DAUBERT CHALLENGES

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I. SCOPE OF ARTICLE. The first part of this article discusses *Daubert*'s concept of reliability of methodology and relevance of expert witness evidence, with a special emphasis on the nonscientific expert. The article distinguishes an expert's qualifications from the reliability of an expert's methodology, and the relevance of expert evidence to the question at hand.

The second part of the article discusses the procedural mechanisms for raising *Daubert* objections.

The third part of the article discusses the trial court's little-discussed Rule 705(c) gatekeeping function regarding the facts or data underlying an expert's opinion, and the procedural vehicles used to raise *Daubert* issues.

The fourth part of this article discusses the application of *Daubert* reliability concepts to mental health experts.

The fifth part of this article discusses the application of *Daubert* reliability concepts to financial experts.

The sixth part of this article takes stock of the governmental regulatory bodies, and professional associations, overseeing certain financial experts, and discusses some of the standards that apply to various areas.

II. QUALIFICATIONS OF EXPERTS.
Under TEX. R. EVID. 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. *Broders v. Heise*, 924 S.W.2d 148, 149 (Tex. 1996). This involves the expert's "qualifications." The party offering the testimony bears the burden to prove that the witness is qualified under Rule 702. *Broders*, 924 S.W.2d at 151. The decision of whether an expert witness is qualified to testify is within the trial court's discretion, and will be reviewed on appeal only if the ruling is an abuse of discretion, meaning that the trial court acted without reference to any guiding rules or principles. *Broders*, 924 S.W.2d at 151.

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*, 924 S.W.2d at 153. *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]. In *K-Mart Corp. v. Honeycutt*, 24 S.W.3d 357, 360 (Tex. 2000) (per curiam) (involving a human factors and safety expert offering to testify that a store was negligent in handling shopping carts), the Supreme Court held that 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.

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*, 924 S.W.2d at 153. Stated differently, the offering party must demonstrate that the witness possesses "special knowledge as to the very matter on which he proposes to given an opinion." *Gammill v. Jack Williams Chevrolet, Inc.*, 972 S.W.2d 713, 718 (Tex. 1998). *See United Blood Services v. Longoria*, 938 S.W.2d 29 (Tex. 1997); Linda Addison, *Recent Developments in Qualifications of Expert Witnesses*, 61 TEX. B.J. 41 (Jan. 1998) [Westlaw cite: 61 TXBJ 41].

In *Travelers Insurance Company v. Wilson*, 2000 WL 1052965 (Tex. App.--Texarkana Aug. 1, 2000, no pet.), the trial court was affirmed in refusing to allow an orthopedic surgeon to testify on the reasonableness and necessity of chiropractic treatment.

In *K Mart Corp. v. Rhyne*, 932 S.W.2d 140, 142, 146 (Tex. App.--Texarkana 1996, no writ), the appellate court held that a chiropractor, who was qualified to testify about the plaintiff's condition, was not qualified to testify about the cost of future surgeries, since no

foundation had been laid regarding the witness's qualifications to give such an opinion.

III. RELIABILITY OF EXPERT'S METHODOLOGY; RELEVANCY.

A. FEDERAL. 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.

In *Kumho Tire Co. v. Carmichael*, 526 U.S.137, 11 S. Ct. 1167, 143 L.Ed.2d 238 (1999) (ruling below: 131 F.3d 1433 (11th Cir. 1997)), 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.*

B. TEXAS CIVIL PROCEEDINGS. The Texas Supreme Court adopted the *Daubert* analysis for TRE 702, requiring that the expert's underlying scientific technique or principle be reliable and relevant. *E.I. du Pont de Nemours v. Robinson*, 923 S.W.2d 549 (Tex. 1995). The Texas Supreme Court listed factors for the trial court to consider regarding reliability: (1) the extent to which the theory has been or can be tested; (2) the extent to which the technique relies upon the subjective interpretation of the expert; (3) whether the theory has been subjected to peer review and/or publication; (4) the technique's potential rate of error; (5) whether the underlying theory or technique has been generally accepted as valid by the relevant scientific community; and (6) the non-judicial uses which have been made of the theory or technique. *Robinson*, 923 S.W.2d at 557. *See America West Airline Inc. v. Tope*, 935 S.W.2d 908 (Tex. App.--El Paso 1996, no writ) (somewhat unorthodox methods of mental health worker in arriving at DSM-III-R diagnosis did not meet the admissibility requirements of *Robinson*). The burden is on the party offering the evidence to establish the reliability underlying such scientific evidence. *Robinson* at 557.

