VALUATION OF BUSINESS INTERESTS IN EQUITABLE DISTRIBUTIONS

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Many thanks to Daniel L. Gray, Esq. for his insights, aid and direction.

PREFACE

I would like to be clear from the outset that what follows is not intended to be a "formal paper." The sole purpose of this outline is to provide an introduction to the terminology you can expect to encounter in cases involving business valuations and a roadmap I hope you will find useful when deciphering valuation experts' reports. My only fear in tackling this task was that I might simplify the matter to the point of inaccuracy – which is why I had a valuation expert review and approve the final version.

For those of you with an accounting background, as well as those of you who prefer totally perfect citations, please accept my apologies!

INTRODUCTION TO THE VALUATION OF BUSINESS INTERESTS

> Code § 20-107.3 (A) directs that the trial court value all property of the parties, but it does NOT define the term "value" for equitable distribution purposes. The statute does not set the **standard of value**, that is the measure of property's worth, for equitable distribution. "Value" is a mercurial term; the term has numerous, distinct meanings. The various meanings are not interchangeable. The meaning of the term "value" depends upon **what** is being valued, **who** is interested, and **why** it is being valued. A piece of property may have **different values for different purposes**. The purpose for which it is being valued determines which definition, or standard of value, is proper. **Purpose determines the standard of value; that [standard of value], in turn, determines the appropriate methods of valuation**.

Howell v. Howell, 31 Va. App. 332, 338 (2000) (emphasis added).

THE STANDARDS OF VALUE

A. **Fair Market Value** – Presumes the legal sale of the interest to a willing buyer. "The price at which the property would change hands between a willing buyer and a willing seller, when the former is under no compulsion to buy, and the latter is not under any compulsion to sell, both having reasonable knowledge of the relevant facts. " IRS Revenue Ruling 59-60.
B. **Fair Value** – Used in state dissenting stockholder and minority oppression statutes. Usually the value just before an event that triggered a dissenting shareholder's action.

C. **Investment Value** – Value to a particular buyer. Buyer must establish parameters, and value the business according to those criteria.
D. **Book Value** – Frequently of little use, as it is a historical accounting concept. The term means the net worth or stockholders' equity on the existing financial statement.
E. **Liquidation Value** – Value at which something would sell, not as part of a going concern.
F. **Intrinsic Value** – The inherent value of a thing. A very subjective concept which looks to the worth of the property or interest in question to particular parties.

INTRINSIC VALUE IS THE APPROPRIATE STANDARD OF VALUE FOR MANY BUSINESS INTERESTS IN EQUITABLE DISTRIBUTION MATTERS

"Trial courts valuing marital property for the purpose of making a monetary award must determine from the evidence the value which represents the property's intrinsic worth to the parties." *Bosserman v. Bosserman*, 9 Va. App. 1, 6 (1989).

In other words, "the value of an item of marital property is its intrinsic worth to the parties; the worth to the husband and wife, the parties; the value to the marital relationship that the court is dissolving." *Howell*, 31 Va. App. at 338.

> Intrinsic value is a very subjective concept that looks to the worth of the property to the parties. The methods of valuation must take into consideration the parties themselves and the different situations in which they exist. The item may have no established market value, and neither party may contemplate selling the item; indeed, sale may be restricted or forbidden. Commonly, one party will continue to enjoy the benefits of the property, while the other must relinquish all future benefits. Still, its intrinsic value must be translated into a monetary amount. The parties must rely on accepted methods of valuation, but the particular method of valuing, and the precise application of that method to the singular facts of the case must vary with the myriad situations that exist between married couples.

Id. at 339.

What is important to take away from the above is the understanding that while "intrinsic value" is the overall concept, or standard of value, to which the trial court aspires when determining the value of a business asset in an ED case, **to translate that intrinsic value concept into an actual monetary value, it is first necessary to determine the appropriate valuation approach and method.**

So what are the various valuation approaches? This is where the terminology can get confusing, because many of the same terms get recirculated, albeit for very different purposes.

VALUATION APPROACHES AND METHODOLOGIES

Under the Statement on Standards for Valuation Services of the American Institute of Certified Public Accountants ("AICPA Valuation Standards") there are three generally- accepted valuation approaches or methodologies.

