

2019 NACA CONFERENCE



National Association of Construction Auditors



Is a Rose Truly a Rose? The Difference Between Owner-Retained Auditors and Counsel-Retained Auditors in Litigation

Carina Kraatz, Esq. and Dominic DeBeul, Esq.

Kitch Attorneys and Counselors

www.kitch.com

Carina.kraatz@kitch.com

Dominic.debeul@kitch.com

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Retained by the Owner

- Pros: Direct communication channel with the Owner, cost effective, cleaner scheduling of meetings,
- Cons: Communications are not protected, everything is discoverable, work-product can be used by opposing side, draft reports are discoverable

Retained by Counsel

As expected, the inverse of the previous slide.

- Pros: Communications are protected, work product protection, more coaching by attorney.
- Cons: Expensive for the Owner.

At the end of the day, it is the Clients decision on how to proceed.

Retained by Counsel – The “Expert” Witness

- Do you qualify to be an Expert Witness in litigation?
 - Federal Rules of Evidence, Rule 702. Testimony by Expert Witnesses.
 - State Courts vary on the qualifications of an “Expert Witness,” but largely follow the same guidelines as the Federal Rules.
 - “[q]ualified as an expert by knowledge, skill, experience, training OR education...”
 - The use of “or” is an important function of FRE 702.

Initial Gathering of Information

- Open communication is key to a healthy expert/client relationship.
- The owner and/or client may know very little on the construction auditing process, so make requests for documents often.
- If the project is of public record, the lawyers will subpoena or FOIA request the project documents on your behalf.
- Ask questions to Owner/Lawyer.

What Documents are Really Necessary?

- Documents you rely on in rendering your auditing opinion!
 - Contract Documents;
 - Contract Specifications including Costs of Work;
 - Change Orders and supporting back-up;
 - Sworn Statements;
 - Construction Schedules and updates;
 - Construction Logs and Progress Reports
 - Job Cost Reports;
 - Cost to Complete Report

Continued

- Time Records for employees;
- Payroll Records;
- Checks/other evidence of payment;
- Any and all budgets;
- Labor Tracking Reports;
- Daily Contractor/Subcontractor Reports;
- Independent Research Completed;
- List of techniques relied upon to render your opinion;
- Anything and everything you will use to validate your audit.

What Information Can you Rely on?

- Federal Rules of Evidence, Rule 703, states that the auditor can use any information that he or she would typically rely on in rendering an opinion.
 - You can use anything you normally would rely on in coming to a decision. Information does NOT need to be admissible evidence for your opinion to be admitted.
 - However, State Court Jurisdictions may have different requirements.

What Information Can you Rely on Continued?

- For example, Michigan Rules of Evidence, Rule 703, provides that the facts and data relied upon by the expert **SHALL** be in evidence.
- The facts and information you use in a Michigan Case must come from admissible evidence only, all others will be discarded by the Court.
- Requirement vary state by state, so this is another “Pro” to being retained by counsel.

To Generate or Not Generate a Report

- It all depends on the scope of your engagement with either the Owner or Lawyer.
- Trial Witness vrs Consulting Expert.
- Federal Rules of Civil Procedure, Rule 26(2)(A) and (B) requires your identity to be disclosed to the opposing side and the disclosure **MUST** be accompanied with a written report **IF** you will be used at trial to present evidence.

To Generate or Not Generate a Report

- Although State Courts generally follow FRCP as a guide, they have not fully adopted the disclosures required under the Federal Rules.
- Current Michigan Example – Rule 2.302(B)(4), facts known and opinions held by testifying experts may only be obtained through certain tactics.
- A report is not necessary at this time, but Michigan is currently changing its approach on this topic.

Substance of your Expert Report

- Federal Rules of Civil Procedure, Rule 26(2)(B)(i-vi):
 - Complete Statement of all opinions you will express and basis for them;
 - Facts or Data considered in forming them;
 - Any exhibits used to support your opinions;
 - Witness qualifications including publications authored over the past 10 years;
 - List of cases you testified in over the last 4 years; and
 - Statement of compensation paid.

Deposition Preparation

How to prepare for your deposition:

- Better sharp than smart;
- Reference everything; and
- Demand practice with the attorney.

Deposition Behavior

How to conduct yourself during your deposition:

- Know the professional standards;
- Be polite and respectful;
- Know your scope boundaries;
- Listen to the question and take a breath before answering;
- Keep it simple and only answer the question asked;
- Never guess;
- Avoid toxic words;
- Avoid answers that open another door;
- Handle hypothetical questions carefully;
- Planning starts with your report;
- Avoid unethical or unqualified attorneys; and
- Use of re-direct questions.

Be Aware

The opposing attorney's goals:

- Disqualify or discredit you or your methodology;
- Neutralize you; and
- Turn you into their witness.

Techniques

The opposing attorney's tactics:

- Identify conflicts of interest or lack of independence;
- Expose any bias;
- Confuse you;
- Use hypotheticals to get you to change your conclusions;
- Introduce conflicting theories;
- Introduce conflicting source documents;
- Identify material you did not consider; and
- Show that your conclusions are unreasonable.

Further Challenge to your Expert Opinions

- *Daubert v Merrell Dow Pharms.*, 509 US 579 (US 1993).
- Motion filed by the opposing side to dismiss your expert analysis.
- The testimony of an expert must pass a two-part test, enumerated by a five part standard:
 - Reliability (FRE 702 amended in response of *Daubert* decision);
 - Relevancy (FRE 703).

