
Financial Expert Exclusions in Lost Profit Cases

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The numbers don't lie
...we tell their story.

Agenda

- What's driving successful and unsuccessful motions to exclude financial experts
- Tips to protect your expert from *Daubert* and other challenges
- Things to watch for in opposing expert's report that courts have latched onto in granting motions
- Weight v. exclusion

“It is not unusual for the opinions of the experts to differ by a factor of ten. It is, therefore, not surprising that courts have evidenced frustration with this process.”

The Shareholders' Appraisal Remedy and How Courts Determine Fair Value, 47 Duke L.J. 613, 629 (1998)

“Accordingly, perhaps I should consider myself fortunate, since the experts in this case vary by a factor of only about five (\$9 million at bottom; \$48 million at top).”

Kaplan v. First Hartford Corp. --- F.Supp.2d ----, 2007 WL 973941 (D.Me. Apr 02, 2007)

For all those reasons experts are so far apart...

The courts are exercising their gate-keeping role

- In 2007, 41% of all challenges to financial experts were successful at excluding the expert's testimony in whole or in part.
- 70% of exclusions target plaintiff's experts
 - *2000-2007 Financial expert witness Daubert study* by PricewaterhouseCooper (PwC), http://www.pwc.com/en_US/us/forensicservices/assets/2000_2007_daubert_study.pdf

Are there legitimate reasons
for experts to be that far
apart?

Are there **illegitimate**
reasons for experts to be that
far apart?

The Bottom Line

Although certainly at the extreme end of exclusion...

- An expert cannot use “accounting alchemy” to transform a “humble enterprise” into “an engine of commerce.”

Sostchin v. Doll Enterprises, Inc., 847 So.2d 1123, 1129 (Fla. 2003).

Vast majority of experts...

- Believe they act with the utmost integrity
- Believe they are highly qualified to do what they do
- Believe they do a thorough job

Common litigation strategy...

- “...securing credible scientific testimony and challenging your opponent’s experts is critical to success.”
 - “Evidence Sooner: Moving Daubert to an Earlier Stage of Litigation”, Cooner & Riester, 5/22/09, *Daubert* on-line

- Why?

- Exclusion of the expert can cause a case to succeed or fail
 - And lead to early disposition

Basic Legal Predicate for Expert Exclusion

Federal Rule of Evidence 702: Testimony by Experts

- If scientific, technical, or other specialized knowledge **will assist the trier of fact to understand the evidence or to determine a fact in issue**, a witness qualified as an expert by knowledge, skill, experience, training or education, may testify thereto in the form of an opinion or otherwise if (1) the testimony is based upon **sufficient facts or data**, (2) the testimony is the product of **reliable principles and methods**, and (3) the witness has applied the principles and methods **reliably to the facts of the case**.

Expert testimony

- “if improperly admitted, expert testimony poses grave risks to the integrity of the trial process”
 - *Daubert*, 509 U.S. at 595
 - ...not surprising to see higher likelihood of exclusions in jury v. bench trials
- Courts increasingly taking control of the use of scientific and expert testimony in the courtroom.
 - “Evidence Sooner: Moving Daubert to an Earlier Stage of Litigation”, Cooner & Riester, 5/22/09, *Daubert* on-line

Basic Legal Predicate for Expert Exclusion

- *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 589 (1993)
 - Trial judge's responsibility with regard to expert opinions is to “ensure that any and all scientific testimony or evidence admitted [at trial] is not only **relevant, but reliable.**”
 - *Daubert* requires the trial judge to make a preliminary assessment of “whether the reasoning or methodology underlying the testimony is scientifically valid and of whether that reasoning or methodology properly can be applied to the facts in issue” in the case.

Basic Legal Predicate for Expert Exclusion

■ **Joiner** (1997)

- A court may conclude that there is simply too great an analytical gap between the data and the opinion proffered.
- *Emphasizes the **need for a connection between the method and opinion**, which is more likely a basis for excluding an expert than the Kumho decision*
- *Although Khumo is credited for bringing financial testimony to the realm of Daubert, this case may have more practical effect on financial experts*

General Electric Co. v. Joiner, 522 U.S. 136, 146 (1997).

Basic Legal Predicate for Expert Exclusion

■ ***Kumho* (1999)**

- the trial judge's general 'gatekeeping' obligation -- applies not only to testimony based on 'scientific' knowledge, but also to testimony based on 'technical' and 'other specialized' knowledge

Kumho Tire Co. v. Carmichael, 526 U.S. 137

“Frye rule”

■ ***Frye (1923)***

- “the opinion be based upon a principle or discovery that is “sufficiently established to have gained general acceptance in the particular field in which it belongs”

Frye v. United States, 54 App. D.C. 46 (1923) overruled by, *Daubert*, 509 U.S. at 584-87.

