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# Family Law and the Role of Financial and Asset Experts

Evaluating Whether, When and How to Use an Expert

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Today's faculty features:

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Lynne Gold-Bikin, Partner, **Weber Gallagher Simpson Stapleton Fires & Newby**, Norristown, Pa.

Martin S. Varon, Principal, **Alternative Resolution Methods**, Atlanta

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# **Family Law and the Role of Financial and Asset Experts**

Evaluating Whether, When and  
How to Use an Expert

# Panel Speakers

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# Panel Speakers

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# Panel Speakers

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# What Type of Financial or Asset Expert to Use?

# Areas of Expertise of Financial and Asset Expert

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- Real Property
- Businesses
- Securities
- Retirement plans/pensions
- Personal Property

# Business Valuations

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- *Daubert* challenge?  
*Daubert v. Merrell Dow Pharmaceuticals*, 509 U.S. 579 (1993)
- *Frye* challenge?
- *Frye v. U.S.*, 293 F. 1013 (DC Cir. 1923)
- What professional association has certified the “expert?”
- ABV, ASA, CBA, CFA, CVA -- none, multiple?
- How many valuations has expert prepared?

# Expert Costs

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- Fees can be hourly, flat fee, or percentage based on value of property or asset
- Rates may differ depending on whether expert is hired as a consultant or testifying expert

# Joint or Client-Specific Expert

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- Who retains the expert?
- Who retains the attorney?
- The client
- Hire expert as a neutral
- Advantage - saves on fees
- Disadvantage - what happens if you do not like the findings?

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# When and How to Use the Expert

# Reasons to Hire an Expert

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- Determining values
- When there is disagreement on values
- Finding weaknesses in opposing side's method of valuation
- Advantage in negotiating settlement

# More Reasons to Hire an Expert

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- Assist in Mediation - may be able to narrow the gap between parties because of tax savings
- When something does not meet the “Smell Test”

# Areas in Which an Expert May Assist

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Assist with tax, financial, and corporate aspects surrounding the case

- Stock Redemption Cases - does the additional ownership caused by another shareholder's redemption convert a separate interest into a marital interest?
- States have conflicting case law; see  
Anson v. Anson, 772 So.2d 52 (Fla. App. 2000)  
Allison v. Allison, 246 S.W.3d (Ky.App. 2008)

Appreciation caused by market forces vs. efforts of the parties will depend on facts in case

# Issues to Consider Before Hiring an Expert

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- Fees
- Affordability
- Amount at stake
- Your relationship with opposing counsel

# Important to Note

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- Not an exact science
- All experts guess, to some extent
- Some guesses are more educated than others
- Experts can do the math and perform the calculations -- then the attorneys can argue about them

# This is Why You Hire an Expert

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- There is no perfect valuation report
- Assumptions made by the expert
- Subjectivity
- Number of years analyzed (1,2,3,4,5?) and why?
- Were equal weights given to each year? Why or why not?
- Two types of reports; see Paragraph 21 of AICPA's Statement (One) on Standards for Valuation Services
  - Valuation Engagement - results in Conclusion of Value
  - Calculation Engagement - results in a Calculated Value

What is the difference?

Why was one prepared and not the other?

Did the attorney and/or client understand the difference?

Both usually want a Conclusion of Value at the Calculation Engagement's fee structure

# Arguments Experts Can Make on their Client's Behalf

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- Approaches used
- Weights assigned (discussed more later)
- Standards of Value

# Expert or Consultant?

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- Use as expert or consultant?
- Pros and cons for each

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# How to Challenge the Expert

# Challenges to an Expert

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- The higher the capitalization (cap) rate, the lower the value
- Might reasonable experts agree on a different number?
- Methodology - which valuation method used and why? Could others have been used to derive a different number?

# More Challenges for the (Opposing) Expert

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- How was cap rate constructed?
- Ibbotson Build-up Model (Morningstar)
- Duff and Phelps Risk Premium Report
- Did you consider one or both? Why not both? Were the differences reconciled?
- What range is typically used for this type of valuation in this area of the country?
- Make experts do the math

# Learning What the Expert Knows

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- Have another attorney or expert “mentor” you and review the valuations
- Develop a professional relationship with a financial expert to review issues, opposing experts’ reports, and consider need to be retained
- A fresh set of eyes can help find inconsistencies and mistakes in the valuation that might otherwise be missed

# Important IRS Revenue Rules

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- Rev. Rul. 59-60
- Sets forth the “approach, methods, and factors to be considered in valuing shares of capital stock of closely held corporations” for estate and gift tax purposes.
- Is also used when market quotes are not available for corporate stock values, to determine a fair market value

# Revenue Ruling 59-60

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- Determination of fair market value (FMV) is based on a number of factors, but is not an exact science
- Factors set out in Sec. 4 of Rev. Rul. 59-60

# Revenue Ruling 59-60

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When trying to determine a cap rate in a closely held business, the type of business, risk involved, and stability or fluctuation of the corporation's earnings must all be considered

# Factors to Consider

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Is the expert using the correct year's rates?

