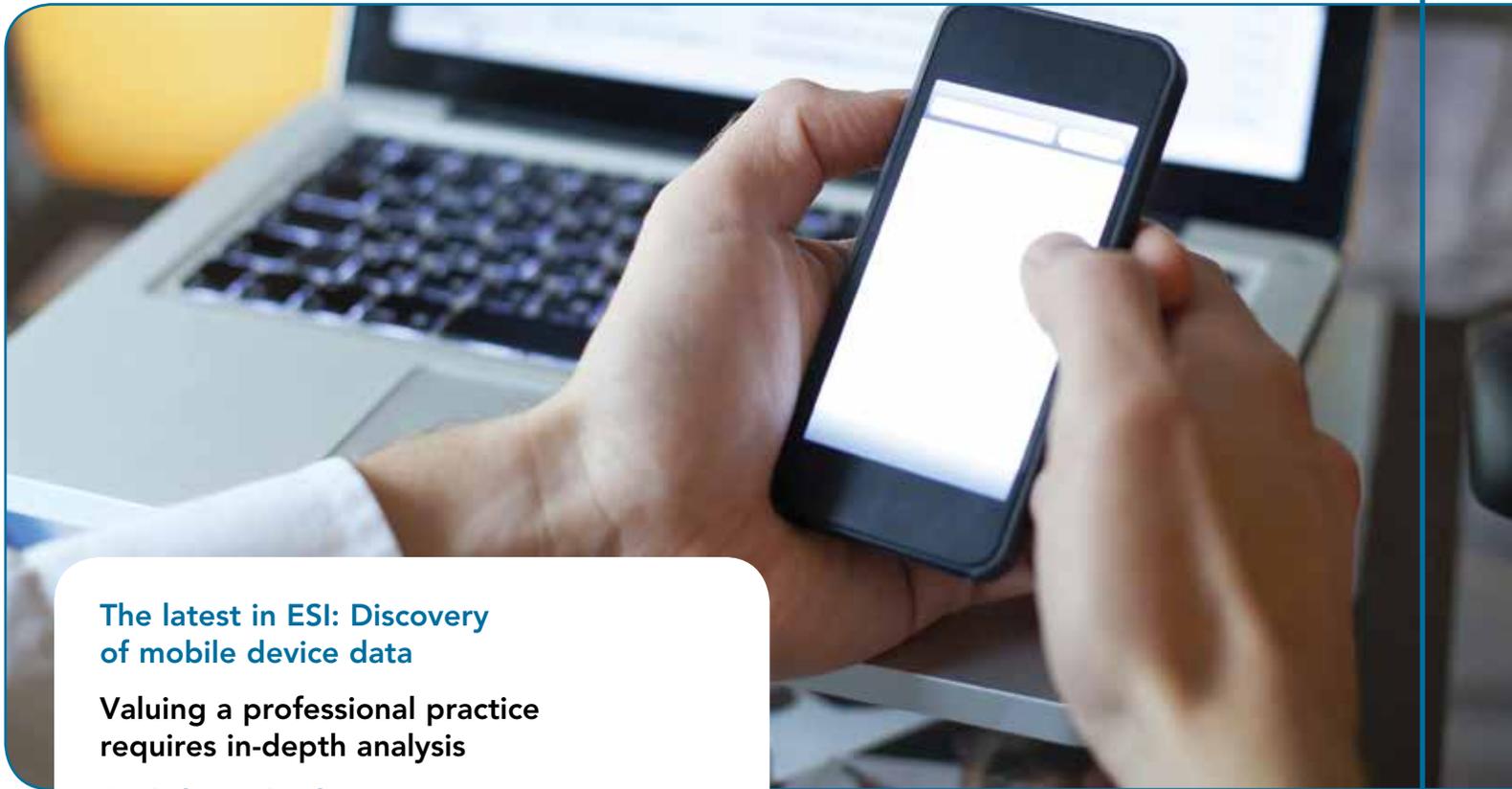


— Advocate'sEDGE —



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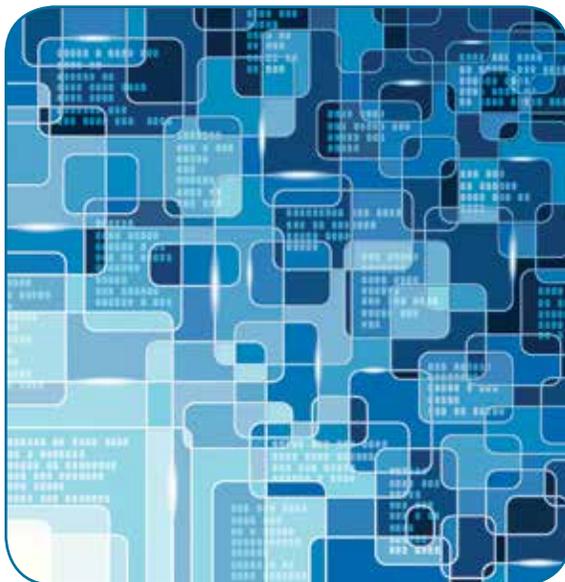
The latest in ESI: Discovery of mobile device data

From smartphones and tablets to “phablets,” mobile devices are everywhere these days. They’ve long since passed over from the realm of simple personal use to become an integral part of how people conduct business. It’s no surprise, then, that electronically stored information (ESI) captured on such devices has become the target of discovery in all types of litigation.

Collecting and reviewing this data presents substantial challenges. Be sure to plan your discovery strategy with input from mobile device data experts.

DATA COLLECTION CHALLENGES

By its nature, mobile device data makes for a more complicated discovery process than one used to capture traditional personal computer or enterprise system data. For example, mobile devices lack industry standards and use several different operating systems. Devices frequently are customized by different mobile carriers or the users themselves and might not have the latest updates installed.



If a device *has* been updated regularly, it could contain data generated under older versions. Further, new devices and operating systems appear almost weekly, usually with little advance notice of their specifications. As a result, experts may need time to develop customized methods for accessing data on the newest mobile models.

Assuming a business controls a mobile device for discovery purposes, it may need to issue a litigation hold to preserve relevant data.

2 APPROACHES TO BYOD

Another potential challenge relates to a device’s ownership. Bring-your-own-device (BYOD) policies have become popular in many workplaces, with employees encouraged to use their personal devices for work purposes. Must an employer produce ESI stored on those devices? The case law has been inconsistent.

Courts have generally taken one of two approaches:

