Economic Damages Litigation: Lessons from *Berkman*

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Economic damages often involve an array of complex issues, intersecting both legal and economic concerns. Many professionals, let alone a panel of lay jurors, may find such issues difficult to navigate. Therefore, experts are often required to identify, quantify, and then explain economic damages. This discussion looks at a real-world example of a two-month jury trial in Portland, Oregon, from 2008. This discussion highlights some of the economic damages issues that can arise in the context of a complex civil dispute.

Introduction

The legal rationale behind compensatory damages is simple: damages are intended to restore the injured party, so far as money can, to the position in which he or she would have been without the injury. Of course, exact equivalence between injury and award can only be attained in an ideal world where decisions can be made with perfect information and complete acceptance by the trier of fact. Generally, compensatory damages calculations are just a function of how a jury judges the reasonableness of the plaintiff's ultimate demand and the factual underpinnings of the case.

As we all know from picking through the daily newspaper, compensatory damages awards are granted all the time for injuries and harms that cannot be precisely monetized. The law assumes that such injuries can be translated into economic terms. In reality, however, there is no way to scientifically measure things like physical disfigurement, pain and suffering, or emotional distress. There is a contradiction in terms, in other words, of so-called "noneconomic damages," which provide monetary compensation for an injury that is by its very nature intangible. As a matter of practicality, these determinations are simply left to a black box of sorts—the "the sound judgment of the jury."

In light of the unpredictability of noneconomic damages, then, it would not come as much of a surprise if the average person underestimates the many uncertainties involved with calculating economic damages. Civil juries, for instance, are typically instructed that noneconomic damages are "*subjective*, nonmonetary losses" whereas economic damages are "the *objectively verifiable* monetary losses" that the plaintiff has incurred or will probably incur in the future.[1]

But even the more precise of these two damages standards—"objectively verifiable monetary losses"—still eludes any precise definition. For example, economic damages can include past and future medical expenses, loss of future earnings, costs of repair or replacement, and loss of business opportunities. All of these items require some degree of speculation or opinion.

Even the simplest case of economic damages, where A sues B for taking $500, can quickly become confounding depending on the particulars of A's circumstances at the time of the taking. Thus, "objectively verifiable monetary losses" under Oregon law means only that the economic damages claimed are "*capable* of confirmation by reference to empirical facts."[2]

A remarkable real-world example of the complexities that can arise in economic damages litigation is found in the *Berkman* trial, which was a two-month jury trial that took place a few years ago in the Multnomah County Circuit Court in Portland, Oregon. In this action, we represented plaintiff investors against a Portland-area fund manager, Craig L. Berkman, his management company (CB&A), and a now defunct national accounting firm, Arthur Anderson LLP.[3]

In the *Berkman* case, the jury entered a verdict in favor of plaintiffs in excess of $60,000,000. The jury's damages award was exceptionally complex because it involved a multiplicity of economic loss and interest calculations.

The following discussion provides a summary background of the case and then presents several of the more complicated financial and business valuation issues that the jury was required to grapple with in its deliberations. This discussion may be helpful in providing guidance to lawyers and consultants who deal with economic loss claims.

