

THE ROLE OF THE FINANCIAL EXPERT IN LITIGATION SERVICES

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CONTENTS

- 1.1 Introduction 1.2
 - (a) Rationale for the Book 1.2
 - (b) Expert Opinions and Admissibility: The Rules of the Road 1.2
 - (c) Role of the Financial Expert in Litigation 1.4
 - (d) Tasks Undertaken by Financial Experts 1.5
- 1.2 The Civil Court System 1.5
 - (a) General Process 1.5
 - (b) Financial Experts' Involvement 1.6
 - (c) Federal District Court System 1.6
 - (d) Federal Courts of Appeals 1.7
 - (e) U.S. Supreme Court 1.7
 - (f) Special Federal Courts 1.7
 - (g) State Courts 1.8
 - (h) Choice of Courts 1.8
 - (i) Applicable Rules Governing Litigation 1.8
 - (j) Alternative Dispute Resolution (ADR) 1.9
- 1.3 The Legal Process 1.10
 - (a) Overview of a Lawsuit 1.10
 - (b) Legal Pleadings 1.10
 - (c) Discovery—Introduction 1.11
 - (d) Discovery—Written Reports 1.11
 - (e) Discovery—Interrogatories 1.12
 - (f) Discovery—Requests for Production of Documents 1.12
 - (g) Discovery—Requests for Admissions 1.13
 - (h) Discovery—Depositions 1.13
 - (i) Discovery—Subpoenas 1.14
 - (j) Trial 1.14
 - (k) Types of Outcomes 1.16
 - (l) Appeal 1.17
- 1.4 Typical Roles of the Financial Expert 1.18
 - (a) Expert Witness 1.18
 - (b) Consultant 1.18
 - (c) Who is the Client? 1.18
 - (d) Trier of Fact 1.19
- 1.5 Financial Expert Services in the Litigation Environment 1.19
 - (a) Discovery Assistance 1.19
 - (b) Proof of Business Facts 1.19
 - (c) Computation of Damages 1.20
 - (d) Development of Strategy 1.20
 - (e) Document Management 1.21
 - (f) GAAP/GAAS Rules and Compliance 1.21
- 1.6 Opinion Testimony 1.21
 - (a) Expert Opinion 1.21
 - (b) Audit Opinion 1.21
- 1.7 Skills Commonly Required of Financial Experts 1.22

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1 • 2 THE ROLE OF THE FINANCIAL EXPERT IN LITIGATION SERVICES

- (a) Auditing 1.22
 - (b) Financial Analysis 1.22
 - (c) Economic Analysis 1.22
 - (d) Marketing Analysis 1.22
 - (e) Statistics 1.22
 - (f) Cost Accounting 1.22
- 1.8 Fee Arrangements and Engagement Letters 1.23
- (a) Contingent Fees 1.23
 - (b) Retainers 1.23
 - (c) Engagement Letter 1.23
- 1.9 Workpapers 1.24
- 1.10 Guidelines for a Financial Expert 1.25
- (a) Competency 1.25
 - (b) Confidentiality 1.25
 - (c) Objectivity 1.25
 - (d) Conflicts of Interest 1.26
 - (e) Other Guidelines 1.27
- 1.11 Professional Standards and Malpractice Concerns 1.28
- 1.12 Special Issues for CPAs 1.29
- 1.13 Conclusion 1.30
- NOTES 1.30

1.1 INTRODUCTION

(a) Rationale for the Book. Anyone who considers undertaking the role of financial expert will find this book valuable. It will help experienced practitioners stay up to date and will guide them in other areas in which they can apply their experience.

This book is a current reference for certified public accountants (CPAs) and other financial experts involved in typical litigation cases and includes technical approaches and case-specific tools in use today. Although not exhaustive on any topic, it addresses the roles that financial experts play in litigation in commonly encountered cases. We incorporate advice from practitioners with extensive experience in litigation services.

(b) Expert Opinions and Admissibility: The Rules of the Road. Over time, the role of experts has expanded in the American legal system. Originally, courts allowed expert testimony only when the facts became too complex for an average juror to understand, and no expert could express an opinion on the ultimate issue. The Federal Rules of Evidence¹ have liberalized this and other rules applying to experts, thereby increasing their use. Rule 702, Testimony by Experts, states:

If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

Rules 703 through 705 of the Federal Rules of Evidence also relate to expert testimony. Rule 703 allows experts in reaching their opinion to rely on otherwise inadmissible facts or data if they are “of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject.” Experts can, for example, rely on hearsay evidence, posing the risk that their testimony will expose jurors to evidence from which the Rules of Evidence aim to insulate them. For this reason, Rule 703 requires judges to guard against the expert acting as a “smuggler of hearsay” to the jury:

Facts or data that are otherwise inadmissible shall not be disclosed to the jury by the proponent of the opinion or inference unless the court determines that their

probative value in assisting the jury to evaluate the expert's opinion substantially outweighs their prejudicial effect.

Rule 704 allows experts to give an opinion on the issue that the trier of fact will ultimately decide. (The only exception relates to an alleged criminal's mental state.) Thus, an expert can give an opinion on such issues as liability or the amount of damages.

The U.S. Supreme Court guided federal trial court judges as to the admissibility of expert testimony in *Daubert v. Merrell Dow Pharmaceuticals*, 113 S. Ct. 2796 (1993). The trial judge has broad discretion to act as a gatekeeper to forbid expert testimony based on mere subjective belief or unsupported speculation. Although the Court decided in the context of scientific expert testimony, the decision applies to any expert testimony including financial, economic, and accounting testimony; the Court provided this clarity in *Kumho Tire Co. v. Carmichael*, 526 U.S. 137 (1999).

Although *Daubert* and its progeny provide no exclusive list or set of tests that the expert's testimony must meet to be admissible—and thus survive the judge's gatekeeping function—one does well to consider the factors that the decision enumerates:

- Is the theory or technique testable? Has it been tested?
- Has it been subjected to peer review or publication?
- Is the potential rate of error known?
- Is it generally accepted within the relevant community of experts?

These *Daubert*-originated factors, bowing to the scientific method, reflect the scientific nature of the expert evidence at issue in that case. We reiterate that these are examples, not tests or a checklist, and one's testimony can flunk a given test yet be judged admissible by the court; similarly, a court will exclude a testimony that meets all the factors if it lacks relevance, doesn't relate to the facts of the case, or otherwise proves unreliable. The Advisory Committee's Note to Amendment (to Rule 702) effective December 1, 2000 includes some bases for doing so, as well as good standards to apply when evaluating one's own prospective testimony:²

Whether testimony is based on research conducted independent of the litigation or was expressly undertaken for the purpose of the testimony;

Whether the expert has unjustifiably extrapolated from an accepted premise to an unfounded conclusion;

Whether the expert has adequately accounted for obvious alternative explanations;

Whether the expert applies the same degree of intellectual rigor within the courtroom as without;

Whether the field of expertise claimed by the expert is known to reach reliable results (for example, astrologers may observe some principles generally accepted within their community but not, per the Committee, within the courtroom).

Diligent, experienced attorneys with adequate time and funding will take the time and care needed to maximize the likelihood of the testimony's admissibility. Many cases lack such resources, and the experts must then apply care and thoughtfulness to avoid exclusion. In the short term, admissibility will avoid the prejudice to the client (and embarrassment to the expert) of a testimony's exclusion. Excluded testimony will also have long-run repercussions: the misfortune

will become a topic of discussion in future depositions and *voir dire*³ proceedings. It will also require a *yes* answer to one of the first questions that most attorneys will ask an expert whom they consider retaining: “Has a court ever excluded your testimony?”

Before one can confront the perils of qualifying to testify in the courtroom, the court must allow the expert to enter. Federal Rules of Civil Procedure Rule 26(a)(2) provides the requirements for federal cases:

(2) Disclosure of Expert Testimony.

(A) In addition to the disclosures required by paragraph (1), a party shall disclose to other parties the identity of any person who may be used at trial to present evidence under Rules 702, 703, or 705 of the Federal Rules of Evidence.

(B) Except as otherwise stipulated or directed by the court, this disclosure shall, with respect to a witness who is retained or specially employed to provide expert testimony in the case or whose duties as an employee of the party regularly involve giving expert testimony, be accompanied by a written report prepared and signed by the witness. The report shall contain a complete statement of all opinions to be expressed and the basis and reasons therefor; the data or other information considered by the witness in forming the opinions; any exhibits to be used as a summary of or support for the opinions; the qualifications of the witness, including a list of all publications authored by the witness within the preceding ten years, the compensation to be paid for the study and testimony; and a listing of any other cases in which the witness has testified as an expert at trial or by deposition within the preceding four years.

(C) These disclosures shall be made at the times and in the sequence directed by the court. ...” [The expert should consult with the retaining attorney regarding the specific provisions that follow.]

Section 1.3(d) of this chapter discusses the nature and content of expert disclosures, including the report substance. Note that the states’ requirements for expert disclosure and discovery have important differences and, in a practical sense, have more variation than do the standards for admission of expert testimony.

(c) Role of the Financial Expert in Litigation. Lawyers use financial experts in litigation for the same reasons that businesses retain financial experts as advisors: lawyers need quality advice when litigating, and financial experts offer this service because they give advice in the real world to real companies with real problems. Juries understand and respect this practical experience. Because accounting is the language of business, accountants can often clarify business transactions and explain the records reflecting them to lawyers, judges, and the jury. Because economists help companies apply the principles of market definition, price theory, economic modeling, and market risk, they can help interpret the effects of a firm’s behavior on competitors or other related entities. Financial experts have the quantitative skills required to undertake and perform the analyses necessary to interpret the technical evidence required in complex commercial cases.

