Clerk of the Superior Court
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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2016-009195
Consolidated

11/08/2019

HONORABLE ROGER E. BRODMAN

CLERK OF THE COURT
M. Corriveau
Deputy

MICHAEL J MAGNOTTA III

MARK A NADEAU

v.

STEVEN A SERRA, et al.

RICHARD L COBB

RYAN W ANDERSON
STEPHEN J ANTHONY
KATE L BENVENISTE
CAMERON A FINE
PHILIP G MITCHELL
JOEL E SANNES
DAXTON R WATSON

RULING ON MOTION TO EXCLUDE MCDONOUGH'S TESTIMONY

Edward McDonough provided an expert report. Defendants challenge the admissibility of his lost profit valuation opinions and his opinion of the value of the ICS Software.

Defendants claim that Mr. McDonough's opinions should be excluded under Rule 702. There is no contention in this case that Mr. McDonough lacks qualifications to render an opinion regarding iColligo's valuation. And it is undisputed that Mr. McDonough's testimony is relevant.

As noted by the Arizona Supreme Court in *State v. Berstein*, 237 Ariz. 226, 229, ¶ 10 (2015):

> Rule 702, which governs expert witnesses testimony, provides that:
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> A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if: (a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue; (b) the testimony is based on sufficient facts or data; (c) the testimony is the product of reliable principles and methods; and (d) the expert has reliably applied the principles and methods to the facts of the case.
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> The rule "recognizes that trial courts should serve as gatekeepers in assuring that proposed expert testimony is reliable and thus helpful to the jury's determination of the facts at issue." Ariz. R. Evid. 702 cmt. (2012). But the comment also observes that "[t]he trial court's gatekeeping function is not intended to replace the adversary system." *Id*. Rather, "[c]ross-examination, presentation of contrary evidence, and careful instruction on the burden of proof are the traditional and appropriate means of attacking shaky but admissible evidence." *Id*.
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> The supreme court went on to rule:
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> Whether errors in application render evidence unreliable will not always be clear. In close cases, the trial court should allow the jury to exercise its fact-finding functions, for it is the jury's exclusive province to assess the weight and credibility of evidence. As long as an expert's scientific testimony rests upon good grounds, . . . it should be tested by the adversary process -- competing expert testimony and active cross-examination -- rather than excluded from jurors' scrutiny for fear that they will not grasp its complexities or satisfactorily weigh its inadequacies.

Bernstein, 237 at 230, ¶ 18.

Defendants first challenge Mr. McDonough's reliance on Mr. Magnotta's projections. Mr. Magnotta projected that iColligo could have reached 150 customers and $5 million in revenues per year by 2020 with income of $33,333 per customer (as opposed to the current revenue of only $23,487 per customer). Defendants challenge Mr. McDonough's assumed EBIT.

There is no doubt that portions of Mr. McDonough's opinions are founded on the testimony of Mr. Magnotta. Defendants argue that the expert's reliance on a party's projections is not appropriate. Defendants point out that Mr. McDonough did no independent verification of Mr. Magnotta's projections.

The issue is whether the evidence is the type of evidence that a reasonable expert would rely upon. To be sure, Mr. Magnotta's projections come from a biased source. But bias goes to the weight of the evidence, not its admissibility. Mr. Magnotta is a CPA who has substantial experience in the HOA industry. The mere fact that the opinion came from Mr. Magnotta doesn't automatically disqualify the testimony. In *State v. Miller,* 234 Ariz. 289, 298, ¶ 22 (2014), the court ruled that "facts or data underlying expert's testimony may include inadmissible evidence, hypothetical facts, and other experts' opinions." While an expert cannot be used to simply parrot the testimony of another witness, Mr. McDonough's opinion appears to do more, relying on five data points to establish an estimate of iColligo's lost profits.

Of course, at trial it will be up to plaintiffs to establish how the expert's methods, reasoning in opinions are based on an accepted body of learning or experience. "The party proffering the evidence must explain the expert's methodology and demonstrate in some objectively verifiable way that the expert has both chosen a reliable scientific method and followed it faithfully." *Miller, id.* at ¶ 23. The relevant inquiry will be on whether Mr. Magnotta has the proper foundation and qualifications to offer the opinion that iColligo would have reached $5 million in revenue by 2020 and his other projections. Mr. Magnotta will presumably testify at trial, and Mr. Magnotta's projections can be tested by evidence and cross-examination. In the event Mr. Magnotta's projections are too speculative to provide a basis for an expert's reliance, any of Mr. McDonough's opinions that rely on those opinions would likewise be inadmissible or stricken. On the other hand, if Mr. Magnotta's testimony is admissible, the Court sees no reason why Mr. McDonough couldn't rely upon it as foundation for Mr. McDonough's opinions.

Defendants complain that Mr. McDonough did not comply with appropriate standards published by the American Institute of Certified Public Accountants for his work in this case and therefore violated business appraisal standards. Whether these standards apply is a disputed issue. Mr. McDonough apparently will testify that he complied with the appropriate standards for Valuation Services in the context of litigation. Defendants' contention that Mr. McDonough used the wrong standards goes to weight of the evidence, not to the admissibility of his opinions.

Defendants next argue that Mr. McDonough's opinion is flawed because it did not specifically account for increases in marketing expenses and related expenses necessary to obtain additional customers. Plaintiffs respond by arguing that Mr. McDonough increased all costs pro rata -- not just marketing costs -- in proportion to its increase in iColligo's size. As a result, plaintiffs contend that Mr. McDonough did account for increased marketing expenses. This is a topic for cross-examination, not exclusion.

Mr. McDonough also looked at appLega's revenues and profits. He deducted $514,000 from appLega's expenses, consisting of what appLega paid to eUnify for the software licensing

fee. Defendants claim Mr. McDonough reengineered appLega's net income to result in a 67 percent EBIT. Not only did Mr. McDonough rely on Mr. Magnotta's opinion that iColligo could obtain a 70 percent to 75 percent profit margin, but he deducted expenses from iColligo that he felt did not have appropriate documentation. In other words, he backed out expenses that he felt were not supported by adequate documentation. Defendants claim this is unreasonable because it fails to account for software upgrades or modifications, etc. Whether Mr. McDonough properly accounted for expenses is a matter of cross-examination, not a reason to exclude all of his testimony.

Defendants also challenge Mr. McDonough's software valuation. He based his opinion on the amount paid by appLega to eUnify. He multiplies that number by comparable sales indexes to reach a value of $5.55 million. He deducted a 10 percent maintenance cost, but defendants claim there is nothing to support that percentage. But Mr. McDonough applied industry data to arrive at a value for the software. Again, cross-examination and the presentation of competing evidence will be the method by which defendants can challenge Mr. McDonough's opinions.

In conclusion, defendants' motion is denied. Of course, nothing in this ruling precludes defendants from challenging all or portions of Mr. McDonough's testimony at trial through objections or by a Rule 50 motion at the end of plaintiffs' case.

IT IS ORDERED that defendants' motion to exclude Mr. McDonough's testimony is denied.