

# Valuation & Litigation Briefing

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are critical in divorces today

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# Timing and financial expertise are critical in divorces today

**A**s the strictest measures against the COVID-19 pandemic subside, clients may be eager to cut ties with a spouse — the sooner, the better, especially for more complicated marital estates. How can you expedite the divorce process?

## Bracing for a possible surge

Many people expect an uptick in divorce filings in the near future. One reason is pent-up demand for divorces: The pandemic forced many couples who were contemplating a divorce to postpone their filings for practical reasons. These may include restrictions on court proceedings, child-care issues, health concerns, layoffs and financial uncertainty.

Another reason is that lockdowns may have resulted in too much “together time.” Without the distractions of normal day-to-day activities, some couples realized that they don’t share the same fundamental beliefs on parenting, finances and health-related matters. Living 24/7 in close quarters also has made it harder for spouses to hide mental health issues, extramarital affairs, and gambling or drug addictions.

Financial difficulties were especially pronounced for small businesses that were adversely affected by

the pandemic. Examples may include restaurants, gyms, salons, recreational facilities and dry cleaners. Some were forced to close due to loss of a key person from COVID-19 or loss of revenue caused by government-mandated closures and operating restrictions. The stress may have driven many of these business owners to divorce.

## Timing the filing

A fast resolution may be desirable for many reasons. Some couples feel they’ve been stuck in a holding pattern and want a quick, fresh start. For others, timing can impact the effective valuation date of marital assets.

For example, a business owner who’s filed for divorce may not want to share with her spouse any post-pandemic sweat equity that she’s investing in rebuilding her business. Alternatively, someone who’s married to the owner of a struggling business might want a piece of the *current* value of her spouse’s business interest — before additional market changes further erode the business’s value.

Timing can also affect awards of spousal and child support payments. A *recipient* of these payments might want a quick resolution if his or her spouse works for a struggling company that’s contemplating layoffs, which could result in lower earnings. Conversely, a *payor* of support payments might want a quick resolution to minimize the monthly payout if he or she expects to earn more in the future.

## Expediting discovery

Working with an outside financial expert early on can make the settlement process more efficient. During discovery, the expert can provide a comprehensive list of documents and procedures needed to complete the job. This can improve the timeliness and scope of discovery.



## King v. King: Goodwill analysis gone bad

In a recent divorce case, a Florida appellate court reversed the trial court's valuation of the couple's insurance agency. A key issue on appeal was the value of the husband's personal goodwill. Under Florida law, personal goodwill isn't a marital asset and should be excluded from the value of the business for equitable distribution purposes.

The husband's expert estimated his personal goodwill at 68% of the agency's value. That estimate was based on the income he produced and the business he could take with him if the company were sold without a noncompete agreement.

The wife's expert estimated the husband's personal goodwill at 7.3% of the agency's value. That estimate was the average amount allocated to noncompete agreements in 28 insurance company transactions from the DealStats database.

The trial court adopted the conclusion set forth by the wife's expert. But the appellate court rejected that conclusion because the expert failed to analyze or disclose the details of the comparable transactions. The court also criticized the use of some transactions that took place outside Florida, as well as some that were almost 20 years old.

When relying on comparable transactions, experts should delve into the details of the guideline companies. You can help, too, by giving your expert enough time and information to perform a comprehensive analysis.

If discovery is incomplete, the opposing spouse may be concealing assets or income. In this situation, the scope of an assignment may need to be expanded to investigate financial misstatement and asset misappropriation. It's better to know about missing or inaccurate financial evidence sooner rather than later.

Additionally, for marital estates that include a private business interest, early involvement of an expert provides adequate time to perform a comprehensive valuation and allocate goodwill, if applicable. (See "*King v. King: Goodwill analysis gone bad*" above.) A valuation takes time to complete, and courts may be critical of experts who perform rushed analyses.

### Encouraging settlement

Out-of-court settlements are generally preferred to court-imposed settlements. First, judges may differ

in their interpretations of legal precedent. In addition, they might arbitrarily allocate marital assets to the parties, regardless of the spouses' personal preferences or the tax consequences.

During settlement negotiations, financial experts can explain complex financial issues, provide summaries of personal income and marital asset values, and evaluate the tax implications of settlement options. They also can help diffuse emotions and focus discussions on valuation and tax matters. Specifically, an expert can pinpoint missing financial information and key valuation discrepancies.

