

# Tennessee Family Law

## Valuation & Forensic Insights for Attorneys

Second Quarter 2018

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This quarter's issue of the *Tennessee Family Law Newsletter* focuses on a few of the business valuation aspects of a divorce case. Specifically, we provide a brief overview of the valuation process, including the general approaches of valuation and potential normalization adjustments, and we examine how the Courts have historically treated the discount for lack of marketability and how that has changed over the last year.

Also, we have included a commentary on Tennessee's Supreme Court's recent decision on Statutory Fair Value for the first time in over 35 years.

We appreciate the great feedback from the inaugural issue of this newsletter and encourage you to provide any suggested content topics that you'd like to see in future editions. You can send your feedback and ideas to **Scott Womack** or **Karolina Calhoun**.

# Changing Tides on Lack of Marketability in Tennessee Courts

For years, cases such as *Bertuca*<sup>1</sup> and *Barnes*<sup>2</sup> governed the landscape on the issue of marketability in the valuation of marital assets in Tennessee family law cases. Specifically, *Bertuca* involved a company called Capital Foods which held several McDonald's franchise locations. In the decision, *Bertuca* did not allow for a discount to be taken for the lack of marketability for a nonpublicly traded company and offered the following reasoning:

*"...no indication...has any intention to sell...thus, the value of the business is not affected by the lack of marketability and discounting the value for non-marketability in such a situation would be improper."*

While *Barnes* involved a dental practice, the Court offered a similar explanation for excluding a discount for lack of marketability:

*"...inappropriate because no sale was ordered and there [was] no indication in the record that the Husband ha[d] any intention of selling his minority stock."*

Both cases focused on the lack of an actual/imminent sale rather than the lack of marketability of these two underlying companies when compared to a publicly traded equivalent. The cases also left business valuation appraisers in a quandary, since this treatment of the lack of marketability didn't seem to match the fair market value standard. The fair market value standard, discussed in Revenue Ruling 59-60, discusses the relevance of a willing buyer and a willing seller and also allows for potential discounts for lack of control and lack of marketability, where applicable.

So what has changed now? In April 2017, House Bill 348 was passed by the Tennessee legislature. This Bill amends the Tennessee Code Annotated Title 36, Chapter 4 (TCA 36-4-121), relating to the equitable division of marital property. Specifically, this Bill allows for "considerations for a lack of marketability discount, a lack of control discount, and a control premium if any should be relevant and supported by the evidence for such assets" "without regard to whether the sale of the asset is reasonably foreseeable."

Effective July 2017, discounts for lack of marketability can now be considered in the valuation of assets in family law disputes. As with the valuation itself, it's important to hire an accredited/credentialed business valuation appraiser to assist in the determination, documentation and support of any discounts for lack of control and marketability, along with any applicable premiums.



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<sup>1</sup> *Bertuca v. Bertuca*, No. M2006-00852-COA-R3-CV, 2007 WL 3379668 (Tenn Ct. App. Nov. 14, 2007).

<sup>2</sup> *Barnes v. Barnes*, No. M2012-02085-COA-R3-CV (Direct Appeal from the Chancery Court for Bedford County No. 27833, April 10, 2014).

# Valuation of a Business for Divorce

## Overview of Valuation Approaches, Normalizing Adjustments, and Potential Need for Forensics Services

Valuation of a business can be a complex process requiring certified business valuation and forensic accounting professionals. Valuations of a closely held business in the context of a divorce are typically multifaceted and may require forensic investigative scrutiny for irregularities in the financials that may insinuate dissipation of business/marital property. Business valuations are a vital element of the marital dissolution process as the value of a business, or interests in a business, impact the marital balance sheet and the subsequent allocation/distribution of marital assets.

### Valuation Approaches

To begin, the financial expert will request certain information and interview management of the Company. Information requested typically includes:

- Financial statements (usually the last five years)
- Tax returns (usually the last five years)
- Budgets or forecasted financials statements
- Buy-sell agreement
- Information on recent transactions
- Potential non-recurring and/or unusual expenses
- Qualitative information such as business history and overview, product mix, supplier and customer data, and competitive environment

The financial expert must assess the reliability of the documentation and decide if the documents appear thorough and accurate to ultimately rely on them for his/her analysis. The three approaches to value a business are the Asset-Based Approach, the Income Approach, and the Market Approach.