14 states still follow *Frye* in whole or in part. 20 others either expressly reject *Daubert*, refer to their state rules of evidence, or something else entirely, accept *Daubert* only in part, or have not yet addressed it.

Weight of testimony v. Exclusion

- “The task for the district court in deciding whether an expert’s opinion is reliable...”:
 - “...not to determine whether it is correct...
 - ..but rather to determine **whether it rests upon a reliable foundation, as opposed to, say, unsupported speculation.**”
 - “**...rejection...is the exception rather than the rule...**”
 - “**We will permit testimony based on allegedly erroneous facts when there is some support for those facts in the record.**”

In re Scrap Metal Antitrust Litigation, 527 F.3d 517 (6th Cir. 2008)

Distinction between...

- Misapplication or mis-used factual data
 - Tends to go to **weight** of testimony
- Pulling out of thin air (speculation, conjecture, unsupported conclusions)
 - Greater tendency toward **exclusion**

Deposition questions then tend to be factual/evidence based:

- *Ms. Financial Analyst*, you didn't read the email dated November 20, 2006 from the owner to his CPA, did you?
 - *Handing the expert one of 3,500 emails received in the electronic production in this matter*
- **Mr. Expert**, did it matter to your calculations if the contract was never signed?
- **Mr. Economist**, where did you take into account that fact that the invention by Acme industries made your client's product obsolete?
- **Ms. CPA**, can you tell me who the companies are that that make up the Widget Manufacturing Industry Association ("WMIA") data that you used as a profit benchmark to arrive at "But-for" profit?

Fallout of e-discovery

- Has had many implications for companies as they have had to comply...
- For financial experts
 - Has created a deluge of documents
 - Where to start?
 - Where to stop?
 - How much is “enough?”
 - *Do we really need 3,500 emails going back three years?*

Does the expert know the answers?

- Balance between sufficient evidence to render a credible opinion, *without* excessive cost or risking exclusion.
 - All in all, it may be a fine line for the attorney managing the case.
 - And for the expert who doesn't want to risk exclusion

Cost of litigating the claim

“There is a serious concern that the costs and burdens of discovery are driving litigation away from the court system and forcing settlements based on the costs, as opposed to the merits, of cases.”

- American College of Trial Lawyers Joint Project with The Institute for the Advancement of the American Legal System on Discovery, 8/1/2008 (“ACTL study”)

Exclusions in Lost Profits Cases

- Qualifications
- Link to causation/rule out other causes for loss
- Selection of reliable methodology
- Gathering evidence—supporting facts, data, and sufficient information

Inadmissibility of expert—must base opinion on more than your reputation

- While the defendant claimed that the court should allow the testimony because the expert was well-regarded, the court held that **being well-regarded “is not a substitute for analysis”** of the *Daubert* factors.

G.T. Laboratories, Inc. v. The Cooper Companies, Inc.,
1998 U.S. Dist. LEXIS 15745, *23 (N.D. Ill. 1998)

Inadmissibility of expert—must base opinion on more than your reputation

- Relying solely on information provided by the attorney, an otherwise “supremely qualified expert cannot waltz into the courtroom and render opinions unless those opinions are based on some recognized scientific method and are reliable and relevant under the test set forth by the Supreme Court in *Daubert*.”

MDG International v. Australian Gold, Inc., 2009 WL 1916728 (June 29, 2009).

- In other words, the court requires factual data and information, and calculations based on proven methods that can be tested.

Inadmissibility of expert—must base opinion on more than your reputation

- Where testimony... of lost profits is not based on historical data, and **is only based on the expert's “experience and knowledge”** of a particular market, it will be excluded as **overly speculative**.

Kemp v. Tyson Seafood Group, Inc., 2000 WL 1062105 (D. Minn. 2000).

Link to causation—failure to identify other factors that contributed to loss

- “The damages ... must be reasonably certain and directly traceable to the breach, not remote or the result of other intervening causes.”

Coastal Aviation v. Commander Aircraft, 937 F. Supp. 1051, (1996).

The attorney should not assume that the expert has tied the plaintiff’s alleged losses to defendant’s actions, or ruled out other causes for the loss.

Link to causation—failure to identify other factors that contributed to loss

- The court affirmed exclusion of lost profits expert's testimony because the **testimony was not sufficiently tied to appellee's possible conduct.** The expert had instead assumed that appellee was liable for all counts charged and no other factors contributed to loss profits.

In *PharmaNetics, Inc. v. Aventis Pharmaceuticals, Inc.*, 182 Fed. Appx. 267, 272-73 (4th Cir. 2006).

