IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

LAWRENCE E. JAFFE PENSION PLAN, on Behalf of Itself and All Others Similarly Situated,	)	Case No. 02 C 5893
Plaintiff,	)	Judge Jorge L. Alonso
v.	)	
HOUSEHOLD INTERNATIONAL, INC., et al.,	)	
Defendants.	)	

DEFENDANTS' MEMORANDUM OF LAW IN SUPPORT OF THEIR MOTION TO EXCLUDE THE TESTIMONY OF PLAINTIFFS' EXPERT PROFESSOR DANIEL R. FISCHEL

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INTRODUCTION

"[I]n order to prove loss causation, plaintiffs in securities-fraud cases need to isolate the extent to which a decline in stock price is due to fraud-related corrective disclosures and not other factors." *Glickenhaus & Co. v. Household Int'l, Inc.*, 787 F.3d 408, 421 (7th Cir. 2015). With respect to this essential element of loss causation, the Seventh Circuit reversed the judgment and remanded for a new trial because Plaintiffs' expert, Professor Daniel R. Fischel ("Fischel"), "did not adequately opine that 'no firm-specific, nonfraud related information contributed to the decline in [Household's] stock price.'" (Order dated Sept. 8, 2015 (Dkt. 2042) at 1 (quoting *Glickenhaus*, 787 F.3d at 422).) The Seventh Circuit explained:

> In light of *Dura*, . . . we conclude that the evidence at trial did not adequately account for the possibility that firm-specific, nonfraud related information may have affected the decline in Household's stock price during the relevant time period. *As things stand, the record reflects only the expert's general statement that any such information was insignificant. That's not enough*.

Glickenhaus, 787 F.3d at 423 (emphasis added).[1]

The Seventh Circuit set forth the following procedure to address this error on remand:

> If the plaintiffs' expert testifies that no firm-specific, nonfraud related information contributed to the decline in stock price during the relevant time period and explains *in nonconclusory terms* the basis for this opinion, then it's reasonable to expect the defendants to shoulder the burden of identifying some significant, firm-specific, nonfraud related information that *could* have affected the stock price. If they can't, then the leakage model can go to the jury; if they can, then the burden shifts back to the plaintiffs to account for that specific information or provide a

[1] In *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 342 (2005), the Supreme Court held that, to establish the loss causation element of a securities fraud claim, it is not enough to show that the investor purchased shares at an inflated price and later sold the shares at a lower price. This is because 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." *Id.* at 342-43. Therefore, to demonstrate loss causation, a securities fraud plaintiff must prove that the stock price declined as a result of the disclosure of the truth. *Id.* at 344.

> loss-causation model that doesn't suffer from the same problem, like the specific-disclosure model.

Glickenhaus, 787 F.3d at 422 (emphasis added). The Seventh Circuit further noted that Fischel's alternative "specific disclosures" model, which was not adopted by the jury in the first trial and therefore was not at issue on appeal, might suffer from the same problem "if indeed there was some additional negative firm-specific, nonfraud related information on the same day as a specific disclosure." *Id*. at 422 n.7.

In accordance with the Seventh Circuit's directive, this Court issued an Order requiring Fischel to submit a supplemental report in conformity with the Seventh Circuit's decision and allowing Defendants an opportunity to challenge the adequacy of Fischel's new report. (Dkt. No. 2042 at 5-6.) Pursuant to that Order, Fischel tendered a supplemental report on September 23, 2015 (the "Remand Report").[2]

As set forth below, Fischel's Remand Report falls well short of the Seventh Circuit's requirement that Fischel competently explain in "*nonconclusory terms*" the basis for any continued opinion that "no firm-specific, nonfraud related information contributed to the decline in stock price during the relevant time period." *Glickenhaus*, 787 F.3d at 422. Fischel's Remand Report also fails to meet the standards governing the reliability of expert testimony set forth in Rule 702 of the Federal Rules of Evidence and in the Supreme Court's decision in *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993).

Fischel previously testified under oath that there were "a lot of disclosures" throughout

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[2] A copy of Fischel's Remand Report, without the appendices and exhibits thereto, is included in the accompanying Appendix at Tab 1. Fischel included as appendices to his Remand Report a copy of his initial expert report in this case, a copy of his rebuttal expert report, and a copy of his first supplemental report. (Remand Report at 1 n.1.) Fischel's initial expert report and rebuttal report previously were filed with the Court. (Dkt. Nos. 1361-2, 1361-6.)

his 228-day "disclosure period" that dealt with "non-fraud related information," *Glickenhaus,* 787 F.3d at 420; he conceded there were "more things going on with respect to Household than just the things that are related to plaintiffs' allegations here in terms of statistically significant price movements" (Dkt. No. 1361-5 (Fischel Dep. Tr.) at 146:21-147:2); and he acknowledged that there were "a bunch of stock price movements that were significant . . . that were not attributable to fraud related disclosures." (*Id.* at 57:12-16.) Against this backdrop, the Seventh Circuit held that Fischel's prior disregard of these non-fraud factors—based on his amorphous, conclusory suggestion that "[t]hey cancel each other out"—was legally insufficient. *Glickenhaus*, 787 F.3d at 420.

The Seventh Circuit's concern has proven justified. Now that Professor Fischel has been called upon on remand to produce a report that specifically addresses the "lot[s] of disclosures" concerning nonfraud-related information that purportedly "canceled each other out" during the 228-day disclosure period, he is unable to do so. Instead, as set forth below in Section I of the Argument, Professor Fischel continues to attempt to veil the shortcomings of his leakage model behind conclusory, subjective commentary and cursory analysis. As Fischel previously acknowledged, and as set forth in the reports of Defendants' experts, there are numerous, readily identifiable disclosures containing firm-specific, nonfraud-related information throughout the disclosure period. Yet in his Remand Report, Fischel addresses only 27 of the 228 days at issue and acknowledges just *a single* nonfraud-related disclosure on *a single day*. (Remand Report (App. Tab 1) at 4-6.) Nowhere to be found are the "lot[s]" of non-fraud-related disclosures that Fischel purportedly had examined "carefully" and determined that they "cancel[ed] each other

out."[3]

The remainder of Fischel's Remand Report is just as superficial and conclusory as Fischel's initial opinions, which the Seventh Circuit held to be legally inadequate. Fischel provides no *actual* analysis of the information disclosed to the market during the 228-day disclosure period, but instead simply invokes a repeated, conclusory comment that he "reviewed the available market evidence and did not find negative firm-specific, nonfraud related information that could reasonably explain the price decline." (*Id.* at 6, *et seq.*) Fischel neither details the evidence he purportedly reviewed nor explains what analysis he might have conducted to arrive at his conclusions. Indeed, as to 171 of the 228 days at issue, Fischel says *nothing*—simply ignoring 75% of the days at issue. Moreover, for 15 of the 27 days addressed in the Remand Report, Fischel concedes there is no information *of any kind* that relates *in any manner* to the fraud. The residual price declines on those 15 days account for $21.40 of the inflation calculated using Fischel's leakage model.

