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Expert Analysis

Methods of Valuation In Matrimonial Appraisals

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Matrimonial appraising is one of the most misunderstood areas of valuation for the attorney, appraiser and the court. Typically, attorneys will seek to obtain a Fair Market Value (FMV) of property. However, in a matrimonial situation, the FMV of property being appraised may differ depending on the nature of the assignment, the type of property being appraised, and the market in which the property might be sold. By using only the general term "Fair Market Value" without specifying a market or valuation method, the attorney leaves it up to the appraiser to determine the methodology and market to be used, which may result in a valuation that is not what the attorney needs, the court expects or the situation requires.

By employing an inappropriate valuation methodology, experts and attorneys risk having their valuations thrown out or even being sued by their clients. In one situation known to the authors, the retainer agreement prepared by a "neutral" appraiser appointed by the court[1] to value various items of jewelry spoke only of the "fair market value," but never defined or identified the value or market to be used. The wife substantially relied on the neutral appraiser's valuations when she agreed to accept the jewelry in lieu of cash or other assets as part of an agreed upon division of the parties' assets. However, when the wife (in need of cash) later sought to sell the items, she received no offers close to the appraised values. The wife is currently pursuing claims against the appraiser for substantially overvaluing the items and is considering an action against her attorney as well.

Therefore, it is important that a matrimonial attorney understand the different ways to appraise items and the role each method should play in placing a value on marital assets. This article can serve as a guide to the various markets and values (principally relating to the valuation of gems and jewelry) and provide suggestions to guard against misunderstandings that might and can occur in these situations.

The definition of FMV, derived from the IRS definition in Treasury Regulation §1.170A-1(c)(2), is typically stated as "the price that an item will sell for between a willing buyer and willing seller both with reasonable knowledge of the facts and neither under compulsion to do so." However, the IRS definition adds a provision generally not employed in matrimonial matters, to wit: "a retail price or the price to the final consumer of the product." Attorneys should note that appraisers are most likely to apply the IRS definition, which alludes to a retail price for the item (either new or used), in placing a value on items in matrimonial disputes.

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Many attorneys, however, are interested in ascertaining the value of the property in the hypothetical non-distress situation under which their clients need to convert the item to cash and obtain the best value for the item in a reasonable period of time. In these situations, it is common to sell items through an intermediary, such as a broker or auction house. Therefore, what attorneys need to receive is the Marketable Cash Value (MCV), which represents the net value to the client after paying fees or commissions to an intermediary.

MCV is often the correct valuation method for matrimonial disputes because it accurately reflects how the item would actually be sold. Since a court might order assets sold for cash and divided equitably or equally by the parties, the MCV of the item is generally fairest for all parties concerned, especially since different items may have different retail markups. A diamond may have only a retail markup of 20 percent to 30 percent over cost, depending on the store and location, while a piece of finished jewelry can range from 50 percent to over double the wholesale cost.

The MCV Process

Unfortunately, not all appraisers are trained in the process of establishing the MCV. Determining MCV requires the appraiser to "shop" the item to dealers and/or seek cash offers, creating a private "mini auction." Appraisers need to solicit and consider cash offers from several dealers who purchase and sell similar items and with whom they have consulted over a period of at least 30 days. Generally, this type of mini auction will produce the best and highest offer. In this manner, the appraiser can determine what the client will likely receive for an item, less any expenses of the sale (i.e., the net value to the client).

The appraiser should also consider if the item is salable at auction and take prior results into consideration. Auctions, however, can present several difficulties: (1) the client might have to wait for the right auction, which could be several months away, but may need cash immediately, (2) auction sales are not always predictable and results of prior auctions may not be indicative of future results, and (3) some items may not be items that can or should be sold via an auction.

The attorney representing a client in a matrimonial action must be mindful of all of these different factors and should determine his/

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her client's wishes or preferences in advance of engaging the appraiser (either "neutral" or independently retained) so as to assure use of the appropriate appraisal method or market for that particular matter. A failure to do so may lead to an unhappy client and, worse, a suit against the attorney for not ensuring that the client's interests were best served.

Which Method to Use

Although MCV may be the more appropriate valuation method in the majority of divorce matters, in some cases FMV may be appropriate. For example, high-end cars and fine art might require a FMV if the parties have agreed to an in-kind division of their property, under which one receives the cars and the other the artwork. A FMV of these items would indicate if there is any "loss of use of value" to one party (e.g., the paintings are worth more than the cars) so that the parties can then work out additional compensation, if necessary, to the party receiving property of lesser value.

To ensure that both appraiser and attorney are on the "same page" when considering a particular valuation situation, the markets and values used should always be clearly stated in the appraiser's retainer agreement. The attorney or attorneys should sign the retainer agreement, as should the client(s), to avoid any potential dispute as to the nature of the assignment and to protect the attorney (and appraiser) from subsequent claims that the appraisal utilized wrong values or markets and/or that it must be redone.

