How Lawyers Use Accountants as Experts

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Why an Accounting Expert?

The Numerous Uses of Accounting Experts
Why An Accounting Expert?

- Accounting experts can serve integral roles in a wide variety of complex litigation
- Some examples include
  - Complicated damages issues
    - *E.g.*, economic losses in shareholder securities class action
    - *E.g.*, analysis of costs, inventory and sales in suit for business interruption
  - Valuation of assets
    - *E.g.*, dispute over buyout or dissolution of a business
    - Large accounting firms maintain practices devoted solely to this issue
  - Professional liability
    - *E.g.*, whether audit was properly planned and supervised
    - Conduct of CPA under professional literature is directly at issue
Why An Accounting Expert?

- Violations of the federal securities laws
  - *E.g.*, accuracy of financial disclosures, revenue recognition issues, reserves, goodwill, etc.
  - *E.g.*, claims of auditor misstatement under Section 10(b) of 1934 Securities Exchange Act

- Antitrust
  - *E.g.*, develop evidence concerning pricing structures, marginal costs, profit margins and other economic enterprise considerations
  - *E.g.*, analyzing enterprise cost structure in predatory pricing claims

- Other disputes
  - Patent and copyright disputes (*e.g.*, questions of appropriate royalties)
  - Employment disputes (*e.g.*, commission compensation disputes)
  - Divorce (*e.g.*, concealment of assets or income)
Accountants Can Help

- Accountants are essential to regulatory inquiries and conducting internal investigations on many different issues

- Accountant experts can assist investigations by
  - Performing quantitative analyses
  - Gathering financial records and other evidence
  - Performing reviews to satisfy special committee of company and/or government agencies
  - Identifying for attorneys the important documents to locate and analyze in a company’s extensive financial records
  - Coordinating with the company’s auditors
  - Educating attorneys and executives on complex accounting issues, and digesting/translating complicated financial information
Choosing The Right Expert Witness

Interviewing and Selecting Accounting Experts

Ivory Tower vs. Practitioner?

Getting the Expert Involved Early
Locate Viable Candidates

- Accountant employed by client?
  - Could be ideal as a consultant due to understanding of how the firm operates and familiarity with the issues
  - Usually not appropriate as testifying expert due to obvious bias

- Best ways to locate accounting experts
  - Consult colleagues and peers
  - Talk to the client and the client’s other outside counsel
  - Ask trusted consultants on other matters
  - As a last resort, consult public databases
Avoid Potential Disqualification Issues

- Attorneys and/or experts can be disqualified in several situations due to the disclosure of confidential information
  - Communicating with an expert who is already retained by the other side. (Possible attorney disqualification.)
  - Hiring an expert who has previously served as an expert for the other side. (Possible expert and/or attorney disqualification.)
  - Hiring an expert after that witness has been interviewed and not retained by the other side. (Possible expert and/or hiring attorney disqualification.)
Avoid Potential Disqualification Issues

• How much information should the attorney provide the potential expert during the interview process?
  • Provide only general information to determine awareness of case and current involvement with other parties
  • Ascertain all facts concerning expert’s prior consultation with, and retention/attempted retention by other parties
  • Avoid the conveyance of case strategy and other confidential information during the interview process
  • An attorney who wishes to retain an expert and establish confidentiality should make this intention unmistakably clear
Conduct a Thorough Background Check

Wise words from a veteran trial attorney:

“Do the due diligence necessary to avoid surprise. Do the same with your adversary’s expert so that you can inflict humiliating surprise.”
Conduct a Thorough Background Check

- Ask for permission to verify credentials
  - Check education, degrees and professional affiliations
  - Check publications and speaking engagements
- Determine the expert’s involvement in prior litigation
  - Who were the parties and attorneys?
  - What was the nature of the claims?
  - For whom did the expert testify?
  - What were his or her opinions?
Conduct a Thorough Background Check

• Research public databases (e.g., Westlaw) and use Google
  • Search for prior appearances, publications not identified
  • Identify any professional discipline or legal trouble
  • Avoid any surprises

• Check all references
  • Check any references provided
  • Also check references not provided
  • Contact attorneys on prior retentions
Criteria to Consider in Accounting Witness

