

# COURT CASE UPDATE

*PRESENTING RECENT COURT CASES AND LITIGATION ISSUES OF INTEREST*

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**NTCHBA 47<sup>th</sup> ANNUAL CONFERENCE**

**September 9-11, 2024**

**Duquesne Club, Pittsburgh PA**

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# WHY CONSIDER COURT CASES?

- Why even consider court cases? Do they have any information content or do court cases only mislead and misinform us?
- What do we find interesting about court cases?
- What do we find misleading or even missing in considering court case decisions?
- What other sources do NTCHBA members use or have available to address potential litigation risk issues?

# WHY CONSIDER COURT CASES - PROs

The Pros of considering court cases:

- They represent actual disputes that arise over CHB issues.
- They may contain similarities or parallels to specific issues faced by you or a CHB client.
- Court decisions can represent settled or influential case law interpreting legal statutes or regulations.
- Provide education on how the litigating parties and the court dealt with certain issues.
- Provide entertainment over the misjudgments of others.

# WHY CONSIDER COURT CASES - CONS

The Cons of considering court cases:

- The danger of citing previous court cases as a basis for your professional valuation opinions. See *Estate of Berg v. Comm* TCM 1991-279.
- Cases may represent old law, issues, or regulations that have been superseded.
- Different facts and circumstances (e.g., state laws) may alter the application of the case to you or your Client's CHB situation.

# U.S. SUPREME COURT

Case: *Connelly v. United States* (Connelly II), 2024 U.S. LEXIS 2385, June 6, 2024

- Split between two circuit courts (11<sup>th</sup> and 8<sup>th</sup>) on prior rulings.
- Supreme Court affirmed the 8<sup>th</sup> Circuit's decision that life insurance proceeds paid for by and payable to a private company to buy out a deceased shareholder should be included when valuing the shares in the estate. The redemption obligation does not offset the proceeds.
- Take-away: It is now important to review all closely held business interests that have insurance funded buy-sell provisions and consider changing those that, as in Connelly, are funded by life insurance payable to the company.

# U.S. TAX COURT

Case: *Cynthia L. Huffman et al v. Comm. IRS*, TCM 2024-12 (January 31, 2024).

- Gift tax case involving an aircraft parts manufacturer (Dukes). The case involved a number of tax valuation issues such as a buy-sell agreement between a son and his parents and reporting various income and personal goodwill on the subsequent sale of Dukes.
- Take-away: Section 2703(b) three-prong test to see if the buy-sell agreement controls the valuation was issue for review. Missing old buy-sell agreement. Personal goodwill included in sales price was an issue. Extraordinary length of time for the decision (7 years!).

# U.S. TAX COURT

Case: *James J. Maggard et al v. Comm. IRS*, TCM 2024-77 (August 7, 2024).

- Unequal distributions among the three stockholders did not create a second class of stock for the S corp (Schriker Engineering Group). Therefore, taxpayer was liable for misreported S corp earnings on his income tax returns, despite his lack of knowledge of this and lack of cooperation from Schriker in providing true data.
- Take-away: Always make sure that the rights of minority shareholders in S corps are protected from abusive distribution and tax/financial information withholding actions by the majority.



# U.S. TAX COURT

Case: *Bucklew Farm, LLC v. Comm. IRS*, TCM 2024-52 (April 25, 2024)

- Charitable deduction for a conservation easement. The court allowed only \$4.6 million deduction versus claimed deduction of \$47.6 million.
- Take-away: The “before and after” valuation method using actual transactions is preferred by the court, not fantasy highest and best use development projections using DCF “before and after” method.

# U.S. DISTRICT COURT

Issue: The December 1, 2023, amendments to the federal rules of evidence, Rule 702 (expert witness testimony and reports), are now being applied in federal courts.

