Litigation in the Bankruptcy World: Selected Hot Issues

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"Litigation In The Bankruptcy World—Selected Hot Issues"

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"Litigation In The Bankruptcy World—Selected Hot Issues"

1. ***Discovery Matters In Bankruptcy Cases:***

"Get to the point, get there quickly, get there cost effectively, and get the facts and documents organized"

2. ***Expert Witness Matters:***

A. "If they know more than you, they must be an expert--right?"

B. Bankruptcy Judges are becoming more discriminating (and more selective) in who and what is a proper expert and the purview of expert testimony. The panel will discuss and explore the *Daubert* criteria for experts, and discuss practical and strategic issues related to the effective use of expert testimony in bankruptcy litigation

3. ***Examiner Reports In Bankruptcy Litigation:***

A. "We won! We have an examiner! She has written a thorough report that's great for our position!....Now what?"

B. The The legal and strategic issues related to examiner reports in bankruptcy litigation.

MATERIALS

A. Bernstein, Seabury & Williams, "The Empowerment Of Bankruptcy Courts In Addressing Financial Expert Testimony", 80 *Am. Bankr. L. J.* 377 (Summer 2006)

B. Salerno, "Expert Witnesses In Bankruptcy Litigation" (2015)

C. Sousa, "The Examiner's Report And The Hearsay Rule: Are Both Mutually Inclusive?" *ABI Journal* (Part I—December/January 2007); (Part II—February 2007)

D. "Order Approving Stipulation Regarding Use Of Examiner's Report", *In re Tribune Company, et al*., Case No. 08-14131 (KJC) (2/4/11)

E. *In re Fibermark, Inc*., 339 B.R. 321 (Bankr. D. Vt. 2006)

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ARTICLE: The Empowerment of Bankruptcy Courts in Addressing Financial Expert Testimony

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LEXISNEXIS SUMMARY:
... Bankruptcy practice famously embraces flexible processes. ... acknowledged that an expert's failure to disclose information in the report can risk exclusion of the expert testimony, the court concluded that the failure to identify a particular treatise in an expert report did not warrant exclusion of the expert testimony, when the reliance upon the treatise was made clear in a "Daubert" hearing outside the presence of the jury and the opposing party, which had more than one day to prepare for cross in front of the jury, was not unduly prejudiced. ... In assessing the reliability of a proffered expert's testimony, a court's inquiry under Daubert must focus, not on the substance of the expert's conclusions, but on whether those conclusions were generated by a reliable methodology. ... More importantly, from the perspective of cost to the estate, both the debtor as the plan proponent and the creditors committee will expect to have the bankruptcy estate bear all of the costs of each respective expert witness and all of the attendant professional fees and costs incurred before, during, and after trial in connection with the reports and testimony of their expert witnesses. ...

TEXT:
[*377]

Bankruptcy practice famously embraces flexible processes. Necessity, especially in chapter 11 cases filed by operating companies, calls for expedited hearings. n1 Unless the parties "in the money" reach global settlements that

promptly reveal to the market who the anticipated management for the reorganized entity will be, the value of the assets, and, thus, the value available for distribution to creditors, is likely to decline. Creditors will also suffer lost opportunity costs if that distribution is delayed. Moreover, the longer a chapter 11 case remains on the docket, the more administrative costs will accrue and inevitably erode the amount of the ultimate distribution to creditors. Only in chapter 7 liquidations of businesses, or in the post-confirmation litigation phase of a chapter 11 case, does the pace slow down.

Meanwhile, the distribution to various classes of creditors depends on seemingly infinite variations of valuation questions that will be addressed by an array of purported experts. In these time-sensitive situations, bankruptcy courts are bound by the Supreme Court's insistence that federal trial courts [*378] act as tough-minded gatekeepers in excluding irrelevant or unreliable expert testimony. This confluence of forces has forced bankruptcy courts to confront expert testimony upon proper and timely objection. Under the standards established by the United States Supreme Court in the Daubert n2 and Kumho Tire n3 cases, bankruptcy judges are showing an increasing degree of comfort and mastery in performing their crucial role as "gatekeepers," excluding the irrelevant and unreliable reports and testimony of purported expert witnesses. This development is most promisingly found in the reported decisions from 1999 through 2006 with respect to the reports and testimony of financial experts.

Daubert and its progeny have prompted bankruptcy courts to be less passive in admitting purported expert testimony. In the past, some bankruptcy courts freely allowed expert testimony without sufficient concern for its reliability or even its relevance. We were told that those questions went to the weight and not the admissibility of the evidence. This Article examines the evolution of expert financial testimony in bankruptcy cases and demonstrates how Daubert and its progeny have slowly but steadily shifted the bankruptcy court's focus to admissibility of expert testimony in the first instance.

Here, we take one field of bankruptcy evidence, financial expert testimony, and analyze this field through a critical federal evidentiary lens. Although this Article highlights several decisions that have dealt primarily with expert financial testimony in an important recurring context, the total enterprise value of the reorganized debtor in contested chapter 11 confirmation hearings, the observations and culled best practices may apply across the spectrum of issues a bankruptcy court confronts. These other contexts in which expert testimony may also be pivotal in business bankruptcy cases include: (1) valuations of income-producing commercial real estate projects; n4 (2) valuations of specific types of tangible or intangible personal property used by chapter 11 debtors; n5 (3) substantive consolidation of affiliated corporations or other business entities; n6 (4) feasibility of plans of reorganization; n7 [*379] (5) ordinary vs. extraordinary administrative expenses in operating chapter 11 cases; n8 (6) market rates of professional compensation; n9 (7) estimations of contingent liabilities, n10 including under-funding of pension liabilities; n11 (8) the sufficiency of funding for post-confirmation claims trusts in mass tort cases; n12 (9) damages arising from the rejection of executory contracts and unexpired leases; n13 (10) damages arising from breaches of prepetition contracts, n14 including franchise agreements; n15 (11) damages from business torts, n16 including intentional interference with third party contractual relationships; n17 (12) comparable compensation levels for key employee performance plans; n18 and (13) application of the ordinary course defense in avoidable preference actions. n19

The goal of this Article is to facilitate this positive judicial development by examining in depth the lessons taught at both the procedural and substantive [*380] level by these recent decisions. We intend to provide guidance to the reader on the independent role bankruptcy courts must take in handling financial expert testimony. Further, we identify the role counsel should take in preparing, offering, and challenging expert testimony. Finally, we seek to aid the expert in developing a better understanding of the role of, and demands upon, the expert in the bankruptcy process.

I. EMERGENCE OF THE STANDARDS GOVERNING EXPERT WITNESSES

A. Deference to the Scientific Community Under Frye

For much of the twentieth century, federal courts determined the admissibility of expert testimony according to the evidentiary standard laid out in Frye v. United States n20 and its progeny at a time when screening out "junk science"

and unproven theories was a major concern. There, in a short citation-free opinion, the Court of Appeals for the District of Columbia Circuit found expert opinion relating to scientific theory or technique to be inadmissible unless the relevant scientific community deemed that theory or technique "generally accepted." n21 In Frye, the court determined that a systolic blood pressure deception test - a precursor to the polygraph test - was not generally accepted by the scientific community; therefore, any expert opinion derived from this technique was inadmissible. n22 Essentially, under the Frye standard, courts addressing the question of admissibility accorded great deference to the "relevant scientific community," thus avoiding a direct confrontation with scientific uncertainty.

B. Judicial Independence under Daubert

Though criticized by commentators and courts for approximately seventy years, the "generally accepted" test was still the dominant standard used to determine admissibility in 1989 when infants and their guardians sued Merrell Dow Pharmaceuticals, Inc., n23 alleging that its anti-nausea drug, Bendectin, caused birth defects when the drug was taken by pregnant women. There the defendant's experts were prepared to testify that no epidemiological studies showed any causal link between the drug and the birth defects. The plaintiffs' experts concluded the causative link was proven through chemical structure analysis, animal studies, and the unpublished "reanalysis" or "meta-analysis" of previously published epidemiological studies. n24 In response to the [*381] defendant's motion for summary judgment, the district court found the testimony of the plaintiffs' experts was inadmissible, ruling for the defendant: "The federal courts have held that epidemiological studies are the most reliable evidence of causation in this area. Accordingly, expert opinion which is not based on epidemiological evidence is not admissible to establish causation because it lacks the sufficient foundation necessary under *FRE 703*." n25

The plaintiffs appealed to the Ninth Circuit, arguing that the reanalysis was a generally accepted scientific method. n26 The Ninth Circuit affirmed the district court's decision, stating that "...reanalysis of epidemiological studies is generally accepted by the scientific community only when it is subjected to verification and scrutiny by others in the field." n27 Because the reanalysis relied upon by the plaintiffs' experts had been developed for litigation, had not been published, and had not been subjected to peer review, it was inadmissible. n28 Other Bendectin lawsuits were proceeding all over the country at that time using virtually the same evidence that was challenged in this case. The Ninth Circuit echoed three other circuits in ruling such testimony inadmissible, n29 and noted that the contrary decision of the Third Circuit had expressly disavowed the "generally accepted" test n30 and was, thus, inconsistent with Ninth Circuit precedent. n31

Recognizing the conflict among the circuits, the Supreme Court granted certiorari in the Daubert case to determine the standard for the admissibility of scientific evidence. Before the Supreme Court, the plaintiffs argued that the application of the Frye test was irrelevant because the adoption of the Federal Rules of Evidence superseded it. The Court agreed, n32 first discussing the application of the Federal Rules of Evidence to the admissibility of expert testimony and the role of the district court in reaching that determination. The Court ruled that the standard for admissibility under the Federal Rules of Evidence was a liberal one: all relevant evidence is admissible, with relevance being determined by *Fed. R. Evid. 401*. n33 The Court went on to observe that the Federal Rules of Evidence contained a specific provision, *Fed. R. Evid. 702*, governing expert testimony, and noted that the rule did not [*382] include any reference to, nor did it incorporate, the "general acceptance" standard, which would be adverse to the liberal thrust of the Federal Rules of Evidence. n34

After determining that the Federal Rules of Evidence, rather than the "general acceptance" test, governed the admissibility of expert testimony; the Court discussed the role of the trial court in screening expert testimony, stating that the trial court must ensure that scientific testimony is both relevant and reliable. n35 For evidence to be relevant, it must relate to an issue in the case and assist the trier of fact in understanding evidence or a fact. n36 In sum, the question of relevance is one of "fit," that is, does the proposed evidence fit into the parameters of the questions presented by the case? n37

If the evidence is relevant so as to assist the trier of fact, the trial court must next determine whether the proffered

evidence is reliable. Among the factors to be considered when determining the reliability of a scientific theory or technique are: whether it can be or has been tested; whether the theory or technique has been subject to peer review or publication; the known or potential error rate; and the general level of acceptance of the theory or technique. n38

C. Judicial Empowerment Under Kumho Tire

In footnote 8 of Daubert, the Supreme Court stated: "Rule 702 also applies to 'technical or other specialized knowledge.' Our discussion is limited to the scientific context because that is the nature of the expertise offered here." n39

This ambiguous footnote raised the question whether the Court intended to limit the holding in Daubert to expert scientific testimony or whether that was too narrow a reading of its scope. n40 This question regarding the precedential scope of Daubert did not linger. The Supreme Court granted certiorari in Kumho Tire Co. v. Carmichael n41 ("Kumho") to address the applicability of the Daubert holding to "technical or other specialized knowledge." n42

The trial court in Kumho had applied Daubert to determine whether testimony by "an expert in tire failure analysis" should be admitted in a personal [*383] injury suit alleging a defective tire. Twice (once upon the initial motion to exclude n43 and once in response to plaintiffs' request for reconsideration n44) the trial court declined, applying a Daubert analysis, to admit the testimony. Upon appeal, the Eleventh Circuit reversed and remanded, reasoning that the Supreme Court itself had explicitly restricted its Daubert analysis to cases involving the application of scientific principles. n45 The Eleventh Circuit viewed the proffered expert testimony as based upon the expert's "years of looking at the mangled carcasses of blown-out tires" rather than upon any scientific theory, and seemed to suggest that the expert's testimony should usually be made available to a jury. n46

While noting that some of the non-exhaustive, non-mandatory factors enumerated in Daubert may be inapplicable to non-scientific expert testimony, the Supreme Court held in Kumho that all expert testimony provided under *Fed. R. Evid. 702* was subject to the gatekeeping analysis required under Daubert. n47 The Court further noted that the purpose of that gatekeeping function is to "... ensure the reliability and relevancy of the expert testimony." n48 Thus, the test must be a flexible one allowing the judge discretion in reaching a conclusion about the testimony in question. "That is to say, a trial court should consider the specific factors identified in Daubert where they are reasonable measures of expert testimony" n49 but should also "have considerable leeway in deciding in a particular case how to go about determining whether a particular expert's testimony is reliable." n50 With this holding, the Court determined that for all expert testimony, the burden of determining relevance and reliability had completely shifted from the "relevant community" to the trial judge. On the particular facts of Kumho, the Court reversed the Eleventh Circuit's ruling and held that the trial court's decision to exclude the proffered expert testimony was not an abuse of discretion.

D. Further Supreme Court Decisions

1. Joiner - Standard of Appellate Review

After making its determination of the appropriate standard for admissibility of expert scientific testimony in Daubert, but before applying Daubert to non-scientific expert testimony in Kumho, the Supreme Court granted certiorari [*384] in General Electric Co. v. Joiner n51 to determine the appropriate standard of appellate review of a trial court's application of Daubert's gatekeeper function. In the Joiner case, the plaintiff began in 1973 to work for the city of Thomasville, Georgia in a job that caused him to come in contact with a mineral-oil based dielectric cooling fluid. In 1983, the city discovered that some of the coolant was contaminated with polychlorinated biphenyls ("PCB"s), which had been banned as hazardous to human health. n52 In 1991, the plaintiff, a smoker, developed small-cell lung cancer. Both the plaintiff's parents had been smokers and there was a familial history of lung cancer. n53 In his suit against several product manufacturers, the plaintiff alleged that if his exposure to PCBs did not cause his cancer, it at least "promoted" an early development of the disease. n54

The district court granted the defendants' motion for summary judgment after determining that the plaintiff's experts failed to prove a link between PCBs and small-cell lung cancer, observing that the expert opinions asserting such a link did not rise above "subjective belief or unsupported speculation." n55 The Eleventh Circuit reversed the district court. While acknowledging that rulings on admissibility are usually reviewed under the "abuse of discretion" standard, the Eleventh Circuit applied "a particularly stringent standard of review" in Joiner "because the Federal Rules of Evidence governing expert testimony display a preference for admissibility" n56 The defendants appealed to the Supreme Court.

The Court determined that, as with other evidentiary rulings, the appropriate standard of review for both the inclusion and exclusion of expert testimony was the abuse-of-discretion standard. n57 An abuse-of-discretion standard is relatively more deferential to decisions by the trial court than other standards of appellate review. The Court concluded that the district court did not abuse its discretion in excluding the expert testimony and granting summary judgment with respect to the PCB issue. n58

2. Weisgram -Limitations on "Supplemental" Expert Testimony

Finally in Weisgram v. Marley Company, n59 the Supreme Court examined the appropriate appellate remedies when expert testimony is improperly admitted [*385] by the trial court. n60 In Weisgram, the Eighth Circuit determined that the District Court for the District of North Dakota improperly admitted expert testimony and, without that improper testimony, the plaintiff did not meet its burden of proof. Rather than remand for a new jury trial, however, the appellate court directed entry of judgment as a matter of law for the defendant. n61

The Court affirmed the directed verdict imposed by the Eighth Circuit. Rejecting the argument that fairness requires a second trial chance for the party who relied, perhaps to the exclusion of introducing additional evidence, upon the trial court's admission of certain evidence, the Court held that Daubert and Kumho placed litigants on notice of the "exacting standards" that apply to the admissibility of expert testimony. n62 Thus, "it is implausible to suggest, post-Daubert, that the parties will initially present less than their best expert evidence in the expectation of a second chance should their first try fail." n63 The Court noted that this is especially true where, as in the case then before it, the opposing party strenuously objected to the prevailing party's experts at every step and the prevailing party took no steps to shore up its case. n64 In effect, the Court ruled that parties are deemed to have brought their "A-Team" to the trial. Therefore, if an expert's testimony is stricken on Daubert grounds by an appeals court, the court may presume that the party who prevailed at trial had presented all of its evidence at trial; if the evidence is insufficient to support the verdict once the appellate decision to reverse the admission of expert testimony has been made, the appeals court may, in the exercise of its discretion, enter judgment as a matter of law in favor of the appellant. n65 The impact of this ruling is quite drastic: bring your "A-Team" from the beginning because you may not have a second chance.

The Supreme Court may have been slightly unrealistic in observing that parties, pre-Weisgram, would have known that they must bring their "A-Team" to the trial. This seems to ignore the practical implications of cost. If a party believes that it can choose between two experts, one who insists on a full-blown analysis that is expensive and the other who may agree to employ a more informal and abbreviated analysis that is less so, the party through counsel may likely choose the less expensive expert in an effort to minimize costs unless a court rules that expert's testimony inadmissible. Should that occur, the more expensive expert could then be utilized. This "cost impact" is particularly true in bankruptcy cases where money is obviously tight and the [*386] range of expert costs, methodologies, and expertise varies drastically. Now, in bankruptcy, the fear is that if you attempt to litigate on the "cheap," you may find yourself without an expert; whereas, if you retain a top-flight expert at an exceptional cost, you may be challenged for "putting a $ 500 dollar saddle on a $ 50 horse."

II. THE PROCEDURES FOR REACHING THE DAUBERT DETERMINATION

A. Federal Rules of Procedure

Many of the Federal Rules of Civil Procedure ("Fed. R. Civ. P.") are made applicable to adversary proceedings via the

Federal Rules of Bankruptcy Procedure ("Fed. R. Bankr. P.") and, as specified in the Rules, to contested matters under *Fed R. Bankr. P. 9014*. Generally, the incorporation of the Federal Rules of Civil Procedure takes place in Section VII of the Federal Rules of Bankruptcy Procedure; for the most part, the incorporated rule is assigned the same number as in the Rules of Civil Procedure, except that the Bankruptcy Rule adds the prefix "70". Because *Fed. R. Bankr. P. 7026*, for example, simply states "*Rule 26 Fed. R. Civ. P.* applies in adversary proceedings," we have referred to the relevant procedures triggered in a Daubert analysis as they are enumerated under the Fed. R. Civ. P. with a footnote to their Fed. R. Bankr. P. counterpart. n66

B. *Fed. R. Civ. P. 26*

Fed. R. Civ. P. 26 n67 addresses discovery related to experts.

1. The Identification of Expert Witnesses

Rule 26(a)(2)(A) requires an attorney to identify, during the pretrial phase of the litigation, every expert witness who may be used in the case. The exchange of information relating to expert witnesses is usually governed by pretrial orders, but in the absence of an order, Rule 26(2)(C) requires disclosures at least 90 days before the trial date. *Fed. R. Civ. P. 37(c)* n68 empowers a court to exclude a witness who had not been properly disclosed under *Fed. R. Civ. P 26(a)* if the failure to disclose was "without substantial justification" unless the failure was harmless error. Further, the abuse of discretion standard is the appropriate standard to apply when reviewing the exclusion of testimony under *Fed. R. Civ. P. 37*. n69

[*387]

2. The Preparation and Exchange of Expert Witness Reports

Fed. R. Civ. P. 26(a)(2)(B) also requires an expert who is expected to testify to submit a signed, written report to be shared with the opposition. Again, *Fed. R. Civ. P. 26(a)(2)(C)* requires this disclosure "at the times and in the sequence directed by the court" or, in the absence of a court order, within 90 days of the trial. As specifically spelled out in Rule 26(a)(2)(B), the report must:

Contain a complete statement of all opinions;

State the basis and reason for each opinion;

Identify the data or other information considered in formulating each opinion;

Include all exhibits that support or summarize the findings and opinions of the expert and that may be relied on in testimony or in the preparation of the report.

State the qualifications of the witness, including any publications authored within the past ten years;

State the terms of compensation regarding the preparation of the report and forthcoming testimony; and,

Contain a list of cases in which the expert has served within four years of trial.

As with the failure to identify an expert, under Rule 37(c)(1) the Court may exclude expert testimony that was not fairly disclosed in the report. Arguably, under Rule 26(a)(2)(B)'s broad description of the information to be included in

the report, the failure of the report to identify well-known treatises considered by the expert in formulating his opinion could lead to exclusion of the expert testimony. We believe that the better approach is to consider whether the failure to identify well-known sources creates an unfair advantage for the proponent of the expert. So, for example, while the court in Robert Billet Promotions Inc. v. IMI Cornelius Inc. n70 acknowledged that an expert's failure to disclose information in the report can risk exclusion of the expert testimony, the court concluded that the failure to identify a particular treatise in an expert report did not warrant exclusion of the expert testimony, when the reliance upon the treatise was made clear in a "Daubert" hearing outside the presence of the jury and the opposing party, which had more than one day to prepare for cross in front of the jury, was not unduly prejudiced. This common sense approach is supported by the language of Rule 37(c), which gives the trial court discretion to impose sanctions "in lieu [*388] of" exclusion. We suggest that courts invoke the sanction of excluding expert testimony only in those cases where the testimony so deviates from the report as to create unfair surprise that cannot be reasonably ameliorated.

In addition to the exchange of expert reports under Rule 26(a)(2)(B), Rule 26(b)(4)(A) provides that a "party may depose any person who has been identified as an expert whose opinions may be presented at trial." In any major engagement, each party routinely takes the deposition of the opposing experts, with its own expert witness either assisting in the deposition and/or in closely reviewing the transcripts of those depositions in final preparation for trial. n71

Deposing an expert may sometimes do more harm than good and is certainly not without risk. The deposition may give the opposing expert an opportunity to revise his report and testimony to overcome issues brought up in a probing deposition. Further, asking questions outside the scope of the expert's report may give opposing counsel an opportunity to ask the expert to testify to that broadened scope at trial. On the other hand, the deposition of the expert may reveal to opposing counsel weaknesses in the expert's substantive analysis, in the support for that analysis, or in the expert's inability to convey his opinions in an understandable manner. Forcefully pointing out these weaknesses may enhance the probability of a settlement. In short, all too often counsel will seek to depose the opposing expert simply because conventional wisdom expects it. Rule 26 already sets out the requirements of an expert's report, including an indication of each basis for her opinion, and case law suffers little variance between the report and the subsequent offered testimony. Counsel should consider carefully the need and balance both the benefits and adverse risks of taking an expert's deposition in light of the role of the expert report.

Litigation counsel should also consider discovery devices other than depositions. n72 *Fed. R. Civ. P. 34* n73 authorizes requests to opposing parties to produce documents in the control of the opposing party and *Fed. R. Civ. P. 45* n74 allows a litigant to subpoena individuals who are not party to the suit. Through these mechanisms, a party has the right to demand production of all prior drafts, correspondence with counsel, hard drives, e-mails, and memoranda that were generated before the submission of the expert's report. If full production is not made, the witness' report and testimony could be excluded [*389] upon proper motion under *Fed. R. Civ. P. 37*. This practice, of course, raises the issue whether drafts of the expert report are discoverable. Although we conclude that there is no general prohibition against the discoverability of drafts, some experts do not keep them, some do not use them, and some overwrite them. Even if the draft is deleted from the computer files, there is generally a back-up and the ability to recover certain deleted files. The real issue then is not whether the drafts may be discoverable, but at what expense in time and money. One practical and often sensible approach to the issue of drafts is to address it in a discovery agreement in which counsel promise to share any draft of the expert report that an expert had shown to counsel. This approach exposes the interaction between counsel and the expert and permits impeachment, if justified, because of the undue influence of counsel in the preparation of the expert report and testimony.

C. Rules 104 and 702

1. Motions in Limine

In severely contested matters and adversarial proceedings, the parties are increasingly resorting to motions in limine as a procedural construction of *Rule 104(a) of the Federal Rules of Evidence* ("Fed. R. Evid."). n75 Some courts may

prefer to rule on an objection to an expert witness' testimony at the conclusion of the voir dire rather than routinely scheduling a pretrial hearing on the qualifications of an expert witness, provided that no party files a formal motion in limine. Under *Fed. R. Evid 104(a)*, a court may evaluate the quality of the evidence for admissibility before it considers that evidence at trial or in ruling on a summary judgment motion. n76 The proponent of the evidence must establish the admissibility of the expert witness's testimony under *Fed. R. Evid. 104(a)* by a preponderance of the evidence. n77 One typical procedural context for determining whether the testimony of an individual identified as an expert is admissible under *Fed. R. Evid. 104* is at a pretrial hearing upon the filing of a motion in limine challenging the actual expertise of the opposing party's proposed expert witness. This is referred to as a Daubert hearing, named after the Supreme Court's first pronouncement in a trilogy of cases addressing the use of expert testimony in federal courts, previously discussed in this Article. n78

In its discretion, a court may rule on a Daubert motion on the pleadings, reports, affidavits, and memoranda of law without actually conducting an evidentiary [*390] hearing. n79 However, when the competence of one or more individuals who are to be called as experts is raised, the majority of the reported decisions suggest that the norm is for the court to schedule at least a non-evidentiary hearing, if not a full-blown evidentiary hearing, to consider motions in limine. n80 This hearing may occur as part of the court's pretrial status conference. Further, the courts of appeal have generally held that these kinds of hearings are "highly desirable" because they allow parties to present expert evidence and conduct cross-examination of the proposed expert, thus assisting the court in its gatekeeping function. n81 In fact, the Third Circuit has held that omitting a Daubert hearing at the summary judgment stage when the question of admissibility turns on factual issues constitutes an abuse of discretion. n82 Obviously courts should apply Daubert in a manner that fits the tempo and reasonable needs of the process at hand. For example, an expedited Daubert hearing with limited or no live testimony is all that may be necessary to develop the necessary information to make an informed decision that the proffered evidence regarding current interest rates for a particular type of loan is both relevant and reliable. In contrast, where it becomes apparent that stakeholders intend to offer conflicting testimony on the reorganization value of a debtor company at an upcoming confirmation hearing on a cram-down plan, the court may embrace a more detailed evidentiary hearing well in advance of the confirmation hearing to assess the Daubert-compliance of the proffered expert testimony.

Whether the motion in limine is decided on the merits or whether it is carried until the trial, the standard for deciding admissibility is found in *Fed. R. Evid. 702*, which provides:

If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the [*391] testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

It is here that the "gatekeeping" function envisioned in Daubert comes into play. The gatekeeping responsibility of the trial court is not necessarily to determine the correctness or persuasiveness of an expert's opinion (that is what a trial is for), or to choose between conflicting expert opinions (that is what the trier of fact is for), or to analyze and study the science or specialized knowledge or skill in question in order to reach its own conclusions from materials in the field (that is what a court-appointed expert is for). Ultimately, it is the role of the trial court as gatekeeper to ensure the relevancy and reliability of expert testimony. While this gatekeeping function in a jury trial primarily precludes the jury's deliberations from being clouded by unreliable evidence, in a trial to the bankruptcy bench, this function keeps irrelevant or unreliable expert testimony from clouding the record and wasting the court's (and the litigants') time. Additionally, a court's reputation for enforcing the dual Daubert requirements influences how experts will approach their task and how trial lawyers will prepare their case.

The purpose of the Daubert hearing is to make certain that the expert, whether basing testimony upon academic research, professional studies, or personal experience, employs the same level of intellectual rigor that characterizes the practice of an expert in the relevant field. n83 Thus, it appears that the findings of the Daubert hearing should focus more on whether the procedures and methodology makes the outcome reasonably reliable than on the outcome itself. However, reliability cannot be ascertained in a vacuum, and in practice, the oft-repeated distinction drawn in the reported opinions between the correctness of the proposed expert's testimony and its relevancy or reliability often collapses.

In sum, the proper procedure for challenging an expert witness' opinion is to move under *Fed. R. Evid. 104* and *702* to exclude the expert's report and testimony prior to its introduction at trial. n84 Nonetheless, a party may also move to strike the report and testimony after its introduction at trial on the ground that, taking the report and testimony as a whole, it clearly does not assist the court as the trier of fact in meeting its responsibility to find the facts at issue. There are times that this objection cannot be fully appreciated until the irrelevance or unreliability of the expert's report and testimony has [*392] been thoroughly tested through cross-examination and rebuttal testimony. n85

In general, a trial court's decision to admit or exclude expert testimony under Daubert is reviewed for abuse of discretion. n86 Thus, the real battle over the admission or exclusion of expert testimony takes place before the trial court. However, to make an appeal meaningful, if expert testimony is excluded, counsel should seek leave of the trial court to proffer such testimony so that it is "on the record." n87

2. Cross-Motions in Limine

In any battle of the experts, each party may attempt to exclude each opposing party's expert(s) from testifying. Frequently, in contested confirmation cases in the large or mega chapter 11 cases, the debtor or trustee will move to exclude the expert put forth by an unsecured creditors committee or by an equity holders committee, and vice versa. If the combatants are each successful in the jousting, no expert remains in his saddle, and the plan proponent is faced with the difficult challenge of putting on its proofs without any experts, perhaps relying on the officers of the debtor to testify as "lay experts." Charged with the burden of persuasion at a confirmation hearing, the plan proponent suffers the most if its expert does not pass muster under Daubert. n88 Today's bankruptcy judges will not permit counsel to prove their cases-in-chief through their zealous representations and arguments, supported by a proffer or by self-serving affidavits or through demands for the court to take "judicial notice" of every "fact" in the two-year record of the case that allegedly supports the plan proponent's motion for confirmation of the plan.