Both the Supreme Court and the Seventh Circuit have stated consistently that such "*ipse dixit*" from an otherwise qualified expert is insufficient to satisfy the reliability requirements of *Daubert.* Federal appellate courts, furthermore, require an expert to address competently "confounding" non-fraud information through an analysis reflecting an appropriate "methodological underpinning," as opposed to mere subjective "judgment call[s]."

As set forth below in Section II of the Argument, Fischel's Remand Report fails each and every one of the reliability guideposts set forth by the Supreme Court and the Seventh Circuit. Fischel's Remand Report cites no academic literature at all—let alone any that would support

[3] Indeed, even as to the *single* nonfraud-related disclosure on January 11, 2002 that Fischel acknowledges, his Remand Report establishes that the share price impact of the nonfraud-related information was not "cancel[l]ed out." (*Id.*)

application of the leakage model that he seeks to advance here. Indeed, the author of the lone article that Fischel cited in his earlier reports as supposed support for his leakage model, Professor Bradford Cornell, has submitted an expert report explaining how Fischel's Remand Report misapplies the model described in Professor Cornell's article, and that the necessary preconditions for the proper application of a leakage model of loss causation, as described in Professor Cornell's article, are not, and cannot be, met in this context.[4]

In prior circumstances in which Fischel has similarly offered an opinion without "explanation . . . research reference or peer review information . . . in support of [his] . . . method," Fischel's testimony has been excluded for failure to satisfy *Daubert* requirements. *See, e.g.*, *In re Pfizer*, *Inc. Sec. Litig.*, No. 04 Civ. 9866, slip op. at 2 (S.D.N.Y. May 21, 2014), (attached hereto as Ex. A) (granting *Daubert* motion to exclude Fischel's testimony because Fischel (i) cited "no research reference or peer review information" to support an adjustment he made to his previously proferred loss causation model, and (ii) did not make any adjustments to disaggregate the inflation attributable to statements for which the court had held defendants were not liable); *see also In re Pfizer, Inc. Secs. Litig.*, No. 04 Civ. 9866, 2014 U.S. Dist. LEXIS 92951, at *15-19 (S.D.N.Y. July 8, 2014) (denying motion to amend Fischel's rejected report because the amended report continued to suffer from the same defects as earlier report); *United States v. Nacchio*, 555 F.3d 1234, 1258 (10th Cir. 2009) (en banc) (noting that "'[t]he trial court's gatekeeping function requires more than simply 'taking the expert's word for it,'" and

[4] A copy of Professor Cornell's expert report is included at Tab 2 in the accompanying Appendix. Professor Cornell currently is a Visiting Professor of Financial Economics at the California Institute of Technology ("Caltech"). Previously, Professor Cornell was a Professor of Finance and Director of the Bank of America Research Center at the Anderson Graduate School of Management at the University of California, Los Angeles, for 26 years. Professor Cornell earned a master's degree in Statistics from Stanford University in 1974 and a doctorate in Financial Economics from Stanford in 1975. Professor Cornell has served as an editor of numerous journals relating to business and finance and has written more than 100 articles and two books on finance and securities. (App. Tab 2 ¶¶ 1,2.)

holding that "the district court properly performed its *Daubert* gatekeeping role in excluding Fischel's testimony as inadmissible for lack of reliability under FRE 702"). Indeed, just last week another federal district court gave "no weight" to Fischel's testimony, noting, with respect to one part of Fischel's analysis, that Fischel "offer[ed] no specific academic citation or support for his analysis . . . beyond personal preference or experience," and, with respect to another part of his analysis, that it "suffer[ed] from methodological flaws." *SEC v. Dubovoy*, Civil Action No. 15-6076, 2015 U.S. Dist. LEXIS 140957, at *21-23 (D.N.J. Oct. 16, 2015).

Because of Fischel's failure on remand to provide nonconclusory testimony that satisfies the Seventh Circuit's directive and the reliability requirements of Federal Rule of Evidence 702 and *Daubert*, the burden does not shift to Defendants to "identify[] some significant, firm-specific, nonfraud related information that *could* have affected the stock price." *Glickenhaus*, 787 F.3d at 422 (emphasis added). Nevertheless, Defendants, through their experts, have identified numerous instances of significant, firm-specific, nonfraud-related information that could have affected Household's stock price during the relevant period, as discussed in Section III of the Argument.

In response to Defendants' evidence, Fischel, in accordance with the Seventh Circuit's directive, must competently "account for that specific information or provide a loss-causation model that doesn't suffer from the same problem." *Id.* Accordingly, unless Fischel is able to present a loss causation model that accounts properly for firm-specific, nonfraud-related information, his testimony must be excluded.

ARGUMENT

The accepted method of proving loss causation in a securities fraud case "is through an event study, in which an expert determines the extent to which the changes in the price of a

security result from events such as disclosure of negative information about a company, and the extent to which those changes result from other factors." *Bricklayers & Trowel Trades Int'l Pension Fund v. Credit Suisse Sec. (USA) LLC*, 752 F.3d 82, 86 (1st Cir. 2014). In *Bricklayers*, the First Circuit described the event study methodology as follows:

> First, the expert selects the period in which the event could have affected the market price. The expert then attempts to determine the effect on the share price of general market conditions, as opposed to company-specific events, using a multiple regression analysis, a statistical means for explaining the relationship between two or more variables. . . . Thus, for any given day, the expert predicts the company's share price based on the market trends on that particular day. The expert then compares this predicted return with the actual return in the event window in order to determine the probability that an abnormal return of that magnitude could have happened by chance. If this probability is small enough, the expert can reject the hypothesis that normal market fluctuations, as opposed to company-specific events, can explain the movement in share price.

Id. (citations omitted); *see also Hubbard v. BankAtlantic Bancorp*, *Inc.* 688 F.3d 713, 722 & n.18 (11th Cir. 2012).

In his prior reports in this case, Fischel used the S&P 500 Index as his market index and the S&P Financials Index as his industry index to address "general market conditions." (Fischel Report dated Aug. 15, 2007 (Dkt. No. 1361-2) ¶ 32.) However, once such "general market conditions" have been addressed through the use of a regression analysis, "[a] recurring problem in event studies is the presence of 'confounding factors'—news stories, statements, or events that coincide with relevant event dates and that themselves potentially affect the company's stock price." *Bricklayers*, 752 F.3d at 89; *Hubbard*, 688 F.3d at 729. Because "plaintiffs in securities-fraud cases need to isolate the extent to which a decline in stock price is due to fraud-related corrective disclosures and not other factors," *Glickenhaus*, 787 F.3d at 421, an expert must address and account for such "confounding information." *See, e.g., Bricklayers*, 752 F.3d at 95 ("[A]n expert must address confounding information that entered the market on the event date.");

Hubbard, 688 F.3d at 726 ("The plaintiff must also offer evidence sufficient to allow the jury to separate portions of the price decline attributable to causes unrelated to the fraud, leaving only the part of the price decline attributable to the dissipation of the fraud-induced inflation.").

