

# Utilizing Witnesses Surrounding Complex Real Estate Development Cases

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All legal and other issues should be independently researched.

by *Barry Gross and David Parr*

**W**ith the collapse of the nation's real estate market, court systems everywhere are bracing for the inevitable tide of litigation involving investors, builders, and contractors whose fortunes were washed away in failed land-development projects.

The historic scale of the land bust—especially in hard hit areas such as Southern California—points to a future with more real-estate cases of greater financial scope and technical complexity than most lawyers have seen in their entire careers.

To help them sort through the mess, legal teams on both sides of the litigation table suddenly have a pressing need for expert consultants and witnesses from the worlds of real-estate finance and land development.

But the recognition of that reality only raises more questions: Exactly what types of experts are out there? Which of them are most relevant to a particular case? And how does one find, retain, and manage them?

The answers are not the kind that can be answered by simply thumbing through the Yellow Pages or conducting a quick Google search. The varieties of professional disciplines and layers of expertise involved in a major real-estate project can be dizzying. With the wrong experts and the wrong strategy for deploying them, a legal case can easily become as shaky as the failed real-estate venture that spawned it.

## The Litigation Landscape

There are several potential lawsuits likely to arise from the wreckage of a failed project, either in or outside of potential bankruptcies.

Landowners and investors are often stuck with property that in today's market is worth just a fraction of what it was previously worth, or they expected to realize at the height of the market. Landowners and investors also may be left with the liability of partially built improvements that must be either completed or abandoned entirely. They might blame the development firm for bungling the entitlements and placing the project far behind schedule. They also might say development costs were not accurately projected, resulting in crippling overruns. Hence they will file suit.

Meanwhile, the development firm may be owed millions of dollars for work that was finished but never paid for, and may counter sue the project owner for breach of contract. Various homebuilding companies and other contractors that are owed money might do the same. Finally, the handful of home buyers who are left stranded in a half-built development can also be expected to retain lawyers.

The list of potential litigants goes on: A joint venture may sue planning or engineering firms for poorly designing a project; a bank that provided institutional financing may sue the development partnership or the guarantors of loans for land or construction; the contractors who provided services or construction activities at the property may file a mechanic's lien for payment of work that was completed.

Other parties may jump in from other directions: The local governmental agency may sue the development firm, the lender and the bonding company for guarantees provided under subdivision improvement bonds. The homeowners association may sue the developer for a poorly-structured association that does not provide the specified services delineated in the sales literature.

## Bringing in Experts

Presenting a case for either the plaintiffs or the defense in lawsuits that arise from such complex situations will require a depth of outside expertise.

It is hard to overstate the important role that expert witnesses play in the resolution of any complex litigation, and real estate is no exception. It is well documented that experts hold considerable clout with juries and are essential to a party meeting his or her burden of proof or refuting a claim by the opponent. Cases can be won or lost based on

the quality of the expert testimony. One example where the Court noted the importance of an expert opinion in deciding a real-estate case is the case of *County of San Diego v. Woodward*, 186 Cal.App.3d 82 (1986). In *Woodward*, the Court noted, "the County presented the testimony of . . . a well qualified independent appraiser with 32 years in the real estate business," while the appellants provided "no appraisal and no indication . . . as to why they felt they should have more." *Id.* at 87, 90.

The *California Evidence Code* states that "[a] person is qualified to testify as an expert if he has special knowledge, skill, experience, training, or education sufficient to qualify him as an expert on the subject to which his testimony relates." *Evid. Code*, §720, subd. (a); see also Rule 702 of the *Federal Rules of Evidence* (28 U.S.C.) for the analogous federal rule. Thus, experts do not need to be professionals and any person who has special knowledge, skill, or experience in an occupation, trade, or craft may qualify as an expert in his or her field. The determination of whether an individual qualifies as an expert for a particular matter is generally within the discretion of the trial judge in the case. (*Miller v. Los Angeles County Flood Control Dist.*, 8 Cal.3d 689, 701 (1973).)

Each expert who one side brings to court will need to be matched by the other side. In litigation surrounding a failed development project, there is a potential need for expert consultants and witnesses in at least the following areas. . . .

- Project revenues: An expert may be needed to review initial revenue projections and update them to the current time. The basic qualifications for testimony in this area include knowledge of the project and competitor's projects in the marketplace over the full life cycle of the project.
- Cost estimating: An expert would be required to review the plans and specifications to determine if initial estimates were reasonable and any increases or decreases to these estimates were appropriate. Qualifications include the ability to read and understand engineering and architectural plans and to have a strong background in understanding field operations.
- Determination of land residual value: The experts should have broad knowledge in developing cash flow schedules, including a strong knowledge of present value theory and understanding what really goes on "under the hood" in a real estate development project.
- Underwriting issues: For preparation of a pro-

ject analysis, there are certain estimates that are made, such as the percentage of revenues used for sales and marketing or the cost to construct a certain type of house in a certain locality, when information is not readily available. It is important that experts understand these ratios are estimates.

