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ADVOCATE'S EDGE



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Federal Circuit rejects unreliable, speculative damages award

Preventing C-suite fraud

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Spotlight on FRE 702: When damages experts go astray

Amendments to Rule 702 of the Federal Rules of Evidence took effect on December 1, 2023. The changes raise the bar on the admissibility of expert testimony. One of the first rulings on a Rule 702 challenge under the amended guidance was *Bextermueller News Distributors, Inc., et al. v. Lee Enterprises, Inc., et al.* Here's a summary of why the court granted the defendants' motion to exclude the testimony of the plaintiffs' damages expert in this case.

Case facts

The plaintiffs were newspaper carriers who had contracted with the defendants to deliver papers to subscribers in specified territories. The contracts gave the plaintiffs exclusive home delivery rights within their territories and provided that the defendants won't "terminate such territorial rights or aid, abet or assist in the creation of other home delivery systems" within those territories.

The defendants began offering an electronic version of the newspaper in 2017. The plaintiffs sued the defendants in 2022. They alleged that the electronic delivery system breached their contracts and damaged the property interests in their routes and their relationships with their customers.

Estimated damages

To calculate lost revenues, the plaintiffs' damages expert multiplied the total digital-only subscribers in their territories for the period leading up to trial by the fee they were entitled to receive for each newspaper they delivered. The expert prepared similar estimates for future revenues over the following 15 years and discounted those amounts to present value.

The defendants challenged the expert's testimony as irrelevant and unreliable. They argued that the damage calculations were based on an erroneous

premise: The expert assumed the plaintiffs were entitled to recover delivery fees for every digital subscriber in their territories, even though there was no evidence that every digital subscriber would otherwise have been a print subscriber. The plaintiffs countered that their agreements required the defendants to pay them a fee for every delivery made in their territories, regardless of who made them or how they were made.



Rule 702 challenge

The U.S. District Court for the Eastern District of Missouri agreed with the defendants. For one thing, the contracts clearly stated that the defendants were obligated to pay a fee for each newspaper delivered “by the carrier.” Because the expert’s calculations were based on the faulty premise that the plaintiffs were entitled to a fee for each digital delivery, her opinion was “so fundamentally unsupported that it can offer no assistance to the jury.”

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The court explained that the alleged breach in this case was the defendants’ creation of an alternate delivery system. While plaintiffs were entitled to recover their lost profits — profits they would have realized but for the breach — the expert’s

calculations weren’t consistent with this measure of damages. For example, she made no attempt to determine how many digital subscribers represented revenue the plaintiffs would have earned had the breach not occurred. The court observed it was quite possible that some digital-only subscribers would never have been print subscribers even without a digital option.

The plaintiffs had access to a “trove” of financial data, and their expert could have used that data to compare their financial performance before and after the alleged breach. However, the expert simply included all the digital-only subscribers in her lost-revenue calculations. This approach, the court concluded, wasn’t consistent with the types of recoverable damages for breach of contract.

Key takeaway: Vet experts carefully

Today, courts no longer give expert witnesses the benefit of the doubt and allow the jury to evaluate the relevance and reliability of their testimony. So, it’s critical to ensure that your experts meet the admissibility standards set forth under the recently updated guidance. ■

Evolution of Rule 702

Federal Rules of Evidence (FRE) Rule 702 governs the admissibility of expert testimony. Originally, the rule allowed qualified experts to testify so long as their “scientific, technical, or otherwise specialized knowledge” would have helped the trier of fact understand the evidence or determine case facts.

In 2000, Rule 702 was amended to reflect the U.S. Supreme Court’s decision in *Daubert* and the cases that followed it. The Court designated federal trial judges as the “gatekeepers” of expert evidence. The amended rule set forth standards regarding experts’ methodology and the factual bases of their conclusions. The amendments were designed to prevent irrelevant or unreliable evidence from being admitted. Nevertheless, some courts interpreted these standards as going to the *weight* of expert testimony rather than its *admissibility*.

To ensure that federal trial judges perform their gatekeeping function, the Supreme Court approved additional amendments to FRE 702, which took effect December 1, 2023. The amendments require a proponent of expert testimony to demonstrate *by a preponderance of the evidence* that an expert’s testimony will assist the jury, 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. These changes clarify that whether expert testimony meets these standards is a question of admissibility for the court.

