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IN THE SUPREME COURT OF IOWA

No. 19-2151

SUSAN A. GUGE AND PEGGY MCDONALD,

Plaintiff-Appellees,

vs.

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

Defendant-Appellants.

Appeal From the District Court for Palo Alto County
The Honorable Charles Borth

DEFENDANT-APPELLANTS' REPLY TO APPELLEES' BRIEF AND BRIEF IN OPPOSITION TO CROSS APPEAL

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I. REPLY ARGUMENT OF APPELLANTS

A. THE DISTRICT COURT CLEARLY MIS-APPLIED THE ASSET-BASED VALUATION METHODOLOGY THEREBY CREATING HIS OWN ERRONEOUS FAIR VALUE CALCULATION.

The Iowa Court of Appeals in Baur v. Baur Farms, Inc., 885 N.W.2d 829 (Table), 2016 WL 4036105 (Iowa Ct. App. 2016) on appeal of the second District Court decision by Judge Kimes stated:

> "We agree with the district court's conclusion the fair value of Jack's shares should take into consideration the taxes and other costs that would result from liquidation of the corporation." (Citing cases.) 2016 WL 4036105 at *4.

Both Guge and McDonald's expert Wagner and Kassel Enterprises' expert Crotty reduced the fair market value of Kassel Enterprises assets by costs of sale. Costs of sale of course include real estate sales commission, attorney fees, real estate tax proration, advertising, etc. The experts disagreed as to what these amounts would total.

The District Court disagreed and decided no costs of sale should be deducted because he believed Craig Kassel would not sell the underlying assets or the stock of Kassel Enterprises. (App. V.II, p.273.) He held "[a] discount based upon some future hypothetical sale is not appropriate and should not be allowed." (App. V.II, p.274.) This directly contradicts the rationale of the District Court in Baur. "No reliable basis existed for

determining when the remaining shareholders would be hit with the impact of that burden," referring to the liquidation burden and relying on Lodden's testimony. Baur v. Baur Farms, (2016 WL4036105 at *3); see also Dunn v. Comm'r, 301 F.3d 339, 352-353 (5th Cir. 2002) where the Court of Appeals stated "under the factual totality of this case, the hypothetical assumption that the assets will be sold is a foregone conclusion – a given – for purposes of the asset based test. The process of determining value of the assets for this facet of asset-based methodology must start with the basic assumption that all the assets will be sold. . . . By its very definition, this contemplates the consummation of the purchase and sale of the property, i.e., the asset being valued."

Moreover, another reason why the District Court here did not follow the experts' teachings on fair value determinations is that he did not measure the ability of Kassel Enterprises to pay the $2,746,650 he awarded against any analysis of Guge and McDonald's reasonable expectations for their gifted shares as the Court did in Baur (id. at *2.) The District Court here ordered Kassel Enterprises to pay $700,000 down and make five annual payments of over $400,000 at 6.5% interest. Kassel Enterprises had offered to pay $400,000 down and annual payments $320,000. (App. V.II, p.280.) The $700,000 down payment arose from a false claim by Guge and

McDonald that Kassel Enterprises would be paid over $700,000 for its interest in Guge's partition proceedings. That never occurred. Further the District Court required Craig Kassel and his wife to guarantee the notes and attempted to restrict the corporation's ability to borrow funds. These same actions in Baur were deemed reasons why the plaintiff's demand for fair market value of the appreciated assets was unreasonable. (Id.; Baur at *2.)

The Iowa Supreme Court in its seminal opinion in Baur v. Baur Farms, Inc., 832 N.W.2d 663 (Iowa 2013) provided that in corporate dissolution proceedings the courts of Iowa were to determine the "fair value" of a corporation's shares "[u]sing customary and current appraisal concepts and techniques general employed by similar businesses in the context of the transaction requiring appraisal." Iowa Code § 490.1301(b). What District Court did not know – or understand – is that the application of the so called "net asset value approach" to the fair value determination required the development of a hypothetical corporate dissolution with discounts for costs and expenses of sale and any other appropriate discounts. SHANNON P. PRATT, VALUING A BUSINESS: THE ANALYSIS AND APPRAISAL OF CLOSELY HELD COMPANIES (5th ed. 2008); Courtney Sparks White, S Corporations: A Taxing Analysis of Proper Valuation, 13 CAPITAL UNIV. L. REV. 1117, 1127 (2009).

This functional flaw in the District Court's analysis in his November 5, 2019 Fair Value decision bleeds over into his misunderstanding of why a liquidation income tax discount was necessitated to arrive at the fair value of Kassel Enterprises' common stock as will be shown in the following section of this Brief.

B. THE FAIR VALUE OF A CORPORATION'S COMMON STOCK IS NOT DETERMINED BY THE MECHANICAL APPLICATION OF THE INTERNAL REVENUE CODE.

In its only recent pronouncement on the shareholder oppression, corporate dissolution issue, the Supreme Court in Baur v. Baur Farms, Inc., stated "every shareholder may reasonably expect to share proportionally in a corporation's gains." 832 N.W. 2d at 673. It proceeded to remand the case with the following direction: "The District Court shall take whatever additional evidence is required for the proper development of the record from which the fair value of Jack's equity interest may be determined."