Daubert Standards

- In assessing the reliability of your expert testimony, the Court will look at:
 - Whether technique or theory can be tested;
 - Has technique or theory been subject to peer review and publication;
 - Rate of error;
 - Existence of standards and controls; and
 - Generally accepted by scientific community.

How does this apply to non-scientific expert such as Construction Auditors?

Kumho Tire Co v Carmichael, 526 US 137 (1999)

- The Court held in *Kumho* that the Daubert Standards can also be used to assess the reliability of nonscientific expert testimony upon “the particular circumstances of the particular case at issue.” *Id.* at 150.
- The Supreme Court has continuously updated the standards to meet the needs of various different expertise.
- The standards are more like guidelines to be applied to an experts skill.

Contract Design Group, et al v Wayne State University, et al

- CDG and Robert Murray sued WSU, et al, alleging violations of procedural/substantive due process (emotional distress) and equal protection, intentional interference with business relations, account state and breach of contract stemming from WSU's concerns that CDG was not complying with Michigan prevailing wage law.
- As a result, in August, 2009, WSU suspended CDG from further work and withheld payment for 29 invoices CDG submitted for completed flooring work.
- Thereafter, in October, 2009, WSU terminated its contract with CDG and later debarred CDG from bidding on future WSU projects.

Contract Design Group, et al v Wayne State University, et al

- WSU employees determined that CDG had not complied with the explicit terms of the underlying contract by failing to produce evidence that it paid its employees Michigan’s statutory prevailing wage rate.
- Contract in question was signed in October, 2008, and was valid through September, 2011, but was open ended and lacked scope or specifications.
 - However, CDG was required to work on a time and materials basis whenever individual projects within the contract period arose.
 - Contractors and subcontractors to keep accurate records and provide the same to WSU upon request.

Contract Design Group, et al v Wayne State University, et al

- In 2008, WSU also required contractors to submit certified payroll documentation before it would process payment. WSU urged CDG to start paying prevailing wage rates.
- CDG complied and submitted the documentation. Although, evidence existed that CDG subcontractors sometimes submitted blank certified payrolls that CDG then filled in to make it appear that the prevailing rate had been paid.
- Anonymous email sent to WSU alleging CDG was in violation of the Prevailing Wage Act putting WSU at risk of losing state funding.
- Documentation showed unusually large profits for and possible payroll tampering by CDG.

Case Study: *Contract Design Group, et al v Wayne State University, et al*

- CDC filed lawsuit against WSU and company due to the termination of the contract and allegations related to prevailing wage loss.
- Of course, the use of an expert was necessary on both sides of the litigation with regards to the account stated and breach of contract claims.
- WSU filed a Motion in Limine to exclude CDG's expert from testifying at trial (which was denied).
- Jury returned a verdict for CDG for \$1,382,064.16.

WSU Appeals Lower Court's Decision RE: Expert Testimony

- Account Stated which WSU failed to pay totaled \$143,837. In the alternative, breach of contract damages would equal the same, cannot recover for both. But, this is exactly what the jury did!
- Argument on appeal
 - Plaintiff may not recover for their breach of contract and account stated claims;
 - Additional damages for those claims and due process “emotional distress” claims were excessive (\$100,000); and
 - Lower court improperly admitted **expert testimony** of Ted Funke.

Whether the Challenged Expert Testimony was Admissible?

- Defense challenged Ted Funke's methodology, that it was based on unsupported assumptions regarding future profits of CDG and that Funke referred to gross profits rather than net profits in his testimony. Lost profits are overly speculative and should be excluded.
- Also argue that the admittance of Funke's testimony was grounds for a new trial because it affected the jury's damages award.

Court of Appeals Decision

- Funke testified that his damages calculations were based on gross profits rather than net profits, contrary to Michigan law stating that such damages must be based on loss of net.
- Further testified that CDG incurred lost profits for 41 months following the disbarment, \$1,062,310.
 - Based on historical sales to WSU over the previous 18 month period.
- Also testified that he never calculated net, as required by MI law, because “[t]here’s no net out of a job cost, there’s just gross profits.”
 - Did not analyze the contract
 - Did not compare the stated profits to contract terms
 - Relied on Plaintiff’s representations explaining the abnormally high gross profits
 - Assumed historical dealings between the parties would be enough to justify calculations
 - Had no accounting information for CDG prior to 2010 although this case involved a 2008 contract.

Court of Appeals Decision

- The Michigan Court of Appeals was anything but complimentary to Ted Funke’s methodology.
 - “Funke’s testimony was hardly a model of precision.”
 - Even as the District Court denied the previous Motion to Strike, it admitted that Funke was nowhere near the “best expert.”
- Ultimately, Funke’s failure to consider certain “key” factors, such as CDG’s probable fraudulent billing practices, reasonably go towards weight of the evidence rather than admissibility.
- Funke’s calculations were scrutinized on cross-examination and critiqued by WSU’s Expert. In this context, the jury could weigh Funke’s testimony accordingly and apparently did so.
- Jury awarded emotional distress damages rather than lost profits.
- Jury performed its function in evaluating such “shaky but admissible evidence.
- Denied WSU’s appeal.



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