

# BUSINESS VALUE AND DIVORCE: AN ANALYSIS OF OREGON APPELLATE CASES

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## I. INTRODUCTION

Since 1975, Oregon appellate courts have issued approximately 40 decisions dealing with the valuation and division of business interests in the context of divorce. Taken together, these cases constitute a hodgepodge of ad hoc rulings that are not always clear or consistent. This paper attempts to analyze the rulings and summarize the various rules that appear to have developed.

In addition, this article is intended to alert lawyers to a seemingly little-known fact, which is that Oregon courts have not adopted “fair market value” as the approved valuation standard in divorce cases. A number of other valuation standards exist that may be appropriate for use in a particular case and may even achieve a more equitable result for the client. These standards include “fair value,” “investment value,” and “intrinsic value.” It is essential that the divorce lawyer be familiar with these alternative standards and give each of them consideration before proceeding with the appraisal of a business.

## II. GENERAL PRINCIPLES REGARDING DIVISION OF BUSINESS INTERESTS

### A. Disentangle the Parties

A number of cases have indicated that separating the parties and disentangling their financial affairs is a high priority. In *Slauson and Slauson*, 29 Or. App. 177, 562 P.2d 604 (1977), the parties owned a convenience store. The court found the business value was negligible and affirmed an award of the entire business to husband, saying: “. . . [I]n dividing the property the dissolution decree should seek to disentangle the parties’ financial affairs and make them free from each other’s interference. The friction resulting from the unsuccessful marriage partnership almost inevitably makes continued business association untenable.” *Slauson*, at 183–184.

Another example of the need to disentangle is *Madden and Madden*, 114 Or. App. 319, 836 P.2d 1349 (1992). *Madden* involved a husband’s two-ninths interest in a company selling wholesale food preservatives. The trial court found it hard to value the interest, so it awarded it to husband but required him to provide wife with annual

accountings and half of all future monies received on account of the interest. The Court of Appeals reversed this decision and gave the wife a simple money judgment because the trial court solution left the parties too entangled.

**B. Maximize Value—Award Business to the Party Who Operates It**

Courts should endeavor to maximize the value of a business interest. Often, this requires that the business be placed in the hands of the spouse who best knows how to run it while awarding the other spouse an offsetting judgment or other property. *Haguewood and Haguewood*, 292 Or. 197, 638 P.2d 1135 (1981), involved a family wheat farm. There, the Supreme Court stated the rule as follows:

“... [T]he corporation reflects the industry and operational control of the husband and its profitability is dependent upon his continued participation. It would be legally possible to order the sale of the corporation and divide the proceeds, thus providing to each party a base upon which to rebuild financially. This solution is not desirable in this case, however, because evidence establishes that the assets of the parties would be substantially reduced by taxes on the proceeds of sale. The value of the corporation to both parties is greatest as an operating entity in the continued operational control of the husband, potentially generating cash, profits and appreciated value, free from the influence of minority ownership in a former spouse.”

*Haguewood, supra* at 207, 208.

For a recent example of the rule, see *Bidwell and Bidwell*, 170 Or. App. 239, 12 P.3d 76 (2000), affirmed on motion for reconsideration in *Bidwell and Bidwell*, 172 Or. App. 292, 18 P.3d 465 (2001). *Bidwell* involved a stock brokerage that was awarded to the husband subject to an offsetting judgment to the wife of \$17.8 million. The court rejected husband’s arguments that if he did not like the price the trial court arrived at, he should be allowed to sell the business and thus he would be forced to pay all of the potential taxes due on any future sale of the business.

For an exception to the rule, see *Malloy and Malloy*, 31 Or. App. 1359, 572 P.2d 672 (1977), where the wife was awarded a grocery store though husband had been more involved because he had other job skills and she did not. See also *Ford and Ford*, 26 Or.App. 353, 552 P.2d 563 (1976) (wife awarded advertising business but husband allowed to compete so he can earn a living).

### III. STANDARDS OF VALUE FOR BUSINESS APPRAISALS

The term “value” has a number of different meanings in the business appraisal field. Accepted standards of value include “fair market value,” “fair value,” “investment value,” “intrinsic value,” and “liquidation value.”<sup>1</sup> The expert’s opinion may vary widely depending on which value definition is selected. Typically, the expert looks to the lawyer to define the standard for the assignment; however, lawyers tend to ignore the issue, and, in the absence of instruction from the lawyer, appraisers tend to turn to “fair market value” as the default standard. This is probably because IRS Revenue Ruling 59–60 approved the fair market value standard for use in the gift and estate tax field, which comprises much of a business appraiser’s work.

Most lawyers are not aware that Oregon has not adopted a single standard of value for divorce cases. Shortly after he wrote the *Tofte* decision (see *infra*), Justice William Riggs, who was then on the Oregon Court of Appeals, gave an interview to the nationally prominent appraiser and author, Shannon P. Pratt, DBA, CFA, ASA. Dr. Pratt asked Justice Riggs about value standards for appraisals in Oregon. The colloquy appears below:

Question: Is there an accepted standard of value in family law cases in Oregon?

Answer: No. Like other states, there is no statutory standard of value, and (also like most states) there is no clear-cut standard established by case precedent. To the extent that we have a standard, we tend to focus on what a hypothetical person would pay; however, the standard of value can be whatever the experts say, and the Court will consider it on a case-by-case basis.<sup>2</sup>

In other words, Oregon lawyers are not bound to the fair market value standard and should consider other standards where appropriate. The standard of value issue is currently a “hot” topic nationally and is being examined by courts throughout the country. Attached as Appendix B is a paper on the subject that was recently presented at the annual convention of the American Academy of Matrimonial Lawyers in

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<sup>1</sup> See Pratt, *Valuing a Business: The Analysis and Appraisal of Closely Held Companies*: Dow Jones-Irwin, 1981, page 28.

<sup>2</sup> Pratt, Deluxe BVUpdate™—December 1995, A Business Valuation Library Publication.

Chicago.<sup>3</sup> Discussion of the implications of using each of the alternate valuation standards is beyond the scope of this article.

**PRACTICE POINTER:** The “fair market value” standard may not always be the most equitable standard to use in divorce because there is typically no “willing buyer” or “willing seller” and the party who is retaining the interest is typically under a compulsion to sell. The standard fails to consider unique factors which may effect the value as it applies to the divorcing couple. Consider using the “fair value” standard, which has long been used in Oregon and other states in the context of dissenting shareholder lawsuits where the shareholder is being forced out and needs to be compensated fairly for the interest. See *Columbia Management Co. v. Wyss*, 94 Or. App. 195, 765 P.2d 207 (1988) (dissenting shareholder’s 14-percent interest in a financial service company was valued at “fair value”).

#### IV. VALUATION METHODS

The appraiser may select from a variety of different approaches<sup>4</sup> in arriving at the valuation conclusion. Methods discussed in the cases are summarized below.

##### A. Capitalization of Earnings

Generally, when the business is a “going concern,” our courts have approved various techniques that capitalize the income stream. *Olinger and Olinger*, 75 Or. App. 351, 357, 707 P.2d 64, *rev. den.* 300 Or. 367, 712 P.2d 109 (1985), was one of the first cases to deal with the issue of valuation methodology. The case dealt with the value of husband’s interests in travel home and auto dealerships. Husband’s expert used a “book value” approach and proposed a deduction for future capital gains taxes. The court rejected husband’s approaches in favor of a capitalization of earnings approach with no deduction for future taxes. The court said:

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<sup>3</sup> *Divorce Value: Standards of Value for Professional Practices and Closely Held Businesses*, reprinted with permission of Joslin Davis and Loretta C. Biggs.

<sup>4</sup> For an excellent discussion of business value cases in relation to divorce, see 1 FAMILY LAW (Oregon CLE 2002 & Supp 2004), Chapter 6, Property Rights and Division, by Paul Saucy and Kevin C. Gage.

“The trial court accepted husband’s expert’s valuation of the dealerships, based on the book value of their assets, a method that might be used by a prospective purchaser. However, there is no indication that husband intends to sell the dealerships, and neither the decision of the trial court nor our modification would necessitate their sale. Husband’s expert also deducted for capital gains tax, which is inappropriate when no sale is planned. *Clapperton and Clapperton*, 58 Or. App. 577, 581, 649 P.2d 620 (1982). Wife’s expert evaluated the dealerships based on the income they generated, taking into account the difference in value between a majority and a minority interest. In doing so, he followed the valuation rules adopted by the Internal Revenue Service. As one might expect, each expert used a method that was more favorable to his client. The fair market value is most likely somewhere between the two, but *the income approach is more realistic if the businesses are to be viewed, as we think they should be, as going concerns.*”

*Olinger, supra*, at 356 (emphasis added).

Other cases to the same effect include *Melander and Melander*, 92 Or.App. 342, 758 P.2d 415 (1988) (bullet mold manufacturer); *Bors and Bors*, 115 Or.App. 572, 839 P.2d 272 (1992) (scrap metal corporation); *Cookson and Cookson*, 134 Or. App. 357, 895 P.2d 345 (1995) (retail cookware store and coffee shop); *Tofte and Tofte*, 134 Or. App. 449, 895 P.2d 1387 (1995) (amusement park); *Hanson and Hanson*, 192 Or.App. 422, 86 P.3d 94 (2004) (electronic component manufacturer); and *Gibbons and Gibbons*, 194 Or.App. 257, 94 P.3d 879 (2004) (logging business).

## **B. Book Value**

Dicta in *Bors, supra*, suggest that book value is an appropriate technique to value a corporation that has just been formed. *Messerle and Messerle*, 57 Or. App. 15, 18, 643 P.2d 1286 (1982), involved a family corporation raising beef and selling timber. The company had \$1.5 million in net earnings but distributed only modest income to the shareholders. The court approved a book value approach because neither party offered evidence of a going concern value.

## **C. Net Asset Value**

*Belt and Belt*, 65 Or. App. 606, 672 P.2d 1205 (1983), *modified on other grounds*, 68 Or. App. 42 (1984), involved husband’s 9-percent interest in a family farm corporation

that had a restrictive stock redemption agreement. The court determined the stock's value to be the "net asset value" of the stock (not book value) minus a discount because it represented a minority interest in a closely held family corporation.