Jack Baur, the plaintiff owned 26.29% of the shares of Baur Farms, Inc. which he offered to sell to the Company for $1,825,000. The plaintiff Baur valued the corporation's assets at over $7,400,000 so he claimed his share was worth about $1,950,000. The District Court, on remand, held this demand to be unreasonable because the corporation's assets were not

discounted to their liquidation value and because Baur Farms did not have the resources to pay $1,825,000. That District Court opinion was affirmed. Baur v. Baur Farms, 885 N.W.2d 829 (Table). In the case at bar, Judge Borth simply divided the net asset market value of Kassel Enterprises, Inc. ($5,782,357) by the number of shares (847) to reach a per share value ($6,826.87). He then multiplied that per share value by the number of shares owned by each Plaintiff to reach a total of $2,746,654, which he required Kassel Enterprises to pay. This is an equation almost exactly like the demand of Jack Baur which the Iowa courts have declared unreasonable. But more importantly the District Court and Guge and McDonald only justify this $2,746,000 dollar award because Kassel Enterprises is an S-Corporation under the Internal Revenue Code not a C-Corporation. 26 USC § 1361-63. Guge and McDonald offer no other facts justifying any reasonable expectations of this result for their gifted stock.[1]

Both the District Court and the Court of Appeals in their search for "proportionality" in a corporation's gains in Baur on remand noted that if the Plaintiffs' fair value demand was ordered, it would have a dramatically

[1] They also had been paid substantial distributions for a number of years and had each received about $320,000 from a family settlement of their mother's estate.

disproportionate effect on the remaining shareholders because of a "built in gain tax" on the appreciated land assets of Baur Farms, Inc. Therefore in the hypothetical dissolution of Baur Farms, the corporation was entitled to a "liquidation tax discount" to arrive at a fair value of its common stock.

In Baur, on remand the District Court stated "the fair value of Jack's shares was the market value of BFI's assets, discounted to their liquidation value." He went on to state:

> "The court cannot say that BFI's insistence on a liquidation tax discount, reduced to "present value," was unreasonable. Both Van Werden and CPA Lodden testified credibly that the use of a liquidation tax discount is customary in such transactions. … With BFI's low tax basis on it assets, a purchase of Jack's interest would give BFI a substantial built-in gain that would constitute a burden on the remaining shareholders. No reliable basis existed for determining when remaining shareholders would be hit with the impact of that burden.
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> X X X
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> If BFI was dissolved as Jack requested, the amount of available BFI's shareholders would be its net liquidation value.
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> X X X
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> The income taxes are only one of the costs that would result from dissolution. Fair value of Jack's shares does not exceed a value that takes the full liquidation tax consequences into consideration." Baur v. Baur Farms, (2016 WL 4036105 at *3 & 4.)"

All of the above was quoted from the District Court's opinion by the Court of Appeals when it stated:

> "We agree with the District Court's conclusion the fair value of Jack's shares should take into consideration the taxes and other

> costs that would result from liquidation of the corporation." (citing a case) (Baur at *4)

The clear holding of the Court of Appeals decision is that in determining the fair value of the common stock of a farm corporation the Court must distribute the burden of the capital gains tax on appreciated assets to all shareholders equally in the context of the hypothetical dissolution valuation methodology called the "net asset value" approach used in Baur and adopted by both experts in the case at bar. Kassel Enterprises and its expert Crotty discounted Guge and McDonald's shares by the capital gain tax on the corporation's appreciated real estate that would be attributed to their 47.5% interest in a hypothetical dissolution at the shareholder level. The impact of this discount is the same as the proportionate share of the "built-in gain tax" in Baur at the corporation level. Likewise, for determining fair value, the impact on the remaining shareholders is the same because the hypothetical dissolution here assumes a true redemption by Kassel Enterprises. In such a transaction when Kassel Enterprises acquires the Plaintiffs' 402.33 shares of stock, it also acquires all of the capital gains on appreciated assets associated with the stock. This appreciation was calculated by Crotty to be $995,332 for each Plaintiff with hypothetical tax on liquidation of $269,739 each. (App. V.II, p.336.).

Kassel Enterprises after the redemption does not have 847 shares but rather 444.675 shares. See Iowa Code § 490.601. But the value of those shares has increased by $1,990,000. Consequently when Craig Kassel sells his shares or the corporation is sold, he will be responsible for an additional $539,478 of capital gain tax. The burden shift from minority shareholder to majority shareholder is thus identical to that of Baur.

