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# HYDE Valuations, Inc.

We Value Both Real Estate and Businesses  
Including Machinery & Equipment

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## *What is Fair Value?*

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So, you've got a client who needs to put together a Buy-Sell Agreement and wants to make sure that everything is set to Fair Market Value. Sounds like a relatively simple matter, right? Be careful!

Several items must be considered before a decision regarding the appropriateness of using the Fair Market Value Standard should be made:

- 1) How did the partners originally buy into the deal?
- 2) Did everyone pay pro rata based on their individual ownership percentage?
- 3) When the company eventually winds up, are the partners going to expect to be paid their pro rata percentage of the proceeds,
- 4) or will discounts for lack of control and lack of marketability apply?

For the most part, everyone has paid in capital based on their pro rata ownership and will expect to be bought out at the same rate in the end. The problems begin with the differences between the definition of "Fair Market Value" and "Fair Value".

Fair Market Value involves a hypothetical scenario where both potential buyers and sellers take into consideration the various characteristics of the subject interest being appraised, including the lack of control and the lack of marketability typically associated with ownership of a minority (non-controlling) interest in the business.

Fair Value, for the most part, involves taking a pro rata percentage of the whole and not applying any discounts whatsoever. Of course, there are States that have determined that one or more discounts may apply under the Standard of Value of Fair Value.

Fair Value is generally the appropriate Standard of Value for shareholder oppression cases, most buy-sell agreements, and in some areas, divorce cases.

Fair Value is defined differently in every state but the following definitions are commonly used:

Fair Value is defined by the Revised Model Business Corporation Act as:

The value of the shares immediately before the effectuation of the corporate action to which the shareholder objects, excluding any appreciation or depreciation in anticipation of the corporate action unless exclusion would be inequitable.<sup>1</sup>

In 1999, the Model Act was amended and the revised definition of fair value is as follows:

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<sup>1</sup> Jay E. Fishman, Shannon P. Pratt, J. Clifford Griffith, and D. Keith Wilson. PPC's Guide to Business Valuations, Volume 3, Thirteenth Edition. (Fort Worth, Texas: Thomson Publishing, 2003), p. 1502.4.

“Fair value” means the value of the corporation’s shares determined:

- (i) immediately before the effectuation of the corporate action to which the shareholder objects;
- (ii) using customary and current valuation concepts and techniques generally employed for similar businesses in the context of the transaction requiring appraisal; and
- (iii) **without discounting for lack of marketability or minority status** except, if appropriate, for amendments to the articles pursuant to section 13.02(a)(5).<sup>2</sup> [bold items highlighted in text by authors].

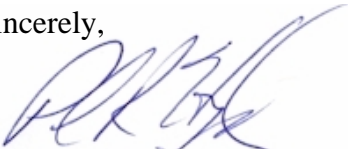
“As of the date this Guide went to press [published January 2003], only Mississippi and West Virginia have adopted the RMBCA’s 1999 version of the definition of fair value. Several court decisions, however, have quoted the revised RMBCA definition in support of disallowing discounts for minority status and/or lack of marketability.”<sup>3</sup>

The actual “definition” of Fair Value is determined by an attorney (or the court) after a review of appropriate case law in each state as of a specific date. However, when used in an agreement, such as a buy-sell agreement, many attorneys define the term as they intend it to be used: i.e., fair market value without any discounts for a minority interest such as, but not limited to, discounts for lack of control or lack of marketability.

We are always happy to discuss how an appraiser would typically determine the value of a company, or other investment, using the standard of value you selected, in order to assist you in achieving the goals that you and your client(s) have in mind.

Valuations play a part in all strategic transactions, tax, and many litigation matters. For additional information or advice on a current situation, please do not hesitate to call. **We value both real estate and businesses including machinery & equipment.**

Sincerely,



Paul R. Hyde, EA, MCBA, ASA, MAI  
Enrolled Agent – Enrolled to Practice Before the IRS  
Master Certified Business Appraiser  
Accredited Senior Appraiser – Business Valuations  
Designated Member – Appraisal Institute (MAI)  
Certified General Real Estate Appraiser  
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<sup>2</sup> Jay E. Fishman, Shannon P. Pratt, J. Clifford Griffith, and D. Keith Wilson. PPC’s Guide to Business Valuations, Volume 3, Thirteenth Edition. (Fort Worth, Texas: Thomson Publishing, 2003), p. 1502.4.

<sup>3</sup> Jay E. Fishman, Shannon P. Pratt, J. Clifford Griffith, and D. Keith Wilson. PPC’s Guide to Business Valuations, Volume 3, Thirteenth Edition. (Fort Worth, Texas: Thomson Publishing, 2003), p. 1502.4.