

SUMMATION OF EVIDENTIARY RULES FOR REAL ESTATE EXPERTS MANDATED BY DAUBERT V. MERRELL DOW PHARMACEUTICALS, INC.

by David G. McLean, John F. Kilpatrick, & Bill Mundy, CRE

INTRODUCTION

In the wake of the Supreme Court's Daubert ruling, the real estate expert witness faces a stringent new set of criteria for admissibility of expert evidence and testimony. Even experts who have previously been accepted by the courts now find the admissibility of their testimony questioned. As attorneys increasingly realize the potential exclusion of evidence from the opposing side through a Daubert challenge, the bar for expert witness engagement will be raised even higher. The real estate expert who engages in litigation support will find that Daubert has become the governing paradigm for testimony and evidence development.

This article addresses the evolving standards of real estate expert evidence and opinion in Court by developing and discussing the foundations of admissibility. It then discusses realistic guidelines for real estate professionals in preparing evidence and opinion for admission to court.

THE CLASSICAL STANDARD FOR EXPERT ADMISSIBILITY—FRYE

For many years, the admissibility of an expert's testimony was dependent on the standards set forth in *Frye v. United States*. James Alphonso Frye was accused of murder. Frye claimed that his passing of the systolic blood pressure deception test, an extremely rough precursor to the polygraph, proclaimed his innocence. His expert witness, the scientist who conducted the test, testified on Frye's behalf. However, the Supreme Court ruled that since the systolic blood pressure deception test had not gained "general acceptance" in its field, it was inadmissible. The resulting "general acceptance"

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benchmark became the standard for admissibility of scientific evidence and expert witness testimony.

Seven decades after Frye, the US Supreme Court in *Daubert v. Merrell Dow Pharmaceuticals, Inc.*,¹ announced that the Federal Rules of Evidence had displaced Frye as the standard for admitting expert scientific testimony in a federal trial.

DAUBERT CHANGES THE EVIDENTIARY LANDSCAPE

The Daubert family claimed that the serious birth defects of their two minor children stemmed from the mother's prenatal ingestion of medication produced by Dow. The original decision in appellate court did not allow the Daubert expert witness's testimony into evidence, primarily because the Court ruled the evidence did not meet the "general acceptance" standard for the field. While linkage of birth defects to the drug had been shown clearly in animals, there was not clear documentation of that impact in humans. The Daubert's countered by arguing that the Frye guidelines for the admissibility of expert evidence should not apply and that the Federal Rules of Evidence should take precedence.

The court agreed. It held that "such a rigid standard (in Frye) would be at odds with the rules' liberal thrust and their general approach of relaxing the traditional barriers to 'opinion' testimony."² In Daubert, the Court outlined a handful of factors to broaden the judge's analysis relative to the acceptability of expert testimony. If the expert's testimony could not meet the restrictive general acceptability standards set forth in Frye, a court could employ other factors to qualify the expert's testimony for admission. At first glance, the Daubert factors seemingly offered a more liberal approach to scientific expert testimony. If the expert fails one factor, there are other factors under which the expert might qualify. Since *Daubert v. Merrell Dow*, however, far more experts have been excluded from the courtroom than admitted (under Daubert).³

Under Daubert, the trial judge must determine at the outset whether the expert is proposing to testify to scientific knowledge that will assist the trier of fact to understand or determine a fact in issue. "This entails, according to the court, a preliminary assessment of whether the reasoning or methodology underlying the testimony is scientifically valid, and of whether that reasoning or methodology properly can be applied to the facts in issue."⁴

The rules—especially Rule 702—place appropriate limits on the admissibility of purportedly scientific evidence by assigning to the trial judge the task of insuring that an expert's testimony both rests on a *reliable* foundation and is *relevant* to the task at hand. Rule 702 provides:

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.⁵

Nothing in Rule 702 establishes "general acceptance" as an absolute prerequisite to admissibility, according to the Court.

