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# Valuation Issues in Chapter 11 Cases

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**LITIGATING VALUATION DISPUTES:  
A PRIMER ON PREPARING EXPERT WITNESSES  
FOR CONTESTED VALUATIONS**

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A Primer on Preparing Expert Witnesses for Contested Valuations**

Introduction

It is becoming more and more common for valuation disputes in bankruptcy to be litigated. That is so despite the cost and uncertainty associated with such litigation, coupled with the prospect of ever-diminishing estate assets. To a degree, the rise in this type of litigation can be attributed to the ever-increasing complexity of corporate and capital structures. As the number of interested parties to a dispute multiplies, reaching agreement among all parties becomes (perhaps exponentially) more challenging. Thus, what was once often resolved consensually is now more commonly subject to contentious litigation.

The successful litigation of a valuation dispute requires lawyers and financial experts to work hand-in-hand to produce a compelling argument in favor of the client's position. Perhaps the single most important aspect of this cooperative relationship is the preparation and presentation of expert witnesses. This article discusses how lawyers may, upon identifying the need for an expert valuation opinion, select an expert, provide logistical and legal support during the preparation of the expert report and prepare a solvency expert for trial.

Selecting an Expert

The first step is the selection of an appropriate expert. Outstanding professional and academic credentials, while essential, are just one part of the selection criteria: the proposed expert's preferred approach to valuation needs to fit your case. Failing to approach expert selection methodically, with an eye towards this need, can lead to any number of headaches as the case progresses.

Selecting an appropriate expert should be approached in three stages: (1) reviewing the credentials of potential experts, (2) interviewing one or more candidates and (3) framing the terms of the engagement. Generally, experts who are already employed by the investment banking/financial advisory firm that has been retained to assist with the reorganization should be avoided – selecting such an expert can give rise to unnecessary and undesirable discovery and disclosure disputes.

### *Reviewing Credentials*

As a gate-keeping matter, any potential expert must have sterling academic and professional credentials that will provide an indisputable basis for qualification as an expert in valuing distressed entities. Next, winnow the list by examining each candidate's prior experience testifying. Ideally, a potential expert should not only have significant practical valuation experience, but should also have testified on valuation issues under oath before a bankruptcy court. While testimony before other types of tribunals should be noted, different experts are better suited to different venues – an expert perfectly suited to testifying before a jury in state court may be less suited for a bench trial in bankruptcy court.

Next, consult with the client's financial advisors, who may be able to provide significant guidance as to what approach to valuation will cast the client's position in the most favorable light. Eliminate any candidates whose most commonly employed valuation methodology does not match the approach that will best advance your case. While certain experts may demonstrate intellectual flexibility and offer to adopt whatever valuation method makes for the best case, courts are unlikely to be impressed by "hired guns" who appear (or are) willing to adopt the most expedient methodology. Worse still, engaging such an expert can provide opposing counsel with the opportunity for a damaging line of cross-examination. If an expert has testified on valuation

many times before, and has consistently preferred certain methodologies, he will be hard pressed to defend suddenly adopting a different methodology (and woe to you if your expert has previously testified as to the unsuitability of the method now adopted).

### *Interviewing Potential Experts*

Once the list of candidates has been narrowed, interview each candidate and get a sense of his demeanor. Ask particularly pointed questions, as though conducting a cross-examination, and see how the potential witness reacts. Consider how the demeanor of the potential expert will mesh with the personality of the presiding judge. Some judges may favor technical arguments while others may favor a big-picture, conversational style of testimony.

Next, the candidate should be given a general background of the case (without divulging sensitive information) and the theory of the case. Verify that the potential expert is comfortable with the theory of the case and that he would be prepared to testify accordingly, assuming his review of the relevant valuation data supports the theory. Confirm that the candidate has not previously testified in a manner that is contrary to the theory. Follow up on the interview by conducting a comprehensive search to verify that (a) the expert testifies consistently and (b) the expert's testimony has not been discredited in any reported or unreported decision. Any revelation at trial that casts fundamental doubt on the forthrightness of an expert can be highly damaging.

The ideal valuation expert should have significant experience in testifying in bankruptcy cases, be familiar with the particular forum, have a communication style that will mesh well with court's preferences, consistently apply the chosen valuation method, be not only comfortable with, but in favor of, the theory of the case and, above all, be eminently credible.