The ideal expert (1) has never testified before and has no relationship with the hiring attorney, firm, or client, so that the jury will be disinclined to regard him as a hired gun but (2) has substantial experience in litigation analyses, testimony, and response to cross-examination. This prospective expert does not exist. The lawyer must weigh the risks and rewards each case presents in making the selection.

This book focuses on the financial expert’s role as an expert witness, because litigation practitioners most often serve in this comprehensive role. As Section 1.4(b)

discusses, however, experts frequently play a behind-the-scenes role as consultant to the legal team or, occasionally, as arbitrator.

(d) Tasks Undertaken by Financial Experts. Attorneys most often retain financial experts to compute or rebut the plaintiff's damages claim for loss resulting from the defendant's legal wrong. They also provide analysis and testimony on liability issues where their expertise suits them to prepare relevant analyses or to discuss compliance with professional standards in malpractice and similar cases. In addition, financial experts sometimes address the business issues in a case: economists and CPAs with suitable experience often consult or testify on issues involving marketing, economics, and industry practices.

Financial experts can organize and synthesize data. Hence, lawyers rely on them to review collections of documents to extract, store, and analyze information relevant to discovery and trial. Chapter 3 discusses the complementary strengths of accountants and economists and the interaction between the two fields of expertise.

1.2 THE CIVIL COURT SYSTEM

(a) General Process. With the exception of criminal activities related to fraud, this book examines civil disputes. Those disputes fall into tort or contract causes of action. A tort is a wrongful act or inaction unrelated to a contract, such as negligence, fraud, or interference with prospective economic relations. Contract causes of action arise from a breach of a contract's essential terms.

Judges and juries resolve disputes. Judges determine the applicable law in all courts; in *bench trials* (i.e., trials heard by judges, without a jury), they also identify the facts when those are in controversy. Parties also have the right to demand a jury to decide disputed facts in trials before most courts of general jurisdiction, but not in trials involving family law, probate and estate, and equitable issues.⁴ In addition, the litigants in some special courts—including tax court and the U.S. Court of Federal Claims—have no right to a jury. Appellate courts have no juries because the trials held in them address only legal issues, not factual issues. Even when parties can demand a jury trial, many prefer that the judge resolve all matters in dispute.

Parties have a right to appeal a decision at a trial court to the first level of the appellate process in either state or federal courts. After that, they have a right of appeal to the higher court(s) but with a diminished likelihood of that court exercising its discretion to hear the case: these higher courts of appeal (usually the supreme court of the jurisdiction) accept or decline to hear cases based on their perception of a matter's importance. Normally, they consider cases in which a number of the lower courts of appeal disagree on an issue that has some societal importance. The courts do not, however, usually consider the matter's importance to the individual appealing the lower appellate court's decision.

Courts of appeal can sustain the lower court's decision, reverse it, or partially sustain and partially reverse it. They can remand the case for retrial on whatever issues they consider appropriate and, in certain circumstances, resolve the matter with a trial *de novo*, an unusual proceeding in which the appeals court in effect retries the case itself based on the original trial record.

(b) Financial Experts' Involvement. Lawyers for the party involved in litigation interview and retain CPAs and economists for their financial expertise and ability to communicate their opinions effectively. The retention usually occurs after the plaintiff files the complaint but before trial. During the pretrial period, the financial expert consults with the lawyers. The expert can assist in discovery by educating the lawyers as to the types of business records to ask for, drafting relevant interrogatory and deposition questions, and suggesting requests for document production.

Once the lawyers receive information, financial experts will analyze it and explain its relevance. Experts then typically reach opinions based on their analyses. If the lawyers deem these opinions helpful to the trial issues, they designate the CPAs or economists as expert witnesses who testify at trial as to their opinions.

CPAs or economists designated as expert witnesses often have to appear and testify at a deposition in which the opposing lawyer will test their expertise and probe for the bases of their opinions.

(c) Federal District Court System. The federal system's trial court is known as a *district court*. To qualify as a plaintiff in a federal case, either the plaintiff must raise a question of federal law, or diversity of citizenship must exist between plaintiff(s) and defendant(s). This means that at least one of the defendants must reside in a state different from that of the plaintiffs. When a federal court tries a case because of diversity of citizenship, it will apply state law.⁵ Federal law applies only when the plaintiffs bring the cause of action under a federal statute. To file a case in federal court, the amount in controversy must exceed a statutory amount (\$75,000 as of 2005).

The federal system has 11 numbered and 2 unnumbered circuits, geographically organized as follows:

Federal Circuit: Jurisdiction not geographically based

District of Columbia Circuit: Washington, DC

First Circuit: Maine, New Hampshire, Massachusetts, Rhode Island, and Puerto Rico

Second Circuit: New York, Connecticut, and Vermont

Third Circuit: New Jersey, Pennsylvania, Delaware, and Virgin Islands

Fourth Circuit: Maryland, Virginia, West Virginia, North Carolina, and South Carolina

Fifth Circuit: Texas, Louisiana, and Mississippi

Sixth Circuit: Tennessee, Kentucky, Ohio, and Michigan

Seventh Circuit: Illinois, Indiana, and Wisconsin

Eighth Circuit: Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota

Ninth Circuit: California, Arizona, Nevada, Oregon, Washington, Idaho, Montana, Alaska, Hawaii, Guam, and Northern Mariana Islands

Tenth Circuit: Colorado, Kansas, New Mexico, Oklahoma, Utah, and Wyoming

Eleventh Circuit: Alabama, Georgia, and Florida

Each state in each circuit has at least one separate district court. More populous states have more than one district court. For example, California and New York

each have four judicial districts. Depending on the population and the court's budget, districts will have different numbers of judges, but each case has only one judge.

The plaintiff selects the district in which it files the case, subject to the restriction that one of the parties must reside in the district.

(d) Federal Courts of Appeals. The federal circuit courts hear appeals from district court decisions. The trial court jurisdiction dictates the appellate court jurisdiction. A federal court of appeals will accept appeals only from district courts in its circuit, with specific exceptions (e.g., appeals involving intellectual property cases) which are heard in the U.S. Court of Appeals for the Federal Circuit. A party has a right to appeal a district court decision to the appropriate court of appeals. Normally, a panel of three judges, selected at random, will hear cases on appeal. Through an *en banc* petition, a party can request that the entire panel of judges in a particular circuit hear the appeal, but the circuit can deny such a request.

(e) U.S. Supreme Court. A party must have a decision from the federal court of appeals before it can petition the U.S. Supreme Court for review. Rare exceptions occur for matters of extreme importance and urgency. The Supreme Court found the antitrust case between the United States and Microsoft insufficiently urgent to require an expedited appeal. A party has no absolute right of appeal to the Supreme Court, which accepts cases of broad relevance only. If the issue affects only the immediate parties, the Supreme Court likely will hear the case only if an unsettled question of law needs clarification, for example, when different circuits have decided a matter differently.

(f) Special Federal Courts

(i) Tax Court. Complex tax law often requires judges with training and experience in taxation to resolve disputes expeditiously. An entity with a federal tax dispute can choose to litigate either in district court or in a special tax court, which exists solely to resolve cases between the Internal Revenue Service and taxpayers. The procedural requirements for filing in tax courts differ from those in district courts. Chapter 37 addresses tax fraud cases.

(ii) U.S. Court of Appeals for the Federal Circuit. Federal district courts hear patent, copyright, and trademark issues, which are collectively referred to as intellectual property disputes and discussed in Chapters 20 through 23. Appeals from district court decisions on such cases do not go to the corresponding circuit court of appeals but to the U.S. Court of Appeals for the Federal Circuit in Washington, DC. The Federal Circuit also hears appeals from the Court of Federal Claims, which we discuss next.

(iii) U.S. Court of Federal Claims. This court renders judgment upon any claim against the United States based on the Constitution, any act of Congress, regulation of an executive department, or an express or implied contract with the United States. Although the U.S. Court of Federal Claims hears most claims for damages against the federal government, district courts have concurrent jurisdiction of certain claims against the United States (e.g., certain tax claims) and exclusive jurisdiction of most tort claims. Chapter 31 describes the handling of federal contract disputes in detail.

(iv) *Bankruptcy Courts.* Each federal district has a bankruptcy court to hear cases filed under Title 11 of the United States Code covering bankruptcy matters. The bankruptcy court has exclusive jurisdiction over all of the debtor's property once a filing for bankruptcy has occurred. Chapter 28 discusses bankruptcy procedure and practice.

(g) State Courts. Similar to the federal system, state court systems have trial courts, courts of appeals, and a supreme court to handle final appeals. State court systems usually have several different types of trial courts, and the nomenclature varies across states.

(i) *Courts of Limited Jurisdiction.* Some state trial courts limit the amount of damages that the plaintiff can collect or the subject matters upon which they can decide. A small claims court is an example of such a court. Many courts of limited jurisdiction cannot hear felony cases but only civil and criminal misdemeanor cases.

(ii) *Courts of Unlimited Jurisdiction.* Each state has general purpose trial courts, similar to the district courts in the federal system. These courts handle cases that involve major issues, whether for large monetary damages or for felony matters in criminal cases. The financial expert involved in state court most often works in these courts.

(h) Choice of Courts. A plaintiff sometimes can choose the court in which to file a lawsuit. If the suit involves only state law issues but meets federal diversity standards, the plaintiff can file in either state or federal court. If the plaintiff elects to file in federal court, more than one federal court often presents a proper venue (location) for the trial.

