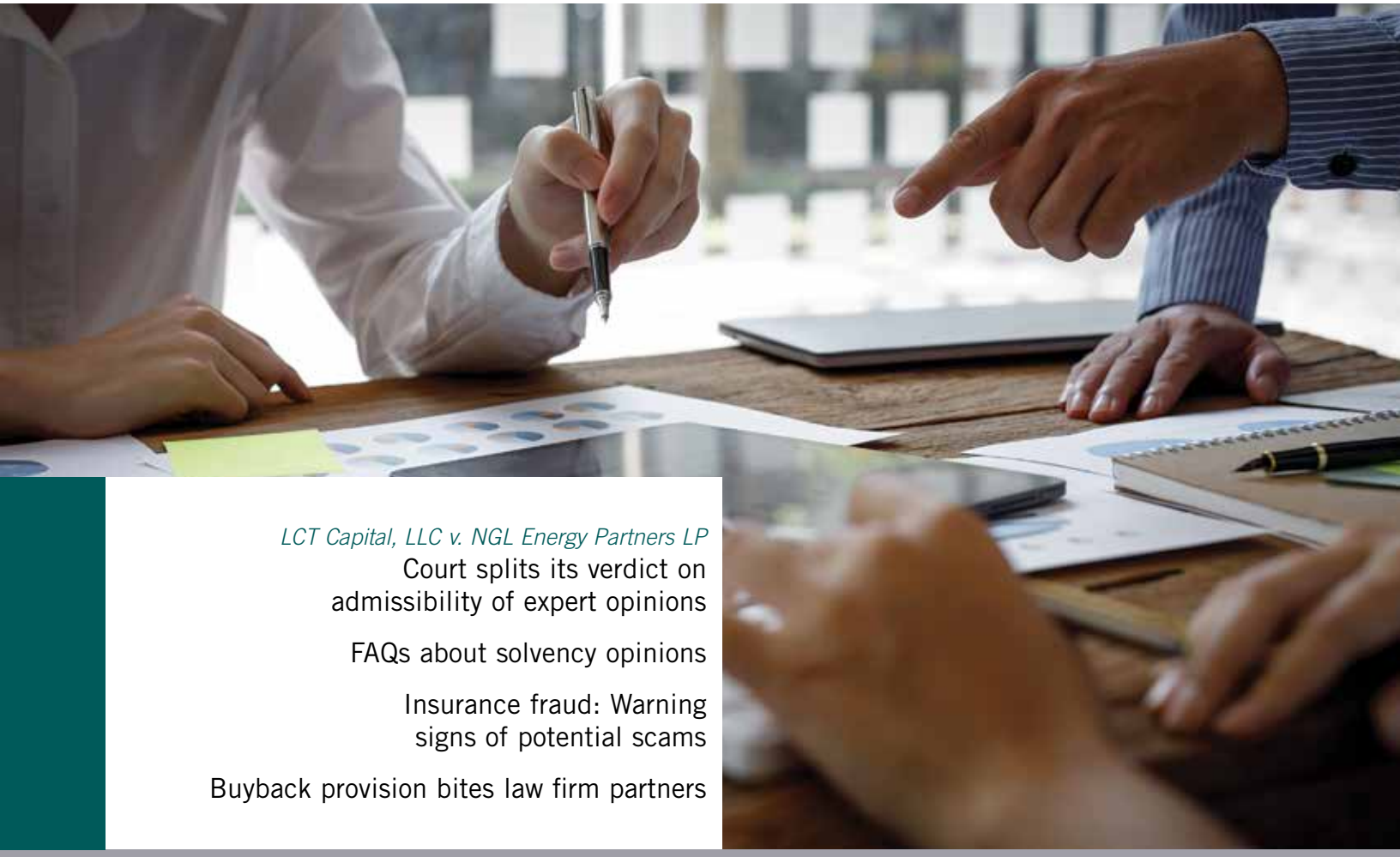
JANUARY/FEBRUARY 2024

LITIGATION SUPPORT



LCT Capital, LLC v. NGL Energy Partners LP
Court splits its verdict on admissibility of expert opinions

FAQs about solvency opinions

Insurance fraud: Warning signs of potential scams

Buyback provision bites law firm partners

Oscher Consulting, PLLC

One Tampa City Center
201 North Franklin Street, Suite 3150
Tampa, Florida 33602
813•229-8250 FAX: 813•229-8674

LCT Capital, LLC v. NGL Energy Partners LP

Court splits its verdict on admissibility of expert opinions

Financial experts are often called on to help clients determine economic damages in commercial litigation. In a recent damages-only trial for a quantum meruit case, the court tackled a slew of motions aimed at limiting the testimony of opposing damages experts.