### *Preparing the Engagement Letter*

Once an expert has been selected, an engagement letter must be prepared, which involves a handful of important choices. First, will the valuation expert be retained directly by the client, or by the law firm on behalf of the client? Both approaches have certain advantages and pitfalls. If the expert is retained directly by the client, the engagement letter should specify that the expert is being retained to assist the law firm in its representation of the client. Failing to do so may inadvertently give rise to certain privilege-waiver issues. If the expert is retained by the law firm, the engagement letter should state that (a) the expert is being retained for the benefit of the client, (b) the client is responsible for ultimate payment of the expert and (c) the law firm has no obligation to pay the expert. Failing to include this language can expose the law firm to liability on account of expert fees not paid by the client.

Additionally, the expert's engagement letter needs to designate whether the expert will be a testifying or non-testifying expert. Privilege is more limited and discovery is broader with respect to testifying experts. As a general rule, any document or communication relied upon by a testifying expert in formulating his opinion is not privileged and is subject to discovery. While courts have ruled inconsistently on the breadth of this privilege waiver, the best practice is to proceed as if any communication with a testifying expert will be discoverable. Thus, if it is uncertain whether the expert will be used to testify, the engagement letter should state that the expert is retained as a valuation consultant who will perform a variety of services as requested by the appropriate attorneys, including, *if necessary*, testifying. Once it becomes clear that an expert will testify, he must be designated as such and the appropriate disclosures to one's adversaries should be made immediately.

Finally, the engagement letter should not contain any terms that could lead someone to suggest that the expert is biased or unreliable. In particular, engagements of valuation experts should never include “success” fees or provide for any additional compensation for a favorable report or outcome.

### Orienting the Expert

Once a valuation expert has been retained, counsel is responsible for providing him with the information and underlying documents that he needs to properly formulate his opinion. An expert will base his opinion on publicly available information as well as data and other materials obtained through discovery. Therefore, one of the first questions to be decided upon retaining an expert is what degree of access he should have to discovery materials. One option is to provide the expert with unfiltered access to all discovery materials and allow him to decide, as he sees fit, what is useful. If the valuation dispute is even reasonably complex, an expert given unfiltered access to discovery materials will need to retain a staff to assist him and conduct a thorough document review. While many experts prefer this approach, there are certain disadvantages. First, the expert’s team may become large and unwieldy, and result in expensive and duplicative document review efforts. Second, the expert may end up relying on his subordinates’ interpretation of materials as he may not personally review all key documents.

As a second option, counsel may, as part of his own document review, select which documents should be reviewed by the expert. While it would be inappropriate to instruct an expert to rely on specific documents, it is appropriate for attorneys to streamline the preparation of a valuation analysis by culling large productions of documents in order to focus the valuation expert on his proper role: analyzing relevant data. This “filtered” approach limits discovery and document review costs, while also ensuring that the expert is personally familiar with the key

documents. This approach is, however, not without its risks, as lawyers performing document review may be less apt than their financial professional counterparts to see the significance in certain documents containing financial data, and consequently fail to pass on relevant information.

While it is important to give the valuation expert access to the raw forms of the appropriate documents, it is equally important not to provide him with any attorney work product related to such materials. Given that communications between an attorney and a testifying valuation expert may be subject to discovery, care must be given not to inadvertently waive attorney-client or work-product privileges by disclosing mark-ups of valuation materials or other attorney work product to a valuation expert. While it is sometimes possible to preserve privilege as to communications with an expert that occurred before he was declared a testifying expert, such privilege is not always available. The best practice is to treat any communication with a testifying expert as though it will ultimately be disclosed. Accordingly, attorneys should be careful to strike the right balance between providing a valuation expert with relevant information and refraining from disclosing privileged material.

As the valuation expert begins to sift through data in preparation for drafting his report, lawyers can provide assistance by advising him on the standards that a court is likely to use to evaluate the expert report. Courts evaluate the admissibility and reliability of valuation reports, like any other expert material, under the standards set forth in the *Daubert* and *Kumho Tire* cases. In practice, this means that the court may disregard an expert report that is based entirely on the client's data. The expert should therefore be advised to consult a wider universe of materials before reaching a conclusion. The expert, in turn, may assist the lawyers by indicating what types of data will be especially helpful in preparing his analysis. This input can be used to

shape discovery requests and the document review process. Once the valuation expert has fully reviewed the relevant materials, he should, with the guidance of counsel, begin to prepare his expert report.

### Drafting the Report

A valuation report will generally serve a crucial function in litigating a valuation dispute. Indeed, the report will provide the basis for the expert's valuation testimony and, along with that testimony, will serve as the primary vehicle for convincing the court to render a favorable valuation decision. Given the centrality of the expert report to the litigation, producing a quality report should be not only the primary concern of the valuation professional (and any staff he may have retained) but should also one of the chief concerns of the lawyers overseeing the case.

