LITIGATION SUPPORT

Expert Testimony in BV Cases Should Be the Exception, Not the Rule

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In our article published in the August 2012 issue of *The Business Lawyer* (American Bar Association) titled "*Campbell*, *Iridium*, and the Future of Valuation Litigation," we proposed a change in the way federal courts handle the receipt of expert testimony in business valuation litigation. Our proposal would likely reduce the number of business valuation cases in which the testimony of paid valuation experts is admitted into evidence. The article provoked some discussion among valuation professionals, and the editor of *The Value Examiner* kindly invited us to present our views to its readers.

Under our proposal, a litigant wishing to present expert testimony in a business valuation dispute should first be required to establish by motion—made, and decided by the judge, at the conclusion of fact discovery, but before the expensive and time-consuming expert witness process has gotten underway—that non-expert market evidence of value is insufficient to permit the finder of fact to make a reasoned determination of value. The party wishing to present expert testimony would have to establish that there is an actual need for it—that the market evidence of value in the fact record needs to be supplemented by expert testimony. No longer would it be a matter of course that, as is now common practice, expert reports are filed within a short time after fact discovery has closed, automatically setting in motion a costly and time-consuming sequence of expert reports and depositions, followed by rebuttal reports and more depositions, and setting the stage for a substantial commitment of valuable trial time—all for a species of evidence that may be wholly unnecessary to a just and reasoned decision of the case.

Our proposal is grounded in two landmark federal court valuation decisions that were issued in 2007. Those two cases were:

- *VFB LLC* v. *Campbell Soup Co.*, 482 F.3d 624 (3d Cir. 2007)
- *In re Iridium Operating LLC*, 373 B.R. 283 (Bankr. S.D.N.Y. 2007)

Both decisions held that contemporaneous market evidence, rather than discounted cash flow or other after-the-fact valuation analyses created for litigation, should be relied on to value corporations and businesses. Although *Campbell* and *Iridium* were both decided in reliance solely on such market evidence, in both cases the parties had retained and presented extensive expert testimony at great cost to themselves and to the litigation process. Likewise, in the numerous decisions that have since followed *Campbell* and *Iridium*,[1] the courts decided the valuation issues without reliance on expert testimony, but only after permitting extensive expert testimony that was ultimately deemed totally unnecessary. Our proposed motion would prevent the expense and delay attendant on the expert process, except upon a showing that market evidence could not supply an adequate basis for decision.

Based on *Campbell*, *Iridium*, and cases that followed them, it is apparent that in many cases market evidence will be adequate, and no expert testimony is needed. Such market evidence includes the contemporaneous actions of executives and directors, who make career and investment decisions based on their views of value; the contemporaneous actions and views of lenders, creditors, investors, and other market participants; and the contemporaneous views of expert advisors expressed at or near the valuation date. Such contemporaneous evidence is of extremely high probative value: it reflects what real people with close knowledge of the business and a real financial stake in the enterprise actually said and did at the time of the valuation. It is thus immune both from the criticism that the actors had inadequate knowledge of the business, and from the injection of legally impermissible hindsight into the valuation process, which is an inevitable problem when an after-the-fact analysis is created.

Some critics have suggested that our proposal is based on a belief that expert valuation testimony is inherently untrustworthy. That is not our view. Our proposal is based on the decided cases in which such expert

1 See, e.g., *In re Wash. Mut., Inc.*, 442 B.R. 314, 342 (Bankr. D. Del. 2011); *In re Boston Generating, LLC*, 440 B.R. 302, 326 (Bankr. S.D.N.Y. 2010); *In re Chemtura Corp.*, 439 B.R. 561, 586 n.106 (Bankr. S.D.N.Y. 2010); *In re TCI 2 Holdings, LLC*, 428 B.R. 117, 156 (Bankr. D.N.J. 2010); *In re Summit Global Logistics*, No. 08-11566, 2008 Bankr. LEXIS 896, at *32 (Bankr. D.N.J. Mar. 26, 2008).

testimony has been found to be unnecessary, but only after major expense and delay have already been incurred. Others have suggested that our motion is duplicative of the *Daubert* motion, typically made in advance of trial and challenging the proposed expert's methods or credentials. This suggestion misconstrues our proposal. Our motion would be required to be made long before trial—indeed before there had even been any expert discovery—and would force a litigant to justify in advance, imposing on his or her adversary and the court the expense and time burdens associated with expert testimony.

