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# ARTICLE

## EXCLUDING TESTIMONY OF FINANCIAL EXPERTS IN FEDERAL LITIGATION: HOW FAR DO THE *DAUBERT* STANDARDS EXTEND?

CECIL C. KUHNE, III\*

### INTRODUCTION

In the 1993 landmark decision of *Daubert v. Merrell Dow Pharmaceuticals, Inc.*,<sup>1</sup> the United States Supreme Court held that the brief provisions of Rule 702 of the Federal Rules of Evidence impose upon a trial court certain stringent, enumerated obligations in order to assure that expert testimony presented to a jury is both reliable and

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<sup>1</sup> 509 U.S. 579 (1993).

relevant.<sup>2</sup> While Rule 702 refers broadly to “scientific, technical or other specialized knowledge,”<sup>3</sup> the *Daubert* decision dealt more narrowly with the admissibility of scientific evidence.<sup>4</sup> The unsettled question of whether the exacting standards for the admissibility of expert scientific testimony established in *Daubert* applied equally to expert testimony based on technical or other specialized knowledge was finally resolved, after much disparity among the circuit courts of appeal, in 1999 by *Kumho Tire Co., Ltd. v. Carmichael*,<sup>5</sup> which held that the basic gatekeeping function for trial judges mandated by Rule 702 applies to *all* expert testimony, not just scientific testimony.<sup>6</sup>

*Daubert* maintains that Federal Rule of Evidence 702 imposes a special obligation on a trial judge to act as a gatekeeper to ensure that “any and all scientific testimony or evidence admitted is not only relevant, but reliable.”<sup>7</sup> The decision discussed four factors – testing, peer review, error rates, and acceptability by the scientific community – that a court should examine in determining the reliability of a particular scientific theory or technique.<sup>8</sup> In extending the *Daubert* factors to nonscientific testimony, the Supreme Court in *Kumho Tire* pointed out the seemingly obvious fact

<sup>2</sup> *Id.* at 593-94 (dealing with expert testimony on the issue of whether the drug Bendectin causes birth defects). Federal Rule of Evidence 702 at the time of the decision provided: “If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, expertise, training, or education, may testify thereto in the form of an opinion or otherwise.” Fed. R. Evid. 702.

<sup>3</sup> FED.R.EVID. 702. *Daubert* made clear that Rule 702 displaced the “general acceptance” test enunciated in *Fry v. U.S.*, 293 F. 1013, 1014 (1923) (holding that expert opinion based on a scientific technique is inadmissible unless the technique is “generally accepted” and reliable in the relevant scientific community). See *Daubert*, 509 U.S. at 586-89.

<sup>4</sup> See *Daubert*, 509 U.S. at 590.

<sup>5</sup> 526 U.S. 137 (1999).

<sup>6</sup> See *id.* at 147 (“The initial question before us is whether this basic gatekeeping obligation applies only to ‘scientific’ testimony or to all expert testimony. We, like the parties, believe that it applies to all expert testimony.”).

<sup>7</sup> *Daubert*, 509 U.S. at 589.

<sup>8</sup> *Id.* at 593-94.

that Rule 702 does not distinguish between “scientific knowledge” and “technical or other specialized” knowledge.<sup>9</sup> The Court in *Kumho Tire* reasoned that *Daubert* referred only to scientific knowledge because that was the nature of the expertise at issue, not because of an intent to distinguish between scientific and other types of knowledge which may form the basis of expert testimony.<sup>10</sup> Noting that there is no clear line dividing the various types of knowledge, the Court saw no need to distinguish between them.<sup>11</sup>

*Kumho Tire* concluded that regardless of the type of knowledge under consideration, Rule 702 requires a judicial inquiry as a precondition to admissibility, and that when the testimony’s factual basis, data, principles, methods, or application is called into question, the trial judge must determine whether the testimony has a reliable basis in the knowledge and experience of the relevant discipline.<sup>12</sup> The Supreme Court summed up its conclusions thus:

We conclude that *Daubert’s* general holding – setting forth the trial judge’s general “gatekeeping” obligation – applies not only to testimony based on “scientific” knowledge, but also to testimony based on “technical” and “other specialized” knowledge. See Fed. R. Evid. 702. We also conclude that a trial court may consider one or more specific factors that *Daubert* mentioned when doing so will help determine that testimony’s reliability. But, as the Court stated in *Daubert*, the test of reliability is

<sup>9</sup> *Kumho Tire*, 526 U.S. at 147.

<sup>10</sup> *Id.* at 147-48 (pointing out that the *Daubert* decision, based on Federal Rules 702 and 703, allowed for considerable latitude with respect to expert testimony without regard to its classification as “scientific” or otherwise).

<sup>11</sup> *Id.* at 151 (“We do not believe that Rule 702 creates a schematism that segregates expertise by type while mapping certain types of questions to certain kinds of experts. Life and the legal cases that it generates are too complex to warrant so definitive a match.”).

<sup>12</sup> *Id.* at 149 (quoting *Daubert*, 509 U.S. at 592).

“flexible,” and *Daubert*'s list of specific factors neither necessarily nor exclusively applies to all experts in every case. Rather, the law grants a district court the same broad latitude when it decides *how* to determine reliability as it enjoys in respect to its ultimate reliability determination.<sup>13</sup>

Federal Rule of Evidence 702 has subsequently been amended to incorporate the holdings of *Daubert* and *Kumho Tire*,<sup>14</sup> though the holdings of those decisions as they relate to the admissibility of expert testimony have not been altered as a result.<sup>15</sup>

### I. THE BROADER MANDATE OF *KUMHO TIRE*

*Kumho Tire* confirmed that *Daubert*'s general standard of evidentiary reliability applies to all expert opinions governed by Rule 702,<sup>16</sup> and that Rule 702 requires as a prerequisite to admissibility a “valid connection to the pertinent inquiry.”<sup>17</sup> While the *Kumho Tire* decision establishes that the factors suggested in *Daubert* “may” control a reliability determination in a particular case, the

<sup>13</sup> *Id.* at 141-42.

