

Summer 1988

Like Pulling Teeth: Identifying, Proving and Valuing Professional Goodwill at Marital Dissolution in Missouri

Thomas M. Harrison

Follow this and additional works at: <https://scholarship.law.missouri.edu/mlr>



Part of the [Law Commons](#)

Recommended Citation

Thomas M. Harrison, *Like Pulling Teeth: Identifying, Proving and Valuing Professional Goodwill at Marital Dissolution in Missouri*, 53 Mo. L. REV. (1988)

Available at: <https://scholarship.law.missouri.edu/mlr/vol53/iss3/7>

This Note is brought to you for free and open access by the Law Journals at University of Missouri School of Law Scholarship Repository. It has been accepted for inclusion in Missouri Law Review by an authorized editor of University of Missouri School of Law Scholarship Repository. For more information, please contact bassettcw@missouri.edu.

LIKE PULLING TEETH: IDENTIFYING, PROVING AND VALUING PROFESSIONAL GOODWILL AT MARITAL DISSOLUTION IN MISSOURI

*Hanson v. Hanson*¹

With the Missouri Supreme Court's 1987 decision of *Hanson v. Hanson*, Missouri joined other states that have considered the difficult issues surrounding the asset of goodwill in a marital dissolution proceeding to which a professional is a party.² The *Hanson* court faced and resolved issues of divorce and the division of a professional's marital property more firmly than had previous courts.³ The Missouri Supreme Court held that goodwill in a professional practice is property subject to division in a dissolution, and it considered issues relating to proving the existence and value of such goodwill.⁴

1. 738 S.W.2d 429 (Mo. 1987) (en banc).

2. See generally *Wisner v. Wisner*, 129 Ariz. 333, 631 P.2d 115 (1981); *Todd v. Todd*, 272 Cal. App. 2d 786, 78 Cal. Rptr. 131 (1969); *Golden v. Golden*, 270 Cal. App. 2d 401, 75 Cal. Rptr. 735 (1969); *Mueller v. Mueller*, 144 Cal. App. 2d 245, 301 P.2d 90 (1956); *In re Marriage of Nichols*, 606 P.2d 1314 (Colo. Ct. App. 1979); *In re Marriage of White*, 98 Ill. App. 3d 380, 424 N.E.2d 421 (1981); *Powell v. Powell*, 231 Kan. 456, 648 P.2d 218 (1982); *Heller v. Heller*, 672 S.W.2d 945 (Ky. Ct. App. 1984); *Brandis v. Brandis*, 489 A.2d 1110 (Me. 1985); *In re Marriage of Hull*, ___ Mont. ___, 712 P.2d 1317 (1986); *Taylor v. Taylor*, 222 Neb. 721, 386 N.W.2d 851 (1986); *Dugan v. Dugan*, 92 N.J. 423, 457 A.2d 1 (1983); *Weaver v. Weaver*, 72 N.C. App. 409, 324 S.E.2d 915 (1985); *Nail v. Nail*, 486 S.W.2d 761 (Tex. 1972); *In re Marriage of Fleege*, 91 Wash. 2d 324, 588 P.2d 1136 (1979); *Holbrook v. Holbrook*, 103 Wis. 2d 327, 309 N.W.2d 343 (1981).

3. For example, Missouri appellate courts have been faced several times with the issue of whether a spouse's graduate or professional degree is marital property under MO. REV. STAT. § 452.330 (1986). Missouri has stopped short of expressly classifying degrees as marital property in the familiar situation of when one spouse puts the other through graduate or professional school; instead, the law in Missouri is that courts may consider contributions made by one spouse toward the other's professional education in balancing the interests of each spouse. See, e.g., *Scott v. Scott*, 645 S.W.2d 193 (Mo. Ct. App. 1982); *Lowrey v. Lowrey*, 633 S.W.2d 157 (Mo. Ct. App. 1982); *In re Marriage of Vanet*, 544 S.W.2d 236 (Mo. Ct. App. 1976). Similarly, in the *Hanson* opinion, the supreme court reemphasized that future earning capacity is not marital property in Missouri. 738 S.W.2d at 435. In general, it appears that courts are more willing to declare that goodwill is marital property despite the attendant problems with valuation. H. FOSTER & R. BROWN, CONTEMPORARY MATRIMONIAL LAW ISSUES: A GUIDE TO DIVORCE ECONOMICS & PRACTICE 230 (1985); Krauskopf, *Marital Property at Marriage Dissolution*, 42 MO. L. REV. 157, 169 (1978).

