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Practice Pointers for Working With Expert Witnesses in Bankruptcy Court

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LITIGATORS are called upon to participate in bankruptcy proceedings in a variety of ways, including frequently to prepare for and conduct hearings. As in any court, such hearings provide parties the opportunity to introduce evidence, including expert testimony, to enable the court to resolve issues of fact.

While similar in many respects to any other litigation, there are some important nuances of bankruptcy court practice to be mindful of, especially when working with expert witnesses. A few factors that may distinguish bankruptcy court litigation are:

- the lack of juries—bankruptcy judges are the sole fact finder, and tend to possess a great deal of experience and sophistication, particularly regarding complex commercial and financial matters;
- the speed of bankruptcy proceedings relative to disputes in many other courts; and
- the fact that the customary federal privilege protections afforded to expert witness communications and work product may not always be available in bankruptcy court.

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This article provides some examples of how expert witnesses are used in bankruptcy court, and an overview of some issues that practitioners should be mindful of when working with experts in bankruptcy court.

Experts in Bankruptcy Litigation

Experts are called upon to offer opinions in myriad circumstances in bankruptcy court. Some common examples are:

Valuation. Expert witnesses are frequently called upon to provide their opinion as to the value of property at issue in the bankruptcy. For example, in *In re Chemtura*, 439 B.R. 561 (Bankr. S.D.N.Y. 2010), a plan confirmation hearing was

held to resolve several issues, including the debtors' total enterprise value. Confirmation of the plan was opposed by the Official Committee of Equity Security Holders, primarily on the grounds that the plan undervalued the debtors, and that a global settlement—upon which the plan was based—did likewise. *Id.* at 567. The determination of the debtors' total enterprise value came down to a battle of the experts between the debtors' witness and the equity holders, both of whom employed standard valuation methodologies (discounted cash flow, comparable companies, and precedent comparable transactions). Following a detailed review of the experts' opinions, the bankruptcy court confirmed the plan, finding that it did not violate 11 U.S.C. §1129(b)'s "fair and equitable" requirement because the debtors' total enterprise value did not exceed the total enterprise value underlying the proposed settlement. *Id.* at 579.

Feasibility. Expert witnesses are also commonly called to opine on the feasibility of proposed reorganizations in Chapter 11 bankruptcies. Chapter 11 sets forth a list of requirements that must be met before a plan will be approved, including the so-called "feasibility" requirement, which requires that: "Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan." 11 U.S.C. §1129(a)(11). The feasibility of the plan of reorganization was one of several issues that was the subject of a hearing on the plan of reorganization in *In re 20 Bayard Views*,

445 B.R. 83 (Bankr. E.D.N.Y. 2011). There, the debtor—a developer of a residential condominium in Williamsburg, Brooklyn—offered a plan of reorganization that was objected to by the debtor’s largest secured creditor. At the hearing on the plan, the bankruptcy court heard expert testimony by witnesses from both parties on feasibility, ultimately finding that the plan was feasible. *Id.* at 103.

Solvency/Fraudulent Transfers. Expert witnesses can also be useful to help sort through solvency in the context of fraudulent transfer claims, which can be one of the most contentious issues in bankruptcy court. As one example, in *In re Fidelity Bond and Mortgage*, 340 B.R. 266 (Bankr. E.D. Pa. 2006), the bankruptcy court heard competing opinions from expert witnesses on the debtor’s solvency at the time that certain transfers were made, ultimately concluding that the debtor was solvent. *Id.* at 290.

Some other common examples include providing testimony concerning the level of compensation of employees, e.g., *In re Main*, No. 00-cv-35, 2000 WL 1796417, at *6 (E.D. Pa. Nov. 28, 2000) (noting that during inquiry into the reasonableness of compensation, bankruptcy court relied in part on testimony of expert witness), and testimony about industry standards and regulations, e.g., *In re American Camshaft Specialties*, 444 B.R. 347, 364 (Bankr. E.D. Mich. 2011) (parties to proceeding used expert witnesses to render opinions as to whether transfers fell within industry standards). These are but a few of the many scenarios in which scientific, technical or specialized knowledge of an expert could help a bankruptcy court judge understand facts or issues in a given case.

Admissibility of Testimony

Rule 702 of the Federal Rules of Evidence governs the admissibility of expert witness testimony in federal court, including in bankruptcy court, and provides:

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.

