

**PART**



# **THE LITIGATION ENVIRONMENT**

**CHAPTER 1**

**A Dispute Resolution Primer**

**CHAPTER 2**

**Serving as a Financial Expert in Litigation**

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# CHAPTER 1

## A DISPUTE RESOLUTION PRIMER\*

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### 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 abreast of current methods and case law 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 Evidence 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.<sup>1</sup>

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 *Daubert* 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 only examples; they are neither mandatory tests nor 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 excluding testimony, as well as good standards to apply when evaluating one's own prospective testimony.<sup>2</sup>

- 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 observe some principles generally accepted within their community but not accepted, 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*<sup>3</sup> proceedings. It will also require a yes answer to one of the first questions that most attorneys

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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 federal 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.

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This book focuses on the financial expert's role as an expert witness because litigation practitioners most often serve in this comprehensive role. 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 alleged 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 that involve 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.

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**(a) General Process.** With the exception of criminal activities related to fraud, this book focuses primarily on 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.<sup>4</sup> 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

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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 parties 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 and in most cases will be required to document those opinions in a report or affidavit. In some cases, the expert provides an evaluation or rebuttal of the opposing expert's report after it has been produced. 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 and 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.<sup>5</sup> 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 1996).

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, D.C.

**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



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**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) that 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 whereas the 2000 presidential election presented issues deemed sufficiently urgent to merit Supreme Court action without a federal court of appeals decision. 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 as when, for example, 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 36 addresses tax fraud cases.

*(ii) U.S. Court of Appeals for the Federal Circuit.* Federal district courts hear patent, copyright, and trademark issues, collectively referred to as intellectual property disputes (discussed in Chapters 18 through 20). 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, D.C.

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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 on 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 27 addresses federal contract disputes.

(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 22 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 that they can decide on. 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. Additional considerations include 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), for insurance companies (e.g., New York), or for conferring a home-field advantage in dispensing justice (e.g., Texas). Regardless of whether or not one credits these

prejudices, 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 addresses opinions and expert testimony. Article IX sets forth the rules governing 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 commonsense 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.

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**(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, the limited supply of judicial resources, 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, mini-trials, and mediation. The second half of this chapter further discusses ADR.

**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.<sup>6</sup>

**(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 claims, as well as those lacking merit. 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 soon after receiving 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, as determined in a scheduling conference and formalized in a scheduling order issued by the judge. 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 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. Chapter 4 provides an overview of typical activities in developing the damages theory, associated models, and expert opinions related thereto. 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 an order from 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

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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.<sup>7</sup> 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. As businesses move toward increased or exclusive use of electronic records, the amount of data produced has increased exponentially. Chapter 14 discusses the methods that experts use to efficiently glean and track information from such records and other issues related to electronic data and communications.

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.

**(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, or 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.

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**(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 can 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 material 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) Code 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, many choose 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 increasingly use 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 back-and-forth 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

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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.

#### 1.4 THE ALTERNATIVE DISPUTE RESOLUTION PROCESS 1 • 17

(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 THE ALTERNATIVE DISPUTE RESOLUTION PROCESS

**(a) Definition and Overview.** Alternative dispute resolution (ADR) refers to processes for resolving a dispute between two or more parties other than through formal litigation in a court system. Several formats can resolve disputes outside of litigation; these range from enforceable determinations by a third party to facilitated negotiations between the parties. The most common forms of ADR are arbitration (an enforceable determination) and mediation (a facilitated settlement). Alternatives to the court system for resolving disputes have existed at least since 1925, when Congress passed legislation recognizing the right of parties to agree to resolve disputes using arbitration. Since that date, the use of ADR has increased.