4. 738 S.W.2d at 439. This case was one of first impression in Missouri. *Id.*

Richard Graham and Jonathan Hanson, both oral surgeons, formed a partnership in 1973 in Jefferson City, Missouri.⁵ Dr. Hanson married in 1974 after completing his education. Mrs. Hanson had obtained a nursing degree and during the marriage earned a master's degree in nursing.⁶ The Grahams were married in 1969, four years before the partnership was launched, and Dr. Graham completed his education during the marriage.⁷

Both couples found it necessary to initiate dissolution proceedings; the Hanson dissolution was tried in Boone County and the Graham case in Cole County.⁸ Mrs. Hanson and Mrs. Graham employed the same accountant to testify as an expert with regard to the value of the oral surgery partnership.⁹ The husbands relied on expert testimony from another accountant. The results of the experts were not uniform; the wives' expert testified that the partnership's total value was \$442,212.00, but the husbands' expert arrived at a total value of only \$91,000.00.¹⁰ In addition, Dr. Hanson employed an oral surgeon from Columbia, Missouri, who testified that when he purchased an interest in a similar partnership he paid nothing for goodwill or going concern value.¹¹ Finally, both Drs. Graham and Hanson introduced their partnership agreement, which dictated that goodwill was not to be a component of a partner's interest.¹²

The trial courts reached disparate results. The Circuit Court of Boone County valued the partnership at \$324,862.00,¹³ but the Circuit Court of Cole County valued Dr. Graham's interest in the partnership at only \$45,140.00.¹⁴ After appeals, the Missouri Supreme Court granted transfer and consolidated the cases.¹⁵

The supreme court's opinion had several components: it defined goodwill for the purposes of dividing it in a dissolution,¹⁶ it gave guidance regarding the methods that should be used to prove that goodwill exists in a professional

5. *Id.* at 431.

6. *Id.* at 432.

7. *Id.*

8. *Id.*

9. *Id.* at 431.

10. *Id.* The expert for the wives attributed a value of \$39,750.00 to equipment, \$51,385.00 to accounts receivable and \$351,077.00 to "going concern value." The husbands' expert, however, determined that no goodwill or going concern value existed after comparing the subject partnership with similar partnerships in the area.

11. *Id.*

12. *Id.* at 431-32.

13. *Id.* at 432. This total consisted of \$39,750.00 for equipment, \$51,385.00 for accounts receivable and \$233,727.00 for the partnership's ordinary income for the preceding year. The trial court used the partnership agreement in arriving at the result.

14. *Id.*

15. *Id.* at 430-31.

16. *Id.* at 433-37. In a somewhat unorganized fashion, the court attempted to spell out what is and what is not included in the Missouri definition of goodwill. See *infra* notes 19-55 and accompanying text.

practice¹⁷ and it sorted through several ways in which to value goodwill.¹⁸ This Note will analyze the court's opinion so as to arrive at a definition of Missouri's view of goodwill in similar cases, discuss the methods that were approved or rejected for proving the existence and value of goodwill, and examine related issues and trends in this area.

MISSOURI'S CALCULUS OF GOODWILL

The *Hanson* court, like courts and commentators elsewhere, struggled in its search for a definition of goodwill and the parameters of the concept of goodwill.¹⁹ The court went from quoting the venerable English case of *Cruttwell v. Lye*²⁰ to citing accounting texts.²¹ While the court considered three familiar definitions, it did not adopt any succinct description of goodwill.²²

A general understanding of goodwill can be had through the following familiar definition:

Goodwill may be properly enough described to be the advantage or benefit which is acquired by an establishment beyond the mere value of the capital, stock, funds, or property employed therein, in consequence of the general public patronage and encouragement which it receives from constant or habitual customers, on account of its local position, or common celebrity, or reputation for skill or affluence, or punctuality, or from other accidental circumstances or necessities, or even from ancient partialities or prejudices.²³

Any concept of goodwill in the professional context, then, must include the notion that it is something beyond the value of the tangible, identifiable assets of a business.²⁴

The view of goodwill from a legal standpoint has not developed uniformly

17. *Id.* at 435. See *infra* text accompanying notes 56-57.

18. *Id.* at 435-37. The court mentioned five valuation methods, expressed a "strong preference" for one and rejected a variety of other methods utilizing accounting principles. *Id.* at 436. See *infra* notes 58-82 and accompanying text.

19. See *supra* note 16.

20. 7 Ves. 335, 34 Eng. Rep. 129 (Ch. 1810).

21. *Hanson*, 738 S.W.2d at 433.

