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' REPLY IN SUPPORT OF THEIR MOTION TO EXCLUDE
<u>THE TESTIMONY OF PLAINTIFFS' EXPERT PROFESSOR DANIEL R. FISCHEL</u>

R. Ryan Stoll
Mark E. Rakoczy
Donna L. McDevitt
Andrew J. Fuchs
SKADDEN, ARPS, SLATE, MEAGHER & FLOM
155 North Wacker Drive
Chicago, IL 60606
(312) 407-0700

Attorneys for Defendant
Household International, Inc.

Tim S. Leonard, Esq.
JACKSON WALKER LLP
1401 McKinney Street
Suite 1900
Houston, TX 77010
(713) 752-4200

Attorneys for Defendant
David A. Schoenholz

Gil M. Soffer, Esq.
Dawn M. Canty, Esq.
KATTEN MUCHEN ROSENMAN LLP
525 West Monroe Street
Chicago, IL 60661

Attorneys for Defendant
William F. Aldinger

David S. Rosenbloom, Esq.
McDERMOTT WILL & EMERY, LLP
227 West Monroe Street
Chicago, IL 60606
(312) 984-7759

Attorneys for Defendant
Gary Gilmer

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INTRODUCTION

Plaintiffs' response leaves no doubt that Fischel has failed to satisfy—and, indeed, *cannot* satisfy—his threshold burden of providing *nonconclusory* testimony to support his opinion that "no firm-specific, nonfraud related information contributed to the decline in [Household's] stock price." *Glickenhaus & Co. v. Household Int'l, Inc.*, 787 F.3d 408, 422 (7th Cir. 2015). This failure alone mandates the exclusion of Fischel's testimony about his leakage model. But even if Fischel had done what the Seventh Circuit directed him to do, Plaintiffs' response also confirms that Fischel's anomalous formulation of a leakage model is not based on any accepted methodology and fails the reliability requirements of *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993), and, for these reasons also, must be excluded.

Defendants demonstrated in their opening memorandum that not only is Fischel's Remand Report every bit as conclusory as his trial testimony, but it also is *inconsistent* with his trial testimony. At trial, Fischel testified that his leakage model contained "a lot" of price movements attributable to nonfraud-related disclosures during the leakage/disclosure period (November 15, 2001 through October 11, 2002), and that he had examined these nonfraud-related disclosures "carefully" and determined that the related price movements "cancel each other out." On remand, Fischel has been unable to substantiate his conclusory testimony about "a lot" of nonfraud-related disclosures that "cancel each other out." Fischel's Remand Report identifies *only one* nonfraud-related price decline during the 228-day leakage period (on January 11, 2002) that Fischel contends (incorrectly) was canceled out by a price increase attributable to a nonfraud-related disclosure two days later. (Defs.' Mem. at 9-11.)

The inconsistency between Fischel's trial testimony and his Remand Report does not simply present an issue of credibility to be determined by the jury, as Plaintiffs contend. (Pls.'

Rest. at 19.) The Seventh Circuit remanded this matter for a retrial of loss causation as calculated by a model that appropriately accounts for firm-specific nonfraud information, "like the specific disclosure model," *Glickenhaus*, 787 F.3d at 422, while also allowing Fischel an opportunity to demonstrate in nonconclusory terms that his leakage model accounted for the "lot[s] of disclosures" relating to nonfraud information during the disclosure period and that the price impact of such information "cancel[s] . . . out." Now that he has been required to do so with specificity, as directed by the Seventh Circuit, Professor Fischel cannot.

It is now indisputable that Fischel's leakage model includes price declines that cannot *reliably* be attributed to the disclosure or leakage of fraud-related information. Defendants' expert, Professor Ferrell, demonstrated that the $23.94 of "inflation" per Fischel's leakage model consists of: (i) $7.32 of statistically significant residual price returns on the 14 days that Fischel included in his specific disclosures model; (ii) $9.86 of residual price returns on the other 43 days during the disclosure period on which there were statistically significant residual returns, which Fischel testified he "wasn't confident" could be attributed to fraud-related disclosures (Trial Tr. (Dkt. No. 1922) at 2967:21-2968:1); and (iii) $6.75 of statistically insignificant residual price returns on the remaining 171 days during the 228-day disclosure period. (Ferrell Report (Dkt. No. 2060-3) at 5.)

