

# Happy New Year!

Enjoy our new look!

We would like to take this opportunity to wish each of you a happy, healthy, and prosperous New Year! The prospect of a new year is always exciting. It is especially so for us as we debut the premier edition of our newly designed newsletter – ISSUES & UPDATES. While the look and name have changed, our commitment to keeping you informed on the latest developments in the business valuation community continues to be strong. Each quarter you can look forward to reviewing the most salient issues and court case updates that have impacted the business valuation industry.

During 2004, **Value Management Inc.** performed more than 240 appraisals. Of those, approximately 80 were gift or estate tax related, 70 were for Employee Stock Ownership Plans or were transaction related, and an increasing number were for intangibles and accounting related projects – mainly FASB issues. Lastly, roughly 70 involved litigation – shareholder disputes, marital dissolution, and damage calculations.

Our appraisals over the past year ranged in size from the very small to values in the billions. Our clients were primarily privately-held businesses and/or owners, but also included public companies, the IRS, the City of Philadelphia, and some of the largest law firms and accounting firms in the country.

We served as transaction intermediaries on several occasions in 2004. We provided consulting and strategy for negotiations, we reviewed and critiqued offers, and initiated and facilitated the successful sale of businesses.

We are pleased to announce that we continue to grow and have added three new people during the past year: Jim Spencer, CFA; Gabrielle Watters-Smith; and Anita Doran.

We would like to sincerely thank all of you who, over the years, have entrusted us with your valuation and transaction projects. We pride ourselves on performing your work thoroughly, ethically, efficiently and objectively. We will continually strive to earn your confidence. For those of you who have not yet had the opportunity to use our services, we urge you to please consider us for your next valuation or transaction matter. We hope that you enjoy our new look and, more importantly, the information that it offers you. Of course, we welcome your comments and suggestions.

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# Court Case Updates

## Delaware Chancery Court Values Stock at Almost Four Times the Going Private Price

In re Emerging Communications, Inc. Shareholders Litigation, No. 16415 (Del.Ch. May 3, 2004, revised June 4, 2004)

*In re Emerging Communications, Inc. Shareholders Litigation*, No. 16415 (Del.Ch. May 3, 2004, revised June 4, 2004) (see our website for the full 117-page opinion), the Court placed a value of \$38.05 per share on the stock of Emerging

“The court ruled against the defendants on the ‘fair dealing’ issue as well as the ‘fair price.’”

Communications, Inc. (ECM). ECM was acquired in a two-step going private transaction at \$10.25 per share based on a fairness opinion.

The standard under which the court reviewed the transaction was “entire fairness”, which includes both “fair dealing” and “fair price.” The court ruled against the defendants on the “fair dealing” issue as well as the “fair price.” The case is now on appeal.

The acquiring company (which was owned by ECM’s CEO), ECM’s CEO and its directors were found jointly and severally liable to the plaintiff class in the amount of the difference between \$38.05 per share and \$10.25 per share. Most of the directors were considered not independent because of their ties to ECM’s CEO. Another aspect of unfair dealing was nondisclosures, including updated projections that were not provided to the committee considering the proposal and to this committee’s financial advisor.

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## Alternate Valuation Date Appropriate for Tax and Distribution Amounts

In re irrevocable Living Trust of Lang v. Chemical Bank (May 4, 2004). *Per Curiam*.

Decedent established a trust that held her shares of William E. Lang, Inc. Before her death in February 1997, **Burnside &**

**Lang, P.C.**, valued her stock at \$422,500, or \$7.20 a share.

### **Valuation evidence**

The issue in this dispute was the selection of the valuation date by the trustee, Chemical Bank. An alternate valuation date, the use of which was authorized by the trust, was selected to minimize the tax effect on the Trust.

Between the time of decedent’s death and the alternate valuation date, the corporation suffered significant operating losses, and decedent’s shares were valued at \$364,000, or \$6.204 a share, on the alternate valuation date.

William Lang, one of decedent’s sons, objected to the use of the alternate valuation date in determining the amount of the distributions. He argued that the date of death would be a more equitable date.

### **Holding and rationale**

The court of appeals upheld the trial court’s determination that the, “express terms of the trust required the use of the federal estate tax valuation.”

The court also noted that William Lang provided no evidence of why the valuation date was not equitable and why the valuation prepared by **Burnside & Lang** was invalid.

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## FLPs at issue under ‘testamentary device test’

Smith v. U.S., 2004 U.S. Dist. LEXIS 14839 (June 30, 2004)  
Magistrate Judge Baxter

This case was an order resulting from motions for summary judgment. At issue in this estate tax case was the recognition of certain restrictions set out in the partnership agreement. If the restrictions were recognized and declared valid, the partnership interest would be subject to a significant marketability discount which would result in a dramatic lowering of the estate’s tax burden.

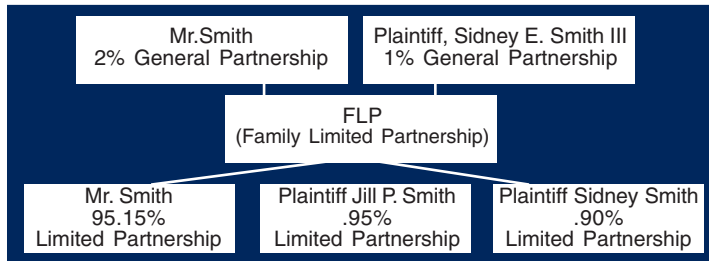
In 1997, the decedent and the plaintiffs formed a family limited partnership (FLP) under Pennsylvania law. The only asset of

# Court Case Updates

the FLP was the entire stock of an operating company known as Erie Navigation Company. The family limited partnership was structured as shown in *Exhibit 1*.

