

Proof and Valuation of Personal Goodwill in a Professional Practice

by Kayte E. Rossi



Introduction

Trial courts have broad discretion in determining the classification and division of property in a divorce, including the existence and value of the property to be divided.¹ Property division in a divorce must be fair and equitable according to the circumstances, after the trial court considers all relevant factors.² Ascertaining the presence and value of the intangible property known as “goodwill” can pose a challenge.

In general, all property acquired during the marriage is classified as marital property, with a few exceptions.³ If a spouse owns a business, the business will also be classified as marital or separate property. The business is subject to valuation and division, like any other asset of the marital estate. A business typically has tangible assets, such as inventory or equipment, as well as intangible assets. These

intangible assets often include enterprise goodwill or professional (personal) goodwill.

Businesses can have enterprise goodwill, which retains a value as part of the practice, without the inclusion of any particular practitioner. Clients, patients or customers may seek out a particular practice, not necessarily any individual practitioner.

For professional practices, goodwill is often intertwined with an individual professional’s unique skills or reputation, in that the practice’s clients, patients, or customers seek out that individual practitioner.

In *Hanson v. Hanson*, the Missouri Supreme Court held that goodwill in a professional practice acquired during a marriage is to be classified as marital property subject to

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division in a divorce.⁴ It defined goodwill as:

...the value of the practice which exceeds its tangible assets, and which is the result of the tendency of clients/patients to return to and recommend the practice irrespective of the reputation of the individual practitioner.⁵

Thus, in Missouri, goodwill in a professional practice is subject to division in divorce, but it is only truly *valuable* to the property division where the goodwill exists independent of the unique skills and reputation of the individual practitioner.⁶

Hanson's Goodwill Analysis

To prove goodwill value in a divorcing spouse's professional practice, attorneys must be familiar with the fact-intensive methods of proof required by *Hanson* and its progeny.

Hanson describes and limits the methods of proof of goodwill as follows:

[A]s a matter of proof, the existence of goodwill is shown only when there is evidence of a recent actual sale of a similarly situated professional practice, an offer to purchase such a practice, or 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. Absent such evidence, one can only speculate as to the existence of goodwill. Divisions of marital property may not be based on speculation as to the very existence of the property being divided.⁷

Professional Practice

Hanson's guidelines only apply in a divorce which involves a professional practice or highly skilled personal service business.⁸ However, no Missouri cases have established an applicable test to determine whether a business qualifies as a professional practice. Each case must be decided on its specific facts and circumstances, giving precedent little value other than setting guidelines.⁹

Dental practitioners, chiropractors, physicians, accounting firms, veterinary practices, real estate brokerage firms, custom tailors and an art gallery purveyor have all been found to be professional practices subject to the *Hanson* analysis.¹⁰

Proving Goodwill Exists

Unless the existence of goodwill is established, the value of goodwill is immaterial. Once goodwill's existence is established, the preferred method of valuation is fair market value, apart from some circumstances where a buy-sell

agreement may serve as a method of valuation.¹¹

Cases often fail to meet these proof requirements, due to a failure to present credible evidence of goodwill's existence under the *Hanson* framework, which requires either a "recent actual sale of a similarly situated professional practice, an offer to purchase such practice or expert testimony and testimony from other members of the same profession as to the existence of goodwill in a similar practice in the relevant geographic market."¹²

The applicable methods of proof are simple in theory. When the value of marital property is in dispute, it is common to hire a valuation expert or appraiser to provide an opinion of value. If divorcing spouses do not agree on the value of their house, one (or both) will hire a real estate appraiser, who typically uses proprietary databases, entering criteria specific to the home in question, and using comparable sales assists in determining the house's value. The fair market value standard assumes the market is efficient and the area's comparable sales can be an indicator of value. *Hanson* extended this reasoning to goodwill in a professional practice. If others are paying a certain amount for the professional practice, which includes goodwill, then it reasonable to opine the market would pay a similar price for a similar professional practice.¹³

The required proof is extremely fact-specific. In many cases, there is not enough public information regarding the private transactions or comparable market for the specific type of professional practice in question.

Spousal claims that professional goodwill was undervalued in the property division have been found to be without merit, absent the required proof of goodwill's existence.¹⁴ The Missouri Court of Appeals, Southern District remanded a case where the parties did not prove goodwill existed under the *Hanson* analysis, but the trial court nevertheless assigned a professional or personal goodwill value to Husband's chiropractic practice.¹⁵ At trial, Wife's expert testified that he had no comparable transactions to demonstrate a recent sale or offer of purchase, and Husband's expert gave no opinion on the existence or value of goodwill in the chiropractic practice. Therefore, the Court of Appeals found the trial court's assignment of goodwill value in error and improperly impacted the overall marital property division.¹⁶

In a case involving Husband's dental practice, Wife argued that other dentists' negotiations in severance of their contracts with Husband's practice was evidence of a "recent actual sale."¹⁷ The Western District disagreed, holding that releasing the contractor-dentists from their noncompete agreements and the severance of their business relationship with Husband's practice was not a sale contemplated by the *Hanson* framework.

