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Dissent Says Appraiser Lacks Necessary Valuation Expertise

***Shaffer v. Visaggio's, Inc.*, 2015 Pa. Super. Unpub. LEXIS 2403 (July 29, 2015)**

A Pennsylvania dissenting shareholder case raised questions about who is qualified to resolve valuation issues, as well as what constitutes competent financial evidence.

In 1980, three partners formed a company that held real estate including land, a restaurant, hotel, garage and banquet facilities. The restaurant had various pieces of equipment related to the business. In 1981, the dissenting shareholder left the business but held on to his 25 percent ownership interest. In 2008, the company was poised for a merger, which prompted the dissenting shareholder to demand the fair value of his interest. The company offered him $35,000, but he claimed his stock was worth $500,000. When the company rejected his proposal, he filed suit in state court.

Under the statute governing valuation proceedings in a dissenting shareholder action, the trial court appointed an appraiser "to receive evidence and recommend a decision on the issue of fair value." The appraiser was an attorney.

An evidentiary hearing took place in front of the appraiser at which both sides presented real estate and business valuation experts. The business valuators' proposed values were the result of three methodologies.

The company's valuation expert was the only expert who performed independent valuations. Using all three approaches, he determined a value between $101,700 and $487, 700 before the contingent liability.

The expert said that the financial statements that management provided showed contingent liabilities related to deferred salaries for the majority owners and unfunded pension obligations of about $1.8 million. Since the liabilities dwarfed all three values, he assigned zero ($0) value to the company's stock. He conceded that if pressed he would caution the owners or employees of the company that it was not likely that they would ever receive the amounts claimed for deferred wages or unfunded pensions given the company's operative reality. He doubted that the company would have borrowed money to pay the accrued but unpaid salaries and he denied that the company was able to pay the deferred compensation at the time of the merger.

The minority shareholder's expert did not perform his own valuation. Instead, finding the opposing expert's approach "reasonable," he used the numbers the company's expert generated as a baseline and made several adjustments including ignoring the claim for unpaid wages and pension obligations.

He pointed out that the claimed wage liabilities were "approximately 147 percent higher on the accrued wage schedule than what is reasonable for an operating business of this nature." The alleged accrual period was considerable, starting in 1981 and going to about 2010, he said. If the company had been paying the claimed compensation amount since 1981, it would have been close to $2 million in deficit, he said. Under industry standards, the claimed wages were excessive and there was no expectation that they would be paid. He said the excessive numbers led him to conclude that the liability was created such that it would reach a number that would make the minority shareholder's interest worthless.

He determined that the market approach was "the most appropriate approach." Using the opposing expert's $487,700 value resulting from that method and applying his modifications, the dissenting shareholder's expert found the company's stock was worth nearly $799,500. This yielded a value of nearly $199,900 for the minority shareholder's interest.

Following the hearing, the appointed appraiser inspected the property and operations and asked to see the company's insurance policies. Subsequently, he determined that the real estate was worth $1.8 million, noting the hotel rooms and liquor license should be factors in the valuation but not to the extent the minority shareholder's expert proposed. Based on insurance information and his inspection, the appraiser concluded the equipment, which he said was "used, readily available, not unique

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and in some cases, very dated," was worth $325,000.

Both sides objected to the appraiser's report, claiming there were factual and legal errors. Nevertheless, the trial court adopted it. After noting there was a $1.6 million debt on the real estate and subtracting that amount from the $1.8 million, the trial court concluded the company was worth $525,000, yielding a $131,250 value for the dissenting shareholder's 25 percent interest. In so doing, the trial court paid no attention to the business valuators' conclusions.

The company appealed the trial court's decision at the Superior Court of Pennsylvania, an intermediate appellate court, claiming two errors: One, there was no evidence to support the business equipment value, and two, the trial court's valuation failed to consider the $1.8 million unpaid wage and pension liabilities.

Under the state law applicable in a dissenting shareholder suit, determining the "fair value" of the stock requires establishing the going concern as opposed to the liquidation value. The Pennsylvania Supreme Court recognized three principal valuation methods with which to determine fair value: asset, market, and income approaches. Known as the "Delaware Block" method, a trial court essentially assigns weight to each of the three values generated by the three methods to arrive at the fair value of the company.

