'SLR' Method to Value Stock Too Novel to Pass **Daubert** *Challenge*

***Haupt v. Heaps*, 2005 Utah App. LEXIS 423 (October 14, 2005)**

Choosing the best witness to offer a valuation report is just as important as choosing the most appropriate methodology, as the plaintiff in this case learned a bit too late. Haupt was a former employee of Authorize.net, a company that provided systems for processing internet credit card transactions. When the company allegedly ran into severe financial trouble in the late 1990's, its CEO (Heaps) asked Haupt to re-sell his 75,000 shares of stock to the company. Haupt finally agreed to sell them back for $12,000, or about $0.16 per share, but only because (he said) the company had convinced him that without the influx of cash, it wouldn't survive at all.

Fast forward a few months later, and Go2Net, a publicly traded company, merged with Authorize.net, valuing the latter's shares between $90 and $96. In his subsequent suit for fraud, Haupt attempted to submit a Form 8-K/A that Go2Net filed with the SEC several months after the merger and a year after Haupt's sale of shares. The form came attached to Go2Net's audited financials, including a footnote that applied a Straight-Line Ramp-up Method (SLR) to determine expense attributable to the sale. The accounting firm KPMG had prepared the financials—but Haupt did not offer a KPMG witness to explain the footnote or the methodology.

Instead, he attempted to introduce Dr. Paul Randle, an economist (Paul A. Randle & Associates, Logan, UT), who would present the value of the Authorize.net shares based on KPMG's Form 8-K/A. Specifically, Randle would have relied on the footnoted SLR method, which plotted the known value of the stock at a point in June 1997 and its known value at the merger in June 1999. "By making the assumption that the value of the stock increased at a steady rate with no variation based on actual events," the Court explained, "a value can be assigned for any date between the two points."

Audited financials not sufficient basis for reliance

However, plaintiff had not requested Randle to perform his own valuation of the Authorize.net stock; nor had he offered a KPMG witness. Instead, Randle was forced to admit that despite his many years as an economics expert, his extensive training and experience in business valuation, he had never seen the SLR method of valuation prior to reviewing the KPMG form; and he had not been able to verify it independently or investigate KPMG's intent in utilizing it. He also did not consider the SLR to be a valuation technique, per se; there was further testimony that KPMG did not use the SLR method to conduct business valuations.

As a result, the trial court excluded Randle's testimony as "too novel" to be reliable under a Utah analogue to the 1993 U.S. Supreme Court *Daubert* decision, which set the standard for the admissibility of expert scientific evidence. The court expressly found that SLR was not "an accepted method of business valuations," as it had never been used by any other court or by the parties and their experts. On appeal, the higher court readily

agreed that the method was "novel," but briefly considered whether an economist's testimony was "scientific." Sidestepping that question, it confirmed the trial court's final ruling that the SLR method was too unreliable to assist the trier-of-fact.

A second attempt to value the stock also fails

Plaintiff also offered Curtis Bramble, CPA (Bramble & Co., Provo) to testify about the value of the stock in 1998, which he arrived at by using 1999 stock values. As with the SLR method, the trial court found that the "use of data not available at the time of the critical sale rendered the opinion likely to confuse rather than to help the jury." The evidence was also irrelevant, due to a prior court ruling that the appropriate measure of damages was "the difference between the price paid by a third party for the stock on [the merger date] and the price that was paid by defendant on [the date of the sale]."

On review of the court's decision to exclude Bramble, the appeals court found the question a bit closer, because Bramble had prepared his own valuation. But under the "wide discretionary standard" of the trial court to weigh the probative value of expert evidence and testimony, its ruling stood.