### The Asset-Based Approach

The asset-based approach is a general way of determining a value indication of a business, business ownership interest, or security using one or more methods based on the value of the assets net of liabilities. Asset-based valuation methods include those methods that seek to write up (or down) or otherwise adjust the various tangible and intangible assets of an enterprise.

### The Income Approach

The income approach is a general way of determining a value indication of a business, business ownership interest, security or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount.

The income approach can be applied in several different ways. Valuation methods under the income approach include those methods that provide for the direct capitalization of earnings estimates, as well as valuation methods calling for the forecasting of future benefits (earnings or cash flows) and then discounting those benefits to the present at an appropriate discount rate. The income approach allows for the consideration of characteristics specific to the subject business, such as its level of risk and its growth prospects relative to the market.

### The Market Approach

The market approach is a general way of determining a value indication of a business, business ownership interest, security or intangible asset by using one or more methods that compare

the subject to similar businesses, business ownership interests, securities or intangible assets that have been sold.

Market methods include a variety of methods that compare the subject with transactions involving similar investments, including publicly traded guideline companies and sales involving controlling interests in public or private guideline companies. Consideration of prior transactions in interests of a valuation subject is also a method under the market approach.

### Synthesis of Valuation Approaches

A proper valuation will factor, to varying degrees, the indications of value developed utilizing the three approaches outlined. A valuation, however, is much more than the calculations that result in the final answer. It is the underlying analysis of a business and its unique characteristics that provide relevance and credibility to these calculations.

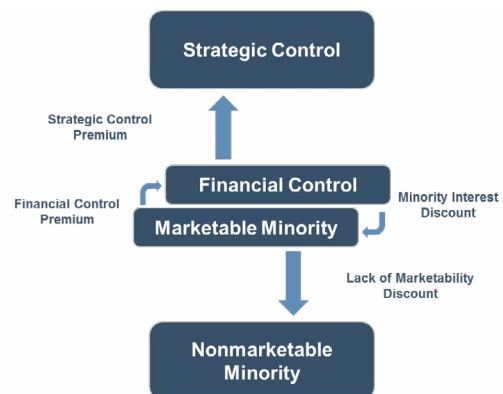
### The Levels (Premise) of Value

Does it make a difference in value per share if you own 10% or 75% of a business? You bet it does. A 10% interest is a minority interest and does not enjoy the prerogatives of control. How does this affect value per share? The minority owners bear witness to a process over which they may have no control or discretion. In effect, they often play the role of silent partners; therefore, the fair market value per share of a minority owner is likely worth less per share than the shares of a 75% owner.

Likewise, a minority owner of a private business likely does not have a ready market in which to sell their interest. Minority ownership in a publicly traded company enjoys near instantaneous liquidity such as trading stock on organized and regulated exchanges. The unique uncertainties related to the timing and favorability of converting a private, minority ownership interest to cash gives rise to a valuation discount (lack of marketability discount) which further distances the minority owner's per share value from that of a controlling owner's value per share.

The following chart provides perspective of the various levels of value. In most cases a valuation is developed at one level of value and then a discount or premium is applied to convert to another level. These discounts are known as discounts for lack

of control and lack of marketability. Knowing when to apply such adjustments and quantifying the size of these adjustments is no simple matter, requiring the need for a credentialed business valuation professional.



### Importance of Normalizing Adjustments

Normalizing adjustments adjust the income statement of a private company to show the financial results from normal operations of the business and reveal a “public equivalent” income stream. Keep in mind the levels of value in business valuation, discussed above. In creating a public equivalent for a private company, another name given to the marketable minority level of value is “as if freely traded,” which emphasizes that earnings are being normalized to where they would be as if the company were public, hence supporting the need to carefully consider and apply, when necessary, normalizing adjustments. There are two categories of adjustments.

