

9-15-2020

## Valuing Community Property Businesses: The Good, the Bad, and the Ugly of Louisiana Law

Sally Brown Richardson

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### Repository Citation

Sally Brown Richardson, *Valuing Community Property Businesses: The Good, the Bad, and the Ugly of Louisiana Law*, 80 La. L. Rev. (2020)

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# Valuing Community Property Businesses: The Good, the Bad, and the Ugly of Louisiana Law

*Sally Brown Richardson*\*

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## INTRODUCTION

Valuing community assets must occur during any partition of the community, yet few legislative or scholarly sources provide guidance for how that valuation should be done in Louisiana.<sup>1</sup> The pertinent statute on

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\* A.D. Freeman Associate Professor of Civil Law, Tulane University Law School. Earlier drafts of this Article have been presented at the Family Law Seminar at the Louisiana State University, Paul M. Hebert Law Center, and during a Faculty Workshop at Tulane University Law School. The author thanks all participants for their helpful input. The author also thanks Lila Tritico Hogan, Ann Lipton, and Ronald J. Scalise, Jr., for their helpful discussions on prior drafts. All views and any errors herein are solely attributable to the author.

1. For discussions on valuing community property in Louisiana, see ANDREA CARROLL & RICHARD D. MORENO, MATRIMONIAL REGIMES § 7:27, in 16 LOUISIANA CIVIL LAW TREATISE 761–76 (4th ed. 2013) [hereinafter MATRIMONIAL REGIMES]; ROBERT C. LOWE, LOUISIANA DIVORCE § 9:123, in 2 LOUISIANA PRACTICE SERIES 199–02 (2019) [hereinafter LOUISIANA DIVORCE];

the topic of partition simply states that parties to a divorce must provide a detailed descriptive list that includes, among other things, all of the community property and the “fair market value” of that community property.<sup>2</sup> The other party to the divorce then has a chance to “traverse or concur” in those valuations,<sup>3</sup> but ultimately the court must “value the [community property] assets”<sup>4</sup> and determine the “fair market value” of each asset.<sup>5</sup> As the Louisiana Second Circuit Court of Appeal aptly observed in the infamous 2003 case *Ellington v. Ellington*, “the law provides no mathematical formula for determining the value of community assets.”<sup>6</sup>

Although legislation gives no exact roadmap for how to value community property, Louisiana courts over the past two decades have provided an increasing number of examples of what not to do in the context of valuing the community’s interest in a business.<sup>7</sup> Following the *Ellington* decision and the legislation that spawned from that decision,<sup>8</sup> courts have increasingly taken the position that the community’s interest in a business is automatically valued at the buy-sell amount stated in the agreement that initially established the community’s interest in that business.<sup>9</sup> Such results, as asserted herein, are a misreading of the statutorily provided valuation requirement in a community property partition and have the potential effect of mis-valuing the community’s interest in a business to the detriment or benefit of the spouse who is not ultimately assigned the asset.

This Article proceeds in five parts. First, the Article explores how courts determined community property business valuations prior to *Ellington v. Ellington*. Second, the Article explains how the *Ellington* case—a case concerning the valuation of goodwill in a community

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Kenneth Rigby, *Matrimonial Regimes: Recent Developments*, 67 LA. L. REV. 73, 98–108 (2006).

2. LA. REV. STAT. § 9:2801(A)(1)(a) (2018).

3. *Id.* § 9:2801(A)(2).

4. *Id.* § 9:2801(A)(4)(a).

5. *Id.* § 9:2801(A)(1)(a).

6. *Ellington v. Ellington*, 842 So. 2d 1160, 1166 (La. Ct. App. 2d Cir. 2003); *see also* *Head v. Head*, 714 So. 2d 231, 234 (La. Ct. App. 2d Cir. 1998) (“Business valuations methods are not an exact science . . .”).

7. *Infra* Part III.

8. *Infra* Part II.

9. *Bulloch v. Bulloch*, 214 So. 3d 930, 940–41 (La. Ct. App. 2d Cir. 2017); *Rao v. Rao*, 927 So. 2d 356, 366 (La. Ct. App. 1st Cir. 2005); *Baumbouree v. Baumbouree*, 202 So. 3d 1077, 1084 (La. Ct. App. 3d Cir. 2016); *see also infra* Part III (discussing the decisions in *Rao*, *Baumbouree*, and *Bulloch*).

property business—served as the unintentional catalyst for courts to dramatically alter how they more generally determined the fair market value of a community property business. Third, the Article details the three recent Louisiana cases that follow this newly utilized method of valuing the community's interest in a community property business. Fourth, the Article details the fallacy of the logic used in these recent cases. And fifth, the Article explains how courts should approach valuing the community's interest in a business going forward.

### I. THE GOOD: A BATTLE BASED ON FACTS

Valuing community businesses is tough.<sup>10</sup> For decades, Louisiana courts correctly allowed valuation of community businesses to be a battle of the experts based on actual facts.<sup>11</sup>

Historically, Louisiana trial courts relied on experts in determining the value of community businesses.<sup>12</sup> Experts utilized a variety of respected accounting techniques to value community businesses, such as: (1) proffering the book value of the business or its economic net worth; (2) using a capitalization of earnings method; (3) employing a capitalization of cash flow method; or (4) utilizing a price earnings ratio method.<sup>13</sup> In reading different experts' reports and taking their testimony,

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10. See J. THOMAS OLDHAM, *TEXAS MARITAL PROPERTY RIGHTS* 271 (Carolina Academic Press 5th ed. 2011); *MATRIMONIAL REGIMES*, *supra* note 1, at 765 (noting courts must be careful to value the community's interest, not just the assets of the business); 41 C.J.S. *Husband and Wife* § 426 (2019).

11. *E.g.*, *Schiro v. Schiro*, 839 So. 2d 304, 307–09 (La. Ct. App. 5th Cir. 2003); *Moody v. Moody*, 622 So. 2d 1381, 1383–84 (La. Ct. App. 1st Cir. 1993); *Head*, 714 So. 2d at 232. Encouraging a battle of the experts in any litigation may be met with the objection that experts are costly. It goes without saying that experts are expensive, see FRANK L. MARAIST, *CIVIL PROCEDURE* § 9.1, in 1 *LOUISIANA CIVIL LAW TREATISE* 276 (2d ed. 2008), and, in some cases, the value of the community's interest in a business may not warrant the hiring of an expert. As noted in many of the cases herein, however, the community's interest in a business may well exceed \$1,000,000. In such cases, it is certainly wise to engage accountants or business valuation experts because their cost, while possibly high, will pale in comparison to the potential amount acquired by the client.

12. *E.g.*, *Chance v. Chance*, 694 So. 2d 613 (La. Ct. App. 2d Cir. 1997); *Head*, 714 So. 2d at 232; *McDonald v. McDonald*, 909 So. 2d 694, 699 (La. Ct. App. 2d Cir. 2005); *Preis v. Preis*, 649 So. 2d 593, 594–95 (La. Ct. App. 3d Cir. 1994).

13. *E.g.*, *Moody*, 622 So. 2d at 1383 (both experts used all five techniques to determine the value of the community business). See also *Preis*, 649 So. 3d at 595 (accepting a net income approach); *Trahan v. Trahan*, 43 So. 3d 218, 229 (La. Ct.

courts regularly relied on experts' opinions,<sup>14</sup> found fault with experts when their opinions failed to take into account pertinent information,<sup>15</sup> and sometimes even averaged differing experts' valuations when it seemed reasonable.<sup>16</sup> In doing so, trial courts performed their function of assessing the credibility of the experts and weighing the experts' testimony based on

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App. 1st Cir. 2010) (accepting a discounted cash flow method); *Schiro*, 839 So. 2d at 308 (using a capitalized excess earnings method).

14. *E.g.*, *Statham v. Statham*, 986 So. 2d 894, 898 (La. Ct. App. 2d Cir. 2008) (relying on the husband's expert); *Landry v. Simon*, 732 So. 2d 587, 589 (La. Ct. App. 3d Cir. 1999) (relying on the husband's expert); *Head*, 714 So. 2d 231 (accepting valuations from both husband's and wife's experts for different community assets).

15. *E.g.*, *Guillaume v. Guillaume*, 603 So. 2d 235, 238 (La. Ct. App. 4th Cir. 1992) (finding fault with an expert opinion as based on "speculation and assumption"); *Statham*, 986 So. 2d at 897–98 (rejecting the wife's expert, in part, because the data used was two years old); *Ellington v. Ellington*, 842 So. 2d 1160, 1165 (La. Ct. App. 2d Cir. 2003) (using the wife's expert's methodology, but finding that more years of data had to be incorporated into the valuation).

16. *E.g.*, *McDonald*, 909 So. 2d at 699; *Schiro*, 839 So. 2d at 309; *see also* *Drennan v. Drennan*, 121 So. 3d 177, 187 (La. Ct. App. 5th Cir. 2013) (trial court averaged the experts' valuations in an attempt to find the "equitable fair market value," but the appellate court rejected the trial court's valuations because it took into account a valuation that used the wrong valuation date). It is worth noting that averaging experts' opinions on the subject of valuation may not actually result in obtaining the fair market value of the business. *See* MATRIMONIAL REGIMES, *supra* note 1, at 1 (Supp. 2018 at 97) (discussing the divided jurisprudence on averaging expert opinions and the propriety of courts averaging experts' valuations). In a recent case in Kentucky involving the valuation of a business created while married, the Kentucky Supreme Court forcefully struck down the idea that a lower court could simply average different experts' valuations to reach the fair market value of the business for purposes of equitable distribution at divorce. *See* *Gaskill v. Robbins*, 282 S.W.3d 306, 315 (Ky. 2009). The Kentucky court stated that:

Using an average to obtain a value, without some basis other than an inability to choose between conflicting and competing valuation methods, is nothing more than making up a number, for there is no evidentiary basis to support that *specific* number. Employing all four methods, then averaging them, is tantamount to no method at all. If an expert believes four methods are valid, yet each produces a different number, this provides little or no help to the trial court. The trial court must fix a value, and there should be an evidence-based articulation for why that is the value used. While an average may present the easiest route, it lacks the proper indicia of reliability.

*Id.*

their professional qualifications and experience.<sup>17</sup> Appellate courts, in turn, did not disturb the findings of trial courts absent manifest error.<sup>18</sup>

Regardless of the ultimate accounting method or methods on which a court relied, Louisiana courts attempted to discern the value of the actual business interest, as opposed to merely valuing the assets of the business entity.<sup>19</sup> By doing so, courts sought to determine to the best of their ability the “fair market value” of the community’s interest in the business, as required under Louisiana legislation concerning the partition of community property.<sup>20</sup>

In discerning the fair market value of the community’s interest in a business, courts did not simply accept the values stated in the partnership or shareholder agreements at face value, but instead engaged in a detailed analysis of the actual fair market value of the community business.<sup>21</sup> For example, in *Borrello v. Borrello*, the husband was a member of a large law partnership.<sup>22</sup> During the spouses’ divorce, the husband asserted that the valuation of his interest, and thus the community’s interest, in the partnership was set by the partnership agreement, and his wife was bound to use that stated amount for purposes of partitioning the community property.<sup>23</sup> The *Borrello* court disagreed.<sup>24</sup> The court held that the wife was “permitted to discover information necessary for her to establish the value of her husband’s partnership interest.”<sup>25</sup> In doing so, the court expressly recognized that the fair market value of the community’s interest

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17. See *Head*, 714 So. 2d at 234; *Statham*, 986 So. 2d at 900; *Alford v. Alford*, 653 So. 2d 133, 136–37 (La. Ct. App. 3d Cir. 1995) (rejecting the husband’s expert based on credibility); see also *Henry v. Henry*, No. 2017-CA-0282, 2017 WL 4700385 \*3 (La. Ct. App. 4th Cir. 2017) (remanding a case to the trial court so that the trial court could “consider the credibility of the expert’s findings before rejecting the expert’s opinion”).