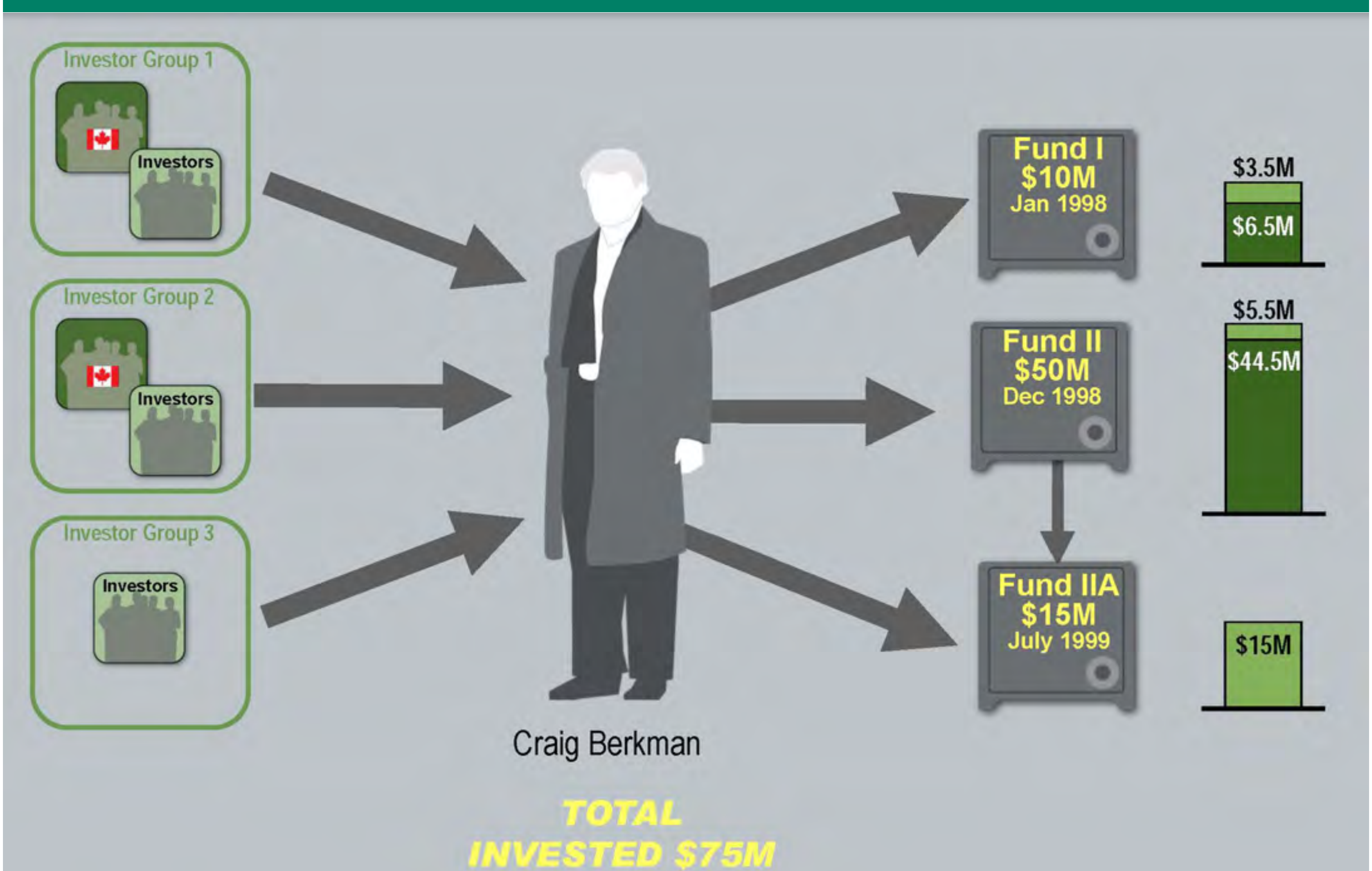
Factual Background

In the *Berkman* case, we represented the plaintiffs, including various individual and institutional investors who had entrusted Berkman with money. We also represented three of Berkman's venture capital funds (which were separate legal entities that had been taken over by the investors prior to suit) (see Figure 1 below). The defendants were Berkman (the former manager/founder of the three funds), Berkman's management company, and Arthur Andersen. The complaint alleged various claims, including claims for conversion, fraud, negligent misrepresentation, breach of contract, breach of fiduciary duty, and aiding and abetting by certified public accountants.

Berkman was a well-known financier within the Portland community, whose personal and professional life intersected with many local notables. He was a major political donor, chair of the Oregon Republican Party in the early 1990s, and a gubernatorial candidate in 1996. But he came to fame as a long-time venture capitalist raising funds for technology startups, mostly in the field of medical devices.

However, despite his outward projections as a man of great wealth, in reality Berkman was in debt. He had borrowed millions of dollars from friends, investors, and business acquaintances through so-called "convertible promissory notes." These "convertible promissory notes" purported to guarantee a perfect, "no lose" situation for investors. Berkman claimed to do this by granting investors the right to choose, *after* the investment plays out, between either a debt position (at 8 percent) or an equity stake, with Berkman personally guaranteeing the

Figure 1
Creation of the Funds



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8 percent return if the investment failed. Thus, if the company prospered, the investor could convert his note to stock. If the company failed, the investor still earned interest and supposedly would get his money back from Berkman when the note matured.

Unfortunately for Berkman (and his investors), most of the companies he had invested in since the late 1980s had failed. Meanwhile, many of the "convertible promissory notes" he had issued over the prior 15 years were coming due. Berkman was in debt and running out of options.

So, beginning in 1998, Berkman formed the first of his venture capital funds, Synectic Ventures I. This fund was a $10 million fund, and membership units were $125,000 each. Like other venture capital funds, the new investment vehicle paid Berkman a management fee and a share of the profits, and required investors' monies to be put into Oregon startups or early-stage companies (see Figure 2).

From approximately 1998 through 2003, he raised tens of millions of dollars in his Synectic Ventures Funds I, II, and III. Money poured in from a variety of individual investors including a Canadian public employee pension fund that invested over $50 million with Berkman.

But instead of acquiring shares in local startups or funding new technology ventures (like he said he would), Berkman diverted much of the funds' money to prop up companies he controlled or in which he had a significant ownership interest—all without proper disclosures or consents from his investors (See Figure 3 on the next page). He also paid himself millions in management fees, and "borrowed" some of the money to make payments to investors in his earlier investment schemes.

Meanwhile, plaintiffs urged that Arthur Andersen, which compiled financial statements and tax returns for the three funds before going out of business in the wake of the Enron scandal in 2002, knew or should have known of Berkman's actions but failed to alert the investors. A large part of the jury trial involved a detailed review of Arthur Anderson's working papers, which we contended (and the jury agreed) showed that Arthur Anderson knew about—and helped Berkman cover-up—his many inappropriate dealings with other people's money.

