

The Role of the Economist in Litigation

Presented by

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CLE Seminar on Expert Witnesses
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What Does an Expert Bring to the Table?

1. A Point of View

- An expert views matters put in front of him/her from the perspective of his/her training and experience.

2. A Tool Box

- We all have specific skills and methodologies. Such attributes are also a function of training.

Perspectives of Various Experts

- **Accountants**

- An accountant's first reaction is to go to the books and records of the firm.

- **Engineers**

- An engineer will want to examine the technology of production.

- **Economists**

- An economist will be drawn to the markets in which the firm operates.

Tools of Various Experts

In some fields verbal logic is most common and in others mathematical. We also have ways of addressing problems.

- **Accountants**
 - Will dissect the books and records -- examine history.
- **Engineers**
 - Will develop mathematical or scale operating models.
- **Chemists/Physicists**
 - Will conduct experiments.
- **Economists**
 - Will develop mathematical or statistical models.

In choosing any expert, you need to consider what type of analysis must be done and what type of data is likely to be available.

An economist will be of little use in computing reliance damages, this is clearly the realm of the accountant. Similarly, an accountant is untrained in projecting sales.

The Economist's Perspective and Tools

Economists tend to think in terms of products, markets and physical volumes.

- Who sells how many of what to whom?
- Where are the buyers and sellers located?
- What is the nature of competition?
- How is the market price determined?
- What drives cost?

Noteworthy Economic "Tools"

- When an economist needs a price, interest rate or other quantity to use in an analysis, he will tend to look to the product and financial markets for an answer rather than "building it up" from accounting costs.
- Economists are trained to think in terms of marginal change
- Economists are generally well-versed in mathematics and statistics and tend to approach problems using those tools.
- Economists also are comfortable with probabilities and will build models incorporating them. We are trained in doing simulation studies.

Types of Economists

Economics is a broadly-scoped profession and one size does not fit all, especially in litigation.

Macro Economics

- The study of the economic system of a region or country or even international economic systems.
- Examples of macro economic schools of thought include Monetarists, Keynesians and Supply-Siders.

Micro Economics

- The study of the economic functioning of product markets, firms or other non-global economic actors.
- Branches of micro economics include finance, labor economics, anti-trust economics and managerial economics.

The type of economist that will be most able to help you in developing and presenting your case depends on the nature of the case.

Both the specific training and the rigor of the command of various analytical tools depends on the branch of economics in which the individual was trained and practices.

In the vast majority of business litigation matters, the best background for an expert is financial or managerial economics.

Most other economists have little training in business matters and are unschooled in accounting, marketing, business strategy, valuation and many of the other important aspects of business analysis.

Fools and Charlatans in the Profession

One of the problems with using economists in litigation is that the profession seems to be populated with such a large number of fools and charlatans.

Especially in the torts area, economists routinely make predictions which are wildly at odds with what one reads in the daily newspaper.