- Easily verifiable criteria
  - Does the witness have adequate professional qualifications?
  - Does the witness have impressive education, licenses, affiliations, etc.?
  - Can the expert be deemed to be independent?
  - Does the witness participate in continuing industry training?
  - Has the witness worked for industry trade bodies/regulators?
  - Does the witness maintain an active role in the industry?
Criteria to Consider in Accounting Witness

• Other important issues to consider
  • Does the witness look and sound credible?
  • How savvy is the witness on the stand?
  • Can the witness hold up under cross examination?
  • Has the witness ever had his or her opinions and work product scrutinized and attacked before?
  • Does the witness have gray hair (and is that necessary or helpful?)
Ivory Tower vs. Practitioner: Pros and Cons

• Ivory Tower Pros
  • Impressive professional pedigree and gravitas
  • Broad and deep knowledge of principles and practice
  • Likely strong communicator due to teaching experience

• Ivory Tower Cons
  • Knowledge and practical experience may be outdated
  • Time and availability may be more limited
  • Likely has not exercised professional judgment recently
Ivory Tower vs. Practitioner: Pros and Cons

• Practitioner Pros
  • Relevant and current hands-on industry experience
  • Likely more accessible than Ivory Tower type
  • May carry more credibility with jury

• Practitioner Cons
  • May be viewed as lacking broad and deep expertise
  • Likely has less experience in a testifying role
  • Writing and subjective thinking may not be as strong
Ivory Tower vs. Practitioner: Professional Judgment in Accounting/Auditing

• Professional judgment plays a prominent role in the practice of auditors and accountants

  • AU Section 230.11 (Due Professional Care)
  
    • “[J]udgment is required in interpreting the results of audit testing and evaluating audit evidence. Even with good faith and integrity, mistakes and errors in judgment can be made.”

    • “[A]ccounting presentations contain accounting estimates, the measurement of which is inherently uncertain and depends on the outcome of future events.”

  • Bily v. Arthur Young & Co., 3 Cal. 4th 370, 400 (1992)
  
    • “Although ultimately expressed in shorthand form, the report is the final product of a complex process involving discretion and judgment on the part of the auditor at every stage.”

    • “Using different initial assumptions and approaches, different sampling techniques, and the wisdom of 20-20 hindsight, few CPA audits [are] immune from criticism.”
Ivory Tower vs. Practitioner: The Importance Of Professional Judgment

- Impressive credentials, including involvement with standard-setting entities, can be extremely powerful
  - E.g., service on panels such as the FASB or EITF
  - Some experts may even have participated in developing the accounting or auditing standards at issue in the litigation

- On the other hand, the auditing/accounting practice is somewhat judgment-based
  - Someone who has not practiced in some time may not have exercised his or her professional judgment recently
  - While a scholarly expert witness may have developed the very literature at issue, he or she may never have applied it in the field
All Experts Are Not Created Equal

- Consideration of fees is an important factor in retaining an expert witness
  - More expensive is not always better, but it can be, and often is
  - Fees may be a strong indicator of experience and credentials, abilities and stature
  - Some factors when considering fees
    - The degree of knowledge, learning, or skill required
    - The uniqueness of the expert’s qualifications
    - The amount charged by similarly situated experts
    - The impact of scheduling difficulties or other commitments
Get the Expert Witness Involved Early

- Early participation and analysis by the expert can be invaluable to the attorney and to the witness
  - Educating the attorney on relevant accounting and/or auditing literature at issue in the litigation
  - Providing the attorney with a strong understanding of the key accounting issues and financial records
  - Obtaining and preserving evidence to support case theories through financial analysis and forensic research
Get the Expert Witness Involved Early

- Marshalling adequate evidence necessary to support and solidify the basis for the expert’s opinions
- Supplying technical knowledge and input into scientific, technical and other specialized underpinnings of the case to guide strategy
- Developing themes to pursue in fact discovery as well as with the other parties’ experts
Working With Testifying Experts and Consultants

Maintaining Privilege and Work Product
Working With The Expert’s Staff
Disclosure of Testifying Experts

- Both California and federal law require the disclosure of the identities and opinions of testifying experts

Federal Rule of Civil Procedure 26(a)(2)(A)
- Requires the disclosure of the identity of any person who may be used at trial to present expert testimony

