

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

ENTERED 10/16/03
FILED
OCT 16 2003
CLERK U.S. BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA
BY JS DEPUTY

FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

In re

LEAP WIRELESS INTERNATIONAL,
INC., and CRICKET
COMMUNICATIONS, INC., *et.al*,

Debtors.

Bankruptcy No. 03-03470-A11
through 03-03535-A11

MEMORANDUM OPINION RE:
MOTION TO STRIKE THE
REPORT AND TESTIMONY OF
BRUCE FALKENBERG

I. INTRODUCTION

MCG PCS, Inc. ("MCG PCS"), shareholder and disputed creditor of Leap Wireless International, Inc. ("Leap"), has objected to and moved to strike the expert report and testimony of Bruce Falkenberg, a witness tendered by Leap and its subsidiaries ("Debtors") to value the wireless license portfolio owned by the Debtors. Because the motion was brought for the first time during the evidentiary hearing on confirmation of the Debtors' plan of reorganization, the Court delayed ruling upon the motion and requested the filing of simultaneous briefs. For the reasons more fully set forth below, the Court grants the motion.

///

1 **II.**

2 **FACTUAL BACKGROUND**

3 The Debtors filed Chapter 11 reorganization petitions on April 13, 2003. The
4 Debtors own ninety nine wireless telecommunications licenses in markets throughout the
5 country. They operate their business through Leap's wholly-owned subsidiary, Cricket
6 Communications, Inc. ("Cricket").

7 The Debtors seek to confirm their Fifth Amended Joint Plan of Reorganization,
8 dated as of July 30, 2003 ("Plan"). The Plan provides for the Debtors' continued
9 operation of their business under the umbrella of Reorganized Leap, a private company.
10 The Plan effects a global compromise between, *inter alia*, the Debtors, Leap's
11 Noteholders and Cricket's Vendor Debt Holders. Pursuant to the compromise, the claims
12 of Leap's general unsecured creditors will be channeled to a trust which will pay them
13 approximately 13-14% of their claims, including receipt of 3.5% of the newly issued
14 common stock of Reorganized Leap. The interests of existing Leap's shareholders will
15 be cancelled, with the remaining 96.5% of the new common stock issued to Cricket's
16 Vendor Debtor Holders. The general unsecured creditors and shareholders of the
17 debtor-subsidaries receive nothing under the Plan.

18 At issue in confirmation of the Plan is not only the value of the licenses but also the
19 enterprise (going concern) value of Reorganized Leap. MCG PCS has objected to
20 confirmation, claiming the license value and the going concern value of the company is
21 far greater than the Debtors claim. Since the Plan is predicated on the assumption that
22 shareholders are "out of the money" and therefore, they should have their shares
23 cancelled, value of the licenses is an important issue in this case.

24 Bruce Falkenberg is president of Falkenberg Capital Corp., an NASD registered
25 broker/dealer specializing in telecommunications investment banking services. In that
26 capacity, the company generally and Mr. Falkenberg personally have represented sellers
27 of wireless spectrum. It is this representation of prior sellers which gives rise to the
28 problem presented in the evidentiary objection.

1 In arriving at his determination that the Debtors' ninety nine licenses should be
2 discounted an average of 70% to Auction 35 pricing,¹ Falkenberg relied on comparable
3 sales information and "term sheets" subject to confidentiality agreements with respect to
4 eighteen of those licenses. Apparently, these were license transactions in which
5 Falkenberg Capital represented one of the parties:

6 Q. Were there any other markets where you used information
7 that was subject to a confidentiality agreement?

8 A. If we went back to the schedule ... that's in the back, every
9 one where we did not disclose a price, we had information that
was subject to a confidentiality agreement. That information
informed our opinion.