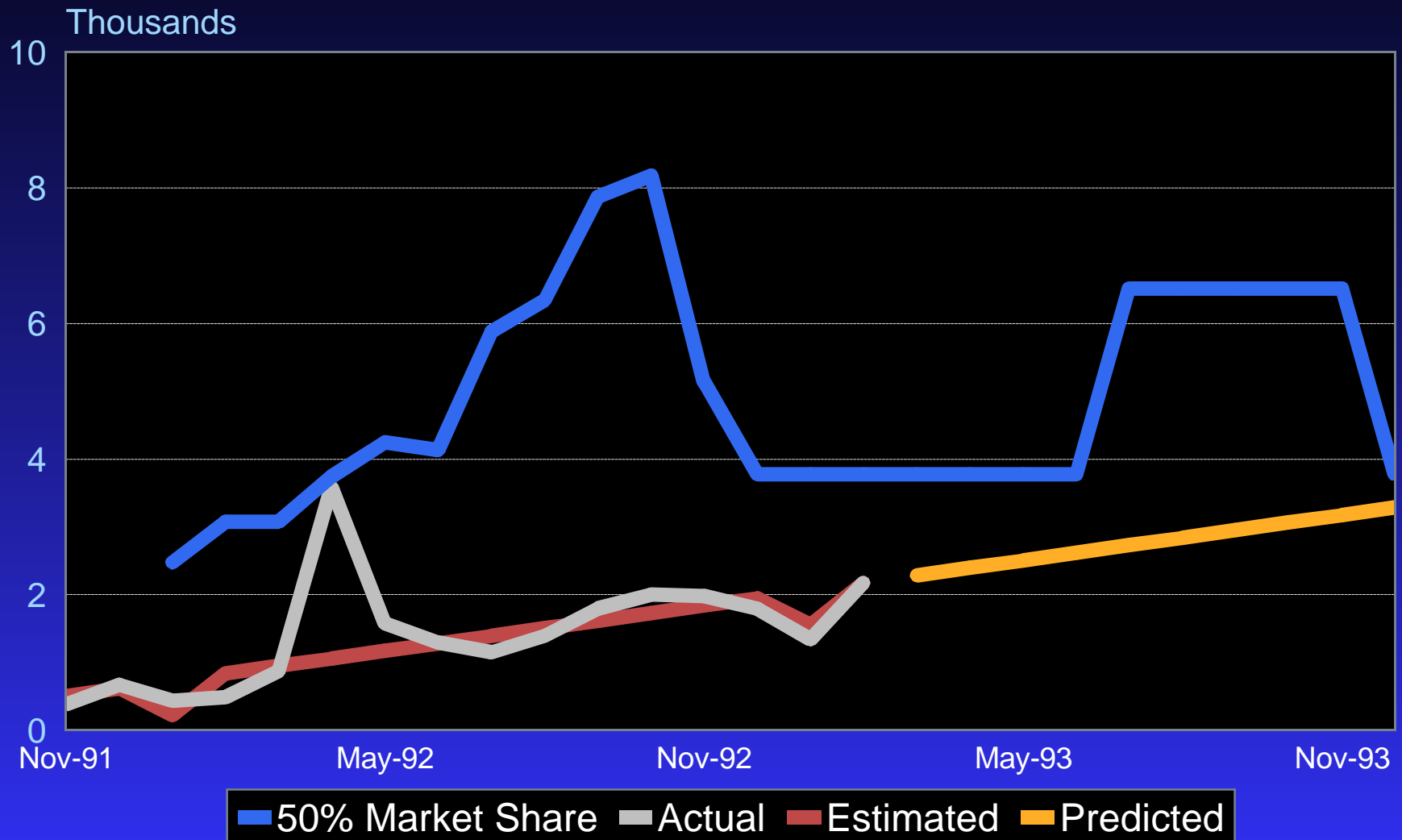
One of the difficulties in dealing with expert testimony in a discipline which is rhetorical is that objective, consistent methodologies appear to be non-existent.

This is not true and perhaps one of the best reasons for hiring an economist to assist you is to help you find the information you will need to reveal a charlatan as such.

Believe it or not, there are objective standards and sources of consensus forecasts that can be used to confront a fool with his folly.

Plaything Toy Co.

