Case & Project Experience

NERA Expert's Role in *In Re Williams Securities Litigation*

Overview

While various plaintiffs' experts have often used different models of the alleged inflation, or excess of stock price over true value absent fraud, in securities fraud cases, rarely do courts have the opportunity to consider the validity of those methodologies. However, in the Williams Communications Group (WCG) securities litigation, plaintiffs' damages expert provided analyses based on what are known as the "index method," the "constant percentage method," and the "constant dollar method." NERA Senior Vice President Dr. David Tabak rebutted the plaintiffs' expert's report, arguing that the index method and the constant percentage method failed to properly account for differences between fraud-related and other influences on the prices of WCG's securities and thereby provided a form of market insurance to investors.

In a ruling on 6 July 2007, United States District Court for the Northern District of Oklahoma Judge Stephen P. Friot agreed, finding that the index method "collides directly with loss causation doctrine and is accordingly rejected," while the constant percentage method as applied in this case impermissibly provides a "partial downside insurance policy" to investors. Though this ruling builds on prior decisions in other cases, this is believed to be the first clear example of an opinion directly addressing the reliability and relevance of the index and constant percentage methods. On 18 February 2009, the United States Court of Appeals for the Tenth Circuit affirmed the district court's exclusion of plaintiffs' damages expert's testimony and the resulting grant of summary judgment for defendants.

Background

Williams Communications Group, Inc. (WCG) was a telecommunications firm whose objective was to own or lease, operate, and extend a nationwide fiber-optic network and to provide services exclusively to communications service providers. WCG was sued on behalf of investors in a shareholder and noteholder class action. The principal allegation was that WCG's stock and note prices were inflated due to allegedly undisclosed financial difficulties at WCG and the glut of dark fiber (fiber that WCG installed but for which it did not provide communications transmission services) in the market.

NERA's Role

Dr. Tabak and plaintiffs' expert submitted simultaneous opening reports in this matter. Plaintiffs' expert submitted a report calculating damages for the stock based on three inflation methodologies—an "index method," a "constant percentage method," and a "constant dollar method"—while his analysis of the notes used the index and constant dollar methods. In his rebuttal report, Dr. Tabak argued that plaintiffs' expert's index and constant percentage methods failed to properly account for differences between fraud-related and other influences on the prices of WCG's securities and thereby provided a form of market insurance to investors. He also noted that plaintiffs' expert's analysis of the WCG notes was inadequate because it failed to use an event study to account for non-company-specific influences on the prices of the notes.

The Result

The Court granted NERA's client's motion for summary judgment, dismissing plaintiffs' claims due to the Court's exclusion of plaintiffs' expert opinion on damages and loss causation as well as on other grounds. Plaintiffs' expert's testimony on loss causation and damages was struck on *Daubert* grounds.

In his decision, Judge Friot found that in order to justify the index method, plaintiffs' expert was forced to "broaden[ ] the concept of corrective disclosure to encompass essentially anything negative about the prospects of the company" and consequently excluded this methodology because it did not adequately tie the damages calculation to disclosures of the alleged fraud, finding that as a result it "collides directly with loss causation doctrine and is accordingly rejected."

With regard to the constant percentage method, the court noted that plaintiffs' expert "acknowledged that he could give no 'economic or logical reason' why a shareholder who sold on January 29 [the date of the first alleged corrective disclosure] would have a claim and a shareholder who sold on January 28 would not have a claim," an adjustment that plaintiffs' expert made to account for the Supreme Court's *Dura* ruling that if a "purchaser sells the shares quickly before the relevant truth begins to leak out, the misrepresentation will not have led to any loss."

The Court further noted that the constant percentage method provides a "partial downside insurance policy" to investors, which would also be contrary to *Dura*. While the Court did allow that it could conceive of a case in which the constant percentage method would pass *Daubert*, it did not explain how such a method could get around the admitted lack of economic or logical reasons for its application, or the fact that it provides for partial insurance, and found no reason to ignore those deficiencies in the report of plaintiffs' expert in the WCG securities litigation. The Court therefore excluded the constant percentage inflation methodology.

Plaintiffs' expert's constant dollar methodology was excluded due to its failure to identify days with statistically significant price movements that were also disclosures of the alleged fraud.

Finally, the Court excluded plaintiffs' expert's analysis of the WCG notes because it found that he had not performed an event study, even though an affidavit from Dr. Tabak provided "a very cogent showing that an event study could have been performed as to the notes."

On 18 February 2009, the United States Court of Appeals for the Tenth Circuit affirmed the district court's exclusion of plaintiffs' damages expert's testimony and the resulting grant of summary judgment for defendants. Plaintiffs chose not to appeal the exclusion of their expert's use of the "constant percentage method." Consistent with the economic reasoning presented by NERA's expert, with regard to the use of the "index method," the court found that a "plaintiff cannot simply state that the market had learned the truth by a certain date and, because the learning was a gradual process, attribute all prior losses to the revelation of the fraud. The inability to point to a single corrective disclosure does not relieve the plaintiff of showing how the truth was revealed; he cannot say, "'Well, the market *must* have known.'" The court then found that plaintiffs' expert had not properly identified any corrective disclosures related to the alleged fraud, and consequently affirmed the exclusion of the "index method" and "constant dollar method," leading to its affirmation of the grant of summary judgment for defendants.

Expert Involved

Dr. David Tabak, Senior Vice President

Dr. Tabak has appeared as an expert in state, federal, and bankruptcy court, and before arbitration panels, including the National Association of Securities Dealers, the American Arbitration Association, and the International Chamber of Commerce International Court of Arbitration. In the area of securities class actions, Dr. Tabak has performed analyses involving issues of class certification, liability, materiality, affected trading volume, and damage calculations in cases with allegations ranging from product issues to the value of an issuer of subprime mortgages. He has also performed valuations of equity, options, other financial derivatives, businesses, and financial institutions. Dr. Tabak has been retained as an expert to address issues including allegations of options backdating, market timing of mutual funds, contract disputes, commercial damages, and disputes between brokers and customers. He has published in forums such as *St. John's Law Review* and *Shannon Pratt's Business Valuation Update,* and has published peer-reviewed articles in *Litigation Economics Review* and the *Journal of Forensic Economics*.

About NERA

NERA Economic Consulting (**www.nera.com**) is a global firm of experts dedicated to applying economic, finance, and quantitative principles to complex business and legal challenges. For over half a century, NERA's economists have been creating strategies, studies, reports, expert testimony, and policy recommendations for government authorities and the world's leading law firms and corporations. With its main office in New York City, NERA serves clients from more than 25 offices across North America, Europe, and Asia Pacific.

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