

# Daubert challenges to financial experts

*A yearly study of trends and outcomes*

2011

07

Exclusion success rate reaches six-year high

09

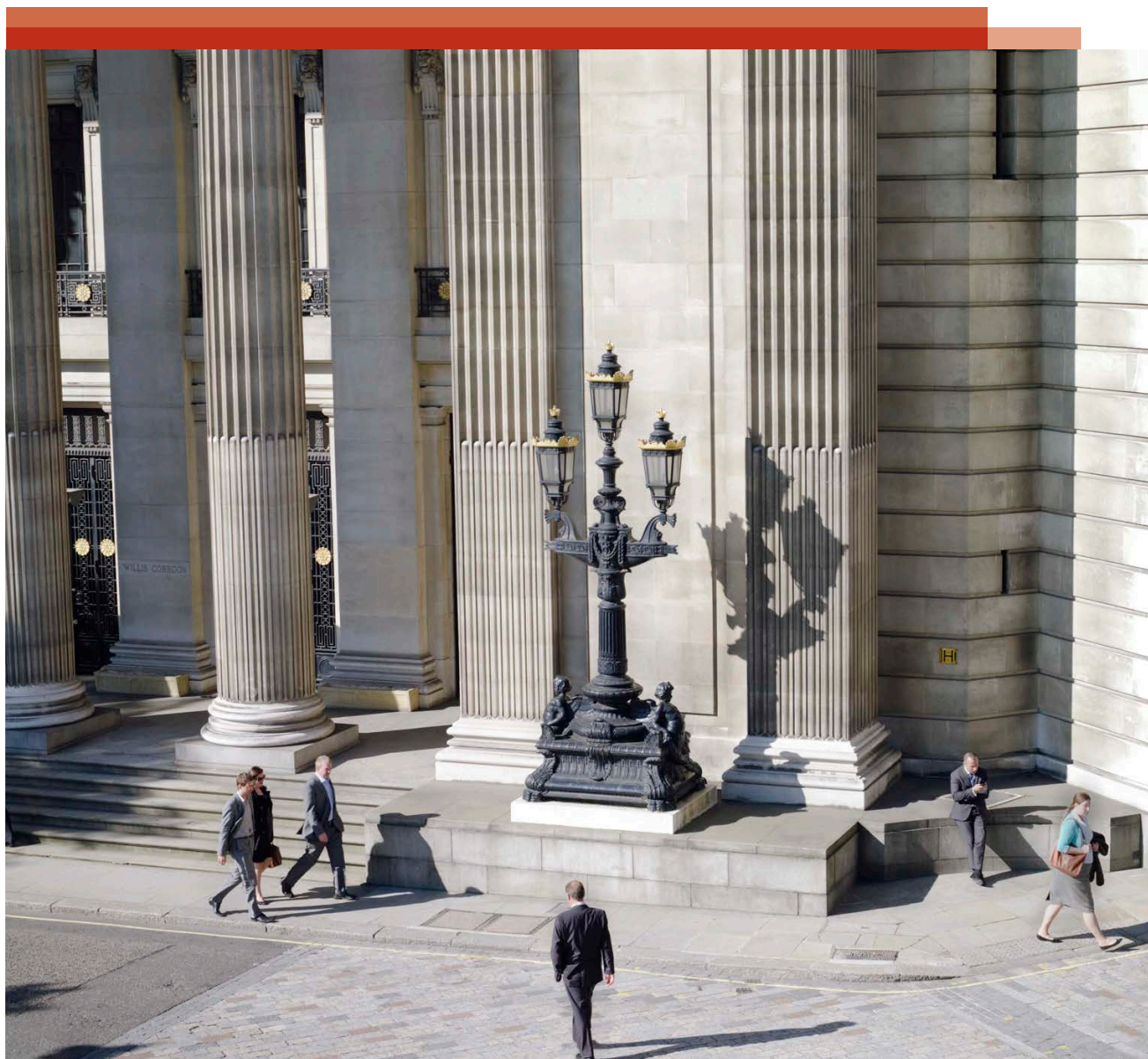
11th circuit has highest exclusion rate

11

Accountants and economists survive exclusion most often

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Lack of reliability is the top exclusion reason





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## ***Overview***

*Daubert* criteria apply to all types of expert testimony in federal cases, including financial expert witness testimony.

In 1993, the US Supreme Court's opinion in *Daubert v. Merrell Dow Pharmaceuticals Inc.* addressed the admissibility of expert scientific testimony in federal trials, affirming a gatekeeping role for judges in determining the reliability and relevance of the testimony.

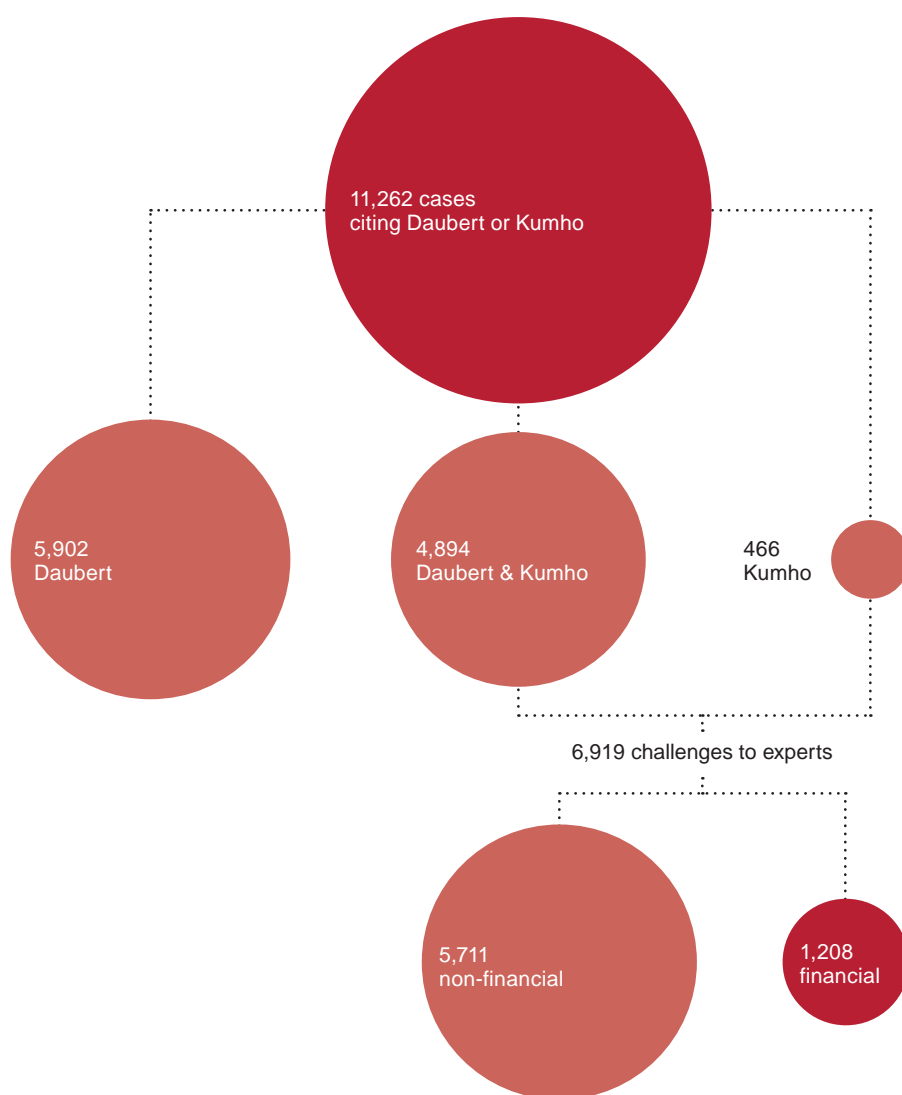
In 1999, the Supreme Court's decision in *Kumho Tire Co. v. Carmichael* clarified that the *Daubert* criteria were applicable to all types of expert testimony in federal jurisdictions, not merely testimony relating to science. Subsequently, many state courts also adopted the *Daubert* standard.

2011 marked the 12th anniversary of the *Kumho Tire* decision. This study analyzes post-*Kumho Tire* (2000–2011) challenges to financial expert witnesses under the *Daubert* standards. We identify observable trends in the frequency and outcome of these challenges based on written opinions in federal and state courts. Because the study is limited to written opinions, the related results should not be presumed to apply to all financial expert challenges, including those resolved by motion or those decisions that do not specifically reference *Kumho Tire*. The study examines these challenges to provide insight into why experts were challenged and excluded and to delve more analytically into the causes of exclusions based on the experts' qualifications and the relevance and reliability of the expert testimony. The study also summarizes some of the specific financial, statistical, economic, and valuation methods that courts have found inadmissible.

Our study of published court opinions has now classified 6,919 *Daubert* challenges to expert witnesses of all types in federal and state courts during 2000–2011. While our study is restricted to the 5,360 cases that

reference *Kumho Tire*, we note that 11,262 cases cite either *Daubert* or *Kumho Tire*. Of those cases, 5,902 cases cite only *Daubert*, 466 cases cite only *Kumho Tire*, and 4,894 cite both *Daubert* and *Kumho Tire* (see Figure 1).