18. *Drennan*, 121 So. 3d at 181; *Gill v. Gill*, 895 So. 2d 807, 813 (La. Ct. App. 2d Cir. 2005); *Landry*, 732 So. 2d at 589; *Schiro*, 839 So. 2d at 305; *Statham*, 986 So. 2d at 900.

19. *McDonald*, 909 So. 2d at 698; *Waguespack v. Waguespack*, 2010 WL 3291815, \*3 (La. Ct. App. 1st Cir. 2010); *Ellington*, 842 So. 2d at 1166.

20. See LA. REV. STAT. § 9:2801(A)(2) (2019) (establishing that “fair market value” is the value to be assigned to all community assets during a partition).

21. E.g., *Borrello v. Borrello*, 614 So. 2d 91, 92 (La. Ct. App. 4th Cir. 1992); *Moody v. Moody*, 622 So. 2d 1381, 1383 (La. Ct. App. 1st Cir. 1993); *D’Spain v. D’Spain*, 527 So. 2d 309, 315 (La. Ct. App. 5th Cir. 1988).

22. *Borrello*, 614 So. 2d at 92.

23. *Id.* at 94.

24. *Id.*

25. *Id.*

in the husband's law partnership may be different than the amount set forth in the partnership agreement.<sup>26</sup>

Similarly, in *Fastabend v. Fastabend*, the husband acquired an interest in a medical partnership while married.<sup>27</sup> The partnership agreement that the husband had signed declared that no partner had an interest in or a claim to the accounts receivable of the medical partnership.<sup>28</sup> When the husband and his wife divorced, the court had to value the community's interest in the medical partnership.<sup>29</sup> In calculating the value of the medical partnership, the trial court included the partnership's accounts receivable.<sup>30</sup> The husband objected to their inclusion, arguing that he had no claim to the accounts receivable under the terms of the partnership agreement.<sup>31</sup>

The appellate court in *Fastabend* disagreed with the husband.<sup>32</sup> The court stated that although the husband individually had no direct claim to the accounts receivable, it was "undisputed that the accounts receivable [were] an asset of the partnership itself. As such they must be used in calculating the value of the partnership. . . . It is the value of the partnership which forms the basis for the determination of [the husband's] interest in it."<sup>33</sup> Accordingly, the *Fastabend* court held that while the partnership agreement provided a means to calculate the husband's interest in the partnership, that calculation method was not inherently binding on the wife for purposes of valuing the husband's interest at divorce.

In refusing to take the stated value at face value, courts sometimes found that the amount stated in a business agreement inflated the business's actual value. For example, in *Moody v. Moody*, the court had to value the community's interest in a community property corporation run by the husband.<sup>34</sup> The husband's expert at trial averaged the book value, economic net worth, capitalization of earnings, capitalization of cash flow, and price earnings ratio methods and asserted that the value of each share held by the community in the corporation was \$2.49.<sup>35</sup> The wife's expert utilized the same five methods of valuing the company, but her expert

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26. *Id.*

27. *Fastabend v. Fastabend*, 606 So. 2d 794, 798 (La. Ct. App. 3d Cir.), *writ denied*, 609 So. 2d 231 (La. 1992).

28. *Id.*

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.*

33. *Id.*

34. *Moody v. Moody*, 622 So. 2d 1381, 1383 (La. Ct. App. 1st Cir. 1993).

35. *Id.*

concluded that the actual value of the shares was higher at \$3.47 per share.<sup>36</sup>

In rejecting the opinions of both experts, the trial court determined the value of the community's shares in the corporation to be \$5.45 per share because the husband, as the president of the corporation, set the price per share at \$5.45 mere weeks prior to the termination of the community.<sup>37</sup> The trial court found that because the husband had the "power and authority and the sole discretion" to sell the stock, the husband should be bound by the value he helped set for the stock.<sup>38</sup>

The appellate court in *Moody* overturned the trial court and found that the wife's expert's valuation represented the net economic worth of the corporation.<sup>39</sup> In rejecting the share value of \$5.45 that was established with the husband's help in a Board of Directors meeting, the appellate court noted that it was evident that the \$5.45 stock value "was not an attempt to determine the true fair market value of the corporation at that time. It was more in the nature of a compromise wherein the corporation agreed to pay \$5.45 for the repurchase of a small amount of corporate stock from an employee."<sup>40</sup>

By rejecting the stated share value, the *Moody* court affirmed the statutory requirement that the value of a community's interest in any community asset, including the community's interest in a business, is the *actual* fair market value of the asset,<sup>41</sup> which may or may not be the amount stated in any particular agreement. In finding the fair market value of the community's interest in the corporation, the *Moody* court recognized that a business may take into account a number of factors when assigning itself a value,<sup>42</sup> which inherently means that any amount a business assigns itself or establishes to buy out its members may or may not reflect the actual fair market value of that business.<sup>43</sup>

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36. *Id.* at 1384.

37. *Id.* at 1383.

38. *Id.*

39. *Id.* at 1384.

40. *Id.* at 1385.

41. *See* LA. REV. STAT. § 9:2801(A)(1)(a) (2019).

42. *Moody*, 622 So. 2d at 1384.

43. Numerous other courts outside of Louisiana have expressly recognized in the context of divorce cases that the value stated in a business agreement is not inherently the fair market value of that business. *See, e.g.,* *Bosserman v. Bosserman*, 384 S.E.2d 104, 108 (Va. Ct. App. 1989) ("The price established for buy-out purposes, however, is often artificial and does not always reflect true value."); *Bettinger v. Bettinger*, 396 S.E.2d 709, 715 (W. Va. 1990) ("It is apparent that buy-sell agreements in a closely held corporation can be



In determining the true fair market value of a community's interest in a business, courts historically engaged in an analysis based on the actual facts pertaining to the divorcing couple, as opposed to alternative realities proposed by an individual spouse. For example, in *Head v. Head*, the husband purchased an interest in a family owned corporation while married.<sup>44</sup> The husband served as the principal officer for the corporation.<sup>45</sup> Upon divorce, the husband and wife each hired appraisers as their experts, and both appraisers used the capitalization of normalized earnings method to value the community's interest.<sup>46</sup> The experts disputed whether the value of the corporation should be discounted for a lack of marketability.<sup>47</sup> The husband's expert noted that the capitalization method used to value the corporation was for valuing interests in a publicly traded business, but the family owned corporation at issue was a privately held business.<sup>48</sup> Because privately held businesses are harder to sell on the open market, the husband's expert asserted that the value of privately held businesses is generally discounted when using a capitalization of normalized earnings method.<sup>49</sup> Accordingly, the husband's expert said the value of the family owned corporation in the case should be similarly discounted.<sup>50</sup>

The *Head* court disagreed. The court noted that the husband intended to continue running the business.<sup>51</sup> As the court stated, "Where a sale of the business to a third party is not contemplated, the value of the stock

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manipulated by the shareholders to reflect an artificially low value. This is why caution should be exercised in accepting their value for equitable distribution purposes."); *Rogers v. Rogers*, 296 N.W.2d 849, 852 (Minn. 1980) (noting that the court did not have to accept the buy-sell amount as dispositive of the husband's interest in a closely-held S corporation for purposes of valuing the husband's shares at divorce). See generally Stevens A. Carey, *Buy/Sell Provisions in Real Estate Joint Venture Agreements*, 39 REAL PPTJ 651 (2005) (discussing how buy-sell amounts may be valued for different purposes and are not necessarily set at the market rate); Eric A. Manterfield, *Buy-Sell Agreements*, ST002 ALI-ABA 59, 87-90 (2011) (noting the different methods of setting a buy-sell amount, not all of which equate the buy-sell amount with the fair market value of the entity).

44. *Head v. Head*, 714 So. 2d 231, 232 (La. Ct. App. 2d Cir. 1998).

45. *Id.*

46. *Id.* Although the experts both agreed on the method of valuation, they disputed the value of perks to be added back to the net cash flow, which is required when using the capitalization of earnings method. *Id.* at 235.

47. *Id.* at 238.

48. *Id.*

49. *Id.*

50. *Id.*

51. *Id.*

should be determined without discounting for lack of marketability.”<sup>52</sup> In reaching this conclusion, the *Head* court recognized that if a closely held corporation is not going to be placed on the open market, courts do not need to discount the corporation’s value as if the corporation were being sold on the open market. In other words, in determining the fair market value of the community’s interest in the corporation, the *Head* court implicitly rejected applying a series of hypothetical facts that the court knew would not occur.

Similarly, in *Segura v. Comeaux*, the Louisiana Third Circuit Court of Appeal found that courts should not take into account pure speculations on the part of one party in valuing a community business.<sup>53</sup> In *Segura*, the husband and wife created a business while married.<sup>54</sup> The wife ran the company and, upon filing for divorce, fired the husband from the business.<sup>55</sup> In determining the value of the community business, the wife asserted that the court should take into account the possibility of a state sales tax audit.<sup>56</sup> The *Segura* court disagreed, stating that the possibility of a tax audit was purely “speculative” and that while everyone agreed such an audit was possible, “no notice of any action by the state had been given.”<sup>57</sup> Thus, the *Segura* court found that mere speculations should not be factored into the fair market valuation of the community business.<sup>58</sup>

What all of the aforementioned cases highlight is the effort by Louisiana courts to determine the actual fair market value of a community business interest when partitioning community property. In doing so,

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52. *Id.*; see also *McGehee v. McGehee*, 543 So. 2d 1126, 1128–29 (La. Ct. App. 1st Cir. 1989) (assigning a value to an insurance agency based on the evidence that the husband did not intend to sell the agency and the wife did not intend to compete with the agency in the future); *Nesbitt v. Nesbitt*, 15 So. 3d 1229, 1232 (La. Ct. App. 2d Cir. 2009) (finding that the trial court did not err in not applying a “marketability” approach to valuing a law partnership when there was no evidence that there was a third party to whom the spouse–lawyer was going to sell the law partnership). *But see Thomson v. Thomson*, 978 So. 2d 509, 515 (La. Ct. App. 3d Cir. 2008) (applying a minority-ownership discount even though a sale of the community’s minority-ownership interest was not being contemplated).

53. *Segura v. Comeaux*, 279 So. 3d 418, 421 (La. Ct. App. 3d Cir. 2017).

54. *Id.* at 419.

55. *Id.*

56. *Id.* at 419–20.

57. *Id.* at 421.

