

LITIGATION SERVICES HANDBOOK

The Role of the Financial Expert

FIFTH EDITION

Edited by
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Daniel G. Lentz
David P. Hoffman



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PREFACE

Ben Franklin wrote in a letter to Jean-Baptiste Leroy (November 13, 1789), “Our new Constitution is now established, and has an appearance that promises permanency; but in this world *nothing can be said to be certain, except death and taxes.*” What he could not know in the early years of our Republic was that a third certainty would annex itself to the American business experience. Litigation has become as much an inevitability for the American corporation as death and taxes were deemed in the human experience by Mr. Franklin.

Consequently, the litigation services practice remains a growth business for financial experts as the complexity and global nature of business disputes continues to expand. The *Litigation Services Handbook* has for more than 20 years, through four previous editions, offered a comprehensive guide for economists, accountants, and litigators involved with the analytic and damages issues in commercial litigation. It has enjoyed critical success as its revised editions served to guide readers and practitioners in the litigation services industry.

This fifth edition of the *Litigation Services Handbook* has a number of changes from previous editions. For the first time since its original publication, professionals from Ernst & Young LLP’s Fraud Investigation and Dispute Services practice have assumed leading editorial responsibility for the selection of material for inclusion. Our team, working closely with Roman Weil, Debbie Asakawa, and many of the authors of chapters included in previous editions, undertook to freshly evaluate the content of the handbook. We have worked to improve the structure and organization of parts of the previous edition, to bring new content and a fresh look at existing content to this edition, and to retain the highest-quality work from predecessor authors and editions. The *Litigation Services Handbook* has become what it is today because of the leadership and strong contributions of many, including those of Peter Frank and Michael Wagner, who together with Roman Weil originally conceived of and brought into being the previous editions. And for this, all readers should be grateful, as are we.

This edition includes several new chapters, incorporates a fresh look at some existing chapters by new authors, and carries forward some existing chapters that have been refreshed by the original authors to assure inclusion of the most current and relevant information on each topic. Each of the 39 chapters in the fifth edition has authors—accountants, economists, academics, and litigators—expert in their fields. Together, these chapters explain the financial theory behind the demonstrated practical application and clarify the relevant case law and statutes.

Organization and Writing. This edition comprises seven sections, each addressing a different practice area or set of functional tools.

Part I, *The Litigation Environment* (2 chapters), discusses the civil court system, principles and techniques of alternative dispute resolution, and how CPAs and economists function in the litigation environment.

Part II, *Developing a Damages Analysis* (11 chapters), addresses the components of damages calculations with a new chapter discussing damages theory and

modeling, as well as new versions of the chapters on causation, estimating cost of capital, business valuation, business interruption claims, and lost earnings of individuals.

Part III, *Litigation Tools and Techniques* (1 chapter), explains data management in regulatory and litigation environments with an entirely revised chapter incorporating the latest information from a rapidly changing subject area.

Part IV, *Ancillary Issues in Damages Matters* (3 chapters), a new section, collects revised and updated discussions of prejudgment interest, punitive damages, and tax treatment of damages—all issues that are ancillary to the underlying damages claims and litigation.

Part V, *Civil Litigation* (18 chapters), addresses specific types of commercial cases, categorized into five subsections:

1. *Intellectual Property* (3 chapters) discusses the complexities of this vexing area of litigation, and describes the process of conducting royalty audits.
2. *Ownership and Business Failure* (3 chapters) guides practitioners in how financial experts contribute to matters involving growth and decline or failure of businesses.
3. *Regulatory Litigation* (4 chapters) deals with a variety of matters that derive from the operation of regulations.
4. *Construction and Real Property Disputes* (2 chapters) provides insights on litigation dealing with property issues.
5. *Other Civil Litigation* (6 chapters, including new discussions of executive compensation, wage and hour litigation, fiduciary duty and directors' and officers' disputes, and failed bank disputes) addresses, among others, emerging or newly prominent areas of civil litigation in which practitioners are increasingly called upon to help.

Part VI, *Criminal Matters and Investigations* (3 chapters), helps practitioners understand the unique issues and skill sets required to serve as an expert in the investigations environment.

Part VII, *Family Law* (1 chapter), summarizes the extensive treatment afforded the topic in previous editions to give readers broad-based but more generally applicable insight into this common area of litigation.

