

VALOREM PRINCIPIA

The Principles of Value

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Fair Trade and Firm Value: Understanding Antitrust Risk

By: Peter Butler, CFA, ASA

Antitrust and unfair competition may seem like risks far removed from the concerns of most daily business operations. However, due to the broad definition of anticompetitive trade, it is important that managers educate themselves about the risks of antitrust actions by and against their firm. Management that is not aware or does not understand antitrust law may expose their operations to depressed earnings or potential antitrust litigation. Firms of all sizes and intents need to understand their rights to fair trade and the effects of unfair competition on earnings and firm value.

The anti-trust regulations, designed to protect competition and free trade in the United States and in California, are limited in number but broad in scope. While the different antitrust laws are few, their reach to prosecute violations of fair competition is extensive. Combined, these straightforward but sweeping acts prohibit "any and all agreements, contracts, combinations, and conspiracies" where any party wields unfair control over consumers and other fairly competing firms.

Collusive conduct, proven through criminal or civil litigation, destroys firm value and may entitle victims of unfair trade practices, consumers and competing firms alike, to reparations of three times the proven loss. Anti-trust activities take two forms: horizontal and vertical. Competitors that collude in explicit or tacit unfair trade agreements or practices participate in horizontal collusion. Anti-competitive alliances between buyers and sellers define vertical collusion. Whether horizontal or vertical, federal law and state statutes supported by complex legal precedent outlaw unfair competition. Examples of free trade violation include: price fixing, bid-rigging, market division, and other non-price trade restraints, such as some exclusive dealing agreements, marketing arrangements, and tying arrangements.

- ◆ **PRICE FIXING:** Any agreement between two or more competitors to price their products a certain way or to limit the supply of their products available in the marketplace.

- ◆ **MARKET DIVISION:** Any agreement among competitors to sell to only certain areas or to certain customers.
- ◆ **TYING ARRANGEMENTS:** Any practice where a firm pushes or "ties" the sale of one product with another product, where in the absence of this tying arrangement the consumer would not have purchased the second product.
- ◆ **BID-RIGGING:** Any collusion among firms that eliminates arms-length competition among bidders for an asset that prevents pricing the asset at its true market value.
- ◆ **EXCLUSIVE DEALING ARRANGEMENTS:** Any agreement where a firm contracts or sells to only one firm in the market.

Firms of all sizes and intents need to understand their rights to fair trade and the effects of unfair competition on earnings and firm value.

SP&H can determine the damages to a firm that has operated in an industry where competitors have committed these unfair trade practices. If it is alleged that competitors have participated in market division, price-fixing, or any other anti-competitive practice, SP&H can quantify the damages, including lost profits and any diminution of firm value. We can also determine if the agreed-upon price for a firm was reasonable or fair in the event of bid-rigging allegations.

As expert witnesses in federal and state courts, we are accustomed to defending our conclusions against stringent, third-party scrutiny. Therefore, in the complicated world of anti-trust law and the specialized process of business valuation, the professional services and experience of SP&H are invaluable tools.

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Fair Trade*Continued from Page 1***Federal**

- **Sherman Act:** prohibits any and all "contracts, combinations, and conspiracies" that may be construed as anti-competitive in addition to proscribing monopoly power in an industry. Enforced by U.S. Justice Department.
- **Clayton Act:** outlaws certain exclusive dealing arrangements, tie-in sales, price discrimination and any mergers or acquisitions that would result in unfair market power. Enforced by Justice Department and Federal Trade Commission (FTC).
- **Federal Trade Commission Act:** designed to prevent any other violations of free trade not enumerated in the Sherman and Clayton Acts. Enforced by FTC.

California

- **Cartwright Act (Business & Professional Code 16720):** Defines anti-competitive horizontal and vertical agreements.
- **Unfair Trade Practices Act (Business and Professions Code 17031):** Bans sales of products at different prices in different locations within California with the intent to destroy or prevent competition.
- **Unfair Competition Statute (Business and Professions Code 17200):** Serves as a consumer protection statute.

Peter Butler, CFA, ASA is the manager of SP&H's San Diego office. He has specialized in business valuation and securities analysis since 1995. Mr. Butler also earned an MBA from SDSU with an emphasis in finance. Melanie Hohlfeld an intern at SP&H's San Diego office, assisted Peter.

