Is There a “Best” Lack of Marketability Discount Model?

By Lance S. Hall, ASA*

Two decades ago, there was basically one approach valuation experts used to determine the discount for lack of marketability of a minority equity interest. That approach was the Benchmark Method, an approach that basically looked to the average discount found in restricted stock transactions. Today, in addition to the Benchmark Method, valuation experts can choose a discounted cash flow approach such as the Quantitative Marketability Discount Model, the Pre-IPO Approach, Hedging Models, or a Comparative Analysis of Restricted Stock Approach. All of these approaches have been developed to aid the valuation expert in more accurately determining the appropriate discount for lack of marketability. However, of all these methods is there a “best” method? Fortunately for the valuation industry there is a best method – The Comparative Analysis of Restricted Stock Approach (CARS). This paper will examine each of the approaches and show why the CARS approach is superior to the others.

Benchmark Method

Perhaps the most widely utilized approach to determine the discount for lack of marketability is the Benchmark Method. Over the years, numerous studies have examined the difference in price between a publicly traded security and its restricted (under Rule 144) twin. It is not uncommon to see in valuation reports the following table, or something like it:

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As the studies tend to coalesce around 35 percent, appraisers tend to use that average discount or attach a subjective premium to the average discount to account for the perceived greater illiquidity of a private company’s stock versus the restricted stock. In other words, the average discount acts like a “benchmark.” For the last three decades, the Benchmark Method has been the primary approach utilized by appraisers and has been widely accepted in Court.

Recently, the Benchmark Approach has come under criticism. The primary weakness of the Benchmark Approach is that it relies on averages and doesn’t involve a direct comparison with the underlying data. In *Peracchio*, the Court stated, “[w]hile restricted stock studies certainly have some probative value in the context of marketability discount analysis…[the Taxpayer’s Expert] makes no attempt whatsoever to analyze the data from the studies as they relate to the transferred interests. Rather, he simply lists the average discounts observed in several such studies, effectively asking us to accept on faith the premise that the approximate average of those results provides a reliable benchmark for the transferred interests. Absent any analytical support, we are unable to accept that premise….” In the *Temple*, the Court criticized the Taxpayer’s Expert’s use of the Benchmark Method saying, “[The Expert] simply listed the studies and picked a discount on the range of the numbers in the studies.”

Paraphrasing *Peracchio*, while restricted stock data is helpful in determining a discount for lack of marketability, merely referencing the average discount found in a study or a group of studies, is insufficient.

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The Quantitative Marketability Discount Model

This model is a discounted cash flow model to which Mr. Z. Christopher Mercer coined the term “Quantitative Marketability Discount Model” (QMDM). Essentially, the QMDM utilizes five inputs: (1) “The expected growth rate in value of the enterprise whose illiquid interests are being valued”, (2) “The expected distributions or dividends attributable to the investment”, (3) “The expected growth of the distributions”, (4) “The expected holding period”, and (5) “The required holding period return (discount rate).” Mr. Mercer’s firm, Mercer Capital, has taken these components and boiled them down into a table with possible holding period ranges across the top and discount rates on the left. The table then calculates the discount for lack of marketability for all of the different combinations of holding periods and discount rates. One table in a 2006 presentation by Mercer Capital showed a range of holding periods from 1 year to 30 years across the top and discount rates ranging from 16 percent to 24 percent on the left. The possible discounts for lack of marketability resulting from these combinations ranged from 1.7 percent to 92 percent.

This highly controversial and widely criticized model has not fared well in Court. While never affirmatively accepted in Tax Court decisions, Courts routinely reject the QMDM. In Estate of Weinberg the Court declared, “We disagree with the discount computed by [the taxpayer’s expert] on the basis of the QMDM model…. …we did not find the QMDM helpful….” In Janda v. Commissioner, the Court states, “…we have grave doubts about the reliability of the QMDM model to produce reasonable discounts…. Given the purposeful use of words in Court decisions it is especially revealing that the Janda Court used the term “grave doubts” to describe the QMDM. As a result of the Weinberg and Janda decisions, the author of Federal Tax Valuation declares that the QMDM has been “squarely rejected.”