Finally in this record, Kassel Enterprises would note that in Baur neither the District Court, nor the Appellate Court discussed the concept of capital gain tax on what the allegedly oppressed shareholder(s) would receive when paid fair value. In fact, the shareholder pays tax on the gain between his or her basis and what he or she receives as fair value from their sale. Crotty calculated Guge and McDonald's basis as $316,832 each. (App. V.IX, p.336.),Wagner on the other hand assumed a basis for each of his clients at zero since he apparently presumed the stock was all gifted. In either hypothetical transaction – and in actuality, the shareholder is only taxed one time. (IRS, *S Corporation Stock and Debt Basis*, February, 18, 2020, *available at* https://www.irs.gov/businesses/small-businesses-self-employed/s-corporation-stock-and-debt-basis) Although Guge and

McDonald claim in the brief that Kassel Enterprises' fair value methodology accounts to double taxation, it does not. [2]

Guge and McDonald made their most forceful attack on Kassel Enterprises' valuation methodology in claiming there exists no other authority where in fair value determinations of minority shares using asset based methodology that liquidation tax discounts have been applied to S-Corporation stock. Appellee Brief pp. 35-42, (App. V.IV, p.142-150.); Plaintiffs' (V.II, p223-228.). In these claims Guge and McDonald only point to the rectitude of using a liquidation tax discount in C-corporations. Guge and McDonald state that Baur Farms was a C-corporation but they fail to mention that the Court of Appeals did not limit its holding to C-corporations. Plaintiff-Appellees do not provide a list of cases where courts have declined to hold that liquidation or tax affected discounts are inappropriate for pass-through entities. Indeed, such discounts have been applied in dissolution of marriage proceedings and in gift and estate tax valuation cases. Liddle v. Liddle, 140 Wis.2d 132, 410 N.W.2d 196 (Wis.

[2] The methodology only seeks to apportion the capital gain tax on liquidation fairly. Indeed if Guge and McDonald's formulation was adopted, Craig Kassel will get the burden to pay the entire capital tax gain on Plaintiffs' shares twice. Once when Kassel Enterprises redeems the stock by paying a price, including all appreciation on the land. Once when he sells the land or the corporation. A truly unfair result.

Ct. App. 1987); In re the Marriage of Hay, 80 Wash. App. 202, 907 P.2d 334 (Wash. Ct. App. 1995); Hogan v. Hogan, 796 S.W.2d 400 (Mo. Ct. App. 1990); Zoldan v. Zoldan, 1999 Ohio App. LEXIS 2644 (Ohio Ct. App. 1999); E.M. Dailey Est., 82 TCM 710, Dec. 54, 506 (M).

Finally, Guge and McDonald attack Craig Kassel for the way the transaction was structured. They claim that if Kassel had purchased the stock of Guge and McDonald personally he would have gotten a "step up" in basis of the stock and not been responsible for the additional capital gain tax when he sold. (App. V.V, p.69-71.), Appellee Brief 40-41. While such may be true Guge and McDonald never explain how Kassel Enterprises could have avoided the irrevocable election buy the Plaintiffs' shares. See Iowa Code § 490.1434(1).

Guge and McDonald also claim rightfully that if Kassel holds all the shares until his death, he will also never pay any capital gains tax. Again the Plaintiffs seem to forget that the asset based model presumes that such a sale is made and when made makes no difference. See Baur v. Baur Farms, 885 N.W.2d 829 (Table) 2016 WL4036105 *3.

Guge and McDonald forgot to mention that the Baur Farms defendants could avoid ever paying the built-in gain tax only applicable to C-corporations by converting to an S-corporation in 2007 – just like Kassel

Enterprises, Inc. did in 2006. Moreover, the individual defendant Baur could also have never sold until his death and thereby avoided the "built in gain" tax or capital gain tax or any "liquidation tax."

C. GUGE AND MCDONALD TACITLY ADMIT THAT IF THE DISTRICT COURT FAIR VALUE FORMULA IS UPHELD §490.1434 OF THE CODE OF IOWA WILL BE ABROGATED.

In Kassel Enterprises' main brief it argued that the District Court's fair value decision, if affirmed, weaponized proceedings under §490.1434 of the Code so that minority shareholders Guge and McDonald could use the statutory procedure to oppress the majority. This is what the Supreme Court cautioned against in its Baur decision (832 N.W.2d at 678). Indeed, Kassel Enterprises asserted that no corporation or majority of shareholders in an Iowa farming corporation would invoke the procedure presented by §490.1434 because the methodology used by the District Court in this case will necessarily lead to prohibitively unfair results. Thus, the statutory remedy approved by the legislature and the Supreme Court is effectively abrogated.

Guge and McDonald do not controvert in any way this argument because they cannot. It is therefore admitted albeit tacitly.

Defendant Kassel Enterprises, Inc. and its owners also argued that the plaintiff shareholders Guge and McDonald had no reasonable expectation of receiving $1,373,327 each for their share of Kassel Enterprises. Guge and McDonald had been gifted their stock. They had never worked for the corporation. They had been paid dividends of $35,000 per year each for seven years with their share cash rent used to purchase land in the prior five years (all of the time they accused their brother of controlling the corporation). Their claim of oppression had such little merit that they dismissed almost all of it before summary judgment on the single remaining claim. Craig Kassel had entered into a family settlement agreement with Guge and McDonald regarding their Mother's estate in 2017, which increased their share by $350,000 each, largely from his bequest. Guge and McDonald carefully collected their last payments and then filed suit.

Guge and McDonald do not contest these facts. Guge and McDonald make no argument that their reasonable expectations have been frustrated. The District Court clearly gave Guge and McDonald "a foothold that is oppressive." If the election to redeem were not irrevocable, Kassel Enterprises might seriously have withdrawn it because Guge and McDonald's claims were so patently without merit.

