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National Litigation Consultants' Review

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Seeking Documents and Information for Forensic Analysis in Divorce Litigation

By Richard M. Wise, CPA, CA, CFF, FASA, MCBA, FRICS, CVA, CFE, FCBV

It's common that engaging counsel needs to file a Motion to Compel Production of Documents, sometimes many months after our initial document request. In deciding the issue, courts generally require a reason or purpose the specific documents are required. Ed.

In the course of performing a forensic analysis in order to issue an expert report, a business valuator or investigative accountant (expert) might be denied access to important, if not critical, documents and information by the opposing party's counsel. Using matrimonial litigation as an example,[1] this article proposes to identify types of documents and information that are often requested by the wife's expert for purposes of determining (a) the value of the defendant's assets for purposes of property division, and (b) the defendant's income-earning capacity (real income) for alimony and/or child support.

The wife is often the best source of information since during the earlier days of the marriage, the defendant would disclose information about his sources of cash. In this hypothetical example, the wife alleges that the defendant's businesses operated as several private companies (companies) he controls are highly profitable, and he has substantial unreported in-

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1 For purposes of this example, the husband (defendant) is assumed to be the "moneyed" spouse who is the owner of various businesses and properties and the one who generates the family income.

View from the bar

Why Does Indubitable Equivalent Matter?

Jeffrey L. Gansberg, Esq.

"Indubitable equivalent" is an important but rarely used strategy to confirm a Chapter 11 plan of reorganization over the objection of a secured creditor. This strategy is rarely used because it is not fully understood and it is difficult to implement. The first issue relates to what "indubitable equivalent" means. "Indubitable equivalent" means providing a secured creditor with the full value of their interest, claim, or lien. The second issue, implementation, is highlighted by a case decided by the United States Court of Appeals for the Seventh Circuit—*In re River East Plaza, LLC*.[1] This article will attempt, in the light of *In re River East*, to explain indubitable equivalent from a practical valuation and/or financial litigation perspective.

Facts

The facts of *In re River East* are straightforward. River East Plaza, a building in downtown Chicago (the building), was owned by River East Plaza, LLC (the debtor). The building was the debtor's sole asset of any significance. LNV Corporation (LNV) was the mortgagee of the building and held the first mortgage on the building. In February 2009, the debtor defaulted on its obligations to LNV and LNV began foreclosure proceedings. LNV was successful in its foreclosure proceedings and scheduled a foreclosure sale of the building for February 2011. Hours before that foreclosure sale was to be held, the debtor filed for protection under Chapter 11 of the Bankruptcy Code. When the debtor filed its bankruptcy case, the building was worth approximately $13.5 million and LNV's claim was approximately $38.3 million. Thus, in bankruptcy language, LNV had a secured claim of $13.5 million and an unsecured deficiency claim of approximately $24.8 million.

By filing the bankruptcy case, which created an automatic stay, the debtor wanted to provide itself with an opportunity to reorganize its affairs and emerge from bankruptcy retaining ownership of the building. While the automatic stay prevented LNV

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1 669 F.3d 826 (7th Cir. 2012).

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come. She also alleges that defendant pays for many personal and family expenses in cash, including expensive ocean cruises and other vacation trips in exotic places, where the family stays in luxury suites at five-star hotels. Personal travel of a more domestic nature, i.e., within the United States or Canada, is paid for by the companies, which records these as business expenses. Other personal living expenses, such as landscaping and gardening, interior decoration, home renovations, electronic equipment such as expensive high-definition television sets, summer sleep-away camps for the children, art, jewelry and vintage wines, are paid for by the defendant in cash. The automobiles of the wife, children, and their respective spouses are leased by the companies from a car dealer and recorded by the business as "automobile expenses." The private yacht is paid for by the companies and charged to automobile expenses. The Florida condo and related expenses are recorded as rent, occupancy, and office expenses.

The expert, having been retained to quantify the values of defendant's business ownership interests as well as defendant's real income, would prepare a detailed list of relevant documents and information to perform his or her financial analysis with respect to valuing the companies and quantifying the real income.

Defendant's counsel might refuse to allow the client to produce the documents and information enumerated in the expert's request, claiming that none, or most, of the requested items are not relevant. As part of a Motion to Compel Production of Documents, the wife's attorney might request that the expert prepare an affidavit that provides the reasons why each item is necessary for the forensic analysis. Often, the expert's affidavit would not only enumerate the documents and information the expert requests, but also specify why each document or item of information being requested is necessary in order to perform a meaningful and thorough analysis. The expert may be cross-examined on the affidavit by defendant's counsel, in which case the expert may have to justify why each of the documents, interviews, and site visits are relevant and necessary. Defendant's counsel will attempt to spin the expert's document/information request as being a "fishing expedition."

The first part of this article provides a list of the various documents and pieces of information that an expert typically requests, along with reasons and/or explanations as to why they are relevant for purposes of his or her valuation and income analysis. The second portion of the list simply identifies the types of documents and information that the expert would request, as appropriate in the specific circumstances, but does not provide the respective reasons. This generalized list may serve as a checklist that can be tailor-made for similar types of matrimonial litigation. However, the respective reasons and explanations will be dictated by the specific types of documents and information being requested, considering the case-specific facts. The first few dozen respective explanations accompanying the items listed are merely suggested examples of reasons/explanations that might help persuade a judge to order the defendant to produce the expert's requested data.

Documents and Information Requested

1. Personal balance sheet of defendant as of the valuation date and financial schedules, including data filed with any banks or other financial institutions, wherever located and for whatever purpose.

   This is basic information and a necessary starting point for purposes of establishing the net worth and financial state of affairs of defendant, including identification of income-generating assets.

2 Federal and state personal income tax returns with supporting schedules as well as respective Revenue Agent Reports (RARs), notice of assessment, and any correspondence to and from the respective income tax authorities. [Some practitioners also request a Form 4506 to request a copy of a tax return from the Internal Revenue Service or a Form 4506-T to request an account transcript from the Internal Revenue Service. *Ed.*]

   The information contained in these documents is relevant for identifying income by source, the assets generating such income, and the disposal of capital assets during the period under review. The tax notices of assessment would contain the tax authorities' revisions, if any, to defendant's reported income, based on information that they might possess. Correspondence with the tax authorities may contain detailed explanations by them and/or by defendant relating to income items and/or the legitimacy of certain deductions, in arriving at the income reported on his tax returns.

3. Listing, including copies of purchase invoices and insurance coverage, of works of art, antiques, paintings, and coin, stamp and wine collections owned by defendant, wherever situated.

   Assists in establishing the net worth of defendant. Insurance coverage generally provides an indication of the replacement value of the assets.

4. Listing, including copies of purchase invoices and insurance coverage, of jewelry owned.

   Assists in establishing the net worth of defendant. Insurance coverage generally provides an indication of the replacement value of the jewelry.