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- Specification of the types of disputes the clause covers
  - Limitations on what the parties can claim in a dispute and the available remedies
  - Method of resolution (litigation or ADR, and type of ADR)
  - Procedures for resolution (timelines, discovery, use of experts, hearings, etc.)
  - Method for selecting the neutral(s) and identification of the neutral(s)
  - Other possible elements
    - Limitations on what disputes can be brought (e.g., time limitations)
    - Confidentiality of the fact of the dispute and the resolution of the dispute
    - Choice of law (if not otherwise covered in the contract)
    - Form for reporting the decision
    - Binding or appealable nature of the decision
- 

The elements shown here relate to arbitration within the United States. For international arbitration matters, the clause should also include a discussion of the language in which the arbitration will be conducted, the governing law for the contract, the seat of the arbitration (which will determine the procedural law for the proceeding), the venue (location of the arbitration), and the composition of the tribunal.

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**Exhibit 1-1. Common Elements of a Commercial Dispute Resolution Clause**

Parties now use ADR for any type of dispute, and it has become the most common method for resolving certain issues, such as construction disputes and disputes under purchase agreements in corporate acquisitions.

Most contracts now include a dispute resolution clause specifying one or more forms of ADR. Exhibit 1-1 lists the elements that such clauses include. Parties often use ADR after formal litigation has commenced, often because of prodding by the judge. Court-ordered, nonbinding mediation has almost become the rule as judges face increasingly overcrowded dockets.

**(b) Advantages and Disadvantages of ADR.** ADR offers several potential advantages over litigation. Many people think that it achieves results more quickly, less expensively, and less disruptively. As ADR has matured and its users have become more sophisticated, not all ADR methods provide these advantages. Certain features of ADR that practitioners often consider advantages often depend on one's position in the dispute. For example, lack of punitive damages in ADR gives an advantage to the defendant at the expense of the plaintiff.

Other features distinguish ADR from litigation. These vary depending on the type of ADR and include the following:

- **Consent of parties.** Parties initiate ADR only by mutual consent, often granted in an underlying contract. They cannot draw third parties involuntarily into the proceeding.
- **Confidentiality.** Parties to ADR can choose to make the content of the proceedings, the outcome, and even the facts of the dispute confidential.
- **Flexibility.** ADR has more flexibility than litigation and affords the parties more control, such as selecting the decision makers, establishing the

## 1.5 FORMS OF ALTERNATIVE DISPUTE RESOLUTION 1 • 19

procedures, and crafting the solutions. Parties can select decision makers with specialized expertise relevant to the dispute. The parties can choose the procedures or allow the decision maker to establish procedures.

A greater range of available remedies exists, although ADR seldom offers interim remedies (e.g., precluding a party from selling in a specific location until a final resolution of the dispute). Solutions can consider ongoing business relations: parties, for example, can structure settlements involving future adjustments to their relationship rather than a one-time payment of damages. This fact, and the generally less adversarial nature of ADR, can help preserve business relations.

- **Discovery.** ADR typically provides for less discovery.
- **Precedent.** Decisions relate only to the dispute at hand and create no precedent. Decision makers can consider precedent in making determinations but are not required to do so.
- **Appealing a decision.** Parties have limited or no ability to challenge an outcome and decision makers are less accountable than in litigation.
- **Enforceability.** The different types of ADR create differing powers to enforce an award.

ADR creates certain unique advantages in international disputes. When the parties come from different countries, use of international arbitration removes possible local bias and a need to proceed under unfamiliar rules and in a foreign language. When the dispute involves a state or parastatal entity, international arbitration enables a sovereign nation to avoid submission to the laws and courts of another country. Arbitration eliminates the possibility that a foreign investor has to dispute a government body in a national court where that same government appointed the judges. As a result of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (adopted in 1959 and ratified by the U.S. Congress in 1970), parties often find it easier to enforce an international arbitration award than an award rendered by a national court.<sup>8</sup> Signatories to the convention recognize and enforce both agreements to arbitrate and arbitral awards. The award recipient can attach a judgment-loser's property located in a country that is a signatory to the convention.

## 1.5 FORMS OF ALTERNATIVE DISPUTE RESOLUTION

### (a) Arbitration

*(i) Description.* Arbitration is probably the most common of alternative dispute resolution mechanisms. Arbitration typically involves the appointment of one or more neutral individuals<sup>9</sup> to adjudicate rights and act as a decision maker. The parties can enter into arbitration voluntarily after a dispute arises or a contractual arrangement between the parties may require such participation.<sup>10</sup> Without a contractual requirement, one party cannot compel another to participate in arbitration; one cannot unilaterally institute arbitration.

