BP Amoco Chemical Company v. Flint Hills Resources, LLC
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# Motion Ex. 20

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**IN THE UNITED STATES DISTRICT COURT**
**FOR THE NORTHERN DISTRICT OF ILLINOIS**
**EASTERN DIVISION**

| | | |
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| **BP AMOCO CHEMICAL COMPANY,** | ) | |
| **Plaintiff/Counter–Defendant,** | ) | |
| **v.** | ) | **Consolidated Case No. 05 C 5661** |
| **FLINT HILLS RESOURCES LLC,** | ) | **Judge Amy J. St. Eve** |
| **Defendant/Counter–Plaintiff.** | ) | |
| **FLINT HILLS RESOURCES LLC,** | ) | |
| **Third-Party Plaintiff,** | ) | |
| **v.** | ) | |
| **BP CORPORATION NORTH AMERICA INC.,** | ) | |
| **Defendant.** | ) | |

**MEMORANDUM IN SUPPORT OF *DAUBERT* MOTION NO. 1:**
**FHR'S PRINCIPAL DAMAGES EXPERTS**

**BP AMOCO CHEMICAL COMPANY AND BP CORPORATION NORTH AMERICA INC.'S MEMORANDUM IN SUPPORT OF THEIR MOTION TO EXCLUDE THE OPINIONS OF SHARON MOORE BETTIUS AND JEFFREY BALIBAN**

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## INTRODUCTION

In March 2004, Flint Hills Resources, LLC ("FHR") and BP Amoco Chemical Company ("BP Amoco") entered into a detailed Asset Purchase and Sale Agreement ("PSA"). These two sophisticated parties agreed on terms that limit the damages either could recover for causes of action related to the PSA. FHR seeks damages based on the opinions of two experts, Sharon Moore Bettius and Jeffrey Baliban, whose opinions are precluded by the PSA. Moreover, Bettius and Baliban offer opinions using methods that have no support, are not reliable, and are in fact rejected by the relevant community. Compounding these problems, Bettius' and Baliban's opinions also are disconnected from the facts of this case. For example, Bettius did not change her opinion even though FHR dropped one-third of its alleged damages claims after she issued her report. These violations of Federal Rule of Evidence 702 and *Daubert* warrant the preclusion at trial of Bettius' and Baliban's opinions and proposed testimony.

## ARGUMENT

Bettius' and Baliban's opinions, and the legal requirements for expert testimony, are summarized in the accompanying Motion. Bettius' and Baliban's opinions suffer from three common flaws that result in their opinions failing the stringent reliability and relevance standards under the Federal Rules of Evidence and *Daubert*: (I) Bettius' and Baliban's opinions contravene the plain language of the PSA; (II) Bettius and Baliban have calculated damages in a manner that is contrary to the law; and (III) Bettius and Baliban fail to fit their opinions to the undisputed facts and claims of this case.

### I. BETTIUS' AND BALIBAN'S OPINIONS CALCULATE AND MEASURE DAMAGES IN A MANNER CONTRARY TO THE PSA.

FHR and BP Amoco bargained for and agreed upon a number of terms in the PSA to limit damages and to restrict the methods for calculating any allowed damages claims. FHR's proposed experts, Bettius and Baliban, however, have reached opinions that are contrary to these contractual provisions and thus are not based on "sufficient facts or data." Fed. R. Evid. 702. Bettius' and Baliban's damages opinions are barred by the following terms in the PSA:

*First,* the PSA explicitly disclaims any "representation or warranty as to value." (Ex. 1, PSA § 7.3 at 72-73) Bettius and Baliban, however, explicitly claim to be calculating damages based upon a difference in value. Baliban describes his assignment as determining "the difference, if any, in value of the Joliet plant." (Ex. 2, Baliban Rep. at 1-2) Similarly, Bettius states that her assignment was "to determine my opinion of the fair market value of the

enterprise" and states her conclusion as a difference in the "Fair Market Value of PCBU." (Ex. 3, Bettius Rep. at 1, 3) Thus, their opinions calculate damages based upon a representation of value, which is prohibited by the PSA's plain language.

*Second*, Section 13.6 states that the parties "WILL NOT BE LIABLE TO BUYER FOR ANY LOSS OF PROFIT, LOSS OF USE, SPECIAL, INDIRECT, INCIDENTAL, OR CONSEQUENTIAL DAMAGES … HOWSOEVER ARISING UNDER THIS AGREEMENT." (Ex. 1, PSA § 13.6 at 121) Contrary to this contract term, Bettius' and Baliban's opinions both rely on projected cash flows, which are the same as lost profits. (*See* discussion and authorities cited in Docket No. 247 at 3-4; Docket No. 352 at 6-7) In addition, Baliban's opinion also incorporates consequential damages arising from the alleged probability of a hypothetical agreement with Eastman Chemical Company, which increases the damages he calculated by approximately $18 million as explained in Section III.C below. (Docket No. 247 at 7; Docket No. 352 at 8; Ex. 2, Baliban Rep. at 29-34; Ex. 4, Elson Rebuttal Rep. at 13-17)

