

Compliments of ...



**SINGER LEWAK GREENBAUM & GOLDSTEIN LLP**  
Certified Public Accountants & Management Consultants



## Business Valuation

### E-Letter

Issue 10-15 April 18, 2006

*A publication of the Business Valuation Committee of the American Society of Appraisers.*

#### **CASE UPDATE**

Provided by *Business Valuation Update*<sup>TM</sup>

[www.BVResources.com](http://www.BVResources.com)

Sherrye Henry Jr., Esq., Managing Editor

[sherryeh@bvresources.com](mailto:sherryeh@bvresources.com)

#### **Appraiser's Notes Become Key Evidence in Finding Breach of Corporate Fiduciary Duty**

*Farndale Co., L.L.C. and Val Participations, S.A. v. Folco Gibellini and Accuma, S.p.A, SA, 2006 N.C. App. LEXIS 423 (Feb. 21, 2006)*

Analysts most always keep meticulous notes, which usually stay in their files. But should a client later face a lawsuit based on allegations relating in any material way to the analyst's valuation, those same perfunctory, proficient notes may start to smoke.

So it happened in Farndale, which concerned a \$2.8 million loan from plaintiffs (minority shareholders) to defendant Accuma and its controlling owners. When the company failed to repay, the plaintiffs sued, prompting Accuma to investigate issuing additional stock to raise money. Based on an appraisal at the time (1998), Accuma's directors proposed to issue over four million shares at approximately \$1.35 per share, for a total recapitalization of \$6 million. Plaintiffs chose not to purchase any of the newly-issued shares, which the defendants bought instead, effectively giving themselves 99% of the company and "squeezing" the plaintiffs' interests to 1%.

#### **Analyst's notes indicate instructions from client**

Defendants had hired Charles Vance (formerly with First Union Bank's business valuation group) to conduct the 1998 appraisal; at trial, Vance testified that Accuma had instructed him to determine the fair market value of the company as of December 31, 1998, to calculate the appropriate price per share and the number of shares that would constitute a \$5 million block of shares

(which the company later revised to \$6 million). Vance submitted his report in early 1999, valuing the company at \$600,000; Accuma never asked him to revise the valuation, even after its profits increased that same year.

Vance also testified regarding his notes, taken during the valuation process, explaining that Accuma had asked him to calculate the dilutive effect on minority shareholder ownership under various scenarios. His notations included that one “might pay too much for an ownership interest,” and referenced an “iterative process of trial and error to get point of ownership.” He’d also noted that “the existing shareholders will maintain a minority interest in the company so you cannot get 100% unless they sell to you;” and finally, “want high 90%,” “no more than \$6,000,000,” and “5.6 to 6.0 scenarios.”

In response, one of plaintiffs’ experts, Michael Paschall, ASA, CFA, J.D. (Banister Financial, Charlotte, NC) alleged that defendant’s report had: (1) relied on inconsistent methodologies, one of which calculated the company’s value at \$5.6 million and the other at \$600,000; (2) contained unsupported projections and assumptions; (3) failed to consider offers to purchase Accuma, including one by its former president of \$8-10 million in 1997. Paschall also testified that the reduction of plaintiffs’ percentage ownership to less than 1% was mathematically dependent on the \$600,000 as opposed to the \$5.6 million valuation. This supported plaintiffs’ allegations that defendants had selected the number of undervalued shares the company would offer to reduce the plaintiffs’ interest and increase their own, in the likely event that plaintiffs would not exercise their preemptive rights, given the “soured” relationships between the parties.

At trial, the jury found that Accuma had breached its fiduciary duty of good faith and fair dealing to protect plaintiffs’ minority interests. On appeal, the Court of Appeals agreed that the company had issued the shares at a price significantly below their true value; and that it had ignored information—including an upturn in profits, which might have justified a higher valuation. Also key in its decision: The Court cited the analyst’s notes regarding the company’s instructions to calculate the dilutive effect of different capitalization scenarios, thus pointing the smoking gun not at the analyst, but at the defaulting parties.

For the full case abstract go to: <http://www.bvresources.com/asa>

---

### **About SLGG**

Established in 1959, Singer Lewak Greenbaum & Goldstein, LLP (SLGG) is a leading

Certified Public Accounting and Management Consulting firm and one of the largest accounting services providers headquartered in Los Angeles, California. The firm provides audit & accounting, taxation, business management, SEC transactional expertise, IT Risk Management, forensic accounting, business valuation, litigation support, forensic accounting, consulting and entrepreneurial business services to public and private companies, non-profit organizations and high net-worth individuals. SLGG has more than 170+ professionals, including 25 partners, with office locations in Los Angeles, Santa Ana, Monterey Park, and Ontario, California.



[Michael Cohen, CPA](#),  
ABV,CFE  
Partner & Director, SLGG  
Forensic Accounting,  
Business Valuation &  
Litigation Support Practice



[John A. Kirby](#), JD, MBA, ASA  
SLGG Forensic Accounting,  
Business Valuation &  
Litigation Support Practice

SINGER LEWAK GREENBAUM & GOLDSTEIN LLP

Certified Public Accountants & Management Consultants

[WWW.SLGG.COM](http://WWW.SLGG.COM)

Los Angeles

Orange County

Inland Empire

877.SLGG.LLP / 877.754.4557 fax: 310.478.6070

*Let our qualified and court-accepted experts assist you with your litigation requirements.*