"Bounce About" Sales



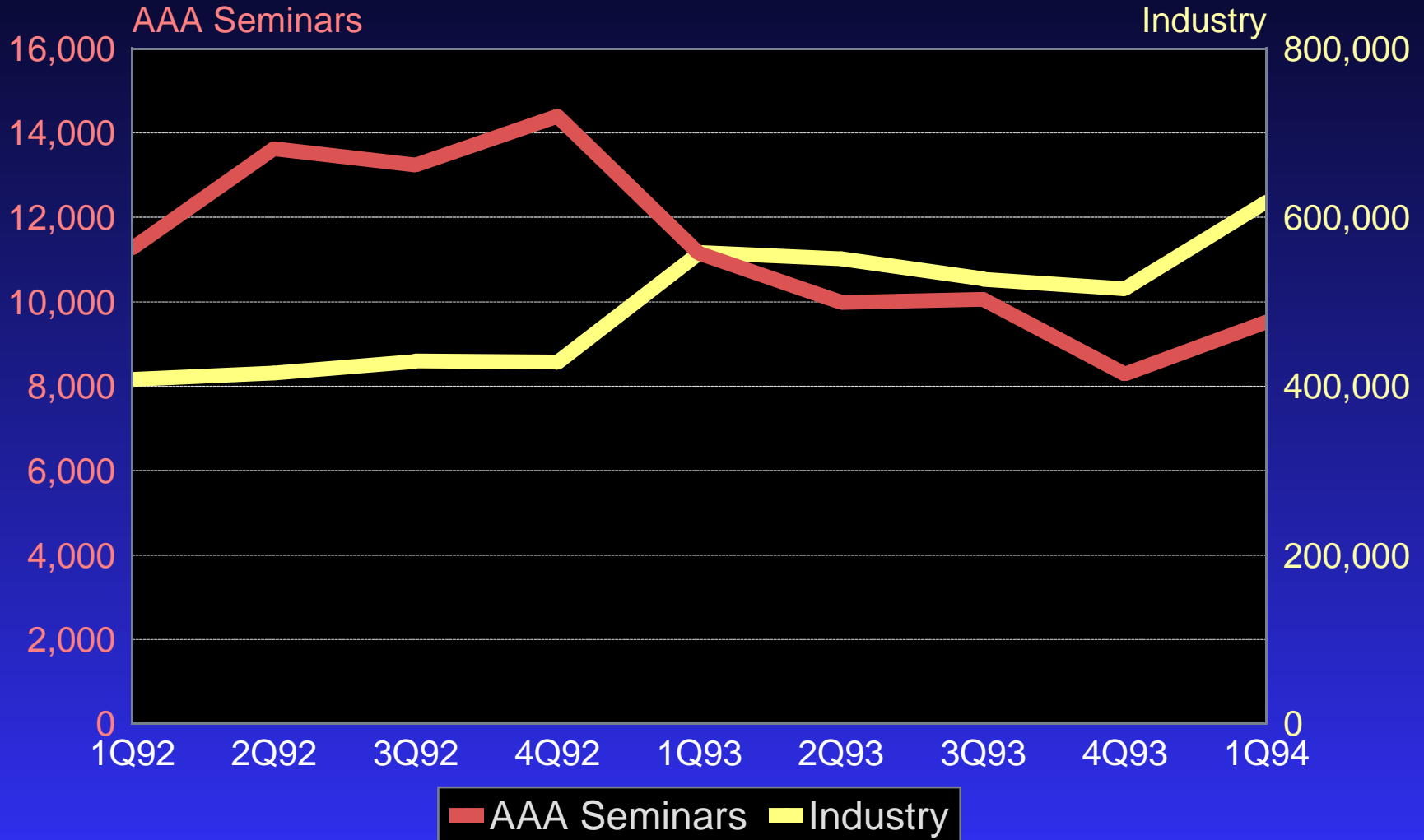
Failure to Prosper

(For Losses & Unrealized Profits, 1985-88)



