



## Divorce Courts Still Caught In 'Quagmire' of Goodwill

Dividing the value of professional practice goodwill is still creating a "quagmire for courts," according to the first of these recent decisions. Are corporate and professional goodwill truly distinct? How does a non-compete agreement affect the distinction? Should there be a rule against considering the professional's earnings in both the practice valuation and the maintenance award? Whether these four cases help answer the questions or deepen the quagmire, only time (and future litigation) will tell.

Wisconsin may have crafted a new standard.

In *McReath v. McReath*, 2010 WL 2943198 (Wis. App.)(July 29,2010), the husband bought his orthodontic practice during the marriage for \$930,000. During divorce, his expert valued the practice at only \$415,000, but the trial court rejected this value, based largely on the husband's buy-in price and his consistently high earnings. It adopted the \$1 million valuation by the wife's expert, attributing a substantial portion to professional goodwill, and used the husband's earnings to award the wife substantial maintenance. The husband appealed, arguing that state law precluded the division of professional goodwill and, further, it should not be used as a basis for spousal support when it was also factored into the overall practice value (the "double dip"). The wife's argument was simple: because the husband's professional goodwill was all *salable*—i.e., subject to a non-compete agreement—it was all divisible marital property.

The appellate court agreed that a non-compete would effectively transfer a substantial portion of the husband's goodwill to a potential buyer. Prior case law precluded the division of *non-salable* goodwill, but said nothing about "salable" goodwill, the court noted. Fairness considerations might also support dividing such salable goodwill. For example, what if the husband planned to retire and sell his practice the day after divorce? Under a *per se* rule prohibiting the division of all professional goodwill, the wife wouldn't share in the practice's full value, but the court would set maintenance knowing that retirement was imminent. Alternatively, a court could include salable goodwill in the property division and adjust maintenance accordingly, but without expert evidence to explain the correct offset, the court could not make such a determination or remand the case with adequate guidance. As a result, it confirmed the trial court's approach, "to include all salable goodwill, both corporate and professional, as a divisible asset and then, essentially, ignore . . . that [the husband's] earnings are intertwined." A single, strong dissent would have remanded the case for a fairness review of the maintenance award vis à vis the division of assets.

#### Tennessee court excludes patient files as professional goodwill

In *McKee v. McKee*, 2010 WL 3245246 (Tenn. Ct. App.)(Aug. 17, 2010), the wife owned a long-standing dental practice with two partners, one of whom recently bought his share for \$749,000, allocating 45% to professional goodwill and 34% to patient files and records. The wife's divorce expert appraised her 33% interest at only \$97,000, however, because state law required the exclusion of all professional goodwill, which he believed included the patient records. By contrast, the husband's expert classified the patient files as a separate asset from professional goodwill. This view was consistent with the two prior valuations for the partnership buy-ins, which he relied on to apportion the goodwill value between the business and the professionals, ultimately appraising the wife's one-third interest at \$460,000.

The trial court adopted the \$97,000 value, because in its opinion, the only salable assets would be the equipment and accounts receivable. It also found the patient records "had no value without a non-compete." The court awarded 75% of the marital property to the wife and 25% to the husband—and the husband appealed, but the appellate court deferred to the lower court's factual findings. It also found that state law excludes personal goodwill from the valuation of a professional practice, and confirmed the \$97,000 value of the wife's interest.

#### Ohio court limits professional goodwill to value of non-compete

In *Banchefsky v. Banchefsky*, 2010 WL 3527578 (Ohio App.)(Sept. 9, 2010), the husband sold his solo cosmetic dentistry practice for \$580,000 during the divorce, specifically allocating \$20,000 to patient records, \$15,000 for a non-compete, \$416,000 for unspecified goodwill, and the remainder to tangible assets. At trial, the husband's expert said the value attributed to the non-compete in the purchase agreement was "arbitrary." Using a quantitative model, the expert allocated \$215,000 to the non-compete as professional, non-divisible goodwill. The trial court accepted the model, but found it didn't apply due to the arm's length sale of the practice. It valued the husband's professional goodwill at \$15,000 and divided the remainder of the sale proceeds (\$565,000) equally between the parties.

On appeal, the court confirmed, finding 1) under state law, a covenant-not-to-compete constituted professional goodwill and was a non-marital asset; and 2) evidence of an actual sale and assigned value supported the trial court's \$15,000 valuation of the non-compete and distribution of the remaining sale proceeds.

Iowa declines to rule against the 'double dip'

Finally, in *In re Marriage of Barten*, 2010 WL 2598333 (Iowa App.)(June 30, 2010), the wife owned her own law practice, earning just \$44,000 per year from about \$88,000 in gross revenues and reported earnings of \$8,000, after payroll and expenses. The wife testified her practice had no value and operated at a loss, supported by her credit cards. "It is essentially like a job to me," she said. The husband estimated the practice was worth \$200,000, based on his estimate of the firm's gross. Neither party retained an appraisal expert.

The trial court valued the practice, its law office fixtures plus the wife's earnings, at \$56,000. The wife appealed, arguing that state law precluded the court from considering her earnings (professional goodwill). The Court of Appeals disagreed, citing Iowa cases that acknowledge precedent from other jurisdictions that permit divorce courts to value goodwill. Moreover, the Iowa cases that declined to value professional goodwill did consider the practitioner's earnings to determine child and spousal support. "Contrary to [the wife's] position, Iowa courts are not prohibited from considering goodwill or future earning capacity when determining the value of a professional practice," the court held, and confirmed the lower court's value.