As a preliminary matter, lawyers should maintain control over the process of developing the expert report. In particular, lawyers should focus the expert's attention on ensuring that the report is a persuasive document rather than a treatise on solvency analysis. At the same time, lawyers should avoid instructing the expert to conduct the solvency analysis in a particular way. Even the appearance that an expert is being directed can severely damage his credibility. A court is unlikely to accord much, if any, weight to the testimony of an expert who is merely parroting the arguments advanced by counsel. If, for whatever reason, an expert intends to employ an unfavorable valuation methodology or reach unfavorable conclusions, it is far better to simply find a new witness than to exert undue pressure on the expert to alter his analysis.

Lawyers should also focus on making sure that the analysis contained in the report is presented in a format that lends itself to convincing advocacy. The report should state clear conclusions (e.g., I have concluded that the Debtors, on a consolidated basis, were insolvent on x date because . . .) and should be readable from beginning to end as a clear narrative. Brevity is a

virtue – endless exposition on possible alternative valuations and low-probability minutiae detract from effective advocacy. However, brevity must be balanced with a need for the report to be comprehensive and authoritative. Striking the proper balance will be critical.

Length and style aside, the expert should be left, within limits, to determine the appropriate content of the report: his expertise puts him in the best position to make these decisions. Lawyers should nevertheless ensure that the report meets all of the requirements for acceptance under *Daubert*. All expert valuation reports must define the interest to be valued, discuss the interest's legal characteristics, set a valuation date, identify the standard of valuation and the valuation methodology to be applied, discuss all assumptions underlying the valuation, and state a conclusion as to valuation. Some of these elements require at least cursory legal analysis, which should be provided by counsel.

One special advantage afforded to experts is that they may consider, and their reports may be based on, what would otherwise be inadmissible hearsay. There is a common-sense reason for this rule: if an expert was limited to testimony about matters within his personal knowledge, it would be impossible to create a meaningful report because valuation experts are likely to have little, if any, first-hand knowledge of the debtors. Instead, a proper valuation report may be based on data and internal company communications that provide insight into that data. Consider taking advantage of this fact by encouraging the expert to discuss particularly helpful documents, which would otherwise constitute hearsay, in the course of his analysis.

Certain best practices should at all times be observed. For example, it is important not to create, and certainly not to circulate, any drafts of the valuation report. Draft reports may be subject to discovery and can lead to damaging questions on cross examination as to why the expert's analysis had changed between one draft version and the next. To avoid this problem,

maintain a single, continuously-evolving copy of the report. Ideally, internet access to the report should be established such that lawyers may insert comments directly into the document itself that can then be incorporated as the expert continues to refine and revise the report. Any notes the expert might develop should likewise be written directly into the report itself. Alternatively, consider avoiding the issue entirely by seeking, up front, an agreement with opposing counsel not to seek discovery of drafts of expert reports.

The Federal Rules of Civil Procedure require the expert to submit, ninety days before trial, the valuation report and certain supporting materials, including the expert's curriculum vitae, a list of all prior instances in which the expert has testified, and all documents that the expert relied on in preparing his valuation analysis. These documents must be thoroughly vetted by counsel. Minor inconsistencies or errors in these submissions can have serious consequences.

#### Preparing for the Deposition

Once the report has been completed and the valuation professional has been designated as a testifying expert, opposing counsel is entitled to take his deposition. The first inquiry that a valuation expert should be prepared for is the so-called *Daubert* inquiry into the reliability of the expert's valuation. In preparing for a *Daubert* challenge, the expert should be prepared to explain that the chosen valuation methodology has been (i) frequently tested, (ii) subjected to peer review and publication, (iii) evaluated for a known or potential error rate and (iv) accepted by the valuation professional community as reliable. So long as the report is based on one of the well-established valuation methodologies, it should have little trouble withstanding "big picture" *Daubert* scrutiny. Undoubtedly, opposing counsel will seek to portray the report as a flawed application of otherwise well-established valuation techniques.

In preparing for this line of attack, every part of the written report should be reviewed in detail. First and foremost, the expert should be prepared to explain why his chosen valuation methodology was not only appropriate, but the best option under the circumstances. He should also be prepared to explain why his analysis is consistent with his regularly-employed valuation techniques, his prior testimony and anything he has written on the subject. If the expert deviated from his normal method of valuation (for example, relying on comparable company analysis when in all previous cases he used a discounted cash flow analysis), he should be prepared to explain why the unique facts of the case mandated a different approach. Additionally, if draft reports were created and turned over as part of discovery, the expert should be prepared to provide convincing explanations for any changes in the report, with particular attention to any changes to the valuation technique employed. Mock depositions can be particularly helpful in preparing the expert to testify.

