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Experts in Court: Round-Up

In many cases, the need for a valuation expert is obvious and inescapable, which raises the question of how to choose and use an expert to the best advantage for a legal argument. Recent case law offers some tips in answer to this question.

It doesn't pay to skimp. In *Villaje del Rio, Ltd. V. Colina, L.P., 2009 WL 1606431 (W.D. Tex.) (June 8, 2009)*, the developer/plaintiff tried to cut costs by designating himself an expert to testify in regards to the value of his own real estate project, and supplemented his own with two experts' testimony, based on appraisals they prepared in connection with the project's financing, two years prior to the insolvency at issue. The court struck the appraisal experts for their failure to consider the relevant facts and data of the actual insolvency, and the plaintiff as well, saying, "lay testimony results from a process of reasoning familiar in everyday life, while expert testimony results from a process of reasoning which can be mastered only by specialists in the field."

A cost efficient compromise. Although a plaintiff often has no choice but to present an expert, the defendant may have other options. In *Sossikian v. Ennis, 2009 WL 2106106 (Cal. App. 1 Dist.) (July 16, 2009) (unpublished)*, the defendant found an ideal solution, by using an expert for rebuttal purposes only to discredit the damages evidence offered by the plaintiff's expert. This choice left the jury with no basis for a damages award and they awarded $42,182 on the plaintiff's $800,000 claim.

Who is qualified? When you make the decision to incur the cost of an expert, you want to make sure it's the right one. In *MDG Internat'l v. Australian Gold, Inc., 2009 WL 1916728 (S.D. Ind.) (June 29, 2009)*, an otherwise "supremely qualified" expert failed to satisfy the requirements of the Federal Rules of Evidence and *Daubert*. The expert, a professor of accounting and chair of an accredited MBA program deeply experienced in valuing public companies, was engaged to value a private company. The court concluded that he lacked the requisite "knowledge, skill, experience, training, or education" to testify regarding the value of the closely held business at issue, and went on to find that the expert's opinions and methodologies were riddled with deficiencies. "Expert" is not broadly defined. It is critical to engage someone experienced in the particular issue of the case.

Of course, there are always outlier situations. *Chick-Fil-A v. CFT Development, LLC, 2009 WL 1754058 (M.D. Fla.) (June 18, 2009)* is one such case. At issue was whether Panda Express (the defendant), which was proposed to be built next to a Chick-Fil-A, would derive 25% or more of its gross sales from the sale of chicken (and thus be enjoined from opening under a restrictive covenant on the property). The plaintiff's and defendant's experts proposed alternative methods of calculating the 25%, and both parties filed *Daubert* motions, claiming the other's expert was unreliable or irrelevant. In the absence of any precedents (legal or accounting) on how to calculate the percentage of sales from chicken (for example, does it include non-chicken ingredients in a chicken dish?), the court permitted both experts to testify, saying that "the certainty and correctness will be tested through cross-examination and presentation of contrary evidence."

Not all experts face the *Daubert* test. Certain states continue to use a hybrid of that new federal rule and their own standard, based on the so-called *Frye* rule (from *Frye v. United States*, 54 App. D.C. 46 (1923)), even though *Daubert* overruled that case. The *Frye* test requires that an expert's opinion derive from a principle that is "sufficiently established to have gained general acceptance in the particular field in which it belongs." This was the test used by the court in *8000 Maryland LLC v. Huntleigh Financial Services, Inc., 2009 WL 2144895 (Mo. App. E.D.) (July 21, 2009)*. There the court of appeals affirmed that the plaintiff's expert, a CPA/ABV, ASA, CVA with a master's degree in finance and twenty-five years experience valuing public and private companies, had based her conclusions on facts and data reasonably relied on by similar experts.

Watch your expert's language. You've hired an expert. They've passed the hurdle of court acceptance. They give their opinion. It goes without saying

(or does it?) that that opinion needs to be powerful, well presented, and not based on speculation. In *Lucent Technologies, Inc. v. Gateway, Inc., 2009 WL 2902044 (C.A. Fed.) (Sept. 11, 2009)*, the plaintiff's expert's patent damages calculation, which resulted in a jury award of $358 million, was thrown out (and the jury award reversed), based largely on the expert's testimony that to calculate a lump-sum amount (of damages), the parties might start by looking at the running royalty "*and then speculating as to the extent of the future use*" (emphasis by court). Perhaps it was semantics, (the expert might just as easily have said "estimate"), but the court held that what it dubbed the "lump sum speculation theory" improperly suggested guesswork, not rigorous analysis. The court went on to bolster its decision, finding that the expert's comparables had no probative value, as the technology at issue was unique and difficult to compare meaningfully.