Case of dueling experts

In 2014, LCT Capital (LCT) helped NGL Energy Partners (NGL) acquire a refined petroleum products distributor. The transaction generated $500 million in value for NGL, more than twice the price NGL paid for the acquisition. But the parties never reached an agreement on LCT's investment banking fees.

In 2015, LCT sued NGL for breach of contract, fraud and the quasi-contractual remedies of unjust enrichment and quantum meruit. After a first trial, post-trial decisions and an interlocutory appeal, only the quantum meruit claim remained for the new trial on remand. As in the first trial, NGL conceded liability under quantum meruit, leaving only the damages issue.

Both parties raised challenges to their opponent's damages expert's testimony. The court considered two *Daubert* motions to exclude and five motions in limine to exclude or admit various evidence, testimony and argument at trial.

Defense's rebuttal expert

The Superior Court of Delaware first addressed the plaintiff's arguments against the defendant's rebuttal expert. The plaintiff claimed that the expert exceeded her scope as a rebuttal expert, offered an unreliable opinion and made an impermissible credibility determination regarding the plaintiff's CEO. However, the court denied the motion to exclude her opinions.

It rejected the notion that the expert exceeded her proper scope, noting that rebuttal witnesses may use new methodologies to rebut or critique an opposing expert. Moreover, if an affirmative expert claims an absence of data, a rebuttal expert can attempt to rebut that claim by proving the existence and reliability of such data. The court also disagreed that the expert's opinion was unreliable because she didn't consider and assign greater weight to certain evidence. It found the allegations

Court gives value creation damages theory a second look

The defendants in *LCT Capital* (see main article) challenged the admissibility of evidence or testimony related to the value creation theory of quantum meruit damages. This theory incorporates the post-acquisition value that the plaintiff's services added to the defendant's acquisition. The court initially precluded the plaintiff's expert from testifying to damages calculations based on the theory. It found that the methodology was contrary to the law of the case and relevant case law. The court noted that, under Delaware law, quantum meruit damages are generally based on the value of the services provided, not the value of the benefit received.

The court subsequently modified its order regarding the value creation theory. It explained that the appropriateness of a flat fee wasn't a foregone conclusion, given the specialized nature of the services. And evidence suggested that the value of the plaintiff's services couldn't be reduced to such a fee. In fairness, the court allowed the jury to consider the increased value the plaintiff added to the acquisition when awarding damages. If the jury found the plaintiff's efforts were "unique, extraordinary and critical," it could permissibly place a value on those efforts.

The court concluded that the sole goal of the services was to increase the deal's value for the defendant. It follows that the plaintiff shouldn't be precluded from presenting evidence or argument that the reasonable value of its services can't be determined without understanding the value it added to the acquisition.

that she didn't consider the information "demonstrably false," citing a section of her report.

Finally, the court found the expert didn't make a credibility determination on the CEO. Although the expert disagreed with the CEO's valuation of his services, she didn't accuse him of being untruthful.

Plaintiff's expert

The court's rulings on the testimony of the plaintiff's expert weren't as favorable as they were for the rebuttal expert. For example, the court agreed with the defense that the plaintiff's expert's opinions violated the law of the case and relevant case law.

The defense also argued that the plaintiff's expert didn't use reliable methodology to form his opinions because he impermissibly engaged in ipse dixit, and his opinions violated the law of the case. The term "ipse dixit" represents the general prohibition of opinions supported only by the expert's qualifications that can't reasonably be traced to other authority or proof. A court doesn't need to admit evidence that's connected to existing data only by the expert's ipse dixit. It may conclude that there's "simply too great an analytical gap between the data and the opinion."

The court's findings on the five ipse dixit opinions from the plaintiff's expert were a mixed bag. It excluded two — in which he opined that a floor of $43.8 million (22% of deal price) is reasonable compensation for LCT's services — because he couldn't tie them to his prior experience as an investment banker. Rather, they were derived from a proposed fee arrangement. It allowed (but in some cases limited) the expert's other opinions.

Jury gets the last word

Ultimately, the jury awarded the plaintiff $36 million for its services. It's worth noting that figure is significantly less than the "floor" provided by the plaintiff's expert.

LCT Capital sheds valuable light on how experts and attorneys who use financial experts to determine damages should approach similar cases. It also highlights potential pitfalls to avoid. ■

FAQs about solvency opinions

Amidst ongoing economic volatility, a growing number of small businesses have become insolvent. In fact, U.S. commercial bankruptcy filings have increased dramatically from 2022 to 2023, according to statistics published by the American Bankruptcy Institute. What happens to a creditor if one of its customers becomes insolvent? Sometimes creditors of liquidating companies have trouble recouping what they're owed. Here are some common questions regarding solvency and how a solvency opinion can help creditors determine whether a liquidating debtor can meet repayment obligations.

