BUSINESS VALUATION ISSUES IN THE RHODE ISLAND COURTS

B V S

BARRETT VALUATION SERVICES, INC.

The Business Valuation Advisors

TABLE OF CONTENTS

Introduction 1

Divorce Valuation Articles 2
Robert W. Gibbons v. Lucinda M. Gibbons 2
Daniel J. Becker v. Kleo K. Perkins-Becker 3
Marilyn J. Moretti v. Vincent F. Moretti (I) 4
Marilyn J. Moretti v. Vincent F. Moretti (II) 5
Donald Gervais v. Virginia Gervais 7

Shareholder Appraisal Articles 8
Gilbert Charland v. Country View Golf Club, Inc. 8
Thomas R. DiLuglio v. Providence Auto Body, Inc. 9
A. Teixeira & Company, Inc. v. Antonio L. Teixeira 10
Elizabeth v. Bogosian, et. al. v. James H. Woloohojian, et. al. 11
McBurney Law Services, Inc. 13

Divorce Valuation Cases (Selected) 14
Robert W. Gibbons v. Lucinda M. Gibbons 14
Daniel J. Becker v. Kleo K. Perkins-Becker 19
Marilyn J. Moretti v. Vincent F. Moretti (I) 28
Marilyn J. Moretti v. Vincent F. Moretti (II) 34

Shareholder Appraisal Cases (selected) 37
Gilbert Charland v. Country View Golf Club, Inc. 37
A. Teixeira & Company, Inc. v. Antonio L. Teixeira 43

Articles 57
Enterprise Goodwill vs. Personal Goodwill 57

Company Profile 63

Copyright @ 1999, 2000, 2001, 2002. This publication is designed only to provide a summary of certain valuation aspects of a sampling of cases. This publication does not constitute legal, tax, accounting or valuation advice. It is provided as an informational service only. Please contact a professional advisor if you need specific advice. No liability whatsoever is assumed in connection with the use of this publication.

Barrett Valuation Services, Inc. is pleased to provide you with a summary of business valuation issues in the Rhode Island Courts. It is our hope that this summary guide will provide you with useful referral information in your day to day professional practice.

For more information regarding business valuation topics, please contact us at 401-942-3900.

Valuation of Professional Practice Using Capitalization of Future Earnings Method

In *Robert W. Gibbons v. Lucinda M. Gibbons*, 619 A.2d 432 (R.I. 1993), per curiam, the Rhode Island Supreme Court considered the valuation of the husband's podiatric practice. Both parties presented valuation experts to the family court. The wife's expert valued the practice using a capitalization of future earnings method. In doing do he considered Rev. Rul. 59-60. He applied a 20 percent lack of marketability discount and concluded that the practice had a fair market value of $672,000. The husband's experts also valued the practice's goodwill using a capitalization of future excess earnings method. One expert applied a 40 percent lack of marketability discount. The lower court valued the practice at $504,000. It accepted the undiscounted valuation of the practice put forward by the wife's expert and applied a 40 percent lack of marketability discount as proposed by the husband's expert. The husband appealed.

On appeal, he argued that the lower court erred in valuing the goodwill of his practice using a capitalization of earnings approach. Two justices agreed. They concluded that "it [wa]s improper as a matter of law to capitalize the earnings of a professional practice on the basis of the services of a single individual in order to arrive at a good-will factor in ascertaining the value of such practice." However, two justices disagreed. They concluded that "this issue has not been preserved on appeal by reason of the fact that the husband's experts also purported to value the goodwill of this practice, utilizing the factor of capitalizing a portion of future excess earnings." Since the Supreme Court was divided on this issue, it affirmed the family court's valuation of the podiatric practice.

Personal Goodwill and Enhanced Earning Capacity Considered

In *Daniel J. Becker v. Kleo K. Perkins-Becker*, 669 A.2d 524 (R.I. 1996), the Rhode Island Supreme Court considered the valuation of a chiropractic practice and the characterization of an advanced degree. The husband, a chiropractor, established a professional practice in the year prior to the parties' marriage. The practice became successful during the marriage. The husband earned $126,904 annually from the practice. The husband also earned a professional degree—Diplomate of the American Board of Chiropractic Neurology—during the marriage.

The trial court denied the husband's motion in limine to bar the testimony of wife's expert regarding the goodwill value of the husband's practice. The wife's expert valued the chiropractic practice using a capitalization of excess earnings method. He calculated the excess earnings using the business' past five years tax returns and industry data from the American Chiropractic Association. He capitalized the excess earnings using a 33.3 percent capitalization rate. He determined that the practice's goodwill had a value of $102,991, which he then added to the value of its tangible assets for a total of $134,463. The lower court accepted this valuation and awarded the wife one-half the practice's goodwill value. The trial court also considered whether the enhanced earning capacity of the husband derived from the advanced degree he earned during the marriage should be divided in the divorce. The lower court declined to divide the enhanced earnings capacity finding, as a matter of law, that enhanced earning capacity is not a marital asset. Both parties appealed.

On appeal, the husband argued that the lower court erred in denying his motion in limine to exclude evidence of the goodwill value of his practice. The Rhode Island Supreme Court agreed. It ruled, "The capitalization of earnings of a professional practice on the basis of the services of a single individual in order to arrive at a good-will factor in ascertaining the value of such practice is improper as a matter of law." Thus, it reversed the lower court's order awarding the wife one-half the value of the goodwill.

It then considered the wife's appeal. She argued that the lower court erred in determining that the husband's enhanced earning capacity was not a marital asset. It noted that this was an issue of first impression in Rhode Island. It then reviewed the law from diverse jurisdictions and concluded that "professional degrees and licenses and the resulting enhanced earning capacity of the holder spouse is not a marital asset subject to equitable distribution under § 15-5-16.1. The value of a professional degree or a license may not be included in the distribution of marital assets upon the dissolution of a marriage." The court further commented, "To embrace a rule that would subject such an item to distribution upon dissolution would result in the foreclosure of consideration of the effect on the individual's earning capacity of such future events as death, illness, or unpredictable market variables."

Enterprise Goodwill and Personal Goodwill Must Be Distinguished

In *Marilyn J. Moretti v. Vincent F. Moretti*, No. 99-171-A (February 9, 2001), the Rhode Island Supreme Court considered whether goodwill should be included in the valuation of a landscaping business. The husband started the 17-year-old business during the marriage. He owned and operated the business, and was the only employee that dealt with clients. Both parties provided CPAs to value the business.

The wife's expert used the excess earnings approach. He described this approach "as a combination of an income approach and an asset approach." He began by determining the fair rate of return on the business' assets. He deducted this figure from the business' earnings and capitalized the difference to determine goodwill. He determined the goodwill value to be $164,011. He added the goodwill value to the value of the assets for a fair market value of $477,000.

The husband's expert valued the business using an asset approach. He concluded that the business was worth $321,058. The expert conceded that "[t]he earning capacity of the Company is also based on the primary contact person of the Company...." However, he relied on *Becker v. Perkins-Becker*, 669 A.2d 524, 528 (R.I. 1996), to exclude any amount for goodwill. *Becker* holds that "[t]he capitalization of earnings of a professional practice on the basis of the services of a single individual in order to arrive at a good-will factor in ascertaining the value of such practice is improper as a matter of law."

The trial court decided *Becker* did not apply to this case. It then accepted the valuation proposed by the wife's expert. The husband appealed.

On appeal, the husband argued that the lower court should not have considered the business' goodwill under *Becker*. The Supreme Court agreed with the lower court that *Becker* was distinguishable. It stated, "Certainly, one is not precluded, as a matter of law, from determining that a landscaping business may have a goodwill component to its corporate value."

In considering the goodwill issue, the Supreme Court noted that the wife's expert admitted that the business' success depended on the husband's involvement with the business. It then applied *Yoon v. Yoon*, 711 N.E.2d 1265, 1268-69 (Ind. 1999), which held that enterprise goodwill is available for division in a divorce, but personal goodwill is not. The court concluded that to include goodwill as an asset for division, the experts should distinguish between personal and enterprise goodwill. Thus, the Supreme Court remanded the decision, "so that enterprise goodwill, as opposed to personal goodwill, may be evaluated and applied to the overall value of ...[the business], taking into account the risk factor that would be applicable if defendant left the business."

Distinguishing Between Enterprise Goodwill and Personal Goodwill

In *Marilyn J. Moretti v. Vincent F. Moretti*, No. 01-523-A, (June 2, 2002), the Rhode Island Supreme Court considered a second appeal involving this case. In the earlier appeal, the Supreme Court affirmed the trial justice's decision in all respects except for his valuation of the goodwill interest in the defendant's landscaping business. The Supreme Court remanded the case "so that enterprise goodwill, as opposed to personal goodwill, may be evaluated and applied to the overall value."

At the hearing on remand, the parties agreed on the overall value of the business's goodwill, in the amount of $164,011. At the hearings on remand, the parties each presented an expert in the field of business valuation. The wife's expert defined enterprise goodwill as that value which will attach to the business itself because of its ability to earn a rate of return over and above what is normally expected for the rate of return on tangible assets. Enterprise goodwill would therefore be expected to continue should management or ownership of the business change. He also defined personal goodwill as a value that would attach to the business due to a specific individual because of that person's capabilities, special training and continued presence in the business.

The wife's expert testified that if Mr. Moretti were to sell the business applying the standard of fair market value, it would be expected, in order to maximize the sale price, he would do all in his power to see that existing customers stayed with the new buyer. He further stated that in order for any sale of the corporation to be successful, a so-called non-compete agreement must be entered into with the prospective buyer.

This contract would be necessary to ensure that Vincent Moretti did not compete with the new business. The contract would prohibit the seller from coming into competition with the buyer. In order to be enforceable, it would be limited by geographical area and type of business. The defendant's witness concurred that in order for a voluntary sale at fair market standards, it would be necessary for Mr. Moretti to enter into a non-compete contract.

The wife's expert testified that the value of the non-compete agreement would be approximately $27,243. After subtracting this figure from the total value of goodwill, he opined that the remaining sum would be all enterprise goodwill. He found the value of the enterprise goodwill of Tangleridge to be $136,768.

The wife's expert made his calculation as to the value of enterprise goodwill by considering the total valuation of Tangleridge Landscaping, Inc., previously determined by the court and in reviewing transactions from the Institute of Business Appraisers' database as well as other statistical reports.

The husband's expert defined enterprise goodwill as that value which the corporation would have due to its reputation, location, name, and assembled work force regardless of the presence or absence of a specific individual. He testified that to determine the existence of personal goodwill, one must consider several factors; the most important of which are that the customers are referred and retained by the key individual because of that person's skill, reputation, knowledge, and personality. In other words, customer loyalty is not to the product or work force, but rather to the individual.

The husband's expert opined that Tangleridge had enterprise goodwill value of $16,401.Apparently, he came to this conclusion based upon the fact that, in his opinion, 10 percent of

Tangleridge's customers are so-called transient. They have not been with the corporation on a long-term basis, as has the remaining 90 percent of the other customers. He further testified that the remaining amount of $147,610 represents personal goodwill.

After finding that his testimony was credible and reliable, the hearing judge accepted the opinions and figures used by the wife's expert. However, the judge ruled that the value of a hypothetical non-compete agreement, as calculated by the wife's expert, would constitute personal goodwill and would not be included in the marital estate. The husband appealed this decision. The Rhode Island Supreme Court upheld the trial judge's decision stating "we discern no indication that the hearing justice overlooked material evidence or was clearly wrong in accepting the valuation of the wife's expert.

Date of Valuation in Marital Dissolution

In Donald Gervais v. Virginia Gervais, Gervais v. Gervais; *688 A.2d 1303; 1997 R.I. LEXIS 45* (February 18, 1997) the Rhode Island Supreme Court considered the appropriate valuation date of the husband's closely held stock.

The Supreme Court ruled "Donald's final contention with respect to the distribution of the marital estate involves the choice made by the trial justice to value the estate on the basis of financial figures computed in 1990 rather than the value of the estate as of 1992, the date of the trial. Donald points out that all assets were valued as of 1990 except for the marital domicile, which was valued as of 1992. The record supports Donald's contention. The trial justice failed to explain in his decision why he elected to value the marital estate upon the basis of records that were produced two years prior to the trial. He referred to no case law or statute giving him the authority to value the marital estate prior to the date of trial and he did not make any findings of fact with respect to this issue. In *Saback v. Saback, 593 A.2d 459 (R.I. 1991),* we held that a trial justice must assess the marital estate as of the time of entry of judgment, *Id. at 461;* see also *Briceno v. Briceno, 566 A2d 397 (R.I. 1989).* As in Saback, we do not have before us any evidence from the record that would suggest any necessity for valuing the marital estate as of a time other than the date of judgment."

Minority Interest and Marketability Discount Inappropriate in Fair Value Determination

In *Gilbert Charland v. Country View Golf Club, Inc.*, 588 A.2d 609 (R.I. 1991), the Rhode Island Supreme Court considered whether valuation discounts should be applied when the lower court determines fair value under § 7-1.1-90.1. Charland held 15 percent of Country View's outstanding stock. In 1984 he filed a petition to dissolve the corporation under § 7-1.1-90. Country View elected to avoid dissolution by repurchasing Charland's shares under § 7-1.1-90.1. Under this statute, the shares are to be valued at their fair value as of the end of the business day on the date the petition is filed. The parties were unable to agree upon the fair value of the shares. Exercising its authority under § 7-1.1-74, the lower court appointed an appraiser.

In 1988, Country View was sold for $2 million. The appraiser discounted the 1988 selling price to 1984 present value, using a discount rate determined by reference to inflationary statistics for residential property. Inflationary statistics for comparable property were not available. This appraiser opined that a minority discount would be appropriate. Since the discount rate was based on information for residential property, whose inflationary impact exceeded that of other parcels of property, the expert did not apply a minority discount since he believed the impact of such a discount was realized in the discount rate used to reduce the sale to present value. The appraiser concluded that the stock had a fair value of $9,273.05 per share. Charland appealed.

On appeal, he argued that the lower court erred when it accepted the court-appointed appraiser's valuation, which considered lack of control in the discount rate. The Supreme Court began by finding that the appraiser's minority discount included characteristics of a minority interest discount as well as a lack of marketability discount. Thus, it considered the appropriateness of both discounts under § 7-1.1-90.1.

The Supreme Court first considered the application of a minority interest discount. It followed the reasoning of a California decision that concluded a minority interest discount was inappropriate since the shares would not be sold on the open market, but to the company. *See Brown v. Allied Corrugated Box Co.*, 91 Cal.App.3d 477, 154 Cal. Rptr. 170 (1979). The California court additionally determined that if the petition for dissolution had been successful, the petitioner would have been entitled to a pro rata share of the liquidation proceeds. It lastly reasoned that application of the discount would penalize the petitioner for bringing the action by reducing the value of his interest. The Rhode Island Supreme Court adopted the reasoning of the *Brown* court, and concluded that the application of a minority interest discount is inappropriate when a corporation elects to purchase the shares of the petitioner pursuant to § 7-1.1-90.1 in order to avoid dissolution.