<sup>14</sup> See FED. R. EVID. 702. The amended rule, incorporating the *Daubert* and *Kumho Tire* holdings, now provides:

If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

*Id.*

<sup>15</sup> See *Cooper v. Smith & Nephew, Inc.*, 259 F.3d 194, 199 n.1 (4th Cir. 2001) (noting that Federal Rule of Evidence 702 “was amended to reflect the Supreme Court’s recent decision in *Daubert* and *Kumho Tire* . . . [T]he amendment does not alter the standard for evaluating the admissibility of experts’ opinions as articulated in those cases.”)

<sup>16</sup> See *Kumho Tire*, 526 U.S. at 147 (specifying that the rule does not distinguish between “scientific” knowledge and “technical” or “other specialized” knowledge).

<sup>17</sup> See *Daubert*, 509 U.S. at 591-92; see also David L. Faigman et al., *How Good Is Good Enough? Expert Evidence Under Daubert and Kumho*, 50 CASE W. RES. L. REV. 645, 650 (2000) (reiterating *Daubert*'s contention that admissibility requires a “valid scientific connection” to the inquiry).

general “reliability” and “fit” of the expert testimony must be supported by evidence in the record.<sup>18</sup> Therefore, although the standards for determining the fact of reliability may have been broadened, the requirement remains that parties offering expert opinion testimony bear the burden of proving the fact of reliability by a preponderance of evidence.<sup>19</sup>

The Court in *Kumho Tire* reiterated that a trial judge must be given considerable discretion in determining whether particular expert testimony is reliable.<sup>20</sup> When the specific factors identified in *Daubert* are reasonable measures of reliability, they should be considered, including: (1) whether a theory or technique can be (and has been) tested; (2) whether it has been subjected to peer review and publication; (3) whether there is a high known or potential rate of error with respect to a particular technique, and whether there are standards controlling the technique’s operation; and (4) whether the theory or technique enjoys general acceptance within a relevant scientific community.<sup>21</sup> However, the Court emphasized that this list of factors is not exhaustive or definitive, and the factors to be considered in any particular case depend upon the specific facts at issue.<sup>22</sup>

<sup>18</sup> *Kumho Tire*, 526 U.S. at 141-42 (recognizing that *Daubert*’s “list of specific factors neither necessarily nor exclusively applies to all experts or in every case”).

<sup>19</sup> *Daubert*, 509 U.S. at 593 (acknowledging that relevance of evidence must be established by preponderance of proof).

<sup>20</sup> *Kumho Tire*, 526 U.S. at 152-53 (“[W]hether *Daubert*’s specific factors are, or are not, reasonable measures of reliability in a particular case is a matter that the law grants the trial judge broad latitude to determine.”).

<sup>21</sup> See *Daubert*, 509 U.S. at 593-95 for further explanation of the factors, and *Kumho Tire*, 526 U.S. at 152, which acknowledges that the *Daubert* factors are “reasonable measures of the reliability of expert testimony.” On remand, the United States Court of Appeals for the Ninth Circuit, in *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, (*Daubert II*) 43 F.3d 1311, 1317 (9th Cir. 1995), added a fifth factor, suggesting that the court additionally inquire whether the expert’s testimony relates to “matters growing naturally and directly out of research they conducted independent of the litigation, or whether they have developed their opinions expressly for purposes of testifying.”

<sup>22</sup> See *Daubert*, 509 U.S. at 593 (indicating that a specific “checklist or test” was not wise given the many factors that can affect an inquiry); see also *Kumho Tire*, 526 U.S. at

The Supreme Court also specified that an appellate court is to apply an abuse-of-discretion standard when reviewing a trial court's decision on reliability of expert testimony.<sup>23</sup> The Court reasoned that a "trial court must have the same latitude in deciding *how* to test an expert's reliability as it enjoys when deciding *whether* that expert's relevant testimony is reliable."<sup>24</sup> Otherwise, the judge would lack the discretionary authority needed both to avoid unnecessary proceedings where the reliability of an expert's methods is properly taken for granted and to require appropriate proceedings where the expert's reliability is legitimately questioned.<sup>25</sup>

The facts underlying *Kumho Tire* were straightforward. The tire of a minivan blew out, causing an accident in which one passenger died and several others were severely injured. The plaintiff sued the tire manufacturer and its distributor, claiming the tire was defective. The plaintiffs relied in large part on deposition testimony of an expert in tire failure analysis.<sup>26</sup> The district court excluded the expert's testimony on the grounds that it was not reliable under the *Daubert* standards and granted summary judgment for the defendants.<sup>27</sup> The Eleventh Circuit reversed and remanded the case for further consideration, holding that *Daubert* applies only to expert testimony based

141 (noting that the factors laid out in *Daubert* are not comprehensive).

<sup>23</sup> *Kumho Tire*, 526 U.S. at 152-53; see also *Gen. Elec. Co. v. Joiner*, 522 U.S. 136, 139 (1977) (explaining that *Daubert* did not change the evidentiary ruling standard of review).

<sup>24</sup> *Kumho Tire*, 526 U.S. at 152.

<sup>25</sup> See *id.*; see also *Gen. Elec.*, 522 U.S. at 142 (emphasizing that appellate courts must apply abuse of discretion review to evidentiary rulings, whether such rulings involve expert testimony or not).

<sup>26</sup> See *Kumho Tire*, 526 U.S. at 142.