The First Admissibility Criterion Under Daubert: Reliability

The court focused on the words "scientific... knowledge" as the basis for the first prong of analysis—"reliability."⁶ The court found that the word "scientific" involved a grounding in the "methods and procedures of science," and that the term "knowledge" referred to "any body of known facts or to any body of ideas inferred from such facts or accepted as truths on good grounds."⁷

This interpretation of Rule 702 leaves it up to the trial court, as opposed to the scientific community, to consider the methodology of the evidence for purposes of determining the admissibility of the expert testimony.

The court specifically outlined several "considerations" which will bear on the analysis of admissibility:

1. Whether the theory or technique in question can be (and has been) tested;
2. Whether it has been subjected to peer review and publication;
3. It has a known or potential error rate; and
4. Whether it has attracted general acceptance within a relevant scientific community.

In cases of scientific testimony offerings, the Daubert factors can be evaluated like performance statistics: rate of error, publication, etc. The court may then compile scores to determine whether the expert may testify.⁸ In testing whether the reasonableness of the data and methodology are appropriate, and in evaluating whether an expert's methodology is reasonable under the circumstances,

the standards of the particular profession can be useful.⁹

The court went on to note that the inquiry should be a flexible one, and its focus must be "solely on principles and methodology, not on the conclusions that they generate."¹⁰

The Second Admissibility Criterion: Relevance

The court found that even if a trial court finds expert testimony reliable, the court must also comply with the second prong of Rule 702—relevance. This test requires judges to function as "gatekeepers" of scientific expert testimony. The test is that testimony "assist the finder of fact to understand the evidence or to determine the fact in issue." In order to be of assistance to the jury, this testimony must be "sufficiently tied" to the issue in question and the facts of the case. The court called the linkage between testimony and the case at hand, "fit."¹¹

The court went on to further state that cross-examination, presentation of contrary evidence, and careful instruction on the burden of proof, rather than wholesale exclusion under an uncompromising "general acceptance" standard, is the appropriate means by which evidence based on valid principles may be challenged.

EXPANSION OF DAUBERT TO NON-SCIENTIFIC EVIDENCE AND TESTIMONY

This year, the Supreme Court extended the Daubert criteria to non-scientific experts in the *Kumho Tire Company v. Carmichael*¹² case. At issue in this case was the testimony of a tire failure expert for the plaintiff who offered the opinion that a tire on the vehicle driven by the plaintiff suffered from a defect and did not fail from misuse by the plaintiff. After decisions and reversals in lower courts, the Supreme Court held that Daubert did apply. In speaking for the court, Justice Breyer wrote that it would be "difficult, if not impossible" for district court judges to sort out experts based on "a distinction between 'scientific' knowledge and 'technical' or 'other specialized' knowledge." Cheered by business, this decision means that non-scientific experts, including real estate appraisers, accountants, social scientists, and others who do not base their opinions on scientific knowledge will be subjected to the same Daubert criteria as scientific experts: testable hypothesis, subject to peer review, rates of error, and general acceptance.

Quasi-scientific experts are also affected by the expansion of the Daubert test. An example of a

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quasi-scientific expert is a mechanical engineer. Such an engineer bases his opinion on experience and training; training that includes scientific principles at its core. However, the testimony is not "scientific knowledge."¹³

Carmichael is especially important to environmental lawyers.¹⁴ Environmental law relies heavily on both applied and environmental sciences. Courts and litigators increasingly call on experts using non-experimental tools to offer opinions on site conditions, environmental affects on health, behavioral implications, and valuation impacts.

EXAMPLES OF TESTIMONY ADMISSIBILITY ADJUDICATED UNDER DAUBERT

Moore Drums, Inc. v. Lockheed Corporation

This real estate appraisal example involved a property contamination case in which Moore Drums alleged that its property had been contaminated as a result of acts and omissions of Lockheed. Moore Drums operated a drum reconditioning business on its property which is located in an industrial park in Charleston, SC. Since 1967, Lockheed operated an airplane parts manufacturing plant on an adjacent property. Moore Drums claimed its property was contaminated with trichloroethylene (TCE), a "degreaser" to remove oil from parts in process by Lockheed.