The Supreme Court next considered the application of a lack of marketability discount. The court noted that diverse jurisdictions are split regarding the application of this discount under the facts of this case. After a review of case law and law review articles, it concluded that a lack of marketability discount should not be applied in this situation. It differentiated its decision from that of jurisdictions like New York, which permit the discount, by noting that the statutory valuation date in Rhode Island implicitly considers the filing of the dissolution petition whereas the other jurisdictions value the stock as of the day prior to the petition's filing.

The court then reversed and remanded the valuation of Charland's interest. It did so because the minority interest and lack of marketability considerations had been included in the determination of the discount rate used by the court-appointed appraiser.

Standard Valuation Discounts Disallowed

In *Thomas R. DiLuglio v. Providence Auto Body, Inc., et al.*, 755 A.2d 757 (R.I. 2000), the Rhode Island Supreme Court considered whether lack of marketability and minority interest discounts were applicable in a court-ordered buyout under § 7-1.1.90.1 – Avoidance of Dissolution by Stock Buyout. DiLuglio assisted Petrarca in financing and establishing an auto body business in the 1980s in exchange for a 20 percent interest in the business. In 1989, DiLuglio became dissatisfied with the return he was receiving from the company. When negotiations between DiLuglio and Petrarca, the company's president and only director, failed, DiLuglio filed for dissolution of the company. In 1992, Petrarca elected to purchase DiLuglio's minority interest.

The trial court ordered a special master to determined the value of DiLuglio's interest as of the date of filing, February 7, 1989. The trial judge accepted the special master's undiscounted valuation ($174,800) of the minority interest. The judge then ruled that neither minority interest nor lack of marketability discounts would be applied because "the sale of this minority block of stock was assured because a known and qualified buyer … existed to purchase DiLuglio's PAB shares." Petrarca appealed.

Before the Supreme Court, Petrarca argued that the trial court erred when it refused to apply the valuation discounts. He claimed that a combined discount amounting to $150,000 should have been applied. The Supreme Court affirmed the trial court's decision. It concluded, "As we stated in *Charland v. County View Golf Club*, Inc., 588 A.2d 609, 613 (R.I. 1991), '[w]e … adopt the rule of not applying [a minority discount or] a discount for lack of marketability in § 7-1.1-90.1 proceedings.'"

Fair Value Determined without Minority Discount

In *A. Teixeira & Company, Inc. v. Antonio L. Teixeira, et al.*, No. 84-0152 (April 12, 2001), the Rhode Island Superior Court determined the valuation of two minority shareholders' stock. A. Teixeira & Company was founded in 1981 with six shareholders to operate retail liquor stores in Rhode Island. After the business relationship failed, two minority shareholders, Antonio and Armenio Teixeira, sought corporate dissolution of the company or a buyout of their shares. The court denied their request for dissolution, and ordered A. Teixeira & Company to purchase Antonio's and Armenio's stock at fair value under G.L. § 7-1.1-90.1.

In determining the fair value of the shareholders' stock, the superior court considered the application of a minority discount. Citing *Charland v. Country View Golf Club, Inc.* 588 A.2d 609 (R.I. 1991), the Teixeiras argued that a minority discount was not permitted in appraisal actions. In *Charland*, the court ruled "that in circumstances in which a corporation elects to buy out a shareholder's stock pursuant to [G.L.] § 7-1.1-90.1, [the Court] shall not discount the shares solely because of their minority status."

A. Teixeira & Company, Inc. argued that a minority discount was permissible. It cited *Jeffrey v. American Screw Co.*, 98 R.I. 286, 201 A.2d 146 (1964), which concluded, "the appraiser 'has a wide discretion to consider and weigh evidence of any value factor that in the circumstance of the case is relevant and material.'" The company noted that under the circumstances of their case, a minority discount should be applied because the minority shareholders brought this action.

The superior court rejected this idea. It stated that the reasoning in *Charland* to forego any discounts was more often recognized and it cited case law from other jurisdictions denying the application of valuation discounts under similar circumstances. The superior court took notice of 13 ALR 5th 840, 850 (1993), which stated, "[W]ithin the context of a dissolution proceeding, almost all of the courts that have considered the question have rejected the application of a minority discount, the courts reasoning, in part, that if the corporation had been dissolved, the minority shareholder would have received the pro-rata value of the shares, with no consideration given to whether the shares represented a controlling interest." Therefore, the superior court did not apply a minority discount in its valuation.

Discount for Built-In Capital Gains Taxes Permitted in Stock Buyout

In *Elizabeth V. Bogosian et al. v. James H. Woloohojian, et al.*, 158 F.3d 1 (1st Cir. 1998), the U.S. Court of Appeals for the First Circuit considered whether to permit a valuation discount for potential built-in capital gins taxes in a stock buyout. Bogosian and her two brothers equally owned a real estate holding company. She petitioned for a corporate dissolution, and the corporation elected to purchase her one-third interest at its fair value plus interest from the date of the election to the date of final payment. See R.I. Gen. Laws Sec. 7-1.1.90.1. A special master was selected to value the property. The parties also presented expert witnesses. The court concluded that the corporation had a value of approximately $14.7 million, and awarded Bogosian her pro-rata share based on that value. Woloohojian argued that a deduction for the built-in capital gains taxes was warranted because the corporation will liquidate or dispose of some properties to pay the award. However, the court declined to deduct an amount for potential built-in capital gains taxes from the $14.7 million figure because it determined that (1) the corporation could borrow enough money to pay Bogosian based on the experts' testimony, (2) the corporation could engage in a tax free Sec. 355 split-off to transfer assets to Bogosian (See 26 U.S.C. 355), and (3) she would pay personal taxes on the proceeds she received and should not be subjected to double taxation. It also determined that 11% compound interest was appropriate. Woloohojian appealed.

The appellate court noted that potential deferred taxes are generally not considered unless sit was reasonably foreseeable that they will be incurred. However, Woloohojian filed a plan to finance its purchase from Bogosian through a sale of one, a transfer of two, and loan(s) in the amount of $3 million against its remaining properties. Thus, the appellate court concluded that some capital-gains taxes were reasonably foreseeable.

The court then investigated the district court's reasoning. It determined that the lower court erred when it found that the corporation could borrow enough to pay Bogosian. The appellate court found that the testimony and the report provided by the court's expert contradicted one another on this issue. It further noted Woloohojian's expert testified that it could only borrow approximately $3 million, and that the debt to Bogosian exceeded that amount. It also noted Bogosian provided no contradictory evidence.

The appellate court also considered the feasibility of a Sec. 355 split-off. It found that the lower court could not disregard the potential deferred taxes under this theory because Sec. 355 only applies to existing shareholders, and Bogosian ceased to be a shareholder under the state statute when the buyout election was made. Furthermore, the appellate court found that the use of this section would have required agreement among all the shareholders before the buyout election was made, and "the possibility of such a transaction at the outset – and it is only a possibility – does not answer the need to take account of the taxes on property sales that were and are required to pay Bogosian for her stock."

The lower court's double taxation reasoning was also found to be in error. A dissolution or a stock sale triggers taxation at the corporate as well as the shareholder levels. See IRC Sec. 331,336. Thus, it concluded that since Bogosian triggered the tax realization event that she "is in no position to avoid the full consequences of her choice."

The appellate court reversed the lower court's decision denying a reduction in value for the potential built-in capital gains taxes. It stated that "[t]he valuation of [the company] must include the expected tax liability that will be incurred on the three specifically planned sales and transfers and Bogosian will effectively shoulder one-third of the reduction. Any other decision would falsely inflate the value of WRC."

The court also considered whether the award of 11% compound interest was appropriate. It noted that the statutory award of interest is designed to compensate the former shareholder for lost dividends and lost investment income on the fair value of stock. However, no Rhode Island court awarded compound interest in a stock buyout case prior to this ruling. The appellate court concluded that the Rhode Island Supreme Court disfavored compound interest. Thus, it reversed this award, and awarded 11% simple interest because "Rhode Island courts would not allow an award of compound prejudgment interest under R.I. Gen. Laws 7-1.1-90.1."

Law Firm Shares – Valuation – Stipulation – Interest

In re *McBurney Law Services, Inc.*, a decision by the Rhode Island Supreme Court's valuation panel, assessing the fair market value of the shares held by an attorney who voluntarily terminated his association with a law firm, must be vacated because the panel erred (1) in allowing a motion by the attorney to modify a stipulation regarding his ownership of 25 percent of the firm's shares and (2) in awarding prejudgment interest from the date the attorney terminated his relationship with the firm, concludes the Rhode Island Supreme Court.

Cite as 619 A.2d 432 (R.I. 1993)

Supreme Court of Rhode Island

Robert W. Gibbons

v.

Lucinda M. Gibbons

No. 91-266-Appeal
January 27, 1993

Stephen J. Fortunato, Fortunato & Tarro, Allen Kirshenbaum, Carolyn Barone, Kirshenbaum Law Associates, Kris Macaruso Marotti, Fortunato & Tarro, Warwick, for plaintiff.

Howard Lipsey, Lipsey & Skolnik, Providence, for defendant.

OPINION

PER CURIAM.

This case comes before us on the appeal of Robert W. Gibbons (husband) from orders of equitable property distribution, counsel fees, and child support awarded to Lucinda M. Gibbons (wife) incident to a judgment entered in the Family Court awarding a divorce to the husband on the grounds of irreconcilable differences. Neither party appeals from the judgment of divorce. The husband and the wife were married on July 28, 1973. As of the time of the entry of the decision pending final Judgment of divorce, the parties had been married for seventeen and a half years. The husband is a podiatrist with an annual business income of approximately $280,000 per year. The general master who presided at the trial of this case awarded to the wife 70 percent of the marital assets, which the master found to be in the amount of $1,214,294.48. The actual total of marital assets from our calculations should have been $1,180,940.23. The master awarded the remainder of the assets to the husband. In calculating the cash amount to be paid to the wife from the value of the podiatric practice, the sum of $442,777 was ordered to be paid on or before January 1, 1991, or at the option of the husband over a period of five years with interest at the rate of 12 percent per annum, each installment payable on January 1 of each year beginning in 1991 in no less an amount than $88,555 per year plus 12 percent interest. These awards were made in lieu of alimony. Our calculation of the cash award indicates that this sum should have been $432,776.29 (deducting $417,223.71 in assets from the total award of $850,000).

We shall consider the points raised by the husband in the order in which they are set forth in his brief. We affirm the orders in part and modify them in part.

I

THE AWARD OF 70 PERCENT OF THE MARITAL ESTATE

We are of the opinion that the general master did not err in awarding the wife 70 percent of the marital estate since we cannot say that he was clearly wrong in applying the criteria for equitable distribution pursuant to G.L.1956 (1988 Reenactment) § 15-5-16.1, which sets forth the factors to be considered in distributing marital assets, namely, (1) the length of the marriage, (2) the conduct of the parties during the marriage, (3) the contribution of each of the parties in the acquisition, preservation, or appreciation in value of their respective estates, and (4) the contribution and services of either party as homemaker. In the instant case the parties had been married for seventeen and a half years. The wife had been an exemplary homemaker, caring for the five children of the parties, and had contributed to her husband's education. She had been employed whenever possible after the birth of the first child and had assisted the husband as a nurse when he opened an office in the town of North Providence. The master attributed no fault to the wife for the break up of the marriage but found that the husband was fully responsible for the termination of the marriage by carrying on an extra-marital affair with one of his employees while his wife was pregnant with the fifth child. The general master, in considering all the factors set forth in the statute, acted well within his discretion in making the award. *See Marocco v. Marocco,* 571 A.2d 572 (R.I. 1990); *Stanzler v. Stanzler,* 560 A.2d 342 (R.I.1989).

II

THE VALUATION OF THE PODIATRIC PRACTICE

After considering the testimony of the expert witnesses, the general master arrived at a value of the podiatric practice in the sum of $504,000. This valuation was made on the basis of the testimony of an expert witness, Alan Gilstein, C.P.A., who capitalized future earnings from the practice and concluded pursuant to Internal Revenue Service ruling 59-60 that the total value of the practice was $840,000. He reduced this figure by 20 percent for lack of marketability to the sum of $672,000 as the fair market value of the practice. The general master in his finding adopted a 40- percent factor for lack of marketability that had been determined by one of the husband's experts, Eugene Amelio, esquire. The master rejected the testimony of another expert presented by the husband, Anthony Melia, C.P.A. Using the 40-percent discount for lack of marketability, the general master arrived at the figure of $504,000.

The court is divided on the propriety of this award. Two justices are of the opinion that it is improper as a matter of law to capitalize the earnings of a professional practice on the basis of the services of a single individual in order to arrive at a good-will factor in ascertaining the value of such practice. *See, e.g., Powell v. Powell,* 231 Kan. 456, 648 P .2d 218 (1982); *Hanson v. Hanson,* 738 S.W.2d 429 (Mo.1987); *Nail v. Nail,* 486 S.W.2d 761 (Tex.1972); *Sorensen v. Sorensen,* 839 P.2d 774 (Utah 1992); *Holbrook v. Holbrook,* 103 Wis.2d 327, 309 N.W.2d 343 (1981).

Two justices are of the opinion the opinion that this issue has not been preserved on appeal by reason of the fact that the husband's experts also purported to value the good will of this practice, utilizing the factor of capitalizing a portion of future excess earnings. Consequently, since the court is equally divided on this issue, the findings of the general master concerning this valuation are affirmed.

III

ATTORNEYS' FEES

The general master awarded to the wife the sum of $82,602 in counsel fees. The husband challenges this award on two grounds. He argues first that the wife has ample funds with which to pay her own counsel fees, particularly in light of the award to be paid in cash on the basis of the valuation of the podiatric practice. Second, the husband argues that the award was excessive. The wife argues that her lack of earnings, both at present and in the foreseeable future, make her less able to pay counsel fees than the husband. The wife further argues that this court should further consider the fact that she has not been awarded a sum for alimony.

Taking both of these positions into account, we believe that this case tends to be sui generis. There is no question that the wife has been awarded substantial assets. There is further no question that the husband's earning power far exceeds that of the wife and is likely to do so on a permanent basis. The wife's ability to seek employment was found by the master to be severely limited in light of her role as caretaker of five children, one of whom has special needs. In the special circumstances of this case, we believe that some award of counsel fee was within the discretion of the general master. However, we are of the opinion that this award should not exceed $35,000. In arriving at this amount, we take into account that the actual services based upon expenditure of time was in the sum of less than $22,000. The balance of the attorney's fee awarded constituted an additional amount that the master derived from factors included in Rule 1.5 of Rule 47 of the Supreme Court Rules of Professional Conduct. Taking these factors into account is a matter of strong dispute between the parties. We find it unnecessary to resolve this dispute in this case. In light of the assets available to the wife as well as the earning capacity of the husband, we believe that the wife is able to bear the costs of a significant amount of her own counsel fees. Therefore, we reduce the amount of the award of counsel fee to the sum of $35,000, which sum shall include costs for expert witnesses and other costs.

IV

THE INSTALLMENT PAYMENT

Although the court is equally divided on the issue of the valuation of the podiatric practice, we believe that the installment option made available to the husband is appropriate. However, in light of present-day interest rates, we are of the opinion that the addition of 12 percent interest is excessive. This is not an action in tort but a marital distribution of property. Therefore, the interest applicable to the optional installment payments is reduced to six percent per annum.