Next, the expert should be prepared for any document that potentially contradicts or casts doubt on his analysis. This type of preparation can be tricky because of the lack of privilege. Consider, either as part of a mock deposition or otherwise, asking the expert, on a hypothetical basis, how a range of possibly damaging documents would impact his analysis. Assuming the expert's original valuation analysis was correct, with sufficient preparation he should be able to clearly articulate why the unfavorable documents would not alter that analysis. Preparing an expert in this way can ensure that a proper valuation analysis is not discredited during depositions.

### Preparation for Direct Examination

Preparing an expert for direct examination is straightforward: the goal is to convert the expert report into a clear narrative in the expert's own words. If drafted properly, the report

should contain enough narrative elements to make this process fairly painless. Lawyers and the valuation expert should work together to transform the technical contents of the report into a convincing story without diluting its authoritative tone. One particularly useful way of accomplishing this is by augmenting testimony with clear demonstratives. For example, a direct examination featuring testimony on a comparable company analysis could feature charts showing the total market capitalization of the selected similar companies. The expert can then explain, with ample references to the charts, why the chosen companies were deemed comparable to the debtor, how the debtor compares to those companies and ultimately how he reached his conclusion. As a corollary, consider asking the expert to adopt an almost “hand-holding” approach to the valuation analysis. For example, testimony that begins along the lines of “economists can determine the value of a company by looking at the cash flow of a company and then applying certain discounts and multipliers” is more likely to create a readily digestible narrative than diving headlong into numerical analysis. The expert should explain, in a tone more akin to a normal conversation than a passage from a textbook, why his valuation technique and conclusions are valid. While many professional valuation experts are extremely adept at delivering engaging testimony, and may need only minimal guidance, others may tend to assume an unreasonable level of financial sophistication and rely on valuation-specific jargon. While valuation of complex companies is not the easiest subject to address without resorting to jargon, every effort should be made to minimize its unnecessary use. The lawyer’s role in this process is to ensure that the expert understands how best to engage the finder of fact and then to provide the necessary support to allow him to do so.

### Preparation for Cross Examination

Cross examination preparation should, in most ways, mimic preparation for a deposition. Additionally, the expert should review deposition transcripts (or videos) as well as repeat the preparation process, including a thorough review of each aspect of the report and the deposition transcript for likely points of attack. It can also be helpful to look for any topics that appeared ripe for questioning at the deposition but received little attention. Good trial lawyers tend to reserve one or more surprises for cross examination, but may inadvertently reveal their intentions during the deposition by shying away from extensive questioning on subjects as to which they hope to present surprises at trial. If these surprises can be anticipated, the expert can be suitably prepared through mock cross examinations.

### Non-Testifying Experts

Although the testifying expert will be the “public face” of the valuation presentation, non-testifying financial advisors retained in the course of the case can assist in preparing for litigation. Financial advisors should be used to support the document review effort where financial data is concerned. Doing so will ameliorate some of the difficulties that may arise during the process of filtering documents for the testifying expert. Additionally, because communications between lawyers and non-testifying financial professionals are privileged, these financial advisors can act as a sounding board for potential arguments and valuation strategies without putting such conversations at risk of being discovered. Financial advisors can also be utilized to directly manage the testifying expert, which has the advantage of providing a firewall between attorney work product and potential discovery or mandatory disclosure. Non-testifying advisors are an excellent resource and lawyers should strongly consider calling on them for the variety of invaluable support services that they are well-suited to provide.

## Conclusion

Preparing a valuation dispute for litigation requires lawyers and financial professionals to work hand-in-hand while appreciating each side's respective role and responsibilities. Lawyers are responsible for formulating strategy, selecting an expert, and providing comprehensive support to ensure that the expert's report and his testimony are as credible and convincing as possible. The expert is tasked with providing numerical analysis, critiquing opposing methodologies, ensuring that counsel knows exactly what materials are needed to complete the report and placing his conclusions in an easily digestible narrative framework. Other financial advisors should act as a sounding board for ideas and a source of preliminary analysis. Ultimately, producing a compelling valuation analysis demands an interdisciplinary team effort that allows lawyers to properly leverage financial professional expertise for the benefit of the client – lawyers would be well advised to fully utilize the capabilities of their financial services counterparts while maintaining privilege and preserving their proper role as the primary formulators of case strategy.