- 1. Practical ability.** From this perspective, a business is deemed to have the necessary “possession, custody or control” of ESI to produce it if the business has the “right, authority or practical ability” to obtain the information from a nonparty to the action, such as an employee.
- 2. Legal right.** With these types of rulings, a business isn’t considered to have the requisite control unless it has actual possession of, or a legal right to obtain, the ESI.

DIGGING INTO A DEEP DATA REPOSITORY

The amount of data commonly found on today's mobile devices is almost overwhelming. In addition to e-mails, texts, voicemails and contacts, the typical mobile device is a repository for:

- ▶ Call logs with a history of calls made, received and missed, including their dates and times,
- ▶ Calendar information on meetings and appointments, important dates and reminders,
- ▶ Chats — including group and video chats — usually via third-party applications,
- ▶ Cloud data from storage and synchronization apps, such as Dropbox and Google Drive,
- ▶ Locations, including geolocation data captured by operating systems, coordinates embedded in photographs and locations determined by apps,
- ▶ Memory card data, ranging from photos, movies and music to text messages and files, which may also be found on the device's internal memory,
- ▶ Social media account access, and
- ▶ Web history, including websites visited, bookmarks and cookies.



Assuming the business *does* control a mobile device for discovery purposes, it may need to issue a litigation hold to preserve relevant data. Counsel will need to determine the appropriate preservation strategy, taking into account where potentially relevant data is stored. For example, some device data may also be available elsewhere, such as on a more accessible server or backup. Attorneys also need to consider how they'll avoid collecting irrelevant personal data and preserve the chain of custody. Keep in mind that possession of a device doesn't guarantee access — passwords and chargers should also be collected.