Much criticism of the QMDM centers on the selection of a holding period (the time frame the hypothetical willing buyer/willing seller will hold the interest before the entire
entity will be sold). In a normal discounted cash flow valuation model, theoretically the value of the entity should not change whether you have a short or long holding period. This is because the terminal value incorporates the present value of all future cash flows. However, in the QMDM, differences in the holding period produce dramatic differences in value (longer holding periods have substantially higher discounts). In Weinberg the Court criticizes the QMDM saying, “We disagree with the discount computed by [the IRS’s expert] on the basis of the QMDM model because slight variations in the assumptions used in the model produce dramatic differences in the results.”

Moreover, the holding period, as used in the QMDM, is simply unknowable and, for privately held entities, cannot be determined with any degree of assurance. In other words, for most private company interests, a minority shareholder can sell their interest anytime. Selecting “when” a sale will occur requires, not judgment, but clairvoyance. For this reason the Weinberg Court states, “Because the assumptions are not based on hard data and a range of data may be reasonable, we did not find the QMDM helpful....” In March, 2006, the Temple Court again rejected the QMDM stating, “Although the Temple Partnerships have a 50 year term, there is no holding period requirement for the Temple Partnership interest. Partners do not have to hold their interests for a specific period of time. If a partner finds a willing buyer, and the partnership or other partners do not wish to purchase the interest, a partner is not prohibited from selling to a third party. Furthermore, the Court finds it is inappropriate to assume a particular holding period for the hypothetical willing buyer.”10 [emphasis added] The Temple Court further stated, “[the taxpayer’s expert’s] holding period assumptions are enough, in the absence of a holding period requirement in the...Agreement, to concern the Court with the reliability of that aspect of [the QMDM].”

After the many Court setbacks suffered by the QMDM, those appraisers who still wish to use the QMDM may better serve their clients by using the QMDM as a secondary approach which will reduce the risk of having the discount determination disregarded and, potentially, give Courts a chance to comment favorably on the QMDM.

The Pre-IPO Approach

The Pre-IPO Approach examines the price at which private company stock trades hands prior to its public offering and compares that price to the public offering price. While intuitively appealing, the Pre-IPO Approach has come under criticism for the following perceived weaknesses:

1) There is a time delay between the private stock transaction and the IPO. As a result, there may be other influences causing the differential in price other than lack of marketability.

2) Most Pre-IPO stock transactions involve company insiders or related parties that represent disguised compensation. By paying below market wages to insiders the

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10 Temple v. U.S. No. 9:03-CV-165 (March 10, 2006)
company increases its perceived profitability and, therefore, public offering price. The company compensates the underpaid insiders by selling them stock at below fair market value prices. While the Securities and Exchange Commission (SEC) is tasked with seeing that this does not happen, the scrutiny of the SEC is questionable as evidenced by stock-option backdating, biased research, sub-prime mortgage, and auction rate securities scandals.

3) There is a success bias in the data. The more successful a company is the more likely it will proceed with its planned IPO. However, those companies which do not achieve the expected success may not go public, as planned. Since more successful companies are likely to go public at higher prices, those companies within the Pre-IPO studies represent the most successful companies and, therefore, result in the highest discounts between the private transaction and the subsequent public price.

In 2003, the entire Tax Court in an en banc decision (McCord) stated, “[the IRS’s Expert] offers a compelling criticism of the [Pre-IPO] studies…. [the IRS’s expert] has convinced us to reject as unreliable [the taxpayer’s expert’s] opinion to the extent it is based on the [pre] IPO approach.”\(^\text{11}\) While there were numerous dissents in McCord, not one was in support of the Pre-IPO approach. In 2006, the Fifth Circuit overturned McCord on a technicality stating, “Our failure to address [the discount issue] should not, however, be viewed as either agreeing or disagreeing with the Majority’s determination on this point. Rather, as shall be shown, we have no need to reach it.”\(^\text{12}\)

On January 29, 2007, the IRS issued tax settlement guidelines titled, “Appeals Settlement Guidelines – Family Limited Partnerships and Family Limited Corporations” (“Guidelines”).\(^\text{13}\) Among other things, the Guidelines provide three examples where a Section 6662 penalty (and, presumably, appraiser penalties) should be considered, provided there was a “substantial” or “gross” under- or over-valuation. In Example 2, a penalty may be appropriate where an independent appraiser bases the FLP discount on “an IPO approach which compares the private-market price of shares sold before a company goes public with the public-market price obtained in the initial public offering of shares ….” This suggests that the IRS will give greater scrutiny to valuations utilizing the Pre-IPO Approach.

