Market Evidence, Expert Opinion, and the Adjudicated Value of Distressed Businesses

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One year ago, The Business Lawyer *published an article arguing that courts, when adjudicating the value of distressed businesses, should predominantly defer to "market" evidence, rather than expert opinion. In* Campbell, Iridium, and the Future of Valuation Litigation, *authors Michael W. Schwartz and David C. Bryan contended that near-universal judicial deference to market data: (1) is supported by recent developments in the case law; (2) would obviate judicial "hindsight bias"; and (3) would enable a more efficient valuation process. Messrs. Schwartz and Bryan further argued that, to solidify the paradigm change, courts should start imposing a pretrial obligation on any litigant intending to present expert valuation opinion to move specially, under Federal Rule of Evidence 702(a), for allowance to do so. This article offers an opposing viewpoint and argues that Messrs. Schwartz and Bryan interpret applicable case law selectively, outside of a broader jurisprudential context, and in a manner that disregards deeply ingrained legal principles. The authors here further contend that: (a) Messrs. Schwartz and Bryan have not presented a compelling case of widespread judicial "hindsight bias"; (b) they have also failed to make a persuasive showing that their proposal will lead to meaningful process efficiencies; and (c) their thesis fails to appreciate the complexity of market dynamics. This article concludes that market evidence tends to require expert interpretation, especially when used to value troubled businesses.*

I. Introduction

Valuing a troubled business is tricky. Like quantum mechanics,[1] determining the fundamental worth of an enterprise in distress may be better stated in ranges and probabilities than by fixed-point value. Even in an optional transaction involving a healthy company, where the price is determined by intelligent and

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1. The value of a distressed business, like the properties of a sub-atomic particle, cannot be discerned by simple observation, is never static (but, rather, always in a state of motion and evolution), and is influenced by the tools available for measurement as well as other aspects of surrounding circumstance. *See* Stephen Hawking (with Leonard Mlodinow), A Briefer History of Time 92 (2005) ("One of the revolutionary properties of quantum mechanics is that it does not predict a single definitive result for an observation. Instead, it predicts a number of different outcomes and tells us how likely each of these is."); Werner Heisenberg, Physics and Philosophy: The Revolution in Modern Science 186 (1958) ("[T]he atoms or elementary particles themselves are not real; they form a world of potentialities or possibilities, rather than one of things or fact.").

arm's-length negotiation, there likely is no agreement as to *intrinsic* value[2]: Voluntary buyers tend to offer only where they think they are getting a good deal (i.e., the business is worth more than they have offered), while voluntary sellers tend to accept only where they think they are getting a good deal (i.e., the business is worth less than what has been offered). Distress makes determining intrinsic value a much more complex assignment, given that financial trouble: (i) is not always immediate, clear, or absolute, but often is a matter of degree and opinion; (ii) imposes changes in business circumstance and future outlook; (iii) compels new business imperatives; (iv) adds procedure and professional cost; (v) constrains credit, trading opportunities, and corporate action; and (vi) introduces strategic behavior among lenders, other creditors, stockholders, potential acquirers, and even management and employees.

In litigation, enterprise valuation tends to be the purview of expert testimony. But, where there is evidence of financing availability, pricing of a distressed company's debt or stock, and/or acquisition interest in the enterprise, litigants increasingly point to such "market" data as persuasive indicators of business worth. Which evidence is superior? One year ago, this journal published a thought-provoking article authored by Michael W. Schwartz and David C. Bryan arguing in favor of more extensive judicial reliance on market evidence instead of expert opinion.[3] In their article, Messrs. Schwartz and Bryan focus on two important opinions where market evidence was found crucial to the ultimate value determination in the context of fraudulent transfer actions.[4] In each

2. In this article, "intrinsic" value refers to the "discounted sum of expected future cash flows, where in forming expectations, investors correctly process all available information." Nicholas Barbeis & Richard Thaler, *A Survey of Behavioral Finance*, *in* HANDBOOK OF THE ECONOMICS OF FINANCE 1053, 1054 (G.M. Constantindies et al. eds., 2003). "Fair market" value refers to "[t]he price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts." AM. INST. OF CERTIFIED PUB. ACCOUNTANTS, STATEMENT ON STANDARDS FOR VALUATION SERVICES NO. 1—VALUATION OF A BUSINESS, BUSINESS OWNERSHIP INTEREST, SECURITY, OR INTANGIBLE ASSET 44 (2007), *available at* http://www.aicpa.org/InterestAreas/ForensicAndValuation/Resources/Standards/DownloadableDocuments/SSVS_Full_Version.pdf; *see also* Rev. Rul. 59-60, 1959-1 C.B. 237. Respecting distressed businesses, courts often phrase their search for "intrinsic" value in "fair market" terms. *See, e.g.*, *In re* Coram Healthcare Corp., 315 B.R. 321, 340 (Bankr. D. Del. 2004) ("[V]aluation must be analyzed in a realistic framework assuming a willing seller and a willing buyer."). Theoretically, this works, provided that sufficient analytical emphasis is placed on the understanding that "fair market" value is based on a hypothetical, unpressured, and optional transaction (i.e., it is a reasonable assumption that, in an unpressured and optional M&A transaction, the agreed-upon price will fairly reflect anticipated future cash flows). "Market" value, by contrast (removing "fair" from the value conceptualization), is generally understood as being more generic and often related to assets lacking the indicia of a liquid market, such as real estate. Problems arise when litigants confuse "market" value with "fair market" value and, in turn, "intrinsic" value. For this reason, a sale pursuant to Bankruptcy Code section 363 may reflect "market" value but not necessarily "fair market" or, by extension, "intrinsic" value. *See* BFP v. Resolution Trust Corp., 511 U.S. 531, 538 (1994) ("In short, 'fair market value' presumes market conditions that, by definition, simply do not obtain in the context of a forced sale."). This is discussed further in Part IV.C.

3. Campbell, Iridium, *and the Future of Valuation Litigation*, 67 BUS. LAW. 939 (2012).

4. *See* VFB LLC v. Campbell Soup Co., 482 F.3d 624 (3d Cir. 2007); Statutory Comm. of Unsecured Creditors v. Motorola, Inc. (*In re* Iridium Operating LLC), 373 B.R. 283 (Bankr. S.D.N.Y. 2007).

of *Campbell* and *Iridium*, the plaintiff unsuccessfully asserted fraudulent transfer claims arising from a transformative prebankruptcy transaction. Both plaintiffs attempted to prove insolvency via expert analytics in the face of overwhelming evidence that the capital and securities markets were, at the time of the transaction in question, functioning properly, well-informed, and supportive of the deal. The courts held that, in the face of such evidence, expert opinion was insufficient and, consequently, the plaintiffs had failed to prove their case.

Messrs. Schwartz and Bryan characterize *Campbell* and *Iridium* as a "landmark" moment in the law,[5] counseling for a new approach (universally applied) to valuation contests stemming from corporate distress, including those generally arising in Chapter 11.[6] The authors suggest that courts start imposing a pretrial obligation on any litigant wishing to present expert testimony in any kind of valuation dispute concerning a troubled company to move specially for allowance to do so.[7] The motion should fail if the proponent does not prove (before any evidence has been received by the court) that "[market] evidence is untrustworthy or lacking in credibility or otherwise insufficient."[8] That is especially true if the transaction in question bears the support of "knowledgeable insiders" and "knowledgeable outsiders," who by proxy purportedly corroborate the valuation.[9] According to the article, any such expert evidence should be excluded pursuant to Rule 702(a) of the Federal Rules of Evidence, not on *Daubert* grounds,[10] but rather as "unhelpful" to "the trier of fact to understand the evidence or to determine a fact in issue."[11] The article further contends that Rule 702(a) exclusion would (i) ensure that hindsight bias does not infect the adjudicated valuation and (ii) reduce the expense and complexity of valuation disputes in a more direct way than the myriad flexible methods courts now employ to control cases proceeding to trial.[12]

This is a controversial proposition. Fraudulent transfer law has been around for hundreds of years, often litigated and analyzed, twice studied for enactment

5. Schwartz & Bryan, *supra* note 3, at 939.

6. For example, the authors: (1) contend that courts are accepting market-based valuations, "[n]ot only in fraudulent transfer cases, but in confirmation contests and reviews of section 363 asset sales as well," *id.* at 940; (2) posit that "each of the substantive issues can and should be disposed of in a manner permitting market evidence to decide most corporate valuation disputes in bankruptcy," *id.*; (3) advance "market evidence of these kinds . . . in virtually every corporate valuation case," *id.* at 946; (4) cite with favor *In re Chemtura Corp.*, 439 B.R. 561 (Bankr. S.D.N.Y. 2010), for the court's reliance on market evidence in connection with contested plan confirmation, *see* Schwartz & Bryan, *supra* note 3, at 947–48; and (5) also cite with favor *In re Boston Generating, LLC*, 440 B.R. 302 (Bankr. S.D.N.Y. 2010), for the court's reliance on market evidence in connection with a contested business sale pursuant to Bankruptcy Code section 363, *see* Schwartz & Bryan, *supra* note 3, at 948–49.

7. Schwartz & Bryan, *supra* note 3, at 954.

8. *Id.* at 953.

9. *Id.* at 946.

10. *See* Daubert v. Merrell Dow Pharms., Inc., 509 U.S. 579, 597 (1993) (trial courts must eject from the evidentiary record opinions of experts who are unqualified or do not provide reliable or relevant testimony to the particular question at hand).

11. Schwartz & Bryan, *supra* note 3, at 952–53 (quoting FED. R. EVID. 702(a)).

12. *Id.* at 950–51.

of uniform statutes, and reconsidered by Congress for incorporation in the Bankruptcy Code. Enterprise valuation for other bankruptcy purposes has been a topic of regular discussion by the Supreme Court, other appellate and decisional courts, scholars, and members of Congress for the better part of a century. For many decades, markets were readily producing data for litigants and courts to observe. Why has the law not previously moved in the direction advocated in the article?

Messrs. Schwartz and Bryan do not answer that question. Rather, they advance their thesis by reading *Campbell* and *Iridium* largely in isolation, separated from applicable legal principles and without any meaningful discussion of market dynamics and the complexity of market thinking. This article, in juxtaposition, proposes reading *Campbell* and *Iridium* in a broader jurisprudential context, with due consideration of the logic and limits of market theory. We argue against the proposal advanced by Messrs. Schwartz and Bryan but, in so doing, we hope to spark deeper and more thoughtful scholarly discussion over when and what forms of market evidence should be deemed probative and persuasive to courts adjudicating the value of distressed business enterprises.[13]

II. Legal Principles and Precedent

A. Contextual Framework

1. Legislative Intent

A natural starting point is to consider what evidence Congress, when crafting the Bankruptcy Code, thought relevant to valuation contests. Procedural devices (such as Rule 702(a) exclusion) are not supposed to vitiate legislative intent, especially if they supplant the adversary process or subvert a statutory allocation of trial burdens.[14] As succinctly stated by Professor David Leonard:

> If trials function primarily to determine and vindicate substantive legal rights, it follows that the rules governing the evidentiary process—rules that establish what evidence will be admissible and that govern the permissible means of offering admissible evidence—should be subordinate. Those rules must in some fashion serve the overriding goals of the substantive law.[15]

The text of the Bankruptcy Code and certain statements in the legislative history provide helpful indications of legislative intent.[16] These markers do not, however, support the thesis advanced by Messrs. Schwartz and Bryan.

13. Much has been written on valuation contests in general, even concerning businesses in distress. *See, e.g.*, Contested Valuation in Corporate Bankruptcy: A Collier Monograph (Robert J. Stark et al. eds., 2011); Stan Bernstein, Susan H. Seabury & Jack F. Williams, *Squaring Bankruptcy Valuation Practice with* Daubert *Demands*, 16 Am. Bankr. Inst. L. Rev. 161 (2008). But less scholarly attention has been paid to the use of market evidence in the adjudicated value of distressed businesses.

14. *See, e.g.*, 28 U.S.C. § 2072(b) (2012) (the Federal Rules of Evidence "shall not abridge, enlarge or modify any substantive right").

15. David P. Leonard, *Rules of Evidence and Substantive Policy*, 25 Loy. L.A. L. Rev. 797, 800 (1992).

16. For an explanation of the Bankruptcy Code's voluminous legislative history, see Kenneth N. Klee, *Legislative History of the New Bankruptcy Law*, 28 DePaul L. Rev. 941 (1979).

a. Fraudulent Transfers

Fraudulent transfer law has long enabled avoidance of certain conveyances made by an insolvent debtor. The law was originally enacted in Elizabethan England,[17] but then re-crafted in early twentieth century America as the Uniform Fraudulent Conveyance Act ("UFCA").[18] When developing the Bankruptcy Code and, in particular, the Code's own fraudulent transfer section (section 548), Congress reconsidered the UFCA and made revisions where it deemed appropriate.[19] After enactment of the Bankruptcy Code in 1978, a new uniform state statute was drafted, corresponding (at least for our purposes) with Congress's articulation of section 548.[20] The Uniform Fraudulent Transfer Act ("UFTA") has since been enacted in all but two states,[21] and is made available to debtors in bankruptcy via the section 544(b) "strong-arm" powers.[22] Thus, any expression of congressional intent regarding section 548 proof requirements has deep impact here.