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SANLI PASTORE & HILL, INC.

is pleased to announce that
 Forrest Vickery is now an
 Accredited Senior Appraiser (ASA)
 in Business Valuation



Forrest A. Vickery, ASA

Forrest has been performing business valuations since joining SP&H in 1995. Forrest is a shareholder of SP&H, a member of SP&H's Board of Directors, and manages SP&H's operations in Northern California. He has an Accredited Senior Appraiser (ASA) designation in business valuation from the American Society of Appraisers. Forrest has testified as an expert witness in several matters involving loss of business goodwill. Forrest's business valuation experience is diverse and includes valuations for estate and gift tax, marital dissolution, corporate dissolution, eminent domain, class action lawsuits, start-up companies, and Employee Stock Ownership Plans (ESOPs).

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***"Success usually comes
 to those who are too busy to
 be looking for it."***

**-Henry David Thoreau
 (1817-1862)**

“COURT OF APPEAL DETERMINES ENTITLEMENT TO COMPENSATION MUST BE DECIDED BY JUDGE, NOT JURY”

by Thomas A. Douvan and Kevin D. Siegel of McDonough, Holland & Allen

On September 6, 2002, the First Appellate District of the California Court of Appeal released for publication the most significant eminent domain decision published in quite some time. In *Emeryville Redevelopment Agency v. Harcros Pigments, Inc. et al.*, the Court of Appeal considered and resolved several critical issues that commonly arise in eminent domain litigation, including:

- ◆ Whether entitlement to goodwill is decided by the court or the jury;
- ◆ Whether a property owner may seek compensation for loss of goodwill when the owner's commercial use of the property is inconsistent with the property's highest and best (i.e., more valuable) use; and
- ◆ The admissibility of evidence regarding agency development plans for the site and agency purchases of neighboring properties.

As discussed below, the Court of Appeal decided each of these issues in the Agency's favor. This included rulings that: **(1)** the threshold determination of whether a property owner has established entitlement to lost business goodwill is for the judge, not the jury, and **(2)** a property owner may not seek compensation for lost business goodwill when the alleged, interim commercial use is not consistent with the valuation of the property for a higher and better use. This victory, achieved by McDonough, Holland & Allen as attorneys for the Agency, in consultation with business goodwill appraisers at Sanli Pastore & Hill, establishes new law and achieves a positive result for the Agency. In addition, it sends a strong message that the evidentiary rules applicable to condemnation proceedings must be enforced to prevent inflated verdicts.

TRIAL COURT PROCEEDINGS

At issue in the Emeryville Redevelopment Agency case was a 13-acre, highly contaminated property. The property, once the site of an ancient Indian burial shellmound, had more recently been used as a pigment factory. The Emeryville Redevelopment Agency obtained an order of possession for the 13-acre property in 1998 and proceeded with a multi-million dollar clean-up effort. The Emeryville Redevelopment Agency acquired the property for use in a mixed use retail, housing, hotel and entertainment redevelopment project as part of a redevelopment plan to transition blighted, formerly industrial properties to higher and better land uses.

The trial court was confronted with many difficult decisions regarding the admissibility of evidence. The trial court decided the goodwill entitlement issue in the Agency's favor. Specifically, the court ruled that the business was not entitled to lost goodwill when the property upon which it operated was being valued assuming a higher and better use. However, the trial court decided several controversial evidentiary issues against the Agency, thus giving rise to the Agency's appeal. For

example, the trial judge excluded evidence of the cost of soil contamination remediation and its effect on the value of the property (even though he admitted evidence of the cost of groundwater remediation). The judge also allowed evidence of the price paid by the Agency for the purchase of neighboring properties, and permitted the property owner's appraiser to assign different values per square foot of a comparable property straddling the boundary between the cities of Emeryville and Oakland (based on the theory that the portion in Emeryville was more valuable per square foot). In addition, the trial judge allowed the jury to hear extensive evidence of the Agency's redevelopment plans.

The jury awarded the property owner \$12.5 million. Both parties appealed, challenging the trial judge's decisions regarding the admissibility of the evidence.