Link to causation—failure to consider other factors

- Where there was testimony that over seventy factors could affect radio revenues, and the expert attributed all the lost profits to one tortious act **without considering the other factors**, the testimony was excluded.

Whitby v. Infinity Radio, Inc., 951 So.2d 890, 899 (Fla. Dist. Ct. App. 2007)

Use of hindsight in causation

- The court found three “separate and distinct causes” that contributed to plaintiff’s loss of sales and that it did not account for in its damages calculation: 1) increased competition; 2) the bankruptcy of a primary supplier; and (3) a major construction project near the entrance to its store.

Penn Mart Supermarkets, Inc. v. New Castle Shopping, LLC. No. 20405-NC (Del. Chan. 2005)

Reasonable Certainty

- An expert should not transform modesty into success or success into modesty.
- The entitlement to lost profit damages cannot be viewed as “the purchase of a winning lottery ticket [and] any lost profits award must be limited to the actual damages sustained.”
- *Sostchin v. Doll Enterprises, Inc.*, 847 So.2d 1123, 1129 (Fla. 2003)

Reasonable Certainty

- “...the law does not require that lost profits be proven with absolute certainty. Rather, the evidence need only afford a reasonable basis for the computation of damages which, with a reasonable degree of certainty, can be traced to the defendant’s wrongful conduct. Defendants should not be permitted to escape liability entirely because the amount of the damage they have caused is uncertain. To do so would be to immunize defendants from the consequences of their wrongful act.”

Belleville Toyota, Inc. v. Toyota Motor Sales U.S.A., Inc. , 199 Ill. 2d 325, 770 N.E. 2d 177 (2002)

Principles & methods—wrong date

- In this patent infringement case relating to transmission of video signals, expert calculated reasonable royalties, assuming royalty negotiations **as of the date the lawsuit was filed**. However, federal law required that the calculation be **as of the date of the first infringement**, resulting in exclusion of the expert's report.

Avocent Huntsville Corp. v. ClearCube Technology, Inc., 2006 WL 2109503 (N.D. Ala. July 28, 2006) (amend. Aug. 21, 2006)

Principles & methods—failure to use peer accepted method

- Expert excluded where analysis was based on a definition of economic loss that he and a colleague had devised years earlier.

Loeffel Steel Products, Inc. v. Delta Brands, Inc., 387 F. Supp. 2d 794, 802-03 (N.D. Ill. 2005)

Principles & Methods—failure to use recognized methods

- Extent to which saved fixed costs are deducted:
 - “Plaintiff is in the business of renting uniforms and providing service on those uniforms, regardless of obtaining the Defendant's account. As such, **the costs that were expended for overhead would have been expended regardless**, as Plaintiff was not seeking to expand their operations, nor was the payment to provide for the expansion of operations by hiring more employees and expanding production facilities. Further, Plaintiff did not expect to put an undue burden on their operations since their overhead, salaries, rent and a number of other costs was something that Plaintiff knew it already had.”

RKR Motors V. Associated Uniform Rental & Linen Supply, Inc., 995 So. 2d 588; 2008 Fla. App.

Principles & methods—lacked economic reality

- The expert took a very short period of success for a new business and calculated damages based upon a forecast that exceeded even the business plan of that new entity... “while estimates and speculation are sometimes necessary in lost profits cases, **extrapolations that are so removed from economic reality are not an appropriate opinion** upon which to determine damages.”

Olympia Equipment Leasing Co. v. Western Union Telegraph Co., 797 F.2d 370, 382 (7th Cir. 1986).

Principles & method—”exceedingly long” period

- lost profits calculations involved a seventy-seven year period after a single flood, the court concluded that the time was “exceedingly long”

Acker v. Burlington, 347 F. Supp. 2d at 1031.

- “Reasonable certainty” probably an issue at 77 years...

Principles & methods—expert opposing views from prior case

- Expert who takes one view in a prior case, and the opposite view in the next
 - the expert's own sworn testimony in other matters had previously stated that the method applied in current case was “unreliable, inadvisable, or unsupportable”

Port Authority of New York and New Jersey v. Affiliated FM Ins. Co.,
245 F. Supp. 2d 563, 568 (D.N.J. 2001)

Principles & Methods—expert had opposing views in same case

- Expert's deposition testimony and expert report were “at war with each other,”
- The court “had no idea which of [the] assumptions truly formed the basis of his calculations.”

KW Plastics v. U.S. Can Co., 131 F. Supp. 2d 1289, 1293 (M.D. Ala. 2001).

Yardstick method

- Utilize selected comparables to demonstrate “but-for” performance during loss period. This requires analyses of the yardstick companies or business units to determine similar size, location, product, capabilities, etc.
- Suspect benchmark data that may be used by financial analysts in non-litigation settings is subject to rigorous vetting in the litigation realm.

