THE Witness Chair

Leading-edge Ideas for CPAs Providing Litigation and Dispute Resolution Services

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Unestablished Businesses, Lost Profits and 'Reasonable Certainty'

by Jeffrey A. Klein, MBA, JD

Recovery of lost profits by businesses in contract and tort actions is constrained by the notion that any estimate of damages must be proven with "reasonable certainty." In *VingCard A.S., et al. v. Merrimac Hospitality Systems, Inc.*, a Texas Court of Appeals described this concept of reasonable certainty to be "at a minimum … based on objective facts, figures or data from which the amount of lost profits can be ascertained."

For unestablished businesses, earlier courts found that recovery of future lost profits of such businesses was inherently speculative due to a lack of historical profits. This is known as the New Business Rule, the application of which was often a *per se* bar to recovery for an unestablished business.

However, over past decades, many courts recognized the inherent unfairness of the New Business Rule, as it could lead to defendants getting away with conduct that had harmed plaintiffs simply because the business in question was categorized as "unestablished."

Today, the stricter form of the New Business Rule is followed in only a handful of states, including Illinois and Virginia—and even those states have seen the courts carve out exceptions that allow for recovery of lost profits in some situations. In the remaining vast majority of states, courts emphasize the sufficiency of the evidence of lost profits suffered by an unestablished business rather than focusing on a categorization of plaintiff as a new or unestablished business (See, for example, *Beverly Hills Concepts, Inc., et al.* v. *Schatz and Schatz, Ribicoff and Korkin et al.*).

Evidence Considered by Courts

In *Kids' Universe et al. v. In2Labs et al.*, the California Court of Appeal quoted the Restatement of Contracts, saying that "… damages may be established [for an unestablished business] with reasonable certainty with the aid of expert testimony, economic and financial data, market surveys and analyses, business records of similar enterprises, and the like." Types of evidence identified by the Court of Appeal include:

- Previous experience of management in the particular industry or market at issue (as well as plaintiff's experience in the same enterprise, subsequent to defendant's actions).
- Prelitigation projections.
- Data from comparable companies operating under similar conditions.
- Average experience of others in the same line of business.
- Whether the relevant market is an established one.
- Scientific market studies.

A key consideration articulated by the courts is that the analysis must be related to the unestablished business in question. More specifically, as described by the Supreme Court of Connecticut in *Beverly Hills Concepts*, "[t]he underlying requirement … is a substantial similarity between the facts forming the basis of the profit projections and the business opportunity that was destroyed."

Management Experience

In *Pauline's Chicken Villa Inc. v. KFC Corp.* the Supreme Court of Kentucky found that recovery for an unestablished business was not barred where factors indicated that any "uncertain variables" were virtually eliminated. There, the business at issue was a national franchise location that had failed to be built due to defendant's actions. In reversing a lower court's decision precluding lost profits because the plaintiff's loss was that of an unestablished business, the Supreme Court of Kentucky pointed to the quality of the information available and the relevant experience of the plaintiff:

"This is a national franchisor, with uniformity of national advertising, uniform quality control, earnings and expense figures on nearby and comparable locations, and an available history concerning success and failure ratios. The franchisee, likewise, is experienced in the field and with the specific product, with a proven record of operation and management, a history of profit and loss, with two current operations in the general area."

Prelitigation Projections

In *Super Valu Stores, Inc. v. Peterson*, the Supreme Court of Alabama confirmed an award of lost profits for defendant's failure to build a discount grocery store and lease it to plaintiff. The court noted that the relevant focus is on "whether the plaintiff had

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Section Action

Business Valuation
by Denise M. Frey, CPA

I was recently reminded how important practical procedures are in increasing the efficiency of our work after I was contacted by an out-of-state sole practitioner to review a valuation report and the underlying analysis. There are a few areas I may have made the process easier for her.