To address the impact of "confounding information" during a disclosure period, an expert may not simply rely upon subjective, conclusory "judgment call[s]." *Bricklayers*, 752 F.3d at 95. Rather, the effect of confounding nonfraud information must be addressed with appropriate "methodological underpinning[s]" consistent with established *Daubert* standards. *Id.* (affirming preclusion of expert testimony where the expert "seemingly made a judgment call as to confounding information without any methodological underpinning," and stating that "a subjective analysis without any methodological constraints does not satisfy the requirements of *Daubert*"); *Hubbard*, 688 F.3d at 729 (holding that loss causation expert failed to meet *Daubert* standards because he failed to adequately account for the effects of confounding factors).

Consistent with these settled principles, the Seventh Circuit found that Fischel's prior general testimony that there were "a lot of disclosures" containing company-specific nonfraud information during his 228-day period, "some positive, some negative; [t]hey cancel each other out," was insufficient as a matter of law. *Glickenhaus*, 787 F.3d at 420, 423. On remand, the Seventh Circuit directed that Fischel must address and account for such confounding information through an appropriate methodology in a "nonconclusory" manner. *Id.* at 422-23 As Fischel's Remand Report now confirms, Fischel is unable to do so through his leakage model.

I. Fischel's Remand Report Fails To Meet the Seventh Circuit's Requirement that Fischel Provide "Nonconclusory" Support For His Opinion that No Firm-Specific, Nonfraud-Related Information Contributed to the Decline in Household's Stock Price.

In his Remand Report, Fischel made no adjustment to the loss causation inflation numbers he submitted in the prior trial. Instead, he opines: "No adjustment to the Quantification

Including Leakage analysis of inflation that I presented at trial due to significant, firm-specific, non-fraud related information is required." (Remand Report (App. Tab 1) at 1.) Fischel's Remand Report, however, provides no specificity, or *actual* methodological analysis, of the nonfraud firm-specific information that could have affected Household's stock price during the disclosure period.

A. Fischel's Remand Report Is at Odds with His Prior Testimony.

At trial, Fischel acknowledged that he was only able to identify 14 days during the 228-day disclosure period on which there were statistically significant residual changes in Household's stock price *and* on which Fischel was "reasonably confident" that the price changes could be attributed to the disclosure of fraud-related information:

> Q. Why were these 14 dates selected?
>
> A. They were selected because I wanted to isolate the fraud-related disclosures that were important to investors. So I had to make a series of judgments based on the event study to do that. I had to isolate disclosures. I had to determine whether those disclosures occurred at a time when there was a statistically significant stock price movement. *And I had to be reasonably confident that the fraud-related disclosure was responsible for the price movement*.

(Trial Tr. (Dkt. No. 1921-3) at 2628:2-11 (emphasis added).) With respect to *all other* statistically significant residual returns during the 228-day period, Fischel testified that he did not include those days in his specific disclosures model because he "*wasn't confident that there was a fraud-related disclosure on th[ose] date[s] that was responsible for that price [movement]*." (Trial Tr. (Dkt. No. 1922) at 2967:21-2968:1 (emphasis added).) Indeed, rather than being "reasonably confident" that the statistically significant price movements on days other than the 14 days he included in his specific disclosures model were caused by the disclosure of fraud-related information, at his pretrial deposition Fischel conceded:

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.

(Fischel Dep. Tr. (Dkt. No. 1361-5) at 57:12-16); *see also* Trial Tr. (Dkt. No. 1921-3) at 2960:14-17 (admitting that under the leakage model, whether residual price changes were "fraud related, combined fraud related or not at all fraud related, they were all included in the leakage model").

Fischel further acknowledged:

Q. Ultimately. So there is more things going on with respect to Household than just the things that are related to plaintiffs' allegations here in terms of statistically significant price movements?

A. Correct, that's certainly true. That's right.

(Fischel Dep. Tr. (Dkt. No. 1361-5) at 146:21-147:2.)

When asked at trial to explain how he accounted for the "company-specific factors unrelated to the alleged fraud" that he conceded existed during the 228-day disclosure period, Fischel testified that he looked at the issue "carefully," noticed "a lot of disclosures" that had nonfraud-related information, and determined that "some of those disclosures [ ] had a positive effect, some had a negative effect; but overall it was impossible to conclude that the difference between the true value line and the actual price would have been any different had there been no disclosures about non-fraud-related information during this particular period. Some positive, some negative. They cancel each other out." (Trial Tr. (Dkt. No. 1921-3) at 2683-2684).)

Given this prior testimony under oath regarding the "bunch of stock price movements . . . that were not attributable to the fraud," and the existence of "a lot of disclosures" containing nonfraud-related information that Fischel purportedly examined "carefully" to determine that they "cancel each other out," one would expect the Remand Report to contain a comprehensive,

systematic, and rigorous analysis of all such nonfraud-related disclosures during the 228-day period, either to account adequately for the nonfraud-related information, or to otherwise demonstrate, through a scientifically valid methodology, how all such disclosures "cancel each other out." The Remand Report, however, does no such thing.

B. Fischel's Remand Report Addresses Only 27 of the 228 Days in His Disclosure Period and Does So in a Conclusory Manner.

Rather than setting forth a systematic, reasoned analysis of the nonfraud-related disclosures throughout the 228-day disclosure period, Fischel's Remand Report addresses only 27 of the 228 days. (Remand Report (App. Tab 1) at 4-20.) These 27 days consist of days on which Fischel's prior model demonstrated a statistically significant negative price impact, but as to which Fischel previously testified that he *could not* attribute the statistically significant price movement to fraud-related disclosures. *See supra* at 9-10.

The Remand Report demonstrates that now, when specifically called upon to do so, Fischel is unable to provide the specificity required by the Seventh Circuit to support his generalized, amorphous testimony that "a lot of disclosures" pertaining to nonfraud-related information "cancel[ed] each other out." Despite having previously testified to "a lot of disclosures" pertaining to nonfraud-related information, Fischel now identifies only a *single* nonfraud-related disclosure on a *single* day. According to Fischel, on January 11, 2002, "debt ratings agency Fitch revised its long-term Rating Outlook of all Household entities to Negative from Stable, which affected $65 billion of rated debt." (Remand Report (App. Tab 1) at 5.) Fischel himself characterized this news as nonfraud-related. (*Id.*) Other than this *single* instance, Fischel fails in his Remand Report to acknowledge or identify *any other* nonfraud-related disclosure during the entire 228-day period, let alone analyze its effect on Household's stock price.