The arbitrator has the authority to decide the dispute, including issues of fact and law, and to issue an award. Arbitrators base their decisions on the parties'

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legal rights and obligations (determined by contract and applicable law). Most arbitrations lead to final and binding decisions, and few circumstances allow for a challenge to an award in arbitration.

*(ii) Procedures.* Arbitration provides flexibility regarding deadlines and timing, the amount and nature of discovery, the number of arbitrators, the selection of the arbitrators, the nature of hearings before the arbitrator, whether the arbitrator provides an explanation for the final decision, and so on. The arbitrator establishes procedures not specified in the contract or not mutually agreed on, often with input from the parties, but taking into account the governing laws. Domestic arbitrations often use standard procedures such as those recommended by the Center for Public Resources (CPR) or American Arbitration Association (AAA); these provide comprehensive guidelines and increase predictability. International arbitral institutions, such as the International Chamber of Commerce (ICC) and the London Court of International Arbitration (LCIA), have standing rules for cases under their administration. For arbitrations that such organizations do not administer (referred to as *ad hoc*), the parties can develop their own procedures or can adopt procedures published by organizations such as the United Nations Commission on International Trade Law (UNCITRAL). Section 1.7 discusses the rules used in international arbitrations.

*(iii) Mechanics.* The mechanics of arbitration include many of the elements of litigation, such as hearings, discovery, and written submissions, but arbitration limits the scope of these elements and increases the involvement of the adjudicator. At the outset, the arbitrator will work with the parties to clarify procedures, set a schedule, and define the issues and facts in dispute. Discovery is typically more limited in arbitration compared with litigation. Discovery involves an exchange of hard-copy documents but normally does not include electronic discovery. Witnesses provide written statements but do not always give depositions. The parties' written submissions—submitted simultaneously in certain cases—state their positions comprehensively.

The final arbitration hearing has many of the same elements as a court trial. One difference lies in testimony: witness statements can substitute for direct testimony, resulting in brief or no direct testimony, and the witnesses appear at the hearing primarily for cross-examination and examination by the arbitrator. Parties often submit post-hearing briefs. Months often pass between the conclusion of the proceedings and the arbitrator's decision. The arbitrator can communicate the decision as only the final numeric result or as a "reasoned" award that reflects not only the final decision but also the basis for that decision in some detail.

**(b) Mediation**

*(i) Description.* Mediation is another common ADR procedure. Mediation involves the use of a neutral third party to facilitate the parties' negotiations. The mediator renders no decision and has no authority to impose any outcome on the parties, who retain decision-making authority and remain responsible for resolving the dispute. This voluntary process requires the cooperation of the parties. As with arbitration, however, contractual obligations can require that a party participate in mediation. Additionally, judges can order litigating parties to participate in



**1.5 FORMS OF ALTERNATIVE DISPUTE RESOLUTION 1 • 21**

mediation. No requirement exists, however, that mediation continue until the parties resolve the dispute. As a result, mediation does not carry the risks of arbitration or litigation because failure to resolve the dispute has no consequences other than lost time.

*(ii) Mechanics.* Mediation involves a less formal process than arbitration and thus requires less time and money.<sup>11</sup> The individuals attending a mediation include one or more representatives of each party (for best results, the representative should have authority to resolve the dispute), counsel for each of the parties, and the mediator. Even though fact witnesses normally do not attend, it is becoming more common for expert witnesses to attend.

The mediator's particular style will govern the process used at mediation. Regardless of style, the mediator needs to maintain control over the proceedings. The typical mediation includes a meeting with all the parties, after which the mediator separates them and has a series of private discussions with each. Occasionally, the mediator will hold additional joint sessions.

