IN THE SUPREME COURT OF IOWA

NO. 19-2151

SUSAN A. GUGE and PEGGY MCDONALD,

Plaintiffs/Appellees/Cross-Appellants

vs.

KASSEL ENTERPRISES, INC.; CRAIG KASSEL; and DEBORAH KASSEL,

Defendants/Appellants/Cross-Appellees.

APPEAL FROM THE DISTRICT COURT OF PALO ALTO COUNTY
THE HONORABLE CHARLES BORTH

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ROUTING STATEMENT

The Iowa Supreme Court should retain this case because it presents substantial issues of first impression (Iowa R. App. P. 6.1101(2)(c)) and substantial questions of enunciating or changing legal principles (Iowa R. App. P. 6.1101(2)(f)) related to statutory dissolution of family farm corporations under Iowa Code Section 490.1430 and would distinguish the *Baur v. Baur Farms, Inc.* progeny for "C corporations" from "S corporations." Specifically, this case will present application of the *Baur* decision to Iowa family farm corporations that have elected subchapter S (partnership) tax treatment with the Internal Revenue Service.

STATEMENT OF THE CASE

A. Nature of the Case

This case arises from minority shareholders' request for dissolution of an Iowa farming corporation under Code Section 490.1430(1)(b)(4) based on the majority shareholder's misapplication and waste of corporate assets.

Kassel Enterprises, Inc., is an Iowa corporation with a subchapter S election for tax purposes ("KE"), which allows it to be taxed as a pass-through (partnership) entity. KE is owned by siblings Plaintiff Peggy McDonald (23.75%) ("Peggy"), Plaintiff Susan Guge (23.75%) ("Susan"), and Defendant Craig Kassel (52.5%) ("Craig"). Plaintiffs sought judicial dissolution of KE because of Craig's misapplication of assets, including his self-dealing in failing to pay market rent, in distributing company farmland to himself to the detriment of KE, and in leveraging corporate assets to obtain loans to fund his separate farming operations. Based on Craig's waste and misapplication of KE assets, the District Court held Plaintiffs' petition was supported by probable grounds.

In order to avoid the possibility of corporate dissolution, Craig caused KE to elect to redeem Plaintiffs' interest in KE. In setting the fair value of Plaintiffs' shares, KE seeks to apply a liquidation tax discount to the purchase price. This demand for a discount is based exclusively on the decision of *Baur v. Baur Farms, Inc.* However, because KE is a "S corporation" that is only taxed once at the shareholder level, the District Court correctly determined a discount for "built-in gain" under *Baur* is inapplicable to S corporations. Given the fundamental tax differences between S corporations and C corporations, the District Court's decision must be affirmed on this point. The District Court likewise rejected a discount for unsupported transactional costs related to a hypothetical sale that Craig plainly admits will not occur.

Given its finding that Craig wasted and misapplied corporate assets, the District Court exercised its discretion and awarded certain attorneys' fees and costs. That award was expressly authorized by Section 490.1434(5) and was carefully determined by the District Court.

Incongruently, however, the District Court improperly refused to include in the "fair value" of KE the value of claims it would have against Craig for waste and misapplication of corporate assets. This failure is particularly salient given the dismissal of Plaintiffs' direct claims against Craig on the basis that such claims belonged solely to KE and that Plaintiffs' interest in such claims was only derivative. In essence, the District Court's decision rewards the wrong-doer, Craig, for the waste and misapplication and ultimately devaluing of corporate assets.

B. Relevant Events of the Prior Proceedings

On May 17, 2018, Plaintiffs filed their petition against Defendants Craig, Deborah Kassel ("Deborah"), KE, Great Oak Farms, and Kassel Farms. (App. v. I pp. 13-78). Defendants filed their answer on June 22, 2018, which included counterclaims by Craig and Deborah. (App. v. I pp. 79-91). Plaintiffs answered the counterclaims on July 5, 2018. (App. v. I pp. 92-97).

On October 10, 2019, an evidentiary hearing was held to determine the fair value of Plaintiffs' shares in KE. At that hearing, Plaintiffs sought to introduce evidence of Craig's waste and misapplication of KE's assets for two purposes: (1) for an increase in the fair value of KE for assets wasted or misapplied by Craig; and (2) to support an award of attorneys' fees under Iowa Code Section 490.1434(5). (App. v. V pp 12:8-16:21, 71:17-75:21; Hearing Tr. pp. 4:8-7:21; 63:17-67:21). Following the fair value hearing, Plaintiffs and Defendants both submitted post-hearing briefs and affidavits on the issues of fair value and requested attorneys' fees. (App. v. II pp. 159-270).

On November 5, 2019, the District Court entered its Order determining the fair value of Plaintiffs' interest in KE, outlining the sale terms, and awarding Plaintiffs attorneys' fees, to be established by a fee affidavit and awarded by separate order. (App. v. II pp. 271-283). Also, on November 5, 2019, the District Court entered its Order granting Plaintiffs' and Defendants' cross-motions for summary judgment, thereby disposing of all remaining claims. (App. v. II pp. 284-293).

On November 20, 2019, Defendants filed their Rule 1.904 Motion to amend or enlarge the District Court's November 5, 2019, Order determining fair value and awarding fees. (App. v. II pp. 356-367). On December 6, 2019, the District Court denied Defendants' Rule 1.904 motion. (App. v. II pp. 386-387). Also on December 6, 2019, the District Court entered its Ruling awarding Plaintiffs attorneys' fees. (App. v. II pp. 378-385).

C. Disposition of the Case in the District Court

In its November 5, 2019, Orders, the District Court determined the fair value of Plaintiffs' interest in KE and dismissed all remaining claims between Plaintiffs and Defendants. (App. v. II pp. 271-293). Further, on December 6, 2019, the District Court denied Defendant's Rule 1.904 motion requesting reconsideration of the November 5, 2019, Order. (App. v. II pp. 386-387). Finally, on December 6, 2019, the District Court entered its award for attorneys' fees and costs related to the dissolution claim (App. v. II pp. 378-385)

STATEMENT OF FACTS

KE is an Iowa corporation with its principal place of business in Emmetsburg, Palo Alto County, Iowa. (App. v. I, p. 13, ¶ 5; App. v. I p. 79, ¶ 5). KE is an "S corporation" for tax purposes and taxed as a partnership. (App. v. IV, pp. 102:14-103:10; Craig Kassel tr. pp. 94:14-95:10). Historically and at all relevant times, KE has owned approximately 660 acres of farmland in Palo Alto County, including approximately 572.84 acres owned outright and an undivided one-third (1/3) interest in approximately 270 acres (or about 89 acres). (App. v. I p. 16, ¶ 30; App. v. I p. 80, ¶ 30).

Originally, the principals of KE were Lawrence Kassel and Georgia Kassel. (App. v. I p. 15, ¶ 22; App. v. I p. 80, ¶ 22; App. v. IX pp. 125-158). On May 16, 2005, Lawrence Kassel passed away. (App. v. I p. 15, ¶ 23; App. v. I p. 80, ¶ 23). After 2005, ownership of KE was as follows: Georgia Kassel – 28.75%; Peggy – 23.75%; Susan – 23.75%; Craig – 23.75%. (App. v. I p. 15, ¶ 24; App. v. I p. 80, ¶ 24). Susan, Peggy, and Craig were each simultaneously gifted their 23.75% ownership interest in KE.[1] Craig, and Craig alone, was given the right to buy all of Georgia's interest in KE at a discounted valuation of $2,000 per acre. (App. v. V pp. 47:1-7, 48:11-24, Hearing tr. pp. 39:1-7, 40:11-24; App. v. IV pp. 16:20-21, 19:10-12, Craig Kassel tr. pp.8:20-21, 11:10-12). Georgia Kassel died on February 5, 2017. (App. v. I p. 16, ¶ 26; App. v. I p. 80, ¶ 26). At the time the Petition was filed, KE was owned as follows: Peggy – 23.75%; Susan – 23.75%; Craig – 52.50%. (App. v. I p. 16, ¶ 29; App. v. I p. 80, ¶ 29).

KE has routinely failed to follow any corporate formalities. Since at least 2005, Kassel Enterprises has never held a meeting of its shareholders or

[1] Craig argues Peggy and Susan were gifted their interest, apparently forgetting he too was gifted an identical interest. (Defendants' Proof Brief, p. 43).

directors.[2] (App. v. IV pp. 44:7-85:18, 224:1-5; Craig Kassel tr. pp. 36:7-77:18, 197:1-5). There are no corporate records evidencing any meeting notices, agendas, or minutes of any shareholder or director meeting for KE. (App. v. IV pp. 44:7-85:18; Craig Kassel tr. pp. 36:7-77:18). Craig has never shared the corporate records with Peggy or Susan, despite their entitlement to them under the Iowa Code (Sections 490.1601, 490.1602 (2017)), repeated requests for those records during discovery, and orders by the District Court to produce them. (App. v. I pp. 112-114). Despite an order compelling production of corporate records, the only corporate record shared by Defendants was hand-written notations by Deborah on the ownership of shares; although, Craig finally did bring the real corporate record book to the fair value hearing. (App. v. IX p. 88; App. v. V. pp. 47:8-48:5, Hearing tr. 39:8-40:5).

Although there was never a meeting of the shareholders or directors of KE, fictitious meeting minutes falsely state meetings were held with Plaintiffs in attendance. (App. v. IX, pp. 90-91; App. v. IV pp. 44:7-85:18, 224:1-5, Craig Kassel tr, pp. 36:7-77:18, 197:1-5). Because there was never

[2] In 2019, a shareholder meeting was held in Emmetsburg Iowa, attended by Plaintiffs, Plaintiffs' Counsel and Defendants' counsel. Defendants' counsel voted Craig's and Deborah Kassel's shares, despite the fact that Deborah Kassel did not own any shares in 2019. (App. v. IV p. 218:14-24, Craig Kassel tr. pp. 191:14-24).

any meeting of the shareholders or directors, there was also never any election of officers for KE. (App. v. IV pp. 44:7-85:18, 224:1-5, Craig Kassel tr. pp. 36:7-77:18,197:1-5).