<sup>27</sup> *Id.* at 145-46. On first impression, the trial court found that the expert's methodology was unacceptable after failing a number of the *Daubert* factors, namely, peer review, known potential rate of error, and degree of acceptance within the relevant scientific community. The trial court granted the plaintiff's motion for reconsideration on the issue, agreeing that its own application of the *Daubert* factors was too "inflexible." However, despite a more flexible review and acknowledgement that the factors are "simply illustrative," the court affirmed its earlier decision and excluded the testimony.

on application of scientific principles, not to testimony based on skill or experience.<sup>28</sup> The Supreme Court, reversing the appellate court's judgment, applied the *Daubert* factors to the case at hand, concluding that the doubts which triggered the district court's initial inquiry into the reliability of the expert's testimony were reasonable.<sup>29</sup>

The question before the Court was not the reliability of the expert's methodology in general, but whether the expert could reliably determine the cause of failure of the particular tire under consideration.<sup>30</sup> The expert concluded that the tire had traveled far enough that some of the tread had been worn bald, that it should have been taken out of service, that it had been inadequately repaired for punctures, and that it bore marks which would indicate abuse, not a defect.<sup>31</sup> Moreover, the expert's own testimony cast considerable doubt on the reliability of his theory about the need for at least two signs of abuse.<sup>32</sup> Furthermore, there was no indication that other experts in the industry used this particular approach, nor were there references to

<sup>28</sup> *Id.* at 146 (the Eleventh Circuit holding that the *Daubert* Court "explicitly limited its holding" to the application of specific scientific principles, therefore rendering it inapplicable where experts' methodology relies only on the expert's skills).

<sup>29</sup> *Id.* at 158. The Court acknowledged the trial court's more flexible reconsideration of defendant's motion to exclude the expert testimony, noting that the court ultimately excluded the testimony based on its failure to meet *Daubert* or "any other set of reasonable reliability criteria." *Id.* As such, the trial court's determination was reasonable and within their "lawful discretion."

<sup>30</sup> *Id.* at 153-54. The Court stated:

For one thing, and contrary to respondents' suggestion, the specific issue before the court was not the reasonableness *in general* of a tire expert's use of a visual and tactile inspection to determine whether over-deflection had caused the tire's tread to separate from its steel-belted carcass. Rather, it was the reasonableness of using such an approach, along with Carlson's particular method analyzing the data thereby obtained, to draw a conclusion regarding *the particular matter to which the expert testimony was directly relevant.*

*Id.*

<sup>31</sup> *Id.* at 154 ("[T]he relevant issue was whether the expert could reliably determine the cause of *this* tire's separation.").

<sup>32</sup> *Id.* at 154-55.



articles or papers which validated the approach.<sup>33</sup>

The Supreme Court noted that deposition transcripts and an earlier report prepared by the expert cast considerable doubt on the reliability of the expert's theory and methodology.<sup>34</sup> The district court had found that none of the *Daubert* factors indicated that the expert's testimony was reliable and that there were no countervailing factors operating in favor of admissibility.<sup>35</sup> For these reasons, the Supreme Court held that the district court did not abuse its discretion in concluding that the expert testimony was unreliable.<sup>36</sup>

## II. *DAUBERT'S* APPLICATION TO FINANCIAL EXPERTS

In dealing with the admissibility of testimony by financial experts – particularly economists and accountants – the courts have emphasized that after the initial determination that an expert is a qualified practitioner,<sup>37</sup> the testimony offered by the expert must be deemed helpful to the jury,<sup>38</sup> as determined by the reliability of the methodology

<sup>33</sup> *Id.* at 157.

<sup>34</sup> *Id.* at 154.

<sup>35</sup> *Id.* at 156 (observing that the trial court, upon rehearing, not only applied *Daubert* but also looked to the expert's testimony itself for factors which would bolster the reliability of his methodology as applied to the tire in question).

<sup>36</sup> *Id.* at 158. The concurring opinion in *Kumho Tire* makes clear, however, that a trial court is still capable of abusing its discretion in such matters. Justice Scalia wrote:

I join in the opinion of the Court, which makes clear that the discretion it endorses – trial-court discretion in choosing the manner of testing expert reliability – is not discretion to abandon the gatekeeping function. I think it worth adding that this is not discretion to perform the function inadequately. Rather, it is discretion to choose among *reasonable* means of excluding expertise that is *fausse* and science that is junky. Though, as the Court makes clear today, the *Daubert* factors are not wholly writ, in a particular case the failure to apply one or another of them may be unreasonable, and hence an abuse of discretion.

526 U.S. at 158-59.

<sup>37</sup> This article will not attempt to cover those judicial issues related to the initial issue of an expert's qualifications; for such a discussion, see Sofia Androgue & Alan Ratliff, *Kicking the Tires after Kumho: The Bottom Line on Admitting Financial Expert Testimony*, 37 HOUS. L. REV. 431, 454-64 (2000).

<sup>38</sup> See FED.R.EVID. 702 ("If [the knowledge at issue] will assist the trier of fact to understand the evidence or to determine a fact in issue . . .").

employed and by the relevance of the opinion to the facts at issue.<sup>39</sup> The courts in these financial cases often refer specifically to the *Daubert* “scientific” factors – testing, peer review, error rates, and acceptability by the relevant scientific community<sup>40</sup> – but it should be emphasized that *Daubert* noted that the factors to be applied in assessing the expert testimony are flexible and not exhaustive<sup>41</sup> and that it is axiomatic that in many instances of evaluating financial data these so-called scientific factors may not be the most appropriate.<sup>42</sup>

<sup>39</sup> See *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 591-93 (1993).

<sup>40</sup> See, *i.e.*, *United Phosphorus, Ltd. v. Midland Fumigant, Inc.*, 173 F.R.D. 675 (D. Kan. 1997), in which the district court excluded an economist’s testimony as to the value of plaintiff’s trade name for lack of the expert’s qualifications, lack of peer review and publication of the methodology used, and lack of acceptance by the scientific community. The court implied that the expert was a hired gun whose testimony was suspect, noting that he was president and shareholder of an economics and statistical consulting firm which provided 90% of its services to the legal profession. *Id.* at 679. The court also stated that if expert testimony is not based on independent research, there must be other evidence that the testimony is based upon scientifically valid principles evidenced by peer review and publication. The court found that the expert violated a fundamental principle of economics in his value estimates and there was no objective, verifiable evidence from which it could conclude that the expert’s methodology was accepted by others in the field. *Id.* at 686.

