

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

UNITED STATES OF AMERICA,

Plaintiff

v.

JOSEPH P. NACCHIO

Defendant.

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) **Crim. No. 05-cr-00545-MSK**
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CORRECTED REPORT OF ANJAN V. THAKOR

I. INTRODUCTION

1. My name is Anjan V. Thakor, and I am the John E. Simon Professor of Finance and Senior Associate Dean at the John M. Olin School of Business at Washington University in St. Louis. Prior to that, I was the Edward J. Frey Professor of Banking and Finance at the University of Michigan Business School during 1996-2003 and Chairperson of the Finance Department at the University of Michigan Business School during 2000-2003. I was previously NBD Professor of Finance and Chairperson of the Finance Department at the School of Business at Indiana University. I have also been Visiting Associate Professor of Finance at the J.L. Kellogg School of Management at Northwestern University (1983-85) and Visiting Professor of Finance at the University of California at Los Angeles (1987-88).

2. I have published (or have forthcoming for publication) over 75 research articles in top academic journals on various topics in economics and finance, and have published over 100 articles in all. I have written numerous monographs for banking industry associations on various topics in banking. I have also published seven books, including a banking textbook, a corporate finance textbook for MBA students, and various other books. The details of these publications are provided in my curriculum vitae, which is attached as *Exhibit 1*.

3. I am a past President and current member of *The Financial Intermediation Research Society*. I am also currently a member of *The American Finance Association*, *The Western Finance Association*, *The American Economic Association*, and *The Royal Economic Society*. I have served on the Nominating Committee for the Nobel Prize in Economics from 1993 until 2004.

4. I am on the Editorial Advisory Committee of *The Journal of Financial Intermediation*, an academic journal that publishes scholarly research articles in the financial services area. I was Managing Editor of *The Journal of Financial Intermediation* during 1996-2005. I am associate editor of *The Journal of Banking and Finance* which also publishes scholarly articles in finance and banking.

5. On behalf of *The Journal of Financial Intermediation*, I have organized numerous banking conferences that have brought academics, regulators and policy-makers together to discuss various issues in bank regulation. Many of these have been in collaboration with Federal Reserve Banks. Recent conferences have been organized with the Federal Reserve Banks of Philadelphia, New York, and Boston, as well as with the Bank for International Settlements in Basel, Switzerland.

6. I have on two occasions been invited as a Distinguished Scholar by The Board of Governors of the Federal Reserve to spend a week each time to serve as a consulting resource

for the Board's research economists. I have also been a Visiting Scholar on multiple occasions at the Federal Reserve Bank of New York. I was invited by the Federal Reserve to join a team of economists to deliberate financial system regulatory reform with a working group consisting of Federal Reserve Bank Presidents and Federal Reserve governors.

7. I have served as a consultant to a number of corporations and boards of directors and have taught many executives. My work has covered a variety of topics, including cost of capital, capital structure, security design, payout policy, financial metrics, capital allocation, financial valuation, risk management, capital markets, and corporate governance.

II. SCOPE OF ASSIGNMENT

8. A federal grand jury found that Joseph Nacchio, as the former Chief Executive Officer of Qwest Communications International, Inc. ("Qwest"), violated securities laws by willfully trading Qwest stock based on material non-public information and engaging in insider trading for personal benefit. Specifically, the government charged that Mr. Nacchio,

"... did knowingly and willfully, directly and indirectly, by the use of means and instrumentalities of interstate commerce and of the mails, and the facilities of a national securities exchange use and employ, in connection with the purchase and sale of a security registered on a national securities exchange, a manipulative and deceptive devise, scheme, artifice or contrivance to defraud in contravention of Rule 10b-5 (17 C.F.R §240, 10b-5) and Rule 10b5-1 (17 C.F.R. §240, 10b5-1) prescribed by the United States Securities and Exchange Commission"¹

9. Mr. Nacchio was indicted and charged in December 2003 with forty-two counts of insider trading. He was ultimately convicted on nineteen counts of insider trading covering trades made between April 26, 2001 and May 29, 2001. The United States District court for the District of Colorado sentenced Mr. Nacchio to seventy-two months' imprisonment on each count, to run concurrently, and two years of supervised release on each count, also to run concurrently. The District Court also assessed a \$19 million fine and ordered him to forfeit approximately \$52 million. On appeal, Mr. Nacchio alleged that the district court incorrectly calculated his "gain resulting from the offense." The Tenth Circuit reversed the district court's sentencing order with respect to its gain calculation and its forfeiture determination and remanded for resentencing consistent with this opinion. The Tenth Circuit held that "Mr. Nacchio's gain should be calculated in a manner that is more narrowly focused on producing a figure that reflects, in at least approximate terms, the proceeds related to his criminally culpable conduct (i.e., trading on material, nonpublic information.)"²

¹ Grand Jury Indictment of Joseph P. Nacchio.

² See, Appeal from the United States District Court for the District of Colorado (D.C. No. 05-CR-545-K), at 14.

10. The United States Department of Justice has asked me to review the facts pertaining to the trades for which Mr. Nacchio was convicted and make a determination of his ill-gotten gains in a manner consistent with the Tenth Circuit's guidelines.

11. For my work on this case, I am being compensated at a rate of \$650 per hour. My compensation is not contingent in any way upon the conclusions I reach here or outcome of Mr. Nacchio's re-sentencing.

III. SUMMARY OF METHODOLOGIES AND OPINIONS

12. My area of expertise is Financial Economics, as explained in the earlier paragraphs. I addressed the question of the size of Mr. Nacchio's ill-gotten gains using methodologies that are well-accepted in academic research in Finance; numerous research articles have been published in the leading journals in the field using those methodologies.

13. The first methodology I used is called an *event study*, which is briefly described in *Appendix A*. The event study methodology, a technique developed by financial economists that has been used extensively in both academic research and securities fraud cases, relates changes in stock prices to the release of new information. With an event study, one identifies first a specific event date on which new information was released to the stock market. Then one identifies an "event window," which in this study is either just the initial reaction date (one-day window), or also additionally includes the day after the initial reaction date (two-day window). After this, one measures how much the price of the security in question changes during the event window. From this change, one subtracts the change that one would have expected due to the movement of the entire market and/or the industry to which the firm in question belongs. The idea is to eliminate portions of the movements in the stock price that are attributable to broader market or industry movements that have nothing to do with the *firm-specific* information disclosure in question. The resulting return is called an "abnormal return" or a "cumulative abnormal return" (if one is adding up abnormal returns over multiple days in the event window), often referred to as "CAR".³ The final step is to examine whether this CAR is statistically significant (i.e. not just caused by random noise), a measure of materiality. This methodology allows me to focus on price movements that are specific to the disclosures of the

³ There are numerous papers that have explained the event study methodology. See Cornell, Bradford and R. Gregory Morgan, "Using Finance Theory to Measure Damages in Fraud on the Market Cases," *UCLA Law Review* 37-883, June 1990; Mackinlay, Craig A., "Event Studies in Economics and Finance," *Journal of Economic Literature* 35, March 1997, pp. 13-39; and Mitchell, Mark, L. and Jeffrey M. Netter, "The Role of Financial Economics in Securities Fraud Cases: Applications at the Securities and Exchange Commission," *Business Lawyer* 49-2, February 1994, pp. 545-590.

non-public information in question, controlling for unrelated market forces, in accordance with the Tenth Circuit's guidelines.⁴

14. I use the event study methodology to examine the CARs associated with eight specific information disclosure events related to Qwest, starting on June 20, 2001 and concluding July 29, 2002. I find that seven of the eight information disclosure events were followed by statistically significant, negative CARs, indicating that material information was disclosed, leading to substantial declines in Qwest's stock price.

15. The percentage decline in Qwest's stock price over this time period that is associated with statistically significant CARs is an indication of the "valuation impact" of the non-public information available to Mr. Nacchio at the time of his trades between April 26, 2001 and May 29, 2001, for which he was convicted of illegal insider trading. Because Qwest chose not to disclose this information earlier, it avoided the significant price decline that occurred as a result of the disclosure, which enabled Mr. Nacchio to sell his stock at higher prices than would have been possible in a full-disclosure world.⁵ The cumulative impact of these disclosures therefore represents Mr. Nacchio's gain from trading on material, non-public information. Using one-day event windows, the CAR from these disclosures was -45.12%. Using two-day event windows, the CAR was -63.30%.

16. Applying these percentages to Mr. Nacchio's total proceeds from selling his shares of \$52,007,548.98, I calculate his gains from trading on material, non-public information to be \$23,465,806.10 using one-day event windows, and as \$32,920,778.50 using two-day event windows.

17. One important condition for properly capturing the information content of events using the event-study methodology is that event studies look at announcement effects over short-term horizons, which requires sharply-defined events. However, in this case, information trickled into the market in small bits over time, which may have tended to diffuse the effect of specific disclosures; I discuss later various examples related to how information trickled into the market

⁴ For example, the Tenth Circuit states, "Therefore, from a policy perspective, it makes sense to adopt a sentencing guideline that is focused on a defendant's criminally culpable conduct and has the effect of excising – even if not completely – unrelated market forces from the sentencing calculus, thereby narrowing the zone of unpredictability in sentencing," Opinion of the United States Court of Appeals, Tenth Circuit, July 31, 2009.