#### **D. Adding Goodwill to the Value of Tangible Assets**

Some cases talk about a methodology whereby "goodwill" is added to the value of the company's assets. An example of the concept is found in *Weakley and Weakley*, 177 Or. App. 363, 33 P.3d 1045 (2001), which involved the valuation of husband's 50-percent interest in a log-thinning corporation. The court affirmed a finding that the business had goodwill beyond its tangible assets, saying:

"A business ordinarily has some value above the value of its assets, known as its goodwill value. See *Hinrichs and Hinrichs*, 37 Or.App. 833, 588 P.2d 130 (1978). The 'goodwill' of a business is commonly understood as the 'favor or advantage in the way of custom that a business has acquired beyond the mere value of what it sells whether due to the personality of those conducting it, the nature of its location, its reputation for skill or promptitude or any other circumstance incidental to the business and tending to make it permanent.' *Webster's Third New Int'l Dictionary*, 979 (unabridged ed. 1993). Thus, when the success or failure of a business depends on one party's personal services, we have tended not to assign a goodwill value to the business. See, e.g., *Lankford and Lankford*, 79 Or.App. 742, 745, 720 P.2d 407 (1986). In *Lankford*, the husband was the sole owner of a logging operation, and he presented evidence that his operation was dependent on his special expertise and ability to negotiate contracts. Thus, the business had no ongoing value, apart from its assets, in his absence."

*Weakley*, *supra*, 368, 369.

Another case that discusses goodwill is *Triperinas and Triperinas*, 185 Or. App. 283, 59 P.3d 586 (2002), which involved a 10.5-percent interest in a car dealership. The court averaged the differing expert values for goodwill, added the compromise goodwill value to the tangible assets, and then applied a 25-percent minority discount to the result. For an opposite result, see *McDuffy and McDuffy* 184 Or. App. 359, 56 P.3d 449 (2002), which involved a trucking business. There the court held that the trial court erred in assigning a goodwill value to the business where the trial court found the business had goodwill but the record was devoid of evidence as to precise value of it.

Lankford, *supra*, held there was no goodwill value in a logging business when the evidence showed that the success or failure of the business was dependent on the husband owner's personal services.

#### **E. Market Value**

This approach is mentioned in *Hanson and Hanson*, 192 Or. App. 422, 425, 86 P.3d 94 (2004). The market approach compares the business to other similar businesses that have sold in the marketplace. Many trial judges prefer this approach because it is easier to grasp than more esoteric approaches such as comparing a company's earnings to that of a publicly traded company on the New York Stock Exchange.

#### **F. Liquidation Value**

The court rejected a liquidation approach in *Hinrichs and Hinrichs*, 37 Or. App. 833, 588 P.2d 130 (1978) (recreational vehicle sales business), finding there was no evidence of an intent to liquidate it. On the other hand, *Webber and Webber*, 99 Or. App. 703, 784 P.2d 111 (1989), *modified on other grounds* 102 Or. App. 93 (1990) (minority interest in grass seed farm) approved a liquidation value method where the company, though operating, had lost money for several years. To the same effect is *Wolhaupter-Heinzel and Heinzel*, 108 Or. App. 514, 520, 816 P.2d 672 (1991) (gun shop), where the court affirmed the use of a bulk liquidation value instead of a going concern value even though the wife intended to continue to operate the business because the business had lost money for several years.

#### **G. Offers to Purchase**

*Madden and Madden*, 114 Or. App. 319, 324, 836 P.2d 1349 (1992), discussed the concept of valuing a business based upon evidence of the price a third party had offered for the company. In that case, the company was struggling and difficult to value. *Arends and Arends* 141 Or. App. 340, 917 P.2d 1060 (1996) (financial service company), considered evidence of the value determined when the owner sold and later bought back a minority interest in the company.

## V. DISCOUNTS FOR MINORITY INTEREST AND LACK OF MARKETABILITY

The value of a business interest may be discounted if it is a minority interest or if the interest is not easily converted into cash (lack of marketability).

### A. Oregon's Lead Case on Discounts

Oregon's lead case on the subject of minority and marketability discounts is *Tofte and Tofte*, 134 Or. App. 449, 895 P.2d 1387 (1995). *Tofte* involved the valuation of husband's 10.1-percent interest in the Enchanted Forest, Inc., an amusement park in Salem, Oregon. *Tofte* allowed a 35-percent marketability discount of husband's shares. Judge William Riggs wrote the opinion for the court. At footnote 3 of the opinion, he explains the difference between minority and marketability discounts as follows:

"The trial court's statement is indicative of the confusion that exists when distinguishing, or, in most cases, failing to distinguish, between a minority interest discount and a marketability discount. A *minority discount* takes into account the relationship between the interest being valued and the total enterprise. A primary factor in determining the value of a minority interest is the *degree of control* that the owner either does or does not have within the corporation. Obviously, the degree of control must be analyzed in the light of the number and size of the remaining shareholders' interests in the corporation. For instance, a 20 percent minority shareholder may have greater control relative to two 40 percent minority shareholders than he or she would have relative to an 80 percent shareholder. In the former situation, a greater degree of control might justify a smaller minority discount than would be imposed in the latter.

"In contrast, a *marketability discount* addresses the *degree of liquidity* of the interest. Such discounts compensate for the lack of a recognized market for a particular stock, lack of ready marketability, or restrictive provisions affecting ownership rights or limiting sale. A marketability discount may apply to either a minority or majority interest, and may be imposed in addition to a minority discount if circumstances warrant. Shannon P. Pratt, *Valuing a Business: The Analysis and Appraisal of Closely Held Companies* 59 (2d ed 1989); W. Terrance Schreier and O. Maurice Joy, *Judicial Valuation of 'Close' Corporation Stock: Alice in Wonderland Revisited*, 31 Okla L Rev 853 (1978)."

*Tofte, supra*, 134 Or. App. page 456.

*Tofte* goes on to say that an expert can properly apply either discount, or both, if appropriate. *Tofte* is instructive on a number of fronts, including its clarification that discounts are a function of determining the actual value of the business and should not be limited to situations where the business is going to be sold.

## **B. Can Marketability Discounts Apply to a Majority Interest?**

*Hanson and Hanson*, 192 Or. App. 422, 86 P.3d 94 (2004), dealt with the question of whether a marketability discount should be applied to the value of a husband's majority interest in a closely held electronics manufacturing company. The court held that it may be appropriate in certain circumstances such as where the evaluator has arrived at a value for the closely held company based upon the analysis of publicly traded companies. The court said:

“The critical distinction between this case and *Tofte* is that, while the expert in *Tofte* compared the amusement park—a privately held company—to comparable *publicly* traded companies, in this case all three experts compared NSI—a privately held company—to other comparable *privately* held companies. That is, while the valuation in *Tofte* was based on a comparison of ‘apples’ and ‘oranges’ (in terms of marketability), the expert valuations here were based on a comparison of a privately held ‘apple’ (NSI) with other privately held ‘apples.’ In substance, the experts’ valuations in this case already accounted for the lack of marketability of husband’s 100 percent ownership interest in NSI. Consequently, no adjustment for differences in marketability was necessary or proper.”

*Hanson, supra*, at 428, 429.

## **C. Other Cases Discussing Discounts**

Oregon cases make it clear that there can be no fixed rules on discounting. Instead, the analysis must occur on a case-by-case basis. For example, *Triperinas and Triperinas*, 185 Or. App. 283, 59 P.3d 586 (2002), involved a wife’s 10.5-percent interest in an auto dealership. The court sustained a discount of 25 percent and rejected husband’s argument that, since the wife did not plan to sell her interest, the concept of selling at a discount was too speculative. The court said:

“We are not persuaded by husband’s argument . . . we have emphasized that ‘valuation is a fact-based analysis necessarily taken on a case-by-case

basis'. . . . For example, in *Reiling* [66 Or. App. 284 (1993)], the court applied a 25 percent discount to a minority interest in a closely held corporation because expert testimony in the case established that the 'minority interests in closely held corporations are generally at the so-to-speak mercy of the other stockholders.' 66 Or. App. at 291. Further, in *Belt and Belt*, 65 Or. App. 606, 610–11, 672 P.2d 1205 (1983), *clarified*, 68 Or. App. 42, 68 Or. App. 42, 680 P.2d 390 (1984), we applied a 50 percent minority discount where expert testimony established that the fact that the stock interest was a minority interest in a closely held family corporation had a substantial impact on what a willing buyer would pay on the open market, even though there was no evidence of a contemplated purchase."

*Triperinas, supra*, at 294.

The most recent case on discounts is *Gibbons and Gibbons*, 194 Or. App. 257, 94 P.3d 879 (2004). *Gibbons* dealt with the value of husband's 20.45-percent interest in a family logging corporation. The court found that a controlling interest in the company was worth \$3,100 per share but that husband's interest was worth only \$684.73 per share (a discount of over 75 percent!). The court based its decision on the fact that husband's shares were subject to a stock transfer agreement that permanently assigned his voting rights and also gave the company the right to purchase the stock at favorable terms if husband decided to sell. The court accepted testimony from husband's experts to the effect that the proper assessment of husband's interest would be to consider the value of the cash flow resulting from an application of the terms of the stock transfer agreement together with the value of a possible future liquidation of the corporation. The court also discussed the importance the buy-sell agreement played in its decision. That discussion appears below in part VI., "Effect of Buy-Sell Agreements."

#### **D. Discounts for Family Farms—An Exception to the Rule?**

At least some Oregon cases appear to have carved out a "no discount" exception for minority interests in family farms. For example, in *Webber and Webber*, 99 Or. App. 703, 784 P.2d 111 (1989), *modified on other grounds* 102 Or. App. 93 (1990), the Court of Appeals approved a liquidation value method for valuing husband's minority interest in a farm but rejected the use of minority or marketability discounts. The court said: "The [trial] court was correct in not reducing the net asset value by the estimated costs of sale or applying a minority or marketability discount. If husband were to sell his

stock, he probably would sell it to his parents without significant costs of sale or minority or marketability discounts." *Webber, supra*, at 706.

To the same effect are *Barlow and Barlow*, 111 Or. App. 179, 826 P.2d 18 (1992) (no discount on 15-percent interest in a farm corporation), and *Batt and Batt*, 149 Or. App. 517, 945 P.2d 517 (1997) (no discounts for interests in multiple-farm corporations because the farms are usually sold as a whole if and when sales occur).