To prevail under section 548, the plaintiff must prove some form of statutorily delineated financial distress,[23] including, but not limited to, "insolvency."[24] Section 101(32) defines corporate insolvency as the condition at which a determination of aggregate debt exceeds "a fair valuation" of all debtor property. The "fair valuation" standard was chosen specifically; this is one instance where section 548 deviated from the UFCA.[25] The "fair valuation" standard also deviated from two other Bankruptcy Code provisions that cast the valuation question in terms of "fair *market* value."[26] By omitting the word "market," one might be inclined to read section 101(32) as enabling fraudulent transfer actions even where "market" data is unavailable. One might also be inclined to think that evidence other than "market" data might inform "a fair valuation." Indeed, as stated by the Supreme Court when interpreting these very provisions of the Bankruptcy Code, "it is generally presumed that Congress acts intentionally and purposely when it includes particular language in one section of a statute but omits it in another."[27]

17. The Fraudulent Conveyances Act, 1571, 13 Eliz., c. 5 (Eng.).

18. Unif. Fraudulent Transfer Act, 7A U.L.A. 13 (2006); *see generally* 5 COLLIER ON BANKRUPTCY ¶ 548.01[2][a][ii] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. rev. 2011).

19. *See* 5 COLLIER ON BANKRUPTCY, *supra* note 18, ¶ 548.05[3][a].

20. *Id.* ¶ 548.01[1][b].

21. *Id.* ¶ 548.01[2][a][ii].

22. *Id.* ¶ 548.01[2].

23. 11 U.S.C. § 548(a)(1)(B)(ii) (2012).

24. *Id.* § 548(a)(1)(B)(ii)(I). "Insolvency" is also a required element in preference actions brought under Bankruptcy Code section 547. *See id.* § 547(b)(3). Consequently, valuation principles established under the fraudulent transfer rubric are generally considered pertinent to the preference rubric, and vice versa.

25. 5 COLLIER ON BANKRUPTCY, *supra* note 18, ¶ 548.05[3][a] (section 101(32)'s "use of 'fair valuation' marks a departure from prior law. The Bankruptcy Code rejected the . . . UFCA's reliance on asset valuation at 'present fair salable value.' The difference between the two tests was known and is significant." (citations omitted)).

26. *See* 11 U.S.C. § 522(a)(2) (2012); 11 U.S.C. § 346(j)(7)(B) (repealed 2005).

27. BFP v. Resolution Trust Corp., 511 U.S. 531, 537 (1994) (quoting Chicago v. Envtl. Def. Fund, 511 U.S. 328, 338 (1994)).

The conclusion also comports with other indicia of legislative intent, prescribing particular valuation evidence in certain contexts but broad flexibility in others.[28]

b. Reorganization Value

Thirty-seven years before enactment of the Bankruptcy Code, the Supreme Court expressed its view on how decisional courts should value reorganizing debtors. In the seminal case, *Consolidated Rock Products Co. v. Du Bois*, the Court focused sharply on the debtor's postbankruptcy earning capacity:

> Such criterion is the appropriate one here, since we are dealing with the issue of solvency arising in connection with reorganization plans involving productive properties. It is plain that valuations for other purposes are not relevant to or helpful in a determination of that issue, except as they may indirectly bear on earning capacity. The criterion of earning capacity is the essential one if the enterprise is to be freed from the heavy hand of past errors, miscalculations or disaster, and if the allocation of securities among the various claimants is to be fair and equitable.[29]

Prior to enactment of the Bankruptcy Code, subsequent Supreme Court decisions reaffirmed the governing evidentiary principle of *Consolidated Rock*.[30]

The Bankruptcy Code does not direct a deviation from *Consolidated Rock* and its progeny. The rules regarding plan cram down stipulate only that the valuation must be "fair and equitable" and comply with the absolute priority rule.[31] It seems telling that Congress cast the evidentiary standard flexibly (mirroring the Supreme Court's chosen words in *Consolidated Rock*), given that: (1) again, other sections of the Bankruptcy Code particularize the valuation approach to be used in other contexts;[32] and (2) it is generally thought that, "if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific," particularly "in construing the scope of bankruptcy codifications."[33] Moreover, the Bankruptcy Code's legislative history speaks

28. *Compare* 11 U.S.C. § 522(a)(2) (2012) ("'[V]alue' means fair market value as of the date of the filing of the petition"), *and id.* § 549(c) ("The trustee may not avoid . . . a transfer . . . to a good faith purchaser . . . for present fair equivalent value"), *with id.* § 506(a)(1) ("[V]alue [is to] be determined in light of the purpose of the valuation and of the proposed disposition or use of such property"), *and id.* § 1129(a)(7)(A)(ii) (each holder "will receive . . . property of a value . . . that is not less than the amount that such holder would so receive . . . if the debtor were liquidated").

29. 312 U.S. 510, 526 (1941) (citations omitted).

30. *See* Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 441–42 (1968) ("The appropriate standard for valuing a company undergoing reorganization was set out at length in [*Consolidated Rock*]."); Grp. of Inst. Investors v. Chi., Milwaukee, St. Paul & Pac. R.R. Co., 318 U.S. 523, 541 (1943) ("The basic question in a calculation for reorganization purposes is how much the enterprise in all probability can earn."); *see also* Galveston, H. & S.A. Ry. Co. v. Texas, 210 U.S. 217, 226 (1908) ("[T]he commercial value of property consists in the expectation of income from it.").

31. *See* 11 U.S.C. § 1129(b) (2012).

32. *See supra* note 28.

33. Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot., 474 U.S. 494, 501 (1986); *see also* Cohen v. De La Cruz, 523 U.S. 213, 222 (1998) (stating that, the Supreme Court "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure" (citation omitted)); Dewsnup v. Timm, 502 U.S. 410, 419 (1992) ("[T]his court has been

approvingly of the *Consolidated Rock* approach to reorganization valuation.[34] There is even mention that "market values, liquidation values, and past earnings records may be relevant, [but] they are not determinative."[35] For these reasons, courts continue to value reorganizing enterprises based on intrinsic data (i.e., earnings potential) rather than defer to then-prevailing market attitudes.[36]

2. Valuation Contests, In General

a. The Adversary Process

Valuation disputes presented for bankruptcy court resolution arise in "adversary proceedings," such as fraudulent transfer actions,[37] or "contested matters," such as non-consensual plan confirmation.[38] In both procedural contexts: (1) parties-in-interest "may . . . appear and may be heard"[39] and, in furtherance of their position, may seek discovery;[40] (2) the judge may not rule absent a hearing,[41] which "shall be conducted in open court";[42] (3) parties may compel trial testimony by subpoena[43] and Federal Rule of Civil Procedure 43[44] and may otherwise adduce evidence pursuant to the Federal Rules of Evidence;[45] and (4) the ultimate ruling must comply with Federal Rule of Civil Procedure 52, obligating the court to "find the facts specially and state its conclusions of law separately."[46] Valuation is, in short, to be determined through the familiar legal construct: a competitive adversary process (i.e., a trial) where each side has a fair opportunity to prepare and present its case.

Many decades ago, the Supreme Court made clear that bankruptcy does not artificially constrain the adversary process, especially as it pertains to matters

reluctant to accept arguments that would interpret the [Bankruptcy] Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history.").

34. *See, e.g.*, S. REP. NO. 95-989, at 124–25 (1978); H.R. REP. NO. 95-595, at 224–25, 227 (1977); H.R. REP. NO. 93-137, at 255–58 (1973) [hereinafter Commission Report].

35. Commission Report, *supra* note 34, at 256.

36. *See, e.g.*, *In re* Mirant Corp., 334 B.R. 800, 816 (Bankr. N.D. Tex. 2005) (court relied on methodologies "likely to ensure that Mirant Group is valued based on the worth of its future ability to produce income"); *In re* Bush Indus., Inc., 315 B.R. 292, 299 (Bankr. W.D.N.Y. 2004) ("[T]he appropriate valuation of Bush Industries is to be grounded upon its earning capacity as a reorganized entity."); *In re* Exide Techs., 303 B.R. 48, 65–66 (Bankr. D. Del. 2003) ("Modern finance has caught up with the Supreme Court's directions in *Consolidated Rock* by providing Courts with valuation methodologies that focus upon earning capacity." (quotations omitted)); *see also* Christopher S. Sontchi, *Valuation Methodologies: A Judge's View*, 20 ABI L. REV. 1, 14 (2012) ("In the majority of instances in chapter 11 in which valuation is implicated, . . . market data will be unavailable or inapplicable.").

37. *See* FED. R. BANKR. P. 7001(1).

38. *See* FED. R. BANKR. P. 9014.

39. 11 U.S.C. § 1109(b) (2012); *see also id.* § 1128(b).

40. *See* FED. R. BANKR. P. 7026, 9014(c).

41. *See, e.g.*, 11 U.S.C. § 1128(a); FED. R. BANKR. P. 7040.

42. FED. R. BANKR. P. 5001(b).

43. *See* FED. R. BANKR. P. 9016(a)(1)(A)(iii).

44. *See* FED. R. BANKR. P. 9017.

45. *See id.*

46. FED. R. CIV. P. 52(a)(1); *see* FED. R. BANKR. P. 7052, 9014(c).

of valuation. In *National Surety Co. v. Coriell*,[47] a large and historically profitable business owned by Morris White was unable to satisfy lender obligations, but otherwise may have been solvent. After a federal receivership case was initiated, a private deal was struck: Mr. White's spouse would buy the debtor's assets, offering creditors 20 percent of their claims in new company notes and 80 percent in new company preferred stock.[48] The Whites would own the common shares, Morris White would continue running the business, and the lenders would provide future working capital.[49] The deal was presented to the district court with lender support, but without any valuation evidence.[50] The district court surreptitiously approved the plan over the strenuous objection of non-lender creditors, who preferred the company be sold at public auction.[51] The Supreme Court reversed, stating: "Every important determination by the court . . . calls for an informed, independent judgment. . . . [T]he court should have secured adequate, trustworthy information."[52] Regarding valuation in particular, the Court stated:

> The nonassenting creditors were entitled to have the plan and their objections considered in an orderly way, and to a degree based on adequate data. The District Court had before it, in support of the plan, only informal, inadequate, and conflicting ex parte assertions unsupported by testimony. It undertook to pass upon the wisdom and fairness of the plan of reorganization, and the rights of nonassenting creditors. For the proper disposition of these questions, definite, detailed, and authentic information was essential. Such information was wholly lacking.[53]

Coriell was a federal receivership case, but the rule announced has since become a foundational principle of bankruptcy adjudication. In *Case v. Los Angeles Lumber Products Co.*, the Supreme Court said that the "function and duty [of courts adjudicating bankruptcy cases] are no less here than they are in equity receivership reorganizations, where this Court said, 'Every important determination by the court in receivership proceedings calls for an informed, independent judgment.'"[54] Eight years later, in *Consolidated Rock*, the Court said that the *Coriell* requirement of "informed, independent judgment" applies in bankruptcy valuation disputes.[55] And, perhaps most salient, in *TMT Trailer Ferry*, the Supreme Court reversed the bankruptcy court's valuation determination because it "did not have before it all of the evidence and testimony relating to the future problems and prospects of the company which were necessary to assess its value as a going concern."[56]

47. 289 U.S. 426 (1933).
48. *See id.* at 428–29.
49. *See id.* at 429–30.
50. *See id.* at 436.
51. *See id.* at 432.
52. *Id.* at 436.
53. *Id.* at 435.
54. 308 U.S. 106, 115 (1939) (quoting *Coriell*, 289 U.S. at 436).
55. Consol. Rock Prods. Co. v. Du Bois, 312 U.S. 510, 520 (1942).
56. Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 444 (1968).

