VALUE MANAGEMENT INC.

Investment Banking + Valuation Services

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Attorney-Prepared Valuation Leads to Malpractice Lawsuit

Sullivan v Loden, 2022 **U.S. Dist. LEXIS 81293; 2022 WL 1409567 (May 4, 2022)**

Plaintiff Colleen Sullivan is the daughter of the decedent, Joanna Sullivan, matriarch of the Foodland Supermarket family business. Colleen asserted a claim of legal malpractice against Joanna's estate planning attorney, defendant Elliot Loden, arising from a 2011-12 valuation of Foodland stock in the course of his work for Joanna. Loden moved for summary judgment on the malpractice claim. Loden also asserted Colleen was collaterally estopped from asserting her claim because the IRS "thrice" accepted Loden's valuation.

Summary judgment was denied because there was a material question as to whether Loden did owe a duty of care to Colleen as an intended beneficiary. Collateral estoppel also did not apply since Colleen was not a party to any IRS acceptance of the Loden valuation.

Facts and background.

Joanna transferred assets to her four children via gift and bequest. Since 2001, only Jenai and Kitty of the four Sullivan children have been involved in the family businesses. In late 2011 and early 2012, Joanna transferred her 221 common shares of Foodland stock equally to Jenai and Kitty. Joanna filed gift tax returns for the gifts for both years, for which Loden performed two appraisals of Foodland stock. The appraisals resulted in reported gifts of $679,350 to each daughter. The IRS made no changes to the filings on the gifts.

Joanna died on Sept. 2, 2015, leaving an estate of approximately $192 million. The will provided substantially for an equal division of her assets to the four children with a carve-out of $1 million cash bequests to Colleen and Patrick to equalize the gifts of stock made to Jenai and Kitty. Loden was named personal representative of the estate. Neither the IRS nor the Hawaii Department of Taxation made adjustments to the estate.

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Colleen expressed concern that her mother's testamentary intent was frustrated by faulty legal advice and pursued corrective action. Colleen challenged the value of the gifts the appraisals assigned. Colleen asserted that Joanna intended to treat the four children "more or less equally" and that Joanna relied on the appraisals in determining her equalizing payments to the other two children. Colleen claimed that Loden's appraisals far undervalued the stock gifts to Jenai and Kitty. She asked Loden to obtain a corrected valuation.

Loden denied Colleen's request for a special administrator and defended the efficacy of his appraisals, contending he had no "conflict of interest." He also denied that Joanna relied on the appraisals in making the equalization payments to Colleen and Patrick. On remand, the probate court appointed Mark Murakami, Esq., as special administrator. On Feb. 1, 2022, Murakami issued his report indicating that the appraisals were not performed according to applicable standards, including USPAP. They were, therefore, unreliable and not trustworthy. Murakami did not order a new appraisal because of the cost and the supposition

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that one side or the other (or both) would oppose the result.

"Nonetheless, he stated that a reliable valuation would be material to Colleen's malpractice claim:

> If [Joanna's] intent was to pay less gift/estate tax, then her intent was fulfilled, but perhaps at the cost of equal treatment of her children. If her intent was equal division to her children, then that intent may not have been effectuated, but I, and the Court, cannot know without a reliable valuation."

Colleen asserted a cause of action against Loden for legal malpractice. On March 5, 2021, Colleen initiated this claim of legal malpractice. She claims Loden shirked his duty either to value the stock correctly or to advise Joanna of the limited utility of the appraisals for nontax purposes. She brings her claims for both contract and negligence theories.

Loden moved for summary judgment on the malpractice claim, contending that Colleen lacked standing because he owed her no duty of care as a nonclient. On Feb. 20, 2022, Loden filed this motion for summary judgment. Loden contended that the appraisals were strictly for IRS purposes and not advice to allocate assets among her children. Loden asserted the appraisals were not intended for Colleen and that there was no proof that Joanna relied on them in allocating assets to her children. Loden also asserted that collateral estoppel barred Colleen's claim because the IRS accepted them three times.