This is another ground for reversal.

II. THE ARGUMENTS AND MISREPRESENTATIONS OF FACT CONTAINED IN APPELLEE'S BRIEF SHOW NO BASIS TO UPHOLD THE DISTRICT COURT'S AWARD OF ATTORNEY FEES AGAINST KASSEL ENTERPRISES, INC.

A. APPELLEES GUGE AND MCDONALD STATE NO STATUTORY BASIS FOR AWARDING ATTORNEY FEES AGAINST KASSEL ENTERPRISES.

Guge and McDonald begin their argument with the following four propositions:

(1) 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 attorney 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).

(2) Iowa law plainly allows a shareholder to seek dissolution on the basis that the "corporate assets are being misapplied or wasted." Iowa Code § 1430(1)(b)(4) (2017).

After stating this is the "procedure" they requested and the Court applied:

(3) "Plaintiffs' Petition sought dissolution of KE on the basis that Craig wasted and misapplied corporate assets (among other reasons").

(4) "Pursuant to Iowa Code § 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."

Kassel Enterprises, Inc. has no quarrel with these statements as what the record reflects. Kassel Enterprises, Inc. does quarrel with the fact that the District Court's finding that the majority shareholder had committed an act, which he (wrongfully) characterized as misappropriation, justified or authorized awarding fees against the corporation. Guge and McDonald first criticize Kassel Enterprises for offering no authority on this issue (which is untrue) and then offer no authority themselves.

Kassel Enterprises notes here in reply that the other provision of Section 4901.1430(1)(b) entitling a dissident minority shareholder to fees in a dissolution proceeding states that if the shareholder establishes:

> "The directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive or fraudulent… . Iowa Code § 490.1430(1)(b)(2)

The District Court can award fees and costs. Here Craig Kassel was identified in the Petition and in the evidence as the person responsible for the alleged misdeeds of misappropriation. There is simply nothing in the statute that says who the fees can be awarded against. This situation is unlike the statutes involving shareholder proceedings such as the case in Security State Bank v. Ziegeldorf, 554 N.W.2d 884, 893 (Iowa 1996) or Sieg v. Kelly, 568 N.W.2d 794, 804 (Iowa 1997) where the statute involved specifically made

the corporate defendant responsible for the dissenting shareholders' attorney fees.

As Kassel Enterprises noted in its opening brief, common sense does not allow for the award of attorney fees against a totally passive party. The argument of the shareholders – Guge and McDonald – may simply be stated as: The District Court can award attorney fees against anyone because he can. This is nonsense.

B. THE DISTRICT COURT'S FINIDNG OF MISAPPLICATION WAS NOT SUPPORTED BY ANY CREDIBLE EVIDENCE AND SUCH ACTIONS CAUSED THE CORPORATION NO DAMAGE.

The second point Guge and McDonald make in their attempt to preserve the award of attorney fees, is that "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." (emphasis added). Guge and McDonald of course neglect to mention that the District Court only found three of the practices cited to be "misapplication." Only two of the three (underpayment of rent and a land swap) were identified in the Petition. The other three "misapplications" would have been barred by the statute of limitations had they been pled. Guge and McDonald never proved how, or even if, any of the misapplications damaged Kassel Enterprises to

say nothing of the Plaintiffs themselves. Finally, by way of notice, Guge and McDonald first notified the Defendants and the Court of these claims justifying an award of fees the afternoon before the hearing began on October 10, 2019. Defendants' counsel had not seen the motion or the exhibits before the hearing commenced.

That said, Guge and McDonald spend seven pages of their statement of facts and twelve pages of their argument restating the "evidence" they claim supports the District Court's finding of "probable grounds" that "corporate assets are being misapplied or wasted. [3] In this reply Kassel Enterprises will first deal with the two claims of Guge and McDonald that the District Court did not find to be misapplication or waste. At page 55 of their brief Guge and McDonald claim that Craig Kassel reduced the value of several pieces of old farm equipment listed in his father's probate inventory (App. V.IX, p.82.) as belonging to Kassel Enterprises from $85,000 to $46,000 and then sold the equipment to himself. Plaintiffs' also rely on a balance sheet given to the bank and signed by Georgia Kassel showing a

[3] This recital of the evidence pales by comparison to Appellees' abusive designation of over 500 pages of deposition and hearing transcripts, numerous pleadings, motions and briefs, and hundreds of pages of exhibits. Most of the transcript has not been electronically filed. Very little of the designation is ever mentioned in the Appellees' Brief. The Designation is abusive and violates Rules of App. P. 6.905(7) and (10)

value for equipment of $246,000. There is no reference anywhere that Craig Kassel valued the equipment or "sold it to himself." Kassel Enterprises, Inc. had over $800,000 of debt when Lawrence Kassel died. How this transaction (the sale of equipment) impacted the value of Kassel Enterprises or the value of Guge's and McDonald's shares is pure speculation. How Craig Kassel's action or inaction regarding the machinery could be nefarious is equally speculative.