The valuation was conducted for gift tax purposes and was the first report of this type she had prepared. She was familiar with AICPA Statement on Standards for Valuation No. 1 and researched valuation requirements for gifting. I inquired if she used a checklist in the preparation of her report. She had not; I referred her to the CalCPA website and SSVS No. 1 checklist (*www.calcpa.org/Content/yoursociety/lit.aspx*). This is the checklist we use and it is available to everyone.

She made a number of changes to her analysis over the course of the engagement due to her client providing "new" information. This may have been avoided if the client had completed a company information questionnaire prior to the start of the analysis. This is something we obtain for every valuation engagement.

This practitioner had a foundation in place. She had read business valuation reference books and materials. She has a valuation credential. It was practical experience and processes she was lacking. Fortunately, she reached out to another business valuation professional to ask for help. As a member of the CalCPA Forensic Services Section I know how helpful the Section members are to each other. Everyone is willing to take a colleague's call to answer questions and will refer engagements to another member when appropriate. Perhaps you can be the next one to offer help. I hope to see you at an upcoming Section meeting.

Denise M. Frey, CPA, ABV, CFF, CVA *is Business Valuation Section chair and a manager at Eckhoff Accountancy Corporation in San Rafael.*

Economic Damages
by Craig M. Enos, CPA

Just thought I would pass on a few reminders of why it is important to be a member of the CalCPA Forensic Services Section. Ever wonder what the status is of a case you worked on a few or more months ago? An easy way to find out, and a great marketing tool, is to call the attorney. What if you want to know the status, but would prefer to find out without contacting the attorney? How can you find information about a potential new case that an attorney left you a message about? Many courts have online services that allow you to view a list of parties, daily minutes, and filed documents, such as the Complaint, tentative rulings, etc., and learn key dates such as a settlement conference or trial date.

Many, if not all, county Superior Courts in California have online services. The online information is very valuable to follow up on the status of a case after hours or prior to discussing a potential case with counsel. When an attorney leaves me a message or sends me an email with the case caption and venue, in addition to checking for conflicts, I can review the complaint and key dates before making contact. I have found this to be very well received by the attorney.

Sargon Enterprises, Inc. v. University of Southern California is discussed in this issue of the *The Witness Chair* and has been discussed at two recent Economic Damages Section meetings. I recently received a call from an attorney I am working with regarding economic damages for lost earnings from self-employment. The attorney and I were discussing the damages that were summarized for settlement discussion purposes and concluded that an element of those damages should not be included in the final analysis.

After further review of the case and the evidence that is expected to be presented at trial, it was concluded that it would be difficult to prove a portion of the damages. The attorney specifically mentioned *Sargon* and his concern to make sure that the claimed damages do not appear to be speculative. The attorney appreciated that I was well-versed in the case.

The *Sargon* decision has the potential to greatly expand the judicial gatekeeping role and result in more damages experts being excluded from testifying at trial. This case serves as a reminder to us as experts to be objective in our analysis and to consider analyzing key assumptions to determine whether the assumptions are reasonable. To learn more about resources available to assist you in your practice and network with your peers, be sure to attend the various Forensics Services Section meetings.

Craig M. Enos, CPA, ABV, CFF, CFE *is Economic Damages Section chair and owner of Enos Forensics in Folsom.*

Family Law
by Dan Close, CPA

Forensic CPAs practicing in family law are frequently asked to participate in mediations and settlement conferences involving divorcing couples. We need to be current on federal and state tax laws so that we can continue to assist clients, attorneys and bench officers with timely prudent information.

For example, your client comes to you and needs assistance. She is divorcing her professional athlete husband and expects to receive more than $600,000 per year in support, both spousal and child. She also asks you if she should make her primary residence at her Las Vegas penthouse, her Los Angeles mansion, her Palm Springs estate or her San Francisco villa.

