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FAMILY LAW ALERT

Divorce Court: Round-Up

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In Alabama, Tennessee, Montana, and New York recent divorce court decisions suggest a trend of “common sense reality checks” on valuations.

Financial disclosure for ante-nuptial must be fair and reasonable. In *Stemler v. Stemler*, 2009 WL 1887435 (Ala. Civ. App.) (July 2, 2009), the court held that a financially naïve wife could not be reasonably considered to have “known” the value of her older, far wealthier, husband-to-be’s assets, though they had been living together and she had “observed his lifestyle.” Without a list of appraised values, she lacked the sophistication to make that assessment herself. The ante-nuptial (which limited her property claims to joint property only and her support to \$50,000) was invalidated for the husband’s failure to disclose his financial assets.

Buy-sell agreement value is binding, but valuation must be well founded. Another example of a court working to marry reasonable reality with valuations can be found in *Inzer v. Inzer, Inc*, 2009 WL 2263818 (Tenn. Ct. App.) (July 28, 2009). In this case, a couple invests in a Sonic Drive-In, but it is the husband who becomes the “working manager-member” and 24% owner of the franchise. However, at the time of purchase, the wife signs an acknowledgement of the buy-sell provision in the Operating Agreement, which set out a specific method of calculating the redemption price for the 24% share in the franchise. Flash forward to their divorce, seven years later, and the husband’s expert comes up with a value of \$33,102, based on the buy-sell agreement, arguing that the value should be based on net book value without any consideration of goodwill or discounts. The wife’s expert valued the same interest without regard to the buy-sell agreement at \$509,000. At trial, the court found that the husband’s expert valuation defied common sense, given the husband’s annual earnings of over \$150,000, but the court also found that the buy-sell provision did not affect value and that a marketability discount did not apply, coming to a (seemingly random) value of \$207,456. On appeal, the court reluctantly found that the buy-sell agreement bound the determination of value, but rejected the husband’s expert valuation, remanding the case for findings of value that specifically followed the terms of the buy-sell.

Discounting minority interests. Here again, a husband’s actual earnings and assets are re-scrutinized by an appellate court concerned with the most “objective” result. In *In re Marriage of Williams*, 2009 WL 2597950 (Mont.) (Aug. 25, 2009), father and son owned equal shares in a trucking business and a real estate holding company. The son’s actual annual income prior to the divorce had been between \$200,000 and \$300,000, but the court reduced it to \$100,000, on the theory that the son could not force the S Corp to pay out to him. The court then valued the real estate company at \$3.36 million, 50% of which was the son’s; but that amount was further reduced by 50%, because it was a non-controlling interest. The son had apparently bought a condo out of company funds and his father had taken away the company checkbook, and with it some of the son’s decision making powers. The wife appealed both the discounted income figure and the discounted business value.

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FairShare Financial, PC
One Glenlake Parkway, Suite 700
Atlanta, Georgia 30328

Paul A. Tigner, CPA/ABV/CFF, CFE, AIBA
Seth P. Murphy, CPA/ABV, CFE

(678) 578-2570 phone (678) 578-2571 fax
www.FairShareFinancial.com

The Montana Supreme Court held that “whether a discount is proper depends on the facts of the case, not the method used to ascertain the underlying value of the stock.” The court found that in fact the son had say over the company’s finances and operations, and, as evidence of this, he used company funds for personal purposes often. Furthermore, the son’s lack of control with respect to the payouts to himself was susceptible to substantial manipulation, and the trial court’s decision increased the potential and incentive for such manipulation. The case was remanded for an “objective determination of child support based on the husband’s actual tax returns, the company’s financial statements, and other relevant information. Discounts were found to be improper, and the entire value of the husband’s marital interest in the real estate company was subject to apportionment.

Wife’s share in law license is limited. In contrast to the previous three cases, a New York court continued a trend toward limiting the equitable share of professional licenses and practices to spouses in divorce. In *Fleischmann v. Fleischmann*, 2009 WL 2217384 (N.Y. Sup.) (July 22, 2009) (*unpublished*), a husband’s law license and 0.5% partnership interest in a high-powered law firm were respectively discounted to 10% and 25%, respectively, though the couple had been married for 26 years throughout his law school studies and rise to partner; while the graduate-degreed wife had left work to raise their three children. The case is non-binding unless reviewed and ratified on appeal.

Splitting the difference is not a decision. Though parties may not like the decision a court reaches, something is better than nothing. In *Brown v. Brown*, 2009 WL 1278430 (Ohio App. 12 Dist.) (May 11, 2009), more than six years after this couple filed for divorce, their case was remanded to trial. At issue was the valuation of the husband’s OB/GYN practice, where the wife had worked part-time to help with accounting. At trial, only the wife presented expert testimony from a CPA with experience appraising businesses and medical practices. He analyzed five years of accounts receivable, concluding that the practice was worth nearly \$98,000. The husband testified that the receivables were only 10% collectible, however, essentially placing a value on his practice of just under \$9,800. Neither party presented testimony on the practice’s goodwill.

Thirty months after trial, the magistrate issued final orders, valuing the medical practice at \$40,000. The magistrate did not provide any findings to support what essentially amounted to splitting the difference between the parties’ evidence. On appeal, the court found that the magistrate’s determination was not detailed enough to permit review. In remanding the matter, the court directed that the trial court provide an evidentiary basis for its valuation of the medical practice and debt.