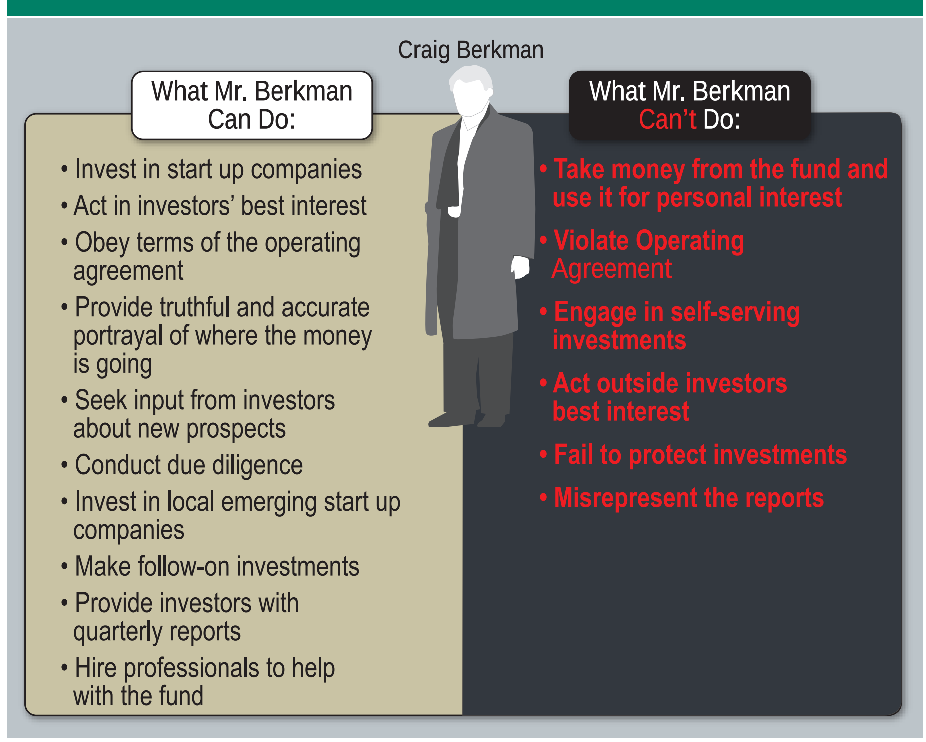
In the end, the investors lost substantially the entire principal invested in the funds.

At trial, the jury was presented with essentially four categories of damages in the case: (1) money that Berkman "borrowed" and never paid back; (2) management fees Berkman paid to himself that, we urged, should be disgorged and returned; (3) money that was diverted to other investment funds that Berkman managed; and (4) money that was invested into portfolio companies that Berkman controlled or in which he held a significant financial interest (see Figures 4, 5, and 6 on pages 32 and 33).

Here, Berkman's ultimate liability may have been relatively clear, but in cases involving economic loss, arriving at "a number" can often be anything but clear. For this reason, it is generally helpful to bring an expert into the litigation process as early as possible. In many cases, it may even make sense to bring in an expert well before the suit is filed. An early examination of the economic merit and potential of a case can clarify the damages issues, help form a theory of damages, and enhance the probability of a pre-trial settlement.

