

Nuances of a White Collar Criminal Investigation: The Defense Side

By Barbara J. Gottlieb, CPA/CFF, CFE, and
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Note: This article is the second in a two-part series on white-collar crime investigations. The first part, in our last issue, covered the concerns of the prosecution side of the case.

The Defense Perspective

White collar crime involving financial schemes can be quite complex in nature. The forensic accountant can be instrumental in assisting defense attorneys to decipher the accounting records and explain the business transactions and the underlying documents, as well as testify as expert witnesses. White collar crime comes in many forms, including money laundering as well as financial institution, bankruptcy, insurance, securities and tax fraud. White collar criminal indictments often include acts of conspiracy and violations under the RICO (Racketeer Influenced and Corrupt Organizations) statute.

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Chair's Corner



Are you excited yet? I am, every time I think about this year's **AICPA Forensic & Valuation Services Conference**, which is right

around the corner. We've made significant enhancements in content, in our presentations and in the value of the overall experience to you and to all of your staff people whom you select to attend.

What are some of the standout benefits? We've added new and timely tracks, including an industry track that spotlights areas where you've asked for a deeper dive, including the financial services and oil & gas sectors. We also have a cutting-edge track that focuses on issues such as social

media and virtual currency. The hands-on course offers an unparalleled chance to work through all the steps of a challenging case study. That's in addition, of course, to the usual indispensable presentations and networking opportunities. The fact that it all takes place in New Orleans just adds to the excitement.

With the conference scheduled for November 9 through 11, there's still time to register, but you'll want to begin making your arrangements now. I look forward to seeing you at this must-attend event!

Carol Carden, CPA/ABV, CFE, ASA

Contact Us

We welcome your comments, questions or article ideas. Please send them to fvsconsultingdigest@aicpa.org.

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The job of the defense team in a criminal matter is different than in a civil case. In a criminal case, the defendant is presumed innocent and it is up to the government to prove the elements of the crime beyond a reasonable doubt. This burden of proof is more onerous than in a civil matter, where the determination of liability is made based upon a preponderance of the evidence.

The role of the criminal defense attorney is not to prove his client's innocence; it is to "create reasonable doubt" so that his client is acquitted. A victory for the defense is a "not guilty" verdict or a hung jury. The defense can present its case by poking holes in the prosecutor's case and providing testimony that shows that the evidence does not support the prosecutor's theory, trying to create a reasonable doubt in the jurors' minds. Many financial crimes require evidence of intent or willfulness as an element of the crime. In such cases, the defense may put forward some "smoke screen" theories, trying to demonstrate a lack of intent that will persuade the jury to excuse their client's guilt. While ignorance of the law is not a defense, in a complex financial scheme it may provide for reasonable doubt. Further, there will be a mistrial unless the jury's verdict is unanimous, so it's only necessary to create reasonable doubt in one juror's mind.

Variety of Roles by Stages

A forensic accountant may be used in different phases of criminal litigation:

Pre-indictment. The attorney may hire a forensic accountant while the client is under criminal investigation but before an indictment. The accountant can conduct witness interviews, request records and perform financial analyses to help provide evidence to persuade the prosecutor that charges should not be brought. Depending upon the nature and complexity of the alleged crime, the level of the accountant's financial investigation

of the facts and evidence will vary. The accountant must identify the relevant documents and exculpatory evidence that will help establish why the prosecutor's case is weak and not viable.

Post-indictment. After the indictment has been filed, the accountant may work as a consultant or as an expert witness. The consultant works behind the scene with counsel to identify key documents and assist in developing the defense's theory. The consultant normally does not testify at trial. It is also possible that the accountant may first be hired as a consultant and then be designated to testify. When an accountant testifies at trial, his or her work is subject to discovery by the prosecution.

Post-conviction. The attorney may use an accountant to assist in the sentencing phase of the trial. Once the defendant is convicted, a sentencing date is set. In federal cases, the sentence is based on federal sentencing guidelines, which provide parameters and factors for the trier of fact to consider when handing down a sentence. They are discretionary, not mandatory, and are based upon a point system. First, the points for the base level of the offense are determined. There are many factors that determine the level of the offense, one of which is the amount of the loss or intended loss resulting from the crime.

A sentencing hearing offers the defense an opportunity to call witnesses who can highlight mitigating factors to be considered by the judge. The calculation determining loss is based on the actual loss or the intended loss, whichever is greater. Further, other relevant conduct by the defendant (other acts committed but not charged in the case) can be factored into the calculation. These calculations can be very intricate and are

often not black or white. Counsel will often use an accountant to help prepare evidence demonstrating why the loss or intended loss is less than the loss calculated by the government.

