Daubert, Kumho Tire and the Forensic Child Expert

Author:

RICHARD R. ORSINGER
McCURLEY, ORSINGER, McCURLEY
& NELSON, L.L.P.
1616 Tower Life Building
San Antonio, Texas 78205
210-225-5567 (Telephone)
210-267-7777 (Telefax)
richard@momn.com
http://www.orsinger.com

Panelists:

Stephen P. Herman, MD, New York, NY
Melvin Guyer, JD, PhD (I), Ann Arbor, MI
Daniel W. Shuman, JD (I), Dallas, TX

2003 Annual Meeting of the
American Academy of Psychiatry & the Law
October 16-17, 2003 – San Antonio, Texas

TABLE OF CONTENTS

Daubert, Kumho Tire and the Forensic Child Expert©

by
Richard R. Orsinger

Board Certified Family Law
& Civil Appellate Law
Texas Board of Legal Specialization

I. SCOPE OF ARTICLE. This article considers the distinction between fact testimony, lay opinions, and expert opinions. The article discusses differences between the roles of lay witnesses and expert witnesses. The article discusses how these concepts have been applied to financial experts. The article discusses how to preserve error of complaints that an expert's methodology does not meet the general acceptance test or does not meet *Daubert* requirements. In this article, FRE = Federal Rules of Evidence; FRCP=Federal Rules of Civil Procedure; TRE=Texas Rules of Evidence. Citations to "WL" are to Westlaw. Citations to "Lexis" are to the Lexis Nexis research service.

The article discusses sources of authority in the real estate valuation and accounting fields that can be used to gauge whether the testimony of a financial expert is the product of reliable principles and methods and whether the expert has applied the principles and methods reliably to the facts of the case. And the article discusses testimony relating to lost profits.

II. OVERVIEW OF FACTS, LAY OPINION, AND EXPERT OPINION. A witness can possibly testify to facts, to lay opinions, and to expert opinions. For example, an accountant who testifies that a set of books are the accounting records of a certain business is testifying to facts. An accountant who states the average of a company's net taxable income for the past five years is testifying to a lay opinion. An accountant who testifies that an audit was not done in compliance with generally accepted auditing standards is testifying to an expert opinion.

Under the Federal Rules of Evidence, and the state rules of evidence patterned after them, the distinction between lay and expert testimony has several practical effects. The U.S Court of Appeals for the Seventh Circuit commented that "[t]he difference between an expert witness and an ordinary witness is that the former is allowed to offer an opinion, while the latter is confined to testifying from personal knowledge." *United States v. Williams*, 81 F.3d 1434, 1442 (7th Cir. 1996). Actually, the distinction drawn by the court is inaccurate, insofar as it suggests that lay witnesses cannot testify to opinions. The following description helps to sharpen the differences between lay testimony and expert testimony

Any witness, lay or expert, can testify to matters regarding which the witness has personal knowledge. Lay witnesses can testify to lay opinions, but only based upon personal knowledge. Experts can rely on things not personally known to them in forming opinions which they can thus relate in court. Also, lay witnesses must state the foundation for their opinions before they are allowed to state the opinion, but an expert can testify to an opinion without first laying the predicate for the opinion. And an expert can testify to opinions that a lay witness is not competent to give, where the opinion relates to an area of the expert witness's expertise. This can be a critical distinction, for some issues necessary to a lawsuit can be established only by expert testimony, and not lay testimony.

John F. Sutton, Jr., former Dean of the University of Texas School of Law, made the following observations in his 1993 article on the Texas Rules of Evidence, which at the time were identical to the FRE. Dean Sutton is highlighting the fact that an expert could be testifying to personally known fact, lay opinions, or expert opinions, or some combination of the three.

Dean Sutton wrote:

> A witness who is qualified as an expert may testify in three different ways: he may testify to his personal knowledge of the facts in issue, in which case he testifies to opinions under Rule 701; he may provide the fact-finder with general back-ground information regarding the theory and principles relative to his field of expertise; and he may evaluate specific data and facts in issue in light of his experience in a particular specialized field, in which case he testifies to opinions under Rule 702. A witness with specialized training or experience is not limited to giving opinion testimony as a Rule 702 "expert." If his opinion rests on firsthand knowledge-that is, if it is rationally based on his own perceptions-then testimony under Rule 701 is also permissible. The greater his experiential capacity, the more likely his opinions will "help" the trier of fact under Rule 701, and the greater the likelihood that his testimony will "assist" the jury under Rule 702. For example, the plaintiff in *Teen-Ed, Inc. v. Kimball International, Inc.*, [620 F.2d 399 (3d Cir. 1980)], offered his tax accountant's testimony regarding lost profits. The trial court, proceeding under the erroneous assumption that only an expert could offer opinion testimony, excluded the

> evidence because the plaintiff had not designated the accountant as an expert before trial. The Third Circuit reversed, stressing that the proffered opinion was predicated entirely on the witness' firsthand knowledge of Teen-Ed's books. He was thus eligible under Rule 701 to give an opinion on lost profits based upon the inferences drawn from his knowledge of Teen-Ed's books. The court held that the accountant's potential qualifications as an expert did not prevent him from testifying within the narrower confines of Rule 701.
>
> To the extent that the defendant in *Teen-Ed* was able to cross-examine and rebut the accountant's opinion adequately, the decision is sound. In *Teen-Ed*, the fact that the accountant was a participant in the events to which he testified and not an expert hired to testify tends to excuse the trial court's failure to distinguish between lay and expert witnesses. An arbitrary and artificial distinction between lay and expert witnesses should not prompt exclusion of relevant, helpful information from witnesses with adequate experiential qualifications. [footnotes omitted]

Sutton, John F., Jr., *Article VII: Opinions And Expert Testimony*, 30 HOUS. L. REV. 797, 819-20 (1993).

As noted by the Seventh Circuit in *United States v. Williams*, 81 F.3d 1434, 1442 (7th Cir. 1996), "[a]n economist . . .is allowed to testify that a particular pattern of pricing indicates that the defendant participated in a price-fixing conspiracy, whereas the lay witness could testify only to what the prices were."

In a malpractice case, the key distinction between lay and expert testimony for purposes of liability relates to establishing the standard of care that applies to the defendant's conduct, and whether that standard was breached, and whether the breach caused damages to the plaintiff. Only an expert, and not a lay witness, can give this kind of testimony.

III. FACT TESTIMONY. There are a number of rules of evidence relating to fact witnesses.

A. COMPETENCY. Rule 601 relates to the competency of witnesses, generally. It begins with the premise that every person is competent to testify, but that exceptions exist. Where state law is the basis of the lawsuit, then the state law of competency applies. In a case removed from a Texas court to federal court based on diversity of citizenship, competency of witnesses would be governed by Texas Rule of Evidence 601, which provides that witnesses are normally competent to testify, except for insane persons, children or other impaired persons who appear not to possess sufficient intellect to answer questions, and parties litigating against representatives of a deceased or incompetent person (the "dead man rule"). FRE 601 provides:

> **FRE 601. General Rule of Competency**
>
> Every person is competent to be a witness except as otherwise provided in these rules. However, in civil actions and proceedings, with respect to an element of a claim or defense as to which State law supplies the rule of decision, the competency of a witness shall be determined in accordance with State law.

B. PERSONAL KNOWLEDGE REQUIRED. Rule 602 requires all witnesses, except for experts testifying to opinions, to have personal knowledge about what they say. TRE and FRE 602 provide:

> **Rule 602. Lack of Personal Knowledge**
>
> A witness may not testify to a matter unless evidence is introduced sufficient to support a finding that the witness has personal knowledge of the matter. Evidence to prove personal knowledge may, but need not, consist of the witness' own testimony. This rule is subject to the provisions of Rule 703, relating to opinion testimony by expert witnesses.

IV. LAY OPINIONS.

A. TRE 701. TRE 701 says:

> Rule 701. Opinion Testimony by Lay Witnesses
>
> If the witness is not testifying as an expert, the witness' testimony in the form of opinions or inferences is limited to those opinions or inferences which are (a) rationally based on the perception of the witness and (b) helpful to a clear understanding of the witness' testimony or the determination of a fact in issue.

B. FRE 701. FRE 701 governs opinions by lay witnesses in federal courts and courts of states who have adopted the FRE. The Rule reads:

> **Rule 701. Opinions by Lay Witness.**
>
> If the witness is not testifying as an expert, the witness' testimony in the form of opinions or inferences is limited to those opinions which are (a) rationally based on the perception of the witness, and (b) helpful to a clear understanding of the witness' testimony or the determination of a fact in issue, and (c) not based on scientific, technical, or

> other specialized knowledge within the scope of Rule 702.

FRE 701has some parallels to FRE 702, which suggests that there is a gate-keeping function for the trial court with regard to lay opinions. A lay opinion must be rationally based on a perception of the witness. The court should engage in an assessment of the reasoning process in arriving at the lay opinion, and if an opinion does not seem to the court to be rational then it should be excluded. And a lay opinion must be helpful to a clear understanding of the witness' testimony or the determination of a fact in issue. This helpfulness requirement is analogous to FRE 702's requirement that expert testimony assist the trier of fact.

It should be noted that even an expert may give an opinion under Rule 701, where the opinion is not based on scientific, technical, or other specialized knowledge that are properly the province of Rule 702.

It is instructive to read the advisory committee's comment to the December 2000 amendment to FRE 701:

> 2000 Amendments
>
> Rule 701 has been amended to eliminate the risk that the reliability requirements set forth in Rule 702 will be evaded through the simple expedient of proffering an expert in lay witness clothing. Under the amendment, a witness' testimony must be scrutinized under the rules regulating expert opinion to the extent that the witness is providing testimony based on scientific, technical, or other specialized knowledge within the scope of Rule 702. See generally Asplundh Mfg. Div. v. Benton Harbor Eng'g, 57 F.3d 1190 (3d Cir. 1995). By channeling testimony that is actually expert testimony to Rule 702, the amendment also ensures that a party will not evade the expert witness disclosure requirements set forth in Fed. R. Civ. P. 26 and Fed. R. Crim. P. 16 by simply calling an expert witness in the guise of a layperson. See Joseph, Emerging Expert Issues Under the 1993 Disclosure Amendments to the Federal Rules of Civil Procedure, 164 F.R.D. 97, 108 (1996) (noting that "there is no good reason to allow what is essentially surprise expert testimony" and that "the Court should be vigilant to preclude manipulative conduct designed to thwart the expert disclosure and discovery process"). See also United States v. Figueroa-Lopez, 125 F.3d 1241, 1246 (9th Cir. 1997) (law enforcement agents testifying that the defendant's conduct was consistent with that of a drug trafficker could not testify as lay witnesses; to permit such testimony under Rule 701 "subverts the requirements of Federal Rule of Criminal Procedure 16(a)(1)(E)").
>
> The amendment does not distinguish between expert and lay witnesses, but rather between expert and lay testimony. Certainly it is possible for the same witness to provide both lay and expert testimony in a single case. See, e.g, United States v. Figueroa-Lopez, 125 F.3d 1241, 1246 (9th Cir. 1997) (law enforcement agents could testify that the defendant was acting suspiciously, without being qualified as experts; however, the rules on experts were applicable where the agents testified on the basis of extensive experience that the defendant was using code words to refer to drug quantities and prices). The amendment makes clear that any part of a witness' testimony that is based upon scientific, technical, or other specialized knowledge within the scope of Rule 702 is governed by the standards of Rule 702 and the corresponding disclosure requirements of the Civil and Criminal Rules.
>
> The amendment is not intended to affect the "prototypical example[s] of the type of evidence contemplated by the adoption of Rule 701 relat[ing] to the appearance of persons or things, identity, the manner of conduct, competency of a person, degrees of light or darkness, sound, size, weight, distance, and an endless number of items that cannot be described factually in words apart from inferences." Asplundh Mfg. Div. v. Benton Harbor Eng' g, 57 F.3d 1190, 1196 (3d Cir. 1995).
>
> For example, most courts have permitted the owner or officer of a business to testify to the value or projected profits of the business, without the necessity of qualifying the witness as an accountant, appraiser, or similar expert. See, e.g., Lightning Lube, Inc. v. Witco Corp. 4 F.3d 1153 (3d Cir. 1993) (no abuse of discretion in permitting the plaintiff's owner to give lay opinion testimony as to damages, as it was based on his knowledge and participation in the day-to-day affairs of the business). Such opinion testimony is admitted not because of experience, training or specialized knowledge within the realm of an expert, but because of the particularized knowledge that the witness has by virtue of his or her position in the business. The amendment does not purport to change this analysis. Similarly, courts have permitted lay witnesses to testify that a substance appeared to be a narcotic, so long as a foundation of familiarity with the substance is established. See, e.g., United States v. Westbrook, 896 F.2d 330 (8th Cir. 1990) (two lay

> witnesses who were heavy amphetamine users were properly permitted to testify that a substance was amphetamine; but it was error to permit another witness to make such an identification where she had no experience with amphetamines). Such testimony is not based on specialized knowledge within the scope of Rule 702, but rather is based upon a layperson's personal knowledge. If, however, that witness were to describe how a narcotic was manufactured, or to describe the intricate workings of a narcotic distribution network, then the witness would have to qualify as an expert under Rule 702. United States v. Figueroa-Lopez, supra.
>
> The amendment incorporates the distinctions set forth in State v. Brown, 836 S.W.2d 530, 549 (1992), a case involving former Tennessee Rule of Evidence 701, a rule that precluded lay witness testimony based on "special knowledge." In Brown, the court declared that the distinction between lay and expert witness testimony is that lay testimony "results from a process of reasoning familiar in everyday life," while expert testimony "results from a process of reasoning which can be mastered only by specialists in the field." The court in Brown noted that a lay witness with experience could testify that a substance appeared to be blood, but that a witness would have to qualify as an expert before he could testify that bruising around the eyes is indicative of skull trauma. That is the kind of distinction made by the amendment to this Rule.

C. CASE LAW. The following cases help to illuminate the operation of FRE 701 & 702. These cases were decided before the December, 2000 amendments to FRE 701 & 702, but the general principles reflected in these cases still apply under the current language of the rules.

1. U.S. v. Williams Case. *United States v. Williams*, 212 F.3d 1305, 1313 (D.C.Cir. 2000), said:

> The Office of Legal Education of the Executive Office for United States Attorneys provides guidelines to establish a proper foundation for the opinion testimony of a skilled lay observer:
>
> 1. That the witness has, on prior occasions sufficient in number to support a reasonable inference of knowledge of or familiarity with a subject, observed particular events, conditions, or other matters.
>
> 2. That the witness on a certain occasion observed a specific event, condition, or matter of the same nature as previously observed.
>
> 3. That on the basis of his knowledge or familiarity with the event, condition or matter, he has an opinion as to the event, condition or matter involved in the case.
>
> 4. That the statement of the opinion will be helpful to a clear understanding of the testimony of the witness [or] the determination of a fact in issue.

2. U.S. v. Riddle Case. *United States v. Riddle*, 103 F.3d 423, 428-29 (5th Cir. 1997), said:

> Before Meier began his testimony, the parties and the court agreed that the prosecution had not designated him as an expert and that he would not be offering expert testimony. Counsel for the government told the court that "what I want this witness to talk about are the specific facts that he observed." This would include such things as accounts of Meier's interaction with bank officials during his examinations and personal observations of bank records and practices.
>
> With this assurance, the trial court allowed the government to proceed. However, with each new trial day the government pushed to squeeze as much as possible from this "lay witness." The result is clear, certainly now, that during Meier's two-and-a-half days on the stand, he wielded his expertise as a bank examiner in a way that is incompatible with a lay witness. In connection with his examination of TNB-Post Oak, Meier explained that "[a]ccording to 12 C.F.R. 32.5, when repayment is expected from only one source, then all of the advances must be combined, again, coming from that one source." Over the defense's objections, Meier expressed his opinion that it was not "prudent" for a bank to rely on repurchase agreements issued by banks selling participations rather than on the creditworthiness of borrowers. The next day, Meier expressed his view that bank officers should discuss OCC circulars when the bank receives them and that the OCC expects officers such as Riddle to know the contents of circulars. The defense objected at length to Meier's testimony about the OCC's position on whether a bank director may bring loans to his bank. In response, the court reminded that Meier was not an expert, but that his reports had been available for some time and that his testimony should come as no surprise to the defense. "Even if you do consider him an expert," the court noted, "it seems to me that we have satisfied the requirements of the rule."

> Meier continued to draw on his specialized knowledge as a bank examiner. He testified that it was imprudent "to have the buyback letter stand separate and apart from the participation certificate itself with neither referencing the other." He asserted that TNB-W violated OCC regulations when it failed to record the fact that Riddle received proceeds from its purchase of participations. He even speculated that unsafe and unsound lending practices, including loans to insiders, caused TNB-W's failure.
>
> Under Fed.R.Evid. 701, a lay opinion must be based on personal perception, must "be one that a normal person would form from those perceptions," and must be helpful to the jury. Soden v. Freightliner Corp., 714 F.2d 498, 510-12 (5th Cir.1983) (quoting Lubbock Feed Lots, Inc. v. Iowa Beef Processors, 630 F.2d 250, 263 (5th Cir. 1980)). We have allowed lay witnesses to express opinions that required specialized knowledge. In Soden, a witness in charge of truck maintenance testified that, based on his experience, step brackets caused the punctures in a fuel tank that had been brought into his repair yard. We held that the district court did not abuse its discretion when it allowed the plaintiff to introduce such lay opinion testimony. "No great leap of logic or expertise was necessary for one in Lasere's position to move from his observation of holes in Freightliner fuel tanks at the location of the step brackets, and presumably caused by them, to his opinion that the situation was dangerous." Id. at 512. Other circuits have construed Rule 701 even more broadly. See Wactor v. Spartan Transp. Corp., 27 F.3d 347, 351 (8th Cir. 1994) (admitting under Fed.R. Evid. 701 the opinions of lockmen, "based as they were upon their years of personal experience, their personal inspection of the lockline, their participation with Wactor in the stoppage of the barges, and their positions as the sole eyewitnesses to the wrapping, fouling, and breaking of the line"); Williams Enterprises v. Sherman R. Smoot Co., 938 F.2d 230, 233-34 (D.C. Cir. 1991) (allowing an insurance broker who had personal knowledge of an insured's business to offer lay opinion testimony on the cause of an increase in the insured's premiums); United States v. Fowler, 932 F.2d 306, 312 (4th Cir. 1991) (admitting lay opinion evidence as to whether a certain government official would know whether classified budget documents were available to contractors).
>
> Meier, however, went beyond the lay testimony in Soden, as well as the testimony in cases from other circuits. He did not merely draw straightforward conclusions from observations informed by his own experience. Instead, he purported to describe sound banking practices in the abstract. He told the jury how the OCC viewed certain complex transactions. And he asserted a causal relationship between Riddle's alleged wrongdoing and the ultimate failure of TNB-W. He functioned not as a witness relaying his own observations so much as a knowledgeable bank examiner who could provide the jury with an overview of banking regulations and practices and who could authoritatively condemn Riddle's actions. He did not offer testimony that a lay person would have been able to offer after conducting the examinations. The district court erred in allowing Meier's testimony under Fed.R. Evid. 701.
>
> The government insists that Meier was nothing more than a fact witness because his review of TNB-W files and the 1985 and 1986 examinations gave him personal knowledge of their contents. It is true that "[t]he modern trend favors the admission of opinion testimony, provided that it is well founded on personal knowledge and susceptible to specific cross-examination." Teen-Ed, Inc. v. Kimball Int'l, Inc., 620 F.2d 399, 403 (3d Cir. 1980). Based on this rule, Meier could draw specific conclusions from his work on the 1984 and 1987 examinations, such as that Riddle did not heed Meier's 1984 advice on self-dealing. See United States v. Leo, 941 F.2d 181, 192-93 (3d Cir. 1991) (allowing an auditor to relate the basis for his opinion that the defendant had altered purchase order dates in a government contract); United States v. Grote, 632 F.2d 387, 390 (5th Cir. 1980) (allowing an IRS official to compare a defendant's tax returns by characterizing some as "acceptable" and some as "unacceptable"), cert. denied, 454 U.S. 819, 102 S.Ct. 98, 70 L.Ed.2d 88 (1981). But latitude under Rule 701 does not extend to general claims about how banks should conduct their affairs. Meier's opinions that TNB-W operated imprudently and that its imprudence caused it to fail depend on an expert's understanding of the banking industry.

