



MERCER CAPITAL'S

# Value Matters™

THE COMPLIMENTARY NEWSLETTER FOR ATTORNEYS AND OTHER PROFESSIONAL ADVISORS TO BUSINESSES

Volume 2007-04 » April 20, 2007  
www.mercercapital.com  
mcm@mercercapital.com

## A Review of Buy-Sell Agreements: Ticking Time Bombs or Reasonable Resolutions?

Review written by L. Paul Hood, Esq. Published in Steve Leimberg's Business Entities Newsletter, Issue 119, February 13, 2007. Courtesy: Leimberg Information Services, Inc. (LISI) at [www.leimbergservices.com](http://www.leimbergservices.com)

This is a review of the newly written book by Chris Mercer, *Buy-Sell Agreements: Ticking Time Bombs or Reasonable Resolutions?* (Peabody Publishing Memphis 2007), available through Peabody Publishing, L.P. (800.769.0967) or through Mercer Capital at [www.mercercapital.com](http://www.mercercapital.com).

The book offers a fresh look at buy-sell agreements through the lens of the business appraiser, who too often enters the picture after, as the book states, "the ox is in the ditch." *Buy-Sell Agreements* discusses in-depth the pricing and valuation provisions of buy-sell agreements, arguably the only important provisions, especially once a triggering event has occurred. However, this book also is written from the viewpoint of someone who has signed buy-sell agreements and who has had significant experience in dealing with signed buy-sell agreements. Mercer's experience shines throughout the tome.

To summarize *Buy-Sell Agreements* in one word, that word would be "methodical." Mercer focuses like a laser beam on virtually all of the possible permutations of the pricing and valuation provisions of buy-sell agreements, together with the advantages and disadvantages of each. Too many of the buy-sell agreements that I see have valuation methods that have far more disadvantages than advantages.

If you are looking for a book that has forms or that discusses the tax consequences of buy-sell agreements, this is not it. However, if you are looking for a book that has a comprehensive discussion of the pricing and valuation aspects of buy-sell agreements (which

**NOW AVAILABLE!**

Order today for only \$79 at [www.mercercapital.com](http://www.mercercapital.com)

### IN THIS ISSUE

<i>Buy-Sell Agreements: Ticking Time Bombs or Reasonable Resolutions?</i> Reviewed .....	1
Mercer Capital Launches New Corporate Web Site .....	2
Recent News About the QMDM .....	3

I've really not ever seen before), this is it. *Buy-Sell Agreements* offers chapters with the following titles:

1. How buy-sell agreements come into existence
2. What are buy-sell agreements designed to accomplish?
3. Business factors to consider with buy-sell agreements
4. Categories of buy-sell agreements
5. Types of buy-sell agreements
6. Fixed price buy-sell agreements
7. Formula buy-sell agreements
8. Shotgun agreements
9. Rights of first refusal
10. Introduction to process buy-sell agreements
11. Process buy-sell agreements
12. Multiple appraiser agreements
13. Single appraiser agreements
14. A hybrid agreement (single appraiser agreement with multiple appraiser options)
15. Other items of importance in process buy-sell agreements
16. Defining element no. 1: the standard of value
17. Defining element no. 2: the level of value
18. Defining element no. 3: the "as-of" date
19. Defining element no. 4: appraiser qualifications
20. Defining element no. 5: appraisal standards
21. Defining element no. 6: funding mechanisms
22. War stories
23. Buy-sell audits & buy-sell checklist
24. The one-percent solution

*Buy-Sell Agreements* is peppered throughout with charts comparing and summarizing its discussion of the advantages and disadvantages of each form of valuation/appraiser provision of buy-sell agreements, as well as action steps. However, *Buy-Sell Agreements* offers a comprehensive buy-sell audit checklist that alone makes it worthy of purchase, serious use and study.

Perhaps not too surprisingly when coming from a business appraiser, *Buy-Sell Agreements* makes a case for beginning a buy-sell agreement with a valuation and for regular valuations, in a manner similar to ESOP's. Nevertheless, Mercer makes a very strong case for his position, which he backs up with reflections, actual situations (no case citations though), stating the advantages and disadvantages of the type of buy-sell agreement and probing questions.