But, under a subsequent ruling from the state appellate court, trial courts are not limited to these methods but may take a "more liberal approach [which] must include proof of value by any technique or methods which are generally considered acceptable in the financial community and otherwise admissible in court." See Glosser Bros. Inc., 555 A.2d 129 (Pa. Super. 1989) (citing Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983)).

The majority of the state appellate court drew on this flexibility in the law when reviewing the trial court's findings on the value of the business equipment and its decision on wage and pension liabilities.

The company contended that neither expert specifically valued the equipment and that the appraiser's valuation of the equipment based on his site visit and the insurance policies was not a proper valuation method. Therefore, there was no competent evidence to support the trial court's valuation.

The majority of the appellate court disagreed, finding that the testimony of the real estate experts and the business valuation experts touched on the value of the equipment. For example, both sides' real estate experts visited the company and the condition of the property, including the business equipment, came up during the proceedings. The majority noted that, even though both sides confined their real estate appraisal to real estate only, "it does not follow based on the [applicable] jurisprudence" that the appraiser was confined to the real estate expert reports to evaluate the business, the court said.

Moreover, the majority said, the business equipment was an asset that appeared on the company's balance sheets and it came up when the parties' business valuators discussed the treatment of certain marketable securities in the amount of $111,750. The company's expert excluded this amount from his valuation because at the time of the merger the securities had been liquidated "and had been rolled into the operations of the company either for equipment or to continue operations during the economic downtown" in 2008. The dissenting shareholder's expert rejected this approach, treating the securities instead as nonoperating assets.

The court's majority said the company's business valuators also referenced the equipment in generally describing the asset approach and the market approach. For example, the dissenting shareholder's expert noted that the opposing expert "refer[red] to Pratt's Stats which is an analysis of sales transactions and concluded … 34 percent of gross sales is an indicator of what a restaurant's operation's value would be, which would include the operating assets, which is property—which is equipment plus any goodwill and conclude[d] the value was $487,714."

And, the majority said, the equipment was listed in the company's insurance policies that the appraiser requested. The appraiser's impressions from his site visit and his review of the insurance policies for the equipment likewise represented competent and relevant information. Finding the appraiser's report was based on substantial and competent information, the appellate court affirmed the trial court's adopting the appraiser's recommended valuation of the business equipment.

The appellate court also found the testimony from the business valuation experts on the subject of unpaid wages and unfunded pension obligations was competent and substantial evidence in support of the appraiser's exclusion of the $1.8 million liability claim. Therefore, the court's majority affirmed the trial court's fair value determination.

The dissent said it agreed with the majority's "thoughtful" analysis of the wage and pension liability issue. However, it found the trial court's adoption of the appraiser's business equipment valuation was error.

Even though there was no statutory requirement that the appointed appraiser be a business valuator and no appellate court had spoken to this issue, a trial court "could presumably appoint an expert in business valuation." The dissent suggested that it might be preferable to do so. It pointed out that the trial court in adopting the appraiser's report cited to an admonition from the state Supreme Court that valuation issues in a dissenting shareholder litigation were "rather economic than legal in character" and could "better be derived by consulting the business man, the banker, and the industrial engineer, than the jurist legal scholar, or lawyer."

Here, the dissent said, the appointed appraiser was an attorney and the record "contains no indication that he has any expertise or qualifications as a business valuation expert." It added that the appraiser functioned more as a special master, receiving evidence in the form of conflicting expert testimony and making a recommendation to the trial court based on that evidence. In this role, the appraiser failed, the dissent concluded.

Although the appraiser received expert valuations based on the Delaware Block method, he ignored them. Instead, he used the value of the company's casualty insurance placed on the equipment and then made a downward adjustment based on his own observation of the equipment. This approach, the dissent said, "bore no relation to, and did not rely in any respect upon, the work performed by the two business valuation experts." The appraiser's valuation did not represent a going-concern value for the equipment but an estimate of its liquidation value, which itself was improper, the dissent added.

