

VALUATION OBSERVATIONS

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VLC

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DID I HEAR SOMEONE SAY ARBITRATION?

Arbitration in Northeast Ohio does not appear to be a very popular route to resolve issues in the domestic relations arena. So I found it intriguing to hear a friend in Detroit talk about his frequent experiences with arbitration in the DR setting. I would like to pass on to you his thoughts and experiences.

The Merits of Arbitration in Family Law: A Financial Expert's Perspective

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Having served as an expert in a handful of family law arbitrations during the last year, and having participated in and/or prepared for a similar number of courtroom trials during the same period, I surmise (and this is not a stretch!) that the use of arbitrations in family law settings will continue to increase in popularity. The merits of arbitration in family law are numerous...

1. Informal process
2. Efficiency (which translates into cost savings!)
3. Selected trier of fact
4. Privacy

Informal Process

In courtroom trials, experts are often limited by the formality of the judicial process in their ability to inform the trier of fact about their conclusions (i.e., advocate for their opinion.) Rather, the onus of this task falls squarely on the attorney. In order to prove a client's position to a trier of fact, the attorney must not only possess the ability to understand the complex financial issues to which the expert will testify (such as business valuation), but also have the ability to ask logical questions of the expert in order to draw out meaningful responses. While this song-and-dance can certainly be prepared ahead of time, the rehearsal becomes meaningless if an expert's position is damaged upon cross examination. At that point, the attorney and expert rarely have sufficient time to prepare recovery questions and answers. The responsibility of rebuilding the expert's position falls to the attorney who, while knowledgeable about most financial issues in divorce, may not have picked up on the "smoking gun" to which his own expert just testified on cross examination.

While the judicial process in arbitration can certainly mirror that of a courtroom trial (adhering to strict evidence rules, with formal direct, cross, re-direct, and re-cross examinations of each witness), I have most frequently encountered arbitrations with a far less formal process. In fact, it is not uncommon in arbitrations to have the experts freely discuss their positions and conduct cross examinations of each other without hearing a peep from the attorneys, thus alleviating or even eliminating the above-described courtroom dilemma when using experts on complicated financial matters. Arbitrations are often used to handle a single specific issue in a divorce, such as the value of a closely-held business, or identifying income available for support. In those situations, it has been especially effective and relatively cost-efficient to have the experts battle it out in front of an informed trier of fact without having to prepare lengthy Q&As with the attorneys.

Efficiency

A frequent problem encountered in family law is the assignment of a judge with a deep backlog of cases on his docket. The costs associated with a trial involving complex financial issues can be extensive. These costs can skyrocket if a judge with a full docket views your case as a bottleneck and agrees to hear your case between ten and noon every Tuesday. Arbitration gives clients certainty about their date of trial, and can alleviate the costs associated with having experts continually prepare for testimony that is repeatedly delayed until the following week, or even month. Most arbitrations can be heard in two to five consecutive days, with opinions being rendered in a matter of weeks, not months.

Selected Trier of Fact

As alluded to above, family court judges are assigned to divorce cases. Notwithstanding a clogged docket, this fact has additional implications. For instance, your case may be assigned to a judge that may not be particularly savvy with the obscure financial issues on which your client's case rests. This forces the attorney (and to some extent the experts) to not only present their opinions, but also educate as to why their opinions are relevant to the matter at hand. This dual role is not only costly, but can lead to unorthodox rulings.

For example, consider the importance of an early hearing in a divorce matter to rule on interim spousal support for your client whose spouse is an extremely wealthy owner of numerous privately-held businesses. However, through an elaborate scheme developed by his team of accountants, your client's husband has managed to show relatively little taxable income on the couple's federal income tax returns during the most recent years. How do you prove to a judge who is not financially proficient (in a cost-efficient manner!) that your client deserves the \$20,000 per month that she is accustomed to based on the recent corporate distributions received by her estranged husband, and not the \$4,000 per month the formal or informal "guidelines" suggest based on his reported taxable income?

On the other hand, your case may be assigned to a long-standing family court judge with a storied history of ruling on the very specific situation faced by your client in a manner contrary to your client's wishes. Because arbitration offers each party the opportunity to choose a trier of fact to hear the specific case at hand, this problem too (of frustrated clients who feel slighted based on their judicial draw) can be alleviated.

Privacy

Very simply, arbitrations are private. There's no public record of testimony given by witnesses or conclusions reached by the arbitrator, and there's no media coverage. In other words, parties can easily thwart attempts of their nosy neighbors or ruthless competitors to seek out the dirty details of their divorce.

Case Study

As a brief example, I participated in an arbitration involving, among other issues, the value of an employee husband's minority interest in a privately-held business that had been received via a series of gifts prior to and during the course of the marriage. As evident from the brief description, there were numerous issues at hand: 1) business valuation at the current date, at the time of each gift, and at the time of the marriage; 2) applicability of valuation discounts for lack of control and lack of marketability due to the minority interest in a closely-held business; and 3) separate versus marital property arguments involving the adequacy of the husband's father's trusts, the intent of gifts, and active versus passive appreciation of the husband's interest in the business.

The trier of fact, an experienced and knowledgeable arbitrator, recognized the inherent difficulties in conducting a formal judicial process. Accordingly, the arbitrator gagged both attorneys (who themselves had been warring at different stages during the divorce proceedings), and engaged each party's business valuation and trust experts directly. Each expert began by explaining his or her opinion to the arbitrator who periodically asked questions for clarification. The arbitrator then allowed each expert to "poke holes" in the opposing expert's opinion by asking questions about the latter's selected methodology and/or assumptions. After hearing these pseudo-cross examinations, the arbitrator then asked his own provocative questions challenging each expert's key assumptions (as drawn out in the pseudo-cross). By eliminating the normal Q&A process that occurs between attorneys and experts in the courtroom (not to mention the grandstanding, posturing, puffing and fluffing), **the arbitrator was able to hear this portion of the case in an afternoon, conduct follow-up questions the following morning, and render his final (and private) opinion addressing all pertinent issues in less than two weeks!**

If you would like additional information, or have a question, please do not hesitate to call.

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Terri Lastovka is the founder of Valuation & Litigation Consulting, LLC. Her practice focuses on business valuations and litigation consulting in the areas of domestic relations, gift and estate tax, probate, shareholder disputes, economic damages, and forensic accounting. She draws from a wide range of experiences, including public accounting, law, banking, and CFO. She has received extensive training from the American Society of Appraisers in the area of business valuation and works closely with members of the bar to effectuate practical settlements. Terri also serves as the Director of Legal & Finance for Journey of Hope, a grass roots non-profit organization providing financial support to cancer survivors.