In The

Supreme Court of Virginia

RECORD NO. 161799

MCR FEDERAL, LLC,

Appellant,

v.

JB&A, INC.,

Appellee.

REPLY BRIEF OF APPELLANT

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SCV: Submitted on 06-30-2017 14:46:25 EDT for filing on 06-30-2017

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SUMMARY OF ARGUMENT

MCR's opening brief showed that the judgment rests on a conspicuous evasion of this Court's decision in *Sensenbrenner*—and thus impermissibly allows a tort suit in a case governed solely by contract—and an egregious disregard of this Court's decision in *Farrar*, because the damages awarded rest on speculative evidence that cannot be meaningfully distinguished from the property valuation at issue there. JB&A completely ignores *Sensenbrenner*, and strains to distinguish *Farrar* based on supposed facts in this record that, unfortunately for JB&A, were mostly present in *Farrar* as well.

Bereft of legal arguments to support the rulings below, JB&A claims that this case is about factual findings. Ironically, however, the facts it touts to support the judgment—including a demonstrably false assertion that MCR "agreed to pay $62.2 million" for the Intelligence Business—largely were not "found" by the court below. More importantly, JB&A's key defenses of the judgment are *inconsistent* with findings the trial court made when it rejected the fraud counterclaim, when it refused to find MCR liable for actual fraud, and when it rested its finding of injury on a theory (the effect of the suspensions *on MCR*) that is completely at odds with JB&A's basic claim: that but for the asserted breach, it never would have become part of MCR.

The trial court also erred under this Court's decision in *Bershader* by

awarding "equitable" attorneys' fees on top of money damages on a legal claim for constructive fraud. JB&A attempts to defend that error primarily by reshaping this Court's holding in *Bershader*, and by rearguing its failed actual-fraud claim. But it points to no authority permitting fee-shifting in a fraud suit outside of *equitable* claims for *actual* fraud, and it waived its actual-fraud argument by failing to cross-appeal. JB&A also cites no cases allowing plaintiffs to collect damages both for breach of a contract and for repudiation of that contract, thereby conceding that the award of inconsistent legal and "equitable" relief handed JB&A a windfall.

ARGUMENT

1. JB&A's Claims Arise Entirely In Contract. (Assignment 1)

In an effort to avoid MCR's authorities, JB&A advances the position (at 6, 21) that MCR had no duty to provide a bring-down certificate that, according to the trial court, "in and of itself" constituted both a "false representation" and "a breach of the contract." A2360. JB&A's conflicting assertions that the bring-down certificate breached the Asset Purchase Agreement (APA), and yet MCR had no contractual duty to deliver it, defy logic. If MCR somehow delivered the bring-down certificate outside the APA, as JB&A suggests, then it could not be a breach of that contract. JB&A cannot have it both ways.

The bring-down certificate was by its express terms delivered "pursuant to Section 5.3(e) of the Asset Purchase Agreement," and it reaffirmed representations

and warranties made in the APA. A1372. Without doubt, the APA itself is the "source" of the bring-down certificate, *Richmond Metro. Auth. v. McDevitt Street Bovis, Inc.*, 256 Va. 553, 558 (1998), and MCR was obligated to deliver that certificate in order to close the transaction. Section 5.3(e) of the APA states:

> (e) Bring Down Certificate. Buyer **shall have delivered** to Seller a certificate of an officer of Buyer to the effect that the conditions precedent set forth in Sections 5.3(b) and 5.3(c) have been satisfied.

A1228 (bold added). Further, delivery of the certificate was the sole basis of the court's finding of a breach. A2298, A2360. The constructive-fraud claim is thus based entirely on an act by MCR undertaken "pursuant to" the parties' contract.[1]

JB&A ignores this Court's seminal decision in *Sensenbrenner v. Rust, Orling & Neale, Architects, Inc.*, 236 Va. 419 (1988), which explains why an act that allegedly breaches a contractual duty generally cannot also breach a tort duty:

> The controlling policy consideration underlying tort law is the safety of persons and property—the protection of persons and property from losses resulting from injury. The controlling policy consideration underlying the law of contracts is the protection of expectations bargained for. If that distinction is kept in mind, the damages claimed in a particular case may more readily be classified between claims for injuries to persons or property on one hand and economic losses on the other.