5. Statement indicating defendant's ownership and/or interest in any life-insurance policies, indicating the names of insurance companies, face

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values of policies, the type of insurance and the cash surrender value of each of the policies, names(s) of beneficiary (ies), and whether such policies are owned by the defendant personally or by a closely held company in which defendant has an equity ownership interest.

This information is relevant for purposes of establishing the net worth of defendant and may provide an indication of his own views of his net worth in that the policy (ies) may have been purchased to provide liquidity for succession planning purposes and/or fund the post-mortem acquisition from his estate of his private-company shares.

6. (a) Canceled checks and bank statements of all personal checking, savings, and other bank accounts, located throughout the world, for the three years immediately preceding the valuation date.

These items would assist in establishing defendant's sources of income receipts; living expenses; allocation of his funds; his lifestyle; possible existence of non-arm's length payees; and unrecorded investments and other assets acquired by him.

(b) List of all bank accounts closed or transferred within the past three years.

There may have been cash transactions that occurred in bank accounts that are now closed. These transactions would be relevant for determining defendant's real income.

(c) List of all safety deposit boxes in defendant's name (and in the name(s) of nominee(s) or alter egos, if applicable), including location of each box over which defendant has signing authority, wherever situated throughout the world, along with schedule of visits during the three years immediately preceding the valuation date and list of all persons having access to these boxes during the said period.

These details may be relevant to establishing the location of defendant's assets and may provide information as to when safety deposit box contents may have been added or removed, possibly indicating unrecorded cash transactions during the relevant period as well as additional information regarding defendant's net worth.

7. Details of all sums paid or credited to or received by defendant by any third persons, companies, firms or corporations either as salaries, bonuses, fees, dividends, profit-share redemptions and/or sale of shares, reimbursement of loans, advances, liquidation or sale of assets, payment and/or reimbursement of expenses (expense accounts), expense allowances, car allowances, golf club, yacht club, social club, and other club dues and expenses, entertainment, sporting events (including season tickets), and other emoluments or forms of payment or remuneration received or enjoyed by defendant, directly, indirectly or in any manner whatsoever, including that received constructively.

This information may be relevant for obtaining a complete perspective of all cash in-flows and out-flows of defendant during the relevant period for purposes of determining his real income, sources of receipts, disposals of assets, and possible identification of the existence of other assets.

8. List of all personal credit cards held in defendant's name, or that/those of his nominee(s) with respective account numbers, as well as monthly statements of his credit cards for the 24-month period ended on the valuation date.

This information may be relevant in determining defendant's level of living expenses, lifestyle, standard of living, identification of payees, etc.

9. Schedule of all payments made on defendant's behalf and/or for his benefit by any of his companies with respect to his use of credit cards or charge cards such as (but not limited to) American Express, MasterCard, Visa, retail stores, restaurants, or any other credit cards, including copies of all credit card statements.

This information may be relevant for purposes of determining defendant's real income. It will assist in the analysis of the nature and amount of expenses paid by the companies on his behalf, thereby forming part of his real income (whether directly, indirectly, or constructively received or enjoyed) as well as for determining the value of the companies for purposes of establishing defendant's net worth. In addition, expenses paid by any of the companies on defendant's behalf, or expenses claimed by such business that are not effectively connected therewith (untaxed benefits in his hands), should be adjusted on the payor company's books income for valuation purposes, thereby increasing the company's valuation and, hence, value of defendant's ownership interest therein.

10. Schedule of all out-of-town travel (business and pleasure) (outside a radius of 300 miles from office/home) during the immediately preceding 36 months, including:

    (a) Purpose of visit
    (b) Place(s) visited
    (c) Duration of stay
    (d) Copies of invoices for hotel and other accommodation
    (e) Copies of airline tickets (or e-mail itinerary)
    (f) Person(s) by whom defendant was accompanied
    (g) Approximate cost per trip
    (h) Names and addresses of travel agents used to book defendant's travel
    (i) Copies of all airline frequent-flyer statements and other air-miles program statements

This information may assist in analyzing expense items such as travel, promotion, etc., paid by the business which may, in fact, be of a personal, non-operational nature and which may have to be adjusted on the books of the business(es) in determining the value thereof for purposes of establishing defendant's net worth. Moreover, this information is relevant for establishing, more accurately, the real income of defendant.

11. Copies of all pages of defendant's passport(s) and, if the passport(s) had recently been renewed, copy of immediately preceding passport(s).

This information may assist in measuring more accurately the indicated real income of defendant by providing details (e.g., destinations and length of visits) of his personal travel charged to the business but enjoyed by him as a personal benefit. To the extent there is indication of frequent visits to tax-haven jurisdictions where assets may be held, it might be a sign that further inquiry is necessary.

12. Copies of all applications submitted by defendant to any third-party or financial institution that were accompanied by his personal balance sheet.

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Applications for credit are significant documents, providing defendant's own representations and assessments of his income and net worth.

13. Financial statements (audited, if available) of all business and investment entities in which defendant has a direct or indirect interest, including (but not limited to) partnerships, joint ventures, and other co-ownerships.

    Financial statements contain basic financial information and are typically a necessary starting point for purposes of valuing business interests and relate to establishing defendant's net worth. As defendant is a shareholder (or partner, as the case may be), it is necessary to value the shares or partnership interest of each entity on an *en bloc* basis in order to value defendant's equity interests therein.

14. Federal and state income tax returns and schedules of the companies, along with respective RARs and notices of assessment, if any.

    Revenue Agents Reports and notices of assessment may contain the taxation authorities' revisions to the companies' respective declared incomes based on information the taxation authorities might possess. The schedules appended to the income tax returns might contain other information relevant from a valuation standpoint, such as tax cost bases, tax credits, loss carryforward balances and the identification of related parties, etc. The information contained therein may impact the value of the companies and, as the defendant derives his income mainly from these closely held entities, such information will also assist in measuring his income-earning capacity for alimentary and child support purposes.

15. Access to minute books of the companies, including articles of incorporation, amendments, by-laws as well as minutes and resolutions of shareholders and directors during the relevant period.

    This information is relevant for ascertaining the rights, privileges, restrictions, obligations, and other attributes of the companies' shares, as contained in the articles of incorporation, by-laws, minutes and resolutions, and the existence of contracts and shareholders' agreements. These factors, in turn, may have a direct and material impact on the value of the shares held by defendant, to the extent that these documents may refer to shareholder agreements, dividend rights, profit-sharing and bonus arrangements, management fees, and other potential income distributions.

16. Copies of (or access to) auditors' or accountants' year-end work papers, including journal entries, in respect of each of the companies for the relevant fiscal years.

