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Further, it noted that the “surgical instrument market is mature and experiences little yearly growth.” The court concluded, “This hole in [Fisherman’s expert’s] sales model renders all of his damage calculations, which are premised on lost sales nationwide, unreliable.”

The court also criticized the expert’s assumption that Tri-anim would have sold \$5,000 per month per representative. It acknowledged that a Tri-anim officer

believed that amount could be sold. However, Tri-anim lacked any experience in the surgical instruments market. Further, Tri-anim sold only \$277 to \$1,100 per month during the operation of the contract. Thus, the court found the expert’s reliance on the \$5,000 per month estimate unreliable.

The court then considered the expert’s inclusion of lost merger/exit value, which was based on the assumption that Fisherman and Tri-anim would be economically incentivized to renew the agreement or merge at the end of the contract. The court rejected this head of damages. It found that “the fact that Tri-anim terminated the Distribution Agreement suggests that [these] assumptions about the parties’ economic incentives are incorrect, at least in the short term.” Thus, the court rejected the expert’s analysis of the losses as unreliable, and excluded his opinions under its gate keeping obligation. ❖

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Lost Profits Expert Excluded under *Daubert*

In *Fisherman Surgical Instruments, LLC v. Tri-anim Health Services, Inc.*, 2007 U.S. Dist. Lexis 61222 (D. Kan. August 20, 2007), the U.S. District Court for the District of Kansas considered whether a financial damages expert should be excluded under Fed. R. Evid. 702 and *Daubert*.

Fisherman Surgical Instruments, LLC (“Fisherman”) manufactured surgical instruments. In February 2005, it entered into an exclusive distributor agreement with Tri-anim. The agreement had an initial term of five years and renewed annually thereafter, but could be terminated on 90 days notice without cause. Tri-anim distributed surgical instruments throughout the United States, but had a sales force of only 13 at the time the agreement was executed. Nevertheless, Tri-anim indicated that

it believed it could sell \$5,000 per month per sales representative exclusive of bulk sales to hospitals.

Later that year, Tri-anim acquired a competitor that distributed another manufacturer’s surgical equipment. In response to Fisherman’s letter addressing this competitive situation, Tri-anim terminated the agreement in October 2005. Thereafter, Fisherman filed suit claiming breach of contract and seeking lost profits over the five-year contract.

Fisherman engaged a CPA with business valuation and fraud credentials to assess its lost profits. Fisherman’s expert assessed losses under three scenarios. First he calculated the loss based on

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Fraud Damages Reversed Where Expert Was Not Used

In *J. Mark Swinnea v. ERI Consulting Engineers, Inc.*, No. 12-05-00428-CV (Tex. App. 12 Dist. [Tyler] August 30, 2007), the Texas Court of Appeals, Twelfth District, considered whether the evidence supported the trial court’s damage award for fraud and breach of fiduciary duty in connection with the sale of a business interest.

Swinnea and Snodgrass owned ERI Consulting Engineers, Inc. (“ERI”), which provided consulting services related to asbestos abatement projects. In 2001, Snodgrass purchased Swinnea’s interest in ERI for \$497,500 in cash and his stock in a

related entity that owned the real estate housing ERI. Contemporaneously, ERI and Swinnea executed a six-year non-compete and employment agreement. The purchase was structured as a stock redemption.

Prior to the buyout Swinnea formed AQA, an asbestos abatement company, which bid on projects managed by ERI. AQA competed directly with Merico, another abatement company with whom ERI had a synergistic relationship. Merico

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New Business Rule Applied to Mine Operation

In *American Safety Indemnity Co., Inc. v. Stollings Trucking Co., Inc.*, No. 2:04-0752 (S.D. WV July 30, 2007), the U.S. District Court for the Southern District of West Virginia considered whether lost profits could be recovered as a consequence of the plaintiff's failure to provide insurance.

Stollings Trucking Co. ("Stollings") operates a mining business. Stollings obtained general liability insurance from the plaintiff. The general liability policy provided \$1 million in coverage per occurrence, while the excess liability policy had an aggregate and per occurrence limit of \$4 million. Between 2001 and 2002, Stollings suffered a series of unfortunate events that resulted in personal injuries, which exposed it to multi-million dollars of liability. The plaintiff construed its policy as to provide a \$1 million per incident limit.

Stollings also suffered additional losses. In 2003, its Coalburg mine collapsed. Stollings obtained permits and intended to reenter the Coalburg mine from the other side of the mountain. Stollings claimed that since the plaintiff limited its insurance to \$4 million and it faced millions in liabilities, it postponed commencing to

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Tri-anim's representation that it could sell \$5,000 per month per sales representative. He then assumed that Tri-anim would increase its sales force from 13 to 101 representatives to completely and adequately cover the United States. This resulted in lost profits of \$3.8 million over the contract's five-year term.