In addition to determining a sentence, the judge may also order the defendant to pay restitution. The restitution is a way of making the victims whole by seizing funds and ordering the defendant to make payments toward a restitution amount once completing his or her prison sentence. Again, the accountant can help analyze the transactions and present alternate theories and calculations for the judge to consider.

Funding Considerations

Mounting a proper defense can be very expensive. The government often has seemingly unlimited resources, including the input of many government agencies and may have spent years investigating its case and gathering evidence.

Defendants often do not have the financial resources to retain counsel and accounting experts to mount a proper defense. Sometimes funds have been seized or frozen pending case resolution. If the defendant cannot afford counsel, an attorney is provided by the court under the Criminal Justice Act. The lawyer may come from the public defender's offices or from an "indigent panel" made up of lawyers in private practice who work on a reduced hourly basis and are paid by the government agency. If the appointed counsel determines the need for an accounting expert, he or she must file a motion with the court seeking approval to retain the expert and receive the necessary funding.

Financial crimes often arise from acts committed by executives of companies who are covered under directors and officers insurance policies and/or errors and omissions insurance policies. While there is usually an exclusion for coverage under the policy for criminal

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acts, before the indictment a civil action may be pending or threatened, making it possible for counsel to be retained along with experts funded by the insurance company. The objectives in the civil and criminal cases often overlap, and the work product is designed to be used in both proceedings.

Information-Gathering Tools

In investigating and preparing its case, the government often seizes financial records from the defendant. This makes the defense's job more challenging, but the government must provide access to the documents. That access most likely will be supervised by a government agent and the defense can identify records it wants to copy. Since access will be limited, it is important for the defense to ask for copies of all the records that might be needed.

Subpoenas are also used in criminal cases to gather information and provide evidence for the defense. They are

issued either to compel a witness to testify at a judicial proceeding or to produce documents and other financial records in their custody or control.

Throughout the government's investigation, witnesses are interviewed and memorandums of interview are prepared for each interview. Key witnesses are often interviewed multiple times, sometimes making inconsistent statements. These interviews or witness statements provide invaluable information on the testimony and evidence the defense will face at trial and are also used to impeach the testimony of a government witness.

Sometimes a related civil matter that may have been adjudicated or is still pending can offer a plethora of discovery, including documents produced in the civil matter, deposition testimony, witness interviews and trial testimony.

Public databases and Internet searches—some of them free--can also be effective information-gathering tools. While the government always has an edge in accessing information, more and more is becoming available instantly online.

A Role for Forensic Accountants

On both the prosecution or defense teams, there is an important role for forensic accountants within the world of white collar criminal litigation.

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Case Law Corner

This special section focuses on several important cases and how they relate to issues that practitioners are likely to encounter. This will be a new recurring section that you can look forward to every issue.

Fixed or Variable, That is the Question

By Adam J. Lang, CPA, CFF, CFE and Melissa Levitt, Esq.

When calculating lost profits, the damages expert establishes an amount of lost revenues and then determines the costs that should be deducted from them. While courts in most jurisdictions agree that variable costs should be deducted, the treatment of fixed costs can differ dramatically, which can have a significant impact on the calculation of lost profits.

In general, fixed costs do not fluctuate based on the volume of sales. On the other hand, variable costs vary directly

with sales (either volume or price). Unless a loss period is very short, it is unlikely that all costs will be purely fixed or variable. For instance, rent is generally thought to be a fixed cost. However, a damages expert needs to consider the circumstances of the particular business being evaluated to determine if a so-called fixed cost, such as rent, may change depending on the length of the loss period or the amount of production and/or sales.¹ For example, assume an accounting firm obtains a large new engagement that warrants hiring multiple new staff members and adding office space. If there is a consequent rent increase, rent

expense becomes semi-fixed (and no longer purely fixed).

Case law regarding whether fixed and variable costs should be deemed avoided costs when computing lost profits varies by jurisdiction. This article discusses the related case law in two states—Florida, where courts have deducted fixed overhead expenses from revenues when calculating lost profits, and Louisiana, where courts have only deducted variable expenses when calculating lost profits. Because of the differences by state, damages experts should consult with counsel on each engagement to understand the relevant case law.

¹ AICPA Forensic and Valuation Services Practice Aid 06-4, *Calculating Lost Profits*, at 29.

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Case Law in Florida: Which Overhead Costs to Deduct?

