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Bryan L. Phipps

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In re Williams Securities Litigation—WCG Subclass: How *Dura* Met *Daubert*

I. INTRODUCTION

The United States Court of Appeals for the Tenth Circuit recently decided a large securities fraud case that will have a significant impact on evidentiary standards pertaining to loss causation theories. The court's February 18, 2009, opinion was its first to apply the Supreme Court's loss causation standard set forth in *Dura Pharmaceuticals, Inc. v. Broudo*.[1] The case, *In re Williams Securities Litigation—WCG Subclass*,[2] addressed the question of whether the district court abused its discretion in granting summary judgment to the defendants on the issue of loss causation after excluding the plaintiffs' expert witness testimony. The court excluded the expert's testimony on the ground that his loss causation scenarios were based on an unreliable methodology.[3]

In deciding *Williams*, the Tenth Circuit became the first federal appellate court to consider *Dura*'s requirements in response to a *Daubert* challenge. After juxtaposing *Dura*'s standards with those set forth by *Daubert* and its progeny, the appellate court affirmed both the lower court's exclusion of the plaintiffs' expert testimony and its grant of summary judgment for the defendants. Though the standards announced by the Tenth Circuit are more burdensome on plaintiffs than those imposed by other courts, *Williams* is more in line with the Supreme Court's reasoning and policy underlying *Dura* than cases decided in other jurisdictions.

II. FACTS AND PROCEDURAL HISTORY

A. Factual Background

Following the forced breakup of AT&T in the early 1980s,[4] WMB (an energy company that produces and transports natural gas)

1. 544 U.S. 336 (2005).
2. 558 F.3d 1130 (10th Cir. 2009).
3. *Id*. at 1132, 1143.
4. United States v. Am. Tel. & Tel. Co., 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom*. Maryland v. United States, 460 U.S. 1001 (1983).

planned to run fiber-optic cables through decommissioned pipelines.[5] As part of this plan, WMB formed a telecommunications subsidiary called Williams Telecommunications Company ("WilTel"), which eventually constructed a nationwide digital fiber-optic network of approximately 9,700 route miles.[6]

In 1995, WMB sold WilTel for $2.5 billion to LDDS Communications.[7] Excluded from the sale, among other things, was a single fiber-optic strand along the original nationwide network.[8] As a condition of the sale, WMB agreed to a three year non-compete agreement that prevented it from reentering the telecommunications industry until 1998.[9]

When WMB's non-compete agreement expired in January 1998, the Telecom Index was thriving—up 42% since the beginning of the previous year.[10] Seeking to reenter the telecommunications industry, WMB formed the subsidiary WCG with the objective of building a nationwide fiber-optic network for the exclusive purpose of providing services to communications service providers.[11] By the end of the year, the Telecom Index climbed to 500.91, up 63%.[12]

In light of the favorable market conditions and in an effort to raise additional capital for operations and continued network construction, WCG conducted an IPO on October 1, 1999.[13] That day, WCG's stock ended trading at $28.06 per share, and the Telecom Index reached 616.80 (a gain for the Index of 23% since the end of 1998).[14] The months following WCG's IPO showed exceptional growth for both WCG's stock price and the Telecom Index, with WCG peaking on March 7, 2000, at $61.81 and the Telecom Index reaching its peak three days later at 1248.06.[15]

5. *In re* Williams Sec. Litig.—WCG Subclass, 496 F. Supp. 2d 1195, 1204 (N.D. Okla. 2007), *aff'd*, 558 F.3d 1130 (10th Cir. 2009).

6. *Id.*

7. *Id.*

8. *Id.*

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.* at 1205.

13. *See id.* at 1206.

14. *Id.*

15. *Id.* at 1207.

Over the next several months, WCG and the Telecom Index both declined significantly.[16] By July 21, 2000, WCG's trading price was down to $29.38 (a decrease of more than 50% compared to its peak).[17] Similarly, the Telecom Index had fallen an alarming 28% since its zenith.[18] On July 24, 2000, the beginning of the class period, WMB announced its plan to spin off WCG in a tax free distribution to its shareholders.[19] A November 16, 2000, press release quoted WMB's CEO, defendant Keith Bailey, as saying:

> This important step continues a process that we believe remains in the best long-term interests of our shareholders. [WMB and WCG] have tremendous opportunities before them. Creating the most effective and efficient access to capital will help fuel that growth, and we believe that can best be achieved by creating two independent businesses.[20]

Conversations among WMB's board members revealed, however, that the real reason behind the spin-off was the board's concern over how WCG was affecting WMB's balance sheet: the massive capital expenditures necessary to keep WCG going were jeopardizing WMB's credit rating and its ability to obtain financing to pursue its own business goals.[21] Many board members saw the spin-off as an opportunity to "heave the junk called WCG overboard as fast as possible."[22]

Publicly, WMB extolled the strength and promise WCG enjoyed. Shareholders were told that WCG was "strongly positioned for success"[23] and "pre-funded for their capital needs . . . to carry them to that point of EBITDA positive."[24] During a road show, executives continued to tout how the spin-off would fully allow each company to pursue its respective business strategies and increase access to capital, creating a "Win-Win for WMB and WCG shareholders."[25]

16. *See id.* at 1211.
17. *Id.*
18. *Id.*
19. *Id.*
20. *Id.* at 1216.
21. *Id.* at 1216–17.
22. *Id.* at 1217.
23. *Id.* at 1222.
24. *Id.* at 1281.
25. *Id.* at 1218, 1222.