Moreover, our proposal does not rule out the presentation of such testimony where the judge determines that adequate market evidence does not exist or is for some reason not trustworthy. In such a case, the court could grant the motion and the expert process that is now routine would be followed. Further, we recognize that the motion requirement we would impose has some expense associated with it. Nonetheless, we believe that significant savings in time and expense would result if our proposal were adopted by the federal courts.[2]

BACHRACH AND *VERIZON*

Since our article was published in August 2012, a recent opinion from the Bankruptcy Court for the Northern District of Illinois, *In re Bachrach Clothing*, 480 B.R. 820 (Bankr. N.D. Ill. 2012), illustrates both the availability of market evidence and the desirability of our proposed motion requirement. In *Bachrach*, the plaintiff attacked the sale of a family-owned retailer of men's apparel as a fraudulent transfer. The court ruled for the defendants, detailing evidence of no fewer than 10 distinct market events, each of which supported the defendants' contention that the business was solvent and adequately capitalized when sold. *See* 480 B.R. 867. In *Bachrach*, both parties had nevertheless retained experts, and the court engaged in a significant evaluation of their testimony—even though it proved unnecessary to its ultimate decision. Had a motion of the kind we propose been required, the expert testimony likely would have been found unnecessary, and the expense and delay associated with the presentation and judicial scrutiny of such expert testimony could have been eliminated.

Another recent case which demonstrates the prudence of our proposed motion is *U.S. Bank National Association v. Verizon Communications Inc.*, 2013 U.S. Dist. LEXIS 8521 (N.D. Tex. Jan. 22, 2013). In *Verizon*, the trustee for the bankrupt spun-off business brought fraudulent conveyance claims against its former parent, all of which were rejected after a trial. Once again, the court's time was wasted dealing with expert testimony unnecessary to the decision of the case. Once again, the expert offered opinions that were contrary to all of the material market-based information available at the time of the transaction. The decision after trial, which bears remarkable resemblance to the trial court's opinion in *Campbell*, shows that, had a motion of the kind we are proposing been required and submitted, it would have been resolved in favor of the defendants, effectively ending the case. None of the evidence proposed by the plaintiff's expert witness would have been admitted.

Our proposal is fully consistent with—indeed, arguably required by—the relevant Federal Court rules. Federal Rule of Evidence 702(a), which permits the presentation of expert testimony, requires that such testimony will "help the trier of fact to understand the evidence or to determine a fact in issue." As *Campbell*, *Iridium*, and later cases show, expert evidence in valuation cases is often not a help to the trier of fact. The present practice, in which such evidence is routinely permitted, is thus inconsistent with the Federal Rule. Likewise a Federal Rule of Civil Procedure (with the ungainly number 16(c)(2)(D)), requires federal judges to consider "limiting the use" of expert testimony where it would be cumulative of other evidence—a requirement now largely disregarded.

Finally, in addition to promoting a more efficient and effective litigation process, the motion practice requirement we advocate will also produce valuable benefits during the planning stages of corporate transactions. Eliminating, or greatly reducing, the threat of *ex-post-facto*, expert-witness-fueled valuation contests will strengthen the ability of corporate decision makers to structure and execute with certainty transactions that make sound business sense to them at the time, and to which contemporaneous market participants and knowledgeable observers attribute positive value. VE



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2 Some have suggested that our approach should not be taken in the case of closely held companies or family-run businesses because market evidence of value will not exist for them. We see no need for such a presumption based on size or nature of ownership. If the court decides on the proposed motion that market evidence about the subject company is not sufficient—for whatever reason, including its size or ownership structure—it will allow expert evidence; otherwise it will not.