Despite the failure to hold any shareholder or director meetings, from 2005 through 2018, KE's records filed with the Secretary of State show Craig was President of KE from 2006 until 2012[3], that his wife Deborah served as an officer of KE, and that Craig was the only Director, as follows:

- February 1, 2006, Deborah – although not a shareholder or officer of KE – filed a false Biennial Report for KE naming herself and Craig as the only officers and directors. (App v. VI p. 68). This Biennial Report also changed the Principal Office to Craig and Deborah's home address so that all filings related to KE came to them (including the forms to complete the Biennial Reports). (App v. VI p. 68).
- January 15, 2008, Craig signed and filed a Biennial Report again listing himself and Deborah as the only officers and directors, signing that report as "President." (App v. VI p. 69). This

[3] Craig testified he was only President in 2006 and then again in 2017, upon the death of Georgia Kassel. (App. v. V, pp. 54:4-55:2, Hearing tr. p. 46:4-47:2). These Secretary of State documents directly contradict his testimony.

Biennial Report continues to list Craig as the registered agent with his home serving as the principal address. (App v. VI p. 69).

- March 31, 2010, Craig signed and filed a Biennial Report again listing himself and Deborah as the only officers and directors, signing that report as "President." (App v. VI p. 70). This Biennial Report continues to list Craig as the registered agent with his home serving as the principal address. (App v. VI p. 70).
- March 26, 2012, a Biennial Report was filed for KE listing Georgia Kassel, Craig, and Deborah as the only officers and directors, and was purportedly signed by Georgia Kassel as President. (App v. VI pp. 71-72). The Biennial Report continues to list Craig as the registered agent with his home serving as the principal address. (App v. VI pp. 71-72). Although the 2012 Biennial Report was filed electronically on the Secretary of State website, Georgia Kassel did not own a computer and did not know how to operate a computer. (App. v. IV pp. 65:1-9, 274:16-17, Craig Kassel tr. pp. 57:1-9, 247:16-17).
- April 2, 2014, a Biennial Report was filed for KE listing Georgia Kassel, Craig, and Deborah as the only officers and directors, and was purportedly signed by Georgia Kassel as President. (App v.

VI pp. 73-74). The Biennial Report now listed Georgia Kassel as the registered agent but kept Craig's home as the principal address. (App v. VI pp. 73-74). Although the 2014 Biennial Report was filed electronically on the Secretary of State website, Georgia Kassel did not own a computer and did not know how to operate a computer. (App. v. IV pp. 65:1-9, 274:16-17, Craig Kassel tr. pp. 57:1-9, 247:16-17).

- March 25, 2016, a Biennial Report was filed for KE listing Georgia Kassel, Craig, and Deborah as the only officers and directors, and was signed by Deborah as Secretary. (App v. VI pp.75-76). The Biennial Report continues to list Georgia Kassel as the registered agent but kept Craig's home as the principal address. (App v. VI pp. 75-76).
- February 18, 2018, a Biennial Report was filed for KE listing Craig and Deborah as the only officers and directors, and was signed by Craig as President. (App v. VI pp. 77-78). The Biennial Report continues to list Georgia Kassel as the registered agent (even though she was deceased) but kept Craig's home as the principal address. (App v. VI pp. 77-78).

In spite of these filings, there was never any election to name Deborah as an officer of KE. (App. v. IV pp. 55:5-14, 56:7-57:3, 78:8-80:1, Craig Kassel tr. pp. 47:5-14, 48:7 – 49:3, 70:8-72:1). In fact, KE never had shareholder meetings electing the officers. (App. v. IV pp. 44:7-85:18, 224:1-5, Craig Kassel tr. pp. 36:7-77:18, 197:1-5).

In addition, since at least 2005, KE has failed to comply with its corporate governing documents by having fewer than four (4) directors; instead, Craig has improperly served as the sole director. (App. v. VI pp. 68-78). KE has never amended its Bylaws to reduce the number of directors. (App. v. IV pp. 43:20-44:6, 45:17-46:12, 280:10-21, Craig Kassel tr. pp. 35:20-36:6, 37:17-38:12, 253:10-21)

Beyond the failure to follow corporate formalities, Craig caused KE's assets to be misused and misapplied for his own benefit. The Articles of Incorporation for Kassel Enterprises require all "[d]eeds, mortgages, leases, or other conveyances . . . shall be executed by the president and shall be countersigned or attested by the secretary." (App. v. VI p. 67, Art. VIII). The 2005 Lease purportedly entered into between KE and Craig and/or his separate companies Kassel Farms and Great Oak Farms fails to satisfy the requirements of the Articles of Incorporation for KE. (App. v. VI p. 67, Art. VIII; App. v. VI p. 79; App. v. IV pp. 86:18-89:25, Craig Kassel tr. pp.

78:18-81:25). There are no meeting minutes or other corporate records approving the 2005 Lease. (App. v. IV pp. 100:15-101:9, 105:13-107:1, Craig Kassel tr. pp. 92:15-93:9, 97:13-99:1). Although he believes the 2005 Lease was near market rates at the time it was executed, Craig admits and acknowledges it was below market rate rents published by Iowa State University. (App. v. IV pp. 100:15-104:21, 105:9-12, 106:2-107:16, 263:11-264:9, Craig Kassel tr. pp. 92:15-96:21, 97:9-12, 98:2-99:16, 236:11-237:9). Craig admitted the high-quality average rental value published by Iowa State University is representative of the rental value of KE's farmland. (App. v. IV pp. 93:10-99:22, Craig Kassel tr. pp. 85:10-91:22). Using the high-quality average rental value published by Iowa State University, the fair market rental value for KE's 660 acres of farmland from 2005 to 2017 was as follows:

Year	**Per-Acre**	**Total @ 660 Acres**
2006	$150	$99,000
2007	$164	$108,240
2008	$194	$128,040
2009	$210	$138,600
2010	$203	$133,980
2011	$254	$167,640
2012	$313	$206,580
2013	$332	$219,120
2014	$302	$199,320
2015	$285	$188,100
2016	$267	$176,220
2017	$248	$163,680

with a total rental value of $1,928,520 during that period. (App. v. VI pp. 90, 93, 107, 121, 135; App. v. VII pp. 12, 23, 34, 45; App. v. VIII pp. 11, 23, 35, 47; App. v. IX p. 11).

In spite of significantly higher market rate rents, Craig paid KE rent at the rate of $133.33 per acre, or $88,000 per year, for a total rent of $1,056,000 for the period from 2006 through 2017. (App. v. VI p. 79; App. v. IV p. 93:10-17, Craig Kassel tr. pp. 85:10-17). The difference between the market rate rent specified by Iowa State University and what Craig paid was $872,520 ($1,928,520 - $1,056,000 = $872,520) – the amount of rent money misapplied or wasted, while Craig used the Corporation's land to generate profits solely to benefit himself. (App. v. VI pp. 79; App. v. VI pp. 90, 93, 107, 121, 135; App. v. VII pp. 12, 23, 34, 45; App. v. VIII pp. 11, 23, 35, 47; App. v. IX p. 11). Craig admitted that less money flowing into KE meant less money paid out from KE. (App. v. IV p. 103:11-18, Craig Kassel tr. p. 95:11-18).

In addition to below market rents, Craig misused and misapplied corporate assets to secure loans – on the back of KE – to fund his separate farming operations. As of 2006, KE's farmland was paid for. (App. v. IV p. 229:4-17, Craig Kassel tr. p. 202:4-17). For all essential purposes, KE's operations were to collect rent on its property. (App. v. IV pp. 140:23-

141:5, Craig Kassel tr. pp.132:23-133:5). The only expenses of KE were real estate taxes, insurance, and less than $100,000 of tiling. (App. v. IV pp. 229:18-232:1, Craig Kassel tr. pp. 202:18-205:1). In spite of 660 acres of income-generating farmland and nominal expenses, from 2005 through 2018, KE borrowed $4,863,011.50, paying interest in the amount of $86,683. (App. v. IX pp. 37-68). Although Georgia Kassel lacked modern amenities like a computer and modern washing machine, during the period Craig was President of KE, $246,077 of loan proceeds were distributed to Georgia (who passed away with only $13,000 in her bank account). (App. v. IX pp. 62-68; App. v. IV pp. 274:7-275:3, Craig Kassel tr. pp. 247:7-248:3).

Of the funds borrowed, $904,006[4] was distributed or misapplied to Craig/Deborah or to their companies, Great Oak Farms and/or Kassel Farms, as follows:

Date	**Amount**	**Recipient**
10/25/2006	$225,000	Craig/Deborah (Account 779)
12/1/2006	$3,000	Craig/Deborah (Account 779)
12/26/2006	$10,000	Craig/Deborah (Account 779)
3/30/2007	$25,000	Craig/Deborah (Account 779)
4/11/2007	$20,000	Craig/Deborah (Account 779)
4/27/2007	$28,309	Craig/Deborah (Account 779)
4/30/2007	$7,802	Craig/Deborah (Account 779)
9/20/2007	$132,000	Craig/Deborah (Account 779)
9/24/2007	$19,375	Craig/Deborah (Account 779)

[4] Craig could not explain the transfers and uses of the moneys. (App v. IV pp. 236:7-249-4, Craig Kassel tr. pp. 209:7-222:4)

2/15/2008	$100,000	Great Oak Farms (Account 377)
1/8/2010	$66,000	Craig/Deborah (Account 779)
1/19/2010	$167,520	Kassel Farms
3/23/2010	$500,000	Great Oak Farms ($500,000 borrowed with $400,000 repaid) (Account 377)
Total	**$1,304,006**	(Account 809)

(App. v. IX pp. 37-71).

Without explanation, Craig only nominally advised KE shareholders of these loans, with a cursory listing of a $500,000 loan in 2011 with a notation of "ours." Similar listings were made in other years as well, including for example in 2006 ($55,761) and 2018 ($22,000). (App. v. IX pp. 26-27, 72, 73). There are no meeting minutes or other corporate records approving these loans or the distributions misapplied to Craig, Deborah, or their companies. (App. v. IV pp. 219:13-223:3, 232:2-252:5, Craig Kassel tr. pp. 192:13-196:3, 205:2-225:5).