*Buy-Sell Agreements* informs estate planners that there are six defining elements of valuation of a subject company in a buy-sell agreement: the standard of value (e.g., "fair market value"), the level

## **MERCER CAPITAL LAUNCHES NEW CORPORATE WEBSITE**

---

Our new web site features a dynamic new look, along with dramatic improvements in navigation, uniformity, and appearance to better allow users access to the wealth of content presented.

Features include the Mercer Capital Toolbox which highlights information specifically relevant to the user. Enhanced graphics and page layouts provide visitors with an improved user experience.

In addition, web pages and menus have been redesigned to work in intuitive and consistent ways, making it easier for users to find what they are looking for and to know where they are within the web site.

Check it out today at  
**[www.mercercapital.com](http://www.mercercapital.com)**

---

of value (e.g., marketable minority), the "as-of" date, the qualifications of appraisers, the appraisal standards and funding mechanisms. Very few of the buy-sell agreements that I review contain all of these elements.

At \$79, *Buy-Sell Agreements* is a no-brainer addition to the library of every one who works with or who drafts buy-sell agreements. It very neatly compliments books on buy-sell agreements such as Howard Zaritsky's seminal book on the subject that is available through RIA (800-950-1216) as well as Lou Mezzullo's book on buy-sell agreements for estate planners that is available through the ABA (800-285-2221).

Review written by L. Paul Hood, Esq. Published in Steve Leimberg's Business Entities Newsletter, Issue 119, February 13, 2007. Courtesy: Leimberg Information Services, Inc. (LISI) at [www.leimbergservices.com](http://www.leimbergservices.com).

**Order your copy of *Buy-Sell Agreements: Ticking Time Bombs or Reasonable Resolutions?* today at [www.mercercapital.com](http://www.mercercapital.com).**

---

**THE BUY-SELL AUDIT  
CHECKLIST NOW  
AVAILABLE**

---

Excerpted directly from the new book, "*Buy-Sell Agreements: Ticking Time Bombs or Reasonable Resolutions?*," the Buy-Sell Agreement Audit Checklist is a 40-page tool that addresses the many obvious, yet overlooked, valuation issues related to buy-sell agreements.

Check it out at  
[www.mercercapital.com](http://www.mercercapital.com)

---

## Recent News About the QMDM

The QMDM has been in the news quite a bit lately. First, in *Juan Armstrong v. LaSalle Bank National Association*, No. 05-3417 (7th Cir. May 4, 2006), the U.S. Court of Appeals for the Seventh Circuit remanded the case back to the district court for further consideration of the discount for lack of marketability. In that holding, the QMDM was favorably mentioned. The court determined that the appropriate standard of review to apply when considering whether an employee stock ownership plan (ESOP) trustee adopts a valuation of the subject stock is the abuse of discretion standard.

The opinion, written by Judge Richard A. Posner, whom many attorneys believe to be one of the most influential judges on business matters in the nation, appears to be important in the gift & estate tax context because it clearly recognizes the lack of liquidity on value and offers guidance to the district court regarding the determination of a marketability discount, if one is deemed to be applicable. Posner states: "There are techniques for calculating a marketability, or illiquidity, discount, see Z. Christopher Mercer, "A Primer on the Quantitative Marketability Discount Model," *CPA Journal*, July 2003, [www.nysscpa.org/cpajournal/2003/0703/dept/d076603.htm](http://www.nysscpa.org/cpajournal/2003/0703/dept/d076603.htm), visited Apr. 6, 2006."

Second, an article was published in the February 2006 issue of *Trust & Estates* entitled "The Preferred Method" which mischaracterized the QMDM. If you saw that article, make sure you see our "Letter to the Editor" recently published in the April 2007 issue ("Letters to the Editor" *Trust & Estates*, April 2007, pp. 12-13) [to receive a copy, just e-mail me at [priceb@mercercapital.com](mailto:priceb@mercercapital.com)]. To quote from the letter: "The purpose of this letter is to address the February 2007 article "The Preferred Method" by Lance Hall. In that article, Hall not only claims that his firm's restricted stock study is the 'preferred method' for determining marketability discounts, he also admonishes attorneys to employ business appraisers who use his study (which, itself, should make an objective reader suspicious.) ... When properly applied by appraisers in the context of the facts and circumstances of individual valuation situations, the QMDM yields reasonable and supportable results. If one disagrees with the underlying

assumptions used in a discounted cash flow model, the integrity and validity of the valuation method is not impugned. As for whether Hall's restricted stock study's status is the 'preferred method,' we find no basis either in case law or in the business appraisal profession. Rather than admonishing attorneys to hire appraisers who will use only a prescribed restricted stock study to determine marketability discounts, we suggest that attorneys employ independent business appraisers whose work is in the mainstream of modern financial theory and compliant with all applicable valuation standards." Also in the April 2007 issue of *Trust & Estates*, the editor notes that they are in the process of creating an advisory committee dedicated to appraisal issues. We welcome such a committee.

