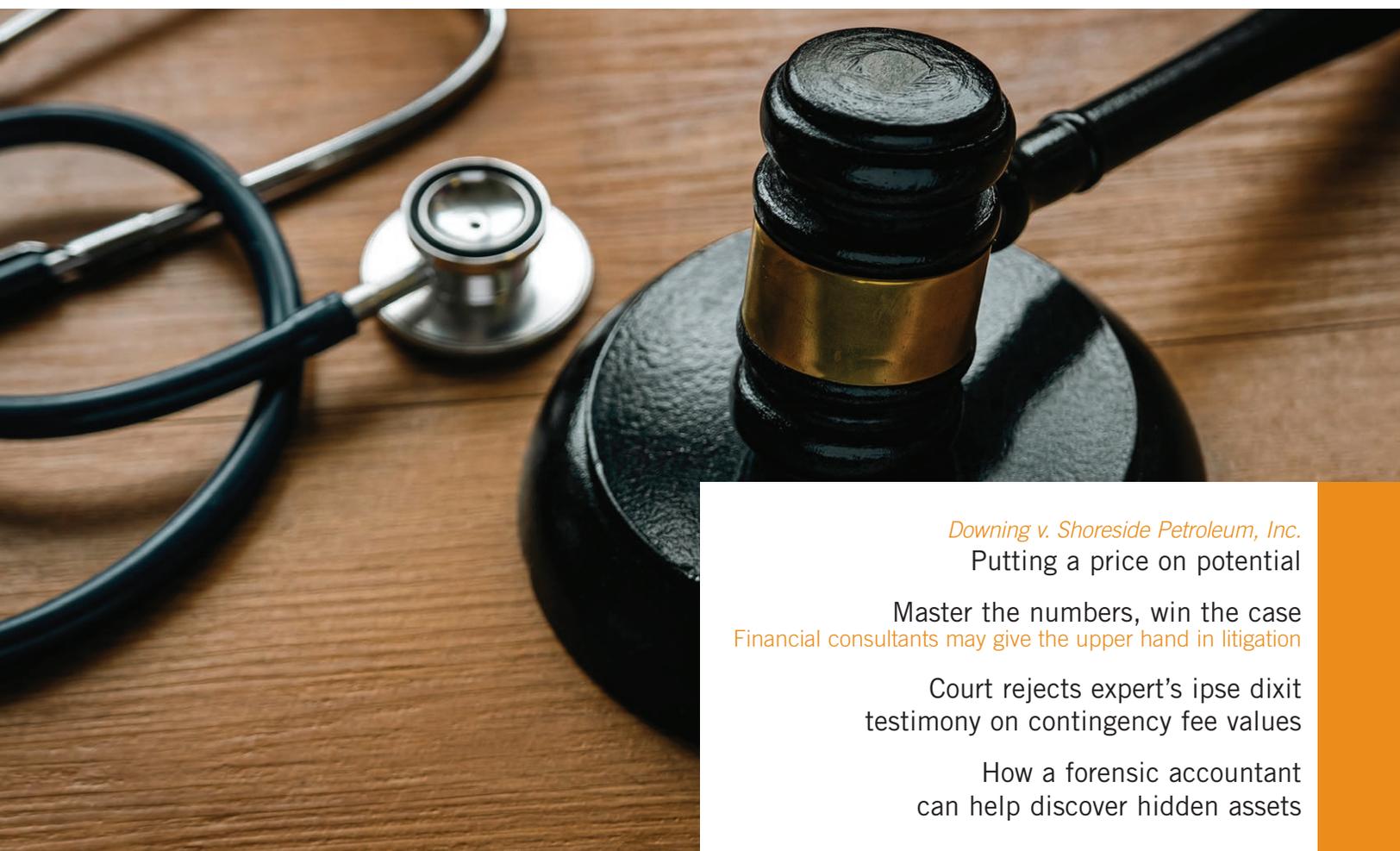


ADVOCATE'S EDGE



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Downing v. Shoreside Petroleum, Inc.

Putting a price on potential

Proving damages for lost earnings capacity in a personal injury case can be challenging given the many uncertainties surrounding a person's future income. A recent Alaska Supreme Court case provides valuable guidance on this issue. In *Downing v. Shoreside Petroleum, Inc.*, a 60-year-old obstetrician-gynecologist whose car was rear-ended by a truck in 2017 suffered bruising, broken ribs and neurological symptoms associated with an alleged traumatic brain injury. She sued the truck driver and his employer.