3. U.S. v. Anderskow Case. *United States v. Anderskow*, 88 F.3d 245, 254 (3d Cir. 1996), said:

> We have held that lay opinion testimony can be based upon a witness' "knowledge and participation in the day-to-day affairs of his business," Lightning Lube, Inc. v. Witco Corp., 4 F.3d 1153, 1175 (3d Cir. 1993), and

> upon a witness' review of written documents. United States v. Leo, 941 F.2d 181, 193 (3d Cir.1991); Teen- Ed, Inc. v. Kimball Int'l, Inc., 620 F.2d 399, 403-04 (3d Cir.1980). Alevy's testimony revealed that he had contact with Anchors by telephone and via facsimile on a weekly basis in the fall of 1991. Most of this correspondence concerned loan schedules that had been promised to borrowers. In explaining the workings of the Trust and the roles of its various members, Alevy testified that he would provide schedules containing false information to Anchors so that he could pass them along to the borrowers. We think that in light of the weekly correspondence by telephone and facsimile between Alevy and Anchors, Alevy had sufficient first-hand knowledge such that his opinion was "rationally based" on his perceptions. Lightning Lube, Inc., 4 F.3d at 1175; Leo, 941 F.2d at 193; Teen-Ed, Inc., 620 F.2d at 403-04.

4. Securiton Case. *Securitron Magnalock Corp. v. Schnabolk*, 65 F.3d 256 (2nd Cir. 1995), said:

> Fed. R. Evid. 701 permits a lay witness to testify to an opinion "(a) rationally based on the perception of the witness and (b) helpful to a clear understanding of the witness' testimony or the determination of a fact in issue." Accordingly, a president of a company, such as Cook, has "personal knowledge of his business . . . sufficient to make . . . [him] eligible under Rule 701 to testify as to how lost profits could be calculated." In re Merritt Logan, Inc., 901 F.2d 349, 360 (3rd Cir. 1990). A company president certainly is capable of projecting lost profits where the projection is based on evidence of decreased sales. See Teen-Ed, 620 F.2d at 403-04.

5. U.S. v. Saccoccia Case. *United States v. Saccoccia*, 58 F.3d 754, 780 (1st Cir.1995), *cert. denied*, 517 U.S. 1105, 116 S.Ct. 1322, 134 L.Ed.2d 474 (1996), said:

> Appellant's third sally alleges error in Shedd's explanation that his initial testimony about Duenas' statement was based on an overall impression from several hours of conversation. Although a witness is generally not permitted to testify about his subjective interpretations of what has been said by another person, he may do so if his opinion is rationally based on his perception and is helpful either to an understanding of his testimony or to the determination of a fact in issue.

6. Lightning Lube Case. *Lightning Lube, Inc. v. Witco Corp.*, 4 F.3d 1153 (3rd Cir. 1993), said:

> We recognize that a trial court's determination of admissibility may be overturned only for clear abuse of discretion, Pollard v. Metropolitan Life Insurance Co., 598 F.2d 1284, 1286 (3d Cir.), cert. denied, 444 U.S. 917, 100 S.Ct. 232, 62 L.Ed.2d 171 (1979); see Hill v. Nelson, 676 F.2d 1371, 1373 (11th Cir. 1981). We reluctantly hold, however, that the trial court clearly abused its discretion in striking Baldwin's testimony insofar as he, based on his personal knowledge, testified to the percentage of downtime due to hearth problems. The record reveals that Baldwin, in his position as Supervisor of Production Control, had extensive personal knowledge of Joy's plants, its on-going heat treating processes, and the two furnaces in question. Baldwin testified in great detail to the work done by Joy at its Reno plant. App. at 42a-46a. He testified that he was directly involved with the negotiations for the furnaces, app. at 46a; Transcript of August 12 at 36-39, with the purchase and installation of the furnaces, app. at 46a; Transcript of August 12 at 39-44, and with the operation of the furnaces on a day--to- day basis, app. at 46a, 47a, 48a, 75a. He testified that as supervisor he attended production meetings where problems with capacity at any work center, including the two furnaces, were discussed. App. at 47a.[fn24] He specifically testified about the hearth problems, app. at 50a, 52a-55a, 59a-60a, and about his observations of what was happening in heat treating on a day-to-day basis, app. at 46a, 75a.
>
> This undisputed testimony indicates Baldwin had sufficient personal knowledge of Joy's heat treating facility to make an estimate of what amount of downtime was due to the hearth problems. His opinion was rationally based on his knowledge, as a personal observer, of Joy's furnace operation. His inability to state precisely why a furnace was inoperable at a particular time was the proper material for effective cross-examination rather than a basis to hold his testimony completely inadmissible.[fn25] See United States v. Jackson, 688 F.2d 1121 at 1125 (7th Cir. 1982). As long as a witness' opinion is rationally based on his perception, that testimony is not barred by Fed. R. Evid. 701.

7. Virgin Islands v. Knight Case. *Government of Virgin Islands v. Knight*, 989 F.2d 619, 629-30 (3d Cir. 1993), said:

> The requirement that a lay opinion be rationally based on the witness' perception requires that the witness have firsthand know-

> ledge of the factual predicates that form the basis for the opinion. Fed.R. Evid. 701(a) advisory committee's note. The district court properly excluded the investigating police officer's opinion because he did not observe the assault. In contrast, the eyewitness obviously had first-hand knowledge of the facts from which his opinion was formed.
>
> Having met the firsthand knowledge requirement of Rule 701(a), the eyewitness' opinion was admissible if it would help the jury to resolve a disputed fact. The "modern trend favors admissibility of opinion testimony." Leo, 941 F.2d at 193 (quoting Teen-Ed, Inc. v. Kimball Int'l, Inc., 620 F.2d 399, 403 (3d Cir. 1980)). The relaxation of the standards governing the admissibility of opinion testimony relies on cross- examination to reveal any weaknesses in the witness' conclusions. Fed.R. Evid. 701(b) advisory committee's note. If circumstances can be presented with greater clarity by stating an opinion, then that opinion is helpful to the trier of fact. See United States v. Skeet, 665 F.2d 983, 985 (9th Cir.1982). Allowing witnesses to state their opinions instead of describing all of their observations has the further benefit of leaving witnesses free to speak in ordinary language. See Stone v. United States, 385 F.2d 713, 716 (10th Cir. 1967), cert. denied, 391 U.S. 966, 88 S.Ct. 2038, 20 L.Ed.2d 880 (1968).

8. U.S. v. Leo Case. *United States v. Leo*, 941 F.2d 181, 193 (3d Cir. 1991), said:

> Kennedy testified about the conclusions he formed while investigating General Electric's purchasing department files. For example, after summarizing the documents, he explained how certain purchase order dates had been changed. His opinion testimony accordingly satisfied Rule 701(a)'s requirement that lay opinion testimony be "rationally based on the perception of the witness." Fed. R. Evid. 701(a). Our Court has specifically held that lay opinion testimony can be based upon a witness's review of business records. See Teen -Ed, Inc. v. Kimball Int'l, Inc., 620 F.2d 399, 403-04 (3d Cir.1980); see also In re Merritt Logan, Inc., 901 F.2d 349, 359-60 (3d Cir. 1990); Eisenberg, 766 F.2d at 781.
>
> Rule 701(b) requires lay opinion testimony to be "helpful." Kennedy's testimony was helpful in allowing the jury to synthesize and understand the many documents contained in the thirty subcontract files that he had examined. The district court did not abuse its discretion in deciding that Kennedy's lay opinion testimony would be helpful to the jury in determining a fact in issue. This satisfies Rule 701's second prong.
>
> In Teen-Ed we stated that the "modern trend favors the admission of opinion testimony, provided that it is well founded on personal knowledge and susceptible to specific cross-examination." Teen- Ed, 620 F.2d at 403. Here, the district court gave Leo wide latitude to cross-examine Kennedy.

9. Eisenberg Case. *Eisenberg v. Gagnon*, 766 F.2d 770 (3rd Cir. 1985), said:

> A number of recent decisions have recognized that some lay witnesses are qualified to give a conclusion based on personal experience with documentary or physical materials. See, e.g., Soden v. Freightliner Corp., 714 F.2d 498, 510-12 (5th Cir. 1983) (service manager in charge of maintenance of trucks allowed to give opinion as to defect and its dangerousness); Joy Manufacturing Co. v. Sola Basic Industries, 697 F.2d 104, 110-12 (3d Cir. 1982) (worker allowed to testify as to proportion of downtime due to hearth problems); United States v. Grote, 632 F.2d 387, 390 (5th Cir. 1980), cert. denied, 454 U.S. 819, 102 S.Ct. 98, 70 L.Ed.2d 88 (1981) (IRS agent could give opinion as to whether tax returns filed were acceptable or not); Teen-Ed v. Kimball International, 620 F.2d at 403-04 (accountant familiar with books could give lay opinion as to how lost profits should be calculated). See also United States v. Ranney, 719 F.2d 1183, 1189 n. 11 (1st Cir. 1983) (investors in heating oil futures could give lay opinion based on their personal knowledge about the value of the investment opportunity offered by defendants).

10. Fairow v. State Case. *Fairow v. State*, 943 S.W.2d 895, 901 (Tex. Crim. App. 1997), said:

> When conducting a Rule 701 evaluation, [FN6] the trial court must decide (1) whether the opinion is rationally based on perceptions of the witness and (2) whether it is helpful to a clear understanding of the witness's testimony or to determination of a fact in issue. See Rule 701. The initial requirement that an opinion be rationally based on the perceptions of the witness is itself composed of two parts. First, the witness must establish personal knowledge of the events from which his opinion is drawn and, second, the opinion drawn must be rationally based on that knowledge. See Wendorf,

> Schlueter & Barton, Texas Rules of Evidence Manual, § VII, p. 5, (4th ed. 1995).
>
> The perception requirement of Rule 701 is consistent with the personal knowledge requirement of Rule 602. [FN7] It requires the proponent of lay-opinion testimony to establish that the witness has personal knowledge of the events upon which his opinion is based. Personal knowledge will often come directly from the witness's senses. See e.g. Smith v. State, 683 S.W.2d 393, 404 (Tex.Crim. App. 1984)(police officer may give non-expert opinion regarding physical facts he has observed); Doyle v. State, 875 S.W.2d 21 (Tex.App.--Tyler 1994, no pet.) (prison guard allowed to give opinion testimony under Rule 701 based on "what he saw "); State v. Welton, 774 S.W.2d 341, 343 (Tex. App.--Austin, pet. ref'd) (police officer permitted to give non-expert opinion regarding intoxication based in part on smelling the odor of alcohol); Lape v. State, 893 S.W.2d 949 (Tex. App. Houston [14th] 1994) (abuse of discretion occurred when lay-witness not permitted to give an opinion on how sound traveled in her home) (all emphases added). It may, however, come from experience. See e.g. Austin v. State, 794 S.W. 2d 408, 410-11 (Tex.App.--Austin 1990, pet. ref'd)(police officer permitted to testify that, based on his personal experience, it was his opinion that "Swedish deep muscle rub" was a code for prostitution); Williams v. State, 826 S.W.2d 783, 785 (Tex.App.--Houston [14th] 1992, pet. ref'd) (using past experience, a police officer was permitted to testify, as either a lay-witness or an expert, that he interpreted the defendant's actions to be a drug transaction); Reece v. State, 878 S.W.2d 320, 325 (Tex.App.--Houston [1st] 1994, no pet.) (based on training and experience, a police officer may testify under Rule 701 that a defendant's actions are consistent with someone selling cocaine). If the proponent of the opinion cannot establish personal knowledge, the trial court should exclude the testimony. See e.g. Bigby v. State, 892 S.W. 2d 864, 889 (Tex. Crim. App.1 994)(holding that a lay witness may not testify as to his opinion on appellant's sanity when that opinion was based on the observation of others); McMillan v. State, 754 S.W. 2d 422, 425 (Tex. App.--Eastland 1988, pet. ref'd) (holding that a lay-witness opinion based on hearsay was inadmissible).

11. Whalen Case. *Whalen v. Condo. Consulting and Mgmt. Servs., Inc.*, 13 S.W.3d 444, 448 (Tex. App.--Corpus Christi 2000, pet. denied), said:

> Lay opinion is adequate to prove causation where general experience and common sense enables a layman to determine, with reasonable probability, the causal relationship between the event and the condition.

12. Uniroyal Case. *Uniroyal Goodrich Tire Co. v. Martinez*, 977 S.W.2d 328, 339 (Tex. 1998), said:

> [W]here the subject matter is not solely for experts, uncontroverted opinion testimony is not conclusive, regardless of whether it comes from an expert or a lay witness. The rule of McGalliard quoted above--that expert testimony is generally not conclusive---follows not because the testimony is from an expert, but because it is opinion testimony. Unless the subject matter is solely for experts, jurors are capable of forming their own opinions from the record as a whole. See Coxson, 179 S.W. 2d at 945 (expert testimony is conclusive only where jurors "cannot properly be assumed to have, or be able to form, correct opinions of their own based upon the evidence as a whole and aided by their own experience and knowledge of the subject of inquiry").

13. Robinson Case. *Robinson v. Watts Detective Agency*, 685 F.2d 729, 742 (1st Cir.1982), *cert. denied*, 459 U.S. 1105, 103 S.Ct. 728, 74 L.Ed.2d 953 (1983), said:

> An owner of a business is competent to give his opinion as to the value of his property. Kestenbaum v. Falstaff Brewing Corp., 514 F.2d 690, 698 (5th Cir. 1975), cert. denied, 424 U.S. 943, 96 S.Ct. 1412, 47 L.Ed.2d 349 (1976). See United States v. Sowards, 370 F.2d 87, 92 (10th Cir. 1966). Whether or not his opinion is accurate goes to the weight of the testimony, not its admissibility. Meredith v. Hardy, 554 F.2d 764, 765 (5th Cir. 1977). Cf. Ford Motor Co. v. Webster's Auto Sales, Inc., 361 F.2d 874, 886 (1st Cir. 1966).

LaCombe v. A-T-O, Inc., 679 F.2d 431, 433 (5th Cir. 1982), suggests that the owner is testifying under FRE 702 (experts) and not FRE 701 (lay opinion). Arguably this is a misconception.

D. LAY OPINION OF VALUE. Texas cases permit lay persons, in some instances, to testify to their opinion of value. For example, in *Hochheim Prairie Farm Mut. Ins. v. Burnett*, 698 S.W.2d 271, 276 (Tex. App.--Fort Worth 1985, no writ), the owner of house was qualified to give lay opinion testimony as to value of house, as was a man who was a builder but not an appraiser qualified under Rule 701 to render an opinion of value of the house. In *Laprade v. Laprade*, 784

S.W.2d 490, 492-93 (Tex. App.--Fort Worth 1990, writ denied), it was proper for the wife to testify that the family business was worth $ 200,000.00, where the wife was a part owner and the evidence showed that the wife had a bases for her opinion of value of the business.

These cases are an expression of the general rule that an owner is permitted to testify to the market value of personalty or realty owned by him or her, even if the owner could not qualify to testify to the value of someone else's property. *Tom Benson Chevrolet, Inc. v. Alvarado*, 636 S.W.2d 815, 823 (Tex. App.--San Antonio 1982, writ ref'd n.r.e.) (value of automobile); *Barstow v. Jackson*, 429 S.W.2d 536, 538 (Tex. Civ. App.--San Antonio 1968, no writ) (value of automobile); *Porras v. Craig*, 675 S.W.2d 503, 504-05 (Tex. 1984) (real property). However, it must be apparent that the owner is referring to market value and not intrinsic or some other kind of value, if the issue being tried is market value. *Porras* at 504-05.

V. EXPERT TESTIMONY. Rule 702 governs the admissibility of expert testimony.

A. TRE 702. TRE 702 reads as follows:

> Rule 702. Testimony by Experts
>
> If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education may testify thereto in the form of an opinion or otherwise.

B. FRE 702. FRE 702 governs the admissibility of expert testimony in federal courts. As explained below, FRE 702 has been interpreted to require that, upon objection, the proponent of expert testimony must show that the expert is qualified, and that his/her opinion is reliable, relevant and helpful to the jury.

FRE 702, amended effective December 1, 2000, reads as follows:

> **Federal Rule 702. Testimony by Experts**
>
> If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

VI. QUALIFICATIONS, GENERAL ACCEPTANCE, RELIABILITY, RELEVANCE & HELPFULNESS. For expert testimony to be admissible, the expert must establish his or her qualifications and, the expert's methodology either (1) must have gained "general acceptance" (the old rule) or (2) must be shown to be reliable (the Federal rule). Additionally, the expert's testimony must be relevant to the issues to be decided in the case, and the expert testimony must assist the jury in deciding a matter they could not decide without expert evidence.

A. QUALIFICATIONS. Under FRE 702, a person may testify as an expert only if (s)he has knowledge, skill, experience, training or education that would assist the trier of fact in deciding an issue in the case. *See Broders v. Heise*, 924 S.W.2d 148, 149 (Tex. 1996). This requirement involves the expert's "qualifications." In gauging an expert's qualifications, it must be remembered that a person who is degreed or licensed in a particular field is not necessarily qualified to give expert testimony regarding all areas of that field. *Broders v. Heise*, 924 S.W.2d 148, 149 (Tex. 1996).

Whether an expert is qualified to testify under Rule 702 involves two factors: (1) whether the expert has knowledge, skill, etc.; and (2) whether that expertise will assist the trier of fact to decide an issue in the case. Courts sometimes evaluate the first prong, of adequate knowledge , skill, etc., by asking whether the expert possesses knowledge and skill not possessed by people generally. *Broders v. Heise*, 924 S.W.2d 148, 153 (Tex. 1996). *See Duckett v. State*, 797 S.W.2d 906, 914 (Tex. Crim. App. 1990) ("The use of expert testimony must be limited to situations in which the issues are beyond that of an average juror"); John F. Sutton, Jr., *Article VII: Opinions and Expert Testimony*, 30 HOUS. L.REV. 797, 818 (1993) [Westlaw cite 30 HOULR 797].

The second prong, assisting the trier of fact, requires that the witness's expertise go to the very matter on which the expert is to give an opinion. *Broders v. Heise*, 924 S.W.2d 148, 153 (Tex. 1996), citing *Christopherson v. Allied Signal Corp.,* 939 F.2d 1106, 1112-1113 (5th Cir.), *cert. denied*, 503 U.S. 912, 112 S. Ct. 1280, 117 L.Ed.2d 506 (1992). The test then for qualifications is whether the expert has knowledge, skill, experience, training or education regarding the specific issue before the court which would qualify the expert to give an opinion on the particular subject. *Broders v. Heise*, 924 S.W.2d 148, 153 (Tex. 1996).

The Supreme Court considered whether an expert was qualified in *Helena Chemical Co. v. Wilkins*, 47 S.W.3d 486, 499 (Tex. 2003). The expert had a Ph.D. in plant physiology, and worked in the field on the physiology of plants, malnutrition, the way the environment affects plants. The Supreme Court held the witness to be qualified, against a challenge that he was not a plan pathologist.

In *Garnac Grain Co., Inc. v. Blackley*, 932 F.2d 1563 (8th Cir. 1991), a corporate client sued its auditors for malpractice and breach of contract for failing to adhere to Generally Accepted Auditing Standards (GAAS) with the result that the corporation did not catch an employee who was embezzling from the corporation. The trial court was affirmed in its exclusion of proposed expert testimony of the plaintiff's president and director of accounting that the accounting firm had failed to comply with GAAS, on the grounds that the witnesses were not qualified under FRE 702 to give expert testimony. Although the president had a business degree, he had never taken courses in auditing or internal controls, he had taken only a basic accounting course, and he was not a CPA. The director of accounting had attended only one year of college, had taken only a few noncredit night courses in auditing or internal controls, had had only a basic accounting course, and was not a CPA. The court also found that the witnesses' experience was not an adequate basis for expert testimony. However, the trial court was reversed for excluding the testimony of a professor at the University of Kansas who taught auditing courses for almost 40 years, but whose work experience consisted of four years at an auditing firm in the 1940's, and whose CPA license lapsed in 1981. The professor was deemed to have sufficient expertise despite his lack of work experience in the industry.