Plaintiffs do not contend that Professor Ferrell incorrectly identified the components of Fischel's leakage model. Plaintiffs, moreover, concede that, "*using standard methodology*," it would not be possible to attribute the statistically insignificant residual price returns on 171 days that are included in Fischel's leakage model "to any particular cause." (Pls.' Resp. at 16 (emphasis added).) And Fischel simply disregards his responsibility under the Seventh Circuit's mandate that he corroborate in a nonconclusory manner his "cancel out" theory with respect to those 171 days (75% of the days at issue), instead providing only the conclusory assertion that the residual returns on those 171 days "*for the most part cancel each other out*, but with the net amount still negative because the $52.19 of negatives outweighs the $45.44 of positives." (Fischel 2d Rebuttal Report ¶ 119 (emphasis added).) Far from "cancel[ing] out" those days add $6.75 of inflation to the leakage model, as Fischel admits. Thus, it is indisputable that Fischel's leakage model, *at a minimum*, contains $16.62 of residual price declines that cannot reliably be attributed to fraud (*i.e.*, $9.86 of residual price returns that Fischel "wasn't confident" were fraud-related, and $6.75 of statistically insignificant residual price returns that cannot be attributed to any particular cause and for which Fischel has not even attempted to show that non-fraud information "cancels out.")[1]

Because Plaintiffs cannot dispute that Fischel's leakage model includes residual returns that cannot reliably be attributed to the disclosure or leakage of fraud-related information, Plaintiffs respond with a tautology. Plaintiffs assert that, "*[b]y definition*, the leakage model includes all days during the Leakage Period—whether significant or not." (Pls.' Resp. at 1 (emphasis added).) This begs the question: "By whose definition?" It is Fischel's only.

Contrary to Plaintiffs' assertion, Fischel's version of a leakage model has not been "well-accepted in the academic literature." (*Id.* at 9.) Plaintiffs fail to identify any post-*Dura* academic treatise that supports the use of a leakage model of the sort proposed by Fischel. This is

[1] Obviously, the $9.86 of net negative statistically significant residual returns on the 43 days on which Fischel testified he "wasn't confident" the price declines could be attributed to fraud-related disclosures do not "cancel each other out." In his Second Supplemental Report, Fischel purported to analyze the disclosures on only 27 of these days (the days on which the price movement was negative). Fischel conceded that the price decline on one of the 27 days (January 11, 2002) was due to a nonfraud-related disclosure but contended (incorrectly) that this price decline was "canceled out" by a price increase two days later. (Defs.' Mem. at 11-12.) With respect to 15 of the remaining 26 days, Fischel admitted that he could not identify *any* fraud-related information that was disclosed on those days. (*Id.* at 12 (identifying the 15 days).) There is, of course, no plausible basis to assign a price movement to the fraud when there is no disclosure or any kind related to the fraud. As Fischel admitted at his deposition, "[y]ou could have a statistically significant price reaction that's attributable to chance alone." (Fischel Dep. Tr. (Dkt. No. 1361-5) at 151:13-14.)

unsurprising because, as demonstrated below, Fischel's leakage model inverts the burden of proof under the Private Securities Litigation Reform Act (the "PSLRA") and the Supreme Court's decision in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005).

The Seventh Circuit, furthermore, did not "endorse[]" Fischel's leakage model, as Plaintiffs erroneously contend. (Pls.' Resp. at 7.) Instead, the Seventh Circuit *reversed and remanded* because "the leakage model, which the jury adopted, did not account for firm-specific, nonfraud factors that may have affected the decline in Household's stock price." *Glickenhaus*, 787 F.3d at 419. But rather than grant Defendants' request for judgment as a matter of law on account of this failure of proof, the Seventh Circuit cited Fischel's trial testimony and gave Fischel a chance to remedy this deficiency on remand by providing a *nonconclusory* opinion corroborating his legally insufficient, "very general" testimony that "lot[s] of disclosures . . . about non-fraud related information . . . cancel[ed] each other out." *Id*. at 419-22.

Because Fischel has failed to meet the burden for admissibility of his leakage model specified by the Seventh Circuit, and because Fischel's leakage model is unreliable and inconsistent with the burden of proof under the PLSRA and *Dura*, Fischel's leakage model should be excluded. Instead, Plaintiffs should be limited to seeking to establish loss causation and damages by using an appropriate specific disclosures model.

ARGUMENT

I. Plaintiffs' Efforts To Reconcile the Inconsistency Between Fischel's Trial Testimony—Upon Which The Seventh Circuit Relied In Giving Plaintiffs a Second Chance To Prove Loss Causation—and Fischel's Remand Report Are Unavailing.

