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JOINTLY-RETAINED BUSINESS VALUATIONS IN DISPUTES-MAKING SURE THE PROCESS WORKS

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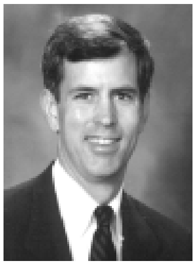
Family law attorney: Our business valuation expert came in at a value of $1 million for the business while their business valuation expert came in at a value of $10 million for the company. We have no idea what the judge is going to do here – he may go entirely with one side, he may just split it down the middle, or he may make us hire additional valuation experts. I have no idea which one of these numbers is correct – they both might be wrong. This whole process is costing these people tens of thousands of dollars just to arrive at one number. There has to be an easier way to do this.



George Hawkins

Increasing Popularity of Jointly-Retained Valuation Agreements. Does the above scenario sound familiar? Apparently it does to a large number of family law, corporate law, and litigation attorneys since the current trend in the legal field is a movement towards the joint retention of an independent valuation expert to prepare an independent valuation report to resolve disputes where valuation is a key issue. As opposed to each side hiring their own expert, by agreeing to jointly retain one independent business valuation expert, both sides of a dispute usually can save thousands of dollars as well as a great deal of time and anguish. Furthermore, under joint retention, there may be a greater sense that the process has been fair.

Michael Paschall

Our experience in the business valuation field has led to the observation of a definite national trend moving in this direction, whether by becoming more accepted practice in various geographic regions, or by statutory decree as in divorces. In fact, one county in California (discussed later) now requires independent, joint appraisals in family law cases. The typical scenario in which joint retention is used is in divorce cases or dissenting shareholder actions, however, joint retention can be used successfully before the matter ever reaches court, such as in settlement attempts or arbitrations. Its use, however, is not limited to legal disputes, as joint retention can be used to successfully navigate the issues of a shareholder departing a company, the purchase of stock under a buy-sell agreement, family business transition to successive generations and so on.

Merely having a third party prepare the valuation does not guarantee that the outcome will be a success and that litigation over value will not result or continue. However, if the joint appraisal process is designed and followed correctly, the odds of a successful outcome can be markedly improved. This article will summarize the basic elements needed for success based on Banister Financial's experience over many years of preparing jointly-retained appraisals.

Identifying the Right Business Appraiser. In the typical joint retention situation, the attorneys for both parties will usually compile a list of potential valuation experts and then compare their lists to see if both parties can decide on the use of a particular business appraiser. If the case is definitely going to trial, both attorneys can draft an order for the judge to approve, appointing the valuation expert on behalf of the court. In other situations, the parties may not agree on an appraiser and the court may appoint a business valuation expert on its own. In some cases, the jointly-retained valuator derives a value merely to facilitate settlement negotiations.

Character and Integrity a Must. Selecting the right business appraiser for the job is the most important aspect of all. Assuming the candidate is competent (this is addressed in a separate article), having the most degrees and certifications and following the best procedures in the world will mean nothing if the appraiser is not honest and unbiased. Integrity is the most important appraiser attribute. The appraiser must be able and willing to objectively listen to the views of the parties and arrive at his or her own unbiased view of the picture, even if this assessment of value is ultimately not to the liking of either or both parties. The appraiser must reach a conclusion of value that is supported by the unique facts and circumstances present, irrespective of what the competing parties believe.

Some business appraisers want both parties to be happy and believe that if the appraisal can come down in between the competing views this will make the parties satisfied and lead to more jointly-retained jobs for the business appraiser in the future. This is not business appraisal, nor is it fair to the parties involved. Business appraisal is about determining the market value of an asset, not about being a psychologist. The appraiser must be willing to call the valuation shots as they are. Trying to engineer a value to make both parties happy is not what valuation is all about. Ultimately, the goal is for the appraiser and the process to be fair. Hopefully the parties will also perceive this to be the case, regardless of whether or not they like the outcome.

To enhance the prospects for a successful jointly-retained assignment, it is important to remember that the parties to the case will be attuned to some sign that the appraiser might be favorable or unfavorable to their position, whether by the appraiser's demeanor, questions asked, or willingness to listen. Even though the appraiser must remain objective, it is important to remember that one's actions can cause the perception by others that the appraiser's objectivity has become tainted. Therefore, the business appraiser should bend over backwards to be unemotional, straightforward, diligent and objective in all interactions with the parties.

Establishing the Ground Rules of a Joint Retention. While the use of a jointly-retained business appraiser can be a key benefit, it is important that certain ground rules be established before the valuator does any work. If the parties to the process know the anticipated timeline and procedure of the valuation process, the chances for a successful outcome can be dramatically improved. While this sounds like obvious advice, it is surprising how often this does not occur. Furthermore, in many cases where one or both parties are not aware of the process, the outcome often is bad. Imagine spending thousands of dollars and months of time to get to the end of the process, only to have the result blow up over comments like this:

> "The Company didn't copy me on that memo they sent the business appraiser, so they must be trying to give him a distorted picture without allowing us to present the other view. I wonder what else they gave him that we didn't know about. I don't believe the value."

