Dated: January 19, 2023
The following is ORDERED:

M. Ruthie Hagan
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re:

Ronald Keith Anderson and Case. No.: 15-21681
Carmen Webb Anderson, Chapter 7

Debtors.

Ronald Keith Anderson and
Carmen Webb Anderson,
Plaintiffs (Realigned Defendants),

v. Adv. Proc. No.: 21-00042

United States of America and
Internal Revenue Service
Defendants (Realigned Plaintiffs).

OPINION AND ORDER DENYING PLAINTIFFS'/RELAIGNED DEFENDANTS' MOTION TO STRIKE EXPERT REPORT

This matter came before the Court upon Ronald Keith Anderson's and Carmen Webb Anderson's (collectively, "the Andersons;" individually, "Mr./Mrs. Anderson") Motion to Strike Expert Report [DE 74] filed October 19, 2022, and the United States of America's and the Internal Revenue Service's ("IRS") Response in Opposition to Debtors' Motion to Strike Expert Report [DE 77] filed November 9, 2022. The Court held a hearing on November 16, 2022, and upon reviewing the supporting documentation and hearing arguments of counsel, the Court took the matter under advisement.

This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I). Accordingly, this Court has the statutory and constitutional authority to hear and determine these proceedings subject to the statutory appellate provisions of 28 U.S.C. § 158(a)(1) and Part VIII ("Bankruptcy Appeals") of the Federal Rules of Bankruptcy Procedure. This memorandum of decision constitutes the Court's findings of fact and conclusions of law under FED. R. CIV. P. 52, made applicable to this contested matter by FED. R. BANKR. P. 7052 and 9014. Regardless of whether specifically referred to in this decision, the Court has examined the submitted materials, considered statements of counsel, considered all the evidence, and reviewed the entire record of the case. Based upon that review, and for the following reasons, the Court hereby denies the Andersons' Motion to Strike Expert Report.

BACKGROUND FACTS AND PROCEDURAL HISTORY

The relevant facts, as admitted, stipulated, or otherwise agreed to between the parties, are set forth as follows. The Andersons filed a joint bankruptcy petition under Chapter 7 of the United States Bankruptcy Code on February 23, 2015. After completion of all requirements under Chapter 7, the Andersons received a discharge on June 7, 2015. On July 2, 2015, the IRS, on behalf of the United States of America, filed its Proof of Claim No. 5 in the amount of $18,067,986.87 for

income taxes accrued during the tax years 2001 to 2004 in relation to an allegedly questionable investment vehicle known as "Distressed Debt Strategy."

After the Andersons' discharge, the couple received a letter dated August 11, 2015, in which Dinita C. White, an IRS bankruptcy specialist, penned "[t]he discharge you received under Chapter 7 of the Bankruptcy Code personally discharged you from liability for certain tax debts as outlined later in this letter. This personal discharge does not apply if we later discover that you made a fraudulent return or willfully attempted to evade or defeat a tax." [DE 54] Letter from Dinita C. White, Bankr. Specialist, IRS, to the Andersons (Aug. 11, 2015). This language effectively mirrors that of 11 U.S.C. § 523(a)(1)(C), outlining exceptions to discharge.

At a time uncertain, but allegedly years after the Andersons' discharge and receipt of Ms. White's corresponding letter, the IRS informed the Andersons that it intended to assert a claim of non-dischargeability of the $18,067,986.87 debt pursuant to 11 U.S.C. § 523(a)(1)(C). Though in dispute between the parties, the exact timing of the IRS's notification is irrelevant to the immediate matter before the Court.[1]

In preparation for the impending trial, the IRS retained Dr. Michael Cragg, Ph.D. of The Brattle Group, a global economic consulting firm headquartered in Boston, Massachusetts, to prepare a report analyzing, among other things, Mr. Anderson's level of investment sophistication, due diligence standards and whether they were adhered to, and Distressed Debt Strategy's reasonable probability of pre-tax profit. The fruits of Dr. Cragg's labor produced a comprehensive 124-page exposition, 51 of which contain the substantive opinions and explanations of Dr. Cragg

[1] The timing of the notification is irrelevant insofar as it relates to the issue of whether Dr. Cragg's export report should be stricken. The Andersons have since filed a motion for summary judgment asserting various estoppel grounds based, at least in part, on the timing of the notification. The Court makes no finding in that regard.

as they relate to Mr. Anderson's investments in Distressed Debt Strategy, with the balance consisting of materials required to comply with FED. R. CIV. P. 26(a)(2)(B).

On October 19, 2022, the Andersons moved to strike Dr. Cragg's expert report, arguing that it fails to satisfy Federal Rule of Evidence 702 and the standards set forth in the Supreme Court's seminal decision in *Daubert v. Merrell Dow Pharmaceuticals, Inc.,* requiring expert testimony to be based on "scientific, technical, or other specialized knowledge" that will "assist the trier of fact to understand the evidence or to determine a fact in issue." 509 U.S. 579, 589 (1993). The Andersons then extrapolate this argument to address Dr. Cragg's four distinct opinions, devoting a subsection to arguing why each fails to satisfy *Daubert* and Federal Rule of Evidence 702, and in at least one instance, Federal Rules of Evidence 401 and 402.

In its response, the IRS contends that Dr. Cragg's expert report, being based on sound economic principles, is necessary to aid the Court in both understanding the Distressed Debt Strategy transactions so that it may make a finding on Mr. Anderson's state of mind, and the due diligence expected of a profit-motivated investor. As noted by the IRS, the Andersons do not question whether Dr. Cragg *is* an economic expert;[2] rather, they argue that his report is not relevant to the ultimate issue in this case, nor is it based on reliable, objective methodology.

At the hearing held on November 16, 2022, the Court heard arguments from counsel regarding the Andersons' Motion to Strike and the IRS's Response in Opposition. The Court took the matter under advisement for further consideration and now addresses the issue before the Court in this Opinion and Order.

[2] However, the Court recognizes that the Andersons do question Dr. Cragg's qualifications as they relate to what makes him qualified to opine that "someone who deals in airplane transactions necessarily has the background to understand foreign currency markets and foreign distressed debt" and that he "never explains how he became an expert in investor due diligence on foreign currency spread options or purchase of foreign distressed debt instruments." Defs.' Mot. to Strike Expert Report 10–12. As mentioned below, whether Dr. Cragg qualifies as an expert pursuant to Rule 702 is an issue this Court is reserving for trial.

LAW AND ANALYSIS

1. **Federal Rules of Evidence 401 and 402**

The Court recognizes that the Andersons object to Dr. Cragg's report being admitted into evidence on relevance grounds, specifically Rules 401 and 402 of the Federal Rules of Evidence. However, the Court's typical approach—and the approach it will observe in this case—is to reserve that issue for trial. Therefore, the Court makes no finding in this opinion as to whether Dr. Cragg's report is relevant pursuant to Rules 401 and 402.

2. **Federal Rule of Evidence 702 and Daubert**

Rule 702 of the Federal Rules of Evidence, promulgated by Congress in 1975, has long served as the basis upon which a witness may qualify and provide testimony as an "expert." Amended in 2000 in response to the Supreme Court's decision in *Daubert v. Merrell Dow Pharmaceuticals* and its progeny, the Rule now permits a witness qualified as an expert by knowledge, skill, experience, training, or education to provide opinion testimony if (1) the expert's scientific, technical, or other specialized knowledge assists the trier of fact in understanding the proffered evidence or determining a fact of consequence; (2) sufficient facts or data underlie the testimony; (3) reliable principles and methods provide the basis for the testimony; and (4) such principles and methods are reliably applied to the facts of the case. FED. R. EVID. 702. *See Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579; *see also Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137 (1999) (extending *Daubert's* gatekeeping function to testimony based on "technical" or "other specialized knowledge.").