**Figure 1: Cases citing *Daubert* and/or *Kumho Tire***

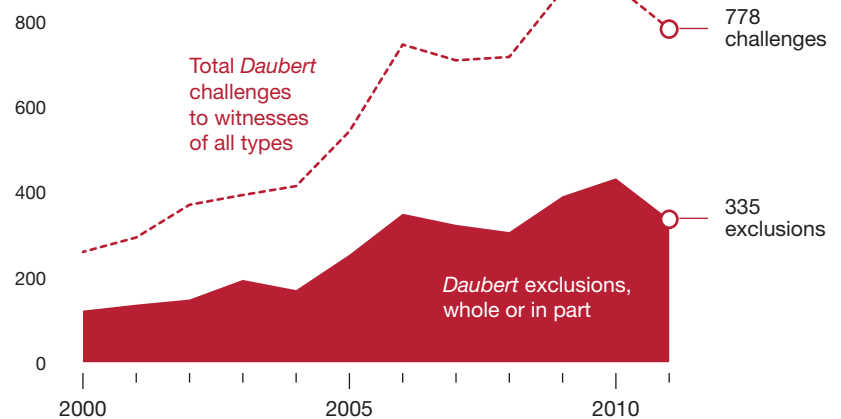


## 1. Number of challenges to all expert witnesses declines, but success rates remain steady.

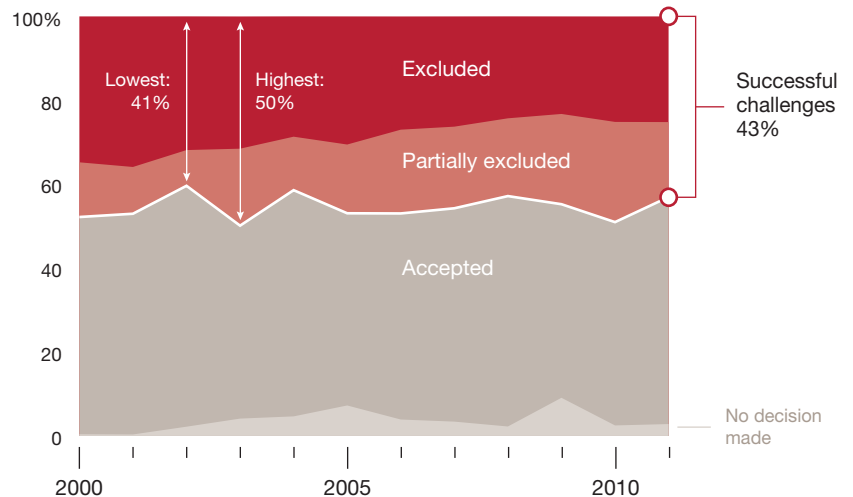
Since the *Kumho Tire* opinion in 1999, the number of challenges to expert witnesses of all types increased from 253 in 2000 to a record 879 in 2010, but decreased to 778 in 2011.<sup>1</sup> In 2011, 335 expert testimonies were excluded in whole or in part as the result of *Daubert* challenges — down from 431 in 2010 (see Figure 2).

Of all the expert testimony challenged during 2000–2011, 45% was excluded in whole or in part, and 50% was admitted.<sup>2</sup> The percentage of all experts excluded in whole or in part decreased to 43% in 2011, down from the 2010 and 2009 exclusion rates of 49% and 45%, respectively. The percentage of successful challenges has remained relatively consistent over the past 10 years, with the highest percentage (50%) in 2003 and the lowest (41%) in 2002 (see Figure 3).

**Figure 2: *Daubert* challenges and exclusions to expert witnesses of all types, 2000–2011**



**Figure 3: Outcome of *Daubert* challenges to expert witnesses of all types, 2000–2011**



<sup>1</sup> Expert witnesses of all types includes both financial and other non-financial experts. See “Methodology” section in back.

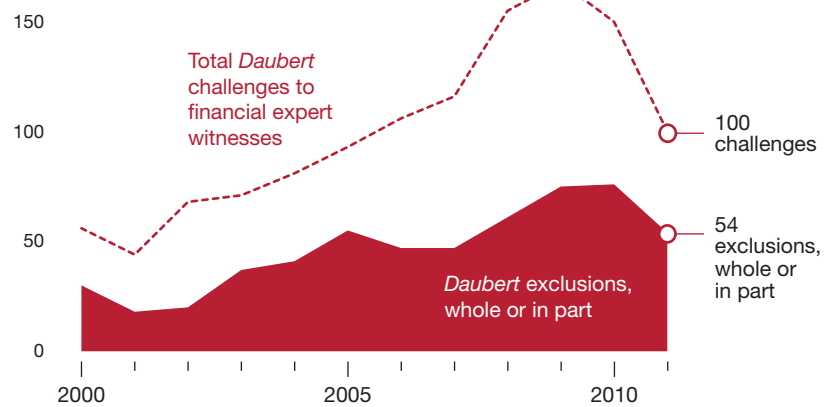
<sup>2</sup> Judges did not render a decision in 4 percent of the challenges reviewed. Because of rounding, totals may not equal 100 percent.

## 2. Number of challenges to financial expert witnesses falls to its lowest level in six years. The number of successful challenges also falls, but the rate of successful challenges increases to a six-year high.

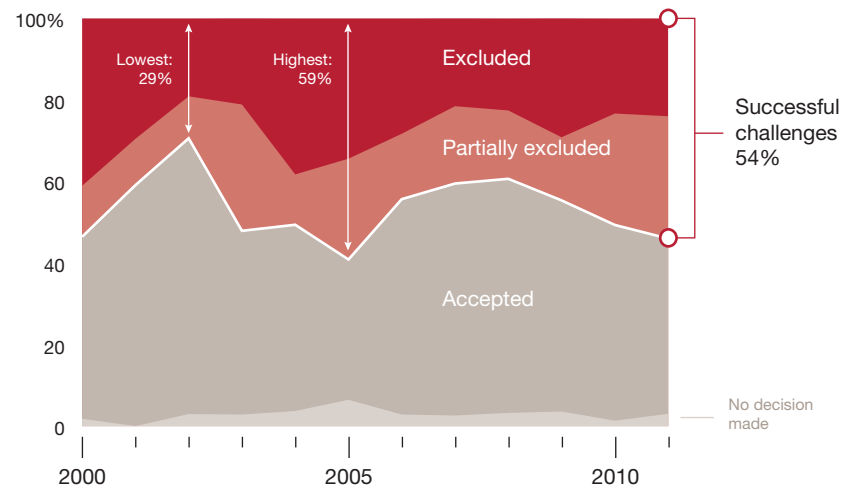
The remaining sections of this study, with the exception of Section 8, are devoted to challenges specifically to financial expert witnesses rather than all experts. Of the 6,919 *Daubert* challenges for 2000–2011 identified in our study, 1,208 were targeted to financial expert witnesses.

- The number of *Daubert* challenges to financial expert witnesses rose every year between 2001 and 2009. In 2010 and 2011, however, the number of financial experts challenged fell in consecutive years for the first time ever, with challenges falling 40% since the peak in 2009. In 2010 and 2011, the testimony of 76 and 54 financial experts, respectively, was excluded in whole or in part (see Figure 4).
- Of all the financial experts challenged during 2000–2011, 28% were completely excluded, 17% were partially excluded, and 52% were admitted. This breakdown is consistent with the outcome of challenges to experts of all types (see Figure 5 compared to Figure 3).<sup>3</sup>
- The percentage of successful challenges has varied widely over the past 12 years, with a low of 29% in 2002 and a high of 59% in 2005. In 2011, 54% of all challenges to financial experts were successful at excluding the expert’s testimony in whole or in part; this was above the 12-year average of 45% and the highest level since 2005 (see Figure 5).

**Figure 4: *Daubert* challenges and exclusions to financial expert witnesses, 2000–2011**



**Figure 5: Outcome of *Daubert* challenges to financial expert witnesses, 2000–2011**



<sup>3</sup> Judges did not render a decision in 3% of the challenges reviewed.



### 3. Three federal circuits (Second, Fifth, and Sixth) adjudicate nearly 40% of all Daubert challenges to financial expert witnesses.

The *Daubert* criteria are the standard of review for the admission of expert witness testimony in federal courts, and the First through Eleventh federal circuits opine on a supermajority of all *Daubert* challenges to financial expert witnesses. Some states have also adopted *Daubert* factors as their standard of review. We noted the following trends in the frequency and outcome of *Daubert* challenges to financial expert witnesses by jurisdiction:

- *Daubert* challenges to financial expert witnesses were concentrated in the Second, Third, Fifth, Sixth, Seventh, and Ninth Circuits, which heard approximately 66% of all challenges during 2000–2011. The Second Circuit alone accounted for 15% of the total challenges to financial experts (see Figure 6).
- In 2011, the Fifth, Sixth, Seventh, and Tenth Circuits each had more than 40% declines in the number of *Daubert* challenges to financial expert witnesses as compared to 2010 (see Figure 6).
- The success rate of challenges varied widely by jurisdiction. During 2000–2011, 62% and 63% of the financial expert witness testimony challenged under *Daubert* in the 10th and 11th Circuits, respectively, were excluded in whole or in part. This represented the highest success rate for exclusions among all federal circuits. In contrast, the Third Circuit excluded only 34% of the challenged financial expert witnesses, the lowest success rate among all circuits (see Figure 7).

