1

Common Standards and Premises of Value

COMMON STANDARDS AND PREMISES

In this chapter, we provide a brief introduction to the standards of value that we discuss and analyze throughout this book. The premises and standards discussed in this chapter will be discussed in more detail in the upcoming chapters.

We begin by analyzing the meaning of value itself and why it is necessary to understand the implications of each standard of value. We also introduce two overarching premises of value: value in exchange and value to the holder. Then we briefly address how these premises of value impact the standard of value and the assumptions that underlie any given standard of value.

Oscar Wilde wrote:

> What is a cynic? A man who knows the price of everything and the value of nothing.[1]

Although Wilde commented on the metaphysical relationship between price and value as social concepts, this quote illustrates quite plainly that the words are not interchangeable.

1. Oscar Wilde, *Lady Windermere's Fan*, Act 3 (1893).

Price, Value, and Cost

In various reference works price, value, and cost are all defined with reference to one another.

Price, for example, is defined by *Webster's New World Dictionary* as "the amount of money, etc. asked or paid for something; cost. 2. Value or worth. 3. The cost, as in life, labor, etc. of obtaining some benefit."[2] *Black's Law Dictionary* defines *price* as "the amount of money or other consideration asked for or given in exchange for something else. The cost at which something is bought or sold."[3]

Webster's defines *cost* as "the amount of money, etc. asked or paid for a thing; price"[4]; *Black's* defines it as "expense; price. The sum or equivalent expended, paid, or charged for something."[5]

While price and cost are transactional outcomes, value is a less concrete concept, not necessarily requiring the arrival at a set price between parties in a transaction. Value exists in a sale, in an ongoing business, and in liquidation. The main question (and the primary focus of this book) is: By what standard should value be judged? Price certainly can sometimes represent value—one arrived at in a transaction. Cost sometimes can as well, insofar as it is the amount of money or compensation required to produce or purchase a product or service. Value, however, can represent a more general concept of worth that may not be easily represented by a transactional price or cost.

In his classic work, *Valuation of Property*, James C. Bonbright writes:

> The contrast between "value" and "cost" as fundamental concepts is that the former term refers to the advantage that is expected to result from the ownership of a given object of wealth (or to the market price that this advantage will command), whereas the latter term refers to the sacrifice involved in acquiring this object. This distinction is clear in our minds when we ask whether anything or any desirable human achievement "is worth what it costs" . . . Cost, then, is the price that must be paid for value.[6]

---

2. *Webster's New World Dictionary of the American Language* (New York: Macmillan, 1996), at 487.
3. Bryan A. Garner, *Black's Law Dictionary*, 8th ed. (St. Paul, MN: Thompson West, 2004) at 1266.
4. *Webster's New World Dictionary*, at 136.
5. Garner, *Black's Law Dictionary*, at 371.
6. James C. Bonbright, *Valuation of Property* (Charlottesville, VA: Michil Company, 1937).

Cost can take the form of an outlay of resources or forgoing other opportunities, the so-called opportunity cost. While cost may be incurred in acquiring value, value does not necessarily equate to cost.

Webster's has 13 definitions for *value*, ranging from "a fair or proper equivalent in money commodities, etc. for something sold or exchanged; fair price" to "that which is desirable or worthy of a scheme for its own sake; a thing or quality having intrinsic worth."[7] *Black's* contains two pages of definitions for term *value*, beginning with its primary general definition: "(1) the significance, desirability, or utility of something." The second definition is "(2) the monetary worth or price of something; the amount of goods, services, or money that something will command in an exchange."[8]

The interrelationship between the terms *price*, *cost*, and *value* and the ambiguities associated with them mandates clear, internally consistent, definitions of these terms.