#### Non-Recurring, Unusual Items

These adjustments eliminate one-time gains or losses, unusual items, non-recurring business elements, expenses of non-operating assets, and the like. Examples include, but are not limited to:

- **One-time legal settlement.** The income (or loss) from a non-recurring legal settlement would be eliminated and earnings would be reduced (or increased) by that amount.
- **Gain from sale of asset.** If an asset that is no longer contributing to the normal operations of a business is sold, that gain would be eliminated and earnings reduced.

- **Life insurance proceeds.** If life insurance proceeds were paid out, the proceeds would be eliminated as they do not recur, and thus, earnings are reduced.
- **Restructuring costs.** Sometimes companies must restructure operations or certain departments, the costs are one-time or rare, and once eliminated, earnings would increase by that amount.

### Discretionary Items

These adjustments relate to discretionary expenses paid to or on behalf of owners of private businesses. Examples include the normalization of owner/officer compensation to comparable market rates, as well as elimination of certain discretionary expenses, such as expenses for non-business purpose items (lavish automobiles, boats, planes, etc.) that would not exist in a publicly traded company.

For more, refer to our article "[Normalizing Adjustments to the Income Statements](#)" and [Chris Mercer's blog](#).

### The Need for Forensic Services

The process of valuing a business is complicated and the financial expert, during the course of his/her analysis, must consider various levels of value, normalization adjustments, as well as methods of valuation to most appropriately conclude on the business.

Valuations of a closely held business in the context of a contentious divorce can be especially multifaceted and may require additional forensic investigative scrutiny for any irregularities in the financials that may insinuate dissipation of business/marital property in anticipation of the divorce and valuation. Examples may include, but are not limited to:

1. **Owner Compensation.** Owners may reduce earnings in anticipation of divorce to appear to have lower earnings capacity. Owners or executives with ownership interest may have made arrangements within the business to receive a post-divorce pay-out. A financial expert, through review of historical financial statements and tax returns, as well as an analysis of the lifestyle of the family, may gather support of the true earnings.
2. **Rent expense.** Owners of a company may also own the land and/or building to which the business' rent expense is paid, otherwise referred to as a related party. If the rent has increased in anticipation of the divorce, the related party may be taking on pre-paid rent or higher than market rent rates to reduce income. A financial expert may review historical expenses and assess the reasonableness of the rent expense.
3. **Discretionary expenses.** Owners may use business funds to pay for personal, non-business related expenses such as vacations, lavish cars, boats, meals & entertainment, among others. A financial expert can review historical transactions to assess if such items are non-business related and if normalization adjustments are necessary for valuation purposes.

It is important to consider these types of situations if only one spouse is involved with the operations and management of the company, otherwise referred to as the "in-spouse." That spouse may, or may not, have been altering the financial position of the business in anticipation of divorce and a potential independent business valuation. The services of a financial expert can be vital to you and your client in such matters, as the accuracy of the valuation may impact the equitable distribution of the marital assets.

### Conclusion

If suspicions do not necessitate forensic services, perhaps only a business valuation scope is necessary. Furthermore, if the business or an interest was recently bought or sold, if it was recently appraised, or if its value is in a financial statement or a loan application, that information may go a long way in establishing the value of the business (if both parties feel that this value is a fair representation). However, since a business valuation report and expert witness are admissible in court as evidence and since the value of a business or interest impacts the marital balance sheet and the subsequent asset distribution, it may be exceedingly beneficial to hire a professional for evidentiary support.

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# Mercer Capital in the News

## Upcoming Speaking Engagements



**Z. Christopher Mercer, FASA, CFA, ABAR** will be participating in a panel discussion on the topic of "Active Passive Appreciation Analysis" at the 2018 Advanced Business Valuation Conference of the American Society of Appraisers in Anaheim, California.



**Karolina Calhoun, CPA/ABV/CFF** will co-present on "Corporate & Business Transactions from a Legal and Financial Perspective" to the Memphis Chapter of Tennessee Society of CPAs.



**Z. Christopher Mercer, FASA, CFA, ABAR** will present on divorce and business valuation at the Florida Bar Family Law Section Retreat in Nashville, Tennessee.