Exclusions based on Yardstick—lack of comparability

- Finding the yardstick analysis flawed because it included **companies too dissimilar** from Celebrity to be valid surrogates

Celebrity Cruises v. Essef Corp.

- In claim for damages from breach of pizzeria lease, plaintiff tried to show that lost profits from the subject restaurant were comparable to a larger pizzeria that he also owned and operated, but court dismissed evidence for **lack of comparability**, including differences in their locations, equipment, rents, and availability of parking.

Nieman v. Bunnell Hill Development Corp., 2008 WL 4694998 (Ohio App. 12 Dist.), 2008 -Ohio- 5541

Exclusions based on lack of independent analysis by expert

- Expert took as fact assertions of owner of this metal manufacturer **without independent verification**; the court excluded, finding no independent investigation to verify whether the facts were accurate or not.

Champagne Metals v. Ken-Mac Metals, 458 F. 3d 1073 (10th Cir 2006)

Exclusions based on sales projection— lack of independent analysis by expert

- The court found the opinion “wholly unreliable [because] ‘the entrepreneur’s “cheerful prognostications” are not enough.’”
 - Improperly assumed the truth of the plaintiff’s own revenue projections and/or placed undue weight on the alleged decrease in plaintiff’s estimate of merger synergies

Celebrity Cruises, Id. (quoting *Schonfeld v. Hilliard*, 218 F.3d 164, 173 (2d Cir. 2000)).

Exclusions based on sales projection— lack of independent analysis by expert

- Calculations were based solely upon projections in an agreement between the parties. The **expert did not perform any independent market analysis** to verify the reasonableness or accuracy of the projections or compare the projections with actual results achieved by other, similar enterprises

Otis v. Doctor's Associates, Inc., 1998 U.S. Dist. LEXIS 15414, *3 (N.D. Ill. 1998).

- **the court cites a lengthy list of problems that permeate the expert's work**

Exclusions based on insufficient facts & data

- “When an expert’s testimony is not tied to the facts of the case, and assumptions are not based on facts in the record, the testimony will be excluded”

See *K & V Scientific Co., Inc. v. The Ensign-Bickford Co.*, 2002 WL 31662326 at *8-9 (Conn.Super.)

- Where the court found there was not “adequate factual data to support the expert’s conclusions” on economic loss, the expert’s testimony was excluded.

Irvine v. Murad Skin Research Laboratories, Inc., 194 F.3d 313, 320-21 (1st Cir. 1999)

Exclusions based on insufficient facts & data—insufficient discovery

- **Expert was ignorant of data** that should have been discovered in the course of the expert's discovery

Supply & Bldg. Co. v. Estee Lauder Int'l, Inc., 2001 WL 1602976 (S. D. N.Y. Dec. 13, 2001)

Exclusions based on insufficient facts & data—failure to provide independent analysis

- “Courts must consider the factual basis of an expert’s testimony when considering its reliability.”
- The expert relied exclusively on data provided by the plaintiff, made an estimate of growth rate without any basis, made an assumption of a comparable market, and failed to analyze other factors regarding the sale of the product in question.

Ellipsis, Inc. v. The Color Works, Inc., 428 F. Supp. 2d 752, 760 (W.D. Tenn. 2006).

Exclusions based on insufficient facts & data—ignoring unfavorable data

- Expert testimony was excluded where the expert ignored data in favor of data more favorable to the expert's client.

Children's Broadcast Corp. v. Walt Disney Co., 245 F.3d, 1008, 1018, 1022 (8th Cir. 2001).

Exclusions based on insufficient facts & data—failure to deal with inconsistent facts

- Expert failed to deal with inconsistent facts or where the expert assumes the fact his or her opinion is intended to prove.

First Savings Bank, F.S.B. v. U.S. Bancorp, 117 F. Supp. 2d 1078, (D. Kan. 2000)

Exclusions based on insufficient facts & data—”too much hypothesizing”

- “relied too heavily on hypothesized contracts in hypothesized markets that lacked any sound economic grounding.”

DSU Medical Corp., 471 F.3d at 1309

Exclusions based on insufficient facts & data—not grounded in actual experience of company

- Lost profit testimony not based on actual past sales statistics, but on sales that never happened, was **held to be speculative**, and therefore, inadmissible.

Message Center Management, Inc. v. Shell Oil Products Co., 857 A.2d 936, 943 (Conn. App. Ct. 2004).

Key watch-words

- Insufficient or mis-used facts & data
- Unreliable or mis-applied principles & methods
- Failure to tie loss to claim, or to rule out other causes for loss
- Failure to independently verify information
- Speculation
- Reliance on data or information (including projections) supplied by plaintiff