Id. at 425. Where plaintiffs "allege nothing more than disappointed economic

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[1] At root, this case involves a difference in contract interpretation over a bring-down certificate disclosure decision. MCR maintains that it acted in good faith based upon what it did and did not know at the time, and the trial court agreed that this did not give rise to actual fraud.

expectations," they allege "a purely economic loss, for which the law of contracts provides the sole remedy." *Id.* JB&A alleges only that the May 31 bring-down certificate frustrated its bargained-for expectation to receive earn-out payments. Thus, the APA provides JB&A's sole cause of action.

Characterizing the APA as an "executory contract" does not alter the principle of *Sensenbrenner*. JB&A contends (at 22) that the "common law duty to tell the truth and not conceal material facts is the source of JB&A's fraud claim," but its authorities do not recognize such a generalized duty. JB&A relies principally on *Ware v. Scott*, 220 Va. 317 (1979), and its progeny, but *Ware* involved a mutual mistake of fact at the time of formation that rendered the real-estate contract voidable. *Id.* at 320-21. Here, no mutual mistake gave rise to a freestanding common-law duty, since (as is undisputed) the events giving rise to JB&A's claim all occurred *after* the parties entered into their agreement on May 5.[2]

JB&A's generalized duty to "not conceal" also runs counter to *Modern Oil Corp. v. Cannady*, No. 141839, 2015 WL 10990113 (Va. Dec. 30, 2015). There, plaintiffs claimed that their employer, who allegedly promised them retention bonuses if they remained with the company, breached a common-law duty to disclose a later decision not to pay the bonuses. The Court found that, while the

[2] JB&A's reliance on *Horner v. Ahern*, 207 Va. 860 (1967), is even farther afield. *Horner* not only involved fraudulent inducement at the time of contract formation, but (unlike here) there was no contractual warranty due at closing. *Id.* at 863, 867.

employer may have breached a contractual obligation by refusing to pay the bonuses, "[n]o Virginia case—either in the context of fraudulent inducement or otherwise—has imposed a tort duty under such circumstances." *Id.* at *5. Similarly, JB&A cites no Virginia authority recognizing a common-law duty for MCR to disclose an entirely new development arising between the execution of the APA and the closing; it cites only the Restatement (Second) of Torts §§ 526, 551 (1977), which Virginia courts have never adopted in this context. That is precisely why MCR and JB&A bargained for a contractual duty.

MCR delivered the bring-down certificate "pursuant to" its contractual duty to provide representations and warranties. A1372. As in *Dunn Construction Co. v. Cloney*, there is no "independent act of fraud." 278 Va. 260, 266 (2009). MCR's delivery of the certificate was governed by the APA; hence, JB&A's claims based on that certificate sound solely in contract. *Sensenbrenner*, 236 Va. at 425.

2. JB&A's Causation Arguments Confirm That There Was No Other Willing Buyer. (Assignment 2)

JB&A does not dispute that causation of injury—the *fact* of damages proximately caused by the alleged breach—is an element of both its breach-of-contract and tort claims, and hence MCR is entitled to judgment on both claims if JB&A did not prove this element. JB&A also does not defend the trial court's clearly erroneous finding that "the catastrophic financial impact on MCR from the suspension" established "causation of damages" because that impact "would not

have occurred but for JB&A's reliance upon the false representation." A2347-48. Nor could it: that "financial impact" has nothing to do with JB&A's theory that it was harmed on May 31, when it supposedly lost the value of a business it would have retained but for the alleged breach.

Instead, JB&A's principal argument is that the Allocation itself proves causation by establishing the "value of the Intelligence Business at closing." But that theory cannot be squared with *SunTrust Bank v. Farrar*, 277 Va. 546 (2009).

JB&A's entire causation argument is an unacknowledged plea to overturn *Farrar*. JB&A argues (at 29) that MCR used the Allocation in its "financial statements." The trustee in *Farrar* also used the appraisal for business purposes, yet the appraisal was insufficient for awarding damages. Here, in rejecting MCR's counterclaim, the trial court found both that (1) the revenue projection driving the Allocation "merely project[ed] a hopeful outcome" (A2352), and (2) MCR did not believe that this projection was accurate (A2318-19). The Allocation is thus even less appropriate as evidence of fair market value than the *Farrar* appraisal.

JB&A next argues (at 29) that the Allocation "had a high degree of reliability" because consultants selected by MCR prepared and certified it. This does not help JB&A. As MCR explained in its opening brief (at 34), the appraisal in *Farrar* was also the product of an "undisputed … expert appraiser and engineer." 277 Va. at 550 n.4. JB&A has no answer to this point.

