Securities and Exchange Commission v. Laurie Bebo

Expert Report of David C. Smith, Ph.D.

March 13, 2015

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I. Qualifications

1. I am a Professor of Commerce at the University of Virginia and Director of the McIntire Center for Financial Innovation. The McIntire School of Commerce ranks consistently in the top tier of U.S. business schools and is currently rated #2 among U.S. undergraduate business school programs by *Bloomberg BusinessWeek*. My research includes the areas of securities pricing, bank lending and corporate credit instruments, distressed debt, corporate restructuring and reorganization, corporate governance, corporate finance, and financial institutions. Exhibit 1 contains a list of my published articles, as well as a list of all prior matters in which I have offered testimony.

2. I earned a Doctor of Philosophy in Finance from the Kelley School of Business at Indiana University, have presented my research at universities and conferences around the world, and have published in leading academic journals, including the *Journal of Accounting Research, Journal of Finance*, *Journal of Financial Economics*, *Journal of Econometrics*, and *Review of Financial Studies*. I have received competitive research grants from the American Bankruptcy Institute, National Bureau of Economic Research, and Research Council of Norway. Prior to joining the McIntire faculty, I was an economist in the International Finance Division of the Federal Reserve Board in Washington, D.C. and before that, an assistant professor of finance at the Norwegian School of Management in Oslo, Norway.

3. I have a background in the empirical analysis of financial data using statistics. My dissertation at Indiana University focused on the application of econometrics to tests of security pricing models. A paper based on my dissertation was published in the *Journal of Econometrics*, a top field journal for economics statisticians. Nearly all of my published research to date is based on the empirical analysis of financial data, across both public and private companies, U.S. companies and non-U.S. companies, and for small and large firms.

4. I specialize in corporate finance and valuation. I have taught undergraduate and graduate level courses in corporate finance, corporate valuation, fixed income, and corporate restructuring, and Ph.D. level courses on empirical asset pricing methodologies, econometrics, and market microstructure. My published research has included work on the stock price performance of disclosed trades by corporate insiders, the pricing of U.S. stocks and bonds

through time, the influence of accounting quality and cross-listing on U.S. investment in foreign companies, and the impact of financial crises on the behavior of banks and borrowers.

5. My more recent published research analyzes debt agreements and loan disclosures of publicly traded companies. I have collected and analyzed data from over 3,700 credit agreements of public corporations, and tracked the impact of more than 3,500 disclosed debt covenant violations on corporate borrower behavior. I have also studied recent trends in the use of secured debt by corporate borrowers and the debt ownership structure of bankrupt firms.

II. Assignment

6. I have been retained by Reinhart, Boerner, Van Deuren, S.C., counsel for Laurie Bebo, in relation to the *Order Instituting Public Administrative and Cease-and-Desist Proceedings in the Matter of Laurie Bebo, and John Buono, CPA,* submitted by the Securities and Exchange Commission on December 3, 2014.[1] I have been asked to evaluate ALC's stock price response to public disclosures during the period of April 26, 2012 through June 21, 2012 (the "Dispute Period") related to allegations of noncompliance with the occupancy and coverage ratio covenants (the "Financial Covenants") in the 2008 lease between Ventas Realty, a subsidiary of Ventas, Inc. ("Ventas"), and Assisted Living Concepts, Inc. and its subsidiaries ("ALC"). I have also been asked to respond, if needed, to any rebuttal opinions expressed by an expert engaged by the SEC. I have been engaged to provide my analysis and opinions on the above assignment, as well as any required testimony with respect to my analysis and opinions.

7. As part of this engagement, I have reviewed various materials including the SEC's order against Laurie Bebo (the "Order"), the January 1, 2008 Amended and Restated Master Lease Agreement (the "Ventas Lease"), court complaints filed by Ventas against ALC (the "Ventas Lawsuit"), SEC filings, news stories, industry and analyst reports, academic literature, stock price data, and other information related to ALC and its peers. A list of all materials I have considered is set forth in Exhibit 2.

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[1] "Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C And 21C of the Securities Exchange Act Of 1934 And Rule 102(e) of the Commission's Rules of Practice" in *Securities and Exchange Commission v. Laurie Bebo, et al.*, filed 12/3/14.

8. I am being compensated based on hours worked on this engagement at my standard hourly rate of $575. I have been assisted by staff of Cornerstone Research ("Cornerstone"), an economics consulting firm, who worked under my direction. I periodically receive compensation from Cornerstone. It is my understanding that compensation I receive from Cornerstone is related to contributions I make, in the course of my consulting work, to Cornerstone. I also understand that I am likely to receive a portion of Cornerstone's non-officer staff billings collected in support of my work in this matter. My compensation is not in any way dependent on the opinions expressed in this report, any testimony with respect to the report, or the outcome of the litigation.

9. My work in this matter is ongoing, and I reserve the right to update my analysis or revise my conclusions if additional documents or information becomes available to me.

III. Summary of Opinions

10. Based on my analysis in this matter, I find that the disclosure of allegations of improper calculations of occupancy rates and coverage ratios related to the Financial Covenants (collectively, "the Financial Covenant Allegations") during the Dispute Period is not associated with a statistically significant change in ALC's stock price after accounting for market and industry factors. Therefore, from the perspective of a financial economist, there is no basis to conclude that this information had an impact on ALC's stock price. Likewise, the lack of a statistically significant price impact is inconsistent with the market interpreting the Financial Covenant Allegations as negative news.

a. Based on a review of public press, SEC filings, and analyst reports, I find that May 14, 2012, was the first date on which there was a public disclosure of the Financial Covenant Allegations.[2] The ALC stock price movement after accounting for market and industry factors was not statistically significant, and, as

[2] The Financial Covenants are covered in Section 8.2.5 of the Ventas Lease. See *Amended and Restated Master Lease Agreement by Ventas, Limited Partnership, as Landlord and ALC CVMA, LLC, ALC GGMG, LLC, ALC HTIF, LLC, ALC PEDG, LLC, ALC TPCG, LLC, ALC TISSC, LLC, ALC TSKG, LLC, and ALC WRWG, LLC, as Tenant, dated as of JANUARY 1, 2008*. Filed as Exhibit 10.1 to ALC Form 8-K, filed 1/7/08, 10:38 AM, henceforth known as the "Ventas Lease."

a result, there is no basis to conclude that the information had an impact on ALC's stock price.

b. There were other dates during the Dispute Period when information was released related to the Ventas Lawsuit. However, I find that these days did not contain new information related to the Financial Covenant Allegations.

IV. Summary of the SEC's Allegations

11. On December 3, 2014, the SEC filed the Order, which alleges that during the period of 2009 through early 2012, Ms. Bebo and former ALC Chief Financial Officer, John Buono, CPA, knew, or were reckless in not knowing, that ALC misrepresented that it was in compliance with the Financial Covenants in filing its Forms 10-Q and 10-K.[3]

12. Specifically, the SEC alleges that Ms. Bebo "undertook an elaborate scheme to hide ALC's lack of compliance with the covenants,"[4] including, among other things, directing ALC personnel to "include in the lease covenant calculations large numbers of fabricated occupants who did not reside at the facilities"[5] and "record journal entries increasing revenue associated with the fabricated occupancy in the accounts for the leased facilities."[6] According to the SEC, at the end of each fiscal quarter during the period 2009 to 2012, ALC provided Ventas, "with covenant calculations which included the fabricated occupants and the associated revenue, thus falsely showing that ALC was meeting the covenants."[7] Further, the SEC contends that "ALC's representations about the lease covenants were false, misleading, and omitted material information."[8]

[3] Order, ¶2.
[4] Order, ¶2.
[5] Order, ¶3.
[6] Order, ¶3.
[7] Order, ¶3.
[8] Order, ¶6.

V. Background

A. ALC and Ventas

13. As of December 2011, ALC was a publicly-traded company listed on the New York Stock Exchange ("NYSE") that operated 211 senior residences in 20 states with a total of 9,325 units.[9] Annual revenues for ALC in 2011 were over $234 million.[10] On July 11, 2013 ALC was acquired by an affiliate of the private equity firm TPG Capital, L.P., at which time ALC delisted from the NYSE.[11] Exhibit 3 shows ALC's stock price and trading volume from April 26, 2011 through June 29, 2012.[12]

14. Ventas is an S&P 500 Company and publicly-traded real estate investment trust that specializes in acquiring and owning senior housing and healthcare properties.[13] As of December 2011, Ventas owned nearly 1,400 properties in the U.S. and Canada.[14]

B. The Ventas Lease

15. Effective January 1, 2008, ALC entered into the Ventas Lease.[15] The Lease covered eight assisted and independent living communities, comprising 541 units, across Alabama, Georgia, Florida, and South Carolina,[16] The Ventas Lease accounted for approximately 6% of all of ALC's units.[17] The Ventas Lease required ALC to pay rent totaling $4.86 million in the first

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[9] ALC 2011 Form 10-K, filed 3/12/12, 4:36 PM, p. 3.
[10] ALC 2011 Form 10-K, filed 3/12/12, 4:36 PM, p. 19.
[11] ALC Form 8-K, filed 7/16/13, 5:23 PM; ALC Form 15-12B, filed 7/23/13, 7:03 AM.
[12] As discussed below, this time period captures the period analyzed when conducting my event study analysis (4/26/11 – 4/25/12) and the Dispute Period. During the period 4/26/11 – 6/29/12, the average weekly trading volume was 442,900 (or 2.2% of shares outstanding). During this same period, I also found that average short interest was 2.7% percent of shares outstanding.
[13] Ventas 2011 Form 10-K, filed 2/22/12, 3:52 PM, p. 1.
[14] Ventas 2011 Form 10-K, filed 2/22/12, 3:52 PM, p. 47.
[15] The Tenants include the following ALC subsidiaries: ALC CVMA, LLC; ALC GGMG, LLC; ALC HTIF, LLC; ALC PEDG, LLC; ALC TPCG, LLC; ALC TISSC, LLC; ALC TSKG, LLC; and ALC WRWG, LLC. See cover page and preamble to the Ventas Lease.
[16] The eight properties covered by the lease were: CaraVita Village in Montgomery, Alabama; Highland Terrace in Inverness, Florida; Greenwood Gardens in Marietta, Georgia; Peachtree Estates in Dalton, Georgia; The Sanctuary in Acworth, Georgia; Tara Plantation in Cumming, Georgia; and Winterville Retirement Center in Winterville, Georgia; and The Inn at Seneca in Seneca, South Carolina. See ALC Form 8-K, filed 1/7/08, 10:38 AM.
[17] 541 / 9,325 = 5.8%

year, with an annual step-up in rent of 2.5% in April of each year through March 2015.[18] Aggregate rent due under the Ventas Lease for the year 2012 would have totaled $5.5 million.[19]

