

How to Survive a Killer Cross-Examination

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HOW TO SURVIVE A KILLER CROSS-EXAMINATION

Several years ago I received what I considered to be the highest compliment ever paid to me by an opponent's business valuation expert. Following several hours of cross-examination this individual, the Managing Partner of a nationally known investment banking firm with a subsidiary known for valuing businesses and their securities for ESOPS, buy-sell agreements, estate and gift tax purposes, mergers and acquisitions and dissolution of marriage proceedings, turned to me and said, "Congratulations, you succeeded in confusing the issues, my valuation report, the Judge and everyone in the courtroom except yourself." I smiled and said, "Thank you but that is what I am paid to do."

The cross-examination of a witness, particularly an expert witness, represents one of the great challenges for a matrimonial lawyer. Similarly, surviving that cross-examination can provide a great source of pride to the testifying expert and financial gain to his or her client. During my talk today I will focus on three main themes, each of which are interrelated and vital to the business valuation expert.

- (1) How do attorneys plan cross-examination.
- (2) How you can become a more effective witness.
- (3) How to "survive" cross-examination.

(I) How Do Attorneys Plan Cross-Examination

The purpose of cross-examination is to expose to the court any weaknesses in the testimony of the expert witness. Since my practice is limited exclusively to matrimonial law, my comments will be predicated solely on how I go about preparing and conducting a cross-examination of a business expert in a divorce case. By understanding how a lawyer approaches cross-examination you will be better prepared to withstand his attack.

Generally speaking, I begin preparing my cross-examination at the same time I retain my own expert. In virtually all valuation cases, a standard set of documents is needed. Over the years I have developed a form which I have titled **BASIC DOCUMENT AND INFORMATION CHECKLIST**. I use this list to ensure my expert has made all the required preliminary inquiries and that my opponent's expert has covered the minimum requirements. During the discovery deposition that I take of my opponent's expert prior to trial, I guarantee you that inquiry will be made of your efforts to acquire this basic information.

SUGGESTION I

Prepare and maintain as part of your file a Basic Document and Information Checklist. See Exhibit "A" for a sample list.

It is imperative that this basic document list be tendered to the attorney representing your client early on.

As stated earlier, I formulate my cross-examination early on. During meetings with my own expert, I have acquired a thorough knowledge of the

pertinent financial information of the subject company, the methodologies appropriate for this particular assignment and his or her conclusion of value. By the time I am ready to depose you, I am familiar with the strengths and weaknesses of my side. I am then ready to learn about you.

SUGGESTION II

OPPOSING COUNSEL WILL USE YOUR DEPOSITION TO PREPARE HIS CROSS-EXAMINATION AT TRIAL.

Lawyers use depositions for various purposes. One is to assess the relative strengths of the opponent's case for guidance regarding possible settlement. A second is to learn enough about you and your report to prepare for cross-examination. From my perspective, the latter is the more significant usage.

You will be asked to produce your entire file at the deposition. This will include your report, all of your workpapers, all books, treatises, periodicals and articles which you reviewed and/or relied upon, interviews conducted, notes, etc. Frequently, I will request that this information be tendered several days in advance of the deposition. Perhaps to your surprise, understand that I will personally read your entire file. Accordingly, you should expect to be questioned about its contents as well. Rarely, however, will I look to challenge your report, the work performed or your opinion at this time. The deposition is used to inform me of the following:

- (1) Who you are - (QUALIFICATIONS)
- (2) The nature of your assignment
- (3) Information which you reviewed

- (4) Methodologies applied
- (5) Steps taken in carrying out the assignment
- (6) Your conclusion

From this information I will plan my cross-examination. Let me give you an example from a specific case.

This particular matter involved valuing a closely-held corporation engaged in the manufacturing and distribution of electronic tubes and semi-conductors. Husband held 100 percent of the issued and outstanding stock. The company had its own special niche, focusing exclusively on the trailing end of technology as opposed to the future. Thus, while R&D expenditures were minimal, the company's growth was fueled through acquisition. The case was particularly complicated by the fact that the valuation date was March 17, 1983 although the trial occurred in 1990. At issue was the validity of a Post-Nuptial Agreement executed by the parties in March, 1983 but being attacked in 1990.

