuming that these declines are the result of a fraud being revealed and artificial inflation coming out of the stock price, he sums these 10 residual movements and concludes that the stock price movement on these days is an alternative measure of artificial inflation. (Kavaler Decl. Ex. 1 (Fischel Report) at ¶¶ 36-37; Ex. 3 (Fischel Rebuttal) at n.14).

An expert's method of analysis must be reliable. Fed. R. Evid. 702. "In evaluating the reliability of an expert's method, however, a district court may properly consider whether the expert's methodology has been contrived to reach a particular result." *Rink v. Cheminova, Inc.*, 400 F.3d 1286, 1293 n.7 (11th Cir. 2005). Professor Fischel manufactured his Specific Disclosure Model so that it would only identify evidence supporting Plaintiffs' allegations. Specifically, Professor Fischel has included in his model only those disclosures that coincide with a significant stock price decline while excluding similar disclosures that do not. Damages experts call this type of defective analysis "cherry-picking."

Professor Fischel's cherry-picking is particularly evident in his analysis of Plaintiffs' "predatory lending" allegations. Plaintiffs claim that the "truth" regarding Household's predatory lending fraud was revealed to the market every time an article, analyst report, or lawsuit discussed predatory lending. In order to evaluate whether the economic evidence supports these claims, an unbiased analysis would identify each disclosure alleging predatory lending, examine Household's stock price movement on that day, and then determine whether it appears based on all the evidence that these types of disclosures were affecting Household's stock price. (See Kavaler Decl. Ex. 2 (Fischel Tr.) at 46:20-24 ("[Y]ou would look at the allegations in the

case, the relevant public disclosures, the stock price reaction to those disclosures”); (*See also id.* at 39:7-13). Professor Fischel did not do this. In his Rebuttal Report, Professor Fischel admitted,

we first identified dates on which news related to Plaintiffs’ allegations became available to the market. We then examined each of these dates to determine whether the news related to Plaintiffs’ allegations led the market to significantly alter its valuation of Household’s stock. *We only included in the Quantification Using Specific Disclosures those dates on which news related to Plaintiffs’ allegations had a statistically significant effect on the Company’s stock price.*

(Kavaler Decl. Ex. 3 (Fischel Rebuttal) ¶ 19 n.14 (2/1/2008)) (emphasis added).

Although Professor Fischel acknowledged that an expert should analyze all disclosures concerning Plaintiffs’ allegations before concluding that those type of disclosures were causing Household’s stock price to fluctuate, he only presented as proof the 7 “predatory lending” disclosures that supported Plaintiffs’ position because they coincided with significant stock price declines. He ignored all lending-related disclosures where Household’s stock price movement was inconsistent with Plaintiffs’ allegations, *i.e.*, where Household’s stock price experienced no significant movement or experienced a significant increase. Indeed, Professor Fischel’s definition of a fraud-related disclosure was limited to only those disclosures that coincided with a statistically significant negative effect on Household’s stock price. As he explained in his deposition:

Q: . . . How did you know if a disclosure related to predatory lending that you considered to be fraud related.

A: . . . [T]o the extent there were disclosures about Household’s predatory lending practices, that had a statistically significant stock price reaction associated with them, I took those disclosures into account in my quantification of inflation focusing on specific disclosures.

(Kavaler Decl. Ex. 2 (Fischel Tr.) at 80:1-12). This biased definition guaranteed that Professor Fischel would only find evidence consistent with Plaintiffs' theory because disclosures that contradicted their theory were not even considered disclosures. By selecting only those disclosures that happened to coincide with a significant stock price decline, Professor Fischel creates a false impression that the price declines can be reliably associated with disclosures about predatory lending. This inaccurate impression is compounded by the empty conclusion that stock price declines are "consistent with" Plaintiffs' claims.¹⁵