WMB's public statements painted a bright and promising future for WCG as an independent company.

Within the company, however, the opinions regarding WCG's ability to satisfy its capital needs were much more pessimistic. In September 2000, after WCG's August sale of $1 billion in high yield bonds, WMB's board of directors was told that, although the bond offering raised more capital than initially forecasted, WCG was still underfunded through the end of 2001 by approximately $800 million.[26] Bailey expressed his concerns when he declared that the company had no other choice but to go on a "capital diet" and sell off non-core assets.[27]

After the spin-off on April 23, 2001, WCG continued to paint a rosy picture of the company's present condition and future prospects.[28] A couple months after the split, WCG's CEO, defendant Howard Janzen, stated that WCG had funding in place to take the company to 2004, with a plan to be cash flow positive by the end of 2003.[29] Janzen also commented that the company was positioned to not only survive the market slowdown, but to thrive in the coming years.[30]

Inside the company, the board members were receiving a different story. At an August presentation, WCG board members were told that the company was "very close to falling into a chasm of the red 'danger' zone" and that WCG's cash flow was insufficient to service its debt.[31] By the end of 2001, WCG's stock price had fallen to $2.35 per share and the Telecom Index was down to 236.63.[32]

The first quarter of 2002 consisted of devastating blow after devastating blow to WCG's shareholders and WCG's stock price. The most substantial releases of negative company information occurred on four separate occasions. On January 29, WMB announced that its 2001 earnings report would be delayed while the

26. *Id.* at 1212.

27. *Id.*

28. *See id.* at 1222 ("WCG is strongly positioned for success. Its core network asset is in place. It has demonstrated history of technical performance. And, it has the financial resources in place to enable it to deliver on the promise of a very bright future.").

29. *In re* Williams Sec. Litig.—WCG Subclass, 558 F.3d 1130, 1133–34 (10th Cir. 2009).

30. *Id.* at 1134.

31. *In re Williams Sec. Litig.*, 496 F. Supp. 2d at 1223.

32. *Id.* at 1224.

company assessed its contingent obligation with respect to WCG.[33] That same day, Milberg Weiss filed the Cali complaint—the first of the lawsuits against WCG (and later consolidated).[34] WCG's stock price fell that day from $1.63 to $1.34.[35]

Just a few days later, a second major revelation occurred. On February 4, WCG announced that it was reviewing the potential impairment of its long-lived assets and that its lenders had recently informed WCG that the company may be in default under its credit agreement.[36] As a result of the default notice, WCG agreed to submit a strategy for restructuring and deleveraging its balance sheet to the banks.[37] WCG reassuringly added that "successful execution of the options currently envisioned does not include seeking bankruptcy protection or the substantial dilution of equity security holders."[38] That day, the company's stock fell again, from $1.42 to $1.00.[39]

The third substantial disclosure occurred on February 25, when WCG revealed that it was considering the potential benefits of Chapter Eleven reorganization.[40] After this announcement, WCG's stock fell by 61.6% to close at $0.22 per share.[41] Finally, on April 22, after the closing bell rang, WCG filed for bankruptcy.[42] The next trading day WCG's stock price closed at $0.06—a 67.3% drop from the day before.[43] During this same period, the Telecom Index had shrunk to 148.94, 12% percent of its March 10, 2000, high.[44]

B. The Daubert *Challenge and Summary Judgment at the District Court*

The disposition of *Williams* hinges on the district court's rulings over a *Daubert* challenge and a summary judgment motion. These motions resulted in a combined filing of 212 motions, briefs,

33. *Id*. at 1225.
34. *Id*.
35. *Id*. (reporting net of market and industry effects).
36. *Id*. at 1225–26.
37. *Id*. at 1226.
38. *Id*.
39. *Id*.
40. *Id*.
41. *Id*.
42. *Id*. at 1227.
43. *Id*.
44. *Id*.

exhibits, and appendices totaling more than 36,650 pages.[45] The defendants' *Daubert* challenge was based, in part,[46] on a perceived failure of one of the plaintiffs' proposed expert witnesses to reliably prove loss causation as required under the standard recently clarified by the Supreme Court in *Dura*.[47] The defendants' success on the *Daubert* motion was a prerequisite to their success on the motion for summary judgment as to loss causation.

In an effort to prove loss causation, Dr. Nye (the plaintiffs' expert) presented two[48] loss causation scenarios. The first scenario was based on a "leakage" theory.[49] Under this theory, nearly the entire decline in WCG's stock price was ascribed to the gradual "leaking" of WCG's alleged fraud into the market.[50] This theory presumed that the market had not been alerted to the fraud prior to January 29, 2002.[51] The leakage theory attributed shareholder losses to the "materialization of the concealed risks, specifically that WCG's assets were overstated, that WCG was in default of its debt covenants, and that there was significant uncertainty about WCG's ability to continue as a going concern."[52] According to the theory, WCG's true value was its trading price on the day the company declared bankruptcy.[53] However, because the leakage theory failed to account for other "obvious alternative explanations,"[54] the district court found that it was an unreliable method for proving loss causation.[55]

Dr. Nye's second loss causation scenario rested on a "corrective disclosure" theory. This theory focused on price declines following

45. *Id.* at 1204.

