

# Tennessee Family Law

## Valuation & Forensic Insights for Attorneys

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This quarter's issue of the Tennessee Family Law Newsletter focuses on lessons learned from several litigation cases that ultimately went to trial. Specifically, those cases contained several key issues that seem to frequently occur in litigated cases: the qualifications/experience of the appraiser; how to support reasonable assumptions by knowing which information sources to rely on; and normalizing adjustments.

Additionally, we summarize a Tennessee Court of Appeals, Middle Section, case from May 2019. The determination of the increase in the value of stock shares as marital or separate property was the key issue in this case. The valuation of a business and its underlying stock, as well as the classification of stock, as marital or separate continue to appear in case decisions and illustrate the need for services from a qualified financial expert.

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

# Lessons from Recent Engagements

In our family law practice, we serve as valuation and financial forensic expert witnesses. There is typically another valuation expert on “the other side.” In several recent engagements, the following topics, posed as questions here, were raised as points of contention. We present them here to help the reader, whether you are a family law attorney or a party to a divorce, understand certain valuation-related issues that may be raised in your matter.

## Should Your Expert Witness Be a Valuation or Industry Expert?

The financial and business valuation portion of a litigation is often referred to as a “battle of the experts” because you have at least two valuation experts, one for the plaintiff and one for the defendant. Hopefully your valuation expert has both valuation expertise and industry expertise. While industry expertise is not necessary in every engagement, it can be helpful in understanding the subtleties of the business in question.

## Does the Appraisal Discuss Local Economic Conditions and Competition Adequately?

Most businesses are dependent on the climate of the national economy as well as the local economy. For businesses who have a national client base, the health of the national economy trumps any local or regional economy. However, many of the businesses we value in divorce engagements are more affected by changes in their local and regional economy. It's important for a business appraiser to understand the difference and to be able to understand the effects of the local/regional economy on the subject business. There is also a fine balance between understanding and acknowledging the impact of that local economy without overstating it. Often some of the risks of the local economy are already reflected in the historical operating results of the business.

## If There Are Governing Corporate Documents, What Do They Say About Value, and Should They Be Relied Upon?

Many of the corporate entities involved in litigation have sophisticated governance documents that include Operating Agreements, Buy-Sell Agreements, and the like. These documents often contain provisions to value the stock or

entity through the use of a formula or process. Whether or not these agreements are to be relied upon in whole or in part in a litigated matter is not always clear. In litigated matters, focus will be placed on whether the value concluded from a governance document represents fair market value, fair value, or some other standard of value.

Two common questions that arise concerning these agreements are:

1. Has an indication of value ever been concluded using the governance document in the history of the business (in other words, has the business been valued using the methodology set out in the document)?
2. Have there been any transactions, buy-ins, or redemptions utilizing the values concluded in a governance document?

These are important questions to consider when determining the appropriate weight to place on a value indication from a governance document. In divorce matters, the out-spouse is often not bound by the value indicated by the governance document since they were not a signatory to that particular agreement. It is always important to discuss this issue with your attorney.

## Have There Been Prior Internal Transactions of Company Stock and at What Price?

Similar to governance documents, internal transactions are a possible valuation data point. A good appraiser will always ask if there have been prior transactions of company stock and, if so, how many have occurred, when did they occur, and at what terms did they occur? There is no magic number, but as with most statistics, more transactions closer to the date of valuation can often be considered as better indicators of value than fewer transactions further from the date of valuation.

An important consideration in internal transactions is the motivation of the buyer and seller. If there have been multiple internal transactions, appraisers have to determine the appropriateness of which transactions to possibly include and which to possibly exclude in their determination of value. Without an understanding of the motivation of the parties and of the specific facts of the transactions, it becomes trickier to include some, but exclude others. The more logical conclusion would be to include all of the transactions or exclude all of the transactions with a stated explanation.

### What Do the Owner's Personal Financial Statements Say and Are They Important?

Most business owners have to submit personal financial statements as part of any guarantee on financing. The personal financial statement includes a listing of all of the assets and liabilities of the business, typically including some value assigned to the value of the business. In divorce matters, these documents are important as yet another valuation data point.