It has come to the Court's attention that there are newly proposed amendments to Rule 702 set to go into effect December 1, 2023, provided they pass review by the Judicial Conference, are

approved by the Supreme Court, and are not disapproved by Congress.[3] Though not yet in effect, Rule 702 in its newest form and the associated Committee Notes may be relied upon and cited to as persuasive authority "because, as the Committee explains, they are 'simply intended to clarify' how Rule 702 should have been applied all along."[4] In fact, the United States Court of Appeals for the Fourth Circuit is among the first courts to rely on the proposed amendments. *See* Sardis v. Overhead Door Corp., 10 F.4th 268 (4th Cir. 2021). This Court is similarly persuaded by, and will observe, the amendments being made to Rule 702 from this point forward to ensure a faithful application of the proper standard.[5]

Rule 702, as it is to be amended, reads:

> A witness who is qualified as an expert by knowledge, skill, experience, training or education may testify in the form of an opinion or otherwise if the proponent has demonstrated by a preponderance of the evidence that:
>
> (a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;
> (b) the testimony is based on sufficient facts or data;
> (c) the testimony is the product of reliable principles and methods; and
> (d) the ~~expert has reliably applied~~ expert's opinion reflects a reliable application of the principles and methods to the facts of the case.

FED. R. EVID. 702. The underlined portions of the Rule reflect the changes being made by the Advisory Committee. To reiterate, these changes are not substantive; rather, they clarify how the Rule was meant to be applied since it was first amended in 2000. The new language makes clear that the burden is on the proponent to demonstrate to the Court that an expert's testimony more

[3] *Don't Say Daubert—Reviving Rule 702*, WINSTON & STRAWN LLP, June 29, 2022, https://www.winston.com/en/product-liability-and-mass-torts-digest/dont-say-daubert-reviving-rule-702.html.

[4] *Id.* (citation omitted).

[5] "Rulings that misstate the admissibility requirements have become commonplace." Lee Mickus & Abigail Dodd, *Stop Calling Them "Daubert Motions": Federal Rule of Evidence 702 and Why Words Matter*, WASHINGTON LEGAL FOUNDATION, Aug. 2021, https://www.wlf.org/wp-content/uploads/2021/08/8-21MickusDoddWebWP.pdf.

likely than not meets the four enumerated requirements for admissibility.[6] However, "proponents 'do not have to demonstrate to the judge by a preponderance of the evidence that the assessments of their experts are correct, they only have to demonstrate by a preponderance of evidence that their opinions are reliable." FED. R. EVID. 702 advisory committee's note to 2023 amendment, quoting Committee Note to the 2000 amendment to Rule 702 and *In re Paoli R.R. Yard PCB Litig.,* 35 F.3d 717, 744 (3d Cir. 1994).

In assessing proffered evidence under Rule 702, a court is tasked with "ensuring that an expert's testimony both rests on a reliable foundation and is relevant to the task at hand." *Daubert*, 509 U.S. at 597. This is accomplished by making a "preliminary assessment of whether the reasoning or methodology underlying the testimony is . . . valid." *Id.* at 592-93. *Daubert* provided instruction to guide this reliability inquiry: can the theory or technique be tested? Has it been subjected to peer review? What is its known or potential rate of error and are there methods to reduce it? Is it generally accepted in the relevant scientific community? *Id.* at 593-94. To be sure, these factors are neither exclusive nor dispositive. *Nelson v. Tenn. Gas Pipeline Co*., 243 F.3d 244, 250 n.4 (6th Cir. 2001). Many courts have concocted proprietary factors relevant to such a determination, necessitated by the fact that "those factors do not all necessarily apply even in every instance in which the reliability of scientific testimony is challenged." *Kumho*, 526 U.S. at 151; *see* FED. R. EVID. 702 advisory committee's note to 2000 amendment. The upshot is that the reliability inquiry should be a flexible one, with its "overarching subject [being] the scientific validity . . . of the principles that underlie a proposed submission . . . . [N]ot on the conclusions they generate." *Daubert*, 509 U.S. at 594-95; *see also id.* at 594 n.12. To that end, a court's

[6] This preponderance standard also applies to the requirement that a witness be qualified as an expert, which typically serves as the Court's natural starting point in conducting Rule 702 analysis. Again, the Court recognizes the competing arguments of counsel regarding Dr. Cragg's qualifications. However, this is an issue it typically reserves for trial. Therefore, the Court makes no finding in this opinion as to whether Dr. Cragg is qualified pursuant to Rule 702.

consideration of any such factors should be focused on ones that are "reasonable measures of reliability in a particular case." *Kumho*, 526 U.S. at 153.

a. **As Applied to Dr. Michael Cragg's Expert Report**

Because the burden of proof is on the proponent, it is necessary that the Court first look to Dr. Cragg's expert report and the IRS's Response in Opposition, then to the Anderson's Motion to Strike. After considering the parties' arguments, the Court must then determine whether that burden has been met.

i. **Opinion 1: Mr. Anderson was an experienced, sophisticated investor who possessed the background required to understand the pre-tax economic potential of the Distressed Debt Strategy.**

Dr. Cragg's first opinion is that Mr. Anderson was an experienced, sophisticated investor who possessed the background required to understand the pre-tax economic potential of the Distressed Debt Strategy. Affidavit/Expert Report of Dr. Michael Cragg (hereinafter "Dr. Cragg Report.") ¶ 9. He arrives at this opinion through his analysis of Mr. Anderson's career history, which involves stints at FedEx as a staff attorney from 1974 to 1979 and Director of Aircraft Acquisition and Sales from 1979 to 1991. *Id.* at ¶¶ 14-15. Aspiring to start his own business, Mr. Anderson resigned from FedEx in 1991 and established Intrepid Aviation later that year. *Id.* at ¶¶ 15-16. Intrepid's original business model was to broker deals between banks seeking to offload passenger planes due to a global downturn in the aviation market and shipping companies seeking to buy them once they were converted to cargo planes. *Id.* at ¶¶ 16-17. After two-and-a-half years of brokering these deals, Mr. Anderson decided to switch Intrepid's business model to aircraft ownership wherein rather than brokering deals between parties, Intrepid would own the converted planes it was selling. *Id.* at ¶ 18. In need of capital, Mr. Anderson became business partners with FedEx Chairman Fred Smith and former FedEx Vice President of Maintenance Jack Finley. *Id.* at

¶¶ 18-19. The capital provided by Mr. Smith allowed the newly formed Intrepid Aviation Partners to get its start in the industry, eventually conducting direct sales of A300-600s Airbuses to FedEx.[7] *Id.* at ¶ 19. In summarizing Mr. Anderson's career history, Dr. Cragg arrives at the conclusion that Mr. Anderson's "long career leading investments in aircraft shows his background and experience in identifying and executing investments." *Id.* at ¶ 20.

