THE LITIGATION NEWSLETTER

Fall 2004

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Chair's Letter

by: *Kevin J. O'Dowd*
Litigation Section Chairperson

As your incoming chairperson, it is my privilege and honor to guide our Litigation Section through another successful year, made possible through the time, creativity and dedication of our council members. First, I proudly reflect upon the accomplishments we made last year under the leadership of our outgoing Chair, Bob June, which includes another excellent "up north" summer conference at Boyne Highlands (featuring a distinguished panel on the subject of *Guerilla Discovery and Tactical Evidence*); the ever-popular "Masters in Litigation" series, made possible through our successful partnering relationship with the ICLE; and a new program launched last year (also in cooperation with ICLE) entitled "Litigation Boot Camp," a series of educational programs offered to young lawyers on both sides of the state — a successful program now in its second running. Not only are these programs recognized for their consistent educational value, but they also offer our section members a unique opportunity to get together in a relaxed setting.

We also have much to look forward to in the upcoming year. Already, we have made arrangements to host our Annual Summer Conference, July 15-17, 2005 at the Grand Hotel on Mackinac Island. ICLE has offered to assist our section in organizing and promoting next years' summer conference and our planning activities are well underway. A special thank you goes out to our friend and partner, Shel Stark, Executive Director of ICLE, for helping make this and other exciting programs possible. Please mark your calendars now and plan on joining us on Mackinac Island in 2005 for what is sure to be one of our most exciting and enjoyable summer conferences.

Once again, we have mapped out another exciting *Masters in Litigation* series, being hosted at the beautiful St. John's Golf and Conference Center in Plymouth, Michigan, including the upcoming program on October 28, 2004, "Lessons Learned from the Trials of the Century," featuring Todd Winegar, one of the country's highest rated legal educators; followed by "Pozner and Dodd on Advanced Cross-Examination" on April 7, 2005. *Litigation Bootcamp* II, a basic training for new litigators, is also currently underway on both sides of the state, and is enjoying increased enrollment in its second year. As a section member, you can take pride in the quality of these programs, and we hope you will find time to enjoy one of these excellent programs in the upcoming year. For their assistance and commitment to excellence, a special thanks goes out to last year's summer conference committee (Sue Keener (chair), James Partridge, Stacie Behler and Christopher Tracy) and to our programs committee (Bob June and Tom Cavalier), and all those who assisted them in making these programs possible.

Beginning with this newsletter, Nicole Winston's Publications Committee rolls out another series of quality newsletters to our members. This issue features the second installment in strategies for winning corporate litigation. Additionally, we have a very interesting article regarding using financial experts after *Daubert*. We welcome and encourage section members to contribute topical articles, so please contact Nicole if you are interested in submitting an article for publication.

There are a number of less visible but equally important activities in which section members can become involved. For example, Lynn Schecter's rules and legislative committee is presently working on drafting procedures for commenting upon proposed rules and legislation affecting our litigation practices; and chair-elect Gordon Gold is forming a task force to explore how our section can support the High School Mock Trial program across the state both through volunteers and financial support. Please feel free to contact us if you would like to become more involved in any of these Litigation Section activities. We welcome your input and participation.

These are just a few of the exciting programs we have to look forward to as we proceed into the next year – none of which could occur year after year without the active participation of our council and section members whom I wish to thank. Once again, I am grateful for this opportunity to build upon our section's past accomplishments and look forward to exploring new opportunities for bringing our section members together.

STATE BAR OF MICHIGAN LITIGATION SECTION
NINTH ANNUAL SUMMER CONFERENCE

June 18-20, 2004

Bob Roll (center) with Peter Osetek (left) and James Partridge (right) at the Saturday evening dinner. Mr. Roll is a Tour de France cyclist who spoke at the summer conference.
Photo courtesy of James Partridge

Four Michigan judges joined Litigation Section Members at the Ninth Annual Summer Conference June 18-20 at Boyne Highlands. The weekend event provided Michigan litigators with numerous opportunities for education, networking and family fun.

An opening networking reception kicked off the program Friday night. On Saturday, Professor Ashley Lipson from the Laverne College of Law presented "Guerilla Discovery and Tactical Evidence." A very dynamic speaker, Professor Lipson offered Section members practical advice and real world analogies. The four judges served as panelists, offering their insight and comment during Lipson's presentation.

Saturday evening, the topic moved from the courtroom to the Tour de France. Guest speaker Bob Roll, a world-renowned professional cyclist, shared his experiences cycling around the world. Earlier in the day, Roll had led some participants on a bike ride along the scenic, serene trails of northern Michigan.

Attendance at this year's event increased 42% over last year and we expect continued growth in 2005.