- To consider whether to exclude all or some portions of expert testimony.
- The court's "gatekeeping" function is now being emphasized regarding unreliable expert testimony (rather than letting it in and going to the weight put on the testimony).
- The "five principles" to be followed under the new amendments to be qualified to testify.
- *Daubert* analysis applied both pre-trial and post-trial.
- The following cases illustrate what is happening.

# U.S. DISTRICT COURT

Case: *In re NFL “Sunday Ticket” Antitrust Litigation*, 2024 U.S. Dist. LEXIS 140596 (August 1, 2024).

- Judge overturned the jury’s \$4.7 billion verdict. One, for not following the judge’s instructions. Two, because economist experts’ testimonies were based on flawed, unreliable methodologies.
- Take-away: Once the experts’ testimonies were rejected, “no reasonable jury could have found (damages).”

# U.S. DISTRICT COURT

Case: *Brown v. Progressive Mt. Ins. Co.*, 2024 U.S. Dist. LEXIS 132448 (July 26, 2024).

- Plaintiffs argued that Progressive adjusted payments on “totaled” cars downward wrongfully (in breach of contract).
- Experts on both sides presented evidence based on calculations and surveys.
- Motions to exclude arguments included: one, lack of specific expertise/experience; two, sample size, survey design/validation, invalid sources, and; three, “not helpful to a jury” or “more prejudicial than probative.”
- Take-away: On motions to exclude before trial, the judge denied the defendant’s motion to exclude and granted plaintiff’s motions to exclude only certain portions of experts’ testimonies.

# U.S. BANKRUPTCY COURT

Case: *In re FTX Trading*, 2024 Bankr. LEXIS 1512 (June 26, 2024).

- In a matter of first impression, the court was presented with various methodologies to estimate values of various cryptocurrencies for debtors'/creditors' claims. Market prices are not always a reliable indicator of value, per the court.
- Many of the cryptocurrency tokens were “locked,” i.e., under contract to become available for sale only at a future date. This was deemed a marketability issue (DLOM).
- Some tokens were valued with a 100% DLOM, despite having current trading market value.
- Take-away: This a useful case to read for cryptocurrency valuation methods. Also useful for seeing what the court determined to be helpful or not helpful DLOM methods.

# ESOP CASES AND ISSUES

Case: *Brian J. Bowers et al v. Julie A. Su, Acting Secretary of Labor*, U.S. Supreme Court, No. 23-1286, July 2024.

- Appeal of: *Julie A. Su, Acting Secretary of Labor v. Brian J. Bowers et al*, U.S. Court of Appeals 9<sup>th</sup> Circ. No. 22-15378, October 25, 2023 (Amended January 8, 2024)
- Request by the ESOP trustees and selling owners as prevailing parties to be reimbursed for attorney fees and costs from DOL.
- Original case was: *Walsh, Secretary of Labor v. Bowers et al*, U.S. Dist. Ct. HI, No. 18-00155, September 17, 2021.
- Take-away: The DOL's case had “many flaws” but the government was “substantially justified” in its litigation position when it went to trial per the appeals court.

# ESOP CASES AND ISSUES

Case: *Julie A. Su, Acting Secretary of Labor v. Bensen*, U.S. Dist. Ct. AZ, 2024 U.S. Dist. LEXIS 145404 (August 15, 2024).

- DOL prevailed in this case the court ruled. Defendants sold their equity to the ESOP but retained their executive positions and operating control over the company.
- The valuation included a 10% control premium in GPC method. Exit multiple used in the DCF method. Was the line of credit part of working capital or debt?
- Take-away: Trustee breached fiduciary duty by not challenging the ESOP valuation, as did the board. ESOP should have paid only \$33 million, not actual \$105 million.

Issue: DOL indicated it intends to issue proposed regulations and guidance about “adequate consideration” (Section 408(e) of ERISA) in valuing ESOP transactions by the first quarter of 2024. The long-awaited guidance has still not been released and the DOL has not updated its intended release date.

