

THE CANADIAN INSTITUTE

IN-HOUSE COUNSEL CONGRESS

THE SUTTON PLACE HOTEL, TORONTO, ONTARIO

NOVEMBER 23 AND 24, 2006

THE FINANCIAL EXPERT'S ROLE IN THE LITIGATION PROCESS

presented by

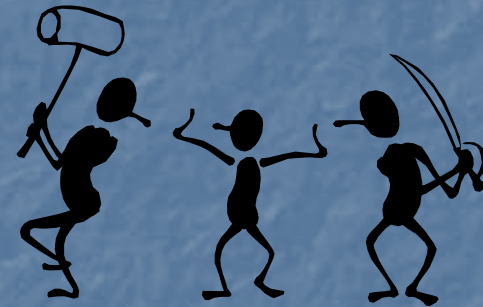
Richard M. Wise
Managing Partner

Dominic Jaar
In-House Counsel, Commercial Litigation



TYPES OF DISPUTES INVOLVING FINANCIAL ISSUES

- ✚ Economic damages — Lost profits; impaired earning capacity; loss of value; loss of goodwill
- ✚ IP infringement damages
- ✚ Breach of contract
- ✚ Tort
- ✚ Taxation and capital gains
- ✚ Transfer pricing
- ✚ Minority shareholder dissent and oppression remedies



TYPES OF DISPUTES INVOLVING FINANCIAL ISSUES (CONT'D)

- ✚ Partner/shareholder disputes
- ✚ Insurance claims — Business interruption and disturbance
- ✚ Expropriation of business or property
- ✚ Professional malpractice suits
- ✚ Personal injury claims: adverse effect on business
- ✚ Trespass and conversion



TYPES OF FINANCIAL LITIGATION-SUPPORT SERVICES

- Interpretation and analysis of financial data
- Investigative and forensic accounting
- Fraud auditing
- Forensic accounting
- Financial analysis



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TYPES OF FINANCIAL LITIGATION-SUPPORT SERVICES (CONT'D)

- Solvency analysis
- Business and securities valuation
- Tax litigation: Quantification of benefits, capital gains, etc.
- Transfer pricing



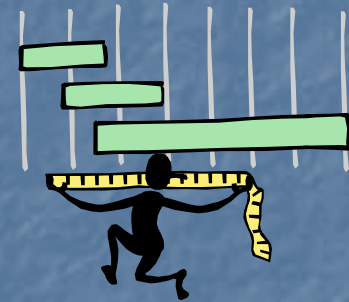
TYPES OF FINANCIAL LITIGATION-SUPPORT SERVICES (CONT'D)

Quantification of:

- Economic damages/lost profits/loss of goodwill/IP infringement damages
- Business disturbance
- Impaired earning capacity

Determination of:

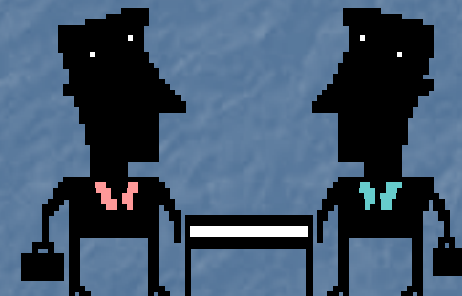
- Financial viability of an enterprise
- Business executive's financial capacity to pay in divorce litigation



TYPES OF FINANCIAL LITIGATION-SUPPORT SERVICES (CONT'D)

■ Interpretation of relevant clauses in agreements:

- Buy/sell clauses
- Price escalation clauses
- Price-adjustment clauses
- Earn-outs
- Non-competition covenants



SERVICES OF EXPERT CAN INCLUDE

- # Proof of business facts
- # Assessing financial issues involved
- # Assisting with discovery
- # Reviewing opposing expert's report
- # Conducting informative site visit and management interview
- # Preparing thorough and convincing report and testimony



SERVICES OF EXPERT CAN INCLUDE

(CONT'D)

- ✚ Assisting lawyer in opposing expert's deposition
- ✚ Assisting lawyer by formulating questions for cross-examination of opposing expert
- ✚ Providing rebuttal testimony
- ✚ Reviewing post-trial briefs regarding financial or valuation issues
- ✚ Assessing prospects for appeal