Unlocking the Gate to Financial Expert Testimony After *Daubert*

by: **Troy Burk**

Introduction

In complex litigation cases, financial experts are routinely hired to provide testimony on a myriad of matters ranging from the establishment of disperate treatment in racial discrimination cases to the quantification of damages in securities fraud cases.[1] Regardless of the type of testimony provided by financial experts, the cardinal goal of district courts is to preclude the introduction of "junk science" into the courtroom. While this appears to be a simple charge, the question of how to evaluate the testimony of these experts was not resolved until the Supreme Court's decision in *Kumho Tire* in 1999.

In *Kumho Tire*, the Supreme Court clarified the scope of *Daubert* and held that the district court's duty to act as a "gatekeeper" extended to the testimony of all experts, including financial experts.[2] The application of the *Daubert* factors to the testimony of financial experts was intended to ensure that the testimony of these experts was both relevant and reliable. The unintended consequence of these two cases has been the emergence of the *Daubert* challenge as a strategic litigation tactic designed to limit the opinions of opposing financial experts. Given this new framework, it is critical that attorneys, and the financial experts hired by them, be cognizant of how recent case developments affect the admissibility of financial expert testimony. A failure to keep apprised of new developments in this area of the law could have deleterious effects for a client whose case hinges on the testimony of a financial expert.

This article is divided into four main sections. The first section briefly discusses the legal framework that shapes the admissibility of testimony by financial experts in federal courts.[3] The second section discusses some key observations gleaned from our review of court opinions from 2003 that have either cited to *Daubert* or to *Kumho Tire*. The third section illuminates two recent court decisions involving the testimony of financial experts. The final section discusses some practical lessons to be learned from the application of the *Daubert* factors to the testimony of financial experts.

I. Understanding the *Daubert* Framework

The federal courts have grappled with the daunting task of how to assess the reliability of testimony offered by experts for centuries.[4] The issue took center stage in the twentieth century with the development of scientific methodologies that produced credible results capable of being tested by other members of the relevant scientific community. Some district courts believed that the increased reliability of scientific methods justified a liberal approach to the evaluation of expert testimony. Other district courts advanced a more prudent approach to the evaluation of expert testimony because of the increasing frequency by which experts were willing to testify on any side of a controversial issue for the correct fee. How these divergent ideologies influenced both policy makers and the courts can be seen in the evolution of the admissibility standards during the twentieth century.

In 1923, the then Court of Appeals for the District of Columbia established the "general acceptance" standard for the evaluation of testimony provided by experts.[5] Under this standard, the courts evaluated the testimony of an expert by determining whether the method used by the expert was generally accepted in the relevant scientific community. Although the standard was rigid in its application, it provided an easy and effective means for district courts to evaluate expert testimony. The standard was criticized by the scientific community, however, for its failure to embrace testimony deemed reliable by a minority of the relevant community. Under the new standard, there did not appear to be a place for novel, reliable methodologies that had not yet been generally accepted by the relevant scientific community.

The general acceptance standard was the dominant standard by which federal courts evaluated the testimony of experts for over 50 years. In 1975, Congress enacted Rule 702 of the Federal Rules of Evidence in 1975. Rule 702 provided: "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 opinion or otherwise."[6] The passage of Rule 702 created conflicting lines of authority in the district courts. Many courts interpreted the passage of Rule 702 to mean that Federal Rule 702 superseded the general acceptance standard, while other courts continued to apply the general acceptance standard to expert testimony.

In its landmark decision, *Daubert v. Merrell Dow Pharmaceutical, Inc.*, the Supreme Court resolved the dispute among the courts and held that the "*Frye* test was superseded by the adoption of the Federal Rules of Evidence."[7] In its stead, the Court opted for a comprehensive test that "relaxed" the fetters of the general acceptance standard and provided for a flexible approach to the evaluation of expert testimony. In *Daubert*, the Court outlined the following four factors for district courts to consider when they evaluated the admissibility of expert testimony:

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1. whether the methodology used by the expert has been tested;
2. whether the methodology used by the expert has been subject to peer review and analysis;
3. whether the methodology has a known rate of error; and
4. whether the methodology is generally accepted in the relevant scientific community.[8]

The *Daubert* court, underscored that the focus of the inquiry by the district court, should be on the principles and methodologies used the expert and provided that the district courts should act as "gatekeepers" to assess the credibility of expert testimony. Under the new flexible standard delineated by the Court, general acceptance in the relevant scientific community was to be considered by a district court, but it was not meant to be dispositive on the issue of admissibility. General acceptance was just one factor among many factors for the district courts to consider. After the *Daubert* decision, the issue arose over whether or not the reach of *Daubert* applied to nonscientific testimony, including the testimony of financial experts.