**Figure 6: Number of *Daubert* challenges to financial expert witnesses, by year and jurisdiction, 2000–2011**

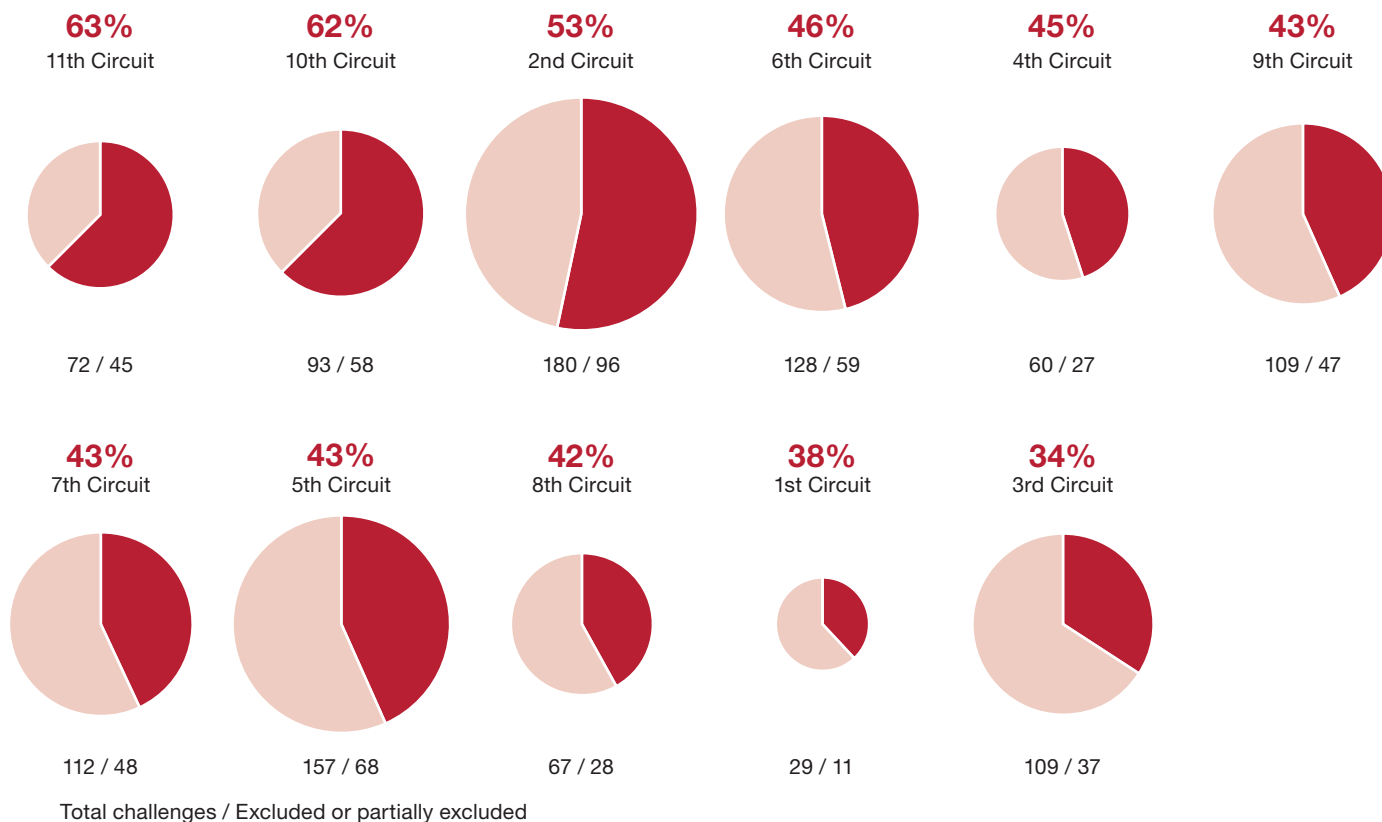
	2000	'01	'02	'03	'04	'05	'06	'07	'08	'09	'10	2011	Total 2000–2011	Percent
1st Circuit	2	2	2	3	4	3	1	2	5	3	2	0	29	2%
2nd Circuit	9	7	9	17	16	20	27	8	19	15	20	13	180	15%
3rd Circuit	2	4	4	4	10	7	19	13	22	13	4	7	109	9%
4th Circuit	3	3	4	3	2	6	3	11	3	7	9	6	60	5%
5th Circuit	8	2	8	5	5	10	4	21	33	26	23	12	157	13%
6th Circuit	1	3	12	11	7	3	6	13	17	17	24	14	128	11%
7th Circuit	7	5	13	3	6	15	8	14	2	24	11	4	112	9%
8th Circuit	4	3	5	8	8	4	5	8	2	6	8	6	67	6%
9th Circuit	1	2	2	4	5	7	7	7	15	17	23	19	109	9%
10th Circuit	5	5	0	1	7	3	13	13	16	16	9	5	93	8%
11th Circuit	5	2	1	0	2	5	10	4	11	17	5	10	72	6%
Other federal & state courts	9	6	8	12	9	10	3	2	10	7	12	4	92	8%
	56	44	68	71	81	93	106	116	155	168	150	100	1,208	100%

■ Highest number in each year



**Figure 7: Success rate of *Daubert* challenges to financial expert witnesses, by jurisdiction, 2000–2011**

Percentage of excluded or partially excluded



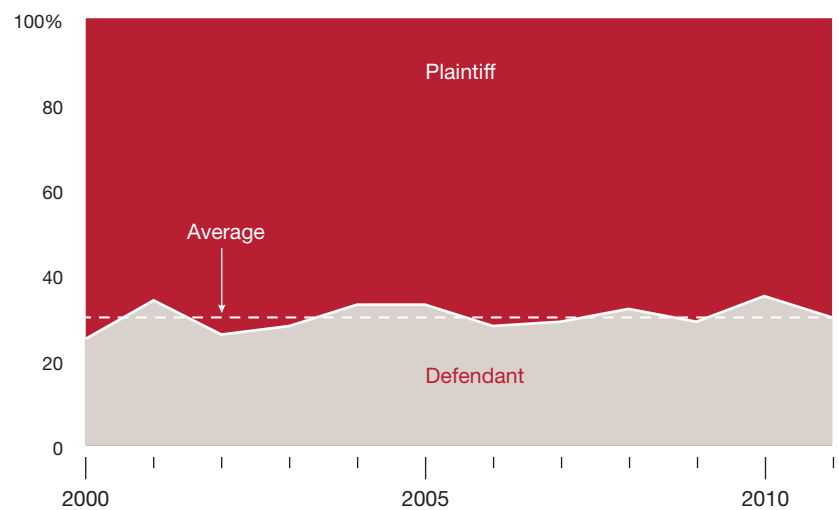
*During 2000–2011, success rates varied widely by jurisdiction. They were highest in the 10th and 11th Circuits (62% and 63%, respectively) and lowest in the 3rd Circuit (34%).*

#### ***4. Plaintiff financial expert witnesses are challenged more frequently, consistently two to three times as often as defense experts, but their exclusion rates have been lower than defense experts' in six of the last eight years.***

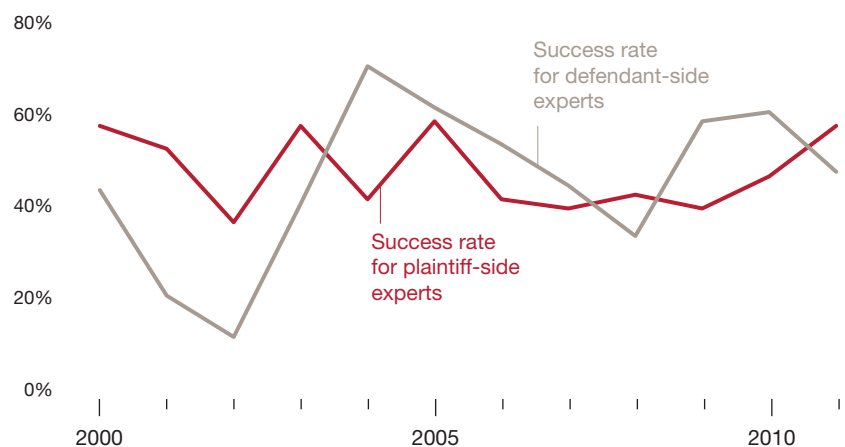
Being a plaintiff-side expert witness versus a defendant-side expert witness is correlated with a higher frequency of *Daubert* challenges. We noted the following trends:

- Plaintiff-side financial experts are consistently challenged much more frequently than defendant-side financial experts. Both in 2011 and for the period 2000-2011, 70% of all financial expert challenges targeted the plaintiff-side expert (see Figure 8).
- On an annual basis, the outcome of challenges varies greatly, with the success rate of challenges ranging from 36% to 58% for plaintiff-side financial experts and 11% to 70% for defendant-side financial experts (see Figure 9).
- For the four-year period of 2000–2003, challenges to plaintiff-side financial experts had a higher success rate than challenges to defendant-side financial experts. The reverse was true for six of the following eight years from 2004–2011. In 2011, 57% of plaintiff-side financial experts were completely or partially excluded from testifying once challenged, versus 47% of defendant-side financial experts (see Figure 9).
- Over the 12-year period, plaintiff-side financial experts have been excluded slightly less often than defendant-side financial experts. During 2000–2011, 46% of challenged plaintiff-side versus 48% of challenged defendant-side financial experts' testimony was either completely or partially excluded from testifying (see Figure 9).

**Figure 8: *Daubert* challenges to financial expert witnesses, plaintiff-side vs. defendant-side, 2000–2011**



**Figure 9: Success rate of *Daubert* challenges to expert witnesses of all types, plaintiff-side vs. defendant-side, 2000–2011**



## 5. Economists, accountants, and appraisers remain the top challenged financial expert witnesses, but economists and accountants are the most likely to survive a challenge while appraisers are the least likely to survive.

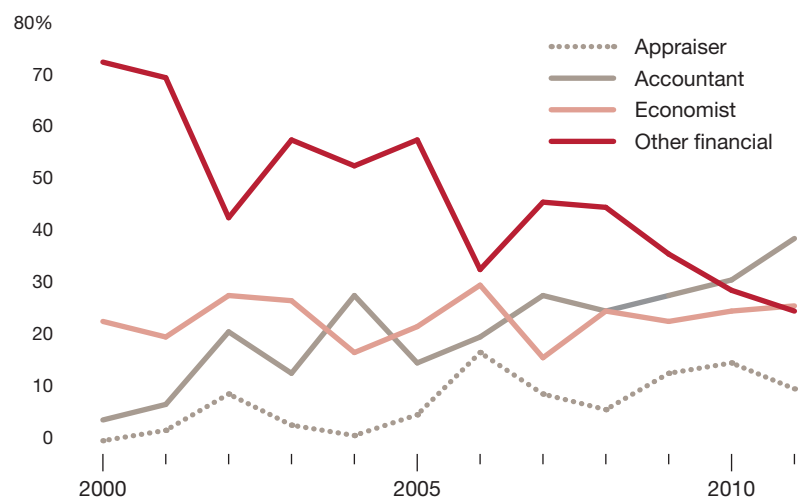
To examine whether certain types of financial expert witnesses were challenged or excluded more frequently than others, we grouped the challenges based on the type of financial experts targeted and observed the following:

Economists, accountants, and appraisers are the most frequently challenged financial expert witnesses, accounting for 24%, 24%, and 9% of all financial expert challenges, respectively, during 2000–2011 (see Figure 10). This trend is likely due to the fact that economists, accountants, and appraisers were engaged more frequently as financial expert witnesses.<sup>4</sup>

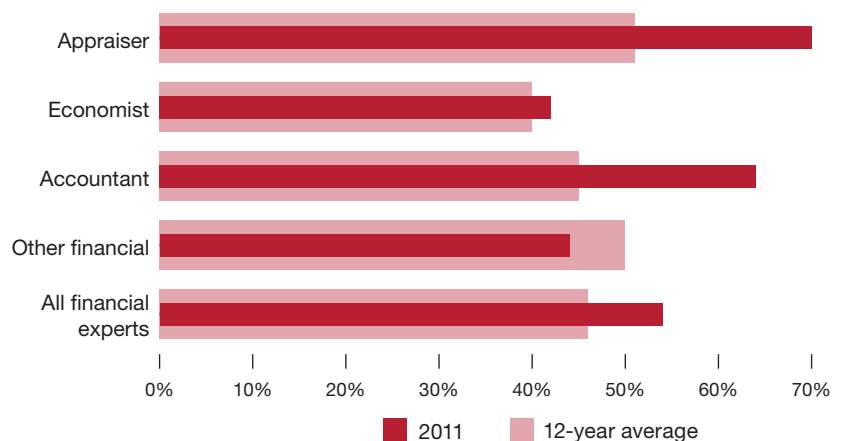
Although more frequently challenged, economists and accountants are more likely to survive a *Daubert* challenge than other financial expert witnesses. During 2000–2011, the success rate of challenges to other financial expert witnesses (50%) was higher than that of successful challenges to accountants (45%) and economists (40%). Over a 12-year period, appraisers were successfully challenged at a rate of 51% (see Figure 11).

