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LETTER OF COMMENT NO. 85

August 7, 2008

Submitted via e-mail (director@fasb.org)

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
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RE: File Reference No. 1600-100, Exposure Draft dated June 5, 2008, *Disclosure of Certain Loss Contingencies, an amendment of FASB Statements No. 5 and 141(R)*

Dear Mr. Golden:

Thank you for the opportunity to provide comments on the FASB's Exposure Draft referenced above. In the attached memorandum my co-author, Laura Simmons, and I discuss research findings that we believe are relevant to issues raised by the Exposure Draft.

We hope that our discussion is helpful to the Board's deliberations on this topic and would be happy to discuss our findings with the Board or its staff.

Sincerely,

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William A. Franke Professor of Law and Business, School of Law
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Enclosure

Submission of Comments to the FASB Regarding Exposure Draft: "Disclosure of Certain Loss Contingencies, an amendment of FASB Statements No. 5 and 141(R)"

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August 7, 2008

1.   Introduction and Summary

A primary goal of the accounting and disclosure process is to assure that investors have adequate information regarding obligations (including contingencies) confronting publicly traded issuers.[1] If investors are systematically surprised by the announcements of litigation-related events, then the argument in favor of expanded disclosure of litigation-related contingencies is strengthened.[2] But if the market anticipates litigation-related announcements because material information about these contingencies reaches investors through other means, the argument in favor of expanded disclosure is modulated.

Empirical analysis of stock market price responses to litigation related announcements can therefore constructively inform the Board's deliberations. To be sure, even if the Board does not view stock price response data as dispositive, market data are not irrelevant to the standard setting process.[3]

Viewed from this perspective, it is instructive to observe that the Background Information to the Exposure Draft states that "[t]he short-term phase of the project was undertaken to address constituents' concerns that the disclosures about certain loss contingencies under existing guidance do not provide sufficient information in a timely manner to assist users in assessing the likelihood, timing, and amounts of cash flows

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[1] "Financial reporting should provide information about an enterprise's economic resources, obligations, and owners' equity. That information helps investors, creditors, and others identify the enterprise's financial strengths and weaknesses and assess its liquidity and solvency." (FASB Statement of Concepts No. 1, para. 41).

[2] However, even if the data demonstrate a statistically significant price response for individual litigation resolutions, such results do not automatically support the conclusion that there has been a disclosure failure. Litigation events often involve the resolution of an intrinsic uncertainty by an action of a third party, such as a judge or a jury. An accounting disclosure prior to the verdict can reflect perfectly accurate descriptions of the uncertainties associated with the litigation, and yet when the jury returns with its verdict - - no matter what it is - - a potentially large stock price change results. It follows that a large stock price response to the announcement of litigation related information is a necessary but insufficient condition to support the conclusion that the market is, in some sense, surprised by the announcement.

[3] "The FASB Board and staff have paid close attention to the results of security price and other economic consequences research. Leading academic researchers quite frequently have come to Stamford to present research updates to the Board and staff; and one of the roles of an academic fellow is to help interpret such research for Board and staff members...Therefore, the FASB has demonstrated its interest in this research in a very concrete manner – by expending a portion of its resources to support this research." (Michael O. Alexander, "Discussion of The SEC 'Reversal' of FASB Statement No. 19: An Investigation of Information Effects," *Journal of Accounting Research*, Vol. 19 Supplement (1981), p. 214.)

associated with loss contingencies."[4] The *Background Information cites no empirical* support for these concerns, and offers no examples of such failures. It fails to explain whether the concerns are systematic or anecdotal. It makes no effort to assess the materiality of these concerns, whether they are pervasive in the market, or arise only in specific, narrowly-defined situations. Careful consideration of stock price responses to litigation related announcements can therefore only help the Board determine the nature of the additional disclosures, if any, that are necessary and appropriate in light of the circumstances that prevail in the litigation process. The purpose of this submission is to help begin that process.

Part 2 of this memorandum presents a summary of the prior literature on market reactions to litigation events and a discussion of its limitations. As described in greater detail below, one set of academic papers has addressed securities litigation exclusively, while another set has investigated stock price responses across a broader range of legal claims. The results are mixed in the context of securities litigation. At least two papers find no significant market reaction[5] to defendants' announcements of securities settlements, while other research reports a positive market response to securities class action settlements. Although the positive reaction to settlements of securities class action litigation may indicate that the market had overestimated the defendant's litigation exposure, a more likely interpretation consistent with other findings in the literature is that the positive stock price response reflects the perceived benefits of removing the burdens of an ongoing litigation.

Most of the research addressing other types of lawsuits also reports either an insignificant negative reaction or a positive reaction to settlement announcements. However, one paper examining a sample of product liability, patent infringement, labor and other cases finds a statistically significant negative reaction to settlement announcements. Thus, while overall the literature suggests that the market does not view settlement announcements as negative events, some of the evidence is mixed, suggesting the need for additional research. Moreover, the findings from prior literature must be

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[4] Financial Accounting Standards Board, Proposed Statement of Financial Accounting Standards Disclosure of Certain Loss Contingencies, an amendment of FASB Statements No. 5 and 141(R), June 5, 2008, A3.

[5] Significant market reaction refers to a stock price movement that is not within a normal range of volatility.

viewed with caution. The existing studies are quite dated, and none are designed to explore questions raised by the Exposure Draft.

Part 3 of this memorandum presents new research findings relevant to the Board's consideration. For securities class action litigation, we find, on average, no significant market reaction to defendants' announcements of settlements for a sample of securities settlements reached in 2007 and 2008, as well as for a sample of the 50 largest securities class action settlements announced since 1996. In addition to finding that stock prices do not react significantly *on average*, reviewing the stock price responses for each case reveals that the price movements surrounding individual settlement announcements do not exhibit any unusual patterns. In other words, even without the presence of information such as lawsuit-related announcements, for any sample of stock price returns we would expect to observe some statistically significant price movements. And this is exactly what we observe – a small number of significant price movements occur around settlement announcements.

An analysis of resolutions to all types of public company lawsuits reported in the *Wall Street Journal* between January 2006 and June 2008 finds that announcements of settlements typically do not cause significant stock price changes for defendant firms. In addition, we find that rulings in favor of the defendant firm (as distinguished from settlements) cause positive, and using some measures, statistically significant stock price reactions. Likewise, rulings against defendant firms lead to negative, and again using some measures, significant stock price reactions. Preliminary investigation indicates that specific resolutions that involved individually significant stock price changes were often based on a reaction to information that was likely unavailable to the company (such as the uncertain outcome to a ruling), or occurred in a unique situation such as a settlement that resolved extreme uncertainty for the company. Accordingly, even statistically significant stock prices responses do not necessarily reflect an information failure.