In analyzing Mr. Anderson's background, Dr. Cragg concludes that Mr. Anderson "grew from a corporate lawyer at FedEx to a sophisticated, high net worth investor," requiring him to (1) perform and provide oversight for due diligence procedures, which included market research of airplane sales and leasing, (2) profitability assessments, which included creating and synthesizing financial models; and (3) negotiation and contract review. *Id.* at ¶ 21. The report further elaborates on these processes, stating what was required of Mr. Anderson to conduct each. Notably, things such as the review of financial models to determine validity and profitability of a proposed transaction, oversight and management of the conversion process, and assessment of the tax effects of proposed transactions (e.g., handling of profits, interest expenses, and depreciation),[8] were routinely required in the course of Mr. Anderson's business, consuming "hundreds of man hours." *Id.* at ¶¶ 24-25, 27. All of this, Dr. Cragg opines, "mirrors the process of what a sophisticated investor would conduct when evaluating an asset-based deal like the [Distressed Debt Strategy transactions]," of which the "lessons on due diligence and sound investment analysis carried over into his personal investments." *Id.* at ¶¶ 28, 30.

[7] Citing a potential conflict of interest, Mr. Anderson would later buy-out Mr. Smith from the partnership, who was then replaced by Michael Goldberg. Dr. Cragg Report ¶ 19.

[8] The tax effects of proposed transactions "ultimately allowed Mr. Anderson to assess the potential for after-tax profitability or to determine that 'the economics of the transaction were profitable.'" *Id*. at ¶ 27. Earlier in his report, Dr. Cragg concludes that "[b]ecause the after-tax analysis he conducted and oversaw also included all of the investigations and analyses necessary for a full pre-tax analysis, Mr. Anderson had the background and experience to understand all aspects of the due diligence necessary to assess if a transaction had the potential for pre-tax profitability." *Id.* at ¶ 21.

Taking this into consideration, Dr. Cragg concludes that because the pre-tax economics of a given transaction are subsumed in the after-tax due diligence, and Mr. Anderson's career in the aviation industry centered around performing after-tax due diligence, Mr. Anderson would have simultaneously performed pre-tax due diligence. *Id.* at ¶ 31. What's more, Dr. Cragg believes that "the due diligence required to evaluate the pre-tax economics of the [Distressed Debt Strategy transactions] is much simpler than many of the due diligence processes he participated in and led throughout his career." *Id.* These facts provide support for Dr. Cragg's first opinion that Mr. Anderson had the required background to assess the pre-tax economic viability of his investments.

The Andersons object to the admission of this opinion into evidence on the grounds that it does not represent an area of knowledge that is either scientific, technical, or specialized, and that it is not based on generally accepted objective methodology. Defs.' Mot. to Strike Expert Report 9. The Andersons reduce Dr. Cragg's first opinion to being based on the following facts: Mr. Anderson (1) has a law degree; (2) served as in-house counsel at FedEx; and (3) was experienced in buying and selling airplanes. *Id.* at 10. Arguing that these facts do not require an expert witness to assist the Court, the Andersons arrive at the conclusion that Dr. Cragg "did not use any 'scientific, technical, or specialized' knowledge in reaching his opinion." *Id.* Further, they argue that Dr. Cragg's analysis is flawed because he compares the processes a rational investor would (or should) undertake in seeking to invest in Distressed Debt Strategy to the processes that Mr. Anderson regularly conducted in his course of business as an aircraft salesman without explaining how the two different transactions are related. *Id.* at 10-11.

In reading Dr. Cragg's report, it becomes clear that the Andersons' characterization of it misses the mark. While it is true, as the Andersons argue, that Mr. Anderson's sophistication is a question of fact to be decided by this Court, the Court cannot agree that it necessarily must be done

without the aid of expert testimony. Dr. Cragg's recital of Mr. Anderson's career history provides the necessary context for his broader opinion that Mr. Anderson was an experienced, sophisticated investor who possessed the background required to understand the pre-tax economic potential of the Distressed Debt Strategy. *See Schall v. Suzuki Motor of Am., Inc*., No. 4:14-CV-00074-JHM, 2020 WL 1162193, at *5 (W.D. Ky. Mar. 10, 2020) ("'However, as opposed to providing a mere factual narrative, [an] expert is allowed to articulate the "factual underpinning" upon which [he] bases [his] opinion.'" (quoting *Pledger v. Reliance Trust Co*., No. 1:15-CV-4444-MHC, 2019 WL 4439606, at *12 (N.D. Ga. Feb. 25, 2019)); *see also In re Nat'l Prescription Opiate Litig*., No. 1:17-md-2804, 2019 WL 4165021, at *3 (N.D. Ohio Sept. 3, 2019) (declining to exclude narrative expert testimony when the movant fails to identify specific testimony it seeks to exclude). In demonstrating his point, Dr. Cragg explains how the processes that Mr. Anderson conducted while working at FedEx and Intrepid Aviation are similar to, or the same as, the ones that a rational investor would generally conduct in entering into a transaction in foreign distressed debt. In so doing, he tends to demonstrate how the two different transactions could be related, contrary to the Andersons' claim that he fails to do so.

The Court is also not persuaded by the Andersons' argument that Dr. Cragg's first opinion, and the entirety of his expert report in general, is not based on scientific, technical, or specialized knowledge. Dr. Cragg holds a B.S.E. from Princeton University, an M.A. in economics from the University of British Columbia, and a Ph.D. in economics from Stanford University; served as a Professor of Economics at both Columbia University and the University of California, Los Angeles; had his research sponsored by the National Bureau of Economic Research and the National Science Foundation; and has held several high-level positions at economic consulting firms such as Bates, White & Ballentine, Cambridge Finance Partners, and now, the Brattle Group.

Dr. Cragg Report ¶¶ 1-2. He uses these experiences to form the basis of his testimony, in which he discusses items such as market research, profitability assessments, financial models, validity and profitability of economic transactions, assessment of tax effects, and pre- and after-tax due diligence. The Court believes this satisfies the requirement that Dr. Cragg's testimony is based on "scientific, technical, or specialized knowledge" that will assist in understanding the evidence or determining a fact in issue. It also believes that this testimony is based on sufficient facts or data, as Dr. Cragg routinely cites to Mr. Anderson's deposition to illustrate, in Mr. Anderson's own words, what was required of him in his roles at FedEx and Intrepid Aviation.

The Andersons' other grounds for objection is that Dr. Cragg's testimony is not based on generally accepted objective methodology. This notion of "general acceptance" served as the standard for the admissibility of expert testimony prior to the Supreme Court's decision in *Daubert*. 509 U.S. at 585. Rather than abandoning it altogether, the *Daubert* Court instead chose to retain the "general acceptance" standard as one of the four factors to guide the inquiry into the reliability of expert testimony. *Id.* at 594. As recited above, Rule 702 analysis is concerned with "ensuring that an expert's testimony . . . rests on a reliable foundation" by focusing on factors that a court believes are "reasonable measures of reliability in a particular case." *Id.* at 597; *Kumho*, 526 U.S. at 153.