*Third*, Bettius and Baliban base their analyses on the sale price of $300 million for the *PCBU as a whole* and thus contradict Section 5.6. The Joliet Plant is only one part of the PCBU, and FHR is complaining only about the condition of less than 1% of the assets of the *Joliet Plant*, not the *PCBU* as a whole. The $300 million that FHR paid was consideration not only for the Joliet Plant but for a variety of assets, including European assets, working capital, and a non-compete agreement. FHR and BP Amoco agreed on an allocation of the purchase price under the PSA and that they "shall be bound by such agreed Purchase Price allocation *for all purposes*, and neither party shall take any contrary position regarding such allocation in any Tax Return, *or otherwise*." (Ex. 1, PSA § 5.6 at 51) FHR admitted that its final purchase price allocation is contained in DX-2577 (Ex. 31), which allocates less than $139 million of the overall $300 million purchase price to the Joliet Plant. (Docket No. 322 at 7) Bettius' and Baliban's use of the $300 million purchase price violates Section 5.6 because FHR's alleged claims involve the *Joliet Plant* only, not the European assets, working capital, or the non-compete agreement.

*Fourth*, Section 13.4, as well as Illinois common law, requires any damages to be calculated on an item-by-item basis. Section 13.4 specifically refers to measuring losses that are "attributable to the particular breach." (Ex. 1, PSA § 13.4 at 100); *see also First Nat'l Bank of Elgin v. Dusold*, 180 Ill. App. 3d 714, 719, 536 N.E.2d 100, 103 (Ill. App. Ct. 1989) (holding that that value of items could be considered separately for determining any diminution in FMV).

Contrary to Section 13.4, as well as Illinois law, neither Bettius nor Baliban consider or calculate alleged damages on a breach-by-breach basis, but instead consider all claims together (Bettius) or all production capacity claims together (Baliban).

*Fifth*, Section 13.5(b) and Illinois law require a party to mitigate damages. (Ex. 1, PSA § 13.5(b) at 119); *Malanowski v. Jabamoni*, 332 Ill. App. 3d 8, 15, 772 N.E.2d 967, 973 (Ill. App. Ct. 2002). Baliban's primary opinion asserts that the Joliet Plant's purified isophthalic acid capacity was 115 kmt, but he also calculates an alternate value based on 140 kmt. Of the $62 million in damages that Baliban purports to calculate, $18 million is attributable to this difference between 115 and 140 kmt. (Ex. 2, Baliban Rep. at 32-33). Baliban admits, however, that FHR told him that for only $2.8 million, far less than $18 million, purified isophthalic acid capacity could be increased from the alleged 115 kmt to 140 kmt. (Ex. 5, Baliban Dep. at 153:3-13) Under FHR's own calculations it spend only $2.8 million to avoid an alleged loss of $18 million. In short, Baliban's opinion based on a 115 kmt capacity of purified isophthalic acid is not based on the facts, ignores FHR's duty to mitigate, is contrary to the 140 kmt capacity FHR's counsel told Bettius to assume, and is contrary to the PSA and common law.

## II. BETTIUS AND BALIBAN USE IMPROPER METHODOLOGIES TO DETERMINE DAMAGES.

Independent of the contractual bars to Bettius' and Baliban's testimony, their opinions should be excluded because they are unreliable and methodologically flawed.

### A. Bettius And Baliban Have Failed To Calculate A Fair Market Value.

Under Illinois law, claims based on diminution in value to real property must be measured by applying a fair market value ("FMV") standard. *Meade v. Kubinski*, 277 Ill. App. 3d 1014, 1022, 661 N.E.2d 1178, 1184 (Ill. App. Ct. 1996); *Gvillo v. Stutz*, 306 Ill. App. 3d 766, 770, 715 N.E.2d 285, 288 (Ill. Ct. App. 1999). The law defines FMV as "the price at which the asset would change hands between a hypothetical willing buyer and willing seller, neither being under any compulsion to buy or sell, both parties having reasonable knowledge of relevant facts." *Newark Morning Ledger Co. v. United States*, 507 U.S. 546, 570 (1993); *Kankakee County Bd. of Review v. Property Tax Appeal Bd.*, 163 Ill. App. 3d 811, 818, 516 N.E.2d 1006, 1010 (Ill. App. Ct. 1987). The standard for FMV is "an objective one, the value of any particular property being set by the forces of the marketplace at a given place and time." *In re Rosewell*, 120 Ill. App. 3d 369, 373, 458 N.E.2d 121, 125 (Ill. App. Ct. 1983); *Chrysler Corp. v. State Prop. Tax Appeal Bd.*, 69 Ill. App. 3d 207, 211, 387 N.E.2d 351, 355 (Ill. App. Ct. 1979).

Under these circumstances, the first step to calculating a diminution in value would be to determine the price at which a hypothetical buyer and seller would be willing to transfer a piece of equipment in its "as-represented" condition. This value would then be compared to the value at which a hypothetical buyer and seller would be willing to transfer a piece of equipment in its "as-sold" condition. The difference between these values (if properly calculated, and if there were no contractual limitations) could then provide a diminution-in-value measure of damages. There is no dispute here that neither Baliban nor Bettius calculated damages in this way, nor did they determine the FMV of the PCBU in its "as-represented" condition.