⁵ The eight disclosure events I examine have to do primarily with information that provided investors with additional clarity about the levels of Qwest's recurring and non-recurring revenues, and hence improved investors' understanding of the quality and sustainability of Qwest's revenues. As Chief Executive Officer of Qwest, Mr. Nacchio had access, at the time of his trades, to the kind of information that was only later disclosed.

over time. In such situations, the price reactions to specific disclosures tend to be smaller than if all the information came out in a single disclosure on a single event date. Moreover, if the information is smeared out sufficiently uniformly over time, then no single event may be associated with statistically significant CARs, and yet *in the aggregate* the information revealed may have been significant. This means that even the statistical significance of the CARs associated with identifiable events may be biased downward in such cases.

18. To deal with this potential issue, I conducted a second analysis, in which I examine longer-term, buy-and-hold cumulative returns.⁶ This methodology is briefly described in *Appendix B*. It involves creating a portfolio of firms with characteristics similar to Qwest, and comparing their stock price performance to that of Qwest over an extended period of time. This analysis shows that Qwest shares underperformed those of similar companies by a statistically significant margin during the period June 20, 2001 through July 29, 2002, which encompasses all of my event study disclosure dates. I therefore conclude that this alternative approach corroborates the finding of the event study, that most of the disclosure events during June 20, 2001 – July 29, 2002 revealed material, negative information to market participants.

19. Proper application of these research methodologies requires that certain conditions be met:

- it is verified that the market for the stock in question is efficient;
- relevant information disclosure events are identified; and
- potentially contaminating pieces of information unrelated to the disclosure of the non-public information in question have been identified for each of the events to make sure that the document CARs can be attributed to the disclosure of non-public information.

20. In accordance with these guidelines, I have conducted a third analysis, in which I verified that the market for Qwest shares was efficient based on a number of factors, including average daily trading volume and the analyst coverage of the stock. Moreover, I have identified the relevant information disclosure events during June 20, 2001 – July 29, 2002. Finally, for each of the events, I checked to verify that there were no other pieces of contaminating pieces of information that could have explained the CARs that I document for the event.

21. Based on my analysis, it is my opinion that Mr. Nacchio's gains from trading on material, non-public information for which he was convicted amount to at least \$23,465,806.10, and possibly \$32,920,778.50.

⁶ This approach is also used extensively in academic finance research. See, for example, Lyon, John, Brad Barber and Chih-Ling Tsai, "Improved Methods for Tests of Long-Run Abnormal Stock Returns", *Journal of Finance* 54-1, February 1999, pp. 165-201.

IV. ANALYSIS

22. In this section, I discuss the analysis that leads to each of my conclusions. The documents that I have considered in performing this analysis and reaching my conclusions are listed in *Exhibit 2*.

23. This section proceeds as follows: I first discuss the market efficiency issue. I then explain how I identified the relevant disclosure events for my event study, followed by the potential information contamination issue. Then I describe the event study and the buy-and-hold analysis. I close with a discussion of the potential effect of Mr. Nacchio “talking up” Qwest as a “growth stock.”

A. TESTS OF MARKET EFFICIENCY

24. I begin with tests of the efficiency of the market for Qwest’s shares. To start with, I note that the fact that Qwest traded on the New York Stock Exchange is in itself a strong indication that the market for the company’s shares would be efficient. I have performed a series of tests, as indicated in *Cammer v. Bloom* and other cited cases, and also find that the market was efficient.⁷ A brief discussion of these tests follows.

- In *Cammer v. Bloom*, the Court noted that high levels of trading volume can improve the efficiency of a market, and that weekly volume of 1 – 2% of shares should be sufficient to conclude a market was efficient. From 1999 through 2002, Qwest’s annual average weekly volume ranged from 2.39% to 5.61%. This indicates sufficient volume for an efficient market.
- The number of securities analysts covering a stock can also be informative about the efficiency of the market for a stock. In general, a greater number of analysts covering a stock leads to greater dissemination of information and analysis regarding the company, and thus a more efficient market. From 1999 through 2002, I found between 21 and 46 separate analysts following the company at any point in time, and these analysts issued more than 1,000 research reports on Qwest’s shares. This depth of analyst coverage is consistent with an efficient market.
- In much the same way, a greater number of market makers and institutional investors can promote the rapid incorporation of information into a stock price. From 1999 through 2002, more than 300 institutions reported owning shares of Qwest, and numerous firms claimed to make a market in Qwest’s shares. This is also consistent with an efficient market.

⁷ *Cammer v. Bloom*, 711 F. Supp. 1264, 1276, 1280 (D. N.J. 1989).

- Finally, in *Cammer v. Bloom*, the Court recognized that firms that are able to register new securities using a Form S-3 are more likely to trade in an efficient market because of the Form's public float requirements. From 1999 through at least mid-2002, Qwest was able to register securities using a Form S-3. Indeed, the company filed a Form S-3 on February 5, 2002.

25. These findings lead me to conclude that the market for Qwest's shares was efficient and would rapidly incorporate new information into Qwest's stock price. Given an efficient market for Qwest's shares from 1999 – 2002, event study analysis is appropriate for measuring the stock price reaction to specific events during this period and deducing the information content.

B. THE EVENT STUDY

26. Having identified the market for Qwest's shares as efficient, the next step is to identify the proper event dates to examine.⁸ To identify the events associated with such disclosures, I have conducted an extensive analysis of news articles, financial filings and analyst reports and have identified the following dates on which the market obtained new information relating to the composition of Qwest's revenues. In particular I identified disclosures specifically pertaining to the levels of recurring and non-recurring revenues, and their implications for the company's future revenue growth; this was the information that Qwest withheld at the time of Mr. Nacchio's illegal stock sales. In addition to the three dates on which the company itself presumably disclosed the extent of its IRU transactions and equipment sales, both of which were sources of non-recurring revenue, I also identified several dates on which relevant information was revealed to the market by *other* participants, including analysts, news media, or regulatory agencies. Such third-party disclosures are not uncommon in securities fraud disputes, and a complete event study analysis should take them into consideration.⁹ The viewpoint in identifying event dates was to look for events that involved disclosure of previously withheld information that could potentially affect investors' assessments of Qwest's value, such as the quality and sustainability of revenues. In particular, an important issue was the clarity investors had about Qwest's recurring revenues, the part of its revenues derived from one-time transactions, and the impact of the various information disclosures on investors' perceptions of the gap between Qwest's publicly-stated financial targets and recurring revenues. The complete list of dates I have examined are as follows:

⁸ See, e.g., Cornell, Bradford, and R. Gregory Morgan, "Using Finance Theory to Measure Damages in Fraud on the Market Cases," 37 *UCLA Law Review* 883 (1990).

⁹ See, e.g., Cornell, Bradford, and R. Gregory Morgan, "Using Finance Theory to Measure Damages in Fraud on the Market Cases," 37 *UCLA Law Review* 883 (1990).

- On June 20, 2001, Morgan Stanley Dean Witter issued an analyst report downgrading Qwest's shares because of concerns with revenue recognition on the part of Qwest.¹⁰ The analyst questioned the sustainability of the company's revenue growth, which had obvious valuation implications. While several other firms, including Lehman Brothers¹¹ and Goldman Sachs¹², did not consider the accounting issues to be serious, this report represents the beginning of a series of disclosures that revealed to the market previously undisclosed information that was potentially relevant for valuation.
- On August 7, 2001, Mr. Nacchio told investors at a Piper Jaffray conference that Qwest had generated \$540 million in revenue from IRU transactions in the first six months of 2001; revenue from IRU sales was considered non-recurring.¹³ Qwest also filed a Form 8-K to the same effect.¹⁴ This was the first acknowledgment from the company since 1999 that it was still involved in IRU transactions.¹⁵ While presenting this report, Mr. Nacchio also indicated that IRU sales were non-recurring revenues, similar to installation fees or asset sales. However, the disclosure also included many more presentation slides emphasizing that Qwest's growth rate significantly exceeded that of its peers and that "'non-recurring' broadband capacity sales" were decreasing as a percentage of total revenue.
- Qwest filed its Form 10-Q for the quarter ending June 30, 2001 after trading hours on August 14, 2001. In this filing, Qwest included for the first time since its 1998 Form 10-K the amount of IRU sales.¹⁶ The Form 10-Q also included other financials and comments

¹⁰ "Qwest Disputes Analyst's Report," Associated Press Online, 6/20/2001; "Qwest Down as it Rebut's Report," TheStreet.com, 6/20/2001 (2:25 PM EDT).

¹¹ Lehman Brothers, "Company Update: Buy Q On This Dip - Accounting 'Issues' Not Real," 6/21/2001.

¹² Goldman, Sachs & Co., "Q: An Accounting Lesson, but No Change to Underlying Fundamentals or Cash Growth," 6/21/2001.

¹³ Qwest's own internal documents listed IRU sales as non-recurring. For example, Gregory Casey, Qwest's Senior Vice President of Wholesale Markets, referred to IRU sales as the largest component of one-time revenue at Qwest for the period beginning in 1998. (See, Testimony of Gregory Casey, p. 1079.)

¹⁴ Qwest Communications Inc. Form 8-K, filed August 7, 2001.

