

1995

Mississippi's New Equitable Distribution Rules: The Ferguson Guidelines and Valuation`

Thomas W. Crockett

Walter P. Neely

Follow this and additional works at: <https://dc.law.mc.edu/lawreview>



Part of the [Law Commons](#)

Custom Citation

15 Miss. C. L. Rev. 415 (1994-1995)

This Article is brought to you for free and open access by MC Law Digital Commons. It has been accepted for inclusion in Mississippi College Law Review by an authorized editor of MC Law Digital Commons. For more information, please contact walter@mc.edu.

MISSISSIPPI'S NEW EQUITABLE DISTRIBUTION RULES: THE *Ferguson* GUIDELINES AND VALUATION

*Thomas W. Crockett**

*Walter P. Neely***

Although Mississippi has no detailed statutory system for dividing property between spouses in the event of a divorce, it now has a system of equitable distribution with an elaborate set of guidelines on dividing marital property. How did we get here, and what does it mean?

Until the mid-1980s, the Mississippi Supreme Court construed the statute providing that the court should make such orders as are "equitable and just," which has been on the books for over a century and a half, as principally providing for the support of a virtuous and deserving wife by her former husband to the extent of his means. Only in the last decade has the court begun fashioning a more reasonable system of dividing property, taking into account the changing position of women in our society and leading to a system of equitable distribution of marital assets.²

It is not surprising that, given the nature of the process and the inherent limitations in the shaping of common law, these guidelines and factors are not always consistent. One must remember that these rules are not the product of a systematic study of the problem, but are the product of a number of cases in which the court is called upon, based upon the factual situation before it, either to affirm or reverse a chancellor's finding and assert the rationale for its decision. Since the court is attempting to provide guidance for future decisions, much of what is written in the opinions is advisory in nature, and thus dicta. Considering these limitations on the decision-making process, the court has fashioned a reasonably workable set of guidelines. One criticism and caveat: As the court has set out these rules, statements contained in the advisory portions of the opinions may not have been thoroughly litigated nor briefed by the parties. Thus, of necessity, they are not as well thought out by the court. Therefore, all of these rules should not be accepted as

* Partner, Watkins, Ludlam & Stennis, Jackson, Mississippi. A.B., University of Mississippi, 1951; LL.B., Harvard University, 1956.

** J. Army Brown Chair of Business Administration, Else School of Management, Millsaps College, Jackson, Mississippi. B.S., M.B.A., Mississippi State University, 1967, 1969; Ph.D., University of Georgia, 1974. Walter Neely, Ph.D., C.F.A., is a consultant in corporate finance, investments, and the valuation of closely held businesses.

The authors are indebted to Aileen McNeill for her thorough research in exploring the political and economic condition of women in Mississippi since pre-Civil War days, and examining the effect this change in circumstances had on the court's decisions in interpreting the predecessors of Mississippi Code Annotated § 93-5-23 (1994), which has remained on the books substantially unchanged since at least 1846. To the surprise of both the authors and Ms. McNeill, her research demonstrated that the court's attitude toward the division of property between spouses in a divorce remained substantially unchanged until the mid-1980s.

1. MISS. CODE ANN. § 93-5-23 (1994).

2. For a treatment of the evolution of the equitable distribution theory through *Jones v. Jones*, 532 So. 2d 574 (Miss. 1988), see Thomas W. Crockett & J. Randall Patterson, *Dividing the Property in a Marital Dissolution*, 62 Miss. L.J. 57 (1992).

being written in stone. As new factual situations are presented, the body of law will, of course, grow.

I. THE DEVELOPMENT OF EQUITABLE DISTRIBUTION

Mississippi's version of equitable distribution evolved from the lump sum alimony award; however, it is more in the nature of an award to the payee spouse of an interest rightfully owned by the payee, rather than a fulfillment of a spouse's duty to support the other spouse. The principal differences are:

(1) The court may order a divestiture of title from one spouse to the other, rather than going through the mechanics of impressing an equitable lien on the asset.

(2) Fault, even adultery by the payee spouse, is not a factor unless it affected the accumulation of the property.

(3) The disparity between the separate estates of the spouses has diminished in its importance.

(4) Homemaking services are presumptively as important as breadwinning services.

