



Effective Use of Economists as Expert Witnesses

Reprint of an article written by Stanley Stephenson, Ph.D. for the DAILY RECORDER, Sacramento, California

Imagine you are lead defense counsel on an airline crash case. More than 200 lives were lost, and liability has been established against your client. The plaintiff in your case, a Korean businessman who imported leather goods, is represented by a major firm who has obtained the services of an academic economist as an expert witness. This witness claims losses are more than \$200 million for this single individual. What should you do?

Similarly, you are asked to represent a dentist whose practice was disrupted when a fire destroyed his office building. As a result the dentist relocated to temporary, suburban offices two miles away from his former location in a medium-sized community in northern Connecticut. What should you do? Are there economic losses involved? How much are these losses, and how do you justify them?

Each of these are real cases. In the first situation, the case settled at less than \$1 million. The second case is ongoing, but a preliminary report estimates economic damages at nearly \$2 million. In each case the economist's role in establishing a reasonable level of economic damages was critically important. This article lists frequently asked questions for litigators to consider in choosing and effectively using an economic expert.

Why Use an Economic Expert?

As implied in the above two cases, a skilled economist can provide valuable advice and counsel and generally enable his or her fees to be more than offset by favorable outcomes for the client. In the airline case, fees were about \$7,500 and the associated savings for the client exceeded \$100 million! Similarly, in the second case, the economist's report has significantly redefined the range of economic loss being considered. In short, one uses an economist as an expert when there is a solid business case to do so.

Are There Minimum Damages One Should Consider Before Hiring An Economist?

The issue is subjective, but in general, if the case is worth at least \$100,000, then it may be worth considering use of an economic expert. This "rule of thumb" is, however, only one of several criteria the attorney should consider.

What Factors are Most Important in Choosing An Economic Expert?

- **Style:** This is generally considered the most important single factor: How credible will this witness be in front of a judge or jury? Is the expert's demeanor convincing? Are questions handled well?
- **Costs:** Can the expected fees be justified? What are the risks of not hiring an expert economist?

- **Case Strategy:** What type of case is this: intellectual property, personal injury, malpractice, security, fraud, antitrust, breach of contract or some other type? Is the work to be done for defense or plaintiff (many times in defense cases, an economist is not even disclosed and is used as a consultant)?
- **Experience:** Credentials such as a Ph.D. in economics from a noted university, a strong resume and academic affiliation are helpful, but less important than "style."

OK, But What Does An Expert Economist Really Do?

There are two ways to answer this question. First, economists offer analysis consisting of several steps:

- **Develop a Theory of Damages.** For example, the human capital model is central to many lost earnings cases, but it is not the only theory. The point is that any theory used should be made explicit.
- **Conduct a "But-For" Analysis.** What are mitigation profits or earnings? If the "event" had not taken place, what would be the results?
- **Use Appropriate Data and Information.** Examine the company or the individual in terms of industry, occupation, past and future outcomes, markets and economic conditions.
- **Make Required Adjustments.** Depending on the case, the expert should consider the following factors; productivity, inflation, taxes, expected duration of the loss, work life and life expected of a person, time value of money, and similar factors.

For the plaintiff the expert writes a report, cites sources and attaches spreadsheet models and references. For defense the expert follows these same steps and/or develops lines of questions for the opposition, e.g., "What was your theory of damages?" Or, in a wrongful death case, the defense expert might suggest using the following sorts of questions: "In projecting foregone lifetime earnings, did you consider the fact that Mrs. Jones has a terminal illness and a 75 percent chance of death in five years?"

During the litigation process, economic experts provide the following services:

- **Before Filing A Complaint:** Informally estimate economic damages; allow use of name for offensive purposes, e.g., a "bargaining chip" to induce settlement.
- **Discovery Phase Activities:** Support interrogatories; data collection and review; damage estimation; review opposition expert's report; develop deposition lines of question for opposition.
- **Settlement and Pre-Trial Activities:** Presentation of economic damages; evaluate settlement offers; develop decision trees.
- **Trial Phase:** Prepare trial binder, including damages reports; question scripts, exhibits, background of expert; present testimony; develop lines of questions for opposition.

When Should You Use an Accountant and When Should You Use an Economist?

The roles of these two groups can overlap, but are distinct. In general economists are

used more in cases requiring economic modeling, forecasts, statistical analyses and market assessments. Whereas, accountants are used more in cases involving accounting data, cost analysis and income tax issues. Moreover, the two roles can be highly complementary, especially in cases which involve substantial data processing in response to an economic theory of damages.

What Tips are There Regarding Hiring an Expert Economist? The process is not unlike hiring any other management consultant. While lists of expert economists are available from bar associations, legal publications and related sources, word of mouth and referrals are the most likely ways in which one hires an economist. Frequently, experts make presentations to law firms or continuing education seminars on a case or particularly sensitive or complicated issue. This is a good opportunity for exchange and to evaluate the expert.

The retention process should involve checking for possible conflicts of interest, a written agreement on scope of work, fees and expenses, and may involve a small retainer. It is not ethical for the expert to be paid on a contingency basis. Early in the engagement, the expert should provide the client with an overall management plan which outlines tasks, resources and milestones. This greatly reduces surprises while enhancing communication and overall quality of results.

During the engagement, the client should expect regular reports, briefings and other progress statements in addition to invoices for fees and expenses.

What are the Most Problematic Issues Which Arise in Estimating Economic Damages?

While highly situational, the most frequent disagreements between expert economists are due to differences in opinion about one or more of the following questions; (1)What is a normal level of past and future earnings or profits; (2)Which interest rate to use in discounting future earnings; (3) What is the timing or duration of economic loss; and (4) What are mitigation earnings (or profits) enabling one to measure net economic damages.

What Really Happened in Those First Two Cases?

In the airline case plaintiff expert's projections of lost income were based on overly optimistic assumptions regarding the future market for imported leather goods, especially high quality skins from Korea. Once more realistic adjustments were made, namely, those reflecting declining industry profit margins, the estimated economic losses were greatly reduced.

In the dentist case economic losses were based on lost rent, asset value of the building, lost profits from his own medical practice (adjusted for mitigation profits), the costs of restoring 5,000 patient records which were destroyed, and less tangible, the loss of practice value due to the erosion in customer base during the disruption.

Who are the Main Providers of Expert Economist Services?

Previously, academic economists offered this service. Many remain active either as

consultants or through affiliation with specialty companies which provide economic analysis. Management consulting firms have started to build economic witness services which complement their other services. However, at the end of the day, it is the credibility of the individual on the stand and the quality of his or her analysis and presentation which makes the difference.