



Southern District of New York Speaks Volumes on Admissibility of Experts

The U.S. District Court for the Southern District of New York has issued an opinion that is very instructive on many issues facing damages experts.

In the case of *Celebrity Cruises, Inc. v. Essef Corp.*, 434 F. Supp. 2d 169 (S.D.N.Y. 2006), the Court ruled on the admissibility of a litany of damages experts offered by both sides in a commercial tort action. This action arose out of an outbreak of Legionnaires' Disease in 1994 on a cruise ship called the Horizon, owned by Celebrity Cruises, Inc. ("Celebrity"). The outbreak originated in a whirlpool spa on the cruise ship. In a related action, the passengers who took ill sued both Celebrity and Essef Corp. ("Essef"), the designer, manufacturer and supplier of the water filter in the whirlpool spa. At trial, the jury found both defendants liable to the passengers and apportioned liability 70% to Essef and 30% to Celebrity. The jury also found that Essef was liable to Celebrity for negligence and other grounds. Celebrity's damages claims against Essef were reserved for the present action, in which Celebrity sought damages for indemnification, other out-of-pocket costs associated with the outbreak, lost profits and lost enterprise value. After each side designated its experts, both sides filed Daubert motions seeking to strike the other's experts for a variety of reasons.

In an opinion harsh for experts but instructive regarding damages issues, the Court struck five of Celebrity's seven experts and limited the testimony of all three of Essef's experts. The following is a summary of many, but not all, of the issues raised in the opinion:

- The fact that one of Celebrity's experts was not a "professional witness" did not disqualify him. Essef moved to disqualify this expert on the grounds that he had never before submitted an expert report in commercial litigation, never provided expert testimony in deposition or court, was unfamiliar with the standards for presentation of expert evidence, and did not know whether his methodology was generally accepted in commercial litigation. Although this expert was ultimately disallowed for substantive reasons, the Court held that his not being a "professional witness does not disqualify him from providing expert testimony. He must be qualified in his field of expertise, qualification that derives from his education and experience; he need not be familiar with the rules of litigation." *Id.* at 178-79.
- All three of Essef's experts were precluded from testifying to what the Court held was a matter of law. All three experts opined that Celebrity was unable to recover for lost enterprise value because that was a damage suffered not by Celebrity but by its owners, who later sold the company to Royal Caribbean Cruise Line ("RCCL") in 1997 and who were not in the present action. The Court did not dispute these facts or the conclusion but nevertheless held that this issue concerned "legal standing, and as such is beyond the province of a financial expert." *Id.* at 191.

- One of Celebrity's experts, who opined that Celebrity's lost profits were due to the stigmatizing effect of the Legionnaires Disease outbreak, was precluded because he failed to consider other possible causes of the loss. *Id.* at 177-78. He also had no facts to back up either his "strong suspicion" that the decline in cruise vacationers was caused by the outbreak, or his speculation that travel agents were steering their clients away from cruises because of the outbreak. *Id.* Nor did the Court find reliable the expert's comparison of Celebrity's losses to those suffered by a Philadelphia hotel as a result of an outbreak of Legionnaires Disease in 1976. *Id.* at 177.
- Another of Celebrity's experts was precluded from opining on Celebrity's lost enterprise value. This expert based his analysis on a comparison of the purchase of Celebrity by RCCL to two other acquisitions in the cruise industry. The Court rejected this analysis as unreliable, because these other acquisitions were not comparable to the Celebrity acquisition for three reasons: 1) the other two were larger in scale, with one of the two almost four times as large, on a per berth basis; 2) the other two transactions were subject to competitive bidding, whereas the Celebrity acquisition had only one other, last-minute bidder; and 3) the other two transactions took place several years later, and the expert made no effort to account for any market changes over the intervening period that might have affected the relative value of the sales. *Id.* at 182.
- One argument that failed in connection with Essef's motion to preclude one of Celebrity's experts is that the expert failed to perform a discounted cash flows (DCF) analysis when calculating lost profits. The expert instead based his analysis on a comparable companies study. The Court held that "it would be wrong to conclude that any valuation analysis must be supported by DCF calculations. Courts recognize that different methods may be acceptable, depending upon the context." *Id.* at 179. Although Essef cited to cases that rejected expert analyses for failure to use a DCF analysis, the Court here distinguished those cases "where the objective was to value a single business entity at a fixed point in time. The goal here is different: it is to calculate damages that were incurred over a period of time and are attributable to a specific event. Consequently, the use of comparable companies has the advantageous feature of 'controlling' in a rough way for market factors. That is, factors that impact the market generally are assumed to affect the target company (Celebrity) and the comparators alike. Thus, a downturn in Celebrity's profits is not attributed to the incident if the comparators suffer similar losses over the same period." *Id.* at 179-80. Ultimately, however, the expert's opinion on lost profits was precluded because of flaws in comparing the chosen proxies to the expected income of Celebrity. *Id.* at 180-81.
- Another expert's lost profits damages model, which was based on a five-year plan formulated by Celebrity's management in January 1994, was also precluded. The expert compared Celebrity's actual performance with that in the five-year plan, and then adjusted the projections in various ways to arrive at alternative results. Relying on Second Circuit precedent, the Court held that "the entrepreneur's 'cheerful prognostications' are not enough." *Id.* at 184. The Court also noted that another of Celebrity's experts rejected the use of this same five-year plan as being prepared at a point too remote in time and failed to account for several relevant factors. Furthermore, the performance of the three ships studied had largely failed to meet the budgeted revenue projections in the two quarters prior to the Legionnaire's incident.

This opinion demonstrates the various ways that an expert's opinion on lost profits or enterprise value may be attacked, as well as the great care that should be taken by

any financial expert. On a different level, however, the opinion underscores the issue of whether deficiencies in experts' analyses should go to the *admissibility* or the *weight* of the evidence. With the possible exception of the "legal standing" issue, the problems cited in the various experts' analyses need not have been fatal. Although the Court herein precluded the experts from testifying because of their deficient damages analyses, other courts ruling on these same issues could just as easily have held that these deficiencies go to the weight of the evidence and thus would have allowed the experts to testify, reserving these problems as potential subjects of cross-examination.