An expert cannot ignore evidence that refutes his conclusions. *See, e.g., Barber v. United Airlines, Inc.*, 17 Fed Appx. 433, 437 (7th Cir. 2001) ("[b]ecause in formulating his opinion [the expert] cherry-picked the facts he considered to render an expert opinion, the district court correctly barred his testimony because such a selective use of facts fails to satisfy the scientific method and *Daubert*, and it thus fails to 'assist the trier of fact'"); *Glover v. DeLuca*, No. 2:03-CV-0288, 2006 WL 2850448, at *16 (W.D. Pa. Sept. 29, 2006) ("[T]he Court concludes that Plaintiff has 'cherry-picked' the worst outcomes from the list of some 30 projects while ignoring more positive results."). When evaluating stock price movements, cherry-picking the disclosure days that support the expert's position renders his opinion inadmissible. *See also Bell v. Ascendant Solutions, Inc.*, No. Civ. A. 301CV0166N, 2004 WL 1490009, at *3 (N.D. Tex. July 1, 2004) (criticizing expert's method in a 10b-5 case and stating that the expert's "identification of 'information days' includes dates that appear to be consciously chosen in order artificially to support his hypothesis of efficiency").

The effect of Professor Fischel's cherry-picking can be demonstrated by the following example. Suppose one wants to test the claim that a particular coin, when flipped, always

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To this date Professor Fischel has still not identified the disclosures that he determined would be considered revelations of the truth under Plaintiffs' allegations.

comes up “tails,” and thus flips the coin 100 times. Only reporting the 50 instances in which the coin comes up “tails” and ignoring the 50 times it comes up “heads” will lead to the improper conclusion that the evidence is “consistent with” the claim that the coin always comes up “tails,” when in reality the coin flip is just as likely to result in “heads” as it is to result in “tails.” That is precisely what Professor Fischel has done here. If an allegation of predatory lending is just as likely to coincide with a significant increase in stock price (or no significant movement at all) as it is to coincide with a significant decrease, then such disclosures obviously were not the cause of price changes in Household’s stock on those particular days.

There are over one-hundred days during the three-year Class Period where disclosures related to Plaintiffs’ predatory lending claims were published. However, Professor Fischel presented as evidence only the 7 disclosures that coincide with a statistically significant stock price decline. He completely ignored the other days because they inconveniently contradict the claims that Plaintiffs asked him to support. Professor Fischel acknowledged that insignificant stock price reactions or significant increases on days when alleged fraud-related disclosures were made would contradict Plaintiffs’ claims.

Q: If the stock hadn’t moved or had gone up significantly on those days, would you deem that fact . . . to be inconsistent with plaintiff’s claims in this case? . . .

A: I would say I certainly would not say that those [] hypothetical stock price reactions would support my opinion that the stock price was artificially inflated

(Kavaler Decl. Ex. 2 (Fischel Tr.) at 163:11-13). Professor Fischel’s choice to ignore all evidence inconsistent with Plaintiffs’ allegations or the opinion he was asked to give is textbook “cherry-picking” and must be excluded.

Professor Fischel acknowledged that such insignificant returns or significant increases would contradict his conclusion. He maintained that although he ignored all disclosures that did not affect Household's stock price, he did include all disclosures where an allegation of predatory lending coincided with a significant stock price increase, but that no such significant positive days existed.

Q: . . . If it went up significantly after Household was accused of predatory lending practices, would that have been included in the 14 days?

A: All statistically significant price reactions in response to any disclosures relating to the alleged disclosure defects, whether the reaction is positive or negative, are included. So, therefore, yes, I would say.

(*Id.* at 169:14-21). However, when confronted with an example of a day (February 7, 2002) in which a significant stock price movement coincided with a new disclosure alleging predatory lending, Professor Fischel changed his story. In his deposition he stated that the date appeared inconsistent with his report and conceded: “[m]aybe it should have been included. I wanted to do a little more investigation” (*Id.* at 172:1-6). In correspondence that followed, however, the story then changed to assert that he did not include the disclosure because based on the “total mix of information available to the market on February 7, 2002, there is no reason to believe that the information you pointed to caused Household’s stock price increase on this date.” (Kavaler Decl. Ex. 10 (April 4, 2008 Letter from Plaintiffs’ Counsel)).¹⁶

