

105 Va. Cir. 86B

UNPUBLISHED OPINION. CHECK COURT RULES  
BEFORE CITING.

Circuit Court of Virginia,  
City of Norfolk.

Ortal BITON

v.

Vladislav KREINIS and New Tomorrow, Inc.

Docket No.: CL19-7991

|  
July 10, 2020

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#### Opinion

David W. Lannetti, Circuit Court Judge

\*1 Dear Counsel:

Today the Court establishes the fair value of New Tomorrow, Inc. (“New Tomorrow”) for the purpose of Defendant Vladislav Kreinis’s election to purchase Plaintiff Ortal Biton’s shares in lieu of dissolution of New Tomorrow, the corporation in which the parties are equal shareholders. The Court also addresses certain terms of the stock purchase as allowed by [section 13.1-749.1 of the Code of Virginia](#), Kreinis’s claim that Biton damaged New Tomorrow after Kreinis filed his election to purchase her shares, and claims by Kreinis and Biton that the other improperly took post-election shareholder distributions.

Biton asserts that the value of Biton’s corporate shares—as of the statutory valuation date—is \$1,494,000, whereas Kreinis contends that the share value is \$195,000. The Court finds that the value of Biton’s New Tomorrow shares is \$1,022,241. The Court further finds that installment payments toward the purchase price and any additional costs or credits are appropriate, provided that Kreinis makes an initial payment of \$150,000 within 60 days and monthly payments of \$30,000

thereafter until the total amount is paid. The Court also finds that it is appropriate that Biton be granted a security interest in New Tomorrow. Additionally, the Court finds that Kreinis failed to prove that Biton breached a fiduciary duty that damaged him or New Tomorrow. Finally, by separate order, an accountant selected by the parties has been tasked with reconciling the appropriate financial records to determine the extent to which corporate payments were made, or inappropriate shareholder distributions were taken, by Kreinis or Biton between August 1, 2019, and May 31, 2020.

Upon entry of an order delineating the terms and conditions of the stock purchase, Biton’s petition for dissolution<sup>1</sup> will be DISMISSED, and Biton will no longer have any rights or status as a shareholder of New Tomorrow. She will, however, retain her right to receive the amounts awarded herein, as well as any amounts the court may award after reviewing the accountant’s report.

#### Background

The matters currently before the Court arise out of an action to dissolve New Tomorrow, a corporation involved in the retail sale of high-end consumer cosmetics. Biton and Kreinis, who are the only directors and shareholders of New Tomorrow, each control separate entities that the Court previously found were corporate assets. *See generally Biton v. Kreinis*, et al., CL19-7991, 2020 Va. Cir. LEXIS 50 (Norfolk Apr. 16, 2020). The entity Kreinis controls—Nuriel-Beauty, LLC (“Nuriel”)—leases a retail location at Lynnhaven Mall in Virginia Beach, and the entity Biton controls—OB Global, Inc. (“OB Global”)—leases a retail location at MacArthur Mall in Norfolk. Both retail locations consist of a store and several kiosks.

\*2 Kreinis and Biton initially met when Biton provided salesforce training to Kreinis’s employees over several days in 2017, which led to Kreinis asking Biton to go into business with him. On September 15, 2017, the two entered into an agreement (the “Agreement”) to jointly operate the two retail locations and to form a new entity, New Tomorrow, a Virginia corporation with its principal place of business located in Norfolk, Virginia.<sup>2</sup> (*See Ex. P-11.*<sup>3</sup>) The Agreement states that creation of New Tomorrow is “for the purpose of combining the businesses ... to include [the Lynnhaven Mall store] and [Biton’s] store which is expected to open by January 2018 at MacArthur Mall.” (*Id.* at 1.) It provides that both Kreinis and Biton will receive a monthly salary

of \$3,500, subject to redetermination by agreement of the parties, and a commission of thirty-five percent of any sales for which they were the sales representative. (*Id.* ¶ 7.) It also states that “[all] profits, expenses and losses will be divided equally.” (*Id.* ¶ 5.) In addition to handling the revenue and expenses of New Tomorrow, the parties were to use the corporation for most administrative functions related to the two locations, including payroll and accounting. (*Id.* ¶ 4.) Per the Agreement, Biton and Kreinis each own fifty percent of the shares of New Tomorrow. (*Id.* ¶ 1.)

Biton opened the MacArthur Mall location sometime in April 2018, after New Tomorrow incurred \$96,933 in one-time construction and start-up “Section 179” depreciation expenses. (*See* Ex. P-54, Form 4562.) For 2018, New Tomorrow had tax-reported total revenues of \$2,988,462<sup>4</sup> and net income of \$551,655. (*Id.*) It made charitable contributions of \$1,485 in 2018. (*Id.*, Form 1120S.) During that year, Kreinis and Biton each received \$98,000 in salary and \$394,805 in shareholder distributions; they agreed not to be paid their commissions. (*Id.*, Form 1120S & Schedule K-1.)

Starting in June 2019, revenues decreased dramatically. The undisputed testimony was that around the same time, the number of employees was significantly reduced,<sup>5</sup> a source of consumer financing was lost, and the relationship between Kreinis and Biton deteriorated to the point that Biton considered filing for dissolution of New Tomorrow. The 2019 total corporate revenue, according to the corporate QuickBooks account, was \$2,443,516. (Ex. P-104; Ex. P-105, at 17.)

On August 2, 2019, Biton filed the instant action to dissolve New Tomorrow. Three days later, on August 5, 2019, Kreinis filed an election to purchase Biton's corporate shares in lieu of dissolution pursuant to [section 13.1-749.1 of the Code of Virginia](#). Biton subsequently opened new accounts for OB Global and used them to support operation of the MacArthur Mall location.

In a prior letter opinion, the Court pointed out that the ultimate valuation order would include provisions requiring, *inter alia*, (1) New Tomorrow to pay Biton for any Unpaid services she provided to and will continue to provide the corporation—as well as any unpaid commissions and shareholder distributions—up until the date that Kreinis purchases Biton's shares, (2) Biton to cooperate in transferring the MacArthur Mall lease and any rights thereunder to New Tomorrow, (3) Biton to transfer to or reimburse New Tomorrow for any funds from

the MacArthur Mall operations that properly should have been forwarded to the corporation since the share valuation date, and (4) Biton to be liable to New Tomorrow for any harm she caused the corporation since the share valuation date. *See Biton v. Kreinis*, et al., CL19-7991, 2020 Va. Cir. LEXIS 69, at \*19-20 (Norfolk May 1, 2020).