In *Kumho Tire, Ltd. v. Carmichael*, the Supreme Court resolved this debate and held that the district court's duty to act as a gatekeeper extended to all expert testimony, including testimony put forth by financial experts.[9]

To codify the holding in *Kumho Tire*, Congress revised Rule 702 of the Federal Rules of Evidence in 2000. Rule 702 now provides:

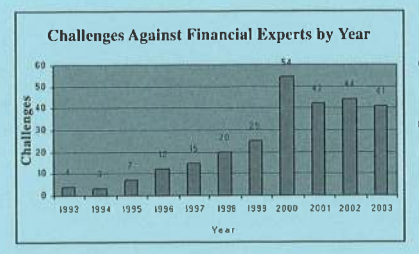
> If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence of to determine a fact in issue, a witness qualified as an expert by knowledge, skill, training, or education may testify thereto in the form of opinion or otherwise, if (1) the testimony is based on sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness applied the principles and methods reliably to the facts of the case.[10]

In the wake of *Daubert*, *Kumho Tire*, and Rule 702, we are left with the following question: does the new standard produce testimony by financial experts that is more reliable than testimony admitted under the old standard? *Frye* left the question of reliability to the scientific community. *Daubert* and its progeny leave the question of reliability to the district courts. Regardless of how members of the legal community interpret the ability of this new standard to ensure the reliability of financial expert testimony, this issue remains ripe for our continued observation.

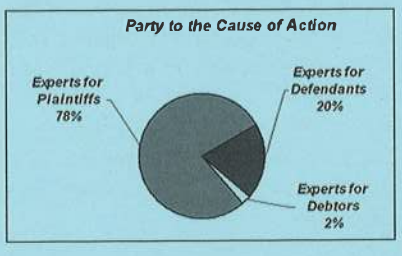
II. A Year in Review: 2003

Using LexisNexis, we reviewed hundreds of federal cases involving the testimony of experts in 2003 that cited either to *Daubert* or to *Kumho Tire*. From this population of cases, we searched for court opinions that discussed the testimony of financial experts. As discussed in our introductory remarks, we defined a financial expert as an expert with a background in accounting, economics, finance, marketing, statistics, or valuation. Based on our search parameters, we identified 41 *Daubert* motions against financial experts in 35 cases during 2003.

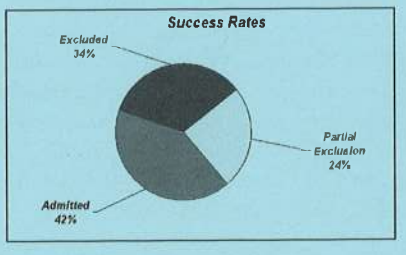
Among our observations for 2003:



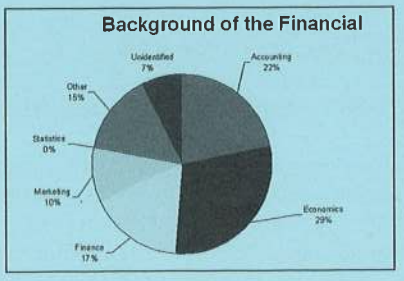
• Challenges against financial experts have increased 164% since the *Kumho Tire* decision in 1999.



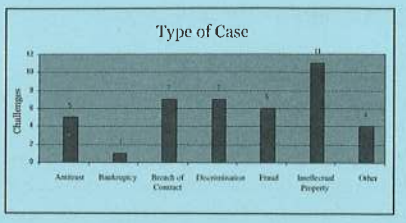
• More challenges against financial experts hired by plaintiffs (78%) occurred than challenges against experts hired by defendants (20%).



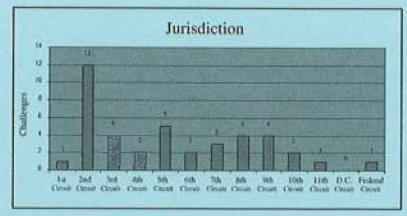
• Challenges against financial experts resulted either in the exclusion or in the partial exclusion of the expert's opinions 59% of the time.



• Challenges against financial experts with a background in economics (43%) occurred more frequently that challenges against experts with backgrounds in other disciplines.



- More challenges against financial experts in intellectual property cases (11), breach of contract (7), and discrimination cases (7) that in other types of cases.



- More challenges against financial experts occured in the Second Circuit with 12 challenges in the jusisdiction that in other jurisdictions.

- In discussions about the reliability of opinions provided by financial experts, the courts primarily focused on the expert's methodology, the expert's incorporation of alternative explanations/hypotheses, and the expert's assumptions used to determine conclusions.