In our experience, the key issues to resolve on the front endinclude the following:

1. Written Correspondence. It is crucial that the jointly-retained business valuator not only *be* independent, but also *appear* to be independent. It goes without saying that the professional appraiser must be unbiased, but if there is even a perception of bias in how the process is handled, one party or the other may reject the ultimate valuation findings even though they are valid, negating the whole point of using a jointly-retained appraiser. One way to be and appear to be unbiased is to be sure that all correspondence between the two attorneys and the business appraiser is copied to each of the parties. That is, if the business appraiser sends a letter to attorney A, the business appraiser should copy attorney B on that letter. Likewise, if attorney B sends a letter to the business appraiser, attorney B should copy attorney A on that letter. This practice creates more paperwork, however, it lessens or eliminates the appearance that one party is having privileged, ex parte conversations with the business appraiser without the knowledge of the other side. It also lessens or eliminates the possibility that the business appraiser will receive key information or data that has not been available to the other side.

2. Information Gathering. Before the business appraiser can begin the valuation process and intelligently know the questions to ask in the company interview, he or she must first be provided a wide variety of information needs about the company. This is best gathered based on an information needs list that will be tailored to the company, its business and industry, and submitted to the parties. In setting the procedures for jointly-retained valuations, it is important to determine the person responsible for preparing and submitting information. This clarifies to the valuator the person to contact if there is a delay in receiving the information. Also, this contact person will be utilized for follow-up purposes to see if any questions have arisen on the data that is being requested. Information needs lists have a habit of sitting in an inbox somewhere in an organization, and are often way down on an individual's "to do" list since it is not a great deal of fun to gather and copy the amount of documents needed. Having a key contact allows for appropriate follow-up by the parties to make sure the project doesn't languish.

In court appointed valuations, attorneys will often set time frames outlining when the documents must be provided to the appraiser. In our experience, attorneys often set the time frames too short (a week or two), and also do not provide for the possibility that the appraiser may identify new needs as the valuation progresses. Setting too short a date for document production often causes the producing party to short-change the process and leave out information that could have been included given sufficient time. Although a reasonable time frame varies depending on the complexity of the assignment, a good working figure needed might more reasonably be a month.

3. Interviews. In any business valuation engagement, it is critical to interview management at the company to derive a better overall understanding of the business and its various aspects and risks. In the jointly-retained situation, it is critical to determine in advance at least some of the specific parties that will be interviewed for the valuation (we say "some" because in any assignment it may be necessary to speak to others within a company with expertise or issues on a specific topic as it emerges). In disputed situations, these interviews usually also include (in addition to company management) the parties to the case (i.e., the husband and wife in a divorce matter, or the minority and majority shareholders in a dissenting shareholder matter). In many cases, these parties are already active in the management of the company.

In our experience, it is far better to conduct these interviews individually (as opposed to having both parties in the room at the same time), as this usually will reduce the potential for conflict and increase the potential for candor. We have also found it best to have all parties and their respective counsels to agree that the interviews will be conducted without the presence of the attorneys. In our experience, the free flow of responses to questions does not occur as readily and the information becomes filtered when the attorneys are present. Some attorneys chafe at this recommendation when we discuss setting the ground rules, although most attorneys ultimately agree to not being present. Although not present during the interview stage, the attorney can still be heard during the comment period. Obviously, if both parties desire to have counsel present, this wish needs to be accommodated.

4. Draft Valuation Report. Every company is unique and there are many specific factors the appraiser must consider to arrive at a supported valuation, even if the purpose is for a non-litigation related reason (e.g., sale of company, estate planning, etc.). Therefore, it is always a good idea, where possible, to send a preliminary draft report to the parties. A draft report allows the parties to review for accuracy and to ensure that there are no other issues, risks, or factors that were not brought to the attention of the appraiser that might reasonably impact the value. This is especially true in a litigated valuation setting where the added "suspicion factor" is present (i.e., one party being concerned that the other party will distort the picture for the appraiser or that he or she will be duped, resulting in an outcome that is inaccurate and unfair).

Issuing a draft report allows both sides to review the report and comment on its contents and result before the final valuation findings are concluded and printed. As with the copy-all-parties procedure recommended for any written correspondence, it is important that each side of the dispute receive the draft copy at the same time and that no preliminary results are "leaked" (orally or in writing) to one side before the other. For example, arranging for overnight, next-morning delivery to both parties should minimize the chance that one party has the report for a significant time before the other party.