The Court held a four-day bench trial that concluded on June 20, 2020.<sup>6</sup> At the conclusion of the trial, the Court took the matter under advisement.

## Positions of the Parties

### Biton's Position

\*3 Biton's valuation expert relied on an income approach to valuation using the capitalization of earnings method. (*See generally* Ex. P-51.) He stated that he based his corporate valuation on New Tomorrow's 2018 revenue because 2018 was the last available year an accountant had filed a corporate tax return, it was the last full year before the valuation date, it was the last year before the breakdown in relations that led to the dissolution filing, and there was no reason to believe New Tomorrow's operations would not continue as in 2018. (*Id.* at 3–4.<sup>7</sup>) The 2018 tax-reported revenue was \$2,988,462, and the associated net income was \$551,655. (Ex. P-65.) Adjusting the net income for the one-time opening expenses of the MacArthur Mall store (\$96,933), 2018 corporate charitable contributions (\$1,485), and potential salary savings that could be realized by hiring a general manager for \$125,000 in lieu of Kreinis's and Biton's combined salaries of \$196,000 (a savings of \$71,000), he calculated an adjusted net income of \$721,073 (\$551,655 plus \$96,933 plus \$1,485 plus \$71,000), which yielded a 2018 adjusted net income margin of 24.13% (\$721,073 divided by \$2,988,462). (Ex. P-51, at 5.)

Using the 2018 tax-reported revenue of \$2,988,462, he calculated a monthly average revenue for the twenty full “store months” that year—twelve months for the Lynnhaven Mall location and eight months for the MacArthur Mall location. (Ex. P-158, at 6.) He then assumed that this monthly average represented the revenue for the months of January through April 2018, when the MacArthur Mall location was not yet fully operational, and seasonally adjusted that total by comparing the January through April 2019 revenues—when both locations were operating—to the corporate revenues between May and December (26.9% actual percentage vs. 33.3% pro rata percentage, *i.e.*, an 81% seasonality adjustment (26.9% divided by 33.3%)). (*Id.*)

This yielded a 2018 adjusted total revenue for New Tomorrow of \$3,472,593 and an estimate of ongoing cash flows of \$837,937 (\$3,472,593 times 24.13%). (*Id.* at 7.)

The expert calculated a capitalization rate of 18.60% to apply to the ongoing cash stream. He first calculated a discount rate of 25.69%: he assumed a 2.31% risk-free rate of return, a 6.91% equity risk premium, a 5.22% small stock risk premium, a 3.25% industry risk premium, and an 8.00% company specific premium. (*Id.*) He then applied a 4.00% long-term sustainable growth rate and a 2.34% mid-year convention. (*Id.*) Finally, he divided the result by 1.04 (1 plus the sustainable growth rate) to adjust the rate to the current year stream. (*Id.*)

He then applied to the \$837,937 ongoing cash flow a \$5,000 annual depreciation, a 6% state income tax deduction, and a 21% federal income tax deduction, yielding a selected ongoing net of debt after tax flow of \$618,500. (*Id.* at 10.)

Using the after-tax cash flow of \$618,500 and the 18.60% capitalization rate, the expert calculated a corporate value of \$3,325,269 (\$618,500 divided by 18.60%). (*Id.*) Finally, deducting non-operating liabilities of \$337,000—an undisputed amount—he determined the selected equity value of New Tomorrow to be \$2,988,000 and the value of Biton's shares to be half of that, or \$1,494,000. (*Id.* at 12.)

Biton also asserts that \$403,837.07 paid to Kreinis—and allegedly commingled with funds in Kreinis's personal accounts—presumptively constitutes improper shareholder distributions. She contends that Kreinis therefore has the burden of proving that the commingled funds were used for corporate purposes.

Finally, Biton contends that if the Court allows Kreinis to purchase Biton's shares via installment payments, the Court should require a substantial down payment and adequate security, as allowed by [section 13.1-749.1\(E\) of the Code of Virginia](#), based on Kreinis's current financial condition. Biton filed a Pretrial Memorandum on Financing Terms shortly before trial, as well as a Post-Trial Memorandum on Collateral. Biton requests that, should the Court allow installment payments, the share purchase terms include, *inter alia*, a down payment of at least \$250,000; a 15-25% rate of interest; a 35% default rate of interest; a first-priority perfected lien on New Tomorrow's current and future assets and on all corporate stock; late payment fees of the greater of 5% of the payment or \$250; debt acceleration in the event

of default; and access by Biton to New Tomorrow's financial records. (Pl.'s Pretrial Mem. Financing Terms 6-7.)

#### Kreinis's Position

\*4 Kreinis's valuation expert also relied on the income-based capitalization of earnings method of valuation. (*See generally* Ex. D-2.) He based his corporate valuation on New Tomorrow's 2019 total revenue, asserting that it is “the best indicator of future ongoing earnings.” (*Id.* at 6.) Although the August through December 2019 revenue could not have been known when Kreinis elected to purchase Biton's shares on August 5, 2019, the expert asserted that “the parties knew the business was not going to produce the same level of revenues [in] the last four months of 2019 as in 2018.” (*Id.*) He claimed that the 2019 revenue—based on the corporate QuickBooks data—was \$2,614,378<sup>8</sup> and that the associated net income was \$197,999.<sup>9</sup> (*Id.* at 7.) Adjusting the net income for the 2019 corporate charitable contributions (\$2,748) and excess legal expenses (\$38,175), he calculated an adjusted net income of \$238,922, which he rounded to \$239,000. (*Id.*) The expert estimated that Kreinis and Biton's 2019 combined salary of approximately \$118,000 is equivalent to what a hypothetical general manager overseeing both stores would be paid, so hiring a general manager theoretically would not result in any salary savings. (*Id.* at 6.) This yielded a 2019 adjusted net income margin of 10.94% (\$2,614,378 divided by \$239,000).