PRE-ENGAGEMENT CONSIDERATIONS

SELECTION OF VALUATOR

- # Qualifications
- # Potential conflicts
- # Experience in subject area
- # Importance of previous testimony



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PRE-ENGAGEMENT CONSIDERATIONS

FEES

- Basis of time charges and disbursements
- Valuation opinion/report
- Attendance at meetings
- Discovery testimony
- Pre-trial preparation



PRE-ENGAGEMENT CONSIDERATIONS

FEES

(CONT'D)

✚ Attendance at court

- Presenting *viva voce* evidence
- Testimony of fact witness(es)
- Testimony of expert witness(es)
- Assisting in formulation of questions for cross-examination



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ENGAGEMENT LETTER WITH CLIENT

- ✚ Fees not contingent upon outcome or amount in dispute
- ✚ Fees based strictly upon direct professional time expended
- ✚ Require retaining fee, in accordance with firm's policy



PRE-ENGAGEMENT CONSIDERATIONS

DEFINITION OF ASSIGNMENT

Financial or valuation concepts

- Required by judicial directive
- Required by statute
- Required by contract
- Recommended by valuator
- Specified definition (alternative to standard)



PRE-ENGAGEMENT CONSIDERATIONS

DEFINITION OF ASSIGNMENT

(CONT'D)

- ✚ Identification of items or entity to be quantified or valued
- ✚ Effective quantification date (damages date or valuation date)
- ✚ Timing
 - Draft
 - Formal report
 - Court filings
 - Anticipated trial date



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DISPUTE MAY INVOLVE

- ✚ Value of a business interest
- ✚ Quantum of damages suffered by plaintiff (e.g., lost profits, adverse effect, etc.)
- ✚ Financial ability of business to continue operations as going-concern



DISPUTE MAY INVOLVE

(CONT'D)

- Quantum of duplicate operating expenses in expropriation
- Reasonableness of royalty payments, management fees, fees, transfer pricing, etc., in non-arm's length transactions



ROLE OF FINANCIAL VALUATION

- ✚ Value of corporate shares for income tax and capital gains purposes
- ✚ Value of business conducted on land that is expropriated
- ✚ Damages — commercial or landlord/tenant actions arising from breach of contract



ROLE OF FINANCIAL VALUATION (CONT'D)

- ✚ IP infringement damages
- ✚ Loss of fair market value of business — trespass and conversion by lending institution
- ✚ Fairness opinions



ROLE OF FINANCIAL VALUATION (CONT'D)

- Value of fractional interests in underlying investments (real estate, joint ventures)
- Lost profits — damage claims arising from tort
- Business losses — insurance claims/
business interruption



ROLE OF FINANCIAL VALUATION (CONT'D)

- “Fair value” of minority shares in freeze-out of minority shareholders by controlling group (“going-private” transaction, including takeover bids)
- “Fair value” of oppressed minority shareholder’s shares in private or public company



ASSISTANCE DURING DISCOVERY

1. Assisting in preparing expert testimony of expert witnesses retained by attorney
2. Identifying for production documents and records thought to exist
3. Analyzing documents, records, and facts, including summaries
4. Indexing of documents



ASSISTANCE DURING DISCOVERY

5. Identifying issues and contentions
6. Preparing questions and documents for, and assisting during, taking of depositions
7. Drafting interrogatories, answers and requests for admissions
8. Preparing for pre-trial and settlement conferences and negotiations



USE OF ECONOMIC/FINANCIAL EXPERTS

“ ... it is incumbent on lawyer to become as knowledgeable as possible in preparing for cross-examination. Consulting with one’s own experts may well shed light on fruitful areas of cross-examination. Where computations are involved, lawyer must understand the mathematics. ... When economists opine, lawyer should understand pertinent economic principles. By understanding technical principles, lawyer may be better able to put them into laymen’s terms.”