While the above Court case and Appeals Settlement Guidelines appear quite damaging to the Pre-IPO Approach, the recent Bergquist/Kendrick v. Commissioner case breaths new life into the Pre-IPO Approach.\(^\text{14}\) In this charitable contribution case, the IRS favored a low value and its expert utilized the Pre-IPO Approach (which generally results in higher discounts). According to the Court, the taxpayer’s expert “[has] not pointed to, nor do we find, significant flaws in respondent’s expert’s analysis or in the studies he relied upon.

\(^\text{11}\) Estate of McCord, 120 T.C. No. 13 (May 14, 2003)
\(^\text{12}\) No. 03-60700, Fifth Cir., (August 22, 2006)
\(^\text{13}\) UIL 2031.01-00
\(^\text{14}\) 131 T.C. No. 2 (July 22, 2008)
that would suggest his report is unreliable, and we adopt [the IRS’s expert’s] discounts and conclusions of value.”

Hedging Models

There exist two primary criticisms of this approach. First, for most privately held companies, the ability to create a perfect hedge is impossible. Therefore, hedge models have limited appeal for discount determination for privately held entities. Secondly, hedge models have nothing to do with liquidity, or lack thereof. Hedge models are almost entirely utilized to reduce risk, or lock in gains, for securities that are already liquid. In other words, since hedging takes place with already liquid securities, hedging models have no explanatory value for illiquidity. In fact, the value of an at-the-money hedge is totally related to its asymmetrical payout – the ability to participate only in the upside and not in the downside (or vice versa if a “put” option) – within a normal probability distribution framework. Liquidity, or lack thereof, does not follow an asymmetrical payout within a normal probability distribution environment. In other words, if the underlying “liquid” stock value increases or decreases, the illiquid investment will also go up or down in a similar, non-asymmetrical fashion. Or, if there is an asymmetrical payoff (going from illiquid to liquid), the asymmetrical payoff does not occur within a normal probability distribution framework. Both are requirements for the use of hedging models.

Comparative Analysis with Restricted Stock Approach

Ideally, a discount for lack of marketability would utilize data involving two classes of stock in the same company, where the only difference between the two classes was marketability (or lack thereof), and a transaction occurred in both stocks simultaneously. That data exists. It is called restricted stock.

Restricted stock is the term commonly used for the stock of a publicly traded company that is restricted under Rule 144 of the Securities Act of 1933. Currently, Rule 144 prevents the resale of unregistered stock in the public marketplace unless it has been registered or, after a holding period. However, Rule 144 allows for a sale of restricted stock to sophisticated private investors at any time, much like private stock. This type of transaction is commonly referred to as a private placement. By measuring the difference between the price of a restricted private placement and its publicly traded counterpart (what a willing buyer will pay and what a willing seller will accept for a limited liquidity

15 For further criticisms see Eckstein, Black Scholes and Marketability: Another View, Valuation Strategies, January/February 1999
16 This section is taken from “The Search for the Holy Grail,” Hall, Lance, The Value Examiner, July/August 2004
17 Originally the holding period was two-years and is now currently six-months.
asset) a discount is evidenced that reflects solely the lack of liquidity between the two otherwise identical stocks.

Where the CARS Approach differs from the Benchmark Method is that the appraiser digs through the underlying private placement transaction data to make comparisons based on factors that impact liquidity such as market value, revenue, profitability, and volatility, as well as other factors.

Increasingly, the Courts are favoring a CARS Approach. Recently, the Temple court stated “The Court finds reliability in the fact that [the IRS’s expert] endeavored to understand and incorporate the market dynamics of restricted stock sales” and “The better method is to analyze the data from the restricted stock studies and relate it to the gifted interests in some manner, as [the IRS’s expert] did.” 18 Courts in Kosman, McCord, Gross, Heck, Peracchio; Lappo and Holman have all commented favorably on the approach.19

Currently, three different CARS type approaches have been examined by the Courts: The Bajaj Method, The Burns Method and The FMV Method.

The Bajaj Method

The Bajaj Method is based on an academic paper titled, “Firm Value and Marketability Discounts” (Bajaj Paper), which examined the differential between discounts for private placements of registered stock and private placements of unregistered stock.20 The underlying premise of the Bajaj Paper is that if private placements of registered stock sell at a discount from the public price it must be for reasons other than lack of marketability since registered stock can be sold in the public marketplace. Moreover, the Bajaj Paper found that there were differences in the characteristics of the companies privately placing registered stock versus unregistered stock. Based upon statistical analyses to isolate the differences between the two data sets, the Bajaj Paper concludes that the discount for lack of marketability is limited to 7.2 percent.