<sup>41</sup> See *Daubert*, 509 U.S. at 594-95 (emphasizing that the inquiry envisioned is flexible); see also *Kumho Tire*, 526 U.S. at 141 (clarifying that the Court in *Daubert* stated the test of reliability is “flexible” and the list of specific factors neither necessarily nor exclusively applies to all experts or in every case).

<sup>42</sup> See *Daubert v. Merrell Dow Pharmaceuticals, Inc. (Daubert II)*, 43 F.3d 1311, 1318 (9th Cir. 1995), which suggests that a proponent of scientific testimony show that: (1) the testimony grows out of pre-litigation research, or (2) the research has been subjected to peer review. Where such evidence is unavailable, *Daubert II* instructs that the proponent may satisfy its burden through the testimony of its own experts, but that for such a showing to be sufficient:

[The experts] must explain precisely how they went about researching their conclusions and point to some objective source – a learned treatise, the policy statement of a professional association, a published article in a reputable scientific journal or the like – to show that they have followed the scientific method, as it is practiced by (at least) a recognized minority of scientists in their field.

*Id.* at 1319. Not all of the factors are equally applicable in a given case, and it often makes little sense to ask whether the technique employed “can be (and has been) tested” or what the “known or potential rate of error might be.” *Id.* at 1317 n.4 (quoting *Daubert*); see also *Lust v. Merrell Dow Pharmaceuticals, Inc.*, 89 F.3d 594, 597 (9th Cir. 1996), which states that “testing” and “rate of errors” factors are not applicable when the expert has not done the original research but has drawn different conclusions from the scientists who performed the original work.

Recognizing the easily manipulable and potentially misleading use of financial testimony,<sup>43</sup> the federal courts have in a number of instances concluded that the methodology used by the expert was inappropriate,<sup>44</sup> and the expert testimony in several of those cases have appeared particularly egregious to the courts, with the evidence being rejected on almost every conceivable ground.<sup>45</sup> The exclusion of the testimony is of course generally within the trial court's discretion, even if the methodology used by the expert is universally accepted within the relevant field.<sup>46</sup> It is often not the general acceptance of the methodology within the discipline that is crucial, but rather the reasonableness of using the approach, along with the expert's particular method of analyzing the data obtained, "to draw a conclusion regarding *the particular matter to which the expert testimony was directly relevant.*"<sup>47</sup>

In financial cases, a district court must therefore determine whether the expert's underlying reasoning or methodology is scientifically valid and whether that reasoning or methodology can be properly applied to the

<sup>43</sup> See *Adams v. Ind. Bell Tel. Co., Inc.*, 2 F. Supp.2d 1077, 1094 (S.D. Ind. 1998) (explaining that verification of statistical evidence involves determining if the measurement process was reliable, valid, and accurate).

<sup>44</sup> See *Blue Dane Simmental Corp. v. American Simmental Ass'n.*, 178 F.3d 1035, 1041 (8th Cir. 1999) (noting "no evidence in the record that other economists use before-and-after modeling to support conclusions of causes of market fluctuation"); see also *Gen. Elec. Co. v. Joiner*, 522 U.S. 136, 146 (1997) (finding that scientific validity of a methodology is the key to admissibility, and that a court may find too great a disparity between the data and the opinion offered).

<sup>45</sup> See *McGuire v. City of Santa Fe*, 954 F. Supp. 230, 232-33 (D.N.M. 1996) (excluding economist's testimony on hedonic damages because methodology and theory: (1) was not easily tested; (2) lacked any widely accepted standards for uniformly measuring the value of the pleasure of life; (3) was found by peers to be lacking any verifiable basis; (4) lacked proof of any known error rate for calculations; (5) had been generally rejected by courts; and (6) was an inappropriate measure of damages in a wrongful termination and job discrimination action).

<sup>46</sup> See *Kumho Tire*, 526 U.S. at 158 ("In sum, Rule 702 grants the district judge the discretionary authority, reviewable for its abuse, to determine reliability in light of the particular facts and circumstances of the particular case.").

<sup>47</sup> *Id.* at 154.

facts at hand.<sup>48</sup> Among the matters to be considered is whether the testimony is “sufficiently tied to the facts of the case that it will aid the jury in resolving a factual dispute.”<sup>49</sup> This relationship is commonly referred to as “fit,” meaning that the expert testimony must not only be based on reliable science but must also suit the particular situation before the court:

[C]onclusion and methodology are not entirely distinct from one another. . . [N]othing in either *Daubert* or the Federal Rules of Evidence requires a district court to admit opinion evidence that is connected to existing data only by the *ipse dixit* of the expert. A court may conclude that there is simply too great an analytic gap between the data and the opinion proffered.<sup>50</sup>

#### A. Testimony of Economists

Even prior to the holding in *Kumho Tire*, the *Daubert* standards had been applied by several judges to exclude the expert testimony of economists,<sup>51</sup> and these courts had often

<sup>48</sup> See *Daubert*, 509 U.S. at 592-93 (explaining that a trial judge, at the outset, must decide whether the expert is proposing to testify about scientific knowledge that will assist the trier of fact to understand a fact at issue); see also *In re Paoli R.R. Yard PCB Litigation*, 35 F.3d 717, 745 (3d Cir. 1994), cert. denied, 513 U.S. 1190 (1995) (stating that an expert’s conclusions must be supported by grounds in each step of the analysis: “Any step that renders the analysis unreliable under the *Daubert* factors renders the expert’s testimony inadmissible.”); *Rutigliano v. Valley Bus. Forms*, 929 F.Supp. 779, 786 (D.N.J. 1996) (concluding that a doctor’s testimony dealing with occupational illness was based on personal experience and instinct and not from scientific reasoning, and therefore was not reliable and would not assist the trier of fact in reaching an accurate result).