As demonstrated above, Fischel's Remand Report is inconsistent with his trial testimony. In a baseless attempt to reconcile this inconsistency, Plaintiffs contend that Fischel's Remand Report, which identifies only one nonfraud-related disclosure during the leakage period that supposedly was "canceled out," is in fact consistent with Fischel's conclusory testimony about "a lot" of nonfraud-related disclosures that "cancel each other out." According to Plaintiffs, when Fischel used the term "a lot," he was referring to: (i) statistically significant nonfraud-related price movements throughout the entire class period—not just to the one statistically significant nonfraud-related price decline on January 11, 2002 that Fischel contends in his Remand Report was "canceled out" by a price increase two days later; and (ii) "a lot" of other disclosures during the leakage period that were associated with statistically insignificant residual price declines. (Pls.' Resp. at 18-19.)

The trial transcript and Plaintiffs' arguments to the Seventh Circuit readily disprove Plaintiffs' assertions.[2] Fischel testified that his leakage model focused on negative disclosures beginning on November 15, 2001 (*i.e.*, the start of the leakage/disclosure period). (PSA184 at 2683:4-12.) Fischel then was asked if he had analyzed "whether company-specific factors unrelated to the fraud can explain Household's stock price decline during this latter part of the relevant period." (*Id.* at 2683: 17-19.) Fischel responded that he had done so and noticed "a lot" of nonfraud-related disclosures during this period, but had determined that they "cancel each other out." (PSA184:2683-20-PSA185:29846.) Fischel also admitted that his leakage model included "a bunch" of statistically significant price movements, and acknowledged that whether these price movements "were purely fraud related, combined fraud related or not at all fraud related, they were all included in the leakage model." (Trial Tr. (Dkt. No. 1922-1) at 2959:22-2960:17.)

Plaintiffs, furthermore, expressly argued to the Seventh Circuit that Fischel's testimony

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[2] Defendants have included as Exhibit A in the accompanying appendix the relevant portions of the trial transcript (bearing the Bates-label prefix "PSA"), which Plaintiffs included in their Seventh Circuit supplemental appendix and upon which Plaintiffs based their arguments on appeal.

about "a lot" of nonfraud-related disclosures canceling each other out addressed disclosures *during the disclosure period*:

> To avoid capturing inflation unrelated to defendants' fraud, Fischel carefully analyzed the non-fraud Household-specific disclosures *during the Disclosure Period*—and concluded they did not impact his Leakage Quantification. PSA 184:13-185:6. As Fischel testified, there were some non-fraud Household-related disclosures that resulted in price increases *and* decreases, but they cancelled each other out, having no impact on final quantification.

(Pls.' Appeal Br. (7th Cir. Dkt. No. 73) at 16 (first emphasis added).)[3]

The Seventh Circuit's opinion shows that the Seventh Circuit *relied* on Fischel's testimony, and Plaintiffs' arguments based on that testimony, in declining to rule for Defendants as a matter of law. The Seventh Circuit stated that it agreed with Defendants that "the leakage model, which the jury adopted, did not account for firm-specific, nonfraud factors that may have affected the decline in Household's stock price." *Glickenhaus*, 787 F.3d at 419. At that point, the Seventh Circuit could have granted Defendants' request for judgment as a matter of law on account of Plaintiffs' failure of proof on the essential element of loss causation. *See, e.g.*, *Weisgram v. Marley Co.*, 528 U.S. 440, 444 (2000); *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23 (1986). Instead, based on Fischel's trial testimony (which the Seventh Circuit *quoted in full* in its opinion, *Glickenhaus*, 787 F.3d at 419-20), the Seventh Circuit gave Plaintiffs a second chance to prove loss causation. *Id.* at 422-23, 433.

Plaintiffs' unavailing efforts to reconcile Fischel's Remand Report with Fischel's trial testimony, therefore, go far beyond merely raising an issue about Fischel's credibility to be decided by the jury, as Plaintiffs contend. (Pls.' Resp. at 19.) They raise serious questions about

[3] Indeed, Plaintiffs' counsel emphasized this precise point to the Panel during oral argument. *See* http://media.ca7.uscourts.gov/oralArguments/oar.jsp?caseyear=13&casenumber=3532&listCase=List+case%28s%29 (Case No. 13-3532) ("[Fischel] did an analysis to look at those days to see whether there was some firm-specific information that was not related to the fraud. He said he carefully examined it and they canceled each other out.")

