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Guide To Valuing Professional Partnership Interests For Purposes Of Equitable Distribution Of Marital Assets Pursuant To Pennsylvania Law: Interpreting And Applying Partnership Agreements

I. Introduction

In the proceedings surrounding the dissolution of a marriage, equitable distribution of marital property is a process often plagued with complications. Questions arise regarding the identification and valuation of marital assets owned by both spouses. Difficulties often present themselves when one spouse is a member of a partnership. Such an equity interest is difficult to value for purposes of equitable distribution. The inherent problem of valuing a partnership interest lies with the fact that the professional spouse¹ usually intends to remain in the partnership despite divorce. Thus, the value of the partnership interest attributable to the professional spouse cannot be ascertained by liquidation. Nor is there an active market for the purchase and sale of a professional partnership interest that can serve as a guide. Furthermore, the partnership interest may have a higher value to the partner who intends to retain it than to a third party buyer. Finally, the partnership interest may have limitations on its value imposed by the partnership agreement.

Accordingly, courts have adopted a variety of approaches to valuing a partnership interest.² The approaches have two common

1. This Comment will refer to the member of the partnership or business entity as the "professional spouse" or "partner". The spouse who is not a member of the organization at issue will be designated as the "nonprofessional spouse."

2. See generally, Wade R. Habeeb, Annotation, *Accountability for Good Will of Professional Practice in Actions Arising from Divorce or Separation*, 52 A.L.R.3d 1344 (1987); Martin J. McMahon, Annotation, *Valuation of Goodwill in Accounting Practice for Purposes of Divorce Court's Property Distribution*, 77 A.L.R. 4th 609 (1991); Martin J. McMahon, Annotation, *Divorce and Separation: Goodwill in Law Practice as Property Subject to*

threads: (1) a careful attention to the facts of each particular case, and (2) the goal of fairness to the parties via accuracy in valuation.

This Comment will examine the valuation of professional partnership interests in Pennsylvania, with an emphasis on the applicability of partnership agreements as a tool for valuation. Attention will also be given to the identification of distributable economic goodwill of a professional partnership. Part II sets forth general considerations for equitable distribution, including the policy behind the Domestic Relations Code which includes the statutory divorce guidelines of Pennsylvania. Part III briefly outlines the basis for recognizing a partnership interest as marital property subject to equitable distribution. Part IV discusses the basic means of valuing a partnership interest such as fair market value or holder's interest value. Part V addresses the identification of the goodwill of a partnership as a marital asset. Part VI examines the applicability of the partnership agreement as a tool for valuation of a partnership interest. Finally, Part VII synthesizes the courts' two primary approaches to valuation into a fact-specific guide to the applicability of partnership agreements for valuation purposes.

II. General Considerations Regarding Equitable Distribution

When enacting the Domestic Relations Code the policy of the Commonwealth of Pennsylvania was to "[e]ffectuate economic justice between the parties who are divorced . . . and insure a fair and just determination and settlement of their property rights."³ A court must equitably divide marital property upon the request of either party in an action for divorce or annulment.⁴ A court must not presume a fifty-fifty division when distributing marital property, because equitable distribution need not be equal, only equitable.⁵

Distribution on Dissolution of Marriage, 79 A.L.R.4th 171 (1992); Eve Barrie Masinter, *Professional Goodwill in Louisiana: An Analysis of its Classification, Valuation, and Partition*, 43 LA. L. REV. 119 (1982).

3. 23 PA. CONS. STAT. ANN. § 3102(a)(6) (1991).

4. *Id.* § 3502(a).

5. *Fratangelo v. Fratangelo*, 520 A.2d 1195, 1200-01 (Pa. Super. Ct. 1987). The court discusses at great length that the starting point of any equitable distribution analysis is the list of factors enumerated by the Divorce Code, 23 PA. CONS. STAT. ANN. § 401(d) (1990) (revised as 23 Pa. C.S.A. § 3323). *Fratangelo*, 520 A.2d at 1200-01. Moreover, the Pennsylvania Supreme Court has declared community property laws unconstitutional, and, therefore, "[t]o the extent that there is an automatic bestowal of the separate property of one spouse on the other, as is the law in community property states, it is unconstitutional as a

Thus, a court must consider each situation individually with reference to the factors set forth in the Domestic Relations Code⁶ in order to distribute the property in a fashion that will promote fair results.⁷ Consequently, a trial court commits no abuse of discretion merely because the parties do not receive equal shares of the marital assets.⁸

The actions of a court in equitably dividing marital property can be divided into three essential steps. The threshold step is the determination of what assets constitute marital property subject to distribution.⁹ The second step involves the accurate valuation of that property.¹⁰ Finally, the marital assets must be allocated between the parties while taking into account the factors enu-

deprivation of property in violation of due process." *Id.* at 1200 (citing *Everson v. Everson*, 431 A.2d 889 (Pa. 1981)).

6. 23 PA. CONS. STAT. ANN. § 3502(a). The section provides:

In an action for divorce or annulment, the court shall, upon the request of either party, equitably divide, distribute or assign in kind or otherwise, the marital property between the parties without regard to marital mis-conduct in such proportions and in such manner as the court deems just after considering all relevant factors, including:

- (1) The length of the marriage.
- (2) Any prior marriage of either party.
- (3) The age, health, station, amount and sources of income, vocational skills, employability, estate, liabilities and needs of each of the parties.
- (4) The contribution by one party to the education, training or increased earning power of the other party.
- (5) The opportunity of each party for future acquisitions of capital assets and income.
- (6) The sources of income of both parties, including, but not limited to medical, retirement, insurance or other benefits.
- (7) The contribution or dissipation of each party in the acquisition, preservation, depreciation or appreciation of the marital property, including the contribution of a party as a homemaker.
- (8) The value of the property set apart to each party.
- (9) The standard of living of the parties established during the marriage.
- (10) The economic circumstances of each party, including Federal, State and local tax ramifications, at the time the division of property is to become effective.
- (11) Whether the party will be serving as the custodian of any dependent minor children.

Id.

7. *Frantangelo*, 520 A.2d at 1203.

8. *Williamson v. Williamson*, 586 A.2d 967, 970 (Pa. Super. Ct. 1991). *See also Brown v. Brown*, 507 A.2d 1223, 1226 (Pa. Super. Ct. 1986) (holding that it is within a court's discretion to determine whether a property right was acquired during marriage and whether equity dictates that it be included as part of the marital estate).

9. *Schneeman v. Schneeman*, 615 A.2d 1369, 1371-73 (Pa. Super. Ct. 1992).

