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UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

WESTERN DIVISION

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

MICHAEL W. PERRY AND A. SCOTT KEYS,

Defendants.

Case No. CV 11-1309-R JC(x)

MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF DEFENDANT MICHAEL W. PERRY'S MOTION IN LIMINE TO EXCLUDE THE TESTIMONY OF PROFESSOR ANTHONY SAUNDERS

Date: June 18, 2012
Time: 10:00am
Judge: Honorable Manuel L. Real
Courtroom: No. 8

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INTRODUCTION

Defendant Michael W. Perry seeks an order precluding the SEC's economic expert, Anthony Saunders, from testifying about the alleged "materiality" of Defendants' alleged misstatements and omissions.[1]

At the upcoming trial, the SEC will have the burden of proving the materiality of information allegedly omitted from IndyMac's May 12, 2008 filings regarding the two remaining issues in the case—an $18 million capital contribution made by Bancorp to the Bank, and the Office of Thrift Supervision's notification that IndyMac was no longer required to double risk-weight its subprime assets when calculating its capital ratios. *See, e.g., Basic Inc. v. Levinson*, 485 U.S. 224, 238, 108 S. Ct. 978, 987, 99 L. Ed. 2d 194 (1988) ("It is not enough that a statement is false or incomplete, if the misrepresented fact is otherwise insignificant."). Materiality is a sharply contested issue in the case, especially in light of IndyMac's extensive and repeated public disclosures of negative information throughout 2007 and 2008.

To buttress its materiality case, the SEC hired Saunders, an economist, "to analyze . . . the importance and materiality, from an economic point of view, of certain allegedly false and misleading statements." Saunders Rpt. (Exh. A to Maskay Decl.) ¶ 4. Saunders testified that the best indicator of materiality is a company's stock price. Saunders Dep. Trans. (Exh. B to Maskay Decl.) at 108:21-109:9. As Saunders acknowledged during his deposition, he typically

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[1] In addition to his materiality opinions, Saunders opined in his expert reports on the extent of dilution to the book value of IndyMac common stock allegedly resulting from sales of stock through IndyMac's Direct Stock Purchase Plan ("DSPP"). *See, e.g.*, Saunders Rpt. ¶ 6(f). He also opined on the materiality of disclosures regarding the DSPP. *See, e.g., id.* ¶ 6(c)-(e), (g). These opinions are irrelevant in light of the Court's May 21, 2012 entry of partial summary judgment in favor of Mr. Perry on the SEC's DSPP-related claims.

relies on an analysis of a company's stock price to test whether certain disclosures were material, and he has performed such analyses in other cases. Indeed, Saunders testified that, "[n]aturally," such a stock-price analysis was "the first thing" he did in this case to assess whether the alleged misstatements and omissions were material. *Id.* at 35:14-16. When he found that this analysis could not support the SEC's allegations, however, Saunders "didn't keep it because for obvious reasons I wasn't using it." *Id.* at 39:23-24. Instead, Saunders elected to submit an expert report containing materiality opinions based on his subjective speculation about what reasonable investors may have deemed important.

Because Saunders' materiality opinions are speculative and unreliable, they should be excluded. Similarly, Saunders' interpretation of newspaper articles, analyst reports, and other non-technical sources would be of no assistance to the Court and is therefore inadmissible.[2]

BACKGROUND

Saunders opines in his report that six pieces of information relating to IndyMac Bank's capital levels "would have been important to a reasonable investor." Saunders Rpt. ¶ 6(a)-(e), (g). In order to reach these conclusions, he "assume[d] that the facts alleged in the SEC's Complaint in this case are true"; he "survey[ed] [select] analysts' reports"; and he reviewed certain of IndyMac's SEC filings from early 2008. *Id.* ¶¶ 8, 26. Saunders' testimony on materiality is based entirely on his review of these documents, which lead him to speculate that additional information would have been material.