In light of the relatively short time period available to us to conduct these analyses, we view our findings as suggestive, not conclusive. Indeed, our major conclusion is that the Board's deliberations can be profitably informed by further research that would consider larger samples and conduct additional forms of analysis.

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The findings that litigation announcements frequently generate no statistically significant stock price responses, preliminary as they are, suggest that the stock market is often not surprised by the resolution of litigation events even with the existing disclosures pursuant to SFAS 5. This finding is not hard to explain. The large majority of litigation in the United States occurs in open court under circumstances that allow investors, analysts, and other market participants to learn a great deal of information about the relative merits of the litigation and the magnitude of potential outcomes.

Indeed, the market's ability to form its own, accurate assessment of the value of litigation distinguishes the litigation process from many other aspects of the disclosure and accounting process. For example, firms typically do not publicly disclose the contents of their inventories in detail sufficient to allow the market to form its own view of the inventory's valuation. Here, however, the market is often able to form its own views regarding the value of litigation, and the stock price data appear consistent with the view that the market's assessment is, on average, as worthy of deference and respect as views that might be formed by the litigants themselves.

Moreover, even if the data demonstrate a statistically significant price response for individual litigation resolutions, such results do not automatically support the conclusion that there has been a disclosure failure. Litigation events often involve the resolution of an intrinsic uncertainty. Consider a case that is submitted to a jury where the defendant publicly reporting company legitimately has a 50% expectation that it will prevail: the jury verdict is, quite literally, a coin toss. Assume that the company's stock is trading at $20 a share. If the defendant prevails its stock price will rise to $30 a share. If the defendant loses its stock will fall to $10 a share. The disclosures prior to the verdict can reflect perfectly accurate descriptions of the uncertainties associated with the litigation, and yet when the jury returns with its verdict - - no matter what it is - - a statistically significant stock price response is assured. It follows that a statistically significant stock price response to the announcement of litigation related information is a necessary but insufficient condition to support the conclusion that the market is, in some sense, surprised by the announcement. In order to determine whether a significant stock price response is indeed indicative of information failure, a more textured analysis of the individual facts and circumstances of the situation is necessary.

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Part 4 concludes with observations regarding the implications and limitations of the current state of research relevant to the Board's deliberations, and suggests directions for further research. Our primary conclusion is that the Exposure Draft is premature. We believe that the Board should defer consideration of the Exposure Draft and of alternative litigation-related disclosure proposals until additional research provides a more refined appreciation of the extent to which expanded disclosures will prove useful to users of the financial statements.

2.   Prior Academic Research

Over 35 years of prior academic literature shows that in an efficient market, stock prices respond rapidly and accurately to information.[6] For information to affect a stock price, it must be new, different from what the market previously expected, or resolve uncertainty about a future event and it must have implications for investors' expectations of cash flows. Academic researchers generally perform "event study" analysis to examine whether specific information has an impact on stock prices.

Event studies in prior academic literature that examine the stock market's reaction to announcements regarding lawsuit events provide information relevant to assessing the potential changes to disclosures that are proposed in the Exposure Draft. Prior literature investigates the market's response to announcements of various lawsuit events, such as case filings, dismissals, settlements, and judgments. A small body of research focuses specifically on securities litigation, while other research addresses a broader range of lawsuits. Particularly for non-securities litigation matters, there is a greater amount of research devoted to the study of the market's reaction to lawsuit filings than to other lawsuit events.

Securities Litigation. For securities class action litigation, research has found that defendants typically experience a statistically significant stock price decline upon case

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[6] For example, Brealey and Myers states: "A study by Patell and Wolfson shows just how fast prices move when new information becomes available. They found that, when a firm publishes its latest earnings or announces a dividend change, the major part of the adjustment in price occurs within 5 to 10 minutes of the announcement." (Richard A. Brealey, Stewart C. Myers, and Franklin Allen, "Principles of Corporate Finance," McGraw-Hill/Irwin, 8th Edition, p. 339.)

filings, even when controlling for the announcement of confounding information precipitating the lawsuit. Research includes reactions to announcements of private securities litigation,[7] as well as to announcements of formal SEC investigations.[8, 9]

It is well known that the majority of securities litigation matters are resolved by settlement. At least two papers have found no statistically significant market reaction to defendants' announcements of settlements in securities cases, either from class actions[10] or from SEC actions.[11] These results are not surprising considering that there is an extensive amount of public information available regarding securities cases, including the allegations involved in a case, as well as data on amounts for which securities cases typically settle.[12] Thus, the combination of the negative reaction at the time of case filings and the lack of response to settlement announcements suggests that at the time the case is filed, the market anticipates that the defendant will suffer a loss as a result of the litigation (either funds to be paid to the plaintiffs or other costs such as reputation loss, management diversion, legal fees, etc.). Before the matter is resolved, the market appears to have formed an expectation about the settlement amount relying on all available public and accounting information regarding the lawsuit, such that it is not surprised when the actual settlement is announced.

Other research has found a positive stock price response to securities class action settlements by as much as almost 5.5%, though this result varies by the time span around

[7] Griffin, Paul, Joseph A. Grundfest and Michael A. Perino, "Stock Price Response to News of Securities Fraud Litigation: An Analysis of Sequential and Conditional Information," *ABACUS*, Vol. 40, No. 1 (2004); Ferris, Stephen and A. Pritchard, "Stock Price Reactions to Securities Fraud Class Actions Under the Private Securities Litigation Reform Act," University of Michigan working paper (2001); Griffin, Paul, Joseph Grundfest and Michael Perino, "Stock Price Response to News of Securities Fraud Litigation: Market Efficiency and the Slow Diffusion of Costly Information," Stanford Law & Economics Olin working paper, (2000).

[8] Feroz, Ehsan H., Kyungjoo Park, and Victor S. Pastena, "The Financial and Market Effects of the SEC's Accounting and Auditing Enforcement Releases," *Journal of Accounting Research*, Vol. 29 (1991); Nourayi, Mahmoud, "Stock Price Responses to the SEC's Enforcement Actions," *Journal of Accounting and Public Policy*, Vol. 33, pp. 333-347 (1994).

[9] As previously indicated, the observation that the filing of a complaint is associated with a negative stock price response does not necessarily imply that there has been a disclosure failure. The market may have accurately anticipated a probability that a complaint would be filed and the filing of the complaint may simply have resolved the residual uncertainty.

