HOT TOPICS IN VALUATION*

Unfair Fair Market Value

Valuing Goodwill

Reasonable Compensation

Cross Examination

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Unfair Fair Market Value[*]
(All things being equal the value of a business should not depend upon the state where the owner resides)

By

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Fair Market Value:

In Revenue Ruling 59-60, the Internal Revenue Service defines fair market value as ". . . the price at which (business interests or) property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both having reasonable knowledge of relevant facts." The International Glossary of Business Terms defines fair market value consistent with Revenue Ruling 59-60. Fair market value for tax purposes also assumes a hypothetical buyer and seller.

Valuing a Business in Dissolution of Marriage Proceedings:

Laws regarding the distribution of assets upon a dissolution of marriage vary from state to state. Most states direct their courts to "equitably distribute" property of the marriage to the divorcing parties. Some states known as community property states consider anything acquired by either party during the marriage as co-owned and, upon dissolution of marriage, either divide the co-owned property equally or in some fashion the court determines to be equitable. In carrying out this mandate, courts will distribute the property of the marriage in an equal or equitable manner. Where a privately-held business is involved, the court must deal with the value of the business. Typically courts will not leave people that are divorcing as business partners, so divisions in kind of ownership interests in a business are rare. Therefore, determining the value of the business is vital in order to accomplish the so-called "equal" or "equitable" division.

Standards of Valuation:

The law regarding standards for valuing a business upon a dissolution of marriage is not ordinarily statutory but evolves from case law. Predictably, different states go in different directions and even courts within the same state may go in separate directions. Nevertheless, for the most part, decisional case law refers to "fair market value" as a standard for valuing a business for dissolution of marriage purposes. Notwithstanding giving this lip service, courts in various states do not strictly adhere to the art and science of business valuators who come to fair market value conclusions using strict adherence to the fair market value definition.

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Is there an unfairness with fair market value in dissolution of marriage cases?

The following are issues that must be dealt with in valuing a business or an ownership interest in a business and impact value for fair market value purposes. They are considered by some to be unfair considerations in valuations for dissolution of marriage purposes:

Personal goodwill being separated from enterprise goodwill;

Potential lack of a covenant not to compete by the entrepreneur owner;

Discounts for lack of marketability;

Discounts for minority interests;

Discounts for costs of a hypothetical sale i.e, broker's commissions, legal and accounting fees.

In various forms, the arguments that emerge focus on there being no real sale and, therefore, the spouse owner will be retain the full value of the entire interest while buying the other spouse out on dissolution of marriage using hypothetical discounts.

Fair Value:

Fair value is generally discussed and used by courts in the context of shareholder disputes where an oppressed or a dissenting shareholder is entitled to payment for their shares. It is sometimes used by real estate developers when doing financial statements to banks for financing purposes. Although the literature tells us that "fair value" is different than "fair market value," it is hard to find any universal definition for "fair value". The Revised Model Business Corporation Act finds it as

> "the value of the shares immediately before the effectuation of the corporate action to which the dissenter objects, excluding any appreciation or depreciation in anticipation of the corporate action unless exclusion would be inequitable."

This definition appears to look at value from the oppressed or dissenting shareholders position and that party may not truly be a willing seller. The concept seeks to assure the seller fair consideration because he is unable to keep the stock. Domestic relations courts, when varying from the fair market value standards sometimes drift into fair value although that may not be expressly stated. After all, the spouse who is leaving the marriage without the business interest is generally not a willing seller either.

Intrinsic Value:

Intrinsic value is also contrasted to fair market value. Its thesis is the true worth of asset based on its own particular circumstances. One looks to the characteristics inherent in the investment or business interest. Intrinsic value analysis may disclose that a dividend paying security discounted to present value may be worth more than its currently publicly-traded market value. So might a husband's business interest be of a greater value than what a fair market value would determine.