Defining a Standard of Value

In 1989, the College of Fellows of the American Society of Appraisers published an opinion on defining standards of value. In that opinion, the College recognized the importance of defining the standard of value:

> . . . . the necessity to identify and define the applicable standard of value as a critical part of any appraisal report or appraisal engagement. It also recognizes that there legitimately can be different definitions of the same appraisal term and different contexts based either on widely accepted usage or legal definitions through statutes, regulations, case law and/or legally binding documents.[9]

With regard to business valuation, the College of Fellows asserts that: "every appraisal report or engagement should identify the applicable standard of value."[10] In addition, the Uniform Standards of Professional Appraisal Practice mandate identification of the standard of value in every appraisal.[11]

---

7. *Webster's New World Dictionary*, at 1609.
8. Interestingly, these two ideas represent the two premises of value that will be discussed later in this chapter, the first representing a value to the holder premise, the second representing a value in exchange premise.
9. *Valuation*, Vol. 34, No. 2 (June 1989) "Defining Standards of Value". Opinion of the college of Fellows.
10. Id. at 4.
11. Uniform Standards of Professional Appraisal Practice, 2006, Standards Rule 2-2 a(v) "state the type and definition of value and cite the source of the definition."

While stating a standard of value in an appraisal engagement seems like a straightforward concept, different standards may have different meanings in different contexts. Therefore, defining *value* and adhering to the assumptions inherent in a particular standard of value, especially in connection with a valuation for tax, judicial, or regulatory purposes, often is no easy task.

Bonbright perhaps sets the issue up best when he writes:

> At first thought one might suppose the problem with the finding value is a fairly simple one—or at all events, that it might be settled once and for all by consensus of those experts who were called upon to pass judgment on property values.[12]

He continues:

> When one reads the conventional value definitions critically, one finds, in the first place, that they themselves contain serious ambiguities, and in the second place, that they invoke concepts of value acceptable only for certain purposes and quite unacceptable for other purposes.[13]

Bonbright further suggests:

> [T]he problem of defining value, for the many practical purposes for which the term is used, is an exceedingly difficult one, deserving quite as much attention as does the technique in proof.[14]

The standard of value is a definition of the type of value being sought. The premise of value is an assumption as to the actual or hypothetical set of circumstances applicable to the subject valuation. Later in this chapter, we introduce the standards and premises of value that are critical to understanding valuation in the judicial and regulatory context.

Premises of Value

Throughout this book, we discuss two overarching premises of value: value in exchange and value to the holder. These premises affect the applicable standard of value. The premise chosen establishes the "value to whom?"

---

12. Bonbright, *Valuation of Property*, at 11.

13. Id. at 11.

14. Id. at 11–12.

- *Value in exchange.* Value in exchange is the value of the business or business interest changing hands, in a real or a hypothetical sale. Accordingly, discounts, including those for lack of control and lack of marketability, are considered in order to estimate the value of the property in exchange. The fair market value standard and, to some extent, the fair value standard fall under the value in exchange premise.
- *Value to the holder.* The value to the holder premise represents the value of a property that is not being sold but instead is being maintained in its present form by its present owner. The property does not necessarily have to be marketable in order to be valuable. We discuss later, however, that the value to the holder may be more or less than the value in exchange. The standard of investment value falls under the premise of value to the holder, as does, in certain cases, fair value.

These two premises represent the theoretical underpinnings of each standard of value. In other words, they represent the framework under which all other assumptions follow.

COMMON STANDARDS OF VALUE

In many situations, the choice of the appropriate standard of value is often dictated by circumstance, objective, contract, operation of law or other factors. In many instances, the choice of the standard of value may be clear, but the meaning of that standard of value is less clear. To the valuation professional, the application of a specific standard of value has significant implications regarding the assumptions, methodologies, and techniques that should be used in a valuation. For instance, What is being valued? Does the property change hands? Who are the buyer and seller?

In a judicial context, the standard of value is generally set by regulations (as in estate or gift tax), by statute (as in dissent and oppression), by case law (as either stated or implied by divorce cases in most states), or some combination of the above. In financial reporting, the standard is set by the Statements of Financial Accounting Standards. Next we introduce some common standards of value.