[10] Romano, Roberta, "The Shareholder Suit: Litigation without Foundation?" *Journal of Law, Economics & Organization*, V7.N1 pp. 55-87, Oxford University Press, (1991).

[11] Feroz, Park, and Pastena (1991).

[12] Simmons, Laura and Ellen Ryan, "Securities Class Action Settlements, 2007 Review and Analysis," Cornerstone Research, Inc. (2008).

the settlement announcement that is considered.[13] This finding could be construed as indicating that the market overestimates the exposure from a particular securities litigation matter; however, consistent with other findings discussed below, the positive stock price response more likely reflects the perceived benefits to the defendant from no longer bearing the burden of the litigation carrying costs (in a manner consistent with the finding in the non-securities area discussed below).

Consistent with the fact that relatively few securities cases are resolved by trial, we are not aware of any research that has examined the market reaction to securities class action verdicts. However, there are a few papers that examine market reactions to case dismissals. Such research has produced mixed results.[14] Accordingly, Griffin, Grundfest and Perino (2004) conclude that further research is needed in this area.

Litigation Involving Non-Securities Claims. Similar to research on securities litigation, research focusing primarily on other types of litigation has found that defendants generally experience a stock price decline upon case filings.[15] Consistent with these results, Haslem (2005) observes that "the initial reaction to a firm being named as a defendant in a lawsuit is universally and significantly negative."[16] Moreover, examining a sample of firms in the automobile and pharmaceutical industries, Prince and Rubin (2002) conclude that losses in firm value at the time of lawsuit announcements reflect the worst-case scenario in terms of legal costs and damages.

Regarding settlements, most papers that examine cases of varied litigation types find either a statistically insignificant negative reaction or a positive reaction to settlement announcements.[17] For example, Bhagat, Brickley and Coles (1994) find a

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[13] See Griffin, Grundfest and Perino (2004).

[14] Romano (1991), Ferris and Pritchard (2001), and Griffin, Grundfest and Perino (2004).

[15] Bizjak, John M. and Jeffrey L. Coles, "The Effect of Private Antitrust Litigation on the Stock Market Valuation of the Firm," *The American Economic Review*, Vol. 85, No. 3 (1995); Cross, Mark L., Wallace N. Davidson, and John H. Thornton, "The Impact of Directors and Officers' Liability Suits on Firm Value" *The Journal of Risk and Insurance*, (1989); Prince, David W., and Paul H. Rubin, "The Effects of Product Liability Litigation on the Value of Firms" *American Law and Economic Review*, Spring (2002).

[16] Haslem, Bruce, "Managerial Opportunism during Corporate Litigation," *Journal of Finance*, August (2005).

[17] Bhagat, Sanjai, John Bizjak, and Jeffrey Coles, "The Shareholder Wealth Implications of Corporate Lawsuits," *Financial Management*, Vol. 27 No. 4, pp. 5-27, Winter (1998); Karpoff, Jonathan and John Lott, "On the determinants and importance of punitive damage awards," *Journal of Law and Economics,*

statistically significant and positive reaction to defendants' announcements of settlements with a sample of cases primarily involving corporate control, patent infringement, or anti-trust issues. Bhagat et al. also find that defendants' stock price declines from lawsuit filings are regained at the time of settlement. However, Haslem (2005) examines a sample of product liability, patent infringement, labor, and other cases and finds a statistically significant negative reaction to settlement announcements. Thus, further research is required to better understand the market's response to defendant settlement announcements across different types of litigation matters.[18]

Prior literature has also examined market reactions to litigation events for publicly-traded plaintiffs. Overall this literature has found that plaintiffs do not experience significant positive stock price returns in response to litigation events. For example, Bhagat, Brickley and Coles (1994) find that upon case filings, plaintiffs experience no significant stock price gains. Similarly, Bhagat, Bizjak and Coles (1998) find insignificant market reactions to settlement announcements by plaintiff firms. Bhagat and Romano (2002) summarize this literature and observe that research indicates that any wealth losses experienced by defendants (i.e., stock price declines) are not fully offset by wealth increases by plaintiffs.[19] These findings support the importance of litigation costs to defendants other than the direct amounts paid to plaintiffs, and are consistent with the observation that defendants settling class action securities fraud cases may, on average, experience statistically significant stock price increases.

As described above, there is consistent evidence from prior research of a statistically significant, negative market reaction to lawsuit filings for defendant firms. In addition, while there is some variation across case types, overall the evidence suggests that the market does not perceive settlement announcements as significant, negative news for defendants. As noted above, these results are consistent with the market having

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42, 527-573 (1999); Bhagat, Sanjai, James Brickley, and Jeffrey Coles, *Journal of Financial Economics*, 35, pp. 221 – 247, *(1994)*

[18] Relative to securities lawsuits, litigation in other areas is more frequently resolved by judgment. Accordingly, several papers examine the market's reaction to judgments in cases involving trademark and other issues. See Filbeck, Greg, Raymond F. Gorman, and Daniel J. Herron, "Stock Price Reaction to Trademark Related Lawsuits," *Trademark Rep.*, Vol. 85, pp. 191-204 (1995); Karpoff and Lott (1999). The findings from this literature are mixed, again suggesting the need for further research.

[19] Bhagat, Sanjai and Roberta Romano, "Event Studies and the Law: Part 1: Technique and Corporate Litigation," *American Law and Economic Review* 4, 141-168 (2002).

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access to public information about the lawsuit and well-formed expectations of settlement amounts, thus not being surprised when settlement outcomes are announced.

Although existing research suggests some preliminary inferences, the strength of the evidence provided by the literature is limited by several factors, including the fact that several of the papers use relatively small sample sizes and none of the research utilizes cases resolved since 2002. Moreover, none of the existing literature of which we are aware is centrally focused on understanding market reactions to announcements of lawsuit outcomes. Thus prior research does not delve deeply enough for purposes of considering the adequacy of litigation-related disclosures in financial statements.