V

VALUATION OF CRANBERRY TERRACE PROPERTY

The Cranberry Terrace property is a piece of residential realty purchased by the husband in Alpine Estates in the city of Cranston. It is agreed that the property was purchased for $390,000 and that at the time of the trial of this case was subject to a mortgage of $307,400. The husband presented an expert, James Sloane, who testified that the current market value of the property was $292,000. The general master's finding in regard to the equity value was based upon the original purchase price together with the cost of improvements made to the property as of the time of purchase.

The general master rejected James Sloane's testimony as unpersuasive. We believe that in this instance the master was not clearly wrong in utilizing a cost basis for his valuation of the property, although normally comparable sales do provide the most persuasive evidence of value. However, on cross-examination, testimony was adduced from the expert that he did not take into account in adjusting his comparable sales the post purchase additional improvements to the Cranberry Terrace property. In this analysis the master was not clearly wrong

VI

CHILD SUPPORT

The general master awarded the sum of $1,000 per month per child for the support of the minor children of the parties. In so doing, he took into account the factors set forth in § 15-5-16.2. He considered the standard of living that the children would have enjoyed had the marriage not been dissolved, the circumstances of the children and their educational needs, and the financial resources and needs of the noncustodial parent. The award of child support is within the sound discretion of the trial justice (here the general master). *Sullivan v. Sullivan,* 460 A.2d 1248, 1249 (R.I.1983).

Considering the circumstances of the husband and the wife, as well as the standard of living of the husband and his probable future income, we believe that the general master did not abuse his discretion in the award of support for the minor children.

VII

THE WIFE'S HEALTH- CARE COVERAGE

The general master required the husband to pay for the wife's health-care coverage in accordance with the Rhode Island Insurance Continuation Act or during the five-year period in which the husband is paying the sums due pursuant to marital distribution, whichever occurs later.

General Laws 1956 (1989 Reenactment) § 27-20.4-1 allows the wife to be eligible for continuing benefits under her husband's health plan until (1) the remarriage of either party to the divorce or (2) such time as provided by the judgment of divorce.

We are of the opinion that this portion of the order requires clarification. We cannot determine whether this health-care coverage would terminate forthwith upon the payment of the lump sum provided in the marital distribution award or upon the remarriage of either party. We therefore remand this question to the general master for clarification.

We have considered other points raised by the husband in support of his appeal and find that they are without merit.

For the reasons stated, the orders issued by the master are affirmed in part and modified in part. The papers in the case are remanded to the general mater with directions to modify his orders in accordance with this opinion.

Cite as 669 A.2d 524 (R.I. 1996)

Supreme Court of Rhode Island

Daniel J. BECKER

v.

Kleo K. PERKINS-BECKER.

No. 92-471-Appeal.

January 12, 1996

William G. Savastano, North Smithfield, for Plaintiff.

Eleanor W. Brown, Providence, for defendant.

MURRAY, Justice.

This case comes before us on the appeal of Daniel J. Becker (the husband) and on the cross-appeal of Kleo K. Perkins Becker (the wife) from a decision and certain orders incident to a final judgment of the Family Court granting the husband's petition and the wife's counterclaim for an absolute divorce on the basis of irreconcilable differences that had caused the irremediable breakdown of the marriage. Neither party appeals from the judgment of divorce. We sustain the husband's appeal in part and deny and dismiss it in part. We deny and dismiss the wife's cross-appeal, A partial summary of facts as found by the trial justice follows.

The parties were married on September 7, 1985, and separated in January 1990. They began having problems shortly after the marriage began and participated in family counseling in the spring of 1987. The trial justice found that during the marriage and during the course of the divorce proceedings the parties engaged in a power struggle that destroyed any chance of achieving a harmonious coexistence. Moreover, they took hard positions on many insignificant decisions and refused to compromise or to work out any sort of accommodation when differences arose. The trial justice found no specific evidence of fault but noted that their failure to communicate led to the final separation.

There was one child born of the marriage, Annika. At the time of the trial in September 1991. The wife was forty years old, the husband was thirty-five years old, and Annika was three years old. The parties were awarded joint custody of Annika with physical possession granted to the wife with specific rights of visitation allowed to the husband.

The husband and wife owned residential real estate in North Smithfield with a fair market value of approximately $137,000 and a mortgage balance of $108,000 at the time of the trial. The husband was awarded a 60 percent interest in the marital domicile, and the wife was awarded a 40 percent interest. The husband is a licensed chiropractor and has been engaged in that profession since one year prior to the marriage of the parties.

The husband's annual income was found by the trial justice to be $126,904 at the time of the trial. Relying on the testimony of Joseph Russolino (Russolino); a certified public accountant, the trial justice found that the fair market value of the husband's chiropractic practice at the time of trial to be $134,463, including good will, which was valued at $102,991. The court also found that the husband's practice had little or no market value prior to the marriage and that the value of the practice was a result of the joint efforts by both parties. He therefore ordered that the parties share equally in the value of the practice.

The wife holds both undergraduate and master's degrees in education and is certified to teach in the State of Illinois. She was found by the trial justice to be capable of becoming certified in Rhode Island within a period of two years. If she did not pursue Rhode Island certification and was available to work full-time, the wife's annual earning capacity at the time of trial was estimated to be $17,000.

The trial justice awarded the marital domicile to the wife and the chiropractic practice to the husband. To accomplish the equal division in the husband's practice and to provide the wife with 40 percent of the equity in the marital domicile, the trial justice ordered the husband to convey a balance of $49,531.50 to the wife by paying the mortgage on the marital domicile at a rate of $303 per week until the mortgage principle was reduced by $49,513.50.

The husband was also ordered to pay $327 per week to the wife in alimony for a period of three and one-half years and $250 per week in child support. Other orders were included in the judgment of divorce which we do not recite in this opinion because the parties do nor dispute their propriety.

Both parties raise several arguments on appeal. We shall first address the arguments raised by the husband in the order in which they are presented in his appellate brief.1 We next shall turn to the remaining arguments advanced by the wife in her cross-appeal. Further facts will be supplied in later portions of this opinion. In the husband's first assertion of error on appeal, he argues that the trial justice erred in failing to recuse himself on the basis of his personal relationship with Russolino. He further alleges that the "trial justice's undisguised boiling blood" revealed a high degree of favoritism toward the wife, making a fair judgment impossible. We find both arguments meritless from the record before us on appeal.

We shall first address the husband's contention that the trial justice erred in not recusing himself on the basis on his relationship with Russolino. During the course of the divorce proceedings a

Family Court justice other than the trial justice in the instant case recommended that the parties retain Russolino as an impartial expert witness to determine the value of the husband's chiropractic practice. Thereafter, during the course of the trial, before Russolino testified the trial justice advised the parties that he had attended school with Russolino and that Russolino had previously testified before him on several occasions. Counsel for the husband informed the court that he wanted an opportunity to speak with the husband before he advised the court whether to proceed. The next day court resumed, counsel for the husband indicted that after speaking with the husband, he would not seek the trial justice's recusal. The trial justice then indicated that he would not recuse himself, and he further stated that "Russolino did some projections for me when I was practicing law. I have no personal familiarity with him at all." The hearing then resumed without further mention of this issue, and Russolino subsequently testified.

The husband contends that the trial justice did not fully apprise the parties of his relationship with Russolino until after the parties agreed not to seek his recusal. We are not persuaded that the husband may raise this issue now on appeal since he presented no objection with regard to the trial justice's participation in the instant case either after the trial justice had informed the parties that he had used Russolino's services while he was in private practice or at any other time during the proceedings. It is well settled that matters not brought to the trial justice's attention will not be reviewed by us on appeal. *State v. Tempest,* 651 A.2d 1198, 1216 (R.I.1995) (citing *632 Metacom Associates v. Pub Dennis of Warren, Inc.,* 591 A.2d 379, 381 (R.I.1991)). Hence the subject of the trial justice's recusal may not be raised on appeal. *Tempest,* 651 A.2d at 1216.

We further reject the husband's contention that the trial justice's "boiling blood" prevented him from rendering a fair and impartial decision. During the trial justice's rendition of his oral decision, he stated that the husband had committed perjury during the course of the proceedings. Later the trial justice stated:

> "I have had to break from case on a number of occasions to restrain myself from taking action against the [husband] in light of his attitude toward the Court and towards [the wife's] counsel. Frankly I was not quite sure which, but rather than getting into it with him I chose to break each *time I felt my blood was starting to boil."* (Emphasis added.)

The husband avers that that remark demonstrates the trial justice's favoritism toward the wife and his antagonism toward and personal prejudice against him. We disagree.

This court has commented that

> "[a] charge that the trial justice was so prejudiced as to impair the fairness and impartiality of the trial is serious. Therefore, the person alleging prejudice carries a substantial burden. *** One asserting prejudice must establish that the actions of the trial justice were affected by facts and events which were not pertinent nor before the court." *Lavey v. Lavey*, 551 A.2d 692, 696 (R.I. 1988) (quoting *State v. Nidever,* 120 R.I.767, 769-70, 390 A.2d 368, 370 (1978))

In the instant case it should be noted that at no time did the husband seek a mistrial or in the instant ask that the trial justice recuse himself. The claim of prejudice comes only after the trial justice rendered his oral decision. We find no evidence of record which would warrant any inference that the trial justice's rulings were based on bias rather than on the evidence established during the proceedings. We therefore reject the husband's contention that the trial justice erred in not recusing himself.

The husband next argues that the trial justice erred as a matter or law when he denied the husband's motion in limine to bar testimony of the good-will evaluation performed by Russolino of the husband's chiropractic practice. We agree.

After considering the testimony of Russolino, the trial justice determined that the husband's chiropractic practice had a value of $134,463, which amount included good will with a value of approximately $102,991 and net tangible assets with a value of approximately $31,472. Russolino employed the "formula method" in his valuation of the practice, which is a two-stage valuation technique that combines the adjusted-book-value method with a valuation of the intangible assets of the business, using an updated version of Internal Revenue Service Appeals and Review Memoranda 34 and Revenue Ruling 68-609. This method measures the value of good will in the practice. The procedure for valuing good will involved the compilation of the husband's annual tax returns for the five years ending December 31, 1990, and certain industry data as provided by the American Chiropractic Association. The computation of good will was determined by applying a weighted factor to each year's excess earnings. A capitalization rate of 33_ percent was then applied to weighted average excess earnings in order to arrive at a value for good will.

We are of the opinion that the trial justice erred in denying the husband's motion in limine to preclude Russolino's testimony regarding the good-will value of his practice. The capitalization of earnings of a professional practice on the basis of the services of a single individual in order to arrive at a good-will factor in ascertaining the value of such practice is improper as a matter of law. *Gibbons v. Gibbons,* 619 A.2d 432, 434 (R.I.1993) (citing *Powell v. Powell,* 231 Kan. 456, 648 P.2d 218 (1982); *Hanson v. Hanson,* 738 S.W.2d 429 (Mo.1987); *Nail v. Nail,* 486 S.W.2d 761(Tex.1972); *Sorensen v. Sorenson,* 839 P.2d 774 (Utah 1992); *Holbrook v. Holbrook,* 103 Wis.2d 327, 309 N.W.2d 343 (1981)). Accordingly, we conclude that the trial justice erroneously included the value of good will in determining the total value of the husband's practice subject to distribution. We therefore reverse the trial justice's decision awarding the wife a 50 percent interest in the good-will value of the practice and reduce the wife's total award by $51,495.50, which amount represents the 50 percent share in the good-will value of the practice erroneously awarded by the trial justice.

We next consider the husband's contention that the trial justice erred as a matter of law in awarding the wife alimony for a period of three and one-half years at a weekly rate of $327. Awards of alimony require the trial justice to evaluate the evidence in view of the several factors

set forth in G.L.1956 (1988 Reenactment) § 15-5-16. 2 The factors a trial justice must consider in determining the amount of alimony are "the length of the marriage; the conduct of the parties during the marriage; the health, age, station, occupation, amount and source of income, vocational skills, and employability of the parties; and the state and liabilities and needs of each of the parties." *Id.*

This court has indicated that alimony is a "rehabilitative tool designed to provide support for a dependent spouse and is based upon need." *Wrobleski v. Wrobleski.* 653 A.2d 732, 734 (R.I.1995) (quoting *Ramsbottom v. Ramsbottom, 542* A.2d 1098, 1100 (R.I. 1988)). We have also noted "that findings of fact by a trial judge in a divorce action will not be disturbed unless the judge misconceived the relevant evidence or was Otherwise clearly wrong." 653 A.2d at 734.

In the instant case the trial justice considered each of the statutory factors in determining that the wife was entitled to temporary rehabilitative alimony. The trial justice considered the income of the parties and noted that the wife was substantially unemployed and that the husband had weekly earnings of $2,442. The trial justice found that the wife's rehabilitation would be obtained sooner if she focused on obtaining teacher certification in this state. The trial justice further noted that using reasonable efforts, the wife could provide Annika with almost full-time care and become self-sustaining within a period of three and one-half years. He therefore ordered the husband to pay the wife weekly alimony in the amount of $327 for a period of three and one-half years, which he deemed a "bare bones" support order. The trial justice in considering all the factors set forth in the statute acted well within his discretion in making the award. *Id.*

The next issue we shall address is the propriety of the award of attorney's fees to the wife. Both parties argue that the trial justice erred in awarding the wife $27,300 in counsel fees. The husband contends that the wife pursued frivolous and meritless claims and should be precluded from receiving attorney's fees entirely. The husband further argues that the general master 3 erroneously awarded the wife attorney's fees pendente lite in the amount of $5,000. The wife avers that the trial justice erred in not awarding her the entire amount of fees she requested in thee sum of $54,398. She contends that the trial justice improperly limited the fee award and penalized her for her attorney's performance of her legal and ethical duty to provide competent representation. We affirm the trial justice's award of attorney's fees.

In his decision the trial justice found that $27,300 was a reasonable fee for the wife's counsel and that the wife was without funds to pay it. He also found that the husband had excess funds in the amount of $150 per week from which he has the ability to pay counsel fees. He therefore ordered that the husband pay the wife's counsel fees in the amount of $150 per week for a period of three and one-half years, without interest. During his discussion of this issue, the trial justice rejected the wife's request for counsel fees in the amount of $54,398. Although the wife presented evidence of the reasonableness of her counsel fees, the trial justice found that the wife's counsel was overly prepared for the trial and had performed significant research on issues that did not "bear any fruit." He opined that there are reasonable limits to the amount of reparation which should be allowed. The trial justice indicated that 273 hours at $100 per hour was in his judgment eminently fair, reasonable, and credible.

Pursuant to § 15-516, the Family Court has the authority to order one spouse to pay the counsel fees of the other spouse. However, prior to making such an award, the trial justice must determine that the party from whom payment is sought has sufficient financial ability to pay such fees and that the spouse seeking payment is without property available for that purpose. *Casey v. Casey,* 494 A.2d 80, 84 (R.I. 1985) (citing *Tarro v. Tarro,* 485 A.2d 558, 564 (R.I. 1984). This court has stated that a trial justice presiding in a divorce proceeding acts within the limits of judicial discretion in fixing the amount of attorney's fees and, absent judicial abuse, this court will not review the exercise of such discretion. *Gartner v. Gartner,* 79 R.I. 399, 408, 89 A.2d 368, 374 (1952). In fixing the amount of the award, the trial justice is not bound by the opinions of attorneys in regard to the value of the services rendered but should exercise his or her own independent judgment since he or she has the requisite skill and knowledge to form a reasonably correct idea of what is fair and reasonable compensation. *Id.*

In the instant case the trial justice made a specific finding that the wife was without funds to pay her counsel fees and that the husband had sufficient financial ability to pay them. Moreover, because he presided over the proceedings, the trial justice was in the best position to evaluate the reasonableness and fairness of the award of counsel fees to the wife in light of the particular circumstances of this case. We cannot say that the trail justice abused his discretion in fixing the amount of the award. We therefore affirm the trial justice's award of $27,300.