The Andersons argue that "there is no reliable, objective method for determining an individual's level of sophistication" and that Dr. Cragg's opinion regarding Mr. Anderson's level of investment sophistication is "not based on sound scientific or technical principles which are capable of being reproduced by another expert in the 'field.'" Defs.' Mot. to Strike Expert Report 11. Taking it further, the Andersons argue that Dr. Cragg "is essentially guessing" and that his opinion "is entirely subjective guesswork." *Id.* However, a review of the footnotes correlating to

Dr. Cragg's conclusions on Mr. Anderson's level of investment sophistication reveal some indicia of objective methodology for determining what constitutes a "sophisticated investor." To be specific, Dr. Cragg cites criteria established by the Securities and Exchange Commission ("SEC") which, when met, constitutes such an investor.[9] The classification of an investor as "sophisticated" by the SEC is notable because "the SEC shields unsophisticated investors from high-risk, unregulated investments and only allows those who fit certain criteria, called accredited investors, to invest in higher-risk investments including early stage companies, venture capital, and hedge funds." Dr. Cragg Report n.19. Applying these criteria to Mr. Anderson in 2001, Dr. Cragg concludes that "Mr. Anderson met the standards to qualify as an accredited investor according to the SEC." *Id.* In addition, Dr. Cragg cites to a Forbes article co-authored by Rebecca Baldridge, a Chartered Financial Analyst, and Benjamin Curry, a Retirement Investing Advisor, stating that the underlying rationale of having these criteria in place is important because "wealthy, high income investors are financially sophisticated enough to understand complex, unregulated investments." *Id.*

The Court is convinced, without making a finding as to whether Mr. Anderson is, in fact, a sophisticated investor, that Dr. Cragg's conclusion is based on a reliable, objective methodology that is generally accepted in the field. The SEC is the government agency tasked with overseeing the nation's securities industry whose mission is "protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation."[10] It is the SEC that set forth an objective test as to who qualifies as a sophisticated investor. If that does not satisfy "general acceptance," then the Court does not know what will.

---

[9] *See* the financial and professional criteria for accredited individual investors set forth at SEC, https://www.sec.gov/education/capitalraising/building-blocks/accredited-investor (last visited Jan. 12, 2023).

[10] *What We Do*, SEC, https://www.sec.gov/about/what-we-do (last visited Dec. 20, 2022).

It also appears that Dr. Cragg's conclusion that Mr. Anderson is a sophisticated investor reflects a reliable application of this method to the facts of the case. Citing again to the deposition of Mr. Anderson, Dr Cragg arrives at the conclusion that "Mr. Anderson fits multiple of the [sophisticated investor] criteria including a net worth of at least $1,000,000, income of at least $300,000 for multiple years, and possession of a limited liability company with $5 million in assets." *Id.* In effect, Dr. Cragg is applying an objective test to an objective set of facts, thereby reliably applying the methodology to the facts, just as Rule 702(d) requires him to do.

As such, the Court finds that Dr. Cragg's expert report as to his first opinion demonstrates by a preponderance of the evidence that it meets the relevant requirements of Rule 702 discussed in this Opinion and Order, and is, therefore, admissible.

ii. **Opinion 2: An investor expecting to realize a pre-tax profit would be expected to conduct a standard set of due diligence to evaluate the risk and potential upside of the investment.**

Dr. Cragg's second opinion is that an investor expecting to realize a pre-tax profit would be expected to conduct a standard set of due diligence to evaluate the risk and potential upside of the investment. *Id.* at ¶ 10. He defines due diligence as "a process of verification, investigation, or audit of a potential deal or investment opportunity to confirm all relevant facts and financial information and minimize the financial, legal or other risks of an asset or investment." *Id.* at ¶ 42. Noting that due diligence factors vary between investments, he states that the process can be reduced to the following threshold question: "should a certain asset be bought (or sold, or held) at a certain price, at this time, by a certain person?" *Id.* (citation omitted).

Applying that general framework to Mr. Anderson's investment in Distressed Debt Strategy, Dr. Cragg notes important factors one should consider before investing. First, analyzing successful debt collection inputs; second, the likelihood of repayment. *Id.* at ¶¶ 44-45. As to the

former, Dr. Cragg opines that this would include analyzing a company's "overall health, and would focus on functions related to collections including credit and collection policies, management of the receivables portfolio, and invoice generation and billing practices" with an additional eye toward the seller remaining as the servicer of the account. *Id.* at ¶ 44. As to the latter, Dr. Cragg notes that when the receivables are distressed and denominated in foreign currency, as is the case with Distressed Debt Strategy, the considerations "require a deeper set of more specialized investigations that ultimately allow an investor to assess the degree of distress and likelihood that buying this debt might result in a return that would be worth the risk" and "needs to factor in the exposure to foreign currency and governments." *Id.* at ¶¶ 45-46.

Dr. Cragg then dedicates the remainder of this section to demonstrating the components of an expected due diligence process for a transaction of the nature of Distressed Debt Strategy. This would include evaluations of known outlays relative to potential returns on the investment, associated risks for non-operating expenses and income, and factors affecting the expected return. *Id.* at ¶ 47. He then provides a detailed summary of these processes. For known outlays, this would include consideration of the cost of the initial investment and any associated fees, requiring an investor to conduct research on the assets to evaluate the proper purchase price.[11] *Id.* at ¶ 48. For non-operating expenses, this would include an evaluation of the exposure to foreign currency by examining fluctuation in the ruble to U.S. dollar exchange rate, which affects the investor's pre-

[11] "Research in this area would investigate past collection activity and any ongoing collection activity. The fees required to purchase the [assets] are an important factor to an investor seeking a pre-tax profit and as a result motivate due diligence to ascertain if the investor will be able to earn enough through expected revenue and the residual sales price to expect to recoup the initial outlay. Thus in a transaction seeking to generate pre-tax profit from an investment in the [assets], I would expect an inquiry into each fee, the values or functions that are being offered, along with potential negotiations to mitigate these fees in order to improve the possibility of a pre-tax profit." Dr. Cragg Report ¶ 48.

tax profit.[12] *Id.* at ¶ 49. For factors affecting the expected return, Dr. Cragg identifies two: prior collections performed on the debt and expected residual sale price of the assets. *Id.* at ¶ 50. As to the former, an investor would be required to perform due diligence on methods of collection, who owes the debt, collection efforts to be attempted once the debt is acquired, and reasons why current collection efforts will be more successful than prior collection efforts. *Id.* As to the latter, the due diligence process "would evaluate the residual sales price expectations by factoring in the effect of any collections improvements and the market conditions at the expected time of sale." *Id.*

The Andersons similarly object to this opinion's admission into evidence on the same grounds as Dr. Cragg's first opinion, arguing that it "does not concern a 'scientific, technical, or specialized' area of knowledge" and that "there is no objective, reliable methodology generally accepted in the field for determining the appropriate amount of due diligence, if any, a hypothetical investor in the Distressed Debt strategy should complete . . . ." Defs.' Mot. to Strike Expert Report 12. Instead, the Andersons believe that this Court should make its determination as to Mr. Anderson's intent in entering the Distressed Debt Strategy transaction after Mr. Anderson, and Mr. Anderson alone, testifies as to what due diligence he did or did not do. According to the Andersons, any attempt by Dr. Cragg to qualify Mr. Anderson's actions prior to entering the Distressed Debt Strategy transaction is an "inappropriate evidentiary sleight of hand, bootstrapping an irrelevant 'due diligence' opinion into something that it is not, an opinion designed to influence an element surrounding a party's 'mental state' and intent." *Id.* at 16.