Federal Rule of Civil Procedure 26(a)(2)(B)
- Requires the testifying expert witness to provide a written report setting forth
  - All opinions to be expressed and the bases for those opinions
  - “Facts or data” considered by the witness
  - Any supporting or summary exhibits
  - Qualifications and compensation
  - Publications (within 10 years) and prior testimony (within 4 years)
Disclosure of Testifying Experts

- California Code of Civil Procedure § 2034.260(b)(1)
  - Requires a list setting forth the name and address of each person whose expert opinion that party expects to offer at trial

- California Code of Civil Procedure § 2034.210(b)
  - For each expert, a declaration setting forth
    - Qualifications
    - General substance of expected testimony
    - Representations that the expert has agreed to testify and will be sufficiently familiar with the action to provide testimony
    - A statement of costs and fees

- California Code of Civil Procedure § 2034.270
  - All discoverable reports and writings made by each expert in the process of preparing his or her opinion
  - Expert report not mandatory
Disclosure of Non-Testifying Experts

- Both federal and California law offer work product protection for the identities and opinions of non-testifying experts

  - Federal Rule of Civil Procedure 26(b)(4)(B)
    - Allows, with a “showing of exceptional circumstances,” discovery of facts known or opinions held by a non-testifying expert only if it is impracticable to obtain facts or opinions on the same subject by other means.

    - “The knowledge, opinions, and report of an expert consulted by an attorney in preparation of his case remain immune from disclosure under the attorney’s work-product privilege as long as the expert does not change his status as a consultant-expert.”
Changes to the Federal Rules Regarding Testifying Experts

• Old Rule – Communications with Testifying Experts Discoverable
  • Previously, attorney communications and work product were discoverable if considered by the testifying expert in forming opinions
  • See, e.g., Fed. R. Civ. P. 26(a)(2) Advisory Committee Notes (1993) (“Given [the] obligation of disclosure, litigants should no longer be able to argue that materials furnished to their experts to be used in forming their opinions—whether or not ultimately relied upon by the expert—are privileged or otherwise protected from disclosure when such persons are testifying or being deposed.”)
Changes to the Federal Rules Regarding Testifying Experts

• See, e.g., *People v. Milner*, 45 Cal. 3d 227, 241 (1988) (“Once the defendant calls an expert to the stand, the expert loses his status as a consulting agent of the attorney, and neither the attorney-client privilege nor the work-product doctrine applies to matters relied on or considered in the formation of his opinion.”)

• See, e.g., *United States v. City of Torrance*, 163 F.R.D. 590 (C.D. Cal. 1995) (“When counsel forwards documents prepared by a non-testifying consultant to a testifying expert, they become discoverable. Any protection the documents may have had no longer applies. In general, the work-product privilege has been held not to apply to opinions and documents generated or consulted by an expert retained to testify at trial.”) (internal quotations and citations omitted)
Changes to the Federal Rules Regarding Testifying Experts

- Old Rule – Drafts of Expert Reports Discoverable
  - Previously, drafts of the expert’s report, including edits made by counsel or others, were discoverable and not subject to any work product or other privilege or protection
  - This resulted in many inefficiencies as lawyers tried to work around these restrictions or stipulate with the other side that such discovery would not occur
Changes to the Federal Rules Regarding Testifying Experts

- New Rule – The information subject to expert discovery is very limited

- New Rules 26(a)(2)(B) and 26(b)(4) extend work product protection to theories or mental impressions, drafts of expert reports and oral and written communications between expert witnesses and counsel
Changes to the Federal Rules Regarding Testifying Experts

- New Rule 26(a)(2)(B)(ii) provides that the written report disclose “facts or data” considered by the expert witness, rather than the “data or other information” disclosure prescribed in the 1993 amendments.

