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5th Edition of Valuation Strategies in Divorce [“VSID”] Published

Wolters Kluwer has now published and shipped the 5th edition of its subscription-based VSID. The latest edition of this reference resource for marital dissolution attorneys includes many recast and expanded chapters. In particular, we are pleased to announce that J.L. Pierson, ASA has significantly updated and expanded chapter 3 “Valuation of Closely-Held Businesses” from its 2009 version. Please do not hesitate to contact me about chapter 3 on pages 3-1 through 3-16. This attractive addition to your law library can be purchased at the publisher: 800–638-8437 or http://wolterskluver.com.

Zelouf and AriZona Iced Tea cases test NYS Corp. Law § 623 on the subject of the Discount for Lack of Marketability

Stressing that the guiding standard in appraisal rights cases was fairness, and not the application of any formula, the Zelouf Court refused to apply a Lack-of-Marketability discount to a 25% minority interest. At issue were inter-family disputes involving a successful textile trading business in New York. The majority shareholders first orchestrated a freeze-out merger against the minority owner. The latter alleged serious corporate waste of assets and self-dealing. She rejected the buy-out offer, and sued under the fair value statutes. If the reasoning behind applying a DLOM is that a minority interest is more difficult to sell, it does not apply here, said the Court, because a sale of the Company was most unlikely. The risk of liquidity was more theoretical than real and applying a DLOM would unrealistically and unfairly reduce the recovery of the minority owner. Post-trial motions focused on the DLOM and pointed out that appellate Courts in New York have applied the discount even when there was little likelihood of a sale, suggesting that New York law is un-ambiguous in requiring a hypothetical sale, the willingness of the owners to sell being irrelevant. The Court would have none of it: no Court has ever held that the discount must be applied, and applying one would be the economic equivalent of imposing a minority discount, which New York law prohibits. Clearly, the issue has produced a complex argument within the Court.

In each of Zelouf and AriZona [see below] the Court used the other case to distinguish the instant facts and circumstances. While AriZona approved a DLOM based on apparent illiquidity, as illustrated by non-binding prior expressions of interests from potential buyers, Zelouf stood firm as disapproving of any DLOM principally for fairness reasons. The Zelouf Court was guided by an appraisal report agreeable to both sides, itself based on a capitalization of earnings with an S-corp adjustment [the latter was rejected by the Court.] Its conclusion was adjusted by the Court to reflect the waste of corporate assets, and the siphoning of substantial sales to a separate company. *Zelouf International Corporation v. Zelouf*, 2014 N.Y. Misc. [Dec. 22, 2014]

The AriZona story starts when 2 friends founded what decades later became the largest U.S. marketer of ready-to-drink flavored teas. Beverage Marketing - the parent of AriZona - has 1,000 employees and annual sales of $1 billion. AriZona had a 37.4% share for U.S. ready-to-drink tea market by case volume in 2013, according to Beverage Digest, ranking No. 1 above PepsiCo Inc's Lipton and Coca-Cola products. In 1998, as part of an agreement in which shareholder Vultaggio would operate the company while shareholder Ferolito moved to Florida, the two agreed to restrict the transfer of company stock to outsiders. By 2005, Ferolito wanted to sell his stake and began pushing for a corporate sale. Vultaggio refused, prompting Ferolito to ask a court to declare the stock sale restrictions unenforceable. After unfavorable court rulings, Ferolito filed a lawsuit to dissolve Beverage Marketing. Vultaggio later elected under state law to buy out his partner. The 2 partners ended up asking a New York state judge to determine what it would take to cash out the inactive partner. The decision followed more than 6 years of litigation, including a non-jury trial in front of Judge Driscoll. The Court’s answer was $1 Billion or half of the $2 Billion total enterprise value as of 2010. One shareholder objected to the Court-determined price, pointing out that the enterprise value was closer to $3.2 Billion, and admittedly more that the $426 million calculated by the other shareholder/co-founder. The seling shareholder had pegged the high value of the Company by reference to non-binding expressions of interest received from Nestle, Coca Cola and Tata Teas. The expressions of interests had not been firmed up, and no due-diligence was performed by the potential buyers because they could not. The Court’s award was based for 20% on uncompleted sales and 80% on a DCF performed by the experts since real comparable transactions were lacking; the experts disagreed on most components, but perhaps the remaining shareholder scored some important points as his expert pointed out that in the large company universe, smaller DLOM are often justified. The judge agreed and used a 25% DLOM. The case is *Ferolito v. AriZona Beverages USA LLC, et al*, New York Supreme Court, Nassau County, No. 004058-12. [October 14, 2014.]