Craig also engaged in self-dealing and misapplication of KE's assets by trading farmland to himself for his separate farming business. In 2017, Craig "swapped" farmland out of KE by trading that land to his separate companies owned by himself and his wife, Deborah, (Kassel Farms and Great Oak Farms) and replacing it with other property. Specifically, Craig transferred 89 acres from KE to Kassel Farms and then transferred back 95 acres from Kassel Farms to KE. (App. v. I pp. 21-22, 72-78; App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3). At the time of the swap, the only owners of Kassel Farms and Great Oak Farms were Craig and Deborah. (App. v. I pp. 21-22, 72-78; App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3). Craig testified the purpose of this swap was so that he could complete a building project for his own personal, separate farming operation. (App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3). Essentially, Craig testified that the bank required that he own the land under the proposed new buildings and he obtained that ownership through the land swap. (App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3). There are no meeting minutes or other corporate records approving the land swap. (App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3). Peggy and Susan never approved, ratified, or consented to the land swap. (App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3). This land swap landlocked 127 acres of KE's farmland because the connecting parcels (that granted access) were traded away to Craig and his companies. (App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3). Although Craig hired an appraiser to state that the land traded back and forth were of equal value, the appraisal specifically notes Craig instructed the appraiser to ignore that land was inaccessible, to "assume" adequate and legal access existed, and to ignore the value of certain buildings. (App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-

166:3). In spite of the fact the land swap caused 127 acres of KE's farmland to be landlocked, and although Peggy and Susan never agreed to the land swap, Craig traded away KE's land anyway so that he could complete his separate building project. (App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3).

In addition, Craig wasted and misapplied KE's assets by discounting and then selling its equipment to himself. In 2004, while Lawrence Kassel was alive, KE owned equipment valued at $254,000. (App. v. IX p. 74). In 2005, after Lawrence Kassel died, Craig reduced the value of KE's equipment to $85,000. (App. v. IX p. 74). In 2006, Craig again reduced the value of KE's equipment to $46,000. (App. v. IX p. 74). During this period, KE continued to own the same equipment. (App. v. IV pp. 253:16-256:1, Craig Kassel tr. pp. 226:16-229:1). Craig unilaterally reduced the value of this equipment from $254,000 to $46,000 before selling it to himself at that discounted price. Craig explains away this decrease in value on the basis that he had a "different perspective" on the value. (App. v. IV pp. 253:16-256:1, Craig Kassel tr. pp. 226:16-229:1).

Finally, Craig wasted and misapplied KE's assets by giving away life insurance proceeds payable to KE. At the time of Lawrence Kassel's death, KE owned a life insurance policy on Lawrence with KE named as the beneficiary of the proceeds totaling $350,000. (App. v. IX p. 85). When Craig received the life insurance proceeds, he simply gave them to Georgia Kassel. (App. v. IV pp. 271:24-272:9, Craig Kassel tr. pp. 244:24-245:9).

Craig excuses all of his self-dealing, misuse, misapplication, and waste of KE resources on the basis it was approved by his mother, Georgia Kassel – a minority shareholder. (App. v. IV pp. 224:6-225:1, 270:16-272:9, Craig Kassel tr. pp. 197:6-198:1, 243:16-245:9). Craig explained to Peggy and Susan that they were born the wrong gender, a fact he admitted (but tried to soften) at his deposition, stating he "won the biological sweepstakes because [he] was a boy." (App. v. IV p. 275:21-24, Craig Kassel tr. p. 248:21-24).

Plaintiffs sought judicial dissolution of KE, including on the basis of Craig's waste and misapplication of KE's assets (App. v. I, pp. 23-24). In response, Defendants filed an untimely election to purchase Plaintiffs' interest in KE. (App. v. I pp. 98-101). Consistent with how he operated KE to the detriment of Peggy and Susan, Craig sought to discount that purchase with contrived discounts for hypothetical sale expenses and inapplicable taxes. It is the District Court's rejection of Defendant's inapplicable discounts from which they appeal.

ARGUMENT

I. THE DISTRICT COURT APPLIED THE CORRECT VALUATION METHODOLOGY TO DETERMINE THE FAIR VALUE OF PLAINTIFFS' INTEREST IN KASSEL ENTERPRISES, INC.

A. Preservation of Error

Plaintiffs do not dispute Defendants preserved error on the issue of the applicability of discounts for hypothetical transactional costs and built-in gains in determining the fair value of KE.

B. Scope and Standard of Review

Plaintiffs do not dispute Defendants' statement of the scope and standard of review; the standard of review for cases tried in equity is de novo. Iowa R. App. P. 6.907; *Van Horn v. R.H. Van Horn Farms, Inc.,* 919 N.W.2d 768 (Iowa Ct. App. 2018).

C. Discussion

1. The District Court utilized the proper methodology to determine the "fair value" of Kassel Enterprises, Inc. as agreed-upon by the Parties.

Importantly, for all that the parties dispute in this case, they and their experts essentially agree on the basic fair value of KE. Where the parties diverge, however, is the applicability of discounts for transactional costs (discussed below in Brief Point I(C)(2)), alleged "built-in gains" in the context of a S corporation (discussed below in Brief Point I(C)(3)), and a value for claims KE has against Craig (discussed below in Brief Point III(C)(1)).

For purposes of a corporate dissolution action, the Iowa Code defines "fair value" as the "value of the corporation's shares" determined "[u]sing customary and current appraisal concepts and techniques," but "[w]ithout discounting for lack of marketability or minority status." Iowa Code §§ 490.1301(4); 490.1434(4) (2017).

Here, Defendants spend several pages chastising the District Court for not distinguishing "fair value" and "fair market value" in its Order. Importantly, however, Defendants fail to acknowledge that both the parties and their respective experts actually ***agree*** as to the valuation methodology ***and*** value of Kassel Enterprises before applicable discounts or additions.

First, both parties agreed the "asset-based approach" was the proper valuation methodology for determining the value of KE's assets and, thus, its shares. (App. v. II p. 272; Hr. Exhibits 28-29, App. v. IX p. 209; App. v. V pp. 84:23-85:25, 112:17-22, 140:3-7, 169:8-14, Hearing tr. pp. 76:23-77:1-25, 104:17-22, 132:3-7, 161:8-14). Defendants' expert, Brian Crotty, defined the "asset-based approach" as follows: "the value of a business is equal to the net value of its assets and liabilities," computed by adjusting the company's assets to market value. (App v. IX p. 208). Defendants' expert

Crotty recognized that "[i]n our appraisal of Kassel Enterprises, Inc., we determined the asset-based approach would provide a reliable indication regarding the value of the Company" because KE is "asset intensive" in farmland holdings and that it has relatively low earnings compared to the value of its assets. (App. v. IX p. 209). Again, the only disagreement between the experts on valuation was the applicability of discounts. (App. v. V pp. 112:17-22, 140:3-7, Hearing tr. 104:17-22; 132:3-7). Stated otherwise, the value of KE's shares *is* the value of its net assets under the approach adopted by both Plaintiffs and Defendants rendering any distinction between fair value and fair market value superfluous.

Second, utilizing the same valuation methodology, both parties agreed to the net value of KE's assets, and thus its equity, in the amount of $5,608,886 before the application of any discounts or additions. (App v. II p. 272; Hr. Exhibit 29; App. v. IX p. 210; App. v. V pp. 112:17-22, 140:3-7, Hearing tr. 104:17-22; 132:3-7). Again, stated differently, Plaintiffs and Defendants agreed the value of KE's shares *is* the net value of its assets, or $5,608,886 before any applicable discounts or additions.

Given the agreement on the proper valuation methodology (asset-based approach) and the resulting value of KE, the District Court observed that both Plaintiffs' and Defendants' experts used the terms "fair value" and "fair market value" interchangeably. (App. v. II p. 272). Consequently, because the parties agreed the value of KE is the value of its net assets, or $5,608,886 before any discounts or additions, the District Court correctly determined it unnecessary to distinguish "fair market value" and "fair value."

In spite of the parties' agreement on the correct valuation methodology and the resulting value, Defendants' brief needlessly spends six pages (pp. 29-34) arguing the Court should have distinguished "fair value" from "fair market value." Incredibly, Defendants now apparently advocate for an income-based valuation, despite their expert Crotty expressly rejected that approach. (Defendants' Proof Brief, p. 35, n. 4). Finally, Defendants now challenge the payment terms (promissory notes and interest rate) they ***explicitly*** requested, calling them "onerous." (Defendants' Proof Brief, p. 32-33) (App. v. V p. 45:5-25, Hearing tr, pp. 37:5-25). Despite these new arguments, given that the parties and the experts agreed upon the proper valuation methodology and the resulting value, the District Court properly adopted the asset-based valuation approach agreed-upon by the parties.

2. The District Court correctly determined that a discount for transactional costs was factually inapplicable because Craig Kassel admitted he had no intentions of selling Kassel Enterprises, Inc. or its farmland.

Defendants next argue the District Court erred in not reducing the fair value of KE for hypothetical transactional costs Craig admits will never be incurred. Because Craig testified he had no intentions of selling KE or its farmland, the District Court properly rejected any fictional transactional discount requested by Defendants.

As noted, Plaintiffs and Defendants agreed the "fair value" of KE was properly determined using the asset-based valuation methodology, and that the resulting valuation was $5,608,886 before any discounts or additions. Defendants' expert Crotty recognized that under the asset-based approach, the valuation of a company's assets would be valued "using either a going-concern or a liquidation assumption." (App. v. IX pp. 208, 210). Importantly, Defendants' expert Crotty further recognized that he had "determined that the net asset value method (going-concern assumption) would provide the most reliable indication regarding the value of the Company." (App v. IX p. 210). Consistent with this "going-concern assumption," Craig testified he intends to keep KE as an "entity as a whole" out of respect for his parents. (App. v. V p. 58:4-20, Hearing tr. p. 50:4-20). Expert Crotty likewise admitted his understanding that Craig would not sell

KE or its farmland. (App. v. V pp. 118:25-119:3, 125:23-126:1, Hearing tr, pp. 110:25-111:3, 117:23-118:1).

Despite Craig's intentions, Defendant's expert Crotty applied a hypothetical discount for "transaction costs," noting that "[i]f the Company sold the real property it would likely incur transaction costs for broker fees and other transactional costs." (App. v. IX p. 210). Crotty admits, however, that these transactional costs were purely hypothetical – an exercise in assumptions – and that he just made up the discount rate at eight percent (8%) of the fair value of KE. (App. v. V pp. 87:1-16, 104:10-18, 106:3-10, Hearing tr, pp. 79:1-16, 96:10-18, 98:3-10). Indeed, despite his willingness to assume, Crotty admits he is not an expert on what the sale expenses might or might not be; that he simply guessed without any real analysis of what rate might be applicable. (App. v. V pp. 119:4-121:6, Hearing tr, pp. 111:4-113:6). Crotty's analysis chooses to ignore that land owned by these same parties was sold in August, 2019, through partition for a mere 2% commission. (Hr. Exhibit 33; App v. V pp. 119:4-121:6, Hearing tr, pp. 111:4-113:6).