In sum, the dissent stated that there was no competent or substantial evidence in the record to support the $325,000 valuation and it "does not even reflect a going concern valuation as is required by law in this context." Since the appraiser had no expertise in valuing business equipment, "his report constitutes, at best, his speculation regarding the liquidation value of the business equipment." The trial court's adopting the appraiser's valuation was reversible error, the dissent concluded.

Different Ways to Find No Claim to Enhanced Value of Nonmarital Asset

***Berg v. Young,* 2015 Fla. App., LEXIS 13077 (Sept. 2, 2015)**

In a Florida divorce case, the trial court heard copious expert testimony on the value of the husband's interest in a car dealership. The dispute turned on the validity and interpretation of the parties' prenuptial agreement; a secondary issue was how to treat any appreciation in value, assuming there was an increase in value in the first place and assuming the nonowner spouse had a claim to it. Although part of the trial court's analysis was flawed, it ultimately arrived at the correct outcome.

The husband's father owned a 40 percent interest in a car dealership in Delray Beach, FL. The father created a trust for the benefit of the husband that held a 30 percent interest in the business. During the marriage, the husband bought half of his father's 40 percent interest in the dealership, "the Delray 20 percent."

Before marrying, the husband and wife executed a prenuptial agreement. Among other things, the contract provided that "any and all real, personal, intangible, mixed, or other property owned by either party prior to the marriage shall be and remain hereafter the separate property of such party, including other property purchased with the proceeds thereon and increases in value during the marriage or changes in form." The contract also included a "title presumption" stating that "any and all real, personal, intangible, mixed, or other property acquired during the marriage in the name of one party alone shall be and remain the separate property of the party in whose name title is taken" and that "[e]ach party waives any claim of a special equity, equitable distribution, or any other claim against any such asset."

The husband bought the Delray 20 percent with a loan for $1.65 million in 2002 based on a contemporaneous business valuation of the dealership. He paid the loan with funds from his separate accounts. In 2004, the business, Delray Motors, paid off a loan to buy the land on which it was located. The funds to pay off that loan came from the business' earnings that were not distributed to the husband and/or other shareholders.

The husband's income included salary, commissions and trust stock distributions from the business. The income varied based on the business' success. During most of the marriage, the wife also worked for the business on a salary basis. In line with the prenuptial agreement, both spouses deposited their earnings in separate accounts.

At trial, the parties presented a raft of experts who testified to the value of the business. A personal property appraiser for the wife found the tangible assets of the business were worth $2 million. A real estate appraiser concluded the buildings and improvements on the land yielded a $17 million value. The wife's CPA determined that, based on his valuation in 2010, the valuation year, the husband's 20 percent interest in the business had increased by $1.85 million. The expert acknowledged that he used a different approach than the firm that did the 2002 appraisal had used.

A financial advisor for the husband said the dealership owned too much land. No reasonable buyer would pay about $19 million—the total amount resulting from the different values the wife's experts assigned to the business—for the dealership. There was not enough gross profit to warrant that kind of investment. This expert determined that, in 2010, the dealership was worth $2.75 million. Accordingly, the husband's interest in the Delray 20 percent had decreased. An independent analysis by the husband's CPA also concluded that the husband's contested interest in the business had dropped in value from the year of purchase to the valuation year.

In reviewing the prenuptial agreement, the trial court found it was valid. At the same time, it said, "The Wife did not waive her right to equitable distribution of the increase in the value or enhancement in value of all separate assets which have appreciated due to the active marital effort of the Husband." Here, the husband bought the Delray 20 percent interest with his separate funds, the trial court determined.

The critical follow-up questions in terms of the community's right to any value in the Delray 20 percent were whether there was an appreciation in the asset. And, if so, was the appreciation in value passive in nature or was it the result of the "active marital efforts of the Husband"? The trial court said that, to the extent the Delray 20 percent interest increased in value, it "is the result of the passive increase in the value of the underlying land and buildings" of the business, not the husband's efforts during the marriage. The court did not make a conclusive finding that there was an appreciation

and how much it was. It declined to award the wife any funds stemming from the Delray 20 percent.