58. *Id.*; see *Mexic v. Mexic*, 577 So. 2d 1046, 1049–50 (La. Ct. App. 4th Cir. 1991) (“The value of the community interests in real estate partnerships should not and cannot be predicated on tax consequences of some future uncertain event.”).

courts routinely rejected the notion that the value stated in a partnership or shareholder agreement was automatically the fair market value of the community business. Instead, courts engaged in detailed accounting analysis to determine the fair market value, as statutorily required under Louisiana law.

## II. THE BEGINNING OF THE BAD: *ELLINGTON*, GOODWILL, AND “PERSONAL QUALITIES”

Trying to find the fair market value of the actual business interest, as opposed to just the value of the assets of the business, is inextricably linked to goodwill—specifically the goodwill of the spouse working at the business.<sup>59</sup> Goodwill is notoriously difficult to value itself,<sup>60</sup> and it has unsurprisingly added a level of complication to valuing community businesses in Louisiana.

Although courts prior to 1900 noted in dicta that goodwill could be part of a community business,<sup>61</sup> the first modern case that wrestled with this concept for purposes of partition at divorce was *Depner v. Depner*.<sup>62</sup> In *Depner*, a husband created a medical corporation prior to marriage.<sup>63</sup> At the termination of the marriage, the court had to determine how much the separate property medical corporation had increased in value during the

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59. DAVID R. HERWITZ & MATTHEW J. BARRETT, ACCOUNTING FOR LAWYERS 571 (Foundation Press 4th ed. 2006) (noting that goodwill is an asset of a business and difficult to value); JOHN TINGLEY & NICHOLAS B. SVALINA, MARITAL PROPERTY LAW § 43:7 (Thomson Reuters 2d ed. 2013).

60. See Helga White, *Professional Goodwill: Is It a Settled Question or Is There “Value” In Discussing It?*, 15 J. AM. ACAD. MATRIM. LAW. 495, 497–501 (1998) (discussing the difficulty in simply defining goodwill); Christopher A. Tiso, *Present Positions on Professional Goodwill: More Focus or Simply More Hocus Pocus?*, 20 J. AM. ACAD. MATRIM. LAW. 51, 55–56 (2006) (noting that although goodwill is difficult to value, such valuations are regularly done outside of divorce).

61. E.g., *Mehnert v. Dietrich*, 36 La. Ann. 390, 391–92 (La. 1884) (finding the goodwill of a business to be part of the community); *Succession of Blancand*, 19 So. 683, 684 (La. 1896) (noting that if there was goodwill in the community grocery business, it passed to the wife upon the husband’s death along with the business); see also Eve Barrier Masinter, *Professional Goodwill in Louisiana: An Analysis of Its Classification, Valuation and Partition*, 43 LA. L. REV. 119 (1982) (discussing how Louisiana courts should value professional goodwill).

62. See *Depner v. Depner*, 478 So. 2d 532, 533 (La. Ct. App. 2d Cir. 1985).

63. *Id.* at 532.

course of the marriage.<sup>64</sup> At dispute was whether any increase in the goodwill of the medical corporation should be included in the corporation's value.<sup>65</sup>

In its analysis, the *Depner* court provided the definition of goodwill that remains in use today.<sup>66</sup> Louisiana courts, in the context of community property partitions, consider goodwill to be “the chance or probability that custom will be had at a certain place of business in consequence of the way that business has been conducted,”<sup>67</sup> or put more simply, “the probability that the customers of the old establishment will continue their patronage.”<sup>68</sup>

Using this definition, the *Depner* court found that the likelihood that patients would return to the medical corporation in which the husband had an interest was not an asset of the corporation, but instead part of the husband himself.<sup>69</sup> In reaching this conclusion, the court stated that:

The good will in which [the wife] seeks to share is the professional competence, as perceived by [the husband's] patients, with which her husband has practiced his art. Professional medical competence is personal to the physician and cannot be attributed to the corporation because it is a personal relationship between physician and patient, not between the corporation and patient.<sup>70</sup>

By making this distinction between goodwill held by the individual and goodwill held by a business, *Depner* began a division that Louisiana courts followed until 2003.

Subsequent courts interpreted *Depner* to establish a division between goodwill attributable to a professional business, such as a medical practice or a legal partnership, and goodwill attributable to a commercial business, such as an oil company or a cotton exchange.<sup>71</sup> Courts found that goodwill

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64. *Id.*

65. *Id.* at 534.

66. *Id.*

67. *Id.* at 534; *see also* *Head v. Head*, 714 So. 2d 231, 236 (La. Ct. App. 2d Cir. 1998); *LeBlanc v. LeBlanc*, 694 So. 2d 1172, 1173 (La. Ct. App. 1st Cir. 1997).

68. *Godwin v. Godwin*, 533 So. 2d 1009, 1010 (La. Ct. App. 1st Cir. 1988) (citing *Ballero v. Heslin*, 128 So. 2d 453, 455 (La. Ct. App. 4th Cir. 1961), and noting that *Depner* cited *Ballero* affirmatively); *Landry v. Simon*, 732 So. 2d 587, 588 (La. Ct. App. 3d Cir. 1999).

69. *Depner*, 478 So. 2d at 533–34.

70. *Id.* at 534.

71. *See, e.g., Landry*, 732 So. 2d at 588 (noting the division between goodwill in professional businesses and goodwill in commercial businesses); *Preis v. Preis*,

in the former was not a community asset but part and parcel of the professional spouse, whereas goodwill in the latter did constitute a community asset because it was an actual asset of the commercial business.<sup>72</sup>

For example, in *Preis v. Preis*, the community had an interest in a law corporation due to the attorney–husband.<sup>73</sup> In valuing the law corporation, the wife’s expert sought to value the assets of the corporation as including its goodwill, while the husband’s expert sought to value the percentage of net income that the husband historically received from the law corporation.<sup>74</sup> The court found nothing “manifestly wrong” with using the husband’s expert’s valuation and refused to consider the husband’s goodwill as part of the valuation of the law corporation.<sup>75</sup> The *Preis* court stated that:

Louisiana has made the distinction between goodwill which attaches to the person because of the person’s unique qualities, and goodwill which attaches to the business because of the nature of the business. . . . The accounts of a commercial business can be sold for a price in the open market regardless of who operates the business. Clients of a law firm choose that firm based on its members and qualifications. Without its attorneys, a law firm has no separate goodwill.<sup>76</sup>

The *Preis* court, like the *Depner* court before, established that in the context of professional businesses, like a law practice, goodwill should not be included in the business valuation given that any goodwill was inextricably linked to the individual spouse.

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649 So. 2d 593, 596 (La. Ct. App. 3d Cir. 1994); see also MATRIMONIAL REGIMES, *supra* note 1, at 52–55; Kelly M. Haggard, *A Catalyst in the Cotton: The Proper Allocation of the “Goodwill” of Closely Held Businesses and Professional Practices in Dissolution of Marriages*, 65 LA. L. REV. 1191, 1245–46 (noting that prior to *Ellington*, goodwill in a commercial business was classified as a community asset).

72. *E.g.*, *Collier v. Collier*, 790 So. 2d 759, 762 (La. Ct. App. 3d Cir. 2001) (noting that “goodwill may be included in the value of a commercial corporation”); *LeBlanc*, 694 So. 2d at 1173 (noting that courts had allowed goodwill to exist in commercial enterprises).

73. *Preis*, 649 So. 2d at 594.

74. *Id.* at 595.

75. *Id.* at 595–96.

76. *Id.* at 596.

On the flip side of cases like *Preis* and *Depner* is the infamous case *Ellington v. Ellington*.<sup>77</sup> *Ellington* involved the divorce of then-State Senator Noble Ellington and his wife, Peggy.<sup>78</sup> During their marriage, Noble and Peggy worked for the community business they created, the Noble Ellington Cotton Company (“NECC”), a company that bought and sold cotton.<sup>79</sup> At the termination of the marriage, the *Ellington* court had to determine the value of NECC for the purpose of partitioning their community property.<sup>80</sup>

Both Noble and Peggy hired experts on the issue of valuing NECC. Peggy’s expert, a certified public accountant, asserted that the best method of valuation was the capitalization of earnings method.<sup>81</sup> Under the capitalization of earnings method, Peggy’s expert concluded that NECC was worth \$668,000 and that a substantial portion of that value was due to the goodwill that Noble created.<sup>82</sup> Noble’s expert, a certified valuation expert, used a net asset method of valuing the community property business.<sup>83</sup> Under the net asset valuation—which did not take goodwill into account—Noble’s expert stated that NECC had zero value because the company’s liabilities exceeded its assets.<sup>84</sup>

The trial court in *Ellington* found that given the nature of NECC, it was more appropriate to use a method of valuing the business that took goodwill into account because NECC was a commercial business, as compared to a professional business like a law or medical partnership.<sup>85</sup> The trial court noted that the customer base acquired by NECC was largely attributable to Noble<sup>86</sup> and that none of the goodwill of NECC was attributable to Peggy.<sup>87</sup> Noble’s suggestion, then, was to allocate NECC to Peggy at a value of \$0 and allow Peggy to run the business.<sup>88</sup> As the court stated, such an idea was preposterous because the business as owned by Peggy would have no customers and no value, but the business owned and operated by Noble was “capable of generating handsome incomes.”<sup>89</sup> As

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77. *Ellington v. Ellington*, 842 So. 2d 1160 (La. Ct. App. 2d Cir. 2003).

78. *Id.* at 1163.

79. *Id.*

80. *Id.*

81. *Id.*

82. *Id.* at 1163–64.

83. *Id.* at 1164.

84. *Id.*

85. *Id.* at 1169–70.

86. *Id.* at 1169.

87. *Id.* at 1168.

88. *Id.*

89. *Id.*

such, the trial court found it was appropriate to take Noble's goodwill into account because NECC was a commercial business, and the court allocated NECC to Noble in the partition.<sup>90</sup> Accordingly, the trial court used the income approach that Peggy's expert suggested.

On appeal, the Second Circuit noted that "the law provides no mathematical formula for determining the value of community assets."<sup>91</sup> The appellate court stated that "[i]f the trial court's valuations are reasonably supported by the record and do not constitute an abuse of discretion, its determinations should be affirmed."<sup>92</sup> In applying this standard of review, the appellate court agreed with the trial court that the business's goodwill should be included in its valuation.<sup>93</sup> Further, the Second Circuit found no error in the trial court's use of an income approach to value the business.<sup>94</sup> Accordingly, the Second Circuit affirmed the trial court's decision in *Ellington*.<sup>95</sup>

The Second Circuit released the *Ellington* decision on March 18, 2003. The 2003 Regular Legislative Session of the Louisiana Legislature convened on March 31 of the same year.<sup>96</sup> In the 2003 Regular Legislative Session, Senator Noble Ellington proposed Senate Bill 844, which was passed into law.<sup>97</sup> Senator Ellington's proposal created a new statute, Louisiana Revised Statutes § 9:2801.2, which established how community property businesses should be valued during a partition of the community. The statute stated:

In a proceeding to partition the community, the court may include, in the valuation of a community commercial business, the goodwill of the business. Goodwill shall not be included in the valuation of a business when goodwill results solely from the identity, reputation, or qualifications of the owner or from his relationship with customers of the business.<sup>98</sup>

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90. *Id.* at 1168–71.

91. *Id.* at 1166.

92. *Id.*

93. *Id.* at 1170.

94. *Id.* at 1171.

95. *Id.* at 1175.