Size Is Not Determinative

Small businesses are less likely to have goodwill value attributable to them, but size alone is not determinative as to whether a business is “similarly situated.” The Eastern District held that businesses subject to *Hanson* are those in which the personal reputation and the service provided by the *spouse* are the reasons that clients return to and recommend the business, rather than the *reputation* of the business entity.¹⁸ In a seven-person roof consulting business where Husband was a “key” employee, and Wife admitted the business was “worth more” with Husband running it this evidence was held not to be sufficient to apply the *Hanson* framework to the business.¹⁹ Courts reached similar conclusions in cases involving a family-owned pharmacy and a machine shop that was started in the couple’s garage.²⁰

Highly Skilled Personal Services

Where no separation between the individual and the practice can be made, there will be no goodwill value. The Eastern District held a custom tailor’s business had no goodwill value, where the tailor testified that he had received no offers for purchase, and even if he had, his business could not be sold, as his customers came to him specifically for his unique suit designs and no one else could work with his customers.²¹ No evidence was offered as to any sales or offers for sale of other custom tailor shops in the St. Louis area.²² A fellow custom tailor testified that he and Husband were the only custom tailors in the area and distinguished his and Husband’s custom tailor shops from those which only take measurements and send the clothing elsewhere for manufacture.²³ In a different case, a similar argument precluded a finding of goodwill value where the business was a sole proprietorship art studio, and no evidence was presented of the sale of similar businesses.²⁴

Similar logic has been employed to a law practice’s purported goodwill value. The Southern District analyzed Husband’s solo law practice and found that if Husband were to terminate his business “the lights would go out and the value...extinguished.”²⁵ Further, a lawyer’s clients “cannot be sold” and are dissimilar from tangible assets like inventory. Representation can only be transferred to another lawyer with the client’s express consent.²⁶

Geographic Area & Scope of Market

The market for one type of professional practice will not necessarily be the same as the market of another practice.²⁷ When recent offers for sale are presented as proof, the factual inquiry includes a determination of the professional practice’s scope, relevant geographic market and professional market.²⁸

In *Gerard v. Gerard*, both spouses retained experts to value Wife’s solo accounting practice including any goodwill. The experts agreed there were no sales of accounting

practices similar to Wife’s in Jefferson City, Missouri, but disagreed on the “relevant geographic and professional market.”²⁹ Wife’s expert opined that the relevant market was limited to Jefferson City and the practice’s value included only tangible assets and receivables, not goodwill. In the opinion of Husband’s expert, however, the relevant market extended to Columbia; this expert noted three sales of accounting practices in Columbia as the required proof that goodwill existed for Wife’s solo practice.³⁰ Despite the latter testimony, the trial court’s ruling that no element of goodwill was included in the value of Wife’s accounting practice was upheld by the Western District, adopting Wife’s expert’s opinion of value.³¹

Valuing Goodwill

Goodwill’s existence and its valuation are separate issues.³² Once existence of professional or personal goodwill is proven, the focus shifts to the valuation process and its impact on asset distribution.³³

The value of property to be divided in a divorce is a factual determination by the trial court, and trial courts may receive any relevant evidence to determine value.³⁴

Trial courts are wary of considering valuation dates so remote in time that they render the opinion of value stale. Generally, the valuation date for property is the date of trial. However, if a basis exists, courts will consider an earlier date. The Western District has upheld a valuation using a report written 26 months prior to trial.³⁵

Fair Market Value Preferred

Where no active market exists, value is a function of negotiation between the buyer and seller.³⁶ In divorce, unless a particular entity was already going to enter the market to sell, the business’s value would not be at issue absent the divorce litigation.

The *Hanson* court stated its preference for “fair market value”: the saleable price of the practice in question on the open market to a qualified professional. In some circumstances, the buy-sell agreement may also be used as evidence of goodwill value.³⁷

The Missouri Supreme Court reasoned that using the fair market value standard (i) avoids assigning value to future earnings, (ii) requires an analysis of comparable businesses sold in the relevant market, and (iii) avoids placing a judicially determined value on something that otherwise could not actually be sold or liquidated for that value.³⁸ The same reasoning was applied by the Court in rejecting various permutations of capitalization formulae as speculative, as these formulae place a present value on future earnings and “[p]rofessional goodwill may not be confused with future earning capacity. We have not declared future earning

capacity to be marital property.”³⁹

Attorneys employing experts should be careful if a *Hanson* valuation is at issue. Experts may provide various approaches to valuation in divorce cases, and, in doing so, may consider goodwill as going concern value as a component in their overall business valuation.⁴⁰ Early on after *Hanson*, parties continued to use capitalization formulae, which took goodwill into consideration. However, for purposes of valuing goodwill in a professional practice, the *Hanson* analysis requires first the proof of goodwill, and only then proof of the value of the goodwill using either fair market value (which is really a standard of value, not a valuation approach) or, when applicable, a buy-sell agreement.⁴¹

When professional goodwill is assigned a value but is not proven using the *Hanson* framework, appellate courts have reversed or remanded those cases for error and reconsideration, because goodwill value can profoundly impact the overall division of marital property.⁴²

Conclusion

Missouri courts recognize professional goodwill as a marital asset subject to division. Because valuation can materially impact the overall distribution of property in a divorce, attorneys should be mindful of what is required by the limited methods of proof and valuation of goodwill in a professional practice. ❀

¹ *Thill v. Thill*, 26 S.W.3d 199, 203 (Mo.App. W.D. 2003); *Herschend v. Herschend*, 486 S.W.3d 346 (Mo.App. S.D. 2015).