One view of the value placed on a business in an owner's personal financial statement is that no formal valuation process was used to determine that number; so, at best, it's a thumb in the air, blind estimate of value. The opposing view is the individual submitting the personal financial statement is attesting to the accuracy and reliability of the financial figures contained in document under penalty of perjury. Further, some would say that the value assigned to the business has merit because the business owner is the most informed person regarding the business, its future growth opportunities, competition, and the impact of economic and industry factors on the business.

For an appraiser, it's not a good situation to be surprised by the existence of these documents. A good business appraiser will always ask for them. The business value indicated in a personal financial statement should be viewed in light of value indications under other methodologies and sources of information. At a minimum, personal financial statements may require the expert to ask more questions or use other factors, such as the national and local economy, to explain any difference in values over time.

### Do You Understand Normalizing Adjustments and Why They Are Important?

Normalizing adjustments are adjustments made for any unusual or non-recurring items that do not reflect normal business operations. During the due diligence interview with management, an appraiser should ask if the business has non-recurring or discretionary expenses and are personal expenses of the owner being paid by the business? Comparing the business to industry profitability data can help the appraiser understand the degree to which the business may be underperforming.

An example of how normalizing adjustments work is helpful. If a business has historically reported 2% EBITDA (earnings before interest, taxes, depreciation, and amortization) and the industry data suggests 5%, the financial expert must analyze why there is a difference between these two data points and determine if there are normalizing adjustments to be applied. Let's use some numbers to illustrate this point. For a business with revenue of \$25 million, historical profitability at 2% would suggest EBITDA of \$500,000. At 5%, expected EBITDA would be \$1,250,000, or an increase of \$750,000. In this case, the financial expert should analyze the financial statements and the business to determine if normalization adjustments are appropriate which, when made, will reflect a more realistic figure of the expected profitability of the business without non-recurring or personal owner expenses.

### Conclusion

There are many other issues a valuation expert faces in divorce matters; however, the issues presented here were top of mind for us because they were present in recent engagements. Valuation can be complex. Serving as an expert witness can be challenging as well. However, having an expert with valuation expertise and experience is an advantageous combination in divorce matters. In future articles, we'll discuss other issues of importance to hopefully help you become a more knowledgeable user of valuation services. In the meantime, if you have a valuation or financial forensics issue, feel free to contact us to discuss it in confidence.



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# Tennessee Case Reviews

## *Spergl v. Spergl*

### Tennessee Court of Appeals Middle Section, May 16, 2019

In this case, the determination of the increase in value of stock shares as marital or separate property was the key issue. Husband and Wife were married in 2004, and Wife filed for divorce in 2015. Before the marriage, Husband received 1,200 shares of Class A UPS stock and 8,400 shares of Class B UPS stock from his father. The stock was continuously held in Husband's name. The shares of stock were worth \$73 each at the time of marriage and \$132.76 per share at trial, according to Husband's testimony.

Both classes of stock paid dividends, and Husband applied all dividends from the Class A shares to a dividend reinvestment program such that 531 additional shares were acquired through the program from the date of marriage to the time of trial. Dividends from Class B shares were used to pay down a line of credit secured by the Class B shares. The line of credit was used for various family and personal expenses such as private school tuition and automobile purchases. The trial court determined Husband's shares received before the marriage to be his separate property. The 531 additional Class A shares purchased through the dividend reinvestment program were determined to be marital property as Wife's contributions as a wage earner and homemaker allowed the dividends to be reinvested rather than used to support the family's lifestyle. As for the Class B shares, the court found that Husband had dissipated \$50,000 of the funds from the line of credit secured by the stock and awarded Wife half of this amount.

On appeal, Wife argued that the increase in value of the shares should be classified as marital property. She argued that she made contributions to the preservation and appreciation of the shares, which

prevented Husband from having to sell the shares to cover living expenses. Husband testified that the increase in value was "market driven." Wife cited evidence to the effect that marital funds helped to preserve the value of the stock by allowing Husband to pay tax liabilities without having to sell the stock. The opinion notes that Wife did not cite evidence "establishing a nexus between the use of her income to pay the tax liabilities and the appreciation in value of UPS stock."