In *RKR Motors, Inc. v. Associated Uniform Rental & Linen Supply, Inc.*,² Florida's Third District Court of Appeals addressed fixed versus variable costs in the calculation of lost profit damages. RKR and Associated entered into three five-year contracts in which Associated was to rent and launder uniforms for RKR employees. RKR terminated the contracts before expiration. The parties stipulated that RKR breached the contracts, so the court only had to decide the amount of lost profits RKR owed Associated as a result of the breach.

In reaching his lost profits opinion, Associated's expert first determined the amount of revenues remaining under the contract between the parties and adjusted those revenues by deducting costs incurred by Associated in performing the contract—such as sales tax, the cost of garments, the cost to launder the garments, fuel costs relating to delivering the garments, etc. These are typically what damages experts consider “variable costs” and therefore deduct from the lost revenues. Based on these deductions, the expert arrived at his lost profits figure of \$82,444 for the three years remaining under contract. Associated's expert claimed that since the contract with RKR only represented approximately 1.5% of Associated's total income of \$4 million, certain fixed expenses remained the same both before the contracts were entered into and after they were terminated. Associated argued that expenses for officer's salaries, office rent and certain employee salaries were so-called fixed costs that remained

the same after the termination of the contracts and thus did not have to be deducted in computing lost profits.

RKR's expert arrived at approximately the same value for lost revenues, but calculated lost profits differently. In addition to the variable costs to service the contracts, he deducted a percentage of the administrative expenses, the general expenses of the company as a whole, and the expenses for selling and delivering the laundered items. In other words, while Associated's expert only subtracted the expenses that he determined would be avoided as a result of not having to fulfill the contracts, RKR's expert subtracted a portion of all of Associated's expenses based on the opinion that all expenses were involved in rendering services to RKR. RKR's expert estimated lost profits to be \$10,437.

The trial court agreed with Associated's expert and entered final judgment for Associated in the amount of \$82,444. The parties appealed, and the Third District Court of Appeals affirmed the trial court's judgment.³ However, Judge Rothenberg authored a dissenting opinion disagreeing with the majority's interpretation and application of Florida law regarding the calculation of lost profits.⁴ Ultimately, over two years later, the appellate court granted a motion for rehearing, withdrew its former opinion and substituted a new opinion—in essence, Judge Rothenberg's dissent.⁵

The *RKR Motors* appellate court determined that, in calculating lost profits, the trial court should have subtracted the portion of Associated's

fixed expenses related to performing the contracts. The court held that the “correct method in determining lost profits is not to subtract only those expenses that would not be ‘saved’ or reduced by not performing the breached contract. . . . [but] to subtract all costs related to performing the contract.”⁶ Because Associated failed to identify any costs that were not required to perform the contract, the court in this case accepted an allocation of all variable and fixed costs to calculate avoided costs, and consequently, lost profits.

In ruling that certain overhead costs must be deducted in a lost profits calculation, the court in *RKR Motors* adopted the standard set forth by the Fourth District Court of Appeals in *Boca Developers, Inc. v. Fine Decorators, Inc.*⁷ In *Boca Developers*, the court required an allocation of fixed overhead costs to be deducted from the lost profits, reasoning there was no evidence offered to suggest that fixed costs were not involved in the performance of the contract in question.⁸ The court in *RKR Motors* explained that the *Boca Developers* methodology made sense, stating “[r]equiring a deduction of a share of fixed costs related to the performance of a contract allows for a true measurement of the amount the non-breaching party would have earned on the contract had there been no breach.”⁹ Not requiring such an allocation of fixed costs, the court reasoned, would lead to “absurd results.”¹⁰

While not all Florida courts may find *RKR Motors* to be binding authority, there have been subsequent Florida

2 995 So.2d 588 (Fla. 3rd DCA 2008).

3 *RKR Motors, Inc. v. Associated Uniform Rental & Linen Supply, Inc.*, Case No. 3D05-2130, at *7 (Fla. 3d DCA Oct. 25, 2006), *withdrawn and replaced by* 995 So.2d 588 (Fla. 3d DCA 2008).

4 *RKR Motors, Inc.*, Case No. 3D05-2130, at *12-26 (Rothenberg, J., dissenting).

5 *RKR Motors, Inc.*, 995 So.2d at 588.

6 *Id.* at 593, n.3.

7 862 So. 2d 803 (Fla. 4th DCA 2003).