The American Taxpayer Relief Act of 2012 resulted in a number of changes to the Internal Revenue Code that will affect clients of CPAs practicing in family law. In addition, California also passed Proposition 30, which will result in increases in the marginal income tax rate from 9.3 percent to 13.3 percent for earnings in excess of $1 million. The Bush-era federal tax rates remain the same in 2013 except for those with taxable income greater than $400,000 (single taxpayers) who will be taxed at 39.6 percent. So, you may consider advising your client that, instead of accepting the higher alimony, she should opt for receipt of property in lieu of support to keep her under the highest marginal tax bracket.

The federal tax on long-term capital gains also increased from 15 percent to 20 percent

for single filers with taxable income more than $400,000; dividends are also taxed at the same rate as capital gains.

To the 20 percent capital gains tax for those in the top tax bracket, add a 3.8 percent Medicare tax, based on certain net investment income for single filers with adjusted gross income more than $200,000. All of this will impact the spouse's net support and property division.

Federal personal exemptions in 2013 phase out with adjusted gross income of $250,000 for single filers and $275,000 for qualifying heads of households. Itemized deductions on the federal level are reduced after $250,000 of income for single taxpayers and $275,000 for heads of households and married filing separately. As for your client with the high-income issues, perhaps she should accept an up-front spousal support buy-out so she can pay cash for that penthouse in Las Vegas?

M. Daniel Close, CPA, ABV, CFF, CVA *is Family Law Section chair and a shareholder of EDR Valuations, Inc. with offices in Solana Beach and Ontario.*

Fraud

by Peter W. Brown, CPA

The Criminal Division of the U.S. Department of Justice and the Enforcement Division of the SEC issued their anticipated guidance Nov. 14, 2012, on the application and enforcement of the U.S. Foreign Corrupt Practices Act. The guidance, *A Resource Guide to the U.S. Foreign Corrupt Practices Act* (*www.sec.gov/spotlight/fcpa/fcpa-resource-guide.pdf*) reaffirms previous statutory interpretations and is largely based upon previously published settlements and opinion releases.

While practitioners have commented that there is not much new in the guidance, it is a welcome and valuable tool for assisting companies in implementing and maintaining FCPA compliance programs. The *Resource Guide* makes it clear that FCPA enforcement will continue to be a regulatory priority. It also provides best practices for companies to avoid government enforcement actions and penalties for violations of the FCPA.

The FCPA covers two broad areas:

- Anti-bribery provisions prohibit individuals and companies designated as "issuers" from making corrupt payments to foreign officials to obtain or retain business.
- Accounting provisions require issuers to make and keep accurate books and records and to maintain an adequate system of internal accounting controls.

The *Resource Guide* identifies the attributes of a strong FCPA compliance program and addresses the elements of effective internal controls. There is no one size fits all when it comes to FCPA compliance. Each company must evaluate its own corruption risk and develop meaningful controls to mitigate those risks. At a minimum, an effective FCPA compliance program should include the following:

- A clear commitment from senior management and a clearly articulated policy against corruption;
- Education and training for employees, including materials translated into local languages and customized for specific FCPA risks;
- Analyzing and monitoring business activity, especially in high risk regions;
- Due diligence on third party agents and partners as well as mergers and acquisitions; and
- Publicizing FCPA related disciplinary actions and rewarding contributions to the company's FCPA compliance program.

While there are no guarantees that adopting an effective FCPA program will insulate an organization from a regulatory enforcement action, the *Resource Guide* makes it clear that the government will give credit to organizations that self-report, cooperate and remediate when FCPA issues arise.

Peter W. Brown, CPA *is Fraud Section chair and a director with PricewaterhouseCoopers LLP in Los Angeles.*

MessagefromtheChair

by Peter Salomon, CPA

A lack of knowledge is a dangerous thing. When CPAs testify as expert witnesses, they have professional obligations imposed upon them by the AICPA. These obligations are codified in the AICPA Professional Standards. There are specific AICPA professional standards for CPAs, whether they are practicing as auditors, tax preparers, personal financial planners or expert witnesses.