² *Moen v. Moen*, 140 S.W.2d 611, 613 (Mo.App. W.D. 2004).

³ Exceptions include property acquired during the marriage by gift, bequest, or inheritance. § 452.330, RSMo (2016) *et seq.*

⁴ *Hanson v. Hanson*, 738 S.W.2d 429, 434 (Mo. banc 1987).

⁵ *Id.*

⁶ Mary Kay Kisthardt, *Professional Goodwill in Marital Dissolution Cases: The State of the Law*, in VALUING PROFESSIONAL PRACTICES AND LICENSES: A GUIDE FOR THE MATRIMONIAL PRACTITIONER, §1.03(c) (Ronald L. Brown, 4th ed. 2014).

⁷ *Hanson*, *supra* at 435-36; *In re Marriage of Stephens*, 954 S.W.2d 672, 674 (Mo.App. S.D. 1997).

⁸ *Knigge v. Knigge*, 903 S.W.2d 225, 227 (Mo.App. E.D. 1995).

⁹ *Id.*

¹⁰ *Knigge*, *supra* at 226; *Theilen v. Theilen*, 847 S.W.2d 116 (Mo. App. W.D. 1992); *In re Marriage of Parker*, 762 S.W.2d 506 (Mo.App. S.D. 1998); *Ikonomou v. Ikonomou*, 776 S.W.2d 868 (Mo.App. E.D. 1989); *Gerard v. Gerard*, 825 S.W.2d 21 (Mo.App. W.D. 1992); *Cohn v. Cohn*, 841 S.W.2d 782 (Mo.App. E.D. 1992); *Wilson v. Wilson*, 822 S.W.2d 917 (Mo.App. E.D. 1991); *Hogan v. Hogan*, 796 S.W. 2d 400 (Mo.App. E.D. 1990).

¹¹ *Hanson*, *supra* at 436.

¹² *Id.* at 435.

¹³ Mark Kohn, *A Primer on the Excess Earnings Business Valuation Method, Its Strengths and Weaknesses*, in VALUING PROFESSIONAL PRACTICES, *supra* note 6, §10.03.

¹⁴ *Cohn*, *supra* at 786; *Gerard*, *supra* at 21; *Taylor v. Taylor*, 736 S.W.2d 388 (Mo. banc 1987).

¹⁵ *In re Marriage of Parker*, 762 S.W.2d 506, 511 (Mo.App. S.D. 1988).

¹⁶ *Id.*

¹⁷ *Theilen*, *supra* at 121.

¹⁸ *Knigge*, *supra* at 227.

¹⁹ *Id.*

²⁰ *Stephens*, *supra* at 674; *In re Marriage of Brooks*, 742 S.W.2d 585, 589-90 (Mo.App. W.D. 1987).

²¹ *Ikonomou*, *supra* at 872.

²² *Id.*

²³ *Id.*

²⁴ *Hogan*, *supra* at 408.

²⁵ *In re the Marriage of Hershewe*, 931 S.W.2d 198, 204 (Mo.App. S.D. 1996).

²⁶ *Id.*

²⁷ *Gerard*, *supra* at 24.

²⁸ *Id.* at 23.

²⁹ *Id.* at 22.

³⁰ *Id.* at 23.

³¹ *Id.* at 22-23.

³² *Parker*, *supra* at 762.

³³ Kisthardt, *supra* note 6, at §1.05.

³⁴ *Thill*, *supra* at 203; *Herschend*, *supra* at 357; *D.K.H. v. L.R.G.*, 102 S.W.3d 93, 102 (Mo.App. W.D. 2003); *In re Marriage of Morris*, 588 S.W.2d 39, 43 (Mo.App. W.D. 1979).

³⁵ *Sparks v. Sparks*, 417 S.W.3d 269 (Mo.App. W.D. 2013).

³⁶ Randall B. Wilhite, *The Effect of Goodwill in Determining the Value of a Business in Divorce*, 35 FAM. L.Q. 351, 354 (2001).

³⁷ *Hanson*, *supra* at 436.

³⁸ *Id.*

³⁹ *Id.* at 435.

⁴⁰ *Taylor*, *supra* at 390.

⁴¹ *Id.*; *Theilen*, *supra* at 121.

⁴² *Parker*, *supra* at 506.