[2] In light of the Court's May 21 decision granting Mr. Perry's motion for partial summary judgment, Mr. Perry believes that expert testimony concerning materiality—by either side—is not necessary. Mr. Perry has attempted to stipulate with the SEC to that effect, but the SEC has refused to do so, thus requiring that Mr. Perry file the instant motion.

In reaching his conclusions, however, Saunders did not rely on any economic or quantitative analysis, despite his acknowledgement that materiality is "reflected . . . most efficiently through the stock price." Saunders Dep. Trans. at 109:8-9. Saunders testified:

> A: I'm an economist. I rely on the market to tell me what the reaction, the aggregation of investors are. They can disagree but the stock price reflects the net aggregation of the investors views. . . .
>
> A: The minds of hundreds of thousands of different investor[s] are reflected . . . most efficiently through the stock price.
>
> Q: That is where you would look to determine materiality; correct?
>
> A: Of a particular piece of information relating to an issue that I'm concerned about.

Id. at 108:21-25, 109:7-14. Although Saunders acknowledges that materiality can be studied " empirically" using a technique known as an "event study," he decided "not to include [the event study] in the report" when he found that the analysis could not support the SEC's allegations. *Id.* at 102:11, 36:3-6; *see also* Exh. C to Maskay Decl. (copy of Saunders' event study).

STANDARD OF REVIEW

Rule 702 of the Federal Rules of Evidence permits a witness qualified as an expert to testify when "scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue." Fed. R. Evid. 702(a). To be admissible, this testimony must be "the product of reliable principles and methods." Fed. R. Evid. 702(c). In interpreting and applying Rule 702, courts have consistently underscored the trial court's role as a gatekeeper to prevent the admission of unreliable or unhelpful evidence. *See, e.g.*, *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579, 592, 113 S. Ct. 2786, 2796,

125 L. Ed. 2d 469 (1993); *Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 149, 119 S. Ct. 1167, 1174-75, 143 L. Ed. 2d 238 (1999).

The Ninth Circuit has explained that "Rule 702 embodies the twin concerns of reliability and helpfulness," and has emphasized that a "court may exclude testimony that falls short of achieving either end." *Stilwell v. Smith & Nephew, Inc.*, 482 F.3d 1187, 1192 (9th Cir. 2007) (internal quotation marks, citation, and ellipsis omitted). "To be admissible, expert testimony must (1) address an issue beyond the common knowledge of the average layman, (2) be presented by a witness having sufficient expertise, and (3) assert a reasonable opinion given the state of the pertinent art or scientific knowledge." *United States v. Vallejo*, 237 F.3d 1008, 1019 (9th Cir. 2001). "Rule 702 demands that expert testimony . . . not include unsubstantiated speculation and subjective beliefs." *Diviero v. Uniroyal Goodrich Tire Co.*, 114 F.3d 851, 853 (9th Cir. 1997).

As demonstrated below, Professor Saunders' proposed testimony on materiality is speculative and unreliable, and would not be helpful to the Court.

ARGUMENT

I. SAUNDERS' MATERIALITY OPINIONS ARE BASED ON SPECULATION, NOT ECONOMIC ANALYSIS, AND ARE THEREFORE UNHELPFUL, UNRELIABLE, AND INADMISSIBLE.

Rather than providing a reasoned economic analysis to support his conclusions about materiality, Professor Saunders asks the Court to accept his subjective and unsubstantiated say-so about how investors would have interpreted additional disclosures by IndyMac. *See, e.g.*, Saunders Rpt. ¶ 6(c) (speculating that a "true understanding" of the facts "would have affected a reasonable investor's assessment of the health and strength of the Bank, its status as a well-capitalized institution and the risk of regulatory intervention, and would have been material to such an investor"). This form of purported expert testimony is

impermissible under Supreme Court and Ninth Circuit precedent. As the Ninth Circuit has explained, "[e]xperts are not to testify to their subjective belief or unsupported speculation." *United States v. Bighead*, 128 F.3d 1329, 1335 (9th Cir. 1997). "[N]othing in either *Daubert* or the Federal Rules of Evidence requires a district court to admit opinion evidence that is connected to existing data only by the *ipse dixit* of the expert." *Gen. Elec. Co. v. Joiner*, 522 U.S. 136, 146, 118 S. Ct. 512, 519, 139 L. Ed. 2d 508 (1997).

