

**UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA**

Case No. 20-CV-81205-RAR

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v.

**COMPLETE BUSINESS SOLUTIONS GROUP,
INC. d/b/a PAR FUNDING, *et al.*,**

Defendants.

**DEFENDANTS' MOTION *IN LIMINE* TO EXCLUDE
EXPERT TESTIMONY AND REPORT OF MELISSA DAVIS**

Defendants, Joseph LaForte, Lisa McElhone, and Joseph Cole Barleta respectfully move this Court to exclude the proffered expert testimony of Melissa Davis, pursuant to Fed. R. Evid. 402, 403, and 702, and, in support thereof, state as follows:

INTRODUCTION

Davis offered two opinions in her Expert Report, only the first of which is at issue in this Motion. This Court should exclude her opinion that the cash flow from Par Funding’s Merchant Advances was not sufficient to pay promised investor returns and operational expenses. While she has the professional qualifications to serve as an expert in this case, her opinion is unreliable and would only mislead rather than assist the jury.

First, Davis’s opinion is unreliable because—and there is no dispute on this point—she did not conduct her analysis under Generally Accepted Accounting Principles (“GAAP”). Davis “analyzed the cash activity of the Merchant Advances on an individual basis to determine their profitability.” (*See* Exhibit A., Expert Report of Melissa Davis, ¶70.) However, GAAP makes clear that a cash flow analysis alone is not appropriate to determine a company’s profitability, and that an accrual-based analysis is the only method of accurately assessing profitability. (*See* Exhibit B, Expert Rebuttal Report of Joel Glick, pp. 8, 20-21) (citing “U.S. GAAP” (Generally Accepted Accounting Principles)).

Davis attempts to remedy this dilemma by suggesting that her cash flow analysis “essentially marries the concepts of accrual based accounting and actual cash flow...” (Expert Report of Melissa Davis, ¶70.) But even this attempt to resuscitate her flawed opinion falls flat. In explaining why she undertook a cash analysis rather than an accrual-based analysis to assess profitability, Davis explained, “*if* the estimate of uncollectible Merchant Advances were understated, the accrual-based income as recorded in the financial statements is overstated...

because it would not account for the fact that Par Funding *had not yet collected* more than \$419 million of its accounts receivable.” (Id. ¶ 69.)

But there is no GAAP provision that supports Davis’s historical cash flow methodology as a proxy for the collectability of Par Funding’s as yet uncollected receivables. GAAP quite literally contradicts her rationale for using a cash-flow analysis:

Accrual accounting depicts the effects of transactions, and other events and circumstances on a reporting entity’s economic resources and claims in the periods in which those effects occur, **even if the resulting cash receipts and payments occur in a different period.** This is important because information about a reporting entity’s economic resources and claims and changes in its economic resources and claims during a period **provides a better basis for assessing the entity’s past and future performance than information solely about cash receipts and payments during that period.**¹²

In other words, GAAP contemplates the risks inherent in accrual-based accounting which Davis cites a justification for refusing to follow GAAP-based methodology, and still prefers it as the only accurate way of assessing a company’s profitability. Davis conducted *no analysis* on an accrual basis to assess whether Par Funding estimate of uncollectible receivables is understated. Consequently, she offers no opinion explaining to what extent the estimate is understated, if it understated at all. She also offers no response to the fact that Par Funding’s estimate for fiscal year 2017, which she also opines is understated, is in line with the recommendation of an auditor whose estimate she admits she did not analyze for accuracy. Moreover, Davis manages to undermine her own opinion by conceding that her “married” cash flow analysis is inapplicable to the receivables from 2019 and 2020 advances, which account for the vast majority of the

¹ Financial Accounting Standards Board **Conceptual Framework for Financial Reporting**, Chapter 1, The Objective of General Purpose Financial Reporting, and Chapter 3, Qualitative Characteristics of Useful Financial Information As Amended, August 2018 a replacement of FASB Concepts Statements No. 1 and No. 2.

