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Daubert *challenges to financial experts*

A yearly study of trends and outcomes 2000–2015

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About the PwC Daubert *Study*

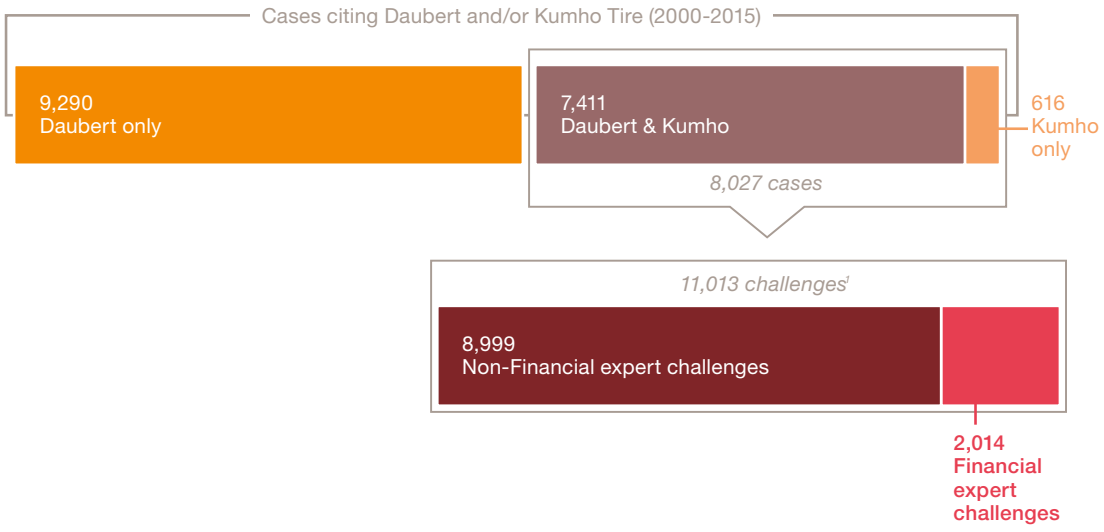
In 1993, the US Supreme Court's opinion in *Daubert v. Merrell Dow Pharmaceuticals Inc.* addressed the admissibility of expert scientific testimony in federal trials, affirming a gatekeeping role for judges in determining the reliability and relevance of the testimony.

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, including financial expert testimony. Subsequently, many state courts also adopted the *Daubert* standard.

In this study, we analyze post-*Kumho Tire* challenges to financial expert witnesses under the *Daubert* standard. By examining 16 years of *Daubert* challenges to financial experts (2000 - 2015), we seek to highlight trends in *Daubert* challenges to financial experts, and to provide insight into why experts were excluded.

Between 2000 and 2015, we identified 8,027 cases that cite *Kumho Tire.* From these cases, we evaluated 11,013 *Daubert* challenges to experts of all types in order to identify the type of expert being challenged.[1] We then further analyzed the 2,014 *Daubert* challenges related to financial experts (see Figure 1).[2] In this study, we present the results of our analysis and look at some key trends.

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



1 Some case opinions citing *Kumho Tire* cover challenges to more than one expert. In addition, some case opinions cite *Kumho Tire* but do not specifically relate to a *Daubert* challenge.

2 Our study is limited to written opinions citing *Kumho Tire.* As such, the related results should not be presumed to represent all possible financial expert challenges (e.g., opinions on financial experts that do not specifically cite *Kumho Tire,* bench decisions, motions *in limine,* etc.)

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Emerging Trends

Over the last few years of our study, we have seen an increasing number of Daubert *challenges to financial experts providing testimony at the class certification stage. In this year's study we explore this trend further to see how courts have approached* Daubert *challenges at the class certification stage.*

Background

In federal courts, the requirements for class actions are governed by Federal Rule of Civil Procedure 23. For a class action to proceed, the court must certify the class under Rule 23, a process often referred to as the class certification stage.[3]

Financial experts are commonly involved at the class certification stage to provide testimony on how a class may or may not meet certain requirements of Rule 23. In a gender discrimination case, for example, a statistician may provide testimony to show how pay differed between male employees and the female employees being proposed as a class. As another example, an economist may provide testimony in an antitrust case regarding how prices were impacted for the whole class as a result of a defendant's alleged anticompetitive behavior.

In the *Daubert* case, the Supreme Court envisioned the judge as the "gatekeeper" in preventing unqualified experts from providing testimony and preventing unreliable and/or irrelevant expert testimony from being presented to the trier of fact. However, the Supreme Court was silent as to whether courts must evaluate the admissibility of expert testimony presented at the class certification stage based on the *Daubert* criteria. As such, circuit courts differed as to whether and to what extent a *Daubert* analysis should be performed at the class certification stage.

Two recent cases before the Supreme Court *(Wal-Mart Stores, Inc. v. Dukes, 564 U.S. 338, 131 S. Ct. 2541* (2011) and *Comcast Corp. v. Behrend, 133 S. Ct. 1426* (2013)) provided additional perspective on the matter, but stopped short of mandating a *Daubert* inquiry at the class certification stage. In the wake of Dukes and Behrend, circuit courts have generally coalesced around the notion that expert testimony at the class certification stage should be evaluated under *Daubert*, but have differed on the breadth and depth of that *Daubert* analysis.

3 Rule 23(a) includes the following prerequisites for certifying a class: "(1) the class is so numerous that joinder of all members is impracticable [numerosity]; (2) there are questions of law or fact common to the class [commonality]; (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class [typicality]; and (4) the representative parties will fairly and adequately protect the interests of the class [adequate representation]."

Current Landscape

The current landscape of *Daubert* challenges at the class certification stage is framed by the Supreme Court's opinions in *Dukes* in 2011 and in *Behrend* in 2013.

In *Dukes*, a group of employees brought a class action against Walmart, alleging gender discrimination in pay and promotions. The district court granted the employee's motion for class certification, a decision affirmed by the Ninth Circuit. The Supreme Court granted certiorari, and in 2011 ruled that the certification of the class was not consistent with Rule 23, thereby reversing the appellate court's decision. In its discussion regarding the testimony of the plaintiff's expert, the Supreme Court noted, in dicta, that the parties disputed whether the expert's testimony met the standards of admission under *Daubert*. **While the district court had concluded that *Daubert* did not apply to expert testimony at the class certification stage, the Supreme Court stated "we doubt that is so."** [4] However, this was the extent of the Supreme Court's comments related to *Daubert*, leaving open questions as to how and to what extent *Daubert* should be applied at the class certification stage. As such, the *Daubert* landscape in the lower courts was mixed.

For example, the Seventh Circuit, in a case frequently cited in other jurisdictions (*Am. Honda Motor Co. v. Allen,* 600 F.3d 813 (7th Cir. 2010)) called for a full *Daubert* analysis at the class certification stage. The defendant in *Allen* filed a *Daubert* challenge against the plaintiff's expert, claiming the testimony was unreliable. The district court expressed reservations about certain elements of the expert's report; however, the district court declined "to exclude the report in its entirety at this early stage of proceedings." However, on appeal, the appellate court held that **"when an expert's report or**

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Expert testimony has become a critical part of the class certification stage. In *Comcast*, without a *Daubert* objection, the Court held a regression model developed by plaintiffs' expert could not be accepted as evidence that damages were susceptible of measurement across the entire class.

Tyson Foods, Inc. v. Bouaphakeo, No. 14-1146, 2016 WL 1092414, at *1 (March 22, 2016), affirmed a FLSA class action awarding damages for uncompensated time spent putting on and taking off protective gear integral to the employees hazardous work. At trial, Plaintiffs introduced statistical "representative evidence" from two experts. Defendant did not file a *Daubert* challenge or respond with a rebuttal expert. The Court held such representative statistical evidence was appropriate in this case where there was an absence of records showing the amount of time employees spent donning and doffing the protective gear. Rather than always permitting such evidence, the Court cautioned that whether and when such evidence can be used will "depend on the purpose for which the evidence is being introduced and on 'the elements of the underlying cause of action.'" Id. at *8 (quoting *Erica P. John Fund, Inc. v. Halliburton Co.,* 536 U.S. 804, 809 (2011)).

After balancing the opportunity to defeat class certification with the potential downside of taking certain positions on incomplete data or of getting locked in early to positions that may need to change, defendants should consider offering their own expert testimony to rebut experts proffered by the plaintiff. When faced with dueling experts, the district court may narrow or reject class allegations. *See Erica P. John Fund, Inc. v. Halliburton Co.,* 309 F.R.D. 251, 280 (N.D. Tex. 2015) (district court certified class, but only as to one of six alleged curative disclosures).

As expert testimony becomes an increasing point of emphasis in class certification, ultimately, we expect the Supreme Court to clarify whether to apply *Daubert*. In the interim, we anticipate *Daubert* challenges at the class certification stage to become routine.

Gordon Shapiro, *Partner and Co-Chair of Special Investigations practice at Jackson Walker LLP*

4 The appellate court noted that a *Daubert* inquiry would not have addressed Walmart's concerns, because Walmart challenged the persuasiveness of the expert's results, not the methodology or relevance.

testimony is critical to class certification … a district court must conclusively rule on any challenge to the expert's qualifications or submissions prior to ruling on a class certification motion. That is, the district court must perform a full *Daubert* analysis before certifying the class if the situation warrants."

The Eleventh Circuit Court of Appeals agreed with this approach in a 2011 case (*Sher v. Raytheon Co., 419 F. App'x 887* (11th Cir. 2011)). In this case, the district court initially held that "it is not necessary at [the class certification] stage of the litigation to declare a proverbial winner in the parties' war of the battling expert … At this stage of the litigation, therefore an inquiry into the admissibility of Plaintiffs' proposed expert testimony as set forth in *Daubert* would be inappropriate, because such an analysis delves too far into the merits of Plaintiffs' case." However, the appellate court found the district court's ruling to be an error. Citing *Allen*, the appellate court noted that **"a district court must make the necessary factual and legal inquiries and decide all relevant contested issues prior to certification."**

In a post-*Dukes* case, *Ellis v. Costco Wholesale Corp.,* 657 F.3d 970 (9th Cir. 2011), the Ninth Circuit also agreed that a *Daubert* analysis was necessary at the class certification stage, but recognized that a *Daubert* analysis is not the end of the court's responsibility with respect to expert testimony. In *Ellis*, the plaintiffs put forth three experts to establish commonality for a class of employees claiming gender discrimination. The district court held that the testimony of the plaintiffs' experts was admissible and certified the class. The appellate court vacated the district court's class certification under Rule 23 and remanded the case for reconsideration. In its opinion, the appellate court noted that the "Supreme Court requires district courts to engage in a 'rigorous analysis' of each Rule 23(a) factor when determining whether

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Often lost in the debate about whether *Daubert* should apply at the class certification stage is the question of what type of expert opinion is being presented in support of or in opposition to class certification. Is the expert testimony presented 1) a preview of the opinions that a party will actually rely upon as evidence at trial (e.g. a computation of class-wide damages) or 2) opinion testimony that the party asserts is helpful to the trial court in evaluating whether common issues predominate over individual issues in deciding the class certification motion itself (e.g. an opinion that statistical methods are available that can be used to establish uniformity in the causation of damages)?