8 Associated's argument in *RKR Motors* was the same argument rejected in *Boca Developers*—that fixed costs did not need to be deducted from a lost profits calculation because no additional costs were incurred by

performing the project in question (and hence, no savings occurred when the project was not performed, as there would be no reduction of fixed costs).

9 *RKR Motors, Inc.*, 995 So.2d at 593.

10 In explaining the potential for these “absurd results,” the court noted that Associated's average net profit had been 8% of its average total revenue and that RKR was a “typical” customer. However, if the allocated fixed costs were not deducted from the lost profits calculation, Associated would realize a 64% net profit margin on services not rendered and an 8% profit margin for services it actually performed. The court stated that this would provide Associated with a windfall of lost profits. *Id.*

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decisions that have followed the *RKR Motors* logic.¹¹

Case Law in Louisiana: Another Approach to Fixed Overhead Costs

The Supreme Court of Louisiana addressed the treatment of fixed and variable costs when calculating lost profits in *White v. Rimmer & Garrett, Inc.*¹² *White* entered into a subcontract with Rimmer & Garrett, Inc. (R&G) to provide excavation services and to deliver all of the dirt to a site. In turn, R&G had a contract with the Louisiana Department of Highways for the construction of a portion of a highway, which anticipated the hauling of approximately 1,738,540 cubic yards of dirt. After disagreements arose, *White* ceased work after having only hauled 985,650 cubic yards of dirt. *White* initiated an action for breach of contract against R&G, seeking specific performance, accounting and alternatively, damages.

The trial court found, and the appellate court affirmed, that R&G had breached the contract and awarded *White* damages. These courts applied the *RKR Motors* logic and assessed lost profits based on a proportionate share of the net income earned by *White*—a figure

that includes both fixed and variable expenses. The matter was subsequently appealed to the Louisiana Supreme Court. The court ruled that the appellate court correctly found that the “proper assessment of damages is the amount of the loss sustained and the profit of which *White* was deprived.”¹³ However, it held that the appellate court erred in assessing *White*’s lost profit on the proportionate basis of his net income experience on the job, since that included expenses that were not variable based on the amount of dirt *White* actually hauled. The court stated that “the proper deductions only include those expenses, such as fuel, oil, truckers’ salaries, etc., which would have been incurred had *White* completed the job.”¹⁴

White therefore stands for the proposition that when calculating lost profits, there should be no deduction of fixed overhead costs. Subsequent Louisiana cases have followed this holding.¹⁵

Knowledge of Prevailing Case Law Is Key

Most courts and damages experts agree that true variable costs should be deducted when calculating lost

profits. However, the handling of fixed overhead expenses is not as clear. As we’ve seen, some Florida courts have taken the view that apportioned overhead expenses must be deducted from a lost profits award, whereas Louisiana courts have found that fixed costs should not be deducted from an award. While not addressed in this article, other courts have found that general fixed expenses, such as overhead, should not be deducted unless they are directly attributable to the lost transaction and would have been saved by not performing the contract.

Although this article only addresses cases in two states, it demonstrates for damages experts the importance of consulting with counsel to understand relevant case law. The method of assessing fixed costs can have a large impact on the calculation of damages.

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A Look into Business Interruption Case Law Stemming from Hurricane Katrina

By Anna Breaux, CPA, JD, LLM, and Travis P. Armstrong, CPA/CFF, CGMA, CFE

As litigation claims related to Hurricane Sandy losses on the East Coast mount, it may be relevant to consider issues

encountered in three cases from Mississippi and Louisiana regarding business interruption loss calculations as a result of Hurricane Katrina nine years ago. The first two cases highlight the proper determination of the period of restoration for business interruption

losses. The final case relates to the consideration of general and specific economic conditions following the natural disaster and how they affect the determination of losses.

11 See, e.g., *Del Monte Fresh Product Co. v. Net Results, Inc.*, 77 So. 3d 667, 674 (Fla. 3d DCA 2011) (stating that a deduction from anticipated contract revenue typically includes an appropriate allocation of overhead expenses that would have been incurred); *James Crystal Licenses, LLC v. Infinity Radio Inc.*, 43 So. 3d 68, 75 (Fla. 4th DCA 2010) (requiring plaintiff to account for certain overhead expenses).

12 340 So. 2d 283 (La. 1976).

13 *Id.* at 286.

14 *Id.*

15 See, e.g., *Breechen v. The News Group, L.P.*, 105 So. 3d 1011, 1030 (La. Ct. App. 2012) (“The jurisprudence is clear that fixed costs are not to be deducted from gross revenues in determining an award for lost profits.”); *Raphael v. Raphael*, 929 So. 2d 825 (La. Ct. App. 2006) (same); *Morton M. Goldberg Auction Galleries, Inc. v. Canco, Inc.*, 650 So. 2d 801, 805 (La. Ct. App. 1995) (holding that when a business is on-going, fixed costs should not be deducted).