During the opening joint session, each party outlines its understanding of the facts giving rise to the dispute, its assessments of its legal rights, and any claims it is making. In some mediations, dialogue between the parties occurs at this opening joint session. During the private caucuses, the mediator evaluates each party's position in more detail. To be effective, the mediator must listen carefully to the arguments of the parties and evaluate unspoken motivations or hidden agendas. The mediator obtains additional information to assess the strengths and weaknesses of each party's positions, identifies areas in which each party could be willing to concede or negotiate, identifies nonstarters (i.e., areas that the parties refuse to concede), and presents the arguments of the opposing parties. The mediator then shifts to evaluative mediation to offer his or her assessment of the relative strengths and weaknesses of the parties' arguments and the likely outcome were the parties to litigate.

Through this process, the mediator attempts to find or create common ground between the parties, identify mutually beneficial solutions, and facilitate a settlement. A persistent and creative mediator can work through impasses and help the parties conclude the matter.

Multiple parties can participate in mediation. The mediation can resolve the dispute between some, but not all, of the parties or can resolve some, but not all, of the issues in dispute. Any of the parties can withdraw from the mediation at any time.

*(iii) Resolution of the Dispute.* The mediator can base the proposed solution on business interests in addition to (or as opposed to) legal obligations. The parties can design the solution, which can also address business issues beyond the scope of the dispute. The parties to the dispute must negotiate with each other (directly or through the mediator) to resolve the dispute, rather than convince an arbitrator of their legal rights and their understanding of the facts. The outcome of the mediation is not binding, unless the parties enter into a settlement agreement. Mediation facilitates ongoing business relations better than litigation and arbitration do because it minimizes the adversarial aspect and requires less time.

Mediation might not resolve the dispute. The parties typically agree that information revealed during the course of mediation remains confidential and parties

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cannot use it for any other purpose, including subsequent arbitration<sup>12</sup> or litigation, if the mediation fails to achieve a settlement. Similarly, if the mediation leads to resolution, parties cannot make the outcome public without an agreement to do so.

**(c) Other Forms of ADR.** Other ADR mechanisms include private judging, early neutral fact finding or evaluation, summary jury trials, mini-trials, and moderated settlement conferences. Parties can develop whatever variations suit their situation. These other forms of ADR resemble mediation more than they do arbitration in that each method aims to facilitate a negotiated settlement between the disputing parties, rather than to have an independent party determine the outcome. Nonetheless, a third party participates in each of these, with roles varying from evaluating the parties' positions to simply moderating their discussions.

Often, a dispute resolution clause will include a combination of mechanisms that the parties execute simultaneously or sequentially. Similarly, a judge presiding over a litigation matter could require that the parties employ a combination of mechanisms in an effort to resolve the dispute. For example, a judge presiding over a litigation matter could order the following sequence of alternatives:

- The parties must first participate in nonbinding arbitration. The arbitration does not aim to resolve the dispute but to provide information to the disputing parties as to how an arbitrator views their liability and damages arguments.
- The judge then has the parties proceed to nonbinding mediation. The judge expects that the arbitrator's perspective will increase the likelihood of resolving the dispute at mediation.
- Failing a resolution at that stage, the parties can return to court and proceed with the litigation.

The following gives a brief overview of other forms of ADR:

- **Private judging** involves the use of independent third parties, typically former judges, in the role of judges. These independent third parties preside over private trials and render a nonbinding judgment.
- **Early neutral fact finding or evaluation** involves appointing neutral experts (on law, financial matters, industry issues, and so on, as appropriate for the situation) to evaluate and analyze facts and data and report their findings to the parties. The fact finders' assessments often include their views on the likely outcome at trial; these perspectives often improve settlement discussions.
- **Summary jury trials** are abbreviated trials presented to mock juries. The juries render a nonbinding decision, which the judges use to facilitate settlement discussions.
- **Mini-trials** form a panel consisting of representatives with decision-making authority from each of the disputing parties and, in some cases, an independent third party. Counsels for the parties argue their case before the panel. The panel then attempts to negotiate a settlement, moderated by the independent third party. The mini-trial forum resulted from efforts to involve



business people early in the resolution of commercial disputes. The mini-trial is a short trial, usually no longer than a day. 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 mini-trial 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 mini-trial 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. The independent third party is often 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 CPR<sup>13</sup> has a list of individuals qualified to serve in the role of facilitator.