He then applied to the \$239,000 ongoing cash flow a \$5,000 annual depreciation, a 6% state income tax deduction, and a 21% federal income tax deduction, yielding a selected ongoing net of debt after tax flow of \$ 173,800. (*Id.* at 7.) He multiplied this by 1.02—the growth rate—to adjust the cash flow to the current year stream, yielding an adjusted net of debt after tax flow of \$177,276. (*Id.* at 9.) The expert then calculated a capitalization rate of 24.38% to apply to the current year stream. (*Id.* at 8.) He did this by (1) assuming a 2.25% risk-free rate of return, a 6.91% equity risk premium, a 5.22% small stock risk premium, and a 12.00% company specific premium (and no industry risk premium); and (2) discounting for a 2.00% long-term sustainable growth rate and not applying a mid-year convention. (*Id.*)

Using the after-tax cash flow of \$177,276 and the 24.38% capitalization rate, the expert calculated a corporate value of \$727,137 (\$177,276 divided by 24.38%). (*Id.* at 9.) Finally, deducting non-operating liabilities of \$337,000, an undisputed amount, he determined the one hundred percent

equity value of New Tomorrow to be \$390,137—which he rounded to \$390,000—and the value of Biton's shares to be half of that, or \$195,000.<sup>10</sup> (*Id.*)

Kreinis also asserts that Biton damaged New Tomorrow and him, as a shareholder, by operating the MacArthur Mall location as a “personal asset” after he elected to purchase her shares. More specifically, he claims that Biton mismanaged the MacArthur Mall operations, allegedly resulting in lost revenue of at least \$269,955, and that Biton owes him \$148,372 for corporate expenses, profit from the MacArthur Mall operations, compensation Biton paid herself, and unauthorized shareholder distributions Biton received.

\*5 Finally, Kreinis argues that he should be allowed to purchase Biton's shares via reasonable installment payments based on his current financial situation. Shortly after filing his election to purchase Biton's shares, Kreinis filed a Motion to Permit Installment Payments, in which he offered to pay six monthly payments of \$25,000 toward the share purchase price (Mot. Permit Installment Payments ¶ 11); the Court reserved ruling on the motion until trial. Kreinis testified at trial that since his election, New Tomorrow has produced little or no revenue despite incurring ongoing expenses, in part due to closure of the stores for several months and ongoing service limitations in 2020 due to the coronavirus pandemic, which the parties concede is a subsequent event that does not affect valuation. Kreinis therefore claims that he is no longer able to pay \$25,000 per month. As collateral, Kreinis offers to grant Biton a security interest in the MacArthur Mall store and in half of New Tomorrow's assets.

## Analysis

### Legal Standard

The *Code of Virginia* provides that the Court

may dissolve a corporation: (1) in a proceeding by the shareholder of a corporation that is not a public corporation if it is established that: (a) the directors are deadlocked in the management of the corporate affairs, the shareholders are unable to break the deadlock, and irreparable injury to the corporation is threatened or being suffered, or the business and affairs of the corporation can no longer be conducted to the advantage of the shareholders generally, because of the deadlock.

*Va. Code* § 13.1-747(A) (2016 Repl. Vol.). It also provides that “in a proceeding under ...section 13.1-747 to dissolve a corporation, ... one or more shareholders may elect to purchase all shares owned by the petitioning shareholder at the fair value of the shares” and that such an election “shall be irrevocable unless the court determines that it is equitable to set aside or modify the election.” *Id.* § 13.1-749.1(A).

Further, “[i]f the parties are unable to reach an agreement ..., the court ... shall ... determine the fair value of the petitioner's shares as of the day before the date on which the petition ... was filed or as of such other date as the court deems appropriate under the circumstances.” *Id.* § 13.1-749.1(D). The Court may consider, among other things, the petitioner's minority status and the marketability of the petitioner's shares. *Id.*

In the Agreement, Kreinis and Biton agreed to, *inter alia*, the following:

Fifth: All profits expenses and losses will be divided equally. All major business decisions will be agreed upon jointly.

....

Seventh: Each party shall receive funds on an equal basis. Such amount is anticipated as Three Thousand Five Hundred (\$3,500.00) Dollars, per month. The parties will continue to determine the timing and amounts of such....

....

Ninth: It is agreed the funds referred to in Seventh hereinabove, shall not include the thirty-five (35%) percent commission relative to the sale of product to which a party is entitled as a sales representative.

Ex. P-11.

“Where experts offer conflicting testimony, it is within the discretion of the trial court to select either opinion.” *Rowe v. Rowe*, 24 Va. App. 123, 140, 480 S.E.2d 760, 768 (1997). Further, a court is not required to uncritically accept an expert's valuation, but rather can accept or reject portions of his testimony as warranted by the evidence as a whole. *Street v. Street*, 25 Va. App. 380, 387, 488 S.E.2d 665, 668 (1997).

Upon determining the fair value of the shares, the court shall enter an order directing the purchase upon such terms and conditions as the court deems appropriate, which may include payment of the purchase price in installments, where necessary in the interests of equity [and] provision

for security to assure payment of the purchase price and any additional costs, fees and expenses as may have been awarded .... Interest may be allowed at the rate and from the date determined by the court to be equitable ....

*Id.* § 13.1-749.1(E).

\*6 Upon entry of an order directing the terms of the share purchase, “the court shall dismiss the petition to dissolve the corporation” and “the petitioning shareholder shall no longer have any rights or status as a shareholder of the corporation, except the right to receive the amounts awarded to him by the order of the court, which shall be enforceable in the same manner as any other judgment.” *Id.* § 13.1-749.1(F).

“To recover on a breach of fiduciary duty claim in Virginia, a plaintiff must show that a duty exists, that the duty was breached and that the breach caused damages.” *Moore v. Law Offices of Shapiro, Brown & Alt, LLP*, No. 3:14cv832, 2015 U.S. Dist. LEXIS 106921, at \*22 (E.D. Va. Aug. 13, 2015) (citing *Carstensen v. Chrisland Corp.*, 247 Va. 433, 434–44, 442 S.E.2d 660, 666 (1994)). “The plaintiff has the burden of proving with reasonable certainty the amount of damages ....” *Carr v. Citizens Bank & Tr. Co.*, 228 Va. 644, 652, 325 S.E.2d 86, 90 (1985).