Shared experts, simplified solutions

Enhance litigation outcomes with joint valuation experts

In recent years, the use of jointly retained business valuation experts has gained traction. When the parties agree to hire a single neutral expert — instead of each side using separate experts — it can streamline disputes, minimize costs and reduce conflict. However, this approach isn't right for every situation.

What are the benefits?

Joint experts offer more than just lower costs. They can facilitate settlements, because both sides are using the same data and may stipulate to key points, possibly eliminating the need to go to court. And using a joint expert can reduce hostility between the parties. This can be particularly beneficial if the parties need to work together in the future — for instance, co-parenting their children or donating time to economic development projects in their local business community.

Courts may prefer these arrangements to avoid “battles of the experts” who often have divergent opinions. Because both parties choose joint experts, they're seen as neutral third parties,

increasing the reliability of their conclusions and credibility of the testimony in the court's eyes.

Some jurisdictions mandate the use of a joint valuator when the marital estate includes a private business interest.

Choosing to work with one expert demonstrates that both sides are willing to collaborate, setting a positive tone during the litigation process. The use of joint experts also tends to be less time consuming because there's only one report and one expert's testimony to review. Cross-examination is also less extensive, because the parties agree in advance that the expert is qualified, and the methods used are relevant.

What are some potential pitfalls?

There are some possible downsides to sharing valuation experts, depending on the complexity of the case, the trust between parties and the nature of the assets involved. For instance, dishonest litigants may hinder discovery and open communication, the prerequisites for using joint experts. In contentious litigation, getting the parties to agree on anything — including choosing a qualified valuation expert — can be challenging. If one party's top choice isn't selected, it can lead to distrust and a perception of bias. Failure to



agree on a joint expert also can delay the valuation process and prolong dispute resolution.

Attorneys often have concerns about using joint valuation professionals who can't advocate for their clients' interests or help evaluate strategic issues during settlement. And if the parties wind up in court, communications between both parties and the joint valuation expert generally won't be granted attorney-client privilege. It also may be harder to cross-examine joint experts or challenge their findings than it would be for opposing experts who work exclusively for the opposition.

When does it work?

Despite these drawbacks, joint valuations can be especially advantageous in divorce cases, where one (or both) parties lack financial resources or access to financial data. In fact, some jurisdictions mandate the use of a joint valuator when the marital estate includes a private business interest. Sharing

experts also can be key to collaborative divorces, where the parties agree to settle outside of court through a series of joint meetings.

Other situations where this approach may be beneficial include shareholder disputes, buyouts, and mergers and acquisitions. Complex cases involving multiple businesses or asset types may call for a joint *team* that include experts with various specialties, such as real estate appraisers, intellectual property and business valuers, and forensic accountants.

What's right for your situation?

If you decide to share experts, it's important to establish some ground rules up-front. Factors to consider include the purpose and scope of the engagement, responsibility for paying fees, timelines, preferred reporting format, and access to data and company personnel. A solid foundation is essential to achieving an outcome that satisfies both sides, while saving both time and money. ■

Federal Circuit rejects unreliable, speculative damages award

In a recent patent infringement case, the U.S. Court of Appeals for the Federal Circuit ruled that a federal trial judge should have granted the defendants' motion to exclude the testimony of the plaintiff's damages expert. Here's a summary of the decision in *Cyntec Company, Ltd. v. Chilisin Electronics Corp., Chilisin America Ltd.*

Trial court decision

The plaintiff sued the defendants for allegedly infringing its patents for molded chokes and an improved method of manufacturing them. Molded chokes — inductors used to eliminate undesirable

signals in a circuit — are found in many modern electronics.

Most of the damages sought by the plaintiff resulted from sales outside the United States. But the plaintiff accused the defendants of indirectly infringing its patents by selling products containing the infringing chokes to customers who imported those products into the United States.

To estimate U.S. sales of infringing products, the expert used Securities and Exchange Commission (SEC) filings to determine the customers' "importation rates" by dividing their U.S. revenue by their



worldwide revenue. To estimate the infringement revenue subject to damages, the expert multiplied the defendants' accused domestic revenue by each customer's importation rate. Then he multiplied these estimated direct sales by the plaintiff's estimated market share to arrive at the plaintiff's lost sales.

