

## ***BUSINESS VALUATION REVIEW***

### **THE EFFECT OF SPECIAL INTEREST PURCHASERS ON FAIR MARKET VALUE IN CANADA**

by

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In developing an opinion of fair market value in a notional-market context, Canadian business valuers will typically address — indeed, *must* address — the possible existence of special interest purchasers or strategic buyers in the marketplace who might be prepared to pay a premium over and above the stand-alone value of the business.

#### **Stand-Alone Value**

The concept of “stand-alone value”, which is synonymous in Canada with “intrinsic value”, relates to notional fair market value, absent consideration of prices paid for possible purchaser-perceived post-acquisition synergies or strategic advantages.

In the U.S., the authors of *Valuing a Business* state:<sup>1</sup>

*“Intrinsic value (sometimes called fundamental value) differs from investment value [value to the owner or acquisition value] in that it represents an analytical judgment of value based on the perceived characteristics inherent in the investment, not tempered by characteristics peculiar to any one investor, but rather tempered by how these perceived characteristics are interpreted by one analyst versus another”.*

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(1) S.P. Pratt, R.F. Reilly and R.P. Schweihs, *Valuing a Business*, 2nd Edition, Dow Jones-Irwin (Homewood, Illinois: 1989), at page 31.

The authors also note that intrinsic value “ ... is referred to, and some of the notions it implies are used, in the context of [fair market value, investment value, and fair value]”.<sup>2</sup>

Reilly and Schweihs, in the November/December 2003 issue of *Valuation Strategies*, provide a cogent and practical comparison of fair market value and investment value, viewed in a U.S. context.<sup>3</sup>

In his book, *The Market Approach to Valuing Businesses*<sup>4</sup>, Dr. Shannon P. Pratt states,

“ ... *acquisition value* in the context of synergistic mergers and acquisitions .... would be something over and above control value, reflecting an *acquisition premium* or *synergistic premium* consisting of the value of perceived synergies included in the transaction price, over and above the control value of the acquiree on a stand-alone basis.”

In Canada, the existence in the marketplace of a special interest purchaser may have the effect of increasing stand-alone “fair market value” in the *notional market* to the “price” that might be paid in the *open market* (“acquisition value”). In this context, “fair market value” for Canadian purposes can be equated with “acquisition value” for U.S. purposes: both would include applicable special purchaser/strategic buyer considerations.

While, for reasons outlined in this article, fair market value in Canada may differ from that in the U.S., Canadian and U.S. valuers nonetheless share the view that if the market includes a group of special interest purchasers, it would become a special purchaser market from which “ordinary purchasers” would be excluded.

Dr. Pratt also notes, in his book *Business Valuation Discounts and Premiums*:<sup>5</sup>

“If fair market value is the applicable standard of value [for U.S. business valuation purposes], then normally any value that reflects synergies would not be appropriate. The reason is because the synergies would be applicable to a *particular* buyer, thus resulting in *investment value*, while fair market value reflects value to a *hypothetical* buyer. The exception to this rule is in situations in which there is a *group* of

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(2) *Ibid.*, page 351.

(3) R.F. Reilly and R.P. Schweihs, “Why Acquirors Often Overpay in Merger and Acquisition Transactions”, *Valuation Strategies*, Vol. 7, No. 2., Warren, Gorham & Lamont, pp. 30-34.

(4) John Wiley & Sons Inc. (New York: 2001), page 142.

(5) John Wiley & Sons Inc. (New York: 2001), page 317.

prospective buyers having the same synergies with the subject, in which case they might collectively create a market, as with industries undergoing consolidation.”

At this point, it is of interest that the *International Glossary of Business Valuation Terms*, jointly developed by the American Society Appraisers, the American Institute of Certified Public Accountants, the National Association of Certified Valuation Analysts, The Canadian Institute of Chartered Business Valuators, and the Institute of Business Appraisers, contains the following definition of fair market value:

“The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm’s length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. [NOTE: In Canada, the term *price* should be replaced with the term *highest price*.]”