Into the modern era, appellate and decisional courts continue to follow this governing principle of law, in both the avoidance context and other bankruptcy-related valuations.[57] The proposal advanced by Messrs. Schwartz and Bryan would inhibit an open and even-handed trial process and, thereby, arguably contravenes a principle deeply ingrained in American law.

b. Rule 702(a) Exclusion, In General

Generally, the law does not favor pretrial exclusion of otherwise admissible expert evidence on "helpfulness" (as opposed to *Daubert*) grounds, especially in bench trials.[58] The gatekeeper function of Rule 702(a) is "not intended to supplant the adversary system."[59] Even "shaky but admissible" expert evidence should be allowed, but then exposed to "vigorous cross-examination, presentation of contrary evidence, and careful instruction on the burden of proof."[60] "[I]n most cases, objections to the inadequacies of a study are more appropriately considered an objection going to the weight of the evidence rather than its admissibility."[61] Even if an expert has a biased viewpoint (e.g., a "hindsight bias"), that is not grounds to exclude the testimony under Rule 702(a).[62]

Ultimately, "the test for determining the appropriateness of expert testimony is 'the common sense inquiry whether the untrained layman would be qualified to determine intelligently and to the best possible degree the particular issue without enlightenment from those having specialized understanding of the subject

57. *See, e.g.*, *In re* Fed. Mogul-Global, Inc., 348 F.3d 390, 406 (3d Cir. 2003) (vacating bankruptcy court order predicated on insolvency determination, where no evidence supported the finding, only argument of counsel); *In re* Cellular Info. Sys., Inc., 171 B.R. 926, 930 (Bankr. S.D.N.Y. 1994) (citing *Consolidated Rock* and *Coriell* in connection with valuation dispute); *In re* N.Y., New Haven & Hartford R.R. Co., 4 B.R. 758, 772–73 (Bankr. D. Conn. 1980) ("[A]bsent the required valuation data, the court is in no position to exercise the informed judgment required of it in assessing the fairness, equity and feasibility of a plan."); *see also In re* Racing Servs., Inc., 332 B.R. 581, 586 (8th Cir. BAP 2005) (bankruptcy court abused its discretion approving stipulation in contested matter without holding an evidentiary hearing).

58. *See, e.g.*, Deal v. Hamilton Cnty. Bd. of Educ., 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."); Gibbs v. Gibbs, 210 F.3d 491, 500 (5th Cir. 2000) ("Most of the safeguards provided for in *Daubert* are not as essential in a case such as this where a district judge sits as the trier of fact in place of a jury."); Berry v. Sch. Dist. of Benton Harbor, 195 F. Supp. 2d 971, 977 n.3 (W.D. Mich. 2002) ("[T]he court's 'gatekeeper' function under *Kumho* and *Daubert* is less critical when the court itself serves as the trier of fact."); United States v. 100.01 Acres Buchanan Cnty., No. 1:00CV00185, 2002 WL 923925, at *2 (W.D. Va. May 7, 2002) ("The gatekeeping function of the court is relaxed where a bench trial is to be conducted . . . because the court is better equipped than a jury to weigh the probative value of expert evidence."); *In re* Commercial Fin. Servs., Inc., 350 B.R. 520, 526–27 (Bankr. N.D. Okla. 2005) (denying motion to exclude valuation opinion prior to bench trial).

59. Maiz v. Virani, 253 F.3d 641, 666 (11th Cir. 2001) (quotations omitted).

60. Quiet Tech. DC-8, Inc. v. Hurel-Dubois UK Ltd., 326 F.3d 1333, 1341 (11th Cir. 2003) (quotations and citations omitted).

61. Hemmings v. Tidyman's Inc., 285 F.3d 1174, 1188 (9th Cir. 2002).

62. *See, e.g.*, Cruz-Vazques v. Mennonite Gen. Hosp., 613 F.3d 54, 59–60 (1st Cir. 2010) (district court erred when it excluded expert testimony on the basis of bias); DiCarlo v. Keller Ladders, Inc., 211 F.3d 465, 468 (8th Cir. 2000) (whether expert was biased went to weight of testimony, not its admissibility, and opposing party was allowed to present its evidence of bias on cross-examination).

involved in the dispute.'"[63] We respectfully posit that Messrs. Schwartz and Bryan presume far too much contending that the "untrained layman" intuitively appreciates the inner-workings of the "market," especially in the mercurial context of corporate distress and bankruptcy.

c. Participant Deference

According to Messrs. Schwartz and Bryan, a court should feel particularly comfortable excluding expert testimony if "knowledgeable insiders" and "knowledgeable outsiders" supported the transaction in question, because their support implicitly confirms the reliability of the valuation. By "knowledgeable insiders," the authors refer to executives, board members, and professional advisors, parties who purportedly "are making real-world decisions about whether to commit their time to the business or make investments in it, and making plans for the future of the business."[64] By "knowledgeable outsiders," the authors refer to lenders, creditors, investors, and potential investors, parties who purportedly "are judging the value of the business, in real time, and with real financial interests."[65] This is held out to be a proxy corroboration for a market valuation.

Respecting "knowledgeable insiders," the authors seem to be analogizing to the business judgment rule, the corporate law principle favoring judicial deference to management decision making.[66] Under the business judgment rule, "courts avoid questioning the merits of a director's decision, but examine instead allegations questioning the motivations fueling the decision."[67] Judicial deference to corporate management largely immunizes considered business decisions from subsequent attack; the law deems this appropriate because corporate managers "must have the freedom to take risks and the power to manage the business without undue interference from shareholders or the courts."[68]

The problem is that the business judgment rule has no place in valuation contests stemming from corporate distress. The only pertinent evidentiary presumptions move in the opposite direction: Under the UFTA, there is a presumption of *in*solvency if, at the time of the transaction in question, the company was not timely servicing its debt[69] and, in preference cases, there is a presumption of *in*solvency if the subject transfer occurred within ninety days of bankruptcy.[70] Otherwise, there are only burdens of proof and an "objective"[71] review of

63. Pelster v. Ray, 987 F.2d 514, 526 (8th Cir. 1993) (quoting FED. R. EVID. 702 advisory committee's note).

64. Schwartz & Bryan, *supra* note 3, at 946.

65. *Id.*

66. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 928 (Del. 2003).

67. Postorivo v. AG Paintball Holdings, Inc., No. 2991-VCP, 2008 Del. Ch. LEXIS 29, at *13 (Feb. 29, 2008).

68. 1 STEPHEN A. RADIN, THE BUSINESS JUDGMENT RULE 34 (6th ed. 2009) (quoting First Union Corp. v. SunTrust Banks, Inc., No. 01-CVS-10075, 2001 WL 1885686, at *4 (N.C. Super. Ct. Aug. 10, 2001)).

69. *See* Unif. Fraudulent Transfer Act § 2(b), 7A U.L.A. 37 (2006).

70. *See* 11 U.S.C. § 547(f) (2012).

71. VFB LLC v. Campbell Soup Co., 482 F.3d 624, 630 (3d Cir. 2007); Moody v. Sec. Pac. Bus. Credit, Inc., 971 F.2d 1056, 1073 (3d Cir. 1992).

evidence. There is reason for this: Determining business worth for insolvency purposes primarily concerns a fair allocation of value among stakeholders. Avoidance recoveries and reorganization value are, in other words, largely inter-creditor matters.[72] Given that corporate insolvency does not, in and of itself, impose management liability under American law,[73] there is no socio-economic benefit in cloaking any particular valuation in "business judgment" deference.[74] On the other hand, it is consistent with American law that the plaintiff in an avoidance action or the proponent of plan cram down bear the burden of proof,[75] including proof as to business valuation, even if (perhaps especially if)[76] it is the debtor bearing that burden.

Moreover, respecting both "knowledgeable insiders" and "knowledgeable outsiders," Messrs. Schwartz and Bryan presume that managers, advisors, and funding sources never (i) act without perfect information, (ii) make irrational business decisions, (iii) embrace heightened risk-reward business strategies, (iv) have conflicting or mixed business agendas or pressures, or (v) are motivated by parochial or personal economic interests.[77] In our experience, the promise of cash is just as tempting a Siren's song[78] in the executive suite as it is on Wall Street.

In the end, the views and actions of "knowledgeable insiders" and "knowledgeable outsiders" are simply one side's factual evidence, no more, no less. They do not supplant other forms of evidence and they do not, in and of themselves, provide any basis for excluding contrary evidence.

72. *See* Buncher Co. v. Official Comm. of Unsecured Creditors, 229 F.3d 245, 250 (3d Cir. 2000) ("The purpose of fraudulent conveyance law is to make available to creditors those assets of the debtor that are rightfully part of the bankruptcy estate, even if they have been transferred away."); *see also In re* Granite Broad. Corp., 369 B.R. 120, 140 (Bankr. S.D.N.Y. 2007) ("There is no dispute that a class of creditors cannot receive more than full consideration for its claims, and that excess value must be allocated to junior classes of debt or equity, as the case may be."); *In re* Genesis Health Ventures, Inc., 266 B.R. 591, 612 (Bankr. D. Del. 2001) ("A corollary of the absolute priority rule is that a senior class cannot receive more than full compensation for its claims.").

73. *See* Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P., 906 A.2d 168, 199 (Del. Ch. 2006), *aff'd*, 931 A.2d 438 (2007).

74. *See* Air Line Pilots Ass'n, Int'l v. UAL Corp., 717 F. Supp. 575, 582 (N.D. Ill. 1989) (a primary rationale for the "business judgment rule" is to encourage board service by "competent individuals . . . who otherwise might decline for fear of personal liability"), *aff'd*, 897 F.2d 1394 (7th Cir. 1990).

75. *See* Schaffer v. Weast, 546 U.S. 49, 56 (2005) ("The burdens of pleading and proof with regard to most facts have been and should be assigned to the plaintiff who generally seeks to change the present state of affairs and who therefore naturally should be expected to bear the risk of failure of proof or persuasion." (quoting 2 J. STRONG, MCCORMICK ON EVIDENCE § 337, at 412 (5th ed. 1999))).

76. It is, after all, the debtor that seeks exoneration from its prepetition financial obligations.

77. *See, e.g.*, Steven M. Davidoff, *In Spinoffs, a Chance to Jettison Undesirable Liabilities*, N.Y. TIMES, Mar. 13, 2013, at B9 ("But spinoffs have a dark side, as they can serve as a convenient dumping ground. In 1999, General Motors spun off its auto parts maker into Delphi, and the following year, Ford Motor did the same with Visteon. Both automakers larded the subsidiaries with too much debt, high labor costs and sweetheart pricing deals. The results sent both spin-offs into bankruptcy. Ford and G.M. are still dealing with the fallout and litigation. These deals show the temptation lurking in a spinoff: liabilities can be freely attached to the company being spun off. This is often management's best opportunity to burnish its own company at another's expense. It's hard to resist.").

78. *See* HOMER, THE ODYSSEY 12.41–58 (1892).

B. *Campbell* and *Iridium*, as Precedent

Campbell involved a "leveraged-spin" transaction: The parent company ("Campbell Soup") deposited underperforming businesses in a newly created corporate shell ("VFI"); VFI borrowed $500 million and handed that money over to Campbell Soup as consideration for the deposited businesses; Campbell Soup then rid itself of VFI by special stock dividend.[79] There was evidence that, initially, VFI's worth was artificially inflated, but all was publicly disclosed shortly thereafter.[80] VFI subsequently was able to refinance much of its debt (at par) and, for several years post-spin, its stock market capitalization (well after dour business information became public) remained above $1.1 billion.[81] The plaintiff still claimed fraudulent transfer at the time of the spin, attempting to prove a scaled-down enterprise value through expert testimony.[82] The district court found the evidence unconvincing.[83] The U.S. Court of Appeals for the Third Circuit affirmed the judgment for the defendant, but under a "clear error" standard of review (i.e., the appeal only considered case-specific fact finding by the district court, not any question of law).[84] In so holding, the appellate court noted, "[a]bsent some reason to distrust it, the market price is 'a more reliable measure of the stock's value than the subjective estimates of one or two expert witnesses.'"[85]

Iridium involved a high-tech "start-up" of massive proportions. Motorola, Inc. ("Motorola") designed the "Iridium System," a constellation of sixty-six satellites, to provide mobile telephone service anywhere in the world.[86] After extensive engineering and market study, Motorola created and then separated from Iridium Inc. ("Iridium"), entering into several agreements with Iridium to build the system at an ultimate cost of $3.7 billion.[87] Investors and lenders conducted extensive additional study of the venture's risk-reward profile, with the primary risks fully disclosed to the public.[88] In the late 1990s (during the "dot-com bubble"), Iridium was able to raise billions in debt and equity capital, and Iridium's stock value soared.[89] Ultimately, the venture proved a failure: The system did not work well and anticipated customers did not subscribe, even though the original business plans were rational at the time of creation.[90] After filing for Chapter 11 protection, Iridium's official creditors' committee sued Motorola to avoid prepetition payments as fraudulent transfers, attempting to prove insolvency through

