

Verdicts

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The Spoiler

Defense counsel can make vast use of a certified public accountant's expert testimony when attempting to avoid or limit assessment of punitive damages.

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Plaintiffs' counsel routinely rely on a certified public accountant's expert testimony regarding punitive damages. However, at times, defense counsel neglect the opportunity to offer expert testimony to rebut plaintiff's evaluation of defendant's wealth or to persuade the trier of fact that punitive damages should not be awarded in the first place. Sometimes, defense counsel believes that if the defendant needs an expert to deal with punitive damages, the defendant should not be in trial, and the case settles.

In fact, CPA assistance to defense counsel can be invaluable in reducing the amount of punitive damages or, better still, avoiding them entirely.

"Punitive damages are awarded only for outrageous conduct, that is, for acts done with a bad motive or with a reckless indifference to the interests of others." *Martin*

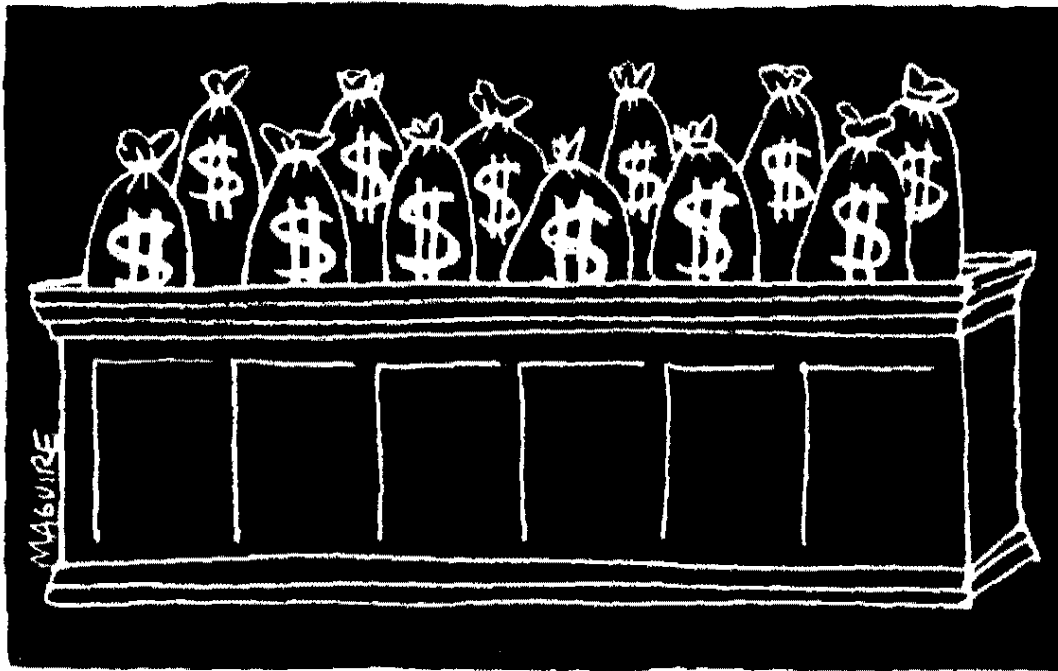
be able to comment on and quantify the effects of defendant's efforts to repair the problem after the fact. In tort cases, punitive damages may not be recovered without proof of actual damages; therefore, CPA expert testimony that there are no economic damages is desirable from a defense perspective.

An effective CPA expert can help defense counsel convince the trier of fact that plaintiff suffered no financial loss even if defendant acted wrongfully. However, avoiding punitive damages by claiming zero economic damages is an all-or-nothing proposition, as an award of nominal damages is enough to support a further award of punitive damages. For example, courts have affirmed an award of \$650,000 in punitive damages based upon an award of \$1 compensatory damages. *Werschull v. United California Bank*, 85 Cal. App. 3d 981, 149 Cal. Rptr. 829 (1978).

tion; the imposition of criminal sanctions on the defendant for its conduct, these to be taken in mitigation; the existence of other civil awards against the defendant for the same conduct, these also to be taken in mitigation.

CPAs have important information to provide the trier of fact about each of these factors. Regarding actual and potential harm caused by defendant's conduct, if the punitive damages phase of trial has been reached, actual economic harm has already been determined. A finding of nominal economic damages does not let defense counsel rest easy on punitive damages, however. Punitive damages awards that are up to 500 times greater than compensatory damages have been found to be reasonable by appellate courts. In addition, if actual damages are found to be nominal, plaintiff's counsel will likely argue that potential damages could have been much greater. Defense counsel should be ready with CPA expert testimony to

rebut this contention. Regarding the duration of conduct and frequency of similar conduct, CPA expert testimony can inform the trier of fact when the wrongful conduct began and ended, based on the review of defendant's financial records. The CPA also may be able to testify to whether similar conduct had been previously discovered. On the question of profits earned by the defendant because of the wrongful conduct and the financial position of the defendant, the analysis of defendant's profitability and financial position is the domain of the CPA expert. Evidence of defendant's financial condition must be presented to the jury before punitive damages can be imposed. *Adams v. Murahami*, 54 Cal.3d 105 (1991). In providing information to the jury about defendant's financial condition, most courts focus on net worth, which should be determined as of the trial date, rather than when the wrongful acts were committed. *Zhadan v. Downtown Los Angeles Motors*, 100 Cal. App.3d 821, 839, 136 Cal. Rptr. 132, 143 (1979). A rule of thumb seems to be that