We further reject the husband's argument that the general master erred in awarding attorney's fees pendente lite to the wife in the amount of $5,000. This court has stated that the Family Court has the power to award counsel fees during the pendency of the appeal or after the death of a party. *Centazzo v. Centazzo,* 556 A.2d 560, 562 (R.I. 1989). The husband sets forth no facts which would demonstrate an abuse of discretion by the general master, whose order is therefore affirmed.

We now turn to the cross-appeal of the wife wherein she argues that the trial justice erred as a matter of law in ruling that the husband's enhanced earning capacity from an advanced degree acquired during the marriage is not a marital asset subject to equitable distribution. She avers that the trial justice erroneously barred her expert witnesses from testifying about the value of the husband's enhanced earning capacity.

In August 1989, during the course of the marriage, the husband received the advanced degree, Diplomate of the American Board of Chiropractic Neurology, and became qualified to perform certain neurological tests which he was previously unable to conduct. During the trial the wife sought to present evidence through the testimony of expert witnesses concerning the value of the husband's advanced degree. The husband objected to the wife's proposed witnesses and through a motion in limine sought to include such testimony. The trial justice entered a written order in which he found as a matter of law that enhanced earning capacity is not a marital asset subject to equitable distribution. He therefore ruled that the proposed testimony of the wife's expert witnesses was inadmissible on the basis that it was irrelevant and immaterial.

GeneralLaws 1956 (1988 Reenactment) § 15-5-16.1(a) governs the distribution of marital assets by the Family Court and provides:

> "In addition to or in lieu of an order to pay alimony made pursuant to a complain for divorce, the court may assign to either the husband or wife a portion of the estate of the other. In determining the nature and the value of property, if any, to be assigned, the court after hearing the witnesses, if any, of each party shall consider the length of the marriage, the conduct of the parties during the marriage, and the contribution of each of the parties in the acquisition, preservation, or appreciation in value of their respective estates, and the contribution and services of either party as a homemaker. The court may not assign property or an interest herein held in the name of one of the parties if the property was held by the party prior to the marriage, but may assign income which has been derived therefrom during the term of the marriage and the court may assign the appreciation of value from the date of the marriage of property or an interest therein which was held in the name of one party prior to the marriage which increased in value as a result of the efforts of either spouse during the marriage. The court also not assign property or an interest therein which has been transferred to one of the parties by inheritance before, during, or after the term of marriage."4

The issue before us is one of first impression, namely, whether the enhanced earning capacity of one spouse from an advanced degree, acquired during the marriage is marital property subject to equitable distribution under § 15-5-16.1. Following our examination of the overwhelming majority of other jurisdictions that have addressed this issue directly, we are persuaded that a professional degree or license is not marital property subject to distribution upon dissolution of the marriage.

In *re Marriage of Graham*, 194 Colo. 429, 432, 574 P.2d 75, 77 (1978), the Colorado Supreme Court held that an educational degree, such as a master's degree in business administration, is not marital property. In making its determination, the *Graham* court relied on the nonproperty characteristics of an educational degree. The *Graham* court stated:

> "An educational degree, such as an M.B.A, is simply not encompassed even by the broad views of the concept of 'property.' It does not have an exchange value or any objective transferable value on an open market. It is personal to the holder. It terminates on death of the holder and is not inheritable. It cannot be assigned, sold, transferred, conveyed, or pledged. An advanced degree is a cumulative product of many years of previous education combined with diligence and hard work. It may not be acquired by the mere expenditure of money. It is simply an intellectual achievement that may potentially assist in the future acquisition of property. In our view, it has none of the attributes of property in the usual sense of that term." *Id.*

In *Drapek v. Drapek,* 399 Mass. 240, 246-47, 503 N.E.2d 946, 950 (1987), the Supreme Judicial Court of Massachusetts held that the husband's medical degree and enhanced earning capacity were not part of his estate subject to division and the lower court's assignment of such was error. The *Drapek* court refused to hold that the present value of future earned income was subject to division Under Mass.Gen.Laws Ann. ch. 208 § 34, because to do so would have involved too much speculation. *See* 399 Mass. at 244, 503 N.E.2d at 949. Moreover, the *Drapek* court opined that adopting a rule that would subject the degree's value to distribution upon divorce would eliminate consideration of the effect of future events on the professional's earning capacity. *Id.* Because a property settlement is not subject to modification like alimony, the *Drapek* court was concerned about the ramifications of future events. *Id.* The *Drapek* court refused to include a professional degree as a martial asset because assigning a present value to a professional degree would involve evaluating the speculative earning potential of the holder. *Id.* Numerous other state courts have similarly held that a professional degree or license is not marital property. *See, e.g., In re Marriage of Olar,* 747 P.2d 676, 680 (Colo. 1987); *In* re *Marriage of Weinstein,* 128 Ill.App.3d 234, 244, 83 Ill.Dec. 425, 433, 470 N.E.2d 551, 559 (1984); *Archer v. Archer,* 303 Md. 347, 357, 493 A2.d 1074, 1080 (1985); *Davey v. Davey,* 415 N.W.2d 84, 88 (Minn.Ct. App.1987); *Mahoney v, Mahoney,* 91 N.J. 488, 505, 453 A.2d 527, 536 (1982); *Stevens v. Stevens,* 23 Ohio St.3d 115, 120, 492 N.E.2d 131, 135 (1986); *Pacht v. Jadd,* 13 Ohio App.3d 363, 365, 469 N.E.2d 918, 921 (1983); *Bodge v. Bodge,* 513 Pa. 264, 268, 520 A.2d 15, 17 (1986); *Martinez v. Martinez,* 754 P.2d 69, 75 (Utah.Ct.App.), *cert. granted.* 765 P.2d 1277 (Utah 1998); *Hoak v. Hoak,* 179 W.Va.509, 370 S.E.2d4.73, 174 (1988); *Grosskopf v. Grosskopf,* 677 P.2d 814, 822 (Wyo. 1984); *see generally,* Brenda Ruel Sharton, Comment, *Spousal Interest in Professional Degrees: Solving the Compensation Dilemma,* 31 B.C.L.Rev. 749 (1990).

New York is the only state whose highest court has determined that a professional degree is marital property. *O'Brien v. O'Brien,* 66 N.Y.2d 576, 489 N.E.2d 712, 498 N.Y.S.2d 743 (1985). In that case, the New York Court of Appeals held that a license to practice medicine, acquired during the marriage was marital property subject to equitable distribution. *Id.* at 580-1, 489 N.E.2d at 713, 498 N.Y.S.2d at 744. The court reasoned that the value of the professional license, as marital property, was the enhanced earning capacity it afforded, the holder and that the spouse who worked while the other attended school was entitled to an equitable portion of the license. The court found a clear legislative mandate to include an interest in a profession or a professional career as marital property pursuant to § 236(B)(1)(6) of the New York Domestic Relations Law. That section provided that the court, in distributing the marital property should consider contributions and expenditures made to the career of the spouse. 66 N.Y.2d at 584, 489 N.E.2d at 715-6, 498 N.Y.S.2d at 746-47.

We find that professional degrees and licenses and the resulting enhanced earning capacity of the holder spouse is not a martial asset subject to equitable distribution under § 15-5-16.1. The value of a professional degree or a license may not be included in the distribution of marital assets upon the dissolution of a marriage. To embrace a rule that would subject such an item to distribution upon dissolution would result in the foreclosure of consideration of the effect on the individual's earning capacity of such future events as death, illness, or unpredictable market variables. *Drapek,* 399 Mass. at 244, 503 N.E.2d at 949. It is our opinion that it is improper to capitalize or apportion future enhanced earning capacity in order to obtain a present

value for distribution of marital assets. We therefore affirm the trial justice's decision finding as a matter of law that enhanced earning capacity is not subject to equitable distribution under § 15-5-16.1 and his decision barring the wife from presenting testimony about the husband's enhanced earning capacity resulting from his advanced degree.

For these reasons the husband's appeal is sustained in regard to the issue of good will. We reduce the wife's total award in the amount of $54,495.50, which amount represents the 50 percent share of the good will erroneously awarded. We deny and dismiss the remainder of the husband's appeal, and we deny and dismiss the wife's cross-appeal. The papers of this case are remanded to the Family Court.

ENDNOTES

1. The issue of the wife's attorney's fees is raised by both parties. We shall address this issue during our discussion of the husband's appeal.

2. General Laws 1956 (1988 Reenactment) § 15-5-16 was recently amended by P.L.1993, ch. 78 § 1. The new version of the statute applies to cases filed on or after July 7, 1993. Because the instant case was filed in 1989 we use the earlier version in our analysis.

3. The wife's motion for attorney's fees pendente lite was granted by a Family Court general master and not by the trial justice who presided over the divorce trial.

4. Under the 1992 amendment (P.L. 1992, ch. 269, § 2) of G.L.1956 (1988 Reenactment) § 15-5-16.1, in making an equitable distribution award, the court may consider "[t]he contribution by one (1) party to the education, training, licensure, business, or, increased earning power of the other." This factor is not included in the earlier 1988 Reenactment of the statute, which applies to the instant case.

Supreme Court

No. 99-171-Appeal.
(K 96-556)

Vincent F. Moretti. :

v. :

Marilyn J. Moretti :

Present: Weisberger, C.J., Lederberg, Flanders, and Goldberg, JJ.

OPINION

PER CURIAM. This case came before the Court for oral argument on January 22, 2001, pursuant to an order that directed both parties to appear in order to show cause why the issues raised by this appeal should not be summarily decided. After hearing the arguments of counsel and examining the memoranda filed by the parties, we are of the opinion that cause has not been shown and that the issues raised by this appeal should be decided at this time. The facts insofar as pertinent to this appeal are as follows.

Marilyn J. Moretti (plaintiff) and Vincent F. Moretti (defendant) were married on October 6, 1974. The parties separated in 1996. Only one of the couple's three children was a minor at the time of trial. All three children resided with plaintiff.

After a trial in the Family Court, the trial justice granted an absolute divorce on the statutory grounds of irreconcilable differences. Before trial, the parties stipulated to an equal distribution of the marital assets and to an award of joint custody of the minor child. Therefore, the only issues for resolution at trial were the value of the marital assets, the issue of goodwill as to defendant's landscaping business, the dissipation of assets by plaintiff during the marriage, and plaintiff's request for alimony. With regard to these issues, the trial justice concluded that the value of defendant's landscaping business included goodwill and that plaintiff had dissipated

$46,700 in marital assets. He also ordered defendant to pay $400 a week to plaintiff for five years as rehabilitative alimony. The defendant appealed. Additional facts will be supplied as needed to address the issues raised in this appeal.

The defendant raises several issues on appeal. First, defendant argues that the trial justice erred when he found that goodwill was a component of the value of defendant's landscaping business. Second, defendant argues that the trial justice erred when he awarded plaintiff rehabilitative alimony. Finally, defendant argues that the trial justice erred when he found that plaintiff dissipated $46,700 in marital assets.

The defendant's first argument on appeal is that the trial justice erred when he found that goodwill was a component of the value of defendant's landscaping business. The defendant, a retired Cranston police officer, is the sole owner of Tangleridge Landscaping, Inc. (Tangleridge or business). The defendant started the business during the marriage and he has operated it for the last seventeen years. His only employees are six workers, all of whom speak very little or no English. The defendant is the only person who deals with clients.

Glen Stevenson (Stevenson), a certified public accountant presented by plaintiff, qualified as an expert witness at trial. He testified that he evaluated defendant's business using the excised earnings method -- a method he described as a combination of an income approach and an asset approach. He testified that he begins such an evaluation by determining what would be a fair rate of return for the assets of the company. Once a fair rate of return has been determined, it is compared to the earnings of the company. The difference between the company's earnings and the earnings from the assets is the earnings from goodwill. Then, to determine the fair market value of the company, one adds the value of the goodwill to the value

of the assets. Stevenson concluded that Tangleridge had a fair market value of $477,000, including the value of goodwill, which he estimated to be $164,011.

The defendant presented the testimony of Richard A. DeMerchant (DeMerchant), who is also a certified public accountant. He testified that he calculated the value of the business by adding together the values of the assets. However, he did not include the goodwill of the business because of this Court's holding in Becker v. Perkins-Becker, 669 A.2d 524, 528 (R.I. 1996) (holding that "[t]he capitalization of earnings of a professional practice on the basis of the services of a single individual in order to arrive at a good-will factor in ascertaining the value of such practice is improper as a matter of law"). According to DeMerchant, the value of the business was $321,058.

The trial justice concluded that Becker was distinguishable from the instant case. We agree with this determination of the trial justice. Certainly, one is not precluded, as a matter of law, from determining that a landscaping business may have a goodwill component to its corporate value. The question here is whether, under the facts of this case, the trial justice erred in accepting the testimony of Stevenson in light of his concession on cross-examination.

In his testimony, Stevenson testified that

> "[t]he earning capacity of the Company is also based on the primary contact person of the Company, Mr. Moretti, and his ability to maintain his relationship with the customers. His goodwill with the customers should continue to provide the Company with future revenue."

He also acknowledged that should defendant die, the business would be worth only the value of the assets. This evidence seems to suggest that the goodwill of defendant's business depended upon his continued presence in the business. Consequently, any potential purchaser of this

business, in determining the price to be paid for it, would have to calculate the risk factor that would apply if defendant left the business. It does not appear that Stevenson's estimate of the value of goodwill took this risk factor into account.

In evaluating goodwill as a company asset, it is important to distinguish between personal and enterprise goodwill. "Enterprise goodwill is an asset of the business and accordingly is property that is divisible in a dissolution to the extent that it inheres in the business, independent of any single individual's personal efforts and will outlast any person's involvement in the business." Yoon v. Yoon, 711 N.E.2d 1265, 1268-69 (Ind. 1999).

In the case at bar, it does not appear that either expert attempted to evaluate enterprise goodwill, as opposed to personal goodwill, which depended upon defendant's continued involvement in the business. We are of the opinion that this case should be remanded to the Family Court so that enterprise goodwill, as opposed to personal goodwill, may be evaluated and applied to the overall value of Tangleridge, taking into account the risk factor that would be applicable if defendant left the business.

With regard to the other issues raised by defendant, that is, the dissipation of assets and the award of alimony, we have considered defendant's arguments in support of these issues and find that they are without merit. The spoliation argument presented to us on the issue of dissipation of assets was waived because it was not addressed to the trial justice.

For the reasons stated, the defendant's appeal concerning the valuation of the goodwill of Tangleridge Landscaping, Inc. is sustained. His appeal in respect to all other issues is denied and dismissed. The papers of the case are remanded to the Family Court for reconsideration of the value of the goodwill of Tangleridge in accordance with this opinion.

Justice Bourcier did not attend oral argument but participated on the basis of the briefs.