### Discussion

The Court has considered the pleadings, evidence provided at trial, argument from counsel, and applicable authorities. The Court now rules on the issue of the value of Biton's shares of New Tomorrow for the purpose of Kreinis purchasing those shares, related terms and conditions of the share purchase, alleged damages to New Tomorrow and Kreinis by Biton, and alleged improper shareholder distributions

#### A. Valuation of Biton's Shares.

The *Code of Virginia* provides that when the parties cannot agree on valuation upon a shareholder's election to purchase corporate shares in response to a petition for dissolution, the Court shall determine the fair value of the shares. *Va. Code* § 13.1-749.1(D) (2016 Repl. Vol.). The statutory valuation date is the day before the date on which the dissolution petition was filed unless the court deems another valuation date appropriate under the circumstances. *Id.* Biton filed her dissolution action on August 2, 2019, so the presumptive valuation date is August 1, 2019. The Court previously denied Kreinis's motion to determine an alternate valuation date. *See Biton v. Kreinis, et al.*, CL 19-7991, 2020 Va. Cir. LEXIS 69

(Norfolk May 1, 2020). The Court finds that the appropriate valuation date therefore is August 1, 2019.

Both experts determined that an income approach to valuation—using the capitalization of earnings method—is appropriate to value New Tomorrow.<sup>11</sup> Under this income-oriented approach, the critical component of corporate valuation is the ability to generate future cash flows. The methodology relies on a representative historical cash flow and assumes that future cash flows will grow at a slow, steady pace into perpetuity. The calculated estimated annual cash flow is divided by a capitalization rate to determine the overall value of the corporation. This method assumes that all corporate assets, tangible and intangible, are indistinguishable parts of the business.

#### 1. New Tomorrow's Representative Annual Revenue.

To calculate the annual cash flow, the Court must first determine New Tomorrow's representative annual revenue. The two experts agree that the appropriate time period to consider must reflect operations at both the Lynnhaven Mall and the MacArthur Mall locations. There is little revenue history for New Tomorrow, as the first full month of operations at the MacArthur Mall location was May 2018 and the valuation date is August 1, 2019. Biton's expert chose to use the 2018 tax-reported annual revenue because it was the last available year an accountant had filed a corporate tax return, the last full year before the valuation date, and the last year before the events that led to Biton filing for dissolution. He also claimed that there was no reason to believe New Tomorrow's operations would not continue as in 2018. He filled in the missing months of MacArthur Mall operations revenue—January through April 2018—by calculating an average 2018 monthly income per location and applying a seasonal adjustment. Kreinis's expert, on the other hand, chose to use the 2019 QuickBooks-indicated revenue because he thought it was the best indicator of future ongoing earnings and because, as of the valuation date, Kreinis and Biton knew New Tomorrow's future performance would be depressed.

\*7 The Court finds that using the 2019 QuickBooks-indicated revenue for valuation purposes is inappropriate. As an initial matter, the 2019 data include five months of revenue after the August 1, 2019, valuation date. Using data after the valuation date is discouraged by the Statement on Standards for Valuation Services, which states that “[g]enerally, the valuation analyst should consider only circumstances existing

at the valuation date and events occurring up to the valuation date.” (Ex. D-126.) Kreinis's expert acknowledged as much in his expert report (Ex. D-2, at 6), and he admitted during his testimony that using post-valuation-date revenue was highly irregular. Both Kreinis and Biton also testified that there was significant corporate dysfunction starting in June 2019—resulting in a substantial decrease in revenue—including a large staff reduction, filing of the dissolution action, and the related litigation and fallout from the dissolution suit, which included operating the MacArthur Mall location independently of New Tomorrow. Additionally, New Tomorrow lost—at least temporarily—a third-party financing partner to fund large customer purchases in March 2019, although the parties disagree about whether this affected revenue.<sup>12</sup> Kreinis's expert opined that all of these conditions were knowable as of the valuation date and that the 2019 data therefore could be used to determine corporate value. The Court finds that projecting this anomalous revenue stream into perpetuity, however, is not indicative of future performance.

Perhaps most importantly, the available 2019 financial information is unreliable. New Tomorrow's 2019 tax return is not yet available. Additionally, the QuickBooks data are suspect, as evidenced by the fact that the QuickBooks 2018 revenue is more than twelve percent higher than the 2018 tax-reported revenue,<sup>13</sup> a fact that neither expert could explain. Further, Biton pointed out that two New Tomorrow QuickBooks profit-and-loss statements produced in discovery by Kreinis for *the same time period*—August through December 2019—are markedly different.<sup>14</sup> (Compare Ex. P-133 with Ex. P-134.) There are also a large number of unusual general ledger entries after the election to purchase shares in 2019 that involved significant payments to Kreinis. (See Ex. P-99; Ex. P-100; Ex. P-135; Ex. P-136.)

The New Tomorrow 2018 revenue information that Biton's expert used, on the other hand, appears reliable. The 2018 corporate tax return is available. Although the MacArthur Mall location did not have its first full month of operation until May 2018, the Court finds that the expert's approach to adjusting the 2018 revenue to account for the “missing” months is sound. He averaged the twenty months of available store revenue for 2018 and seasonally adjusted the average to create estimated revenues for the MacArthur Mall location for the missing months. Although using the twelve months of revenue immediately prior to the valuation date arguably would have yielded a more accurate representative annual revenue for valuation purposes, that would have required

using the monthly QuickBooks figures, which—as discussed above—are not reliable.<sup>15</sup>

\*8 For valuation purposes, the Court finds it appropriate to use the 2018 revenue as calculated by Biton's expert—\$3,472,593—as New Tomorrow's representative annual revenue, subject to discounting to account for Biton's unique contributions, as discussed below.

## 2. Revenue Discount Due to the Loss of Biton.

Although neither expert expressly considered Biton's upcoming disassociation from New Tomorrow in his valuation report, at trial Biton's expert—and Biton—argued that the loss of Biton would not affect corporate income, *i.e.*, that her sales expertise is easily replaceable. Kreinis, by contrast, asserted that Biton added significant value to New Tomorrow and that it will cost between \$350,00 and \$400,000 to replace her.<sup>16</sup> The Court finds, based on evidence presented at trial, that Biton's sales expertise is not easily replaceable and that the corporate revenue for purposes of valuation therefore should be discounted based on her loss.