An exception to the "no discount" rule stated in *Webber, Barlow, and Batt, supra*, is *Belt and Belt*, 65 Or. App. 606, 672 P.2d 1205 (1983). *Belt* involved a husband's 9-percent interest in a family dairy corporation that was subject to certain restrictions on transfer. The case involved convoluted facts, but it appears that the trial court valued husband's interest based upon a value for the company stated in a loan application. The trial court valued husband's interest at 9 percent of the total with no discounts. The Court of Appeals reversed and allowed a 50-percent discount, saying:

"The trial court's approach would not have been unreasonable if the corporation was about to be liquidated or if husband had the right to force a liquidation. Absent either of those circumstances, it is not proper to treat husband as owning an undivided interest in the corporate assets, which appears to be what the trial court did here."

*Belt, supra*, at 609, 610.

Another exception is found in *Cunningham and Cunningham*, 74 Or. App. 311, 702 P.2d 1157 (1985), where the wife owned 7.38 percent of a closely held family farm corporation. She testified that her parents planned to retain control of the farm until their deaths and that the stock had no value to her. No expert testimony was presented. The court affirmed a trial court decision that assigned no value to the stock.

## VI. EFFECT OF BUY-SELL AGREEMENTS

Shareholder buy-sell agreements and various corporate governance restrictions may impact a shareholder's ability to market and control his or her shares. Such restrictions may or may not affect value depending on the circumstances. An excellent discussion of the rules in this area and the evolution of them is found in *Gibbons, supra*. *Gibbons* dealt with the value of husband's 20.45-percent minority interest in a logging

business that was subject to a mandatory buy-sell agreement that permanently assigned his voting rights and also gave the company the right to purchase his stock at favorable terms if he decided to sell. The court allowed a substantial discount of more than 75 percent in the value of his shares and made the following comments about the effect of buy-sell agreements and stock restrictions:

“Wife argues that the trial court should have ignored the stock transfer agreement when it assigned a value to the stock, citing *Reiling and Reiling*, 66 Or. App. 284, 673 P.2d 1360 (1983), *rev den*, 296 Or 536 (1984), and *Phillipakis and Phillipakis*, 14 Or. App. 377, 513 P.2d 529 (1973). In both of those cases, we concluded that the relevant stockholder agreements did not affect the value of the stock. In *Reiling*, we concluded that the . . . purpose of a corporate resolution that placed a value on the corporation was not, as the trial court concluded, to value the corporate stock but to effect a corporate dissolution and, therefore, that the resolution had no determinative effect on the stock’s value. 66 Or. App. at 290–91. *Phillipakis* involved a buy-sell agreement that ‘did not contain any obligation on either party to purchase at’ the price stated in the agreement. 14 Or. App. at 379–80. Here, in contrast, the . . . agreement . . . deprives husband’s shares of all voting power and any possibility that husband could orchestrate a liquidation of the company with other minority shareholders to reach the assets of the company. . . .”

*Gibbons, supra*, at 262, 263.

## VII. EFFECT OF TAXES ON VALUATION

According to *Olinger and Olinger*, 75 Or. App. 351, 357, 707 P.2d 64, *rev. den.* 300 Or. 367, 712 P.2d 109 (1985), deduction for capital gains tax in the valuation of a business for divorce is not appropriate when no sale of the business is planned. *Webber, supra*, held that even where a liquidation value is used to value a company, no taxes should be deducted unless the business is really going to be liquidated. In *Bidwell, supra*, the court declined to reduce the \$57 million value of husband’s business for taxes. The court rejected husband’s argument that the effect of the ruling would be to force him to pay the capital gains tax on the entire appreciated value of the company, including wife’s share. The court said:

“When dividing property on dissolution, the court may consider the tax consequences that the divisions will have on the parties. ORS 107.105(2).

In this case, however, it is not certain that husband will choose to sell the company. He testified that he planned to continue to operate the company but if the court did not accept his valuation of the company he was willing to sell. *Additionally, and more importantly, there is no evidence in this record of what the tax consequence would be if husband sold the company.*"

*Bidwell, supra*, at 243 (emphasis added).

## VIII. SECURITY AND PAYMENT PROVISIONS

The trial court is free to fashion appropriate provisions to secure the debt the continuing business owner may owe the other spouse as a result of the divorce. For example, in *Messerle and Messerle*, 57 Or. App. 15, 18, 643 P.2d 1286 (1982), the Court of Appeals authorized the insertion of the following security provision into the dissolution judgment:

"4. Respondent is awarded all the preferred and common stock of Fred Messerle & Sons, Inc., standing in his name on the 27th day of May, 1981, as his sole and separate property; subject, however, to a lien in favor of appellant on each and every share and all of the shares in the aggregate amount of \$251,002, which lien shall bear interest from May 27, 1981, at the rate of 9 percent per annum, simple interest, and shall be paid at the rate of not less than \$2,095.85 per month for 120 months, beginning on the first day of the third full month following the effective date of the decision on appeal; the first payment shall have added to it accrued interest from May 27, 1981, and each 12th payment thereafter shall have added to it the accrued interest since the last payment of interest.

"5. Respondent shall not permit, cause or allow any sale, transfer or encumbrance of any of the stock awarded to him without the express written consent of petitioner or the court unless and until 75 percent of the lien amount plus accrued interest has been paid and then only upon the furnishing of such security for the payment of the balance then owing, plus interest to accrue, as shall satisfy the court.

"6. Any and all taxes that may become due by reason of the property division in this decree shall be the sole responsibility of respondent, except with respect to property included in paragraph 1 of this division of the decree, which shall be the sole responsibility of petitioner."

*Messerle, supra*, at 22.

In *Haguewood, supra* (wheat farm), the court affirmed a provision that required the husband's corporation to *redeem wife's stock* valued at \$40,500 over a four-year period. No mention was made of the fact that the corporation was not a party to the divorce; perhaps because the husband would be the sole remaining shareholder and could control the company's decision to redeem.

In *Waker and Waker*, 114 Or.App. 255, 834 P.2d 522 (1992) (engineering firm), the court modified a dissolution judgment to eliminate a provision that required corporate shareholders who were not parties to the divorce case to *guarantee payments* to wife totaling \$373,445.

**PRACTICE POINTER:** Where appropriate, consider making the corporation a party to the dissolution case so the court has control over the corporation as well as the spouse. This is especially appropriate where the corporation appears to be the "alter ego" of a spouse. *See* ORCP 29A.

## **IX. COMPELLING AN OWNER NOT TO COMPETE.**

*Ford and Ford*, 26 Or.App. 353, 552 P.2d 563 (1976), involved a specialty advertising business that was awarded to the wife. The court affirmed the trial court's refusal to impose a noncompetition agreement, saying:

"Restrictions on free competition are generally disfavored and are allowed only in limited situations, even where the parties themselves agree to such a restriction. *See*: Annotation, 45 A.L.R.2d 77 (1956); Annotation, 41 A.L.R.2d 15 (1955). Additionally, we note that the husband has pursued this type of business for most of his working life and is prepared to do little else. To impose such a restriction upon him would therefore greatly impair his ability to earn a livelihood."

*Ford, supra*, at 355.

## **X. VALUING A PROFESSIONAL PRACTICE**

Professional practices are typically service-type business such as those operated by doctors, lawyers, and CPAs. These businesses are typically valued in the same manner as other businesses; however, a portion of the value of a professional practice may be dependent on the skill and reputation of the individual professional. This is

known as “professional goodwill” or “personal goodwill,” as distinguished from “practice goodwill,” which usually forms a part of every professional practice.<sup>5</sup> Personal goodwill often cannot be transferred. Oregon courts appear to have recognized this distinction without always clearly expressing it.

#### A. Law Practice

*Reiling and Reiling*, 66 Or.App. 284, 673 P.2d 1360 (1983), *rev. den.* 296 Or. 536, 678 P.2d 738 (1984), is Oregon’s landmark case dealing with a lawyer’s professional practice. In *Reiling*, the wife appealed, contending that the trial court erred in failing to assign a goodwill value to husband’s practice. The court affirmed the trial judge, saying:

“Here, the trial court may have believed that good will should not be considered in the property division, that husband’s law practice had no good will or that the evidence of value was speculative. Wife’s expert witness determined his value for good will by taking the median income of lawyers in Linn County with more than 20 years’ experience, subtracting 25 percent from that to account for the salary husband receives as a judge, taking an average of the excess of husband’s earnings above the median income for the past three years and multiplying that by 4.5.

“....

“We find that the evidence that wife presented does not adequately consider the factors of health, professional reputation, skill, knowledge, work habits and the nature and duration of husband’s law practice. Assuming that the value of good will could be considered in a dissolution proceeding in valuing a sole practitioner’s law practice, we do not find that the testimony of wife’s expert proves a basis on which to assign a value to good will. We do not, accordingly, include a value for good will.”

*Reiling, supra*, at 288, 289.

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<sup>5</sup> See Gary Trugman, CPA, ABVE, MCBA, ASA, MVS: *Divorce Value: Standards of Value for Professional Practices and Closely Held Businesses: A View from the Appraiser*.

## **B. CPA Practice**

*Goebel and Goebel*, 56 Or.App.52, 641 P.2d 59 (1982), held that trial court erred in failing to consider evidence of the value of husband's solely owned professional corporation, which had a book value of approximately even \$90,000, even though the business was the source of husband's income from which he must make spousal support payments. The case did not discuss the question of goodwill in any detail. *See also Kelley and Kelley*, 40 Or.App. 605, 595 P.2d 1294 (1979), which affirmed a trial court decision to include the tangible assets of husband's sole proprietorship CPA practice but declined to assign a goodwill value because it was too speculative.

## **C. Medical Practice**

*Steinbrenner and Steinbrenner*, 60 Or. App. 106, 652 P.2d 845 (1982), found some goodwill value in husband's Grants Pass medical practice despite testimony by husband's expert that goodwill value was negligible and that he was familiar with 15 sales of medical practices in the area and that in only one of those was any value assigned to goodwill.

*Stuart and Stuart*, 107 Or. App. 549, 813 P.2d 49 (1991), involved a doctor who worked on contract in an emergency room. The court found there was no goodwill to consider, because husband had no private professional practice. "He does not maintain an office, has no accounts receivable and owns no equipment or supplies. As a result, wife's argument fails." *Stuart, supra*, 107 Or. App. 552.

*Peterson and Peterson*, 141 Or. App. 446, 918 P.2d 858 (1996), involved husband's sports medicine practice with offices in Eugene and Roseburg. The practice was valued on a formula provided by an appraiser. It added the value of the accounts receivable, cash on hand, goodwill, equipment, and furnishings and subtracted liabilities.

