

# Valued News



**TRINITY**  
Valuation Consulting Group, PLC

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## Business Valuation Considerations for Divorce



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Jason Fleming has valued over 500 businesses over his ten year career as a business valuation expert. He has provided expert witness testimony in both federal and local courts.

Valuation professionals should have sufficient knowledge of case law relating to business valuation matters in the courts.

Trinity performs business valuations for a number of reasons including that of marital dissolution or divorce. For our readers that practice in this area, we would like to provide you with five factors to consider the next time a business is part of the marital estate of your client.

1. Consider talking to a business valuation professional. A credible professional should be willing to review the financial information of the business and the facts and circumstances of the case to let you know whether a business valuation should be pursued. This should be done free of charge. Trinity encounters many businesses that have nominal, if any, value. We also encounter many businesses that have value ranging from \$100,000 to \$50,000,000. While a professional valuator will not be able to give you an exact number on the front end, they should be able to tell you whether or not a business valuation should be pursued.
2. Not all valuation analysts are the same. There are a multitude of questions to be answered before a business valuation professional is chosen. Although price of the valuation and expert testimony should be considered, it certainly should not be the driving factor. There are many other considerations such as: Does the professional have the appropriate valuation credentials? Do they have sufficient experience providing expert witness testimony for court and depositions? Does the expert have experience with the type of business being examined? Does the expert have a reputation for being fair and unbiased, or are they known as a "hired gun" for the attorney with whom they are working? Has the expert's testimony been previously accepted in the court in which your case is being tried? It is important to note that Trinity's professionals are advocates for our opinions as a matter of practice and as a matter of professional responsibility. A credible professional should advocate for their opinion regardless of which party is required to pay their fee.

*continued on page 2...*



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Wayne Kirk has been actively involved with the valuation of companies for almost 25 years. His expertise is sought after in matters of acquisitions, divestitures, and capital restructuring to name a few.



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Travis McMurray has extensive business valuation experience in a wide variety of industries. He has served as an expert witness in matters of divorce, shareholder disputes, and economic damages.

*Continued from page 1...*

3. Business valuations should be prepared to meet the requirements of the state in which the divorce proceedings will occur. Therefore, it is imperative that the business valuation professional have sufficient knowledge of case law relating to business valuations. For example, different states have different "standards of value." The two most common expressions indicating definitions of value are fair market value and fair value. The same expression, or "standard of value," can have different meanings from one state to another. If an expert's procedures do not follow the pertinent legal definition of value for a particular state, the judge may disallow the entire testimony.
4. Business valuations in family courts of some states should consider personal goodwill versus enterprise goodwill.

Personal goodwill is the value of earnings or cash flow directly attributable to the individual's characteristics or attributes. Personal goodwill, sometimes referred to as professional goodwill, is a function of the earnings from repeat business that will patronize the individual as opposed to the business, new consumers who will seek out the individual, and new referrals that will be made to the individual.

Enterprise goodwill is the value of earnings or cash flow directly attributable to the enterprise's characteristics or attributes. Enterprise goodwill, sometimes referred to as practice goodwill, is a function of the earnings from repeat business that will patronize the business as opposed to the individual, new consumers who will seek out the business, and new referrals that will be made to the business.<sup>1</sup>

Although a number of courts make no distinction between personal and enterprise goodwill, personal goodwill is excluded as a marital asset in the majority of states in which Trinity serves clients. Selecting a business valuation professional with courtroom experience and one that is well versed in relevant case law will help to ensure that goodwill (among other important factors) is properly considered.

5. Business valuations for marital dissolutions should consider the "double dip effect." Double dipping means computing a value based, at least in part, on the spouse's future earnings for property division and then using the future earnings capacity as a basis for determining spousal support or alimony payments. Courts in different states may approach the concept of double dipping differently. The important factor is that a business valuation professional communicates this potential effect to the court so that the court and each party's counsel can take double dipping into consideration when negotiating property settlement and spousal support.