79. *See* VFB LLC v. Campbell Soup Co., 482 F.3d 624, 627 (3d Cir. 2007).
80. *See id.* at 627–28.
81. *See id.* at 628.
82. *See id.* at 629.
83. *See id.* at 630.
84. *See id.*
85. *Id.* at 633 (quoting *In re* Prince, 85 F.3d 314, 320 (7th Cir. 1996)).
86. Statutory Comm. of Unsecured Creditors v. Motorola, Inc. (*In re* Iridium Operating LLC), 373 B.R. 283, 290 (Bankr. S.D.N.Y. 2007).
87. *See id.*
88. *See id.* at 311–14.
89. *See id.* at 329–30.
90. *See id.* at 290–91.

expert testimony reliant on reconstituted projections.[91] The bankruptcy court (i) found no basis for reconstituting historical projections, (ii) was troubled by the official committee's inability "to account for, to adequately explain or to reconcile the abundant market data"[92] conflicting with its offered expert testimony, and (iii) ultimately found that the official committee failed to carry its burden of proof.[93] In so holding, the bankruptcy court stated, "the public trading market constitutes an impartial gauge of investor confidence and remains the best and most unbiased measure of fair market value and, when available to the Court, is the preferred standard of valuation."[94]

Messrs. Schwartz and Bryan call *Campbell* and *Iridium* "landmark."[95] While well-reasoned and important decisions, the authors' characterization appears overstated in several respects. First, only *Campbell* could have precedential impact, given that the rulings of decisional courts may have only persuasive effect in other matters.[96] Second, neither decision purports to establish a new legal paradigm governing future valuation litigation. Both opine only about the sufficiency of particular evidence offered at trial to prove a fact, and case-specific, fact-oriented decisions generally do not qualify as precedent.[97] Third, *Iridium* involved a highly unusual fact pattern: a high-tech "start-up" without any historical performance able to attract billions in debt and equity capital on pure "upside potential" (presumably reflecting the "bubble" market environment), and an attendant rise in stock market value. Time will tell if courts find *Iridium* easily applicable to other fact patterns. Fourth, neither opinion includes any directional statement bearing on valuation litigation outside the fraudulent transfer context. Neither, in fact, says anything at all about reorganization value, let alone in specific contradistinction to *Consolidated Rock* and its progeny.

Aside from the technicalities of stare decisis, it seems somewhat exaggerated to present *Campbell* and *Iridium* as a groundbreaking moment in the law. In many areas, the law has long looked to the market for valuation purposes. As observed by Seventh Circuit Judge Richard Posner fifteen years before *Campbell* and *Iridium*: "It is the superiority of the market to the courts in determining subjective values that provides the major reason for the law's seeking to channel resource allocation through the market wherever possible."[98] Almost twenty years before *Campbell* and *Iridium*, the Supreme Court provided a solid market endorsement

91. *See id.* at 350–52.

92. *Id.*

93. *See id.* at 353.

94. *Id.* at 293.

95. Schwartz & Bryan, *supra* note 3, at 939.

96. *See* Camreta v. Greene, 131 S. Ct. 2020, 2033 n.7 (2011) ("A decision of a federal district court judge is not binding precedent in either a different judicial district, the same judicial district, or even upon the same judge in a different case." (quoting 18 MOORE'S FEDERAL PRACTICE § 134.02[1][d] (3d ed. 2011))).

97. *See* Tug Helen B. Moran, Inc. v. Moran Towing & Transp. Co., 607 F.2d 1029, 1031 (2d Cir. 1979); *see also* 18 MOORE'S FEDERAL PRACTICE § 134.05[3] (3d ed. 2011) ("The doctrine of stare decisis does not apply to the determination of the facts of a case.").

98. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 221 n.4 (4th ed. 1992).

in *Basic Inc. v. Levinson*,[99] where it embraced the "fraud on the marketplace" theory in securities law. The Court provided another example in the bankruptcy context eight years before *Campbell* and *Iridium*, in *Bank of America National Trust v. 203 North LaSalle Street Partnership*.[100] There, the Court held that, if it is ever permissible to confirm a "new value" (equity participation) plan over creditor objection, it can only be after estate assets have been subject to full and fair marketing.[101] Failure to do so, the Court noted, would require "any determination that the price was top dollar [to] be made by a judge in bankruptcy court, whereas the best way to determine value is exposure to a market."[102]

But, at the same time, notable jurists have explained why market data has persuasive limitations. As Delaware Supreme Court Justice Jack Jacobs stated, "the market price of shares is not always indicative of fair value. . . . [M]arkets occasionally make errors, . . . it is possible for a stock that trades even in an efficient market to be mispriced, especially in the short run. . . . [T]he market may be inefficient if material information is withheld from it."[103] Bankruptcy Judge Kevin Carey expressed similar concerns when, in a recent valuation contest, argument was predicated on postpetition trading levels of debt:

> Some plan objectors argue that the Debtors' value is best determined by referring to the active market for buying claims. There is some evidence before me about the amounts being paid for the various types of claims . . . ; however, there is no evidence beyond the mere statement of certain trading prices. There is no record on the number of trades, over what period of time such trades occurred, how open the market is to participants or other factors that may be relevant.[104]

Similarly, in his often-cited *Mirant* valuation opinion, Bankruptcy Judge D. Michael Lynn expressed a need to get behind market evidence, ensuring that market pricing truly reflects an efficient market, before finding it a persuasive indicator of enterprise value.[105]

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99. 485 U.S. 224, 241 (1988).

100. 526 U.S. 434 (1999).

101. *Id.* at 458.

102. *Id.* at 457.

103. *In re* Emerging Commc'ns, Inc. S'holders Litig., No. 16415, 2004 Del. Ch. LEXIS 70, at *83–84 (May 3, 2004) (Delaware Supreme Court Justice Jacobs sitting by designation); *see also* Cede & Co. v. Technicolor, Inc., 684 A.2d 289, 301 (Del. 1996) (the "market price of shares may not be representative of true value" (quotation omitted)); Harris v. Rapid-Am. Corp., C.A. No. 6462, 1992 WL 69614, at *1, *4 (Del. Ch. Apr. 6, 1992) ($28 merger price, representing a 28 percent premium over unaffected trading price, was barely one-third of adjudicated fair value of $73.29); *In re* Shell Oil Co., No. CIV.A.8080, 1990 Del. Ch. LEXIS 199, at *14–15, *38 (Dec. 11, 1990) (market price $44, adjudicated fair value $71.20), *aff'd*, 607 A.2d 1213 (Del. 1992).

104. *In re* Spansion, Inc., 426 B.R. 114, 130 (Bankr. D. Del. 2010).

105. *See In re* Mirant Corp., 334 B.R. 800, 832 n.113 (Bankr. N.D. Tex. 2005) ("There is, however, no ready, 'efficient' market in which merchant energy companies are bought and sold."); *see also* Cammer v. Bloom, 711 F. Supp. 1264, 1285–87 (D.N.J. 1989) (establishing the following five factors to determine whether a security trades in an efficient market: (1) the average weekly trading volume of the stock; (2) the number of securities analysts following the stock; (3) the extent to which market makers and arbitrageurs traded in the stock; (4) the issuer's eligibility to file an SEC registration Form S-3; and (5) the demonstrations of a cause-and-effect relationship between unexpected, material disclosures and changes to the stock's prices); Krogman v. Sterritt, 202 F.R.D. 467, 477–78 (N.D.

Viewed through a more retracted lens, *Campbell* and *Iridium* are not so much precedential "landmarks" as clear and emphatic applications of a proposition long accepted in the law: In certain circumstances, market data may be quite compelling—even dispositive—valuation evidence. But neither *Campbell* nor *Iridium* nor the larger jurisprudential backdrop establishes that market data is the *only* evidence, or that it is *always* the most persuasive evidence, of enterprise worth. The cases do not support the assertion that, in *every* valuation contest (including where the law focuses specifically on intrinsic worth, such as contested plan confirmation), the court should indiscriminately defer to market attitudes without any expert interpretation or assistance.[106] Judicial deference to market valuation requires, among other things, (i) comfort that there is, in fact, a truly relevant market, and that it is well-informed and functioning properly,[107] (ii) evaluation of the pricing "snapshot" in a larger market context,[108] and (iii) confidence that pricing is not unduly reflective of momentary or legal/procedural issues, or strategic behavior of market participants.[109] At the very least, there needs to be assurance of market objectivity and integrity, given that no one "would knowingly roll the dice in a crooked crap game."[110] All this requires careful study on a case-by-case basis, rendering the thesis advanced by Messrs. Schwartz and Bryan not a simple and universal solution.

III. Rationales for the Proposed Rule Change

Legal context notwithstanding, Messrs. Schwartz and Bryan offer two reasons for a change in the law: (i) purportedly, judges adjudicating complex valuation

Tex. 2001) (setting forth the following three additional factors: (1) the company's market capitalization; (2) the size of the bid-ask spread; and (3) the percentages of shares available to the public (public float)).

106. In this regard, the authors' thesis tends toward the logic fallacy *a dicto simpliciter*: a sweeping generalization that ignores legitimate exception.

107. *See In re* Am. Home Mortg. Holdings, Inc., 637 F.3d 246, 257 (3d Cir. 2011) ("We find the bankruptcy court's analysis persuasive. It stated that the market price should be used to determine an asset's value when the market is functioning properly. It is only when the market is dysfunctional and the market price does not reflect an asset's worth should one turn to other determinants of value."); *see also* Sontchi, *supra* note 36, at 1–2 ("Even where there is a market it may not fairly estimate the potential sale price of an asset if the market is inefficient, disrupted or dysfunctional.").

108. *See Mirant*, 334 B.R. at 838 ("The court again questioned the use of a single day's closing price for comparable company stocks. It seems to the court that it would make better sense to factor into valuation comparable companies' stock prices over a period of time, thus avoiding bringing into valuation metrics temporary instability in stock prices.").

109. *See id.* at 832 ("Delays in the confirmation schedule, uncertainties as to post-petition, pre-confirmation interest rates (on both Mirant and MAG debt) and the possibility of a change in treatment through compromise or valuation would have to be considered when buying Mirant debt pre-confirmation.").

110. Basic Inc. v. Levinson, 485 U.S. 224, 227 (1988) (quoting Schlanger v. Four-Phase Sys. Inc., 555 F. Supp. 535, 538 (S.D.N.Y. 1982)); *see also In re* Chemtura Corp., 439 B.R. 561, 586 n.106 (Bankr. S.D.N.Y. 2010) ("Many observers believe that behavior in the marketplace is the best indicator of enterprise value. . . . I don't believe that always to be the case since . . . financial accounting techniques (such as capitalizing expenses without writing them down to realizable values) or fraud can give the marketplace a distorted impression of a company's worth." (citations omitted)).

trials almost invariably suffer from "hindsight bias" infecting a fair trial result;[111] and (ii) a more streamlined litigation experience will result in cost and administrative savings.[112] We consider each of these rationales in turn.

A. "Systemic Hindsight Bias"

As a preliminary matter, if "systemic hindsight bias" does in fact exist, it would have no application in general bankruptcy valuation. Chapter 11 is an event driven process; adjudicated valuation occurs because circumstances demand a trial. Contested confirmation, for example, requires valuation as of the anticipated plan effective date.[113] There can be no hindsight bias in such trials because there is no valuation "way back when." The valuation is only "in the here and now" and, per *Consolidated Rock*, looks to the future. The argument thus only applies in the avoidance context.

Second, if there is any systemic bias, it is not easy to discern from the substantial body of fraudulent transfer case law now in existence. The "improper hindsight" rule was articulated by the U.S. Court of Appeals for the Third Circuit in *Mellon Bank, N.A. v. Official Committee of Unsecured Creditors (In re R.M.L., Inc.)* as follows:

> [When evaluating the debtor's financial condition at the time of transfer in question, the court should look] at the circumstances as they appeared to the debtor and determine whether the debtor's belief that a future event would occur was reasonable. The less reasonable a debtor's belief, the more a court is justified in reducing the assets (or raising liabilities) to reflect the debtor's true financial condition at the time of the alleged transfer.[114]

The rule is stated simply and seems easy for decisional courts to follow, and courts have not generally expressed trouble implementing the mandate. To the contrary, the case law broadly reflects systemic respect for and observation of the rule.[115] *Campbell* and *Iridium* are excellent cases in point: The courts there

111. Schwartz & Bryan, *supra* note 3, at 950–52.

112. *Id.* at 950.

113. *See* 11 U.S.C. § 1129(a)(7)(A)(ii) (2012) (valuation for purposes of the "best interests" test determined "as of the effective date of the plan"); *id.* § 1129(b)(2)(B)(i) (valuation for purposes of unsecured creditor cram down determined "as of the effective date of the plan").

114. 92 F.3d 139, 156 (3d Cir. 1996).