## **D. Contract Logging**

*Lankford and Lankford*, 79 Or. App. 742, 720 P.2d 407 (1986), held that there was no goodwill value in a logging business, when the evidence showed that the success or failure of the business was dependent on the husband owner's personal services and on his ability to generate new work. "There is generally no goodwill in such an

operation,' we wrote, 'unless the owner personally promised his services to accompany the sale of the business.'" *Lankford, supra*, at 745.

#### **E. Electrical Contractor**

In *Rolie and Kunkel*, 127 Or.App. 428, 433 n 3, 873 P.2d 397 (1994), the court found no goodwill value in a business operated by husband as a "one man shop." One customer accounted for 85 percent of his income, and his work for that customer was ending. The court said, "we question if the business is the kind that can have any goodwill value." *Rolie, supra*, at 400.

#### **F. Advertising Copywriter**

*Maxwell and Maxwell*, 128 Or. App. 565, 876 P.2d 811 (1994), involved the question of goodwill in relation to a self-employed advertising copywriter. The court found that the business had no goodwill because husband was the sole proprietor, and the success of the business depended on his skills and talents.

#### **G. Financial Service Company**

*Arends and Arends*, 141 Or. App. 340, 917 P.2d 1060 (1996), found substantial goodwill in two financial service companies operated by husband. The companies employed other professional employees, who were paid substantial salaries. The court discussed in detail the capitalization of earnings approach the experts used and noted that it is appropriate to subtract a reasonable salary expense from the income stream to arrive at normalized earnings for the company. The decision also mentioned that the court could consider case evidence of the sale and repurchase of a minority interest in the company as some evidence of value.

### **XI. CASH FLOW TREATED AS AN ASSET**

*Fisher and Fisher*, 148 Or. App. 208 (1997), involved the question of whether an insurance agent's income from future policy renewals should be counted as an asset when it has also been considered in connection with the award of spousal support. The 48-year-old husband was a sales manager for an insurance company. His income of

\$10,000 per month came from sales of new insurance policies and commissions from policies sold in previous years. The wife presented evidence that the present value of the future renewals was \$600,000 and that, after taxes, the future renewals had a present value of \$435,720. The trial court then granted wife an equalizing judgment of \$217,860, which was payable in installments including 9-percent interest. Husband argued that his future commissions were already counted in arriving at his \$2,500 monthly spousal support obligation and should not also be counted as property. The Court of Appeals rejected this argument, saying:

“. . . [T]he fact that an asset produces monthly income does not necessarily lead to the conclusion that it may not be valued as a marital asset. See *Colling and Colling*, 139 Or. App. 16, 22, 910 P.2d 1165, *rev den* 324 Or 78 (1996) (husband’s monthly retirement income treated as property); *Pugh and Pugh*, 138 Or. App. 63, 906 P.2d 829 (1995) *rev den* 322 Or 644 (1996) (personal injury award paid out monthly under an annuity treated as property). The characterization of an asset such as this as ‘income’ or ‘property’ for purposes of dissolution proceedings depends on the specific nature of the particular asset. In considering renewal commissions in particular, the contract between the agent and the employed is especially important. Under husband’s contract here, he has a vested right to the renewal commissions. If he leaves his employment with AFLAC, he will continue to receive the monthly income that he entitled to for the renewals unless he violates the noncompete clause. If he dies, his surviving spouse will receive 50 percent of the amount that husband is entitled to for the commissions. Husband’s employer may not unilaterally terminate husband’s right to these commissions unless he violates the contract. As discussed above, the fact that there is some uncertainty in the percentage of policies that actually will be renewed was considered in the valuation of this asset and, as demonstrated by that evidence, the value is adequately predictable and quantifiable. . . . Based on the above considerations, we conclude that the trial court properly treated the renewal commissions as a marital asset.”

*Fisher, supra*, at 213.

## APPENDIX A—INDEX OF CASES

1. *Adams and Adams*, 121 Or. App. 187, 854 P.2d 501 (1993) (lumber trading business). Affirmed a trial court finding of substantial goodwill value (five times projected earnings) in husband's international lumber trading business.
2. *Arends and Arends*, 141 Or. App. 340, 917 P.2d 1060 (1996) (financial service companies). Found substantial goodwill value in what was essentially a personal service business. The case discusses the methodology used in the capitalization of earnings method and also discusses evidence of value found in the sale and repurchase of a minority interest in the business.
3. *Barlow and Barlow*, 111 Or. App. 179, 826 P.2d 18 (1992) (family farm). Involved the valuation of husband's 15-percent interest in a family farm corporation. The trial court allowed a 25-percent discount for reduced marketability but rejected husband's argument that his interest should have been discounted by 75 percent due to a restrictive bylaw and his minority interest status.
4. *Batt and Batt*, 149 Or. App. 517, 945 P.2d 517, *rev den* 326 Or 323, 952 P.2d 60 (1997) (family farm). Husband held a minority position in various family farm operations. The court disallowed any minority or marketability discounts. The court reaffirmed its statement in *Tofte* that "valuation is a fact-based analysis necessarily taken on a case-by-case basis." The court held that this family farm situation was more like the situations in the *Webber* and *Barlow* cases in that the farm's value was derived from its underlying assets, and there was expert testimony to the effect that small family farm corporations are normally sold as a whole.
5. *Belt and Belt*, 65 Or. App. 606, 672 P.2d 1205 (1983), *modified on other grounds* 68 Or. App. 42 (1984) (family farm). *Belt* involved husband's 9-percent interest in a family farm corporation that had a restrictive stock redemption agreement. The court determined the stock's value to be the "net asset value" of the stock (not book value) minus a discount because it represented a minority interest in a closely held family corporation.
6. *Bidwell and Bidwell*, 170 Or. App. 239, 12 P.3d 76 (2000) ("Bidwell #1") (stock brokerage). Husband offered no appraisal evidence to rebut wife's evidence. Instead, he testified that in his opinion the company was worth much less and that if the court did not agree with his lower value, he was prepared to sell the company. Court affirmed trial court award of \$17 million adjustment judgment to wife.
7. *Bidwell and Bidwell*, 172 Or. App. 292, 18 P.3d 465 (2001) ("Bidwell #2") (stock brokerage). Husband petitioned for review, arguing the court should have ordered a sale. Case discusses when to sell versus award to operator.

8. *Bors and Bors*, 115 Or.App. 572, 839 P.2d 272 (1992) (scrap metal business). Case held that the capitalized earnings method was properly used to determine the value of this closely held corporation, and adjustments made because of the corporation's recent switch from partnership status were proper.
9. *Browning and Browning*, 28 Or. App. 563, 559 P.2d 1314 (1977) (farm operation). Court found trial court had undervalued husband's farm operation by not considering its value as a going concern and thereafter adjusted the property division.
10. *Cookson and Cookson*, 134 Or. App. 357, 362–363, 895 P.2d 345 (1995) (retail cookware store and coffee shop). The court approved of a capitalization of earnings approach to the value of a wife's store; however, the court adjusted the calculation by subtracting a reasonable salary expense for wife and her partner, thereby lowering the total value of the business.
11. *Fisher and Fisher*, 148 Or. App. 208 (1997) (insurance agent's future policy renewals). This case counted as marital property the present, after-tax value of husband's future policy renewals despite the fact that the future renewals were a part of his income stream from which he was expected to pay spousal support.
12. *Ford and Ford*, 26 Or. App. 353, 552 P.2d 563 (1976) (specialty advertising business). The court awarded the business to the wife but refused to impose noncompetition on the husband, saying restrictions on free competition are generally disfavored.
13. *Gibbons and Gibbons*, 194 Or. App. 257, 94 P.3d 879 (2004) (20.45 percent of logging operation). The court discounted the value of a controlling interest in the company by more than 75 percent because husband's shares were subject to a highly restrictive stock transfer agreement. The court accepted testimony from husband's experts to the effect that the proper assessment of husband's interest would be to consider the value of the cash flow resulting from an application of the terms of the stock transfer agreement together with the value of a possible future liquidation of the corporation.
14. *Goebel and Goebel*, 56 Or.App.52, 641 P.2d 59 (1982) (CPA practice). Held trial court erred in failing to consider the value of husband's professional practice even though it was the source of husband's income from which he must make support payments.
15. *Haguewood and Haguewood*, 292 Or. 197, 207–08, 638 P.2d 1135 (1981) (wheat farm). The case did not discuss valuation methods. It is best known for establishing the principle that an entity's value is greatest as an operating entity in the control of the person who best knows how to operate it.
16. *Hanson and Hanson*, 192 Or. App. 422, 86 P.3d 94 (2004) (electronic components). The case dealt with the question of whether a marketability discount should be applied to the value of a husband's majority interest in a closely held electronics manufacturing

company. The court held that it may be appropriate in certain circumstances such as where the evaluator has arrived at a value for the closely held company based upon the analysis of publically traded companies.

17. *Hinrichs and Hinrichs*, 37 Or. App. 833, 588 P.2d 130 (1978) (recreational vehicle sales). Court affirmed a modest goodwill value assigned to husband's one-third interest in the business, saying the valuation of the business must be as a going concern, which, generally, is greater than its asset value.

18. *Kelley and Kelley*, 40 Or.App. 605, 595 P.2d 1294 (1979) (CPA practice). Affirmed a trial court decision to include the tangible assets of husband's sole proprietorship CPA practice but declined to assign a goodwill value because it was too speculative.

19. *Kollman and Kollman* 195 Or. App. 108 (2004) (harvesting and marketing blue green algae products—voting rights). The case involved a long-term marriage in which the wife, some years earlier, had signed an agreement granting husband voting control over her shares in the business. Once the divorce was filed, husband sought to control wife's shares and later argued that her shares should have been awarded to him and/or that presumption of equal contribution was rebutted with respect to the shares. The Court of Appeals rejected these arguments and divided the stock equally between the parties.

20. *Lankford and Lankford*, 79 Or.App. 742, 745, 720 P.2d 407 (1986) (logging operation). Husband was the sole owner of a logging operation. The court found that his operation was dependent on his special expertise and ability to negotiate contracts. Thus, the business had no ongoing value, apart from its assets, in his absence.

21. *Madden and Madden*, 114 Or. App. 319, 836 P.2d 1349 (1992) (food ingredients sales). Trial court found it hard to value two-ninths interest, so it awarded the interest to husband but required him to provide wife with annual accounting and half of all future monies received on account of the interest. The Court of Appeals modified to give wife a simple money judgment because the trial court ruling left the parties too entangled when their relationship should be severed.