46. *Id.* at 1253 n.36.

47. *Id.* at 1252–53.

48. Dr. Nye actually prepared three loss causation scenarios, but Scenario 2 and Alternative Scenario 2 contained no differences "with respect to the matters which the court [found] to be dispositive." *Id.* at 1261.

49. *Id.* at 1253–58.

50. *Id.* at 1253–54.

51. *Id.* at 1256–57.

52. *In re* Williams Sec. Litig.—WCG Subclass, 558 F.3d 1130, 1134–35 (10th Cir. 2009) (internal quotation marks omitted).

53. *In re Williams Sec. Litig.*, 496 F. Supp. 2d at 1254.

54. *Id.* at 1266–67. "He fails to differentiate between losses rooted in causes cognizable under loss causation doctrine, on one hand, and, on the other hand, losses attributable to industry-specific stresses, the meltdown in the telecommunications sector, and other negative developments unrelated to the alleged fraud." *Id.* at 1266.

55. *Id.* at 1267.

four specific public announcements: WMB's January 29, 2002, press release announcing the delay of its earnings report; the February 4, 2002, revelation by WCG that it may be in default; WCG's February 25, 2002, announcement concerning the possibility of the company filing bankruptcy; and WCG filing for Chapter Eleven bankruptcy protection on April 23, 2002.[56] Under the corrective disclosure theory, the drop in value after each corrective disclosure was credited to the revelation of fraud.[57] Dr. Nye asserted that, although these "partial disclosures" did not precisely mirror the alleged misrepresentations, they nonetheless "revealed the risks that had been concealed by the prior misrepresentations and omissions."[58] Thus, the four corrective disclosures represented the materialization of the concealed risks and, therefore, caused the shareholders' losses.

The district court excluded Dr. Nye's testimony regarding the corrective disclosure theory on the grounds that it was unreliable under *Daubert*.[59] Specifically, the court found that this theory failed to establish that "any material, new, company-specific, and fraud-related information became available to the efficient market on January 29, 2002, or on the three subsequent corrective disclosure dates proposed by plaintiffs."[60] Accordingly, the court found that there was no "triable issue as to loss causation," and therefore entered summary judgment in favor of the defendants.[61] The plaintiffs appealed both the *Daubert* ruling and the court's grant of summary judgment.

III. SIGNIFICANT LEGAL BACKGROUND

A. Dura

The importance of *Williams* is found where *Daubert* and its progeny intersect with *Dura*. *Dura* establishes the level of causation plaintiffs must prove in order to bring a securities fraud claim; *Daubert* helps govern the reliability of proffered expert testimony. Thus, for a plaintiff's expert to testify on the issue of loss causation (and meet the requirements of *Dura*), he must first pass *Daubert*

56. *Id*. at 1225–27, 1258.
57. *Id*. at 1269.
58. *Id*. at 1269 n.53 (internal quotation marks omitted).
59. *Id*. at 1270.
60. *Id*. at 1269.
61. *Id*. at 1294–95.

scrutiny. Understanding the interplay of these two doctrines is necessary to fully appreciate the impact of *Williams*.

The basic elements of a federal securities fraud action include (1) a material misstatement or omission, (2) scienter, (3) a connection between the misstatement or omission and the purchase or sale of a security, (4) reliance, (5) economic loss, and (6) loss causation.[62] The last of these elements, loss causation, was addressed by the Supreme Court in *Dura Pharmaceuticals, Inc. v. Broudo*.[63]

In *Dura*, the plaintiffs alleged that the defendants, a pharmaceutical company and various individuals, made false statements about the profitability of certain drugs and the future FDA approval of a new product.[64] Plaintiffs further alleged that these misrepresentations caused them to purchase the defendant's stock at an artificially inflated price.[65] The Court concluded that, contrary to the "price inflation" theory, plaintiffs could not meet their burden of proving that a defendant's fraud caused an economic loss merely by demonstrating that the plaintiffs purchased stock at an artificially inflated price.[66] The court noted that loss causation—the "causal connection between the material misrepresentation and the loss"—is established by showing that the disclosure of "the relevant truth" resulted in a loss attributable to "the earlier misrepresentation."[67] In effect, *Dura* did away with the price inflation theory by unanimously labeling it insufficient.[68] However, while *Dura* explained what form of pleading was inadequate, it did not go so far as to say what level of detail would be sufficient to show loss causation.

