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Expert Witnesses in Franchise Cases

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I. INTRODUCTION

Expert testimony in franchise termination cases usually falls into one of two categories. Most typically, a franchisee claiming wrongful termination will present the testimony of an accountant, business valuation expert or, with less frequency, an economist, on the subject of damages sustained by the terminated franchisee. Secondly, and with increasing frequency, one party, often (but not necessarily) the franchisee, will attempt to present the testimony of a businessperson or other professional with some experience in franchising, as an expert on liability issues, i.e. issues which typically relate to whether the conduct of one party or the other was proper under the relevant circumstances. The ‚Äúliability expert‚Äù witness might have experience in the particular industry (hospitality, automotive aftermarket etc.), or with a particular investigative methodology (e.g. audits), or might be a

consultant or executive with experience in franchising practices generally. What all of the potential experts have in common is that they intend to testify to their opinion, presumably based on the facts of the case, which, if the opinion is accepted as true, would provide grounds for deciding the issue in that party,Äôs favor.

We will focus primarily on the use of testifying experts on liability issues related to the conduct of the franchisor or franchisee, and secondarily on damages experts. We address the fundamental questions that are at issue whenever a party seeks to introduce expert testimony: Just what makes someone an ‚Äúexpert‚Äù who is qualified to express opinions, not facts, on an issue related to a franchise termination? And, why should the rights of the parties to a written agreement, the franchise contract, have the outcome of their case influenced to any degree by the opinions of a person who was not a party to the agreement?

To answer these questions, we review the rules governing the admissibility of expert testimony, and the manner in which these rules have been interpreted in the courts. We address the initial question of whether an expert is needed or is desirable, and review the fundamentals in retaining, preparing and disclosing an expert witness. We explore the ways that expert witnesses may effectively be examined, and

cross-examined, in deposition.

Beyond these tactical and procedural concerns, we address the substance of expert testimony in franchise termination cases, which, as discussed, frequently involve claims or counterclaims that cover the entire spectrum of franchise disputes. In particular, we focus on efforts, usually by the franchisee, to introduce testimony of ‚Äúindustry customs and standards‚Äù as a means of holding the franchisor to duties beyond those that are expressly set forth in the written agreement. In sum, we endeavor to provide the ammunition that will enable you to win the ‚Äúbattle of experts‚Äù in your next case.

II. THE RULES OF EVIDENCE GOVERNING EXPERT TESTIMONY

A. The Applicable Federal Rules Of Evidence

In federal cases, the admissibility of expert opinion testimony is governed by 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. Understanding Federal Rules 702-704 and their interpretation by the courts is therefore essential to successful practice with expert witnesses. However, anyone

looking for uniform interpretation of these rules will be disappointed, for decisions by a trial court as to whether to admit or exclude an expert opinion are committed to the discretion of the district judge, and will not be disturbed on appeal unless the court of appeals were to find an abuse of discretion. See, McEwen v. City of Norman, 926 F.2d 1539, 1545 (10th Cir. 1991).

Historically, trial courts in the exercise of their discretion were liberal in admitting expert testimony under the well-known ‚ÄúFrye‚Äù standard, that an expert should be allowed to testify if his or her methodology was ‚Äúsufficiently established to have gained general acceptance in the particular field in which it belongs.‚Äù Frye v. United States, 289 F. 1013, 1014 (D.C. Cir. 1923). Decisions by the trial court to admit an expert‚Äôs opinion were rarely reversed on appeal. This liberality has been restricted in recent years as discussed below.

1. Federal Rule of Evidence 702

Federal Rule of Evidence 702 (as enacted in 1975 and amended in 2000) sets forth the basic test for admissibility of an expert opinion. The Rule 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, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles or methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

In a nutshell, Rule 702 establishes multi-level tests for determining the reliability and utility of an expert,Äôs opinion, with (i) reliability depends upon the expert,Äôs qualifications and his or her ,Äúspecialized knowledge;,Äù and (ii) utility meaning useful for the trier of fact in deciding the case. Historically, Rule 702 was generally given a liberal interpretation under Frye, supra. Rule 702,Äôs tests for the admissibility of expert opinions make no distinction between retained experts or employees of the parties themselves. A party may elicit lay opinions from its own employees under Rule 701 , or may attempt to qualify its employees as experts under Rule 702.