16. In addition to requiring the timely payment of rent, the Ventas Lease contained other provisions, restrictions, and covenants that ALC was required to meet to avoid being in breach, or default, under the contract.[20]

17. These included the Financial Covenants, described in Section 8.2.5 of the Ventas Lease. The Financial Covenants consisted of requirements that ALC maintain:

a. a "Coverage Ratio" of at least 0.8 to 1.0 for each Facility for the 12-month period ending in each fiscal quarter,[21]

b. a "Portfolio Coverage Ratio" of at least 1.0 for the 12-month period ending in each fiscal quarter,[22] and

c. a "Minimum Average Occupancy" of at least 65% at each Facility for the quarter just ended, at least 75% at each Facility for the trailing 12 months then ended, and at least 82% across all Facilities.[23]

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[18] ALC Form 8-K, filed 1/7/08, 10:38 AM. Following the March 31, 2015 expiration, the Ventas Lease also allowed for three five-year renewals with further pre-specified step-ups in rent.

[19] ALC 2011 Form 10-K, filed 3/12/12, 4:36 PM, p. F-24.

[20] Ventas Lease.

[21] The Coverage Ratio is defined in the Defined Terms section of the Ventas Lease (Appendix B) as the ratio of "Cash Flow of any Facility for the applicable period" to the "sum of the Fixed Rent payments allocated to such Facility," plus any other debt service or lease payments associated with such Facility. Ventas Lease p. K-96. Appendix B defines "Cash Flow" to be "the net income of any Tenant arising from the applicable Facility as reflected on the income statement of Tenant plus (i) the provision for depreciation and amortization in such income statement; plus (ii) the provision for management fees in such income statement; plus (iii) the provision for income taxes in such income statement; plus (iv) the provision for Fixed Rent payments allocated to such Facility (and, for the purpose of calculating the applicable Cash Flow with respect to any period commencing prior to the Commencement Date, the Fixed Rent for any Facility for any period prior to the Commencement Date shall be assumed to have accrued and been payable by Tenant at the same annual rate of Fixed Rent that is allocable to such Facility as of the Commencement Date) and interest and lease payments, if any, relating to such Facility in such income statement; minus (v) an imputed management fee equal to six percent (6%) of gross revenues of such Facility (net of contractual allowances); and minus (vi) a replacement reserve of $300 per licensed bed at such Facility per year," p. K-95. Appendix B defines "Fixed Rent" to mean "for the period from the Commencement Date through the Expiration Date, rent at an annual rate of Four Million Four Hundred Seventy-three Thousand Five Hundred and No/100 Dollars ($4,473,500.00), as such amount shall be increased or adjusted from time to time during the Term as provided in this Lease, including as such amount shall be increased or adjusted from time to time during the Term as set forth in Section 3.1.2, Section 43.2 and Section 43.3," p. K-99.
Appendix B defines "Facility" to be "the facility or facilities located on the applicable Leased Property," p. K-98.

[22] The Portfolio Coverage Ratio is defined in Appendix B of the Ventas Lease to be the "Cash Flow for all the Facilities for the applicable period" to the "sum of the Fixed Rent," plus all other debt service or lease payments associated with such Facilities," pp. K-105.

C. Dispute Period: The Ventas Lawsuit and it Resolution

18. The Dispute Period comprises a series of events that occur during April, May, and June 2012 related to the Ventas Lawsuit. Exhibit 4 shows a timeline of these events.

19. On April 26, 2012, Ventas filed the Ventas Lawsuit against ALC in the United States District Court for the Northern District of Illinois "seeking a declaratory judgment that [ALC] has breached its obligations under the lease and forfeited its right to possession of the leased premises."[24] The lawsuit alleged a lease violation due to notices received by ALC from state regulators in Georgia and Alabama that threatened to revoke operating permits in three ALC facilities operated by ALC within those states. In addition, the lawsuit alleged that the regulatory notices identified "numerous deficiencies with the respective ALC Entity's operations which are jeopardizing the health, safety, and welfare of the residents."[25]

20. On May, 3, 2012, ALC announced it would delay its Q1 2012 earnings release and associated conference call.[26]

21. On May 4, 2012, ALC disclosed the Ventas Lawsuit in an 8-K filing. In addition, ALC disclosed an internal investigation by the "Company's Board of Directors... to investigate possible irregularities in connection with the Company's lease with Ventas... and retained counsel for such purpose."[27]

22. On May, 9, 2012, Ventas Vice President Joseph Lambert sent a letter via fax (the "Ventas Letter") to ALC alleging, among other things, that ALC:

> may have failed to comply with Section 8.2.5 of the Lease by failing to maintain required occupancy and coverage ratios. Such fraud has included treating units

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[23] Ventas Lease, pp. K-21-K-22. Based on my reading of the Ventas Lease, the phrase "minimum average occupancy," as used and referenced in the Minimum Average Occupancy financial covenant, is left undefined in the Ventas Lease.

[24] ALC Form 8-K, filed 5/4/12, 9:27 AM. See also "Verified Complaint for Declaratory Relief" in *Ventas Realty, Limited Partnership v. ALC CVMA, LLC et al.*, filed 4/26/12.

[25] "Verified Complaint for Declaratory Relief" in *Ventas Realty, Limited Partnership v. ALC CVMA, LLC et al.* filed 4/26/12, ¶¶2-4.

[26] "Assisted Living Concepts, Inc. Announces Delay On Earnings Release And Conference Call," Dow Jones News Service, 5/3/12, 3:53 PM.

[27] ALC Form 8-K, filed 5/4/12, 9:27 AM.

leased to employees as bona fide rentals by third parties. Such actions constitute Events of Default under Section 17.1.5 of the Lease.[28]

23. On May 10, 2012, Ventas filed a motion to amend the complaint filed on April 26, 2012 to include some matters referenced in the Ventas Letter and expand relief to include termination of the lease and monetary damages.[29] Attached to the motion was an amended complaint. Neither the motion nor the amended complaint mention the Financial Covenant Allegations, nor is any reference made to section 8.2.5 in the Ventas Lease.

24. On May 11, 2012, ALC filed with the SEC a Notification of Late Filing (Form 12b-25) of the ALC 2012 Q1 10-Q. In the Notification of Late Filing, ALC referenced the early stage of its internal investigation into possible irregularities pertaining to the Ventas Lease, previously disclosed on May 4, 2012, and "whether the findings of the investigation would have any impact on the Ventas lease, the Company's results of operations or financial condition, or other matters relating to the Company and its business."[30]

25. On May 14, 2012, ALC disclosed in an 8-K filing the contents of the Ventas Letter, including that on:

a. "May 4, 2012, Ventas filed papers with the court seeking the emergency appointment of a receiver to operate the facilities covered by the lease. The application for the appointment of a receiver was denied by the court on May 9, 2012."[31]

b. May 9, 2012, ALC received the Ventas Letter asserting that ALC was in violation of the Ventas Lease due to a number of events that allegedly constituted default, including that ALC:

   i. "[S]ubmitted fraudulent information by treating units leased to employees as bona fide rentals by third parties and, therefore, may not have been in

[28] ALC00154439-45.

[29] ALC Form 8-K, filed 5/14/12, 10:21 AM; "Motion for Leave to File First Amended Complaint" in *Ventas Realty, Limited Partnership v. ALC CVMA, LLC et al.*, filed 5/10/12.

[30] ALC Form 12b-25, filed 5/11/12, 5:24 PM.

[31] ALC Form 8-K, filed 5/14/12, 10:21 AM.

compliance with the minimum occupancy covenant and coverage ratio covenants" (i.e., the Financial Covenants).

ii. "[A]ttempted to voluntarily terminate a license to operate an assisted living facility in Alabama."

iii. Failed to provide required notices related to fires at a facility in Florida.

iv. Failed to give notice to Ventas prior to commencing repair work.

v. "Failed to provide information previously requested by Ventas."[32]

c. May 10, 2012, Ventas filed a motion to amend the Ventas Lawsuit to expand the allegations related to ALC's proposal to voluntarily terminate the license at an Alabama facility and ALC's failure to report two fires at the Florida facility, and to request relief for the asserted breaches of contract that included termination of the Ventas Lease, acceleration of all rental payments due under the Ventas Lease, and monetary damages for breach of the guaranty.[33]

26. In addition, ALC provided an estimate of the potential exposure and losses from the Ventas Lawsuit.

a. If the Ventas Lawsuit was successful, damages to ALC could include, among other things, an estimated $10.2 million reduction in net income due to the accelerated rental payments under the Ventas Lease.

b. ALC was party to a separate lease with MLD Delaware Trust (the "MLD Lease"), covering four properties with 156 units. ALC believed that, through a merger, Ventas, or one of its affiliates, had acquired the MLD Lease. The MLD Lease contained "cross-default" provisions that stated that any default on a lease involving ALC, as lessee, and Ventas (or its affiliates), as lessor, would also constitute a default under the MLD Lease. If a default was asserted under the MLD Lease, then remedies associated with such a default could result in

[32] ALC Form 8-K, filed 5/14/12, 10:21 AM.
[33] ALC Form 8-K, filed 5/14/12, 10:21 AM.

additional losses to ALC, including reductions in net income amounting to $3.5 million.[34]

27. On May 15, 2012, ALC filed its 10-Q containing the financial results for the first quarter of 2012.[35] The filing also reiterated the disclosures in the May 14, 2012, 8-K.