10. *Id.*

merated in the Domestic Relations Code as well as the ultimate goal of fairness in the distribution.¹¹

III. Recognition Of A Professional Partnership Interest As Marital Property Subject To Equitable Distribution

Pennsylvania Courts first recognized marital property in a partnership interest by implication in *Semasek v. Semasek*.¹² When addressing one spouse's depletion of funds in a banking account, the *Semasek* court held that the "intentional dissipation of marital assets by one party does not preclude the asset's status as marital property in equitable distribution."¹³ Extending this principle, the court found that one spouse's intentional interference with the other's law practice likewise constituted the dissipation of marital assets.¹⁴ Thus, the court implied that the growth of a partnership interest is a marital asset subject to equitable distribution.¹⁵

The Pennsylvania Superior Court applied its holding in *Semasek* to find the existence of marital property in such partnership interests as law firms,¹⁶ medical practices,¹⁷ architectural enterprises,¹⁸ equine clinics and horse breeding businesses,¹⁹ and dental firms.²⁰ Other jurisdictions have also recognized that partnership interests are marital property.²¹ The superior court noted, however, that although the general principle that an interest

11. *Id.* at 1374.

12. 479 A.2d 1047 (Pa. Super. Ct. 1984).

13. *Id.* at 1051. Accordingly, the court included the \$75,000 appropriated by one of the spouses from joint bank accounts in its calculations for equitable distribution. *Id.*

14. *Id.* at 1052 n.3. The court noted that the income of the professional spouse's private practice had declined over \$16,000 as a result of the nonprofessional spouse's behavior. Thus, the decline in salary was lost value of marital property within the purview of 23 PA. CONS. STAT. ANN. § 401(d)(7) (revised as 23 Pa. C.S.A. § 3323). *Semasek*, 479 A.2d at 1052 n.3.

15. *Id.* at 1051.

16. *Beasley v. Beasley*, 518 A.2d 545 (Pa. Super. Ct. 1986).

17. *DeMasi v. DeMasi*, 530 A.2d 871 (Pa. Super. Ct. 1987).

18. *Buckl v. Buckl*, 542 A.2d 65 (Pa. Super. Ct. 1988).

19. *Solomon v. Solomon*, 611 A.2d 686 (Pa. 1992).

20. *Fexa v. Fexa*, 578 A.2d 1314 (Pa. Super. Ct. 1990).

21. *See, e.g., Dugan v. Dugan*, 457 A.2d 1 (N.J. 1983) (holding that a husband's interest in a law practice, which he conducted through the means of a professional corporation in which he was the sole owner, was marital property); *E.E.C. v. E.J.C.*, 457 A.2d 688 (Del. 1983) (concluding that lawyer's interest in his practice, which he conducted as a sole proprietor, was marital property subject to equitable distribution).

in a partnership is easily determined,²² the absolute valuation of such an interest for purposes of equitable distribution is a difficult, if not impossible task.²³ Numerous states have recognized the problems inherent in the valuation of partnership interests.²⁴ For example, the New Jersey Supreme Court has stated: “[p]lacing a precise or even an approximately accurate value upon an interest in a professional partnership, when the partner whose interest is in question intends to continue as a member of the firm, is no easy matter.”²⁵

IV. Basic Valuation Methods For Partnership Interests

A court valuing a professional practice interest will seek to find a value that accurately reflects the worth of the asset. In most instances, the method used by any court will be fact specific rather than a predetermined formula.²⁶ Of primary importance to a court's analysis is the viewpoint from which it begins its calculations. For instance, if the value of the interest is to be based on what another party would pay in an arms-length transaction, then fair market value can be established. Alternatively, the “going concern” or “holder's value” will be ascertained if the court seeks to find the value of the interest to the partner continuing in the enterprise.

Fair market value is a widely recognized standard of value. For estate and gift tax purposes, fair market value has been defined as the price for which “property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and both having a reasonable knowledge of relevant facts.”²⁷ As a sales-based measure of value, fair market

22. *Buckl*, 542 A.2d at 67.

23. *Id.* The Pennsylvania Superior Court reiterated its concern with the difficulty of valuing partnership interests in *McCabe v. McCabe*, 543 A.2d 558, 559 (Pa. Super. Ct. 1988) when it said that “[j]udicial experience leads us to state that the difficulty in valuing marital property becomes more acute when the subject of the valuation becomes less tangible.”

24. *See, e.g., Mori v. Mori*, 603 P.2d 85 (Ariz. 1979) (ruling that accounts receivable by professional law corporations were marital assets includable in distribution of property). *But see, McClennon v. McClennon*, 464 P.2d 982 (Ariz. Ct. App. 1970) (holding that a trial court did not err in dividing community property in divorce proceedings when it evaluated husband's interest in law partnership even though the valuation did not account for the husband's share of accounts receivable).

25. *Stern v. Stern*, 331 A.2d 257, 260 (N.J. 1975).

26. *Butler v. Butler*, 663 A.2d 148, 154 (Pa. 1995).

27. *Treas. Reg. § 25.2512-1* (1958). Another definition of fair market value is the price that goods or property would bring in a market of willing buyers and sellers in the ordinary

value often conflicts with the possibility that the professional spouse will continue in a partnership after the divorce.²⁸ Nevertheless, fair market value provides a basis for valuing many of the components of a business entity that wholly comprise the value of the enterprise.

When valuing a partnership interest as a going concern, however, the focus of the analysis is on the value of the interest to the partner who plans to remain in the business.²⁹ Basically, if the interest in the business is worth considerably more to the owner than to another party, assuming the owner plans to continue to operate the business and reap financial rewards, then the value accorded to the business should be the higher value. This is determined by the owner's preference to continue in the enterprise,³⁰ and has been labeled the "holder's interest value."

In most instances, a court will value a business by combining the value of the separate components of the enterprise.³¹ Such an approach provides for easier valuation because individual assets, such as fixtures or accounts receivable, are part of an active market by which a value can be established. Thus, a court must look to a multitude of factors when valuing a partnership interest.³² Generally, the valuation of a partnership interest upon dissolution of a marriage involves the calculation of the professional spouse's share of the following combination of business assets:

capital investment, capital accounts, accrued equity, and
accounts receivable . . . any other fixed share of partnership

course of trade. Naturally, such value cannot be determined on the basis of a price that would be acceptable to a buyer or seller operating under pressures or constraints. BLACK'S LAW DICTIONARY 597-98 (6th ed. 1990).

28. Joseph W. Cunningham, *Equitable Distribution and Professional Practices: Case Specific Approach to Valuation*, 3 MICH. BUS. L.J. 666, July 1994.

29. *Id.* at 667.

30. *Id.* at 667-68. Cunningham notes, however, that the "holder's interest value" approach is not radically different from the case specific methods of valuation that have evolved and become generally accepted. This is due to the fact that the use of the holder's interest measure brings into conformity the valuation of personal service businesses with the way most other marital assets have been valued over the years. *Id.* A practice will likely possess value to the owner over and above that available on the fair market, and accordingly, the non-owner spouse should share in the higher value for purposes of equitable distribution. *Id.*

31. *Buckl v. Buckl*, 542 A.2d 65, 67 (Pa. Super. Ct. 1988) (relying on *Dag E. Ytreberg*, Annotation, *Evaluation of Interest in Law Firm or Medical Partnership for Purposes of Division of Property in Divorce Proceedings*, 74 A.L.R.3d 621 (1976)).