2. Judicial Interpretation of Rule 702 in Daubert and Its Progeny

By 1993, the Supreme Court was concerned that ‚Äújunk science‚Äù was infecting trials and swaying juries. In 1993, the Court decided a personal injury suit which had implications for franchising and other business disputes. The Court held in Daubert v. Merrell Dow Pharmaceuticals, 509 U.S. 579 (1993) that Rule 702 required trial courts to apply a stricter test for determining whether an opinion is sufficiently reliable to be allowed to influence the result in a lawsuit. Daubert gave 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:

a. Whether the theory can be and has been tested;

b. Whether the theory has been subjected to peer review and publication;

c. The known or potential rate of error; and

d. The general acceptance of the theory in the scientific community.

As one district judge explained, ‚Äúthe most important factor in the Daubert analysis is whether the proffered scientific theory can be and has been tested by the scientific method. ‚Ä¶ ‚ÄòScientific methodology today is based on generating hypotheses and testing them to see if they can be falsified.‚Äô ‚Ä¶ Accordingly, a scientific theory that is not supported by

appropriate validation is not admissible under Rule 702. ‚Ä¶ Courts must exclude ‚Äòsubjective belief or unsupported speculation.‚Äô‚Äù

In 1999, the Supreme Court in Kumho Tire Co. Ltd. v. Carmichael, 119 S.Ct. 1167 (1999), expanded Daubert beyond the realm of junk science. The Court held that under its earlier decision in Daubert, Rule 702 ‚Äúimposes a special obligation on a trial judge to ‚Äòensure that any and all scientific testimony ‚Ä¶ is reliable.‚Äô‚Äù 119 S.Ct. at 1174. Although Kumho Tire was another personal injury suit with more junk science opinions, the Court took the occasion to state in dicta that this gatekeeping function applies to all expert testimony, regardless of whether the opinion was based on scientific or other ‚Äúspecialized knowledge‚Äù as provided in Rule 702. Id.

Following Daubert and Kuhmo Tire, its progeny, Rule 702 was amended in 2000 to add the enumerated three part test stated above, which codifies Daubert and which is intended to assure the reliability of the expert opinion, both in theory, and in the application of theory to the facts of the case.

Thus, there is no longer any question that all expert testimony, including the testimony of ‚Äúfranchising experts‚Äù, must meet the enhanced reliability requirements of amended Rule 702. Meeting the Daubert challenge, i.e.

overcoming an actual or potential motion in limine to exclude the testimony of an expert, is now a central challenge to any party seeking to present an expert opinion, as discussed further below.

3. Federal Rules of Evidence 703 and 704

The basic test for admissibility under amended Rule 702 is augmented by Rules 703 and 704. Federal Rule of Evidence 703, as amended in 2000, provides:

Rule 703. Bases of Opinion Testimony by Experts

The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to the expert at or before the hearing. If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be admissible in evidence in order for the opinion or inference to be admitted. Facts or data that are otherwise inadmissible shall not be disclosed to the jury by the proponent of the opinion or inference unless the court determines that their probative value in assisting the jury to evaluate the expert's opinion substantially outweighs their prejudicial effect.

Federal Rule of Evidence 704 provides in pertinent part:

,Äú[T]estimony 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.,Äù

Rules 703 and 704 give an expert great latitude in framing his or her opinions (assuming Rule 702 is satisfied). For example, where there is a claim for breach of the implied covenant of good faith and fair dealing, a franchisee might want to call an expert to testify that in his or her opinion, there was no legitimate business reason for the franchisor,Äôs conduct, and that impliedly the conduct was in bad faith. This type of testimony approaches the giving of an opinion on an ultimate issue. The party opposing the admissibility of this opinion will argue that the expert would literally be instructing the trier of fact how to decide the case. The proponent will attempt to ,Äúpush the envelope,Äù in framing the questions posed to the expert in order to suggest the desired resolution of the case without purporting to decide the case.