Consistent with the facts and evidence admitted, the District Court determined "the record contains no evidence that Kassel Enterprises will be liquidated." (App. v. II p. 273). To the contrary, the District Court found "[i]n fact, in lieu of dissolution and liquidation, the corporation is purchasing the shares owned by the Plaintiffs" and that "Craig, who will be the sole remaining shareholder, has no intentions of selling the corporation." (App. v. II p. 273). The District Court properly rejected expert Crotty's opinion for an 8% discount, holding it was not only unsupported by the record, but was "speculative at best" considering "Craig Kassel has no present intention of selling Kassel Enterprises or its land." (App. v. II p. 273). Accordingly, the District Court held a "discount based upon some future hypothetical sale is not appropriate and should not be allowed." (App. v. II p. 274).

Based on the undisputed facts of this case, the District Court correctly rejected a discount to the stipulated fair value for hypothetical transactional costs, which if allowed here would allow Craig to purchase a 47.5% equity interest for the price of a 34% equity interest. (App. v. V pp. 149:2-150:5, Hearing tr, pp. 141:2-142:5). Notably, Defendants have cited no case law that mandates a discount for expenses that will admittedly not be incurred. Consequently, the District Court correctly determined a discount for transactional costs was inapplicable based on the undisputed fact Craig had no intentions of selling KE or its farmland.

3. <u>The District Court correctly determined that a discount for "built-in gains" applicable to "C corporations" was inapplicable to "S corporations" because of the fundamental tax differences.</u>

Understanding the fundamental difference between C corporations (burdened by double taxation relative to corporate-held appreciated value property) and S corporations (pass-through, single taxation) is inherent for Iowa practitioners. For S corporations, it is basic that you do not reduce the value of shares of stock to be sold by the taxes the selling shareholder will incur on his/her shares; that was not the holding of *Baur*. Instead, the reduction there was for the corporate tax that would be incurred ***<u>before</u>*** the proceeds could be distributed to the shareholder. That tax is non-existent in a S corporation. In a S corporation (unlike a C corporation), there is no corporate level tax. Nonetheless, Defendants seek to reduce the purchase price of Plaintiffs' interest in KE for a tax that will ***<u>never</u>*** materialize. Indeed, Defendants cannot cite a single case holding the fair value of a S corporation using an asset-based approach should be discounted for hypothetical taxes for "built-in gains."[5] Instead, in an attempted legal "slight of hand," Defendants substitute misdirection for legal authority to further oppress Plaintiffs by arbitrarily reducing the value of their interest in KE.

[5] Ignoring that Defendants' expert overstated the applicable tax rate by at least 1/3. (App. v. V pp. 122-124, 141-152, Hearing tr, pp 114-116, 133-144; App. v. III pp. 33-36, Crotty tr. pp. 25-28).

Recognizing Defendants' attempts to conflate how gains are taxed for S corporations and C corporations, the District Court correctly determined a discount for "built-in gains" was inapplicable in this case.

It is undisputed that KE is – and at all relevant times was – an S corporation. (App. v. V pp. 88:19-89:8, Hearing tr, pp. 80:19-81:8). For S corporations, all tax consequences pass-through to the shareholder level and the company itself pays no income taxes on any income or gains. *See* 26 U.S.C. § 1363(a) ("S corporation shall not be subject to the [income] taxes imposed by this chapter"); *see also* 26 CFR 1.1363-1(a) and Eustice & Kuntz, FEDERAL INCOME TAXATION OF S CORPORATIONS, 7.1 (4th ed. 2013) (E&K). Simply stated, the fundamental difference between C corporations and S corporations is that to get assets or funds to its owners, C corporations incur double taxation, once at the corporate level when the gain is realized and then again at the shareholder level when the proceeds are distributed. Conversely, a S corporation's sale of appreciated property flows only to the shareholder (increasing their tax basis in their stock, which would be correspondingly reduced upon the distribution of sale proceeds), resulting in a single layer of shareholder taxation. 26 U.S.C. § 1366(a) (determining S corporation shareholder's income tax "there shall be taken into account the shareholder's pro-rata share of the corporation's" income, deduction, and loss items); 26 U.S.C. § 1367(a) (gains passed through an S corporation increase the shareholder's basis by a corresponding amount); *see also* 26 CFR 1.1366-1(a) and E&K, 7.07. Defendants' expert Crotty admitted this fact, noting that capital gains are paid at the corporate level in C corporations, but passed down to shareholders in S corporations. (App. v. V pp. 88:19-89:8, Hearing tr, pp. 80:19-81:8). In spite of this distinction, Defendants nonetheless seek a discount for a tax that does not exist and for which Defendants cannot cite a single supporting legal authority. Defendants' unsubstantiated request for this fictitious discount was properly rejected for three reasons.

First, Defendants have failed to identify a single case supporting a discount for "built-in gains" in determining the fair value of a S corporation using the asset-based valuation method. In fact, Defendants' expert Crotty admits there is no authority supporting the discount he advocates for. (App. v. V pp. 102:22-103:17, 110:10-112:1, Hearing tr, pp. 94:22-95:17; 102:10-104:1). Moreover, despite Defendants' exclusive reliance (without analysis) on the decision of *Baur v. Baur Farms, Inc.*, that case indisputably applied a tax discount for a C corporation, recognizing the significant taxes that are paid at the corporate level in a liquidation. *Baur*, (No. 14-1412) 885 N.W.2d 829 (table), 2016 WL 4036105 at *4 (Iowa Ct. App. July 27, 2016) (noting that because the tax is recognized at the corporate level, all shareholders should share proportionately in such burden). In relying on *Baur*, and without addressing the basis for the discount applied there, Defendants argue there was not "any mention or inference that the application of the so-called liquidation tax discount is limited to 'C corporations.'" (Defendants' Proof Brief, p. 38). Indeed, implicit in Defendants' argument is the misconception that built-in gains are taxed identically in both C corporations and S corporations. (Defendants' Proof Brief, p. 38). Argument notwithstanding, Defendants fail to cite a single authority that would support discounting shares of S corporations for built-in gains that will never be recognized at the corporate level. *See Id.* at *4 (discount for built-in gain necessary "in such transactions" involving liquidation of C corporation); Iowa Code § 490.631 (2017) (cited by Defendants; permits redemption of shares but silent on tax consequences); Iowa Code § 490.1434 (2017) (definition of "fair value" does not include discount for "built-in gains" in S corporations); *Dunn v. Commr.*, 301 F.3d 339 (5th Cir. 2002) (cited by Defendants, held discount for built-in gains appropriate in determining fair market value in C corporation).

Despite their reliance on *Baur*, Defendants' analysis fails to grasp the decision could only be based on the tax consequences inherent to a C corporation, which are simply not applicable to KE, which is a S corporation. *Baur*, 2016 WL 4036105 at *4. The discount requested by Defendants for "built-in gains" in this case is legally unsupported precisely because it purposefully ignores the taxation differences for S and C corporations. Specifically, Plaintiffs' expert, a C.P.A. tax expert, Anthony Wagner, testified succinctly that applying a discount at a corporate level in an S corporation is inappropriate because taxes are only paid at a shareholder level. (App. v. V pp. 143:8-144:1, 144:21-145:6, 145:15-146:9, Hearing tr, pp. 135:8-136:1, 136:21-137:6, 137:15-138:9). Indeed, expert Wagner testified that a potential buyer of KE (or the IRS for valuation purposes) would not discount the priced based on taxes because it is an S corporation. (App. v. V pp. 168:17-169:14, 170:12-171:22, 175:3-176:22, Hearing tr, pp. 160:17-161:14, 162:12-163:22, 167:3-168:22). Given the testimony of the experts, and Defendants' requested discount being totally unsubstantiated by any legal authority, the District Court rightly recognized that KE – more than 5 years beyond its subchapter S election – would not incur any taxes at a corporate level in a theoretical or actual liquidation. (App v. II pp. 274-275). Consequently, the District Court correctly held that a discount for "built-in gains" – although equitable and applicable in a C corporation because of the entity-level tax recognized in *Baur* – was inequitable in a S corporation because the shareholders will already pay their proportionate share of tax due to the nature of the entity. (App v. II pp. 274-275).

Second, Defendants' request for a discount for hypothetical taxes actually creates impermissible double-taxation on Plaintiffs. In fact, Defendants' expert Crotty plainly admits this shifts a double tax to Plaintiffs, noting the "double taxation argument comes from discounting [the value of KE] now and then having a – a purchase of the [discounted] shares where they then are, in effect, having the impact twice of tax."[6] (App v. V pp. 107:21-109:25, 113:11-114:12, Hearing tr, pp. 99:21-101:25; 105:11-106:12). Plaintiffs' expert likewise agrees that including a discount for built-in gains results in an S corporation passing an improper double taxation on to Plaintiffs. (App. v. V p. 141:1-8, Hearing Transcript, p. 133:1-8).