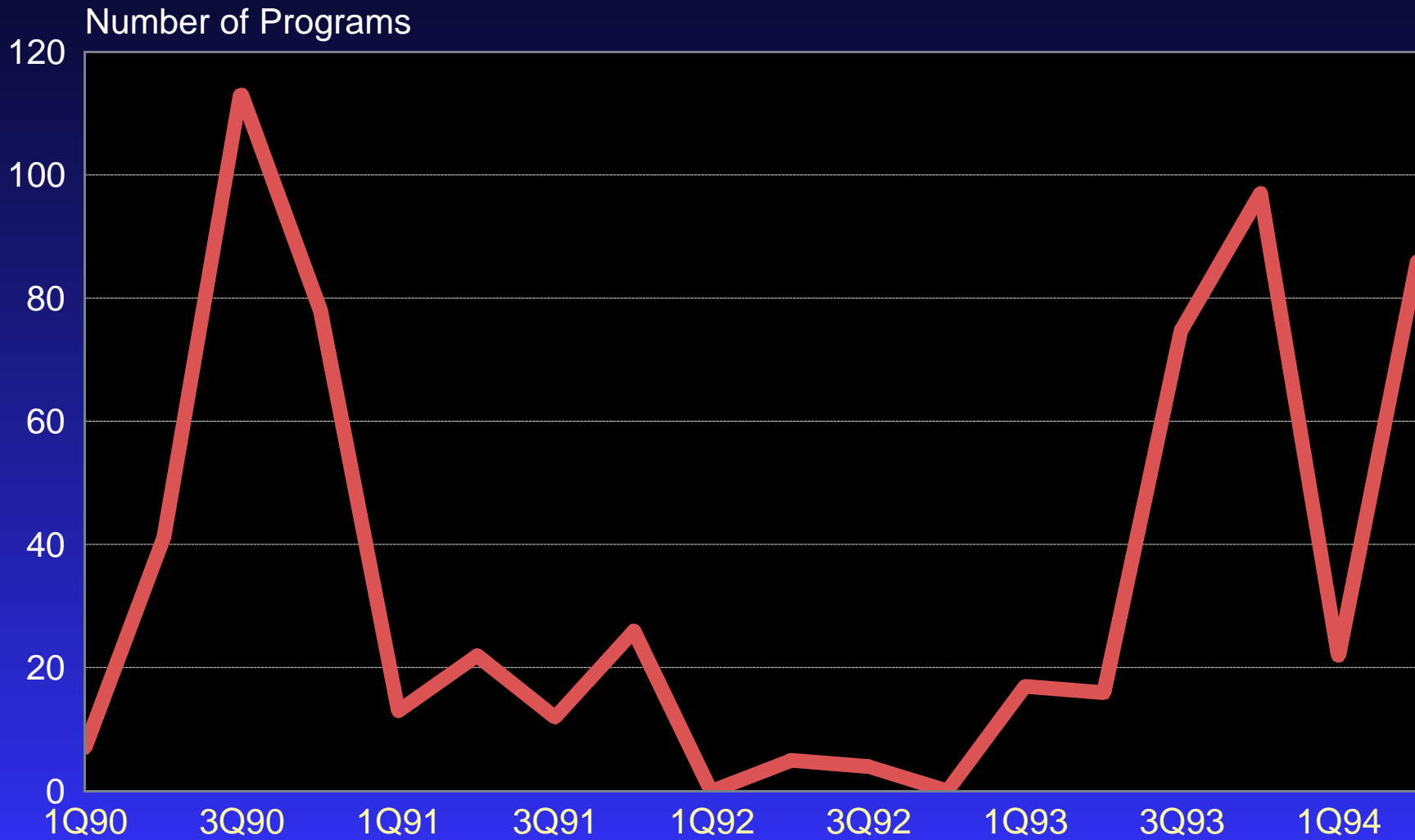
Seminar Attendance

AAA Seminars & Industry



Number of Seminars With New Topics

AAA Seminars



Value of 20% Interest Estimated by John Korschot

