

MAKING SURE THAT THE EXPERT OPINIONS ARE ADMISSIBLE

Expert testimony is often the most powerful testimony in any trial. This is particularly true in franchising trials where the franchisee has the opportunity to level the playing field by presenting the testimony of experienced franchise industry executive (such as Don Boroian) in order to expose the positions being taken by the franchisor as false.

To succeed in presenting expert testimony, the trial lawyer must master the Rules of Evidence. In other words, the expert's testimony must be admissible into evidence to be of any value. In this section of the paper, we review the rules governing the admissibility of expert testimony and address the latest challenges being mounted against expert testimony – a challenge known as the “*Daubert challenge*” based on the name of a Supreme Court case where the court sought to raise the hurdles for the admissibility of expert testimony in federal cases in order to exclude “junk science.” As discussed below, expert opinions as to industry standards are vital in franchising and should easily withstand the so-called *Daubert challenge* as long as the expert has time to adequately prepare.

The Federal Rules of Evidence

In federal cases, the three most important rules are Federal Rules of Evidence 702, 703 and 704. These rules are also important in arbitration where, as common, the parties agree that the arbitration shall follow the federal rules of evidence. The federal rules do not apply in state court trials, but nonetheless, the principles embodied in the federal rules often apply in state cases except as discussed below.

Federal Rule of Evidence 702 provides that:

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.

Federal Rule of Evidence 703 provides:

The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived or made known to him 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.

Federal Rule of evidence 704 provides:

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.

Working backwards, Rule 704 gives the expert great latitude in framing his opinions. For example, Don Boroian mentioned his view that there is an “implied relationship” in franchising. In my view, Don’s opinions as to how this “implied relationship” fits into a particular case may be used to support a claim for breach of the implied covenant of good faith and fair dealing. This is a perfect example of how an expert’s opinion should be admissible even though it seems to “embrace” the ultimate issue in a “good faith” case – i.e. whether the franchisor breached the implied covenant by acting in bad faith. Thus, the use of an expert allows the party to present direct evidence of the alleged violation. This principle is limited to the extent that an expert may not simply instruct a jury how to decide a case. Care must be taken in framing the questions posed to the expert in order to “push the envelope” of embracing an ultimate issue without purporting to decide the case.

Likewise, Rule 703 also gives an expert wide latitude by allowing him or her to

consider facts beyond those that are admissible in evidence in the trial. This allows the expert to bring to the trial all of his experience in franchising. He may testify based on his experience in other systems that is relevant to the system on trial – and moreover, there is usually no need to introduce evidence about the “other system” into the trial because Rule 703 would allow the expert to base his opinions on non-admissible facts.

Rule 702, in its practical application, serves to encourage, and restrict, an expert’s testimony. First, consistent with the other rules cited above, Rule 702 encourages the widespread use of experts by setting forth a test for admissibility – whether the opinion would “assist the trier of fact to understand the evidence or determine a fact in issue.” This, once again, is a broad standard. Referring back to the “implied relationship” of a franchisee that Don Boroian will discuss, Don’s testimony as to a franchisor’s implied duties would clearly assist the trier of fact in understanding the good faith/bad faith issue.

Thus far, we have viewed Rules 702, 703 and 704 as encouraging the broad use of expert witnesses. So then, what is the big issue facing the trial lawyer seeking to admit the testimony of an expert such as Don who is clearly qualified?

The Franchisor’s “Daubert” Challenge To Expert Testimony

Embedded in Federal Rule of Evidence 702 are these words: “scientific, technical, or other specialized knowledge.” In a series of cases in the 1990’s, the United States Supreme Court used these words to limit the admissibility of expert testimony to eliminate what the Court feared was a proliferation of “junk science” masquerading as sound expert testimony in the courtroom. See, *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993); and *Kumho Tire Co. Ltd. v. Carmichael*, 119 S.Ct. 1167 (1999). *Daubert* and *Kumho Tire* were personal injury lawsuits, not franchising cases. *Kumho*, for example, involved an expert who opined that a tire was

defective and that the subsequent blowout of that tire was allegedly caused by the defect and not overuse of the tire. *Kumho* at 1172. The district court excluded the opinions, concluding that the expert was offering flimsy science. The Supreme Court ultimately affirmed the district court's decision to exclude that testimony. The Court held that under its earlier decision in *Daubert*, FRE 702 "imposes a special obligation on a trial judge to 'ensure that any and all scientific testimony ... is reliable.'" 119 S.Ct. at 1174. The Court added that this gatekeeping function applies to all expert testimony – and not merely the type of expert testimony involved in personal injury suits. *Id*