Lockheed reasoned that the testimony regarding diminution in value offered through Moore Drums' real estate expert failed to establish diminution in value on either a permanent or temporary

basis. Specifically, Lockheed argued that Moore Drums' expert did not appraise the property on the basis of it being contaminated and thus there was no evidence regarding whether there would be any diminution in value of the property after cleanup. The appellate judge, in overturning a jury verdict against Lockheed, stated that "a trial judge must insure that any and all (expert) testimony or evidence admitted is not only relevant but reliable,"¹⁵ citing Daubert. While noting that the plaintiffs' approach to damages in this case was appealing in its simplicity, the court held that his methodology was not the basis upon which any court will allow an expert in real estate appraisal to form an opinion as to value.

Moore Drums' original expert, an MAI, and an acknowledged expert in the appraisal of real estate, performed a full real estate appraisal on the Moore Drums' property in an unimpaired condition. Rather than performing a full appraisal of the property in its actual contaminated condition, the expert instead took the position that the property was worthless because lenders would not readily make loans for the purchase of the property. The only testimony he offered to support that opinion was a small telephone survey limited in scope and time. He did not give respondents the characteristics or description of the contaminated property. He did not tell them that Lockheed had a DHDC approved permit and that it had acknowledged responsibility to remediate the property. He did not differentiate between contamination which Moore had caused to the subject property and the contamination caused by Lockheed. He did not tell them the estimated cost of cleaning up the Moore property. Most of the conversation with bankers took less than five minutes, and some did not take three minutes. Most of the lenders he spoke with were not interested in property that was contaminated at all from any source. Others would have to examine the property on a case-by-case basis and make a risk assessment which included Moore Drums' contamination of its own property. As to what market existed for contaminated properties, the expert was uninformed and made little effort to find out whether there was a market for this particular property.

There are several problems the court cited with the approach of the Moore Drums expert. First, he abandoned the methodology of the professional appraiser, i.e., the three approaches to value, and completely replaced it with a telephone survey of bank and savings and loan officers as to their lending practices. Second, he acknowledged that there

was a market for contaminated properties, and conceded that he had no special expertise in valuing contaminated properties (which was not fatal to his rendering an opinion). He further conceded that he did not appraise the property in a contaminated state, which was fatal (according to the Court) to his ability to render an opinion as to its value. Third, even if the bank survey were accepted as an appropriate basis for rendering an expert opinion, the expert acknowledged that the majority of bankers to whom he spoke indicated they would not loan money on any contaminated property. This undermined the plaintiff's approach because Moore contaminated the property itself as did Lockheed. Fourth, the plaintiff's approach ignored the fact that the defendant had acknowledged the responsibility for cleanup of the property and is presently working on-site under DHDC permits from the State of South Carolina.¹⁶

Whether Moore Drums' expert had any special expertise in appraising contaminated property is a moot issue according to the court, because he did not appraise the property in its contaminated condition. If he had done so using his usual methodology, the court would have accepted his opinion in evidence and allowed the jury to evaluate his expertise of contaminated properties and decide how much weight to give it. The court goes on to say that the second major requirement of Rule 702 is that the expert must testify to scientific, or technical, or other specialized knowledge that will assist the trier of fact per Daubert. "Rule 702 requires that an expert's opinion must be based on the methods and procedures of a science or profession rather than on subjective belief or unsupported speculation. The record is clear that the expert totally disregarded the methods of the appraising profession in reaching his second opinion, i.e., that the property is worthless. Consequently, that part of his testimony was deemed unreliable."¹⁷

In addition to reliability, the court cited Rule 702 requiring that the expert's testimony must assist the trier of fact, and characterizes this as the "fit" requirement per Daubert. Admissibility depends in part on the connection between the technical research or testing presented, and the particular disputed factual issues in the case. The expert's testimony about the value of this property in its contaminated property does not fit.¹⁸

In ruling out the expert's testimony, the court found the verdict in favor of Moore Drums could not be allowed to stand, citing that the plaintiff

failed to provide a sufficient basis for assessment of actual damages.¹⁹

Subaru and Fuji v. Compton and Product Liability Advisory Council, Inc.