In *Gammill v. Jack Williams Chevrolet, Inc.*, 972 S.W.2d 713 (Tex. 1998), the Texas Supreme Court announced that the reliability and relevance (discussed below) requirements of *Robinson* apply to all types of expert testimony, whether or not it is based on science. In *Gammill* a unanimous Supreme Court said:

> We conclude that whether an expert's testimony is based on "scientific, technical or other specialized knowledge," *Daubert* and Rule 702 demand that the district court evaluate the methods, analysis, and principles relied upon in reaching the opinion. The court should ensure that the opinion comports with applicable professional standards outside the courtroom and that it "will have a reliable basis in the knowledge and experience of [the] discipline." [FN47]
>
> We agree with the Fifth, Sixth, Ninth, and Eleventh Circuits that Rule 702's fundamental requirements of reliability and relevance are applicable to all expert testimony offered under that rule. Nothing in the language of the rule suggests that opinions based on scientific knowledge should be treated any differently than opinions based on technical or other specialized knowledge. It would be an odd rule of evidence that insisted that some expert opinions be reliable but not others. All expert testimony should be shown to be reliable before it is admitted. [FN48]

Gammill, 972 S.W.2d at 725-26.

After noting that the reliability and relevancy criteria listed in *Daubert* may not apply to experts in particular fields, the Texas Supreme Court noted that nonetheless there are reliability criteria of some kind that must be applied.

The Court said:

> [E]ven if the specific factors set out in *Daubert* for assessing the reliability and relevance of scientific testimony do not fit other expert testimony, the court is not relieved of its responsibility to evaluate the reliability of the testimony in determining its admissibility.

Gammill, 972 S.W.2d at 724.

C. TEXAS CRIMINAL PROCEEDINGS. The Texas Court of Criminal Appeals, which established a reliability requirement even before the U.S. Supreme Court decided *Daubert* (see *Kelly v. State*, 824 S.W.2d 568 (Tex. Crim. App. 1992)), has extended reliability requirements to *all* scientific testimony, not just novel science. *See Hartman v. State*, 946 S.W.2d 60 (Tex. Crim. App. 1997) (applying *Kelly*-reliability standards to DWI intoxilyzer). In *Weatherred v. State*, 15 S.W.3d 540, 542 n. 5 (Tex. Crim. App. 2000), the Court of Criminal Appeals distinguished "hard" sciences from "soft" sciences:

> The "hard" sciences, areas in which precise measurement, calculation, and prediction are generally possible, include mathematics, physical science, earth science, and life science. The "soft" sciences, in contrast, are generally thought to include such fields as psychology, economics, political science, anthropology, and sociology. See The New Columbia Encyclopedia 2450 (1975).

The Court of Criminal Appeals has articulated a different standard of legal reliability on "soft" science cases. In the case of *Nenno v. State*, 970 S.W.2d 549 (Tex. Crim. App. 1998), the Court extended the *Kelly*-reliability standards to mental health experts, but indicated that the *Daubert* list of factors did not apply. Instead, the Court of Criminal Appeals suggested the following factors be applied to fields of study outside of the hard sciences (such as social science or fields relying on experience and training as opposed to the scientific method): (1) whether the field of expertise is a legitimate one; (2) whether the subject matter of the expert's testimony is within the scope of that field; (3) whether the expert's testimony properly relies upon and/or utilizes the principles involved in the field. *Nenno*, 970 S.W.2d at 561.

D. RELEVANCE. *Daubert* and *Robinson* contain a relevancy requirement, to be applied to expert evidence. As explained in *Gammill v. Jack Williams*, 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. RECAP. Due to increasing complexity and specialization, 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. Federal courts in Texas, and Texas courts in both civil and criminal cases, 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.