As to the remaining 26 days addressed in the Remand Report, Fischel simply invokes, repeatedly, the conclusory statement: "We reviewed the available market evidence and did not find negative, firm-specific, nonfraud related information that could reasonably explain the price decline." (*Id.* at 6-20.) Fischel undertakes no effort whatsoever to identify or categorize the nonfraud-related information on each of those days, and no effort to assess the relative impact of the confounding nonfraud-related information on those days. He provides no methodology of any kind, other than his subjective, conclusory declaration that he "did not find negative, firm-specific, nonfraud-related information that could reasonably explain the price decline."

Significantly, with respect to 15 of the 27 days that Fischel analyzed in his Remand Report (April 25, 2002, April 29, 2002, July 1, 2002, July 9, 2002, July 10, 2002, July 25, 2002, August 9, 2002, August 13, 2002, August 23, 2002, September 10, 2002, September 17, 2002, September 27, 2002, October 1, 2002, and October 7, 2002, and October 9, 2002), Fischel *concedes* that he is unable to identify the disclosure of *any* information related to the fraud that could plausibly account for *any portion* of the statistically significant residual price decline on those days. Indeed, Fischel is unable or unwilling to identify *any* information to explain the statistically significant residual price declines on those 15 days. Yet, those 15 days account for $21.40 of the inflation that Fischel attempts to ascribe to the fraud under his leakage model.

As to the *single* day on which Fischel acknowledges the presence of firm-specific, nonfraud-related information (January 11, 2002), even Fischel's "cancel out" theory proves inaccurate.[5]

[5] Fischel attempts to assert that the negative price impact on January 11, 2002, was "canceled out" by a subsequent disclosure four days later, on January 15, 2002. Yet a simple mathematical comparison demonstrates that the net effect is *not* zero (a -3.04% impact on January 11, 2002 and a +2.53% impact on January 15, 2002). (Remand Report (App. Tab 1) at 4-6.)

Fischel, furthermore, does not address *in any manner*, let alone analyze, the 171 days during his disclosure period in which there was not a statistically significant residual price movement. Thus, he simply ignores 75% of the days at issue. In this respect, the Remand Report does *nothing* to meet the Seventh Circuit's requirement that Fischel account, in "nonconclusory terms," for the confounding firm-specific, nonfraud-related information relating to Household during this overwhelming majority of his "leakage period."[6]

In short, Fischel's Remand Report fails to meet the Seventh Circuit's requirement that Fischel address, with specificity and in "nonconclusory terms," the basis (if any) by which he has accounted for firm-specific, nonfraud-related information during the relevant time period. Now that he has been required to present a report that "adequately account[s]" for firm-specific, nonfraud-related information during the disclosure period—rather than rely on the insufficient "general statement" that "a lot of disclosures . . . cancel each other out"—Fischel is unable to do so. Because Fischel's Remand Report fails to meet the threshold requirement directed by the Seventh Circuit, it should be excluded.

II. Fischel's Remand Report Does Not Satisfy the Reliability Standards of *Daubert*.

"The admissibility of expert testimony is governed by Federal Rule of Evidence 702 and the Supreme Court's opinion in *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 113 S. Ct. 2786, 125 L. Ed. 2d 469 (1993)." *Lewis v. CITGO Petroleum Corp*., 561 F.3d 698, 705 (7th Cir. 2009). Under *Daubert*, the opinion offered must be "reliable." 509 U.S. at 589. "[Q]ualifications alone do not suffice. A supremely qualified expert cannot waltz into the

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[6] The statistically insignificant residual returns that Fischel improperly included in his leakage model, moreover, do not "cancel each other out." To the contrary, the aggregate residual returns for the 171 days on which the residual returns were statistically insignificant total is negative $6.76. Thus, $6.76 of the $23.94 of "inflation" per Fischel's leakage model is due to his improper inclusion in that model of residual returns that cannot reliably be attributed to the disclosure of fraud-related information.

courtroom and render opinions unless those opinions are based upon some recognized scientific method." *Clark v. Takata Corp.*, 192 F.3d 750, 759 n.5 (7th Cir. 1999); *see also, e.g., Am. Honda Motor Co. v. Allen*, 600 F.3d 813, 817 (7th Cir. 2010); *Lewis*, 561 F.3d at 705. On this score, recent courts have found that Fischel, despite his qualifications, improperly sought to offer opinions that were not based upon a recognized scientific method. *See, e.g., Nacchio*, 555 F.3d at 1258 (noting that "[i]t appears that Mr. Nacchio relied on Professor Fischel's qualifications to tip the balance in favor of the admissibility of his expert testimony," but "the district court properly performed its *Daubert* gatekeeping role in excluding Professor Fischel's testimony as inadmissible for lack of reliability under FRE 702."); *Dubovoy*, 2015 U.S. Dist. LEXIS 140957, at *21-22 (noting that Fischel "offer[ed] no specific academic citation or support for his analysis . . . beyond personal preference or experience," and finding "fundamental methodological flaws"); *In re Pfizer, Inc. Sec. Litig.*, attached as Ex. A (finding that Fischel cited "no research reference or peer review information" and holding that his opinion was not "the product of reliable principles and methods reliably applied").

With respect to expert testimony regarding loss causation, the expert must provide a reliable methodology to address confounding nonfraud-related information during the disclosure period. *Bricklayers*, 752 F.3d at 95; *Hubbard*, 688 F.3d at 726. "[A] subjective analysis without any methodological constraints does not satisfy the requirements of *Daubert*." *Bricklayers*, 752 F.3d at 95; *accord In re Pfizer, Inc. Sec. Litig.*, No. 04 Civ. 9866, slip op. at 2 (attached hereto as Ex. A (holding that Fischel's expert report on loss causation "has not been shown to be the product of reliable principles and methods reliably applied," and noting that "Fischel did not make any adjustments or otherwise disaggregate his computations to identify any stock price inflation attributable to the dismissed claims").