Likewise, Rule 703 gives an expert wide latitude by allowing for consideration of facts beyond those that are admissible in evidence in the

trial. This allows the expert to bring to the trial all of his or her experience in franchising. The expert may testify based on experiences in other systems, which the expert could summarize from his or her memory of the other system, so long as this information is the type usually relied on by experts in the field. There is usually no need to introduce evidence about the ‚Äúother system,Äù into the trial because Rule 703 would allow the expert to base his opinions on non-admissible facts. The wide-open range of facts that could underlie an expert‚Äôs opinion present a challenge for the cross-examining attorney that is discussed below.

B. Beware Of Daubert In State Court Cases

Without a uniform code of evidence in any of the fifty states, it is impossible to generalize as to the current requirements for the admissibility of expert testimony in state cases. However, it would be a serious mistake in a state court action to ignore the possibility of a challenge based on Daubert, which could be cited as a persuasive authority,Äì indeed, a LEXIS search for ‚Äúdaubert,Äù in state courts will be interrupted due to more than 1,000 cites.

III. PRE-DEPOSITION ISSUES

It is a truism that 90% or more of civil cases are resolved before trial. Where the goal is to settle a case as favorably as possible, either by direct negotiation or through mediation, the potential for presenting expert testimony at the potential trial can facilitate a favorable settlement by:

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A. Identify The Appropriate Subjects For Expert Testimony

Franchise terminations (or non-renewals) occur for many reasons which are discussed elsewhere in this book. For example, there might have been non-payment, non-performance, violation of an in-term non-compete, or the franchisor's decision to take over the operation or franchise it to someone else at the end of the term. Likewise, there are many defenses such as the franchisor's failure to perform, fraud, statutory claims and the duty of good faith and fair dealing. Therefore, there is no uniformity in the type of termination cases in which expert testimony might be presented on liability issues. Rather, the question of whether experts are needed will be fact specific, and further, this question will be driven in large part by your theory of the case.

Here are some overlapping, and certainly non-exhaustive, examples of how experts might be used in termination cases by both franchisors and franchisees:

1. Termination Based on Fraudulent Underreporting: Where franchisees are terminated for underreporting sales and hence, underpaying royalties, the potential for expert testimony is obvious. Franchisors have found underreporting by auditing the franchisee,Äôs financial statements, inventory, consumption of food ingredients (as compared to sales of the final food product), and even ,Äúauditing,Äù the franchisee,Äôs garbage to compare, e.g., the number of oil cans consumed versus the reported sales of oil changes. These cases lend themselves to expert testimony on both sides as to the accuracy of the audit and/or other explanations for the observed discrepancy Franchisors may have the luxury of using their own employees to conduct these audits, or alternatively the franchisor might want to retain an independent auditor for any number of reasons, including the elimination of a bias challenge to the audited results. Likewise, while a franchisee might attempt to rebut this serious allegation on his or her own, the franchisee should, whenever possible, retain a forensic accountant or certified fraud examiner to refute the audit claims.

2. Termination Based on Health, Sanitation, and Safety Standards Created by the Franchise Agreement (or imposed by law, and incorporated into the franchise agreement). Franchisors again might rely on their own employees to testify to the manner in which their inspections are conducted and the results of those inspections, or may rely on governmental inspectors. See, Dunkin,Äô Donuts, Inc. v. Third Dunkin,Äô Donuts Realty, Inc, 2000 U.S. Dist. LEXIS 17927, *8 (N.D. Ill. December 6, 2000)(franchisor relied on evidence of municipal health inspector, on whose orders the franchise was closed on three separate occasions). Franchisees could likewise attempt to rely upon local municipal inspectors, but if that testimony is not available, the franchisee could retain a professional franchise inspector to refute the ‚Äúdirty store‚Äù claim. See, Dunkin,Äô Donuts Inc. v. Patel, 174 F. Supp. 2d 202 (D. N.J. 2001), where the franchisee challenged the franchisor,Äôs claim for attorney,Äôs fees and costs which the franchisor asserted after commencing a termination proceeding based on its findings in a health, safety and sanitation inspection, which the franchisee argued had been done in bad faith. The franchisee sought to introduce its own expert (a New Jersey State Registered Environmental Health Specialist) to testify the Dunkin,Äôs inspections and findings were conducted by ‚Äúnon-qualified personnel‚Äù and were ‚Äúinaccurate and based on critically flawed practice and procedure.‚Äù The trial court granted the motion to strike this particular expert report