The expert then determined the acquisition/exit value at the end of the five-year term. He reasoned that Fisherman and Tri-anim would develop interdependence over the contract period such that they would either renew the contract or merge. Then based on merger data and the distribution agreement, the expert determined that as a result of the loss of this relationship Fisherman suffered loss of value of \$1.7 million. This amount was then added to the lost profits for a combined loss of \$5.5 million.

The expert lastly combined the two approaches discussed above in his third scenario. Under this scenario, he increased expected sales over the five-year contract term from \$5,000 per sales representative to \$21,500 per sales representative. The second figure was the amount

reopen the mine. As a result, Stollings claimed that it lost between \$20 and \$28 million.

The plaintiff moved for summary judgment. It argued that Stollings failed to present any foundation for its lost profits, whether through expert testimony, documentary evidence, or otherwise.

The district court granted the plaintiff summary judgment on the issue of lost profits. The court found that opening a new mine is akin to a new business, which requires heightened scrutiny of lost profits claims. That heightened scrutiny includes "expert testimony, economic and financial data, market surveys and analyses, business records of similar enterprises, and the like." However, Stollings did not present any evidence of its loss, including affidavits, expert testimony, or any financial data. Moreover, the court considered the Coalburg mines' operating history for the five years before its 2003 closure, which indicated an average annual profit of \$134,000. The court determined that this amount did not support the claimed \$20 to \$28 million in lost profits. Thus, it granted summary judgment to the plaintiffs. ❖

of sales Tri-anim made per month per sales representative of the competing surgical instruments and included bulk sales to hospitals. Based on this revised assumption, the expert increased the lost profits estimate to \$10.5 million and lost exit value to \$6.6 million, for a total loss of \$17.1 million.

Tri-anim challenged the expert's damage calculation on several fronts in its *Daubert* motion. It argued that the expert used erroneous assumptions in assessing those losses: (1) the sales projections were not supported by the contract or Tri-anim's historical sales and (2) there was no obligation to merge or renew at the end of the initial contract term. The court agreed.

The court first addressed the sales assumptions relied on by Fisherman's expert. It noted that while the contract contemplated nationwide distribution, no evidence supported the expert's assumption that Tri-anim could expand its sales force to 101 representatives over the first 3.5 years of the contract, especially when it took Tri-anim 20 years to grow its first nationwide division.

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would allow ERI to bid on projects under its control and vice versa, but the bid had to be competitive.

In 2005, ERI sued Swinnea for breach of fiduciary duty and fraud in connection with the buyout. The lower court found Swinnea liable on both counts and awarded ERI the amount it paid for Swinnea's stock as well as lost profits of \$300,000. Swinnea appealed.

On appeal, Swinnea argued that the damage awards were not supported by the evidence. The appellate court considered the awards under the alternative measures of damages available for fraud: (1) recovery of out-of-pocket losses, which is the difference between the value given and the value received, and (2) recovery of the benefit-of-the-bargain, which is the difference between the value as represented and the value received. No expert testimony was provided to the court by either party regarding either measure of damages.

The court first considered the out-of-pocket measure of damages. The court noted that Snodgrass testified that he believed that ERI was worth "what he paid for it" and ERI's accountant, who did not opine as to the value of the business, indicated that he thought the transaction was a "good deal." The court noted that ERI's financials provided insufficient information from which to determine its value at any time. The court emphasized the accountant's disclaimer accompanying the financials, which indicated that they lacked sufficient information to provide an accurate picture and care should be taken in their use. Moreover, the court noted that goodwill was a valuable, if intangible asset of the business, but that no information regarding its value was presented to the court. Thus, the court concluded that no evidence regarding the value of the business on the date of the buyout was presented and therefore, the out-of-pocket measure indicated no damages.

The court then considered the benefit-of-the-bargain damages. Under this measure, ERI prayed for lost profits. Snodgrass claimed he expected Swinnea to bring in additional business which did not materialize when Swinnea formed AQA because Merico suspended working with ERI for a short period. The court noted that "[l]ost profits are measured by comparing the anticipated profits under the fraudulently promised bargain with profits actually received." However, it also noted, "Anticipated profits cannot be recovered where they are largely speculative, such as when they are dependent upon uncertain and changing conditions, including market fluctuations, or the chances of business, or where there is no evidence from which they may be intelligently estimated." Here, the court found that the trial court's \$300,000 lost profits award was not supported by the evidence. It noted that Snodgrass's evidence consisted of the significant decrease in pre-buyout sales to Merico from monthly averages of \$19,833.10 to \$1,792.59. However, the court noted that these figures were gross revenues rather than net revenues. It further determined that based on Snodgrass's later testimony that ERI had a net margin of 30%. This indicated a total damage estimate of \$178,601.04, which fell far below the trial court's award and thus could not be supported. The court further rejected the lost profits award because the evidence indicated that the asbestos removal and abatement business was in decline since there were a finite number of contaminated buildings. Therefore, the court found that the trial court's award of \$300,000 in lost profits was not supported by the evidence.

The appellate court reversed and remanded the matter back to the trial court on the issue of damages. It found that damages were not proven under either the benefit-of-the-bargain or the out-of-pocket measure. ❖