By addressing only 27 days during the 228-day disclosure period, Fischel's Remand Report fails, on its face, to meet Rule 702's requirement that an expert's testimony be based on "sufficient facts or data." Fed. R. Evid. 702(b). As succintly stated by Professor Allen Ferrell, the author of the article cited with approval by the Seventh Circuit in its opinion for proper methodologies to address confounding firm-specific, nonfraud-related information, *see Glickenhaus*, 787 F.3d at 422-23: "Given that the leakage model by construction crucially depends on the use of residual stock price declines throughout the entire leakage period—not just the 14 specific disclosure days and the 27 additional statistically significant decline days—Professor Fischel's opinion that no adjustment of his leakage model is necessary remains unsupported for this reason alone." (Ferrell Report (App. Tab 3) ¶ 17 .)[7]

In any event, Fischel's Remand Report fails to meet *any* of the established guideposts by which reliability is to be determined. "*Daubert* sets forth a non-exhaustive list of guideposts to consult in assessing the reliability of expert testimony." *American Honda*, 600 F.3d at 817. Those guideposts are: "(1) whether the scientific theory can be or has been tested; (2) whether the theory has been subjected to peer review and publication; and (3) whether the theory has been generally accepted in the relevant scientific, technical or professional community." *Id.*

First, Fischel provides *no* systematic analysis of the confounding information during the disclosure period. As set forth above, his Remand Report discusses a *single* nonfraud piece of information on a *single* day. The Remand Report fails to set forth any methodology addressing

[7] Professor Ferrell is the Greenfield Professor of Securities Law at Harvard Law School and also holds a Ph.D. in economics from the Massachusetts Institute of Technology. (*Id.* ¶ 1). Professor Ferrell clerked for Justice Kennedy of the United States Supreme Court and has, inter alia, served as a member of the Board of Economic Advisors to the Financial Industry Regulatory Authority and as Chairperson of Harvard's Advisory Committee on Shareholder Responsibility. (*Id.* ¶¶ 1, 2.) Professor Ferrell has published approximately 30 articles in leading journals in the general areas of law and finance, including papers on securities damages, loss causation and event study analysis. (App. Tab 3 ¶ 3.)

the universe of firm-specific, nonfraud-related information that Fischel conceded existed. Instead, with the exception of his analysis of the *single* day in the 228-day disclosure period, Fischel either *ignores* the day entirely (the 171 days on which Household's residual stock price movements were statistically insignificant are never addressed) or provides *only* his subjective conclusion that he "reviewed the available market evidence and did not find negative, firm-specific, nonfraud-related information that could reasonably explain the price decline." (Remand Report (App. Tab 1) at 6-20.)

Where, as here, the expert "seemingly made a judgment call as to confounding information without any methodological underpinning," the theory cannot be verified by the scientific method through testing and fails to "satisfy the requirements of *Daubert*." *Bricklayers*, 752 F.3d at 95. As set forth in the expert reports of Professor Ferrell and Professor Christopher James (a highly-regarded expert with respect to financial institutions and the manner by which economic and regulatory factors differentially impact those institutions),[8] a proper analysis demonstrates that there were numerous firm-specific, nonfraud-related factors throughout the entire 228-day disclosure period that have not been accounted for in Fischel's general regression calculation and that are not addressed in his conclusory Remand Report.

Second, Fischel's application of the "leakage model" in this context has not been subject to peer review or publication. Significantly, in his Remand Report, Fischel cites no academic literature supporting his analysis. Previously, Fischel cited a *single* article to support his leakage

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[8] Professor James is an internationally-recognized Professor of Finance and Economics who has held positions with the Federal Deposit Insurance Corporation, the U.S. Department of the Treasury Office of the Comptroller of the Currency, and the Federal Reserve Bank of San Francisco. (James Report (App. Tab 4 ¶ 1). Professor James's research and publications address the manner in which the "stock price reaction of financial institutions to regulatory changes and macroeconomic factors is often heterogenous, with the impact varying based on the business focus of the institution." (*Id.* ¶ 2.)

model—B. Cornell & R.G. Morgan, *Using Finance Theory to Measure Damages in Fraud on the Market Cases*, 37 UCLA L. Rev. 883, 905 (1990). *See* Fischel Report (Dkt. No. 1361-2) ¶ 38 & n.22. Yet, the author of that lone article cited by Fischel, Professor Cornell, has reviewed Fischel's Remand Report and has provided a report in which he states that Fischel fundamentally misapplied the article and the financial principles upon which it was based. (Cornell Rep. (App. Tab 2) ¶ 16.) As Professor Cornell explains in his report, Fischel's attempt to use the leakage model here violates the preconditions required for proper application of a "leakage model" theory. (Cornell Report (App. Tab 2 ¶ 16.) More fundamentally, as Professor Cornell sets forth, no peer-reviewed publication supports Fischel's use of the "leakage model" theory in this context, and Fischel's application violates basic, well-established principles of financial economics. (*Id.*) Accordingly, Fischel has no peer-reviewed support for his attempted application of the leakage model in this case.

Third, the Remand Report contains numerous flaws squarely at odds with generally-accepted standards in the financial economics field. For instance, asserting that the 15 *statistically significant* price movements for which there is no disclosure of any kind related to the fraud are nonetheless "caused" by the fraud, violates fundamental financial principles. As one would expect, it is a straightforward financial (and legal) principle that "price declines on days for which one cannot reliably attribute the price decline to fraud-related information should not be used for purposes of calculating inflation of damages per share." (Ferrell Report (App. Tab 3) ¶ 30); *see also, e.g.,* Allen Ferrell & Atanu Saha, *The Loss Causation Requirement for Rule 10B-5 Causes of Action: The Implications of Dura Pharmaceuticals, Inc. v. Broudo*, 63 Bus. Law. 163, 169 (2007), *cited in Glickenhaus*, 787 F.3d at 423; Cornell Report (App. Tab 2) ¶¶ 18, 19.)

Notably, with respect to the 171 days in which there was no statistically significant residual price movement, there is no proper scientific basis to attribute stock price movement to an alleged disclosure of the fraud, even had Fischel undertaken to analyze such days. (*Id.* ¶ 113-114.) Fischel has acknowledged in his own writing and testimony that statistically insignificant residual price movements cannot be attributed to the revelation of any particular event, including an alleged fraud. *See, e.g.,* Daniel R. Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 Bus. Law. 1, 19 (1982) (explaining that, "[i]f the difference between the actual return and the predicted return is not statistically significant, investors were not injured. . . ."); *see also* Corrected Report of Daniel R. Fischel in *United States v. Nacchio*, No. 05-545 (D. Col.), Dkt. No. 589-4 at 6-7 (attached as Exhibit B hereto) (opining that if "residual returns are not considered to be statistically significant . . . one concludes that observed stock return . . . is not attributable to the firm specific events that occurred on that day").