<sup>49</sup> *Daubert*, 509 U.S. at 591 (quoting *U.S. v. Downing*, 753 F.2d 1224, 1242 (3d Cir. 1985)).

<sup>50</sup> See *Gen. Elec.*, 522 U.S. at 146 (holding that the testimony “did not rise above ‘suspicious belief or unsupported speculation’”); see also *Jaurequi v. Carter Mfg. Co.*, 173 F.3d 1076, 1082-83 (8th Cir. 1999) (upholding trial court’s exclusion of testimony regarding an engineer’s alternative design in a products liability case).

<sup>51</sup> See, e.g., *Watkins v. Telsmith, Inc.*, 121 F.3d 984, 991 (5th Cir. 1997) (“Whether the expert would opine on economic valuation, advertising psychology, or engineering application of the *Daubert* factors is germane to evaluating whether the expert is a hired gun or a person whose opinion in the courtroom will withstand the same scrutiny that it

held that such testimony was unreliable because of the poor methodology employed, particularly if the expert failed to consider other possible variables in the economic analysis,<sup>52</sup> or if the testimony would not aid the jury in its determination.<sup>53</sup> These courts were particularly critical of testimony tailored specifically toward litigation, without any evidence of prior testing or acceptance within the relevant discipline.<sup>54</sup>

### (1) Unreliable Methodology

In a decision the court explicitly compared to *Kumho Tire*, the Eighth Circuit in *Blue Dane Simmental Corp. v. American Simmental Assn.*<sup>55</sup> upheld the disqualification of an agricultural economist in a case in which the plaintiff, claiming violations of RICO, the Sherman Act, and the Lanham Act, sued a breeding association and an individual who had registered 19 head of cattle.<sup>56</sup>

In support of its claim, plaintiffs introduced the evidence

would among his professional peers.”); *Kay v. First Cont'l Trading, Inc.*, 976 F. Supp. 772, 774-76 (N.D. Ill. 1997) (excluding testimony of statistician because it was lacking in “accountability for the risks involved”); *In re Aluminum Phosphide Antitrust Litig.*, 893 F. Supp. 1497, 1503 (D. Kan. 1995) (holding that there was no factual basis for any hypothesis which would support expert’s calculations and opinion); *Ayers v. Robinson*, 887 F. Supp. 1049, 1064 (N.D. Ill. 1995) (refusing to admit economist’s testimony on hedonic damages).

<sup>52</sup> See *Cochran v. Scheider Nat'l Carriers, Inc.*, 980 F.Supp. 374, 378-80 (D. Kan. 1997) (concluding that economist’s testimony regarding parent’s loss of financial support and services from a deceased child should be excluded because of unreliability of methodology and speculative nature of the damages).

<sup>53</sup> See *Saia v. Sears Roebuck & Co.*, 47 F.Supp.2d 141, 148-50 (D. Mass. 1999) (stating that expert’s hedonic damages analysis failed *Daubert* tests of testability and acceptability, with the court noting that assumptions underlying damage valuation were arbitrary and “perhaps most importantly, . . . [the expert’s] testimony [would] not assist the jury in understanding the evidence or determining any fact in issue”).

<sup>54</sup> See *Aluminum Phosphide Antitrust Litig.*, 893 F. Supp. at 1506-07 (“Dr. Hoyt’s analysis is driven by the desire to enhance the measure of plaintiff’s damages, even at the expense of well-accepted scientific principles and methodology.”); see also D.H.Kaye, *The Dynamics of Daubert: Methodology, Conclusions, and Fit in Statistical and Economic Studies*, 87 VA. L. REV. 1933, 1939 (2001) (discussing how courts fear that the “infallibility” of some expert testimony lead jurors to give it more credibility than it deserves).

<sup>55</sup> 178 F.3d 1035 (8th Cir. 1999).

<sup>56</sup> *Id.* at 1039.

of Dr. Alan Baquet, who was to testify that the introduction of the animals at issue into the full-blood Simmental market in the United States caused the market value of all American Simmentals to drop substantially. To support this testimony, Dr. Baquet posited that following the introduction of these animals, the United States market dropped 53 percent, while the Canadian market dropped only 26 percent; he attributed this 27 percent difference in market price to the introduction of defendant's animals.<sup>57</sup> Plaintiffs contended that Dr. Baquet's research method, known as the before-and-after model, is a common tool used by economic researchers, and that the proper remedy for defendants was to challenge the methodology through cross-examination and introduction of rebuttal expert testimony.<sup>58</sup>

In determining that the testimony was not reliable, the district court did not dispute that Dr. Baquet was adequately qualified. Instead, the court found that the methodology employed was unreliable, stating that the analysis was "simplistic" in that it attributed the entire difference in market price within the United States and Canada to the animals, despite the fact that they made up a tiny fraction of the market – only 19 out of a total of 138,169.<sup>59</sup>

<sup>57</sup> *Id.* at 1040.

<sup>58</sup> *Id.*

<sup>59</sup> *See id.* at 1040; *see also* Adams v. Indiana Bell Telephone Co., 2 F. Supp. 2d 1077, 1110 (S.D. Ind. 1998), in which plaintiff, seeking to use statistical evidence to prove discrimination against a group to allow the inference of intentional discrimination against individual members, offered the admissibility of opinion and testimony from a labor economist. The court, after a lengthy analysis, concluded:

In light of these significant deficiencies, the plaintiffs' statistical evidence appears to be unreliable, in that the expert failed to explain how his methods comport with generally accepted scientific principles, and were the proper methods for conducting a statistical analysis for purposes of supporting a hypothesis about causation. He did not know what actually occurred in the group of individuals he studied, nor did he know that they were dissimilar in ways that mattered in terms of the reasons for the resizing. The statistical evidence is also irrelevant, because it has no tendency to prove a fact that is material to the plaintiffs' claim.