FHR previously has relied on *In re Excello Press, Inc.*, 890 F.2d 896 (7th Cir. 1989), to claim that the sale price of the PCBU is necessarily the best evidence of the FMV of the PCBU in the "as-represented" condition. To begin with, what is at issue here is the Joliet Plant, and in accordance with the PSA, the allocated amount paid for the Joliet Plant was slightly less than $139 million, not the $300 million assumed by Bettius and Baliban. Moreover, Illinois courts have recognized that a variety of different methods can be used to determine the FMV of property. *People ex rel. Toman v. Pickard*, 377 Ill. 610, 614, 37 N.E.2d 330, 332 (Ill. 1941); *Kankakee County Bd. of Review v. State Property Tax Appeal Bd.*, 337 Ill. App. 3d 1070, 1075, 787 N.E.2d 865, 870 (Ill. Ct. App. 2003) (noting that an appraisal can be more indicative of FMV than a sale price). In addition, *Excello* did not involve a determination of the diminution in value, as Bettius and Baliban purport to do. As a result, *Excello* did not need to perform an "apples to apples" comparison between the value of property in two allegedly different states. By contrast, as explained below, Bettius and Baliban apply assumptions that decrease the value of the PCBU, inflate damages in calculating the alleged "as-sold" value, and at the same time fail to apply consistent assumptions to calculate an "as-represented" value.

Here, there are two threshold flaws with the FMV assumptions of Bettius and Baliban. First, they use the $300 million purchase price for the PCBU as a whole, rather than the $139 million allocated amount paid for the Joliet Plant. That erroneous assumption alone is a disqualifier. Second, they assume that the $300 million number is the FMV for the PCBU in an "as-represented" condition without conducting any analysis. But proposed experts for both BP Amoco and FHR agree that a sale price does not necessarily establish FMV. (Ex. 5, Baliban Dep. at 65:23-67:17; Ex. 6, Bergmark Dep. at 311:13-313:2; Ex. 7, Elson Dep. at 84:6-90:24) FHR's proposed expert Baliban does not agree "that any sale that occurs between a buyer and a

seller necessarily occurs at the fair market value"; he further admitted "that there can be instances in which there are transactions that occur at prices other than what you would describe as the fair market value." (Ex. 5, Baliban Dep. at 65:23-66:7) BP Amoco's expert Brian Bergmark explained that the sale price here may not have been the FMV for various reasons, including the lengthy period of exclusive negotiations between BP Amoco and FHR and changes in market conditions. (Ex. 6, Bergmark Dep. at 308:9-310:21, 311:13-313:2) Bettius' and Baliban's assumption that the $300 million purchase price equals the FMV is methodologically flawed even if that were the right number to consider (as compared to $139 million).[1] The impact of this flawed methodology on each of these expert's opinions is significant.

**1. Bettius Has Not Calculated An "As-Represented" Value Using Her Assumptions.**

By her own admission, Bettius did not "perform an appraisal of the fair market value of the PCBU in the as-represented condition." (Ex. 8, Bettius Dep. at 66:5-8) Instead, she simply adopted a price ($300 million) agreed to by two particular parties. By failing to calculate an FMV for the Joliet Plant in the "as-represented" condition, she has not applied the proper methodology for calculating a diminution in value.

Bettius' failure is particularly serious because of the number of different adjustments she then makes to the allegedly "as-sold" value of the PCBU in her "market approach" methodology that are *not* based on any alleged contract breaches. Bettius' "market approach" relies on two methods. The first ("guideline publicly traded company method") purports to determine a value for the PCBU based on multiples of prices paid for minority shares in publicly traded companies, and the second ("guideline merged and acquired company method") attempts to determine a value for the PCBU from multiples of prices paid for minority or controlling interests in public or private companies. (Ex. 3, Bettius Rep. at 18-19) Under both methods, Bettius applied discounts to the multiples of the prices paid, which has the effect of decreasing the value she calculates for the PCBU. (*Id.* at 24-28) For example, in comparing the PCBU to the value of publicly traded companies, she applied a 40% "comparative discount" to multiples of those

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[1] Moreover, the fact that Baliban used an FHR-specific model that yielded a value of $300 million does not support that $300 million is the appropriate FMV for the PCBU. Further, there is no evidence that the particular cash flow projections and discount rate informing the FHR model which yielded a $300 million were FMV-based. An infinite number of combinations of cash flow and discount rate assumption scenarios could produce a value of $300 million.

companies to take into account that the PCBU was allegedly smaller, had lower growth, and was less profitable than those companies, in addition to the alleged condition of the Joliet Plant. (*Id.* at 24) In comparing the sale of the PCBU to other mergers and acquisitions, she applied a 20% "comparative discount" to the value of those transactions for the same reasons. (*Id.* at 27-28) She also applied a "liquidity discount" of 15% to the PCBU's value because it is a non-public company and thus more difficult to sell than shares in a publicly traded company. (*Id.* at 25)