3.   New Empirical Findings

Considering the limits identified in the existing literature, we have performed an empirical study to assist in the FASB's deliberations. Given the time constraints under which we were operating, this initial analysis focuses on lawsuit settlements and other resolutions, in part because that is the area where there is the least prior research. Our analysis divides lawsuit resolutions into securities class action litigation settlements (discussed in section 3a) and resolutions of non-securities class action matters, such as patent infringement and intellectual property disputes (discussed in section 3b).[20]

3a.   Securities Class Action Litigation

Our securities class action analysis focuses solely on settlements, because the majority of securities class action litigation matters are resolved through a settlement. To the best of our knowledge, no published research has studied market reactions using settlements since 2002. Hence, to provide the Board with relevant analysis based on recent evidence, we focus on a sample of court-approved settlements between January 2007 and June 2008, as well as a sample of the 50 largest securities class action settlements since 1996. Our findings are consistent with the prior literature and indicate that stock prices do not, on average, react in a statistically significant manner to the

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[20] Our event study methodology follows standard approaches applied in academic literature. More specifically, we either use a market model, controlling for the sensitivity of a company stock price to movement of a broad market index ("residual return"), or we use the total company return net of market return on a relevant day ("excess return"). Our conclusions are not affected by the choice of a model used in the event study.

announcements of a settlement in securities class action lawsuits. Thus, settlement announcements do not appear to significantly impact the mix of information available to market participants. In addition to finding that stock prices do not react significantly *on average*, we also find that the insignificant average is not simply a reflection of large positive reactions offsetting large negative reactions. In other words, very few of the settlement announcements *individually* lead to significant stock price movements. The lack of statistically significant returns is here again consistent with the market relying on publicly available information about a lawsuit in forming its expectation about the settlement amount such that it is not surprised when the actual settlement is announced.

We identify securities class action settlements through *Securities Class Action Services*. Our first sample consists of securities class action settlements with final court approval dates between January 2007 and June 2008 ("2007/2008 settlements"). The second sample is assembled from the 50 securities class action cases with the largest total settlements between 1996 and June 2008 ("largest 50 settlements"). For all class action securities settlements in either sample, we identify the first public announcement of the amount of a tentative settlement from public press searches.[21]

The event study results for the 2007/2008 settlements sample are presented in Exhibit 1, Panel A. The average residual return on the impact day of the tentative settlement announcement is 0.43%.[22] This return is not statistically significant at the standard level of significance.[23] Because some of the settlement announcements were announced along with earnings announcements or other potentially confounding information, Exhibit 1, Panels B and C report results for a set of settlements without confounding information either on the event day (Panel B) or during a three-day event window (Panel C). The average residual returns of 0.26% in Panel B and 0.00% in Panel C are not statistically significant at the standard level of significance.

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[21] Once the first public announcement of a tentative settlement date was identified, the mix of public information for each company was also reviewed for confounding information.

[22] We use a one-day event window in our analyses of securities settlements because we were able to identify the precise timing of the relevant announcements. As is often applied in academic research, we also consider a three-day event window. Our conclusions are not affected by choice of the length of an event window.

[23] The implications of the securities class action settlement analyses are unchanged when the median is used instead of the average.

Because some of the settlements in the 2007/2008 sample may be perceived as small, hence may not be expected to lead to significant stock price changes, we also analyze the 50 largest securities class action settlements since 1996.[24] The event study results for the largest 50 settlements are presented in Exhibit 2, Panel A. The average residual return of 0.04% for tentative settlement announcements is not statistically significant at the standard level of significance. Exhibit 2, Panels B and C report results for the largest 50 settlements without confounding information either on the event day (Panel B) or during a three-day event window (Panel C). The average residual returns of 0.96% in Panel B and 0.26% in Panel C are not statistically significant at the standard level of significance.

In addition to analyzing the average stock price reaction for both samples, we also investigated the extent to which the individual settlement announcements resulted in statistically significant stock price changes. We found that very few of the individual observations were associated with significant stock price reactions. Specifically, only one case in the 2007/2008 settlements sample had a significant, negative stock price return and did not have some type of confounding information associated with the settlement announcement. Four cases in this sample had a significant, positive stock price return and did not have confounding information associated with the settlement announcement. Similarly, only one case in the largest 50 settlements sample had a significant stock price return without some type of confounding information released at the same time as the settlement announcement, and this return was positive. Observing a small number of significant stock price reactions associated with settlement announcements would be expected even in the absence of litigation related news. Thus, the finding of limited significant stock price changes for *individual* observations is an important result because it provides further support for the hypothesis that the market is doing more than simply "getting it right" on average with significant positive reactions being offset by significant negative reactions.

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[24] For the companies in the sample not publicly traded at the time of the settlement we also collected information on tentative settlements of the publicly traded co-defendants, such as underwriters, and added them to the sample. The results for this expanded sample are reported in Exhibit 3 and are consistent with the results for company defendants only (Exhibit 2). For brevity, we focus our discussion on results solely for company defendants in Exhibit 2.

3b. *Litigation Involving Non-Securities Claims*

Resolutions of a range of non-securities types of lawsuits involving publicly traded companies were identified from a review of articles in the Wall Street Journal.[25] This sample covers the time period January 2006 – June 2008. As with the analysis of securities class action settlements, we analyze the stock prices returns for defendant firms over the three-day period surrounding the date the article was published.

The sample results in 439 observations of a resolution to a lawsuit (other than a securities class action) for defendant public companies where stock price data was available to perform an event study and an event confounding the announcement of the lawsuit was not identified.[26] Event study analysis is used to analyze the stock price reactions to resolutions for three sub-samples of the data: settlements, rulings in favor of defendants, and rulings against defendants.[27]

A review of the data uncovered some "outlier" resolution observations that affect the event study results using average statistics as were used in section 3a.[28] We believe it is more appropriate to focus on median residual return statistics instead of average statistics to lessen the influence of the outlier observations. The results for the settlement sub-sample (236 cases), including average and median statistics, are shown in Exhibit 4.

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[25] Articles from in *The Wall Street Journal* were obtained from Factiva. A comprehensive set of search terms were applied to Factiva's category C12: Corporate crime, legal investigations, lawsuits and court rulings.

[26] The resolutions were identified as settlements, rulings, or dismissed / dropped. If the Wall Street Journal article mentioned a confounding event, then the observation was excluded. As a second step, we reviewed news headlines from all Factiva publications for companies with individually significant residual returns over the three day period. Observations for which confounding information was found from this review were also excluded.

[27] The implications from the "rulings in favor of defendants" sub-sample analysis are similar when dismissed and dropped announcements are added to the sub-sample.

[28] For example, ten out of the 236 settlements resulted in individually positive significant residual returns over the three-day window. Some of these settlements involved patent lawsuits that were critical to the company's business, and removed an extreme form of uncertainty. Particularly, a settlement of a patent suit between Vonage Holdings Corp. and Sprint Nextel Corp. resulted in a 98% residual return for Vonage (the defendant) over the three day-window. This settlement occurred two weeks after a jury ruling against Vonage that "left Vonage open to the risk of an injunction barring it from offering its Internet-based phone service." The settlement "marked the resolution of Vonage's second largest legal problem and allowed the firm to license Sprint's internet calling technology." A second settlement of a patent suit followed a ruling against Boston Communications as defendant. "Boston Communications had spent some $27 million defending the lawsuit and had said it would have to file for bankruptcy protection if its appeals of the ruling were unsuccessful." The settlement announcement resulted in an 82% residual return over the three day period for that company's stock. In comparison to the ten settlements with individually positive significant results, only three out of the 236 settlements had individually negative significant residual returns over the three-day window, and as described in section 3a, we would expect to find a small number of statistically significant price movements even in the absence of any litigation-related news.