Third, on its face, the discount – caused by a hypothetical sale that admittedly will not occur (Defendants' Proof Brief, p. 39) – impermissibly shifts a tax to Plaintiffs that neither KE nor Craig will ever pay. This inequity is particularly salient given that both experts agree Craig will not

[6] Despite this admission by their expert, Defendants argue "Plaintiffs will not be taxed twice." (Defendants' Proof Brief, p. 40). This is a subtle misdirection by Defendants. Although Plaintiffs will not actually pay taxes twice, Defendants' expert Crotty admits Plaintiffs' share is being reduced for hypothetical taxes and then that reduced amount is taxed by the government, effectively creating two levels of tax on Plaintiffs' interest in KE.

absorb any tax related to Plaintiffs' ownership interest in KE. In fact, Defendants' expert Crotty admitted that if Craig dies while owning all of the stock in KE, the tax basis in the stock will be increased to fair market value thereby avoiding any gain and related income tax. (App. v. V pp. 114:16-116:15, Hearing tr, pp. 106:16-108:15). Crotty further admits that as KE continues to make money (*i.e.*, by receiving cash rent), by paying the promissory notes to Plaintiffs, Craig's basis in his stock will incrementally increase until all gain attributed to Plaintiffs is added to his stock basis, thereby avoiding any related income tax. (App. v. V pp. 116:15-119:4, Hearing tr, pp. 108:16-111:4). Moreover, any risk of such hypothetical gain only exists in the first place because of the decision of Craig to force KE to redeem Plaintiffs' shares; alternatively, Craig could have simply purchased Plaintiffs' shares directly, which would have received an immediate step-up in tax basis to the purchase price and avoided even the possibility of a gain on Plaintiffs' shares.[7] (App. v. V pp. 124:10-126:1, Hearing tr, pp. 116:10-118:1). Because Craig's basis will increase to negate any possible gain related to Plaintiffs' interest in KE, Defendant's expert Crotty admitted that the Iowa District Court, in *Goettsch v. Goettsch*, (No. EQCV015164) 2014

[7] As a further attempt to enrich himself on the backs of his sisters, Craig apparently chose a corporate redemption rather than direct purchase specifically for the purpose of trying to obtain a discount for taxes that does not, and will not, exist.

WL 12809997 (Ida County Nov. 3, 2014) correctly rejected the discount for "built-in gain" requested by Defendants here. (App. v. V pp. 130:5-131:12, Hearing tr, pp. 122:5-123:12). Plaintiffs' expert Wagner likewise agreed that Craig would not be attributed any gain attributable to Plaintiffs' ownership of KE. (App. v. V pp. 143:8-148:11, Hearing tr, pp. 135:8-140:11).

For these reasons, the District Court correctly held there was "no credible reason to apply a discount for tax on built-in gains of Kassel Enterprises' assets." (App v. II p. 275). Indeed, the District Court found it important that neither Defendants nor the Court could find a case supporting such a discount in the context of a fair value determination of a S corporation, as in this case. (App v. II p. 275). On the other hand, the District Court cited *Matthew Norton Co. v. Smyth*, 51 P.3d 159, 169 (Wash. App. 2002) for the proposition that such a discount was inapplicable to S corporations. (App v. II p. 275).

II. THE DISTRICT COURT PROPERLY ASSESSED ATTORNEYS' FEES AND COSTS BECAUSE OF CRAIG KASSEL'S WASTE AND MISAPPLICATION OF CORPORATE ASSETS."

A. Preservation of Error

Plaintiffs do not dispute Defendants preserved error on the issue of the imposition of costs and fees.

B. Scope and Standard of Review

Plaintiffs do not dispute Defendants' statement of the scope and standard of review; the standard of review for an award of attorneys' fees is abuse of discretion. Iowa R. App. P. 6.907; *Ferguson v. Exide Techs., Inc.*, 936 N.W.2d 429, 431 (Iowa 2019) (citing *Lee v. State*, 874 N.W.2d 631, 637 (Iowa 2016)).

C. Discussion

1. <u>An award of attorneys' fees and costs against the corporation is explicitly authorized in a fair value determination if the petition for dissolution under Section 490.1430(1)(b)(4) (waste or misapplication of corporate assets) was based on "probable grounds."</u>

As a matter of law, in determining the fair value of a plaintiff's interest in a corporation, the district court is expressly empowered to award attorneys' fees and costs if the request for dissolution for waste or misapplication of corporate assets under Section 490.1430(1)(b)(4) is based on "probable grounds." Iowa Code § 490.1434(5). Importantly, implicit in that authorization is the existence of an election to purchase the petitioner's interest in lieu of dissolution. *Id.* Consequently, the District Court's award of attorneys' fees and costs were expressly authorized by the Iowa Code.

Iowa law plainly allows a shareholder to seek judicial dissolution of an Iowa corporation on the basis that the "corporate assets are being misapplied or wasted." Iowa Code § 490.1430(1)(b)(4) (2017). In lieu of such dissolution, "the corporation may elect . . . to purchase all shares owned by the petitioning shareholder at the fair value of the shares." Iowa Code § 490.1434(1). The parties are free to attempt to reach an agreement on the fair value of the petitioner's shares. Iowa Code § 490.1434(3). However, if such efforts are unsuccessful, the court shall stay the dissolution proceedings "and determine the fair value of the petitioner's shares." Iowa Code § 490.1434(4). Importantly, in determining such fair value, "[i]f the court finds the petitioning shareholder has probable grounds for relief under section 490.1430, subsection 1, paragraph "b", subparagraph (2) [oppression] or (4) [waste or misapplication of asses], it may award the petitioning shareholder reasonable fees and expenses of counsel and of any experts employed by the shareholder." Iowa Code § 490.1434(5). Thereafter, upon determining fair value, the petitioning shareholder ceases to be a shareholder and the petition to dissolve is dismissed by operation of law. Iowa Code § 490.1434(6).

This statutory procedure is ***exactly*** what occurred in this case. Plaintiffs' Petition sought judicial dissolution of KE on the basis that Craig wasted and misapplied corporate assets (among other reasons). (App. v. I pp. 23-24). In response, KE eventually made an (untimely) election to purchase Plaintiffs' interest in KE. (App. v. I pp. 98-101). Because the parties could not agree on the "fair value" of the Plaintiffs' interest in KE, a hearing was held on October 10, 2019 to determine that fair value, resulting in the Order from which Defendants currently appeal. (App. v. II pp. 271-283). Pursuant to Iowa Code Section 490.1434(5), the District Court awarded attorneys' fees, holding Plaintiffs' Petition to dissolve KE was founded on "probable grounds" on the basis that Craig wasted and misapplied corporate assets. (App. v. II pp. 276-279). Pursuant to Iowa Code § 490.1434(6), the Court's Order terminated Plaintiffs' interest in KE and dismissed the Petition for Dissolution. (App. v. II p. 281).

Despite that the proceedings in this case fit precisely within the statutory framework for corporate dissolution actions, Defendants argue "there was no basis for imposing an attorney fee award on the defendant corporation." (Defendants' Proof Brief, p. 50). Defendants continue their argument, alleging "[t]here is simply no statutory or evidentiary basis for the entry of an attorney fee award against Kassel Enterprises, Inc. and this portion of the judgment must be reversed and dismissed without more." (Defendants' Proof Brief, p. 51). Notably, however, Defendants fail to cite even a single authority supporting these arguments. To the contrary, the Iowa Code explicitly provides it "is not necessary to make shareholders parties to a proceeding to dissolve a corporation unless relief is sought against them individually." Iowa Code § 490.1431(2) (2017). Indeed, taken together, the Iowa Code makes clear that a plaintiff shareholder may seek dissolution of a corporation based on the waste/misapplication of corporate assets; that the other shareholders need not be included as a party to the case; that the Corporation can avoid dissolution by electing to purchase the plaintiff's shares; that absent agreement otherwise, the court will determine the fair value of the plaintiff's shares; and that in determining fair value – in the context of a corporate dissolution claim by a plaintiff shareholder against a defendant corporation – the court may award attorneys' and experts' fees if the petition for dissolution was based on "probable grounds;" thereafter the plaintiff's interest in the company is terminated and the dissolution action is dismissed. Iowa Code §§ 490.1430(1)(b)(4); § 490.1431(2); 490.1434(1); 490.1434(3); 490.1434(4); 490.1434(5), 490.1434(6).

In spite of the clear statutory framework, Defendants argue fees are inappropriate in this case because the District Court found no oppression. (Defendants' Proof Brief, p. 50). Although true, this argument still fails because fees may be awarded in the absence of oppression if there were probable grounds for waste or misapplication of corporate assets, which the District Court found. Iowa Code § 490.1434(5). (App. v. II pp. 276-279).

Next, Defendants incorrectly argue fees are impermissible because KE "prevailed by exercising its statutory right to redeem the shares for fair value." (Defendants' Proof Brief, p. 50). Again, Defendants' argument fails because that is exactly the procedure required by the statute; namely, a request for dissolution, an election to avoid the dissolution, a hearing to determine fair value, and the subsequent dismissal of the dissolution petition. Simply stated, the permissible award of attorneys' fees under Section 490.1434(5) is predicated on an election to redeem and the subsequent dismissal of the dissolution request. Iowa Code §§ 490.1430(1)(b)(4); § 490.1431(2); 490.1434(1); 490.1434(3); 490.1434(4); 490.1434(5); 490.1434(6).

Defendants' argument that attorneys' fees are not permitted in a judicial dissolution is just wrong. Defendants' charge that the District Court's "absurd order is a clear abuse of discretion" is meritless because it is not only unsupported by any legal authority, but in fact it is explicitly contradicted by the plain language of Iowa Code Chapter 490. As a matter of law, the Iowa Code explicitly authorizes an award of attorneys' fees against the corporation if the petition for dissolution based on waste or misapplication of assets is based on probable grounds. In this case, as analyzed next, the District Court correctly held such probable grounds existed. (App. v. II pp. 276-279). Consequently, there is a clear statutory basis supporting the award of attorneys' fees in this case.

2. The District Court's Order finding Craig wasted or misapplied corporate assets was supported by substantial evidence.

As noted above, a petition to dissolve a corporation for waste or misapplication of corporate assets, if based on probable grounds, will support an award of attorneys' fees. Iowa Code § 490.1434(5). Here, the District Court's Order finding that Craig wasted or misapplied corporate assets was supported by substantial evidence. Accordingly, the award of attorneys' fees in this case was not an abuse of discretion.

Attorneys' fees may be awarded where a petition for judicial dissolution based on waste or misapplication of corporate assets is based on "probable grounds." Iowa Code §§ 490.1430(1)(b)(4); 490.1434(5). In evaluating this standard, the District Court adopted the ordinary, dictionary definition of "misapplied" to "include use or spending of assets or money without proper authority or use of such assets improperly." (App. v. II p. 277). The District Court's resorting to the dictionary definition was entirely consistent with Iowa law; indeed, it is held that in "interpreting statutes, we [the courts] strive to discern and give effect to the legislature's intent." *State v. White*, 563 N.W.2d 615, 617 (Iowa 1997) (citing *State v. Johnson*, 528

N.W.2d 638, 640 (Iowa 1995)). "The words used in the statute evidence that intent. *Id.* (citing *State v. Kidd*, 562 N.W.2d 764, 765 (Iowa 1997)). "In the absence of a legislative definition of a term or a particular meaning in the law, we give words their ordinary meaning. *Id.* (citing *State v. White*, 545 N.W.2d 552, 555 (Iowa 1996)). "The dictionary provides a ready source for ascertaining the common and ordinary meaning of a word." *Id.* (citing *Kidd*, 562 N.W.2d at 765). Defendants do not challenge the District Court's reliance on the dictionary definitions of waste and/or misapplication. Instead, assuming those definitions to be proper, Defendants only challenge whether Craig's conduct meets that definition. Although disputed by Craig, the facts of this case objectively evidence a pattern and practice of Craig to use KE's assets in furtherance of his separate financial interests in **five** distinct ways.