There are a number of flaws in The Bajaj Method. Its most glaring flaw is the underlying premise that registered stock is liquid. The average block size of the registered shares in the Bajaj Paper is 13.1 percent. Under Rule 144, any block over ten percent must be sold under Rule 144’s dribble-out provisions. The dribble-out provisions of Rule 144 limit the amount of stock that can be sold in any quarter to the greater of one percent, or the average weekly trading volume over the four weeks prior to the sale. Based upon the dribble-out provisions of Rule 144, the average registered stock block in the Bajaj Paper

18 Temple v. U.S., No. 9:03-CV-165 (March 10, 2006)
20 Mukesh Bajaj, David J. Denis, Stephen P. Ferris, and Atulya Sarin, Journal of Corporation Law, Fall 2001
was not immediately liquid. Moreover, large blocks of stock suffer from what is termed “blockage.” Blockage is the inability to sell a block of stock in the public marketplace without negatively impacting the public stock price. As a result, all conclusions arising from the Bajaj Paper cannot be relied upon.  

While the Courts have generally favored The Bajaj Method’s comparative analysis with restricted stock, the Courts have yet to fully embrace The Bajaj Method, as it relates to privately held companies. In McCord, the Court stated,

[Dr. Bajaj’s] apparent confusion regarding the nature of the discount for lack of marketability (i.e., whether such discount can be explained purely in terms of illiquidity or whether other factors may be involved) is troubling. In his direct testimony, Dr. Bajaj is fairly clear that assessment and monitoring costs associated with private placements are outside the realm of the marketability discount. In his rebuttal testimony, however, he indicates that such costs may contribute to the marketability discount for a closely held entity.

While The Bajaj Method hasn’t been fully adopted by the Courts, it has received generally favorable comments in McCord, Gross, Heck, and Lappo.

The Burns Method

The Burns Method was developed by Mr. Francis X. Burns and was successfully introduced in Holman v. Commissioner.22 Mr. Burns divides the discount for lack of marketability into two components: “a market access (liquidity) component and a holding period component.”23 Mr. Burns further observes that over time as the SEC has relaxed the holding period requirement of Rule 144 from one-year to two-years, the discounts in restricted stock transactions have diminished. Regarding the “market access” component, Mr. Burns suggests that prior to 1990 there was essentially no market in which to sell restricted stock. However, the 1990 Amendment to Rule 144 allowed certain previously prohibited buyers of restricted stock to now buy restricted stock. Mr. Burns argues that, as a result of the 1990 Amendment, a market was created to purchase Rule 144 stock. The difference between the discounts observed prior to 1990 and those observed after 1990 (but before the one-year holding period went into affect in 1997) represent the value of marketability. All other portions of the pre-1990 discounts only reflected the effects of the holding period. The difference between the pre-1990 discounts and the post-1990 discounts, according to Mr. Burns, is 12 percent.

One primary criticism of The Burns Method is that it misinterprets the 1990 Amendment to Rule 144 and its impact on private company equity. First, the 1990 Amendment did

21 For further criticisms of The Bajaj Method see Hall, Chapter 15: The Courts’ Favored Discount Methodology: And What Your Appraiser Can Do About It, The University of Southern California Gould School of Law Fifty-Ninth Institute on Federal Taxation – Major Tax Planning for 2007, August 2007
22 130 T.C. No. 12 (May 27, 2008)
23 Ibid
not create a market for Rule 144 stock. The 1990 Amendment merely expanded the pool of buyers thus making Rule 144 stock more liquid. The 1990 Amendment did not, however, create greater liquidity for private held company interests. Prior to the 1990 Amendment, private company equity was more illiquid than restricted stock of a public company. The 1990 Amendment just made the gulf between private equity liquidity and restricted stock liquidity greater. The illogical conclusion underlying The Burns Method is that private company stock is more liquid than public restricted stock. All things being equal, that can never be.