Biton's history with New Tomorrow demonstrates her unique value as a saleswoman to the corporation. Kreinis was so impressed with Biton's sales ability that after only a few days of witnessing her interact with his employees and customers—while she visited the Lynnhaven Mall store upon his request to the cosmetic distributor for a trainer—he offered to partner with her in an enterprise where each would have the same ownership stake. Biton later stood up the MacArthur Mall location and, during the first eight months of its operations, her location generated 57% of New Tomorrow's revenue. (See Ex. P-158, at 6.) In other words, in the *first two-thirds of a year while operating a new store*, Biton's location was 33% more productive than Kreinis's location (57% divided by 43%, or 1.33); this means that New Tomorrow arguably was more than 16% more profitable *with* Biton than it would have been if Biton—or someone else—had been responsible for the same revenue as Kreinis (100% divided by 86%).<sup>17</sup> Of note, Kreinis clearly was a very successful salesman even prior to Biton joining New Tomorrow, as his 2017 adjusted profit margin based on tax-reported revenue and expenses was 26.36%,<sup>18</sup> making the 2017-to-2018 total revenue increase—from \$583,523 (with only the Lynnhaven Mall location operating) to \$2,988,462 (both locations operating)—all the

more impressive. (See Ex. P-53, Form 1120S; Ex. P-54, Form 1120S.)

In light of the above, the Court finds it appropriate to discount the representative annual revenue by ten percent to represent New Tomorrow's future cash flows without the benefit of Biton's sales expertise. The Court finds that New Tomorrow's representative annual revenue for the purpose of valuing Biton's shares therefore is \$3,125,334 (\$3,472,593 times 90%).

### 3. Estimate of Ongoing Cash Flows.

To estimate New Tomorrow's ongoing cash flows, *i.e.*, ongoing net income stream, the representative annual revenue is multiplied by the net income margin. As discussed previously, the QuickBooks data are unreliable, so—like Biton's expert—the Court relies on the 2018 tax-reported information. According to the tax filing, the 2018 total revenue was \$2,988,462,<sup>19</sup> and the 2018 net income was \$551,655. (Ex. P-54.) The Court agrees with Biton's expert that adjustments need to be made to account for the one-time 2018 opening expenses of the MacArthur Mall store (\$96,933) and the 2018 corporate charitable contributions (\$1,485). (Ex. P-51, at 5.) Regarding the potential salary savings from hiring a general manager in lieu of the combined 2018 officer salaries of \$196,000, the Court notes that Biton's expert opined that the market rate for a general manager is \$125,000 per year (Ex. D-2, at 6) while Kreinis's expert opined that the market rate is approximately \$118,000 per year (Ex. P-51, at 5).<sup>20</sup> Significantly, Biton's expert bases his opinion on the annual mean salary for general and operations managers in the Hampton Roads area according to the Bureau of Labor Statistics (Ex. P-51), whereas Kreinis's expert provides no basis for his general assertion that the 2019 officer salary is “a reasonable level for a hypothetical general manager overseeing both stores” (Ex. D-2, at 6). The Court finds use of a \$125,000 annual salary for a general manager to be proper; this expense represents a savings of \$71,000 compared to the 2018 combined officer salaries of \$196,000. The net income margin therefore is 24.13% (((\$551,655 plus \$96,933 plus \$1,485 plus \$71,000) divided by \$2,988,462).<sup>21</sup>

\*9 Of note, Kreinis's expert bases his ongoing-cash-flow calculations on the 2019 QuickBooks data, adjusted for charitable contributions and excess legal costs, which yields a net income margin of 10.94%. (See Ex. D-2, at

7.) Kreinis also argues—using *unadjusted* total revenue and net income figures, including not accounting for the \$96,933 one-time opening expenses of the MacArthur Mall store in 2018—that the corporate profit margin has been continually declining since 2017.<sup>22</sup> As discussed above, the Court finds the QuickBooks data unreliable, especially for 2019. Additionally, this approach significantly—and inappropriately—affects the 2018 net income margin by not adjusting for non-operating costs.<sup>23</sup> Further, the Court notes that the adjusted net income margin for the business in 2017—*before* Biton joined—was 26.36%,<sup>24</sup> which is *higher* than the 2018 net income margin of 24.13% that the Court finds appropriate.

Using a net income margin of 24.13% and a representative annual revenue of \$3,125,334, the Court finds that the proper estimate of ongoing pre-tax cash flows is \$754,143 (\$3,125,334 times 24.13%).

### 4. Corporate Value Based on Capitalization of Earnings.

The capitalization rate represents the risk an investor is willing to accept for the potential rate of return on his investment. It consists of a net cash flow discount rate, a long-term sustainable growth rate, potentially a mid-year convention calculation, and an adjustment to calculate the next year cash stream.

The experts agree to a large extent on the discount rate to be used to calculate the capitalization rate applicable to the ongoing cash flows. They both used a 2.31% risk-free rate of return,<sup>25</sup> a 6.91% equity risk premium, and a 5.22% small stock risk premium. Their approach to the company specific premium differed slightly: Biton's expert assumed a 3.25% industry risk premium and an 8.00% company specific premium, while Kreinis's expert assumed a 12.00% company specific premium without any industry risk premium. Biton's expert testified that his combined premium accounted for the same factors that Kreinis's expert considered to arrive at his company specific premium; hence, one expert assumed an “equivalent” 11.25% company specific premium and the other assumed a 12.00% company specific premium. Based on the expert reports and testimony, the Court finds that the appropriate company specific premium is 12.00%, which yields a net cash flow discount rate of 26.44% (2.31% plus 6.91% plus 5.22% plus 12.00%).