The first case in Mississippi in which equitable distribution as a distinct concept was recognized was *Jones v. Jones*.³ The majority opinion affirmed an award of lump sum alimony reflecting an equitable division of the marital property of the spouses.⁴ Justice Lenore Prather, in her concurring opinion, reached the same result, but advocated that the court do away with the step of placing an equitable lien on the property and simply require a transfer of title from one spouse to the other.⁵ *Jones* was significant also because the court specifically found that the payee spouse had no great need for the distribution; she was simply entitled to it by her contributions to its accumulation.⁶

*Cleveland v. Cleveland*⁷ followed the lead in *Jones* reversing a lump sum alimony award as being inadequate,⁸ and, relying on factors set out in *Cheatham v. Cheatham*,⁹ held that the award should be increased, and that the spouse was entitled to an equitable share of the property accumulated during the marriage.¹⁰ *Box v. Box*¹¹ reversed a chancellor's findings of fact and pointed out the distinction between a lump sum award and an award of periodic alimony.¹² By this time, lump sum alimony was beginning to look more and more like equitable distribution. In *Pratt v. Pratt*,¹³ the court recognized that the husband was also entitled to lump sum

3. 532 So. 2d 574 (Miss. 1988).

4. *Id.* at 580-81.

5. *Id.* at 583 (Prather, J., concurring).

6. *Id.* at 580-81 (Robertson, J.).

7. 600 So. 2d 193 (Miss. 1992).

8. *Id.* at 197.

9. 537 So. 2d 435, 438 (Miss. 1988).

10. *Cleveland*, 600 So. 2d at 198.

11. 622 So. 2d 284 (Miss. 1993).

12. *Id.* at 288-90.

13. 623 So. 2d 258 (Miss. 1993).

alimony, but refused to award it to him.¹⁴ In *Bland v. Bland*,¹⁵ the court reaffirmed its view that the most important factor to be considered in awarding lump sum alimony was the separate income or separate estate of the parties.¹⁶ This is one of the distinguishing features between lump sum alimony and equitable distribution, in which cases disparity of separate estates is of little significance. *Draper v. Draper*¹⁷ removed the last barrier to equitable distribution by stating unequivocally that the chancellor had the power to order a party to convey title to both real estate and personal property in a divorce proceeding.¹⁸ The stage was now set for equitable division.

Equitable division as we know it today came into full flower in *Ferguson v. Ferguson*.¹⁹ Justice Prather wrote the majority opinion, which essentially adopted her concurring opinion in *Jones* and provided for the equitable division of marital assets.²⁰ Before dealing with how marital assets are divided, however, one must first determine what constitutes marital assets. *Hemsley v. Hemsley*,²¹ decided the same day as *Ferguson*, set out the following rule: "Assets acquired or accumulated during the course of a marriage are subject to equitable division unless it can be shown by proof that such assets are attributable to one of the parties' separate estates prior to the marriage or outside the marriage."²² This definition may be a bit simplistic; but, given the limitations of the decision-making process, it may be the best the court could do under the circumstances. *Johnson v. Johnson*²³ provides additional guidance on this issue. Even though most of this guidance consists of advice to the chancellor for use on remand, it is a unanimous decision comporting generally with the rules of other jurisdictions and contains several important points:

(1) It reaffirms the *Hemsley* rule that domestic contributions are presumed as valuable as breadwinning contributions, and that all property acquired after the marriage is subject to the presumption that it is marital property, but this presumption may be rebutted.²⁴

(2) It provides that separate property may be transmuted into marital property by commingling, and then transmuted back into separate property by uncommingling²⁵ (whether this rule will stand the test of vigorous advocacy remains to be seen).

14. *Id.* at 262, 264.

15. 629 So. 2d 582 (Miss. 1993).

16. *Id.* at 587.

17. 627 So. 2d 302 (Miss. 1993).

18. *Id.* at 305.

19. 639 So. 2d 921 (Miss. 1994).

20. *Id.* at 927.

21. 639 So. 2d 909 (Miss. 1994).

22. *Id.* at 914.

23. No. 92-CA-00957, 1994 WL 707269 (Miss. Dec. 21, 1994).

24. *Id.* at *3.

25. *Id.* at *4.

(3) It specifically holds that separate debts of a spouse, while not affecting the *nature* of the property as marital or not, will affect the *amount* of the marital property to be awarded.²⁶

*Davis v. Davis*²⁷ provides guidance on what constitutes marriage for the purpose of determining marital property, ultimately holding that mere cohabitation did not constitute marriage.²⁸ However, *Chrismond v. Chrismond*²⁹ indicates that cohabitation coupled with a mistaken belief that one is married may well be sufficient to constitute a marriage.³⁰ These are indeed interesting times for divorce practitioners.

