Preface

This book is for lawyers who frequently, occasionally, or even for the first time encounter disputed (or potentially disputed) business valuation issues. It serves all of the above because it is written and organized both as a tutorial and as a reference manual.

The authors have over 40 years of combined experience in transactional matters (e.g., mergers and acquisitions, going public, going private) and also litigation or potential litigation (e.g., tax matters, shareholder disputes, marital dissolutions). All of these have elements in common, and many have specialized elements, thus requiring generalized chapters and also chapters addressing a particular valuation purpose.

Same Shares May Have Different Values

It is important to recognize that the same block of shares may have different values, even on the same day, depending on the statute and the case law governing the transaction. For example, an increasing number of states are not allowing discounts for lack of control and/or lack of marketability in dissenting stockholder suits, whereas federal, gift, estate, and income tax statutes universally use the standard of fair market value, which the courts have interpreted to allow such discounts.

Personal versus Enterprise Goodwill

One area in which we have done a great deal of work lately is the distinction between personal and enterprise goodwill. Entrepreneurs are invoking the Martin Ice Cream case, where the income tax on the sale of the company was less to the extent that it encompassed personal goodwill. Also, there is a trend among state courts to take the position that the value of the enterprise attributable to personal goodwill is excluded from the marital estate in marital dissolutions. We have added a new chapter on personal versus enterprise goodwill.

One issue that arises in almost every business and professional practice valuation case is reasonable compensation, and we have added a chapter on that.

Premiums and Discounts

A major issue in many cases is premiums and discounts, especially discounts for lack of marketability (DLOM). There has been great progress in empirical DLOM data-

bases, and today most courts prefer that the analyst go into the databases and select the transactions most resembling the subject company rather than just use the average discounts. Other discount and premium issues that we see often are discounts for lack of control (minority interests) or premium for control.

The Tax Court in recent years has fully embraced discounts for trapped-in capital gains, and today it is not a question of whether but a question of how much. Other courts, however, have been slow to follow suit. Other discounts include voting versus nonvoting stock, key person discounts, discounts for nonhomogeneous assets (portfolio discount), and discounts for environmental litigation and other contingent liabilities.²

**S Corporations and Other Pass-Through Entities**

Almost half the valuations that our company has done lately involve S corporations or other pass-through entities, and we have added a chapter on those. We have also added a chapter on valuing professional practices and small service businesses.

**“Fair Value” for Financial Reporting**

One valuation purpose that has come to the fore lately is valuation for financial reporting. Financial Accounting Standard (FAS) 157 says that the standard of value for financial reporting is “fair value,” but its definition of fair value comes closer to fair market value than to fair value as used in state statutes governing shareholder disputes (and interpreted through case law). We have added a chapter on fair value for financial reporting.

**Buy-Sell Agreements**

In the course of reviewing valuation reports pursuant to buy-sell agreements, we see many ambiguous valuation provisions in buy-sell agreements. Many even omit the applicable definition of value (the subject of Chapter 1). To assist lawyers in drafting unambiguous valuation provisions in such agreements, we’ve added a chapter on buy-sell agreements.³

**Report Reviews**

One of the most frequent (and hard to catch) categories of errors in business valuation reports is errors of omission. We’ve added two chapters on valuation reports—a gen-

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³ *See also* Z. Christopher Mercer, *Buy-Sell Agreements: Ticking Time Bombs or Reasonable Resolutions*? (Peabody Publishing, LP 2007).
eral chapter (what a good report should have) and a “working chapter” for reviewing reports. The report review chapter is free of copyright restrictions and is meant to be copied and the blanks filled in for each report. Two or more copies may be utilized for comparing your expert’s report with that of the opposing expert and identifying the differences.

Cross-Examining Business Valuation Experts

And finally, in response to popular demand, we’ve added a chapter on cross-examining a business valuation expert.

Court Positions Cited, Sometimes Challenged

Illustrative court cases are cited throughout to illustrate courts’ positions on many issues. On some issues various courts are unanimous in their positions, but on other issues courts’ positions vary according to jurisdiction. For those that vary, we cite from decisions on either side of an issue. Occasionally, when we feel that one court’s treatment of an issue is sounder than another, we say so, and tell you why. We believe that lawyers should know court precedents and usually should follow them, but sometimes it pays to challenge an unsound precedent and make new law.

The appendixes include a glossary, a list of business appraisal professional organizations with contact information, and a bibliography that includes business valuation databases.

We welcome questions and comments at Shannon Pratt Valuations, Inc., www.shannonpratt.com, (503) 459-4700, 6443 S.W. Beaverton Hillsdale Highway, Suite 432, Portland, Oregon 97221.

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