First, Craig engaged in self-dealing by renting KE's farmland at below market rate rents. The Articles of Incorporation for KE require all "[d]eeds, mortgages, leases, or other conveyances . . . shall be executed by the president and shall be countersigned or attested by the secretary." (App. v. VI p. 67, Art. VIII). Yet, in 2005, a lease was purportedly entered into between KE and Craig and/or his separate companies Kassel Farms and Great Oak Farms, which fails to satisfy the requirements of the Articles of

Incorporation for Kassel Enterprises. (App. v. VI p. 67, Art. VIII; App. v. VI p. 79; App. v. IV pp. 86:18-89:25, Craig Kassel tr. pp. 78:18-81:25). Notably, there are no meeting minutes or other corporate records approving the 2005 Lease. (App. v. IV pp. 100:15-101:9, 105:13-107:1, Craig Kassel tr. pp. 92:15-93:9, 97:13-99:1). Although he believes the 2005 Lease was near market rates at the time it was executed, Craig admits and acknowledges it was below market rate rents published by Iowa State University. (App. v. IV pp. 100:15-104:21, 105:9-12, 106:2-107:16, 263:11-264:9, Craig Kassel tr. pp. 92:15-96:21, 97:9-12, 98:2-99:16, 236:11-237:9). Craig admitted the high-quality average rental value published by Iowa State University is representative of the rental value of KE's farmland. (App. v. IV pp. 93:10-99:22, Craig Kassel tr. pp. 85:10-91:22). Using the high-quality average rental value published by Iowa State University, the fair market rental value for KE's 660 acres of farmland from 2005 to 2017 was as follows:

Year	**Per-Acre**	**Total @ 660 Acres**
2006	$150	$99,000
2007	$164	$108,240
2008	$194	$128,040
2009	$210	$138,600
2010	$203	$133,980
2011	$254	$167,640
2012	$313	$206,580
2013	$332	$219,120

2014	$302	$199,320
2015	$285	$188,100
2016	$267	$176,220
2017	$248	$163,680

with a total rental value of $1,928,520 during that period. (App. v. VI pp. 90, 93, 107, 121, 135; App. v. VII pp. 12, 23, 34, 45; App. v. VIII pp. 11, 23, 35, 47; App. v. IX p. 11).

In spite of the significantly higher market rate rents during the lease period, Craig paid KE rent at the rate of $133.33 per acre, or $88,000 per year, for a total rent of $1,056,000 for the period from 2006 through 2017. (App. v. VI p. 79; App. v. IV p. 93:10-17, Craig Kassel tr. pp. 85:10-17). The difference between the market rate rent specified by Iowa State University and stipulated to as accurate by Craig, and what Craig actually paid, was $872,520 ($1,928,520 - $1,056,000 = $872,520); this lost rent constitutes an asset of KE that misapplied or wasted so that Craig could generate profits solely to benefit himself. (App. v. VI pp. 79; App. v. VI pp. 90, 93, 107, 121, 135; App. v. VII pp. 12, 23, 34, 45; App. v. VIII pp. 11, 23, 35, 47; App. v. IX p. 11). Craig admitted that less money into KE meant less money paid out from KE to its shareholders. (App. v. IV p. 103:11-18, Craig Kassel tr. p. 95:11-18).

Second, in addition to below market rents, Craig misused and misapplied corporate assets to secure loans – on the back of KE – to fund his separate farming operations. As of 2006, KE's farmland was paid for. (App. v. IV p. 229:4-17, Craig Kassel tr. p. 202:4-17). For all essential purposes, KE's operations were to collect rent on its property. (App. v. IV pp. 140:23-141:5, Craig Kassel tr. pp.132:23-133:5). The only expenses of KE were real estate taxes, insurance, and less than $100,000 of tiling. (App. v. IV pp. 229:18-232:1, Craig Kassel tr. pp. 202:18-205:1). In spite of 660 acres of income-generating farmland and nominal expenses, from 2005 through 2018, KE borrowed $4,863,011.50, paying interest in the amount of $86,683. (App. v. IX pp. 37-68). Although Georgia Kassel lacked modern amenities like a computer and modern washing machine, during the period Craig was President of KE, $246,077 of loan proceeds were distributed to Georgia, yet she died with a meager $13,000 in her bank account. (App. v. IX pp. 62-68; App. v. IV pp. 274:7-275:3, Craig Kassel tr. pp. 247:7-248:3).

Of the funds borrowed, $904,006 was distributed or misapplied to Craig and Deborah or their companies, Great Oak Farms and/or Kassel Farms, as follows:

Date	**Amount**	**Recipient**
10/25/2006	$225,000	Craig/Deborah (Account 779)
12/1/2006	$3,000	Craig/Deborah (Account 779)
12/26/2006	$10,000	Craig/Deborah (Account 779)
3/30/2007	$25,000	Craig/Deborah (Account 779)
4/11/2007	$20,000	Craig/Deborah (Account 779)
4/27/2007	$28,309	Craig/Deborah (Account 779)

4/30/2007	$7,802	Craig/Deborah (Account 779)
9/20/2007	$132,000	Craig/Deborah (Account 779)
9/24/2007	$19,375	Craig/Deborah (Account 779)
2/15/2008	$100,000	Great Oak Farms (Account 377)
1/8/2010	$66,000	Craig/Deborah (Account 779)
1/19/2010	$167,520	Kassel Farms
3/23/2010	$500,000	Great Oak Farms ($500,000 borrowed with $400,000 repaid) (Account 377)
Total	**$1,304,006**	(Account 809)

(App. v. IX pp. 37-71).

Without explanation, Craig only nominally advised KE shareholders of these loans, with a cursory listing a $500,000 loan in 2011 with a notation of "ours." Similar listings were made in other years as well, including for example in 2006 ($55,761) and 2018 ($22,000). (App. v. IX pp. 26-27, 72, 73). There are no meeting minutes or other corporate records approving these loans or the distributions to Craig, Deborah, or their companies. (App. v. IV pp. 219:13-223:3, 232:2-252:5, Craig Kassel tr. pp. 192:13-196:3, 205:2-225:5).

Third, Craig also engaged in self-dealing and misapplication of KE's assets by trading farmland to himself for his separate farming business. In 2017, Craig "swapped" farmland out of KE by trading that land to his separate companies owned by himself and his wife, Deborah, (Kassel Farms, Inc. and Great Oak Farms, Inc.) and replacing it with other property. Specifically, Craig transferred 89 acres from KE to Kassel Farms and then transferred back 95 acres from Kassel Farms to KE. (App. v. I pp. 21-22, 72-78; App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3). At the time of the swap, the only owners of Kassel Farm and Great Oak Farms were Craig and Deborah. (App. v. I pp. 21-22, 72-78; App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3). Craig testified the purpose of this swap was so that he could complete a building project for his own personal, separate farming operation. (App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3). Essentially, Craig testified that the bank required that he own the land under the proposed new buildings and he obtained that ownership through the land swap. (App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3). There are no meeting minutes or other corporate records approving the land swap. (App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3). Peggy and Susan never approved, ratified, or consented to the land swap. (App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3). This land swap caused 127 acres of farmland owned by KE to be landlocked because the connecting parcels (that granted access) were traded away to Craig and his companies. (App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3). Although Craig hired an appraiser to state that the land traded back and forth were of equal value, the appraisal specifically notes that Craig instructed the appraiser to ignore that land was inaccessible and to "assume" adequate and legal access existed. Craig also asked the appraiser to value some of the buildings and improvements being traded to himself, ignoring others. (App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3). In spite of the fact the land swap caused 127 acres of KE's farmland to be landlocked, and although Peggy and Susan never agreed to the land swap, Craig traded away the KE's land anyway so that he could complete his separate building project. (App. v. IV pp. 165:20-174:3, Craig Kassel tr. pp. 157:20-166:3).

Fourth, Craig wasted and misapplied KE's assets by discounting and then selling its equipment to himself. In 2004, while Lawrence Kassel was alive, KE owned equipment valued at $254,000. (App. v. IX p. 74). In 2005, after Lawrence Kassel died, Craig unilaterally reduced the value of KE's equipment to $85,000. (App. v. IX p. 74). In 2006, Craig again reduced the value of KE's equipment to $46,000. (App. v. IX p. 74). Despite the reduction in value, KE continued to own exactly the same equipment. (App. v. IV pp. 253:16-256:1, Craig Kassel tr. pp. 226:16-229:1). After unilaterally reducing the value of KE's equipment from $254,000 to $46,000, Craig then unilaterally sold such assets it to himself at the discounted price he alone assigned. Craig explains away this decrease in value on the basis that he had a "different perspective" on the value. (App. v. IV pp. 253:16-256:1, Craig Kassel tr. pp. 226:16-229:1).

Fifth, Craig wasted and misapplied KE's assets by giving away life insurance proceeds payable to KE. At the time of Lawrence Kassel's death, KE owned a life insurance policy on Lawrence with KE named as the beneficiary of the proceeds (totaling $350,000). (App. v. IX p. 85). When Craig received the life insurance proceeds, he gave them to Georgia Kassel. (App. v. IV pp. 271:24-272:9, Craig Kassel tr. pp. 244:24-245:9).