Third, there is an interesting article in the most recent issue of *Business Appraisal Practice*, the peer-reviewed journal of the Institute of Business Appraisers entitled "A Robust Approach for Justifying the Discount for Lack of Marketability in Business Appraisal Reports" by David J. McLaughlin, CBA, CFA (*Business Appraisal Practice*, Winter 2006/2007, pp. 22-30). In the article, Mr. McLaughlin advocates using the pre-IPO and restricted stock studies along with the QMDM to develop a marketability discount, which is how many appraisers approach the determination of marketability discounts. In our *QMDM Fact Sheet* [available for download at [www.mercercapital.com](http://www.mercercapital.com)], we state, "Valuation experts use the QMDM either as a primary means of determining a discount for lack of marketability or to test or to corroborate the concluded discount developed using other methods." While we have no opinion on the specifics of how Mr. McLaughlin arrived at the discounts in his example, we quote him as to the QMDM: "The appeal of the QMDM is that it is based on finance doctrine and quantifies the factors of risk and holding period mentioned in RR 77-287 that an investor would take into consideration when analyzing whether to buy a share of non-marketable stock instead of a similar marketable one....it is crucial that the business appraiser not generalize but apply the factors specifically to the subject company. I do feel more confident in justifying my DLOM by discussing the issues surrounding the studies and including a QMDM analysis in my reports." Mr. McLaughlin, you are not alone.

Whether you are a business appraiser who includes a QMDM analysis in his or her reports or an attorney who employs appraisers who use the QMDM, you need to have the most recent version of The *QMDM Fact Sheet*. It is so named because we have collected all the facts about the QMDM and its history and put them in one five-page document. Why five pages? Because each statement of fact is supported by extensive footnotes. Do not be misled. You can download the facts about the QMDM with our compliments at [www.mercercapital.com](http://www.mercercapital.com).



Barbara Walters Price  
[priceb@mercercapital.com](mailto:priceb@mercercapital.com)

*April 23, 2007*

**"A Theoretical and Practical Review  
of the DCF Method"**

FCG University

Atlanta, Georgia

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

*May 21, 2007*

**"Application of Industry & Economic Data  
in Business Valuation"**

New York Society of CPAs

Business Valuation Conference

New York, New York

**Timothy R. Lee, ASA**

*May 22, 2007*

**"Core Deposit Intangible Asset Valuations"**

SNL Securities

New York, New York

**Andrew K. Gibbs, CFA, CPA/ABV**

*May 23, 2007*

**"SFAS 141(R)"**

BV Resources Teleseminar

**Matthew R. Crow, ASA, CFA**

*June 21, 2007*

**"Buy-Sell Agreements: Ticking Time Bombs  
or Reasonable Resolutions?"**

The Institute of Business Appraisers

2007 Annual Conference

Denver, Colorado

**Z. Christopher Mercer, ASA, CFA**

*July 18, 2007*

**"Developing Reliable Valuation Models"**

Advanced Business Valuation Seminar sponsored by the  
American Society of Appraisers