In 1998, Mr. Smith made two gifts to his children Sidney and Jill (the plaintiffs) that are detailed in *Exhibits 2 and 3*. The IRS disputed the value of the gifts. Mr. Smith died prior to this litigation, so his estate assumed his role in the matter.

## Exhibit 1: Structure Before Gift



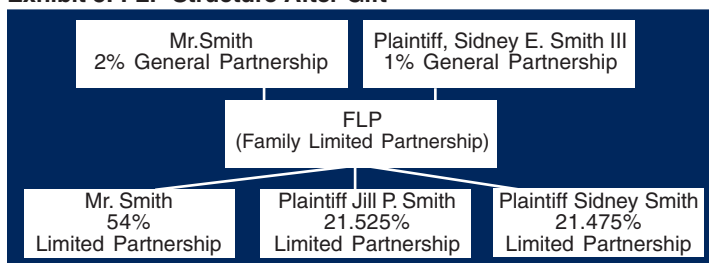
## Exhibit 2: Gift Value

Gift from Mr. Smith:  
20.575% of limited partnership interest to Sidney E. Smith III

Gift from Mr. Smith:  
20.575% of limited partnership interest to Jill P. Smith

Value of 41.15% gifted limited partnership interest	
Estate's value	\$1,025,392
IRS's value	\$1,828,598

## Exhibit 3: FLP Structure After Gift



In the partnership agreement, the parties agreed to limit the price and terms in which the partnership would be required to pay a partner for their limited partnership interest if the partnership exercised its right of first refusal.

## Valuation evidence

The plaintiff's valuation report reflected a marketability discount based on the limitations in the partnership agreement. However, the IRS disregarded the limitations in the partnership agreement, based on its reading of 26 U.S.C. §2703(a), which states:

- a) General Rule. - For purposes of this subtitle [governing estate, gift, and generation-skipping transfer taxes], the value of any property shall be determined without regard to –
- 1) any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right), or
  - 2) any restriction on the right to sell or use such property.

## Holding and rationale

Both parties filed motions for summary judgment. The magistrate judge concluded that the restrictions set out in the partnership agreement were subject to §2703(a) but that it had complied with the exception that was required by §2703(b)(1) (bona fide business arrangement test). The magistrate judge did not grant summary judgment to either party on the issue of whether the restrictive provision satisfies §2703(b)(2) (testamentary device test). That issue remained for trial.

## Summary Judgment

A summary judgment motion is a request by one of the parties for an immediate judgment based on the facts presented in the pleadings viewed in a light that is least favorable to the moving party. It is a procedural device for prompt and expeditious disposition of a controversy without trial when there is no dispute as to material facts or inferences that can be drawn from undisputed facts, or when only a question of law is involved. *Black's Law Dictionary (7th ed. 1999)*.

## Erroneous Assumptions Lead to Exclusion of Testimony

Jarrell v. Miller, 2004 La. App. LEXIS 2097 (September 9, 2004). Judge Brown.

The issue in this procedurally complex malpractice appeal was the damages caused by attorney's actions and inactions. **Harry Kenneth Lefoldt, Jr.** testified on behalf of the plaintiff. Lefoldt valued the stock of **Jarrell Transport Inc.** using multiple assumptions that never materialized. The appellate court did not discuss the expert's methodology but noted that because his assumptions were erroneous his testimony should have been excluded.

# VMI Highlights

**Value Management Inc.** welcomes **Gabrielle Watters-Smith** as our newest financial analyst. With a BS in finance from St. Joseph's University, Gabrielle brings with her more than 10 years of analytical experience. She is responsible for providing research and performing financial and economic analysis for the valuation of closely held enterprises for estate tax, gift tax and ESOP purposes. Gabrielle's e-mail address is [gws@valuemanagementinc.com](mailto:gws@valuemanagementinc.com).

**Andrew Wilusz**, ASA and Director of Mergers & Acquisitions at **VMI** will be speaking on March 15, 2005 to the Bucks County (PA) Estate Planning Council and on April 20, 2005 to the Mercer County (NJ) Estate Planning Council. The title of both presentations is: The "Five C's" of Ethics for Estate Planning Practitioners.

**Ed Wilusz**, ASA, CFA and President of **Value Management Inc.**, recently spoke at the 11<sup>th</sup> Annual Estate Law Institute in Philadelphia, PA. The topic for Ed's presentation was "Valuation

Discounts: Can They Be Sustained at a Tax Audit." A copy of his presentation is available upon request.

**Joseph Egler**, CFA, is presenting topics related to business valuations to various law firms as part of a "Lunch and Learn" series for the winter. Please contact him at our office if you would like to discuss a similar program.

## **First State Recycling of Delaware, Inc.**

Wilmington, DE

*has been acquired by*

## **First State Plastics, LLC**

Hudson, OH

## **Value Management Inc.**

initiated the transaction and served as financial advisor to First State Recycling, Inc.

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