B. GENERAL ACCEPTANCE. For some 70 years, the rule in American courts has been that expert opinion based on scientific evidence is admissible only where the methodology used by the expert has gained "general acceptance" in the relevant scientific community. This rule is traces back to a short opinion issued by the D.C. Circuit Court of Appeals in *Frye v. United States*, 54 App. D.C. 46, 47, 293 F. 1013, 1014 (1923). The "general acceptance" standard for admissibility of scientific evidence continues to be used in a number of states, such as: California, *see People v. Leah,* 8 Cal.4th 587 (1994); Florida, *see Flanagan v. State*, 625 So.2d 827 (Fla. 1993); Illinois, *see Donaldson v. Central Illinois Public Service Co.*, 767 N.E.2d 314 (Ill. Feb. 22, 2002); and New York, *see People v. Wesley*, 83 N.Y.2d 417, 611 N.Y.S.2d 97, 633 N.E.2d 451 (1994). Where the evidence is not "scientific," the states adhering to the "general acceptance" standard tend to diverge when articulating standards for admissibility of non-scientific expert testimony. Almost universally, however, the trial court has broad discretion on when to admit expert testimony. *Robinson v. Astra Pharmaceutical Products, Inc.*, 765 So.2d 378, 382 (La. App. 1 Cir. 3/31/00), *writ denied*, 763 So.2d 607 (La.6/2/00) ("The trial court has great discretion in determining whether to qualify a witness as an expert, and such discretion will not be disturbed on appeal in the absence of manifest error"). Consequently, the issues raised in this article can be important even in states that have not endorsed the *Daubert* standard of admissibility.

C. RELIABILITY OF METHODOLOGY. In the case of *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 113 S. Ct. 2786, 125 L.Ed.2d 469 (1993), the U.S. Supreme Court held that FRE 702 overturned earlier case law requiring that expert scientific testimony must be based upon principles which have "general acceptance" in the field to which they belong. *See Frye v. U.S.*, 293 F. 1013 (D.C. Cir. 1923) (establishing the "general acceptance" test for scientific expert testimony). Under Rule 702, the expert's opinion must be based on "scientific knowledge," which requires that it be derived by the scientific method, meaning the formulation of hypotheses which are verified by experimentation or observation. The Court used the word "reliability" to describe this necessary quality. The U.S. Supreme Court's opinion in *Daubert* applies in all federal court proceedings.

In *Daubert*, the Supreme Court gave a non-exclusive list of factors to consider on the admissibility of expert testimony in the scientific realm: (1) whether the expert's technique or theory can be or has been tested; (2) whether the technique or theory has been subject to peer review and publication; (3) the known or potential rate of error of the technique or theory when applied; (4) the existence and maintenance of standards and controls; and (5) whether the technique or theory has been generally accepted in the scientific community.

In *Kumho Tire Co. v. Carmichael*, 526 U.S.137, 11 S. Ct. 1167, 143 L.Ed.2d 238 (1999), the Supreme Court said that the reliability and relevancy principles of *Daubert* apply to all experts, not just scientists, and where objection is made the court must determine whether the evidence has "a reliable basis in the knowledge and experience of [the relevant] discipline." The trial court has broad discretion in determining how to test the expert's reliability. *Id. Kuhmo Tire* acknowledged that the list of factors in *Daubert* did not apply well to certain types of expertise, and that other factors would have to be considered by the court in such instances.

Thus, under the FRE, the court must determine the appropriate criteria of reliability and relevancy for all experts who testify, and as a preliminary matter must determine that those criteria are met before the expert is permitted to testify.

An application of these evidentiary principles to accounting is reflected in *Garnac Grain Co., Inc. v. Blackley*, 932 F.2d 1563 (8th Cir. 1991). As noted above, there a corporate client sued its auditors for negligently failing to conduct audits in accordance with GAAS. The corporation hired a new auditing firm to review the old auditing firm's work, and the new auditing firm concluded that the old auditors failed to adhere to GAAS only during the fiscal year ending 1-1-82. At trial, plaintiff offered the testimony of an accounting professor who opined that the auditors violated GAAS for a period of six years. Although the second auditing firm spent 600 hours in arriving at its conclusion as compared to the 20 hours spent by the

professor, and although the second auditors looked at the first auditors' work papers while the professor looked only at the second auditors' report before arriving at his opinion, the appellate court ruled that the professor's opinion was admissible under FRE 702 and 703. The appellate court noted that the professor later reviewed the first auditors' work papers and reaffirmed his earlier conclusion. Note that in *Garnac Grain Co.*, the standard of care was admittedly set by GAAS; the issue was whether the plaintiff's experts had the qualifications and used the proper methodology in determining whether the defendant breached that standard of care.

Not all states have adopted the *Daubert* analysis for state court proceedings. For example, the California Supreme Court rejected the *Daubert* standard in California criminal prosecutions. *See People v. Leah,* 8 Cal.4th 587 (1994). The Florida Supreme Court also declined to adopt *Daubert* in Florida courts, in *Flanagan v. State*, 625 So.2d 827 (Fla. 1993). And the Supreme Court of Illinois rejected the *Daubert* standard and continues to use the "general acceptance" test for areas of expertise that are new. *See Donaldson v. Central Illinois Public Service Co.*, 767 N.E.2d 314 (Ill. Feb. 22, 2002). The New York Court of Appeals rejected the *Daubert* standard of scientific reliability, and retained the *Frye* general acceptance test. *People v. Wesley*, 83 N.Y.2d 417, 611 N.Y.S.2d 97, 633 N.E.2d 451 (1994). The following states have adopted *Daubert* or a similar standard for the admissibility of expert testimony: Alaska , Arkansas, Colorado, Connecticut, Delaware, Idaho, Indiana, Iowa, Kentucky, Louisiana, Maine, Montana, Nebraska, New Mexico, North Carolina, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Vermont, West Virginia, and Wyoming. Alice B. Lustre, *Post-Daubert Standards for Admissibility of Scientific and Other Expert Evidence in State Courts*, 90 A.L.R.5th 453 (2001). The Louisiana Supreme Court adopted *Daubert* in *State v. Foret*, 628 So.2d 1116 (La. 1993).

D. RELEVANCE. *Daubert* contains a relevancy requirement, to be applied to expert evidence. As explained in *Gammill v. Jack Williams Chevrolet, Inc.*, 972 S.W.2d 713, 720 (Tex. 1998):

> The requirement that the proposed testimony be relevant incorporates traditional relevancy analysis under Rules 401 and 402 of the Texas Rules of Civil Evidence. To be relevant, the proposed testimony must be "sufficiently tied to the facts of the case that it will aid the jury in resolving a factual dispute." Evidence that has no relationship to any of the issues in the case is irrelevant and does not satisfy Rule 702's requirement that the testimony be of assistance to the jury. It is thus inadmissible under Rule 702 as well as under Rules 401 and 402.

Some courts and commentators call this connection the "fit" between the evidence and the issues involved in the case.

E. ASSISTING THE TRIER OF FACT. Rule 702 requires that the expert's testimony "assist the trier of fact." There are some issues where the jury is capable of making its own determination, without the assistance of expert testimony. In those instances, expert testimony is not admissible. *K-Mart Corp. v. Honeycutt*, 24 S.W.3d 357, 360 (Tex. 2000) ("When the jury is equally competent to form an opinion about the ultimate fact issues or the expert's testimony is within the common knowledge of the jury, the trial court should exclude the expert's testimony.") As noted in *Assiter v. State*, 58 S.W.3d 743, 751-52 (Tex. App.--Amarillo 2000, n.p.h.):

> Two themes are prevalent within the language of the rule allowing the use of expert testimony. First, the jury must not be qualified to intelligently and to the best possible degree determine the particular issue without benefit of the expert witness's specialized knowledge. Second, the use of expert testimony must be limited to situations in which the expert's knowledge and experience on a relevant issue are beyond that of an average juror. See Duckett, 797 S.W.2d at 914. When the jury is equally competent to form an opinion about the ultimate fact issues as is the expert, or the expert's testimony is within the common knowledge of the jury, the trial court should exclude the expert's testimony. K-Mart Corp. v. Honeycutt, 24 S.W.3d 357, 360 (Tex. 2000) (per curiam).

F. ADVISORY COMMITTEE COMMENT TO FRE 702 (2000). The lengthy Advisory Committee Comment to the 2000 Amendment to FRE 702 sheds light on the federal conception of the *Daubert* requirement.

> 2000 Amendments
>
> Rule 702 has been amended in response to Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579 (1993), and to the many cases applying Daubert, including Kumho Tire Co. v. Carmichael, 119 S.Ct. 1167 (1999). In Daubert the Court charged trial judges with the responsibility of acting as gatekeepers to exclude unreliable expert testimony, and the Court in Kumho clarified that this gatekeeper function applies to all expert testimony, not just testimony based in science. See also Kumho, 119 S.Ct. at 1178 (citing the Committee Note to the proposed amendment to Rule 702, which had been released for public comment before the date of the Kumho decision). The amendment

affirms the trial court's role as gatekeeper and provides some general standards that the trial court must use to assess the reliability and helpfulness of proffered expert testimony. Consistently with Kumho, the Rule as amended provides that all types of expert testimony present questions of admissibility for the trial court in deciding whether the evidence is reliable and helpful. Consequently, the admissibility of all expert testimony is governed by the principles of Rule 104(a). Under that Rule, the proponent has the burden of establishing that the pertinent admissibility requirements are met by a preponderance of the evidence. See Bourjaily v. United States, 483 U.S. 171 (1987).

Daubert set forth a non-exclusive checklist for trial courts to use in assessing the reliability of scientific expert testimony. The specific factors explicated by the Daubert Court are (1) whether the expert's technique or theory can be or has been tested---that is, whether the expert's theory can be challenged in some objective sense, or whether it is instead simply a subjective, conclusory approach that cannot reasonably be assessed for reliability; (2) whether the technique or theory has been subject to peer review and publication; (3) the known or potential rate of error of the technique or theory when applied; (4) the existence and maintenance of standards and controls; and (5) whether the technique or theory has been generally accepted in the scientific community. The Court in Kumho held that these factors might also be applicable in assessing the reliability of non- scientific expert testimony, depending upon "the particular circumstances of the particular case at issue." 119 S.Ct. at 1175.

No attempt has been made to "codify" these specific factors. Daubert itself emphasized that the factors were neither exclusive nor dispositive. Other cases have recognized that not all of the specific Daubert factors can apply to every type of expert testimony. In addition to Kumho, 119 S.Ct. at 1175, see Tyus v. Urban Search Management, 102 F.3d 256 (7th Cir. 1996) (noting that the factors mentioned by the Court in Daubert do not neatly apply to expert testimony from a sociologist). See also Kannankeril v. Terminix Int'l, Inc., 128 F.3d 802, 809 (3d Cir. 1997) (holding that lack of peer review or publication was not dispositive where the expert's opinion was supported by "widely accepted scientific knowledge"). The standards set forth in the amendment are broad enough to require consideration of any or all of the specific Daubert factors where appropriate.

Courts both before and after Daubert have found other factors relevant in determining whether expert testimony is sufficiently reliable to be considered by the trier of fact. These factors include:

(1) Whether experts are "proposing to testify about matters growing naturally and directly out of research they have conducted independent of the litigation, or whether they have developed their opinions expressly for purposes of testifying." Daubert v. Merrell Dow Pharmaceuticals, Inc., 43 F.3d 1311, 1317 (9th Cir. 1995).

(2) Whether the expert has unjustifiably extrapolated from an accepted premise to an unfounded conclusion. See General Elec. Co. v. Joiner, 522 U.S. 136, 146 (1997) (noting that in some cases a trial court "may conclude that there is simply too great an analytical gap between the data and the opinion proffered").

(3) Whether the expert has adequately accounted for obvious alternative explanations. See Claar v. Burlington N.R.R., 29 F.3d 499 (9th Cir. 1994) (testimony excluded where the expert failed to consider other obvious causes for the plaintiff's condition). Compare Ambrosini v. Labarraque, 101 F.3d 129 (D.C. Cir. 1996) (the possibility of some uneliminated causes presents a question of weight, so long as the most obvious causes have been considered and reasonably ruled out by the expert).

(4) Whether the expert "is being as careful as he would be in his regular professional work outside his paid litigation consulting." Sheehan v. Daily Racing Form, Inc., 104 F.3d 940, 942 (7th Cir. 1997). See Kumho Tire Co. v. Carmichael, 119 S.Ct. 1167, 1176 (1999) (Daubert requires the trial court to assure itself that the expert "employs in the courtroom the same level of intellectual rigor that characterizes the practice of an expert in the relevant field").

(5) Whether the field of expertise claimed by the expert is known to reach reliable results for the type of opinion the expert would give. See

> Kumho Tire Co. v. Carmichael, 119 S.Ct.1167, 1175 (1999) (Daubert's general acceptance factor does not "help show that an expert's testimony is reliable where the discipline itself lacks reliability, as for example, do theories grounded in any so-called generally accepted principles of astrology or necromancy."), Moore v. Ashland Chemical, Inc., 151 F.3d 269 (5th Cir. 1998) (en banc) (clinical doctor was properly precluded from testifying to the toxicological cause of the plaintiff's respiratory problem, where the opinion was not sufficiently grounded in scientific methodology); Sterling v. Velsicol Chem. Corp., 855 F.2d 1188 (6th Cir. 1988) (rejecting testimony based on "clinical ecology" as unfounded and unreliable).

All of these factors remain relevant to the determination of the reliability of expert testimony under the Rule as amended. Other factors may also be relevant. See Kumho, 119 S.Ct. 1167, 1176 ("[W]e conclude that the trial judge must have considerable leeway in deciding in a particular case how to go about determining whether particular expert testimony is reliable."). Yet no single factor is necessarily dispositive of the reliability of a particular expert's testimony. See, e.g., Heller v. Shaw Industries, Inc., 167 F.3d 146, 155 (3d Cir. 1999) ("not only must each stage of the expert's testimony be reliable, but each stage must be evaluated practically and flexibly without bright-line exclusionary (or inclusionary) rules."); Daubert v. Merrell Dow Pharmaceuticals, Inc., 43 F.3d 1311, 1317, n.5 (9th Cir. 1995) (noting that some expert disciplines "have the courtroom as a principal theatre of operations" and as to these disciplines "the fact that the expert has developed an expertise principally for purposes of litigation will obviously not be a substantial consideration.").

A review of the caselaw after Daubert shows that the rejection of expert testimony is the exception rather than the rule. Daubert did not work a "seachange over federal evidence law," and "the trial court's role as gatekeeper is not intended to serve as a replacement for the adversary system." United States v. 14.38 Acres of Land Situated in Leflore County, Mississippi, 80 F.3d 1074, 1078 (5th Cir. 1996). As the Court in Daubert stated: "Vigorous cross-examination, presentation of contrary evidence, and careful instruction on the burden of proof are the traditional and appropriate means of attacking shaky but admissible evidence." 509 U.S. at 595. Likewise, this amendment is not intended to provide an excuse for an automatic challenge to the testimony of every expert. See Kumho Tire Co. v . Carmichael, 119 S.Ct.1167, 1176 (1999) (noting that the trial judge has the discretion "both to avoid unnecessary 'reliability' proceedings in ordinary cases where the reliability of an expert's methods is properly taken for granted, and to require appropriate proceedings in the less usual or more complex cases where cause for questioning the expert's reliability arises.").

When a trial court, applying this amendment, rules that an expert's testimony is reliable, this does not necessarily mean that contradictory expert testimony is unreliable. The amendment is broad enough to permit testimony that is the product of competing principles or methods in the same field of expertise. See, e.g., Heller v. Shaw Industries, Inc., 167 F.3d 146, 160 (3d Cir. 1999) (expert testimony cannot be excluded simply because the expert uses one test rather than another, when both tests are accepted in the field and both reach reliable results). As the court stated in In re Paoli R.R. Yard PCB Litigation, 35 F.3d 717, 744 (3d Cir. 1994), proponents "do not have to demonstrate to the judge by a preponderance of the evidence that the assessments of their experts are correct, they only have to demonstrate by a preponderance of evidence that their opinions are reliable.... The evidentiary requirement of reliability is lower than the merits standard of correctness." See also Daubert v. Merrell Dow Pharmaceuticals, Inc., 43 F.3d 1311, 1318 (9th Cir. 1995) (scientific experts might be permitted to testify if they could show that the methods they used were also employed by "a recognized minority of scientists in their field."); Ruiz-Troche v. Pepsi Cola, 161 F.3d 77, 85 (1st Cir. 1998) ("Daubert neither requires nor empowers trial courts to determine which of several competing scientific theories has the best provenance.").

The Court in Daubert declared that the "focus, of course, must be solely on principles and methodology, not on the conclusions they generate." 509 U.S. at 595. Yet as the Court later recognized, "conclusions and methodology are not entirely distinct from one another." General Elec. Co. v. Joiner, 522 U.S. 136, 146 (1997). Under the amendment, as under Daubert, when an expert purports to apply principles and methods in accordance with

professional standards, and yet reaches a conclusion that other experts in the field would not reach, the trial court may fairly suspect that the principles and methods have not been faithfully applied. See Lust v. Merrell Dow Pharmaceuticals, Inc., 89 F.3d 594, 598 (9th Cir. 1996). The amendment specifically provides that the trial court must scrutinize not only the principles and methods used by the expert, but also whether those principles and methods have been properly applied to the facts of the case. As the court noted in In re Paoli R.R. Yard PCB Litig., 35 F.3d 717, 745 (3d Cir. 1994), "any step that renders the analysis unreliable ... renders the expert's testimony inadmissible. This is true whether the step completely changes a reliable methodology or merely misapplies that methodology."

If the expert purports to apply principles and methods to the facts of the case, it is important that this application be conducted reliably. Yet it might also be important in some cases for an expert to educate the factfinder about general principles, without ever attempting to apply these principles to the specific facts of the case. For example, experts might instruct the factfinder on the principles of thermodynamics, or blood clotting, or on how financial markets respond to corporate reports, without ever knowing about or trying to tie their testimony into the facts of the case. The amendment does not alter the venerable practice of using expert testimony to educate the factfinder on general principles. For this kind of generalized testimony, Rule 702 simply requires that: (1) the expert be qualified; (2) the testimony address a subject matter on which the factfinder can be assisted by an expert; (3) the testimony be reliable; and (4) the testimony "fit" the facts of the case.

As stated earlier, the amendment does not distinguish between scientific and other forms of expert testimony. The trial court's gatekeeping function applies to testimony by any expert. See Kumho Tire Co. v. Carmichael, 119 S.Ct. 1167, 1171 (1999) ("We conclude that Daubert's general holding--setting forth the trial judge's general 'gatekeeping' obligation--applies not only to testimony based on 'scientific' knowledge, but also to testimony based on 'technical' and 'other specialized' knowledge."). While the relevant factors for determining reliability will vary from expertise to expertise, the amendment rejects the premise that an expert's testimony should be treated more permissively simply because it is outside the realm of science. An opinion from an expert who is not a scientist should receive the same degree of scrutiny for reliability as an opinion from an expert who purports to be a scientist. See Watkins v. Telsmith, Inc., 121 F.3d 984, 991 (5th Cir. 1997) ("[I]t seems exactly backwards that experts who purport to rely on general engineering principles and practical experience might escape screening by the district court simply by stating that their conclusions were not reached by any particular method or technique."). Some types of expert testimony will be more objectively verifiable, and subject to the expectations of falsifiability, peer review, and publication, than others. Some types of expert testimony will not rely on anything like a scientific method, and so will have to be evaluated by reference to other standard principles attendant to the particular area of expertise. The trial judge in all cases of proffered expert testimony must find that it is properly grounded, well-reasoned, and not speculative before it can be admitted. The expert's testimony must be grounded in an accepted body of learning or experience in the expert's field, and the expert must explain how the conclusion is so grounded. See, e.g., American College of Trial Lawyers, Standards and Procedures for Determining the Admissibility of Expert Testimony after Daubert, 157 F.R.D. 571, 579 (1994) ("[W] hether the testimony concerns economic principles, accounting standards, property valuation or other non-scientific subjects, it should be evaluated by reference to the 'knowledge and experience' of that particular field.").

The amendment requires that the testimony must be the product of reliable principles and methods that are reliably applied to the facts of the case. While the terms "principles" and "methods" may convey a certain impression when applied to scientific knowledge, they remain relevant when applied to testimony based on technical or other specialized knowledge. For example, when a law enforcement agent testifies regarding the use of code words in a drug transaction, the principle used by the agent is that participants in such transactions regularly use code words to conceal the nature of their activities. The method used by the agent is the application of extensive experience to analyze the meaning of the conversations. So long as the principles and methods are reliable and applied reliably to the facts of the case, this type of testimony should be admitted.