1. **The Market (Market-Based) Approach** – The market approach assumes a sale, and is based upon the value of a business interest in a market where willing buyers and sellers negotiate price. This approach presumes a sale of the business, and is generally based on recent sales of comparable companies or similar business interests. A general approach for determining the value of a business, business ownership interest, securities, or intangible asset by using one or more methods that compare the subject asset/interest to similar assets/interests that have been sold. (Note that since there is typically no public or private market for the sale of professional partnership interests, the market-based approach will usually not be the appropriate valuation approach or methodology for those types of assets). As an example, a technology start-up might hope to be acquired by a larger parent company. It may have received several purchase offers on the market that might be availing in determining value.
2. **The Asset-Based (or Liquidation) Approach** – This valuation approach assumes a liquidation, and is based upon the value of the marketable tangible and intangible assets of a business. This approach pre-supposes an orderly disposition of the assets, rather than viewing the business as a profitable going concern. The **premise of value** of the asset-based approach is that the best and highest value of the business would be best achieved in liquidation, as opposed to continuing as a going concern, because the business has consistently produced operating losses, and is likely to continue to do so, and may therefore have its greatest intrinsic worth in liquidation. For example, a landscaping company, with equipment, plant stock, and vehicles, may have more value in liquidation than in other methods of value.
3. **Income-Based Approach** – This approach assumes an ongoing concern, and is the approach that you, as a trial judge are more likely to see on a regular basis, as it pre-supposes that the business interest at issue will continue to operate as a profitable income-producing asset. The appropriate **premise of value** to assess the best and highest use of the subject business asset lies in its continued use as part of a going concern business enterprise or interest. Professional practices, such as law firms and medical groups will generally be suited to this valuation approach.

Wait a second! Didn't I begin by saying that the standard of value utilized in determining the value of a business interest in equitable distribution cases must be the Intrinsic Value of that asset, and NOT the Fair Market Value or Liquidation Value? If the standard of value is indeed the Intrinsic Value, then why would the court ever have to consider a market-based (fair market value) valuation approach, or an asset-based (liquidation) valuation approach to determine the value of a business interest?

Remember what the Court of Appeals stated in <u>*Howell*</u>, 31 Va. App. at 339. The "intrinsic value must be translated into a monetary amount, [and] the parties must rely upon accepted methods of valuation." In other words, while the standard (or concept) of value for this purpose is the intrinsic (or inherent) value to the Husband and Wife, to translate that intrinsic value into an actual monetary amount, the experts (and trial court) must first determine which one of the accepted valuation approaches is appropriate, and then rely upon an accepted method of valuation within that valuation approach to come up with an actual monetary amount that reflects the intrinsic value.

The most appropriate valuation approach will be determined by **first looking at the unique and individual circumstances** of the parties, the marital relationship, and the specific business interest in question; and then determining the most appropriate **premise of value** for the subject business interest. The premise of value assumes a particular use of the property that will most likely result in the best and highest use of the property. The premise of value will, in turn, dictate what may be the most appropriate **valuation approach and method**.

It is unfortunate, and certainly confusing, that the same terms seem to keep getting recycled through this process. Nonetheless, while the **Standards of Value** and **Valuation Approaches** may use the same or similar terms, as I pointed out above, those terms have very different purposes. At the risk of over-simplifying the analysis, I would suggest looking at it as follows:

1) What is the Standard of Value for determining the value of a business interest in an ED case? *Bosserman* , 9 Va. App. 1, defined value for ED purposes, and set **intrinsic value** as the **standard of value** for trial courts to apply when valuing marital property for the purpose of making a monetary award.
2) What is the **premise of value** for the specific business interest in question? In other words, what assumed use constitutes the best and highest use of the specific business interest? (I would recommend looking at the decision in *Howell*, 31 Va. App. 332 for a discussion of how this inquiry plays into the process).
3) Determining the highest and best use (aka **premise of value**) for the asset should lead, in turn, to the appropriate **valuation approach**.
4) Once the **valuation approach** is determined, then the various methods within each "class" of valuation approaches need to be examined to determine which **method of valuation** will result in a monetary amount that will most closely reflect the intrinsic value of the business interest in question for the parties.