III. Recent *Daubert* and *Kumho Tire* Decisions

Since the *Daubert* decision in 1993, there have been hundreds of cases involving the testimony of financial experts. In 2003, we found two cases that were particularly illustrative of the evaluation of financial expert testimony by the district courts.[11]

A. *Lippe v. Bairnco Corp.*

In January of 2003, the United States District Court for the Southern District of New York excluded the testimony of two valuation experts because the judge could not be persuaded that their testimony was based on a reliable foundation. In *Lippe v. Bairnco Corp.*, the plaintiffs alleged that the defendant engaged in several fraudulent conveyances designed to place assets beyond the reach of asbestos claimants.[12] After reviewing the record, the valuation experts concluded that the defendant did not receive adequate consideration for the value of the transferred assets to a newly created holding company. The defendants moved to exclude the testimony of the two valuation experts on the grounds that their testimony was unreliable and would not assist the jury.

In its opinion, the court found the testimony of the investment banker was unreliable for several reasons. Among those reasons:

- The expert failed to use the discounted cash flow method in his analysis.[13] The court noted that this failure did not provide the expert with a means "to do a 'check' on his determinations."[14]

- With the exception of one business, the expert failed to provide a range of values for the businesses.[15] The court noted that "common sense and the authorities in the area suggest that an opinion as to the value of a business should be expressed as a range of values rather than a single numbers."[16]

- The opinions of the expert were not the product of reliable principles and methods because he was not familiar with the academic literature on business valuations, he did not pay attention to different valuation approaches, and he did not read on a regular basis any publications on the valuation of businesses.[17]

- The expert failed to apply a valuation method that was capable of being tested.[18]

- The expert failed to explain his analysis and decision-making process in the valuation of several businesses.[19]

- The expert failed to provide an explanation not only for the use of a control premium in his analysis, but also for the amount of the control premium.[20]

- The expert's decision to use a control premium in numerous scenarios assumed there existed prospective buyers who were willing to pay it.[21]

- The expert failed to consider variables that could have affected the value of the businesses.[22]

- The conclusions of the expert lacked "sufficient indicia of reliability because of the many errors in his analysis."[23]

In its opinion, the court found the testimony of the finance professor was also unreliable for several reasons. Among those reasons:

- The expert inconsistently applied a control premium in her valuation analysis because she did not use a control premium when calculating the value of the parent company for solvency purposes, but she did use a control premium when calculating the value of the transferred assets.[24]

- The valuations of the transferred businesses did not "make sense" to the court in light of the facts of the case.[25]

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- The expert demonstrated a lack of experience in conducting valuations. The court noted that the expert revealed in deposition testimony that she had never valued a company, that she had never been employed to review the valuation report of another person, that she had never been asked to value a company, that she had never been employed to value a stock interest in a company, and that she had never been employed to do any kind of business valuation.[26]

- The expert relied upon counsel for a list of comparable companies, but she failed to verify the accuracy of the comparable companies provided to her.[27]

- The expert assumed the existence of prospective buyers who were willing to pay a control premium.[28]

- The expert failed to provide an explanation for the use of a control premium in her discounted cash flow analysis of the transferred businesses.[29] The court noted that the application of a control premium in a discounted cash flow analysis is not consistent with accepted methodology in the valuation community.[30]

- The expert's use of a takeover premium in her valuation analysis was inconsistent with the facts of the case.[31]

- The expert appeared to provide biased opinions. The court noted that when the expert reached divergent conclusions in her analysis, she failed to reconcile her valuations and appeared to choose the favorable valuation.[32]

- Without an explanation, the expert assumed a growth rate in her discounted cash flow analysis that was inconsistent with the facts of the case.[33]

- The expert failed to apply generally accepted valuation principles when she "used only a single year's projected cash flow in her DCF analyses" and when she selectively chose earnings figures to value a business.[34]

Based on its analysis of the record, the district court concluded that the opinions of the two experts "are so unreliable—'so unrealistic and contradictory'—as to suggest bad faith or, at a minimum, as to constitute an 'apples and oranges' comparison."[35] The court noted that it was "convinced that (the investment banker) and (the finance professor) had only one goal in mind—to come up with conclusions that would support the plaintiffs' position in the case, and they were determined to get to that point anyway they could."[36] The court granted the defendants' motion to exclude the testimony of the two experts.[37]

B. *In re Imperial Credit Indus. Secs. Litig.*

In February 2003, a district court judge excluded the testimony of a securities analyst who provided testimony regarding damages in a securities fraud class action because he did not perform either an event study or a similar analysis.[38] In *In re Imperial Credit Indus. Secs. Litig.*, the plaintiffs alleged that the defendant's stock price was inflated because of certain undisclosed losses at a subprime mortgage lender in which the defendant possessed an ownership percentage of 47 percent.[39] After the plaintiffs' expert submitted his report, the defendants moved for summary judgment on all of the plaintiffs' claims.