28. On May 29, 2012, ALC filed an 8-K and press release announcing that Ms. Bebo was no longer President, CEO, or an employee of ALC, effective immediately.[36] The 8-K also disclosed that Charles H. Roadman, II M.D. would serve as interim President and CEO of ALC while the company searched for a permanent CEO.[37]

29. On June 18, 2012, Ventas reported in a press release that ALC had agreed to purchase twelve properties from Ventas for a total of $100 million in cash, and would dismiss the Ventas Lawsuit.[38] Under the agreement, ALC would take possession of the properties, the Ventas Lease would be terminated, and ALC would be released from all litigation claims associated with the Ventas Lawsuit.[39]

30. On June 21, 2012, ALC filed an 8-K reiterating the purchase of the Ventas properties disclosed on June 18, 2012.[40] ALC's 8-K also stated that ALC would fund the purchase using its revolving credit facility at a borrowing rate of LIBOR plus 3%.[41]

VI. Event Study Analysis

A. Overview of the Event Study Methodology

31. An event study is a commonly employed method used to analyze how stock prices respond to the public release of new, firm-related information. The event study methodology originates from the academic finance literature, where it is commonly used to analyze the impact of a given "event" (such as the disclosure of corporate earnings) on the stock price of the firm (or

[34] ALC Form 8-K, filed 5/14/12, 10:21 AM.
[35] ALC Q1 2012 Form 10-Q, filed 5/15/12, 4:02 PM.
[36] ALC Form 8-K, filed 5/29/12, 6:23 PM.
[37] ALC Form 8-K, filed 5/29/12, 6:23 PM.
[38] "Ventas Sells 12 Communities to Assisted Living Concepts," Business Wire, 6/18/12, 8:33 AM.
[39] "Ventas Sells 12 Communities to Assisted Living Concepts," Business Wire, 6/18/12, 8:33 AM.
[40] ALC Form 8-K, filed 6/21/12, 5:19 PM.
[41] ALC Form 8-K, filed 6/21/12, 5:19 PM.

firms) affected by the event.[42] I have used the event study methodology in my own published research.[43]

32. The event study methodology is motivated by the economic theory that stock prices rapidly adjust to reflect new and unexpected information relevant to the value of the stock.[44] For example, if new information arrives in the market that a company's profits will be higher than previously expected, then, all else equal, the company's stock price should increase as investors find the stock to be a more attractive investment. Likewise, when new information is released that suggests that a company's future profits will be lower than expected, stock prices will fall as investors perceive the stock to be less valuable.[45]

33. The event study methodology measures how a stock price changes following the release of firm-specific information relative to how much the stock price would be expected to change in the absence of the arrival of the information. In the event study vernacular, expected stock returns that occur in the absence of the arrival of new information are termed to be "normal" or more commonly, "expected" returns. The amount that a stock return deviates from its expected return in response to new information is termed the "abnormal" return.

34. To determine a stock's expected return, the event study methodology first estimates how a company's stock return moves, on average, with market- and industry- level factors on a day-to-day basis. These relationships are estimated using a linear regression model of the company's daily stock returns on market and industry returns over a given time period (often referred to as the "control period"). This model can then be used to determine the expected return in a

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[42] Event studies were first developed and employed in the academic studies of Fama, Fisher, Jensen, and Roll (1969) and Ball and Brown (1968); see Eugene Fama, Lawrence Fisher, Michael Jensen, and Richard Roll, "The Adjustment of Stock Prices to New Information," *International Economic Review* 10 (1969); and Ray Ball and Philip Brown, "An Empirical Evaluation of Accounting Income Numbers," *Journal of Accounting Research Autumn* (1968), 159-178. The efficacy of the use of event studies for accurately measuring the impact of information on stock prices has been examined by Brown and Warner (1985), MacKinlay (1997), and Kothari and Warner (2004). See Stephen Brown and Jerold Warner, "Using Daily Stock Returns: The Case of Event Studies," *Journal of Financial Economics* 14 (1985), 3-31; A. Craig MacKinlay, "Event Studies in Economics and Finance," *Journal of Economic Literature* 35 (Mar., 1997), 13-39; and S.P. Kothari and Jerold Warner, "Econometrics of Event Studies," (October 20, 2004). Kothari and Warner (2004) note that as of the early 2000s, the number of published event studies exceeded 500.

[43] See, for example, B. Espen Eckbo and David C. Smith, "The Conditional Performance of Insider Trades," *Journal of Finance* 53 (1998), 467-498; Steven Ongena, David Smith, and Dag Michalsen, "Firms and their distressed banks: lessons from the Norwegian banking crisis," *Journal of Financial Economics* 67 (2003), 81-112; and Greg Nini, David C. Smith, and Amir Sufi, "Creditor Control Rights, Corporate Governance, and Firm Value," *Review of Financial Studies* 25 (2012), 1713-1761.

[44] See Eugene Fama, "Efficient Capital Markets: A Review of Theory and Empirical Work," *The Journal of Finance* 25 No. 2 (1970) and Eugene Fama, "Efficient Capital Markets: II," *The Journal of Finance* 46 No. 5 (1991).

[45] See Fama (1991), MacKinlay (1997), Kothari and Warner (2004).

company's stock price on a given event day, based on its historical relationship with market and industry movements. The difference between this expected return and observed return is a firm's abnormal return.

35. In addition to the stock's upward and downward movements related to market and industry factors, a stock's abnormal return will also experience random fluctuations on a day-to-day basis. Therefore, to evaluate the impact of new information on a company's stock price, a researcher must also assess whether the new information causes an impact beyond what is expected in this typical day-to-day variation. If an abnormal return is outside of the bounds of the typical day-to-day variation, the abnormal return is considered to be *statistically significant*. If new information is released and the associated abnormal stock price change is statistically significant, then a researcher can conclude that the information released on that day caused the observed stock price reaction.[46]

36. When a stock's abnormal return following the release of new information is statistically *in*significant (that is, not statistically distinguishable from zero), the implication is that, as a matter of financial economics, there is no basis to conclude that this information had an impact on the stock price.

B. Event Study Methodology for ALC

37. I use an event study in this matter to estimate the impact, if any, that disclosures regarding the Financial Covenant Allegations during the Dispute Period may have had on ALC's stock price. To calculate ALC's expected return, I estimate the relationship between ALC's stock return and overall stock market and industry returns using a linear regression model. To

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[46] On average, abnormal returns are expected to be zero, meaning that, in the absence of the arrival of company-specific information that impacts the stock price, the expected return should equal the observed return. Statistical significance judges whether or not an observed return differs from the expected return by an amount large enough to exceed a predetermined significance level (e.g., 5%). In the context of evaluating abnormal returns, the significance level is the probability that, given repeated sampling, an observed return differs from the expected return for random reasons only. The standard significance level put forth by statisticians is 5%. This means that for an observed return (e.g., following a news release) to be deemed statistically different from the expected return, the difference must be large enough so that the probability that the observed return is due simply to random fluctuations around the observed return is less than 5%.
"In practice, statistical analysts often use certain preset significance levels— typically .05 or .01. The .05 level is the most common in social science, and an analyst who speaks of "significant" results without specifying the threshold probably is using this figure." *Reference Manual on Scientific Evidence*, 2nd Edition (2000), Federal Judicial Center, 124. See also John A. Rice, *Mathematical Statistics and Data Analysis*, 3rd Edition (2007), 337-9.

measure overall stock market movements, I use a value-weighted, dividend-inclusive index of the New York Stock Exchange ("NYSE"), the exchange on which ALC traded during the Dispute Period.[47]

38. To measure industry movements, I use a peer group composed of the companies to which ALC compares its performance in its 2011 Form 10-K (the "Peer Group"): Brookdale Senior Living, Inc., Capital Senior Living Corporation, Emeritus Corporation, Five Star Quality Care, Inc., and Sunrise Assisted Living, Inc. I selected the list from the 2011 ALC 10-K – filed on March 12, 2012 – because the list was within my event study's estimation period and in close proximity to the Dispute Period. I calculate an index of the Peer Group's returns on an equal-weighted basis, consistent with how ALC evaluates the Peer Group's returns in its SEC filings.[48] Exhibit 5 plots the performance of ALC's stock price versus the NYSE and the Peer Group from April 26, 2011 through June 29, 2012.

39. I estimate the linear regression model using daily stock returns over a one-year period from April 26, 2011 through April 25, 2012. Exhibit 6 reports summary statistics from the regression. The exhibit shows that the NYSE index and Peer Group returns are statistically significant predictors of the variation in ALC stock returns over this time period. Together, these variables explain 60.9% of the variation in ALC's daily return, as measured by the adjusted R-squared.[49] I apply the Exhibit 6 model to calculate abnormal returns following disclosures during the Dispute Period.

VII. Opinions

40. Based on my analysis in this matter, I find that the release of information during the Dispute Period regarding the Financial Covenant Allegations is not associated with a statistically significant change in ALC's stock price after accounting for market and industry factors.

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[47] ALC 2011 Form 10-K, filed 3/12/12, 4:36 PM, p. 3.

[48] ALC 2011 Form 10-K, filed 3/12/12, 4:36 PM, pp. 17-18.

[49] To evaluate the robustness of my model, I estimated a number of alternative models. These included using two alternate equal-weighted industry indices composed of two lists of comparators ALC named in its 2012 Form 10-K; estimating one-factor models against the NYSE index and the three industry indices identified in the 2011 and 2012 Form 10-Ks; and estimating all of these models over a six-month estimation period. These models produced similar results and do not affect my conclusions in this matter.

41. Therefore, from the perspective of a financial economist, there is no basis to conclude that this information had an impact on ALC's stock price. Likewise, the lack of a statistically significant price impact is inconsistent with the market interpreting the Financial Covenant Allegations as negative news.