due to an inadequate disclosure, but the potential use of experts in this area is not diminished by that holding.

3. Terminations or Non-Renewals Where the Franchisor Has a Duty to Buy Out the Franchisee,Äôs Interests. Some franchise agreements contain provisions for a buy-out of the franchisee,Äôs interest, and of course, the parties to a franchise agreement are free to negotiate potential buy out agreements. Likewise, the Petroleum Marketing Resources Act, 15 U.S.C. ¬ß 2802 (b)(3)(D), requires that a franchisor make a bona fide offer to sell, transfer, or assign to the franchisee his interests in the leased marketing premises when the franchisor decides not to renew the franchise relationship before it sells the property to a third party. See, Patel v. Sun Co., 141 F. 3d 447, 453 (3rd Cir. 1998). Either or both parties might present valuation or appraisal experts on the issue of whether an offer was bona fide. Id.; see also, Seahorse Marine Supplies, Inc. v. P.R. Sun Oil Co., 2002 U.S. App. LEXIS 13654 (1st Cir. July 9, 2002) (same); see also, 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)

4. Cases Where the Franchisee Attempts to Sell the Franchise. A franchisee faced with imminent termination might wisely attempt to sell

the franchise before an incurable termination, and indeed, many franchisors have given their failing franchisees this option either before or after pulling the termination trigger. In these situations, the franchisee might present a potential buyer to the franchisor, either for approval, or pursuant to a right of first refusal clause. In an ‚Äúapproval‚Äù situation, the franchisor‚Äôs failure to approve the sale will almost inevitably give rise to an attempted defense to termination based on an alleged breach of the implied covenant of good faith and fair dealing in the exercise of discretion under the approval clause. See, e.g. Fiore v. McDonald‚Äôs Corporation, 1996 U.S. District LEXIS 12354 (E.D. N.Y. 1996) (‚Äú[The franchisees] claim that McDonald‚Äôs abused its contract rights by creating a risk of forfeiture of all the ¬ franchises, and that McDonald‚Äôs refusal to permit the sale of [two] restaurants to the buyer of the [franchisees'] choice, and its reinvestment requirements for the renewal of [a third] restaurant, were in bad faith in violation of McDonald‚Äôs contractual obligations to operate in good faith‚Äù). In situations such as this, both the franchisor and franchisee might resort to independent expert testimony to review the qualifications of the proposed buyer or the terms of the offer for the purpose of challenging, or defending, a non-approval decision under a good faith standard.

Likewise, a franchisor operating under a ‚Äúfirst refusal‚Äù clause might wish

to challenge whether an offer is bona fide, or whether it was contrived for purposes of inflating the price. In this type of case, obtaining direct evidence of collusion between the franchisee and the offeror would be key, but nonetheless, expert testimony could be used to challenge the validity of the offer and to demonstrate that there were legitimate business reasons for not accepting the offer, and proceeding with a termination. The franchisee, of course, would have the opposite goal and could seek to present an expert on its position.

5. Alleged Breach of the Implied Covenant of Good Faith and Fair Dealing When the Termination is Based on Non-Payment of Royalties. Where the franchisee asserts the franchisor‚Äôs breach of the implied covenant of good faith and fair dealing as a defense to termination, there is always a threshold question of whether the franchisor‚Äôs alleged breach creates a valid defense to the termination. In cases where the termination is for non-payment of royalties, the franchise agreement likely provides that the duty to pay royalties is independent of all other duties, such that a franchisor‚Äôs alleged breach of the agreement‚Äôs express or implied terms could arguably be irrelevant as a defense to termination.