Certainly *Daubert* will ultimately be applicable to the first type of opinion testimony at some point before it can actually be presented to a fact finder at trial, so there are practical reasons why *Daubert* should be considered at the class certification in evaluating this type of opinion testimony. Lower courts often find evaluating the admissibility of the second category presents more problematic because the factors relevant to assessing whether a class should be certified are different from the question of admissibility of evidence at trial.

Still, the availability of admissible evidence on an issue of fact is itself something that the court should consider at the class certification phase, so there are still good arguments to be made that the court should perform some evaluation of the reliability of expert opinion focused on one or more of the class certification factors before blindly accepting it as true (e.g. do the statistical methods proposed actually show that there is uniformity in the causation of damages from one class member to another).

Recognizing and clearly articulating the distinction between these two different types of expert opinion can be very helpful in framing challenges to expert testimony at the class certification stage, as well as responses to those challenges.

Paul Karlsgodt, *Partner and leader of Class Action Defense practice at BakerHostetler LLP*

plaintiffs seeking class certification have met the requirements of Rule 23." In considering the defendant's motion to strike, the district court "correctly applied the evidentiary standard" set forth in *Daubert*. However, the court of appeals explained that the **"district court seems to have confused the *Daubert* standard it correctly applied to Costco's motions to strike with the 'rigorous analysis' standard to be applied when analyzing commonality. Instead of judging the persuasiveness of the evidence presented, the district court seemed to end its analysis of the plaintiffs' evidence after determining such evidence was merely admissible."** The appellate court found that "instead of examining the merits to decide the issue, it appears the district court merely concluded that, because both Plaintiffs' and Costco's evidence was admissible, a finding of commonality was appropriate." As such, the appellate court ruled that the district court "failed to resolve the critical factual disputes" and vacated and remanded the district court's commonality determination.

Conversely, a post-*Dukes* case at the Eighth Circuit held that a more limited *Daubert* approach is appropriate. In *Cox v. Zurn Pex, Inc. (In re Zurn Pex Plumbing Prods. Liab. Litig.),* 644 F.3d 604 (8th Cir. 2011), the defendant filed *Daubert* challenges against two of the plaintiff's experts, but the district court denied these motions and granted class certification, concluding that a "full and conclusive *Daubert* inquiry would not be necessary or productive at this stage of the litigation, particularly since the expert opinions could change during continued discovery." On appeal, the appellate court noted that the district court applied "what it termed a 'tailored' *Daubert* analysis" by examining "the reliability of the expert opinions in light of the available evidence and the purpose for which they were offered." The appellate court also stated that **the defendant's "desire for an exhaustive and conclusive *Daubert* inquiry before the completion of merits discovery cannot be reconciled with the inherently preliminary nature of pretrial evidentiary and class certification rulings."** In addition, the appellate court highlighted that the **"main purpose of *Daubert* exclusion is to protect juries from being swayed by dubious scientific testimony. That interest is not implicated at the class certification stage where the judge is the decision maker."** As such, the appellate court ruled that the district court did not err by conducting a "focused *Daubert* analysis" at the class certification stage.

It was expected that the *Behrend* case would provide more guidance to the courts on the use of *Daubert* at the class certification stage. In *Behrend*, a group of subscribers brought a class action alleging that cable television service providers violated antitrust laws by swapping services with competitors in order to serve certain areas. The district court certified the class, a decision which was upheld by the Third Circuit Court of Appeals. In its ruling, the appellate court noted that in neither the district court case nor the appellate case did Comcast raise the issue of whether *Daubert* applied at the class certification stage (rather, the issue was raised for the first time in the appellate court's dissenting opinion).[5] In addition, the appellate court interpreted the Supreme Court's opinion in

5 In the dissenting opinion, the court of appeals cited *In re Hydrogen Peroxide Antitrust Litig*., 552 F.3d 305 (3d Cir. 2008), in which the Third Circuit explained that "opinion testimony should not be uncritically accepted as establishing a Rule 23 requirement merely because the court holds the testimony should not be excluded, under *Daubert* or for any other reason." The dissenting opinion noted that "inherent in that statement is the conclusion that a court could, at the class certification stage, exclude expert testimony under *Daubert*."

Dukes to only require a district court "to evaluate whether an expert is presenting a model which could evolve to become admissible evidence, and not requiring a district court to determine if a model is perfect at the certification stage." The Supreme Court granted certiorari, and in 2013 ruled that the group of subscribers was improperly certified as a class since the subscribers failed to show common issues of damages. The question presented before the Supreme Court was "whether a district court may certify a class action without resolving whether the plaintiff class had introduced admissible evidence, including expert testimony, to show that the case is susceptible to awarding damages on a class-wide basis." However, because Comcast failed to file a *Daubert* challenge, the Court did not address the *Daubert* issue head-on and instead focused on whether damages could be measured on a classwide basis.[6] As such, the Court did not provide the hoped for guidance regarding the application of *Daubert* at the class certification stage. However, the Court did note that "by refusing to entertain arguments against respondents' damages model that bore on the propriety of class certification, simply because those arguments would also be pertinent to the merits determination, the Court of Appeals ran afoul of our precedents requiring precisely that inquiry."

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Plaintiffs attempting to obtain class certification in class action suits are increasingly relying on expert testimony to satisfy the requirements of Federal Rule of Civil Procedure 23. Defendants opposing certification likewise lean heavily on experts to establish, for example, that damages are not capable of measurement on a classwide basis under Rule 23. As a result, courts are often faced with challenges to expert testimony at the class certification stage.

Some practitioners choose simply to challenge the sufficiency of the opposing party's proof in the context of the class certification briefing, without specifically moving to exclude the expert testimony under the Federal Rules of Evidence and *Daubert v. Merrell Dow Pharmaceuticals, Inc.,* 509 U.S. 579 (1993). Others file motions to exclude under *Daubert*, as in *Zurn Pex*.

The Supreme Court has not yet definitively weighed in on this issue. On the one hand, the Court has expressed "doubt"—in dicta—that *Daubert* does not apply to expert testimony at the certification stage of class action proceedings. And yet *Comcast* seems to suggest that a party may achieve an end-run around *Daubert* by merely maintaining its objections to the sufficiency of the opposing party's evidence. Given the uncertainty, parties who choose to forego a formal *Daubert* challenge at class certification for strategic reasons risk waiving their objections to admissibility of the opposing expert's testimony during later stages of the proceedings.

Robert Manley, *Principal*, and **Ryan Hargrave**, *Associate at McKool Smith, P.C.*

6 In a dissenting opinion, the rephrasing of the question before the Court was criticized, particularly considering that parties "devoted much of their briefing" to the question of whether the standards set out in FRE 702 and *Daubert* apply in class certification proceedings.

The future?

The Supreme Court's decisions in the *Behrend* and *Dukes* cases, while silent on *Daubert*, reinforced that courts should undertake "rigorous analysis" of the evidence, including expert testimony, to ensure the requirements of Rule 23 are met. This rigorous analysis may also require some inquiry into the merits of the claim. As such, these rulings put additional emphasis on the need for parties to put forth robust expert testimony at the class certification stage.

The Supreme Court ruling in *Erica P. John Fund, Inc. v. Halliburton Co.,* 563 U.S. 804, 131 S. Ct. 2179 (2011) placed added focus on class-certification related expert testimony, specifically as it relates to securities litigation cases. The Court's ruling in this case allowed parties to present evidence at the class certification stage to show the impact of alleged misinformation on stock prices. This ruling could be helpful for defendants, since successfully demonstrating lack of price impact from the alleged misrepresentations may end the plaintiffs' chance for class certification.[7] Thus there will likely be strong incentive for parties at the class certification stage to put forth financial expert testimony related to price impact.

With the aforementioned cases suggesting potentially increased significance of expert testimony at the class certification stage, we expect to see financial experts being more commonly challenged at the class certification stage. And while the Supreme Court has thus far stopped short of requiring courts to perform a full *Daubert* analysis at the class certification stage, the "rigorous analysis" standard and prevailing practice at the circuit courts will likely result in courts performing an in-depth assessment of the expert's testimony at the class certification stage. As such, it behooves both experts and counsel at the class certification stage to assess whether their expert is qualified, has provided relevant testimony, and has utilized a reliable methodology.

The authors wish to thank our attorney contributors for providing their insight.

Attorney Insight

As a result of recent decisions in securities fraud class actions, securities defendants will routinely submit expert event studies and other statistical analyses at the class certification stage, and plaintiffs will regularly submit expert reports attempting to rebut those studies and analyses. This, in turn, will likely lead to more *Daubert* motions challenging the admissibility of expert testimony at the class certification stage, as well as new decisions regarding the validity of different approaches to analyzing the impact of alleged misrepresentations and corrective disclosures.

Tom O'Brien, *Partner at Baker Botts LLP*

7 For example, when *Halliburton* was reevaluated on remand, the district court ruled that price impact was not demonstrated with respect to five out of the six alleged misrepresentations and corrective disclosures identified by the plaintiffs.

Recent Cases

The following cases are recent examples of *Daubert* challenges to financial experts at the class certification stage and demonstrate some of the factors considered by the courts when evaluating the necessity of a *Daubert* inquiry.

- In this antitrust case, the plaintiffs, a putative class of fertility clinic egg donors, alleged that guidelines issued by the defendants regarding "appropriate" compensation for egg donors constituted a horizontal price fixing agreement in violation of the Sherman Act. Both parties challenged the other's expert reports, which had been offered to support the commonality and predominance inquiries. **The court considered the *Daubert* motions a "threshold issue" to the class certification motion and determined that it must decide "whether the reports reliably assist the resolution of those issues."** The plaintiffs put forth expert testimony by an economist to address whether damages and impact could be shown through class-wide proof. The expert selected three agencies that had renounced the guidelines and analyzed compensation data from the periods when the agencies complied with the guidelines and the periods when they did not. The expert then prepared regression models to isolate the resulting impact on compensation. The court noted however that the "regressions for these three agencies produced significantly different conclusions as to the impact of adhering to the [g]uidelines." The expert did not explain the variation between the agencies, nor did he "explain with any specificity how these disparate results could be applied to other agencies or clinics." **The court excluded the expert's testimony because his analysis did "not reliably support his conclusion that impact or damages are subject to classwide proof."** However, the plaintiffs' motion for class certification was ultimately granted in part. *(Kamakahi v. Am. Soc'y for Reprod. Med., 305 F.R.D. 164 (N.D. Cal. 2015))*
- In this antitrust matter, a putative class of egg purchasers alleged that several of the nation's largest egg producers conspired to control and limit the supply of eggs and egg products, resulting in artificially inflated prices during the period of 2000-2008. The court determined that the **"general consensus appears to be that the Court should subject expert witnesses to *Daubert* scrutiny at the class certification stage of the litigation."** However, the court noted that the "question might arise as to whether the *Daubert* analysis is limited to expert testimony relating to class certification, meaning the analysis does not extend to expert testimony regarding the merits." The court found this a "particularly unsettled and confounding issue," but determined that it **"is wiser and more useful to err on the side of a more rigorous *Daubert* inquiry."** The court also made clear that a court could consider testimony admissible under *Daubert*, but still deny class certification. The defendants challenged the plaintiff expert's qualifications and the reliability and

relevance of his testimony. After evaluating these factors, the court allowed the expert's testimony to be proffered. In addition, class certification was granted in part. *(In re Processed Egg Prods. Antitrust Litig., 81 F. Supp. 3d 412 (E.D. Pa. 2015))*