Investment Value:

This value is also in contrast to fair market value. Here, one looks to a particular investor and what it would mean to that investor to acquire the spouse's interest being valued. It considers synergies that might occur to a particular buyer by obtaining the asset (or business) that may be of greater value to him than others who might be interested in purchasing the asset. This too is a cousin of fair value. In marital dissolution cases, some courts expressly or implicitly adopt this value when straying from fair market value. .

Although Fair Market Value Requires Consideration Of A Hypothetical Sale In A Divorce Case, Why Isn't It A Fair Standard Considering:

- The value of an asset in dollars is measured by what someone would pay for that asset. The non-owning spouse effectively receives a cash buy-out while the owning spouse receives a closely-held business where the spouse must continue working and shouldering responsibility to protect the value of the asset.

- In professional practices, the owner spouse would otherwise pay a personal goodwill value to the non-owning spouse who may in turn invest her share in a passive investment generating income while the owning spouse must continue to work to generate the income that was the measure of value for the professional practice.

- Isn't paying the non-owning spouse for personal goodwill paying an ex-spouse for the owning spouse's post-dissolution efforts.

- Where there is no covenant not to compete, one should not be assumed in determining value, since the owning spouse's execution of a covenant not to compete prohibits him from earning a livelihood in what may be the only field where he is able to earn a reasonable livelihood. The issue is the value of the business at the time of the divorce without consideration for the owner's continued employment nor any prohibition of him working in a similar business after sale. Any value for that would compensate the spouse for the owning spouse's post-divorce conduct.

- Regarding the lack of marketability or liquidity discount, the reality is that the non-owning spouse should have her interests purchased considering the lack of marketability or liquidity. When the owner ultimately sells to enjoy the cash value of the asset, the consideration he receives will be affected by the business's lack of marketability or liquidity by the next purchaser.

- Regarding a minority discount, there is no guarantee to the owning spouse that he will indefinitely be in business with the owners comprising the majority. He alone should not bear the risk. Prudence or necessity may require the sale of his minority interest and thereby he would suffer reduced consideration in selling his minority interest.

- Costs of sale, like brokerage, attorney's fees and accounting fees, should be subtracted from value since, when the owning spouse sells his interests post-divorce, he will suffer these costs to realize cash – therefore, why shouldn't the non-owning spouse on divorce have her consideration affected by these same customary costs?

Valuing Goodwill*
(What a Quagmire)

By

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Goodwill:

In the financial reporting/accounting world, goodwill is what is left after all intangible and identifiable intangible assets have been valued. In divorce valuations, goodwill is generally defined as the value received with the sale of a business that exceeds the value of the company's tangible assets. Factors like possessing brand names; reputation for quality; good values; reliability; and the expectation of continued patronage are all elements of goodwill. When one buys a going concern, paying a price higher than tangible asset value is mostly due to goodwill, notwithstanding that there may be other intangible assets affecting value as well.

Valuing Goodwill:

There is no overall consensus on how goodwill should be valued. Obviously, it is an intangible asset and a first step might be to separate it from other intangible assets defined under Internal Revenue Code Section 197 as including workforce in place, books and records, operating systems, customer lists, patents, copyrights, licenses, permits, franchises, trademark or trade name, to include a few. Nevertheless, because of the peculiarities of individual state laws, it often requires a segregated value as well as a segregated subvalue.

The Premise for Segregated Value for Goodwill:

In dissolution of marriage cases, courts seek to make equal or equitable distributions of property and consider the value of all marital or community assets and liabilities. A spouse's business may be a marital or community asset. If the business is a closely-held and there is no readily obtainable value for the owner's interests, it is necessary to value the business or, in a case where the spouse is a fractional owner, the fractional interest in the business. As discussed before, the general standard of value employed by most states in valuing a business is "fair market value." Fair market value of a business ordinarily includes all aspects of value including goodwill. Nevertheless, in dissolution of marriage matters, there is a tension between making an equitable distribution of assets as they exist at the time of the dissolution and not allowing a spouse's future efforts and earnings and post-divorce activities be considered in the property aspects of the

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division. The fundamental basis for the this concern is that the business-owning spouse's future income will also be considered in arriving at support obligations, and may be a factor in determining the percentages of an equitable distribution and, therefore, should not be counted twice. Therefore, to the extent it is possible, in a number of states personal goodwill must be segregated from enterprise goodwill and only the latter is permitted to be included in the business valuation.