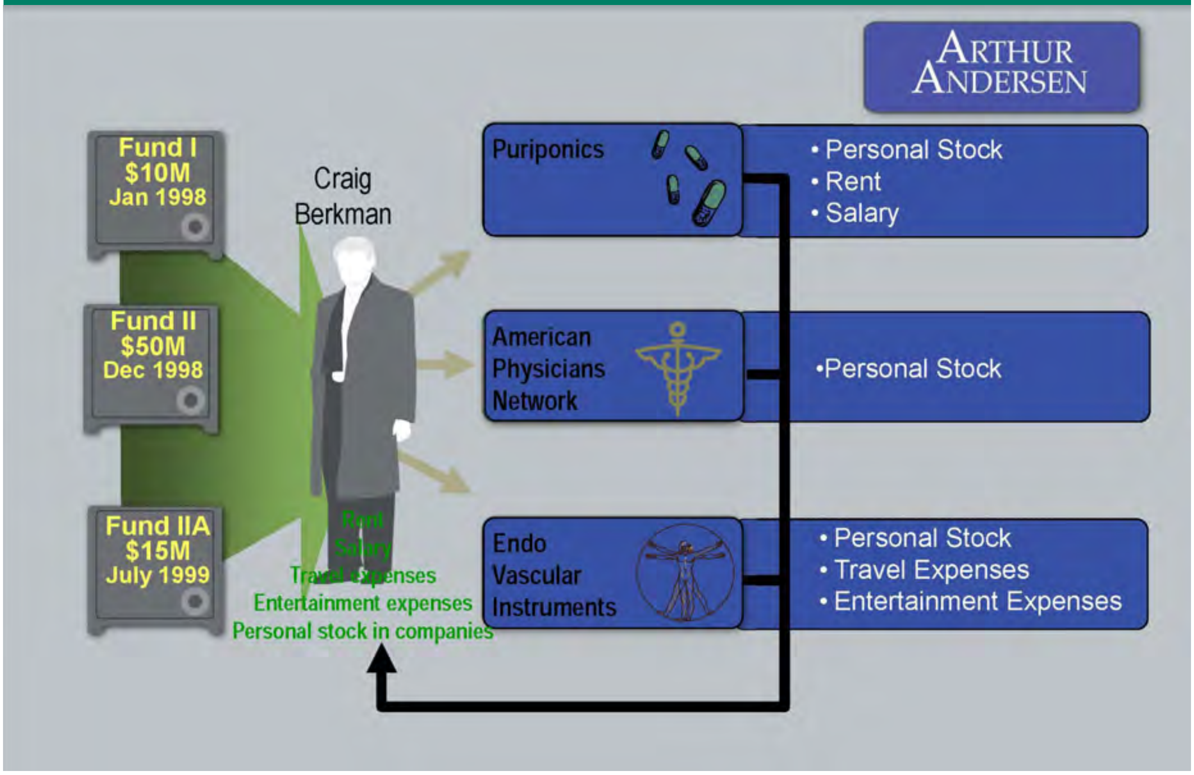
This is particularly true in cases like *Berkman*, where the defendant does not simply breach a contract or injure the plaintiff in an accident, but, rather, actively conceals his misconduct over the course of several years, with the intentional or unwitting help of professionals. In other words, while it may be straightforward to find that Berkman wrongfully misappropriated investors'

Figure 2
Roles of a Fund Manager



Credit: Tsongas Litigation Consulting, Inc.

Figure 3
Related Party Portfolio Companies



Credit: Tsongas Litigation Consulting, Inc.

Figure 4
Berkman Case Summary of Damages

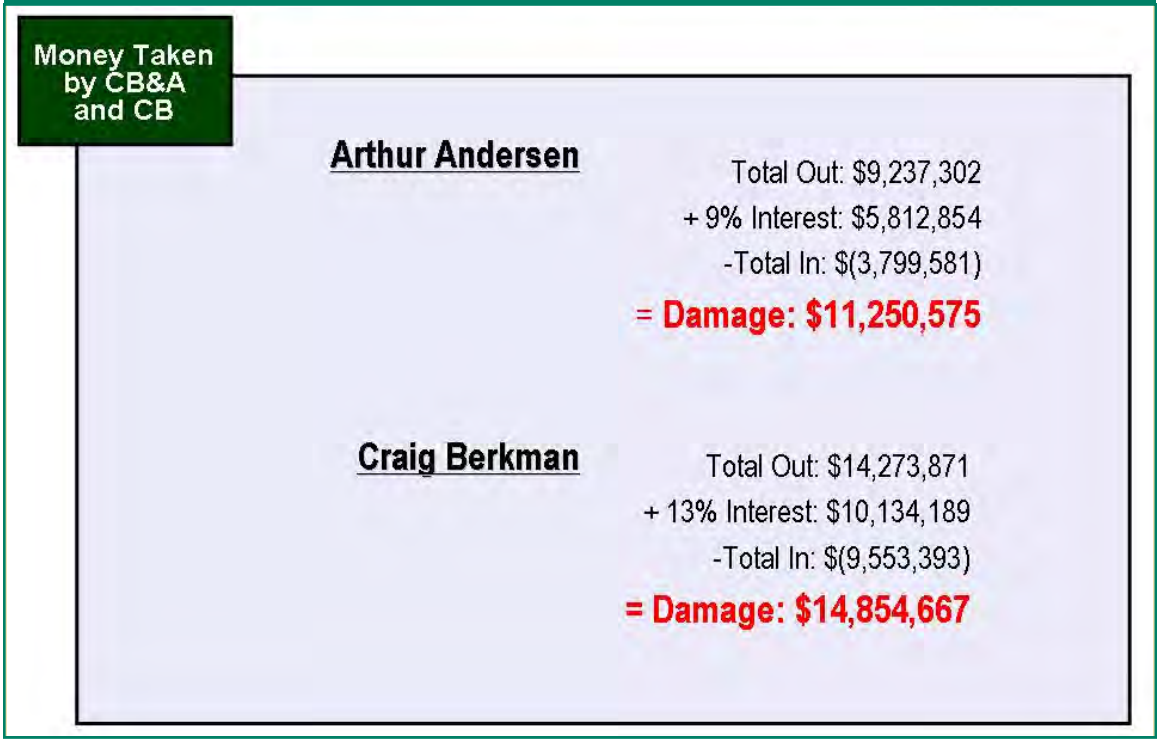
	Money Taken by CB&A and CB°	CB&A Fees & AA Fees*	Related Party Portfolio Companies*	Payments to Funds IV & V°	GeoTrust
Andersen	$ 11,250,575	$4,969,496	$10,504,756	$ 2,548,336	$16,882,000
Craig Berkman	$14,854,667	$7,257,208		$4,023,014	$16,882,000