Next, on page 55 of their Brief, Guge and McDonald claim that Craig Kassel "wasted and misapplied KE's assets by giving away life insurance proceeds payable to KE." In support of this completely unfounded claim, Guge and McDonald cite to their father's probate inventory as showing an insurance policy with KE named as the beneficiary of the proceeds (totaling $350,000). For this proposition Guge and McDonald cite a different schedule on (App. V.IX, p.85.). That schedule indicates there were four life insurance policies. Three payable to Georgia and a fourth to Kassel Enterprises. No face values of the policies are stated. Craig Kassel stated that when as Executor of his father's estate he received the insurance proceeds checks, he gave them to his mother. The bank records shown in Hearing Ex. 19A disclose principal debt payments of $250,000 on Kassel Enterprises loans from Iowa Trust and Savings Bank in July of 2005 and

another $280,000 of principal payments before year end 2005 by the Company. Clearly nothing nefarious was done by either Craig as executor – or his Mother as president of Kassel Enterprises.

Turning now to issues the District Court was misled into believing were somehow misapplications of the assets of Kassel Enterprises by Craig Kassel, Guge and McDonald claimed for the first time on October 10 at the fair value hearing that Craig Kassel and his wife "distributed or misapplied" $904,006 of funds borrowed by Kassel Enterprises, Inc. (Brief p. 52.) They make this claim, and the District Court adopted it, despite the fact that Sara Bonnstetter, from Iowa Savings Bank, Georgie Kassel and Kassel Enterprises' bank testified at the hearing that every loan was repaid with principal and interest. She also said all the notes were signed by Georgia Kassel. (App. V.IV, p.24, V. II p. 364.) Further Craig testified that this lending practice was arranged by the banker and approved by his mother (App. V.IV, p.221-222.). There was no waste, misapplication or loss. Heidecker Farms v. Heidecker, 791 N.W.2d 429 at *12 (Iowa Ct. App. 2010). [4]

[4] Guge and McDonald further mislead this Court by false claims that (1) Kassel Enterprises borrowed 5 million dollars between 2005 and 2018. This is simply false. They claim Kassel Enterprises wasn't buying farmland after

Next, Guge and McDonald complain of the fact that in 2017, Craig Kassel traded 95 acres of land he owned for 89 acres of land owned by Kassel Enterprises. The land was appraised by a competent appraiser at Plaintiffs' request. The land traded was of equal value (R. App. V. II, Def. Mot. SJ, pp. 137-227). But most importantly, Guge and McDonald had stipulated to the value of the farmland owned by Kassel Enterprises. (App. V.II, p.278.) That stipulation included the value of the land traded. It was the basis for their expert's opinion. His opinion adds nothing for the value of the land traded away. Guge and McDonald never at any time testified to any amount of harm either to themselves or Kassel Enterprises as a result of the trade. Even the District Court couldn't find any "waste." (Order, Nov. 5, 2019, p. 9.)

Finally, there is the claim of under payment of rent made at the hearing on October 10, 2019 and adopted by the District Court almost verbatim. The claim made at the District Court was that Craig Kassel had underpaid cash rent between 2005 and 2017 by $872,520. It was based on an exhibit numbered 14A at the hearing which purported to show Craig's payments and the Iowa State University average cash rent payment for high

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his father's death which is false and they claim Georgia died a pauper. In fact she had over $400,000 (App. V.IX, p.24.) in the bank.

quality land in Palo Alto County. That amount of under payment was adopted by the District Court (App. V.II, p.277.). That purported claim and the exhibit are so misleading as to be materially false and knowingly so. The Exhibit 14A used at the hearing is different than the similar Exhibit 10 used in Craig Kassel's deposition. (App. V.IX, p.59, 89-92.). The Exhibit 10 used in Craig's deposition shows him paying $110,000 a year in cash rent from 2006 to 2011 – not $88,000. That Exhibit shows Craig Kassel supplementing Guge and McDonald's cash rent distribution by $20,000 each per year from 2011 to 2017. Thus their cash rent would have been the equivalent of $260 per acre per year. But more importantly had Craig paid the supposed market rate of cash rent to everyone, the money would not have stayed in the corporation. The other half the Plaintiffs did not receive would have simply gone back to Craig and his Mother who did not want it. But the Exhibit 14A adopted by the Court is materially false in another respect. From 2006 to 2011, Kassel Enterprises was purchasing another 60 acres of land. (App. V.IX, p.73-87.) All of the cash rent payments - $110,000 per year were being used to pay the purchase price of the 60 acre tract. That 60 acre tract has trebled in value since 2005. Plaintiffs and the corporation have been more than fully compensated and there is no conceivable loss or misappropriation by Craig Kassel.

The claims of the Plaintiffs of misappropriation or waste are completely without merit and cannot form a basis for the award of attorney fees.

C. GUGE AND MCDONALD HAVE FAILED TO IDENTIFY ANY CAUSE OF ACTION PLED ON WHICH THEY WERE SUCCESSFUL

In the District Court's Order on attorney fees entered December 6, 2019 he stated:

> "The Court recognizes that the Plaintiffs are entitled to fees under Iowa Code Section 490.1434(5) only under Count I of their six Count Petition. Counts II through VI were either dismissed by Plaintiffs voluntarily or by Court via Summary Judgment. Either way they were unsuccessful on Counts II through VI of their Petition, and they are not entitled to an award of attorney fees on those claims." (Emphasis supplied.) (Order, 12-6-2019.)