DATA REVIEW HURDLES

Collecting mobile data is just one challenge. Reviewing that data can be another. Most forensic tools for mobile data aren't able to extract data into the generic format that's needed to use many common discovery review platforms. This can make it more difficult to review several different data types together.

What's more, the dates and times on mobile data must be normalized so that, for example, text messages and e-mails share the same time zone. This can be especially tough with texts because times may differ between sending and receiving devices. A message is timestamped on the sending device with the time on that device, as well as the server time on the receiving device when the message is delivered. If the receiving device is turned off or in airplane mode, or is otherwise incapable of immediately receiving a text, timestamps can differ substantially for a single message.

TAKE A PROACTIVE STANCE

Given the difficulty of retrieving mobile device data, you need to consider the issue as early in the litigation process as possible. It's not enough to know a client's document and data retention policies and procedures. You also must determine which types of mobile data exist, how and where that data is stored, and how it can be retrieved for discovery purposes. ▶

Valuing a professional practice requires in-depth analysis

Goodwill can be a significant asset for a professional practice. It may include both “personal” goodwill that’s attributable to individual owners and “business” goodwill that can be transferred to third parties. When accountants and other types of professionals divorce, the amount of goodwill to include in the marital estate can become contentious (and may vary depending on state law). If expert testimony on the issue is inadequate, a court might look elsewhere for help, as it did in a recent Texas divorce case, *Hill v. Hill*.



A CRITICAL BALANCE

The husband in the case became a principal at a Big Four accounting firm shortly after getting married. The partnership agreement provided that his sole interest in the firm was his required capital contribution.

When accountants and other types of professionals divorce, the amount of goodwill to include in the marital estate can become contentious.

In the case of “separation” — death, withdrawal or retirement — he would receive the balance of his capital account, less any amount he borrowed from the partnership. At the end of 2010, the husband’s capital account held \$715,000, and his loan balance was \$700,900.

EXPERTS DISAGREE OVER VALUE

At trial, the wife’s expert used what was essentially an excess earnings method to value the husband’s

partnership interest. The expert found that the husband owned a 0.1% interest in the firm and his \$1.5 million average annual income included \$700,000 in replacement compensation based on comparable positions. This left \$800,000 in income attributable to the husband’s ownership interest (goodwill). The expert applied a 33.3% capitalization rate and concluded that the fair market value of the interest, including goodwill, was approximately \$2.4 million.

The husband’s expert conceded that a large professional practice could possess business goodwill, separate from individual partners’ personal goodwill. But he stressed that the practice’s governance was important when valuing interests in the firm. The expert opined that the only way the husband could access the value of his interest was to sell it back to the firm in case of separation. He therefore valued the interest at \$14,100 — the difference between the capital account and the outstanding loan amount.

COURTS WEIGH IN

The trial court didn’t agree with the husband’s expert that the partnership agreement controlled the interest’s value. However, it ultimately relied

on the agreement to value that interest. In light of the lack of reliable evidence presented on the values of business and personal goodwill, the court concluded that the value of the husband's interest to include in the marital estate was \$14,100.

The court of appeals affirmed, characterizing the expert testimony on the existence and availability of business goodwill as "vague and confusing." It pointed out that the wife's expert failed to distinguish between personal and business goodwill, while the husband's expert acknowledged business

goodwill could exist but deemed the partnership agreement controlling.

MINIMIZING LITIGATION RISKS

The appellate court in *Hill* observed that part of the problem was that the firm's partnership agreement lacked provisions addressing the valuation of a partner's interest. Ensure that your clients' buy-sell agreements stipulate a clear method for valuing ownership interests, ideally via an independent appraisal. ▶

Back from the future

Discounting losses for lost profits damages

Increasingly, financial experts are asked to project damages for losses that a plaintiff will incur in the future and discount those losses to present value. With business litigation such as infringement and breach-of-contract cases showing little sign of letting up, attorneys need to understand how such discounting works.

