



# Construction Law Newsletter



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## Gatekeeper for Experts in CD Cases?

*Probably not yet, but maybe a step closer.*

*By Calvin R. Stead, Esq.*

On November 26, 2012, in a breach of contract and lost profits case, the California Supreme Court upheld a trial court that excluded expert testimony regarding lost profits. *Sargon v. USC* (2012) 55 Cal.4th 747 (Case No. S191550) claims.

In 1991, Sargon Enterprises, Inc. (Sargon) patented a dental implant. In 1996, they contracted with the University of Southern California (USC) to conduct a five-year clinical study of the implant. In May 1999, Sargon sued alleging breach of contract and USC cross-complained. In 2003, a jury awarded Sargon \$433,000 in



compensatory damages. It also found in Sargon's favor on USC's cross-complaint for breach of contract. On appeal by Sargon the court of appeals reversed the judgment, holding that the trial court had erred in excluding expert evidence of Sargon's lost profits on the ground of foreseeability.

On remand, the case proceeded to retrial on the breach of contract claim. Following an eight-day hearing on the admissibility of expert testimony of one expert, the trial court concluded that the expert's opinions were not based upon matters upon which a reasonable expert would rely, and did not show the nature and occurrence of lost profits with evidence of reasonable reliability, because his opinion was not based on any historical data from Sargon or a comparison to similar businesses. Testimony based on 'market drivers' was found to be meaningless, and opinions based on speculation and unreasonable assumptions were also inadmissible.

Sargon appealed again. The court of appeal reversed the exclusion of the expert testimony, acknowledging the difficulty in determining lost profits when it is based on the factor of innovation which is not easily converted into dollars and cents. The court also noted that exactitude is not required, stating that an expert opinion based on "economic and financial data, market surveys and analyses, business records of similar enterprises, and historical financial data is sufficient to allow the testimony. The court

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concluded that the opinions were sufficiently well founded to have been "left for the jury's assessment."

The California Supreme Court granted USC's petition for review to decide whether the trial court erred in excluding the expert's testimony.

### THE CALIFORNIA SUPREME COURT'S DECISION

The California Supreme Court confirmed the trial court's gatekeeping function under California Evidence Code section 801 and 802 stating, "We construe this to mean that the matter relied upon must provide a reasonable basis for the particular opinion offered, and that an expert opinion based on speculation and conjecture is inadmissible." *Lockheed Litigation Cases* (2004) 115 Cal.App.4th 558, 564. Citing to Evidence Code section 802, the court also noted that "the [trial] court may also inquire into the expert's reasons for his opinion." But the court appears to have gone at least one step further, extending the application of section 802 to constitutional, statutory and decisional law: "under Evidence Code sections 801, subdivision (b), and 802, the trial court acts as a gatekeeper 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. Other provisions of law, including decisional law, may also provide reasons for excluding expert opinion testimony."

The California Supreme Court emphasized that under existing law, irrelevant and speculative matters are not proper basis for an expert opinion. Thus, under Evidence Code section 801, the trial court acts as a gatekeeper to exclude speculative or irrelevant expert opinion. The court also stated:

"As we recently explained, the expert's opinion may not be based on assumptions of fact without evidentiary support [citation], or on speculative or conjectural factors . . . [¶] Exclusion of expert opinions that rest on guess, surmise or conjecture [citation] is an inherent corollary to the foundational predicate for admission of the expert testimony: will the testimony assist the trier of fact to evaluate the issues it must decide?" (*Jennings v. Palomar Pomerado Health Systems, Inc.* (2003) 114 Cal.App.4th 1108, 1117.) (*People v. Richardson* (2008) 43 Cal.4th 959, 1008; accord, *People v. Moore* (2011) 51 Cal.4th 386, 405.)

After an extensive discussion of the expert's methodology, the California Supreme Court reversed, finding no error with the exclusion of his testimony. The court noted that the market share approach was not based on any market share that had ever actually been achieved. The proposed opinion that Sargon's market share would have increased spectacularly over time to levels far above anything it had ever reached was too speculative to be admissible.

The Court also questioned the assumption that Sargon's product (and its lost profits) was comparable to the other Big Six dental implant companies stating that the expert "based his comparison solely on his belief that Sargon, like the Big Six, and unlike the rest, was innovative, and that innovation was the prime market driver." The Supreme Court found that reasoning circular under Evidence Code Section 802 and, therefore, inadmissible. Finally, it concluded:

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"An accountant might be able to determine with reasonable precision what Sargon's profits would have been if it had achieved a market share comparable to one of the Big Six. The problem here, however, is that the expert's testimony provided no logical basis to infer that Sargon would have achieved that market share. The lack of sound methodology in the expert's testimony for determining what the future would have brought supported the trial court's ruling. [¶] The Court of Appeal majority was concerned that '[t]he trial court's ruling is tantamount to a flat prohibition on lost profits in any case involving a revolutionary breakthrough in an industry.' We disagree. Other avenues might exist to show lost profits. An expert could use a company's actual profits, a comparison to the profits of similar companies, or other objective evidence to project lost profits. Sargon itself argues that the record in this case contains evidence of specific lost sales and canceled contracts due to USC's failure to complete the study. Evidence of this kind might support reasonably certain lost profit estimates. The trial court's ruling merely meant Sargon could not obtain a massive verdict based on speculative projections of future spectacular success. [¶] The trial court properly acted as a gatekeeper to exclude speculative expert testimony. Its ruling came within its discretion. The majority in the Court of Appeal erred in concluding otherwise."



## DISCUSSION

While not specifically a construction case, this was a contract case. This clarification of the interaction between Evidence Code sections 801 and 802 seems to bring California one step closer to the federal *Daubert* admissibility standard. It certainly empowers the trial court to use the 801/802 hearing process to exclude junk science, opinions based on speculation, and opinions based on questionable methods, such as extrapolation of damages from a handful of homes to a whole project. This decision should provide further ammunition for challenging expert testimony-not just on methodology, but also on the reasoning and foundation for the expert's opinion. Finally, the opinion provides good language when facing speculative economic claims, not just those based on prospective profits.

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