¹⁵ In fact, many of Qwest's filings in 1999 had indicated to market participants that IRU sales—which had been a part of the Construction Services segment of the company—had *declined* substantially. For example, in its Forms 10-Q for the quarters ending June 30, 1999 and September 30, 1999, Qwest made disclosures regarding the diminishing significance of Construction Services revenue. In its Form 10-Q for the quarter ending June 30, 1999, filed August 11, 1999, the company stated that it "expects that revenue from Construction Services will be less than \$20 million for the remainder of 1999." (See, Qwest Communications Inc. Form 10-Q for the period ending June 30, 1999, filed August 11, 1999, p. 16.) For the quarter ending September 30, 1999, Qwest commented that "The Company expects that revenue from Construction Services will be incidental for the remainder of 1999." (See, Qwest Communications Inc. Form 10-Q for the period ending September 30, 1999, filed November 15, 1999, p. 16.)

¹⁶ Qwest Communications Inc. Form 10-Q for the period ending June 30, 2001, filed August 14, 2001.

related to how the adoption of a new accounting standard would reduce annual amortization expense going forward.

- On August 22 and 23, 2001, analyst reports from Morgan Stanley Dean Witter and Davenport & Co. explained that Qwest's accounting for non-recurring IRU sales had the effect of overstating past revenue growth rates, and that these growth rates were unsustainable moving forward,¹⁷ although other analysts remained somewhat skeptical about the concerns expressed by Morgan Stanley Dean Witter and Davenport & Co.¹⁸ This was also potentially value relevant.
- On September 27, 2001, CalPoint disclosed in documents relating to a private debt placement that it had negotiated a previously undisclosed series of swap transactions with Qwest.¹⁹ In these transactions, Qwest agreed to sell CalPoint approximately \$200 million worth of equipment during the second half of 2001, while Qwest would purchase managed-wavelength services from CalPoint. Although participants exchanged no cash in these swap transactions, Qwest had recognized the associated sales as upfront revenues. Analysts indicated that this further revealed Qwest's non-recurring revenue streams and unsustainable growth rates.²⁰
- On October 31, 2001, Qwest announced its earnings for the third quarter of 2001, which fell short of the market's expectations. According to Qwest, this was due to a decline in the market for IRU sales.²¹ The company also disclosed the existence of non-recurring equipment sales, which had declined in this period. In a report the next day, J.P. Morgan indicated that "Qwest has historically traded at a premium to its competitors on the basis that it appeared to be growing revenues at a faster rate. It appears now that revenue growth in prior periods was overstated."²² The market reaction to this earnings release provides an indication of how the market may have reacted to prior earnings announcements in 1999 and 2000, had the extent of IRU and equipment sales, and Qwest's revenue recognition with respect to these transactions, been revealed at that time.
- On February 13, 2002, the Wall Street Journal identified four swap transactions over the previous two years in which Qwest sold equipment to KMC Telecom Holdings, Inc., and

¹⁷ Morgan Stanley Dean Witter, "Qwest: Listening to the 10-Q," 8/22/2001; Davenport & Company, "Lowering Rating from Buy (1) to Underperform (4); Lowering Estimates," 8/23/2001.

¹⁸ Prudential Securities, "Q: Stock Under Pressure, but Valuation Low and Business Healthy," 8/27/2001.

¹⁹ See, e.g., Mannes, George, "For Qwest, More Accounting Gripes," TheStreet.com, 9/28/2001.

²⁰ See, e.g., J.P. Morgan, "Qwest Communications: More Revenue Quality Concerns," 9/28/2001; Banc of America Securities, "Qwest Communications International: Downgrading Shares of Qwest to Buy from Strong Buy; Lowering Revenue & EBITDA Estimates; Adjusting Price Target," 10/1/2001.

²¹ Qwest Communications Inc. Form 8-K, filed October 31, 2001.

²² J.P. Morgan, "Qwest Communications: 3Q Below, Maintain as Market Performer," 11/1/2001.

also agreed to pay millions of dollars for internet services using the same equipment.²³ The equipment sales identified by the Wall Street Journal, which were distinct from the CalPoint transaction discussed above, amounted to \$450 million, revenue that Qwest recognized upfront even though it received no cash. Drake Johnstone, securities analyst at Davenport & Co. noted that these swap transactions, in which the participants exchange no cash and may inflate sale prices for their mutual benefit, give “the impression that they’re growing at a higher-than-expected rate.”²⁴

- On July 29, 2002, Qwest announced that it expected to restate financial results for 1999 through 2001 due to improper revenue recognition in connection with IRU sales.²⁵ While the total magnitude of the restatement was unclear at the time, the company revealed that \$874 million in revenues were booked upfront rather than over time. This had the impact of overstating revenue at the time this amount was booked as revenue, and thus brought into question the reliability of Qwest’s statements about its recurring revenue and the sustainability of its revenue.

27. I have identified these as relevant event dates because they represent various points in time at which information pertaining to the levels of Qwest’s recurring and non-recurring revenues trickled into the market and had the potential effect of gradually undoing the earlier obfuscation in Qwest’s reporting and Mr. Nacchio’s public statements. It is apparent from the statements of professional stock analysts that they continued to be unsure about how to interpret Qwest’s financials well after the company lowered its earnings guidance on September 10, 2001. For example, Morgan Stanley Dean Witter commented in a report dated September 11, 2001:

“The composition of IRU versus non-IRU revenues and margins was not provided, nor was there any detailed split of revenues and profits between US WEST and Qwest.” [Emphasis added]²⁶

28. Continuing the theme, on October 8, 2001, ABN AMRO remarked:

“[T]he quality of Classic Qwest revenues have been muddled with sales that resemble asset swaps as well as sales of equipment not related to Qwest’s core product line... Without access to this information, which we may not receive until the company files its 10-K for 2001, it is simply

²³ Liesman, Steve and Deborah Solomon, "Deals With KMC Helped Qwest to Improve Its Books," Wall Street Journal, 2/13/2002.

²⁴ Liesman, Steve and Deborah Solomon, "Deals With KMC Helped Qwest to Improve Its Books," Wall Street Journal, 2/13/2002.

²⁵ Qwest Communications Inc. Form 8-K, filed July 29, 2002; Young, Shawn, "Leading the News: Qwest to Restate Results, Withdraw Forecasts for 2002," Wall Street Journal, 7/29/2002.

²⁶ Morgan Stanley, "Qwest Communications International: Lowering Guidance: Maintain Neutral," 9/11/2001.

too early to determine what percentage of our 2002 revenue and EBITDA estimate might be associated with equipment sales and/or effective asset swaps recorded as revenues as happened in 2Q01."²⁷

29. In a follow-up report dated November 1, 2001, ABN AMRO further commented on Qwest's lack of disclosures:

"The difficulty begins anew this quarter as Qwest has for the first time reported the growth of the recurring Internet, Data and IP services, whereas in the past, the company spoke of only growth in total Internet, Data and IP services revenues, not growth in recurring services revenues." [Emphasis added]²⁸

30. In a December 11, 2001 report, Merrill Lynch regrets not having been able to see through Qwest's misleading financials:

"Qwest's reporting of revenues does not make for helpful comparisons with peers nor does it provide a clear view of revenue drivers... We suspect many (us included) regret not having been more insightful in identifying the decline in revenue quality here and consequent rise in revenue risk." [Emphasis added]²⁹

31. These comments reflect a lack of clarity among analysts with respect to the impact of Qwest's non-recurring IRU and equipment sales on its reported revenue and the future predictability of its revenue. I would therefore anticipate that the stock market would react when information was disclosed that revealed the deception and added clarity to Qwest's reliance on non-recurring IRU and equipment sales in its reported revenue and the future predictability of its revenue.

32. I also conducted an extensive search of news announcements during each of the above event dates to verify that there were no other contemporaneous events unrelated to the disclosure of the non-public information in question that might contaminate the effect produced by the disclosure of the relevant non-public information. My search did not reveal any confounding events with *negative* information content for the event dates I have identified.

33. I then conducted event study analyses on Qwest's stock price movements for each of these disclosure dates, using a multifactor model to control for broad market and industry influences. More specifically, I quantified the relationship between the daily returns on Qwest's shares and those of the broad market, represented by the New York Stock Exchange Composite Index, and Qwest's industry, represented by the American Stock Exchange North American

²⁷ ABN AMRO, "Is the Dust Beginning to Settle?" 10/8/2001.

²⁸ ABN AMRO, "Disappointing 3Q; Downgrading to Hold from Add," 11/1/2001.

²⁹ Merrill Lynch, "Investor Day Preview - Expect Form but Limited Substance," 12/11/2001.