Significantly, Bettius admits that many of the factors used for her "comparative discount" as well as her "liquidity discount" would apply regardless of whether there was a breach. (Ex. 8, Bettius Dep. at 266:11-24; 279:11-24) For example, Bettius suggested that 25% of the 40% comparative discount she uses in her guideline publicly traded company method could be "based on nothing other than its size." (*Id.* at 267:14-269:8) Because these factors are not dependent on any alleged breach, they should have been used to calculate an "as-represented" value, so that the difference between the "as-represented" and allegedly "as-sold" value would be confined to a difference resulting from the alleged breaches. But she did not do that. Instead, Bettius took an undiscounted $300 million figure, failed to take into account the discounts that would exist in her model regardless of and unrelated to any breach, and then compared that to an allegedly "as-sold" FMV that applied those discounts. Because of this simple error in her methodology, she has not determined what portion of her calculated diminution in value is attributable to the claimed breach, and her opinion should be excluded. *E.g.*, *Kempner Mobile Electronics, Inc. v. Sw. Bell Mobile Sys.*, 428 F.3d 706, 712-13 (7th Cir. 2006) (affirming exclusion of damages opinion that failed to separate allege damages caused by defendant from other factors); *Children's Broad. Corp. v. Walt Disney Co.,* 245 F.3d 1008, 1018 (8th Cir. 2001) (rejecting opinion where putative expert failed to limit damages to factors caused by defendant's alleged breach); *Concord Boat Corp. v. Brunswick Corp.*, 207 F.3d 1039, 1056 (8th Cir. 2000); *see generally Fuesting v. Zimmer, Inc.*, 421 F.3d 528, 535 (7th Cir. 2005) (reversing district court's decision to admit expert testimony where expert failed to exclude alternative causes), *reh'g en banc granted on other grounds*, 448 F.3d 936 (7th Cir. 2006); *TAS Distrib. Co. v. Cummins Engine Co.*, 491 F.3d 625, 632-33 (7th Cir. 2007) (party must show damages can be traced to defendant's wrongful conduct with a reasonable degree of certainty).

Notably, Bettius' opinions previously have been excluded by another court for making this very error of failing to distinguish between damages that are caused by the plaintiffs'

allegations and those caused by independent events. *Calgon Carbon Corp. v. Potomatic Capital Investment Corp.*, CA No. 98-0072, slip op. at 30-37 (W.D. Pa. Jan. 14, 2003) (Magistrate Judge's Report and Recommendation) (copy attached as Ex. 9). Because Bettius' methodology fails to distinguish between damages caused by a breach or fraud and losses, discounts, and/or value reductions that would exist regardless of FHR's claims, her opinions should be excluded.

**2. Baliban Has Calculated An Investment Value, Not An FMV.**

In direct contradiction to basic legal requirements, Baliban has not calculated a difference in FMV. In fact, Baliban admits that he is "not specifically saying that my model results in the fair market value of the plant in the true condition." (Ex. 5, Baliban Dep. at 96:4-11) Thus, Baliban's report does not say that he is attempting to calculate a FMV. (Ex. 2, Baliban Rep. at 1-2) Instead, Baliban has attempted to calculate the subjective and unique value of the PCBU *to FHR*, not to a hypothetical buyer in the marketplace.

The key drivers of Baliban's analysis depend on factors unique to FHR. *First*, Baliban uses FHR's financial model as the basis of his analysis. *Second*, he incorporates cash flows from a speculative potential deal that was never reached between FHR and Eastman Chemical Company for purposes of calculating an internal rate of return ("IRR"). This potential agreement was based on FHR being an existing supplier of feedstocks to Eastman. It would not have been available to a hypothetical buyer in the marketplace. (Ex. 2, Baliban Rep. at 25) *Third*, Baliban uses FHR's IRR (artificially increased by 50% of the speculative Eastman cash flows) to discount the value of the PCBU in its supposedly "as-sold" condition. (*Id*. at 30-34)

Case law and other authorities are clear, and hold that a party's subjective expectations are not a proper measure of damages. *E.g.*, *Zenith Elec. Corp. v. WH-TV Broad. Corp.*, 395 F.3d 416, 420 (7th Cir. 2005) (rejecting plaintiff's attempt to prove damages by using its own "internal projections," which like "many other internal projections [] represent hopes rather than the results of scientific analysis"); *Target Market Publ'g, Inc. v. ADVO, Inc.*, 136 F.3d 1139, 1145 (7th Cir. 1998) (similar); 3 Dan B. Dobbs, LAW OF REMEDIES § 12.2(1) at 26 (2d ed. 1993) (for benefit-of-the bargain damages, "it is not the plaintiff's subjective estimate that matters"). In addition, the parties in the PSA specifically agreed that neither could seek special or consequential damages from the other. (Ex. 1, PSA § 13.6 at 121)

Moreover, because FHR's projections were not tied to the past performance of the PCBU but were instead predicated on a shift to a new "commodity" business model that BP Amoco had

not historically pursued (Ex. 10, Sementelli Dep. at 97:3-99:16; Ex. 5, Baliban Dep. at 176:17-177:18), the projected lost cash flows Baliban calculates are too speculative to support an award of damages. *See, e.g., Euroholdings Capital & Inv. Corp.*, 2009 WL 650373, at *5 (N.D. Ill. Mar. 11, 2009) ("Prior success with a similar business generally does not provide ample information to calculate lost profits for a new business because conditions vary with each business venture."); *id.* at *7-9 (excluding expert opinions where reasonableness of projections had not been established by comparative analysis to other market data); *see also* 3 Dan B. Dobbs, LAW OF REMEDIES § 12.4(d) at 77 (2d ed. 1993) ("the use of profit evidence to prove value necessitates a longer chain of inference without making anything more certain or simpler.").