22. *Malloy and Malloy*, 31 Or.App. 1359, 572 P.2d 672 (1977) (grocery store). The issue was who got to own and run the store. There was no mention of value. The trial court found the husband had marketable skills and could become employed within a brief period of time. Since it would be more difficult for the wife to find employment, she was awarded the store.

23. *Maxwell and Maxwell*, 128 Or. App. 565, 876 P.2d 811 (1994) (advertising copywriter). Case involved the question of goodwill in relation to a self-employed advertising copywriter. The court found that the business had no goodwill because

husband was the sole proprietor and the success of the business depended on his skills and talents.

24. *McDuffy and McDuffy*, 184 Or. App. 359, 56 P.3d 449 (2002) (trucking business). Court held the trial court erred in assigning a goodwill value to the business where the trial court found the business had goodwill but the record was devoid of evidence as to precise value of it.

25. *Melander and Melander*, 92 Or.App. 342, 758 P.2d 415 (1988) (bullet mold manufacturer). Court rejected a book value approach in favor of a cash flow capitalization method.

26. *Messerle and Messerle*, 57 Or. App. 15, 18, 643 P.2d 1286 (1982) (family corporation raising beef and selling timber). The company had \$1.5 million in net earnings but distributed only modest income to the shareholders. The court approved a book value approach because neither party offered evidence of a going concern value.

27. *Olinger and Olinger*, 75 Or.App. 351, 356, 707 P.2d 64, *rev. den.* 300 Or. 367, 712 P.2d 109 (1985) (travel home and auto dealerships). This was one of the first cases to deal with the issue of valuation methodology. The case dealt with the value of husband's interests in travel home and auto dealerships. Husband's expert used a "book value" approach and proposed a deduction for future capital gains taxes. The court rejected husband's approaches in favor of a capitalization of earnings approach with no deduction for future taxes.

28. *Peterson and Peterson*, 141 Or. App. 446, 918 P.2d 858 (1996) (sports medicine practice). Husband's medical practice was valued based on a formula provided by an appraiser. It added the value of the accounts receivable, cash on hand, goodwill, equipment, and furnishings and subtracted liabilities.

29. *Phillipakis and Phillipakis*, 14 Or. App. 377, 513 P.2d 529 (1973) (restaurant business). An older case in which neither party offered expert testimony on value. Husband would operate the business. He felt it was worth \$20,000. His wife believed it was worth at least \$70,000. She offered evidence of a financial statement showing a value of \$80,000 and a buy/sell agreement that valued the business at \$140,000. The court noted that the \$140,000 value may have been for insurance purposes and did not contain any obligation on either party to purchase at the price recited in the agreement. The court affirmed the trial judge, who found the business was struggling and accepted husband's \$20,000 value.

30. *Reiling and Reiling*, 66 Or.App. 284, 291, 673 P.2d 1360 (1983), *rev. den.* 296 Or. 536, 678 P.2d 738 (1984) (law practice). Oregon's landmark case on valuing a lawyer's professional practice. The court affirmed trial court's refusal to assign a goodwill value

to husband's practice. The court also approved a minority discount of 25 percent in valuing husband's fractional interest in a closely held corporation.

31. *Rolie and Kunkel*, 127 Or.App. 428, 433 n 3, 873 P.2d 397 (1994) (electrical contractor). The court found no goodwill value in a business operated by husband as a "one man shop." One customer accounted for 85 percent of his income, and his work for that customer was ending. The court said, "we question if the business is the kind that can have any goodwill value." *Rolie, supra*, 127 Or. App. at 400.

32. *Slauson and Slauson*, 29 Or. App. 177, 562 P.2d 604 (1977) (convenience store). The court found business value was negligible where the balance sheet showed a net operating loss and a stockholders' equity of \$595. The court affirmed an award of the entire business to husband, saying: "Similarly in dividing the property the dissolution decree should seek to disentangle the parties' financial affairs and make them free from each other's interference. The friction resulting from the unsuccessful marriage partnership almost inevitably makes continued business association untenable." *Slauson, supra*, 20 Or. App. at 183-184.

33. *Steinbrenner and Steinbrenner*, 60 Or. App. 106, 652 P.2d 845 (1982) (medical practice). Court found some goodwill value in husband's Grants Pass medical practice despite testimony by husband's expert that goodwill value was negligible and that he was familiar with 15 sales of medical practices in the area and that in only one of those was any value assigned to goodwill.

34. *Stuart and Stuart*, 107 Or. App. 549, 813 P.2d 49 (1991) (physician working on employment contract). Case involved a doctor who worked on contract in an emergency room. The court found there was no goodwill to consider, because husband had no private professional practice. "He does not maintain an office, has no accounts receivable and owns no equipment or supplies. As a result, wife's argument fails." *Stuart, supra*, 107 Or. App. 552.

35. *Tofte and Tofte*, 134 Or. App. 449 (1995) (amusement park). The business in question was a family-owned amusement park near Salem called Enchanted Forest. This is Oregon's lead case on minority interest and marketability discounts. The court concluded that appraisers must evaluate whether or not to use a discount on a case-by-case basis.

36. *Triperinas and Triperinas*, 185 Or. App. 283, 59 P.3d 586 (2002) (auto dealership). Wife had a 10.5-percent interest in an auto dealership. The court averaged the differing expert values for goodwill, added the compromise goodwill value to the tangible assets, and then applied a 25-percent minority discount to the result

37. *Waker and Waker*, 114 Or. App. 255, 257, 834 P.2d 522 (1992) (engineering firm). The court modified a dissolution judgment to eliminate a provision that required corporate

shareholders who were not parties to the divorce case to *guarantee payments* to wife totaling \$373,445.

38. *Weakley and Weakley*, 177 Or. App. 363 (2001) (log-thinning business). Case involved valuation issues relating to husband's 50-percent interest in a small log thinning business. The court did the following:

- a. Accepted the value developed by wife's expert;
- b. Included a goodwill value because:
  - i. Husband was not the sole shareholder;
  - ii. Fifty percent of the company's business came from fixed contracts; and
  - iii. There was no evidence in the record that the business is dependent on husband's personality or reputation;
- c. Refused to deduct for assumed sales commissions that would be incurred *if* logging equipment were sold; and
- d. Refused to discount the shareholder loan owed by husband's company to him because "the amount of any discount would necessarily have to be speculative, based on the record before us."

39. *Webber and Webber*, 102 Or. App. 93 (1990) (farming operation). This ruling came out of a petition for reconsideration from the court's earlier ruling appearing at 102 Or. App. 93 (1990). Husband held a minority interest in a farming operation. In its original decision, the court rejected husband's arguments for a 25-percent minority discount and a 30-percent marketability discount and noted that if his interest were sold, it would probably be to his parents. On reconsideration, the court again disallowed the discounts, saying: "If a sale should occur, and there is no evidence of any prospective sale, it could as well be by a sale of the corporate assets at their fair market value as by a transfer of the stock. We decline to apply either a minority or a marketability discount." *Webber, supra*, at page 95.

40. *Wolhaupter-Heinzel and Heinzel*, 108 Or. App. 514 (1991) (gun shop). Court approved wholesale value of gun shop inventory where business had been losing money for several years.

## APPENDIX B—“DIVORCE VALUE: STANDARDS OF VALUE FOR PROFESSIONAL PRACTICES AND CLOSELY HELD BUSINESSES”\*

### I. A STATE OF CONFUSION IN MARITAL DISSOLUTION—STANDARDS OF VALUE IN BUSINESS VALUATION—INTRODUCTION

When a valuation expert undertakes to value a business, the expert usually first determines the standard of value to apply for the assignment. The expert looks to the attorney to inform the expert of the applicable standard of value in marital dissolution cases. We, as attorneys, and our experts turn to our state statutes and case law for the proper definition of the standard of value to apply. With the confused state of the law within many states, it is a very difficult task for attorneys and experts alike in those states to pinpoint the proper standard of value.

The standards of value appearing in state statutes and the case law interpreting those standards differ from state to state. Many state statutes simply state the standard of value to apply in marital dissolution cases is “value” or “net value” without further definition. The attorneys and experts then review case law to determine the characteristics that comprise the appropriate standard of value. In many instances, the case law creates confusion rather than clarifying or sensibly defining the characteristics of a standard of value.

Why is there such a state of confusion in many states relating to standards of value in valuing businesses and professional practices in the divorce context? The confusion seems to arise from the case law in which the courts are trying to define a standard of value to fit its state’s policy for a fair division of assets between divorcing parties. We will examine how courts in several states have interpreted standards of value with the goal of creating a fair division of assets in marital dissolution cases.

### II. STATUTES IN MANY STATES PROVIDE LITTLE, IF ANY, GUIDANCE OF THE APPLICABLE STANDARD OF VALUE

The standards of value defined by statute and further defined by case law in some jurisdictions baffle even the best experts. As John W. Marcus, in his article, “Where have all the Experts Gone?” in the *American Journal of Family Law*, Volume 17, Number 4 (Winter 2004), puts it:

When a credentialed expert values a business, we pay particular attention to the standard of value. We know that *fair market value* is the standard used by the IRS and in most types of litigation. We understand that *fair value* is usually used in shareholder disputes. . . . We are even familiar with the concepts of

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*intrinsic value* and *investment value*, but the standard of value that baffles even the most experienced valuator is what we sometimes refer to as *divorce value*.

## **A. Standards of Value**

The commonly accepted standards of value are defined as follows.

(a) Fair market value is typically defined as “the price, expressed in terms of cash equivalence, 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 where neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.” *International Glossary of Business Valuation Terms*.

(b) Fair value has often been used in dissenting minority interest shareholder suits, which has been either statutorily or judicially defined.

(c) Investment value is typically the value to a specific buyer requiring consideration of buyer specific attributes of the buyer, such as the buyer’s cost of capital as opposed to the market cost of capital. This value to a specific buyer is opposite to that of the hypothetical buyer assumed in the fair market standard of value.

(d) Intrinsic value is also referred to as “holder value” and is sometimes also referred to as investment value to the owner of the business. The intrinsic value typically recognizes the fact that the business owner going through a divorce will not be selling the business, and there is no hypothetical transaction as there is in the fair market value appraisal, and the owner will continue to receive the value of the business into the future.

(e) Divorce value varies from state to state.