A plaintiff considers several factors before deciding in which court to file: the judges' reputations, existing law, and the length of wait to trial. The plaintiff might also consider the number of jurors necessary to reach a verdict (this can differ by court—federal district courts require a unanimous decision by 6 jurors; many states require 12 jurors, but not all states require a unanimous decision) as well as the record and apparent attitude of the related appeals court. Commentators often belittle this decision process regarding which court to file in as forum shopping, an attempt to find the court that will exhibit the most sympathy for the plaintiff's position. Certain states have a reputation of presenting rosier prospects for class plaintiffs (e.g., Alabama), for commercial defendants (e.g., Delaware), or for conferring a home-field advantage in dispensing justice (e.g., Texas). Whether one credits these prejudices or not, most litigants will find it more economical to proceed in their local courts than to bring or defend an action on the other side of the country.

(i) Applicable Rules Governing Litigation

(i) *Evidence.* All judicial systems have rules of evidence governing what the parties can present to the trier of fact for deliberation. The judge rules on objections to the admissibility of evidence. Mistakes in evidential rulings, if material, become grounds for appealing the trial court decision.

Financial experts who offer litigation services should become familiar with the rules of evidence of the court systems in which they work. Article VII of the

Federal Rules of Evidence deals with opinions and expert testimony. Article IX addresses authentication and identification of evidence. These rules affect the work of financial experts.

The rules of evidence in state courts vary. Many follow the Federal Rules of Evidence, but some do not. Of particular significance are the hearsay rules. All courts exclude hearsay, which is evidence offered based on something other than the personal experience of the witness. Some exceptions to the hearsay rule exist, such as business records kept in the normal course of operations. Hearsay can, however, form the basis of expert opinions in some circumstances in some courts, and experts should understand the requirements of their venue. The hearsay rules have evolved as common-sense safeguards against unjust trial results, and understanding the logic of the rules can help experts present their testimony more clearly and thoughtfully.

(ii) *Procedure.* Courts differ in their methods of operation. *Procedure* is the set of formal steps that guides the judicial process between the filing of the complaint and the culmination of the trial and appeals. It is the machinery by which litigants resolve their disputes.

Criminal and civil courts differ in their procedures. This book emphasizes civil cases, so it discusses civil procedure. As with evidence, formal rules govern procedure. These rules, enacted by statute in each state and by the United States, set out the particular discovery devices that lawyers can use and when they can use them. Section 1.3 of this chapter explains typical discovery tools and their use. In addition to controlling discovery, the rules of civil procedure explain the requirements that pleadings and other motions before the court must meet.

One important rule of civil procedure that affects experts is Federal Rule of Civil Procedure 26, which governs the discovery permitted of experts and consultants. Section 1.3(d) of this chapter discusses this rule.

(iii) *Local Rules.* Local court rules supplement the rules of civil procedure in federal and some state courts. The rules of civil procedure do not cover all situations at the detailed level that some judges prefer. Therefore, some judges supplement them with additional procedures that litigants must follow in their courts. Typical local rules deal with page limits on motions, time limits on depositions, mandatory mediation provisions for certain types of action, and similar matters of efficiency in practice. Failure to follow the local judge's special rules can cause delay and the court can refuse to accept legal filings.

(j) Alternative Dispute Resolution (ADR). Many perceive the United States to have a slow and expensive court system. Several reasons account for this: the ease with which plaintiffs can initiate cases and the limited supply of judicial resources. Moreover, the rights to extensive discovery and the difficulty of scheduling attorneys' time add to the delay. These factors have encouraged disputants to pursue other means of resolution, including arbitration, minitrials, and mediation. (Chapter 4 further discusses ADR.)

(i) *Arbitration.* Arbitration involves the submission of a dispute to one or more unofficial persons who will resolve the dispute privately. A contract, the law, or agreement of the parties can set the procedures. Such bodies as the American Arbitration Association, the National Association of Securities Dealers, and private

arbitration providers have established arbitration procedures, some tailored to specific types of dispute (e.g., employment or construction disputes). Arbitration offers the benefit of finality: although most settings offer certain rights of appeal through the formal legal system, judges are slow to revisit the findings of an arbitrator—often a technical expert selected by the parties for that reason—absent fraud or a material undisclosed conflict of interest.

(ii) *Minitrials*. The minitrial forum resulted from efforts to involve business people early in the resolution of commercial disputes. In a short trial, usually no longer than a day, both sides present their cases to senior management, such as the chief executive officers of the companies, who has authority to settle the matter. The process does not bind the parties, nor can they use information learned in the proceeding in a subsequent trial on the issues in dispute.

The minitrial has no formal rules of procedure or evidence. Each lawyer presents arguments or a few witnesses. When each side has heard the best arguments of the other, the decision makers discuss the case, with no lawyers present, in an attempt to resolve the dispute.

The minitrial has proved most successful when a commercial settlement seems feasible, the parties share an interest in their ongoing relation, and the parties retain a facilitator or pseudo-judge to conduct the proceeding. They often appoint a retired judge or a person experienced in the industry. The facilitator has no power to decide the matter but can ask questions of the parties, meet individually with them, and lead the discussion between them, giving an informed view of the strengths and weaknesses in each side's case. The Center for Public Resources⁶ has a list of individuals qualified to serve in the role of facilitator.

(iii) *Mediation*. Marital dissolution cases make the most use of mediation. A mediator works with disputants in an attempt to arrive at a settlement. A mediator helps the parties recognize the strengths and weaknesses of their own and each other's positions; mediators can also suggest compromises and strategies to resolve the dispute.

Similar to a minitrial, this process is nonbinding. A decision requires agreement by all the parties. Success often depends on the parties' desire to resolve the dispute and the skill of the neutral participant.

1.3 THE LEGAL PROCESS

(a) Overview of a Lawsuit. This section discusses the steps in a typical litigation that proceeds to trial. The expert who understands this structure can work better in the process and communicate better with the lawyers on the team. Litigation comprises five major stages, some of which occur concurrently: pleadings, discovery, trial, the outcome, and appeal.

(b) Legal Pleadings

(i) *Complaint*. The complaint is the first pleading in a civil case, in which the plaintiff sets out the actions (or inactions) that prompted the lawsuit. The complaint contains a list of the defendants, the name of the court in which it is filed, the laws and legal theories under which the plaintiff seeks relief, the remedies sought, and whether the plaintiff demands a jury (when that option exists).

Jurisdictions and causes of action differ in the amount of detail the complaint must include. Some courts require the plaintiff to list all known material facts used to support the claims. Other courts require minimal disclosure of facts in the complaints, requiring little more than that the plaintiff notify the defendant of the lawsuit.

(ii) *Demurrer.* A defendant who believes that the plaintiff has not met the legal standards of a proper complaint can file a demurrer. This pleading disputes the legal sufficiency of the complaint (or other pleading). It aims to eliminate, at the outset, tangential or nonmeritorious claims. A demurrer states that, even assuming the facts alleged by the plaintiff are true, no cause of action exists that imposes any legal liability on the defendant. The demurrer states that the court need not decide an issue of law and requests the court to dismiss the complaint.

This device often forces the plaintiff to clarify the complaint (or other pleading) because the plaintiff must provide additional information in responsive pleadings. Sometimes the plaintiff must also amend the complaint to make it sufficient. The demurrer also provides time for the defendant to respond to the complaint.

(iii) *Answer.* The answer by the defendant responds to the plaintiff's complaint. Normally, defendants admit the allegations in the complaint with which they agree and deny the allegations with which they disagree. Defendants can also plead affirmative defenses based on the facts pled in the complaint, which, if successful, preclude the plaintiff from prevailing.

The answer can also contain a cross-complaint in which the defendant will make claims against the plaintiff (cross-defendant), which the plaintiff will have to answer and defend at trial. Generally, the defendant must file an answer within a short time of receipt of the complaint (20 to 30 days, unless the court grants an extension).

(c) Discovery—Introduction. Discovery occurs in the time between filing the original pleadings and the trial. In discovery, each party attempts to ascertain the other party's facts and theories. Most litigation never advances to the trial stage but settles during the discovery phase or shortly before trial. Resolving confusing sets of facts and expanding client and counsel's knowledge of the economic landscape decreases the uncertainty of the litigation's outcome, increasing the likelihood of a settlement.

Experts perform most of their work during this period. Before identifying and collecting information, counsel and the financial analyst should educate each other: counsel educates the financial analyst about the legal issues in the litigation; the financial analyst educates counsel on the economic and financial propositions that relate to these legal issues and on the analyses that could develop them. Then the expert, with the assistance of counsel, collects the necessary facts, analyzes them, develops any assumptions, and forms expert opinions.

Lawyers can use various legal tools in discovery to help their experts perform their work. The following sections describe the major discovery tools and their uses.

(d) Discovery—Written Reports. Federal Rule of Civil Procedure 26(a)(2)(B) requires that experts prepare and sign a written report. (Section 1.1(b) of this chapter contains the full text, including required elements.) Counsel must disclose this

report to the other parties before the court will allow the expert to testify at trial. Local rules of the court, or agreement of the parties, or the trial judge will often set the date of this disclosure. Otherwise, counsel must disclose the report at least 90 days before trial. If counsel retains an expert strictly to rebut the testimony of an opposing expert, counsel must disclose the report of this rebuttal expert within 30 days of the disclosure of the other expert's report.

The written report's content should permit full discovery by the opposing side of all the opinions and bases for the opinions. In addition, if the expert has any changes to the report (or subsequent deposition) that correct, complete, or add to the report, counsel must disclose these before trial, or the court can preclude the expert from testifying to these additional opinions or new reasons for the previously disclosed opinions.

District courts can opt out of the requirement for a written report. Financial experts should check with the attorneys who have retained them to ascertain the requirement of the district court in which the plaintiff has filed the case as well as any agreements specific to the case.