Professors Ferrell and Cornell identify other anomalies and flaws with respect to Fischel's leakage model that are flatly contrary to basic financial economics, such as the erroneous, *ad hoc* "cap" that Fischel had to adopt for his leakage model's calculation of "inflation," his misapplication of statistical significance measures, and impermissibly wide "error bands" resulting from the forecast and prediction errors in his 228-day observation window. *See* Ferrell Report (App. Tab 3) ¶¶ 16-26); Cornell Report (App. Tab 2) ¶¶ 16-29.) Professor Ferrell further points out that Fischel's prior "cancel each other out" explanation is not only factually inaccurate, but also methodologically erroneous. (Ferrell Report (App. Tab 3) ¶¶ 121-126.) As Professor Ferrell correctly explains, in order to properly determine the amount of damages for any given plaintiff based on the specific days on which that plaintiff executed transactions in

Household stock, one must know the extent to which the price was inflated *on the specific day* on which the transaction was executed. (*Id.* ¶¶ 122-124.) Therefore, it is wholly insufficient to generically assert that various firm-specific, non-fraud factors somehow, in the aggregate, "canceled out" over the course of the 228-day period. (*Id.*) Rather, the impact of such confounding information on the amount of inflation on *each specific day* must be determined, which is an analysis Fischel has not undertaken. (*Id.*)

Against these established financial principles, and with no peer-reviewed support, Fischel postulates in his Remand Report that, if he subjectively could not "find negative firm-specific, nonfraud related information that could reasonably explain the price decline" then it is somehow reasonable to assume that *all* such residual price declines should be attributed to the fraud. Such an opinion fails *Daubert*'s reliability requirement. In the words of the Supreme Court: "[N]othing in either *Daubert* or the Federal Rules of Evidence requires a district court to admit opinion evidence which is connected to existing data only by the *ipse dixit* of the expert." *Gen. Elec. Co. v. Joiner*, 522 U.S. 136, 146 (1997); *see also, e.g.*, *Zenith Elecs. Corp. v. WH-TV Broad. Corp.*, 395 F.3d 416, 420 (7th Cir. 2005) ("Reliable inferences depend on more than say-so"); *In re Pfizer*, attached hereto as Ex. A (excluding Fischel's loss causation expert opinion where "no research reference or peer review information is cited in support of Fischel's" analysis); *Dubovoy*, 2015 U.S. Dist. LEXIS 140957, at *21-23 (rejecting Fischel's testimony where Fischel failed to present "specific academic citation or support for his analysis").

Fischel's position, furthermore, is at odds with the fundamental requirement that the plaintiff provide competent expert testimony appropriately addressing and accounting for confounding nonfraud-related information. As the Seventh Circuit made clear in this very case, "in order to prove loss causation, plaintiffs in securities-fraud cases need to isolate the extent to

which a decline in stock price is due to fraud-related corrective disclosures and not other factors." *Glickenhaus*, 787 F.3d at 421. If Fischel's conclusory analysis were accepted, this fundamental requirement would be abrogated and the burden of proof under *Dura* would be impermissibly inverted. *See Dura*, 544 U.S. at 342-44.

Because Fischel's Remand Report presents an incomplete, conclusory analysis, and fails to present any valid, reliable means by which to address confounding information during the 228-day disclosure period, the Remand Report "does not satisfy the requirements of *Daubert*." *Bricklayers*, 752 F.3d at 95; *Hubbard*, 688 F.3d at 726.

III. Fischel Fails To Account For Significant Firm-Specific, Nonfraud-Related Information During the 228-Day Disclosure Period.

Under the framework prescribed by the Seventh Circuit, *if* Fischel provides nonconclusory testimony to support his opinion that no portion of the $23.94 of "inflation" per his Leakage Model can be attributed to the disclosure of firm-specific, nonfraud-related information, *then* (and only then) would the burden shift to Defendants "of identifying some significant, firm-specific, nonfraud related information that *could* have affected the stock price." *Glickenhaus*, 787 F.3d at 422 (emphasis added). Because Fischel has failed to provide the required nonconclusory testimony, no further analysis is necessary, and his testimony should be excluded. But even if Fischel had met his burden of providing nonconclusory testimony, the reports of Professors Ferrell and James, submitted herewith, identify significant firm-specific, nonfraud-related information that must be accounted for during the 228-day period.

As Professor Ferrell identifies through an appropriate analysis of the disclosure period, there are numerous items of significant firm-specific, nonfraud-related information that must be accounted for properly during the 228-day period. Among the confounding firm-specific, nonfraud-related information during the 228-day period that has not been addressed and

accounted for by Fischel are: (1) disclosures regarding Household's liquidity, access to capital markets, and widening bond spreads; (2) disclosures regarding credit quality; (3) disclosures relating to increased capital requirements for subprime lending institutions; (4) disclosures and concerns regarding future regulatory and legislative changes (as opposed to past compliance with existing legal requirements); (5) disclosures relating to matters specific to the auto and credit services business lines of Household; (6) the disproportionate impact of the "double-dip" recession on consumer lenders serving primarily subprime consumers (as opposed to financial institutions more generally) and (7) firm-specific "random noise" with respect to stock price movement. (Ferrell Report (App. Tab 3) ¶¶ 27-56.)

Professor Ferrell addresses the information being disclosed to the market with respect to firm-specific, nonfraud factors on *each* of the 27 days discussed in Fischel's Remand Report, identifying numerous instances in which firm-specific, nonfraud-related information was disclosed to the market on those days. (*Id.* ¶¶ 56-101.) As Professor Ferrell points out, Fischel's Remand Report fails to account for such information. (*Id.*)

With respect to the 171 days simply *ignored* by Fischel in his Remand Report, Professor Ferrell explains that there is no plausible basis to ascribe the stock price movement on such days to the purported disclosure of fraud-related information. (*Id.* ¶ 120.) In addition to explaining that the stock price movement on these 171 days could be attributed to the firm-specific non-fraud factor of random noise, Professor Ferrell also identifies numerous disclosures of firm-specific, nonfraud-related information throughout the period that could have caused the price movement. (*Id.*)

Notably, Professor Ferrell also identifies firm-specific nonfraud-related information on certain of the days included in the 14 days previously used by Fischel in his "specific

disclosures" model. (*Id.* ¶¶ 102-111.) Thus, the Seventh Circuit's prediction that Fischel's specific disclosures model might suffer from the same problem as his leakage model "if indeed there was some additional negative firm-specific, nonfraud related information on the same day as a specific disclosure," *Glickenhaus*, 787 F.3d at 422 n.7, is, in fact, the case.

As Professor Ferrell correctly notes, "firm specific, nonfraud information" necessarily includes information that would impact Household in a manner that is different than the general impact reflected in the market and industry indexes used by Fischel for his regression analysis. (Ferrell Report (App. Tab 3) ¶¶ 27-32.) Fischel acknowledged as much in his deposition in this case. (Fischel Dep. Tr. (Ex A) at 200:18-201:1 ("If [Household is] disproportionately affected by—hypothetically—a regulatory change, meaning that the regulatory change has a bigger effect on its expected future profitability than for other firms, then the industry index would maybe partially pick up the effect of the change. But there still could be hypothetically a firm specific effect for Household.").)

