

Proposed Expert Testimony in Refco Limited under Federal Rule of Evidence 702

By Boris J. Steffen, CPA, ASA, ABV, CDBV, CGMA – June 28, 2015

Refco, Inc. (Refco) was a New York-based financial services company doing business as a broker of commodities and futures contracts. One of Refco's customers was SPhinX Ltd. (SPhinX), a global hedge fund comprised of seventy Cayman Island funds, one of which, SPhinX Managed Futures Fund (SMFF), maintained brokerage accounts with Refco's onshore and offshore affiliates. Over the course of litigation to recover damages for breach of fiduciary duty subsequent to Refco's bankruptcy in October 2005, counsel for the parties filed motions to exclude the testimony of each other's experts based on the qualifications, reliability, and fit requirements of Federal Rule of Evidence 702.

The defendants' motion to exclude the testimony of the plaintiffs' CFTC and CEA expert was granted in part and denied in part, as was the plaintiffs' motion to exclude the testimony of the defendants' rebuttal expert. In both cases, the court excluded testimony deemed to constitute legal opinions. Background testimony concerning the futures industry, account segregation issues, and the industry customs and practices during the relevant time frame was allowed, however.

The court rejected the defendants' "effort to recalibrate" the plaintiffs' valuation expert's testimony to recover damages as the report clearly related only to the valuation of PlusFunds Group, Inc. (SPhinX's investment advisor). The court also found the defendants' challenges to the bases of the plaintiffs' expert's report to relate to weight rather than admissibility, and that the issues were therefore appropriately handled through cross-examination rather than by exclusion of otherwise relevant and reliable valuation work.

The court found the defendants' damages expert's consideration of events subsequent to PlusFunds Group, Inc.'s failure, including financial market conditions in 2008–2009, did not cause the expert's opinion to be unreliable. Further, the court concluded that the expert's professional certifications, experience providing expert testimony and in bankruptcy matters supported his opinion that the plaintiffs' could have achieved a larger recovery through Refco's bankruptcy proceeding. Lastly, the court held that the expert's reliance on the plaintiffs' expert's assumptions to support certain opinions absent any independent analysis went to the weight of his testimony and not its admissibility since the assumptions had sufficient foundation in the record, and could be challenged through cross-examination.

The defendants' motion to exclude the testimony of the plaintiffs' expert regarding the defendants' knowledge of Refco's failure to segregate SMFF's cash was granted in part and denied in part. The court excluded portions of the plaintiffs' expert's testimony that opined as to the defendants' state of mind and/or subjective intent, as well as testimony it found to be inadmissible legal opinion. The court did allow testimony concerning

industry practices, however, reasoning that while an expert must have specialized knowledge in the area of testimony, that knowledge does not have to be from formal academic training and professional credentials. Rather, the specialized knowledge may be acquired from practical experience that equips the expert at a minimum with “skill or knowledge greater than the average layman.”

The plaintiffs’ motion to exclude the defendants’ expert’s testimony concerning the practices of fund administrators was denied. In doing so, the court rejected the plaintiffs’ arguments that the defendants’ expert’s testimony contained improper and/or unsupported “findings of fact and conclusions of law.” The court found rather that the plaintiffs’ argument relied entirely on an abbreviated overview contained in the executive summary of the expert’s report, and that the substantive sections of the report provided in-depth analysis of the bases for the expert’s opinions, supported by detailed citations to the record along with his perceptions of industry practices.

The defendants’ motion to exclude the testimony of the plaintiffs’ expert regarding audit and advisory services provided to Refco was granted in part and denied in part. The argument made by the defendants’ was that the plaintiffs’ expert should be precluded from testifying with respect to any of the SMFF financial statements because the defendants’ did not prepare the statements or the accompanying footnotes. Further, the defendants’ argued that at a minimum, the plaintiffs’ expert should not be allowed to testify regarding SMFF’s 2002 financial statement since it was not referred to in his report.

In the latter case, the court granted the defendants’ motion since, while an expert is not limited to the exact words contained in their report, the report should contain a complete statement of all opinions along with the underlying basis for each. The court denied the defendants’ motion to exclude the plaintiffs’ expert’s limited testimony regarding 2003 and 2004, however, as it was substantially similar to the relevant paragraphs of his report and his opinion.

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