Telecommunications Index. I estimated this relationship using an estimation window of 252 trading days—the equivalent of one year of trading data—ending 20 days prior to each event.³⁰

34. The results of my event study are shown in *Exhibit 3*. I have examined the stock price reactions on the day of the disclosure (or the day after the disclosure for events that occur after the close of trading), the subsequent trading day, and the two-day cumulative price reaction. I report the results of tests of the statistical significance of each of the residual, or abnormal, returns.³¹ In each case, given the steady stream of earnings reassurances provided by Qwest – at least through late 2001 – and the lack of clarity when the relevant information about IRU sales was disclosed, the confounding-information bias works *against* finding statistically significant negative abnormal returns. Hence, the discovery of such returns despite these forces provides strong evidence of the materiality of the negative information in this context. My findings are summarized below:

- The Morgan Stanley Dean Witter report on June 20, 2001 was associated with a statistically significant, one-day abnormal return of -5%.
- Qwest’s August 7, 2001 presentation, which included IRU sales for the first half of 2001, was not followed by a statistically significant price movement. This may, in part, be because the presentation was not sufficiently clear about the implications of the IRU sales for Qwest’s overall revenue, and also because of other possibly confounding information included in the presentation.
- Qwest’s August 14, 2001 Form 10-Q filing was not followed by statistically significant abnormal returns. Since negative information was disclosed, the absence of any statistically significant announcement effect suggests that either the information was not considered material or that there was confounding information with possibly positive information content. The consistently positive statements about earnings made by Mr. Nacchio may be an example of such information. Moreover, as described above, the Form 10-Q contained a number of new disclosures, including IRU sales for the first half of 2001, which may have also had an effect.
- The analyst reports from Morgan Stanley Dean Witter and Davenport & Co. on August 22 and 23, 2001, respectively, were associated with statistically significant price drops on both days. The one-day abnormal returns for August 22 and 23 were -4.8% and -6.7%,

³⁰ This is consistent with the practice adopted by the author of an authoritative survey article on event studies. See, A. Craig MacKinlay, “Event Studies in Economics and Finance,” 35 *Journal of Economic Literature* 1 (March 1997). My event study methodology is explained in more detail in *Appendix A*.

³¹ I have employed the 95% one-tailed confidence level, which is equivalent to the 90% two-tailed confidence level as the threshold for statistical significance.

respectively. The cumulative two-day abnormal return was -11.3% and was statistically significant.

- On September 27, 2001, there was a disclosure of equipment sales from Qwest to CalPoint. This resulted in a statistically significant abnormal return of -14.2% in the one-day window, and a statistically significant abnormal return of -15.5% in the two-day window.
- Qwest's disappointing earnings announcement on October 31, 2001, was followed by two days of statistically significant, negative abnormal returns. The one-day window showed a statistically significant abnormal return of -17.9%. The cumulative two-day abnormal return was -25.2%. It was also statistically significant.
- There was a February 13, 2002 Wall Street Journal article disclosing swap transactions involving equipment sales by Qwest. This was followed by two days of statistically significant price drops. The one-day windows showed abnormal returns of -5% and -9.5%. The cumulative two-day abnormal return was -14% and was also statistically significant.
- Qwest announced a restatement of earnings on July 29, 2002. This was also followed by two days of statistically significant share price declines. The one-day windows showed abnormal returns of -9.3% and -16.2%. The two-day cumulative abnormal return was -23.9% and was also statistically significant.
- The cumulative impact of these disclosures was also statistically significant. Considering only the one-day windows, the cumulative abnormal return from these disclosures was -45.12%. With the two-day windows, the cumulative abnormal return is -63.30%.

35. In interpreting the findings of the event study analyses on these dates, I have been careful to deal with the potential influence of confounding information on event dates. Specifically, I note that the effect of confounding information would have been to push the abnormal returns *away* from being statistically significantly negative. For example, as discussed earlier, the lack of statistical significance for the August 14, 2001 disclosure may have been due to this. Similarly, the October 31, 2001 earnings announcement may also have been affected by confounding information. In particular, Qwest specifically noted that the earnings miss was due to a decline in IRU and equipment sales, which it recognized as non-recurring revenue, and emphasized that recurring service revenue had increased. This confounding information may have led my analysis to generate a smaller absolute value (*i.e.* closer to zero) for the abnormal return than I would have otherwise observed.

36. Overall, the analysis reveals that market participants were interested in the predictability and growth of Qwest's revenue and earnings. By failing to disclose to investors

the extent of its non-recurring IRU and equipment sales and to clarify the implications of this for the quality and sustainability of Qwest's revenues, Qwest made it difficult for investors and analysts to understand the predictability of the company's revenue and earnings, thereby impeding a reliable valuation of the company. When the extent of its non-recurring IRU and equipment sales, and the implications of this for recurring revenue growth, became clear to investors, either from the company or through third-party sources, they adjusted their valuations and Qwest's stock price declined significantly.

37. As I noted earlier, these significant, negative price declines occurred during a period in which Mr. Nacchio continued to make comments refuting analysts' concerns and supporting the idea that Qwest's revenues were predictable and consistent. The presence of any negative, significant abnormal returns in this environment is worth noting.

38. The next step is to use this information to compute Mr. Nacchio's ill-gotten gains. I begin by listing all of the insider trades for which Mr. Nacchio was convicted. See *Exhibit 4*.

39. I then apply the cumulative (negative) CARs of -45.12% and -63.30% associated with the one-day and two-day windows respectively to the \$52,007,548.98 of proceeds collected by Mr. Nacchio on the insider trades for which he was convicted, in order to calculate his ill-gotten gains. These calculations appear in *Exhibit 5*. They show that the *minimum* estimate of the ill-gotten gains is \$23,465,806.10, and it is possible that the gain resulting from trading on material, non-public information was \$32,920,778.50.

C. LONGER-TERM PRICE REACTIONS TO INFORMATION DISCLOSURES

40. As I mentioned earlier, analyses of short-term price reactions, such as event studies, may be limited in their scope under certain circumstances. By definition, event studies look at announcement effects over short time horizons; this requires sharply-defined events. When information trickles into the market gradually over time, rather than in identifiable bursts, longer-horizon buy-and-hold cumulative returns may supplement our understanding from the event studies. Thus, I have conducted an analysis of Qwest's long-term stock price returns using a methodology that is frequently used in peer-reviewed academic journals. In general, the findings are consistent with my event study results—as investors became incrementally aware of the extent of Qwest's reliance on non-recurring revenues, including equipment sales and IRU revenues and the upfront recognition of such revenues, they lowered their valuations of Qwest's shares and its stock price fell.

41. The buy-and-hold cumulative return analysis, explained in more detail in *Appendix B*, involves creating a portfolio of firms with similar characteristics to Qwest, and comparing their

stock price performance to that of Qwest over an extended period. For the purpose of matching Qwest to its industry peers, I select these matching firms from the NASDAQ Telecommunications Index. The selection of matching firms from this index allows me to test whether Qwest's stock price was being impacted solely by industry declines, or if there were other factors that caused it to underperform these matched firms.

42. As shown in *Exhibit 6*, I find that Qwest shares underperformed similar companies by a statistically significant margin. As the exhibit shows, these findings are robust across a number of different matching criteria, including company size, the ratio of book value to market value, prior performance, beta, and combinations therein.

43. Finally, I note that measures of Qwest's stock price performance during the one-, two- and three-year periods *prior to the start of the analysis period* indicate that during these prior periods, Qwest was *not* underperforming its peers. This further suggests that market reacted negatively and significantly to the multiple disclosures of Qwest's IRU transactions and equipment sales, and the negative information this conveyed to investors about Qwest's future revenues.

44. Based on all of the analyses and evidence discussed above, I conclude that various disclosures related to the make-up of Qwest's recurring and non-recurring revenues, including Qwest's IRU transactions and equipment sales were material information for market participants, and that Qwest's stock price declined when investors became aware of the extent of these sales.

D. QWEST'S PERCEPTION AS A "GROWTH" STOCK

45. The final issue has to do with the fact that Mr. Nacchio was consistently promoting Qwest as a "growth" stock, despite the fact that Qwest's earnings growth was predicated on non-recurring revenues that were not sustainable. For example, in a teleconference with investors on July 27, 1999, Mr. Nacchio stated that Qwest had "successfully navigated the transition from **one-time construction revenues** to services." [Emphasis added]³² The following quarter, Mr. Nacchio told investors and analysts that the company's strong revenue growth was due to "strong demand on the wholesale side, particularly for broadband capabilities;"³³ as I have discussed earlier, Qwest did not disclose until much later the extent to which its reported revenue numbers depended on booking IRU and equipment sales as upfront revenue. Mr. Nacchio further reinforced the image of Qwest as a growth company by stating that "We've said from the beginning that we are creating a growth company and our results clearly show

³² Qwest teleconference, July 27, 1999.

³³ Qwest teleconference, October 27, 1999.

the steps we've taken... and rapidly growing our Internet and data business segment."³⁴ In finance research, it is well known that stocks with higher growth potential are valued higher.³⁵ By inflating the market's expectations about Qwest's future earnings growth, Mr. Nacchio likely increased Qwest's price earnings multiples above the levels they would have been at had the disclosures made during 2001-02 occurred earlier. The event study and the buy-and-hold returns analyses support the view that market participants lowered Qwest's valuation when they recalibrated their expectations in response to the various disclosures that have been examined in this report.

V. CONCLUSION

46. Based on the evidence I have seen and the analyses described above, it is my opinion that the gains from Mr. Nacchio's trades on material, non-public information for which he was convicted amount to at least \$23,465,806.10, and possibly \$32,920,778.50.

³⁴ Qwest Communications Inc. Form 8-K, filed October 28, 1999.

³⁵ See, for example, Boquist, John, Todd Milbourn and Anjan V. Thakor, *The Value Sphere*, World Scientific Press, 2009.