22. *Id.* The court noted that a "common theme in all of these definitions is that the goodwill which can be sold, and is therefore property, attaches not to an individual but to a business entity." *Id.* This proposition is discussed *infra* notes 27-29 and accompanying text.

23. J. CRANE & A. BROMBERG, LAW OF PARTNERSHIP § 84 (1968).

24. *Hanson*, 738 S.W.2d at 433. This Note will not carry on an extended discussion of the various points of view regarding goodwill's exact nature. For such discussions, see Adams, *Is Professional Goodwill Divisible Community Property?*, 6 COMMUNITY PROP. J. 61 (1973); Lurvey, *Professional Goodwill on Marital Dissolution: Is it Property or Another Name for Alimony?*, 52 CAL. ST. B.J. 27 (1977); Comment, *Valuation of Professional Goodwill Upon Marital Dissolution*, 7 SW. U.L. REV. 186 (1975). Instead, the only definition with which this Note is concerned will be that of Missouri as enunciated in *Hanson*, along with the attendant problems.

with accounting and economic views.²⁵ One commentator has argued that it is accountants and economists who have shaped the concept of goodwill and understand it best; judges, however, when faced with issues pertaining to goodwill have tended to distort the concept.²⁶ The main flaw in the legal concept is that courts have often failed to distinguish between individual and business earnings.²⁷ More specifically, goodwill has been erroneously identified with the reputation of the individual.²⁸ Missouri's treatment of goodwill in *Hanson* and its sister case, however, began correctly as the supreme court declared that "the reputation and skill of an individual entrepreneur — be he a professional or a traditional businessman — is not a component of the intangible asset we identify as goodwill."²⁹

Missouri law after *Hanson* also dictates that, in dissolution proceedings, goodwill is to be synonymous with the concept of going concern value.³⁰ Going concern value certainly has characteristics similar to those of goodwill, but in a strict accounting sense the two are distinct.³¹ The United States Supreme Court described going concern value as "an element of value in an assembled and established plant, doing business and earning money, over one not thus advanced."³² The going concern element, then, refers to the amount by which the total value of a business entity exceeds the value of the separate items of property; the excess value is a result of the fact that the assets already have been combined into the form of a business.

Courts often have failed to distinguish goodwill from going concern value when such a distinction is needed.³³ The *Hanson* court cited two cases supporting the courts' traditional treatment of goodwill and going concern value as the same in dissolution proceedings.³⁴ Whether courts have done this unknow-

25. See Parkman, *The Treatment of Professional Goodwill in Divorce Proceedings*, 18 FAM. L.Q. 213 (1984).

26. *Id.*

27. *Id.* at 215.

28. *Id.* Fortunately, the *Hanson* court took steps to avoid making this common mistake. 738 S.W.2d at 433. See *supra* note 22.

29. *Hanson*, 738 S.W.2d at 434. The court noted that its view is "consistent with and no broader than the economic, accounting and legal definition" which has developed. *Id.* Insofar as considerations of *reputation* are concerned, the court is correct.

30. *Id.* at 437.

31. Comment, *Valuation of Professional Goodwill Upon Marital Dissolution*, 7 Sw. U.L. REV. 186, 187 n.6 (1975).

32. *Los Angeles Gas & Elec. Corp. v. Railroad Comm'n*, 289 U.S. 287, 313 (1933) (quoting *Des Moines Gas Co. v. City of Des Moines*, 238 U.S. 153, 165 (1915)); see also *City of Denver v. Denver Union Water Co.*, 246 U.S. 178, 191-92 (1918). *Los Angeles Gas & Electric* is a good example of an instance in which goodwill was expressly not held to be synonymous with going concern value. The case dealt with the issue of whether rates for public service corporations were confiscatory. The *Hanson* court, in contrast, held that goodwill and going concern value were the same in dissolution proceedings. See *supra* note 30 and accompanying text.

33. Cf. *Northern Natural Gas Co. v. United States*, 470 F.2d 1107, 1108-09 (8th Cir. 1973) (warning against such confusion of the two principles).

34. *Hanson*, 738 S.W.2d at 437. The court cited *In re Marriage of Hall*, 103

ingly or with purpose, the approach probably is acceptable even though the concepts differ from an accounting point of view.³⁵ Where a professional practice is involved the difference between the two concepts is less important,³⁶ and therefore Missouri is in line with most other states in treating goodwill and going concern value as equivalents in dissolution proceedings.

