Where's My Expert? Deposing, Qualifying and Examining a Financial Expert Witness Regarding Opinions on Solvency, Reasonably Equivalent Value and Plan Feasibility

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As a bankruptcy lawyer, you may ask your Financial Advisor ("FA") to step out of the role as a consultant to a debtor or a committee in a bankruptcy case and into the role of testifying expert witness. This raises questions about what communications have occurred with counsel and client throughout the course of a bankruptcy case are consider privileged and what is discoverable by the objecting parties. Moreover, while many FAs have extensive experience working in the restructuring area, they may have little or no experience acting as an expert. What should you advise your FA to expect when testifying before a bankruptcy court? What are your FA's responsibilities and what potential problems can your FA expect to encounter? We hope this program will provide you with some basic information that you will find helpful as you guide your FA through his or her role as an expert witness.

I. Financial Expert Witnesses in Bankruptcy Litigation – Process Overview

- A. What do I need the testifying expert to do?
- B. Identifying, interviewing, and engaging the testifying expert. Areas to inquire about - conflicts, prior experience, qualifications, reputation, etc.
- C. Working with your testifying expert – getting the information she needs to develop her opinion; best practices for asking questions, communicating with testifying expert, comments and revisions; using a consulting expert; developing assumptions and the report itself; filing; preservation of source materials
- D. Qualifying an Expert
- E. Expert discovery
  - 1. Your expert
    - a. Preparing your expert for written discovery that seeks communications with counsel, internal emails, drafts, prior testimony, etc.
    - b. Preparing your expert to be deposed
  - 2. Taking discovery of opposing expert

F. Experts at trial

1. Your expert

a. Qualifying the expert

b. Presenting direct testimony/opinion

c. Redirect/rehabilitating your expert after cross-examination

2. Opposing expert

a. Voir dire

b. Cross-examination

II. FA as Expert Witness

A. Summarized Federal Rules of Evidence Relating to Expert Witness[1]

1. **701 Lay Opinion**: If the witness is not an expert, opinion is admissible only if it is 1) rationally based on perceptions and 2) helpful to the trier of fact.

2. **702 Testimony by Experts**: Expert opinions may be admissible if 1) the testimony assists the trier of fact and 2) the witness is qualified as an expert.

3. **703 Bases of Opinion Testimony by Experts**: Expert opinions may be based on facts or data 1) actually seen or heard by the experts or 2) communicated at or before the hearing to the experts. Admissibility of the facts or data relied upon is not essential if typically relied upon in this field.

4. **704 Opinion on Ultimate Issue**: Experts may express opinions that address ultimate issues of fact.

5. **705 Disclosure of Facts or Data Underlying Expert Opinion**: Experts need not provide facts supporting the reason for their opinions unless 1) the court so requires or 2) asked on cross examination.

6. **706 Court Appointed Experts**: The court 1) may issue an order to show cause why experts should not be appointed, 2) may request nominations of experts by parties, and 3) may appoint experts whether or not the parties

[1] This summary is drawn heavily on "Qualifying the Expert Witness: A Practical Voir Dire," http://www.chm.uri.edu/forensics/courses/Appendix%20%20forensic%20science%20&%20expert%20witness/Voir%20Dire.pdf, which had been reprinted therein with permission from Forensic Magazine, Feb/Mar 2007.

agree to the experts, if the experts consent. Appointed experts shall be informed of their duties in writing (copies of which are filed with the court). The experts shall communicate their findings to the parties and 1) may be deposed, 2) may be called to testify, 3) may be cross examined, and 4) shall be paid as the court directs. This rule does not limit parties from calling other experts.

B. Qualifying the Expert Witness

1. Rule 702. Testimony by Expert Witnesses. 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; it is not necessary that the witness possess all five so long as he possess one. *Cooper v. Laboratory Corp. of America Holdings, Inc.*, 150 F.3d 376, 380 (4th Cir. 1998); the Court is to construe broadly the five bases upon which an expert can be qualified. *In re Young Broad. Inc*., 430 B.R. 99, 122 (Bankr. S.D.N.Y. 2010).

   b. the testimony is based on sufficient facts or data; quantitative rather than a qualitative analysis. Fed.R.Evid. 702 advisory committee's note; can rely on facts or data that are inadmissible under other rules of evidence, so long as the fact or data is of a kind reasonably relied upon by expert's in the field.

   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.

2. The proponent of any expert testimony must establish its admissibility by a preponderance of the evidence. *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 592 n.10 (1993).

3. "Rule 702's 'helpfulness' standard requires a valid scientific connection to the pertinent inquiry as a precondition to admissibility." *Daubert* 509 U.S. at 591-92. *See Carroll v. Otis Elevator Co.*, 896 F.2d 210, 212 (7th Cir. 1990) ("Whether a witness is qualified as an expert can only be determined by comparing the area in which the witness has superior knowledge, skill, expertise, or education with the subject matter of the witness's testimony."); *see also In re WorldCom, Inc.*, 371 B.R. 33, 42 (Bankr. S.D.N.Y. 2007) (court denied admissibility of an expert because "[t]here is no nexus between his credentials and the subject matter of his testimony.") and *In re Citadel Broad. Corp.*, No. 09-17442-BRL, 2010 Bankr. LEXIS 1606 (Bankr. S.D.N.Y. May 19, 2010) (court denied

admissibility of an expert because there was no nexus between expert's background and the valuation of a radio broadcasting company).