The court vacated the jury's lost profits award, finding that the expert's calculation was unreliable and speculative.

The jury awarded the plaintiff the full amount of requested damages: \$1,552,493 in lost profits, plus \$320,463 in reasonable royalty damages. The district court granted the plaintiff's motion for enhanced damages, resulting in a total damages award of \$5,553,244.

The defendants had filed a motion under Rule 702 of the Federal Rules of Evidence to exclude the damages expert's testimony. However, the U.S. District Court for the Northern District of California admitted it, ruling that the expert's opinions relied on "data sources that are sufficiently reliable that a jury can determine whether the assumptions made in his calculations were valid."

Appellate court finding

The defendants appealed on several grounds. Notably, they argued that the district court should have granted the Rule 702 motion. The appellate court agreed, holding that the district court abused

its discretion by admitting the expert's testimony. It vacated the jury's lost profits award, finding that the expert's calculation was unreliable and speculative. The revenue reported in customers' SEC filings included sales of noninfringing products and services, and the expert failed to account for those unrelated products and services.

The defendants also appealed the district court's rulings on two motions for judgment as a matter of law (JMOL). First, the defendants argued that the district court erred by granting the plaintiff's motion for a JMOL that its claims weren't invalid as obvious. The defendants asserted that factual disputes regarding this issue should have gone to the jury. The appellate court agreed, reversing and remanding this issue.

Second, the defendants argued that the district court should have granted their motion for a JMOL of noninfringement. They contended that the jury verdict rested on an erroneous construction of certain patent terms and wasn't supported by substantial evidence. The appellate court sided with the plaintiff. It found that the district court's construction of patent terms was proper and the evidence supported the verdict.

Experts in the crosshairs

Cyntec demonstrates how federal and state courts that follow the FRE scrutinize expert testimony for relevance and reliability. The appellate court recognized the trial court's duty to serve as gatekeeper to ensure that expert evidence is relevant and reliable. However, this case was decided shortly before amendments to Federal Rules of Evidence (FRE) Rule 702 took effect. (See "Evolution of Rule 702" on page 3). ■

Preventing C-suite fraud

Some businesses mistakenly assume executives aren't motivated to commit fraud because they're generously compensated. But 19% of fraud schemes are committed by owners and executives, according to "Occupational Fraud 2024: A Report to the Nations," published by the Association of Certified Fraud Examiners. The report also found that the median loss from executive-level fraud was approximately \$500,000, compared to only \$60,000 for rank-and-file employees who steal.

Most organizations can't afford such losses. Plus, there's the risk of bad publicity, potential for lawsuits, and productivity losses from demoralized co-workers to consider.

Key drivers

Most executives are trusted, long-term employees. But, like other workers, they may feel internal and external pressures to steal from their employers. For instance, executives often face lifestyle pressures — such as the need to live in an expensive neighborhood or wear costly clothing and jewelry to prove they've "made it." They may also feel pressure to boost sales or profits to make their companies, and their own performance, look better.

High-ranking employees generally have power and authority. So, they may have ample opportunity to steal or cheat — particularly if their company hasn't adopted, or doesn't enforce, internal controls that cover everyone.

Preventive measures

Internal controls are critical to preventing and detecting occupational fraud. But to help deter executives from engaging in criminal activity, extra steps may be required. For example, because upper management often has the authority to override internal controls, company policies should clearly explain when overrides are permissible. If an executive believes an override is necessary, the

company's policies should require the person to document the incident and obtain a second opinion.

Other suggestions include:

- Mandating fraud training for *all* workers,
- Giving internal and external audit teams full access to the company's records,
- Conducting surprise audits to catch dishonest executives off guard,
- Implementing third-party anonymous reporting hotlines that allow whistleblowers to share concerns without risking their jobs, and
- Conducting fair and unbiased external investigations of all fraud allegations.

The ACFE reports that executives generally are less likely to receive punishment for fraud offenses than lower-level employees. So, it's important for organizations to pursue legal civil and criminal remedies when fraud is found. Prosecuting fraud sends would-be thieves a clear message that the company won't tolerate illegal activities by employees at any level.

Outside guidance

Forensic accountants can help organizations evaluate their antifraud policies and procedures to help ensure they address executive fraud risks. They can also conduct companywide fraud training sessions and investigate fraud suspicions. ■





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