



# *The* Expert

Perspectives on Litigation Services

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# Statutory attorneys' fees: Make your case with the help of the FJC manual

Determining that an attorneys' fee award is proper under federal fee-shifting statutes is only the first step for judges. They also must calculate the appropriate amount. A Federal Judicial Center (FJC) manual for judges, *Awarding Attorneys' Fees and Managing Fee Litigation*, offers insights into how a judge might approach the award in your case.

## The lodestar defined

In 1983, the U.S. Supreme Court established the lodestar method for calculating attorneys' fees in fee-shifting cases. The method is simple: Multiply the hours the attorneys reasonably expended by the applicable hourly market rate, disregarding any contingency fee agreement.

A judge determines the reasonable rate by referring to the marketplace. While the particular attorney's customary billing rate marks a starting point, it's not always decisive. The Supreme Court, for example, has allowed nonprofit attorneys to recover compensation at the market rate of the community at large. The D.C. Circuit extended this holding to for-profit attorneys who charge some clients lower rates to promote public interest. And the reasonable rate for out-of-town counsel is based on the rates in the court's jurisdiction, so it might be lower or higher than the attorney's actual billing rate.

***A majority of courts have rejected the notion that the lodestar in a case should be adjusted downward for unsuccessful claims.***

Some courts also might use a rate lower than the attorney's usual rate if the case is outside the attorney's usual field of practice. And, the Supreme Court has noted that a reasonable rate for experienced attorneys is likely greater than for new attorneys in the same market.



Finally, different rates might apply to different tasks. In-court work might earn more than out-of-court work, while the liability phase of a trial might merit more than the remedy phase.

## Reasonable hours expended

The Supreme Court expects counsel to exercise "billing judgment." It also advises trial courts to exclude from the initial fee calculation any hours that weren't "reasonably expended," including hours for "excessive, redundant and otherwise unnecessary" work.

Courts have reduced awards for a variety of reasons, such as:

- Duplication of services,
- Failure to pursue settlement prior to filing a straightforward suit,
- Excessive total time billed considering the lack of difficulty of the case, and
- The deployment of too many attorneys or too much conferencing.

But reasonable hours can include travel, lobbying and public relations work, if they are necessary to litigating the case.

## Downward adjustments

A majority of courts have rejected the notion that the lodestar in a case should be adjusted downward for unsuccessful claims. They usually hold that successful

and unsuccessful claims were legally or factually intertwined, or that counsel devoted most of its time to the litigation as a whole. Exceptions do exist, such as where claims were based on different factual theories and different legal theories.

Federal courts, however, have been known to adjust the lodestar amount downward in these circumstances:

**Limited success.** A judge may reduce the lodestar amount if the plaintiff achieved only limited success, as gauged by the results in terms of relief. But a reduction is unlikely merely because not every argument or theory succeeded.

**Low or nominal damages.** The Supreme Court has said that a judgment of low or nominal damages can result in the plaintiff receiving low or no fees, but that not every nominal damages award must lead to a denial or significant downward adjustment of fees. Nominal damages can represent a victory in the sense of vindication or the advancement of public policy goals.

**Disproportionately low damages.** According to the FJC, at least in cases that serve the public interest, the fact that a lodestar amount far exceeds the damages award doesn't alone represent sufficient grounds for a downward adjustment. At the same time, it theorizes that "disproportionality could come into play when determining if counsel spent an unreasonable number of hours on the case in light of the probable outcome."

**Rejected Rule 68 settlement offer.** Under fee-shifting statutes that treat fees as part of legal costs, attorneys' fees incurred after a settlement offer are not compensable if

the rejected offer proved more favorable than the eventual judgment.

## Upward adjustments

Federal courts also have considered upward adjustments to a lodestar award. The Supreme Court, however, has repeatedly stated that the novelty and complexity of a piece of litigation are reflected in the lodestar and thus are not a basis for an upward adjustment.



Similarly, superior results or representation typically don't form the basis for an upward adjustment. According to the manual, though, in rare cases where "the success or quality of representation transcends what can be expected given the hourly rates and number of hours expended," a judge can enhance the lodestar amount.