### B. No Methodology Connects The Amounts Of Bettius' Changes To Capital Expenditures, Profitability, Or The Discount Rate To Any Alleged Breaches.

Under *Daubert* and FRE 702, a proposed expert must rely on "reliable principles and methods." Putative expert testimony must be excluded where it is not based on a method but merely on the expert's "judgment," "training" or "experience." *See Zenith*, 395 F.3d at 418; *Clark v. Takata Corp.*, 192 F.3d 750, 758 (7th Cir. 1999). "[N]othing in either *Daubert* or the Federal Rules of Evidence requires a district court to admit opinion evidence that is connected to existing data only by the *ipse dixit* of the expert." *General Elec. Co. v. Joiner*, 522 U.S. 136, 146 (1997). Instead, "federal courts must ensure that the methodology and data behind an opinion are scientific." *McMahon v. Bunn-O-Matic Corp.*, 150 F.3d 651, 658 (7th Cir. 1998).

Here, Bettius applies various adjustments to her projections, supposedly to account for the condition of the Joliet Plant as alleged by FHR. For her "market approach," her adjustments include: (i) some portion of the amount in her "comparative discount" that she cannot specify; (ii) removing normalization adjustments to the PCBU's financial statement, which results in decreasing the PCBU's earnings.[2] (Ex. 3, Bettius Rep. at 15-17, 24; Ex. 8, Bettius Dep. at 263:19-264:20, 269:5-8) For her "income approach," these adjustments include: (i) decreasing the PCBU's gross profit to 15%, increasing to 30% over time; (ii) increasing the PCBU's capital

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[2] BP Amoco's advisors made these normalization adjustments because the PCBU's financial numbers were not reported on a stand-alone basis. The normalizations more accurately account for the costs and earnings of the PCBU on a stand-alone basis. (Ex. 11, Bergmark Rep. at 8; *see also* Ex. 30, DX-2787 (American Institute of Certified Public Accountants ("AICPA") Statement on Standards for Valuation Services 1) at 17 (indicating that a valuation professional should consider normalization adjustments in valuing assets according to the discounted cash flow method); *id.* at 57 ¶ 11 (indicating standards apply to loss-of-value damage computations))

expenditures to $20 million for the initial periods and to $10 million during later years. (Ex. 3, Bettius Rep. at 29-31; Ex. 8, Bettius Dep. 208:3-14) Bettius simply picked these adjustments and the particular numbers without basis. When asked, she could not say why she chose these particular numbers as opposed to some lesser or greater figures. Her report does not cite or rely upon any methodology to explain why she chose these numbers, or indeed why she chose to make these particular adjustments at all. Nor does she cite any actuarial standards, scholarly articles, or similar works stating that adjustments to comparative discounts, normalization, profitability, or capital expenditures are appropriate when assets are allegedly not as represented, much less that the particular values she selected are appropriate.

When asked to explain her methodology, Bettius testified to nothing more than that she considered a number of factors. (*E.g.*, Ex. 8, Bettius Dep. at 94:9-98:4, 208:20-209:19) In response to questions about how she arrived at a decreased profitability, for example, Bettius testified that she did not believe she had performed any quantitative analysis and there was no "particular calculation" she used to adjust the profitability. (*Id.* at 210:14-21) Similarly, Bettius could not explain how much of her comparative discount (if any) was attributable to FHR's alleged claims as opposed to independent and unrelated factors such as differences in size. (*Id.* at 267:14-269:8 (Bettius admitted she "did not do any kind of dollar-for-dollar quantification of how much of that discount reflects to one issue versus the other.")) Instead, Bettius said that she relied on her "judgment" and "best assessment." (*Id.* at 208:20-209:19)

Under Seventh Circuit precedent, relying merely on "judgment" and "best assessment" -- instead of a recognizable, supported methodology -- is precisely what Bettius cannot do. *See Zenith*, 395 F.3d at 418; *Clark*, 192 F.3d at 758. Bettius has failed to explain any principled methodology connecting FHR's claims and the particular adjustments she made to her cash flow projections, and for that reason her opinion should be excluded. *E.g., F:A J Kikson v. Underwriters Laboratories, Inc.*, 492 F.3d 794, 802 (7th Cir. 2007) ("a plaintiff must present testimony from a qualified witness using 'professional methods' to reach a 'testable' dollar amount."); *Zenith*, 395 F.3d at 419 (an expert "must offer good reason to think that his approach produces an accurate estimate using professional methods, and this estimate must be testable").

**C. Baliban Improperly Uses FHR's IRR To Discount Cash Flows.**

Baliban's opinion also misunderstands the purposes of discounting and how to calculate a discount rate. A discount rate must take into account both the time value of money and the

riskiness of future cash flows. *Douglass v. Hustler Magazine, Inc.*, 769 F.2d 1128, 1143 (7th Cir. 1985). For this reason, the proper rate for discounting an enterprise's projected future cash flows to net present value is the company's weighted average cost of capital ("WACC"). The WACC measures the riskiness of a company's cash flows -- the more risky the company's cash flows, the greater the cost to finance those cash flows, and the higher the discount rate will be (and vice versa). Cases regularly endorse the use of WACC to discount an enterprise's projected future cash flows. *E.g.*, *Horn v. McQueen*, 353 F. Supp. 2d 785, 817 (W.D. Ky. 2004); *Celebrity Cruises Inc. v. Essef Corp.*, 478 F. Supp. 2d 440, 452-53 (S.D.N.Y. 2007); *In re Oneida Ltd.*, 351 B.R. 79, 88 (Bankr. S.D.N.Y. 2006).