32. *Id.*

worth carried on the partnership books, the value of work in progress, any appreciation of the true worth of tangible personalty over and above book value, goodwill, if any, . . . and partnership life insurance.³³

A court will attempt to establish the total value of any property possessed by the enterprise. The partner's share of the above assets will provide a value for the partnership interest. Most of the assets listed above can be valued by ascertaining fair market value. Some portions of a business, however, are not as easily valued. Specifically, the intrinsic value of the business to the owner is often difficult to ascertain. Likewise, valuing the goodwill of a corporation is difficult when the business is not for sale.³⁴

Despite the difficulties in valuation, a court acting in equity has great discretion in examining the facts of a case and calculating what it deems to be a fair value.³⁵ Accordingly, the partnership agreement can be of great value in guiding a court by establishing what assets a partner owns as well as the priorities of the enterprise as a whole.³⁶

V. Goodwill As An Asset Subject To Equitable Distribution

While most assets of a business entity can be both easily identified and valued, the valuation of goodwill is more difficult and therefore problematic.³⁷ Goodwill has been narrowly defined as that element of the value of a business which arises in the fixed and favorable consideration of customers as their regard for an established, well-known, and properly operated business.³⁸ In other words, goodwill is the probability that prior customers will return to the business.³⁹ Goodwill is therefore distinguishable from the "going value" or "profits" of an enterprise.⁴⁰ When broadly defined, goodwill encompasses the advantage acquired by

33. Ytreberg, *supra* note 31, at 624-25. The formula has been adopted by numerous courts. See, e.g., *Stern v. Stern*, 331 A.2d 257, 261 (N.J. 1975); *Buckl*, 542 A.2d at 70; *In re Marriage of Morris*, 588 S.W.2d 39, 40 (Mo. Ct. App. 1979).

34. See part V, *infra*.

35. *Williamson v. Williamson*, 586 A.2d 967, 970 (Pa. Super. Ct. 1991).

36. *Buckl*, 542 A.2d at 70.

37. *Id.* at 68 (stating that "[t]he concept of goodwill is nebulous at best and consequently the placing of a dollar valuation is most difficult").

38. *Beasley v. Beasley*, 518 A.2d 545, 550 (Pa. Super. Ct. 1986) (relying on 38 C.J.S. *Goodwill* § 1 (1943)).

39. *Id.* at 550 (citing 38 AM. JUR. 2D *Goodwill* § 1).

40. *Id.* (relying on 38 C.J.S. *Goodwill* § 1 (1943)).

an establishment, beyond the value of property or funds, resulting from any factors contributing to the reputation of the business and public patronage.⁴¹ This advantage may be composed of any of the following factors: common celebrity, reputation for skill or affluence, punctuality, and other accidental circumstances or necessities, or even simply partialities or prejudices.⁴² Under any definition, goodwill is inseparable from the business in which it inheres because it has no independent existence; it is a product of the continuing efforts of the business.⁴³

Although the concept of goodwill is often difficult to define and value, Pennsylvania courts have established distinctions based upon the nature of the business and the efforts of the individual whose partnership interest is subject to equitable distribution.⁴⁴ In *Beasley v. Beasley*,⁴⁵ the Pennsylvania Superior Court addressed the issue of the goodwill of a sole proprietorship.⁴⁶ The court's analysis involved a comparison of the nature of goodwill possessed by a sole proprietor versus that held by a professional corporation.⁴⁷ In the former, goodwill cannot be transferred upon dissolution of the enterprise, while in the latter, goodwill has value which can be exchanged.⁴⁸ Simply stated, a sole proprietorship has goodwill, but that goodwill is attached to the owner rather than the enterprise itself.⁴⁹ The professional corporation, on the other hand, holds goodwill in the context of the association, or some share of it, as an entity separate and apart from the members that comprise it.⁵⁰ The court bolstered its opinion with the additional argument that the goodwill of a sole proprietorship can be related

41. *Id.* at 550 (quoting 38 AM. JUR. 2D *Goodwill* § 1 (1968)).

42. *Id.*

43. *Beasley*, 518 A.2d at 550 (relying on 38 C.J.S. *Goodwill* § 3 (1943)).

44. *Fexa v. Fexa*, 578 A.2d 1314, 1317 (Pa. Super. Ct. 1990). The court reiterated that the determination of whether alienable or realizable goodwill exists in a particular enterprise may "often be a difficult and subtle question of fact." *Id.* Additionally, the court questioned the ethics of selling professional clients, as encompassed by goodwill, because of the likely presence of client confidences, especially with regard to doctors and attorneys. *Id.*

45. 518 A.2d 545 (Pa. Super. Ct. 1986).

46. *Id.* The professional spouse, an attorney, operated the practice in the form of a sole proprietorship while employing approximately fifteen other attorneys. *Id.*

47. *Id.* at 552.

48. *Id.*

49. *Id.*

50. *Beasley*, 515 A.2d at 552. See also *Geesbright v. Geesbright*, 570 S.W.2d 427 (Tex. Ct. App. 1978).

only to the future earnings of the owner,⁵¹ and future income is not within the realm of marital property subject to equitable distribution.⁵² Based on the facts of the case, the superior court found that although the sole proprietorship had goodwill, it could not be included in the value of the enterprise for purposes of equitable distribution.⁵³

The superior court refused to allow goodwill to be added to the value of a business in situations, other than sole proprietorships, when the goodwill attaches itself only to an individual.⁵⁴ For example, the case of *DeMasi v. DeMasi*⁵⁵ involved a doctor who was a joint member of a partnership with another physician.⁵⁶ The professional spouse was a rheumatologist, who received patients from the community through a referral network composed of other physicians.⁵⁷ The patients patronized the business with the specific purpose of seeking the rheumatologist's expertise.⁵⁸ Thus, the doctor's partner would be incapable of retaining the patients if the rheumatologist left the firm.⁵⁹ Accordingly, the court found that although the business was a partnership and could continue without the professional spouse, the goodwill inherent in

51. *Beasley*, 515 A.2d at 553.

52. *Id.* See also *Hodge v. Hodge*, 520 A.2d 15 (Pa. 1986). The primary issue in *Hodge* was whether an advanced degree, such as a medical license, qualified as marital property. *Id.* at 16. In deciding that an advanced degree was not property for purposes of equitable distribution, the court analyzed earning capacity under Pennsylvania statutes. *Id.* at 17. In its analysis, the court reasoned that future income would be earned at a time after the dissolution of the marriage. *Id.* As a result, the future income cannot be marital property because any property classified as such must by definition be acquired during the marriage. *Id.*

53. *Beasley*, 518 A.2d at 554. *But see* *Holbrook v. Holbrook*, 309 N.W.2d 343 (Wis. Ct. App. 1981).