I represented the Husband. The discovery deposition of the Wife's expert disclosed that he valued the stock using the following methodologies:

- (A) MARKET
 - (1) Comparable Company Analysis
 - (2) Comparable Company transaction analysis
- (B) INCOME - DISCOUNTED CASH FLOW

During his deposition I interrogated the expert on each method used, being careful not to challenge his findings at that point. My objective was to learn what he did and did not do. Let me suggest to you what I was looking for under each line of inquiry:

SUGGESTION III

IN PLANNING A CROSS-EXAMINATION OF AN EXPERT USING A COMPARABLE COMPANY MARKET APPROACH, THE LAWYER LOOKS FOR THE FOLLOWING:

- (1) Is the population of possible companies from which the guideline companies were chosen clearly defined?
- (2) Were the selection criteria clearly identified and were they appropriate.

Here I am looking to determine the following:

- (a) Do these companies have comparable capital structure to the subject?
 - (b) Do they truly compete with the subject company in terms of:
 - 1) Products
 - 2) Markets
 - 3) Management
 - 4) Earnings
 - 5) Dividend-Paying Capacity
 - 6) Size
 - 7) Position within Industry
 - 8) Sales Volume by Product
 - 9) Customer Mix
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(c) The relevant time period for comparative analysis of the subject and guideline companies.

(d) Were the financial statements, annual reports and SEC filings of the guideline companies reviewed and used for the relevant time period?

(e) Were appropriate adjustments made to the financial statements of the guideline companies and the subject?

(f) Were appropriate financial ratios for the subject and guideline companies selected?

The discovery deposition and review of the file of the expert witness revealed several deficiencies. First, although the guideline companies and the subject enjoyed the same Standard Industrial Code, they were not engaged in comparable businesses. Product lines and markets bore no resemblance. Yet, at the same deposition, I restrained myself from asking him a single question regarding products, markets and sales. There are several reasons to defer those questions to trial. They include the following:

(1) Expert witnesses are busy people. Their tendency is to read their deposition testimony prior to trial in the expectation that trial cross-exam will mirror deposition questions. They are unable to adequately address surprise cross-examination.

(2) The person testifying at trial is frequently the senior member of the valuation team, the individual with the best qualifications and most courtroom

experience. However, in most situations that individual has performed little of the empirical research and is least familiar with the underlying data.

(3) The expert witness views his knowledge of the business valuation process, techniques, and methodologies as being far superior to the lawyer. Generally, they are correct in that position. However, what is often misunderstood is that cross-examination rarely focuses upon selection of methodology or qualifications. Rather, cross-examination, when done effectively, focuses upon the improper application of the methodology by the expert witness. For example, if cross-examination reveals that the selected comparable companies are not comparable, the entire method fails.

SUGGESTION IV

IN PLANNING A CROSS-EXAMINATION OF AN EXPERT WITNESS USING A COMPARABLE COMPANY TRANSACTION APPROACH, THE LAWYER LOOKS FOR THE FOLLOWING:

(1) Are the comparable companies selected in the transaction analysis truly comparable to the subject company.

(2) The quantity and quality of data available. For example, if private companies are involved, the available data is rarely verifiable. Reported purchase prices may or may not reflect considerations such as covenants not to compete or employment contracts. It often is difficult to ascertain the assets included in the purchase price or what liabilities were or were not assumed. Profitability figures are difficult to obtain. When analyzing public comparative transaction data, differences between companies, time period differences and market aberrations must be examined.

SUGGESTION V

IN PLANNING A CROSS-EXAMINATION OF AN EXPERT WITNESS USING A DISCOUNTED CASH FLOW METHOD THE LAWYER LOOKS FOR THE FOLLOWING:

(1) The discounted cash flow method is extremely sensitive to changes in the input variables - that is, the projected cash flows and the discount rate.

(2) Regarding projected revenue growth, are the assumptions reasonable? Are they based upon historical performance of future projections? Can historical growth rates be sustained in perpetuity? What if recent historical growth was based upon acquisition as opposed to internal growth? Very high rates of growth generally are not sustainable for long periods.

(3) Is the discount rate being applied appropriate to the risk being undertaken?

(4) How are future working capital expenditures projected? Are they underestimated?