- In this breach of warranty case, a putative class of consumers alleged that the defendant "deceptively and misleadingly marketed its Wesson brand cooking oils, made from genetically-modified organisms ('GMO'), as '100% natural.'" **Referencing *Ellis*, the court determined that it would apply the evidentiary standard set forth in *Daubert* to the parties' expert witnesses. The court also noted that "on a motion for class certification, it is not necessary that expert testimony resolve factual disputes going to the merits of the plaintiff's claims; instead, the testimony must be relevant in assessing 'whether there was a common pattern and practice that could affect the class as a whole.'"** The defendants argued that the testimony offered by the plaintiffs' economics expert lacked a reliable factual foundation because it offered an incomplete hedonic regression and conjoint analysis. The court agreed, noting that the expert "provides no damages model at all." Specifically, the expert did not identify variables he intended to build into the models or identify data to which the models could be applied, leaving the court with only the expert's "assurance that he can build a model to calculate damages." As such, the court granted the defendant's motion to strike the expert's testimony and did not consider the testimony in deciding the class certification motion. Ultimately, the court denied the plaintiffs motion for class certification *(In re Conagra Foods, Inc., 302 F.R.D. 537 (C.D. Cal. 2014))*

- In this case, a putative class of plaintiffs claimed they suffered property damage, as well as mental and emotional anguish, as a result of defendants' construction of an intake canal. In its opinion, the district court indicated that at the class certification stage, **"the district court does not conduct a comprehensive *Daubert* review. Rather, the plaintiffs need only show that their 'expert o[pi]nions contain no flaws that would render them inadmissible as a matter of law.'"** As such, **"comprehensive expert reports that are required on the merits are not feasible at the Rule 23 stage."** The defendants argued that the expert testimony offered by the plaintiffs' experts failed "both the *Daubert* and the *Daubert*-lite standards required for admissibility." In addition, the defendants complained that the plaintiffs' "experts have not yet gathered and applied to their methodologies all of the data necessary to analyze causation, damages, and typicality." However, the court underscored that **"the full requirements of *Daubert* need not be met at this stage, and any argument to the contrary is misplaced."** As such, the court denied the defendants' motion to exclude the plaintiffs' experts. Ultimately, however, the court denied the plaintiffs' motion for class certification. *(Crutchfield v. Sewerage & Water Bd. of New Orleans, No. 13-4801, 2015 U.S. Dist. LEXIS 82674 (E.D. La. June 25, 2015))*

- In this putative securities class action, plaintiffs alleged that the defendant made false and misleading statements that overstated its income and understated its expenses. The court indicated that **"[w]here an expert opinion is critical to class certification and a party challenges the reliability of that opinion, the reviewing court must engage**

in a two-step analysis before analyzing whether Rule 23's requirements have been met: (1) whether the party's challenges bear upon those aspects of [the] expert testimony offered to satisfy Rule 23 and (2) if so, whether the opinion is admissible as to those aspects under Federal Rule of Evidence 702 and *Daubert*." The defendants filed a *Daubert* challenge against the plaintiffs' financial expert, arguing that the expert's theory that a particular charge affected stock price was faulty because there were other disclosures on the same day which the expert did not consider. Further, the defendants argued that the expert's damages model "merely describes a framework for calculating damages without actually applying it in this case." The court acknowledged that the expert's model did not aim to prove that the charge caused the defendant's stock price to drop, but that is not a cause for exclusion. Further, the court indicated that it "need not consider the reliability of [the expert]'s damages model at this stage" and that "class treatment would still be appropriate here even if damages were required to be calculated on an individual basis." *(City of Sterling Heights Gen. Emps.' Ret. Sys. v. Prudential Fin., Inc., Civil Action No. 12-5275, 2015 U.S. Dist. LEXIS 115287 (D.N.J. Aug. 31, 2015))*

- In this gender discrimination case, plaintiffs alleged that their employer discriminated against them in pay and promotions. The court highlighted that neither the Supreme Court nor the Second Circuit had definitively decided on the use of *Daubert* at the class certification stage; however, the court found that **"the cases that hold *Daubert* to be applicable at the class certification stage…are more persuasive [than those which do not find *Daubert* applicable to class certification]." It also noted that "the scope of the *Daubert* analysis is cabined by its purpose at this stage: 'the inquiry is limited to whether or not the expert reports are admissible to establish the requirements of Rule 23.'"** As such, "it would be premature to decide whether aspects of an expert opinion that go exclusively to the merits and not to the elements of Rule 23 would be admissible in subsequent proceedings." Both sides filed multiple *Daubert* challenges in this case. One of the defendant's experts provided opinions about the structure of compensation in the financial services industry. The plaintiffs argued that the expert's testimony was irrelevant (because it related to the financial services industry as a whole rather than the defendant specifically) and unreliable (because it was based on surveys for which the underlying data was not available). The court agreed that industry practice might ultimately be relevant, but was not pertinent to class certification. Since the testimony did not address common issues relating to the defendant and the claims against it, the expert was excluded. *(Chen-Oster v. Goldman, Sachs & Co., 114 F. Supp. 3d 110 (S.D.N.Y. 2015))*

Recurring Themes

Overview

2014 marked the fifteenth anniversary of the *Kumho Tire* decision. In our 2014 *Daubert* study, we presented the following recurring themes that we had seen in challenges to financial experts over the previous 15 years. For this year's study, we identify cases from 2015 that also demonstrate these themes.

The hand on the gate – *Daubert* established judges as gatekeepers between juries and testimony offered by experts. But how heavy should their hands be on the gate? Often, rather than excluding financial expert testimony, judges prefer that flaws in the testimony be exposed through cross-examination at trial.

Data dangers – The use and misuse of data is a common stumbling block for financial experts. We've seen financial experts be excluded for various reasons, including not providing sufficient support for calculations and not performing due diligence on data received from clients.

Are you qualified? – Rule 702 states that experts may testify if they are qualified based on their knowledge, skill, experience, education, or training. However, the interpretation of what that requisite knowledge, experience, and skill is can vary widely.

A rule of thumb – In the landmark 2011 *Uniloc* decision, the court described the royalty rate rule of thumb in intellectual property cases as a "fundamentally flawed tool" that fails to tie the royalty rate to the specific facts and circumstances of the case.

Better luck next time – In the past few years, we have seen several instances where the court allowed the expert to remedy challengeable issues in his or her original report by submitting a revised report.

In legal territory – Financial expert testimony is often excluded if the court considers it a legal conclusion. Such legal conclusions are typically the domain of the trier of fact.

The hand on the gate

The Supreme Court's decision in the *Daubert* case provided judges a gatekeeping role in admitting expert testimony. In performing this gatekeeping role, courts have generally been advised to not keep "a heavy hand on the gate," and to work under the presumption of admissibility.[8] In 16 years of court decisions related to financial experts, we have seen, on average, approximately 53% of financial experts admitted by courts after being challenged.

Across this timespan, the most common reason for financial expert exclusions has been lack of reliability. However, evaluating reliability can be tricky. While an expert may use a generally accepted methodology, does the poor application of the methodology make the expert's testimony unreliable, or is that a matter for the trier of fact to decide? Depending on the specific facts and circumstances of the case, we have often seen the court admit a financial expert and allow for such issues to be illuminated through rigorous cross-examination.

Illustrative cases

- In this breach of contract case, the plaintiff's expert prepared a valuation of the plaintiff's business based on an analysis of business plans, financial statements, and financial projections. To determine the sales projections to be used in his valuation model, the expert made several assumptions regarding the future performance of the company's new product. The defendants asserted that the expert's assumptions were "so wildly speculative, so 'pie-in-the-sky,' as to render [the expert's] opinions unreliable." **While the court acknowledged that an expert's testimony could be excluded if it rests on faulty assumptions, the court did not believe the defendants had shown that the assumptions were so unreliable as to necessitate exclusion.** For example, the court found that the non-binding expressions of interest from third parties for the plaintiff's product were "not made up out of whole cloth, but rather are based on clear indicia of demand for the product." Therefore while the "defendants may cross-examine [the expert] as to his presumption that all of these non-binding orders would manifest into sales," the expert may not be excluded on this ground. *(Clear-View Techs., Inc. v. Rasnick, No. 13-cv-02744-BLF, 2015 U.S. Dist. LEXIS 71990 (N.D. Cal. June 2, 2015))*
- In this securities litigation case related to the dissolution of various funds as a result of alleged fraud, the defendants' expert concluded that the plaintiffs had failed to demonstrate a causal connection between the defendants' alleged misconduct and the losses claimed as damages, and that the plaintiffs' damages failed to account for conduct after the disclosure of the alleged fraud. In their motion to exclude the defendants' expert, the plaintiffs argued that the expert should not be able to opine on the value of the funds based on events subsequent to the funds' collapse, particularly the financial market conditions during the financial crisis. However, the court indicated that the expert's opinion regarding subsequent events went not to the issue of the value of the funds as of the valuation date, but rather to a different and supported conclusion that "the calamities plaintiffs attribute to defendants' conduct may ultimately have occurred" even in the absence of the alleged wrongful conduct. In addition, the court could not conclude that the subsequent events

8 See *MacDermid Printing Solutions, Inc. v. Cortron Corp., 2014 U.S. Dist. LEXIS 79941 (D. Conn. June 12, 2014)*

had no relevance to the potential calculation of damages nor that the "subsequent events would, under no circumstances, have been reasonably foreseeable to a hypothetical willing buyer as of the valuation date." The plaintiffs also critiqued the expert's opinions regarding the bankruptcy claim for a separate fund, but **the court ruled that the plaintiffs' criticism of the defense expert's assumptions "goes to the weight to be afforded his testimony, but not to its admissibility." The court denied the plaintiffs' motion to exclude the defendants' expert, noting that "these perceived weaknesses [in the expert's testimony] can, in turn, be addressed through cross-examination, but do not present a basis for exclusion."** *(Krys v. Aaron, 112 F. Supp. 3d 181 (D.N.J. 2015))*

- In this breach of contract case, the defendant's expert calculated damages to the defendant as a result of alleged overcharges by the plaintiff. The plaintiff challenged the expert's calculation, in particular the expert's alleged failure to account for reimbursements the defendant received from various manufacturers. However, the court indicated that this argument did not speak to the expert's methodology "so much as to the parties' competing theories of the case." The "failure to take such factors into account is only a methodological failure to the extent the jury chooses to accept [the plaintiff's] damages theory. [The plaintiff] is of course free to argue this theory to the jury. **But to exclude [the expert's] opinions for failing to take the … factors into account would necessarily be to choose [the plaintiff's] damages theory over [the defendant's] damages theory, thus abrogating the jury's role as the finder of fact."** The court found that because the defendant expert's analysis was methodologically sound, his opinions could be properly presented to the jury. *(Prime Media Grp., LLC v. Acer Am. Corp., No. 12-cv-05020-BLF, 2015 U.S. Dist. LEXIS 7515 (N.D. Cal. Jan. 22, 2015))*