54. *DeMasi v. DeMasi*, 530 A.2d 871 (Pa. Super. Ct. 1987). See also *Levy v. Levy*, 397 A.2d 374 (N.J. Super. Ct. App. Div. 1978) (holding that goodwill generated by an attorney who operated a professional association was marital property subject to valuation); *Nehorayhoff v. Nehorayhoff*, 437 N.Y.S.2d 584 (N.Y. Civ. Ct. 1981) (stating that the goodwill of a medical partnership is distributable where patients are derived from advertisement, reputation or referral, and where the physician's skills were not unique in the area). *But see* *Dugan v. Dugan*, 457 A.2d 1 (N.J. 1983) (implying that goodwill in a sole proprietorship may be marital property in finding that attorney's goodwill in an exclusively owned corporation was marital property).

55. 530 A.2d 871 (Pa. Super. Ct. 1987).

56. *Id.* at 883.

57. *Id.*

58. *Id.* The court found that eighty-five percent of the doctor's patients were treated for rheumatism. *Id.* Further, seventy percent of the patients developed from the referrals of other physicians. *Id.*

59. *Id.* at 883.

the business was similar to the type of goodwill possessed by a sole proprietorship.⁶⁰ Specifically, the goodwill existed because of the doctor's personal reputation, and without his efforts, the firm would be unable to retain his clientele.⁶¹

In summary, the nature of the business will provide the most guidance and will aid in assessing the goodwill of an enterprise for purposes of equitable distribution.⁶² Specifically, the reputation established by the corporate entity as enhanced by the professional spouse must be analyzed. If the nature of the goodwill is purely personal to the individual and results only from the efforts of that person, then the goodwill is not likely to be an asset subject to equitable distribution. Such goodwill can be characterized by its inability to be transferred by or alienated from the professional because it would not survive disassociation of the professional spouse from the business entity.

Conversely, as the efforts of the individual become less substantial in enhancing the reputation of the business, the goodwill enjoyed by the enterprise becomes more a product and asset of the business itself. The value of such goodwill can be realized by the sale of the partnership, in whole or in part, to another. The goodwill, then, can be separated from the professional spouse, and it will last beyond the employment of the individual by the firm. Therefore, goodwill can be included in the value of the enterprise when the business is valued as a marital asset for equitable distribution.

VI. The Use Of The Partnership Agreement As A Guide To Valuation

Business enterprises are often founded with a partnership agreement that outlines the substantive rights of the partners regarding equity ownership in the organization.⁶³ Generally, the partnership agreement will indicate the considerations of the business that are most important to the enterprise.⁶⁴ The use of a partnership agreement, however, often presents difficulty because such agreements usually address valuation in the context of

60. *Demasi*, 530 A.2d at 883-84.

61. *Id.*

62. *See supra* notes 44-61 and accompanying text.

63. *McCabe v. McCabe*, 575 A.2d 87, 89 (Pa. 1990).

64. *Id.*

voluntary withdrawal, death of a partner, or dissolution of the firm.⁶⁵ Partnership agreements rarely address the valuation of a partner's interest vis a vis equitable distribution following the termination of a marital relationship.⁶⁶ Nevertheless, courts have found partnership agreements⁶⁷ and the Uniform Partnership Act⁶⁸ to be important factors for purposes of valuation because they indicate the value that can, in some instances, be removed from an enterprise by a partner.⁶⁹

A. *Pennsylvania Decisions*

The Pennsylvania Supreme Court has had two recent occasions to examine partnership agreements as valuation aids for equitable distribution. In *McCabe v. McCabe*,⁷⁰ the court found the terms of the agreement to be controlling, whereas in *Butler v. Butler*,⁷¹ the partnership agreement was disregarded after detailed consideration. This apparent contradiction turns on the accuracy of the agreement in valuing the current worth of the business enterprise. An examination of the facts of each case provides clues as to the court's view of what constitutes a partnership agreement valid for use in the context of equitable distribution.

In *McCabe*, the Pennsylvania Superior Court and the Court of Common Pleas disagreed as to the application of the partnership

65. *Buckl v. Buckl*, 542 A.2d 65, 70 (Pa. Super. Ct. 1988).

66. *Id.*

67. *Stern v. Stern*, 331 A.2d 257, 260 (N.J. 1975) (explaining that if a partnership agreement exists, valuation of the partner's interest can be attempted by reviewing the agreement). See also *Weaver v. Weaver*, 324 S.E.2d 915, 917 (N.C. Ct. App. 1985); *Holbrook v. Holbrook*, 309 N.W.2d 343 (Wis. 1981); *In re Marriage of Fonstein*, 126 Cal. Rptr. 264, 265 (Cal. Ct. App. 1976) (using partnership agreements as the starting point for valuation).

68. 59 PA. CONS. STAT. ANN. § 331 (1975) (repealed 1989). The section, which set forth the rights and duties of the partners in relation to the partnership agreement, provided:

The rights and duties of partners in relation to the partnership shall be determined, subject to any agreement between them, by the following rules:

(1) Each partner shall be repaid his contributions, whether by way of capital or advances to the partnership property, and share equally in the profits and surplus remaining after all liabilities, including those to partners, are satisfied; and must contribute towards the losses, whether of capital or otherwise, sustained by the partnership, according to his share in the profits.

Id.

69. *Buckl*, 542 A.2d at 70.

70. 575 A.2d 87, 90 (Pa. 1990).

71. 663 A.2d 148, 152-53 (Pa. 1995).

agreement for valuation purposes.⁷² The Pennsylvania Supreme Court found that the court of common pleas had overestimated the value of the enterprise by viewing it as a going concern.⁷³ Endorsing the view espoused by the superior court, the supreme court found the value which utilized the explicit terms of the partnership agreement to be accurate.⁷⁴ The supreme court qualified its decision by noting several factors specific to the particular partnership agreement.⁷⁵

The court believed that the business entity to be valued was different from many other types of enterprises, including other firms with partnership agreements.⁷⁶ First, the firm did not have a market through which shares in the organization could be bought or sold.⁷⁷ Second, a partner could not sell his share to another individual.⁷⁸ Such an opportunity could aid in valuation by revealing a fair market value for the firm or a portion thereof.⁷⁹ Third, a partner could not dictate individually that the firm be sold or liquidated.⁸⁰ Finally, a partner did not have the right to retire from the firm and continue to receive a share of the enterprise's profits.⁸¹ The court believed these factors to indicate that a valuation of the firm as a going concern was inaccurate for purposes of equitable distribution.⁸²

72. *McCabe v. McCabe*, 543 A.2d 558, 560 (Pa. Super. Ct. 1988), *aff'd* 575 A.2d 87 (Pa. 1990).

73. *McCabe*, 575 A.2d at 89. The court of common pleas disregarded the partnership agreement entirely when valuing the partnership interest at approximately \$286,000. *Id.* at 88. Included in the "going concern" value were all of the firm's assets, such as equipment, books, cash, etc., accounts receivable, minus accounts payable and an allowance for bad debt, and work in progress meaning services rendered but not yet billed. *Id.* The appraisal did not indicate any attempt at the valuation of goodwill. *Id.*

74. *Id.* at 88. The formula, as provided by the partnership agreement and utilized by the superior court in valuing the partnership interest at \$18,900, allowed a partner to receive a share of the capital account, minus any indebtedness to the firm, and, if ninety days notice was given, the partner's share of undistributed profits to date. *Id.* The formula was applicable for valuing a partner's interest in the firm regardless of the reason for leaving. *Id.*

75. *Id.* at 89-90.

