

THE NEW FRENCH RULES
FOR MERGER CONTROL
(CONTINUED)

The decision can be appealed before the French administrative courts.

Sanctions

Failure to comply with the mandatory notification requirements may lead to heavy penalties. Corporate entities can be fined in an amount up to 5% of the pre-tax turnover made in France during the previous fiscal year, increased by, where applicable, the turnover of the acquired party for the same period. Individuals can be fined in an amount up to €1.5 million.

Any misrepresentation or omission of information can entail, in addition to the foregoing financial consequences, a cancellation of the decision authorizing the transaction. In this case, if the parties are still willing to go ahead with the transaction, they are bound to file another notification within one month from the withdrawal of the authorization.

Ayache Salama & Associés has offices in Paris. If you have any questions, please contact Msrs. Salama and Ayache at ayache-salama.com.

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PUTTING THE "VALUE" IN
VALUATION SERVICES (CONTINUED)

ments are then common-sized as a percentage of an appropriate item, such as sales for income and expense items and total assets for asset items, for ease in making comparisons to industry norms and public companies.

Next comes the selection and application of accepted valuation methodologies. There are three fundamental valuation methods that are generally accepted and routinely debated in the cases: (1) the Market Approach, (2) the Asset-Based Approach, and (3) the Income Approach.

The *Market Approach* is based upon the proposition that a business should have a value which can be determined with reference to the value of businesses in the same or similar lines of business having their shares actively traded in a free and open market on an exchange or over-the-counter. The method requires finding similar businesses and then using the share price for the public company in conjunction with other factors such as book value, cash flow or earnings to create a pricing multiple. A discount for lack of marketability, determined by reference to available financial studies, is then applied. While difficult in application to small closely held businesses and requiring, in such cases, company-specific adjustments, where comparable public companies are found, this method provides powerful support for a valuation.

The *Asset-Based Approach* (sometimes called the Net Asset Method) treats the various assets and liabilities as an assemblage rather than a going concern, and values them at their respective fair market values, netting assets against liabilities and transaction costs as if sold (including income taxes). It is not generally the method of choice for the valuation of a going concern.

The *Income Approach* values a business based on its ability to produce earnings or cash flow. It requires a mathematical approach (the Build-Up Method) and is used frequently in modified forms by the financial markets. The object of this method is the development of a cost of capital or discount rate reflecting the rate of return an investor would demand to invest in the target company as compensation for the use of his money and risk associated with a particular investment.

The application of this valuation method in the valuation of a closely held business interest is more difficult than it sounds. It is often difficult to get solid projections from small businesses and the estimation of company-specific risk is subjective.

Ultimately, valuation is an art, not a science. While the foregoing methods only approximate value, each constitutes a broadly accepted approach and *all are likely required by the courts to be addressed as to applicability in a proper valuation.* Anticipate the courts to now expect legal counsel to take a more active role in the valuation process; a more active role that will both improve the valuation report and provide strategic added value to the client and its business.

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THE DREADED (AND COMPLICATED)
ALTERNATIVE MINIMUM TAX

A major goal of income tax planning is to reduce the individual taxpayer's tax liability to the greatest extent possible. However, taxpayers that focus only on the regular income tax may receive the message the individual taxpayer dreads most: "You are subject to the Alternative Minimum Tax."

A taxpayer who is subject to Alternative Minimum Tax (AMT) will be subject to a larger tax burden than his regularly computed income tax, and will lose the benefit of many of his or her itemized deductions which are otherwise available to reduce his or her regular tax liability, because of the AMT "give backs." AMT liability is triggered when a taxpayer's tentative minimum tax exceeds his regular tax liability for the tax year.

When the top regular tax rate was at 50% and the AMT rate was 20% there was little need to consider the AMT when tax planning. However, since the top regular tax rate has dropped to 38.6% and the

AMT rate has increased to 28%, the need to plan has taken on added importance. In fact by 2010, one-third of all individual taxpayers will be paying the alternative minimum tax rather than the regular tax. You could be subject to AMT if you are married and filing jointly and your taxable income is at least \$112,850, or if you are single with taxable income of at least \$67,700.