Saunders' opinions on materiality are nothing more than such personal "*ipse dixit*." He claims that additional disclosures regarding the $18 million capital contribution and the decision by the Office of Thrift Supervision to allow IndyMac to stop double risk-weighting its subprime assets when calculating its capital ratios "would have been material to . . . investors' decisions" because they "would have affected investors' understanding" of the condition of the Bank. Saunders Rpt. ¶¶ 49, 53. Yet he does not provide any empirical analysis to support these conclusory statements. Instead, he offers only speculation as to what investors "almost certainly" would have believed. Testimony that is "unsubstantiated and subjective" is "speculative and would not assist the trier of fact," and must therefore be excluded. *Diviero*, 114 F.3d at 853; *see also DeMarco v. DepoTech Corp.*, 149 F. Supp. 2d 1212, 1222 (S.D. Cal. 2001) ("Conclusory allegations and speculation carry no additional weight merely because a plaintiff placed them within the affidavit of a retained expert.").

As noted above, even Saunders himself concedes that more is required to assess materiality. Saunders acknowledged during his deposition that he typically relies on an analysis of a company's stock price to test whether certain disclosures were material. Saunders Dep. Trans. at 108:21-109:14. He has also performed such analyses in several other securities fraud cases. *See, e.g., In re Xerox Corp. Sec. Litig.*, 746 F. Supp. 2d 402, 408 (D. Conn. 2010); *Freeland v. Iridium World Comm'cns, Ltd.*, 545 F. Supp. 2d 59, 87 (D.D.C. 2008); Saunders Dep. Trans. at

110:24-111:16. So, "[n]aturally," that was "the first thing" he did in this case to assess whether the alleged misstatements and omissions were material. Saunders Dep. Trans. at 35:14-16. As noted, when he found that this analysis could not support the SEC's allegations, Saunders "didn't keep it because for obvious reasons I wasn't using it." *Id.* at 39:23-24.

Courts concur that such analyses are crucial to the reliable assessment of materiality. Specifically, when the market for a company's stock is efficient—which Saunders believes is a reasonable assumption as to IndyMac, *id.* at 153:11-13, 20-23—experts should use "a concrete method of measuring the materiality of information." *SEC v. Berlacher*, No. 07-cv-3800, 2010 WL 3566790, at *7 (E.D. Pa. Sept. 13, 2010); *see also In re Imperial Credit Indus., Inc. Sec. Litig.*, 252 F. Supp. 2d 1005, 1015 (C.D. Cal. 2003), *aff'd sub nom. Mortensen v. Snavely*, 145 F. App'x 218 (9th Cir. 2005).

Without a rigorous quantitative analysis, however, Saunders' report provides no basis to assess whether the alleged misstatements and omissions in the Q1 2008 10-Q were material. Instead, Saunders is impermissibly "guessing what a reasonable investor would find important." *Berlacher*, 2010 WL 3566790, at *7. "Such expert speculation as to how the market may have perceived certain pieces of information taken out of the context . . . is insufficient to overcome the fact that the unbiased market of reasonable investors clearly determined that the information was immaterial." *SEC v. Mangan*, 598 F. Supp. 2d 731, 737 (W.D.N.C. 2008).

Whatever expertise Saunders may have with respect to the operations of "commercial banks and other financial institutions," Saunders Rpt. ¶ 1, he acknowledges that he is not an "expert on disclosure," Saunders Dep. Trans. at 63:13-14. He has no way of knowing how investors would have interpreted additional disclosures about IndyMac in 2008 without more rigorous analysis.

II. SAUNDERS' NARRATIVE SUMMARIES OF NEWSPAPER ARTICLES, ANALYST REPORTS, AND SEC FILINGS WILL NOT ASSIST THE COURT IN FINDING THE FACTS IN THIS CASE.