5. Comment Periods. The purpose in issuing the report initially in draft form is to give the parties a chance to review and understand the methodologies and techniques utilized by the appraiser. The independent business appraiser wants constructive feedback on his or her report, as there may be issues with the company that the appraiser did not give enough attention to or needs to readdress, factors of which the appraiser was not made aware, or simply matters where a party has a different opinion than the appraiser. Furthermore, allowing comment on the draft report enables the parties to have some input in the matter and at least have the opportunity to voice their opinion as to issues in the report. While a comment period is a necessary and beneficial stage of the valuation process, it is crucial that the parties and the appraiser agree beforehand to some ground rules.

6. Length of Comment Period Should Be Limited. The comment period should be for a *limited* amount of time (such as two weeks). This forces the parties to immediately focus their attention on the report and make its review a priority. Business valuations can be complex documents (particularly for people who do not have any financial training or experience), therefore, the time period should not be so short that a meaningful review of the draft cannot be done. However, if the time period is too long, review of the report either falls by the wayside or, worse, allows more time for "fishing expeditions" where parties attack every minute detail of the report (including issues that have little or nothing to do with the ultimate value). Furthermore, longer time periods allow for emotions to simmer and potentially boil over. A limited time period forces the parties to give their immediate attention to the report and focus only on the major issues. Banister Financial has found very few instances where a two-week comment period was not acceptable.

7. Submission of Comments in Writing Only. Hand in hand with the limited time period aspect suggested above, the parties should also agree beforehand that any comments on the draft during the comment period will be in writing only and will be copied to the opposing party. It should be made clear that oral comments will not be considered, as they would most likely be ex parte, not allowing the other side a chance to refute. Furthermore, requesting comments in writing forces the parties to clarify and carefully organize their thoughts, a far superior form of feedback as opposed to the potential of numerous long, rambling telephone calls contesting every conceivable issue in the draft report. Early in our careers we learned that these phone calls often have little to do with issues relevant to the value, but rather involve emotional issues about how one side has been wronged by the other. Requiring written comments keeps the parties from focusing on the emotional element. The parties may well have valid issues about who did what to whom, however, if these issues do not relate to value, they need to be dealt with separate and apart from the valuation process.

8. Providing for a Subsequent Second Comment Period. In most cases, a second comment period is needed and should be set forth prior to undertaking the joint appraisal. The first comment period enables both parties to voice their issues, differences in opinion with the valuation, corrections and other matters for consideration by the appraiser. However, neither party wants to be precluded from responding if they believe that the comments raised by the other party are erroneous and would result in misleading the business appraiser before his or her issuance of a final valuation report. Therefore, in the majority of instances, Banister Financial proposes at inception that both parties agree to procedures that allow for a second follow-up comment period where issues raised by a party in the first round can be refuted by the other party.

9. Avoiding Oral Reports. Engagements where only an oral report will be given are unacceptable and unwise. Oral reports are an invitation to potential disaster, since clients often will hear what they want to hear and ignore that which they do not want to hear. Additionally, there is a risk the appraiser may fail to raise a key point, or that the audience may fail to grasp the significance of a crucial valuation element without the chance to study it. Finally, humans have faulty memories. Even if a client is given a fully-informed oral presentation, they may not remember a key factor two days later. Sound, well-supported and fully documented written valuation reports help reduce the potential for these types of misunderstandings.

10. Payment Methods for Valuation Services to Avoid Allegations of Bias. While both parties may be jointly footing the appraiser's bill, it is often the case (particularly in divorces) that one particular party will bear this responsibility. In a divorce this is typically the spouse involved in the business being valued. The other party may harbor suspicions that the business appraiser may be swayed in his or her opinion of value to the interests of the paying party in order to make sure that payment is received. One simple way to minimize or avoid this perception is to simply require that no valuation report or findings (even in draft form) will be issued until the balance of any fees owed to the appraiser are first received in full. Banister Financial has long followed this policy in jointly-retained appraisals and has found it to work well. This policy should be incorporated in the engagement agreement. If the paying client balks at this on the front-end in discussing the ground rules, this client may not really want an unbiased appraisal after all, and the jointly-retained process probably will end in failure.

11. Issuing the Final Report. Ultimately, it is imperative that a final report is issued in a timely manner where possible. While the business valuator should never cut any time corners to reach a conclusion of value, neither should the valuator allow a project to linger interminably once the comment period is over and any remaining issues have been resolved. In dispute cases, it is important to reach supportable and independent opinions of value, however, it is also important to have closure to the situation and allow people to get on with the rest of their lives. The business valuator and the parties should agree that the final report will be issued soon after the valuator has had the opportunity to consider the valid comments made and reach a final conclusion of value. Unless the comment period uncovered significant issues that were not addressed in the report, the final report should usually be issued within several weeks after the closing of the comment period. It does no good for the business valuator to dictate a brief comment period to the parties and then take two months after that to reach a final decision on value. In addition to inconveniencing the parties involved, the business appraiser who does this also is compromising his or her reputation for professionalism and reliability.