Evidence of lost future income

At trial, the plaintiff's experts testified that her injuries limited her ability to work. Among other things, the injuries allegedly caused her to relinquish privileges at one of three hospitals where she performed "complex and expensive surgeries." The plaintiff's damages expert — a rehabilitation counselor and disability management specialist — determined her pre-accident earnings capacity by averaging her income for 2015 and 2016. This represented a "high water mark" for her earnings.

The expert testified that absent her injury, the plaintiff could have earned approximately \$4.78 million during the four years between the accident and trial. Her actual earnings during that period totaled only about \$950,000, so he estimated that she'd already lost roughly \$3.8 million in past earnings.

Regarding the plaintiff's *future* earnings capacity, the average remaining work life for a 60-year-old woman is only 6.3 years. However, the plaintiff's expert determined that, if the accident hadn't occurred, she likely would've worked another 8.5 years to meet the terms of her business's lease. Her expert also made the following assumptions:

- The accident decreased the plaintiff's future working life to only 4.1 years.
- Her annual earnings capacity at the time of trial would have been approximately \$1.24 million, but for the accident.
- Her expected future earnings were only \$100,000 per year, based on earnings statistics for professionals with some cognitive disability.



As a result, the plaintiff's expert estimated that her lost past earnings and future lost earnings capacity totaled approximately \$14 million.

Lost earnings amount lowered

Conversely, the defendants' CPA expert compared the amount the plaintiff generated for the practice to the earnings generated by the practice's other providers. Based on the plaintiff's "net provider charges," he concluded her lost earnings attributable to the accident were only about \$80,000 in the months following the accident.

The trial court awarded the plaintiff just over \$1.5 million in medical expenses and “noneconomic damages,” plus roughly \$80,000 in lost past earnings. The court found that the plaintiff had met her burden of proving that the accident diminished her future earnings capacity. However, she failed to establish the amount of her future loss with reasonable certainty.

First appeal

On appeal, the Alaska Supreme Court reversed and remanded the trial court’s dismissal of the plaintiff’s future lost earnings claim. The court explained that once the *fact* of damages is proven with reasonable certainty, establishing the *amount* of damages requires only “evidence sufficient to enable the fact finder to make a reasonable estimate.”

On remand, the trial court reevaluated the experts’ testimony. Regarding the plaintiff’s pre-accident earnings capacity, it found her expert unpersuasive. By averaging business income for the two highest-grossing years, the expert failed to 1) account for income fluctuations, and 2) “separate the business from the person” by attributing all revenue to the plaintiff’s efforts.

The court adopted the defendants’ expert’s estimate of pre-accident earnings capacity at approximately \$1.17 million, based on the plaintiff’s net provider charges. Regarding future lost earnings capacity, the court found the estimate provided by the plaintiff’s expert “conjectural at best.” It also rejected the defendants’ expert’s estimate of lost earnings capacity (zero) because the plaintiff’s injuries had been proven to affect her ability to work.

Instead, the court estimated the plaintiff’s annual lost earnings capacity at roughly \$150,000 by calculating the plaintiff’s daily loss rate in the months following the accident and multiplying that figure by the workdays in a year. Assuming the plaintiff would have been likely to work another 6.3 years,

What about fringe benefits?

Claims for lost earnings capacity often seek compensation for lost fringe benefits, such as employer-provided health care coverage, retirement benefits and paid time off. However, placing a monetary value on noncash benefits can be difficult.

Possible market-based value indicators include the employer’s cost or value to the employee (typically based on replacement cost). These figures may differ significantly, leading to disputes.

For example, the replacement cost of lost health benefits for a plaintiff may be substantially higher than the cost of premiums under a group plan. Experts may also consider industry benchmarks for fringe benefits or evaluate the employee’s entire compensation package and then calculate fringe benefits as a percentage of total compensation.

her lost future earnings totaled approximately \$950,000 (6.3 times \$150,000, rounded).

Second appeal

On appeal, the Alaska Supreme Court affirmed the award. It rejected the plaintiff’s contention that the trial court was required to choose a damages award within the range of values proposed by the plaintiff’s witnesses (and not directly challenged by the defendants). Instead, the court was free to accept or reject the experts’ reports and come to its own conclusion regarding future lost earnings capacity.

The court noted that estimates of future earnings capacity are “necessarily imprecise.” As a result, it ruled that the trial court didn’t “clearly err” in estimating the plaintiff’s post-accident earnings capacity.

An inexact science

As *Downing* illustrates, calculating damages for lost earning capacity is a matter of professional judgment. It’s critical for experts to offer objective, market-based analysis that allows the court to reasonably estimate those damages. ■

Master the numbers, win the case

Financial consultants may give the upper hand in litigation

Outside financial experts often serve a *consulting* role in cases involving complex financial matters. For instance, they can help attorneys and business owners navigate the complexities of accounting and tax principles, valuation and forensic accounting methodologies, and financial analysis techniques.