Accountants and appraisers were excluded much more frequently in 2011 compared with their 12-year average. Specifically, accountants and appraisers saw their testimony excluded, in whole or in part, 64% and 70% of the time, respectively, in 2011. ‘Other financial experts’ was the only group to see a lower rate of successful challenges in 2011 when compared to its 12-year average (see Figure 11).

**Figure 10: *Daubert* challenges to financial expert witnesses by expert type, 2000–2011**



**Figure 11: Success rate of *Daubert* challenges to financial expert witnesses, by expert type, 2000–2011**



<sup>4</sup> Other financial expert witnesses include statisticians, financial analysts, finance professors, business consultants, etc.

<sup>5</sup> Figures include exclusions made in whole or in part.

6. Case type affects the frequency and outcome of Daubert challenges to financial expert witnesses.

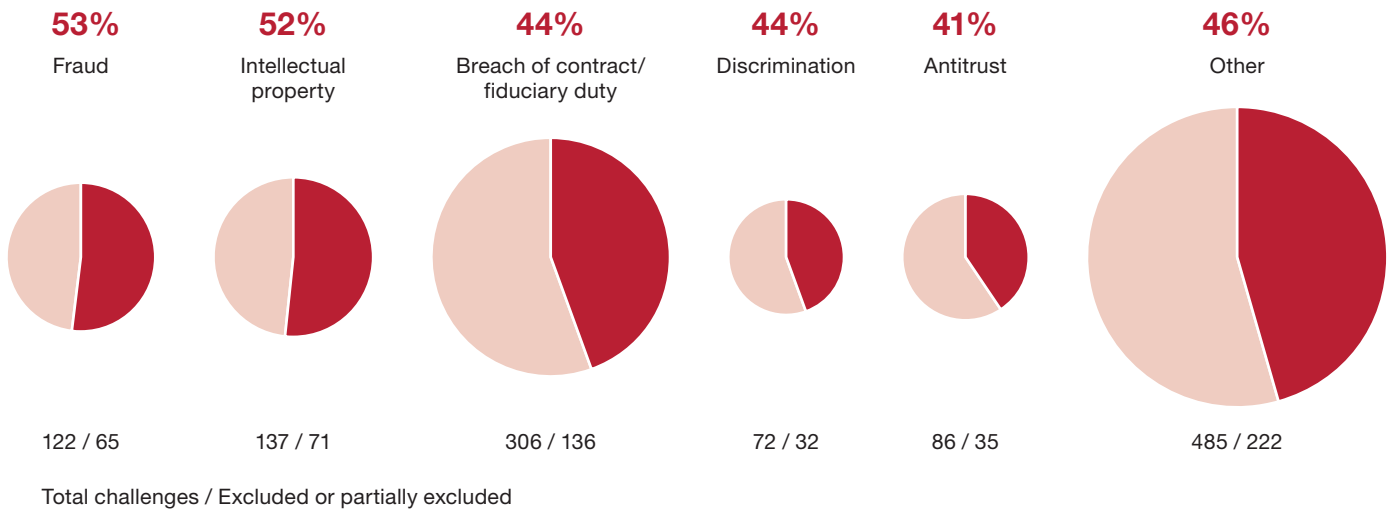
Financial experts assist in a wide range of disputes. However, certain types of disputes are more likely to result in *Daubert* challenges than others.

- During 2000–2011, challenges to financial expert witnesses occurred most frequently in disputes involving a breach of contract or fiduciary duty (see Figure 12).

- During 2000–2011, once challenged, financial expert witnesses experienced higher rates of exclusion in matters involving fraud or intellectual property as compared to disputes involving a breach of contract or fiduciary duty, antitrust, or discrimination (see Figure 12).

Figure 12: *Daubert* challenges to financial expert witnesses, by case type (2000–2011)<sup>6</sup>

Percentage of excluded or partially excluded



<sup>6</sup> Figures include exclusions made in whole or in part. Percentages for excluded or partially excluded witnesses represent success rates for each case type. 'Intellectual property' includes cases involving infringement of patent, copyright, trademark, trade dress, and trade secrets. 'Other' includes case types of asbestos claims, bankruptcy, civil rights, criminal proceedings, insurance claims, medical malpractice, personal injury, product liability, real estate, securities litigation, and wrongful death.

## 7. For the 12th consecutive year, lack of reliability is the top reason financial experts are excluded.

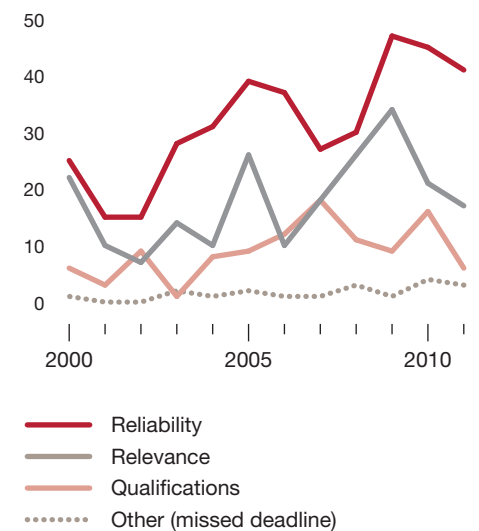
Federal Rule 702 of the Federal Rules of Evidence, “Testimony by Experts,” focuses on the qualifications of the expert and the relevance and reliability of the expert testimony. We analyzed the reasons financial expert testimony was excluded in whole or in part using Rule 702. Our analysis shows that:

- In each year from 2000–2011, lack of reliability was the leading cause that a financial expert opinion was excluded in whole or in part, followed by lack of relevance, then lack of qualifications. During the past 12 years, of the 561 *Daubert* challenges that resulted in full or partial exclusion of financial expert testimony, lack of reliability was a cause in 380 instances (68%), lack of relevance in 215 instances (38%), and lack of qualifications in 108 instances (19%) (see Figure 13, 14 and 15).
- In 2011 alone, lack of reliability was a cause in 76% of the exclusions of financial expert testimony (see Figure 15).
- When a financial expert is excluded for lack of reliability, it’s most frequently caused by a lack of valid data. Particularly, there is more often a problem with the quality of

the data (218 of the 380 instances) available to the financial expert or how the data is reflected in the analytical framework of the financial expert rather than the misuse of an otherwise acceptable methodology (see Figure 14).

- A significant number of exclusions are also related to the relevance of the financial expert testimony. When the expert is addressing a topic requested by counsel, this type of exclusion speaks more to the suitability of the task assignment from counsel rather than the poor execution by the financial expert. Typically relevance is cited with other factors; it’s rare that a financial expert is successfully challenged on the basis of relevance alone.
- Financial expert testimony is often excluded because of a failure to meet multiple *Daubert* criteria. Over the past 12 years, of the 561 challenges in which expert testimony was excluded in whole or in part, 157 exclusions (28%) resulted from failure to meet two or more criteria. Of these, the most common combination was lack of relevance and reliability, which accounted for 85 exclusions in whole or in part (15%) (see Figure 14 and Figure 15).

Figure 13: Exclusion reasons history



**Figure 14: Number of exclusions of financial expert testimony, by exclusion reason (2000–2011)<sup>7</sup>**

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total
Total partially or fully excluded financial experts	30	18	20	37	41	55	47	47	61	75	76	54	<b>561</b>
<b>Breakdown by exclusion reason</b>													
Reliability	25	15	15	28	31	39	37	27	30	47	45	41	<b>380</b>
Relevance	22	10	7	14	10	26	10	18	26	34	21	17	<b>215</b>
Qualifications	6	3	9	1	8	9	12	18	11	9	16	6	<b>108</b>
Other (missed deadline)	1			2	1	2	1	1	3	1	4	3	<b>19</b>
<b>Further breakdown of reliability</b>													
<b>Facts/data</b>	Quantity	17	8	13	7	3	3	2	1				<b>54</b>
	Validity	16	12	14	20	15	31	31	16	15	25	10	<b>218</b>
<b>Methods/principles</b>	Testability	14	7	4	8	8	6	5	8	5	3	1	<b>71</b>
	Peer review	10	6	8	2		3	4	2	4	4	2	<b>46</b>
	Rate of error	8	6	5	14	9	3	3	1	2	1	1	<b>54</b>
	General acceptance	10	9	8	7	17	10	13	17	12	10	1	<b>120</b>
<b>Further breakdown of qualifications</b>													
Education	6	1	4	1	5	3	5	4	1	1		1	<b>32</b>
Knowledge	5	2	7	1	4	5	7	8	6	4	4	2	<b>55</b>
Skill	5	2	6	1	2	1	3	1			1		<b>22</b>
Training	3	2	6		2	3	2	2	2	2		1	<b>25</b>
Experience	5	3	9	1	6	6	8	14	3	4	3	2	<b>64</b>
<b>Breakdown of exclusions resulting from failure to meet two or more criteria</b>													
Reliability and relevance	12	6	2	8	1	11	3	3	7	15	8	9	<b>85</b>
Qualifications and reliability	2	2	4		6	4	3	4	4	4	6	1	<b>40</b>
Qualifications, reliability & relevance	4		3		1	2	3	3	1			2	<b>19</b>
Qualifications & relevance						2	1	3			1		<b>7</b>
Missed deadline, relevance & reliability	1												<b>1</b>
Missed deadline & reliability								1		1		1	<b>3</b>
Missed deadline & qualifications				1					1				<b>2</b>
Missed deadline, reliability & qualifications													
Total exclusions resulting from failure to meet two or more criteria	19	8	9	9	8	19	10	14	13	20	15	13	<b>157</b>

<sup>7</sup> The exclusion reasons are not mutually exclusive. An expert's testimony may have been excluded for more than one reason. Figures include exclusions made in whole or in part.