Moreover, The Burns Method mistakes marketability as an on/off switch. The idea that prior to 1990 there was essentially no market for restricted stock and after 1990 there was a market so the differential in discounts is the cost to make a market defies logic. It is more accurate to view marketability as a continuum. On one end of the continuum is complete liquidity where you can receive cash for your shares immediately on a moments notice and on the other end of the continuum, the investor is prevented from ever selling or receiving cash for their investment, by law. Prior to 1990, restricted stock was still on the illiquid side of the liquidity continuum. The minor change in 1990 to Rule 144 merely made it slightly more liquid, but still on the illiquid side of the continuum. Subsequent changes to Rule 144 reducing the holding period time frame merely moved restricted stock closer to the liquidity side of the continuum. The relevant analysis then is where does private company stock fit in the liquidity continuum. Logically, private company stock must be more illiquid than any Rule 144 stock and, of the categories mentioned above, rest firmly on the most illiquid side of the continuum.

While The Burns Method proved successful in Holman, given its glaring weaknesses it is questionable that it will have further success.24

The FMV Method

In examining restricted stock transactions, FMV Opinions, Inc. (the author’s employer) observed that the discount varied based upon the underlying financial characteristics of the company. FMV found the following relationships:

The magnitude of the observed discount is negatively correlated with:
- the market value of the subject entity;
- the subject entity’s revenues;
- the earnings and net profit margin of the subject entity;
- the dividend payout ratio of the subject entity;
- the total assets of the subject entity;
- the book value of shareholders’ equity of the subject entity;
- the subject entity’s stock price per share;
- the trading volume of the subject entity’s stock; and
- the size of the block sold (dollar value).

The magnitude of the observed discount is positively correlated with:

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24 Ibid
The subject entity’s market-to-book ratio (market value divided by book value);  
the subject entity’s unrestricted stock price volatility;  
the subject block size relative to the trading volume of the stock; and  
the block size, described as a percent of the total ownership.

The following table examines 197 transactions under the two-year holding period limitations (the most illiquid) of Rule 144 and is divided into quintiles based upon the magnitude of the discount. The discount under a given quintile represents the median discount within that quintile. Financial characteristics of the companies falling within each quintile are then calculated. The concluded number represents the median within that quintile set (note: dollar values, except price per share, given in thousands).

<table>
<thead>
<tr>
<th>Quintile</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
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<tbody>
<tr>
<td>Discount</td>
<td>4.8%</td>
<td>13.0%</td>
<td>21.1%</td>
<td>31.2%</td>
<td>43.3%</td>
</tr>
<tr>
<td>Market Value ($)</td>
<td>114,206</td>
<td>69,239</td>
<td>63,217</td>
<td>40,137</td>
<td>24,760</td>
</tr>
<tr>
<td>Volatility</td>
<td>56.5%</td>
<td>58.1%</td>
<td>72.7%</td>
<td>77.7%</td>
<td>94.9%</td>
</tr>
<tr>
<td>Total Assets ($)</td>
<td>45,038</td>
<td>23,558</td>
<td>16,305</td>
<td>10,890</td>
<td>5,941</td>
</tr>
<tr>
<td>Revenues ($)</td>
<td>16,801</td>
<td>23,475</td>
<td>11,495</td>
<td>9,721</td>
<td>5,311</td>
</tr>
<tr>
<td>Price per Share</td>
<td>$8.75</td>
<td>$8.13</td>
<td>$5.85</td>
<td>$4.00</td>
<td>$4.00</td>
</tr>
</tbody>
</table>

*Registration Rights and Premiums Excluded. 197 Transactions in Sample.

As one can observe, the discount generally increases as the company revenues, market value and assets decrease. Moreover, discounts are greater for those firms displaying greater price volatility. For a privately held firm where volatility cannot be directly calculated a market-to-book value ratio may be used. Theoretically, the more a company’s value is dependent upon intangible assets the greater the investment risk. Overall, we believe that this type of comparative analysis is a superior way to show the relevance of Rule 144 data to the private company equity being valued.

In examining the restricted stock data, FMV also observed that under the dribble-out provisions of Rule 144 some blocks of restricted stock actually had liquidation time frames greater than the holding periods otherwise dictated by Rule 144. For example, a 30 percent block of restricted stock may have a two-year holding period before the investor can begin to sell it in the public marketplace. However, the dribble-out provisions basically limit any such sales to one percent of the total shares outstanding. Accordingly, dribbling out all of the stock would take 7.5 years after the holding period ended. Therefore, large blocks of restricted stock are more illiquid than small blocks of restricted stock even in the same company. The following table summarizes the results when the restricted stock transaction data is divided by the size of the restricted stock block.
While the size of the stock block affects the liquidity of restricted stock, this is not generally the case for private company stock. For a private company, a five percent block of stock is generally just as illiquid as a 20 percent block. Given the fact that private company stock is more illiquid than even the largest blocks of restricted stock, the large block restricted stock data provides a floor to the private company stock discount, regardless of the private company block size.