Too often I come across CPAs that provide forensic accounting services and hold themselves out to the Court as accounting experts that are either not aware that there are specific professional standards governing their testimony or cannot state what those standards are. Can you imagine either a judge or opposing counsel asking a testifying CPA if there are any professional standards that govern the work they performed and the expert opinions they just provided on direct testimony, and the answer is "I am not sure." Or if the CPA answers "yes," but is then asked about those standards—and the response is a deer in the headlights look with the words "I don't know" or "I don't remember." How do CPAs know if they complied with those standards if they can't tell the Court what the standards are? I believe that CPAs have failed to comply with professional standards simply by not knowing what the standards are.

The professional standards CPAs must comply with as expert witnesses are Statement on Standards for Consulting Services No. 1 and the AICPA Code of Professional Conduct. The standards include certain requirements, such as obtaining sufficient relevant data, performing services with professional competence, exercising due professional care and adequately planning and supervising the performance of professional services. The standards also require integrity and objectivity, which impose the obligation to be impartial, intellectually honest and free of conflicts of interest.

— **Peter A. Salomon, CPA, CFF** *is a principal with Hemming Morse LLP in Los Angeles.*

Keepin' It Legal

Sargon Merges Time-Honored Standards for Admissibility of Expert Testimony

by Brian R. Davis, Esq.
and Mengmeng Zhang, Esq.

Trial court judges continue to hold a strong "gatekeeper" role in determining the reliability of expert testimony and conclusions. In *Sargon Enterprises Inc. v University of Southern California* (2012) 55 Cal.4th 747, the California Supreme Court held that the trial court properly rejected expert lost profits testimony as inadequately supported. The Court concluded that "the trial court has the duty to act as a 'gatekeeper' to exclude speculative expert testimony." (*Sargon* at 753.)

Dr. Sargon Lazarof's Sargon Enterprises contracted with USC's dentistry school in 1996 to conduct a five-year study of a new implant that promised to significantly shorten dental crown installments. The trial court judge rejected Sargon's accountant's testimony that the botched study by USC cost Sargon somewhere between $220 million and $1.18 billion in lost profits, even though Sargon's highest annual profits were never above $101,000.

The Court in *Sargon* held that the trial court judge, acting as a gatekeeper, did not abuse his discretion when he excluded the expert witness's "speculative" findings. The Court explained that a trial court's role as a gatekeeper for expert testimony "is to make certain that an expert, whether basing testimony upon professional studies or personal experience, employs in the courtroom the same level of intellectual rigor that characterizes the practice of an expert in the relevant field." (*Kumho Tire Co. v. Carmichael* (1999) 526 U.S. 137, 152.)

California: *Frye* Standard

California employs the *Frye* standard [(*Frye v. United States*, 293 F. 1013 (D.C. Cir. 1923)] for determining the admissibility of scientific evidence. The *Frye* standard, or general acceptance test, provides that expert opinion based on a scientific technique is admissible only where the technique is generally accepted as reliable in the relevant scientific community or has "gained general acceptance in the particular field in which it belongs." (*Frye* at 1014.)

Under California law, the trial court acts to exclude expert opinion testimony that is (1) based on matter of a type on which an expert may not reasonably rely; (2) based on reasons unsupported by the material on which the expert relies; or (3) speculative.

Under California Evidence Code section 801: "If a witness is testifying as an expert, his testimony in the form of an opinion is limited to such an opinion as is: (a) Related to a subject that is sufficiently beyond common experience that the opinion of an expert would assist the trier of fact; and (b) Based on matter … that is of a type that reasonably may be relied upon by an expert in forming an opinion upon the subject to which his testimony relates, unless an expert is precluded by law from using such matter as a basis for his opinion."

In *Lockheed Litigation Cases*, (2004) 115 Cal.App.4th 558, 563, the Court construed Evidence Code section 801, subdivision (b) to mean that "the matter relied on must provide a reasonable basis for the particular opinion offered, and that an expert opinion based on speculation or conjecture is inadmissible."