COVER SHEET

TITLE OF CASE: Marilyn J. Moretti v. Vincent F. Moretti

DOCKET NO.: 99-171 - A.

COURT: Supreme Court

DATE OPINION FILED: February 9, 2001

Appeal from **County:**

SOURCE OF APPEAL: Family Court

JUDGE FROM OTHER

COURT: Shawcross, J.

JUSTICES: Weisberger, C.J., Lederberg, Bourcier, Flanders, Goldberg, JJ. **Concurring**

WRITTEN BY: PER CURIAM

ATTORNEYS: Kathleen Managhan, Joseph T. Houlihan

For Plaintiff

ATTORNEYS: Allen M. Kirshenbaum

For Defendant

Supreme Court
No. 01-523-A.
(K/96-556)

Marilyn J. Moretti

v.

Vincent F. Moretti

ORDER

This case came before the Court sitting in conference pursuant to Rule 12A(6) of the Rules of Appellate Procedure. By agreement of the parties and after careful review of the record and the statements filed by the parties, we proceed to decide this case without further briefing or argument. The defendant, Vincent F. Moretti, appeals for the second time from a judgment pending entry of final judgment of divorce. The plaintiff, Marilyn Moretti, has cross-appealed.

In the earlier appeal, we affirmed the trial justice's decision in all respects except for his valuation of the goodwill inherent in the defendant's landscaping business. We remanded the case "so that enterprise goodwill, as opposed to personal goodwill, may be evaluated and applied to the overall value" of the landscaping business. Moretti v. Moretti, 766 A.2d 925, 928 (R.I. 2000) (per curiam). We said that enterprise goodwill would be included in the marital estate, while personal goodwill would not. Id.

At the hearing on remand, the parties agreed on the overall value of the business's goodwill. However, their experts differed dramatically on the portion of that value that could be attributed to either personal or enterprise goodwill. After finding that his testimony was credible and reliable, the hearing judge accepted the opinions and figures used by the plaintiff's expert. However, the judge ruled that the value of a hypothetical non-compete agreement, as calculated by the plaintiff's expert, would constitute personal goodwill and would not be included in the marital estate.

The defendant argues that the hearing justice erred in accepting the plaintiff's expert's valuation. It is well settled, however, that a trial justice may accept the opinion of one valuation expert and reject the opinion of another. Willow Street Associates LLP v. Board of Tax Assessment of Providence, No. 01-125-A (R.I. filed 06/05/02) (per curiam); Ferland Corp v. Bouchard, 626 A.2d 210, 215-16 (R.I. 1993). The factual findings of a judge sitting without a jury are entitled to great weight, and will not be disturbed absent a showing that the judge misconceived or overlooked material evidence, or was otherwise clearly wrong. Associated Builders & Contractors of Rhode Island, Inc. v. Dep't of Administration, 787 A.2d 1179, 1184 (R.I. 2002). We discern no indication that the hearing justice overlooked material evidence or was clearly wrong in accepting the valuation of the plaintiff's expert.

Nor was the hearing justice wrong in excluding hearsay evidence about conversations the defendant's expert had with the defendant's customers. The admission of evidence lies within the sound discretion of the trial justice. Graff v. Motta, 748 A.2d 249, 252 (R.I. 2001). We are satisfied that the hearing judge did not abuse his discretion in excluding this hearsay testimony. Moreover, the parties had agreed prior to the hearing that they would be bound by the evidence and facts introduced in prior proceedings, and would not introduce new evidence at the remand hearing. The defendant reiterated his willingness to abide by that stipulation. In light of that agreement, it would have been improper and prejudicial to permit the defendant to introduce new evidence in the form of hearsay statements purportedly made by defendant's customers.

The defendant also contends that the judge's findings were "devoid of substance" and not supported in the record. A trial judge's decision need not include exhaustive analysis, but it must include reasons for the judge's ultimate conclusions. The decision will be sufficient if it "reasonably indicates that he exercised his independent judgment in passing on the weight of the

testimony and the credibility of the witnesses." Brum v. Brum, 468 A.2d 924, 926 (R.I. 1983). The trial judge's decision in this case was sufficient.

Finally, the plaintiff argues in her cross-appeal that the hearing judge erred in considering the estimated value of a hypothetical non-compete agreement as personal goodwill, and therefore not part of the marital estate. Many other courts have refused to include non-compete agreements within marital property. See Kricsfeld v. Kricsfeld, 588 N.W.2d 210, 221 (Neb.Ct.App. 1999) (and cases cited therein). We agree with this reasoning, and conclude that the hearing judge did not err in deducting the theoretical value of a non-compete agreement from the overall goodwill.

For these reasons, the defendant's appeal and the plaintiff's cross-appeal are denied and dismissed, and the judgment appealed from is affirmed.

Entered as an order of this Court with 2nd day of June, 2002.

Cite as 588 A.2d 609 (R.I. 1991)

Supreme Court of Rhode Island

Gilbert Charland, in his capacity as
a shareholder of Country View Golf Club, Inc.

No. 89-406 Appeal
March 28, 1991

v.

Country View Golf Club, Inc.
and Albert Favreau.

Edward F. St. Onge, Smithfield, for plaintiff.

William L. Bernstein, Greenville, for defendant.

Matthew Medeiros, Jeffrey Schreck, Robert Karmen, Flanders & Medeiros, Providence, for amicus curiae.

OPINION

KELLEHER, Justice.

The plaintiff in this litigation, Gilbert Charland, is a minority shareholder in a Rhode Island closely held corporation that owned and operated an eighteen-hole, 147- acre golf course located in the town of Burrillville. The defendant, Country View Golf Club, Inc., is the corporation.[1] Hereafter we shall refer to the plaintiff as Charland and to the defendant as Country View.

On September 4, 1984, Charland, a 15 percent shareholder of Country View's stock, that is, an owner of fifteen shares, filed a complaint in the Superior Court asking that Country View be dissolved. Charland relied on G.L.1956 (1985 Reenactment) § 7-1.1-90,[2] which provides:

> "(a) The superior court shall have full power to liquidate the assets and business of a corporation:
>
> > (1) In an action by a shareholder when it is established that, whether or not the corporate business has been or could be operated at a profit, dissolution would be beneficial to the shareholders because
> >
> > * * *
> >
> > (B) The acts of the directors or those in control of the corporation are illegal, oppressive, or fraudulent."

Specifically Charland alleged that one of the officers of the corporation was engaging in illegal activities.

After filing an answer, Country View, acting pursuant to § 7-1.1-90.1, elected to purchase Charland's fifteen shares. Section 7-1.1-90.1 provides, in part:

> "Whenever a petition for dissolution of a corporation is filed by one or more shareholders (hereinafter in this section referred to as the 'petitioner') pursuant to... § 7-1.1-90 ... the corporation or one or more of its other shareholders may avoid such dissolution by filing with the court ... an election to purchase the shares owed by the petitioner *at a price equal to their fair value.* ... If the parties are unable to reach an agreement as to the fair value of such shares, the court shall ... stay the proceeding and determine the value of such shares, in accordance with the procedure set forth in § 7-1.1-74, *as of the close of business on the day on which the petition for dissolution was filed.*" (Emphasis added.)

Thus § 7-1.1-90.1 contains three provisions. First, a corporation, rather than be forced to dissolve by a shareholder dissolution petition, can elect to buyout the shareholder's stock. Second, the corporation must pay fair value for such shares. Third, if the fair value cannot be agreed upon, the court shall determine the value of such shares as of the close of business on the day on which the petition for dissolution was filed.

Charland and Country View could not agree on the fair value of Charland's shares. Therefore the court, in accordance with § 7-1.1-74, appointed an appraiser. Section 7-1.1-74(e) provides that "The court may, if it so elects, appoint one or more persons as appraisers to receive evidence and recommend a decision on the question of fair value. The appraisers shall have such power and authority as shall be specified in the order of their appointment or an amendment thereof."

When this matter came before a Superior Court justice, the appraiser testified regarding the contents of his report. The trial justice then determined that the appraiser's testimony, instead of resolving the problem involving the value of Charland's stock, raised further questions. Consequently the trial justice designated a second accountant as the court's appraiser pursuant to an order dated March 4, 1988. The order directed the second appraiser, Joseph R. Smith (Smith), to determine the fair value of Charland's shares as of September 30, 1984.[3]

Smith's report to the trial justice noted the inherent difficulties in evaluating the value of a golf course in Burrillville. The appraiser then discussed the applicability of a minority discount in evaluating the shares. Smith concluded that a "minority discount" would be appropriate in determining the fair value of Charland's shares.[4] Smith submitted two figures in his report. The first, or lower, valuation included a minority discount and was the one suggested by Smith. The trial justice, however, accepted the second, or higher, calculation.

The second figure of $9,273.05 per share, or $139,095.73, was arrived at in the following manner: first, Smith noted that the golf course was sold for $2 million in 1988; second, Smith used the present value procedure to discount the $2 million figure and arrive at the value of the entire golf course as of September 30, 1984; and finally, without applying an additional minority discount, Smith took 15 percent of the 1984 value in order to arrive at the value for Charland's 15 shares (out of 100) in the corporation. The trial justice ultimately awarded Charland the sum of $139,095.73.

Although Smith did not discount Charland's shares for their minority status, his explanation accompanying this evaluation is noteworthy, Smith stated:

"[T]he 1988 selling price in the amount of $2,000,000.00 was discounted back to the year 1984. ... Regrettably there are no inflationary statistics available for the like kind property in Burrillville, Rhode Island for the intervening years and reliance had to be placed on the statistics available for personal residences. It is self evident that the inflationary impact on personal homes vastly exceeded the norm for other parcels of property. In recognition of that fact, the valuation derived from this present value procedure in the amount of $927,305.00 was not again discounted for minority shareholders diminished capacity, *since in effect the impact of such a discount had already been realized.* " (Emphasis added.)

Although Charland raised a number of issues on appeal, he failed to furnish us with a complete transcript of the Superior Court proceeding. As a result, we shall consider the only issue that was before the trial justice. This issue is whether Charland received fair value for his shares pursuant to § 7-1.1-90.1.

Three separate issues must be resolved in determining fair value. The first issue is whether this court should apply a minority discount to Charland's shares. The second issue is whether this court should apply a discount for lack of marketability. The third issue is whether any discount was, in fact, applied to Charland's shares with the result that Charland received less than the fair value prescribed by § 7-1.1-90.1. We shall now consider each of these three issues.

A minority discount has been described as a second-stage adjustment for valuing minority shares. *See* Note, *Rejecting the Minority Discount,* 1989 Duke L.J. 258, 260. That is, after a minority shareholder's stock is initially discounted for the minority percentage owned, the pro rata value is determined. Then an additional discount is applied to the pro rata value because the minority shareholder lacks corporate decision making power. *Id.* This second calculation is called a minority discount.

The issue of whether to apply a minority discount in a situation in which a corporation elects to buyout a shareholder who has filed for dissolution has never been resolved by this court. In fact, few jurisdictions have decided this question.[5]

Most courts that have considered this question have agreed that no minority discount should be applied when a corporation elects to buyout the shareholder who petitions for dissolution of the corporation. *See, e.g., Brown v. Allied Corrugated Box Co.,* 91 Cal.App.3d 477, 485-87, 154 Cal. Rptr. 170, 173-76 (1979); *Blake v. Blake Agency, Inc.,* 107 A.D.2d 139, 486 N.Y.S.2d 341, *appeal denied,* 65 N.Y.2d 609, 484 N.E.2d 671, 494 N.Y.S.2d 1028 (1985). *But see McCauley v. Tom McCauley & Son, Inc.,* 104 N.M. 523, 535, 724 P.2d 232, 244 (1986) (trial justice has discretion in determining whether a minority discount is applicable).

Brown v. Allied Corrugated Box Co. is an often-cited case in this area of law. In *Brown* a minority shareholder in a closely held corporation initiated an action for involuntary dissolution. The majority shareholder asked to purchase the minority shareholder's stock. The two parties could not reach an agreement regarding the value of the minority shares. A commission comprising three appraisers valued the shares, and two of the three commissioners (majority commissioners) devalued the shares for their noncontrolling status.

On appeal the court reversed the judgment confirming the report of the majority commissioners. The court conceded that if the shares were placed on the open market, their minority status would substantially decrease their value. The court, however, went on to note that this devaluation has little validity when the shares are to be purchased by the corporation. When a corporation elects to buyout the shares of a dissenting shareholder, the fact that the shares are noncontrolling is irrelevant.

In addition the court in *Brown* observed that had the plaintiffs proved their case and had the corporation been dissolved, each shareholder would have been entitled to the same amount per share. There would be no consideration given to whether the shares were controlling or noncontrolling. Furthermore an unscrupulous controlling shareholder could avoid a proportionate distribution under dissolution by buying out the shares, and the very misconduct and unfairness that incited the minority shareholders to seek dissolution could be used to oppress them further. *Brown,* 91 Cal.App.3d at 486-87, 154 Cal.Rptr. at 176; *see also* Note, 1989 Duke L.J. at 269 n.63.

We agree with the rationale of *Brown* and hereby adopt the rule that in circumstances in which a corporation elects to buyout a shareholder's stock pursuant to § 7-1.1-90.1, we shall not discount the shares solely because of their minority status.

A second and more difficult issue to resolve is whether a lack of marketability discount should be applied to Charland's shares. This discount is separate from and bears no relation to a minority discount. The courts that have addressed this question are divided.

The California courts have rejected a lack of marketability discount for the same reasons that they have rejected a minority discount. *See Brown,* 91 Cal.App.3d at 483, 154 Cal.Rptr. at 175. That is, no lack of marketability discount should be applied because the shares are not being sold on the open market; they are purchased by the corporation. The New York courts, however, have decided to apply a lack of marketability discount to shares in a closely held corporation when the corporation elects to buyout a minority shareholder in order to avoid dissolution. The reason for applying this discount is that shares of a closely held corporation cannot readily be sold on the public market. *Blake v. Blake Agency, Inc.,* 107 A.D.2d at 149, 486 N.Y.S.2d at 349.

The difference between the approach taken by the New York and the California courts regarding the question of whether a lack of marketability discount should be applied when a corporation elects to buy out the shareholder who has filed for dissolution is based upon the statutes of each state. The California statute determines fair value "on the basis of the liquidation value as of the valuation date but taking into account the possibility, if any, of sale of the entire business as a going concern in a liquidation." Cal. Corp.Code Ann. § 2000(a)(West 1990). As there is no lack of marketability discount if the corporation dissolves, no such discount is applied by the California courts.

The New York statute, like its Rhode Island counterpart, states that the courts are to determine the *fair value* of the shares. *See* N.Y. Bus. Corp. Law § 1118(b)(McKinney 1986); G.L.1956 (1985 Reenactment) § 7-1.1-90.1. A difference between the Rhode Island and the New York statutes, however, is that whereas the New York statute requires the court to determine the value of the shares as of the close of business the *day before* the petition for dissolution is filed, the Rhode Island statute requires the court to use the *end of the business day on the day the petition* is *filed.* This difference is significant. Indeed, the New York Supreme Court stated that the specific language of the relevant statute required the appraiser to apply a lack of marketability discount in determining the fair value of the petitioner's shares:

> "[T]his failure on the part of the Referee to apply an illiquidity discount flies in the face of the clear and unambiguous language of the statute, and this portion of this report cannot be confirmed. Indeed, as indicated above, § 1118(b) of the statute specifically provides that the court shall determine 'fair value of the petitioner's shares as of the day prior to the date on which such petition was filed, exclusive of any element of value arising from such filing.' ... Furthermore, the explicit language contained in the statute

requiring that there be no consideration given to either an increase or diminution in value arising from the filing of the petition, was also violated when an illiquidity discount was not applied." *Matter of Gift Pax, Inc.,* 123 Misc.2d 830, 834, 475 N.Y.S.2d 324, 328 (1984), *aff'd,* 107 A.D.2d 97, 486 N.Y.S.2d 272 (1985).