The *Hanson* court devoted only a paragraph to the issue of future earning capacity, holding that goodwill is not to be confused with future earning capacity.³⁷ This separation is especially appropriate in Missouri, where courts never have held that future earning potential is marital property.³⁸ Further, it is consistent with the majority of American jurisdictions.³⁹

Cases in other states such as California have rejected the equation of goodwill and future earning potential. *In re Marriage of Aufmuth*⁴⁰ rejected such an argument, as did *In re Marriage of Lopez*.⁴¹ The *Lopez* court summarized its position: "We think . . . that in marital cases the expectancy of future earnings is not synonymous with, nor should it be the basis for, determining the value of 'goodwill' of a professional practice, but is simply a factor to consider in deciding if such an asset exists."⁴² If Missouri follows this reasoning, it is clear that future earning capacity has no place in the goodwill equation in Missouri.

The *Hanson* court criticized cases which treated professional goodwill at dissolution but failed to distinguish the *individual* professional's reputation from the *business entity's* reputation.⁴³ Here again, although the Missouri Supreme Court took care to avoid other courts' mistakes, the court's analysis on the point is susceptible to the criticism that it is superficial.

Wash. 2d 236, 692 P.2d 175 (1984) (en banc), and *In re Marriage of Hull*, ___ Mont. ___, 712 P.2d 1317 (1986).

35. Accounting texts may distinguish goodwill and going concern value by giving goodwill a less expansive understanding. Goodwill is only a part of going concern value because goodwill is only the amount actually paid that is more than a firm's specific assets when another company is purchased. See A. DREBIN, *Other Intangibles*, in HANDBOOK OF MODERN ACCOUNTING 22-15 (1977).

36. See Comment, *Valuation of Professional Goodwill Upon Marital Dissolution*, 7 SW. U.L. REV. 186, 187 n.6 (1975).

37. *Hanson*, 738 S.W.2d at 435; see *supra* note 3.

38. *Hanson*, 738 S.W.2d at 435.

39. Comment, *Identifying, Valuing and Dividing Professional Goodwill as Community Property at Dissolution of the Marital Community*, 56 TUL. L. REV. 313, 323 (1981).

40. 9 Cal. App. 3d 446, 152 Cal. Rptr. 668 (1979).

41. 8 Cal. App. 3d 93, 113 Cal. Rptr. 58 (1974).

42. 8 Cal. App. 3d at 108-109, 113 Cal. Rptr. at 68. Other factors mentioned by the court were "the practitioner's age, health, past demonstrated earning power, professional reputation in the community as to his judgment, skill, knowledge, his comparative professional success, and the nature and duration of his business. . . ." *Id.*, 113 Cal. Rptr. at 68. The *Hanson* court discussed these factors in view of the professional's reputation. See *infra* notes 43-52 and accompanying text.

43. *Hanson*, 738 S.W.2d at 433.

The court criticized *Dugan v. Dugan*,⁴⁴ which held that "reputation is at the core" of professional goodwill.⁴⁵ One critic of *Dugan* and other cases which confuse individual reputation with goodwill argued that the cases are "placing a value on an individual's reputation, which is something possessed by everyone."⁴⁶ Similarly, the court criticized *In re Marriage of Fleege*⁴⁷ for having the same defects as *Dugan*.⁴⁸

After citing *Dugan* and *Fleege* as examples of cases which incorrectly take reputation into account, the supreme court cited with approval three cases which view goodwill "independently of the individual professional's reputation."⁴⁹ *Taylor v. Taylor*⁵⁰ contains a particularly lucid discussion of the reputation facet of goodwill. In that case, goodwill is considered a distinct business asset and as such has a readily determinable value as part of a commercial or business entity. If the asset depends on the presence of an individual, however, it obviously and by definition cannot be an asset distinct from the individual.⁵¹ *Hanson* was consistent with *Taylor* in holding that goodwill "is the result of the tendency of clients/patients to return to and to recommend the practice *irrespective of the reputation of the individual practitioner*."⁵²

Finally, *Hanson* held that goodwill in Missouri is not affected by the size or organization of a professional practice.⁵³ Professional goodwill obviously may exist in either a solo practice or a very large firm, but the problem often is proving its existence.

The definition of goodwill in a professional practice proffered by the Missouri Supreme Court includes "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

44. 92 N.J. 423, 457 A.2d 1 (1983).

45. *Id.* at —, 457 A.2d at 6.

46. Parkman, *The Treatment of Professional Goodwill in Divorce Proceedings*, 18 FAM. L.Q. 213, 219 (1984).

47. 1 Wash. 2d 324, 588 P.2d 1136 (1979) (en banc).