Following the Supreme Court decision in *Kumho Tire*, virtually every disclosure by a plaintiff of an expert witness is met with a "*Daubert* challenge." In other words, the defendant can be routinely expected to file a motion in limine, asking the trial judge to rule in advance of the trial that the expert's opinions should not be admitted into evidence because they supposedly fall short of the "scientific", "technical" or other "specialized knowledge" that would assist the jury. The motion to exclude an expert's testimony is committed to the court's discretion. *McEwen v. City of Norman*, 926 F.2d 1539, 1545 (10th Cir. 1991).

A federal court in Chicago has summarized the standards for a *Daubert* challenge to expert testimony that have emerged in the last several years. In *Otis v. Doctor's Associates, Inc.*, 1998 U.S. Dist. LEXIS 15414 (N.D. Ill. 1995), where the issue was a claim for lost profits, the court held that *Daubert*:

[first] directs the district court to determine whether the expert's testimony pertains to scientific knowledge. This task requires that the district court consider whether the testimony has been subjected to the scientific method; it must rule out "subjective belief or unsupported speculation." Second, the district court must determine whether the evidence or testimony assists the trier of fact in understanding the evidence or in determining a fact in issue. That is, the suggested scientific testimony must fit the issue to which the expert is testifying.

...

Daubert provides four non-exhaustive guideposts to assist district courts in determining whether the proffered scientific expert testimony can be fairly characterized as "scientific knowledge" within the meaning of Rule 702. The nonexclusive factors in *Daubert* are:

- (1) whether the theory can be and has been tested;
- (2) whether the theory has been subjected to peer review and publication;
- (3) the known or potential rate of error; and
- (4) the general acceptance of the theory in the scientific community.

... The most important factor in the *Daubert* analysis is whether the proffered scientific theory can be and has been tested by the scientific method. ... 'Scientific methodology today is based on generating hypotheses and testing them to see if they can be falsified.' ... Accordingly, a scientific theory that is not supported by appropriate validation is not admissible under Rule 702. ... Courts must exclude 'subjective belief or unsupported speculation.'"

The criteria established in *Daubert* emerged in what the courts perceived as "junk science" cases. The standards set forth above are plainly applicable to "scientific" or mathematically determined opinions, which are subject to objective measurement, *i.e.*, testing, error rates, and "general acceptance in the scientific community."

Franchisors, seeking every advantage they could find, are now arguing that the "junk science" standards should apply to industry consultants whose opinions may tend to be more subjective. Clearly, these criteria are not always going to be applicable to the franchise industry expert. For example, can "good faith" be measured and tested objectively? Sometimes it might be measurable, for example, when the franchisor is applying different standards to different franchisees. For another example, must the

opinions of the franchisee's expert witness meet with "general acceptance in the [franchising] community?" If so, must the franchisee demonstrate that its expert's opinions are acceptable to the IFA? (Arguably not).

At this time, the federal courts have not fully explored the ramifications of *Daubert* to industry standards experts. Nonetheless, franchisors have not hesitated to file *Daubert* motions to exclude expert testimony on the grounds that the expert is merely speaking to his own opinions on such topics as "fairness" or "good faith" – as opposed to addressing industry standards. The franchisor's argument continues with the assertion that the expert is thus attempting to instruct the jury how to decide the case.