How To Un-Lock Private Company Wealth

I recently had the opportunity to attend a seminar by a nationally known business appraiser which reminded me of various assignments over the years, all geared to helping the private entrepreneur *cash out*. This is particularly important now as many of the baby boomers who built businesses during their professional lives are facing the prospect of retirement. Consider that 66% of all U.S. businesses with at least 1 employee are owned by baby boomers, the latter group representing 25% of the total population.

Several types of transfers are theoretically available, either voluntary or not, and affecting the entire business or a partial transfer. Total transfers can be either: the sale of the business; stock-for-stock exchange for public company; stock cash sale to a public company; installment sales to insiders/relatives; ESOP or Management buyout; liquidation or buy-sell agreements [all voluntary;] or death, divorce; forced restructuring; bankruptcy; shareholders disputes; liquidation or buy-sell agreements [involuntary transfers.]

Among the partial transfer options: ESOP; outside investors; sale to insiders/relatives; combination merger/cash out; going public; gifting programs and buy-sell agreements [all voluntary;] death; divorce; forced restructuring; shareholder disputes and buy-sell agreements [involuntary.]

Of course the appropriate option depends on the financial condition of the business, its value, and whether management understand that options/decisions must be implemented for the long term, not in a knee-jerk fashion. All owners know that they, in the long run must sell to a financial or strategic buyer, which requires preparation. Easy to implement decisions include: establishing a dividend policy covering both regular and special dividends; the repurchase of shares from an owner desiring to sell; the establishment of a management buying program. Control-level options include: a leveraged dividend recap; a leveraged stock recap or buy-back; an employee stock ownership plan [all over 50%] and private equity [majority.] Minority options include: a leveraged dividend recap; a leveraged stock recap [buy-back;] ESOP [all less than 30%] or a non-control private equity investment for liquidity/growth.

The use of reasonable leverage is a powerful tool to obtain some liquidity for key shareholders. So is a partial ESOP, particularly in consistently profitable distributors or professional corporations. So are Private Equity investments, of which many are minority in nature; the latter are often advocated when management needs help in taking the business to the next level. It goes without saying that any business which is sellable must have a workable buy-sell agreement well understood by management. Typically, the preferred agreement calls for a single appraiser, with periodic valuation until the agreement is triggered. Generally, a valuation will be the starting point, and it will identify potential problems of concentration, and outline feasible options for management, If this sounds familiar, please contact us.

ESOP Appraisers No Longer Automatic Fiduciaries, DOL Concedes

After almost 3 years spent trying to convince appraisers and others that its new "appraiser-as-fiduciary" rule would help ESOPs in general, the agency has dropped the rule to the relief of almost all appraisers active in the field. The rule, of course, would have created an unnecessary conflict between a fiduciary's strict duty of loyalty to plan participants and appraisal standards, which require appraisers to perform their assignments with impartiality, objectivity and independence. Of course, trustees continue as fiduciaries of the plan participants.

J.L. Pierson, ASA is an experienced business appraiser who supports the NY, NJ and CT business communities from his base in Darien, CT. His clients are closely-held businesses with revenues of up to $300 million in all industries, as well as owners of family limited partnerships/LLCs, professional corporations and their advisors. He specializes in business valuation for estate/gift tax, succession planning, sale/purchase and litigation such as shareholder and corporate disputes and divorce, corporate development and transactional support purposes. This newsletter is generated internally to reflect key development in BV which appear to affect users. Court decision analysis is prepared from the perspective of a BV analyst, not from that of an attorney.

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