Under Rule 702, the trial court judge serves as “gatekeeper,” and excludes expert witnesses who are deemed not qualified, reliable, or able to provide relevant testimony. *Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579, 589 (1993). The gatekeeper’s duty, in essence, is to ensure that the fact finder is not tainted by evidence that does not meet “the same level of intellectual rigor that characterizes the practice of an expert in the relevant field.” *Kumho Tire v. Carmichael*, 526 U.S. 137, 152 (1999).

Because the judge rather than a jury serves as fact finder in bankruptcy court, however, the rationale for a bankruptcy judge to exercise his or her gatekeeper duties before testimony occurs may be less compelling. While some bankruptcy courts have consistently applied the Rule 702 analysis before permitting experts

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to testify, other bankruptcy courts have permitted the expert testimony in the first instance, and later addressed whether the testimony satisfied the Rule 702 standard. Compare *In re Citadel Broadcasting*, Case No. 09-17442 (BRL), 2010 Bankr. LEXIS 1606, at *17 (Bankr. S.D.N.Y. 2010) (bankruptcy court exercised gatekeeping role and barred testimony of expert witness on valuation of radio broadcasting company), and *In re Med Diversified*, 334 B.R. 89, 92 (Bankr. E.D.N.Y. 2005) (exercising “role as the gatekeeper,” and determining that proposed witness did not satisfy *Daubert* standard as to direct testimony, but could testify as a rebuttal witness to plaintiffs’ proposed expert), with *Deal v. Hamilton Cty. Bd. of Education*, 392 F.3d 840, 852 (6th Cir. 2004) (“The ‘gatekeeper’ doctrine was designed to protect juries and is largely irrelevant in the context of a bench trial”), and *In re Salem*, 465 F.3d 767, 777 (7th Cir. 2006) (noting that “court’s gatekeeping role is necessarily different” during a bench trial; “[w]here gatekeeper and factfinder are one and

the same—that is, the judge—the need to make [gatekeeping] decisions prior to hearing the testimony is lessened”). Given the conflicting views among courts as to when the Rule 702 analysis will be applied, practitioners should review the practices of the bankruptcy court in which they are appearing to determine whether the court will exercise its gatekeeping duties before or after an expert witness has testified.

Privilege Concerns

Bankruptcy court practitioners working with expert witnesses should also be aware that the generally-applicable federal rules of privilege apply in some, but not all, contexts. Under Rules 26(b)(4)(B) and 26(b)(4)(C) of the Federal Rules of Civil Procedure, drafts of expert reports, and communications between counsel and experts, are not discoverable. Rule 26, however, only applies to adversary proceedings, not contested matters.¹ F.R.B.P. 7026.

So what happens in contested matters? Rule 9014 of the Federal Bankruptcy Rules specifically precludes application of Rule 26(a)(2) of the Federal Rules of Civil Procedure, which requires disclosure of expert reports, to contested matters, unless the bankruptcy court directs otherwise. In practice, this means that while there may be no need to prepare an expert report in a contested matter, if one is in fact prepared and produced, it may not receive Rule 26(b)’s protections afforded to drafts and communications with attorneys. One solution is to obtain a stipulation from the other parties or an order from the court explaining what privilege protections will apply.

Expert Witnesses as Advisers

Another privilege concern arises from the frequent practice of having a debtor’s advisers serve as expert witnesses. Unlike in most litigations, in bankruptcy court litigation the subject of testimony usually involves ongoing issues. As a result, oftentimes a business adviser will be in the best position also to serve as an expert. A common example of such an arrangement is having investment bankers, consultants, or other financial advisers provide expert testimony about a company’s viability as an ongoing business.

In these circumstances, practitioners should separate the two roles to the extent practical. Ideally, the testifying expert should be insulated by not serving in an advisory role, but instead have a separate person or team manage the advisory issues. This separation will minimize the privilege concerns that may arise from having a testifying

expert involved in strategic decisions or reviewing preliminary plans or documents—especially in contested matters, where the protections of Rule 26 may not apply. See *In re Tri State Outdoor Media Group*, 283 B.R. 358, 365 (Bankr. M.D. Ga. 2002) (creditor waived much of the work product protection and attorney client privilege it had to documents and information in possession of its financial consultant by offering consultant as expert on disputed issues in Chapter 11 case). It may also reduce the credibility concerns that could arise if advisers' fee arrangements are contingent upon particular outcomes. See, e.g., *In re Chemtura*, 439 B.R. at 588-90 (finding that incentives in engagement agreements of expert witnesses "materially and adversely" affected their credibility); *In re Granite Broadcasting*, 369 B.R. 120, 142 (Bankr. S.D.N.Y. 2007) (expert's testimony "was seriously undermined by the fact that his compensation from the Preferred Holders is contingent on the total consideration to be received by the Preferred Holders under a confirmed plan").