The bottom line: it pays to hire an expert, but be sure it's the right expert doing the best job possible.

Credibility in Court—the View from the Bench

At the recent Summit on Business Valuation in Divorce, the very first question posed to the panel of four judges was, "What makes a BV expert credible in court?"

Credibility, by any standard definition, connotes the quality, capability, or power to elicit belief. The following are the qualities that convey credibility to a court:

Flexibility. "I can tell you what makes an expert *incredible*: it's taking the defensive… saying 'nothing will change, my valuation stands as it is,' then you become incredible," said Judge Jacqueline Silbermann (New York). Your experts should be adaptable and prepared to recalculate their values depending on what a judge or opposing attorney asks.

"Show reasonableness," added Judge Moshe Jacobius (Illinois). Be careful your expert doesn't compare the small subject company to a Fortune 500 or omit an exceedingly obvious (even to a lawyer or judge) item from a valuation. Judge Howard Lipsey (Rhode Island) says he doesn't like the "wise-ass, defensive expert, who gets on the stand and says, 'I know everything.'"

Transparency. Judge Edward Jordan (Illinois) expects valuation experts to demonstrate "transparent objectivity." Should the witness come across as a "hired gun," then "that gets my attention quickly," he said. "And if that person's credibility goes, it's gone completely, no matter how hard counsel may work to rehabilitate."

Real credentials, not just alphabet soup. "It really doesn't make any difference how many designations an expert has," Judge Jacobius said, perhaps summing up the panel's view. Of greater significance is how much work the expert has done in an area, and how knowledgeable and reasonable they are. "My experience has been that some experts are more interested in marketing their qualifications than offering sound, substantial opinions," said Jacobius. But you don't always have to hire the most experienced expert. Judges are also willing to give newly credentialed experts a break. "I like getting rookies in my courtroom," Judge Jordan said. "Everyone has to start somewhere," and as long as they offer transparent, objective, and inherent rationale opinions, they'll lay a foundation to lasting credibility.

Industry vs. appraisal experience. "Remember the five P's," Judge Jordan said: "prior planning prevents poor performance." The more credible expert is the one who puts the most work into the valuation. In other words, "If you have more experience in industry, take the time to learn business valuation," Jay Fishman, a leading valuation expert, said, "and vice versa."

Written vs. oral. "An oral report is only as good as the paper it's written on," joked Judge Lipsey. Even written, technically, all valuation reports are hearsay. To expedite matters, consider asking whether the attorneys on the case will stipulate to the *admissibility* of the report. If they will, then the content is still open to cross-examination but the hearsay problem becomes moot. As for rebuttal reports, it's a better idea to use a chart to show the contrasting points between your expert's opinion and that of the opposing expert. This helps the court focus on the critical differences and the reasons behind them. Also, in the case of court-appointed experts, each side may retain its own expert to critique the neutral.

Prior disqualifications or discredited opinions. What if opposing counsel argues that the expert was disqualified in a prior decision? That evidence is simply not admissible; it's highly prejudicial and irrelevant. "Your credibility is based on our report, the work you've done, your transparency, and your objectivity in this case," Jordan said. However, there are some exceptions. If an expert valued a company five years prior to trial, then that report is likely to be relevant. To be on the safe side, experts should always disclose to the lawyer anything in their past that might discredit their opinion—a rejected report,

findings of incredibility by a certain judge, etc.—so they can prepare the issue for depositions and trial.

Do judges give more credibility to court-appointed experts?

"I vouch for the credentials of court-appointed experts, not their credibility," Judge Lipsey said. "We have to be open-mined; fair-minded," Judge Jacobius concurred. "We have to base our ultimate opinions on the requirements and results of testimony."