10 [R.T. 108:15-21]

11 Falkenberg's expert witness report has virtually no information concerning the
12 methodology he used to arrive at the license values. At trial, Falkenberg described his
13 methodology as follows: first, a senior analyst went to the FCC website to accumulate
14 data concerning the licenses and to compile a complete list of the Debtors' licenses.
15 Next, the analyst compared the independently prepared list with the Debtors' data to
16 create an accurate list of the Debtors' licenses. At that point, the analyst priced the
17 licenses under the assumption they were in Auction 35, as a bench mark to measure
18 against, and forwarded the analysis to the managing director. [R.T. 35:3-17]

19 Thereafter, the managing director evaluated each of the licenses on a market-by-
20 market basis using the four criteria that Falkenberg believes impact value. These criteria
21 are: (1) the overall market conditions in a particular market; (2) the strategic plans of
22 potential buyers to purchase spectrum in a particular market; (3) the population size of the
23 market; and (4) the amount of other spectrum for sale in a particular market. Based upon

24 ///

25 ///

27 ¹Auction 35 was an FCC license auction concluding in January 2001 which is generally agreed
28 to be the top or highest price at which FCC licenses have sold. Their values since have declined
precipitously from that peak.

1 this criteria, the marketing director made initial judgments as to the appropriate discount
2 to Auction 35 prices for each license, and wrote a narrative for each market. [Falkenberg
3 Capital Corp. Report at Exh. 1; R.T. 35:18-25; 36:1-17]

4 This package was forwarded to Falkenberg, who reviewed each individual market,
5 and for some of the markets, adjusted the discounts based upon his personal knowledge
6 of actual price information that he was aware of. [R.T. 35:3-25, 36:1-24; 57:13-20] He
7 was unable to disclose some of this actual price information due to confidentiality
8 agreements. [See Falkenberg Capital Corp. Report at Exh. 2; R.T. 58:1-25, 59:1-21;
9 62:22-25, 63:1-18]

10 In sum, each of the licenses was discounted by a different percentage to Auction
11 35 prices based upon the managing director's initial judgments applying the four criteria
12 that impact value, and Falkenberg's additional adjustments based upon his personal
13 knowledge of actual price information. The combined analysis yielded an average
14 discount of approximately 70% to Auction 35 prices. Falkenberg guessed that the
15 majority of the managing director's initial discounts were modified to some extent by
16 him. [R.T. 56:18-25]

17 **III.**
18 **ANALYSIS**

19 As a preliminary matter, MCG PCS makes its motion to strike in part based on
20 Federal Rule Civil Procedure 26(a)(2)(B).² That rule requires that the disclosure of expert
21 testimony shall be accompanied by a written report prepared and signed by the witness.
22 The report shall contain a complete statement of all opinions and the basis and reasons
23 therefor; the data or other information considered by the witness in forming those
24 opinions; any exhibits to be used as a summary of or support for those opinions; the
25 qualifications of the witness, including a list of the publications authored by the expert;

26
27
28

² Federal Rule 26(a)(2)(B) is identical to Federal Rule Bankruptcy Procedure 7026(a)(2)(B),
which applies in Bankruptcy cases.

1 and the compensation to be paid by the expert. MCG PCS correctly points out that
2 Falkenberg's report had none of these.

3 However, the Debtors counter that the objection to the report based on its failure
4 to comply with Rule 26 is untimely as it was first made during trial. The Court agreed
5 in part with the Debtors' position, having overruled some of the objections to the report
6 based on Falkenberg's failure to sign the report and the failure of the report to comply in
7 many other respects with Rule 26.

8 Although there is scant case law concerning Rule 26 objections, generally, the
9 remedy for a deficient expert report is a motion to compel in advance of trial. *See*
10 *Intercargo Insurance Co. v. Burlington Northern Santa Fe Railroad*, 185 F. Supp. 2d
11 1103, 1107 (C.D. Cal. 2001) ("Defendants did not seek to compel a more adequate
12 disclosure within a reasonable time of service of the expert reports. Accordingly,
13 defendants may not now seek to exclude plaintiff's experts."); *see also* Schwarzer,
14 Tashima & Wagstaffe, Cal. Prac. Guide: Fed. Civ. Pro. Before Trial (The Rutter Group
15 2003), ¶¶ 11:415-418 at 11-37-11-38 (suggesting judges are not likely to exclude an
16 expert's testimony because of an insufficient expert report unless the attorney promptly
17 moved for more adequate disclosures.)

