

2nd Post-Bernier Court Says Income Approach May Be Preferred, But Not Exclusive

Case name: Palmerino v. Palmerino

Citation: 2011 WL 1450359 (Mass. App. Ct.)(unpub.)

Date of decision: April 15, 2011

Country: US

State or Federal: State

State/Jurisdiction: Massachusetts

Court: Court of Appeals

Type of action: Marital Dissolution

Experts: David Gannett (joint expert); Felix Betro (husband's expert)

Judge: Rubin

***Palmerino v. Palmerino*, 2011 WL 1450359 (Mass. App. Ct.)(April 15, 2011)(unpub.)**

After a 35-year marriage, the parties filed for divorce. By far, their largest asset was the husband's one-third interest in Big Bunny Market, Inc., a closely held grocery store business founded by his father in 1947.

Expert changes his opinion at trial. The parties' joint expert, a CPA and professional business appraiser, valued the husband's stock in the S corporation at \$557,000, based on the net asset approach and after the application of a 20% discount for lack of marketability and a 20% discount for lack of control. At trial in 2007, counsel for the wife asked the expert about the then-recent case, *Bernier v. Bernier*, 449 Mass. 774 (2007) (see the November 2007 *BVU*). The expert testified that valuation professionals were still "wrestling" with the import of *Bernier*, but in light of its holding—which barred marketability and minority discounts absent evidence of an imminent sale or other "extraordinary" circumstances—he said that discounts were "likely" no longer applicable in this case. Accordingly, he adjusted his valuation of the husband's shares in the closely held corporation to roughly \$870,000.

After the expert changed his opinion, the trial court permitted the husband to present a rebuttal expert, a CPA and certified valuation analysis. The husband's expert criticized the joint expert for improperly including leasehold improvements in his valuation and for using the net asset approach, which improperly equated net book value of the ongoing business to fair market value. He believed that the more "accurate and accepted measure" of such a business was the income approach, which the joint expert had discussed in his report but dismissed "without explanation," the husband's expert said. Applying the income approach to the same data that the joint expert used, the rebuttal expert calculated the value of the husband's 33% interest at \$534,000. Notably, the rebuttal expert excluded minority and marketability discounts from this value, agreeing that they were inapplicable after *Bernier*.

Notwithstanding this second opinion, the trial court adopted the \$870,000 value by the parties' joint expert, and the husband appealed. The judge erred by failing to apply discounts, the

husband argued; he distinguished *Bernier* by its reliance on direct evidence that the grocery store in that case was “not for sale at any price.” The husband also claimed that the trial court erred by applying net asset value to a going-concern enterprise.

Implicit fair value standard applies. The appellate court disagreed on both counts. First, the absence of direct testimony indicating that the family supermarket would not be sold was “inconsequential” in light of other indirect evidence, including the husband’s statements that the next generation was being groomed to take over the business. Further, the *Bernier* court made it clear (albeit in dicta) that “neither a marketability nor a minority discount should be applied absent extraordinary circumstances,” the court held. In particular, the trial court should be careful to treat the parties “not as arm’s-length hypothetical buyers and sellers in a theoretical open market, but as fiduciaries entitled to equitable distribution of their marital assets,” the court said, citing *Bernier* and its reliance on *Brown v. Brown*, 348 N.J. Super 466 (2002)(see the May 2002 *BVU*).

Second, the trial court’s reliance on an asset-based valuation did not undermine its ultimate decision, the appellate court held. “While the income approach has emerged as the dominant approach in business valuation, the weight of authority does not support the husband’s assertion that it is the only appropriate measure of [the grocery store’s] value or that the use of any other methodology is clearly erroneous,” the court explained, citing Shannon Pratt and Alina Niculita, *The Lawyer’s Business Valuation Handbook* (2nd ed. 2010)(available at BVResources.com). (See also the discussion by the Mass. Supreme Judicial Court of the direct capitalization method as the “preferred” method for valuing corporations, stocks, and similar interests in the *Adams* decision on page **XX** of this issue.)

“The valuation of an S corporation is an inexact science,” the court added, citing *Bernier* again. “There is no standard method for the valuation of shares in close corporations.” In the absence of a determinable market value, the court said, “experts commonly value a closely held business by the assignment of value to the assets of the business (as was done here) and by the capitalization of earnings (as was done in *Bernier*).” The court also quoted at least one authority for the proposition that the return-on-investment method can often be speculative and therefore “a dubious basis” for evaluating business assets in the context of divorce.

Accordingly, the court affirmed the undiscounted value of the husband’s interest in the grocery store business as reasonable and within the range of evidence at trial. *Note:* Unlike the *Adams* case, the *Palmerino* opinion does not indicate whether tax-affecting the S corporation ever came up at trial, leaving appraisers and attorneys to keep wrestling with the issue, in Massachusetts and beyond.