*Id.*

The district court suggested it was obvious that at least one other variable contributed to falling markets, since it was undisputed that both the Canadian and American markets were falling *prior* to the introduction of the animals.<sup>60</sup> Furthermore, during his deposition Dr. Baquet admitted that various factors contribute to particular breeds losing market value, and that generally an economist attempts to identify and evaluate all independent variables significantly affecting changes in the value of a breed; he acknowledged that he neglected to consider any variables other than the introduction of the animals at issue.<sup>61</sup>

Agreeing with the district court's exclusion of the testimony, the Eighth Circuit concluded:

This case is analogous to *Kumho*. Although Dr. Baquet utilized a method of analysis typical within his field, that method is not typically used to make statements regarding causation without considering all

<sup>60</sup> *Blue Dane Simmental*, 178 F.3d at 1040; see also *Stelwagon Mfg. Co. v. Tarmac Roofing*, 63 F.3d 1267 (3d Cir. 1995), in which the court noted that the expert's analysis failed to sufficiently link any decline in plaintiff's sales to price discrimination because sales may have been lost for other reasons, such as the fact that plaintiff had higher overhead costs than its competitors and had experienced several business complications (including termination of a vice president, two territorial managers, and three key employees for their part in an embezzlement scheme). *Id.* at 1275. The Court pointed out that the only evidence directly linking the violation to any decline in sales and profits was the anecdotal testimony of plaintiff's employees. *Id.* at 1274. The plaintiff also failed to identify a single lost customer. *Id.* at 1275-76.

<sup>61</sup> *Blue Dane Simmental*, 178 F.3d at 1040; see also *Aluminum Phosphide Antitrust Litigation*, 983 F. Supp. 1497, a price-fixing case where defendants sought to preclude plaintiffs' economic expert from testifying about damages caused by defendants' alleged conspiracy. The court found that nothing in the analysis made the data for his "normative" period more relevant than any other pre- or post-conspiracy. *Id.* at 1503. Furthermore, the court found that the expert had not shown that his "before-and-after" model accounted for undisputed increases in competition between conspiratorial and normative periods, nor had he justified his constant cost industry assumption or application of individual benchmark prices for each defendant. *Id.* at 1505. See also *Schiller & Schmidt, Inc. v. Nordiseo Corp.*, 969 F.2d 410 (7th Cir. 1992), a copyright infringement case where a professor was hired for the mere appearance of authority, mocking the concept of expert knowledge. The court held that the expert should have separated injury due to unlawful conduct from that due to new market entry. *Id.* at 415-16.

independent variables that would affect the conclusion. We find no evidence in the record that other economists used before-and-after modeling to support conclusions of causes of market fluctuation. [citing cases]. Nor do plaintiffs cite any articles or papers that would support Dr. Baquet's approach. [citing *Kuhmo*]. Accordingly, we conclude that the district court did not abuse its discretion by excluding Dr. Baquet's testimony.<sup>62</sup>

## (2) Poor "Fit"

In light of *Kuhmo Tire*, other courts have rejected the testimony of an economist not because of the methodology used, but because it did not "fit" the specific facts of the case under litigation. In *Concord Boat Corp. v. Brunswick Corp.*,<sup>63</sup> the Eighth Circuit ruled inadmissible the testimony of an economist in an antitrust case because not all relevant circumstances were incorporated into the expert's economic model, and because the model failed to account for market events which did not relate to any anti-competitive conduct.<sup>64</sup> The Court focused on the requirement in *Daubert* that the expert testimony must not only be based on reliable science, but must fit the particular facts before the court.<sup>65</sup> Even though a theory meets certain *Daubert* factors (such as testing, peer review and publication, known or potential error rate, and general acceptance), it should not be admitted at trial if it does not apply to the facts at hand.<sup>66</sup>

In *Concord Boat*, a number of boat manufacturers sued

<sup>62</sup> *Blue Dane Simmental*, 178 F.3d at 1040.

<sup>63</sup> 207 F.3d 1039 (8th Cir. 2000).

<sup>64</sup> *Id.* at 1057 (finding that "[e]xpert testimony that is speculative is not competent proof and contributes nothing to a legally sufficient evidentiary basis").

<sup>65</sup> See *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 591 (1993).

<sup>66</sup> See *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d. 1039, 1056 (2000) (noting that simply meeting some of the *Daubert* factors may not be enough to determine admissibility); see also *Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137, 154 (1999); *Gen. Elec. Co. v. Joiner*, 522 U.S. 136, 146 (1997).



Brunswick Corporation for violations of the Sherman and Clayton Acts.<sup>67</sup> The plaintiff's evidence to establish Brunswick's antitrust liability was presented by their sole expert, Dr. Robert Hall, a professor of economics at Stanford University, who testified that Brunswick's monopoly in the stern-drive engine market enabled the company to use market share discount programs to impose a "tax" on boat builders and dealers who chose to purchase engines from other manufacturers.<sup>68</sup> Dr. Hall testified that Brunswick's discount programs, combined with market power acquired by purchasing Bayliner and Sea Ray, enabled it to capture 78 percent of the market.<sup>69</sup> Dr. Hall relied on the Cournot model of economic theory, and postulated that in a stern-drive engine market that was competitive, Brunswick and some other firm would each maintain a 50 percent market share; under this theory, any market share over 50 percent would be *prima facie* evidence of anti-competitive conduct on Brunswick's part.<sup>70</sup> Brunswick argued that Dr. Hall's opinion should be excluded because it was contrary to undisputed record evidence and because it did not separate lawful from unlawful conduct.<sup>71</sup>

After reviewing the evidence, the appellate court held it was clear that not all relevant circumstances were incorporated into the expert's method of analysis as it related to antitrust liability, such as:

- Dr. Hall's opinion that Brunswick's discount programs imposed a tax on boat builders who chose to purchase engines from other manufacturers was not supported by evidence. Some boat builders chose to purchase 100 percent of their engines from

<sup>67</sup> *Concord Boat*, 207 F.3d at 1047.