The sources Baliban cites likewise state that WACC is the appropriate discount rate to use for determining the net present value of businesses. *See* Richard DeFusco, et al., *Quantitative Methods for Investment Analysis* 58-59 & n.2 (CFA Institute 2d ed. 2004) (Ex. 26) ("In calculating the NPV of an investment proposal, we use an estimate of the opportunity cost of capital as the discount rate," and noting that WACC "is often used to discount cash flows"); Aswath Damodaran, *Investment Valuation* 387-88 (John Wiley & Sons, Inc. 2002) (Ex. 27) (discussing the use of WACC and stating that "[t]o value a firm, you first need to estimate a cost of capital"); Richard A. Brealey, et al., *Principles of Corporate Finance* 507-12 (McGraw Hill 8th ed. 2006) (Ex. 28) (discussing use of WACC to value businesses); Aswath Damodaran, *Applied Corporate Finance* 121 (Ex. 29) (net present value should be determined by discounting cash flow using the cost of capital if the cash flow is to the firm), *available at* <http://pages.stern.nyu.edu/~adamodar/pdfiles/execscf2day2007notes.pdf>. Indeed, Bettius uses WACC in discounting cash flows under her "Income Method" (Ex. 3, Bettius Rep. at 30), as does BP Amoco's expert Brian Bergmark (Ex. 11, Bergmark Rep., Exhibit D at 32-34).

Baliban did not use the WACC method. Instead, he used FHR's IRR. (Ex. 2, Baliban Rep. at 27-34) But Baliban does not provide any evidence that using an IRR to discount the value of a business is a reliable method. *See Daubert*, 509 U.S. 579, 593-94 (holding that a court should consider factors including peer review and general acceptance in determining whether an expert's opinion is admissible); *Zenith*, 395 F.3d at 419 (to be admissible, experts must "follow scientific approaches normal to their disciplines"). Indeed, because an IRR is based on a company's subjective evaluation of what it expects the return to be, rather than the objective riskiness of an investment as required by *Douglass*, using an IRR to discount a business's cash

flows to net present value is improper. *See generally Deimer v. Cincinnati Sub-Zero Prods., Inc.*, 58 F.3d 341, 344-45 (7th Cir. 1995) (affirming motion to strike expert witness who "did not establish a proper scientific basis for his opinion"); *Cummins v. Lyle Indus.*, 93 F.3d 362, 368-69 (7th Cir. 1996); *see also Blue Dane Simmental Corp. v. Am. Simmental Assoc.*, 178 F.3d 1035, 1040-41 (8th Cir. 1999) (excluding expert opinion where there was no evidence that other economists used the expert's modeling "to support conclusions of causes of market fluctuation").

Critically, if one applies the discount rates used by BP Amoco and FHR to discount the cash flows of the PCBU, Baliban's methodology results in a calculation establishing that FHR has no damages at all from the alleged production capacity limitations. (Ex. 4, Elson Rebuttal Rep. at 16-17) Indeed, if one uses the WACC-based discount rate used by FHR's other proposed expert Bettius, Baliban's method yields zero damages. (*Id.*) Baliban's opinions thus depend on using an IRR instead of WACC to determine alleged damages, and should be excluded for using this unreliable and unaccepted methodology.

## III. BETTIUS' AND BALIBAN'S OPINIONS ARE FUNDAMENTALLY FLAWED BECAUSE THEY DO NOT FIT THE FACTS OF THIS CASE.

Expert testimony must be "based upon sufficient facts or data" and the expert's methodology must be applied reliably to the facts of the case. Fed. R. Evid. 702; *Wasson v. Peabody Coal Co.*, 542 F.3d 1172, 1176 (7th Cir. 2008). "When the assumptions made by an expert are not based on fact, the expert's testimony is likely to mislead a jury, and should be excluded by the district court." *Tyger Constr. Co. v. Pensacola Constr. Co.*, 29 F.3d 137 (4th Cir. 1994). Moreover, "the suggested scientific testimony must 'fit' the issue to which the expert is testifying." *Deimer*, 58 F.3d at 344; *Porter v. Whitehall Lab.*, 9 F.3d 607, 616 (7th Cir.1993). The opinions of Baliban and Bettius fail these requirements.

### A. Significant Changes In FHR's Alleged Damages Have No Effect On Bettius' Opinion.

FHR's most recent changes in its repair-cost claims confirm that Bettius' opinion is not based on any methodology and is fundamentally disconnected from the facts and allegations of this case. When Bettius issued her report in October 2008, FHR's was asserting nearly 60 claims, seeking a total of $180 million or more in alleged repair-cost damages -- even though Bettius acknowledged that one cannot tie these numbers to the assumptions she made. (Ex. 3, Bettius Rep. at 63; Ex. 25, 6/09/08 Claim Chart; Ex. 8, Bettius Dep. at 94:9-95:15) Since June 2008, FHR has dropped 7 of its claims altogether and reduced its alleged repair-cost damages for

the remaining claims by one-third, to $120 million. (Ex. 12, 2/13/09 Claim Chart) What has been the effect on Bettius' opinions of FHR dropping those claims and reducing its alleged repair costs by over $60 million? Nothing at all. The failure of Bettius' opinion to change in response to these reductions in FHR's alleged repair costs further confirms that her opinions are not based on the facts of this case or the claims FHR is making. *E.g., Children's Broad.,* 245 F.3d at 1018 (rejecting expert opinion where expert did not change his opinion after summary judgment was granted against certain claims).