Many state court systems model their rules of civil procedure after the Federal Rules of Civil Procedure, requiring written expert reports as well.

(e) Discovery—Interrogatories. Interrogatories are written questions that one party asks of the adversary, who must answer in writing under oath. The financial expert's special knowledge of business or a particular industry can help counsel construct questions to develop a thorough understanding of the adversary's systems, documentation, files, and structure. For example, the nature and extent of the opposing party's financial reporting and management information systems present possible areas of inquiry. A party can learn the names and titles of officers or principals in the business to enable further discovery of pertinent files or to identify potential sources of deposition testimony.

(f) Discovery—Requests for Production of Documents. A request for production of documents requires one party to provide documents that the other considers relevant to issues in the case. These requests usually follow interrogatories. If the requests do not name documents with great specificity, the opposing party often will not produce them, even when the request makes clear the information sought.⁷ When possible, therefore, the request should state exact titles of reports, which the lawyer has learned from the information obtained through previous interrogatories or depositions.

The party responding to the request often does not copy the documents. Instead, it makes the documents available, typically at its attorney's offices, where the requesting party can review them and decide which ones to copy at its own expense.

The requesting party's attorney often will want the financial expert to review financial and other business records produced to aid in identifying and copying the relevant documents. In addition, the financial expert and the attorney will review the documents copied, so costs will increase as the number of documents discovered increases. Knowledgeable experts can reduce unnecessary copying (and subsequent review costs) by identifying the types of financial and business records that they will need to prove the issues and by helping the attorney

efficiently select which of the opponents' documents to review. Section 17.4 of Chapter 17 discusses how to find and obtain data, including e-mail files and traffic.

(g) Discovery—Requests for Admissions. A request for admission seeks the opposing party's verification of information as fact. The request must relate to the litigation. Verifying the information as fact usually proves adverse to the interest of the party making the admission.

Admissions help narrow the factual issues that the parties will litigate at trial. The trial need not address undisputed facts, which decreases the time for trying a case. Judges like admissions. Financial experts can suggest the types of facts within their area of expertise that opposing parties might admit prior to a civil trial. The expert can also assist the attorney in developing arguments about why the party should or should not admit certain business facts prior to trial.

(h) Discovery—Depositions. A deposition is the oral testimony of a witness questioned under oath by an attorney, who can use the written record later at trial under certain circumstances.

(i) Deposition of a Financial Expert. When a CPA, economist, or other financial analyst serves as an expert witness, the opposition's attorney usually deposes the expert to learn his or her background and the bases for the opinions in the case. The attorney uses the deposition to evaluate the expert as a trial witness, find strengths and weaknesses, and develop a comprehensive understanding of the opinions, studies, and analyses. In rare cases, some experienced attorneys omit the deposition, in part because it can educate the expert. A deposition sometimes allows an expert to test theories or approaches and then correct them as needed for the trial. Depositions present a final risk for the adverse party in that the expert can use the deposition as an opportunity to correct deficiencies in previous disclosure that might otherwise lead to exclusions by the judge for failure to comply with Rule 26.

Questions at the deposition usually cover all work that the financial expert performed, including rejected analyses, blind alleys, and information obtained but not used. In addition, the opposing lawyer can use the deposition to narrow the scope of the expert's testimony at the trial, because the lawyer can use information from the deposition to impeach the expert's credibility at the trial. The expert must give consistent testimony in the deposition and at trial or be prepared to explain why they differ.

Federal Rule of Civil Procedure 26(b)(4)(A) covers the taking of depositions of experts in federal cases. Counsel can take a deposition of any person whom the opposing side has identified as an expert who may testify at trial. The deposition cannot occur, however, until after counsel has disclosed the written report required by Federal Rule of Civil Procedure 26(a)(2)(B).

(ii) Assisting in a Deposition. Although only an attorney can ask questions at a deposition, a financial expert (retained as either a witness or a consultant) can assist the attorney during the examination, particularly of people in the financial or accounting areas. Attorneys also ask the financial expert for assistance at a deposition of the opposition's expert. The expert knows the language of business and can often detect a witness's uninformative answer or a sign of weakness that the

attorney might miss. The financial expert can suggest additional questions to the attorney by passing notes or by discussions during breaks in the deposition. In this way, the expert can help identify an inconsistency, suggest a follow-up question, or expose a flaw in the testimony. Although the financial expert has no right to attend another expert's deposition, the attorneys will often agree on an attendance policy for all depositions.

Even when the financial expert does not attend the deposition, the attorney often will request the expert to provide questions for the attorney to ask. These questions have two aims: (1) to clarify the opinions the opposing expert is likely to express at trial and the analytical work that supports it and (2) to point out problems, inconsistencies, and errors in the analysis.

Some lawyers do not want to alert the witness to analytical flaws during the deposition. They prefer to hold this information for use at the trial. Others prefer to use the deposition to point out the weaknesses in their opponent's case, thus encouraging settlement or, at a minimum, forcing the expert to correct the analysis before use at the trial.

(i) Discovery—Subpoenas. Most often, parties comply with requests for documents and witness appearances. For those situations where a party does not cooperate with such requests, the attorney can use a subpoena to compel such cooperation. The subpoena *ad testificandum* commands a person to appear and testify as a witness. The subpoena *duces tecum* commands a person to produce documents. Practice varies by jurisdiction: serving a subpoena on a party or expert can be an insult in one forum; failing to do so may constitute malpractice in another.

Frequently, only the subpoena will obtain information from third parties not related to the litigation. The court can hold an uncooperative recipient of a subpoena in contempt and impose sanctions as severe as incarceration.

Any party or subpoena recipient, including the financial expert, can object to a subpoena, thus requiring a hearing on the relevance and propriety of materials demanded. A financial expert who objects to a subpoena for documents might thereby delay the trial and generate costly legal fees. Sometimes, however, the expert must object, as when a subpoena requests materials related to other clients. Often the opposing attorneys agree on how much they will try to discover from the experts and thereby avoid unproductive controversy.

The opposing counsel may wish to explore the records of other nonparty clients of the financial experts using the subpoena and deposition process. CPAs must avoid violating Ethics Rule 301 of the American Institute of Certified Public Accountants (AICPA) Rules of Professional Conduct, which requires the CPA to maintain client confidentiality with past as well as current clients. Because CPAs have a duty to comply only with a validly issued subpoena, they may need to test the subpoena's validity before revealing confidential client information.

(j) Trial

(i) Opening Statements. For a jury trial, the court and attorneys first pick the jury. Each side's attorney then makes an opening statement. (The defendant can choose to delay an opening statement until presenting its case.) The attorneys explain the issues of the case as they view them, the conclusions that the trier of fact should reach on these issues, and the evidence they will present.

The attorney uses this time to educate the trier of fact about the entire case. Although the opening statement does not present evidence, some observers believe that many cases turn on opening statements.

(ii) *Plaintiff's Case.* The plaintiff carries the burden of proof at trial and in most civil cases must meet the standard of a preponderance of the evidence, 51 percent in layman's terms. The plaintiff presents its case first. Normally, witnesses present evidence, and the normal process of examination proceeds, as discussed in the following sections.

(iii) *Direct Examination.* Direct examination is the first examination of a witness by the attorney who calls the witness. During this question-and-answer session, the plaintiff must introduce the evidence that proves its case.

Formal rules of evidence apply, and the opposing counsel can object to defective questions or to questions intended to elicit inadmissible evidence; the judge can either allow the question or sustain the objection.

Experts serve themselves and their clients well if they understand the typical grounds for objection. Such grounds include questions that call for hearsay evidence or lead the witness, or testimony that misstates prior testimony or assumes facts not in evidence. As with the rules of evidence, understanding the elements of proper questioning can help the expert provide clear and accurate testimony that the court will respect.

(iv) *Cross-Examination.* Cross-examination is the first examination of a witness by the attorney for the opposing party. It immediately follows the end of direct examination. The opposing side will try to discredit the witness or to obtain evidence favorable to its case.

In principle, opposing attorneys must limit cross-examination to issues raised in the direct examination of the witness. If attorneys for the opposing side wish to raise other issues, they must call the witness as an adverse witness in their own case and then conduct direct examination. Some judges, however, allow fairly wide cross-examination, particularly of expert witnesses.

Unlike direct examination, cross-examination rules permit leading questions—those that suggest a particular answer. In addition, the opposing attorney can read (if germane) prior deposition or other testimony or writings of the witness into the record in an attempt to impeach the witness. Courts have increased the use of video to replace reading from a deposition transcript.

(v) *Redirect Examination.* This examination immediately follows cross-examination of a witness. Rules of procedure limit redirect examination to issues raised on cross-examination. An attorney who forgets to ask about a matter on direct examination cannot raise the matter for the first time during redirect unless it relates to issues raised in the cross-examination. In redirect, counsel tries to rehabilitate the witness if necessary and possible or, if applicable, to demonstrate that the cross-examining attorney has treated the witness unfairly or employed artifice in an attempt to mislead the jury.

(vi) *Recross-Examination.* This examination immediately follows redirect examination, and the attorney must limit it to issues raised in the redirect examination. Recross-examination normally has a narrow scope. In theory, iterations of re-redirect

and re-recross can proceed indefinitely. In practice, few judges have the patience to permit such excess, and most lawyers know better than to test that patience.

(vii) *Defendant's Case.* The plaintiff will present all of its witnesses and exhibits before the defendant begins its case. When the plaintiff rests, the defendant can request a *directed verdict*, discussed in Section 1.3(k)(iv) of this chapter. Unless the judge grants such a motion, the defendant presents all of its witnesses. The examination proceeds as described previously in (iii) through (vi) for the plaintiff's case.