State's Prohibiting the Inclusion of Personal Goodwill as Part of Fair Market Value:

The following states are a sampling of those that do not permit inclusion of personal goodwill in a fair market value business valuation:

> Illinois (*In Re the Marriage of Schneider*, 214 Ill.2d 152, 824 N.E.2d 177, 291 Ill.Dec. 601)
>
> Maryland (*Prahinski v. Prahinski*, 321 Md. 227, 582, A.2d 784)
>
> Pennsylvania (*Beasley v. Beasley*, 359, Pa. Super.20, 518 A.2d 545)
>
> Texas (*Geesbreght v. Geesbreght*, 570 S.W. 2d 427)
>
> Wisconsin (*Holbrook v. Holbrook*, 103 Wis.2d 327, 309 N.W.2d 343)

The Illinois Supreme Court in *Schneider* stated:

> ". . . goodwill represents merely the ability to acquire future income. Consideration of goodwill as a divisible marital asset results in gross inequity."
>
> "Notably, in *Talty*, although no award of maintenance or child support was made, this court nonetheless held that personal goodwill should not be considered an asset of the business [car dealership] because the elements that constitute personal goodwill are considered under section 503(d) of the Dissolution Act in dividing marital property."

Also, the Wisconsin Supreme Court in *Holbrook* stated:

> ". . . The goodwill or reputation of [the law firm] is reflected in [Holbrook's] substantial salary. The salary was considered in setting the family support award. To also treat the goodwill of the law firm as a separate divisible asset would constitute double-counting. . . . The California approach has been deservedly criticized as a 'confusion of rules and methods of valuation, compounded by inconsistencies in logic and application and conceptual problems over possible duplication of spousal support and denial of equal protection."

States That Allow the Inclusion of All Goodwill in Business Valuations Include:

The following states are a sampling of those allowing consideration of all goodwill.

Arizona (*Mitchell v. Mitchell*, 152 Ariz. 317, 732 P.2d 208)

California (*Golden v. Golden*, 270 Cal.App.2d 401, 75 Cal.Rptr. 735) and (*In Re The Marriage of Lopez*, 38 Cal.App.3d 93, 113 Cal.Rptr. 58)

Colorado (*In Re The Marriage of Graff*, 902 P.2d 402)

New Jersey (*Dugan v. Dugan*, 92 N.J. 423, 457 A.2d 1)

Washington (*In The Matter Of The Marriage of Fleege*, 91 Wash,2d 324, 588 P.2d 1136).

The California cases of *Golden* and *Lopez* tell us that, although goodwill may be difficult to value, it must be considered in the division of property and that personal goodwill is something that was earned through joint spousal efforts and labors. The non-owning spouse contributed to the acquisition of the goodwill in the same manner that the spouse contributed to any of the owner spouse earnings and assets acquired during the marriage and is therefore entitled to be compensated for that contribution which the owner spouse will continue to benefit from after divorce.

Arizona's *Mitchell* case put it this way . . . "The economic reality [is] that the goodwill of a professional practice has value and it should be treated as property upon dissolution of the community."

Are the Methods Used to Value Covenants Not to Compete Reasonable to Use in Valuing Personal Goodwill?

Valuing a covenant not to compete seems to measure the same factors as valuing the personal goodwill of an owner. Also, like with personal goodwill, a number of courts have held that covenants not to compete are not part of the marital estate because to the extent that a covenant restricting an individual from competing after divorce is dependent on the reputation of the person who gives the covenant, it is not a marital asset. (*See Lowe v. Lowe*, 372 N.W.2d 65 (Minn. Ct. App. 1985) (supporting proposition that one spouse should not benefit from an agreement that restricts the other spouse's employment); *Johnson v. Johnston*, 778 S.W.2d 674 (Mo. Ct. App. 1989) (holding that value of covenant not to compete is not marital property); *Hoeft v. Hoeft*, 600 N.E. 2d 746 (Ohio Ct. App. 1991) (stating monies received from covenant not to compete in sale of dental practice were not marital property).