**Karolina Calhoun, CPA/ABV/CFF** will co-present "Getting Command of the Numbers in a Valuation" at the Tennessee Society of CPAs Southeastern Forensic & Valuation Services Conference in Nashville, Tennessee.



**Scott A. Womack, ASA, MAFF** will be presenting "Creativity in Financial Elements of a Collaborative Divorce" at the International Academy of Collaborative Professionals' Networking and Educational Forum in Seattle, Washington.



**A couple of Mercer Capital professionals are on the schedule at this year's AICPA Forensic & Valuation Services Conference in Atlanta, Georgia.**

**Karolina Calhoun, CPA/ABV/CFF** will be speak on the topic of "Lifestyle Analysis/Pay & Need Analysis," will participate in panel discussion on "Collaborative Law the New Horizon," and is a member of the conference planning committee. Karolina is also co-facilitating the NextGen pre-conference workshop.

**Z. Christopher Mercer, FASA, CFA, ABAR** will be participating in two panel discussions on "Active Passive Appreciation" and "Valuation Tax."



Join us in congratulating **Karolina Calhoun, CPA/ABV/CFF** on her President-Elect appointment to the Memphis Chapter of Tennessee Society of CPAs for 2018-2019 year.



# Mercer Capital in the News

## Takeaways from ABA Spring CLE Session

I recently attended the Spring CLE session held by the American Bar Association in Nashville. Here are two quick takeaways concerning other impacts of the Tax Cuts and Jobs Act (TCJA) as we [addressed in our prior newsletter](#).

1. The changes in the tax rates for C Corporations, and specifically the lowering of rates, can have an impact on the valuation of C Corporations. Like Mercer Capital, the professionals who presented at the ABA conference have concluded the impact of the lowered tax rates could potentially lead to a 15-20% increase in the value of a C Corporation under an income approach. For a technical discussion of this impact and result, see [Chris Mercer's recent blog post](#) on the topic.
2. One of the other most talked about changes in the TCJA concerning family law, is that for all divorces after December 31, 2018 alimony will no longer be deductible for the payor and taxable to the recipient. This change

could have a dramatic impact on high-earner spouses who would be ordered to pay alimony and would no longer be afforded the tax deduction. The table below presents the change based on the current law in 2018 and the new law that takes effect in 2019.

From the illustration, you can see that the payor spouse earning \$500,000 and ordered to pay \$150,000 in alimony would be negatively affected by \$52,500, while the recipient spouse would benefit by \$39,399.

The application of this change in the tax law should be an interesting one to discuss and explore starting in 2019.

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Description	2018 - Single No Kids			2019 - Single No Kids		
	Recipient	Payor	Total	Recipient	Payor	Total
<b>Wages</b>	0	500,000	500,000	0	500,000	500,000
<b>Alimony</b>	150,000	(150,000)	0	0	0	0
<b>Income</b>	150,000	350,000	500,000	0	500,000	500,000
<b>Standard Deduction</b>	(12,000)	(12,000)	(24,000)	0	(12,000)	(12,000)
<b>Taxable Income</b>	138,000	338,000	476,000	0	488,000	488,000
<b>Less: Federal Taxes</b>	(27,399)	(93,990)	(121,388)	0	(146,490)	(146,490)
<b>Non-Taxable Income</b>	0	0	0	150,000	(150,000)	0
<b>After-Tax Income</b>	110,602	244,011	354,612	150,000	191,511	341,511
<b>% of After-Tax Income</b>	31%	69%		44%	56%	

Results	
<b>Higher Total Taxes Paid</b>	25,102
<b>Gain for Recipient</b>	39,399
<b>Loss to Payor</b>	(52,500)