the integrity of the proceedings in this case and reinforce the need to exclude the leakage theory at the *Daubert* stage. *See, e.g., Butler v. Round Lake Police Department*, 585 F.3d 1020, 1022 (7th Cir. 2009) (prohibition against advancing inconsistent positions at different stages of litigation is "designed to protect the integrity of the judicial process and to prevent litigants from playing fast and loose with the courts" (internal quotations and citation omitted)); *Fireman's Fund Ins. Co. v. Canon, U.S.A., Inc.*, 394 F.3d 1054, 1059 (8th Cir. 2005) (affirming exclusion of opinion and noting that expert's changed opinion "seriously undermines . . . reliability"); *Comer v. Am. Elec. Power*, 63 F. Supp. 2d 927, 935 (N.D. Ind. 1999) (changed testimony demonstrated that expert opinion was not scientifically based, but was "mere *ipse dixit.*").[4]

II. Plaintiffs' Response Confirms that Fischel Has Failed To Meet His Threshold Burden Under the Seventh Circuit's Framework and Also Leaves No Doubt that Fischel's Leakage Model Is Not Based on Any Reliable Methodology.

A. Fischel's Qualifications Do Not Suffice To Establish that Fischel's Leakage Model Is Reliable.

Tellingly, Plaintiffs begin their response by pointing to Fischel's qualifications. (Pls.' Resp. at 3.) It is well-settled, however, that "[a] court's reliability analysis does not end with its conclusion that an expert is qualified to testify about a given matter." *Smith v. Ford Motor Co.*, 215 F.3d 713, 718 (7th Cir. 2000). Indeed, the Seventh Circuit reversed and remanded *despite* acknowledging Fischel's credentials. *Glickenhaus*, 787 F.3d at 415 & n.3. Fischel, furthermore, is by no means infallible. As Defendants demonstrated, Fischel has been the subject of several

4 In the last two years, Plaintiffs' counsel, Robbins Geller Rudman & Dowd LLP, has been sanctioned twice in this district for advancing inaccurate positions. *See City of Livonia Emps.' Ret. Sys. v. Boeing Co*., 306 F.R.D. 175, 180, 183 (N.D. Ill. 2014) (awarding defendants their fees and costs of defense where Robbins Geller advanced arguments based on testimony that their witness subsequently disavowed, and stating that "[t]he record before the Court regarding Plaintiffs' counsel's conduct throughout the litigation is troubling"); *Boca Raton Firefighters' & Police Pension Fund v. Devry Inc.*, No. 10 C 7031, 2014 U.S. Dist. LEXIS 63523 at *23, *31-32 (N.D. Ill. May 8, 2014) (holding the defendants presumptively were entitled to recover their costs of defense where Robbins Geller's initial and amended complaints contained "loss-causation allegations [that] cross the line between merely flawed and outright frivolous.").

recent successful *Daubert* challenges. (Defs.' Mem. at 5-6, 14, 19.)

B. No Post-*Dura* Academic Literature Supports Use of a Leakage Model of the Sort Proposed by Fischel.

There is no basis for Plaintiffs' assertion that Fischel's leakage model methodology is "well-accepted in the academic literature." (Pls.' Resp. at 9.) The sole authority on which Fischel purported to base his leakage model was a 1990 article by Professor Bradford Cornell and R. G. Morgan titled "*Using Finance Theory to Measure Damages in Fraud on the Market Cases*," 37 UCLA L. Rev. 883 (June 1990). (Fischel Report (Dkt. No. 1361-2) at 23 n.22.) The Cornell and Morgan article shows that the approach described therein, upon which Fischel based his leakage model, is inconsistent with the PSLRA and the Supreme Court's subsequent decision in *Dura*.

In their article, Cornell and Morgan noted that the question of which party bore the burden of proof on causation and damages was (at that time) unclear. 37 UCLA L. Rev. at 914-16. They further stated: "*Assuming* . . . that plaintiffs still must present some evidence that the fraud affected market price, there remains the question of how precisely plaintiffs need to explain movements in market prices." *Id.* at 916 (emphasis added). Cornell and Morgan then suggested: "One alternative is for plaintiffs to satisfy their burden by presenting market model evidence of the type described in Part II *and to shift the burden to defendants to prove that any part of the market price movement and residual returns resulted from causes unrelated to the fraud*." *Id.* (emphasis added).