For this sub-sample, the median residual return over for the three-day period surrounding the article date was 0.07%. This return is not statistically significant. Similar to the analysis of securities class action settlements, the median results for the announcements of settlements in litigation involving non-securities claims demonstrates that the market, in general, is well informed about defendant firm litigation.

Not surprisingly, the event study analysis finds positive stock price reactions associated with the announcements of rulings (as distinguished from settlements) in favor of defendants, a finding again consistent with the observation that rulings by third parties, such as judicial decisions or jury verdicts, provide information because they resolve uncertainty, and not necessarily because of a failure to provide adequate information to the market. As shown in Exhibit 5, using some measures, this is a statistically significant result over for the three-day period. Similarly, the result for rulings against defendants is negative, and as shown in Exhibit 6, is significant using some measures.

4.   Concluding Observations and Recommendations

This memorandum summarizes the current academic event study literature relevant to the Board's consideration of the proposed Exposure Draft regarding loss contingencies, and extends that literature through an event analysis of recent litigation-related announcements. Consistent with the market either accurately anticipating litigation settlement outcomes or not viewing such events as material to the value of the firm, empirical analyses indicate that settlement announcements typically result in insignificant stock price reactions for the defendant firms. These results can be interpreted as suggesting that the market is informed regarding potential litigation settlements under current disclosure practices followed by publicly-traded firms. This is an important finding because the vast majority of lawsuits are resolved by settlement.

We have also reviewed the literature and conducted new research relating to litigation events that involve the resolution of an intrinsic uncertainty. Not surprisingly, prior academic research and our own analyses find that in circumstances of litigation rulings that involve the resolution of uncertainty, statistically significant stock price effects are more likely to be observed. However, as noted, these results do not automatically support the conclusion that there has been a disclosure failure, because the

outcome of the ruling is not only an uncertainty to outside market participants, but also to management, and significant stock price reactions can occur even in the face of the most accurate and complete possible disclosures.

As noted, we believe that the FASB's decision process would benefit from further empirical research. In addition to examining other types of lawsuit events, we recommend that future research test the robustness of the general results we report herein, as well as investigate more specific questions such as whether there are systematic variations in the market's response to lawsuit announcements based on factors related to the firm and the nature of the litigation (e.g., firm size, relative magnitude of the exposure to the firm, or stage of the litigation when a settlement occurred). We suggest that future research also investigate the effect of prior disclosures regarding the litigation on the market's response to ultimate lawsuit outcomes.

Accordingly, while we recognize the limitations of the current state of the literature and believe that further research is required, the current state of the literature suggests that FASB proceed with caution before reaching any conclusions based on the assumption that the investing public is, in any systematic sense, materially ill-informed or systematically unable to assess the implications of litigation-related events on stock price valuation. Simply put, the available event study data do not support those assumptions.

The significance of our observations regarding the need for further empirical analysis are amplified, we believe, by the fact that counsel regularly involved in the litigation process are likely to express the view that disclosures of the sort contemplated by the Exposure Draft will systematically disadvantage defendants in litigation. The contemplated disclosure requirements also raise a range of issues regarding attorney-client privilege and the possibility that FASB mandated disclosures will constitute admissions against interest. The net result of the proposed Exposure Draft can therefore potentially harm shareholder interests by increasing litigation and settlement costs for firms while not providing a commensurate benefit in the accuracy or efficiency of market pricing. Put another way, the Exposure Draft may be detrimental to investor interests, and further research is necessary in order to develop a more robust understanding of the costs and benefits of FASB's proposed revisions to SFAS 5. Accordingly, we suggest that the timetable for consideration of potential expanded loss contingency disclosures be

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deferred to allow for the proper conduct of relevant research and that the FASB and the academic community embark on a careful and balanced consideration of the issues raised by the Exposure Draft.

Exhibit 1: Securities Class Action Lawsuits
Settlements with January 2007 – June 2008 Approval Hearing Dates
Settlement Announcement Event Study Results
Source: *CRSP*; *Bloomberg*; Factiva; LivEdgar; Securities Class Actions Services

Event Day	Excess Returns [1]		Residual Returns [2]	
	Average	Median	Average	Median
A: All Observations				
-1	0.07%	-0.14%	0.17%	0.07%
0	0.34%	0.16%	0.43%	0.40%
1	0.19%	0.04%	0.07%	-0.08%
(-1,1)	0.60%	0.57%	0.67%	0.75%

Number of Observations: 74

Event Day	Excess Returns [1]		Residual Returns [2]	
B: Excluding Observations with Confounding Information on Event Date (t₀) [3]				
-1	0.30%	-0.16%	0.45%	0.05%
0	0.19%	0.12%	0.26%	0.16%
1	0.36%	0.32%	0.22%	0.00%
(-1,1)	0.86%	0.52%	0.94%	0.82%

Number of Observations: 51

Event Day	Excess Returns [1]		Residual Returns [2]	
C: Excluding Observations with Confounding Information during 3-Day Event Window [3]				
-1	0.45%	-0.10%	0.53%	0.15%
0	-0.09%	0.12%	0.00%	0.25%
1	0.11%	-0.14%	0.00%	-0.34%
(-1,1)	0.46%	-0.06%	0.54%	0.37%

Number of Observations: 36

Exhibit 1, continued: Securities Class Action Lawsuits
Settlements with January 2007 – June 2008 Approval Hearing Dates

Note:

The sample consists of defendant companies for which the class action settlement was approved by the court between January 2007 and June 2008. For each observation, the impact date, t_0, corresponds to the impact date of the first public announcement that contains information on the tentative settlement amount. Information on the settlement amount is identified using public press searches on Factiva All and Bloomberg. Information on the settlement amount is defined as the disclosure of the full settlement amount, an indication of full insurance coverage, or the disclosure of the tentative settlement's financial impact on the company. Specifically, t_0 is the event date if the news became public before or during trading hours; it is the next trading day if the news became public after trading hours. To be included in the sample, companies must have Center for Research in Securities Prices (CRSP) data available on the trading day before t_0 (t_0-1), on t_0, and on the trading day after t_0 (t_0+1).