The reliability and relevancy requirement for expert testimony has become one of the most controversial evidentiary issues, nationwide. Virtually every week some court in the USA makes a ruling on *Daubert* or *Robinson*-like issues. One important area is expert testimony from treating physicians, based upon differential diagnosis and not large-scale research. The Fifth Circuit Court of Appeals issued an en banc opinion saying that the *Daubert* reliability factors precluded a clinical physician from testifying to the cause of a patient's condition. *See Moore v. Ashland Chemical Co., Inc.*, 151 F.2d 269 (5th Cir. 1998) (en banc).

IV. PROVING RELIABILITY. A proponent of expert testimony may establish reliability "by deposition testimony, affidavits, proffers, stipulations, learned treatises, testimony or some combination thereof." R. Murrian, *The Admissibility of Expert Eyewitness Testimony Under the Federal Rules*, 29 CUMB. L. REV. 379, 385 (1999). *Accord*, *United States v. Downing*, 753 F.2d 1224, 1241 (3rd Cir.1985).

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 or 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. *See Weatherred v. State*, 15 S.W.3d 540, 542 n. 4 (Tex. Crim. App. 2000).

V. MAKING AND PRESERVING ERROR ON A DAUBERT CHALLENGE. It is a fundamental rule of evidence law that 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; TRAP 33. How, then, can a *Daubert, Robinson*-type of objection be raised, and error preserved?

A. PRELIMINARY QUESTIONS OF ADMISSIBILITY UNDER TRE 104. FRE 104 and TRE 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. FRE 104(a), TRE 104(a). Such a preliminary proceeding must be conducted out of the hearing of the jury, "when the interests of justice so require." FRE 104(c), TRE 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 ("[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 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).

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The U.S. Supreme Court has ruled that 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).

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

B. MOTION IN LIMINE. In a Texas court, a motion in limine alone is not an adequate vehicle to pursue 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 is 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. In criminal cases, the aggrieved party who timely objects and receives a curative instruction, but who is still not satisfied, must push further and secure an adverse ruling on a motion for a mistrial, in order to preserve appellate complaint. Immediately pushing for a mistrial should not be necessary in a civil proceeding, for the following reason. If the harm is curable, then by necessity a curative instruction will cure the harm. If the harm is incurable, then an instruction will not cure the harm, and the only relief is a new trial. However, a new trial is not necessary if the aggrieved party wins. Judicial economy suggests that the aggrieved party should be able to raise incurable error after the results of the trial are known, rather than having civil litigants moving for mistrial in a case that they otherwise might have won. TRCP 324(b)(5) specifically permits incurable jury argument to be raised by motion for new trial, even if it was not objected to at the time the argument was made. *See generally In re W.G.W.*, 812 S.W.2d 409, 416 (Tex. App.--Houston [1st Dist.] 1991, no writ) (insinuation that cervical cancer was caused by immoral conduct was incurable error). Counsel's violation of a motion in limine exposes the lawyer to a contempt citation.

Thus, if a motion in limine is used to bring a *Daubert* challenge, 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 an offer of proof or bill of exception must be made 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 inadequate.) If the motion in limine based on *Daubert* is overruled, the opposing party will have to assert an objection when the evidence is offered during trial.

In federal court, 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).

Some courts recognize an exception to this rule 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 Int'l, 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.

C. RULING OUTSIDE PRESENCE OF JURY. TRE 103(b) 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." *Accord*, FRE 103(b). If the objection is made in connection with presenting a motion in limine, does Rule 103(b) 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 old Rule 52(b), now Rule 103(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.

See K-Mart No. 4195 v. Judge, 515 S.W.2d 148, 152 (Tex. Civ. App.--Beaumont 1974, writ dism'd) (even if trial objection was seen as incorporating objections set out in motion in limine, still the objection was a general objection). Restating the objection made outside the presence of the jury was held not to be necessary in *Klekar v. Southern Pacific Transp. Co.*, 874 S.W.2d 818, 824-25 (Tex. App.--Houston [1st Dist.] 1994, no writ).

D. OBJECTION DURING TRIAL. It is proper and sufficient to make a *Daubert* objection during trial. However, a court could adopted a local rule or scheduling order in a particular case requiring that *Daubert* objections be raised before trial or they are precluded. In *Scherl v. State*, 7 SW3d 650 (Tex. App.–Texarkana 1999, pet. ref'd), the Texas appellate court ruled that TRE 702 is not a sufficiently precise objection to preserve appellate complaint. The court's language is worth reading:

> 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.

