Fair Value Standard in Mass. Precludes Any Discounts in Divorce

Case name: Caveney v. Caveney
Citation: 2012 Mass. App. LEXIS 32
Date of decision: Jan. 12, 2012
Country: US
State or Federal: State
State/Jurisdiction: Massachusetts
Court: Court of Appeals
Type of action: Marital Dissolution
Experts: Steven B Boyles (wife); Bernard L. Caniff Jr. (husband)
Judge: Graham
SIC: 1521 -- Specific categories --

Massachusetts first established the fair value standard in divorce with *Bernier v. Bernier*, 873 N.E.2d 216 (Mass. 2007). In that case, the Supreme Court held that the value of a closely held corporation should not be "unfairly deflated" by a marketability discount, absent extraordinary circumstances such as evidence that the company was about to be sold or converted to cash.

Carve out an exception for restricted shares? In the current case, the wife held a quarter interest (24.75%) in three different family-owned construction companies. Her three siblings held identical interests in the same businesses, which their father controlled with a 1% voting share in each.

At her divorce trial, the wife's expert applied the "fair value standard" to value the three interests under the income, asset, and market approaches. At the time of the valuation (Dec. 31, 2008), the economic crisis had "driven the income approach . . . out of favor related to these types of businesses," he explained, which were "very asset heavy." Since the risk of "tainting" the earnings from these firms was so high in the current economy and could actually drive their value below what the assets themselves could attain, the expert believed that an adjusted net asset value approach was the most appropriate in this case.

Accordingly, he determined that the wife's 24.75% interest in the primary construction company was worth approximately $490,000, to which he applied a 15% discount for lack of control and a 30% discount for lack of marketability, for an ultimate value of $291,000. Due to the intertwined natures of the second and third companies, he combined them into a single entity, valuing the wife's interest (after application of the same discounts) at roughly $127,000.

In response, the husband's expert defined the "fair value standard" in its simplest form as "fair market value without discounts." He also understood that *Bernier* required this interpretation of the fair value standard in Massachusetts divorce cases. Nevertheless, the trial court adopted the approach and the valuation by the wife's expert, and the husband appealed.

On appeal, the wife argued that this case was distinguishable from *Bernier*. Although the businesses were not under any imminent threat of sale, as a "practical matter," the wife could not "sell, transfer, or pledge her shares"; nor could she convert them into cash. Under these facts, a discounted value was warranted, she said.

The Court of Appeals agreed that these facts differed from those in *Bernier*, which involved two closely held, wholly owned supermarkets. However, the "principles espoused in *Bernier* concerning the valuation of closely held businesses in the divorce context" also applied in this case. As in *Bernier*, none of the wife's businesses were about to be sold or converted to cash. In these circumstances, "liquidity, a hallmark of the marketability discount, is of little consequence," the court said, and to apply a marketability discount would "unfairly deflate" the value of the wife's interests. Further, although *Bernier* did not squarely address the application of a minority discount, the decision, "through dictum, made clear that such a discount should not be applied absent extraordinary circumstances," the court held.

Asset approach also appealed. The husband also argued that the wife's expert (and, consequently, the trial court, in adopting his ultimate valuation) erred by applying the asset approach rather than an income approach. The appellate court dismissed this contention, however. In particular, it credited the testimony and report by the wife's expert that described why the economic crisis had rendered the income approach "practically meaningless" in this case and made the asset approach preferable. The court also noted that the husband's expert had applied an asset-based approach, albeit as a "baseline" valuation.

"While it has been stated that the consensus approach to valuation deployed by appraisers and experts in marriage dissolutions has coalesced around some variation of what is known as the 'income approach,'" the court said, citing *Bernier*, "we do not think a judge is necessarily precluded from relying on an asset-based valuation." Consequently, it refrained from "further disturbing" the trial court's findings and remanded the case solely on a recalculation of value without the discounts.