



AMERICAN
BANKRUPTCY
INSTITUTE

2020 Rocky Mountain Bankruptcy Conference

Make Your Assets Count! Vote for a Great Expert and Get Them Qualified with the Court

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U.S. Bankruptcy Court (D. Colo.); Denver

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Credibility of Expert Report and Qualification of the Expert

I. The Role of The Market

- In the valuation of a particular asset or business, fair market value usually applies. Fair market value is “[t]he price at which property would change hands between a willing buyer and a willing seller, when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of relevant facts.”¹ The valuation is typically based upon market, economic, financial and other conditions as they existed and could be evaluated as of the measurement date, which is case specific.
- As Judge Christopher Sontchi of the U.S. Bankruptcy Court for the District of Delaware has noted, “the easiest and most accurate way to determine the amount of money for which an asset can be exchanged is to do just that—exchange the asset for money or, put more plainly, sell it. When one does not wish to sell the asset or simply cannot do so it becomes more difficult to determine the asset’s value. Nonetheless, in determining an asset’s value the ultimate goal remains the same—to determine as accurately as possible what the sale price would be.”²
- The most direct method for estimating an asset’s potential sale price in the current market is to consult the contemporaneous market price for that asset. Court decisions in *Campbell Soup*³ and *Iridium*⁴ held that contemporaneous market evidence, rather than discounted cash flow or other after-the-fact valuation analyses created for litigation, should generally be relied on to value corporations and businesses.
- The fair market value standard can assist the trier of fact in ascertaining the value as of measurement date, as the valuation keeps the perspective of a hypothetical willing buyer and not a particular buyer. The *Iridium* Court explained that “[t]he ‘market’ in this definition can be thought of as all the potential buyers and sellers of like businesses, business interests, or property. The definition also assumes that the property will be exposed to the market for a reasonable period of time. What constitutes a reasonable period of time depends on the type of property and market conditions. In legal interpretations of fair market value, the willing buyer and willing seller are hypothetical persons dealing at arm’s length, rather than any ‘particular’ buyer or seller. In other words, a price would not be considered representative of fair market value if influenced by special motivations not characteristic of a typical buyer or seller.”⁵
- There are two challenges to relying on a direct market approach. First, many valuation assessments are for a date certain in the past, and the contemporaneous market is not accessible. Second, not all assets can be readily bought and sold in the market.
- When a market price is not available, three standard business valuation methodologies are commonly employed to determine an enterprise value: the Income Approach, the Precedent Transactions Method and the Guideline Public Company Method.⁶
- Income Approach - Discounted Cash Flow (“DCF”) Method determines an indicated value of a subject business as the present value (“PV”) of expected future cash flows to all of its sources of capital, both debt and equity on an unlevered basis. The cash flow projections reflect the reasonable expectations as of the measurement date. Additionally, the discount rate reflects market expectation of risk and return on the subject or like businesses.
- The Market Approach often involves deployment of two methods. The first, Precedent Transactions Method, estimates the value of the subject business based on the price a

¹ Internal Revenue Service, Revenue Ruling 59-60

² “Valuation Methodologies: A Judge’s View”, Hon. Christopher S. Sontchi [WHERE IS THIS FOUND?]

³ VFB LLC v. Campbell Soup Co., 482 F.3d 624 (3d Cir. 2007)

⁴ In re Iridium Operating LLC, 373 B.R. 283 (Bankr. S.D.N.Y. 2007)

⁵ Defining Standards of Value, Shannon P. Pratt, FASA, Valuation, vol. 34, no 2 (June 1989)

⁶ Valuing a Business (Fifth Edition) Shannon P. Pratt (2007)

prospective buyer would pay to acquire a company similar to the business. The approach is to develop a multiple of earnings based on those implied by the prices paid for a selected group of comparable companies in recent acquisitions, which are applied to the operating data of the subject business.

- The second common method that is an aspect of the Market Approach is the Guideline Public Company Method, which entails estimating the value of a business by comparing it to the market value of selected reasonably similar publicly traded companies ("Guideline Companies"). Valuation multiples, typically of revenue and EBITDA, are derived from the operating data of Guideline Companies. Appropriate multiples are applied to the operating data of the subject business to estimate an indication of value.
- Financial projections are an essential aspect of each of these both the Income Approach and the Market Approach. Projections be drawn from estimates contemporaneously prepared with the measurement date by either management, a buyer, or another party assessing the business (e.g., a lender). Those projections must, however, be reasonable.

II. Applicable Professional Guidance and Affiliation

Many times valuation experts are accountants or hold accounting certifications. In those instances, the American Institute of Certified Public Accountants' (AICPA) Code of Professional Conduct (AICPA Code of Professional Conduct) governs all services rendered by Certified Public Accountants (CPAs) who are AICPA members. Certain sections of the AICPA Code of Professional Conduct have particular applicability to the practice of litigation support services. AICPA members and their employees are required, at a minimum, to adhere to the Statement on Standards for Consulting Services Section 100, *Definitions and Standards* (CS Section 100) when performing litigation support services. CS Section 100 specifically subjects litigation support engagements to Rules 1.300.001, 1.310.001, and 1.100.001 of the AICPA Code of Professional Conduct.

In other instances, valuation experts may be subject to and must comply with the Professional Standards set forth by the National Association of Certified Valuators and Analysts (NACVA).

A. CS Section 100: Standards for Consulting Services

CS Section 100 establishes and defines certain terms and types of services applicable to AICPA members holding themselves out as CPAs when providing consulting services. Specifically, CS Section 100 defines the "Consulting Services Practitioner," the "Consulting Process," and "Consulting Services."⁷ CS Section 100 also defines certain services that qualify as consulting services for purposes of the standard, including "consultations," "advisory" services, "implementation" services, "transaction" services, "staff" and other support services, and "product" services.⁸ Litigation services, including the preparation of expert reports, are classified as transaction services by the AICPA, or services in which the practitioner's function is to provide assistance related to a specific client transaction, generally with a third party.⁹

B. Rule 1.300.001: Accepting and Performing the Engagement

CS Section 100 requires practitioners engaged in litigation support services to comply with the "general standards" of the accounting profession as promulgated by AICPA Rule 1.300.001.¹⁰ Rule 1.300.001 requires that practitioners possess professional competence, exercise due professional care in the performance of their work, adequately plan and supervise the performance of staff, and obtain sufficient

⁷ *Statement on Standards for Consulting Services Section 100*, Am. Inst. of CPAs, available at www.aicpa.org/InterestAreas/ForensicAndValuation/Resources/Standards/Pages/default.aspx.

⁸ *Id.*

⁹ *Id.*

¹⁰ Practitioners must also comply with relevant standards established by the state boards of accountancy or other licensing agencies and other professional organizations to which the practitioner belongs. *Id.*

relevant data to afford a reasonable basis for conclusions reached.¹¹ The expert report, in turn, should also contain relevant information supporting compliance with these standards.

1. Examine Qualifications Before Accepting Engagement

Practitioners should carefully consider their compliance with standards relating to professional competence prior to accepting an expert witness engagement, as it is likely that the practitioner's qualifications as an expert will be examined and possibly challenged by opposing counsel. Therefore, it is imperative that practitioners accept expert witness engagements only in cases where their professional experience is appropriate and commensurate with the case-specific facts and circumstances, and they are able to defend their qualifications if necessary. Generally, broad-based accounting, auditing, economic, financial and forensic qualifications can serve as the foundation for expert witnesses' qualifications and experience. In other instances, unique industry experience, prior work experience, or specialized skills may be required to qualify a practitioner as an expert witness. The legal requirements related to providing expert testimony are detailed later in this chapter.

2. Exercise Due Professional Care and Planning

Practitioners are required to exercise due professional care in the performance of their work. Due professional care requires practitioners to exercise diligence and critically analyze all work performed.¹² When serving as an expert witness, the work of the practitioner will likely be scrutinized to determine its reliability and relevance for use by the trier of fact. Therefore, practitioners should carefully evaluate all principles, methodologies, facts and assumptions used in the economic computations and analyses performed. To exercise due professional care, practitioners must properly plan their work, supervise the performance of staff working under their direction, and obtain sufficient relevant data to provide a reasonable basis for any findings, observations, opinions, conclusions and recommendations.