Other than selecting the appropriate standard of value, none of the subsequent determinations will necessarily be obvious or easy to make. Not all cases involve a relatively straightforward partnership interest in a highly successful law firm, where there is no question but that the best and highest use of the partnership is to view it as a going concern, which leads in turn to the Income-Based Valuation approach. (Even then, you will still be presented with a battle selecting the best methodology within that valuation approach). As a trial judge, you are just as likely to be asked to value a closely held family-owned business that has been suffering steady losses in the recent economic downturn; or a small medical practice that is getting squeezed out by larger competing practices; or a minority interest in a successful business with mandatory buy-out provisions or other restrictions on the sale of that interest. There is really no limit to the number of potential situations with which the court must deal.

For this reason, the trial judge may receive testimony and reports that discuss a number of potentially appropriate premises of value (or assumed uses), as well as a variety of valuation approaches and methodologies. Although the accounting experts will offer their opinions as to the approaches and methods they believe to be most appropriate, the trial court is **not bound by those opinions**, and will most often be faced with a battle of the experts.

So let's look again at that great quote from *Howell,* because it should now make even more sense:

> Intrinsic value is a very subjective concept that looks to the worth of the property to the parties. The methods of valuation must take into consideration the parties themselves and the different situations in which they exist. The item may have no established market value, and neither party may contemplate selling the item; indeed, sale may be restricted or forbidden. Commonly, one party will continue to enjoy the benefits of the property while the other must relinquish all future benefits. Still, its intrinsic value must be translated into a monetary amount. The parties must rely on accepted methods of [or approaches to] valuation, but the particular method of valuing and the precise application of that method to the singular facts of the case must vary with the myriad situations that exist among married couples.

Howell, 31 Va. App. at 339.

DETERMINING THE APPROPRIATE PREMISE OF VALUE

The premise of value is the hypothetical set of circumstances under which the subject business interest will be valued. The selection of the most appropriate premise of value will depend upon the actual functional and economic status of the asset in question. The premise of value selected as being the most appropriate for determining the intrinsic value of the business interest at issue will ordinarily be dictated by the premise or use at which the asset will be at its highest and best value.

This does NOT mean that the premise of value which yields the highest monetary amount is automatically the most appropriate premise. The highest **and best** use is that use which is the most reasonably probable or likely use of the business interest. Thus, the selection of the most appropriate premise of value must be sufficiently supported by testimony and evidence establishing the following: 1) that the assumptions and factual scenarios the valuation expert relied upon in making his/her selections reflect the actual circumstances of the parties and the business interest; and 2) that the assumptions are financially feasible, legally possible; or likely to occur.

Remember that the most appropriate premise of value for a particular business interest may not be the one selected by the expert(s) – particularly if the expert has made a series of assumptions in reaching their various conclusions **that do not accurately reflect the testimony in the case and/or the actual economic status of the parties and/or asset in question**. For example, consider whether the expert assumed a flat rate of growth, when the evidence has established that, in actuality, there has been no growth and the profitability of the business has been legitimately declining at a steady rate for a number of years. Or ask yourself whether the expert assumed a sale of the business interest when no such sale is likely, contemplated, or even feasible.

For instance, a premise of value assuming a liquidation may be the most appropriate means of assessing the best and highest use of a property in those situations where the highest realistic value of a business is found in its assets rather than in its profitability as an ongoing concern, and there is no viable market for the business, <u>even though a higher value would be ascertained by applying an income-based approach and method</u>. This would particularly be true if the expert relied upon factually incorrect assumptions in his choice and application of the income-based approach.

It is essential, therefore, to pay close attention to the factual bases and assumptions that the experts rely on in reaching their conclusions to select or reject the various valuation approaches and methodologies, as well as in considering the relevant risks and discounts associated with the business interest. (More on that later.) In addition, you really want to consider asking for the accountants' reports up front so that you can take your time deciphering them, and not have to rely upon the ability of the attorneys to pull out all of the relevant and necessary testimony during trial!

Consider the following passage from <u>*Howell*</u>:

> In <u>*Bosserman*</u>, the wife asked the court to value the husband's interest in a family-owned, closely-held corporation. A restrictive agreement required a shareholder to offer the stock first to the corporation at "true book value." The husband argued that the restriction defined value. This Court recognized that the value set by such agreements "is often artificial and does not always reflect true value," even though the agreements may be binding on business partners. **The sale price set by restrictive provisions on transfer is not conclusive as to the value of the stock. A restriction on transfer does not control its value, "but the restriction on transfer is a factor which affects the value of the stock for purposes of equitable distribution."**

<u>*Howell*</u>, 31 Va. App. at 340 (emphasis added).