Ferguson not only announced the principle of equitable distribution, it set out guidelines which, today, are the most important guidelines for chancellors and divorce practitioners. Even in his dissent in *Ferguson*, Chief Justice Armis Hawkins referred to them as "excellent factors;"³¹ and, today, these guidelines are now accepted by all members of the court.³² This is not to say that the pre-*Ferguson* factors have disappeared. *Ferguson* itself recognized that the guidelines for periodic lump sum alimony and child support set out in previous cases were still viable.³³ This view was confirmed by subsequent cases.³⁴

Let us now look at the *Ferguson* guidelines³⁵ and consider them in light of both earlier and later decisions.

A. Substantial Contribution to the Accumulation of Property

1. Direct or Indirect Economic Contribution to the Acquisition of Property

Substantial contribution to the accumulation of property is the most prominent of all the guidelines. In *Ruff v. Ruff*,³⁶ Chief Justice Hawkins, speaking for eight members of the court,³⁷ in reversing and remanding a chancellor's decision gave the following as his main advice on remand: "[A] chancellor must make a careful analysis of the parties' economic contributions to the marriage."³⁸

This contribution can be that of a homemaker, as well as that of a breadwinner.³⁹ In *Hemsley*, the court stated that there would be a presumption of an equal contribution to the marital assets.⁴⁰ However, later cases held that this

26. *Id.*

27. 643 So. 2d 931 (Miss. 1994).

28. *Id.* at 936.

29. 52 So. 2d 624 (Miss.), *cert. denied*, 342 U.S. 878 (1951).

30. *Chrismond*, 52 So. 2d at 630.

31. *Ferguson v. Ferguson*, 639 So. 2d 921, 938 (Miss. 1994) (Hawkins, C.J., dissenting).

32. *See Pierce v. Pierce*, 648 So. 2d 523, 529-30 (Miss. 1994) (Lee, J., dissenting).

33. *Ferguson*, 639 So. 2d at 929.

34. *Pierce*, 648 So. 2d at 525-26.

35. *Ferguson*, 639 So. 2d at 928.

36. 645 So. 2d 944 (Miss. 1994).

37. Justice Chuck McRae concurred in the result only. *Id.* at 954.

38. *Id.* at 947.

39. *See Pickens v. Pickens*, 490 So. 2d 872, 876 (Miss. 1986).

40. *Hemsley v. Hemsley*, 639 So. 2d 909, 915 (Miss. 1994).

presumption should not be relied upon, and evidence should be presented sufficient to allow the chancellor to make a finding of fact as to each party's contribution to the marital assets.⁴¹ In any event, it is now well established that the services of a homemaker are an indirect contribution to the acquisition of property, and the homemaker will share in the marital assets.⁴²

Recognizing the value of homemaking services should signal an end to unfair results such as those found in *Tutor v. Tutor*.⁴³ Dr. Tutor was a neurosurgeon who had a net worth, even without considering the value of his lucrative practice, in the neighborhood of \$1,000,000.⁴⁴ Mrs. Tutor had worked through her forty years of marriage and contributed substantially to the income of the family.⁴⁵ The chancellor awarded her \$2500 per month alimony and a lump sum award of \$50,000.⁴⁶ On appeal, the lump sum was increased to \$150,000.⁴⁷ Under *Ferguson*, decided six years later, the equitable distribution award more likely would have been in the range of \$300,000 to \$500,000.

2. Contribution to the Stability and Harmony of the Marital and Family Relationships as Measured by the Quality, Quantity of Time Spent on Family Duties, and Duration of the Marriage

This factor is becoming less important in making an equitable distribution of assets. In *Carrow v. Carrow*,⁴⁸ the court reversed a refusal by a chancellor to award an equitable distribution on the grounds of adultery by a wife of twenty-nine years.⁴⁹ The court recognized that this adultery could be a factor in the amount of the equitable distribution, but only if the misconduct placed "a burden on the stability and harmony of the marital and family relationship."⁵⁰ In *Pierce v. Pierce*,⁵¹ the court affirmed an award of fifty percent of a military retirement plan to a wife who was guilty of adultery and who, in fact, was living with her " 'male business partner and best friend.' "⁵²

This approach to an equitable distribution is consistent with the view of adultery and awards of periodic alimony. In *Hammonds v. Hammonds*,⁵³ the court held that post-divorce cohabitation did not, in and of itself, constitute a reason to

41. See *Johnson v. Johnson*, No. 92-CA-00957, 1994 WL 707269 (Miss. Dec. 21, 1994); *Pierce v. Pierce*, 648 So. 2d 523 (Miss. 1994); *Ruff v. Ruff*, 645 So. 2d 944 (Miss. 1994); *Davis v. Davis*, 643 So. 2d 931 (Miss. 1994).