3. Judicial Determinations on the Submission of the Motion Papers

If the judge is satisfied that the issues have been adequately addressed, the judge may decide motions in limine on the papers. Illustrative of this approach is ProtoComm Corp. v. Novell Advanced Services, Inc., n89 a complex contract action before the federal district court in Philadelphia. Each party filed a motion or a cross-motion in limine to exclude the report, affidavit, or testimony of the opposing party's expert witness. After reading the motion papers, affidavits, and replies, the court found that each expert witness met [*393] the Daubert standard. The papers showed that the experts for each of the parties were well qualified n90 and so the court denied the motion and cross-motion without conducting a hearing. Had the court been leaning toward granting either the motion or the cross-motion, the court would probably have scheduled an evidentiary hearing. The development of an evidentiary record certainly increases the likelihood of avoiding reversal in any appellate review.

4. Evidentiary Hearings on Motions and Cross Motions in Limine

In the best of all worlds, motions and cross-motions in limine should be heard and determined during the final pretrial phase of an adversary proceeding or at some pre-hearing stage before a contested hearing of a cram-down plan in a chapter 11 case. Resolution of the evidentiary issues before the hearing on confirmation, for example, may alleviate the need to hold the hearing in the first instance and most certainly would streamline the presentation of evidence.

Moreover, waiting until the actual hearing to resolve Daubert objections may also put objecting parties to unnecessary expense, inconvenience witnesses that may no longer be needed, and waste time on the court's calendar.

5. An Extensive Voir Dire Incident to a Continued Motion in Limine

When the court is unfamiliar with the methodologies used by the purported experts in the case, the court may elect to reserve decision on any motion in limine and to proceed to the opening phase of the trial or hearing with an extensive voir dire of each proposed expert, allowing each expert to have a fair opportunity to bring the court up the learning curve. For example, if a judge faces for the first time a discounted cash flow analysis as a method for measuring the total enterprise value of a debtor with a complex financial or corporate structure, the counsel calling the witness will have to lay a foundation for the expert witness' report and testimony. This means that counsel will have to walk his expert through an exposition of the method or methods used by the expert, the expert's assumptions, the sensitivity of those assumptions, and other points of discretion and judgment. Skilled [*394] litigators should rise to the occasion, but the great danger they will have to overcome is the tendency of some experts to manifest their arrogance, condescension, impatience, and defensiveness in having to spend so much time on the stand presenting "Corporate Finance Theory 101" to the court. Some experts fail to appreciate that a judge may be genuinely interested in developing some clear understanding of the methodologies, particularly as applied to the debtor's industry, in all matters on that judge's docket. Indifference to the expressed desire of the court or, worse, hostility exhibited by an expert, is often fatal to any testimony offered. Moreover, it would be a major tactical blunder for an expert witness to let pass an opportunity to educate the judge either in the fundamentals of valuation methodologies or the rationale for choosing the appropriate methodology and factors appropriate to the debtor's business.

6. Motions to Strike Reports and Testimony

If the court determines that a purported expert is either not qualified or the expert's testimony is either irrelevant or unreliable, the opposing party is permitted to recast its motion in limine into a motion to strike the expert's testimony and report. n91 Of course, if it is the testimony of the plaintiff's (or movant's) n92 sole expert witness, the plaintiff may be unable to carry its burden of proof, and the defendant will move for judgment as a matter of law.

7. Reduced Scope of the Expert Witness on Methodologies

Some courts that have excluded the testimony and reports of experts on financial matters because their testimony was found unreliable have nevertheless permitted these individuals to testify as rebuttal witnesses in challenging the testimony and reports of the experts of the opposing parties. n93 Assuming that these rebuttal witnesses have a sufficient degree of technical knowledge to evaluate the expert evidence, we perceive this as a reasonable approach [*395] that balances the Daubert requirements with the limited historical role of the rebuttal witness.

8. Limitations on the Substitutions of Experts

If unsuccessful in overcoming a Daubert challenge, a party may attempt to offer a replacement expert. This attempt is often unsuccessful in procedural situations that are analogous to or expand upon the reasons set forth in the Supreme Court's Weisgram decision. n94 By contrast, in In re Porter McLeod, Inc., n95 after the court had excluded the testimony of plaintiffs' "standard of care" expert at the conclusion of a pretrial hearing, the plaintiffs sought leave to amend their designation with a replacement expert. The district court granted the plaintiffs' request, holding that the defendants had long known that plaintiffs planned to offer an expert on the "standard of care" issue and that there remained sufficient time before trial to allow defendants to conduct discovery of the replacement expert. Under these circumstances, the court believed that depriving the plaintiffs of any expert evidence would constitute a manifest injustice. n96 Nevertheless, at least one district court has held that if the introduction into evidence of a replacement expert witness will prove to be prejudicial to the opposing party, then it falls within the sound exercise of the court's discretion to deny any request to bring in another expert witness. n97 In a familiar phrase, a litigant may be limited to taking only one bite at the apple.

In Lippe v. Bairnco Corp., n98 for example, the Southern District of New York relied upon Weisgram to deny plaintiffs' motion to leave to substitute a new expert or to add a supplemental expert report after the court had excluded plaintiffs' expert testimony at the conclusion of a Daubert hearing. The exclusion of their experts had left the plaintiffs, who were trustees of a creditor trust, with no evidence that the debtor corporation had received less than reasonably equivalent value for the sale of certain assets to the defendants. The court therefore granted summary judgment against the plaintiffs on their fraudulent transfer claim. In light of the number of years that the case had been pending, and the full opportunity the plaintiffs had to find valuation experts, the court refused to grant the plaintiffs' request for what the court considered a "do-over." n99

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D. Objections to Expert Witnesses on Grounds of Bias

1. Switching Sides

Disqualification of expert witnesses may be based not only on the failure to satisfy the Daubert standards, but also on "general equitable principles," though courts are understandably reluctant to deprive a party of its chosen expert based solely on the broad and ill-defined rubric of "equity". In the Malden Mills n100 case, for example, the court refused to disqualify an expert whom the plaintiffs claimed had "switched sides". In resolving the matter, the court asked two questions: (1) was it objectively reasonable for the plaintiffs to believe that they had established a confidential relationship with the expert? and (2) if a reasonable belief of a confidential relationship did exist, did the plaintiffs disclose any confidential and substantive information to the expert? n101 Because in Maulden Mills the contact with the expert was made by a third party who did not disclose the plaintiffs' identity, the court concluded that there was no reasonable belief of a confidential relationship and the expert should not be disqualified. n102

In In re McCarter, n103 the bankruptcy court not only addressed the same question about disqualifying witnesses for having switched sides, but also addressed the issue of whether the expert may be disqualified on the ground of bias. In that case, the proposed witness had prepared a real estate appraisal for the secured creditor before a chapter 11 petition was filed, but was later employed by the debtor-in-possession as approved by an order of the court. n104 When the secured creditor moved for relief from the automatic stay and relied upon the prepetition appraisal prepared by the individual who was now the court-approved appraiser for the debtors, the debtors sought to disqualify the appraiser's testimony. The court found that under Tennessee's versions of The Principles of Appraisal Practice and Code of Ethics" ("Appraisal Practices"), the debtors had an objectively reasonable belief that a [*397] confidential relationship existed between them and the appraiser. n105 The record was devoid of any evidence that the debtors had disclosed confidential information to the appraiser, so the court could not disqualify the witness under the Malden Mills test. Clearly troubled by what it perceived as a conflict of interest, the court finally concluded that the appraiser should be disqualified for his failure to comply with Section 4.5 of the Appraisal Practices, which provided that an appraiser could not properly serve more than one client unless he had the consent of all parties.

2. Gatekeeper Determinations under Daubert

The Daubert challenge is multi-faceted. Initially, a court must determine whether an expert is qualified to offer an opinion. After a court has determined that the expert is otherwise qualified, the court must determine whether the expert testimony offered is both relevant and reliable. These related inquiries nonetheless should be addressed separately by courts. The purpose of qualifying an expert is to ensure that the trier of fact is assisted in its duty by a competent and qualified expert with the relevant knowledge, experience, education, certification, or other credentials where scientific, technical, or otherwise specialized testimony may be necessary. A wholly distinct purpose of a Daubert hearing is to determine whether the proffered expert testimony is relevant to the issues as framed by the parties and rests on a reliable foundation. n106 The party seeking to call an expert has the burden of establishing by a preponderance of the evidence, both the qualification of the expert and the relevance and reliability of the expert's testimony. n107

3. Objections for Lack of Qualification

The Federal Rules of Evidence envision a flexible, non-formalistic or non-doctrinaire standard regarding who may qualify as an expert witness. The Rules do not contain any specific requirements. To be sure, advanced education, a formal academic appointment, years of specialized experience, and formal certification may be important considerations; however, no one source of expertise is necessary so long as the court finds that the expert has specialized knowledge, experience, training, or the like. For example, in the bankruptcy context, there are many cases where a witness with the CPA credential has failed to qualify as an expert because of lack of experience relevant to the particular case, while a non-CPA witness with accounting or financial experience specific to the debtor's industry or certifications in bankruptcy and insolvency matters is easily qualified. Often disqualification turns, not on a lack of expertise, but on an expert's utter and glaring failure to (1) perform sufficient [*398] due diligence into the relevant financial background to the fact issues in litigation; (2) apply each of the standard methodologies; n108 or (3) "do the math" correctly. In this fundamental respect, the would-be expert has effectively forfeited his right in the particular case to testify because he has not performed in accordance with the professional standards required in his particular field. In short, a testifying expert must not only possess expertise, he must apply that expertise in the particular case. Although several of these factors may also apply in the Daubert setting, for example, where a court is assessing the reliability of a qualified expert's testimony, a report and resulting testimony could be so unreliable that one may call into question the expert's qualifications.

A review of several cases illustrates how courts have applied the standards of qualification as influenced by the Daubert inquiry. In Biben v. Card, n109 the court addressed the qualifications of an economic loss expert. Although the expert had significant academic credentials, the credentials were not in the area of the expertise required by the case. However, the court found that a self-educated economic loss expert with substantial academic credentials, who was a frequent expert witness on the issues before the court, who devoted much time to the preparation of the report, and who devoted much time to gaining and maintaining knowledge of the relevant standards was qualified and the expert's testimony was acceptable under Daubert.

To understand how Daubert has affected the qualification inquiry, it is key to realize that an expert should no longer rely on a listing of credentials in his resume. An expert should state - not only in the expert report, but also on the record - what credentials and certifications he may have, what the applicable standards are to achieve those credentials or certifications, and why he is entitled to be an expert in a particular case. These credentials and certifications must reasonably fit the inquiry at issue. An expert's report should address that fit in reasonable detail. Thus, qualifications, even stellar qualifications, are simply not enough; rather, the qualifications one possesses must be relevant to the subject upon which the testimony is to be offered.

In the case of In re Valley-Vulcan Mold Co., n110 the appellate court addressed the objection of the unsecured creditors committee to the defendant's expert. The trial court admitted the testimony of a financial analyst regarding solvency over the committee's objection to the expert's qualification. After [*399] reviewing the standards as established by Daubert and its progeny and the background of the proposed witness, a partner in a leading financial firm and director of the valuation services group, the Sixth Circuit BAP determined that the trial court did not abuse its discretion in qualifying the expert and admitting his testimony. n111

In Tasch, Inc. v. Sabine Offshore Service, Inc. (In re Tasch, Inc.), n112 the court embraced a sensible approach in addressing the preliminary question of when expert testimony is needed. There, the debtor/plaintiff filed an adversary proceeding against the defendants for monies owed under the "add-ons" to a contract between the parties. n113 The plaintiff retained an expert to review the contract, prepare a report, and calculate damages. n114 The defendants objected to the expert's testimony, arguing that the trier of fact did not need assistance on the issues in question, the expert's testimony would invade the purview of the trier of fact, and the expert did not have the appropriate background to provide accounting testimony. n115 The court quoted the advisory committee note to *FRE 702*, n116 stating:

There is no more certain test for determining when experts may be used than the common sense inquiry whether the untrained layman would be qualified to determine intelligently and to the best possible degree the particular issue without enlightenment from those having a specialized understanding of the subject in dispute. n117

The court reasoned that expert testimony on issues a jury can decide without assistance should be excluded, noting that an expert must bring more to the table than that which a lawyer can explain in arguments. n118 Using that paradigm, the court determined that expert testimony was not necessary or appropriate on contract issues as to intent, contract language, and breach. n119 However, the court determined that assistance would be needed on the question of contract damages. The defendants asserted that the expert was not qualified to address these issues because he lacked any formal education or accounting background. n120 The court analyzed the blended question of qualifications and reliability presented by the defendant's objection. [*400] The court determined that the expert's significant experience with job-costing and job-accounting was sufficient to overcome this deficiency. n121 Noting that the defendants had not criticized the expert's methodology and that the "trustworthiness" questions related to the expert's opinions rather than his methodology, the court determined that "vigorous cross examination," n122 not exclusion, was the appropriate method for determining trustworthiness. n123

In TUF Racing Products, Inc. v. American Suzuki Motor Corp., n124 the Seventh Circuit addressed the issue of the admissibility of accounting testimony. The court observed there was no requirement that the expert be an academic, a Ph.D., or a CPA. Additionally, accounting testimony need not be "scientific" in the common meaning of the word. As the Seventh Circuit observed, accountants do not do science. "Anyone with relevant expertise enabling him to offer responsible opinion testimony helpful to judge or jury may qualify as an expert witness." n125 Thus, the court concluded that discounted present value calculations based on financial information furnished by the relevant party and assumptions provided by counsel are within the competence of an accountant.

In contrast, the court in In re Husting Land & Development, Inc. n126 rejected the movant's proposed expert testimony as to what constituted the ordinary course of business for the debtor in possession, a residential real estate developer. n127 The debtor had entered into a prepetition construction contract with a construction company to build the infrastructure for the debtor's development project, but the quality of the work was so defective that the debtor accepted a replacement bid from another construction company without first moving for an order authorizing the replacement contract under §363(b) of the Bankruptcy Code. The contract was bid on a time and materials basis, with an initial bid of under $ 250,000. By the time the construction work of the second contractor was nearly completed, the invoiced cost was close to $ 1.0 million. The replacement contractor argued that it was in the ordinary course of business for a real estate development company to incur debt to construct infrastructure at one of its developments. n128 To make this showing, the creditor sought to have a real estate developer qualified as an expert. The court rejected the developer's expert testimony on the [*401] ground that he did not use any standard or recognized methodology. n129 The court noted than an expert whose testimony was based upon his specialized experience as a developer must be able to identify which factors were considered and how his experience was applied to those factors to reach his conclusions. n130 The court determined that the witness in question could testify as a lay or non-expert witness regarding the practices in the real estate development business, n131 but he could not qualify as an expert witness to prove what is the "ordinary course of business" for a debtor-in-possession in a chapter 11 case without knowledge of the legal tests courts use to determine ordinary course and without any derivative capability of offering testimony tending to show whether a test was met. n132 The real bite to this decision excluding the expert witness's testimony was that the contractor had to write off close to $ 1.0 million in invoiced costs, because the court also denied any allowance as an administrative expense on a quantum meruit basis. n133

In re Bonham n134 offers an interesting view at how Daubert may have changed the world of bankruptcy litigation. The case involved an alleged Ponzi scheme that was the subject of conflicting testimony by forensic fraud investigators. In one corner stood the trustee's expert who lacked a CPA designation but possessed extensive experience in

reconstructing records of companies that simply did not maintain records. The court quickly noted that the lack of a CPA credential posed no problems under *FRE Rule 702*. n135 [*402] The court also noted that the trustee, a CPA, may also qualify as an expert in a case he was prosecuting. n136 In the other corner, supporting the defendant, stood a CPA with impressive accounting credentials and certifications. However, the court found the expert's opinion would be excluded in this case. The court pointed to the expert's report, which was based on substantial misstatements of fact, speculation, innuendo, and inferences that were not supported by full explanations and analysis. In sum, the court found that the report was simply "not worthy of an expert of [the witness'] caliber, nor worthy of admission as evidence in this case." n137 There are many lessons in this case, the most important of which is that preparing a "place holder" report to meet an impending deadline or doing a report "on the cheap" may not only harm an expert's reputation, but may also seriously prejudice the client's interest.

In In re Integrated Health Services, Inc., n138 the respective experts retained by the lessor and the debtors in these jointly administered chapter 11 cases testified about the fair rental value of a nursing home that the debtors continued to occupy after rejecting the underlying real property lease. n139 Although the court denied the lessor's motion in limine to disqualify the debtors' expert, at the conclusion of the trial the court found this witness's testimony to be unreliable. In particular, the court found that the expert had limited experience in appraising the fair market value of nursing homes and that in his analysis of the value of this facility, the expert inexplicably did not consider his own prior appraisals of other nursing homes. In addition, the court found that the expert's "market analysis" was limited to analyses which he or his company prepared without considering third party appraisals or analyses. Further, the properties the witness used for comparables were senior living centers rather than nursing homes. n140

Next, the court criticized the expert's unquestioning acceptance of the projections provided by the debtors because those projections did not reflect the historical performance of the debtors or the typical performance of others in the industry. n141 Finally, the court addressed the methodology utilized by the proposed expert and found it "suspect" and unreliable. The methodology utilized was not the standard in the industry for appraising nursing homes, it was not used by any other known expert, and there were no studies, reports, or articles endorsing the method. n142

[*403] Ultimately, a court should embrace a liberal, flexible approach in evaluating qualifications. "The proposed expert should not be required to satisfy an overly narrow test of his own qualifications." n143 Any "quibble" over an expert's lack of academic qualifications, where the expert had "extensive practical experience," should go to the weight, not admissibility, of the proffered expert testimony. n144 However, both Bonham and Integrated Health Services present a subtle question of whether the weight or persuasiveness of testimony transmutes into the qualification of the expert. At some point an expert's presentation is so unpersuasive in its conclusion that one must conclude that the witness is not qualified to testify. In both Bonham and Integrated Health Services, one may infer that the trial court found the witnesses to be qualified as experts; however, the clients in Bonham did not even get their expert testimony admitted and the clients in Integrated Health Services were no better off in light of the court's determination that the expert's presentation was so flawed as to be unreliable and entitled to little weight.

4. Objections for Lack of Reliability

In assessing the reliability of a proffered expert's testimony, a court's inquiry under Daubert must focus, not on the substance of the expert's conclusions, but on whether those conclusions were generated by a reliable methodology. n145 In Daubert, the Supreme Court set out a list of non-exclusive factors the trial court may consider in determining whether an expert's reasoning or methodology is reliable. The Supreme Court never insisted that these factors were intended to be either exhaustive or applicable in all situations. Rather, the purpose behind the articulation of the factors was to serve as a touchstone when a court confronts expert testimony. A review of the cases reveals that courts have appropriately added to the Daubert list. Factors listed as one through five below are from Daubert; the remaining factors are culled from other cases.

1. Whether the theory or technique on which the expert relies has been tested - that is, whether the expert's theory can be challenged in some objective sense, or whether it is instead simply a subjective, conclusory approach that cannot

reasonably be assessed for reliability; n146

[*404] 2. Whether the theory or methodology has been generally accepted by the relevant community, though Daubert made clear that this is not a sine qua non for finding expert testimony to be admissible

3. Whether the theory or technique has been subjected to peer review and publication;

4. The known or potential rate of error of the technique or theory when applied;

5. The existence and maintenance of standards controlling the technique's operation; n147

6. Whether the theory or method offered by the expert has been put to any non-judicial use; n148

7. Whether the expert has developed the opinion expressly for the purpose of testifying; n149

8. Whether the expert's opinion fails to square with a judge's opinion and common sense; n150

9. Whether the discipline in which the witness purports to be an expert is in and of itself unreliable; n151 and,

10. Where the expertise is experience-based, "whether the methodology has produced erroneous results in the past." n152

These factors guide discretion; they do not replace it. Thus, a court enjoys the same "broad latitude" in deciding the "reasonable measures of reliability in a particular case" as it does in reaching its ultimate determination of reliability. n153 In short, the test of reliability is a flexible and functional one. The Supreme Court has been adamant that the factors set forth in Daubert do not constitute a "definitive checklist or test." n154 Whether the Daubert factors are pertinent to assessing reliability in a particular case depends on "the nature of the issue, the expert's particular expertise, and the subject of his testimony," n155 and "a trial court should consider the specific factors identified in Daubert where they are reasonable measures of the reliability of expert testimony." n156 Thus, "the gatekeeping inquiry must be 'tied to the facts' [*405] of a particular case," n157 and "the trial judge must have considerable leeway in deciding in a particular case how to go about determining whether particular expert testimony is reliable." n158 In summary, no single factor is necessarily dispositive of the reliability of a particular expert's testimony. Moreover, we agree that "[a] review of the case law after Daubert shows that the rejection of expert testimony is the exception rather than the rule." n159

Courts both before and after Daubert have found other factors relevant in determining whether expert testimony is sufficiently reliable to be considered by the trier of fact. n160 Certainly, the trial court's role as a gatekeeper in screening out unreliable testimony is "tempered by the liberal thrust of the Federal Rules of Evidence and the 'presumption of admissibility.'" n161 A case in point is Gross v. Commissioner. n162 There, the court held that although knowledge as used in *Fed. R. Evid. 702* means more than subjective belief or unsupported speculation, some methods for valuing the shares of a publicly held corporation could be so well established that they bear an inherent reliability. For example, the use of a discounted cash flow analysis to obtain the enterprise value of a publicly held corporation is such a well established methodology that it should meet the reliability standard in most circumstances. In the valuation of business assets or of the businesses as a whole, the court observed that the discounted cash flow method of valuation is a reliable method. Any attack on such an assumption would generally be relegated to cross-examination.

Although there is no magic to what factors a court may consider in determining whether an expert's testimony in a bankruptcy matter is compliant with Daubert, we find that five factors are most salient in determining whether to admit financial testimony.

a. Testing

When analyzing the reliability of an expert's testimony, a "key question" is "whether it can be (and has been) tested." n163 Thus, the ability to assess whether an expert's opinion can be replicated becomes a guiding beacon in Daubert's sea of uncertainty. After Daubert, solid qualifications are not enough. n164 Guesswork and hunches by either qualified or unqualified experts [*406] are destined for the same receptacle. Unscientific opinion offered by a genuine scientist is simply not sufficient. n165 While conjecture by a qualified expert is worthy of careful attention, the courtroom is "not the place for scientific guesswork, even of the inspired sort." n166 Rather, an expert should attempt to verify or cross-validate both the foundation of his opinion and his ultimate opinion, where possible, and share that validation with the court.

Although the ability to replicate a financial expert's opinion is not an "absolute prerequisite" for admissibility, it does show that an expert "adhered to the same standards of intellectual rigor that are demanded in their professional work." n167 In the world of financial testimony, if an individual versed in the relevant discipline could not replicate the results contained in an expert witness' report, following the assumptions embraced by the expert even though he may disagree with those assumptions, there is a fairly strong indication that the testimony is not reliable. Absent exceptional circumstances, that report and testimony should be excluded under *Rules 104 and 702 of the Federal Rules of Evidence*.

In re Lake States Commodities, Inc n168 demonstrates how the reliability of expert testimony may be addressed and weaknesses exposed. Here the trustee hired a CPA with twenty years of experience and excellent credentials as an expert to assess the solvency of the debtor and to determine whether a Ponzi scheme was in place. n169 The expert testified that he prepared his report based (i) on a database of over 11,598 transactions compiled by a well known accounting firm retained by the interim trustee, which information the expert testified was prepared in accordance with standard business practices, and (ii) on the debtor's business records. n170 The expert further testified that an associate tested between one and two percent of the underlying transactions and that additional testing "would have been cost prohibitive." n171 While the defendants objected to the entry of the underlying documents upon which the report was based, resulting in those documents being [*407] excluded, the expert report was admitted without an objection. n172

In its opinion addressing whether a Ponzi scheme had been established, the bankruptcy court acknowledged that an expert can, and often must rely on inadmissible evidence. n173 In this particular case, however, the court found that the expert's report did not meet the trustee's burden, as part of establishing a Ponzi scheme, of proving insolvency. Indeed, the court indicated that had an objection been raised, the report may have failed to meet the requirements of Daubert because the expert had performed inadequate testing of the underlying data and had failed to interview those familiar with the debtor's financial statements. n174 Thus, the court found the expert's report was unreliable and entitled to no weight. n175 While we caution that too much may be read into the court's analysis on the precise manner and method of testing the reliability of the underlying data, n176 we note that authentication and reliability of the underlying data is an important consideration in formulating and articulating a reliable opinion. However, the extent of testing, the manner and method of testing, and the like, are all driven by the facts and circumstances of each particular case.

In some contexts, statistical or quantitative testing may play a role in determining whether to qualify an expert and admit his or her testimony. Consider the expert who is hired in a preference action to help establish the "ordinary course of business" defense found in Section 547(c)(2)(C) of the Code. That expert may be qualified by experience, training, or education. Assume that the defendant offers an expert with over twenty years of experience as a credit manager with specialized experience in the relevant industries. Clearly, Daubert would not require a trial court to ignore the witness's experience simply because experience cannot be "tested and verified." Such an assertion misconstrues the Daubert requirement of reliability. Testimony based on years of experience in a given field on what constitutes ordinary business terms under §547(c)(2)(C) is not necessarily conclusory. The processes by which the experience was acquired and by which the opinion was formulated are indicia of reliability in themselves. Thus, a discussion of [*408] such an expert's experience, how knowledge of the industry was acquired, education, continuing education, contacts in the relevant industries, methodologies by which the opinion was developed and formulated, metrics, etc., would demonstrate the process by which the expert reached his opinion. That process then can be assessed to determine whether it is reliable and, therefore, whether the fruits of that process are reliable. Further, any experience-based opinion could be cross-validated through a qualitative and quantitative analysis of collection practices and periods and payables practices

and periods in the relevant industries, although this additional step may not always be necessary.

b. Acceptance

In the area of financial expert testimony, the general acceptance of a particular methodology employed by an expert is a sound indicator of reliability. n177 Two examples may flesh out the "general acceptance" factor. First, in calculating the total enterprise value of a chapter 11 debtor, the standard methodologies are the comparable company method, the comparable transaction method, the discounted cash flow method, and the asset method; each of these methods turns on algebraic formulas or standard methodologies in which the expert calculates the variables drawn from, among other things, data in financial records, the prices of shares traded on the major exchanges, the studies of mergers and acquisitions, etc. n178 Second, in assessing the insolvency of a debtor as of a specific date, the standard methodologies include an adjusted balance sheet method, an ability to pay method, and an unreasonably small capital (assets) method, in which the expert must consider all of the debtor's property (including non-severable goodwill) and not just those categories listed on the balance sheet, and all of the debtor's debts, including legacy liabilities, environmental liabilities, and contingent liabilities. n179 Moreover, an assessment of a debtor's liquidity, leverage, profitability, and performance may be necessary. Finally, a consideration of working capital, working capital needs, capital expenditure requirements, any capital expenditure plan, the mix of current assets, and the mix of current liabilities may be necessary.

Although in either the valuation of a company or the assessment of its [*409] solvency, deviation from the standard methodologies may be necessary, any deviation must be explained and reasonably justified. For example, an expert should be eager and willing to demonstrate to the court why the asset method is inappropriate in valuing a particular company or why a valuation of nonseverable goodwill is irrelevant to a determination of insolvency. Silence, in contrast, may be fatal.

c. Peer Review

Another indicator of qualification and/or reliability is whether the expert has written or published any articles, preferably peer-reviewed, describing her theories or proposed models or methodologies. Additionally, an expert may rely on the published works of others meeting the above criteria. n180 The inquiry often then shifts to the question whether the writings have themselves been published in refereed journals and subject to peer-review or critical commentary.

d. Error Rate

The concept of an "error rate," which is essential to testing the validity of research designs and to statistical inference drawn from empirical research, does not generally apply to expert testimony on financial matters. n181 To be certain, some forms of expert testimony can be attacked on grounds of error, but these attacks are generally framed as "subjective" (that is, unjustified) adjustments by the expert witness to the normalized range of "multiples" used in calculating discount rates and the like. It is more appropriate to speak of these "error rates" as "errors in judgment."

Analogous to the error rate in the context of financial expert testimony is the question of sensitivity regarding assumptions employed by an expert in reaching her opinion. For example, consider an expert assessing, for fraudulent transfer purposes, the solvency status of a company under the adjusted balance sheet test embodied in *Section 101(32) of the Bankruptcy Code*. In preparing a solvency analysis based on the adjusted balance sheet model, several important and integrated assumptions must be formulated and tested. For example, an expert must determine (1) whether the business was a going concern or a failed enterprise at the time of the transfer; (2) what additional assets should be included in the analysis and at what value; (3) how goodwill should be treated (both severable and nonseverable intangibles); (4) how identified balance sheet assets are to be valued; (5) what additional liabilities should be included in the analysis; (6) how any legacy, environmental, or contingent liabilities should be treated; and (7) whether any projections of [*410] cash flows that may have been developed at or around the transfer date were reasonable. The solvency report should generally address each of these assumptions and test for sensitivity, for example, how much play

in a given assumption has to exist before a preliminary opinion swings the debtor from one financial state to another.

e. Sources of Facts and Data

Some courts have stated that an opinion offered by an expert based solely on the expert's client's data is not reliable. n182 Other courts have found such opinions reliable because these courts consider the source of data to go to the weight rather than the admissibility of the evidence. n183 In the financial expert context, the source documents are generally available (or can be reconstructed) and little debate turns on the underlying data. The better view would consider the reliability of the source and whether the source documents were available and at what cost to gain access. Aside from a threshold inquiry whether this is the type of data relied on by financial experts, any other challenge to the data source should be relegated to the weight and not admissibility of the expert witness testimony.

