

*National Business
Institute*

Forensic Business Valuation for Attorneys

Wednesday, October 27, 2010



PREPARATION: Every Case or Matter Involving the Use of a Valuation Expert Presents the Same Six Questions:

Who uses experts?

What kind of expert is utilized?

Why use experts?

When to use experts?

Where do you use an expert?

How do you best use an expert?

*** We will answer these questions in the context of both litigation and non-litigation related matters and attempt to provide a basic overview from the viewpoint of civil litigation in a practice that provides forensic, litigation and valuation services.**

Pay peanuts....get monkeys!



Who (which lawyers) use Valuation Experts?

General Counsel - In house

Outside Counsel

M&A Counsel

Tax Counsel

Defense Counsel (Criminal and Civil)

Plaintiff's Counsel (Government, Regulatory and Civil)

Bankruptcy Counsel

Intellectual Property Counsel

Insurance Counsel

International Corporation (In-house and Outside Counsel)

Many others

What kind of Expert will be utilized?

Consulting Expert

Testifying Expert

Auditor

Tax Specialist

Bankruptcy Expert

Turnaround Specialist

Business Interruption or Property Claims Specialist

CPA, CFE, CFA, ASA

Economist (PhD)

Statistician (PhD)

Securities and Exchange Specialist

Former Government or Regulatory Investigator

Industry Specialist by training and practice

Others

Why Use an Expert?

Specialized knowledge and training

Industry expertise

Specialized understanding of financial statements and theory (GAAP)

Planning strategy and tactics

Conduct fact gathering

Theoretical underpinning for cause of action (GAAS)

Comfort or approval for deal due diligence

Front run tax issues

Determine value in a transaction, tax situation lawsuit

Establish damages, lost profits, royalties due, losses from infringing trademark and copyright, contract breaches, personal injury, fraud, etc.

Properly structure deals and turnaround situations

Determine compliance with standards other than GAAP (IFRS, SAP)

When Should Counsel use a Valuation Expert?

Transactions

- **M & A Due Diligence**
- **Deal Financials**
- **Tax Issues**
- **Transfer Pricing**
- **Specialized Industry knowledge**
- **Turnaround Expertise**

Tax Planning

- **Specialized knowledge**
- **Estates & Trusts**
- **Ad Valorem Valuations**

When Should Counsel use a Valuation Expert?

Civil, Criminal, Bankruptcy, Regulatory Investigations, Proceedings, Litigations and Dispute Resolution

- **Corporate and Business Matters**
- **Allegations of Fraud**
- **Malpractice Actions**
- **Personal Injury, Wrongful Death**
- **Matrimonial and Family Court Matters**

Where Do Lawyers Use Valuation Experts?

Experts are usually either Consulting Experts or Testifying Experts

Role of the expert determines many aspects of the interface with counsel

- **Attorney-Client Privilege and Waiver of privilege**
- **Turnover of drafts and final work product reports**
- **Exposure of communications between expert and counsel**
- **Exposure of the existence of the expert**

Complexity of the facts determines how early an expert is retained and commences working with counsel

How information is gathered and preserved, and its accessibility, determine whether expert is on site at client, adversary, takeover target, etc.

Litigations require close inter-relation between counsel and expert at early stage

How Should Counsel Best Use Valuation Experts?

All litigations and other situations are predominantly determined by the “*FACTS*”

Counsel must determine very early on:

- What is the situation?
- What facts exist?
- What needs to be proven or disproved?
- What is the theory?
- What do you need?
- How will you get it?

Is the case about “Money”?

Does it require specialized knowledge, experience or training?

Determine what kind of Knowledge? Experience? Training?

- Dictated by the Industry
- Dictated by the Issue
- Dictated by Criteria

How Should Counsel Best Use Valuation Experts?

Testifying areas can use a CPA, an economist or other financial expert

- **Intellectual Property - may use more than one to determine markets based on needs such as competitive markets, elasticity or cost accounting issues**
- **Damages are the measurement of the loss, counsel needs to determine how to measure the loss**
- **CPA's use economists and others as the basis of the measurement of damages**
- **CPA's pull together all the various elements to determine the number**

For both litigation and non-litigation situations, it is critical to retain an expert or a consultant (non-testifier) early on in the discovery process or before the deal is papered. The CPA needs to be well capable of working with teams of experts.