    ***T*his information is relevant, as a review of these auditors' or accountants' work papers may provide information with respect to adjustments that may be necessary for valuation and income-measurement purposes.**

17. Copies of all shareholders' agreements, including buy-sell covenants, to which either defendant or his nominee was party, as well as copies of agreements that were previously in effect.

    Shareholders' agreements may include buy-sell provisions that contain a formula or other mechanism to acquire or sell shares of the companies, as well as references to price/value "formulas" and so forth, when there is a "triggering event." They can also include provisions restricting the transferability of shares, and provisions regarding payments and distributions of profits and gains.

18. Copies of all bank, mortgage loan, and government grant applications of the companies during the relevant period, including all documentation filed with the particular lending institution(s) for purposes thereof.

    Applications for financing are important documents and may provide defendant's or management's own assessment of income and value. [Many documents filed with lending institutions are filed under penalty of perjury. *Ed*]

19. Copies of all contracts and agreements to which the companies were party as of the valuation date.

    This information will facilitate the assessment of the nature and amount of any contractual benefits or obligations of the companies, as the case may be, for valuation purposes. Further information that might be provided by these contracts and agreements may include the length of time over which such benefits would be received or obligations would be payable. For purposes of the valuation, a materiality threshold could be applied, limiting the request to all contracts and agreements involving financial consideration in excess of $20,000.

20. Copy of insurance policy (or summary sheet) with respect to the companies' fixed assets (other than land) and inventory, including business interruption.

    This information may help corroborate the value of the companies' tangible assets as well as the companies' profitability and intangible value. The business interruption portion of the policy might indicate what the companies' management considers to be the level of profitability of the business (es). Profitability can directly impact corporate value, the ability of the companies to make corporate distributions of income by dividends or otherwise, and/or invest in capital projects.

21. Copies of municipal valuations for land and building.

    This information may help corroborate the values of the companies' tangible business assets, which in turn impacts the value of defendant's shares.

22. Copies of any appraisals of the companies' real estate commissioned within the two years immediately preceding the valuation date.

    This information may help corroborate the values of the companies' real properties, which in turn impacts the value of defendant's shares.

23. Copies of any arm's length offers received during the immediately preceding three years for the companies' assets and/or issued shares.

    This information may help corroborate the indicated value of the companies and/or their assets, as arm's length, open-market transactional market data may provide a good indication of price/value.

24. Details of any non-arm's length, or related party, transactions of the companies during the three fiscal years immediately preceding the valuation date.

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Such details may be relevant in determining defendant's real income through the determination of personal (or other non-business) amounts and to assess the level and quality of earnings[2] generated by each of the companies. Moreover, given the closely held, family run nature of the companies, any non-arm's length or related-party transactions involving consideration not at market values or market prices, or non-operational in nature, may distort the income-generating capacity and, hence, the value of the companies' business(es). The defendant's principal sources of income and business equity value are derived from the companies.[3]

25. Copies of all contracts and sub-contracts with respect to any and all repairs, renovations, and improvements made at any of defendant's residence(s) or with respect to any real estate which defendant owns or has an interest in, and names and addresses of architects, engineers, designers, roofers, electrical and plumbing contractors, and gardeners who rendered services at any time during the three years immediately preceding the valuation date.

    This information may be relevant as it will provide information as to the amount of expenditures, which may have been charged to, and paid by, the companies, but which were for the personal benefit of defendant. There is also the possibility that certain of these contractors/suppliers may have been paid partly or totally in cash. It may impact both the value of defendant's shares and his real income by helping to trace the sources of cash used to make the payment.

26. List of securities owned directly or indirectly by defendant in public companies and private corporations wherever located throughout the world; investments and other beneficial interests in entities in tax havens such as Bermuda, the Bahamas, Liechtenstein, Luxembourg, Switzerland, Cayman Islands, Turks and Caicos, Cook Islands, or elsewhere; stock rights and warrants, bonds, debentures, guaranteed investment certificates, term deposits, bankers acceptances, treasury bills and bonds, interests in limited partnerships, interests in commercial partnerships, undivided co-ownership and joint tenancy interests in real estate, interests in joint ventures, pension plans, retirement savings plans, employee profit sharing plans, put options, call options, tax shelters, and any other investments or business ownership interests of any nature, held directly, indirectly, or in any manner whatsoever, located anywhere in the world.

    May help establish the net worth of defendant in that it would disclose his direct, indirect, and/or beneficial interests in similar investment vehicles and other assets.

The following suggested requests are case specific and the reason/explanation needs to be developed by the expert based upon the specific needs of the case.

- Schedule of loans, accounts, and claims receivable as of the valuation date, along with related details and agreements.
- Details of any patents, patterns, designs, trademarks, trade names, traded secrets, copyrights and any other intellectual property owned and/or licensed by defendant.
- Real Estate Inquiries
    (a) Schedule of all real estate and interests therein (including, without restriction, undivided co-ownership interests) owned by defendant, directly, indirectly, or in any manner whatsoever, wherever located throughout the world.
    (b) Copies of any real-estate agent agreements, listings, and/or advertisements to purchase or sell real estate on behalf of defendant or on behalf of any group of co-owners or joint venturers of which defendant is a member within the immediately preceding 24 months.
    (c) Copies of municipal tax assessments for the said real estate.
    (d) Copies of all appraisals commissioned within the immediately preceding 24 months in respect of any real property owned directly, indirectly, or affiliated with defendant.
    (e) Insurance coverage on said real estate as of the valuation date.
    (f) Copies of any arm's length offers received within the immediately preceding 24 months in respect of defendant's real estate holdings.
- Details of any contingent assets and liabilities of defendant, including litigious claims by or against him, and the respective status of each (other than with respect to the subject matrimonial proceedings).
- Names and addresses of any persons to whom defendant has given power of attorney (whether general or specific) within the immediately preceding five years.
    (a) Copies of relevant documents applicable to above
- Schedule of all vehicles owned or leased by, or for the personal use of, defendant and his family, including (but not limited to) automobiles, boats, planes, snowmobiles, sea-doos, jet skis, etc.
- List of horses owned and barns used to stable said horses as well as insurance policies, if applicable.
- Agreements regarding any trusts established by defendant.

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Richard served as president of The Canadian Institute of Chartered Business Valuators, international governor of the ASA, and is chair of ASA's Business Valuation Standards Subcommittee. He has been valuation advisor to the Canadian Department of Justice and Canada Revenue Agency. He has given expert evidence in more than 200 cases in the U.S. and Canada and has been appointed by courts and arbitration panels as their business valuation expert in major valuation cases.

He is active with NACVA and CTI and is a member of its Executive Advisory Board and is its liaison with the Litigation Forensics Board. In 2013, Richard was honored by NACVA as a recipient of the 2012 Instructor of Exceptional Distinction Award for Excellence.