Decisions interpreting *Dura* prove helpful in determining what a plaintiff must allege in order to meet *Dura*'s loss causation pleading standard. Based on lower court decisions, plaintiffs can meet *Dura*'s standards in two ways. The first is by adequately demonstrating that the plaintiffs' losses were caused by the corrective disclosure of a previously concealed truth.[69] Under this approach, plaintiffs must

62. Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 341 (2005).
63. *Id.*
64. *Id.* at 339.
65. *Id.* at 340.
66. *Id.*
67. *Id.* at 342–43.
68. *Id.* at 348.
69. *See, e.g.*, Jefferson Ins. Co. v. Rouhana (*In re* Winstar Commc'ns.), 2006 U.S. Dist. LEXIS 7618 (S.D.N.Y. Feb. 27, 2006); *In re* eSpeed, Inc. Sec. Litig., 457 F. Supp. 2d 266

show that the price of a corporation's stock dropped in response to a public disclosure that revealed a prior fraudulent misrepresentation or omission regarding the value of that security.[70] Additionally, a plaintiff proceeding under a corrective disclosure theory must differentiate between disclosures relating to fraud and any other negative company- or industry-specific information simultaneously revealed (often referred to as "multiple causation.") Where there is an industry-wide catastrophe accompanied by an immense flow of negative information (unrelated to fraud) about the industry and company in question, the non-fraud "contributing forces must be isolated and removed."[71] Thus, by isolating the non-fraud forces from the corrective disclosure, a plaintiff can establish the causal connection between the revelation of fraud and his losses.

Under the second, alternative method of proving loss causation, the plaintiffs may allege materialization of the concealed risk. Using this model, plaintiffs must show that the defendants' misstatements or omissions concealed risks that later materialized (in a way other than by a public corrective disclosure) to cause the plaintiffs' losses.[72] Although *Dura* did not expressly describe the concept of materialization of the risk as a substitute for corrective disclosure, the Supreme Court did recognize the possibility that there could be cases in which the "relevant truth begins to leak out."[73] This approach, however, does not do away with *Dura*'s requirement that the plaintiffs must establish a causal connection between the misrepresentation and the loss: if a plaintiff asserts that the fraud surfaced through disclosure of another event (which caused the concealed risk to materialize), then the plaintiff "must provide proof that the market recognized a relationship between the event disclosed and the fraud."[74] Under both approaches, this causal connection is usually shown with the help of expert witnesses.[75] An expert witness, though, must be able to pass *Daubert* scrutiny.

(S.D.N.Y. 2006); *In re* Bristol-Myers Squibb Sec. Litig., 2005 U.S. Dist. LEXIS 18448 (D.N.J. Aug. 17, 2005).

70. Robbins v. Koger Properties, Inc., 116 F.3d 1441, 1447 (11th Cir. 1997).

71. *Id*. at 1447 n.5.

72. *In re* AOL Time Warner, Inc. Sec. Litig., 503 F. Supp. 2d 666, 677 (S.D.N.Y. 2007).

73. *Dura*, 544 U.S. at 342.

74. McKowan Lowe & Co. v. Jasmine, Ltd., 2005 U.S. Dist. LEXIS 32164, at *26–27 (D.N.J. June 30, 2005).

75. *Robbins*, 116 F.3d at 1447 n.5.

B. Daubert

Since the Federal Rules of Evidence were amended in 2000, district judges have been entrusted with the duty to serve as evidentiary "gatekeepers."[76] This gatekeeping function is meant to prevent juries from hearing irrelevant and unreliable expert testimony.[77] In essence, the trial judge is required to "assess the reasoning and methodology underlying the expert's opinion, and determine whether it is scientifically valid and applicable to a particular set of facts."[78] This is accomplished by subjecting the proffered expert testimony to a *Daubert* analysis.

As an integral part of any *Daubert* analysis, a trial judge must determine the relevance of the proposed expert testimony.[79] As explained in the Federal Rules of Evidence, "'[r]elevant evidence' means evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence."[80] Thus, even when proffered expert testimony is reliable, it is to be excluded if it does not have "sufficient bearing on the issue at hand."[81]

In addition to making relevance determinations, *Daubert* scrutiny also addresses the reliability of proffered expert testimony.[82] To assess reliability, the court must determine whether an expert's conclusions are the result of "(i) application of that expertise using recognized and supportable methodologies, (ii) on the basis of adequate data which is (iii) rationally tied to the opinions which purport to be based on that data."[83] By way of assistance, the Supreme Court in *Daubert* enumerated several nonexclusive factors that the district court may consider in making a determination as to

76. *See* FED. R. EVID. 702 advisory committee's notes; *see also* Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579 (1993).

77. *Daubert*, 509 U.S. at 589–90.

78. Goebel v. Denver and Rio Grande W. R.R. Co., 215 F.3d 1083, 1087 (10th Cir. 2000).

79. *Daubert*, 509 U.S. at 589.

80. FED. R. EVID. 401.

81. Bitler v. A.O. Smith Corp., 391 F.3d 1114, 1121 (10th Cir. 2004).

82. FED. R. EVID. 702; *Daubert*, 509 U.S. at 590; Ralston v. Smith & Nephew Richards, Inc., 275 F.3d 965, 969 (10th Cir. 2001).