Five years later, Congress made clear that the plaintiff has the burden of proving loss causation. *See* 15 U.S.C. §78u-4(b)(4) ("In any private action arising under this chapter, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages."). And in *Dura*, the Supreme Court confirmed that the plaintiff bears the burden of isolating the extent to which a decline in stock price is due to fraud-related corrective disclosures and not other factors. 544 U.S. at 342-43. Thus, to the extent the Cornell and Morgan article suggests that a plaintiff might prevail on loss causation simply by using a residual price decline model (*i.e.*, determining price declines after using an index to account for market and industry factors), and shifting to the defendant the burden of proving that all remaining price declines are *not* fraud-related, the PSLRA and *Dura* make clear that such an approach is not viable to prove loss causation.

Plaintiffs have failed to cite any post-*Dura* academic literature endorsing a loss causation model analogous to the one described in the Cornell and Morgan article. As more recent academic treatises show, the limited context in which a "leakage model" remains feasible post-*Dura* is to analyze discrete "event windows" involving "several days" preceding or following an identifiable disclosure and "looking at joint statistical significance" over the event window. *See, e.g.*, Madge S. Thorsen, et al., *Rediscovering the Economics of Loss Causation*, 6 J. Bus. & Sec. L 93, 111 (April 2006) (cited in Plaintiffs' response brief at 10). The Thorsen article further explains: "As 'event windows' are expanded, however, the power of the statistical inferences diminishes." *Id.* at 111 n.69.[5]

Notably, in *United States v. Ferguson*, 584 F. Supp. 2d 447 (D. Conn. 2008), the district court declined to accept a leakage model of the sort described in the Thorsen article, which was based on *a 30-day event window*. In *Ferguson*, the district court quoted the Thorsen article when

5 As Professor Cornell explains in his report, that is precisely the problem here. Given the "compounded errors" associated with the use of a leakage model over the expansive and unprecedented 228-day period, "the 95% confidence interval around Prof. Fischel's true value stock price spans $24 to $53." (Cornell Report (Dkt. No. 2060-2) ¶ 30). Such a result is unreliable. Because Plaintiffs are unable to respond to the substance of Professor Cornell's criticisms, they assert that the Court should refuse to consider Professor Cornell's testimony because it supposedly was "considered and rejected" by Judge Guzmán. (Pls.' Resp. at at 10 n.14.) As set forth more fully in Defendants' Response to Plaintiffs' Motion to Preclude Defendants from Substituting New Experts, this assertion is incorrect. (Dkt. No. 2072.) Professor Cornell's Rebuttal Report is included as Exhibit B in the accompanying appendix. In his rebuttal report, Professor Cornell demonstrates, among other things, that none of the academic articles that Fischel cites support his leakage model. (App. Ex. B, ¶¶ 7-10.)

acknowledging that "some academics and courts have endorsed the general concept of leakage event studies that 'may consider "event windows" or several days over time,' when a 'day where movement is not statistically significant may be part of a series of days which, taken together, are highly statistically significant.'" (*Id.* at 453 (quoting Thorsen, 6 J. Bus. & Sec. L. at 111-12).) The court, however, rejected the Government's leakage model because "the Government has not justified sufficiently [its expert's] *30-day event window* or accounted for . . . confounding factors that may have affected AIG's stock price during that time." *Id.* (emphasis added.)

Fischel's leakage model bears no resemblance to the type of leakage model discussed in the Thorsen article. Fischel does not identify information that "leaked out" a few days (or even a few weeks) before or after a specifically identified disclosure, and then test the declines over that "event window" for joint statistical significance. Rather, Fischel simply starts with the residual returns on the 14 days that he testified he was "confident" were fraud-related and then adds the residual returns on all remaining days during his 228-day "leakage" period based only on his *ipse dixit* that fraud-related information "leaked" into the market on every day throughout the 228-day disclosure period. No case law or academic treatise supports this "methodology."