115. *See, e.g.*, Boyer v. Crown Stock Distrib., Inc., 587 F.3d 787, 795 (7th Cir. 2009) ("Whether a transfer was fraudulent when made depends on conditions that existed when it was made, not on what happened later to affect the timing of the company's collapse."); *In re* Taxman Clothing Co., 905 F.2d 166, 170 (7th Cir. 1990) ("Caution should be taken not to consider property as 'dead' merely because hindsight teaches that the debtor was traveling on the road to financial ruin." (citation omitted)); MFS/Sun Life Trust-High Yield Series v. Van Dusen Airport Servs. Co., 910 F. Supp. 913, 944 (S.D.N.Y. 1995) ("[A] court must consider the reasonableness of the company's projections, not with hindsight, but with respect to whether they were prudent when made."); *In re* Energy Coop, Inc., 109 B.R. 822, 824 (N.D. Ill. 1989) ("[C]ase law precludes hindsight, perfect though that vision may be."); Credit Managers Ass'n v. Fed. Co., 629 F. Supp. 175, 186–87 (C.D. Cal. 1985) ("With 20/20 hindsight it is clear that Crescent's cash flows did not work out as projected by GECC. . . . [T]he court's task in determining whether Crescent had sufficient capital as evidenced by cash flow projections is not to examine what happened to Crescent, but whether the GECC projections, as modified,

were quick to eschew "hindsight" evidence and did so in fairly emphatic terms.[116]

Messrs. Schwartz and Bryan state, nevertheless, that "judges are . . . simply unable to avoid employing hindsight in considering such testimony."[117] This bold assertion relies principally on a law review article by Professor Michael Simkovic and Benjamin Kaminetzky titled *Leveraged Buyout Bankruptcies, The Problem of Hindsight Bias, and the Credit Default Swap Solution.*[118] That article, in turn, cites certain social and psychological studies, contending they "demonstrate that hindsight bias affects judges."[119] Admittedly, we are not well-positioned to critique the accuracy of these social and psychological studies and/or whether they actually prove that, due to human frailty, federal court judges are incapable of fairly adjudicating fraudulent transfer cases.[120] But, there seems good reason for healthy skepticism, given that the assertion suggests that federal courts have been working a substantial injustice that went unnoticed for decades, if not centuries.

Presuming for the sake of discussion that there is some truth to the claim of systemic hindsight bias, there is yet another level of analysis: Is the bias

were prudent. The court finds that they were."); *In re* Hechinger Inv. Co., 327 B.R. 537, 548 (Bankr. D. Del. 2005) ("[B]ecause valuation is, to a great extent, a subjective exercise dependent upon the input of both facts and assumptions, the court will give deference to 'prevailing marketplace values,' rather than to values created with the benefit of hindsight for the purpose of litigation." (citation omitted)); *In re* Commercial Fin. Servs. Inc., 350 B.R. 520, 541 (Bankr. N.D. Okla. 2005) ("For the purpose of a solvency analysis, . . . assets and liabilities must be valued based upon information *known or knowable* as of the date of the challenged transfer."); *In re* WRT Energy Corp., 282 B.R. 343, 407 (Bankr. W.D. La. 2001) ("Solvency valuations, including those undertaken by experts, generally must be based on conditions and standards as they existed at the time of the transaction at issue, not on hindsight."); *In re* WCC Holding Corp., 171 B.R. 972, 985 (Bankr. N.D. Tex. 1994) ("Evaluation of cash flow projections must focus on information available at the time of transaction, not on hindsight. The court should principally focus not on whether the projections were correct but on whether they were reasonable and prudent at the time they were made." (citation omitted)); *In re* Total Tech. Servs., Inc., 150 B.R. 893, 900 (Bankr. D. Del. 1993) ("Fair value is based upon information available to the parties during the preferential period, and not upon information that only became available after the filing of the bankruptcy petition.").

116. *See* VFB LLC v. Campbell Soup Co., 482 F.3d 624, 633 (3d Cir. 2007) ("To the extent that the experts purport to measure actual post-spin performance, as by, for example, discounted cash flow analysis, they are measuring the wrong thing. To the extent they purport to reconstruct a reasonable valuation of the company in light of uncertain future performance, they are using inapt tools."); Statutory Comm. of Unsecured Creditors v. Motorola, Inc. (*In re* Iridium Operating LLC), 373 B.R. 283, 293 (Bankr. S.D.N.Y. 2007) ("With hindsight (and with what Motorola refers to as 'hindsight bias'), the market value for Iridium securities during the relevant period turned out to be an unreliable indicator of future fair market value, but that does not justify ignoring this data. This conspicuously inconsistent data contradicts the opinions of the Committee's experts and needs to be explained and overcome in order for the Committee to carry its burden during [the valuation] phase of the trial.").

117. Schwartz & Bryan, *supra* note 3, at 950–51.

118. 2011 COLUM. BUS. L. REV. 118.

119. *Id.* at 153.

120. One particular concern focuses on the hypothetical fact patterns administered in these studies. Unlike criminal, tort, constitutional, family, and other kinds of law, fraudulent transfer cases are often dry, commercial disputes with far less likelihood of the heart overwhelming the mind. Studies of "hindsight bias" involving scenarios of particular human impact, therefore, may not extrapolate well to the fraudulent transfer context.

so pervasive and severe that it renders the judicial process entirely unfair? The law has long acknowledged that litigants are not entitled to a perfect trial procedure.[121] Even where an overzealous litigant exposes the trier of fact to inadmissible evidence (the proverbial "unring-the-bell" scenario), the problem is typically dealt with by instruction and reliance on the allocation of trial duties,[122] not automatic declaration of mistrial. Only in cases of true prejudice does trial imperfection require a new proceeding,[123] especially in bench trials.[124] This suggests more than the assertion of *some modicum* of "hindsight bias" is needed here. For the type of rule change proposed, Messrs. Schwartz and Bryan need to show bias causing true prejudice in valuation cases generally. Respectfully, they have not offered that kind of showing.

B. Efficiency

In one respect, the authors are undoubtedly correct when they contend that pretrial exclusion of expert testimony boosts efficiency. As it is often observed, valuation trials tend to be "battles of the experts."[125] If a litigant is procedurally disabled from presenting its case, the trial most assuredly will end (rightfully or wrongfully) quickly.

But presuming due process and other foundational legal principles do not supercede the efficiency interest,[126] query whether (i) courts are already sufficiently armed to move cases along and (ii) cost savings resulting from Rule 702 exclusion are, on the whole, likely to be as significant as the authors suggest.

121. *See, e.g.*, Bruton v. United States, 391 U.S. 123, 135 (1968) ("[N]ot every admission of inadmissible hearsay or other evidence can be considered to be reversible error, unavoidable through limiting instructions; instances occur in almost every trial where inadmissible evidence creeps in . . . . A defendant is entitled to a fair trial, but not a perfect one." (quotations omitted)); Marcavage v. Bd. Trs. Temple Univ., 400 F. Supp. 2d 801, 806 (E.D. Pa. 2005) ("The Supreme Court has long held that litigants are entitled to fair trials although not perfect trials."); Dennis J. Sweeny, *An Analysis of Harmless Error in Washington: A Principled Process*, 31 Gonz. L. Rev. 277, 281 (1996) ("[A] lawsuit, like any human enterprise, is not perfect. No litigant is therefore entitled to a perfect trial.").

122. It is the burden of any litigant wishing for pretrial exclusion of relevant expert testimony to make an appropriate motion in limine. *See, e.g.*, Green Constr. Co. v. Kan. Power & Light Co., 1 F.3d 1005, 1014 (10th Cir. 1993) ("It is certainly within the district court's discretion to limit the number of experts, provided the witnesses are not excluded arbitrarily, or on the basis of mere numbers.").

123. *See* United States v. Newby, 11 F.3d 1143, 1147 (3d Cir. 1993) ("An incorrect admission of evidence, however, does not automatically mandate a new trial. . . . [W]e presume that the jury will follow a curative instruction unless there is an 'overwhelming probability,' that the jury will be unable to follow it and a strong likelihood that the effect of the evidence would be 'devastating,' to the defendant." (citations omitted)); United States v. Giampa, 904 F. Supp. 235, 302 (D.N.J. 1995) (quoting *Newby* for the proposition that improper admission of evidence by a trial court "does not automatically mandate a new trial").

124. *See, e.g.*, *In re* Joy Recovery Tech. Corp., 286 B.R. 54, 69 (Bankr. N.D. Ill. 2002) ("Peltz would not be allowed to make such pronouncements to a jury. However, the court is able to view such statements as mere surplusage, and to focus instead on those portions of Peltz's analyses that assisted the court's understanding of the financial data.").

125. *See, e.g.*, *In re* Armstrong World Indus., Inc., 348 B.R. 111, 126 (D. Del. 2006); *In re* Scheffler, 471 B.R. 464, 478 (Bankr. E.D. Pa. 2012); *In re* Mid-Continent Elec., Inc., 278 B.R. 607, 611 (Bankr. M.D. Fla. 2002).

126. *See* Goldberg v. Kelly, 397 U.S. 254, 266 (1970) (due process may entitle a litigant to an evidentiary hearing).

Regarding the first question, courts undeniably have (without the creation of any new procedural devices) implicit and extensive powers to control the tempo, pace, and expense associated with cases advancing to trial.[127]

Regarding the second question, it bears noting that massive valuation trials are a very rare occurrence, more the remote exception than the rule.[128] But, even if they were a more common experience, it also bears noting that pretrial exclusion focuses on only the final aspects of a complex litigation effort. In sophisticated commercial matters, often the bulk of litigation expense is discovery and pretrial motion practice. In *Iridium*, for example, the trial followed "years of fact and expert discovery, pretrial motions and submissions of a final pretrial order."[129] Contested matters tend to move with much greater speed than adversary proceedings, but, in either procedural context, a litigant's case perspective and theory develops as evidence is produced in discovery.[130] The practical reality is that valuation experts are not by rule retained on the eve of trial, after discovery has concluded; they are often retained early in the process, and help the parties develop their case as evidence becomes available.[131] This suggests that, even if

127. *See* 11 U.S.C. § 105(a) (2012) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."); *In re* Volpert, 110 F.3d 494, 500 (7th Cir. 1997) ("We therefore hold that, under 11 U.S.C. § 105(a), bankruptcy courts may punish an attorney who unreasonably and vexatiously multiplies the proceedings before them."); Gulf Water Benefaction Co. v. Pub. Util. Comm'n of Tex., 674 F.2d 462, 468 (5th Cir. 1982) ("It is clear that discovery motions fall within the broad discretionary powers of the trial court."); Crompton-Richmond Co. v. Briggs, 560 F.2d 1195, 1202 (5th Cir. 1977) ("[T]he grant or denial of a continuance is within the sound discretion of the Trial Judge.").

128. *See* ABI COMM. TO STUDY THE REFORM OF CH. 11: FIELD HEARING (Feb. 21, 2013) (statement of Drain, Bankr. J.) ("I want us to step back a second because it seems to me that this Commission, which I think is performing a valuable function, is looking at valuation to see what works and doesn't work and what can be improved, but there are levels to that. I have been a judge for over 10 years now, it's clear to me . . . and I practiced in the bankruptcy area since 1984 . . . it's clear to me that if you measure success by the parties' agreement or self-determination, valuation and bankruptcy generally works. As I said, I've been a judge for over 10 years. I've had in all cases, not just large Chapter Elevens but in consumer cases, Chapter Sevens, I think I've had five contested valuation hearings and I think for judges who served that long, that maybe more than they generally have. It hardly ever happens."). Our experience comports with Judge Drain's: valuation disputes, whether arising in avoidance or reorganization contexts, tend to be settled well before trial. This is another important attribute of *Chemtura*, where the plan at issue settled a valuation issue by affording certain creditors the option of taking their distribution in cash or securities. *See also* Marshall S. Huebner & Damian S. Schaible, *Settling the Valuation Question*, *in* CONTESTED VALUATION IN CORPORATE BANKRUPTCY: A COLLIER MONOGRAPH ch. 20 (Robert J. Stark et al. eds., 2011) (discussing plan structures and other strategies employed to settle complex valuation disputes).

129. Statutory Comm. of Unsecured Creditors v. Motorola, Inc. (*In re* Iridium Operating LLC), 373 B.R. 283, 290 (Bankr. S.D.N.Y. 2007).

130. *See* Hickman v. Taylor, 329 U.S. 495, 507 (1947) (federal discovery rules presume that litigants at case inception do not have, but intend for all litigants ultimately to achieve, "[m]utual knowledge of all the relevant facts"); *see also* FED. R. CIV. P. 26(b) advisory committee's note ("The purpose of discovery is to allow a broad search for facts, the names of witnesses, and any other matters which may aid a party in the preparation or presentation of his case. . . . In such a preliminary inquiry admissibility at trial should not be the test as to whether the information sought is within the scope of proper examination.").