The remainder of Saunders' report—indeed, the bulk of the report—consists of a slanted, narrative recounting of IndyMac's public filings, analyst reports, and the SEC's allegations. This testimony is inadmissible, as it will not "help the trier of fact to understand the evidence" in this case. Fed. R. Evid. 702(a).

"To be admissible, expert testimony must address an issue beyond the common knowledge of the average layman." *Mukhtar v. Cal. State Univ.*, 299 F.3d 1053, 1065 n.9 (9th Cir. 2002) (internal quotation marks and ellipsis omitted). In the Ninth Circuit, trial courts "jealously" protect information within common knowledge "from expert elucidation." *United States v. Rahm*, 993 F.2d 1405, 1413 (9th Cir. 1993). Courts have thus repeatedly excluded portions of expert reports that do nothing more than "contain[] a factual narrative of the case and address[] lay matters which a [trier of fact] is capable of understanding and deciding without the expert's help." *Highland Capital Mgmt., L.P. v. Schneider*, 379 F. Supp. 2d 461, 468-69 (S.D.N.Y. 2005) (internal quotation marks omitted); *see also Fener v. Operating Eng'rs Constr. Indus. & Misc. Pension Fund (Local 66)*, 579 F.3d 401, 410 (5th Cir. 2009) (expert testimony recounting analyst opinions is merely "well-informed speculation" that is inadmissible); *Bricklayers & Trowel Trades Int'l Pension Fund v. Credit Suisse First Bos.*, __ F. Supp. 2d __, 2012 WL 118486, at *8 (D. Mass. Jan. 13, 2012) (when an expert's "principal approach was to read all the [company]-related news released on a given day and to make subjective judgments about which news impacted the stock price," it "would be just as scientific" to simply allow the trier of fact to "speculate" as to the effects on the stock price).

Despite this requirement that expert testimony "address an issue beyond . . . common knowledge," *Mukhtar*, 299 F.3d at 1065 n.9, lengthy portions of Saunders' report simply quote IndyMac's SEC filings and summarize the allegations made in the SEC's Complaint. *Id.* ¶¶ 32-34, 40, 50-51. Other portions amount to verbatim statements from selected analyst reports and a newspaper article written in December 2008, several months after the period of the alleged fraud. *Id.* ¶¶ 27-28, 38, 52. Since "[i]t does not require any special competence to read" these public disclosures and commentaries, these portions of Saunders' report are not proper expert testimony. *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1116 (9th Cir. 1989).

Indeed, in restating the contents of these documents, Saunders does not even attempt to place them in the context of the "total mix of information" available to investors at the time, in order to aid the Court's understanding of whether additional information would have been material. *See Basic*, 485 U.S. at 232, 108 S. Ct. at 983 (internal quotation marks and citation omitted). Nor can the SEC salvage Saunders' testimony by "interject[ing] his opinion as to the state of mind and knowledge possessed" by analysts and investors. *Highland*, 379 F. Supp. 2d at 469; *see also Xerox*, 746 F. Supp. 2d at 415 (precluding Saunders from testifying "as to what management knew or should have known").

The Court is well equipped to determine for itself, without the testimony of Saunders, what IndyMac said in its filings and whether the allegedly omitted information would have been material. The type of factual narrative presented by Saunders "is properly presented through percipient witnesses and documentary evidence," not through expert testimony. *In re Rezulin Prods. Liab. Litig.*, 309 F. Supp. 2d 531, 551 (S.D.N.Y. 2004).

CONCLUSION

Excluding speculative opinions like those of Saunders is the essence of the court's gatekeeping responsibility under *Daubert* and its progeny. Here, despite conceding that the standards of his field involve the use of empirical analysis to test materiality, Saunders' proposed testimony rests on no such empirical analysis. By Saunders' own admission, his speculative approach in this case is inconsistent with the "level of intellectual rigor that characterizes the practice of an expert" in his field. *Kumho Tire*, 526 U.S. at 152, 119 S. Ct. at 1176. Accordingly, he should not be permitted to testify at trial.

Dated: May 25, 2012

Respectfully submitted,

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