- Accounting: An expert may be required to determine if accounting was performed properly. Each accounting expert should be a licensed CPA with a specific background in real estate development.

- Project due diligence: An expert may be required to review the history of the project to determine if the entitlements were appropriate for the project and/or if concessions made to local government agencies were in accordance with contemporary standards. The basic expert qualifications should include knowledge of the *Subdivision Map Act*, the *California Environmental Quality Act*, and familiarity with the development process.

- Construction issues: The expert should have field experience that will enable the expert to make reasonable judgments about whether improvements were installed in accordance with the plans.

- Grading issues: Many projects, especially those in hillside areas or flood control regions, are the source of major lawsuits. The expert should have the tools available, especially knowledge of specific grading computer programs, to allow a comprehensive evaluation of data to determine if the grading operation were run in the most efficient manner.

- Project scheduling: The expert should have a working knowledge of project scheduling software and the ability to understand which items are precedents to other items so that the schedule can provide a roadmap for project execution.

- Common interest subdivisions: Often, lawsuits arise between the developer and purchasers of property in a subdivision. An expert in this area should have a strong knowledge of the standards and practices of the Department of Real Estate, as well as an understanding of potential construction defect litigation.

- Public finance: During the past 10 years, public finance in the way of Community Facilities District formations has provided significant benefits to developers. Unfortunately, as the market has changed in the past several years, the perceived benefits of public finance have acted as a detriment to a project. The expert should be able to testify on creation of the special districts and

the impact they have on a project's viability.

- Damages: The expert should have a broad working knowledge of all the items described above in order to support the claim for damages at the conclusion of the trial. As stated above, an expert should understand the development process, the construction process, the sales and marketing process. The expert should also possess the ability to provide courtroom exhibits for use in the trial.

## Managing the Team

An important distinction needs to be drawn between an expert retained by an attorney for the attorney's own use, and an expert who will testify as an expert in a trial.

Information produced by an expert for the attorney's own use is generally protected from being discovered by the opponent by reason of the attorney work product privilege. *Scotsman Mfg. Co. v. Superior Court*, 242 Cal.App.2d 527, 531 (1966). Counsel often needs to discuss the strengths and weaknesses of the case with an expert in confidence and without the threat of disclosure in discovery. A consulting expert can fill this role by sharing opinions, conducting investigations, and preparing reports that are not discoverable so long as the expert is not named as a witness at the trial.

However, the privilege is destroyed once that expert is designated as a prospective witness at a trial. (*Scotsman Mfg. Co. v. Superior Court, supra*, 242 Cal.App.2d at 531.) Upon such a designation, the product of the expert's employment is subject to discovery under *California Code of Civil Procedure* §2034.210, subdivision (c). *National Steel Products Co. v. Superior Court*, 164 Cal.App.3d 476, 488 (1985).

When the same expert's status changes from a confidential consultant to a testifying expert, the scope of discovery should be limited to those issues upon which the consultant is retained to testify, with work product protection remaining for other issues and subjects. However, there are few bright lines in this area and counsel should recognize the risk that all work done by the testifying expert could be subject to discovery by opposing counsel.

The experts must be experienced and prepared for analysis and testimony required at both depositions and the trial. Many individuals or organizations are inexperienced in legal procedures and may often make simple mistakes that affect the trial. An expert should under-

stand that use of email almost always leaves a "smoking gun" that can be used against the client.

If an organization is chosen as an expert witness, one person should be designated the "Testifier" and this person should be insulated from exposure to facts that could be harmful to the client.

Others in the organization should screen damaging documents from the Testifier. This practice will assist in providing a clean record for use in conclusion of the dispute. Under attorney-client privilege, if the Testifier should happen to discover information that is damaging to the case, the Testifier should be removed from the case and another expert witness should be hired. The expert also must understand that there is a requirement to provide all documents reviewed, prepared, or relied on during the assignment. As a result, preparation of information that may prove harmful should not be memorialized in writing.

In conclusion, the historic nature of the real-estate collapse calls for an equally weighted response from the legal profession. The basic guidelines outlined here will serve legal professionals not just in a case or two, but time and again. So they should be treated not just as another "quick tip list," but as a solid framework for what might become a major chunk of any given law firm's future business.



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