However, there is precedent for a franchisee to challenge its termination where it can allege that the franchisor‚Äôs predatory conduct put the

franchisee in position that caused the non-payment by essentially putting the franchisee in financial ruin. See, Interim Health Care of Northern Illinois, Inc. v. Interim Health Care, Inc., 225 F.3d 876 (7th Cir. 2000), where the court of appeals upheld a franchisee,Äôs claim that it was terminated in bad faith, where the franchisor had allegedly coveted the franchised territory for itself, and withheld referrals of national account patients from the franchisee, as a way of weakening the franchisee financially to the point that non-payment was inevitable. The court held that this was the ,Äúparadigmatic case of a contract party invoking a reasonable contract term (the discretionary obligation to furnish account leads) dishonestly to achieve a purpose ,Äòcontrary to that for which the contract had been made.,Äô Such manipulation, we have intimated, is the essence of bad faith.,Äù 225 F.3d at 886, citing, Original Great American Chocolate Chip Cookie Co. v. River Valley Cookies, 970 F.2d 273, 280 (7TH Cir. 1992). The Interim franchisee sought to prove the alleged bad faith based on proof of the relevant facts, and supported by the opinion testimony of a franchise industry consultant as to industry standards; and a Daubert challenge to his testimony was not adjudicated before the case was resolved.

6. Other Defenses Based on ,ÄúIndustry Standards,Äù. Experts in franchise ,Äúindustry standards,Äù are permitted to testify for the purpose of

defining the standard, and opining as to whether a party,Äôs conduct met, or violated the industry standard. See, TCBY Sys., Inc. v. RSP Co., 33 F.3d 925 (8th Cir. 1994), where an expert testified to the adequacy of TCBY,Äôs site review and evaluation process, and the expert was permitted to opine that ,Äúto a reasonable degree of certainty,Äù,Ä¶ ,Äúthe process that TCBY followed in approving a TCBY store,Äù for the franchisee in the particular location did not meet ,Äúthe minimum custom and practice observed by franchisors in the fast food industry.,Äù See also, In re: Midway Airlines, 69 F.3d 792 (7th Cir. 1994) (admitting expert testimony to prove industry standards); Fund of Funds, Ltd. v. Arthur Anderson & Co., 545 F.Supp. 1314, 1372 (S.D.N.Y. 1982) (It is ,Äúappropriate for experts to testify about ordinary practices of a profession or trade ,Äòto enable the jury to evaluate the conduct of the parties against the standards of ordinary practice in the industry,Äô,Äù); U.S. v. Russo, 74 F.3d 1383, 1394-95 (2nd Cir. 1996) (allowing expert testimony concerning securities industry).

It does not take imagination to see how non-compliance with industry standards could be asserted as a defense to termination. However, determining exactly what are ,Äúindustry standards,Äù in a field as diverse as franchising is itself a complex issue that is addressed further below.

7. Other Defenses Based on the Implied Covenant of Good Faith and

Fair Dealing. Closely related to industry standards is the implied covenant of good faith and fair dealing, which depends upon the application of ‚Äúcommunity standards of decency, fairness or reasonableness.‚Äù Restatement (Second) of Contracts, ¬ß205, comment a (1981). When a franchisee sets forth a defense to termination based on the franchisor‚Äôs alleged bad faith, expert testimony is usually appropriate, as the above examples illustrate. For example, in a non-franchise dispute involving the implied covenant of good faith and fair dealing, Employers Reinsurance Corp. v. Mid-Continent Cas. Co., 202 F. Supp. 2d 1212, 1216 (D. Kansas 2002), the district court provisionally admitted expert testimony in a contract dispute where the opinions to assist the jury (1) understanding technical terminology which is not adequately defined in the agreement; (2) by explaining custom and industry with respect to ambiguous terms; and (3) determining the parties' intentions and reasonable expectations under the agreement.

