



# Fannon Valuation Group

## Financial Expert Exclusions—Are You Prepared to Defend Yourself?

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The following is a fictional narrative depicting the facts and circumstances of a lost profits case, created from an amalgamation of real-life experiences and illustrative of potential financial expert witness exclusion landmines. The case also depicts the expert's decisions, with an assessment from the perspective of the court's "gate-keeping" role presented in the later sections of this article. How will the expert perform? Will he be excluded from the case? More importantly, do you recognize yourself in these fact patterns, and how will you perform in similar circumstances after understanding the myriad of expert admissibility requirements?

### The Case: Bilkem Steel v. Morphus Machines

Lester Moore's phone rang—on the other end, an attorney—Dan Dukem, Esq., whom Moore had never worked with before but whose successful reputation preceded him. Moore was a business appraiser, and Dukem had a big case for him - a really big case, the likes of which Moore's office had never handled before. Dukem required a lost profits damage expert for a case in the evolving steel industry. Moore had previously handled a small lost profit claim—about \$50,000—for a client that settled fairly quickly, and was anxious to move onto something bigger. As fees and billable hours danced in his head, Moore wondered, Could he do it? With Dukem's estimate of damages in the tens of millions, this was an opportunity of a lifetime that would put Les Moore's name on the map. Besides, Moore was a highly respected financial analyst with years of experience as a business appraiser. He'd been around businesses a long time, and had a good sense about many different kinds of businesses and their profits—So he said Yes! Right away Moore agreed to send Dukem his retention agreement.

Moore's engagement letter contemplated calculating lost profits and loss of business value relating to Morphus' actions. Dukem promised to send Moore the documents produced in discovery so that he could immediately get started, with the first disc containing the financial documents Moore would need. Moore had been called at the last minute and now the court's scheduling order timing was really short. Not only that, but his client was now out of business as a result of Morphus' actions, so money was a little tight, at least until they won the case, which Dukem was confident they would. Dukem warned Moore that he may have to use "whatever he can get for financial information" and work as expeditiously as he could.

Dukem told Moore that his client, Bilkem Steel, had been growing revenue at a rate of over 10% a year for several years until the defendant, Morplus Machines, installed a bogus laser cutter on their cutting line. Steel was a high-end precision machine shop making parts for manufacturers located world-wide. Dukem informed Moore that Steel had earned a reputation for their precision that was matched by none in the industry. Until, that is, Morplus installed the bogus machine. Although Steel didn't put two and two together at the time, Steel represented that they began getting complaints from customers about some of their products. Over time, the complaints turned to cancellations as customers' products began to fail. Steel now blamed the failure on the bad laser cutter supplied by Morplus. Steel represented that their reputation was badly hurt, resulting in the loss of customers and inability to gain new customers. Steel had made no attempt to alter production after receiving complaints, nor did Steel notify Morplus of any problems with the installation. Instead, the cutter was permanently shut down and a lost profit claim was filed. Evidence of a modest problem in production had begun to show up in production reports (documented on Disc 4) the very day after the laser cutter was installed.

Along with these initial representations, Moore received a disk containing the financial documents Dukem had agreed to send over. Three days later, Moore received two more disks and, subsequently, an additional three disks arrived. Moore was told these latter discs contained no financial statements or forecasts, but rather, were filled with thousands of emails, production documents, contracts, and deposition transcripts. In all, the disks contained approximately 6,500 unlabeled documents. Moore had spent almost three days wading through the first disk to find appropriate financial documents to use in his calculations and therefore thought it unlikely that there would be any additional useful information on the additional disks. He spent another day paging through the remaining five discs but then quickly realized how much his fees would escalate if he spent three days on each of the additional discs, and abandoned the effort. He grumbled to himself that it was a well-known defense strategy to overwhelm the plaintiff with document discovery. Besides, Moore thought, Dukem had informed him they didn't contain any financial data. Further, he was pressed for time and worried he wouldn't get paid for these fruitless efforts in any event, so he began his calculations with the financial data he obtained from the first disc.