If the defendant believes that the plaintiff has not proved its case but no directed verdict has been granted, it can decide against presenting a case and simply rest. The defendant in these circumstances hopes it has made its case through cross-examination and recross-examination of the plaintiff's witnesses. Attorneys usually find this strategy difficult and ineffective because most of the plaintiff's witnesses will prove hostile to the defendant's positions. In the words of an experienced trial attorney: "If your best defense is that the plaintiff hasn't carried his burden, you need another defense."

(viii) *Plaintiff's Rebuttal Case.* After the defendant rests its case, the plaintiff has a chance to rebut the defendant's case. This occurs through witnesses and documents as described previously in (vii) for the defendant's case. The plaintiff must limit the rebuttal's scope to issues raised in the defendant's case. Some judges and jurisdictions do not allow a rebuttal case. Financial experts often participate in rebuttal when the defendant has sufficiently discredited the plaintiff's damages theory or study so that the plaintiff must present a revised damages study to address the problems raised by the defendant.

(ix) *Defendant's Surrebuttal Case.* Some jurisdictions permit the defendant to respond to issues raised by the plaintiff's rebuttal case. Courts refer to this response as *surrebuttal* and restrict it to issues raised in the plaintiff's rebuttal case. Other jurisdictions do not allow surrebuttal or leave it to the judge's discretion.

(x) *Closing Arguments.* Once both sides have rested, the plaintiff (in a civil trial) will make its closing arguments first, followed by the defendant. The attorney will summarize the evidence from the trial record and try to persuade the trier of fact why his or her client should prevail.

(xi) *Post-Trial Briefs and Findings of Fact.* The judge often will ask the attorneys to file briefs summarizing points that the lawyers think they have proved and the relevant law that the court should apply to the case. This helps the judge write an opinion in a bench trial (i.e., a trial heard only by a judge without a jury).

These briefs contain suggested findings of fact and conclusions of law. Financial experts sometimes assist the lawyer in drafting a portion of the brief, particularly the part summarizing the expert's testimony. The findings of fact must refer only to evidence admitted in the trial. The facts must be part of the record in the trial and cannot result from new or objectionable evidence.

(k) Types of Outcomes

(i) *Verdict.* The verdict is the decision rendered by a jury (or a judge in a bench trial). It presents the formal decision or finding made by a jury and reported to the court upon the matters or questions submitted to them at trial. The jury can render

a general or a special verdict. In a general verdict, the jury finds in favor of the plaintiff or defendant on all issues. In special verdicts, the jury decides only the facts of the case and leaves the decisions on the application of the law up to the judge. A special verdict results when a jury must make separate decisions as to different issues in the case. This most often occurs through interrogatories to the jury.

(ii) *Judgment.* A judgment is the court's official decision as to the rights and claims of the litigants. If the court (i.e., the judge) accepts the jury's verdict, that verdict becomes the judgment. In almost all cases, the judge makes this judgment with no further comment or opinion. If the court does not accept the jury's verdict, the judge can make a judgment, as explained later in (v). If the judge is the trier of fact, the judge's decision becomes the judgment.

(iii) *Opinion.* Judges will state the reasons for their decision and their understanding of the application of the relevant law. These writings, if appealed and sustained, become the precedents that form the basis for court-made law in our judicial system.

In some cases, a party asks the judge to rule on part or all of the case even before the trial begins. The party moving for such a *summary judgment* argues that even if all the facts alleged by the opponent hold true, no triable issue of law exists. In other words, the facts alleged do not violate the laws or legal rights asserted by the opponent. Even though full dismissal of an action on motion for summary judgment occurs rarely (many judges have a bias in favor of allowing parties their day in court), they often prove effective in paring away pieces of an action, reducing the complexity, required time, and, of course, cost of an ensuing trial. Additionally, many attorneys believe they can educate the judge to their perspective in the case, creating a more favorable starting point for them at trial.

(iv) *Directed Verdict.* At the close of the plaintiff's case, the defendant requests a directed verdict when the defendant believes the plaintiff has not proved its case either factually or as a matter of law. If the judge grants the directed verdict, the case concludes (although the judgment can be appealed, like any other), and the defendant does not have to present its case.

(v) *Judgment as a Matter of Law.* In a jury trial, the jury decides the case and renders a verdict. Before the court (i.e., the judge) accepts the verdict, the losing party can request—or the judge can volunteer—a decision contrary to the verdict rendered by the jury. In effect, the court does not accept the verdict of the jury and renders an opposite decision. This is called a *judgment as a matter of law* (JMOL).

(I) Appeal. A losing party in a trial who believes that the court has committed an error at the trial can appeal to a superior court to reverse the decision of the lower court. The appeals court does not offer a forum for a new trial of the facts. The appeals court will accept the record of the original trial court and decide whether the lower court committed any legal error in procedure or reasoning. Because the appeals focus on analysis of law rather than facts, financial experts rarely assist in this phase.

1.4 TYPICAL ROLES OF THE FINANCIAL EXPERT

(a) Expert Witness. An expert witness renders an expert opinion at trial. The financial expert's opinion usually relates to business issues in which the expert has special education, training, or work experience. The trier of fact lacks this knowledge or expertise, so the financial expert's opinion will help it reach a decision.

One party retains the CPA, economist, or other expert and identifies the individual(s) to the opposing party as expert witnesses. Once a party has identified an expert, the opposing side likely can discover all the work the expert performs—or has already performed—related to the litigation. Sometimes the parties agree to limit such extensive discovery. In addition, some issues are poorly settled in certain jurisdictions, notably the question of whether all or only certain communications between expert and retaining counsel are subject to claims of privilege and are hence undiscoverable. The expert should obtain an early understanding with counsel on that attorney's philosophy,⁸ including the related topic of whether the best practice of discarding draft expert work-product is appropriate to the circumstances of the case. Many experts believe that they should retain any drafts of reports shown to attorneys. They believe the negative implications (including possible preclusion from testifying) of destroying these drafts far outweigh any cross-examination related to subsequent changes that one makes to the drafts. Regardless of anyone's views, the expert should conduct the engagement from the outset assuming that all work, communications, and documents will be subject to discovery.

(b) Consultant. The attorney hires the CPA or economist as consultant to advise about the facts, issues, and strategy of the case. The consultant does not testify at trial. Consequently, the opposition often never knows of the financial consultant. The attorney work-product doctrine generally protects the consultant's opinion, discussions, workpapers, and impressions from discovery by the opposition. If a financial analyst progresses from consultant to expert witness, all the analyst's work product, writings, workpapers, and even notes likely will become discoverable. For large cases, attorneys often have one CPA or economist as a consultant and designate another to provide expert testimony. Coordinating their roles without exposing the consultant's work to discovery demands some care and close communication with counsel.

The work of a consultant usually includes analyzing, and advising on how best to discredit, the opposing expert's work. Sometimes the consultant also examines the strengths and weaknesses of the client's case and how best to represent these facts at trial.

Attorneys retain consultants on occasion to evaluate the effects of particularly troublesome facts not shared with the testifying expert. Philosophies vary on the advisability of this practice. If the opposing side knows the troublesome information, it could surprise the unprepared expert at deposition or, worse, at trial. If counsel is curious as to how the expert might respond to a difficult question, performing the experiment in front of the jury can be a costly adventure.

(c) Who Is The Client? The expert retained to perform a litigation services engagement has two potential clients: the law firm and the party to the lawsuit.

Most attorneys believe that to protect a nontestifying expert consultant's work from discovery, the expert must work for the lawyer. If the disputant hires the expert, the attorney work-product doctrine likely will not apply, nor will the attorney-client privilege, which protects communications only between a client and its attorney. Commercial considerations can enter into the discussion when an attorney has concerns over the client's ability or willingness to pay and prefers to stay out of the contracting loop. Section 1.8 of this chapter addresses such issues.

(d) Trier of Fact. The court can appoint the financial expert as special master who will decide certain facts in a dispute. In effect, the financial expert will act in this function as the judge and jury. The special master becomes useful when a case has difficult accounting or financial issues that only a CPA or economist can understand. On rare occasions, the judge retains the expert to advise the judge in deciding these issues. Sometimes the parties want to agree on an individual to make these decisions in an effort to get an informed decision, accelerate the process, or save expenses. (Chapter 4 discusses the financial expert's role as a neutral person in alternative dispute resolution.)

1.5 FINANCIAL EXPERT SERVICES IN THE LITIGATION ENVIRONMENT

(a) Discovery Assistance. Business litigation often depends on documents to prove or disprove an issue at trial. As a result, the parties undertake voluminous document discovery and production. Business records become crucial to a number of issues in most cases. Financial experts can assist in finding, understanding, and explaining the information from these documents.

Lawyers need to know the types of documents that exist in managing a business so they can formulate precise requests for documents. This knowledge also helps the lawyer to assess the responsiveness of particular productions and to understand what other documents might exist (*see* Chapter 17, Data Management).

Depositions of financial and management people often relate to technical business issues. Attorneys need help in understanding the real issues and in formulating effective questions. Because technical people will often answer questions in jargon that has a special meaning in a particular industry or business discipline, attorneys often need assistance in understanding the answers and developing follow-up questions. Financial experts can assist in this area.

Lawyers need information about the opposing expert's work to effectively cross-examine and rebut the opposing expert's opinion. When the expertise involves business, financial experts can assist lawyers in analyzing the expert's work and the strengths and weaknesses of its support.

(b) Proof of Business Facts. In commercial litigation, factual evidence—except that derived from testimony—comes principally from the business records of the parties or from industry and market sources. Financial experts can help lawyers obtain, understand, authenticate, organize, and explain this information.