² Davis testified at deposition that the Statement of Financial Accounting Concepts is guidance for GAAP accounting issued by FASB. (Davis Dep., pp. 135-136.)

receivables held by the company. Finally, in comparing the cash flow she expects the company to generate to promised investor returns and operational expenses, she “made no attempt to reconcile her view with real world events,”³ including the revenue Par Funding would collect on new business and, just as importantly, the fact that maturity dates for the notes at issue in her opinion have largely been extended to April 2027. For these and other reasons set forth below, Davis’s opinion should be excluded by the Court as speculative and unreliable.

MEMORANDUM OF LAW

I. APPLICABLE STANDARD

Federal Rule of Civil Procedure 702 allows “a witness qualified as an expert by knowledge, skill, experience, training, or education” to testify “[i]f scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue.” Fed. R. Civ. Pro. 702. The Supreme Court’s decision in *Daubert v. Merrell Dow Phram., Inc.* “requires the trial court to act as a gatekeeper to ensure that speculative and unreliable opinions do not reach the jury.” 509 U.S. 579 (1993).

Expert testimony is admissible under Fed. R. Evid. 702 only 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 witness has reliably applied the principles and methods to the facts of the case.

Fed. R. Evid. 702. *Daubert v. Merrell Dow Pharms.*, 509 U.S. 579 (1993), requires district courts to act as “gatekeepers” to ensure expert opinions are reliable and relevant. *Rink v. Cheminova, Inc.*, 400 F.3d 1286, 1291 (11th Cir. 2005); *see also Hendrix, ex rel. G.P. v. Evenflo Co.*, 609 F.3d 1138, 1194 (11th Cir. 2010) (describing a “rigorous three-part inquiry”). “The burden of laying the

³ *Comm. of Unsecured Creditors v. Motorola, Inc. (In re Iridium Operating LLC)*, 373 B.R. 283, 350 (Bankr. S.D.N.Y. 2007).

proper foundation for the admission of the expert testimony is on the party offering the expert, and admissibility must be shown by a preponderance of the evidence.” *Allison v. McGhan Med. Corp.*, 184 F.3d 1300, 1306 (11th Cir. 1999) (citing *Daubert*, 509 U.S. at 592 n. 10).

“Even if a witness is qualified as an expert regarding a particular issue, the process used by the witness in forming his expert opinion must be sufficiently reliable under *Daubert* and its progeny.” *In re BankAtlantic Bancorp, Inc. Sec. Litig.*, No. 07-61542-CIV, 2010 U.S. Dist. LEXIS 143162, at *8 (S.D. Fla. Aug. 31, 2010) (citing *Quiet Tech. DC-8, Inc. v. Hurel-Dubois UK Ltd.*, 326 F.3d 1333, 1342 (11th Cir. 2003) (stating that “one may be considered an expert but still offer unreliable testimony”). While the Defendants do not dispute that Davis has the proper educational and professional pedigree, the processes and methods she used in forming her opinions are clearly unreliable under *Daubert* and its progeny.

II. DAVIS’S EXPERT OPINION SHOULD BE EXCLUDED BECAUSE IT DOES NOT COMPLY WITH GAAP.

“The ASC [Accounting Standards Codification] is the “source of authoritative” Generally Accepted Accounting Principles (“GAAP”) published by the Financial Accounting Standards Board (“FASB”). *In re Perrigo Co. PLC Sec. Litig.*, No. 19cv70 (DLC), 2021 U.S. Dist. LEXIS 131766, at *1 n.1 (S.D.N.Y. July 11, 2021) (citing Financial Accounting Standards Board, Accounting Standards Codification: About the Codification 4 (Dec. 2014), <https://asc.fasb.org/imageRoot/71/58741171.pdf>). *Frymire-Brinati v. KPMG Peat Marwick*, 2 F.3d 183, 186-187 (7th Cir. 1993) (trial court should not have admitted expert valuation that relied on discounted cash flow analysis which was not GAAP compliant); *MSC Software Corp v. Altair Engineering, Inc.*, 2014 WL 6485492, *9 (E.D. Mich. Nov. 13, 2014) (excluding expert report and opinion as unreliable under F.R.E. 702 as it cites no authority, no GAAP, other standards or articles”); *ABS Glob., Inc. v. Inguran, LLC*, 2015 WL 1486647, at *4 (W.D. Wis. 2015) (expert