### **The Special-Purchaser Premium**

As open-market (real-world) negotiations between the buyer and seller will likely not have occurred proximate to the effective valuation date, it may be difficult, if not impossible, to identify potential special interest purchasers for the business — and even assuming they can be identified, whether such buyers would have both the motivation and the financial ability to transact. However, assuming that such a purchaser is identified, it may be difficult at best to identify, let alone quantify, the purchaser-perceived post-acquisition net economic value-added and other benefits resulting from the transaction. Value being in the eye of the beholder, there can be as many possible prices for a business or business ownership interest as there are potential purchasers, as each purchaser will view post-acquisition net economic value-added differently. If a willing and able special purchaser/strategic buyer can be clearly identified, and the perceived net economic value-added (achieved as a result of post-acquisition synergies and/or strategic advantages by combining the target’s business and that of the purchaser) can be reasonably quantified, Canadian business valuers will add a special-purchaser premium to the acquiree’s intrinsic, stand-alone value in a *notional-market* context to arrive at fair market value. The premium is the *open-market* price (acquisition value) that a special interest purchaser may pay over and above that which “ordinary” purchasers (financial buyers) would pay. Of course, the valuator will have the problem of attempting to estimate the type of premium that might be reasonably negotiated, as a special purchaser will not knowingly pay dollar-for-dollar for the perceived post-acquisition net economic value-added. The buyer’s risk increases as the price for the perceived post-acquisition synergies and strategic advantages increases.

Unless the market has been tested, however, or the valuator has held fruitful discussions or negotiations with possible purchasers, it would be difficult, if not impossible, to know whether the “highest price” (the term employed in the Canadian definition of fair market value) has been arrived at in a notional-market context. In this regard, the Federal Court of Canada, in *Dominion Metal & Refining Works Ltd. v. The Queen*,<sup>6</sup> held that “[t]he special purchaser theory ... requires some evidentiary base before it may be applied”. This had been the case in *Lynall*,<sup>7</sup> a decision of the British House of Lords, in which the existence of a special purchaser influenced value only where it was established by cogent evidence that, at the valuation date, the special purchaser was in fact:

- offering to purchase the shares;
- financially able to buy the shares at the enhanced price; and
- this fact was known to the public.

An important issue that was raised by the Federal Court of Canada in the *Dominion Metal* case was whether, at the relevant valuation date, the buyer, Ogilvie Mills, was a special purchaser even though its presence in the notional market “wasn’t even known to itself”. That is, at the time Ogilvie acquired the property from Dominion Metal in 1974, it was a special purchaser; however, as of the relevant valuation date in 1971, there was no evidence led supporting the proposition that it was a special purchaser on the valuation date:

“The special purchaser theory, as all theories, requires some evidentiary base before it may be applied. As I have observed before, Ogilvie Mills had been a neighbour of the subject lands for generations, without any covert or overt, or presumed intentions to acquire more property. There is no evidence of Ogilvie Mills exerting any acquisitive clout or giving the mere impression of it to alert the notional buyer that at [the valuation date] the subject lands might have a considerably enhanced value over other locations simply because they were located next door to it. There is no evidence of notional movement by Ogilvie Mills in any direction. Even if one might establish the presence of Ogilvie Mills as a special purchaser [18 months subsequent to the valuation date], I cannot readily see where as at [the valuation date], Ogilvie Mills can fit into the special purchaser category.

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(6) 86 DTC 6311 (Trial Division).

(7) *Re Lynall* [1971] 3 All ER 914, (1971) 3 WLR 759 (HL).

“... In the cases cited by the plaintiff and to which lengthy reference was made, there were facts which gave credence to the presence of special purchasers not only at the date of acquisition but at the relevant valuation date as well. In the case before me, I fail to find that kind of foundation upon which the presence of a special purchaser in the notional market [at the valuation date] may be reasonably established. I can only ascribe the excellent price paid for the subject property in 1974 to a fortuitous combination of a self-compelled buyer on the one hand and an astute and obviously knowledgeable seller on the other.”