It's often prudent for one financial expert to act as a behind-the-scenes consultant and strategic partner while a different independent expert testifies at trial. Keeping these roles separate generally protects the consultant's opinions and communications from discovery — except under extraordinary circumstances. This allows attorneys and clients to share information freely with consultants and seek their opinions on sensitive issues without fear of revealing strategies to opponents.

Reviewing financial documents

In most cases, testifying experts issue written reports before their depositions. The reports outline their opinions, methodologies and supporting evidence. A financial consultant can evaluate reports prepared by both your side's testifying expert and

the opposing expert. Their reviews help identify weaknesses in financial analyses, highlight errors in calculations and assess whether conclusions align with industry standards.

Asking “what-if” questions forces testifying experts to justify their methodologies under alternative circumstances.

Attorneys may also hire financial consultants to interpret documents central to a case, such as tax returns, financial statements, general ledgers and accounting schedules, and shareholder agreements. Their interpretations may uncover potential discrepancies or hidden financial details that could be pivotal in litigation.

Drafting technical EBT questions

Financial consultants can help attorneys draft questions for depositions, also known as examinations before trial (EBTs). These questions typically assess the experts' qualifications and experience,

clarify calculations, challenge subjective assumptions, and identify biases and inconsistencies.

In addition, financial consultants might help frame hypothetical scenarios to test the consistency of an expert's analyses. Asking “what-if” questions — such as how a valuation would change under different market conditions



or how damage calculations would shift with adjusted revenue assumptions — forces testifying experts to justify their methodologies under alternative circumstances. This can expose weaknesses or subjectivity in their conclusions and provide valuable insights into the expert’s ability to withstand cross-examination.

“Mock” EBTs, where the financial consultant plays the role of the opposing expert, can help attorneys refine questions, test strategies for direct and cross-examination, anticipate objections, and assess their own testifying expert’s ability to perform under pressure. Simulating responses to key financial questions improves expert witness preparation and helps attorneys strengthen their ability to challenge financial evidence effectively.

Preparing for trial

Once EBTs are complete, financial consultants can review the testifying experts’ testimony for inconsistencies in written reports and other financial documents. Major concerns or contradictions may help support motions for summary judgment or to impeach expert witnesses. Although testifying experts generally don’t issue new reports post-deposition, they may submit a supplemental report if new information emerges or to clarify or expand on prior opinions. Financial consultants can also

evaluate supplemental reports before trial and advise attorneys accordingly.

With the help of a financial consultant, attorneys can refine their trial strategy and draft pointed cross-examination questions for opposing experts. Moreover, they can evaluate their own experts’ positions and adjust direct-examination questions and trial arguments.

In addition, attorneys can use financial consultants to help prepare trial exhibits that distill complex financial data into easy-to-understand charts, graphs and tables. These exhibits may help reinforce testimony, summarize key findings and visually support arguments while adhering to evidentiary standards. They should clarify key points without misleading or overwhelming judges and juries with limited financial or accounting backgrounds.

Gaining a competitive edge

Partnering with a financial consulting expert — from the onset of a case to closing arguments — provides a strategic advantage in litigation. It allows attorneys to build stronger cases and present well-supported financial arguments in depositions and at trial. ■

Court rejects expert’s ipse dixit testimony on contingency fee values

The legal term “ipse dixit” refers to an unproven assertion supported only by the authority of the person who made it. It’s the equivalent of “because I said so.” In a recent case, *Freedman Normand Friedland LLP v. Cyrulnik*, the U.S. District Court for the Southern District of New York excluded a valuation expert’s testimony because he failed to provide reliable support for his methodology’s underlying assumptions.

Unsupported assumptions

The case involved a law firm partner who alleged he’d been wrongfully terminated. One element of the damages claim was his alleged share of expected fees from four contingency fee cases. Because the outcome of these cases is uncertain, estimating their values can be challenging. The partner hired an expert with “extensive credentials

in finance, accounting, and the valuation of companies” to value the firm’s contingency fees.

Before trial, the firm filed motions in limine to preclude 1) the partner’s damages expert from testifying on the value of the contingency cases, and 2) the partner from offering lay testimony on his damages. Although the expert lacked any legal training and had never valued a lawsuit, the court held that he might still be qualified to testify if he could demonstrate that “his valuation expertise could be reliably applied to the valuation of lawsuits.” However, the expert failed to demonstrate that it could.