4. Expert witness testimony is much broader than a fact witness. A judge must rule on expert qualifications before an expert witness testifies. The lawyer must prove that the expert has the training, education, experience, or background that qualifies the expert to offer specialized opinion testimony. Witnesses need not have graduate degrees or come from Ivy League backgrounds. Extensive experience with computers may goes farther to qualifying someone as an expert on computers than someone who has a Ph.D. degree in technology.

    a. *In re Aphton Corp.*, 423 B.R. 76, 89 (Bankr. D. Del. 2010) (expert admitted to testify on valuation); *In re Am. Classic Voyages Co.*, 367 B.R. 500 (Bankr. D. Del. 2007) (same); *In re Flintkote Co.*, 486 B.R. 99, 143 (expert testimony admitted for plan feasibility); *In re W.R. Grace & Co.*, 475 B.R. 34, 114 (D. Del. 2012), aff'd (July 24, 2013) (same); *In re Fed.-Mogul Global, Inc.*, 330 B.R. 133, 164 (D. Del. 2005) (relying on expert testimony applying discount rate); *In re Zenith Electronics Corp.*, 241 B.R. 92, 104 (Bankr. D. Del. 1999) (accepting discount rate supplied by expert testimony).

5. Courts may also consider the *Daubert* factors:

    a. Whether the theory or technique applied by the expert can be/has been tested;

    b. Whether the theory or technique has been subject to peer review or publication;

    c. The known or potential rate of error for the technique or theory, and the existence and maintenance of controlling standards; and

    d. Acceptance of the technique or theory in the relevant area of expertise.

6. The *Daubert* factors are not exclusive. *See Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137, 151 (1999). While courts are given discretion to determine the reliability of an expert's testimony, "[t]he polestar, however, must always be 'scientific validity - and thus the evidentiary relevance and reliability - of the principles that underlie a proposed submission.'" *Jaurequi v. Carter Mfg. Co., Inc.*, 173 F.3d 1076, 1082 (8th Cir. 1999) (quoting *Daubert*, 509 U.S. at 594-95)). Challenges to an expert are also based on the *Daubert* factors. *See* Plenary Session: Selecting and Qualifying an Expert: Not Just Anyone Will Do, 041207 ABI-CLE 559.

7. Statistics on *Daubert* Challenges

   a. In the first 6 months of 2014, there were 103 Daubert challenges to financial expert testimony. Of the experts challenged, 42% had their testimony at least partially excluded.

   b. In the Third Circuit, 43% of challenged testimony was excluded or partially excluded.

   c. According to a study conducted by PricewaterhouseCoopers in 2011, of the 6,141 reported *Daubert* decisions from 2000-2010, 45% of the *Daubert* challenges made against financial expert witnesses were successful in excluding all or a portion of the expert testimony.[2] The study noted that lack of reliability was the dominant reason for exclusion by the Court.[3] These issues are more likely caused by the misuse of an acceptable methodology.[4]

8. Voir Dire Examination to Establish/Diminish Credentials

   a. A lawyer lays the foundation for expert witness testimony by asking the witness questions that establish competency and knowledge in the specific field of inquiry. This might mean asking questions about education and published work. Alternatively, the focus might be on the witness' practical experience. When counsel is done, the opposing attorney may ask questions to disprove the expert's qualifications or experience. This examination and cross-examination by counsel is known as "voir dire." When voir dire is completed, the judge rules on whether a proper foundation has been laid for the witness to testify as an expert.

   b. Five questions trial courts may ask before admitting expert testimony on financial issues:

      1) Is the expert qualified for *this* type of analysis?

      2) How reliable is the underlying data relied upon by the expert?

      3) Are the expert's assumptions supported by the record?

      4) Does the expert deal adequately with facts inconsistent with the expert's theory?

      5) Has the expert considered alternative scenarios?

[2] Challenges against financial experts represented 1,108 of the 6,141 cases reported.
[3] *Id*. at 19.
[4] *Id.*

c. As the attorney, you should use a series of questions to establish the expert's qualifications before asking the judge to admit the witness as an expert in a specified field. One way to do this follows:

1) Establish the expert's educational background: "Please tell us about your education in this field?" "Please describe any scholarly papers you have had published on the subject?" "Please describe any additional training you have received after obtaining your degree?"

2) Establish the expert's experience: "Please tell the court about your work experience."