In Moore's opinion, the business owner was the most knowledgeable regarding Steel's prospects and, because the attorney knew the case so well, Moore relied on the attorney's description and on management's projections of what Steel would have done during the damage period. As Moore was told that the installation was the cause of Steel's losses, Moore's damage analysis began on the date of the installation and extended for a period of 24 months. At this point, Steel claimed that the loss of existing customers and inability to gain new ones damaged Steel to the extent that the entire business shut down.

Either Steel had been operating in a bubble, or had failed to pass on the full story to their expert and attorney. While Steel represented that they had established themselves as a valuable niche company, there had actually been an explosion of direct competition during the year of the Morplus installation, resulting in a price war and compressed margins. Not only was there new direct competition, but also there was an industry-wide improvement in design techniques that Steel did not implement. Consideration of this design upgrade was

adequately documented in internal email correspondences provided on the second and third document disks. The industry innovations, coupled with the overall increased customer base via the internet, had significantly changed the market, but Steel had lagged behind, making no changes in operations during the last ten years.

Moore's two-part damage analysis included a calculation for the 24 month damage period, as well as a value for the lost business.

For his lost profit calculation, the first methodology Moore relied on was the yardstick method. Moore selected comparable industry data including revenue growth and profit margins from the industry association that Steel belonged to. If Moore had completed any further analysis, he would have found that, according to the Association website and a follow up phone conversation, the industry medians Moore applied to Steel were generally ambiguous, represented only a couple dozen companies and provided no overall assurance that the data represented anything other than the medians of the particular companies involved in the analysis. There was no information provided as to the type of company, the location or the financial standing of any of the survey participants.

As a second lost profit method, Moore used the sales projection method. Moore again accepted Management's projections, completing no independent analysis on them. In keeping with the projections, Moore was confident in the positive outlook that was the result of Management's opinion that they would have obtained a significant new contract Steel represented they had been courting for some time and were on the cusp of obtaining, resulting in 35% growth for the next two years. Further, the new laser cutter was supposed to have dramatically cut manufacturing time, resulting in expanding margins. Steel had been counting heavily on this, as although they had been a highly profitable company years ago, margins had shrunk considerably, and in fact, the last two years had actually dipped below the line. Both of these assertions—the revenue growth and the expanding profits—made sense to Moore, based on Management's representations relating to the new customer and his extensive experience as a financial analyst.

For his loss of business value at the end of two years, Moore calculated the fair market value of Steel, relying on these same sales projections provided by management. Projecting beyond the two-year period used in the lost profit calculation, Management further represented that this new customer was the linchpin to a whole new group of customers. On this basis, Moore also concluded that solid growth was appropriate and that Steel would continue the hockey stick trend in both revenues and profits for the several years into the future, after which growth would return to the historical rate of 10%. Again, Moore uses these assumptions with out any independent verification or due diligence, relying on his own experience and judgement of what made sense. Because he did not perform any further inquiry into Management's projections or historical performance, Moore was oblivious to the source of growth. The historical growth was derived from new customers; however, Steel had a low customer retention rate due to poor customer service that was increasingly offsetting new customer gains—also documented in the email correspondence on disc 5. Management's projections did not distinguish between the sources of growth, or in Steel's high customer losses. Moore did not discuss sales and marketing plans with Management. Had he done so, it would have been revealed that one of the Steel owners, the

youngest brother in the family, Clive Haddit, had decided he no longer wanted to participate in the family business, fed up with fighting over the cause of customer losses. Haddit's deposition was on disc 6, and included his dissatisfaction with Steel's failure to address these issues. Upon his abrupt departure as VP of sales and marketing, several of Steel's sales reps and marketing department also left, setting up shop to compete with Steel. Rather than remedy this situation, which was also documented in board minute meetings and numerous email correspondence (documented in discs 3 and 4), Steel choose to take no action to replace the critical sales and marketing VP and staff.

On this basis, Moore filed his report stating his opinion of a substantive loss of profits and value, exceeding even Dukem's initial estimates. When the defendant's expert, Frankly Less' report arrived, the damages were only a small fraction of those found by Moore. Dukem sent the report along to Moore, who flipped to the last pages to quickly look at Less' calculations. Moore scoffed to Dukem that Less clearly didn't know what he was doing, and set it aside.