analysis “appears to be indefensible under any meaningful cost of goods sold calculation, much less GAAP.”)

During a December 15, 2020 status hearing, this Court wrestled with the notion that Defendants so vehemently disagreed with the DSI Report authored by Bradley Sharp, which suggested, as Davis has, that the cash flow from Par Funding’s Merchant Advances was not sufficient to pay the promised investor returns and operational expenses: “One of the issues I am having is I -- if this is a methodology problem, if this is -- you know, this isn’t a dispute over GAAP principles, this is -- I mean, to me as far as I can tell from Mr. Sharp, this is all well-rooted in verifiable numbers...” (*See Exhibit C, Dec. 15. 2020 Status Hrg., p. 37.*) The Court’s view of the issue at the core of this disagreement was prescient. This is a methodology problem, and there is no dispute that GAAP principles should be applied in any reliable assessment of Par Funding’s profitability.

Only the Defendants have offered this Court what it requested: a GAAP compliant assessment well-rooted in what the parties agree are verifiable numbers. Davis has chosen to conduct a cash flow analysis to assess Par Funding’s profitability. (*See Exhibit D, Deposition of Melissa Davis, at pp. 77-78, 150-151.*) Davis’s chosen methodology is one that the *Receiver agreed was improper* after reviewing Joel Glick’s first declaration, which used an accrual-based methodology:

A. GAAP Profitability Analysis. The Glick Declaration accurately stated that an analysis of the profitability of Par Funding should be performed in accordance with U.S. Generally Accepted Accounting Principles (“GAAP”).

(D.E. 577, p.15). Davis’ use of a cash-flow based assessment of Par Funding’s profitability is particularly galling given that Par kept its books on a GAAP basis and, according to Davis herself, intended to recognize revenue on a GAAP compliant basis. (*Id.*, p. 73).

Not surprisingly, when asked during her deposition to point the undersigned to a GAAP provision that supported her use of a cash flow analysis to assess a company's profitability, despite multiple opportunities, Davis was unable to do so. (Davis Dep., pp. 152-154.)⁴ It seems clear that in suggesting that her cash-based analysis "marries" to the GAAP approved accrual-based analysis, Davis was attempting to lend credibility to a methodology lacking in the same. But even this attempt falls short because Davis acknowledged that her cash-flow methodology only "marries" to an accrual-based methodology so long as the collection cycle applicable to the receivables she analyzed were complete. (*Id.*, pp. 143-144.) And this is where her theory completely falls apart.

First, Davis admits that the collection cycle would not even be complete for receivables stemming from merchant advances made in late 2019 and 2020. (*Id.*, p. 144.) In other words, Davis admits that her historical cash-flow assessment does not "marry" to the more reliable accrual-based assessment for those receivables. Second, while Davis relies on a collection cycle of 120 days, she admits that she did nothing to actually calculate the collection cycles for the actual transactions at issue in her opinion:

Ms. Berlin: Ms. Davis, earlier in your testimony, you referenced the collections cycle. I wonder if -- is -- did you calculate the collections cycle for the -- each of the transactions -- for the transactions?

Ms. Davis: *So the collections cycle is not something that I calculated, so no, I did not calculate that.*

(*Id.*, p. 288-289). Instead, Davis simply estimated the collection cycle at 120 days, even though "some of them could have been longer." (*Id.*) And Davis's own exhibits demonstrate a much longer collection cycle:

Mr. Soto: Okay. And there are various other examples in your chart that suggest that Par Funding *continued to collect on advances made over a course of years*, correct?