Estimate After Correcting Errors

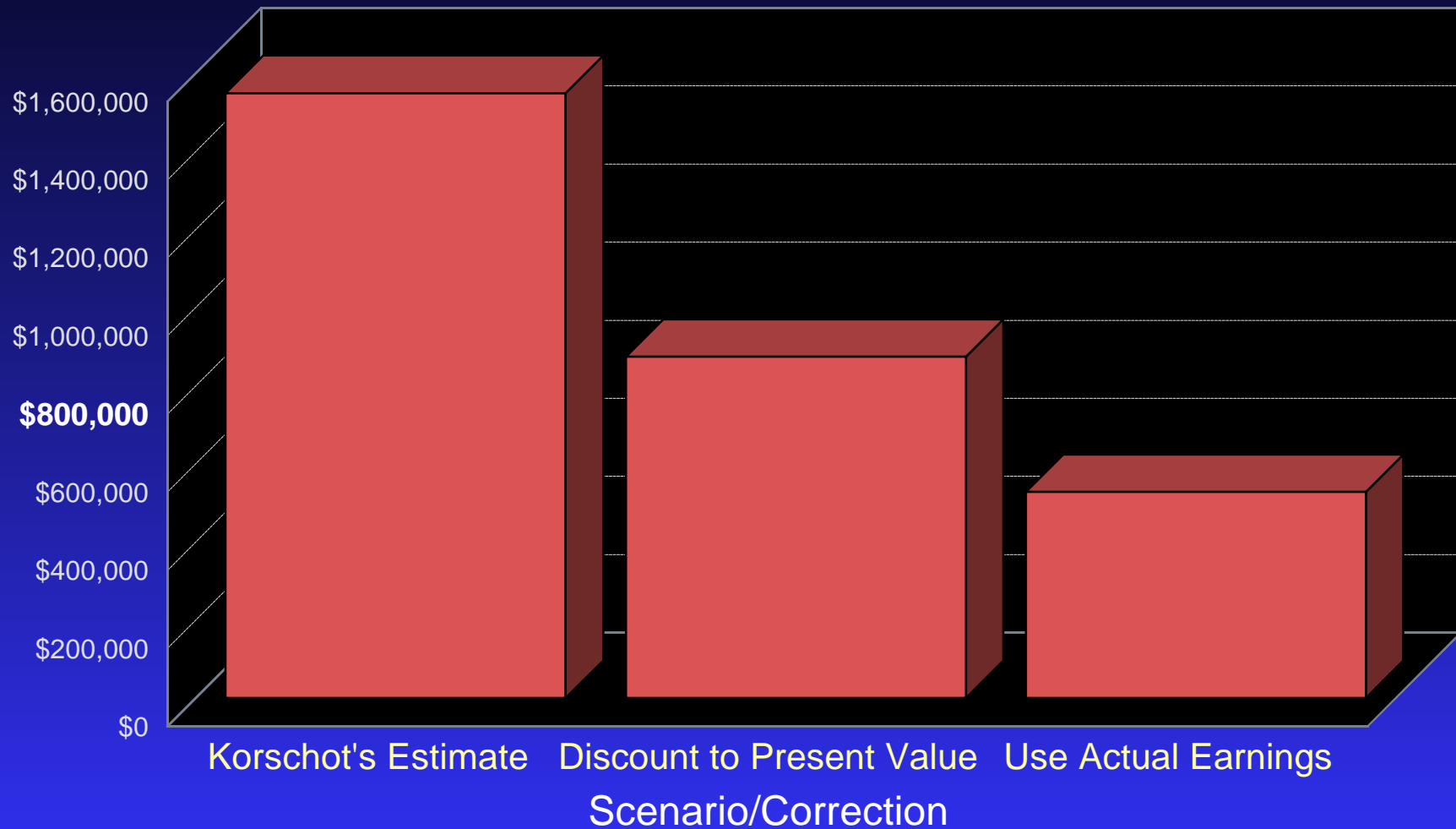


Figure 1
Original Data

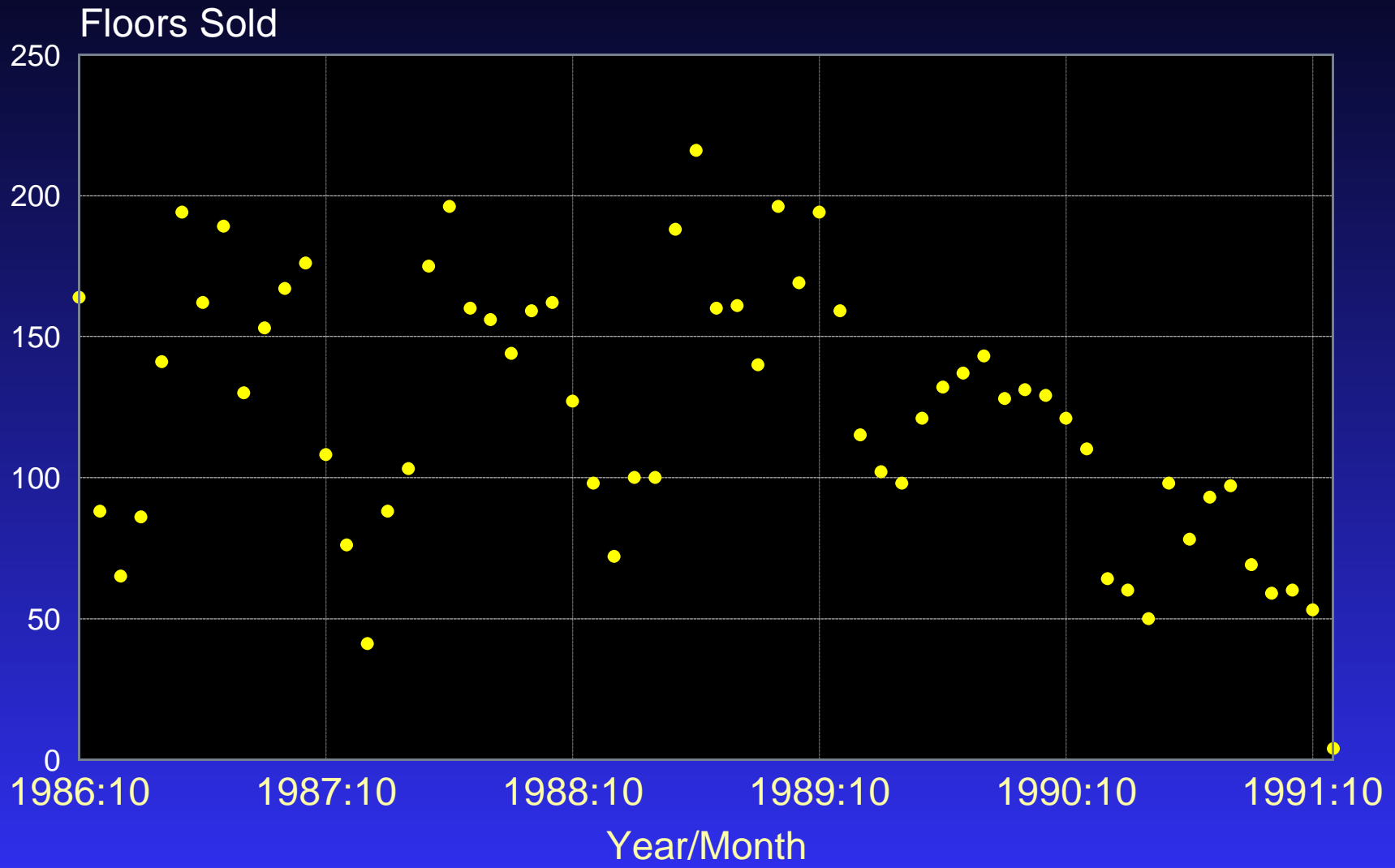