- In this infringement case, the plaintiff brought a claim against the defendant, a supermarket chain, for misappropriation of his identity under the Illinois Right of Publicity Act ("IRPA"). Specifically, the defendant had used the plaintiff's name and player number as part of an advertisement published in a limited distribution magazine commemorating the plaintiff. The court ruled that the defendant had violated the IRPA and, as specified by the act, the plaintiff was owed "actual damages, profits derived from the unauthorized use, or both." Both the plaintiff's and the defendant's experts offered opinions on the fair market value of the defendant's use of the plaintiff's identity, but used different methodologies to determine this fair value. The plaintiff's expert argued that the proper method was by reference to "amounts received by comparable persons for comparable uses," or by looking to "amounts the plaintiff has obtained from similar licensing programs." However, he calculated fair market value in general, which was not intended to correspond with the plaintiff's ultimate damages request to the jury. The defendant objected that the plaintiff's expert "improperly considered non-comparable licenses in calculating fair market value." In contrast, the defendant's expert assumed that the willing buyer/willing seller, or "hypothetical-negotiation test," was the appropriate framework. The plaintiff objected to the use of comparable transactions for both the plaintiff and the defendant in formulating his opinion. **The court concluded that both experts should be heard by the jury and be subject to cross-examination, since "in the end, this is not overly complex material, and a jury will be more than capable of deducing an appropriate damages award amidst these conflicting opinions."** *(Jordan v. Dominick's Finer Foods, 115 F. Supp. 3d 950 (N.D. Ill. 2015))*

Data dangers

Federal Rules of Evidence Rule No. 702, which incorporates precedent set by *Daubert, Kumho Tire,* and other related cases, permits a qualified expert to testify if, among other factors, the testimony "is based on sufficient facts or data." This factor has been a common stumbling block for financial experts, and is the most frequent reason for reliability exclusions. Indeed, whether the expert relied on enough data to form an opinion, or failed to consider necessary information, can impact the outcome of a *Daubert* challenge.

Illustrative cases

- In this breach of contract case arising from an alleged supply agreement, it was claimed that "on the brink of filing this lawsuit, [the co-owner of the plaintiff], a CPA with nearly twenty years of accounting experience, destroyed all of her business's accounting records, including those saved on a store computer." The plaintiffs put forth two financial experts in this case, one to evaluate the plaintiffs' accounting data and the other to determine the present value of the alleged damages. **Because the "plaintiffs' prior destruction of evidence left the pair with no other adequate inputs," the plaintiffs' experts resorted to the defendant's financial projections of plaintiffs' sales in order to form their expert opinions.** In doing so, the defendant argued that the experts had taken a "no questions asked" approach when selecting their model inputs because they had performed no independent analysis or verification of the projections. In fact, the defendant claimed that these forecasts were unreliable because they had already been internally rejected for use by the defendant and were devised for the purposes of a break-even loan analysis rather than to project sales. During the course of the proceedings, additional information was produced by a third party that provided the plaintiffs' actual sales data for the base year in the projection. Although the actual sales data was significantly lower than the amount used in the projection, the experts did not update their opinions. Explaining that the role of an expert witness requires, "at a minimum, an appropriate mix of careful fact-gathering and constructive analysis," the court excluded both of the plaintiffs' financial experts. *(Bruno v. Bozzuto's, Inc., 311 F.R.D. 124 (M.D. Pa. 2015))*
- In this theft of trade secrets case, the plaintiff's expert, a CPA, based his conclusions on spreadsheets summarizing the plaintiff's monthly sales averages. This data was determined to be overstated due to an IT error in generating the report from the plaintiff's database. The plaintiff's expert prepared a revised opinion based on this new data, which reduced his damage calculation by half. The court noted that "it is undisputed that [the expert] did not review any hard data concerning sales," and that even when the error came to light, "he still declined to review the underlying documents," which were readily available. The plaintiff argued that "an examination of all of the sales data would have been unwieldy." However, this "ignores the possibility of at least reviewing a sampling of the data." **The court observed that the expert's "reliance on [plaintiff's] monthly sales spreadsheets, without examination of or inquiry into any of the underlying documents, raises serious questions about the reliability of his opinion," and therefore excluded the expert's testimony.** *(Orthofix Inc. v. Lemanski, No. 13-11421, 2015 U.S. Dist. LEXIS 130662 (E.D. Mich. Sep. 29, 2015))*
- In this insurance case, the plaintiff alleged that the defendant, an insurer, did not provide adequate compensation for property damage sustained during Superstorm Sandy. The

plaintiff's expert, an appraiser, did not visit the property, inspect the property, ask about the property's condition before the storm, or inquire about the damage done by the storm. Rather, the expert looked at photographs taken of the property after the storm and used a computer program to generate an estimate of the damage. **The court noted that the expert had not articulated a sufficient methodological or factual basis for his conclusion that the property damage was caused by Sandy rather than from other sources of damage, such as wear and tear. As such, the court deemed the expert's conclusion to be "tenuous and speculative," and excluded his testimony.** *(Wehman v. State Farm Fire & Cas. Co., Civil Action No. 14-1416 (FLW)(DEA), 2015 U.S. Dist. LEXIS 117445 (D.N.J. Sep. 3, 2015))*

- In this fair value dispute, the defendant challenged the methodology of the plaintiff's expert, who was providing an alternative property valuation method. **Since complete data was not available, the plaintiff's expert, a CPA followed the guidelines of the American Institute of Certified Public Accountants (AICPA) Standards for Valuation Services, which allows for alternative valuation methods when it is "not practical or reasonable to obtain or use relevant information" and when you cannot apply the standard appraisal methods "because of the unreliability of the financial data."** Denying the defendant's motion, the District Court ruled that the "reliability inquiry is a flexible one" and that the expert's methodology met the "threshold requirement" for reliability. *(Hutchison v. Parent, No. 3:12 cv 320, 2015 U.S. Dist. LEXIS 55350 (N.D. Ohio Apr. 27, 2015))*

- In this copyright infringement case, the plaintiff alleged that the defendants improperly used a sample of the plaintiff's song. The plaintiff sought to claim damages based on the commercial success of the defendants' song. The plaintiff's expert was an entertainment reporter for a local morning news show in Los Angeles. In this capacity, the expert asserted that he had "interviewed dozens of popular musicians and reported on hundreds of concerts and musical events." The expert opined that some of the profits of the main defendant's concerts were attributable to the infringing song, because the song was a major hit and "because consumers attend concerts to hear musicians perform their hits." The expert also concluded that it would be reasonable to attribute at least 15 percent of the revenue from a show to the infringing song based on factors "such as the significance of hit songs to an artist's popularity and the desire of concert goers to hear hit songs." The court found that the expert's conclusions were not expert opinions, but were "based on his personal experiences attending concerts, an experience millions of members of the public and likely many members of the jury share." In addition, the expert did not adequately support his opinions for apportioning concert revenues. While the expert stated that certain factors might support attributing a greater percentage of the defendant's concert revenues to the infringing song, the expert did not "state in his expert report that he considered these factors or how those factors might function in connection with his 15 percent valuation." **The court excluded the expert's testimony, stating that his "opinion appears to be based primarily on speculative conclusions and lacks the factual basis required for expert testimony."** *(Fahmy v. Jay Z, No. 2:07-cv-05715-CAS(PJWx), 2015 U.S. Dist. LEXIS 129446 (C.D. Cal. Sep. 24, 2015))*

Are you qualified?

Another factor under Rule 702 is that an expert be qualified as such based on "knowledge, skill, experience, or education." Over the course of our study, we have seen courts ascribe different weights to each of these factors. For example, is industry experience necessary for a lost profits expert if that expert has significant experience in performing lost profits calculations over a wide range of industries? Or is a college-level course in statistics sufficient qualification to incorporate statistical analysis in a lost profits calculation? The cases below provide examples from 2015 of the many interpretations courts have used in determining whether experts are "qualified" under the *Daubert* standard.

Illustrative cases

- In this insurance claim case, the plaintiffs retained an expert, both a CPA and Chartered Financial Analyst (CFA), to calculate the diminution of property value caused by an undisclosed easement. **The expert testified that his practice focused on valuing closely held assets in the context of transactions, tax, financing, and disputes. However, the expert had no experience in the appraisal of real property.** In order to determine the diminution of property value, the expert created an index designed to measure price changes of high-end properties in Pebble Beach, CA, specifically for this litigation matter. The court excluded the expert's opinion and testimony, citing among several reasons the " 'very significant fact' that [the expert's] methodology was developed for this litigation," that the expert's methodology had not been "reliably or independently verified," and that the index was "developed by a person with absolutely no experience in valuing real property."
(Feduniak v. Old Republic Nat'l Title Co., No. 13-cv-02060-BLF, 2015 U.S. Dist. LEXIS 57694 (N.D. Cal. May 1, 2015))

- In this maritime case, a ship chartered by the defendant to conduct underwater surveys hit a mooring line holding in place a drilling rig owned by the plaintiff. The defendant moved to exclude the plaintiff's damages expert on the basis that she had "very limited knowledge of the drilling business, and is not familiar with the types of expenses and costs incurred in the drilling of a well." The defendant also critiqued the expert's reliance on "erroneous assumptions provided by [plaintiff's counsel] regarding such expenses and costs." However, the defendant did not suggest that the expert "failed to reliably apply 'accepted accounting principles' as she asserts in her report." **The court denied the defendant's motion to exclude the plaintiff's expert, citing precedent that suggested an expert does not need expertise in a particular industry to help the jury understand certain concepts.** *(Shell Offshore, Inc. v. Tesla Offshore, L.L.C., No. 13-6278, 2015 U.S. Dist. LEXIS 130199 (E.D. La. Sep. 28, 2015))*

- In this product liability case, the plaintiff contended that the defendant was negligent in designing and manufacturing ballasts for fluorescent light fixtures that contained banned toxic chemicals known as Polychlorinated Biphenyls ("PCBs"). The plaintiff alleged that failing ballasts released PCBs into classrooms maintained by the plaintiff, and that PCBs could cause toxic injuries. As such, the plaintiff asked that the defendant be ordered to pay for testing and for the remediation of the contaminated

facilities. The plaintiff's financial expert calculated the cost to test and remediate the PCB contamination based on a "standard, generic protocol" created by the Environmental Protection Agency (EPA). The court found the expert's testimony to be unreliable because the EPA protocol upon which he relied was "not the protocol that ultimately will be used in plaintiff's schools." **The court also stated that the plaintiff's expert had "never created a PCB remediation plan," had not "received any training on PCB remediation," and was "unfamiliar with plaintiff's facilities and classrooms."** The court excluded the plaintiff's financial expert because a remediation protocol for the schools had not been written and because the expert was "not even qualified to speculate about the possible details of such a PCB-specified protocol." *(Tuscumbia City Sch. Sys. v. Pharmacia Corp., Civil Action No. CV-12-S-332-NW, 2015 U.S. Dist. LEXIS 17199 (N.D. Ala. Feb. 12, 2015))*

- In this discrimination case related to Section 8(a) of the Small Business Act, the plaintiff put forth an expert to rebut the reports of two of the defendant's experts, both Ph.D. economists. The plaintiff's expert was the vice president of the company with an undergraduate degree in electrical engineering. While the expert stated that it had been his "job, avocation and passion to review and analyze … data on small and small disadvantaged businesses for the purpose of knowing where contracts were being distributed," the court found that it was "undisputed that [the expert] does not have any formal education or training in statistical or econometric analysis … and he has never worked with regression models prior to this case." In addition, the expert's report did not address the statistical significance of any of his calculations. Rather, the expert claimed that "he didn't do any statistics that required computation of statistical significance … [his calculations] were 100 percent significant because they weren't statistics." **The court therefore ruled that "based on [the expert's] own admissions regarding his lack of training, education, knowledge, skill, and experience in any statistical or econometric methodology, [the expert] is plainly unqualified to testify as an expert with respect to [the defendant experts'] reports."** *(Rothe Dev., Inc. v. DOD, 107 F. Supp. 3d 183 (D.D.C. 2015))*

A rule of thumb

An intellectual property case from 2011 (*Uniloc USA, Inc. v. Microsoft Corp.*), which was included in our 2011 study, was widely seen as a landmark decision in intellectual property cases dealing with reasonable royalty calculations. In the case, the court rejected a 25 percent "rule of thumb" to approximate a reasonable royalty rate. The court described the rule of thumb as a "fundamentally flawed tool" because it fails to tie the royalty rate to the particular facts of the dispute, and does not differentiate between industries, technologies, or parties. Our study identified other instances in 2015 where expert testimony was excluded due to the use of rules of thumb and generalizations that did not relate to the specific facts of the case.