Fair Market Value

Fair market value is perhaps the most well known standard of value and is commonly applied in judicial and regulatory matters. Fair market value applies to virtually all federal and state tax matters, including estate, gift, inheritance, income, and ad valorem taxes, as well as many other valuation situations.[15]

The Treasury Regulations give the most common valuation definition of fair market value:

> The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.[16]

Black's Law Dictionary defines fair market value as "the price that a seller is willing to accept and a buyer is willing to pay on the open market and in an arm's length transaction; the point at which supply and demand intersect."[17]

The willing buyer and willing seller are presumed to deal at arm's length; they are independent third parties, not specific individuals, and therefore the price arrived at will not be influenced by any special motivations or synergies of a specific buyer. Fair market value implies a market on which the buyer and seller transact and assumes current economic conditions as of the date of the valuation.[18]

Under fair market value, discounts may be applied to shares of a closely held company if they lack control over the corporation or lack marketability. Additionally, the property is being valued assuming a sale, regardless of whether the property actually will actually be sold.

Estate and gift tax cases applying fair market value provide the most frequent interpretation of the definition and application of its principles. Using these principles, fair market value has been applied in other areas. In this book, when used in other contexts, the terms of fair market value are discussed only when they depart from the interpretation in estate and gift tax matters.

Fair market value is the espoused standard of value used in a number of states for valuations in connection with divorce. Generally, only assets that can be sold are considered under a fair market value standard. In these cases, only the elements of a company's assets, including certain types of goodwill that are salable, will be included in the valuation. In addition, discounts for lack of control or lack of marketability are usually considered.

---

15. Shannon P. Pratt, Robert Reilly, and Robert Schweihs, *Valuing a Business*, 4th ed. (New York: McGraw-Hill, 2000), at 28.
16. Treasury Regulation § 20.2031-1.
17. Garner, *Black's Law Dictionary*, at 1587.
18. Pratt, Reilly, and Schweihs, *Valuing a Business*, at 29.

Fair market value also acts as a default standard in shareholder dissent and oppression matters in states that follow the Revised Model Business Corporation Act. If one dissents or oppression is proven, absent special circumstances, fair value without discounts is generally applied.

Fair Value

Fair value may be the applicable standard of value in a number of different situations, including financial reporting, valuation of a company going private, shareholder dissent and oppression matters, corporate dissolution, and divorce.

The definition of fair value depends on its context. For financial reporting, fair value is defined in relevant accounting literature and is closely akin but not the same as fair market value. The definition of fair value from the Financial Accounting Standards Board for financial reporting purposes is:

> The amount at which an asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale.[19]

This definition is similar to the one used in estate and gift tax regulations, but it does not require that buyers and sellers be as well informed as in fair market value for estate and gift tax. While the parties are required to be uncompelled under the Treasury Regulations, fair value for financial reporting purposes prohibits only a forced or liquidation sale.[20]

In judicial appraisals, fair value is a legally mandated standard that applies to specific transactions and is commonly used in matters involving dissenter's rights and shareholder oppression. Until recently, there was no clear consensus on the definition of fair value in judicial valuations, but prevailing precedents have suggested that use of the term fair value distinguishes it from fair market value and the assumptions that underlie its application. While not clearly defined until the last 20 years or so, the most recent applications of fair value have established it, absent special circumstances, as the value of the shares on a pro rata enterprise basis.

---

19. SFAS No. 141, Business Combinations, Glossary, and FASB Concepts Statement No. 7, Using Cash Flow Information and Present Value in Accounting Measurement, Glossary of Terms.

20. David Laro and Shannon P. Pratt, *Business Valuation and Taxes* (Hoboken, NJ: John Wiley & Sons, 2005), at 285.

Investment Value

Investment value, in the nomenclature of business valuation, means the value of an asset or business to a specific or prospective owner. Accordingly, this type of value considers the owner's (or prospective owner's) knowledge, abilities, expectation of risks and earning potential, and other factors.[21] Investment value often considers synergies available to a specific purchaser.

For example, for some companies, investment value may reflect the added value to that company of vertical or horizontal integration. For a manufacturer, it may reflect the added value of a distributor in order to control the channel of distribution of the manufacturer's particular products. For other companies, it may reflect the added value to acquire a competitor in order to achieve the cost savings of combined operations and possibly eliminate some price competition.

For an individual, investment value considers value to the owner and typically includes a person's reputation, unique skills, and other attributes.