We believe that the New York statute (and the rule of an illiquidity discount that emanates therefrom) can be distinguished from its Rhode Island counterpart. Section 7- 1.1-90.1 states that the valuation should be made at the close of business on the day on which the petition is filed. As the Rhode Island statute specifically allows for consideration of the filing of the petition, the New York cases are distinguishable.

Furthermore we believe that independent of any discrepancy between the New York and the Rhode Island statutes, a lack of marketability discount is inapposite when a corporation elects to buyout a shareholder who has filed for dissolution of a corporation. As a recent law review article noted:

> "In dissolution cases, strong reasons support the use of pro rata value without a discount. ... A minority shareholder seeking dissolution claims that majority shareholders have engaged in some unfair, possibly tortious, action. If the minority shareholder succeeds in having the company dissolved, all shareholders will receive their pro rata share of the assets, with no account given to the minority [or illiquidity] status of their shares. Minority shareholders should not receive less than this value if, instead of fighting the dissolution action, the majority decides to seek appraisal of minority shares in order to buyout the minority and reduce corporate discord." Note, 1989 Duke L.J. at 269 n.63.

We therefore today adopt the rule of not applying a discount for lack of marketability in § 7-1.1-90.1 proceedings.

Given that we today refuse to apply either a minority discount or a lack of marketability discount to Charland's shares in Country View, one question remains: did the trial justice in fact apply a discount, thereby awarding Charland less than the fair value of his shares pursuant to § 7-1.1-90.1?

We believe that the trial court, in adopting Smith's valuation, did apply a discount that resulted in less than fair value being awarded to Charland. As noted earlier, Smith believed that a minority discount was appropriate. The only reason that Smith refused to apply such a discount, however, was that the only available figures used to reduce the $2 million selling price in 1988 to 1984 were "statistics ... for personal residences." Smith went on to observe that "the inflationary impact on personal homes vastly exceeded the norm for other parcels of property." Therefore, Smith did not "again discount ... for minority shareholder diminished capacity, since in effect, the impact of such a discount had already been realized." As we today adopt the principle that no minority discount or lack of marketability discount should be applied in § 7-1.1-90.1 proceedings, we believe that the discounting of Charland's shares by using residential real estate values resulted in Charland's receiving less than fair value.

We therefore remand this case to the Superior Court to determine the fair value of Charland's shares as of September 4, 1984, without applying a discount for either minority status or lack of marketability of his shares in Country View in conformity with the rules set forth herein.

ENDNOTES

1. Albert Favreau is president of Country View Golf Club, Inc., and is also a named defendant in this controversy.

2. At the time Charland filed the complaint, the 1969 Reenactment was in effect. The 1985 Reenactment, which is used throughout this opinion, made no substantive changes to the 1969 Reenactment.

3. There appears to be an error in the order of March 4, 1988, that appoints Smith as the appraiser. General Laws 1956 (1985 Reenactment) § 7-1.1-90.1, as noted earlier, requests the court to calculate the fair value of the shares "as of the close of business on the day on which the petition for dissolution was filed." Charland filed the petition for dissolution on September 4, 1984. The order, on the other hand, requests the appraiser to determine the fair value of the shares "as of the close of business on September 30, 1984." Smith complied with the order and made recommendations regarding the value of Charland's shares as of the close of business on September 30, 1984.

4. In his report, Smith failed to distinguish between a minority discount and a lack of marketability discount. Smith combined elements of both discounts but ultimately labeled the discount a "minority discount." Because of the ambiguity created by Smith's report, we will address the applicability of both a minority discount and a lack of marketability discount to Charland's shares.

5. Many jurisdictions, including this one, have decided the question of determining the fair value of shares when a *dissenting* shareholder elects to request the fair value of his or her shares in case of a merger or consolidation. *See* § 7-1.1-74; *see also Jeffrey v. American Screw Co.,* 98 R.I. 286, 201 A.2d 146 (1964)(appraiser given wide discretion to consider all relevant factors in determining fair value of dissenting shareholder's stock). This is a separate issue from whether a minority discount should be applied when a corporation elects to buyout a shareholder who has petitioned for *dissolution* proceedings.

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

PROVIDENCE, SC SUPERIOR COURT

A.TEIXEIRA & COMPANY, INC. :

v. :

: C.A. No. 84-0152

:

ANTONIO L. TEIXEIRA, :
ARMENIO TEIXEIRA, and :
CESAR TEIXEIRA, Alias :

DECISION

GIBNEY, J. Before the Court are questions pertaining to the valuation of stock held by defendants and counterclaim plaintiffs Antonio L. Teixeira and Armenio Teixeira (the Teixeiras), the calculation of interest on said shares of stock, the entitlement of Armenio Teixeira to the full value of his shares after redemption in 1990, and finally, the entitlement of the Teixeiras to the repayment of principal and interest on alleged outstanding loans. A. Teixeira & Company, Inc. (the corporation), requests offsets to the fair market value of the minority stock based upon dividends paid. Jurisdiction is pursuant to G.L. § 7-1.1-74 and § 7-1.1-90.1.

Travel/Facts

After a jury verdict and counterclaim action heard by this Court and our Supreme Court, thereafter, the Teixeira dispute once again resurfaces. By way of background, the corporation was incorporated in 1981 as a friendly business venture owned by six shareholders: among them, Armenio and Antonio Teixeira, Honorato Custodio, Joaqium Duarte, Manuel Moitoso, and Artur Moto.[1] The defendants in the instant claim. Armenio and Antonio Teixeira, are minority share-

---

[1] In April, 1982, Artur Moto offered to sell his stock to the corporation and was formally rejected. Thereafter, he sold his shares to Joaquim Duarte, who then owned 200 shares while the other shareholders held 100 shares each.

holders of plaintiff corporation, which operates retail liquor stores in Cumberland, Rhode Island. In 1982, Armenio Teixeira purchased an interest in a second liquor store, and the corporation sued the Teixeiras claiming that this purchase was made in usurpation of corporate opportunity. Thereafter, a jury found the Teixeiras liable for misappropriation of a corporate opportunity and awarded punitive damages together with the transfer of the corporate stock in the second liquor store to the corporation. This verdict, however, was subsequently reversed.

In reversing this jury verdict, the Rhode Island Supreme Court stated that the corporation failed to successfully prove the two required elements for misappropriation of a corporate opportunity: that the Teixeiras were corporate fiduciaries and that they diverted a corporate opportunity. A. Teixeira & Co., Inc. v. Antonio L. Teixeira, et. al., 699 A.2d 1383, 1386 (R.I. 1997). Although the Court concluded that the Teixeiras "assumed a fiduciary duty toward one another and their corporation," they "did not breach that duty because plaintiff corporation was financially unable to avail itself of the opportunity of purchasing [the second liquor store]." Id. at 1388.[2]

The Counterclaim

In their counterclaim action before this Court in 1994, the Teixerias, as minority shareholders, sought relief against the majority shareholders for allegedly engaging in oppressive conduct, thereby breaching the duty of good faith owed to the minority. The Teixeiras requested that this Court liquidate the assets of the corporation, or in the alternative, order the buyout of the Teixeiras' minority stock.

---

[2] The Court clarifies that unlike Armenio Teixeira, Antonio Teixeira never acquired any interest in the second liquor store and "thus could not in law have been found to have breached his fiduciary duty to plaintiff." Id. at 1388.

In its 1994 decision, this Court did not find minority oppression that would warrant the drastic remedy of corporate dissolution. However, the Court did order the corporation, or its majority stockholders, to purchase the Teixeiras' stock at a price equal to its fair value in accordance with the values of those shares at the time the original action was filed and pursuant to G.L. 1956 § 7-1.1-90.1.

On appeal, our Supreme Court sustained this Court's order that the majority shareholders purchase the stock of the Teixeiras. A. Teixeira & Co., Inc. v. Teixeira, 674 A.2d 407 (R.I. 1996). However, the Court determined that the fair market value should be set "as of the date that the [Teixeiras] amended their complaint to request the purchase of the stock by the majority stockholders. . . May 23, 1990." Id. Furthermore, the Court ordered that the cost of assessing the fair market value of the stock would be shared among the parties. Id. Finally, the Court ordered that interest would be awarded to the Teixeiras on the amount of the fair market value of the stock from May 23, 1990.

After engaging in failed attempts to reach an acceptable financial arrangement, the Teixeiras request that this Court determine the valuation of their shares, the interest to be added thereto, Armenio Teixeira's appropriate status as a shareholder of the corporation who was bought out by the corporation in 1990, and loan repayments from the corporation that the Teixeiras assert are due to them.

Standard of Review

This Court previously ordered, pursuant to G.L. §.7-1.1-90.1, the stock buyout of the minority shareholders by the majority to avoid corporate dissolution, and was subsequently affirmed on appeal. Section 7-1.1-90.1 provides, in part:

> "If the parties are unable to reach an agreement as to the fair value of the shares, the court shall, upon the giving of a bond or other security sufficient to assure to the petitioner payment of the value of the shares, stay the proceeding and determine the value of the shares, in accordance with the procedure set forth in § 7-1.1-74, as of the close of business on the day on which the petition for dissolution was filed. Upon determining the fair value of the stock, the court shall state in its order directing that the stock be purchased, the purchase price and the time within which the payment is to be made, and may decree any other terms and conditions of sale that it determines to be appropriate, including payment of the purchase price in installments extending over a period of time, and, if the shares are to be purchased by shareholders, the allocation of shares among shareholders electing to purchase them, which, so far as practicable, are to be proportional to the number of shares previously owned. The petitioner is entitled to interest, at the rate on judgments in civil actions, on the purchase price of the shares from the date of the filing of the election to purchase the shares, and all other rights of the petitioner as owner of the shares terminate on that date. The costs of the proceeding, which include reasonable compensation and expenses of appraisers but not fees and expenses of counsel or of experts retained by a party, shall be allocated between or among the parties as the court determines. Upon full payment of the purchase price, under the terms and conditions specified by the court, or at any other time that is ordered by the court, the petitioner shall transfer the shares to the purchaser."

In determining the fair value of corporate stock, G.L. § 7-1.1-74 (e) (f) (g) provides, in part:

> "(e) The court may, if it so elects, appoint one or more persons as appraisers to receive evidence and recommend a decision on the question of fair value. The appraisers have the power and authority that is specified in the order of their appointment or an amendment of the order. The judgment is payable only upon and concurrently with the surrender to the corporation of the certificate or certificates representing the shares. Upon payment of the judgment, the dissenting shareholder ceases to have any interest in the shares."

> (f) The judgment shall include an allowance for interest at the rate of interest on judgments in civil actions from the date on which the vote was taken on the proposed corporate action to the date of payment.

> (g) The costs and expenses of any proceeding shall be determined by the court and assessed against the corporation, but all or any part of the costs and expenses may be apportioned and assessed as the court deems equitable against any or all of the dissenting shareholders who are parties to the proceeding to whom the corporation has made an offer to pay for the shares if the court finds that the action of the shareholders in failing to accept the offer was arbitrary or vexatious or not in good faith. The expenses include reasonable compensation for and reasonable expenses of the appraisers, but exclude the fees and expenses of counsel for and experts employed by any party; but if the fair value of the shares as determined materially exceeds the amount which the corporation offered to pay for the shares, or if no offer was made, the court in its discretion may award to any shareholder who is a party to the proceeding a sum that the court determines to be reasonable compensation to any expert or experts employed by the shareholder in the proceeding."

The Minority Discount

The Teixeiras maintain that a minority discount should not be applied to the valuation of their stock. In asserting said contention, the Teixeiras rely upon the holding set forth in Charland v. County View Golf Club, Inc., 588 A.2d 609 (R.I. 1991), wherein our Supreme Court refused to apply either a minority discount or a lack of marketability discount to minority shares in determining the fair value of minority shares. Id. at 613. The Charland Court "adopt[ed] the rule that in circumstances in which a corporation elects to buy out a shareholder's stock pursuant to [G.L.] § 7-1.1-90.1, [the Court] shall not discount the shares solely because of their minority status." Id. at 612

Alternatively, the corporation argues that a minority discount is appropriate and that the rule in Charland does not apply to the instant scenario. In support of this contention, the corporation asserts that there are two lines of authority with respect to minority shareholder discounts: the Charland rule and the holding promulgated in Jeffrey v. American Screw Co., 98 R.I. 286, 201 A.2d 146 (1964). Our Supreme Court in American Screw determined that when the shareholder elects to be bought out, the appraiser "has a wide discretion to consider and weigh

evidence of any value factor that in the circumstance of the case is relevant and material." Id. at 150. Subsequently, the corporation maintains that the distinction between these authorities turns on who initially requested the buyout in the first place. The corporation claims that in this case, where it is the minority shareholders who elect to sell and "a corporation is forced to buy shares it does not want after having done nothing wrong, as here, it is the shareholders who gain an unfair profit unless a minority discount is applied." (See Sur-Reply Memorandum, p.2).

Our Supreme Court has most recently followed the rationale enunciated by Charland with respect to the inapplicability of minority discounts in G.L. § 7-1.1-90 scenarios. Analogous to the instant matter, the minority shareholder in DiLuglio v. Providence Auto Body, Inc., 755 A.2d 757 (R.I. 2000), sought dissolution of the corporation under G.L. § 7-1.1-90. In DiLuglio, the trial justice also ordered the majority shareholder to purchase the minority shares as an alternative to the drastic option of dissolution. The Supreme Court affirmed the decision of the trial justice in her refusal to allow for any reduction or discount since "the sale of this block of minority stock was assured because a known and qualified buyer [the majority shareholder] existed to purchase [the minority] shares." Id. at 774. A majority of other jurisdictions have followed this practice in refusing to apply a minority discount when the Court orders a minority buyout to avoid dissolution. See e.g., Hansen v. 75 Ranch Co., 957 P.2d 32 (Mont. 1998) (application of minority discount is inappropriate when minority shareholders in close corporation sell their shares to corporation); Foy v. Klapmeir, 992 F.2d 774 (Minn. 1993) (minority discount should not be applied in valuing stock held by dissenting shareholder); Columbia Management Co. v. Wyss, 765 P.2d 207, 94 Or. App. 195 (1988) (a minority discount was improperly applied in the context of valuing a dissenting minority shareholder's stock); ("within the context of a dissolution proceeding, almost all of the courts that have considered the

question have rejected the application of a minority discount, the courts reasoning, in part, that if the corporation had been dissolved, the minority shareholder would have received the pro-rata value of the shares, with no consideration given to whether the shares represented a controlling interest." 13 ALR 5th 840, 850 (1993)). Accordingly, this Court will not apply a minority discount to the value of the Teixeiras' shares.