Use of Experts in Commercial Litigation — Discovery and Trial Techniques,
Practising Law Institute (New York: 1988)



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USE OF ECONOMIC/FINANCIAL EXPERTS (CONT'D)

"Industry experts alone often are insufficient, It is the professional economists, financial experts, cost accountants, and marketing analysts who are equipped with the analytical skills required to do a competent analysis of such questions as: Did the business lose money? Was the loss caused by the defendant's conduct? How much profit could have been earned but for the defendant's conduct? What is the discounted present value of that sum? ... An expert familiar with the industry in question often will be able to perform an analysis of lost profits more quickly at a lower cost than one not familiar with the industry"

Recovery of Damages for Lost Profits, Lawpress Corporation (Westport, CT: 1998)



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EARLY INVOLVEMENT OF FINANCIAL VALUATION EXPERT

“The lawyer who brings a sound, credible valuation expert into case early and makes maximum use of expertise available will best serve client, and be rewarded by well-deserved and earned favorable decisions when valuation of a personal property, real estate, business or practice is a significant issue.”

Valuation Strategies, May/June 2000, Warren, Gorham & Lamont (New York), page 47.



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EARLY INVOLVEMENT OF FINANCIAL VALUATION EXPERT (CONT'D)

“Early retention of economic expert(s) help litigator shape pleadings and chart meaningful discovery course, and thereby avoid many pitfalls that result from lack of early expert assistance. Moreover, with courts increasingly attempting to move cases rapidly to trial, economic issues -- and need for economic expertise -- arise sooner than might be expected.”

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EARLY INVOLVEMENT OF FINANCIAL VALUATION EXPERT (CONT'D)

" ... expert can provide invaluable -- indeed case saving -- assistance in early stages of litigation. It may be far too late in discovery to repair the damage done by prior testimony when litigator has not focused on economic issues of the case. This often results from a myopic belief that economic issues relate purely to damages and can be focused upon after discovery is complete. It is strongly suggested that economic issues be given primacy in any litigation, even if early analysis leads one to conclude there is no need to retain an economic expert at early stage of litigation."

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EARLY INVOLVEMENT OF FINANCIAL VALUATION EXPERT (CONT'D)

"There are many reasons for early retention of an expert. The expert can participate in preliminary case strategy and discovery. There may be facts that will be essential for the expert to determine in order to reach an opinion. If the expert is not retained until late in the case, when discovery has been mostly taken or is closed, the attorney may not be able to provide the expert with the facts necessary for the expert to reach an opinion. ... the expert can also give the attorney ideas for trial strategy and discovery that can be pursued early on but not late in the case. The expert can provide suggestions concerning subjects for deposition questions, interrogatories, and documents to be produced. Most important, the expert can give the attorney *ideas*. In the author's experience, it is the rare case that interaction with a qualified expert does not produce at least one good approach for trial success."

Expert Witnesses — Law and Practice, Lawpress Corporation (Westport, CT: 1997)



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EARLY INVOLVEMENT OF FINANCIAL VALUATION EXPERT (CONT'D)

“[w]hether one represents the plaintiff or defendant, economic proof is often considered as important only to proof of damages. And, because of the inertia that confronts us all, proof of damages is given low priority -- at least at the initial stages of a litigation. *This is often a critical mistake that is regretted as the pleading stage passes and the parties are well into discovery*”. (Emphasis added.)

Use of Experts in Commercial Litigation — Discovery and Trial Techniques,
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EARLY INVOLVEMENT OF FINANCIAL VALUATION EXPERT (CONT'D)

“First, it is generally advisable to retain an expert as a consultant early in the litigation process. ... An expert consultant can help the attorney develop theories and empirical tests of causation and measurement of lost profits, which can then be used to develop arguments to be presented at trial by fact witnesses or to influence settlement negotiations. ... the theories and analytical approaches used by experts often will help to guide the discovery and proof processes. In many cases, the data (or general facts) needed by an expert are available only through discovery. Unprepared litigators who retain experts only when trial is imminent have found that data critical to the expert’s analysis are unavailable.”

Recovery of Damages for Lost Profits, Lawpress Corporation (Westport, CT: 1998)



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EARLY INVOLVEMENT OF FINANCIAL VALUATION EXPERT (CONT'D)

"Second, experts can offer substantial assistance to both plaintiff and defendant. ... economists can evaluate theories to check their consistency with basic price theory, can evaluate empirical claims in light of the existing empirical economic literature that addresses the same issue, can critique other experts' methodologies and note any deviations from those normally employed within the profession, and perform their own hypothesis testing or damage calculations. ... an expert used only as a consultant may be able to assist an attorney in cross-examination and thereby help to undermine or refute an opponent's expert.