# Tennessee Case Reviews



## **Telfer v. Telfer**

**Tennessee Court of Appeals, Middle Section, March 5, 2018**

This case appeared before the Court of Appeals for a second time earlier this year. A final divorce decree was entered in 2012, and Husband appealed the trial court's determination that he had no marital interest in two of the wife's business entities. The Court of Appeals found that the appreciation in value of the businesses was in fact marital property, and the Remand Court valued the appreciation and divided the marital estate. Husband appealed again arguing that the Remand Court erred in its valuation and division of the marital estate, specifically raising issues with the valuation date of the marital interests and the marketability discount applied to the two business entities. The Court of Appeals ruled that the valuation date originally agreed to by the parties' respective experts (July 30, 2011) was acceptable, despite the fact that the case had been drawn out considerably since that date. Regarding the marketability discount, the Court of Appeals ruled that the Remand Court did not err in applying the discount. The Court of Appeals cited an opinion from 2016 (*Grant v. Grant*) in explaining the use of a marketability discount. The opinion states that the decision to use such a discount "depends on the characteristics of the ownership interest being valued, not whether the owner of the interest actually intends to sell the interest" and is "discretionary and dependent on the facts of the case."

Marketability discounts are often included when valuing interests in privately owned businesses to account for the illiquidity (or inability to be quickly and easily converted to cash) of the interests. Litigation settings present unique challenges in determining and applying marketability discounts. An experienced appraiser can help analyze the relevant facts and determine the appropriate valuation treatment of the subject interests.

This case also addresses very important issues regarding separate property converting to marital property, contribution of spouses and co-mingling. Stay tuned to a further discussion of this case and these issues in an upcoming issue of the newsletter.



## **Barnes v. Barnes**

**Tennessee Court of Appeals, Middle Section, April 10, 2014**

This divorce case involved issues of business valuation and alimony, among others. Husband owns a dental practice in Shelbyville, TN, and both parties engaged experts to value the practice at the time of divorce. Wife's expert determined a value of \$678,179, and Husband's expert determined a value of \$50,000. The disparity in these two figures had to do primarily with the consideration of debt, goodwill, and a marketability discount. The trial court valued the practice at \$328,392. Wife appealed, and the Court of Appeals affirmed the trial court's valuation with the exception of the marketability discount. The trial court included a 15% marketability discount, consistent with the valuation performed by the Husband's expert. The Court of Appeals ruled that the trial court erred in applying this discount because, "Husband had no intention of selling his interest in the corporation." Were this case to be tried today, the outcome might be different. Public Chapter 309, signed into law on May 5, 2017, allows for these types of discounts in the valuation of closely held businesses, without regard to whether a sale is foreseeable.<sup>1</sup>

<sup>1</sup> House Bill 348 has been assigned Public Chapter Number 309 by the Tennessee Secretary of State. The bill passed the Senate on April 26, 2017, and Governor Bill Haslam signed the bill into law on May 5, 2017. The law became effective July 1, 2017.



# Tennessee Supreme Court Addresses Statutory Fair Value for the First Time in 35 Years in *Athlon Sports Communications*

In a 1983 case, *Blasingame v. American Materials, Inc.*, 654 S.W. 2d 659 (Tenn. 1983), the Supreme Court of Tennessee adopted what is called the “Delaware Block” method for determining the fair value of shares in dissenters’ rights cases in Tennessee. This method, considered alone, was already outdated by precedent case law in Delaware when *Blasingame* was issued. However, in the recent *Athlon Sports Communications* case, the Tennessee Supreme Court finally brings Tennessee dissenters’ rights appraisal determinations more in line with the majority of states.

## The *Blasingame* Ruling

In *Blasingame*, the Tennessee Supreme Court adopted the Delaware Block rule or method for determining statutory fair value in appraisal cases. Under the basic application of the Delaware Block method, an appraiser first determines the value of the subject corporation under each of the three valuation methods identified in *Tri-Continental Corp. v. Battye*, 74 A. 2d 71 (Del. 1950), a 1950 Delaware case.

The methods are (a) the market value method, (b) the asset value method, and (c) the earnings value method. The conclusion under the Delaware Block is a weighted average of the three methods, with the weights to be assigned by the appraisers or the courts. The weights for each method took into account the type of business, the objectives of the corporation, and other relevant factors.

In the seminal 1983 case of *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), the Delaware Supreme Court concluded that

although the Delaware Block method had been used for stock valuation for decades, it was outmoded because it “excludes other generally accepted techniques used in the financial community and the courts...”

