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BUSINESS VALUATION

Gardner, Willis, Sweat & Handelman, LLP hopes you find the information in this newsletter helpful. This information is intended to be general in nature and is not a substitute for competent legal advice. Because every issue is unique, we do not recommend that you apply the information in this newsletter without first seeking appropriate legal advice.

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Examples of seminars:

- General Banking Law
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- Workers' Comp Overview
- Return to Work-Workers' Comp
- Sexual Harassment
- Americans with Disabilities Act
- Family and Medical Leave Act
- Negligent Hiring
- Estate Planning

PROFESSIONAL SERVICE FIRM VALUATION IN DIVORCE

Quite often medical and other professional service firms require valuation when an owner/partner is in the midst of a divorce proceeding. A Florida appellate court case is instructive in this regard.

In *Garcia v. Garcia*, District Court of Appeal of Florida, Fourth District, January 20, 2010, the former husband objected to the trial court's valuation of his 25% interest in a medical partnership. Since 1996, he has been a 25% owner in a medical professional corporation.

The former husband argued that the trial court erred in valuing his 25% interest at approximately \$900,000. Specifically, he argued that the trial court ignored a restrictive transfer provision in the shareholders' agreement governing the ownership of the medical practice. Also, the former husband argued that the trial court erred in ignoring a designated stock value in the agreement.

The shareholders' agreement provided that if a triggering event occurred (such as a shareholder dying or becoming disabled), the shareholder would receive a payment of \$15,000 for three months — a total payment of \$45,000 for his interest in the practice.

The Florida Court of Appeals looked to Virginia and New Jersey cases for guidance. Both of these cases held that, although restrictive transfer clauses in shareholders' agreements should be considered in valuing the underlying stock in the entity, such provisions are not conclusive as to value. In essence, these appellate court decisions advocate a facts and circumstances type approach to valuation of professional practices in divorce proceedings.

The *Garcia* court sided with the former wife's expert, who applied the net asset approach in valuing the former husband's interest in the medical practice. The mechanics of the net asset approach basically involves valuing all the assets of a practice, except cash, at fair market value and deducting any liabilities to arrive at a net asset fair market value. The former wife's expert examined the shareholders' agreement and concluded that the designated value created an artificial and unrealistic estimate. The expert also determined that it was not necessary to further discount the net asset value due to the restrictions on transfer common to such agreements.

The former husband's expert valued the practice initially at \$45,000, which is the amount that would be received on a buyout pursuant to the agreement. The former husband hired a second expert, who valued the practice at about \$565,000 using the net asset approach. The difference between the experts (\$900,000 vs. \$565,000) is attributable to their handling of the practice's accounts receivable.

The *Garcia* appellate court sided with the trial court in using the former wife's net asset value methodology, which was espoused in the Virginia and New Jersey cases previously mentioned.

More importantly, the *Garcia* appellate court noted that the former husband's expert did not apply any discount to the net asset value due to the restrictive agreement. Also, the former wife's expert declined to recognize a discount on the net asset value due to the agreement. Therefore, the appellate court was left with no choice but to view the evidence before it and side with the former wife's expert's valuation as being supported by competent, substantial evidence. Significantly, the decision could have been different if the former husband's expert explicitly considered a discount to the net asset value due to the restrictive covenants in the shareholders' agreement.

In summary, when valuing a medical practice, an earnings approach may be employed or, more importantly, a net asset approach may be relevant in valuing the business. The Florida appellate court seemed to indicate that restrictive covenants could be considered as a discount to the resulting value using a net asset approach. However, it is important that the discount be supported by facts pertinent to the valuation engagement.

This newsletter was prepared by Glenn Booker. Glenn's practice centers around estate planning for property transfers and estate/trust administration. He also specializes in appraising closely-held business interests. Glenn advises clients on complex accounting and finance issues, yet his conversational approach enables him to explain such issues in simple and understandable terms. You may contact Glenn at (229) 883-2441 or e-mail him at glenn.booker@gwsh-law.com.

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