For these reasons, reflecting the *added* value of the combination of the company's or individual's unique attributes with the subject property, investment value may result in a higher value than fair market value, which reflects the value to a *hypothetical* investor and may not reflect the added value to an owner or unique purchaser.

Investment value crops up primarily in the context of marital dissolutions, whether the court calls it by that name or not. It is not uncommon to have a family law court's opinion refer to a standard of value by name, but upon reading the text of the opinion, one may find that the court considered some aspects of what the business appraisal community would view as a different standard of value, often investment value. In this context, investment value usually considers the value of property not to a hypothetical buyer or seller, but to its current owner. From a business valuation perspective, when a divorce court uses investment value in this manner, the particular buyer is the current owner, and the application of value to that particular buyer translates to an investment value. Hence, *investment value* is often used synonymously with *value to the holder*.

Fair market value is impersonal, but investment value reflects the unique situation of a particular person or company. For example, whereas Revenue Ruling 93-12 did away with family attribution in fair market value, a minority holder who is part of a family control group may not be accorded a minority discount under the standard of investment value.

21. Id. at 201–209.

Investment value can be measured, for example, as the discounted net cash flow that a particular investor would expect a company to earn, in the way that particular investor would operate it. For a potential corporate acquirer, for example, investment value could be measured as the stand-alone value of the subject company plus any revenue increases or cost savings that the buyer would expect to achieve as a result of the synergies between the companies.

Investment value considers value from these perspectives of the potential sellers and buyers:[22]

- Respective economic needs and abilities of the parties to the transaction
- Risk aversion or tolerance
- Motivation of the parties
- Business strategies and business plans
- Synergies and relationships
- Strengths and weaknesses of the target business
- Form of organization of target business

Intrinsic Value

Intrinsic value is the value considered to be inherent in the property itself. Intrinsic value is defined by *Webster's Dictionary* as "being desirable or desired for its own sake without regard to anything else";[23] and by *Black's Law Dictionary* as "the inherent value of a thing, without any special features that might alter its market value. The intrinsic value of a silver coin, for instance, is the value of the silver within it."[24]

Intrinsic value is not the legal standard of value in any federal or state statute. Nevertheless, the phrase *intrinsic value* is found in many judicial opinions regarding business valuation, particularly in family law cases and dissenting stockholder or oppressed stockholder cases. Because it connotes the inherent value of a thing, the term *intrinsic value* has often been used synonymously with the term *investment value*.

The concept of intrinsic value arises out of the literature and practice of security analysis. In fact, the most widely sold book ever on security analysis,

---

22. Laro and Pratt, *Business Valuation and Taxes*, at 285.

23. *Webster's Third New International Dictionary* (Springfield, MA: G & C Merriam Company, 1966).

24. Garner, *Black's Law Dictionary*, at 1587.

Graham and Dodd's Security Analysis, has an entire chapter on intrinsic value.[25] Graham and Dodd define intrinsic value as "*the value which is justified by assets, earnings, dividends, definite prospects, and the factor of management*" (emphasis original).[26]

According to Graham and Dodd, these four factors are the major components of intrinsic value of a going concern:

1. Level of normal earning power and profitability in the employment of assets as distinguished from the reported earnings, which may be, and frequently are, distorted by transient influences
2. Dividends actually paid or the capacity to pay such dividends currently and in the future
3. A realistic expectation about the trend line growth of earning power
4. Stability and predictability of these quantitative and qualitative projections of the future economic value of the enterprise

> In general, investment practitioners now concede the existence of an intrinsic value that differs from price. Otherwise, the merit of substantial expenditures by both Wall Street and investment management organizations for the development of value estimates on broad lists of common stocks would be highly questionable.[27]

In other words, when a security analyst says something like "XYZ stock is selling at $30 per share, but on the basis of its fundamentals, it is worth $40 per share," the $40 value is that analyst's estimate of the stock's intrinsic value, but the trading price on that date is $30 per share. If the analyst is right, the stock price may make it to $40 per share, in which case the intrinsic value would equal the fair market value.

Graham and Dodd say that "perhaps a more descriptive title for this estimated value is central value . . . intrinsic value is in essence the central tendency in price."[28]

However, as mentioned, the term *intrinsic value* has not been restricted to securities analysis. It has been used in connection with valuations for other purposes.