COURT OF APPEAL DECISION

In a decisive victory for the Agency, the Court of Appeal rejected the property owner's appeal, affirming the trial court's ruling that the property owner was not entitled to present its lost goodwill evidence to the jury. The Court of Appeal declared that when entitlement to goodwill is disputed, the court, not the jury, must decide whether the condemnee has established entitlement. The Court of Appeal ruled that entitlement disputes must be decided by the trial judge even though some courts had allowed juries to make entitlement determinations and the eminent domain jury instructions include an entitlement instruction. This precedential ruling is consistent with the general rule that judges must decide all disputed issues in condemnation cases except for actual determination of value.

Further, the Court of Appeal determined that the trial court had correctly decided that the condemnee had not established entitlement, and therefore could not present evidence of lost goodwill to the jury. The Court of Appeal explained that the property owner's claim for lost business goodwill necessarily assumed that the property would continue to be used for industrial purposes. However, the property owner simultaneously appraised the property based upon its conversion to a higher and better (i.e., more valuable) use, which necessarily assumed the business would no longer operate on the property. Accordingly, the condemnee could not prove two of the entitlement factors set forth in the Eminent Domain Law: **(1)** that the loss of goodwill is the result of the taking (because the loss was due to the assumed change in land use), and **(2)** that the condemnee would not receive a compensation windfall by means of a double recovery (because the land uses for the goodwill and property value claims were mutually exclusive).

The Court agreed with the Agency on its appeal, ruling that the judgment as to the value of the real estate and fixtures and equipment must be reversed due to several errors regarding the admission of evidence prejudicial to the Agency. The Court of Appeal determined that the trial judge erred by allowing the property owner to offer

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NEWSFLASH

September 10th - Orange County

IRWA Chapter 67 Orange County

Nevin Sanli presented "The Entitlement: Case Studies of Successful Challenges to Large Goodwill Claims"

September 24th - Los Angeles

IRWA Chapter 1 Los Angeles

Nevin Sanli presented "The Entitlement: Case Studies of Successful Challenges to Large Goodwill Claims"

October 16th - Pacific Palisades

LAVA Investment Capital Conference Workshop 2002

SP&H will be sponsoring this event and Nevin Sanli will presenting "Valuation for Equity Financings"

October 21st - 22nd - San Francisco

CLE Eminent Domain Conference

Thomas Pastore will be presenting "Goodwill Loss Valuation for Eminent Domain"

November 12th - Los Angeles

California Society Certified Public Accountants - 2002 Tax Night

SP&H will be an Exhibitor

November 14th - Sacramento

Goodwill Loss Seminar II

"Advanced Topics - Goodwill Loss Analysis"

December 7th - Beverly Hills

28th Annual Family Law Symposium -

Beverly Hills Bar Association

SP&H will be an Exhibitor

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Court of Appeal

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evidence regarding Agency purchases of neighboring properties, permitting the property owner's appraiser to "appraise the comparable" by assigning different "zones of value" to the comparable property, and admitting evidence of the redevelopment project. The Court of Appeal also reversed the trial court's award for the fixtures and equipment because it was based on an assumption of a continued use that was inconsistent with the determination of the highest and best use, a ruling which is consistent with the goodwill ruling described above.

Natalie West and Richard Rypinski, of McDonough, Holland & Allen, were lead trial and appellate counsel for the Agency. They were assisted in the appeal by the authors and other attorneys at MH&A. During the discovery process and in preparation for trial, the Agency hired Sanli Pastore & Hill to review both parties' goodwill expert opinions and to advise Agency counsel regarding the entitlement and valuation issues. By consulting with Sanli Pastore & Hill and carefully analyzing and articulating the goodwill issues, the Agency was able to convince the trial court that the property owner could not claim a loss of business goodwill while simultaneously claiming compensation for the property's value based upon a higher and better use. This ruling was expanded by the Court of Appeal, which ruled that entitlement to loss of goodwill must first be proven to the trial judge before a jury may determine valuation of the loss. Given the nascent nature of this ruling, we recommend that those dealing with any goodwill entitlement issues, particularly where there is some overlap between property value and business value, consult with condemnation counsel and goodwill valuation experts in order to most appropriately analyze the situation.

For more information regarding this case or condemnation law generally, please telephone Thomas Douvan, Kevin Siegel or Ben Stock at MH&A's Oakland office (510-273-8780) or David Beatty at the firm's Sacramento office (916-444-3900). For information regarding goodwill valuation analysis, please contact Sanli Pastore & Hill at bizval@sphvalue.com or by telephone at one of its local offices.

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