This example is instructive due to the arguments offered by Subaru and Fuji which might now be interpreted with a different result under the extension of Daubert to non-scientific experts.

Steven D. Compton brought a products liability action after sustaining severe injuries in an automobile rollover accident. Mr. Compton sued the automobile manufacturer, Fuji Heavy Industries, Ltd., and its distributor, Subaru of America, Inc., alleging the accident vehicle was defectively designed. After a jury trial, Subaru and Fuji were found 56 percent at fault, and a judgment was entered against them in the amount of over \$6 million. On appeal, Subaru and Fuji contended the district court erroneously admitted the testimony of Compton's design expert and thus failed to carry out its gatekeeping function as required under Daubert.²⁰

Under Daubert's test for the admissibility of scientific evidence, Subaru and Fuji argued that the testimony of plaintiff expert Mr. Bihlmeyer, an aerospace and mechanical engineer, should have been excluded because it lacked reliability and was not grounded in any particular reasoning or methodology. They contended Bihlmeyer's testimony was nothing more than his personal opinion that the roof of the vehicle was not sufficiently resistant to crush. Further, Subaru and Fuji asserted Bihlmeyer did not rely on industry data and did not refer to any scientific principles or knowledge supporting his personal standard for roof crush resistance. Accordingly, because there was no peer review, no testing, and no evidence of general acceptance of Bihlmeyer's theory, Subaru and Fuji argued that his testimony should be excluded. In response, Compton contended Daubert was inapplicable to Bihlmeyer's non-scientific testimony. The court agreed, stating that Daubert simply "had little bearing on Bihlmeyer's testimony" as a non-scientific expert. The court, ruling prior to expansion of the Daubert principal to all experts, concluded that Daubert was not appropriate to be applied in this case.

FORMAL INTEGRATION OF DAUBERT INTO RULE 702

The Advisory Committee on Evidence Rules of the American Bar Association has approved the post-amendments to Federal Rules of Evidence 701, 702, and 703 considered in light of *Daubert v. Merrell Dow*

Pharmaceuticals, Inc., Issues that appellate courts have addressed since Daubert include:

- How to assess the reliability of research done in anticipation of litigation as opposed to independent from litigation;
- How far an expert can go in extrapolating data to reach an opinion not directly supported by the data;
- When an expert has adequately accounted for obvious alternative explanations for results, and
- Whether experts have been as careful in their paid litigation work as they would be in regular professional work outside of the litigation consulting.²¹

The Advisory Committee has proposed to incorporate Daubert into Rule 702, to state that when scientific, technical, or other specialized knowledge will assist the trier of fact, expert testimony is admissible "provided:

1. The testimony is adequately based upon reliable underlying facts, data or opinions;
2. The testimony is based upon reliable principles and methodology; and
3. The principles and methodology employed by the witness have been applied reliably to the facts of the case."²²

Intentionally absent from the amendment is any provision regarding the procedure trial judges will follow in making a reliability assessment. Says U.S. District Judge Fern Smith, Chair of the Advisory Committee, "The cases since Daubert have shown that the courts are capable of considerable flexibility and ingenuity in considering Daubert challenges and we expect that to continue under the new rule."²³

The Advisory Committee was scheduled to present the amendments to the Judicial Conference Standing Committee on Rules of Practice and Procedure in June, 1998. If the Standing Committee approves the proposals, it was to submit them for public comment.

POSSIBLE APPROACH FOR REAL ESTATE EXPERTS IN ADDRESSING THE DAUBERT TEST

A synthesis of current legal opinion sought by Mundy & Associates suggests the following paradigm to organize a real estate expert's case relative to meeting the Daubert challenge.²⁴ The subjects fall into four categories:

1. What is the applicable relevant body of knowledge?
2. Is the expert truly an expert in the field?
3. What are the appropriate methodologies in the field?
4. Has the expert applied the relevant methodologies appropriately—is the evidence and opinion reliable and relevant?