**Figure 15: Percentage of exclusions of financial expert testimony, by exclusion reason (2000–2011)<sup>8</sup>**

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Avg.
Total partially or fully excluded financial experts	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
<b>Breakdown by exclusion reason</b>													
Reliability	83%	83%	75%	76%	76%	71%	79%	57%	49%	63%	59%	76%	68%
Relevance	73%	56%	35%	38%	24%	47%	21%	38%	43%	45%	28%	31%	38%
Qualifications	20%	17%	45%	3%	20%	16%	26%	38%	18%	12%	21%	11%	19%
Other (missed deadline)	3%	0%	0%	5%	2%	4%	2%	2%	5%	1%	5%	6%	3%
<b>Further breakdown of reliability</b>													
<b>Facts/data</b>	Quantity	57%	44%	65%	19%	7%	5%	4%	0%	2%	0%	0%	10%
	Validity	53%	67%	70%	54%	37%	56%	66%	34%	25%	33%	13%	39%
<b>Methods/ principles</b>	Testability	47%	39%	20%	22%	20%	11%	11%	17%	8%	4%	1%	13%
	Peer review	33%	33%	40%	5%	0%	5%	9%	4%	7%	5%	3%	8%
	Rate of error	27%	33%	25%	38%	22%	5%	6%	2%	3%	1%	1%	10%
	General acceptance	33%	50%	40%	19%	41%	18%	28%	36%	20%	13%	1%	21%
<b>Further breakdown of qualifications</b>													
Education	20%	6%	20%	3%	12%	5%	11%	9%	2%	1%	0%	2%	6%
Knowledge	17%	11%	35%	3%	10%	9%	15%	17%	10%	5%	5%	4%	10%
Skill	17%	11%	30%	3%	5%	2%	6%	2%	0%	0%	1%	0%	4%
Training	10%	11%	30%	0%	5%	5%	4%	4%	3%	3%	0%	2%	4%
Experience	17%	17%	45%	3%	15%	11%	17%	30%	5%	5%	4%	4%	11%
<b>Breakdown of exclusions resulting from failure to meet two or more criteria</b>													
Reliability and relevance	40%	33%	10%	22%	2%	20%	6%	6%	11%	20%	11%	17%	15%
Qualifications and reliability	7%	11%	20%	0%	15%	7%	6%	9%	7%	5%	8%	2%	7%
Qualifications, reliability & relevance	13%	0%	15%	0%	2%	4%	6%	6%	2%	0%	0%	4%	3%
Qualifications & relevance	0%	0%	0%	0%	0%	4%	2%	6%	0%	0%	1%	0%	1%
Missed deadline, relevance & reliability	3%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Missed deadline & reliability	0%	0%	0%	0%	0%	0%	0%	2%	0%	1%	0%	2%	1%
Missed deadline & qualifications	0%	0%	0%	3%	0%	0%	0%	0%	2%	0%	0%	0%	0%
Missed deadline, reliability & qualifications													
Total exclusions resulting from failure to meet two or more criteria	63%	44%	45%	24%	20%	35%	21%	30%	21%	27%	20%	24%	28%

<sup>8</sup> The exclusion reasons are not mutually exclusive. An expert's testimony may have been excluded for more than one reason. Figures include exclusions made in whole or in part.



8. Of the 68 Daubert challenges they considered in 2011, appellate courts overturned the lower courts’ rulings in part or in whole for 10 experts.

While we have always included federal and state appellate court rulings in our study, we examined the rate of reversal of *Daubert* rulings<sup>9</sup> as to financial and non-financial experts for the first time in 2011.

- In 2011, appellate courts considered 68 *Daubert* challenges to financial and nonfinancial experts. Of those 68 challenges, the lower court had excluded in part or in whole the testimony of 37 experts, had accepted the testimony of 29 experts, and had not considered testimony under *Daubert* criteria for two experts (see Figure 16).
- Of the 68 *Daubert* challenges considered by appellate courts in 2011, the appellate court affirmed the lower court’s ruling for 58 experts and overturned the lower court’s ruling for 10 experts (see Figure 16).
- The 6th Circuit and 11th Circuit appellate courts heard the most appeals regarding *Daubert* challenges with nine and seven financial and non-financial experts, respectively (see Figure 17).
- For the 68 experts considered on appeal, appellate courts heard cases for six financial experts and 62 non-financial experts. Of the six financial experts, appellate courts affirmed the lower courts’ rulings for four financial experts and overturned the rulings for two financial experts.

Figure 16: *Daubert* challenges to financial and non-financial expert witnesses in appellate courts in 2011, by whether the appellate courts agreed or disagreed with lower court ruling

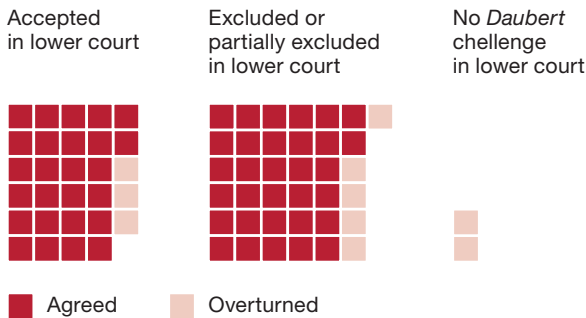
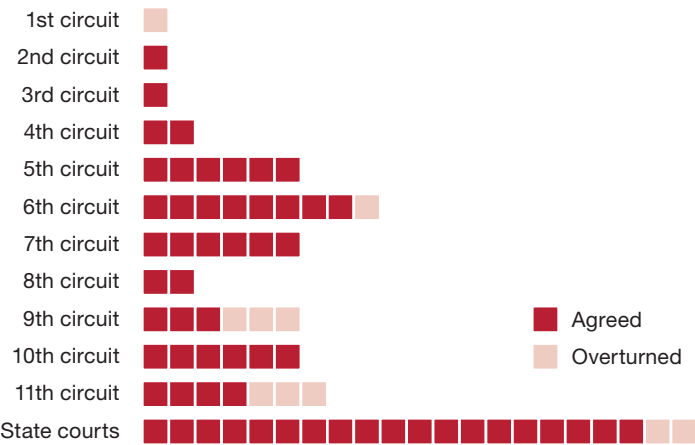


Figure 17: *Daubert* challenges to financial and non-financial expert witnesses in appellate courts in 2011, by federal and state jurisdictions



9 In written opinions referencing *Kumho Tire* in 2011.

## **Overtured cases in 2011**

When overturning the lower courts' rulings, the appellate courts allowed four experts to testify at trial, excluded the testimony of one expert, and remanded the case for the trial court to apply or reapply the *Daubert* standards for five experts.

### *Experts allowed by appellate courts:*

- In *Milward v. Acuity Specialty Products Group, Inc.*, the appellate court overturned the district court's ruling and allowed the expert to testify at trial. The appellate court ruled that the district court exceeded the scope of its discretion in placing "undue weight on the lack of general acceptance" of the expert's testimony and crossing the "boundary between gatekeeper and trier of fact" (2011 WL 982385).
- In *Rosenfeld v. Oceania Cruises, Inc.*, the appellate court ruled that the lower court erred in excluding the expert's testimony because the lower court believed the testimony would be unhelpful to a jury. The appellate court found that the expert's testimony would be relevant to a jury's decision and ordered a new trial in which the expert's testimony would be admitted (2011 WL 3903172).
- In *Robertson v. Doug Ashy Building Materials, Inc.*, the appellate court ruled that the trial court's decision to exclude the plaintiff's expert was in legal error, as the defendant did not prove that the expert's report was unreliable and the trial court failed to perform the required analysis of the *Daubert* standards (2011 WL 4572067).
- In *Wells v. Illinois Central Railroad Company*, the appellate court overturned the trial court's exclusion of one expert, arguing that the expert's testimony had "expressed sufficient factual knowledge to opine" on the plaintiff's work activities. In the same case, the appellate court also affirmed the exclusion of another expert because the plaintiff failed to provide the appellate court with relevant testimony that was necessary for a proper review of the trial court's decision (2011 WL 6777921).

### *Expert excluded by appellate court*

- In *Uniloc USA, Inc. v. Microsoft Corp.*, the appellate court ruled that the district court erred by including the expert's testimony, as the testimony was based on an "arbitrary, general rule" that was "unrelated to the facts of the case" (2011 WL 9738).

*Appellate courts remanded case and ordered lower court to apply or reapply Daubert standards*

- In *Ellis v. Costco Wholesale Corp.*, the appellate court vacated and remanded the district court's ruling to allow three experts' testimony at the class certification stage. The appellate court ruled that the district court failed to apply the "rigorous analysis" required to assess commonality at the class certification stage (2011 WL 4336668).
- In *An v. Active Pest Control South, Inc.*, the trial court did not perform a *Daubert* analysis to determine the admissibility of two of the plaintiff's experts before granting summary judgment to the defendant. The appellate court vacated the lower court's judgment and remanded the case to the trial court to reconsider the experts using *Daubert* standards (2011 WL 5529847).

## **9. Exclusions more commonly result from the misuse of accepted methodologies than from the introduction of unusual or untested analytical methods.**

Our study reveals that methodological flaws caused by the misuse of accepted financial or economic methods are a more frequent cause of financial expert exclusion than the use of novel or untested methodology. We have summarized illustrative recent cases where one or more courts found fault with the approach taken under the *Daubert* standard of reliability, as follows.