Frequently the expert or the consultant can help evolve the strategy, work on the theory of the case, (or do the same for the defense).

How Should Counsel Best Use Valuation Experts?

Keep the expert involved in the discovery process

Rely on the expert with others and counsel through formal discovery and otherwise to develop the facts

The wrong facts can be devastating - Example

- **Plaintiff used a Professor**
- **Professor wrote lengthy report concluding \$520 million in lost profits in a case of failed financing for startup in China**
- **Because of the Professor's possessive view of the limited information available from China, he did very little independent research for the report prepared discovery closed**
- **Defendant used team of CPA's, Forensic Accountants, Investigators**
- **Defense counsel had team help prepare deposition questions**
- **Defense counsel team understood in-country access to information and prepared devastating rebuttal report**
- **Plaintiffs' professor clearly wrote about the wrong industry, based on the wrong facts. Plaintiffs' professor pure speculation**
- **Case settled without Defense expert being deposed**

How Should Counsel Best Use Valuation Experts?

No expert can work on his or her own

- **Counsel has to know what is going on and what the expert is using both in theory, required by standards, regulations, statutes and case law**
- **Testimony ultimately will be guided by Federal and State statutes, regulations and case law as well as professional standards**
- **Is it a GAAP issue, a GAAS issue?**
 - ❑ **Accounting Standards - How should things be reported and recorded and accounted for?**
 - ❑ **Audit Standards - Auditors make an opinion whether what is reported is done so in accordance with GAAP without material variance?**
- **Does counsel need to understand the FASB (Financial Accounting Standards Board) views on GAAP? (Why the Board adopted the Standard?)**
- **Is counsel familiar with the “Current Text” which codifies GAAP based on subject matter and is updated yearly by AICPA?**
- **Counsel and/or expert may or may not be familiar with prevailing law or regulations. Each must educate the other and take nothing for granted**

How Should Counsel Best Use Valuation Experts?

Counsel must well utilize the consulting and testifying experts and well prepare them and vice versa

- **The expert needs complete familiarity with the facts**
- **The expert should “be in the room” for depositions and trial testimony**

The testifying CPA through training, experience and specialized knowledge should be able to provide a reasonable basis for the conclusions, report and testimony

- **Identify appropriate facts**
- **Determine the amount in question**
- **Within a reasonable degree of accounting certainty**

How Should Counsel Best Use Valuation Experts?

How wide open are the expert's eyes to what could be?

- **Evidence of single mindedness**
- **Things may interpreted many ways**

How multi-dimensional does the expert think?

Overcome the fact that accounting issues may appear very black and white

Prepare expert for testimony and for possible *Daubert* challenge

➤ **Attack on**

- Skills**
- Knowledge**
- Experience**
- Training**
- Facts**
- Assumptions**
- Report**

RETAINING A BUSINESS APPRAISER

Conflicts

Ethics

**Accountability and
Responsibility**

Retainer Agreements

Professional Licenses

**Firm size and
personnel**

Experience and references

**Availability and
subcontractors**

Assembling a team

Billing and costs

STRATEGIES FOR A SMOOTH VALUATION PROCESS

Lines of Authority and Reporting

Clearly identify decision makers for the assignment of tasks and actions to be taken.

Must be understood by everyone on the team and must function effectively.

Only One “Captain of the Team”.

Communication and Teamwork

Daily or Weekly meetings or conference calls.

Communicate important information immediately.

As the investigation progresses, counsel must be available on short notice.

Modify the plan as the case changes.

Tools Available in an Investigation

The Client

The Law Firm

Public Information (Open Sources)

- **commercial databases**
- **private and proprietary databases**
- **public records**
- **the Internet**

Tools Available in an Investigation

People as sources

Interviews of witnesses

Surveillance

Forensics

Public relations

The Client

Often the source of significant information

- **experience in the industry**
- **anecdotal information**
- **trade journals and magazines**
- **industry studies**
- **databases**
- **confidential sources**
- **former employees**

Legal Counsel

In-house expertise and information regarding clients' industries, suppliers, customers, competitors and regulatory environment.

Outside Counsel familiar with the players, the regulators and the issues.

Investigative Approaches

“Quiet” (covert).

“Visible” (overt).

Transition from quiet to visible inquiries.

Public relations.

Quiet Inquiries

Commercial databases, public records and Internet searches

Reviews of online media articles, local newspapers and trade publications

Criminal records checks

Loose surveillances

Undercover operations

Quiet Inquiries

Forensic examinations of computers, hard drives, servers, email, digital media and handwriting.