Respectfully,

s/ Anjan V. thakor

Anjan V. Thakor

January 12, 2010

EXHIBIT 1

ANJAN V. THAKOR
Curriculum Vitae
(November 2009)

CURRENT POSITION: John E. Simon Professor of Finance and Senior Associate Dean and Research Associate, *European Corporate Governance Institute* (ECGI)

ADDRESS: (Office) Olin Business School
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CITIZENSHIP: U.S. Citizen.

EDUCATION: Ph.D. (Finance) 1979, Northwestern University, Evanston, IL 60201

AWARDS AND HONORS

- Winner of the Reid MBA Teaching Excellence Award, Olin School of Business, 2005.
- President, *Financial Intermediation Research Society*, 2006-08
- Vice President, *Financial Intermediation Research Society*, 2003-2005.
- Nobel Prize in Economics Nominating Committee, 1993, 1994, 1995, 1996, 1997, 1998, 1999, 2000, 2001, 2002, 2003, and 2004.
- University of Michigan Business School Finance Faculty Award “In Appreciation of Your Leadership in Shaping and Revitalizing the Finance Group as Chairman, 2000-2003”, April 2003.
- Awarded the Outstanding Teacher in Doctoral Program award for the University of Michigan Business School, April 2003.
- Nominated as Outstanding Teacher in Doctoral Program (Finance), University of Michigan Business School, 1999, 2000, and 2001.
- American Finance Association Nominating Committee for Vice-Presidents and Directors, 1999.
- Outstanding Senior Faculty Research Award, University of Michigan Business School, 1998.
- Member of Beta Gamma Sigma, Northwestern University Chapter.
- Certificate for Exceptional Inspiration and Guidance, awarded by the Doctoral Students Association, School of Business, Indiana University, 1980.
- Awarded the 1985 J. Dwight Peterson Faculty Fellowship, Indiana University.
- Winner of the 1986 MBA Teaching Excellence Award, Indiana University.
- Invited to be a Distinguished Visiting Scholar for a week by the Board of Governors of the Federal Reserve System in April, 1990.
- Nominated as Outstanding Teacher in MBA Program, 1991-92.
- Invited to be a Distinguished Visiting Scholar for a week by the Board of Governors of the Federal Reserve System in November 1993.
- Invited to organize and chair the *Doctoral Students Consortium at The Financial Management Association Meeting*, 1995.
- Featured in *International Who's Who of Professionals*, Gibraltar Publishing Limited, 1995.

GRANTS BY AGENCIES OUTSIDE UNIVERSITY

- U.S. Department of Treasury Grant 1997-98.
- Prochnow Educational Foundation Grant, 1992.
- Garn Institute of Finance Grant (with S. Greenbaum and A. Boot), 1990.
- Prochnow Educational Foundation Grant 1985-86 and 1988-89.
- Federal Home Loan Bank Board Grant (with S. Greenbaum), 1983-84.
- Bank Administration Institute Grant (with S. Greenbaum), 1983-84 and 1984-85.

EMPLOYMENT

Washington University in St. Louis, John E. Simon Professor of Finance, July 2003-present, and Senior Associate Dean, 2005-present.

University of Michigan, Edward J. Frey Professor of Banking and Finance, 1996 –2003, and Chairman of the Finance Area, 2000-2003.

Indiana University, Chairman of the Finance Department, 1992 - 1996, and 1989 - 90.

Indiana University, NBD Professor of Finance, September 1994 - 1996.

Indiana University, INB National Bank Professor of Finance, August 1992-August 1994.

UCLA, Visiting Professor of Finance, 1987 - 1988.

Indiana University, Professor of Finance, 1987 – 1989, 1990-1992.

Indiana University, Associate Professor of Finance, 1983 - 1987.

Northwestern University, Visiting Associate Professor of Finance, 1983 - 1985.

Indiana University, Assistant Professor of Finance, 1979 - 1983.

TEACHING AND RESEARCH INTERESTS

Corporate Finance, Financial Intermediation and Economics of Asymmetric Information.

DOCTORAL DISSERTATIONS (SUCCESSFULLY DEFENDED) CHAIRED

Ray Gorman, Greg Udell, Gautam Vora, Salman Shah, Marcia Millon, Paul Chaney, Pu Liu, Arnoud Boot, Patty Wilson, Priscilla Jaggia, Daniel Indro, Richard Shockley, Michael Ferguson, Jess Beltz, Stephen Peters, Todd Milbourn, Kenneth Li, Kathleen Petrie, Jeff Bacidore, Michael Fuerst, Aida Charoenrook, Emre Ergungor, Ralph Bachmann, Anand Goel, Jun Yang, Rong Wong, Gopalan Radhakrishnan, and Fenghua Song.

PUBLICATIONS

A. Book Publications

Financial Intermediation, Corporate Finance, and the Capital Market (with Arnoud W.A. Boot), *Publisher*: Elsevier. First Publication Date: 2008

Competing Values Leadership: Creating Value in Organizations (with Kim S. Cameron, Robert E. Quinn, Jeff Degraff), *Publisher*: Edward Elgar Publishing Ltd. First Publication Date: 2006

Contemporary Financial Intermediation (with Stuart Greenbaum). *Publisher*: Elsevier. Second Edition: 2007.

The Value Sphere: The Corporate Executive's Handbook for Creating and Retaining Shareholder Wealth (with John Boquist and Todd Milbourn). *Publisher*: VIA Press. First Publication Date: January 2000, Third edition 2006.

Becoming a Better Value Creator: How to Improve Your Company's Bottom Line—and Your Own. *Publisher*: Jossey-Bass. First Publication Date: August 2000.

Designing Financial Systems in Transition Economies: Strategies for Reform in Central and Eastern Europe (edited with Anna Meyendorff). *Publisher:* MIT Press, 2002.

Credit, Intermediation and the Macro Economy: Models and Perspectives (edited with Arnoud Boot and Sudipto Bhattacharya). *Publisher:* Oxford University Press, 2004.

B. Major Publications

“Bank Capital and Value in the Cross-Section” (with Hamid Mehran), forthcoming, ***Review of Financial Studies***.

“Financial System Architecture and the Co-evolution of Banks and Markets” (with Fenghua Song), forthcoming, ***The Economic Journal***.

“Do Envious CEOs Cause Merger Waves?” (with Anand Goel), forthcoming, ***Review of Financial Studies***.

“Overconfidence, Leadership Selection, and Corporate Governance” (with Anand Goel), ***Journal of Finance*** 63-6, December 2008, 2737-2784.

“Market Liquidity, Investor Participation and Managerial Autonomy: Why do Firms Go Private?” (with Arnoud Boot and Radhakrishnan Gopalan), ***Journal of Finance*** 63-4, August 2008, 2013-2059.

“Relationship Banking, Fragility and the Asset-Liability Matching Problem” (with Fenghua Song), ***Review of Financial Studies*** 20-6, November 2007, 2129-2177.

“Why Do Firms Issue Equity?” (with Amy Dittmar), *Journal of Finance*** 62-1, February 2007, 1-54.

“Information Control, Career Concerns and Corporate Governance” (with Fenghua Song), ***Journal of Finance*** 61-4, August 2006, 1845-1896.

“The Entrepreneur’s Choice Between Private and Public Ownership” (with Arnoud Boot and Gopalan Radhakrishnan), ***Journal of Finance*** 61-2, April 2006, 803-836.

“Do Loan Commitments Cause Overlending?”, ***Journal of Money, Credit and Banking*** 37-6, December 2005, 1067-1100.

“Green with Envy: Implications for Corporate Investment Distortions” (with Anand Goel), ***Journal of Business*** 78-6, November 2005, 2255-2287.

“Sunflower Management and Capital Budgeting” (with Arnoud Boot and Todd Milbourn), ***Journal of Business*** 78-2, March 2005, 501-527.

“Financial Intermediation as a Beliefs-Bridge Between Optimists and Pessimists” (with Josh Coval), ***Journal of Financial Economics*** 75-3, March 2005, 535-570.

“Why Do Firms Smooth Earnings?” (with Anand Goel), ***Journal of Business*** 76-1, January 2003, 151-192.

“The Many Faces of Information Disclosure” (with Arnoud Boot), ***Review of Financial Studies*** 14-4, Winter 2001, 1021-1058.

“Managerial Career Concerns and Investments in Information” (with Todd Milbourn and Richard Shockley), ***RAND Journal of Economics*** 32-2, Summer 2001, 82-99.

“Can Relationship Banking Survive Competition?” (with Arnoud Boot), ***Journal of Finance*** 55-2, April 2000, 679-714.

“Megamergers and Expanded Scope: Theories of Bank Size and Activity Diversity” (with Arnoud Boot and Todd Milbourn), ***Journal of Banking and Finance*** 23-2, February 1999, 195-214.

** “Corporate Control Through Board Dismissals and Takeovers” (with David Hirshleifer), ***Journal of Economics and Management Strategy*** 7-4, Winter 1998, 489-520.

“A Brief Retrospective and Prospective Look at the *Journal of Financial Intermediation: 1990-98*”, ***Journal of Financial Intermediation*** 7-4, October 1998, 331-337.