2 Quality of earnings is the amount of earnings attributable to higher sales or lower costs rather than artificial profits created by accounting anomalies such as inflation of inventory.

3 This sentence would be used if true and deleted if not true.

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from asserting its rights against the building, the debtor formulated its plan of reorganization.[2] In formulating its plan of reorganization, the debtor had three possible ways to deal with LNV. The debtor could: (1) retain the building and make payments on LNV's $13.5 million secured claim with LNV's lien remaining on the building until its secured claim was paid in full; (2) sell the building free and clear of LNV's mortgage (but LNV would have the opportunity to credit bid the entire amount of its $38.3 million claim at that sale); or (3) provide LNV the "indubitable equivalent" of its collateral—the building. The debtor chose the third option and attempted to provide LNV with the "indubitable equivalent" of its collateral—$38 million worth of Treasury bonds. That strategy was not successful because both the Bankruptcy Court and United States Court of Appeals for the Seventh Circuit determined that 30-year Treasury bonds were not the "indubitable equivalent" of LNV's collateral. The strategy was not successful, at least in part, because LNV made a decision to treat its claim as fully secured. Pursuant to the Bankruptcy Code, LNV had the option to treat its claim as fully secured even though the value of the building was less than the amount outstanding under the mortgage.[3]

Discussion

The debtor's attempt to provide LNV with the "indubitable equivalent" of its claim was unsuccessful. In the first instance, the Bankruptcy Court rejected the theory that Treasury bonds were the "indubitable equivalent" of the building and modified the automatic stay and dismissed the bankruptcy case. The Bankruptcy Court determined that a creditor that makes a section 1111(b) election can never receive anything other than its collateral as the "indubitable equivalent" of its collateral. The matter was heard on direct appeal to the United States Court of Appeals for the Seventh Circuit[4], which affirmed the Bankruptcy Court after extensive discussion about "indubitable equivalent." Although it affirmed the Bankruptcy Court's decision, the Seventh Circuit did not agree completely with the Bankruptcy Court.

The Seventh Circuit explained in detail why the Treasury bonds that the debtor proposed to provide to LNV were not the "indubitable equivalent" to the building and the mortgage. As stated, LNV determined that its claim should be treated as a $38.3 million secured claim rather than having a secured claim and an unsecured claim. This, the Seventh Circuit explained, is attractive to a mortgagee that believes that the property securing the mortgage is undervalued and that the reorganizing debtor will default again. It is attractive because it allows the mortgagee to recognize any appreciation in the value of its collateral either by (1) credit bidding for its collateral and owning the collateral at its appreciated value or, (2) by accepting an increased cash bid from a third party buyer at the foreclosure sale.[5]

In an effort to approximate LNV's $38.3 million claim, the debtor proposed to purchase $13.5 million in Treasury bonds that would have a value, after payment of interest and the passage of 30 years, of $38.3 million. That, reasoned the Debtor, is the "indubitable equivalent" of the lien on the building.

In discussing "indubitable equivalent," the Seventh Circuit explained that it might be proper for an oversecured creditor to receive substitute collateral so long as the substitute collateral does not increase the creditors' risk of becoming undersecured in the future. This, the Seventh Circuit reasoned, does not allow an oversecured creditor to hold the reorganization process hostage. The question that the Seventh Circuit did not answer is: "What type of substitute collateral would be the 'indubitable equivalent' and not raise the secured creditor's risk of becoming undersecured?" It did give us a hint though. It stated that "substituted collateral that is more valuable and no more volatile than a creditor's current collateral would be the indubitable equivalent of that current collateral even in the case of an undersecured creditor. But no rational debtor would propose such a substitution, because it would be making a gift to the secured creditor." So, it seems that an "indubitable equivalent" of a creditor's lien may exist, but no debtor would ever provide it to the secured creditor.

After stating that there are few circumstances when a debtor would be willing to provide a secured creditor with the "indubitable equivalent," the Seventh Circuit explained why the Treasury bonds were not the "indubitable equivalent" of the lien and the building. It is here that the value in the opinion comes to light for financial litigation consultants and/or those in the valuation industry. The Seventh Circuit's first example dealt with appreciation of the building. The Seventh Circuit assumed that the debtor improving the building, coupled with the passage of time, caused the building to appreciate to $40 million in five years. If the debtor then defaulted, LNV would be able to foreclose and given the increased value of the building, likely would be paid in full. However, if its lien were transferred to the Treasury bonds, it would still have to wait 25 years to be paid in full. And, over that time, inflation would depress the value of the Treasury bonds. The depressed value resulting from inflation, the Seventh Circuit opined, is not the "indubitable equivalent" to the building.

Moreover, to the extent that interest rates rose during that 30-year period, the Treasury bonds would be worth less. The Seventh Circuit's example involved comparing the three percent interest rates on the Treasury bonds when the debtor proposed its plan to an increase in interest rates to six percent. In absolute terms, if the interest rate on Treasury bonds doubles, the value of the original bonds would be cut in half. Additionally, there are other sources of risk associated with Treasury bonds (or other substitute collateral). Accordingly, logic goes, Treasury bonds are not the "indubitable equivalent" of the building and the lien.

Indeed, the Seventh Circuit took a very restrictive view of "indubitable equivalent" and stated that although substitute collateral might turn out to be worth more than the original collateral, it still would not be the "indubitable equivalent" of its original collateral.

How River East Affects Financial Litigation Consultants and/or Valuation Professionals

River East teaches financial litigation consultants and valuation professionals important lessons regarding the evaluation of "indubitable equivalent." Specifically, the professional should be prepared to testify as to why the proposed substituted collateral

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2 The debtor had proposed a first plan of reorganization that was not confirmed for reasons not relevant to this discussion.

3 This is referred to as making a section 1111(b) election. The mechanics are not relevant to this article other than to understand that a secured creditor gives up its unsecured deficiency claim to be treated as fully secured.

4 28 U.S.C. §158(d) provides a mechanism for appeals to bypass the District Court (or Bankruptcy Appellate Panel in select other judicial circuits) and be heard immediately by the appropriate circuit court of appeals.

5 This issue is complicated, but put simply, if a debtor defaults on its obligations post-confirmation, the lender would have a $38.3 million claim (less any payments made) to credit bid at a sale of the collateral. The secured creditor would then be able to sell the property for whatever the market value might be, but likely in excess of $13.5 million and would be able to benefit from the increase in value. If the mortgagee chose not to treat its claim as fully secured, it would have only a $13.5 million claim (less any payments made) to credit bid at the subsequent sale. If the property had appreciated, the market value would be such that a third party would purchase the property and the lender's claim would be capped at $13.5 million.