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The Period of Restoration

In the case of *Meadowcrest Living Center, LLC v. Hanover Ins. Co.*¹⁶, the plaintiff sued its insurer for damages related to the physical damage caused by Hurricane Katrina, the resulting business interruption and extra expense loss, and for bad faith breach of contract. The dispute between the parties over the appropriate length of the period of restoration is of particular interest to experts assessing damages in this context.

In moving for partial summary judgment, Meadowcrest claimed that the period of restoration did not end until June 15, 2006, the day repairs were completed and the Department of Health and Hospitals (DHH) approved the facility for re-occupation. Hanover argued that, based on language in the policy, the period of restoration ended on March 1, 2006, or the “date when the property at the described premises **should be repaired, rebuilt or replaced with reasonable speed** and similar quality.” (Emphasis added)

To substantiate its position, Hanover submitted the testimony of a construction expert, who opined that if work had started in a timely manner and progressed uninterrupted, the repairs should have been completed by January 1, 2006 (four months after Hurricane Katrina). In support of its position, Meadowcrest relied on the fact that DDH did not approve the location for re-occupancy until June 15, 2006. Meadowcrest also proffered its contractor’s testimony that although the repairs at issue could have been made in four months under normal conditions, labor and material shortages after Hurricane Katrina caused delays.

Ultimately, the Eastern District of Louisiana found there were issues

of material fact regarding when the property should have been repaired with reasonable speed, and thus denied Meadowcrest’s motion for partial summary judgment with regards to the period of restoration end date.¹⁷ Although it appears this case settled before trial, it serves as a reminder to damages experts assessing business interruption losses to consider the impact of the post-disaster environment (e.g., labor or material shortages, extraordinary price increases or decreases, etc.) on not only the loss analysis but also the period of restoration.

Another interesting case related to the determination of the period of loss is *Pontchartrain Gardens, Inc. v. State Farm Gen. Ins. Co.*¹⁸. The same judge as in the *Meadowcrest* matter was faced with another motion for partial summary judgment related to the length of the period of restoration concerning a loss of business claim from Hurricane Katrina. In this case, the insurer determined the period of restoration for each apartment in the claim based on the damages to each unit. Therefore, the period of restoration varied from apartment to apartment, even though the claim for loss of income was submitted for the entire complex. The Court found this calculation was not appropriate. The insured’s claim was based on State Farm’s failure to properly consider the damage and completion of repairs to the apartment complex’s common areas (e.g., complex office, gym, lobby and kitchen.) According to this ruling, it would be prudent for damages experts to consider how the unfinished repairs to common areas, connected properties, or other related property impact the insured’s ability to restore operations. For example, in its ruling the Court stated, “One could infer that without functioning offices and other amenities, the apartment

complex may have been unable to reopen and begin incurring income, even if certain apartments were fully repaired and inhabitable.”¹⁹

Economic Conditions after a Disaster

*Catlin Syndicate Ltd. v. Imperial Palace of Mississippi*²⁰, involved the business interruption provision of the insurance policy that Catlin issued to Imperial Palace. Imperial Palace ran a casino on the Mississippi Gulf Coast that sustained damages as a result of Hurricane Katrina.

Catlin argued that only historical (pre-hurricane) sales figures should be considered when determining the loss, while Imperial Palace claimed that the policy language could allow sales figures after re-opening to be taken into account. Imperial Palace wanted its earnings after the interruption to be considered because the casino was one of the first in the area to re-open after Hurricane Katrina, giving it few competitors and revenues that far exceeded its pre-hurricane proceeds.

Catlin argued that the business interruption loss calculation should be based on net profits Imperial Palace would have earned if the hurricane did not strike the Mississippi Gulf Coast and cause the related damage. Imperial Palace argued that the proper hypothetical for the measure of damages was one in which the hurricane struck and damaged other casinos but not Imperial Palace’s facilities. As a result, Imperial Palace based its damages in part on the revenues earned after re-opening.