Proper planning guides the practitioner's conduct, supervision, control and completion of an engagement. The litigation process is dynamic, and changes to work product and reports are generally not documented for discovery reasons. As such, proper supervision is critical in ensuring quality performance. The level of supervision will vary depending on the number of staff, their experience and qualifications, and the complexity of the engagement; ultimately, the practitioner is responsible for the work performed.¹³

3. Obtain Sufficient Relevant Data

The practitioner is required to obtain sufficient relevant data to provide a reasonable basis for any findings, observations, opinions, conclusions and recommendations. *Sufficiency* is a measure of the quality and quantity of the relevant data obtained by the practitioner, as well as its admissibility under applicable rules of evidence.¹⁴ *Relevance* implies that the data used by the practitioner can reasonably be linked with specificity to case facts.¹⁵ *Data* refers to the evidence produced during the discovery process, the nature and extent of which may vary.¹⁶

The practitioner is required to maintain adequate documentation of the procedures applied, the information obtained and the conclusions reached. Such documentation may include results of research,

¹¹ Code of Professional Conduct Rule 1.300.010 — Competence, Am. Inst. of CPAs, available at www.aicpa.org/Research/Standards/CodeofConduct/DownloadableDocuments/2014December15CodeOfProfessionalConduct.pdf, at 104.

¹² "The practitioners' general standards require you to exercise due professional care in the performance of professional services. Due care requires diligence and critical analysis of all work performed:" *Practice Aid: Forensic & Valuation Services*, Am. Inst. of CPAs, 2014, at 41.

¹³ *Id.* at No. 13, at 8.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

analyses and work paper documentation (including emails, memos to file, spreadsheets and correspondence). While the determination of what documentation to retain is a matter of professional judgment, all documentation fundamental to the practitioner's conclusions and judgments and on which he or she relied in reaching the opinions offered should be retained.¹⁷

C. Rule 1.310.001 and 2.310.001: Relationship with the Client

Rule 1.310.001 of the AICPA Code of Professional Conduct addresses the distinctive nature of consulting services and how agreements with the client may establish valid limitations on the practitioner's performance of services. Rules 1.310.001 and 2.310.001 requires the practitioner to: (1) serve the client's interests with integrity and objectivity; (2) establish an understanding with the client regarding the responsibilities of the parties and the nature, scope and limitations of services to be performed; and (3) inform the client of any conflicts of interest,¹⁸ reservations concerning the scope or benefits of the engagement, and significant engagement findings or events.¹⁹

Generally, the practitioner's client is an attorney in litigation-support engagements. If the client is the attorney, the practitioner's work may be protected from discovery by opposing parties. In most instances in which the practitioner is hired as a consultant by the attorney, such work will be protected by privilege. However, if the practitioner's client is the attorney's client, the practitioner's work may not be protected by the attorney's work-product privilege.²⁰ If the practitioner is hired as an expert, his or her work will likely be discoverable, regardless of the client.²¹ The extent to which practitioners' work is protected by legal privilege can influence future communications and how work is directed, documented and disclosed; therefore, it is important for the practitioner to obtain direction from counsel to determine if legal privilege will be asserted.

In instances where legal privilege applies, the practitioner should confirm communication and documentation protocols with counsel, and identify all work product "privileged" on its face to assist in identification and protection.²² In the event that a practitioner is retained by an attorney on behalf of a litigant client, and communication between the practitioner and the litigant is minimal or nonexistent, the practitioner may determine that it is appropriate to advise the attorney and the litigant client that any communication with the attorney will be deemed communication with the client. The practitioner may also consider having the litigant co-sign the engagement letter or retention documents with the attorney to ensure that all parties have a clear understanding of the services to be performed and to ensure adherence to the communication requirements set forth in CS Section 100 and Rules 1.310.001 and 2.310.001.²³

D. Rule 1.100.001: Integrity and Objectivity Rule

Rule 1.100.001 addresses integrity and objectivity. The role of a practitioner in an expert witness engagement differs from that of the attorney in the litigation process. Litigation is an adversarial proceeding whereby the plaintiff and defendant present their cases to the trier of fact. While attorneys must advocate

¹⁷ "Finally, the practitioner also may want to consider adopting a formal record retention policy in litigation matters and ensure that the staff are in compliance with the document retention policy or respond appropriately to any subpoenas or agreements between the parties to the litigation." *Practice Aid: Serving as an Expert Witness*, Am. Inst. of CPAs, 2014, at 15.

¹⁸ Statement on Standards for Consulting Services Section 100.

¹⁹ *Id.*

²⁰ *Practice Aid: Serving as an Expert Witness*, Am. Inst. of CPAs, 2014, at 11.

²¹ *Id.*

²² *Id.* at 12.

²³ A practitioner's responsibility to communicate with a client generally extends only to the engaging party; however, this may differ in a bankruptcy or valuation setting, or if the parties have entered into a joint defense agreement. Am. Inst. of CPAs - Forensic and Valuation Services Section.

for their clients, expert witnesses must serve clients with objectivity and free of bias. Practitioners should exercise objective neutrality and avoid advocating the positions of attorneys or their clients.²⁴

The role of the expert witness is to assist the trier of fact with complex or unfamiliar concepts. As such, the expert should not subordinate his judgment to the attorney, the attorney's client, or any other party. To be objective, a practitioner must also be free from conflicts of interest.²⁵ In the event the practitioner has a relationship with another person or entity, or provides a product or service that could be perceived as impairing the practitioner's objectivity, the practitioner should disclose this information and obtain a waiver from the attorney and the attorney's client before proceeding.²⁶

III. NACVA Professional Standards²⁷

The National Association of Certified Valuators and Analysts ("NACVA") provides principles-based standards that were developed to provide guidance to members and other professionals performing valuation services. Although the use of professional judgment is an essential component of estimating value, NACVA members must comply with these standards, which include (i) general and ethical standards; (ii) scope of services; (iii) development standards; and (iv) reporting standards. These standards are summarized below and can be accessed at NACVA's website at <https://www.nacva.com/standards>

- General and ethical standards cover core tenets that govern the provision of valuation services.
 - Must remain objective, maintain professional integrity, and not knowingly misrepresent facts, or subrogate judgment to others and not act in a misleading or fraudulent manner, even when serving the client's interest;
 - Should only accept engagements the member can reasonably expect to complete with a high degree of professional competence either through past knowledge and/or experience or by taking the steps necessary to gain expertise through additional research and/or consultation with other professionals believed to have knowledge and/or experience prior to completion of such engagements;
 - Must exercise due professional care in the performance of services, including completing sufficient research and obtaining adequate documentation;
 - Should establish with the client an understanding of the nature, scope, and limitations of services to be performed and the responsibilities of the parties;
 - Should adequately plan and supervise the performance of services and obtain sufficient relevant data to afford a reasonable basis for conclusions, recommendations, or positions;
 - Should retain documentation for a sufficient time period to comply with legal, regulatory, and professional requirements, which the NACVA recommends for five years; and
 - Shall not express a Conclusion of Value or a Calculated Value without disclosing financial interest.
- Scope of services standards are applicable when a professional is valuing a business, business ownership interest, security, or an intangible asset. A professional may express either a Conclusion of Value or a Calculated Value.

²⁴ "The practitioner needs to maintain his or her independence and objectivity at all times during the engagement and not become the client's advocate." *Practice Aid: Serving as an Expert Witness*, Am. Inst. of CPAs, 2014, at 10.

