Appeals Court Says Missing Information Doesn't Prevent Business Valuation

September 2014

A recent Appeals Court decision addressed what level of evidence is required to demonstrate business value in a divorce proceeding. In *Hugh v. Hugh*, 2014, the wife in a divorce proceeding filed a cross-appeal on a number of issues, including the trial court's failure to value her husband's business ("E-Tech"). The Appeals Court agreed that while the husband had effectively "stonewalled" discovery, the Trial Court had the ability and obligation to make a value determination based on the available evidence.

The available evidence regarding E-Tech came from the husband. The husband's testimony was described as "*vague, indefinite, and confusing*" and accompanied documentary evidence that was "*scant and indefinable*". E-Tech apparently underwent various name changes and other corporate changes in its history, but for all practical purposes was a reseller of semiconductor manufacturing equipment controlled by the husband. Headquartered in Virginia with offices in Rockville, Maryland and Korea, the husband described that it did business "*everywhere*". Its website touted the "*the world's largest inventory of semiconductor and manufacturing equipment parts*". However, the husband testified at trial that E-Tech had no inventory and no value. The limited documentation regarding the company included:

- A 2010 tax return showing $9.3 million in revenue and profit of just under $400,000.
- A 2010 financial statement showing income that was "more than double" what was recorded on the tax return
- A 2011 tax return with revenue of $6.8 million (for the 8 months prior to a corporate dissolution), profit of $50,000, and compensation to officers of $240,000.
- A 2011 tax return for the remaining four months with revenue of $155,000 and a loss of $13,000.
- A 2012 tax return with revenue of approximately $1 million and $150,000 in losses.
- 2012 corporate bank account statements showing $335,000 of personal expenses including almost all of the husband's counsel's fees

The husband claimed the 2012 losses were generally a result of "the bad economy" where "the semiconductor business was not doing well at all." He testified that to him, E-Tech was worth nothing.

In contrast, the wife's expert, a certified public accountant (the "CPA") analyzed the available information and concluded that E-Tech had an intrinsic value of $1.4 million based on a market approach to value and after consideration of the husband's goodwill. In forming his conclusion, the CPA utilized 31 comparable companies. The CPA acknowledged the data limitations did not allow for a standards based valuation and that more information was preferable, but stated that his opinion of value was based on "*sound foundation and fact and accounting theory*" and provided a useful and "*reasonable estimate of the value of the company*". He expressed concern that the tax returns likely understate income due to personal expenses being run through the business, which would cause his opinion based on those records to understate the actual business value.

The Trial Court concluded that it had "*insufficient evidence upon which to place a value on* [E-Tech]." The Trial Court noted (i) the husband's valuation of zero and (ii) the likelihood that the information relied upon by the wife's CPA was incorrect and thereby declined to value E-Tech or subject it to equitable distribution. However, the Trial Court did order the husband to pay $25,000 of plaintiff's expert fee because, in the Court's view, the husband had stonewalled the discovery process and "*the expert witness would have been able to value the business and entity now owning it had* [the husband] *provided sufficient information for him to do so*".

The husband's success in avoiding a proper valuation of his firm and a related distribution by "stonewalling" his wife's expert is troubling. The Appeals Court agreed with the Trial Court's assessment that expert fees were driven up by (and should be paid by) the husband. However, it disagreed with the Trial Court's assessment that the information available was wholly insufficient to provide evidence of value, concluding:

"While the parties have the burden of bringing forth sufficient evidence for the trial court to base its award, where there is sufficient and credible evidence as to the value of a business, a trial court must assign a value to the business when making its equitable distribution award. There is no precise approach to the valuation of a business. Rather, courts have adopted a flexible approach that allows for consideration of the individual circumstances in each case. To that end, the type or quantity of evidence required to enable a trial court to value a business is not fixed….The trial court in this case had a relative wealth of information regarding E-Tech from which it could have valued the business….[The CPA] *employed the market approach to value E-Tech, which he described as a "sound and reasonable method to value a closely-held business"….Even though the trial court had understandable doubts as to husband's credibility, as well as the professionally limited basis for* [the CPA]'*s testimony, in addition to questioning the credibility of the various tax returns, the trial court was nonetheless confronted with sufficient information from which to value E-Tech. As the Court stated in Collins, "[a]ssuredly, a business that has gross income can be valued." In this case, the trial court had more than gross income as evidence of E-Tech's intrinsic value and had the discretion to place a value within the range provided in witness testimony and documents received into evidence. Therefore, we hold that the trial court erred when it did not value and distribute E-Tech*." [citations omitted]

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