Review of toll other records.

Tape and audio recordings.

Review of client documents and materials.

Limited interviews with client's top management.

Public Information

Commercial Databases

Public records

Internet

Media

Trade and Business Journals

Dissertations

Surveillance

During the initial phase of the investigation

Covert

Dangers inherent in this technique

Costs

Client Expectations

Digital Forensics

Desktop and Laptop Computers

Servers

Mobile Telephones

Blackberry Devices

Other Digital and Digital Media Devices

Key Stroke Monitors

Developing Deleted Material

Establishing Downloads and Theft

Digital Forensics

Email

- Locating and developing
- Sources and IP Addresses

Electronic Discovery

Document Coding

Relational Databases

Forensics

Forensic Accounting and Fraud Auditing

Handwriting and document analysis

Enhancing video and audio tapes

Tapes recordings and transcripts

Stings

Polygraphs

Examinations of Trash

Visible Inquiries

Conducted on various levels:

- **No concern that adversary discovers the investigation; but field investigators and others urged not to go out of their way to advertise the inquiries.**
- **Investigative team instructed to take overt actions to ensure adversary knows about the inquiries.**
- **Public relations.**

People as Sources

**The key to most investigations is
the effective use of people
as sources**

Interviews of Witnesses

Who may be interviewed?

Practical considerations

Different approaches for interviews

Tape recording interviews

Eavesdropping and bugging

Demands for payment and other requests

Hiring former employees of an adversary

Attorney-Client and Work-Product and Other Privileges

Creating documents and databases

- **Indicate privileged and confidential nature only on all materials**
- **Limit access to and distribution of database materials**
- **Destroy all out-of-date computer disks and CD-ROMS**

Self-evaluative privilege

Additional Legal Considerations

The Bank Secrecy Act/Right to Financial Privacy Act

Fair Credit Reporting Act

Telephone Record

➤ **Electronic Communications and Privacy Act of 1986**

Conflicts

Actual or potential conflicts should be checked immediately with the potential firm.

Counsel should explain to investigative firm the various ways a conflict could arise.

Ethics

An investigator serves as the agent of an attorney.

Do not use an investigator to circumvent the canons of ethics.

Interview prospective investigators, check their references and test their understanding of legal and ethical obligations.

Exercise control over the investigation and work closely with the investigative firm.

Accountability and Responsibility

Need complete confidence in the lead investigator.

- **request a written proposal.**

Define lines of authority and responsibility

- **vital in national investigations.**

**Lead investigator must be capable of coordinating
all investigative activities nationwide**

Retainer Agreement

Written retainer agreement between counsel and investigative/valuation firm.

Scope and methodology of investigation.

Kovel

- **“Privileged attorney-client and confidential work-product communication” or**
- **“Privileged joint defense attorney-client and confidential work-product communication.”**

Professional Licenses

- ❑ Retain only licensed investigators performing investigations without a license is a crime in some states**

Firm Size and Personnel

National and international practices.

Members from a broad range of professional experiences:

- **Former federal, state and local agents and investigators, ex-prosecutors, database researchers, forensic accountants, industry specific experts and others.**

Experience and references.

Availability and Subcontractors

Ensure that local investigators are licensed, bonded and insured.

Require signed confidentiality agreements, as appropriate.

Warn of civil and criminal consequences of disclosure and insider trading.

Billing and Costs

Estimate and Determine costs at beginning of case.

Fees:

- **Hourly**
- **Flat**
- **Contingent**

Bill counsel directly, not the ultimate client.

Bills should not include a narrative description of the work performed.

Commercial Databases

Provides the following types of information among other useful data:

- **social security numbers**
- **dates of birth**
- **address histories**
- **names, addresses and telephone numbers of neighbors**
- **criminal records**

Public Records

Found at court houses, county and municipal clerks or other document repositories or online if available and include:

- **federal and state civil and criminal litigation records, judgments and liens**
- **bankruptcy court filings**
- **real estate ownership and mortgage records**
- **licenses, permits, UCC filings**

Online Searches

Many Federal, State and Local agencies have placed their regulatory and litigation databases online.