The Delaware Supreme Court concluded, “It is time we recognized this in appraisal and other stock valuation proceedings and bring our law current on the subject.” In *Weinberger*, the “other techniques” that were excluded under the Delaware Block method included the discounted cash flow method, which was advanced by the dissenters’ expert in that case.

*Blasingame* was issued shortly after *Weinberger*. While *Weinberger* was not mentioned in *Blasingame*, the petition to rehear was appended to the end of the case. Noting *Weinberger* in a footnote to the petition to rehear, the Tennessee Supreme Court stated that it did “not find anything in *Weinberger* that cause[d] it to alter the adoption of the weighted average method” [i.e., the Delaware Block method].

That resounding adoption of the Delaware Block method by the Tennessee Supreme Court, together with its rejection of the then recent guidance regarding more current techniques from *Weinberger*, essentially made the Delaware Block method the law of the land in Tennessee from 1983 until the issuance of *Athlon Sports Communications*.

While I have not personally handled a fair value case in Tennessee in a number of years, I can attest to the fact that in the 1980s and 1990s, I would not render a fair value appraisal without using the Delaware Block method.

## Athlon Sports Communications

*Athlon Sports Communications* was filed on June 8, 2018. The company, Athlon Sports Communications, Inc. ("Athlon") had been in business for more than fifty years leading to late 2011, when Athlon engaged in a recapitalization transaction that effectively squeezed out certain shareholders, including Mr. Stephen Duggan (the lead defendant), who was previously an officer and investor in Athlon.

As an aside, under Tennessee law, when shareholders dissent to transactions and perfect their dissents, it is the corporations that file the appraisal cases, so Mr. Duggan, while the economic plaintiff, is the defendant in this case.

The Company was successful for many years but fell on hard times during the Great Recession in 2008-2009. Mr. Duggan invested \$1.5 million in the company for a 15% interest (plus the opportunity to acquire restricted shares totaling an additional 10% ownership in Athlon). He prepared a business plan that was approved by the Board of Directors, was hired, and proceeded to attempt to implement the plan.

The Supreme Court provides some detail about the Company and its history, but suffice it to say that the new business plan, while increasing circulation, did not generate profitability. By late 2011, having sold its previously owned building for \$3.9 million to pay down debt and generate working capital, Athlon was in need of substantial equity capital.

The need for more capital gave rise to the transaction reviewed by the Supreme Court.

The experts for Athlon and the dissenters both employed the Delaware Block method, but also used the discounted cash flow method. The expert for Athlon concluded that the fair value of shares as of the transaction date was \$NIL, meaning zero. Athlon ultimately offered the dissenters \$0.10 per share as the fair value of their shares based on their expert's opinion and the Board's judgment.

The dissenters' expert found a variety of values ranging from \$6.48 per share (using the Delaware Block method), to \$4.55 to \$9.58 per share (based on comparable public companies), to \$22.32 per share (using the discounted cash flow method).

The trial court found that the Company's expert was the more credible and concluded that the fair value of the shares was \$0.10 per share.

The case went to the Tennessee Court of Appeals and then, ultimately, to the Supreme Court of Tennessee. Given the case's winding course, we could spend many pages describing the transaction, the trip through Chancery Court and the Court of Appeals, and the Supreme Court's description of events, and the work of the two experts in the matter. Instead, we will focus briefly on the Court of Appeals decision, which affirmed the trial court, and on the Supreme Court's conclusions in *Athlon Sports Communications*.

## The Court of Appeals

The dissenting shareholders appealed, arguing first that the trial court erred in relying exclusively on the Delaware Block method in its fair value determination because of its focus on the past, rather than on prospective performance.

In the alternative, the dissenting shareholders argued that even if the Delaware Block method was the appropriate method to use, the trial court erred in its application of the method.

The Court of Appeals rejected both arguments regarding each of the defendants' arguments in its decision:

*"[t]he Trial Court correctly followed Tennessee case precedent in utilizing the Delaware Block Method of valuation..."*

The Court of Appeals noted that *Blasingame* specifically adopted the Delaware Block method while acknowledging the Delaware Supreme Court's criticism of the method in *Weinberger*. The Court of Appeals went on to say that, "[i]f the holding of *Blasingame* . . . is to be reversed or modified by a Tennessee Court, it is the Tennessee Supreme Court that will have to do it and not this Court."