3) Establish that the expert used reliable methods to reach the expert conclusions: "Did you have sufficient facts and data to reach a conclusion in this case?" "Did you use reliable methods to reach those conclusions?" "Did you apply those reliable methods to the facts in this case?" [N.B. – Some schools of advocacy urge counsel to ask the witness to describe in detail the facts and data, the reliable methods, and the application of the methodology to the facts and data.]

d. Once you have established sufficient foundation, you should ask the judge to qualify the witness as an expert in a specific field, supported by the witness' training and experience:

1) "Your Honor, at this time we ask that [Mr./Ms./Dr._____] be admitted as an expert in the field of [describe]." If admitted, the expert may now give an opinion about an event the witness did not observe. For instance: "The inappropriate financial accounting previously and presently used by the Debtor was and is inherently unreliable. If the Debtor had used appropriate financial accounting methods, the Debtor would have seen years in advance that it was having financial difficulties and would see now that its projected financial health is improperly based on faulty assumptions."[5]

[5] *See also* "Qualifying the Expert Witness," *supra*, for its list of potential questions you could use in qualifying an expert witness – the order of usage being flexible.
1. Name.
2. Occupation.
3. Place of employment.
4. Present title.
5. Position currently held, duties and responsibilities, and length of time in the position.
6. Describe briefly the subject matter of your specialty.

e. Voir Dire to Challenge the Expert

1) Once the proffering attorney asks the Court to qualify the expert, you should ask for the opportunity to voir dire the expert. Voir dire provides the opposing attorney an opportunity to question the expert on her qualifications in an effort to discredit and, hopefully, keep her from being qualified and accepted by the Court. There is often overlap between the voir dire and cross-examination questions.

2) Publications – counsel should review the expert's publications to look for evidence of bias, due diligence and/or foundational challenges for the expert's opinion.

3) Prior Experience Consulting and/or Testifying – review in detail the expert's consulting and testifying experience, including any deposition or trial testimony. The attorney should look for any prior testimony that may contradict the current opinion, or whether the expert has ever been disqualified or had his opinion rejected by a court.

4) Bias – areas to consider inquiring about: 1) working for only plaintiffs/defendants; 2) unpaid fees; 3) personal relationship with lawyers; or 4) previous referrals/business relationship between the expert and the lawyer/law firm.

5) Due Diligence of the Expert – areas to consider inquiring about: 1) timing and extent of diligence performed (e.g., was the report a "last minute" effort); and 2) the documents

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7. Specializations within that field.
8. What academic degrees are held and from where and when obtained.
9. Specialized degrees and training.
10. Licensing in field, and in which state(s).
11. Length of time licensed.
12. Length of time practicing in this field.
13. Board (or other) certified as a specialist in this field.
14. Length of time certified as a specialist.
15. Positions held after completion of formal education, and length of time in each position.
16. Duties and function of current position.
17. Teaching or lecturing by you in your field and when and where you lecture or teach.
18. Publications by you in this field and titles.
19. Membership in professional societies/associations/organizations, and special positions in them.
20. Requirements for membership and advancement within each of these organizations.
21. Honors, acknowledgments, and awards received by you in your field.
22. Number of times testimony has been given in court as an expert witness in this field.
23. Availability for consulting to any party, creditors, debtors, governmental bodies, etc.

- Put curriculum vitae or resume into evidence as an exhibit.
- "Your Honor, pursuant to Rule 702 of the Federal Rules of Evidence, I offer (name) as a qualified expert witness in the field of ____."

reviewed by the expert and the source. Expert notes and draft reports are not discoverable.

f. Court's Determination of the Expert Qualification Battle

1) So long as the expert witness has established that the expert has adequate background to provide testimony that could be helpful to the trier of fact, the Court will be reluctant to exclude the testimony. Often, the Court will state that disputes over the expert's credentials "go to the weight, not admissibility, of an expert's testimony." In re Young Broad. Inc., 430 B.R. 99, 122 (Bankr. S.D.N.Y. 2010) (although lacking M.B.A. or related business credentials, and not having published articles on valuation, proposed expert was qualified to testify on valuation issues because of his practical experience in financing and acquiring companies in debtor's field).

C. Questions that professional experts might ask of you as counsel:

1. What do I do if the attorney who has called me to testify refuses to meet with me before I testify?

2. Should I ever say "I don't know" on the witness stand? Does it not make me sound inadequate as an expert?

3. What do I do if asked a question outside my field of expertise?

4. How do I correct a fact or conclusion that has been misstated by the attorney?

5. What will be the most common tactics used to discredit me?

D. Things to Consider in Selecting Your FA as an Expert Witness (Fed. R. Evid. 702)

1. Knowledge

2. Education (technical training and education not required where other factors are met)

3. Skill

4. Experience (we have seen former attorneys with little formal financial education qualified based on their experience)

5. Training

6. Able to competently give evidence (don't need to have testified before to be an expert – everyone has to have a first time)

III. Written Expert Reports

A. Bankruptcy Rule 9014(c) – reports are not always required.

1. Fed. R. Civ. P. 26(a)(2)(B) provides that an expert witness who is "retained or specially employed to provide expert testimony in the case or one whose duties as the party's employee regularly involve giving expert testimony" must provide a written report.