In essence, the husband's expert in <u>*Bosserman*</u> selected a sale of the business interest as the most appropriate premise of value, and then applied a market-based valuation approach, based on his assumption of a sale, to determine the value of the subject business interest. The trial court rejected that assumption and resulting opinion, accepting instead the wife's expert's opinion that the most appropriate premise of value was to view the business interest as a going concern (that is, the husband would continue to own the stock and enjoy the benefits of that ownership), and then utilize the income-based valuation approach.

For those of you who are scratching your heads over the last line in the quote above, I am glad you noticed that language. As the Court of Appeals noted in <u>*Owens v. Owens*</u>, 41 Va. App. 844, 859 (2003), "This inconsistency stems from a fine, but critical, distinction in the statutory design." That distinction lies between the process of **valuation** versus the process of **distribution**. As a result, when the trial court is distributing the marital assets, it must take into consideration those certain factors enumerated in Code § 20-107.3 (E), such as the potential tax consequences.[1] The principle leading to this distinction is based upon the maxim that valuation cannot be based upon mere guesswork.

The _Arbuckle II_ decision, 27 Va. App. 615 (1998), has a helpful discussion on this point, as follows:

> There are three stages to making an equitable distribution of property. The court first must classify the property as either separate or marital. The court must then assign a value to the property based upon evidence presented by both parties. Finally, the court distributes the property to the parties, taking into consideration the factors presented in Code §§ 20-107.3(E)…
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> In the prior *Arbuckle* appeal, the question we decided concerned the trial judge's valuation decision under Code § 20-107.3(A) because the trial judge reduced the **valuation** of the dental practice by the amount of capital gains tax liability that would have accrued had the practice then been sold.… Code § 20-107(A) requires a trial judge to value the parties' separate and marital property before making a monetary award. Thus, when the parties in an equitable distribution proceeding request the trial judge to decree as to their property, the trial judge must determine the **value** of any such property as of the date of the evidentiary hearing on the evaluation issue.… We held that the trial judge erred in considering the tax consequences of a hypothetical sale when **valuing** the dental practice. We reasoned that the tax consequences of a hypothetical sale were too speculative to be considered by the trial judge in determining the **present value** of Dr. Arbuckle's dental practice.
>
> The *Arbuckle* holding is consistent with the well-established principle that the trial judge's valuation cannot be based on mere guesswork.… After the valuation process is completed, the statutory scheme recognizes, however, that a degree of imprecision will be inevitable in applying the factors of Code § 20-107.3(E). Thus, under 20-107.3(E), the amount of any division or transfer of jointly owned marital property, and the amount of any monetary award, the apportionment of marital debts, and the method of payment shall be determined by the court after consideration of ten specified factors.

Arbuckle II, 27 Va. App. at 617-18.

INCOME BASED VALUATION APPROACH

In most instances, the appropriate premise of value to assess the best and highest use of the subject business interest will lie in the continued use/ownership of the interest as part of a going concern. The reason for that is because intrinsic value is measured by the value of the business interest to the

[1] Note that "Va. Code § 20-107.3 (E)(9) does not mandate that a trial court reduce an award for potential capital gains tax consequences no matter how certain or uncertain they may be…. [It] requires only that the trial court consider tax consequences when formulating an equitable distribution award." _Owens v. Owens_, 41 Va. App. 844, 859 (2003).

holder(s) of the interest. It assumes that the business owner will continue to enjoy the benefits generated by the business that were created, or that appreciated, during the marriage. It further assumes that any premise of value, or discount, predicated on a hypothetical sale would dilute the value that both spouses enjoyed during the marriage, as only one spouse will continue to benefit from that value after the marriage ends.

The income-based valuation approach is applied to the valuation of a profitable business as a going concern, and is based on determining the present value of expected future benefits accruing to the owner by virtue of his/her continuing ownership of the business interest. Each of the methods of valuation under the income-based valuation approach involves the capitalization of a selected stream of expected future benefits accruing to the continuing ownership interest. The stream of economic benefits is a unique stream of "income" that will be unique to the subject business interest, and is distinguished from any ordinary income received by the owner of the business interest. In *Uniform Standards of Professional Appraisal Practice,* 2000 Edition(USPAP), capitalization is defined as "converting an estimate of income into an estimate of value by the use of a rate."