C. Fischel's Leakage Model Was Not Endorsed by The Seventh Circuit and Has Not Been Accepted by Any Other Court.

Contrary to Plaintiffs' assertion, the Seventh Circuit did not "endorse[]" Fischel's leakage model. (Pls.' Resp. at 7.) Rather, the Seventh Circuit refused to accept Fischel's leakage model and *reversed and remanded* because it concluded that Fischel's leakage model "did not account for firm-specific, nonfraud factors that may have affected the decline in Household's stock price." *Glickenhaus*, 787 F.3d at 419. The Seventh Circuit simply acknowledged the *possibility* that, if Fischel put forth a reliable method to account for the "lot[s] of . . . disclosures about non-fraud related information during this particular period" that purportedly "cancel each other out," *id.* at 422, his leakage model *might* be admissible. The Seventh Circuit noted the uncontroversial proposition that "the Supreme Court has generally recognized that the truth can leak out over time," *id.* (citing *Dura*, 544 U.S. at 342), and remarked that "other circuits have acknowledged the viability of the leakage theory, at least in principle." *Id.* (citing *In re Flag Telecom Holdings, Ltd. Sec. Litig.*, 574 F.3d 29, 40-41, 40 n.5 (2d Cir. 2009)). These comments say nothing about the viability of the leakage model Fischel advances here.[6]

Like *Flag Telecom*, most cases discussing "leakage" have involved a series of specifically identified disclosures, and thus are analogous to what Fischel calls his "specific disclosures" model. *See, e.g., Katyle v. Penn Nat'l Gaming, Inc.*, 637 F.3d 462, 480 (4th Cir. 2011) ("Plaintiffs allege that the following purported corrective disclosures leaked the truth onto the market . . ."); *Lormand v. US Unwired, Inc.* 565 F.3d 228, 259-60 (5th Cir. 2009) (identifying six separate disclosures by which the "truth" allegedly leaked into the market); *In re Pilgrim's Pride Corp. Sec. Litig.*, No. 2:08-cv-419 TJW, 2010 U.S. Dist. LEXIS 84260, at *89 (E.D. Tex. Aug. 17, 2010) (complaint alleged that "the leaking of the relevant truth regarding the alleged misstatements through these partial disclosures . . . [and] link[ed] each partial disclosure to a corresponding drop in Pilgrim's Pride's stock price"); *Norfolk County Ret. Sys. v. Ustian*, No. 07 C 7014, 2009 U.S. Dist. LEXIS 65731, at *19 (N.D. Ill. July 28, 2009) (plaintiffs "identified a series of disclosures—a leakage of information—which indicated that Navistar's financial statements and accounting practices were unreliable").

[6] The issue in *Flag Telecom* was whether in-and-out traders who sold their shares several months before the company issued corrective disclosures should be included in the certified class. 574 F.3d at 37. Plaintiffs and their expert contended that these traders had been harmed because the "truth" had begun to leak out prior to the company's corrective disclosures *through a series of specifically identified industry events*. *Id.* at 40-41. The Second Circuit, while stating that it did "not take issue with the plausibility of Plaintiffs' 'leakage' theory," *id.* at 40 n.5, concluded that the specific industry events identified by plaintiffs did not reveal the alleged misrepresentations, and that plaintiffs had "fail[ed] to connect the decline in the price of Flag stock to any corrective disclosures." *Id.* at 41.

This case law refutes Plaintiffs' contention that Defendants' arguments amount to a repudiation of the very concept of leakage. (Pls.' Resp. at 15.) Plaintiffs note (correctly) that if one removes from Fischel's leakage model the $9.86 of statistically significant residual returns that Fischel "wasn't confident" were caused by fraud-related disclosures (including the 15 days on which he concedes in his Remand Report that he had been unable to identify *any* fraud-related disclosures), and the $6.75 of statistically insignificant returns (as to which Fischel does not even attempt to address the disclosures, whether fraud-related or not), "only the specific disclosures would remain." (*Id.*) As the cases cited above show, this result would still be consistent with the concept of leakage, because Fischel's so-called "specific disclosures" model is what most courts consider to be a "leakage" model.

By contrast, Fischel's particular formulation of a "leakage" model—which includes all residual price movements over a 228-day "disclosure period," regardless of whether they are associated with any fraud-related disclosure—or, indeed, any disclosures at all—is *unprecedented* and has not been accepted by *any* court.[7]

In sum, the Seventh Circuit did not "endorse[]" Fischel's leakage, model, but rather gave Fischel the opportunity on remand to remedy his *insufficient* leakage model by providing nonconclusory testimony to support his "cancel out" theory and to "account for the extent to which firm-specific, nonfraud related information may have contributed to the decline in Household's share price." *Id.* at 421. Under the Seventh Circuit's framework, Fischel's failure to satisfy this threshold burden mandates the exclusion of his leakage model.

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[7] The Seventh Circuit acknowledged that it had been unable to find any precedent either upholding or rejecting a leakage model of loss causation similar to the one that Fischel developed for this case. *Glickenhaus*, 787 F.3d at 422.