2. However, Bankruptcy Rule 9014(c) provides that Fed. R. Bankr. P. 26(a)(2) "shall not apply in a contested matter unless the court directs otherwise." Thus, unless the court directs otherwise, expert disclosures are not applicable to contested matters in bankruptcy proceedings.

3. Example: In a contested DIP Hearing, in the absence of a discovery request or agreement between the parties, a party is not required to disclose an expert to the other side.

B. When/What is Required:

1. If the witness is "retained or specially employed to provide expert testimony in the case or one whose duties as the party's employee regularly involve giving expert testimony," the witness must provide a written report containing the following information:

a. A statement of all opinions to be provided and the bases and reasons for those opinions.

b. All facts and data considered by the witness (note: this does not use the term relied upon, therefore if an expert considered a fact or data but decided not to rely upon it, it is arguably required to be disclosed).

c. Any exhibits that will be used in summarizing opinions. (Side Note: Rule of Evidence 1006 regarding summary testimony requires that all data that was summarized has to be provided to the other side is a reasonable time. Example of iBanker testifying about industry standard on compensation).

d. Qualifications, including all publications in the past 10 years, not just those deemed relevant.

e. All cases where the expert testified by deposition or at trial in the past 4 years.

f. Statement of compensation.

g. Be sure to check and recheck for any errors – the other side may not point them out at your deposition and instead point them out at the hearing, preventing you from correcting your mistake and undermining your credibility.

2. Common mistakes in drafting expert reports:

a. Failing to verify assumptions provided by counsel.

b. Failing to undertake in depth analysis of the facts and data.

c. Using a cookie cutter opinion.

d. Too many disclaimers – not taking responsibility for opinions.

e. Remember the purpose of the expert report – need to provide a roadmap for your opinions.

3. If an expert is not required to provide a written report, the expert must provide a disclosure including the following information:

a. The subject matter on which the witness is expected to present evidence under Federal Rule of Evidence 702, 703, or 705; and

b. A summary of the facts and opinions to which the witness is expected to testify.

IV. Privilege Issues

A. Generally, communications between FAs, attorneys, and clients are considered privileged where the FA's role is necessary to providing legal advice to the client.

B. If the communication is unrelated to the provision of legal advice, communications are susceptible to discovery. *See In re Grand Jury Investigation*, 599 F.2d 1224, 1233 (3d Cir. 1979) *La. Mun. Police Emples. Ret. Sys. v. Sealed Air Corp.*, 253 F.R.D. 300, 305 (D. N.J. 2008) ("[T]he general rule is 'while legal advice given to a client by an attorney is protected by the privilege, business advice generally is not.'" (citing *In re Nat'l Smelting of New Jersey, Inc. Bondholders' Litig.*, No. 84-3199, 1989 U.S. Dist. LEXIS 16962, at *18 (D. N.J. June 29, 1989))); *Claude P. Bamberger Int'l, Inc. v. Rohm & Haas Co.*, No. 96-1041,1997 WL 33768546, at *2 (D. N.J. Aug. 12, 1997) ("Business and personal advice are not protected by the privilege . . . ." (citing *United States v. Davis*, 636 F.2d 1028, 1044 (5th Cir. 1978))).

C. Merely copying an attorney on a communication does not provide protection for that communication if it's not related to the provision of legal advice.

D. Dual role as advisor and trial consultant - where there is a failure to distinguish between the two roles, there is a risk a court will find the privilege does not apply. Example: *Hexion Specialty Chemical v. Huntsman Corp.*, 959 A.2d 47, 48 (Del. Ch. 2008), a Delaware Court of Chancery case – where iBanker's role changed from transaction advice to litigation consultant advice but because iBanker did not take steps to distinguish between the two roles, all work done by iBanker was discoverable. (Court noted they should have set up separate teams to deal with each part of the proceedings).

E. Three exceptions that may provide protection to communications:

1. Functional Equivalent Test – where outside professional is the functional equivalent of an employee.

2. Financial Advisor as Interpreter or Facilitator – where FA is useful in providing an attorney with information about information provided by the client in assisting lawyer in providing legal advice but not directly involved in providing business advice.

3. Financial Advisor Involved in Providing Legal Advice – where the nature of the communication ensures the maximization of the free flow of information concerning the client's legal affairs.

F. Open Question – When FA is involved in a bankruptcy is providing advice to a debtor or committee on 363 sale and later becomes a testifying expert at a hearing challenging the sale, what is discoverable by the objecting party?

V. Trial Preparation – a party may depose any person who has been identified as an expert who may testify at trial.

A. If an expert is identified and later withdrawn as a witness, the other side may still be able to take the deposition.

B. Draft reports are no longer discoverable.

C. Communication between trial expert and attorney for a party now has greater protection. Can only discover communications relating to compensation, facts or data provided to the expert and considered in formulating opinions (note: It is arguable that any facts or data provided to an expert are discoverable even if the expert decided not to rely on those facts or data), and any assumptions counsel asks the expert to make in formulating opinions. *See* Fed. R. Civ. P. 26, Advisory Comm. Notes on 2010 Amendment.