In its opinion, the court found the testimony of the securities analyst was unreliable for several reasons. Among those reasons:

- The expert failed to perform either an event study or a similar analysis to determine damages in a securities fraud action.[40]

- The expert failed "to distinguish between fraud-related and non-fraud related influences" on a company's stock price.[41] The court noted that the expert's failure to perform either an event study or a similar analysis prevented the plaintiffs from arriving at this distinction.[42]

- The expert failed to apply a methodology generally accepted in his field.[43]

- The expert failed to provide authority to support the conclusion that expert's approach was either a reliable methodology or an acceptable replacement/substitute for the event study.[44]

- The expert improperly relied upon excerpts from the testimony developed by another expert for the purposes of a different litigation.[45]

Based on its analysis of the record, the district court concluded that there was not a "legally sufficient evidentiary basis for a reasonable jury to find for the plaintiffs as to the existence of loss causation and damages."[46] The court granted the defendants' motion for summary judgment.[47]

IV. Practical Lessons for the Presentation of Financial Experts

The decision by a judge to exclude the testimony of a financial expert can often have detrimental effects on the ability of a party to plead its case. In many instances, it could mean the opposing party wins on a summary judgment motion. It could also mean

that a party wins a psychological victory with liability being favorably determined for the party but with such a low damages award for the party that the battle seems unworthy of the effort to reach it.

In court opinions, judges often only provide minimal detail about the reasoning behind their decisions. Nevertheless, a review of the rationale provides us with practical lessons on how they evaluate the testimony of financial experts. From our review of hundreds of court decisions, we draw the following suggested practices:

Observation 1

The financial expert should be qualified to provide testimony based on her academic background and professional experience. The financial expert should not provide testimony outside her field of expertise. The financial expert should also have relevant industry experience.

Observation 2

The financial expert should be well versed in the relevant academic literature in his field. The financial expert should also be familiar with the relevant case law applicable to the cause of action in the case, especially in intellectual property disputes, to ensure that his testimony does not contradict legal precedent.

Observation 3

The financial expert should follow generally accepted methodologies and principles in her relevant field to reach her conclusions. The financial expert should adequately disclose any novel theories to the trier of fact. Finally, the financial expert should carefully apply these methodologies and principles to the unique facts and circumstances of the case.

Observation 4

The financial expert should not only consider, but also incorporate alternative explanations and hypotheses into his conclusions. By considering all possibilities, a financial expert can increase his understanding of the facts of the case and overt any implications of bias in his testimony.

Observation 5

The financial expert should adequately disclose all assumptions used to reach her conclusions. Furthermore, the assumptions used by the financial expert should be based on the facts and circumstances of the case.

Observation 6

The financial expert should not have any inconsistencies in his testimony. If the financial expert is going to provide testimony that contradicts previously provided testimony, then the expert should be prepared to provide a logical reason for the discrepancy in his testimony. Often the change of testimony is a result of on-going discovery. It can also be understood in the context of the case nuances.

Observation 7

The financial expert should interview interested parties with the intent of learning objective facts of the case. Questions drafted with the intent of eliciting bias and favorable results can compromise the objectivity of the financial expert's testimony.

Observation 8

When a financial expert opines on damages, the financial expert should consider the possibility of mitigation, the variability of operational expenses with varying sales projections, and the risk of the company in her calculation of the applicable discount rate. The financial expert should also choose a damages period that is consistent with the facts of the case. The financial expert should independently verify sales projections prepared by a party and compare those projections either to similarly situated businesses or to industry averages. Finally, the financial expert should attempt to attribute different damages to each cause of action, and to be careful to assure that the method used to measure damages conforms to case law.

Observation 9

When a financial expert opines on liability, the financial expert should consider all relevant variables in his analysis. The financial expert should be prepared to disclose whether his regression analysis is statistically significant (i.e., a known rate of error) and whether there was any bias in the selection of his sample.

Observation 10

The financial expert should not express a legal opinion. The financial expert should refrain from trying to prove/disprove the evidence in the case.

Observation 11

The financial expert should subject her analyses and conclusions to peer review. The financial expert can have this service performed by someone in her firm. Peer review is beneficial because it routinely reveals mathematical errors, inconsistent testimony, and analytical weaknesses.

Observation 12

The financial expert should test both his methodology and his conclusions for reasonableness, including an evaluation of the assumptions and hypotheses that he used in his analysis.

Observation 13

The financial expert should endeavor to be familiar with the relevant facts and circumstances of the case. The performance of work by the financial expert's team does not relieve her from the

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duty to understand the facts of the case. The financial expert should base her conclusions on sufficient data.