Nothing in this amendment is intended to suggest that experience alone--or experience in conjunction with other knowledge, skill, training or education-- may not provide a sufficient foundation for expert testimony. To the contrary, the text of Rule 702 expressly contemplates that an expert may be qualified on the basis of experience. In certain fields, experience is the predominant, if not sole, basis for a great deal of reliable expert testimony. See, e.g., United States v. Jones, 107 F.3d 1147 (6th Cir. 1997) (no abuse of discretion in admitting the testimony of a handwriting examiner who had years of practical experience and extensive training, and who explained his methodology in detail); Tassin v. Sears Roebuck, 946 F.Supp. 1241, 1248 (M.D.La. 1996) (design engineer's testimony can be admissible when the expert's opinions "are based on facts, a reasonable investigation, and traditional technical/mechanical expertise, and he provides a reasonable link between the information and procedures he uses and the conclusions he reaches"). See also Kumho Tire Co. v. Carmichael, 119 S.Ct. 1167, 1178 (1999) (stating that "no one denies that an expert might draw a conclusion from a set of observations based on extensive and specialized experience.").

If the witness is relying solely or primarily on experience, then the witness must explain how that experience leads to the conclusion reached, why that experience is a sufficient basis for the opinion, and how that experience is reliably applied to the facts. The trial court's gatekeeping function requires more than simply "taking the expert's word for it." See Daubert v. Merrell Dow Pharmaceuticals, Inc., 43 F.3d 1311, 1319 (9th Cir. 1995) ("We've been presented with only the experts' qualifications, their conclusions and their assurances of reliability. Under Daubert, that's not enough."). The more subjective and controversial the expert's inquiry, the more likely the testimony should be excluded as unreliable. See O'Conner v. Commonwealth Edison Co., 13 F.3d 1090 (7th Cir. 1994) (expert testimony based on a completely subjective methodology held properly excluded). See also Kumho Tire Co. v. Carmichael, 119 S.Ct . 1167, 1176 (1999) ("[I]t will at times be useful to ask even of a witness whose expertise is based purely on experience, say, a perfume tester able to distinguish among 140 odors at a sniff, whether his preparation is of a kind that others in the field would recognize as acceptable.").

Subpart (1) of Rule 702 calls for a quantitative rather than qualitative analysis. The amendment requires that expert testimony be based on sufficient underlying "facts or data." The term "data" is intended to encompass the reliable opinions of other experts. See the original Advisory Committee Note to Rule 703. The language "facts or data" is broad enough to allow an expert to rely on hypothetical facts that are supported by the evidence. Id.

When facts are in dispute, experts sometimes reach different conclusions based on competing versions of the facts. The emphasis in the amendment on " sufficient facts or data" is not intended to authorize a trial court to exclude an expert's testimony on the ground that the court believes one version of the facts and not the other.

There has been some confusion over the relationship between Rules 702 and 703. The amendment makes clear that the sufficiency of the basis of an expert' s testimony is to be decided under Rule 702. Rule 702 sets forth the overarching requirement of reliability, and an analysis of the sufficiency of the expert's basis cannot be divorced from the ultimate reliability of the expert's opinion. In contrast, the "reasonable reliance" requirement of Rule 703 is a relatively narrow inquiry. When an expert relies on inadmissible information, Rule 703 requires the trial court to determine whether that information is of a type reasonably relied on by other experts in the field. If so, the expert can rely on the information in reaching an opinion. However, the question whether the expert is relying on a sufficient basis of information--whether admissible information or not--is governed by the requirements of Rule 702.

The amendment makes no attempt to set forth procedural requirements for exercising the trial court's gatekeeping function over expert testimony. See Daniel J. Capra, The Daubert Puzzle, 38 Ga.L.Rev. 699, 766 (1998) ("Trial courts should be allowed substantial discretion in dealing with Daubert questions; any attempt to codify procedures will likely give rise to unnecessary changes in practice and create difficult questions for appellate review."). Courts have shown considerable ingenuity and flexibility in considering challenges to expert testimony under Daubert, and it is contemplated that this will continue under the amended Rule. See, e.g., Cortes-Irizarry v. Corporacion Insular, 111 F.3d 184 (1st

> Cir. 1997) (discussing the application of Daubert in ruling on a motion for summary judgment); In re Paoli R.R. Yard PCB Litig., 35 F.3d 717, 736, 739 (3d Cir. 1994) (discussing the use of in limine hearings); Claar v. Burlington N.R.R., 29 F.3d 499, 502-05 (9th Cir. 1994) (discussing the trial court's technique of ordering experts to submit serial affidavits explaining the reasoning and methods underlying their conclusions).
>
> The amendment continues the practice of the original Rule in referring to a qualified witness as an "expert." This was done to provide continuity and to minimize change. The use of the term "expert" in the Rule does not, however, mean that a jury should actually be informed that a qualified witness is testifying as an "expert." Indeed, there is much to be said for a practice that prohibits the use of the term "expert" by both the parties and the court at trial. Such a practice "ensures that trial courts do not inadvertently put their stamp of authority" on a witness's opinion, and protects against the jury's being "overwhelmed by the so-called 'experts'." Hon. Charles Richey, Proposals to Eliminate the Prejudicial Effect of the Use of the Word "Expert" Under the Federal Rules of Evidence in Criminal and Civil Jury Trials, 154 F.R.D. 537, 559 (1994) (setting forth limiting instructions and a standing order employed to prohibit the use of the term " expert" injury trials).

The new FRE 702 was criticized in the following terms in Michael W. Shore & Kenneth E. Shore, *Civil Evidence*, 54 SMU L. Rev. 1167, 1171-72 (2001):

> The Evidence Advisory Committee's (the "Committee") comment notes for revised Rule 702 state that "this amendment is not intended to provide an excuse for an automatic challenge to the testimony of every expert." [FN29] The Committee also explained that it was not attempting to set procedural requirements for Daubert proceedings and emphasized that trial courts shall enjoy broad discretion in fashioning their analytical methods. [FN30] On its face, however, the revised Rule 702 does add a component to a trial court's gatekeeper duties--a quantitative assessment of the foundations for the expert's opinions.
>
> The three new factors will likely do little to clear up the confusion and inconsistency in Rule 702's application. The revised rule's first new factor, whether testimony is based upon "sufficient facts or data," adds unnecessary incentives for advocates to "pile up" foundation evidence, ensuring Rule 702's application will become more time-consuming and expensive. The Committee's notes say very little about this requirement other than it is a "quantitative rather than qualitative analysis." [FN31] Judges already look at the amount of data analyzed by an expert and then make their own determination, under an abuse of discretion standard, whether these facts or data are "sufficient." How has this change helped? It likely has only ensured that litigants will add excessive amounts of background data and "foundation" evidence to the trial record to ensure that their experts are quantatively qualified. This will add cost and time to an already burdensome and expensive process.
>
> The second and third new factors in revised Rule 702 require the trial court to first determine the reliability of the principles or methods underlying the expert's testimony and then determine whether the expert has applied those principles or methods reliably to the facts of the case. Thus, the new rule essentially codifies the Daubert/ Kumho Tire analysis. Under Daubert, the trial court would analyze the relevance and reliability of the expert's testimony. [FN32] Under Kumho, the trial court was directed to first analyze the reliability of the principle or method, and then determine whether the expert "has applied the principles and methods reliably." [FN33]

VII. BASES OF EXPERT OPINION. Rule 703 governs the bases of opinion testimony by experts.

A. TRE 703. TRE 703 reads:

> Rule 703. Bases of Opinion Testimony by Experts
>
> The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by, reviewed by, or made known to the expert at or before the hearing. If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be admissible in evidence.

B. FRE 703. FRE 703 relates to the bases of expert opinion testimony. FRE 703 provides:

> **Rule 703. Bases of Opinion Testimony by Experts**
>
> The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to the expert at or before the hearing. If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be admissible in

> evidence in order for the opinion or inference to be admitted. Facts or data that are otherwise inadmissible shall not be disclosed to the jury by the proponent of the opinion or inference unless the court determines that their probative value in assisting the jury to evaluate the expert's opinion substantially outweighs their prejudicial effect.

FRE 703 says that experts are not limited to personal knowledge in formulating opinions. Experts can rely on inadmissible evidence, such as hearsay, in arriving at opinions, if that is customary in their field. Courts are told to keep inadmissible underlying data from the jury unless the value in assisting the jury substantially outweighs the prejudicial effect of the inadmissible data.

VIII. OPINION ON ULTIMATE ISSUE.

A. TRE 704. TRE 704 reads:

> **Rule 704. Opinion on Ultimate Issue**
>
> Testimony in the form of an opinion or inference otherwise admissible is not objectionable because it embraces an ultimate issue to be decided by the trier of fact.

B. FRE 704. FRE 704 permits an opinion to be stated on the ultimate issues in the case. FRE 704 provides:

> **Rule 704. Opinion on Ultimate Issue**
>
> (a) Except as provided in subdivision (b), testimony in the form of an opinion or inference otherwise admissible is not objectionable because it embraces an ultimate issue to be decided by the trier of fact.
>
> (b) No expert witness testifying with respect to the mental state or condition of a defendant in a criminal case may state an opinion or inference as to whether the defendant did or did not have the mental state or condition constituting an element of the crime charged or of a defense thereto. Such ultimate issues are matters for the trier of fact alone.

IX. DISCLOSURE OF UNDERLYING FACTS

A. TRE 705. TRE 705 reads:

> **Rule 705. Disclosure of Facts or Data Underlying Expert Opinion**
>
> (a) Disclosure of Facts or Data. The expert may testify in terms of opinion or inference and give the expert's reasons therefor without prior disclosure of the underlying facts or data, unless the court requires otherwise. The expert may in any event disclose on direct examination, or be required to disclose on cross-examination, the underlying facts or data.
>
> (b) Voir dire. Prior to the expert giving the expert's opinion or disclosing the underlying facts or data, a party against whom the opinion is offered upon request in a criminal case shall, or in a civil case may, be permitted to conduct a voir dire examination directed to the underlying facts or data upon which the opinion is based. This examination shall be conducted out of the hearing of the jury.
>
> (c) Admissibility of opinion. If the court determines that the underlying facts or data do not provide a sufficient basis for the expert's opinion under Rule 702 or 703, the opinion is inadmissible.
>
> (d) Balancing test; limiting instructions. When the underlying facts or data would be inadmissible in evidence, the court shall exclude the underlying facts or data if the danger that they will be used for a purpose other than as explanation or support for the expert's opinion outweighs their value as explanation or support or are unfairly prejudicial. If otherwise inadmissible facts or data are disclosed before the jury, a limiting instruction by the court shall be given upon request.

B. FRE 705. FRE 705 reads:

> **Rule 705. Disclosure of Facts or Data Underlying Expert Opinion**
>
> The expert may testify in terms of opinion or inference and give reasons therefor without first testifying to the underlying facts or data, unless the court requires otherwise. The expert may in any event be required to disclose the underlying facts or data on cross-examination.

X. FORBIDDEN OPINIONS.

A. OPINIONS ON THE LAW. Experts cannot testify what the law of the forum state is. They can, however, testify to the law of sister states and foreign countries. *Cluett v. Medical Protective Co.*, 829 S.W.2d 822 (Tex. App.--Dallas 1992, writ denied), was a contract case, involving scope of coverage under an insurance policy. The court of appeals ruled that an expert could not render an opinion on whether a particular event was or was not within the scope of an

insurance policy. The court cited an earlier case which held that the question of "whether or not a legal duty exists under a given set of facts and circumstances is a question of law for the court." *See St. Paul Ins. Co. v. Rahn*, 641 S.W.2d 276, 284 (Tex. App.--Corpus Christi 1982, no writ). In *Texas Workers' Compensation Com'n v. Garcia*, 862 S.W. 2d 61, 105 (Tex. App.--San Antonio 1993), *rev'd on other grounds*, 893 S.W.2d 504 (Tex. 1995), the appellate court held that expert testimony of a law professor as to the constitutionality of a statute was not admissible, since it was opinion testimony on a legal issue. However, in *Transport Ins. Co. v. Faircloth*, 861 S.W.2d 926, 938-39 (Tex. App.--Beaumont 1993), *rev'd on other grounds*, 898 S.W.2d 269 (Tex. 1995), the appellate court held that expert testimony of a former Texas Supreme Court justice regarding the proper procedure for settling a personal injury claim of a minor child, and whether it had been followed in this instance, was admissible. And in *Lyondell Petrochemical Co. v. Fluor Daniel, Inc.*, 888 S.W.2d 547, 554 (Tex. App.--Houston [1st Dist.] 1994, writ denied), a former OSHA compliance officer could testify whether a training regimen did or did not comply with OSHA regs, since that was a mixed fact law question involving the application of OSHA regs to the facts of the case.

See Fleming Foods of Texas, Inc. v. Sharp, 951 S.W.2d 278 (Tex. App.--Austin 1997, writ denied) (former Attorney General Waggoner Carr not permitted to testify that changes to the Texas Tax Code were substantive, since statutory construction is a pure question of law).

B. EXPERT APPLYING THE LAW TO THE FACTS. While it is generally improper for an expert to testify on a question of pure law, experts can apply the given law to particular facts and arrive at opinions based on that analysis.

In *Welder v. Welder*, 794 S.W.2d 420 (Tex. App.--Corpus Christi 1990, no writ), a divorce case involving tracing of commingled separate and community funds, the appellate court held the trial court properly refused to let Wife's attorney cross-examine Husband's CPA as to the CPA's understanding of the community-money-out-first presumption under the case of *Sibley v. Sibley*, 286 SW2d 657 (Tex. Civ. App.–Dallas 1955, writ dismissed). However, the court noted a "host of legal problems" raised by the rule permitting a witness to testify on mixed fact-law questions. Where the "law part" is debatable, one party's right to elicit expert testimony on mixed fact-law questions collides with the opponent's right to cross-examine, all in the context of the trial court's power to restrict cross-examination to avoid jury confusion.

The court, in *Crum & Forster, Inc. v. Monsanto Co.*, 887 S.W.2d 103, 134 (Tex. App.--Texarkana 1994, writ dism'd by agr.), explores the distinction between an expert testifying on mixed fact-law questions and pure law questions. The court posited the following definition of a mixed fact-law question:

> [A]n opinion or issue involves a mixed question of law and fact when a standard or measure has been fixed by law and the question is whether the person or conduct measures up to that standard.

Id. at p. 134. This definition works well for liability cases, but not so well for matrimonial cases.

In *Holden v. Weidenfeller*, 929 S.W.2d 124 (Tex.App.--San Antonio 1996, writ denied), the trial judge excluded expert testimony from a law school professor, who was Board Certified in Real Estate Law, based upon the pleadings, depositions, and documents on file in the case, as to whether an easement appurtenant, an easement by estoppel or a public dedication existed in the case. The appellate court held that the opinion offered was not one of pure law, but rather of mixed fact-law. However, since the trial was to the court without a jury, it was not an abuse of discretion to exclude the testimony since it was not "helpful to the trier of fact," as required by TRE 702. This is because the trial court, being a legal expert himself, was "perfectly capable of applying the law to the facts and reaching a conclusion without benefit of expert testimony from another attorney." *Id.* at 134.

In *De Jager Const., Inc. v. Schleininger*, 938 F.Supp. 446, 449 (W.D. Michigan 1996), the federal district judge considered the admissibility of the testimony of a CPA who was offered to establish damages incurred by allegedly fraudulent behavior of various defendants. The federal district judge excluded the testimony, saying the following about the expert CPA:

> The first problem with Humes' testimony is that it blurs the distinction between substantive liability and a calculation of damages. This Court is convinced that Humes' testimony, as presented to this Court on April 9, 1996, is as much substantive assertions and arguments about the liability of the defendants as it is a calculation of damages. As explained by Schellenberg, Humes' testimony assembled a group of facts from which a conclusion would be drawn that defendants were engaging in the wrongful acts alleged in the complaint. As explained in Berry v. City of Detroit, 25 F.3d 1342, 1353 (6th Cir.1994), cert. denied, 513 U.S. 1111, 115 S.Ct. 902, 130 L.Ed.2d 786 (1995), an expert cannot opine on the ultimate liability of defendants even though an expert may, under some circumstances, give the jury all of the information from which it can draw inferences as to the ultimate issue. This Court holds that if the plaintiff intends to prove the existence of kickbacks and other types of wrongful behavior, plaintiff must do so by using facts

> introduced into evidence, as distinguished from an expert opinion based upon facts which may or may not have been admitted into evidence. It is the jury's responsibility to determine if the defendants did the things that plaintiff claims, and the jury is to make this decision based on evidence. Much of plaintiff's case will turn on the jury's determination as to the credibility of witnesses. Expert testimony is not needed to determine whether a declarant or witness is telling the truth. If Humes' testimony is permitted to come into evidence as it was presented to this Court during the April 9 hearing, a jury would almost certainly be confused into believing that Humes' calculations of losses are evidence that the charged wrongful conduct actually occurred. Thus, Humes' opinion does not meet the threshold test of assisting the trier of fact to understand the evidence or to determine a fact in issue. Fed.R. Evid. 702. More importantly, after listening to Humes testify and discovering the basis for his opinions, this Court is convinced that Humes is seeking to weave a story. In doing so, Humes has selected those portions of the available material which support his client's position, and has deliberately ignored other portions that do not support his client's claim.

C. EXPERT TESTIFYING TO MEANING OF CONTRACT TERMS. The construction of written agreements is reserved to the court, and witnesses are not permitted to testify as to the legal effect of the agreements. *Marx & Co., Inc. v. Diners' Club, Inc.*, 550 F.2d 505, 509-510 (2d Cir. 1977). Thus, an expert witness may not testify simply regarding his reading of a contract. "The question of interpretation of the contract is for the jury and the question of legal effect is for the judge. In neither case do we permit expert testimony." *Loeb v. Hammond*, 407 F.2d 779, 781 (7th Cir.1969). However, experts are allowed to testify to the custom and usage in an industry. *Energy Oils, Inc. v. Montana Power Co.*, 626 F.2d 731, 737 (9th Cir. 1980).

In *Phillips Oil Co. v. OKC Corp.*, 812 F.2d 265, 279 (5th Cir. 1987), the issue was presented in the following way:

> Over the objection of OKC, the district court accepted the testimony of its own expert and the two expert witnesses produced by Aminoil. The court's own expert, appointed pursuant to Rule 706 of the Federal Rules of Evidence, was Julian P. Brignac. Brignac is an attorney and certified public accountant who retired in 1982 from his position as a partner in the accounting firm of Peat Marwick Mitchell & Company and is now special counsel to a law firm. Aminoil's experts were Ronald Bannister and William Powell, partners in the accounting firm of Price Waterhouse & Co. Bannister and Powell testified to their extensive accounting experience in general and, in particular, to their oil and gas accounting experience. They were accepted by the court as experts in oil and gas accounting.
>
> Powell and Bannister testified that the net profits accounting provisions in the Farmout at issue in this case, as with similar accounting provisions, are consistently interpreted to exclude interest unless interest is specifically designated as a chargeable item. [FN29] With regard to OKC's charge against the net profits account for litigation expenses, Powell and Bannister testified that such accounting language, under accepted accounting practices in the oil and gas industry, never includes legal expenses related to a dispute between the contracting parties. [FN30]

The trial court in the *Phillips Oil Co.* case said that, while the experts were interpreting net profits accounting provisions, it was an accounting interpretation based on their training and experience, which they were explaining in aid of the court's legal determination of the issue of whether OKC has improperly charged legal expenses and interest. The appellate court held that "the admission of the expert testimony of the individuals experienced in the oil and gas accounting field for the purpose of obtaining explanation of the technical meaning of terms used in the net profits accounting provisions of the Farmout seems prudent." *Id.* at 281.

In one federal district court case, the defendant attempted to establish a special meaning for the words "excess funds" as they appeared in paragraph 4 of a workout agreement. The defendant asked one of the contracting parties, as well as the defendant's accountant, in his capacity as an expert about the meaning of the term. The trial judge excluded the testimony because the defendant did not establish that these words, as used by the parties, were given a specialized usage requiring expert aid to determine their meaning, and also because the accountant did not purport to render an accounting interpretation of these words, but instead offered only his own interpretation, resting upon the of these words context within the agreement. *United States v. Gregory Park, Section II, Inc.*, 373 F.Supp. 317, 333 (D.N.J. 1974).

XI. EXCLUDING RELEVANT EVIDENCE. The FRE and similar state rules of evidence permit a court to exclude even relevant evidence, in certain circumstances. Since a number of courts have used this basis to exclude expert testimony, it is necessary to consider this rule in the present context.