At his deposition several weeks later Moore was questioned concerning his knowledge regarding certain facts in the case, but he wasn't too worried—after all, he had based his calculations on Management's financial data, and wasn't getting involved in what he considered the facts leading to liability issues. So he was shocked when Dukem, sounding agitated, called to tell him that the defense had filed a motion to exclude his opinion in the case.

Moore boldly told Dukem that “Of course I can help avert the motion to exclude my opinion. I'm sure it has no basis. Don't worry.” When he sat behind his closed door and read it, though, his color and his confidence drained. Could Moore really get out of this mess? Let's find out.

### Basis for expert testimony

Federal Rule of Evidence 702: *Testimony by Experts* is the basic legal predicate for expert exclusion. Rule 702 necessitates the relevance and reliability of expert testimony and evidence presented. Specifically, an expert may testify 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. Most states have similar rules.

Espousing an expert's lack of relevance and reliability is a fundamental tenet of expert exclusion under *Daubert*. With regard to expert opinions, it is a trial judge's responsibility to “ensure that any and all scientific testimony or evidence admitted 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 (*Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 589 (1993)). *General Electric Co. v. Joiner* (522 U.S. (1997)) and *Kumho Tire Co. v. Cabmichael* (526 U.S. (1999)) rounded out the trilogy of cases that guide the admissibility of expert evidence today, replacing the more

liberal *Frye v. Unites States*, 54 App. D.C (1923)), although many states still harken back to the so-called “Frye rule.”

According to a 2007 PricewaterhouseCoopers study, 41% of all challenges to financial experts were successful in excluding the expert’s testimony in whole or in part.<sup>1</sup> Although this study does not discuss the reasons for exclusions, the following analysis provides an overview of some of the circumstances which an expert should be aware when rendering expert testimony.

### Defining the engagement

Moore’s retention agreement should specifically state what services Moore is and is not being asked to provide. If at all possible, Moore should indicate to Dukem the documents and information that are critical to performing a damage analysis. In addition, Dukem may want Moore to assist in crafting interrogatories or deposition questions.

Clearly indicating the services he will be providing in an engagement letter would help Moore eliminate a potential pitfall. Despite this, performing analysis in an area that Moore is not familiar with could turn into a major strike against Moore’s admissibility. Courts are skeptical of experts testifying outside of his or her normal field of expertise (*DePaepe v. General Motors Corp.*, 141 F.3d 715, 719 (Ill. 1998)). Knowing your own limitations is a critical aspect of becoming a successful expert.

### Causation

Neither Dukem nor Moore should assume that the other has ensured that the losses flow from the defendant’s behavior, and not other possible causes. It is often the responsibility of the expert to rule out other possible causes for the loss. Failing to do so, the expert could be excluded for lack of relevance. 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)). In a more egregious example, an expert attributed all the lost profits to one tortious act without considering other factors even though there was testimony that over seventy factors could affect revenues. The expert’s testimony was excluded. (*Whitby v. Infinity Radio, Inc.*, 951 So.2d 890, 899 (Fla. Dist. Ct. App. 2007)).

Other causes may include market saturation and reduced prices of alternate products (*Isaksen v. Vt. Castings, Inc.* 825 F.2d 1158, 1165 (7th Cir. 1987)). In assessing cause, the expert should also consider general economic factors and market demand such as inflation and growth, along with “separate and distinct causes” such as increased competition, bankruptcy of a primary supplier or major construction project near the entrance to its store (*Penn Mart Supermarkets, Inc. v. New Castle Shopping, LLC*. No. 20405-NC (Del. Chan. 2005)).

