

## Forensic & Valuation Services Conference

### Anatomy of a Corporate Divorce Litigation

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# Session 6

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# Anatomy of a Corporate/Business Divorce

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## Learning Objectives

- Identify real-life issues encountered in the different types of Business Divorce actions.
- Demonstrate knowledge and understanding investigating claims and seeking information for use in Business Divorce actions.
- Recognize impact of jurisdictional differences affecting Business Divorce cases.
- Ability to interact with counsel to address issues encountered in Business Divorce actions.

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## **Business Divorce Actions**

### **Types of Disputes Between Co-Owners of Closely Held Business Entities**

- **Dissenting Shareholder Actions**
- **Judicial Dissolution Actions (Oppression/Deadlock)**
- **Fiduciary Breach Actions**
- **Buy/Sell Disputes**
- **Member Dissociation Actions**

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## **Business Divorce Actions**

### **Dissenting Shareholder Actions**

- **Generally, dissenting shareholder matters relate to statutory rights provided to minority shareholders for an action the shareholder disagrees with.**
- **Allows shareholders the opportunity to dissent from extraordinary corporate actions that will adversely impact their interests.**

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## **Business Divorce Actions**

### **Dissenting Shareholder Actions**

- **These matters involve appraisal rights generally governed by state statutes and case law.**
  
- **Triggered by various actions to which shareholder objects:**
  - Merger
  - Sale of assets
  - Exchange of shares

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## **Business Divorce Actions**

### **In a Dissenting Shareholder action:**

- **A shareholder must “perfect” their appraisal rights.**
  
- **This is generally done by following a series of predetermined steps before they are allowed resolution.**

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## **Business Divorce Actions**

### **Oppressed Shareholder Actions**

- Occurs when the majority shareholders in a corporation take action that unfairly prejudices the minority or defeats reasonable expectations
- Oppression actions are founded in corporate dissolution statutes.
- Delaware has no oppression statute.

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## **Business Divorce Actions**

### **Oppressed Shareholder Actions**

- Statutes allow minority shareholders who have been “oppressed” to file for judicial dissolution.
- Many states have adopted statutory provisions which allow for the buy-out of a minority shareholder’s interest.
- Some states give courts discretion to order reverse buy-out.

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## Business Divorce Actions

### Oppressed Shareholder Actions

- Occurs in close corporations because of the lack of a public market for the company's shares.
- General concept: Without the opportunity to sell their holdings in an open market, the *minority shareholders* are unable to escape mistreatment by selling their stock and exiting the corporation.

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## Business Divorce Actions

### Grounds for Oppression Actions

- Deceptive practices – fraud
- Nonpayment of Distributions
- Mismanagement including diversion of business opportunities
- Illegal actions and Self Dealing

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## **Business Divorce Actions**

### **Grounds for Oppression Actions**

- **Personality clashes**
- **Termination of Employment**
- **Active versus passive shareholders:**
  - **Active seeking higher pay and lower distributions**
  - **Inactive seeking lower salaries and higher distributions**

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## **Business Divorce Actions**

### **Deadlock Actions in 50-50 Companies**

- **Director deadlock**
- **Shareholder Deadlock**
- **Internal dissension**

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## **Business Divorce Actions**

### **Deadlock Actions**

- **Only some states provide buy-out remedy in deadlock cases.**
- **Courts can appoint receiver to wind up and liquidate assets of dissolved corporation.**

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## **Business Divorce Actions**

### **Actions Involving LLCs**

- **Grounds for judicial dissolution:**
  - Not reasonably practicable to continue business in conformity with operating agreement
  - Deadlock without tiebreaker provision
- **Minority of state statutes include oppression as ground for dissolution action by minority member.**

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## **Business Divorce Actions**

### **Actions Involving LLCs**

- **Minority of state statutes provide a buy-out remedy in LLC dissolution actions.**
- **Some courts have authorized “equitable” buy-outs in LLC dissolution cases.**

## **Business Divorce Actions**

### **Disassociation Actions**

- **Dissociation occurs when an owner of a business ceases to be associated in operating the business, voluntarily or involuntarily.**
- **Generally, the withdrawing owner may want his ownership interest redeemed.**

## Business Divorce Actions

### Claims for Damages, Accounting, Injunctive Relief, etc.

- Direct – Action by which the minority shareholders were directly injured by a breach of fiduciary duty.
- Derivative – Action in which the corporation is injured.
- The distinction between direct and derivative claims often determines whether a claim can proceed, and what steps must be taken before it can be brought.

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## Business Divorce Actions

### Threshold and Basis for proceeding with a claim:

- Establish requisite ownership interest.
- Establish requisite grounds for relief.
- Establish appropriateness of dissolution or other equitable remedy.

