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 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. 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 non-professional 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 non-professional 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 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’ 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.

A. 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 healthcare practitioner’s personal goodwill is a large component of the healthcare 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, and his or her 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.”
B. **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.

C. 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 which 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.

D. 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 non-marketable goodwill. In addition some jurisdictions have embraced an intrinsic valuation standard.


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).


[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.


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. \textit{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. \textit{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. \textit{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. \textit{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 . . . \textit{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. \textit{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. \textit{Id.}


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. \textit{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. \textit{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.


Goodwill 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.

[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


Marcus, John W., “Where have all the Experts Gone?”, AMERICAN JOURNAL OF FAMILY LAW, Volume 17, Number 4 (Winter 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.