42. Below, I first analyze the event study results and information disclosed on May 14, 2012, the first public disclosure of the Financial Covenant Allegations. I then discuss other dates during the Dispute Period on which disclosures related to the Ventas Lawsuit were made. My event study results for disclosure dates identified in the Dispute Period are shown in Exhibit 7.

A. May 14, 2012 Disclosure

43. I find that May 14, 2012, is the first date on which the Financial Covenant Allegations are disclosed publicly.[50] As described in paragraph 25 above, on the morning of May 14, 2012, ALC filed an 8-K disclosing the contents of the Ventas Letter, including the assertion by Ventas that ALC had "submitted fraudulent information" related to the calculations of occupancy rates and coverage ratios for tests of the Financial Covenants under the Ventas Lease.[51] While ALC received the Ventas Letter on May 9, 2012, I did not find any public press discussing the receipt of this letter or its contents until May 14, 2012.

44. In addition to the 8-K disclosed that morning, May 14, 2012, was the first trading date following ALC's post-market filing – on the preceding Friday – of a Form 12b-25, which reported why ALC would be late to file its Q1 10-Q.[52]

45. Exhibit 7 shows that on May 14, 2012, ALC's stock price declined $0.37 or 2.26%. Measured relative to the benchmark based on the returns of the NYSE and Peer Group, the abnormal return on ALC stock on this day was -0.40% and was not statistically significant.[53]

[50] To evaluate the public disclosures during the Dispute Period, I reviewed the SEC filings by Ventas and ALC. I reviewed public press available through Factiva, Lexis Nexis, Bloomberg, and the online version of the Milwaukee Journal Sentinel. According to S&P Capital IQ and Thomson Research, there were at least 11 analysts covering ALC during 2012, and I found three companies published equity-research analyst reports about ALC: Sidoti & Company, Jefferson Research, and CJS Securities during the Dispute Period.
[51] ALC Form 8-K, filed 5/14/12, 10:21 AM.
[52] ALC Form 12b-25, filed 5/11/12, 5:24 PM.
[53] My event study analysis shows that on May 14, 2012, abnormal returns of less than -3.14% or greater than 3.14% would be significant at the 5% significance level.

Therefore, I conclude that there is no evidence that the information disclosed on May 14, 2012, including the Financial Covenant Allegations, had an impact on the ALC stock price.[54]

B. Additional Disclosures during the Dispute Period

46. As detailed in Section V.C above, other public releases of information related to the Ventas Lawsuit occurred during the Dispute Period, including disclosures by ALC. While some of these disclosures are associated with statistically significant abnormal returns, I find that these abnormal returns are not attributable to the disclosure of the Financial Covenant Allegations because the information contained in the other disclosures was either (i) not related to any allegations of wrongdoing related to the Financial Covenants, or (ii) simply repeated the information contained in the May 14, 2012 8-K disclosure.

1. Reporting of the Ventas Lawsuit

47. As discussed in paragraph 21 above, on the morning of May 4, 2012, ALC disclosed in an 8-K filing that Ventas had filed a lawsuit in an Illinois court on April 26, 2012, alleging a breach of the Ventas Lease.[55] The May 4, 2012 8-K also included an announcement that the ALC Board had launched an internal investigation to investigate "possible irregularities" in connection with the Ventas Lease.[56]

48. As the SEC acknowledges in the Order, the Ventas Lawsuit contained no allegations related to the Financial Covenants.[57]

49. Exhibit 7 shows that ALC experienced a statistically significant abnormal decline in its stock price on May 4, 2012; the stock price declined by $2.37, or 12.36%, over the day and the abnormal return for the day was -11.20%.

50. In my opinion, two factors drove the ALC stock decline on May 4, 2012.

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[54] I reviewed all public disclosures after market close on Friday, May 11 through market hours on Monday, May 14 and did not find any information releases that would confound or offset any potential negative price reaction this day.
[55] ALC Form 8-K, filed 5/4/12, 9:27 AM.
[56] ALC Form 8-K, filed 5/4/12, 9:27 AM.
[57] The SEC acknowledges in the Order that this lawsuit was "unrelated to the financial covenants." Order, ¶51.

51. The first factor relates to an announcement on May 3, 2012. At 3:53 PM on Thursday, May 3, 2012, ALC announced that it would delay releasing its Q1 2012 earnings report and associated conference call with investors.[58]

52. Exhibit 8 graphs the intraday transaction prices for ALC stock on May 3, 2012. As shown, the ALC stock price jumped up 8.31% in the last seven minutes of trading – from approximately $17.70 immediately prior to the earnings-delay announcement to $19.17 at market close. The abnormal return over the entire trading day on May 3, 2012 was 8.00% and statistically significant. The stock price increase implies that the market interpreted the delay announcement as positive news, anticipating that the delay meant that ALC had news to share that would be positive for shareholder value, but that could not yet be announced.[59]

53. However, the next morning, ALC released its 8-K at 9:27 AM, just prior to market open. The market incorporated the 8-K information by reversing the price gains that occurred at the end of the previous day.

54. The price pattern observed in Exhibit 9, which shows intraday transaction prices for May 4, 2012, is consistent with a quick reversal of the stock price climb the previous day. The ALC stock price at the opening traded at $18.25 and declined quickly to near $17.70 (the price before the previous day's earnings-delay announcement), before continuing to decline further throughout the day.[60]

55. The second factor likely driving the significant negative abnormal decline on May 4, 2012, was the contents of the 8-K itself. The disclosure revealed the Ventas Lawsuit, alleging that ALC had received notices of intent to revoke permits on three properties from state regulators in Alabama and Georgia, in violation of the Ventas Lease. ALC also disclosed its internal investigation into irregularities with the Ventas Lease.

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[58] "Assisted Living Concepts, Inc. Announces Delay On Earnings Release And Conference Call," Dow Jones News Service, 5/3/12, 3:53 PM.

[59] I did not find any analyst reports or press discussing the reason for the positive price increase. However, at the time of the May 3, 2012 announcement, there were market rumors that ALC could be the target of a potential acquisition. For example, the March 2012 issue of *The SeniorCare Investor* mentioned a rumor that Citi may have been retained to help the company in a potential acquisition deal. The following April 2012 issue of *The SeniorCare Investor* contained an article entitled "Assisted Living Concepts on the Block." The article noted that that a "potential sale was more than a 'rumor.'" These rumors are consistent with information provided by the SEC; the Order describes interactions between ALC and potential bidders in March 2012 (see Order, ¶40). The large increase in price due to the announcement of the delay of ALC's earnings release could have been interpreted by investors as an indication that ALC would soon announce that it was being acquired.

[60] ALC Form 8-K, filed 5/4/12, 9:27 AM.

56. Published reports that analyzed or commented on the May 4, 2012, disclosure attributed the observed price decline on that day to a reduction in earnings associated with the Ventas Lawsuit. For instance, sell-side stock analyst, Sidoti & Company, issued a note to clients during trading hours on May 4, 2012. The Sidoti & Company analyst maintained a "BUY" rating for ALC and described the market response on May 4 as "overblown," while stating that "a worst case scenario would trim 2013 EPS to $1.21, only 8% lower than our current 2013 EPS projection."[61]

57. A second report by Sidoti & Company, issued on May 7, 2012, noted that "details from [the] lawsuit suggest any violations are benign," and that the Ventas Lawsuit related to "staffing issues, compliance issues related to paperwork, and fire safety issues."[62] The Sidoti & Company analyst also stated that "an answer from management concerning current staffing policies and attempts to address this issue would help alleviate concerns, in our view."[63]

58. The May issue of the *The SeniorCare Investor* newsletter discussed the abrupt delay in announcing Q1 earnings on May 3, 2012 and the subsequent negative disclosure of the internal investigation and the Ventas Lawsuit. The newsletter noted the potential negative impact this announcement could have on an acquisition of ALC: "Investors were not expecting negative news, and sent the shares down by 15% by mid-day on May 4. It would seem highly unlikely that a buyer for the company will step forward at this point." [64]

59. Together, the analyst reports by Sidoti & Company and *The SeniorCare Investor* newsletter suggest that the price reaction on May 4, 2012 was driven by reactions to the Ventas Lawsuit and to disappointment following the May 3, 2012 earnings delay.

60. Based on my review of the publicly available materials, I found no disclosure related to May 4, 2012 that discusses the Financial Covenant Allegations. Therefore, there is no basis to conclude that the ALC abnormal returns observed on May 4, 2012 is attributable to the Financial Covenant Allegations.

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[61] Sidoti & Company, Intraday Note, 5/4/12.
[62] Sidoti & Company, Intraday Note, 5/7/12.
[63] Sidoti & Company, Intraday Note, 5/7/12.
[64] "Acquisition Updates," *The SeniorCare Investor*, Volume 24, Issue 5, May 2012.

2. Filing of the Amended Ventas Complaint

61. As discussed in paragraph 23 above, on Thursday, May 10, 2012, Ventas filed a motion in court to amend and expand its original April 26, 2012 complaint. The proposed amended complaint, filed as an exhibit to the motion, included alleged breaches discussed in the Ventas Letter from May 9, 2012, including allegations that ALC attempted to terminate an operating license at an Alabama facility and failed to report two fires at the Florida facility.[65] The amended complaint also sought additional remedies, including the termination of the Ventas Lease and damages for a guaranty provided by ALC.[66]

62. However, the amended complaint contained no allegations of ALC wrongdoing in relation to the Financial Covenants.[67] In no part of the amended complaint does Ventas mention the Financial Covenants, or make any allegations as to improper calculations of occupancy rates or coverage ratios.[68]

63. I found no time stamp associated with the filing of Ventas' motion and amended complaint on May 10, 2012. If Ventas filed the motion prior to when markets closed (4:00 PM), the impact of the announcement would be reflected on May 10. However, if Ventas filed the motion after markets closed, the impact of the announcement on ALC stock would not be reflected until trading occurred on Friday, May 11, 2012.

