

THIRD EDITION

*Shannon Pratt's*  
The Lawyer's  
Business  
Valuation  
Handbook

Understanding Financial Statements,  
Appraisal Reports, and Expert Testimony

Shannon P. Pratt and ASA Educational Foundation

  
AMERICAN **BAR** ASSOCIATION  
Family Law Section  
Real Property Trust and  
Estate Law Section

  
ASA  
Providing Value Worldwide  
Educational Foundation

# Foreword—Perspective from the Bench

*Judge Steven I. Platt (Ret.)*

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In my over 35 years serving as a judge on three different Maryland courts, cases where valuation was an important component were among the most challenging. Valuation is not an area where law schools provide much background for what's ahead. The terminology and theories can be challenging even for experienced attorneys. The third edition of *The Lawyer's Business Valuation Handbook* provides the attorney first confronted with valuation issues with a thorough understanding of the techniques for valuing used by "experts" for closely held businesses and interests in closely held businesses.

The beginning chapters cover the terminology and theories of appraisal employed by valuation practitioners. For example, disputes arise over the meaning of *fair market value*, often used as the default definition of value in contracts, such as buy-sell agreements. But the value of partial interests in businesses most often requires analysis of whether a discount needs to be applied to a proportionate interest in the entity owning the business in order to correctly value it. The chapter "Discounts and Premiums" provides the attorney with a thorough understanding of the theory and the different methodologies used to estimate appropriate partial interest discounts in business entities.

That chapter is followed up with a chapter "Valuing Interests in Real Property Holding Entities" that deals specifically with the nuances of differences between the real estate appraisal that may be used in valuing the underlying real property and the valuation of a partial interest in an entity owning the real property.

Many chapters deal with specific areas of controversy. For example, the chapter "Employment and Noncompetition Agreements" walks the reader through the legal and valuation aspects of this often contentious and evolving area of the law, and includes an example that helps the attorney understand the intricacies that surround quantifying the damages resulting from a breach of contract.

The chapter "Valuing Intellectual Property and Intangible Assets" provides a good overview of an area where infringement disputes can arise, and the chapter "Valuation in Lost Profits Damages Matters" lays out the concepts and process of quantifying damages from such infringements.

The series of chapters “Admissibility and Impact of Expert Business Valuation Evidence,” “Discovery and the Business Valuation Expert,” and “Examining a Business Valuation Expert in Depositions and at Trials,” contributed by a noted litigator, can prepare an attorney for litigation of valuation disputes, from screening and selecting an appropriate, qualified expert to understanding the discovery process to effectively preparing your witness for deposition and trial and finally to delving into the positions taken by an opposing expert at deposition and at trial.

Since leaving the bench, I have been focused on resolving disputes through mediation and arbitration. These paths are often preferable to the courtroom because they are private venues, keeping confidential information and the “dirty laundry” out of the public eye. The chapter “Alternative Dispute Resolution” provides a good primer on the value of such procedures and the process, so an attorney can explain these alternative methods of dispute resolution, which often are more efficient and more economical than litigation to the attorneys’ client.

I therefore highly recommend the third edition to any attorney first confronted with a valuation dispute and even to an experienced attorney as a refresher. Judges confronted with hearing a valuation dispute will also benefit from the easy-to-read style of the third edition and its thorough content focused on giving an attorney what he or she needs to effectively represent clients, while at the same time assist the court or the ADR tribunal in reaching a fair and evidence-based resolution of the dispute presented to it for disposition.

Note: Upon “retirement” from the bench, Judge Platt is currently engaged in mediation, arbitration, and neutral case evaluation of complex civil litigation. He is a Neutral and member of the Maryland Board of Directors of The National Academy of Distinguished Neutrals, which, after a thorough peer review by the board of directors, selects only the top 10% of Neutrals in the country. Judge Platt is the author of *Lessons Lived and Learned—My Life On and Off The Bench*, available at [www.judgestevenplatt.com](http://www.judgestevenplatt.com).

# Foreword—Tax Law Perspective

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Valuation controversies in federal tax issues are frequent and complicated. The third edition of *The Lawyer's Business Valuation Handbook* introduces the reader—often an attorney—to valuation theory in straightforward terms, providing knowledge necessary to work with sophisticated business appraisers, zealous IRS representatives, and thoughtful judges. The contributing authors provide a thorough background on valuation theory, highlighting the major areas of which attorneys should be aware.