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<sup>1</sup> 2000-2007 Financial expert witness Daubert study by PricewaterhouseCooper (PwC), [http://www.pwc.com/en\\_US/us/forensic-services/assets/2000\\_2007\\_daubert\\_study.pdf](http://www.pwc.com/en_US/us/forensic-services/assets/2000_2007_daubert_study.pdf)

Given the various facts and circumstances of the case, Moore failed to consider any other operational or industry causes for Steel's loss beyond the alleged faulty installation of the laser cutter. A more thorough investigation would reveal different causation and, therefore, a much different damage calculation. For example, the recent developments in the design upgrades, increased competition and compressed margins require further examination to determine the impact on Steel's revenues and profits. Additionally, internal factors such as the departure of key employees could hinder Steel's performance. In fact, the large customer that Steel was on the "cusp" of obtaining had emailed the customer service manager with a laundry list of issues with the product—none of which were addressed by Steel. Further, Steel's own failure to address the production problems upon early detection may have exacerbated a problem that could have been averted. All of these factors were documented in production provided to Moore, but considering it "non-financial" and being on a tight time frame and budget, he was not aware of it. Each of these factors could cause Moore's opinion to be determined unreliable by the court, and therefore excludable.

### Reliance on Management

Moore believed he was qualified to take on this engagement on the basis of his years of experience as a business appraiser, and the fact that he was a highly respected financial analyst who had seen many businesses over the years. Surely he could discern how Steel would have performed, if Morphus hadn't been so negligent in their actions. Moore believed Management was being perfectly reasonable in making their projections.

In fact, being well-regarded "is not a substitute for analysis" (*G.T. Laboratories, Inc. v. The Cooper Companies, Inc.*, 1998 U.S. Dist. LEXIS 15745, \*23 (N.D. Ill. 1998)). The Courts have readily identified and excluded expert testimony based on "experience and knowledge" of a particular market as overly speculative (*Kemp v. Tyson Seafood Group, Inc.*, 2000 WL 1062105 (D. Minn. 2000)). This requires experts to follow Rule 703, which, as one court found, requires the information presented by the expert to be reliable, "beyond the opinion of the individual witness" (*Security Sys. Canada, Inc. v. Checkpoint Sys., Inc.*, 249 F. Supp. 2d 622, 695-96 (D. Pa. 2003)). Rule 703 holds that the sufficient facts or data reasonably relied upon as required by Rule 702 be those of a type that are "reasonably relied upon by expert in a particular field in forming opinions or inferences upon the subject" and do not need to be admissible in evidence for the opinion to be admitted.

The Courts have reiterated that experts "cannot just rely upon their status as an expert to bootstrap the admission of their opinion testimony," particularly when the expert fails to show how their opinion was "reliably" obtained from their experience and knowledge..." (*Hoy v. DRM, Inc.*, 114 P.3d 1268, 1283 (W.V. 2005)). Thus, an expert report that merely mimics Management's prognostications may not suffice in the court's eyes. "The court found the opinion "wholly unreliable [because] 'the entrepreneur's "cheerful prognostications" are not enough.'" (*Celebrity Cruises, Id.* (quoting *Schonfeld v. Hilliard*, 218 F.3d 164, 173 (2d Cir. 2000)).

### Exclusions for lack of sufficient facts and data

In this case, Moore accepted Management's hockey-stick projection of revenues on the basis of Moore's subjective experience, rather than on the facts in the record. He also accepted Management's view of expanding margins without any supporting documentation. Such views lead Moore to conclude substantial damages, for a company that was losing money and falling behind the competition. The courts have admonished such actions, saying "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)).

There are many examples of exclusions based on insufficient facts and data of by experts. Expert testimony can be excluded when it is "not tied to the facts of the case, and assumptions are not based on facts in the record" (*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)). An expert cannot be insulated from copious amounts of documents by limiting their document request, or by ignoring documents, if they are found ignorant of data that should have been discovered in the course of expert discovery (*Supply & Bldg. Co. v. Estee Lauder Int'l, Inc.*, 2001 WL 1602976 (S. D. N.Y. Dec. 13, 2001)).

Alternately, an expert cannot just ignore unfavorable data or rely on only the data that is more favorable (*Children's Broadcast Corp. v. Walt Disney Co.*, 245 F.3d, 1008, 1018, 1022 (8th Cir. 2001)). An expert can not plead ignorance, either (*Supply & Bldg. Co. v. Estee Lauder Int'l, Inc.*, 2001 WL 1602976 (S. D. N.Y. Dec. 13, 2001)).