64. Exhibit 7 shows that on May 10, 2012, ALC's stock price declined by $0.25, or 1.39%. ALC's abnormal return for this day was -1.87%, which was not statistically different from a zero abnormal return. Thus, if the amended complaint was filed by Ventas during trading hours, it had no statistically significant price impact on ALC stock on that day.

65. ALC's stock price did experience a statistically significant decline on Friday, May 11, 2012. As shown in Exhibit 7, ALC's stock price fell $1.31, or 7.40%, resulting in a statistically

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[65] "Motion for Leave to File First Amended Complaint" in *Ventas Realty, Limited Partnership v. ALC CVMA, LLC et al.* filed 5/10/12.

[66] "Motion for Leave to File First Amended Complaint" in *Ventas Realty, Limited Partnership v. ALC CVMA, LLC et al.* filed 5/10/12; ALC Form 8-K, filed 5/14/12, 10:21 AM.

[67] The SEC alleges in the Order that "Ventas moved to amend its complaint against ALC to include allegations relating to ALC's inclusion of employees in the covenant calculations." (Order, ¶53) I find no such evidence of these allegations in my review of the amended Ventas complaint.

[68] "Motion for Leave to File First Amended Complaint" in *Ventas Realty, Limited Partnership v. ALC CVMA, LLC et al.*, filed 5/10/12.

significant abnormal return of -6.94%. If the complaint was filed after market close, the May 11 stock decline could be due to negative information contained in the amended complaint.

66. Regardless of the observed ALC abnormal returns on these days, I found no public disclosure on these dates that discussed the Financial Covenant Allegations. Therefore, there is no basis to conclude that the ALC abnormal returns observed on these days are attributable to the Financial Covenant Allegations.

3. Announcement of ALC Quarterly Results

67. As discussed in paragraph 27 above, after market close on Tuesday, May 15, 2012, ALC filed its 2012 Q1 10-Q. The 10-Q contained financial information for ALC for the fiscal quarter ending on March 31, 2012, including consolidated financial statements and footnotes, management's discussion and analysis of the financial and operating condition of the company, disclosures about market risk, and discussions of controls and procedures, legal proceedings, and risk factors.[69]

68. ALC reported earnings per share of $0.24.[70] These earnings were below the market's anticipated EPS of $0.26.[71]

69. The 2012 Q1 10-Q also repeated the entirety of the disclosures contained in the May 14, 2012, 8-K, first under Footnote 10 ("Subsequent Events") to the consolidated financial statements,[72] and then again under the "Future Liquidity and Capital Resources" subsection of management's discussion and analysis of the financial and operating condition of the company.[73] ALC did not disclose any new information regarding the allegations of noncompliance with the Financial Covenants.

70. During May 16, 2012, Sidoti & Company issued an analyst report in which it cut ALC's price target from $21 to $15 and downgraded the stock to a "NEUTRAL" rating.[74] Sidoti &

[69] ALC Q1 2012 Form 10-Q, filed 5/15/12, 4:02 PM
[70] Sidoti & Company, Morning Meeting Note, 5/16/12.
[71] Sidoti & Company identified the consensus expectation of $0.26. See Sidoti & Company, Morning Meeting Note, 5/16/12.
[72] ALC Q1 2012 Form 10-Q, filed 5/15/12, 4:02 PM, p. 17.
[73] ALC Q1 2012 Form 10-Q, filed 5/15/12, 4:02 PM, p. 30.
[74] Sidoti & Company, Morning Meeting Note, 5/16/12.

Company stated that "moderated growth assumptions, legal concerns and persistent regulatory issues" contributed to its decision to downgrade ALC, and that "adverse publicity is hurting the business."[75]

71. Consistent with a reported decline in financial performance as documented in the Sidoti & Company May 16, 2012 report, Exhibit 7 shows that ALC's stock price declined on May 16, 2012 by $0.90, or 5.57% on a raw basis. This equated to an abnormal return of -4.79% and was statistically significant.

72. I find no additional information in the 2012 Q1 10-Q regarding the Financial Covenant Allegations that was not already in the May 14, 2012 8-K and thus incorporated into the ALC stock price on that trading day. I conclude that ALC's abnormal return on May 16, 2012 is attributable to new information contained in the 10-Q that is unrelated to the Financial Covenant Allegations.

4. Departure of Ms. Bebo

73. As discussed in paragraph 28 above, after market close on Tuesday, May 29, 2012, at 6:23 PM, ALC filed an 8-K announcing that CEO & President Laurie Bebo was no longer part of the company, and that Dr. Charles Roadman would serve as interim CEO and President.[76] Contemporaneously, the public press reported on the event, in which one source reported that ALC's "board thought it was time for a leadership change and no one issue prompted the move."[77]

74. The *Milwaukee Journal Sentinel* published an article on Ms. Bebo's departure on Wednesday, May 30, 2012. The article did not specify an immediate cause for Ms. Bebo's leaving ALC, but noted "[r]egulators in several states, including Wisconsin, have found a string of violations at several of the company's centers in the past year."[78] These violations included an Idaho facility that was shut down for inadequate staffing, facilities in Alabama and Georgia that

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[75] Sidoti & Company, Morning Meeting Note, 5/16/12.
[76] ALC Form 8-K, filed 5/29/12, 6:23 PM.
[77] See "Assisted Living Concepts board fires CEO Bebo; Roadman named interim president, CEO," Associated Press Newswires, 5/29/12, 7:15 PM, which reported information from the Milwaukee Journal Sentinel.
[78] "Falls assisted living company fires CEO – Physician named interim chief – State regulators cited chain for violations," Milwaukee Journal Sentinel, 5/30/12.

regulators found to be inadequately staffed, and a facility in Wisconsin that regulators threatened to revoke ALC's license to operate "for not providing adequate nursing services."[79]

75. On May 30, 2012, CJS Securities issued an analyst report affirming its earnings estimates and "market outperform" rating for ALC. The report stated that while the firing provided "no reason or basis to change [its] earnings estimates... [the] sudden departure of [a] CEO is never a good thing."[80]

76. Consistent with public press and analysts' interpretation that the dismissal of Ms. Bebo signaled bad news for ALC, Exhibit 7 shows that on May 30, 2012, ALC's stock price declined $1.20 or 8.29%. The abnormal return on ALC stock on this stock was -6.55% and was statistically significant.

77. Based on my review of the publicly available materials, I found no disclosure that linked Ms. Bebo's dismissal to the Financial Covenant Allegations. Therefore, there is no basis to conclude that the ALC abnormal return observed on May 30 is attributable to the Financial Covenant Allegations.

5. Resolution of the Ventas Lawsuit

78. As discussed in paragraph 29 above, on Monday, June 18, 2012, Ventas announced in an 8:33 AM press release that it had sold to ALC 12 properties for a total of $100 million in cash.[81] The purchase resulted in the termination of the Ventas Lease and the lease on the four additional properties under the MLD Lease, as well as the dismissal of the Ventas Lawsuit.[82] Press further detailed that the total consideration consisted of $97 million to purchase the properties, an additional $3 million (plus fees) to cover the litigation settlement, and that ALC would finance the purchase through a revolving credit agreement.[83]

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[79] "Falls assisted living company fires CEO – Physician named interim chief – State regulators cited chain for violations," Milwaukee Journal Sentinel, 5/30/12.
[80] CJS Securities, Company Update, 5/30/12.
[81] "Ventas Sells 12 Communities to Assisted Living Concepts," Business Wire, 6/18/12, 8:33 AM.
[82] "Ventas Sells 12 Communities to Assisted Living Concepts," Business Wire, 6/18/12, 8:33 AM; "Ventas, Inc. Sells 12 Communities To Assisted Living Concepts, Inc.; Dismisses Pending Litigation," Reuters Significant Developments, 6/18/12.
[83] "Assisted Living Concepts settles lawsuit with Chicago firm," Milwaukee Business Journal Online, 6/18/12.

79. As shown in Exhibit 7, ALC shares closed up $0.50, or 3.90%, on June 18, 2012. This movement corresponded to an abnormal return of 3.81%, which is statistically significant.

80. ALC filed an 8-K disclosing its purchase of the properties from Ventas after market close on Thursday, June 21, 2012 at 5:19 PM.[84] The 8-K reiterated that ALC had purchased twelve properties from ALC for the same financial consideration reported by the press on June 18, 2012. However, the 8-K provided more details on the locations of the properties and disclosed that ALC would finance the purchase via "borrowings available under ALC's $125 million revolving credit agreement" at a rate of LIBOR plus 3%.[85]

81. ALC's 8-K filing also stated that ALC paid $6.4 million in rent in 2011 on the 12 properties that were part of the purchase agreement and estimated that, on a pro forma basis, ALC would have saved $3.2 million (rent saved less interest paid) in 2011 if ALC had financed the purchase of the property at LIBOR plus 3% prior to 2011.[86]

82. On Friday, June 22, 2012, the first trading day on which the information in ALC's June 21, 2012 8-K was available to the market, ALC's abnormal return was 2.13%, which was not statistically significant.

83. Based on my review of the publicly available materials, I found no disclosure that discussed the Financial Covenant Allegations on these days. Therefore, there is no basis to conclude that the ALC abnormal returns observed on these days are attributable to the Financial Covenant Allegations.

Executed this 13th of March, 2015

Doug Clark, PhD

[84] ALC Form 8-K, filed 6/21/12, 5:19 PM.
[85] ALC Form 8-K, filed 6/21/12, 5:19 PM.
[86] ALC Form 8-K, filed 6/21/12, 5:19 PM.

Exhibit 1

Curriculum Vitae

DAVID C. SMITH
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Email: dcs8f@virginia.edu

EDUCATION

Ph.D. (Finance)	Indiana University, 1993
B.S.	University of Delaware, 1988

PRESENT EMPLOYMENT

Professor of Commerce, University of Virginia, McIntire School of Commerce, 2013 -

Director, McIntire Center for Financial Innovation, 2007 -

PREVIOUS POSITIONS

Visiting Professor, University of Pennsylvania, The Wharton School, Fall 2013.