8. Termination in Alleged Violation of Antitrust Laws. Any termination that is challenged under sections 1 or 2 or the Sherman Act as alleged unlawful restraint of trade or attempted monopolization is certain to require expert testimony to define the relevant market and to ascertain the market power of the relevant actors, and possibly to opine on the parties‚Äô conduct.

9. Disclosure and Registration Issues. Franchisees might defend against termination by raising disclosure issues, which could include whether proper disclosure was made in the particular case, whether there were errors or improprieties in the disclosure documents, or whether there were errors in the registration process. Experts on disclosure and registration could be used in this scenario, although there is a danger that the proffered opinion might be challenged as an impermissible legal opinion that would not assist the trier of fact. See, Palazzetti Import/Export, Inc., v. Morson, 2001 WL 793322 (S.D.N.Y. July 13, 2001), where the court refused to allow the testimony of franchise attorney *** on the issue of whether the parties,Äô agreement in that case was a franchise agreement, or whether it was exempt from New York,Äôs disclosure requirements. The court excluded these opinions under Rule 702 on the grounds that determining whether the agreement satisfied the elements of franchise agreements did not require knowledge ,Äúbeyond the ken of the average juror.,Äù The court also rejected the expert,Äôs attempt to testify to industry custom, because there was no ambiguity in the agreement, and hence there was no need to defer to industry custom to determine whether there was a franchise agreement. Id.

10. Damage Claims by the Franchisee. Any claim of lost profits

resulting from termination is likely to result in expert testimony from an accountant or appraiser, or an economist. The owner of the business is probably free to present the damage claim through his or her own testimony, as long as there is an adequate foundation based on the owner,Äôs participation in the business. See, Lightening Lube, Inc. v. Witco Corp., 4 F.3d 1153 (3rd Cir. 1993). However, it is far more persuasive to limit the owner,Äôs testimony to his or her actual experience in running the business, which provides a foundation for an independent expert to make projections of future results. See, e.g., Drew Distributing, Inc. v. Leisure Time Technology, Inc., 1999 U.S. App. LEXIS 6121 (4th Cir. April 5, 1999), where the court affirmed a judgment for more than $3 million in a case involving breach of an exclusive agreement for the sale of video gambling games. The court held that the trial court had not abused its discretion in ruling that the damage expert, an economist, had a reasonable basis upon which to calculate damages. Rather than rely simply on unsupported projections, the expert reviewed the actual sales data of the product in that area where the distributor was to have exclusive rights as well as a careful study of government revenue reports supporting the sales data. The expert,Äôs review of this market information as support for the opinion was surely ‚Äúvalue added‚Äù and beyond the scope of any opinion that the business owner might have offered.

11. Damage Claims by the Franchisor. Similarly, franchisors claiming damages for premature termination by the franchisee might require expert testimony particularly where the lost royalties must be calculated as a percentage of the franchisee‚Äôs revenue. Like all lost profit claims, a claim of lost royalties depends on assumptions made as to future revenue streams, as well as assumptions as to future economic conditions, which will affect interest rates, and hence affect the determination of the present value of the lost future profits.

B. Finding The Best Expert

Once the potential areas for expert testimony are identified, the task is to find and select the best available person. Here are some tips based on experience:

The expert‚Äôs qualifications should match the case to the extent possible. Specifically, ‚Äúfranchising‚Äù covers a diverse series of industries, and to the extent possible, the expert should have relevant experience with the specific type of business that was franchised (retail, hospitality, restaurant, etc.).

If possible, find an expert who appears to have a balanced point of view on the matter at issue, and ideally, one who does not limit his or her career working for only franchisors or only franchisees.

Outside the area of damages testimony, the ideal expert should not make his or her primary living as an expert witness. Preferably, the expertise is the natural consequence of his or her primary work. University or college professors often make good experts at reasonable prices, and their title might impress a jury, but there is no substitute for practical experience on the part of the expert, which might be lacking from a strictly academic experience.

Do not be alarmed if the ‚Äúexpert‚Äù has never been an ‚Äúexpert‚Äù before or if he or she has never testified. There is a first time for everything, and in working with you, even a novice expert might outperform a seasoned veteran. If the novice has the right experience and makes an otherwise favorable impression, do not be afraid to trust your instincts.

