Tips from the Experts: Working Effectively With a Financial Expert Witness

by Susan M. Mangiero

Commercial legal actions are often complex with potentially large dollar payoffs. Recent headlines suggest that the trend will continue. Some prospective litigants see investment risk woes as a business development bonanza, with billions of dollars at stake. Law firms and litigation support firms are creating special teams to address the areas of sub-prime write-downs, option backdating, risk controls, pricing and adequacy of disclosures. As a result, many litigators are ramping up their knowledge of arcane topics such as derivatives, valuation models, trading leverage and risk metrics. Close quarters, binding deadlines, massive amounts of documents, and the undue pressure of high visibility cases can consume even the most experienced practitioner. Add a financial expert to the mix and things can unravel quickly in the absence of ground rules and managed expectations. The role of a financial expert witness is to render analytical clarity, and that goal is best achieved when the expert and attorney work together effectively.

Billable Time and Data Costs

If men are from Mars and women are from Venus, attorneys are from Mercury and experts are from Neptune. Known for quick thinking and speed, "Mercurians" seek to keep clocked time to a necessary minimum. While an expert should always be mindful of not overcharging, differences of opinion about what must be done are common. At the beginning, an attorney typically provides a verbal case overview and a copy of the complaint. Once hired, an expert unearths relevant and often material facts as she is given new documents. This results in more billable time. Like Neptune, god of the sea, good experts create tempests if asked to do a second-rate job by scaling back on work they deem essential. Three things can occur, none of which are good. An expert may withdraw from an assignment if she believes that her adherence to best work practices are being compromised. An expert may complete work but feel resentful about not being paid for a job well done. Some may take shortcuts.

To avoid problems, attorneys and experts should share project budget information at the outset. Scarce resources do not necessarily preclude the use of a qualified expert. To the contrary, a professional may be able to render a limited analysis as long as he identifies the report accordingly and makes the appropriate disclaimers with the opinion.[1] For example, in lieu of providing a full-blown opinion of value, an analysis of risk factors that drive worth may suffice. Alternatively, it may not always be necessary to examine hedges for a large portfolio if it can be shown that risk controls failed on even a few occasions.

Data is another budgetary consideration when hiring an expert to assist with business litigations. Most commercial disputes require accounting or financial numbers, sometimes going back many years. The expert should inform the attorney about likely costs and availability. When historical price or fee information is rare or hard to obtain in a user-friendly format, the expert needs extra time to properly assemble a dataset. An expert's request to be paid up front to acquire numbers is not unusual, with some datasets costing thousands of dollars. If confidentiality and easy access to technical support are important factors, direct subscription in the name of the expert is the way to go.

Business data varies by vendor, packaging and quality. To illustrate, consider financial futures price data. A 90-day constant maturity contract is not the same instrument as the traded spot contract that gets closer to expiration with each passing day. Beta, a measure of a stock's volatility vis-à-vis a general index like the S&P 500, can be reported on a levered or unlevered basis. Unless one is familiar with how a particular supplier does its calculations, trouble is sure to follow, especially with multiple step analyses.[2]

A good financial expert will be able to identify relevant information sources, know how to handle data "idiosyncrasies" and understand how bad inputs can distort computational outputs. In a similar fashion, a financial expert should be relatively familiar with canned software choices and know when and how a particular analytics program or model is likely to influence a result. Even when *Daubert* factors do not directly apply, a financial expert should be able to

guide a thorough discussion about ease of use, ability to replicate numbers and acceptance by academic and industry peers.

Clear Communication

Some attorneys favor experts who carefully listen. Others want fearless analysts who ask the right questions. A majority enjoy individuals who can explain difficult concepts without the use of jargon or overly technical language. Clear communication goes a long way to making everyone's life easier. Anything can be restated in common terms or illustrated in a manner that puts laymen at ease. Writing well and speaking persuasively are "must have" skills for any expert, but arguably more crucial for complex financial litigation. Imagine trying to explain funding status to a jury of part-time or unemployed workers who do not have a pension plan. Discuss regression or Monte Carlo simulation as a rocket scientist and wait for the inevitable request to speak plainly.

Clever use of visuals is another preferred tool for clear communication. With complex financial cases, a timeline is an invaluable tool. Even when oft-used methods are relied upon (such as an event study to determine "but for" impact on stock price), a simple graph, tied to date of occurrence, speaks volumes. That said, graphs and statistical tabulations vary by quality and purpose. A savvy analyst should be familiar with how information can be effectively or deceptively presented. For example, volatility may appear dire when asset prices are reported for a particularly turbulent calendar interval that is far from representative of "average" performance.

Meaningful conversation is a two-way responsibility. Attorney and expert must each understand what the other is saying, acknowledging that attorneys are seldom comfortable with the intricacies of investing, valuation or risk mitigation techniques. The use of a few buzz words by the attorney might convey a false impression of financial literacy that tempts an expert to launch into an overly technical discussion of the issues in the case. The converse is true as well. Experts frequently benefit when an attorney takes the time to provide an overview of basic legal concepts. For example, concepts such as investment suitability or prudence vary by venue or type of organization. A primer on legal viability can assist an expert in identifying what economic characteristics or elements of the process to emphasize. Egos checked at the door make for a smooth communication channel in both directions. Feigning comprehension does no party any good. "Give me the 101 version" is an apt mantra if doing otherwise adds to billable hours, or corrupts the process by introducing more confusion and prevents resolution of the dispute.

When citing academic studies or explaining statistical techniques, experts should refrain from automatically assuming that the work is known, understood or legitimate. If research is considered leading edge or dominates a field, the expert should say so and explain why. If some dispute the underlying assumptions, methodology or conclusions, elaborate rather than inviting a successful rebuttal.

Conclusion

The use of a financial expert or team of experts is more a necessity than a luxury in cases involving complex securities or transactions. Managing expectations and understanding budgetary and time constraints contribute to a smooth process. When litigations stretch into months or even years, attorneys must keep experts apprised as their schedules fill with other projects during interim lulls. Many financial experts enjoy the intellectual stimulation of working on multi-faceted cases. At a time of unprecedented and large-scale courtroom encounters, attorneys and financial experts must learn to work together effectively as they will likely be spending a lot of time together.

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[1] Some certification standards expressly prohibit limited analyses.

[2] Bad beta numbers beget imprecise cost of capital numbers which in turn result in economic damages that are either too low or too high.