## Valuable knowledge

The FJC manual provides valuable guidance for attorneys building their cases for fees. When seeking fees, familiarize yourself with the applicable statutory language; a little knowledge can help determine whether your fees are treated as costs, among other things. ■

## Proving the lodestar

The party applying for an attorneys' fee award carries the burden of establishing the lodestar to the satisfaction of the judge. Rules regarding necessary documentation vary by jurisdiction.

The 11th Circuit Court of Appeals, for example, has indicated that a fee petition should include a summary of time entries, while the Third Circuit has explicitly rejected the requirement of time summaries, finding a chronological listing of time spent per task sufficient. A number of courts mandate that such a listing not be too general. Some courts require contemporaneous fee records and may substantially reduce or even deny a fee award in their absence. Others accept reconstructed time records if supported by other evidence.

When it comes to reasonable rates, applicants must offer more than an affidavit attesting to their usual rate. Judges will require evidence that this rate is in line with the market rate. Generally, affidavits from other attorneys verifying their rates or the prevailing market rate will suffice. Judges also may rely on their own knowledge of the market — especially in the absence of satisfactory documentation. They cannot, however, substitute their own notions of fairness for the market rate.

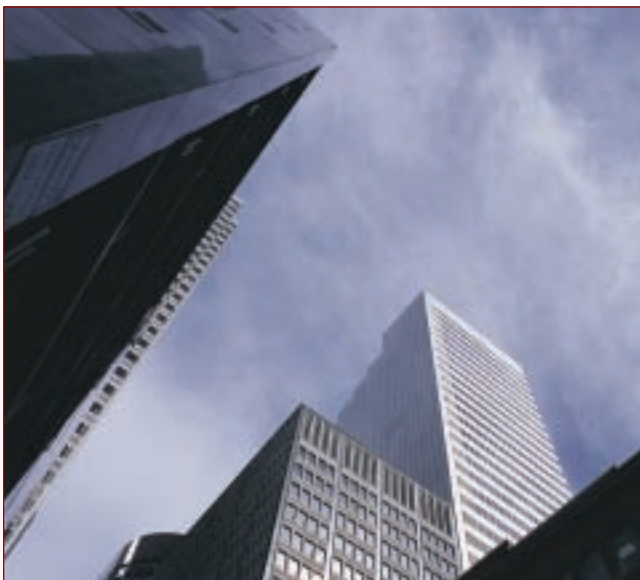
# New rules for business combinations

## FASB's proposed Statement 141 requires reports at full fair value

The Financial Accounting Standards Board's (FASB's) proposed replacement of Statement No. 141, *Business Combinations*, would dramatically alter the accounting standards for all types of business combinations. Among other changes, it would require business combinations to be reported at full *fair value* under the acquisition method. Statement 141 currently requires that a business combination be reported on the basis of the accumulated *cost* of the combination.

### Fair value matters

The acquisition method requires an acquirer to: 1) determine the acquisition-date fair value of the acquired business, 2) measure and recognize individual assets acquired and liabilities assumed, and 3) identify which company was the acquirer and which was acquired.



Under the new Statement 141, the acquiree's *fair value* matters, not its *cost*. This is usually based on the fair value of the consideration transferred by the acquirer to the acquiree, including contingent consideration and the acquirer's equity securities. Any subsequent changes in the fair value of contingent consideration should be recognized as income.

Consideration that is transferred for something other than assets or liabilities — including payments to reimburse the acquiree for acquisition-related costs — wouldn't be regarded as part of the business combination. This consideration must be accounted for separately.

The new statement also changes the treatment of costs for services provided by third parties, such as consultants, attorneys and auditors. These costs would be expensed, rather than included in the purchase price.

### Special cases

The proposed statement acknowledges that transferred consideration isn't always the best basis for measuring fair value. Transferred consideration wouldn't suffice in cases where no consideration is transferred on the acquisition date or when a majority shareholder obtains control because a minority shareholder's substantive participating rights expire. In these and similar cases, the acquirer must use some other valuation method.