- “Bank Efficiency and Financial System Evolution: An Analysis of Complementarity Problems in State-Dominated Economies”, *Research in Economics* 52-3, September 1998, 271-284.
- “The Economics of Bank Regulation” (with Sudipto Bhattacharya and Arnoud Boot), *Journal of Money, Credit and Banking* 30-4, November 1998, 745-770.
- “Banking Scope and Financial Innovation” (with Arnoud Boot), *Review of Financial Studies* 10-4, Winter 1997, 1099-1131, to be reprinted as a “CEPR Classic” in a book to be published by *Oxford University Press* (eds: Bruno Biais and Marco Pagano).
- “Bank Loan Commitment Contracts: Data, Theory, and Tests” (with Richard Shockley), *Journal of Money, Credit and Banking* 29-4, November 1997, 517-534.
- “Financial System Architecture” (with Arnoud Boot), *Review of Financial Studies* 10-3, Fall 1997, 693-733, to be reprinted as a “CEPR Classic” in a book to be published by *Oxford University Press* (eds: Bruno Biais and Marco Pagano).
- “The Design of Financial Systems: An Overview”, *Journal of Banking and Finance* 20-5, June 1996, 917-948.
- “Capital Requirements, Monetary Policy and Aggregate Bank Lending: Theory and Empirical Evidence”, *Journal of Finance* 51-1, March 1996, 279-324.
- “Capital Requirements, Loan Renegotiation, and the Borrower's Choice of Financing Source” (joint with Patricia Wilson), *Journal of Banking and Finance* 19-3, June 1995, 693-712.
- “Moral Hazard and Secured Lending in an Infinitely Repeated Credit Market Game” (with Arnoud Boot), *International Economic Review* 35-3, November 1994, 899-920.
- “A ‘Barter’ Theory of Bank Regulation and Credit Allocation” (with Jess Beltz), *Journal of Money, Credit and Banking* 26-3, August 1994, 679-705.
- “Firm-Specific Human Capital and Optimal Capital Structure” (with Priscilla Jaggia), *International Economic Review* 35-2, May 1994, 283-308.
- “Managerial Performance, Boards of Directors and Takeover Bidding” (joint with David Hirshleifer), *Journal of Corporate Finance* 1-2, March 1994, 63-90.
- “Continuous Signalling Within Partitions: Capital Structure and the FIFO/LIFO Choice” (with Pat Hughes and Eduardo Schwartz), *Journal of Accounting, Auditing and Finance* 9-2, Winter 1994.
- “Information, Investment Horizons and Price Reactions”, *Journal of Financial and Quantitative Analysis* 28-4, December 1993, 459-482.
- “Reputation and Discretion in Financial Contracting” (with Arnoud Boot and Stuart Greenbaum), *American Economic Review* 83-5, December 1993, 1165-1183.
- * “Contemporary Banking Theory” (with Sudipto Bhattacharya), *Journal of Financial Intermediation* 3-1, October 1993, 2-50.
- + “Security Design” (with Arnoud Boot), *Journal of Finance* 48-4, September 1993, 1349-1378.
- “Self-Interested Bank Regulation” (with Arnoud Boot), *American Economic Review* 83-2, May 1993, 206-212.
- “Relationship Banking, Deposit Insurance and Bank Portfolio Choices” (with David Besanko), in *Capital Markets and Financial Intermediation* (Xavier Vives and Colin Mayer; eds.), Cambridge University Press, 1993, 292-318.
- “Litigation Risk, Intermediation, and the Underpricing of Initial Public Offerings” (with Pat Hughes), *Review of Financial Studies* 5-4, Winter 1992, 709-742.
- “Managerial Conservatism, Project Choice and Debt” (with David Hirshleifer), *Review of Financial Studies* 5-3, Fall 1992, 437-470.
- “Banking Deregulation: Allocational Consequences of Relaxing Entry Barriers” (with David Besanko) *Journal of Banking and Finance* 16-5, September 1992, 909-932.

- + “Is Fairly Priced Deposit Insurance Possible?” (with Yuk-Shee Chan and Stuart Greenbaum), *Journal of Finance* 47-1, March 1992, 227-246. Reprinted in *Studies in Financial Institutions: Commercial Banks* (eds: C.M. James and C.W. Smith, Jr.), McGraw-Hill, Inc, 1994. Also reprinted in *The Regulation and Supervision of Banks* (ed: Maximilian J.B. Hall), Edward Elgar Publishing, 2000.
- “Off-Balance Sheet Liabilities, Deposit Insurance and Capital Regulation,” (with Arnoud Boot), *Journal of Banking and Finance* 15-4, September 1991, 825-846.
- “Cooperation versus Competition in Agency” (with Ram Ramakrishnan), *Journal of Law, Economics and Organization* 7-2, Fall 1991, 248-283.
- “Credible Commitments, Contract Enforcement Problems and Banks: Intermediation as Credibility Assurance” (with Arnoud Boot and Gregory Udell), *Journal of Banking and Finance* 15-3, June 1991, 605-632.
- “Secured Lending and Default Risk: Equilibrium Analysis, Policy Implications and Empirical Results” (with Arnoud Boot and Gregory Udell), *Economic Journal* 101-406, May 1991, 458-472.
- +** “Shareholder Preferences and Dividend Policy” (with Michael Brennan), *Journal of Finance* 45-4, September 1990, 993-1018.
- “Investment ‘Myopia’ and the Internal Organization of Capital Allocation Decisions,” *Journal of Law, Economics and Organization* 6-1, Spring 1990, 129-154.
- “Learning, Corporate Control and Performance Requirements in Venture Capital Contracts” (with Yuk-Shee Chan and Daniel Siegel), *International Economic Review* 31-2, May 1990, 365-381.
- “Competitive Equilibrium with Type Convergence in an Asymmetrically Informed Market” *Review of Financial Studies* 2-1, Spring 1989, 49-71.
- “Bank Reserve Requirements as an Impediment to Signaling” (with Stuart Greenbaum), *Economic Enquiry* 27-1, January 1989, 1-16.
- “Private versus Public Ownership: Investment, Ownership Distribution, and Optimality” (with Salman Shah), *Journal of Finance* 43-1, March 1988, 41-59.
- “Collateral and Rationing: Sorting Equilibria in Monopolistic and Competitive Credit Markets” (with David Besanko), *International Economic Review* 28-3, October 1987, 671-689.
- “Bank Funding Modes: Securitization Versus Deposits” (with Stuart Greenbaum), *Journal of Banking and Finance* 11-3, September 1987, 379-401.
- “Competition, Risk Neutrality and Loan Commitments” (with Arnoud Boot and Gregory Udell), *Journal of Banking and Finance* 11-3, September 1987, 449-471.
- “An Economic Rationale for the Pricing Structure of Bank Loan Commitments” with Gregory Udell), *Journal of Banking and Finance* 11-2, June 1987, 271-289.
- “Optimal Capital Structure and Project Financing” (with Salman Shah), *Journal of Economic Theory* 42-2, August 1987, 209-243.
- “Competitive Equilibrium in the Credit Market under Asymmetric Information” (with David Besanko), *Journal of Economic Theory* 42-1, June 1987, 167-182.
- “Collateral and Competitive Equilibria with Moral Hazard and Private Information” (with Yuk-Shee Chan), *Journal of Finance* 42-2, June 1987, 345-363.
- “A Theory of Stock Price Responses to Alternative Corporate Cash Disbursement Methods: Stock Repurchases and Dividends” (with Aharon Ofer), *Journal of Finance* 42-2, June 1987, 365-394.
- “Regulatory Pricing and Capital Investment Under Asymmetric Information About Cost” (with Wayne Lee), *Southern Economic Journal* 64-1, January 1987, 720-734.

- “Information Reusability, Competition and Bank Asset Quality” (with Yuk-Shee Chan and Stuart Greenbaum), *Journal of Banking and Finance* 10-2, June 1986, 243-253.
- “Moral Hazard and Information Sharing: A Model of Financial Information Gathering Agencies” (with Marcia Millon), *Journal of Finance* 40-5, December 1985, 1403-1422.
- “Incentive Effects of Benevolent Intervention: The Case of Government Loan Guarantees” (with Paul Chaney), *Journal of Public Economics* 26-2, March 1985, 169-189.
- “Information Reliability and a Theory of Financial Intermediation” (with Ram Ramakrishnan), *Review of Economic Studies* 51-3, July 1984, 415-432.
- “Interest Yields, Credit Ratings and Economic Characteristics of State Bonds: An Empirical Analysis” (with Pu Liu), *Journal of Money, Credit and Banking* 16-3, August 1984, 344-351.
- “The Valuation of Assets Under Moral Hazard” (with Ram Ramakrishnan), *Journal of Finance* 39-1, March 1984, 229-238.
- “Screening, Market Signaling and Capital Structure Theory” (with Wayne Lee and Gautam Vora), *Journal of Finance* 38-5, December 1983, 1507-1518.
- “Costly Information Production Equilibria in the Bank Credit Market with Applications to Credit Rationing” (with Richard Callaway), *Journal of Financial and Quantitative Analysis* 18-2, June 1983, 229-248.
- “Capital Accumulation and Deposit Pricing in Mutual Financial Institutions” (with Sudhakar Deshmukh and Stuart Greenbaum), *Journal of Financial and Quantitative Analysis* 17-5, December 1982, 705-725.
- “Moral Hazard, Agency Costs and Asset Prices in a Competitive Equilibrium” (with Ram Ramakrishnan), *Journal of Financial and Quantitative Analysis* 17-4, November 1982, 503-532.
- “An Exploration of Competitive Signaling Equilibria with ‘Third Party’ Information Production: The Case of Debt Insurance” *Journal of Finance* 37-3, June 1982, 717-739.
- “Toward a Theory of Bank Loan Commitments”, *Journal of Banking and Finance* 6-1, March 1982, 55-83.
- “Bank Loan Commitments and Interest Rate Volatility” (with Hai Hong and Stuart Greenbaum), *Journal of Banking and Finance* 5, 1981, 497-510.
- Notes:** * Lead article and winner of the D.P. Jacobs Prize as the Most Significant Contribution in Volume 3 of the *Journal of Financial Intermediation*.
 **Lead article.
 + Nominated for the Breeden Best Paper Prize in the *Journal of Finance*.