25. Sidney Cottle, Roger Murray, and Frank Block, *Graham and Dodd's Security Analysis*, 5th ed. (New York: McGraw-Hill, 1988).
26. Id. at 41.
27. Id. at 43.
28. Id.

Here is a representative example from a divorce case:

> The value of an item of marital property is its intrinsic worth to the parties; the worth to the husband and wife, the value to the marital partnership that the court is dissolving. (*Howell v. Howell*, 31 Va. App. 332, 523 S.E.2d 514 (2000))

Intrinsic value and investment value may seem like similar concepts, but they differ in that intrinsic value represents a judgment of value based on the perceived characteristics adhering to an investment itself, while investment value is more reliant on characteristics adhering to a particular purchaser or owner.[29]

While using the language of "intrinsic worth," the court applied a standard of value more closely associated with fair value, as treated in dissenting and oppressed stockholder matters.

Below is another representative example from a dissenting stockholder case:

> In *Robbins v. Beatty*, 246 Iowa 80, 91, 67 N.W.2d 12, 18, we define "real value" as the "intrinsic value, determined from a consideration of every relevant factor bearing on the question of value," including "the rate of dividends paid, the security afforded that dividends will be regularly paid, possibility that dividends will be increased or diminished, the size of the accumulated surplus applicable to payment of dividends, record of the corporation, its prospects for the future, selling price of stocks of like character, value of its assets, book values, market conditions, and reputation of the corporation. It is unwise to attempt to state every factor that may bear on value of stock in a particular case." *Woodward v. Quigley*, 257 Iowa 1077; 133 N.W.2d 38; 1965 Iowa Sup. LEXIS 599

As can be seen, courts may use the term *intrinsic value* rather liberally. Because of this, if practitioners are requested to determine the intrinsic value of a company or a fractional interest in a company, they should seek further definition or clarification of what type of value is being sought.[30]

---

29. Pratt, Reilly, and Schweihs, *Valuing a Business*, at 31.

30. Jay E. Fishman, Shannon P. Pratt, and J. Clifford Griffith, "PPC's Guide to Business Valuation," (Fort Worth, TX: Thompson PPC 2004), at 201.10.

Book Value

We do not go into depth about book value, as it is not viewed as a standard of value in the way standards of value are discussed in this book. *Book value* is an accounting term and refers to an asset's historical cost reduced by any allowances for unrealized losses or depreciation, impairment, and amortization. Essentially, for a company, book value is the value of owner's equity on a balance sheet, that is, assets less liabilities.[31]

COMMON OPERATIONAL PREMISES UNDERLYING THE STANDARD OF VALUE

While value in exchange and value to the holder are general premises under which the standards of value fall, other operational premises further refine the assumptions that should be made under a given standard of value. For instance, in finding fair market value (a standard falling under a value in exchange premise), typically the valuation professional is looking to establish a value of a company either as a going concern or, when appropriate, upon liquidation. This operational premise of value may have a substantial effect on the value of property.

These operational premises impact the amount that will be paid upon the exchange of a business. For example, most businesses are valued under the premise that they will continue operating as going concerns. However, when valuing a controlling interest, there are times when the amount realized upon the liquidation of the assets and extinguishment of all liabilities is more appropriate. Either could be higher, depending on the nature of a business and the composition of its balance sheet. An accounting practice might have a high going concern value but a low liquidation value. A golf driving range, however, might be worth more if the land could be zoned for property development and sold in liquidation.

Going Concern

Most judicial valuations look to determine the value of a company as a going concern. *Black's Law Dictionary* defines *going concern value* as: "the value of a commercial enterprise's assets or of the enterprise itself as an active business

31. Pratt, Reilly, and Schweihs, *Valuing a Business*, at 308.

with future earning power as opposed to the liquidation value of the business or of the assets."[32]

In judicial valuations, it is often assumed that a company will continue functioning as it had been during and after the valuation. The circumstances of a business may be different because of the event necessitating or triggering the valuation, such as the death of a shareholder or key person, or the departure of a dissenting or oppressed shareholder. In other cases, the business may continue as usual, as in the case of a valuation upon divorce.