Illustrative cases

- In this intellectual property case, the plaintiff accused the defendant of infringing on the plaintiff's portfolio of patents related to internet security. The plaintiff's expert used three methods to apportion the royalty base for the infringing products. Each method was challenged by the defendants. The plaintiff's first method used forward citation analysis, which suggests that a patent's value is strongly correlated with the number of times that patent is cited as prior art by future patents. However, the defendant asserted that this methodology has "little meaningful connection to the accused features in this lawsuit." The court agreed with the defendant's challenge and excluded the plaintiff expert's first methodology. The court found that "most problematically, [the plaintiff's expert] offers no explanation as to why the forward citation methodology is an appropriate measure of the value of the patents at issue in this case. **Without facts tying her analysis to the facts of the case, [the expert's] reliance on a methodology discussed in empirical economics literature has little more probative value than the '25 percent rule of thumb' and Nash Bargaining Solution analyses that the Federal Circuit rejected in *Uniloc* and *VirnetX*."** *(Finjan, Inc. v. Blue Coat Sys., No. 13-cv-03999-BLF, 2015 U.S. Dist. LEXIS 91528 (N.D. Cal. July 14, 2015))*

- In this intellectual property case, the plaintiff alleged that the defendant infringed on its patents related to mobile data and device management ("MDM") technologies. The plaintiff's expert used four reasonable royalty scenarios to calculate damages for the alleged infringement. In one of these scenarios, the expert estimated that the plaintiff would only be able to negotiate for 30 percent of the defendant's profit margin. To arrive at this percentage, the expert began "his profit split calculation with the Nash Bargaining Solution ["NBS"], in which [the plaintiff and defendant] negotiate a 50/50 profit split." The expert then adjusted the split by measuring the relative importance of the patents-in-suit using industry reports on the "ten criteria necessary for any MDM product to compete in the market. After determining the functionality of [the plaintiff's] patents-in-suit covers at least three of those categories, [the expert] adjusts the profit split so that [the plaintiff] received 30 percent of the profits." **Citing the *VirnetX* ruling, the court determined that a default assumption of a 50/50 split was an impermissible "rule of thumb," that "the NBS cannot be assumed to apply in every case and that the 50/50 split, even if later modified, impermissibly risked skewing the baseline assumptions of the jury."** The court found that the expert failed to "tie the 50/50 split to the specifics of this

case or to explain why such a split would be reasonable – other than to invoke a boiler-plate assertion about the relative bargaining powers of the parties." The court also critiqued the expert's use of the ten criteria to arrive at a 30/70 split, specifically that the expert had assigned equal value to each criterion and did "no investigation into whether any of the criteria is more important than others, or how strongly each criterion is tied to the patents." Ultimately the court excluded this particular reasonable royalty scenario, as well as two of the expert's other scenarios. *(Good Tech. Corp. v. MobileIron, Inc., No. 5:12-cv-05826-PSG, 2015 U.S. Dist. LEXIS 87347 (N.D. Cal. July 5, 2015))*

Better luck next time

While a *Daubert* exclusion typically means "game over" for an expert's involvement in a case, we have recently seen courts provide financial experts a chance to revise or update their testimony before providing a final decision on the expert's admissibility.

Illustrative case

- In this case, the defendant's expert prepared a before-and-after appraisal of the market value of a tract of land taken from the defendant by the United States for the use of the Tennessee Valley Authority. In performing his appraisal, the expert mistakenly believed that the plaintiff took a fee-simple interest in one parcel of the tract of land, and as such, did not appraise the after-taking value of that parcel. However, the plaintiff actually took only an easement and right-of-way in that parcel, which would have affected the expert's market value calculation. The plaintiff argued that the defendant's expert should be excluded because his opinions were "based upon a mistake of fact." The court agreed that this would be a reason to exclude the expert's opinions as unreliable. However, the defendants requested leave to file an amended expert report based on a corrected understanding of the interest taken by the plaintiff. **Although discovery in the case had closed, the court granted the request for an amended report since a trial date had not been set. The court's decision was on the condition that the defendant provide the plaintiff an opportunity to depose the defendant's expert regarding the amended report.** *(United States v. An Easement & Right-of-Way Over 4.95 Acres of Land, Civil Action No. 5:14-cv-00241-CLS, 2015 U.S. Dist. LEXIS 61154 (N.D. Ala. May 11, 2015))*

In legal territory

In case decisions throughout the past 16 years of the study, we have observed financial experts being excluded or partially excluded for offering testimony that veered into the territory of legal conclusions. This can often happen when financial experts opine on contractual obligations or conclude on the interpretation of disputed contracts in the context of their financial testimony. However, these questions depend heavily on the facts and circumstances of each individual case.

Illustrative cases

- In this securities litigation case, the defendants' expert prepared a rebuttal report in which he discussed regulations and common industry practices relative to the segregation of customer funds. The defendants' expert concluded that certain transfers "comported with regulatory requirements and industry practices," and "complied with applicable CEA and CFTC regulations." **The court ruled that these conclusions reflected legal opinions and excluded these portions of the expert's testimony. However, the court found that there was "little doubt that [the expert's] testimony on industry customs and practices with respect to segregation and cash sweeps will prove helpful to the jury."** The court allowed the expert to testify as to industry customs and practices because this testimony would "allow the jury to contextualize the transactions at issue in this litigation, and will further provide helpful comparative information concerning industry standards relevant to this litigation." (*Krys v. Aaron, 112 F. Supp. 3d 181 (D.N.J. 2015)*)
- In this breach of contract case, the plaintiff claimed that the defendant failed to complete an audit of the plaintiff's financial statements for the purposes of an S-1 Registration Statement. The plaintiff's expert provided opinions that the defendant's audit was not consistent with industry practice and standards and that the defendant was negligent in its responsibilities. The defendant challenged various aspects of the plaintiff's expert's opinions, including the expert's qualifications, the reliability of his opinions, the application of his opinions to the facts of the case, and his improper legal conclusions. Specifically with respect to the expert's legal conclusions, the expert opined that the defendant was in breach of its engagement letter and that the defendant was negligent in its responsibilities to the plaintiff. **The court agreed that these opinions "would improperly substitute [the expert's] judgment for that of the trier of fact," and precluded the expert from offering these opinions at trial.** *(Avangard Fin. Grp., Inc. v. Raich Ende Malter & Co, LLP, No. 12-6497, 2015 U.S. Dist. LEXIS 52034 (E.D. Pa. Apr. 17, 2015))*

2015 Results

Overview

How ?

How have exclusion rates changed over time? 44% of financial experts were excluded in 2015. This is consistent with the 16-year average of **44%**.

Why ?

Why are financial experts being excluded? Lack of **reliability** has been the most common reason for the exclusion of financial expert witness testimony, both in 2015 and over the last 16 years.

What ?

What types of cases have higher exclusion rates? Financial-expert *Daubert* challenges most commonly occur in **breach of contract/fiduciary duty** cases. Over the last 16 years, the exclusion rates of financial experts have been highest in **intellectual property** and **product liability** cases.

Where ?

Where are exclusion rates highest? Both in 2015 and over the last 16 years, challenges most frequently occurred in the **Second, Fifth, Sixth,** and **Ninth** circuits. Over the last 16 years, exclusion rates have been highest in the **Second**, **Tenth**, and **Eleventh** circuits.

Who ?

Who experiences higher exclusion rates? In 2015, **accountants** faced the highest number of challenges and experienced the highest exclusion rate. **Plaintiff-side** financial experts experienced almost twice as many challenges as defendant-side experts, but only had a slightly higher exclusion rate (47%).

When ?

When *Daubert* rulings are appealed, how often are they overturned? Appellate courts have agreed with lower courts on financial-expert *Daubert* rulings approximately 78% of the time. However, appellate court agree rates are lower in instances where the lower court excluded the financial expert.

How have exclusion rates changed over time?

- In 2015, there were 230 reported challenges to financial expert witnesses—an increase of 10% from 2014.
- Of the 230 challenges against financial experts in 2015, 102 challenges (44%) resulted in partial or full exclusion of the expert (see Figures 2 and 3).

Figure 2: *Daubert* challenges and exclusions to financial expert witnesses, 2000–2015

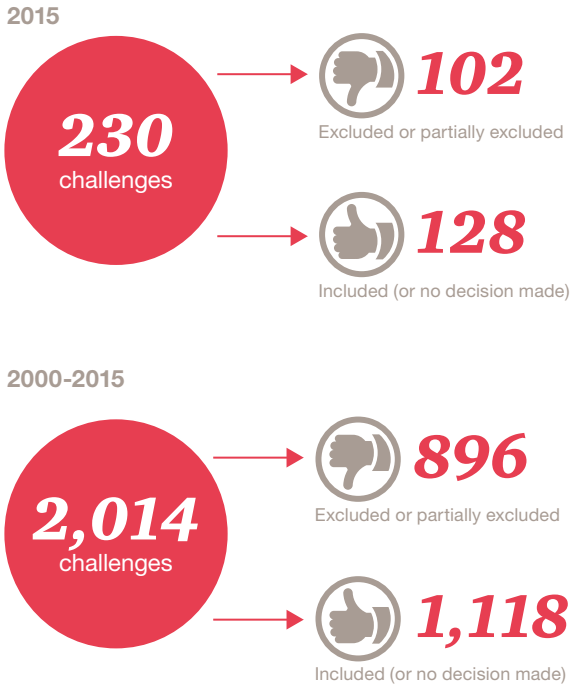
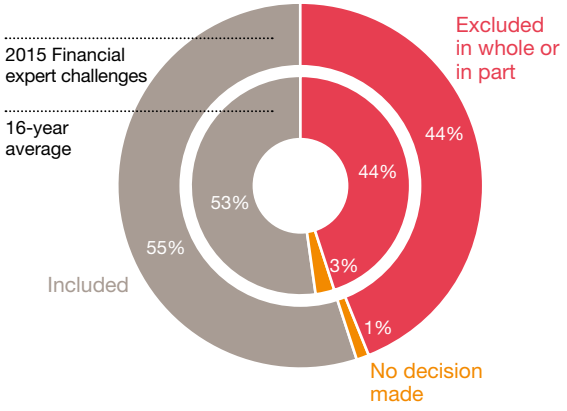