Methods Used to Value Covenant Not To Compete:

Compensation Approach: The Seller's average compensation is calculated and projected over the life of the covenant and discounted to present value. This measures the loss to the seller by not being able to be employed where there might be competition. This

approach is not reasonable in determining the value of the business where there is no covenant not to compete.

Value Of What Buyer Acquired: – The value of the business and what it would be worth if the seller competed. (Anson Tool & Manufacturing v. Commissioner T.C. Memo 1992-121) First, determine the fair market value of the business with a covenant not to compete from Seller and then subtract the present value of the expected loss of future earnings during the forecast period.

This method is full of pitfalls in:

(i) trying to forecast (speculate) earnings without the covenant;

(ii) considering a risk analysis of the seller's likelihood to compete and arriving at an Earnings Discount rate. The following is an example of a Risk Analysis:

RISK ANALYSIS CHART*
TYPE OF COVENANT – NON-PIRACY

Risk Factors	Highly Like or Yes	Somewhat Likely	Somewhat Unlikely	Unlikely or No
Seller's financial ability to compete	X			
Seller's health condition		X		
Seller's Age		X		
Seller's stated intentions to compete	X			
Seller has ability to attract existing customers/clients				X
Seller ability to develop new business		X		
Seller's ability to establish same or similar product lines		X		
Seller's ability to hire existing employees or contractors				X
The length of the agreement is less than 5 years				X
The protected market area is reasonable				X
Other agreements which prevent Seller from competing				X
Discount to First Year Earnings (%)	31%+	21-30%	11-20%	0-10%
Selected Earnings Discount		15%		

* *Divorce Interactive: Risk Criteria And Valuation Methods For Valuing Covenants Not To Compete*, by Jeff Jones.

Courts will want to know the reliability of the data used for the percentage ranges in the chart. Effectively this method is the same as doing a second business valuation assuming no covenant and adjusting percentages based on the likelihood that the seller would compete. The difference between the second adjusted value and the first value would be the value of the covenant not to compete

Courts As Gatekeepers:

The United States Supreme Court's standards as expressed in *Daubert v. Merrell Dow, etc.*, (1993) 509 U.S. 579, 113 S.Ct. 2786, are used by most state courts in screening expert scientific testimony. In *Daubert*, the Supreme Court reminded us that scientific methodology is based on generating hypotheses and "testing" them. Publication of a theory and peer review does "not necessarily correlate with reliability".

Tensions Affecting Value Of Covenant Not To Compete:

Even if there is an expressed value for the covenant not to compete, can it be relied upon as the statement of true value? Each party may have their own agenda:

- Buyer: Overvalue the covenant not to compete since it will be amortizing it for income tax purposes.
- Seller: Minimize the value so more of the proceeds of sale are treated as capital gains rather than ordinary income.
- Divorcing Spouse/Owner who may want to have more value assigned to the covenant in an attempt to keep those proceeds out of the marital estate.

In a small or medium sized business or profession with an owner employee having product acquisition contracts as well as customer contacts, can there be a going concern value for the business that would not include personal goodwill within a "reasonable degree of certainty?"

Reasonable Compensation*
(Do You Know It When You See It?)

By

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Reasonable Compensation As It Relates To Dissolution Of Marriage Cases:

Determining a spouse's "reasonable compensation" is a significant issue in many dissolution of marriage cases. Superficially it needs to be determined for alimony and child support paying purposes. Where there is a family business involved, it is a necessary factor in doing a valuation of a spouse's interest. The business valuator in attempting to normalize earnings must consider if the owner/spouse as well as other employed family members are being paid more than reasonable compensation thereby increasing the expenses, decreasing profitability, and distorting the value of the business. Reasonable compensation is a key factor for those who choose to use the Capitalization of Earnings and Excess Earnings Method in valuing a business. It is basic to determine "reasonable compensation" for the owner/employee in order to determine the amount of the excess earnings that are to be capitalized. Reasonable compensation may also need to be determined in analyzing an S-corporation owner's compensation from employment in contrast to his pro-rata share of corporate earnings which may be merged on the owner's personal income tax return.