There was at least a genuine issue of material fact as to whether Loden owed Colleen a duty, precluding summary judgment on standing. In determining a duty of care, six factors should be considered, according to the Hawaii Supreme Court in Blair. These factors were listed in the opinion. Here, Loden had not carried his burden of showing that the six factors weighed against Loden having a duty of care to Colleen. "Much of the Blair analysis here depends on whether Colleen was an intended beneficiary of the Appraisals. There is no doubt that she was." The appraisals were important to all four children because the evidence showed that Joanna intended to treat all four children equally. The record also showed that Loden knew of Joanna's wish to treat all children equally in the estate. The court went through each of the six factors to show how they apply to Loden's potential duty of care in this case.

The court also determined that there was no collateral estoppel regarding the appraisals since there was no connection between the IRS and Colleen.

Corona Is Still the Most Valuable Beer Brand, per Brand Finance Study

Corona has retained the No. 1 spot on the list of the world's most valuable beer brands, according to *"Beers 50 2022,"* an annual report from Brand Finance. During the pandemic, the Corona brand hit some trouble because of the similarity of its name to coronavirus, which put off some consumers, especially in the United States. Despite that, Corona's value jumped 21%, to $7 billion, in the wake of the entertainment economy reopening post-COVID-19. Not far behind Corona is Heineken in the No. 2 spot, with Budweiser, Bud Light, and Modelo Especial rounding out the top-five valuable brands. The fastest-growing beer brand is Desperados (up 57%, to $564 million), and new entrant Kronenbourg saw its brand value grow 40%, to $601 million. What's become of some of the once-famous U.S. brands, such as Pabst, Schaefer, Schlitz, and Miller (the "Champagne of Beers")? They're still around but not on the Brand Finance Top 50 list.

New Jersey US District Court Dismisses Plaintiffs' Complaint That Public Company Defendant Overvalued Its Goodwill

***In re Ascena Retail Grp., Inc. Sec. Litig.*, 2022 U.S. Dist. LEXIS 114434; 2022 WL 2314890 (June 28, 2022)**

In this securities putative class action litigation, plaintiff shareholders alleged that the defendants (Ascena) misrepresented the value of Ascena's goodwill and trade names in order to inflate Ascena's stock price artificially. In June 2017, Ascena announced an impairment charge to those assets of $1.3 billion "causing Ascena's already-declining share price to fall precipitously."

The plaintiffs alleged that the defendants possessed the necessary scienter. In addition to noting other statements, the plaintiffs also claimed that the sheer size and importance of the ultimate write-down belie any claims by the defendants that they were ignorant of Ascena's deteriorating value.

The district court analyzed each type of evidence for scienter:

1. *The defendants' statements in press releases and investor conference calls.* "Plaintiffs' allegations more plausibly yield the inference that Defendants' valuations of Ascena's goodwill and tradenames were judgment calls—reasonable at the times they were made, even if ultimately shown to be overly optimistic."
2. *The plaintiffs' allegations that Ascena's internal reporting mechanisms and the defendants' own expertise provided them with scienter were similarly deficient.* The plaintiffs did not allege that any of these sources informed the defendants that the value of goodwill and trade names had deteriorated.
3. *The plaintiffs argued that the magnitude of the ultimate write-down, $1.3 billion, points to impairment.* But the complaint lacks "particularized allegations of fraudulent intent." The plaintiffs offered too few facts to show fraudulent motivation or that they did not believe their own statements. "[T]he $1.3 billion impairment charge more plausibly reflects the collision of Ascena's 'expansion-driven strategy' with changes in the clothing retail market—bad luck or an unsuccessful strategy, perhaps, but a slender basis for an inference of scienter."
4. *The plaintiffs argued that, because Jaffe was the son of Ascena's founders, he had an incentive in concealing any failings in Ascena's business.* There was no indication, and no evidence proffered, that Jaffe achieved any personal benefit.

"Plaintiff's complaint is thus subject to dismissal on the additional and alternative basis that it has failed to adequately allege scienter."

Conclusion. The plaintiffs asked for leave to amend, stating they have a confidential witness with additional information. The district court granted this request. In conclusion then, the court granted the motion to *dismiss* without prejudice.

Do Fair Value Audit Woes Impact M&A?