The experts disagree regarding New Tomorrow's long-term sustainable growth rate. Kreinis's expert asserts that, based on his assessment of New Tomorrow's prospects, "as well as average historical increases in [gross domestic product ("GDP")] including inflation and future prospects for retail sales, especially in Malls," a 2.0% long-term compound annual growth rate is appropriate. (Ex. D-2, at 8.) Biton's expert, on the other hand, contends that a 4.0% annual growth rate is proper. (Ex. P-52, at 3–4; Ex. P-158, at 7.) Noting that "the 10-year consensus forecast of the nominal GDP average annual growth rate has been around 4.5% to 5.5%" and that "the ten-year projected inflation rate is 2.3%," Biton's expert claims that by using only a 2.0% growth rate, Kreinis's expert "is implying that the long-term growth rate for [New Tomorrow] is significantly lower than expected growth in the economy as a whole" and below the projected inflation rate. (Ex. P-52, at 3–4.) Considering the totality of the evidence, as well as New Tomorrow's current circumstances, the Court finds that a 2.5% long-term sustainable growth rate is appropriate.

\*10 Biton's expert argues for the application of a mid-year convention, which assumes that future cash flows occur twice—instead of once—a year, whereas Kreinis's expert asserts that such a convention is not required. Biton's expert admits that there is no standard in the business valuation industry and that use of the convention is purely discretionary. Based on that concession, the Court does not find that application of a mid-year convention is warranted.

The capitalization rate is calculated by subtracting the sustainable growth rate from the net cash flow discount rate, adjusting for the mid-year convention (if appropriate), and then dividing the result by the sum of one plus the growth rate to calculate the next year cash stream. Hence, the capitalization rate here is 23.36% ((26.44% minus 2.5%) divided by 1.025).

This capitalization rate needs to be applied to the *after-tax* cash flows. Both experts agree that a \$5,000 annual ongoing depreciation amount,<sup>26</sup> a 6% state income tax rate, and a 21% federal income tax rate<sup>27</sup> are appropriate. The after-tax cash flow, net of debt, therefore is \$556,314 ((\$754,143 minus \$5,000) x 0.94 x 0.79). Applying the 23.36% capitalization rate yields an unadjusted corporate value, otherwise known as a selected equity value, of \$2,381,481 (\$556,314 divided by 23.36%).

##### 5. Adjusted Value of New Tomorrow.

The calculated corporate value then must be reduced by any non-operating liabilities. Here, Kreinis and Biton agree that the non-operating liabilities—which stem from pending lawsuits and claims each has for past sales commissions—total \$337,000. Reducing the corporate valuation by this amount yields a final corporate valuation of \$2,044,481 (\$2,381,481 minus \$337,000)<sup>28</sup> The value of Biton's shares is half of the final corporate valuation, or \$1,022,241.

##### B. Terms and Conditions of Share Purchase.

The *Code of Virginia* provides that upon determining the fair value of the shares that a shareholder elects to purchase in response to a dissolution petition, "the court shall enter an order directing the purchase upon such terms and conditions as the court deems appropriate." *Va. Code* § 13.1-749.1(E) (2016 Repl. Vol.). The statute expressly provides that payment of the purchase price may be in installments; that the Court may require security to assure payment of the purchase price and any additional costs, fees, and expenses; and that the Court may award interest at the rate and from the date determined to be equitable. *Id.* It also provides that, upon dismissal of the dissolution petition and removal of the petitioning shareholder from the corporation, the petitioning shareholder retains the right to receive the amounts awarded to her, "which shall be enforceable in the same manner as any other judgment." *Id.* § 13.1-749.1(F).

\*11 Kreinis argues that any payment terms associated with his purchase of Biton's shares should include reasonable installment payments, as expressly allowed by [section 13.1-749.1\(E\)](#). Although he offered to pay six monthly installment payments of \$25,000 shortly after he filed his election to purchase shares, Kreinis testified that since his election, New Tomorrow has produced little or no revenue despite incurring ongoing expenses that he has paid or for which he is responsible. According to Kreinis, this in part was due to closure of the stores for several months in 2020 and ongoing service limitations due to the coronavirus pandemic.

Biton contends that because Kreinis is not creditworthy, any judgment the Court awards should include a substantial down payment and adequate collateral, as permitted by statute, should the Court allow installment payments. Specifically, Biton requests that the purchase agreement provide for, *inter alia*, a down payment of at least \$250,000; a 15-25% rate



of interest; a 35% default rate of interest; a first-priority perfected lien on New Tomorrow's current and future assets and on all corporate stock; late payment fees of the greater of 5% of the payment or \$250; debt acceleration in the event of default; and access by Biton to New Tomorrow's financial statements.

Based on the evidence presented at trial, the Court finds that, in the interests of equity, payment of the purchase price in installments is warranted. In light of Kreinis's current financial condition and the reduced operational status of the New Tomorrow stores due to the ongoing pandemic, the Court directs Kreinis to pay Biton a \$150,000 initial payment, payable within 60 days, and monthly payments of \$30,000 thereafter until all amounts owed are paid. The Court also finds that providing Biton security is appropriate to ensure payment and awards Biton a first-priority perfected lien on New Tomorrow's current and future assets as well as on all New Tomorrow stock. The applicable statute both provides the Court equitable discretion to award interest and specifies that the share purchase amount “shall be enforceable in the same manner as any other judgment.” [Va. Code § 13.1-749.1\(F\)](#). Based on the security interest provided to Biton and the current low federal reserve discount rate, the Court sees no reason to depart from the statutory post-judgment interest rate of 6.0% afforded to other judgment creditors. *See Va. Code § 6.2-302* (2016 Repl. Vol.). Further, the Court will not impose a different default rate of interest or any late payment fees, although it will order debt acceleration in the event of default. A default is defined as the failure to comply with any of the terms or conditions the Court orders with respect to Kreinis's purchase of Biton's shares, including but not limited to the failure to make any payment when due.

Additionally, until Biton is paid in full for her shares, Kreinis and New Tomorrow are prohibited from taking any action outside the ordinary course of business that could negatively impact the financial condition of New Tomorrow or of its stock, including but not limited to disposing of or encumbering any assets, transferring any rights, merging with any other entities, issuing any equity interests, or making any unusual purchases. Additionally, until Biton is paid in full for her shares, New Tomorrow shall not (1) pay Kreinis a monthly salary of more than \$7,000—the total amount allowed by the Agreement for officer pay—in addition to commissions of thirty-five percent of his sales or (2) make any shareholder distributions.