Associate Professor of Commerce, University of Virginia, McIntire School of Commerce, 2005-2013

Director, Berkeley Research Group, LLC, 2011 -2012

Visiting Associate Professor, University of Minnesota, Carlson School of Management, 2004-2005.

Economist, Board of Governors of the Federal Reserve System, Washington, D.C., 2000-2005

Visiting Assistant Professor, University of Florida, Gainesville, FL., 1998-2000

Assistant Professor, BI Norwegian School of Management, Oslo, Norway, 1993-1999

TESTIFYING EXPERIENCE

SEC v. Heart Tronics, Inc., et al., United States District Court Central District of California, January 2015. Have been deposed (January 2015). Testified at trial (March 2015).

Litigation in American Arbitration Association Court in Phoenix, Arizona, September 2014. Testified at trial (September 2014). Confidential under protective order.

Phyllis Johnson, et al., v. Meriter Health Services Employee Retirement Plan, and Meriter Health Services, Inc., United States District Court for the Western District of Wisconsin, May 2014. Testified at deposition (May 2014); case settled prior to trial.

Litigation pending in Supreme Court of State of New York, April 2013. Testified at deposition (May 2013). Confidential under protective order.

Deutsche Bank Securities Inc. and SPCP Group, LLC v. Lexington Drake L.P., Supreme Court of the State of New York, March 2012. Testified at trial (March 2012).

Nycal Offshore Development Corp. v. United States, United States Court of Federal Claims, December 2010. Testified at deposition (September 2010) and at trial (December 2010).

OTHER CONSULTING EXPERIENCE

Liquidating trust of a large resort, U.S. Bankruptcy Court, District of Montana, November 2009-September 2010.

PROFESSIONAL AWARDS, RECOGNITION, AND PRIZES

2014	Named an "extraordinary contributor" to University of Virginia undergraduate experience by President Teresa A. Sullivan.
2011	Order of the Claw & Dagger Annual Faculty Recognition Award, McIntire School of Commerce
2010	Seven Society Faculty Honoree for Outstanding Contributions to the University of Virginia
2009	PriceWaterhouseCoopers Grant for Professional Services Development
2009	Faculty Inductee, Beta Gamma Sigma
2009-10	Competitive research grant from the National Bureau of Economic Research to study financial restructurings of firms backed by private equity
2007-10	Competitive research grant from the Research Council of Norway's *Finansmarkedsfond.*
2007-09	Competitive research grant from the American Bankruptcy Institute for the study of the trading of distressed debt claims, 2007-2009.
2000	1st Runner up, Outstanding Paper of the Year Award at the *Journal of Financial Intermediation* for "What Determines the Number of Bank Relationships? Cross-Country Evidence"
1998	Nominee, Smith-Breeden Prize at the *Journal of Finance* for "The Conditional Performance of Insider Trades,"

EXTERNAL GRANTS

2009 National Bureau of Economic Research

2007 Research Council of Norway

2007 American Bankruptcy Institute

PROFESSIONAL AFFILIATIONS

Coordinating Editor, *American Bankruptcy Institute Journal*, 2011 –

Associate Editor, *Journal of Financial Services Research*, 2007-2011

Member, American Finance Association, 1993-

Member, European Finance Association, 1993-

Member, American Bankruptcy Institute, 2006-

RESEARCH PAPERS UNDER SUBMISSION

"The Ownership and Trading of Debt Claims in Chapter 11 Restructurings," with Victoria Ivashina and Ben Iverson, conditionally accepted to *Journal of Financial Economics.*

"Private Equity Sponsors and the Resolution of Financial Distress," with Edith Hotchkiss and Per Strömberg.

PUBLICATIONS

"What Happens in Nevada? Self-Selecting into Lax Law," with Michal Barzuza. *Review of Financial Studies*, December 2014, 27(12), 3593-3627.

"Some Facts and Figures on Secured Lending," with Greg Nini, *2013 LSTA Chronicle.*

"The Restructuring of Danfurn LLC," with Larry Halperin and Michael Friedman, Darden Business Publishing's *McIntire School of Commerce* Business Case Series, January 2013.

"U.S. International Equity Investment," with John Ammer, Sarah Holland, and Francis Warnock, *Journal of Accounting Research*, December 2012, 50(5), 1109-1139.

"Creditor Control Rights, Corporate Governance, and Firm Value," with Greg Nini and Amir Sufi, *Review of Financial Studies*, June 2012, 25(6), 1713-1761.

"Claims Trading Promotes Ownership Concentration," with Tinamarie Feil, *American Bankruptcy Institute Journal*, April 2011, 30-3, 1.

"Creditor Control Rights and Firm Investment Policy," with Greg Nini and Amir Sufi, *Journal of Financial Economics*, June 2009, pp. 400-420.

"On the Sequencing of Projects, Reputation Building, and Relationship Finance," with Dominik Egli and Steven Ongena, *Finance Research Letters*, March 2006, 23-39.

"Maximizing the Value of Distressed Assets: Bankruptcy Law and the Efficient Reorganization of Firms," with Per Strömberg, in *Systemic Financial Distress: Containment and Resolution*, Patrick Holohan and Luc Laeven editors, Cambridge University Press, 2005.

"The Impact of Bank Consolidation on Commercial Borrower Welfare," with Jason Karceski and Steven Ongena, *Journal of Finance*, August 2005, 2043-2082.

"Loans to Japanese Borrowers," *Journal of the Japanese and International Economies*, September 2003, 283-304.

"Global Integration in the Banking Industry," with Allen Berger, *Federal Reserve Bulletin*, November 2003, 451-460.

"To What Extent Will the Banking Industry be Globalized? A Study of Bank Nationality and Reach in 20 European Nations," with Allen Berger, Qinglei Dai and Steven Ongena, *Journal of Banking and Finance*, February 2003, 383-415.

"Firms and Their Distressed Banks: Lessons from the Norwegian Banking Crisis (1988 - 1991)," with Steven Ongena and Dag Michalsen, *Journal of Financial Economics*, January 2003, pp. 81-112.

"The Duration of Bank Relationships," with Steven Ongena, *Journal of Financial Economics*, September 2001, pp. 449-475.

"Are Banks Still Special? New Evidence on their Role in the Capital-Raising Process," with Christopher James, *Journal of Applied Corporate Finance*, Spring 2000, pp. 52-63.

"Bank Relationships: A Review," with Steven Ongena, in *The Performance of Financial Institutions*, 2000, P. Harker and S.A. Zenios, editors, Cambridge University Press, pp. 221-258.

"What Determines the Number of Bank Relationships? Cross-Country Evidence," with Steven Ongena, *Journal of Financial Intermediation*, January 2000, pp. 26-56.

"Finite Sample Properties of Tests of the Epstein-Zin Asset Pricing Model," *Journal of Econometrics*, November 1999, pp. 113-148.

"The Elasticity of Interest Rate Volatility - Chan, Karolyi, Longstaff and Sanders Revisited," with Robert Bliss, *Journal of Risk*, Fall 1998, pp. 21-46.

"The Conditional Performance of Insider Trades," with B. Espen Eckbo, *Journal of Finance*, April 1998, pp. 467-498.

"Quality and Duration of Bank Relationships," with Steven Ongena in *Global Cash Management in Europe*, D. F Birks, editor, MacMillan Press, 1998.

3/5/2015

Documents Considered
Report of David C. Smith, Ph.D.

In addition to the documents cited in my report, I have considered the following materials:

Legal Documents

- "Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant To Sections 4C And 21C of the Securities Exchange Act Of 1934 And Rule 102(e) of the Commission's Rules of Practice" (the "Order") in *Securities and Exchange Commission v. Laurie Bebo, et al.* filed 12/3/14
- "Verified Complaint for Declaratory Relief" and Exhibits in *Ventas Realty, Limited Partnership v. ALC CVMA, LLC et al.*, filed 4/26/12
- "Motion for Leave to File First Amended Complaint" and Exhibits in *Ventas Realty, Limited Partnership v. ALC CVMA, LLC et al.*, filed 5/10/12
- "SEC Announces Fraud Charges Against Two Executives in Scheme Involving Fake Occupants at Senior Residences," SEC.gov Press Release, 2014-269, released 12/3/14
- "Emergency Motion for Expedited Appointment of Receiver," in *Ventas Realty, Limited Partnership v. ALC CVMA, et al.*, filed 5/6/12
- "Memorandum by Defendants Opposing Plaintiff's Motion for a Receiver" in *Ventas Realty, Limited Partnership v. ALC CVMA, et al.*, filed 5/6/12
- "Memorandum in Support of Motion for Expedited Appointment of Receiver" in *Ventas Realty, Limited Partnership v. ALC CVMA, et al.*, filed 5/6/12

Academic Literature

- Rice, John A., *Mathematical Statistics and Data Analysis*, 3rd Edition (2007), 337–9.
- *Reference Manual on Scientific Evidence*, 2nd Edition (2000), Federal Judicial Center, 124.
- Eugene Fama, "Efficient Capital Markets: A Review of Theory and Empirical Work," *The Journal of Finance* 25 No. 2 (1970)
- Eugene Fama, "Efficient Capital Markets: II," *The Journal of Finance* 46 No. 5 (1991)
- Eugene Fama, Lawrence Fisher, Michael Jensen, and Richard Roll, "The Adjustment of Stock Prices to New Information," *International Economic Review* 10 (1969)
- Ray Ball and Philip Brown, "An Empirical Evaluation of Accounting Income Numbers," *Journal of Accounting Research* Autumn (1968), 159-178
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- A. Craig MacKinlay, "Event Studies in Economics and Finance," *Journal of Economic Literature* 35 (Mar., 1997), 13-39
- S.P. Kothari and Jerold Warner, "Econometrics of Event Studies," (October 20, 2004)
- B. Espen Eckbo and David C. Smith, "The Conditional Performance of Insider Trades," *Journal of Finance* 53 (1998), 467-498

Documents Considered
Report of David C. Smith, Ph.D.

