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# Business Valuation

## E-Letter

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### CASE UPDATE

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### Is a 35 Percent Minority Discount Appropriate in a Statutory Buyout of Real Estate Partnership?

*Cannon v. Bertrand, 2008 WL 1734158 (Louisiana) (April 16, 2008)*

Here is yet another case in which the parties might have saved substantial effort and expense if their partnership agreement had provided a buy-sell clause—including direction on the appropriate standard of value and the application of discounts. Instead, because state law (Louisiana) permitted a factual determination of minority discounts in a partnership buy-out case, the trial court faced widely divergent sources and opinions, including dueling experts and a 1994 study of limited partnership pricing.

#### Experts posit discount range of 0% to 80%

The plaintiff owned a one-third interest in a partnership that harvested and sold timber from its 562 acres of forestland. In 2006, the plaintiff wanted to withdraw, but the parties were unable to agree on a value for his interest, forcing the plaintiff to seek judicial determination of his shares.

At trial, each party presented a “certified appraiser,” whose valuation of the partnership’s underlying assets including a timber appraisal by a professional forester. Each party also presented a CPA/valuation expert to extrapolate from the asset appraisal the value of the total partnership, and from that, the plaintiff’s share. From this evidence, the trial court determined that the total value of the partnership was \$1.05 million (the appellate opinion does not detail the experts’ respective valuation methods or conclusions). The plaintiff’s one-third interest was \$351,456.

Not surprisingly, the plaintiff’s expert claimed that a minority discount was not appropriate, because: 1) the partnership agreement did not address payments to a withdrawing partner; 2) the controlling statute entitles a withdrawing partner to “an amount equal to the value that the [former partner] had at the time the membership ceased”; and 3) unless the partnership is liquidated, an “automatic market” for the shares exist—i.e., in the remaining partners’ obligation to

repurchase the shares.

By contrast, the defendants' expert argued for applying a combined discount for lack of control and lack of marketability totaling approximately 80%. The defendants relied on a 1989 state Supreme Court case, which gives trial courts a broad, discretionary "tool" in the form of minority discounts to determine the "fair market value" of a withdrawing partner's share. In that case—which also valued a real estate partnership—the court applied a 33% minority discount. Second, defendants' expert cited a 1994 study, "Pricing Non-Publicly Traded Limited Partnerships," by Steven Kam, Hans Schroeder, and Curt Smith (Houlihan Valuation Advisors), which found an average 38% minority discount for partnerships traded in the private, secondary market.

The trial court's ruling fell nearly halfway in between the expert opinions. It applied a 35% minority discount to reach "a true market value" for the plaintiff's interest of \$228,447. The plaintiff appealed the decision on four grounds, "the crux of each...that the trial court should not have used a minority discount in determining the value of the partnership share."

### **Appellate court stresses 'fair market value'**

The appellate court began by confirming the broad, discretionary basis that the state Supreme Court precedent permits trial courts for determining the value of a withdrawing partner's share—which is "fair market value...in a true arms length transaction." In these cases, the most significant adjustment to fair market value recognizes that a withdrawing partner's share "is a minority interest in a closely held business."

Thus, it was "certainly feasible" that an outside investor would be unwilling to pay a full one-third of the partnership's value for the withdrawing partner's interest, the court said, particularly because the main asset was land. The situation is not analogous to a partner's withdrawal from a professional practice, where the interest's value is often closely tied to the partner's personal reputation and goodwill (thereby making the application of a discount more tenuous). In fact, when the plaintiff's own expert was asked under cross-examination whether he would—in a hypothetical, outside sale scenario—"recommend that your client...pay a full one-third for" the interest, the expert replied simply, "No, sir."

The appellate court also discredited the plaintiff's expert's rationale for not applying discounts in this case. "First, had the partnership agreement addressed the issue of payment to a withdrawing partner, there would likely be no need for judicial determination of the value of [those] shares." Second, the controlling statute and case law require finding the "true market value" of the shares in an "arms length transaction," which contradicts the expert's position that the court should find an "automatic market" for the shares in the remaining partners.

Finally, the trial court applied a discount that fell well within the experts' range of discounts (0% - 80%) and within the average posited by the 1994 study. Based on all of these factors, the court of appeals upheld the 35% minority discount.

For the full text of the court opinion go to: <http://www.bvresources.com/asa>

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