

MEDICALADVISORS, INC

TECHNICAL NETWORK CONSULTING SERVICE®

NON-COMPETE AGREEMENTS

ALLOCATION OF FAIR MARKET VALUE TO NON-COMPETE AGREEMENTS IN VALUATION OF PERSONAL SERVICE BUSINESSES Accountant from Massachusetts

Personal service businesses include accounting (CPA), law, medical and other practices where the clientele strongly identifies with an individual running the practice, be that person a sole proprietor, major stockholder, significant practitioner, etc. Commonly, such practices are sold on an earnout over a period of, usually, five years and require a non-compete agreement from the sole proprietor or other major players in the practice. The requirement of a non-compete agreement is key because it binds the Seller into assuring the continuing loyalty of the clientele and, commonly, the payments over time to the Seller are pegged to and contingent on retention of clientele existing at date of closing.

It is common in divorce and other matters for the opposing party (the Buyer) to value personal service businesses as if the Seller is compelled to consent to such a non-compete arrangement and payment over time. This flies in the face of the concept of Fair Market Value because:

The Seller is entitled to cash at closing
AND

The Seller is under no compunction to enter into a non-compete agreement. This event is separate and distinct from the Fair Market Value of the personal service business.

As a practical matter, particularly in divorce matters, one can often agree with the value assigned by the opposing party, i.e.: that party's opinion of what a Buyer would pay, said value being predicated on time payment of the purchase price and non-compete agreements. Such an agreed value is not Fair Market Value and needs to be adjusted for the following discounts:

AN ILLUSTRATION

| | |
|---|-------------------------|
| Agreed Value | \$700,000 |
| A. Discount for risk of accepting payment over time 30% | - \$210,000 |
| B. Discount for value of non-compete agreement | - \$250,000 |
| Fair Market Value | <u>\$240,000</u> |

Discounts, of course, vary with specific situations. In the above illustration:

- A. Who would not accept a 30% discount for payment today, which is implicit in Fair Market Value, as opposed to payment over five years?
- B. Assuming a practitioner with average earnings of \$250,000 / year, who would argue that the non-compete was not worth \$50,000 / year or $(\$50,000 \times 5) = \$250,000$?

The foregoing deals with the "sleight of hand" where the opposing Party / Buyer presents a valuation without discounting same to Fair Market Value.

The typical tractor/trailer combination weighs on the order of 30,000 pounds empty. Most are capable of transporting loads in the range of 50,000 pounds, making the cargo far heavier than the tractor and trailer itself. Should a load like this not be adequately secured in place, it may shift in transit, which can result in the tractor and trailer rolling over or the driver losing control. There is nothing subtle about a truck wreck. Tractor/trailer combinations are commonly about 65 feet long and 8½ feet wide and can have a gross vehicle weight of up to 80,000 pounds. When it rolls over or is otherwise involved in a wreck, it can cause catastrophic injuries and/or major damages. Defects in loads may take the form of a hidden hazard within the load. When a cargo vehicle is loaded, heavy goods should be placed on the bottom and lighter goods placed on the top. When heavy containers are placed on the top of a load, they can fall and injure material handlers during the unloading process. Shippers, manufacturers, distributors, warehousing organizations, motor carriers, drivers, loaders, maintenance organizations, and highway agencies may be culpable when a truck is involved in an accident involving shifting and falling cargo.