

Chapter 4

Expert Determination by Accounting Firms

Some Practical Considerations and Real-Life Examples

Fabienne Borde*

1. Accounting firms are often required to act as “independent expert,” mainly in the context of post-acquisition disputes, when the Buyer and the Seller cannot agree on the calculation of the aggregates (e.g., working capital, net debt) that will be used to assess the final price to be paid in connection with a transaction.
2. There are other instances, less frequent, where an accounting firm may be appointed to act as an “independent expert,” to assess the value of a compensation the parties agreed upon. For instance, an African State and one of its suppliers decided to appoint an accounting firm to independently assess the costs already incurred by the supplier over a mining project that the State had decided to stop.
3. As the parties had agreed not to start litigation, and that the supplier would be compensated for all its costs up to the date the project was stopped, the purpose of the expert determination exercise was to review the costs presented by the supplier and make sure there were correctly calculated, documented and were in effect related to the project.
4. Whatever the final purpose of the “expert determination” be, there are some risks and benefits associated with the use of such a process (section I).
5. There are also some very important aspects to anticipate or verify upfront before appointing any expert (section II), these aspects representing the first mandatory steps of a “classical” expert determination process as carried out by accounting firms (section III).

I

BENEFITS AND RISKS ASSOCIATED WITH THE INVOLVEMENT OF AN ACCOUNTING FIRM IN AN EXPERT DETERMINATION EXERCISE

6. It is commonly admitted that resorting to an expert determination saves time and money for the parties, especially for a determination made in the context of purchase price disputes.
7. One particular appeal of an expert determination in a purchase price dispute is that the issues in dispute can be defined narrowly enough to allow the expert in accountancy and dispute resolution to expeditiously resolve the amounts in question.
8. Moreover, as there is no formal discovery procedure in an expert determination process, the additional time and risks generated by such

* Partner in Forensic Services, PwC Advisory (France)

procedure are avoided. The document production phase will be led by the expert and even if the parties can suggest some documents that may appear of interest to them, the expert will only require and review those that are of relevance for the analyses he wants to carry out.

9. Another benefit of an expert determination is the fact that the parties in most cases agree that the expert determination will be final and binding, which means that there will be no means to appeal to it (unless it can be proven that it is tainted by a “gross mistake”).
10. The fact that the expert determination, once rendered, becomes binding and somehow enforceable, gives some comfort and reassurance to the parties as it sets a limit in time to the dispute and gives the parties some visibility as to the future.
11. For the finance/M&A teams within a business organization that will be involved in the expert determination process, having such a clear limit in time is instrumental as such process is generally very time consuming and business organizations cannot afford to have people devoting all their time to such litigation over a long period of time.
12. Of course, the fact that the expert determination is binding can also be perceived as a risk as there is always a possibility that the expert determination be tainted by a mistake, or even a “gross mistake.”
13. As being able to demonstrate that the expert committed a “gross mistake” in its determination is always a challenge, especially if the expert did not specify clearly the reasons why he reached such and such decision, there is a risk that one of the parties ends up with a determination that is “wrong” with but that it cannot ignore.
14. Yet, “gross mistake” types of situation are rare and can be avoided provided the parties select the appropriate expert.
15. The appropriate expert is not only the one that has all the technical capabilities to work on the accounting/financial issues, but is also the one who is used to dealing with purchase price or other types of disputes.
16. In particular, an accounting expert is the one that will not decide issues of fairness or equity. An expert is not likely to rehabilitate part of an agreement for or against either of the parties, independent of the rest of the negotiated agreement.
17. An expert will read the SPA as it is and will determine the intent of the parties manifested by the SPA’s express contract terms, even if the SPA was constructed poorly¹.
18. As the expert is chosen jointly by the parties and sometimes at the time of drafting the SPA or the contract, they have the ability to take their time and look for the best person to appoint, should they enter into an expert determination process at a later stage.
19. In summary, there are several benefits in using an accounting expert, particularly in purchase price disputes, and these benefits are generally perceived to outweigh some of the risks in expert determination process, such as the binding nature of the outcome or the lack of formal discovery.

IMPORTANT THINGS TO CONSIDER WHEN CHOOSING AN ACCOUNTING EXPERT

Assessing the expert's independence

20. When selecting an expert, it's beneficial to name a firm believed to be capable as early as possible in the SPA process to help avoid potential conflicts that otherwise could arise.
21. It is important to inform the named firm that it is referenced in the SPA as the "expert." The firm can then monitor potential new matters that may be relevant later should a dispute arise.
22. Surprisingly, parties to a SPA rarely inform the named firm and the named firm may not even know it has been referred to in the SPA.
23. Instead, the SPA often includes language that refers to the engagement of a similar firm, should the named firm not be able to proceed with the requested service when asked.
24. One of the main reasons that can preclude an expert from accepting his appointment is a lack of independence or a conflict of interest.
25. When an expert receives from the parties the information that he was selected to act in an expert determination process, his first task is to verify that he is "independent" from each party.
26. Independence can have different meanings in various jurisdictions, however, for an accounting firm this means first that the expert should verify if his firm is the statutory auditor of one the entities involved in the dispute. If this is the case, the expert should normally turn down the appointment as most regulations prohibit the auditor to act in such capacity.
27. As a second stage, the envisaged expert must verify if he or his firm has already undertaken or is currently doing some work for one party or the other. For large accounting firms, such verification may take some time as it is possible that some work was carried out by other teams located in countries different from where the dispute sits.
28. The result of such verification must be disclosed in writing to the parties by the envisaged expert so that each party is made aware of the fact that the expert or the expert's firm has already a business relationship with one party or the other.
29. Depending on the nature, length and/or "value" of this business relationship, the envisaged expert may be considered too close to a party and therefore be considered as not "independent".
30. However, in some instances, even if the outcome of the conflict check shows that the expert has/had a business relationship with one of the parties, the other party may decide to retain the envisaged expert, for whatever reason.
31. In such cases, the fact that these relationships were disclosed to the parties and that a decision was made to nonetheless retain the expert, must be clearly described in writing in the engagement letter.
32. An example of a standard paragraph setting out such situation is enclosed below:

As required by the procedures of our company, we have searched for potential conflict of interest. It appears so far that [X/Y/Z] are recurrent clients of our company, for which we [description of the nature of engagements]. You have indicated that you do not consider these engagements to represent a coming challenge for our independence in the work for which you want to instruct us.