[12] "Due diligence on the potential for foreign exchange exposure would examine historical movements in the exchange rate, the expected holding period as longer holding periods mean more risk, the expected forward interest rates in each country, and subsequently the expected foreign exchange rates when the conversion back to USD from the sale of the portfolio is expected to occur. In addition, there are also geopolitical considerations, including unpredictability of actions by sovereign governments or courts to change rules of actually receiving the collected funds. These types of investigations can occur in interviews with the parties, such as Gramercy, and evaluating the types of due diligence they performed on the geopolitical risks of the Russian government prior to their acquisition of the [assets]. There are also consultancies that specialize in analyzing this type of geopolitical risks." *Id.* at ¶ 49 (citation omitted).

To begin, the Court has already stated why it believes Dr. Cragg's testimony is based on scientific, technical, or other specialized knowledge, and for the sake of brevity, it will not re-analyze that finding here, or any subsequent section of this Opinion and Order. Next, the Court does not agree with the Andersons that Dr. Cragg's second opinion as to the appropriate amount of due diligence a hypothetical investor in Distressed Debt Strategy should undertake is not based on objective, reliable methodology generally accepted in the field. Dr. Cragg cites to multiple authorities on the subject, including *The AMA Handbook of Due Diligence* by William M. Crilly and Andrew J. Sherman, *Security Analysis* by Benjamin Graham and David Dodd, *Structured Finance: Trade Receivable Criteria* by Standard & Poor's Rating Services, *Distressed Debt Analysis: Strategies for Speculative Investors* by Stephen G. Moyer, and *Due Diligence in Acquiring Distressed Debt* by Russell Bershad, among others. *See, e.g.*, Dr. Cragg Report ¶ 42, 44-45 nn.49-60.

As the IRS points out, at least one of these treatises, *Security Analysis*, has been relied on by federal courts for more than 70 years, *see Niagara Hudson Power Corp. v. Leventritt*, 340 U.S. 336, 346 nn.6-7 (1951), and another, *Structured Finance Trade Receivable Criteria*, is authored by Standard & Poor, one of the big three credit rating agencies that "is a market leader in the provision of financial market analysis."[13] In any event, Dr. Cragg utilizes each one of these sources to set forth the definition of due diligence, factors an investor should consider in conducting due diligence, examples of due diligence in action, and evaluations an investor should make in entering certain transactions. Dr. Cragg Report ¶¶ 42, 44-50. These are not benchmarks that Dr. Cragg has made up out of whole cloth, but rather are objective standards established by leaders in the

[13] CFI Team, S&P—Standard & Poor's: A Complete Overview of all Standard and Poor's Products, Corporate Finance Institute, https://corporatefinanceinstitute.com/resources/fixed-income/sp-standard-poors/ (last updated Oct. 13, 2022).

industry. That is, they are objective, reliable methods generally accepted in the field of economics, as Rule 702 requires.

After describing the due diligence process as it relates to receivables, distressed assets, and assets denominated in foreign currency, Dr. Cragg states "[i]n the case of . . . Distressed Debt Strategy, a due diligence process would have combined the due diligence required for [all three]. *Id.* at ¶ 47. He then demonstrates "components of what an expected due diligence process should have been for the Distressed Debt Strategy in order to evaluate its pre-tax economics" by applying the principles and methods derived from the above-mentioned sources, drawing on his detailed explanation of the Distressed Debt Strategy earlier in his report. *Id.*; *see also id.* at ¶¶ 32-41. Taking the two together, the Court concludes that Dr. Cragg's testimony is based on sufficient facts or data, is the product of reliable principles and methods, and his opinion reflects a reliable application of those principles and methods to the facts of the case.

The Andersons also argue that Dr. Cragg's report is "of no use to the court" because "it is internally inconsistent." Defs.' Mot. to Strike 13. To support this claim, the Andersons point to Dr. Cragg's description of the due diligence required of Distressed Debt Strategy as "fairly simple" involving a "cursory investigation," which they believe is contradicted by the fact that Dr. Cragg needed 51 pages of narrative, 50-plus graphs and flow charts, 27 pages of "additional information," and another 31 pages of "documents considered" that consists of a total of 4,320 documents to illustrate his opinion. *Id.* at 13-14. This is evidence, in the Andersons' opinion, that they could not have possibly understood or have been reasonably expected to self-analyze their investments in Distressed Debt Strategy as ostensible laypeople. *Id.* at 15. Without wading into whether the Andersons understood the ramifications of their investments, the Court is of the opinion that the Andersons' argument in this regard demonstrates exactly why Dr. Cragg's expert report is

necessary—it helps the Court, as a layperson, to understand the evidence or to determine a fact in issue in accordance with Rule 702(a).

Finally, the Andersons' contention that "opinions on intent are not the type of scientific, technical, or specialized knowledge which the Federal Rules of Evidence mandate for an expert's opinion to be admissible" is factually correct. *Id.* at 13, citing *Secs. Inv'r Prot. Corp. v. Bernard L. Madoff Inv. Secs. LLC,* 581 B.R. 370, 380 (Bankr. S.D.N.Y. 2017). However, the Court does not agree with the Andersons that Dr. Cragg is attempting to "bootstrap a non-issue" or perform an "inappropriate evidentiary sleight of hand" by simply reciting expected due diligence standards for entering Distressed Debt Strategy transactions and opining whether they were followed by the Andersons. Defs.' Mot. to Strike 16. After a thorough review of Dr. Cragg's expert report, the Court has not identified a single instance in which he attempts to usurp the role of this Court, as finder of fact, in applying the law to the facts before it. *Weisfelner v. Blavatnick (In re Lyondell Chem. Co*.), 558 B.R. 661, 666 (Bankr. S.D.N.Y. 2016) (citing *Highland Capital Mgmt., L.P. v. Schneider*, 379 F.Supp.2d 461, 468 (S.D.N.Y. 2005)). Dr. Cragg is free to opine, as he has been hired to do, on these due diligence standards, just as Mr. Anderson is free to testify as to what due diligence he did or did not perform—the two are not mutually exclusive. At the conclusion of the trial, this Court, taking into consideration the arguments of counsel, will exercise its power to determine which party ultimately prevails on the issue.

Therefore, the Court finds that Dr. Cragg's expert report as to his second opinion demonstrates by a preponderance of the evidence that it meets the relevant requirements of Rule 702 discussed in this Opinion and Order, and is, therefore, admissible.

iii. **Opinion 3: Neither Mr. Anderson nor his associates conducted the analysis that would be expected from an investor seeking to profit from his investment in the Distressed Debt Strategy before consideration of taxes.**

Dr. Cragg's third opinion is that neither Mr. Anderson nor his associates conducted the analysis that would be expected from an investor seeking to profit from his investment in the Distressed Debt Strategy before consideration of taxes. Dr. Cragg Report ¶ 11. Such an analysis would have included obtaining information on known outlays,[14] expected non-operating expenses or income,[15] investigation into expected returns (including collections or changes in the fair market value of the receivables during Mr. Anderson's holding period),[16] and a valuation and/or negotiation of the receivables disposition price.[17] *Id.* at ¶ 51a-d. According to Dr. Cragg, "it would have taken just a cursory due diligence investigation to reveal that this was not a pre-tax investment that could reasonably be expected to generate a profit." *Id.* at ¶ 53. He arrives at this conclusion by combining the amount Mr. Anderson paid for the receivables ($139,050 for the 2001 transaction; $196,939 for the 2002 transaction) with the associated fees ($890,000 for the 2001 transaction; $425,000 for the 2002 transaction), stating that "[Mr. Anderson] would have had to

[14] "This might have involved performing research or valuation analyses to estimate the value of the debt when it was acquired, or negotiating with Gramercy on the price relative to their expectation about its value." Dr. Cragg Report ¶ 51a.

