Keeping current: securities

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Tenth Circuit Clarifies Loss Causation Burden

On February 18, 2009, the U.S. Court of Appeals for the Tenth Circuit issued a significant decision in *In re: Williams Securities Litigation—WCG Subclass* (Docket Number 07-5119), that clarified the contours of a plaintiff's "loss causation" burden under federal securities laws. Although the loss causation requirement always requires evidence that a loss was caused by fraud, the Tenth Circuit's decision suggests that in certain cases, the loss causation burden also requires affirmative evidence that a loss *was not* caused by other negative market, industry, or company-specific information unrelated to the specific allegations of fraud.

Facts and Procedural History

Williams arose out of the collapse in share value of Williams Communications Group (WCG), a telecommunications company and a former subsidiary of The Williams Companies (Williams). The months following WCG's spin-off from Williams proved rocky for WCG and the telecommunications company. The market as a whole suffered in the wake of the September 11 terrorist attacks and the Enron bankruptcy, and the telecommunications industry in particular suffered industrywide price declines of approximately 83 percent. WCG stock suffered declines that paralleled the declines of other telecommunications companies: WCG's stock price, which had peaked at over $60 during the boom days of the telecommunications market, declined from around $28.00 per share on July 21, 2000, to $1.63 by January 29, 2002. WCG filed for bankruptcy on April 22, 2002.

The first of several federal securities lawsuits were filed against WCG and Williams on January 29, 2002.

> The Tenth Circuit affirmed the exclusion of the proposed loss causation testimony as unreliable evidence of loss causation.

Plaintiffs claimed that various defendants had intentionally misrepresented the financial well-being of WCG, and thereby inflated the price of WCG shares.

During the course of the litigation, the Supreme Court decided *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336 (2005), which made clear that federal securities plaintiffs cannot recover simply by proving that they purchased at an inflated price, but must instead demonstrate "loss causation"—i.e., that plaintiffs' losses were caused by fraud. In an attempt to satisfy this burden, plaintiffs submitted the testimony of a proposed loss causation expert. Defendants moved to exclude the proposed expert testimony under *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (1993), and argued that the proposed evidence failed to reliably isolate losses caused by the revelation of fraud. The district court agreed and excluded the testimony. After the district court granted summary judgment in favor of the defendants, the reliability of the proposed loss causation testimony became the primary issue on appeal.

The Tenth Circuit's Decision

In its first decision to apply *Dura*, the Tenth Circuit affirmed the exclusion of the proposed loss causation testimony as unreliable evidence of loss causation.

The court held that, under *Dura*, a plaintiff is required to "show that it was [a] revelation that caused the loss and not one of the 'tangle of factors' that affect price." Both aspects of this requirement—that the loss (1) "was [caused by] a revelation" and (2) was not caused by "one of the tangle of factors that affect price"—proved significant in *Williams*.

First, the Tenth Circuit held that one of the plaintiffs' loss causation theories failed to properly establish a "revelation." Plaintiffs claimed that the alleged "truth" about WCG "leaked" out over time, thus obviating the need to identify any particular disclosure of the alleged misrepresentations. The court rejected this approach, however, because the plaintiffs failed to present evidence of specific revelations of fraud: "The inability to point to a single corrective disclosure does not relieve the plaintiff of showing how the truth was revealed."

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Second, the court rejected the plaintiffs' alternative loss causation theory for failure to sufficiently account for the possibility that the plaintiffs' losses were caused by "one of the tangle of factors that affect price" such as market, industry, or company-specific factors. For example, the plaintiffs attempted to satisfy loss causation by coupling the stock price decline of January 29, 2002, with the delay in WCG earnings that was announced on that same day. But the court rejected that effort because of plaintiffs' failure to account for the possibility that other pieces of news from the same day were responsible for the plaintiffs' loss—including the filing of the plaintiffs' own class action. The court held that the plaintiffs could not show loss causation with evidence that "ma[kes] no attempt to show why . . . losses were entirely attributable to the revelation of fraud and nothing else."

More generally, the court rejected the plaintiffs' effort to define the alleged frauds so broadly as to render the loss causation element meaningless. In *Williams*, the plaintiffs' expert "beg[an] with the assumption that WCG was virtually valueless" and labeled "any negative information about WCG a corrective disclosure" so as to support the argument that any negative information about WCG "drained the fraud premium." But the Tenth Circuit held that *Dura* requires proof of a more precise relationship between a misrepresentation and a later decline in price: "We must again be careful not to connect each and every bit of negative information about a company to an initial misrepresentation that overstated a company's chances for success."

Implications of *In re: Williams*

Williams may well have important implications for securities class actions and other defendants—not just in the Tenth Circuit, but also across the country.

First, the case strongly supports the proposition that a plaintiff's loss causation burden requires affirmative evidence that a loss was not caused by plausible nonfraud factors, especially where the stock prices of others in the industry suffer comparable declines.

Second, *Williams* makes clear that in all securities fraud cases, a plaintiff must identify specific pieces of information or disclosures that revealed past misstatements.

Third, *Williams* rejects efforts to define a misrepresentation so broadly as to render the loss causation requirement meaningless. Although the *Williams* plaintiffs claimed that the entire financial picture of WCG was fraudulent, the Tenth Circuit opinion demanded a much more precise connection between a particular fraud and a particular revelation. BLT