²⁵ Code of Professional Conduct Rule 1.110.010 — Conflicts of Interest for Members in Public Practice, Am. Inst. Of CPA's

²⁶ *Id.*

²⁷ NACVA website <https://www.nacva.com/standards>

- For a Valuation Engagement, should apply valuation approaches or methods deemed in the member's professional judgment to be appropriate under the circumstances to yield a "Conclusion of Value"; and
- For a Calculation Engagement, should agree to specific valuation approaches, methods, and procedures to yield a "Calculated Value."
- Where NACVA standards differ from published governmental, judicial, accounting, or other authority that specifies valuation development or reporting procedures, should follow the applicable published authority or stated procedures, along with other non-contradictory parts of the NACVA standards, such as performing services in ethical and competent manner, which remain in effect.
- Development Standards govern when a professional is expressing either a Conclusion of Value or a Calculated Value.
 - Value can be expressed as a single number or a range and void of any bias in the development of a Conclusion of Value or a Calculated Value.
 - Any source may be relied on without corroboration if disclosed in the report (*e.g.*, a real estate or equipment appraiser).
 - Valuation methods are commonly categorized into the asset-based, market, income, or a combination of these approaches;
 - Rules of thumb are acceptable as reasonableness checks but should not be used as stand-alone methods;
 - The scope of work necessary is to be defined by identification of the : (1) subject to be valued; (2) interest to be valued; (3) valuation date; (4) purpose and use of the valuation; (5) standard of value; (6) premise of value; (7) intended users; (8) valuation approaches and methods; (9) assumptions, limiting conditions and scope limitations; (10) ownership size, nature, restrictions and agreements; (11) sources of information; and (12) other factors that may influence value; and
 - For a Conclusion of Value, applicable information, including the following, is essential: (1) the nature of the business and the history of the enterprise; (2) the economic outlook in general and the condition and outlook of the specific industry in particular; (3) the adjusted book value of the interest to be valued and the financial condition of the enterprise; (4) the earnings and dividend paying capacity of the enterprise; (5) whether or not the enterprise has goodwill or other intangible value; (6) prior sale of interests in the enterprise being valued; (7) size of interest to be valued and its control, liquidity and marketability characteristics; (8) the market price of interests or enterprises engaged in the same or a similar line of business having interests actively traded in a free and open market; (9) hypothetical conditions appropriate for the circumstances; and (10) other relevant information.
- The Reporting Standards establish minimum reporting criteria and govern both Conclusion of Value and Calculated Value engagements. These standards ensure consistency and quality of valuation reports issued by valuation professionals.
 - The form of a report should be appropriate for the engagement, its purpose, its findings, and the needs of the decision-makers who receive and rely upon it. The report may be written or oral.

- A report expressing a Conclusion of Value may be presented in either a Summary or Detailed Report. A Calculated Value must be presented in a Calculation Report.

A valuation performed for a matter before a court, an arbitrator, a mediator, or other facilitator, or a matter in a governmental or administrative proceeding, is exempt from the reporting provisions of these standards. The reporting exemption applies whether the matter proceeds to trial or settles. This litigation waiver does not, however, relieve the member from complying with the Development Standards and all other standards promulgated by NACVA.

IV. The Rules

An expert witnesses must ensure that their expert reports comply with all applicable legal standards, including the Federal Rules of Evidence (FRE). An expert's failure to comply with applicable legal standards could result in the expert being disqualified or prohibited from testifying. Disqualification may negatively affect the outcome of a client's case, and may limit the expert's ability to testify in future engagements. It is important that experts coordinate with legal counsel to ensure compliance with applicable legal requirements.

The FRE govern the admission of facts in civil and criminal cases in the U.S. federal court system. The FRE are applicable to expert witnesses in federal civil matters. Of specific applicability are the following: Rule 702, *Testimony by Expert Witnesses*; Rule 703, *Bases of an Expert's Opinion Testimony*; Rule 704, *Opinion on Ultimate Issue*; Rule 705, *Disclosing the Facts or Data Underlying an Expert's Opinion* and Rule 706, *Court-Appointed Expert Witnesses*.

A. FRE 702: Testimony by Expert Witnesses

Rule 702 states:

A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if: (a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue; (b) the testimony is based on sufficient facts or data; (c) the testimony is the product of reliable principles and methods; and (d) the expert has reliably applied the principles and methods to the facts of the case.²⁸

Rule 702 permits an expert to testify in non-opinion form, recognizing that an expert may give a comprehensive description of scientific or other principles relevant to a case, leaving the trier of fact to apply them to the case.²⁹ However, in such instances, it is permissible for the expert to take the additional step of suggesting the inference that should be drawn from applying his specialized knowledge to the facts.³⁰ Examples of circumstances where a practitioner may be engaged to provide expert testimony include investigations of suspected fraud, investigations of asserted fraud, or developing fraud-loss estimates, among other roles.

B. FRE 703: Bases of an Expert's Opinion Testimony

Rule 703 states that an "expert may base an opinion on facts or data in a case that the expert has been made aware of or personally observed."³¹ If experts in a particular field would reasonably rely on those kinds of facts or data in forming an opinion on the subject, these facts or data need not be admissible for the opinion to be admitted. But if the facts or data would otherwise be inadmissible, the proponent of

²⁸ Fed. R. Evid. 702.

²⁹ *Id.*

³⁰ *Id.*

³¹ Fed. R. Evid. 703.

the opinion may disclose them to the jury only if their probative value in helping the jury evaluate the opinion substantially outweighs their prejudicial effect.³² Practitioners should confer with legal counsel to understand whether or not such data would be admissible or inadmissible.

Under Rule 703, facts or data supporting expert opinions may be derived from three possible sources: (1) first-hand observations of the expert witness; (2) presentation at trial; and/or (3) presentation of data to the expert outside of court and other than by the expert's own perception. The rule is intended to broaden the basis for expert opinions and to align the judicial practice with the practice of the experts when not in court.³³ For example, a practitioner engaged in a fraud examination (suspected or asserted) can obtain facts and data to support his opinion in a variety of ways, such as public document reviews and background investigations, interviews of knowledgeable persons, use of confidential sources, analysis of physical and electronic evidence, physical and electronic surveillance, performance of undercover operations, and analysis of financial transactions.³⁴

C. FRE 704: Opinion on an Ultimate Issue

Rule 704 states that an opinion is not objectionable just because it embraces an ultimate issue to be decided by the trier of fact.³⁵ For example, the ultimate issue of a fraud examination could be whether or not the individual committed a suspected or alleged fraud. Generally, the rule permits the admission of an expert opinion when such opinion is helpful to the trier of fact.³⁶ However, as an exception to this rule, in criminal cases, an expert witness must not state an opinion about whether the defendant did or did not have a mental state or condition that constitutes an element of the crime charged or of a defense. Those matters are for the trier of fact alone.³⁷

D. FRE 705: Disclosure of Facts or Data Underlying Opinion

Rule 705 provides that unless the court orders otherwise, experts may state an opinion, and give the reasons for that opinion, without first testifying to the underlying facts or data.³⁸ However, experts may be required to disclose those facts or data upon cross-examination.³⁹ Given the broad scope of fraud examinations, physical and electronic evidence can be voluminous. As such, it is important that the practitioner adhere to his firm's work paper production and document-retention guidelines and otherwise document the conduct and final conclusions of the examination contemporaneously to ensure quality control throughout the process. This rule is applicable whether experts base their opinions on data obtained first-hand or furnished to them second-hand. These safeguards are reinforced by the discretionary power of the judge, who may require preliminary disclosure under certain circumstances.⁴⁰

E. FRE 706: Court-Appointed Expert Witnesses

Rule 706 addresses court-appointed expert witnesses, specifically detailing the appointment process, the expert's role and compensation, disclosure of the appointment to the jury, and the parties' choice of their own experts.⁴¹ The court may appoint any expert on which the parties agree and any of its

³² *Id.*

³³ *Id.* States have their own rules of evidence, and it is important to understand the rules applicable to the specific engagement.

³⁴ "You can view these seven investigative techniques as available tools to utilize in an investigation, depending on the unique circumstances. It is helpful to frame the engagement performance steps along with these related techniques: 1. Public document review and background investigation; 2. Interviews of knowledgeable persons; 3. Confidential sources; 4. Laboratory analysis of physical and electronic evidence; 5. Physical surveillance and observation; 6. Undercover operations; 7. Analysis of financial transactions." *Practice Aid: Forensic Accounting — Fraud Investigations*, Am. Inst. of CPAs.

³⁵ Fed. R. Evid. 704.

³⁶ Fed. R. Evid. 702.

³⁷ Fed. R. Evid. 704.

³⁸ Fed. R. Evid. 705.