76. *Id.* at 89.

77. *Id.*

78. *McCabe*, 575 A.2d at 89.

79. *Id.*

80. *Id.*

81. *Id.*

82. *Id.* at 89. The supreme court believed that valuation of the partnership interest as a going concern would be correct only when the partner could "sell, liquidate, or otherwise realize the going concern value." *Id.* The court believed that the facts had clearly

The court believed that the substantive rights of the partners as enumerated by the agreement could not be disregarded since the agreement strictly limited the value of the partner's interest that could in any event be realized.⁸³ Such value consisted of a share of the capital account, minus any indebtedness to the firm, and, if proper notice was provided, a share of undistributed profits to date.⁸⁴ The partnership agreement was designed to constrict the ownership interest of any partner in the firm, in an effort to place the "continuing welfare of the partnership as a whole above the interests of any particular member of the firm."⁸⁵ The court thought that such limitations could not be ignored in valuing the partner's interest for equitable distribution.⁸⁶ Additionally, the court noted that by the partner's association with the firm in the past, both parties had already benefitted from the continuing welfare of the firm.⁸⁷

A factually distinct situation in *Butler* caused the Pennsylvania Supreme Court to disregard the partnership agreement as the primary means of ascertaining the value of the professional spouse's interest in the partnership.⁸⁸ The professional spouse in *Butler* attempted to rely upon *McCabe's* strict adherence to the partnership agreement.⁸⁹ In disregarding the agreement, the supreme court emphasized several factors.

First, the agreement in *Butler* provided for two substantially different values depending on whether the partner died or voluntarily withdrew from the enterprise.⁹⁰ If the former occurred, the partner's beneficiary would receive the proceeds of a life insurance policy in the amount of \$100,000.⁹¹ In the latter instance, the partner would get only \$2,450, a sum calculated from the partner's shares of stock in the firm multiplied by a set value of \$10 per share.⁹² Thus, for purposes of equitable distribution

established that the going concern value could not be realized in any event. *Id.*

83. *McCabe*, 575 A.2d at 89 ("[T]he agreement must be viewed as the preeminent factor in valuing a partner's rights.").

84. *Id.*

85. *Id.* at 89.

86. *Id.*

87. *Id.* at n.4.

88. *Butler*, 663 A.2d at 153.

89. *Id.*

90. *Id.* at 150.

91. *Id.*

92. *Id.* at 150.

the partnership agreement did not provide a clear value of the interest in the firm held by the partner.⁹³ In contrast, the *McCabe* agreement allowed only one payment for a partner's interest regardless of the reason for departure from the firm.⁹⁴ Second, the professional spouse in *McCabe* was one of many partners in the firm,⁹⁵ while the individual in *Butler* was one of two partners at the time of separation.⁹⁶ Third, the value of the partnership in *Butler*, as based on the stock held by the members of the firm, had not changed in the nearly twenty years of the firm's operation.⁹⁷ Since the value of the firm was essentially predetermined, such a value did not reflect the company's current financial status.⁹⁸ Conversely, the partnership in *McCabe* was valued with a formula that considered the present day assets and liabilities of the firm.⁹⁹ The valuation in *McCabe* based on the partnership agreement incorporated the growth of the business entity during the time of the marriage and thus allowed for a more accurate assessment of the partnership interest as marital property.

The Pennsylvania Supreme Court's decisions in *McCabe* and *Butler* were based on different situations and partnership agreements. The court appeared to be guided by different goals in each case. In *McCabe*, the court found it determinative that the agreement limited the amount that the partner could realize for his interest in the partnership.¹⁰⁰ The court thought that injustice would result from any value greater than the dollar amount which

93. *Butler*, 663 A.2d at 150. Additionally, the shareholder agreement provided for termination of the partnership upon either bankruptcy, receivership or dissolution of the Company; the death of all stockholders within a ninety-day time period; or where only one shareholder remains under the agreement. *Id.*

94. *McCabe*, 575 A.2d at 88.

95. *Id.* at 89 n.3.

96. *Butler*, 663 A.2d at 150 n.2.

97. *Id.* at 153.

98. *Id.*

99. *McCabe*, 575 A.2d at 88.

100. *Id.* at 89. While the Pennsylvania Supreme Court paid little attention to the partner's situation arising from valuation of the partnership interest as a going concern, the Superior Court felt that such a resulting situation would be inequitable. *McCabe v. McCabe*, 543 A.2d 558, 561, (Pa. Super. Ct. 1988), *aff'd* 575 A.2d 87 (Pa. 1990). The court noted that termination of the professional spouse's partnership interest would leave the partner, at the age of 62, with only the partnership interest and \$26,000 worth of cash and property. *Id.* In equitable distribution proceedings, however, the nonprofessional spouse would receive \$301,000 worth of cash and personalty. *Id.* The court stated, "[T]his hardly appears equitable . . ." *Id.*

the partner could withdraw from the enterprise.¹⁰¹ In *Butler*, the court placed emphasis on the actual value of the partnership interest rather than on any realizable gain which could result when the partner disassociated from the firm.¹⁰² In each decision, the court believed its valuation to be the fairest possible and thus, appropriate in advancing the goal of fairness in equitable distribution.

Despite the difference between the two cases, both *McCabe* and *Butler* offer valuable guidance for using a partnership agreement as a valuation tool.¹⁰³ Initially, no single formula exists for valuing a partnership interest because such matters are fact specific. The partnership agreement remains the starting point for valuation, even if it is not determinative. The agreement should be examined to determine if it provides a clear value of the partner's interest. A value that is constant despite the reasons for the professional spouse's departure or a value designated specifically for purposes of equitable distribution will likely be helpful. Any method of valuation must have a basis in the current worth of the enterprise. Such a method will encompass the various assets of the firm at moments relevant to the divorce. Thus, a fixed value will likely be of no assistance. Furthermore, the valuation formula can provide clues as to the importance of the partnership as a collective of the individual members. Formulas that restrict the ability of a partner to remove portions of the assets will show that the continuing welfare of the enterprise is paramount. Accordingly, all characteristics of the business entity and the partnership agreement must be weighed in order to arrive at an accurate value which both fulfills the goals of the Domestic Relations Code¹⁰⁴ and effects a fair settlement of marital assets.

101. *McCabe*, 575 A.2d at 89. (The court stated that "[i]t would be unrealistic therefore to assign this [unrealizable] value to the partnership interest for purposes of equitable distribution.").