Online sources include:

- ❑ Dialog/Datastar: dialog.com/datastar.com**
- ❑ Database Technologies (DBT):
autotrackxp.com & informedinvestigator.com**
- ❑ DowJones: wsj.com & dowjones.work.com**
- ❑ Hoovers Directory: hoovers.com**
- ❑ Choicepoint: choicepoint.com**

Who May Be Interviewed

Ensure ex parte interviews are permitted in the jurisdictions where the current or former employee is located.

May not seek or obtain privileged information from any current or former employee.

May not interview any such person who is represented by an attorney.

Give investigators or interviewers model guidelines to take into field.

Practical Considerations

Where should the interview be conducted?

Who should conduct the interview?

How many interviewers should be present?

Retaining versus discarding notes?

Decide whether to obtain sworn statements or affidavits from witnesses or whether or not to record the interview?

Different Approaches for Interviews

Appearing assertive and knowledgeable.

Appearing uninformed and seeking assistance.

Simply letting the witness tell his/her story and memorializing the statements.

Taking outline notes.

Writing out a statement by hand.

Demands for Payment and Other Requests

No legal prohibitions barring these payments.

Expert witnesses may receive payment if amount is reasonable and not contingent on the trial's outcome.

Non-expert witnesses can be compensated for lost income and opportunity cost of testifying.

Consider witnesses credibility.

Hiring Employees of an Adversary

Confidentiality agreements.

Ethical rules and decisional authority in many states.

Determine employee's participation in any prior litigation on behalf of adversary.

Determine employee's past exposure to privileged information.

DOCUMENTS – CHECKLIST AND OVERVIEW

Things to Think About When Drafting the Data Request

- **Full vs. Shortened Document Requests**
- **Understand the Analysis to be Conducted**
- **Format Needed for Efficient Analysis**
- **Relevant Time Period**
- **Relevant Accounts**
- **Sources of Data**
- **Relation between the Electronic Data and Other Relevant Hard Copy Backup**

Common Mistakes (eDiscovery)

Poor planning for data review and analysis

- Think about how the data will be reviewed and used

Requesting the wrong data

- Understand what you are requesting
- What about archived data?
- Understand the data retention architecture

Requesting too much data

- Overwhelming requests cause

Not specifying the appropriate data format

- What will be most compatible with your review tool?

Handouts and Reference Material



Handouts

- **Importance of Engagement Letter**
- **List of Appraisal Organizations and Designations**
- **Generalized Document Request**

Engagement Letter

Information Needed	Information Provider	Common Options and Examples	
Entity To Be Valued	Client or Attorney	C-Corporation S-Corporation Limited Partnership	Joint Venture Professional Association Others
		Corporate Attorneys	Litigators
Interest To Be Valued	Client or Attorney	Stock (Voting or Non-Voting) GP/LP Interest Total Invested Capital Product Lines or Divisions Derivatives or Debt Intellectual Property	Lost Profits Lost Value Damage Calculations
Standard of Value	Attorney	FMV Fair Value Others	FMV Fair Value Others
Valuation Date	Client or Attorney	Date of Transaction Date of Death Date of Gift	Damage Date
Purpose	Client or Attorney	Estate & Gift Tax Corporate Planning Financial Reporting Transactional	Shareholder Oppression Dissenting Shareholder Action Marital Dissolution
Scope Limitations	Agreement Among: - Client - Attorney - Valuation Analyst	Less Important - Third Party Appraisals of Fixed Assets or Real Property	More Important - Site Visit? - Access to Management?
Deliverable	Dependent on Purpose	Full Report Summary Report Schedules Oral Consultation	Expert Report and Testimony Rebuttal Reports Consultation

Appraiser Qualifications

Designation		Sponsoring Organization
CPA/ABV	Accredited in Business Valuation	American Institute of Certified Public Accountants
ASA	Accredited Senior Appraiser	American Society of Appraisers
CBA	Certified Business Analyst	Institute of Business Appraisers
CVA	Certified Valuation Analyst	National Association of Certified Valuation Analysts
AVA	Accredited Valuation Analyst	National Association of Certified Valuation Analysts

For More Information Contact:

James Alterbauem, Esq.
Senior Partner
MOSES & SINGER LLP
(W) 212-554-7800
jalterbaum@mosessinger.com
New York

Paul Marquez, JD CPA/ABV/CFF CBA ASA CFM CMA
Principal
SIGMA VALUATION CONSULTING
(W) 917-450-0828
pmarquez@sigmavaluation.com
New York