Craig excuses all of his self-dealing, misuse, misapplication, and waste of KE assets on the basis it was approved by his mother, Georgia Kassel – a minority shareholder of KE. (App. v. IV pp. 224:6-225:1, 270:16-272:9, Craig Kassel tr. pp. 197:6-198:1, 243:16-245:9). Worse yet, when pushed for explanation, Craig plainly noted that Peggy and Susan that they were born the wrong gender and that he "won the biological sweepstakes because [he] was a boy." (App. v. IV p. 275:21-24, Craig Kassel tr. p. 248:21-24). Notwithstanding the legal maxim of "mom said so," none of Craig's actions were disclosed to, or approved by, KE or its shareholders, despite that Craig and his wife, Deborah, served as the managing officers/directors of KE. In fact, KE routinely failed to follow any corporate formalities. Since at least 2005, KE has never held a meeting of its shareholders or directors. (App. v. IV pp. 44:7-85:18, 224:1-5; Craig Kassel tr. pp. 36:7-77:18, 197:1-5). There are no corporate records evidencing any meeting notices, agendas, or minutes of any shareholder or director meeting for KE. (App. v. IV pp. 44:7-85:18; Craig Kassel tr. pp. 36:7-77:18). Craig never shared the corporate records with Peggy or Susan, even though they were entitled to those records under the Iowa Code (Sections 490.1601, 490.1602), had requested those records during discovery, and were ordered by the District Court to produce them. (App. v. I pp. 112-114). In fact, the only corporate record shared by Craig was hand-written notations on the issued/outstanding shares. (App. v. IX p. 88). Despite failing to produce the corporate record book during this litigation (and in spite of a Court Order to do so), Craig testified at the fair value hearing that he brought the corporate book to Court with him.

Even though Craig admits there was never a meeting of the shareholders or directors of KE, fictitious meeting minutes were created that falsely state that meetings were held with Plaintiffs in attendance. (App. v. IX pp. 90-91; App. v. IV pp. 44:7-85:18, 224:1-5; Craig Kassel tr. pp. 36:7-77:18, 197:1-5). Nevertheless, from 2005 through 2018, KE's records filed with the Secretary of State show that Craig was President of KE from 2006 until 2012, that his wife Deborah served as an officer of KE, and that Craig was the only Director. (App. v. VI pp. 68-78; App. v. IV pp. 65:1-9, 274:16-17, Craig Kassel tr. pp. 57:1-9,247:16-17). Likewise, in spite of the filings with the Secretary of State, there was never any election to name Deborah as an officer of the KE. (App. v. IV pp. 55:5-14, 56:7-57:3, 78:8-80:1, Craig Kassel tr. pp. 47:5-14, 48:7 – 49:3, 70:8-72:1). In fact, KE never had shareholder meetings electing the officers or directors. (App. v. IV pp. 44:7-85:18, 224:1-5, Craig Kassel tr. pp. 36:7-77:18, 197:1-5).

Based on these facts, the District Court made the following findings: (1) KE failed to follow corporate formalities; (2) Without meetings or notices, Craig and Deborah served as the sole officers, to the exclusion of Plaintiffs and in spite of the requirements of KE's Bylaws; (3) that after putting himself in control of KE, Craig benefited himself by farming KE's land "at a rate substantially less than the fair market value" from 2006 through 2017 in the amount of $872,520; (4) that KE incurred significant debts to fund the operations of Craig's separate companies, Great Oak Farms and/or Kassel Farms; (5) and that Craig traded farmland in and out of KE to complete a building project for his separate farming operations, leaving a significant portion of KE's farmland "landlocked" without legal access. (App. v. II pp. 277-278).

In cases involving awards of attorneys' fees under Chapter 490, Iowa appellate courts utilize a two-step analysis: (1) a prerequisite factual finding that the circumstances supporting an award of fees under the Code has been met; and (2) if such factual finding exists, then the exercise of its discretion to award fees. *Sec. State Bank, Hartley, Iowa v. Ziegeldorf*, 554 N.W.2d 884, 893 (Iowa 1996) (employing two-step analysis for award of fees under Section 490.1331). The Court holds that the standard of review is likewise a two-step analysis. *Id.* In particular, reviewing the trial court's factual findings is for errors of law and the appellate court is "bound by the court's findings if supported by substantial evidence." *Id.* "If a factual basis for an award of attorney fees exists and is supported by substantial evidence, we then examine the trial court's decision to award or not award attorney fees for an abuse of discretion." *Id.*

Importantly, Defendants' disagreement regarding the Court's finding of waste or misapplication notwithstanding, their proof brief ***admits*** the operative facts, including the failure to follow corporate formalities, the payment of below-market rents and purported "bonuses" to mitigate a small portion of that loss, Craig's personal use of loans obtained by KE, and Craig's unilateral decision to trade farmland to himself in furtherance of his separate farming operations. (Defendants' Proof Brief, pp. 51-57). Yet, short of demanding that that this Court come to a different conclusion (even while conceding Craig engaged in the conduct alleged), Defendants simply fail to articulate how the District Court's findings are not supported by substantial evidence.[8]

Accordingly, the District Court's finding that Plaintiffs had "probable grounds" for their petition for dissolution of KE based on waste or misapplication of corporate assets is supported by substantial evidence and is binding on this Court. *Sieg Co. v. Kelly*, 568 N.W.2d 794, 804 (Iowa 1997) (in reviewing discretionary award/denial of attorneys' fees under Chapter 490, if factual finding is supported by substantial evidence it is binding in appellate court, which must affirm the award).

3. <u>The District Court's Order awarding fees was not clearly an abuse of discretion.</u>

After finding a decision to award attorneys' fees under Chapter 490 is supported by substantial evidence, the final step in a review whether the amount of the award is a clear abuse of discretion. In this case, because the District Court's award of fees was not clearly an abuse of discretion, the award must be affirmed.

[8] Instead, Defendants only posture the District Court's decision is an "incomprehensible . . . abuse of discretion," even while admitting that Craig engaged in the challenged conduct. (Defendants' Proof Brief, p. 57).

“If a factual basis for an award of attorney fees exists and is supported by substantial evidence, we then examine the trial court's decision to award or not award attorney fees for an abuse of discretion.” *Ziegeldorf*, 554 N.W.2d at 893. In awarding fees, the District Court should engage in a two-step process, as follows:

> First, while fees can be awarded for time devoted generally to the litigation as a whole, the district court should make an appropriate reduction for ... unrelated time spent on claims for which fees are not recoverable. Then, ... if the plaintiff only obtained partial or limited success on the claim for which the legislature has authorized fees, the court must consider the reasonableness of the hours expended in light of this ultimate result.

Ferguson v. Exide Techs., Inc., 936 N.W.2d 429, 435 (Iowa 2019). In making the award, the District Court “need not “make dollar-by-dollar attorney fee reductions for time spent on matters such as an overlong proof brief.” *Id.* (quotation omitted). Instead “Courts may consider such issues, but are “not required to ‘sift through all the legal work done.’” *Id.* (citation omitted).

Although “there is no rigid formula that must be followed,” a “request for attorney’s fees should not result in a second major litigation.” *Id.* (citations omitted). To that end, “‘[t]he district court is considered an expert in what constitutes a reasonable attorney fee, and we afford it wide discretion in making its decision.’” *Id.* (quoting *GreatAmerica Leasing*

Corp. v. Cool Comfort Air Conditioning & Refrigeration, Inc., 691 N.W.2d 730, 733 (Iowa 2005)).

In this case, Plaintiffs submitted an attorney fee affidavit totaling $231,410.11 and expert fees of $6,540.00. (App. v. II pp. 378-385). Nonetheless, in an eight (8) page ruling, the District Court pared the attorney fee request down to award of fees of $93,620.74 – a reduction of $137,789.37 (approximately 60% reduction). (App. v. II pp. 378-385). This reduction included the District Court culling fees related to counts other than the dissolution claim, and for time the District Court believed was either "unrelated" to the claim for which fees were granted for, or unsuccessful claims for which fees were not recoverable. (App. v. II pp. 378-385). The District Court further identified specifically the time entries it was disallowing and the reasons therefore. (App. v. II pp. 378-385). Recognizing that Plaintiffs' claims were "inextricably intertwined in many ways," the District Court ultimately reduced Plaintiffs' requested fees by 60% to what it believed "can reasonably be connected to the judicial dissolution and fair value determination," for which attorneys' fees were found to be statutorily supported. (App. v. II pp. 279-284).

Indeed, the District Court's analysis was so sufficiently detailed that Defendants describe it as "tedious." (Defendant's Proof Brief, p. 49). Yet, despite the District Court's exhausting analysis, resulting in a reduction of fees of 60% to the benefit of Defendants, they nonetheless charge the District Court with an abuse of its discretion, although they do not articulate how. Instead, the "abuse of discretion" alleged by Defendants appears to be nothing more than general dissatisfaction to the outcome of the fair value hearing.

The District Court's December 6, 2019, Order goes to great lengths to "show its work." Given the detail and analysis included in its Order, as a matter of law, the District Court – as an expert in attorneys' fees – exercised its discretion in a reasonable and measured way and must, therefore, be affirmed.

Additionally, on remand Plaintiffs request the District Court be instructed to award reasonable appellate attorney fees incurred in the present appeal. *See Schaffer v. Frank Moyer Const., Inc.*, 628 N.W.2d 11, 23 (Iowa 2001) (finding an award of appellate attorney fees permissible where the statute authorizing the award does not limit the award to fees incurred in the district court). Here, there is no language in Iowa Code section 490.1434(5) limiting reasonable fees and expenses to only those incurred in the District Court. *See* Iowa Code § 490.1434(5). Instead, just as in *Schaffer*, the statute utilizes broad language in an effort to ensure petitioning shareholders can recover expenses incurred enforcing their rights against oppressive and wasteful majority shareholders. *See Schaffer*, 628 N.W.2d at 23; *Bankers Trust Co. v. Woltz*, 326 N.W.2d 274, 278 (Iowa 1982) (finding the same justification for awarding attorneys fees in the trial court justifies an award of fees incurred on appeal). Since development of a record regarding what constitutes reasonable appellate attorney fees in this matter may be necessary, remand to the District Court for the purpose of holding a hearing and awarding the fee's is appropriate. *See Bankers Trust Co.*, 326 N.W.2d at 278 ("We prefer that the district court determine the reasonable amount of attorney fees plaintiffs should be awarded on this appeal.").

CROSS-APPEAL ARGUMENT

I. THE DISTICT COURT ERRED BY NOT INCREASING THE FAIR VALUE OF KASSEL ENTERPRISES BY THE WASTE AND MISAPPLICATION OF ASSETS BY CRAIG KASSEL.