96. See Senate Information Bulletin, 2003 Regular Session Date and Fact Sheet, <http://senate.legis.state.la.us/SessionInfo/Archives/2003/RS/LinkShell.asp?Type=Bulletin>.

97. Act No. 837, 2003 La. Acts 2696 (codified at LA. REV. STAT. § 9:2801.2 (2018)).

98. *Id.*; see MATRIMONIAL REGIMES, *supra* note 1, at 57 ("Clearly, the thrust of the new statute was to treat a business such as that in *Ellington* differently from

The statute as passed in 2003 was short-lived.<sup>99</sup> Senator Ellington proposed an amended version of the statute during the 2004 Regular Legislative Session.<sup>100</sup> Act 177 was ultimately passed by the Louisiana Legislature and signed into law, creating the version of Louisiana Revised Statutes § 9:2801.2 that remains in effect today:

In a proceeding to partition the community, the court may include, in the valuation of any community owned corporate, commercial or professional business, the goodwill of the business. However, that portion of the goodwill attributable to any personal quality of the spouse awarded the business shall not be included in the valuation of a business.<sup>101</sup>

Following the passage of Act 177, courts were statutorily forced to make a number of determinations in valuing the community's interest in a business. First, in valuing a community property business, courts now had to determine whether the business was a "corporate, commercial or professional" business to which the new statute applied.<sup>102</sup> Second, courts must determine whether goodwill should be added to the valuation because the statute permits goodwill to be added to the valuation of the business, but does not require that goodwill be added.<sup>103</sup> Third, if goodwill is to be added to the valuation of the business, then courts must determine the amount of goodwill attributable to the "personal quality" of the spouse who is to be awarded the business. This third step requires courts to

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other commercial businesses and to treat these special commercial businesses equivalently to a professional practice.”).

99. See *MATRIMONIAL REGIMES*, *supra* note 1, at 57 (discussing the problems with the original statute as enacted in 2003).

100. S.B. 146, 2004 Leg. Reg. Sess. (La. 2004).

101. Act No. 177, 2004 La. Acts 1161 (codified at LA. REV. STAT. § 9:2801.2).

102. Some community property scholars have written that by including "corporate, commercial or professional" in Act 177, the legislature meant to include all community property businesses. See *MATRIMONIAL REGIMES*, *supra* note 1, at § 2.9. Although it may be difficult to conceive of a business that does not fall under the corporate, commercial, or professional rubric, the inclusion of those descriptors certainly means that a court's first order of business in applying the statute is to ensure that the community business is in fact corporate, commercial, or professional in nature.

103. Some courts have incorrectly read the plain meaning of the statute to mean that goodwill must be applied. See *McDonald v. McDonald*, 909 So. 2d 694, 699 (La. Ct. App. 2d Cir. 2005) ("If the underlying business is community, the goodwill should be and will be considered in dividing the community property as part of the partition.").



simultaneously determine which spouse is to receive the business in the partition because only the personal qualities of the spouse awarded the business must be omitted from the goodwill valuation.<sup>104</sup>

Whereas before *Ellington* and its legislative offspring, courts discussed whether community property businesses were commercial or professional in nature, following the 2004 statute Louisiana courts' discussions shifted to what constituted a "personal quality" of the spouse who acquired the business. For example, among the issues argued in *Bulloch v. Bulloch* was the extent to which the value of the community's interest in a surgical clinic was attributable to the husband-physician's personal goodwill or attributable to the clinic's goodwill.<sup>105</sup> The husband's expert valued the community's share in the surgical clinic at \$1,174,566 and stated that \$730,649 of that interest was goodwill, with 30% of the goodwill as attributable to the surgical clinic and 70% of the goodwill as attributable to the personal qualities of the husband-physician.<sup>106</sup> In accepting the husband's expert's valuation, the *Bulloch* court discussed the factors that showed goodwill was attributable to an individual doctor's personal qualities.<sup>107</sup> The *Bulloch* court stated that having a patient base dedicated to an individual physician was an example of goodwill based on the personal qualities of that physician.<sup>108</sup>

Cases like *Bulloch* are easily contrasted with cases like *Amaraneni v. Amaraneni*.<sup>109</sup> As in *Bulloch*, the husband in *Amaraneni* started a medical business during his marriage.<sup>110</sup> The medical limited liability company

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104. In *Rao v. Rao*, the court erroneously held that not only should the goodwill attributable to the personal qualities of the spouse awarded the business be subtracted from the business's valuation, but that any goodwill attributable to the personal qualities of other members of the business should be subtracted from the business's valuation. *Rao v. Rao*, 927 So. 2d 356, 366 (La. Ct. App. 1st Cir. 2005). The plain text of the statute clearly provides that only the "portion of the goodwill attributable to any personal quality of *the spouse awarded the business*" should be subtracted from the business's valuation. LA. REV. STAT. § 9:2801.2 (2018) (emphasis added).

105. *Bulloch v. Bulloch*, 214 So. 3d 930, 937 (La. Ct. App. 2d Cir. 2017). *Bulloch* is discussed in detail below. *Infra* Part III.

106. *Bulloch*, at 937.

107. *Id.*

108. *Id.* See also MATRIMONIAL REGIMES, *supra* note 1, at 55 (giving examples of personal qualities that create goodwill as an individual's reputation, experience, or training, whether customers deal directly with the professional, and whether the corporate name is different than the individual professional).

109. *Amaraneni v. Amaraneni*, 2010 WL 502958 (La. Ct. App. 1st Cir. 2010).

110. *Id.* at \*1.

operated an urgent care facility.<sup>111</sup> The husband asserted that the medical business had no value outside of goodwill attributable to his personal qualities, but the court disagreed.<sup>112</sup> The court found that the husband rarely worked at the urgent care facility and, when he did, it was only as a regular shift physician.<sup>113</sup> Patients were unable to call and make an appointment specifically with the husband–physician.<sup>114</sup> Accordingly, the *Amaraneni* court found that any goodwill held by the LLC was not attributable to the husband’s personal qualities and thus should be included in the valuation of the business.<sup>115</sup>

Since the *Ellington* decision and the passage of Louisiana Revised Statutes § 9:2801.2, Louisiana courts have shifted the focus in valuing goodwill in community businesses from whether the business is a professional or commercial business to whether any goodwill generated by the business is attributable to the personal qualities of the spouse who is ultimately awarded the business. *Ellington* and its statutory progeny have been discussed in Louisiana scholarship,<sup>116</sup> and re-litigating their merits is not the intent of this Article. The confusion created following *Ellington*, however, is important because it unintentionally served as the catalyst for a trend in recent jurisprudence.

### III. THE UGLY: TAKING STATED VALUE AT FACE VALUE

As courts have shifted their analysis regarding goodwill to whether any goodwill generated by a community business is attributable to the personal qualities of the spouse who is awarded the business, courts have been increasingly concerned about how to calculate the value of a community business without incidentally including goodwill. Of late, courts have implied that if a shareholder agreement or partnership agreement provides some buy-sell amount, values above and beyond that amount must be attributable to goodwill.<sup>117</sup> Because of the aforementioned goodwill statute, courts have assumed the stated buy-sell amount is the fair market value of the community business without any goodwill added.

In *Rao v. Rao*, a husband acquired an interest in a medical corporation with five other physicians, with each physician acquiring a one-sixth

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111. *Id.* at \*6.

112. *Id.*

113. *Id.*

114. *Id.* at \*7.

115. *Id.*

116. See MATRIMONIAL REGIMES, *supra* note 1, at 58–63; Haggar, *supra* note 71, at 1245.

117. See *Rao v. Rao*, 927 So. 2d 356, 365–66 (La. Ct. App. 1st Cir. 2005).

interest in the corporation.<sup>118</sup> In the creation of the medical corporation, the husband and wife both signed a Stockholder Agreement.<sup>119</sup> The Stockholder Agreement stated that if any stockholder resigned, died, or was otherwise terminated from the corporation, the stockholder agreed to sell his interest back to the corporation for a price of \$25,000.<sup>120</sup> The Stockholder Agreement further stated that if any of the stockholders' spouses acquired an interest in the corporation due to community property law or any other form of joint ownership and if the stockholder and his spouse divorced, the non-stockholder spouse agreed to sell her interest in the corporation to the stockholder spouse.<sup>121</sup> In the case of divorce, the Stockholder Agreement provided that the price the non-stockholder spouse would sell her interest to the stockholder spouse was to be the same as the amount the stockholder spouse would receive if he had to sell back his interest to the corporation.<sup>122</sup> Thus, a divorcing non-stockholder spouse was contractually obligated to sell her interest in the corporation to the stockholder spouse for \$25,000, or if she held only a one-half interest as would be the case under Louisiana's community property law, then for \$12,500.<sup>123</sup>

Within a year of the husband and wife signing the Stockholder Agreement, the wife filed for, and was granted, divorce.<sup>124</sup> During the partition of community property, the husband and wife disputed the value of the community's interest in the medical corporation.<sup>125</sup> The wife's expert, using a capitalization of cash flow method to value the community's interest, found that the value of the community's one-sixth interest in the medical corporation was between \$741,000 and \$1,349,000.<sup>126</sup> In utilizing the capitalization of cash flow method, the wife's expert acknowledged that goodwill was represented in his calculation.<sup>127</sup>

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118. *Id.* at 358.

119. *Id.* at 359. The wife disputed whether she was able to see the entire agreement or only the page on which she signed. *Id.*

120. *Id.* at 362.

121. *Id.*

122. *Id.*

123. *Id.* Under Louisiana Civil Code article 2336, each spouse has a one-half interest in any community property; thus, upon divorce, the non-shareholder spouse would have only a one-half interest in the shareholder spouse's interest.

124. *Rao*, 927 So. 2d at 359.

125. *Id.* at 364–65.

126. *Id.* at 365.

127. *Id.*

The husband's experts disputed the applicability of the method used by the wife's expert, instead asserting that the value of the community's interest was only the buy-sell amount stated in the Stockholder Agreement.<sup>128</sup> One expert for the husband, a certified public accountant, testified that he actually viewed the value of the husband's interest to be only \$2,000, which was the amount the husband actually paid to acquire the stock in the corporation.<sup>129</sup> In his testimony, the accountant acknowledged that the \$25,000 used in the Stockholder Agreement was "arbitrary" and bore no relation to the "profitability" of the corporation."<sup>130</sup>

The husband's other expert, a lawyer with a concentration in the health care industry who prepared the Stockholder Agreement for the medical corporation, similarly testified that the value of the community's interest was contractually limited to \$25,000.<sup>131</sup> In his testimony, the attorney stated that the inclusion of a valuation in the Stockholder Agreement was a regular practice for medical groups and served to financially protect "the corporation's ongoing business in the event of the departure of a stockholder physician."<sup>132</sup>

The *Rao* court, siding with the husband's experts, found that the Stockholder Agreement established a stipulated, binding value for the interest of the community.<sup>133</sup> In doing so, the court stated: "A stock transfer agreement which is unambiguous, clearly sets forth its terms, and is executed by capable parties is enforceable. The sell/buy provisions . . . were valid and binding stock transfer restrictions, and clearly governed the valuation of the stock."<sup>134</sup>

The court's conclusion that the buy-sell amount automatically established the fair market value of the community's interest in the corporation was based in part on a rejection of the wife's expert's use of goodwill.<sup>135</sup> Citing the newly enacted goodwill statute, the *Rao* court stated that "[t]he evidence clearly supports the conclusion that the hypothetical value postulated by [the wife's] expert accountant was largely based upon goodwill attributable to the personal qualities and patient relationships of [the husband] and his fellow stockholder physicians . . ."<sup>136</sup>

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128. *Id.* at 364–65.