Planning to avoid AMT begins with understanding its fundamentals. The AMT calculation starts with your regular taxable income and makes you "give back" certain tax preferences and adjustments to arrive at AMT taxable income. Some of the "give backs" include, but are not limited to:

- 1) Private activity bond tax-exempt-interest;
- 2) State and local income tax or real estate or property tax deductions;

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A Newsletter from
the Law Firm

GOULD & RATNER

G&R Review is published by the law firm of Gould & Ratner to update clients and friends on legal trends and developments of interest. The material contained in this newsletter is only a synopsis of recent cases and legislative developments and is not legal advice. If you have a question or an individual claim involving a topic covered in this newsletter, you should seek a legal opinion based on the law as a whole and the facts of your particular case.

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THE DREADED (AND
COMPLICATED) ALTERNATIVE
MINIMUM TAX (CONTINUED)

- 3) Miscellaneous itemized deductions;
- 4) Personal and dependency exemptions;
- 5) Incentive Stock Options ("ISO") income which is not currently recognized for regular tax purposes—(the taxpayer must add back the value of the stock received less what was paid for the stock in the year of the ISO exercise);
- 6) Depreciation deductions — (certain assets are placed on slower depreciation schedules); and
- 7) Standard deduction.

These "give backs" serve to increase the individual taxpayer's taxable income for AMT purposes. It is imperative in the tax planning process to determine the best strategy for recognizing these "give backs" and, particularly, the timing of these items. By proper planning, the taxpayer will be able to maximize the individual taxpayer's use of certain of these "give backs" and thereby minimize overall income tax liabilities. Without proper planning, the individual taxpayer may hear those dreaded words: "Alternative minimum tax".

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THE NEW FRENCH RULES FOR MERGER CONTROL

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A French Decree dated April 30, 2002 has recently complemented the new French rules governing merger control, set out in the New Economic Regulations (NER) which came into force on May 15, 2001, and was intended to harmonize French law with the European Commission Merger Control procedure (the "ECMR", EU Council Regulation n°4064/89 of December 21, 1989). The NER introduces a system of mandatory notification instead of the previous voluntary mechanism, linked to new thresholds, and gives a clearer definition of the concepts of concentration and control.

The Concentrations Subject to Merger Control

The French control comes into play only if the contemplated transaction does not fall under the scope of the ECMR.

Broadly, a concentration is deemed to exist in the event of a modification of the structure of control of a company (by way of merger, acquisition of a controlling interest, joint venture or otherwise).

Unlike the former governing rules, the new French thresholds are now expressed solely in terms of turnover, irrespective of the market share held by the parties involved. A merger control notification must be filed when the parties to the concentration, and their respective groups, have an aggregate world-wide turnover of €150 million, and each of at least two of the parties concerned realizes a turnover in France over €15 million.

As a result, the French merger control regulations will apply to foreign entities realizing, even in the absence of incorporated subsidiaries in France, the required foregoing turnover. A mere impact is enough, provided that the thresholds are met.

The Notification

Once the conditions are satisfied, the notification is mandatory. Such notification has a suspensive effect, i.e., the

operation cannot be completed before having obtained the prior approval from the Minister of the Economy.

The notification form, which is a rather heavy document to prepare, must be filed with the Minister of the Economy (in particular with the Competition direction known as the "DGCCRF"). It is advisable to consult the DGCCRF on an informal basis prior to the sending of the form in order to assess the volume of information expected.

The parties may only notify when they are "irrevocably committed", that is, for example, after the execution of a legally binding agreement. The execution of letter of intent or of heads of agreement is insufficient to trigger the notification obligation. In practice, the final merger agreement or share purchase agreement will contain a condition precedent relating to the approval of the transaction by the merger control authorities.

A common form for mergers having a simultaneous impact in the United Kingdom, France and Germany, is available in order to simplify the merger control proceedings in those three State Members.

Procedure

The Minister of the Economy must render its decision within a five-week period (which can be extended under certain circumstances) as from the date of filing of a complete notification. A lack of response by the Minister is deemed to be an implied authorization. The Minister will either decide (i) that the transaction does not fall under his jurisdiction, or (ii) that the transaction should be approved as presented, or (iii) that the transaction is likely to harm competition. Completion of the transaction may be subject to certain undertakings submitted by the parties (often, divestments) or may be prohibited. If the operation is deemed as harming the competition, a second phase may be triggered. This second phase can last up to four months.