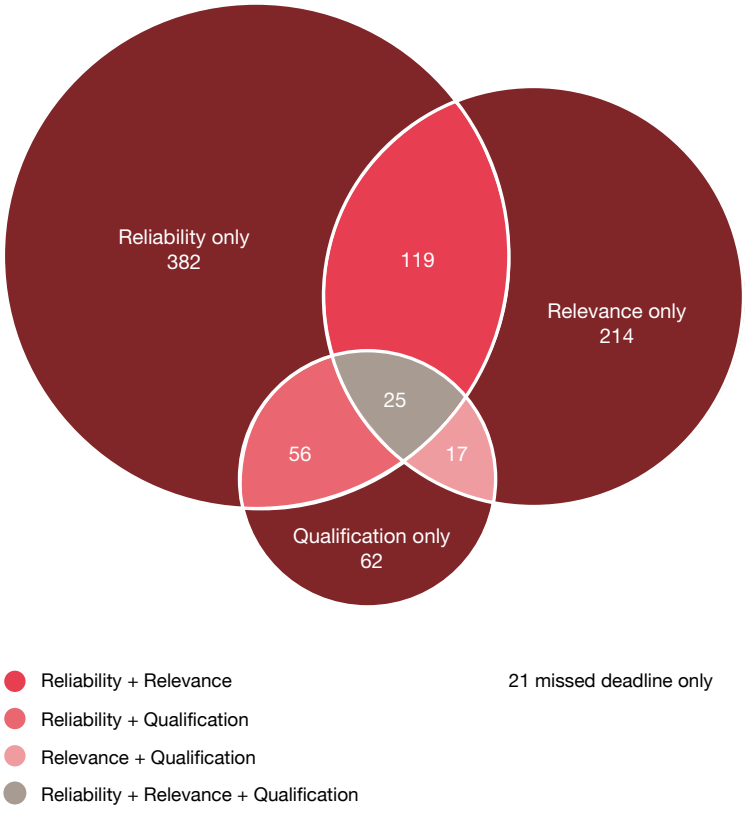
Figure 3: Outcome of *Daubert* challenges to financial expert witnesses



Why are financial experts being excluded?

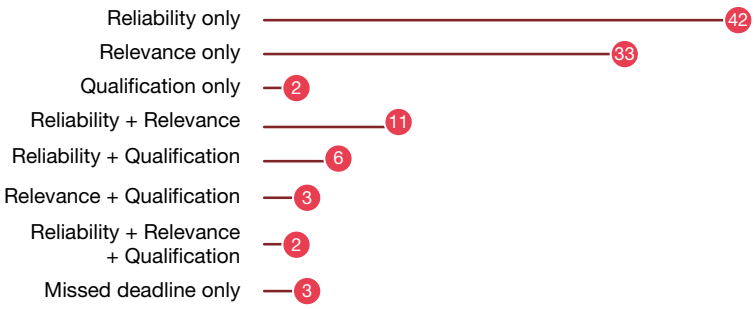
- Federal Rule of Evidence No. 702, "Testimony by Experts," governs the admissibility of expert witness testimony and incorporates the precedent set by *Daubert*, *Kumho Tire*, and other rulings. Rule 702 provides that a qualified expert's testimony is admissible if it is both relevant and reliable, and identifies criteria for evaluating relevance and reliability. We used the criteria from Rule 702 to evaluate the reasons for financial expert witness exclusions.
- In 2015, financial experts were most commonly excluded because their testimony was not considered reliable (see Figure 5). Reliability, either on its own or in combination with other factors, has consistently been the main reason for financial expert witness exclusions over the course of our study (see Figure 4).
- When excluding testimony due to a lack of reliability, courts most frequently cited a lack of sufficient data or the use of methods that are not generally accepted as reasons for exclusion.

Figure 4: Reasons cited in financial expert exclusions, 2000–2015



- The second most common reason for exclusion in 2015 was that the testimony was not considered relevant to the case. This again is consistent with historical trends. When a financial expert is excluded for lack of relevance, it is often caused by testimony that was beyond the scope of the financial expert's role (e.g., testimony related to legal matters) or testimony that will not help the trier of fact (e.g., the opinion is not tied to the specific facts of the case).

Figure 5: Reasons cited in financial expert exclusions, 2015

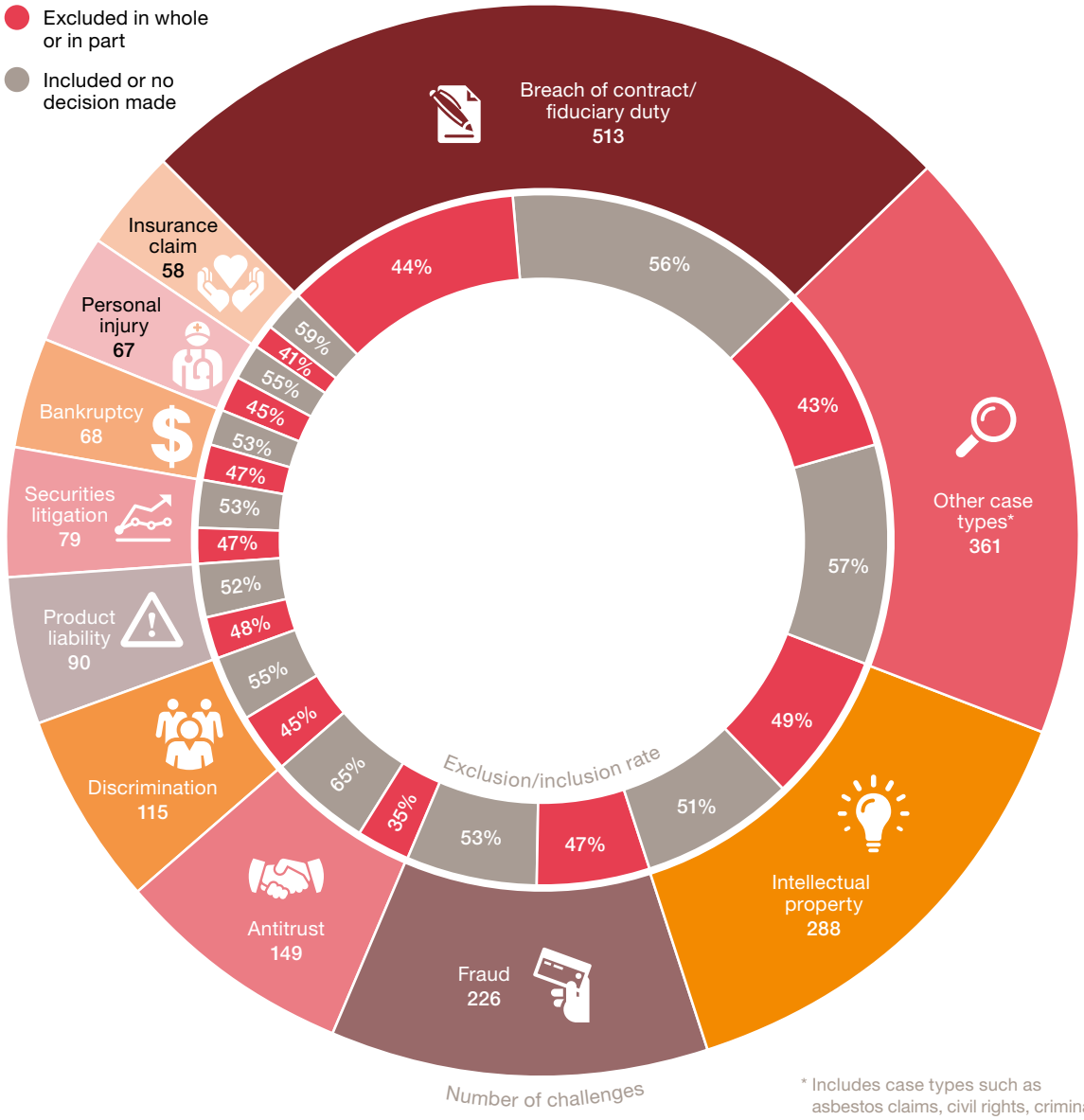


Illustrative case

In this case related to determining the market value of a ground lease for a billboard site, the court found that the plaintiff expert willfully failed to list cases in which he had previously provided expert testimony, contrary to the requirements of Rule 26 of the Federal Rules of Civil Procedure. In his CV, the expert provided only a list of judges and their chambers addresses, with no dates or case captions. The court explained that not being able to identify these cases would prevent the defendants from having the opportunity to evaluate the expert's prior opinions and use them as a gauge against the expert's testimony in this case. The court also critiqued the plaintiff's "insouciance towards its obligations under Rule 26" with respect to disclosures of the expert's prior publications. Furthermore, the court faulted the expert for failing to disclose the facts or data used to arrive at his conclusions. While the expert stated that he had relied on data he had accumulated over the years and on several data points to form his opinion, this data was not disclosed or identified within his report. Rather, in deposition, the expert explained that it was "stuff that he knows." The court excluded the expert for failing to comply with Rule 26 and for failing to disclose the particular data he acknowledged he relied upon in forming an opinion. *(Paramount Media Grp., Inc. v. Vill. of Bellwood, 308 F.R.D. 162 (N.D. Ill. 2015))*

What types of cases have higher exclusion rates?

Figure 6: *Daubert* challenges to, and exclusions of, financial expert witnesses, by case type, 2000–2015



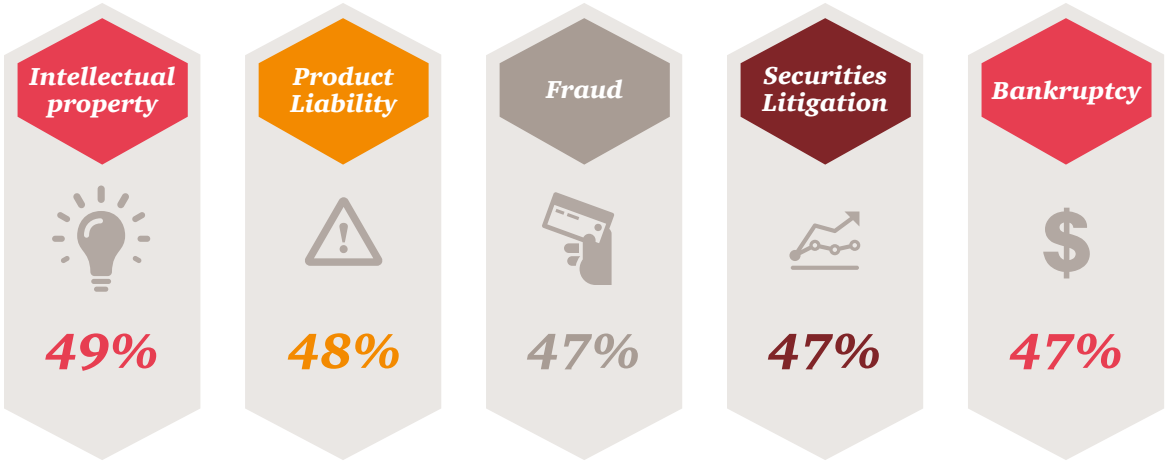
* Includes case types such as asbestos claims, civil rights, criminal proceedings, medical malpractice, real estate, and wrongful death.