⁴ And there is no GAAP provision that that references a "marriage" of cash and accrual methodologies, or one that supports a backwards looking cash flow analysis as equally reliable for purposes of assessing the collectability of uncollected receivables.

Ms. Davis: Agreed.

(*Id.*, p. 146). In other words, Davis did nothing to calculate the collection cycles applicable to the receivables at issue here. She did not examine the appropriate collection cycle for receivables in the industry. She did not rely on any guidance. She simply decided on a period of 120 days, which happens to be at odds with the actual, years-long collection cycles in her own report.

Not surprisingly, Davis's dartboard approach yields results that find no support in reality. Par Funding's former controller, James Klenk, himself a CPA, testified that the collection cycle for Par Funding's merchant cash advance receivables can sometimes exceed two years:

Mr. Futerfas: And *did there come a point in 2018 when you knew the actual default losses for 2017?*

Mr. Klenk: I'm sorry. You're saying the *actual losses* for '17?

Mr. Futerfas: Yes.

Mr. Klenk: Friedman [Par Funding's auditor] provided their estimate what the losses -- the adjustment for the losses.

Mr. Futerfas: Okay, and... you testified that before that that's an estimate. Correct?

Mr. Klenk: It was still an estimate [in 2018] because we had outstanding AR [Accounts Receivable] from 2017 that was not collected."

Mr. Futerfas: Well, let me ask you this, *by 2019, did you have actual loss in numbers for 2017?*

Mr. Klenk: "No, because a number of those deals were still outstanding."

(*See* Exhibit E, Deposition of James Klenk, pp. 69-70) (emphasis added). Klenk's testimony makes clear that actual loss numbers based on cash collected could not be computed in 2019 for merchant cash advances made in 2017 because they were still collecting cash on those deals. In other words, the collection cycle on those deals was still not complete even after two years. Because Davis's cash-flow methodology only works if the collection cycle applicable to the receivables she analyzed is "complete," (*id.*, pp. 143-144), and that cycle can continue for years, her methodology at a minimum is not applicable to receivables for such advances made in *all of*

2019 and 2020, because, as Mr. Klenk testified, those deals are still outstanding.⁵ In Davis's chart, the deals in 2019 and 2020 alone account for \$180,300,390 and \$166,389,580, respectively, for a total of \$346,689.970 of "active AR." (See Exhibit A, Davis Expert Report, at Exhibit J). In other words, her methodology is unreliable with respect to the vast majority of the "active AR," because those deals are still outstanding.

ABS illustrates why Davis' methodology is unreliable. There, Defendants sought to exclude the lost profits opinion of plaintiffs' damages expert because his analysis violated GAAP accounting methods. See *ABS*, 2015 WL 1486647, at *7-8. Defendants argued that the expert's decision to exclude certain fixed costs from his analysis, which did not "follow GAAP." *Id.* The court held that the expert's justification for excluding fixed costs "*appears to be indefensible under any meaningful cost of goods sold calculation, much less GAAP.*" *Id.* The court reserved ruling before deciding to exclude the expert's "flawed approach," but only to consider whether it might be possible to have him recalculate his numbers to comport with GAAP. *Id.* That, of course isn't possible here, because first, collections ceased for 2019 and 2020 receivables after the Receiver took over the business and, second, the collection cycles for those receivables still would not be complete anyway.