PURPOSE OF DISCOUNT RATES

To project damages for losses, an expert first determines the relevant loss period. This could be derived from the:

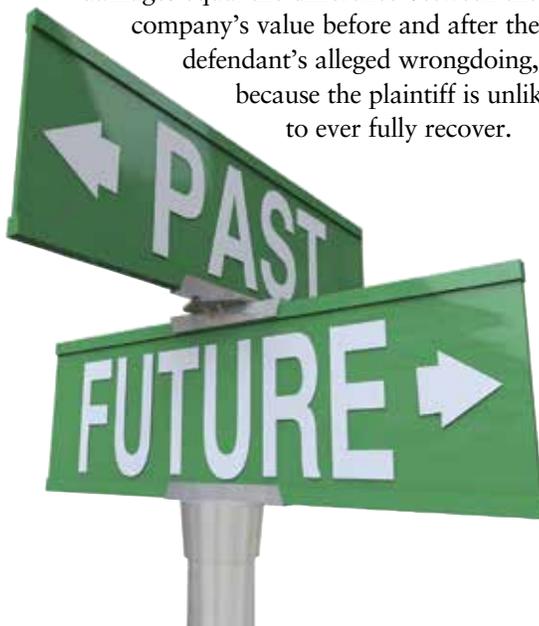
- ▶ Term of a contract,
- ▶ Useful life of a product, or
- ▶ Amount of time required for the plaintiff to reasonably mitigate losses.

Undiscounted lost profits generally represent the difference between the plaintiff's expected net cash flow (or other measure of economic benefit), "but for" the alleged legal violations of the defendant, and the plaintiff's actual net cash flow.

An expert then uses discount rates to compute the present value of lost profits from each month or

year. Each period's discounted losses are combined to arrive at the net present value of lost profits. Discount rates must accurately reflect the time value of money and the risks a particular business faced in the absence of an injury — specifically, uncertainty that lost profits the business has claimed would actually have been achieved.

It's important to note that the value of the business may be more appropriate for computing damages involving the destruction of a business, shareholder oppression, family law or tax issues — or when the loss is permanent and complete. In these cases, damages equal the difference between the company's value before and after the defendant's alleged wrongdoing, because the plaintiff is unlikely to ever fully recover.



MULTIPLE CHOICES

Discount rates should reflect the probability that a plaintiff's lost profits would have materialized "but for" the defendant's alleged wrongdoing. If the company has a consistent earnings history and is likely to achieve its projected future earnings, a lower rate of return may be appropriate. Experts also consider relevant case law, contract terms and the lawsuit's context when deciding on an appropriate discount rate, though never as a primary or sole support for calculations.

Common rates chosen by experts include:

Safe rate. The so-called safe rate, or Treasury rate, is often a good starting point. It reflects inflation and a "rental rate" for the use of funds.

Cost of equity. A financial expert can determine the cost of equity using one of several build-up methods or the capital asset pricing model, which considers market, industry and company-specific risks. The discount rate may begin with

the Treasury rate and increase based on risk, using stock market benchmarks and qualitative assessments of the plaintiff's operations.

Cost of debt. The use of this discount rate presumes that the plaintiff's borrowing rate approximates both the time value of money and the risks the plaintiff faced in the absence of an injury.

Weighted average cost of capital (WACC). The WACC represents a weighted average of the returns paid to debt and equity holders for their investments, based on the costs of equity and debt.

NO SIMPLE MATTER

Calculating lost profits damages is rarely as straightforward as it may seem. If a financial expert applies the wrong discount rate, the result could significantly under- or overestimate lost profits. That's why it's important to engage someone with extensive damages experience. ▶

Warning signs of vendor fraud

Vendor fraud can be one of the worst violations of a business owner's trust because it involves the collusion of an employee with an outside party or a conspiracy between two or more — often longtime — suppliers. Such collusion can be costly. According to the Association of Certified Fraud Examiners, the median loss in a fraud committed by a single person was \$80,000, but when incidents involved two perpetrators, the median loss jumped to \$200,000. When four or more perpetrators were involved, the median loss exceeded \$500,000.

So it's important that your clients know how to spot vendor fraud. Here are some of the most common schemes.

