

2023

ESOP VIRTUAL CONFERENCE

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ESOP Litigation: Is the Tide Turning?

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Introduction

- ESOP valuation controversies can and do arise.
- Trustees, other fiduciaries, board members, and management are required to demonstrate that they relied on a credible valuation in good faith.
- Controversies can often be mitigated by recognizing best practices such as ensuring ESOP valuations:
 - Comply with standards.
 - Follow generally accepted business valuation theory and principles.
 - Are appropriately documented.
 - Manage conflicts of interest.

A Lookback on the Last 2 Decades

- How has the litigation landscape changed over the last 20 years.
- Who are plaintiffs in ESOP cases? DOL or Plaintiff's Bar, and sometimes both.
- Fiduciary process agreements with DOL since first in 2014.
- Most cases – ~98% - settle before trial or any merits decision.
- Rare trial victories (*Walsh v. Bowers, Fish, et al. v. GreatBanc Trust Co., et al.*).

Common Critiques in Business Valuations

- Failure to use the appropriate standard of value.
- Failure to conclude as to the appropriate level of value.
- Internal inconsistencies.
- Language or analysis that reveals a bias or lack of objectivity.
- Extensive and irrelevant boilerplate.
- Undefined jargon.
- Inadequate guideline company market data and analysis.
- Leaps of faith.
- Computational errors.
- Emphasis of items not in proportion to their relative importance.
- Inadequate detail regarding relevance of research and analysis to the subject company.

The Role of Valuation Standards

- In addition to providing a credible opinion of value, a valuator should also show and explain that opinion.
- They should also provide a narrative report that:
 - Complies with valuation standards.
 - KNOWN OR KNOWABLE CONCEPT
 - Follows a comprehensive and reasoned approach.
 - Will withstand regulatory and judicial scrutiny.
- The purpose of valuation standards is to promote and maintain a high level of public trust in the valuation practice.
- Best-known are those issued by The Appraisal Foundation (TAF), the American Society of Appraisers (ASA), and the American Institute of Certified Public Accountants (AICPA).

Vetting the Forecast

- Consider purpose of the forecast.
- Historical comparison Actual v. Budget.
- Sophistication of internal personnel.
- Level of detail.
- Level of support.

Common Allegations in Lawsuit Complaints

- Transaction process and due diligence was rushed.
- Negotiations were not arms length.
- Appraiser engaged by company before Trustee/prior relationships.
- Forecast was overly optimistic, not properly vetted.
- Failure to test value in market.
- DLOM/control premium.

Common Areas of ESOP Valuation Controversy

- Governance
 - Who's really in control here?
- Diligence
 - How much is enough?
- Forecasts
 - What will the future hold?
- Seller Financing
 - How do warrants affect value?
- Standard of Value
 - Must the ESOP pay the lowest price possible?

The Litigation Process

- DOL Investigation to DOL complaint or private plaintiff class action complaint (plaintiff's bar).
- Discovery and Depositions.
 - Valuation expert collaboration is critical here
- Expert Reports – Affirmative, Rebuttal.
- ~98% of cases settle after expert reports and before trial.
- Trial Preparation –. work, work, work (i.e., expensive)
 - Expert Trial Declaration v. Direct Testimony.
- Trial – Lots of risk but when prepared for & done right, lots of reward.



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ESOP Organization Support

- Amicus Briefs - American Society of Appraisers.
- TEA Recent Legislative Push for “Actual” Regulations.
- Regional/National Conferences.



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Q&A

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Kenneth J. Pia, Jr. is a partner and the leader of the National Matrimonial and Business Valuation groups. With more than 30 years of professional business valuation and litigation support experience, Mr. Pia has developed a national reputation working on a wide range of complex valuation engagements. He has performed valuations of businesses and partial business interests for a variety of purposes including, but not limited to, family law matters, employee stock ownership plans, business damages, buy-sell agreements, shareholder litigation, estate and gift tax matters, and buying and selling businesses.

Mr. Pia is heavily involved with the American Society of Appraisers (ASA). He is the immediate past-chairperson of the ASA's Business Valuation Committee, is a member of the National Business Valuation Education Committee, and teaches nationally for the ASA's accreditation program. Mr. Pia is also a Co-Chair of the American Academy of Matrimonial Lawyers Foundation's Forensic & Business Valuation Division and has been named to the American Academy for Certified Financial Litigators Advisory Board for New York and Connecticut.

Mr. Pia is a frequent speaker on business valuation topics on the national and local levels for numerous professional organizations, including the American Bar Association, American Institute of Certified Public Accountants, American Academy of Matrimonial Lawyers, and National Center for Employee Ownership. In addition to teaching for the ASA's accreditation program, he previously instructed for the American Institute of Certified Public Accountants' Certificate of Educational Achievement (CEA) program in business valuation. He is also an Adjunct Professor at Quinnipiac University. Mr. Pia has technically reviewed publications on divorce finance and taxation for the American Bar Association, as well as several books on business valuation. In 2007, he was appointed as one of two appraisers to the State of Connecticut's Eminent Domain Task Force, established to determine the methodologies to be used in the calculating lost intangible economic value of businesses due to the state exercising domain rights.

Mr. Pia has been qualified as an expert witness in Federal District Court and the State Courts of Connecticut, Commonwealth of Massachusetts, New York, Virginia, and California, as well as various arbitration proceedings. He has also rendered extensive services relating to court testimony. Mr. Pia is on the State of New York Courts' list to receive court appointments in the following counties: New York, Kings, Richmond, Queens, Nassau, Suffolk, and Westchester. He has received court appointments in New York and Connecticut.

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- Lead trial counsel in *Fish v. GreatBanc Trust Co., et al.* resulting in defense judgment for ESOP fiduciaries after 4 month trial
- Former head of KMK Litigation Group, Chair of KMK Diversity Committee and Adjunct Professor of Law, Trial Practice, University of Cincinnati College of Law
- Author, Arbitration Clause Lessons, ESOP Report; White Paper, Case Guide for ESOP Company Board and ESOP Fiduciaries
- Grateful Dead fanatic and historian

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THANK YOU!