To resolve these differences, the Fifth Circuit Court of Appeals looked to the 2005 Fifth Circuit decision in *Finger Furniture Co. v. Commonwealth Insurance Co.*,²¹ and decided against the

16 2008 WL 2959707, (ED La. July 2008)

17 This ruling is in contrast to a subsequent ruling by a Louisiana Court of Appeal in *Urology Clinic of New Orleans Inc APMP v. United Fire and Casualty Co.* The appeal court upheld a jury’s verdict that a similarly situated plaintiff’s period of restoration did not end until the fire alarm system was repaired and the fire marshal certified the clinic to re-open.

18 2009 W.L. 86671 (E.D. La. 2009)

19 *Pontchartrain Gardens, Inc. v. State Farm Gen. Ins. Co.*, 2009 W.L. 86671 (2009), §II.E.

20 600 F.3d 511 (5th Cir. 2010), United States Court of Appeals, Fifth Circuit, 2010

21 404 F.3d. 312 (5th Cir. 2005)

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Imperial Palace. As stated in the *Catlin* ruling, “[The Fifth Circuit] explained that the proper method for determining loss under the business-interruption provision was to look at sales before the interruption rather than sales after the interruption.”²² There are also scenarios in which it may be appropriate for the damages expert to consider sales levels of peer companies during the damage period. In this way, the damages expert may develop a better understanding of what might have happened to the subject entity during the damage period itself.

Anything But Straightforward

As can be seen by a review of the cases discussed above, the calculation of business interruption losses can be anything but straightforward, especially when related to claims following a natural disaster like Hurricane Katrina. Professionals involved in such calculations should be aware that both the amount of the lost sales to be used and the time period of the interruption can be subject to litigation.

The authors would like to thank Susan G. Keller-Garcia, J.D., Senior Associate

from Fowler Rodriguez out of New Orleans for her contributions to this article.

Anna Breaux, CPA, JD, LL.M., is Professor of Accounting at Strayer University. Travis P. Armstrong, CPA/CFF, CGMA, CFE, is a Manager at Hemming Morse LLP. Anna and Travis will participate in a panel discussing case law relevant to economic damages issues at the upcoming AICPA FVS Conference in New Orleans on November 9-11, 2014. Visit cpa2biz.com/fvc for more information

Court Spotlights Lack of Control in Oil and Gas Interest Valuation

By Sylvia Golden, JD, Legal Editor,
Business Valuation Update

Taubman v. U.S. Bank, N.A., 2014 Cal. App. Unpub. LEXIS 4303 (June 17, 2014)

A nasty battle over a trust’s oil and gas assets offers guidance into one court’s thinking about how to establish fair market value when indirect and fractional ownership and lack of marketability issues are present.

In 1990, the decedent established a trust naming herself as the sole trustee and her two children as beneficiaries. The assets included business interests in a shopping center and in oil and gas leases. In essence, the daughter was to receive the shopping center trust assets and the son the oil and gas trust interests, with an “equalization payment” at the time of distribution.

The mother died in 1999, and litigation developed between the siblings, and between the joint siblings and the trustee. In January 2011, the trial court issued a judgment, finding it had to modify the trust to effect the decedent’s intent because the brother had been

“overpaid” during the life of the trust by some \$6 million. The court determined that the daughter had an equitable lien on the brother’s pro rata interest in the assets; the brother, on the other hand, would receive credit against the debt in the amount of one-half of the current fair market value of the oil and gas interests. As a result, the trustee was to make an in-kind distribution of all assets to the daughter, except for the shopping center assets, which were to be divided evenly between the siblings. The court would terminate the trust and discharge the trustee after a final accounting.

Given the court’s findings, the brother would benefit from a higher valuation and the sister from a lower valuation of the oil and gas interests. In March 2011, the daughter asked the court to instruct the trustee on how to value the interests. She argued that since there was no identifiable market for buying the fractional interests, the court should use the value the estate had stated in its 2000 federal and state tax returns. The amount was approximately \$1,248,000 and was based on an appraisal the

estate had obtained from a petroleum engineering company in 1999.

In a subsequent filing in May 2011, the daughter urged the court to value the interests at twice the amount of the gross annual royalties generated by the oil and gas interests in the past 12 months. Since the royalties amounted to “approximately \$630,000,” the interests’ fair market value was \$1.26 million, she claimed.

Futures market vs. spot prices. In June 2011, the trustee said he had retained an expert, a “registered professional petroleum engineer,” in the belief that “a more informal method, such as an informal survey of the industry’s use of multiples of ‘trailing cash flow’ will not provide the certainty” necessary to “satisfy the adverse interests of the beneficiaries.” An informal survey would not end the controversies “which have plagued this Trust for the last 11 years.” The seven-page appraisal valued the interests at over \$4.4 million and included 250 pages of charts, schedules and other supporting documentation. The appraiser used 36-month strips of futures contracts quoted on the New

22 *Catlin Syndicate v. Imperial Palace of Mississippi*, 600 F.3d 511 (5th Cir. 2010), §III.