¹⁶

February 7, 2002 is a day in which Plaintiffs themselves claim that the “truth was revealed” regarding the alleged fraud. (Kavaler Decl. Ex. 5 (Plaintiffs’ Response to Defendants Interrogatories No. 31)). Yet Professor Fischel fails to include it in his Specific Disclosure Model or discuss it at all in his reports. Additional days that Plaintiffs have identified as “corrective” that Fischel does not include in his Specific Disclosure Model are 2/19/2002, 4/18/2002, 5/7/2002, 5/14/2002, 5/30/2002, 5/31/2002, 6/02/2002, 6/07/2002, 8/19/2002, 8/26/2002, 8/29/2002, 9/09/2002, 9/10/2002, 9/12/2002, 10/08/2002. (*compare* (Kavaler Decl. Ex. 5 (Lead Plaintiffs’ Third

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Professor Fischel's newly-minted description of his process for selecting the days included in his Specific Disclosure Model highlights a key defect with his methodology. First, the fact that Household's stock price would significantly increase even after new allegations of predatory lending were levied demonstrates that such news was not driving Household's stock price in one direction or another. If Household's stock price was moving for unrelated reasons on February 7, 2002, then it was likely moving for unrelated reasons on the days that Professor Fischel self-selected. There are at least 7 days in which such predatory lending allegations coincide with a statistically significant stock price increase, as indicated in Chart B, all of which Professor Fischel ignored. Professor Fischel's Specific Disclosure Model identifies 7 days in which such disclosures coincide with statistically significant declines. At best, the connection is a "coin-flip."¹⁷ Regardless, as Professor Fischel appeared to concede at his deposition, this information certainly should have been included in his analysis to consider and present the whole picture.

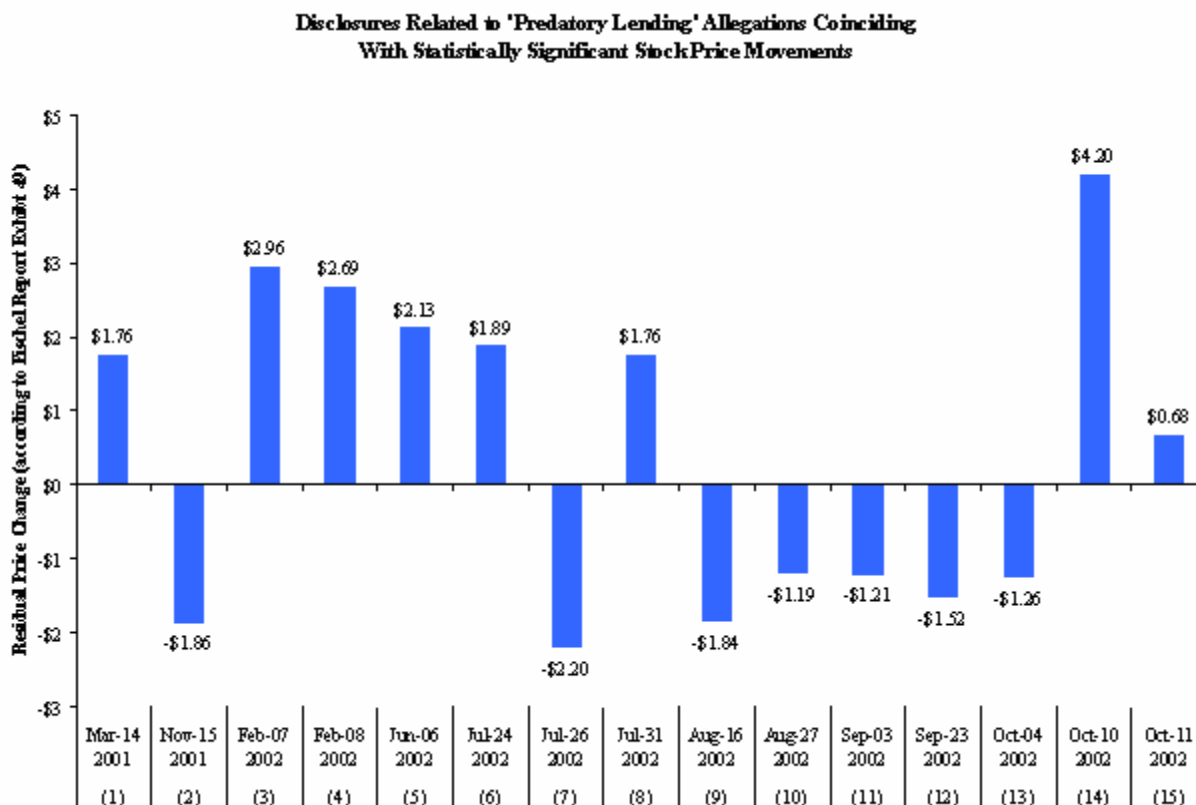
Footnote continued from previous page.