At that time in the litigation he had also dismissed Count I in which Guge and McDonald had requested dissolution of Kassel Enterprises. He had ruled that Guge and McDonald's evidentiary presentation at the Fair Value hearing did not "support a finding of probable grounds of illegal, oppressive or fraudulent conduct by the Defendants" (App. V.II, p.277.) Therefore it is apparent that Guge and McDonald were unsuccessful on Count I.

He then, in his Order of November 5, 2019, proceeded to rule that Plaintiffs were successful on the claim for attorneys' fees and ordered further proceedings to determine the amount. He also made the corporation which was never accused of any wrongdoing responsible for the fees. Assuming this is not an abuse of discretion, the District Court's finding is that Guge and McDonald are entitled to attorneys' fees for proving they are entitled to attorney fees under Iowa Code § 490.1434(5). These fees are to be paid by an entity which was allegedly harmed and accused of no wrongful conduct.

According to Guge and McDonald the District Court properly reduced their $231,000 fee bill to $94,000 because the "Plaintiffs claims were 'inextricably intertwined in many ways'… 'to the judicial dissolution and fair value determination' for which attorneys' fees were to be statutorily supported." There was of course no judicial dissolution. The fact that all of Plaintiffs claims were intertwined is meaningless because they were all dismissed and therefore no fees should have been awarded. Smith v. Iowa State University, 885 N.W.2d 620, 625 (Iowa 2016).

Guge and McDonald were entitled to no attorney fees and the award was an abuse of discretion.

III. CROSS-APPEAL ARGUMENT OF APPELLANTS'-CROSS APPELLEES

Introduction

It is the Kassel Enterprises, Inc. Defendant-Appellants' understanding of the Rules of Appellate Procedure that portions of a Proof Brief responding to a cross appeal may be omitted.

Thus, this Reply Brief will include a single table of contents, table of authorities, statement of issues, Argument and Conclusion relating to Reply and responding to the Cross Appeal.

A. THE PLAINTIFFS DID NOT PRESERVE ERROR ON THE ISSUE OF INCREASING THE FAIR VALUE OF THEIR STOCK BECAUSE OF ALLEGED MISCONDUCT OF CRAIG KASSEL.

Plaintiff-Appellees and Cross-Appellants Guge and McDonald (hereafter "Guge and McDonald") have dismissed their cross appeal claiming that the District Court erred in reducing the attorney fees he awarded them after the October 10, 2019 Fair Value evidentiary proceeding. The only issue now on cross-appeal is whether the District Court erred in refusing to allow Guge and McDonald to present evidence at the hearing "increasing the fair value of Kassel Enterprises by the waste and misapplication of assets by Craig Kassel." Guge and McDonald claim that they preserved error on three occasions. First they claim error was preserved

by filing a document the afternoon before the October 10 hearing entitled (App. V.II, p.102 et seq.) The Plaintiffs do not state the content of the document. Next, Guge and McDonald claim they preserved error by mentioning the issue twice to the Court at the October 10 hearing. At both times, the District Court told Plaintiffs' counsel he believed the proffered evidence was irrelevant to the issue of fair value. The Court also stated the evidence might be relevant to the Plaintiffs' case at trial set approximately a month later. (App. V.V, p.12-15, 71-75).

What Guge and McDonald do not state is that they had already dismissed Counts III, IV, V, and VI of their Petition and the only remaining claims in Count II against Craig Kassel were two that they wanted the Court to admit evidence on (cash rent and land swap). Plaintiffs do not admit that they had already stipulated to the land value, including the swap and the issue was disposed of (App. V.IX, p.311 et seq.). Plaintiffs do not state that they had submitted expert reports which placed a value on all the "assets" of the corporation. (App. V.IX, p.329-331.). The value was identical to that of Defendants' experts (App. V.IX, p.332-337.). They do not say that some of the claims that they were for the first time asserting at the October 10 hearing were nowhere mentioned in any pleading.

Moreover, Guge and McDonald never tell this Court why the District Court refused to allow the evidence they proffered in relation to the value of their shares. Guge and McDonald never mention the issue in their post hearing brief. They never made any Rule 1.904 motion after the court entered his November 5, 2019 Orders on fair value and attorney fees asking for an alteration or amendment. Finally, the Plaintiffs Guge and McDonald did not challenge in the District Court the summary judgment ruling on Plaintiffs' breach of fiduciary duty claims for damages by a Rule 1.904 motion or an appeal. Those damage amounts would presumably equal the increase in fair value of their stock which the Court should have added.

There were many reasons why Judge Borth might not have allowed Guge and McDonald to proceed to offer evidence of an increase of value of Plaintiffs' stock arising from Craig Kassel's alleged bad acts. First there is the issue of timeliness and lack of notice to the Defendants. Guge and McDonald first raised the issue in a document filed electronically in mid-afternoon of October 9. Defendants had no time to review and did not even have a copy of the motion or exhibits on the morning of October 10. Secondly, the Plaintiffs had waived the damage claim arising from the land swap by stipulating formally to the value of the asset several months before the October 10 hearing. Thirdly, Plaintiffs had already dismissed four

counts of the Petition because the claims were derivative in nature and only one claim against Kassel remained – underpayment of cash rent – and that claim was also being challenged as derivative.