- **Moderated settlement conferences** are negotiations moderated by independent parties, often judges. Moderators facilitate the discussions and often share their evaluation of the parties' positions and arguments.

## 1.6 DOMESTIC ADR

**(a) Rules Governing the Use of ADR.** A substantial body of law governs the conduct of litigation in U.S. courts. Even though ADR offers more flexibility than litigation does, a similar, though narrower, basis in statute and common law supports ADR. Congress enacted the Federal Arbitration Act in 1925. This act recognized the right of parties to agree to resolve disputes using arbitration—including binding arbitration, which limits the right to appeal an arbitrator's decision—and recognized written arbitration agreements as enforceable in federal courts. It allowed a judge to stay a litigation and refer the case to arbitration. The act granted various authorizations related to private arbitration; these include authorization of the courts to appoint arbitrators under certain circumstances and to grant certain powers to the arbitrator(s). Additionally, the act recognized arbitration awards, rendering them enforceable in federal court, and established the circumstances under which courts could set aside awards.

In response to increased reliance on ADR to resolve disputes, Congress in 1990 passed the Civil Justice Reform Act and the Administrative Dispute Resolution Act, which addressed the use of ADR with the federal government. In 1998, Congress passed the Alternative Dispute Resolution Act. This act granted courts the power to use ADR in all civil matters and provided related directives and guidance to the courts. As a supplement to federal arbitration laws, individual states have enacted arbitration laws, most of which add detail to the procedural aspects of the Federal Arbitration Act.

In addition to legislation, various interested bodies have established standard procedures for conducting ADR, as well as established codes of conduct for those serving as neutrals. Entities involved in ADR and the standard-setting processes

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include the AAA, the American Bar Association (ABA), the CPR, the Society of Professionals in Dispute Resolution (SPIDR), and Judicial Arbitration and Mediation Services (JAMS).

Procedural rules established by these organizations address topics such as commencement of the dispute resolution process; appointing the neutral(s) (including the number and qualifications); authority of the neutral; confidentiality of the proceedings; conduct of the proceedings (including submissions, hearings, etc.); and the award.

Three organizations<sup>14</sup> collaborated to establish the Code of Ethics for Arbitrators in Commercial Disputes. They designed the code to ensure fairness and integrity in the arbitration process. The elements of this code include disclosure of any relation that might impair impartiality, prohibition of *ex parte* communications, maintaining confidentiality, and clear and complete communication of the award. Model standards for mediators<sup>15</sup> include recognition that mediation is a process of self-determination by the parties, impartiality, disclosure of any potential conflicts of interest, serving only when qualified, and confidentiality. Arbitrators and mediators should comply with any other standards applicable to the forum or their profession.

**(b) The Neutral.** The parties have the right to decide the number (normally either one or three) and identity of neutrals. In disputes that have three neutrals, the parties will choose a chairperson. If the parties do not make a decision within a particular time period or cannot reach agreement related to the neutrals, the organization (such as the AAA) administering the resolution process will select the neutral(s) according to its rules. Many of these organizations have standing panels of qualified neutrals. Any neutral must be independent of the parties to the dispute, must have no vested interest in the outcome, and must demonstrate objectivity. One should consider the specific skills or expertise required of the neutral. Most cases require a background in law, as the legal rights and obligations of the parties often determine a fair decision. In some cases, however, specialized industry or technical knowledge has importance. For example, a post-acquisition purchase price dispute would require that the neutral understand accounting.

When not otherwise specified by the parties (by agreement or through adoption of certain institutional procedures), the neutral has the right to establish the timetable; administrative procedures; extent of discovery; nature, number, and timing of submissions; and the nature of the information communicated in rendering the decision. In most cases, neutrals can engage their own independent experts, although this rarely occurs. Apart from engaging their own experts, neutrals do not perform their own research but rather rely on information that the parties present.