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ Fed. R. Evid. 706.

own choosing, so long as the expert consents to act. The court must inform the expert of the expert's duties, either orally or in writing. "The expert: (1) must advise the parties of any findings the expert makes; (2) may be deposed by any party; (3) may be called to testify by the court or any party; and (4) may be cross-examined by any party, including the party that called the expert."⁴² The expert is entitled to reasonable compensation, as set by the court. The court may also decide to disclose to the jury that the expert was appointed by the court. This rule does not prohibit a party from calling its own experts.⁴³

V. PRACTICE TIPS FOR RETAINING AND USE OF EXPERTS PRIOR TO TRIAL

A. Issues in the Selection and Retention of an Expert.

1. Does the Expert have any Conflicts?
 - (a) Are they related to and/or consulted with any party in the case?
 - (b) Has the Expert performed work for or against other side (and their counsel) in the past?
 - (c) Has the Expert performed prior work with opposition expert?
 - (d) Has the Expert performed previous work for or against your client?
 - (e) Who is the Expert's Client base: Creditors? Debtors? A mix?
 - (f) Does the expert have a financial stake in the case? Is the Expert a shareholder, investor, officer, director, member or manager of any party in the case?
2. What is the form of the compensation of the Expert?
 - (a) Hourly?
 - (b) Flat Fee?
 - (c) Contingency?
 - (i) Does your jurisdiction even allow an expert's compensation to be on a contingency basis?
 - (ii) If the expert's compensation is based on the results of their opinion? Or the case? This could result in further conflicts.
 - (1) If the Debtor is retaining the expert, whether Court approval of the employment is necessary under 11 U.S.C. §327? If so, whether to seek advance approval of compensation under 11 U.S.C. §330? If Debtor's Counsel is retaining the expert, whether Counsel must make a supplemental fee disclosure under Fed.R.Bankr.P. 2016?
 - (2) Can the client afford the Expert's services?

⁴² *Id.*

⁴³ *Id.*

- (iii) What are the risks to the client if they cannot afford to retain an expert, but must proceed to trial? Counsel should advise the client ***in writing***, of such risks.
 - 3. Whether the Expert possesses the necessary credentials for qualification as an expert without being challenged?
 - (a) What publications has the Expert authored, participated in, or been cited by?
 - (b) What kinds and level of industry experience?
 - (c) Does the Expert have bankruptcy experience or other valuation experience?
 - 4. Whether the Expert is available to provide not only a report, but testify if necessary?
 - 5. Has the Expert been qualified before?
 - (a) Has the Expert been subject to challenges, or disqualification?
 - (b) Whether other courts and/or forums have rejected the Expert's prior opinions?
 - (c) Are there any published decisions on the Expert's prior opinions, qualifications and/or rejections?
 - 6. What, if any, prior trial experience does the Expert have, including deposition testimony?
 - (a) Has the Expert testified before the Court in the pending action previously? If so, what is their track record?
 - (b) Can the Expert testify persuasively and stand up to a rigorous cross-examination?
 - 7. Whether the Expert is the right fit for your case?
 - (a) Does the case require multiple approaches and/or valuations, such as cost-basis, going concern basis, or market analysis?
 - (b) Will the Expert devote sufficient attention to prepare their report, but not overwork the case?
 - 8. Attorneys should consider whether the expert witness selection process is in reality selection bias – whether you are seeking to retain a qualified expert or seeking an expert who will testify favorable to the position you advocate?
- B. Using Multiple Experts during the Case
- 1. Why do you need multiple experts?

- (a) One for Real Estate vs. another for Business Valuation.
- (b) Cost-Benefit of Multiple Experts
- 2. Can each expert rely on the others' work product or opinions for their use?
- 3. What are the risks that the Experts' opinions or methodology might conflict with one another?
- 4. Counsel should provide clear and concise instructions to each expert on the scope of their work. This will require sufficient description in their retention agreements along with management of the progress of the multiple reports.
- 5. What information and documents does each expert require?
 - (a) Can they use a common set of documents?
 - (b) Will each expert require further discovery in the case?
- 6. Is one Expert's report and opinion necessary for the second expert? Can or should the reports be prepared sequentially or contemporaneously?
- 7. Is one Expert a better witness than the other? Would a poor performance by one expert impact the credibility of one or both reports and opinions?

The Expert Report

Expert reports prepared in connection with civil matters in federal court must comply with the Federal Rules of Civil Procedure (FRCP). In particular, Rule 26, *Duty to Disclose; General Provisions Governing Discovery*, addresses the requirements for disclosure, reports and testimony of expert witnesses. It further governs the basis upon which a federal judge can disallow opinions of a lay witness, the determination of whether testimony by expert witnesses meets the minimum standards, and the identification of the basis of opinion testimony by experts, among other requirements.⁴⁴

A. The Purpose of the Expert Report

Expert reports prepared under Rule 26 are an important and useful litigation tool to reduce litigation costs and surprises at trial by requiring full disclosure.⁴⁵ Expert reports provide a means for experts to express their opinions prior to depositions and trial. Attorneys thus have advance notice of the expert's opinions, which facilitates the conduct of more effective and efficient depositions and allows for additional responsive facts and witnesses to be identified as appropriate.⁴⁶ Furthermore, Rule 26 requires advance disclosure of the topics on which an expert plans to testify, thus effectively defining and limiting the scope of the expert's testimony.

B. Who Must Provide an Expert Report

Under Rule 26, not all experts are required to submit expert reports. Only those experts who are "retained or specially employed to provide expert testimony in the case or whose duties as an employee of the party regularly involve giving expert testimony" are required to submit expert reports.⁴⁷ As interpreted,

⁴⁴ Fed. R. Civ. P. 26.

⁴⁵ Fed. R. Civ. P. 26(a)(2).

⁴⁶ *Reed v. Binder*, 165 F.R.D. 424, 429 (D.N.J. 1996).

⁴⁷ Fed. R. Civ. P. 26(a)(2)(B).

this rule requires expert reports from practitioners who are retained by a party to testify in a federal legal proceeding, and allays the necessity of expert reports from employees of a litigation party who qualify as experts but who are not regularly engaged in testifying.⁴⁸ This provision attempts to balance the benefits provided by, and the burden of drafting, an expert report.⁴⁹

C. Elements of the Expert Report

In the event an expert report is mandated, Rule 26(a)(2)(B) sets forth the required elements to be included in the written expert report ("Rule 26 Report"):

1. a complete statement of all opinions the witness will express and the basis and reasons for them;
2. the facts or data considered by the witness in forming them;
3. any exhibits that will be used to summarize or support them;
4. the witness's qualifications, including a list of all publications authored in the previous 10 years;
5. a list of all other cases in which, during the previous 4 years, the witness testified as an expert at trial or by deposition; and
6. a statement of the compensation to be paid for the study and testimony in the case.⁵⁰

Rule 26 requires that Rule 26 Reports be in writing, signed by the expert, and drafted in a manner consistent with the testimony to be given.⁵¹

D. Statement of All Opinions

The first primary requirement of a Rule 26 Report is that the report contains a complete statement of all opinions the witness will express, and the basis and reasons for these opinions.⁵² The expert report is the medium by which expert witnesses communicate opinions. Rule 26 requires that a Rule 26 Report contain all opinions that the expert intends to provide at trial.⁵³ The failure to include an opinion in a report may preclude the expert from expressing such opinion at trial and may subject the expert to a high degree of vulnerability upon cross-examination.⁵⁴ Furthermore, the expert's opinions should be stated clearly and definitively, though the expert should avoid conclusory statements.

In addition to the ultimate opinions offered, a Rule 26 Report must answer the question of how the expert arrived at such conclusions and must provide complete statements of the basis and reasoning for all opinions.⁵⁵ This provides for a more persuasive and credible report, and decreases the susceptibility of the Rule 26 Report to legal challenge. Opinions that lack basis may be found to be legally insufficient and stricken under Rule 26.

⁴⁸ *GSI Group Inc. v. Sukup Mfg. Co.*, 2007 U.S. Dist. LEXIS 18764 (C.D. Ill. Mar. 16, 2007).

⁴⁹ Fed. R. Civ. P. 26(a)(2)(B).

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² Fed. R. Civ. P. 26(a)(2)(B)(i).

⁵³ *Report Writing Manual*, Ass'n of Certified Fraud Exam'rs 44 (2012).

⁵⁴ *Id.*

⁵⁵ *Reed v. Binder*, 165 F.R.D. 424, 428 (D.N.J. 1996).