If interviewing a candidate from a firm, be sure to pin down who will be doing the work. An expert who testifies based on a report prepared by underlings is at a serious disadvantage, and of course, the cost of bringing the testifying expert up to speed if he or she did not do the work could become prohibitive.

You should always interview more than one potential expert for each issue in the case.

Once you identify potentially suitable candidates, you should ask for references and follow-up by talking to other lawyers who have worked with

the expert; read every available deposition or trial transcripts of the expert,Äôs testimony in other cases; and research the expert on the Internet as well as by reading everything that the expert has written that you can get your hands on.

C. Interviewing Potential Expert(s)

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D. Identify Potential Impeachment

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E. The Engagement Letter

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F. Working With The Expert As The Opinions Are Developed

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G. The Disclosure Of Expert Opinions Under The Federal Rules

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H. Disclosure Under State Rules Or In Arbitration

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I. Contents Of The Expert Report

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J. The Rebuttal Expert Report

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IV. EXPERT DEPOSITION PRACTICE

C. Defending Your Expert‚Äôs Deposition

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V. MOTIONS IN LIMINE

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VI. INDUSTRY CUSTOMS AND STANDARDS

From the foregoing, it is fairly clear that ‚Äúindustry customs and standards,‚Äù permeates the subject of expert testimony in franchise cases. See, TCBY Sys., Inc. v. RSP Co., supra, 33 F.3d 925; In re: Midway Airlines, supra, 69 F.3d 792; Fund of Funds, Ltd. v. Arthur Anderson & Co., supra, 545 F.Supp. at 1372 (S.D.N.Y. 1982).

To summarize, the major issues that arise include:

A. Defining The Applicable ‚Äúindustry.‚Äù Consultants in franchising frequently offer their opinions on industries as diverse as janitorial cleaning franchises to franchises for the provision of professional health care services. Arguably there are common ‚Äústandards,‚Äù arising from the franchising practices in diverse industries, but the burden is on the proponent of the expert testimony to satisfactorily explain the proposed industry standard, and to refute any specific industry standards that might override the proposed franchise industry standard.

B. Persuading The Court That The Standard Is Relevant. As discussed, franchisors will typically argue that the relationship must be governed by the franchise agreement and applicable decisional law, while the franchisee will seek to interject industry standards on the grounds that the agreement is ambiguous.

C. Validating The Proposed Standard. As discussed, Daubert requires that the proponent of franchise ‚Äúindustry standard‚Äù testimony is valid, i.e., that is it widely-accepted in the ‚Äúindustry‚Äù and not merely the expert‚Äôs personal opinion. See, Morgens, Waterfall, Vintiadis & Co., v. Donaldson, Lufkin & Jenrette Securities Corporation, 198 F. Supp. 2d 432 (S.D.N.Y. 2002) (‚ÄúThe Court is not required to admit out of hand, opinion evidence which is substantially connected to existing data only by the ipse dixit of the expert and by subjective conclusions that have not been validated or are not objectively verifiable.‚Äù); see also, Brown v. Miska, 1995 WL 723156, at *4 (S.D. Tex. Jul. 19, 1995) (‚Äú[w]ithout any account of [an expert‚Äôs] intermediate reasoning or methodology, the validity of that reasoning cannot be tested.‚Äù)

Courts addressing the validity of proposed industry standards opinions are becoming more stringent in demanding proof that a standard is widely