83. *In re* Williams Sec. Litig.—WCG Subclass, 496 F. Supp. 2d 1195, 1235 (2007); *see also* FED. R. EVID. 702.

reliability: (1) whether the theory is susceptible to an objective challenge, (2) "whether the theory or technique has been subjected to peer review and publication," (3) the "known or potential rate of error" associated with the methodology employed, and (4) whether the theory has been generally accepted in the scientific community.[84] This list is not exhaustive, and the district court has broad discretion to consider a variety of other factors.[85]

When subjecting proffered expert testimony to a *Daubert* analysis, "'any step that renders the analysis unreliable . . . renders the expert's testimony inadmissible. This is true whether the step completely changes a reliable methodology or merely misapplies that methodology.'"[86] A successful *Daubert* challenge, if made to exclude expert testimony regarding a necessary element of the proponent's case, may result in an entry of summary judgment as a matter of law.[87]

IV. THE COURT'S DECISION

On appeal from the Northern District of Oklahoma, the Tenth Circuit considered whether the district court abused its discretion in granting summary judgment to the *Williams* defendants after excluding the plaintiffs' expert witness's testimony concerning loss causation on the grounds that it was unreliable under *Daubert*.[88] After considering two scenarios offered by the plaintiffs' expert witness, the Tenth Circuit found that the plaintiffs "failed to identify a causal nexus between the revelation of the previously-concealed truth and the decline in value of WCG securities."[89] Without a showing "that their losses were caused by a revelation of the fraud and not some [other] non-compensable" factor, the plaintiffs did not adequately answer the issue of loss causation as required by *Dura*.[90] Therefore, the Tenth Circuit affirmed both the district court's

84. *Daubert*, 509 U.S. at 593–94.
85. *See* Kumho Tire Co. v. Carmichael, 526 U.S. 137, 150 (1999).
86. Mitchell v. Gencorp, Inc., 165 F.3d 778, 782 (10th Cir. 1999) (internal quotation marks omitted) (alteration in original) (quoting *In re* Paoli R.R. Yard PCB Litig., 35 F.3d 717, 745 (3d Cir. 1994)).
87. Gen. Elec. Co. v. Joiner, 522 U.S. 136, 142–43 (1997).
88. *In re* Williams Sec. Litig.—WCG Subclass, 558 F.3d 1130, 1136 (10th Cir. 2009).
89. *Id*. at 1143.
90. *Id*.

exclusion of the expert testimony and the grant of summary judgment.[91]

A. Loss Causation: Scenario One—Leakage and Materialization of the Concealed Risks

In reviewing the district court's exclusion of Dr. Nye's testimony, the circuit court first considered whether the trial court properly excluded Scenario One as a basis for loss causation. Under Scenario One, the plaintiffs' expert first attempted to prove loss causation on a leakage theory.[92] The plaintiffs' expert put forth the idea that the relevant truth regarding WCG's alleged fraud gradually leaked into the market—as opposed to a "full and immediate disclosure"—which caused the corporation's stock price to fall.[93] As it would do with a corrective disclosure theory, the court considered whether the plaintiffs had linked the revelation of the alleged fraud to actual losses: it is not enough to say, "Well, the market *must* have known."[94] This is essentially what the plaintiffs' expert argued under his first theory.

Under the leakage theory, Dr. Nye asserted that, within the class period, "a number of tiny corrective disclosures occurred each and every day . . . which had the cumulative [result] of gradually revealing the fraud."[95] In support of this theory, Dr. Nye "submitted a 1300-page compendium of news articles, reports, and SEC filings that was supposed to show 'numerous instances of leakage of corrective information concerning WCG's true financial condition.'"[96] The Tenth Circuit pointed out, however, that the majority of these clippings either pertained to the telecommunications industry as a whole or contained positive statements about WCG.[97] Because none of the announcements revealed anything negative about WCG particularly, the circuit court found that the district court did not abuse its discretion in rejecting the leakage theory.[98]

91. *Id.*
92. *Id.* at 1137.
93. *Id.* at 1138.
94. *Id.*
95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.*

In response to the court's dismissal of the leakage theory, the plaintiffs contended that Scenario One was developed, instead, to support loss causation based on the theory of materialization of the concealed risks.[99] Plaintiffs argued that the primary purpose of Scenario One was not that any specific disclosure notified the market of fraud, but, rather, that the "[p]laintiffs' losses were caused by the materialization of the concealed risks . . . ."[100] While the court acknowledged that materialization of the concealed risks is a viable theory, it had a problem with this justification because Dr. Nye failed to identify any specific occasion within the class period when these concealed risks actually materialized.[101] The court reminded the plaintiffs that such a theory "would still have to identify when the materialization occurred and link it to a corresponding loss."[102]

Ultimately, the appellate court found Scenario One an unreliable method for proving loss causation because it failed to specifically identify the losses attributable to fraud. Instead, the first loss scenario assumed that any decline in WCG stock was attributable to the revelation of fraud.[103] The Tenth Circuit noted that this approach failed to "differentiate between losses rooted in causes cognizable under loss causation doctrine, on one hand, and, on the other hand, losses attributable to industry-specific stresses, the meltdown in the telecommunications sector, and other negative developments unrelated to the alleged fraud."[104] Thus, Scenario One could not be used by the plaintiffs to prove loss causation due to its unreliability under *Daubert*.