129. *Id.* at 365.

130. *Id.* at 364.

131. *Id.*

132. *Id.*

133. *Id.* at 366.

134. *Id.* at 366–67.

135. *Id.* at 365.

136. *Id.*

The *Rao* court then concluded that any goodwill attributable to the husband or any other physicians with an interest in the medical corporation should not be incorporated into its valuation.<sup>137</sup>

Building on the decision in *Rao*, the Third Circuit in *Baumbouree v. Baumbouree* similarly held that a Shareholder Agreement that stipulated a purchase price for the shares in a medical corporation acquired by the community established the value of the community's interest in the corporation for purposes of partitioning community property.<sup>138</sup> In *Baumbouree*, the husband, a pediatrician, purchased one share of stock in a medical corporation consisting of other physicians.<sup>139</sup> In purchasing the stock, the husband signed a Shareholder Agreement, but the wife refused to sign the agreement.<sup>140</sup> The Shareholder Agreement provided that the purchase price for each share of stock was \$1,000.<sup>141</sup> The Shareholder Agreement further stated that the medical corporation would purchase a member's share in the event of the death of the shareholder, the suspension, revocation, or cancellation of the member's right to practice medicine in Louisiana, any restriction or limitation to the member practicing medicine, or the termination of the member's employment with the corporation.<sup>142</sup>

Upon the divorce of the husband and wife, the wife's expert testified that the function of a stated purchase price like that in the Shareholder Agreement was "to penalize the member/shareholder upon exiting the practice."<sup>143</sup> The wife's expert further stated that "two distinct intangible assets, goodwill and going concern value" had to be determined, and that "the subjective and static stated value contained in the shareholder agreement excludes all of the necessary elements which must be considered in quantifying either the fair market value or the fair value of the community property."<sup>144</sup> The husband, in contrast, argued that the Shareholder Agreement was binding on the community and provided the

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137. *Id.* at 366.

138. *Baumbouree v. Baumbouree*, 202 So. 3d 1077, 1082–84 (La. Ct. App. 3d Cir. 2016).

139. *Id.* at 1078.

140. *Id.* At the time the husband signed the agreement and tried to get his wife to sign it, the spouses were physically separated and contemplating divorce. *Id.* at 1080. The wife stated that the husband "told her that the purpose of the document was to protect the company, that it would not affect her, and that it had nothing to do with their divorce." *Id.*

141. *Id.*

142. *Id.*

143. *Id.* at 1080.

144. *Id.* (quotations omitted).

value of the community's share in the medical corporation, namely, \$1,000.<sup>145</sup>

The *Baumbouree* court agreed with the husband, finding that the facts were indistinguishable from *Rao*.<sup>146</sup> In doing so, the Third Circuit stated that it would be "irrelevant" and "inappropriate" to incorporate the goodwill or going concern value of the medical corporation or any physician in the group.<sup>147</sup> Citing *Rao*, the *Baumbouree* court noted that "the valuation of the stock in a 'close corporation,' such as a medical practice, . . . has the purpose of effecting 'an orderly transfer of ownership' should one of the physician shareholders have to leave the practice."<sup>148</sup> The court reasoned that because the husband would only be paid \$1,000 if he left the practice due to any of the reasons provided in the Shareholder Agreement, the community's interest in the medical corporation was \$1,000.<sup>149</sup>

In his dissent in *Baumbouree*, Judge Saunders found that the Shareholder Agreement only purported to assign a value to the stock in the limited instances in which the husband had to transfer the interest back to the medical corporation, and those instances did not include divorce.<sup>150</sup> Further, Judge Saunders argued that although the Shareholder Agreement stated a value for the stock, ownership of the stock inured to the husband a multitude of benefits, thus making its value to the husband and, in turn, the community, greater than the amount stated in the Shareholder Agreement.<sup>151</sup> To support his conclusion, Judge Saunders cited earlier decisions, such as the aforementioned cases of *Borrello* and *Fastabend*.<sup>152</sup>

With both *Rao* and *Baumbouree* decided, it was not long before other courts followed suit. In the aforementioned 2017 case *Bulloch v. Bulloch*, a husband-physician acquired an interest during the marriage in

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145. *Id.* at 1079–80.

146. *Id.* at 1083. The court found it irrelevant that, unlike in *Rao*, the wife in *Baumbouree* did not sign the Shareholder Agreement because the husband had the exclusive right to manage the community's stock interest in the medical corporation. *Id.* at 1084. Judge Saunders, in his dissent in *Baumbouree*, agreed with the majority that the husband had exclusive authority to manage the stock. *Id.* at 1085 (Saunders, J., dissenting).

147. *Id.* at 1084.

148. *Id.*

149. *Id.*

150. *Id.* at 1085 (Saunders, J., dissenting); *see also* David M. Prados, *Family Law*, 64 LA. B.J. 453, 453 (2017).

151. *Baumbouree*, at 1085–86 (Saunders, J., dissenting).

152. *Id.* at 1086 (Saunders, J., dissenting); *see also supra* Part I (discussion of *Borrello* and *Fastabend*).

Orthopedic Clinic Enterprises where the husband was an affiliated physician.<sup>153</sup> The Shareholder Agreement signed by the husband, but not by the wife, stated that in the event of the divorce of one of the members, the member–spouse had the “obligation to purchase all of the interest of his spouse in the shares of [Orthopedic Clinic Enterprises] for a price determined according to this Agreement.”<sup>154</sup> The Shareholder Agreement further stated that “the terms of this Agreement are binding upon the interests and rights of the spouse of any shareholder.”<sup>155</sup> Finally, the Shareholder Agreement established a formula for calculating the buy-sell amount that any shareholder was owed upon leaving Orthopedic Clinic Enterprises.<sup>156</sup> Just as experts in the previous cases noted, the husband attested that “[t]he Shareholder Agreement and Buy-Sell Agreements were designed for valid business reasons to control the transfers and amounts in order to protect business interests and provide for orderly buy-ins and buy-outs.”<sup>157</sup>

Applying the formula stated in the Shareholder’s Agreement put the husband’s interest in Orthopedic Clinic Enterprises at \$19,500.<sup>158</sup> The wife’s expert valued the community’s interest in Orthopedic Clinic Enterprises at \$1,960,530.<sup>159</sup> Following the decisions of *Rao* and *Baumbouree*, the *Bulloch* court easily held that the Shareholder Agreement signed by the husband–physician, but not by the wife, established the value of the husband’s interest in Orthopedic Clinic Enterprises.<sup>160</sup>

The outcome of *Bulloch* is not surprising given the results in *Rao* and *Baumbouree*, but the case is noteworthy for showing how financially valuable a Shareholder Agreement can be for the member–spouse during a divorce. In addition to acquiring an interest in Orthopedic Clinic Enterprises while married, the husband–physician in *Bulloch* similarly

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153. *Bulloch v. Bulloch*, 214 So. 3d 930, 935 (La. Ct. App. 2d Cir. 2017); Original Brief on Behalf of Plaintiff/Appellant, Lydia Clare Bulloch, at 17, *Bulloch*, 214 So. 3d 930 (No. 13-2820-3).

154. Original Brief on Behalf of Plaintiff/Appellant, Lydia Clare Bulloch, at 19, *Bulloch*, 214 So. 3d 930 (No. 13-2820-3).

155. *Id.* at 18.

156. Written Reasons for Judgment Regarding Partition of Community Property, at 7–8, *Bulloch*, 214 So. 3d 930 (No. 13-2820-3); Original Brief Filed by Defendant-Appellee, at 12, *Bulloch*, 214 So. 3d 930 (No. 13-2820-3).

157. Original Brief Filed by Defendant-Appellee, at 12, *Bulloch*, 214 So. 3d 930 (No. 13-2820-3).

158. *Bulloch*, 214 So. 3d 930, 939.

159. *Id.* at 939.

160. *Id.* at 940–41.

acquired an interest in a medical limited liability company, the Advanced Surgery Center, while married.<sup>161</sup> Ownership in the Advanced Surgery Center and Orthopedic Clinic Enterprises substantially overlapped,<sup>162</sup> though the documents creating the interests in the two entities were different. The operating agreement that controlled the physicians' interests for the Advanced Surgery Center established a value at which the Center would purchase back a physician's interest if he disassociated from the Center, but the operating agreement did not include divorce or community property partition as a disassociation event.<sup>163</sup> Accordingly, the *Bulloch* court found that the operating agreement for the Advanced Surgery Center did not apply to the valuation of the husband's interest in the Center for purposes of partitioning the community property.<sup>164</sup> Instead, the court relied on the experts of the husband and wife, both of which used an income method to value the husband's interest in the Center.<sup>165</sup> In determining which expert to follow, the court was faced with the previously discussed issue of how to subtract goodwill attributable to the personal qualities of the husband from the overall valuation.<sup>166</sup> But the ultimate outcome highlights just how valuable a Shareholder Agreement can be if courts continue to follow *Rao*, *Baumbouree*, and *Bulloch*—the community's interest in the Advanced Surgery Center that did not have a controlling agreement was \$663,112,<sup>167</sup> whereas the community's interest in Orthopedic Clinic Enterprises that did have a controlling agreement was \$19,500.<sup>168</sup>

#### IV. UNRAVELING THE WRONGNESS OF *RAO*

*Rao*, *Baumbouree*, and *Bulloch* have created a trilogy of decisions that rely on faulty logic and defy how a community's interest in a business must be valued based on the statutory requirements of Louisiana's

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161. *Id.* at 935. The husband acquired a 5.1% interest in the Advanced Surgery Center. *Id.*

162. *Id.*

163. *Id.* at 936; Written Reasons for Judgment Regarding Partition of Community Property, at 10–11, *Bulloch*, 214 So. 3d 930 (No. 13-2820-3).

164. *Bulloch*, 214 So. 3d 9 at 936.

165. *Id.*

166. *Id.* at 937–39; *supra* Part III (discussing how the *Bulloch* court determined that goodwill was attributable to the husband–physician's personal qualities).

167. *Id.* at 939.

168. *Id.* at 940.



partition statute.<sup>169</sup> Louisiana Revised Statutes § 9:2801 establishes that the value of a community asset for purposes of partition is the “fair market value” of the asset at the time of trial.<sup>170</sup> Based on the plain text of the statute, courts have an obligation to determine the “fair market value” of any community asset to partition the community property.