- This change explicitly provides “work-product protection against discovery regarding draft reports and disclosures or attorney-expert communications. The refocus on ‘facts or data’ is meant to limit disclosure to material of factual nature by excluding theories or mental impressions of counsel.” Fed. R. Civ. P. 26(b)(4) Advisory Committee Notes (2010 Amendments)

- “The intention is that ‘fact or data’ to be interpreted broadly to require disclosure of any material considered by the expert, from whatever source, that contains factual ingredients. The disclosure obligation extends to any facts or data ‘considered’ by the expert in forming opinions to be expressed, not only those relied upon by the expert.” Fed. R. Civ. P. 26(b)(4) Advisory Committee Notes (2010 Amendments)
Changes to the Federal Rules Regarding Testifying Experts

• New Rule 26(b)(4)(B) provides work product protection to draft expert reports
  • “Rules 26(b)(3)(A) and (B) protect drafts of any report or disclosure required under Rule 26(a)(2), regardless of the form in which the draft is recorded.” Fed. R. Civ. P. 26(b)(4)(B)
With certain exceptions, Rule 26(b)(4)(C) provides work product protection to attorney-expert communications regardless of the form of the communications, including oral, written, and electronic communications.

“Rules 26(b)(3)(A) and (B) protect communications between the party’s attorney and any witness required to provide a report under Rule 26(a)(2)(B), regardless of the form of the communications . . .” Fed. R. Civ. P. 26(b)(4)(C)
The exceptions contained in Rule 26(b)(4)(C):

- “Rules 26(b)(3)(A) and (B) protect communications between the party’s attorney and any witness required to provide a report . . . except to the extent that the communications
  - Relate to compensation for the expert’s study or testimony;
  - Identify facts or data that the party’s attorney provided and that the expert considered in forming the opinions to be expressed; or
  - Identify assumptions that the party’s attorney provided and that the expert relied on in forming the opinions to be expressed.” Fed. R. Civ. P. 26(b)(4)(C)
Changes to the Federal Rules Regarding Testifying Experts

- Communications that are not privileged are communications which
  - Address compensation for the expert’s services
    - “It is not limited to compensation for work forming the opinions to be expressed, but extends to all compensation for the study and testimony provided in relation to the action.” Fed. R. Civ. P. 26(b)(4) Advisory Committee Notes (2010 Amendments)
    - “Any communications about additional benefits to the expert, such as further work in the event of a successful result in the present case, would be included [in the exception].” Fed. R. Civ. P. 26(b)(4) Advisory Committee Notes (2010 Amendments)
Changes to the Federal Rules Regarding Testifying Experts

- Identify facts or data provided by the lawyer that the expert considered in forming his/her opinion
  - “The exception applies only to communications ‘identifying’ the facts or data provided by counsel; further communications about the potential relevance of the facts or data are protected.” Fed. R. Civ. P. 26(b)(4) Advisory Committee Notes (2010 Amendments)
• Identify assumptions provided to the expert by the lawyer that the expert actually relied upon in forming his/her opinion
  • “This exception is limited to assumptions that the expert actually relied on in forming the opinions to be expressed. More general attorney-expert discussions about hypotheticals, or exploring possibilities based on hypothetical facts, are outside this exception.” Fed. R. Civ. P. 26(b)(4) Advisory Committee Notes (2010 Amendments)
• The expert report itself still must be produced

• A party seeking discovery can ask the court to pierce the work product privilege if the party has a “substantial need for the discovery and cannot obtain the substantial equivalent without undue hardship”
  • However, the Advisory Committee Notes indicate it will be “rare” for a party to make such a showing

• The Advisory Committee Note clearly states that the changes “alter the outcome in cases that have relied on the 1993 formulation in requiring disclosure of all attorney-expert communications and draft reports”
• To date, several federal courts have applied the new Rule 26(b)(4) to a party’s motion to compel the production of expert work product
  • *Sara Lee Corp. v. Kraft Foods, Inc.*, 273 F.R.D. 416
  • *Graco, Inc. v. PMC Global, Inc.*, 2011 U.S. Dist. LEXIS 14717
What the Law Requires For Disclosures
Working With the Expert to Create Reports
• **Federal disclosures**

• **California disclosures**
California law requires a testifying expert to submit a declaration, but also provides for the discovery of all reports and writings made in the process of preparing his or her opinion (see Cal. Code of Civ. Proc. §§ 2034.210(b); 2034.270)
• The federal rules contemplate that attorneys may assist the expert in preparing his or her report

• Experts may need guidance in organizing the report to meet legal requirements of substantive law or procedural rules

• See Federal Rule of Civil Procedure 26(a)(2), Advisory Committee Notes (1993) (“Rule 26(a)(2)(B) does not preclude counsel from providing assistance to experts in preparing the reports, and indeed, with experts such as automobile mechanics, this assistance may be needed.”)