Professor Christopher James applies his financial sector-specific expertise to demonstrate that Fischel's regression calculation (which uses the S&P 500 Index and the S&P Financials Index as the bases for the regression calculation) fails to address various macroeconomic and regulatory nonfraud factors that had unique and specific impacts on Household, given its line of business, during the disclosure period. (James Report (App. Tab 4) at ¶¶ 24-57.) These firm-specific impacts, which differed from the general indexes used by Fischel in his model, included differential impacts arising from Household's increased cost of funds, the deteriorating credit quality given macroeconomic factors, and the specific impact of prospective regulatory changes, including capital requirements. (*Id.*). None of these factors is addressed by Fischel in his Remand Report or accounted for in his loss causation models.

The similar failure by a loss-causation expert to account for nonfraud-related factors affecting a particular niche of a broader market sector led the Eleventh Circuit, in *Hubbard v. BankAtlantic Bancorp, Inc.*, 688 F.3d 713 (11th Cir. 2012), to affirm the district court's exclusion of the expert's testimony. The plaintiffs' expert in that case performed an event study in which she used the S&P 500 Index as her market index and the NASDAQ Bank Index as her industry index. *Id.* at 721-22, 728-29. The Eleventh Circuit found the expert's analysis to be insufficient, explaining:

> Preston failed, however, to account for the effects of the collapse of the Florida real estate market. The NASDAQ Bank Index may be well suited to capture the effects of national trends in the banking industry, such as the broader national financial crisis that reached its nadir in 2008. But in 2007, Florida, having benefitted more than most states from the real estate boom of the previous years, was hit harder than most by the ensuing bust. And Florida financial institutions, as Preston admitted on cross-examination, made up only a small percentage of the NASDAQ Bank Index. That index, therefore, would be inappropriate for the task of filtering out the effects of industry-wide factors that might affect the stock price of a bank, or of the holding company of a bank, whose assets were concentrated in loans tied to Florida real estate in 2007.

Id. at 729. The Eleventh Circuit continued:

> BankAtlantic is just such a bank. As Bancorp acknowledged in several public SEC filings during the class period, BankAtlantic's assets were concentrated in loans tied to Florida real estate. As a result, BankAtlantic and Bancorp were particularly susceptible to any deterioration in the Florida real estate market, in addition to any national developments. To support a finding that Bancorp's misstatements were a substantial factor in bringing about its losses, therefore, State-Boston had to present evidence that would give a jury some indication, however rough, of how much of the decline in Bancorp's stock price resulted not from the fraud but from the general downturn in the Florida real estate market—the risk of which Bancorp is not alleged to have concealed.

Id. The same deficiency, among others, renders Fischel's Remand Report invalid here.

In short, Fischel's Remand Report fails to account adequately for confounding firm-specific, nonfraud information throughout the disclosure period, including the 14 days used by Fischel in his specific disclosures model. This is a fatal defect in his analysis:

> When proving loss causation in a securities fraud suit, plaintiffs bear[] the burden of showing that [their] losses were attributable to the revelation of the fraud and not the myriad other factors that affect a company's stock prices . . . account for some or all of that lower price. . . *Thus, when conducting an event study, an expert must address confounding information that entered the market on the event date*.

Bricklayers, 752 F.3d at 95 (emphasis added).

As the Seventh Circuit made clear in its opinion remanding this case, "in order to prove loss causation, plaintiffs in securities-fraud cases need to isolate the extent to which a decline in stock price is due to fraud-related corrective disclosures and not other factors." *Glickenhaus*, 787 F.3d at 421. Fischel has not done so. Accordingly, to the extent his testimony is not excluded based upon his failure to tender a Remand Report complying with the Seventh Circuit's directive and *Daubert* requirements, plaintiffs must now "account for th[e] specific information" identified by Professors Ferrell and James. *Id.* at 422.

CONCLUSION

Because of Fischel's failure on remand to provide nonconclusory testimony that satisfies the Seventh Circuit's directive and the reliability requirements of *Daubert*, the burden does not shift to Defendants to "identify[ ] some significant, firm-specific, nonfraud related information that *could* have affected the stock price." *Glickenhaus*, 787 F.3d at 422 (emphasis added). For this reason alone, the Court should grant Defendants' motion and strike Fischel's Remand Report. But even if Defendants had such a burden, that burden has been more than satisfied through the reports of Defendants' experts. In any event, therefore, Fischel must comply with the Seventh Circuit's directive that he "account for that specific information or provide a loss-causation model that doesn't suffer from the same problem, like the specific disclosure model."

Id. [9] Unless Fischel is able do so, his testimony must be excluded.

Dated: October 23, 2015

Respectfully submitted,

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[9] As set forth above, any "specific disclosures" model that Fischel may attempt to put forth must account properly for the "additional negative firm-specific, nonfraud related information" released on any days included in such model. *Glickenhaus*, 787 F.3d at 422 n.7.

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CERTIFICATE OF SERVICE

R. Ryan Stoll, an attorney, hereby certifies that on October 23, 2015, he caused true and correct copies of the foregoing Defendants' Memorandum of Law in Support of Their Motion To Exclude the Testimony of Plaintiffs' Expert Daniel R. Fischel to be served via the Court's ECF filing system on the following counsel of record in this action:

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<u>INDEX OF EXHIBITS</u>

<u>Tab</u>

In re Pfizer, *Inc. Sec. Litig.*, No. 04 Civ. 9866, slip op. (S.D.N.Y. May 21, 2014)......................A

Excerpt from Corrected Report of Daniel R. Fischel in *United States v. Nacchio*,
No. 05-545 (D. Col.)..B

EXHIBIT A

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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IN RE PFIZER INC. SECURITIES LITIGATION

No. 04 Civ. 9866 (LTS)(HBP)

THIS DOCUMENT RELATES TO:
The Consolidated Securities Class Action
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ORDER

Defendants move to preclude the expert testimony of Daniel R. Fischel concerning stock price inflation damages caused by Defendants' alleged misrepresentions and omissions concerning Celebrex and Bextra. Fischel's original report utilized an event study and identified inflation principally by reference to stock price declines associated with certain disclosures. Fischel reduced the inflation so identified by reference to intermediate stock price increases associated with other disclosures concerning the drugs.