102. *Butler*, 663 A.2d at 153. The Pa. Supreme Court knew that under the terms of the partnership agreement, the partner would never be able to realize the value placed on the interest as a going concern. *Id.* Nevertheless, the court did not believe that the shareholder agreement should necessarily control valuation of the partnership interest. *Id.*

103. See *supra* notes 70-102 and accompanying text.

104. 23 PA. CONS. STAT. ANN. §§ 3102-3707.

B. Response of Other Jurisdictions to Equitable Distribution Situations Not Yet Examined by Pennsylvania Courts

While Pennsylvania courts have addressed the valuation of a partnership interest in various situations, the practices of other jurisdictions may serve as a guide to clarifying the process of valuation. All states seek to value a partner's interest in a business enterprise fairly, and the variations in a court's approach often can be accounted for by the circumstances of the action.

In many instances the usefulness of the partnership agreement lies somewhere between the Pennsylvania decisions in *McCabe* and *Butler*. Since most agreements anticipate only the voluntary withdrawal, death, or retirement of a partner, particular difficulty can arise when the values for each contingency are closer to one another than were the values in the *Butler* decision, but are still substantially different from that case. In situations of this nature, a court may review evidence that supports the greater likelihood of one contingency occurring as compared to another. For example, in *Balogh v. Balogh*,¹⁰⁵ the Court of Appeals of Minnesota reversed a trial judge who relied on one of three options in a partnership agreement for valuation without showing evidence to support his decision.¹⁰⁶ The professional spouse was not questioned regarding his future plans, but an expert did provide statistical evidence of the probable occurrence of each contingency addressed by the agreement.¹⁰⁷ Nevertheless, the trial judge was

105. 356 N.W.2d 307 (Minn. Ct. App. 1984).

106. *Id.* at 312. The partnership agreement provided three formulas depending upon the contingency which was addressed. *Id.* at 311. The purchase price in the event of death, normal retirement or full disability included the following: two and one half times the annual draw as defined by the three highest years in the preceding ten years of partnership, payable in sixty equal monthly installments without interest, and a pro-rata share of profit or loss for the year in which the partner left the organization. *Id.* In case of termination of interest and retirement from private practice in the State of Minnesota prior to normal retirement age, the price included: the greater of the prior year's draw or the partner's capital account at the close of the previous year, payable in twenty-four equal monthly installments, and a pro-rata share of the profit or loss for the year of termination. *Id.* In the case of termination of interest and continuation in private practice in the State of Minnesota, the purchase price was to be based on the following: the lesser of the partner's capital account at the close of the prior year or the previous year's draw, to be paid in twenty-four equal monthly installments. *Id.* The trial judge valued the partnership interest at approximately \$128,000 pursuant to the formula for death, normal retirement or full disability. *Id.*

107. *Id.* at 312. The expert determined that the likelihood of normal retirement, death or disability was twenty-five percent, the probability of early retirement was five percent, and the chance of termination to practice elsewhere was seventy percent. *Id.* While the trial

found in error for failing to support his conclusions, and the case was remanded to determine the chance of each contingency occurring in order to ascertain the proper valuation formula, or to allow an award based on the professional spouse's payout "if and when such benefits are paid."¹⁰⁸ A later Minnesota case, *Flynn v. Flynn*,¹⁰⁹ underscored the importance of evidence in the selection of a specific option for purposes of valuing a spouse's interest in a partnership. The court reiterated that "[a] valuation reasonably supported by . . . testimony will be affirmed."¹¹⁰

Therefore, the use of a particular contingency formula set forth by a partnership agreement will be upheld if sufficient reasons exist to support the choice. An appropriate goal for choosing a particular option has been its consistency in the accuracy of valuation. A voluntary withdrawal option provided guidance for an Indiana appellate court in *Peddycord v. Peddycord*.¹¹¹ The court held that the formula based on the voluntary withdrawal of a partner provided a more accurate assessment of value than did the formula applied in the event of a partner's death.¹¹² The opinion used an analogy based on a life insurance policy.¹¹³ Both the

judge had discretion to ignore these figures, the judge failed to incorporate any of the probabilities in the explanation for his conclusions. *Id.*

108. *Id.* (quoting *Janssen v. Janssen*, 331 N.W.2d 752, 765 (Minn. 1983)). The court of appeals believed either of the two alternatives would be satisfactory. *Id.* Thus, a valuation based on evidence that one particular option would likely occur would be just. *Id.* at 312. Alternatively, the payment based on the partnership interest could be distributed upon receipt. *Id.* The court analogized the present situation with *Janssen*, 331 N.W.2d at 752, which held that an unmatured pension could be divided at the time of marital dissolution but paid when the pension benefits were received because of the difficulty in valuing the pension benefits prior to vesting or maturity. *Id.*

109. 402 N.W.2d 111 (Minn. Ct. App. 1987). The agreement governing the law partnership provided formulas for three types of termination: death or permanent disability, withdrawal prior to retirement and termination at retirement. *Id.* at 116. In the first instance, the partnership interest was to be valued at a twelve-month share of the partner's allocated income; while in the second the partner received a sixth-month share of its allocated income. *Id.* In the last scenario, the partner received no additional compensation. *Id.*

110. *Id.* at 117 (quoting *Sefkow v. Sefkow*, 372 N.W.2d 37, 43 (Minn. Ct. App.), *remanded on other grounds*, 374 N.W.2d 733 (Minn. 1985)).

111. 479 N.E.2d 615 (Ind. Ct. App. 1985). See also *Weaver v. Weaver*, 324 S.E.2d 915 (N.C. Ct. App. 1985); *In re Marriage of Lewis* 336 N.W.2d 171 (Wis. Ct. App. 1983); *In re Marriage of Wilson*, 443 N.E.2d 31 (Ill. App. Ct. 1982); *Holbrook v. Holbrook*, 309 N.W.2d 343 (Wis. 1981); *Johnson v. Johnson*, 277 N.W.2d 208 (Minn. 1979).

112. *Peddycord*, 479 N.E.2d at 616.

113. *Id.* The court believed that such an analogy was appropriate when considering the payout provisions of each type of agreement. *Id.*

partnership agreement and the life insurance policy yielded lower payouts when the individual terminated the relationship at a time of his or her own choosing.¹¹⁴ The court deemed such values, which, similar to divorce itself, are based on voluntary withdrawal, more accurate because the decision was within the control of the person.¹¹⁵

In contrast, the death benefit option in a partnership agreement was used to calculate the value of a partnership interest in *Harmon v. Harmon*.¹¹⁶ While neither option in the partnership agreement, death or voluntary withdrawal of the partner, was likely to occur,¹¹⁷ the court found that the formula based on the death of the partner represented the value closest to economic reality.¹¹⁸

While many courts select a particular contingency provision in the partnership agreement for valuation purposes, other courts give little, if any, credence to the partnership agreement.¹¹⁹ Remembering that the goal of valuation is accuracy, a court need not restrict itself to using merely one or even any of the formulas as provided by the partnership agreement.¹²⁰ Such a limitation could be futile because agreements rarely contemplate valuation of the partnership interest for purposes of equitable distribution.¹²¹

Alternatively, a court could permit valuation of the partnership interest, but only when the professional spouse terminates the relationship with the firm.¹²² Thus, no award for the partnership

114. *Id.* at 617.