Rule 26 Reports further assist federal judges in assessing whether a witness's proposed testimony is reliable in determining whether expert testimony should be admitted under the FRE and the standard outlined in *Daubert v. Merrell Dow Pharmaceuticals, Inc.*⁵⁶ The disclosure of opinions, including the basis and reasons therefore, is paramount in light of the U.S. Supreme Court decision in *Daubert*. Under *Daubert*, the court examines the facts on which the witness relies, the methods by which the witness draws conclusions from those facts, and how the witness applies the facts and methods to the case.⁵⁷ The examination of an expert's methods under *Daubert* correlates with the "basis and reasons" requirement of Rule 26. A Rule 26 Report is a critical, arguably *the* most critical, piece of evidence in a *Daubert* hearing.⁵⁸

E. Facts and Data Considered

The second primary required element of a Rule 26 Report is that the expert provides the facts or data "considered" in forming opinions.⁵⁹ Prior to the amendment of Rule 26 in 1993, the expert was to provide the facts or data "relied upon" in forming opinions. Today's expansive scope serves a key purpose in discovery in that "information considered, but not relied upon, can be of great importance in understanding and testing the validity of an expert's opinion."⁶⁰ Experts must cite all tests that support the opinions offered, and must organize, list and describe all documents reviewed in a clear and concise manner.⁶¹ This requirement compels the expert to keep track of all documents reviewed and allows the parties to determine what documents the expert did or did not review and to navigate more easily through the expert's report.⁶²

F. Identification of Exhibits

The third primary required element in a Rule 26 Report is that the report must identify all exhibits the expert intends to use as a summary for, or in support of, opinions presented.⁶³ References to exhibits alone do not satisfy the requirements of Rule 26.⁶⁴ The expert should provide exhibits that are clear and easy to understand and that logically explain the basis or rationale for any calculations presented.⁶⁵ Unclear or confusing exhibits may subject the expert to attack upon cross-examination.⁶⁶ The court may strike an expert's designation and prohibit the expert from testifying for failure to attach exhibits, even if the expert later cures the deficiency in a supplemental report.⁶⁷

G. Expert's Qualifications

The fourth primary requirement of a Rule 26 Report is that the expert report contains a description of the expert's qualifications, including a list of all publications authored by the expert in the previous 10 years.⁶⁸ This requirement bears directly upon whether the expert is qualified and provides a factual basis on which to assess the credibility of the expert. A common approach to fulfill this requirement is to attach the expert's *curriculum vitae* (CV) as an appendix to the report. It is important that the expert's CV is accurately and objectively stated, while ensuring sufficient professional experience in the area about which he or she will testify. A CV lacking the requisite experience may form the basis for a *Daubert* challenge,⁶⁹

⁵⁶ *Daubert v. Merrell Dow Pharm. Inc.*, 509 U.S. 579, 113 S. Ct. 2786 (1993).

⁵⁷ *Heller v. Shaw Indus. Inc.*, 167 F.3d 146, 153 (3d Cir. 1999).

⁵⁸ See, e.g., *Reynolds v. Freightliner LLC*, 2006 U.S. Dist. LEXIS 97244 (E.D. Ky. June 21, 2006).

⁵⁹ Fed. R. Civ. P. 26(a)(2)(B)(ii).

⁶⁰ *Trigon Ins. Co. v. United States*, 204 F.R.D. 277, 282 (E.D. Va. 2001).

⁶¹ Report Writing Manual at 44.

⁶² *Id.* Note that the parties involved in litigation may agree to limit disclosure to documents relied upon. However, it is imperative that the expert understand the level of disclosure required in the specific case.

⁶³ Fed. R. Civ. P. 26(a)(2)(B)(iii).

⁶⁴ *Pierce v. CVS Pharm. Inc.*, 2007 U.S. Dist. LEXIS 69006 (D. Ariz. Sept. 13, 2007).

⁶⁵ Report Writing Manual at 45.

⁶⁶ *Id.*

⁶⁷ *Minebea Co. v. Past*, 231 F.R.D. 3 (D.D.C. 2005).

⁶⁸ Fed. R. Civ. P. 26(a)(2)(B)(iv).

⁶⁹ *Redding Linden Burr Inc. v. King*, 2009 U.S. Dist. LEXIS 8248, at *6-7 (S.D. Tex. Feb. 4, 2009).

while courts have found that a CV evincing an expert's expertise or experience on the subject matter may negate a report lacking substance.⁷⁰

Rule 26's requirement that the expert list all publications authored over the previous 10 years is without regard to the relevance to the case at hand. It is important that the expert not be selective in determining which publications to include, as an incomplete list is not compliant with Rule 26.⁷¹ The expert should be knowledgeable about the content of prior publications, as it is likely that they will be the topic of questions by opposing counsel. As such, it is important that the expert's current approaches and methodologies are consistent with prior publications.

H. List of Other Cases

The fifth primary required element of a Rule 26 Report requires the expert to provide a list of all other cases in which the expert has testified as an expert at trial or by deposition in the previous four years.⁷² Similar to the publication requirement in Rule 26(a)(2)(B)(iv), complete disclosure is required regardless of the relevance or relationship to the case at hand.⁷³ This disclosure should include, at a minimum, the names of the courts and administrative agencies, names of the parties, case numbers, and whether the testimony was by deposition or at trial.⁷⁴ As with the publication requirement, the expert should be knowledgeable about his prior testifying experience and consistent in application of approaches and methodologies (or able to differentiate the current case if not).⁷⁵ If the expert has no prior testifying experience, then there is no such information to disclose.⁷⁶

I. Disclosure of Compensation

The last primary required element of a Rule 26 Report requires the expert to disclose compensation received for his review and testimony.⁷⁷ Compensation information and disclosure allows for the identification of potential bias and prejudice by opposing counsel; however, courts may limit the extent of inquiries on this subject matter where appropriate.⁷⁸ The expert should provide his customary billing rate and the billing rates of the staff assigned to the engagement, or other billing arrangements, and should be prepared if asked in discovery to provide the total amount billed on the engagement.⁷⁹ Courts may disqualify an expert for failing to disclose compensation information.⁸⁰

J. Assistance of Counsel in Preparing Expert Report

Court interpretations differ as to the amount of assistance counsel can lend to an expert witness when drafting an expert report. While Rule 26 does not explicitly prohibit counsel from providing assistance to experts in the preparation of the report, the expert witness should ensure that this assistance does not alter the substance of the expert's opinions.⁸¹ The expert witness should be cognizant that the amount of assistance provided by counsel will likely be a topic of cross-examination, and therefore should carefully consider the potential negative implications of allowing counsel to write, alter, dictate or influence the substance of a report in any way.⁸² The preparation and signing requirement of Rule 26, as interpreted, is to ensure that the expert report expresses "what the expert himself has freely authorized and adopted as

⁷⁰ *Meyer v. Christie*, 2009 U.S. Dist. LEXIS 19955 (D. Kan. Mar. 12, 2009).

⁷¹ *Branche v. Zimmer Inc.*, 2008 U.S. Dist. LEXIS 106789 (E.D. Tenn. Aug. 11, 2008).

⁷² Fed. R. Civ. P. 26(a)(2)(B)(v).

⁷³ Report Writing Manual at 45.

⁷⁴ *Nguyen v. IBP Inc.*, 162 F.R.D. 675, 682 (D. Kan. 1995).

⁷⁵ Report Writing Manual at 46.

⁷⁶ *Dunkin' Donuts Inc. v. Patel*, 174 F. Supp. 2d 202, 211 (D.N.J. 2001).

⁷⁷ Fed. R. Civ. P. 26(a)(2)(B)(vi).

⁷⁸ *Cary Oil Co. v. MG Ref. & Mktg.*, 257 F. Supp. 2d 751, 756 (S.D.N.Y. 2003).

⁷⁹ Report Writing Manual, *supra* note 304 at 46.

⁸⁰ *See Am. Gen. Life & Accident Ins. Co. v. Ward*, 530 E Supp. 2d 1306, 1311-12 (N.D. Ga. 2008).

⁸¹ Report Writing Manual at 43.

⁸² *Id.*

his own” as opposed to expressing an opinion “merely for appeasement or because of intimidation or some undue influence by the party who has retained him.”⁸³

K. Techniques for Drafting an Effective Expert Report

An expert’s report is an important document in a legal proceeding that allows the expert to express his opinions to the trier of fact in an efficient, cost-effective manner. As discussed above, Rule 26 requires the expert to disclose a list of all other cases in which the expert has testified at trial or at deposition in the past four years. Accordingly, expert reports will ultimately become a permanent part of the expert’s record. A poorly written expert report could impair an expert’s credibility and jeopardize the case in which he or she was retained to testify. As such, it is important that the expert take the necessary time to carefully draft a powerful, persuasive and effective expert report.