Moore ignored key facts in the case. The production records evidenced the problem with the laser cutter. Had he looked on disc 6, he would have found Steel's Master Installation Agreement with Morphus, requiring Steel to notify Morphus within 48 hours of evidence of any problems with an installation, and a provision giving Morphus an opportunity to cure. Failure to notify, according the Agreement, limited damages to 90 days. While the importance of this fact is for the trier of fact to determine, (and no doubt had Moore read the defendant's answer to the complaint, he would have found that they argued that their damages were limited to this 90-day term), if the judge finds that the 90-day damages clause applies, the plaintiff would be left with no damage claim matching this period, thus rendering Moore's testimony excludable. Dukem might want Moore to calculate an alternate damage calculation for the duration of this damage period.

Moore also ignored key facts that were available and in the record. These facts were documented in depositions and emails. The failure to account for these facts in his calculations may render his testimony irrelevant and excludable.

#### Exclusions for failure to do independent research and analysis

Lack of independent analysis is another prevalent expert exclusion. When an expert takes the assertions of an owner without independent verification, the Court excluded and found that the expert performed 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)). As discussed previously, improperly assuming or blindly accepting a plaintiff's own revenue

projections represents another form of lack of independent analysis by experts (*Celebrity Cruises*, Id. (quoting *Schonfeld v. Hilliard*, 218 F.3d 164, 173 (2d Cir. 2000)). In *Celebrity Cruises*, the Court found that because the expert improperly assumed the truth of the plaintiff's own revenue projections and placed undue weight on the alleged decrease in plaintiff's estimate of merger synergies, the opinion based on "cheerful prognostications" was "wholly unreliable." Expert testimony needs to be based on substantial evidence and be reasonably certain.

The courts expect the expert to provide independent analysis, including analysis of projections that were prepared by the plaintiff. Although such projections may in some cases be provided by Management, it is the responsibility of the expert to vet the reasonableness of those provided from the plaintiff. Experts should perform adequate due diligence since the Courts remain split on relying on plaintiff projections (*Natural Balance Pet Foods, Inc. v. Chenango Pet Foods, Inc.*, No. B162239 (Cal. App. 2 Dist. September 30, 2003)). The extent and necessity of facts and circumstances vary by case and jurisdiction.

Failure to perform independent analysis on industry or market data can also lead to expert exclusion. For example, an expert was excluded for the lack of independent analysis and failure to understand the methodology used in a marketing projection prepared by a third party (*Chemipal Ltd. v. Slim-Fast Nutritional Foods Intern., Inc.*, 350 F. Supp. 2d 582, 588 (D. Del. 2004)). In another case, the expert was excluded when they did not perform any independent market analysis to verify reasonableness or accuracy of projections or compare projections to actual results (*Otis v. Doctor's Associates, Inc.*, 1998 U.S. Dist. LEXIS 15414, \*3 (N.D. Ill. 1998)).

By failing to provide independent analysis, an expert's testimony has been found unreliable and excluded in cases where the expert relied exclusively on data provided by the plaintiff (*Ellipsis, Inc. v. The Color Works, Inc.*, 428 F. Supp. 2d 752, 760 (W.D. Tenn. 2006)). This ruling was premised under the assumption that "courts must consider the factual basis of an expert's testimony when considering its reliability." Similar to valuation techniques, an expert can not create estimates in a vacuum by simply disregarding a comparable market or other relevant factors of the business. Indeed, the Court has excluded expert testimony that had demonstrated such reckless disregard for ignoring unfavorable data (*Children's Broadcast Corp. v. Walt Disney Co.*, 245 F.3d, 1008, 1018, 1022 (8th Cir. 2001)).

Rather than deal with inconsistent facts, an expert was excluded for assuming the fact his or her opinion was intending to prove (*First Savings Bank, F.S.B. v. U.S. Bancorp*, 117 F. Supp. 2d 1078, (D. Kan. 2000)). As a more blatant warning for experts, the Courts have found hypothesizing as grounds for exclusion (*DSU Medical Corp.*, 471 F.3d at 1309). Speculative data not grounded in actual experience of company was also found to be inadmissible (*Message Center Management, Inc. v. Shell Oil Products Co.*, 857 A.2d 936, 943 (Conn. App. Ct. 2004)).

