UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK
CHAMBERS OF THE BANKRUPTCY JUDGE

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RE: Barbara C. Lawrence
Chapter 11 Case No. 97-11258

LETTER DECISION AND ORDER

On June 12, 2008, the Court issued its Scheduling Order for Evidentiary Hearing on Motion pursuant to Rule 60(b)(3) of the Federal Rules of Civil Procedure. Under the terms of the Scheduling Order, the parties had until October 8, 2008, to file pre-hearing submissions. On October 8, 2008, counsel for the Respondents filed a Notice of Objection pursuant to Rules 402 and 702 of the Federal Rules of Evidence, along with a Memorandum of Law (Dkt. No. 1110), objecting to the admission of any opinions or reports submitted by Lucy P. Allen ("Allen") as Movants' expert. The Evidentiary Hearing was commenced on October 15, 2008, and continued on October 16, 2008 and October 17, 2008, and adjourned to December 3, 2008.

On October 16, 2008, the Movants filed a response to the Respondents' Notice of Objection (Dkt. No. 1115). At the hearing on October 17, 2008, the Court heard extensive argument on the issue of the admissibility of Allen's testimony and reports before reserving on Respondents' objection. On October 24, 2008, the Movants filed a supplemental response (Dkt. No. 1116), as did the Respondents (Dkt. Nos. 1117 and 1118), on October 24, 2008. The purpose of this Letter Decision/Order is to rule upon Respondents' objection.

Under the standards set forth by the U.S. Supreme Court in *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993), this Court is charged with ensuring that expert testimony "rests on a reliable foundation and is relevant to the task at hand." *Id.* at 597. In analyzing the admissibility of expert evidence, the Court has broad discretion in any such determination. *Amorgianos v. National R.R. Passenger Corp.*, 303 F.3d 256, 265 (2d Cir. 2002). It is a flexible inquiry that focuses on "the principles and methodology employed by the expert, without regard to the conclusions the expert has reached or the [ ] court's belief as to the correctness of those conclusions." *Id.* at 266. "'The Court's role is not to determine whether [the expert's] testimony is correct, but rather whether it falls 'outside the range where experts might reasonably differ . . . .'" *Freeland v. Iridium World Communications , Ltd.*, 545 F.Supp.2d 59, 88 (D.D.C. 2008) (citations omitted). As noted by the Supreme Court, "[v]igorous cross-examination, presentation of contrary evidence, and careful instruction on the burden of proof [in the case of a jury trial] are the traditional and appropriate means of attacking shaky but admissible evidence. *Daubert*, 509 U.S. at 596.

Event Study

In this case, Respondents challenge Allen's use of an event study[1] in her analysis of the impact of what she has described as "allegedly withheld information" on the price of the stock of Mechanical Technology Inc. ("MTI") and its materiality with respect to negotiations for the sale of said stock in 1997. In a recent decision, the Second Circuit Court of Appeals acknowledged that an event study "may be rejected . . . if it is methodologically unsound or unreliable." *Teamsters Local 445 Freight Div. Pension Fund v. Bombardier, Inc.*, – F.3d – , 2008 WL 4554156, at *9, n.14. (2d Cir. October 14, 2008). In this case, the Respondents argue that the use of an event study is inappropriate based on their assertion that the MTI stock did not trade in an efficient market.

Allen contends that the stock need not trade efficiently for her to use an event study in her analysis. Moreover, she asserts that in addition to the event study she used, she also reviewed and

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[1] An event study is a "statistical method of measuring the effect of a particular event such as a press release . . . on the price of a company's stock. *In re Enron Corp. Securities*, 529 F.Supp.2d 644, 720 (S.D.Tex. 2006).

> An event study is a statistical regression analysis that examines the effect of an event on a dependent variable, such as a corporation's stock price. This approach assumes that the price and value of the security move together except during days when disclosures of company-specific information influence the price of the stock. The analyst then looks at the days when the stock moves differently than anticipated solely based upon market and industry factors-so-called days of "abnormal returns." The analyst then determines whether those abnormal returns are due to fraud or non-fraud related factors.... [E]vent study methodology has been used by financial economists as a tool to measure the effect on market prices from all types of new information relevant to a company's equity valuation.

Id., citing Jay W. Eisenhoffer, Geoffrey C. Jarvis, and James R. Banko, *Securities Fraud, Stock Price Valuation, and Loss Causation: Toward A Corporate Finance-Based Theory of Loss Causation*, 59 BUS. LAW. 1419, 1425-26 (August 2004). "[N]umerous courts have held that an event study is a reliable method for determining market efficiency and the market's responsiveness to certain events or information." *In re Flag Telecom Holdings, Ltd. Sec. Litig.*, 245 F.R.D. 147, 170 (S.D.N.Y. 2007).

analyzed "court documents, documents produced by [Respondents], deposition transcripts, trading data including stock price and volume data for multiple companies, financial filings with the SEC and news coverage" in reaching her conclusions. *See* Declaration of Lucy P. Allen, dated October 24, 2008, attached to Movants' Supplemental Response (Dkt. No. 1116).

