

1 UNITED STATES DISTRICT COURT  
2 EASTERN DISTRICT OF WASHINGTON

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5 No. CV-04-25-FVS

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7 In re METROPOLITAN SECURITIES  
8 LITIGATION

9  
10 ORDER RE THE EXPECTED  
11 TESTIMONY OF CHRISTOPHER  
12 JAMES

13 **THIS MATTER** comes before the Court without oral argument based  
14 upon the plaintiffs' motion to exclude the expected testimony of  
15 Christopher James.

16 **BACKGROUND**

17 The plaintiffs seek damages from PricewaterhouseCoopers LLP  
18 ("PwC") under Section 11 of the Securities Act of 1933. 15 U.S.C. §  
19 77k(a). They allege PwC committed accounting errors that allowed  
20 Metropolitan Mortgage & Securities Co., Inc., ("Met") and Summit  
21 Securities, Inc. ("Summit") to falsely portray themselves as healthy  
22 companies in registration statements they filed with the Securities  
23 and Exchange Commission ("SEC"). PwC has retained the services of  
24 economist Christopher James, Ph.D. He has performed at least two  
25 functions for PwC. For one thing, he has combed public records  
26 looking for references to PwC's alleged accounting errors. For  
another thing, he has attempted to identify events that occurred  
during the Summer and Fall of 2003 that caused the decline in share

1 price of Met's publicly-traded securities. According to Dr. James,  
2 the decline was caused by the following five events: the  
3 investigation of Metropolitan Investment Securities, Inc. ("MIS") by  
4 the National Association of Securities Dealers ("the NASD"); Roth  
5 Capital Partners' June 2003 decision to withdraw as Met's qualified  
6 independent underwriter; the October 2003 agreement between the NASD  
7 and MIS prohibiting MIS from selling securities; Met's November 2003  
8 decision to suspend the payment of dividends on preferred stock; and  
9 Met's December 2003 announcement that MIS was closing.

10 The plaintiffs argue Dr. James employed an unreliable method  
11 while investigating the cause of the decline in the share price of  
12 Met's publicly-traded securities. As they see it, all he did was to  
13 identify five events that happened to occur during the same period of  
14 time as the share price decline; which, in their opinion, is not  
15 enough to establish a causal relationship. After all, the fact event  
16 "A" occurs before event "B" does not mean A caused B. In order to  
17 establish a causal relationship, one must engage in rigorous empirical  
18 analysis. The plaintiffs argue Dr. James did not do that; for which  
19 reason, say the plaintiffs, the Court should prohibit him from  
20 testifying that the five events listed above caused the decline in  
21 share price that occurred during the Summer and Fall of 2003.

### 23 **RULING**

24 PwC has asserted the affirmative defense of "negative causation."  
25 *Akerman v. Oryx Communications, Inc.*, 810 F.2d 336, 340 (2d Cir.1987).  
26 Negative causation is the mirror image of "loss causation," which is

1 the burden born by a person bringing a securities fraud claim under §  
2 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. *In*  
3 *re WorldCom, Inc. Sec. Litig.*, No. 02 Civ. 3288, 2005 WL 375314, at \*6  
4 (S.D.N.Y. Feb. 17, 2005) ("the negative causation defense in Section  
5 11 and the loss causation element in Section 10(b) are mirror  
6 images"). In order to establish loss causation, a § 10(b) plaintiff  
7 must prove the defendant's material misstatement or misleading  
8 omission was revealed to the public and the public reacted adversely  
9 to the revelation. *In re Williams Securities Litigation-WCG Subclass*,  
10 558 F.3d 1130, 1140 (10th Cir.2009). The public's adverse reaction  
11 may be reflected by a decline in share price. Frequently, the decline  
12 occurs after a number of items of negative information about the  
13 company have been disclosed to the public. The § 10(b) plaintiff must  
14 prove the defendant's misstatement or omission, as opposed to some  
15 other negative information, caused the decline in share price. "When  
16 multiple negative items are announced contemporaneously, mere  
17 proximity between the announcement and the stock loss is insufficient  
18 to establish loss causation." *Oscar Private Equity Invs. v.*  
19 *Allegiance Telecom, Inc.*, 487 F.3d 261, 271 (5th Cir.2007)  
20 (hereinafter "*Oscar*"). The § 10(b) plaintiff "must prove that it is  
21 more probable than not that it was this negative statement, and not  
22 other unrelated negative statements, that caused a significant amount  
23 of the decline." *Id.* at 270 (internal punctuation and citation  
24 omitted). In order to satisfy this requirement, the § 10(b) plaintiff  
25 must offer "some empirically-based showing that the corrective  
26

1 disclosure was more than just present at the scene." *Id.* at 271  
2 (citation omitted). Typically, the § 10(b) plaintiff submits an  
3 "event study." *See id.* An event study is "an empirical technique for  
4 determining how securities returns react to new information."

5 Jonathan R. Macey et al., *Lessons from Financial Economics:*  
6 *Materiality, Reliance, and Extending the Reach of Basic v. Levinson*,  
7 77 Va. L.Rev. 1017, 1028 (1991). "[E]vent study methodology has been  
8 used by financial economists as a tool to measure the effect on market  
9 prices from all types of new information relevant to a company's  
10 equity valuation." Jay W. Eisenhoffer et al., *Securities Fraud, Stock*  
11 *Price Valuation, and Loss Causation: Toward A Corporate Finance-Based*  
12 *Theory of Loss Causation*, 59 Bus. Law. 1419, 1419, 1426 (August 2004).  
13 Dr. James did not perform an event study. Instead, according to the  
14 plaintiffs, he simply correlated negative information concerning Met  
15 with declines in the price per share of Met's publicly traded  
16 securities. The plaintiffs argue the method Dr. James employed is  
17 inadequate to support his theory of loss causation.

18  
19 Given the analysis Dr. James has performed, he can say two things  
20 with confidence. First, the events he has identified are the type of  
21 events that could have affected a reasonable investor's decision to  
22 sell or buy Met's publicly-traded stock. Second, the events occurred  
23 during the same period Met's publicly-traded securities declined in  
24 value. But the investing public heard other things about Met during  
25 the Summer and Fall of 2003 that could have affected a reasonable  
26 investor's conduct. Which items of negative information caused the

1 plaintiffs' losses? The ones Dr. James identified or some other ones.  
2 Dr. James has failed to demonstrate that the items he has identified,  
3 rather than other items, caused the plaintiffs' losses. Consequently,  
4 Dr. James lacks an adequate empirical basis for his theory of loss  
5 causation. His theory is insufficiently reliable to satisfy the  
6 requirements of Federal Rule of Evidence 702.

7 **IT IS HEREBY ORDERED:**

8 The plaintiffs' motion to exclude Dr. James' testimony (**Ct. Rec.**  
9 **762**) is **granted in part**. He may not testify the five events listed  
10 above, *see supra* p. 2, lines 2-9, caused the decline in share price of  
11 Met's publicly-traded securities that occurred during the second half  
12 of 2003.

13 **IT IS SO ORDERED.** The District Court Executive is hereby  
14 directed to enter this order and furnish copies to counsel.

15 **DATED** this 18th day of February, 2010.

16  
17 s/Fred Van Sickle  
18 Fred Van Sickle  
19 Senior United States District Judge  
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