The Court of Appeals also rejected the defendants' second argument regarding the application of the Delaware Block method, holding that the trial court's findings were supported by the evidentiary record. The Court of Appeals clouded the record a bit with a comment regarding Athlon's projections

noting “that it seems an odd circumstance, to say the least, that forecasts made by and represented as reliable at the time are now dismissed as unreliable.” Having said this, the Court of Appeals said that the trial court was justified in giving “little or no credence to Athlon’s forecasts.”

As an aside, the Supreme Court noted in its analysis that the referenced forecasts, which were prepared in connection with raising new capital, were “aspirational.”

The Court of Appeals affirmed the trial court’s decision in all respects.

It seems that the Court of Appeals set it up for the Supreme Court to address an issue that could (should?) have been addressed 35 years ago in *Blasingame*.

## The Supreme Court’s Ruling

The Supreme Court granted permission to appeal in *Athlon Sports Communications* to address the methods by which a trial court may determine the “fair value” of the shares of dissenting shareholders under Tennessee’s dissenters’ rights statutes (Tennessee Code Annotated sections 48-23-101, *et seq.*).

Both experts in this matter employed the Delaware Block method, and both also advanced their opinions under the discounted cash flow method, albeit with widely differing results.

The defendants’ appeal raised some confusion over whether the trial court relied solely on the Delaware Block method in reaching its conclusion, or if it considered the discounted cash flow methods. This “confusion” was possible because, as I read the case:

- Athlon’s expert employed both the Delaware Block method and the discounted cash flow method. He reached a conclusion of fair value or \$NIL in both cases.
- Defendants’ expert used the Delaware Block method, the guideline public company method, and the discounted cash flow method, reaching a range of conclusions, as noted above, substantially greater than \$NIL.

Given the record at the trial court and the Court of Appeals dodging (or passing the buck) of the underlying issue in

*Blasingame*, the Supreme Court provided a new interpretation for fair value determinations in dissenters’ rights matters:

*Given the nearly universal approval the Weinberger approach has won in the years since Blasingame, we overrule Blasingame to the extent that it implies that trial courts are allowed to use only the Delaware Block method of valuation. We adopt the more open Weinberger approach, which allows “proof of value by any technique or methods which are generally considered acceptable in the financial community and otherwise admissible in court.”*

As in *Weinberger*, the Tennessee Supreme Court adopted the explicit exclusion against considering speculative elements of value that could arise as a result of the accomplishment or expectation of the merger [i.e., the merger giving rise to the dissenters’ rights appraisal].

However, the Supreme Court made it clear, at least to this reader, that the discounted cash flow method can be considered, stating:

*But elements of future value, including the nature of the enterprise, which are known or susceptible of proof as of the date of the merger and not the product of speculation, may be considered.*

I read this language, as all cases, from business and valuation perspectives. It says to me that it would be appropriate to consider reasonable projections of a business (“which are susceptible of proof as of the date of the merger”), excluding any consideration of changes that might be anticipated from a merger.

The Supreme Court, however, did not dismiss consideration of the Delaware Block method by business appraisers or trial courts, stating:

*The Delaware Block method of valuation remains available where appropriate, but trial courts may now choose to use another valuation method to determine the fair value of a dissenting shareholder’s shares of stock.*

The Supreme Court then moved to eliminate any confusion in the trial court's opinion over the use of the Delaware Block method – or not. Normally when trial courts' orders are vacated or reversed, it is a bad thing for the trial court (at least that's my observation as a non-lawyer). The court noted:

*Because we cannot determine on this record whether the trial court's evaluation of the evidence was affected by its perception that Blasingame mandated use of the Delaware Block valuation method, we vacate the trial court's order and remand for reconsideration the valuation of the dissenting shareholders' shares in light of our decision herein.*

*The decision of the Court of Appeals is reversed, the decision of the trial court is vacated, and the case is remanded for further proceedings consistent with this opinion...*

With the Supreme Court's decision, the Court of Appeals is reversed, but, it appears (to me at least), in a friendly way. In addition, the trial court, whose order was vacated, has an opportunity to "get it right for sure" given the new decision regarding the Delaware Block method and the use of more modern valuation methods.