Location of the expert

33. While it's common that an accounting firm is named in a SPA as the one that will act as the "expert" in case of an expert determination process, the office in which the envisaged expert should sit is not often mentioned.
34. Yet, in some instances, matters that do not seem important at first sight may become very important when the decision as to "which expert" is to be made.
35. For instance, if the dispute is between two parties of a different country, there would be a tendency for each party to reject an expert that would sit in the country where its opponent has its headquarters or its main operations.
36. As an arbitration clause often provides for a "neutral" place for potential arbitration, the expert determination clause should probably use the same language, to avoid lengthy debates between the parties about which "office" of the accounting firm should be retained to make the determination.
37. Clearly, the qualifications and experience of the envisaged expert should be considered first, before any consideration regarding his location as in some cases, the technicalities of the issues or of the industry/business under review require a high level of experience or knowledge that only a few individuals may have within a firm.

III

WHAT ARE THE IMPORTANT STEPS OF AN EXPERT DETERMINATION PROCEDURE?

38. Once the expert is chosen, the expert determination process can start, mostly following the same pattern.
39. The first step of the process is the definition of the disputed issues, meaning the issues by which the expert is required to make his determination.
40. This first step is fundamental in the process as this will allow the expert to understand the scope of his assignment, describe precisely the purpose of the determination, and the methodology/guidelines he intends to follow and to calculate a budget and a time table that will be submitted to the parties.
41. In some instances, the parties cannot agree on the scope of the dispute (mainly in purchase price disputes) and the expert may accept to make an initial determination about what claims will be moved forward into the determination phase of the dispute.
42. Once the disputed items are known and agreed by the parties, the expert can draft his engagement letter in which the main aspects of his assignment will be presented.

43. Typically, an engagement letter in an expert determination exercise includes the following clauses:
- Scope / issues in dispute / contractual or agreed method to make the determination
 - Conflicts of interests
 - Timetable
 - Communications with the expert / opposing party
 - Type of deliverable
 - Fees
 - Terms and conditions
 - Governing law and dispute resolution process
44. In the engagement letter, it is important that the expert indicates that he will not accept any ex-parte communication with any party and that all communication should actually respect the adversarial principle (*principe du contradictoire*). In particular, all written submissions to the expert are required to be concurrently submitted at a stipulated time to the adverse party.
45. The fee payment process needs also to be clearly described in the engagement letter, especially since the expert's fees typically must be paid before the determination is released. The most common arrangement is to split such fees equally or in some predetermined percentage among the parties.
46. The engagement letter will also try to describe the way the expert plans to examine and resolve the dispute.
47. Typically, an expert will ask the parties to prepare a first submission in which they will present and document their position, and to prepare a rebuttal to the submission presented by the opponent.
48. Based on these two submissions and its own analyses, the expert will typically prepare a set of his own questions for the parties and give them the opportunity to answer these questions, either in writing or during a physical meeting.
49. The engagement letter must precisely state these different phases and the associated timetable, along with the envisaged date for the production of the expert determination.
50. A last important topic to discuss upon drafting of the engagement letter by the expert is the format/content of the final report.
51. In essence, the expert can issue a long-form or a short-form report.
52. Drafting a long-form report necessarily adds to the total time and cost of the expert's effort, which is something the parties are not eager to accept on many instances.
53. In a long-form report however, the expert must explain the reasons for a decision on an issue-by-issue basis. In such a report, the parties can see if the expert understood the issues and can possibly find grounds for a possible "gross mistake," if any.

54. This would not be possible with a short-form report as in such report, the expert just has to state its determination without disclosing the grounds for them.
55. Therefore, unless the issues in dispute are extremely simple and straightforward, a recommended practice is that the expert should provide a long-form report.

CONCLUSIONS

56. The success of an expert determination exercise is largely dependent on the expert's previous experience of such procedures and its ability to impose and respect a calendar that will be defined in its engagement letter.
57. In order to save time, the expert can be named in advance in the contract or the SPA, but this should not preclude the envisaged expert and the parties to carry out independence checks at the time of the expert's formal appointment.
58. Carrying out this independence check and disclosing its outcome in writing in the engagement letter is crucial in an expert determination process, in particular in order to avoid any subsequent independent concern that could undermine an ongoing process.
59. Other important aspects of the expert determination process must also be clearly defined or described in the engagement letter, particularly the expected format of the report written by the expert.
60. As expert determinations are very often binding and not subject to appeal, except in case of "gross mistake," it may be in the parties' interest to require from the expert a long-form report that would clarify on an issue-by-issue basis the grounds for each one of the expert's decision.

NOTE

- 1 In one dispute, the SPA separated a defined cash adjustment from an additional net working capital adjustment, as also defined; however the SPA did not remove the cash line item from net working capital so the cash balance was determined to count twice in an adjustment.