Similarly, JB&A insists (at 16, 28, 37, 38) that the Allocation was sufficient because it reflected MCR's "own valuation," but that too is a repudiation of *Farrar*. MCR explained in its opening brief (at 34-35) that the trustee in *Farrar* commissioned the appraisal specifically to estimate the "fair market value" of the property, whereas the Allocation was prepared only to assign "Fair Value" "for U.S. GAAP reporting purposes" and "should not be used for any other purpose." A2071. JB&A ignores this point as well.

JB&A posits (at 29) that the Allocation is reliable because it was prepared "prior to this litigation, when MCR did not have a motive to undervalue JB&A's business," but that is yet another repudiation of *Farrar*. The *Farrar* appraisal also was prepared before the trustee's dispute with the beneficiaries arose.

JB&A argues (at 16, 29, 35) that the Allocation was based on a sound "methodology," but that argument again flies in the face of *Farrar*. This Court never questioned the appraiser's methodology in *Farrar*, yet held that the appraisal was insufficient because there was no evidence of a willing buyer at the appraised price. Even assuming the Allocation employed a sound methodology in estimating the probability-weighted fair value of the earnouts, it does not establish the existence of another willing buyer, or what that buyer would have paid.

JB&A argues (at 16, 29) that a witness—MCR's CFO, Marcia O'Brien—testified that the Allocation represents the purchase price for the Intelligence

Business in an "arms-length transaction" on May 31, but that is another refusal to acknowledge *Farrar*. There, an expert economist testified that plaintiffs were injured based on the appraised value of the property, yet this testimony did not cure the appraisal's deficiencies. 277 Va. at 556.[3]

At last acknowledging *Farrar* on the eighth page of its causation argument, JB&A tries to distinguish it on its facts. It argues that the coal industry in *Farrar* was in decline, the property had a lease, and the last willing buyer was five years earlier. These irrelevant points do not alter *Farrar*'s holding that there must be a willing buyer at the claimed value, which JB&A has not shown. When McLean declared that the "exhaustive marketing process was completed," MCR had made the *only* written offer. A1948. JB&A's argument that "MCR need only look in the mirror" to find a willing buyer is merely the "circular proposition" that a business is worth what a party paid for it—a proposition that "does not hold true in the sale of a going concern." *Interim Healthcare, Inc. v. Spherion Corp.*, 884 A.2d 513, 549-50 (Del. Super. Ct. 2005).

Nor was there any "other proof … of a viable market" at the Allocation

[3] In any event, O'Brien testified as a fact witness on the proper accounting for the transaction in MCR's financial statements, not as a valuation expert. As with the Allocation itself, fact-witness testimony that MCR recorded the transaction based on "the amount that came out of the probability table decision tree," A891, says nothing about whether another buyer existed or would pay that amount if JB&A had backed out of the MCR deal. Indeed, the evidence proved that *no* such buyer existed. A1948; A1984; A1998; A2045.

price. *Farrar*, 277 Va. at 555. JB&A asserts (at 34-35) that McLean "identified more than sixty other potential buyers" and it "could have approached these or other potential buyers" if the MCR transaction did not close. These buyers *were* approached, and none made an offer. Moreover, a seller always "could have" approached other "potential" acquirers, just as the *Farrar* trustee could have marketed the property to other buyers. Such speculation is not evidence that there *were* willing buyers at the Allocation price.

JB&A's contention (at 35) that MCR's nonbinding letter of intent "precluded JB&A from discussing a sale with any other buyers" grossly distorts the sale process—a process about which the trial court made no findings. JB&A's investment banker reported that "61 potential acquirers *were* contacted" in "[a]n *exhaustive* marketing process [that] was *completed*," A1948 (emphases added), yet these "exhaustive" efforts met with "lack luster response from the market," A2045. JB&A agreed to the letter of intent's conditions after it knew there were no other written offers. A1948, A2045. Rather than identifying another willing buyer, this evidence established the opposite—"the lack" of "a market for the [business]"—making it "impossible to conclude that anything [MCR] did or did not do caused any damage." *Farrar*, 277 Va. at 556.

As a fallback, JB&A tries to resurrect a lost-earnout theory that it discarded at trial and that the court found "would have required the Court to speculate."

A2507. Although JB&A now argues that it did not abandon the theory (*but cf.* A940-41, A947, A2495, A2507), it does not argue that the lost-earnout theory independently proves causation—only that it somehow "corroborates the trial court's damages finding." Appellee's Br. 35. But given that the Allocation is impermissibly speculative under *Farrar*, adding more "'speculation and conjecture cannot form the basis of the recovery.'" *Farrar*, 277 Va. at 554 (citation omitted).