*Rao* and its progeny incorrectly equate the stated buy-sell amount in an agreement with the fair market value of the member’s interest in the business. Certainly, it is an accurate statement that businesses, like medical corporations or law partnerships, can and should provide a buy-sell amount in the paperwork establishing the entity.<sup>171</sup> Establishing such an amount is “crucially important to resolve the question of price definitively in advance, leaving nothing to negotiation at the time of the actual transfer, when extrinsic factors (such as a breakdown in relationships) may make it difficult or impossible to achieve consensus.”<sup>172</sup>

The reality, however, is that buy-sell amounts are not inherently the fair market value of the business.<sup>173</sup> As discussed by Professors Glenn Morris and Wendell Holmes in their treatise on business organizations in Louisiana, buy-sell amounts serve different purposes, and the amounts an entity establishes should reflect the purpose the entity wants those amounts to serve. As the scholars state:

It is, however, probably fair to say that the price issue is rarely given the degree of serious consideration it deserves. Indeed, in many circumstances it appears that drafters are unaware that there are different functions which these agreements may serve, and that these functions should have some bearing on the way that the price for shares is set. For example, if control over participation is the

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169. See LOUISIANA DIVORCE, *supra* note 1, at 78–79.

170. LA. REV. STAT. § 9:2801(A)(1)(a), (A)(4)(a) (2018).

171. See GLENN G. MORRIS & WENDELL H. HOLMES, BUSINESS ORGANIZATIONS § 29.1, in 7 LOUISIANA CIVIL LAW TREATISE 727 (2d ed. 2017) [hereinafter BUSINESS ORGANIZATIONS]. *Rao*, *Baumbouree*, and *Bulloch* all make the unequivocally current point that such agreements are not contrary to public policy. See *Rao v. Rao*, 927 So. 2d 356, 366 (La. Ct. App. 1st Cir. 2005); *Baumbouree v. Baumbouree*, 202 So. 3d 1077, 1083 (La. Ct. App. 3d Cir. 2016); Original Brief Filed by Defendant-Appellee, at 12, *Bulloch*, 214 So. 3d 930 (No. 13-2820-3). That the agreements are not contrary to public policy, however, does not automatically lead to the proposition that the agreements are in fact representative of the fair market value of the business.

172. BUSINESS ORGANIZATIONS, *supra* note 171, at 742.

173. A buy-sell amount need not represent the fair market value of the business at the time the business is created, see BUSINESS ORGANIZATIONS, *supra* note 171, at 743–45, much less the fair market value of the business at the time of divorce.

primary goal, then the parties may wish to set a price which deliberately undercompensates a stockholder who wishes to dispose of his shares, thereby discouraging his withdrawal. On the other hand, the primary purpose of the agreement may be to insure that each shareholder receives the fair value of his investment. In this regard, a distinction might also be drawn between voluntary and involuntary transfers. A clear understanding of the parties' actual intent should thus precede the attempt to arrive at a pricing formula for their agreement.<sup>174</sup>

The buy-sell amount in an agreement can serve any legitimate purpose desired by the entity. The statutory requirement for valuing a community property asset, though, is to value the "fair market value" of the asset at the time of trial.<sup>175</sup> To the extent that the buy-sell amount reflects anything other than the fair market value of the business at the time of the trial of the divorce, the buy-sell amount should not be automatically equated to the business's fair market value.

That the drafters of a shareholder agreement or a partnership agreement could have alternative motives in setting the buy-sell amount was not lost on the court in *Rao*. In *Rao*, both experts who argued that the amount stated in the Shareholder Agreement should be used as the fair market value of the community's interest testified that the amount was "arbitrary," "bore no relations to the 'profitability' of the corporation," and served to financially protect "the corporation's ongoing business in the event of the departure of a stockholder physician."<sup>176</sup> The courts in *Baumbouree* and *Bulloch* made similar acknowledgements.<sup>177</sup>

As all three courts understood that there were legitimate business reasons that the particular entities set for a particular buy-sell amount, and that those amounts were to some extent arbitrary, it is difficult to accept that the courts viewed the buy-sell amount as the actual fair market value of the community's interest. More plausibly, it appears that the underlying rationale on which the courts rested was the notion that if the member-spouse left the business, he would receive only the stated buy-sell amount. The *Baumbouree* court highlighted this rationale expressly when it stated that "we note that if [the husband] is forced to sell his one share of . . .

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174. BUSINESS ORGANIZATIONS, *supra* note 171, at 742–43.

175. LA. REV. STAT. § 9:2801(A)(1)(a).

176. *Rao v. Rao*, 927 So. 2d 356, 364 (La. Ct. App. 3d Cir. 2016).

177. *Baumbouree v. Baumbouree*, 202 So. 3d 1077, 1080 (La. Ct. App. 3d Cir. 2016); Original Brief Filed by Defendant-Appellee, at 12, *Bulloch v. Bulloch*, 214 So. 3d 930 (La. Ct. App. 2d Cir. 2017) (No. 13-2820-3).

stock back to the corporation upon the occurrence of any of the triggering events . . . he will only be paid \$1,000.00 as fixed in that agreement.”<sup>178</sup>

*Baumbouree* is correct in its conclusion that if the husband left the medical corporation, he would receive only the buy-sell amount provided for in the agreement. The logic of automatically applying that amount as the fair market value of the community’s interest in the corporation is flawed, however, for multiple reasons.

First, although the individual member–spouse would receive only the buy-sell amount if he exited the business, that does not mean the business, as an entity, would be sold for only the buy-sell amount. Louisiana courts have repeatedly defined fair market value as meaning the price a willing buyer will pay a willing seller on the open market.<sup>179</sup> The fair market value for the business, be it a law partnership or a medical corporation, is the amount for which the business would be sold on the open market. The value of the community’s interest in the business is then the community’s share of what the overall business would be sold for on the open market.<sup>180</sup> The amount the business would be sold for on the open market may have no relation to the buy-sell amount established in a shareholder agreement.<sup>181</sup>

That the buy-sell amount is not inherently equal to the fair market value of the business is apparent from a simple example with law partnerships. A law partnership of three individuals might limit how much any individual partner can receive upon departing the firm to \$1,000 to make it financially disadvantageous for a partner to leave. If the three-person law firm is purchased by a larger law firm, the price that the larger law firm pays the three-person partnership is not limited to the aggregate buy-sell amount from the three partners’ agreement of \$3,000. In such a situation, assuming the three partners shared equally in the profits of their

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178. *Baumbouree*, 202 So. 3d at 1084.

179. *See Exxon Pipeline Co. v. Hill*, 788 So. 2d 1154, 1160 (La. 2001) (defining fair market value for purposes of expropriation); *Dep’t of Highways v. Tolmas*, 113 So. 2d 288, 290 (La. 1959) (same); *Shopf v. Marina Del Ray Partnership*, 549 So. 2d 833, 839 (La. 1989) (defining fair market value for purposes of a partner withdrawing from a partnership); *Thomson v. Thomson*, 978 So. 2d 509, 514–15 (La. Ct. App. 3d Cir. 2008) (applying the fair market value definition from *Shopf* to the community property partition statute).

180. *E.g.*, *Fancher v. Prudhome*, 112 So. 3d 909, 912 (La. Ct. App. 2d Cir. 2013) (affirming the trial court taking the value of an LLC, then multiplying the overall LLC’s value by one-third, the amount of the withdrawing member’s interest).

181. *See Brett R. Turner, Theories and Methods for Valuing Marital Assets*, 52 J. AM. ACAD. MATRIM. LAW. 1, 33–34 (2012).

original partnership, the three partners would equally share in whatever amount the larger law firm paid to purchase their partnership.

The second logical flaw in assigning a business only the buy-sell amount—because that is the amount the member-spouse would receive if he departed the business—is that none of the courts mentioned any evidence that the member-spouse was actually leaving the business. Louisiana courts have generally rejected taking hypothetical or speculative facts into account when valuing the community's interest in a business.<sup>182</sup> If the member of a business with a Shareholder Agreement is in fact leaving the entity simultaneously to his divorce, that certainly could impact the fair market value of the member's interest in the business,<sup>183</sup> but such facts were never presented in the cases of *Rao*, *Baumbouree*, or *Bulloch*.

Third, given that *Rao* and *Baumbouree* discussed goodwill and the goodwill statute enacted after *Ellington*,<sup>184</sup> it appears that the courts erroneously extended the logic that the member-spouse would only receive the buy-sell amount if he exited the business one step further. In doing so, the courts assumed that because the member-spouse would receive only the buy-sell amount upon exiting, then any value of the business over and above the buy-sell amount must be attributable to the *future* value of the business, or what might otherwise be referred to as

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182. See, e.g., *Head v. Head*, 714 So. 2d 231, 238 (La. Ct. App. 2d Cir. 1998); *McGehee v. McGehee*, 543 So. 2d 1126, 1128–29 (La. Ct. App. 1st Cir. 1989); *Segura v. Comeaux*, 279 So. 3d 418, 421 (La. Ct. App. 3d Cir. 2017); *Nesbitt v. Nesbitt*, 15 So. 3d 1229, 1232 (La. Ct. App. 2d Cir. 2009); see also *supra* Part I (discussing Louisiana cases in which courts have refused to take speculative facts into account). Other jurisdictions have rejected speculative facts when valuing at divorce the marital estate's interest in a business created during marriage. E.g., *Bowen v. Bowen*, 473 A.2d 73, 79 (N.J. 1984); *Cole v. Cole*, 110 S.W.3d 310, 315–16 (Ark. App. Ct. 2003).

183. It is worth noting that although the fair market value of a member's interest in a business could be impacted if the member in fact departed the business simultaneously to his divorce, a spouse cannot fraudulently depart a business in an effort to decrease the value of the community property subject to partition. See LA. CIV. CODE art. 2354 (2018) (“A spouse is liable for any loss or damage caused by fraud or bad faith in the management of the community property.”); *Thigpen v. Thigpen*, 91 So. 2d 12, 20 (La. 1956), *overruled on other grounds*, *Fowler v. Fowler*, 861 So. 2d 181 (La. 2003); MATRIMONIAL REGIMES, *supra* note 1, at 482–93.

184. *Rao v. Rao*, 927 So. 2d 356, 365–66 (La. Ct. App. 1st Cir. 2005); *Baumbouree v. Baumbouree*, 202 So. 3d 1077, 1082–83 (La. Ct. App. 3d Cir. 2016).

goodwill.<sup>185</sup> Although there may be mathematical ease in making such an assumption, it is simply incorrect. The valuation of a business is based on a series of assets, goodwill being but one. Goodwill might account for some of the value of the business over the stated buy-sell amount, but goodwill does not inherently account for all of the excess value.

A simple example showcases the logical flaw in assuming that any amount in excess of the buy-sell amount is attributable to goodwill. Before being purchased by the larger law firm, the small three-person law partnership acquires an office building valued at \$250,000. The firm then purchases computers, desks, tables, and other movable assets necessary to operate a law firm. The value of the movable and immovable assets of the partnership is \$350,000. Recall, the partnership agreement sets the buy-sell amount for each partner's shares at \$1,000. It is obvious that the value of the law partnership is not \$3,000. At a minimum, the value of the partnership is \$350,000, which is the value of the physical assets held by the partnership. It would be incorrect to find that all of the value above \$3,000 is attributable to the goodwill of the partnership.

Finally, *Rao*, *Baumbouree*, and *Bulloch* focus on the fact that the member-spouse has the legal authority to manage the community's interest in the business.<sup>186</sup> The courts are correct that the spouse in whose name stock is issued has the exclusive right to manage the stock,<sup>187</sup> and the spouse who is a member of a partnership or a limited liability company has the exclusive right to manage that interest.<sup>188</sup> In exercising his exclusive managerial authority, the member-spouse can bind the community with respect to third parties.<sup>189</sup> Thus, if the managing spouse exited the business while married, the community would certainly be bound to receive only the buy-sell amount to which the managing spouse contractually agreed. Such a result would be a legitimate exercise of the managing spouse's sole managerial authority.