The Franchisee's Response to the *Daubert* Challenge

Surviving the inevitable *Daubert* challenge is thus a critical issue for the franchisee and its lawyer who are seeking to introduce expert testimony to bolster their case. As a strategy to survive the *Daubert* challenge, the franchising expert should be presented as an expert on industry customs and standards. See, *In re: Midway Airlines*, 69 F.3d 792 (7th Cir. 1994) (expert testimony is admissible to prove industry standards). *Old Security Life Ins. v. Continental Bank*, 740 F.2d 1384, 1396 (7th Cir. 1984)(same).

Under *Daubert*, the expert must be prepared to bolster his or her opinions on industry standards with concrete examples of his direct experiences and/or second-hand familiarity with other franchise systems in order to provide a basis for opining as to what the industry standards actually are. This is a key point – the testimony must be directed to what the standards are, as opposed to what we might think they should be. And yet, each time that we succeed in presenting an expert on industry standards in a way that is

favorable to the franchisee, we have succeeded in nudging the standards closer to what we believe they should be.

As a practical matter, the expert should be able to cite specific systems with which he or she is familiar, and should be able to distinguish between antidotal behavior and industry standards. Likewise, the expert should be familiar with all of the research and writing that exists in the field of franchising and be able to cite supporting references (or distinguish non-supporting references) to the extent possible. In this way, the expert should be able to demonstrate the “specialized knowledge” prong of the Rule 702 test – as opposed to the scientific or technical knowledge criteria.

Testimony as to industry standards should be admissible for establishing a franchisor’s duty of good faith and fair dealing – not in the abstract, but within the precise facts of the case. As a matter of law, the implied covenant depends upon the application of “community standards of decency, fairness or reasonableness.” Restatement (Second) of Contracts, §205, comment a (1981). It is well established that it is “appropriate for experts to testify about ordinary practices of a profession or trade ‘to enable the jury to evaluate the conduct of the parties against the standards of ordinary practice in the industry.’” *Fund of Funds, Ltd. v. Arthur Anderson & Co.*, 545 F.Supp. 1314, 1372 (S.D.N.Y. 1982) (citation omitted). Consequently, experts are generally permitted to testify about terms, concepts and practices in their industry of expertise when such standards are relevant to the case. *U.S. v. Russo*, 74 F.3d 1383, 1394-95 (2nd Cir. 1996) (allowing expert testimony concerning securities industry); *Mineral Investors Ltd. v. Lamb*, 1993 U.S. App. LEXIS 27318 (6th Cir. 1993) (permitting expert testimony on the reasonableness of relying

on an appraisal in a real estate transaction).

In franchising, the Eighth Circuit has expressly upheld the admissibility of expert testimony on industry standards in the franchising industry. *TCBY Sys., Inc. v. RSP Co.*, 33 F.3d 925 (8th Cir. 1994). The opinions related to the adequacy of TCBY's site review and evaluation process. The expert was permitted to opine (in response to a question from Mike Dady) that "to a reasonable degree of certainty"... "the process that TCBY followed in approving a TCBY store" for the franchisee in the particular location did not meet "the minimum custom and practice observed by franchisors in the fast food industry."

A Case Example

In *Interim Health Care of Northern Illinois, Inc. v. Interim Health Care, Inc.*, 225 F.3d 876 (7th Cir. 2000), I disclosed Donald Boroian as the franchisee's expert witness on liability issues. In *Interim Health Care*, the franchisee alleged claims for breach of the express language of the franchise agreement with respect to the grant of a territory, and also alleged a claim for breach of the implied covenant of good faith and fair dealing with respect to (1) territorial encroachment; (2) failure to refer national account and governmental account patients to the franchisee; and (3) termination of the franchise after the franchisee had complained about the encroachment and lack of referrals. Don Boroian was disclosed to opine on the franchisor's conduct from the standpoint of good faith and the discretion afforded to the franchisor under the franchise agreement to compete against the franchisee within its territory. In substance, Don opined that the franchisor's competition against its franchisee was unreasonable, contrary to franchising and business standards, and calculated to destroy the plaintiff's legitimate economic

interests and expectations under its franchising agreement. Some examples of his opinions include the finding that when the franchisor performed a “fraud audit” of the franchisee, the audit was not justified, but was instead part of a bad faith scheme. Don also explained how national franchisors typically administer their national account programs, and opined that the franchisor did not meet industry standards in withholding referrals from its franchisee in order to keep that business for itself. Don also reviewed the franchisor’s offers to buy-out the franchisee and opined on whether those offers were reasonable.