A. Preservation of Error

Plaintiffs preserved error on the issue of whether the fair value determination of KE should include claims for waste and misuse of corporate assets by Craig Kassel by briefing the issue in its pretrial brief. (Plaintiffs' Statement of Issues and Trial Brief: Re Fair Value Hearing). Plaintiffs further preserved error through oral argument to the District Court on this issue. (App. v. V pp. 71:17-75:21, 12:8-15:21, Hearing tr, pp. 4:8-7:21; 63:17-67:21)

B. Scope and Standard of Review

As noted above (Brief Point I(B)), Plaintiffs and defendants agree the scope and standard of review for cases tried in equity, including fair value determinations under Chapter 490, is de novo. Iowa R. App. P. 6.907; *Van Horn v. R.H. Van Horn Farms, Inc.*, 919 N.W.2d 768 (Iowa Ct. App. 2018).

C. Discussion

1. <u>The District Court correctly held Craig Kassel wasted and misapplied the assets of Kassel Enterprises.</u>

As already thoroughly analyzed above (Brief Point II(C)(2)), which is incorporated herein, the District Court correctly determined Craig wasted and misapplied assets of KE. Although Craig's waste was more pervasive, harm to KE, and thus its shareholders, can be traced to three specific situations caused by Craig's waste and misapplication of corporate assets.

First, most notably, the District Court found Craig (or his wholly-owned companies) underpaid cash rent by $872,520. (App. v. II pp. 277-278). Although Craig attempted to make-up the difference through small "bonuses," Plaintiffs were still shorted $87,373 each. (App. v. II p. 278; App. v. II pp. 103-105).

Second, Craig unilaterally reduced the value of KE's equipment from $254,000 to $46,000 before selling it to himself at the reduced rate. (App. v. IX pp. 73-75; App. v. IV pp. 253:16-256:1, Craig Kassel tr. pp. 226:16-229:1). Craig explains away this decrease in value on the basis that he had a "different perspective" on the value. (App. v. IV pp. 253:16-256:1, Craig Kassel tr. pp. 226:16-229:1). This represents a loss to KE, which flows to each Plaintiff in the amount of $49,400.

Third, Craig plainly admits to giving away life insurance proceeds payable to KE. At the time of Lawrence Kassel's death, KE owned a life insurance policy on Lawrence with KE named as the beneficiary of the proceeds with a value of $350,000. (App. v. IX p. 85). Craig simply gave the proceeds to Georgia Kassel. (App. v. IV pp. 271:24-272:9, Craig Kassel tr. pp. 244:24-245:9). Again, this represents a loss to KE, which flows to each Plaintiff in the amount of $83,125.

As determined by the District Court, the facts of this case make clear KE has claims against Craig for the waste, misapplication, or misappropriate of its assets; Craig, of course, as the majority shareholder, has elected not to pursue those claims against himself.

2. <u>The fair value of Kassel Enterprises determined under the asset-based methodology includes legal claims it has against Craig Kassel.</u>

In this case, the District Court and both parties <u>*agree*</u> on how to value KE. Specifically, it is agreed the "asset-based approach" was the proper valuation methodology for determining the value of KE's assets and, thus, its shares. (App. v. II p. 272; Hr. Exhibits 28-29, App. v. IX p. 209; App. v. V pp. 84:23-85:25, 112:17-22, 140:3-7, 169:8-14, Hearing tr. pp. 76:23-77:1-25, 104:17-22, 132:3-7, 161:8-14). Defendants' expert, Brian Crotty, defined the "asset-based approach" as follows: "the value of a business is equal to the net value of its assets and liabilities," computed by adjusting the company's assets to market value. (App. v. IX p. 208). Defendants' expert Crotty recognized that "[i]n our appraisal of Kassel Enterprises, Inc., we determined the asset-based approach would provide a reliable indication of regarding the value of the Company" because KE is "asset intensive" in farmland holdings and that it has relatively low earnings compared to the value of its assets. (App. v. IX p. 209). Stated otherwise, the value of KE's shares <u>*is*</u> the value of its assets under the approach adopted by both Plaintiffs and Defendants.

As a matter of basic accounting principles, a company's assets include claims it may have against others. *In re Marriage of Keener*, 728 N.W.2d

188, 194–95 (Iowa 2007) (labeling ongoing litigation as an "intangible asset"); *See Bob McKiness Excavating & Grading Inc. v. Morton Bldgs., Inc.*, 507 N.W.2d 405, 410 (Iowa 1993) ("[O]nce a cause of action accrues, a plaintiff has a vested property right that cannot be summarily destroyed by legislative action."); *Arbie Mineral Feed Co., Inc. v. Farm Bureau Mut. Ins. Co.*, 462 N.W.2d 677, 680 (Iowa 1990) ("A cause in action is in existence prior to judgment and is personal property upon which, under Iowa law, a creditor may levy."); *Branson Label, Inc. v. City of Branson*, 793 F.3d 910, 917 (8th Cir. 2015) (recognizing legal claims as "assets of value"); *Asset*, Black's Law Dictionary (11th ed. 2019) ("An item that is owned and has value."). The value that Craig misapplied and wasted must be added back into the fair value of the Corporation. Otherwise, the law would encourage such waste and abuse with no legal recourse by the wronged shareholders and the word "fair" is rendered meaningless. Although the certainty (contingency) or amount (liquidity) of those claims may be at issue, such issues go to the fair value of the claim, not whether or not it should be included. *See Keener*, 728 N.W.2d at 195 (recognizing litigation proceeds should be included in division of property subject to sufficient evidence supporting the measure of the claims fair market value).

Consequently, as a matter of law, any claim that KE has against Craig related to his waste, misapplication, or misappropriation of corporate assets constitutes an asset of KE. As an asset of KE, such claims should have been included in the asset-based valuation of KE and, thus, the fair value determination of Plaintiffs' ownership interest in KE.

3. In determining the fair value of Plaintiffs' interest in Kassel Enterprises, the District Court erred by failing to consider potential legal claims the company has against Craig Kassel for waste or misapplication of corporate assets.

In this case, the District Court found several instances where Craig, as the majority shareholder of KE, wasted or misapplied corporate assets in favor of himself or the operations of his separate farming enterprises. Indeed, the District Court held these facts were sufficiently clear that Plaintiffs' petition to dissolve KE was founded on "probable grounds," even awarding more than $93,000 in attorneys' fees to Plaintiffs in their pursuit of the dissolution or fair value determination of KE. (App. v. II pp. 378-385).

Yet, in spite of these findings, and without reliance on any legal authority, the District Court summarily refused to take such claims into consideration in valuing KE and Plaintiffs' interest therein. (App. v. V p. 12:14-22, Hearing tr, p. 4:14-22).

The District Court's arbitrary failure to consider such claims in the asset-based valuation of KE constitutes clear error. In particular, the District Court both refused to consider the value of such claims (an asset) in determining the fair value of KE[9] ***and*** denied Plaintiffs' ability to pursue such claims directly. Indeed, the District Court dismissed Plaintiffs' direct claim against Craig for breach of fiduciary duties for waste and misapplication of corporate assets, holding such claims were only derivative, meaning any damages would flow to KE directly, only affecting Plaintiffs derivatively. (App. v. II pp. 284-293). Stated otherwise, the District Court dismissed Plaintiffs' direct claims specifically because it believed Craig's misconduct only damaged KE, and that Plaintiffs' injury was only related to their equity interest (*i.e.*, fair value) in KE.[10] (App. v. II pp. 284-293).

Very simply, the District Court dismissed Plaintiffs' direct claims because it found the harm caused by Craig's waste and misapplication of corporate assets caused direct damage only to Kassel Enterprises, and that

[9] Further, pursuant to Iowa Code Section 490.1434(6), upon determining the fair value of KE, all of Plaintiffs rights and status as shareholders in KE terminated, except the right to receive the fair value awarded.

[10] The District Court denied the exception of *Redeker v. Litt*, which allows shareholders in closely-held companies to pursue otherwise derivative claims if such claims will not (1) unfairly expose the corporation/defendants to multiplicity of actions; or (2) interfere with a fair recovery among all interested persons. *Redeker v. Litt*, (No. 04-0637) 699 N.W.2d 684 (table), 2005 WL 1224697 at **5-6 (Iowa Ct. App. May 25, 2005).

any harm to Plaintiffs was indirect (derivative) in the context of a reduction of their stock value. (App. v. II pp. 284-293). Indeed, in ruling that such claims are derivative, the District Court observed that a corporation (rather than the shareholder) should maintain the action because "any proceeds resulting from the litigation will be **treated as corporate assets**." (App. v. II pp. 286 (emphasis added)). Consequently, because the District Court believed the harm caused by Craig's waste and misapplication of corporate assets flowed only to KE, the Court was compelled to consider that damage (an asset of KE) in determining the value of KE (under the asset-based approach) and the fair value of Plaintiffs' interest therein. Its failure to do so constitutes error.

Accordingly, this Court should order a limited remand so that the District Court can receive evidence for, and rule on the value of the claims Kassel Enterprises has against Craig related to his waste and misapplication of corporate assets, and how such value affects the fair value of Plaintiffs' ownership interest in KE.

CONCLUSION

For the reasons and authorities set forth herein, the District Court correctly rejected Defendants' requested discounts for transaction costs and alleged "built-in gains" in the context of a S corporation. Likewise, the

District Court's award of attorneys' fees and costs was both authorized by law and well within the court's discretion, based on the evidence of the case. Accordingly, the District Court's decisions on these issues must be affirmed.

Conversely, in determining the fair value of Kassel Enterprises, the District Court erred in not considering the value of claims Kassel Enterprises has against Craig Kassel for his waste and misapplication of corporate assets. This Court should order a limited remand instructing the District Court to receive evidence on value of such claims as related to the fair value of Plaintiffs' equity interest in Kassel Enterprises and undertake necessary steps to grant Plaintiffs' reasonable attorney fees incurred on appeal pursuant to Iowa Code section 490.1430(5).

REQUEST FOR ORAL ARGUMENT

Plaintiffs hereby requests to be heard in oral argument in this matter.

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This Brief complies with the type-volume limitation of Iowa R. App. P. 6.903(1)(g)(1) because it contains 13,725 words, excluding the parts of the Brief exempted by Iowa R. App. P. 6.903(1)(g)(1).

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The undersigned certifies a copy of this Brief was filed with the Clerk of the Iowa Supreme Court via EDMS and served upon the following persons by EDMS on the 9th day of July, 2020.

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