In appealing the trial court's ruling with the Florida Court of Appeals, the wife claimed it was an error not to find any active appreciation in the Delray 20 percent and not to award the community a share of the appreciation.

The appeals court first reviewed the language of the prenuptial agreement to determine whether the trial court's findings were correct. Under controlling case law, "[w]here a prenuptial agreement does not address the right to enhanced value of a non-marital asset, that value is subject to equitable distribution," the appeal court said (citing Weymouth v. Weymouth, 87 So. 3d 30 (Fla. 4th DCA 2012)).

The key was the title presumption provision in the agreement, the appeals court noted. This paragraph combined with the agreement's other provisions, including those that addressed property acquired during the marriage, was enough to suggest a waiver of the future enhancement of nonmarital property even if the enhancement resulted from the marital earnings or labor. Consequently, the trial court's interpretation of the prenuptial agreement was wrong. Under the agreement alone, the wife had no claim to any interest in the Delray 20 percent.

But, the appeals court continued, the trial court ultimately reached the correct conclusion—first, by finding that the Delray 20 percent represented the husband's separate property; and second, by finding that, if there was a change in the value of the contested interest, it was due to an increase in the value of the land the dealership owned. This kind of increase was the result of market forces, not the husband's efforts. The appeals court pointed out there also was evidence that the part of the business that was under the husband's management, new car sales, had dropped in value from the time the husband bought the Delray 20 percent.

This was an instance where the "tipsy coachman" doctrine applied, the Court of Appeals said, in affirming the trial court's final determination. The trial court "reach[ed] the right result, but for the wrong reasons."

Damages Expert Stumbles Over Causation

***Rowe v. DPI Specialty Foods,* 2015 U.S. Dist. LEXIS 110605 (Aug. 19, 2015)**

Causation confounds even experienced valuators. A common mistake is not to address it at all and risk exclusion under Daubert. But a recent decision presents the opposite situation: an expert who made causation his be-all and end-all and improperly expanded the role of a damages expert.

After the plaintiff was terminated, he filed suit, claiming an employee of the defendant had made defamatory statements about him that eventually cost him his job. He pursued a host of damages, including loss of earnings and benefits and loss of economic relations. Whether and to what extent the alleged defamatory statements caused the plaintiff's termination was a key issue in the case. The plaintiff retained an expert to calculate damages. The expert report said the damages determination was "based on an assumption of liability. I have done no work to determine liability and do not expect to do any such work."

The defense offered a rebuttal expert, an experienced valuator, whose main objection seemed to be that the rivaling expert's calculations were based on flawed assumptions. But he went further. Citing litigation practice guides, the rebuttal expert proposed that: (1) there were "two different contexts of causation, legal and economic"; (2) the issue of causation "continues to be expanded"; and (3) "an expert has a duty to understand and prove that a causal link exists between the incident and each of the damages elements." As he saw it, "an expert is specifically precluded from relying upon an assumption that economic causation exists." And "the consideration of all facts available in a case is critical to any economic loss analysis." When opposing counsel asked him whether causation gave him "license to weigh and compare facts and reliability of witnesses," he replied: "From an economic point of view, yes." He added, "Expert witnesses are allowed to sit in the courtroom and listen to all of the testimony, because all of that has a bearing on causation, for example." He concluded that "based on the economics and my review of the economics," the plaintiff was terminated for reasons other than claimed.

The plaintiff challenged the testimony under Daubert, arguing that the expert's opinions "invade the proper province of the jury to weigh the facts and evaluate witness credibility." The court agreed. It said the rebuttal expert "twist[ed]" reference material into a concept the texts did not support, a "dichotomy between economic and legal causation that he attempts to exploit." He "would elevate himself above the witnesses, attorneys, other experts, and even the jury in drawing conclusions." His "misreading" of the cited authorities was "very troubling," the court said, but his "serious misconception" of the role of an expert in the courtroom was "significantly more troubling."

The court only admitted the portion of the opinion that critiqued the assumptions informing the plaintiff's expert's calculations.

According to the court, an expert "should understand causation and base his opinions on sound causation but is not to argue causation or prove it."

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