131. It is, in fact, quite customary for investment bankers and other financial advisors to be retained by debtors and official creditors' committees per Bankruptcy Code sections 327 and 1103 very early in the Chapter 11 process, well before the initiation of any particular contested matter or adversary proceeding involving business valuation. *See, e.g.*, *In re* XO Commc'ns, Inc., 323 B.R.

courts start embracing the authors' thesis, the costs associated with discovery and the development of expert opinion are not necessarily going to drop as precipitously as suggested.

On this topic, one further point must be made. In advancing their argument, Messrs. Schwartz and Bryan point to a 2011 study by PricewaterhouseCoopers LLP ("PwC"), stating it "shows that over half of the retained expert trial witnesses in the valuation area likewise never get to testify. According to PwC, even as the number of challenges to financial expert witnesses has risen almost threefold from 2000 to 2010, the fraction of successful challenges has remained fairly constant at around 45 percent."[132] This is misleading in several important respects. First, the PwC study focused exclusively on *Daubert* challenges, not expert exclusion on "helpfulness" grounds.[133] Second, the study focused on incidences of exclusion involving all types of "financial experts," including those retained in securities fraud and copyright infringement cases.[134] The study does not, in other words, prove high expert exclusion "in the valuation area." Finally, the study focused only on exclusions detailed in written opinions and, thus, "the related results should not be presumed to apply to all financial expert challenges, including those resolved by motion or those decisions that do not specifically reference [the Supreme Court's 1999 decision in] *Kumho Tire*."[135] The study has limited utility here.

The collective experience among sophisticated bankruptcy professionals, we suspect, reflects a reality far different from that proposed by Messrs. Schwartz and Bryan. In our experience, courts: (1) do, in fact, regularly admit expert testimony in solvency-related valuation disputes; and (2) do not, in fact, regularly exclude expert valuation testimony on "helpfulness" (or even *Daubert*) grounds. This is evidenced by, among other things, the volume of published opinions cited in this article carefully considering expert valuation testimony.

IV. Market Data

As the preceding legal discussion suggests, there are no simple, formulaic valuations of distressed companies. Market evidence is often important, but it does not necessarily have superceding importance and usually requires specialized knowledge and expertise to understand fully. There are certainly times when market evidence is the best indicator of value, as *Campbell* and *Iridium* signify. However, there are times when market evidence does not reflect "intrinsic" or

330, 336 (Bankr. S.D.N.Y. 2005) ("[A]s part of [the debtor's] 'first day' motions, [the debtor] . . . filed an application seeking to retain and employ [an investment banking firm] as its financial advisor.").

132. Schwartz & Bryan, *supra* note 3, at 950.

133. PriceWaterhouseCoopers LLP, *Daubert* Challenges to Financial Experts: An 11-Year Study of Trends and Outcomes (Feb. 2011), *available at* http://www.pwc.com/us/en/forensic-services/publications/daubert-study-2010.html.

134. *Id.* at 24–31.

135. *Id.* at 5 (citing Kumho Tire Co. v. Carmichael, 526 U.S. 137 (1999)).

"fair market" value.[136] We have observed numerous case incidences where market indicators and/or the pricing of specific securities seemed remarkably and obviously mismatched to either "intrinsic" or "fair market" value.[137] We recognize, of course, that our case observations do not satisfy as an exposé of markets as reliable indicators of a distressed business's worth. Thus, we turn to a few, more practical considerations that substantiate the importance of the market and its limitations in the world of distressed businesses and bankruptcy.[138]

In doing so, we first observe that Messrs. Schwartz and Bryan do not dedicate any part of their article to discussing market attributes. Nor do they consider the circumstances under which market data may adequately reflect enterprise worth or is more reliable than expert opinion. To them, the market appears as their *deus ex machina*. In fairness, markets tend to be studied by business school academics and experts of Wall Street technique,[139] not lawyers. But the authors' preference for market evidence, to the exclusion of expert opinion, dictates exposure to market ambiguities and inefficiencies. These include (i) the vague definition of the term "markets"; (ii) the challenges particular to valuing a business

136. One might visualize the probative value of market evidence on a continuum—at one end, investment grade, Fortune 50 companies (reasonable confidence in the reliability of markets based on stability, size, quality of reporting, coverage, trading liquidity, etc.); at the other, companies in the throes of reorganization (little confidence in the reliability of market evidence due to uncertain business futures, opaque financials, illiquid markets, vagaries of a legal process, etc.). There are myriad reasons for characterizing a particular company's position on such a continuum and expecting that position to change over time.

137. Energy Conversion Devices, Inc. ("ECD") is an interesting case in point. *See In re* Energy Conversion Devices, Inc., Case No. 12-43166 (Bankr. E.D. Mich. 2012) (disclosure statement of confirmed plan of liquidation available at Docket No. 754). ECD produced photovoltaic products that did not attract sufficient customer interest during the "Great Recession," a period that saw a series of photovoltaic producers liquidate. To fund operations, ECD sold $316.3 million in unsecured convertible notes under a "covenant light" indenture. By fall 2011, approximately $150 million remained with the company, the market expected continued future value erosion, and note holders had had enough. An "ad hoc" note holders committee pressed an aggressive restructuring agenda and, notwithstanding the lack of an identifiable indenture breach, persuaded management to sell all assets and wind up the company's affairs. In the days preceding ECD's Chapter 11 filing, ECD's notes were trading at 37.5 percent face, a level substantially below the company's liquidation value (the bond market apparently presumed that, absent an identifiable indenture breach, the bondholders had little leverage with which to stave off continued value erosion). Nevertheless, ECD's stock was trading for $1.35 a share, far in excess of "option value" (the stock market, in juxtaposition to the bond market, apparently presumed that the company would use the remaining $150 million to effectuate an operational restructuring and "out run" the unfavorable macroeconomic industry environment). Thus, even though ECD's "intrinsic" value (essentially liquidation value) was readily discernible from the company's public disclosures, neither the bond nor stock markets then came close to reflecting it.

138. For a general discussion of mispricing respecting firms in bankruptcy, see Philip S. Russel & Ben Branch, *Market Valuation of Bankrupt Firms: Is There an Anomaly?*, 38 Q.J. Bus. & Econ. 55 (1999).

139. *See, e.g.*, Stuart C. Gilson, Creating Value Through Corporate Restructuring (2d ed. 2010); Shannon P. Pratt, Valuing a Business: The Analysis and Appraisal of Closely Held Companies (5th ed. 2008); Scott A. Hoover, Stock Valuation: An Essential Guide to Wall Street's Most Popular Valuation Models (2006); Tim Koller et al., Valuation: Measuring and Managing the Value of Companies (4th ed. 2005); David Frykman & Jakob Tolleryd, Corporate Valuation: An Easy Guide to Measuring Value (2003); Aswath Damodaran, Investment Valuation (2d ed. 2002); Bradford Cornell, Corporate Valuation: Tools for Effective Appraisal and Decision Making (1993).

in distress compared to a stable company; (iii) the inefficiency of trading distressed securities, including lack of research coverage and delisting; and (iv) a presumption that federal judges, schooled in law and not necessarily in market theory and operation, can intuitively sense distortions and errors. In this way, Messrs. Schwartz and Bryan's article suggests that market evidence is almost always facially clear, understandable, self-sufficient, and automatically reliable. As mentioned above, widely respected jurists have already expressed reservations about that suggestion. We think such reticence deserves greater consideration and analysis.

A. Access to Liquidity

Iridium reflects one "market" conceptualization: the subject company's ability, at a particular moment in time, to access liquidity from potential lenders or investors. As a matter of basic corporate finance, cash is typically received from the capital markets in exchange for a debt obligation (i.e., a loan) or an equity investment (i.e., investor stock purchase). Loans typically require debt service (e.g., interest), are sometimes supported by liens and/or affiliate guarantees, and are usually protected by carefully written contractual terms. Depending on the type of loan, contractual protections may be sturdy and restrictive (e.g., an asset-based working capital facility, where funds are loaned in accordance with a strict "borrowing base" formula) or comparatively more flexible (e.g., a "covenant light" convertible note indenture). The capital markets appreciate that lender rights of structural or contractual seniority (vis-à-vis other voluntary or involuntary creditors) are honored in bankruptcy.[140] The capital markets also appreciate that equity is automatically subordinated in bankruptcy.[141] Given that sophisticated lenders and investors generally do not part with cash absent diligence and an evaluation of the proposed risk-reward profile, instances of raising outside capital—either debt or equity—can thus serve as "market" evidence bearing on enterprise worth. The *Iridium* court, for example, found compelling that, notwithstanding the plaintiff's retrojection of business doom, the capital markets supplied an exceptional amount of cash at the relevant times.[142]

But, for at least three reasons, the *Iridium* conclusion cannot be extrapolated to every fact pattern. First, each company's capital structure is *sui generis*. A company's ability to access capital might not be reflective of an otherwise rosy future if, for example: (i) contractually senior debt is raised, reliant on contractual subordination provisions in a preexisting bond indenture (i.e., the "push-down" of

140. *See In re* Owens Corning, 419 F.3d 195, 211 n.19 (3d Cir. 2005) (structurally senior debt rights generally enforced in bankruptcy "to protect in bankruptcy the prepetition expectations of those creditors"); 11 U.S.C. § 510(a) (2012) (contractual seniority entitlements enforced in bankruptcy).

141. *See* 11 U.S.C. § 1129(b)(2)(B)(ii) (2012) (establishing the absolute priority rule).

142. *See* Statutory Comm. of Unsecured Creditors v. Motorola, Inc. (*In re* Iridium Operating LLC), 373 B.R. 283, 349 (Bankr. S.D.N.Y. 2007) ("The fact that Iridium closed on three syndicated bank loans and raised over $2 billion in the capital markets between 1996 and 1999 is an indication of both solvency and capital adequacy.")

preexisting debt might actually render the company insolvent);[143] (ii) the debt reflects an unsuccessful effort pursuing equity capital, when comparable market participants were able to do so; (iii) the debt refinances preexisting debt on more expensive or restrictive terms; (iv) capital is advanced on terms that are more expensive or restrictive by comparison to comparable market participants (the capital raise is, colloquially stated, "over-market"); (v) the debt requires substantial lien support, guarantees, and/or contractual seniority; or (vi) the agreed upon terms have, in light of the company's foreseeable future, a high probability of failure (i.e., the new capital fits a "loan-to-own" profile).[144] The inverse also is true: A company's inability to access capital might not accurately reflect a dour future. Even profitable businesses may have trouble accessing capital if they are, for example: (x) burdened by an unfavorable, but transient, circumstance that should not be included in a market-standard valuation model;[145] (y) operating in a "cyclical" industry and, at the particular moment in time, are at the bottom of the cycle, but fortunes are expected to turn; or (z) saddled with ownership or management perceived by potential lenders or investors as unreliable or unqualified.

Second, capital markets evolve, general liquidity availability fluctuates, and terms of access change. Markets can be fickle and aloof one day, warm and embracing the next, and the attitude shift may be explained by a host of company-specific or exogenous reasons.[146] Extrinsic factors, such as actions by the Federal Reserve, changes in fiscal policy, political instability, macroeconomic conditions, or the financial health of the banking industry or Wall Street in general, impact market volatility and capital availability. *Iridium* is an interesting case in point: That venture found it easy to access capital during the "bubble" days of the late 1990s; all things being equal, that very same "start-up" enterprise probably would have had a far more difficult time accessing capital in subsequent years.

Third, the capital markets have changing attitudes toward risks and rewards. There are times when the market's tolerance for risk is exceedingly low. For example, the Lehman Brothers bankruptcy filing in 2008 ushered in a period during which the capital markets were essentially "closed" to corporate borrowers, even those with very strong credit.[147] But there are also times when the market has a big appetite for reward that may, in turn, overwhelm thoughtful risk assessment.[148] These swings in market attitude at least partially explain the *Iridium*

143. *See, e.g.*, *In re* Tribune Co., 464 B.R. 126 (Bankr. D. Del. 2011).

144. *See, e.g.*, *In re* DBSD N. Am., Inc., 421 B.R. 133 (Bankr. S.D.N.Y. 2009).

145. *See, e.g.*, Cox Enters. v. News-Journal Corp., 510 F.3d 1350, 1358–59 (11th Cir. 2007) (court "normalized" margins to enable a valuation comparison with other companies); Chartwell Litig. Trust v. Addus Healthcare, Inc. (*In re* Med Diversified, Inc.), 346 B.R. 621, 629–30 (Bankr. E.D.N.Y. 2006) (referencing "normalized" EBITDA to enable a more accurate valuation).