B. Loss Causation: Scenario Two—Corrective Disclosures

Even though Scenario One was the plaintiffs' preferred loss causation theory, they also provided an alternate theory.[105] Scenario Two identified four specific corrective disclosures that occurred during the class period: WMB's January 29, 2002, press release announcing the delay of its earnings report; the February 4, 2002, revelation by WCG that it may be in default; WCG's February 25,

99. *Id.*
100. *Id.*
101. *Id.*
102. *Id.*
103. *Id.* at 1139.
104. *Id.* at 1135.
105. *Id.*

2002, announcement concerning the possibility of the company filing bankruptcy; and WCG actually filing for Chapter Eleven bankruptcy protection on April 25, 2002.[106] The court added that the disclosure, to be corrective, did not have to "precisely mirror the earlier misrepresentation, but it must at least relate back to the misrepresentation and not to some other negative information about the company."[107] Thus, the question became whether "the risk that caused the loss was within the zone of risk concealed by the misrepresentations and omissions alleged by a disappointed investor."[108]

In analyzing the reliability of Scenario Two, the appellate court examined each of the four disclosures. The court needed to determine if the information they revealed was sufficiently within the zone of risk. This was necessary to support Dr. Nye's conclusion that it was the revelation of fraud, and not other non-compensatory factors, that caused the subsequent declines in WCG's stock price.[109]

1. January 29, 2002, corrective disclosure

Dr. Nye identified the January 29 press release as the first corrective disclosure.[110] On this occasion, WMB announced a delay in the release of its fourth quarter financial statements while the company reviewed the status of certain contingent liabilities it had with respect to WCG.[111] Following this announcement, the share price fell from $1.63 to $1.34.[112] Dr. Nye admitted that this was not a significant negative return for that day given the fact that the market as a whole fell 2.5% and the industry was down as well.[113] The Tenth Circuit acknowledged that an announcement that WCG could be in default may fall within the zone of risk concealed by the alleged misrepresentations, but questioned whether Dr. Nye's basis

106. *Id.*

107. *Id.* at 1140.

108. *Id.* (quoting Lentell v. Merrill Lynch & Co., 396 F.3d 161, 173 (2d Cir. 2005) (original emphasis omitted)).

109. *Id.* at 1140–43.

110. In the heading on page 1140, the court labeled this disclosure as "January 29, 2009." *Id.* at 1140. The remainder of the opinion, however, makes it clear that the actual date of disclosure must have been January 29, 2002, as it clearly preceded the February 4, 2002, disclosure. *Id.* at 1140–43.

111. *Id.* at 1140–42.

112. *Id.* at 1140–41.

113. *Id.* at 1141.

for asserting that the January 29 press release revealed any new information to the market that would make that day's losses attributable to the disclosure.[114] The court also quickly pointed out that, on that same day, Milberg Weiss filed its Cali complaint identifying the same misrepresentations. This suggests that the market already had at least some knowledge of the fraud.[115] With at least one other major piece of negative information having been released on the same day, the court lacked a detailed analysis by Dr. Nye showing why all the losses from that day should be attributed to the press release (and its assumed revelation of fraud) and nothing else.[116]

2. February 4, 2002, corrective disclosure

The second corrective disclosure identified by Dr. Nye occurred on February 4. That day's press release made two announcements: (1) WCG had been informed by its lenders that it may be in default, and (2) WCG was reviewing the potential impairment of its long-lived assets.[117] As with the January 29 announcement, Dr. Nye credited the entire decline in WCG's stock price that day to the press release without first considering the effect other non-fraudulent factors might have had.[118] In fact, the court notes, the press release itself revealed a significant piece of information unrelated to fraud: WCG was performing a review of the possible impairment of its long-lived assets.[119] Dr. Nye did not provide an explanation as to why the entire February 4 decline should be ascribed to fraud and not to other information also revealed that day.[120]

3. February 25 and April 22, 2002, corrective disclosures

The last two corrective disclosures were WCG's announcement on February 25 that it was considering Chapter Eleven bankruptcy and the company's actual filing of bankruptcy on April 22.[121] The

114. *Id*.
115. *Id*.
116. *Id*.
117. *Id*. at 1142.
118. *Id*.
119. *Id*.
120. *Id*.
121. *Id*.

plaintiffs argued that bankruptcy was within the zone of risk concealed by the earlier alleged misrepresentations and, therefore, the losses following these announcements could fairly be attributed to the revelation of fraud.[122] The appellate court disagreed: "The alleged misstatements involved the risks of defaulting on debt and the true reasons that WCG was spun off from WMB; they did not involve the certainty of a bankruptcy."[123] The court noted that bankruptcy might have been a possibility—even a probability—from the moment WCG was spun off.[124] Expressing doubt as to Dr. Nye's conclusions, the court asserted, "[T]here are simply too many potential intervening causes to say that bankruptcy was WCG's legally foreseeable destiny such that its trading price at bankruptcy equaled its true value on the day the spinoff was announced."[125]

As with Scenario One, the appellate court found that the district court did not abuse its discretion in finding Scenario Two was based on an unreliable methodology for proving loss causation.[126] In so doing, the court noted that Dr. Nye himself failed to link the four disclosures to any of the alleged misrepresentations;[127] he neglected to discuss why these particular disclosures should be considered "corrective;"[128] and he did not account for any potential non-fraud related information that could have also affected WCG's value.[129] In light of these findings, the Tenth Circuit determined that the district court did not abuse its discretion when it rejected the second loss causation scenario as unreliable under *Daubert*.[130]

C. Summary Judgment

The plaintiffs argued that, even if the district court did not abuse its discretion in excluding Dr. Nye's testimony, it improperly granted summary judgment.[131] They contended that there was still a genuine