Total Arthur Andersen = $46,155,163
Total Berkman Defendants = $43,016,889

*Applying 9% interest
°Applying 13% interest

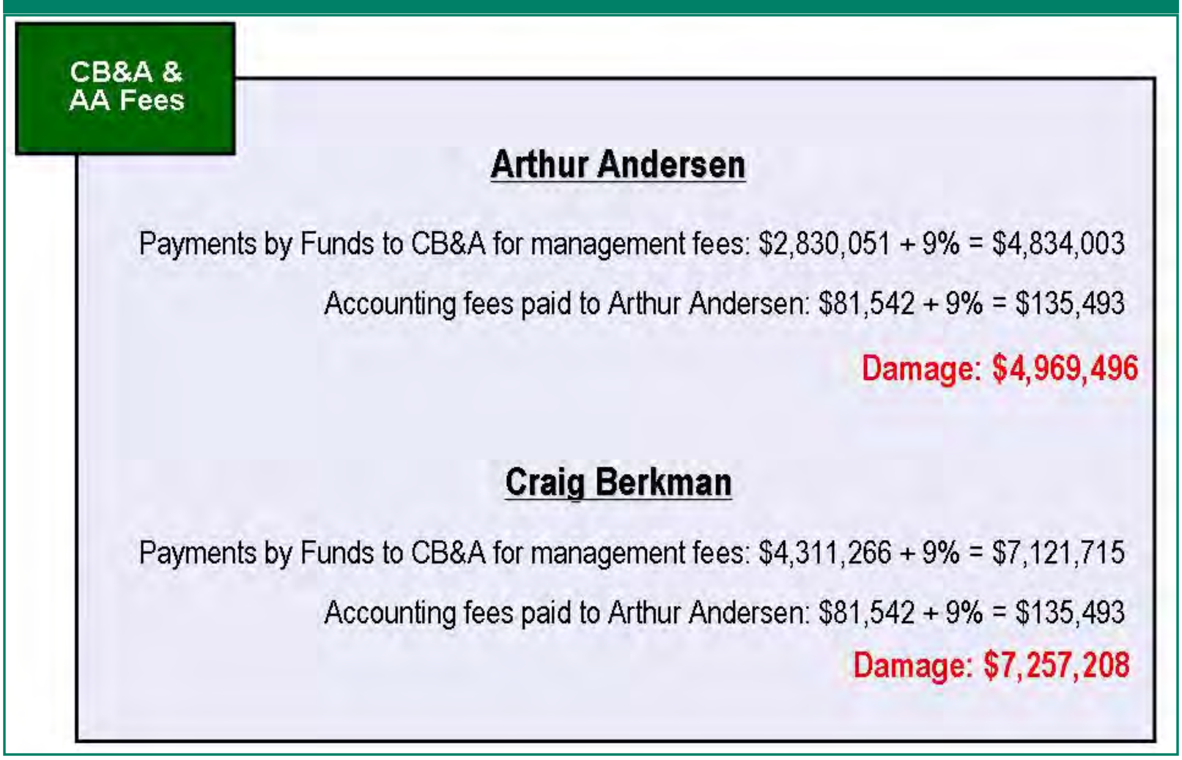
Credit: Serena Morones of Morones Analytics

Figure 5
Money Taken by CB&A and CB



Credit: Serena Morones of Morones Analytics

Figure 6
CB&A & AA Fees



Credit: Serena Morones of Morones Analytics

money under the terms of the funds' operating agreements, it is an entirely different and more difficult task to understand and then explain to a jury precisely what happened to the money.

Like any Ponzi-scheme, Berkman got away with what he did for so long by constantly moving and redirecting funds to holes that needed plugging. It takes a forensic expert to trace years of these kinds of transactions.[5] Unscrambling eggs is no easy task.

Prejudgment Interest

Prejudgment interest was highly contested in *Berkman*, where damages had occurred years before trial and prejudgment interest could amount to millions of additional dollars in liability. Nonetheless, the judge in the case allowed the question of interest to go to the jury—and the jury agreed that interest should be awarded.

The general approach to the awarding of prejudgment interest is that the plaintiff should receive interest at the defendant's cost of unsecured borrowing. Of course, we cannot know specifically what the plaintiff would have done with that money if it had been received earlier. Because of the taking, however, the plaintiff has invested it, albeit unwittingly, in the defendant. The general concept here is that the plaintiff should be paid the same return that would be paid to a voluntary creditor of the defendant.