" ... although it is in the plaintiff's burden to prove lost profits, *in many cases a defense expert can show that the plaintiff's lost profits were not caused by the defendant's conduct.*"

Recovery of Damages for Lost Profits, Lawpress Corporation (Westport, CT: 1998)



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JUSTIFICATION FOR VISITS AND INTERVIEWS BY VALUATOR

- Gaining a better understanding of Company's operations;
- Having a better understanding of information contained in Company's financial statements and other financial documents;
- Identifying current and potential changes that might cause Company's future results to differ from those indicated by extrapolation of historical data; and
- Providing additional insight as to the future prospects of Company's business, major risks, concerns, etc.



ADVISORY EXPERT WILL:

- Identify technical financial issues relating to particular subject matter
- Explain technical financial terms and significance of each
- Identify and explain technical financial issues from opponent's point of view
- Advise as to key areas of discrepancy



ADVISORY EXPERT WILL: (CONT'D)

- Identify respective strengths and weaknesses of each side's position
- Help prepare for expert's examination-in-chief and cross-examination of opposing side's expert
- Assist in fight/settle strategy and settlement negotiations



SOME REASONS TO INTERVIEW DIRECTORS

Directors have statutory duty to act honestly and in good faith, with view to safeguarding best interests of corporation and to exercise care, diligence and skill that reasonably prudent person would demonstrate in comparable circumstances.



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SOME REASONS TO INTERVIEW DIRECTORS (CONT'D)

- Directors required to disclose in reasonable detail:
 - a. material factors on which their beliefs regarding offer are based,
 - b. background of their deliberations, and
 - c. their analysis of expert opinions obtained.



JUSTIFICATION FOR INTERVIEWS WITH MEMBERS OF INDEPENDENT COMMITTEE

- Committee would have been provided with relevant documents, information and professional opinions to assist them:
 - a. In determining whether proposed offer to minority shareholders would be fair to them, from a financial point of view, and
 - b. In recommending if offer should be accepted or rejected.



FAIRNESS OPINIONS

Committee's initial involvement and subsequent monitoring of process likely include:

- **Appropriate definition of "fairness" from a financial point of view**
- **Disclosure to Fairness Opinion Provider of any valuation issues particular to circumstances already identified by Independent Committee**



FAIRNESS OPINIONS

(CONT'D)

Committee's initial involvement and subsequent monitoring of process likely include:

- Scope of review undertaken by Fairness Opinion Provider, including consideration of any restrictions likely to be encountered
- Requirement for retention of experts other than Fairness Opinion Provider, such as tax counsel



FAIRNESS OPINIONS

(CONT'D)

Committee's initial involvement and subsequent monitoring of process likely include:

- Identification of members of management and of related-party acquiror, who have knowledge with respect to company's history and prospects, industries in which it operates, and may be aware of any "distinctive material value" that might accrue to acquiror
- Identification of independent outside parties, knowledgeable as to industries in which company operates, who may be able to offer special insight into industries as well as relevant valuation issues



FAIRNESS OPINIONS

(CONT'D)

Committee's initial involvement and subsequent monitoring of the process likely include:

- Discussions with Fairness Opinion Provider as to market for company's shares or underlying assets, including consideration of possible strategic acquirors (including, but not limited to, acquiror and "distinctive material value" that might accrue to it), efforts of company to divest of securities or underlying assets, and comparable transactions, if any
- Request for a draft fairness opinion for critical review and comment by Independent Committee and such representatives of management



TELEMEDIA INC. (QUEBEC SUPERIOR COURT)

And I am mindful of this aspect that appears to me to be of the utmost importance. The minority shareholders are the members of the company, Telemedia, and, accordingly, they have the right of access to pertinent information. In my humble opinion, why should they not have the right to the same sources of information that the controlling shareholders would have?



TELEMEDIA INC. (QUEBEC SUPERIOR COURT)

In my opinion, the minority's experts have the right to have access to the very same sources of information as the experts for the majority shareholders. The *Canada Business Corporations Act* has introduced the concept of fairness in the legislation such that neither group of shareholders should be disadvantaged *vis-à-vis* the other. For this reason, the Court grants the request of the minority shareholders.