III. Fischel's Leakage Model and the Conclusory Assertions in Fischel's Remand Report Improperly Invert the Burden of Proof.

Under *Daubert*, an expert opinion not only must be reliable (which, as demonstrated above, Fischel's is not), but it must also be relevant, *i.e.*, it must "fit" the inquiry that the trier of fact will be called upon to answer. *Daubert*, 509 U.S. at 591-92. If "proffered testimony misrepresent[s] the . . . burden of pro[of]" it fails *Daubert*'s "fit" requirement. *United States v. Wintermute*, 443 F.3d 993, 1001 (8th Cir. 2006) ("By misconstruing the legal question at issue, the testimony [is] not relevant . . . [and] would have served to confuse rather than assist the jury in the jury's attempt to understand the evidence on this issue."); *see also Noskowiak v. Bobst, SA*, No. 04-C-0642, 2005 WL 2146073, at *5 (E.D. Wis. Sept. 2, 2005) (precluding expert opinion and stating that "[t]estimony based on an incorrect legal standard may confuse the jury"); *Bailey v. Allgas, Inc.*, 148 F. Supp. 2d 1222, 1246 (N.D. Ala. 2000), *aff'd*, 284 F.3d 1237 (11th Cir. 2002) (precluding expert opinion where the "conclusions are based upon analyses that are contrary to the law"). Thus, where an expert advances a "theory [that] conflicts with the substantive legal principles of loss causation," the opinion "must be excluded as unreliable and unfit." *In re DVI, Inc. Secs. Litig.*, No. 2:03-cv-05336, 2010 WL 3522090, at *9 (E.D. Pa. Sept. 3, 2010).

As Plaintiffs and Fischel would have it, *every* change in Household's stock price over a 228-day period that differs from the price movement of the S&P 500 Index and the S&P Financials Index is deemed to have been caused by the revelation of the fraud, *unless* Defendants affirmatively prove that "firm-specific nonfraud information released on statistically significant dates . . . *caused* [Household's] stock price to decline." (Pls.' Resp. at 2 (emphasis added); *see also id*. at 19, 20.) Not only is such a theory of loss causation inconsistent with accepted economic principles, but it also impermissibly inverts the burden of proof.

Of course, the Seventh Circuit's decision did not purport to alter a plaintiff's burden of proof under the PSLRA and *Dura*. As the Seventh Circuit explained: "[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*, 787 F.3d at 421. For this reason, the Seventh Circuit articulated a threshold test for the *admissibility* of an expert opinion on loss causation structured to *ensure* that the proffered opinion does not "evade the loss-causation principles explained in *Dura*." *Id.* at 422.

Consistent with the burden of proof under the PLSRA and *Dura*, the Seventh Circuit assigned to Defendants an intermediate burden of production (not proof), *if* Fischel met his threshold burden of providing nonconclusory testimony to support his opinion that "no firm-specific, nonfraud related information contributed to the decline in [Household's] stock price during the relevant time period" (which, as demonstrated above, Fischel has failed to do). In that event, Defendants would have been required to "identify[] some significant, firm-specific, nonfraud related information that *could* have affected the stock price." *Id.* (emphasis added). In light of the ultimate burden of proof, the Seventh Circuit carefully chose the phrase "could have affected," rather than requiring Defendants "to establish" that significant nonfraud-related factors "caused" Household's stock price decline, as Plaintiffs contend. (Pls.' Resp. at 19 (asserting that, upon Fischel satisfying his threshold burden (which he failed to do), "the burden shifted to defendants *to establish* that significant non-fraud firm-specific disclosures caused Fischel's models to materially overstate the damages") (emphasis added).)

Although not required to do so, given Fischel's failure to meet his threshold burden under the Seventh Circuit's framework, Defendants readily identified an array of nonfraud-related disclosures throughout the 228-day disclosure period that did not "cancel each other out."