JB&A's own expert conceded that the lost-earnout theory was "highly speculative," and the trial court agreed. Appellant's Br. 24-25. Moreover, even if this theory was not waived, JB&A fails to show how it satisfied its burden of identifying specific lost business opportunities that, but for the alleged breach and subsequent suspensions, would have allowed JB&A's Intelligence Business to achieve the financial thresholds for earnout payments. Appellant's Br. 23-24; *see* A2056; Trial Tr. 1806-07 (Knight), 3345-51 (Kiernan).

There is but one conclusion: JB&A has not shown that it was injured when MCR paid $42.7 million to acquire the Intelligence Business. JB&A's owners, including the ESOP pensioners, received a price well above JB&A's own $37.6 million valuation of its business (A1998), and no other buyer was willing to pay even as much (A1948). JB&A failed to prove an essential element of its claims—causation of damages—and the judgment must be reversed on both counts.

3. JB&A's Damages Arguments Are Based On Speculative Projections. (Assignment 3)

As a threshold matter, JB&A's assertion (at 5, 34) that MCR "agreed to pay approximately $62.2 million for the Intelligence Business" is factually wrong and merely a backdoor attempt to revive the lost-earnout theory that JB&A's own expert admitted was "much more speculative" than even the insufficient Allocation. A940. There is no credible evidence that but for MCR's actions, JB&A would have realized $19.5 million in contingent earnout payments.

Moreover, the Allocation itself reflects rosy revenue projections that the trial court found no party believed. The Allocation's calculations use projections in the Confidential Information Memorandum that McLean prepared in mid-2010 to help JB&A sell its Intelligence Business. A1871-1905. That document projected total revenues of $66.1 million in 2011 and $69.6 million in 2012 (A1876)—optimistic goals that, by April 2011, JB&A's management privately concluded were "unlikely," a "stretch," and "not possible" for all practical purposes. A1988; Trial Tr. 1766 (Apr. 21, 2015); Trial Tr. 3624-25 (May 6, 2015).

Significantly, the trial court rejected MCR's fraudulent-inducement counterclaim *because* it found that JB&A's inflated revenue projections were "merely projecting a hopeful outcome" that MCR "just didn't believe." A2318-19, A2352; *see* Appellant's Br. 33. These factual findings foreclose any conclusion that the Allocation—which used those same $66.1 million and $69.6 million

revenue projections in its earnout calculation—proves causation and damages for JB&A's claims. Projections that were unreliable and disbelieved by both sides when they signed the APA on May 5, 2011 cannot be a reliable basis for valuing JB&A's business as of May 31, 2011 for purposes of awarding damages.

JB&A responds with misdirection, arguing (at 30) that the "financial information" in the 2010 projections is "materially different" than that in the Allocation. But the 2011 and 2012 total revenue projections—the numbers that would determine whether earnout thresholds are met—are the same. Appellant's Br. 8, 33. JB&A also argues (at 30-31) that "MCR provided" the projections to McLean, but that does not make the projections reliable or overcome the trial court's contrary finding that they "merely project[ed] a hopeful outcome." A2352.

JB&A argues (at 32) that the Allocation was calculated on a "stand-alone" basis and does not reflect "synergies." The record is otherwise: MCR's initial letter of intent reflected significant "Strategic Value of JB&A to MCR." A1949. Apart from an adjustment to correct JB&A's overstatement of EBITDA, the final purchase price included the same "Strategic Value."

JB&A internally estimated the fair market value of its business as of year-end 2010 at $37.6 million. A1998. It argues (at 32) that this valuation was not the price at which it could be sold "in an arms-length sale," but the valuation expressly reflects "Fair Market Value" (A1995), which is a property's "'sale price when

offered for sale by one who desires, but is not obliged, to sell it, and is bought by one who is under no necessity of having it.'" Appellee's Br. 29 (citation omitted). That this price "disregards synergistic or strategic values that might be recognized in the marketplace by a specific strategic buyer" (A1995) *confirms* that MCR paid a premium to the ESOP pensioners for that anticipated added strategic value.

There was no willing buyer at the Allocation price. Like the appraisal in *Farrar*, the Allocation was an "unsupported projection[]" that will not sustain a damage award. 277 Va. at 555. JB&A failed to prove damages.