Federal: *Daubert* Standard

The Court in *Daubert v. Merrell Dow Pharmaceuticals, Inc.* (1993) 509 U.S. 579 held that Rule 702 of the Federal Rules of Evidence did not incorporate the *Frye* general acceptance test as a basis for assessing the admissibility of scientific expert testimony, but that the rule incorporated a flexible reliability standard instead.

Daubert guidelines for admitting scientific expert testimony emphasizes the judge's role as gatekeeper, requires the trial judge to ensure that the expert's testimony is "relevant to the task at hand" and that it rests "on a reliable foundation," and requires that the expert's scientific knowledge is the product of sound "scientific methodology." (*Daubert* at 584-587.)

By requiring experts to provide relevant opinions grounded in reliable methodology, proponents of *Daubert* were satisfied that these standards would result in a fair and rational resolution of the scientific and technological issues.

The Court in *Daubert* warned that the gatekeeper's focus "must be solely on principles and methodology, not on the conclusions that they generate." (*Daubert* at 595.) The trial court must not weigh an opinion's probative value or substitute its own opinion for the expert's opinion. Rather, the court must simply determine whether the matter relied on can provide a reasonable basis for the opinion or whether that opinion is based on a leap of logic or conjecture.

Sargon—California and Federal Standards Merged?

The Court in *Sargon* held that the trial court acted within its discretion in excluding manufacturer's expert's testimony on lost profit damages for the university's breach of contract in failing to conduct a clinical trial on manufacturer's dental implants, "since expert's opinion that manufacturer's market share would have increased spectacularly was not based on matter that was of a type that reasonably could be relied upon by an expert in forming an opinion upon the subject …" (*Sargon* at 752.)

The Court assumed for purposes of its ruling "that a 'market share' analysis is appropriate and warranted under California law." But it found that the expert's "market share opinion is not based on any actual historical financial results or comparisons to similar companies and, therefore, is not based on matter of a type [on which] an expert may reasonably rely." (*Sargon* at 759.)

Further, the Court found that "comparing 'degrees of innovation' with other products fails to give the jury standards from which it can make a rational decision, is inherently speculative and subjective, and thus fails to assist the jury in its fact-finding function. The relevance of [the expert's] testimony, if any, is that it provides the jury with an evidentiary basis to make market share choices and thus

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AICPA Alert

by Annette M. Stalker, CPA

November marked the first AICPA Forensic and Valuation Services sections joint conference, held in Orlando. The conference featured sessions devoted to all specialty areas including practice management, litigation, bankruptcy and computer forensics. There was favorable response to the format, which combined valuation and forensic related topics with several dynamic speakers from California, including Ted Israel, Brian Brinig, Jim Andersen, Mark Luttrell and Joe Rosenbaum. Greg Regan was recognized with the Volunteer of the Year award for his contributions to the forensic and litigations services community.

Plans for this year's AICPA FVS Conference are under way and CalCPA representatives on planning committee include Greg Regan and Annette Stalker.

Start planning now for two upcoming FVS conferences:

- Family Law Conference, May 8-10, Las Vegas
- Forensic and Valuation Services Conference, Nov. 10-12, Las Vegas

The FVS Section committees and task forces are busy developing a number of relevant tools and resources for forensic accounting and valuation practitioners. On the horizon, be on the lookout for:

- A CPA's Guide to Family Law Services
- Calculation of Damages from Personal Injury, Wrongful Death and Employment Discrimination Practice Aid (updated)
- Business Valuation in Bankruptcy Practice Aid
- Providing Bankruptcy and Reorganization Services Practice Aid
- Forensic Accounting – Fraud Investigations, Procedures and Tools Practice Aid
- Introduction to Civil Litigation Services (updated)
- Serving as an Expert Witness or Consultant (updated)
- Reasonable Certainty in Damage Calculations

All guidance is available to AICPA members of the FVS Section at *www.aicpa.org/fvs*.

FVS Section members also benefit from complimentary subscriptions to Daubert Tracker and Business Resource Guide. If you are not an FVS Section member, email *bandrews@aicpa.org* for a special $99 introductory pricing for the first year of membership.