### B. Bettius Assumes The Absence Of Any Representations And Warranties Instead Of A Partial Breach, As Alleged By FHR.

Bettius' opinion also misunderstands the nature of FHR's claims, and indeed FHR's claims cannot have caused the extent of the damages that Bettius calculates. FHR alleges only that a limited number of assets at the Joliet Plant failed to satisfy the representations in the PSA. (Ex. 12, 2/13/09 Claim Chart) As BP Amoco has previously explained, FHR voices no complaint about the vast majority of the equipment at the Joliet Plant. (Docket No. 281 at 10-11)

In contrast to FHR's discrete and limited allegations of breach, Bettius assumes that the relevant representations in the PSA did not exist at all, for any of the equipment or production units at the Joliet Plant. Her opinions are premised on an assumption "that the transaction did not include the express representations and warranties contained Section 7(d)(ii)." (Ex. 3, Bettius Rep. at 1; *see also* Ex. 8, Bettius Dep. at 137:9-12) In effect, Bettius assumes that none of the representations were true and thus that those representations had no value at all to a potential buyer because they were non-existent. Bettius then calculates damages based on this incorrect premise, instead of assuming only that the representations were breached with respect to certain assets, as FHR alleges. As a result, there can be no causal connection between FHR's allegations and Bettius' alleged damages, and her opinions are not relevant.

### C. Baliban Incorporates Speculative Cash Flows To Increase FHR's IRR And Thus His Alleged Damages Calculations.

In applying Federal Rule of Evidence 702, a court must "reject any subjective belief or speculation." *E.g. Ammons v. Aramark Unif. Servs., Inc.*, 368 F.3d 809, 816 (7th Cir. 2004). Baliban's opinion fails this requirement by incorporating speculative assumptions. Specifically, Baliban arbitrarily assumes that there was a 50% probability that FHR would have become the exclusive supplier of purified isophthalic acid to Eastman Chemical Company following the closing. (Ex. 2, Baliban Rep. at 31) This assumption increases the IRR that Baliban calculates

for FHR and thus increases his alleged damages. (*Id.* at 32)

The evidence from FHR's own witnesses and documents confirms that the Eastman opportunity was highly speculative and not at all developed prior to closing -- let alone developed to the point where anyone could reliably assign it a 50% probability. In fact, FHR itself did not include any cash flows from the Eastman project in the "expected case" projections used in its financial model. (Ex. 13, Sanders Dep. at 199:8-200:7; Ex. 14, DX-1180) FHR's Steve Sanders admitted that this was because the Eastman "venture[] would take a great deal more development and analysis to, to prove out." (Ex. 13, Sanders Dep. at 199:8-200:7) Jeff Ramsey, another FHR witness, testified that during the period when FHR was conducting its due diligence on the PCBU, "there wasn't really much depth that I remember of the conversation [with Eastman], if there was one." (Ex. 15, Ramsey Dep. at 81:12-22)

Before the sale of the PCBU, any discussions between Eastman and FHR were at a very preliminary level, looking at beginning a dialogue between the companies and considering potential options. (*E.g.*, Ex. 16, DX-2152) FHR has not produced any evidence (such as term sheets or agreements regarding pricing) showing that discussions with Eastman went beyond the initial stages. (Ex. 17, Miller Dep. at 60:23-61:8) Moreover, Eastman repeatedly expressed reservations about any agreement with FHR, in part because Eastman was "nervous about Flint Hills becoming a competitor in that market and knowing [Eastman's] cost structure." (Ex. 16, DX-2152) Eastman later expressed doubts about any hypothetical deal because it would continue to incur costs for its production facility. (Ex. 18, DX-2364) Eastman eventually ended discussions with FHR to focus on higher priority projects, and FHR never entered into the deal assumed by Baliban and forming the basis for his damages opinion here. (Ex. 19, DX-2365) In short, calculating damages based on a deal that had not yet been negotiated at the transaction's closing is pure speculation, and contrary to undisputed facts showing that there was little likelihood of any such deal, much less one with the terms that Baliban assumes.

Given these actual facts regarding the Eastman opportunity, Baliban's assertion that "Flint Hills nearly completed an agreement with Eastman" is unfounded. (Ex. 2, Baliban Rep. at 29-30) Baliban bases his opinion on unmemorialized conversations with a few FHR employees, but makes no effort to explain or investigate the foundation these individuals had for estimating the probability of concluding a deal with Eastman. (Ex. 5, Baliban Dep. at 233:13-234:7) Baliban also cites selected documents (Ex. 2, Baliban Rep. at 30 n. 122), but none state that *FHR*

believed an agreement had even a 50/50 chance of completion, much less that *Eastman* was willing to enter into an agreement. The evidence of Eastman's reluctance to do any deal, the preliminary nature of the discussions, and that Eastman terminated the discussions demonstrates that Baliban's reliance on cash flows from a hypothetical deal with Eastman are speculative.[3] *E.g.*, *Loeffel Steel Prods., Inc. v. Delta Brands, Inc.*, 387 F. Supp. 2d 794, 806 (N.D. Ill. 2005).