### **Illustrative recent cases**

#### **Failure of plaintiffs in class action case to establish commonality at the class certification stage.**

In *Wal-Mart Stores, Inc. v. Dukes*, the Supreme Court of the United States ruled that the plaintiffs' case failed the test of commonality required in class action cases. The plaintiffs' case included a statistical expert who used a regression analysis showing "statistically significant disparities between men and women at Wal-Mart in terms of compensation and promotions" and another statistical expert who used a benchmarking study showing that Wal-Mart "promotes a lower

percentage of women than its competitors." Despite support for the expert's findings by statistical and other anecdotal evidence, the Supreme Court held that the plaintiffs' case failed to demonstrate that the cause of the disparities evidenced was the result of common Wal-Mart institutional practices so as to constitute a class action. The Supreme Court's decision is widely understood to endorse greater scrutiny of experts at the class certification stage.<sup>10</sup> (*Wal-Mart Stores, Inc. v. Dukes*, 131 S.Ct. 2541)

#### **Failure to use the income-capitalization approach to calculate the present value of future cash flows.**

In a condemnation action, the plaintiff moved to exclude the expert's testimony regarding the present value of future cash flows derived from an intangible asset. The expert computed the present value as the difference between the revenue earned as if the plaintiff were allowed to charge monopoly prices and the revenue received if the plaintiff had to charge lower rates. According to the court, the expert failed to implement the income-capitalization approach, under

***During 2000–2011, methodological flaws more often than novel approaches resulted in the inadmissibility of expert testimony.***

<sup>10</sup> The appellate court ruling in *Wal-Mart Stores, Inc. v. Dukes* was included in our study *Daubert* challenges in 2010. We have included the US Supreme Court ruling in our summary of illustrative cases because of the ruling's impact on expert testimony at the class certification stage. Although not counted in our 2011 study, on January 13, 2012, the Seventh Circuit appellate court also endorsed greater scrutiny of expert testimony at the class certification stage. The Seventh Circuit appellate court held that the district court failed to make a necessary *Daubert* ruling at the class certification stage. During the class certification stage, the district court declined to make a *Daubert* ruling regarding the defendant's expert report, finding that the plaintiffs had ample opportunity to respond and the court had given the report "the weight it believes it is due." The appellate court rejected the district court's argument, stating that a *Daubert* ruling is required at the class certification stage unless the court believes the expert report is "not relevant to the predominance inquiry" (*Messner v. Northshore University HealthSystem*, 2012 WL 129991).

which “the anticipated net income which the property is expected to generate over its usable life is capitalized and processed to indicate the capital investment which produces the net income.” The court held that the expert’s testimony should be excluded because it was based upon “subjective beliefs or unsupported speculation.” (*Dedaux Utility Company, Inc. v. The City of Gulfport, Mississippi*, 2011 WL 1314049)

#### **Failure to reference a recognized authority when valuing an intangible asset.**

In the same condemnation action cited in the previous example, the defendant moved to exclude the expert’s testimony regarding the present value of future “contributions in aid of construction,” which is also defined as “donated property.” The expert’s testimony on future contributions in aid of construction was based on professional judgment. The court held that the expert’s testimony was inadmissible because it did not “reference a recognized authority,” and it was “too speculative to constitute a valid consideration in intangible-asset valuation.” (*Dedaux Utility Company, Inc. v. The City of Gulfport, Mississippi*, 2011 WL 1314049)

#### **Failure of expert witness to sufficiently validate inputs in damages calculation.**

In a tortious interference and breach of contract case, the plaintiff filed an appeal against the district court’s decision to exclude its expert witness. The district court stated that the plaintiff’s expert witness had little to no familiarity with how the damages presented in his expert report were calculated as they were provided to him by the plaintiff and the expert did not undertake an analysis or perform due diligence to verify the calculations. The district court determined that the expert’s opinion was not based on “sufficient facts and data” and, thus, could not be considered reliable. The appellate court affirmed the district court’s decision to exclude. (*Auto Industries Supplier Employee Stock Ownership Plan v. Ford Motor Company*, 2011 WL 2610584)

#### **Lack of acceptance of damage assessment methodology.**

In a class action fraud case, the plaintiff’s expert witness, a forensic accountant with long-standing experience, calculated damages using the “benefit-of-the-bargain” method, where the damages were calculated as the difference between what the plaintiff actually received and what the plaintiff was fraudulently led to believe he would receive. According to California law, the appropriate methodology for

assessing damages in fraud cases is the “out-of-pocket” loss rule. Therefore, the court determined that the expert’s testimony was not “the product of reliable principles and methods” because the method is precluded by law. (*Ralston v. Mortgage Investors Group, Inc.*, 2011 WL 6002640)

#### **Lack of reliability in a comparables model.**

In a case involving breach of contract relating to the development of video games, the plaintiff’s expert witness, a certified public accountant and chartered financial analyst, calculated the plaintiff’s alleged damages using two models. The court excluded the damage calculation under the comparables method because it determined that the expert’s process for determining comparable video games revealed “a series of ad hoc decisions based on subjective considerations, rather than identifiable (or principled) criteria.” Regarding the unjust enrichment model, the court found that the model “rested on an unfounded assumption” and, where the expert witness substituted alternative figures into an audit report that was relied upon, “provided no factual support for the alternative figures he used.” Therefore, the expert witness’s testimony was ruled unreliable and excluded. (*Silicon Knights, Inc. v. Epic Games, Inc.*, 2011 WL 6748518)

**Failure to apply realistic or objective assumptions in valuations.**

In a charitable contribution deduction case related to conservation easement, the judge excluded the expert testimonies of the petitioner regarding the value of property. The experts provided the highest and best use valuation of the property prior to the easement, but not after. Also, the experts did not make any adjustments to their calculations after admitting factual errors. The court held that the experts' appraisals "fail to apply realistic or objective assumptions," and it reasoned that the calculations were not conducted using reliable methods. (*Boltar, LLC v. Commissioner of Internal Revenue*, 2011 WL 1314445)

**Failure to take into account market factors and previous year's financial statements to value property.**

In a debtor action against a creditor, the court found the creditor's expert to be less reliable than the debtor's expert in valuing a poultry farm, which was used as collateral. Thus, the debtor's expert's opinion was assigned more weight in the decision. The creditor's expert failed to take into consideration the economic recession when using the sales comparison approach to value the real estate, resulting in an inflated

number. Under the income approach, the creditor's expert included the value of the farmer's house and land per acre based on the assumption that the house could be rented and the acreage used. However, the court agreed with the debtor's expert that these should not be included because the farmer would live in the house and the land would bring in little income from hay production. Therefore, the court reasoned that the creditor's expert was not as reliable and gave his calculations less weight when reaching a decision. (*In re Mark Hudson, and Rachel Scarlett Hudson*, 2011 WL 1004630)

**Improper calculation of royalty rates.**

In a patent infringement action, the defendant moved to exclude the expert's testimony regarding the plaintiff's royalty calculations. The expert based the royalty calculation upon two settlement agreements that were not similar to this particular patent. In addition, the expert calculated the royalty rate and then increased it without offering an explanation. The court excluded the expert's testimony because the calculations were speculative. The court reasoned that the expert's opinions were not "based in sound economic precepts" and that the proposed royalty rate could not be explained to the jury. (*ePlus, Inc. v. Lawson Software, Inc.* 2011 WL 250671)

**Failure to provide reliable basis in calculation of reasonable royalty.**

In a misappropriation of trade secrets and breach of contract case, the plaintiff's expert witness, a certified public accountant who is also certified in financial forensics, created his royalty analysis according to the guidelines set forth in *Georgia-Pacific Corp. v. United States Plywood Corp.* These guidelines outline a 15-point process in developing a "reasonable" royalty analysis. One of the factors requires identifying a date at which "the misappropriation began." The date identified by the expert was designated as arbitrary and without any factual basis, and the testimony was excluded. (*De Lage Landen Operational Services, LLC v. Third Pillar Systems, LLC* 2011 WL 1771044)

## **Illustrative 2000–2010 cases**

### **Arbitrary and unreliable method for calculating royalty rates.**

In an intellectual property dispute, the plaintiff's expert witness used the 25 percent rule of thumb to calculate an estimate of the damages to be awarded based off the royalty fees that would have been expected from a negotiation. Despite the fact that the 25 percent rule was a commonly referenced rule of thumb originally based on examination of years of licensing and profit data across multiple companies and industries, the court found in a well-publicized decision that the rule of thumb was fundamentally flawed because it was too abstract and had no relation to the specific facts of the case. The expert was unable to support his use of the 25 percent royalty rate beyond stating that it was a generally accepted practice. The court ruled that the expert's "starting point of a 25 percent royalty had no relation to the facts of the case and as such, was arbitrary, unreliable, and irrelevant." (*Uniloc v. Microsoft*, 2011, Case No. 03-CV-0440)<sup>11</sup>

### **Inappropriate selection of growth rate to calculate business-interruption loss.**

In the calculation of business-interruption losses for a 14-month period, the plaintiff's expert, a forensic accountant, failed to conduct an economic analysis in determining the appropriate growth rate to calculate projected revenues. The expert used a growth rate based on a five-month period, during which new management was in place, assuming that the growth rate under new management would have continued throughout the interruption period. The Eastern District Court of Wisconsin determined that the expert failed to consider various economic factors that could have impacted the revenue growth rate and hence deemed the testimony unreliable. (*Manpower Inc. v. Insurance Co. of Pennsylvania*, 2010 WL 3730968)

### **Failure to consider other relevant data in a statistical analysis.**

In a case of discriminatory employment practices based on gender and pregnancy, a labor economist analyzed the impact of gender and maternity leave on compensation. The expert performed a statistical analysis of historical data to determine whether gender and/or maternity leave played a role in the defendant's pay decisions.

However, the expert failed to consider other employees who have taken a substantial amount of leave; hence, his testimony could not assist the trier of fact in understanding the unique impact of gender and pregnancy and was therefore deemed inadmissible. (*E.E.O.C. v. Bloomberg L.P.*, 2010 WL 3466370)

### **Insufficient supporting market data in calculating infringement damages.**

In calculating damages and profits related to copyright infringement, the defendant's expert failed to support his calculation with sufficient historical data or prove that it was based on his experience. The court ruled that the damage amount calculated by the expert included numbers that "have no basis in fact or his experience" and that the testimony should be partially excluded due to absence of "concrete support for such estimates." (*Dalen Products, Inc. v. Harbor Freight Tools, USA*, 2010 WL 3083543)

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11 As the court opinion was issued in 2011, this case was not counted in the survey results elsewhere in this report.