While Moore is going through the motions to obtain the evidence needed to support his damage calculation, his opinion is not based on reliable facts and data. Thus far, Moore has yet to conduct any additional analysis of the facts and data appropriate to create an independent, objective opinion of Steel's historical, current or future financial performance.

Without such knowledge, it would be impossible for Moore provide an exclusion-proof (or cross-examination proof) opinion that attributes Steel's damages to a faulty installation performed by Morphus. Both exclusions and cross examination would address the lack of factual foundation for Moore's claim:

- How much of lost revenue was due to the new, intense competition?
- How much was due to the new innovation that Steel had declined to manufacture, but customers were turning towards?
- How much of the margin compression was due to price competition, that Steel would not be able to recover, regardless of the new laser cutter?
- How many customers had they lost due to their poor customer service?
- What effect on revenue did the loss of key sales personnel have?
- How did they know this new customer they believed they were on the cusp of obtaining—and which would lead to their forecasted 35% revenue growth—would have come on board, given that their concerns with the product were not addressed by Steel's customer service department?

Lacking consideration of these critical questions, Moore's opinion would be compromised.

Once the facts and data have been identified, the next step is for Moore to properly apply peer-accepted methods. "Identification of facts and data and basing an opinion on scientific methods and procedures is necessary to provide a relevant testimony" (*Trugreen Co., L.L.C. v. Scotts Lawn Service*, 508 F. Supp. 2d 937 938 (D. Utah 2007)). Unfortunately for Moore, he fails on this front as well.

#### Date and timing of damages

Application of an appropriate method begins with selection of the correct date of damages in calculations.

For example, incorrectly calculating damages based on the date of lawsuit rather than the infringement lead to an expert exclusion (*Avocent Huntsville Corp. v. ClearCube Technology, Inc.*, 2006 WL 2109503 (N.D. Ala. July 28, 2006) (amend. Aug. 21, 2006)). In some jurisdictions, it may also be appropriate to calculate per diem losses, or those losses accruing from the date of infringement until the date of settlement. Early and effective communication with counsel establishing a timeframe of facts, as well as applicable laws by jurisdiction helps to prevent any such error.

The selected damage period must match the actual or estimated damages. The Court has found a calculation using a 77 year damage period to be "exceeding long" (*Acker v. Burlington*, 347 F. Supp. 2d at 1031). This illustrates the necessity of the damage period being within the realm of reasonable certainty.

Moore's selection of 24 months as the damage period is representative of the amount of time from installation to the date Steel went out of business. He then adds on

the loss of value of the business, indicating that the damages continue “forever.” No damages were calculated for the 90-day period referenced in the Master Installation Agreement.

Whether the Master Installation Agreement applied or not, in making this claim, Moore attributes 100% of Steel’s problems to the laser cutter-ignoring the fact that Steel was already on the decline, and falling rapidly behind competition. Moore might have considered if Steel were already on a downhill trajectory irrespective of the alleged issues relating to the laser cutter, and more seriously investigated what they were doing to turn themselves around. As it is, he has nothing but the plaintiff’s word.

#### Exclusions relating to selection and application of reliable method

Failure to use peer accepted methodologies can result in exclusion of the expert. In one example, an expert was excluded because his 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)). Alternatively, application of an accepted method, but failing to factor in normal assumptions (i.e. expenses incurred to generate income and sales) can also be deemed a failure to use recognized methods (*Club Car, Inc. v. Club Car (Quebec) Import, Inc.*, 362 F.3d 775, 780 (11th Cir. 2004)). A typical pitfall usually involves properly recognizing and allocating fixed versus variable costs related to damages. The following highlight method-specific exclusions.

#### *Yardstick*

Application of the yardstick method demonstrates what the plaintiff would have done based on the performance of selected comparables using similar size, location and product attributes. Benchmark data that is typically used by valuation analysts in non-litigation settings is subject to rigorous examination in the litigation realm. Exclusions exist in the yardstick method because of lack of comparability to the selected data. Such exclusions have been particularly exacerbated by the Courts’ ability to distinguish differences in comparable evidence (*Celebrity Cruises v. Essef Corp.* and *Nieman v. Bunnell Hill Development Corp.*, 2008 WL 4694998 (Ohio App. 12 Dist.), 2008 -Ohio- 5541). Moore’s application of industry ratios demonstrated no indication that underlying data was examined, much less understood or directly comparable to Steel, leaving him vulnerable to a motion to exclude his opinion.