Observation 14

Finally, the financial expert should apply the same intellectual rigor and standard of care in reaching his conclusions as he would in a non-litigation situation.

Conclusions

Daubert and *Kumho Tire* now guide district courts in the evaluation of testimony by financial experts. These two cases strongly reinforce the notion that district courts serve as gatekeepers to ensure that junk science does not enter into the courtroom. As financial experts prepare to assist their clients, they should not only be aware of the *Daubert* factors, but also speak its language in their opinions.

Endnotes

1. For purposes of this article, we define a financial expert as an expert with a background in accounting, economics, finance, marketing, statistics, and valuation.
2. *Kumho Tire, Ltd. v. Carmichael*, 526 U.S. 137 (1999).
3. The scope of our research is limited to the laws and rules applicable to the testimony of financial experts in the federal courts. *Daubert*, *Kumho Tire*, and Rule 702 are federal authority that is not binding authority in the state courts.
4. See Learned Hand, *Historical and Practical Considerations Regarding Expert Testimony*, 15 HARV. L. REV. 40, 42 (1901).
5. *Frye v. United States*, 293 F. 1013 (D.C. Cir. 1923).
6. *Federal Rules of Evidence*, 2000-2001 Edition, St. Paul: West Group, 2000, p. 112.
7. *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993).
8. *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993).
9. *Kumho Tire, Ltd. v. Carmichael*, 526 U.S. 137 (1999).
10. *Federal Rules of Evidence*, 2000-2001 Edition, St. Paul: West Group, 2000, p. 113.
11. BDO Seidman, LLPis not rendering legal, accounting, tax, or other professional advice through the two case reviews presented in this section. Our discussion of these cases is only provided for informational purposes to our readers. Readers should form their own professional judgment regarding these cases based upon research and investigation conducted independent of this article.
12. *Lippe v. Bairnco Corp.*, 288 B.R. 678 (S.D.N.Y. 2003).
13. *Lippe* at 689.
14. *Lippe* at 689.
15. *Lippe* at 690.
16. *Lippe* at 690.
17. *Lippe* at 690.
18. *Lippe* at 691.
19. *Lippe* at 691.
20. *Lippe* at 691.
21. *Lippe* at 693.
22. *Lippe* at 693.
23. *Lippe* at 694.
24. *Lippe* at 694.
25. *Lippe* at 695.
26. *Lippe* at 696-97
27. *Lippe* at 697.
28. *Lippe* at 698.
29. *Lippe* at 698.
30. *Lippe* at 698.
31. *Lippe* at 698-99.
32. *Lippe* at 699.
33. *Lippe* at 700.
34. *Lippe* at 700.
35. *Lippe* at 701.
36. *Lippe* at 701.
37. *Lippe* at 701.
38. The case also involved the testimony of an accountant who opined on the existence of material misrepresentations in the financial statements of the defendant. The testimony of the accountant was excluded on *Daubert* grounds because the expert relied "upon excerpts from opinions developed by another expert for the purposes of litigation."
39. *In re Imperial Credit Indus. Secs. Litig.*, 252 F. Supp. 2d 1005 (C.D. Cal. 2003).
40. *In re Imperial Credit Indus. Secs. Litig.* at 1014.
41. *In re Imperial Credit Indus. Secs. Litig.* at 1015.
42. *In re Imperial Credit Indus. Secs. Litig.* at 1015.
43. *In re Imperial Credit Indus. Secs. Litig.* at 1016.
44. *In re Imperial Credit Indus. Secs. Litig.* at 1016.
45. *In re Imperial Credit Indus. Secs. Litig.* at 1016.
46. *In re Imperial Credit Indus. Secs. Litig.* at 1014.
47. *In re Imperial Credit Indus. Secs. Litig.* at 1017.

Brainstorming Ways to Win Corporate Litigation: 101 Strategies (Part II – Strategies 21-40)

by: *Irving B. Levinson*
Principal, BDO Seidman, LLP

Corporate America faces serious issues when it either brings or defends a lawsuit. Lay juries, and even judges, may be biased and antagonistic towards the style, mode and practice by which corporations make and execute their business decisions. The culture, environment and jargon of American businesses are, in large part, foreign to juries and judges. Corporate America faces even greater hostility in the present post-Enron environment. The obstacles faced by businesses litigating their disputes, are not, however, insurmountable.

The first article of this five part series focused on overall strategies for overcoming the anti-business bias of jurors. Winning trial themes for America's businesses were discussed, as well as strategies for developing persuasive technical cases that work with lay juries. This segment focuses on ways to avoid having to litigate company problems in the first instance as well as ways to position pre-litigation disputes for favorable litigation rulings. Finally, this segment addresses how to begin developing a focused winning approach in the very first days and weeks of being confronted with litigation.