**Unreliable methodology for calculating trading volume and determination of an efficient market.**

In a securities fraud class action, the plaintiff's expert witness calculated trading volume of public shares using the average trading volume over a five-year period, rather than calculating the average daily trading volume for various months or various years within the relevant class period. Furthermore, the expert understated the volatility of the stock by excluding 117 event dates in her calculations, which led to the skewed determination of an efficient market. The District Court of Illinois ruled to exclude the expert's testimony based on these unreliable methodologies. (*In re Northfield Laboratories, Inc., Securities Litigation*, 2010 WL 2011945)

**Testimony irrelevant to the case facts.**

In a case of breach of contract, the defendant's expert's testimony about the appraised or market value of leases was deemed irrelevant because it "does not 'fit' the particular facts of the case." The appraiser's testimony, although based on an acceptable methodology to appraise the market value of leases, was not relevant to the inquiry "as it does not address whether the fact allegedly concealed affected the value of the property to the reasonably prudent buyer." (*Lafarge North America, Inc. v. Discovery Group LLC*, 2010 WL 3025120)

**Insufficient evidence for calculation of damages.**

In a case of copyright infringement, the plaintiff's expert, a certified public accountant, sought to calculate the estimated gross revenues and net profit realized from the alleged copyright infringement. The expert witness based his damage assessment on a "long string of assumptions" regarding the lost profits and lacked proper evidence to support his assertion. The assumptions included what the terms of contracts would be and the amount of profits that would be realized, among other assumptions. The District Court of Texas found the expert's opinion concerning actual damages to be too speculative and therefore unreliable. (*Baisden v. I'm Ready Productions Inc.*, 2010 1855963)

**Lack of detail and supporting data.**

In a case for breach of contract, the plaintiff's expert aimed to calculate the premium paid by the plaintiff for a product based on one of the characteristics of the product. However, the expert did not review and rely on all the relevant information in pleadings or testimony to calculate the premium. The court found that the expert's testimony was based on, "at most, a cursory review of the underlying record in this action. His report shows that [the

expert] reviewed the complaints, but no other pleadings or testimony. He did not read the plaintiffs' depositions." Therefore, the court deemed the expert's testimony to be unreliable. (*Weiner v. Snapple Beverage Corp.*, 2010 WL 3119452)

**Failure to include variables in calculation of damages.**

In a case of copyright infringement, the plaintiff's expert's calculation of lost revenues failed to account for all of the reasons contributing to the defendant's gross revenues. Instead, the expert assumed that all of the revenues were derived solely from the alleged infringement. Furthermore, the court believed that the expert's testimony should have included a comparison of projected revenues and the realized revenues. Due to the lack of "non-speculative evidence," the court deemed the expert's testimony unreliable. (*Interplan Architects, Inc. v. C.L. Thomas, Inc.*, 2010 WL 4065465)

**Incomplete statistical analysis.**

In a litigation case, an expert was retained to provide a statistical comparison of the incidence rates and high levels of calcium in patients treated with two Vitamin D analogs. The statistician's testimony was deemed incomplete by the Seventh Circuit Court because, although the expert used a methodology that is acceptable in his industry, the expert



presented an incomplete analysis because he failed to gather patient level data, interview the clinician, and conduct a sensitivity analysis. The court determined that the expert did not meet the “standards of intellectual rigor that are demanded in their professional work.” (*Bone Care Intern. LLC v. Pentech Pharmaceuticals, Inc.*, 2010 WL 3928598)

#### **Improper and unreliable statistical analysis and survey.**

In an employment discrimination case, the defendant’s expert performed a sub-store (micro level) analysis of the company’s facilities. The expert’s survey of store managers was concluded to be biased based on its methodology and therefore “not the type of evidence that would be ‘reasonably relied upon by experts.’” The court determined the defendant’s expert analysis to be both insufficient and unreliable, and dismissed the statistical challenges. (*Dukes v. Wal-Mart Stores Inc.*, 2010 WL 1644259)

#### **Improper exclusion from sample population.**

In evaluating the aggregate change of hospital billing over time, an accountant excluded certain selections from a sample population. The expert reasoned that the excluded selections’ associated charges were reduced to

zero, resulting in individual percentage change calculations that required division by zero. The court, however, found this reason to be unacceptable because when the selections were combined with the entire population, there was no mathematical problem in the overall calculation. The District Court of Illinois found that it was improper for the expert to exclude the selections and deemed the expert unreliable. (*Alexian Brothers Health Providers Ass’n, Inc. v. Humana Health Plan, Inc.*, 2009 WL 1059189)

#### **Unreliable lost profits calculation.**

In an intellectual property dispute, the plaintiff’s damages expert made a lost profit projection 10 years into the future without providing supporting industry research. The expert failed to test the model against historical data to confirm its long-term predictive power. Both the District Court for the Eastern District of Michigan and the Sixth Circuit Court of Appeals agreed that the expert’s calculations fell short of the level of rigor that professional economists normally exercise. The testimony was excluded because of the lack of testability, peer review, and general acceptance in the economic community. (*Multimatic, Inc. v. Faurecia Interior Systems USA, Inc.*, 2009 WL 4927957)

#### **Improper use of averages in lost earnings calculation.**

In a personal injury lawsuit, the plaintiff’s damages expert used average national figures to calculate the plaintiff’s lost earnings capacity. However, the expert failed to account for the plaintiff’s actual historical wages, even though he admitted that the plaintiff’s “actual earnings didn’t match what the capacity determinations were.” The Sixth Circuit District Court ruled to exclude the expert’s testimony in its entirety because the use of averages was based on unreasonable assumptions. (*Andler v. Clear Channel Broadcasting, Inc.*, 2009 WL 3855178)

#### **Unreliable discounted cash flow (DCF) analysis.**

In valuing a company involved in a bankruptcy case, an economist employed the DCF method. Upon *Daubert* review, the 11th Circuit District Court recognized the DCF method as a well-accepted valuation methodology, but concluded the expert did not correctly apply the facts of the case when determining the variables used in the DCF analysis. As a result, the expert was precluded from offering any conclusions with respect to the company’s solvency. (*Kipperman v. Onex Corp.*, 2009 WL 2515664)

**Failure to provide sufficient facts and data.**

In a fire-related insurance claim, an expert calculated a building's pre-damage value as its replacement cost less depreciation. Because this calculation essentially relied on only two numbers, the court focused on determining the reliability of those two figures. The expert was unable to provide sufficient support for the two numbers used. In addition, the court found that the methodology used had not been reviewed or generally accepted in the relevant community. The expert's opinion was, therefore, excluded from trial. (*James River Ins. Co. v. Rapid Funding, LLC*, 2009 WL 481688)

**Improper use of sampling and extrapolation methodologies.**

In a false claims lawsuit, the plaintiff's statistical expert used a cohort sampling and extrapolation methodology instead of a random sample. The expert's cohort sampling method was not exclusive among samples and resulted in an overlap of the sample selections. Extrapolation of the overlapping sample selections resulted in an overstated damage claim. The District Court of Massachusetts ruled that the expert's sampling and

extrapolation methodology was invalid because the expert failed to use a generally accepted sampling methodology and failed to provide justification for the use of weighted averages to compensate for acknowledged overlapping samples. (*U.S. ex rel. Loughren v. UnumProvident Corp.*, 2009 WL 530575)

**Lack of support for the duration of the damage period.**

Three certified public accountants developed a "but for" model to assess economic losses related to a contract dispute. In calculating the losses, the experts assumed that the plaintiffs would have enjoyed the same trading returns for up to 46 years in the future, were it not for the defendant's actions. With no data to support this long-lived assumption, the experts' methodology was seen as nothing more than a "blind extrapolation" from the plaintiffs' trading history. The Second Circuit District Court ruled that despite the qualifications of the experts, their unreliable methodology was sufficient to rule that none of the experts was qualified to offer a relevant expert opinion in this case. (*Helft v. Allmerica Financial Life Ins. and Annuity Co.*, 2009 WL 815451)

**Doubtful principles and errors.**

In a contract dispute case, the plaintiff retained an accountant to testify on the valuation of a closely held business. The expert had considerable experience in valuing large public companies but acknowledged that he was not an expert on valuing closely held businesses to the extent that the principles underlying the valuation differed from those of a large, publicly traded company. As a result, the Seventh District Court ruled that the accountant was not qualified as an expert for this case. The court further stated that even if the accountant was qualified as an expert, his opinions failed to satisfy *Daubert's* reliability standard because of significant methodological errors. (*MDG International, Inc. v. Australian Gold, Inc.*, 2009 WL 1916728)

**Unreliable methodology for valuing personal guaranties.**

When valuing personal guaranties, the defendant's expert witness determined that the risk of providing personal guaranties is comparable to the risk of an equity investment. His methodology pertained to the cost of debt in the context of valuing a business, rather than a personal guaranty. Furthermore, prior to this case, the expert had never valued a personal

guaranty, nor had he seen someone value a personal guaranty using the methodologies that he employed. The District Court of Maine ruled to exclude the expert's testimony based on unreliable methodology. (*Baldwin v. Bader*, 2008 WL 2875351)

#### **Unreliable analysis based on purely anecdotal data.**

In this criminal case, the defendant's financial expert testified to inaccuracies and incompleteness in the National Firearms Registration and Transfer Record (NFRTR). His testimony relied on his conversations with the Bureau of Alcohol, Tobacco, Firearms and Explosives personnel; a 1998 audit of the NFRTR; and the experiences of two gun owners. The First Circuit Court of Appeals affirmed the district court's decision to exclude the expert's testimony because he relied on data that was purely anecdotal and without scientific basis. (*United States v. Giambro*, 2008 WL 4427360)

#### **Unreliable assumption used for sales comparison valuation.**

In a products liability case, the plaintiff's expert witness offered an opinion on the value of a building rendered uninhabitable. The expert used both the cost approach and the sales comparison approach to determine the value of the building. In applying

a sales comparison model, the expert assumed that the highest and best use for the property was "a non-impact home based business," which can be conducted only in a dwelling. The expert admitted that the building at issue did not fit the legal definition of a dwelling. The District Court of Pennsylvania excluded the expert's sales comparison valuation because his underlying assumption was unreliable. (*Steffy v. The Home Depot, Inc.*, 2008 WL 5189505)

#### **No identifiable technique or theory.**

In an antitrust case, the plaintiff's damage expert calculated lost aluminum sales related to an antitrust violation by including nonaluminum sales without providing any justification. Furthermore, the expert's method of estimating lost sales was not based on any identifiable theory or technique. The expert's approach involved considering multiple factors and evaluating them as a matter of professional judgment. The plaintiff argued that this approach is generally accepted in various settings for making profit projections, but the expert never identified his methodology beyond saying that he used professional judgment. The District Court of Oklahoma ruled to exclude the expert's testimony because it was neither testable nor reliable. (*Champagne Metals v. Ken-Mac Metals, Inc.*, 2008 WL 5205204)

#### **Unreliable economic damages calculation.**

In proving damages arising from the loss of enjoyment of life (hedonic damages), the plaintiff's economics expert witness proposed a hypothetical benchmark of the dollar value of a statistical life. However, the District Court of New Mexico ruled to exclude the expert's testimony because the sustainability of the hypothetical benchmark was not established. (*Harris v. United States*, 2008 WL 5600225)