Amended Objections and Responses to Defendants' [Fifth] Set of Interrogatories, 02/01/2008, pp. 12-22), Ex. 11 (Lead Plaintiffs' Fourth Amended Objections and Responses to Defendants' [Ninth] Set of Interrogatories, 02/01/2008, pp. 10-14) *with* Professor Fischel's Specific Disclosure Model (Kavaler Decl. Ex. 1 (Fischel Report) at ¶¶ 34-37, Ex. 53)). Professor Fischel's failure to evaluate why these allegedly "corrective disclosures" did not affect Household's stock price while including the few dates that coincide with stock price declines is a direct result of his "cherry-picking."

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The 7 disclosures alleging predatory lending that coincide with a significant stock price decline are not substantively different than the 8 disclosures alleging predatory lending that coincide with a significant stock price increase. (*Compare* Kavaler Decl. Ex. 12 - 21 *with* Ex. 22 - 30)

Chart B



Second, Professor Fischel's "total mix of information" explanation contradicts his statement in his deposition that he used a reproducible and verifiable bright-line criteria to construct his Specific Disclosure Model — that he included all days where a disclosure coincided with a significant stock price reaction, regardless of direction. It is now clear that Professor Fischel undertook some additional winnowing process in which he excluded certain disclosures from this already result driven method to arrive at the days included in his model. He has never described what this process was except to belatedly assert that he excluded certain unspecified disclosures based on it.

Putting aside for the moment Fischel's failure to disclose it in his report, another defect arises in that the process is not reproducible or verifiable. He does not identify what information he considered to arrive at his decision, how he weighed it or what criteria he used. He did not even identify which disclosures and dates he excluded based on this cryptic process. Professor Fischel's winnowing process amounts to "I know it when I see it." Which disclosures and dates he chose to exclude will never be known and his decision as to exclude them based upon the "total mix" of information is no more than a conclusory statement that he is an expert. Professor Fischel himself admitted that such a conclusory method is unacceptable in the economics field:

[I]t's not possible to analyze issues of what the market was aware of or not aware of, or what information was material or not material by what I referred to in my writings as -- I know it when I see it test, it's necessary to perform an analysis of not just stock price movements, but the extent of awareness of particular information in all publicly available sources of information, as well as the footnote indicates, interpreting stock price movements in a way that is consistent with what it is that you are trying to measure.

(Kavaler Decl. Ex. 2 (Fischel Tr.) at 39:2-13).

If Professor Fischel conducted such an analysis when evaluating "the total mix of information," he did not include it in his report and it could not be evaluated by Defendants' expert or the fact finder. There is no way to know if the process that he used is even generally accepted in the scientific community. The information Professor Fischel does provide, however, indicates that he relied on a flawed, result-oriented approach such that his results must be excluded. *See Daubert*, 509 U.S. at 593; *Ryan v. Flowserve Corp.*, 245 F.R.D. 560, 573 (N.D. Tex. 2007) ("The flawed thread interwoven throughout [the expert's loss causation study] is his results-oriented approach to the public data often discounting inconvenient but relevant facts."); *In re Polymedica Corp. Securities Litigation*, 453 F. Supp. 2d 260, 270 (D. Mass. 2006) (rejecting

loss causation study of plaintiffs' expert because, as here, the expert "self-selected" trading days to examine instead of looking at all trading days).