According to an article provided by Respondents in support of their position, the statement is made by the authors that "[e]vent study methodology has its foundation in the efficient markets hypothesis." *See* Mark L. Mitchell & Jeffry M. Netter, *The Role of Financial Economics in Securities Fraud Cases: Applications at the Securities and Exchange Commission,* 49 BUS. LAW. 545, 557 (1994), attached as Exhibit F to the Declaration of Respondents' Counsel, Douglas Henkin, Esq. (Dkt. No. 1110). However, the Court notes that in the same article the authors also observe that "[i]nquiry into whether a stock trades in an efficient market is unnecessary. Instead, courts should address whether a misstatement caused the stock to trade at an artificially low or high price." *Id.* at 547, n.14, citing to Jonathan R. Macey, Geoffrey P. Miller, Mark L. Mitchell and Jeffry M. Netter et al., *Lessons from Financial Economics: Materiality Reliance, and Extending the Reach of Basic v. Levinson,* 77 VA. L. REV. 1017, 1021 (1991); *see also* Jon Koslow, *Estimating Aggregate Damages in Class-Action Litigation under Rule 10b-5 for Purposes of Settlement,"* 59 FORDHAM L. REV. 811-842 (1991), cited at p. 37 of Exhibit J attached to Declaration of Respondents' Counsel, Douglas Henkin, Esq. (Dkt. No. 1110) and consisting of a "Supplemental Expert Report of Lucy P. Allen," dated January 18, 2008, in the case of *The Archdiocese of Milwaukee Supporting Fund, Inc. v. Halliburton Co.*, 02-CV-1152 (N.D. Tex.) (in which Koslow is quoted as stating that "calculations should be based not on whether the market was efficient or inefficient, but rather on whether the fraud was sufficiently material to have a statistically significant impact on the market price, given the degree

of market efficiency").

> The Supreme Court in 1988
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> > articulated a doctrine, known as the "fraud on the market theory," that permits plaintiffs to establish reliance, a necessary component of securities fraud, by reference to the integrity of the market price. Namely, rather than having to show that the plaintiff actually saw or heard misleading information from the defendant, the presumption is that the market price of a security reflects its value, and an affirmative misstatement or omission that distorts that value is fraudulent even if the shareholder had no knowledge of the statement: the fraud is on the market as a whole, on whose determination of value the individual shareholder is entitled to rely.

Sanjai Bhagat and Roberta Romano, *Event Studies and the Law: Part II: Empirical Studies of Corporate Law*, 4 AM. L. & ECON. REV. 380, 397-98 (2002), citing *Basic v. Levinson*, 485 U.S. 224 (1988). The rebuttable presumption is particularly useful in the context of a class action, as was the situation in *Basic*, *Cammer v. Bloom*, 711 F.Supp. 1264 (D.N.J. 1989) and in *Bombardier*. To take advantage of the benefit of a rebuttable presumption provided by the fraud on the market doctrine, namely, that (1) misrepresentations by an issuer affect the price of securities traded in the open market, and (2) investors rely on the market price of securities as an accurate measure of their intrinsic value, a plaintiff must establish that the market for the shares was "open and developed or, in other words, efficient." *See In re Parmalat Sec. Litig.*, 375 F.Supp.2d 278, 303 (S.D.N.Y. 2005); *see also* Macey, et al., 77 VIRGINIA L. REV. at 1017 (citing to *Basic*'s theory that "plaintiffs who traded in an efficient market need not prove actual reliance on specific misrepresentations, but their counterparts who traded in an *inefficient* market must"). Thus, "showing a cause and effect relationship between unexpected corporate events or financial releases and an immediate response in the stock price . . . is the essence of an efficient market and the foundation for the fraud on the market theory." *Cammer*, 711 F.Supp. at 1287. However, this Court is concerned with a private sale of the MTI stock following negotiations between representatives of the respective parties and not with a class action involving a public sale

of stock.

In this regard, the Court notes that "[e]vent studies are used not only to establish or rebut the efficient market reliance presumption . . . [they] are also employed to argue that (1) an alleged misrepresentation was or was not material; (2) the misrepresentation did or did not cause any loss to the plaintiff; and (3) if the misrepresentation caused a loss, a measurable part of the loss was due to the fraud, with the rest due to other facts that also affected the stock price." William O. Fisher, *Does the Efficient Market Theory Help Us Do Justice in a Time of Madness?* 54 EMORY L.J. 843, 871 (2005).