Only one time, on the record, did the Plaintiffs elicit any rationale for the District Court's ruling and that is after offering all the evidence of Kassel's bad acts at the hearing at page 64 of the transcript:

> "Mr. La Van: We would have continued to ask questions with regard to a number of these exhibits - - - in order to show that Mr. Kassel misapplied or wasted the assets in this case and that those same assets would still be in the corporation but for Mr. Kassel's wrongful conduct and actions of wasting assets.
>
> X X X
>
> And I understand the Court's ruling that we're not going to deal with that here today, but I'd just like to make a record that we believe that those amounts and numbers should be applied back into the case value of this corporation.
>
> The Court: That is noted for the record. And the Court did make an indication off the record that the evidence would not be allowed for determining the fair market value as it wasn't relevant to that issue, and instead, was actually relevant to Count II of the Petition, which is scheduled for a jury trial in November of this year." (App. V.V, p.72.)

So the question becomes what did the District Court mean? Count II of the Petition was a claim by Plaintiffs against Craig and Deborah Kassel for actual and punitive damages for breach of fiduciary duties. The damages were to be paid to Guge and McDonald individually and – at least according to the

pleadings are not apportioned on their shareholding interest. (App. V.I, p.24-25.) As noted above, after Guge and McDonald lost the Defendants' summary judgment motion on Count II, they neither filed a Rule 1.904 motion nor appealed the loss on the summary judgment motion.

Thus it is obvious that Guge and McDonald have done nothing to (1) identify the error of the Court's refusal to admit the evidence on the issue of fair value, and (2) preserve the error as no objection to the Court's ruling appears of record. Rule 6.903(2)(g) states:

> "The argument section shall be structured so that each issue raised on appeal is addressed in a separate numbered division. Each division shall include in the following order: (1) A statement addressing how the issue was preserved for appellate review, with references to the places in the record where the issue is raised and decided."

Iowa R. App. P. 6.903(2)(g). Under Iowa law an issue is not preserved unless a party raises the issue and preserves the issue by allowing the trial court to rule on it. Fenceroy v. Gelita USA, 908 N.W.2d 235 (Iowa 2018), Est of Gottschalk v. Pomeroy Dev., 893 N.W.2d 579 (Iowa 2017). Further, an error excluding evidence or testimony affords no grounds for reversal when the error is not preserved by an offer of proof. Iowa R. Evid. 5.103, Strong v. Rosenthal. 523 N.W.2d 597 (Iowa Ct. App. 1994), Kengorco, Inc. v. Jorgenson 176 N.W.2d 186 (Iowa 1970).

It is appropriate for the appellate court to refuse to consider issues not preserved when there are ample other reasons to deny consideration of the newly asserted theory. See, e.g., Mayes and Vaitheswaran, Error Preservation in Civil Cases: Perspectives on Present Practice, 55 Drake Law Rev. 39 (2006) Sec. V. A.

The Cross Appeal of Guge and McDonald should be dismissed without more.

B. BASED UPON THEIR OWN FAILURES TO PROPERLY PLEAD AND CHARACTERIZE THEIR FIDUCIARY BREACH CLAIMS AS WELL AS FAILURE TO PROVE HOW DAMAGES WOULD FLOW TO THEM AS SHAREHOLDERS, PLAINTIFFS SEEK A NEW TRIAL.

1. After Failing to Convince The District Court That Their Claims Of Damage Should Be Added To The Value of Their Stock, Plaintiffs Now Claim The Same Additions Should Be Made Because The Court Ruled The Claims Were Derivative.

At page 65 under Section I.C.1 of their brief, Guge and McDonald claim that there are three specific instances of conduct by Craig Kassel which the District Court should have ruled were assets of the corporation which the District Court should have valued and added to the price of their stock. In the first instance, only one of these "misapplications" was found

by the District Court – under payment of rent (App. V., p.277-278.). Secondly, the Plaintiffs show no basis for adding any particular amount of money to their share value, either as damage to the corporation or themselves individually.

The only "misapplication" found by the District Court was that Craig had underpaid cash rent for several years to the tune of $872,520. Through stated calculations Plaintiffs reach the conclusion that $87,373 of that under payment should be added to their shares. But Plaintiffs never understand that they are not entitled to 23.75% of the cash rent each. They are only entitled to 23.75% of the dividends (or more properly distributions) paid by the corporation. Plaintiffs admit that their mother set the cash rent – not Craig (R. McDonald Dep. pp. 93:24-95:3; 139:23-140:1-2). This was nothing more than a disguised breach of fiduciary duty claim. Knobloch v. Home Warranty Company, Inc., 2016 WL 6662709 (N.D. Iowa 2016).