Figure 2
Seasonally Adjusted Data

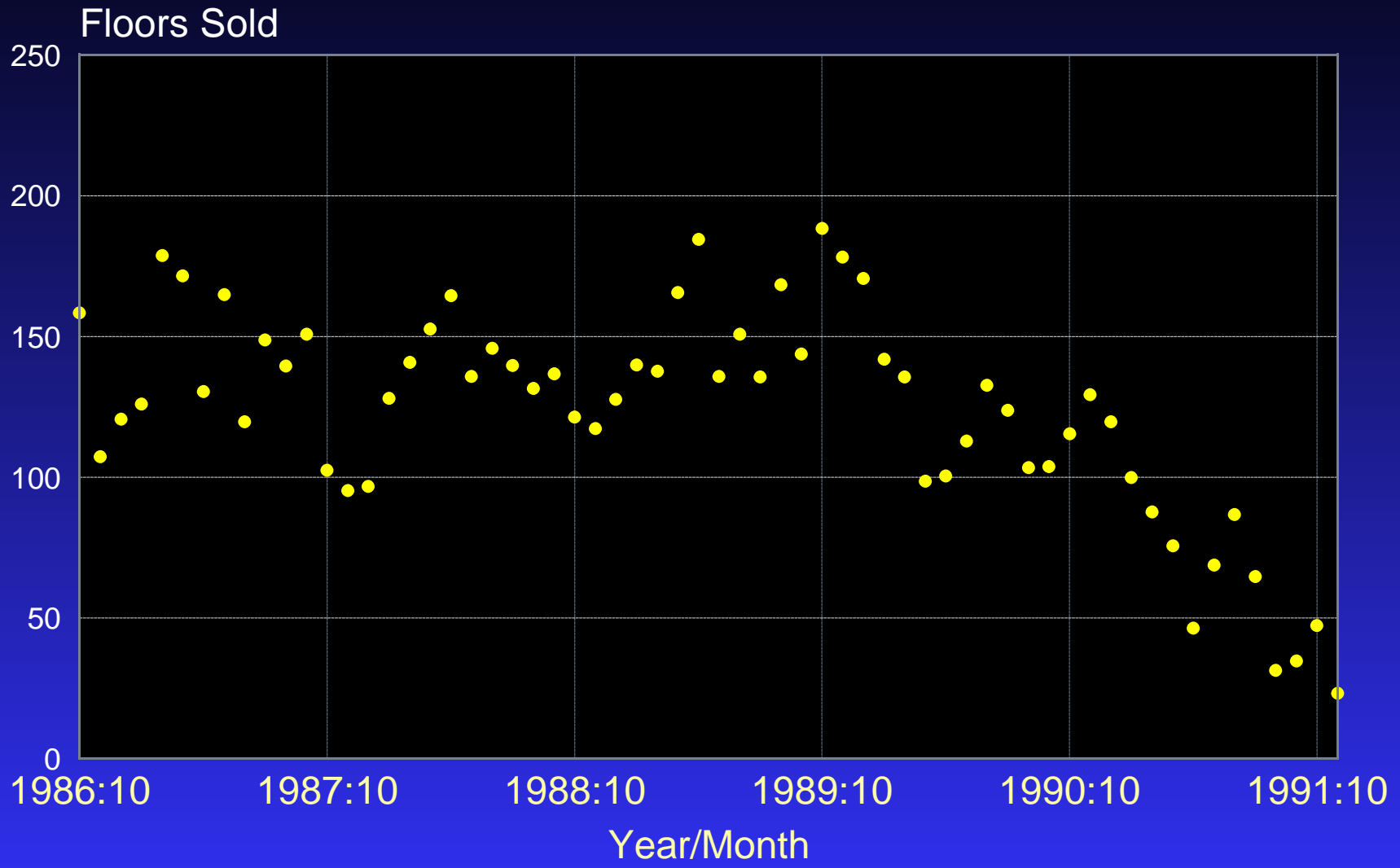


Figure 3

Intercept Shift Model

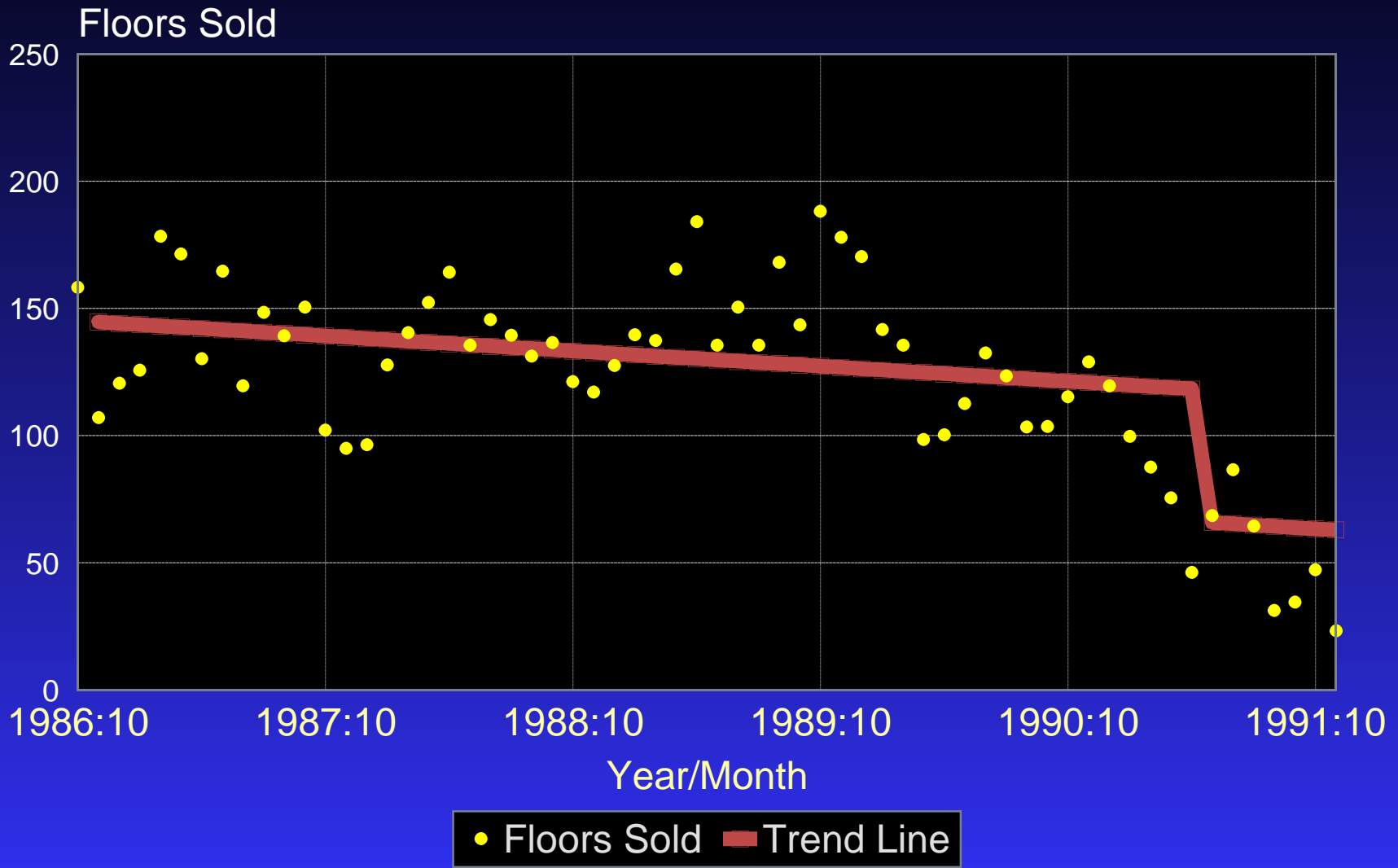