Litigators are cautioned to consider how detailed they should be in asserting a *Daubert* or *Robinson* objection.

A party objecting based on *Daubert* should also object based on Rule of Evidence 403, arguing that probative value is outweighed by charges or prejudice or confusion. This is an independent basis to exclude the evidence.

E. "NO EVIDENCE" CHALLENGE. 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.
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> 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 (9 th 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:
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> > [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].'
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> 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).

VI. FACTS OR DATA UNDERLYING EXPERT OPINION. TRE 705 reads as follows. Pay particular attention to TRE 705(c), new to Texas civil litigation, establishing a gatekeeper function for the trial judge concerning the facts or data supporting an expert's opinion.

> **RULE 705. DISCLOSURE OF FACTS OR DATA UNDERLYING EXPERT OPINION**
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> **(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.
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> **(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.
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> **(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. [Emphasis added]
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> **(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.
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> **Notes and Comments**
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> Comment to 1998 change: Paragraphs (b), (c), and (d) are based on the former Criminal Rule and are made applicable to civil cases. This rule does not preclude a party in any case from conducting a *voir dire* examination into the qualifications of an expert.

It can be seen that new TRE 705(b) offers a right to voir dire the expert about the underlying facts or data outside the presence of the jury. TRE 705(c) permits the trial court to reject expert testimony if the court determines that the expert doesn't have a sufficient basis for his opinion. And TRE 705(d) establishes a balancing test for underlying facts or data that are inadmissible except to support the expert's opinion: the court should exclude the inadmissible underlying information if the danger of misuse outweighs the value as explanation or support for the expert opinion.

VII. *DAUBERT* PRINCIPLES APPLIED TO MENTAL HEALTH EXPERTS.

A. CASES INVOLVING MENTAL HEALTH EXPERTS. The following cases involve the admissibility of mental health expert testimony measured against the requirement of legal reliability.

The Texas Court of Criminal Appeals considered how to apply legal reliability standards to mental health experts in *Nenno v. State*, 970 S.W.2d 549 (Tex. Crim. App. 1998). The Court of Criminal Appeals suggested the following factors be applied to fields of study outside of the hard sciences (such as social science or fields relying on experience and training as opposed to the scientific method): (1) whether the field of expertise is a legitimate one; (2) whether the subject matter of the expert's testimony is within the scope of that field; (3) whether the expert's testimony properly relies upon and/or utilizes the principles involved in the field. *Nenno*, 970 S.W.2d at 561. In *Nenno*, the Court of Criminal Appeals upheld the admission of the testimony of a Supervisory Special Agent in the Behavioral Science unit of the FBI who specialized in studying the sexual victimization of children, and who concluded that the defendant was a pedophile, would be difficult to rehabilitate, and posed a continuing threat to society.

In *Wright-Thomas v. State*, 2000 WL 1184591 (Tex. App.--Dallas Aug. 22, 2000) (not for publication), the exclusion of a psychologist's opinions regarding the unreliability of eyewitness testimony was affirmed because the expert did not sufficiently relate his testimony to the facts of this case.

In *Mega Child Care, Inc. v. Texas Department of Protective And Regulatory Services*, 2000 WL 1421705, *3 (Tex. App.--Hous. [14th Dist.] Sept. 28, 2000, no pet. h.), it was not error for the trial court to admit the testimony of an expert with a degree in sociology, who had been employed by TDPRS for twenty years, had been in the child care licensing division for ten years, and had been a supervisor for TDPRS for eight years, on the question of whether a child care facility had been operating in violation of state law.

In *Roise v. State*, 7 S.W.3d 225, 237 (Tex. Crim. App. 1999), the Court of Criminal Appeals held it was error to admit the testimony of a psychologist, that certain photographs would promote sexual impulses and sexual fantasies and that children in the photographs were

developmentally harmed. The Court noted that "[d]egrees, experience, and training do not qualify an expert to answer every conceivable question about psychology," and held that the opinion was not reliable under *Nenno*, nor was the expert's theory of four stages of sexual arousal relevant to the factual issues in the case.