Accordingly, it appears clear that the existence of a special purchaser must be proven beyond a reasonable doubt.

The English courts require clear evidence of this situation before the effect of a special purchaser on fair market value is given any weight. In the English decision in *Clay (infra)*, the special fact enhancing the price of the property was assumed to be a matter of local knowledge. This will be discussed later.

However, the stand-alone value of a target business in the *notional market* might not necessarily be increased by a special-purchaser premium for Canadian fair market value purposes (even assuming that it could be reasonably quantified) because:

- (a) If there is only one special purchaser, the purchase price may be only nominally higher than what “ordinary purchasers” would pay in order to ensure a successful bid for the target;
- (b) If there are two or more special purchasers, the market would become a special-purchaser market (where there may be competitive bidding) and ordinary purchasers would therefore be excluded. These special purchasers would bid up the price for the business to an amount that would represent its value to them. In this regard, a special purchaser is not considered to be an exceptional purchaser, but, rather the more typical kind of buyer present in the open market. If a number of notional purchasers are willing to pay a “premium” over the price offered by other purchasers, it would certainly not be considered a “premium”, but simply fair market value!

A good, practical example of competitive bidding is given by Dr. Wolfe D. Goodman, QC — a distinguished and highly-respected Canadian attorney, whose expertise in income tax and trust law is widely recognized, including related valuation issues — in his presentation at the 1976 Biennial Conference of The Canadian Institute of Chartered Business Valuators:

“... where there is no single majority shareholder but, rather, there are several minority shareholders, to each of whom the shares of another minority shareholder have a special value, fair market value may be affected by their position as special purchasers.

“Assume, for example, that there are three equal shareholders in a company, A, B and C, that the value of 100% of the shares of the company in the hands of a single shareholder would be \$300,000, but outside investors would be prepared to pay only \$60,000 for a one-third interest in the company. In valuing C’s shares, it is not unreasonable to assume that there would be competitive bidding between A and B to acquire these shares, which, together with the purchaser’s original holding, would constitute a majority shareholder. If A or B could realize only \$60,000 each by selling their shares to investors but, by acquiring C’s shares and obtaining majority control of the company, they could ensure that their total shareholdings were worth their full rateable value of \$200,000, A or B might be prepared to pay up to \$140,000 for C’s one-third interest in the company. C’s minority interest might, in these circumstances, be worth substantially more than its rateable value of \$100,000.

“This is hardly surprising: In an extreme case, where there are two equal shareholders, each with 49% of the shares, a stranger with only 2% of the shares might be able to realize vastly more than the rateable value of his shareholding, if there were competitive bidding for his shares by the other shareholders.”<sup>8</sup>

While Canadian courts have looked to the U.S. jurisprudence for assistance in developing the valuation principles applied in determining “fair value” in dissenting shareholder and oppression cases, they have sought guidance from U.K. jurisprudence in addressing “fair market value” issues. This may explain the “differences” in fair market value determinations, in a notional-market context, between Canada and the U.S.

### **The U.K. Jurisprudence**

In *Inland Revenue Commissioners v. Clay and Buchanan*<sup>9</sup>, an early English decision, Lord Justice Swinfen Eady of the Court of Appeal, referring to the presence of a special purchaser in the marketplace noted:

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(8) W.D. Goodman, QC, “Valuation of Shares: Some Areas of Controversy”, *The Journal of Business Valuation*, Vol. 3, December, 1976 (Proceedings of the Third Biennial Valuation Conference), page 43.

(9) [1914] 1 KB 339, [1914] 3 KB 466, a case under subsection 25(1) of the U.K. *Finance Act*, 1910.

“It was then urged by the Solicitor-General that if the probability of this special buyer purchasing, above the price, which but for his needs would have been the market price, could be taken into consideration at all, then only one further point or bid could be allowed, and it must be assumed that this special buyer would have become the purchaser upon making this one extra bid. Such an assumption would ordinarily be quite erroneous. The knowledge of the special need would affect the market price, and others would join in competing for the property with a view to obtaining it at a price less than that at which the opinion would be formed that it would be worth the while of the special buyer to purchase.” (At page 476.)