#### *Sales projection*

As has already been discussed, insufficient facts and data are a major cause of exclusion, so an expert needs to be keenly aware of the source and composition of information relied upon. This inherently requires an expert to perform independent analyses to scrutinize information. Failure to do so provides ample ammunition for expert exclusion.

Moore’s sales projection method was riddled with inconsistent data. Use of Management’s projections simply highlighted the fact that Moore had not completed any

independent analysis of their reliability. Moreover, there were simultaneous industry trends that did not bode well for Steel's outlook.

A damages analysis considering a "but-for" marketplace must also have "some footing in economic principle" (*DSU Medical Corp.*, 471 F.3d at 1309). Such basis in economic reality is dictated by the estimates and speculation that are sometimes necessary in lost profits cases, but "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)). Estimates lacking economic reality – whether provided by the plaintiff or developed by the expert – not only fail to adhere to appropriate methodologies, but also are counter-productive to an expert's testimony. Because Moore's reliance on Steel's projections demonstrates insufficient facts and data based on lack of expert analysis, it would be difficult to avoid exclusion.

#### *Loss of business value*

Moore calculated the "fair market value" of Steel at the end of the damage period, assuming that the alleged faulty installation was the only problem Steel had. Issues of causation and lack of factual support have already been discussed at length, and Moore may, or may not, calculate "fair market value" appropriately. However, the analyst should consider the remedy called for is loss of business profits. In that context, "the purpose of compensatory damages for lost *business value* is to place an injured party in the same position as it would have been in had there been no injury; that is, to compensate for the injury actually sustained" (*Action Marine, Inc. v. Continental Carbon*, 481 F.3d 1302 (11th Cir. 2007)). "This is no different than the purpose of compensatory damages for lost profits: the amount necessary to "make the defendant whole" and "place it in the same position it would have been but for [the defendant's breach]." (*Sierra Wine and Liquor Co. Heublein, Inc.*, 626 F.2d 129, 132 (9th cir. 1980))

In a lost profit calculation, in contrast with the standard definition of fair market value, the analyst is not dealing with hypothetical parties, and the plaintiff is certainly under compulsion to sell. Further, in a "fair market value" construct, subsequent information is typically not considered. In contrast, the use of hindsight is considered in a loss profits calculation, and failure to do so can lead to exclusion. For example, when considering causation, the analyst necessarily considers hindsight: "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). The application of any of the "methods" further necessitate the consideration of hindsight.

The definition of value may, therefore, need to be modified to ensure that the purpose of the damages—that is, to make the plaintiff whole, is served. In this case, at the valuation date Moore would have known of the intense competition and failure of Steel to partake in upgrading products to the current market standard. Failure to consider this information may cause Moore's report to be excluded.

## Conclusion

The courts are increasingly looking for experts to provide substantive, reliable evidence in support of their calculations. Common exclusions relate to the failure to link to causation, lack of supporting facts, data and sufficient information, and the selection and application of reliable methodology.

Did Moore really need to read 3,500 emails, 12 depositions, the contract and four addendums, countless production reports, and whatever else was produced in the mass of documents? With the explosion of discovery since the electronic evidence rules went into effect, keeping up with the flow of documents is an increasingly challenging task, particularly as studies document that corporate litigation officers and client's budgets are strained. Working within this conundrum at the same time that experts seek to satisfy the courts admissibility requirements takes communication between the lawyer and the expert to be certain that all relevant facts are considered. In some cases, it may mean reading all the documents; in others, it may mean a more targeted search. In all cases, it requires careful fact-finding and a realization that *every* story has two sides, and the other side is there, buried somewhere in the documents—and the last place an expert wants to hear it for the first time is in their deposition, on the witness stand, or by reading it in a motion to exclude their testimony.