- Steven Ongena, David Smith, and Dag Michalsen, "Firms and their distressed banks: lessons from the Norwegian banking crisis," *Journal of Financial Economics* 67 (2003), 81-112
- Greg Nini, David C. Smith, and Amir Sufi, "Creditor Control Rights, Corporate Governance, and Firm Value," *Review of Financial Studies* 25 (2012), 1713-1761

Public Press *(see enclosed CD)*

- Selected public press about Assisted Living Concepts and Ventas from *Factiva*, *Lexis Nexis*, and Bloomberg

Industry Reports and Analyst Reports *(see enclosed CD)*

- SeniorCare Investor Newsletters: March 2012 – June 2012
- Analyst report coverage of Assisted Living Concepts

Data Sources *(see enclosed CD)*

- Tick Data for Assisted Living Concepts
- Bloomberg
  - Short interest data for Assisted Living Concepts
  - Corporate Action Calendar for Assisted Living Concepts and companies mentioned in ALC Peer Group and Broad Comparator group in ALC's 2011 and 2012 Form 10-Ks.
  - Pricing and volume data for: Alliance Healthcare Services Inc., Sunrise Senior Living, Five Star Quality Care, Brookdale Senior Living Corporation, Emeritus Corporation, U.S. Physical Therapy Inc., Metropolitan Health Networks, Cross Country Healthcare, IPC The Hospitalist Co. Inc., Examworks Group Inc., Corvel Corp., Continucare Corp, Chindex Intl. Inc., Alliance Healthcare Services Inc., Cardionet Inc., and Great Wolf Resorts Inc.
  - NYSE return data
- CRSP pricing data for: Assisted Living Concepts, Almost Family Inc., Landauer Inc., Marcus Corporation, and Medcath Corporation
- S&P Capital IQ
- Thomson Research

Documents Considered
Report of David C. Smith, Ph.D.

SEC Filings ***(see enclosed CD)***

- SEC filings for Assisted Living Concepts
- SEC filings for Ventas

Miscellaneous

- ALC00154439-45
- PACER

Exhibit 3

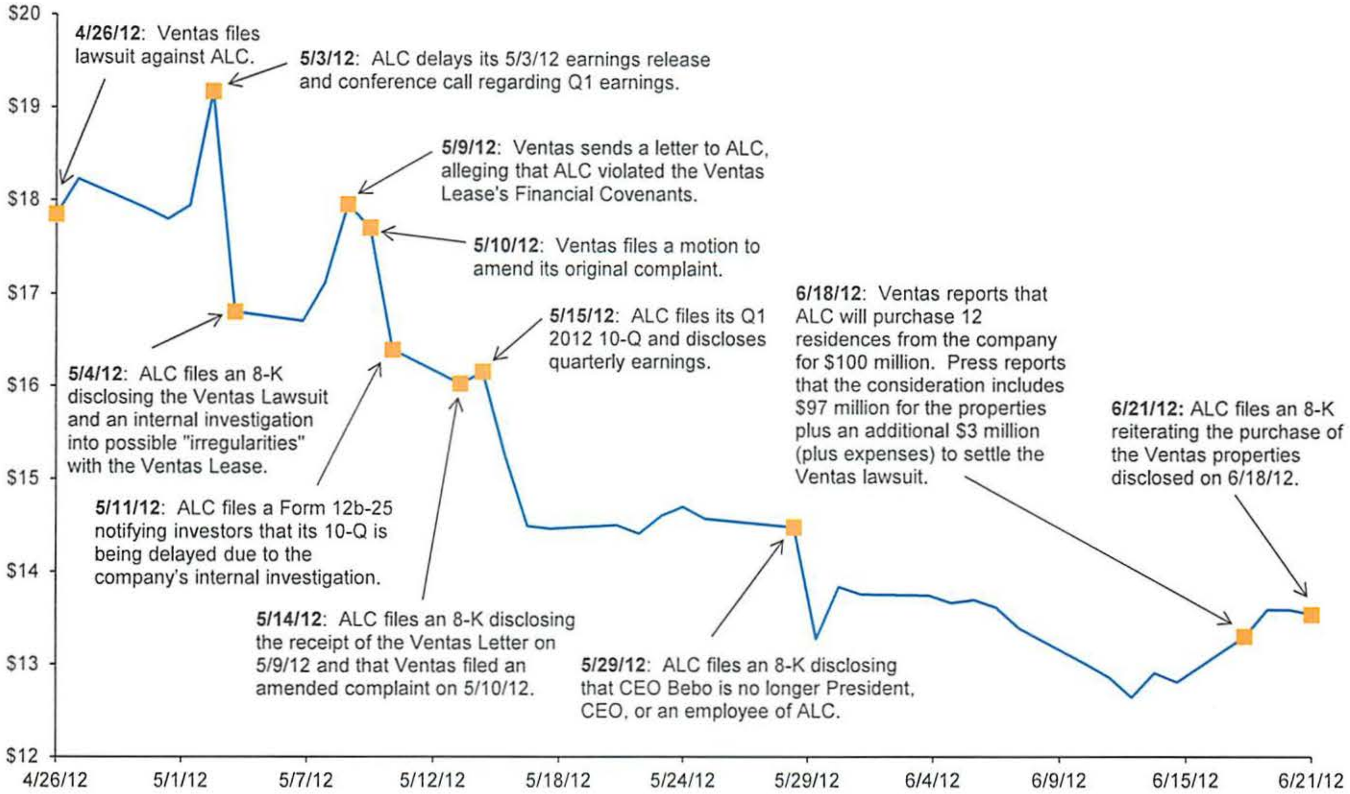
Assisted Living Concepts, Inc.
Adjusted Closing Stock Price and Volume
4/26/11 – 6/29/12

Source: CRSP

Note: Stock price and volume are adjusted for dividends and a 2-for-1 split that was effective on 6/16/11.

Exhibit 4

Assisted Living Concepts, Inc.
Dispute Period Events and Closing Stock Price



Source: CRSP; Public Press; PACER; SEC Filings

Exhibit 5

Assisted Living Concepts, Inc., Adjusted Closing Stock Price vs. NYSE and Peer Group
4/26/11 – 6/29/12

Source: CRSP; Bloomberg

Note: Prices are pegged to the value of ALC's share price as of 4/25/12 and are adjusted for dividends and a 2-for-1 split that was effective on 6/16/11. Peer Group is as defined in the company's 2011 10-K, filed on 3/12/12. Returns for the Peer Group are calculated on an equal-weighted basis.

Exhibit 6

Assisted Living Concepts, Inc.
Event Study Regression Summary [1]
4/26/11 – 4/25/12

Parameter/Statistic	Coefficient [2]	t-statistic
NYSE	0.66 *	5.42
Peer Group [3]	0.33 *	5.31
Constant	0.00	0.58
Adjusted R-squared	60.9%	
RMSE	1.60%	
Observations	253	

Source: CRSP; Bloomberg; SEC Filings

Note:

[1] Regression model evaluates the historical relationship between ALC's daily stock price return and the returns on the NYSE and the Peer Group over the period 4/26/11 through 4/25/12.

[2] Asterisks (*) denote that the coefficient for the respective parameter is statistically significant at the 5% significance level.

[3] Peer Group is as defined in ALC's 2011 Form 10-K, filed on 3/12/12. ALC's peers include Brookdale Senior Living, Inc., Capital Senior Living Corporation, Emeritus Corporation, Five Star Quality Care, Inc. and Sunrise Assisted Living, Inc. ALC defines its peers as the companies that "most closely [match] ALC in terms of market capitalization and market niche." Returns for the Peer Group are calculated on an equal-weighted basis, consistent with how ALC evaluates the Peer Group's returns in its 10-K.

Exhibit 7

Assisted Livings Concepts, Inc.
Selected Events and ALC Abnormal Price Movements

Trading Date [1]	Disclosure Date [2]	Time of Release [3]	Event	Closing Stock Price [4]	Volume [4]	Raw Return [4]	Abnormal Return [4] [5]
Thursday, May 3, 2012	Thursday, May 3, 2012	3:53 PM	ALC delays its 5/3/12 earnings release and conference call regarding Q1 earnings.	$19.17	631,800	6.86%	8.00% *
Friday, May 4, 2012	Friday, May 4, 2012	9:27 AM	ALC files an 8-K disclosing the Ventas lawsuit, as well as an internal investigation into "possible irregularities in connection with the Company's lease with Ventas."	$16.80	825,800	-12.36%	-11.20% *
Thursday, May 10, 2012	Thursday, May 10, 2012	N/A	Ventas files a motion to amend its original complaint to include some matters referenced in the Ventas Letter and to expand relief to include termination of the lease and monetary damages.	$17.70	370,900	-1.39%	-1.87%
Friday, May 11, 2012	N/A	N/A		$16.39	373,700	-7.40%	-6.94% *
Monday, May 14, 2012	Friday, May 11, 2012	5:24 PM	ALC files a Form 12b-25 notifying investors that its 10-Q is being delayed due to the company's internal investigation.	$16.02	260,400	-2.26%	-0.40%
	Monday, May 14, 2012	10:21 AM	ALC files an 8-K disclosing the receipt of the Ventas Letter on 5/9/12 and that Ventas filed a motion to expand its complaint on 5/10/12.				