115. *Id.*

116. 578 N.Y.S.2d 897 (N.Y. App. Div. 1992). *See also* Stern v. Stern, 331 A.2d 257 (N.J. 1975) (holding that the calculation of a partner's interest upon death is probably the most accurate means of valuation).

117. *Harmon*, 578 N.Y.S.2d at 901-02. While the court conceded that the death benefit valuation was a fiction because the partner could not receive it, the court believed that the withdrawal option could also not be realized as the partner intended to continue with the firm. *Id.*

118. *Id.* at 902. Specifically, the court found the voluntary withdrawal formula to be inaccurate because it failed to include any interest in work in progress, uncollected accounts or goodwill, interests which the court believed to be of economic value to the continuing partner. *Id.*

119. *See, e.g., In re Marriage of Morris*, 588 S.W.2d 39 (Mo. Ct. App. 1979).

120. *In re Marriage of Morris*, 588 S.W.2d at 43. The court held that the trial court was in error for allowing the parties to successfully argue that the valuation was restricted to one of the methods in the redemption agreement. *Id.* The court believed that a true determination of value need not be limited only to formulas listed in the agreement. *Id.*

121. *Id.* at 44.

122. *Flynn v. Flynn*, 402 N.W.2d 111, 117 (Minn. Ct. App. 1987). *See* Balogh v. Balogh, 356 N.W.2d 307, 312 (Minn. Ct. App. 1984); *Janssen v. Janssen*, 331 N.W.2d 752, 756 (Minn. 1983).

interest would be available to the nonprofessional spouse at the dissolution of the marriage; rather, both the spouse and the partner would be required to wait for the happening of a contingency as enumerated by the partnership agreement before any payout.¹²³ At that time, each party would recognize a portion of the financial gain, if any, that is allowed by the agreement.¹²⁴ Such an approach would delay the division of the partnership interest as marital property; however, it would allow for an actual valuation rather than an approximation that burdens the professional spouse with the payment for a marital asset that, at the time of divorce, is essentially not liquid.

C. Limitations on the Inclusion of Goodwill by the Partnership Agreement

The value of goodwill possessed by a firm can be successfully insulated from equitable distribution. Goodwill has been found in large firms, but it is usually unrealizable and, therefore, unavailable for equitable distribution.

The Supreme Court of New Mexico addressed a partnership agreement that limited goodwill to \$1 in all cases unless another figure for goodwill was consistently shown on the corporation books.¹²⁵ The agreement had been followed by members of the firm on over 150 occasions for buy-ins and buy-outs of partners.¹²⁶ In each instance, goodwill was limited as per the agreement.¹²⁷ The fact that goodwill was limited in all circumstances indicated that the partnership agreement lacked an intent to frustrate any community property principles.¹²⁸ Accordingly, the court held that the non-shareholder spouse should be held to the terms of the partnership agreement as it affected the partner.¹²⁹ This prevented the non-shareholder spouse from realizing a value greater than that which the shareholder spouse could have received under the agreement.¹³⁰

123. Flynn, 402 N.W.2d at 117.

124. *Id.*

125. *Hertz v. Hertz*, 657 P.2d 1169 (N.M. 1983).

126. *Id.* at 1174.

127. *Id.*

128. *Id.*

129. *Id.*

130. *Hertz*, 657 P.2d at 1174. The court noted the inequity of compelling a professional practitioner to pay a spouse intangible assets that could not be realized by sale or liquidation. *Id.*

Similar reasoning was employed by the Court of Appeals of Texas in *Finn v. Finn*.¹³¹ The court found that “[w]ithout question the goodwill of a long established firm has commercial value.”¹³² Nevertheless, when it held that the goodwill of the enterprise was not subject to equitable distribution the court found certain factors decisive. First, the practice was conducted in the names of two retired founding partners rather than the partners currently senior in the firm.¹³³ Second, the professional spouse had been working for the firm for only twenty-five of the nearly one hundred years of the firm’s existence.¹³⁴ Finally, a partner could not receive a portion of the goodwill held by the firm under any circumstances including death or voluntary withdrawal.¹³⁵

The New Mexico and Texas courts’ limitations on the equitable distribution of goodwill by the partnership agreement were firmly based on factors also utilized by Pennsylvania courts in other situations. Both courts emphasized the significance of the fact that in no situation could the partners access the value of the firms’ goodwill.¹³⁶ Additionally, the *McCabe* court emphasized the efforts of the partnership agreement to keep the goodwill with the firm, indicating that the partners’ intention to place the prosperity of the firm above that of any individual member.¹³⁷ By enhancing the well-being of the business, each partner could thereby benefit in the future though continued efforts on behalf of the enterprise.¹³⁸

These considerations bear a striking similarity to those found important by the Pennsylvania Supreme Court in *McCabe*. *McCabe* emphasized that the fortune of the firm could be a legitimate goal that justified the limitations on the access of partners to the assets of the enterprise.¹³⁹ Additionally, *McCabe* found that the realizable value of the partnership interests was important.¹⁴⁰ Injustice could result when the spouse of a partner

131. 658 S.W.2d 735 (Tex. Ct. App. 1983).

132. *Id.* at 741.

133. *Id.*

134. *Id.*

135. *Id.* at 741-42.

136. *Hertz*, 657 P.2d at 1174; *Finn*, 658 S.W.2d at 742. See *McCabe v. McCabe*, 575 A.2d 87, 89 (Pa. 1990).

137. *McCabe*, 575 A.2d at 89, 89-90 n.4.

138. *Id.* at 89.

139. *Id.*

140. *Id.*

had greater access to the business assets than did the partner.¹⁴¹ The *McCabe* court also found decisive the fact that the value of a partner's interest remained virtually unchanged regardless of the reasons for departure from the firm.¹⁴² If a professional spouse's interest remained unchanged regardless of whether she left the firm voluntarily, by retirement, or because of death, then surely the value of that interest would be the same for purposes of equitable distribution.

Not all courts have allowed a restrictive partnership agreement to control whether goodwill exists for purposes of property distribution upon divorce. When deciding *In re Brooks*¹⁴³ the Court of Appeals of Washington found that the value of goodwill could be distributed at divorce even though it could not be sold or realized by the partner.¹⁴⁴ The important consideration was that the goodwill had value to the professional spouse as a member of the organization.¹⁴⁵ The Court of Appeals of Arizona reached the same conclusion in *Malloy v. Malloy*.¹⁴⁶ In this case, the partnership agreement provided for different valuation formulas depending upon the nature of the partner's withdrawal from the firm.¹⁴⁷ Accordingly, the court deemed the agreement to be only one factor for valuation purposes, and thus, emphasis was placed on the value of the goodwill to the partner.¹⁴⁸

The Pennsylvania Supreme Court briefly addressed the relationship between a partnership agreement and goodwill in

141. *Id.*

142. *McCabe*, 575 A.2d at 89.