[15] "Which . . . would have involved an investigation into the foreign exchange and sovereign risk, including forming an opinion about the forward rates on the RUB/USD exchange rate during Mr. Anderson's expected holding period, and evaluating any political risks with debt collection in Russia." *Id.* at ¶ 51b.

[16] "[There is] a lack of evidence that [Mr. Anderson] investigated changes in value due to collection improvements, or market conditions such as the interest rate environments or the expected foreign exchange rate, type of debt, the borrowers, the history of the debt, the collection process that had been conducted to-date, and the additional collection efforts that would commence upon their investment in the Receivables." *Id.* at ¶ 51c.

[17] "This might have involved a valuation on the assets and negotiation of its sale price to maximize the Anderson Receivables Disposition Price." *Id.* at ¶ 51d.

believe he could acquire an asset for [a fraction of] the return he would be able to realize from it to begin to make a pre-tax profit."[18] *Id.* at ¶ 53-54.

Dr. Cragg continues, "[t]he only ways to realize a pre-tax return on the [Distressed Debt Strategy transactions] were to collect on the debts or sell the assets at a higher price," which in his opinion, are areas that any profit-motivated investor would have investigated prior to entering a transaction of this nature. *Id.* at ¶ 55. Further, Dr. Cragg notes that an investor expecting to realize a profit on this type of transaction must believe either that the investor paid far below the asset's fair market value or that the asset's value would experience a significant increase during the investor's period of ownership against market expectations. *Id.*

Regarding the fair market value, Dr. Cragg writes "willing, well-informed unrelated parties will generally transact assets at a price which is consistent with an asset's expected cash flows." *Id.* at ¶ 56. This "cash flow" is generated either through collections[19] or re-sale,[20] the expectations of which form the basis for calculating the asset's fair market value, "meaning a rational investor

---

[18] One-seventh for the 2001 transaction; one-third for the 2002 transaction.

[19] Analyzing the collections path to pre-tax profit, Dr. Cragg opines that "a rational investor would examine the likelihood of collecting on the underlying debt, and the expected cash flow resulting from those collections." Dr. Cragg Report ¶ 57. In addition, the investor would also verify the existence of an appropriate collections infrastructure, and whether that infrastructure was likely to obtain a better return than previous efforts. *Id.* at ¶ 58. Dr. Cragg then cites to the "Collection and Servicing Agency Agreement between GRAMERCY ADVISOR and OAO SARATOV ENERGO," the terms of which provided to the collections agent 75% of the collections return after the first 10%. *Id.* at ¶ 59. These terms meant that Mr. Anderson was only entitled to a 32.5% return on his investment, significantly limiting its upside. *Id.* Describing this agreement as "onerous," Dr. Cragg then states that he has "seen no evidence that [Mr. Anderson] or his associates attempted to negotiate the terms." *Id.*

[20] Analyzing the re-sale path to pre-tax profit, Dr. Cragg opines that "a rational investor [would] consider the original sale price of the [assets] and the price paid for his interest in the [assets]." *Id.* at ¶ 60. To that end, Dr. Cragg explains that the Distressed Debt Strategy transactions were conducted at arms-length with no reason for two unrelated parties (Gramercy and the Russian energy companies) to sell the assets above or below their fair market value. *Id.* This analysis, which Dr. Cragg believes is both necessary for a profit-motivated investor and simple to perform and understand, demonstrates that "it was virtually impossible that Mr. Anderson could have recouped his initial known outlay of the Distressed Debt Strategies before consideration of taxes." *Id.* at ¶ 61.

seeking to earn a pre-tax return from their acquisition should perform due diligence on those items to ascertain what he should pay for the [assets]." *Id.* at ¶ 57.

To conclude his third opinion, Dr. Cragg states that given Mr. Anderson's pre-tax loss in the 2001 Distressed Debt Strategy transaction, "the due diligence burden on him to uncover the pre-tax economics on the similar 2002 Transaction was even higher if he was truly motivated by the pre-tax return." *Id.* at ¶ 62. Further, not only should Mr. Anderson have conducted due diligence on the 2001 and 2002 transactions separately, but he "should have conducted due diligence on why the 2001 Transaction resulted in such a loss, and despite their similarities, what differences might be conducted in the 2002 collection efforts." *Id.* According to Dr. Cragg, "[t]here is no evidence that Mr. Anderson made such an investigation." *Id.*

The grounds on which the Andersons object to the admission into evidence of Dr. Cragg's third opinion appears to be that the Andersons' level of due diligence in investing in Distressed Debt Strategy is not at issue and that Dr. Cragg improperly fails to account for the obvious alternative explanation that the Andersons relied on BDO, Gramercy, and other recognized experts in the field of investments. Defs. Mot. to Strike 16-17.

As to the first, the Andersons believe this opinion implies they "should not have let themselves be defrauded by BDO and the other professionals they relied upon" and that Dr. Cragg "expresses no opinion on what due diligence, if any, was undertaken by Gramercy Advisors, when selecting the specific distressed debt investments in question." *Id.* at 16. The Court recognizes the nuances of this case as it relates to other involved parties; however, the ultimate issue in this adversary proceeding is whether the Andersons either filed a fraudulent return or willfully attempted to evade or defeat a tax pursuant to 11 U.S.C. § 523(a)(1)(C) such that they may, or may

not, be obligated to pay the disputed debt. To that end, the Court finds it perfectly acceptable for Dr. Cragg, an expert hired by the IRS, to opine on issues potentially relevant to that determination.

As to the second, the Andersons argue that Dr. Cragg "ignores the fact that Mr. Anderson was relying on [BDO and Gramercy], who at the time were the premier institutions in their fields." *Id.* at 17. Whether an expert has adequately accounted for obvious alternative explanations is a factor that some courts have considered to assess the reliability of expert testimony. *See* FED. R. EVID. 702 advisory committee's note to 2000 amendment, citing *Claar v. Burlington N.R.R.,* 29 F.3d 499 (9th Cir. 1994) and *Ambrosini v. Labarraque,* 101 F.3d 129 (D.C. Cir. 1996). The Court finds that any such failure on the part of Dr. Cragg to account for an alternative explanation presents a question of weight to be accorded to his testimony, and not a question of admissibility. *Ambrosini,* 101 F.3d at 140.

With that in mind, the Court finds that Dr. Cragg's third opinion is the product of reliable principles and methods that reflect a reliable application of the same to the facts of the case. In formulating this opinion, Dr. Cragg employs sound mathematical principles combined with definitions of "fair market value" and "worth" derived from authorities in the field to demonstrate that Mr. Anderson would have had to believe that he could acquire these assets anywhere from one-third to one-seventh of the value he would be able to realize from them before he could make a pre-tax profit.