[1] The excess return is calculated as the difference between the observation's actual return on a particular day and the return of the CRSP NYSE/AMEX/NASDAQ Value-Weighted Index on the same day. The cumulative excess return from t_0-1 to t_0+1 is the sum of the excess returns for days in the event window (-1,1). [*] indicates that average/median is different from zero at the 5% level of statistical significance. Statistical significance tests rely on the cross-sectional t-statistic for the average and the sign test for the median. The cross-sectional standard error is calculated as the standard deviation of the average of the cross section of cumulative excess returns during the corresponding event window. Source: Campbell, John Y., Andrew W. Lo, and A. Craig MacKinlay, 1997, *The Econometrics of Financial Markets*, Princeton University Press, Chapter 4, p. 168.

[2] The residual return is calculated as the difference between the actual return and the predicted return. The predicted return results from regressing observation returns on CRSP NYSE/AMEX/NASDAQ Value-Weighted Index returns over the estimation period. The estimation period spans one year ending 20 days prior to the first announcement of the tentative settlement. The cumulative residual return from t_0-1 to t_0+1 is the sum of the residual returns for days in the event window (-1,1). [*] indicates that median is different from zero at the 5% level of statistical significance based on the sign test. For the average residual return, [*] and [†] indicate that the return is significant at the 5% level of significance based on cross-sectional and market model estimates of standard errors, respectively. The market model standard error is based on the standard deviation of residual returns of each observation. The standard error of a daily average residual return is the square root of the sum of individual observations' variances of residual returns divided by the number of observations. For event windows longer than one day, the standard error is multiplied by the square root of the number of days.

[3] Confounding information was identified using public press searches on Factiva All, restricted to the company name in the lead paragraph, and includes information related to, for example, earnings announcements, ratings changes and releases, as well as new partnerships or contracts.

Exhibit 2: Securities Class Action Lawsuits
50 Largest Settlements Approved By the Court
Settlement Announcements Event Study Results

Source: *CRSP*; *Bloomberg*; Factiva; LivEdgar; Securities Class Actions Services

Event Day	Excess Returns [1]		Residual Returns [2]	
	Average	Median	Average	Median
A: All Observations				
-1	-0.46%	-0.29%	-0.33%	-0.15%
0	0.00%	0.53%	0.04%	0.28%
1	-0.05%	-0.38%	0.01%	-0.40%
(-1,1)	-0.51%	-0.30%	-0.27%	-0.22%

Number of Observations: 38

Event Day	Excess Returns [1]		Residual Returns [2]	
B: Excluding Observations with Confounding Information on Event Day (t_0) [3]				
-1	-1.59%	-0.79%	-1.26%	-0.52%
0	0.84%	0.63%	0.96%	0.74%
1	-0.23%	-0.27%	-0.21%	-0.12%
(-1,1)	-0.98%	-0.46%	-0.51%	-0.36%

Number of Observations: 13

Event Day	Excess Returns [1]		Residual Returns [2]	
C: Excluding Observations with Confounding Information during 3-Day Event Window [3]				
-1	0.13%	-0.02%	0.58%	-0.17%
0	0.27%	-0.35%	0.26%	0.13%
1	-0.87%	-1.31%	-0.73%	-0.76%
(-1,1)	-0.46%	-0.41%	0.11%	-0.30%

Number of Observations: 6

Exhibit 2, continued: Securities Class Action Lawsuits
50 Largest Settlements Approved By the Court

Note:

The sample is constructed based on the largest 50 settlements approved by the court between 1996 and 2008. For each observation, the impact date, t_0, corresponds to the impact date of the first public announcement that contains information on the tentative settlement amount. Information on the settlement amount is identified using public press searches on Factiva All and Bloomberg. Information on the settlement amount is defined as the disclosure of the full settlement amount, an indication of full insurance coverage, or the disclosure of the tentative settlement's financial impact on the company. Specifically, t_0 is the event date if the news became public before or during trading hours; it is the next trading day if the news became public after trading hours.

The following companies do not have CRSP data available on or around the day of the tentative settlement: Enron Corp., WorldCom, Inc., Adelphia Communications Corp., HealthSouth Corp., Lernout & Hauspie Speech Products, AT&T Wireless Tracking Stock, Refco, Inc., Conseco, Inc., Sears, Roebuck & Co., and Sunbeam Corp. Other companies excluded from the sample are Global Crossing, which itself never settled the case, although its officers and codefendants did, and Electronic Data Systems Corp., which did not have public press coverage of the tentative settlement.

[1] The excess return is calculated as the difference between the observation's actual return on a particular day and the return of the CRSP NYSE/AMEX/NASDAQ Value-Weighted Index on the same day. The cumulative excess return from t_0-1 to t_0+1 is the sum of the excess returns for days in the event window (-1,1). [*] indicates that average/median is different from zero at the 5% level of statistical significance. Statistical significance tests rely on the cross-sectional t-statistic for the average and the sign test for the median. The cross-sectional standard error is calculated as the standard deviation of the average of the cross section of cumulative excess returns during the corresponding event window. Source: Campbell, John Y., Andrew W. Lo, and A. Craig MacKinlay, 1997, The Econometrics of Financial Markets, Princeton University Press, Chapter 4, p. 168.

[2] The residual return is calculated as the difference between the actual return and the predicted return. The predicted return results from regressing observation returns on CRSP NYSE/AMEX/NASDAQ Value-Weighted Index returns over the estimation period. The estimation period spans one year ending 20 days prior to the first announcement of the tentative settlement. The cumulative residual return from t_0-1 to t_0+1 is the sum of the residual returns for days in the event window (-1,1). [*] indicates that median is different from zero at the 5% level of statistical significance based on the sign test. For the average residual return, [*] and [†] indicate that the return is significant at the 5% level of significance based on cross-sectional and market model estimates of standard errors, respectively. The market model standard error is based on the standard deviation of residual returns of each observation. The standard error of a daily average residual return is the square root of the sum of individual observations' variances of residual returns divided by the number of observations. For event windows longer than one day, the standard error is multiplied by the square root of the number of days.

[3] Confounding information was identified using public press searches on Factiva All, restricted to the company name in the lead paragraph, and includes information related to, for example, earnings announcements, ratings changes and releases, as well as new partnerships or contracts.