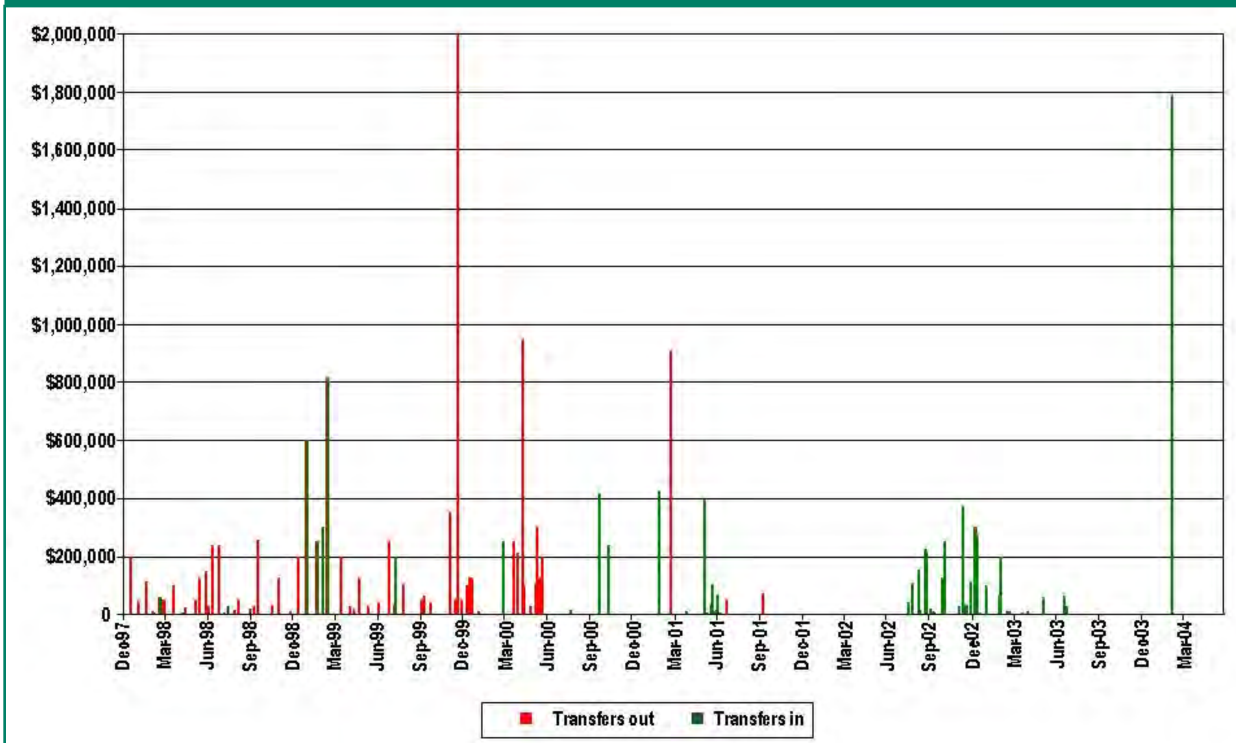
Where the parties have not otherwise agreed to a rate of interest, Oregon provides a statutory rate of 9 percent per annum. Under Oregon law, a party must specifically plead a foundation for prejudgment interest. This rule requires that the party: (1) request prejudgment interest in the prayer of the complaint, and (2) plead facts sufficient to state a claim for prejudgment interest in the body of the complaint.[6]

In addition, prejudgment interest is appropriate only when "the exact amount is ascertained or easily ascertainable by simple computation or by reference to generally recognized standards such as market price and where the time from which interest should run is also easily ascertainable."[7]

Calculating interest under these standards is supposed to be easy. These standards follow this basic formula: principal multiplied by rate multiplied by time. Things are not so simple, however, in a complicated case involving hundreds upon hundreds of transactions, both inbound and outbound, spanning the course of many years (see Figure 7 below).

And the complications in this case didn't end there. For example, Berkman repaid many of his

Figure 7
Berkman's Transfers Out of and Into the Funds (Timing of Repayments)



Credit: Serena Morones of Morones Analytics

"loans" in the form of "in-kind" contributions of company stocks that were not actively traded on the market. Thus, in order to determine what credit, if any, Berkman should get for these "in-kind" contributions, we needed to obtain an expert valuation of the underlying businesses and their shares. Also, sometimes Berkman's repayments through "in kind" stock contributions weren't actually tied to any particular outbound payment to Berkman, creating even more confusion.

Because of these issues, the defendants argued that damages were unascertainable at any certain date, such that no pre-judgment interest should be awarded at all.

The court soundly rejected this argument. Despite the complexity and sheer volume of the transactions involved, they were supported in evidence by various ledgers, check entries, account records, financial statements, and testimony about specific amounts that went out on specific dates.

In cases like these, certain assumptions may have to be made regarding the data, but that does not make the damages calculation unascertainable. Under Oregon law, the fact that an amount owed is disputed or cannot be ascertained without resolving complex issues of fact does not bar an award of prejudgment interest.[8]

By defendant's logic, the more complex the investment scheme, and the longer one hides it, the less likely that one has to pay prejudgment interest. However, just as one court held that prejudgment interest is especially appropriate where the complexity in ascertaining the amount owed is attributable to inadequate recordkeeping by the defendant, wrongdoers like Berkman should not benefit by their own fraud.[9]

Nonstatutory Rates of Interest

By law, Oregon's statutory interest rate of 9 percent is only the "default rate" and does not apply where the parties have agreed to a different rate of interest. In other words, the general rule in Oregon is that rates of interest agreed to in contracts control.