Exhibit "B" consists of the cross-examination of my opponent's expert witness in this case study. The entire cross-examination grew out of the discovery deposition and review of the expert's file. Several points should be noted:

(1) The comparable company approach fell apart because the cross-examination established that the guideline companies were not appropriate. Product lines, markets, capital structure, revenues derived by product lines bore no resemblance. The data used to attack the witness come from annual reports, SEC

filings and financial statements, all of which were either within his workpapers or obtained from the Securities Exchange Commission.

(2) The discounted cash flow technique fell apart when the expert's first assumption, projected revenue growth, proved to be incorrect. The expert made future growth projections based upon inconsistent assumptions; first, he acknowledged that historical growth was based upon acquisition, that the revenue growth in the 12 month period preceding the valuation date was almost all acquisition related (15%), that future acquisitions were unlikely; yet he applied a 15% future annual growth rate to his model.

(3) He selectively applied time periods to suit his purpose. For example, in his comparable company approach he used a six month or one year EBIT analysis rather than a traditional five year analysis. This selectivity got him the number he needed but subjected his entire report to lack of credibility by ignoring established valuation guidelines.

Attorneys make their living by embarrassing and impeaching witnesses. They look for any opening that can be exploited and will pound you into the ground once the weakness is identified.

However, it must be remembered that frequently they are feasting upon the errors made by the expert witness. This leads us into the second phase of our discussion. How can you be more effective as a witness.

SUGGESTION VI

**DEVELOP AN UNDERSTANDING OF HOW LAWYERS WORK
AND THINK**

I have told you in the preceding pages a little bit of how lawyers plan their examination. Just as valuation and other financial companies prepare data bases on transactions, on industries and numerous other financial information, lawyers maintain data bases on expert witnesses. Information is compiled by subject matter, methodologies, opinions of value, forums in which testimony is given, law firms for whom the work is performed, etc. In my firm we collect and review deposition and trial testimony of expert witnesses.

There is no reason why expert witnesses should not maintain similar information. If you have been burned by a particular lawyer, maintain some record reflecting how he successfully examined you to insure it does not occur again.

SUGGESTION VII

ALWAYS BE PREPARED

Lawyers as well as experts make mistakes. However, proper preparation can reduce your chance for error. Here are some suggestions which will make you a better witness:

- (1) Meet and work with your client's attorney on a regular basis.
 - (2) Jointly develop a document request.
 - (3) Supplement the document request when additional inquiry is needed.
 - (4) Do not rely on the lawyer to follow-up on document production. Lawyers get busy also. If you require information for your report, pursue it relentlessly. For example, on-site inspection of the business premises and personal interviews of management are your responsibility. I have observed numerous
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expert reports which contain limiting language concerning availability of documents, difficulty in gaining access to premises and owners. There is no justifiable reason for this language. You all recognize the importance of these details. Make sure they get done. No excuse is acceptable.

Last year I examined a real estate appraiser on several commercial and residential properties. This appraiser came into court with videos of not only the subject properties but the comparables as well. There was no question in anyone's mind regarding the effectiveness of that witness.

Similarly, I would suggest that when you perform an on-site inspection of a business, take pictures of the factory, the shipping area, the inventory office space, and the employees. Trial judges love to view this type of evidence. You look prepared and informed.

If your report has potential weaknesses, inform trial counsel. Generally speaking, it is wiser to identify and disclose these weaknesses in your own report and discuss them during your direct examination where you have the opportunity to place your "spin" on the facts or issue, then to wait to be slaughtered by opposing counsel.

I am often asked the following questions:

- (1) How complete and thorough should I make my report?
 - (2) Should I give a high value or a low value?
 - (3) What kind of answers should I give at my deposition?
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(4) Will you agree to admit both expert reports into evidence subject only to cross-examination, thereby saving court time?

I will attempt to answer each of these questions and provide additional thoughts on how you can become a more effective witness in the next section of this discussion.

SUGGESTION VIII

ASSUME THE TRIAL JUDGE KNOWS LITTLE, IF ANYTHING, ABOUT YOUR CLIENT'S BUSINESS

Court testimony challenges an expert witness because it is part of an adversary proceeding. Competent, thorough preparation must culminate in a clear and convincing presentation.

It is essential that an analyst be objective and unbiased when legal testimony is involved. You must not be an advocate. That is the attorney's role. Your role is to present the facts as they are and to use your professional expertise to interpret those facts to reach an objective conclusion.