In *GTE Southwest, Inc. v. Bruce*, 998 S.W.2d 605, 611-12 (Tex. 1999), the Supreme Court rejected the testimony of a psychologist that certain behavior was extreme and outrageous, and said: "[e]xcept in highly unusual circumstances, expert testimony concerning extreme and outrageous conduct would not meet" the requirement that expert testimony involve scientific, technical, or other specialized knowledge that would assist the trier of fact.

In *America West Airlines, Inc. v. Tope*, 935 S.W.2d 908, 918 (Tex. App.--El Paso 1996, no writ), a conclusion by a mental health practitioner that her patient suffered from post-traumatic stress disorder was properly excluded because of the expert's somewhat unorthodox methods, failure to keep notes, lack of psychological testing, etc.

In *Campos v. State*, 977 S.W.2d 458 (Tex. App.–Waco 1998, no pet.), the trial court admitted the testimony of a clinician who had a Bachelor's Degree in Education, a Master's Degree in Spanish and counseling, and training to become a licensed professional counselor and "registered play therapist." The witness's training included study, passing an examination, and 2,000 hours of supervised work. The witness's experience included counseling hundreds of children, 75% of whom were victims of abuse. The expert testified that play therapy was accepted in the counseling community as a legitimate form of counseling. She said that her training permitted her to interpret the actions of children in a way that a jury could not do. The witness had not written an article, but had lectured and had testified on 3 occasions. *Id*. at 463. The expert testified that she had seen the child 10 times in 8 months, that the child had drawn several pictures including a picture of a tree and a house. The expert testified that abused children generally draw "X's" in the houses and holes in the trees, and that the child's pictures contained these symbols. She testified that the child chose to play in the sandbox, and that the male doll always ended up "gone" or "dead." She testified that sexually abused children often feel guilty, frustrated, confused, and angry, and that the child had exhibited all of these feelings. The appellate court held that no error was committed by admitting this evidence

In *Wessmann v. Gittens*, 160 F.3d 790 (1st Cir. 1998), the U.S. Court of Appeals for the First Circuit said:

> When scientists (including social scientists) testify in court, they must bring the same intellectual rigor to the task that is required of them in other professional settings. See Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579 (1993); Braun v. Lorillard, Inc., 84 F.3d 230, 234 (7th Cir. 1996); see also People Who Care, 111 F.3d at 537 (declaring, in reviewing admissibility of social science evidence purporting to quantify causes of achievement gap, that "the methods used by the expert to derive his opinion [must] satisfy the standards for scientific methodology that his profession would require of his out-of-court research")

In *Skidmore v. Precision Printing and Pkg., Inc.*, 188 F.3d 606 (5th Cir. 1999), the Fifth Circuit applied the *Daubert* reliability concept to a psychologist who testified to a diagnosis that the plaintiff suffered from post-traumatic stress disorder and depression brought on by the defendant's conduct, and held no abuse in admitting the testimony.

In *Nichols v. American National Insurance Co.*, 154 F.3d 875 (8th Cir. 1998), the Eight Circuit Court of Appeals affirmed the trial court's rejection of the opinion of an M.D. and two Ph.D. psychologists that several children had been subjected to child abuse. The professionals supported their conclusions by Child Behavior Checklists (CBCs) completed by the children's parents; (2) conducting clinical interviews with the children that involved role playing with anatomically correct dolls; and (3) interviews with the children's parents and assessment of their credibility. The District Court found:

> (1) that the CBCs relied upon in part by the appellants' experts had not been validated for use with mentally retarded children; (2) that in any event a CBC is insufficient, on its own, to establish that a child has been abused; (3) that Dr. Sullivan's clinical interview protocol, which [the children's] experts submitted and which they claimed was accepted by the relevant scientific community, did not provide specific guidance for conducting clinical interviews; and (4) that in interviewing the [children], [the children's] experts departed significantly from the clinical protocol that they submitted to the court.

The Eight Circuit Court of Appeals also noted that there was no support for the low rate of error claimed by the experts. And the Court noted that the experts' methodology led to the choice of a mode of therapy for these children, and not a diagnosis of child abuse.