L. Report Structure and Formatting

Expert report formats can vary, and there is no commonly accepted format or structure to which an expert must adhere. Every case, engagement or situation is different, thus requiring the expert witness to tailor his approach on a case-by-case basis. However, the expert should be aware of any client-specific requirements for report format or structure, as this is often the case with governmental investigative bodies.⁸⁴ Also, local court rules may dictate certain formatting requirements. Absent such requirements, the expert may consider the following format:

1. *Cover page:* The cover page should include the name of the court hearing the case, the case number, the parties to the litigation, the name and contact information of the expert (and his employer, if applicable), and the date of the report.
2. *Font and spacing:* Generally, the expert should use no less than a 12 point font. Smaller fonts may be difficult to read, especially when used in tables, graphs, or appendices. Additionally, the expert should consider one and one-half (1½) to two (2) lines of space between lines.
3. *Topic headings and page numbers:* Topic headings allow the reader to navigate through the expert’s report more easily. General topic headings may include the following: background, executive summary, qualifications of expert, documents considered or relied upon, principal opinions or conclusions, approach and methodologies, factual support, conclusions, and others as appropriate for the case. Additionally, the expert should number the pages of the report to allow for easy navigation in the event the expert or counsel must reference a page in his report at deposition or trial.
4. *Concise paragraphs:* The expert should draft short, concise paragraphs that are easy to read and understand. Long, circuitous paragraphs are difficult to read and may not effectively convey the expert’s message. Also, the expert should avoid clichés, legalese, and emotional language.
5. *Visual aids, exhibits and appendices:* The expert should utilize tables and figures with visual aids to present complex or heavily quantitative information. The expert should consider which visual-aid format is most effective for illustrating the information. For example, pie charts are generally more effective for showing proportions, while line graphs are better for showing trends over time. Additionally,

⁸³ *Marek v. Moore*, 171 F.R.D. 298, 302 (D. Kan. 1997).

⁸⁴ Report Writing Manual at 13.

the expert should consider including pertinent information, analyses or documents as exhibits or appendices, particularly those that directly support an expert's opinions or conclusions.

M. Proper Review and Disclosure of Documents Produced

There is a direct correlation between the credibility of an expert's conclusions and the thoroughness of the expert's examination. The thoroughness of the examination is directly related to the documents the expert reviewed. If an expert fails to perform a sufficient review of the documents produced, there is heightened risk that the expert's knowledge regarding material facts of the case will be lacking. Ensuing deficiencies could result in disqualification of the expert and exclusion of the report in its entirety.⁸⁵ Additionally, an expert's credibility may be questioned if the complete population of relevant documentary records in a case is not received and reviewed. As such, it is a best practice for an expert to request and review all pleadings, documents, and relevant information in the case prior to formulating his opinions.⁸⁶

The expert should organize, explicitly list and precisely describe all of the documents, materials and other information reviewed in connection with the examination and preparation of the report. Such efforts allow the expert to (1) ensure that all material received and reviewed has been accounted for; (2) remove any ambiguity about what was or was not reviewed; and (3) consult his report efficiently and testify as to what was, or was not, reviewed.⁸⁷ When preparing a list of the documents reviewed, the expert should be specific. Using words and phrases such as "including," "including, but not limited to," "various" and/or "relevant portions of" in front of a document or list of documents (unless details and explanations are subsequently provided elsewhere) may elicit attempts by opposing counsel to undermine the expert's credibility and argue an intentional omission or laxity.⁸⁸

N. Stating the Expert's Qualifications Accurately and Objectively

As previously described, Rule 26 requires an expert report to contain the expert's qualifications, including a list of all publications authored by the witness in the preceding 10 years. Many experts satisfy this requirement by including a copy of their CV. It is imperative that the expert not exaggerate the qualifications included in his CV. As a general rule of thumb, an expert should be familiar with the legal setting of the case, ensure his qualifications are presented accurately and objectively, and be careful not to overstate his knowledge on current authoritative literature applicable to the case at hand.

The expert should understand the legal requirements governing what is required to be included when presenting qualifications. Under the FRCP, an expert who fails to provide a CV as required by applicable discovery rules could bar the admissibility of the expert's testimony and potentially jeopardize the case in its entirety.⁸⁹ The expert should also ensure that all qualifications are completely accurate and objectively presented. Errors or omissions, regardless of intent, could have an adverse effect on the expert's credibility.⁹⁰ Additionally, the expert should avoid using subjective, self-serving statements and characterizations in the CV, as this may cause an expert to be vulnerable upon cross-examination.⁹¹ Lastly, the expert should employ caution when claiming knowledge of the current authoritative literature in his respective field. It is common for opposing counsel to attempt to undermine an expert's credibility by testing the expert's knowledge on current or recent changes to rules or regulations.⁹²

⁸⁵ United Phosphorus Ltd. v. Midland Fumigant Inc., 173 F.R.D. 675 (D. Kan. 1997).

⁸⁶ Steven Babitsky, Esq. & James J. Mangraviti, Jr., Esq., *Writing and Defending Your Expert Report: The Step-by-Step Guide with Models*, SEAK, Inc., 2004, at 59.

⁸⁷ *Id.* at 55.

⁸⁸ *Id.* at 56.

⁸⁹ *Id.* at 65.

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² *Id.*

O. Presenting Factual Assumptions that Serve as a Basis for Opinions

As required by Rule 26, experts must disclose the basis and reasons for the opinions offered. The factual assumptions upon which opinions are formulated are the foundation on which an expert report is built. Factual assumptions should be described in a detailed, specific manner, and cited appropriately. All factual assumptions should be obtained from reliable sources and verified as necessary. Experts should be cautious in relying upon any information that cannot be verified unless explicitly disclaiming such information. Experts should not guess or draw conclusions where verifiable facts are lacking.

When presenting factual assumptions, the expert should precisely describe the documents and information utilized and avoid vague factual assumptions. Such behavior may suggest that the expert failed to understand all the facts, chose not to review all the facts, or intentionally omitted certain facts in preparing the expert report.⁹³ The expert should cite the specific source of the information that gave rise to the factual assumptions included in the report. This practice serves a dual purpose. First, citations imply that a degree of research was performed. Second, citations assist the expert in trial preparations.⁹⁴

The expert should ensure that the documents and information utilized in forming factual assumptions are reliable. This is imperative for an expert report to be persuasive and will likely be an area of focus upon cross-examination.⁹⁵ An expert's opinion that is based upon incorrect factual assumptions is not credible.⁹⁶

The completeness of the documents and information utilized by the expert in forming factual assumptions is of equal importance as the reliability of the documents and information.⁹⁷ If the expert lacks the requisite documentation or information to form a factual assumption, the expert should not attempt to guess or assume to bridge such shortfall. If the expert obtains facts or data provided by another party and utilizes or relies upon such in forming factual assumptions, the expert should attempt to independently verify the source and content of such materials.

P. Formulating Opinions and Conclusions in a Defensible Manner

Experts are retained to express an opinion or opinions, principally through an expert report in anticipation of subsequent testimony. The expert's opinions must be communicated clearly, with confidence, in an effective and defensible manner. Vague opinions, equivocal opinions, or opinions expressed with insufficient certainty may be rejected by the court. The expert's report should contain all the opinions that the expert intends to express at trial, in addition to the basis and methodology supporting each opinion. As described below, conclusory statements and net opinions may be stricken and found legally insufficient under Rule 26.

Experts must state their opinions clearly, explicitly, and with a certain degree of confidence. For an expert to issue an opinion, he or she must believe that it is more likely than not that the opinion is correct (*i.e.*, 51 percent or greater certainty).⁹⁸ An expert's opinions that fail to meet this threshold may be rejected by the court or may be inadmissible in civil cases. There are certain commonly accepted phrases that experts can use to convey 51 percent or greater certainty, such as "based upon a reasonable degree of certainty" or "based upon a reasonable degree of possibility."⁹⁹ Courts have rejected reports where the expert's opinions were expressed vaguely, equivocally or with insufficient certainty. Opinions must be

⁹³ *Id.*

⁹⁴ *Id.* at 74.

⁹⁵ *Id.* at 80.

⁹⁶ *Culley v. Trak Microwave Corp.*, 117 E Supp. 2d 1317 (M.D. Fla. 2000).

⁹⁷ *Babitsky & Mangraviti* at 81.

⁹⁸ *Id.* at 99.