146. *See* BENJAMIN GRAHAM, THE INTELLIGENT INVESTOR: A BOOK OF PRACTICAL COUNSEL 204–05 (rev. ed. 2003).

147. *See, e.g.*, Carrick Mollenkamp et al., *Lehman's Demise Triggered Cash Crunch Around the Globe*, WALL ST. J., Sept. 29, 2008, at A1.

148. *See* Elizabeth Macdonald, *PIMCO's Gross: Irrational Exuberance, the Sequel*, FOXBUSINESS (Feb. 28, 2013), http://www.foxbusiness.com ("PIMCO's Gross warns investors that, on a scale of one to ten, markets are now a six for 'asset price irrationality.'").

conundrum.[149] Each of the above-discussed factors—limitations on market access due to circumstances unrelated to the company, exogenous economic or capital market conditions unrelated to intrinsic value or inherent risk—is often grounds for expert examination in court.

B. Trading Prices in Debt and Stock

Campbell and *Iridium* reflect another "market" conceptualization: trading in a company's debt and stock. Trading volumes and price levels can readily reflect enterprise worth, especially respecting healthy companies that enjoy wide analyst coverage and/or highly liquid trading in their stock.[150] Following this theory, both the courts in *Campbell* and *Iridium* found compelling that the companies' debt and equity securities traded at levels consistent with healthy, stable credit, even after dour business information was publicly disseminated.[151]

But, here too, the *Campbell* and *Iridium* conclusion cannot be extrapolated to every case. Particularly when considering distressed businesses, trading levels are not necessarily reflective of efficient markets, adequately informed investors, a reasonable understanding of business strategy, or, in short, intrinsic value.

1. The Efficient Market Hypothesis

The intuitive appeal of relying on markets to determine enterprise value is founded on a body of research developed over the past fifty years.[152] This research has led to broad cultural acceptance that markets efficiently price securities.[153] The so-called "efficient market hypothesis" ("EMH") postulates that public markets accurately price securities based on the market's access to relevant information and facility to respond in a rational process. The significance of EMH in corporate finance and investment cannot be overstated.[154] EMH is nec-

149. *See* Statutory Comm. of Unsecured Creditors v. Motorola, Inc. (*In re* Iridium Operating LLC), 373 B.R. 283, 293 (Bankr. S.D.N.Y. 2007) ("Even though Iridium's failure demonstrates that the public markets turned out in this instance to be a very poor predictor of Iridium's future value, the Court has no doubt that the markets, especially after commercial launch, were reasonably well informed as to Iridium's operating characteristics and constraints, yet still managed to be terribly wrong about the company's actual prospects.").

150. *See, e.g.*, Metlyn Realty Corp. v. Esmark, Inc., 763 F.2d 826, 835 (7th Cir. 1985) ("[T]he price of stock in a liquid market is presumptively the one to use in judicial proceedings.").

151. *See* VFB LLC v. Campbell Soup Co., 482 F.3d 624, 633 (3d Cir. 2007) ("[W]e do not think that the district court erred in choosing to rely on the objective evidence from the public equity and debt markets."); *Iridium*, 373 B.R. at 294 ("[T]he market value for Iridium securities during the relevant period turned out to be an unreliable indicator of future fair market value, but that does not justify ignoring this data.")

152. *See* Robert J. Shiller, *From Efficient Markets Theory to Behavioral Finance*, 17 J. Econ. Persp. 83 (2003).

153. *See* Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. Fin. 383 (1970). Professor Fama subsequently qualified EMH's applicability. *See, e.g.*, Eugene F. Fama, *Efficient Capital Markets: II*, 46 J. Fin. 1575 (1991).

154. EMH is the foundation for, among other things, the "capital asset pricing model" ("CAPM"). CAPM is key to the "discounted cash flow" ("DCF") method for business valuation. DCF is generally

essarily the intellectual construct underpinning the thesis advanced by Messrs. Schwartz and Bryan.[155]

EMH contends that the "observable market value" ("OMV") of a company's securities reflects the intrinsic value of the business,[156] based on two related but different assumptions.[157] First, each security's price reflects all relevant and available information including the level and risk of future cash flows.[158] Second, rational investors can (and will) immediately arbitrage away any market deviation from intrinsic value. Thus, EMH depends on both the availability of information and immediate, rational arbitrage.

a. Availability of Information

Although "publicly available" information is broader in scope than the information that must be filed with regulatory agencies, such filings are a common start (and, in many instances, the finish) in assessing the information reasonably accessible to and relied on by investors. Reporting companies, including those with equity or debt trading on a public market, are subject to detailed disclosure regulations promulgated and enforced by the Securities and Exchange Commission ("SEC"). Pursuant to the Securities and Exchange Act of 1934 (the "Exchange Act"), reporting companies file periodic and annual reports with the SEC,[159] which are simultaneously made available to the investing public.

Upon registering its securities under the Exchange Act, a company must keep its books and records in a manner that fairly reflects its financial condition and dispositions of, and transactions involving, its assets.[160] A reporting company must also "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances" that financial statements are prepared in accordance with generally accepted accounting principles ("GAAP").[161] Under these disclosure requirements, a company must disclose an array of information annually, including discussions concerning its business and financial condition, operating results, financial highlights (including complete audited financial statements on an annual basis), management's discussion and analysis of the financial condition and performance results, management compensation, and other delineated areas of its businesses.[162] Federal law further requires

acknowledged as the primary methodology for valuing businesses, especially those in bankruptcy. *See* Sontchi, *supra* note 36, at 16.

155. *See* Schwartz & Bryan, *supra* note 3 *passim*.

156. OMV is the financial principle that the market value of debt (less cash) plus the market value of equity should, in an efficient and properly operating market environment, equal intrinsic enterprise value.

157. Technically, there is a third assumption, that returns follow a normal (that is, "bell-shaped") distribution; however, it suffices for our purposes to focus on the two assumptions identified above.

158. There are differing views on what "available information" means. The most common viewpoint offered is that available information means all public information. This interpretation is referred to as the "semi-strong" form of EMH. *See* ROBERT HAGIN, MODERN PORTFOLIO THEORY 89–91 (1979).

159. *See* 17 C.F.R. § 240.13a-1 (2012).

160. *See id.* § 240.13b2.

161. *Id.*

162. *See id.* § 240.13a-1.

companies to file a quarterly report on Form 10-Q[163] and current reports on Form 8-K.[164]

But SEC rules do not require overly exacting disclosures. In fact, the current system of mandatory corporate disclosure, known as the integrated disclosure system, implements the SEC policy of making disclosures in a manner less burdensome on corporations. This SEC policy is implemented through standardizing various forms and eliminating some differences in reporting requirements to the SEC. SEC rules do not augment disclosure in the event a company is experiencing financial trouble. Even though a company shows signs of distress and its future may be more uncertain, the SEC does not require management to disclose the spectrum of considered options or the state of negotiations among stakeholders.[165] Moreover, companies in distressed circumstances typically reassess their business imperatives and prepare new short-term and long-range business plans. Such changes in business priority also do not need to be disclosed. As the business moves more deeply into financial distress, GAAP reporting provides increasingly less meaningful information.[166] SEC filings eventually become of relatively limited utility to stakeholders, leading to the conclusion that market pricing lacks a reliable foundation of information.[167]

Where relevant information is available but scattered (e.g., spread across hundreds of bankruptcy court pleadings), such information may be too costly to uncover, collect, manage, and understand, or market pricing may lag because it is not particularly profitable for investors to exploit it.[168] Information costs can be high in situations where, for example, liabilities are complex and the potential benefit of such added data appears low. Even assuming a universe of rational investors, lack of complete information may result in a variance of market price from intrinsic value. Either way, expert testimony is often needed to assist the trier of fact in assessing the reliability, relevance, and credibility of pricing information at the time a company is in financial distress.

163. *See id.* § 240.13a-3.

164. *See id.* § 240.13a-11.

165. Severe financial distress may ultimately lead the accounting firm conducting the subject company's annual audit to refuse to issue an unqualified opinion and raise going concern issues. At that stage, disclosure may be mandated.

166. Historical accounting and performance data are often said to be of limited utility and relevance in the valuation of reorganizing businesses. *See, e.g.*, Arrow Elecs., Inc. v. Justus (*In re* Kaypro), 230 B.R. 400, 413 (B.A.P. 9th Cir. 1999); *In re* Sierra Steel, Inc., 96 B.R. 275, 278 (B.A.P. 9th Cir. 1989); Peltz v. Hatten, 279 B.R. 710, 743 (D. Del. 2002); Zeta Consumer Prods. Corp. v. Equistar Chems., L.P. (*In re* Zeta Consumer Prods. Corp.), 291 B.R. 336, 347 (Bankr. D.N.J. 2003); Lids Corp. v. Marathon Inv. Partners, L.P. (*In re* Lids Corp.), 281 B.R. 535, 542 (Bankr. D. Del. 2002); *In re* WRT Energy Corp., 282 B.R. 343, 369 (Bankr. W.D. La. 2001).

167. Perhaps for this reason, sizeable bankruptcy cases typically witness securities fraud claims asserted against management, primarily on the basis of omission ("fraud in the retention") liability.

168. *See, e.g.*, Stewart C. Myers & Nicholas S. Majluf, *Corporate Financing and Investment Decisions When Firms Have Information that Investors Do Not Have*, 13 J. FIN. ECON. 187 (1984); Sanford J. Grossman & Joseph E. Stiglitz, *On the Impossibility of Informationally Efficient Markets*, 70 AM. ECON. REV. 393 (1980).

b. Arbitrage

EMH also relies on the assumption that the actions of economically irrational investors are cancelled out by the swift actions of rational investors. This is usually done by arbitrageurs intending to enrich themselves by closing the gap between "market" and "intrinsic" value. There are, however, at least two reasons why rational arbitrageurs would not drive market pricing to intrinsic value: (1) cost and (2) risk. An investor incurs costs when its actions result in the correction of a mispricing of securities. Such costs include trading, holding, and short-selling costs, among others. Furthermore, sentiment and fundamental risk are also present, especially where information is lacking. Obviously, it must be worth an investor's financial while to invest, incur the cost, and bear the risk. Otherwise, notwithstanding the variance between a security's price and intrinsic value, there is insufficient net gain to warrant making the investment.

2. Challenges to EMH

EMH has been under reconsideration by a broad cross-section of economists and market commentators for over twenty years.[169] Myriad challenges have led to a growing contrary viewpoint on markets. Major market reversals during this period have increased the ascendancy of such divergent views.[170] More to the point, given the nature of businesses facing difficulties, reliance on public markets is further suspect due to the challenges markets confront in order to value distressed securities.[171] These challenges include the uncertainty surrounding business plans, the transitional nature of operations, and the complexity and often untimely financial reporting that characterize businesses in distress, as discussed above. Given these circumstances, markets are often denied a reliable or stable basis for investment decision making.

In addition to these recognized inefficiencies, distressed securities are often mispriced (relative to intrinsic value) due to external factors. The advent of "distressed" or "special situations" fund management has enabled large pools of capital to amass behind relatively few portfolio managers.[172] These managers tend to be highly sophisticated in the myriad means for resolving corporate distress.

169. *See, e.g.*, Rafael LaPorta et al., *Good News for Value Stocks: Further Evidence on Market Efficiency*, 52 J. FIN. 859 (1997).

170. For a general discussion of issues impinging EMH, see Lynn A. Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. CORP. L. 635 (2003). More specific references illustrating the range of issues include Kent Daniel et al., *Investor Psychology and Security Market Under- and Overreactions*, 53 J. FIN. 1839 (1998); Lauren Cohen et al., *Sell-Side School Ties*, 65 J. FIN. 1409 (2010); Chitru S. Fernando et al., *The Value of Investment Banking Relationships: Evidence from the Collapse of Lehman Brothers*, 67 J. FIN. 235 (2012).

171. *See* Anders J. Maxwell, *Markets, Uncertainty, and the Role of Judgment in Bankruptcy Valuation*, *in* CONTESTED VALUATION IN CORPORATE BANKRUPTCY: A COLLIER MONOGRAPH ch. 12 (Robert J. Stark et al. eds., 2011).

172. The thesis that distressed security markets are inherently inefficient is the basis for the substantial growth in private investment funds devoted to this asset class, which by one recent estimate is now estimated at approximately $1.5 trillion. *See* Jacob Wolinsky, *Bloomberg Hedge Fund Summit 2012: Marc Lasry Talks [LIVE]*, BLOOMBERG NEWS (Dec. 5, 2012), http://www.valuewalk.com/2012/12/bloomberg-hedge-fund-smmit-2012-marc-lasry-talks-live.