Experts can base opinion testimony on either facts or assumptions. They usually base assumptions on facts or presumptions from facts. In either case, the expert must lay a proper foundation as to the source of the information. Financial experts

can help to develop these facts by collecting the relevant business or industry data to support their own or other experts' opinions. Federal Rule 702 requires that experts reliably apply their methods to the facts of the case. Accordingly, even when testifying based on hypothetical premises, the expert must have confidence in the reliability of those premises. The expert who accepts the-moon-is-cheese assumptions is fishing with his reputation for bait.

(c) Computation of Damages. Financial experts often calculate damages in commercial litigation, and this topic dominates much of the remainder of this book. Numerous types of damages occur—such as actual losses of cash, or equivalents, or other property, or expected profits—and practitioners have developed methods to compute them. The type of damages that the expert must compute can be a question of fact or opinion, but the law limits recovery of certain types of damages in certain causes of action.

The financial expert should communicate with the attorney to agree on the type of damages to calculate and an appropriate method of computation. Otherwise, the court can rule a calculation inadmissible as inappropriate to the circumstances.

Actual loss incurred defines one type of damages recovery. Experts compute this form of restitution, which applies in many fraud cases, as the difference between what the plaintiff paid for something and the actual value received, or as the value of something once, but no longer, possessed.

The expected profits from a proposed contract or deal represent another common type of recovery. Practitioners often refer to this as the benefit-of-the-bargain approach of computing damages in contract disputes. Plaintiffs often claim lost profits in business litigation. One measures this as the amount by which the plaintiff's actual earnings fall short of the earnings that would have occurred but for the defendant's illegal actions. Practitioners most often state this formula as the difference between but-for profits (i.e., those that would have been earned but for the defendant's improper act) and actual profits. More generally, most damages analyses require the use of assumptions and projections about what would have happened if certain behavior of the defendant had been different.

Other examples of damages claim types include reasonable royalty analyses in patent infringement, actual cash value computations under business property insurance policies, and monetary cost to restore the plaintiff back to the starting point under equitable rescission theories in some contract cases.

(d) Development of Strategy. Financial experts who serve as litigation consultants can suggest approaches to the business issues in a case. Even the best trial lawyers usually lack the business experience and insights that such financial experts have learned from their business consulting, experience, training, and education.

Lawyers need independent analysis of the positions they believe they must prove to win the case. The financial expert can help the lawyer identify errors and devise different approaches, perhaps using different facts. Although financial consultants, in contrast to experts who are impartial, may be in an advocacy situation, they should maintain as much objectivity and independence as the circumstances permit. Their clients will find these qualities most useful, and often in short supply, on the trial team.

(e) Document Management. Financial services firms frequently have expertise in management information, information technology (IT), and computer systems. Such experts can help attorneys collect, organize, and summarize the large volume of documents that often arises in a business case. They usually use IT systems to manage the large databases of documents or images created for the case. Chapter 17 discusses techniques involved in such management issues.

Small cases that do not justify the cost of automated document retrieval systems nevertheless need some system. The expert can help organize the documents so that lawyers can locate relevant evidence.

(f) GAAP/GAAS Rules and Compliance. Some CPAs have the qualifications to render opinions on generally accepted accounting principles (GAAP) and generally accepted auditing standards (GAAS). Such issues arise when a party questions the accuracy of financial statements or the care with which they have been audited. Accountants will frequently structure such testimony as an *attestation engagement* (see Section 1.6 of this chapter).

GAAP and GAAS issues arise when a plaintiff sues an accounting firm for violating these standards, alleging harm because it relied on the accuracy of the financial statements. Chapter 19 discusses accountants' liability.

GAAP issues also arise when a dispute relates to the purchase or sale of a business and one party questions the accuracy of the prior financial statements or those on which a post-closing working capital adjustment is based. GAAP issues can also arise in any damages computations that rely on financial statements.

1.6 OPINION TESTIMONY

(a) Expert Opinion. Expert opinion is testimony by a person qualified to speak authoritatively because of some combination of special training, skill, study, experience, observation, practice, and familiarity with the subject matter. Expert knowledge is knowledge not possessed by laymen or inexperienced persons. State or federal rules of evidence define the scope and nature of admissible expert opinion testimony.

The courts consider CPAs and some others with appropriate experience and training as experts on accounting matters. Economists and some CPAs (depending on training and experience) have expertise in the application of economic, financial, statistical, and econometric techniques. Either of these types of expert frequently possess industry expertise as well. We encourage experts to objectively weigh their qualifications for any opinion they are asked to give and to do so early in the case lest they find themselves and their clients harmed by a successful *Daubert* challenge (see Section 1.1(b) of this chapter).

(b) Audit Opinion. Experts develop their own findings, conclusions, and opinions. In an attest engagement, which requires a CPA's expertise, the CPA expresses a conclusion about the reliability of a written assertion that is the responsibility of another party—the asserter. Only rarely does a litigation services engagement call for an attest opinion. Although an audit opinion is an expert opinion, it differs from an expert witness opinion given at trial.

Sometimes the opposing lawyer tries to confuse the trier of fact by muddling audit opinions with expert opinions. The lawyer might ask whether the CPA performed an audit and can render an audit opinion. When the CPA answers “no,” the attorney might suggest incorrectly that the CPA with no audit opinion can have no expert opinion.

1.7 SKILLS COMMONLY REQUIRED OF FINANCIAL EXPERTS

As Section 1.5 of this chapter shows, financial experts provide many services throughout the litigation process. The discussion that follows lists the special skills such experts need to competently perform such work. Of course, crossover can occur where an accountant has training in economic analysis and an economist understands accounting principles. Chapter 3 discusses the interaction between accountants and economists.

(a) Auditing. Litigation services engagements frequently use the skeptical attitude, investigative skills, and accounting knowledge required by the audit function. Examples include investigation of fraudulent transactions and reconstruction of financial statements.

(b) Financial Analysis. Development and analysis of financial ratios and relations often aid in understanding the causes of a litigant’s business problems. The financial expert can also modify ratio analysis to derive assumptions as to what would have happened but for the alleged unlawful action. Financial experts often perform present value analyses, capital market theory applications, and business valuations.

(c) Economic Analysis. Economists and accountants perform both macro- and microeconomic analyses in a litigation services engagement. Development of elasticity functions can prove important in claims for antitrust damages or for price erosion claims in a patent infringement matter.

(d) Marketing Analysis. Much marketing analysis focuses on the collection of quantitative data. Financial experts can help collect and assess the required data. Examples include the number of competitors in a particular market or computation of the market share of each participant based on sales.

(e) Statistics. Economists and many accountants understand statistical techniques such as sampling and regression analysis. An expert uses sampling when analysis of an entire population is too time consuming or expensive for the case. Regression analysis can help to project sales or suggest cost relations.

(f) Cost Accounting. The calculation of damages often requires cost accounting skills. For example, cases in which the plaintiff is a multiline product manufacturer or service provider require allocation of common costs to each product line affected by the defendant’s actions.

1.8 FEE ARRANGEMENTS AND ENGAGEMENT LETTERS

Practitioners bill most litigation services engagements as they do other consulting engagements, with fees based on hours extended by hourly rates, plus expenses. The expert can also perform work for a fixed fee, although the unpredictable course of litigation can make this a risky proposition for all but the most narrowly focused topics of testimony.

Some lawyers want the attorney work-product doctrine to apply and yet do not want the responsibility of paying the experts' fees. Such lawyers will ask the expert to send bills directly to the party and may ask the expert to sign a retainer agreement expressly disclaiming any recourse against the lawyer for payment of the expert's bills. The lawyer needs to contemplate and understand the risk to the applicable attorney work-product protection arising from this type of arrangement.

The expert could consider both the lawyer and the litigants as clients. Most experts recognize that the litigant ultimately pays their fees and that lawyers engage the expert as an agent for their clients. Some experts insist on holding the lawyer equally or solely responsible for fees, even at the risk of losing the engagement.

(a) Contingent Fees. The American Bar Association and many state bars make it an ethical violation for a lawyer to proffer testimony from an expert witness who receives contingent compensation. The AICPA does not prohibit a CPA from charging contingent fees in litigation services engagements, except for audit clients of the CPA, although most state boards of accountancy prohibit such fees.

Even if the witness concludes and counsel concurs, that a contingency arrangement is permissible, one should avoid it in any testifying role. An expert witness working on a contingency basis loses independence and objectivity. Opposing counsel likely will effectively impugn the testimony of an expert whose compensation depends on the outcome. Experts working as consultants rather than witnesses need to decide on the wisdom of accepting contingent arrangements.

(b) Retainers. Financial experts require a retainer in some litigation services engagements. A retainer will protect the expert's billing only if the expert holds it as security for payment of the final bill. Experience shows that unfavorable outcomes often lead to unpaid bills.

The final outcome of marital dissolution actions usually makes both parties unhappy. Paying spouses feel that they have lost too much, and receiving spouses feel that they have obtained too little. Many financial experts who practice in the marital dissolution field always require a sizable retainer.

An expert should investigate the client's financial ability to pay if the litigation proves unsuccessful. If the client cannot pay in this situation, the financial expert should consider obtaining a retainer against the full anticipated final bill. We recommend this practice regardless of the client's ability to pay. Otherwise, the judge and jury could view the expert as working effectively on a contingent fee basis.

(c) Engagement Letter. The financial expert should consider whether to use an engagement letter in a litigation engagement, and the authors strongly encourage

this practice. Some experts believe that an engagement letter unnecessarily restricts and limits the areas of testimony; however, this argument lacks merit. In fact, the contrary holds true: most attorneys prefer that the engagement letter be inexplicit as to the nature and content of the opinions they hope the expert will develop. At a minimum, experts should reach a clear oral agreement with the attorney regarding the services they will render.