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is or is not the "indubitable equivalent" of the secured creditor's collateral. This includes valuation issues—the indubitable equivalent must be of equal or greater value than the current collateral. This analysis would include the financial professional valuing assets under generally accepted asset valuation models to assist the court in determining whether the new collateral is or is not the indubitable equivalent of the collateral being replaced.

Additionally, the professional must be able to analyze and discuss the risks associated with the proposed "indubitable equivalent" compared to the original collateral. Lastly, and perhaps most difficult, the professional should be able to show that the risk and valuation profile of the "indubitable equivalent" approximates the risk and valuation of the original collateral at any point in time. In undertaking their analysis, a financial litigation consultant or valuation professional should be prepared with multiple "what if" scenarios to show that the proposed "indubitable equivalent" either is, or is not, just that.

While the Seventh Circuit has suggested that the "indubitable equivalent" standard is difficult to meet, it has also given valuation professionals hints on how to best prepare to assist with litigating that issue in the future. During the consulting phase of work, financial litigation professionals should be prepared to analyze the *In re River East* issues with retaining counsel. If also testifying as an expert, the financial litigation consultant and valuation professional should be prepared to have solid foundations for their expert opinion and be prepared to articulate those foundations to the court.

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Tousa, Inc.—A Lesson in Expert Testimony Strategy

By Jonathan T. Brand, JD

In May 2012, the United States Court of Appeals for the Eleventh Circuit entered a significant ruling, which caused waves in the credit, financing, and distressed investment industries—waves that still impact financing distressed businesses. The Circuit Court, in *Senior Transeastern Lenders v. Official Committee of Unsecured Creditors (In re TOUSA, Inc.)*, 2012 WL 1673910 (11th Cir. 2012), made two significant findings.

First, in upholding the Bankruptcy Court, the Circuit Court determined that the lenders received a fraudulent conveyance by financing the payment to certain lenders known as the "Transeastern Lenders." Second, the Transeastern Lenders were repaid by the proceeds of the fraudulent conveyance and, accordingly, were subject to potential 'claw back' litigation as the initial transferees. The Circuit Court's holding was ground breaking, and much has been written concerning the impact of TOUSA in financing distressed opportunities. This article provides an overview of TOUSA's case and examines the parties' strategy and use of experts in regards to solvency.

Background

TOUSA, Inc. (TOUSA) was a Florida-based homebuilder focused on constructing residential homes, townhomes, and condominiums. TOUSA and a subsidiary, TOUSA Homes, LP, (Homes LP) entered into a joint venture with Falcone/Ritchie, LLC, (Transeastern) that was funded by the Transeastern Lenders. TOUSA provided the Transeastern Lenders an unsecured guarantee of the obligations under the Transeastern loan. At the end of 2006, the joint venture failed and the Transeastern Lenders sued the joint venture and TOUSA for defaulting under the terms of the loan.

In June 2007, TOUSA agreed to settle the litigation with the Transeastern Lenders. To settle the litigation, TOUSA borrowed funds through a secured loan from a group of new lenders (new lenders).

The loan was secured by essentially all of TOUSA's unencumbered assets, including having its subsidiaries (the conveying subsidiaries) serve as guarantors to the new lenders' loan. The conveying subsidiaries owned most of the enterprise's assets and accounted for the vast majority of its revenues.

TOUSA used the proceeds of the loans to settle the pending litigation with the Transeastern Lenders. As a result of the transaction with the new lenders, the unencumbered assets of the conveying sub-

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sidiaries were suddenly subject to a lien, and the unsecured obligation owed to the Transeastern Lenders was converted into a secured obligation owed to the new lenders by the conveying subsidiaries. The conveying subsidiaries, in essence, collateralized their assets by giving 'upstream guarantees' to the new lenders in order to resolve their parent's obligation to the Transeastern Lenders.

TOUSA's Chapter 11 Filing and the Committee's Fraudulent Conveyance Suit

TOUSA and the conveying subsidiaries filed their Chapter 11 petitions approximately six months after the transaction closed and the Transeastern Lender litigation settled. In an adversary proceeding, the Official Committee of Unsecured Creditors of TOUSA, Inc. (the committee) sought to avoid the obligations and transfers of the conveying subsidiaries as a fraudulent transfer to the new lenders that should be recovered from the Transeastern Lenders.

Under the provisions of Section 548 of the Bankruptcy Code, the Bankruptcy Court can enter an order avoiding a transfer by the debtor within two years of the bankruptcy petition where the debtor transferred property for less than "reasonably equivalent value" and was either insolvent at the time of the transfer or became insolvent as a result. The Bankruptcy Court held an extensive 13-day trial hearing the testimony of nearly 20 witnesses, numerous expert witness deposition transcripts, and considering thousands of pages of exhibits.

In a 182-page opinion, the Bankruptcy Court determined that the transfers were fraudulent because the conveying subsidiaries failed to receive reasonable equivalent value for their collateral and were either insolvent at the time the transfer was made or became insolvent as a result of such transfer. Important to the court's ruling was its determination the 'upstream guarantees' provided by the conveying subsidiaries did not result in the conveying subsidiaries receiving any direct economic benefit.

In reaching this ruling, the Bankruptcy Court found that the conveying shareholders: (a) were insolvent before and after the July 2007 transaction with the new lenders; (b) had unreasonably small capital and were unable to pay their debts as they became due; and (c) did not receive "reasonably equivalent value" in exchange for the granting of the liens to the Transeastern Lenders. The Bankruptcy Court reasoned the conveying subsidiaries did not owe anything to the Transeastern Lenders and, therefore, received no equivalent value for the transfer of their secured guarantees to the new lenders.

In reaching this conclusion, the Bankruptcy Court analyzed the various elements necessary to prove whether a fraudulent conveyance occurred. The court relied on expert opinions and evidence from the public domain regarding the condition of the housing market, TOUSA's sagging stock price, and the public comments of TOUSA executives regarding a potential restructuring. Here, the Bankruptcy Court's analysis of the parties' competing expert testimony concerning solvency is telling.

Defendants' Strategy Regarding Solvency Opinions

Reviewing the Bankruptcy Court's ruling as a whole, the defendants consistently attempted to poke holes in the committee's expert evidence in an attempt to prevent the committee from proving the elements of a fraudulent conveyance while contemporaneously arguing that the conveying subsidiaries were solvent and received reasonable equivalent value from the upstream guarantees. The Bankruptcy Court saw through the defendants' strategy and refused to look past the anecdotal evidence that the housing market had crashed, TOUSA was struggling as an enterprise prior to the July 2007 transaction, could not maintain basic requirements of the loan after the July 2007 transaction, and filed Chapter 11 approximately six months after the transaction.