The present value of the business interest is thus determined by:

1) estimating the expected future benefit stream accruing to the ownership interest; and
2) converting those future benefits into a present value;
3) by using a rate of risk, or capitalization rate; and
4) that capitalization rate must be suitable for the risks associated with realizing those benefits.

There are a variety of valuation methods within the Income Based Approach, and different experts may call them by differing names, but, essentially, those names are drawn primarily from the type of economic benefit stream which is to be capitalized. Regardless of the name given to the method, the capitalization of future economic benefits requires that the benefit trends be stable, or exhibit constant, or decreasing growth. To the extent that the economic benefit streams chosen by the experts differ (and they will), the trial judge will encounter some of the biggest issues.

It is extremely important to recognize that the asset you are valuing is the **ownership interest**, as distinguished from the **ordinary earnings or salary derived from the asset**. Even though the definition from the USPAP above refers to the capitalization of income, what is actually being capitalized should not include the owner's personal future earning capacity or salary, as that will result in a double-counting of earnings, or unfair duplication of income.

I found the following paragraph in a recent valuation report to be particularly illustrative in drawing this distinction when dealing with a partnership interest in a professional firm:

> The value of Ms. X's ownership interest in the Firm is measured as the present value of the future economic benefits accruing to her by reason of her ownership interest. The future economic benefits of ownership accruing to Ms. X is measured as the total amount of economic benefits paid to her by the Firm in excess of the value of the compensation and benefits she could expect to receive for similar professional services

> provided to the Firm if she were not an owner. This excess represents the economic benefits provided to Ms. X because of her ownership interest in the Firm.

Excerpted from Business Valuation Report of Alan Zipp, CPA, Fairfax County Case No. 2012-755, reprinted with permission of counsel.

Another good description of the methodology can be found in ***Howell***, 31 Va. App. at 343, as follows:

> The wife's expert began by comparing the husband's average income for three years to that of a peer group.[2] The difference between the two was the excess earnings due to the husband's association with the firm, but not the earnings due to his personal efforts. It was the additional income he received from being associated with his law firm. The wife's expert projected those excess earnings over the husband's expected career with Hunton & Williams. Using the discounted future earnings method, he then calculated the present value of the husband's future excess earnings.

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If there is any one area, however, in which the experts' discretion (and the trial court's discretion as a result) is most likely going to be in play, it will be in the calculation of the capitalization rate. Although the term can be intimidating, another way to look at it is to call it the rate of risk.

Simply put, the appraiser is going to determine a capitalization rate that estimates the risk associated with (or the likelihood of) the selected stream of economic benefits continuing at the same level on into the future. The higher the risk (cap rate), the lower the present value of the subject business interest, because the likelihood of that economic benefit stream continuing into the future is riskier. The lower the risk (cap rate), the higher the present value of the asset, because the likelihood of the economic benefit stream continuing into the future is more certain.

How do the appraisers create this capitalization rate? I wish I could tell you that the process was simple, but it is not. It's a little like listening to a physics lecture. One minute you have a clear understanding, and the next… you don't.

Shannon Pratt gave the following description in her *Overview of Business Valuations for Judges and Lawyers*, as part of her presentation to the Virginia State Bar in 2001:

> One commonly used method to determine the discount rate for a small business is referred to as the "Build-Up Method." This method is based on the principle that the discount rate applicable to a particular company is composed of a number of risks for which a prudent investor would expect to be compensated…. Once we get a discount rate, we subtract a growth rate to get a capitalization rate.

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[2] Some of the major arguments in ***Howell*** were over the selection of that particular peer group, as well as the period of time selected for the husband's average income.