Annette M. Stalker, CPA, CFF, CITP, CFE *is a principal at Ueltzen & Company LLP in Sacramento.*

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evidence that provides a basis from which the jury could with 'reasonable certainty' calculate the amount of lost profits," not whether a business is "new" or "unestablished."

In finding the reasonable certainty standard met, the court pointed to the fact that plaintiff's damages were fundamentally based on defendant's own projections of profits for a new store "from the [proven] application of a scientific methodology" that had been produced in the normal course of business. In particular, the court pointed to defendant's description of its projections that made it possible for it "to make accurate forecasts for any site, for any type of supermarket, in any part of the country." The court also noted that defendant created pro forma projections from its forecasts and that based on its extensive analysis, defendant itself felt the proposed location "look[ed] like a winner."

In *Parlour Enterprises, Inc. v. Kirin Group, Inc.*, the court noted that using prelitigation projections was an approved means for evaluating lost profits damages for an unestablished business, but clarified that such projections still must be analyzed and tied to the facts of the case. In this matter, plaintiff sued defendant for its termination of a franchise agreement that granted plaintiff the right to develop Farrell's Ice Cream Parlour locations. In reversing an award for lost profits covering three proposed locations where specific development plans existed, one of the factors pointed to by the Court of Appeal was plaintiff's expert's failure to analyze the nature of the prelitigation projections incorporated into his analysis.

The record showed the projections were part of an offering circular prepared by plaintiff that were not based on any actual operations, but rather plaintiff's assumptions. The court concluded that "none of [it] show[ed] how the projections were actually calculated or upon what facts they were based." Thus, the Court of Appeal concluded such projections had not been shown to be based on facts substantially similar to the lost business opportunity of the Farrell's Ice Cream Parlour locations in question, rejecting the expert's analysis and conclusions as to lost profits.

Similarity of Businesses Used as Comparison

As noted by the court in *Kids' Universe*, one of the ways lost profits may be proven with reasonable certainty is through experience of similar companies. However, courts have been clear that any company selected must be similar by objective standards. For example, a second failing identified by the Court of Appeal in *Parlour Enterprises* was that plaintiff's expert's analysis inappropriately relied upon the comparison to a publicly traded large restaurant chain. The Court of Appeal found that the record only evidenced a "cursory description of [the publicly traded company's] business model" that failed to establish a "profit and loss experience […] sufficiently similar to [the plaintiff's business in question] to be relevant to the question of plaintiff's alleged lost profits."

Conclusion

Cases such as those identified above indicate a willingness by courts to allow for recovery of future lost profits by an unestablished business. However, for the quantum of damages to be proven with reasonable certainty, plaintiffs need to develop a record that provides a strong and objective basis to calculate lost profits. Failure to do so may result in the courts' rejection of an analysis based on a heightened level of scrutiny of the evidence relied upon in a lost profits claim relating to an unestablished business.

Jeffrey A. Klein, MBA, JD *is a principal in the Los Angeles office of LitiNomics, Inc. where he assists clients with forensic accounting and economic damages matters.*

HAPPENINGS

FORENSIC SERVICES SECTION ALL SECTIONS MEETINGS

Wednesday, May 22; 9 a.m.–4:15 p.m.; 4:30–5:30 p.m./networking reception
Hilton Hotel Los Angeles Airport

This FSS all-section meeting is full of topics for all forensic services practitioners. Scheduled presentations include:

- Crossing the Line and Committing Corporate Fraud: Confessions of a former CAO
- Tips from Chambers: How One Magistrate Judge Approaches Settlement Conferences
- Making Experts' Reports Bulletproof and the Use and Misuse of Experts in Deposition and Trial
- Hardball with Jim Hitchner: A Q&A with Business Valuation Experts
- Issues with DissoMaster and the New Tax Laws
- Advanced Discount Rate Applications: A Closer Look
- How to Effectively Use Private Investigators in Corporate Investigations
- Case Study: Foreign Corrupt Practices Act (FCPA)

The meeting concludes with a networking reception 4:30-5:30 p.m. to share what you've learned and catch up with colleagues.