What a spouse with sole managerial authority cannot do, however, is use his sole managerial authority to contractually bind the spouses vis-à-vis one another. Under basic contract law, parties may create obligations between themselves, but those contractual obligations bind the parties to

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185. This rationale was expressly adopted by a Texas court in *R.V.K. v. L.L.K.*, 103 S.W.3d 612, 619 (Tex. App. Ct. 2003).

186. *Bulloch v. Bulloch*, 214 So. 3d 930, 940–41 (La. Ct. App. 2d Cir. 2017); *Rao*, 927 So. 2d 356, 366–67; *Baumbouree*, 202 So. 3d 1077, 1083.

187. LA. CIV. CODE art. 2351.

188. *Id.* art. 2352.

189. See MATRIMONIAL REGIMES, *supra* note 1, at 397–99.

the contract, not third parties.<sup>190</sup> This principle is easily recognizable in the sale of a house. If a seller enters into a contract with a buyer to sell a house for \$300,000, the parties to the contract are bound by that agreement. The tax assessor, however, is not bound by the contract between the buyer and seller.<sup>191</sup> If the reasonable market value of the house is actually \$350,000, the tax assessor will assess taxes based on the amount of \$350,000, not the price contracted for by the buyer and seller.

The same house example applies in the community context as well. If a wife, while married, purchased a house for \$300,000, the house would be a community asset as it was acquired during marriage.<sup>192</sup> If the spouses file for divorce on the following day, then the house would be included in the partition of the community. If the fair market value of the house was actually \$350,000 instead of the \$300,000 that the wife paid, the husband would not be bound to value the house for purposes of the partition at only \$300,000.<sup>193</sup> The *community* would be bound to pay the seller only \$300,000 for the house, but as between the spouses, the contract would not be binding with regard to its value for purposes of partition.<sup>194</sup>

Businesses, although perhaps more complicated to value than houses, operate just like the house example. A spouse, exercising his managerial authority, can contractually obligate the community to receive a certain amount should the member-spouse exit the business while married. That

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190. Obligations in Louisiana law establish a legal relationship between the obligor and obligee only. *See* LA. CIV. CODE art. 1756; *see also* MATRIMONIAL REGIMES, *supra* note 1, at 397 (noting that under the basic principles of obligations, “in absence of an intent to benefit a third person, only the persons who are party to a contract are affected by it”).

191. *E.g.*, *Park Esplanade Ltd. Partnership v. Williams*, 577 So. 2d 1028 (La. Ct. App. 4th Cir. 1991) (finding that the actual value of a house, and thus the amount on which taxes should be assessed, was lower than the purchase price).

192. LA. CIV. CODE art. 2338.

193. *See generally* MATRIMONIAL REGIMES, *supra* note 1, at 761–65 (discussing that the actual value of the asset must be determined for purposes of partition).

194. The absurdity of applying the purchase price as the *de facto* value of a house for community property partition purposes is highlighted by the practice in some real estate markets in Louisiana of listing a trifling amount as the purchase price. *See* Kate Moran, *Buyers, Sellers Can Conceal Real Value of Property in Transaction Records*, *TIMES-PICAYUNE* (2009). If the stated purchase price for a \$1,000,000 house is “\$10 and other valuable consideration,” certainly upon divorce the spouses are not bound to value the house at only \$10.

contractual obligation, however, cannot bind the spouses vis-à-vis each other as to the value of the community's interest in the business.<sup>195</sup>

#### V. GETTING BACK TO THE GOOD: HOW COURTS SHOULD VALUE THE COMMUNITY'S INTEREST IN A BUSINESS

Valuing a community property business is unquestionably difficult and, as many Louisiana courts have noted, not an exact science.<sup>196</sup> The *Rao* court was correct to note that “[g]iven the dynamics of businesses and business practices, and factoring in circumstances that may be unique to the parties, an inflexible formula for determining business value would be impractical.”<sup>197</sup> The irony of *Rao*, then, is that courts have interpreted the *Rao* decision as creating an inflexible formula to determine business value, namely that the buy-sell amount is the de facto business value.

Prior to *Rao*, courts recognized that they did not have to accept at face value a party's claim of the valuation of an asset,<sup>198</sup> and at a minimum, courts should return to that practice. Undoubtedly, any buy-sell amount included in a partnership or shareholder agreement may be considered in

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195. To allow one spouse to use his exclusive managerial authority to bind the other spouse as to the value of community property would be permitting the managing spouse to unilaterally execute matrimonial agreements, which law clearly does not permit. *See* LA. CIV. CODE arts. 2329, 2331. Even if the law did permit one spouse to unilaterally execute a matrimonial agreement, none of the agreements in the *Rao* line of cases complied with the form requirements of a post nuptial agreement. *Id.* Louisiana courts have made clear that the form requirements of a postnuptial matrimonial agreement must be strictly construed. *E.g.*, *Acurio v. Acurio*, 224 So. 3d 935 (La. 2017). This is not to say that spouses could not bind themselves as to the value of the community's interest in a business. Certainly, spouses could execute a matrimonial agreement that assigned the value of the community's interest in any particular business. *See* LA. CIV. CODE art. 2330 (delineating the limited items spouses may not alter via matrimonial agreement).

196. *E.g.*, *Landry v. Simon*, 732 So. 2d 587, 589 (La. Ct. App. 3d Cir. 1999); *Ellington v. Ellington*, 842 So. 2d 1160, 1166 (La. Ct. App. 2d Cir. 2003); *Head v. Head*, 714 So. 2d 231, 232 (La. Ct. App. 2d Cir. 1998).

197. *Rao v. Rao*, 927 So. 2d 356, 365 (La. Ct. App. 1st Cir. 2005); *see also Head*, 714 So. 2d at 234 (“Given the dynamics of businesses and business practices, factoring in circumstances that may be unique to the parties, an inflexible formula for determining value is said to be impractical.”).

198. *See McDonald v. McDonald*, 909 So. 2d 694, 698 (La. Ct. App. 2d Cir. 2005); *Ellington*, 842 So. 2d at 1166; *Alford v. Alford*, 653 So. 2d 133, 136 (La. Ct. App. 3d Cir. 1995).

the court's analysis, but such an amount should not be taken at face value as the fair market value.<sup>199</sup>

In valuing the community's interest in a business, courts need not restrict themselves to only reviewing how businesses are valued in other divorce cases; businesses are regularly valued in other areas of the law, particularly for tax purposes in the area of estate planning.<sup>200</sup> The method by which courts value businesses in this context can prove informative for courts handling a community property partition.

Just as the community property partition statute in Louisiana requires courts to determine the fair market value of each community property asset,<sup>201</sup> the fair market value of any asset, including business interests, must be determined for the purposes of calculating any estate taxes owed.<sup>202</sup> In such context, courts interpret fair market value as meaning the value at which a willing buyer and a willing seller would agree to exchange the property.<sup>203</sup> Just as courts have recognized in valuing businesses for a community property partition, courts recognize that valuations for tax purposes are not an exact science.<sup>204</sup>

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199. This is the majority view in other jurisdictions. *See, e.g.*, *Money v. Money*, 852 P.2d 1158, 1161 (Alaska 1993); *Barton v. Barton*, 639 S.E.2d 481, 482 (Ga. 2007); *Bailey v. Bailey*, 954 P.2d 962, 966 (Wyo. 1998); *Cole v. Cole*, 110 S.W.3d 310, 314 (Ark. App. Ct. 2003); *Bosserman v. Bosserman*, 384 S.E.2d 104, 108 (Va. 1989); *Bowen v. Bowen*, 473 A.2d 73, 79 (N.J. 1984); *In re Marriage of Huff*, 834 P.2d 244, 256–57 (Colo. 1992); *Drake v. Drake*, 809 S.W.2d 710, 713 (Ky. Ct. App. 1991); *Colclasure v. Colclasure*, 295 P.3d 1123, 1129 (Okla. 2012); *Burns v. Burns*, 643 N.E.2d 80, 83 (N.Y. Ct. App. 1994); *Von Hohn v. Von Hohn*, 260 S.W.3d 631, 640 (Tex. App. 2008); *Butler v. Butler*, 663 A.2d 148, 154 (Penn. 1995); *Argyle v. Argyle*, 688 P.2d 468, 471 (Utah 1984); *Lyon v. Lyon*, 439 N.W.2d 18, 20 (Minn. 1989); JOHN ELDER, HANDBOOK OF TEXAS FAMILY LAW § 10:2, in 33 TEXAS PRACTICE SERIES (2018) (noting that “[t]he correct value to be established is fair market value . . . . Other sums, such as the purchase price, or replacement cost are usually not relevant.”).

200. Neil H. Weinberg, *Valuation Adjustments to Transfers of Family*, 28 EST. PLN. 268, \*2 (2001). *See generally* Edwin T. Hood, John J. Mylan, & Timothy P. O’Sullivan, *Valuation of Closely Held Business Interests*, 65 UMKC L. REV. 339 (1997) (detailing the different manners in which a closely held business may be valued).

201. LA. REV. STAT. § 9:2801(A)(1)(a) (2018).

202. This is less relevant today given the high level of the estate tax, but it was a consideration previously.

203. *E.g.*, *U.S. v. Cartwright*, 411 U.S. 546, 550–51 (1973); *Estate of Andrews v. Comm’r of Internal Revenue*, 79 T.C. 938, 954 (1982).

204. *E.g.*, *Messing v. C.I.R.*, 48 T.C. 502, 512 (1967).



To aid in determining the fair market value of closely held corporations where comparable market equivalents are lacking, the Internal Revenue Service Ruling 59-60 provides a non-exclusive list of factors to consider.<sup>205</sup> The factors include: (1) the nature and history of the business; (2) the economic outlook for the business; (3) the book value of the business's stock and the current financial condition of the business; (4) the business's earning capacity; (5) the business's dividend-paying capacity; (6) any intangible assets of the business, such as goodwill; (7) the sales of stock of the business; and (8) the market price of stock of similar businesses.<sup>206</sup> These factors have become widely accepted as good practices for valuing closely held businesses.<sup>207</sup>

To the extent these factors are applicable for the particular business in question, courts—and lawyers—would be wise to at least consider the factors as courts have done in tax cases. In doing so, though, courts and lawyers must recognize that not all of the factors will be pertinent in every case. For example, rule 59-60 examines the goodwill of the business in determining its value.<sup>208</sup> To the extent that the goodwill of a business is attributable to the personal qualities of the spouse to be awarded the business, Louisiana courts are prohibited by statute from factoring it into the overall business valuation.<sup>209</sup>

Tax cases also provide a good example on how courts can recognize actual facts that may impact a business's valuation, as opposed to speculative facts.<sup>210</sup> For example, if an entity is on the brink of dissolution, courts are more likely to find the book value of the company to be its fair

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205. Rev. Rul. 59-60.

206. Rev. Rul. 59-60; *see also* *Moody v. Moody*, 622 So. 2d 1381, 1384 (although the court did not follow the factors from ruling 59-60, one expert noted that the ruling provided accepted factors in calculating fair market value).