A new study suggests that firms avoid obtaining intangibles via acquisition because they don't want to face scrutiny from the PCAOB over impairment matters. The alternative would be to invest internally in corporate innovation for the intangibles. The paper, *"The Effect of PCAOB Inspections on Corporate Innovation: Evidence From Deficiencies About the Valuation of Intangibles,"* examines the economic consequences on corporate innovation when PCAOB inspections cite auditors for insufficient procedures in auditing the valuation of intangibles. The study found that audit deficiencies in fair value measurements trigger larger and timelier impairment of intangibles. But this dampens managers' discretion to delay the recognition of losses. Of course, the timely recognition of impairments is the goal of the regulators, but managers may not want to admit that an acquisition fell short of expectations. But to think that accounting optics would materially alter overall corporate strategies may be a bit of a stretch by the study's author. A "build or buy" option may not be feasible for certain intangibles, such as intellectual property.

Understanding the Alphabet Soup of M&As

Selling your corporation or your LLC? If so, what's the current ETA for an M&A in the USA? You had a deal but now the buyer is MIA, should you call more MBAs? FYI, it's TBD, but likely better than the SEC or the IRS!

Like it or not, alphabet soup is a part of life. Abbreviated language can be heard regularly in normal conversation and is ubiquitous in written correspondences – letters, emails, texts and tweets.

Abbreviations such as the above acronyms and initialisms, can save time and effort when communicating verbally or in writing. Of course, that is only true if everyone understands what the abbreviations mean. Misunderstanding the concepts behind abbreviations can be costly when selling a business. Presented below are our Top 5

M&A abbreviations that all sellers should know:

1. NDA – Non-Disclosure Agreement
   A. Most business owners are very protective of confidential company information, particularly their financial information or trade secrets. They say that “flattery gets you everywhere” and unfortunately this can be true for buyers courting business owners.
      - It’s surprising how many sellers will provide buyers with highly confidential information (think tax returns or financial statements) with no little more than a verbal assurance of confidentiality.
      - Or the buyer may offer their own, one-sided NDA.
   B. As investment bankers (IB), we rarely even identify the selling company without a signed NDA.
   C. NDAs can be tricky, and they are binding; the best practice is to have the seller’s M&A lawyer create an appropriate NDA.
   D. With counsel-approved NDA in hand, the investment banker can secure a signed NDA from all qualified buyers.
   E. Buyers often make changes to the seller’s NDA.
      - The investment banker should consult the seller’s lawyers for approval on changes.
2. EBITDA – Earnings before Interest, Taxes, Depreciation and Amortization (pronounced “ee-bit-dah”).
   A. EBITDA is one of the most important metrics for owners selling a business. Value in the finance world is typically defined as the present value of future benefits (or earnings). For many businesses, EBITDA is the key measure of historical earnings that most buyers focus on when assessing the potential future return on their investment.
      - EBITDA is often a primary determinant to value and pricing; offers are commonly quoted as a multiple of EBITDA (e.g. if a buyer is offering an “8x multiple” and EBITDA is $10 million, the offer is $80 million for the debt and equity of the business).
   B. The “E” of EBITDA is for earnings, and it makes sense why that is important – but what about “BITDA,” or “before interest, taxes, depreciation and amortization?
      - Interest expense reflects how the current owner chooses to finance operations. One owner may use much interest-bearing debt while another may use none. Interest expense can distort/deflate earnings capacity and/or cash flow.
      - Similarly, interest income reflects interest-producing assets of the current owner. Such assets and the related interest income are often not part of regular business activities. Here, interest income can inflate earnings and/or cash flow.
      - A buyer wants to know the level of sustainable and/or potential earnings without the impact of how the current owner finances the business.
   C. Pre-tax income is used because the tax circumstances of the buyer and seller are likely different.
      - Using an inaccurate tax scenario can distort earnings.
   D. Depreciation and amortization are non-cash expenses which can lower earnings but do not reduce cash flow.
      - They are accounting/tax adjustments which create a tax benefit by reducing taxable income and can reflect wear-and-tear on assets.
      - Buyers wanting to learn the potential return of an investment are more concerned about actual/potential cash flow than taxable income.
      - Tangible assets will be examined by buyers for condition and suitability.
3. IOI – Indication of Interest
   A. An IOI is a verbal or written offer to purchase made by the buyer, reflecting the buyer’s initial offer or pricing range.
      - An IOI helps the seller to know if it is worthwhile to continue discussions with a particular buyer.
      - If the IOI pricing is in the ballpark, the seller’s team may choose to negotiate; if not, they can move on.