### Experts are valuable assets in divorce

Financial experts can help settle complex estates. But they also recognize that settlement isn't always feasible — and are ready to customize their procedures to handle unexpected developments throughout the divorce process. ■

# Court rejects “apples-to-oranges” valuation analysis as unreliable

**T**he claim that a business valuation expert is making flawed comparisons can be devastating to the expert’s credibility and the client’s case. In *Dieckman v. Regency GP LP*, a class of limited partners of Regency Energy Partners (Regency) sued the general partner for breaching the partnership agreement’s implied covenant of good faith and fair dealing, as well as an express provision requiring that a merger be “fair and reasonable” to the partnership.

The plaintiff’s valuation expert estimated their damages at roughly \$1.68 billion. But the Delaware Chancery Court rejected his conclusion in its entirety, finding his “apples-to-oranges” analysis unreliable. Here are the details.

## Conflicting views

Energy Transfer Equity (ETE) was a Delaware master limited partnership that held controlling interests in Regency and Energy Transfer Partners (ETP). Both Regency and ETP were also Delaware master limited partnerships whose units were traded on the New York Stock Exchange.

In 2015, Regency acquired ETP for approximately \$10 billion in a unit-for-unit merger. In connection

with the merger, Regency tasked its board’s conflicts committee with evaluating the fairness of the proposed transaction. However, a member of the conflicts committee had a conflict of interest: He also served on the board of an affiliated entity, which violated Regency’s limited partnership agreement.

*The gist of the expert’s opinion was that Regency’s unitholders gave more than they got.*

The Chancellor agreed with the plaintiff that this conflict breached the implied covenant of good faith and fair dealing inherent in the partnership agreement. As a result, two safe harbors in the agreement — one for mergers approved by the conflicts committee and another for mergers approved by the unitholders — weren’t satisfied. Had they applied, the board’s good faith would have been presumed, precluding judicial review of the merger. Instead, judicial review was appropriate, and the defendants had the burden of proving the merger was fair and reasonable.





## Give vs. get

The court ruled in favor of the defendants, finding that:

- ◆ The defendants demonstrated that the merger was fair and reasonable to the partnership and its unitholders,
- ◆ The plaintiff failed to prove damages, and
- ◆ The plaintiff failed to prove that Regency's general partner acted in bad faith or engaged in willful misconduct or fraud. Had the plaintiff succeeded, he would have voided a provision in the partnership agreement that shields the general partner from monetary damages.

Regarding damages, the gist of the opinion provided by the plaintiff's expert was that Regency's unitholders gave more than they got in the exchange of limited partnership units. Using a discounted cash flow analysis based on a dividend discount model, the expert valued the "give" (one Regency unit) at \$29.06. He valued the "get" (0.4124 ETP units) at \$23.83, based on its market price on the merger date ( $\$57.78 \times 0.4124$ ). The difference was \$5.23 per unit, for total damages topping \$1.68 billion.

The Chancellor rejected the use of different valuation methods. The defendants' expert's apples-to-apples analyses (dividend discount model-to-dividend discount model and market-to-market) showed no damages.

The plaintiff's expert argued that his comparison between the dividend discount model and the market price was valid based on a "valuation overhang" theory. According to that theory, ETE received greater incentive distribution rights (a greater share of incremental distributable cash flow) from ETP, giving ETE a financial incentive to favor ETP over Regency. This advantage stifled interest in Regency and made its market price an unreliable indicator of value. But the expert offered no empirical proof that ETE favored ETP, and the court said that the record showed otherwise.

## Use mixed methods with caution

The court didn't rule out apples-to-oranges comparisons in *all* cases. Had there been evidence that one partnership received preferential treatment, the outcome might have been different. But there's a clear preference for consistent apples-to-apples analysis. ■

## Forensic investigations

# The ins and outs of questioned document examinations

**F**orensic investigations almost inevitably require documentary evidence to be examined. Experts often look beyond the *content* of documents. They also may consider physical and latent evidence — such as handwriting, alterations, and faded or decomposed material.

## Mission-critical objectives

Forensic experts may follow questioned document examination procedures to analyze a disputed

document using scientific processes and methods. These examinations can produce a wealth of evidence that a layperson could easily miss. For example, an expert can examine and compare documents to:

- ◆ Establish genuineness, expose forgery or reveal alterations,
- ◆ Identify or eliminate individuals as the source of handwriting,



- ◆ Identify or eliminate the sources of printing or other impressions, marks or relative evidence,
- ◆ Write reports or give testimony, and
- ◆ Aid the users of the examiner's services in understanding the examiner's findings.