At this juncture, the Respondents have, in the view of the Court, not provided sufficient evidence for the Court to make a finding, one way or the other, as to the extent to which the MTI stock traded efficiently/inefficiently. The statement that "event study methodology has its foundation in the efficient markets hypothesis" does not equate with the argument that the stock must trade in an efficient market in order for an event study to have some relevance. Indeed, as noted by the court in *Flag Telecom,* the approach may actually be used to determine market efficiency. *In re Flag Telecom*, 245 F.R.D. at 170; *see also Bombardier*, 2008 WL 4554156 at *10 (pointing out that "[t]o use prices that assume market efficiency in an event study designed to determine whether or not that market is efficient is circular reasoning"). It may be that the market for MTI stock was less than efficient, particularly in light of allegations that a small percentage of the shares was held by the public in contrast to the percentage held by insiders; however, the Court does not believe that the efficiency, or lack thereof, of the market for MTI stock should prevent Movants from offering the report and testimony of Allen. The Respondents will have the opportunity to cross-examine her. In addition, they will have the opportunity to present the testimony and critique of their own experts, assuming that

they are found to be qualified, to counter Allen's analysis and conclusions.

Peer Group Index

"[E]stimating the impact of the release of new information on the value of a stock . . . involves comparing the return on the particular stock with the return to an index of stocks that have not been affected by the information." Stephen Mahle, *Daubert and Commercial Litigation Expert Testimony*, BL FL-CLE 13-1, § 13.27 (2007). The Respondents have questioned Allen's reliance on selected peers using the Bloomberg price index, rather than using an index comprised of fuel cell companies such as Ballard Power Systems Inc. and Energy Research Corporation.

In *In re Executive Telecard, Ltd. Sec. Litig.*, 979 F.Supp. 1021 (S.D.N.Y. 1997), the expert relied on the S & P Telecommunications Index, which was comprised of highly capitalized companies in the communication fields. The court found that they were not comparative to Executive Telecard given that it was "not traded on reported earnings per share, but instead move[d] in accordance with the market's expectations and perceptions of its long term economic prospects." *Id.* at 1027, n.3. The court quoted from a treatise on corporate finance for the premise that "'[a] decent estimate [of damages] is possible if you find traded firms that have roughly the same profitability, risks, and growth opportunities as your firm.'" *Id., quoting* Richard A. Brealy & Stewart Meyers, *Principles of Corporate Finance* at 72 (5th ed. 1996). Accordingly, the court denied the admissibility of the expert's testimony.

On the other hand, in *Carpenters Health & Welfare Fund v. Coca-Cola Co.*, Civil Action No. 1:00-CV-2838, 2008 WL 4737173 (N.D.Ga. March 14, 2008), the court concluded that the expert's report was admissible despite the fact that the expert had used a peer group index that included tobacco companies. The court noted that "the choice of variables in conducting a statistical analysis

is a question of fact rather than a question of method." *Id.* at *3.

In this case, Allen points out that MTI's business was not just fuel cells and, therefore, it is "relevant to test whether MTI's stock price movement is explained by stock price movements of companies that may have common industry factors with MTI." *See* Declaration of Lucy P. Allen, dated October 24, 2008, at 16-17. The question of her use of the Bloomberg index goes to the weight of the evidence but not its admissibility. She should have an opportunity to explain why she believes the index was an appropriate benchmark for her analysis. Her testimony may then be tested on cross-examination and be subjected to scrutiny and criticism by Respondents' own expert(s).

In a letter, dated November 14, 2008 (Dkt. No. 1128), Respondents provided the Court with two recent decisions, which they assert support their request that Allen's testimony and reports be deemed inadmissible. On November 17, 2008, the Movants objected to this late submission (Dkt. No. 1129). In the November 14th letter, Respondents contend that Allen's Declaration of October 24, 2008, referenced above, is inappropriate based on their argument that "[i]t is well-established that a plaintiff may not submit new or modified proposed expert testimony after weaknesses in the original testimony have been pointed out." However, according to *City of Owensboro v. Kentucky Utilities Co.*, Civil Action No. 4:04CV-87, 2008 WL 4542706 (W.D. Ky. Oct. 8, 2008), one of the decisions submitted by the Respondents to the Court,[2] the court noted that "'there is no requirement that such [expert] disclosures cover any and every objection or criticism of which an opposing party might conceivably complain. In other words, an expert need not stand mute in response to an opposing party's *Daubert* motion.'" *Id.* at *2, quoting *Allgood v. General Motors Corp.*, 2006 WL 2669337, *5

[2] The second decision provided to the Court is *In re Human Tissue Products Liability Litig.*, – Fed.Supp.2d –, 2008 WL 4665765 (D.N.J. Oct. 22, 2008).

(S.D. Ind. Sept. 18, 2006). As long as Allen is not attempting to offer an alternative methodology for determining the materiality of what she identifies as "alleged withheld information," the Court finds no basis to exclude her declaration of October 24, 2008. Certainly, the Respondents will have an opportunity on cross-examination at the evidentiary hearing to pursue any new information set forth in her declaration.

In conclusion, at this stage in the proceedings, the Court finds no basis not to admit Allen's report and allow her to testify, as long as she is found qualified as an expert to render an opinion on the issues before the Court.

IT IS SO ORDERED.

Dated at Utica, New York

this 18th day of November 2008

/s/ Hon. Stephen D. Gerling
STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge