



## February 2010 – Relevant Court Decisions Involving Valuation Issues

### *Bankruptcy (U.S. Bankruptcy Court in Delaware)*

In *In re American Home Mortgage Holdings, Inc.*, 2009 WL 2855888 (Bankr. D. Del. Sept. 8, 2009) the U.S. Bankruptcy Court for the District of Delaware determined that the phrase “commercially reasonable determinants of value” as used in 11 U.S.C. sec 562 was ambiguous. It defined the term to mean “any commercially reasonable valuation methodology may be use as evidence of the damages under a repurchase agreement after its rejection, termination or acceleration.” The court then adopted the debtor’s expert’s discounted cash flow valuation of the loan portfolio that was the subject of the repurchase agreement at issue notwithstanding the actual market for the loan portfolio was dysfunctional.

### *Lost Profits in context of New Business Rule (California Appellate Court)*

In *Gullwing International Motors, Ltd. v. Ostermeier*, 2009 WL 2961939 (Cal. App. 2. Dist. Sept. 17, 2009), the Second District California Court of Appeals, affirmed the lower court’s decision denying the defendant’s challenge to a jury’s lost profits award based on the new business rule in this breach of fiduciary duty and fraud action. The appellate court found that the new business rule did not apply when the business had been in existence for at least six years, had a strategic business plan, and expert testimony was introduced regarding its operations and profits. Therefore, the court affirmed the jury’s \$17MM jury award for defendant’s misconduct.

*Divorce Court – Late Retention of Expert Witness (Ohio) (It is amazing how often we see this type of case; hiring an expert witness just before trial is always a disaster waiting to happen!)*

In *Lee v. Lee*, 2009 WL 3155054 (Ohio App. 5 Dist. Sept. 30, 2009), the Ohio Court of Appeals for the Fifth District affirmed the lower court’s determination that the value of a restaurant was equal to the value of the business’ equipment. In reaching this determination, the trial adopted the parties’ stipulated value of the business’ equipment, acknowledged that the business’ liquor license had value of unknown amount, and that the business had debt well over \$150,000. Additionally, the appellate court affirmed the trial court’s decision to give an expert CPA’s valuation the business little weight where the expert was



retained three weeks prior to trial, and the expert's report was delivered to opposing counsel the day of trial, and the expert was not provided sufficient information to accurately value the business.

### *Estate and Gift Tax Valuations*

In *Estate of Malkin v. CIR*, T.C. Memo. 2009-212 (U.S. Tax Court Sep. 16, 2009), the U.S. Tax Court concluded that IRC sec. 2036 should be applied to recapture the value of publicly traded stock transferred to two FLPs during decedent's life. The Court found that there was an implied agreement allowing the decedent to retain the enjoyment of the transferred assets where the FLP's permitted the decedent to use the transferred stock as collateral for his personal loans. In addition, the court found that there was not a legitimate non-tax reason for the contribution of the stock to the FLPs that would permit the transaction to be shielded from IRC sec 2036 under the bona fide sale exception. The Tax Court also considered issues relating to indirect gifting of LLC interests to the FLPs.

In *Estate of Murphy v. CIR*, 2009 WL 3366099 (W.D. Ark. Oct. 2, 2009), the U.S. District Court for the Western District of Arkansas valued a 95% limited partnership interest in an FLP holding publicly traded securities subject to Rule 144 as well as cash and real property. The FLP was valued using the net asset value approach and applying discounts for lack of marketability and lack of control. The Court adopted the estate's expert's calculations for the Rule 144 blockage discounts. This expert considered (1) the size of the block, (2) the volatility of the stock, (3) the actual price change under recent and preceding market conditions, (4) the current economic outlook for the company (5), the stock price trend and financial performance, (6) the company's earnings trend and, (7) any resale restrictions. The Court also adopted the estate's expert's discounts for lack of control, which for the equity interests, were based on closed end fund data. Further, the court adopted the estate's expert's 32.5% discount for lack of marketability which was based on data from the FMV Opinons, MPI and Silber studies. The court also valued 49% interest in a limited liability company that held general partnership interest in the FLP discussed above as well as valued four artworks.

Source: *Business Valuation Cases in Brief*, by John J. Stockdale, Jr., JD