⁹⁹ *Id.*

sufficient to establish cause in fact, which requires proof by a preponderance of the evidence.¹⁰⁰ Vague reports containing indefinite language will not be accepted by the court.¹⁰¹

The expert's report should contain all the opinions that the expert intends to express at trial and the supporting reasons and basis for each, as required under Rule 26. As described above, this is important in determining whether expert testimony should be admitted under the FRE and *Daubert*. In order for an expert report to survive a *Daubert* challenge, the expert must utilize a reliable methodology and clearly state such in the expert report. In assessing whether an expert's testimony should be permitted under *Daubert*, a judge will consider the following: (1) whether the theory or technique used by the expert can be, and has been, tested; (2) whether the theory or technique has been subjected to peer review and publication; (3) the known or potential rate of error of the method used; and (4) the degree of the method's or conclusion's acceptance within the relevant scientific community.¹⁰² Expert reports that merely provide bare conclusions without proper support, referred to in certain jurisdictions as "net opinions," are insufficient to prove an expert's point and are inadmissible under Rule 26 and under the fit requirement of FRE 702.¹⁰³ Additionally, Rule 26 prohibits an expert from providing conclusory statements in lieu of a factual basis.¹⁰⁴ Net opinions and conclusory statements should be avoided when preparing an expert report.

Q. Drafting a Powerful, Persuasive and Understandable Expert Report

There are many techniques an expert can utilize to draft a powerful, persuasive and understandable expert report. Most importantly, experts should be honest and should confine their opinions to their areas of expertise. The below list provides certain techniques an expert may utilize when drafting an expert report.

1. Experts should write for a lay audience. The expert should assume that his audience has little-to-no education in areas covered in the expert report.¹⁰⁵
2. Experts should state things clearly using precise language. Clearly expressed opinions and precise language provide for a more persuasive expert report.¹⁰⁶
3. Experts should limit their use of legal terms. Generally, experts are not attorneys, and the use of legal terminology could be used to undermine the expert's credibility.¹⁰⁷
4. Experts should be careful when using boilerplate language. While this is not uncommon, the expert should be sure to tailor the expert report to the case at hand. Precise language bolsters an expert's credibility.¹⁰⁸
5. Experts should be careful with the use of emphatic language, such as bolding, italicizing, or using exclamation points and capital letters, as this may be misconstrued as a sign of bias.¹⁰⁹

¹⁰⁰ *Perkins v. Entergy Corp.*, 756 So.2d 388 (La. App. 1 Cir. 2000).

¹⁰¹ *Piascyk v. City of New Haven*, 64 F. Supp. 2d 19 (D. Conn. 1999).

¹⁰² Babitsky & Mangraviti at 111.

¹⁰³ *Bank Brussels Lambert v. Credit Lyonnais*, 2000 U.S. Dist. LEXIS 17309 (S.D.N.Y. 2000); *Holman Enterprises v. Fid. & Guar. Ins. Co.*, 563 E Supp. 2d 467, 472 (D.N.J. 2008).

¹⁰⁴ *Ohime v. Foresman*, 186 F.R.D. 507 (N.D. Ind. 1999).

¹⁰⁵ Report Writing Manual at 48.

¹⁰⁶ *Id.* at 49.

¹⁰⁷ *Id.* at 47.

¹⁰⁸ Babitsky & Mangraviti at 137.

¹⁰⁹ *Id.* at 143.

6. Experts should use an active voice and avoid ambiguous sentences. This syntax provides for a clearer, more persuasive expert report.¹¹⁰
7. Experts should utilize confident language and avoid hedge words. The use of hedge words such as “it seems,” “could,” “apparently” and “I believe” could indicate a lack of confidence and result in an expert report being ruled legally insufficient¹¹¹ or in undue cross-examination.¹¹²
8. Experts should utilize objective language and avoid bias. An expert is assumed to be an impartial, disinterested witness. A report that displays bias, lack of impartiality or the selective use of data will likely be discounted, discredited or stricken in its entirety.¹¹³ Furthermore, experts should avoid the use of argumentative language, as this could be interpreted as a form of bias.¹¹⁴
9. Expert reports should be internally and externally consistent. Experts should ensure that their approaches, methodologies and conclusions are consistent across expert witness engagements. Discrepancies within an expert’s reports will likely be identified by opposing counsel and examined by the court, thus casting doubt on the credibility of the expert.¹¹⁵ This becomes more problematic for the expert when opposing counsel can show that the expert is utilizing different legal forums to achieve different results.¹¹⁶ Discrepancies between an expert’s reports will undoubtedly create significant doubt as to the expert’s credibility.¹¹⁷
10. Experts should avoid explicitly or implicitly commenting on the credibility of another witness, as this assessment is the judge’s or jury’s duty. Such actions may portray an attitude of bias and result in a loss of credibility for the expert.¹¹⁸

The above techniques, combined with the other suggestions included within this section, will help ensure that the expert’s report is powerful, persuasive and effective in communicating the expert’s findings and conclusions.

Market Test versus Theoretical Valuations

I. Context of valuation opinions

A. Common Bankruptcy Matters Involving Expert Opinion

- Solvency analysis
- Valuation
- Damages analysis
- Plan feasibility
- Forensic analyses
- Fiduciary standards

¹¹⁰ *Id.* at 144.

¹¹¹ See *Samos Imex Corp. v. Nextel Comm’n Inc.*, 194 F.3d 301 (1st Cir. 1999).

¹¹² Babitsky & Mangraviti at 148.

¹¹³ *Id.* at 165.

¹¹⁴ *Id.* at 149.

¹¹⁵ *Sita v. Danek Med. Inc.*, 43 F. Supp. 2d 245 (E.D.N.Y. 1999).

¹¹⁶ Babitsky & Mangraviti at 163.

¹¹⁷ Report Writing Manual at 50.

¹¹⁸ *Id.* at 49.

B. Less Common Matters Involving Expert Opinion

- Complex fraud precipitates the bankruptcy
- Consulting expert assists counsel to determine whom to sue and for what
- Testifying expert aids the court's understanding of prepetition activity
- Complex cases
- Mass torts
- Specialized or heavily regulated industry
- Problems arise within the bankruptcy
- Motions to convert, dismiss or appoint a trustee
- Allegations of fraud or collusion
- Professional misconduct

Documentary Requirements for the Expert Witness

Documents provide the evidentiary foundation for the expert's opinion.¹¹⁹ For that reason, the foundation of any credible expert report requires a thorough review of the underlying corporate and financial documents.¹²⁰ In fact, the scope of the expert witness's diligence can mean the difference between winning and losing in a valuation dispute.¹²¹

Because the credibility of the expert report relies upon sufficiency of the expert's diligence, the expert should collaborate with the client's advisors to develop a "punch list" of key documents. The scope of the diligence will depend on the valuation scenario: a solvency valuation will rely exclusively on data contemporaneous to the time applicable to the valuation¹²²; whereas a valuation of the reorganized value of a debtor will rely on all available documents pertaining to the company's past, present, and future performance.¹²³ Even then, prior transactions or valuations should be evaluated to insure that the data matches the current facts. In *In re Eastman Kodak Co.*, No. 12-10202 (ALG), 2013 WL 4413300, at *4 (Bankr. S.D.N.Y. Aug. 15, 2013), the expert failed to adjust prior years' annual patent revenue that included "revenue from Kodak's most valuable digital imaging patents that were sold to a consortium of buyers for more than \$500 million."

While many going-concerns will require some form of an income approach to valuation, companies in a rapidly consolidating market may require a comparable transaction approach. Alternatively, an expert may make an argument for using an asset-based approach to valuing companies operating in a declining industry. If two experts disagree on the optimal valuation method, the expert who considered multiple methodologies may appear more credible.¹²⁴

Most expert valuation reports rely upon certain core documents. The expert should review:

1. the company's financial data (including balance sheets and cash flow statements);
2. any information shared with third parties in past solicitation materials (for debt or equity);
3. indicators of the market-value of the company's assets;

¹¹⁹ *Williams v. Illinois*, 132 S. Ct. 2221, 2241 (2012).

¹²⁰ See *In re Lehman Bros. Holdings, Inc.*, 445 B.R. 143, 185 (Bankr. S.D.N.Y. 2011) ("An expert's opinion that is not based on sufficient facts or data nor the product of reliable principles and methods properly applied, should be rejected.") (internal quotations omitted).