The problems with Davis's methodology, however, do not end there. Davis's objection to the use of an accrual-based assessment of Par Funding's receivables stems from her concern that the "accrual-based income has not been collected yet," and, based on her historical cash flow

⁵ It may be that Davis' inexperience dealing with merchant cash advance businesses has contributed to her flawed approach here: Q: "You've never assessed the accuracy of credit loss provisions for an MCA business, correct? A: "... I -- *I think that is correct.* There have been some engagements that I've worked on, you know, involving MCA, you know, companies, *but in terms of specifically evaluating the terminology that you used, evaluating their credit loss provision, you know, from a GAAP perspective, I don't think that's something I've done in those projects.*" (Id. p. 114).

methodology, may not be collected. (*Id.* p. 137; 140-141, 144.) However, this is true of every business, such as Par Funding, which keeps its books on an accrual basis in compliance with GAAP, which means that the cash-flow methodology rejected by GAAP would be the only method available for companies that keep their books on an accrual-basis—an absurd result.

Second, among the credit loss estimates Davis believes is understated is fiscal year 2017. (*Id.*, p. 137.) The problem with her opinion is that Par recorded a credit loss for 2017 that agrees with the estimate of its auditor, Friedman & Associates. In 2018, the Friedman firm prepared a version of Par’s Funding’s 2017 financial statement that was presented in accordance with GAAP, including a factoring loss of \$20,293,950 million. (*Id.*, p. 80.) Davis agreed that the factoring loss figure Par Funding recorded for 2017, \$20,580,713, was in line with (and actually exceeded) the number recommended by Friedman. (*Id.*, pp. 121-122.) Moreover, Davis conceded that she had no basis to disagree with the Friedman estimate because she never conducted an independent estimate of her own. (*Id.*, p. 81).⁶ See *In re Iridium*, 373 B.R. at 348 (Bankr. S.D.N.Y. 2007) (“thorough analysis by an independent accounting firm of the projections that affirm their validity is an indicator of reasonableness.”) Friedman’s independent analysis of Par Funding’s estimate of credit losses is the very indicator of reasonableness contemplated by the *Iridium* court and clearly undermines the reliability of Davis’s opinion. This is yet another reason for this Court to reject Davis’s opinion that Par Funding’s credit losses were understated.

Finally, Davis’s opinion should be excluded because it fails to account for “real world events.” *In re Iridium*, 373 B.R. at 350 (Bankr. S.D.N.Y. 2007). In assessing whether the cash flow from Par Funding’s Merchant Advances was sufficient to pay promised investor returns and operational expenses, Davis simply compared the amount of account receivables available as of

⁶ Davis, in fact, admitted that she never conducted an accrual-based assessment of the appropriate credit loss estimates for any of the years she now takes issue with. (*Id.*, pp. 77-78).

July 27, 2020 to the amount owed to investors and joint funders as of the same date. (Davis Dep., p. 287). Davis admitted that she “did not consider future business operations,” or “the dates that the payments were due to the investors or joint funders.” (*Id.*) There is no reference to the fact that 88% of the noteholders agreed to renegotiate the terms of their notes, dropping the interest rate to 5% and extending maturity to April 2027 on a back-weighted basis. (*See* Expert Rebuttal Report of Joel Glick, p. 23.) Davis simply ignores these real-world events, admitting that she was not even aware when the debt she claims Par Funding could not pay was due. (*Id.*, p. 279.) *See In re Iridium*, 373 B.R. at 350 (Bankr. S.D.N.Y. 2007) (expert opinion is unreliable when the expert fails to acknowledge and account for real world events); *Zenith Elecs. Corp. v. WH-TV Broadcasting Corp.*, 395 F.3d 416, 418 (7th Cir. 2005) (“failure to look at facts even for a reality check means that an expert lacks sufficient facts and renders his opinion unreliable.”) For these reasons as well, Davis’s opinion should be excluded as unreliable.

CONCLUSION

WHEREFORE, the Defendant, Joseph LaForte, Lisa McElhone, and Joseph Cole Barleta respectfully request that this Court grant the Motion and exclude the proffered expert testimony of Melissa Davis, and for such other and further relief as this Court deems just and proper.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing has been filed on the Court's CM/ECF system which will serve a copy on all counsel of record via notices of electronic filing.

Respectfully submitted,

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