Okay… Then there was this explanation from Alan Zipp in the appraisal report excerpted earlier :

> One generally accepted method of developing a capitalization rate is to apply the capital asset pricing model (CAPM) based on the well-established capital market theory in developing a build-up rate applicable to a specific business valuation. The CAPM is a combination of published rates of return on alternative investments *to which is added a specific risk factor attributable to the subject business interest*…. The total then determined represents the required rate of return a prudent investor would require to purchase the subject business interest.
>
> This required rate of return is referred to as the "discount rate" and is used to calculate the present value of specific annual future benefits associated with the subject business interest. The discount rate is applied annually to specific projected annual economic benefits while the "capitalization rate" is applied to a single annual economic benefit projected to be constant into the foreseeable future. The discount rate includes an imputed annual growth rate which can be used to convert the discount rate into a capitalization rate. Subtracting the growth rate from the discount rate converts the discount rate into a capitalization rate.
>
> In valuing the subject business interest it is not possible to project differing economic benefits each year into the future. Consequently, a constant projected annual benefit is determined as a single amount [*this is the assumed economic benefit stream]* subject to capitalization to determine the present value of the projected annual economic benefits *[emphasis added]*.

Typically, a table representing the build-up model will be provided in the report, and Mr. Zipp's report was no exception (reprinted again with permission):

Capitalization Rate Build-Up Model

Risk Free Rate (20 year Treasury Bond Yield)	4.13%
Large Cap Stocks yield in excess of Risk Free Rate	5.30%
Small Cap Stocks yield in excess of Large Cap Stocks	6.36%
TOTAL LONG-TERM RATE OF RETURN ON ALTERNATIVE INVESTMENTS	15.79%
RISK PREMIUM ATTRIBUTABLE TO SUBJECT BUSINESS INTEREST	20.00%[3]

[3] Here is where the appraiser will oftentimes present all of his assumptions that led to his conclusions and opinions as to which special discounts and premiums that he took into account when creating the risk premium. Obviously, this is highly subjective, and will be the biggest area of contention between the experts and counsel. While most of the appraisers won't really contest the published risk numbers used in the build-up model, they will fight like cats and dogs over the risk premium. Needless to say, the trial judge needs to

DISCOUNT RATE APPLICABLE TO THE SUBJECT BUSINESS INTEREST	35.79%
Less projected annual growth rate	2.00%
CAPITALIZATION RATE APPLICABLE TO FUTURE BENEFITS	33.79%

HOW DOES GOODWILL FACTOR INTO THIS ANALYSIS?

I am only going to touch on this subject very lightly, because this outline was prepared solely as an introduction to the topic of business valuations. Treading into the area of goodwill considerations is akin to walking on quicksand!

"Goodwill is defined as the increased value of the business over and above the value of its assets that results from the expectation of continued public patronage." *Russell v. Russell*, 11 Va. App. 411, 415 (1990).

"Goodwill should be valued with great care, for the individual practitioner will be forced to pay the ex-spouse *tangible* dollars for an *intangible* asset at a value concededly arrived at on a basis of some uncertain elements. " *Id.* at 417.

For marital property purposes, the goodwill value of a business may include both marital and separate components. As the Court of Appeals stated in *Howell*:

> "The value of goodwill can have two components. **Professional goodwill** (also designated as individual, personal, or separate goodwill) is attributable to the individual and **is categorized as separate property** in a divorce action. **Practice goodwill** (also designated as business or commercial goodwill) is attributable to the business entity, the professional firm, and **may be marital property**."

Howell, 31 Va. App. at 344 (emphasis added).

Personal or professional goodwill adheres to the individual, and is considered separate property of the individual because it consists of personal attributes of the individual, such as the practitioner's own expertise, skill, knowledge, personality, relationships, and personal reputation. Generally, these are factors that belong solely to the individual, and cannot be transferred from the individual, thus, they cannot have marital value.

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pay close attention to all of the facts, factual bases, and assumptions that went into the creation of this number. The assumptions and facts relied upon by the experts in creating this risk premium can allow the trial court to distinguish between the experts' opinions.

It is also important for the trial court to ensure that the risks and benefits used to build the risk premium rate are actually the risks and benefits of the individual, as opposed to the risks and benefits of the business entity. Otherwise, the calculated value could end up reflecting the value of the firm's interest, rather than the value of the individual's interest.

Practice or business goodwill is considered to be marital property because it is something separate from the individual. Patrons or customers come to the practice or business due to location, facilities, or staff, or as a result of the firm's established reputation, or firm advertising in the name of the business (as opposed to the individual), and so forth.

It is important to recognize that it is easy to confuse personal or professional goodwill with the value of the partnership or business entity. For this reason, it is necessary to distinguish the future earnings of the owner spouse from the excess earnings attributed to the partnership or business interest.