For example, Mr. Anderson paid $890,000 in fees for the right to acquire $139,050 in foreign distressed debt, bringing the total price tag for the investment to $1,029,050. Dr. Cragg Report ¶ 53. Dr. Cragg then divides the total price by the fair market value of the debt to generate

a figure of 7.38.[21] *Id.* To arrive at the conclusion that this expectation was unrealistic, Dr. Cragg considers the Organization for Economic Cooperation and Development's definition of "fair market value," which is "[t]he price at which an asset would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." *Id.* at ¶ 56 n.70. According to Dr. Cragg, one approach to estimate fair market value is to examine an asset's expected "cash flow," which is reflected by the price paid for an asset. *Id.* (citation omitted). In the words of Dr. Cragg, "[a] profit-maximizing buyer is not willing to pay more for an asset than its cash flows are worth, while a profit-maximizing seller is not willing to accept a price below what the cash flows are worth." *Id.* This means that "willing, well-informed unrelated parties will generally transact assets at a price which is consistent with an asset's expected cash flows." *Id.*

Without agreeing whether Dr. Cragg's opinion is correct, the Court believes that this one example—of which there are multiple—demonstrates a reliable principle or method that reflects a reliable application of the same to the facts of the case. Moreover, it is based on sufficient facts or data, as Dr. Cragg uses concrete numerical figures borrowed from the consulting agreement between IAP Holdings, LLC and BDO Seidman, that will assist this Court in its determinations. Therefore, the Court finds that Dr. Cragg's expert report as to his third opinion demonstrates by a preponderance of the evidence that it meets the relevant requirements of Rule 702 discussed in this Opinion and Order, and is, therefore, admissible.

[21] "The multiple required to breakeven is calculated as: (investment + fees) / (investment). For the 2001 investment this calculation is ($139,050 + $890,000) / $139,050 = 7.38x. In 2001, Mr. Anderson would need a 7.38x return on his known outlay to begin to make a pre-tax profit." *Id.* at ¶ 53 n.65.

iv. **Opinion 4: Mr. Anderson's investments in the Distressed Debt Strategy in both 2001 and 2002 lacked any reasonable probability of pre-tax profit.**

Dr. Cragg's fourth opinion is that Mr. Anderson's investments in the Distressed Debt Strategy in both 2001 and 2002 lacked any reasonable probability of pre-tax profit. He subdivides this opinion into three parts. *Id.* at ¶ 12; *see id.* at ¶¶ 63-97.

Mr. Anderson's investments in the Distressed Debt Strategy in 2001 and 2002 had no reasonable possibility of pre-tax profit. Here, Dr. Cragg denotes the U.S. dollar face value of the assets, which was $2,488,799 in 2001 and $3,575,676 in 2002. *Id.* at ¶ 63. As previously noted, the terms of the collection agreement limited Mr. Anderson's return on these investments to 32.5%. Mr. Anderson's return was further limited by another agreement in which Gramercy charged a 20% "performance fee" for the management of Mr. Anderson's investment, thereby limiting Mr. Anderson's total potential collection to 26% of the U.S. dollar face value.[22] *Id.* at ¶ 64. Given these terms, and disregarding the tax benefits, "it is virtually impossible that Mr. Anderson would recoup the value of his initial investments plus fees." *Id.* at ¶ 65.

Dr. Cragg then provides multiple tables illustrating the investments, which includes various expenses,[23] and makes two assumptions: all collections occurred immediately and breakeven exchange rate movements and collection rates. *Id.* at ¶ 67. Further assuming an excessive collection rate increase to 30% during Mr. Anderson's holding period, Dr. Cragg states that the ruble to U.S. dollar exchange rate would have to significantly appreciate before an investor could recover its investment and realize a pre-tax profit. *Id.* at ¶ 68. For the 2001 transaction, the exchange rate

[22] Though not quantified by Dr. Cragg, it appears that Mr. Anderson was limited to collecting $647,087.74 on his 2001 investment and $929,675.76 on his 2002 investment, for a total of $1,576,763.50. This is assuming, of course, that Mr. Anderson was 100% successful in his collection efforts on the purchased debt.

[23] The Anderson Receivables Acquisition Price, consulting fees paid to BDO for the Distressed Debt Strategy, legal fees paid to DeCastro West and Proskauer Rose, the impact of the Collection and Servicing Agency Agreement, and the 20% performance fees paid to Gramercy. Dr. Cragg Report ¶ 66.

would need to move from 30 rubles per U.S. dollar to 9 rubles per U.S. dollar; for the 2002 transactions the exchange rate would need to move from 32 rubles per U.S. dollar to below 25 rubles per U.S. dollar. *Id.* at ¶ 69. However, this ran contrary to market expectations, as the ruble was expected to decrease in value both short- and long-term. *Id.* According to Dr. Cragg, this sort of speculation on the volatility of foreign currencies and variable exchange rates is better suited for investments in capital markets rather than distressed debt. *Id.* Concluding this sub-opinion, Dr. Cragg states that a rational investor could not have reasonably expected to obtain a pre-tax profit given the miniscule chance of both an increased collection rate and a large appreciation in the ruble, and he found no evidence that Mr. Anderson reviewed either prior to his 2001 and 2002 investments. *Id.* at ¶ 70.

Only after consideration of taxes does Mr. Anderson recover the transaction costs and generate a profit from the Transactions. Factoring in the tax benefits of the Distressed Debt Strategy transaction, in Dr. Cragg's opinion, makes clear why a rational investor would enter a transaction that is nearly guaranteed to lose money before taxes. *Id.* at ¶ 71. The generated losses can be used to offset taxes one would otherwise be required to pay, and in Mr. Anderson's case were used to offset taxes on capital gains (20% in 2001 and 2002) and ordinary income (39.1% in 2001 and 2002 for the top marginal rate). *Id.* After inputting these values, Dr. Cragg generates a minimum and maximum value for the tax benefits and after-tax profits for Mr. Anderson's investments. The tax benefit itself was worth somewhere between $6,240,685 and $12,200,540, which would generate an after-tax profit in the range of $4,926,632 and $10,886,487. *Id.* at Table 5. According to Dr. Cragg, "[t]hese benefits were known prior to the outset of the [Distressed Debt Strategy transactions], and from an economic perspective, explain why a rational investor might

invest so heavily in a portfolio of dated foreign receivables with high fees and no reasonable possibility of profiting outside of taxes." *Id.* at ¶ 73.

The Lehman Brothers and Refco Offsetting Option Pairs were designed and implemented to absorb the tax loss claimed by Mr. Anderson from the Distressed Debt Strategy. The third sub-opinion begins with Mr. Anderson's 2001 and 2002 investments in offsetting option pairs through IAP Holdings, LLC. Dr. Cragg describes these investment vehicles as "options written . . . on the same underlying securities, having the same notional amounts and expiration dates, with Mr. Anderson taking opposing and offsetting positions in each, save for a small spread between the strike prices which he could potentially profit on." *Id.* at ¶ 74. He details four separate options that Mr. Andersons transacted—2001 Russian Offsetting Option Pair, 2001 Mexican Offsetting Option Pair, 2002 Yen Offsetting Option Pair, and 2002 Offsetting Peso option Pair. After providing an overview of each, Dr. Cragg discusses minimum mandated collateral and margin requirements that Mr. Anderson would have been obligated to abide by if the option pairs were classified as independent securities and not a part of a net position. *Id.* at ¶¶ 76-86. Because Mr. Anderson did not post collateral, nor was he contractually required to do so, with the counterparty banks, the options were considered "economically intertwined." *Id.* at ¶ 74; *see also id.* at ¶¶ 87-93. Next, Dr. Cragg demonstrates the limited payoff of the offsetting options, which had the effect of reducing the net economic value of his contributions to IAP Holdings, LLC to closer resemble the net premia paid for the options and not the claimed losses they enabled—a figure that is at least 80 times higher. *Id.* at ¶¶ 75, 94-95; *see also id.* at Table 10. Finally, he discusses that although the investments in the offsetting option pairs and Distressed Debt Strategy bear a relation on an after-tax basis, any pre-tax benefit from the offsetting option pairs did not neutralize expected losses and lack of pre-tax profit potential from Distressed Debt Strategy. *Id.* at ¶ 96-97.