122. *Id*.
123. *Id*. at 1143.
124. *Id*.
125. *Id*.
126. *Id*.
127. *Id*. at 1140 ("[Dr. Nye] admitted, 'I have not tied those four things specifically to allege[d] misrepresentations.'").
128. *Id*. at 1139–40.
129. *Id*. at 1143.
130. *Id*.
131. *Id*.

issue of material fact as to loss causation and that a jury should decide the question.[132] Unconvinced, the appellate court commented that, given the evidence presented, there was "simply no way for a juror to determine whether the alleged fraud caused any portion of Plaintiffs' loss."[133] Since the plaintiffs were unable to meet their burden under *Dura*, the Tenth Circuit affirmed the district court's grant of summary judgment as to the issue of loss causation.[134]

V. ANALYSIS

The Tenth Circuit's decision in *Williams* has several significant implications for securities fraud plaintiffs. First, *Williams* clarifies the contours of *Dura*'s loss causation requirements and provides a warning to securities fraud plaintiffs that courts may exclude expert testimony that neither passes *Daubert* scrutiny nor meets *Dura*'s pleading requirements. Second, *Williams* established that plaintiffs carry a relatively hefty evidentiary burden in order to proceed on a securities fraud claim, which is in harmony with the language of the Securities Exchange Act of 1934 ("the Act"), as well as the reasoning and policy driving the Supreme Court's decision in *Dura*.

A. Williams*'s Warning*

Although *Dura* rejected the price inflation theory as an adequate basis for proving loss causation, it did not set the precise level of proof required by plaintiffs in order to satisfy their loss causation burden. *Williams* clarified this uncertainty within the Tenth Circuit by holding that plaintiffs, regardless of the loss causation theory they use, must (1) disentangle any potential non-fraud factors from those revealing the alleged misrepresentations or omissions and (2) link the disclosure of the truth regarding the alleged misrepresentations or omissions to a subsequent loss.[135]

Because *Williams*'s application of *Dura*'s standards requires plaintiffs to present affirmative evidence as to loss causation, event studies will most assuredly become common place in securities fraud litigation. Without such studies, it will be impossible for plaintiffs to

132. *Id.*

133. *Id.* (quoting *In re* Omnicom Group, Inc. Sec. Litig., 541 F. Supp. 2d 546, 554 (S.D.N.Y. 2008)).

134. *Id.*

135. *See id.* at 1140–43.

adequately link for the jury—or trial judges performing their gatekeeping function—the public disclosure of the alleged fraud to a subsequent loss, and to isolate from the tangle of possible factors the portion of the loss actually attributable to the revelation of the alleged fraud.

Given the defendants' success in *Williams*, the loss causation experts retained and the event studies prepared in anticipation of litigation will increasingly become the subject of *Daubert* challenges. Defendants making such a challenge can allege that experts are unqualified as to the area of loss causation or that their testimony is unreliable and inadmissible under *Daubert*. Plaintiffs must be sure that the statistical methodology underlying their expert analysis conforms to the standards pronounced by *Daubert* and its progeny. This task includes ensuring that the expert has properly isolated the effects of the revelation of fraud on stock price from other possible factors. Neglecting to do so is to follow the path trod by the plaintiffs in *Williams* and risk an adverse finding on summary judgment.

B. Williams*'s Burden*

In *Williams*, the Tenth Circuit established a relatively heavy evidentiary burden for plaintiffs on the issue of loss causation. The court broke new ground at the appellate level by placing squarely upon the shoulders of plaintiffs not only the burden of proving that defendants committed fraud and the task of linking that fraud to a subsequent loss, but also the responsibility of producing affirmative evidence isolating the effects that the alleged fraud had on the stock price from other non-fraud factors possibly affecting the stock price.[136] This requirement is consistent with the language of the Securities Exchange Act of 1934 and the policy considerations announced in *Dura*.

1. The Securities Exchange Act of 1934

The Private Securities Litigation Reform Act of 1995 added Section 21D(b)(4) to the Securities Exchange Act of 1934.[137] This section states, "In any private action arising under this chapter, the

136. *See id.*
137. 15 U.S.C. § 78u-4 (2006).

plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages."[138] The language of the Act does not *expressly* state which party bears the burden in cases involving multiple causation—which side must show the portion of the stock decline attributable to the fraudulent conduct, as opposed to other non-fraud factors—but the plain text of the statute makes it clear that the burden of proof in these types of cases should be on the plaintiff.

If the language of the Act is to be given any weight, it is clear that the plaintiff has the burden of proof in cases dealing with multiple causation. The Act notes a very specific burden of proof: "[T]he plaintiff shall have the burden of proving that *the act or omission of the defendant* . . . caused the loss . . . ."[139] The language of the Act is unambiguous: the plaintiff carries the burden of proving that (1) the defendant committed an act or omission violative of the Act; (2) the plaintiff suffered a loss; and (3) the defendant's act or omission caused the loss. Thus, it follows that, in order to prove it was the defendant's act or omission that caused the loss, the plaintiff must also rule out other known possible causes of the loss.