Their funds seek profit by, for example: (i) acquiring debt or securities at levels that they believe do not accurately reflect the intrinsic value of the business; (ii) utilizing a so-called "blocking position" in the company's capital structure to influence the restructuring outcome;[173] (iii) providing "rescue" financing (prepetition or postpetition) on profitable terms; (iv) offering additional junior capital into the reorganization (e.g., underwriting an equity "rights offering"); or (v) advancing legal entitlements or court arguments that they believe will favorably change the restructuring outcome. Often these funds can move adroitly, given that their structure enables deployment of capital quickly and without bureaucratic delay. Large restructurings now typically witness "ad hoc" committees comprised of such entities, playing a meaningful role in the resolution.[174]

The market for distressed securities is influenced by such involvement: Market pricing can become distorted by the perception of strategic imperatives.[175] A stakeholder might observe price appreciation, if: (a) it serendipitously enjoys an incremental gain in value caused by a larger holder's strategic design; (b) others in the marketplace bid to participate in that gain; and/or (c) the larger holder, as part of its case agenda, bids to increase its holdings. Conversely, a stakeholder might expect price deterioration if the market assesses added risk attendant with a more challenging case dynamic or attitude. These distortions may result in pricing far removed from intrinsic value, as would be predicted under EMH.[176]

Strategic distortions may also occur naturally, in the normal course of the bankruptcy process, without undue influence by self-interested stakeholders. Should the company file for Chapter 11 relief, the bankruptcy will follow a course typically charted by the debtor-in-possession. Thus, case circumstance and often the attitudes of management can have significant influence on the terms of the corporate restructuring. In their influential study, Professors Stuart Gilson, Edith Hotchkiss, and Richard Ruback concluded that the views of management and the forging of alliances can have a profound effect on the end determination of enterprise worth.[177] This phenomenon is well understood in the securities marketplace and (like other forms of strategic distortion) may require analysis for the benefit of the court.

173. *See* Dish Network Corp. v. DBSD N. Am., Inc. (*In re* DBSD N. Am., Inc.), 634 F.3d 79, 104 (2d Cir. 2011).

174. By including this discussion here, we do not intend to wade into the academic debate over whether distressed investing is generally good or bad for corporate reorganization. We do, however, offer one focused consideration: Distressed investing has challenged and, most assuredly, propelled forward (but relatively recently) American jurisprudence on the valuation of distressed businesses, and has, in turn, generally enabled more studied (and presumably better) valuation conclusions. *See In re* Exide Techs., 303 B.R. 48, 65–66 (Bankr. D. Del. 2003) ("Modern finance has caught up with the Supreme Court's direction in *Consolidated Rock* by providing courts with valuation methodologies that focus upon earning capacity . . . ." (quotations omitted)); Sontchi, *supra* note 36, at 16 ("[B]ankruptcy judges have become familiar and comfortable with the DCF, comparable companies, and comparable transactions methodologies.").

175. *See* RICHARD A. BREALEY ET AL., PRINCIPLES OF CORPORATE FINANCE 322–25 (10th ed. 2011).

176. *See, e.g.*, Anders J. Maxwell, *Bankruptcy Valuation: A Word from Mr. Market*, AM. BANKR. INST. J., June 2012, at 58, 59, 96–97 (analysis of the National Gypsum Corp. Chapter 11 case).

177. *See* Stuart C. Gilson et al., *Valuation of Bankrupt Firms*, 13-1 REV. FIN. STUD. 43 (2000), *cited in In re* Exide Techs., 303 B.R. 48, 60 (Bankr. D. Del. 2003).

3. Option Value

One final trading consideration is the market phenomenon known as the "option" value of equity. As a rule, the price of a share of stock does not drop to zero. Even when a company's equity is worthless, its stock typically will retain positive trading value because the shareholders are not obligated to contribute more money to the enterprise. As long as equity remains outstanding, there is always a chance that the enterprise value will increase sufficiently to put equity back "in the money." In this way, equity can be analogized to a call option with a strike price equal to the market value of debt. This equity call option provides the shareholder the right, but not the obligation, to control the assets of the enterprise by paying off the outstanding debt (i.e., equity must satisfy debts before it has sole access to the assets). This is the reason why stock may have positive trading value and, yet, the company may be insolvent.[178]

C. Expressions of M&A Interest

In their article, Messrs. Schwartz and Bryan offer yet a third "market" conceptualization: the pricing level of M&A offers to acquire the business.[179] The article cites with favor *In re Boston Generating, LLC*,[180] where the bankruptcy court approved a contested section 363 sale of the debtor's business, following a heavy marketing process and other indicia of value that supported the value of the bid and deviated from the objectors' discounted cash flow analytics. Though we think the article reflects a relatively myopic view of *Boston Generating* and the multi-faceted analysis contained therein,[181] we generally accept the proposition that a full M&A bid—even for a debtor in bankruptcy—can faithfully track "intrinsic" enterprise value. We have, in fact, observed cases where a competitive Chapter 11 bidding process yielded a final bid far sur-

178. In his piece, *A Further Comment on the Complexities of Market Evidence in Valuation Litigation*, 68 Bus. Law. 1071 (2013), Gregory A. Horowitz discusses "option" value and how it relates to OMV (as a reflection of "intrinsic" value). Mr. Horowitz proposes a "debt discount" test, which he argues establishes insolvency if equity capitalization is less than the discount debt is trading from par. Though it might serve as a useful tool or "litmus" test in any given case, we do not agree with the universal application of Mr. Horowitz's thesis, given that the "debt discount" may be caused by a host of reasons that are separate and apart from the market's assessment of intrinsic enterprise value: (a) equity pricing may actually be due to debt discounts; (b) debt and equity markets may have an effect on each other's pricing; (c) either market (debt or equity) may, at a particular point in time, be more efficient than the other; (d) the ownership profiles may differ between either, influencing pricing; (e) pricing of either debt or equity may be distorted by strategic market participants; or (f) as reflected by the opaque and complex circumstances thoughtfully illustrated by Mr. Horowitz, there may be other divergent investment criteria between classes that preclude practical consideration of observable outcomes. The case of ECD, discussed in *supra* note 137, illustrates the reasons why the "debt discount" test may not be a reliable gauge in all circumstances.

179. *See* Schwartz & Bryan, *supra* note 3, at 948–49.

180. 440 B.R. 302 (Bankr. S.D.N.Y. 2010).

181. *See, e.g.*, *id.* at 328 ("Given the costs and time associated with confirming a plan under these circumstances, I find that the Debtors do not have the liquidity to survive until confirmation of a plan.").

passing aggressive discounted cash flow valuations advanced earlier in the case.[182]

But, respecting M&A outcomes in bankruptcy, generalizations are particularly dangerous. The law has long viewed distressed M&A processes with skepticism, considering them a more problematic strategy for realizing "intrinsic" enterprise value. The following quote from Warren Buffet suggests the reason why: "Price is what you pay; value is what you get. Whether we're talking about socks or stocks, I like buying quality merchandise when it is marked down."[183]

Again, "fair market" value reflects the value level achieved in an unpressured and optional M&A transaction, not one compelled by the legal process, need for liquidity, or the self-serving demands of parties occupying senior levels of the capital structure.[184] Further, a distressed M&A process may not be run well, lack management attention (especially while the company is attempting a Herculean operational turnaround) or executive support,[185] or be pursued under inopportune market conditions. The law has also observed that the "stigma of bankruptcy" itself can have unfair economic consequences: As a market phenomenon, buyers may offer less for companies in distress (i.e., "bottom-fishing") than their intrinsic value based on earnings expectations.[186] Stated more plainly, the distressed M&A process can be arranged to serve up a depressed, factitious

182. *See, e.g.*, *In re* Nortel Networks, Inc., No. 1:13-CV-00757, 2013 WL 1385271, at *2 n.3 (Bankr. D. Del. Apr. 2, 2013) (M&A process, commencing with a $900 million "stalking horse" bid, eventually yielded "results beyond expectations" of $9 billion).

183. WARREN BUFFETT, BERKSHIRE HATHAWAY 2008 ANNUAL REPORT 5 (Feb. 27, 2009) (quotation omitted), *available at* http://www.berkshirehathaway.com/2008ar/ 2008ar.pdf.

184. *See, e.g.*, *In re* Lionel Corp., 722 F.2d 1063, 1071 (1983) (holding that, before a bankruptcy court should approve a business sale per Section 363, the debtor must provide "a good business reason" for the proposed exit strategy, and also establish how an M&A transaction, as opposed to plan confirmation, would further "the diverse interests of the debtor, creditors, and equity holders, alike").

185. On this point, the Chapter 11 case involving American Safety Razor Company ("ASR") is instructive. *See In re* Am. Safety Razor Co., No. 10-12351 (Bankr. D. Del. July 28, 2010) (case summation transcript available at Docket No. 750). ASR filed for Chapter 11, intending to sell its business by prompt section 363 auction and proposing a credit bid extended by ASR's first lien lenders as the initial "stalking horse" bid. Historical management decision making was a topic of controversy but, regardless, the first lien lenders offered senior executives future jobs following consummation of their bid. A competitor firm (the Schick division of Energizer Holdings, Inc.) advanced a competing bid that was $51 million higher than the lenders' credit bid, but did not include guarantees of future executive employment. Management refused Schick the diligence necessary to finalize its "hostile" bid. Following a lengthy trial, the bankruptcy court did not approve consummation of the credit bid; instead it directed management to provide Schick necessary final diligence and, over the company's staunch objection, ruled one week later that Schick's "hostile" bid was the winning bid at auction. *See also* Sontchi, *supra* note 36, at 8 n.13 ("In addition, the projections may be manipulated by management to favor its interests or those of others 'friendly' to management.").

186. *See, e.g.*, *In re* Penn Cent. Transp. Co., 596 F.2d 1102, 1115–16 (3d Cir. 1979) ("[T]he market value of the [reorganized debtor's] security will depend upon the investing public's perception of the future prospects of the enterprise. That perception may well be unduly distorted by the recently concluded reorganization and the prospect that lean years for the enterprise in the immediate future."); *In re* N.Y., New Haven & Hartford R.R. Co., 4 B.R. 758, 792 (Bankr. D. Conn. 1980) ("The stigma of bankruptcy alone is a factor that will seriously depress the market value of a company's securities."); *In re* Exide Techs., 303 B.R. 48, 66 (Bankr. D. Del. 2003) ("[A methodology designed] to bring value calculations in line with current market value . . . is not appropriate . . . since the 'taint' of bankruptcy will cause the market to undervalue the securities and future earning capacity of the Debtor.").

bid grossly understating value to the economic benefit of management and senior creditors, but at the expense of a due recovery to junior stakeholders.[187] Such distortions can be aggravated when a bidding process dictates cash only consideration, arguably preferable to cram-down stock in a reorganized business, but resulting in a low valuation. These complexities clearly warrant the court's evaluation based on expert testimony.

V. Conclusion

There is, to be sure, a natural tendency to believe that markets reflect intrinsic business value. This perception is, after all, a premise underlying the long-term functioning of markets. It is also logical that laws supporting a capitalistic system should rely on market data. But American law is highly nuanced, benefiting from two hundred years of practice that has afforded the growth of the most developed commercial society in history. The law recognizes that "market" valuation and intrinsic business worth can be quite different. This is especially the case when considering troubled companies. The Supreme Court made this point explicitly more than seventy years ago in *Consolidated Rock* and repeated that view several times since. Congress, when crafting the Bankruptcy Code, appears to have carefully followed the Supreme Court's lead. Bankruptcy procedures were designed specifically to enable a fair and even-handed judicial process so that courts can, among other things, bear witness to such valuation discrepancies. Markets today make legal history look prescient: Trading in distressed debt and other securities has resulted in observable market data that often does not reflect efficiency based on unbiased information adequately and rationally reflected in bids and offers. Rather, particularly distressed securities markets are prone to imbalanced and illiquid trading conditions and myriad misinformation and price distortion.

In summation, we agree with Messrs. Schwartz and Bryan that *Campbell* and *Iridium* are important and well-reasoned decisions. But we do not believe that either opinion supports a new paradigm under which market valuation or intrinsic business worth can be automatically deemed to be one and the same. We do not agree with their views regarding systemic efficiency. The contentions regarding judicial bias do not comport with our experience and, to be frank, we have deeper faith in the federal judiciary. We do not think the proposal to rely on markets as the sole and final arbiter of the enterprise worth of distressed businesses is warranted.

187. *See, e.g.*, Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 Mich. L. Rev. 1 (2007) (studying differential between enterprise reorganization value and bankruptcy-sale value); *see also Exide Techs.*, 303 B.R. at 59 n.24 (in valuation contest, the bankruptcy court essentially disregarded evidence of the postpetition "private equity process" conducted by the debtors during the Chapter 11 case that yielded low bid, relying instead on discounted cash flow and other analytics offered by plan objectors).