THE CHALLENGE ATTEMPTING TO PREVENT THE CORPORATE LITIGATION DISASTER IN THE FIRST INSTANCE

Corporate litigation does not just inevitably spring into existence one day and continue persistently for the next three to seven years. The corporate business environment, which leads to expensive and disruptive lawsuits, can sometimes be managed to avoid the war before it begins. Companies can avoid disastrous jury verdicts by proactively taking steps to avoid litigation in the first instance.

STRATEGIES:

21. Corporate legal "wellness programs" can increase your chances of avoiding lawsuits with huge punitive damages. The corporate "case from hell" can be headed off by inside and outside counsel who practice preventative law approaches to avoiding and resolving disputes. The very best litigation approach is one that anticipates problems and systematically develops strategies to avoid or resolve disputes before they ripen into lawsuits.

22. Corporate counsel should conduct a comprehensive review of areas that could pose problems and give rise to litigation. Potentially perilous business arenas that frequently give rise to difficult litigation issues include: labor and employment law, product liability, antitrust, patent and intellectual property, environmental issues and major corporate business transactions. Additionally, of special note, in this post-Enron era are corporate compliance issues and business, financial and accounting integrity issues. Every company should be persistently seeking ways to prevent and/or detect corporate fraud.

23. After identifying areas that may lead to significant exposure, review existing practices and policies in those areas. Develop and implement new procedures to prevent the catastrophic lawsuit. Inside counsel, outside counsel, business managers and executives should all provide input to this process of reviewing and changing company policies and practices.

24. Periodically conduct a detailed review of forms and contracts that are commonly used by your company. Careful analysis and improvements in the company's documentation procedures can help prevent business lawsuits. If lawsuits do occur, contractual language that is clear, straightforward and favorable to the company will someday impress, rather than turn-off lay jurors. Huge damages may be avoided by a simple paragraph or two of revised contractual language that addresses damages and liability issues.

25. Do not enter into significant business transactions without involving either inside and/or outside counsel whose objective is, at least in part, to

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Brainstorming Ways to Win Corporate Litigation ...

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minimize the potential for disastrous litigation. Due diligence is more than just exercising careful business judgment; it is also identifying and avoiding the transaction that will result in disastrous litigation. Someone has to be in a position to say "no," or at least to provide clear warning, when the legal risks of a business transaction outweigh its financial rewards.

26. Obtain validity and infringement opinions from experienced outside patent counsel before making any decisions regarding new product development and product release. Rely on opinions of patent counsel to help prevent the likelihood of treble damages regarding claims of willful infringement.

27. Follow outside counsel's views on advertising product instructions and product warnings to help protect your company against punitive damages claims for negligent or reckless misconduct.

28. Obtain outside counsel's input on your company's employment policies and practices. Create an active "wellness program" that is employee-friendly to help prevent future discrimination and sexual harassment claims that may later be brought against your company. "Restructuring" or "downsizing" must include an assessment of legal risks and careful attention to complying with good legal and human resource practices.

29. A company will quite often rise, or fall precipitously on the integrity and reliability of its financial and accounting systems. It is no longer sufficient to rely completely on your outside accounting firm. Active audit committees, involved in-house counsel compliance strategies, and prominent employee whistle-blowing programs will help head-off catastrophic claims of corporate fraud.

THE CHALLENGE: POSITIONING YOUR PRE-LITIGATION DISPUTE FOR A SUCCESSFUL LITIGATION OUTCOME ONCE IT RIPENS INTO A LAWSUIT

30. Before a case is filed, inside counsel is in a position to powerfully shape the evidence that will be presented in the case. The correspondence that passes between opposing parties prior to litigation is very often critical to the ultimate outcome of a case. This correspondence should be crafted in a manner that will ultimately be user-friendly to jurors who may review it. Correspondence written in a formalistic, legalistic or overly "corporate" tone should be rewritten and made simpler, more direct and more personal. Try "Joe" we are really disappointed ...", instead of "Mr. McConnell, you are hereby advised ..."

31. Lawsuits alleging corporate fraud are usually preceded by allegations of wrongdoing. In the corporate fraud area, aggressive and independent investigation of all fraud allegations is a must, to managing the potentially disastrous results of a lawsuit challenging integrity of the company's financial and accounting systems. The investigation should include outside counsel and accountants who are independent of their company's regular outside auditors.

THE CHALLENGE: WINNING CORPORATE LITIGATION FROM DAY ONE

STRATEGIES:

32. Strategy decisions made in the first 10 days of corporate litigation may determine whether a company wins or loses its business litigation. Therefore, from the very first moment that litigation is expected, inside counsel should begin bringing together a cohesive and motivated case team to formulate and carry out a strategic plan for achieving victory.