In cases where the appraiser is acting as a neutral expert (i.e., agreed to by both parties and/or appointed by the court), the market(s) to be considered must be agreed upon by both parties' attorneys and such agreement should be incorporated into the joint retainer agreement. It also should be incorporated into the court's order appointing the neutral appraiser. As an aside, appraisers need to bear in mind that they may be called upon to testify in court, in which case they could be questioned about prior valuations to make sure the expert/appraiser is not switching positions or opinions and acting only as a "hired gun" for one of the parties. The potential for such a claim being made only heightens the need to be vigilant in assessing each case, to make sure there is understanding and agreement on the markets and valuation methods to be utilized, and to adhere to the same standards and practices in each case.

Following are definitions utilized in valuations and examples of each, followed by two simple practice tips for attorneys:

Fair Market Value (FMV)—What a willing buyer would accept and a willing seller would pay for an item when neither is under any compulsion to buy or sell and both possess reasonable knowledge of the facts. By way of example: A diamond ring worn by a spouse might be resalable in the secondary marketplace (used) so the price would be what that ring would sell for to the end consumer at a secondary market retail price. In contrast, the end consumer for a parcel of 200 one-carat blue topaz stones would be a manufacturer who would use the stones to set into mountings and pay for the entire lot. This fair market value is then the wholesale price.

Marketable Cash Value (MCV)—This represents the remaining proceeds of sale of an item after deduction of any fees and commissions incurred in connection with that sale. For an auction sale, the MCV would be the net amount received by the client after payment of any commissions and fees incurred. However, when considering the use of auction results to determine MCV, the appraiser should also solicit or investigate cash offers from dealers (of that type of item), since cash sales or offers by several dealers over a period of at least 30 days might demonstrate true value.

The appraiser's retainer agreement should incorporate the specific valuation or method of valuation to be used for each item being appraised. In addition, where applicable, it is advisable to ask the court to incorporate such information in any order of appointment of a neutral appraiser.

Appraisers may combine, if possible, auction results and cash offers to determine a reasonable cash price for an item. An example of this is that a two-carat diamond ring's value would be based on what the diamond trade might pay in cash (typically 30 percent to 60 percent less than a price indicator such as the Rappaport Diamond Report). This type of item might be offered at auction where the value might reflect the same as the cash offer or it could be higher or lower depending on conditions at the auction that day. In contrast, a monogrammed gold bangle bracelet that has a small resale market would be purchased as scrap gold for cash and most likely not be offered at auction where it might reflect scrap value less fees.

Market (Cash) Value—This is the same as FMV but the lack of compulsion is removed and the items have to be sold in a given time frame. The term "Market Value" is sometimes used incorrectly to refer to "Marketable Cash Value." In short, market (cash) value is a cash sale in a given time frame with reasonable exposure in an open market where both parties are informed or advised of all of the facts.

Loss of Use of the Value—This concept is employed in "high value" and more "normal" situations where the parties are contemplating an in-kind division or exchange of assets in lieu of a sale. For example, one spouse wants to retain artwork valued at $5 million and the other wants to retain cars valued at $2 million. Both are losing the use of the other property. The party retaining the lesser valued item(s) (in this case the cars) would typically be entitled to a credit in some fashion to compensate him/her for the loss of use or possession of the higher valued items. The party retaining the cars would therefore be entitled to a credit of $1.5 million from the other (if assets are being divided 50/50), so each ultimately retains $3.5 million in marital asset "value."

Practice Tips

The appraiser's retainer agreement should incorporate the specific valuation or method of valuation to be used for each item being appraised. In addition, where applicable, it is advisable to ask the court to incorporate such information in any order of appointment of a neutral appraiser. Such inclusion of information will eliminate any potential for confusion or finger pointing at either the appraiser or attorney and/or displeasure if the resulting appraisal is not what the attorney or client actually wanted. It is recommended that the client be asked to sign off on the retainer agreement as well.

It is also advisable to inform the appraiser that he may need to update a report if it is prepared many months before the appraiser will be called upon to testify about its findings, at which point an updated valuation becomes necessary. The retainer agreement should make sure to incorporate additional fees to be charged for an updated valuation and/or appearing and testifying at a hearing or trial.

In conclusion, attorneys must understand and choose the appropriate markets and values to use in a particular case. Attorneys, clients, appraisers and when necessary the courts must agree on what market and valuation method should be used. Failure to follow these simple precautionary suggestions could result in confusion, delay, additional expense, and potential liability for the attorney and appraiser should the wrong market be used.

1. Compounding the problem, the neutral appraiser only sought the husband's signature on his retainer agreement/contract, communicated only with the husband or his attorney, and failed to review a "grading report" concerning a particular diamond stone which was one of the subjects of the appraisal.