Most engagement letters describe the engagement's scope and limit the use of data or reports that the financial expert prepares to the litigation (e.g., the client cannot use a valuation opinion developed for a litigation to subsequently market the company for sale). The scope should identify the nature of the services and state whether such services include an audit or review (for CPAs). The letter should restrict use of the expert's work product to the case and prohibit distribution to others. Most engagement letters specify hourly rates and fees and call for reimbursement of expenses. Some letters provide for a retainer that will apply against the final billing (discussed in Section 1.8(b)). The letter can also specify that the client will reimburse any costs that the expert's firm incurs for related and necessary legal counsel during or after the case. The engagement letter might also address the possibility that the client could change attorneys, give the expert the option to withdraw, provide for the return of original documents, and state that the expert implies no warranty or prediction of results.

An engagement letter benefits both the expert and the attorney, setting forth an agreement on the engagement's terms and each party's responsibilities. The expert's insurance carrier or professional standards may require one.

1.9 WORKPAPERS

A financial expert in a litigation engagement will generate workpapers or analyses that develop and document opinions. The workpapers and analyses do not follow a prescribed format. As Section 1.1(b) of this chapter explains, the Federal Rules of Civil Procedure require the witness to identify the bases and underlying data supporting the opinion (Rule 26(b)(2)), and the Federal Rules of Evidence require the witness to disclose, if asked, the facts or data underlying the opinion (Rule 705).

Opposing counsel will likely gain access to all materials prepared: notes, any drafts retained, calculations, correspondence, and materials to which an expert witness refers. For an expert serving as a consultant, the attorney probably can assert a work-product privilege, and opposing counsel likely will never discover and analyze such workpapers. Nonetheless, we suggest that experts maintain their files free of superseded drafts, completed to-do lists not otherwise needed, and other such extraneous materials.

Once the lawyer and expert agree on the expert's role, the expert should understand that notes of meetings can include preliminary opinions, draft schedules, and reports. After preparing final versions, the expert will usually find it unnecessary and even inadvisable to retain the preliminary work product so long as the expert can trace the final conclusions and opinions back to source documents.

Lawyers, as a matter of professional principle, will generally not instruct an expert witness to destroy notes, files, and outdated work. More often, they will ask what the expert's normal practice is and suggest that practice be followed.

Most experienced experts keep lean files, retaining only current versions. This procedure reduces the problems caused in comprehensive discovery but can cause the witness extra work to become familiar again with items once learned and since forgotten or to recreate discarded work later deemed useful. Such extra work can generate extra costs for the client, but most lawyers prefer that procedure. The expert who maintains lean files should announce to the lawyer a policy of not keeping notes and extensive files, giving the lawyer an opportunity to provide any differing guidance, rather than waiting for the lawyer to suggest such a policy.

1.10 GUIDELINES FOR A FINANCIAL EXPERT

The AICPA, through its standards and code of professional conduct, has set criteria for its members to help maintain the integrity of the profession and its members. We discuss many of these here as prudent guidelines for *all* financial experts providing litigation services.

(a) Competency. Experts should “undertake only those professional services that the member or the member’s firm can reasonably expect to complete with professional competence.”⁹ Experts embarking on their first litigation engagement can find themselves ill equipped, ill prepared, and lacking foundation for some of their opinions. The attorney retaining the expert frequently cannot evaluate the expert’s abilities. An expert uncertain of competence for the engagement should not accept it.

(b) Confidentiality. Experts bring to the courtroom all their prior experience and knowledge of clients and their practices, operations, and trade secrets. The expert should not disclose information obtained during other professional engagements except with the client’s consent or pursuant to an appropriate order of the court. Experience in similar cases enables someone to render expert opinions, but the expert must protect confidential information obtained in previous engagements. Often the expert will not need to disclose any confidential information but must recognize the dual responsibility of truthfulness and honesty while preserving past and present clients’ confidential information.

If experts rely on specific information obtained in an unrelated client engagement and use that information as a basis for their opinion, a judge can require them to disclose the information’s source. If the expert refuses, the judge can preclude use of the testimony because the opposing counsel could not take discovery on the information providing the basis of the expert’s opinion.

(c) Objectivity. Financial experts should avoid taking any position that might impair their objectivity. Although experts can resolve doubt in favor of their client—as long as they can support the position—they must not become blind to objectivity in an effort to please their client. Such a lack of objectivity can become apparent, thus damaging the client’s case and the expert’s own reputation.

Any opinions and positions an expert has taken in previous cases can become a matter of inquiry. For example, the expert should not testify in a matter involving

an accounting or financial principle from a position inconsistent with one previously taken with similar facts unless the expert can reconcile the apparent inconsistency. Opposing counsel can quickly cast doubt on the expert's objectivity and credibility.

(d) Conflicts of Interest. Conflicts of interest arise from the expert's ethical obligation to preserve client confidences or from other relations that can affect the expert's ability to present a client's position.

The financial expert must investigate possible conflicts of interest before accepting a litigation engagement and must check whether any adverse party in the litigation, including counsel, is a current or past client of the expert or the expert's firm. This in itself does not create a conflict, but the expert should consider the implications and discuss this with counsel. Although certain professions and professional organizations may impose ethical guidance differing by the expert's discipline, the existence of a legal conflict of interest is rare.¹⁰

Even when no direct conflict of interest exists, the expert should consider whether to accept an engagement that could prove contrary to the interests of another existing client. For example, civil complaints often identify many persons and entities as defendants. Experts should be wary when asked to work for one defendant when another defendant is a client. A problem can arise if the plaintiff proves joint damages, because then the defendants will lose the unity forged when trying to defeat the plaintiff and will instead dispute the portion that each owes. The defendants often cross-complain against each other in an attempt to escape the ultimate payment of damages. At this point, experts could find themselves opposing a current client.

When a litigation engagement involves a former client as the opposing party, the expert must resolve the question of a conflict on a case-by-case basis. Factors to consider include the length of time since the party was a client, the confidential information the expert possesses that could become an issue in the litigation, and the issues of the case.

The financial expert should consider disclosing all current and former relations with all parties to the litigation to the inquiring lawyer, even though the expert has concluded that no conflict of interest exists. On occasion, duties of confidentiality to a present or former client will not permit that disclosure, and seeking permission to disclose from that client might violate the confidentiality owed to the prospective attorney-client. There is no tidy exit from this box.

(i) Preliminary Interview with Prospective Clients. When a prospective client approaches an expert regarding a litigation engagement, the client or attorney often gives the expert sufficient information regarding the case to help identify the parties and opposing counsel as well as the key issues in dispute. In describing the matter, the potential client will sometimes communicate confidential information to the expert. Assume that this prospective client does not retain the expert, but the client's opposition subsequently approaches the expert. Should the expert decline the subsequent offer of an engagement to protect the confidential information received previously?

Although the implication of a conflict of interest seems readily apparent, a California appellate court decision, *Shadow Traffic Network, et al. v. the Superior Court of Los Angeles County*,¹¹ highlights the importance of full disclosure and

analysis of any potential conflict of interest in a litigation service environment. In *Shadow Traffic Network*, the plaintiff's law firm interviewed a prospective CPA expert and then decided not to retain the CPA for trial purposes. Subsequently, opposing counsel retained the same CPA to assist in the same litigation even though the CPA expert had informed the new counsel of previous discussions with plaintiff's counsel. When plaintiff's counsel learned that defendant's counsel had retained the rejected CPA firm in the matter, the law firm moved to disqualify the defendant's law firm from further representation of its client because the firm had retained the CPA to whom it had disclosed confidential information. The trial court disqualified the law firm. On review, the appellate court decision upheld the trial court's decision.

The *Shadow Traffic Network* ruling provides aggressive lawyers with an opportunity to foreclose the participation of potential experts by contacting them and disclosing minor bits of confidential information. To avoid the problem, experts will want to limit the information they receive from lawyers before officially being retained and to inform the inquiring lawyers that they have adopted this approach. The authors know of a case in which lawyers for one side contacted many experts and gave each trivial tasks that effectively foreclosed them from working for the other side.

(ii) *Simultaneous Consultations.* Particularly with multinational accounting and consulting firms and national law firms, a law firm might engage different experts from the same firm to work simultaneously for and against the law firm's clients in different cases. Consider the following situation: Counsel A has retained Expert A to assist Plaintiff A by valuing an apartment building. Defendant B's attorney in this matter is Counsel B1. Prior to Plaintiff A's case going to trial, Counsel B2 approaches Expert A regarding the valuation of income property for Defendant C. Counsel B2, a partner with Counsel B1, is unaware that Expert A is a consultant or expert opposing B1's case. Does Expert A have a conflict of interest in this situation? In terms of Rule 301 of the Federal Rules of Evidence, the situation does not involve confidential client communications.

This question of conflicts presents more of a problem for counsel than an ethical question for the expert witness. The expert, however, should know the potential for problems in such circumstances and should, given confidentiality constraints, fully disclose such relations to counsel before accepting an engagement or, when this is not possible, alert counsel to the possibility of such an eventuality.

(iii) *Regulatory Considerations.* The Sarbanes-Oxley Act of 2002 has transformed the litigation services arena for CPAs whose firms audit companies subject to regulation by the Securities and Exchange Commission (SEC). Such audit clients, once an important source of expert witness and consultant business, can no longer employ partners or staff of their audit firms in this capacity.¹² The AICPA has no similar prohibition for attest clients who are non-SEC-registered issuers, but the profession continues to examine its position in this area through the work of various committees.