Credibility

Based on its experts' analysis, the committee demonstrated that the conveying subsidiaries were insolvent before and after the transaction. The court found the committee's experts' analysis and conclusions appeared to be rational, reasonable, and methodologically sound. The defendants, while criticizing the committee's experts, did little to undermine the methodology used or conclusions reached by the committee's solvency experts. In reaching its ruling, the Bankruptcy Court questioned the credibility of the defendants' evidence. The court questioned the credibility of one of the defendants' solvency witnesses, finding that the witness had misrepresented the results of his expert testimony in other matters. The court then stated that it believed the expert, "for the right price…would opine as desired on anything." This undoubtedly did not help the defendants' case.

Solvency Opinion Rejected

Next, the Bankruptcy Court found a solvency opinion on TOUSA issued in Spring 2007 unpersuasive. Here, the defendants attempted to rely on such opinion to destroy the committee's argument that TOUSA was insolvent prior to and after the July 2007 transaction. TOUSA, as a condition to receiving a commitment letter for the loan from the new lenders, was required to secure a solvency opinion from a 'nationally recognized, independent financial advisory firm that has substantial experience in providing solvency opinions in connection with transactions similar to the [anticipated July 2007 transaction].' TOUSA identified a nationally recognized company that had not issued a solvency opinion for a home developer since 2005. Based on this fact, the court determined that the company had an "apparent lack of experience" in issuing such opinions for home developers.

TOUSA hired such company on a contingency fee arrangement which, arguably, weighed in favor of finding TOUSA solvent at all costs. TOUSA agreed to pay the valuation company $2 million if it determined TOUSA was solvent immediately after the July 2007 transaction. If the valuation company determined TOUSA was not solvent, such company would only pay for the company's time charges and expenses. The face of the terms of the expert's fee arrangement raised questions of whether the valuation company would be able to separate its obligation to help the trier of fact to determine a fact in issue from its own self-interest. By comparison, the new lenders had identified a company which could provide a solvency opinion with no contingency for a quarter of the fee. The principal of TOUSA's valuation company described the $2 million as a 'premium' based on the riskiness of the assignment.

As if this was not enough to weigh against accepting the expert's solvency opinion, the court noted the speed by which the valuation company had reached its conclusion. The valuation company was retained on June 15, 2007. TOUSA held a board meeting five days later and the valuation company noted at that meeting that it expected to deliver a favorable opinion. A draft solvency opinion was then issued on June 27, 2007. Given the complexity of TOUSA's business, the issues in the market-place, the speed by which the valuation company issued its initial draft was remarkable. So remarkable, the court refused to find it persuasive.

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Conclusion

A case can be won or lost in the preparation stages—and can be won or lost by the manner in which financial expert witnesses are used at trial. Here, the defendants had a tough uphill climb with the solvency opinion. However, a more thorough screening of their expert—and a fee arrangement that raised fewer eyebrows—may have resulted in the defendants presenting an expert that the Bankruptcy Court would find more credible. Arguably, this may have assisted the defendants in presenting a more vigorous defense of the committee's allegations.

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The Uncertain Nature of Contract Damages in Pennsylvania Legal Malpractice Cases

By: Patrick K. Gibson, Esq.; and Paul Fellman, Esq.

On July 17, 2012, the Superior Court of Pennsylvania held in *Coleman v. Duane Morris, LLP,* that a plaintiff's damages for a legal malpractice claim, based upon breach of contract, *are not necessarily* limited to the attorneys' fees paid to the defendant during the underlying representation. In doing so, the court held that the attorneys' fees limitation previously announced by the Supreme Court of Pennsylvania in *Bailey v. Tucker,* 621 A.2d 108, 115 (Pa. 1993) is inapplicable when the underlying case is a civil action. Accordingly, plaintiffs' attorneys and aggrieved clients should proceed with caution, as the state of the law with respect to this issue remains unsettled.

The Legal Landscape

In Pennsylvania, the statute of limitations for legal malpractice stemming from negligence is a relatively short two years, pursuant to 42 Pa.C.S. §5524. On the other hand, a litigant has four years, pursuant to 42 Pa.C.S. §5525, to commence a malpractice action based on a breach of contract. The distinction is important because in Pennsylvania "when an attorney enters into a contract to provide legal services, there automatically arises a contractual duty on the part of the attorney to render those legal services in a manner that comports with the profession at large." *Gorski v. Smith*, 812 A.2d 683, 694 (Pa. Super. Ct. 2002). Accordingly, a plaintiff can *always* pursue their case under a contract theory and enjoy the longer four year statute of limitations, at first glance effectively rendering the two year negligence statute obsolete.

However, in *Bailey,* the Supreme Court ruled that a legal malpractice plaintiff suing under a contract theory can only recover the amount of legal fees, actually paid, in the underlying matter. Until *Bailey*, a legal malpractice plaintiff could be made "whole" only by succeeding on a claim sounding in[1] negligence—thus negating the benefit of the longer contractual period of limitations. *Coleman*, however, adds important qualifications to *Bailey*.

1 Sounds in adj. referring to the underlying legal basis for a lawsuit or one of several causes of action in a suit, such as contract or tort (civil wrong). The phraseology might be: "Plaintiff's first cause of action against Defendant sounds in tort, and his second cause of action sounds in contract."

The Facts

The plaintiffs in *Coleman* were the owners of BCA Management, Inc., and BCA Professional Services, Inc. (together BCA). The plaintiffs decided to sell BCA after it was determined that the companies owed approximately $2.16 million in unpaid taxes, for which the plaintiffs were personally liable. The plaintiffs engaged the services of Duane Morris, LLP (defendants), via oral agreement, to assist in the sale to purchaser Mirabilis Ventures, Inc. (Mirabilis). Pursuant to BCA's agreement with Mirabilis, Duane Morris would bill BCA for their services, but Mirabilis would ultimately pay the fees after the sale was completed. Despite the plaintiffs' expressed expectation that the sale would eliminate their liability for the back-taxes, an alleged error on the part of a Duane Morris attorney left them personally liable.

Subsequently, the plaintiffs brought an action against the defendants for legal malpractice based upon breach of contract, as they were outside the two-year window for a negligence claim. The defendants filed a new matter asserting, *inter alia*, that their invoices for legal services remained unpaid. Thereafter, the defendants moved for judgment on the pleadings[2] arguing that because the plaintiffs had not in fact paid their legal fees, they had incurred no recoverable damages. Based upon the holding of *Bailey*, the trial court agreed with the defendants and dismissed the suit. The plaintiffs filed a timely appealed the dismissal to the Superior Court.