An excellent case showing the importance of the source of data is Total Containment, Inc. v. Dayco Products, Inc. n184 In that case, the court held a Daubert hearing in response to the defendant's motion to preclude testimony from the plaintiff's expert regarding the appropriate "lost sales" damages for breach of a supply agreement. n185 The court ruled that while a proponent of expert evidence does not have to prove that an expert's testimony is correct, the proponent must prove that the expert's testimony is reliable. n186 In observing that the test of reliability was an exacting one, the court indicated that it must assess the reliability of the data analyzed or employed to formulate and articulate the expert opinion. n187 Specifically, the court noted that it must assess whether the expert relied on data reasonably used by financial experts and had good grounds to rely on such data. n188 Interestingly, the court observed that it may scrutinize assumptions to determine reliability in [*411] certain circumstances. The court reviewed several problems with the expert's analysis, including the expert's reliance on Dunn and Bradstreet data - data compiled primarily for making decisions whether to extend credit - to deduce the sales market shares of the plaintiff and its competitors. n189

5. Objections for Lack of Relevancy or Fit

The trial court must not only determine whether the testimony is reliable; it must also determine whether an expert's testimony is "relevant to the task at hand." Thus, a court must concern itself with whether an expert's reasoning or methodology can be properly applied to the facts before the court. n190 In this context, relevance is a measure of how well the methodology "fits" the facts of the case. n191

A case that illustrates the nature of fit is Main Street Mortgage, Inc. v. Main Street Bancorp Inc. n192 In that case, a party filed a motion in limine to exclude expert testimony on damages resulting from an alleged service mark infringement. After noting that *Fed. R. Evid. 702* embraces a liberal policy of admissibility, the court addressed the question of relevance or fit. In explaining the requirement, the court observed that there must be a valid connection between the expertise in question and the inquiry being made in the case. If that fit among facts, methodology, and opinion has been established, the evidence is admissible and the opposing party's efforts should then turn toward undermining the weight of the expert testimony, either through cross-examination or presentation of an expert witness in opposition. n193

E. Court-Appointed Experts under *Fed. R. Evid. 706*

Fed. R. Evid. 706 authorizes the bankruptcy court to appoint an expert witness on it own motion. n194 Some judges prefer to issue an order to show cause why an expert witness should not be appointed by the court. That strikes us as unnecessary. Alternatively, a party may move for the issuance of an order to show cause why the court should not appoint an expert witness. If the court decides to issue an order to show cause and then, upon a showing [*412] of cause, to order the appointment, it may also request the parties to submit nominations.

Reaching out to the lawyers for their recommendations may make sense on several levels. Broad participation in the process of nomination of the expert should add legitimacy to the appointment. This assumes that the court will make an appointment of an expert from the nominees. In addition, the court may find it advantageous to tap the collective

intelligence of the lawyers who regularly appear in the large chapter 11 cases. These lawyers should be familiar with the first-rate witnesses and whether these witnesses have participated as consultants, financial advisors, or as forensic accountants in other cases. In making the nominations, counsel for the parties should submit fairly complete resumes of their nominees that highlight any experience outside of testifying, any academic positions or research agenda, and the prior appointments of the expert witnesses on comparable issues.

Despite the rather open-ended invitation under Rule 706, the standard treatises on federal evidence have noted the general reluctance of federal courts to appoint their own experts. n195 Court-appointed witnesses have tended to be limited to technically complicated cases like antitrust cases, n196 multidistrict court litigation, n197 mass torts cases, n198 and patent infringement cases. n199

A 1998 decision by a senior federal district judge denied an indigent plaintiff's motion for a court-appointed expert witness; that court's reasoning fully and chillingly endorsed the formalist ideology against court-appointed witnesses. n200 The plaintiff had filed a personal injury action against the "Dalkon Shield Claimants Trust" established under the plan of reorganization for A. H. Robins Co., Inc. The indigent plaintiff needed the assistance of an expert witness to prove the causative link between the implanting of an intrauterine device ("IUD") and her pelvic inflammatory disease ("PID"), but she could not afford to hire one. The Trust opposed her motion. In support of its decision, the court first observed that courts in the proper exercise of their discretion should only appoint an expert witness in "extraordinary circumstances." There was nothing, the court found, so "highly technical" about the disputed facts in this case that required "independent expert guidance." [*413] Any appointment by the court of an expert witness would necessarily constitute interference with, and a lack of judicial respect for, the adversarial process. n201 Second, the court noted that the cost for the expert witness would have to be borne unfairly by the Trust because of the indigence of the plaintiff. As the court noted, "judges have expressed reluctance to charge all of the costs to one party, unless the non-indigent party agrees to pay." n202 Here the Trust, not surprisingly, objected to bearing the costs of the plaintiff's expert. Under the circumstances, the court was "unwilling to place this financial burden on the defendant." n203 In what might otherwise be perceived as an ironic comment, the court expressed its concern that the recoveries of the other claimants should not be diminished by requiring the trust to bear the cost of an expert witness. n204 What the court ignored was that the Trust always retained its own expert witnesses to defend aggressively against these claims, and those costs also obviously reduced the fund available for distribution to the successful claimants. The object of the Trust was to simplify the processing of personal injury claims, but in this instance, the Trust patently evinced its antagonism to the very class of beneficiaries it was supposed to protect. n205

Fortunately, recent reported court decisions suggest that this earlier reluctance of the federal courts to appoint their own expert witnesses is beginning to wane. n206 Within the context of business bankruptcy cases, several of the traditional normative constraints against court-appointed experts under Rule 706 should have little or no bearing. Those traditional concerns included: (1) a suspicion that ex parte contacts between the court-appointed expert and the appointing court (that is, "back-channel communications") may prejudice the rights of one of the litigants; (2) the perception that appointment by the court of its own expert subverts the traditional normative structure of the adversarial process in which the litigants bear the full burden of proving their version of the operative facts, which is tested through pretrial discovery and in vigorous cross-examination of the opposing party's expert witness and the introduction of rebuttal expert witnesses; and (3) the belief that parties should not have to bear the cost the court's expert witness. Each concern is addressed in turn.

[*414]

1. Back-Channel Communications

As to ex parte contacts between a court-appointed witness and the court, the present generation of bankruptcy judges is remarkably sensitive to avoiding not only ex parte contacts but the appearance of ex parte contacts. *Fed. R. Bankr. P. 9003* expressly prohibits almost all forms of ex parte contact with the bankruptcy court; the Rule specifically refers to examiners, who in bankruptcy cases are perhaps the most common of court-appointed experts. We believe that this

prohibition is respected by the bankruptcy courts. Additional safeguards may be built into the pretrial process by having the bankruptcy court follow Standard 11(c) of the proposed Civil Trial Practice Standards of the American Bar Association, issued in February 1998, n207 which states in relevant part:

The court should ensure that the parties are aware of all communications pertaining to the merit between the court and a court-appointed expert by:

i. Permitting the parties to be present when the court meets or speaks with the expert;

ii. Providing that all communications between court and expert will be in writing with copies to the parties; or

iii. Recording oral communications between court and expert and making a transcript or copy of the recording available to the parties. n208

In practice, the expert witness may participate by telephone in pretrial status conferences or in preliminary hearings held on the record or in conferences in chambers. The very busy expert witness is likely to be less available for routine physical appearances in court. The court may also post copies of any correspondence it receives immediately upon receipt on the electronic filing record of the bankruptcy case or any related adversary proceeding. It is now relatively inexpensive for any party who wishes to review the communications during a status conference or preliminary hearing to order a copy of the CD-ROM of that conference or hearing. The much greater cost of ordering an official transcript is usually unnecessary.

2. Subverting the Traditional Normative Structure of the Process

As to subverting the integrity and the efficacy of the adversary process, this is, in our judgment, a red herring. Bankruptcy judges (as underscored by the reported decisions of the courts of appeals) believe that they bear direct responsibility for maintaining the integrity of the bankruptcy process, and that necessarily implies that a bankruptcy judge has to be a very active and assiduous "case manager." Perhaps in a more perfect world, the bankruptcy courts would look to the United States Trustee to take the lead in maintaining [*415] the integrity of the bankruptcy process, but that office, notwithstanding the high caliber and great sacrifice of those who serve in that capacity, is insufficiently staffed and is critically underfunded to perform that role effectively across all issues in bankruptcy. Finally, bankruptcy judges have an acute sense of how cases should be properly managed and when parties or their professionals appear to be engaged in suspect activities. n209 Any initiative on their part in appointing their own expert witnesses does not by itself transform mega or large bankruptcy cases into grand inquisitions.

In the context of contested hearings on the confirmation of plans of reorganization, the bankruptcy judge is under a statutory duty to find, inter alia, that the plan complies with the provisions of the Bankruptcy Code, that the plan proponents have proposed the plan in good faith, and that the plan satisfies the best interests of the creditors test. If the plan proponent resorts to the cram-down provisions under section 1129(b), the court has the further duty of determining, among others, that the treatment of each class of impaired creditors or impaired equity security holders is fair and equitable; this has increasingly meant that the court has to conduct an evidentiary hearing on the enterprise value of the reorganized debtor. n210 This critical duty often imposes a degree of initiative on the part of the bankruptcy judge, which may dictate the court's appointment of an expert witness. The traditional model of the passive judge who cedes control over the adversary process to lawyers representing opposing private parties, if it ever existed, no longer fits the character of the mega or large chapter 11 cases. The court has to be concerned with the impact of these chapter 11 cases on the employees, the retirees, and the communities in which these debtors operate their principal facilities.

Under *Fed. R. Evid. 706*, the appointment by the court of an expert witness is as fully consistent with the traditional adversary process as is practicable. This is manifested in the full right of the litigants to review the court's expert's report in advance of trial, to take the expert's deposition, to move to preclude the expert's report and testimony under the Daubert standards, and to examine the expert at trial. Indeed, one may argue that having a court-appointed witness in

lieu of the "battle of experts retained by the opposing parties" aids considerably in supporting the trial court in focusing on the crucial issues in the case. The other alternative is much less attractive or efficient. The court would have to spend hour after hour during nights and [*416] week-ends comparing and contrasting the reports and going back and forth among the massive exhibit books in excruciating detail.

The bankruptcy courts have repeatedly expressed their intense frustration over the glaring disparities between the valuations of the opposing party's expert's witnesses. n211 These disparities severely tempt some judges to throw out both witnesses' reports and testimony as far more confusing than modestly helpful. One should not forget the fundamental purpose of having expert witnesses in the first place; namely, to aid the court in finding the facts relevant and dispositive in the bankruptcy case itself. In the battle of expert witnesses, too many experts subordinate their independence and objectivity in order to advance the interests of their clients as advocates and to gain very substantial fees; the "reserve power" of bankruptcy judges to appoint their own experts may prove to be the only effective counter to these very disappointing practices.

3. Additional Costs

As to the traditional constraint that court-appointed witnesses add to the costs of litigation, a cost that under Rule 706 has to be borne by the parties, this concern fails to take into consideration the actual dynamics of business bankruptcy cases and the incurrence of litigation costs. For example, in litigation over the total enterprise value of the reorganized debtor, the cost and expenses of the expert witnesses is doubled or tripled when the debtor as the plan proponent and the creditors committee as objector each retain its own expert witness(es). Each party scrutinizes the opposing expert witness's report, takes intensive depositions of the opposing expert witness, and each prepares and calls its own expert witness for direct testimony (and rebuttal testimony), and the other party cross-examines the opposing expert. More importantly, from the perspective of cost to the estate, both the debtor as the plan proponent and the creditors committee n212 will expect to have the bankruptcy estate bear all of the costs of each respective expert witness and all of the attendant professional fees and costs incurred before, during, and after trial in connection with the reports and testimony of their expert witnesses. The counter-consideration is that in bankruptcy litigation, the normative goal of a cost-efficient and expeditious determination of contested matters and adversary proceedings may be more readily achieved through the "objective" testimony of a single court-appointed expert whose qualifications, the fitness or relevancy of the expert's report and testimony, and the reliability of the [*417] expert's application of the standard methodologies may still be challenged under the Daubert standards implementing Rule 702.

The reported decisions that we have discussed often voice intense frustration with the substantial amount of time the bankruptcy court has to expend in controlling against the contrary biases of purported expert witnesses whose testimony appears unduly influenced by the strategic objectives of the parties who retain them. n213 In this respect, it surely seems more likely to advance the goal of an expeditious and cost-efficient determination of important issues like the solvency of the debtor as of the date of allegedly avoidable transfers or the total enterprise value of the reorganized debtor if the bankruptcy court appointed its own experts. With the appointment of its own financial expert, the bankruptcy court may avoid having to spend so much time in holding evidentiary hearings on motions in limine to preclude unqualified, irrelevant, or unreliable purported experts from testifying on issues of solvency or total enterprise value. Alternatively, the bankruptcy court may keep its authority to appoint its own expert in reserve, and only appoint its own expert after the expert witnesses of the opposing parties have submitted expert reports that are so radically divergent in applying the standard methodologies that the most practical alternative is scrapping those reports or appointing its own expert to reconstruct the data and apply the standard methodologies with a very self-conscious effort to be as objective as is reasonably possible.

F. Technical Advisors

Perceived as less intrusive to the adversarial process, "technical advisors" have also been appointed by courts. n214 This office does not rise to the level of the expert witness, for the technical advisor's role is often to assist the court in understanding the methodologies the experts are using. Under these circumstances, the technical advisor will not submit

a written report, and will not undertake to find the relevant and material facts that are genuinely at issue. In a sense, the technical advisor may be viewed as a tutor to the court. If a technical advisor is less violative of the traditional norms of the adversarial system, then perhaps bankruptcy judges may feel more comfortable in appointing technical advisors to assist them in mastering the methodologies [*418] of corporate finance and total enterprise valuation in lieu of resorting to the more elaborate and costly process of appointing expert witnesses.

III. THE PROCEDURES FOR USING EXPERT REPORTS AND TESTIMONY AS SUBSTANTIVE EVIDENCE

A. Affidavits of Experts

Affidavits of witnesses are often essential in supporting a defendant's motion for summary judgment or dismissal under *Fed. R. Civ. P. 56*. n215 In a complaint to avoid a preferential transfer, for example, the defendant may have pled an affirmative defense under section 547(c) that the payments at issue were made by the debtor in the ordinary course of its and the defendant's business. n216 If the defendant is to prevail in its motion for summary judgment based upon this defense, it bears the burden of proof that there is no genuine issue of a material fact in dispute and that the defendant is entitled to relief as a matter of law. Generally, the motion has to be supported by affidavit(s) to establish that there is no genuine issue of material fact; an affidavit of a fact witness must be based upon the affiant's personal knowledge of the relevant facts and, furthermore, these facts will generally have to be attested to by properly attached and authenticated or certified business records that would be admissible at trial. n217

If an affidavit of an expert is submitted in support of summary judgment, the affidavit must show that the expert is qualified, that the testimony will assist the trier of fact (that is, that it is relevant), and that the testimony is reliable. Mere conclusory opinions in an affidavit about payment practices between the debtor and the defendant and in the relevant industry will be insufficient to win the motion. n218 It should, however, be possible for an expert such as a credit manager, factor, or forensic accountant to demonstrate in [*419] an affidavit that he or she has reviewed invoices, checks, and payment history between the debtor and the defendant, and that he has industry-specific experience or specialized knowledge about the payment practices within the relevant industry. The affiant will have to spell out his or her personal experience or specialized knowledge (education, research, etc.) in researching, performing, or supervising credit management, factoring, or finance for companies in that industry.

In contested motions and in adversary proceedings, some bankruptcy courts allow, and, in fact, prefer that the direct proofs in contested evidentiary hearings be presented in the form of detailed affidavits, including the proffered testimony of expert witnesses, with the affiant present at the hearing to be cross-examined by opposing counsel. This practice should reduce the amount of trial time in court. Particular care has to be taken by counsel that the affidavits clearly set forth the expert's qualifications to testify on the precise issues in the contested motion or adversary proceeding, the investigation performed by the expert of the relevant facts, the methods or principles used by the expert, their general level of acceptance by other expert witnesses in the same field, and their rigorous and reliable application to the relevant facts. In this respect, the detailed affidavit begins to resemble an expert witness's report. It is also strongly advisable for any party intending to introduce affidavits as substantive testimony to file and serve them with sufficient time in advance for the court and the opposing counsel to read them carefully. Nothing is more off-putting to a bankruptcy judge (or inconsiderate of opposing counsel) than to have an attorney offer to hand up to the bench detailed affidavits with a large number of attached (and un-tabbed) exhibits at the beginning of the evidentiary hearing.

B. Introduction of Expert Reports and Testimony during Trial

If no motions in limine are brought before the beginning of a trial in an adversary proceeding or contested motion, then once a foundation is laid by a party, that party may move to call its expert to testify and in connection with that testimony further move to admit the expert's report. n219 At this point, standard evidentiary objections such as failure to lay an adequate foundation or lack of relevance may be raised by opposing counsel.

In Part IV, we discuss some of the recurring issues presented when parties offer up expert financial testimony in bankruptcy cases. In Part IV, we [*420] also include a discussion of best practices, culled from our analysis of bankruptcy cases and our own collective experiences as a judge, lawyer, expert, and academic.

IV. DAUBERT BEST PRACTICES

There exists a pressing need for a frank discussion of the requirements of the Daubert/Kumho in the bankruptcy context and their application to financial testimony. In order to develop Daubert best practices by parties, experts, and courts, we consider the typical Daubert issues in the context of various substantive disputes. We provide a discussion of cases to tease out a meta-approach that points to the best practices as developed by the courts in real situations. n220 As previously mentioned, bankruptcy practice embraces flexible processes. Additionally, the bankruptcy court is invested with broad discretion in addressing challenges to the admissibility of expert testimony. Notwithstanding the culture of flexibility and the grant of discretion, Daubert imposes a non-delegable duty on bankruptcy courts to confront the issue of the admissibility of expert financial testimony. This is no less true in a world of bankruptcy cases, a world largely of bench and not jury trials.

A. Daubert's Meaning in a World of Bench Trials

How does the largely non-jury, cost-shifting bankruptcy environment affect the application of the Daubert/Kumho requirements? What can and should judges do to promote efficient and accurate input from experts on issues that require a deliberate, sophisticated, and detailed kind of analysis? To what extent does the absence of a jury in almost all bankruptcy proceedings alter the gatekeeping function of the bankruptcy judge? These are among some of the more important questions presented in the course of understanding the meaning of Daubert in the bankruptcy context. Underlying this cluster of questions is a fundamental theme - in a bench trial where jury confusion simply does not exist, is it efficient to exclude expert testimony based on an appropriate Daubert objection and risk, if not invite, appellate review and possible reversal?

Daubert changed the course a bankruptcy court must take in assessing whether expert financial testimony will assist the trier of fact, whether the evidence offered is relevant, and whether the methodology employed and the ultimate opinion are reliable. This is a non-delegable duty as relevant in a bench trial as in a jury trial. To be sure, the stakes may appear greater in a jury trial in that a lay panel may be unjustifiably swayed by nonsense offered by so-called experts. That risk, for the most part, does not exist in a bench [*421] trial. But limiting the teaching of Daubert to the prevention of jury confusion eviscerates much of the opinion. Daubert also disciplines litigants, advocates, and experts. Litigants who seek "made to order" expert testimony will see that tactic backfire under Daubert. Attorneys who push their experts toward an opinion on a dispositive issue in the case that is not objectively supported by relevant and reliable testimony will find themselves before the hearing or trial expert-less. Experts who succumb to the pressures of the client or the advocate may increasingly find themselves excluded or professionally embarrassed. Daubert does not merely thrust the court into a position to ensure relevance and reliability; that case and its progeny are also designed to impose discipline on the constituents who appear before a court and offer expert testimony. Thus, at a minimum, even those bankruptcy judges who tend to defer to the desires of counsel for the opposing parties in shaping pretrial activity must become more proactive when expert testimony is anticipated. Their institutional duty demands no less.

There are some judges who may hold fast to the notion that efficiency, especially in bankruptcy cases, should be the prime institutional duty. Thus, on the side of efficiency in the debate, if a judge determines to exclude proffered expert opinion because it is either not a subject where expertise is needed or because the proffered testimony will not be helpful to the judge as the fact-finder, the concern is that the appellate issues thus presented may likely dash the hoped-for efficiency. After all, in the situation where a judge is the fact-finder and it is becoming apparent that the expert's opinion is not accomplishing the expert's mission as articulated in Daubert, efficiency may be appropriately served by allowing the expert opinion for what it's worth and then finding that it's worth gornisht. This passive approach presents two problems: not only does it abdicate the institutional responsibility mandated by Daubert, but it also invites what we would characterize as posturing and opportunistic behavior on the part of counsel and experts. This behavior

wastes trial court time and still presents its own host of appellate issues. In our opinion, nothing is gained in the realm of efficiency by carrying expert testimony that fails to pass muster under the requirements of Daubert. Moreover, without having to bear the direct and adverse consequences, attorneys and experts may continue to push beyond the envelope of reasonableness and reliability in offering expert financial testimony.

B. Pretrial Approach to Daubert Conflicts

To suggest, as we do, that bankruptcy courts must actively confront the relevance and reliability of expert testimony does not demand any particular suit of response. After our review of bankruptcy cases and our discussion with judges, attorneys, and experts, it is obvious that there is no "off the rack" model for handling all the permutations of Daubert issues. As previously [*422] mentioned, we have found that there exists substantial merit to handling Daubert issues through pretrial procedures such as the motion in limine. Early judicial intervention on the Daubert issues may ensure that the purported experts are dealing with the same relevant dataset, that the assignment given the expert has been framed appropriately, that the expert's neutrality is real, and that the methodologies employed and the ultimate opinion are reliable.

1. Expert Retention Stage

The first opportunity to address any Daubert issues may occur when the debtor or some official committee seeks authority to retain an expert whose fee is expected to be paid from the estate. One could ask whether bankruptcy judges should be more active in reviewing retention applications filed for experts. At that stage, one could argue that a court should assess (1) what, if any, historical ties the expert firm has with any of the key players; (2) whether the expert firm has substantial experience with respect to the issues in the case; and (3) whether the expert has been retained under some contingency fee arrangement. The merits of early intervention could be viewed as having a Daubert hearing at the time when most of the mischief could be avoided. The concern with judicial intervention at this point is that no methodology has been employed, no opinion rendered by which to gauge relevance and reliability. Our conclusion is that it is appropriate in certain circumstances at the retention stage to assess some but not all of the expert evidentiary issues. For example, a court may consider the qualifications of the expert, the relevance of the expert's assignment, the existence of systemic bias, and the nature of compensation. However, the question of reliability is premature at the retention stage. No expert is going to undertake even the initial assessment of the financial dataset, the scope of analysis, or the construction of the model without the assurance of compensation, nor is it reasonable to expect an expert to do so.

2. Expert Report Stage

The second opportunity at which to gauge Daubert issues is at the expert report stage. As mentioned previously, *Rule 26 of the Federal Rules of Civil Procedure* (and its Bankruptcy Rules counterpart) mandate that an expert prepare a report and that any reports be exchanged. This process is generally regulated by pretrial procedures. At this point, if counsel and the expert have complied with their duties under Daubert, then a court may make an informed decision on the relevance and reliability of the expert testimony. Recall that the expert report must set the footprint of any subsequent testimony. That is sometimes not the case in bankruptcy. Rather, some experts take their responsibility seriously, seeking to comply with Rule 26 and Daubert. Others simply do not. For example, in our experience we have [*423] observed expert reports on the ordinary course of business defense in preference actions that contain discussions of the relevance and the reliability of the opinion offered, even where the opinion ultimately rests on the expert's experience. In contrast, we have seen expert reports of a page or two at most that essentially state "that is how we always do it" without any discussion of the experience and its fit, the steps taken to develop the opinion, the facts relied on, etc. In another example, we have encountered fraudulent transfer actions involving the question of insolvency where one side prepares a detailed report considering the adjusted (to fair value) balance sheet test under Section 101(32) of the Code and other going concern valuation techniques such as the income approach, the guideline (comparable) company approach, and the comparable transaction approach, where the various techniques are used to cross-validate

the opinion. In contrast, we have seen ten-page PowerPoint presentations prepared by experts retained on a contingency fee and utilizing one of the various tests of insolvency with no attempt to assess validity through employment of the other tests. Finally, in yet another context, we have seen experts prepare business enterprise valuations for confirmation hearings where the report carefully assesses the relevance and reliability of the dataset, employs various valuation techniques, makes and explains all significant assumptions and adjustments, and tests for sensitivity. In contrast, we have seen expert reports that make wild assumptions, fail to explain their assumptions and methodologies, drive to specific values, and, on their face, are so biased or conclusory as to render the reports legally fatal. In all of these situations, the Daubert deficiencies could have been identified at the expert report disclosure stage. In many of these cases, however, the estate incurred further expense in depositions, pretrial motions, and in some cases trial. More active involvement by the court would have accomplished several goals: first, deficient expert reports would be culled and cases that failed to meet Daubert requirements in their reports would be truncated, thus preserving assets of the estate; second, systemic bias or contingency fee arrangements could be unearthed, thus preserving estate assets by truncating cases that cannot be maintained; third, experts would insist on preparing full Daubert-compliant reports demonstrating that the testimony would assist the trier of fact, be relevant, and be reliable; and finally, counsel's use of the place-holder report to continue a weak case toward settlement and past the expert-designation-and-report hurdle would end - either the parties would fund their cases appropriately or they would not have a case - thus, preserving estate assets and judicial integrity.

We suggest that courts consider a review of the expert reports in certain circumstances even before depositions. Recall that the preparation and disclosure of expert reports in accordance with Rule 26 are designed to make the expert deposition unnecessary in most circumstances. Although it is entirely [*424] proper for a court to allow discovery to play out in its entirety, parties may press the issue. If the expert report is properly prepared, a court may make a meaningful assessment of whether the expert will pass muster under Daubert. Thus, we generally envision that the expert reports should be shared with the court early in expert discovery.

Moreover, we suggest that courts analyze expert reports before they hear expert testimony. A reading of the expert report before testimony better prepares a court to understand the examination and cross-examination and to identify questions that a court may hope will be asked by counsel. If counsel fails to ask those questions, particularly in the context of a bench trial, a court should not shy from asking the expert questions, since the whole rationale for an expert's testimony is to aid the trier of fact.

Active judicial questioning presents an awkward situation for counsel. What does counsel do if a question asked by a court would be objectionable if it were asked by opposing counsel? We share with you the practice of several bankruptcy judges. In actively questioning experts, some judges have developed a practice of informing counsel that they may object if they find any questions objectionable, stating the nature of the objection. This affords the court an opportunity to rule on the objection or, more prudently, to withdraw the question, if the judge realizes that he or she may have overstepped an arguable boundary of detachment and impartiality. At the least, an opportunity to object to an objectionable question leveled by a court is necessary to preserve error for appeal.

C. Pretrial Daubert Hearing

A third opportunity at which to gauge Daubert compliance is a pretrial Daubert hearing through the use of a motion in limine. This is the approach embraced by the court in In re Mirant Corp., n221 at present one of the most [*425] sophisticated opinions on total enterprise valuation in the burgeoning bankruptcy court "literature." n222 In Mirant a conglomerate in the merchant energy business filed its chapter 11 petitions in the Northern District of Texas. Under the debtors' Joint Second Amended Plan of Reorganization ("Plan"), the interests of the prepetition equity security holders were cancelled on the premise that there was insufficient value in the reorganized debtor to pay the allowed claims of the unsecured debtors in full. Unfortunately, the plan proponents refused to negotiate a consensual plan and prepared to force the issue of a cram-down of the interests of the existing shareholders. n223 Believing that the Plan was based upon an erroneously low valuation of the debtors, the Official Committee of Equity Holders ("Equity Committee") filed a motion and complaint asking the court to direct the debtors to convene a meeting of stockholders. In this context of a

pending cram-down confirmation and a motion aimed at ousting existing management, the Court convened a status conference and proposed a separate hearing to determine the debtors' enterprise value. The parties agreed to this approach. n224 This is a practice we fully endorse in the appropriate circumstsances.