## After Athlon Sports Communications in Tennessee

Appraisers and courts can use the Delaware Block method in Tennessee fair value determinations – if its use is appropriate. And they (we) can use more modern valuation methods like the discounted cash flow method – again, where its use is appropriate and does not include expected benefits from the merger.

What is not clear in *Athlon Sports Communications* is whether or not it is appropriate to use valuation discounts such as minority interest discounts or marketability discounts. Neither *Blasingame* nor *Athlon Sports Communications* address the issue of the applicability of valuation discounts in fair value determinations.

In the **Tri-Continental decision** quoted in *Athlon Sports Communications*, we learn from the Delaware Supreme Court:

**[1] The basic concept of value under the appraisal statute is that the stockholder is entitled to be paid for that which has been taken from him, viz., his proportionate interest in a going concern. By value of the stockholder's proportionate interest in the corporate enterprise is meant the true or intrinsic value of his stock which has been taken by the merger. In determining what figure represents this true or intrinsic value, [2] the appraiser and the courts must take into consideration all factors and elements which reasonably might enter into the fixing of value. Thus, market value, asset value, dividends, earning prospects, the nature of the enterprise and any other facts which were known or which could be ascertained as of the date of the merger and which throw any light on future prospects of the merged corporation [3] are not only pertinent to an inquiry as to the value of the dissenting stockholders' interest, but must be considered by the agency fixing the value.**

### **[parentheticals and emphasis added]**

Regarding [1] above, it could be argued that a "proportionate interest in a going concern" necessarily means that fair value represents a dissenting shareholder's interest in the value of a company as a whole and as a going concern. That interpretation would not include valuation discounts such as minority interest and marketability discounts.

As an aside, however, that same language appears in New York fair value cases, and New York courts sometimes (although less frequently than in years past) consider marketability discounts, with courts and appraisers arguing first over whether a marketability discount should be applied, and then over whether the marketability discount should apply to an interest or to an entire corporation.

Parentheticals [2] and [3] leave open for discussion "all factors" regarding "the value of the dissenting stockholders' interest[s]."

The stockholders' interests are always (or nearly always) minority interests in corporations.

Yet to be argued in a Tennessee court is the applicability of valuation discounts, either for a proportionate interest in a going concern or as a dissenting stockholders' [minority] interest.

The great majority of other jurisdictions that have addressed the issue have held, either by statute or by judicial interpretation, that valuation discounts are not appropriate for application in fair value determinations.

It seems that there is at least one more chapter to be written by the Tennessee Supreme Court (or the Tennessee Legislature) before the appropriate means of fair value determination in dissenting stockholders' cases is finally and fully set in

Tennessee. I hope there is never an issue, but I can foresee that the issue will come up in future dissenting stockholder cases. Time will tell.



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# Family Law Services

Mercer Capital is a national business valuation and financial advisory firm with offices in Memphis, Nashville, and Dallas. We bring a team of experienced and credentialed experts and over 35 years of experience to the field of dispute analysis and litigation support. Services for family law attorneys and advisors are listed below.

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- Valuation of privately held businesses and professional practices
- Valuation of intellectual property and other intangible assets
- Determination and valuation allocation of personal and enterprise goodwill
- Valuation of stock options, pensions, notes, & other investment assets
- Employment contracts and other compensation agreements
- Serving as the business valuation professional in a collaborative divorce

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- Classification of assets and liabilities
- Investigation of asset flight and/or dissipation of assets
- Asset-tracing of separate versus marital property
- Lifestyle/needs and ability to pay analyses for assistance to determine spousal support
- Tracing appreciation of separate retirement assets
- Identification of diverted or unreported income and double-counted expenses
- Identification of and interviewing parties of interest
- Data analysis
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- Serving in mediation, arbitration, or as court-appointed and/or mutually agreed-upon experts
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- Trained in collaborative law

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