B. LICENSING OF MENTAL HEALTH PROFESSIONALS.

To understand the issue of qualifications and professional limits on the opinions of mental health experts, it is important to understand the licensing of mental health practitioners in Texas. The following explanation of

licensing is provided by clinical and forensic psychologist Jan DeLipsey, Ph.D., 4514 Travis Street, Dallas, Texas. Dr. DeLipsey was an editor and chief contributing author to the Family Law Section's EXPERT WITNESS MANUAL. The copyright to this section of the paper is reserved to Dr. DeLipsey.

The State of Texas licenses psychologists, social workers, licensed professional counselors (LPC's), marriage and family therapists (MFT), and psychiatrists (MD's). Only these individuals may deliver general mental health services. There are restrictions with some of the licenses regarding the scope of practice and all allow an exclusion to ministers and pastoral care. One of the restrictions is the use of the word psychologist or psychological – it can only be used professionally by a psychologist--it cannot be used by a marriage and family therapist or a licensed professional counselor. Only a psychologist or psychiatrist can use the term "psychological evaluation."

The licensing statutes codify standards and guidelines for the various professions. For governmental agencies there is an exclusion – they can perform services without licenses – an example would be child protective services. For family court services, educational or licensing requirements for workers are determined on a local basis. Larger counties tend to employ those with advanced degrees who are also licensed.

Licensed psychologists usually have either a MA in psychology or a PhD in psychology. In recent times some psychologists have a D.Psych. Prior to 1979 other doctorate degrees in mental health could sit for the psychology exam so there are still a few psychologists who might have an doctorate in social work or counseling education.

The master's level licensee is termed a psychological associate.

A PhD and Psy. D. may practice independently but a psychological associate must practice under the supervision of a doctorate degreed individual.

An Ed.D. is a doctorate in education. Because the individual does not have a doctorate degree in psychology, he or she cannot sit for the psychology board licensing exam. Therefore the Ed.D. will take a license as either a marriage and family therapist or as a licensed professional counselor.

Licensed social workers can have any type of mental health degree. There are 5 different levels of licensing but the act is only a title act – not a practice act. Anyone in the State of Texas can perform or practice social work – but only a licensee can claim to be a social worker or do social work.

With regard to Licensed Professional Counselor's (LPC) and Licensed Marriage and Family Therapist's (LMFT), in order to sit for either of these exams, the individual must have an advanced degree in a mental health field as well as well documented supervised experience in the delivery of services – currently 3,000 hours for the LPC and 2,000 hours for the LMFT.

Psychiatrists must hold a medical license from the State Board of Medical Examiners-- they can hold a degree as either a medical doctor or osteopath. They need not hold any special training in psychiatry. Any individual – a podiatrist for example, with a medical license can hold themselves out to be a psychiatrist if they so choose.

In order to be "Board Certified" the doctor must have at least one year of specialized training in the area as well as sit for an exam. There are also specific rules and guidelines for board certified psychiatrists.

Only licensed psychologists and psychiatrists can perform projective testing. Examples of projective testing would be the Rorschach Inkblot Test or a Complete the Sentences Test. Objective psychological testing (MMPI, MCMI, etc.) can be conducted by any licensed professional who has the proper training However, the terminology for the resulting product such as psychological evaluation or psychological functioning is restricted.

All of these licensed mental health practitioners can make a mental health diagnosis, provided they have sufficient underlying training. All of the licensing acts stress that the professional must practice within the limits of their training.

C. RELIABILITY AND VALIDITY IN SOCIAL SCIENCES. Two measures of the legitimacy of mental health expert evidence are "reliability" and "validity." The following description of reliability and validity is taken from writings of and discussions with Jan DeLipsey, Ph.D., Dallas, Texas.

"Reliability," in the social science sense, means consistency. It measures the degree of consistency of results. The same test given to the same person should reliably reach the same result, time-after-time.

"Validity" is the accuracy of a mental health test or theory. Psychologists ask: "Are we testing what we think we are? Are we seeing what is really there? Does this test for depression really test depression? Does this treatment for depression really alleviate the symptoms?" Validity research answers these questions.