Another special case is the so-called "bargain purchase," where the fair value of the acquiree exceeds the value of the consideration transferred. In this situation, the excess consideration should first reduce the amount of goodwill. If the goodwill is reduced to zero, the remaining amount is recognized as a gain at the acquisition date.

### Treating goodwill

Under the new Statement 141, the amount of goodwill recognized would be the difference between the fair value of the acquiree and fair value of the identifiable net assets acquired. The current statement requires recognition only of the portion attributable to the acquirer.

If the acquirer owns less than 100% of equity interests in the acquiree at the acquisition date, goodwill must be allocated to the controlling and noncontrolling interests. The amount allocated to the controlling interest would equal the difference between the fair value of the controlling interest and the controlling interest's share in the fair value of the identifiable net assets acquired.

### Coming soon

FASB expects to issue its final statement — which would also include changes to the accounting for tax benefits and other aspects of recording business combinations — in the first half of 2007. The International Accounting Standards Board has been working with FASB on this project and is expected to issue its corresponding standard at the same time. ■

# Getting the house in order

## How forensic accountants conduct internal investigations

As the recent Enron trial has returned public attention to questionable corporate accounting practices, businesses and their attorneys increase their focus on uncovering fraud. More than ever, the assistance of forensic accountants is required to help companies ease the concerns of investors, vendors, employees and oversight agencies.

### Professional help

Forensic accountants specialize in conducting fraud audits and investigations to detect irregularities and troubling trends — looking for both telltale and subtle signs of fraudulent activity. Certified fraud examiners in particular undergo extensive training in fraud discovery, recognition, documentation and prevention. These experts are also generally knowledgeable about human behavioral factors and motivations that contribute to the commission of fraud, such as the ability to rationalize fraudulent conduct.

Often, forensic accountants are retained to detect misrepresentations of financial data or to locate missing funds. If you or your client suspects this type of activity, it's important to investigate suspicions as early as possible.

### Typical fraud audits

When you engage a forensic accountant, you can expect the expert to work closely with you and your client to tailor an appropriate investigation to the situation at hand. Depending on the type of fraud suspected, the investigation may be performed on a comprehensive, companywide or a random, spot-check basis.

Forensic accountants will work to determine the scope of the fraud, including how long it has gone on and the parties involved. Investigations typically require extensive document review. In a case involving asset misappropriation, for example, experts might search for forged documents.

***Fraud investigations can be particularly useful to monitor the activities of top executives — even if only for policy lapses.***



They also look for evidence of compliance — or noncompliance — with Generally Accepted Accounting Principles (GAAP). Of course, GAAP compliance doesn't guarantee legitimate accounting, so an investigation might also focus on specific areas that wouldn't necessarily be caught in an audit, such as the use of assets at the operational level. Are they being used as intended or for the benefit of an employee?

### Special investigations

Fraud investigations can be particularly useful to monitor the activities of top executives — even if only for policy lapses. Upper-management employees often are given greater latitude and may be tempted to bend the rules.

When this occurs, it can influence the ethical environment of an entire company and encourage other employees to disregard policies or even commit fraud.

Special investigations also can be effective in uncovering high-level financial fraud. A board usually receives its financial and operational information from a company's highest executives. Investigations provide a method for the board to obtain access to deeper, more detailed information without going through the executive level of management. Instead, investigators can gather information directly from those in the trenches, using methods such as interviews, and immerse themselves in data and information unfiltered by top management. They then can communicate directly with the board.

## Negotiating the privilege issue

While investigations by a forensic accountant can be useful in ferreting out fraud, understand that attorney-client privilege can become an issue. Because accountants lack the protective privilege, they must work closely with you to determine their roles and they need to be cautious about whom they interview. If, for example, plaintiffs' attorneys become involved, these parties are likely to request any notes of interviews conducted by forensic experts.

Even with privilege issues a concern, however, retaining a forensic accountant as early as possible is generally a good idea. It's likely to limit the damage caused by fraud and can even reduce your client's overall litigation costs. ■

## Are your prenuptial agreements as comprehensive as they could be?

Couples enter prenuptial agreements for a variety of reasons. These include protecting specific assets from transfer to the other party at death, protecting the rights of children from previous relationships and preempting disputes over issues such as valuation methods.