Once the share purchase order is entered, Biton will no longer have any rights or status as a shareholder of New Tomorrow. She will, however, retain her right to receive the amounts awarded herein, as well as any amounts the court might award her after reviewing the accountant's report. Further, Biton is directed to cooperate in transferring the MacArthur Mall lease and any rights thereunder to New Tomorrow, including releasing Biton from the current personal guarantee or otherwise indemnifying her for any liability incurred under the guaranty.

#### C. Alleged Damages to New Tomorrow and Kreinis.

\*12 Kreinis alleges that he and New Tomorrow were injured as a result of Biton taking certain post-election actions—including opening new accounts to operate the MacArthur Mall location and precluding him from accessing the “NOVA” sales system and the “Time Center” client scheduling program—and mismanaging the MacArthur Mall operations. He asserts that this resulted in direct lost revenue in the MacArthur Mall operations of at least \$269,955.

It is not clear whether, at trial, Kreinis abandoned his claim for damages stemming from Biton's alleged corporate mismanagement or other actions that allegedly negatively impacted New Tomorrow's revenue. Even if he did not, the Court finds that he failed to satisfy the burden of proving that Biton's actions breached a fiduciary duty, that such a breach caused any damages, or the amount of such damages with reasonable certainty. *See Carstensen v. Chrisland Corp.*, 247 Va. 433, 443–44, 442 S.E.2d 660, 666 (1994) (holding that a successful breach of fiduciary duty claim requires proof that (1) a duty existed, (2) the duty was breached, and (3) damages were proximately caused by that breach). In fact, the only “evidence” regarding the alleged quantum of damages presented at trial was the revenue difference between the Lynnhaven Mall operations and the MacArthur Mall operations for the months of September 2019 through March 2020, which the Court finds insufficient to satisfy the requisite reasonable certainty. *See Carr v. Citizens Bank & Tr. Co.*, 228 Va. 644, 652, 325 S.E.2d 86, 90 (1985) (holding that the moving party must “prov[e] with reasonable certainty the amount of damages”); *Barnes v. Graham Va. Quarries*, 204 Va. 414, 418, 132 S.E.2d 395, 397 (1963) (“Damages which are uncertain, contingent, or speculative cannot be recovered.”).

#### D. Alleged Improper Shareholder Distributions.

Kreinis contends that Biton owes him \$148,372 as a result of (1) corporate expenses Kreinis paid for which Biton was responsible (\$47,550), (2) fifty percent of the profit from the MacArthur Mall operations that was not forwarded to New Tomorrow (\$59,882); and (3) fifty percent of Biton's claimed compensation, including shareholder distributions (\$40,940). Biton, on the other hand, contends that Kreinis commingled \$403,837.07 in corporate funds with his personal funds after she filed the dissolution action. (*See* Ex. P-156; Ex. P-157.)

The Court in a separate order directed an independent accountant—chosen by Kreinis and Biton—to determine whether either of them took any improper distributions and to file a report with the Court. (*See* June 19, 2020, Order.)<sup>29</sup> At trial the Court found that Kreinis had commingled funds by distributing corporate money to accounts that were in his personal name and, in the June 19 Order, the Court held that the burden had shifted to Kreinis to prove what, if any, portion of the commingled funds constituted valid business expenses. *See id.*; *see also Tauber v. Commonwealth*, 263 Va. 520, 540–41, 562 S.E.2d 118, 129 (2002) (holding that, as a result of commingling funds, directors of a corporation in dissolution had the burden of distinguishing personal funds from corporate assets). The Order further directs that the party who has received the greater amount of “shareholder distributions” pay to the other party one half the difference.” (June 19, 2020, Order.) The Court therefore will defer ruling on the claims of improper shareholder distributions until it receives the report from the independent accountant.

\*13 Counsel for Biton is directed to draft and circulate an order incorporating the rulings of the Court regarding the share purchase—with appropriate seller and purchaser representations and warranties—and forward it to the Court within seven days.

## Conclusion

The Court finds that the value of New Tomorrow, based on a capitalization of earnings methodology, is \$2,044,482. The

## Footnotes

- <sup>1</sup> Biton's complaint includes counts for dissolution of New Tomorrow, battery against Kreinis, and assault against Kreinis. The battery and assault counts were bifurcated from the dissolution count and subsequently nonsuited. *See* June 23, 2020, Order. Biton filed a separate suit for prior unpaid commissions, which has yet to be tried.

value of Biton's New Tomorrow shares therefore is half of that amount, or \$1,022,241. The Court finds that installment payments toward the purchase price and any additional costs or credits are appropriate, provided that Kreinis pays an initial payment of \$150,000 within 60 days and monthly payments of \$30,000 thereafter until the total amount is paid. The Court further finds that providing Biton security—in the form of a first-priority perfected lien on New Tomorrow's current and future assets and on all corporate stock—is appropriate.

The Court also finds that Kreinis failed to prove that Biton damaged New Tomorrow or Kreinis since Kreinis's election to purchase her shares. By separate order, an accountant selected by the parties has been tasked with reconciling the appropriate financial records to determine the extent to which inappropriate shareholder distributions were taken by Kreinis or Biton between August 1, 2019, and May 31, 2020.

Biton's petition for dissolution will be DISMISSED once the share purchase order is entered, whereupon Biton no longer will have any rights or status as a shareholder of New Tomorrow. She will, however, retain her right to receive the amounts awarded herein, as well as any amounts the court might award her after reviewing the accountant's report. Attached is an Order incorporating the Court's ruling. The attached Order is not a final order in this matter, as the Court has yet to resolve the crossclaims for improper shareholder distributions.