The franchisor moved to exclude Don’s testimony under *Daubert*. The issue was briefed, but the case ultimately settled (after an appeal) before the trial and the *Daubert* challenge was not decided. The franchisor’s arguments, and our responses, were as follows:

1. Ultimate issues:

The franchisor argued that in giving opinions on bad faith, Don was supposedly instructing the judge and jury what their ultimate decision should be. On this issue, the franchisor’s lawyer attempted to goad Don at his deposition into claiming that he was going to instruct the jury on the legal meaning of the implied covenant of good faith and fair dealing. However, Don avoided that trap by testifying that he was “not going to testify on whether the defendant’s conduct meets ‘the litmus test of good faith and fair dealing as a legal principle [for that] is really not [his] purview.’” Don elaborated that he was testifying to industry standards based on the implied relationship of franchising, which he views as an overriding duty of good faith.

Our written response to this argument was, of course, that under Rule 704, Don was entitled to embrace ultimate fact issues in forming his opinions. Here, we took care to point out that the legal arguments as to the contract language that gave rise to the duty of good faith (e.g. the franchisor's discretionary duty to refer national account patients to the franchisee) were presented independently of Don's testimony and were based on the language of the agreement itself. But once the duty was established, the testimony as to industry standards was essential to proving the franchisor's violation.

2. Interpreting the contract:

The franchisor argued that Don was trying to interpret the franchise agreement, contrary to the rule that "the interpretation of the contract is for the jury and the question of the 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). But in *Delta Mining Corp. v. Big Rivers Electric Corp.*, 18 F.3d 1398 (7th Cir. 1994), the Seventh Circuit held:

Absent any need to clarify or define terms of art, science or trade, expert opinion testimony to interpret contract language is inadmissible. 18 F.3d at 1402.

We argued that Don's testimony was needed with respect to portions of the Interim franchise agreement to "clarify" the "terms of trade" as used in the franchise agreement.

3. The Daubert challenge:

The franchisor argued that Don was merely expressing his personal opinions as to

how franchisors should behave. The franchisor asserted, in effect, that the witness was acting as a self-declared expert on fairness. Plain and simple, IHC argued that there is no such thing as a “franchising expert” because it is impossible to apply scientific principles to determine what is, or is not, fair and reasonable in the context of a franchise relationship. We responded that Mr. Boroian has “specialized knowledge” of the franchising industry within the meaning of FRE 702 – not “scientific” or “technical” knowledge. Consistent with *Kumho*, the relevant inquiry is whether Mr. Boroian has sufficient knowledge of franchising industry standards to assist the jury in determining those standards and applying them to IHC’s conduct. We argued that neither *Kumho* nor *Daubert* precludes the admissibility of expert testimony on industry standards and fairness based on industry experience, as applied to the specific facts of the case. The implied covenant of good faith & fair dealing creates issues of fairness within the context of the particular industry, in this case, the franchising industry. Familiarity with “fairness” in franchising after a lifetime of experience in this field is precisely what is called for from an expert in this case. Mr. Boroian has ample experience to evaluate all the nuances of a franchise relationship and expose abuses and predatory practices that a lay jury, or even a judge, might not so readily grasp.

In summary, we asserted that what the franchisor was really trying to achieve was an unlevel playing field at trial. The franchisor was hoping that it could put its executives on the witness stand, to testify as to “how” and “why” it took the specific actions at issue in this case, and to provide their own, self-serving opinions as to how they met their duty of good faith to the franchisee.

We concluded in our brief, and I conclude today, that having an expert witness with

the credentials of Don Boroian is necessary to assess the franchisor's stated reasons for its in light of industry standards that the judge and jury are otherwise not familiar with.