The expert applies both technology and subjective interpretation, based on training and experience, to accomplish these objectives.

### Requested vs. nonrequested standards

Typically, a forensic expert examines a questioned document and compares it with known documents referred to as "standards." The similarities and differences between the standards and questioned documents form the basis for the expert's conclusions.

Standards generally fall into one of two categories:

- 1. Requested.** The individual is instructed to write the exact words desired. These standards, however, are vulnerable to distortions by the individual.
- 2. Nonrequested.** These standards are writings executed in the normal course of events, without knowledge of their future use for questioned document examination procedures. Although they're not subject

to willful distortions, nonrequested standards may not contain the exact words or phrases an expert is seeking.

Ideally, an expert can compare like documents or shared components, such as cursive or particular phrases used in both. If the same words or phrases don't appear in both, the expert likely will require a greater volume of standards and more analysis to reach conclusions. If the expert can reach a conclusion, he or she will provide it on a scale, usually ranging from "positively identified" to "eliminated."

### Technological tools

Experts use different types of technology to detect changes to documents

and to retrieve or recover evidence. An electrostatic detection apparatus, for example, detects invisible indentations on questioned documents based on microscopic damage on their surface. Such a discovery could indicate that a notation on a document was added at a different time than claimed. In some cases, this technology is used to determine the age of the document.

An expert also might use a spectral comparator. Video spectral comparators enable examiners to analyze inks and watermarks, visualize hidden security features, and uncover alterations and obliterations on a document. The main purpose of a Raman spectral comparator is to compare ink samples to determine whether they match based on shared spectral characteristics.

### Team effort

Of course, forensic experts aren't solely responsible for successful evidence testimony. Attorneys and clients can bolster their experts' testimony by maintaining document integrity. If possible, you should avoid folding, cutting, stapling or making notes on documentary evidence. Above all, it's important to preserve the chain of custody. Contact your forensic accounting expert for more information. ■

# Why words matter when making defined value gifts

**D**efined value gifts can be used to minimize gift tax on transfers of difficult-to-value assets, such as interests in a closely held business or family limited partnership (FLP). In simple terms, this technique involves transferring a specific dollar amount of an asset, rather than a set number of shares or units or a specific percentage interest.

The goal is to protect the transfer against an assessment of gift or estate taxes if the IRS subsequently determines that the asset was undervalued. But this tax-saving technique can be undermined by improperly worded transfer documents.

In *Nelson v. Commissioner*, the U.S. Tax Court made a distinction between the following two types of clauses:

**1. A formula clause.** This type transfers a fixed dollar amount. It's subject to adjustment in the percentage interest transferred based on a final determination of the fair market value for federal gift tax purposes. A formula clause can effectuate a defined value gift.

**2. A saving clause.** This type transfers a percentage interest or set number of shares. But it provides for a portion of the gift to be returned to the

donor if it's ultimately determined to be taxable. A saving clause can't be used for a defined value gift.

In *Nelson*, the taxpayers made the following transfers of FLP interests:

- ◆ A gift to a trust, which was purported to transfer an interest "having a fair market value of [\$2,096,000] as of December 31, 2008, ... as determined by a qualified appraiser within [90] days," and
- ◆ A sale to the same trust, which was purported to transfer an interest "having a fair market value of [\$20 million] as of January 2, 2009, ... as determined by a qualified appraiser within [180] days."

The taxpayers subsequently attempted to adjust the size of the transfers to reflect their stated intent to transfer defined values. But the court relied on the terms of the transfer documents. By describing the transfers in terms of interests "having a fair market value of a specified amount as determined by an appraiser within a fixed period," the taxpayers essentially transferred fixed percentages, rather than specific dollar amounts. The outcome may have been different, the court suggested, if the

transfer documents had provided for an adjustment to the number of units if the value were finally determined for federal gift tax purposes to exceed the amount described.

In recent years, the Tax Court has given its blessing to defined value gifts. However, *Nelson* reminds taxpayers and their advisors that the transfer documents must use *precise* language to protect transfers from unintended adverse tax outcomes. ■



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- Shareholder/Partner and Business Disputes
- Lost Profits Analysis
- Damage Analyses
- Domestic Relations Matters
- Bankruptcy Services
- Fraudulent Actions
- Criminal Tax Matters
- Valuing Closely Held Businesses
- Purchase or Sale of Business
- Succession Planning
- Estate Planning for Gifts or Inheritances