**D. Baliban Assumes Production Capacities Lower Than Those Assumed By FHR's Putative Capacity Expert.**

Finally, Baliban assumes production capacity numbers supplied by FHR's counsel that are less than the capacities calculated by Russell Ogle, FHR's proposed expert on production capacity issues. FHR's expert Ogle determined that the Joliet Plant can produce more than the production capacity numbers Baliban uses to calculate damages. Baliban's production capacity assumptions are, in short, unrelated even to the opinions reached and alleged by FHR and its other experts.

Neither Bettius nor Baliban attempted to calculate the production capacity of the Joliet Plant. (Ex. 5, Baliban Dep. at 117:14-22, 153:10-17; Ex. 8, Bettius Dep. at 92:5-22) Both rely on supposed production capacity numbers given to them by FHR's attorneys, which are 140 kmta for purified isophthalic acid (Baliban assumes 115 kmta with 140 kmta as an alternative), 65 kmta for TMA, and 48 kmta for MAN.[4] (Ex. 2, Baliban Rep. at 2 n.3; DX-2768) Baliban converted these numbers into supposed maximum effective capacities of 108.2 or 131.8 kmta for purified isophthalic acid, 56.8 kmta for TMA, and 45.2 kmta for MAN.[5] (Ex. 2, Baliban Rep. at 32-33) Consistent with the general disconnect between the conditions alleged by FHR and the loss of value Bettius calculates, Bettius does not know whether she attempted to translate the capacity numbers given to her by FHR's attorneys into effective capacities, and she is not even

[3] All of these points apply *a fortiori* to Baliban's claim that that "the Eastman project can be used as a modeling proxy for the various opportunities to absorb unutilized capacity more quickly than the baseline forecast suggests. (Ex. 2 Baliban Rep. at 30) Baliban has done nothing to support his speculative assertion that the Eastman deal, at 50% or otherwise, represents a reasonable proxy for other hypothetical upside opportunities that Baliban alleges were lost as part of the transaction.

[4] The AMDSP capacities of the production units represented in the PSA are 170 kmta for purified isophthalic acid, 71 kmta for TMA, and 51 kmta for MAN. (Ex. 1, PSA § 7.1(d)(ii))

[5] Baliban bases these conversions on the ratio for nameplate to effective capacity found in the Confidential Information Memorandum. (Ex. 21, DX-890 at 39, 72) But he provides no support for this ratio being the same at the lower capacities he assumes. *See Loeffel Steel*, 387 F. Supp. 2d at 807-10 (excluding damages expert where no competent proof supported the expert's assumption).

certain what capacities are assumed by her valuations. (Ex. 8, Bettius Dep. at 89:12-17)

The numbers assumed by Baliban are lower than those calculated by FHR's own proposed production capacity expert, Ogle. For example, Ogle states that in February 2001 and March 2003, the TMA unit achieved rates that would be 65 kmt on an annualized basis (Ex. 22, Ogle Rep. at 108-09), or more than 14% higher than what Baliban assumes. And Ogle further notes that the Joliet Plant produced more than 59 kmt of TMA in 2000 (*id.* at 102) -- several kmt in excess of the maximum capacity Baliban assumed for TMA. Ogle also determined that the MAN unit produced 48.85 kmt on an annualized basis in May 2002 and assumed it produced 47.5 kmta in May 2004 (*id.* at 118-19), or over 8% and 5% more, respectively, than Baliban's assumption. Finally, for purified isophthalic acid, Ogle's methodology results in 150 kmt on an annualized basis from actual production in September 2003, as well as production of 144 kmt on an annualized basis in August 2003. (Ex. 23, Ogle Dep. at 212:7-215:13; Ex. 24, DX-2819) This 150 kmta is almost 14% more than Baliban's 131.8 kmta assumption for the purified isophthalic acid unit's effective capacity, and is more than 38% greater than his lower assumption of 108.2 kmt. Because Baliban uses assumptions that are lower than, and contradicted by, the opinions of FHR's alleged production capacity expert, they are not based on any facts of this case and should be excluded.

**CONCLUSION**

FHR cannot establish that the opinions of either Bettius or Baliban are admissible. Both of these putative "experts" rely on assumptions that contradict the PSA, fail to apply the proper methodology, fail to explain how their methodology leads to their conclusion, and rely on assumptions that contradict both the undisputed facts in this case as well as FHR's own allegations and other proposed experts. For these reasons, the opinions of both Jeffrey Baliban and Sharon Moore Bettius should be excluded.

Date: April 10, 2009

Respectfully submitted,

/s/ R. Chris Heck
One of the Attorneys for BP Amoco and BPCNA

**CERTIFICATE OF SERVICE**

I hereby certify that on April 10, 2009, I caused a true and correct copy of the foregoing to be served electronically via the CM/ECF system on the following:

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