- Financial experts testify in a wide range of disputes. The most common cases where we see challenges to financial expert witness testimony are ones arising from a breach of contract or of fiduciary duty (see Figure 6).
- For the 16 years captured in our study, intellectual property, product liability, fraud, securities litigation, and bankruptcy cases had the highest rates of exclusion for financial expert witness testimony (see Figure 7).
- During 2015, cases involving intellectual property disputes resulted in the most challenges to financial expert witnesses, and cases arising from product liability had the highest exclusion rate.

Illustrative case

In this intellectual property case, the plaintiff alleged that the defendant had infringed on its patents related to a web-based media submission tool. On appeal, the appellate court reviewed the district court's decision to allow the testimony of the plaintiff's damages expert. The defendant argued that the expert's methodology was "unpublished, created specifically for this litigation, and never before employed by [the expert] or by another expert." The defendant also claimed that the expert's premise that "a feature's use is proportional to its value" was "incorrect and contradicted by other expert testimony." However, the appellate court disagreed with the defendant's arguments and upheld the district court's ruling, recognizing that "estimating a reasonable royalty is not an exact science." The court found that the expert's "damages methodology was based on reliable principles and was sufficiently tied to the facts of the case." In addition, the fact-based nature of the damages model "made it impractical, if not impossible, to subject the methods to peer review and publication." *(Summit 6, LLC v. Samsung Elecs. Co., 802 F.3d 1283 (Fed. Cir. 2015))*

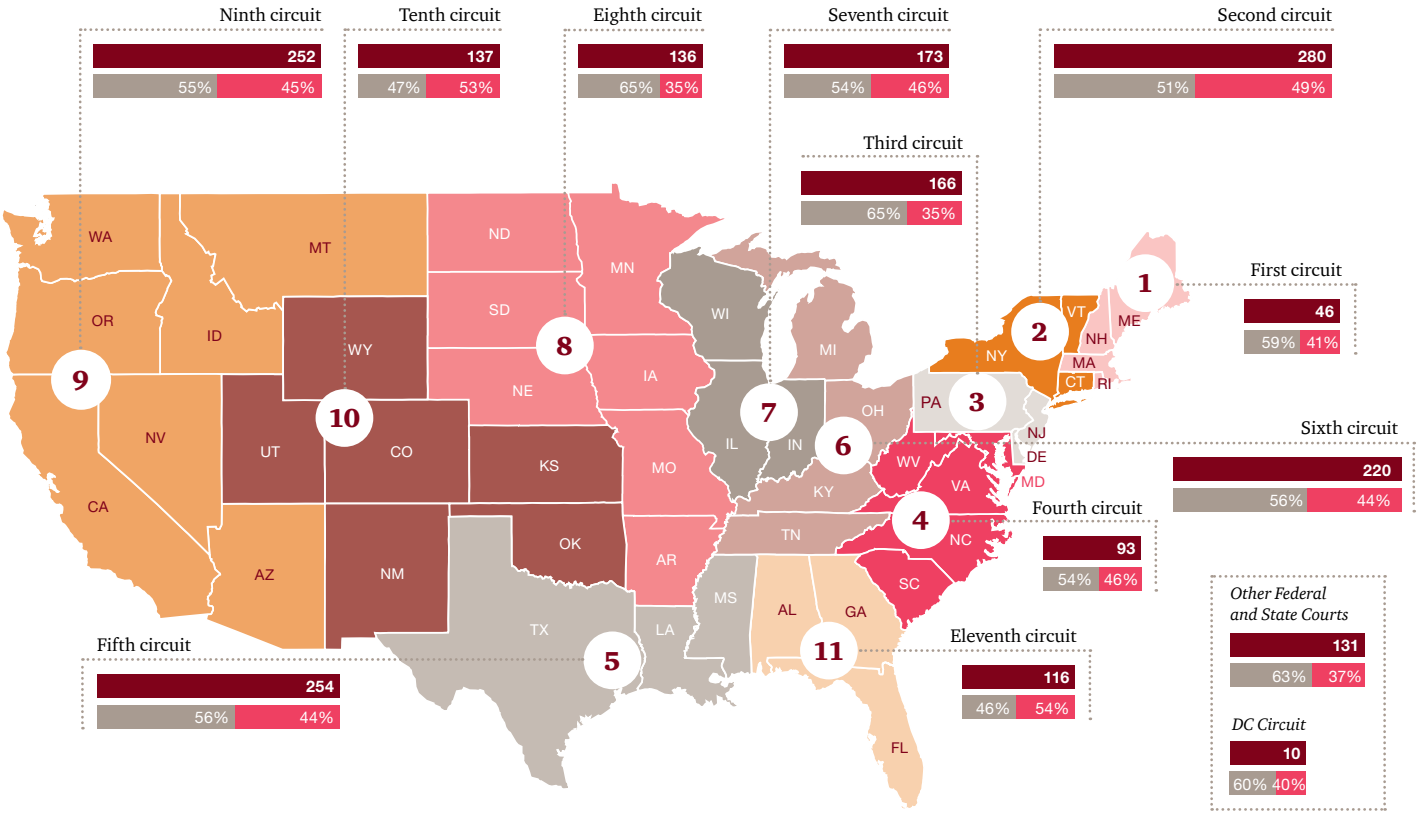
Figure 7: Case types with the highest exclusion rates, 2000–2015



Where are exclusion rates highest?

- The *Daubert* criteria are the standard of review for the admission of expert witness testimony in the federal courts. Some states have also adopted *Daubert* factors as their standard of review.
- Over the 16 years of our study, the Second, Tenth, and Eleventh Circuits have, on average, had the highest exclusion rates, while the Third and Eighth Circuits have had the lowest. In the Tenth and Eleventh Circuits, the exclusion rate has been greater than 50% (see Figure 8).

Figure 8: Number of *Daubert* challenges and exclusions to financial expert witnesses, by Federal Circuit, 2000–2015



- In 2015, *Daubert* challenges to financial experts most frequently occurred in the Fifth, Sixth, and Ninth Circuits, circuits which include Texas, Ohio, and California, respectively. The Second Circuit, which includes New York, has seen the most challenges over the course of our study (see Figures 8 and 10).

Figure 9: Most frequently challenged case types in jurisdictions with the most challenges, 2015

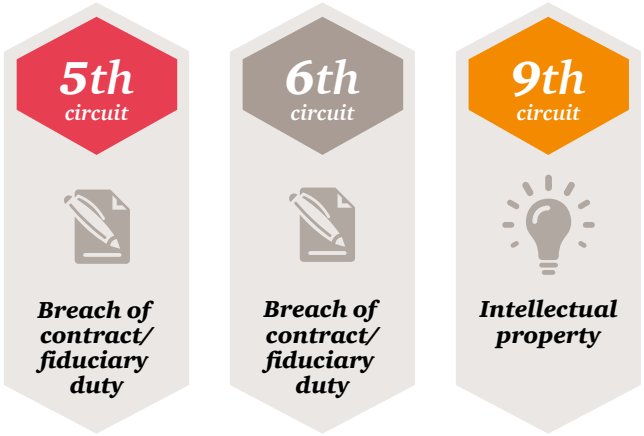
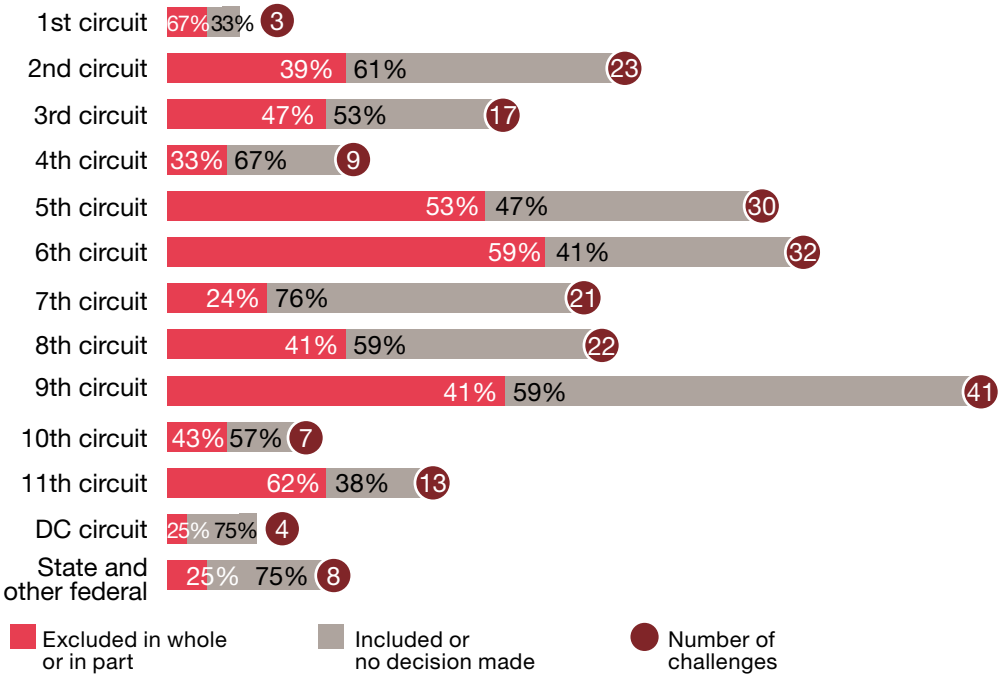


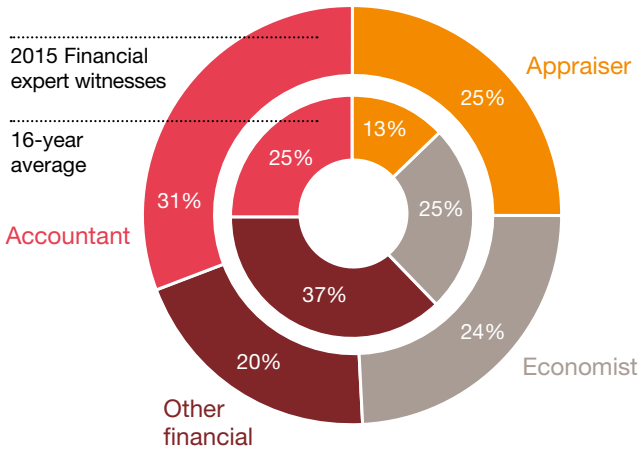
Figure 10: Number of challenges and exclusion percentages by circuit in 2015



Who experiences higher exclusion rates – accountants, appraisers, or economists?

- The most common types of experts engaged to provide financial expert witness testimony are accountants, appraisers, and economists. We also see other financial experts such as statisticians, financial analysts, finance professors, etc.
- In 2015, accountants faced the highest number of *Daubert* challenges (see Figure 11). Over the last 16 years, of the three most common financial expert types, accountants and economists have been the most frequently challenged experts.