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York Mercantile Exchange (NYMEX strips) and a 10% discount rate to account for inflation. He also assumed a 50-year timeline for future oil production from the properties.

The daughter did not hire her own expert, but, in a preliminary response to the trustee's position, she contended that the appraiser used a flawed methodology. His valuation was based on a speculative futures market, and it failed to consider a temporary spike in oil prices in June 2011 owing to the political unrest in Libya and other oil-producing countries in the Middle East. She claimed the valuation date was January 2011, the date of the final judgment, rather than June 2001, and she contended that the interests should be valued at twice their annual earnings. In the alternative, if a multiple of gross annual earnings was not an appropriate basis, the court should use an average of the historic closing prices for oil and gas interests over the life of the trust. This method yielded a value of \$2.32 million.

Meanwhile, the son maintained the assets were worth \$10 million but did not formally object to the trustee's fair market valuation.

At an evidentiary hearing, the appraisal firm's representative said he had "conducted more than 1,000 valuations of similar properties." He explained

that he relied on futures contracts because they were "the closest publicly-traded reference point" for oil and gas reserves to be produced in the future and were widely used in the industry for valuation purposes. When cross-examined by the daughter's counsel, he admitted that the 50-year life of production he estimated was unsupported. The daughter also pointed out that he failed to include a discount to account for the fractional and indirect nature of ownership in the properties and its effect on their marketability.

The court agreed that the appraisal failed to discount for "the fact that ownership of that oil and gas is indirect. It is not ownership of the oil and gas, but ownership in [the family trust] or [the oil company]." Subsequently, the court put it to the trustee that the "problem is there is no control" over the oil company or the trust's interest in the oil and gas leases. The court suggested that the Internal Revenue Service "routinely discounts for lack of control" and asked the trustee about his familiarity with the IRS approach. The trustee replied that to his knowledge for estate tax purposes the fair market value was "usually reduced by 20 to 35 percent to reflect the indirect nature of the ownership interests," but he was unable to cite the applicable code section.

The trial court, sustaining the sister's objections, reduced the fair market value to \$3.9 million, which was a 12.5% reduction of the appraiser's value.

Improper deviation from expert valuation. The brother attacked the valuation in his appeal, arguing the trial court lacked the evidence necessary to justify the additional discount or to deviate from the appraiser's value in other ways. After all, there was only one valuation expert.

The state Court of Appeals disagreed. It noted that the trial court was not required to accept the testimony of the sole expert witness. The trial court had the authority to rely on all, part, or none of the testimony given by the trustee's expert. More important, there was evidence in the record contesting the expert's valuation. For one, the sister offered the early appraisal and estate tax returns reflecting the \$1.2 million valuation from 1999, which was based on multiples of cash flow. She also submitted written objections to the expert's methodology and challenged numerous aspects of his calculation during cross-examination. The trial court sustained the objections, even if it did not specify which of the various objections it considered significant for its calculation. The appeals court concluded that the trial court's valuation was within the range of values in evidence and affirmed the valuation.

The First Voice Your Client Hears

By Preston Willcox, CPA, CGMA

Have you ever called your own office? What is the first voice you hear? Unless you have a fully automated system, it is likely a member of the administrative team, not you or your CPA staff. With first impressions being everything, the person answering the phone sets the tone for how the next conversation will go. What are your potential clients

thinking about you and your firm from this first interaction?

The administrator is often the first line of communication at your firm, playing a frequently overlooked and undervalued role. When a client needs immediate help or has an issue with billing, the first stop is also usually a member of the administrative team. Their response can put the client at ease and assist

with solving the problem or escalate the issue and cause additional stress that may prompt your client to leave the firm. This article offers tips and tricks to interviewing and selecting a member of the administrative team.

Set the Right Level

With all hires, it's essential to understand the role the person will play and the

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skill set needed to perform their duties. Bad planning and preparation can fill firms with people who are likeable but who don't have the right professional skills. In an engagement, you would plan every aspect and document every step that will lead to a successful job, and hiring should be approached in the same way. Even before posting the job with recruiters and open source channels, map out what the position will entail and write requirements that will identify and attract the right candidates. In online recruiting, the keywords and requirements posted can result in zero responses or 20,000 applications without one exemplary candidate.