A. TRE 403.

> **Rule 403. Exclusion of Relevant Evidence on Grounds of Prejudice, Confusion, or Waste of Time**
>
> Although relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, or needless presentation of cumulative evidence.

FRE 403 is identical, except that FRE 403 includes one additional ground for exclusion: waste of time.

B. USE SPARINGLY. The Fifth Circuit court of appeals has said that "[b]ecause Rule 403 requires the exclusion of relevant evidence, it is an extraordinary measure that should be used sparingly." *U.S. v. Morris*, 79 F.3d 409, 412 (5th Cir. 1996).

XII. CASES APPLYING *DAUBERT* TO FINANCIAL EXPERTS.

A. ECONOMISTS. The *Daubert* reliability concept has been applied to economists.

In *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039 (8th Cir. 2000), the court of appeals applied the *Daubert* reliability standard to the testimony of an economist in an anti-trust case, and ruled the testimony inadmissible because not all relevant circumstances were incorporated into the expert's economic model, and the model failed to account for market events that did not relate to any anticompetitive conduct.

In *In re Valley-Vulcan Mold Co.*, 2001 WL 224066 (6th Cir. 1999) [No. 98-8070] (not selected for publication in the Federal Reporter), the Court of Appeals applied *Kuhmo* and affirmed the admission of the opinion of a financial expert on the solvency of a company in connection with an effort to recover fraudulent conveyances. The witness, who was national director of a valuation services group, had degrees from prestigious universities, and had experience in determining the solvency of companies.

In *Liu v. Korean Air Lines Co., Ltd.*, 1993 WL 478343 (S.D.N.Y. 1993), the trial court applied *Daubert* standards and partially admitted and partially rejected a professional economist's testimony. The court permitted testimony on: the future growth of Taiwan's economy and its effect on employment in the shipping industry; the concept of the lost value of household services (but not the value of them, since the expert's value was based in US and not Taiwanese figures); the decedent's statistical work life expectancy; the projected spread of growth of decedent's income over 10 years. The court rejected testimony on: the likelihood of the decedent being promoted on any particular dates; the assumption of an 8% annual increase in the decedent's earnings; lost fringe benefits (because the expert did not support with evidence his assumption that fringe benefits equaled 19.95% of salary).

Other cases applying the *Daubert* reliability concept to economists are discussed in Androgue & Ratliff, *Kicking the Tires After Kuhmo: the Bottom Line on Admiting Financial Expert Testimony*, 37 HOUS. L. REV. 431, 454-464 (2000).

B. ACCOUNTANTS. The *Daubert* reliability concept has been applied to accountants. In *G.T. Laboratories, Inc. v. The Cooper Companies, Inc.*, No. 92-C-6647 (W.D. Ill. Sept. 24, 1998) [1998 WL 704302], an accountant's testimony was excluded because it was based on non-standard methodology and the expert did not show that the methodology had been tested or subjected to peer review or had had an error rate determined. In *S.E.C. v. Lipson*, 46 F. Supp.2d 758 (N.D. Ill. 1999), a CPA's opinion that a company's internal financial reports were not reliable was excluded because the expert's opinions were not based on the methods and principles of accountancy. These cases and others are discussed in Androgue & Ratliff, *Kicking the Tires After Kuhmo: the Bottom Line on Admiting Financial Expert Testimony*, 37 HOUS. L. REV. 431, 454-464 (2000).

In *TUF Racing Products v. American Suzuki Motor*, 223 F. 3d 585 (7th Cir. 2000), the court of appeals upheld the admission of a CPA's opinion on lost profits under *Daubert* standards. It was permissible for the CPA to testify to the discounted present value of lost future earnings based upon information provided by the plaintiff and assumptions given by counsel.

In *City of Tuscaloosa v. Harcros Chemicals, Inc.*, 158 F.3d 548, 564 n. 17 (11th Cir. 1998), the court said: "We do not doubt that accounting expertise is among the sorts of technical and specialized expertise the use of which is governed by Rule 702 and Daubert."

C. OTHER FINANCIAL EXPERTS. In *M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d 513 (Del. 1999), the Delaware Supreme Court held that *Daubert* and *Kumho Tire* apply to valuation experts testifying in appraisal proceedings regarding corporate stock. The court upheld the lower court's decision to reject an expert's capital market approach to valuation, and both sides' experts' discounted cash flow approach to valuation. How *Daubert* standards might be applied to valuation experts is further discussed in Androgue & Ratliff, *Kicking the Tires After Kuhmo: the Bottom Line on Admiting Financial Expert Testimony*, 37 HOUS. L. REV. 431, 454-464 (2000).

In *Callahan v. A.E.V. Inc*., 182 F.3d 237 (3rd Cir. 1999), the court of appeals indicated that *Daubert* applied to lost profit testimony in an antitrust case and ruled that the testimony of two financial experts was admissible.

In *Guadalupe-Blanco River Authority v. Kraft*, 77 S.W.3d 805 (Tex. 2002), the Texas Supreme Court applied *Daubert* and *Kuhmo Tire* standards to a real estate appraiser.

In *United States v. Whitehead*, 176 F.3d 1030 (8th Cir. 1999), the appellate court upheld the admissibility of an FBI agent's opinions explaining the criminality of a check kiting scheme. *Accord*, *United States v. Yoon*, 128 F.3d 515, 527-28 (7th Cir. 1997) (also involving a check-kiting scheme).

XIII. ACCOUNTING STANDARDS. To establish the qualifications of accountant witnesses, it is necessary to know something about the licensing and professional standards in the accounting field. To lay the predicate for an expert opinion, it is necessary to become familiar with sources of authority in the accounting field.

A. LICENSING.[1] Certified Public Accountants (CPAs) are licensed professionals in the broad field of accounting. After passing a uniform national CPA examination, CPAs are licensed and governed by state (and related U.S. jurisdictions such as the District of Columbia, etc.). Boards of Accountancy that set forth their own education, experience and other requirements. These State Boards are given broad powers to adopt regulations, promulgate rules of conduct for the proper administration of the law, and ensure that the public is served by qualified professional accountants. They are generally made up of practicing CPAs plus attorneys, economists, state officials and public members among others. The State Boards of Accountancy are generally guided by their respective governments, the American Institute of Certified Public Accountants (AICPA), and to a lesser extent the Securities and Exchange Commission (SEC). Authorized Edition of The AICPA's Uniform CPA Exam – 1991; Information for CPA candidates section, page xiii.

In Texas, for example, the Texas State Board of Public Accountancy has been given the legal authority to govern the practice of public accountancy in Texas. The Board has adopted many of the AICPA professional standards as their own professional conduct rules. The Texas State Board of Accountancy requires that a CPA have a Bachelor's Degree and complete not fewer than 150 semester hours (of which 30 semester hours are accounting courses), and pass a test administered by the Texas State Board of Accountancy.

Most states provide for periodic peer review of CPAs' accounting and auditing practices. The AICPA has promulgated "Standards for Performing and Reporting on Peer Reviews." These standards have been adopted in various states.

In some states it is permissible for a person to render bookkeeping services without being licensed.

> Some states have additional categories of accounting practitioners, such as public accountants or registered accountants, who are not certified but who are otherwise licensed to offer certain types of services to the general public.

D. Edward Martin, ATTORNEY'S HANDBOOK OF ACCOUNTING, AUDITING AND FINANCIAL REPORTING § 1.01[1] at 1-4 (1996), cited in *Ferriso v. NLRB*, 125 F.3d 865, 871 (D.C.Cir. 1997). For example, Federal law permits audits of employee benefit plans and publicly traded firms to be performed either by certified public accountants or by licensed public accountants. *Ferriso v. NLRB*, 125 F.3d 865, 871 (D.C.Cir. 1997).

B. THE AICPA. The American Institute of Certified Public Accountants (AICPA) describes itself as the premier national professional association for CPAs in the United States. The AICPA has more than 330,000 members.

To qualify for admission to membership in the American Institute, a CPA must:

– possess a valid and unrevoked CPA certificate issued by the legally constituted authorities of the states, the District of Columbia, territories, or territorial possessions of the United States;

– have passed an examination in accounting and other related subjects satisfactory to the AICPA Board of Directors, which the board has resolved is the Uniform CPA Examination;

– practice in a firm enrolled in Institute-approved practice monitoring programs as long as one is engaged in public accounting as a proprietor, partner, or shareholder, or as an employee who has been licensed as a CPA for more than two years;

– agree to abide by the AICPA Bylaws and the Code of Professional Conduct.

In order to retain membership in the AICPA, a member in public practice for each three-year reporting period must complete 120 hours of continuing professional education with a minimum of 20 hours each year. A member not engaged in public practice must, during the each three year reporting period complete 90 hours of continuing professional education with a minimum of 15 hours in each year.

C. STANDARDS GOVERNING ACCOUNTANTS.. CPAs doing audits, financial statements, or

[1]The author received assistance in preparing this section from Patrice L. Ferguson, of Ferguson, Camp & Poll, Houston, Texas. Ms. Ferguson is both an attorney and a CPA, and has a forensic and accounting practice throughout Texas, with her office being located in Houston.

income reporting ordinarily use Generally Accepted Accounting Principles (GAAP) and Generally Accepted Auditing Standards (GAAS). CPAs who are performing consulting or valuation services don't have "generally accepted" guidelines.

1. FASB Standards. The Financial Accounting Standards Board (FASB) is a 7-person committee which sets standards for financial accounting and reporting in the USA. The members of the FASB are selected by the Financial Accounting Foundation. The Financial Accounting Standards Advisory Council (FASAC), made up of 30+ members who are broadly representative of preparers, auditors and users of financial information, consults with the FASB on technical issues.

The FASB standards are officially recognized as authoritative by the Securities and Exchange Commission (Financial Reporting Release No. 1, Section 101) and the American Institute of Certified Public Accountants (Rule 203, Rules of Professional Conduct, as amended May 1973 and May 1979). See *PNC Bancorp, Inc. v. Commissioner*, 212 F.3d 822, 824 (3d Cir. 2000) (the Securities and Exchange Commission recognizes the FASB's financial accounting standards as authoritative.).

In *General Elec. Co. v. Delaney*, 251 F.3d 976, 979 (Fed. Cir., 2001), the court said:

> Standard financial accounting practice recognizes a hierarchy of generally accepted accounting principles. The highest authorities in the system of accounting norms are the statements published by the Financial Accounting Standards Board (FASB).

2. GAAP. Generally Accepted Accounting Principles ("GAAP") are the official standards adopted by the American Institute of Certified Public Accountants (the "AICPA"), based on the decisions of three groups it has established: the Committee on Accounting Procedure; the Accounting Principles Board (the "APB"); and the Financial Accounting Standards Board. *See Ganino v. Citizens Utilities Co.*, 228 F.3d 154, 168-69 (2d Cir. 2000).

The AICPA Professional Standards Vol. 1 AU §411.05 describes the sources of established accounting principles that are generally accepted in the United States as:

> (1) Pronouncements of an authoritative body designated by the American Institute of Certified Public Accountants (AICPA) Council to establish accounting principles pursuant to Rule 203 of the AICPA Code of Professional Conduct, including the Financial Accounting Standards Board (FASB) Statements of Financial Accounting Standards, FASB Interpretations; Accounting Principles Board (APB) Opinions, and AICPA Accounting Research Bulletins;
>
> (2) Pronouncements of groups of expert accountants that deliberate accounting issues in public forums and have been exposed for public comment for the purpose of establishing accounting principles or describing existing accounting practices that are generally accepted;
>
> (3) Pronouncements of groups of expert accountants organized by an authoritative body that deliberates accounting issues in public forums but have not been exposed for public comment for the purpose of interpreting or establishing accounting principles or describing existing accounting practices that are generally accepted;
>
> (4) Practice or pronouncements that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry.

The U.S. Supreme Court has noted that GAAP are far from being a canonical set of rules that insure identical accounting treatment of similar transactions. Instead, GAAP tolerates a range of reasonable treatments, leaving the choice among the alternatives to company management. *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522, 99 S.Ct. 773, 58 L.Ed. 2d 785 (1979).

Thus, GAAP does not prescribe a fixed set of rules, but rather represent "the range of reasonable alternatives that management can use." *In re Burlington Coat Factory*, 114 F.3d at 1421 n. 10 (citing *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522, 544 (1979)). The determination that a particular accounting principal is generally accepted can be difficult to establish since no single reference source exists for all such principles.

3. OCBOA.[2] The FASB has elected not to address accounting bases other than those prepared on a GAAP basis. Additionally, the AICPA's accounting standards executive committee has not issued any guidance in this area of other bases of accounting presentations.

The only guidance for the issuance of Other Comprehensive Bases of Accounting (OCBOA) financial statements is that issued by the AICPA in Statement of Accounting Standards No. 62, Special Reports. That statement identifies only the following

[2]The author received assistance in preparing this section from William C. Bradley, CPA/ABV, who has an accounting office and forensic practice in San Antonio, Texas.

four categories as being appropriate OCBOA presentations.

1. A basis of accounting that the reporting entity uses or expects to use to file its income tax return for the period covered by the financial statements.

2. The cash receipts and disbursements basis of accounting, and modifications of the cash basis having substantial support, such as recording depreciation on fixed assets or accruing income taxes.

3. A definite set of criteria having substantial support that is applied to all material items appearing in financial statements, such as the price- level basis of accounting.

4. A basis of accounting that the reporting entity uses to comply with the requirements or financial reporting provisions of a governmental regulatory agency to whose jurisdiction the entity is subject; for example, the basis of accounting that insurance companies use pursuant to the rules of a state insurance commission.

Non-authoritative guidance on OCBOA financial statements can be found in the AICPA's Technical Practice Aids, Section 1500, Financial Statements Prepared Under an Other Comprehensive Bases of Accounting (OCBOA).

4. GAAS. "Auditing" is the process whereby the independent CPA conducts an examination of management's financial statements to determine whether the statements present fairly the financial information which they purport to convey. *SEC v. Arthur Young &* Co.*,* 590 F.2d 785, 788 n. 2 (9th Cir.1979). "Generally accepted auditing standards ('GAAS') are the standards prescribed by the Auditing Standards Board of the . . . AICPA . . . for the conduct of auditors in the performance of an examination." *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1200 n. 3 (11th Cir.2001). GAAS are general standards of conduct relating to the auditor's professional qualities as well as to the judgments exercised by him in the performance of his examination and issuance of his report. AICPA, Professional Standards, Statements on Auditing Standards No. 1, § 150.01. *See SEC v. Arthur Young &* Co.*,* 590 F.2d 785, 788 n. 2 (9th Cir. 1979); *Potts v. SEC,* 151 F.3d 810, 812 (8th Cir. 1998) (GAAS are "well-established norms of the accounting profession").

5. Financial Statements. Most businesses prepare financial reports to reflect the financial condition of the business. When the financial reports are prepared by the owners or managers of the company, there is no independent assurance of accuracy. When the financial reports are prepared by a certified public accountant, the rules imposed by the accounting profession regarding the accuracy of the financial reports can give a degree of assurance of accuracy, depending upon the extent of the involvement of the CPA.

From highest to lowest, the degree of assurance of a CPA-prepared financial report ranges from (1) audited (highest), to (2) reviewed, to (3) compiled (lowest). Financial reports prepared without input from a CPA are called "internally-generated" reports.

a. Audited. The objective of the ordinary audit of financial statements by the independent auditor is the expression of an opinion on the fairness with which they present, in all material respects, financial position, results of operations, and its cash flows, in conformity with GAAP. The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Because of the nature of audit evidence and the characteristics of fraud, the auditor is able to obtain reasonable, but not absolute, assurance that material misstatements are detected. As noted in *Potts v. SEC*, 151 F.3d 810, 812-13 (8th Cir. 1998), some of the standards required for an audit are:

> [A]n auditor's opinion must have a reasonable basis in sufficient evidence. . . . An auditor must maintain "an appropriate level of professional skepticism." . . . . An auditor who has reason to suspect a material misstatement in the audited company's financial report must extend his or her audit accordingly. . . . The more important the item, or the greater the possibility of material misstatement, the stronger must be the grounds for the auditor's opinion.

b. Reviewed. The objective of the review is to perform inquiry and analytical procedures that provide the accountant with a reasonable basis to express limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with GAAP or, if applicable, an OCBOA (Other Comprehensive Basis of Accounting, e.g. cash basis or tax basis). A review differs from the audit in that a review does not provide the basis for the expression of an opinion because a review does not require the obtaining of an understanding of the internal control structure or assessing control risk, tests of accounting records and responses to inquiries by obtaining corroborating evidential matter through inspection, observation or confirmation, and certain other procedures ordinarily performed during an audit. Authorized Edition of The AICPA's Uniform CPA Exam – 1991; Information for CPA candidates section, page xiii., AR §100.04. As stated in *Prescott v. County of El Dorado*, 177 F.3d 1102, 1106-07 (9th Cir.1999):

> In a review, an accountant relies on the representations of management to issue a report "stating that he or she is not aware of any material modifications that should be made to the financial statement in order for

> it to be in conformity with" generally accepted accounting principles.

c. Compiled. The objective of the compilation is to present in the form of financial statements information that is the representation of management without undertaking to express any assurance on the statements. A compilation differs from a review in that a review should provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements. No expression of assurance is contemplated in a compilation. Authorized Edition of The AICPA's Uniform CPA Exam – 1991; Information for CPA candidates section, page xiii., AR § 100.04. As stated in *Prescott v. County of El Dorado*, 177 F.3d 1102, 1106 (9th Cir.1999):

> A compilation involves the preparation of a financial statement regarding which the accountant expresses no assurance of accuracy, completeness, or conformity with generally accepted accounting principles.

d. Internally Generated. The objective of the internally generated financial statement is to provide information to the client's management for use in its internal operations. The accountant may not report on financial statements that include one or more periods of client-prepared financial statements that have not been audited, reviewed, or compiled by the accountant.

6. Income Reporting. Tax accounting is different from ordinary accounting. The sources of authority for tax reporting principles include the Internal Revenue Code, Revenue Rulings, and court rulings. Tax laws are promulgated for purposes of federal revenue and not to make an accurate measure of the income and resources of a business.

7. SEC Disclosure Standards.[3] The Securities and Exchange Commission imposes accuracy requirements on the financial statements of publicly-traded businesses. In general terms, the SEC requires that the accounting records and financial reports be kept in accordance with GAAP. Item 303 of Regulation S-K requires financial statements to include a narrative portion that makes certain disclosures. The disclosures include: (1) specific information about liquidity, capital resources, and results of operation; (2) known material events and uncertainties that make the historical financial information misleading; (3) the cause of material changes in line items of the prior period's financial report; (4) the effect of inflation and changing prices on the business; and (5) any other information the company feels is necessary to understand its financial condition. For purposes of matrimonial litigation, the reporting standards of the SEC are, as a general rule, not important, since any company coming under SEC reporting requirements will have a market for its publicly traded shares, and the market price probably will determine the value of the spouse's ownership interest in the business, as opposed to the financial statements. There will be exceptions to this when dealing with various types of stock options and stock restricted from the freely traded marked due to certain SEC rules.

D. SARBANES-OXLEY. The collapse of several major corporations in 2001-2002 in a "wave of accounting scandals," prompted Congress to pass new legislation to enforce a higher degree of accuracy in corporate accounting. Pursuant to Section 302 of the Sarbanes-Oxley Act, which applies to public companies, the SEC has adopted Exchange Act Rules 13a-14 and 15d-14, which require a public company's principal executive officer or officers and the principal financial officer or officers to certify, in each quarterly or annual report, among other things, that the report does not contain any untrue statement of material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading, and the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the company. The accounting industry is in the process of strengthening its auditing approaches in response to the Enron and similar debacles, which will no doubt affect GAAS.

E. LITIGATION SERVICES, OR FORENSIC WORK.[4] Litigation services are rendered by a CPA using accounting and consulting skills to assist a client in a matter that involves pending or potential litigation or dispute resolution proceedings with a trier of fact. These services may include fact-finding (including assistance in the discovery and analysis of data), damage calculations, document management, expert testimony, and other professional services required by the client or counsel. Application of AICPA Professional Standards in the Performance of Litigation Services, AICPA Consulting Services Special Report 93-1, 1993.