For example, the chapters on “Employment and Non-Competition Agreements” (an expanded and updated chapter in this third edition) and “Valuation of Stock of S-Corporations and Interests in Other Pass-through Entities” provide attorneys with straightforward explanations of the complexities of these often controversial topics in such a way that the reader comes away with an understanding difficult to find elsewhere and armed with convincing arguments as a result.

The chapters “Financial Statement Terminology” and “Financial Statement Adjustments” provide important background in the process of converting basic financial statement information to information used in valuing closely held businesses and interests in such businesses.

The chapters covering “Discounts and Premiums,” “Valuations for Gift, Estate, and Charitable Contribution Matters” (two chapters that have been updated in the third edition) and “Valuing Interests in Real Property Holding Entities” (a new chapter in this edition) are contributed by noted practitioners, providing not just the background for, but also insights into, what are most likely the most controversial areas in federal gift, estate tax, and charitable contribution litigation—the valuation of interests in closely held businesses.

The third edition also provides a good introduction into other areas of federal income tax controversies in the chapter “Valuations for Federal Income Tax Matters” (another new chapter in the third edition), including a good primer on related party transfer pricing issues.

The chapter “Appraisal Reports” will assist the attorney in understanding the content that should be included in a thorough appraisal report, and the chapter “Checklists

for Reviewing Valuation Reports” provides invaluable resources to assist in the appraisal review process.

The chapters “Admissibility and Impact of Business Valuation Evidence,” contributed by a noted litigator, and “Business Valuation Standards and Credentials” provide insights into screening and selecting business valuation experts.

The chapters “Discovery and the Business Valuation Expert” and “Examining a Business Valuation Expert in Depositions and at Trials,” both contributed by a noted litigator, will help the attorney understand the processes, and how to avoid the pitfalls, of taking a dispute to court.

The chapter “Alternative Dispute Resolution” explains alternative avenues of settling a dispute in the valuation and tax contexts.

Finally, the chapter “Valuation and Appraiser Penalties” (another new chapter in the third edition) explains the ins and outs of dealing with the Internal Revenue Service when the differences between the taxpayer’s and IRS’s positions are significant.

I recommend the third edition to any attorney involved in tax controversy work (and to CPAs and other tax professionals as well). Our highly charged environment of increased scrutiny by the IRS at the audit level only increases the need for tax practitioners’ preparedness to assist in obtaining the best supportable and defensible appraisal report against often ill-founded positions of the IRS.

The third edition stands ready to equip you with the tools you are likely to need in guiding our colleagues at the IRS as to valuation methodologies and approaches that they need to consider.

Background: Ms. Price has assisted clients in numerous federal tax cases in U.S. Tax Court, the U.S. Court of Claims, and the U.S. Courts of Appeals for the Fifth, Eighth, and Eleventh Circuits. Named *Lawyer of the Year*—Trust and Estates in Austin by *Best Lawyers in America*, 2020 and 2024.

# Foreword—Family Law Perspective

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Academy of Matrimonial Lawyers*

Family law practitioners are confronted with valuation issues every day. Among the most difficult issues that family lawyers confront is the valuation of interests in closely held businesses. The third edition will provide counsel who is first confronted with such a valuation issue with the background necessary to understand valuation theory and the basics of conducting an appraisal. The third edition will also prepare you for discussing valuation issues with the business appraiser and, more importantly, with your clients.

The beginning chapters walk through the basics of valuing a closely held business and partial interests in closely held entities, the appraisal process, and the more difficult areas that can lead to disagreement. For example, partial interests in closely held entities require an understanding of discounts that may be applicable in arriving at a valuation conclusion. The chapters “Discounts and Premiums” (a completely updated chapter in the third edition) and “Valuing Interests in Real Property Holding Entities” (a new chapter in the third edition) walk you through the reasons for discounts and the current methodologies used in estimating supportable discounts and when they are applicable.