FMV takes this data and examines the discount in a two-step process. The following illustration provides a framework for the FMV two-step process.

<table>
<thead>
<tr>
<th>Pct. Shares Placed</th>
<th>Discount</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>High</td>
<td>Low</td>
<td>Median</td>
</tr>
<tr>
<td>More than 35%</td>
<td>42.80%</td>
<td>38.88%</td>
<td>48.72%</td>
</tr>
<tr>
<td>More than 30%</td>
<td>42.80%</td>
<td>30.42%</td>
<td>44.32%</td>
</tr>
<tr>
<td>More than 25%</td>
<td>42.80%</td>
<td>25.01%</td>
<td>39.69%</td>
</tr>
<tr>
<td>More than 20%</td>
<td>42.80%</td>
<td>20.48%</td>
<td>37.86%</td>
</tr>
<tr>
<td>Less than 20%</td>
<td>19.80%</td>
<td>0.10%</td>
<td>24.41%</td>
</tr>
</tbody>
</table>
The first step in The FMV Method requires a comparative analysis with the small block restricted stock data to derive an “as if” restricted stock discount for the private company interest. The second step is to develop a set of small-block and large-block data that share similar financial characteristics such that, except for block size, would otherwise share similar discounts. The differential between the “matching sets” for small block discounts and large-block discounts represents the private company discount increment. The following illustrates The FMV Method.

The reason that a direct comparison between the large-block data and the private company interest is not performed is that there remain relatively few large-block transactions to make such a direct comparison as meaningful. Accordingly, a comparison with the plentiful small-block data can be performed to arrive at an “as if” restricted stock discount. Then, a meaningful comparison can be performed between the large-block data and a set of small-block data that share similar financial characteristics to the large-block data. The discount differential between the large-block data and small-block data sharing similar characteristics provides direct evidence for an added incremental discount to reflect the greater illiquidity of the private equity interest.

The advantage to using the two-step FMV Method is that it recognizes that liquidity is a continuum and that, all things being equal, the private equity interest should always have a discount greater than a similarly situated large-block restricted stock interest, regardless of the size of the private company stock block. Further, this analysis is based on empirical, observable data. The data upon which The FMV Method is based was
victorious in Kosman. The disadvantage of using The FMV Method is that it requires analysis and analysis takes time.

Regardless of whether you choose to use The FMV Method, the underlying restricted stock data is available to the appraiser to use as they best see fit.

Summary and Conclusion

Over the last 30 years, appraisers have become more sophisticated in the methodologies utilized to determine the discount for lack of marketability. The Tax Courts play a unique role in impartially assessing the different discount methodologies. The Courts have repeatedly rejected the Quantitative Marketability Discount Model and have rejected the Benchmark Method and the Pre-IPO Approach. However, the Pre-IPO Approach may have some new life based on the recent decision in Bergquist/Kendrick v. Commissioner which supported the IRS’s expert’s use of the Pre-IPO Approach. Overall, the Courts seem to be favoring a Comparative Analysis with Restricted Stock Approach. However, there are different interpretations on how to use the restricted stock data. An examination of the underlying premise of The Bajaj Method and The Burns Method indicate serious problems with these methods. Nonetheless, the Courts have generally reacted favorably to the methods. FMV has introduced a two-step method that allows for a more relevant comparison between the restricted stock data and the private company interest utilizing financial characteristics that impact the magnitude of the discount. Moreover, The FMV Method explicitly recognizes that large-blocks of restricted stock are much more illiquid than smaller blocks of restricted stock and that such large-block stock discounts provide a minimum discount for private company minority blocks of any size. Finally, the two-step method provides a more meaningful discount comparison and support.

Simply put, the Courts favor a Comparative Analysis with Restricted Stock Approach and The FMV Method is currently the best approach to determine a discount under CARS.

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25 Estate of Kosman – T.C. Memo. 1996-112
26 For more about The FMV Method, see the FMV Companion Guide available at BVMarketData.com on the FMV introduction page.
27 Bringing Sanity to Marketability Discounts – A New Data Source, Espen Robak and Lance S. Hall, Valuation Strategies, July/August 2001, pp. 7-13,45,46. (Warren, Gorham & Lamont)