<sup>68</sup> *Id.* at 1046.

<sup>69</sup> *Id.*

<sup>70</sup> *Id.* at 1046-47.

<sup>71</sup> *Id.* at 1046.

Brunswick when they only needed to purchase 80 percent to qualify for the maximum discount. There was also evidence that some boat builders were willing to forego Brunswick's discounts.<sup>72</sup>

- The Cournot model of a hypothetical market ignored inconvenient evidence, such as the fact that Brunswick achieved a 75% share of the market in the mid-1980s before it started the discount programs and before it acquired Bayliner and Sea Ray. The model also failed to account for market events which both sides agreed were not related to any anti-competitive conduct, such as the recall of OMC's Cobra engine and the problems associated with the Volvo/OMC merger.<sup>73</sup>

The Court therefore concluded that Dr. Hall's opinion should not be admitted because it did not incorporate all aspects of the market's economic reality and because it did not separate lawful from unlawful conduct.<sup>74</sup> Because of these deficiencies, Dr. Hall's opinions were held to be "mere speculation."<sup>75</sup>

### (3) Standard of Review

The importance of the appellate court's standard of review in financial cases is well illustrated by *Atlantic Richfield Co. v. Farm Credit Bank of Wichita*,<sup>76</sup> in which the Tenth Circuit relied heavily on the abuse-of-discretion standard in affirming the district court's exclusion of the expert's testimony.<sup>77</sup> That case involved a dispute over a gas lease for carbon dioxide in West Texas, where the

<sup>72</sup> *Id.* at 1056.

<sup>73</sup> *Id.*

<sup>74</sup> *Id.* at 1057.

<sup>75</sup> *Id.*

<sup>76</sup> 226 F.3d 1138 (10th Cir. 2000).

<sup>77</sup> *Id.* at 1168.

lessors offered the testimony of an economist on the question of fair market value.<sup>78</sup> The expert's theory was that market prices did not provide a reliable indicator of value in that geographical region because most carbon dioxide producers are vertically integrated and produce carbon dioxide primarily for their own use, thereby creating incentives to keep prices artificially low.<sup>79</sup> The expert instead computed fair market value by equating price in a hypothetical competitive market with economic benefits derived by purchasers from use of the gas.<sup>80</sup>

The district court excluded the expert testimony, maintaining that the expert had developed his views solely for litigation, had not employed the same methodology on previous occasions, and had not subjected his methods to peer review.<sup>81</sup> The court also pointed out that the economist had failed to take account of actual prices of carbon dioxide in West Texas and comparable markets.<sup>82</sup>

After thoroughly reviewing the record, the Court of Appeals held that the district court's conclusion that the expert strayed too far from available sales data could not, in the end, be described as "manifestly unreasonable."<sup>83</sup> The appellate court, deferring to the trial court's discretion, then stated that the exclusion of the evidence was a very close call, but that the legal standard of review allowed it no other course of action:

Suffice it to say that our standard of review plays a major role in the disposition of this issue. Whether the existence of other markets and the sales data presented by ARCO fatally undermine Smith's theory is eminently debatable. If our review were

<sup>78</sup> *Id.* at 1164.

<sup>79</sup> *Id.* at 1165.

<sup>80</sup> *Id.*

<sup>81</sup> *Id.* at 1166.

<sup>82</sup> *Id.* at 1167.

<sup>83</sup> *Id.*

de novo, we might very well conclude that Smith's theory explains or otherwise accounts for these markets and data. When we apply an abuse of discretion standard, however, "we defer to the trial court's judgment because of its first-hand ability to view the witness or evidence and assess credibility and probative value." [citations omitted].<sup>84</sup>

### B. Testimony of Accountants

The *Daubert* standards had previous to the holding in *Kumho Tire* been applied by several courts to exclude the testimony of accountants,<sup>85</sup> and those expert opinions which appeared to be concocted for litigation were notably rejected by the courts as unreliable.<sup>86</sup>

<sup>84</sup> *Id.* at 1168 (quoting *Towerridge, Inc. v. T.A.O., Inc.*, 111 F.3d 758, 763 (10th Cir. 1997)).

<sup>85</sup> *See, e.g.*, *Frymire-Brinati v. KPMG Peat Marwick*, 2 F.3d 183, 186–87 (7th Cir. 1993) (accounting expert admitting he had not employed generally accepted methodology); *Sec. and Exch. Comm'n v. Lipson*, 46 F. Supp. 2d 758, 762 (N.D. Ill. 1998) (stating that expert's opinion must be "squarely grounded in the principles and methodology of the relevant discipline," no matter how impressive his credentials); *De Jager Constr., Inc. v. Schleining*, 938 F. Supp. 446, 447–49, 455 (W.D. Mich. 1996) (excluding opinions of accounting expert because too speculative and of little probative value because principles and methodology underlying testimony were based upon speculation).

<sup>86</sup> *See Lipson*, 46 F.Supp.2d at 764, an insider trading action where court found unreliable the expert's opinion because it was not premised on the principles, practices, or methodology of accounting; the expert never attempted to audit, determine the accuracy, or assess the reliability of those reports. The court noted:

*First*, the Court finds that Mr. Perks' opinions that the internal financial reports in March and April 1995 were unreliable are not sufficiently rooted in the principles and methodology of accountancy. Mr. Perks' deposition testimony makes explicit what is implicit in his Rule 26 report: that he did not attempt to audit the Supercuts' internal financial reports, that he did not attempt to determine their accuracy, and that he did not assess the reliability of those reports in reporting revenue or how revenues compare to budget. Moreover, although Mr. Perks cited as one basis for his opinion an Arthur Andersen report for the audit period covering 1993, which he described as finding "material weakness" in Supercuts' internal controls, Mr. Perks did not explain in his report or his deposition what consideration, if any, he gave to the fact that Arthur Andersen did not find any material weaknesses for the audit periods 1994-1995. Expert opinion that is "carefully tailored to support [a] position" is not reliable.