Exhibit 3: Securities Class Action Lawsuits
50 Largest Settlements Approved By the Court (Including Bank-Codefendants)
Settlement Announcement Event Study Results

Source: *CRSP*; *Bloomberg*; Factiva; LivEdgar; Securities Class Actions Services

Event Day	Excess Returns [1]		Residual Returns [2]	
	Average	Median	Average	Median
A: All Observations				
-1	-0.31%	-0.11%	-0.21%	-0.03%
0	-0.15%	0.06%	-0.12%	0.05%
1	-0.10%	-0.34%	-0.07%	-0.33%
(-1,1)	-0.57%	-0.13%	-0.40%	-0.11%

Number of Observations: 51

Event Day	Excess Returns [1]		Residual Returns [2]	
B: Excluding Observations with Confounding Information on Event Date (t_0) [3]				
-1	-1.05%	-0.48%	-0.81%	-0.47%
0	0.63%	-0.06%	0.71%	0.09%
1	0.07%	0.48%	0.08%	0.13%
(-1,1)	-0.36%	0.49%	-0.03%	0.27%

Number of Observations: 17

Event Day	Excess Returns [1]		Residual Returns [2]	
C: Excluding Observations with Confounding Information during 3-Day Event Window [3]				
-1	0.37%	0.12%	0.64%	0.07%
0	0.20%	-0.07%	0.16%	0.02%
1	-0.16%	0.38%	-0.11%	0.27%
(-1,1)	0.40%	0.61%	0.69%	0.63%

Number of Observations: 10

20

Exhibit 3: Securities Class Action Lawsuits
50 Largest Settlements Approved By the Court (Including Bank-Codefendants)

Note:
The sample is constructed based on the largest 50 settlements approved by the court between 1996 and 2008. For each observation, the impact date, t_0, corresponds to the impact date of the first public announcement that contains information on the tentative settlement amount. Information on the settlement amount is identified using public press searches on Factiva All and Bloomberg. Information on the settlement amount is defined as the disclosure of the full settlement amount, an indication of full insurance coverage, or the disclosure of the tentative settlement's financial impact on the company. Specifically, t_0 is the event date if the news became public before or during trading hours; it is the next trading day if the news became public after trading hours. The companies excluded from the sample are Global Crossing, which itself never settled the case, although its officers and codefendants did, and Electronic Data Systems Corp, which did not have public press coverage of the tentative settlement. The following companies do not have CRSP data available on or around the day of the tentative settlement or publicly traded bank-codefendants: HealthSouth Corp., Lernout & Hauspie Speech Products, AT&T Wireless Tracking Stock, Refco, Inc., Conseco, Inc., Sears, Roebuck & Co, and Sunbeam Corp. Publicly traded bank-codefendants who settled are included in the analysis for the following lawsuits: Enron Corp., WorldCom, Inc., Adelphia Communications Corp., and Global Crossing. If multiple bank-codefendants in the same case settled on the same date, their stock price data is combined into an equal-weighted portfolio.

[1] The excess return is calculated as the difference between the observation's actual return on a particular day and the return of the CRSP NYSE/AMEX/NASDAQ Value-Weighted Index on the same day. The cumulative excess return from t_0-1 to t_0+1 is the sum of the excess returns for days in the event window (-1,1). [*] indicates that average/median is different from zero at the 5% level of statistical significance. Statistical significance tests rely on the cross-sectional t-statistic for the average and the sign test for the median. The cross-sectional standard error is calculated as the standard deviation of the average of the cross section of cumulative excess returns during the corresponding event window.
Source: Campbell, John Y., Andrew W. Lo, and A. Craig MacKinlay, 1997, The Econometrics of Financial Markets, Princeton University Press, Chapter 4, p. 168.
[2] The residual return is calculated as the difference between the actual return and the predicted return. The predicted return results from regressing observation returns on CRSP NYSE/AMEX/NASDAQ Value-Weighted Index returns over the estimation period. The estimation period spans one year ending 20 days prior to the first announcement of the tentative settlement. The cumulative residual return from t_0-1 to t_0+1 is the sum of the residual returns for days in the event window (-1,1). [*] indicates that median is different from zero at the 5% level of statistical significance based on the sign test. For the average residual return, [*] and [†] indicate that the return is significant at the 5% level of significance based on cross-sectional and market model estimates of standard errors, respectively. The market model standard error is based on the standard deviation of residual returns of each observation. The standard error of a daily average residual return is the square root of the sum of individual observations' variances of residual returns divided by the number of observations. For event windows longer than one day, the standard error is multiplied by the square root of the number of days.
[3] Confounding information was identified using public press searches on Factiva All, restricted to the company name in the lead paragraph, and includes information related to, for example, earnings announcements, ratings changes and releases, as well as new partnerships or contracts.

Exhibit 4: Resolutions Reported in *The Wall Street Journal*
January 2006 – June 2008
Defendant Settled Cases Event Study Results
Source: *CRSP*; Factiva; *The Wall Street Journal*

Event Day	Excess Returns[1]		Residual Returns[2]	
	Average	Median	Average	Median
-1	1.57% *	0.13%	1.57% * †	0.15% *
0	-0.20%	-0.11%	-0.20%	-0.09%
1	-0.08%	-0.02%	-0.03%	-0.03%
(-1,1)	1.29% *	-0.01%	1.34% * †	0.07%

Number of Observations: 236

Note:

The sample consists of defendant companies for which a settlement was identified in an article in *The Wall Street Journal* between January 2006 and June 2008. Observations identified as securities class actions were excluded. If confounding information was mentioned in the article, the observation was also excluded. For example, confounding information may include earnings announcements, ratings changes and releases, as well as new partnerships or contracts. As a second step, a headline search of Factiva All was performed for observations with an individually significant residual return over the 3 day window. Observations with confounding information found from this search were excluded. The date of the article is defined as t_0 if the article occurred on a trading day. If the article did not occur on a trading day, t_0 was defined as the next trading day. Finally, to be included in the sample, companies must have Center for Research in Securities Prices (CRSP) data available on the trading day before t_0 (t_0-1), t_0, and on the trading day after t_0 (t_0+1).

[1] The excess return is calculated as the difference between the observation's actual return on a particular day and the return of the CRSP NYSE/AMEX/NASDAQ Value-Weighted Index on the same day. The cumulative excess return from t_0-1 to t_0+1 is the sum of the excess returns for days in the event window (-1,1). [*] indicates that average/median is different from zero at the 5% level of statistical significance. Statistical significance tests rely on the cross-sectional t-statistic for the average and the sign test for the median. The cross-sectional standard error is calculated as the standard deviation of the average of the cross section of cumulative excess returns during the corresponding event window. Source: Campbell, John Y., Andrew W. Lo, and A. Craig MacKinlay, 1997, The Econometrics of Financial Markets, Princeton University Press, Chapter 4, p. 168.