C. Practitioner-Oriented Publications

- “Creating Sustained Shareholder Value -- and Dispelling Some Myths,” (with Jeff DeGraff and Robert Quinn), *Financial Times* Pt. 5, October 25, 1999, 8-10.
- “The Search for the Best Financial Performance Measure: Yes, Basics are Better — If You Understand Them,” (with Jeff Bacidore, John Boquist and Todd Milbourn), *Financial Analysts Journal*, May/June 1999, 55-3, 14-16.
- “How Do You Win the Capital Allocation Game?” (with John Boquist and Todd Milbourn), *Sloan Management Review* 39-2, Winter 1998, 59-71.
- “EVA and Total Quality Management,” (with Jeff Bacidore, John Boquist and Todd Milbourn), *Journal of Applied Corporate Finance* 10-2, Summer 1997, 81-89.
- **“The Search for the Best Financial Performance Measure,” (with Jeff Bacidore, John Boquist and Todd Milbourn), *Financial Analysts Journal* 53-3, 1997, 11-20.

D. Articles in Books and Invited Papers

- “The Accelerating Integration of Banks and Markets and its Implications for Regulation” (with Arnoud W.A. Boot), chapter in *Oxford Handbook of Banking*, (eds. Allen Berger, Phil Mullineaux and John Wilson), September 2009.
- “Financial Intermediation, Corporate Finance and the Capital Market” (with Arnoud W.A. Boot), chapter in *Handbook of Financial Intermediation and Banking*, (eds. Arnoud W.A. Boot and Anjan V. Thakor), Elsevier, expected publication date 2008.
- “The Evolving Integration of Banks and Markets and its Implications for Regulation” (with Arnoud W.A. Boot), chapter in *The Oxford Handbook of Banking* (eds. Allen Berger and Phil Molyneux), Oxford University Press, forthcoming.
- “Comparing Financial Systems,” *Review of Financial Studies* (Review of book by Allen and Gale) 14-2, 2001, 577-581.
- “Introduction: Key Issues in Transition Economies” (joint with Anna Meyendorff), *Designing Financial Systems in Transition Economies: Strategies for Reform in Central and Eastern Europe*, MIT Press, 2002.
- “Romanian Financial System Reform” (joint with Anna Meyendorff), *Designing Financial Systems in Transition Economies: Strategies for Reform in Central and Eastern Europe*, MIT Press, 2002.
- “Poor Financial Performance” (joint with Jeff Bacidore), *The Pressing Problems of Modern Organization: Transforming the Agenda for Research and Practice* (eds: Robert Quinn, Regina O’Neill, and Lynda St. Clair), AMACOM Press, 2000, pp. 197-213.
- “Refined Economic Value Added: A Better Performance Measure,” *Investor Relations Quarterly* 1-4, Spring 1998, 24-29.
- “Financial Conglomeration: Issues and Questions,” *The North American Journal of Economics and Finance* 7, 1996, 135-145.
- “Banking Structure and Financial Innovation” (joint with Arnoud Boot), Chapter 14 in *Universal Banking: Financial System Design Reconsidered* (eds: Anthony Saunders and Ingo Walter), Irwin Professional Publishing, 1996, 420-430.
- “Financial Intermediation and the Market for Credit”, Chapter 32 in *North-Holland Handbooks of Operations Research and Management Science: Finance* (ed: R. A. Jarrow, V. Maksimovic, and W. T. Ziemba), Elsevier-Science, 1995.
- “The Theory of Security Design” (joint with Arnoud Boot and Todd Milbourn), in *Handbook of Equity Derivatives* (ed: J.C. Francis, W. Toy and J.G. Whittaker), Irwin Professional Publishing, 1994.
- “Corporate Investments and Finance,” *Financial Management* (invited paper) 22-2, Summer 1993, 135-144.
- “Maturity Transformation”, *The New Palgrave Dictionary of Money and Finance*, The MacMillan Press Limited, London, 1992.
- “Game Theory in Finance,” *Financial Management* (invited paper) 20-1, Spring 1991, 71-94.
- “Strategic Issues in Financial Contracting: An Overview,” *Financial Management* (invited paper) 18-2, Summer 1989, 39-58.

E. Monographs

- “The Economic Reality of Securities Class Action Litigation”, (joint with Jeffrey Nielsen and David Gulley), published as a *Monograph* by the *U.S. Chamber of Commerce Institute of Legal Reform*, October 2005.

- “Common Ground: Increasing Consumer Benefits and Reducing Regulatory Costs in Banking”, (joint with Jess Beltz and J.S. Barefoot, Marrinan & Associates), *Monograph* published by **The Prochnow Educational Foundation**, 1993.
- “Commercial Bank Contingent Claims Products: Pricing and Risk Management,” *Monograph* published by **The Prochnow Educational Foundation**, 1988.
- “Understanding Commercial Bank Contingent Liabilities” (with Stuart Greenbaum and John Soss), *Monograph* published by the **Bank Administration Institute**, 1986.
- “Legal Reserve Requirements in Banking: A Review and Assessment” (with Stuart Greenbaum), *Monograph* published by the **Bank Administration Institute**, 1985.

F. Proceedings of Special Conferences and Miscellaneous Publications

- Discussion of “Monitoring-Enhancing Credit Risk Transfer: The Case of Banks” by Gabriella Chiesa, at the **FDIC/JFSR Conference** in Washington DC, September 2008.
- Discussion of “Leadership, Coordination and Mission-Driven Management” by Patrick Bolton, Markus Brunnermeier and Laura Veldkamp, at the **Utah Winter Finance Conference**, February 2008.
- Discussion of “Is the U.S. Going Bankrupt?” by Lawrence Kotlikoff, **Federal Reserve Bank of St. Louis Review**, 88-4, July/August 2006, 251-258.
- Discussion of “Crisis in Competitive vs. Monopolistic Banking Systems” by John Boyd and Gianni De Nicolo, **Journal of Money, Credit and Banking**, 2005.
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EXHIBIT 3: Results of Event Study Analysis

<u>Date</u>	<u>Description of Event</u>	<u>Abnormal Return (Z - Statistic)</u>		
		<u>First Price Reaction Date</u>	<u>Subsequent Trading Day</u>	<u>Cumulative 2- Day Return</u>
06/20/01	Morgan Stanley Dean Witter report questions Qwest's accounting	-5.09% (-1.77)	-0.26% (-0.09)	-5.34% (-1.31)
08/07/01	Mr. Nacchio discloses IRU sales	-1.36% (-0.48)	3.49% (1.19)	2.09% (0.51)
08/14/01 (after hours)	Qwest Form 10-Q recognizes IRU sales	-0.98% (-0.34)	-0.34% (-0.12)	-1.32% (-0.33)
08/22/01	Analyst reports explain Qwest's overstated growth rates	-4.83% (-1.71)	-6.74% (-2.41)	-11.25% (-2.91)
09/27/01	CalPoint discloses swap transactions involving Qwest equipment	-14.16% (-5.09)	-1.55% (-0.53)	-15.49% (-3.97)
10/31/01	Qwest discloses disappointing earnings due to decreased IRU sales	-17.88% (-6.10)	-8.92% (-2.88)	-25.21% (-6.35)
02/13/02	Wall Street Journal discusses 4 Qwest swap transactions	-4.99% (-1.67)	-9.48% (-3.24)	-13.99% (-3.47)
07/29/02	Qwest announces need to restate past financials	-9.29% (-2.44)	-16.15% (-4.62)	-23.94% (-4.99)
	TOTAL	-45.12% (-7.67)	-35.53% (-6.58)	-63.30% (-9.70)

Note: For more detail, see Appendix A.