After a two-month period of expedited pretrial discovery, including the filing of eight expert reports and counter-reports and the depositions of three other witnesses, the court conducted a valuation hearing over twenty-seven days within an eleven-week period. At the end of this phase of the chapter 11 cases, the court released a "letter ruling" of its preliminary determinations, with a direction to the experts to submit revised reports that responded to the court's detailed concerns, another procedure we endorse in the appropriate circumstances. n225 As the court noted in its preliminary ruling, it was not prepared to calculate a "melded" valuation by averaging the valuations of the experts for the principal parties in interest, for there were far too many adjustments that would have to be made to each expert's report to reflect the changing price for natural gas and other fuels consumed by the debtors in their operation, peak capacity demands for electricity, and the value of additional [*426] power plants that were coming on line. n226

In its comprehensive opinion following confirmation, the court reviewed the qualifications of the principal expert witnesses proposed by the debtors, by the official committees of creditors at the level of the merchant energy trading companies, by the equity security holders committee, and by the sub-debt holders. The three expert witnesses for the Equity Committee were found to be very well qualified, but the court rejected each of their reports on valuation because the projections on future gas prices that lay at their base were riddled with mathematical errors and those errors rendered unreliable all further computations in the total enterprise valuations. n227 Although the court held that their reports could not be admitted into evidence, it did give some weight to the rebuttal testimony of these experts and adopted some of their objections in directing the debtors and debtor's experts to revise their valuation report. n228

The court found that the business plan developed by the debtors was well prepared and was reasonably reliable, and the court was prepared to rely upon that report as the basis for determining the total enterprise value of the Mirant Group, with some adjustments. n229 In addition, the court found the valuation report prepared by the debtors' experts and based on the business plan to be reasonably reliable, subject to the same kind of adjustments. n230 In marked contrast, the court gave very little credence to the expert report and testimony that was prepared for the sub-debt holder entities. n231

[*427] The court then proceeded step by step through its proposed four initial adjustments to the data: the discount rates and the multiples to be used by the debtors and debtors' experts in their revised valuation analysis. n232 In the next section of its opinion, the court ruled on various objections made to the debtors' business plan noting the inability of the market to project the true value of a reorganizing debtor. n233 To the extent that the debtors' experts sought to project market prices in the immediate post-confirmation period as part of its valuation analysis, the court rejected that approach as unacceptable and directed the debtors and their experts to rely upon the "last twelve months" valuation method in re-computing their valuation analysis in order to ground that analysis in the historical performance of the debtors. n234 The court then upheld as reasonable the selection by the debtors and their experts of four comparable public companies in the merchant energy business, and agreed in their rejection of a fifth company proposed by the experts for the Equity Committee and the sub-debt holders. n235 The court also overruled the objection to assign different weights to each of the comparable companies; without any elaboration, the court held that equal weights were appropriate. n236

The court proceeded to its rulings on the imputed interest rates on debt and imputed returns on equity, the two basic components in applying the discounted cash flow method. The debtors' experts sought to rely upon the pre-confirmation trading of the debtors' debt instruments as a basis for determining the cost of debt as a component of the weighed average cost of capital, but the court rejected that approach, noting the additions and subtractions to the component owing to the chapter 11 process. n237 Under these circumstances, the court held that pre-confirmation market activities in the debtors' debt instruments could not be considered in determining the cost of the debt component to the weighted average cost of capital. n238 Similar considerations applied to determining the cost of the equity component, according to the court. n239 The court continued to impose further adjustments, most of which appeared to be based upon a very

thin evidentiary record, at least as reflected in the reported opinion. n240

The court then wrapped up its analysis by explaining briefly why it overruled a series of objections by the experts for the Equity Committee and the [*428] sub-debt holders, calling for additional values arising from the following topics: capacity payments, the capital structure, the value of the Bowling 3 plant, which never went on line and which was sold, and the minority interests of the debtors in other companies. n241 No value would be given for these assets. n242

In all, the court embraced a sophisticated approach, employing what we consider to be a host of best practices in light of the Daubert mandates. First, the court conducted an evidentiary hearing well before the confirmation hearing. Although as we have noted throughout this Article, a separate pretrial hearing is not necessary, it does point to best practices. This is the case in that a court may be able to dismiss expert testimony that fails to assist the trier of fact, is irrelevant, or is unreliable without putting to great expense the parties or stakeholders in a bankruptcy matter. Second, the court refrained from the "seek and select" method, and rather than act as its own expert, embraced the role of gatekeeper. Third, the court, in its painstaking effort to get it right, sent the experts back to the drawing board with specific instructions to supplement their reports and analysis. Fourth, the court recognized that a qualified expert is retained precisely to exercise sound judgment, even subjective judgment, and that such exercises of judgment are permissible if relevant, reliable, and not conclusory. n243

D. Pitfalls of the "Search and Select" Method

Of concern is the practice (both real and perceived) that courts "split the difference" between expert opinions, for example, on business enterprise valuations of the reorganized debtor or on solvency analyses. The conventional wisdom is that courts do not ham-handedly split the difference between expert opinions (for example, by adding the expert valuations and dividing by the number of experts), but that they rather engage in the practice of "search and select," that is, culling and winnowing reports to arrive at a meta-report that sustains a value within the range of values provided by the experts but not clearly supported by any one expert's report.

The problems with the "search and select" approach are several-fold. [*429] First, it encourages greater divergence in opposing expert opinions. If counsel and experts believe, justifiably or not, that a court may "split the difference," then the one party's expert may be convinced that a higher value point within the range of justifiable values may be appropriate while the opposing party's expert may be equally convinced that a lower value point should be proposed. Notice, the expert is formulating and rendering a reasonable valuation in their judgment, but is influenced by the fact that a court may split the difference. Although experts generally struggle to be as objective as possible, they are human beings who may be influenced, whether consciously or not, by the perception that the range created by the opposing experts' valuations will impact the court's final decision. n244

Second, the search and select method may result in a judicial valuation, for example, that no qualified expert would accept let alone render. In such situations, the court has inappropriately inserted itself as an expert rather than a gatekeeper. While the judicial roles of determining valuation and acting as an evidentiary gatekeeper may overlap, they are two very distinct trial functions. Although the court should be active in the latter role, it should abstain from essentially ignoring experts in the former. If further expert analysis is necessary after the parties' experts have testified, then the court should consider appointing its own expert or technical advisor or sending the experts back to the "drawing board." n245

Finally, expert financial testimony, such as that testimony offered in the solvency, reasonable value, and enterprise valuation contexts is a holistic endeavor that should not be cleaved by a "search and select" judicial approach. Let us consider the testimony offered at confirmation on the total enterprise value of the reorganized debtor. The expert will often testify as to total enterprise value based on the application of several valuation techniques, each requiring assumptions and adjustments be made. Cash flow adjustments and projections, appropriate discount values, cash flow metrics, terminal values, comparable transactions, or comparable companies are not isolated and independent factors

that may be selected off the shelves of competing expert testimony. Many variables in the valuation process are driven, in part, by an expert's observations and analysis of other variables and metrics. Thus, when a court employs a search and select approach, it fails to appreciate the interdependence of numerous assumptions and variables in a valuation methodology [*430] and possibly violates the internal integrity, reliability, and coherence of the valuation itself.

As previously mentioned, there is a perception that bankruptcy courts regularly employ a search and select method to expert testimony, or regularly split the uprights by "compromising" competing expert opinions. This perception, whether in fact supportable in practice, influences how some lawyers try their cases and how some experts prepare their reports. Although there are situations where it is both reliable and appropriate to adopt various parts of the opinions of competing experts, a court must be careful that such an approach does not violate the internal coherence, integrity, and consistency of the expert opinions. Thus, courts must tread carefully when starting down the "search and select" path.

E. Use of Court-Appointed Experts and Technical Advisors

The recent cases addressing expert financial testimony demonstrate the trend toward a more sophisticated performance of the court's gatekeeping role in excluding "irrelevant and/or unreliable" expert reports and testimony. This more sophisticated performance by the judges is evidenced by their increasing mastery of critical accounting and finance principles and practices and their higher degree of confidence in their ability to root out irrelevant and unreliable evidence offered under the rubric of financial expertise. This judicial implementation of its gatekeeping function is not, however, without a downside: litigants are experiencing the collateral consequence of increased expenses not only in the proper preparation of the expert reports, but also in preparing for and defending Daubert/Kumho cross-motions for disqualification. In many of these situations, the estate picks up the bill - multiple bills to be precise.

The obvious question is why do courts refrain from the appointment of a court expert and the limitation of the retention of multiple experts who will ultimately be looking to have their fees paid from estate assets? Where almost all parties are likely to seek to have the bankruptcy estate absorb the cost of expert witnesses, should the court's concern for not exhausting estate assets for the payment of administrative expenses extend to the bankruptcy judge policing the proliferation of experts?

As a partial response to the preceding questions, courts should consider the use of court-appointed experts or technical advisors. As previously mentioned, courts have surprisingly broad discretion in the appointment of court experts or technical advisors. Moreover, the concern of ex parte contact between the court-appointed expert and the court may easily be alleviated by the procedures we have identified above. Additionally, the concern in circumventing the traditional normative structure is minimized in a collective [*431] action wherein parties will generally seek to have the estate to cover the costs of retention.

Short of the appointment of an expert, a court may insist that parties minimize the posturing of warring experts. For example, few bankruptcy judges are strangers to the basic approaches to valuing businesses. Judges have witnessed the build up of competing assumptions from (a) which are the debtor's peer comparable companies to (b) what discount rates are appropriate to (c) what terminal year should be chosen to cut off projecting debtor revenues and to (d) what future multiple should be applied to the terminal year value. These factors seem to invite ballooning or shrinking depending on who has retained the expert. Courts also regularly hear the descriptions of the breadth of the due diligence work performed by each firm in an effort to build up their expert opinions. A court may appoint a limited expert, for example, who can construct the financial dataset as a neutral expert upon which other experts may rely. An expert with a limited scope should preserve some of the adversarial nature of the process while reducing the redundant costs associated with multiple experts ostensibly slogging over the same ground, each seeking payment from the estate.

F. Addressing Systematic Bias

What can and should judges do if they perceive to a high level of certainty that a purported expert's work is infected by the answer that the retaining client needs for its case? Courts may exclude expert testimony where the expert's analysis

is poisoned by systematic bias in applying the standard methodologies. As traditionally understood, bias is most often left for cross-examination and possible impeachment at trial. However, systematic bias may rise to a level that renders any application of even a standard methodology unreliable to the point that it fails the Daubert requirements. That is precisely the situation the bankruptcy court faced in In re Med Diversified Inc. II. n246 That case demonstrates the type of systematic bias that warrants exclusion of the expert's testimony and report as unreliable. There, the court concluded that the expert's bias in performing a discounted cash flow analysis was manifested by a series of negative adjustments made during his analysis. n247 In particular, the court pointed to three areas where this bias was most evident: (1) computation of the discount rate; n248 (2) the discount taken for lack of marketability; n249 and (3) calculation of the control premium. n250 [*432] These adjustments were made with little to no reasonable justification offered, no suggestion that other adjustments were considered and discarded and for what reason, and no indication that the expert's approach was objective. Based on these flagrant and systematic biases in applying the standard methodology, the court excluded the expert report and testimony.

As previously mentioned, the existence of a contingency in the retention of an expert should generally result in the disqualification of the expert. An expert who has a "financial dog in the fight" cannot be objective; his opinion will be swayed by his financial stake and, thus, be inherently unreliable. The court in In re Oneida, Ltd., n251 is the most recent in a line of cases that rejects the testimony of experts on a contingency fee. In contrast is the situation in In re Joy Recovery Technology Corp. n252 In Joy, the court addressed the question of bias on the part of the expert. The defendant alleged that the trustee's expert was biased by his contingent interest in the outcome of the case - because of the administrative insolvency of the bankruptcy case itself, the witness could only be compensated if his client prevailed in the pending fraudulent conveyance action, which, in turn, depended upon the testimony he was to offer. n253 The court properly overruled that objection, because if it were sustained, very few creditors' representatives in liquidating chapter 7 or 11 cases would ever be in a position to assure payment of the proposed expert witness' fees. Thus, there is a practical need to recognize a contingency in fact in actual payment (not in the obligation itself), allow the expert to testify, and raise the contingency in payment (as opposed to obligation to pay) during cross-examination. This situation is different from the situation in which the expert as a matter of agreement, receives a contingency fee when the obligation is in fact contingent. The bias in such matters is so great, without implicating the practical policy of necessity, that a court should carefully scrutinize the very strong likelihood of unreliability of the testimony.

G. Appreciating the Difference Between Unreliability and Uncertainty

Over the last decade many bankruptcy courts have held evidentiary hearings in the context of contested confirmations to determine the total enterprise value of the reorganized debtor, each with the proverbial battle of experts, and whether the total enterprise value was properly allocated among numerous levels of creditors, senior management, and new and old equity. What is remarkable about these hearings is the common objection that under [*433] the debtor's proposed plan, the claims of the senior creditors, often purchased at a discount by junior capital, second lienholders, venture capitalists or hedge funds, will receive much more of the value of the reorganized debtor, and, as such, proposed plans of this character violate the standard of fairness and equal treatment embedded in sections 1129(b)(1)(2)(B) or (C) of the Bankruptcy Code.

Valuations, in the best of circumstances, are fraught with uncertainty. The income approach turns on a gaggle of assumptions, often times with one assumption building on another. The market approach turns on either comparable companies or comparable transactions, where comparability is often in the eye of the expert and where typically inferences must be drawn from public companies to support valuations of private companies. The asset approach turns on projected replacement cost or liquidation values, with its own viperous nests of estimates. But, as any good statistician will say, there is a world of difference between uncertainty and unreliability. The former state is an inherent part of reasoned discretion and good judgment, indicia of any well-reasoned expert opinion; the latter state is fatal under Daubert. Often times, we confound uncertainty with unreliability. The two concepts are not congruous.

CONCLUSION

Daubert signaled a sea-change in the way in which federal courts address expert witness testimony. No longer approaching expert testimony from the perspective of deference to the relevant expert community, the court must assess whether the qualified expert is providing testimony that (1) will assist the trier of fact, (2) is relevant, and (3) is reliable. Although numerous factors have been generated to aid the court in this critical task, the overriding thrust of the dual requirements of reliability and relevance in Daubert is as clear as it is sensible. First, relevance tests the nature of the fit between the expert testimony offered and the issues in play against the general threshold of expert admissibility - will the testimony offered assist the trier of fact. Relevance itself requires an understanding of the precise question being asked, for example, insolvency under an adjusted balance sheet approach. In such circumstances, GAAP book value testimony is largely irrelevant. Moreover, the requirement of relevance ensures that the fit among the facts, the methodology, and the opinion is reasonable. Second, the requirement of reliability ensures that the assumptions, exercises in discretion, methodology, process, and results square with the requisite skill, training, or experience that experts in the relevant field possess. A conclusory opinion fails to pass muster; by its nature, the process by which such an opinion was reached is unknowable and, thus, presumptively unreliable. However, a subjective [*434] opinion, or an opinion based on subjective metrics or variables, may be reliable. We offer another name for subjectivity as exercised by experts; we call it experience. Courts must refrain from confounding subjectivity with conclusory thinking or uncertainty with unreliability. This multi-prong approach to admissibility responds to the natural inquiry of whether the expert knows whereof he speaks. n254

Rule 702 of the Federal Rules of Evidence and Daubert slay once and for all the myth that in a bankruptcy case, evidentiary rules are mere "suggestions" and that an expert's "guesses" and "hunches" will be admitted and "given the weight they deserve." A hunch, even by an otherwise qualified expert, does not result in admissible expert testimony. Conclusory or "placeholder" opinions have no place under Daubert and the Federal Rules of Evidence. "For an expert that supplies nothing but the bottom line supplies nothing of value to the judicial process." n255

Daubert itself was designed to empower courts. But with increased power comes increased responsibility. After all, one needs no gatekeeper if the gate is always closed or always opens. *Rule 702 of the Federal Rules of Evidence*, as understood in the context of Daubert and its progeny, provides both a methodology and a conceptual tool in an effort to guide courts, counsel, and experts. The Rule as properly understood vests in the court reasoned discretion guided by first principles embodied in the Federal Rules of Evidence and by indicia of reliability and relevance embodied in the Daubert standards. These standards, far from constraining judicial discretion, expand it, and are ushering a new world in bankruptcy practice. It will be up to the courts to uphold the standard of "intellectual rigor," identified by the Supreme Court as of essential importance in admitting or excluding the testimony and reports of experts. Similarly, it will be the arduous duty of the bankruptcy courts to be vigilant in precluding the testimony and reports of expert witnesses whose methodologies are little more than self-validating and self-promoting claims of technical knowledge. So far the results have been mixed, but there are some promising signs of greater sophistication on the part of the bankruptcy courts, the bankruptcy litigators, and ultimately of self-respecting experts with integrity and discipline in preparing expert reports and testifying as objectively as they can on financial matters. Daubert demands nothing less from us all.

Legal Topics:

For related research and practice materials, see the following legal topics:
Bankruptcy LawPractice & ProceedingsAppealsStandards of ReviewAbuse of DiscretionEvidenceScientific EvidenceDaubert StandardEvidenceTestimonyExpertsGeneral Overview

FOOTNOTES:

n1. See United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assoc. (*In re Timbers of Inwood Forest Assoc., 793 F.3d 1380, 1405 (5th Cir. 1986)* (congressional recodification of bankruptcy law in 1978 was designed to encourage a more rapid resolution of reorganization cases), aff'd, *484 U.S. 365*, (1988); *Acequia,*

Inc. v. Clinton (In re Acequia, Inc.), 34 F.3d 800, 808 (9th Cir. 1994) (the fair and equitable reorganization of the debtor's capital structure on an expedited basis is the primary goal of chapter 11 business reorganization cases).

n2. *Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579, 597 (1993)*.

n3. *Kumho Tire Co. v. Carmichael, 526 U.S. 137 (1999)*.

n4. See *In re Hotel Assocs., LLC, 340 B.R. 554 (Bankr. D.S.C. 2006)* (determination of value of a full-service hotel under §506(a)).

n5. See *Alberts v. HCA Inc. (In re Greater Southeast Community Hospital Corp.), 2007 Bankr. LEXIS 1* (Jan. 2, 2007 Bankr. D.C) (denying motion to exclude the chapter 11 liquidating trustee's expert testimony on the value of the debtor's equipment and real estate); *Linc Capital, Inc. v. Interlink Electronics, Inc. (In re Link Capital, Inc.), 312 B.R. 368 (Bankr. N.D. Ill. 2004)* (court relied on expert testimony to determine the value of equipment the defendant failed to return to the debtor).

n6. See *In re Owens Corning, 316 B.R. 168 (Bankr. D. Del. 2004)*, rev'd, *419 F. 3d 195 (3d Cir. 2005)*, cert. denied, *U.S. , 126 S. Ct. 1910* (May 1, 2006).

n7. See *In re Greate Bay Hotel & Casinso, Inc., 251 B.R. 213 (Bankr. D.N.J. 2000); In re CGE Shattuck, LLC, 2000 Bankr. LEXIS 1783 (Bankr. D.N.H. 2000); In re Westpointe, L.P., 234 B.R. 431 (E.D. Mo. 1999)*, aff'd, *241 F.3d 1005 (8th Cir. 2001)*.

n8. See *In re Integrated Health Services, Inc., 289 B.R. 32 (Bankr. D. Del. 2003)* (expert testimony in valuing $ 20,000,000 in use and occupancy charges as an administrative expense arising from continued occupancy of nursing homes after the rejection of the leases). See also *In re Husting Land & Development Co., 255 B.R. 772 (Bankr. D. Utah 2000)* (rejecting proffered expert witness testimony that post-petition construction work on the debtor's residential housing project was ordinary course of business entitled to allowance as a first priority administrative expense), aff'd, *255 B.R. 772 (D. Utah 2002)*.

n9. See *In re River Landings, Inc., 180 B.R. 701 (Bankr. S.D. Ga. 1995)* (four attorneys qualified as experts to testify on reasonable hourly attorney rates, which was probative on the issue of the appropriate market rate for attorney services in the Southern District of Georgia).

n10. *Brandt v. Samuel, Son & Co. (In re Longview Aluminum, L.L.C.), 2005 Bankr. LEXIS 1312* (Bankr. N.D. Ill. July 14, 2005); *Geron v. Schulman (In re Manshul Construction Corp.), 2000 U.S. Dist. LEXIS 12576* (S.D.N.Y. Aug. 29, 2000);

n11. See *In re CF & I Fabricators of Utah, Inc., 150 F.3d 1293 (10th Cir. 1998)*

n12. See *In re Dow Corning, 316 B.R. 168 (Bankr. D. Del. 2004);* rev'd, *419 F. 3d 195 (3d Cr. 2005);* cert. denied, *U.S. , 126 S. Ct. 1910* (May 1, 2006).

n13. See *In re U. S. Truck Co., 89 B.R. 618 (E.D. Mich. 1988)*.

n14. See *Doctors Health, Inc. v. NYLCare Health Plans of the Mid-Atlantic, Inc. (In re Doctors Health, Inc.), 335 B.R. 95 (Bankr. D. Md. 2005)* (expert testified on the value of the loss resulting from prepetition breach of contract).

n15. See *Charts v. Nationwide Mutual Ins., 397 F. Supp. 2d 357 (D. Conn. 2005)* (expert testimony was sufficient to establish damages resulting from breach of franchise agreement); *In re Matusalem, 158 B.R. 514 (Bankr. S.D. Fla. 1993)* (expert testimony offered in favor of rejecting franchise agreement).

n16. See *In re Usery, 242 B.R. 450 (B.A.P. 8th Cir. 1999)* (damages arising from fraud in connection with the sale of two nursing homes), aff'd *242 F.3d 378 (8th Cir. 2000)*.

n17. See *In re Worldcom, Inc., 340 B.R. 719 (Bankr. S.D.N.Y. 2006)* (expert testimony offered regarding damages resulting from, among other claims, tortious interference with contractual relations).

n18. See *Pension Transfer Corp. v. Beneficiaries Under the Third Amendment to Fruehauf Trailer Corp. Retirement Plan No. 003 (In re Fruehauf Trailer Co.), 319 B.R. 76 (D. Del. 2005)*, aff'd, *444 F.3d 203 (3rd Cir. 2006); In re Brooklyn Hosp. Ctr., 341 B.R. 405 (Bankr. E.D.N.Y. 2006)*.

n19. See *G.H. Leidenheimer Baking Co. v. Sharp (In re SGMS Acquisition Co., LLC), 439 F.3d 233 (5th Cir. 2006)* (expert testimony was insufficient to establish ordinary course of business defense); *Montgomery Ward, LLC v. OTC Int'l, Ltd., (In re Montgomery Ward, LLC), 348 B.R. 662 (Bankr. D. Del. 2006)* (admitting expert testimony on aging of alleged preference payments and on statistical techniques to assess typical payments and measures of dispersion); cf. *Barrett Dodge Chrysler Plymouth, Inc. v. Cranshaw (In re Isaac Leaseco, Inc.), 389 F.3d 1205 (11th Cir. 2005)* (expert testimony established sales were not in the ordinary course of business).

n20. *54 App. D.C. 46, 47, 293 F. 1013, 1014 (1923)*

n21. Id.

n22. Id.

n23. *Daubert v. Merrell Dow Pharmaceuticals, Inc., 727 F.Supp. 570* (S.D.Ca, 1989), aff'd *951 F.2d 1128 (9th Cir. 1991)*, rev'd and remanded, 509 U.S.579 (1993).

n24. *Id. at 573-575*.

n25. *Id. at 575*.

n26. *Daubert v. Merrell Dow Pharmaceuticals, Inc., 951 F.2d 1128, 1129 (9th Cir. 1991)*.

n27. *Id. at 1131*.

n28. Id.

n29. *Brock v. Merrell Dow Pharmaceuticals, Inc., 874 F.2d 307*, modified, *884 F.2d 166 (5th Cir. 1989)*, cert. denied, *494 U.S. 1046 (1990); Richardson v. Richardson-Merrell, Inc., 857 F.2d 823 (D.C.Cir. 1988)*, cert. denied, *493 U.S. 882 (1989); Lynch v. Merrell-National Labs., 830 F.2d 1190 (1st Cir. 1987)* (opinion by Noonan, J., sitting by designation).

n30. *DeLuca v. Merrell Dow Pharmaceuticals, Inc., 911 F.2d 941 (3rd Cir.1990)*.

n31. *951 F.2d at 1130*.

n32. *Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579, 587 (1993)*.

n33. *Id. at 587*.

n34. *Id. at 588*.

n35. *Id. at 589-90*.

n36. *Id. at 591*.

n37. Id.

n38. *Id. at 593-595*.

n39. Id.

n40. See generally *Ullman-Briggs, Inc. v. Salton/Maxim Housewares, Inc., 1996 U.S. Dist. LEXIS 13621, at 9* (N.D. Ill. Sept. 16, 1996).

n41. *526 U.S. 137 (1999)*.

n42. *Id. at 141*

n43. See *Carmichael v. Samyang Tires, Inc., 923 F. Supp. 1514, 1520-21 (D. Ala. 1996)*.

n44. See *Carmichael v. Samyang Tires, Inc., 1996 U.S. Dist. LEXIS 22431 at3-10* (D. Ala., June 6, 1996).

n45. *Carmichael v. Samyang Tire, 131 F.3d 1433 (11th Cir. 1997)*.

n46. *Id. at 1436*.

n47. *526 U.S. at 147*.

n48. *Id. at 152*.

n49. Id.

n50. Id.

n51. *522 U.S. 136 (1997)*.

n52. *Id. at 139*.

n53. Id.

n54. *Id. at 140-41*. The plaintiff also alleged that he had been exposed to furans and dioxins that had contributed to his cancer. *Id. at 139 & 147*.

n55. *Joiner v. General Electric, Co., 864 F. Supp. 1310, 1326 (N.D.Ga. 1994)*.

n56. *Joiner v. General Electric, Co. 78 F.3d 524, 529 (11th Cir. 1996)*.

n57. *522 U.S. at 141-42*.

n58. *Id. at 146-47*,. The case was remanded for further proceedings with respect to the claims based upon furans and dioxins. See note 54 supra.

n59. *528 U.S. 440*, (2000).

n60. *Id*. *at 443*.

n61. *Id*. *at 445*.

n62. *Id*. *at 455*.

n63. Id.

n64. *Id*. *at 456*.

n65. Id.

n66. One should be aware that although the bankruptcy rule generally mimics its civil procedure rule counterpart, there are some key differences. Thus, it is incumbent to consult both rules to compare both their similarities and their differences.

n67. Made applicable in bankruptcy practice by *Fed*. *R*. *Bankr*. *P*. *7026*.

n68. Made applicable in bankruptcy practice by *Fed*. *R*. *Bankr*. *P*. *7037*.

n69. See *Joiner v*. *General Electric, Co, 522 U.S*. *136, 139 (1997)*.

n70. *1998 U.S*. *Dist*. *LEXIS 16080* (E.D. Pa. Oct. 13, 1998).

n71. Interestingly, the Advisory Committee Notes to Rule 26 suggest that the introduction of an expert report at trial was not contemplated; after all, the witness may be called to testify in person at trial. However, it is common practice in bankruptcy matters to introduce the expert report into evidence and to call the expert witness to testify at trial.

n72. See Gregory P. Joseph, Expert Approaches, 28: Litigation No. 4, at p.20 (A.B.A. Summer 2002).

n73. Made applicable to adversary proceedings via *Fed. R. Bankr. P. 7034*.

n74. Made applicable to all bankruptcy cases via *Fed. R. Bankr. P. 9016*.

n75. Rule 104(a) states in pertinent part: "Preliminary questions concerning the qualification of a person to be a witness, ... or the admissibility of evidence shall be determined by the court ... In making its determination [the court] is not bound by the rules of evidence except those with respect to privileges."

n76. See *Donnelly v. Ford Motor Co., 80 F. Supp. 2d 45, 47-48 (S.D.N.Y. 1999)*.

n77. See *Bourjaily v. United States, 483 U.S. 171, 175-76 (1987)*.

n78. See discussion, supra at pp. 106-113.

n79. See *Oddi v. Ford Motor Co., 234 F.3d 136, 154-55 (3d Cir. 2000)* (affirming summary judgment granted after excluding expert testimony without holding in limine Daubert hearing); *ProtoComm Corp. v. Novell Advanced Services, Inc., 171 F. Supp. 2d 473 (E.D. Pa. 2001)*, discussed infra at pp 125 et seq.; *In re Husting Land & Development, Inc., 255 B.R. 772 (Bankr. D. Utah 2000)*, discussed infra at ppp 137 et seq.

n80. See Michael H. Graham, 2 Handbook of Federal Evidence §702.5 (5th ed. 2002) (stating that court has discretion); Margaret Berger, "Supreme Court's Trilogy on Admissibility of Expert Testimony," Reference

Manual on Scientific Evidence 29 (Fed. Judicial Center 2000) (same). Of course, one cannot draw any sound inferences about the frequency of the use of the motion in limine in the much larger universe of unreported decisions.

n81. *Borawick v. Shay, 68 F.3d 597, 608 (2d Cir. 1995)* (pretrial evidentiary hearing highly desirable to determine admissibility of hypnotically-refreshed memories).

n82. See e.g., *Padillas v. Stork-Gamco, Inc., 186 F.3d 412, 418 (3d Cir. 1999)*. But see *In re TMI Litig., 199 F.3d 158, 159 (3d Cir. 2000)* (Padillas not intended to require in limine hearing in all cases).

n83. *Kumho Tire Co. v. Carmichael, 526 U.S. 137, 152 (1999)*.

n84. See United Phosphorus, Ltd., v. Midland Fumigant, Inc., Nos. 91-2133-EEO & 95-2267-*EEO, 1997 U.S. Dist. LEXIS 993* (D. Kan. Jan. 24, 1997).

n85. See e.g., *Chartwell Litigation Trust v. Addus Healthcare Inc. (In re Med Diversified Inc. I), 334 B.R. 89 (Bankr. E.D.N.Y. 2005)*. The first listed author of this article is the bankruptcy judge who presided over the Med Diversified chapter 11 cases, and the affiliated Tender Loving Care chapter 11 cases.

n86. See *Zuchowicz v. United States, 140 F.3d 381, 386 (2d Cir.1998)* (reviewing Daubert decision of lower court to admit or exclude testimony under "highly deferential abuse of discretion standard"); *McCullock v. H.B. Fuller Co., 61 F.3d 1038, 1042 (2d Cir.1995)* (stating that a decision to admit is not an abuse of discretion unless "manifestly erroneous").

n87. *Sagamore Park Centre Assoc. Ltd Partnership v. Sagamore Park Properties, 200 B.R. 332, 339 (N. D. Ind. 1996)*.