The Business Valuator's Role In Determining Reasonable Compensation:

Determining reasonable compensation may be a major issue in a business valuation assignment. Because of the nature of the business, the duties of the owner/employee, the amount of money involved, and other nuances about the particular business, determining reasonable or normalized compensation may be a major assignment in and of itself. Commentators DeRouen and Lide in their article "How Did You Reach Your Conclusion Regarding Normalized Compensation" (*The Valuation Examiner* – October/November 1998) suggest business valuators "typically have no particular expertise relative to compensation." They expressed concern about the adequacy and weaknesses in the various data sources that are commonly relied on. The authors suggest that unless the evaluator is able to procure appropriate specific data related to the specific business, that the valuator hire a vocational expert to develop the appropriate current and historical compensation data. The vocational expert would do case specific studies and not rely on homogenized databases. In fact, DeRouen, who is himself a CPA and CVA, stated that a

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compensation conclusion as part of a business valuation is inappropriate for a business valuator who has not had extensive training as a "vocational counselor or professional head hunter".

Know And Completely Understand Your Database Source:

When using statistical surveys and databases for the purpose of comparison to determine reasonable compensation, a business valuator must fully understand the data used for comparisons. Either in direct examination, in laying a foundation for one's opinion, or in cross-examination, in defending the comparison, weaknesses in the data used will be magnified and brought to the court's attention. The worst thing for the credibility of the business valuation expert is not knowing how the databases and surveys were compiled and what it truly represents. Know and consider the following:

1. Is the data collected on a national or regional basis?

2. Does the data include owner/employees where the amount of compensation reported may also include business profits as compensation (i.e., partners in professions and businesses)?

3. Concerning data from business and professional associations, what are the sampling sizes that relate to the subject valuation?

4. When using SIC Codes in identifying comparables, how does the particular characteristics of the subject company compare with the broader range of companies covered by the SIC Code?

5. How are the job titles used defined and are the actual duties comparable to the duties and hours of the subject owner/employee?

6. Does the data survey reflect averages? Medians? Quartiles?

7. Does the data or survey fairly reflect compensation for people with particular niches and sub-specialties, i.e., matrimonial lawyers, forensic accountants, lobbyists, etc.?

8. Does the valuator need to include multiple job titles from the survey data to cover the owner/employee's duties?

9. The reliability of the statistics and the source of the statistics that are being used.

10. Where applicable, are stock options, restricted stock, shadow stock compensation as well as other perks reflected in the data survey and comparable to the owner/employee in question?

11. Were all companies used in the database consistent in having or not having retirement plans separate from salary?

12. Is the owner a key person in the business or a top performer, e.g., top sales generator?

Understand What The Owner/Employee Does. Titles Do Not Always Tell The Story:

Highly motivated owner/employees may work over 80 hours a week, and serve multiple functions so that when he is replaced the company will need to hire several employees rather than one. On the other hand, the owner/employee may have an impressive title but do little or nothing. It is therefore important to learn what the owner/employee does, not only from him but from others in the work place. The owner/employee may not truly see himself as others see him. Depending on the purpose of the valuation, he also may not be candid with the valuator.