4. This Case Is No Exception To The American Rule. (Assignment 4)

In *Prospect Development Co. v. Bershader*, this Court expressly limited its holding to fraud claims before a "chancellor"—*i.e.*, claims in equity. 258 Va. 75, 92 (1999). JB&A insists (at 41) that the trial court "ruled that it was sitting i[n] equity," but by awarding only money damages, the court awarded *legal* relief. Appellant's Br. 39-40 (citing authorities). Even JB&A's circuit-court case law suggests that its argument is "'doubtful[].'" *Grp. Ins. Concepts, Inc. v. Visium Sols. Corp.*, 61 Va. Cir. 110, 113 (Roanoke City Cir. 2003) (citation omitted).

Even in equity, *Bershader* applies only on claims of *actual* fraud. JB&A cites no case applying *Bershader* to constructive fraud. It dismisses *Oswald v. Holtzman*, 90 Va. Cir. 9 (2015), as an "outlier," but it is the only decision to address *Bershader* in analogous circumstances. Further, JB&A's argument (at 44)

that this Court may "affirm" the fee award by finding actual fraud is a request to reverse the portion of the judgment dismissing its actual-fraud claim, which JB&A did not cross-appeal. Its actual-fraud argument is therefore waived.

Even if attorneys' fees could be awarded for constructive fraud, they would not be warranted here. The trial court: (1) expressly found there was no actual fraud; (2) expressly "did not award attorneys' fees as sanctions," A2646; (3) did not find that MCR's counterclaim was brought in bad faith; and (4) did not find any argument or defense frivolous. Those facts do not warrant fee-shifting.[4]

JB&A notes that the trial court found that MCR's witnesses supposedly provided "false testimony." Because factfinders must always make credibility assessments to resolve disputed fact questions, the only thing unusual about this case is the court's lurid characterization of its findings. The court's description of MCR's actions as "almost sinister" also conflicts with its express finding that MCR was at most "negligent." Hrg. Tr. 71 (Jan. 13, 2016). Similarly, JB&A's argument that MCR "does not and cannot dispute" the court's findings regarding the supposed "pattern of misconduct" is both wrong and entirely beside the point. As MCR has explained, it strenuously disagrees with those findings, but they are irrelevant to the legal errors identified in this appeal. Appellant's Br. 13.

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[4] JB&A's efforts to impugn MCR's trial counsel are yet another instance of running from the record. The trial court repeatedly praised counsel (*see* Hrg. Tr. 93 (Sept. 21, 2016)) and insisted it was not awarding fees as a sanction (A2646).

5. JB&A's Recovery For Both Fraud And Breach Of Contract Contravenes Bedrock Principles Of Remedies. (Assignment 5)

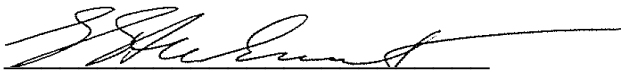
The merger of law and equity did not abrogate the blackletter rule that a plaintiff generally must elect between receiving equitable and legal relief based, as here, on incompatible claims. JB&A's damages award for breach of contract is fundamentally incompatible with its fraud award based on repudiation of that contract, as JB&A's own cases confirm. *See, e.g.*, *Millboro Lumber Co. v. Augusta Corp.*, 140 Va. 409, 421 (1924); *Modern Oil*, 2015 WL 10990113, at *4. JB&A's cases affording both legal and equitable relief on compatible claims are inapposite. *See Adv. Marine Enter. v. PRC Inc.*, 256 Va. 106, 124 (1998); *Waskey v. Lewis*, 224 Va. 206, 213 (1982).

Moreover, JB&A's authorities suggesting that parties may plead inconsistent legal and equitable theories are irrelevant to whether a plaintiff must elect its remedy if it *prevails* on both theories. *See, e.g.*, Code § 8.01-281 and Rule 1:4(k). A court may not stack legal and equitable remedies to award more than the amount that would make the plaintiff's recovery complete. *See* A2594.

CONCLUSION

JB&A's shareholders received $42.7 million for an asset they valued at $37.6 million. The trial court added to this $5 million premium a further $12 million windfall by ignoring reality: there was no other buyer for this business. In the absence of such a buyer, there can be no liability or damage award here.

Dated: June 30, 2017



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CERTIFICATE

I hereby certify that on this 30th day of June, 2017, pursuant to Rule 5:26, three paper copies of the Reply Brief of Appellant were hand-filed with the Clerk of the Supreme Court of Virginia and an electronic copy of the Reply Brief was filed, via VACES. On this same day, an electronic copy of the Reply Brief of Appellant was served, via email, upon:

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