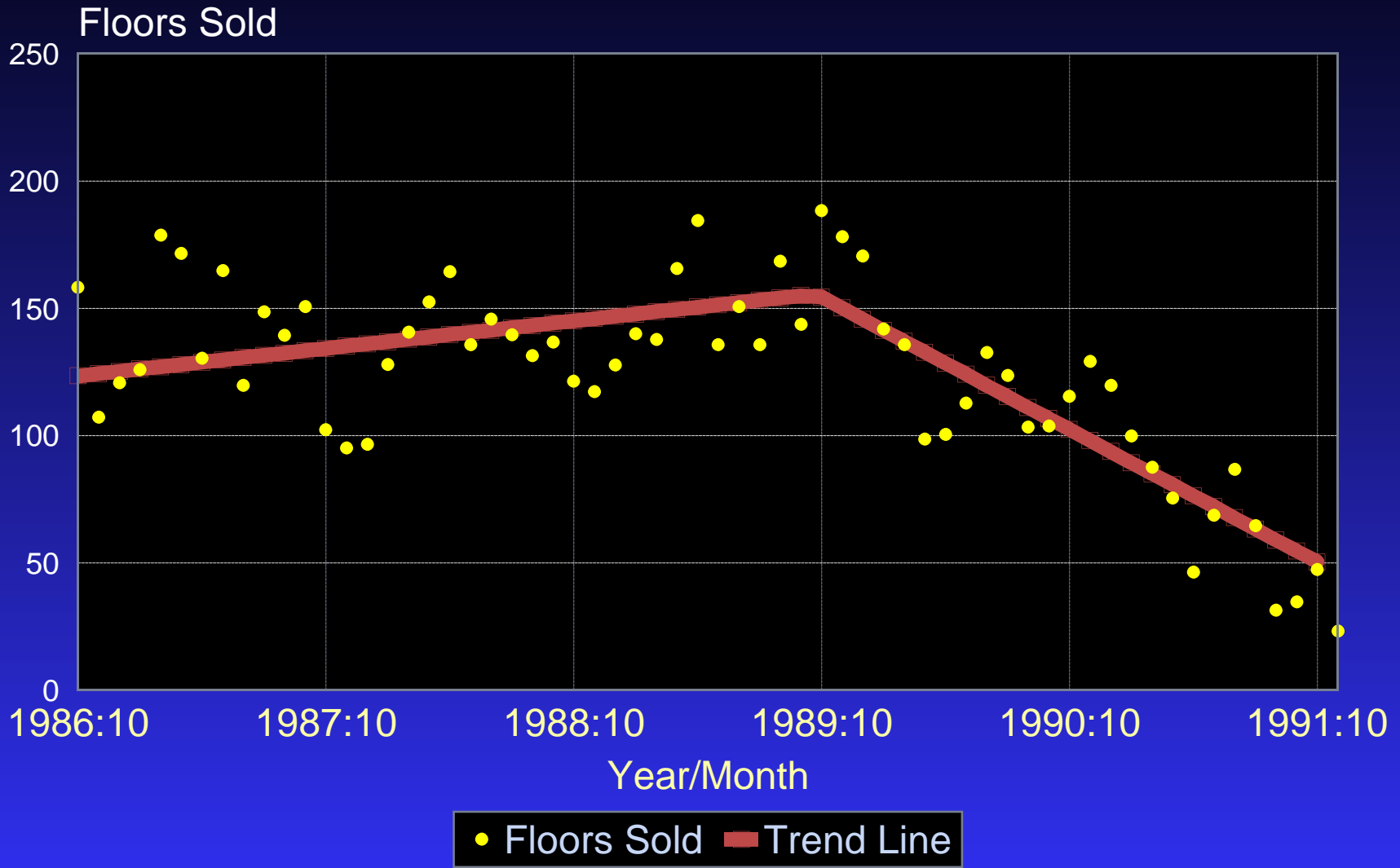


Figure 4
Seasonally Adjusted Data



Business Valuation

Application of Statistical Analyses

Cluster Analysis

- Identifying comparable companies on the basis of similar financial profiles

Regression Analysis

- Identifying a relationship between value multiples and fundamental financial characteristics