## **B. State Statutes**

Jay Fishman, a nationally noted evaluator, notes that many state divorce property valuation and division statutes use the term “value” without any guidance as to the characteristics of the standard of value. Fishman, “Value: More than a Superficial Understanding Is Required,” *Journal of the American Academy of Matrimonial Lawyers*, Volume 15, Number 2, 1998, p. 322. For example, the Divorce Code in Pennsylvania does not indicate the “standard of value” to be employed. The New York Domestic Relations Law also does not define value. In Florida, fair market value is employed, not as a standard of value, but as one of the approaches for valuing professional goodwill. *Id.* at 323. North Carolina General Statute §50–20(c) provides there shall be an equal division by using “net value. . . .” The statute does not further define “net value.”

## **C. Judicial Interpretation**

Since the Divorce Code in Pennsylvania does not indicate the standard of value to use, Pennsylvania cases interpret the governing statutes to require “net realizable value.” In his article cited above, Jay Fishman reviews a number of Pennsylvania cases

involving business and professional practice valuations and concludes that the principle of valuation (standard of value) appears to be “realizable value.” Fishman concludes that the valuation task in Pennsylvania is to analyze the factors specific to the subject business or practice interest, including ownership agreements, and determine what value would be realizable in a transaction of the subject interest. *Id.* 327–328.

In his review of the New Jersey cases, Fishman notes that, “. . . cases create the interesting dichotomy of holding business valuations to the fair market value standard, while, in other instances, quantifying professional goodwill and even celebrity goodwill, which have no value in exchange.” *Id.* The same dichotomy appears in North Carolina cases.

In North Carolina, the courts have defined the statutorily mandated “net value” as being “market value, if any, less the amount of any encumbrance serving to offset or reduce market value.” *Alexander v. Alexander*, 68 N.C. App. 548, 315 S.E.2d 772 (1984). In the nearly 20 years since *Alexander*, North Carolina appellate courts have routinely stated that when making an equitable distribution of marital and divisible property, the court must “determine the net value of the marital property . . . with net value being market value, if any, less the amount of any encumbrances.” *Smith v. Smith*, 111 N.C. App. 460, 433 S.E.2d 196 (1993); *accord Walter v. Walter*, 149 N.C. App. 723, 561 S.E.2d 571 (2002); *Beightol v. Beightol*, 90 N.C. App. 58, 367 S.E.2d 347 (1988); *Nix v. Nix*, 80 N.C. App. 110, 341 S.E.2d 116 (1986).

The authors of “Divorce Valuations and Standards of Value” presented at the 2004 AAML/AICPA seminar note that many states started with a fair market value standard but have deviated from it. These authors state, “The reasons for the deviations from fair market value are as numerous as the thought processes of the various jurists making the decisions.” *Id.*

### III. VALUING GOODWILL—WHY DEVIATE FROM A WELL DEFINED FAIR MARKET VALUE STANDARD?

There is considerable discussion in many states whether use of a fair market value standard in every case, particularly when valuing the goodwill of professional practices and closely held businesses, satisfies the fundamental goal of creating a fair and equitable distribution of assets between divorcing parties.

Generally, the professional practice or closely held business will continue to operate after divorce. Goodwill is often the most valuable asset, though it may have little or no market value. The question then becomes how to value this intangible marital asset (what standard of value should be used) so as to compensate the nonprofessional spouse for his or her marital labor in the development of the asset, while at the same time recognizing that the professional spouse will be required to pay “tangible” dollars in exchange.

Some would argue that a fair market value standard ignores the contribution of the nonprofessional spouse in the development of the practice or business and creates a windfall for the professional spouse. Others would argue that utilizing a different standard, i.e., an “intrinsic value,” or as it is called in some jurisdictions “holder’s

value,” is highly speculative, results in excessive values, and forces the professional spouse to pay for gain that he or she may never realize.

The question also arises as to whether the fair market value standard can or should be applied in the face of a partnership agreement or shareholders agreement. For example, in *Weaver v. Weaver*, 72 N.C. App. 409; 324 S.E.2d 915 (1985), the court noted that the partnership agreements may be a presumptive value that can be attacked by either plaintiff or defendant is not reflective of “true value.” Assuming that “true value” is “fair market value” as defined by the North Carolina court in *Poore v. Poore*, 75 N.C. App. 414, 331 S.E.2d 266 (1985), and its progeny, then there must be a comparison of the value produced by the partnership agreement against an evaluation of the fair market value of the practice.

This manuscript will address how different jurisdictions have struggled with issues related to the applicable standard of value for valuation of the goodwill of professional practices and closely held businesses in attempting to achieve a fair division between divorcing spouses.

#### **IV. CONFUSION FROM THE APPLICATION OF THE FAIR MARKET VALUE STANDARD TO GOODWILL**

##### **A. The Fair Market Value Standard and Goodwill**

The fair market standard of value is the one most widely used and has been applied in inconsistent ways by courts in various jurisdictions in the valuation of goodwill of professional practices and businesses in divorce cases.

The authors of “Divorce Valuations and Standards of Value” presented to the AAML/AICPA 2004 National Conference on Divorce comment regarding the fair market value standard that

The objective of the fair market value standard is to determine a likely value for a business or interest in a business at which it might be sold. However, in the case of a non-marketable interest in a business, the value is purely hypothetical. It cannot be proven because it is an opinion of the analyst determining the fair market value. What it clearly is *not* is a transactional value. What a business or business interest is actually sold at is not its fair market value but rather its transactional value.

These authors further note,

“In marital dissolution cases the courts have often confused this standard. They have often commented that fair market value should not be used because in a marital dissolution the business or business interest is not to be sold. The fair market value standard does not contemplate a single sale but is much like a synthesis of possible sales. So in its raw state it still represents a sale albeit a hypothetical sale.”

So the fair market value standard begs the question, if an asset cannot be sold by law or by contract, can it have value applying a fair market value standard? Many experts and commentators say yes and others say no. Much of the confusion arising from the application of a fair market value standard to goodwill relates to whether or not the asset can be sold.

Jay Fishman, in his article “Whose Fair Market Value Is it Anyway?” observes that fair market value has been defined as being a sale between a hypothetical willing buyer and seller not under compulsion to buy or sell and having reasonable knowledge of all of the relevant facts. Fishman states that when one values an asset that is clearly not transferable, one ventures outside the confines of the application of the fair market value standard and fair market value assumptions. Fishman states the resulting analysis is then usually classified as intrinsic or holder value or investment value.

### **B. *Hamby v. Hamby*—A Good Example of the Debate**

The North Carolina case of *Hamby v. Hamby*, 143 N.C. App. 635, 547 S.E.2d 110 (2001), has created considerable discussion regarding the application of the fair market value standard to goodwill by a highly credentialed expert and is a good example of the debate. Many practitioners argue that the expert actually applied an intrinsic value standard. In *Hamby*, the trial court was called upon to value an insurance agency. The North Carolina Court of Appeals agreed with the trial court’s reliance on expert testimony by T. Randolph Whitt that, although pursuant to his agency agreement with Nationwide he was unable to sell or transfer the agency, the business still had value in excess of the agency’s fixed assets. This has led some to argue that the expert, while articulating the standard of value used in arriving at his value of the business’s goodwill as fair market value, actually applied an intrinsic value standard. They cite the following excerpt from the expert’s testimony as illustrative of this position:

To begin with I valued . . . the Agency as a going concern. It was a going concern on date of separation. And it’s my understanding when we say we’re valuing at fair market value we’re trying to determine *what if the entity that’s being valued could have traded hands* on date of separation, date of valuation. We don’t have to know there’s a buyer. It’s a hypothetical situation. . . . [W]e know on date of separation that the sale wasn’t imminent nor was it necessary. So my purpose in valuing, and I think the appropriate purpose in valuing the agency at date of separation is what is it worth to Mr. Hamby as a going concern.

*Hamby v. Hamby, id.* On the other hand, Randy Whitt, the highly credentialed expert in *Hamby, supra*, argues that even if a professional practice or business cannot be sold, such an entity can have value when applying a fair market value standard. T. Randolph Whitt, CPA, ABV, “Commentary on *Hamby*: The Courts Got it Right,” *Family Forum*, North Carolina Bar Association, Volume 24, Number 5, June 2004. Mr. Whitt testified in *Hamby, supra*, that Mr. Hamby’s insurance agency had value using a fair market

value standard even though it could not be sold pursuant to the agency's contract with Nationwide. Consequently, Hamby has served as the catalyst for significant discussion among practitioners and financial experts concerning the appropriate standard of value to be applied by North Carolina courts and practitioners when valuing a closely held business that is not marketable or transferable.

In explaining his valuation process, Mr. Whitt explained that when applying the fair market value standard, one assumes that it is a hypothetical buyer and seller situation using the definition of fair market value as indicated in the *International Glossary of Business Valuation Terms*. In concluding that the appropriate standard of value for equitable distribution purposes is "fair market value using a hypothetical situation," Mr. Whitt valued Mr. Hamby's ownership interest in the insurance agency assuming a hypothetical sale.

Mr. Whitt states that contracts to restrict transferring ownership in property should not have an effect on the underlying economic value of the entity. He explains that "[h]aving someone prepare a contract or an agreement to restrict the sale of the company or individual ownership in the company does not change the underlying economic factors. . . ." Mr. Whitt points out that while buy-sell agreements include provisions for the computation of value, to him, it seems inappropriate to accept a valuation premise that relies on a contract that can create or eliminate value. He argues, "[a] valuation of a closely held business for equitable distribution should be performed with the intent to determine the value with consideration and analysis regarding restrictions that can be changed with a new contract." Mr. Whitt further concludes, "[I]t may be very obvious, but if one is allowed to indicate that the value is determined by a buy-sell agreement, or a restriction that is simply based upon a contract, then it is likely we will see a lot of closely held businesses with zero value for equitable distribution purposes." Mr. Whitt also poses the question—what if the entity has accumulated "value" inside the business and cannot be distributed but retained? The extreme example could be that in the restricted nature of a Hamby Insurance Company, all funds over and above a normal operating salary could have been accumulated inside the entity and not distributed to the family, yet the value of the entity would still be considered to be restricted and not distributable. *Id.* Thus, in *Hamby*, Mr. Whitt argues he is properly applying a fair market value standard using a hypothetical buyer and seller even in the face of a contract restricting transferability.

### **C. Application of a Fair Market Value Standard to Professional Goodwill**

Further debate and confusion arises from the application of a fair market value standard to professional goodwill. We know that whether professional goodwill is even considered a marital asset to be divided depends on the jurisdiction. There are three basic views: (1) professional goodwill is never a divisible marital asset (Utah); (2) professional goodwill is marital and to be valued regardless of whether it is practice or personal (New Jersey, North Carolina); (3) differentiation between practice or entity goodwill and personal goodwill (Texas, Maryland, Florida, Wisconsin, Illinois, Pennsylvania, Mississippi, Indiana). A common example is where a health care

practitioner's personal goodwill is a large component of the health care entity's total value.