accepted, i.e. that it is truly a standard. See, Roper Whitney of Rockford, Inc. v. TAAG Machinery Co., 2002 U.S. Dist. LEXIS 4489 (N.D. Ill. Mar. 18, 2002) (to be binding, ‚Äúindustry custom or usage‚Äù must be ‚Äúso uniform, long-established and generally acquiesced in and so well known as to induce the belief that the parties contracted with reference to it, nothing appearing in their contract to the contrary, and the existence of such a custom or usage cannot be considered established when the proof consists of a few isolated instances‚Äù); see also, Nat‚Äôl Diamond Syndicate, Inc. v. United Parcel Serv. Inc. 897 F.2d 253, 260 (7th Cir. 1990) (holding that evidence of an industry custom thus should be presented by ‚Äúseveral witnesses so as to establish the general knowledge and acceptance of the purported custom or usage within a particular industry, and noting that a party seeking to introduce evidence of industry standards bears an unusually heavy burden of proof‚Äù; and Pickus Const. and Equipment v. American Overhead Door, 326 Ill.App. 3d 518, 524, 761 N.E. 2d 356, 361-62 (2nd Dist. 2001) (rejecting proof of industry standard based on ‚Äúa few isolated instances‚Äù).

To meet the Daubert challenge, the expert must be prepared to bolster his or her opinions on industry standards with concrete examples of his or her 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. See, Den Norske Bank AS v. First Nat. Bank of Boston, 75 F.3d 49, (1st Cir. 1996) (Potential expert witness was qualified to testify in banking industry practices in loan participation agreements, where witness was a forty-year banking veteran who attested that he had (i) served as a vice-president in charge of ‚Äúlarge commercial loan transactions,,Äù (ii) had ‚Äúbecome very familiar with participation agreements from the perspective of both the lead bank and the participating banks,,Äù and (iii) observed firsthand the ‚Äúwell established industry custom and practice with regards to minority-participant vetoes‚Äù (which were at issue in the case). As a practical matter, the expert should be able to cite specific and numerous systems with which he or she is familiar, and should be able to distinguish between antidotal behavior and industry standards. Mathematical precision is simply not possible.

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 ‚Äúspecialized knowledge‚Äù prong of the Rule 702 test.

D. The AAFD Fair Franchising Standards

Into the void of clearly defined, widely accepted franchise industry standards comes the ‚ÄúFair Franchising Standards,Äù being promulgated by the American Association of Franchisees & Dealers. In Broussard v. Meineke Discount Muffler Shops, 958 F.Supp. 1087 (W.D. N.C. 1997), rev‚Äôd on other grounds, 155 F.3d 331 (4th Cir. 1998), the trial court permitted the franchisor‚Äôs attorney to cross-examine *** an expert for the franchisees, on his involvement in the AAFD Fair Franchising committee and its attempt to adopt ‚Äústandards,Äù that were supposedly intended to ‚Äúlevel the playing field,Äù for franchisees, i.e. to cause a change in the industry standards. [The expert] was specifically cross-examined about AAFD standard 10.1 relating to advertising funds, which was the principal topic of the case, and which had been approved by the AAFD committee about one month before the trial started.

The intent of this cross-examination was to discredit [the expert's] direct testimony that Meineke‚Äôs conduct in regard to the advertising fund was contrary to industry standards of fairness, by showing that [the expert] was trying to hold the franchisor to a proposed standard that was not yet accepted in the ‚Äúindustry.‚Äù In no other known cases since 1996 have the AAFD standards been used as the basis for establishing, or refuting, a claimed industry standard.

However, on October 17, 2001, the AAFD and ‚ÄúLexington Insurance Company (an AIG Company) jointly announced ‚Ä¶ that Lexington can provide a substantial 25% premium discount for its Franchisor Errors and Omissions Insurance products for franchising companies that earn the AAFD‚Äôs Fair Franchising Seal.‚Äù

As the AAFD discloses on its Web page, its decision to award its Fair Franchising Seal is largely but not exclusively based on franchisor‚Äôs compliance with the AAFD Standards. The question arises, with tangible economic recognition of the AAFD standards now a fact, will these standards become an acceptable yardstick for measuring franchise industry standards, thus enabling experts to more assuredly comply with the heightened Rule 702 requirements?

VII. CONCLUSION

Expert witness testimony will continue to play a key role in most commercial litigation including franchise cases. However, the courts will no longer reflexively admit the testimony of a self-proclaimed expert (if indeed, they ever did). Trial lawyers must plan for the admission, or exclusion, of expert testimony from the outset of the case, and the ultimate battle over the admissibility of the expert‚Äôs testimony might be

outcome-determinative.

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