2. Dura*'s policy considerations*

The Supreme Court has mentioned several times its continuing concern that securities laws not be transformed into an insurance policy.[140] This consideration has been used in justifying the Court's reasoning on several securities-related issues, not just loss causation.[141] The Supreme Court reiterated in *Dura* that it did not want to create a broad insurance policy for investors out of securities laws.[142] This suggests an initial presumption in multiple causation securities fraud cases that any decline in a stock's price was caused by non-fraud factors. It follows, then, that in order to put the question of loss causation before a jury, plaintiffs should have to overcome

138. *Id.* § 78u-4(b)(4).

139. *Id.* (emphasis added).

140. *See, e.g.*, Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 345, 347–48 (2005).

141. *See, e.g.*, Basic, Inc. v. Levinson, 485 U.S. 224, 252 (1988) ("[A]llowing recovery in the face of affirmative evidence of nonreliance . . . would effectively convert Rule 10b-5 into a scheme of investor's insurance. There is no support in the Securities Exchange Act, the Rule, or our cases for such a result." (internal quotation marks and citations omitted)).

142. *Dura*, 544 U.S. at 345, 347–48.

this presumption by presenting affirmative evidence to the contrary. That is, plaintiffs must present evidence that the revelation of a previous misrepresentation or omission, isolated from known non-fraud factors, caused a certain drop in a stock's price. Any rule that does not require plaintiffs to carry this burden assumes that because there was an act or omission violative of the Act, and because there was a decline in stock value, the decline was caused by the fraud; this approach effectively alters "loss causation" into "loss coincidence" and does just what the Supreme Court wanted to prevent: it transforms securities laws into an insurance policy.

3. The Tenth Circuit

The Tenth Circuit ultimately rested on a burden of proof standard that is in harmony with the language of the Act. *Williams* was the Tenth Circuit's first case requiring an interpretation of *Dura*'s loss causation requirements and the first case among the circuits generally to do so in response to a *Daubert* challenge. Thus, it was up to the Tenth Circuit to set a persuasive precedent as to the burden of proof plaintiffs must meet in order to proceed to a jury for a multiple causation case. By placing the burden of loss causation fully on the plaintiffs, including the burden of showing which portion of a decline in share price is attributable to the revelation of previously concealed risks and which portion is attributable to other non-fraud related factors, *Williams* clearly follows the plain meaning of the Act. Under the Tenth Circuit's approach, the plaintiff must appropriately show that the defendant "caused the loss for which the plaintiff seeks to recover damages."[143]

Additionally, the approach adopted in *Williams* takes into account the policy underlying *Dura*. A rule requiring plaintiffs to differentiate a decline in stock price due to fraud from a decline due to other factors holds defendants accountable only for losses caused by their allegedly fraudulent conduct. Thus, under the Tenth Circuit's burden of proof standard, defendants are far less likely to be left holding the tab for losses not attributable to fraudulent conduct: only losses "fairly attributable to the public airing of the alleged fraud"[144] are charged to the defendants.[145] This prevents the

143. 15 U.S.C. § 78u-4(b)(4).

144. D.E. & J. Ltd. P'ship. v. Conaway, 284 F. Supp. 2d 719, 748–49 (E.D. Mich. 2003), *aff'd*, 133 F. App'x 994 (6th Cir. 2005).

securities laws from being transformed into a broad insurance policy for investors, which is what *Dura* aimed to avoid. Under *Williams*, this concern is met by holding that an expert's failure to account for other possible non-fraud factors constitutes unreliable methodology. As such, the expert witness cannot survive a *Daubert* challenge and the plaintiffs are unable to meet their burden of proof regarding loss causation.

The Tenth Circuit adopted its burden of proof requirements in the face of the competing standards of various district courts. These other approaches ranged from placing on the defendant the burden of "severing the link" between the misrepresentation and the stock price (in effect creating a rebuttable presumption that the price decline was fraud related),[146] to treating multiple causation as a fact-intensive inquiry best resolved by the jury and not on summary judgment (in effect relieving the plaintiff, at the pleading stage, of the burden of isolating the effect of fraud-related factors on stock).[147] When compared to these approaches, it becomes even clearer that the Tenth Circuit's loss causation requirements best support the language of the Act and the Supreme Court's policy considerations.

VI. CONCLUSION

The Tenth Circuit's decision in *Williams* has many significant consequences for plaintiffs alleging securities fraud. First, *Williams* clarifies the contours of *Dura*'s loss causation requirements and provides a warning to securities fraud plaintiffs that courts may exclude expert testimony that does not pass *Daubert* scrutiny or meet *Dura*'s requirements. Further, *Williams* places the burden of proving loss causation squarely on the shoulders of plaintiffs, including the burden of accounting for the effect of possible non-fraud factors on a company's stock price. Plaintiffs within the reach of the Tenth Circuit wishing to avoid an unfavorable summary judgment decision should study *Williams* and meet the appropriate standards regarding loss causation in light of *Dura* and *Daubert*.

145. *Dura*, 544 U.S. at 345–46.

146. *See In re* Micron Techs., Inc., Sec. Litig., 247 F.R.D. 627, 635 (D. Idaho 2007).

147. Freeland v. Iridium World Commc'ns, Ltd., 545 F. Supp. 2d 59, 80 (D.D.C. 2008).

Bryan L. Phipps[*]

* J.D. candidate, April 2010, J. Reuben Clark Law School, Brigham Young University.