48. *Fleege* listed the almost identical factors that *Lopez* did. See *supra* note 42. The *Hanson* court disapproved of these factors with these words: "Each of these factors is, in our view, directly attributable to the professional as a person. For this reason, we find that the *Fleege* analysis is mired in the same mixture of personal reputation and entity reputation as is found in *Dugan*." 738 S.W.2d at 434.

49. *Hanson*, 738 S.W.2d at 434. Based on what the court said about *Dugan* and *Fleege*, it appears that the court liked what was said in *Taylor v. Taylor*, 222 Neb. 721, 386 N.W.2d 851 (1986); *Beasley v. Beasley*, 359 Pa. Super. 20, 518 A.2d 545 (1986); and *Geesbreght v. Geesbreght*, 570 S.W.2d 427 (Tex. Civ. App. 1978).

50. 22 Neb. 721, 386 N.W.2d 851 (1986).

51. *Id.* at 731, 386 N.W.2d at 858.

52. *Hanson*, 738 S.W.2d at 434 (emphasis added).

53. *Id.* at 435. The court said that it is more likely that goodwill will exist in large firms "because reliance by patients/clients on the reputation and skill of the individual practitioner is, in most cases, inversely related to the number of practitioners in the practice." *Id.* No authority was offered for this assertion.

individual practitioner.”⁵⁴ A complete description of goodwill in Missouri — complete at least as far as *Hanson* is concerned — would state that the concept may attach only to a business entity, does not depend on the organization or size of a firm, is generally synonymous with a firm’s going concern value. It is not linked to a professional’s future earning capacity or reputation as an individual.⁵⁵

PROVING THE EXISTENCE OF GOODWILL

Hanson devoted only one paragraph to the problem of proof of goodwill’s existence. The court’s reason for this lack of discussion is that it was concerned that certain valuation methods may confuse value and proof.⁵⁶ In his discussion of proof Judge Robertson again referred to the complexities surrounding reputation.

If nothing else, by saving space in its discussion of proof, the court strengthened its clarity. Everything the practitioner needs to know about proving the existence of goodwill in a professional context in Missouri (at least immediately after *Hanson*) was contained in two sentences:

Because of the difficulties inherent in separating the reputation of the professional from that of his enterprise, evidence that other professionals are willing to pay for goodwill when acquiring a practice is, in our view, the *only* acceptable evidence of the existence of goodwill. Thus, as 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.⁵⁷

Because of the definiteness with which this statement was made, *Hanson* offers a clear guide to the practitioner regarding the method of proof. At the same time, however, it offers flexibility in that a party may use expert testimony, recent sales and offers to purchase to prove goodwill valuation.

VALUATION

The problem of valuing goodwill probably has been the foremost hurdle with which courts have had to deal.⁵⁸ The *Hanson* court outlined five formulas

54. *Id.* at 434.

55. As indicated in note 2, *supra*, no fewer than fourteen states have dealt with the issue in *Hanson*. On the issue of defining goodwill, the court seemed to express a preference for three cases from other jurisdictions. See *supra* note 49. Therefore, it may be wise for anyone dealing with this aspect of goodwill in Missouri to read those cases in conjunction with *Hanson*.

56. *Hanson*, 738 S.W.2d at 435.

57. *Id.* (emphasis added).

58. See Comment, *Identifying, Valuing, and Dividing Professional Goodwill as Community Property at Dissolution of the Marital Community*, 56 TUL. L. REV. 313,

which are most often used in the valuation stage. In so doing, it stated a preference for one and rejected another widely used formula.⁵⁹

The method of valuation to be used in Missouri, according to *Hanson*, is the fair market value approach, under which goodwill's value is set by the sale price of the practice in the market.⁶⁰ The court offered three reasons for its preferential treatment of this method. First, it does not consider future earning capacity. Second, it is the most accurate measure. Third, it does not require the professional to pay his former spouse a sum that is not a result of a realistic valuation.⁶¹

Fair market value, of course, is the value assigned to an asset by a buyer and seller, both of whom are willing parties in the transaction and have full knowledge of the facts.⁶² Therefore, to be useful, the approach would seem to require a sale of the asset. This probably is the most serious flaw in applying the fair market value method, since the sale of a practice rarely coincides with the parties' divorce. In many cases the problem of lack of a sale is ignored, and instead the fair market value essentially is estimated using expert testimony. In addition, prices in similar sales can be used to estimate the value of a practice's goodwill.⁶³ The use of these alternatives to a sale are not entirely consistent with a fair market value approach, however, because that method, in its true form, necessitates a sale.