D. Communications with the Client are discoverable.

E. Expert employed as a Non-Testifying Litigation Expert.

1. Ordinarily information regarding non-testifying experts cannot be discovered except upon a showing of exceptional circumstances under which it is impractical for a party to obtain the same facts or opinions by other means. There is an exception for medical or mental examination which does not apply for FAs.

F. What to expect during preparation for testimony:

1. Discussions with counsel are generally protected (may be asked during deposition if discussed any facts or data provided by counsel).

2. Discussions with client are not protected. Client, expert and attorney together during preparation raise concerns.

3. To prepare for your deposition, you should role play with the attorney in your case, review any documents you considered and be prepared to explain their contents and significance, and identify the core concepts that support your opinion.

G. What your FA should expect during a deposition:

1. All attorneys take different approaches, from pointing out all your FA's mistakes to drilling down on minute detail. Generally, the attorney is going to want to know (i) everything your FA considered, and what your FA didn't consider, (ii) your FA's opinions and the basis for them, (iii) eliminate what your FA is not providing an opinion about, and (iv) whether your FA is qualified to be an expert in the field.

2. Attorney may not point out your FA's errors to prevent your FA from correcting them.

3. The opposing attorney may have several goals in taking your FA's deposition: (i) discovering what your FA will say at trial, (ii) undermining your FA's credibility, and (iii) exposing weaknesses in your FA's opinion

4. Your FA should keep his or her answers brief and accurate and refrain from providing unrequested information.

5. Your FA may be asked questions that your FA does not know the answer to, or does not understand. It is okay for your FA to answer with "I don't know," "I don't remember," or by asking for clarification.

VI. Trial Testimony and Cross Examination

A. On direct examination, the attorney on your case will ask your FA questions regarding your FA's qualifications and opinions.

B. Your FA's focus should be on teaching the judge what his or her opinion is and how he or she reached it in a way that makes it understandable. Your FA should avoid using jargon, overly technical language, or an abundance of acronyms.

C. Your FA can use visual aids and demonstrative exhibits to help explain complex ideas. Demonstrative exhibits are not admitted into evidence, but are useful for making your FA's testimony more clear and convincing.

D. If your FA does use visuals, be sure that they are simple and uncluttered. Instruct your FA to stand next to any visuals, not in front, and point to appropriate places as you speak. If your FA makes marks on the visuals during your FA's testimony, instruct your FA not to speak and write at the same time.

E. On cross examination, your FA is likely to be challenged as to assumptions underlying your FA's opinion and steps that your FA did not take or factors that your FA did not consider in reaching his or her opinion.

F. Any potential weaknesses in your FA's testimony should be addressed by the attorney on your case in direct examination, thus allowing your FA to defuse their negative impact on cross.

G. Your FA may also be asked about his or her qualifications on cross examination in an attempt by the opposing counsel to undermine your FA's credibility with the judge.

H. Opposing counsel may attempt to create new exhibits on cross. If these exhibits do not accurately reflect your FA's opinion or methods, your FA should disagree with them. Use buzz words such as "misleading," "incomplete," and "confusing."

I. Tips to give your FA for cross examination:

1. Maintain your composure.

2. Know what you testified to in your deposition.

3. Know what opinions you have testified to in other cases.

4. Don't argue with the lawyers, explain why they are wrong.

5. Watch out for the setup, i.e., getting you to agree with facts that their expert relies upon.

6. Watch out for the incomplete hypothetical – bring it back to your opinion.

VII. Application of Expert Rules in Particular Matters

A. Insolvency/Valuation in Avoidance Actions

1. Fair Valuation Standard – In order to render a solvency opinion, an expert must be able to value the assets of the transferor to determine whether the value of those assets exceed the transferor's liabilities. *See Miller & Rhoads, Inc. Secured Creditors' Trust v. Robert Abbey, Inc. (In re Miller & Rhoads, Inc.),* 146 B.R. 950, 955 (Bankr. E.D. Va. 1992) ("Fair valuation" for purposes of § 101(31) [now 32] is generally defined as the going concern or fair market price unless a business is on its deathbed.") (internal quotation marks and modifications omitted); *see also Devan v. CIT Group/Comm. Servs., Inc. (In re Merry-Go-Round Enters., Inc.)*, 229 B.R. 337, 342 (Bankr. D. Md. 1999) ("The GAAP standards for asset valuation . . . are not synonymous with the fair valuation standard of 11 U.S.C. § 101(32)(A).").

a. "In determining a "fair valuation" of the entity's assets, an initial decision to be made is whether to value the assets on a going concern basis or a liquidation basis." *In re Am. Classic Voyages Co.*, 367 B.R. 500, 508 (Bankr. D. Del. 2007) *aff'd sub nom. In re Am. Classic Voyages, Co.*, 384 B.R. 62 (D. Del. 2008). This determination is based on whether the debtor is "on its deathbead." *Id.* (quoting *Heilig-Meyers Co. v. Wachovia Bank, N.A.*, 319 B.R. 447 (Bankr. E.D. Va. 2004) (refusing to accept at face value either the plaintiff's expert or the defendant's expert. The plaintiff's expert report more closely resembled a liquidation analysis (instead of a "going concern"), and the Defendant's expert's DCF and market multiple approaches failed to consider the debtor's unique circumstances and was of "doubtful reliability." The Court conducted its own solvency analysis which followed somewhat the Defendant's expert's market analysis to find that the debtor was solvent as of the transfer date, just less solvent than in the defendant's expert report.)) Thus, if liquidation is not "clearly imminent on the transfer date," the assets should be attributed a going concern value. *Id.*

