



# FORENSIC PERSPECTIVE



## CASE IN POINT

### Defense and Damages Experts: To Hire or Not to Hire?

The Defense in a lost profits/economic damages case usually has a difficult decision to make with respect to a financial damages expert: *to hire or not to hire?* This decision can be an integral part of the overall strategy. On one hand, the Defense oftentimes disagrees with the Plaintiff's damage calculation and wants it to be adjusted. On the other hand, by hiring an expert to calculate damages, the Defense may worry the jury will assume damages should be paid no matter what. Also, the Defendant may be hesitant to incur the extra cost of hiring an expert.

As a compromise, Defense attorneys are making the strategic decision to hire a financial expert only to rebut the Plaintiff's expert witness without creating a separate damage calculation. A recent case demonstrating an effective use of this strategy is *Sossikian v. Ennis*, 2009 WL 2106106 (Cal. App. 1 Dist.) (July 16, 2009) (unpublished).

In *Sossikian v. Ennis*, the parties were bound by a rental agreement. Mr. and Mrs. Sossikian maintained and operated a gas station on property owned by a group of eight owners, referred to as the Ennis/Cooke group. In late 2005, the Sossikians accepted an offer from prospective buyers to purchase the gas station for \$1.2 million. In order for the sale to be in accordance with the rental agreement, the Sossikians were required to obtain consent for the assignment of the lease from the Ennis/Cooke group. Only three of the eight owners approved the assignment, saying they disagreed with certain provisions in the lease that extended the lease period to 2028, as well as other adjustments. The Sossikians claimed that because they did not receive consent to assign the lease within a reasonable amount of time, the buyers walked away from the deal. The Sossikians sued the Ennis/Cooke group claiming they had incurred damages because the Ennis/Cooke group had unreasonably withheld consent to the assignment, thus, breaching their rental agreement.

At trial, the Plaintiff hired a real estate broker and general appraiser as an expert ("Plaintiff's Expert") to calculate damages. Plaintiff's damages were \$1,171,733, which included \$800,000

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## Defense and the Damages Expert Witness: To hire or not to hire? (cont'd)

from the loss of sale (the \$1.2 million sales price less the \$400,000 fair market value of the business, which their expert valued) and \$371,733, representing the amount of principal and interest on loans taken out by the Plaintiff to run the business from the breach date until the trial date.

To rebut the Plaintiff's expert, the Defense engaged a Certified Public Accountant ("CPA") and business valuation professional. In his testimony, the Defendant's Expert raised several issues with Plaintiff's Expert's damage calculation, including:

- If given the same documents Plaintiff's Expert used to value the business, Defendant's Expert would not have been able to "reach any conclusion" as to the value of the business,
- Plaintiff's Expert did not have enough information to appropriately value the business,
- Plaintiff's Expert's market analysis should have been based on actual sales amounts of comparables, not asking prices, which are inflated,
- Plaintiff's Expert only used five comparables in his market analysis, and
- Plaintiff's Expert should not have relied so heavily on uncited articles to justify the decrease in value of similar companies within the industry.

At trial, the jury decided in favor of the Plaintiff as a matter of law, finding that the Ennis/Cooke group did unjustly withhold consent of assignment. The jury awarded them damages of \$43,184.20 and attorneys fees of \$142,690.75. The damage amount represented the amount of rent paid by the Sossikians' business to the Ennis/Cooke group from June 2006 through September 2007. This amount was much less than the \$1,171,733 claimed by the Plaintiff.

The Ennis/Cooke group appealed the trial court's decision, claiming there was a legitimate, "commercially reasonable" basis for their decision not to approve the assignment, among other claims. Also on appeal, the Plaintiff renewed its argument that they should have been awarded \$800,000 (the damages from the loss of sale) because their financial expert's damage calculation was uncontradicted. They argued that because the jury received no other evidence regarding the correct damage amount to be paid, the jury *must* use the damage amount given by their expert.

The appellate court disagreed with the Sossikians' argument that the jury must accept their expert's uncontradicted testimony. They said,

*"Expert testimony is not conclusive in the sense that it must be accepted as true. It is really an argument of an expert to the [trier of fact], and is valuable only in regard to the proof of the facts and the validity of the reasons advanced for the conclusions. The weight to be given to the opinion of an expert depends on the reasons he [or she] assigns to support that opinion."*

The appellate court noted that the Defendant's expert was able to cast sufficient doubt on the calculation submitted by the Plaintiff's Expert. Even though the Defendant's expert did not calculate his own damages, his rebuttal of the Plaintiff's damages was sufficient to call the Plaintiff's damages into question. The appellate court stated the jury was free to accept or reject the opinions of both experts. As for the Plaintiff's argument that the jury should have awarded \$800,000 in damages, the appellate court stated that the jury's task was to determine "if" the damages were warranted and, if so, how much. They were under no obligation to award the damages from the loss of the sale.

By using a rebuttal expert, the Defense was able to protect itself against the Plaintiff's damage calculation while at the same time not implying to the jury that damages should be awarded. Their strategic decision *to hire* proved to be valuable in this case.

## FRAUD CORNER

## Fraud Prevention Practices: Tips to safeguard your company's assets

In times of economic downturn, there is believed to be a corresponding uptick in reported fraud cases committed against organizations. During these times of heightened risk, it is important to take proper steps to protect your company against occupational fraud. Because few companies ever recover their losses after fraud (the ACFE found that the average recovery is 20% of the original loss, and 40% of companies recover none of their losses), the most cost-effective way to implement a good fraud prevention program. A few ways to prevent fraud are:

**1) Perform a fraud risk assessment**—In order to create an effective fraud prevention program, it is essential to understand where your company currently stands in regards to fraud and internal controls risks through a process known as a "fraud risk assessment". During a fraud risk assessment, the company's important processes and procedures are studied. Based on an understanding of current procedures and a knowledge of occupational fraud, the team brainstorms and prioritizes the potential threats.

**2) Perform an internal control assessment and remediation**—This analysis uncovers instances in which internal controls need to be adjusted or augmented. Implementing these new controls will give your organization a stronger defense against occupational fraud.

**3) Create a system of ongoing monitoring**—Implementation of an ongoing monitoring and testing plan will ensure that your organization continues to focus on preventing and detecting fraud in the future.

**4) Create a "perception of detection"**—A "perception of detection" among employees is an effective deterrent to fraud since an employee is less likely to commit fraud if they think they will get caught.

**5) Use a hotline**—Hotlines allow employees to place anonymous tips regarding fraud to a third party answering service. A number of companies provide these services, but EthicsLine is a common choice ([www.ethicsline.com](http://www.ethicsline.com)).

The likelihood of a fraud occurring decreases dramatically when a fraud risk prevention program is in place. While these techniques are known to prevent and detect fraud, no method is 100% full-proof. However, by remaining vigilant, continuing to fine-tune internal controls and staying up-to-date on current issues, your company will be better-equipped to handle fraud.

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