33. The case team should consist of inside counsel, outside counsel, and company management who are all absolutely committed to obtaining a favorable settlement or a courtroom victory. Where accounting issues are involved, independent accountants should be brought to the team in an early point in the litigation. Without an energized team committed to winning, the corporate litigant is bound to lose to a more spirited, determined opponent.

34. Inside counsel, as leader of the team, must initially play the most active role in formulating and executing case strategies. Inside counsel will take the lead in bringing together the case team and in setting the course for the critical first weeks of litigation. Knowing the business and being onsite with management, inside counsel is in a better position than outside counsel to conduct early dispute management and to begin factual investigation of the dispute.

35. Enlisting the total and steadfast support of your business people to the case team is critical to winning litigation that may be long, difficult, expensive and stressful. Both inside and outside counsel should involve and motivate executives by meeting with them and reporting to them early and often on the status of new findings and progress made. While business executives may be reluctant to become involved in yesterday's issues that are the subject of lawsuits, their support in the litigation is critical. The old corporate practice of giving "heads up" warnings is especially relevant in the fast-changing environment of complex business litigation.

36. Make inside and outside paralegals active case team members from the early days of the lawsuit. Often overlooked as members of the team, paralegal assistants play critical roles in complex litigation in helping conduct detailed factual investigations and in marshaling and organizing evidence that is necessary to win corporate litigation.

37. Aggressive investigation of the case should begin on day one of the lawsuit, and earlier whenever possible. Conduct early interviews of key employees and ex-employees, especially where their future cooperation is uncertain. Consider obtaining affidavits or statements from key, favorable witnesses regarding the facts of the case. Utilize the internet as the incredible compendium of information on almost all subjects. Develop a plan for optimizing the likelihood that your investigation will be protected by the attorney client privilege and work product immunity doctrine.

38. Assess your case, and its strengths and weaknesses as completely as possible – even in its very early stages. Settlement, mediation or arbitration alternatives to lawsuits may present themselves before the litigation positions mature and harden. An early, realistic assessment of exposure is critical to enhancing intelligent settlement decisions.

39. An important early step is the preparation of a case plan and budget. The litigation plan should be a blueprint for the continuing case investigation, motion practice strategy and case themes. The most important work product in three years of extensive pre-trial preparation may be the succinct five-page memo that clearly summarizes the other side's claims and the thematic defenses that will win the case.

40. Even in the early stages, attention should be given to identification and selection of expert witnesses. Corporate litigation will often hinge on technical, financial, accounting, and/or scientific issues. Early selection of case experts will help counsel frame technical issues, begin intelligent discovery on these issues and permit parties to realistically assess the case for early settlement. The common practice of waiting until fact discovery is nearly closed to retain experts is a recipe for disaster, forcing key factual positions and strategic decisions to be forged without the valuable assistance of expert witnesses.

Conclusion

While trial lawyers rightfully spend a great deal of time and energy worrying about the last 90 days before trial, careful planning before a lawsuit is even filed may prove successful in eliminating years of lawsuit distraction and expense. Large companies, in particular, need to harness their great bureaucracies, and focus attention on avoiding or winning corporate litigation.

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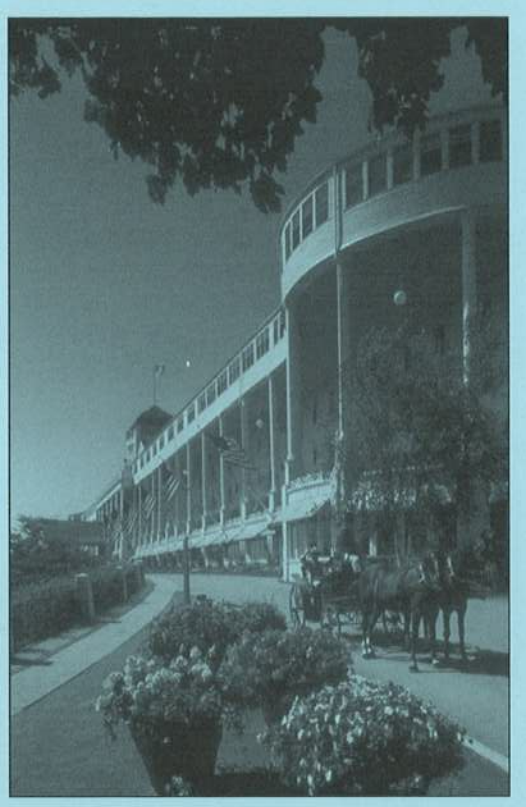

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