An appraiser cannot assume that the trial judge has any knowledge about the particular business or industry involved. Every fact on which you are relying should be presented, both verbally and in writing. I strongly emphasize the creation of a thorough and complete written report accompanied by a thorough direct examination. Each gives you the opportunity to distinguish yourself from your opponent. Meet with your client's attorney and jointly draft and discuss your direct examination. The following points should be covered:

- (1) Your qualifications.

- (2) A description of the assignment.
- (3) Steps taken in carrying out the assignment. During direct examination identify, discuss and introduce into evidence all of your back-up material including treatises, articles and studies relied upon. Inform the Court what was obtained from the various sources. When identifying individuals interviewed, describe what was discussed and learned from each source. **Do not be afraid to tell the Court you worked hard on this assignment.**
- (4) Your findings.
- (5) Your conclusion.

Rehearse the direct exam with counsel. Ask counsel to take you through anticipated cross-examination.

Prepare exhibits that will help communicate the thoroughness and credibility of the valuation. Make sure these exhibits are explained to the court. A typical list of exhibits submitted to the court to be amplified upon through your testimony should include the following:

- (1) Your curriculum vitae.
- (2) Pictures of business facilities.
- (3) Latest five years' financial statements for the subject company.
- (4) Five year summary of the subject company's balance sheets.

- (5) Five year summary of the subject company's income statements.
- (6) Subject company's financial ratios compared with industry norms.
- (7) Market price data for guideline publicly traded companies.
- (8) Summary statistics of valuation approach used and conclusions.

To the extent that associates or other partners worked on the assignment with you, meet with them, review all their work and be as familiar with it as they are and equally competent to testify. You **must** read all case decisions and articles relevant to the valuation. You must have a complete working knowledge of the comparable companies, their product lines, sales by product lines, markets, competitors, etc. and how those numbers relate to the subject company.

You should avoid attempting to bluff if you do not know an answer. Any suspicion of bluffing could cast doubt on your entire testimony. If you do not know an answer, admit it. Similarly, if your data contains error, you should admit it and correct it, making whatever adjustment to the conclusion the correction warrants.

Finally, if you have properly done your homework, over cross-examination by opposing counsel can actually help your case. For example, by carefully explaining why you rejected certain possible comparable companies or valuation methodologies, you have an opportunity to challenge and discredit your opposition expert prior to the presentation of his testimony.

CONCLUSION

Hopefully, you have learned several things from this speech. Most importantly, please understand that five years ago when the business valuation expert approached me and congratulated me “for confusing the issues,” his statement was incorrect. I did not create confusion. I made him look bad before his client and the court because he failed to properly prepare for cross-examination. By following the recommendations contained in this article, you should not experience a similar result.

EXHIBIT "A"

BASIC DOCUMENT AND INFORMATION CHECKLIST

Financial Statements

Balance sheets, income statements, statements of changes in financial position, and statements of stockholder's equity. Suggest for the last 5 years.

Income tax returns for 5 years. Interim statements prepared subsequent to latest financial statements.

Other Financial Data

- Fixed Asset Ledger
 - Depreciation schedule
 - Aged accounts receivable summary
 - Aged accounts payable summary
 - Budgets, forecasts and projections (historical as well as prospective)
 - List of marketable securities
 - Leases
 - Inventory summary with explanation of accounting policies
 - Corporate Minute Book, Stock Certificates, Stock Transfer Ledgers
 - Compensation Schedule of Key Personnel, including Perquisites
 - Keyman Insurance
 - Insurance on Property and Equipment
 - Buy-Sell Agreements, Options
 - Shareholder Lists with Ownership
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- Existing Contracts which may influence value

Covenants Not To Compete

Royalty Agreements

Patents, Copyrights, Trademarks

Customer or Supplier Agreements

Equipment Leases

- Cash Disbursements Journal
- Cash Receipts Journal
- List of Subsidiaries and Relevant Financial Data

Other Important Information

- History of Business including any Recent Stock Transfers or Offers
- Marketing Literature
- List of Competitors, Location
- Any recent appraisals of business or its assets
- Organization Chart
- Trade Association Materials and Publications (Forecasts)
- Any Contingent or off-balance sheet liabilities
- Identification of Extraordinary or Non-Recurring Recent Expenses