Even if Professor Fischel's unverifiable "cherry-picking" does not render his analysis inadmissible, his failure to consider any non-fraud related information affecting Household's stock price will. Professor Fischel concludes that because he did an "event study" and the alleged disclosures coincide with a significant stock price decline, those declines are permissible measurements of inflation. However, Professor Fischel does not consider or exclude the effect of all the other industry and firm specific news that was also released on those days.¹⁸ (Kavaler Decl. Ex. 1 (Fischel Report) at ¶¶ 34-37). Failure to consider and exclude the other firm specific information released on corrective disclosure days mandates exclusion of an expert's analysis, even if the expert conducted an "event study." *In re Omnicom Group, Inc. Securities Litigation*, 541 F. Supp. 2d 546, 554 (S.D.N.Y. 2008) (holding that plaintiffs' expert's event study failed to demonstrate loss causation because he did not remove the effects of negative characterizations of information from the affect of the information itself. The court noted that a negative characterization of previously disclosed facts can cause a loss unrelated to any fraud and such a loss is "among the 'tangle of factors' that plaintiffs must distinguish" from the actual fraud.) (citation omitted); *United States v. Schiff*, 538 F. Supp. 2d 818, 837 (D.N.J. 2008) (excluding expert's testimony because even though he performed an event study that "controll[ed] for exogenous mar-

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For example, Professor Fischel includes in his Specific Disclosure Model September 3, 2002 because Household's stock price declined significantly compared to the S&P 500 and S&P Financials. Household's stock price declined by 7.62% that day. However, all consumer finance companies declined that day after Citigroup was downgraded. Citigroup declined 10.39%, MBNA declined 8.76% Countrywide declined 4.12% and Capital One declined 6.25%, Americredit declined 4.25% and Cash America declined by .38%. Indeed, the entire Consumer Finance Index declined more than Household, 7.52%. By focusing only on broad market indexes, Professor Fischel failed to consider the impact of consumer finance-specific news on Household's stock price that day, which was clearly affecting Household's stock price.

ket, industry, and economy-wide effects” and concluded that there was a “statistically significant” movement on the disclosure day, “[h]e did not, however, attempt to control for the multiple simultaneous adverse [company] news that included both events charged in the indictment and events not charged in the indictment.” “Without a causal link to the curative disclosure . . . charged in the indictment, evidence of a stock price drop is not probative of materiality of that alleged misstatement, and instead is more prejudicial or confusing than probative.” *Id.* at 838).

In *Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, the plaintiffs alleged that the “truth” of the defendants’ fraud was revealed to the market when the company issued its 4Q01 announcement, which contained the “corrective disclosure.” 487 F.3d at 271. The Fifth Circuit denied class certification because “[t]he plaintiff’s expert report did not establish loss causation.” *Id.* at 270. Although the plaintiff’s expert conducted an “event study” supporting a finding that “Allegiance’s stock reacted to the *entire bundle* of negative information contained in the 4Q01 announcement,” it was inadequate because the 4Q01 also contained non-fraud related negative news. *Id.* at 271 “When multiple negative items are announced contemporaneously, mere proximity between the announcement and the stock loss is insufficient to establish loss causation.” *Id.* Rather the court emphasized that in order to establish loss causation, an expert must parse out the effect of the corrective disclosure from the other firm specific information released on that day and “offer some empirically-based showing that the corrective disclosure was more than just present at the scene.” *Id.*

Professor Fischel has committed the same error here. While he has shown that the alleged corrective disclosures coincided with a statistically significant residual stock price movement and controlled for general market forces, he has not analyzed and excluded from his calculation other firm-specific or industry-specific information that was released on the same day. Failure to conduct such an analysis renders his event study inadmissible. As the government’s expert in *Schiff* stated, “an event study just identifies statistically-significant price

changes' and 'does not establish causation.'" (*Schiff*, 538 F. Supp. at 837). This type of analysis fails because "all that Dr. Wazzan is able to opine is that *something* in the April 3, 2002 disclosure is material." *Id.* at 839.

CONCLUSION

For the foregoing reasons, Defendants respectfully request that Defendants' Motion *In Limine* to Exclude the Testimony of Plaintiffs' Proffered Expert Daniel R. Fischel be granted, and that the Court issue an Order excluding his testimony from trial for any purpose, including both inflation models contained in his Report.

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