1. General Standards. The AICPA classifies litigation services as one of six types of consulting services and is therefore subject to the general standards of the AICPA Code of Professional Conduct. The general standards cover professional competence, due professional care, planning and supervision, and sufficient relevant data. The general standards are

[3]The author received assistance in preparing this section from William C. Bradley, CPA/ABV, who has an accounting office and forensic practice in San Antonio, Texas.

[4]The author received assistance in preparing this section from William C. Bradley, CPA/ABV, who has an accounting office and forensic practice in San Antonio, Texas.

concerned with the quality of the performance of any professional service.

2. Consulting Standards. In addition to the general standards, specific consulting standards apply to the consulting process and are established by the Statement on Standards for Consulting Services (SSCS) under Rule 202 of the AICPA Code of Professional Conduct. The consulting standards apply specifically to the consulting process to guide practitioners in their relationships with consulting clients. These standards concern serving the client's interest, entering into an understanding with the client, and communicating with the client

In Texas, the Texas Board of Public Accountancy has determined that the SSCS set the professional standards for practice in the consulting area and thus Texas CPAs are bound under the Board's Rules to these AICPA standards.

3. No Forensic Standards, Per Se. The CPA organizations do not promulgate standards for much of the forensic work accountants do. CPAs testifying as to lost profits, business valuation, or the character of marital property as separate or community, are operating without controlling standards issued by the accounting profession. In June of 2003, the AICPA published a 33-page pamphlet, *Litigation Services and Applicable Professional Standards*, which discusses Rules of the AICPA Code of Professional Conduct that can apply to forensic work (independence, integrity and objectivity, professional competence, due professional care, sufficient relevant data, compliance with standards, etc.) Appendix F is the "Testimony Pyramid," in which "Admissible Opinions" are derived from "Accepted Methodology, Reliably Applied" to "Data Analysis" based on "Source Data, Facts and Assumptions."

XIV. REAL PROPERTY APPRAISERS. This section of the paper considers licensing and methodology of real property appraisers.

> In Gammill we held that all expert testimony must be relevant and reliable under Evidence Rule 702. [FN7] This includes the testimony of expert appraisal witnesses in condemnation actions. Appraisal expertise is a form of "specialized knowledge [used to] assist the trier of fact to ... determine a fact in issue." [FN8] It is therefore subject to Gammill's relevance and reliability requirements.

Guadalupe-Blanco River Authority v. Kraft, 77 S.W.3d 805, 807 (Tex. 2002). An expert's "'bald assurance' that he was using that widely accepted approach was not sufficient to demonstrate that his opinion was reliable." *Id.* at 808.

A. LICENSING IN TEXAS. In Texas, a real property appraiser can be, but is not required to be, licensed or certified by the Texas Appraiser Licensing and Certification Board. [See the Texas Appraiser Licensing and Certification Act, Tex.Admin. Code ch. 153.] The federal Financial Institution Reform and Recovery Act (FIRREA) requires an appraiser to be certified by the state if the transaction is subject to federal jurisdiction. But it is only when the appraisal is connected with a "federally related transaction" that the appraiser is required to be certified by the Board. *Smith v. Levine*, 911 S.W.2d 427, 433 (Tex. App.--San Antonio 1995, writ denied).

In Texas, only certified or licensed appraisers can do "certified appraisals" or "licensed appraisals." These kinds of appraisals must conform to USPAP. (See Section XV below for a discussion of USPAP). *See* TEX. ADMIN. CODE ANN. § 155.1, "Standards of Practice."

As far as appraising other types of assets, like personal property or business interests, no particular licensing is required.

B. METHODOLOGY OF VALUING REAL PROPERTY. Traditionally there are three approaches to valuing real property: cost, market, and income approaches. Valuation theory calls for real property appraisers to use all three methods for each valuation, and to "reconcile" the three results into a final estimate of value.

1. Cost Approach. An expert using the cost approach calculates the cost of replacing the subject property with equivalent property of similar quality, condition, etc. Factors in determining cost include legal and brokerage fees, site preparation, connecting to utilities, building materials, architectural and engineering costs, construction costs, etc. Because of changes in available building materials and construction techniques, the replacement cost is not necessarily the cost of reproduction. The replacement cost must be reduced by any physical deterioration, functional obsolescence and economic obsolescence of the subject property. This calculated replacement cost is added to the land value, to arrive at a total value for the property. The land value typically is determined using the market approach.

2. Market Approach. The market or comparable sales comparison approach compares the subject property to other properties of similar size, quality and location that have recently sold. Comparability is based on the time of sale, similarity of land (e.g., location and size) and improvements (age, condition, etc). After adjustments (positive and negative) for differences between the subject property and the comparable property, the market approach establishes the most probable price (not an average) for which the property could be sold.

Potential difficulties with comparables include: true sales price may not be known; terms of financing of the comparable may have affected sales price; tax considerations may have affected sales price; pressure to buy or sell may have affected sales price.

"Comparable sales are generally admissible unless it should appear that reasonable minds cannot differ from the conclusion that the evidence of the other sale lacks probative force because of its dissimilarity to the subject property." *State v. Harrison*, 97 S.W.3d 810, 813 (Tex. App.–Texarkana 2003, no pet.). In *Guadalupe-Blanco River Authority v. Kraft*, 77 S.W.3d 805, 808 (Tex. 2002), the Supreme Court rejected expert testimony on the value of land subject to condemnation, because "a review of [the expert]'s 'underlying data' reveals that the local sales he relied on were not comparable to the condemned easement."

3. Income Approach. Income valuation methods, whether capitalization of earnings or discounted future cash flows, are based on the concept that the money an investor will pay for an asset is a function of the amount of income or cash the investor will receive over time as a benefit of ownership. The appraiser must develop a projection of the stream of earnings or cash flows, and then apply the appropriate capitalization rate to the stream of earnings, or discount rate to the stream of cash, to get to a single present value of the future earnings/cash flows.

The income approach to real property estimates value based on the expected rate of return if the property were to be leased. The fundamental factors are the projected income or cash flows, including changes over time, and the uncertainty or risk that the projected income or cash flows will not be maintained. Because of the assumption that the property will be used to generate income, the income approach is typically not important in valuing residential properties. In using the income method, the appraiser estimates the annual income or cash flows of the subject property based on rates obtained from comparable properties. Then the appraiser finds recent sales of comparable income-generating properties. The price-to-earnings ratio (or capitalization rate or discount rate) taken from sales of comparable income-generating properties is then adjusted for differences between the subject property and the comparable. Adjustments would be made based on the type of tenant, degree of landlord involvement, economic conditions, vacancy rates, property management costs, etc. This price-to-earnings ratio, discount rate, or capitalization rate is then applied to the projected income stream of future cash flows from the subject property to estimate the value.

In some applications, the appraiser will determine a cap rate or a discount rate by calculating a weighted average for the cost of capital and the cost of equity. The cost of capital is the interest that must be paid on the portion of the purchase price to be paid with borrowed funds. The cost of equity is the rate of return that would be required to attract an investor to invest in the component of the land to be paid by down payment. The cost-of-equity assessment involves comparing the rates of return for other investments, the degree of risk in each investment, the liquidity of each investment, etc. The weighted average cost of capital is used to capitalize the expected net income or discount the expected cash flows from the property back to present value.

4. Highest and Best Use. Appraisal theory requires that real property always be valued on the basis of its highest and best use, which may or may not be its present use. Highest and best use is defined in the DICTIONARY OF REAL ESTATE APPRAISAL (10th Ed.) as:

> The reasonably probable and legal use of vacant land or an improved property, which is physically possible, appropriately supported, financially feasible, and that results in the highest value.

The current use of the property is presumed to be its highest a best use, but another use can be considered if there is a reasonable probability that the property is adaptable and needed or would likely be needed in the near future for another use. *McAshan v. Delhi Gas Pipeline Corp.*, 739 S.W.2d 130, 131 (Tex. App.--San Antonio 1987, no writ) (a condemnation case).

In determining highest and best use, the appraiser must consider legal, physical, market, and economic factors. Economic considerations such as supply and demand are also important. The highest and best use must occur within the reasonably near future and can't be remote or speculative.

Legally permissible uses are usually determined by current zoning and other land use regulations. However, some types of land use restrictions, such as easements, are permanent. Others, like zoning restrictions, can be changed depending on who sits on the zoning commission, city council, variances from zoning restrictions that have been granted in the past, etc.

In *Exxon Pipeline Co. v. Zwahr*, 88 S.W.3d 623, 629 (Tex. 2002), the Supreme Court rejected an expert's opinion of value based on a faulty conception of highest and best use: the appraiser had "premised his valuation on the fact of . . . . condemnation, thus improperly including project enhancement in that valuation."

XV. STANDARDS OF APPRAISAL PRACTICE.

There are some national standards of appraisal practice, primarily relating to real estate valuation.

A. WHO ISSUES STANDARDS FOR APPRAISING THE VALUE OF ASSETS?

1. The Appraisal Foundation. The Appraisal Foundation was formed in 1987, consisting of nine major professional U.S. appraisal organizations, all

exclusively involved in real estate valuation except the ASA, which is multi-disciplinary. The Foundation is governed by a 32-member Board of Trustees, including appointees of member appraisal organizations, certain government bodies, other sponsor organizations and trustees-at-large. Funding is provided by member and sponsor organizations and the federal government under Financial Institutions Reform, Recovery and Enforcement Act (FIRREA). The chairman of the Board of Trustees appoints a nominating subcommittee, which appoints the Appraisal Standards Board and the Appraiser Qualifications Board.

2. Appraisal Standards Board. The Appraisal Standards Board (ASB) is a subdivision of the Appraisal Foundation. The Appraisal Foundation was established pursuant to congressional authority to be a source of appraisal standards and appraiser qualifications. The Appraisal Foundation promulgates appraisal standards through the Appraisal Standards Board (ASB) and qualifications through the Appraiser Qualifications Board (AQB). The Appraisal Standards Board has issued valuation standards, called USPAP. See <http://www.appraisalfoundation.org>.

3. Appraiser Qualifications Board. The Appraiser Qualifications Board (AQB) is a subdivision of the Appraisal Foundation. The AQB has set minimum qualifications for real estate appraisers and is studying qualifications for personal property and business appraisers.

B. WHAT ARE USPAP? USPAP are the Uniform Standards of Professional Appraisal Practice, issued by the Appraisal Standards Board. USPAP were adopted by the Appraisal Standards Board of the Appraisal Foundation on January 30, 1989.

FIRREA requires that real estate appraisals used in conjunction with federally-related transactions be performed in accordance with USPAP. According to the Foundation web site, more than 80,000 state certified and licensed appraisers are currently required to adhere to USPAP. <https://www.appraisalfoundation.org/html/aboutus.asp?FileName=aboutus> Since 1992, the Office of Management and Budget (OMB) has required federal land acquisition and direct lending agencies to use appraisals conforming to USPAP. *Ibid*.

As a result of their importance to federally-related real property appraisals, USPAP come as close as anything to generally accepted standards of real property appraisal practice. *See e.g., Cottonwood Affordable Housing v. Yavapai County*, 72 P.3d 357 (Az. TaxCt. 2003)(Court will give "strong deference" to USPAP).

1. USPAP Not a Standard of Admissibility of Opinions on Value. Courts of some states have held that USPAP are not rules of evidence.

Connecticut has adopted executive department regulations requiring that real property appraisals be performed according to USPAP. *See* Conn. Comm. of Consumer Protection Reg. 20-504-2. One Connecticut judge rejected a claim that an appraisal report was inadmissible for violating USPAP, saying that the purpose of the Connecticut legislative scheme and related regulations was to provide for the licensing and certification of appraisers, and "not to impose threshold standards for the admissibility, or content of, an appraisal . . . ." *Connecticut Housing Finance Authority v. Moniz*, CV-950553406S (Conn. Super. Ct. Hartford Nov. 10, 1997) (unreported) [1997 Conn. Super. LEXIS 3027]. Several Minnesota courts have arrived at the same opinion, rejecting challenges to admissibility based upon a violation of USPAP, saying for example that "USPAP standards are not Rules of Evidence. Rules of Evidence govern the admissibility of evidence at trial." *Ferche Acquisitions, Inc. v. County of Benton*, C5-94-513 and CX-95-274 (Minn. Tax Ct. Sept. 21, 1995) [1995 Minn. Tax LEXIS 62]. *See Huisken Meat Center, Inc. v. County of Murray*, C4-95-87 *3 (Minn. Tax Ct. June 3, 1996) [1996 Minn. Tax LEXIS 34] (failing to adhere to USPAP goes to the credibility, not the admissibility of evidence"); *Small Building Redevelopment Corp. v. County of Hennepin*, TC-19147 (Minn. Tax Ct. April 12, 1995) ("failing to adhere to USPAP goes to the credibility, not the admissibility, of the evidence") [1995 Minn. Tax LEXIS 19]. The Mississippi Supreme Court rejected an attack on an appraisal by an expert who owned nearby land, saying that the USPAP preamble and Rule 2-3 "do not render incompetent an appraiser with interests in nearby land or in the subject property being appraised. The emphasis of USPAP is on disclosure of any material interest which the appraiser may have." *Broadhead v. Bonita Lakes Mall, Ltd.*, 702 So.2d 92, 98 (Miss. 1997).

In one case during year 2000, a federal district judge ruled that USPAP were "persuasive evidence of appropriate appraisal ethics and practices," and the court relied on USPAP in weighing the credibility of an appraiser's opinion. *McKesson Corp. v. Islamic Republic of Iran*, 116 F.Supp. 2d 13(Dist. Ct. D.C, 2000), *rev'd on other grounds*, 271 F.3d 1101(D.C. Cir. 2001). However, the appraiser's violation of USPAP ethics rules did not lead to exclusion of the appraiser's opinions.

It thus appears that failure to comply with USPAP is at most just one factor to consider on admissibility. A variation from USPAP in how much disclosure is contained in a written report is not very important from a reliability standpoint. However, a variation from the valuation methodology in USPAP is important to the question of whether the evaluator's methodology is reliable.

2. USPAP Not Generally Accepted for Business Valuation. USPAP Standards 9 & 10 apply to business appraisals. See: <https://www.appraisalfoundation.org/html/USPAP2003/toc.htm>. These standards do not have general acceptance. For example, the

American Institute of Certified Public Accountants and the IRS have not adopted USPAP.

XVI. BUSINESS VALUATION.[5] The IRS, in Rev. Rul. 59-60, said that business valuation "is not an exact science." The business valuation field has general principles that are widely-acknowledged, but business valuation involves many subjective decisions that are not subject to precise measurement. Additionally, there is no "peer reviewed" publishing industry in business valuation, in contrast to scientific fields.

A. BUSINESS EVALUATORS: LICENSING AND PROFESSIONAL ORGANIZATIONS. Business evaluators are not licensed or accredited by the State. Most business evaluators belong to one or more of four associations that offer education and accreditation in business appraisal. These are the American Institute of Certified Public Accountants (AICPA), the American Society of Appraisers (ASA), the Institute of Business Appraisers (IBA), and the National Association of Certified Valuation Analysts (NACVA).

1. AICPA. The American Institute of Certified Public Accountants (AICPA) is the national professional organization for all CPAs. Membership is voluntary. In 1997 the AICPA instituted a professional designation for CPAs who have met experience, education and testing requirements for business valuation. That designation is ABV–Accredited in Business Valuation. See: <http:// www. aicpa. org/members/div/mcs/abv .htm>. The AICPA is in the process of developing uniform standards of business valuation. They are expected to be released for public comment in 2002, and to be finalized in 2003.

2. American Society of Appraisers. The American Society of Appraisers (ASA) was formed in 1936 and is an appraisal certifying organization representing all major disciplines of appraisal specialists, including those who specialize in business valuation. In order to ensure that professional appraisers adhere to high technical and ethical standards in performing valuation projects, ASA has prepared a comprehensive set of *Principles of Appraisal Practice and Code of Ethics* for its members. These principles are appropriate for business valuation specialists as well as appraisers for other valuation disciplines within the ASA membership. Among topics addressed by the principles are the following major issues:

Objectivity

Obligations to the client

Obligations to other appraisers

Guidance on the application of various methods and practices

Unethical and unprofessional practices.

Guidance on the appraisal report.

Beyond the preceding general standards, the Business Valuation Committee of the ASA has adopted standards that relate specifically to business valuation engagements. These standards currently include eight Business Valuations Standards, Definitions, a Statement of Business Valuation Standards, and one Advisory Opinion.

The ASA follows mainstream business valuation methods for appraising businesses. See <http:// www. appraisers.org>.

3. Institute of Business Appraisers. The Institute of Business Appraisers (IBA) consists of persons who engage in the valuation of mid-sized to smaller businesses. Members include CPAs, business brokers, attorneys, economists, college professors and estate appraisers. Formed in 1978, the IBA has over 3,000 members, half of whom are CPAs. The IBA awards Professional Certifications, including: CBA, Certified Business Appraiser; AIBA, Accredited by IBA; BVAL, Business Valuation Accredited for Litigation.

4. National Association of Certified Valuation Analysts. The NACVA is an organization of some 4,500 CPAs and other valuation professionals who engage in business valuation, litigation support and other types of valuation services. The NACVA was formed in 1991. The NACVA offers three designations: Certified Valuation Analyst (CVA); Accredited Valuation Analyst (AVA); and Government Valuation Analyst (GVA). Approximately 3,500 members have obtained one of these designations. A CVA must be a licensed CPA and a member of the local CPA society or of the AICPA. An AVA must have a business degree and experience in business valuation. A GVA must be currently employed by a government agency and performing valuation work. See <http://www. nacva.com>.

5. The International Business Brokers Association. The International Business Brokers Association (IBBA) has established authoritative principles for conducting business brokerage activities. The IBBA Standards provide a minimum standard of methodology for business brokers when dealing with customers, clients, and other business brokers. In addition to six standards a glossary is included in the standards for terms that are unique to the business brokerage industry.

B. SOURCES OF AUTHORITY ON BUSINESS VALUATION. Sources of authority for business valuation include the IRS, the Appraisal Standards

[5]The author received assistance in preparing this section from Patrice L. Ferguson, of Ferguson, Camp & Poll, Houston, Texas. Ms. Ferguson is both an attorney and a CPA, and has a forensic and accounting practice throughout Texas, with her office being located in Houston.

Board, the AICPA's Business Valuation Committee, and the other business valuation organizations mentioned above. The non-governmental organizations publish materials, conduct educational classes, conduct testing, and award special designations for business evaluation. There are some privately published books and journals that many consider authoritative. For example, Shannon Pratt's books on business valuation are highly respected. And there are court decisions involving valuation issues–mostly estate tax litigation. However, case law usually is fact-specific and not very helpful in articulating business valuation standards.

C. IRS STANDARDS ON BUSINESS VALUATION. For purposes of business valuation methods, the main authoritative statements by the Internal Revenue Service are revenue rulings. However, private letter rulings (PLRs) which, although not public, do present the IRS' position on substantive tax issues. There are some PLRs that relate to business valuation, and many business evaluators consider PLRs. Remember, these are IRS positions.

The most important source of authority on valuing closely-held businesses, from the IRS or from any other source, is Rev. Rul. 59-60 (1959-1 C.B. 237), which provides guidance regarding the valuation of stock of closely held corporations for estate and gift tax purposes. In RR 59-60, the IRS reviewed in general the approach, methods, and factors to be considered in valuing shares of closely held corporate stock for estate and gift tax purposes. RR 59-60 was modified by Rev. Rul. 65-193. The provisions of Rev. Rul. 59-60, as modified, were extended to the valuation of corporate securities for income and other tax purposes by Rev. Rul. 68-609, 1968-2 C.B. 327. Rev. Rul 93-12 deals with attributions. There are others, as well.

The IRS has issued other Rev. Rulings on valuing business interests that are considered authoritative. For example, Rev. Rul. 77-287 deals with the valuation, for Federal tax purposes, of securities that cannot be immediately resold because they are restricted from resale pursuant to Federal securities laws. RR 77-287 is on-line at: <http://www.min val. com/ irs rev rule 77287mineral.htm>.

D. GENERALLY ACCEPTED BUSINESS VALUATION METHODS. For valuing publicly-traded stock, market reports reflect what price shares are selling for–this is the value you use, subject to some adjustment.

For valuing privately-held businesses, the starting point is the historical, existing financial records, including books of account, financial statements, and tax returns. Financial reports and tax returns are designed for purposes other than establishing value, so the rules for preparing these documents are different from the generally-accepted methods for valuing business interests. Additionally, there may be questions about the accuracy of a business's books of account, financial statements, and tax returns.