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## **Business Divorce Actions**

### **Potential Remedies**

- **Buy-Out**
- **Forced Liquidation**
- **Maintain Status Quo**

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## **Business Divorce Actions**

### **Testifying Experts' Role?**

- **Valuation – Valuation of Shares**
- **Forensic – Investigate Direct and Derivative Claims**
- **Forensic - Quantify Damages or Offsets**
- **Both Valuation & Forensic**

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## **Business Divorce Actions**

### **Testifying Experts' Role?**

■ **If hired as an expert for valuation or damages you must:**

- Advocate for your opinion only
- Must be seen as objective and working with integrity
- Covered under SSVS1 and SSS1

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## **Business Divorce Actions**

### **Consulting Experts Role?**

- **Work to shadow and review work of expert.**
- **Provide advice on deal structuring.**
- **Guidance on tax issues.**
- **Provide rebuttal points on testifying expert.**

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## Business Divorce Actions

### Engagement Issues:

- Must develop an understanding of engagement:
- Communicate with client and counsel to understand the issues at dispute.
- Read complaints and counterclaims.
- Understand direct and derivative claim issues.
- Assess your ability to provide services to the client.

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## Business Divorce Actions

### Engagement Issues:

- What role will you perform?
- Are you a testifying or consulting expert?
- What is expected of you?
- If consulting expert, could you be converted to a testifying expert?

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## **Business Divorce Actions**

- **What services will you perform?**
- **What is the expected deliverable?**
- **What is the expected time frame for completing your work?**
- **What are discovery end dates and report dates?**

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## **Business Divorce Actions**

### **Valuation Engagements**

- **Valuation Date or Dates**
- **Standard of Value**
- **Approach to Valuation**
- **Method of Valuation**
- **Valuation Adjustments**

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## **Business Divorce Actions**

### **Valuation Dates**

- Obtain an understanding of the valuation date.
- Communicate and discuss with counsel.
- Dates could impact issues of known or knowable?

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## **Business Divorce Actions**

### **Standards of Value**

- Know the standard of value for your jurisdiction.
- Understand difference between Fair Value and Fair Market Value.
- Consult with legal counsel on this issue.

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## **Business Divorce Actions**

### **Approaches and Methodology Used – Remember!!**

- **The approach to each engagement is case specific.**
- **Valuation expert should use professional judgement.**
- **Be aware of what the courts in the jurisdiction are accepting of.**
- **You are working to convince a trier of fact not prepare for your doctorate.**

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## **Business Divorce Actions**

### **Valuation Adjustments**

- **Excess compensation**
- **Ghost employees**
- **Family members on the payroll**
- **Payment of personal expenses (loans, credit cards, vacations, household)**
- **Related party expenses including rent**
- **Uncollectible accounts and inventory**

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## **Business Divorce Actions**

### **Valuation Adjustments**

- **Excess working capital**
- **Excess operating expenses**
- **Excess SG&A**
- **Debt position relative to industry norms**
- **Capital investment relative to industry norms**
- **Historical dividends/distributions**
- **Excess and non-operating assets**
- **Discounts – DLOM, DLOC, both or neither?**

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## **Business Divorce Actions**

### **Discovery**

- **What do you ask for?**
- **General blanket request or targeted request?**
- **What do you get?**
- **Responsive or paper churn?**

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## **Business Divorce Actions**

### **Discovery**

- **Incomplete or missing records – Can you reconstruct or perform alternative procedures?**
- **Negative inferences and assumptions and reports – Need to be credible. Remember reasonable certainty and causation issues. Don't be led to a conclusion.**

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## **Business Divorce Actions**

### **Forensic Issues and Claims**

- **Issues in shareholder actions often go beyond the valuation of the shares.**
- **Each case is fact sensitive - know your case.**
- **No general rule governs the personalities and motivations of unique shareholders and management personnel. Reflect on past engagements but don't be ruled by them.**

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## **Business Divorce Actions**

### **Case Issues**

- **Negative inferences due to lack of discovery production - When does an inference become advocating?**
- **What happens if your client was a party to behavior similar to that they are objecting to in complaint?**

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## **Business Divorce Actions**

### **Case Issues**

- **What do you do if client and counsel do not like your finding or conclusion?**
- **What happens if you uncover additional issues while performing your work?**

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## Business Divorce Actions

### Current Cases & Discussion

- Arizona Iced Tea – One of the largest ever fair value cases in which court relied solely on DCF method, rejected synergistic value, and applied 25% marketability discount and key man discount.
- Zutrau – Classic fair value analysis by Delaware Chancery Court mostly sustains minority shareholder cash-out
- Cortes – Damages award and fair value turned largely on forensic evidence of cash skimming by majority owners of restaurant

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## Resources

- <http://www.nybusinessdivorce.com/articles/accountantsexperts/>
- <http://www.njlawblog.com/articles/shareholder-oppression/>
- <http://www.hklaw.com/news/uniGC.aspx?xpST=BlogList&type=2569>
- <http://www.romanosumner.com/law-blog/minority-shareholder-rights-in-texas/>

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## **Business Divorce Actions**

**Questions????**

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## **Business Divorce Actions**

**Thank You**

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