n88. The same would hold true in other contexts. The party with the burden of persuasion is the one most impaired if all experts are excluded.

n89. *171 F. Supp. 2d 473 (E.D. Pa. 2001)*

n90. The defendant's expert was a CPA, a certified fraud examiner, and a Canadian chartered accountant with over two years of experience in his field, with specialized knowledge in conducting fraud audits and in analyzing the financial condition of distressed debtors and fraudulent transfers in bankruptcy litigation. The court also discussed the fourteen stages of due diligence of this expert in preparing his report - this discussion is quite instructive for attorneys in ensuring that their proposed experts have done their homework. As for the plaintiff's two experts, one was an investment banker and attorney with more than thirty-four years of experience. He also had testified as an expert in over fifty cases relating to acquisitions and mergers and total enterprise value. The plaintiff's other expert witness was a C.P.A. and certified fraud examiner with over thirty years of experience also relating to acquisitions and mergers. He had a history of testifying to the S.E.C. in cases of major acquisitions.

n91. This same ruling can be reached without the objecting parties having filed a motion in limine. However, if the party is committed to disqualifying another party's expert witness, based upon a deposition held after the exchange of expert witness reports, a court may prefer addressing that preliminary matter in a pretrial motion in limine, particularly when the court has had to clear its docket for two or more weeks for the preliminary trial.

n92. In this Article, we have decided to use the terms "plaintiff" and "defendant." Of course, in the bankruptcy context, these terms imply an adversary proceeding; however, much of what a bankruptcy court does is in the context of contested matters and the like, where there is no plaintiff or defendant, but rather movant, applicant, etc. The discussions in this Article apply in all proceedings in bankruptcy.

n93. See *In re Mirant Corp., 334 B.R. 800 (Bankr. N.D. Tex. 2005)* (excluding expert reports based on mathematical errors , but taking testimony from those same experts challenging expert opinions and reports offered by opposing parties; *Chartwell Litigation Trust v. Addus Healthcare, Inc. (In re Med Diversified Inc,) 334 B.R. 89 (Bankr. E.D. N.Y. 2005)* (court found witness did not qualify as an expert on valuation of a business, but allowed his testimony as a rebuttal witness to challenge the methodology and resulting opinions of the opposing parties' proposed expert witness).

n94. *Weisgam v. Marley Company, 528 U.S. 440 (2000).*

n95. *196 F.R.D. 389, 390 (D. Colo. 2000).*

n96. *Id. at 390-391*.

n97. See *LNC Invs Inc. v First Fidelity Bank (In re LNC Investments, Inc), 2000 U.S. Dist. LEXIS 13038* (S.D.N.Y. Sept. 12, 2000) (refusing in the second, remanded trial to adjourn for substitution of an expert from the first trial, who was unavailable to testify due to increasingly poor health).

n98. *249 F. Supp. 2d 357* (S.D.N.Y. Mar 14, 2003) ("Lippe 8")

n99. *Id. at 377*.

n100. *Commerce Industry Ins. Co. v. E.I. Du Pont De Nemours & Co. (In re Malden Mills Industries, Inc.), 275 B.R. 670* (Bankr. D. Mass.).

n101. *Id. at 673*.

n102. *Id. at 674*. In a corollary to the situation discussed above, the third-listed author of this Article found himself the subject of a motion to disqualify his retention by the plaintiff as a solvency and valuation expert in an adversary proceeding. The basis of the motion to disqualify was that the expert was privy to certain information disclosed by defendant's counsel through a series of questions asked during and immediately after a bar conference presentation by this author on a related topic. All discussion had taken place in public with numerous third parties present. The court summarily rejected the motion.

n103. *296 B.R. 750 (Bank. E.D. Tenn. 2003)*.

n104. The court noted that other grounds for disqualification had been alleged - presumably the very incomplete and misleading disclosure in the appraiser's affidavit about the nature of his prior connection with the secured creditor. But the opinion was restricted to the issue of disqualification on the ground of switching sides and of failing to comply strictly with the appraiser's code of professional ethics and of the legislatively enacted Tennessee state code of ethics.

n105. *296 B.R. at 756-57*.

n106. *Zuchowicz v. United States, 140 F.3d 381, 386 (2d Cir.1998)* (quoting *Daubert, 509 U.S. at 597);* see *Koppell v Bd. of Elections, 97 F. Supp.2d 477, 479 (S.D.N.Y. 2000)*.

n107. See *Daubert, 509 U.S. at 592 n. 10; Koppell, 97 F. Supp. 2d at 479*.

n108. *Chartwell Litigation Trust v. Addus Healthcare Inc. (In re Med Diversified Inc. I), 334 B.R. 89 (Bankr. E.D.N.Y. 2005)* (expert disqualified based, in large part, on his failure to use one of the three standard valuation methodologies - the discounted cash flow method - in his report and testimony without explanation).

n109. *1994 U.S. Dist. LEXIS 18132* (W.D. Mo. Dec. 14, 1994).

n110. *Committee v. Ampco-Pittsburg Corp., 237 B.R. 322 (6th Cir. BAP 1999)*.

n111. *Id. at 335-336*.

n112. *1999 U.S. Dist. LEXIS 12368* (E.D.La. Aug. 4, 1999).

n113. Id. at 1.

n114. Id.

n115. Id. at 2 - 3.

n116. Which, in turn, quotes Mason Ladd, Expert Testimony, *5 Vand. L. Rev. 414, 418 (1952)*.

n117. *FRE 702* (advisory committee note).

n118. *1999 U.S. Dist. LEXIS 12368 at 6-7*.

n119. Id. at 7.

n120. Id. at 8.

n121. Id. at 10.

n122. Id. at 11.

n123. Id.

n124. *223 F. 3d 585*, (7th Cir. 2000)

n125. *Id. at 591*.

n126. *255 B.R. 772 (Bankr. D. Utah 2000)*.

n127. *Id. at 774-5*.

n128. *Id. at 780*.

n129. Id.

n130. *Id. at 781*.

n131. Id.

n132. Id.

n133. What is troublesome about this particular decision on the issue of admitting or rejecting expert testimony is that it is very clear that the court determined on six different ad hoc criteria that there was no way that construction work of this remedial character could ever be considered as falling within the ordinary course of a chapter 11 debtor-in-possession's business. Assuming that this legal analysis is correct, then, it is unfair and quite pointless to fault the contractor's expert witness for not having mastery of one line of precedents on a highly contested issue of law. As the court noted, there are two main approaches to determining the nature of ordinary course of business under §363, the "vertical approach" and "the horizontal approach." Under the vertical approach as an operational definition of an ordinary course of business, the test was whether the general prepetition creditors would have supported the authorization of the debtor in possession to enter into a time and materials contract in the ordinary course of business, which in this case the court was fully confident in assuming on a priori grounds that these creditors would never have approved a post-petition remedial contract on an open-ended time and materials billing basis. The horizontal approach for which the expert witness's testimony would have at least been relevant is tested by the ordinary course of the relevant industrial practices, here in the residential real estate development sector. Since the court declined to follow that approach for operationally defining the ordinary course of business of the debtor in possession, as a matter of logical inference, it could not matter whether the expert witness did or did not possess any mastery of the horizontal approach. Finally, even as to the vertical approach, it is very clear that the court did not believe that it needed the assistance of any expert to testify about the standard methodology, quite apart from the fact that there is unlikely to be any standard methodology for that approach either.

n134. *251 B.R. 113 (Bankr. D. Alaska 2000)*.

n135. *Id. at 132*.

n136. Id.

n137. *Id. at 136*.

n138. *289 B.R. 32 (Bankr. D. Del. 2003)*.

n139. *Id. at 36*.

n140. Id.

n141. *Id. at 36-37*.

n142. *Id. at 37*.

n143. *Lappe v. American Honda Motor Co., 857 F. Supp. 222, 226 (N.D.N.Y. 1994)*, aff'd, *101 F.3d 682 (2d Cir. 1996)*.

n144. *McCullock v. H.B. Fuller, 61 F.3d 1038, 1043 (2d Cir. 1995)*.

n145. See *Daubert, 509 U.S. at 590, 595;* see also *Amorgianos v. National Railroad Passenger Corp., 137 F. Supp.2d 147, 162 (E.D.N.Y. 2001)*.

n146. "Subjective" does not necessarily mean "conclusory". Testimony from an individual with years of experience in a given field - for example, a factor, receivables lender, or credit manager testifying on what constitutes the ordinary course of business under §547(c)(2)(C) - may be subjective but is not necessarily conclusory. A discussion of such an expert's experience, how knowledge of the industry was acquired, education, continuing education, contacts in the relevant fraternity, etc., would demonstrate the process by which the expert reached his opinion - subjective, possibly, but not conclusory.

n147. In addition to *Daubert, 509 U.S. at 594*, see *Brown v. S.E. Pa. Transport Auth. (In re Paoli R.R. Yard PCB Litig.), 35 F.3d 717, 742 (3d Cir.1994)* (existence or maintenance of standards controlling the expert's experiments and testing).

n148. *Cabrera v. Cordis Corp., 134 F.3d 1418, 1420-21 (9th Cir. 1998); In re Paoli R.R. Yard PCB Litig., 35 F.3d at 742 n. 8;* see also *Elcock v. Kmart Corp., 233 F.3d 734, 745-46 (3d Cir.2000)* (the non-judicial uses to which the method has been put).

n149. *Daubert v. Merrell Dow Pharms., Inc., 43 F.3d 1311, 1317 (9th Cir. 1995)* ("Daubert II ").

n150. *Cowan v. Treetop Enter., 120 F. Supp.2d 672, 683 (M.D. Tenn. 1999)*.

n151. *Lippe v. Bairnco Corporation, 288 B.R. 678, 687 (S.D.N.Y. 2003)*.

n152. Id.

n153. *Kumho Tire, 526 U.S. at 142, 153*.

n154. *Id. at150* (quoting *Daubert, 509 U.S. at 593)*.

n155. Id. at 152.

n156. Id.

n157. Id. at 150 (quoting *Daubert, 509 U.S. at 591)*.

N158. Id. at 152.

n159. Advisory Committee Notes, 2000 Amendments, *Fed. R. Evid. 702*.

n160. See, e.g., Advisory Committee Notes, 2000 Amendments, *Fed. R. Evid. 702* (collecting cases).

n161. *Bunt v. Altec Indus., Inc., 962 F. Supp. 313, 317 (N.D.N.Y. 1997)* (quoting *Borawick v. Shay, 68 F.3d 597, 610 (2d Cir. 1995),* cert denied, *517 U.S. 1229 (1996))*. See also *Liriano v. Hobart Corp., 949 F. Supp. 171, 176 (S.D.N.Y. 1996)* (presumption of admissibility). Daubert is not intended to replace the adversary system. See Advisory Committee Note, *Fed. R. Evid. 702*.

n162. *272 F.3d 333 (6th Cir. 2001)*.

n163. *Daubert, 509 U.S. at 593*.

n164. See *Watkins v. Telsmith, Inc., 121 F.3d 984, 991-92 (5th Cir. 1997)* (affirming the lower court's decision to exclude expert testimony on the ground that the expert failed to conduct necessary testing, rejecting the lower court's reasoning that the expert should be excluded based on his lack of qualifications); *Clark v. Takata, 192 F.3d 750, 758-59 & n.9 (7th Cir. 1999)* (excluding testimony of otherwise qualified expert who failed to conduct tests, stating "[a] supremely qualified expert cannot waltz into the courtroom and render opinions unless those opinions are based upon some recognized scientific method and are reliable and relevant under the test set forth by the Supreme Court in Daubert.").

n165. *Cummins v. Lyle Indus., 93 F.3d 362, 369 (7th Cir.1996)* (citing *Rosen c. Ciba-Geigy Corp, 78 F.3d 316 (7th Cir. 1996)*.

n166. *Rosen v. Ciba-Geigy Corp., 78 F.3d 316, 319 (7th Cir. 1996)*.

n167. *Cummins, 93 F.3d at 369*.

n168. *Fisher v. Prime Table Restaurant & Lounge, Inc. (In re Lake States Commodities), 271 B.R. 575 (Bankr. N.D. Ill. 2002)*.

n169. *Id. at 580*.

n170. Id.

n171. *Id at 581*.

n172. Id.

n173. *Id. at 585*.

n174. *Id. at 587-88*.

n175. *Id. at 588*.

n176. The use of random sampling from a population of transactions is a common approach to testing the population. If the court were concerned that the sample was limited to 1-2%, of the population, that concern may have been misplaced. A random sample of 1-2% may have been sufficient. Nonetheless, it appears that the expert failed to communicate to the court the reliability of that method. If the court were concerned that the expert, or someone under his supervision, failed to speak with those who prepared the financial statements, than that observation is compelling. Financial statements are summaries of financial data. Often times, particularly in cases like this, an expert needs to know "the story behind the story," and must obtain greater specificity about the items recorded on the financial statements.

n177. See *Daubert, 509 U.S. at 594* (general acceptance can still have a bearing on the inquiry). Generally, the law will lag behind science, including financial innovations.

n178. It is difficult enough to calculate the variables when the debtor issued shares that were publicly traded, but the effort by some valuation experts to apply these same methodologies to quantify the total enterprise value of debtors whose shares were privately held and, thus, never publicly traded, strikes us as potentially problematic.

n179. The term "legacy liabilities" refers to the liabilities to which a successor corporation is subject by operation of law that arose when the assets and business were operated by the predecessor corporation, including unfunded contributions to the corporation's pension plans and products liability.

n180. Note that in accordance with *Fed. R. Civ. P. 26*, all sources relied on in forming an expert witness' opinion must be adequately disclosed in the expert report.

n181. See, e.g., *Chartwell Litigation Trust v. Addus Healthcare Inc. (In re Med Diversified Inc. I), 334 B.R. 89 (Bankr. E.D.N.Y. 2005); In re Bush Industries, Inc., 315 B.R. 292 (Bankr. W.D.N.Y. 2004)*.

n182. *Pestel v. Vermeer Mfg., 64 F.3d 382*. 384 (8th Cir. 1995) (refusing to allow expert to rely on testing done by manufacturer because he had not developed, participated in, nor supervised the testing). See also *Clay v. Ford Motor Co., 215 F.3d 663, 676 (6th Cir. 2000)* (Ryan, C.J., dissenting) ("While there is a certain logical appeal to the notion that [a plaintiff's expert's] opinion must be reliable if it rests upon data produced by the defendant, the notion does not withstand close consideration.")

n183. See *Sharp v. Chase Manhattan Bank USA, N.A. (In re Commercial Financial Services, Inc.), 350 B.R. 520, 529 (N.D. Okla. 2005)* (flaws in the facts assumed by the expert in formulating his or her opinion do not necessarily render the opinion unreliable because such flaws often go to the weight of the evidence).

n184. *2001 U.S. Dist. LEXIS 15838* (E.D. Pa. Sept. 6, 2001).

n185. Id. at 7.

n186. Id. at 10

n187. Id. at 11.

n188. Id.

n189. Id. at 18-21

n190. See *Daubert, 509 U.S. at 592-93; Stagl v. Delta Air Lines, Inc., 117 F.3d 76, 81 (2d Cir. 1997);* Koppell v.*Bd of Education, 97 F. Supp.2d 477, 480 (S.D.N.Y. 2000).*

n191. *Daubert, 509 U.S. at 591-92; Koppell, 97 F. Supp. 2d at 480.*

n192. *158 F. Supp.2d 510 (E.D. Pa. 2001).*

n193. *Id. at 516.*

n194. *Fed. R. Evid. 706(a)* states in pertinent part:

The court may on its own motion or on the motion of any party enter an order to show cause why expert witnesses should not be appointed, and may request the parties to submit nominations. The court may appoint any expert witnesses agreed upon by the parties, and may appoint expert witnesses of its own selection."

n195. See, e.g., Ch. 706, 4 Weinstein's Federal Evidence (2d ed., Joseph M. McLaughlin ed., Matthew Bender & Co., a Division of Lexis-Nexis, 2006).

n196. See, e.g., *In re High Fructose Corn Syrup Antitrust Litig., 295 F.3d 651 (7th Cir. 2002)* (evaluation of technical statistical evidence in a price fixing conspiracy case).

n197. See, e.g., *In re Joint Eastern and Southern District Asbestos Litigation, 982 F.2d. 721 (2d Cir. 1992),* r'hrg granted and opinion modified *993 F.2d 7 (1993)*.

n198. See, e.g., *Meister v. Med. Eng'g Corp., 267 F3d. 1123 (D.C. Cir. 2001); In re Breast Implant Cases, 942 F. Supp. 958* (S.D.N.Y. & E.D.N.Y.1996).

n199. See, e.g., *Unique Concepts, Inc. v. Brown, 659 F. Supp. 1008 (S.D.N.Y. 1987)*

n200. *Gold v. Dalkon Shield Claimants Trust, 1998 U.S. Dist. LEXIS 22414* (D. Conn. June 3, 1998).

n201. Id. at 3-4.

n202. Id. at 4-5.

n203. Id. at 5.

n204. Id.

n205. The abuses of the victims in the A. H. Robins Co., Inc. case due directly to the administration of this chapter 11 case are set forth in shocking and numbing detail in Richard B. Sobel's Bending the Law: The Story of the Dalkon Shield Bankruptcy (1991).

n206. See e.g., *In re Fibermark North America, Inc., 339 B.R. 321 (Bankr. D. Vt. 2006)* (Bankruptcy Examiner).

n207. Appendix B to Emerging Problems Under the Federal Rules of Evidence [(David A. Schlueter, Editor-in-Chief) (American Bar Association Section on Litigation)], (3d ed. 1999).

n208. Id.

n209. The Federal Judicial Center regularly offers seminars for bankruptcy judges in effective case management practices, beginning with "baby judges' school" and on a continuous annual basis.

n210. See. e.g., *In re Mirant Corp., 334 B.R. 800 (Bank. N.D. Tex. 2005); In re Exide Technologies, 303 B.R. 48, 65-*(Bankr. D. Del. 2003).

n211. See. generally *In re Mirant Corp., 334 B.R. 800 (Bank. N.D. Tex. 2005); In re Exide, 303 B.R. 48 (Bankr. D. Del. 2003).*

n212. Not to mention additional committees that may be appointed, for example, an equity committee, an

employee committee, or a bondholders committee.

n213. See generally *In re Mirant Corp., 334 B.R. 800 (Bank. N.D. Tex. 2005); In re Exide, 303 B.R. 48, 65*-(Bankr. D. Del. 2003).

n214. In one frequently cited Court of Appeals opinion, the court upheld the use of a court appointed technical advisor that the lower court had described as "'in the nature of a law clerk' ... someone with whom the judge could engage in 'freewheeling discussion'". *Reilly v. United States, 863 F. 2d 149, 158 (1st Cir. 1998)* (quoting *Reilly v. United States, 682 F. Supp. 150, 152 (D. R.I. 1988)* (describing the appointment of a technical advisor as an appointment of an expert to the judges staff who "becomes, in effect, a specialized law clerk.").

n215. *Fed. R. Civ. P. 56* is made applicable to adversary proceedings via *Fed. R. Bankr. P. 7056*, which provides, in relevant part:

A party ... may ... move with or without supporting affidavits for a summary judgment in the party's favor ... [but] when a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials in the adverse party's pleading, but the adverse party's response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing there is a genuine issue for trial. If the adverse party does not so respond, summary judgment, if appropriate, shall be entered against the adverse party. [format for quote]

n216. Section 547(c)(2), as amended by the 2005 Amendments to the Bankruptcy Code, provides an affirmative defense based upon payment by the debtor of a debt incurred in the ordinary course of business or financial affairs of the debtor and the transferee, as long as that transfer was either made in the ordinary course of business of both the debtor and the transferee or made according to ordinary business terms.

n217. See *Fed. R. Civ, P 56 (c)* and (e) .

n218. See *In re Merry-Go-Round Enterprises, Inc., 272 B.R. 140, 144-48 (Bankr. D. Md. 2000)* (denying defendant's motion for summary judgment because the supporting affidavit of insider expert was merely

"conclusory" and therefore insufficient to prove the payment history between the debtor and the defendant and the payment practices in the relevant industry).

n219. We note that initially the call for expert reports under *Fed. R. Civ. P. 26* was designed to share such reports among the parties in order to render an expert deposition unnecessary and were not intended to be shared with the court. That intention never came to fruition.

n220. For a thorough critique of each of the cases discussed in this section, you may contact the third author at the email address provided.

n221. *334 B.R. 800 (Bankr. N.D. Tex. 2005)*. After the valuation hearing, the court issued a preliminary letter ruling, as further amended a month later, in which it directed the debtors' experts to recalculate the total enterprise valuation consistent with the court's adjustments to the data, discount rates, and multiples. The debtors' experts protested that it would take a full two months of work to generate these revised calculations of value; nevertheless, the court directed them to proceed and it promised that it would later release a comprehensive opinion to substantiate the grounds for its adjustments. Perhaps exhausted after the two-month ordeal of valuation hearings, the parties then went forward to negotiate a consensual plan in which the plan proponent finally agreed to distribute some of the value of the reorganized debtor to the existing shareholders and the holders of the subordinate debt. With that accomplished, the plan coalition sought an in-chambers conference during which its members asked that the court put a hold on the recalculation of value and not issue its opinion on valuation. The court acquiesced in this request until the confirmation hearing was held in December 2005, and then issued its comprehensive opinion justifying the adjustments it had directed be made six months earlier. Our point is that the court did not determine the value of the reorganized debtor in this opinion, and by the time it was released, the parties had already rendered the opinion largely moot by negotiating a consensual plan that obviated an enterprise valuation. In a rather strained justification for releasing its opinion, the court mentioned that a dissident shareholder threatened to appeal the order of confirmation and, thus, the district court might find the opinion instructive; moreover, the opinion was also relevant to findings the court had to make that the plan was in the best interest of creditors and to the issue on interest raised by the Till decision.

n222. Equally impressive are the companion opinions finding that each of the plaintiff's trustee's proposed experts was qualified and that the expert's methods and application of those methods was reliable in *In re Commercial Financial Services, Inc., 350 B.R. 520* and *350 B.R. 559 (Bankr. N.D. Okla. 2005)*. See also *In re Nellson Nutraceutical, Inc,, 2006 Bankr. LEXIS 3186 (Bankr. D. Del. 2006)* (disqualifying proposed expert witness for deleting adjustments for capital expenditures from his discounted cash flow analysis).

n223. 334 B.R. at at 806-07. Under this increasingly common circumstance, the only way for the existing shareholders or the subordinated unsecured creditors to bring the plan proponent to the negotiating table is to

force a valuation hearing.

n224. Id. at 807.

n225. *334 B.R. at 810-11*.

n226. Id. (see letters dated June 30 and July 26, docket nos. 10393 and 10723). The letter ruling, as further amended a month later, directed the debtors' experts to recalculate the total enterprise valuation consistent with the court's adjustments to the data, discount rates, and multiples. The debtors' experts protested that it would take a full two months of work to generate these revised calculations of value; nevertheless, the court directed them to proceed and it promised that it would later release a comprehensive opinion to substantiate the grounds for its adjustments. Perhaps exhausted after the two-month valuation hearing, the parties negotiated a consensual plan in which the plan proponent finally agreed to distribute some of the value of the reorganized debtor to the existing shareholders and the holders of the subordinated debt. With that accomplished, the plan coalition sought an in-chambers conference during which its members asked the court to put a hold on the recalculation of value and not issue its opinion on valuation. The court acquiesced in this request until the confirmation hearing was held in December 2005, and then issued its comprehensive opinion justifying the adjustments it had directed be made six months earlier. Our point is that the court did not determine the value of the reorganized debtor in the post-confirmation opinion, and by the time it was released, the parties had already rendered the opinion largely moot by negotiating a consensual plan that obviated an enterprise valuation. The court explained its decision to enter its valuation opinion noting that a dissident shareholder threatened to appeal the order of confirmation and, thus, the district court might find the opinion useful and that the opinion was also relevant to findings the court had to make concerning the best interests of creditors and the issue on interest arising from the decision in *Till v. SCS Credit Corporation, 541 U.S. 465 (2004)*.

n227. Id. at 814.

n228. Id. at 814 n. 40.

n229. Id. at 825.

n230. Id. at 830-31.

n231. Id.

n232. Id. at 836-46.

n233. Id. at 832-36.

n234. Id. at 835-36.

n235. Id. at 836-37.

n236. Id. at 838.

n237. Id. at 840-41.

n238. Id. at 841.

n239. Id.

n240. Id.

n241. Id. at 846-47.

n242. Id. at 846.

n243. Although we conclude that the better practice is to conduct a Daubert hearing, if necessary, before a hearing or trial, we are willing to acknowledge that this approach may not fit all circumstances. For example, in a situation where a relatively small amount is at issue, such as in many avoidance actions, a court may roll the pretrial Daubert challenge into the trial, reserving a ruling until after the evidence has been presented. See, e.g., *Daley v. Chang (In re Joy Recovery Technology Corp.), 286 B.R. 54 (Bankr. N.D. Ill. 2002)*. In other situations, courts may decide to roll the Daubert issues into an omnibus pretrial hearing. See *In re Exide Technologies, 303 B.R. 48 (Bankr. D. Del. 2003)*. However, we do not endorse the approach that would read out the Daubert duty by simply recasting what is a relevance and reliability question into a question of weight.

n244. We have often thought that if a court adopted, in place of "search and select", a protocol thataccepted either one or the other of dueling Daubert-compliant expert opinions, the amount of the variance between the opinions would dramatically shrink.

n245. See, e.g., *In re Mirant, 334 B.R. 800 (Bankr. N.D. Tex. 2005)* (expert sent back to consider court questions and concerns); *In re Oneida, Ltd., 351 B.R. 79 (Bankr. S.D.N.Y. 2006)* (one expert served role as de facto technical advisor).

n246. *Chartwell Litigation Trust v. Addus Healthcare, Inc. (In re Med Diversified Inc. II), 346 B.R. 621,* (Bankr. E.D.N.Y. 2006). Because the first author issued this opinion, we have omitted the detailed analysis in support of these findings and respectfully refer the reader's attention to the full text of this opinion.

n247. *Id. at 625-26*.

n248. *Id. at 635-37*.

n249. *Id. at 638-40*.

n250. *Id. at 637-38*.

n251. *In re Oneida Ltd., 351 B.R. 79 (Bankr. S.D.N.Y. 2006).*

n252. *Daley v. Chang (In re Joy Recovery Technology Corp.), 286 B.R. 54 (Bankr. N.D. Ill. 2002).*

n253. *Id. at 69.*

n254. *Sagamore Park Centre Assoc. Ltd Partnership v. Sagamore Park Properties, 200 B.R. 332 (N. D. Ind. 1996).*

n255. Ullman-Briggs, Inc .v. *Salton/Maxim Housewares, Inc., 1996 U.S. Dist. LEXIS 13621* (N.D. Ill. Sept. 16, 1996) (business valuation expert).

EXPERT WITNESSES IN BANKRUPTCY LITIGATION©[1]

ABI SOUTHWEST BANKRUPTCY CONFERENCE
Las Vegas, Nevada
(September 11, 2015)

Thomas J. Salerno, Esq.
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1. EVIDENCE IN LITIGATION

- ***What is it?***
  - ✓ Oral testimony
  - ✓ Documents (letters, e-mails, photos)
  - ✓ "Demonstrative" exhibits (diagrams, etc.)
- ***"Argument of Counsel" vs. "Evidence"***
  - ✓ Know the difference
- ***Limits on Evidence***
  - ✓ ***Must be***:
    - ❖ ***"Relevant"*** - "evidence having any tendency to make the existence of any fact that is of consequence . . . more probable or less probable than it would be without evidence" (FRE 104/401)
    - ❖ ***"Competent" - i.e***. based on witnesses' personal knowledge, not speculation or hearsay (FRE 601/602) ***But See*** "Expert Testimony" below
    - ❖ ***Not unfairly prejudicial***, misleading, or cumulative (FRE 403)
    - ❖ ***Not "opinion,"*** unless such opinion is "rationally based on perception of witness" and it is "helpful to a clear understanding of the witness' testimony or the determination of a fact in issue." (FRE 701) ***But See*** "Expert Testimony," below.

2. EXPERT TESTIMONY IN BANKRUPTCY LITIGATION

- ***Large part of Bankruptcy Litigation***
  - i. Valuation
  - ii. Feasibility
  - iii. Adequate consideration/reasonable value
  - iv. "ordinary course of business" practices

[1]

- ***"Expert Testimony"***

  - ✓ ***Who is an "expert"?***[2]

    - ❖ Someone with recognized scientific, technical or specialized knowledge, acquired through "knowledge, skill, experience, training or education." (FRE 702)
    - ❖ Must "qualify," and be recognized by Court, as expert (FRE 702)
    - ❖ ***Noteworthy Decisions Re Experts***

      - o *Daubert v. Merrill Dow Pharmaceuticals, Inc*. 509 U.S. 579 (1993) (trial court has to "ensure that the courtroom door remains closed to junk science"—the trial court as "gatekeepers").

      - o *Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137 (1999) (review of factors trial courts should consider in determining whether proffered expert testimony "is the product of reliable principles and methods").

      - o *Lippe v. Bairnco Corp*., 288 BR 678 (SDNY), *aff'ed* 99 Fed. Appx. 274 (2d Cir. 2004).

      - o *In re Med Diversified, Inc*. 346 BR 621 (Bankr E.D.N.Y. 2006) (Bernstein, J.) — the Court as advocate?