Multifactor Tests Determining Reasonable Compensation:

There are a number of Tax Court and Court of Appeal cases that rely on multifactor tests in determining reasonable compensation. For example, in the case of *Haffner's Service Stations, Inc. v. Commissioner,* 326 Fed.3d 1 (1st Circuit 2003), the Court of Appeals discussed ten factors in arriving at reasonable compensation. They included:

1. The employee's personal qualifications.

2. The nature, extent and scope of the actual work.

3. The size and complexity of the subject business.

4. Comparison of shareholder/employee compensation paid with the company's gross income.

5. The general economic conditions.

6. Comparison of salaries paid to non-deductible dividends and to total retained earnings.

7. Prevailing rates of compensation for comparable positions in comparable companies.

8. Salary policy for other non-owner employees.

9. Was the compensation paid to owner/employees in prior years adequate?

10. Absence of a pension or profit sharing plan.

The Independent Investor Test For Determining Reasonable Compensation:

In contrast to the multifactor test, there appears to be movement by Federal Courts of Appeals toward a much simpler "independent investor test". See *Exacto Spring Corporation v. Commissioner,* 196 Fed.3d 833 (7th Circuit 1999). In the *Exacto Spring* case, Justice Posner gave a blistering critique of the multifactor test. The Tax Court had used a seven factor test for which Posner stated, ". . . the seven factor test invites the Tax Court to set itself as a super personnel department for closely held corporations, a role unsuitable for courts, as we have repeatedly noted . . . and as the Delaware Chancery Court has noted . . . [in] suits alleging excessive compensation of corporate employees." According to Posner, the multifactor test " . . . invites the Court to decide what the taxpayer's employees should be paid on the basis of the Judge's own ideas of what jobs are comparable, what relation an employee's salary should bear to the corporation's net earnings, what types of business should pay abnormally high (or low) salaries, and so forth. The Judges of the Tax Court are not equipped by training or experience to determine the salaries of corporate officers; no Judges are."

The independent investor test presumes that the owner/employee's compensation is reasonable so long as the return on the investment for the business owners is at a reasonably expected level. The *Exacto Spring* opinion recognizes that the higher the rate of return that a manager can generate for the business, the greater the salary the manager can command. If the rate of return for the investors is extremely high after considering the compensation in question, it would be difficult to prove that the manager is overpaid. Interestingly, in *Exacto Springs*, to determine the rate of return for the investors, the income statement was adjusted to remove improper deducted expenses that had no relationship to the compensation. Without the adjustment for those other deductions, the compensation in that case would have caused the company to have below the reasonably expected rate of return for the investors.

The independent investor test creates the *presumption* of reasonableness. The *Exacto Spring* decision acknowledged that it is still possible to rebut that presumption by showing such things as that the CEO had little to do with the high rate of return or that the company truly did not intend to pay the full amount of salary but did so to conceal a dividend.

Cross Examination Of Valuation Expert*
(It Is Not A Fair Fight Unless Lawyers Really Know What They Are Doing.)

By

Donald C. Schiller
Schiller, DuCanto and Fleck

Scoring Points Against The Valuator On Methods And Process Are Meaningless If They Can Hurt Your Own Expert Too:

Making fun of the opposition's expert by belittling weaknesses in the valuation process usually backfires. Pointing out that the witness may never have actually bought or sold a business; the speculative nature of trying to build or arrive at discount or capitalization rates; the use of comparables from large public companies for a relatively tiny company and the like can cut both ways. Remember, making points challenging procedure and process only helps if your own expert is doing things differently.

Find The Fundamental Points Where There Are Weaknesses And Forget The Rest:

The lawyer and his own valuation consultant need to work together and focus on finding and fully understanding the key weaknesses in the other party's expert report. Taking issue with numerous things in a 30 page report will rarely get you very far. Think about using a consulting expert separate from your own witness to protect your plan from discovery. Then bear down on those fundamental issues. Judges are not usually financial experts, so look to simplify and make it understandable to the Court by pointing out a few fundamental weaknesses that would make anyone question the value conclusion.

Questioning too many things and arguable details where the expert can likely out fence the lawyer, will build up the expert and compromise the good points that could have been clearly made.

The Expert Who Knows The Business The Best Wins:

In cross examination try to show how much less the other expert knows about the business in particular and the industry in general. This is powerful if there is a contrast between the experts. Many times both experts are speaking over the Judge's head (as well as the lawyers). The Judge will try to be neutral and think each expert is expressing their true beliefs and opinions. Both

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will make plausible sounding explanations for what they did. Because of all the subjective decisions that the valuator makes during the valuation process, if one seems to know the business and the industry best, the Judge will likely accept that person's opinion.