143. *In re Marriage of Brooks*, 756 P.2d 161 (Wash. Ct. App. 1988) (relying on *In re Marriage of Fleege*, 588 P.2d 1136 (Wash. 1979)).

144. *Id.* at 163.

145. *Id.* at 162-63. See also *Mitchell v. Mitchell*, 732 P.2d 208 (Ariz. 1987) (ruling that a partnership agreement provided no value be placed on goodwill of firm even though the agreement considered payments to partner in the event of death or retirement that were not limited to tangible assets and accounts receivable, thus implying payment for goodwill); *In re Marriage of Slater*, 160 Cal. Rptr. 686 (Cal. Ct. App. 1979) (holding that a partnership agreement was not binding because it did not contemplate situation of equitable distribution upon divorce). But see *Hanson v. Hanson*, 738 S.W.2d 429 (Mo. 1987) (explaining that under certain circumstances value of goodwill may be established via buy-sell agreement); *In re Marriage of Ondrasek*, 377 N.W.2d 190 (Wis. Ct. App. 1985) (concluding that the value of a partner's interest for purposes of dissolution to be determined by monetary consequences of partner's withdrawal from business).

146. 761 P.2d 138 (Ariz. Ct. App. 1988).

147. *Id.* at 141.

148. *Id.* at 142.

Butler.¹⁴⁹ The court, having disregarded the partnership agreement as a guide to valuation, had no reason to apply the agreement's limitations as to goodwill.¹⁵⁰ Consequently, the court held that the nature of the goodwill in the business in question was to be considered.¹⁵¹ If the goodwill of the enterprise was attached only to the professional spouse, similar to a sole proprietorship, then the goodwill was not distributable.¹⁵² Conversely, any goodwill possessed by the corporation itself, divisible from the efforts of the individual members, was distributable.¹⁵³ The supreme court adopted a view different from both lower courts when it found that some, but not all, of the goodwill of the corporation was distributable upon divorce.¹⁵⁴

Again, the dichotomy in reasoning as evidenced by *McCabe* and *Butler* is apparent. In *Brooks* and *Malloy*, as in *Butler*, the value of the partnership interest to the individual partner is important. Therefore, the agreement does not take priority, and certain other factors again come into play. Specifically, the partnership agreement does not provide a clear value of the partner's interest because the value is subject to change depending upon whether the partner leaves the firm voluntarily or through some occurrence beyond the partner's control. The ability of the professional spouse to realize gain from ownership of the corporate asset, such as goodwill, is of no importance.

Thus, jurisdictions other than Pennsylvania offer some guidance on the ability of a partnership agreement to limit value of corporate goodwill as an asset subject to equitable distribution. In an effort to effect equity between parties, the courts will apply the restrictions and formulas set forth in partnership agreements only in certain situations.

149. *Butler v. Butler*, 663 A.2d 148, 155-56 (Pa. 1995).

150. *Id.* at 156.

151. *Id.*

152. *Id.* See, e.g., *Buckl v. Buckl*, 542 A.2d 65 (Pa. Super. Ct. 1988); *DeMasi v. DeMasi*, 530 A.2d 871 (Pa. Super. Ct. 1987); *Beasley v. Beasley*, 518 A.2d 545 (Pa. Super. Ct. 1986).

153. *Butler*, 663 A.2d at 155-56.

154. *Id.* at 156.

VII. General Guidelines For Determining The Applicability Of A Partnership Agreement To Valuing A Partner's Interest For Equitable Distribution

A court will value a partnership interest with the paramount goal of accuracy. Consideration will be given to the various assets of a business enterprise including both physical and intangible property. In most instances, a court will look first to the terms of a partnership agreement for a formula to aid in the valuation of a partner's interest. Based on precedent, Pennsylvania courts will likely follow one of two approaches when reviewing the partnership agreement. While initially a court may allow the agreement to limit the value of the partner's interest to a figure which can be realized upon departure from the firm, the court may later disregard realization as a measure and focus on the value of the interest to the partner as the sum available for equitable distribution upon divorce.

The following facts and circumstances may indicate, based on Pennsylvania precedent and persuasive authority of other jurisdictions relying on similar rationales, that the partnership agreement provides a valid formula for valuing a partner's interest in a firm.¹⁵⁵ The agreement and the formulas it sets forth must have a basis in the current value of the enterprise. Fixed or predetermined values will be of no use to achieve this goal. Provided the contingency options are based on the current assets and liabilities of the business, then a contingency option designed specifically for equitable distribution purposes will be controlling. Alternatively, contingency options which yield the same value regardless of whether the partner voluntarily withdraws, dies, or retires may provide guidance as well. A consistent value in many situations will allow a court to apply that value to equitable distribution. In addition, despite changing situations, a constant formula will indicate that the value of a partnership interest is realizable to only a certain extent. Such a limitation on the ability of a partner to access corporate assets may be enforced against the nonprofessional spouse as well.

The partnership agreement will indicate the priority of the needs of the firm over the desires of its members when the agreement limits the ability of a partner to withdraw assets. Such

155. See *supra* Part VI.A-B.

a consideration has been endorsed by the courts as a valid reason for restricting the value of a partnership interest.

Provided the partnership agreement conforms to the above criteria, it may limit the value of economic goodwill. Similar reasoning dictates that goodwill can be retained to benefit the enterprise as a whole. Goodwill that exists but is unrealizable for the partner can be excluded from equitable distribution.

Alternatively, the considerations listed below may signify that the partnership agreement does not provide an accurate means of valuation.¹⁵⁶ Partnership agreements that use formulas based on outdated asset valuation will likely be disregarded. Agreements which provide no clear value of a partner's interest will also be of little use. Specifically, contingency options in the agreement that change formulas depending upon whether the partner leaves involuntarily or by choice indicate that the agreement is ambiguous for purposes of equitable distribution. In such an instance, a court may not recognize the limitations of what value can be realized by a partner because the realizable value will change with the reason for departure.

Further, such a partnership agreement will likely be ineffective in limiting goodwill. The goodwill must first be established, however, by examining the nature of the business and the efforts of the partner in enhancing the reputation of the entity. If goodwill is possessed by the firm, then it is likely to be distributable. Goodwill attached to the professional spouse alone will not be considered a marital asset, and thus, the terms of the partnership agreement will be irrelevant.

VIII. Conclusion

Valuing a partnership interest for equitable distribution is a difficult but manageable task. Keeping in mind the goal of justice and fairness, as set forth by the Divorce Code, will aid in determining an accurate assessment of the worth of the partnership interest. Since the issues in equitable distribution are fact specific, precedent can provide guidance only in the form of general considerations for valuation. Accordingly, both the business

156. *See supra* Part VI.A-B.

enterprise and the governing partnership agreement must be analyzed to find an accurate valuation of a partner's interest for equitable distribution of marital assets upon divorce.

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