A Proposal to Help the Bankruptcy Court in Resolving Valuation Problems
Testimony on Valuation by Hon. James M. Peck
ABI Field Hearing - February 21, 2013

Anyone who has had to deal with a major valuation dispute knows that valuation trials can be time-consuming ordeals. During my tenure on the bench, I have handled two unusually challenging contested valuation proceedings – the 50-day insolvency trial in *Iridium* that lead to my decision on the need to account for public market data in determining value and the equally long Rule 60(b) trial in Lehman that, among other things, challenged the fairness of the sale to Barclays from a valuation perspective and highlighted the great difficulty in valuing complex securities at a time of financial market turmoil. Each trial was a fascinating experience for me but very costly in terms of time, professional fees and judicial resources. I also was the U.S. judge in cross-border chapter 11 and CCAA cases involving Quebecor, North America's second largest commercial printer with headquarters in Montreal. That case gave me the opportunity to observe and grow to appreciate the function played by the Monitor in Canadian insolvency proceedings.

My comments this afternoon are based on these three judicial experiences. I am convinced that valuation disputes, while critically important to determining distribution rights and to confirming a plan, are also inefficient and burdensome to the bankruptcy system and can lead to unpredictable results. Perhaps most importantly, bankruptcy judges often are not well equipped to decide tough valuation questions on their own and may lack the resources and expertise to do their jobs in this area with utmost confidence.

Valuation is really too important to creditor recoveries and determinations of plan feasibility to be left to judges acting alone. Decisions on value should not just be about convincing a lay judge that one or another expert is more persuasive or deciding which party has carried its burden of proof. My own experience in *Iridium* is a good illustration of this point. The parties in that case had access to six years of discovery and placed considerable reliance on their own well-prepared expert witnesses. But when it came time to decide a 3.7 billion dollar dispute that turned on the debatable question of solvency, I had access only to my law clerks and a complex record that I had to weigh and decipher on my own. Judges have major responsibilities to answer such disputed questions but for the most part do not have access to all the resources needed to decide these questions reliably.

Regardless of whether a judge is sophisticated or unsophisticated in applying valuation methodologies, judges perform their valuation functions on a part time basis and can never be as competent as an independent valuation expert would be in critically assessing a valuation question. Litigants depend on our decisions but also play games with us by advancing aggressive theories that are more tied to their hopes and dreams than to economic reality. Not all judges have the background to assess the opinion evidence presented, often confected as a means to justify a recovery rather than to an estimate true value.

An inexperienced judge navigating unfamiliar territory introduces an extra element of risk and uncertainty into what necessarily is an unpredictable process in which the skills and personality of the advocate and witness may be the most important variables. An experienced judge is likely to be more facile in deciding these questions but reliability and predictability remain a problem because the experienced judge will be applying his or her own valuation judgments without being able to confer with someone deeply grounded in the subject. Such a valuation professional would be more skilled than most judges in being able to verify or question the assumptions and adjustments that so often dictate the conclusions reached. Valuation is an art more than a science, and it would be helpful for the Court to have access to a seasoned art critic in deciding whether a particular challenged valuation is genuine or a fake.

This leads to the question of whether it is truly sensible and efficient for valuation expertise to be the exclusive domain of the hired experts of the parties and for valuation to be decided in a purely adversarial setting by a judge who lacks access to independent expertise. A hybrid approach in which the Court, at its election, routinely would have access to a valuation consultant of its own may be more desirable. I suggest that the Valuation Advisory Committee take a careful look at the Canadian experience with the Monitor – typically these are major accounting firms – and consider adapting this concept to chapter 11 practice. The Monitor in Canada performs an oversight function and makes recommendations to the Court regarding proposed transactions. As I understand it, the Monitor does not run the business or make any business decisions for the debtor company but evaluates what is going on within a distressed business from a neutral, best practices perspective. The emphasis is on business review coupled with reliable and credible reporting.

My thought is that the appointment of a firm serving in a capacity similar to a monitor might be comparable to the appointment of an examiner but would be in the discretion of the Court acting on its own motion or the motion of parties in interest. Not every large chapter 11 case would need one, but the process of determining value in a fair and dependable fashion might be advanced by the services of an independent valuation firm charged with the responsibility of providing balanced and unbiased valuation evidence to be considered and evaluated by the parties and by the Court. The expenses would be a cost of administration and the work product would be publicly available to all parties (including market participants).

In effect, the monitor would function as a valuation ombudsman, an expert to aid the Court in making a sound decision on value, but the opinions expressed by the firm would be filed of record and available to all stakeholders. Some portions might have to be redacted or filed under seal if necessary to protect sensitive information. The opinions expressed would not be determinative as to any disputed questions, but they could be. Depending on the case, the parties would be able to stipulate to accept the findings of the monitor and use those findings as the basis for structuring a plan, thereby potentially avoiding plan confirmation litigation with respect to value. In a contested setting, the monitor's indications of value would be part of the evidence to be considered by the Court and could be critiqued by other experts. Regardless of whether the valuation issue arises in a contested or consensual setting, the monitor would also be available to respond to questions in open court during status conferences.

In appropriate circumstances, the Court might be able to consult with the monitor on an *ex parte* basis (with the prior consent of the parties) as a resource to analyze the work product of the retained expert witnesses and assist with questioning those opinions. My hypothesis is that having a monitor in cases with significant valuation issues would also facilitate settlements and minimize the need for major contests over value. The monitor would be able to serve as a valuation mediator, a diplomat of sorts, who, depending on the nature of the dispute, might promote compromise or acquiescence.

I understand that Tony Schnelling performed a function such as this successfully as a court appointed expert in the *Calpine* case a number of years ago. The fact that the Court has the ability to appoint its own expert in

appropriate cases indicates that existing law may not need to be changed to achieve the purposes noted. But court appointed experts are not typical. Adding a provision to the Code that would allow for the discretionary appointment of a monitor would be one way to encourage the use of independent valuation experts. And in my view, that would be a desirable change.