Other cases in which the British House of Lords and/or Privy Council addressed the issue of special purchasers include *Robinson Brothers (Brewers) Limited v. Durham County Assessment Committee*<sup>10</sup> and *Raja Vyricherla Narayana Gajapatiraju v. Revenue Divisional Officer, Vizagapatam*<sup>11</sup>.

The issue in *Robinson Brothers* was a notional-market valuation in a context involving a number of special purchasers. Lord Macmillan stated:

“I can see no justification for including [the special purchasers] among the competitors but excluding [the amount] which they would offer. The motives which actuate buyers in a market may be of all kinds, but it is not their motives but their bids that matter.”

In *Vyricherla*, an Indian case, the U.K. Privy Council had to decide whether the value of potentialities (or unusual features) of certain land as a building site should be included for valuation purposes:

“[F]or it has been established by numerous authorities that the land is not to be valued merely by reference to the use to which it is being put at the time at which its value has to be determined ... , but also by reference to the uses to which it reasonably capable of being put in the future. No authority, indeed, is required for this proposition. It is a self-evident one. No one can suppose, in the case of land which is certain or even likely, to be used in the immediate or reasonably near future for building purposes, but which at the valuation date is waste land, or is being used for agricultural purposes, that the owner, however willing a vendor, will be content to sell the land for its value as waste or agricultural land, as the case may be. It is plain that in ascertaining its value the possibility of its being used for building purposes would have to be taken into account. ... “

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(10) [1938] AC 321.

(11) [1939] AC 302, [1939] 2 All ER 317 (P.C.)

“The same consideration will apply to cases where the owner is not the only person, but merely one of the persons, able to turn the potentiality to account. The value to him of the potentiality will not be less than the profit that would accrue to him by making use of it had he retained it in his own possession. Take the case, however, where the owner is himself unable to turn the potentiality to account, whether by promotion of a company or otherwise. In such a case there may be several other persons who would be able to do so, or there may be only one. If there are more than one, it is recognized by all the authorities that have been cited to their Lordships, and seems to be consistent with common sense, that the owner is entitled to be paid the value to him of the potentiality, though the ascertainment of its value may in many cases be a matter of considerable difficulty.”

The English courts appear to have adopted the following “rules” from an historical perspective, based in particular on *IRC v. Clay*<sup>12</sup> and *IRC v. Crossman*<sup>13</sup>:

- Where the attraction to the special purchaser is inherent in the property itself, e.g., the adjoining house in *Clay*, and there is an identifiable purchaser in the market as well as evidence as to the price at which a seller could negotiate a sale to the purchaser, the value is that price. This is similar to the issues respectively addressed by the tax courts in Canada (*Dominion Metal v. The Queen*<sup>14</sup>) and in the U.S. (*Serdar v. Commissioner*<sup>15</sup>).
- Where the attraction arises from the particular position of the purchaser, e.g., a trust company being insulated from the restrictions triggered by the death of a shareholder (as in *Crossman*), the price is not whatever price the purchaser could afford to pay; it would instead be the price at which an assumed sale could take place, *viz.*, the special-purchaser price.

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(12) *Supra*, Note 9.

(13) *Inland Revenue Commissioners v. Crossman* [1937] AC 26 (HL), *rev'g* [1935] 1 KB 26.

(14) *Supra*, Note 6.

(15) T.C. Memo No. 86-504.