This complicated matters in the *Berkman* case. This is because some of Berkman's "borrowings" were subject to express agreements or promissory notes, even though Berkman was negotiating with himself when he agreed to both sides of the transactions. Still, the existence of some contractual documents concerning some of Berkman's "borrowings" led to a question in the case about whether Berkman's claimed contractual rate of interest (5 percent) or a higher contractual rate should be applied.

The court in the case ultimately allowed the jury to determine the contractual rate of interest on these documented "loans" as a function of what the jury found to be a "competitive" rate of interest. Explaining all of the reasons for this ruling is beyond the scope of this discussion, but ultimately the court determined that the contractual interest rate should be a function of some contractual language in one of Berkman's documents by which he arguably agreed to pay a "competitive rate" of interest on his "borrowings."

At trial, we disputed Berkman's position that 5 percent was a competitive rate of interest for the type and nature of loans involved. Berkman testified that 5 percent was "competitive" because the prevailing rates of interest at the time were between 1 percent and 2 percent. But as our expert testified, these were essentially personal lines of credit unsecured with any property or asset as collateral. Based on her review of the historical interest rates, she testified that 13 percent was a reasonable market rate at the time for an unsecured personal loan. The jury ultimately agreed with our expert.

All parties agreed, however, that the 13 percent rate did not apply to Arthur Andersen. Though many of the personal "loans" occurred during the time period in which it did accounting work for the three investment funds, Arthur Andersen did not enter into any agreement regarding the rate of interest. While both defendants may have been jointly liable for plaintiffs' damages, Arthur Anderson was only liable in tort. As a result, the default rate of 9 percent applied to Arthur Anderson, not the 13 percent applicable to Berkman.

Business Valuation

At trial, we presented substantial evidence that Berkman had diverted investor dollars to private companies that he either controlled or in which he held a significant interest. We contended, and the jury agreed, that this was a breach of fiduciary duty by Berkman, as Berkman failed to make the appropriate disclosures and stood to directly and personally benefit from his investment decisions.

Despite the simplicity of the liability proposition here, we still had to prove the specifics of the investor's damages. In this particular circumstance, the proper measure of damages was the differential between the amounts that were invested and the actual value, if any, of the equity positions that Berkman provided. That, in turn, required a valuation of each of the underlying companies—which was an enormous undertaking.

There are three generally accepted asset valuation approaches: (1) the cost approach, (2) the market approach, and (3) the income approach.

The cost approach is based on the principle that a prudent investor would pay no more for an investment than the cost to obtain an investment of equal value or utility. In other words, it basically asks what it would cost to recreate the asset or investment.

The market approach determines the value of an asset based on the selling price of similar items, making adjustments for differences in size, quantity or quality. The basic principle behind this approach is that valuation measures of similar companies that have been sold in arms-length transactions should represent a good proxy for the specific company being valued.

The income approach assesses value by either discounting future projected benefits (e.g., cash flow) to the present or by capitalizing normalized historical benefits into a single present dollar amount.

As an example, one of Berkman's tainted companies that our expert valued at trial was PuriPonics. PuriPonics was a technology startup trying to artificially develop blue-green algae that grows naturally in Oregon's North Klamath Lake. Another Oregon company had already created a natural health supplement using the algae, and developed a multilevel marketing company around the product.

Employing the income approach, our expert rendered a valuation opinion that PuriPonics was worthless, implying that the investors should be awarded a full loss for Berkman's investment in that company. Our expert based this opinion on a number of facts. For example, PuriPonics' board minutes revealed that the technology was a long way from being viable, which, to be sure, might be said of any new technology in the development process. But more importantly, PuriPonics' business plan operated under the assumption of an unproven market.

PuriPonics' competitor had 90 percent of the market for the product as a multilevel marketing company, meaning it was far from being a market in the normal sense. People within multilevel marketing companies are, in effect, generating their own market within the company and, further, tend to be extremely loyal to that company. There was no evidence that sales would be made outside the competitor's group of customers, or that other retailers or customers would be interested in purchasing blue-green algae. Yet the three funds ended up investing over $4 million in PuriPonics and never received any return, whether as a dividend or even a return of capital, on any of that investment.

The jury ultimately awarded a $4 million loss on this investment. It also awarded millions of additional dollars for the other "self-interested" investments that Berkman made into his own companies, again based largely on our expert's testimony about the true (and low) value of those investments.

Hiring an Expert

A damages expert, who can have a background as a CPA, a financial analyst, or an economist, is often critical for translating potential mountains of data and streams of numbers into a clear and understandable depiction of the losses suffered by the plaintiff. The expert is necessary to guide the lawyer (who may have no financial training at all), and eventually the trier of fact, toward the correct damages analysis. When hired early as a consultant, a damages expert can help on any number of issues, including strategic decision-making, analysis and discovery, and deposition assistance.