Rate of Interest

The DiLuglio Court also calculated interest on the purchase price of the minority shares. The Supreme Court determined that the trial justice erred in her decision to award compound interest based upon G.L. § 7-1.1-74 (f), which then provided that "[t]he judgment shall include an allowance for interest at the rate of interest the court may find to be fair and equitable in all the circumstances." Id. at 775. Instead, the Court adopted the principle promulgated by the First Circuit Court of Appeals' decision in Bogosian v. Woloohojian, 158 F.3d 1 (1st Cir. 1998), which disallowed an award of compound interest in G.L. § 7-1.1-90.1 election to purchase proceedings. Id. at 775 (citing Bogosian, 158 F.3d at 8). The Bogosian Court stated that "no Rhode Island court had allowed compound prejudgment interest under any statute that did not specifically authorize it." DiLuglio, at 775 (quoting Bogosian at 8-9). Our Supreme Court "disfavor[s] compounding the interest on monetary awards in a judgment when the Legislature has not specifically authorized it." Id. at 775.

The legislature did in fact address this deficiency with respect to both the rate and methodology to be employed in calculating the interest on the purchase price of the shares. On July 8, 1999, the legislature enacted P.L. 1999, ch. 474, § 1, amending G.L. §§ 7-1.1-74 and 7 1.1-90.1 to include the following provisions, respectively:

> "(f) The judgment shall include an allowance for interest at. . . the rate of interest on judgments in civil actions, from the date on which the vote was taken on the proposed corporate action to the date of payment.
>
> The petitioner is entitled to interest, at the rate on judgments in civil actions, on the purchase price of the shares from the date of the filing of the election to purchase the shares, and all other rights of the petitioner as owner of the shares terminate on that date."

Accordingly, this Court orders the application of the statutory interest rate of twelve percent[3] per annum, from the date set forth by our Supreme Court in A. Teixeira & Co., Inc. v. Teixeira, 674 A.2d 407 (R.I. 1996), May 23, 1990, which is the date Teixeiras amended their complaint to request the purchase of the stock by the majority stockholders.

Armenio Teixeira's Status

During the pendency of this extended litigation, Armenio Teixeira was convicted of criminal conduct (unrelated to the corporation), which resulted in his removal as a shareholder on November 16, 1990. The corporation removed Armenio pursuant to Article V, Paragraph 4 of its bylaws, which provide:

> "Upon the vote of more than Fifty (50%) percent of the then outstanding shares of the corporation, any shareholder who has been

---

[3] G.L. § 9-21-10, "Interest in civil actions" expressly provides:

> "(a) In any civil action in which a verdict is rendered or a decision made for pecuniary damages, there shall be added by the clerk of the court to the amount of damages interest at the rate of twelve percent (12%) per annum thereon from the date the cause of action accrued, which shall be included in the judgment entered therein. Post-judgment interest shall be calculated at the rate of twelve percent (12%) per annum and accrue on both the principal amount of the judgment and the prejudgment interest entered therein. This section shall not apply until entry of judgment or to any contractual obligation where interest is already provided."

> convicted of a crime, whether in Rhode Island or any other jurisdiction, shall be compelled to transfer to the corporation, all the shares of the corporation then registered in his name, and upon such transfer shall receive in return his initial capital investment in the corporation, without interest." (emphasis added).

The Teixeiras assert that because Armenio was still a shareholder on the date that the Supreme Court ordered the shares to be valued, May 23, 1990, he therefore should be entitled to receive the full value of his shares with interest to the present. The Teixerias maintain that this Court should "view the relationship between the shareholders as if it was frozen as of May 23, 1990, voiding the redemption of Armenio's shares on November 16, 1990." Thus, the Teixerias contend that Armenio "should be deemed to have been a shareholder until the Court ordered corporate buyout is completed" and should therefore collect his share of the dividends paid by the corporation to its shareholders in 1998 and 1999. Furthermore, the Teixerias argue that the decision entered by this Court on December 14, 1994, explicitly includes Armenio in the stock buyout:

> "[A]n order will be entered requiring A. Teixeira & Co., Inc., or the majority of its stockholders, specifically Honorato Custodio, Joaquim Duarte and Manuel Moitoso, to purchase the stock of the minority stockholders; namely, the counterclaim plaintiffs Armenio and Antonio Teixeira, at a price equal to their face value."

The Teixerias also advert that this inclusion of Armenio in the judgment was never challenged by way of either a Rule 60 (a) Motion or on appeal to the Supreme Court.

Alternatively, the corporation maintains that Armenio cannot recover anything beyond his capital contribution of $17, 000.00 because of the 1990 redemption of his shares. In addition, the corporation asserts that Armenio was merely a nominal plaintiff who was a necessary party to the proceedings. It suggests that "[i]f Armenio wanted to recover additional monies it was his obligation to successfully plead his case to the Supreme Court." Finally, the corporation

proposes that this Court may make the appropriate corrective actions pursuant to Rule 60 (a) of Super.R. Civ. P.

In Rhode Island, corporate bylaws "may contain any provisions for the regulation and management of the affairs of the corporation not inconsistent with law or the articles of incorporation." G.L. § 7-1.1-25. In addition, corporate bylaws in closely held corporations effectuate the intent of the parties and are largely considered *inter se* contracts between the shareholders.[4] Thus, this Court shall employ contract interpretation analysis in determining whether Armenio's removal as a shareholder was, in fact, a nullity as suggested by the Teixeiras.

In interpreting whether a contract is clear and unambiguous, the Court shall view the document in its entirety and its language must be given its plain, ordinary and usual meaning. W.P. Associates, v. Forcier, Inc., 637 A.2d 353, 356 (R.I. 1994) (citing Antone v. Vickers, 610 A.2d 120, 123 (R.I. 1992)). Courts may deem a contract ambiguous "only when it is reasonably and clearly susceptible to more than one interpretation." Id. at 356 (citing Gustafson v. Max Fish Plumbing & Heating Co., 622 A.2d 450, 452 (R.I. 1993)); Nelson v. Ptaszek, 505 A.2d 1141, 1143 (R.I. 1986)). This Court finds the intention of the parties can be fairly carried out to provide a proper financial return to Armenio, commensurate with his investment in the corporation. Id. at 356.

This Court is satisfied that Armenio Teixeira was effectively removed as a shareholder in November of 1990, pursuant to the legally enforceable corporate provision terminating his shareholder status upon the occurrence of a criminal conviction. To regard him as a shareholder until the corporate buyout is completed would be a legal fiction. Accordingly, the decision

---

[4] See F. Hodge O'Neal, Molding the Corporate Form to Particularize Business Situations: Optional

Charter Clauses, 10 Vand. L. Rev. 1, 20-21 (1956). rendered by this Court on July 21, 1994, and upheld by our Supreme Court in Teixeira, supra. 674 A.2d 407, did not pertain to Armenio's shares. Pursuant to Article V, Paragraph 4 of the corporate bylaws, Armenio is compelled to transfer to the corporation all the shares of the corporation in his name, and upon such transfer shall receive in return his initial capital investment in the corporation, without interest.[5]

Loan Repayments Versus Capital Contributions

The Teixeiras argue that they are entitled to repayment of both principal and accrued interest on alleged loans made to the corporation in 1981. At the time the business was formed, the Teixeiras contributed $20,000.00 each for 100 shares of stock apiece. The Teixeiras submit that these were loans made in good faith to the corporation with the expectation of repayment. However, these loans were listed as capital contributions on the corporation's 1983 tax return.

---

[5] The parties have been embroiled in litigation for well over sixteen years. During that interim, neither the corporation nor Armenio Teixeira affirmatively discussed the practical and financial ramifications of Armenio's removal as a shareholder. It is elementary that in order to be bought out as a shareholder, one would have to actually be a shareholder at the time of the actual buyout. In its 1994 decision, this Court inadvertently stated the following recitation relating to Antonio rather than Armenio in 1991 rather than 1990:

> "In 1991, Antonio Teixeira, precluded from participating in the corporation following a conviction of a crime unrelated to corporate activity and affairs, was removed as a shareholder."

However, on appeal, neither party argued Armenio's status, and this point was largely overlooked. At present, this Court is merely clarifying and defining the specific entitlement of Armenio Teixeira, which is neither contrary to the Supreme Court orders nor creating a new status for Armenio that was not known by all parties to this controversy at the time of his removal in 1990.

The Teixeiras claim that they were never notified of this classification of their loans to equity and never consented to said classification, warranting said classification void.

The corporation correctly suggests that the actions of the Teixeiras do not comport with the execution of a loan to the corporation. They failed to exercise any promissory notes that would suggest a debtor-creditor relationship and also collected dividends on their shares. Furthermore, our Supreme Court classified these "loans" as contributions in its 1997 decision: "After having each made capital contributions of $20,000, the shareholders each received 100 shares of stock in the corporation." (Emphasis added.)

Other than our Supreme Court's aforementioned recitation, Rhode Island law offers no statutory guidance to differentiate a shareholder loan from a capital contribution. Tanzi v. Fiberglass Swimming Pools, Inc., 414 A.2d 484, 489 (R.I. 1980). Our Supreme Court has turned to other jurisdictions for guidance on this issue. Id. The Tanzi Court notes that the Supreme Court of Idaho failed to find the requirements of a valid shareholder loan when the shareholders were not listed on the corporate records as creditors, no note was executed, and the shareholders never considered the advanced security as a loan until litigation had already commenced. Id. at 489 (citing Weyerhaeuser Co. v. Clark's Material Supply Co., 90 Idaho 455, 461, 413 P.2d 180, 183 (1966)). This Court finds the circumstances surrounding the Teixeiras' advancement analogous to those of Weyerhauser. The Teixeiras never executed a note, were not listed as creditors in the corporate records, and failed to object to the classification of the security as a capital contribution until the latter stages of this litigation. The "transaction itself bore very few earmarks of an arm's length bargain," thus warranting its classification as capital contributions. See Id. at 491.

Corporate Offsets

As a final matter, the corporation suggests that the fair market value of Antonio Teixeira's shares must be offset by the dividends he has already been paid (totaling $24, 000.00). The corporation asserts that Antonio "lost the right to dividends when he elected to be bought out." In the alternative, the Teixeiras maintain that there is no basis for the value of Antonio's shares to be reduced by dividends paid by the company from 1990 through 1999.

Our Supreme Court adopted the rationale of the Delaware Court stating that "a shareholder's fixed contractual right to unpaid dividends is of such dignity that it cannot be diminished or eliminated retrospectively. . . ." Bove v. Community Hotel Corp. of Newport, 249 A.2d 89, 93, (R.I. 1969) (quoting Consolidated Film Industries, Inc. V. Johnson, 22 Del. Ch. 407, 197 A. 489 (1937)). According to Article V (2) (b), of A. Teixeira's corporate bylaws, "[t]he corporation shall be entitled to treat the holder of record of any share as the holder in fact thereof. . . ." In addition, Article VII of the bylaws provides that "[t]he shareholders may from time to time declare, and the corporation may pay, dividends on its outstanding shares in the manner and upon the terms and conditions provided by law." Through the pendency of this litigation, Antonio Teixeira has been a shareholder of record entitled to corporate dividends. Accordingly, the corporation may not offset or diminish the fair market value of Antonio's shares with the dividends already paid.

In ascertaining the fair market value of Antonio Teixeira's stock, this Court shall seek the services of a special master, pursuant to Rule 53 (a) of Super. R. Civ. P. Such an individual shall be "'versed in the intricacies of corporate finance'" and shall "consider all relevant value factors including market value, book value, asset value, and other intrinsic factors probative of value."

Bove v. Community Hotel Corp. of Newport, 105 R.I. 36, 249 A.2d 89, 100 (1969) (quoting Jeffrey v. American Screw Co., 98 R.I. 286, 201 A.2d 146, (1964)).

However, pursuant to Rule 53 (c) of Super. R. Civ. P., the master shall be instructed by this Court as follows: (1) to value Antonio's shares as of May 23, 1990, without the application of a minority discount; (2) to apply the statutory interest rate of twelve percent per annum from May 23, 1990; (3) to consider Armenio Teixeira removed as a shareholder as of November 16, 1990 and only entitled to the return of his initial capital investment in the corporation -- without interest; (4) to consider the Teixeiras' 1981 investments to be capital contributions and not loans to the corporation; and (5) to value Antonio's shares without offsetting that amount by the dividends paid to him by the corporation.

Counsel shall submit the appropriate judgment for entry.

American Journal of
Family Law

VOLUME 16 NUMBER 2 SUMMER 2002

ARTICLES

Bobby Marzine Harges — The Reliability of the Social Science Testimony of Custody Evaluators after *Daubert* and *Kumho*

Darrell D. Dorrell — The Valuation Report Card©

Anju D. Jessani — A Step-by-Step Approach to the Divorce Mediation Process: From Soup to Nuts

John E. Barrett, Jr. — Bifurcating Enterprise and Personal Goodwill

DEPARTMENTS

Kalman A. Barson — Are Company Retained Earnings Marital Savings?

David L. Walther — Ethics 2000 Commission Update for Family Lawyers

COMMENTARY

Stephen J. E. Sprague — Protecting Family Autonomy

FEATURES

Ira Lurvey — California: 2001 Developments—Diamond "Gifts," Lottery Win as Loss, Custody Fighting

Ron Brown — Fairshare Cases: QDRO Rights vs. IRS Lien on Pension, Fifth Amendment Inference, Disqualification for Support of Judge's Reelection, Parental Cybersex, Savings Alimony

INDEX

Aspen Law & Business

American Journal of
Family Law

VOLUME 16 NUMBER 2 SUMMER 2002

CONTENTS

Articles

The Reliability of the Social Science Testimony of Custody Evaluators after *Daubert* and *Kumho* 93

Bobby Marzine Harges

After reviewing the US Supreme Court decisions in *Daubert* and *Kumho*, the author (a professor of law) focuses on their applicability to custody evaluators. The article also offers guidance to matrimonial attorneys and judges in a variety of possible scenarios (*e.g.*, in jurisdictions in which *Daubert* and *Kumho* have and have not been adopted).

The Valuation Report Card© 109

Darrell D. Dorrell, CPA, MBA, ASA, CVA, CMA, DABFA, CMC

The Valuation Report Card© permits matrimonial attorneys to assess rapidly and objectively the opponents valuation work product. It can also be provided to your client, the other party's counsel, other experts, and the judge to encourage them to agree with your viewpoint. This useful tool is described and illustrated.

A Step-by-Step Approach to the Divorce Mediation Process: From Soup to Nuts 118

Anju D. Jessani, MBA, APM

This is a guide to divorce mediation. It explains mediation and then takes readers from the beginning of the process (initial contact and scheduling of the first mediation session) through each subsequent session outlining the goals to be accomplished at each stage leading to the final Memorandum of Understanding.

Bifurcating Enterprise and Personal Goodwill 129

John E. Barrett, Jr., CPA, ABV, CVA, MST, MBA

A valuation expert takes matrimonial practitioners through the various issues that arise when valuing goodwill in a closely held business or a professional practice. Among the subjects discussed are transferability and the hypothetical noncompete agreement (in the context of the hypothetical sale in a divorce case).