2. *Heilig-Meyers Co. v. Wachovia Bank, N.A.*, 319 B.R. 447 (Bankr. E.D. Va. 2004) – the Court refused to accept at face value either the plaintiff's expert or the defendant's expert. The plaintiff's expert report more closely resembled a liquidation analysis (instead of a "going concern"), and the Defendant's expert's DCF and market multiple approaches failed to consider the debtor's unique circumstances, calling the DCF analysis of "doubtful

reliability."[6] The Court conducted its own solvency analysis which followed somewhat the Defendant's expert's market analysis to find that the debtor was solvent as of the transfer date, just less solvent than in the defendant's expert report.

3. *Trustee of Chartwell Litig. v. Addus Healthcare, Inc. (In re Med Diversified, Inc.)*, 334 B.R. 89, 91-92 (Bankr. E.D.N.Y. 2005) – The expert was retained to offer opinion testimony on the value of one of the defendants, a privately-held company. *See id*. at 92. The opposing party sought "to exclude all of [the expert's] testimony on the ground that he [did] not qualify as an expert on valuation . . . ." *Id*. at 94. The court agreed, concluding that the expert was not qualified to offer valuation testimony despite "his substantive experience over the past twenty-plus years as an accountant and as a liquidating agent or bankruptcy trustee in bringing avoidance actions in the bankruptcy court . . . ." *See id*. at 96-97. The court held that such experience did not "add up to a satisfactory substitute for formal education and training in business valuations and in peer-recognition in this sub-branch of substantive expertise in business valuations . . . ." *Id*. at 97. Among other things, the court was troubled that the expert had (i) "no formal education or training in business valuation," *id*. at 96, and (ii) "no experience in preparing valuation reports . . . ." *Id*. at 97. In rejecting the defendants' "urg[ing] … to accept a lower standard of expertise to support [the expert's report] and testimony," *see id*. at 96, partly because Rule 702 embraces a "'liberal' standard for admission of expert testimony," *see id*. at 97, the court "decline[d] to find that [the expert's] thin record is an adequate and reliable substitute for extensive and direct experience in valuing businesses . . . as a consultant or as an expert witness in fraudulent transfer actions of this character before the federal district or bankruptcy courts." *Id*.

4. *In re Tousa*, 422 B.R. 783 (Bankr. S.D. Fla. 2009) – trial court excluded defendants' valuation expert for a number of reasons including the following: 1) credibility; 2) inflated projections; 3) reliance on rejected fact witness; 4) inappropriate valuation of goodwill and 5) unsupported IP valuation.

[6] Heilig Meyers had a securitized its $1 billion customer loan portfolio that required customers to make payment in person at the stores. The debtor was downsizing and closing stores, which made collection of the loan portfolio a challenge.

5. *In re TOUSA, Inc.*, 680 F.3d 1298, 1311 (11th Cir. 2012) – Court of appeals upheld bankruptcy court's factual determination that subsidiaries did not receive reasonably equivalent value for liens given to secure lenders' loan to parent; declining to decide whether value might include opportunity to avoid or delay bankruptcy filing.

6. *In re Iridium Operating LLC*, 334 B.R. 89 (Bankr. S.D.N.Y. 2005) – trial court excluded defendants' valuation expert in the solvency context because, *inter alia*, the expert employed a flawed analysis and exhibited a "conscious disregard of traditional valuation techniques."

7. *In re Fruehauf Trailer Corp.*, 444 F.3d 203, 212-13 (3d Cir. 2006) – "reasonably equivalent value" considers fair market value of benefit received, whether transferor-transferee relationship was arms-length, and transferee's good faith.

8. *VFB, LLC v. Campbell Soup Co.*, 482 F.3d 624, 632-33 (3d Cir. 2007) -- market capitalization used to determine value of debtor after challenged transaction.

9. *Mellon Bank, N.A. v. Official Committee of R.M.I., Inc.* (*In re R.M.I., Inc.*), 92 F.3d 139, 148 (3d Cir. 1996) – holding that value may include opportunity to receive future benefit.

10. *In Re Scheffler*, 471 B.R. 464 (Bankr. E.D. Pa. 2012) – Court avoided liens on debtor's real estate where court found that intellectual property given to debtor ostensibly in exchange for granting liens had no economic value because costs of production and sale vastly exceeded sales revenue.

11. *Proving Solvency*: *Defending Preference and Fraudulent Transfer Litigation*, by Robert J. Stearn, Jr., available at http://www.rlf.com/files/Bank08.pdf (last visited June 1, 2015).