Ultimately, the Court affirmed the trial court's determination that the appreciation in value of the stock was Husband's separate property. Tennessee Code Annotated Section 36-4-121(b)(1)(B), effective July 1, 2017, provides that the increase in value of property determined to be separate property can also be separate; alternatively, the increase in value can be marital property if the non-owning spouse contributed to both the preservation and appreciation of the separate property.

The stock in question of this matter was publicly traded and the market price was readily observable. In situations involving privately held businesses, a financial expert can provide a valuation as of multiple dates to determine the increase in value over the course of the marriage. A financial expert can provide forensic and valuation services for publicly traded stock matters too, such as vested and unvested stock options, vested and unvested restricted stock, incentive compensation, among others. Furthermore, a financial expert can categorize marital versus separate by tracing or timeline analysis to assist the trier of facts. Retaining a financial expert can ensure that adequate evidence is presented to the court as it makes determinations of separate and marital property, appreciation in value, proper valuation, among other services.

Click [here](#) for the opinion

# Mercer Capital in the News

## Speaking Engagements



**Scott Womack, ASA, MAFF**

“Will Kress v. U.S. Change Your Life? Or Will It Change Your Valuation Practice?”  
TSCPA 2019 Forensic & Valuation Services Conference in Brentwood, TN



*Three Mercer Capital professionals were on the schedule at this year's AICPA Forensic & Valuation Services Conference in Las Vegas, NV.*

**Karolina Calhoun, CPA/ABV/CFF**

“Cautionary Tales of Valuation Adjustments & Potential Forensic Implications in Litigation”  
“How to Groom and Mentor your Future FLVS Leaders - Dual Perspectives”  
Karolina was also a member of the conference planning committee.

**Travis W. Harms, CFA, CPA/ABV**

“Seven Deadly Sins of Doing Valuation – Part I & II” with James R. Hitchner, CPA/ABV/CFF, ASA  
“At the Intersection of the Income and Market Approach”

**Z. Christopher Mercer, FASA, CFA, ABAR**

“DLOM: Back to the Basics”  
“Communicating Complex Financial Topics” with Jeffrey Tarbell, CFA, ASA



**Z. Christopher Mercer, FASA, CFA, ABAR**

“Explaining Financial Complexity to Non-Financial Professionals”  
“Buy-Sell Agreements for Attorneys”  
PICPA Valuation & Forensic Accounting Conference in Philadelphia, PA



**Scott Womack, ASA, MAFF**

“Critical Issues in Divorce Valuations”  
Family Law Conference for Tennessee Attorneys in Nashville, TN

## In Other News

**Karolina Calhoun, CPA/ABV/CFF** has been appointed as the Valuation Chair of The 2020 & 2021 AICPA Forensic & Valuation Services Conference. She will be Co-Chairing alongside Nicole Lyons, CPA/CFF, CVA, who is the Forensics Chair.

# Family Law Services

Mercer Capital is a national business valuation and financial advisory firm with offices in Memphis, Nashville, Houston, 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.

## Valuation Services

- 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

## Forensic Services

- 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
- Lost profits analysis

## Advisory Services

- Expert witness testimony
- Serving as the financial neutral in a collaborative divorce
- Serving in mediation, arbitration, or as court-appointed and/or mutually agreed-upon experts
- General litigation support
- Assistance with discovery
- Critique of opposing expert reports
- Impact of transactions on valuation
- Economic research
- Public securities, market, and industry research
- Assistance with depositions and cross-examination
- Developing case strategy
- Preparation of demonstrative exhibits

## Who We Serve

- Divorcing spouses
- Consulting for family law attorneys
- Courts, mediators, and others in need of neutral experts
- Business owners
- Family offices
- High-wealth professionals

## Our Qualifications

- Deposition and testimony experience
- Technical and industry expertise
- National reputations for independence and objectivity
- Valuation and forensic credentials from the AICPA, the American Society of Appraisers, the CFA Institute, the Royal Institute of Chartered Surveyors, and the National Association of Certified Valuators and Analysts
- Trained in collaborative law

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