Note on Writing Style. Many chapters contain a variety of statements of the form, "The expert will measure cash flows and discount them to present value." Often, the authors originally wrote, and meant, "The expert will usually measure cash flows and then, typically, discount them to present value."

Rather than qualify every positive or absolute statement with "typically" or "usually" or "generally," we have omitted those qualifiers. The reader should understand that unless the statement says something like, "always do X," the writer intended to qualify the statement with "typically" or "generally" or the like, not to assert a prescriptive formula. As a result of this style simplification, we think the reader more easily will comprehend the message.

Relation between Authors and Editors. We acknowledge the cooperation and patience that our contributing authors have shown. We do not agree with everything they say and sometimes so indicate in the notes. We prefer to have experts give their own opinions, even when controversial, rather than less specific guidance—like bland committee reports—on which we can all agree. Note to litigators cross-examining us: just because the author of the chapter said it doesn't mean we agree with it.

Acknowledgments. We thank Debbie Asakawa for her work in managing, editing, and adding consistency and clarity to the manuscript, and for her assistance in encouraging authors, in addition to the other tasks that helped bring the book to fruition. We acknowledge the diligent work of our liaisons at John Wiley & Sons: John DeRemigis, Jennifer MacDonald, Kimberly Monroe-Hill, and Natasha Andrews-Noel.

We invite readers and practitioners to submit proposals for chapters to include in the *Litigation Services Handbook's* annual cumulative supplements. Contact Dan Lentz at Daniel.Lentz@ey.com for more information.

Roman L. Weil

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ABOUT THE EDITORS

Roman L. Weil, PhD, CMA, CPA, CFA, is an emeritus faculty member of the Chicago Booth School of Business, retired after 45 years on the faculty there. He is currently visiting professor at the Stern School of Business at NYU and program fellow at Stanford Law School. He is a member of the Standing Advisory Group of the Public Company Accounting Oversight Board.

Professor Weil studies financial literacy and corporate governance. His preliminary work suggested, correctly it turned out, that corporate board audit committee members have surprisingly weak financial literacy and that the gains in shareholder wealth accompanying improvement in such financial literacy are both significant and large. He is now recognized as an expert in financial illiteracy.

His approach to teaching emphasizes fundamental understanding of the building blocks in accounting (asset, liability, revenue, and expense) that will enable students to continue learning and understanding as the world of business transactions changes over time. "In 20 years, they'll have to understand new transactions, which haven't been conceived yet, and the accounting for them."

Professor Weil codirects the Chicago/Stanford/Tuck Directors' Consortium, which he cofounded. Weil has designed and implemented continuing education programs for partners at the accounting firms of Arthur Andersen and PricewaterhouseCoopers as well as for employees at Goldman Sachs, Montgomery Ward, Merck, and William Blair and for business executives in Great Britain, Hong Kong, and Singapore. Recently, he has been visiting professor at Harvard Law School, Princeton Economics Department, Carnegie Mellon Tepper School, and the Cox School at Southern Methodist University.

Professor Weil has been a CPA in Illinois since 1973 and a CMA from 1974 until his retirement from Chicago Booth in 2008. The coauthor of more than 12 textbooks, Weil has published more than 100 articles in academic and professional journals and has served as the principal investigator on various research projects of the National Science Foundation. He has served as editor or associate editor of the *Accounting Review*, *Communications of the Association for Computing Machinery*, *Management Science*, the *Journal of Accounting and Economics*, and the *Financial Analysts Journal*.

He has consulted to governmental agencies, including the U.S. Treasury Department and the Securities and Exchange Commission.

Professor Weil has served on the Securities and Exchange Commission Advisory Committee on Replacement Cost Accounting. At the Financial Accounting Standards Board, he has served on two task forces—one on consolidations and the other on interest methods—and on the Financial Accounting Standards Advisory Council.

He received a bachelor's degree in economics and mathematics from Yale University, then a master's degree in industrial administration and a PhD in economics in 1966 from GSIA/Tepper of Carnegie Mellon University.

Outside of academia, Professor Weil is a grandfather of eight; his interests include sabermetrics, oenometrics, and oenonomy.