Hollywood, California

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

*September 8-9*

**"A Theoretical and Practical Review  
of the DCF Method"**

CICBV Regional Conference

Montreal, Canada

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

*September 18-19, 2007*

**"Buy-Sell Agreements: Ticking Time Bombs or Reasonable  
Resolutions?"**

CFA Chapter Meetings

Dallas, Texas and Houston, Texas

**Z. Christopher Mercer, ASA, CFA**

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

*December 3-4, 2007*

**"A Theoretical and Practical Review of the DCF Method"**

AICPA BV Conference

Baltimore, Maryland

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

*December 3-4, 2007*

**"Discounts for Lack of Marketability Panel"**

AICPA BV Conference

Baltimore, Maryland

**Z. Christopher Mercer, ASA, CFA**

COMING SOON

**The Integrated Theory of Business Valuation - SECOND EDITION**

by Z. Christopher Mercer, ASA, CFA and

Travis W. Harms, CFA, CPA/ABV

Offered by Wiley & Sons

To be published October, 2007

**MERCER CAPITAL'S E-BOOK LIBRARY**

TITLE	DESCRIPTION	INVESTMENT	RELEASE DATE
<b>Quantifying Marketability Discounts</b> <i>Valuing Shareholder Cash Flows</i>	<i>Quantifying Marketability Discounts</i> has been updated and is now offered as an e-book. This edition provides a brand new chapter which discusses each of the assumptions of the QMDM in-depth. As a bonus, when you purchase the e-book, you will also receive the QMDM Companion, the latest edition of the QMDM in spreadsheet format.	<b>\$95.00</b>	<i>Currently available</i>
<b>Valuing Financial Institutions</b>	We are responding to requests to put this book back into print and we are doing so as an e-book.	<b>\$65.00</b>	<i>Currently available</i>
<b>Are S Corporations Worth More Than C Corporations?</b>	An e-booklet that adds to the S Corporation vs. C Corporation debate.	<b>\$19.95</b>	<i>Currently available</i>
<b>Embedded Capital Gains</b> <i>The History and the Issues</i>	A closer look at the embedded capital gains issue.	<b>\$19.95</b>	<i>Currently available</i>
<b>Employee Stock Option Valuation Issues</b>	A compilation of articles on the subject of valuation of employee stock options.	<b>Complimentary</b>	<i>Currently available</i>
<b>Rate &amp; Flow: An Alternative Approach to Determining Active/Passive Appreciation in Marital Dissolutions</b>	In this e-book, we present an alternative model for determining active / passive appreciation in a marital dissolution. In states where an owner/spouse's active management of a business does not preclude the consideration of passive appreciation, we offer a fresh approach based on rate and flow analysis.	<b>Complimentary</b>	<i>Currently available</i>
<b>The QMDM Fact Sheet</b> <i>UPDATED AS OF FEBRUARY, 2007</i>	A summary of the history of the QMDM and its acceptance in the business appraisal profession.	<b>Complimentary</b>	<i>Currently available</i>

**New Series: "Understand the Value of Your ..."**

<b>(NEW) Understand the Value of Your Physician Practice</b>	The ownership of every practice will change hands. The event that triggers the transfer can be categorized as either voluntary or involuntary. It is important for physicians to consider the universe of ownership transfer possibilities, because sooner or later, you will be involved.	<b>Complimentary</b>	<i>Currently available</i>
<b>Understand the Value of Your Auto Dealership</b>	While death and taxes may be thought to be the only things that are truly certain, it is equally certain that the ownership of every business will eventually change hands. If we can agree that you will not own your business forever, then we should also be able to agree that it is important for you as a business owner to consider the universe of ownership transfer possibilities.	<b>Complimentary</b>	<i>Currently available</i>
<b>Understand the Value of Your Wholesale Distributorship of Malt Beverage Products</b>	Given the scrutiny of the IRS, the control of the breweries, the evolution of product mix, and the wide ranging concerns of shareholders, it is critical that value be determined and articulated in a credible fashion. The purpose of this article is to provide insight into the situational (when and why) and analytical (how) aspects of valuing beer distributorships.	<b>Complimentary</b>	<i>Currently available</i>

Visit our website at [www.mercercapital.com](http://www.mercercapital.com) for more information or to download an e-book.

## MERCER CAPITAL ON THE ROAD

The professionals of Mercer Capital have a great deal of experience speaking to industry and professional groups across the nation on topics such as:

- » Buy-Sell Agreements
- » The Integrated Theory of Business Valuation
- » Is Your Business Ready for Sale?<sup>™</sup>
- » Purchase Price Allocation
- » Valuation of Employee Stock Options
- » Litigation Support and Expert Testimony
- » Valuation of Privately Held Businesses, Partnerships, or LLCs
- » Financial Institution Valuation
- » ESOP Valuation

**To book a Mercer Capital professional as a speaker at your next conference or CLE/CPE meeting, please contact Barbara Walters Price at [priceb@mercercapital.com](mailto:priceb@mercercapital.com).**

## A GENTLE PLUG FOR OUR FIRM

**MERCER CAPITAL** is a business valuation and investment banking firm serving a national and international clientele. Our reputation for excellence is based on an ability to solve complex financial problems expeditiously. We convert over 20 years of experience, including thousands of assignments, into solutions for the issues of today.