In *Howell*, although the trial court characterized the asset being valued as "the goodwill," what was in fact being valued was the value of the partnership, as the court determined that no portion of the firm's practice goodwill was attributable to the husband personally. In calculating the value of the husband's partnership interest, the value of his compensation was deducted from his total earnings to remove all of his personal goodwill from the valuation. What remained was the "economic advantage he enjoyed because he was a partner in that firm." *Howell* at 344. In essence, the husband's partnership interest consisted of his share of the firm's practice goodwill.

Recognize also that an expert in a particular case may not separate the practice goodwill from the personal goodwill . Virginia recognizes a distinction between the two; that does not mean that the expert will always provide a clear-cut analysis of the issue. Experienced counsel and valuation experts will thoroughly review relevant Virginia statutes and precedents in fashioning a conclusion as to value, and will commonly provide an analysis of the distinction between the two. There may, however, be strategic reasons to avoid doing so. Alternatively, the expert may not have been properly briefed or charged before forming his or her conclusions and fail to note a distinction where it may be indicated.

As I said, it is not always an easy task to either determine the value of the personal goodwill, as opposed to the practice/business goodwill, or to determine the ratio of personal goodwill to practice goodwill. In *Howell* the court found that the expert was able to clearly distinguish the future earnings from the excess earnings, but this will not always be the case.

ROLE OF THE TRIAL JUDGE AS THE TRIER OF FACT

Once again, I strongly suggest that you ask for the opportunity to read the reports of the valuation experts, rather than rely entirely upon the skills of the attorneys to draw out the necessary information from those reports. Not only will reading the experts' reports help you prepare for their testimony, but you will also be able to see for yourself the assumptions and facts taken into account by those experts in choosing their recommended valuation approaches and methodologies, as well as in choosing the risks and benefits they may have used to build any risk premium and capitalization rate.

Moreover, the mere fact that these reports have been written and presented by experts does not mean that you have to accept everything they say. As trial judges, you are the triers of fact, and you are not required to accept either of the experts' opinions wholesale. You may accept or reject any portions of those reports as you deem appropriate… however, you must state your reasons for doing so on the record. Therefore, check the assumptions, and the factual bases the experts rely on, carefully. Make sure that they reflect the particular present circumstances of the parties. The recent case of *Patel v. Patel*, 2013 Va. App. LEXIS 110 (Apr. 9, 2013), is a good illustration of the above.

The experts are witnesses. Nothing more, nothing less. Even if just one expert has testified, or if both parties have jointly presented an expert, the trial judge is not bound by the opinions propounded by the expert witness, and can reach different conclusions. Although *Street v. Street*, 25 Va. App. 380 (1997) did not involve a business valuation, the trial court in that matter rejected the testimony of two experts. In affirming the decision, the Court of Appeals stated as follows:

> It is well established that the trier of fact ascertains a witness' credibility, determines the weight to be given to their testimony, and has the discretion to accept or reject any of the witness' testimony. Further, the fact finder is not required to accept the testimony of an expert witness merely because he or she has qualified as an expert. In determining the weight to be given the testimony of an expert witness, the fact finder may consider the basis for the expert's opinion.

Street, 25 Va. App. at 387.

As a final note, please keep in mind the following language in *Howell*:

> [T]he value of property is an issue of fact, not of law…. The evidence presented at trial determines the result, and the result may vary from case to case as the evidence differs. If conflicting, competent evidence is presented, that found more credible will determine whether goodwill exists and its value if it does exist. The existence is not fixed as a matter of law, nor is the method of valuation; both are functions of the fact finding process.

Id. at 340-341.

> Because intrinsic value must depend on the facts of the case, we give great weight to the findings of the trial court. We affirm if the evidence supports the findings and if the trial court finds a reasonable evaluation based on proven methodology and on the application of it to the particular facts of the case. "The trial court's valuation of goodwill will not be disturbed if it appears that the court made a reasonable approximation of the goodwill value, if any of the professional practice based on competent evidence and the use of a sound method supported by that evidence."

Id. at 339 (quoting *Russell v. Russell*, 11 Va. App. at 417 (1990)).

> The trial court has discretion to resolve conflicting expert testimony to determine an asset's value…. The court's decision will not be disturbed on appeal unless plainly wrong or without evidence to support it.

Id. at 341.

CASES CITED

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