The basic idea underlying personal goodwill is that an entity has higher profits and therefore higher value as a result of an individual employee's unique abilities and characteristics, whereas entity goodwill is that goodwill which attaches to the practice and is not associated with the individual employee's unique abilities and characteristics.

In jurisdictions that include both personal and entity goodwill as marital or community property, a dilemma arises when applying the fair market standard to personal goodwill. Some experts say that under no circumstances can a fair market value standard be applied to personal goodwill. These experts say that a hypothetical knowledgeable buyer will not pay cash for personal goodwill. The assumption is that if the professional leaves the practice, the client will go with him or her. Experts will also tell you that if an intrinsic value standard is used to apply to professional goodwill instead of a fair market value standard, a higher value will always be obtained because the value will include both personal and entity goodwill. For this proposition, Jay Fishman cites the case of *Lopez v. Lopez*, 38 Cal. App. 3d 1044 (1974), which is very similar to the North Carolina case of *Poore v. Poore*, 75 N.C. App 414, 331 SE2d 266 (1985). The *Lopez* case involves the valuation of a professional practice. The factors, including age and health of the practitioner, demonstrated past earning capacity, reputation, and comparative professional success, were noted in *Lopez*. The wife's expert in *Lopez* used a modified capitalization of excess earnings method and did not apply a discount for lack of marketability because the husband was not going to sell his practice. Fishman notes that once an evaluator starts looking at a particular practitioner's age, health, judgment, and skill, you are looking at intrinsic value, not fair market value. Fishman, "Whose Fair Market Value Is it Anyway?" *supra*.

Common misunderstandings also develop when intrinsic or holder value is used interchangeably with fair market value. We see cases in several jurisdictions where a court may say it is applying the fair market value standard, but the factors described in the case are not the factors associated with fair market value. Many cases use different nomenclature to describe the characteristics of fair market value. For example, fair market value may be the presumed standard of value, but from an analysis of the case and a description of the characteristics being applied, it may appear the court is using intrinsic or holder value. *Fishman, id.*

Yet another nationally known expert, Gary R. Trugman, points out in his manuscript, "Valuation of Marital Property," that factors such as a professional's age, health, judgment, and skill may also be considered in a fair market value appraisal. Trugman notes the following:

However, many of these factors may also be considered in a fair market value appraisal. The intrinsic value argument takes the position that since the professional will be staying with the practice, it is important to consider these personal attributes of the individual. Since fair market value assumes *any willing buyer* rather than *a specific buyer* or *the owner*, consideration of personal

attributes violates the spirit of fair market value. The fair value argument states that the willing buyer must be able to carry on the practice in a similar manner as the willing seller, as such, must be able to have a similar level of ability (judgment and skill) to maintain the practice in a manner that has value. Clearly this can be argued both ways.

Problems thus arise when the fair market value standard is purportedly applied to the total of professional goodwill, also including personal goodwill. North Carolina courts and other states' courts have not made the distinction when valuing the goodwill of a professional practice between practice and personal goodwill. Can, then, a fair market value standard be properly applied to the personal goodwill component of professional goodwill? Nearly 20 years of appellate cases would indicate that North Carolina courts believe it is proper. However, given the opinions of experts as noted herein, it appears such an application might be challenged. Up to 36 states distinguish between personal and professional goodwill and exclude personal goodwill from the marital estate. Alerding, et al., "Divorce Valuations and Standards of Value," *supra*. These authors also comment, "Excluding personal goodwill is often seen as a deviation from Fair Market Value, but is it? If it cannot be transferred, then it shouldn't be a part of Fair Market Value."

#### **D. Separating Personal and Practice Goodwill**

In those states that do not recognize personal goodwill as a marital asset but do allow entity or practice goodwill to be included in the marital or community estate, methods have been used to separate the personal from the practice goodwill for valuation under a fair market value standard. Evaluator James Alerding from Indianapolis, Indiana, has stated there are no accepted methodologies to divide goodwill into personal and entity components, "Valuation of Personal Goodwill" presented to the American Academy of Matrimonial Lawyers (November 2003), but he discusses methods that have been used. Alerding points out that one method employed is if an entity can be sold in a market transaction, that might indicate a value that includes only entity goodwill. Another approach is to analyze the various factors that relate to entity versus personal goodwill and then to allocate the total goodwill to "entity" and "personal." Factors that indicate *personal* goodwill are such factors as appear in *Lopez v. Lopez*, 38 Cal. App. 3d 1044 (1974):

- The age and health of the professional;
- The professional's demonstrated earning power;
- The professional's reputation in the community for judgment, skill, and knowledge;
- The professional's comparative professional success;
- The nature and duration of the professional practice, whether as a sole practitioner or a contributing member of a partnership or professional corporation.

Alerding states, however, that the above-enumerated factors are used to value personal goodwill to which a fair market value standard cannot be applied. Alerding further

notes that, “Although the allocation between personal and entity goodwill based on these factors is an approach, one cannot assume that there is an ‘average percentage’ of goodwill that generally represents [personal] goodwill.” He also notes that there are no empirical studies that provide a baseline against which the specific personal goodwill might be measured and admits that the approach analyzing the various factors is subjective.

The state of Texas utilizes a fair market value standard and, thus, does not allow the inclusion of personal goodwill in the community property state with the premise that fair market value standard cannot be applied to personal goodwill. George P. Roach in the 1998 *Fairshare* article, Vol. 18, No. 8, August 1998, describes a methodology used by him in Texas to divide personal goodwill from practice or entity goodwill. Some of the factors used to identify the *entity* goodwill are:

- What would be an appropriate compensation package for the replacement for the professional spouse?
- Which customers or patients would be likely to follow the departing professional (i.e., over which accounts the professional has a controlling relationship)?
- Looking at competitors, would the pricing strategy need to change upon the departure of the professional spouse?
- How would departure of the professional spouse affect operating efficiency; does the professional spouse have unique management abilities (or weaknesses) to minimize operating costs?
- What are the qualifications of the remaining personnel?
- Is there tangible evidence of entity goodwill (cumulative advertising, years of ongoing business and reputation, databases, intellectual property, trade secrets)?
- How would the departure of the professional spouse change the operating risk of the business or practice?
- Are there any employment agreements or other contracts between the business and professional that would prevent him from competing with the business for a period of time?

These factors have been cited as factors that indicate that the goodwill has attached to the practice and is not based on the personal characteristics of the practitioner, such as age, reputation, and health of the practitioner.

#### **E. Methodologies Rejected and Accepted for the Valuation of Goodwill Under a Fair Market Value Standard**

Some experts also say that the excess earnings methodology cannot be properly applied under a fair market standard because it includes a component of earnings based on personal, as opposed to entity, goodwill. Some courts, using a fair market value standard, have not accepted the application of an excess earnings methodology to be applied to professional goodwill (*Fairshare*, Volume 18, No. 8, August 1998). *Hanson v. Hanson*, 738 SW2d 429 (Mo. banc 1987). *But see Wright v. Wright*, 2003 WL 22231909

(Neb. Ct. App. September 30, 2003), where expert used an excess earnings methodology that was approved because the expert was “careful to distinguish between professional goodwill and goodwill of the practice as an ongoing enterprise.” *See also Zasler v. Zasler*, 2003 WL 22076354 (Va. App. Ct. September 9, 2003), where, in valuing husband’s medical practice, the court accepted wife’s expert using the “capitalization of historical income method yet making a deduction of \$130,000 for husband’s personal goodwill.”

A number of courts using a fair market value standard of value have held that they will not require evidence of comparable sales, “so long as a reliable and reasonable basis exists for an expert to form an opinion.” *Makowski*, 613 So.2d 924, 926 (1993). On the other hand, the Missouri Supreme Court in *Hanson v. Hanson*, *supra* at 434, states the three exclusive methods of proof of the fair market value of professional goodwill are: (a) when there is evidence of a recent actual sale of a similarly situated professional practice; (b) “an offer to purchase such a practice” or (c) “expert testimony and testimony of members of the subject profession as to the existence of goodwill in a similar practice in the relevant geographic and professional market.” *Id.* at 435; White, Helga, “Professional Goodwill; Is it a Settled Question or Is There ‘Value’ in Discussing It?” *Journal of American Academy of Matrimonial Lawyers*, Vol. 15, 1998, No. 2.

Some experts have used a key man discount to quantify the personal goodwill.

Jurisdictions like North Carolina that have not differentiated between practice and entity goodwill for professional practices and apply a fair market standard to professional goodwill have repeatedly accepted the application of an excess earnings methodology when valuing professional goodwill under a fair market value standard with no differentiation between personal and practice goodwill.

## **F. Many Definitions of Fair Market Value**

After reviewing the case law of a number of jurisdictions and articles written by nationally recognized experts, it is apparent that there continues to be much debate as to the characteristics of fair market value in marital dissolution cases involving professional practices and closely held businesses. Even the most well regarded expert witnesses may have different interpretations of the applications of the principles of fair market value in a divorce setting, all the while trying to interpret the accepted divorce standard of value within a particular jurisdiction. These different views give matrimonial lawyers opportunities to advocate a position for the court to apply characteristics of the fair market value standard that will most favor that lawyer’s client. There is room for good lawyering and advocacy within this developing area of the law.

## **V. OTHER SELECTED CASE LAW**

In a number of other jurisdictions, courts have declined to dictate one standard of value when valuing nonmarketable goodwill. In addition, some jurisdictions have embraced an intrinsic valuation standard.

1. New York—*O'Brien v. O'Brien*, 502 N.Y.S.2d 250 (1986) (the court used an intrinsic value standard in valuing a medical license in equitable distribution).
2. *McNamara v. McNamara*, 178 Mich. App. 382, 443 N.W.2d 511 (1989) (valuation of law practice).

The trial court failed to value husband's law practice, stating, "This Court cannot reasonably place a value on the law practice. . . . [T]he law practice has no readily ascertainable market value." *Id.* at 392, 443 N.W.2d at 516.

The Court of Appeals found that the trial court abused its discretion in failing to value the law practice and remanded to the trial court for a determination of value. The Court of Appeals noted, "[T]here is nothing in the record to support the assumption that [Husband] will discontinue his law practice. Thus a *valuation of the practice should amount to its value to [Husband]* as a going concern. . . ." *Id.* at 393, 443 N.W.2d at 517 (emphasis added).