In addition, because the subject of the expert witness' testimony is often current and potentially in a state of flux, practitioners must ensure that the testimony is kept up to date, including updating the expert's knowledge and opinions between the preparation of an initial report or affidavit (if any), deposition testimony, and hearing testimony.

Speed of Proceedings

Bankruptcy issues are often litigated much more quickly than counterpart matters in state or federal courts. In many instances, particularly in contested matters (as opposed to adversary proceedings), parties will not have the luxury of a leisurely discovery schedule with months of fact discovery, followed by months of expert witness discovery, followed by a month of depositions. In bankruptcy court, it is not uncommon to see an expert report comprised of a short affidavit prepared in a matter of days (if one is prepared at all),² followed by a deposition several days thereafter, and a hearing a few days after that. Given the short time frame, a practitioner in bankruptcy court should, before the other parties identify their experts, consider what kinds of experts other parties might offer, assemble responsive material, and locate possible rebuttal experts; and once they are identified, a practitioner should focus any research and deposition outlines on only the key issues, as there may not be time for the broad-ranging preparation normally done in other contexts.

Approval of Retention and Fees

Finally, an interesting question for practitioners to consider is whether an expert witness is a

professional under §327 of the Bankruptcy Code, thus requiring court approval. 11 U.S.C. §327(a). Most courts have held that expert witnesses are not professionals within the meaning of §327. See, e.g., *In re Napoleon*, 233 B.R. 910, 913-14 & n.1 (Bankr. D.N.J. 1999) (noting that "most courts have come to the conclusion that there is no requirement of prior court authorization for retention of an expert witness because an expert is not a 'professional person' within the meaning of §327," and listing cases in accord). However, the issue becomes more complicated where an expert is also the debtor's adviser. In such circumstances, bankruptcy courts are more likely to treat the expert as professionals within the meaning of §327. See, e.g., *In re Acands*, 297 B.R. 395, 402-03 (Bankr. D. Del. 2003) (finding that expert was a professional within the meaning of §327 given its extensive involvement as an adviser).

Reimbursement of fees for expert witnesses retained under §327 is subject to court approval pursuant to §330, and is generally considered within the context of §330(a)(1)(B), which governs "reimbursement for actual, necessary expenses."³ 11 U.S.C. §330(a)(1)(B). When making determinations about reimbursement of expert witness fees, many bankruptcy courts will not rule on the amount owed to each expert—"that is a contractual matter between [counsel] and each expert over which this court has no jurisdiction. [The] court will merely decide how much the estate will be permitted to pay to [counsel] by way of reimbursement." *In re Napoleon*, Case No. 89-30612, 1999 Bankr. LEXIS 816, at *2 (Bankr. D.N.J. May 26, 1999).

Conclusion

As in any court, the key to working with expert witnesses in bankruptcy court is proper preparation within the limited time available. Beyond developing a substantive plan as to how their experts will advance their case—and how to minimize the impact of others' experts—practitioners must also avoid potential pitfalls by considering the particular privilege, timing, and fee issues that arise in bankruptcy litigation, as guided by the rules of the specific bankruptcy court in which they appear.



1. A contested matter is a disputed matter filed within the main bankruptcy case, such as an objection to a motion, and is governed by Rule 9014 of the Federal Rules of Bankruptcy Procedure, while an adversary proceeding is a separate lawsuit filed in bankruptcy court that arises out of the main bankruptcy case, and is governed by Part VII of the Federal Rules of Bankruptcy Procedure.

2. Declarations and affidavits are frequently used in lieu of direct examination of witnesses in bankruptcy court, particularly in less contentious matters. While some commentators have criticized the practice for essentially permitting admis-

sion of hearsay evidence, such criticisms are generally not successful. See, e.g., *Ball v. Interoceania*, 71 F.3d 73, 77 (2d Cir. 1995) (approving "procedure allowing [] parties to produce direct evidence from their witnesses in writing while permitting subsequent oral cross-examination—particularly when the parties agree to that procedure in advance").

3. If a debtor chooses to engage an expert witness who is not a professional person, retention of the expert pursuant to §327 is not necessary. Similarly, such an expert's compensation is subject to §503(b) rather than §330. However, the distinction between which experts require approval under §327, and which do not, is not always clear. Unless the practitioner is certain that approval is not required, the prudent practice is to seek court approval under §327.