Although the court expressed a preference for the fair market value approach, it gave very little guidance on the crucial question of how fair market value will be determined under less than ideal circumstances. The fair market value approach is fraught with difficulties, uncertainties and imprecision, but the court's off-hand treatment belies these facts. A business comparable to the one being valued will be very difficult to find. Expert testimony will present additional problems. What, for example, will the experts examine in order to prepare their testimony? As was the case in *Hanson*, trial courts almost always will be confronted with the task of choosing between the testimony of opposing experts. These concerns and unanswered questions were not adequately addressed in the opinion.

The problem of lack of a sale price sometimes can be overcome by using other means to set a fair market value. *Hanson* declared that a buy-sell agreement could be used under "certain circumstances."⁶⁴ A buy-sell agreement can meet the requirements of a test for determining fair market value if a

330-31 (1981).

59. *Hanson*, 738 S.W.2d at 435-36.

60. *Id.*

61. *Id.* at 436.

62. Comment, *Professional Goodwill in Louisiana: An Analysis of its Classification, Valuation, and Partition*, 43 LA. L. REV. 119, 142 (1982).

63. *Id.* at 142.

64. *Hanson*, 738 S.W.2d at 436. See also *Geesbreght v. Geesbreght*, 570 S.W.2d 427, 434-36 (Tex. Civ. App. 1978), in which a buy-sell agreement was heavily relied upon.

willing buyer and seller are involved.⁶⁵ The parties to a partnership frequently determine at the outset the respective values of their interests in the entity, and this established value can be used for several purposes, including valuation upon the sale by a partner of his interest or valuation upon the death of a partner. The buy-sell agreement would seem to represent an indication of what the business is worth from the partners' viewpoints.

Hanson dictates that a buy-sell agreement may be used on the issue of goodwill valuation when the trial court finds that it is proper.⁶⁶ Using a buy-sell agreement, however, is subject to a good deal of criticism. The value of a partner's interest which is set out in a buy-sell agreement, for example, may not represent goodwill value or it may not constitute an accurate measure.

Still, the fair market value method seems to be a popular approach among many courts.⁶⁷ Despite the approach's shortcomings, the Missouri practitioner should become familiar with it and, in view of *Hanson*, should use it whenever possible. Even with its uncertainties and disadvantages,⁶⁸ the fair market value method has been used in states such as Texas,⁶⁹ Colorado⁷⁰ and it is very popular and frequently used in California.⁷¹ Finally, the Internal Revenue Service seems to favor the approach over the other commonly used methods.⁷²

65. This discussion will view a buy-sell agreement as one way that can be used to determine goodwill's fair market value. It should be noted that *Hanson* used as an example of a buy-sell agreement "the value established in a partnership agreement. . . ." *Hanson*, 738 S.W.2d at 436. However, the parties to a buy-sell agreement are not necessarily (or often even remotely) considering fair *market* value of business assets when drafting the agreement. Ordinarily, neither party will know who will be buying and who will be selling, and, therefore, the parties have an incentive to arrive at only a "fair" price. Even so, the price determined may not necessarily be appropriate in a dissolution situation. In short, a buy-sell agreement ordinarily is not formulated to provide a value for assets in the event a partner subsequently goes through a divorce. Relying on such an agreement in such circumstances, therefore, contains hazards if the goal is to arrive at market value.

66. *Id.*

67. See Comment, *supra* note 62, at 142. The word "preferred" is not defined in the comment. It is not explained whether the fair market value approach is simply the most *popular* or whether courts believe it is the most accurate gauge. *Id.* To the extent that an accurate fair market value can be determined, few would quarrel that the method should be used. However, it is not often that an accurate market value can be determined. See text accompanying notes 63-64 *supra*.

68. See *id.* at 143-44. See *supra* note 65 and accompanying text.

69. *Geesbreght v. Geesbreght*, 570 S.W.2d 427 (Tex. Civ. App. 1978).

70. *In re Marriage of Nichols*, 43 Colo. App. 383, 606 P.2d 1314 (1979).

71. See, e.g., *In re Marriage of Aufmuth*, 89 Cal. App. 3d 446, 152 Cal. Rptr. 668 (1979); *In re Marriage of Lopez*, 38 Cal. App. 3d 93, 113 Cal. Rptr. 58 (1974); *In re Marriage of Foster*, 42 Cal. App. 3d 577, 117 Cal. Rptr. 49 (1974); *In re Marriage of Fortier*, 34 Cal. App. 3d 384, 109 Cal. Rptr. 915 (1973).