Reliability is consistency only and is the foundation for validity. If a person is shooting at a target and consistently hit the same area of the outer ring, there would be good reliability because all of the bullets are going to the same place. The shooter is consistent. But if the goal was accuracy - to hit the bull's eye, then there would be no validity – none of the shots had gone into

the bull's eye. So the shooter would be a reliable, but not valid.

Reliability is the foundation for validity – if you can't be consistent – you don't even get to the question of accuracy.

Reliability is established through a calculation called a "reliability coefficient" that is often symbolized by "*r*". A reliability coefficient value ranges from 0.0 (no reliability) to +1.0 (perfect reliability). ELAZAR PEDHAZUR AND LIORA PEDHAZUR SCHMELKIN, MEASUREMENT, DESIGN, AND ANALYSIS: AN INTEGRATED APPROACH 85-86 (1991). Note that a reliability coefficient never has a negative value. For example, if the reliability coefficient is equal to .90, that indicates that 90% of the variance[1] of the total score is reliable (systematic) variance rather than error variance. Obviously, higher reliability is always better.

VIII. 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.*, ___ F.3d ___ (6th Cir. 1999) [No. 98-8070], 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*, ___ F. 3d ___ (3rd Cir. July 24, 2000) [2000 WL 1022649], 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.

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),

[1] Variance can be thought of as a measure of variability in a sample of scores on a given test. Use of variability is essential to statistically analyzing a group of scores.

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.

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).

IX. ACCOUNTANTS. To apply the mandate of *Kumho Tire* and *Gammill* to accountant witnesses, it is necessary to know something about the licensing and professional standards in the accounting field.

A. LICENSING. 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 in Houston.

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.

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.

It is permissible for a person to render bookkeeping services in Texas without being licensed. But these persons cannot provide audit or "attest" services. Only licensed CPA's can do that.

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 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. Audits. CPAs conducting audits conform to GAAS, generally accepted auditing standards, developed by the AICPA.

2. 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.

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. Ibid., AR§100.04.

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. Ibid., AR§100.04.

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.

3. Income Reporting

Tax accounting is different from ordinary accounting. The sources of authority for tax reporting principles is 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.

D. LITIGATION SERVICES, OR FORENSIC WORK.

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 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

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.

X. APPRAISERS AND EVALUATORS.

This section of the paper considers licensing and professional organizations relating to appraisers, and standards of valuation practice.

A. LICENSING.

A real estate 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. Rev. Civ. Stat. Ann. art. 6573a.2)]. The 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).

Only certified or licensed appraisers can do "certified appraisals" or "licensed appraisals." These kinds of appraisals must conform to USPAP. [TEX. ADMIN. CODE ANN. § 155.1]

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

B. 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.

C. WHAT IS USPAP?

USPAP is the Uniform Standards of Professional Appraisal Practice, issued by the Appraisal Standards Board. USPAP has been adopted by various federal and state agencies. Much of USPAP applies to valuing real estate. However, Standards 9 & 10 apply to business appraisals. See: <http://www.appraisalfoundation.org/uspap2000/ toc.htm>.

The ASB says this about USPAP:

> The Uniform Standards of Professional Appraisal Practice [were] adopted by the Appraisal Standards Board of the Foundation on January 30, 1989 and [are] recognized throughout the United States as the generally accepted standards of professional appraisal practice.

<https://www.appraisalfoundation.org/overviw.htm>.

Although USPAP is widely-recognized, and some state laws require that appraisals be done in conformity with USPAP, USPAP is not universally acknowledged. For example, the American Institute of Certified Public Accountants and the IRS have not adopted USPAP.

3. USPAP Not a Standard of Admissibility of Opinions on Value. There are no Texas cases considering USPAP as a standard for admissibility of expert valuation evidence. Courts of other states have held that USPAP is not a rule of evidence.

Connecticut has adopted executive department regulations requiring that real property appraisals be performed according to USPAP. 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).

It thus appears that failure to comply with USPAP is at best 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.

XI. BUSINESS VALUATION.

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 in Houston.

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>.

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 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.minval.com/irsrevrule77287mineral.htm>.

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

The starting point for valuing a privately-held business 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.

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* is not part of the value of the business for purposes of divorce.