In summary, there are numerous factors to consider when a business is a component of a marital estate. The aforementioned items are not a comprehensive list nor should these factors be considered to be legal advice. It is important to note that no two marital dissolution cases are alike and these factors may apply differently given the facts and circumstances of each case. Please contact Jason Fleming at 423-722-5007, if you would like additional information about our services or if you would like a free consultation regarding a particular case.

<sup>1</sup>"Goodwill Attributes: Assessing Utility," The Value Examiner, David Wood, January/February, 2007, Edition.

## Value Drivers: Established & Diversified Customer Base

It is important for a seller to put on the shoes of a prospective buyer. Envision yourself examining a company that may have an excellent management team and solid systems in place but whose cash flow is dependent on one or two customers. Why spend millions of dollars on a business only to have those customers go elsewhere after you have acquired the company? Frequently, a prudent buyer will structure a buyout to protect against the loss of a key customer, probably by making much of the purchase price contingent or requiring the seller to carry a note for the bulk of a purchase price. As a seller, binding your financial security (possible for several years) to your former company and its customer is the last scenario you would prefer.

Another value driver then is the development of a customer base in which no single client accounts for more than 10% of total sales. A diversified customer base helps to insulate a company from the loss of any single customer. Achieving this objective can be problematic when you are building a business with limited resources and one or two good customers are willing to pay for everything you can deliver. If this is the situation in which you find yourself, it is important to reinvest your profits into additional capacity that will make developing a broader customer base possible.

## Recognitions

Jason Fleming was nominated as Vice Chair of ETSU's College of Business and Technology (CBAT) Board of Advisors. He has served on the Board since its inception in 2012.

## TN Case Law: Personal Goodwill v. Enterprise Goodwill

Chattanooga Judge Accepts Personal vs. Enterprise Goodwill Allocation Based Upon the Multi-attribute Utility Model (MUM). Chancellor Jeffrey M. Atherton issued a Memorandum Opinion on November 26, 2012 in the case Andrew R. Lunn, DDS vs. Carole Michelle Lunn, No. 11-0250 in which the MUM was accepted as an approach for separating personal goodwill and enterprise goodwill. As mentioned in paragraph 4 of our cover article, many states including Tennessee exclude the value of a business related to personal goodwill from marital property. This is particularly applicable for professional practices. The cases in Tennessee that are most commonly relied upon for excluding personal goodwill from the marital estate are as follows:

- McKee vs. McKee, No. M2009-01502-COA-RC-CV (TN Court of Appeals, 2010)
- York vs. York, No. 01-A-01-9104-CV-00131, 1992 WL 181710 (TN Court of Appeals, 1992)
- Witt vs. Witt No. 01-A-019110CH00360, 1992 WL 52746 (TN Court of Appeals, 1992)

The allocation of business value to personal goodwill and enterprise goodwill has always been a challenge in "finding an objective and scientific method to making imprecise value judgments . . ." <sup>1</sup> The MUM was developed by David Wood, CPA, ABV, CVA as a "step-by-step guide that [offers] a reasonable position against evidentiary challenges, allows for a consistent method for the allocations from case to case, and a comprehensive method that objectively addresses [an] imprecise task." <sup>2</sup>

Since the MUM is one of the tools Trinity utilizes to distinguish between personal goodwill vs. enterprise goodwill, we believe this case is a major win in acknowledging and accepting an approach that is much less subjective than that used by many practitioners which is often times an educated guess with no significant analyses to support the conclusion.

<sup>1</sup>Wood, David N., CPA, ABV, CVA, "An Allocation Model for Distinguishing Enterprise Goodwill From Personal Goodwill."

<sup>2</sup>IBID

Jason was also recently recognized as one of the Business Journal of the Tri-Cities' "Forty Under 40" for 2012. Travis McMurray is also a past recipient of this award. To see a list of all honorees, visit [40under.com/honorees.shtm](http://40under.com/honorees.shtm).



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Travis - @TravisMcMurray  
Jason - @JasonHFleming



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## *Business Valuation Considerations in a Divorce*

See cover page article

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