72. Rev. Rul. 68-609, 1968-2 C.B. 327, 328 states that other approaches "may be used for determining the fair market value of intangible assets of a business only if there is no better basis therefor available."

Three other methods commonly used on the valuation issue, all of which are complex accounting formulas, were rejected in *Hanson* because they "draw no distinction between the future earning capacity of the individual and that of the entity in which he or she practices."⁷³ This apparently ill-thought-out pronouncement by the *Hanson* court is the most troubling aspect of the opinion. Although the practitioner obviously should concentrate on the fair market value and buy-sell agreement approaches outlined above, the methods which were rejected merit some attention, if for no other reason than to see what Missouri is missing.

Under a straight capitalization method, the professional's average net profits are determined, and this figure is then capitalized using a definite rate.⁷⁴ The result yields what is the total value of the business; to determine goodwill, the business's book value is subtracted from the total value.⁷⁵ Some judges and commentators — like the Missouri Supreme Court — have not endorsed the straight capitalization method because, they say, it is arbitrary⁷⁶ and fails to consider the professional's excess earnings.⁷⁷

Finally, the court rejected the capitalization of excess earnings method.⁷⁸ There are two recognized variations of this method. In one, the average practitioner's salary is deducted from the average net income of the practice and the difference is capitalized to determine goodwill.⁷⁹ The IRS variant requires a valuation of the net tangible assets and then a determination of the value of goodwill by capitalizing any excess earnings over a reasonable return on the net assets.⁸⁰

73. *Hanson*, 738 S.W.2d at 436. The disapproved methods were the straight capitalization method, the capitalization of excess earnings method and the Internal Revenue Service variation of capitalized excess earnings.

74. *Id.* at 435; *In re Marriage of Hall*, 103 Wash. 2d 236, 243-44, 692 P.2d 175, 179 (1984) (en banc). The capitalization rate represents the percentage of return on capital which will be attractive to investors. See 5 AM. JUR. PROOF OF FACTS 505, 515 (1960), which contains a standard approach to proving the value of goodwill.

75. *Hanson*, 738 S.W.2d at 435. For illustrations of this method, see *In re Marriage of Hall*, 103 Wash. 2d 236, 244, 692 P.2d 175, 179 (1984) (en banc); G. WELSCH, C. ZLATKOVICH & W. HARRISON, INTERMEDIATE ACCOUNTING 521 (5th ed. 1979).

76. See Comment, *Valuation of Professional Goodwill Upon Marital Dissolution*, 7 SW. U.L. REV. 186, 194 (1975).

77. G. WELSCH, C. ZLATKOVICH & W. HARRISON, *supra* note 75, at 521; see also *Levy v. Levy*, 164 N.J. Super. 542, 547, 397 A.2d 374, 376 (1978).

78. *Hanson*, 738 S.W.2d at 436.

79. *Id.* at 435.

80. Rev. Rul. 68-609, 1968-2 C.B. 327. Following this formula, the following steps could be used to value the goodwill of a business:

1. Determine the average earnings of the business for a representative number of years immediately preceding the date on which valuation occurs. Earnings should be based on at least the last five years, disregarding years with abnormally high or low earnings.
2. Arrive at the average annual value of the tangible assets of the business for a representative number of years before the valuation date.

In rejecting these accounting formulas the *Hanson* court made its most harmful error. The court explained that its rationale for rejecting capitalization formulas was their consideration of future earning capacity.⁸¹ An analysis of greater scrutiny than that of the court proves this claim inaccurate.

All of the factors which go into the formula — the business's average net income and the business's average net tangible assets — involve *past* earnings or assets data. In other words, past earnings and assets are used to determine *current* goodwill. The postmarital experiences of the professional spouse are not considered because the goodwill that was generated during the marriage exists at time of dissolution.⁸² The capitalization formulas, therefore, do not necessarily present the problem which distressed the *Hanson* court.

INITIAL REACTIONS TO AND APPLICATION OF *Hanson*

In *Taylor v. Taylor*,⁸³ which was decided the same day as *Hanson*, the Missouri Supreme Court made it very clear that it meant what it had said in *Hanson*. In *Taylor*, Patricia Taylor had been trained as a chiropractor during the marriage and had founded the Taylor Chiropractic Center.⁸⁴ At trial, David Taylor employed an expert to place a value on the chiropractic practice.⁸⁵ The expert arrived at a total value of \$280,978.00, which included \$121,334.00 attributable to goodwill.⁸⁶ In arriving at the value of the practice's goodwill, however, the expert capitalized the average adjusted annual net income of the practice.⁸⁷

Both the trial court and the supreme court held that there was no evi-

3. Determine a "fair percentage return" (usually the industry average) on the tangible assets determined in 2.

4. Deduct 3 from 1, which yields the amount of average earnings attributable to goodwill.

5. Capitalize the amount resulting from 4 at a proper percentage (usually about 20%). This results in the fair market value of the goodwill.