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KRUGER INC. v. HERMITAGE ET AL **(1991) R.D.J. 259 (Quebec CA)**

The orders for discovery and production of documents have similar counterparts in the rules of the *Code of Civil Procedure*; even the order to permit Respondents' expert to visit plants and mills is analogous to the provisions of Article 420, which authorizes an expert appointed by the court to visit any place which he considers useful.



KRUGER INC. v. HERMITAGE ET AL

(1991) R.D.J. 259 (Quebec CA)

One aspect of this matter that has not been emphasized by either party and which should be stressed is that Respondents are shareholders, 'members', of Appellant, and as such entitled to a great deal of information about their company. In this way it differs from, say, a case of a stranger suing the company for damages; in that situation the plaintiff's right to information would be more limited. But here we have shareholders asking the court to fix a value of their own shares in their own company, which I think is an important factor in judging how far they can go.



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HERMITAGE ET AL v. KRUGER INC. **(QUEBEC SUPERIOR COURT)**

The Court, *seeing ... the letter of [the minority shareholders' expert] as to the necessity of various kinds of information to permit the determination of the fair value of the shares of the dissident minority shareholders, and seeing the affidavits in support of the motion; ...*

Grants the motion in part [and] authorizes applicants to examine out of court the three [senior executives];

Authorizes the issuance of *subpoenas duces tecum* to such persons with respect to all documents and information [in the list accompanied by the valuator's request for information and documents] which exist, and in respect of all documents which do not exist;



HERMITAGE ET AL v. KRUGER INC. (QUEBEC SUPERIOR COURT)

Orders [Kruger Inc.] to give communication to Applicants of all documents, books and records required to enable Applicants' expert to obtain the desired information; ...

Orders that the said examinations out of court be held in camera;

Orders [Kruger] to permit minority's valuation expert to visit and inspect the plants and mills of Kruger or its subsidiaries



WESTFAIR FOODS LTD.

INTERESTS OF CLASS A SHAREHOLDERS BEING UNFAIRLY DISREGARDED — PROCEDURAL CONFLICTS

- Unfairness based on dividend policy — rejected
- Auditors ignored existence of Class A shares in describing Westfair as “*wholly-owned* subsidiary” of its parent, in annual report
- Westfair permitted Toronto Stock Exchange to de-list Class A shares without protest
- Westfair and its parent company considered Class A shareholders to be a nuisance



WESTFAIR FOODS LTD. COURT OF APPEAL

Q. Why would shareholders of public company ask Court to order company to purchase shares when they could easily be sold on the public market?

A. [They] obviously consider public-market grossly under-valued [and] believe that [judge] had uncovered valuable right of which the market has been unaware: the right to force purchase at break-up value.



WESTFAIR FOODS LTD.

Alberta Court of Appeal:

“If [Westfair] liquidated itself in the future [because of being] unsuccessful, then ... the assets [presumably] would be worth little. It is true that there is a *metaphysical possibility* that this company might liquidate itself while possessing significant assets ... *such metaphysical possibilities can have almost no weight whatever.*” (Emphasis added.)



FORMAL JUDGMENT OF COURT OF APPEAL OF ALBERTA

In valuing Westfair's Class A Shares, Mr. Richard Wise of Montreal, court-appointed expert, must not directly or indirectly consider:

- ➔ Westfair's income (beyond the fixed \$2 annual dividend, which has been paid continuously for 35 years)
- ➔ Westair's retained earnings
- ➔ Value of Westfair's assets



FORMAL JUDGMENT OF COURT OF APPEAL OF ALBERTA (CONT'D)

- ➔ Market or trading prices of the shares
- ➔ Value to Westfair (of acquisition or extinguishment of shares)
- ➔ Future business plans of Westfair or its affiliates
- ➔ Any allowance or premium for taking or the compulsory nature of the sale of the Class A shares



QUESTIONS?

Please feel free to contact us:

Richard M. Wise's E-Mail — rmwise@wiseblackman.com

Wise, Blackman LLP
Royal Bank of Canada Building
1 Place Ville Marie
Suite 3430
Montreal, Quebec
Phone: (514) 875-8100 or (866) 998-8100
Fax: (514) 875-9109
www.wiseblackman.com



Richard M. Wise, FCA, CA-IFA, FCBV, FASA, MCBA
Wise, Blackman LLP
Business Valuators • Litigation Accountants