### *Speculators*

The possible existence of speculators, who might purchase the property simply in order to “flip” it at a profit to a special purchaser must also be considered. The English decision in *IRC v. Clay and Buchanan*<sup>19</sup> concerned the value of a house. The house was valued by the assessor at approximately £750. However, it adjoined a nursing home that was considering adding an extension. The trustees of the nursing home purchased the house for £1,000. The Court of Appeal was satisfied that £1,000 was the appropriate commercial value to the purchaser and not a “fancy price”, commenting that anyone knowing beforehand that the nursing home was willing to purchase would be entitled to anticipate a price of approximately £1,000 and not £750. Lord Cozens-Hardy M.R. stated:

“I can see no ground for excluding from consideration the fact that the property is so situate that to one or more persons it presents greater attractions than to anybody else ... . To say that a small farm in the middle of a wealthy landowner’s estate is to be valued without reference to the fact that he will probably be willing to pay a large price but solely with reference to its ordinary agricultural value, seems to me absurd. If the landowner does not at the moment buy, land brokers or speculators will give more than its agricultural value with a view to reselling it at a profit to the landowner.”

The appellate court appeared to suggest that if there were one special purchaser and if it was general knowledge in the marketplace that the subject property had special value to this purchaser, then in addition to ordinary purchasers, the market would be assumed to contain speculators who would be prepared to pay more than ordinary purchasers in the hope that they could resell at a profit to the special purchaser. Lord Justice Swinfen Eady stated:

“A value, ascertained by reference to the amount obtainable in an open market, shows an intention to every possible purchaser ... . Not only is the probable buyer a competitor in the market, but other persons, such as property brokers, compete in the market for what they know another person wants, with a view to a resale to him at an enhanced price, so as to realize a profit.

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(19) *Supra*, Note 9.

“The justification for the second approach which envisages a resale of the controlling shares is that a market is to be assumed from which no buyer is to be excluded and this market is deemed to include persons who buy with a view to resale at an enhance price to others whose wants are known to the market.”

In *Glass v. IRC*<sup>20</sup>, a Scottish case, there was only one special purchaser. The court, citing two English cases, *Gough v. Aspatria Silloth District Joint Water Board*<sup>21</sup> and *Lucas v. Chesterfield Gas and Water Board*<sup>22</sup>, valued the subject land at substantially more than the price ordinary purchasers would have been willing to pay, and not at a value just “one point higher” than might otherwise be the case when there is no competitive bidding, because of the probability of potential speculators in the marketplace:

“I think it highly probable that, in these circumstances, more than one speculator would have come forward with offers substantially in excess of the agricultural value, in the reasonable expectation that they would sooner or later find a purchaser in the Water Commissioners, at a figure that would yield them a profit on the transaction.”

The court suggested that if there is a single special purchaser, and if the fact that the property in question had a special value to that purchaser was a matter of general knowledge in the marketplace, it must be assumed that, in addition to ordinary purchasers, the market would also contain speculators who would be prepared to pay more than an ordinary purchaser in the hope that they could later resell the property at a gain to the special purchaser.

### **Canadian Jurisprudence**

The principle that the use of property by the purchaser must be a determinant of value has also been applied by the Supreme Court of Canada in *Fraser v. The Queen*,<sup>23</sup> an expropriation (eminent domain) case, where the property involved 110 acres of rocky ground. Its “bare ground” value was \$50 per acre. However, it was strategically situated on the Canso gut

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(20) [1915], 52 Sc LR 414 (Valuation Appeal Court).

(21) [1904] 1 KB 417.

(22) [1909] 1 KB 16.

(23) [1963] SCR 455.

between the Mainland and Cape Breton Island where the public authorities had decided to build a causeway linking the two. The purpose of the expropriation was to make a quarry site for the 9,000,000 tonnes of rock required for the causeway. Canadian Supreme Court Justice Cartwright, in addressing the valuation issue, observed:

“We must deal with the realities of the situation. What was compulsorily taken from the appellant was intended to be used not as land but as a source of building material for which there was an ascertainable market price.” (At page 458.)

Justice Ritchie, in adopting the reasoning of the House of Lords in *Vyricherla (supra)*, stated:

“The exclusion from the Court’s consideration of ‘increase in value consequent on the execution of the undertaking’ to build a causeway and of any value based on the Crown acting under compulsion as a necessitous purchaser does not mean that the value of the special adaptability to the owner at the date of expropriation is to be disregarded.” (At page 474.)