On March 28, 2013, the Court granted partial summary judgment in Defendants' favor, as relevant here precluding Plaintiffs' claims based on two of the disclosure events, and precluded claims based on certain statements that had been made by Pharmacia rather than by any defendant in this action. Fischel thereafter served a four-paragraph Supplemental Report in which he opined that the stock inflation reduction attributable to the two excluded disclosure events reduced the overall stock inflation figure by 9.7% and that he therefore revised his damages calculations to reduce by 9.7% the intermediate stock price increases associated with the other events. Fischel proffered no explanation of the analytical basis for this parallel adjustment other than the assertion that "[b]ecause eliminating the stock price declines related to

Celebrex and Bextra on [the] dates [excluded by the Court] reduces the total residual stock price decline I estimated related to these drugs . . . by 9.7%, I proportionally reduce the stock price increases I measured that are related to these drugs . . . by 9.7%." (May 10, 2013 Supplemental Report of Daniel R. Fischel.) No explanation of the relationships among the events triggering the respective price decreases and increases was offered, and no research reference or peer review information is cited in support of Fischel's parallel adjustment method. Furthermore, Fischer did not make any adjustments or otherwise disaggregate his computations to identify any stock price inflation attributable to the dismissed claims that were based on statements by Pharmacia, although he has asserted in his prior report and in deposition testimony that his stock inflation opinions are premised on the assumption that Defendants are responsible for all of the alleged misrepresentations and omissions alleged in the complaint. In a further Reply submission, Fischel posits that other methods that he did not use would have resulted in larger damages claims, but provides no further foundation or references in support of his parallel 9.7% adjustments.

Federal Rule of Evidence 702 permits the admission of expert testimony where, inter alia, the testimony is the product of reliable principles and methods reliably applied to the facts of the case. The Court, in performing this "gatekeeping" function, must "make certain that an expert, whether basing testimony upon professional studies or personal experience, employs in the courtroom the same level of intellectual rigor that characterizes the practice of an expert in the relevant field." Kumho Tire Co. v. Carmichael, 526 U.S. 137, 152 (1999). Fischel's 9.7% parallel adjustment has not been shown to be the product of reliable principles and methods reliably applied. Furthermore, an expert's testimony must be of a character that "will help the trier of fact to understand the evidence or to determine a fact in issue." Fed. R. Civ. P. 702(a).

Fischel's failure to account in any way for the impact of the excluded Pharmacia statements renders his opinions unhelpful to the jury in making calculations of damages proximately caused by Defendants' alleged misrepresentations and omissions. Fischel's expert testimony thus fails to meet the standards set by Rule 702 and will not be admitted.

For these reasons, and for substantially the reasons set forth in Defendants' opening and reply memoranda in support of their Motion in Limine No. 8 (docket entry nos. 574 and 623), Defendants' Motion in Limine No. 8 is granted and the expert testimony of Daniel R. Fischel is excluded from the trial of this action.

Because the Court grants Defendants' Motion in Limine No. 8, thereby excluding the testimony of Plaintiffs' damages expert Daniel R. Fischel from the upcoming trial of this action, Plaintiffs' Motion in Limine No. 11 (docket entry no. 538) to strike the rebuttal damages testimony of Paul A. Gompers is granted on the sole ground that, in the absence of the testimony of Fischel, Gompers' proposed testimony is irrelevant.

This Order resolves docket entries no. 521 and 538.

SO ORDERED.

Dated: New York, New York
May 21, 2014

/s/ Laura Taylor Swain
LAURA TAYLOR SWAIN
United States District Judge

EXHIBIT B

EX 4

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

UNITED STATES OF AMERICA, Plaintiff, v. JOSEPH P. NACCHIO Defendant.	Crim. No. 05-c-00545-EWN

CORRECTED REPORT OF DANIEL R. FISCHEL

and subtracting the expected return from the actual return to derive a residual return (sometimes referred to as an "abnormal return" or "market -adjusted return"). In this case, we estimated the relationship between Qwest's return and Nasdaq Composite Index during the period from April 1, 1999 to March 31, 2000 (i.e., the calendar year ending one year prior to the month in which the improper sales began). I report results using the CRSP Value-Weighted NASDAQ market index return, which reflects the dividend adjusted performance of the NASDAQ market, because the Nasdaq Composite Index is one of the two market indices that Qwest used for performance measurement comparisons (see Qwest Communications International Inc., Proxy Statement, May 2, 2001, at 22), and the CRSP value-weighted market return explained a greater percentage of the variation in Qwest's stock price during the estimation period than the other market index (the Standard & Poor's 500) during the estimation period.[12]

11. When performing event studies, the conventional practice in finance is to test the "null hypothesis" that the residual return is zero against either the alternative hypothesis that the residual return is different from zero, or the alternative hypothesis that the residual has a particular sign (i.e., it is positive, or it is negative).[13] If the null hypothesis cannot be rejected at conventional levels of significance, then the

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12. We also estimated a five-factor model that included each of the market and industry indices that Qwest used for performance measurement comparisons and obtained results that were qualitatively similar to those reported in the text.
13. See, e.g., John Y. Campbell, Andrew W. Lo, & A. Craig MacKinlay, The Econometrics of Financial Markets, (Princeton University Press, 1997), at 160-66; A. Craig MacKinlay, "Event Studies in Economics and Finance," 35 Journal of Economic Literature (March 1997), 13-39; G. William Schwert, "Using Financial Data to Measure Effects of Regulation," 24 The Journal of Law and Economics (1981) 121-57; Daniel R. Fischel, "Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities," 38 The Business Lawyer (1982), 1-20, at 19.

residual returns are not considered to be statistically significant, i.e., they are not considered to be significantly different from zero. Under these circumstances, one concludes that the observed stock return on a particular date can be explained by the independent variable(s) considered in the estimation model (and is not attributable to the firm-specific events which occurred on that date).

12. In event studies, the statistical significance of the residual returns is typically assessed by calculating a standardized measure of the size of the residual return known as a "t-statistic."[14] A t-statistic with an absolute value of 1.96 or greater denotes statistical significance at the 5 percent level of significance (a conventional level at which such assessments are made) in a "two-tailed" test of statistical significance.[15] In a two-tailed test, the null hypothesis is that the residual return is zero, and the alternative hypothesis is that the residual return is different from zero (i.e., either positive or negative). A t-statistic with an absolute value of 1.65 or greater denotes statistical significance at the 5 percent level of significance in a "one-tailed" test of statistical significance.[16] In a one-tailed test, the null-hypothesis is that the residual return is zero, and the alternative hypothesis is that the residual return has a particular sign (e.g., it is positive).

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14. See, e.g., J. Campbell, A. Lo, & A.C. MacKinlay, The Econometrics of Financial Markets, (Princeton University Press, 1997), at 160-66; A.C. MacKinlay, "Event Studies in Economics and Finance," 35 Journal of Economic Literature (March 1997), 13-39; G. W. Schwert, "Using Financial Data to Measure Effects of Regulation," 24 The Journal of Law and Economics (1981) 121-57; D.R. Fischel, "Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities," 38 The Business Lawyer (1982), 1-20, at 19.
15. See, e.g., J.E. Mendenhall, W. Reinmuth & R.J. Beaver, Statistics for Management and Economics (Duxbury Press, 1993), at 346-47.
16. Id.