Some businesses are valued based on fair market value of assets and liabilities. Others are valued based on capitalized income. Others are based on cash flow.

E. VALUING LESS THAN A 100% OWNERSHIP INTEREST. An appraiser valuing a partial interest in a business may make adjustments to the ownership interest being valued. Adjustments would include (1) marketability discount; (2) blockage discount; (3) control premium; (4) minority discount. There are many published tax cases that discuss these issues. *See* e.g., *Mandelbaum v. C.I.R.*, 69 T.C.M. (CCH) 2852, 1995 WL350881 (1995) (applying 30% marketability discount). These adjustments are subjective, and often not based on objective data but rather on the experience and judgment of the expert. Consequently, adjustments made by different experts on the same business can vary widely. Most tend to be case-specific and not too helpful in establishing standards of admissibility.

F. OTHER FACTORS IN VALUING BUSINESSES. The appraiser may have to consider tax attributes of the corporation (such as capital gains tax on shares, LIFO reserve on inventory, retained earnings in a corporation, etc.), buy-sell agreements, and restricted stock, meaning stock that cannot be sold at the present time due to federal securities laws. In a Texas divorce, the business appraiser may have to deal with the issue of personal goodwill, which under *Nail v. Nail*, 486 S.W.2d 761 (Tex.1972), is not part of the value of the business for purposes of divorce.

XVII. LOST PROFITS. The admissibility of testimony on lost profits must be considered against the backdrop of what is required in order to show lost profits.

California state courts, as well as the U.S. Court of Appeals for the 9th Circuit, have recognized that lost profits are "necessarily an estimate," *Portland 76 Auto/Truck Plaza, Inc. v. Union Oil Co.*, 153 F.3d 938, 947 (9th Cir. 1998), *cert. denied*, 526 U.S. 1064, 119 S.Ct. 1454, 143 L.Ed.2d 541 (1999), and that their "amount cannot be shown with mathematical precision." *Berge v. Int'l Harvester Co.*, 142 Cal.App. 3d 152, 190 Cal. Rptr. 815, 822 (Ct. App. 1983). In Illinois, "the evidence need only to tend to show a basis for the computation of damages with a fair degree of probability." *Medcom Holding Company v. Baxter Travenol Laboratories, Inc.,* 106 F.3d 1388, 1398 (7th Cir.1997) (quoting *In re Busse*, 124 Ill. App. 3d 433, 79 Ill.Dec. 747, 464 N.E.2d 651, 655 (1st Dist.1984)). New York law does not require absolute certainty in proving lost profits, either. In *Ashland Management Inc. v. Janien*, 82 N.Y.2d 395, 403, 604 N.Y.S. 2d 912, 915, 624 N.E.2d 1007, 1010 (1993), the court said: "Damages resulting from the loss of future profits are often an approximation. The law does not require that they be determined with mathematical precision. It

requires only that damages be capable of measurement based upon known reliable factors without undue speculation . . . ."

In *Smith Barney, Inc v. Settle*, No. 13-97-554-CV (Tex. App.--Corpus Christi May 21, 2000, pet. denied) (unpublished) [2000 WL 1146516], the Corpus Christi Court of Appeals summarized the requirements of proving lost profits in Texas:

> [R]ecovery of lost profits does not require that the loss be susceptible to exact calculation. Szczepanik v. First Southern Trust Co., 883 S.W.2d 648, 649 (Tex. 1994); Texas Instruments v. Teletron Energy Management, Inc., 877 S.W.2d 276, 279 (Tex. 1994). However, the injured party must do more than show that they suffered some lost profits. The amount of the loss must be shown by competent evidence with reasonable certainty. Id. What constitutes reasonably certain evidence of lost profits is a fact intensive determination. At a minimum, opinions or estimates of lost profits must be based on objective facts, figures, or data from which the amount of lost profits may be ascertained. Recovery of lost profits must be predicated on one complete calculation. Szczepanik, 883 S.W. 2d at 649; Holt Atherton Ind., Inc. v. Heine, 835 S.W. 2d 80, 84 (Tex.1992).

In Texas, an award of damages for lost profits may be based on estimates. *Little Darling Corp. v. Ald, Inc.*, 566 S.W.2d 347, 349 (Tex. Civ. App.--Dallas 1978, no writ).

In *Foust v. Estate of Walters*, 21 S.W.3d 495 (Tex. App.–San Antonio 2000, pet. denied), the appellate court upheld the admissibility of a farmer's projections of future crop yields based on a government agency's records of past crop yields. The court also upheld against a *Daubert* attack the testimony of a witness who had a Ph.D. in agricultural accounting and had been on the Texas A&M faculty for 30 years.

In *Scruggs Management Services, Inc. v. Panasonic Communications & Systems Co.*, No. 05-99-00518-CV (Tex. App.--Dallas Aug. 7, 2000) (not for publication) [2000 WL 1093230], the appellate court upheld the exclusion of the testimony of an actuary and a CPA that problems with a voice mail system caused lost profits to the plaintiff.

In *TUF Racing Products v. American Suzuki Motor*, 223 F. 585 (7th Cir. 2000), the court of appeals upheld the admission of a CPA's opinion on lost profits under *Daubert* standards. It was permissible for the CPA to testify to the discounted present value of lost future earnings based upon information provided by the plaintiff and assumptions given by counsel. The court rejected the argument that only a person with a degree in economics, statistics, or mathematics could give such testimony.

XVIII. MAKING AND PRESERVING A "GENERAL ACCEPTANCE" OR DAUBERT COMPLAINT.

A. OPPOSING THE ADMISSION OF EVIDENCE. A party wishing to exclude evidence offered by another party must make a timely objection. Otherwise the evidence is admitted and no right to complain on appeal has been preserved. *See* TRE 103; FRE 103; FRCP 46.

B. PROPOSING EXPERT EVIDENCE. If the trial court excludes tendered evidence, the party who wishes to complain on appeal about the exclusion must make an offer of proof, so that the court reporter's record reflects the evidence that was excluded. TRE 103 (a)(2); FRE 103(a)(2). The offering party should make its offer of proof outside the presence of the jury. TRE 1-3(b); FRE 103(b). The trial court can add any other or further statement which shows the character of the evidence, the form in which it was offered, the objection made, and the ruling thereon. The offer can be in the form of counsel summarizing the proposed evidence in a concise statement, but the court can require that the offer be made in question and answer form. TRE 103(b); FRE 103(b). In Texas, no further offer need be made. *Mosley v. Employer Cas. Co.*, 873 S.W.2d 715, 718 (Tex. App.--Dallas 1993, writ denied) (in order to complain on appeal about the refusal to admit evidence, the proponent must make an offer of proof or bill of exceptions to give the appellate court something to review); *Palmer v Miller Brewing Co.*, 852 S.W.2d 57, 63 (Tex. App.--Fort Worth 1993, writ denied) (party complaining that trial court would not permit a party to pose a particular question on cross-examination failed to preserve error, because the proponent did not elicit from the witness, on bill of exception, what his answer to the question would have been).

XIX. PRELIMINARY QUESTIONS OF ADMISSIBILITY What is the quantum of proof necessary to establish an expert's qualifications, the reliability of his or her methodology, and the reliability of the underlying data?

The U.S. Supreme Court has ruled that in federal courts preliminary determinations of admissibility are made by the trial court on a preponderance of the evidence standard, as opposed to a prima facie showing, or in a criminal case, proof beyond a reasonable doubt. *See Bourjaily v. U.S.*, 483 U.S. 171, 175 (1987).

The Texas Court of Criminal Appeals held that, in a criminal case, in *Kelly v. State*, 824 S.W.2d 568, 573 (Tex. Crim. App. 1992), the preliminary showing of reliability of expert testimony must be made by clear and convincing evidence.

In some instances, the trial court may take judicial notice of matters going to the reliability of an expert's technique. This occurs when any fact is "capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned." *Emerson v. State*, 880 S.W.2d 759, 764 (Tex. Crim. App. 1994). If the court takes judicial notice of some component of the reliability requirement, the proponent of the evidence is relieved of the burden to prove the judicially noticed fact. *Id.* at 764.

XX. DETERMINATIONS MADE UNDER TRE & FRE 104. TRE 104 and FRE 104 provide that the court shall determine preliminary questions concerning the qualification of a person to be a witness, or the admissibility of evidence. In making its determination, the trial court is not bound by the rules of evidence other than with respect to privileges. TRE 104(a); FRE 104(a). In a civil case, such a preliminary proceeding must be conducted out of the hearing of the jury, "when the interests of justice so require." TRE 104(c); FRE 104(c).

Although trial courts often conduct pre-trial *Daubert* hearings without reference to the specific procedural rule they are relying upon, the procedure for pretrial determination of the admissibility of evidence is Rule of Evidence 104. The *Daubert* case itself says this. *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 592 (1993) ("[T]he trial judge must determine at the outset, pursuant to Rule 104(a), whether the expert is proposing to testify to (1) scientific knowledge that (2) will assist the trier of fact to understand or determine a fact in issue.") The Third Circuit has specifically suggested that a Rule 104 hearing be the vehicle to determine a *Daubert* objection. *U.S. v. Downing*, 753 F.2d 1224, 1241 (3rd Cir. 1985). And the Third Circuit points out that the obligation of the trial court to offer the parties an adequate opportunity to be heard may require a hearing at which the proper showing of the reliability of the expert's methodology can be made, if possible. *See Padillas v. Stork-Gamco, Inc.*, 186 F.3d 412 417-18 (3rd Cir. 1999) (reversing a summary judgment granted because the plaintiff's expert did not meet *Daubert* criteria, saying that the trial court should have conducted a FRE 104 hearing, with an opportunity for the plaintiff to develop a record).

The use of pretrial "Daubert" hearings was recognized in *McMahon v. Regional Transit Authority*, 704 So.2d 392 (La. App. 4 Cir. 12/10/ 97). One Louisiana court held that it is necessary to hold a "Daubert" hearing if a party requests it. *Caubarreaux v. E.I. Dupont de Nemours*, 714 So.2d 67, 71 (La. App. 1998) ("Because duPont requested a preliminary Daubert hearing and ruling prior to trial, the trial court no longer had the discretion to deny duPont's motion for a hearing and was required to give the parties a ruling applying Daubert"). However, this requirement of a hearing was identified as a "minority view" and was criticized by a Judge in the Court of Chancery of Delaware, in *Minner v. American Mortg. & Guar. Co.*, 791 A.2d 826, 845-46 (April 17, 2000):

> "A pretrial procedure of some sort is, however, required. The Judge must gather the necessary information and evaluate the reliability of the underlying principles, the methodology employed by the expert witness, [FN24] and the potential relevance of the proposed evidence. Standards and Procedures for Determining the Admissibility of Expert Evidence after Daubert, 157 F.R.D. 571, 580 (1994). The Court, in the normal course, should be supplied with the expert's report and the expert's deposition testimony, as well as any supporting affidavits, prior to making any determination as to whether a Daubert hearing is necessary. At that point, the Court should decide: 1) if a Daubert hearing should be held, and 2) on what issues. If, for special reasons, a Daubert hearing is deemed necessary, the Court should try to narrow the issues prior to the evidentiary hearing. If allowed, the hearings should be brief and targeted to the specific questions of the Court. The Court, however, should normally be able to rule, as a matter of law, on the papers, as to whether a hearing should be allowed and whether an expert or set of experts is qualified to speak on a particular subject."

It is worth noting that the U.S. Supreme Court, in *Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137, 152, 119 S.Ct. 1167 (1999), said:

> The trial court must have the same kind of latitude in deciding how to test an expert's reliability, and to decide whether or when special briefing or other proceedings are needed to investigate reliability, as it enjoys when it decides whether or not that expert's relevant testimony is reliable.

XXI. MOTION IN LIMINE. In jury trials, lawyers will sometimes file a "motion in limine" asking the court to make the opponent approach the bench and get permission before mentioning to the jury a particular issue. These motions are taken up before the start of the jury trial. Federal courts are split on whether a ruling on a motion in limine will preserve error to complain on appeal. In the Fifth Circuit, a motion in limine alone does not preserve error for admitting evidence. *Marceaux v. Conoco, Inc*., 124 F.3d 730, 734 (5th Cir. 1997) (general rule in Fifth Circuit is that an overruled motion in limine does not preserve error on appeal–an objection at trial is required). The same rule applies in the Eight Circuit, where that court has said that "a motion in limine is not a substitute for an objection and does not alone preserve error for review." *United States v. Roenigk*, 810 F.2d 809, 815 (8th Cir.

1987). However, the 3rd and 9th Circuit Courts of Appeals say that a motion in limine will preserve error, *American Home Assurance Co. v. Sunshine Supermarket*, Inc., 753 F.2d 321, 324 (3rd Cir. 1985); *Sheehy v. Southern Pac. Trans. Co.*, 631 F.2d 649 (9th Cir. 1980). In the 7th Circuit, the answer is that "it depends." The 7th Circuit Court of Appeals has held that a definitive ruling in limine preserves an issue for appellate review, without the need for later objection--but this is just a presumption, subject to variation by the trial judge, who may indicate that further consideration is in order. Moreover, according to the 7th Circuit court of appeals, issues about how the evidence is used, as opposed to yes-or-no questions about admissibility, frequently require attention at trial, so that failure to object means forfeiture of the right to complain on appeal. *See Wilson v. Williams*, 182 F.3d 562, 563 (7th Cir.1999).

The 10th Circuit court of appeals recognizes an exception to the rule that motions in limine don't preserve error, when "the issue (1) is fairly presented to the district court, (2) is the type of issue that can be finally decided in a pretrial hearing, and (3) is ruled upon without equivocation by the trial judge." *U.S. v. Nichols*, 169 F.3d 1255 (10th Cir. 1999); *United States v. Mejia-Alarcon*, 995 F.2d 982, 986 (10th Cir. 1993).

As to excluding evidence pursuant to a motion in limine, the Fifth Circuit has said:

> Generally speaking, "this circuit will not even consider the propriety of the decision to exclude the evidence at issue, if no offer of proof was made at trial." Stockstill v. Shell Oil Co., 3 F.3d 868, 872 (5th Cir. 1993); United States v. 873 Winkle, 587 F.2d 705, 710 (5th Cir.), cert. denied, 444 U.S. 827, 100 S.Ct. 51, 62 L.Ed.2d 34 (1979). While a formal proffer is not essential, the proponent of the evidence "must show in some fashion the substance of the proposed testimony." Id.

Seatrax Inc. v. Sonbeck International, Inc., 200 F.3d 359 (5th Cir. 2000). Thus, when a motion is limine is granted, the aggrieved party must make an offer of proof at trial in order to complain on appeal.

In Texas, a motion in limine alone is not an adequate vehicle to preserve error regarding a *Daubert* challenge. Texas appellate cases have made it clear that a ruling on a motion in limine cannot itself be reversible error. *In Hartford Accident & Indemnity Co. v. McCardell*, 369 S.W.2d 331, 335 (Tex. 1963), the Supreme Court said:

> If a motion in limine is overruled, a judgment will not be reversed unless the questions or evidence were in fact asked or offered. If they were in fact asked or offered, an objection made at that time is necessary to preserve the right to complain on appeal . . . .

Id. at 335. Nor can the granting of a motion in limine be claimed as error on appeal. *Keene Corp. v. Kirk*, 870 S.W.2d 573, 581 (Tex. App.--Dallas 1993, no writ) (after motion in limine was sustained as to certain evidence, counsel conducted the balance of his examination of the witness without ever eliciting the excluded evidence; error was therefore waived); *Waldon v. City of Longview*, 855 S.W.2d 875, 880 (Tex. App.--Tyler 1993, no writ) (fact that motion in limine was sustained, and proponent offered exhibit on informal bill of exceptions, did not preserve error, since it was incumbent upon the proponent to tender the evidence offered in the bill and secure a ruling on its admission).

If a motion in limine is granted and the evidence is nonetheless offered, or comment of counsel made, in violation of the order in limine, an objection to the offending evidence or argument may be prerequisite to raising a complaint on appeal at the violation of the order. If the objection is sustained, then the aggrieved party should move that the jury be instructed to disregard the improper evidence or argument. If the instruction is denied, complaint can be premised on the denial. If the instruction is granted, it will cure harm, except for incurable argument, such as an appeal to racial prejudice.

Thus, if a motion in limine is used to challenge the admissibility of expert testimony, and the challenge is upheld, the proposing party will have to approach the court during trial and indicate a desire to offer the evidence, and if that request is denied, then make an offer of proof outside the presence of the jury. (It is possible, but not guaranteed, that any proof offered at the motion in limine hearing could suffice as an offer of proof for appellate purposes. But if all that is offered at the hearing on motion in limine is attorney argument, that is likely inadequate.) If the motion in limine challenging expert testimony is overruled, the opposing party will have to assert an objection when the evidence is offered during trial.

XXII. RULING OUTSIDE PRESENCE OF JURY.
TRE 103(a)(1) provides that "[w]hen the court hears objections to offered evidence out of the presence of the jury and rules that such evidence be admitted, such objections shall be deemed to apply to such evidence when it is admitted before the jury without the necessity of repeating those objections." FRE 103(a)(2) states it differently: "Once the court makes a definitive ruling on the record admitting or excluding evidence, either at or before trial, a party need not renew an objection or offer of proof to preserve a claim of error for appeal." The Federal rule applies by its own terms to both admission and exclusion of evidence, while the Texas rule speaks only to admission of evidence.

A question arises: if the objection is made in connection with presenting a motion in limine, does Rule 103 obviate the need to object in the presence of the jury? This question was considered in *Rawlings v. State*, 874 S.W.2d 740, 742-43 (Tex. App.--Fort Worth 1994, no pet.), in connection with the Texas Rule of Appellate Procedure governing preservation of error in the trial court (old TRAP 52(b)). In determining whether counsel's objection was a motion in limine or an objection outside the presence of a jury, the appellate court disregarded the label used by counsel and the trial judge, and looked instead to the substance of the objection or motion. The court made the following observations:

> [A] motion in limine characteristically includes: (1) an objection to a general category of evidence; and (2) a request for an instruction that the proponent of that evidence approach the bench for a hearing on its admissibility before offering it. Conspicuously absent from a motion in limine is a request for a ruling on the actual admissibility of specific evidence.
>
> In contrast, Rule 52(b) seems to require both specific objections and a ruling on the admissibility of contested evidence. In fact, we question whether Rule 52(b) comes into play until specific evidence is actually offered for admission. Rule 52(b) only provides that complaints about the admission of evidence are preserved when the court hears objections to offered evidence and rules that such evidence shall be admitted.

The court concluded that in that case the request was a motion in limine that did not preserve error.

XXIII. EVIDENTIARY OBJECTIONS IN SUMMARY JUDGMENT PROCEEDINGS. In Texas, evidentiary objections, such as a hearsay objection, or lack of personal knowledge, etc. must be made in the summary judgment response or reply in order to stop the trial court and the appellate court from relying upon the inadmissible evidence in connection with the summary judgment. *Washington v. McMillan*, 898 S.W.2d 392, 397 (Tex. App.--San Antonio 1995, no writ); *Roberts v. Friendswood Dev. Co.*, 886 S.W.2d 363, 365 (Tex. App.--Houston [1st Dist.] 1994, writ denied); *Dolenz v. A.B.*, 742 S.W.2d 82, 83-84 n.2 (Tex. App.--Dallas 1987, writ denied). The trial court's ruling sustaining an objection to summary judgment evidence must be reduced to writing, filed, and included in the transcript, to be given effect on appeal. *Dolenz v. A.B.*, 742 S.W. 2d 82, 83-84 n.2 (Tex. App.--Dallas 1987, writ denied). This can be done by having the trial court sign a written order ruling on the objection. Or by including a ruling on the objection in the summary judgment order.

The U.S. Court of Appeals for the Third Circuit points out that the obligation of the trial court to offer the parties an adequate opportunity to be heard may require a hearing at which the proper showing can be made, if possible. *See Padillas v. Stork-Gamco, Inc.*, 186 F.3d 412 417-18 (3rd Cir. 1999) (reversing a summary judgment granted because the plaintiff's expert did not meet *Daubert* criteria, saying that the trial court should have conducted a FRE 104 hearing, with an opportunity for the plaintiff to develop a record).

XXIV. OBJECTION DURING TRIAL. It is proper and sufficient to make a *Daubert* objection during trial. However, a court could adopt a local rule or scheduling order in a particular case requiring that *Daubert* objections be raised before trial or they are precluded.