Valuation Experts Beware:

- Have backup authority you can cite to for every principle you express or rely upon in your report. If there is no authoritative basis for something you did, candidly explain why you did what you did. Do not make it appear that you relied on some method or principle that is not from a recognized source.

- When asked if a publication is a "standard text" or a "learned article", watch out. Not every text is a "standard text" nor article "learned". What you authenticate may be used to take issue with your testimony, without the author needing to come to court to be cross examined as you were.

- If asked whether a text is "authoritative" be careful of your answer. You may say that you are unaware of any appraisal or valuation association that has deemed any text "authoritative." You could say certain texts, e.g., Pratt, Hitchner, Trugman, etc., are respected in the industry but nevertheless you and your peers disagree with some of the information and concepts presented in those texts.

Soft Points Where Lawyers Can Focus That Significantly Effect Value:

There are certain fundamentals in the valuation process that directly or indirectly have application in all methods used to value a going concern. It is important for the Judge to understand what is empirically based and what appears there because of subjective decision making by the valuator. The subjective aspects of the opinion that are most vulnerable to cross examination. Think about these fundamentals in challenging a valuation opinion.

1. Revenue: This is the starting point for any income-based method for valuations. Is the revenue used or projected reasonable and appropriate? If it is different from historical reporting there should be very good reasons. Consider the reliability of the company's historic books and records.

2. Expenses: If expenses are being "normalized" or restated, know exactly why. Test the reasons for adjustments to wages, obsolete inventory, non-recurring exclusions, and the sources used as a basis to change the actuals. Are the foundations adequate to use the substituted figures?

3. Earnings: One might think this is merely the difference between 1 and 2 above. However, not all "earnings" used in valuation methods are the same. Are they: earnings before tax (EBT); earnings before interest, taxes, depreciation and

amortization (EBITDA); net income (income after depreciation, interest and taxes) or net cash flow (net income with depreciation added back and capital expenditures subtracted).

4. Discount Rate Or Capitalization Rate: How was it built? What systematic/unsystematic risk factors were used and to what extent each effected the rate. From where may have rates been taken? What are all the computations and reasons used to arrive at the rate? If derived from "comparable companies" or industry figures, distinguish those sources from the subject company.

5. Comparable Or Guideline Companies: How similar are these to the subject to justify use? If from survey data, what went into it that may question its use? Are you comparing minority interests or controlling? Have guideline company's earnings been "normalized" too? Do they both count inventory the same? Do they use the same methods of depreciation? Are the comparables covering the same time period? Are the earnings measured the same way?

6. Marketability And Liquidity Discounts: What is the reliability of studies used to arrive at the percent discounted? What are the sizes of companies in the studies compared to the subject company? Does ownership in the subject type of business frequently change hands? How long is the typical waiting time on the market and effect on value?

7. Minority Discounts: If FMV is the standard and it cannot be sold, does it have a FMV? What is the reliability of studies used to arrive at the percent discounted? What are the sizes of companies in the studies compared to the subject company? What are the percentages of the minority interests used in the surveys? Do fractional ownership interests in the subject type of business frequently change hands? How long is the typical waiting time on the market and effect on value?

Cross The Expert Pointing Out What He/She Lacks:

It is not a good idea to be aggressively critical of the opposing expert's qualifications unless they are so weak he/she may be barred from testifying. Lawyers who try cases know that if you are too aggressive or belittling, the Judge might come to the defense of the witness. Obviously, it is important to have the Judge trust your expert more than the other party's expert. On direct examination the Judge will hear all the virtues of your expert. In cross examination of the other side's expert, where possible, ask that expert if he/she accomplished things that your expert did and the witness did not. This is particularly effective where one expert has a more advanced relevant degree, certification or more experience in the particular industry or business involved.