¹²¹ See *In re Prudential Ins. Co.*, 962 F. Supp. 572, 583 (D.N.J. 1997) (a non-bankruptcy decision discussing the unreliability of a "best-guess estimate" ("[F]aced with a credible expert report, courts should not hesitate to rely on the conclusions therein. Here, however, Hoyer explicitly warns that his valuations are based on a remediation rate that is, at most, a best-guess estimate.")).

¹²² *In re Eastman Kodak Co.*, 2013 Bankr. LEXIS 3325, at *21-22 (Bankr. S.D.N.Y. 2013)(eschewing past value of brand name post-sale of significant business segments).

¹²³ See *In re Iridium Op. LLC*, 373 B.R. 283, 293 (Bankr. S.D.N.Y. 2007); *In re Breitburn Energy Partners LP*, 582 B.R. 321, 332 (Bankr. S.D.N.Y. 2018).

¹²⁴ See *In re Tribune Co.*, 464 B.R. 126, 151 (Bankr. D. Del. 2011).

4. financial projections;
5. recent comparable transactions; and
6. market-multiples.

If the company is publicly-held, then the expert should aim to review all recent public filings.¹²⁵ An expert may also benefit from reviewing recent debt financings by the company, including any solvency opinions incorporated in those transactions. If the company recently completed a sale of assets, then that transaction may provide a trove of relevant data. Insider transactions in particular have the benefit of often involving several legal and banking opinions. An expert should consider all of the company's recent transactions in the preparation of the valuation report.

To maximize credibility, an expert must minimize errors. This is no easy task, given the complexity of a valuation report. Three avoidable errors commonly doom too many valuation reports. *First*, the expert should review all relevant documents for the valuation report.¹²⁶ *Second*, the expert must not omit damaging information from her diligence for the valuation report. The expert must fight the natural tendency to avoid damaging data. Rather than omitting these documents, the expert should incorporate them into the report and expressly address the merits of the damaging data. *Third*, the expert should seek to limit assumptions. Each assumption included in the valuation report provides an opportunity for the opposing expert to attack the report.¹²⁷ An expert can and should address assumptions through the discovery process.

The discovery process should provide the expert with the documentation necessary for forming a valuation of the company. Whether that discovery is internal or directed towards an opposing party, the expert should collaborate with the client's legal and financial advisors to create the "punch list" of key diligence documents. Rule 2004 of the Federal Rules of Bankruptcy Procedure provides an ideal method for creditors, counterparties, and equity holders to gather financial data from the debtor.

Changes to Rule 26 of the Federal Rule of Civil Procedure allow for the attorney and the expert to communicate without those communications being discoverable. In December 2010, Rule 26 was amended to address the undesirable effects of routine discovery into attorney-expert communications.¹²⁸ Thus, prior case law allowing for discovery of those communications is no longer valid.¹²⁹ However, as stated by the rule, an experts assumptions are discoverable and even after the rule changes, attempting to influence the outcome by selectively providing documents to an expert should result in a flawed opinion or disqualification. In *Faulkner v. Arista Records LLC*, 46 F. Supp. 3d 365, 380 (S.D.N.Y. 2014), plaintiff's counsel provided only a subset of discovered documents aimed at achieving a particular result. "Such analysis is unreliable, and therefore Mr. Coleman's opinion about Arista's records must be excluded. *Faulkner v. Arista Records LLC*, 46 F. Supp. 3d 365, 381 (S.D.N.Y. 2014), citing *E.E.O.C. v. Bloomberg L.P.*, Civ. No. 07-8383(LAP), 2010 WL 3466370, at *14 (S.D.N.Y. Aug. 31, 2010) (exclusion of an expert is required where the expert makes "no effort to ensure that the materials he reviewed were representative"). Thus, counsel should provide full access to discovery databases to avoid the appearance of undue influence. While drafts of expert reports can be exchanged freely, the expert's conclusions must be based on full and unfettered freedom to explore the evidence. This caution should also apply to the expert's assumptions, that, like documentary foundations, are fully discoverable.

¹²⁵ But see, *In re 3dfx Interactive, Inc.*, 389 B.R. 842, 883 (Bankr. N.D. Cal. 2008), subsequently *aff'd sub nom.* *In re 3DFX Interactive, Inc.*, 585 F. App'x 626 (9th Cir. 2014) ("The Court gives no credence to Mr. Wagner's implied market capitalization method.").

¹²⁶ Expert report lacked reliability where the expert did not review data he believed to be unavailable, when the data was, in fact, produced. See *Faulkner v. Arista Records LLC*, 46 F. Supp. 3d 365, 380 (S.D.N.Y. 2014), citing *Lippe v. Bairnco Corp.*, 288 B.R. 678, 694 (S.D.N.Y.2003) *aff'd*, 99 Fed.Appx. 274 (2d Cir.2004); see also *Celebrity Cruises Inc. v. Essef Corp.*, 434 F.Supp.2d 169, 182 (S.D.N.Y.2006) (excluding damages expert who was not aware of availability of "actual performance data" because she "declined to incorporate their actual growth rates into her methodology" once she became aware of data).

¹²⁷ See *In re Cellular Information Systems, Inc.*, 171 B.R. 926, 932 (Bankr. S.D.N.Y. 1994).

¹²⁸ *Sara Lee Corp. v. Kraft Foods Inc.*, 273 F.R.D. 416, 419 (N.D. Ill. 2011)

¹²⁹ E.g. *Reg'l Airport Auth. of Louisville v. LFG, LLC*, 460 F.3d 697, 717 (6th Cir.2006)(under prior Rule, holding privileges waived by disclosure to testifying expert).

Cautionary case law provides many bases to pressure test an expert's conclusions. Under the 2010 revisions, there should be no reason to not expose the expert to a variety of alternative methodologies to prepare the expert for cross examination. Cases bear out the need to thoroughly consider all potential criticisms. Particularly in connection with confirmation hearings, courts reject valuation testimony that defies economic reality. In *In re Websci Techs, Inc.*, 2007 U.S. App. LEXIS 11572, at *13-14 (3rd Cir. 2007), the circuit court affirmed bankruptcy courts' assigning zero value to software that required significant investment to make it marketable.

In the context of considering a chapter 11 trustee's fraudulent conveyance action, the court: found multiple bases to reject a valuation expert. The court (i) rejected the expert's argument that the transaction in question was a sale of a business as opposed to a sale of specific assets; (ii) rejected the chapter 11 trustee's expert's testimony of the value of the business based upon the buyer's analysis of the value of the transaction to the buyer, the decrease in the stock price of the seller after the transaction was announced, and an unsupported value of each engineer hired by the buyer; and (iii) found that the purchase price paid was the best indication of the value of the assets acquired. *Brandt v. nVidia Corp. (In re 3DFX Interactive, Inc.)*, 389 B.R. 842 (Bankr. N.D. Cal. 2008). Again, the expert's conclusions ignored the contemporaneous data that the debtor's business had been extensively marketed and only one buyer emerged. After several years of negative earnings, the expert chose to rely on irregular market indicators. In particular, the expert resorted to valuing the debtor's **engineers at approximately \$2 million each**.

Similarly, in *Holber v. M&T Bank (In re Scheffler)*, 471 B.R. 464, 478-83 (Bankr. E.D. Pa. 2012), the expert's testimony ignored the fact that the debtor's product only sold at a loss. "No matter how many Stackers SAS sold, it had historically enjoyed and would in the future enjoy no profit. Payroll, travel, administration, insurance, utilities, and other hard and soft operating costs and expenses could not be paid from the revenue generated by sales. Another opinion criticizing the failure to consider costs arose in *In re Bicoastal Corp.*, 164 B.R. 1009, 1017-18 (Bankr. M.D. Fla. 1993). There the bankruptcy court noted that in valuing a compromise of a royalty claim, the expert did not take into consideration the risks or costs of litigation in either the appeals or future collection of the royalty payments.

Other courts balk at valuing assets at zero dollars merely because no money exists within the bankruptcy estate to deploy the asset effectively. *In re Surfango, Inc.*, No. 09-30972 (RTL), 2009 WL 5184221, at *10 (Bankr. D.N.J. Dec. 18, 2009) (rejecting the argument that patents only have value to the Debtor in the context of a going concern. The *Surfango* court denied confirmation of a plan that arrogated the intellectual property to the debtor at zero dollar valuation.

Multiple cases highlight the importance of providing full access to discovery to the expert, not dictating assumptions to the expert, and pressure-testing the expert's conclusions to insure that key information is not being ignored or can be explained effectively.

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