



Lawyers Try Hard to Argue Their Firm Has No Goodwill Value

Dixon v. Crawford, McGilliard, Peterson & Yelish, 2011 WL 4348058 (Wash. App. Div. 1)(Sept. 19, 2011)

One of the five founding partners of a well-established, 30-year-old public defense firm left in 2006, taking all of his civil defense clients with him. Two years later, a junior (non-equity) partner left the firm and sued for an accounting and purchase of his interest. At this point, the senior founding partner—concerned about potential liability—intervened in the suit. But only after the court dismissed the junior partner’s claims did he assert his own for a judicial buyout.

Notably, the firm had no written partnership agreement, and the partners had always distributed 100% of the practice’s profits equally among themselves. Since the late 1990s, public defense contracts had generated over half the firm’s income, sufficient to pay its overhead as well as the salaries of employees who handled this work.

Law firm retains three experts. To establish the value of his one-fifth share in the firm, the dissociated partner presented an accounting expert, who used a capitalization of excess earnings approach, defining goodwill value as the “difference between the firm’s earnings and the remaining partners’ collective ‘replacement values.’” The expert ultimately determined the partner’s 20% interest ranged between \$350,000 and \$360,000, which included both the tangible and intangible (goodwill) values.

The law firm presented three accounting experts to value the entire practice. One testified that, in his experience, law practices carried no goodwill value, but the other two experts conceded that they do. All three agreed that, to the extent there is any goodwill value, the capitalization of excess earnings is an appropriate approach. Two of the three experts (the ones who conceded goodwill value) used substantially higher “replacement values” for the remaining partners than the expert for the dissociated partner did, and they ultimately concluded that there was no goodwill value in this particular firm, leaving only the tangible assets, which all four experts agreed were worth between \$36,000 and \$48,000 for a one-fifth share.

Because the firm was “highly respected” and had “enjoyed success as a preeminent public defense firm,” the court found the excess earnings method was appropriate. It valued the entire firm at \$1.16 million and awarded the dissociated partner \$232,142 for his share, plus nearly \$100,000 in statutory interest, and the law firm appealed.

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The appellate court held the only issue was the practice's value as a going concern, and the law firm had failed to cite any "law, policy, or disciplinary rule" that barred a dissociated partner from receiving his share of that value that constituted goodwill.

As to the method for valuing goodwill, the court rejected the law firm's argument that the capitalization of excess earnings approach was proper only in matrimonial cases, particularly since four out of the parties' five experts agreed that it applied in this case.

Finally, the firm tried to argue that by including the earnings from its public defense practice, the trial court had essentially "forced" the sale of the firm's contracts and treated its clients as "commodities." But this contention was equally unfounded, the appellate court held. Public defense contracts are no different for purposes of valuing firm goodwill than agreements to handle large litigation cases for employees, union members, or any other large class of clients.

In sum, "there is no definitive formula for ascertaining the value of goodwill," the court held, essentially defining goodwill as "the monetary value of a reputation." In this case, there was no partnership agreement that excluded a departing partner's claims to goodwill, and the trial court's method was logical and provided an "accurate reflection of the goodwill value of the firm as a whole," the appellate court found in affirming the award.