**Corporate Valuation.** Mercer Capital provides a broad range of independent valuation and financial advisory services, including:

- » Dispute Analysis Services and Expert Testimony
- » Valuation for Corporate Tax Matters
- » Valuation for Corporate Income Tax Issues
- » Valuation for ESOPs
- » Purchase Price Allocations
- » Valuation of Employee Options
- » Goodwill Impairment Testing
- » Valuation of Intangible Assets
- » Fairness Opinions

**Investment Banking.** Mercer Capital's investment banking division specializes in providing merger and acquisition services to sellers or buyers of private businesses or public companies divesting divisions and subsidiaries. In addition, we assist clients in industry consolidations, roll ups, and refinancings.

## INTERNET COMMERCE: OBTAIN PROPOSALS TO VALUE YOUR COMPANY, BANK, FLP OR LLC VIA OUR WEBSITE

The cost of your time and delays in obtaining proposals has just gone down. Use one of the PROPOSAL REQUEST FORMS on our website.

Many of your colleagues have already used our PROPOSAL REQUEST FORMS and are impressed by the decrease in transactional overhead and the increased ease in obtaining actionable proposals for their clients. We are pleased to be doing business with them. Try it yourself! Visit our website and provide us with the pertinent information via this form, and we'll prepare a proposal and deliver it to you via e-mail, fax or USPS. Complete confidentiality is assured.

## UNSUBSCRIBE

We will continue to send the newsletter as published at no cost unless you notify us that you wish to be removed from the distribution list. To REMOVE yourself from this list, send an e-mail to: [mercercapital@mercercapital.com](mailto:mercercapital@mercercapital.com) and type the words "Unsubscribe – Value Matters" in the subject line (without the quotation marks).



Business Valuation • Investment Banking

Headquarters:  
5860 Ridgeway Center Parkway, Suite 400  
Memphis, Tennessee 38120  
901.685.2120 » Fax 901.685.2199

Louisville Office:  
511 South 5th Street, Suite 206  
Louisville, Kentucky 40202  
502.585.6340 » Fax 502.585.6345

[www.mercercapital.com](http://www.mercercapital.com)

---

DISCLAIMER. This publication does not constitute legal, valuation, tax, or financial consulting advice. It is offered as an information service to our clients and friends. Those interested in specific guidance for legal and accounting matters should seek competent professional advice. Inquiries to discuss specific valuation or corporate finance matters are welcomed. Permission is specifically granted to send copies of this Value Matters™ to others who might have an interest in its contents. Permission is also granted to quote portions of this newsletter with proper attribution.

---

Copyright © 2007 by Mercer Capital Management, Inc., all rights reserved. Text, graphics, and HTML code are protected by US and International Copyright Laws, and may not be copied, reprinted, published, translated, hosted, or otherwise distributed by any means without explicit permission.



BV Resources and Mercer Capital present a 3-part teleseminar

# BUY-SELL AGREEMENTS

TICKING TIME BOMBS OR REASONABLE RESOLUTIONS?

MAY 24, 2007 » JUNE 14, 2007 » JULY 19, 2007

BVR and Mercer Capital bring you this three-part teleconference series featuring Chris Mercer. His new book, *Buy-Sell Agreements: Ticking Time Bombs or Reasonable Resolutions?* has already proven to be a transformational contribution to the valuation profession.

Join the discussion with Chris and his diverse panels.

## ***May 24, 2007***

Noon - 1:40pm (Central)

### **“An Overview of Buy-Sell Agreements”**

with Z. Christopher Mercer, ASA, CFA

## ***June 14, 2007***

Noon - 1:40pm (Central)

### **“Buy-Sell Agreements from the Perspective of an Attorney and Financial Planner”**

Moderator: Z. Christopher Mercer, ASA, CFA

Panelists: L. Paul Hood, Esq. and

John H. Brown, President, Business Enterprise Institute, Inc.

## ***July 19, 2007***

Noon - 1:40pm (Central)

### **“Valuation Issues Surrounding Buy-Sell Agreements”**

Moderator: Z. Christopher Mercer, ASA, CFA

Panelists: Roger Grabowski, ASA, Managing Director, Duff & Phelps, and

James R. Hitchner, CPA/ABV, ASA, Managing Director, The Financial Valuation Group

**For more information, visit [www.bvresources.com](http://www.bvresources.com)**