There is a danger that a *Daubert* objection may be too general to preserve error for appeal. In *Scherl v. State*, 7 SW3d 650 (Tex. App.–Texarkana 1999, pet. ref'd), the Texas appellate court ruled that reliability objection was not a sufficiently precise objection to preserve appellate complaint. The court said:

> Scherl objected to the intoxilyzer evidence when it was offered at trial on the basis that it was inadmissible under Rule 702, Daubert, Kelly, and Hartman. However, to preserve error an objection to the admission of evidence must state the specific grounds for the objection, if the specific grounds are not apparent from the context. Tex.R. Evid. 103(a); Tex.R. App. P. 33.1; Bird v. State, 692 S.W.2d 65, 70 (Tex. Crim. App. 1985). An objection to an improper predicate that fails to inform the trial court exactly how the predicate is deficient will not preserve error. Bird, 692 S.W.2d at 70; Mutz v. State, 862 S.W.2d 24, 30 (Tex. App.-Beaumont 1993, pet. ref'd). Rule 702, Daubert, Kelly, and Hartman cover numerous requirements and guidelines for the admission of expert testimony. An objection based on Rule 702 and these cases alone is effectively a general objection to an improper predicate and is by no means specific. [FN3] Scherl's objection, without more specificity, did not adequately inform the trial court of any complaint upon which it might rule. Therefore, we conclude that no specific complaint about the reliability of the evidence was preserved for appellate review.
>
> [FN 3] Based on the objection made, how was the trial judge to know if Scherl was objecting because: (1) the judge failed to conduct a hearing outside the presence of the jury, or (2) the witness was not "qualified as an expert by knowledge, skill, experience, training, or education," or (3) the witness's testimony would not "assist the trier of fact to understand the evidence or to determine a fact in issue" and therefore was not relevant, or (4) the witness's testimony

> was not reliable because (a) the underlying scientific theory is not valid, or (b) the technique applying the theory is not valid, or (c) the technique was not properly applied on the occasion in question? See Texas Rule of Evidence 702, Daubert, Kelly, and Hartman.

However, in *Guadalupe-Blanco River Authority v. Kraft*, 77 S.W.3d 805 (Tex. 2002), the Supreme Court found the following objection sufficient to preserve a *Daubert* complaint:

> "I'm going to make an objection based upon the failure of this witness's methodology to meet the reliability standards as articulated by the Supreme Court in Gammill versus Jack William[s] Chevrolet as applying to all expert testimony." After voir dire, the trial court overruled the objection. The objection was timely, its basis was clear, and the Authority obtained a ruling. The Authority preserved its complaint for our review.

Although *Scherl* may not reflect the current state of the law on preserving a *Daubert* complaint, litigators are cautioned to consider how detailed they should be in asserting a *Daubert* or *Robinson* objection.

XXV. REPEATED OFFER OF INADMISSIBLE EVIDENCE. The case of *Marling v. Maillard*, 826 S.W.2d 735, 739 (Tex. App.--Houston [14th Dist.] 1992, no writ), stands for the proposition that where evidence is admitted over objection, and the proponent later offers the same evidence again, the opponent must renew the original objection or the right to complain about the erroneous admission of the original testimony is waived. *Accord*, *Badger v. Symon*, 661 S.W.2d 164-65 (Tex. App.--Houston [1st Dist.] 1983, writ ref'd n.r.e.) (and cases cited therein); *see also Commercial Union Ins. v. La Villa Sch. D.*, 779 S.W.2d 102, 109-110 (Tex. App.--Corpus Christi 1989, no writ) (party cannot complain on appeal of improper admission of evidence where that party has introduced evidence of a similar character). The Texas Supreme Court has said that where evidence is admitted over objection once in a trial, and the same evidence is later admitted without objection in the trial, that the admission of the evidence the second time renders harmless any error in the first admission of the evidence. *Richardson v. Green*, 677 S.W.2d 497, 501 (Tex. 1984). To quote the Court:

> The general rule is that error in the admission of testimony is deemed harmless if the objecting party subsequently permits the same or similar evidence to be introduced without objection.

On the other hand, Texas courts have held that in some circumstances, a party is not required to constantly repeat an objection. One such circumstance is when the objection would be futile because the court has just overruled a valid objection to the same testimony. *Graham v. State*, 710 S.W.2d 588, 591 (Tex. Crim. App. 1986); *D.L.N. v. State*, 590 S.W.2d 820, 823 (Tex. Civ. App.--Dallas 1979, no writ).

In *Atkinson Gas Co. v. Albrecht*, 878 S.W.2d 236, 242-43 (Tex. App.--Corpus Christi 1994, writ denied), the court of appeals noted the two opposing lines of authority and said:

> We conclude that the determination of whether a prior objection is sufficient to cover a subsequent offer of similar evidence depends upon a case-by-case analysis, based on such considerations as the proximity of the objection to the subsequent testimony, which party has solicited the subsequent testimony, the nature and similarity of the subsequent testimony as compared to the prior testimony and objection, whether the subsequent testimony has been elicited from the same witness, whether a running objection was requested or granted, and any other circumstances which might suggest why the objection should not have to be reurged.

XXVI. RUNNING OBJECTIONS. A "running objection" or "continuing objection" is a request to the court to permit a party to object to a line of questioning without the necessity of objecting to each individual question. Customarily this requires counsel obtaining permission from the court to have a "running objection" to all testimony from a particular witness on a particular subject.

The 5th Circuit court of appeals has recognized that a continuing objection granted by the court at trial will preserve error for appeal under FRE 103. *See Ward v. Freeman*, 854 F.2d 780 (5th Cir.1988), *cert. denied*, 490 U.S. 1065, 109 S.Ct. 2064, 104 L.Ed.2d 629 (1989); *United States v. Marshall*, 762 F.2d 419 (5th Cir.1985).

The utility of a running objection has been recognized by the Texas Court of Criminal Appeals. *Ethington v. State*, 819 S.W.2d 854, 858 (Tex. Crim. App. 1991) ("This Court has held on prior occasions that a continuing or running objection has properly preserved error"). In *Sattiewhite v. State*, 786 S.W.2d 271, 283-84 n. 4 (Tex. Crim. App. 1989), the Court stated:

> In promulgating these rules [Rules of Appellate Procedure and specifically Rule 52(a)], we took no "pot shots" at running objections because in

> certain situations they have a legitimate function. A running objection, in some instances, will actually promote the orderly progression of the trial. When an attorney has an objection to a line of testimony from a witness, it is often disruptive for the trial judge to force him to make the same objection after each question of opposing counsel just so that the attorney can receive the same ruling from the trial judge to preserve error. As long as Rule 52 is satisfied, that is, as long as the running objection constituted a timely objection, stating the specific grounds for the ruling, the movement desired the court to make (if the specific grounds were not apparent from the context of the running objection) then the error should be deemed preserved by an appellate court.

Running objections have been recognized in Texas civil cases such as *Leaird's, Inc. v. Wrangler, Inc.*, 31 S.W.3d 688, 690-91 (Tex. App.--Waco 2000, pet. denied), where the court said:

> If a trial court permits a running objection as to a particular witness's testimony on a specific issue, the objecting party "may assume that the judge will make a similar ruling as to other offers of similar evidence and is not required to repeat the objection." *Commerce, Crowdus & Canton*, 776 S.W.2d at 620; City of Fort Worth v. Holland, 748 S.W.2d 112, 113 (Tex. App.--Fort Worth 1988, writ denied); accord Atkinson Gas, 878 S.W.2d at 242; *Crispi v. Emmott*, 337 S.W.2d 314, 318 (Tex. Civ. App.--Houston 1960, no writ).

Ordinarily, in jury trials running objections apply only to similar testimony by the same witness. *Commerce, Crowdus & Canton v. DKS Const.*, 776 S.W.2d 615 (Tex. App.--Dallas 1989, no writ); *Leaird's Inc. v. Wrangler, Inc.*, 31 S.W.3d 688, 690 (Tex. App.--Waco 2000, pet. denied); *City of Fort Worth v. Holland*, 748 S.W.2d 112, 113 (Tex. App.--Fort Worth 1988, writ denied). The extent to which a running objection covers testimony of subsequent witnesses depends on several factors: (1) the nature and similarity of the subsequent testimony to the prior testimony; (2) the proximity of the objection to the subsequent testimony; (3) whether the subsequent testimony is from a different witness; (4) whether a running objection was requested and granted, and (5) any other circumstances which might suggest why the objections should not have to be reurged. *Correa v. General Motors Corp*., 948 S.W.2d 515, 518-19 (Tex.App.--Corpus Christi 1997, no writ).

The effect of running objections in a non-jury trial was considered In *Commerce, Crowdus & Canton, Ltd. v. DKS Const., Inc.*, 776 S.W.2d 615, 620-21 (Tex. App.--Dallas 1989, no writ):

> In considering the effectiveness of a running objection, it is widely considered that a party making a proper objection to the introduction of testimony of a witness, which objection is overruled, may assume that the judge will make a similar ruling as to other offers of similar evidence and is not required to repeat the objection. See Bunnett/Smallwood & Co. v. Helton Oil Co., 577 S.W.2d 291, 295 (Tex. Civ. App.--Amarillo 1979, no writ); Crispi v. Emmott, 337 S.W.2d 314, 318 (Tex. Civ. App.--Houston 1960, no writ). Some courts, though, have held that a running objection is primarily limited to those instances where the similar evidence is elicited from the same witness. See City of Fort Worth v. Holland, 748 S.W.2d 112, 113 (Tex. App.--Fort Worth 1988, writ denied); City of Houston v. Riggins, 568 S.W.2d 188, 190 (Tex. Civ. App.--Tyler 1978, writ ref'd n.r.e.). In these cases, however, the trial was to the jury. In our case, the trial was to the court. We hold that a running objection is an effective objection to all evidence sought to be excluded where trial is to the court and an objection is clearly made to the judge. Therefore, appellant's running objection to any evidence admitted for the purpose of proving alter-ego was an effective objection, and the issue was not tried by consent.

It is important that the basis for the running objection be clearly stated in the court reporter's record of the trial proceedings. *See Anderson Development Co., Inc. v. Producers Grain Corp.*, 558 S.W.2d 924, 927 (Tex. Civ. App.--Eastland 1977, writ ref'd n.r.e.) ("'The same objection on that question' and a 'running objection' are general objections where several objections have been made"). And it is necessary that the request and granting of a running objection be reflected in the court reporter's record of the trial proceedings. *See Freedman v. Briarcroft Property Owners, Inc.*, 776 S.W.2d 212, 217-18 (Tex. App.--Houston [14th Dist.] 1989, writ denied).

XXVII. "NO EVIDENCE" CHALLENGE. In *Weisgram v. Marley Co.,* 120 S. Ct. 1011 (2000), the U.S. Supreme Court unanimously held that, where a federal district court admitted expert testimony over objection, and the federal court of appeals determined that the evidence was not admissible under *Daubert*, the appellate court can, if it finds the remaining evidence insufficient to support a favorable verdict, reverse and render judgment for the opposing party, or the appellate court can reverse and remand for a new trial, or the appellate court can send the case back to the trial court to determine whether to enter judgment for the opposing party or to order a new trial. A party in a Texas civil proceeding can attack the sufficiency of the evidence on appeal, on the ground that the expert testimony admitted into evidence did not meet the necessary standards of reliability and relevance. *Merrill Dow Pharmaceuticals v. Havner*, 953 S.W.2d 706, 711 (Tex. 1997), *cert. denied*, 523 U.S. 1119, 118 S.Ct. 1799, 140 L.Ed.2d 939 (1998). However, this complaint cannot be raised for the first time after trial.

In the case of *Maritime Overseas Corp. v. Ellis*, 971 S.W.2d 402, 406-07 (Tex.), *cert. denied*, ___ U.S. ___, 119 S.Ct. 541, 142 L.Ed.2d 450 (1998), the Texas Supreme Court said:

> Under Havner, a party may complain on appeal that scientific evidence is unreliable and thus, no evidence to support a judgment. See Havner, 953 S.W.2d 706. Havner recognizes that a no evidence complaint may be sustained when the record shows one of the following: (a) a complete absence of a vital fact; (b) the reviewing court is barred by rules of law or evidence from giving weight to the only evidence offered to prove a vital fact; (c) the evidence offered to prove a vital fact is no more that a mere scintilla; or (d) the evidence establishes conclusively the opposite of the vital fact. See Havner, 953 S.W.2d at 711 (citing Robert W. Calvert, "No Evidence" and "Insufficient Evidence" Points of Error, 38 TEX. L. REV. 361, 362-63 (1960)). Here, like in Havner, Maritime contends that because Ellis's scientific evidence "is not reliable, it is not evidence," and the court of appeals and this Court are "barred by rules of law or of evidence from giving weight" to Ellis's experts' testimony. See Havner, 953 S.W.2d at 711, 713.
>
> * * *
>
> To preserve a complaint that scientific evidence is unreliable and thus, no evidence, a party must object to the evidence before trial or when the evidence is offered. See Robinson, 923 S.W.2d at 557; see also Havner, 953 S.W.2d at 713 ("If the expert's scientific testimony is not reliable, it is not evidence."). Without requiring a timely objection to the reliability of the scientific evidence, the offering party is not given an opportunity to cure any defect that may exist, and will be subject to trial and appeal by ambush. See Marbled Murrelet v. Babbitt, 83 F.3d 1060, 1066-67 (9th Cir. 1996), cert. denied, ___ U.S. ___, 117 S.Ct. 942, 136 L.Ed.2d 831 (1997); Sumitomo Bank v. Product Promotions, Inc., 717 F.2d 215, 218 (5th Cir.1983). Reviewing courts may not exclude expert scientific evidence after trial to render a judgment against the offering party because that party relied on the fact that the evidence was admitted. Babbitt, 83 F.3d at 1067. To hold otherwise is simply "unfair." Babbitt, 83 F.3d at 1067. As the Babbitt court explained:
>
> > [P]ermitting [a party] to challenge on appeal the reliability of [the opposing party's] scientific evidence under Daubert, in the guise of an insufficiency--of-the- evidence argument, would give [appellant] an unfair advantage. [Appellant] would be 'free to gamble on a favorable judgment before the trial court, knowing that [it could] seek reversal on appeal [despite its] failure to [object at trial].'
>
> Babbitt, 83 F.3d at 1067 (citations omitted). Thus, to prevent trial or appeal by ambush, we hold that the complaining party must object to the reliability of scientific evidence before trial or when the evidence is offered.

Ellis, 971 S.W.2d at 409-10.

Accord, General Motors Corp. v. Sanchez, 997 S.W.2d 584, 590 (Tex. 1999); *Melendez v. Exxon Corp.*, 998 S.W.2d 266, 282 (Tex. App.–Houston [14th Dist.] 1999, no pet.); *Harris v. Belue*, 974 S.W.2d 386, 393 (Tex. App.–Tyler 1998, pet. denied) (party, who did not object to admission of expert testimony on *Daubert* grounds until after plaintiff rested and in connection with motion for instructed verdict, waived *Daubert* attack).

XXVIII. JUDICIAL NOTICE. In litigation, most facts are established through the introduction of evidence. However, under TRE 201 and FRE 201, a court may take "judicial notice" of adjudicative facts. A party who requests judicial notice should supply the court with necessary information. The opposing party is entitled to be heard on opposing the taking of judicial notice. Upon taking judicial notice, the Court should instruct the jury to accept as conclusive any fact judicially noticed. TRE 201 and FRE 201 are identical, and read as follows:

> Rule 201. Judicial Notice of Adjudicative Facts
>
> (a) Scope of rule. This rule governs only judicial notice of adjudicative facts.
>
> (b) Kinds of facts. A judicially noticed fact must be one not subject to reasonable dispute in that it is either (1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned.
>
> (c) When discretionary. A court may take judicial notice, whether requested or not.
>
> (d) When mandatory. A court shall take judicial notice if requested by a party and supplied with the necessary information.
>
> (e) Opportunity to be heard. A party is entitled upon timely request to an

> opportunity to be heard as to the propriety of taking judicial notice and the tenor of the matter noticed. In the absence of prior notification, the request may be made after judicial notice has been taken.
>
> (f) Time of taking notice. Judicial notice may be taken at any stage of the proceeding.
>
> (g) Instructing jury. In a civil action or proceeding, the court shall instruct the jury to accept as conclusive any fact judicially noticed. In a criminal case, the court shall instruct the jury that it may, but is not required to, accept as conclusive any fact judicially noticed.

There may be certain expert methodologies that have been established as being reliable by prior court rulings establishing stare decisis. As explained in *Donaldson v. Central Illinois Public Service Co.*, 767 N.E.2d 314, 325 (Ill. 2002):

> Once a principle, technique, or test has gained general acceptance in the particular scientific community, its general acceptance is presumed in subsequent litigation; the principle, technique, or test is established as a matter of law.

While *Donaldson* is a case rejecting *Daubert* and applying the *Frye* rule, the concept of previously-established reliability is applicable even in *Daubert* jurisdictions.

Court of Criminal Appeals Judge Keller wrote in her concurring and dissenting opinion in *Hartman v. State*, 946 S.W.2d 60, 63-64 (Tex. Crim. App. 1997):

> I agree with the majority that Kelly v. State, 824 S.W.2d 568 (Tex.Crim.App.1992) announces the proper test for all scientific evidence. As the majority correctly states, scientific evidence must meet a three-pronged reliability test to be admissible: (1) the underlying scientific theory must be valid; (2) the technique applying the theory must be valid; and (3) the technique must have been properly applied on the occasion in question. Id. at 573.
>
> I would add, however, that in many instances, prongs (1) and (2) can be decided by appellate courts as matters of law. Absent constitutional concerns, the Legislature can recognize the validity of particular scientific theories and techniques through statutory enactment. Trial and appellate courts would be bound to follow such enactments. Even absent legislative action, however, the validity of a particular scientific theory or technique may be established well enough that parties should not be required to relitigate its admissibility. Indeed, the Supreme Court has recognized that some scientific principles are so well established that they may be subject to judicial notice. Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579, 592 n. 11, 113 S.Ct. 2786, 2796 n. 11, 125 L.Ed.2d 469, 482 n. 11 (1993). Even if a scientific theory or technique does not occupy a status deserving of judicial notice, it may nevertheless have been established sufficiently to warrant admissibility as a matter of course. Any disputes about the validity of such theories and techniques may then be litigated in the adversarial setting before the factfinder. Permitting judicial recognition of the validity of a scientific theory or technique would provide guidance to trial courts through the development of precedent. See Villarreal v. State, Keller, J. concurring, 935 S.W.2d 134, 148-49 (Tex. Crim. App. 1996). Trial courts should not become constantly embroiled in determining the admissibility of scientific theories and techniques that have already been well established as reliable.
>
> Of course, absent legislative action, until an appellate court announces that a scientific theory or technique has been proven sufficiently reliable to be admissible as a matter of law, parties will have to litigate its admissibility; this is true of any issue of first impression. Villarreal, Keller, J. concurring, at 147-48. Moreover, the reliability of many scientific theories and techniques may not be sufficiently established that an appellate court can with confidence declare the theory or technique admissible as a matter of law. In such cases, an appellate court should refrain from making such a declaration until such time as scientific knowledge has progressed to enable doing so. Further, even after a particular theory or technique has been declared admissible as a matter of law, parties should be permitted to urge a re-examination of the status of a theory or technique if subsequent developments in the scientific field cast doubt upon its continuing validity.
>
> Finally, unlike the first two prongs of the Kelly test, the third prong--whether the technique has been properly applied on the occasion in question--must necessarily be decided on a case-by-case basis.

There are a number of financial-related matters that could be judicially noticed, including SEC regulations, FASB standards, etc. In *Marquardt Co. v. United States*, 822 F.2d 1573, 1578 (Fed. Cir.1987), and

Urbanek v. United States, 731 F.2d 870, 873 n. 3 (Fed.Cir.), *cert. denied*, 469 U.S. 1034, 105 S.Ct. 508, 83 L.Ed.2d 398 (1984), the appellate courts took judicial notice of accounting texts.

XXIX. COURT-APPOINTED EXPERTS. FRE 706 permit the court to appoint an expert witness to assist the court. There is no equivalent TRE. The expert may be appointed on motion of a party, or on the court's own initiative. The witness must advise the parties of his or her findings, and the expert's deposition may be taken by any party. The expert can be called to testify by any party or the court. The expert is entitled to reasonable compensation set by the court, and in ordinary civil litigation that expense can be imposed on the parties in a proportion set by the court.

E N D