What does "solvency" mean?

Solvency is generally defined as the ability of a business or individual, at a specific point in time, to meet its long-term interest and repayment obligations. To determine whether a business is solvent, both the federal Bankruptcy Code and the Uniform Fraudulent Transfer Act look at the fair value of a debtor's assets.

A company is generally determined to be solvent when the fair value of its assets is greater than its debts. This may seem straightforward, but sometimes the waters get muddied. For example, some companies may be legally solvent but nonetheless unable to pay their debts because the fair value of assets might include nonliquid assets.

How do experts test solvency?

Financial experts apply the following three tests to analyze solvency:

1. Balance sheet test. This test evaluates whether, at the time of the transaction at issue, the debtor's asset value exceeded its liability value. Assets are generally valued at market value, rather than at book value, which is typically based on historic cost. In addition to business valuators, other appraisal specialists may sometimes be hired to determine the fair market value of such assets as real estate, equipment and intellectual property. Adjustments also may be required for unrecorded contingent assets and liabilities.

A company is generally determined to be solvent when the fair value of its assets is greater than its debts.

2. Cash flow test. This test examines whether the debtor incurred debts that were beyond its ability to pay as they matured. It involves analysis of a series of projections of future financial performance. Such projections are developed by varying some key operating characteristics of the business, such as revenue growth. Experts often consider a range of scenarios. These include management's growth expectations, lower-than-expected growth and no growth — as well as past performance, current economic conditions and future prospects. They may also evaluate various financial metrics, such as debt-to-equity and working capital ratios.

3. Adequate capital test. Here, the expert determines whether a company is likely to survive in the normal course of business, bearing in mind reasonable fluctuations in the future. In addition to looking

at the value of net equity and cash flow, experts consider other relevant factors, such as asset volatility, debt repayment schedules and available credit. The capital adequacy test is passed if the debtor corporation is expected to have sufficient cash on hand to pay operating expenses, capital expenditures and debt repayment obligations.

A company must pass all three tests to be considered solvent. Courts generally will presume that a company is insolvent unless it can prove otherwise. In some cases, a fourth test — shareholder distribution — may be applicable.

A solvency opinion is an independent professional analysis that questions and tests the debtor's assumptions and projections. It provides an informed opinion based on the debtor's historic and expected future performance of whether the company will be reasonably able to meet its obligations.

Why is professional guidance needed?

Performing a solvency analysis requires considerable knowledge and experience. Most business owners and attorneys aren't necessarily capable of determining whether a financially distressed debtor can pay — or whether it's hiding something. Solvency issues may also come into play in a variety of litigation scenarios, including fraudulent conveyance, bankruptcy alter ego and due diligence actions. For help determining whether a debtor is providing accurate information or is capable of repaying debt, discuss your case with a solvency expert. ■

Insurance fraud: Warning signs of potential scams

Although businesses potentially can become victim to a variety of schemes that bilk insurance companies and workers' compensation funds, on-the-job injury and property-casualty fraud are the most common. There are specific clues that fraud experts use to uncover dishonest behavior. In addition to investigating claims, these experts can help prevent such fraud from happening in the first place.

Workers' compensation abuse

Falsified injury claims, unnecessary medical services, missed work and off-hours injuries are some of the most common workers' comp scams perpetrated by employees. For example, though most accidents are legitimate, the National Floor Safety Institute claims that roughly 10% of "slip-and-falls" are staged.

Experts generally look for several signs that such fraud is being perpetrated:

Suspicious timing. An employee who reports an on-the-job injury Monday morning, with no witnesses, could be trying to pull a fast one. Workers who get hurt over the weekend pursuing leisure activities sometimes try to turn their woes into workplace accidents. Also worth investigating are employees who report injuries just before seasonal layoffs, strikes or other work stoppages.

Short tenure. Experts look carefully at accident claims made by new employees. With a little digging, they sometimes find that an injured employee who was recently hired has pulled the same scam on previous employers. It's also important to evaluate claims made by employees who were

terminated or resigned and who might have a motivation to commit fraud.

Communication issues. It may be prudent to investigate a claim if, after repeated attempts, an employer can't get in touch with an employee on disability leave during the workday. The employee may be "double dipping" — working another job while collecting benefits for an injury that supposedly makes work impossible.

> Scammers often describe their accidents differently to their employers than they do to their doctors.

Medical irregularities. Scammers often describe their accidents differently to their employers than they do to their doctors. "Injured" employees also change medical providers frequently and may refuse diagnostic procedures.