Figure 11: *Daubert* challenges to financial expert witnesses, by expert type, 2000–2015



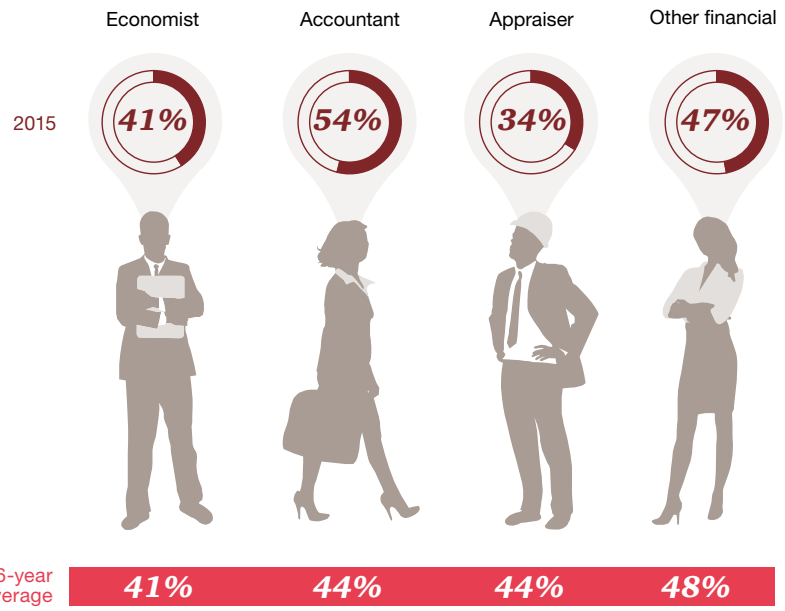
Illustrative case

In this trademark infringement case, the defendants sought to exclude the opinions of the plaintiff's expert, an economist. Specifically, the defendants objected to the inclusion of several spreadsheets created by the expert that reflected the defendants' revenues, margins, and profits "on the grounds that she simply took data produced by [the defendants] and reformatted it." However, the court disagreed, stating that the expert "did more than simply add a few numbers – she combed through at least 100 pages of sales reports, compiled and aggregated the data, … and presented it in a more readily understandable format." The defendants also objected to the expert's opinions on the effect of the defendants' sales on the plaintiff's brand value because "she relied on articles about brand value and deposition testimony without performing any analysis of her own." The court, however, found that such sources "are clearly within the universe of those on which [the expert] could possibly rely," and the fact that the expert's testimony "is qualitative, rather than quantitative, does not mean that it must be excluded." *(Louis Vuitton Malletier S.A. v. Sunny Merch. Corp., 97 F. Supp. 3d 485 (S.D.N.Y. 2015))*

- In 2015, accountants also had the highest exclusion rate of the three most common financial expert types. 54% of *Daubert* challenges to accountants resulted in full or partial exclusion during 2015 — a rate that represents a 10% increase compared to the 16-year average exclusion rate for accountants (see Figure 12).
- When it comes to the exclusion of financial expert witness testimony, economists have typically been excluded at the lowest rate (see Figure 12).

Figure 12: Exclusion rates for financial expert witnesses, by expert type, 2015 vs. 16 year average

Percentage excluded in whole or in part



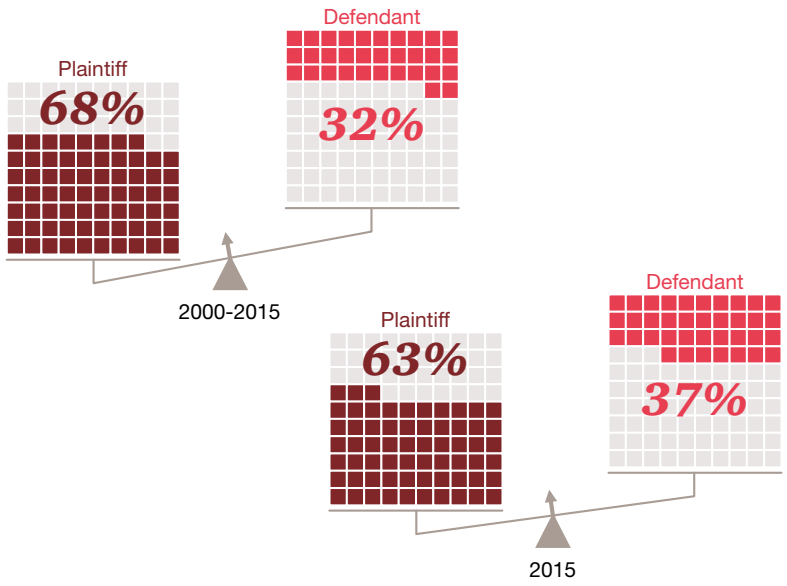
Illustrative case

In this antitrust case, plaintiffs alleged that Major League Baseball and the National Hockey League conspired with regional sports networks and multichannel video programming distributors to limit the viewing options available to plaintiffs and inflate prices. Defendants challenged the reliability of plaintiffs' expert economist on the grounds that the expert's methodology was flawed. The expert used a model to calculate damages for the entire class of plaintiffs that included both supply-side and demand-side analyses. The court excluded the expert's opinions related to the demand-side analysis, stating that "the problem for plaintiffs is that, at bottom, all of the examples defendants and [their economist] point to...expose the same underlying problem, which is quite fundamental and fatal: [the] estimates [of plaintiff's expert] do not rely on sufficient data about consumer tastes and preferences." *(Laumann v. NHL, No. 12-cv-1817 (SAS), 2015 U.S. Dist. LEXIS 63744 (S.D.N.Y. May 14, 2015))*

Who experiences higher exclusion rates – plaintiff- or defendant-side experts?

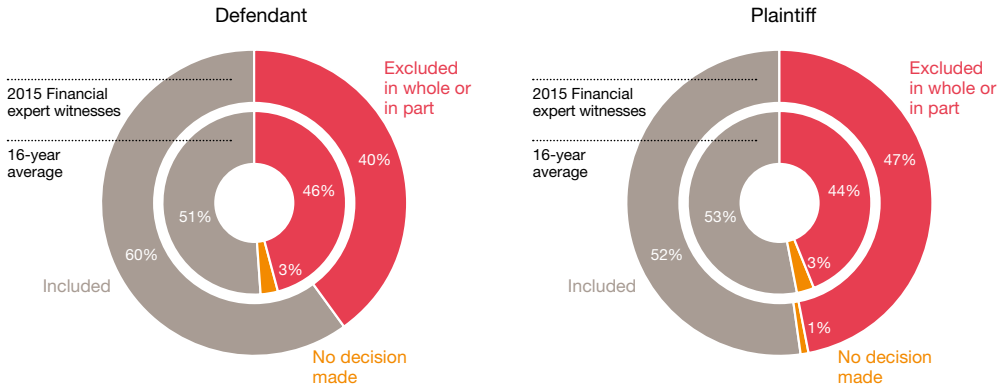
- Over the course of our study, there have consistently been almost twice as many *Daubert* challenges to plaintiff-side financial experts as there have been to defendant-side financial experts. In 2015, 63% of challenges were to plaintiff-side experts (see Figure 13).

Figure 13: *Daubert* challenges to financial expert witnesses, plaintiff-side vs. defendant-side, 2000–2015



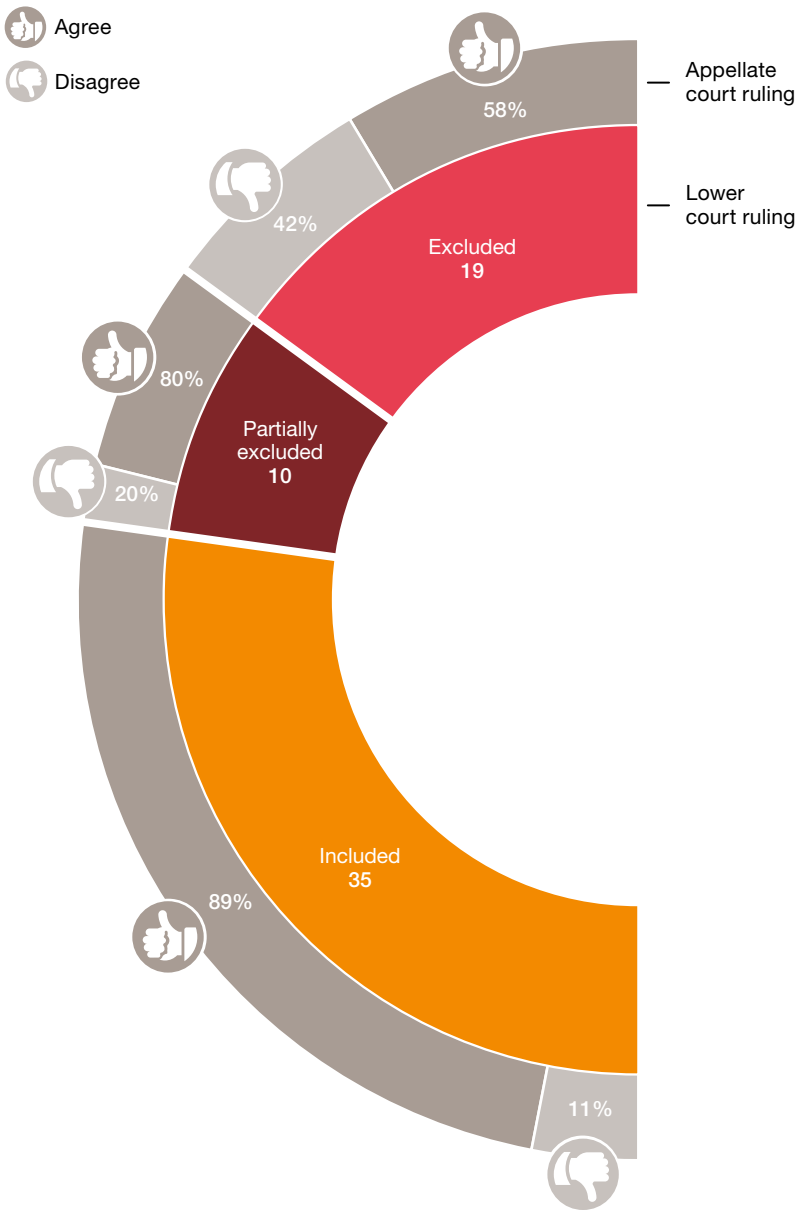
- On average, defendant-side financial experts experience a marginally higher exclusion rate than plaintiff-side financial experts. However, during 2015, the exclusion rate for plaintiff-side financial experts was higher than for defendant-side financial experts (see Figure 14).

Figure 14: Exclusion rates for financial expert witnesses, plaintiff-side vs. defendant-side, 2000–2015



When lower-court Daubert *challenge rulings are appealed, how often are they overturned?*

Figure 15: *Daubert* challenges to financial witnesses in appellate courts, 2011–2015



- In 2011, we began analyzing the approach of appellate courts to lower-court rulings on financial-expert *Daubert* challenges.
- Between 2011 and 2015, there were 64 appeals of lower-court rulings on financial-expert *Daubert* challenges. More than half of the appeals were related to financial experts whose testimony had been accepted by the lower court (see Figure 15).
- In the majority of appeals, the appellate court upheld the ruling of the lower court (see Figure 15).

Methodology

We searched written court opinions issued between January 1, 2000, and December 31, 2015 (i.e., post–*Kumho Tire*), using the citation search string "526 U.S. 137" (*Kumho Tire v. Carmichael*). Our search identified 8,027 federal and state cases during 2000–2015 that involved 11,013 *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 the 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 2,014 *Daubert* challenges were aimed at financial experts during 2000–2015. 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 No. 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 is 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, we define "success" 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.

Authors

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