The chapters “Personal versus Enterprise Goodwill” and “Marital Dissolution Valuations” (both completely updated chapters in the third edition), contributed by two noted experts in marital valuations, go deep into the controversies that confront the family law practitioner. The chapters provide the insights into the theories and some of the most important court decisions with which you need to be familiar.

The chapters “Admissibility and Impact of Business Valuation Evidence,” contributed by a noted family law litigator, and “Business Valuation Standards and Credentials” provide invaluable insight into screening and selecting business valuation experts.

The chapters “Discovery and the Business Valuation Expert” and “Examining a Business Valuation Expert in Depositions and at Trials,” both contributed by that noted litigator, will help you understand the processes and the pitfalls of taking a dispute to court.

Finally, the chapter "Alternative Dispute Resolution" explains viable alternative avenues of settling a dispute.

I highly recommend the third edition to all family law practitioners. For the novice, it is a valuable primer that will help get you up to speed in the most important areas of valuing closely held businesses and interests in closely held entities. For the experienced practitioner, the third edition will be a valuable refresher and will provide you with important references to some of the best resources that go deeper into valuation theory and controversies. The third edition will provide both the novice and experienced practitioner with the key terminology and an understanding of the logic used in the valuation process so that you can better communicate with your clients and help them select the best business valuation expert to deal with the business valuation issues that are a part of the dissolution of their marriage.

Background: Mr. Sasser is past chair of the Family Law Section of The Florida Bar and four-time past chair of the Florida Bar Marital and Family Law Board Certification Review Course and was selected to *Super Lawyers*, 2006–2024.

# Foreword—Corporate Law Perspective

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Valuation issues are ubiquitous for lawyers working in sophisticated practices with corporations, limited liability companies, or other business entity forms. Whether in advising a client concerning a potential transaction, or in assessing how a reviewing court may assess valuation issues after the fact, *The Lawyer’s Business Valuation Handbook* has been a key resource for transactional attorneys and business litigators alike since its initial publication in 2000. Reflecting its importance, this Handbook is frequently cited by courts in Delaware and elsewhere in addressing valuation issues involving business entities.

The third edition provides the attorney confronted with valuation issues, whether tax-related or dispute-related, with a thorough understanding of the theory of valuing businesses and interests in business entities. The chapters reflect updates or contributions by noted valuation practitioners who are steeped in the theory and well-experienced in the controversies that can develop. Like prior editions, the third edition provides business lawyers with critical information and perspective in considering the various areas in which valuation issues may arise.

For example, for those lawyers whose clients are confronted with owner disputes, the chapter “Shareholder and Partner Disputes” provides an overview of the current state of the law and theory concerning valuation in disputes involving the exercise of dissenters’ rights and actions involving alleged breaches of fiduciary duties. The chapters “Reasonable Compensation,” “Employment and Noncompetition Agreements” (a newly updated and expanded chapter in the third edition), and “Valuation Provisions in Buy-Sell Agreements” each provide background in these specialized areas that will help practitioners explain them to clients to minimize potential problems in the future. The Handbook also includes new chapters on “Valuing Intellectual Property and Intangible Assets” and “Valuation in Lost Profits Damages Matters,” recurring issues specifically addressed in the Handbook.

Employee stock ownership plans (ESOPs) are often discussed among business owners. The chapter “Valuations for Employee Stock Ownership Plans” (a new chapter in the third edition) explains the intricacies of ESOPs and the valuation issues that result.



For those whose areas of practice include federal taxation, the chapter “Valuations for Federal Income Tax Matters” will serve as a valuable primer or refresher into some of the more controversial areas, including related-party transfer pricing.

A new chapter “Valuation in Fairness Matters” addresses the law and valuation theory pertinent to financial advisors’ fairness opinions—that is, assessing whether a transaction is financially fair to the business entity, its owners, or some subset thereof. Similarly, the new chapter “Valuation in Solvency Matters” discusses the legal standards and analytical approach to assess whether an entity is solvent and expected to remain so following an anticipated transaction. These are critical issues to owners, members of management, and their legal counsel to help ensure legal compliance, to minimize risk to important transactions, and to appropriately present disputes when they arise.