Brevity of time, however, should not come at the expense of the validity of the report. It is possible that the issues raised during the comment periods will require the appraiser to request additional information from the Company or the parties and to undertake additional analysis that may require an extended time frame. While this often occurs rapidly (several weeks or less), there can be circumstances where the issues can take substantially longer to resolve.

12. Responding to Issues Raised in the Final Report. In issuing the final report it is helpful and important for the business appraiser to address major issues raised during the comment period (by both parties), and any resulting changes to the report. The business appraiser ultimately must make his or her own determination of the validity of any changes or issues raised by the parties, however, it is helpful for the appraiser to articulate to the parties the changes made and the reasons for those changes. Even if the appraiser took a different view than the party, articulating this view in the final report or by a cover letter with the report will allow the appraiser to explain why he or she made that particular decision. While one or both parties might not be happy with the decision, at least they will see that the appraiser had a reasonable basis for acting.

13. Allegations of Company Accounting Fraud Versus the Business Appraiser's Role. In many dispute situations (particularly those that are noticeably acrimonious), there may be allegations of financial misrepresentation by one or both parties. Another article in this issue of *Fair Value* deals with the business appraiser's role as it relates to fraud, and why what is often cited as fraud is actually the expensing of non-business-related costs through the business. This related article also investigates the wide variety of potential income statement distortions for which the business appraiser might consider necessary adjustments.

Statutory Dictates for Jointly-Retained Valuation Experts. As noted at the beginning of this article, at least one jurisdiction in the United States has mandated the joint retention of business appraisers in family law disputes. Under Rule 12.8 of Division V (Family Law) of the Coordinated Rules of the Superior and Municipal Courts of San Diego County, the following rules apply (for equitable distribution purposes), among others:

1. Before filing an "at issue" memorandum, the parties must jointly retain a business appraiser.
2. Before contacting a business appraiser for use at a settlement conference or trial, counsel shall meet and confer to select a joint appraiser.
3. If counsel cannot agree on a joint appraiser, a joint appraiser shall be appointed by the court on ex parte motion.
4. The appraiser shall be informed that he or she is retained as a neutral expert working for both parties.

Other provisions in the statute cover the various time periods expected in the appraisal process, the fact that all parties must be copied on written correspondence, the fact that the parties may not have verbal communication with the appraiser unless both parties and the appraiser participate in the communication, provisions for a draft report, provisions for a comment period, and other various items. The full statute (which is much more encompassing) has some very serious flaws, although it is at least an attempt to move jointly-retained appraisals into the mainstream to resolve marital cases. Whether the above statute (or some derivative thereof) will become accepted law in other jurisdictions is unknown, however, the San Diego statute is an indication of movement towards joint retention.

Importance of Independent Work. A good business appraiser must be independent in any valuation work he or she does – whether jointly-retained or for a single client. Although attorneys by definition must be advocates for their client, business appraisers play a very different role in that they are prohibited by the Uniform Standards of Professional Appraisal Practice (USPAP) from being advocates for a particular side in a dispute. Unfortunately, many business appraisers do not understand or abide by this policy, with the result being that many appraisers in the industry are perceived as "husband-friendly" or "wife-friendly" depending on whether the appraiser manufactures a low or high value for a business. Although these types of appraisers may be useful to a party desiring a particular outcome, if these manufactured appraisal reports are ultimately unsupportable, a knowledgeable attorney or qualified appraiser doing an independent appraisal will quickly expose the "low-ball" or "high-ball" appraisal for what it really is. In the context of the jointly-retained valuation context, it is crucial that the business appraiser at all times creates both the perception and the actuality of impartiality. An unsupportable high or low valuation is as bad as having no valuation report at all.

Conclusion. The use of jointly-retained valuation experts is on the rise and, when handled correctly, can be a valuable solution to parties in a dispute. Although this may be detrimental to the business valuation industry (our business opportunities are cut in half!), overall, we believe this is a positive development in regards to increasing the time and efficiency of dispute resolution as well as to the hope that business valuation will be perceived, as it must be, as a truly independent exercise. Of course, this will be a positive development only if the valuation result reached by the jointly appointed appraiser is independent, fully supportable, and does not reflect any bias whatsoever from either side of the conflict. Therefore, in order for the jointly-retained approach to work, it is critical that the right business appraiser be selected and the appropriate process agreed to in advance by the parties and then followed thereafter. While the parties involved may not ultimately like or agree with the findings of the appraiser, the chances that they will accept the end result will be dramatically improved. ♦

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