EXHIBIT 4: Insider Trades for Which Mr. Nacchio Was Convicted

Trade Date	# of Shares	Sale Price per Share	Gross Sale Price
4/26/2001	350,000	\$38.8559	\$13,599,565.00
4/27/2001	300,000	\$39.6716	\$11,901,480.00
4/30/2001	110,000	\$41.1182	\$4,523,002.00
5/1/2001	100,000	\$40.8353	\$4,083,530.00
5/3/2001	50,000	\$39.0852	\$1,954,260.00
5/7/2001	70,000	\$38.3086	\$2,681,602.00
5/8/2001	20,000	\$38.7000	\$774,000.00
5/9/2001	30,000	\$38.0000	\$1,140,000.00
5/10/2001	43,200	\$38.0000	\$1,641,600.00
5/11/2001	20,000	\$37.2250	\$744,500.00
5/14/2001	56,800	\$37.6367	\$2,137,764.56
5/15/2001	105,000	\$37.7667	\$3,965,503.50
5/18/2001	20,000	\$38.0000	\$760,000.00
5/21/2001	10,000	\$38.1140	\$381,140.00
5/22/2001	10,000	\$38.6027	\$386,027.00
5/23/2001	10,000	\$38.2320	\$382,320.00
5/24/2001	4,100	\$38.0012	\$155,804.92
5/25/2001	15,900	\$38.0000	\$604,200.00
5/29/2001	5,000	\$38.2500	\$191,250.00
	<u>1,330,000</u>		<u>\$52,007,548.98</u>

EXHIBIT 5: Calculation of Ill-Gotten Gains

	[A]	[B]	[C] = [A] x [B]
	Total Proceeds on Insider Trades for Which Mr. Nacchio Has Been Convicted	Aggregate Inflation in the Selling Price, as Calculated in the Event Study	Ill-Gotten Gains
Calculations Using the One-Day Abnormal Returns	\$52,007,548.98	45.12%	\$23,465,806.10
Calculations Using the Two-Day Cumulative Abnormal Returns	\$52,007,548.98	63.30%	\$32,920,778.50

EXHIBIT 6: Analysis of Buy-and-Hold Cumulative Returns Shows that Qwest Significantly Underperformed Peer Companies

June 20, 2001 - July 29, 2002

<u>Matching Criteria</u>	<u>Number of Matched Firms</u>	<u>Average Matched Firm Return</u>	<u>Lower 95% Confidence Level of Average Matched Firm Return</u>	<u>Upper 95% Confidence Level of Average Matched Firm Return</u>	<u>Actual Qwest Return</u>	<u>Qwest Within 95% Confidence Interval?</u>	<u>Signed Rank P-Value</u>
Size (Market Cap)	28	-65.52%	-78.72%	-52.32%	-95.04%	No	<.0001
Book to Market Ratio	22	-42.49%	-64.77%	-20.22%	-95.04%	No	<.0001
Prior Performance (1 Year)	23	-49.35%	-71.24%	-27.46%	-95.04%	No	<.0001
Prior Performance (2 Years)	14	-40.21%	-68.58%	-11.83%	-95.04%	No	0.0002
Prior Performance (3 Years)	12	-47.87%	-63.19%	-32.55%	-95.04%	No	0.0010
Beta	24	-58.71%	-75.60%	-41.82%	-95.04%	No	<.0001
Size & Book to Market Ratio	13	-63.17%	-88.31%	-38.02%	-95.04%	No	0.0327
Book to Market Ratio & Size	13	-58.68%	-85.66%	-31.71%	-95.04%	No	0.0574
Size & Beta	15	-59.28%	-76.20%	-42.36%	-95.04%	No	0.0015
Beta & Size	14	-61.43%	-83.97%	-38.89%	-95.04%	No	0.0134
Size & Prior Performance (1 Year)	15	-77.05%	-88.25%	-65.85%	-95.04%	No	0.0009

Note: For more detail, see Appendix B.

APPENDIX A: Event Study Models

In this Appendix, I provide additional details about the mechanics and specification of the event study models which generate the results in *Exhibit 3*.³⁶

The event study model simultaneously controls for the effects of both economy-wide, industry, and selected company-specific factors when evaluating security prices of a company. I employ a statistical technique called multiple regression analysis to determine why the price moved at the time of the event (*i.e.*, the new information disclosure). I use the following multiple regression model:

$$R_t = \alpha + \beta_1 \cdot R_{Market,t} + \beta_2 \cdot R_{Industry,t} + \delta_1 \cdot D_{1t} + \dots + \delta_k \cdot D_{kt} + \varepsilon_t$$

For an event study, daily share price movements are converted to percentage changes or “returns.” For example, the dependent variable (R_t) is Qwest’s daily stock return on trading day t , measured as the natural log of the ratio of Qwest’s price on trading day t divided by Qwest’s price on trading day $t - 1$.³⁷ Market and industry returns ($R_{Market,t}$ and $R_{Industry,t}$) are calculated in the same manner using the New York Stock Exchange Composite Index and the American Stock Exchange North American Telecommunications Index, respectively.

The estimation window is the period prior to the event window that is used to estimate the relationship between Qwest’s stock price and the market/industry factors. I measure this relationship using an estimation window of 252 trading days, ending 20 trading days prior to each event.³⁸ The event period itself is not included in the estimation period to eliminate the possibility of the event influencing the parameter estimates. In addition, I include a vector of dummy variables (D_{1t} through D_{kt}) in order to control for price movements on dates in the estimation window unrelated to the event in question.³⁹

For each event period in question, I compare the actual return with the return predicted by the model above. This difference, referred to as the “abnormal return,” represents the portion of the price movement which cannot be explained by the broad market, industry or other

³⁶ See, *e.g.*, A. Craig MacKinlay, “Event Studies in Economics and Finance,” 35 *Journal of Economic Literature* 1 (March 1997) 13-39; Cornell, Bradford, and R. Gregory Morgan, “Using Finance Theory to Measure Damages in Fraud on the Market Cases,” 37 *UCLA Law Review* 883 (1990), for additional detail about event study models.

³⁷ Note that non-trading days (*e.g.*, weekends and holidays) are excluded from the analysis.

³⁸ The period 252 trading days is approximately equivalent to one calendar year.

³⁹ I have controlled for all dates of quarterly earnings announcements, along with June 26th and 27th, 2002—dates with extremely large price movements stemming from speculation related to accounting fraud in the wake of an admission from WorldCom. A dummy variable is a variable which is equal to zero or one. In this case, each dummy variable is set equal to one on a single date, and zero otherwise.

company-specific factors. The abnormal return can either be caused by the release of new information to the market, or by simple randomness (everyday price fluctuations or volatility). Event studies use statistical tests to determine the likelihood that a price movement occurred by chance.⁴⁰ A statistically significant abnormal return is a price movement that, after controlling for the broad market, the industry, and the unrelated company-specific price movements, is large enough that it is unlikely to be a mere random fluctuation. Rather, it is linked in a statistically significant way to the event in question. For purposes of my opinions, I have used a standard statistical measurement of 90 percent significance, indicating that only 5 percent of daily returns are lower.

⁴⁰ See, e.g., Dodd, Peter and Jerold B. Warner, "On Corporate Governance - A Study of Proxy Contests." 11 *Journal of Financial Economics* (1983) 401-438.

APPENDIX B: Buy-and-Hold Cumulative Abnormal Returns

In this Appendix, I discuss the details related to the calculations that generate the results in *Exhibit 6*.

First, I identify the list of all companies included in the NASDAQ Telecommunications Index. For each company, I collect daily data on closing price, market cap, and book-to-market ratio.⁴¹

I consider the period encompassing all of my event study disclosure dates, June 20, 2001 to July 29, 2002. For each firm, I collect the following information at specific points in time prior to the start of each holding period:

- *Size (Market Capitalization)* – Measured one month prior to the start of the holding period.
- *Book-to-Market Ratio* – Measured one month prior to the start of the holding period.
- *One-, Two-, and Three-Year Prior Stock Price Performance* – Calculated for the one-, two-, and three-year periods ending one day prior to the start of the holding period.
- *Beta* – Calculated by regressing daily excess returns for the company on daily excess returns on the market for a window of 252 trading days, ending 20 trading days prior to the start of each holding period.⁴² Beta is the estimated coefficient on the daily excess returns for the market.

Next, I partition these firms using eleven different matching methods based on the criteria above, in the following manner:⁴³

- If one criterion is used, I split the group of companies with available data into deciles.
- If two criteria are used, I split the group of companies with available data into quartiles according to the first criterion. Each quartile is then split into quartiles according to the second criterion, resulting in 16 different partitions.

⁴¹ Source: Bloomberg. Book-to-market ratio was calculated by taking the reciprocal of the price-to-book ratio (Bloomberg variable name: PX_TO_BOOK_RATIO).

⁴² The daily excess return for each company is calculated by subtracting the daily return on the one-month Treasury bill rate from the return for company. The excess return on the market is the value-weighted daily return on all NYSE, AMEX, and NASDAQ stocks minus the daily return on the one-month Treasury bill rate. The risk-free rate and the excess return on the market were taken from Kenneth French's website: http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html.

⁴³ This approach is very similar to the construction of reference portfolios in the academic literature. See, e.g., Lyon, John, Brad M. Barber, and Chih-Ling Tsai "Improved Methods for Tests of Long-Run Abnormal Stock Returns", 54 *Journal of Finance* 1, (February 1999) 165-201.

For each matching method, I identify the partition which includes Qwest. I then calculate the cumulative return for each company in Qwest's partition over the measurement period.⁴⁴ I compute the average return for all other matched companies (*i.e.*, other than Qwest) and construct a confidence interval around this average. In all cases, Qwest's return was lower than the lower bound of this confidence interval. I therefore conclude that this difference was statistically significant.

⁴⁴ There are several instances where a company's available stock price data ends prior to the end of the measurement period. In these cases, I calculate the cumulative return from the beginning of the measurement period through the last date with available price data.