Lay Experts Only Allowed in Limited Circumstances

***Von der Ruhr v. Immtech International, Inc.,* 2009 WL 1855986 (C. A. 7 (Ill.)(June 30, 2009)**

The owner of several medical technology companies patented a drug to treat sepsis, an infectious disease for which there was only one other drug competing on the market. He assigned all licensing rights to another company, but it failed to run clinical trials and perform other conditions of the parties' agreement. In a lawsuit for damages, the patent owner planned to testify that "but for" the defendant's breach, he would have found a "major pharmaceutical" partner to "[walk] the product through the FDA clearance process." The drug would have immediately captured 50% of the market, he said, and he would have made "great profits," including a 5% royalty on all future sales, for total damages of over $42 million.

Limits on lay experts' testimony. The defendants moved to preclude the owner from presenting what amounted to expert damages testimony, and the federal district court granted the motion. In the realm of lost profits, lay opinion testimony is allowed in limited circumstances, and "only when the witness has particular and personal knowledge," the U.S. Court of Appeals for the Seventh Circuit explained on review. Here, the patent owner had no personal experience in obtaining a corporate licensing agreement. He had never brought a drug to market or made a profit from a drug. He lacked any expertise or data to support his claims.

"[The plaintiff] attempts a difficult task in this case: (1) to prove lost profits damages (2) in a complex market (3) from a product that has never been sold (4) without any expert testimony." This is precisely the testimony that qualifying experts traditionally provide in addition to "true" market analysis, the court held, and it rejected the owner's testimony as speculative and uncertain.

Top Five Must-Haves for Tax Valuation Reports

Hiring an expert for a tax valuation? Is the expert you've hired following best practices? At the recent NACVA/IBA 2009 Consultants' Conference in Boston, the Honorable David Laro (U.S. Tax Court) joined fellow panelists Howard Lewis, currently the IBA's executive director and former National Program Manager for the IRS Engineering and Valuation programs; and Mike Eggers, principal of American Business Appraisers (San Diego), to come up with the following checklist for "best practices" in tax-related valuation reports:

1. Transparency. Valuation reports must be logical, rational, and clear, with transparent analysis by the lead appraiser of the company, the data, the factors supporting the conclusion, and the underlying rationale. If you don't understand a valuation report, chances are the judge won't either, and that makes it hard for the judge to reach a decision that will withstand review on appeal.

2. Credibility. In other words, the report is believable, reliable, experienced, well prepared, sincere, and performed using peer-reviewed methods. The strengths and weaknesses of the good expert's valuation report should be self-evident, with clearly stated rationale for why areas or methods might have been ignored or omitted, for lack of data or lack of applicability. Though the lawyer's role is advocacy for a position, the role of the expert is the same as that of the judge—to arrive at the truth. Anything else will diminish the credibility of your expert.

3. Intellectual honesty. In case it wasn't clear from the above, your expert's opinion must be free of bias and advocacy, independently arrived at, and transparent. *What about sitting at the attorney table?* Are you passing notes with your expert during the opposing witnesses' testimony? Your expert may be offering guidance regarding what questions to ask the witness on cross-examination, but the practice can blur the line between independence and advocacy. "When I see that happening in the courtroom I put an end to it," Judge Laro said. The same caution applies when an attorney comments on drafts or otherwise assists in developing an expert's opinion. Allow your expert to be credible, ethical, and independent.

4. Complete. Rule 26 of the Federal Rules of Civil Procedure limits expert evidence to the content that is actually written or displayed in the report. Everything your expert says on the stand needs to be in their report.

5. Credentialed. This point speaks for itself.

Reconciling Compliance Valuations

Your client corporations have a new compliance challenge on their hands. Valuations for compliance purposes are becoming increasingly complex to navigate. FAS 123R, Share-based Payment, demands one kind of valuation of common stock, while FAS 142, Goodwill and Other Intangible Assets, requires quite a different enterprise valuation, most likely performed by a different appraiser. And the CFO hasn't even gotten to FAS 157, Fair Value Measurements, for valuing the company's preferred stock.

CFOs are often left with the problem of reconciling these disparate valuations so that they comply with all the financial reporting standards. A corporation can no longer settle for choosing the valuation that most suits its needs in that moment when communicating with auditors, management, and shareholders.

The appraiser who reconciles. This community of appraisal experts is working to find solutions to the inevitable collisions between differing valuations. Professional groups, such as the Appraisal Issues Task Force and the Fair Value Forum, are grappling with the question at every meeting. Ideally, any expert you engage to reconcile your client's disparate valuations will be an active participant in those discussions.