Level setting is an important consideration. If you require a BA in business to answer your phone and take messages, the likelihood of hiring and retaining someone is quite low. On the other hand, if you are vague in your requirements or simply ask for someone with experience in a formal business setting, you may attract a lot of great people who aren't the ones you need. Think about what your new hire will do all day, what skills you want them to contribute to the firm and the minimum and maximum level of experience and try to articulate your requirements in your ad. The more specific and clear your description, the better the applications you receive will be.

Understanding Interview Questions

Once you have the right candidates, the next step is to make the most of the interview. You can rely on many of the skills FVS practitioners already possess and use in their engagements—such as interviewing and analysis. These skills can be used in any interview but are especially important when there is not a technical skill involved, such as when hiring a new accountant for the practice. The AICPA Private Company Practice Section provides some basic principles and selection concepts in its resource [Interviewing and Selection](#). Some of the highlights are included below.

The interview should focus on the key areas and tasks of the job, using questions about prior employment and interesting aspects of their résumé to judge their suitability. Take thorough notes. Listen carefully, too, because interviewees will often give the answer they think you want to hear, so it's important to read between the lines. Useful questioning techniques include:

The unstructured question. Candidates are more likely to go into detail if a simple yes or no won't suffice. Unstructured questions help the interviewer find out and understand the candidate's views. Questions beginning with who, what, when, where, why, and how will elicit unstructured answers, as well as ones that encourage the candidate to talk about him- or herself. Examples:

- Tell me about . . .
- Would you tell me about . . .
- I'd be interested in knowing . . .
- How did you feel about . . .
- Would you explain . . .
- I'm not certain I understand . . .
- Would you explain in more detail?
- What do you mean by that?
- Tell me more about . . .
- Perhaps you could clarify . . .
- What was there about . . . that appealed to you?

Structured questions. These place the candidate in a position to answer either "yes" or "no." The answer need not be elaborated on. For example: Q. Did you like your last job? A. Yes.

Unstructured question combined with structured question. A structured question followed by an unstructured question can help clarify the candidate's feelings, pinpoint a fact or obtain additional information. For example: Q.

Did you like your last job? A. Yes.
Q. What in particular did you like?
A. Well, . . .

The use of silence. A brief pause between questions allows the candidate time to elaborate on an answer if he or she desires.

Reflective feelings. The interviewer paraphrases the candidate's statement as to content and feelings. Phrases beginning with "it seems that . . ." or "it sounds like . . ." reflect feelings.

Active listening. The interviewer repeats or restates what the candidate has said, usually in the form of a question. The candidate is then aware of the interviewer's interest. For example: Q. What did you think of your previous supervisor? A. He was all right, but a bit overbearing. Q. Overbearing? Would you explain? A. Well, he . . .

Assertions of understanding. Neutral phrases that encourage the candidate to elaborate on his or her answer. These phrases include: "I understand," "Uh-huh," "Yes, I see," and the like.

During the interview, always remember to respect the issues around potential discriminatory personal information and avoid questions about it, no matter how innocent their intent. As a reminder, examples of protected personal information include:

- Date of birth.
- Marital status.
- Spouse's occupation.
- Child care arrangements.
- Ancestry.
- National origin/race.
- Affiliations with a union.

While many of these seem obvious, it is always a good idea before interviewing to review the types of information considered discriminatory.

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A Pivotal Role

Once you're done, compare and review notes on the candidates with all the people who interviewed them. While soft skills such as communication are incredibly important for these roles, think beyond personal appeal and consider the person best suited for the multifaceted role of an administrative

person in an FVS practice. Although their work, and the interview process, may not relate directly to forensic or valuation engagements, these team members will be the first to greet clients and the ones they rely on for help in various areas. It's important to find the right people for this pivotal role in your practice.

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Coming Events for FVS Professionals

Learn more about FVS Section events and learning opportunities on the FVS at the section site at www.aicpa.org/fvs. Go to www.cpa2biz.com to register for events.

AICPA Forensic & Valuation Services Conference	November 9-11	New Orleans	FVS Section members and ABV/CFF credential holders receive a \$100 discount on registration at this must-attend event. An online option makes it possible to attend from the comfort of your home or office. CPE: 20 credits.
Live Courses			
AICPA CFF & ABV Exam Review Course	November 7-8	CFF Live in New Orleans	FVS Section members enjoy a \$100 discount on registration. Participants receive a comprehensive overview of forensic accounting or business valuation information, positioning them to take and pass the CFF or ABV exam.
	November 7-8	ABV Live in New Orleans	

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