**(c) The Role of Financial Experts.** Parties will typically engage financial experts to evaluate financial issues in the dispute, similar to the use of experts in litigation matters. These issues most frequently involve damages claimed. Financial experts can also perform financial analysis and related fact finding to help establish the facts supporting liability arguments. In addition to fact finding through a review of the accounting, financial, and related records, many financial professionals

have skills in investigations or specific industry expertise that enable them to find information not produced through discovery.

The specific analysis employed by experts will rely on established damages theory or financial analysis practices and will not vary based on the forum for resolving the dispute.<sup>16</sup> Arbitration's limited discovery reduces the financial experts' access to information compared with that of litigation; they often have to rely more heavily on data of comparable companies, industry data, or reasonable assumptions rather than company-specific information. Experts present the information to a neutral, rather than a jury, and should tailor the communications accordingly. Experts have less opportunity to explain the analysis through testimony, so their report should clarify the analysis and results. In any case, the expert should consult with the client's legal counsel on these matters.

As mentioned, neutrals sometimes engage independent experts to perform analyses and advise them on technical matters. Financial experts can fill this role in ADR. The expert should perform the analysis as if working for one of the disputants, although the needs of the neutral will determine the nature of communications.

Financial experts can also serve in the role of a neutral. This would most likely occur when the dispute focuses on financial, rather than legal, issues. In this case, the expert will evaluate the parties' submissions and make a final determination in the dispute.

## 1.7 INTERNATIONAL ARBITRATION

**(a) Differences from Domestic Arbitration.** The rules of procedure and evidence in international arbitration cases can vary from those of arbitrations in the United States. Most arbitral institutions give flexibility to the parties and to the arbitral tribunal to tailor procedures for each dispute. Depending on the parties, the arbitrators, and the place of arbitration (referred to as the seat), the rules can contain elements from various legal systems around the world—common law, civil law, and other traditions. Different rules often affect elements such as discovery and the expert's duty. The influence of civil law limits international discovery more than that of U.S. litigation and even that of U.S. domestic arbitration. Some cases exchange only documents on which the owners of the documents intend to rely in building their affirmative case. Outside the United States, arbitrations use depositions rarely or never, relying instead on written evidence rather than oral testimony. Individual states' data protection acts also affect the extent of discovery and the ability to use certain data.<sup>17</sup>

**(b) Rules Governing International Arbitration.** To prove effective as dispute resolution mechanisms, arbitrations need the force of law: the results must be binding and the awards enforceable. Most countries have national laws that give arbitrations such authority, and many have entered into treaties that support arbitration. Finally, many countries have entered into multistate conventions that address the resolution of disputes and the enforcement of related awards. For example, over 140 countries have signed the 1959 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, under which the signatory states have

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agreed to recognize arbitral awards as binding and to enforce them according to the rules of procedures of the territory that enforces the award.

The rules of procedure and evidence vary in each case. The International Bar Association has issued rules of evidence for use in international disputes, which international arbitrations often use.

Various institutions that administer arbitrations, listed in Section 1.7(c), have established procedural rules for the conduct of arbitrations. These rules also provide a framework in which a tribunal can set procedures and timetables for each case.

An arbitration proceeding fully administered by one of the arbitral institutions provides more certainty and less opportunity for disagreement surrounding procedures. These institutions periodically update their procedures to incorporate their experience in administering arbitrations, so the procedures address most issues that will likely arise. An arbitration conducted under institutional rules can have more credibility and, under certain circumstances, will facilitate the enforcement of an award. Arbitrations most often use the procedures propounded by the ICC, the LCIA, and the International Center for Dispute Resolution (ICDR), the international branch of the AAA. Most institutional rules include provisions related to the following items:

- Powers and authority of the institutional administrator;
- Commencement of the proceedings;
- Appointment of the tribunal, including challenges to an appointed arbitrator
- Presentation of evidence<sup>18</sup>;
- Powers of the arbitrator(s); and
- Methods for deciding the language of, site of, and applicable law for the arbitration.