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B. A written IOI is not mandatory.
   - If written, it can be best described as an offer letter to the owner which typically praises the business, cites the wisdom of purchasing it, and provides an offer (the buyer's initial value or pricing).

C. Typically, a written IOI is not meant to be signed by the seller, it is informative in nature.
   - It may be the first mention of pricing, or it may reflect pricing that was verbally presented.

D. An IOI is not always offered, requested, nor needed. It all depends on the specifics of the deal being considered.
   - However, for a seller it is generally a good idea to have an idea of a buyer's pricing as early in the process as feasible.

4. LOI – Letter of Intent

A. An LOI, as the name indicates, is a letter expressing the buyer's intentions to purchase a business.
   - Since it is an executable document, ***an LOI should be reviewed by the seller's lawyers.***

B. The LOI may follow an IOI or a verbal offer, or it may be the first quantification of the buyer's intentions.
   - It depends on how the deal was initiated, among other factors.

C. Generally, an LOI comes after a buyer has learned enough to want to proceed with additional due diligence prior to an acquisition.
   - Aggressive buyers may lead with an LOI, hoping for a best-case scenario for them where it is quickly signed by the seller, with little negotiation.

D. While an LOI is an executable document, the LOI terms are typically non-binding.
   - Some provisions may be binding so it is worth repeating: ***an LOI should be reviewed by the seller's lawyers.***

E. While most provisions in an LOI are non-binding (including pricing), the period of exclusivity requested by buyers to perform due diligence is usually binding.
   - For the agreed-upon period of exclusivity (usually ranging from 30 to 90 days prior to closing):
     - The seller can't sell or offer to sell the business to other buyers.
     - The seller can't talk to other buyers or investors about selling.
     - The seller can only discuss the current negotiations or any activity relating to selling the company with those parties covered by the LOI.

F. An LOI also broadly outlines what a final purchase agreement could look like, including:
   - the type or form of payment to be made
   - the purchase price or price range
   - the terms of payment
   - the amount of target net working capital
   - the disposition of fixed assets, escrow, key contracts/people, representations & warranties, and indemnifications.

G. An LOI attempts to state and clarify the negotiations which have occurred thus far and lay the foundation for the final purchase agreement.
   - Some typical provisions of an LOI (mentioned above) are primarily legal in nature and beyond the scope of this article.
   - Ideally, members of the seller's team (investment banker and attorney) will coordinate review of the LOI and cooperate on helping the seller to understand what is being offered to him/her, asked of him/her, and how to respond to the buyer.

5. SPA or MIPA or APA – Stock Purchase Agreement or Members Interest Purchase Agreement or Asset Purchase Agreement

A. The purchase agreement is the definitive, binding sale document when selling a business.
   - It is legal in nature and handled directly by the respective legal teams of the buyer and seller, with cooperation from the investment bankers and buyer's business team.

B. An SPA is used to transfer stock in a corporation; an MIPA is used to transfer

membership interests in an LLC (limited liability company).

- The key terms in the SPA or MIPA will include a purchase price, representations & warranties, indemnifications, and instructions for closing.

C. An APA is used to sell all or some of the assets of a business, rather than an equity interest in the company or the LLC. APAs can be used by LLCs, corporations, and partnerships.

- The assets may include tangible property, such as inventory, office equipment, machinery, and vehicles, as well as intangible property, such as intellectual property and goodwill.
- Key terms of an APA will include the purchase price, a list of the assets to be acquired, representations & warranties, indemni-fications, and instructions for closing.

D. Other agreements which may be part of or related to an SPA, MIPA, or APA include:

- non-solicitation and non-compete clauses, employment agreements, terms of future contingent payments/bonuses, and real estate or equipment leases (all as applicable)

So, when your IB identifies a qualified buyer, he/she will secure an executed NDA and then provide the buyer with company information, including EBITDA. Then, the IB can request an IOI (verbal or written). If the IOI is in a workable range of the seller's pre-determined goals, with the seller's approval, the IB will negotiate towards an LOI. Once the LOI is fully executed, the buyer can begin due diligence. About mid-way through due diligence, the legal teams will begin drafting and negotiating the SPA (or MIPA or APA). If there are no other requirements, when the SPA (or MIPA or APA) is ready to be signed by all parties, the deal is ready to close. It's as simple as ABC!

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