The second claim was that Craig Kassel "unilaterally reduced the value of KE's equipment from $254,000 to $46,000… ." (Br. p. 65.) To support this claim Guge and McDonald cite to their Hearing Ex. 22 and to a portion of Craig's deposition. Exhibit 22 is a balance sheet of Kassel Enterprises signed by Georgia Kassel as President on December 29, 2006. It shows the value of Kassel Enterprises machinery as $254,000 in 2004 before

her husband died, $85,000 after her husband died, and $46,000 at the end of 2006. The next exhibit, the inventory of Lawrence Kassel's estate (App. V.IX, p.82.) shows more equipment in the estate than the 2006 balance sheet. The references to the transcript of Craig's deposition are meaningless and do not show that Craig was responsible for the reduction in valuation of the machinery.

Finally, there is the claim of a missing $350,000 life insurance policy payable to Kassel Enterprises from Lawrence's estate. Craig Kassel testified he gave the check for the insurance proceeds to his mother – as he should have. She was the President of Kassel Enterprises. Kassel Enterprises had at that point in time in excess of $815,000 of debt. That is what the policy was for. Defendants presume the Plaintiffs are not asking that 47.5% of the debt be assessed against them.

2. Defendant Kassel Enterprises Position on Whether Legal Claims are Assets

Defendant Kassel Enterprises does not argue that valid and liquidated legal claims owned by a corporation are assets. Kassel Enterprises asserted no claims against Craig and Deborah Kassel. Plaintiffs filed no derivative claims against Craig or Deborah Kassel and did not appeal the individual

claims they made against these individual Defendants. Thus, any such claims have not be preserved. See Iowa R. App. P. 6.101(1).

3. Guge and McDonald Seek to Shift Responsibility For Their Failure to Plead Their Claims As Derivative Claims On To The District Court

With no citation of any authority to support this extraordinary claim, Guge and McDonald seek to blame the District Court for their failure to file their various claims as derivative claims. Every claim that the Plaintiffs sought to have the Court consider at the fair value hearing was pled as an individual shareholder claim against another individual shareholder. The relief request is for calculated amounts ($87,373 of back rent each; $49,400 of machinery value each) to be added to the value of their shares. To the extent the District Court disclosed on the record that he would not allow the evidence, he said the claims were alleged against Craig Kassel (correctly) in the still pending Count II of the Petition. At that very same moment Defendants' summary judgment motion was pending. It asserted that all of Plaintiffs' claims, other than for dissolution, were derivative. After the District Court refused to allow the evidence on October 10, Plaintiffs never challenged the District Court's ruling nor even requested clarification or a written Order on the issue.

On November 5, 2019, Guge and McDonald's breach of fiduciary duty claims were dismissed by Judge Borth largely as Guge and McDonald

recite because the claims were derivative and Plaintiffs had failed to comply with the simple procedural requirements. But the significant issue for these proceedings is that on that very same day the District Court ruled on the fair value of Plaintiffs' stock and awarded them attorneys' fees for the "waste and misapplication", the very inconsistency about which Plaintiffs accuse the Court of committing occurred. But Plaintiffs did nothing. They filed no motion to alter or amend and they did not appeal.

CONCLUSION AND REQUEST FOR RELIEF

The Cross Appeal of the Plaintiffs has utterly no merit and should be summarily dismissed.

With respect to Kassel Enterprises, Inc.'s claims that the fair value determination for its common stock must be reversed and remanded, the issues are now clearly stated. The Iowa Supreme Court has stated that each shareholder has a reasonable expectation of receiving a proportional return on the corporation's gains. That principle requires all of the shareholders to share equally in the income or capital gains tax on appreciated assets when the fair value of the stock is determined. It doesn't – or shouldn't – be divided by the serendipitous fact that the corporation is taxed as a C- or an S-corporation. Baur Farms was a C-corporation but could have changed to

an S-corporation as Kassel Enterprises, Inc. did in 2006. Moreover, if the District Court's decision is allowed to stand, Section 490.1434 of the Code will be emasculated for the bulk of Iowa's corporations (to say nothing of the impact on other pass through entities such as partnerships and limited liability companies).

For these and the other reasons stated herein, the decision of the District Court should be reversed and remanded with directions to apply a liquidation tax discount to determine the fair value of Kassel Enterprises common stock.

Respectfully submitted

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CERTIFICATE OF FILING & CERTIFICATE OF SERVICE

I hereby certify that on the 10th day of July, 2020, I electronically filed the foregoing document with the Clerk of the Court by using the Iowa Judicial Branch electronic filing system which will send a notice of electronic filing to the following:

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I further certify that I mailed the foregoing document and the notice of electronic filing by first-class mail to the following non-EDMS participants:

None

/s/ *Cindy S. Dillinger*
Cindy S. Dillinger

CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Iowa R. App. P. 6.903(1)(g)(1) because this brief contains 7,254 words, excluding the parts of the brief exempted by Iowa R. App. P. 6.903(1)(g)(1).

2. This brief complies with the typeface requirements of Iowa R. App. P. 6.903(1)(e) and the type-style requirements of Iowa R. App. P. 6.903(1)(f) because this brief has been prepared in a proportionally spaced typeface using Times New Roman font and utilizing the 2016 edition of Microsoft Word in 14 point font plain style.

/s/ *Cindy S. Dillinger* — July 10, 2020
Cindy S. Dillinger — Date