      - o *See also* Bernstein, Seabury & Williams, "The Empowerment of Bankruptcy Courts In Addressing Financial Expert Testimony," 80 *Am. Bankr. L.J.* 377 (Summer 2006).

  - ✓ ***So what?***

    - ❖ Experts may provide opinion testimony ***(FRE 702).***
    - ❖ Experts may base that opinion on something other than personal knowledge and/or facts that would otherwise not be admissible as evidence otherwise (such as hearsay, etc.) ***(FRE 703)***
    - ❖ Expert opinions need not be preceded by all of the underlying facts/data supporting that opinion, although the expert may be required to divulge same on cross examination ***(FRE 705)***

      - o That said, strategic issue involved: Does an expert's opinion have more credibility if all facts/data are disclosed before opinion testimony?
      - o Summaries are admissible if underlying documents are disclosed and made available to other side. Summaries are very helpful in

[2] "An expert is a fool 50 miles from home." Prof. Frank Booker, Evidence Professor, *Univ. of Notre Dame Law School* (1980)

dealing with experts, particularly in bankruptcy cases. ***(FRE 1006)***

- ❖ Expert opinions can go to the ultimate issue in the case (except as to state of mind of criminal defendant if such issue is an element of crime) ***(FRE 704)***
- ❖ Court can appoint its own experts***. (FRE 706)***

- ▪ ***Exclusion of Witnesses***

  - ✓ ***What is it?***

    - ❖ At request of party (or *sua sponte*), witness may be excluded from courtroom while other witnesses are testifying ***(FRE 615)***
    - ❖ Cannot exclude party (***Id.***)
    - ❖ ***Why?*** Avoid influencing witness' testimony.
    - ❖ ***Particularly important re experts—*** you don't want the opposing expert to sit thru the testimony/cross examination of your expert! Gives them time to rethink their own (possibly weak or flawed) positions, etc.

3. PRACTICAL POINTERS

A. FRE 702

Bankruptcy cases and proceedings present many issues that commonly call for expert testimony. In fraudulent conveyance actions, for example, financial experts regularly testify as to whether the debtor received reasonably equivalent value for the suspect conveyance. In consumer bankruptcies, experts are often consulted when assessing the value of a debtor's vehicle. Oftentimes a party's case will hinge on the persuasiveness of its expert, and in some instances the exclusion of a party's expert can have devastating consequences. The importance of expert witnesses cannot be overstated, and every bankruptcy litigator should have a working knowledge of the standards applicable to expert testimony.

The admission of expert testimony is governed Federal Rule of Evidence 702, which provides:

> If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and

> methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

Rule 702 incorporates the trial court's "gatekeeper" duty to exclude expert witnesses that are not qualified, reliable, and relevant. *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579, 589 (1993). However, the Rule 702 standard is flexible, and the trial court, as with most evidentiary decisions, has substantial discretion. The focus "must be solely on principles and methodology, not on the conclusions that they generate." *Id.* at 594.

The court must ensure that the expert is qualified and that the expert's methodology is valid and reliable. The Supreme Court has provided a non-exhaustive list of factors that courts may use to evaluate the reliability of scientific methodology: (1) whether the methodology has been tested; (2) whether it has been subject to peer review and publication or otherwise submitted to the scrutiny of the scientific community; (3) the known error rate; and (4) whether the methodology has attained "general acceptance" in the relevant scientific community. *Daubert*, 509 U.S. at 593–94. The trial court must also review the expert's analysis to ensure that the expert applied the methodology to the facts of the case in a reliable and consistent manner. *Chartwell Litig. Trust v. Addus Healthcare, Inc. (In re Med Diversified, Inc.)*, 334 B.R. 89, 95 (Bankr. E.D.N.Y. 2005) (*Med Diversified I*). In short, an expert witness must employ "the same level of intellectual rigor that characterizes the practice of an expert in the relevant field." *Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137, 152 (1999). "If the court determines that either the data, methodology or the studies upon which the expert's opinion is based are inadequate to support the expert's conclusions, then the court must exclude the expert's testimony." *Med Diversified I*, 334 B.R. at 95.

B. Application of the "Gatekeeper" Function in Bankruptcy

Rule 702, like all Federal Rules of Evidence, applies with equal force in bankruptcy proceedings. Fed. R. Bankr. P. 9017. Although some courts have suggested that the "gatekeeper" function is unnecessary in bench trials because there is no risk of jury confusion, a growing number of bankruptcy decisions suggest that courts are willing to consider pre-trial motions to exclude expert testimony. *Compare Deal v. Hamilton County Board of Education*, 392 F.3d 840, 852 (6th Cir. 2004) ("The 'gatekeeper' doctrine was designed to protect

juries and is largely irrelevant in the context of a bench trial."), *with Med Diversified I*, 334 B.R. at 92-104 (exercising the "gatekeeper" function and granting the plaintiff's motion *in limine*).

The Seventh Circuit has taken a different approach to this issue, noting that the question in a bench trial is not *whether* a "gatekeeper" analysis is necessary, but rather *when* such analysis must occur. *In re Salem*, 465 F.3d 767, 777 (7th Cir. 2006). In a jury trial, the decision to exclude testimony must occur prior to trial; once the jury has heard the testimony, it is difficult to effectively exclude it from their consideration. On the other hand, the timing is more flexible in a bench trial, and a court may reserve a decision on admissibility until after the testimony is given:

> Where the gatekeeper and the fact finder are one and the same—that is, the judge—the need to make such decisions prior to hearing the testimony is lessened. That is not to say that the scientific reliability requirement is lessened in such situations; the point is only that the court can hear the evidence and make its reliability determination during, rather than in advance of, trial.

Id.[3]

Regardless of the proper timing of the "gatekeeper" analysis in bench trials, there are clear benefits to seeking the exclusion of an opposing party's expert witness prior to trial. A successful motion *in limine* can often increase the likelihood of a favorable settlement and can even result in an early victory. *See*, *e.g*., *Faulkner v*. *Kornman (In re Heritage Org*., *L.L.C*.*)*, 2009 Bankr. LEXIS 1149, at *51 n.15 (Bankr. N.D. Tex. May 11, 2009) ("The Court granted the Defendants' Daubert motion regarding the Trustee's solvency expert, the effect of which was to preclude the Trustee from pursuing his constructive fraudulent transfer claims."). At the very least, a pre-trial motion will focus the court on the weaknesses of the expert's opinion.

The ultimate success of an effort to exclude expert testimony may depend largely on the court or judge you are in front of on the issue. As many bankruptcy litigators have found, different courts take different views on the issue of excluding expert testimony. For example in *Med Diversified I*, 334 B.R. at 92; and *Chartwell*

[3] The term "gatekeeper," contrary to the Seventh Circuit's conclusion in *Salem*, suggests that the inquiry should occur at the threshold, prior to the actual testimony. *See also* Bernstein, Seabury & Williams, "The Empowerment of Bankruptcy Courts In Addressing Financial Expert Testimony," 80 *Am*. *Bankr*. *L.J*. 377 (Summer 2006).

Litig. Trust v. Addus Healthcare, Inc. (In re Med Diversified, Inc.), 346 B.R. 621, 626 (Bankr. E.D.N.Y. 2006) (*Med Diversified II*), the bankruptcy court was strict and unyielding in its application of *Daubert*, ultimately rejecting both parties' experts. By contrast, the Oklahoma bankruptcy court took a different approach in *Sharp v. Chase Manhattan Bank USA, N.A. (In re Commercial Financial Servs., Inc.)*, 350 B.R. 520 (Bankr. N.D. Okla. 2005) (*Sharp I*); and *Sharp v. Chase Manhattan Bank USA, N.A. (In re Commercial Financial Servs., Inc.)*, 350 B.R. 559 (Bankr. N.D. Okla. 2005) (*Sharp II*). In the *Sharp* cases, the court was more flexible in its decision to allow the testimony, and relied instead on cross examination of the opposing party to ferret out the problems with the expert's testimony -- and then applying those points in weighing the value to be placed on the testimony.

C. Practice Pointers

Although the analysis of expert testimony will likely vary from court to court, it pays to be prepared for stringent review of your expert's qualifications, analysis and opinions. The following points are helpful in selecting an expert and presenting expert testimony:

1. Be rigorous and specific in your selection of an expert. Understand the specific issue and, to the greatest extent possible, locate an expert with *that specific experience*. When it comes to expert witnesses, one size does not fit all. Your financial advisor is not necessarily an expert (or at least not an effective expert) on all issues.

2. Once you select your proposed expert, don't screen the facts. The lawyer and the expert need to have a full and mutual understanding of (1) what information is needed to perform a complete analysis, and (2) what information is available. Make sure all information relied upon is accurate and complete. Beware of the "garbage in; garbage out" objection to your expert's opinion.

3. Be careful about assumptions. Are they fair? Are there too many of them? Do you need your expert (or another expert) to justify the reasonableness of your assumptions?

4. It is your expert's opinion. Not yours. Resist the temptation to meddle. Let the witness arrive at his or her own opinion. Forcing the issue on an expert opinion will never work.

5. Make sure your witness does the work. Relying entirely on the analysis of subordinates is dangerous. Beware of the "mouthpiece" objection. If your

witness relied on the work of others you may need to have the "others" available to testify.

6. Review your expert's draft report with the same rigor you would give to your opposing witness's report. Consider a peer review or "fresh eyes" review.

7. Before allowing your witnesses to take the stand, cross examine them with the same rigor you would apply to the cross of your opposing witness. Make sure the witness can defend his or her credentials, experience and methodologies.

8. Go over in advance any points that should, or will need to be, conceded.

9. Require your witness to not only defend his or her own positions, but also to discredit competing views. If one method of analysis is chosen over several others, make sure your witness can explain why his or her method makes more sense than the others.

10. Financial and valuation opinions often require more "professional judgment" than "exact science." However, be careful to connect the dots between the data and the opinion. "Because I said so" is never a basis for an opinion. Even professional judgment can be explained by reference to prior experience and comparative data.

D. Procedural Issues

Federal Rule of Civil Procedure 26 (incorporated by FRBP 7026) governs the disclosures that are required with respect to expert testimony. Rule 26 was amended on December 1, 2010 -- and these amendments have important implications for expert witness disclosures. There are at least three things the bankruptcy litigator should know.

First, the Rule 26 amendments make it easier for attorneys to work with expert witnesses because (1) drafts of an experts reports are no longer discoverable under Rule 26(b)(4)(B), and (2) communications between counsel and a testifying expert are now largely undiscoverable under Rule 26(b)(4)(C).

Second, under the amendments to Rule 26(a)(2)(B) and (C), an employee of a party who is to provide expert testimony need not supply the standard Rule 26 expert report unless the employee was specially retained to supply expert testimony or his or her duties as an employee of the party regularly include supplying expert

testimony. This is departure from the prior language of Rule 26(a)(2), which left in doubt the issue of whether non specially-retained experts (such as regular employees of a party) needed to prepare a Rule 26 expert report. Under the new version of Rule 26, employees testifying as experts need not prepare a full Rule 26 report; however, they must disclose the subject matter of the testimony and the facts and opinions to be offered. In this respect, the new Rule 26 eliminates any argument that non specially-retained experts need not make *any* disclosure of the substance of their testimony (which was at least *one* interpretation under the old version of Rule 26).

Third, neither of the two points raised above *necessarily* apply to contested matters -- they *may* only apply to adversary proceedings. Why? The reason is because FRBP 7026 applies only to adversary proceeding, unless Federal Rule of Bankruptcy Procedure 9014 specifically adopts it. And Rule 9014 in fact specifically excludes Rule 7026(a)(2), which deals with expert disclosures, from application to contested matters. Thus, in contested matters, there is no need for a report at all. But if an expert report is prepared and supplied, one cannot necessarily rely on the new protections regarding discoverability of drafts and attorney communications, because those protections only apply with respect to expert reports required under Rule 26(a). Because reports are not required in contested matters under Rule 26(a), strictly speaking, the protections under Rule 26(b) may not apply. Of course, the fix is not difficult. One need only seek a stipulation or order from the Court on this matter. As with all things, the key is to be aware of the issue.

339 B.R. 321
United States Bankruptcy Court.
D. Vermont.

In re FIBERMARK, INC., FiberMark North America, Inc., and FiberMark International Holdings, Inc., Debtors.

No. 04–10463. | March 10, 2006.

Synopsis
Background: Reorganized Chapter 11 debtors moved to admit into evidence, as expert opinion, the 298-page report compiled by independent examiner appointed by court to investigate and address disputed fact questions regarding motives of corporate Chapter 11 debtors' principals and of members of committee in connection with certain disputed transactions.

[Holding:] The Bankruptcy Court, Colleen A. Brown, J., held that only examiner's conclusions, and not evidence of his underlying rationale or facts as found by examiner, could be introduced into evidence over hearsay objection.

So ordered.

Attorneys and Law Firms

***322** D.J. Baker, Rosalie Walker Gray, Edward J. Meehan, Adam S. Ravin, David M. Turetsky, Skadden, Arps, Slate, Meagher & Flom LLP, New York, NY, Jennifer Emens–Butler, Raymond J. Obuchowski, Bethel, VT, for Debtors.

MEMORANDUM OF DECISION

DENYING IN PART, AND GRANTING IN PART, THE MOTION OF THE REORGANIZED DEBTORS TO ADMIT THE EXAMINER'S REPORT INTO EVIDENCE, AS AN EXPERT OPINION

COLLEEN A. BROWN, Bankruptcy Judge.

The Reorganized Debtors have filed a request for a ruling on the admissibility of the Examiner's Report in this case. They wish to rely upon it in connection with their objection to the fee application of Chanin Capital Partners, LLC ("Chanin") (doc. # 2137) (the "Motion"). The Reorganized Debtors (the "Debtors") argue that the entire Report may be admitted into evidence, as an expert opinion, on the basis that it is relevant to the Debtors' assertion that Chanin failed the test of disinterestedness and acted with an interest adverse to that of the bankruptcy estate. *See* Motion at pp 1–2. Chanin does not oppose admission of those portions of the Examiner's Report that constitute the Examiner's recommendations and conclusions, but characterizes the remainder of the report as "rank hearsay." *See* Chanin Opposition, doc. # 2150, p. 3, pars. 7 and 1, respectively.

For the reasons set forth below, the Court rules that those portions of the Examiner's Report (doc. # 1805) that constitute the Examiner's recommendations and conclusions (to wit, pp 25–26 and 284–322), are admissible as an expert opinion. However, the Court denies admission of the balance of the Examiner's Report as inadmissible hearsay.

PROCEDURAL BACKGROUND

When the Debtors filed the instant chapter 11 cases on March 31, 2004, it appeared to all parties and the Court as if the Debtors were poised to emerge from chapter 11 by the end of 2004. The Debtors, the U.S. Trustee, the Committee and the primary secured creditor were proceeding in a remarkably collaborative fashion and projected that a Joint Plan of Reorganization would be filed in the fall and confirmed by the end of 2004. All proceeded according to that schedule through the filing of a Joint Disclosure Statement and Plan in November, 2004. However, in January, 2005 the issue of corporate governance of the post-confirmation entity caused the collaboration to begin to disintegrate. A stalemate occurred which ultimately derailed the reorganization process and led the Debtors to withdraw their plan on March 21, 2005 (doc. # 1332). Based upon a number of allegations by several parties against several other parties (including principals of the Debtor and the members of the Committee), coupled with the Debtors' inability to proceed with their case under the cloud of these many allegations and the stalemate over post-confirmation governance, the Court issued an Order to Show Cause (doc. # 1354) directing parties to present arguments as to why an examiner should not be appointed to investigate all of the allegations, and make recommendations, on both the alleged breaches of fiduciary duty and the revitalization ***323** of the Debtors' reorganization. The Debtors, the U.S. Trustee,

the Committee, Wilmington Trust Company ("Wilmington Trust"), Silver Point Capital LP ("Silver Point"), AIG Global Investment Corp. ("AIG"), Post Advisory Group LLC ("Post"), and Alex Kwader ("Kwader," the CEO of FiberMark) (collectively, the "interested parties") all filed papers supporting (to varying extents) the appointment of an examiner. *See* docs # 1393, 1392, 1396, 1342 [fn 3], 1377, 1395, and 1399, respectively. After consulting with the interested parties, the U.S. Trustee recommended and the Court appointed Mr. Harvey R. Miller to serve as examiner. (Mr. Miller is hereafter referred to as "the Examiner"). Prior to making this recommendation, the U.S. Trustee had consulted with all key players and conducted its own independent inquiry into the Examiner's competence and disinterestedness, as set forth in the statement filed with the Court on April 18, 2005 (doc. # 1409). No party objected to the Examiner's selection or questioned his expertise to serve in this capacity. All interested parties participated in a hearing defining the scope of the Examiner's duties on April 19, 2005, and agreed to the scope of the Examiner's duties. An Order (doc. # 1422) was subsequently entered that, in pertinent part, provided:

1. The United States Trustee's Office is directed to appoint an independent examiner to conduct an investigation into the following matters:

   a. the transfer of the Debtors' executives' claims, including but not limited to, the claims of Alex Kwader, and other persons who were employees of the Debtors at the time of the transfer of their claim(s), to Silver Point Capital, L.P. ("Silver Point"), the nature and extent of the disclosure of those transfers and whether breach(es) of fiduciary duties to the estate resulted;

   b. the transfer of the claim of former committee member Solutions Dispersions, Inc. to Silver Point;

   c. the quality of the "screening wall" Silver Point, and the other members of the Creditors' Committee, established in accordance with this Court's Order Approving Specified Information Blocking Procedures and Permitting Trading in Securities of the Debtors Upon Establishment of a Screening Wall (doc. # 684) (the "Trading Order"), whether it was breached, and whether the Trading Order was violated;

   d. the dispute among Committee members regarding corporate governance issues and whether any Committee member breached its fiduciary duty to act in the best interest of all creditors; and

   e. any other matter the Examiner deems necessary and relevant to the complete and full investigation of the four enumerated areas included herein.

2. In order to meet his or her responsibilities, the Examiner has the authority to retain counsel, to issue subpoenas, and to require document production and conduct examinations under FED. R. BANKR. P.2004, provided the Examiner exercises this authority in a manner which is consistent with the Examiner's obligation to complete the investigation in a prompt and cost-effective fashion.

3. The Official Committee of Unsecured Creditors and its members, Alex Kwader and other individuals who were employed by the Debtors when his or her individual claims ***324** were transferred to Silver Point, representatives of Solutions Dispersions, Inc. and all other parties in interest who have information that the Examiner deems relevant to this investigation shall cooperate fully with the Examiner.

4. The Examiner shall commence his or her investigation immediately upon the Court's approval of the United States Trustee's appointment of the Examiner.

...

7. In the event that the Examiner finds that a Committee member or any other party has violated the Trading Order, has breached fiduciary duties, or has acted to intentionally thwart the plan confirmation process in these cases, the Examiner shall include in the report recommendations regarding

   (a) how the culpable conduct should affect the allocation of the cost of the Examiner;

   (b) whether such conduct warrants the imposition of sanctions against any such party, including without limitation, the avoidance of claims transfers or subordination of claims; and

   (c) any such other recommendations the Examiner has based upon the totality of his or her findings.

See doc. # 1422.

The Examiner spent eleven weeks conducting his investigation, and filed a 298 page report (the "Report")

that included 1244 footnotes and cost the estate $1,750,000. The Report was initially filed under seal, but the Court later entered an Order unsealing the report, subject to the caveat that the following cautionary ledger be printed on each page:

> The statements and conclusions in this report have not been adopted or accepted by the Court, and constitute only the opinions of the Examiner. No portion of this report has been admitted into evidence. Several parties dispute the accuracy of the contents of this report. The publication of this report is without prejudice to the right of any party to challenge the statements contained in the report.

See doc # 1798. The Court determines today the extent to which the Report is admissible.

DISCUSSION

[1] The Bankruptcy Code provides bankruptcy courts with the power to appoint an independent examiner for the purpose of investigating matters related to the debtor's estate, "including an investigation of any allegations of fraud, dishonesty, or gross mismanagement ..." 11 U.S.C. § 1104(c). An examiner's investigation is conducted under Fed.R.Bankr.P.2004 and is broader than the scope of civil discovery. "The investigation of an examiner in bankruptcy, unlike civil discovery under Rule 26(c), is supposed to be a 'fishing expedition,' as exploratory and groping as appears proper to the Examiner." *Air Line Pilots Assoc. Int'l v. American National Bank and Trust Co. of Chicago* (*In re Ionosphere, Inc.*), 156 B.R. 414, 432 (S.D.N.Y.1993). Unfortunately, the Bankruptcy Code is silent on the question of how an examiner's report may be used, and neither the parties nor the Court has been able to find a case which squarely addresses the circumstances under which an examiner's report may be admitted into evidence, over the objection of an interested party, or how an examiner's report fits into the rubric created by the Federal Rules of Evidence. Therefore, the Court considers the instant dispute to present a case of first impression.

***325** **[2]** **[3]** As the Debtors have argued, if bankruptcy courts were unable to consider the findings and recommendations of an examiner's report, the process of appointing an examiner would be an exercise in futility. However, it is not necessary to determine that the report is admissible—or to admit it into evidence—in order for the examiner's investigation and report to be of benefit to the estate. The benefits of an examiner's investigative efforts flow directly to the debtor and its creditors and shareholders. *In re Apex Oil Co.*, 101 B.R. 92, 99 (Bankr.E.D.Mo.1989); *In the Matter of Baldwin United Corp.*, 46 B.R. 314, 316 (Bankr.S.D.Ohio 1985). While the examiner answers solely to the court and is required to file a report of his or her investigation with the court, an examiner's findings have no binding effect on the court. *See* 11 U.S.C. § 1106; *Ionosphere*, 156 B.R. at 432, *citing Baldwin*, 46 B.R. at 316. The record compiled by the examiner is meant to be a source of information that assists parties in identifying assets of the estate, evaluating a plan of reorganization, or describing likely and legitimate areas for recovery. *Ionosphere*, 156 B.R. at 432. Thus, while courts are aided by the conclusions of examiners and often rely on their reports in contested matters, the decision not to admit the examiner's written explanation of how he or she reached his conclusions does not diminish the value of the examiner's conclusions.

[4] **[5]** The benefit of appointing an independent examiner is that he or she will act as an objective nonadversarial party who will review the pertinent transactions and documents, thereby allowing the parties to make an informed determination as to their substantive rights. *See Ionosphere*, 156 B.R. at 432; *Apex Oil*, 101 B.R. at 99. Often, the information that an examiner provides in his or her report serves as a road map for parties in interest as they evaluate and pursue their substantive rights. A party must prove a cause of action based upon admissible evidence, and though the examiner's report may not be admissible, it is a resource containing information and observations of an independent expert. Bankruptcy courts routinely consider and rely on the testimony and reports of examiners. As Mr. Miller so aptly opined, an examiner's report is helpful to the court in understanding facts, but is not intended to establish evidence (doc. # 1667). In essence, an examiner's report paints a picture, his or her image of what happened in the case, and ends with that expert's opinion of what that story means, in legal terms. The report puts the story on paper and provides a context for debate. It is the duty of the parties to formulate a fuller version of the debate using the rules of evidence.

[6] The Debtors have referred the Court to dozens of cases in which bankruptcy courts have considered an examiner's written report and testimony in contested matters. The Debtor asks this court to rely on these cases and find that it is

the "regular practice in the bankruptcy courts for examiner's reports to be received into evidence and considered as part of the evidentiary record" (doc. # 2155, at 4). As Chanin correctly indicated, and the Debtors conceded however, none of the cited precedent holds that hearsay in an examiner's report is admissible. None of the case law relied upon by the Debtors addresses the salient issue of the admissibility of an examiner's full report.

Moreover, most of the cited cases involve situations where the nature of the investigation and report were markedly different than Mr. Miller's and do not raise the same issues of reliability as are introduced by the out-of-court statements set forth in Mr. Miller's Report. It appears ***326** that the examiners in the cases cited by the Debtors were appointed either to conduct an analysis of objective issues that experts in a field of business routinely rely on, or the examiner's report was not in dispute. *See e.g., In re 22 Acquisition Corp.*, 2004 WL 870813, *1 (E.D.Penn.2004) (court appointed an independent examiner to evaluate whether debtor's employment of consultant was appropriate); *Apex Oil*, 118 B.R. at 688 (court relied on an examiner's report that analyzed causes of action available to the estate); *In re Best Products Co., Inc.*, 168 B.R. 35, 45 (Bankr.S.D.N.Y.1994) (examiner appointed to examine potential legal claims of the estate); *In re Concept Clubs, Inc.*, 125 B.R. 634, 636 (Bankr.D.Utah 1991) (examiner analyzed the reasonableness of real estate broker fees); *DeLorean v. Allard* (*In re DeLorean Motor Co. Litigation*), 59 B.R. 329, 336 (E.D.Mich.1986) (the court admitted the examiner's report as it was undisputed); *In re General Dev. Corp.*, 147 B.R. 610, 615–617 (Bankr.S.D.Fla.1992) (court relied on examiner who conducted an investigation as to the proper interest rates of claims under a plan); *In re Granite Partners, L.P.*, 219 B.R. 22, 26 (Bankr.S.D.N.Y.1998) (the examiner's report was not disputed by the parties); *In re Industrial Commercial Electrical, Inc.*, 304 B.R. 24 (Bankr.D.Mass.2004), *rev'd*, 319 B.R. 35 (D.Mass.2005) (court appointed an examiner with an expertise in accounting to analyze tax issues); *In re Medical Software Solutions*, 286 B.R. 431, 437 (Bankr.D.Utah 2002) (examiner appointed to evaluate the sale of debtor's assets outside of plan); *Paul Ruth Trading Co. v. Royal Yarn Dyeing Corp.* (*In re Royal Yarn Dyeing Corp.*), 114 B.R. 852, 856 (Bankr.E.D.N.Y.1990) (real estate specialist appointed as examiner to evaluate the condition of property); *In re PWS Holding Corp.*, 228 F.3d 224, 231 (3d Cir.2000) (court appointed independent examiner to evaluate legal claims of the debtor); *In re Revco D.S., Inc.*, 118 B.R. 468, 470 (Bankr.N.D.Ohio 1990) (examiner appointed to evaluate causes of action arising out of Michigan corporate statutory law). Since the examiners in the cited cases were appointed to investigate questions that could be answered in purely objective terms, and based upon objective data from their field of expertise, there was little reason to dispute the reliability of the premises upon which those examiners based their conclusions.

By contrast, Mr. Miller produced the Report at issue by examining over 65,000 pages of documents, correspondence and emails (doc. # 1734, at 16), the vast majority of which were created without expectation of public inspection. Mr. Miller and his attorneys also conducted nineteen Rule 2004 Examinations, resulting in 4,425 pages of testimony (*Id*). After his analysis of these materials, Mr. Miller reached a conclusion as to the parties' motives in relation to the dispute among the members of the Committee. By Mr. Miller's own account, the materials upon which he relied to produce the Report constitute out-of-court statements that lack the indices of reliability required for admission into evidence under the Federal Rules (doc. # 1667, at 41). Furthermore, as discussed above, and as found by our sister court in the Southern District of New York, the evidence and findings in an examiner's report that underlie the examiner's conclusions are not binding. Chief Judge Bernstein, in addressing a situation similar to the one now before the Court, found that while an examiner is employed to conduct an investigation, "he [is] not charged—nor could he be—with the duty to 'hear and determine' any claims in a case."[1] *Rickel* ***327** *& Associates, Inc. v. Smith* (*In re Rickel & Associates, Inc.*), 272 B.R. 74, 87–88 (Bankr.S.D.N.Y.2002). Judge Bernstein held that an examiner's report was hearsay, and a party could not rely on such a report to prevail on his or her motion without more. *Id*. at 88. This Court finds the *Rickel* holding to be well reasoned and will follow it. Thus, if the FiberMark parties wish to "prove" the accuracy of the Examiner's conclusions they must do so with admissible evidence. The facts, as found by the Examiner, are not "true" just because they are in the Report. They explain and justify the Examiner's conclusions. That is all. The Examiner's rendition of the facts may not be relied upon to prove the truth of the matter asserted.

[7] The Debtors attempt to overcome the hearsay argument, such as espoused by the *Rickel* court, by urging this Court to adopt the entire Examiner's Report as an expert report under Fed.R.Evid. 706. This Court has recognized, and the Parties have acknowledged, Mr. Miller's status as an expert in the field of bankruptcy and reorganization law. Mr. Miller's status as an expert however does not change the fact that the factual portions of his report contain an abundance of

statements that are the purest sort of hearsay. Therefore, this Court finds that while Fed.R.Evid. 706 can be used to justify the admission of the Examiner's conclusions, that rule does not permit the underlying rationale, or facts, of the Examiner to be introduced into evidence.

The Federal Rules of Evidence define as hearsay any statement made by an out-of-court declarant that is introduced to prove the truth of the matter asserted. Fed.R.Evid. 801(c). Generally, hearsay evidence is not admissible. Fed.R.Evid. 802. The hearsay rule is premised on the theory that-out of-court statements are subject to particular hazards. *Williamson v. United States,* 512 U.S. 594, 598, 114 S.Ct. 2431, 129 L.Ed.2d 476 (1994). The Report produced by Mr. Miller represents the findings of his investigation into the affairs and motives of the members of the Committee and their professionals. The Report is a one-sided presentation of the facts in that the people who were investigated did not have the opportunity to respond to Mr. Miller's findings. *See In re Gitto/Global Corp.,* 321 B.R. 367, 376–377 (Bankr.D.Mass.2005). The Court appointed an expert in whom it had confidence, an expert the parties respected as competent and disinterested. There is no basis to find that Mr. Miller did not do his very best in gathering all pertinent data, considering the information presented in an objective fashion, and reaching well founded conclusions that were wholly supported by the record he had created. However, that does not make the facts, as he defines them, true. They are still hearsay.