Defendants also pointed out that, on various days during the disclosure period, there were *no disclosures of any kind*, let alone "corrective disclosures" that revealed the fraud, yet Fischel's leakage model includes the residual price declines on those days in its calculation of "inflation." [8]

Because Fischel has failed to account for the numerous nonfraud-related factors during the disclosure period, Plaintiffs and Fischel again attempt to shift the burden of proof to Defendants. As demonstrated above, there is no basis in law or in the Seventh Circuit's decision for this inversion of the burden of proof that Plaintiffs advocate. Accordingly, to permit Fischel's leakage model to be introduced to the jury would contravene *Daubert*'s "fit" requirement and confuse the jury. *See, e.g.*, *In re DVI, Inc. Sec. Litig.*, 2010 WL 3522090 at *9-12; *In re Williams Sec. Litig.*, 496 F. Supp. 2d 1195, 1261-62, 1275 (N.D. Okla. 2007) (excluding loss causation testimony that conflicted with substantive legal principles of loss causation), *aff'd* 558 F.3d 1130 (10th Cir. 2009); *accord Wintermute*, 443 F.3d at 1001; *Noskowiak*, 2005 WL 2146073 at *5.[9]

CONCLUSION

For the reasons set forth herein and in Defendants' opening memorandum of law, the Court should grant Defendants' motion to exclude Fischel's testimony about his leakage model of loss causation.

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8 There is no merit to Plaintiffs' assertion that, at trial, Defendants produced an analysis that identified 93 days on which fraud-related information was disclosed during the leakage period. (Pls.' Resp. at 6-7.) The chart, and the testimony of Defendants' expert, demonstrated that the disclosures that Fischel contended were fraud-related were similar to many other disclosures that Fischel did not contend were fraud-related, and that the information that Fischel contended was fraud-related was not hidden from investors, but rather was well-known to market participants. (Trial Tr. (Dkt. No. 1923-1) at 4237:13-4238-22.)

9 Plaintiffs also contend that the nonfraud-related information identified by Professors Ferrell and James is not "firm-specific" information because it did not affect Household only, but also affected other subprime lenders. (Pls.' Resp. at 22-23.) This assertion is contrary to settled economic principles: Where, as here, nonfraud information disproportionately impacts a particular firm relative to the index being used for comparison (the index used in the regression model), the impact is necessarily considered to be firm-specific (*i.e.*, not otherwise captured by the regression calculation). This principle is established in the economic literature and has been conceded by Fischel under oath. *See* Ferrell Report (App. Ex. C) ¶¶ 31-33; James Report (App. Ex. D) ¶¶ 23-30.

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Respectfully submitted,

/s/R. Ryan Stoll
R. Ryan Stoll
Mark E. Rakoczy
Donna L. McDevitt
Andrew J. Fuchs
SKADDEN, ARPS, SLATE,
MEAGHER & FLOM
155 North Wacker Drive
Chicago, IL 60606
(312) 407-0700

Attorneys for Defendant
Household International, Inc.

Gil M. Soffer, Esq.
Dawn M. Canty, Esq.
KATTEN MUCHEN ROSENMAN LLP
525 West Monroe Street
Chicago, IL 60661
Attorneys for Defendant
William F. Aldinger

Tim S. Leonard, Esq.
JACKSON WALKER LLP
1401 McKinney Street
Suite 1900
Houston, TX 77010
Attorneys for Defendant
David A. Schoenholz

David S. Rosenbloom, Esq.
McDERMOTT WILL & EMERY, LLP
227 West Monroe Street
Chicago, IL 60606
(312) 984-7759
Attorneys for Defendant
Gary Gilmer

CERTIFICATE OF SERVICE

R. Ryan Stoll, an attorney, hereby certifies that on December 21, 2015, he caused true and correct copies of the foregoing Defendants' Reply in Support of Their Motion To Exclude the Testimony of Plaintiffs' Expert Daniel R. Fischel and the accompanying Appendix to be served via the Court's ECF filing system on the following counsel of record in this action:

Michael J. Dowd, Esq.
Daniel S. Drosman, Esq.
Spencer A. Burkholz, Esq.
ROBBINS GELLER RUDMAN & DOWD LLP
655 West Broadway, Suite 1900
San Diego, CA 92101

Marvin A. Miller, Esq.
Lori A. Fanning, Esq.
MILLER LAW LLC
115 South LaSalle Street, Suite 2910
Chicago, IL 60603

Gil M. Soffer, Esq.
Dawn M. Canty, Esq.
KATTEN MUCHEN ROSENMAN LLP
525 West Monroe Street
Chicago, IL 60661

Stewart T. Kusper, Esq.
THE KUSPER LAW GROUP, LTD.
20 North Clark Street, Suite 3000
Chicago, IL 60602

Tim S. Leonard, Esq.
JACKSON WALKER LLP
1401 McKinney Street, Suite 1900
Houston, TX 77010

David S. Rosenbloom, Esq.
McDERMOTT WILL & EMERY, LLP
227 West Monroe Street
Chicago, IL 60606

/s/ R. Ryan Stoll
R. Ryan Stoll