Liquidation Value

Black's Law Dictionary defines *liquidation value* as "the value of a business or of an asset when it is sold in liquidation, as opposed to being sold in the ordinary course of business."[33] This definition broadly encompasses the idea of liquidation value, that is, that assets and liabilities are valued individually. However, there may be additional refinements to the assumptions under liquidation value, mostly dealing with the time and circumstances surrounding the disposal of the assets and extinguishment of liabilities. Methodologically, liquidation value considers not only the proceeds from selling the assets of a business but also takes into consideration any associated expenses.[34]

The liquidation value of a business is most relevant in the case of an unrestricted 100% control interest.[35] There are different levels of liquidation. In the valuation of machinery and equipment, these levels are fairly well developed; there is orderly liquidation, liquidation value in place, and liquidation in a forced sale. As discussed, each level deals with the time and circumstances surrounding the disposition of the machinery and equipment. Pratt, Reilly, and Schweihs have attempted to apply these definitions to valuing a business:[36]

- *Value as an orderly disposition is a value in exchange on a piecemeal basis.* A value in exchange that contemplates the price at which the assets of a business will be sold with normal exposure to their appropriate secondary markets.

---

32. Garner, *Black's Law Dictionary*, at 1587.

33. Id.

34. Fishman, Pratt, and Griffith, "PPC's Guide to Business Valuation," at 201.12.

35. Michael Bolotsky, "Valuation of Common Equity Securities When Asset Liquidation is an Alternative," in *Financial Valuation: Businesses and Business Interests*, ed. James Warren Zukin. New York: Warren Gorham & Lamont, 1990 with annual supplements), at 10-3.

36. Pratt, Reilly, and Schweihs, *Valuing a Business*, at 33.

- *Value as a forced liquidation.* A value in exchange that contemplates the price at which assets will be sold on a piecemeal basis, but instead of normal exposure to the market, these assets will have less than normal exposure.
- *Value as an assemblage of assets.* A value in exchange, consisting of the value of the assets in place, but not in their current use in the production of income and not as a going concern business enterprise.

OTHER ISSUES

Fair Value in Alternate Contexts

In this book, we discuss fair value in the context of judicial valuations in oppression, dissent, and divorce and in the regulatory context of financial reporting. Although we do not go into further detail in this book, other contexts for fair value deserve mention.

Fair value is a central element in fairness opinions. A fairness opinion is generally prepared by a qualified financial advisor in the form of a letter, to state whether the financial terms of a proposed transaction are fair from a financial point of view. Fairness opinions are advisable in a variety of situations, including acquisitions, share buybacks, sales of assets, and related transactions. Typically, this standard applies regardless of whether the transaction falls under the state's statutory guidelines for shareholders who avail themselves of the appraisal remedy.[37]

The term *fair value* is also frequently used in the securities and futures markets. While it is not generally defined in this context, there are some specific definitions. Capital Markets Risk Advisors explains fair value as referring to: " . . . the price at which a single unit of an instrument would trade between disinterested parties in an arm's length transaction. Fair value does not generally take into account control premiums or discounts for large or illiquid positions."[38]

Standard and Poor's Advisor Insight gives this explanation for its use of what it calls "fair value" (this description is closer to the definition of intrinsic value, as we discussed earlier): "helps determine if the stock is a good buy based on S&P's proprietary quantitative model and our analysis of what the

---

37. Robert Reilly and Robert Schweihs *The Handbook of Advanced Business Valuation* (New York: McGraw-Hill, 2000), 311–313.

38. Capital Market Risk Advisors, www.cmra.com/html/body_glossary.html.

stock is currently worth."[39] These assessments, however, are all outside the scope of our studies for the purposes of this book, as we are primarily concerned with the tax, judicial, and regulatory treatment of standards of value, rather than their use in the financial markets.