• However, the expert should be encouraged to do his/her own work

• The expert should not rely extensively on staff and/or attorneys

• The expert should drill down into the facts and documents

• The expert should take a bottom-up approach instead of a cloud-level, top-down approach
• Experts are entitled to, and often do, rely upon staff to perform many tasks that support their opinions
  • See, e.g., Dura Automotive Sys. of Ind., Inc. v. CTS Corp., 285 F.3d 609, 612 (7th Cir. 2002) (“An expert witness is permitted to use assistants in formulating his expert opinion.”)
  • New Rule 26(b)(4) also extends to protect communications between counsel and the expert’s assistants and individuals who assist the expert witness in preparing the testimony
    • “Protected ‘communications’ include those between the party’s attorney and assistants of the expert witness.” Fed. R. Civ. P. 26(b)(4) Advisory Committee Notes (2010 Amendments)
• Benefits of using staff
  • Reduces fees by allowing staff to digest documents and data
  • Allows attorneys to more freely communicate through employees
  • Staff under the expert’s direction can put together the requisite documentation while the expert focuses on testimony

• It is essential, however, that the work the expert relies on for conclusions either be performed by the expert or under the expert’s direction and supervision
The Basis for the Expert’s Opinions
Preparation for Unexpected Facts & Hypothetical Questions
• Provide information that is most relevant and helpful at the outset and work with the expert to determine what else is needed

• Provide the expert with a fair view of the facts of the case by supplying everything that might bear on opinions, including
  • Pleadings and court papers (to gain familiarity with parties and allegations)
  • Relevant, non-privileged documents on both sides (provide a roadmap if extensive records)
  • Deposition transcripts (provide excerpts where appropriate)
  • Discovery responses (most likely of limited benefit)
  • Other experts’ reports in the case
The Basis for the Expert’s Opinions

- Benefits of supplying a robust compilation of information including both supportive and contrary facts
  - Provides the expert with a comprehensive basis for opinions
  - Avoids attacks on the expert’s opinions as being the product of a biased and narrow view
  - Allows the expert to provide reliable advice to the attorney regarding legal theories and strategies
• When the time comes for live testimony, the witness should be able to say

  • He or she reviewed all documents, facts, testimony, reports and data that are relevant/material to his or her opinion

  • He or she had access to everything, even if he or she did not feel it necessary to review and rely upon it

  • He or she was provided with and considered contrary facts and opinions and they did not change his or her opinion

  • He or she did his/her own work or closely supervised it
Anything can happen at deposition and trial, so the witness should be prepared for unknown facts and hypothetical questions

- When the witness is cross examined about facts or documents not considered, he/she should opine whether it alters any opinions
- If properly prepared, the witness should be able to say judgment would not change
• The keys for the expert witness at deposition are responsiveness, accuracy and brevity

• To prepare the witness for deposition, counsel should
  
  • Ensure that the witness has reviewed all relevant documents, and reviewed his or her reports
  
  • Cross-examine the witness extensively with hypothetical questions
  
  • Make the witness aware that counsel may try to build a fence around his or her testimony and prepare how to hedge against it
  
  • Rehearse the expert in refusing to answer unclear questions, avoiding expansive answers and not volunteering information
  
  • Go over prior testimony and opinions as possible impeachment material
  
  • Consider video rehearsal
The keys for the expert witness at trial are **accuracy, clarity and persuasiveness**

To prepare the witness for trial, counsel should

- Emphasize the importance of teaching the jury complex issues in an understandable, down to earth manner without equivocating
- Address the arrogance factor, if any
- Rehearse an effective direct examination with the witness (consider video)
- Rehearse any demonstratives as exhibits
- Take the witness to the courtroom, let him or her see the judge and listen to the testimony of experts on the other side
- Prepare for cross examination much like for deposition (hypothetical questions, unknown facts, limitations of opinions, etc.)
- Emphasize the importance of being courteous to and not argumentative with opposing counsel on cross examination
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