

BDG Business Valuation Insight

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Federal Rules meet
the 21st century

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Electronic discovery: Federal Rules meet the 21st century

Most businesses create and retain information in some type of electronic format, which may include e-mails, spreadsheets, voice mails, text messages, blogs, accounting records and text files. Increasingly, companies are replacing their file cabinets with laptops, backup tapes, servers, flash drives, cell phones and MP3 players. And all of this electronically stored information (ESI) could be relevant in a lawsuit.

After five years of research, debate, compilation and public comment, the federal judiciary's Civil Rules Advisory Committee finally unveiled its amendments to the Federal Rules of Civil Procedure (FRCP), which govern ESI.

The amended rules strive to provide litigants with a cost-effective, timely way to share electronic data. As attorneys and valuers gain experience with the new-and-improved FRCP, which took effect in December 2006, they're learning that ESI brings to the table many information storage challenges and space-saving opportunities.

Making discovery proactive

It's never too soon to bring in a valuation expert, especially when a case involves electronic information. The amended rules require the parties to discuss e-discovery issues no later than 100 days after a lawsuit's filing.

A valuation expert can help attorneys prepare for meet-and-confer conferences by addressing such issues as potential sources of electronic data, control concerns, preferred formats for electronic documents, and ESI preservation and authentication.

Requesting ESI requires a delicate balance. On the one hand, electronic data is prolific compared with conventional paper discovery, and "fishing expeditions" can be costly. In fact, amended FRCP Rule 26(b) protects litigants from the necessity to produce ESI from sources that are not reasonably accessible because of undue burden or cost. The amended rule also provides for a "safe harbor" limit on sanctions under Rule 37 for the loss of electronically stored information resulting from routinely operating computer systems.

Conversely, if the parties request too little information at meet-and-confer conferences, the court might deny later



ESI requests. Even if the court grants access, late e-discovery limits the time available for analysis, authentication and integration of the findings into a valuator's report.

Seeking authentication

One characteristic that differentiates electronic data from tangible evidence is the ease with which it can be changed. In a keystroke or in the normal course of business operations, electronic data can be altered or deleted — sometimes without the creator's knowledge. This risk of alteration is compounded because multiple users at remote locations sometimes have access to ESI.

A valuation is only as reliable as the information upon which it is based. Like any type of evidence, ESI cannot be taken at face value. All parties must take steps to verify the sources and protect the accuracy of electronic data. (See "Authentication checklist" on page 3.)

Most important, management should institute a "litigation hold" when it decides to file a lawsuit or reasonably anticipates that the company will be sued. If not, ESI may be compromised. A litigation hold suspends all routine document destruction and retention policies. Furthermore, employees are instructed to collect and preserve all relevant ESI.

Factoring in forensics

Forensic specialists often can recover electronic data that appears to have been changed or deleted. For example, when an e-mail is drafted, sent, forwarded or deleted, the computer stores related metadata that doesn't appear on the face of the e-mail. Although the person might think e-mail has been deleted from the system, forensic specialists can track the metadata to reveal who created the original draft, who received and read the file, and who deleted it (and when). Likewise, information erased from a computer hard drive is often recoverable.

If you suspect spoliation of relevant evidence, forensic retrieval can locate, restore and search lost information. Larger valuation firms typically employ forensic specialists. Smaller boutique firms can refer you to a competent forensic professional in your area.

Using search functions

Manually searching ESI for relevant information can be costly and time consuming. Fortunately, experts can cull

and vet large datasets using search software. For example, the software can narrow down the volume of electronic data using search parameters, such as keywords, file types, custodians and dates. Alternatively, hashing and near-duplication tools can determine whether two documents are exact duplicates — or where they differ.

Many valuers have access to and experience in using these software tools in cases involving ESI. Thus equipped, an expert is more efficient and less likely to overlook relevant information.

Recognizing expertise as key

Electronic data is a fact of life in the digital world. When interviewing potential experts, inquire about their working knowledge of the amended FRCP, including e-discovery requests, authentication, forensics and searchability techniques.

For more information on e-discovery, visit the U.S. Court's "Federal Rulemaking" Web site at: www.uscourts.gov/rules/congress0406.html. ●

Authentication checklist

A recent federal court case, *Lorraine v. Markel American Insurance Co.*, outlines an 11-step checklist for authenticating electronic records:

1. Does the business use a computer?
2. Is the computer reliable?
3. Has the business developed a procedure for inserting data into the computer?
4. Does the procedure have built-in safeguards to ensure accuracy and identify errors?
5. Does the business keep the computer in a good state of repair?
6. Did the witness have the computer read out certain data?
7. Did the witness use the proper procedures to obtain the readout?
8. Was the computer in working order at the time the witness obtained the readout?
9. Did the witness recognize the exhibit as the readout?
10. Did the witness explain how he or she recognizes the readout?
11. If the readout has strange symbols or terms, did the witness explain the meaning of the symbols or terms for the trier of fact?



Unless the attorney and valuator establish this foundation, ESI may be excluded from evidence or rejected from consideration during summary judgment. To the extent that an appraiser relies on inadmissible evidence, the court may disregard his or her opinion as well.