[2] The residual return is calculated as the difference between the actual return and the predicted return. The predicted return results from regressing observation returns on CRSP NYSE/AMEX/NASDAQ Value-Weighted Index returns over the estimation period. The estimation period spans one year ending 20 days prior to t_0. The cumulative residual return from t_0-1 to t_0+1 is the sum of the residual returns for days in the event window (-1,1). [*] indicates that median is different from zero at the 5% level of statistical significance based on the sign test. For the average residual return, [*] and [†] indicate that the return is significant at the 5% level of significance based on cross-sectional and market model estimates of standard errors, respectively. The market model standard error is based on the standard deviation of residual returns of each observation. The standard error of a daily average residual return is the square root of the sum of individual observations' variances of residual returns divided by the number of observations. For event windows longer than one day, the standard error is multiplied by the square root of the number of days.

Exhibit 5: Resolutions Reported in *The Wall Street Journal*
January 2006 – June 2008
Favorable Defendant Rulings Event Study Results
Source: *CRSP*; Factiva; *The Wall Street Journal*

Event Day	Excess Returns[1]		Residual Returns[2]	
	Average	Median	Average	Median
-1	1.04%	0.20%	1.01% †	0.13%
0	-0.04%	-0.17%	-0.08%	-0.07%
1	0.03%	-0.02%	0.06%	0.02%
(-1,1)	1.03%	0.57% *	0.99% †	0.47%

Number of Observations: 69

Note:

The sample consists of defendant companies for which a favorable ruling was identified in an article in *The Wall Street Journal* between January 2006 and June 2008. Observations identified as securities class actions were excluded. If confounding information was mentioned in the article, the observation was also excluded. For example, confounding information may include earnings announcements, ratings changes and releases, as well as new partnerships or contracts. As a second step, a headline search of Factiva All was performed for observations with an individually significant residual return over the 3 day window. Observations with confounding information found from this search were excluded. The date of the article is defined as t_0 if the article occurred on a trading day. If the article did not occur on a trading day, t_0 was defined as the next trading day. Finally, to be included in the sample, companies must have Center for Research in Securities Prices (CRSP) data available on the trading day before t_0 (t_0-1), t_0, and on the trading day after t_0 (t_0+1).

[1] The excess return is calculated as the difference between the observation's actual return on a particular day and the return of the CRSP NYSE/AMEX/NASDAQ Value-Weighted Index on the same day. The cumulative excess return from t_0-1 to t_0+1 is the sum of the excess returns for days in the event window (-1,1). [*] indicates that average/median is different from zero at the 5% level of statistical significance. Statistical significance tests rely on the cross-sectional t-statistic for the average and the sign test for the median. The cross-sectional standard error is calculated as the standard deviation of the average of the cross section of cumulative excess returns during the corresponding event window. Source: Campbell, John Y., Andrew W. Lo, and A. Craig MacKinlay, 1997, The Econometrics of Financial Markets, Princeton University Press, Chapter 4, p. 168.

[2] The residual return is calculated as the difference between the actual return and the predicted return. The predicted return results from regressing observation returns on CRSP NYSE/AMEX/NASDAQ Value-Weighted Index returns over the estimation period. The estimation period spans one year ending 20 days prior to t_0. The cumulative residual return from t_0-1 to t_0+1 is the sum of the residual returns for days in the event window (-1,1). [*] indicates that median is different from zero at the 5% level of statistical significance based on the sign test. For the average residual return, [*] and [†] indicate that the return is significant at the 5% level of significance based on cross-sectional and market model estimates of standard errors, respectively. The market model standard error is based on the standard deviation of residual returns of each observation. The standard error of a daily average residual return is the square root of the sum of individual observations' variances of residual returns divided by the number of observations. For event windows longer than one day, the standard error is multiplied by the square root of the number of days.

Exhibit 6: Resolutions Reported in *The Wall Street Journal*
January 2006 – June 2008
Unfavorable Defendant Rulings Event Study Results
Source: *CRSP; Factiva; The Wall Street Journal*

	Excess Returns[1]		Residual Returns[2]	
Event Day	Average	Median	Average	Median
-1	-1.02%	-0.21%	-0.96% †	-0.25% *
0	-0.89%	-0.36%	-0.84% †	-0.33% *
1	0.41%	0.07%	0.44% †	-0.02%
(-1,1)	-1.50%	-0.51% *	-1.37% †	-0.55%

Number of Observations: 92

Note:

The sample consists of defendant companies for which an unfavorable ruling was identified in an article in *The Wall Street Journal* between January 2006 and June 2008. Observations identified as securities class actions were excluded. If confounding information was mentioned in the article, the observation was also excluded. For example, confounding information may include earnings announcements, ratings changes and releases, as well as new partnerships or contracts. As a second step, a headline search of Factiva All was performed for observations with an individually significant residual return over the 3 day window. Observations with confounding information found from this search were excluded. The date of the article is defined as t_0 if the article occurred on a trading day. If the article did not occur on a trading day, t_0 was defined as the next trading day. Finally, to be included in the sample, companies must have Center for Research in Securities Prices (CRSP) data available on the trading day before t_0 (t_0-1), t_0, and on the trading day after t_0 (t_0+1).

[1] The excess return is calculated as the difference between the observation's actual return on a particular day and the return of the CRSP NYSE/AMEX/NASDAQ Value-Weighted Index on the same day. The cumulative excess return from t_0-1 to t_0+1 is the sum of the excess returns for days in the event window (-1,1). [*] indicates that average/median is different from zero at the 5% level of statistical significance. Statistical significance tests rely on the cross-sectional t-statistic for the average and the sign test for the median. The cross-sectional standard error is calculated as the standard deviation of the average of the cross section of cumulative excess returns during the corresponding event window. Source: Campbell, John Y., Andrew W. Lo, and A. Craig MacKinlay, 1997, The Econometrics of Financial Markets, Princeton University Press, Chapter 4, p. 168.

[2] The residual return is calculated as the difference between the actual return and the predicted return. The predicted return results from regressing observation returns on CRSP NYSE/AMEX/NASDAQ Value-Weighted Index returns over the estimation period. The estimation period spans one year ending 20 days prior to t_0. The cumulative residual return from t_0-1 to t_0+1 is the sum of the residual returns for days in the event window (-1,1). [*] indicates that median is different from zero at the 5% level of statistical significance based on the sign test. For the average residual return, [*] and [†] indicate that the return is significant at the 5% level of significance based on cross-sectional and market model estimates of standard errors, respectively. The market model standard error is based on the standard deviation of residual returns of each observation. The standard error of a daily average residual return is the square root of the sum of individual observations' variances of residual returns divided by the number of observations. For event windows longer than one day, the standard error is multiplied by the square root of the number of days.