The “generally acceptable” criteria of Frye are reflected in the first three issues. Daubert addresses and adds a significant layer of complexity to the fourth question.

1. What is the relevant body of knowledge?

Probably the simplest and surest answer to this question is to define what is taught under the rubric of “real estate” in the nation’s colleges and universities. Real estate is and has been taught at the nation’s leading universities for virtually all of this century. It is currently a mainstay of the curriculum at most leading business schools.

Typically, the study of real estate at the college level will include significant coursework in finance, economics, and marketing, with related work in geography (principally GIS and economic geography) and business law.

Clearly this is an important definitional point. The expert witness in real estate values would be a person trained and experienced in these fields. The real estate trained witness would not be expected or allowed to offer testimony or evidence in, for example, structural engineering aspects of a case. Conversely, the valuation testimony offered by a civil engineer would probably be ruled inadmissible.

The pertinent issue for real estate appraisal and the assessment of impaired property is the relevant body of knowledge in that specific field. One approach to defining the relevant body of knowledge is that contained in the *Appraisal Journal*; the *Journal of Real Estate Research*; *Real Estate Economics*, and appropriate real estate appraisal texts and publications.

Because a survey component is increasingly used as a complement to the traditional appraisal approaches, especially when markets operate without full knowledge (as frequently is the case in impaired property scenarios and where there is a limited market for the property), the applicable relevant body of knowledge is marketing and

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survey research texts and journals, as well as behavioral research and statistical sources.

The relevant body of knowledge governs both the expert and the evidence. For example, income producing property valuation models are financial in nature, and hence the governing body of knowledge draws upon that field. Engineers may be interested in valuation formulas, and may be perfectly capable of the mathematical manipulation needed to arrive at justifiable results. However, the engineer’s training and experience would not lend him or her to be a credible witness as to the reasonableness or appropriateness of the results of that mathematical exercise. Hence both the witness and the evidence would be inadmissible.

2. Is the expert truly an expert in that relevant body of knowledge?

What defines a “master” carpenter from a “journeyman” carpenter? It is usually years of experience; a broad array of knowledge in the field; the ability to lead and train others; certification (often through union or craft guild membership and testing). An “expert” witness in property valuation must show credible evidence of expertise within the field of real estate.

In the pre-Daubert era, once an expert testified, he or she was often tenured into the expert fraternity. Beyond simply extending the Frye criteria, however, Daubert has stimulated a whole new look

by judges into the credentials of experts. It is clear that acceptance of an expert will include such criteria as:

- Educational attainment, both preparatory and continuing;
- Scholarly publication in generally recognized real estate journals;
- Licensing;
- Certification by recognized body; and
- Experience as a teacher or practitioner in the field.

This list is neither all-inclusive nor exhaustive, but experts in the major litigation cases will clearly need to have substantial credentials in all five of these areas.

3. What are the appropriate methodologies in the field?

Again, the governing criteria will be most easily met by looking to the academic profession. The texts, journals, and economic societies will set forth the methodologies acceptable to the courts.

In terms of traditional appraisal methodologies, including sales comparison, costs, and income, which one or more is appropriate to the valuation issue for the subject property? Examples of survey methodologies which might be used as complements to the traditional methods are perceived diminution of affected and/or control group property owners or users, contingent valuation, and conjoint analysis. Questions which should be anticipated include the following. Are the methodologies being utilized published in journals in the applicable body of knowledge that are peer reviewed? Have studies using the methodologies been published not only to outline theories, but to also show empirical results which build upon a foundation of theory?