#### **Determination of terminal value.**

In determining the enterprise value of Chapter 11 debtors' business under a discounted cash flow (DCF) analysis, the debtors' valuation expert used the debtors' projected earnings before interest, tax, depreciation, and amortization (EBITDA) minus capital expenditures as the metric of value for determining the debtors' terminal value. The opposing experts testified that "while EBITDA minus Cap Ex [capital expenditures] is used as a 'credit statistic' to measure, among other things, whether a company can adequately service its debt, it has never been used by any expert before any court in the United States to determine a company's terminal value under a DCF analysis." Given

the expert's inability to identify any publications, treatises, or articles that validated his methodology, the Delaware Bankruptcy Court found that "the unprecedented use by the Debtors' expert of EBITDA minus Cap Ex to determine the Debtors' terminal value was so unreliable as to render the opinion of the Debtors' expert witness as to the Debtors' enterprise value inadmissible." (*In re Nellson Nutraceutical, Inc.*, 2006 WL 3479293)

#### **Failure to consider discounted cash flow (DCF) analysis in business valuation.**

The Eastern District Court of New York ruled that failing to use the DCF method and relying solely on the comparable companies method did not provide the necessary "check" that would render the expert's value assessment a reliable measure of the company's worth. (*In re Med Diversified, Inc.*, 334 B.R. 89, 2005)

The Southern District Court of New York, in *Lippe v. Bairnco Corp.*, excluded a financial expert because he "failed to adequately explain why he chose not to use DCF as a check against the comparables he employed in the valuations." (*Lippe v. Bairnco Corp.*, 288 B.R. 678, 2003)

#### **Misuse of the Black-Scholes method of valuation.**

In this constructive fraudulent transfer case, the plaintiff argued that the Black-Scholes model could be used in valuing an option to purchase 100% of controlled shares in a privately held company since each of the variables in the model could be instantiated. The Eastern District of New York Bankruptcy Court indicated that the Black-Scholes model is principally applied to valuing an option for a minority of publicly traded shares. The court ruled that the method should not be used for valuing an option to purchase 100% of controlled shares in a privately held company. (*In re Med Diversified, Inc.*, 334 B.R. 89, 2005)

#### **Unreliable "straight-line ramp-up method" (SLR method).**

The SLR method plots the known value of a stock at one point in time and the known value at a later time, then draws a line between the two points and assumes that the value of the stock changed at a consistent rate in the intervening time. The Utah Court of Appeals ruled that the SLR method is "not an accepted method of business valuation." (*Haupt v. Heaps*, 2005 UT App 436)

#### **Enhancement of a reasonable royalty rate through the application of a multiplier.**

In a patent infringement matter, a methodology for determining actual damages to a patentee (the producer of the patented item) is to determine the sales and profits lost to the patentee because of the infringement. In cases where the patentee cannot establish entitlement to lost profits, the statute provides entitlement at no less than a reasonable royalty on an infringer's sales. The Northern District Court of California stated that "application of an additional amount, over and above a royalty rate, must be based on realistic, appropriate factors, such as royalties actually received by the patentee and the patentee's relationship with the infringer."

The Federal Circuit law "nowhere sanctions the use of a multiplier to determine adequate compensation for infringement." The court ruled that "such an enhancement to the reasonable royalty calculation is simply untethered by legal or factual support." (*Technology Licensing Corp. v. Gennum Corp.*, Not Reported in F.Supp.2d, 2004 WL 1274391, 2004 US Dist. LEXIS 10604)

**Unreliable “consumption theory.”**

In proving damages arising from contended fraudulent transfers, the plaintiff’s accounting expert applied a “consumption theory,” which estimated losses over a period of time by examining the values of “cash assets” — a measure of liquid assets defined by the expert — at two points in time. Damages were calculated as the difference between these two values. This theory assumes that all of the downward change in the amount of ‘cash assets’ was caused by or consumed in a company’s operating activities. The consumption theory employs “indirect evidence, the decrease in the amount of the ‘cash assets,’ as proof of both payment of less than reasonably equivalent value and the amount of monies a company was entitled to receive had it been paid the market price, its damages, in lieu of comparing each price paid for products to each’s reasonably equivalent value damage measuring point, generally the market price.” The Northern District of Alabama Bankruptcy Court found this method of calculating damages unreliable. (*In re Perry County Foods, Inc.*, 313 B.R. 875, 2004)

**Untested “proportional trading model.”**

In a securities litigation matter, the plaintiff’s expert applied the proportional trading model to estimate aggregate damages to a class of securities by multiplying the alleged per-share price differential by the aggregate number of shares “damaged” by the alleged fraud. The Northern District Court of Illinois ruled that the proportional trading model does not meet any of the *Daubert* standards because it “has never been tested against reality” and “has never been accepted by professional economists.” (*Kaufman v. Motorola Inc.*, Not Reported in F.Supp.2d, 2000 WL 1506892, 2000 US Dist. LEXIS 14627)

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## ***Methodology***

We searched written court opinions issued between January 1, 2000 and December 31, 2011 (i.e., post-*Kumho Tire*), using the citation search string “526 U.S. 137” (*Kumho Tire v. Carmichael*). During 2000–2005, our search was conducted in the LexisNexis database; and since 2006, we have used the WestLaw database. Our search identified 4,107 federal and state cases during 2000–2011 that involved 6,919 *Daubert* challenges to expert witnesses of all types. In some instances, more than one *Daubert* motion was filed in a case or several expert witnesses were challenged with one motion.

From each *Daubert* challenge, we extracted detailed information concerning each case, the characteristics of each challenged expert, the nature of the evidence challenged, and the outcome of each challenge. We classified experts into two categories for this study: financial experts (accountants, economists, statisticians, finance professors, financial analysts, appraisers, business consultants, etc.) and non-financial experts (scientists, engineers, mechanics, physicians, police officers, fingerprint experts, psychologists, psychiatrists, etc.). Our search showed that 1,208 *Daubert* challenges were addressed to financial experts during 2000–2011. In each instance where a challenge to a financial expert resulted in the full

or partial exclusion of the expert’s testimony by the court, we categorized the factor(s) that resulted in the inadmissibility of the expert’s testimony, using as a basis for analysis Federal Rules of Evidence Rule 702, “Testimony by Experts.”

Our methodology entailed searches on written opinions related to expert challenges and may not encompass all challenges in all cases. Consequently, our analysis focused on trends and comparative metrics rather than on the absolute number of challenges or exclusions.

Throughout the study, whenever we refer to the success rate of *Daubert* challenges or similar phrases, ‘success’ is defined as the exclusion of expert witness testimony in whole or in part. Similarly, when we refer to the exclusion of an expert witness, we are referring to the testimony and opinions the witness intended to proffer.

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***Appendix:  
Supporting yearly data for  
report figures***

**Support data for figure 2: *Daubert* challenges and exclusions to expert witnesses of all types, 2000–2011**

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Challenges	253	287	364	387	408	537	741	704	712	869	879	778
Exclusions	121	135	147	193	169	252	348	322	305	389	431	335

**Support data for figure 3: Outcome of *Daubert* challenges to expert witnesses of all types, 2000–2011**

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Avg.
Accepted	52%	53%	57%	46%	54%	46%	49%	51%	55%	46%	48%	54%	<b>50%</b>
Excluded	35%	36%	32%	32%	29%	31%	27%	26%	24%	23%	25%	25%	<b>28%</b>
Partially excluded	13%	11%	9%	18%	13%	16%	20%	19%	19%	22%	24%	18%	<b>17%</b>
No decision made	0%	0%	2%	4%	5%	7%	4%	3%	2%	9%	3%	3%	<b>4%</b>

**Support data for figure 4: *Daubert* challenges and exclusions to financial expert witnesses, 2000–2011**

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Challenges	56	44	68	71	81	93	106	116	155	168	150	100
Exclusions	30	18	20	37	41	55	47	47	61	75	76	54

**Support data for figure 5: Outcome of *Daubert* challenges to financial expert witnesses, 2000–2011**

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Avg.
Accepted	45%	59%	68%	45%	46%	34%	53%	57%	57%	52%	48%	43%	<b>52%</b>
Excluded	41%	30%	19%	21%	38%	34%	28%	22%	23%	29%	23%	24%	<b>28%</b>
Partially excluded	13%	11%	10%	31%	12%	25%	16%	19%	17%	15%	27%	30%	<b>17%</b>
No decision made	2%	0%	3%	3%	4%	6%	3%	3%	3%	4%	1%	3%	<b>3%</b>

Support data for figure 8: *Daubert* challenges to financial expert witnesses, plaintiff-side vs. defendant-side, 2000–2011

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Avg.
Plaintiff	75%	66%	74%	72%	67%	67%	72%	71%	68%	71%	65%	70%	<b>70%</b>
Defendant	25%	34%	26%	28%	33%	33%	28%	29%	32%	29%	35%	30%	<b>30%</b>

Support data for figure 9: Success rate of *Daubert* challenges to financial expert witnesses, plaintiff-side vs. defendant-side, 2000–2011

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Avg.
Plaintiff-side experts	57%	52%	36%	57%	41%	58%	41%	39%	42%	39%	46%	57%	<b>46%</b>
Defendant-side experts	43%	20%	11%	40%	70%	61%	53%	44%	33%	58%	60%	47%	<b>48%</b>

Support data for figure 10: *Daubert* challenges to financial expert witnesses, by expert type, 2000–2011

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Avg.
Appraiser	0%	2%	9%	3%	1%	5%	17%	9%	6%	13%	15%	10%	<b>9%</b>
Accountant	4%	7%	21%	13%	28%	15%	20%	28%	25%	28%	31%	39%	<b>24%</b>
Economist	23%	20%	28%	27%	17%	22%	30%	16%	25%	23%	25%	26%	<b>24%</b>
Other financial	73%	70%	43%	58%	53%	58%	33%	46%	45%	36%	29%	25%	<b>44%</b>

Support data for figure 11: Success rate of *Daubert* challenges to financial expert witnesses, by expert type, 2000–2011

	2011	Avg.
Appraiser	70%	<b>51%</b>
Economist	42%	<b>40%</b>
Accountant	64%	<b>45%</b>
Other financial	44%	<b>50%</b>
All financial experts	54%	<b>46%</b>



***To have a deeper conversation  
about how this subject may affect  
your business, please contact:***

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