The special-value approach had also been adopted by the Federal Court of Canada in *Cyprus Anvil Mining Corp. v. Dickson et al*<sup>24</sup> and *Laycock v. The Queen*<sup>25</sup>.

In *Cyprus Anvil*, a case involving a takeover bid followed by the compulsory acquisition of dissenting minority stockholders’ shares and the fixing of “fair value”, the British Columbia Supreme Court (a trial court) stated that “it is a fundamental principle of valuation that the subject property [a mine located close to the purchaser’s mining and milling operations] will be valued at its highest and best use”, and held that the value that the single special purchaser placed on the property must accordingly be considered the fair value of the property.

Chief Justice McEachern, stated:

“It is a fundamental principle of valuation that the subject property will be valued at its highest and best use. Anything else is unreal. Thus when a buyer and seller discuss the price of a property — not an *objet d’art* or something having personal or

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(24) (1982), 20 BLR 21 (BCSC).

(25) (1978), 78 DTC 6349, at 6356.

sentimental value — they assume its highest and best use. For example, if a prudent farmer is selling his farm to a developer, he will not accept a price based upon agricultural use, and the developer would not expect him to do so. Problems of zoning may affect the potential of the property but that is just a factor which is taken into account in assessing the potential of the property.”

In *Laycock*, an income tax case dealing with “fair market value”, the court recognized a value 50% higher than its value as “ordinary farm land”.

In *Lakeshore Enterprises Ltd. et al v. Minister of National Revenue*,<sup>26</sup> the Tax Review Board held that, for fair market value purposes, a special value existed for the land, and that “the Royal Bank of Canada was a special purchaser”.

In *931 Holdings Ltd. v. Minister of National Revenue*,<sup>27</sup> the City of Toronto was willing to pay a premium of 40% over and above the normal fair market value because the owner of the lands involved enjoyed a non-conforming use that the city authorities wished to eliminate. The Court held in deciding on the issue of fair market value for income tax purposes:

“It is clear from the evidence that on December 31, 1971, the City of Toronto was in the market to purchase the property to rid it of an obnoxious non-conforming use.” (At page 395).

Recognizing the “open-market” component of the “fair market value” definition, Canadian courts generally recognize that all possible purchasers should be considered. In *The Queen v. Edmund Littler, Sr.*<sup>28</sup>, the Federal Court of Appeal upheld the decision of the lower court with respect to the valuation of shares of a Canadian publicly-traded company acquired by the U.S. conglomerate, Standard Brands Limited. Mr. Justice Decary of the Federal Court — Trial Division stated:

“Furthermore, the shares of Lowney were worth far more to Standard because Standard wished to acquire not only the voting control of Lowney, not only a passive holding, but a going concern to be integrated in their own business as the business of

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(26) 83 DTC 388 (Tax Review Board).

(27) 85 DTC 388 (Tax Review Board).

(28) [1976] CTC 379, 76 DTC 6210 (FCTD); aff’d, [1978] CTC 235, 78 DTC 6179 (FCA).

Lowney, the making of candy, was akin to the one of Standard, the food business. The evidence of ... the Chairman of the Board of Standard leaves no doubt that the control of Lowney is worth, per share, many times more than the Exchange Value. Standard wanted a wholly-owned subsidiary. As to the value, in such an instance, the evidence of [the] President of Kraft Foods (Canada) Ltd. is to the same effect.”

The Canadian family law courts have also accepted the effect of special purchasers on value.<sup>29</sup>

### **Canadian Professional Practice Requirements**

As can be seen from the foregoing conceptual framework, Canadian business valuers must address the issue of special purchasers when determining fair market value.

That the effect of special purchasers on fair market value is a key consideration in Canadian business valuation is exemplified by Standard 110 of The Canadian Institute of Chartered Business Valuators (“CICBV”), *Valuation Report Standards and Recommendations*:

“V.E. The report must disclose **the extent, if any, to which special purchasers were considered and give reasons why.** *Recommendation:* Disclosure of the steps taken to investigate their existence, the problems of quantifying net economic value-added in open market price, and the degree to which they have influenced the conclusions.”