B. Reasonably Equivalent Value

1. "The term "reasonably equivalent value" is not defined by the Bankruptcy Code. Congress left to the courts the task of setting forth the scope and meaning of this term, and courts have rejected the application of any fixed mathematical formula to determine reasonable equivalence" *In re Aphton Corp.*, 423 B.R. 76, 89 (Bankr. D. Del. 2010).

2. Courts look to the following factors in determining whether reasonably equivalent value was given:

   a. the 'fair market **value**' of the benefit received as a result of the transfer;

   b. the existence of an arm's-length relationship between the debtor and the transferee; and

   c. the transferee's good faith. *In re Fedders N. Am., Inc.*, 405 B.R. 527, 547 (Barnk. D. Del 2009)

3. Areas for Expert Testimony

   a. Courts may accept expert testimony to determine whether a debtor received reasonably equivalent value in a transaction. *See*, *e.g.*, *Peltz v. Hatten*, 279 B.R. 710, 728-29. Courts give significant deference to marketplace values, however, and will view expert testimony on reasonably equivalent value "through this lens" *Id.* at 738.

C. Chapter 11 Plan Confirmation – Valuation/Interest Rate Issues

4. *Cramdown of a Secured Creditor* – Under § 1129(b)(2)(A)(ii), the Court may confirm a chapter 11 plan in the face of an objection by an impaired secured creditor so long as the plan includes a provision for deferred cash payments to the creditor totaling the present value of its interest in the collateral. *In re Deep River Warehouse*, *Inc.*, No. 04-52749, 2005 WL 2319201, at *8 (Bankr. M.D.N.C. Sept. 22, 2005). Thus, a debtor must select an appropriate interest rate to provide an impaired secured creditor the present value of its interest in the collateral through payments to be made over time.

5. *Till v. SCS Credit Corp*., 541 U.S. 465 (2004) – Courts often look at the United States Supreme Court decision of *Till v. SCS Credit Corp*., 541 U.S. 465 (2004) when determining the appropriate interest rate. In the context of a chapter 13 case, the Supreme Court in *Till* held that the formula approach constituted the best method for determining the appropriate interest rate in a cram down fight with an impaired secured

claim. Using the formula approach, the debtor selects a prime rate of interest and the adjusts this rate based on several risk factors. *Id*. at 479. In a footnote, the Supreme Court, stated that "when picking a cramdown rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce." *Id*. at 476 n. 14.

6. Application of *Till* – Courts interpreting *Till* in the context of chapter 11 cram downs have held that where there exists an efficient market for exit or cram down financing, the market rate is to be used. *In re American Homepatient Inc.*, 420 F.3d 559, 568 (6th Cir. 2005); *see also In re VDG Chicken, LLC*, *No. NV-10-1278*, 2011 Bankr. LEXIS 1795 (B.A.P. 9th Cir. Feb. 18, 2011); *SPCP Group LLC v. Cypress Creek Assisted Living Residence, Inc. (In re Cypress Creek Assisted Living Residence, Inc.)*, 434 B.R. 650, 660 (M.D. Fla. 2010). *See also In re Renegade Holdings, Inc.*, 429 B.R. 502, 525 (Bankr. M.D.N.C. 2010) *new trial granted on other grounds* No. 09-50140C-11W, 2010 WL 2772504 (Bankr. M.D.N.C. Jul. 13, 2010). However, if no efficient market exists, the formula approach should apply. *In re American Homepatient Inc.*, 420 F.3d at 568.

7. Efficient Market Rate

   a. A debtor does not have to actually attempt to find exit or cram down financing before the bankruptcy court can determine whether an efficient market exists. *SPCP Group*, 434 B.R. at 658. Rather, an expert's testimony may establish whether such a market exists. *Id*. The determination of whether an efficient market exists "does not necessarily entail consideration of the particular risks associated with the particular type of loan or property of the debtor." *Id*. at 659.

   b. The Fifth Circuit Court of Appeals in *In re Texas Grand Prairie Hotel Realty, LLC*, refused to mandate the methodology for determining the cramdown rate for an impaired secured creditor in a chapter 11 case, holding that the court "will not tie bankruptcy courts to a specific methodology as they assess the appropriate Chapter 11 cramdown rate of interest". 710 F.3d 324, (5th Cir. 2013). The Fifth Circuit, while affirming the bankruptcy court's use of the formula approach under a "clear error" standard of review, stated that its opinion should not be read as a finding that "the prime-plus formula is the only – or even the optimal – method for calculating the Chapter 11 cramdown rate." *Id.* at 337.

8. Expert Testimony on Existence of Efficient Market

   a. Remember - an expert's qualifications with regard to credit markets must still comply with the general rules regarding admissibility of an expert opinion to the principles of expert

testimony above, e.g. facts or data. For example, in *SPCP Group*, the party opposing confirmation sought to have an expert qualified as to the existence of an efficient credit market. The court denied the request for admission because the expert, while qualified, did not base his testimony on any facts or data concerning loans to an entity like the debtor and the court, therefore found the testimony unreliable. *Id*. at 659.