Sincerely,

/s/ David W. Lannetti

David W. Lannetti

Circuit Court Judge

## All Citations

Not Reported in S.E. Rptr., 105 Va. Cir. 86B, 2020 WL 8837633

- 2 Although the Agreement does not reference New Tomorrow by name, it is undisputed that the “new entity” to which the Agreement refers is New Tomorrow.
- 3 Plaintiff's exhibits are identified herein as “Ex. P-” and Defendants' exhibits as “Ex. D-.”
- 4 The corporate QuickBooks account indicates that the 2018 revenue was \$3,361,878. (Ex. P-103.) At trial, neither expert was able to explain the variance of almost \$400,000 between the QuickBooks figure and the amount reported to the Internal Revenue Service.
- 5 Based on testimony, the salesforce staff apparently went from twenty-five to six individuals.
- 6 New Tomorrow was not represented at trial, as the corporate dissolution action essentially was converted to an action to value New Tomorrow for the purpose of one fifty percent shareholder purchasing the shares of the other fifty percent shareholder.
- 7 The cited page numbers are to the expert report itself, which is a part of the exhibit.
- 8 It is not clear why this figure—\$2,614,378—differs from the QuickBooks 2019 total revenue figure of \$2,443,516 that is included in the 2019 financial records (Ex. P-104; Ex. P-105, at 17) and referenced by Biton's expert (Ex. P-51, at 4).
- 9 It also is unclear from where the net income of \$197,999—or any of the other 2019 total revenue figures used by Kreinis's expert (see Ex. D-2, at 7)—came, as they differ from the amounts in the financial records admitted into evidence (Ex. P-104; Ex. P-105, at 17).
- 10 Kreinis also points to evidence—largely testimonial—of other sales or potential sales that arguably are comparable and therefore indicative of New Tomorrow's valuation, including his initial purchase of the Lynnhaven Mall store (\$50,000), Biton's investment in New Tomorrow per the Agreement (assuming \$60,000 in debt), a supposed offer by an employee to purchase the Lynnhaven Mall operations in 2020 (\$150,000), and Kreinis's attempted sale of the MacArthur Mall operations in 2020 (\$201,936). Kreinis's expert uses the last of these as a “sanity check” on his valuation calculation. Based on the limited supporting evidence and the unique circumstances involved, as well as the available expert capitalization-of-earnings valuations, the Court gives the evidence regarding these other “sales” very little weight.
- 11 Other valuation methods considered and rejected by the experts include asset approach methods, market approach methods, and the income-based discounted future cash flow method. (See Ex. P-158, at 10-11; Ex. D-2, at 4-5.)
- 12 Biton pointed out that, according to the corporate QuickBooks data, the May 2019 revenue—when the financing was *not* available—was almost identical to the May 2018 revenue—when the financing was available. (See Ex. P-51, at 5.) Kreinis's expert, on the other hand, opined that this loss of consumer financing negatively affected sales in the short term, and potentially in the long term. (Ex. D-2, at 4.)
- 13 The QuickBooks 2018 revenue is \$3,361,878 (Ex. P-102; Ex. P-103), and the 2018 tax-reported revenue is \$2,988,462 (Ex. P-51, at 4, 6).
- 14 One profit-and-loss statement indicates a net income of -\$198,517.05 (Ex. P-133), and the other indicates a net income of -\$63,830.81 (Ex. P-134). Additionally, the net-income disparity is driven by differences in both income and expenses. This may explain the 2019 revenue figure discrepancy noted earlier, where Kreinis's expert used a different revenue amount than that indicated in certain New Tomorrow financial records admitted into evidence (Ex. P-104; Ex. P-105, at 17). See *supra* note 8. In any case, this is further proof of the unreliability of the QuickBooks data.
- 15 This methodology relied on the QuickBooks data only to determine the seasonal adjustment, as it calculated the proportional share of revenue by comparing the January through April 2019 revenue with the May 2018 through April 2019 annual revenue. Of note, this initially was one of two methods used by Biton's expert to determine annual revenues, which he averaged; when challenged at trial that his other method relied on QuickBooks data that he could not reconcile with the 2018 tax-reported data, he opted to reject his alternate approach.

- 16 It is undisputed that once Kreinis purchases her shares, Biton will no longer have any relationship with New Tomorrow.
- 17 Although testimony at trial indicated that the MacArthur Mall store is bigger, and offers additional services, than the Lynnhaven store, the Court finds that this is offset to a considerable degree by the challenges Biton confronted in opening a new store.
- 18 See *infra* note 21.
- 19 This admittedly includes a period of time during which the MacArthur Mall location was not yet operable, but the Court finds use of the 2018 tax-reported data preferable to using unreliable QuickBooks data.
- 20 The Court views Biton's value as a corporate officer/manager separate and distinct from her unique value as a saleswoman.
- 21 This admittedly does not account for any change in net income margin due to the loss of Biton. The Court has no evidence on which to base such a calculation, however.
- 22 The unadjusted profit margins are as follows: 25.53% for 2017, 18.46% for 2018, and 12.23% for 2019.
- 23 Without adjustments, the 2018 net profit margin is 18.46% (\$2,988,462 divided by \$551,655), as opposed to the adjusted net profit margin of 24.13%.
- 24 There were no reported corporate charitable contributions in 2017, and the 2017 one-time "Section 179" depreciation expenses were only \$4,808. (See Ex. P-53, Form 4562.) Hence, with a net income of \$148,982 and a total revenue of \$583,523 (see *id.*, Form 1120S), the 2017 adjusted net income margin was 26.36% ((\$148,982 + \$4,808) divided by \$583,523).
- 25 Kreinis's expert actually used a risk-free rate of return of 2.25%, although he conceded that the two experts should have arrived at the same rate of return and that the difference between the two rates used by the experts is insignificant.
- 26 As Kreinis's expert notes, under this methodology the cash flow stream needs to account for changes in capital expenditures, working capital, and long-term debt. (Ex. D-2, at 7.) Here, however, there is no working capital or long-term debt that needs to be accounted for. (*Id.*)
- 27 Kreinis argued during closing argument that 37% is the appropriate federal tax rate, although no evidence was presented at trial to support this assertion and, as noted, both experts agreed that a 21% federal tax rate is appropriate.
- 28 The parties stipulated that the corporate value does not need to be discounted to account for the petitioner's minority status or marketability of Biton's shares, as the statute allows. See [Va. Code § 13.1-749.1](#).
- 29 The Order also specifies that both Kreinis and Biton are entitled to receive a \$3,500 monthly salary and a thirty-five percent sales commission for post-election operations and sales pursuant to the Agreement. June 19, 2020, Order.