Daniel G. Lentz, CPA, CFE, MBA, is the Americas leader of the Dispute Services team within Ernst & Young's Fraud Investigation and Dispute Services practice. Mr. Lentz majored in business and economics and earned a bachelor of business administration degree, summa cum laude, from Roanoke College in 1983. He earned an MBA, majoring in finance, from Loyola College in Baltimore in 1992. Prior to his current role, he served as the leader of both Ernst & Young's Government Contracts and its Insurance Claims teams, in the latter of which he continues to play a significant role.

Mr. Lentz has been an author of a number of articles and a contributor to books addressing a variety of topics ranging from fraud investigation to insurance recovery. He is an author of *The Business Interruption Book: Coverage, Claims, and Recovery*, published in 2004 by the National Underwriter Company, and its second edition, published in 2011. His principal areas of focus include insurance claims, insolvency matters, and computation of commercial damages. He has testified numerous times in his career, both in deposition and in trial, and he has served many times as an independent arbitrator or as an expert representing one of the parties in arbitration proceedings.

Mr. Lentz's professional experience of nearly 30 years encompasses government contract matters; business interruption and lost profits claims; product liability litigation; merger and acquisition disputes; reinsurance disputes; broker and agency disputes; contract disputes and other insurance-related litigation matters; fraud investigations; solvency analysis; class action lawsuits; and surety bond claims. Mr. Lentz's work has involved companies in most major U.S. industries, including manufacturing, agriculture, oil and gas, pharmaceuticals, financial services, real estate and construction, hospitality and tourism, insurance, mining, retail, government contracting, entertainment, and transportation.

Mr. Lentz has served on the Litigation Services Committee of the Maryland Association of CPAs, and is a member of the American Institute of Certified Public Accountants, the Association of Certified Fraud Examiners, and the Association of Insolvency and Restructuring Accountants. He is an associate member of the ABA, and its Tort and Insurance Practice and Litigation sections. Mr. Lentz is married to Deanna Lentz and has two children, Katherine and Kevin. He lives in Laurel, Maryland.

David P. Hoffman, CPA, CFF, CFE, is a partner in the Fraud Investigation and Dispute Services practice in Ernst & Young's Atlanta office. He provides business and financial advice to attorneys, lenders, companies, and individuals throughout the investigation, litigation, and commercial dispute process.

Mr. Hoffman has conducted numerous forensic accounting investigations in situations involving allegations of misstated financial statements, accounting malpractice, government investigations, bank fraud, employee theft, fraudulent or illegal business activities, and disputes between buyers and sellers of companies. During the course of these investigations, he has assisted companies in restating financial results, interviewed witnesses, traced misappropriated funds, retrieved hidden or deleted electronic evidence maintained on computers, facilitated client responses to subpoenas, and uncovered misstated accounting records and financial statements. Mr. Hoffman has 21 years of experience tracing and understanding complex business transactions, starting with underlying source

documents through various accounting journals and ledgers and ultimately to financial statement presentation. He has assisted clients and their counsel in preparing claims or reports for submission to insurance companies and to law enforcement agencies. Many of his forensic accounting engagements have related to civil claims of accounting malpractice and SEC investigations. He has assisted boards of directors, audit committees, special committees, and counsel in the investigation of accounting irregularities and allegations of financial statement manipulation.

Mr. Hoffman has served as a consulting and testifying expert in a variety of commercial litigation matters, including construction disputes, allegations of corruption, alleged tax fraud, post-acquisition disputes, shareholder class action, business interruption, breach of contract, and other types of commercial litigation. He has provided expert witness testimony in state and federal court on the topics of lost profits, damages, accounting issues, and financial statement disclosure. He has assisted counsel and their clients in the conduct of internal investigations of accounting practices in a variety of industries and situations.

Mr. Hoffman has participated in audit and review engagements for clients in the construction, real estate, and financial institution industries. He has provided pre-loan and acquisition due diligence services to lenders and companies and has provided consulting services to lawyers, lenders, and companies in bankruptcy and troubled loan situations. Mr. Hoffman's consulting services have involved numerous industries including construction, banking, carpet manufacturing, production and retail sale of oil, gas, and other chemical products, car dealerships, convenience stores, plastic injection molding, textile trading, and real estate development. He received a BA in accounting from Louisiana State University and is a diplomat of the American Board of Forensic Accounting.

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