We highly recommend the third edition to any business lawyer as an important resource for advising clients concerning recurring valuation issues, whether *ex ante* when considering a potential transaction, or *ex post* in ensuring the merits of any valuation disputes are presented appropriately to a reviewing court. Whether practitioners find it on a bookshelf or in digital form, business lawyers and their advisors working on important matters for sophisticated clients should have this excellent treatise at the ready.

Background: For almost 40 years, Lewis Lazarus’s practice has focused on representing parties in disputes concerning the governance of Delaware corporations and other business entities. He has served as counsel in seminal cases that have helped shape the contours of Delaware corporate law. He has been recognized by *Chambers and Partners*, *Best Lawyers in America*®, and *Super Lawyers*®, among other publications.

Tyler O’Connell has more than 20 years’ experience representing directors, officers, members of management, and significant investors in litigation involving Delaware business entities, as well as transactions that may present litigation risk. His work has been recognized by *Chambers and Partners*, *Best Lawyers in America*®, and *Super Lawyers*®, among other publications.

# Preface

This third edition is designed for attorneys and judges who frequently, occasionally, or even for the first time encounter disputed (or potentially disputed) business valuation issues. It serves all of the above because it is written and organized both as a tutorial and a reference manual.

The authors have extensive experience in business valuation matters for a wide variety of purposes, including tax matters (e.g., estate, gift, charitable contributions), transactional matters (e.g., mergers and acquisitions, going public, going private), and litigation or potential litigation (e.g., tax matters, shareholder disputes, marital dissolutions). All of these have elements in common, and many have specialized elements, thus requiring generalized chapters and also chapters addressing a particular valuation purpose.

## **EVOLUTION OF *THE LAWYER'S BUSINESS VALUATION HANDBOOK***

The first edition was published in 2000. Before Shannon Pratt retired, planning had begun for updating both his *Valuing a Business: The Analysis and Appraisal of Closely Held Business*, the primary source for educating business appraisers in valuing closely held businesses since it was first published in 2001, and this book. After he retired, the ASA Educational Foundation took leadership in maintaining Shannon's legacy. First, a group of some of the foremost valuation practitioners updated *Valuing a Business*, with the sixth edition being released in 2022. Now a group of renowned attorneys and valuation practitioners have updated this book, working to maintain the style of the book as established by Shannon while updating the content to 2024.

## **SAME SHARES MAY HAVE DIFFERENT VALUES**

It is important to recognize that the same block of shares may have different values—even on the same day—depending on the statute and the case law governing the transaction. For example, a number of states do not allow discounts for lack of control and/or lack of marketability in dissenting stockholder suits, whereas federal, gift, estate, and income tax statutes universally use the standard of *fair market value*, which the courts have interpreted to allow such discounts.

## **UPDATED CHAPTERS**

Much has happened since the last edition and most chapters have been expanded and all have been updated to reflect the changes. For example, we updated the discussion on *levels of value*, reflecting the current thinking on explaining differences in value conclusions.

Valuation discounts and premiums continue to be a prime area of controversy. The chapter “Discounts and Premiums” reflects the most current thinking on estimating appropriate discounts. A separate chapter, “Valuations of Gift, Estate, and Charitable Contribution Matters” highlights the decisions that have come down where discounts have been a major issue and discusses the conflicting *Blount* and *Connelly* decisions; in early 2024, the U.S. Supreme Court issued its opinion in *Connelly v. U.S.*, and the chapter discusses that opinion.

When originally written, the chapter on “Examining Business Valuation Experts at Deposition and at Trial” was not designed to distinguish between taking discovery deposition testimony and eliciting trial testimony from expert witnesses. This updated chapter differentiates between the two to illustrate how treating each differently aids discovery and structuring trial testimony.

We added a discussion on appraiser's reliance on other experts in the chapter “The Asset-Based Approach.”

References at the end of each chapter are updated, providing the reader with resources that go even deeper into the chapter topics. Appendix A, Glossary of Business Valuation Terms, has been updated to provide the reader with updated references.

## HIGHLIGHTS OF WHAT'S NEW IN THIS EDITION

We added a brief outline at the beginning of each chapter, highlighting topics covered in the chapter.