In ad hoc arbitrations that an institution does not administer, the parties have greater flexibility to create their own rules and process. Although this maximizes flexibility and autonomy, it creates a risk of slowing progress if the parties cannot reach agreement as to how the arbitration will proceed. Both the CPR Institute and UNCITRAL have developed procedures for use in ad hoc arbitrations. The CPR Institute developed the CPR Rules for International Non-Administered Arbitration. UNCITRAL adopted arbitration rules in 1976.

The UN General Assembly established UNCITRAL in 1966 to reduce obstacles to the flow of trade. UNCITRAL arbitration rules provide a comprehensive set of procedural rules for conducting arbitral proceedings; these rules blend common law and civil law features. Ad hoc arbitrations and some administered arbitrations use these rules.

**(c) Arbitral Institutions.** Numerous arbitral institutions (listed here) administer international arbitrations and have their own procedural rules.

- AAA/ICDR—New York and Dublin
- British Columbia International Commercial Arbitration Centre (BCICAC)—Vancouver

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- Cairo Regional Centre for International Commercial Arbitration (CRCICA)—Cairo
- China International Economic and Trade Arbitration Commission (CIETAC)—Beijing
- Deutsche Institution für Schiedsgerichtsbarkeit (German Institution of Arbitration; DIS)—Frankfurt
- Hong Kong International Arbitration Centre (HKIA)—Hong Kong
- Inter-American Commercial Arbitration Commission (ICAC)
- International Chamber of Commerce International Court of Arbitration (ICC)—Paris
- International Centre for the Settlement of Investment Disputes (ICSID)—Washington, D.C.
- London Court of International Arbitration (LCIA)—London
- Netherlands Arbitration Institute (NAI)—Rotterdam
- Stockholm Chamber of Commerce (SCC)—Stockholm
- Singapore International Arbitration Centre (SIAC)—Singapore

Of these institutions, disputants most frequently use the ICC, LCIA, ICDR, and SCC. Over half of the cases heard by the ICC have disputed amounts in excess of \$1 million. ICC arbitrations offer the most supervised of arbitration proceedings. In addition to its arbitration rules, banks apply the rules of the ICC's Uniform Customs and Practice for Documentary Credits (UCP 500) to finance billions of dollars' worth of annual world trade.

**(d) Arbitration with a State or Parastatal Entity.** Resolving a dispute with a governmental entity presents special challenges. Section 1.7(b) discusses the advantages of resolving such a dispute through arbitration rather than a local court system. These disputes arise either from a direct contractual relation with the state or through guarantees or other commitments provided in an investment treaty.

*(i) Investment Treaties.* Investment treaties are agreements between two or more state governments that govern the terms of the economic interactions between the states. Investment treaties protect and encourage investment between companies in the signatory countries so as to facilitate cross-border investment. Bilateral investment treaties involve two states, and multilateral investment treaties include three or more states.

These treaties provide an important right and protection for private company investors: the right to sue the host government. Foreign investors can use the dispute resolution terms contained in the investment treaty even if the contractual agreements underlying their transactions do not address a dispute resolution mechanism or contradict the mechanism laid out in the investment treaty. If an investment treaty contains an agreement to arbitrate investment disputes, the treaty itself normally constitutes the host state's consent to an arbitration.

*(ii) Rules for Investment Treaty Arbitration.* Most investment treaties specify the rules for arbitrations. Most treaties will suggest ICSID arbitration or *ad hoc* arbitration using UNCITRAL rules.

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The Washington Convention on the Settlement of Investment Disputes between States and Nationals of Other States established the ICSID in 1965. As the title of the convention implies, it aimed to resolve investment related disputes between a state and a national of another state. ICSID is a part of the World Bank.

Approximately 140 countries have signed the convention. Signatory countries agree to recognize and enforce the obligations imposed by ICSID awards. This applies to any ICSID award, whether or not it involves the particular signatory.

**(e) The Tribunal.** In most international arbitrations, the parties determine the size and composition of the arbitral tribunal. Most often, they use a three-member panel: each side proposes one arbitrator (who should serve in an unbiased manner even though selected by one of the parties) and the other two members of the panel or the arbitral institution selects a neutral chairman. The chairman is usually a lawyer. The other members are often also attorneys or have a particular technical expertise (e.g., accountant or engineer).