9. Establish the Prime Rate

   a. The starting point under the formula approach is to determine the prime rate. While the prime rate could be the daily national prime rate, as stated in *Till*, the facts of the case may make another metric, such as LIBOR or U.S. Treasuries more appropriate. *See Deep River Warehouse*, Inc. 2005 WL 2319201, at *12 (using the interest rate on ten-year U.S. Treasury notes as the prime rate).

10. Adjust the Prime Rate

   a. After establishing the prime rate, the court must consider whether "the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization plan" in order to make necessary adjustments to the rate. *Till*, 541 U.S. at 479. The creditor opposing the cramdown rate bears the burden of proof on this issue. *Till*, 541 U.S. at 479. Expert testimony, or testimony from witnesses with knowledge regarding the prospects of the debtor's reorganization is necessary for proving a plan's feasibility. *Deep River Warehouse, Inc.*, 2005 WL 2319201, at *3. Expert and lay testimony should focus on (1) the adequacy of the debtor's capital structure; (2) the earning power of its business; (3) the economic conditions; (4) the ability of the debtor's management; (5) the probability of the continuation of the same management; and (6) any other related matters which determine prospects of a sufficiently successful operation to enable performance of the provisions of the plan. *Id*. at *2 (citing 11 U.S.C. § 1129(a)(11)).

D. Plan Confirmation - Feasibility

11. In order to confirm a plan, the bankruptcy court must make a finding that the plan is feasible**.** *In re W.R. Grace & Co.*, 475 B.R. 34, 114 (D. Del. 2012), aff'd (July 24, 2013). This requires a finding that "the plan presents a workable scheme of organization and operation from which there may be reasonable expectation of success." *Id.* Factors considered include "assessment of the debtor's capital structure, the earning power of the business, economic conditions, and the ability of the corporation's

management," with the most important factor being the debtor's future earning capacity. *Id.*

12. Courts consider expert testimony on plan feasibility.

    a. In *W.R. Grace*, the court found that the debtors' expert, who was "a vastly experienced investment banker and financial advisor" was "more than qualified to testify as to [the debtor's] future earning capacity, capital structure, and earning power," based on the expert's prior experience in similar bankruptcy cases. *Id.* at 115. The court noted that the expert's testimony was properly based on analysis of the debtor's "corporate structure, internal records and historical precedent, financial reports of [the debtor's] current business performance, financial projections of its future earning capacity, review of cost-cutting measures and productivity programs implemented since [the debtor] entered bankruptcy, and analysis of a $37.3 million reserve established by [the debtor] to cover its unsettled property damage claims and allocate payment for future claims. *Id.* The expert's testimony was used to objections to plan feasibility. *Id.* at 117-20.

    b. In *In re Flintkote Co.*, the court credited the testimony of the Debtors' expert on the company's earning power over an objection that it omitted federal income taxes, noting that the preferred method for evidence on earnings is "to present earnings before taxes." 486 B.R. 99, 143. In response to an arfument based on the Debtors' failure to present complete company-wide financial statements" the court also noted that a debtor is not required to submit specific documents proving feasibility. *Id.* at 142.

E. Additional Cases and Authorities for Reference

1. *In re Heritage Highgate, Inc.*, 679 F.3d 132 (3d Cir. May 2012) (where debtor's plan proposed to retain collateral securing lender's claim, and plan feasibility thus tied to value of collateral, valuation must be replacement value determined as of confirmation).

2. *In re GAC Storage Lansing, LLC,* 485 B.R. 174 (Bankr. N.D. Ill. 2013) – Court denied confirmation where expert projections failed to consider rent concessions, vacancy rate, and weak economic conditions.

3. *In re Exide Technologies*, 303 B.R. 48, 53 (Bankr. D. Del. 2003) – Court denied confirmation of plan after extensive valuation trial.

4. *In re 785 Partners LLC*, 2012 WL 959364 (Bankr. S.D.N.Y. Mar. 20, 2012) – contains a discussion of the contested valuation of debtor's empty Manhattan apartment building at plan confirmation stage.

5. *In re Nellson Nutraceutical, Inc.*, 356 B.R. 364 (Bankr. D. Del. 2006) -- Court excluded expert's opinion of value based upon discounted cash flow as unreliable where expert deducted cost of capital expenditures from EBITDA, a novel approach neither followed by other experts nor subjected to peer review.

6. *In re Nellson Nutraceutical, Inc.*, 2007 Bankr. Lexis 99 (Bankr D Del. Jan 18, 2007) – where creditors' experts relied upon debtors' long-term business plan as basis for deriving enterprise value, and business plan had been deliberately manipulated by debtors to inflate values, court determined enterprise value by accepting creditor valuations and making judicial adjustments to reflect evidence, including evidence of declining debtor performance).

7. *Valuation Methodologies*: *A Judge's View*, by Hon. Christopher S. Sontchi,http://commission.abi.org/sites/default/files/10sontchi.pdf (last visited June 1, 2015).