(e) Other Guidelines. In addition to the guidelines discussed elsewhere in this section of the chapter, the AICPA also lists the following standards under Rule 201 of the AICPA Code of Professional Conduct. As stated previously, all financial experts should consider these standards when conducting a litigation engagement.

- **Professional Competence.** Discussed in Section 1.10(a) of this chapter.
- **Due Professional Care.** Exercise due professional care in any performance of professional services.
- **Planning and Supervision.** Adequately plan and supervise the performance of professional services.
- **Sufficient Relevant Data.** Obtain sufficient relevant data to afford a reasonable basis for conclusion or recommendations in relation to any professional services performed.

Rule 202 of the AICPA Code of Professional Conduct adds the following three standards:

- **Client Interest.** Serve the client interest by seeking to accomplish the objectives established by the understanding with the client while maintaining integrity and objectivity.
- **Understanding with the Client.** Establish with the client a written or oral understanding regarding the responsibilities of the parties and the nature, scope, and limitations of services to be performed and modify the understanding if circumstances require significant change during the engagement.
- **Communication with the Client.** Inform the client of (1) conflicts of interest that can occur pursuant to interpretations of Rule 102 of the Code of Professional Conduct, (2) significant reservations concerning the scope or benefits of the engagement, and (3) significant engagement findings or events.

1.11 PROFESSIONAL STANDARDS AND MALPRACTICE CONCERNS

In a California case, *Mattco Forge, Inc. v. Arthur Young and Co.*, an appellate court ruled that experts cannot assert a statutory litigation privilege against their own clients. (A statutory litigation privilege denies the opposing party the right to sue an expert on the other side of the case for anything the expert witness says at deposition or trial. This privilege protects the work of persons assisting in litigation who may otherwise fear that an aggressive adversary will sue them later for their work.) Thus, the opposing litigant cannot sue the CPA, but the court can review the performance of the CPA on behalf of the CPA's client in light of the applicable professional standards. The appellate court stated that

Applying the privilege in this circumstance does not encourage witnesses to testify truthfully; indeed, by shielding a negligent witness from liability, it has the opposite effect. Applying the privilege where the underlying suit never reached the trial stage would also mean that the party hiring the expert witness would have to bear the penalty for the expert witness's negligence. That result would scarcely encourage the future presentation of truthful testimony by the witness to the trier of fact.¹³

In California, therefore, as a result of the above decision, a CPA who provides expert witness services faces some exposure to the party employing him as an expert, and the applicable professional standards of the accounting profession may determine the appropriate standard of care. Others find similar standards of their professions invoked against them in similar circumstances. In the authors' experience, such cases are rare.

1.12 SPECIAL ISSUES FOR CPAs

CPAs offering litigation services must abide by two sets of rules. First, they must meet the legal standards appropriate to the expert's role, as discussed throughout this chapter, paying particular attention to the requirements of the Sarbanes-Oxley Act with respect to SEC clients. Second, CPAs should adhere to the AICPA's professional standards and their state's Board of Accountancy rules and regulations; they must also ascertain which professional standards apply to the litigation services rendered in the specific case.

As Section 1.6(b) of this chapter discusses, attestation (or auditing) services differ fundamentally from most litigation services engagements. The AICPA has stated that litigation services do not meet the definition of an attestation engagement (and therefore the attestation standards do not apply¹⁴), except for the rare occasions when a CPA must give an attest opinion during a litigation or when others will receive the written work of the accountant and, under the rules of the proceeding, do not have the opportunity to analyze and challenge the accountant's work. The AICPA recognizes that in a litigation engagement, the opposition and trier of fact will scrutinize the information and conclusions reached by a CPA. CPAs must understand that their opinions will receive the close attention of counsel and, in most instances, an opposing expert or consultant.

CPAs must ensure that anyone using their reports or workpapers understands why the CPA prepared them or has the right to depose or cross-examine with respect to them. A CPA should prevent a third party who does not know of the litigation from relying on the reports; such a person could not challenge or fully understand the underlying assumptions.

The AICPA's Management Consulting Services Division has oversight of litigation services; Statements on Standards for Consulting Services guide the work performed. Section 1.10 of this chapter discusses many of these standards as guidelines for all financial experts, but as specific requirements for CPAs and other professionals employed by accounting firms. As this practice area continues to grow, the AICPA will continue to develop standards and guidelines. We urge all practitioners to remain current on such pronouncements, particularly the current text and any updates or modifications to *AICPA Consulting Services Special Report 03-1, "Litigation Services and Applicable Professional Standards."*

The AICPA has produced a number of publications dealing with litigation services. These include the following:

1. *AICPA Statement on Standards for Consulting Services No. 1, "Consulting Services: Definitions and Standards"*
2. *AICPA Consulting Services Practice Aid 93-4, "Providing Litigation Services"*
3. *AICPA Consulting Services Special Report 03-1, "Litigation Services and Applicable Professional Standards"*
4. *AICPA Business Valuation and Litigation Services Practice Aid 04-1, "Engagement Letters for Litigation Services"*
5. *AICPA Consulting Services Practice Aid 96-3, "Communicating in Litigation Services: Reports"*
6. *AICPA Consulting Services Practice Aid 97-1, "Fraud Investigations in Litigation and Dispute Resolution Services"*

7. *AICPA Consulting Services Practice Aid 98-1, "Providing Bankruptcy and Reorganization Services"*
8. *AICPA Consulting Services Practice Aid 98-2, "Calculation of Damages from Personal Injury, Wrongful Death, and Employment Discrimination"*
9. *AICPA Consulting Services Practice Aid 99-2, "Valuing Intellectual Property and Calculating Infringement Damages"*

The AICPA's Web site contains a comprehensive listing of resources that it publishes or makes available (including this book); the list above simply identifies the most immediately relevant. In addition, the AICPA publishes a quarterly newsletter, *CPA Expert*, that deals with litigation services and business valuation. Experienced practitioners submit articles for publication dealing with all areas of litigation services and business valuation.

1.13 CONCLUSION

This chapter provides an overview of the process and terminology that the financial expert faces when acting as an expert witness or consultant in litigation.

Preparing a complex commercial litigation for trial requires financial experts to accomplish many tasks. They can bring training and expertise to an adversarial proceeding that will challenge and scrutinize their conclusions. The balance of this book discusses the specific types of cases and approaches that the financial expert will face and employ.

NOTES

1. This Rule 702 qualification discussion and the disclosure discussions of Federal Rules of Civil Procedure Rule 26(a)(2) that follow are based on federal court requirements. Most states follow procedures that are similar from a practical point of view, but experts must ensure that they know the standards of the venue that they work in.
2. Available from a variety of Web sites including those of Cornell University and the U.S. Department of Justice. The reader proposing to act as an expert witness is strongly encouraged to read the text of and Note to Rule 702 as well as the short text (11 pages in all) of the *Daubert* and *Kumho* decisions.
3. *Voir dire*, as relevant here, is the procedure by which courts, on their own or a party's motion, hear evidence on whether experts and their opinions are of a standard sufficient to qualify as admissible.
4. *Equitable* actions are those in which the plaintiff seeks an equitable remedy: a nonmonetary order by the court such as issuance of an injunction, the reformation of a contract, the setting aside of corporate liability protection to look through to an owner acting as *alter ego*, or some similar adjustment of the parties' relationship. They are not based on the common law, but on the court's determination of how to achieve fairness in a particular situation. The contrast is to *legal* actions, which seek remedies in the form of monetary damages. Until the early 20th century, many jurisdictions maintained separate courts of law and equity. Today, jurisdictions preserve that distinction rarely, the most prominent example being the Delaware Court of Chancery.
5. On matters of federal law, the rulings of each circuit's Court of Appeals establish precedent within that circuit and, with weaker effect, advisory weight in those other circuits which have not ruled on the issue. When a matter has reached the circuit court due to diversity and, by operation of law or contract, is subject to state rather than federal law, the circuit's ruling carries considerably less predictive value, because the ultimate arbiter of a given state's laws is the highest court of appeals within that state.

6. www.cpradr.org/.
7. This proposition is eroding in many jurisdictions as courts display increasingly limited patience with perceived gamesmanship. Particularly in government-initiated actions, the risks of fines or procedural sanctions for failing fully to respond to discovery requirements tend to outweigh by far the potential tactical or cost-saving advantages of failing to produce arguably responsive documents.
8. For philosophy it is. Skilled, knowledgeable attorneys operating in the same venue and even the same firm will often differ dramatically in their understanding and interpretation of the relevant laws of privilege and protection. Although many describe the concept as “attorney-client privilege,” protection under the attorney work-product doctrine is the more relevant concept, since attorney-client privilege is available only to the attorney and client, and the expert is neither.
9. *AICPA Code of Professional Conduct*, Rule 201.
10. One example of a situation in which a legal conflict can occur is when an expert is appointed to a role working for the debtor in a bankruptcy proceeding. The Bankruptcy Code contains a quite restrictive concept of “disinterested person” with which experts must comply lest they see their fees and reputation evaporate.
11. *Shadow Traffic Network v. The Superior Court of Los Angeles County*, 22 Cal. App. 4th 853 (1994).
12. Section 201(a) of the Sarbanes-Oxley Act amends Section 10A of the Securities Exchange Act of 1934 by listing at the latter’s (g)(8) as a prohibited activity “legal services and expert services unrelated to the audit.”
13. *Mattco Forge, Inc. v. Arthur Young & Co.*, 5 Cal. App. 4th 392 (1994).
14. The AICPA *excludes* consulting—and thus litigation services—from its three general categories of AICPA technical standards: Statements on Auditing Standards (SASs), Statements on Standards for Attestation Engagements (SSAEs), and Statements on Standards for Accounting and Review Services (SSARs).

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