This meeting is designed for CPAs, attorneys, judges and other professionals working in forensic services.

For a listing of speakers and to register, visit *www.calcpa.org/FSS*. If you have any questions, contact Emily Ku, *emily.ku@calcpa.org* or (818) 546-3502.

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assess damages…The fatal problem with this is that there is little rational basis for this choice, and no rational standards for how the jury is to choose." (*Sargon* at 763.)

The Court explained why, in its view, the expert's opinion was speculative. "A jury can determine if a Ford was defective, because there are objective facts, such as industry standards and standards for safety, as well as a body of case law on the subject of products liability. A jury cannot say if a Ford is a better car than a Chevrolet, because that is subjective and depends upon what the driver wants and what he can afford, among other things." (*Sargon* at 764.)

The Court stated that: "Case law demands that to establish such lost profits through expert testimony, the expert must base his/her opinion on either historical performance of the company or a comparison to the profits of companies similar in terms of size, locality, sales, products, number of employees and other relevant financial factors. A party is not permitted to 'make up' its own factors as a basis for comparison and invite the jury to decide whether the corporations are similar. To allow this is to invite proceedings where there are no objective standards as there will always be some way to argue that companies are 'similar,' no matter how superficial or irrelevant.

"Here, for example, the factors [the expert] uses would lead to the absurd result that Sargon, one of the industry's smallest companies, was 'similar' to the largest. In assessing lost profit damages in this context, there is a meaningful difference between biggest and smallest. [The expert] admittedly shunned historical performance and comparison to companies of similar size and financial situation, choosing instead to compare Plaintiff to multi-national industry giants based upon his own criteria of 'similar.' His criteria, even assuming he has the qualifications to decide them, which he does not, are nebulous and legally irrelevant under case law. Accordingly, there is no issue of similarity to give to the jury to compare and decide." (*Sargon* at 766.)

[The expert] gave the opinion that, to a reasonable certainty, Sargon would have become a market leader within 10 years. But, as the trial court found, this testimony was inherently speculative. It "involved numerous variables that made any calculation of lost profits inherently uncertain." (*Sargon* at 775.) [The expert's] attempt to predict the future was in no way grounded in the past.

The Court concluded "that [the expert's] opinions are not based upon matters upon which a reasonable expert would rely, and do not show the nature and occurrence of lost profits with evidence of reasonable reliability, because his opinion is not based on any historical data from Plaintiff or a comparison to similar businesses. The court also finds his 'market drivers' meaningless for comparison purposes. Additionally, his opinion rests on speculation and unreasonable assumptions." (*Sargon* at 767.)

Conclusion

The general acceptance test under *Frye* was not explicitly applied in *Sargon*. But, the requirements under California law that the expert's opinion must be based on matter of a type on which an expert may reasonably rely and that the expert opinion may not be speculative, are both upheld in *Sargon*.

The *Daubert* relevancy and reliability standard is also analyzed and upheld in the *Sargon* decision. Like in *Daubert*, the Court in *Sargon* held that the expert's opinion must be based on matters for which there is a reliable foundation and rational basis with evidence of reasonable reliability for the opinion.

Brian R. Davis *and* **Mengmeng Zhang** *are attorneys at Bogaards Davis LLP based in San Francisco. Brian and Mengmeng specialize in commercial litigation and trials, which often include business and real estate cases involving proof and recovery of economic damages. (bogaardsdavis.com).*

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Editor
Susan Bleecker

Associate Editors
Leslie O. Dawson
Maria N. Nazario

Section Chair
Peter A. Salomon

Individual Section Chairs

Business Valuation	Denise M. Frey
Economic Damages	Craig M. Enos
Family Law	M. Daniel Close
Fraud	Peter W. Brown

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