207. *See* James L. Rigelhaupt, *Valuation of Stock of Closely Held Corporations*, 2 AM. JUR. POF. 1, § 3 (2019).

208. Rev. Rul. 59-60.

209. LA. REV. STAT. § 9:2801.2 (2018); *supra* Part II (discussing goodwill under Louisiana law).

210. *See Snyder's Estate v. U.S.*, 285 F.2d 857, 861 (4th Cir. 1961) ("Closely held corporate stock cannot be valued reasonably by the application of any inflexible formula. One tailored to the particular case must be found, and that can be done only after a discriminating consideration of all information . . .").

market value,<sup>211</sup> whereas if a company will continue in operation, the book value is less indicative of the entity's fair market value.<sup>212</sup>

In addition to obtaining guidance from tax cases, other jurisdictions may also give guidance in calculating the fair market value of a business at divorce. Texas, a community property state, serves as a good comparison because Texas courts must similarly determine the fair market value of community assets to divide those assets upon divorce.<sup>213</sup> Moreover, in the valuation of a community property business, Texas jurisprudence similarly excludes goodwill attributable to the personal abilities of one spouse<sup>214</sup> but includes other goodwill not attributable to the personal qualities of a spouse.<sup>215</sup>

In examining the issue of whether a partnership agreement controls the value of the community's interest in the partnership, Texas courts have held that such partnership agreements do not automatically control the value of the community's interest in the partnership.<sup>216</sup> In *Von Hohn v. Von Hohn*, the husband was a partner in a law firm, and the law firm had a partnership agreement that included a specified amount the partner would be paid if he withdrew from the firm.<sup>217</sup> The husband testified that he had no plans to withdraw from the partnership.<sup>218</sup> The *Von Hohn* court

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211. *E.g.*, *Estate of Sobel v. Comm'r*, 10 T.C.M. (CCH) 613 (T.C. 1951) (using the book value as fair market value for a business that was likely to dissolve due to the death of a member who was the key factor in the business's success).

212. *See, e.g.*, *Rothgery v. U.S.*, 475 F.2d 591, 594 (Claims Ct. 1973) (using an asset valuation for an automobile dealer because that type of valuation was the industry norm); *Estate of Thalheimer*, 33 T.C.M. 87 (1974) (finding that if a company acts more like an investment company than an operating company, the company's valuation should be primarily based on the underlying net asset valuation of the company's shares).

213. *See R.V.K. v. L.L.K.*, 103 S.W.3d 612, 618 (Tex. App. Ct. 2003) (citing *Walston v. Walston*, 971 S.W.2d 687, 690 (Tex. App. Ct. 1998)). Unlike in Louisiana, however, Texas does not mandate that community property be divided equally upon divorce. *See Murff v. Murff*, 615 S.W.2d 696, 698–99 (Tex. 1981); *Bell v. Bell*, 513 S.W.2d 20, 22 (Tex. 1974).

214. *See Nail v. Nail*, 486 S.W.2d 761, 763–64 (Tex. 1972); *Hirsch v. Hirsch*, 770 S.W.2d 924, 927 (Tex. App. Ct. 1989); *Keith v. Keith*, 763 S.W.2d 950, 952 (Tex. App. Ct. 1989).

215. *E.g.*, *Finch v. Finch*, 825 S.W.2d 218, 224–25 (Tex. App. Ct. 1992); *Rathmell v. Morrison*, 732 S.W.2d 6, 18 (Tex. App. Ct. 1987); *Geesbreght v. Geesbreght*, 570 S.W.2d 427, 436 (Tex. App. Ct. 1978).

216. *See, e.g.*, *Von Hohn v. Von Hohn*, 260 S.W.3d 631, 640 (Tex. Ct. App. 2008); *Keith v. Keith*, 763 S.W.2d 950, 953 (Tex. App. Ct. 1989).

217. *Von Hohn*, 260 S.W.3d at 640.

218. *Id.*

found that the withdrawal amount provided for in the partnership agreement had no bearing on the community's interest in the partnership because the withdrawal amount did not represent the actual value of the community's interest based on the actual facts and circumstances of the spouses at the time of divorce.<sup>219</sup>

In reaching a value for the community's interest in the husband's law partnership, the *Von Hohn* court also provided an insightful discussion of what courts in Texas can and cannot consider. The court made clear that the valuation of the law partnership was to be based on its value at the time of divorce; future profits generated by future efforts of the husband were not to be considered because those profits would be generated *after* the divorce and thus would not be part of the community.<sup>220</sup> The court also recognized in valuing the law partnership, however, that income of the firm attributable to labor that occurred during the marriage must be included in the partnership valuation, even if that income had yet to be collected.<sup>221</sup>

In the more recent case of *Mandell v. Mandell*, the Texas appellate court found that the shareholder agreement's buy-sell amount did control the value of the community's interest in the husband's medical association,<sup>222</sup> but the court gave a number of important caveats in its holding. The *Mandell* court distinguished *Von Hohn* on the basis that the partnership agreement in *Von Hohn* did not include divorce as an event that triggered the application of the withdrawal amount, whereas the shareholder agreement in *Mandell* expressly named divorce as a triggering event.<sup>223</sup>

More importantly, the *Mandell* court provided guidance for what the wife failed to prove at trial:

[The wife's] offer of proof likewise did not include evidence that the actual value of the stock to [the husband] was greater than the \$11,000 "buy/sell" price by showing that by virtue of ownership of the closely held stock, he obtained benefits such as driving a new automobile, having health insurance paid for by the company, having a company-financed life insurance policy, belonging to a

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219. *Id.*

220. *Id.* at 641.

221. *Id.*

222. *Mandell v. Mandell*, 310 S.W.3d 531, 540–41 (Tex. Ct. App. 2010).

223. *Id.* at 540. The reliance on this distinction is similar to the *Rao* court's reliance on the fact that the shareholder agreement included divorce. *See Rao v. Rao*, 927 So. 2d 356, 362 (La. Ct. App. 1st Cir. 2005). As argued herein, the reliance on divorce as a triggering event is misplaced in both cases. *See supra* Part IV.

country club at company expense, or gaining any other similar financial benefit. Because [the wife's] offer of proof did not include testimony or evidence that might have been relevant to establish that the value of [the husband's] shares of stock to him was greater than the \$11,000 value set by the Shareholders Agreement, the trial court did not abuse its discretion by refusing to admit the valuation evidence propounded by [the wife].<sup>224</sup>

Implicit in the court's statement is that the wife *could* have shown that the fair market value of the community's interest in the medical association was greater than the buy-sell amount, but the wife did not put on the requisite evidence to do so. In making such a statement, the *Mandell* court recognized that a buy-sell amount may be considered the fair market value of a business, but it is not automatically assumed to be the fair market value. The parties may put on evidence to the contrary.

Separate property jurisdictions similarly must value business interests at divorce to equitably distribute the marital assets,<sup>225</sup> and separate property jurisdictions similarly battle with topics such as goodwill,<sup>226</sup> with many jurisdictions jurisprudentially reaching a similar result to Louisiana.<sup>227</sup> Thus, Louisiana courts can also turn to separate property jurisdictions in considering how to approach fair market valuations of businesses.

One recent opinion that may guide judges and lawyers in considering the types of questions to be asked when valuing a business for purposes of partitioning community property comes from the Supreme Court of Kentucky.<sup>228</sup> In determining the fair market value of a business created during marriage, the Supreme Court of Kentucky in *Gaskill v. Robbins* noted the difficulty in its task, but it went on to lay out the following common sense guidance:

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224. *Mandell*, 310 S.W.3d at 541.

225. *E.g.*, *Sullivan v. Sullivan*, 757 S.E.2d 129, 132 (Ga. 2014); *Carney v. Carney*, 167 A.3d 127, 131–32 (Pa. 2017); *Bair v. Bair*, 214 So. 3d 750, 752–58 (Fla. Ct. App. 2017).

226. *E.g.*, *May v. May*, 589 S.E.2d 536, 541 (W.Va. 2003); *Troyer v. Troyer*, 987 N.E.2d 1130, 1135 (Ind. Ct. App. 2013); *Hess v. Hess*, 927 A.2d 391, 395–96 (Me. 2007); *Nuveen v. Nuveen*, 795 N.W.2d 308, 312–13 (N.D. 2011).

227. *E.g.*, *Weigel v. Weigel*, 24 N.E.3d 1007, 1011 (Ind. Ct. App. 2015) (distinguishing between personal goodwill that is not a marital asset and enterprise goodwill that is a marital asset); *Ahern v. Ahern*, 938 A.2d 35, 40 (Me. 2008) (finding that goodwill attributable to one spouse's skill and reputation was not a transferable marital asset); *Beasley v. Beasley*, 518 A.2d 545, 556 (Pa. 1986).

228. *Gaskill v. Robbins*, 282 S.W.3d 306, 311–12 (Ky. 2009).

[W]hen a business is established during a marriage and is thus marital property, the trial court is required to fix a value and divide it between the spouses. To do this, a trial court must hear factual evidence, which generally will include expert testimony. If a court is to arrive at a fair market value of a business, often stated as what a willing buyer will pay a willing seller, the court must have the means to answer at least the following questions a willing buyer would ask:

1. What can be earned from the business over a reasonable period of time? This value must then be reduced to present value, and includes the concept of transferable goodwill.
2. What is the value of the hard assets? This includes real estate, equipment, client lists, cash accounts or anything else the business may own or control.
3. What is the value of the accounts receivable? This has a potential discount because all the accounts may not be collectible.
4. What is the value of the training of the personnel who will remain with the practice, or what is the cost to train new personnel?
5. What are the liabilities that will remain after the purchase? This includes personnel salaries, taxes, debt service, and other costs of doing business.<sup>229</sup>

Although valuing a business can be difficult for judges and lawyers alike, approaching the valuation from basic questions like those offered in *Gaskill* can make the task more manageable.

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229. *Id.* The questions posed by the court in *Gaskill* implicitly recognize that the buy-sell amount in an agreement is not inherently the fair market value of the business, and these questions also implicitly recognize that simply taking a net asset valuation of a business will not capture all of the assets of the business. *See* OLDHAM, *supra* note 10, at 271 (“A net asset valuation will undervalue most business, however, because that approach ignores the value of the business as a going concern. For this reason most appraisals include an analysis of the earnings or cash flow of a business.”).

## CONCLUSION

Businesses are ultimately an asset, just like a house or a car, and thus must be valued as part of the community upon partition. The valuation of a business may be more difficult than that of a house or a car because comparable businesses can be hard to find and a business's assets are usually comprised of both tangible and intangible items, such as goodwill.

Although valuing the community's interest in a business is difficult, it is doable. The statutory requirement in Louisiana is that courts must take the fair market value of the community's interest at the time of the trial for divorce. Buy-sell agreements may represent the fair market value in some cases, depending on the surrounding circumstances, but they cannot be accepted as the de facto fair market value.

Going forward, courts should return to their practices prior to *Ellington* and the creation of Louisiana Revised Statutes § 9:2801.2 concerning goodwill. Courts should weigh all of the expert testimony, consider what the best valuation method for a business is based on the actual facts surrounding the parties, and to the best of their ability reach a true fair market value for the community's interest. In doing so, courts can achieve the statutorily required equity for both spouses.