*Id.* (quoting *Minasian v. Standard Charter Bank*, 109 F.3d 1212, 1216 (7th Cir. 1997)).

### (1) Unreliable Methodology

In the recent case of *Children's Broadcasting Corp. v. Walt Disney Co.*,<sup>87</sup> ABC Radio had agreed to conduct advertising sales, affiliate developing, and consulting for Children's Broadcasting but later exercised its right to terminate the agreement after Disney acquired ABC. Children's brought suit against ABC and Disney for fraud, breach of contract, breach of fiduciary duties, and misappropriation of trade secrets as to Children's advertiser lists, advertising rates, and programming methods.<sup>88</sup> After a jury verdict for Children's, the district court granted a motion for directed verdict, excluding the expert testimony on damages offered by Dr. Stephen Willis, one of Children's experts, as unreliable because it was speculative and based upon faulty assumptions.<sup>89</sup>

The Eighth Circuit held that while plaintiff's expert used uncontroversial accounting methods (*i.e.*, discounted cash flow), he failed to take legitimate Disney competition into account. The expert also erred by testifying that *any* breach of contract, *any* use of confidential information, and *any* misappropriation of trade secrets would have caused *exactly* the same damages.<sup>90</sup> The Court noted substantial deficiencies in the expert's opinion:

[The plaintiff's expert] acknowledged, however, that he did not take into account the announcement of Radio Disney as a competitor when drawing his conclusions. The agreement between Children's and ABC Radio did not include a non-compete clause, and the establishment of Radio Disney cannot be considered wrongful conduct. The

<sup>87</sup> 245 F.3d 1008, 1013 (8th Cir. 2001).

<sup>88</sup> *Id.* at 1015.

<sup>89</sup> *Id.* (stating that "Willis's damages projections went so far beyond realistic optimism as to be 'fairy-tale-like'").

<sup>90</sup> *Id.* at 1018 (noting that the "assertion that any or all of the alleged wrongful acts would have caused the same outcome is dubious").

existence of Radio Disney was relevant to Children's value, but [plaintiff's expert] did not consider it.<sup>91</sup>

Children's argued that the *Daubert* decision sanctions only evaluations of an expert's methods, not their conclusions, but the court, citing *General Electric Co. v. Joiner*,<sup>92</sup> responded that an expert's methodology must be linked to conclusions by ties stronger than mere *ipse dixit*.<sup>93</sup> Concluding (a) that the expert failed to consider the effect of competition on the plaintiff, (b) that his theory of causation was questionable, and (c) that his report was based on a report prepared before the plaintiff's claims were narrowed for trial, the appellate court held that the trial court had not abused its discretion in excluding the expert's testimony.<sup>94</sup>

## (2) Standard of Review

The latitude provided to a district court's decision to exclude the financial testimony of an accountant was reiterated in *Seatrax, Inc. v. Sonbeck Int'l, Inc.*,<sup>95</sup> a lawsuit claiming trademark infringement and misappropriation of a trade secret for offshore marine cranes. In that case, plaintiff offered an expert with fifteen years of experience in the marine crane industry to opine on defendant's profits from the sale of replacement parts and the diversion of sales due to unfair trade practices.<sup>96</sup> The expert's testimony was excluded by the district court because the expert had no formal training in accounting and conducted no

<sup>91</sup> *Id.* at 1019.

<sup>92</sup> 522 U.S. 136 (1997).

<sup>93</sup> *Id.* at 146 (observing that a court "may conclude that there is simply too great an analytical gap between the data and the opinion proffered").

<sup>94</sup> *Children's Broad. Corp.*, 245 F.3d at 1018. The court noted that the jury award of \$20 million in damages for the breach of contract terminable on 90 days' notice suggested that the jury gave weight to the expert's estimate, and that a new damage trial was therefore appropriate on the theory that the \$127 million estimate tainted the first trial. *Id.* at 1019.

<sup>95</sup> 200 F.3d 358 (5th Cir. 2000).

<sup>96</sup> *Id.* at 371.

independent examination of defendant's gross sales figures.<sup>97</sup> In deferring to the abuse of discretion standard, the Fifth Circuit concisely stated:

In the instant case, the record reveals that the court thoroughly reviewed Campbell's proffered testimony. In its ruling to exclude Campbell's testimony, the magistrate judge noted that Campbell did not have any formal or professional training in accounting. Furthermore, Campbell did not conduct any independent examination of Sonbeck's gross sales figures, which were provided by Seatrax's attorneys.<sup>98</sup>

The Court therefore concluded that there was no abuse of discretion on the part of the district court in excluding the expert's testimony:

In a complex case involving trademark infringement, Campbell's lack of former training or education in accounting, and his failure to conduct an independent analysis of Sonbeck's sales figures were insurmountable obstacles for Seatrax in its attempt to qualify him as an expert. Under these circumstances, the court's ruling did not amount to an abuse of discretion.<sup>99</sup>

## CONCLUSION

In a highly volatile economy resulting in litigation in which the expert knowledge of economists and accountants is increasingly called into play, the gatekeeping provisions of Federal Rule of Evidence 702, as interpreted by *Daubert* and *Kumho Tire*, will undoubtedly be more stringently

<sup>97</sup> *Id.* at 372.

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

applied to financial opinions and testimony in the future, in spite of the fact that such financial data may not be as susceptible to precise scrutiny as scientific matters. This trend has been borne out both by early appellate decisions and those written in the light of *Kumho Tire*, and it is clear that the courts will not only apply the enumerated *Daubert* factors but other parameters to ensure that financial expert evidence conforms to a routine methodology that is both reliable and relevant to the facts before the court. Such judicial scrutiny will ensure that the jury is not forced to speculate on tenuous evidence, and that an expert will employ in the courtroom the same intellectual rigor used in the financial discipline itself.