21 Fed. Tax Coordinator 2d (Res. Inst. Am.) P-6517 to P-6522 (1988).

81. *Hanson*, 738 S.W.2d at 436. The court said: "The very purpose of capitalization formulae is to place a present value on the future earnings of the business entity being valued."

82. See generally Krauskopf, *Marital Property at Marriage Dissolution*, 43 MO. L. REV. 157, 170 (1978) ("It seems that the only valuation methods that do not utilize evidence of individual future prospects are those applying a capitalization multiple derived either from the I.R.S., from retirement or buy-sell agreements, or from guidelines in the industry or profession.") Other courts have shared the same fear concerning future earnings which was expressed by the *Hanson* court. *In re Marriage of Foster*, 42 Cal. App. 3d 577, 117 Cal. Rptr. 49 (Dist. Ct. App. 1974), for example, approved two of the accounting methods rejected in *Hanson* because they *do* measure goodwill by looking at the past.

83. 736 S.W.2d 388 (Mo. 1987) (en banc).

84. *Id.* at 389.

85. *Id.*

86. *Id.*

87. *Id.*

dence that the chiropractic practice had any goodwill element. The husband in *Taylor* failed to produce evidence of the fair market value of any goodwill. Nor did he present evidence of the sales prices or offers on similar practices in the same area.⁸⁸ As a consequence and example of an application of *Hanson*, the husband did not prove that the professional practice involved had any goodwill value.

*In re Marriage of Brooks*⁸⁹ provided an interpretation of *Hanson* (which, of course, concerned only goodwill in the professional context) and the treatment of commercial goodwill in a divorce context. The only issue in *Brooks* was how the goodwill in a family machine and tooling business should be valued upon dissolution of marriage.⁹⁰ The *Brooks* court held that the goodwill was marital property and that the capitalization of excess earnings method was a proper valuation method.⁹¹

The expert who valued the goodwill of the business involved in *Brooks* used the capitalization of excess earnings method.⁹² The court correctly noted that the method "appears to be a method approved by accountants and accepted, for the most part, by the courts."⁹³ In explaining its interpretation of *Hanson*, the court said:

[W]e consider that in *Hanson v. Hanson* . . . our Supreme Court held that the goodwill of a commercial or professional corporation is an intangible asset susceptible of division under the provisions of § 452.330, if it may properly be classified as marital property within the intent of § 452.330.2; that *Hanson* also held the goodwill of a professional corporation is peculiar to organizations of that order, and its value should be determined by ascertaining the price the professional practice would bring were it sold on the open, relevant market to a qualified professional. We do not understand that our Supreme Court necessarily rejected all other methods of valuing goodwill if the corporation or other business entity is a commercial business enterprise.⁹⁴

This interpretation gives rise to the hope that Missouri courts are on the right track with respect to valuing commercial goodwill in the dissolution context and will not in the future resort to the superficial analysis of the *Hanson* court as to professional goodwill. Unfortunately, the *Brooks* court did not attempt to explain why accounting formulas are appropriate when dealing with commercial goodwill but not when dealing with professional goodwill.⁹⁵ This is a question on which the supreme court should eventually rule and, if the difference remains, explain itself.

88. *Id.* at 390.

89. 742 S.W.2d 585 (Mo. Ct. App. 1987).

90. *Id.*

91. *Id.* at 590. In actuality, the only relevance which *Brooks* has to this Note is its interpretation of *Hanson* and, in contrast to the *Hanson* opinion, its sensible treatment of accounting methods to value the asset of goodwill.

92. *Id.* at 589.

93. *Id.*

94. *Id.* at 590.

95. Perhaps this is because there is no sound reason for the differentiation.

CONCLUSION

In *Hanson*, the Missouri Supreme Court had another chance to deal with important issues relating to disposition of property at marriage dissolution. While the court more forcefully and willingly decided the questions presented to it,⁹⁶ its opinion nevertheless deprives parties the chance to prove adequately the value of professional goodwill. The court's imprecise analysis and holding effectively will reduce such cases to a confrontation between expert witnesses. The Missouri practitioner's central objective in dissolution actions involving professionals after *Hanson* may be to package his expert's testimony in the slickest package possible.

THOMAS M. HARRISON

96. See *supra* note 3 and accompanying text.