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PUTTING THE "VALUE" IN VALUATION SERVICES

Business valuation services, once the purview of the accountant and appraiser, is now a critical skill for the attorney in many practice areas, demanding that he or she have expertise in this growing area.

Where valuation disputes are the subject of litigation, the Courts are more closely and critically reviewing expert valuation testimony. Judges have become more financially sophisticated and are no longer either accepting expert testimony on its face or willing to "split the baby" between litigating parties when warring experts are at variance. In fact, an Appellate Court recently held that "...the assignment of relative weights to the results of different valuation approaches is deemed a matter of law...", *Estate of Dunn v. Commissioner*, 90 AFTR 2d 2002-5527 (2002).

Both attorneys and their clients have to be more attuned to valuation problems. There is too much to lose, for instance, by "low-balling" discounts for gift or estate valuations without obtaining appropriate support. In the gift and estate tax context, a client's goals may be compromised by taking less than a supportable discount on transfers of closely held business interests. There is even more at stake if a professional takes large discounts that seem to be within parameters supported by case law should the IRS come in and throw out a poor valuation and assess penalties and compounding interest, assessable on tax underpayments. Careful planning to support transaction values is more necessary now than ever.

The purposes for business valuations extend beyond the estate and gift tax areas, of course. Business valuations are also performed for mergers and acquisitions, reorganizations, liquidations, bankruptcies, purchase price allocations, loan financings, marital dissolutions, employee stock ownership plans, buy-sell agreements, shareholder disputes, incentive

stock option plans, IPO's, litigation damages, and charitable gifts.

Valuations can range from estimates usable for internal planning or litigation settlement purposes to full opinions prepared to support positions that may be litigated. When an opinion is needed, litigation counsel must weigh whether an independent expert's testimony warrants engaging an outside professional.

However, to the extent required services are available from a client's legal team, not only is the work product protected by the attorney-client privilege, there is value added to the valuation from the firm's intimate knowledge of a client's business history and affairs, and added to the business process itself, since the process will identify the tangible and intangible assets and relationships driving value and enhance legal strategies to preserve and protect that value.

The Valuation Process and Procedures. The first step in a valuation is to define the engagement in terms of what is being valued, and the valuation's purpose, scope and use. A critical part of this step is the legal determination of the applicable standard of value to be used. "Fair Market Value" for Federal Estate and Gift Tax purposes does not equal "Fair Value" for state shareholder dispute purposes. "Fair Value" for state shareholder dispute purposes does not equal "Fair Value" for marital dissolution purposes.

The next step is to perform a financial review of historical and projected financial statements, entailing the identification of the proper income stream to value and making adjustments thereto for non-recurring items, controlling shareholder items, industry methods and other appropriate items. The "normalized" financial state-

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MAJOR INTELLECTUAL PROPERTY SETTLEMENT

Gould & Ratner recently assisted a prominent medical technology entrepreneur and inventor settle a complex intellectual property dispute for \$15.25 million. The dispute stemmed from the inventor's sale of his patent rights in certain medical/surgical technology to a medical technology company, which was subsequently acquired by a major publicly traded corporation. Our client alleged breach of contract and fraud. After two years of hard-fought litigation in federal court in downstate Illinois, Gould & Ratner successfully positioned the case so that the defendant, which had refused to even discuss settlement, agreed to our creative structured settlement. The settlement included a sizable cash payment, together with a license of that very technology from the large medical company back to our client. The settlement permitted our client in turn to sublicense some of the technology to another publicly traded medical technology company not involved in the suit, thus enabling our client to recover a substantial multiple of what the defendant was willing to pay in the settlement. This result exemplifies how the teamwork between our litigation, corporate and tax departments, together with our working relationship with our client and his industry leading consultant, coupled with our creativity and zealous advocacy, produced substantial added value for our client. Litigation partner Robert Carson and Corporate partner Fredric Tannenbaum led the team which litigated, negotiated and documented the transaction.