CONCLUSION

For the reasons set forth above, the Court finds that the conclusions and opinions of the Examiner are admissible as an expert opinion and the balance of the Report is inadmissible hearsay.

328 *ORDER

DENYING IN PART, AND GRANTING IN PART, THE MOTION OF THE REORGANIZED DEBTORS TO ADMIT THE EXAMINER'S REPORT INTO EVIDENCE, AS AN EXPERT OPINION

For the reasons set forth in the memorandum of decision of even date,

IT IS HEREBY ORDERED that the conclusions and recommendations of the Examiner, as set forth in the Examiner's Report (doc. # 1805) at pages 25–26 and 284–322, are admissible as an expert opinion and the balance of the Report is denied admissibility on the ground that it is hearsay.

SO ORDERED.

All Citations

339 B.R. 321, 46 Bankr.Ct.Dec. 51

Footnotes

1 In *Rickel & Associates,* the plaintiffs had attached a copy of the examiner's report to their complaint alleging that the defendant, who was a member of the committee of unsecured creditors, had defrauded the debtor and the committee into selling stock warrants to the defendants for much less than their fair market value. *Rickel & Associates,* 272 B.R. at 81. The court held that while a document attached to a pleading becomes part of that pleading, it does not mean the party adopts every statement in the Report as true. *Id.* The attached exhibit will be read to be what it appears to be. *Id.* at 91–92. In essence, the attaching of the report clearly indicated that the report had been created, but it did not make the facts in the report true and reliable.

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The Examiners Report and the Hearsay Rule Are Both Mutually Inclusive Part I

Dec/Jan 2006

Code to Code

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Journal Article:

Given the current corporate climate where the conduct and decisions of an entity's directors, officers, principals and employees are under increased scrutiny by the courts, and in light of the heightened obligations placed upon a corporation and its leaders under the Sarbanes-Oxley Act, it is hardly a far-fetched notion that bankruptcy courts in the future will be more routinely faced with motions to appoint a trustee filed by a debtor-in-possession's (DIP's) creditors when the creditors suspect fraud, dishonesty or gross mismanagement with respect to the business operations of the DIP. However, a less draconian but perhaps more economical method for investigating any alleged misconduct by the DIP's corporate management is for the court to appoint a bankruptcy examiner pursuant to §1104 of the Bankruptcy Code.1 Indeed, the appointment of an examiner is warranted whenever allegations of corporate fraud or misconduct are substantiated by credible evidence.2 As part of his or her duties in investigating the affairs of the DIP, §1106 of the Code requires an examiner to "file a statement" with respect to any investigation conducted, "including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement or irregularity in the management of the affairs of the debtor."3 The examiner is required to file a copy of his or her statement with the court and transmit a copy to any creditors' committee, equity securityholders' committee, indenture trustee or any other entity as the court designates.4 Although it may not be apparent at first blush, the examiner's report creates a problematic issue for a party that wishes to introduce the report into evidence during a motion, contested matter or trial for the truth of the matters contained in the report.5 In short, the report satisfies the definition of "hearsay" contained within Federal Rule of Evidence 801 and would be otherwise inadmissible unless the moving party could demonstrate that the report fell within an exception to the hearsay rule. Indeed, Federal Rule of Evidence 802 provides that "[h]earsay is not admissible except as provided by these rules or by other rules prescribed by the Supreme Court pursuant to statutory authority or by Act of Congress."6v The Code is silent on the issue of how an examiner's report may be utilized in a bankruptcy case. More particularly, until the recent decision by the U.S. Bankruptcy Court for the District of Vermont in In re Fibermark Inc., 339 B.R. 321 (Bankr. D. Vt. 2006), no judicial decision squarely addressed the circumstances under which an examiner's report may be admitted into evidence over the objection of a party, or how a filed examiner's report "fits into the rubric created by the Federal Rules of Evidence."7 Thus, the decision rendered in Fibermark was an issue of first impression for the federal courts. This article will address the intersection between the hearsay rule and an examiner's report and offer suggestions for practitioners seeking to admit an examiner's report into evidence during a hearing or trial. The General Rule of Hearsay Federal Rule of Bankruptcy Procedure 9017 makes the Federal Rules of Evidence applicable to bankruptcy cases.8 Consequently, "hearsay" is not admissible in bankruptcy cases except as permitted by the Federal Rules of Evidence.9 Federal Rule of Evidence 801(c) defines "hearsay" as "a statement, other than one made by the declarant while testifying at the trial or hearing, offered in evidence to prove the truth of the matter asserted."10 Federal Rule of Evidence 801(b) defines a "declarant" as "a person who makes a statement."11 In turn, Federal Rule of Federal Rule of Evidence 801(a) defines a "statement" in part as "an oral or written assertion."12 At its core, hearsay testimony is presumptively unreliable under the common law because the opposing party has no opportunity to cross-examine and test the declarant's truthfulness under oath before the factfinder.13 Consequently, the hearsay rule was devised precisely because the truthfulness of an "out-of-court declarant cannot be assessed by the ordinary methods with which we determine the truth of testimonial evidence—oath,

cross-examination and the factfinder's scrutiny of the witness' demeanor."14 As articulated by the Fifth Circuit Court of Appeals in Southmark Properties v. Charles House Corp., "the hearsay rule is not merely a technicality, but rests on the sound principle that the reliability of out-of-court declarations not made under oath and not subject to cross-examination and other checks of the trial process is inherently suspect."15 Federal Rule of Evidence 801(d)(1) excludes the following types of statements from the definition of hearsay: a prior statement by a witness that is either (1) inconsistent with the declarant's testimony and was given under oath subject to the penalty of perjury at a trial, hearing or other proceeding, or in a deposition; (2) consistent with the declarant's testimony and is offered to rebut an express or implied charge against the declarant of recent fabrication or improper influence or motive; or (3) one of identification of a person made after perceiving the person.16 Moreover, Federal Rule of Evidence 801(d)(2) also excludes from the definition of hearsay a statement offered against a party and is either (1) the party's own statement, in either an individual or representative capacity; (2) a statement of which the party has manifested an adoption or belief in its truth; (3) a statement by a person authorized by the party to make a statement concerning the subject; (4) a statement by the party's agent or servant concerning a matter within the scope of the agency or employment, made during the existence of the relationship; or (5) a statement by a co-conspirator of a party during the course and in furtherance of the conspiracy.17 An examiner's report, without more, would not fall under the ambit of a statement that is "not hearsay" under either Federal Rule of Evidence 801(d)(1) or (d)(2).18 Appointment of a Bankruptcy Examiner Section 1104(c) of the Code governs the appointment of an examiner in a chapter 11 case and provides as follows: If the court does not order the appointment of a trustee under this section, then at any time before the confirmation of a plan, on request of a party in interest or the U.S. Trustee, and after notice and a hearing, the court shall order the appointment of an examiner to conduct such an investigation of the debtor as is appropriate, including an investigation of any allegations of fraud, dishonesty, incompetence, misconduct, mismanagement or irregularity in the management of the affairs of the debtor of or by current or former management of the debtor, if— (1) such appointment is in the interests of creditors, any equity securityholders, and other interests of the estate; or (2) the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services or taxes, or owing to an insider, exceed $5 million.19 Thus, based on the language contained in §1104(c), the appointment of an examiner has four requirements: (1) the debtor must still be in possession of the estate—that is, a trustee must not have been previously appointed; (2) a reorganization plan must not yet have been confirmed by the court; (3) a party in interest must request the appointment of an examiner; and (4) either the appointment of an examiner is in the best interests of the estate or the debtor's liquidated unsecured debts exceed $5 million.20 As a corollary to §1104(c), §1104(d) provides that if the court orders the appointment of an examiner, then the U.S. Trustee, after consultation with the parties in interest, shall appoint one "disinterested" person to serve as examiner in the bankruptcy case.21 A court-appointed bankruptcy examiner typically investigates the debtor's business and handles other duties specifically assigned by the bankruptcy court within the context of the chapter 11 case, but unlike a trustee, an examiner does not replace the DIP or "divest the debtor of control over the progress of the case or the operation of the business."22 More specifically, §§1106(b) and 1106(a)(3) of the Code, taken together, provide that a bankruptcy examiner shall, except to the extent the court orders otherwise, "investigate the acts, conduct, assets, liabilities and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan."23 The investigation of a bankruptcy examiner ordinarily focuses on alleged fraud, dishonesty, incompetence, misconduct, mismanagement or other irregularities surrounding the business operations of the debtor; nonetheless, a bankruptcy court "retains broad discretion to direct the examiner's investigation, including its nature, extent and duration."24 The investigation of the examiner is conducted pursuant to Federal Rule of Bankruptcy Procedure 2004 and is broader than the scope of civil discovery.25 In fact, the parameters of a Rule 2004 examination have been likened to a "fishing expedition," and is supposed to be "as exploratory and groping as appears proper" to the bankruptcy examiner.26 Directly relevant to the rule of hearsay is Code §106(a)(4), which provides that a trustee shall as soon as practicable (a) file a statement of any investigation conducted...including any fact ascertained pertaining to fraud, dishonesty, incompetence, misconduct, mismanagement or irregularity in the management of the affairs of the debtor, or to a cause of action available to the estate; and (b) transmit a copy or a summary of any such statement to any creditors' committee or equity securityholders' committee, to any indenture trustee, and to such other entity as the court designates.27 The Fibermark Decision In In re Fibermark Inc., when the debtors filed their bankruptcy cases, it appeared to the court that the debtors, the U.S. Trustee, the unsecured creditors' committee and the primary secured creditor "were proceeding in a remarkably collaborative fashion" towards the filing of an acceptable reorganization plan.28 However, approximately a year after the bankruptcy filing, the issue of corporate governance of the post-confirmation entity became a subject of dispute among the parties, and caused the collaboration to disintegrate.29 A stalemate ensued that derailed the confirmation process and prompted the debtors to withdraw their reorganization plan.30 As a consequence of this development, the bankruptcy court issued an order to show cause as to why an examiner should not be appointed to investigate the parties' allegations and to make recommendations on various matters, including the debtors' principals' alleged breaches of fiduciary duty.31 All of the parties supported the appointment of an examiner. The U.S. Trustee subsequently recommended, and the court ultimately appointed, Harvey R. Miller to serve as the examiner.32 A court-appointed bankruptcy examiner typically investigates the debtor's business and handles other duties specifically assigned by the bankruptcy court within the context of the chapter 11 case, but unlike a trustee, an examiner does not replace the DIP or "divest the debtor of control over the progress of the case or the operation of the business." The

examiner spent 11 weeks conducting his investigation and thereafter produced a 298-page report that included 1,244 footnotes and cost the bankruptcy estate $1.75 million.33 The reorganized debtors sought to admit the examiner's report into evidence in connection with their objection to the fee application of Chanin Capital Partners LLC.34 In sum, the reorganized debtors argued that the entire examiner's report could be admitted into evidence, as an expert opinion, "on the basis that it [was] relevant to the [d]ebtors' assertion that Chanin failed the test of disinterestedness and acted with an interest adverse to that of the bankruptcy estate."35 Notably, Chanin did not oppose admission "of those portions of the [e]xaminer's report that constitute[d] the [e]xaminer's recommendations and conclusions, but characterize[d] the remainder of the report as 'rank hearsay.'"36 In arguing for the admittance into evidence of the examiner's report, the debtors relied upon "the regular practice in the bankruptcy courts for examiner's reports to be received into evidence and considered as part of the evidentiary record."37 The court, however, refused to rely upon this argument because none of the precedent offered by the debtors specifically addressed whether an examiner's report that contained hearsay statements is admissible into evidence over the objection of another party to the bankruptcy proceeding.38 Contrary to the situation where an examiner is employed to conduct an analysis of purely objective issues based on objective data from the examiner's particular field of expertise, the examiner in Fibermark was specifically appointed by the court to investigate the motives of parties involved in the bankruptcy case and whether any breaches of fiduciary duty occurred. To that end, the examiner reviewed more than 65,000 pages of documents and conducted 19 Rule 2004 examinations, which resulted in approximately 4,425 pages of testimony.39 Because the out-of-court statements upon which the examiner relied in drafting his report lacked the indices of reliability required under the Federal Rules of Evidence and "the factual portions of his report contain[ed] an abundance of statements that [were] the purest sort of hearsay," the bankruptcy court denied the request to admit the examiner's report in its entirety. Nonetheless, the bankruptcy court admitted into evidence the examiner's conclusions and opinions as an expert opinion.40 Editor's Note: Part II will appear in the February 2007 issue. Footnotes 1 See In re 1243 20th St. Inc., 6 B.R. 683, 685-86 (Bankr. D.C. 1980) (holding that "an examiner will entail less administrative expense than the appointment of an independent trustee, and, in view of the examiner's limited role, will not result in any untoward disruption of the debtor's business"). See also In re Gilman Servs. Inc., 46 B.R. 322, 328 (Bankr. D. Mass. 1985) ("the appointment of an examiner is a cautious, intermediate procedure which is more economical than the appointment of a trustee") (citation omitted); In re Texasoil Enters. Inc., 296 B.R. 431, 436 (Bankr. N.D. Tex. 2003) ("an examiner, too, can be expensive, though the cost is perhaps more easily controlled by the court than in the case of a trustee"). 2 Id. at 686. 3 See 11 U.S.C.A. §1106(a)(4) (West 2006). 4 See 11 U.S.C.A. §1106(a)(4)(B) (West 2006). 5 Admittedly, this might be a rare occasion, but its significance cannot be diminished. 6 Fed. R. Evid. 801 (2006). 7 In re Fibermark Inc., 339 B.R. 321, 324 (D. Vt. 2006). 8 Federal Rule of Bankruptcy Procedure 9017 provides as follows: "The Federal Rules of Evidence and Rules 43, 44 and 44.1 F.R.Civ.P. apply in cases under the Code." See Fed. R. Bankr. P. 9017 (2006). 9 See In re Rigby, 47 B.R. 614, 618 (Bankr. N.D. Ala. 1985). 10 Fed. R. Evid. 801(c) (2006). Federal Rule of Evidence 801(d)(1) excludes the following types of statements from the definition of hearsay: a prior statement by a witness that is either (i) inconsistent with the declarant's testimony, and was given under oath subject to the penalty of perjury at a trial, hearing or other proceeding, or in a deposition; (ii) consistent with the declarant's testimony and is offered to rebut an express or implied charge against the declarant of recent fabrication or improper influence or motive; or (iii) one of identification of a person made after perceiving the person. See Fed. R. Evid. 801(d)(1) (2006). Moreover, Federal Rule of Evidence 801(d)(2) also excludes from the definition of hearsay a statement offered against a party and is either (i) the party's own statement, in either an individual or representative capacity; (ii) a statement of which the party has manifested an adoption or belief in its truth; (iii) a statement by a person authorized by the party to make a statement concerning the subject; (iv) a statement by the party's agent or servant concerning a matter within the scope of the agency or employment, made during the existence of the relationship; or (v) a statement by a co-conspirator of a party during the course and in furtherance of the conspiracy. See Fed. R. Evid. 801(d)(2) (2006). 11 Fed. R. Evid. 801(b) (2006). 12 Federal Rule of Evidence 801(a) provides in full that a "statement" is "(1) an oral or written assertion or (2) nonverbal conduct of a person, if it is intended by the person as an assertion." See Fed. R. Evid. 801(a) (2006). 13 United States v. Shukri, 207 F.3d 412, 417 (7th Cir. 2000) (citation omitted). 14 Saltzburg, Stephen A. et al., 4 Federal Rules of Evidence Manual §801.02[1][a] (9th ed. 2006). 15 742 F.2d 862, 875 (5th Cir. 1984). 16 See Fed. R. Evid. 801(d)(1) (2006). 17 See Fed. R. Evid. 801(d)(2) (2006). 18 Because a bankruptcy examiner is appointed by the court, and not retained by one of the constituents in a bankruptcy case, the examiner's report does not satisfy Federal Rule of Evidence 801(d)(2)(C) or (D), namely, "a statement by a person authorized by the party to make a statement concerning the subject" or "a statement by the party's agent or servant concerning a matter within the scope of the agency or employment, made during the existence of the relationship." See Fed. R. Evid. 801(d)(2)(C) and (D) (2006) (emphases added). Interestingly, however, some cases hold that an expert retained by a party to a litigation can be considered that party's agent under Federal Rule of Evidence 801(d)(2)(C) and, consequently, the expert's report and deposition testimony were deemed admissible. See, e.g., Collins v. Wayne Corp., 621 F.2d 777, 780-82 (5th Cir. 1980). But see Kirk v. Raymark Indus. Inc., 61 F.3d 147, 164 (3d Cir. 1995) (rejecting the holding in Collins, concluding that "[s]ince an expert witness is not subject to the control of the party opponent with respect to consultation and testimony he or she is hired to give, [an] expert witness cannot be deemed an agent." In theory, "despite the fact that one party retained and paid for the services of an expert witness, expert witnesses are supposed to testify impartially in the sphere of their expertise"). 19 11 U.S.C.A. §1104(c) (West 2006). In addition, a bankruptcy court has the authority to appoint an

examiner sua sponte. See In re Pub. Serv. Co. of New Hampshire, 99 B.R. 177, 182 (Bankr. D. N.H. 1989). 20 See In re UAL Corp., 307 B.R. 80, 84 (Bankr. N.D. Ill. 2004). 21 Section 1104(d) provides as follows: "If the court orders the appointment of a trustee or an examiner, if a trustee or an examiner dies or resigns during the case or is removed under §324 of this title, or if a trustee fails to qualify under §322 of this title, then the U.S. Trustee, after consultation with parties in interest, shall appoint, subject to the court's approval, one disinterested person other than the U.S. Trustee to serve as trustee or examiner, as the case may be, in the case." 11 U.S.C.A. §1104(d) (West 2006). In turn, §101(14) of the Code defines a "disinterested person" as a person that "(A) is not a creditor, an equity securityholder, or an insider; (B) is not and was not, within two years before the date of the filing of the petition, a director, officer or employee of the debtor; and (C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity securityholders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason." 11 U.S.C.A. §101(14) (West 2006). 22 7 Collier on Bankruptcy ¶1104.01 (15th ed. rev. 2006). See also In re Gliatech Inc., 305 B.R. 832, 835 (Bankr. N.D. Ohio 2004) ("an examiner 'typically investigates the debtor's business and handles other duties specifically assigned by the bankruptcy court, but does not replace the DIP in handling the day-to-day affairs of the business'") (quoting United States v. Schilling (In re Big River Elec. Corp.), 355 F.3d 415, 422 (6th Cir. 2004)); In re Am. Bulk Transp. Co., 8 B.R. 337, 341 (Bankr. D. Kan. 1980) ("the examiner's primary duty is to investigate and report on the financial position of the debtor, the operation of the debtor's business and the desirability of the continuance of the business"). 23 See 11 U.S.C.A. §1106(a)(3) (West 2006); see also 11 U.S.C.A. §1106(b) (West 2006). 24 Morgenstern v. Revco D.S. Inc. (In re Revco D.S. Inc.), 898 F.2d 498, 501 (6th Cir. 1990). 25 Air Line Pilots Ass'n. v. Am. Nat'l. Bank & Trust Co. of Chicago (In re Ionosphere Clubs Inc.), 156 B.R. 414, 432 (S.D.N.Y. 1993) ("Bankruptcy Rule 2004 likewise gives the examiner scope to investigate which is broader than that of civil discovery under Rule 26") (citation omitted), aff'd, 17 F.3d 600 (2d Cir. 1994); In re Fibermark Inc., 339 B.R. at 324. Specifically, Federal Rule of Bankruptcy Procedure 2004(b) provides as follows: "The examination of an entity under this rule...may relate only to the acts, conduct or property or to the liabilities and financial condition of the debtor, or to any matter which may affect the administration of the debtor's estate, or to the debtor's right to a discharge. In a family farmer's debt adjustment case under chapter 12, an individual's debt adjustment case under chapter 13, or a reorganization case under chapter 11 of the Code...the examination may also relate to the operation of any business and the desirability of its continuance, the source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan and the consideration given or offered therefor, and any other matter relevant to the case or to the formulation of a plan." Fed. R. Bankr. P. 2004(b) (2006). 26 In re French, 145 B.R. 991, 992 (Bankr. D. S.D. 1992) ("Bankruptcy Rule 2004 is designed to be a quick 'fishing expedition' into general matters and issues regarding the administration of the bankruptcy case and, as such, does not offer the procedural safeguards available under Rule 26 of the Federal Rules of Civil Procedure") (citation omitted); In re Valley Forge Plaza Assocs., 109 B.R. 669, 674 (Bankr. E.D. Pa. 1990) ("R[ule] 2004 permits a party invoking it to undertake a broad inquiry of the examiner, in the nature of a 'fishing expedition'") (citations omitted); Air Line Pilots Ass'n. v. Am. Nat'l. Bank & Trust Co. of Chicago (In re Ionosphere Clubs Inc.), 156 B.R. 414, 432 (S.D.N.Y. 1993); Air Line Pilots Ass'n. v. Am. Nat'l. Bank & Trust Co. of Chicago (In re Ionosphere Clubs Inc.), aff'd, 17 F.3d 600 (2d Cir. 1994). 27 11 U.S.C.A. §1106(a)(4) (West 2006). 28 In re Fibermark Inc., 339 B.R. at 322. 29 Id. 30 Id. 31 Id. 32 Id. at 323. 33 Id. at 324. 34 Id. at 322. The decision does not state which constituency employed Chanin Capital Partners LLC. 35 Id. 36 Id. (citation omitted). 37 339 B.R. at 325. 38 Id. 39 Id. at 326. 40 Id. at 327.

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The Examiner's Report and the Hearsay Rule: Are Both Mutually Inclusive?

Part II

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Editor's Note: *Part I appeared in the December/January 2007 issue.*

A Synthesis of the Bankruptcy Examiner's Required Report and Its Admissibility Pursuant to the Federal Rules of Evidence

Although no reported cases other than *Fibermark* exist with respect to the admissibility of an examiner's report into evidence over the hearsay objection of a party, at least three solid arguments exist to overcome the hearsay objection. One avenue for the admission into evidence of an examiner's report is using Federal Rule of Evidence 706, which governs court-appointed experts and dovetails nicely with §1104 of the Bankruptcy Code. It provides, in relevant part:

> The court may on its own motion or on the motion of any party enter an order to show cause why expert witnesses should not be appointed, and may request the parties to submit nominations. The court may appoint any expert witnesses agreed upon by the parties, and may appoint expert witnesses of its own selection... A witness so appointed shall advise the parties of the witness's findings, if any; the witness's deposition may be taken by any party; and the witness may be called to testify by the court or any party. The witness shall be subject to cross-examination by each party, including a party calling the witness.[1]

As the U.S. Bankruptcy Court for the District of Vermont explicitly recognized in *Fibermark,* Federal Rule of Evidence 706 "can be used to justify the admission" of an examiner's conclusions, albeit so long as "the underlying rationale, or facts, of the [e]xaminer" are not introduced into evidence."[2] It is important to cautiously note, however, that the U.S. Bankruptcy Court for the Southern District of Ohio in *In re Baldwin United Corp.* concluded, albeit without any explanation or analysis, that an examiner's report does not have "the evidentiary character of an opinion by a [c]ourt expert appointed pursuant to Rule 706 of the Federal Rules of Evidence."[3]

About the Author

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Code to Code

Michael D. Sousa

However, this blanket conclusion appears to be too much of a generalization. Because the bankruptcy court retains "broad discretion" to define the contours and parameters of an examiner's investigation to suit the needs of a particular case,[4] in certain instances an examiner will be appointed to conduct an investigation of the debtor-in-possession (DIP) regarding subject matters that are more "traditionally" left to expert testimony, such as issues of (1) ethics, (2) economic and business damages,[5] (3) financial analysis,[6] (4) corporate valuation, (5) standard accounting practices;[7] (6) business customs and industry practices[8] and (7) environmental contamination.[9] Contrary to the overriding pronouncement by the bankruptcy court in *Baldwin,* an examiner's report or testimony on matters such as the foregoing list should have the evidentiary character of the kind contemplated by Federal Rule of Evidence 706.

From this, then, if a party seeking the admission of an examiner's report or testimony convinces the bankruptcy court that the examiner is an "expert" within the contours of Federal Rule of Evidence 706, then Federal Rules of Evidence 702 and 703 are implicated. Federal Rule of Evidence 702 provides as follows:

> If scientific, technical or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.[10]

As the Advisory Committee's Note to Federal Rule of Evidence 702 relates, the rule is broadly phrased. That is, "[t]he fields of knowledge which may be drawn upon are not limited merely to the 'scientific' and 'technical' but extend to all 'specialized' knowledge."[11] Moreover,

1 Fed. R. Evid. 706(a) (2006).

2 339 B.R. at 327.

3 46 B.R. 314, 316 (Bankr. S.D. Ohio 1985).

4 *See In re Bradlees Stores Inc.*, 209 B.R. 36, 39 (Bankr. S.D.N.Y. 1997) (noting that after an examiner has been appointed, the bankruptcy court retains "broad discretion to direct the examiner's investigation, including its nature, extent and duration") (citation omitted). *See, also, In re Texasoil Enters. Inc.*, 296 B.R. at 435-36 (noting that "[w]hile an examiner is most often an independent investigator...the court may expand the duties of an examiner to suit the needs of the case") (internal citations omitted).

5 *See, e.g., McDermott v. Middle E. Carpet Co.*, 811 F.2d 1422, 1427-28 (11th Cir. 1987) (finding expert testimony admissible on the issue of lost profits due to a delay in commencing production).

6 *See, e.g., Schleier v. Kaiser Found. Health Plan of the Mid-Atlantic States Inc.*, 876 F.2d 174, 180 (D.C. Cir. 1989) ("We believe that discounting to present value falls within the class of tasks which 'lend themselves to clarification by expert testimony because they involve the use of statistical techniques and require a broad knowledge of economics.'") (citation omitted).

7 *See, e.g., In re Bonham*, 251 B.R. 113, 132 (Bankr. D. Ala. 2000) ("Accounting testimony can be the subject of expert testimony.").

8 *See, e.g., Suter v. Gen. Accident Ins. Co. of Am.*, 424 F. Supp. 2d 781, 791 (D. N.J. 2006) (noting that testimony with respect to business custom and practice is admissible into evidence) (citation omitted).

9 *See, e.g., Pinal Creek Group v. Newmont Mining Corp.*, 352 F. Supp. 2d 1037, 1046-47 (D. Ariz. 2005).

10 Fed. R. Evid. 702 (2006). While trials in bankruptcy court are rare, there is no apparent restriction for concluding that the bankruptcy judge can be considered "the trier of fact" within the context of a motion, adversary proceeding or contested matter.

the expert witness is viewed "not in a narrow sense, but as a person qualified by 'knowledge, skill, experience, training or education.' Thus within the scope of the rule are included not only experts in the strictest sense of the word, *e.g.*, physicians, physicists and architects, but also the large group sometimes called 'skilled' witnesses, such as bankers or landowners testifying to land values."[12] In instances where an expert report or testimony does not rely upon a scientific method, as may often be the case in instances where a bankruptcy examiner is appointed, the report or testimony "will have to be evaluated by reference to other standard principles attendant to the particular area of expertise."[13] Nonetheless, in all cases of proffered expert testimony, the trial court must find "that it is properly grounded, well-reasoned and not speculative before it can be admitted. The expert's testimony must be grounded in an accepted body of learning or experience in the expert's field, and the expert must explain how the conclusion is so grounded."[14] Indeed, Federal Rule of Evidence 702 affords the trial court broad discretion in deciding to admit expert testimony, "in the form of an opinion or otherwise."[15]

While Federal Rule of Evidence 702 tests the sufficiency of the basis of an expert's report or testimony, Federal Rule of Evidence 703 permits an expert to form an opinion based on facts or data, or both, that are not admissible in evidence.[16] Federal Rule of Evidence 703 provides as follows:

> The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to the expert at or before the hearing. If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be admissible in evidence in order for the opinion or inference to be admitted. Facts or data that are otherwise inadmissible shall not be disclosed to the jury by the proponent of the opinion or inference unless the court determines that their probative value in assisting the jury to evaluate the expert's opinion substantially outweighs their prejudicial effect.[17]

Simply stated, Federal Rule of Evidence 703 "permits an expert to rely on inadmissible information, such as hearsay, if it is the type of information on which other experts in the field would reasonably rely."[18] Therefore, the opinion of an expert, whether conveyed by written report or through testimony, is not rendered inadmissible or incompetent merely because it may be based on knowledge of facts gained from hearsay sources.[19] This is particularly relevant to

continued on page 64

11 Saltzburg, Stephen A., Martin, Michael M. and Capra, Daniel J., *Federal Rules of Evidence Manual* §702.04[1] (Matthew Bender & Co. 2006) (citation omitted).

12 *Id.* (citation omitted).

13 Saltzburg, Martin and Capra, *Federal Rules of Evidence Manual* §702.04[2] (Matthew Bender & Co. 2006) (citation omitted).

