H.S. Grace & Company, Inc.

Defining the Difference # 67 – June 2013

DEFENDING DAMAGE CLAIMS IN COMPLEX COMMERCIAL LITIGATION

Damage claims made by plaintiffs in complex commercial litigation may be based on unreasonable business and financial assumptions. For that reason it is important to look behind the methodology used in formulating the damage model to the underlying assumptions on which the claim is based. Examining not only the accuracy of the calculations, but also the integrity of the model and the applicability of the model to the underlying facts in the case is critical. The following H.S. Grace & Company, Inc. (HSG) expert witness assignment in which HSG was requested to evaluate plaintiff's damage calculations in a complex financial transaction demonstrates how a careful and thorough analysis of the facts underlying the damage claim can show not only that the quantum of the damages is incorrect, but that the entire basis for the claim is flawed and that there were, in fact, no damages as a result of or caused by the liability allegations.

Allegations

Plaintiff Seller of a major league sports team sued a financial institution (HSG client) for fraud and negligent misrepresentation for allegedly providing false positive information to the Seller about the financial capability of a client of the institution. The client was one of two "finalist" potential purchasers of a 50% interest in the team. After the transaction with the financial institution's client failed to close within the very tight timeframe desired, the Seller sold the entire team to the other finalist purchaser several months later. Following the sale, the value of the team rose substantially, and the Seller sued the financial institution claiming that the allegedly false information provided by the financial institution caused the Seller to expend time and effort negotiating with the financial institution's client in reliance upon the information and ultimately forced the Seller to have to sell the entire team rather than the 50% interest in the team it could have sold. As a result the Seller claimed damages equal to the appreciation in value of the 50% interest it could have retained, a high eight-figure sum. The financial institution's counsel asked HSG to evaluate the damage claim.

Analysis

The HSG team, utilizing their extensive experience in financial transactions and with customary terms and practices with respect to such transactions, reviewed information relating to the negotiations for the transaction, the financial condition of the Seller, and the relationship of the Seller with its lenders. Based on this analysis HSG concluded there was no viable business basis for a 50/50 partnership between the Seller and the ultimate purchaser, and, therefore, no damages. HSG's analysis showed:

- There were many difficulties and unresolved contingencies between Seller and the ultimate purchaser during the brief interval when a 50/50 partnership was discussed. Terms discussed for a 50/50 partnership included requiring Seller to pay off its full indebtedness to one of Seller's lenders as a condition of sale, which would have left Seller with little or no capital going forward.
- Seller's troubled financial condition raised multiple questions as to Seller's ability to be a viable, creditworthy partner going forward. Substantial capital contributions would have been required to fund Seller's 50% share of operating losses and stadium requirements in the near

future. Seller's relationship with its lenders was troubled, and it was highly unlikely Seller could have met its financial requirements for a 50% ownership interest going forward.

- Control issues had not been addressed between Seller and the ultimate purchaser during the brief discussions of the 50/50 relationship. Seller and the ultimate purchaser had very different visions for the team with the ultimate purchaser's vision requiring significant financial infusions for the team – something Seller was financially unable to do.
- The consequences of a partner being unable to make a cash call had not yet been defined between the Seller and the ultimate purchaser, but customary provisions in similar situations would have likely resulted in a stepdown or cramdown provision, which would have resulted in the ultimate purchaser's acquisition of Seller's remaining 50% interest in the highly likely event that Seller could not come up with its share of a cash call.
- Seller's damage calculations were grossly overstated, even assuming for the purposes of argument that there was liability and causation in the case. Plaintiff's expert failed to consider that Seller would have been required to pay off debt related to the team and to fund operating losses and stadium requirements. When these amounts were taken into consideration Seller had almost no damages.

Results

Counsel for the financial institution used HSG's report to negotiate a favorable settlement just prior to the scheduled trial.

H.S. Grace & Company, Inc. is a team of senior executives who diagnose and resolve critical corporate problems in business governance, operations, finance and control. With more than 1,000 years of experience, our goal is to help companies enhance shareholder value, protect reputation and their long-term ability to succeed, avoid and manage litigation, and navigate major changes such as mergers and acquisitions or bankruptcies. We often serve as consulting and testifying experts, identifying and analyzing critical business issues.

Representative Issues Examined

- Lender Liability
- D&O
- Corporate Split-off
- Family Trust
- Health Care
- Professional Services
- Intellectual Property
- International Structured Finance Transaction
- Fraud
- Pension Fund Investments
- SEC White Collar Defense
- Stock Option Backdating
- Oil & Gas
- Real Estate
- Fiduciary Issues
- Contract Dispute
- Fund Management
- Market Timing Allegations
- Financial Derivatives
- Portfolio Management
- Special Purpose Corporation

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