v. Johns-Manville Corp., 508 Pa. 154, 494 A.2d 1088, 1097 (1985). CPA expert testimony can be used to help persuade the trier of fact not to award punitive damages. Often, the alleged wrongful acts were purportedly committed by an individual, or a very small number of employees or agents of a company. In such cases, the CPA may be able to testify that the company's system of financial internal controls could not have been expected to detect the agent's wrongful acts, as the agent's acts were not in furtherance of the company's business and outside the scope of the agent's employment; the agent was not in a management capacity, as the agent's acts were not authorized, ratified or approved by the company; or the agent's employment history and work performance were consistent with the company's and industry employment standards.

In some instances, the CPA may be able to testify that defendant's allegedly wrongful acts are a normal business practice in defendant's industry. The CPA may also

There is no clear-cut limit to the size of punitive damages. The U.S. Supreme Court has stated: "We need not, and indeed we cannot, draw a mathematical bright line between the constitutionally acceptable and constitutionally unacceptable that would fit every case. We can say, however, that general concerns of reasonableness and adequate guidance from the court when the case is tried to a jury properly enter into the constitutional calculus." *Pacific Mutual Life Insurance Co. v. Hastip*, 499 U.S. 1, 19 (1991). The high court then endorsed a list of factors that could be taken into consideration in determining whether a punitive damage award was excessive or inadequate (499 U.S. at 21): whether there is a reasonable relationship between the punitive damage award and the harm likely to result from the defendant's conduct as well as the harm that actually has occurred; the degree of reprehensibility of the defendant's conduct; the duration of that conduct; the defendant's awareness, any concealment, and the existence and frequency of similar past conduct; the profitability to the defendant of the wrongful conduct; and the desirability of removing that profit and of having the defendant also sustain a loss; the "financial position" of the defendant; the costs of litiga-

tion; the imposition of criminal sanctions on the defendant for its conduct, these to be taken in mitigation; the existence of other civil awards against the defendant for the same conduct, these also to be taken in mitigation.

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Suppose, for example, plaintiff's expert relies on the net worth of a company as reported in its audited financial statements prepared in accordance with generally accepted accounting principles. This would seem to be an ideal basis for determining a company's net worth. However, a company's net worth as reported in its financial statements often is quite different from the company's actual current market value. The primary reason for this is that assets are recorded in financial statements at their depreciated historical purchase prices, rather than their current market values. Perhaps defendant's net worth consists primarily of a non- Continued on Page 13

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liquid, non-income-producing asset, for example, undeveloped land, purchased and recorded in defendant's financial statements at a price higher than its current market value. In this case, defendant's net worth as reported in its financial statements would overstate both defendant's actual net worth and its ability to pay a punitive damages award.

Plaintiff's expert may have focused primarily on plaintiff's business and may have a limited understanding of that business, limited access to defendant's business records and limited time and resources to conduct an analysis of defendant's net worth or profit margins. In such cases, defense counsel should memorialize at deposition plaintiff's expert's scanty understanding of defendant and its industry. Defense counsel should use the CPA expert to uncover any errors plaintiff's expert has made in interpreting defendant's financial records and help develop cross-examination questions highlighting this expert's lack of knowledge about unusual aspects of defendant's accounting records, non-recurring items, or the "story" behind specific entries in financial statements. Defense counsel may be able to use this information to show the jury that plaintiff's expert really is not particularly expert in this setting.

A CPA retained by defense counsel may have the advantage of being better informed than plaintiff's expert about defendant's business operations. If plaintiff has not made a claim for disgorgement of defendant's unjust enrichment, defendant may not be required to disclose its financial records prior to the punitive damages phase of trial. For non-publicly held defendants, plaintiff's expert may

have only a matter of days or even hours to analyze defendant's financial records to determine defendant's wealth or profits. For publicly held corporations, detailed financial information disclosed in Securities and Exchange Commission filings are readily accessible via the Internet. Similarly, insurance companies' financial statements are available through quarterly filings with the state departments of insurance. However, even in these cases, the superior knowledge about the defendant's financial and business operations available to the defense CPA expert may be able to tip the scale in defendant's favor.

Another situation in which CPAs can assist defense counsel may arise if plaintiff attempts to present financial information to the jury pertaining to defendant's owners or parent or controlling companies. CPAs can assist defense counsel in protecting the "corporate veil" by providing expert testimony as to whether defendant filed articles of incorporation, issued stock, adopted corporate by-laws, appointed officers, held and documented meetings of shareholders and the board of directors, obtained an employer identification number, invested sufficient capital to conduct business, maintained separate accounting records, filed corporate tax returns, segregated corporate and personal funds, documented and maintained at arms length all related-party transactions, or treated as compensation all personal use of corporate assets.

CPAs can be used by defense counsel to collect, verify, analyze and testify about both plaintiff's and defendant's costs and expenses, and can rebut overstated claims made by plaintiff. For example, a significant portion of costs of litigation claimed by plaintiff may in fact be regular legal costs incurred in plaintiff's ordinary course of business.