



Bad Benchmarking In Damages Determinations: Consulting Experts Can Help

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In the complex world of commercial litigation and damages calculation, even experts can make critical mistakes that put litigation at risk. In particular, experts sometimes use the wrong benchmarks to calculate damages, making assumptions that don't stand up under legal scrutiny and causing their testimony to be excluded on *Daubert* challenge.

For example, experts sometimes erroneously rely on metrics designed for valuation analysis for benchmarking damages associated with lost profits or lost enterprise value. These metrics are based on assumptions that fail to reflect a business' operational reality, or what happened to the economy as a whole after the period of alleged damages.

Choosing the right benchmarking method is critical in the analysis of damages from lost profits, lost enterprise value, and business valuation. Using inappropriate benchmarks or methodologies can lead to the wrong conclusions – and that, in turn, can jeopardize your case.

The consequences are serious because during the legal process expert testimony is aggressively challenged. According to an annual study by PricewaterhouseCoopers, in 2010 over 50 percent of financial expert witnesses were excluded in whole or in part on *Daubert* challenges. Bad

benchmarking is often the basis for a successful *Daubert* challenge. In a recent case involving Celebrity Cruises, five of seven experts testifying on behalf of Celebrity and one of three experts testifying on behalf of Essef were excluded on *Daubert*, all because of faulty benchmarking assumptions. (See *Celebrity Cruises, Inc. v. Essef Corp.*, 434 F. Supp. 2d 169 (Dist. Court, SD New York 2006 No. 96 CIV. 3135 (JCF)).

Which Benchmarking Method is Appropriate?

Both litigators and expert witnesses often fail to understand which benchmarking methodology is the right one for a particular situation.

For example, experts often try to force-fit valuation metrics into damages benchmarks. Valuation experts and investment bankers use metrics that are designed to forecast future performance. They measure past performance, then look ahead in order to create a prediction, using data that might include the company's own forecasts. While appropriate for valuation analysis, these ex ante benchmarks are not appropriate for estimating damages.

In estimating damages, the task is different – you start from a given date in the past, the date when the alleged harmful event took place, and then try to calculate two different scenarios – one reflecting what actually happened, and the other reflecting what might have happened if the event had not occurred. There is more and different data required – including information about how the company, the industry and economy actually performed. None of that should apply in projecting a valuation, but it's essential for calculating lost profits or lost enterprise value.

Such ex post benchmarks – measurements applied after the period under scrutiny – factor in such details as operating costs, fluctuations in business demand and changes in the economy. This makes them defensible, because they conform as closely as possible to business and economic reality, controlling for all factors other than the alleged act of harm. Many experts have had their testimony excluded because they used valuation metrics in cases involving damages from harmful acts.

A Consulting Expert Can Improve Benchmarks

How can a litigation team know whether a particular benchmarking method is reliable?

The answer may be to hire a consulting expert – in other words bring in an expert to catch an expert on the other side, or to keep your own experts in check.

Typically, litigators hire experts late in the trial preparation process whose only responsibility is to prepare testimony that supports the case. One alternative is to engage a consulting expert at the beginning of the litigation process, not to testify but to help develop the strategy of the case, vet the experts, and prepare *Daubert* challenges to the opposition's experts.

This expert can improve the quality of the case by developing an accurate approach to benchmarking and by developing strategies used to attack the opposition's benchmarking methodologies.

In addition, a consulting expert can add value that stretches beyond benchmarking assessment. For example, a consulting expert can help assess the odds of winning a particular case; assist with strategy, discovery matters, and identifying issues appropriate for summary judgment; and test alternative theories or prepare rebuttal of the opposition's experts.

While it can be more costly to engage a consulting expert earlier in the process, the cost can often be justified. Engaging a consulting expert is a strategy that can assist in optimizing case outcome by choosing the right benchmarking method and testifying expert witnesses, thereby giving your case a better chance of standing up in court.

How has bringing in a consulting expert early on improved your case strategy?

Comments

Jean T.

How do you evaluate losses through ADA non compliance of a new building that was not designed or constructed to meet ADA compliance and get stuck with the costs of the attorneys, and the work to alter and correct the new work that was done incorrectly? Do you start the clock from the day the new facility opened up in 2004 roughly 14 years after the ADA law went into effect? Can the whole amount including attorney fees be reclaimed from the designers and contractors that did the work wrong? Where and how does the metric for this value get placed?

FYI there is a finite method of measurement and defined criteria to meet ADA compliance which is based on the ANSI A117.1 which was produced by the University of Illinois back in the late 1940's.

Thank you for your time and consideration.

Jean T.

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