14 *Id.* Pursuant to Federal Rule of Evidence 702, the decision of whether to admit expert testimony is left to the discretion of the trial judge and will not be set aside on appeal unless "manifestly erroneous." *United States v. Feliciano*, 223 F.3d 102, 120 (2d Cir. 2000) (citation omitted). *But see United States v. Shukri*, 207 F.3d 412, 416 (7th Cir. 2000) (noting that the "abuse of discretion" standard is utilized by an appellate court when reviewed a lower court's decision to admit hearsay testimony).

15 *Feliciano*, 223 F.3d at 120. *See, also, Gray v. Briggs*, 45 F. Supp. 2d 316, 323 (S.D.N.Y. 1999) ("A trial court has broad discretion to exclude expert testimony for its lack of helpfulness or for the expert's lack of qualifications....") (citation omitted).

16 Saltzburg, Martin and Capra, *Federal Rules of Evidence Manual* §703.02[2] (Matthew Bender & Co. 2006)

17 Fed. R. Evid. 703 (2006).

18 Saltzburg, Martin and Capra, *Federal Rules of Evidence Manual* §703.02[4] (Matthew Bender & Co. 2006). *See, also, Olson v. Ford Motor Co.*, 410 F. Supp. 2d 855, 864 (D. N.D. 2006) ("It is well-established that an expert may rely upon evidence not otherwise admissible to form his opinion."); *United States v. LeClair*, 338 F.3d 882, 885 (8th Cir. 2003) ("The facts or data that form the basis for an expert opinion 'need not be admissible in evidence' in order for the expert's opinion to be admitted so long as the evidence is a type reasonably relied on by the experts in the field.").

Code to Code: The Examiner's Report and the Hearsay Rule

from page 21

the bankruptcy examiner's function, which is most likely to investigate the DIP for fraud or corporate mismanagement; such a task will almost by definition require the bankruptcy examiner to interview the corporation's managers, directors, officers and employees. As the Supreme Court of Maine aptly noted in 1967 in *Warren v. Waterville Urban Renewal Authority*:

> Any expert worthy of the name must of necessity assimilate prior learning derived from the experiences of others. As an expert witness, he [or she] draws upon various sources of information whose credibility or trustworthiness he [or she] must determine in the light of his [or her] experiences. It would completely frustrate the use of expert witnesses if they were obliged to substantiate each single factor upon which their ultimate opinion must depend upon firsthand knowledge or personal experience. If some of the expert's factual information is derived from sources fairly trustworthy though hearsay and he [or she] has as such the ability to coordinate and evaluate that information with all the other facts in his [or her] possession secured through personal observation, the trial court may in the exercise of sound discretion permit the expert's ultimate opinion to be considered....[20]

Under Federal Rule of Evidence 703, an expert may rely upon hearsay in formulating his or her opinion provided that the requirements of Federal Rule of Evidence 702 are satisfied, but the evidence is admissible, despite being based in part upon inadmissible hearsay, precisely because the evidence is offered for the purpose of informing the court on the basis of the expert's opinion and not for proving the truth of the matters asserted.[21] Stated differently, the expert's opinion "is distinguishable from the information upon which the expert relied. Yet if an expert reasonably relies on the hearsay, the information is admissible in a certain sense—it is admissible to assist the factfinder in weighing the expert's testimony. That is, the hearsay is admissible for credibility purposes."[22] But as the U.S. District Court for the Northern District of Illinois recognized in *Loeffel Steel Products Inc. v. Delta Brands Inc.*, while Federal Rule of Evidence 703 was intended to "liberalize" the rules relating to expert testimony, "it was not intended to abolish the hearsay rule and to allow a witness, under the guise of giving expert testimony, to in effect become the mouthpiece of the witnesses on whose statements or opinions the expert purports to base his [or her] opinion."[23]

Despite the last admonition, however, a party seeking to admit the report of a bankruptcy examiner into evidence over the objection of a party might need to move under Federal Rule of Evidence 706 to have the examiner qualified as a court-appointed expert witness. If successful, then the examiner's report could be admitted into evidence despite the inclusion or reliance upon otherwise inadmissible hearsay, so long as the information is of the type reasonably relied upon by other experts in the particular discipline or profession. Moreover, so long as the bankruptcy court subscribes to the philosophy advanced in *Warren v. Waterville Urban Renewal Authority*, the bankruptcy examiner would be able to incorporate his or her discussions with the DIP's management in producing the report required under §1106(a)(4)(A) of the Code.

A second avenue for the admission of an examiner's report is to demonstrate that the report is excluded from the hearsay rule by operation of Federal Rule of Evidence 803. Federal Rule of Evidence 803 contains 23 specific categories of statements that are excluded from the ambit of the hearsay rule.[24] Obviously, most of the hearsay exclusions would never apply to an examiner's

19 *Warren v. Waterville Urban Renewal Auth.*, 235 A.2d 295, 300 (Me. 1967).

20 *Id.*

21 *Loeffel Steel Prods. Inc. v. Delta Brands Inc.*, 387 F. Supp. 2d 794, 808 (N.D. Ill. 2005) (citations omitted). *See, also, Olson v. Ford Motor Co.*, 410 F. Supp. 2d 855, 864 (D. N.D. 2006) ("Because [an expert's report or testimony] is not admitted for its truth, but rather to inform the jury of the factual basis of the expert's opinion, it is admissible.") (citation omitted).

22 Saltzburg, Martin and Capra, *Federal Rules of Evidence Manual* §703.02[4] (Matthew Bender & Co. 2006).

23 *Loeffel Steel Prods. Inc.*, 387 F. Supp. 2d at 808.

24 The 23 exceptions to the hearsay rule where the availability of the declarant is immaterial are as follows: (1) present sense impression; (2) excited utterance; (3) then existing mental, emotional or physical condition; (4) statements for the purposes of medial diagnosis or treatment; (5) recorded recollection; (6) records of regularly conducted activity; (7) absence of entry in records kept in accordance with the provisions of Federal Rule of Evidence 803(6); (8) public records and reports; (9) records of vital statistics; (10) absence of public record or entry; (11) records of religious organizations; (12) marriage, baptismal and similar certificates; (13) family records; (14) records of documents affecting an interest in property; (15) statements in documents affecting an interest in property; (16) statements in ancient documents; (17) market reports and commercial publications; (18) learned treatises; (19) reputation concerning personal or family history; (20) reputation concerning boundaries or general history; (21) reputation as to character; (22) judgment of previous conviction; and (23) judgment as to personal, family or general history or boundaries. *See* Fed. R. Evid. 803 (2006).

report.[25] Nonetheless, and though no reported case addresses this specific hearsay exception, one could argue that an examiner's report is excluded from the hearsay rule pursuant to Federal Rule of Evidence 803(8), the "public records and reports" exclusion. Federal Rule of Evidence 803(8) provides as follows:

> The following are not excluded by the hearsay rule, even though the declarant is available as a witness:
>
> (8) Public records and reports.
>
> Records, reports, statements, or data compilations, in any form, of public offices or agencies, setting forth (A) the activities of the office or agency, or (B) matters observed pursuant to duty imposed by law as to which matters there was a duty to report, excluding, however, in criminal cases matters observed by police officers and other law enforcement personnel, or (C) in civil actions and proceedings and against the government in criminal cases, factual findings resulting from an investigation made pursuant to authority granted by law, unless the source of information or other circumstances indicate lack of trustworthiness.[26]

The exception "is based upon the assumption that public officers will perform their duties, that they lack motive to falsify, and that public inspection to which many such records are subject will disclose inaccuracies."[27] In short, reports that include findings and opinions from an official investigation are admissible under Federal Rule of Evidence 803(8) if the contents are trustworthy.[28] The proponent of a public record or report must establish its foundation "by showing that it does in fact set forth 'findings resulting from an investigation made pursuant to authority granted by law'; once the foundation is established, the evidence will be admitted unless the party opposing it shows that it is untrustworthy."[29] In deciding to admit a report in accordance with Federal Rule of Evidence 803(8), and in particular under Federal Rule of Evidence 803(8)(B), courts will generally rely upon the following factors: (1) the timeliness of the investigation, (2) the special skill or experience of the official, and (3) possible motivational problems.[30]

Although a bankruptcy examiner is not, by strict definition, a "public office" or "agency," a court-appointed examiner should be considered sufficiently related to the government as a public officer or officer of the court so as to satisfy the requirement of Federal Rule of Evidence 803(8).[31] The investigatory report or "statement" prepared by a bankruptcy examiner is certainly pursuant to a "duty imposed by law as to which matters there was a duty to report" as a result of Code §1106(a)(4). Moreover, because a "disinterested" person is appointed by the court as bankruptcy examiner under §1104 whose appointment is vetted by the U.S. Trustee "after consultation with parties in interest," any report prepared by the examiner should be imbued with all indicia of trustworthiness. Therefore, Federal Rule of Evidence 803(8) serves as a second possible alternative for seeking the admissibility of a bankruptcy examiner's report even though it contains hearsay statements.[32]

A final possible justification for admitting the report of a bankruptcy examiner into evidence over the objection of a party rests with Federal Rule of Evidence 807, otherwise known as the "residual" or "catch all" exception to the hearsay rule. Federal Rule of Evidence 807 provides as follows:

> A statement not specifically covered by Rule 803 or 804 but having equivalent circumstantial guarantees of trustworthiness, is not excluded by the hearsay rule if the court determines that (A) the statement is offered as evidence of a material fact; (B) the statement is more probative on the point for which it is offered than any other evidence which the proponent can procure through reasonable efforts; and (C) the general purposes of these rules and the interests of justice will best be served by admission of the statement into evidence. However, a statement may not be admitted under this exception unless the proponent of it makes known to the adverse party sufficiently in advance of the trial or hearing to provide the adverse party with a fair opportunity to prepare to meet it, the proponent's intention to offer the statement and the particulars of it, including the name and address of the declarant.[33]

The "catch all" exception to the hearsay rule generally applies "only in those novel or unusual circumstances where no other exception applies."[34] The stated purpose of Federal Rule of Evidence 807 "is to provide a vehicle for the growth of the law in areas unforeseen by the Rule's drafters in enumerating the other [23 hearsay] exceptions."[35] Further, as the Fifth Circuit Court of Appeals stated in *United States v. Mathis,* the "residual" exclusion to the hearsay rule has a significant purpose and substantial vitality of its own, and that is "to encourage the progressive growth and development of federal evidentiary law by giving courts the flexibility to deal with new evidentiary situations which may not be pigeon-holed elsewhere."[36] No doubt, an effort to admit into evidence a court-appointed bankruptcy examiner's report over the hearsay objection of another party presents a new evidentiary situation that cannot be "pigeon-holed" either by bankruptcy law or by the Federal Rules of Evidence. Consequently, and given the federal courts' view that Federal Rule of Evidence 807 offers an outlet to promote the development of evidence law, the "catch all" exception might very well be the best avenue for seeking to admit a bankruptcy examiner's report into evidence. ■

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25 Further, the hearsay exclusions contained within Federal Rule of Evidence 804 presumably would also not apply to a bankruptcy examiner because these exclusions depend upon the witness's "unavailability." *See, generally,* Fed. R. Evid. 804 (2006).

26 Fed. R. Evid. 803(8) (2006).

27 Russell, Barry, *Bankruptcy Evidence Manual* §803.20 (West 2006).

28 *Distaff Inc. v. Springfield Contracting Corp.,* 984 F.2d 108, 111 (4th Cir. 1993) (citation omitted).

29 *Jama v. U.S. Immigration & Naturalization Serv.,* 334 F. Supp. 2d 662, 677 (D. N.J. 2004) (citations omitted). *See, also, Rambus Inc. v. Infineon Technologies AG,* 222 F.R.D. 101, 106 (E.D. Va. 2004) ("In this circuit, the admissibility of a public record as defined under Fed. R. Evid. 803(8) is 'assumed as a matter of course,' unless there are sufficient negative factors to 'indicate a lack of trustworthiness.'") (citations omitted).

30 *Anderson v. Westinghouse Savannah River Co.,* 406 F.3d 248, 264 (4th Cir. 2005) (*quoting Distaff Inc. v. Springfield Contracting Corp.,* 984 F.2d 108, 111 (4th Cir. 1993).

31 *Cf. In re Endeco Inc.,* 1 B.R. 64, 67-68 (Bankr. D. N.D. 1979) (noting that trustees in bankruptcy are public officers and officers of the court).

32 While the examiner's report in and of itself constitutes an exclusion to the hearsay rule, statements by third parties that are recorded in an investigative report are "hearsay within hearsay." As such, "they are inadmissible unless they qualify for their own exclusion or exception from the hearsay rule...or as qualifying under some other hearsay exception." *See Weinstein's Federal Evidence* §803.10[4][a] (LexisNexis 2003). *See, also,* Fed. R. Evid. 805 (2006) ("Hearsay included within hearsay is not excluded under the hearsay rule if each part of the combined statements conforms with an exception to the hearsay rule provided in these rules.").

33 Fed. R. Evid. 807 (2006).

34 *Cent. Fid. Bank v. Denslow (In re Denslow),* 104 B.R. 761, 766 (E.D. Va. 1989).

35 *Id. (citing Universal Elec. Co. v. United States Fid. & Guar. Co.,* 792 F.2d 1310 (5th Cir. 1986).

36 559 F.2d 294, 299 (5th Cir. 1977).

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	:	**Chapter 11**
TRIBUNE COMPANY, *et al.*,[1]	:	**Case No. 08-13141 (KJC)**
Debtors.	:	**Jointly Administered**
	:	**Related to Docket No.** 7423, 7767

ORDER APPROVING STIPULATION REGARDING USE OF EXAMINER'S REPORT AT THE CONFIRMATION HEARING

Upon the motion (the "Motion"),[2] of the Debtors for entry of an order approving the stipulation regarding use of the Examiner's Report at the Confirmation Hearing; and adequate notice of the Motion having been given as set forth in the Motion; and it appearing that no other

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: Tribune Company (0355); 435 Production Company (8865); 5800 Sunset Productions Inc. (5510); Baltimore Newspaper Networks, Inc. (8258); California Community News Corporation (5306); Candle Holdings Corporation (5626); Channel 20, Inc. (7399); Channel 39, Inc. (5256); Channel 40, Inc. (3844); Chicago Avenue Construction Company (8634); Chicago River Production Company (5434); Chicago Tribune Company (3437); Chicago Tribune Newspapers, Inc. (0439); Chicago Tribune Press Service, Inc. (3167); ChicagoLand Microwave Licensee, Inc. (1579); Chicagoland Publishing Company (3237); Chicagoland Television News, Inc. (1352); Courant Specialty Products, Inc. (9221); Direct Mail Associates, Inc. (6121); Distribution Systems of America, Inc. (3811); Eagle New Media Investments, LLC (6661); Eagle Publishing Investments, LLC (6327); forsalebyowner.com corp. (0219); ForSaleByOwner.com Referral Services, LLC (9205); Fortify Holdings Corporation (5628); Forum Publishing Group, Inc. (2940); Gold Coast Publications, Inc. (5505); GreenCo, Inc. (7416); Heart & Crown Advertising, Inc. (9808); Homeowners Realty, Inc. (1507); Homestead Publishing Co. (4903); Hoy, LLC (8033); Hoy Publications, LLC (2352); InsertCo, Inc. (2663); Internet Foreclosure Service, Inc. (6550); JuliusAir Company, LLC (9479); JuliusAir Company II, LLC; KIAH Inc. (4014); KPLR, Inc. (7943); KSWB Inc. (7035); KTLA Inc. (3404); KWGN Inc. (5347); Los Angeles Times Communications LLC (1324); Los Angeles Times International, Ltd. (6079); Los Angeles Times Newspapers, Inc. (0416); Magic T Music Publishing Company (6522); NBBF, LLC (0893); Neocomm, Inc. (7208); New Mass. Media, Inc. (9553); Newscom Services, Inc. (4817); Newspaper Readers Agency, Inc. (7335); North Michigan Production Company (5466); North Orange Avenue Properties, Inc. (4056); Oak Brook Productions, Inc. (2598); Orlando Sentinel Communications Company (3775); Patuxent Publishing Company (4223); Publishers Forest Products Co. of Washington (4750); Sentinel Communications News Ventures, Inc. (2027); Shepard's Inc. (7931); Signs of Distinction, Inc. (3603); Southern Connecticut Newspapers, Inc. (1455); Star Community Publishing Group, LLC (5612); Stemweb, Inc. (4276); Sun-Sentinel Company (2684); The Baltimore Sun Company (6880); The Daily Press, Inc. (9368); The Hartford Courant Company (3490); The Morning Call, Inc. (7560); The Other Company LLC (5337); Times Mirror Land and Timber Company (7088); Times Mirror Payroll Processing Company, Inc. (4227); Times Mirror Services Company, Inc. (1326); TMLH 2, Inc. (0720); TMLS I, Inc. (0719); TMS Entertainment Guides, Inc. (6325); Tower Distribution Company (9066); Towering T Music Publishing Company (2470); Tribune Broadcast Holdings, Inc. (4438); Tribune Broadcasting Company (2569); Tribune Broadcasting Holdco, LLC (2534); Tribune Broadcasting News Network, Inc., n/k/a Tribune Washington Bureau Inc. (1088); Tribune California Properties, Inc. (1629); Tribune CNLBC, LLC, f/k/a Chicago National League Ball Club, LLC (0347); Tribune Direct Marketing, Inc. (1479); Tribune Entertainment Company (6232); Tribune Entertainment Production Company (5393); Tribune Finance, LLC (2537); Tribune Finance Service Center, Inc. (7844); Tribune License, Inc. (1035); Tribune Los Angeles, Inc. (4522); Tribune Manhattan Newspaper Holdings, Inc. (7279); Tribune Media Net, Inc. (7847); Tribune Media Services, Inc. (1080); Tribune Network Holdings Company (9936); Tribune New York Newspaper Holdings, LLC (7278); Tribune NM, Inc. (9939); Tribune Publishing Company (9720); Tribune Television Company (1634); Tribune Television Holdings, Inc. (1630); Tribune Television New Orleans, Inc. (4055); Tribune Television Northwest, Inc. (2975); ValuMail, Inc. (9512); Virginia Community Shoppers, LLC (4025); Virginia Gazette Companies, LLC (9587); WATL, LLC (7384); WCCT, Inc., f/k/a WTXX Inc. (1268); WCWN LLC (5982); WDCW Broadcasting, Inc. (8300); WGN Continental Broadcasting Company (9530); WLVI Inc. (8074); and WPIX, Inc. (0191). The Debtors' corporate headquarters and the mailing address for each Debtor is 435 North Michigan Avenue, Chicago, Illinois 60611.

[2] Capitalized terms used but not defined herein shall have the meaning ascribed to them in the Motion.

or further notice is necessary; and the Court having jurisdiction to consider the Motion and the relief requested therein pursuant to 28 U.S.C. §§ 157 and 1334; and the Court having determined that consideration of the Motion is a core proceeding pursuant to 28 U.S.C. § 157(b)(2); and the Court having determined that just cause exists for the relief requested in the Motion, and that such relief is in the best interests of the Debtors, their estates, their creditors and the parties in interest; and upon the record in these proceedings; and after due deliberation it is hereby

ORDERED, ADJUDGED AND DECREED THAT:

1. The relief requested in the Motion is GRANTED.

2. The Stipulation, a copy of which is attached hereto as Exhibit 1, is APPROVED.

3. The Court retains jurisdiction with respect to all matters arising from or related to the implementation of this Order.

Dated: February 4, 2011
Wilmington, Delaware

THE HONORABLE KEVIN J. CAREY
CHIEF UNITED STATES BANKRUPTCY JUDGE

EXHIBIT 1
(Stipulation)

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re:	Chapter 11
TRIBUNE COMPANY, et al.,[1]	Case No. 08-13141 (KJC)
Debtors.	Jointly Administered

STIPULATION REGARDING USE OF EXAMINER'S REPORT AT THE CONFIRMATION HEARING

WHEREAS on May 11,2010, the Bankruptcy Court entered the Examiner Approval Order [Docket No. 4320], approving the appointment of Kenneth N. Klee, Esq. as Examiner.

WHEREAS on July 26, 2010, the Examiner issued his Report.

WHEREAS the issue of the use of the Examiner's Report at the Confirmation Hearing was raised in connection with the Court's consideration and approval of the Case Management

[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: Tribune Company (0355); 435 Production Company (8865); 5800 Sunset Productions Inc. (5510); Baltimore Newspaper Networks, Inc. (8258); California Community News Corporation (5306); Candle Holdings Corporation (5626); Channel 20, Inc. (7399); Channel 39, Inc. (5256); Channel 40, Inc. (3844); Chicago Avenue Construction Company (8634); Chicago River Production Company (5434); Chicago Tribune Company (3437); Chicago Tribune Newspapers, Inc. (0439); Chicago Tribune Press Service, Inc. (3167); ChicagoLand Microwave Licensee, Inc. (1579); Chicagoland Publishing Company (3237); Chicagoland Television News, Inc. (1352); Courant Specialty Products, Inc. (9221); Direct Mail Associates, Inc. (6121); Distribution Systems of America, Inc. (3811); Eagle New Media Investments, LLC (6661); Eagle Publishing Investments, LLC (6327); forsalebyowner.com corp. (0219); ForSaleByOwner.com Referral Services, LLC (9205); Fortify Holdings Corporation (5628); Forum Publishing Group, Inc. (2940); Gold Coast Publications, Inc. (5505); GreenCo, Inc. (7416); Heart & Crown Advertising, Inc. (9808); Homeowners Realty, Inc. (1507); Homestead Publishing Co. (4903); Hoy, LLC (8033); Hoy Publications, LLC (2352); InsertCo, Inc. (2663); Internet Foreclosure Service, Inc. (6550); JuliusAir Company, LLC (9479); JuliusAir Company II, LLC; KIAH Inc. (4014); KPLR, Inc. (7943); KSWB Inc. (7035); KTLA Inc. (3404); KWGN Inc. (5347); Los Angeles Times Communications LLC (1324); Los Angeles Times International, Ltd. (6079); Los Angeles Times Newspapers, Inc. (0416); Magic T Music Publishing Company (6522); NBBF, LLC (0893); Neocomm, Inc. (7208); New Mass. Media, Inc. (9553); Newscom Services, Inc. (4817); Newspaper Readers Agency, Inc. (7335); North Michigan Production Company (5466); North Orange Avenue Properties, Inc. (4056); Oak Brook Productions, Inc. (2598); Orlando Sentinel Communications Company (3775); Patuxent Publishing Company (4223); Publishers Forest Products Co. of Washington (4750); Sentinel Communications News Ventures, Inc. (2027); Shepard's Inc. (7931); Signs of Distinction, Inc. (3603); Southern Connecticut Newspapers, Inc. (1455); Star Community Publishing Group, LLC (5612); Stemweb, Inc. (4276); Sun-Sentinel Company (2684); The Baltimore Sun Company (6880); The Daily Press, Inc. (9368); The Hartford Courant Company (3490); The Morning Call, Inc. (7560); The Other Company LLC (5337); Times Mirror Land and Timber Company (7088); Times Mirror Payroll Processing Company, Inc. (4227); Times Mirror Services Company, Inc. (1326); TMLH 2, Inc. (0720); TMLS I, Inc. (0719); TMS Entertainment Guides, Inc. (6325); Tower Distribution Company (9066); Towering T Music Publishing Company (2470); Tribune Broadcast Holdings, Inc. (4438); Tribune Broadcasting Company (2569); Tribune Broadcasting Holdco, LLC (2534); Tribune Broadcasting News Network, Inc., n/k/a Tribune Washington Bureau Inc. (1088); Tribune California Properties, Inc. (1629); Tribune CNLBC, LLC, f/k/a Chicago National League Ball Club, LLC (0347); Tribune Direct Marketing, Inc. (1479); Tribune Entertainment Company (6232); Tribune Entertainment Production Company (5393); Tribune Finance, LLC (2537); Tribune Finance Service Center, Inc. (7844); Tribune License, Inc. (1035); Tribune Los Angeles, Inc. (4522); Tribune Manhattan Newspaper Holdings, Inc. (7279); Tribune Media Net, Inc. (7847); Tribune Media Services, Inc. (1080); Tribune Network Holdings Company (9936); Tribune New York Newspaper Holdings, LLC (7278); Tribune NM, Inc. (9939); Tribune Publishing Company (9720); Tribune Television Company (1634); Tribune Television Holdings, Inc. (1630); Tribune Television New Orleans, Inc. (4055); Tribune Television Northwest, Inc. (2975); ValuMail, Inc. (9512); Virginia Community Shoppers, LLC (4025); Virginia Gazette Companies, LLC (9587); WATL, LLC (7384); WCCT, Inc., f/k/a WTXX Inc. (1268); WCWN LLC (5982); WDCW Broadcasting, Inc. (8300); WGN Continental Broadcasting Company (9530); WLVI Inc. (8074); and WPIX, Inc. (0191). The Debtors' corporate headquarters and the mailing address for each Debtor is 435 North Michigan Avenue, Chicago, Illinois 60611.

Order [Docket No. 7235] and the Plan Proponent Groups at that time sought additional time to consider the issue.

WHEREAS the Plan Proponent Groups have had an opportunity to engage in such discussions and each of the Plan Proponent Groups agree that the Examiner's Report should be available for use at the Confirmation Hearing and there is agreement as to the terms by which such use should be permitted.

NOW THEREFORE IT IS HEREBY STIPULATED AND AGREED by the undersigned that the Examiner's Report should be available for use in connection with the Confirmation Hearing as follows:

1. The opinions expressed by the Examiner (the "Examiner's Opinions") regarding the law and/or the facts will be admissible by any entity in connection with the Confirmation Hearing for all purposes to the same extent as the opinions testified to by an expert witness under the Federal Rules. The Examiner's Opinions will not be binding on the Court or any entity, nor will there be any presumption of correctness attributed to such opinions. The Court may accord the Examiner's Opinions whatever weight the Court deems is appropriate. All entities will have an opportunity to state and describe their agreement or disagreement with any of the Examiner's Opinions in their confirmation briefs in connection with the Confirmation Hearing, and to submit appropriate evidence and/or expert testimony in support of their positions during the Confirmation Hearing. For purposes of this Paragraph 1, Volume II of the Examiner's Report and pages 1 through 42 of Volume I of the Examiner's Report shall be considered the Examiner's Opinions.

2. Statements of Historical Facts (as defined below) contained in pages 43 through 671 of Volume I of the Examiner's Report will be admissible for all purposes, including the truth of the matter asserted and will be presumed to be correct, unless disputed. Any entity may

dispute such statements, in accordance with Paragraph 3 below, and submit evidence in support of its position during the Confirmation Hearing.

a. For purposes of this paragraph, the term "Statements of Historical Facts" means facts which are capable of being verified by reference to documents or deposition or interview testimony cited by the Examiner. For the avoidance of doubt, and consistent with Paragraph 4 *infra*, any statements cited or quoted by the Examiner that are contained in analyst reports, rating agency reports, newspaper articles, emails, other documents, or deposition or interview testimony shall be admissible to show that such statements were made, but shall not be admissible for the underlying truth of such statements, solely as a result of this Stipulation.

b. Notwithstanding anything in paragraph 2a above, Statements of Historical Facts do not include statements constituting or embodying (i) inferences, characterizations or assessments concerning an individual's state of mind or credibility; (ii) conclusions of law; or (iii) applications of law to fact. Such statements shall be considered Examiner's Opinions and treated in accordance with Paragraph 1.

3. On January 10, 2011, the Debtors, on behalf of the Debtor/Committee/Lender Plan Proponent Group shall serve on all entities entitled to notice pursuant to paragraph 35 of the Discovery and Scheduling Order for Plan Confirmation (the "Requesting Parties"),a copy of Volume I designating: (a) in yellow marker all Statements of Historical Facts which the Debtor/Committee/Lender Plan Proponent Group does not dispute, and (b) in blue marker all Statements of Historical Facts which the Debtor/Committee/Lender Plan Proponent Group does

dispute. Those portions of the Examiner's Report that the Debtor/Committee/Lender Plan Proponent Group deems not to be Statements of Historical Fact but instead to be Examiner's Opinions should not be highlighted. On January 21, 2011, the Noteholder Plan Proponent Group, the Bridge Proponent Group, and any other Requesting Parties who wish to participate in this designation process shall serve on the other parties a copy of Volume I that is annotated to reflect any areas of disagreement with the designations of the Debtor/Committee/Lender Plan Proponent Group. Thereafter, the Plan Proponent Groups and any other Requesting Parties who wish to participate in this designation process shall meet and confer to discuss any areas of disagreement. To the extent (i) there is disagreement among the Requesting Parties regarding whether portions of the Examiner's Report constitute Statements of Historical Fact or Examiner's Opinions following these discussion and (ii) such portions become material to an issue in dispute at the Confirmation Hearing, the Court shall determine whether such portions shall be deemed Statements of Historical Fact or Examiner's Opinions. By indicating that it does not dispute particular Statements of Historical Facts, an entity does not waive any arguments concerning the relevance of those facts, the weight to be accorded to those facts, or the completeness of those facts. (For example, by not disputing that a document includes a particular statement, a party does not waive any argument that the same document includes other statements.) Additionally, all entities reserve the right to submit amended designations to the extent such amendments are (i) based on newly discovered evidence produced during the course of discovery; or (ii) intended to correct any errors in the original designation process.

4. The documents and transcripts relied upon by the Examiner will be deemed authentic. Subject to any further stipulations or orders of the Court, all other objections to the introduction into evidence or use of those documents and transcripts are preserved.

5. This stipulation shall apply only to the Confirmation Hearing. To the extent there are further proceedings with regard to the LBO-Related Causes of Action, all entities' rights regarding the admissibility of any part of the Examiner's Report are reserved.

Dated: January_, 2011

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