The Decision

The Superior Court found the Supreme Court's reasoning in *Bailey* unpersuasive when applied to the facts of *Coleman* and reversed and remanded the trial court's dismissal of the case. The Superior Court reviewed the *Bailey* decision and noted that the Supreme Court had specifically addressed the issues within the context of policy con-

2 Motion for judgment on the pleadings is a party's request to the court to rule in his or her favor based on the pleadings on file, without accepting evidence, as when the outcome of the case rests on the court's interpretation of the law. A function of a motion for judgment on the pleadings is to dispose of baseless claims or defenses when the formal pleadings reveal their lack of merit. A motion for judgment on the pleadings is the proper procedure when all of the material allegations of fact are admitted in the pleadings and only questions of law remain. When the pleadings do not resolve all factual issues, judgment on the pleadings is generally inappropriate.

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siderations unique to cases where the underlying subject matter is criminal. The Superior Court concluded that the Supreme Court intended its holding in *Bailey*, regarding recoverable damages in a legal malpractice contract claim, to be limited to cases where the underlying action was criminal. The Superior Court in *Coleman* stated:

> [W]e conclude that limitation on damages imposed by the *Bailey* Court applies to an action in assumpsit[3] based on a claim of attorney malpractice in a criminal case, *but that limitation does not extend to an action for legal malpractice in assumpsit where the underlying action was, as here, a civil action*.
>
> *Coleman v. Duane Morris, LLP*, 58 A.3d 833, 838 (Pa. Super. Ct. 2012). (Emphasis added)

Practical Application

The decision in *Coleman* certainly appears to have positive implications for aggrieved clients and their counsel. After all, the law in the commonwealth at the moment indicates that a plaintiff can recover more than attorneys' fees in a legal malpractice action based on breach of contract, provided, of course, the underlying matter was a civil action. However, there is reason for pause.

The *Coleman* defendants appealed the Superior Court's decision to the Supreme Court of Pennsylvania. On June 13, 2013 the Supreme Court certified the following question for appeal:

> Does the limitation on damages in a legal malpractice action sounding only in contract set forth in *Bailey v. Tucker,* 533 Pa. 237, 252, 621 A.2d 108, 115 (1993)—which limited such damages to "the amount actually paid for the services plus statutory interest" in a case involving an underlying criminal representation—apply where the underlying representation is a civil one?
>
> *Coleman v. Duane Morris, LLP*, 68 A.3d 328 (Pa. 2013).

Clearly, the highest court in the commonwealth was intent on settling this question. However, the Supreme Court did not get the chance to do so, as the parties in *Coleman* settled before court could render its decision and the appeal was withdrawn on September 17, 2013.

Following *Coleman*, a plaintiff can file a legal malpractice action based on breach of contract and claim damages in excess of their underlying attorneys' fees. The Superior Court will likely uphold the trial court's award of consequential damages based on *Coleman*. However, that hypothetical decision may be appealed to the Supreme Court, which appears poised to decide the question. Until such time as the Supreme Court conclusively determines this issue, attorneys should counsel potential plaintiffs that if they wish to pursue a legal malpractice claim based upon breach of contract, they should be prepared to prosecute the case through multiple levels of appeal. Moreover, the risk remains that the Supreme Court could overturn the *Coleman* decision and reestablish the preeminence of *Bailey*.

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3 action of assumpsit, is a form of action at common law for the recovery of damages caused by the breach or non-performance of a simple contract (formerly known as an "assumpsit"), either express or implied, whether made orally or in writing not as a deed (i.e., not under seal or in presence of attesting witnesses).

Business Valuation for the Litigation Practitioner

Hypothetical Transaction? But She's Not Selling!

By Dan Branch, ASA; and John A. Sugg, Esq.

In divorce, participants (including attorneys) frequently confuse the actual subjective intent of the parties with the hypothetical characteristics of the standard of value being applied. This article attempts to highlight some of the key issues regarding actual subjective intent and the fair market value standard of value and what the courts have said or are continuing to develop on these matters.

What is This "Value" Thing?

Your client is getting divorced, and she owns an interest in a private business. The business may be part of the marital assets. You are sitting across from your client, and she asks, "Well, what is the value of my business?" Though clients typically think of "value" as something concrete, as a business valuator can tell you, "value" has different meanings in different contexts. Therefore, it is important to determine the context that applies in each case. In business valuation, the context to apply is the standard of value. Determining the appropriate standard of value to apply in divorce can be a challenging task for the attorney and valuation specialist involved, especially in states lacking clear case law on the question of standard of value. Typically, states express a desire to ascertain the "value" of the assets to be considered in the divorce.

But, does this "value" mean fair value? Or fair market value? Or intrinsic value? Or value to the holder? Or does it mean something else? And though attorneys and valuation specialists may finally decide the standard of value to apply in the case, will their clients understand it, let alone support it during depositions or cross examination? For our discussion, we'll focus on the fair market value standard of value.

Fair market value, as defined by the Business Valuation Standards (BVS) of the American Society of Appraisers (ASA), is "the 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."[1]

1 It may be helpful to note that the definition of fair market value is similar in the Statement on Standards for Valuation Services No. 1 (SSVS) promulgated by the American Institute of Certified Public Accountants (AICPA).

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Who Are These "Hypothetical" People?

Immediately, some conceptual limitations are brought into play. "Willing" buyer and "willing" seller may not necessarily reflect the actual willingness of the parties in a divorce. "Hypothetical" buyers or sellers are not involved in a divorce. In fact, the parties have typically lived with each other for years—they are not hypothetical at all. And the idea that the hypothetical seller is not "under compulsion" seems absurd to the litigants when the divorce is essentially compelling them to act. And certainly in some divorces, neither side may feel particularly "able" to sell.

To make matters more confusing, under the fair market value standard of value, control and/or marketability discounts may be applicable due to the size of the interest valued (i.e., control) or restrictions on transfers of ownership or accreditation requirements (i.e., marketability).

For example, in a recent valuation of a medical practice owned jointly by the physician spouse (wife) and non-physician spouse[2] (husband), a discount for lack of marketability was applied. This discount reflected an expectation that, in the hypothetical transaction, the buyer of an interest in the practice would likely be an accredited physician and, as such, the potential pool of hypothetical buyers was limited. However, the non-physician owner of the medical practice felt that such a discount was ridiculous because the physician owner would be the *actual* purchaser of his interest. Specifically, the non-physician owner felt that the "pool" should not be limited as the physician owner was going to purchase his interest, not a *hypothetical* physician; in that case, why discount it? On the flip side, the physician owner was happy to learn of the discount, and was adamant that the likely discount would be even higher given her perceived complexities of the practice and region, expected increased competition, etc.

It is not surprising that clients (or sometimes even judges) want to consider elements beyond the framework of the standard of value—the parties involved are sitting across the proverbial table; they are not *hypothetical*, but *flesh*. That is, they want to consider the facts and circumstances relevant to the parties involved, or the parties' *actual subjective intent,* and not what could happen in some hypothetical transaction. But should they?

The Courts Have It Figured Out, Right?