Additional red flags

Like fake workers' comp claims, property-casualty fraud can be detected if you know the signs. For instance, an auto accident claim could be false if witnesses aren't available to support the claimant's story, or if an overly enthusiastic witness or one related to the claimant comes forward at the last minute. Fraudulent claimants also frequently push for immediate cash settlements and may threaten the insured with adverse publicity if their claims aren't settled quickly.

Such perpetrators may be unwilling to provide identification or verifiable addresses. Related behavior includes:

- Frequent changes in home address and phone number,
- A preference for handling business in person, or
- Reluctance to use the U.S. postal service.

In this type of case, further investigation often reveals that the claimant has an active claims history under various aliases.

Certain industries are particularly vulnerable to insurance fraud. Restaurants and retailers that sell food may be victims of food poisoning scams. In the case of fraud, claimants usually are the only people to get sick, and they may be unable to produce a foreign or contaminated substance to support their claims. Similarly, manufacturers could be fraud targets if a product liability claimant produces only a package wrapper or box, not the allegedly dangerous product.

An ounce of prevention

In addition to investigating workers' comp or property-casualty claims, a fraud expert can help your clients prevent scams. Businesses need to establish and clearly communicate procedures for filing claims, as well as for reporting and investigating incidents. Managers also should be taught to spot the signs of insurance fraud. Contact a fraud expert for more help investigating suspicious activity and implementing policies to minimize insurance fraud risks. ■

Buyback provision bites law firm partners

In a recent case — *Laurilliard v. McNamee Lochner, P.C.* — two law firm shareholders were left in the cold after their firm merged. In hindsight, they likely regret not giving more thought to the buyout language in their shareholders' agreement. A New York trial court found they were owed only $100 each for their shares in the old firm.

Winding down

The plaintiffs had practiced with the firm for decades and were shareholders. In early 2020, several other shareholders accepted offers to join another firm. In March 2020, the firm began "winding down" — pension plan contributions were discontinued, and much of the staff was terminated. The plaintiffs were terminated in April. In May 2020, a managing shareholder asked them to surrender their shares and in exchange, each would receive a check for $100.

The plaintiffs refused and filed suit against the old firm and nine of its shareholders. Among other things, they alleged that the defendants anticipatorily breached the shareholders' agreement by stating that the firm would be "ceasing the practice of law in the near future."

The agreement stated that, in the event shareholders terminated — or have terminated — their employment with the firm, the shareholder was obliged to tender their share to the firm within five days. Then the firm was obliged to purchase shares for $100, payable within six months of delivery of the shares duly endorsed for transfer.

Trial court's reckoning

The court dismissed the plaintiffs' breach claim, finding the shareholders' agreement didn't prevent the firm from winding down or "ceasing the practice of law." In fact, the shareholders' agreement

didn't speak to dissolution, liquidation, winding down or the distribution of assets to members upon dissolution. The court ruled the firm tendered its only obligation — to pay the plaintiffs under the shareholders' agreement the $100 purchase price for an offered share. Thus, the plaintiffs were in breach because they refused to deliver their shares.

The court also rejected the plaintiffs' accounting claim. Under the shareholders' agreement, termination of their employment triggered a mandatory duty to deliver their shares to the firm. Because they hadn't done so, the court concluded the plaintiffs had been divested, at least equitably, of any rights as shareholders. So they lacked the standing necessary to maintain a claim for an equitable accounting.

Look before you leap

This case demonstrates the importance of carefully crafting shareholders' agreements to ensure shareholders receive fair compensation when they exit a business. Contact a business valuation professional to discuss the appropriate valuation language to add to shareholders' agreements to ensure equitable buyouts. ■

Oscher Consulting, PLLC

One Tampa City Center
201 North Franklin Street, Suite 3150
Tampa, Florida 33602
813•229-8250 FAX: 813•229-8674

Oscher Consulting, PLLC

A Certified Public Accounting firm providing litigation support services in the areas of Accounting, Finance, and Information Systems.

Areas of Expertise: Economic and financial analysis associated with:

- forensic accounting and fraud investigation
- contract disputes
- personal injury and wrongful death litigation
- bankruptcy issues
- environmental damages analysis
- family law issues
- business valuation
- securities fraud and manipulation
- employment law issues

Education/Training: Our consulting group includes:

- Certified Public Accountants
- Accredited Business Valuators
- Certified Fraud Examiners
- Ph.D.s in economics, finance, accounting, marketing and information systems

The personal, professional and specialized service provided to our litigation clients demands the intensive involvement of people who understand the litigation process and who provide accessible, comprehensive service.

Working as part of your support team, Oscher Consulting presents innovative approaches and creative solutions to problems related to the development of successful litigation strategies. The result: responsive, accurate and confidential services that are highly valued by our clients.

CPA
The CPA. Never Underestimate The Value.