3. *In re Marriage of R.M. Lukens*, 16 Wash. App. 481, 558 P.2d 279 (1976) (valuation of medical practice).

[I]t is recognized that the practice of an attorney, physician, or other professional person may include such an element [i.e., goodwill], even though the goodwill in such instances is personal in nature and not a readily marketable commodity. *Id.* at 484, 558 P.2d at 281.

While we do not disagree with [Husband's] argument that his goodwill is not readily salable, we do not think it follows a fortiori that his goodwill is without value. *Id.* at 485, 558 P.2d at 281.

[W]e do not think the dispositive factor is whether [Husband] can sell his goodwill. His goodwill has value despite its unmarketability, and so long as he maintains his osteopathic practice in Tacoma he will continue to receive a return on the goodwill associated with his name. The fact that professional goodwill may be elusive, intangible, and difficult to evaluate is not a proper reason to ignore its existence in a proper case. . . . *Id.* at 486, 558 P.2d at 282.

The value of goodwill . . . is not synonymous with the spouse's expectation of future earnings. *Id.*

[Husband's] expert . . . concluded [the practice] had no goodwill of any value, his theory being that all income was derived solely from the doctor's personal efforts. *Id.* at 487, 558 P.2d at 282. The Court of Appeals rejected this conclusion.

4. *In re Marriage of Robert E. Zeigler*, 69 Wash. App. 602, 849 P.2d 695 (1993) (valuation of an insurance agency).

Husband entered into an agency agreement with State Farm Insurance Company, Inc. with Husband being an agent of State Farm. The agreement was later amended to incorporate Husband's agency with Husband being the sole stockholder. *Id.* at 603–604, 849 P.2d at 696. Husband's agency was a "captive" agency of State Farm in that all sales were limited to State Farm products; all policyholders and information related to their policies were trade secrets of State Farm; and Husband could not sell the record of policyholders to anyone. *Id.* at 604, 849 P.2d at 696.

Husband's expert testified that there was no goodwill or, alternatively, the value of the goodwill was zero based on the contractual limitations placed on Husband's agency by State Farm. Goodwill was an asset owned by State Farm that Husband merely developed. *Id.* at 605, 849 P.2d at 696–697.

The trial court found Husband's agency had no goodwill because its success was due to Husband's personal earning capacity. Further, Husband's income was a result of his skill, knowledge, and hard work; in short, his income was a result of his earning capacity. *Id.* at 607, 849 P.2d at 698.

Goodwill is not earning capacity; rather, it is an attribute of a business or professional practice which supplements earning capacity. Goodwill represents the expectation of continued patronage. . . . *Id.*

The Court of Appeals found that the agency's captive status meant that any expectation of continued patronage was indistinguishably intertwined with the reputation and goodwill of State Farm. If Husband terminated his relationship with State Farm, he could not solicit business from State Farm's existing policyholders. *Id.* at 608, 849 P.2d at 698. Since State Farm retains the expectation of continued patronage, State Farm retains the goodwill, not its captive agency. *Id.*

5. *In re the Marriage of Sharon Graff*, 902 P.2d 402 (Colo. Ct. App. 1994) (valuation of an insurance agency).

Husband's expert testified there was no property interest that could be identified in Husband's insurance agency because Husband was a "captive agent" whose rights were defined by his contract with State Farm Insurance Company, Inc. The expert emphasized that Husband was unable to sell his rights to the State Farm contract and could not assign the value represented by his ability to generate income. *Id.* at 404.

The trial court found the restrictions on transferring the agency did not preclude the existence of goodwill, particularly since there was no

evidence that Husband was contemplating any transfer or termination. The Court of Appeals agreed. *Id.* at 404.

Goodwill reflects not simply a possibility of future earnings, but a probability based on existing circumstances. Further, goodwill is a property or asset which supplements the earning capacity of another asset . . . and therefore, it is not the earning capacity itself. *Id.* at 405.

That goodwill may be difficult to value, is elusive in nature, and is not easily marketable, are not proper reasons to disregard it in the valuation of the marital estate. *Id.*

[T]he value of goodwill is not necessarily dependent upon what a willing buyer would pay for such goodwill; rather, the important consideration is whether the business has a value to the spouse over and above the tangible assets. . . . Goodwill may be valued even though an agreement, as here, prevents the sale of an agency. *Id.* at 405.

6. *Dugan v. Dugan*, 92 N.J. 423, 457 A.2d 1 (1983) (valuation of law practice).

[G]oodwill is essentially reputation that will probably generate future business. *Id.* at 429, 457 A.2d at 3.

Goodwill is keyed to reputation; going concern value to the enhanced value of the assets due to their presence in an established firm. . . . When goodwill exists, it has value and may well be the most lucrative asset of some enterprises. . . . Future earning capacity *per se* is not goodwill. However, when that future earning capacity has been enhanced because reputation leads to probable future patronage from existing and potential clients, goodwill may exist and have value. . . . Moreover, unlike the license and the degree, goodwill is transferable and marketable. *Id.* at 433, 457 A.2d at 6. After divorce, the law practice will continue to benefit from that goodwill as it had during the marriage. Much of the economic value produced during an attorney's marriage will inhere in the goodwill of the law practice. It would be inequitable to ignore the contribution of the non-attorney spouse to the development of that economic resource. An individual practitioner's inability to sell a law practice does not eliminate the existence of goodwill and its value as an asset. . . . Obviously, equitable distribution does not require conveyance or transfer of any particular asset. *Id.* at 434, 457 A.2d at 6.

Goodwill should be valued with great care, for the individual practitioner will be forced to pay the ex-spouse "tangible" dollars for an intangible asset at a value concededly arrived at on the basis of some uncertain elements. *Id.* at 435, 457 A.2d at 7.

As matters now stand limitations on the sale of a law practice with its goodwill have an adverse effect upon its value. However, as previously observed, goodwill may be of significant value irrespective of these limitations. *Id.* at 439, 457 A.2d at 9.

7. *Piscopo v. Piscopo*, 231 N.J. Super. 576, 555 A.2d 1190 (1988) (valuation of celebrity goodwill).

[D]ifficulty of determination is no deterrent to valuation where equity demands monetary compensation. *Id.* at 578, 555 A.2d at 1191.

Husband argued that professional goodwill is distinguishable from celebrity goodwill in that the latter requires ineffable talent which can have no “average” against which to measure. *Id.* at 578, 555 A.2d at 1191.

The Court of Appeals, in rejecting Husband’s argument, noted that tort law has protected infringement upon a celebrity’s financial interest in commercial use of his identity and that goodwill has always been a component of that interest. *Id.* at 579, 555 A.2d at 1192. It would be inequitable to protect Husband’s person and business from “another’s unjust enrichment by theft of [his] goodwill” and yet deprive a spouse from sharing in that very same protectible interest. *Id.*

That valuing Husband’s celebrity goodwill may be difficult does not eliminate the distributability of the celebrity goodwill. *Id.* at 580, 555 A.2d at 1192.

In the Wyoming case of *Newman v. Newman*, 842 Pac. 2d 575 (Wyoming 1992), the valuation dealt with husband’s minority interest in a family trucking business. In that case, husband’s expert utilized a comparable sales approach and took a 35-percent discount for lack of marketability. The wife’s expert did not include any discounts, agreeing that the business was not going to be sold, and no discounts were applied. The trial court adopted wife’s expert’s valuation. The Supreme Court of Wyoming agreed with the trial court, citing a distinction between the valuation of the business for divorce purposes and its value to a willing buyer leading one to conclude that the standard in Wyoming is closer to intrinsic or investment value rather than fair market value.

## VI. SELECTED ARTICLES

Alerding, James R., Fishman, Jay E., Mason, Miriam E., “Divorce Valuations and Standards of Value.” AAML/AICPA 2004 National Conference on Divorce (April 2004).

Cunningham, Joseph W. “Equitable Distribution and Professional Practices: Case Specific Approach to Valuation,” 73 MICH. B.J. 666 (1994).

Fishman, Jay E., and Bonnie O’Rourke, “Value: More than a Superficial Understanding Is Required,” *Journal of the American Academy of Matrimonial Lawyers*, Volume 15, Number 2, 1998.

Frumkes, Melvyn B., “Valuation of Professional Practices,” JOURNAL OF THE AMERICAN ACADEMY OF MATRIMONIAL LAWYERS, Volume 2, Number 1, 1986.

Marcus, John W., "Where Have All the Experts Gone?" *American Journal of Family Law*, Volume 17, Number 4 (Winter 2004)

Roach, George P., "A Business Appraisers Model for Separating Professional and Personal Goodwill," *Fairshare*, Volume 18, No. 8, August 1998.

Trugman, Gary R., CPA, ABV, MCBA, ASA, MVS, *Valuation of Marital Property*, (2004).

White, Helga, "Professional Goodwill: Is it a Settled Question or Is There 'Value' in Discussing It?" *Journal of the American Academy of Matrimonial Lawyers*, Volume 15, Number 2, 1998.

Whitt, T. Randolph, CPA, ABV, "Commentary on Hamby: The Courts Got it Right," *Family Forum*, N.C. Bar Association, Volume 24, Number 5, June 2004.

## VII. CONCLUSION

In many states, there is no generally recognized standard of value being consistently applied in divorce cases. Some states have defined the applicable standard through case law in an inconsistent manner. Some do not apply generally recognized characteristics to the stated standard of value. The inconsistent applications of standards of value in marital dissolution cases can make the task of valuing businesses difficult for the attorney and business valuator.

When valuing professional practices under the fair market value standard, many questions arise with the application of this standard to professional goodwill, which may include both personal and practice goodwill. As a result, there are inconsistencies in the decisions of the courts of various jurisdictions on how to properly value professional goodwill. If fair market value is the standard, then courts may need to differentiate between personal and practice goodwill because many experts believe that the fair market value standard cannot be applied to personal goodwill. However, those experts face problems in attempting to separate entity practice goodwill from personal goodwill, with some experts doubting whether this can be done with any measure of reliability. On the other hand, when applying a fair market value standard, some courts do not differentiate between personal and practice goodwill, which many experts argue is a misapplication of the fair market value standard and that the actual standard may instead be intrinsic or holder value.

Because of the uncertainties in many jurisdictions about the applicable standard of value and in some jurisdictions uncertainties about how to apply the fair market value standard to goodwill, the expert faces challenges in these states in formulating reliable opinions of value of professional practices and closely held businesses in divorce cases.

## NOTES