Because every situation is unique, you should avoid using boilerplate language when crafting a prenuptial agreement. To ensure all of the concerns and goals of a couple are adequately addressed, consider working

with a CPA. This professional's input is likely to improve the odds that the agreement will hold up in court and that the desired results will be achieved.

### Areas of expertise

CPAs are experts on a variety of tax and valuation issues included in prenuptial agreements. Work with a CPA to:

- Identify assets and liabilities of the individual or parties to be outlined in the agreement and to develop a personal statement of net worth,
- Choose appropriate language, because terms like "assets," "liabilities," "income" and "market value" can carry specific meanings in the context of valuation,
- Run models based on methodologies described to ensure they achieve the results sought, and
- Test for the completeness of disclosures to be included as part of the agreement, because the nondisclosure of major assets or liabilities can form the grounds for the agreement's rescission.

CPAs also can advise on a variety of income and estate tax issues that will help your client minimize these burdens.

### Update agreements

Remember, tax and trust laws change constantly. Prenuptial agreements, therefore, should be reviewed — with the input of a CPA — on a regular basis after marriage to ensure they continue to accomplish the parties' goals.



# Strategic advice on proving trade secret damages

Companies often fear — and with good reason — that departing employees will reveal trade secrets to their new employers or use them to start their own businesses. Trade secret misappropriation can devastate a company financially. Damages in such cases can be measured in several ways, but as a recent case, *Carbo Ceramics, Inc. v. Keefe*, demonstrates, the choice of measure can determine whether a company recovers any damages at all.

## The *Carbo* case

Terry Keefe had misappropriated trade secrets from his employer, Carbo Ceramics, and planned to build a plant that would compete with the company. Keefe served as an officer of Carbo. His transgressions were discovered before he could build the plant or manufacture competitive products.

On appeal, the Fifth Circuit found that evidence supported a jury's liability finding on the plaintiff's misappropriation claim, but the court questioned the damages aspect. Based on Keefe's own revenue projections for a 10-year period, as well as his business plan, the plaintiff's economic expert projected Keefe's revenues over 10 years to be \$238.5 million, with an operating profit of about \$96 million. The expert determined that \$9.3 million of that could be attributed to the trade secrets and discounted that amount to a present value of \$3.9 million.

The court rejected the plaintiff's damages formulation based on its flawed starting point: Keefe's projected revenues. Because Keefe had neither built a plant nor produced a product, the damage model relied on speculative revenues and operating profit. Despite their basis in Keefe's own figures and estimations, the expert's projections were deemed inadmissible, being speculative projections based on "uncertain or changing market conditions, or on chancy business opportunities, or on promotion of untested products or entry into an unknown or unviable market, or on the success of a new and unproven enterprise."

## Alternative damages measures

The *Carbo* court noted that the plaintiff's damage theory did not fit any of the typical theories for trade secret damages. It cited four common methods for measuring such damages: 1) the defendant's actual profits from use of the trade secret, 2) the amount that a reasonably prudent investor would



have paid for the trade secret, 3) the costs saved by the defendant, and 4) a "reasonable royalty" based on the amount a willing buyer and seller would settle on as the trade secret's value.

The court indicated that the last of these, the reasonable royalty method, was appropriate "where the secret has not been destroyed, where the plaintiff is unable to prove specific injury, and where the defendant has gained no actual profits by which to value the worth to the defendant of what it misappropriated."

Ultimately, the plaintiff in *Carbo* failed to present any evidence relevant to the four alternative theories cited by the court. Although the court found evidence supported the liability portion of the misappropriation claim, it affirmed the trial court's grant of summary judgment for lack of evidence as to actual damages recoverable.

## Pick an appropriate theory

Because trade secrets aren't covered by any federal statute, the calculation of damages for misappropriation varies by state. But to avoid the plaintiff's mistake in *Carbo*, consider basing a damages claim on one of the more commonly accepted theories. The most advantageous method will likely depend on the case and party. ■