Exhibit 7

Assisted Livings Concepts, Inc.
Selected Events and ALC Abnormal Price Movements

Trading Date [1]	Disclosure Date [2]	Time of Release [3]	Event	Closing Stock Price [4]	Volume [4]	Raw Return [4]	Abnormal Return [4] [5]
Wednesday, May 16, 2012	Tuesday, May 15, 2012	4:02 PM	After market close on 5/15/12, ALC files its Q1 2012 10-Q, reiterating the disclosures about the Ventas lawsuit from its 5/14/12 8-K. The 10-Q also discloses ALC's Q1 2012 earnings results. ALC reports EPS of $0.24, below consensus estimates of $0.26.	$15.25	325,100	-5.57%	-4.79% *
Wednesday, May 30, 2012	Tuesday, May 29, 2012	7:15 PM	After market close, ALC files an 8-K disclosing that CEO Bebo is no longer President, CEO, or an employee of ALC, and that Dr. Charles Roadman will serve as interim President and CEO.	$13.28	460,800	-8.29%	-6.55% *
Monday, June 18, 2012	Monday, June 18, 2012	8:33 AM	Ventas reports that ALC will purchase 12 residences from the company for $100 million. Public press reports that the consideration includes $97 million for the properties plus an additional $3 million (plus expenses) to settle the Ventas lawsuit, and will be financed through ALC's existing revolving credit facility.	$13.31	160,200	3.90%	3.81% *

Exhibit 7

Assisted Livings Concepts, Inc.
Selected Events and ALC Abnormal Price Movements

Trading Date [1]	Disclosure Date [2]	Time of Release [3]	Event	Closing Stock Price [4]	Volume [4]	Raw Return [4]	Abnormal Return [4] [5]
Friday, June 22, 2012	Thursday, June 21, 2012	5:19 PM	After market close, ALC files an 8-K reiterating the purchase of the Ventas properties disclosed on 6/18/12.	$14.00	226,100	3.32%	2.13%

Source: CRSP; Public Press; PACER; SEC Filings

Note:

[1] Trading date reflects the first date on which the information could have been incorporated into ALC's stock price. For dates on which an event occurs after 4:00 PM, the trading date represents the trading date following the disclosure date. For dates on which no time stamp is available through public press or SEC EDGAR, the trading date is assumed to be the same as the disclosure date.

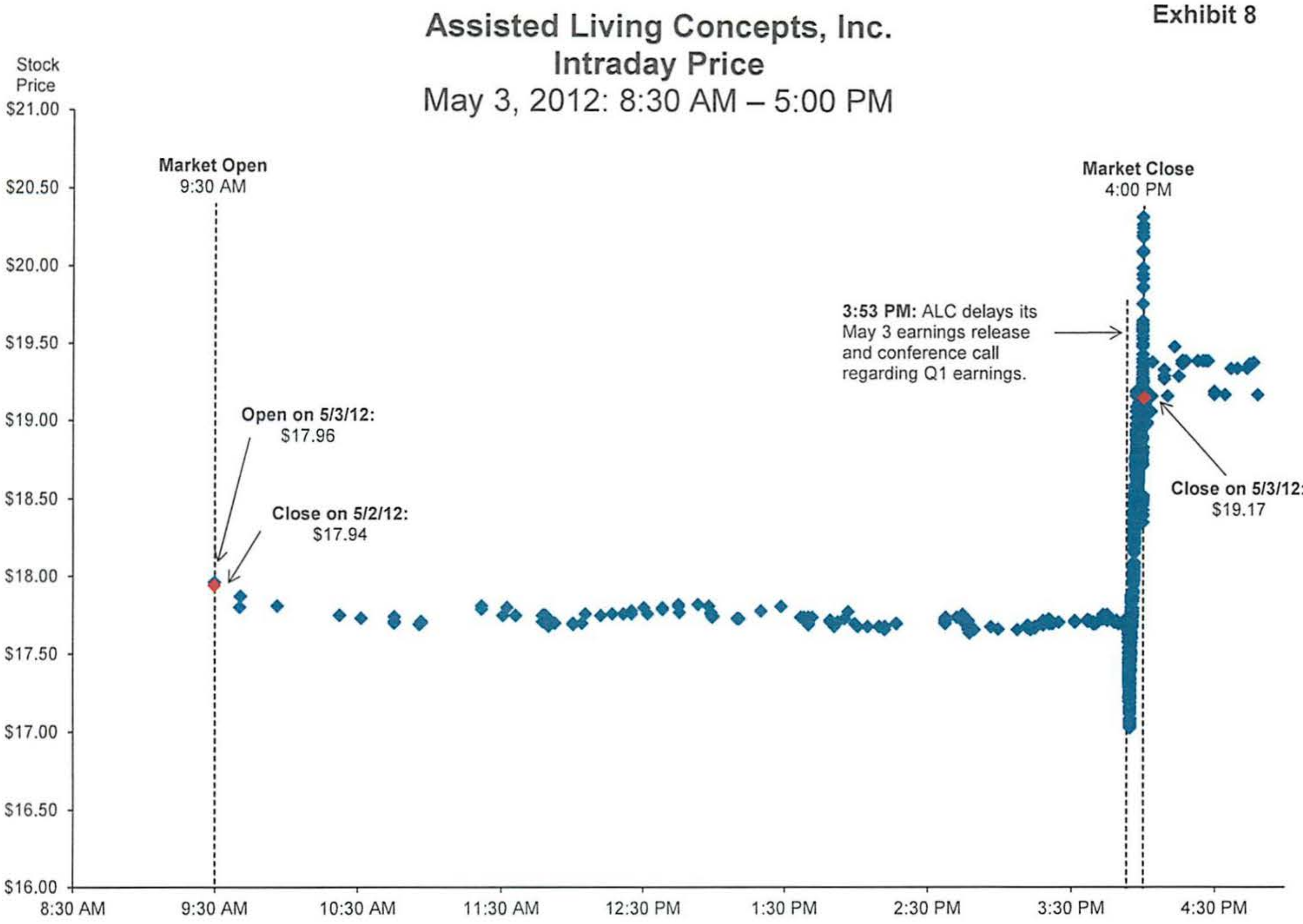
[2] Disclosure date reflects the date of the event identified.

[3] Time stamps for SEC filings are as reported by the SEC. Time stamps for other items are as reported by Factiva.

[4] ALC stock price, volume, and returns data are as of the trading date referenced.

[5] Asterisks (*) denote that the abnormal return is statistically significant at the 5% significance level.

Exhibit 8

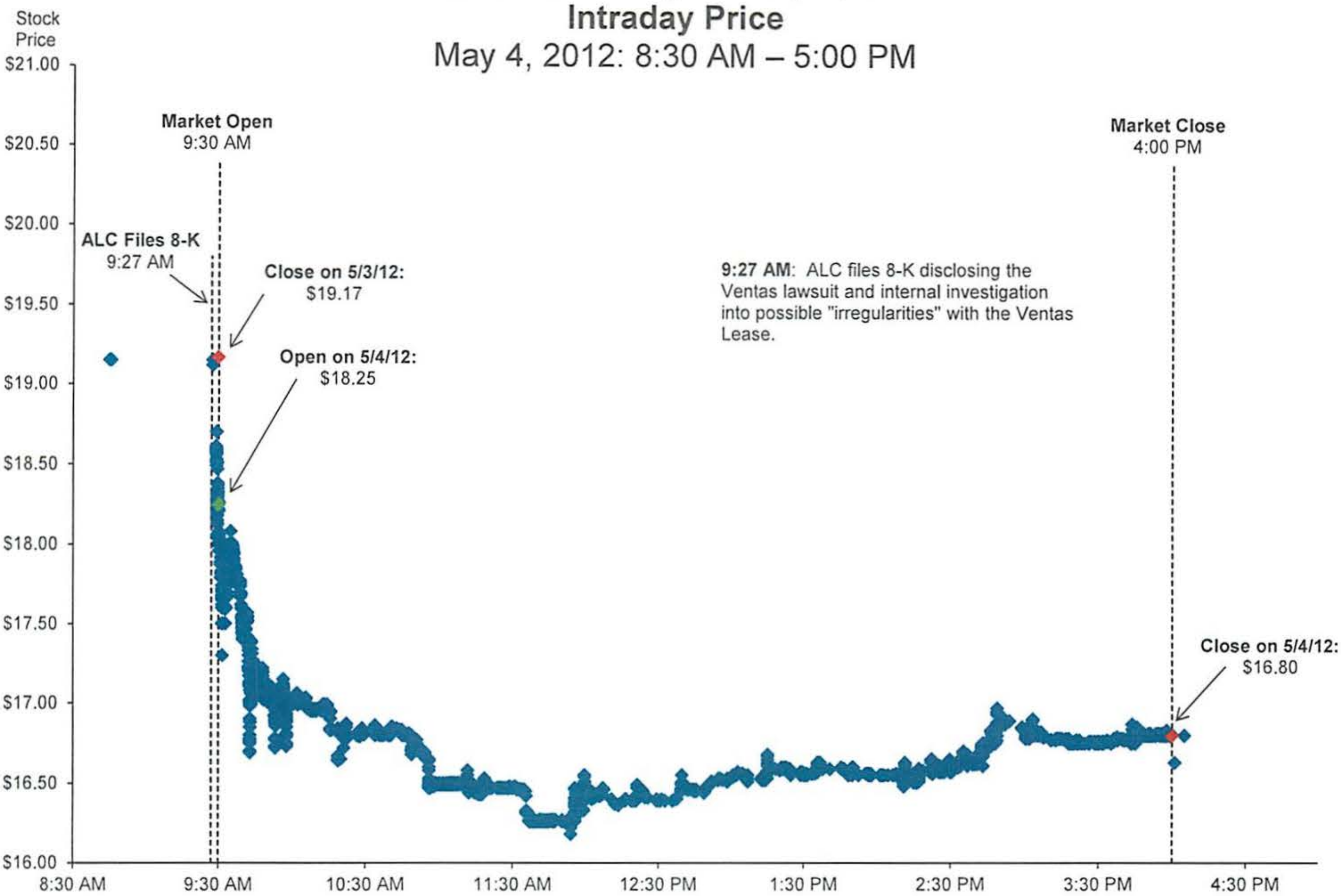


Source: Tick Data; Bloomberg; Dow Jones News Service

Note: Opening and closing prices are from Bloomberg.

Exhibit 9

Assisted Living Concepts, Inc.
Intraday Price
May 4, 2012: 8:30 AM – 5:00 PM



Source: Tick Data; Bloomberg; SEC Filings

Note: Opening and closing prices are from Bloomberg.