18 While in this unusual case the time to make such motions was extremely limited --
19 the expert reports were exchanged on September 8, 2003 and Falkenberg's deposition
20 taken on September 16, 2003 with trial commencing September 29, 2003 -- a motion to
21 compel could have been presented to this Court on an emergency basis. MCG PCS made
22 no effort to bring such a motion; nor did it introduce any evidence that it made any
23 informal requests for more adequate disclosures. Accordingly, the motion to strike for
24 failure to fully comply with Rule 26(a)(2)(B) has been waived.

25 ///

26 ///

27 ///

28

1 In contrast, MCG PCS' objection to Falkenberg's use of confidential information
2 to determine the appropriate discount to Auction 35 prices is not a mere Rule 26
3 objection. Rather MCG PCS' objection invokes this Court's "gatekeeping" functions
4 assigned to trial courts by *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579
5 (1993) and extended to include all non-scientific experts by *Kumho Tire Co., Ltd. v.*
6 *Carmichael*, 526 U.S. 137, 141 (1999).

7 In *Daubert*, 509 U.S. at 593-94, the Supreme Court identified four flexible,
8 nonexclusive factors for determining whether the expert's opinion is sufficiently reliable:
9 (1) whether the theory has been or can be tested; (2) whether the theory has been
10 subjected to peer review and publication; (3) when a particular technique is used, whether
11 there is a known or potential rate of error; and (4) the extent of acceptance of the theory
12 in the relevant scientific community. Further, in *Kumho Tire*, 526 U.S. at 158, the
13 Supreme Court instructed that a trial court is to use its discretion to determine what are
14 the reasonable criteria of reliability and whether the proposed testimony meets those
15 criteria based on the circumstances of that case. Finally, as observed by the Supreme
16 Court in *Bragdon v. Abbott*, 524 U.S. 624, 653 (1998), in assessing reliability the court
17 must determine whether the expert testimony has "a traceable, analytical basis in
18 objective fact."

19 In the particular circumstances of this case, we have a valuation expert who is
20 valuing the Debtors' license portfolio based on a comparable license sale analysis. As
21 more fully set forth above, Falkenberg testified each of the licenses was discounted by a
22 different percentage to Auction 35 prices based upon the managing director's initial
23 judgments applying the four criteria that impact value. Thereafter, Falkenberg made
24 additional adjustments based upon his personal knowledge of actual price information that
25 he was aware of. Some of this price information was public information; some of it was
26 not.

27 ///

28

1 At trial, Falkenberg testified the confidential information was consistent with the
2 other assumptions in his report, stating:

3 A. Those computations do include proprietary information, and
4 I mean, they track extremely well with the assumptions
throughout the report.

5 [R.T. 108:25-109:3] Of course, this testimony and the underlying assumptions were
6 never able to be tested by cross-examination. Federal Rule of Evidence 702 requires that
7 (1) the opinion be based on sufficient facts or data; (2) the testimony be the product of
8 reliable principles and methods; and (3) the witness applied the principles and methods
9 reliably to the facts of the case.³ Fed. R. Evid. 705 states that an expert may be required
10 to disclose the underlying facts or data on cross-examination. However, because of
11 confidentiality agreements, Falkenberg declined to do so at his deposition and continued
12 in his refusal at trial.