The court found the expert’s opinions unreliable because they were contradicted by actual results or case status.

The expert purportedly based his methodology on a 10-factor test for valuing a portfolio of contingency cases, but he lacked sufficient data to apply that test. Instead, he devised a simple (but unsupported) test for evaluating the four contingency matters based on probable damages and the probability of success. Apart from his own ipse dixit testimony, the expert provided no support for his assumptions.

Contradictory evidence

The court also found the expert’s opinions unreliable because they were contradicted by actual results or case status. For example, for one class action contingency fee case, the expert assumed the firm had a 50% chance of recovering \$850 million in probable damages, based solely on unverified newspaper accounts. Further, he opined that the partner would be entitled to nearly \$3.3 million of the expected fee — even though the firm had been removed as class counsel and was no longer involved in the case.

For another case, the expert estimated the firm had a 50% chance of recovering \$50 million in probable damages. The partner’s expected share of the contingency fee would be roughly \$740,000. There was “no persuasive basis for [the expert’s] estimate of the damages or the chance for success.” Moreover, the case had been settled without any payment, and the firm recovered no contingency fee.

Partner allowed to testify

Although the court didn’t permit the expert to testify, it allowed the partner’s testimony about the value of the firm and its cases. It’s common for owners with personal knowledge of a company’s finances and operations to act as lay witnesses about business (or asset) values.

The court acknowledged that opposing counsel would have the right to object to specific portions of the partner’s testimony if there was a good-faith basis to question his personal knowledge. However, the parties settled before going to trial.

Explanation needed

Often, the admissibility of expert testimony can make or break a case. As this case shows, mere conclusory opinions aren’t enough. To be admissible, an opinion must explain how the expert reached his or her conclusion using proven methodologies and reliable data. ■

How a forensic accountant can help discover hidden assets

In shareholder disputes, divorces and other high-stakes litigation, dishonest parties may attempt to hide income or assets to protect their financial interests. Here's an overview of two methods forensic accountants commonly use to demonstrate the existence of hidden financial items.

1. Net worth analysis

Net worth analysis entails looking at changes in a subject's net worth and reconciling those changes with income and expenses. Financial experts can reconstruct data from various sources, including:

- Bank records,
- Real estate and court filings,
- Payroll records,
- Expense reports,
- Phone bills,
- Insurance documents,
- Credit reports, and
- Employment and loan applications.

An expert might compare a subject's net assets at the beginning and end of the year, adding known income and subtracting known expenses. Any result other than zero indicates income from unknown sources.

Alternatively, an expert may look for discrepancies between the subject's expenditures and his or her sources of funds, including salaries, commissions, investment dividends, inheritances, loans, gifts and cash on hand at the beginning of the year. If someone's spending exceeds the available funds, an unknown source of funds exists. However, this analysis can be complicated because many people pay cash for expenses such as meals and entertainment and don't keep receipts. If it appears a subject is using skimmed funds to pay for cash items, a more in-depth investigation will be necessary.



In other cases, an expert might assess the individual's bank deposits. This technique assumes that all money is either spent or deposited. The expert starts with net deposits to all accounts during the year and adds cash expenditures to arrive at total annual receipts. If that amount exceeds funds from known sources, the difference represents an unknown source of funds.

2. Tax return reviews

Forensic specialists may review several years of tax returns for specific items and general trends. They pay particular attention to wage income, interest and dividend income, state and federal tax refunds, alternative minimum tax, and retirement plan contributions.

Tax return schedules also can contain a wealth of information. For example, Schedule A (itemized deductions) covers real estate and personal property taxes. Amounts reported on this schedule should correspond to known property. If not, further investigation may lead to undisclosed assets. Entries regarding state and local taxes may reveal income (or income-producing property) in other states.

Digging deeper

The existence of a previously unacknowledged source of funds doesn't necessarily mean the subject is wrongfully concealing assets. However, when experts find an unexplained gap, they know that the subject's financials merit further investigation. ■

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- ▶ Contract dispute and analysis
- ▶ Fraud investigations
- ▶ Lost profit analysis
- ▶ Securities claims
- ▶ Shareholder derivative actions
- ▶ Purchase/Sales agreement warranty claims
- ▶ Legal and accounting malpractice claims
- ▶ Intellectual property analysis
- ▶ Other economic damage claims

Arnie & Company has an especially strong depth of experience in the analysis of commercial damages and in conducting forensic investigations. Dennis Arnie is both a Certified Public Accountant and a Certified Fraud Examiner. He has frequently testified as an expert witness in a variety of state and federal courts and various arbitration hearings.

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