Departments

Are Company Retained Earnings Marital Savings? 81

Kalman A. Barson, CPA

Bifurcating Enterprise and Personal Goodwill

JOHN E. BARRETT, JR., CPA, ABV, CVA, MST, MBA

Family courts are increasingly looking to bifur cate the intangible value of a closely held business, for marital dissolution purposes. To facilitate this result, the courts are requiring the business appraiser to distinguish between enterprise goodwill (or more appropriately enterprise intangible value) and personal goodwill.[1] In each of these cases, a state appellate court remanded the cases back to the lower court to differentiate the established intangible value, which had previously been determined, between enterprise intangible value and personal goodwill. Many jurisdictions consider only the enterprise intangible value as part of the marital estate, with the personal goodwill treated as a nonmarital asset. Often states indicate that personal goodwill is an entrepreneurial skill to be considered for spousal maintenance and child support purposes, but not a property right subject to division. Of course, this determination varies on a state-by-state basis.

SOME BASIC DEFINITIONS

The process of bifurcating the intangible value of a business or professional practice between enterprise intangible value and personal goodwill can be a difficult task. Perhaps a good starting point toward completing this task is to review some definitions of intangible assets and goodwill. *The International Glossary of Business Valuation Terms* defines "intangible assets" as "non-physical assets (such as franchises, trademarks, copyrights, goodwill, equities, mineral rights, securities, and contracts as distinguished from physical assets) that grant rights, privileges, and have economic benefits for the owner."[2] We can determine from this definition that goodwill is only one possible component of intangible assets that might exist in a specific business. Other intangible assets that often exist in a business, based on a going concern premise, include name recognition, customer loyalty or retention, location, a trained workforce in place, and operating systems. *The International Glossary of Business Valuation Terms* defines "goodwill" as "that intangible asset arising as a result of name, reputation, customer loyalty, location, products, and similar factors not separately identified."[3] This would indicate that goodwill is often used as a catchall when intangible assets are not separately identified and valued.

In his book *Valuing a Business*, Shannon Pratt states, "The criterion as to whether goodwill exists usually is the ability to earn a rate of return in excess of a normal rate of return on the net assets

John E. Barrett, Jr., CPA, ABV, CVA, MST, MBA, is the principal at Barrett Valuation Services, Inc., Cranston, RI. John is Chair of the RI Society of CPAs Business Valuation Committee.

of a business, after reasonable compensation to operating personnel."[4] This definition could probably be expanded to include all the intangible assets of the business. Mr. Pratt also states, "[P]ersonal goodwill may be described as the intangible value attributable solely to the efforts of or reputation of an owner spouse of the business."[5] He further states that institutional or practice goodwill (enterprise intangible value) "may be described as the intangible value that would continue to inure to the business without the presence of that specific owner spouse."[6] In other words, enterprise intangible value focuses on the intangible value of the business that would continue should the current owner spouse be replaced with either a replacement employee or a new owner employee.

Enterprise intangible value focuses on value that would continue should the owner spouse be replaced.

TRANSFERABILITY OF GOODWILL

Enterprise intangible value is generally transferable subject to the usual difficulties embedded in selling or transferring an interest in a closely held business. Therefore, the market approach to valuation can be a strong indicator as to the enterprise intangible value of the business. This is commonly demonstrated when a business is sold to a financial buyer. New ownership may or may not be interested in retaining the current owner/employee. It is quite common for a buyer of a closely held business to intend to directly manage the newly acquired business. If the continued services of the owner are not needed, this would indicate there is little or no personal goodwill. Any intangible value would be attributable to the business and represent enterprise intangible value. In a marital dissolution case, an actual sale is usually not contemplated. If it is reasonable to assume that a hypothetical buyer either could or would replace the owner spouse with comparable management, however, then little or no intangible value should be allocated to personal goodwill.

Personal goodwill also has some degree of limited transferability with proper effort and cooperation by both a willing buyer and a willing seller of a business. In this context, often what is actually transferable is not personal goodwill. Rather, what is transferred is the opportunity offered by the seller to the buyer to forge similar relationships with the business' existing customer base. The transferability of intangible value would be a strong indicator that the intangible value is more likely to inure to the business itself and represent enterprise intangible value rather than be attributable to a specific individual. Once a sales transaction has been consummated and possibly a transitional phase completed, the services of the seller may not be required or desired. If the seller does remain with the business, his or her role is often dramatically altered.

BIFURCATION FACTORS

In attempting to bifurcate the overall intangible value of a closely held business or professional practice between enterprise intangible value and personal goodwill, there are a number of factors that should be addressed. These factors should be considered on a case-by-case basis and will vary based on the applicable fact pattern. Factors that would be indicative of enterprise intangible value would include, but not be limited to, such elements as: (1) name recognition; (2) location; (3) computer systems; (4) operating procedures; (5) a trained and assembled workforce; and (6) an existing customer base.[7] Factors to review in considering personal goodwill would include the business spouse's: (1) age; (2) health; (3) past earning power; (4) reputation and business skills; (5) technical skills; and (6) past success.

Standard of Value

The next step in completing the process of allocating intangible value between enterprise intangible value and personal goodwill is to review the applicable standard of value utilized. The majority of family courts apply a fair market value standard or some variation of that standard, depending on state law. Revenue Ruling 59-60 defines fair market value as, "[T]he price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy, and the latter is not under any compulsion to sell, both parties having reasonable knowledge of the relevant facts."

Premise of Value

In addition to the standard of value, the appraiser must also consider the premise of value.

The going concern premise of value is the value of a business in continued use. This is often the appropriate premise of value in a marital dissolution case. The appraiser will frequently base valuation assumptions on existing management continuing in the business. This is often the case, even when a sale is contemplated and the potential new owner plans to replace the existing owner in managing the business. There is frequently either a stated or an implied assumption that replacement management of equal or similar capabilities could be substituted for the existing management. This assumption would tend to be correct in situations in which many potential buyers of the business would have the needed skills to operate the business successfully on an on-going basis.

Unique Factors

Normally, many of the unique factors that might indicate the presence of personal goodwill should be accounted for in determining an estimate of fair market value. For instance, qualitative factors dealing with such issues as thinness of management, concentration of sales, or other factors that might tend to indicate that the business is overly reliant on one or a few individuals must be taken into account in developing an estimate of value. An income based approach would consider such factors through normalization adjustments to the earnings stream (owner's compensation) and the increased measure of risk through development of an appropriate discount rate or capitalization rate. A market based approach would consider such factors through adjustments to the multiples applied. An asset based approach would consider such factors through actually identifying and valuing specific intangible assets.

The fair market value standard, based on a going concern premise, would indicate a transferable value of the subject business. This would represent the price that a willing buyer would pay a willing seller, with full knowledge of any reliance that the business would have on the seller. In terms of marital dissolution, any risk associated with the business' reliance on a specific individual should be factored into the overall estimate of value of the business. The development of an estimate of fair market value essentially adjusts for any such defect.

As previously mentioned, enterprise intangible value focuses on the intangible value of the business that would continue should the current owner spouse exit the business. This assumes, of course, that competent or at least similar management is brought in to replace the existing owner spouse. Whether the services of the current owner spouse would be desired would be part of the negotiating process, but separate and apart from the value of the business. Such negotiations would result in an employment contract. Therefore, the fair market value standard, based on a going concern premise, would primarily represent enterprise intangible value, except for any amount allocated to a noncompete agreement.

HYPOTHETICAL NONCOMPETE AGREEMENT

The business valuation process, in marital dissolution cases, also may require the business appraiser to value not only a hypothetical sales transaction but also a hypothetical noncompete agreement, as if a sale were to take place. The noncompete agreement is not a value in addition to the value of the business, but rather an allocable portion of the overall value of the business. That is to say, if the business were valued at $500,000, a buyer would not pay $500,000 plus the value assigned to the noncompete agreement. Rather, the value assigned to the noncompete agreement would be included in the $500,000. To determine the value of a noncompete agreement, the appraiser must first value the business. Then the appraiser must estimate future cash flows that would be lost to the seller should the seller compete. Next, the appraiser must consider the probability that the seller would compete. This analysis would be applied over the estimated life of the hypothetical noncompete agreement and present valued to today's dollars.[8]

Various states have formed differing opinions as to whether a noncompete agreement should be considered a marital asset. Several take the position that the noncompete agreement is not a marital asset because it restricts the postmarital activity of the owner spouse. A few states have ruled that the noncompete agreement is a marital asset. This is based, in part, on the conclusion that the noncompete agreement is signed in conjunction with the sale of a business and represents the goodwill of the business.

Noncompete agreements are usually time specific and geographic specific. Normally, a prudent business advisor would not advise that a prospective buyer complete a purchase transaction with-

out a noncompete agreement in place. This is to ensure that the buyer gets what the buyer sees. Basically, the noncompete agreement is an implied warranty that would have no value but for the sale of the business. This would tend to support the conclusion that the noncompete agreement simply represents a portion of the enterprise intangible value.

To determine the value of a hypothetical noncompete agreement, the appraiser must first value the business.

The definition of intangible value was discussed previously in this article. Intangible value was defined, in part, as having economic benefits for the owner. Therefore, to exist, intangible value must have some foundation in terms of economic benefits. A noncompete agreement, in and of itself, does not provide an economic benefit. Rather it functions as a form of protection to the prospective buyer. A noncompete agreement would not be sold or transferred independent of a sale of a business. It has relevance only in terms of a sales transaction. As such, any value assigned to a noncompete agreement would represent an allocable portion of the overall enterprise intangible value. Certainly the noncompete agreement places restrictions on the seller. These restrictions, however, apply only in a limited geographic and a limited time specific manner. The seller can generally apply his or her specific abilities outside of that limited scope.

SUMMARY

Family courts are increasingly looking to the business appraiser to distinguish the components of intangible value in a closely held business or professional practice. The appraiser should keep this in mind and review applicable state law with attorneys before beginning an engagement. The business appraiser may also be called on to value a hypothetical noncompete agreement in a marital dissolution case. The appraiser should be prepared to meet these tasks.

END NOTES

1. *See* Frazier v. Frazier, 737 N.E.2d 1220 (Ind. App. 2000); and Moretti vs. Moretti, 766 A.2d 925 (R.I. 2001).

2. Shannon P. Pratt, Robert F. Reilly, Robert P Schweihs, Valuing a Business, the Analysis and Appraisal of Closely Held Companies, 4thh Edition, Appendix, A.1

3. *Id.*

4. Shannon P. Pratt, Robert F. Reilly, Robert P. Schweihs, Valuing a Business, the Analysis and Appraisal of Closely Held Companies, 4th Edition, p. 820.

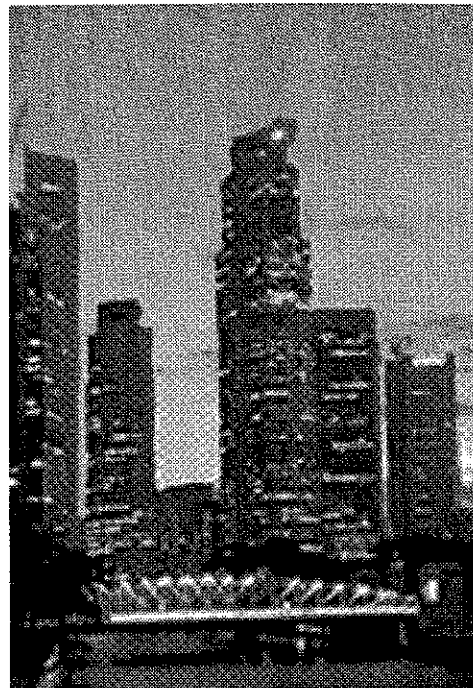
5. *Id.*

6. *Id.*

7. *See* Shannon P. Pratt, Robert F. Reilly, Robert P. Schweihs, Valuing Small Businesses and Professional Practices, 3d Edition, p.585.

8. For a detailed analysis of valuing noncompete agreements, *see* Mark O. Dietrich, "Valuing Covenants Not to Compete in a Professional Practice," *AICPA's CPA Expert*, Summer 2002.

Barrett Valuation Services, Inc.



WHAT IS MY BUSINESS WORTH?

This is an important question for most owners of a closely-held business. Value in a closely-held business is not easily determined as there are numerous factors that can impact value. Each business is unique and no public market exists for the shares of the business.

Valuation is not an exact science whereby a given formula can be applied to a set of data and a conclusive result determined. The informed judgment of the professional must be inherent in the valuation process. A systematic professionally prepared business valuation report can provide objective guidance in answering this critical question.

WHEN AND WHY DO I NEED TO DETERMINE A VALUE FOR MY BUSINESS?

You may need to determine value for a variety of important reasons:

- Do you need a valuation for a shareholder buy/sell agreement, or is an existing agreement's method of determining business value out of date?
- Are you interested in selling the business - or selling an interest?
- Do you want to transfer/gift company shares to heirs or others?
- Is there an estate planning situation that requires a determination of business value?
- Is the company electing Sub-chapter 'S' status?
- Are company shareholders interested in value-based planning, and do they need business-valuation models to guide planning efforts?
- Are you involved in a shareholder dispute, marital dissolution, or other litigation where business valuation is critically important?

WHAT IS A BUSINESS VALUATION REPORT AND WHAT TYPE DO I NEED?

Valuation engagements range from informal to very formal depending on the purpose of the valuation and its intended use. The circumstances of each situation will dictate the level of formality and type of report required.

A formal valuation report is a comprehensive document which includes definition of the valuation assignment, financial and economic analysis, an explanation of the appropriate valuation methodologies, and a reconciliation of the value estimate along with conclusions regarding value.

WHO IS QUALIFIED TO DO A BUSINESS VALUATION REPORT?

Many professionals (consultants, lawyers, accountants) provide business valuation services. John E. Barrett, Jr. is a Certified Public Accountant Accredited in Business Valuation by the American Institute of Certified Public Accountants (AICPA). John is a Certified Valuation Analyst certified by the National Association of Certified Valuation Analysts (NACVA). John is a Certified Business Appraiser certified by the Institute of Business Appraisers (IBA), and an associate member of the American Society of Appraisers (ASA).

Barrett Valuation Services, Inc. subscribes to the highest professional standards developed and published by the Appraisal Foundation with its Uniform Standards of Professional Appraisal Practice (USPAP). Barrett Valuation Services, Inc. subscribes to the business valuation standards of the American Institute of Certified Public Accountants, the National Association of Certified Valuators and Analysts, the Institute of Business Appraisers, and the American Society of Appraisers. These highly respected organizations are recognized as being the leaders in the field of business valuations. Our adherence to these standards demonstrates a commitment to providing the client with a well-reasoned value conclusion that is supportable and credible.

Barrett Valuation Services, Inc. can benefit the client in the following ways:

- Assess the valuation factors that impact the value of a closely-held business.
- Provide unique insights into the valuation process.
- Offer a systematic, professional approach to determine business value and provide a high-quality final report.
- Employ our expertise to solve your particular valuation problem.
- Provide business appraisal review services.

Fees

Fees will vary according to several factors ranging from the complexity and size of the business to the type of report required.

For more information on how BVS can serve your business valuation needs, please call for an appointment:

Barrett Valuation Services, Inc.
989 Reservoir Avenue
Cranston, RI 02910

Tel: (401) 942-3900
Fax: (401) 942-3988
Email: JBarrettVal@hotmail.com
Website: www.barrettvaluation.com