FIX, RIG AND DIVIDE

Most people are at least somewhat familiar with the concept of price fixing. But contrary to popular belief, price fixing isn't only an agreement



among competitors to set the same price for goods or services. It also refers to competitors jointly establishing a price range or minimum price. Such agreements violate the Sherman Antitrust Act, regardless of whether the prices are unreasonable.

A similar fraud is bid rigging, where two or more vendors agree to steer a company's purchase of goods or services. A *bid-rotation* scheme calls for all participating vendors to submit bids while taking turns as the low bidder. Under a *bid-suppression* scheme, two or more vendors illegally agree that at least one of the participants will withdraw a previously submitted bid or not bid at all. The intent is to ensure acceptance of one particular bid. *Complementary bidding* is marked by competing vendors submitting token bids with a high price or special terms that will make them unacceptable to the company.

Another way vendors cheat is through market division. This occurs when competitors agree not to compete in a specific segment of a market — whether based on geography or customer type. If bids are solicited by a customer in that segment of the market, the competitors either won't bid or will submit complementary bids. A lack of competitive bidding drives up the price for the soliciting company.

OVERCHARGING TRICKS

Vendors might involve an employee on the inside by paying that person kickbacks to facilitate his or her employer's payment of a fraudulent invoice. The vendor typically incorporates the kickback amount in the price charged, thereby compounding the amount the company is overbilled.

Kickbacks aren't the only vehicle for overbilling a company. Vendors can submit invoices for their goods and services that are inflated in several

WHERE DOES PROCUREMENT FRAUD FIT IN?

Many use the terms "procurement fraud" and "vendor fraud" interchangeably, yet there's a difference between the two. Procurement fraud encompasses a broader range of schemes — some of which don't involve actual vendors.

For example, employees might invent a phantom company and submit false invoices under its name. Signs suggesting that a phantom is at work include photocopied (rather than original) invoices, payments made without supporting invoices, and suspicious vendor addresses, including a post office box or one that matches an employee's home address.



subtle ways. The price charged may exceed the prices agreed upon in the related contract. In other cases, the invoice might reflect charges for more goods than the customer actually received. Or a vendor could alter the date on a genuine invoice and submit for duplicate payment.

TO CATCH A SCHEME

Share with your clients information about the types of vendor fraud that could be occurring in their organization. Although it's difficult to recover damages once an incident has occurred, catching a scheme early can help limit losses. They might consider, for example, hiring an expert to conduct vendor audits.

Better yet, encourage clients to put strong internal controls in place that will discourage their employees from attempting this type of theft. ▀

The experience you need. The service you want.

Whether you are dealing with matters of contract disputes, fraud investigations or other economic damages, you need accountants who have extensive experience in preparing and presenting complex commercial cases. In other words, you need Arnie & Company.

For more than a decade, our firm has provided the legal community, business owners and other individuals throughout Texas with prompt, accurate and effective accounting, consulting and litigation support services that include:

- ▶ Contract dispute and analysis
- ▶ Fraud investigations
- ▶ Lost profit analysis
- ▶ Securities claims
- ▶ Shareholder derivative actions
- ▶ Purchase/Sales agreement warranty claims
- ▶ Legal and accounting malpractice claims
- ▶ Intellectual property analysis
- ▶ Other economic damage claims

Arnie & Company has an especially strong depth of experience in the analysis of commercial damages and in conducting forensic investigations. Dennis Arnie is both a Certified Public Accountant and a Certified Fraud Examiner. He has frequently testified as an expert witness in a variety of state and federal courts and various arbitration hearings.

Thanks to the firm's commitment to delivering outstanding service, Arnie & Company has become a trusted advisor to many leading law firms and businesses in the Houston, Dallas, and Austin areas. Our clients include numerous Fortune 500 companies in various industries, as well as significant privately held companies and individuals.

We welcome the opportunity to put our experience and advanced knowledge of commercial damage analysis and forensic accounting to work for you and your clients. Please call us at 713-840-1634 and let us know how we can be of assistance. ▶

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