13 The Court is left with a report which inextricably relies on confidential information
14 for the conclusions reached by the witness. Falkenberg could have excluded this
15 information entirely in reaching his analysis of value. Alternatively, he could have valued
16 the confidential transactions at full Auction 35 prices to remove the confidentiality
17 infirmity.⁴ The Court and MCG PCS are left with the bare option of, to paraphrase, to
18 trust but not to verify. Although this evidence may be probative, its probative value is
19 substantially outweighed by the danger of unfair prejudice. Fed. R. Evid. 403. To cure
20 would cause undue delay and result in presentation of cumulative evidence.⁵ As stated

21 ///

23 ³ Fed. R. Evid. 702's second requirement is not in dispute here as the comparable sales analysis
24 is well-established as a valuation method.

25 ⁴In fairness, given the late challenge to the reliance on confidential information, the witness did
26 not have an opportunity to revise or recalculate his report in this manner. However, at this juncture re-
opening the evidence to allow him to cure would cause much delay and the Debtors are anxious to
proceed with their remaining evidence in support of confirmation of the Plan.

27 ⁵The Informal Vendor Debt Committee has also submitted expert testimony in support of an
28 opinion of the value of the Debtors' FCC licenses. That report has been admitted, subject to challenges
raised by MCG PCS as to the weight this Court should give it.

1 in *Kumho Tire*, opinion evidence that is connected to existing data only by *theipse dixit*
2 of the expert should not be admitted. 526 U.S. at 157.

3 Further, the Court rejects the Debtors' argument of non-materiality of the
4 confidential information. Falkenberg possessed confidential information concerning
5 eighteen of the Debtors' ninety nine licenses. This means Falkenberg used confidential
6 information which cannot be tested for roughly 18% of the Debtors' license portfolio. It
7 is irrelevant that Falkenberg now states that the confidential information caused him to
8 adjust only three of the eighteen licenses -- he claims he downward adjusted one license
9 and upward adjusted two.⁶ It is possible more of the licenses should have been adjusted
10 and the upward adjustments increased.

11 Finally, the Court is cognizant that Falkenberg's overall opinion of value is
12 generally consistent with the expert opinion submitted by the Vendor Debt Holders, and,
13 although the report is not in evidence, with the opinion of MCG PCS' own valuation
14 expert (which MCG PCS withdrew.) The Court declines Debtors' invitation to use these
15 other expert opinions to establish the non-materiality of the confidential information used
16 by Falkenberg. To do so would condone the Debtors' clear violation of the disclosure
17 obligations of Rule 26(a)(2)(B), which was added to eliminate a litigant's ability to claim
18 that materials furnished to their experts are privileged or otherwise protected when their
19 expert witness is testifying or being deposed.⁷ Further, that practice would encourage the
20 hiring of multiple experts to validate each other's methodology and conclusions, thereby
21 increasing the costs and expense of trials to the parties and the Court.

22 ///

23 ///

24
25 ⁶ See Debtors' Brief in Support of Admissibility of Falkenberg's Expert Valuation Report filed
October 7, 2003. This brief is not accompanied by a declaration from Mr. Falkenberg.

26
27 ⁷ See Advisory Comment to the 1993 Amendments to Fed. R. Civ. P. 26 (explaining: "[t]he
28 report is to disclose the data and other information considered by the expert Given this obligation of
disclosure, litigants should no longer be able to argue that materials furnished to their experts to be used
in forming their opinions ... are privileged or otherwise protected from disclosure when such persons
are testifying or being deposed.").

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

IV.
CONCLUSION

The motion to strike is granted. The expert report and testimony of Bruce Falkenberg is stricken. Falkenberg relied upon confidential information in preparing his report and in arriving at his conclusion the Debtors' license portfolio should be discounted an average of 70% to Auction 35 pricing. It denied MCG PCS the right to cross-examine Falkenberg concerning his entire methodology. Further, it prevented the Court from performing the "gatekeeping" functions which it must perform to admit his testimony. Counsel for MCG PCS is directed to prepare and lodge an order in accordance with this decision within 10 days of its entry.

Dated: 16 Oct 03



LOUISE DE/CARL ADLER, Judge
United States Bankruptcy Court