We have added the following new chapters:

- **Company Information, Site Visits, and Interviews:** due diligence that should be taken in preparing a business valuation
- **Developing a Discount Rate:** expanded discussion in a separate chapter on this integral component of any income approach valuation including new material on discount rates for small closely held businesses
- **Employment and Noncompetition Agreements:** expanded discussion, moved to a separate chapter
- **Valuations for Federal Income Tax Matters:** separate chapter covering federal tax valuation issues (other than gift, estate, and charitable contribution matters), including an introduction to transfer pricing
- **Shareholder and Partner Disputes:** new Appendix B, Fair Value in Dissent and Oppression, with state-by-state definitions of value in dissent and oppression matters and new Appendix C, Terms of the Market Exception, with state-by-state restrictions on appraisal rights for publicly held shares
- **Valuing Interests in Real Property Holding Entities:** covering partial interest discounts and the relationship between entities owning the real property and those owning a related operating business
- **Valuing Intellectual Property and Intangible Assets:** covering legally protected intellectual property, rights of publicity, income tax and transfer pricing considerations, and differences in valuing such assets for financial reporting purposes
- **Valuation in Fairness Matters:** introduction to principles of corporate law relevant to fairness opinions, role of corporate directors and their fiduciary duties, and directors' responsibilities and decision-making in a transactional context
- **Valuation in Solvency Matters:** introduction to claims of fraudulent conveyance/transfers, *reasonably equivalent value*, solvency opinions, director duties as a company approaches insolvency

- **Valuation in Lost Profits Damages Matters:** estimation of lost profits or lost business value, prerequisites to damage recovery, and key concepts in damage calculations
- **Valuation and Appraiser Penalties:** relationship of standards and valuation penalties at the federal level, history and definitions, qualified appraiser and appraisal, and examples of penalty calculations

An Index of Court Decisions complements the Subject Index.

## **DISCOUNTS AND PREMIUMS**

This chapter has been greatly expanded and updated as a major issue in many cases is premiums and discounts, especially discounts for lack of marketability (DLOM). As empirical DLOM databases have expanded, courts prefer that the business appraiser access the databases and select the transactions most resembling the subject company rather than just use the average discounts. Further, current valuation practice has evolved to encompass greater application of quantitative methods in measuring discounts for lack of control (i.e., discounts applicable to minority interest) and lack of marketability. The chapter covers developments in discounts for tax on trapped-in capital gains, voting versus nonvoting stock, key person discounts, and discounts for environmental litigation and other contingent liabilities.

## **VALUING STOCK IN S CORPORATIONS AND INTERESTS IN OTHER PASS-THROUGH ENTITIES**

Pass-through entities have become the predominant form of closely held business organization. We updated this chapter to reflect recent valuation-related developments. We have also updated the chapter on valuing professional practices and small service businesses.

## **BUY-SELL AGREEMENTS**

In the course of reviewing valuation reports pursuant to buy-sell agreements, we see many ambiguous valuation provisions in buy-sell agreements. Many even omit the applicable definition of value (the subject of Chapter 1). To assist attorneys in drafting unambiguous valuation provisions in such agreements, we have updated and expanded the chapter on buy-sell agreements.

## **REPORT REVIEWS**

One of the most frequent (and hard to catch) categories of errors in business valuation reports is errors of omission. We've updated the two chapters on reports—a general chapter on appraisal reports (what a good report should have) and a “working chapter” with checklists for reviewing reports. The chapter “Checklist for Reviewing a Business Valuation Report” is free of copyright restrictions and is meant to be copied and the blanks filled in for each report. Two or more copies may be utilized for comparing your expert's report with that of the opposing expert and identifying the differences.

## **COURT POSITIONS CITED, SOMETIMES CHALLENGED**

Court decisions are cited throughout to illustrate courts' positions on many issues. On some issues, various courts are unanimous in their positions, but on other issues courts' positions vary according to jurisdiction. For those that vary, we cite from decisions on either side of an issue. Occasionally, when we feel that one court's treatment of an issue is sounder than another, we say so, and tell you why. We believe that attorneys should know court precedents and usually should follow them, but sometimes it pays to challenge an unsound precedent and make new law.

We welcome questions and comments: please send to Roger J. Grabowski at [rjg264@comcast.net](mailto:rjg264@comcast.net).