Standard 110, which applies to all valuation reports that are not in draft form and are prepared by a valuator acting independently (as opposed to acting in an advisory capacity), makes such disclosure mandatory.

Appendix A to the Standard relates specifically to Securities Regulations and Policies in the context of related-party transactions. Ontario Securities Commission (“OSC”) Companion Policy 61-501 CP to Rule 61-501, *Insider Bids, Issuer Bids, Going-Private Transactions and Related Party Transactions*, states that “the disclosure standards [of] Appendix A to Standard 110 of [the CICBV] ... generally represent a reasonable approach to meeting the applicable legal

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(29) See, for example, *Verdun v. Verdun* (1994), 9 RFL (4th) 54 (Ontario Court of Justice — General Division); and *Simms v. Simms* (1996), 20 RFL (4th) 147 (New Brunswick Court of Queen’s Bench).

requirements ...”.<sup>30</sup> Importantly, the standard of value for purposes of OSC Rule 61-501 is “fair market value”, defined therein as “the maximum monetary consideration that, in an open and unrestricted market, a prudent and informed buyer would pay to a prudent and informed seller, each acting at arm’s length with the other and under no compulsion to transact”.<sup>31</sup>

CICBV Standard 120<sup>32</sup> requires members to consider “key valuation components and assumptions”, including any “special purchasers”.

Failure by an accredited member or a registered student to comply with the CICBV Practice Standards is a violation of the Code of Ethics.<sup>33</sup>

When a Canadian business valuator provides an opinion on fair market value for *notional market* purposes, the opinion will generally be accompanied by a caveat to the effect that, as the business had not actually been exposed for sale in the open market on or about the valuation date, it was not possible for the valuator to determine whether there were any arm’s length purchasers (including special purchasers/strategic buyers) who might have been prepared to pay a higher price for the business than the indicated value (intrinsic, stand-alone fair market value) on which he or she opined.

For example, a valuation report of American Appraisal Canada, Inc., which was filed in the Court of Queen’s Bench of Alberta in a much-publicized Canadian case<sup>34</sup>, included the following wording:

“In order to conclude that fair market value is higher than the intrinsic value of an asset, one has to demonstrate that the following conditions are met:

- a. There is at least one purchaser in the market who can achieve synergy with the subject assets (i.e., a special purchaser). Synergy is defined as: ***The ability to obtain benefits over and above the cash flow expected to be obtained from the subject asset in its current use and under its current ownership.***

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(30) Subsection 5.1(2).

(31) Section 1.1.

(32) Section V.

(33) Code of Ethics, Section 201.1.

(34) *Pocklington Foods Inc. v. Alberta (Provincial Treasurer)*, (1998), 159 DLR (4th) 81 (Alta. Q.B.), aff’d (2000) 184 DLR (4th) 152 (Alta CA).

- b. That the special purchaser/s identified can be negotiated into a position to pay for such synergy.”

## Summary

In Canada, special interest purchasers must be considered in determining fair market value and, if they can be identified, an assessment made as to whether they would have the interest and financial ability to transact. An attempt must also be made to quantify/estimate the purchaser-perceived post-acquisition net economic value-added and the degree to which such purchaser can be negotiated into paying for it.

Generally, the position of the Canadian courts is that a special purchaser market will affect the determination of fair market value if (a) it can be established that, at the valuation date, such purchaser was present in the market and was financially able to transact, and (b) the market was aware of the special purchaser’s presence.

Where there is only one special purchaser in the marketplace:

- (a) the special purchaser would need to pay only “one point up” over the price paid by ordinary purchasers;
- (b) where the market is aware of a special purchaser, speculators would enter the market to drive the price up that which they believe a special purchaser would be prepared to pay; and
- (c) the potentiality or special nature of the property that is especially desirable to a potential purchaser would bring a higher price for the property than its ordinary use.

Where there is more than one special purchaser, there will be competitive bidding, which will drive up the price; in this scenario, ordinary purchasers will be excluded and the market will become a special purchaser market.