**(f) The Role of Financial Experts.** Financial experts in an international arbitration perform the same tasks as those of domestic arbitration, with some additional considerations. They will need to understand in each case to whom they owe their duty and to check whether any special rules exist (arising from either the tribunal or the seat of the arbitration) that might govern the conduct of the assignment.

Just as attorneys work with local counsel, experts who lack experience in the local country should consider working with someone in the country where the transactions and dispute occurred. A local contact can provide insight into the local culture and business practices, will understand local tax and accounting rules and regulations (and therefore be better able to interpret and evaluate locally prepared financial information), will know how to locate publicly available information, and will have familiarity with local laws for CPA licenses. A local contact should also know the local data protection laws.

When preparing financial models, other issues come into play in the international arena. For example, one must consider the choice of currency or the timing of currency conversions. Discount rates should reflect political risk.

An expert in international arbitration will usually have to produce a written report of the evidence, explaining the approach, method adopted, evidence seen, and conclusions reached. Sometimes the experts appointed by each side will meet before the hearing and produce a joint report that sets out the areas of agreement and disagreement in their evidence. A recent trend is for witness conferencing. Most often, the expert will not participate in a deposition. If a tribunal appoints the expert, each of the disputing parties will cross-examine the expert at the final hearing.

**1.8 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 or participates in a form of alternative dispute resolution.



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.

ADR has become common for resolving disputes; it is increasing in popularity both domestically and internationally. As a result, governments and private arbitral organizations have implemented legislation, procedural rules, codes of conduct for arbitrators and mediators, international investment treaties, international conventions, and foreign legislation in support of this dispute resolution process. Many participants perceive ADR as superior to litigation as a method for resolving disputes. Some of those advantages depend on one's vantage point. Parties can best realize advantages if they understand the ADR process.

In ADR, a financial expert can serve in the role of an expert for one of the parties, or as a neutral expert assisting the arbitrator, or as the neutral. The financial expert can face different procedures for resolving the dispute and a different manner for communicating the results of analysis in ADR. The nature of the analysis and the method of approaching the analysis remain the same as those of a dispute resolved through litigation.

## 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 websites, 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 twentieth 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 that 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. Financial experts are sometimes hired to aid a disputant on a contested matter before it becomes the subject of a formal dispute resolution process. In such cases, the financial expert should be cognizant of the possibility that testimony as a fact witness, or

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even on rare occasions as a corporate witness, is possible. Any work done in this context is generally subject to discovery, especially if the expert is subsequently retained to provide expert witness services, and due consideration should be given to the issues of privilege, attorney work product, methods and procedures employed, and the nature and means of communications between parties.

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. The Inter-American Convention on International Commercial Arbitration (or the Panama Convention) has provisions similar to those of the New York Convention. It was adopted in 1975, and most Latin American countries are signatories.
9. The use of party arbitrators (serving as advocates for a party rather than as a neutral) is no longer common.
10. In international arbitration matters (discussed in Section 1.7), investment treaties can also require arbitration.
11. Of course, the overall process of resolving the dispute will be quicker only if the mediation is successful.
12. An occasional exception is seen in hybrid proceedings, usually under construction contracts, in which the mediator, if no settlement is reached, becomes the arbitrator in the subsequent arbitration proceeding.
13. [www.cpradr.org/](http://www.cpradr.org/).
14. The organizations cooperating on this effort include the Arbitration Committee of the Section for Dispute Resolution of the ABA, AAA, and CPR Institute for Dispute Resolution.
15. The organizations establishing standards for mediators include the ABA, AAA, and SPIDR.
16. Certain damages theories that are built on case law are appropriate for use in arbitration.
17. For example, the Data Protection Act adopted by the European Union in 1998 protects the privacy of personal information that is often contained on an individual's company-issued computer, data storage device, email, and so on. This can complicate the discovery process.
18. Most rules provide for significant flexibility in the presentation of evidence. Much of the decision-making authority related to evidence is granted to the tribunal.

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