In one recent state court case, valuation testimony was challenged because the expert used multiple regression as a supporting approach. The other side opined that the legal texts and law journals made no provision for use of multiple regression in a valuation model. The expert, however, showed the court that recent issues of the leading real estate journals all contained valuation studies which used regression models. The judge very quickly ruled that the evidence was admissible, and that real estate journals, not law journals, were the governing criteria for admissibility. Notably, this ruling occurred in a state operating under the Frye

standard, and so the court was not obliged to determine the proper use of the methods (the step below), but only obliged to determine if the methodologies themselves were relevant.²⁵

4. Has the expert applied the relevant methodologies appropriately?

The Daubert ruling has certainly focused additional attention on the first three criteria. However, Daubert adds this additional role to the court's gatekeeper function in the federal courts and in 29 of the states. With the 1999 application of Daubert to non-scientific testimony (e.g., real estate valuation), it is still not apparent just how the courts will rule in real-estate specific evidence and testimony challenges. However, a glance at the Daubert rulings in scientific cases give some indication as to what can be expected.

One of the tests which will be applied in real estate opinion screening by the court is that to be "helpful," the opinion must "fit the facts." That is, the testimony and/or evidence must be "sufficiently tied" to the issue in question and the facts of the case.

Daubert also requires the court to determine whether the offered testimony and evidence is reliable. The four general guidelines which are likely to be employed by a Court in evaluating real estate evidence and opinion include:

- Whether the theory or technique "can be (and has been) tested";
- Whether the theory or technique "has been subjected to peer review and publication";
- The "known or potential rate of error" of the theory; and
- How widely accepted the theory or technique is in the professional appraisal community.

The Daubert factor analysis also dictates that the testimony is not scientific testimony unless it is based on the scientific method.²⁶ Has the knowledge and testimony regarding the subject issue followed the steps of the scientific method including observation, formulation of hypotheses, prediction and testing?²⁷ For example, the following will demonstrate the use of the scientific method in applying survey research based components to damage assessment, where such surveys are used due to the lack of full knowledge of the market relative to a contamination situation. The first step, observation, recognizes the contamination situation, including the existence and nature of the

impairment. It may also be observed that property values near the contamination have not been affected by market forces as fully as the analyst might expect. This leads to the hypothesis generating stage. The hypothesis in this case might be that the lack of information about the contamination and its effects has a lower impact than if the market had full knowledge about the impairment. The prediction phase suggests that if the market is given full information that behavior will adjust accordingly and market values will be lower than without full information. The fourth step is testing the prediction through survey-based means in which reliable samples are surveyed and when given full information about the contamination likely behaviors are measured.

The known or potential rate of error of a theory should be clearly expressed in addressing the Daubert test. This not only relates to the validity of the theory or technique, but also to the variance associated with data developed in the testing phase, including such measures as standard deviations and sampling deviations.

The acceptance of the theory or technique in the relevant "scientific" community can be supported by similar studies accepted as evidence in other cases, peer reviewed publication, and following recognized guidelines developed for the specific issue. An example of the latter for contingent valuation and other similar surveys is following the guidelines of the National Oceanic and Atmospheric Administration published in the Federal Register.²⁸

Examples of relevant questions to be answered in relation to this dimension of the Daubert test include the following: Have we used these methodologies and approaches in a way that is congruent with the applicable body of knowledge? Have we shown that we have applied the methodologies in the same way that has been exhibited in peer reviewed publications? Does the methodology "fit" the case and the facts? Does the methodology assist the trier of fact to understand or determine a fact and issue? Is the method valid and reliable?

There are still some unanswered questions raised by Daubert:²⁹

- Should the Daubert criteria be applied to both the methodology utilized as well as the conclusions offered by a testifying expert?

- What is the most effective procedure for challenging validity of an expert's opinion prior to trial?
- Will Daubert change the law in state court jurisdictions which have a pre-existing body of law on the subject?

SUMMARY

A half century after Frye, Daubert has changed the face of evidence admissibility assessment from expert witnesses in a historical manner. The expansion of the Daubert principles to non-scientific as well as scientific experts broadens its implications and applicability.

While the Daubert ruling was originally intended to promote the admissibility of expert testimony, broadening the umbrella of admissibility beyond the stricter Frye "general acceptability" test, time has proved that much expert testimony has been excluded under Daubert. The court appears to have intended, however, for the courtroom under Daubert to be a battleground of experts to which any particular methodology and opinion will be challenged in order for the trier of fact to determine its admissibility.^{REI}

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