The Andersons object to Dr. Cragg's fourth opinion's admission into evidence on the grounds that it is not relevant to this case and does not assist the Court in determining a fact in issue.[24] Defs.' Mot. to Strike 18. Their basis for this objection, especially as it goes to relevancy, is that "[t]he economic outcome of the Distress [sic] Debt Strategy is not in dispute. It has already been determined that the deductions generated by the investments were not legitimate and those deductions have been disallowed." *Id.* In arguing their point, the Andersons contend "[s]ince Dr. Cragg cannot opine on the Andersons' state of mind at the time of investing, Dr. Cragg's opinion is not necessary to aid the Court on that issue." *Id.* In addition, they state "[t]he only reason the IRS offers Dr. Cragg's opinion on this issue is to suggest that the Andersons must have or could have realized [that Distressed Debt Strategy would generate substantial loss deductions disallowed by the IRS] . . . and therefore had the necessary intent to evade their taxes." *Id.*

Again, the Court fails to make the correlation the Andersons wish it to make. The known economic outcome of Distressed Debt Strategy (i.e., with the benefit of hindsight) is an entirely different issue than what Dr. Cragg is opining on, which is what a rational investor would (or should) have done prior to investing in Distressed Debt Strategy—and more importantly, prior to knowing the outcome of that investment. While it may be undisputed that Distressed Debt Strategy "generated substantial loss deductions which were disallowed by the IRS," *id.*, what continues to be in dispute is whether the Andersons either filed a fraudulent return or willfully attempted to evade or defeat a tax pursuant to 11 U.S.C. § 523(a)(1)(C). One line of inquiry into making this determination is whether the transaction enjoyed economic substance, because "[a] transaction that lacks economic substance is a 'sham.'" *Kerman v. C.I.R.*, 713 F.3d 849, 864 (6th Cir. 2013)

23. It is not clear whether this specific relevancy argument relates to Federal Rules of Evidence 401 and 402, as the Andersons do not cite to either in making their objection. To the extent that it may, the Court reserves that issue for trial and makes no finding at this time.

(citation omitted). The standard for deciding what constitutes a sham transaction "is whether the transaction has any practicable economic effects other than the creation of income tax losses." *Id.* (citation omitted). In this case, it is Dr. Cragg's opinion that the Andersons' investments in Distressed Debt Strategy lacked any reasonable probability of pre-tax profit. To that end, Dr. Cragg's expert report will assist the Court in making its determination.

Further, the Court renews its disagreement with the Andersons that Dr. Cragg attempts to opine on Mr. Anderson's state of mind. If the extent of the Court's inquiry were as simple as taking Mr. Anderson at his word, as the Andersons have previously suggested, "determining whether he acted with fraudulent intent [would be] difficult." *Sicherman v. Rivera (In re Rivera)*, 356 B.R. 786 (B.A.P. 6th Cir. 2007). Because this is so, the Bankruptcy Appellate Panel of this Circuit has permitted courts within its jurisdiction to infer fraudulent intent from the surrounding facts and circumstances, taking into account the "whole pattern of conduct" to support a finding. *Id.* (citations omitted). Mr. Anderson's pattern of conduct, combined with what that pattern of conduct would (or should) have been, is the very subject of Dr. Cragg's expert report. Therefore, the Court does not find that Dr. Cragg's testimony is improper in this regard. The Andersons, however, are not without recourse. Should he testify at trial, to the extent that Dr. Cragg purports to opine as to Mr. Anderson's mental state, the Andersons would be well within their rights to object.

The inquiry does not end here; Dr. Cragg's fourth opinion must independently meet the admissibility standards of Rule 702. The Court has already determined that Dr. Cragg's expert report is based on scientific, technical, or other specialized knowledge, and made a specific finding as to whether this opinion will assist this Court in determining a fact in issue. Having answered in the affirmative, there are three remaining bars to admissibility: whether Dr. Cragg's fourth opinion

is based on sufficient facts or data; is the product of reliable principles and methods; and reflects a reliable application of the same to the facts of the case.

In this section of Dr. Cragg's report, he again uses concrete numerical figures that reflect the U.S. dollar face values of Mr. Anderson's investments in addition to fee percentages detailed in agreements to which Mr. Anderson was a party. Employing simple mathematical principles, Dr. Cragg demonstrates what he characterizes as the "limited . . . potential of the Anderson [assets]." Dr. Cragg Report ¶ 64. In addition, he uses graphs to illustrate what the ruble to U.S. dollar exchange rate was at the time of the investment and what it would need to be in order for the Andersons to "break even" on their investment. *Id.* at Figure 2, 3. In fact, he employs the use of graphs and charts throughout this section of his expert report, using accurate figures, to demonstrate things such as the Andersons' pre- and after-tax profits, Russian and Mexican bond options, Yen and Peso offsetting option pairs, and foreign currency exchange rates, among other things. *See id.* at Section V. Interspersed throughout the visual aids are citations to recognized authorities in the economics arena, such as Bloomberg, *Derivatives: Valuation and Risk Management* by David A. Dubofsky and Thomas W. Miller, Jr., to explain options and initial and maintenance margins, *Fundamentals of Futures and Options Markets* by John C. Hull, the Chicago Board Options Exchange Margin Manual to describe "naked" options, and the Financial Industry Regulatory Authority regulations. *Id.* at ¶¶ 87-93 nn.96-104.

Upon review, the Court finds that Dr. Cragg's fourth opinion contained in his expert report demonstrates by a preponderance of the evidence that it is one that is based on sufficient facts or data, is the product of reliable principles and methods, and reflects a reliable application of those principles and methods to the facts of the case. It is therefore admissible.

CONCLUSION

For the reasons stated herein, the Court hereby denies the Andersons' Motion to Strike Expert Report. Having satisfied all requirements of Rule 702 considered in this Opinion and Order, Dr. Michael Cragg's expert report is hereby conditionally admitted into evidence. The Court restates that it is reserving issues related to Federal Rules of Evidence 401, 402, and whether Dr. Cragg is qualified as an expert by knowledge, skill, experience, training, or education pursuant to Rule 702 of the same.

IT IS SO ORDERED.

The Bankruptcy Court Clerk shall serve a copy of this Opinion and Order on the following interested parties:

Ronald Keith Anderson and Carmen Webb Anderson
Realigned Defendants
1855 Enclave Hollow Lane East
Germantown, TN 38139

Mr. Michael P. Coury, Esq.
Mr. Ricky Hutchens, Esq.
Attorneys for Realigned Defendants
6000 Poplar Avenue
Suite 400
Memphis, TN 38119

Mr. William J. Harrington, Esq.
Attorney for Realigned Plaintiff
Trial Attorney, Tax Division
U.S. Department of Justice
P.O. Box 227
Washington, D.C. 20044

Ms. Elisabeth Bruce, Esq.
Attorney for Realigned Plaintiff
Trial Attorney, Tax Division
U.S. Department of Justice
555 4th St. N.W.
Washington, D.C. 20001