In both divorce and non-divorce cases, courts have recognized that substituting the actual subjective intent of the owner of a business interest for the "hypothetical willing and able seller" violates the requirements of the Fair Market Value standard of value.

In *Rattee v. Rattee*[3], the New Hampshire Supreme Court applied the fair market value standard of value in a divorce case and rejected the wife's argument that a lack of control discount on her husband's interests in a family company was inappropriate. The wife claimed that no discounts should be applied because her husband actually controlled the company, and neither he nor his mother intended to sell the business. The husband owned a 49.6 percent interest in the company, and his mother owned the controlling 50.4 percent interest. The New Hampshire Supreme Court affirmed a 28.5 percent lack of control discount on the husband's interest and held, "[t]he fact that an actual sale of the [husband's] interest in the company was not contemplated at the time of the final hearing is irrelevant to the concept of fair market value."[4]

Similarly, in *Ferguson v. Ferguson*[5], a Connecticut trial court applied a 15 percent lack of marketability discount to a husband's 100 percent interest in a company. The trial court rejected the wife's expert's refusal to apply a lack of marketability discount because the husband had articulated a strong position that he would not sell the business.

Federal courts have also refused to consider the actual subjective intent of the owner of the interest that is being valued using the fair

2 Whether or not a non-physician can own an interest in an incorporated medical practice is a matter of state statute.

3 146 N.H. 44, 767 A.2d 415 (2001).

4 *Id.* at 51, 420.

5 1998 WL 851426 (Conn. Super. Nov. 13, 1998).

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market value standard of value. In *Estate of Bright v. United States*[6], the United States Court of Appeals, Fifth Circuit, held that a control premium should not have been applied to a minority interest in a company held by a trust despite evidence that the trustee would have only sold that interest along with his personal minority interest in the company to form a majority interest block. The court held that such evidence was inadmissible "because it assumes an unwillingness to sell in direct contradiction to the established valuation formula which assumes a willing seller."[7] The court further found that such evidence "is logically inconsistent with the willing buyer-seller rule" and noted that the "willing seller is not the estate itself, but is a hypothetical seller."[8] The United States Court of Appeals, Eleventh Circuit, has also recognized that the actual subjective intent of the hypothetical buyer and seller is irrelevant to the determination of fair market value.[9]

Likewise, in *Propstra v. United States*[10], the United States Court of Appeals, Ninth Circuit, held that an estate was entitled to a 15 percent discount for lack of marketability to its one-half interest in some real estate that the decedent and his wife had held at the time of his death. The court rejected the government's claim that the estate must prove that the estate's interests would be sold separately from the wife's remaining interest. The court held, "we see good reason to consider the 'willing seller'…as a hypothetical seller rather than the estate or any of decedent's beneficiaries. Defining fair market value with reference to hypothetical willing-buyers and willing-sellers provides an objective standard by which to measure value."[11]

In the *Estate of Ford v. Commissioner*[12], an opinion affirmed by the United States Court of Appeals, Eighth Circuit, the United States Tax Court rejected an expert's refusal to apply a discount to a minority interest because the seller would only want to sell that minority interest as part of a portfolio with other assets. In doing so, the Tax Court reasoned that the highest possible price that a seller would sell his or her interest is not always the same price that a willing buyer would agree to pay for it.

Despite the foregoing, at least one court has considered a business owner's actual subjective intent in a divorce case while purporting to apply the fair market value standard of value. In *Bernier v. Bernier*[13], the Supreme Judicial Court of Massachusetts held that the trial court incorrectly applied a lack of marketability discount to the fair market value of a husband's interest in a company because the husband had testified that the company was not for sale. The court reasoned that a marketability discount was inappropriate because marketability is "the ability to convert the subject company to cash."[14] In reaching this decision, the Supreme Judicial Court of Massachusetts relied upon *Brown v. Brown*[15], an opinion by the Superior Court of New Jersey applying a different standard of value, the fair value standard of value, which does not recognize discounts absent extraordinary circumstances.

6 658 F.2d 999 (5th Cir. 1981).

7 *Id.* at 1002; id. n. 3.

8 *Id.* at 1005.

9 *Estate of Watts* v. C.I.S., 823 F.2d 483, 486 (11th Cir. 1987) (noting that "[i]t is well-settled that the willing buyer-willing seller test is an objective one").

10 680 F.2d 1248 (9th Cir. 1982).

11 *Id.* at 1251-52 (citations omitted).

12 66 T.C.M. (CCH) 1507 (U.S. Tax Court 1993), affirmed in 53 F.3d 924 (8th Cir. 1995).

13 449 Mass. 774, 873 N.E.2d 216 (2007).

14 *Id.* at 792, 232.

15 348 N.J. Super. 466, 792 A.2d 463 (2002).

So, What Now?

It is important for both the attorney and the business valuator to know which standard of value applies in the jurisdiction where a case is pending and whether that jurisdiction departs from the appropriate definition of that adopted standard of value. Otherwise, the business valuator's testimony could be excluded by a *Daubert* challenge or a motion *in limine*.

The expert's testimony could also be excluded under Federal Rule of Evidence 703 or its state counterpart, based upon a finding that the probative value is substantially outweighed by the danger of unfair prejudice, confusion, or misleading a jury. Alternatively, if a particular jurisdiction does consider the actual subjective intent of a business owner, attorneys should be careful to elicit factual evidence regarding the owner's intent because an expert's opinion that is predicated on the expert's subjective belief or unsupported speculation is still subject to a *Daubert* challenge.

Outside of court, parties may try to introduce actual subjective intent, especially in settlement discussions or negotiations, to bolster or defend their negotiating positions. Knowledge of the jurisdictional applicability of such actual subjective intent may help strengthen the position of an informed attorney or business valuator.

A factor in the appropriate use of actual subjective intent is frequent communication between the attorney and business valuator, especially prior to engaging the business valuator. Having the attorney and business valuator on the same page regarding the standard of value prior to commencing the engagement helps reduce the likelihood of confusion on this point during the engagement. Doing so also helps ensure that they present similar concepts and frameworks when they independently discuss the valuation with the client.

We have found that educating the client early in the process is important. Educating the client helps him or her understand the unfamiliar standard of value concepts, which, in turn, can help frame the client's expectations. Key topics to explain to the client include the standard of value applicable to value a business in a divorce, the business valuator's role, and the guidance provided by professional standards.

Summary

It is important that the attorney and business valuator:

(1) Know the appropriate standard of value in the jurisdiction

(2) Communicate frequently to ensure they are unified regarding the standard of value

(3) Educate the client on the standard of value and any limitations on the inclusion of actual subjective intent.

Following these steps will place the attorney, business valuator, and client in agreement as to the standard of value. So, when the client asks, "What is the value?" the client will have a better understanding of the context used to determine the amount.

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