- Risk Free factor
- Common stock equity
- Small stock factor
- Industry factor
- Specific Company Risk factor

# American Institute of Certified Public Accountants Statement of Standards for Valuation Services

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## Premise of Value

- Going concern
- Liquidation value
- Orderly disposition
- Assemblage of assets

# Standards of Value

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- Fair Market Value (FMV)
- Fair Value
- Investment Value
- Intrinsic Value

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# Methods and Approaches for Business Valuations

# Business Valuation Method Depends on Type of Business

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- Many different approaches to valuing businesses
- Methods depend of type of business being valued - family -owned, closely held, sole proprietorship, partnership, publicly traded company, etc.

# Commonly Used Methods of Valuation

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- Income Approach
- Market Approach
- Net Asset Approach
- Were all approaches considered? Were different weights allocated to each? Why not a different weight?
- What about industry benchmarks or “rules of thumb?”

# Frequently Used Valuation Methods

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- Other often used methods include:
- Adjusted Net Asset Value
- Fair Market Value
- Going Concern Value
- Investment Value
- Book Value

# Strategizing with your Expert

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- Be sure expert uses most often applied method for business/asset in particular area of the country
- Want to limit opposing counsel's opportunity to challenge
- Discounts?
  - Lack of control
  - Lack of marketability

# Revenue Ruling 78-367

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- Rev. Rul. 78-367
- Section 2512 - Valuation of Gifts
- When determining stock value of a closely held corporation, any possible merger of the corporation with a publicly held company should be taken into account, as it can affect the value of the stock

# Revenue Ruling 78-367

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- Section 2512 states that a gift of such stock will be taxed on the basis of the value of the stock on the date of actual transfer
- Section 25.2512-2(f) states that where selling or asking prices for the corporate bonds or stock are unavailable, FMV is determined by considering the soundness of the corporate bonds, interest yield, date of maturity, and any other relevant factors
- If stock FMV needs to be determined, the corporation's net worth, prospective earning potential, and capacity to pay dividends to shareholders can be used, along with any other relevant factors

# Revenue Ruling 68-609

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- Rev. Rul. 68-609 states that a “formula” approach to valuation may be used to determine the FMV of a corporation’s intangible assets only if there is no better method of determining their value
- This applies to “goodwill” value in a business

# Revenue Ruling 68-609

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Formula Approach is "a percentage return on the average annual value of the tangible assets used in a business is determined, using a period of years (preferably not less than five) immediately prior to valuation date. The amount of the percentage return on the tangible assets, thus determined, is deducted from the average earnings of the business for such period and the remainder, if any, is considered to be the amount of the average earnings from the intangible assets of the business for the period. This amount (considered as the average earnings from intangibles), capitalized at a percentage of, say 15 to 20 percent, is the value of the intangible assets of the business determined under the "formula" approach."

# Personal Goodwill vs. Enterprise Goodwill

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In many states:

Personal Goodwill is deemed to be separate property not subject to equitable distribution.

Entity Goodwill is deemed to be marital property subject to equitable distribution.

How do you determine the amount of personal goodwill vs. enterprise goodwill?

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# Financial or Asset Expert as a Consultant

# Consultant Instead of Expert

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Why consult?

# Consultant vs. Expert

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Consultant first, expert later

Caveat: once the consultant is disclosed as an expert, virtually ALL work product, including communications with counsel as of the date of retainer, become discoverable

# Issues to Consider

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- If consulting only, communications and information are not subject to discovery
- Consultant cannot testify as expert unless properly disclosed

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# When to Compromise

# Time to Compromise When:

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- When amounts/values in contest are known to a reasonable degree of certainty
- Not financially feasible to litigate the issue
- Client wants another asset more than the one at issue
- Little chance of success on issue at trial

# Recommended Reading

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## Business Valuation Body of Knowledge

Shannon Pratt, 2 edition Wiley (2003)

## The Lawyers Business Valuation Handbook

Shannon P. Pratt, American Bar Association (2000)

## Standards of Value: Theory and Application

Jay E. Fishman, Shannon P. Pratt and William J. Morrison, Wiley (2006)