Damages experts are also useful for defense attorneys, though there may be reasons why defense counsel might be more reluctant to retain one on behalf of his client. For one, there is always the possibility that the defense expert will arrive at a loss value that is not significantly different from the plaintiff's. And in some cases, any number that an expert arrives at arguably puts a floor on a potential damages award by the jury.

Despite these concerns, however, attorneys should remember that the damages expert will be the last, or one of the last, designated witnesses to appear at trial, and does not actually have to be called to testify. Attorneys should also bear in mind that, by failing to put on an expert to rebut the plaintiff's determination of damages, there is a risk that the jury will infer that there is no effective rebuttal to be made. Personal experience has shown that even a withering cross-examination of the plaintiff's expert does not have the same effect on the trier of fact as an affirmative critique from another expert.

In any event, a damages expert can be valuable to defense attorneys as a consultant, even if the attorney does not elect to retain his or her services as an expert witness. If an expert is not called to the stand, the expert's work is seldom discoverable, even in federal court. Yet the attorney can assess the legitimacy and accuracy of the plaintiff's report.

Moreover, with rare exceptions, the identity of an expert and his or her written work product are not discoverable as a part of the litigation process in the Oregon state court system—at least not until the moment the expert takes the witness stand. This feature of the Oregon legal system has a number of unique effects:

1. There are no expert depositions in Oregon state court matters.
2. Experts are not disclosed until right before trial or their testimony, so they are often retained earlier in the case and also to provide more complete and thorough analyses of issues.
3. Experts must anticipate objections and challenges to their conclusions from potential experts on the opposing side.
4. The appearance of an expert with little to no prior notice means that pre-trial motions to exclude opinions are very rare, and the opposing counsel must often deal with the expert solely during trial.

Lastly, if an expert is to testify in front of a jury, whether on behalf of the plaintiff or defendant, it is important that the expert have the following qualifications:

1. Presentation skills to be a convincing and credible expert witness
2. Strong academic and professional qualifications
3. Conclusions that are supported by strong and accurate assumptions, methodology and data
4. The ability to clearly explain complex subject matter to jurors who, more than likely, have never had a course in economics
5. Trial experience to survive challenge and vigorous cross-examination by opposing trial counsel

In short, in addition to the obvious requirement of finding expertise in a complicated field, lawyers should also be something of a casting director, a psychologist, and an excellent judge of character when selecting the ideal expert.

Summary and Conclusion

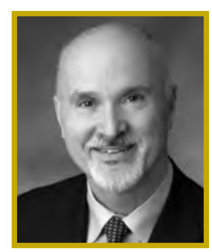
After a five-week trial, the jury in the *Berkman* case returned verdicts in favor of the plaintiffs for nearly $60 million, including punitive damages. The case also set a new precedent requiring accountants to alert investors of problems in financial documents, even when their engagement is limited to tax returns and compilations. Meanwhile, in June 2013, Berkman pleaded guilty to defrauding another set of investors from Florida and was sentenced to six years in federal prison.

Given the complexities of economic damages, it is not uncommon for the victory in a case to go to the side making the clearest, most understandable presentation. Contrary to what many might expect, jurors can often be quite interested in the subjects of income growth, benefits, the value of household services, and similar economic topics. Though they may not have a working knowledge of complex issues such as real interest rates, discounting and present value, and probabilities, the general concepts behind economic damages are matters to which they can personally relate.

The key is in winning and holding the jury's attention, which is why it is important to present the salient parts of the damages testimony in a brief and tightly focused manner. Don't overreach. And make sure your economic damages analysis is logical and tied fairly to the underlying facts of the case.

Notes:

1. Oregon Uniform Civil Jury Instructions, UCJI No. 70.02 and 70.03 (2005); *see also* ORS 18.560.
2. DeVaux v. Presby, 136 Or.App. 456, 902 P.2d 593 (1995) [emphasis added].
3. Synectic Ventures I, LLC, et al. v. Craig L. Berkman and Arthur Anderson, LLP, et al., Case No. 0512-13245 (2008) ("Berkman").
4. Berkman's "convertible promissory note" scheme gives rise to a host of securities law issues. A discussion of Berkman's entanglements with Oregon securities regulators is beyond the scope of this article.
5. Issues relating to damages experts will be discussed later in the article.
6. Emmert v. No Problem Harry, Inc., 222 Or.App. 151, 158, 192 P.3d 844 (2008).
7. Farhang v. Kariminaser, 230 Or.App. 554, 556, 217 P.3d 218 (2009).
8. Jones v. Dorsey, 193 Or.App. 688, 692-93, 91 P.3d 762, 765 (2004); Strader v. Grange Mut. Ins. Co., 179 Or.App. 329, 339, 39 P.3d 903, 909 (2002).
9. Jones, 193 Or.App. at 693, 91 P.3d at 765.



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