# STATE COURT CASES

Issues: State court cases are helpful in understanding (among other issues):

- Personal versus company goodwill (divorce)
- Fair value under dissenters' rights
- Damages for breach of fiduciary duties



# STATE COURT CASES

Delaware Case: *Hyde Park Venture Partners Fund III L.P. v. FairXchange, LLC*, 2024 Del. Ch. LEXIS 270; 2024 WL 3579932 (July 30, 2024)

- Chancery Court had to review experts' various methodologies. The court found problems with all the methodologies used. It decided to default to the actual deal value as "fair value" in this dissenters' rights case.
- Valuing a private, early-growth-stage company that did not generate free cash flow.
- Valuing a company pursuing a disruptive business model that would likely generate binary results. "Either the Company would succeed brilliantly, or it would go to zero."
- Take-away: A good case to read to review the influential Delaware Chancery Court's reasoning about valuing this type of business.

# STATE COURT CASES

Florida Case: *Rosenberg v. Rosenberg*, 2024 Fla. App. LEXIS 4882; 2024 WL 3076490 (June 21, 2024).

- This Florida case addresses the issue of whether the personal goodwill of all the professionals in a multi-member professional practice (medical doctors) be deducted from the value of the company in a divorce case.
- The alternative valuation procedure would be to deduct only the personal goodwill of the divorcing professional
- The court in this case decided on the former approach.
- Take-away: This case has been highlighted as a case that should be appealed to the Florida Supreme Court for final determination, as this issue has become more common in divorce cases in the state.

# STATE COURT CASES

Pennsylvania Case: *In re Estate of Susan L. Kittler*, 2023 Pa. Super., No. J-A20028-23, LEXIS 429 (September 25, 2023).

- Decedent executed a new will during the pandemic in November 2020 via a videoconference with her attorney and two witnesses.
- Decedent's electronic signature failed to Pennsylvania's legal standard for signing a will.
- A will is considered an exception to the Pennsylvania Electronic Transactions Act.
- Take-away: We have become so used to dealing with many issues via the internet and creating and transmitting documents via electronic format (and not on paper with manual signatures) that fiduciaries can trip over this.

# OTHER COURT-RELATED ISSUES

Issue: the Federal Trade Commission's recent (dating to April 23, 2024), controversial ban on many noncompete agreements or clauses.

Case: *Ryan LLC, Plaintiff, Chamber of Commerce of the United States of America, Business Roundtable, Texas Association of Business, and Longview Chamber of Commerce, Plaintiff-Intervenors, v. Federal Trade Commission, Defendant*. U.S. District Court for the Northern District of Texas Dallas Division, Civil Action No. 3:24-CV-00986-E M.

- Take-away: A federal court has instituted a blanket national ban on the FTC enforcing their new rule. But businesses should be aware of this emerging issue in negotiating or imposing noncompetes.

# SPEAKER PROFILE - CURTIS R. KIMBALL

Curtis R. Kimball, CFA, ASA, is president of Vinewood Investment Analytics Inc. (VIA).

He recently retired as Senior Managing Director of Willamette Management Associates after 35-plus years of experience and continues to work with Willamette as a consultant through his firm, VIA. His professional involvement also includes his work on the Board of Governors of the American Society of Appraisers representing the Business Valuation discipline.

He provides independent valuation consultation, valuation review, and specialty fiduciary services to institutional and individual fiduciaries, wealthy clients, attorneys, and others involved in estate, gift, and investment planning as part of their work in wealth management.

He holds the CFA charter from the CFA Institute. He also holds the ASA accreditation in business valuation (BV) and in appraisal review and management for business valuation (ARM) from the American Society of Appraisers. He has a B.A. in economics from Duke University and an M.B.A. from Emory University.

He has presented expert witness testimony over 75 times in federal and state courts and in alternative dispute resolution venues, including IRS audit and appeals conferences.

Contact Curtis and see more at: [www.vinewoodinv.com](http://www.vinewoodinv.com) or call 440-222-0379 for a no-obligation consultation.

# SOURCES & DISCLAIMER

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