Fair Market Value in Alternate Contexts

In this book, we are looking at fair market value solely in the context of a business valuation. One of the most common applications of fair market value is in the valuation of real property. However, in the valuation of real property, it is referred to as *market value*. The 2006 *Uniform Standards of Professional Appraisal Practice* defines *market value* as:

> A type of value, stated as an opinion, that presumes the transfer of a property (i.e., a right of ownership or a bundle of such rights), as of a certain date, under specific conditions set forth in the definition of the term identified by the appraiser as applicable in an appraisal.[40]

Fair market value in real estate is generally expressed in terms of the highest and best use for the property, as established by the Tax Court in the early twentieth century as may be seen in the Tax Court case *Kaplan v. United States*.[41] In this case, the owners of a parcel of property in Arizona were assessed a tax deficiency based on their acquisition of that property as payment for services rendered. While the taxpayers' assessor valued the property at $54,000, the Tax commissioner valued the property at $120,000 based on what he considered to be comparable sales in the area. The court acknowledged that the land should be assessed at its highest and most profitable use, given sufficient exposure to the market and the various other requirements of fair market value. In this case, however, the majority of the property was unimproved desert land located in the flood plain of a nearby river. Only a small proportion of the property had the potential for development, and therefore the land could not be valued as comparable to land with the potential for development.

---

39. S&P Advisor Insight Glossary, www.advisorinsight.com/pub/cust_serv/glossary.html.
40. http://commerce.appraisalfoundation.org/html/2006%20USPAP/DEFINITIONS.htm
41. 279 F. Supp. 709; 1967 U.S. Dist. LEXIS 10787; 68-1 U.S. Tax Cas. (CCH) P9113; 21 A.F.T.R.2d (RIA) 331.

It should be noted that in prior versions of this definition, the phrases *the most probable price* and *the highest price* for property have been used.[42] Interestingly, the term *highest price* used by real property appraisers in the United States is also used in Canadian business and property valuations.[43] In the United States, the concept of highest and best use may stretch into business valuations when determining whether to apply a value to the holder or value in exchange concept, or in determining whether to consider strategic purchasers. However, as mentioned, there are hundreds of different statutes that use fair market value, and most of them are beyond the scope of our analysis.

Standards of Value in the International Context

Just as the nature of business has changed within the United States in the past 150 years, the need for valuation guidelines has transcended national borders. Just as each state treats the standard of value differently across different areas of valuation, each country involved in business internationally may have its own independent standards and definitions of value.

In an attempt to resolve differences in definition, the International Valuation Standards Board (IVSB), a nongovernmental organization of the United Nations, has established guideline definitions. For example, *market value* is defined as:

> The estimated amount for which property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.[44]

42. Pratt, Reilly, and Schweihs, *Valuing a Business* at 30.

43. "Market Value—The highest price in terms of money, which the property will bring to a willing seller if exposed for sale on the open market allowing a reasonable time to find a willing purchaser, buying with the knowledge of all the uses to which it is adapted and for which it is legally capable of being used, and with neither party acting under necessity, compulsion or peculiar and special circumstances." www.coldwellbanker.ca/genglossary.html.

44. *International Valuation Standards*, 7th ed. (London, England: International Valuation Standards Committee, 2005), at 38.

It defines *investment value, or worth*, as:

> The value of property to a particular investor, or a class of investors, for identified investment objectives. This subjective concept relates specific property to a specific investor, group of investors, or entity with identifiable investment objectives and/or criteria. The investment value, or worth, of a property asset may be higher or lower than the Market Value of the property asset. The term investment value, or worth, should not be confused with the Market Value of an investment property.[45]

Similarly, the recent Toronto Valuation Accord has attempted to bring nations together in terms of accounting policy and definitions, and the Royal Institute of Chartered Surveyors, a group out of the United Kingdom, has attempted to resolve the differences in the U.K.'s standards and the International Valuation Standards established by the IVSB.

A broader discussion of International Valuation Standards is available in Appendix A, where we have compiled further information and definitions regarding international standards of value.

SUMMARY

This chapter provides a brief introduction to the premises and standards that we will address throughout the book. In the chapters to come, we address the origins of the standards of value in varying contexts and the judicial and regulatory decisions that provide insight into the underlying assumptions inherent in them. We will further discuss the standards in each context and issues surrounding their application.

---

45. Id. at 110.