42. See *Ferguson v. Ferguson*, 639 So. 2d 921, 934 (Miss. 1994).

43. 494 So. 2d 362 (Miss. 1986).

44. *Id.* at 364.

45. *Id.* at 363.

46. *Id.* at 362.

47. *Id.* at 365.

48. 642 So. 2d 901 (Miss. 1994).

49. *Id.* at 908.

50. *Id.* at 905.

51. 648 So. 2d 523 (Miss. 1994).

52. *Id.* at 527 (Lee, J., dissenting).

53. 641 So. 2d 1211 (Miss. 1994).

terminate alimony.⁵⁴ Alimony would only be affected if the cohabitation resulted in a substantial change in the economic circumstances of the recipient.⁵⁵ In *Chamblee v. Chamblee*,⁵⁶ the court stated: "In recent years, this court has been moving away from using divorce proceedings as a means of punishing the party adjudged to be at fault towards creating a more fair and equitable jurisprudence of divorce law."⁵⁷

The teaching of these cases is that while adultery, if it impacts the stability of the marriage, may be a factor in reducing equitable distribution or alimony awards, it is not a complete bar to these awards. Given the court's emphasis on expert testimony on valuation, we may have experts testifying about the value of an adulterous affair. This should spice up the pages of the *Southern Reporter*.

Although on appeal the marital misconduct will not be a basis for reversing a chancellor's finding, one must remember that many of the individual chancellors view marital misconduct seriously and, at least subconsciously, will weigh that factor heavily in making an award of equitable distribution or alimony. If the chancellor justifies the opinion with a reasonable finding of fact, the decision would be sustained on appeal.

The "quantity of time spent on family duties and duration of the marriage" have often been factors in making an equitable distribution of assets by way of lump sum alimony.⁵⁸ Obviously, the longer the duration of the marriage, the greater the amount of marital property.

3. Contribution to the Education, Training, or Other Accomplishment Bearing on the Earning Power of the Spouse Accumulating These Assets

The court has long recognized this as a factor in making an award of lump sum alimony, but the method of valuation of this contribution can best be described as "pick a number." In *Robinson v. Erwin*,⁵⁹ the wife had put the husband through law school, had helped finance the opening of his law office, and had made other substantial contributions to the marital estate.⁶⁰ The court reversed a lump sum award of \$5400 and remanded to the chancery court for reconsideration of the amount of the award.⁶¹ In *McIntosh v. McIntosh*,⁶² under similar facts the chancellor had not made an adequate award based upon the wife's contribution to the husband's education, and the supreme court on appeal simply awarded the wife \$10,000 as lump sum alimony.⁶³ In *McNally v. McNally*,⁶⁴ the husband was unable to pay any lump

54. *Id.* at 1216.

55. *Id.*

56. 637 So. 2d 850 (Miss. 1994).

57. *Id.* at 863.

58. See *Retzer v. Retzer*, 578 So. 2d 580, 593 (Miss. 1990).

59. 546 So. 2d 683 (Miss. 1989).

60. *Id.* at 683, 686.

61. *Id.* at 686.

62. 378 So. 2d 629 (Miss. 1979).

63. *Id.* at 631.

64. 516 So. 2d 499 (Miss. 1987).

sum, and the supreme court ordered the chancery court to keep the case open in order to award periodic alimony at a subsequent time.⁶⁵ This procedure, while it may lead to future litigation, may be the only fair approach when the divorce occurs shortly after the completion of the education or professional training of a spouse.

Expert testimony will thus be required to value two separate intangibles: (1) the value of the payee spouse's contribution to the education of the payor; and (2) the value of the earning power of the spouse accumulating the assets. This may require the testimony both of a business appraiser and a forensic economist.⁶⁶

B. The Degree to Which Each Spouse Has Expended, Withdrawn, or Otherwise Disposed of Marital Assets and Any Prior Distribution of Such Assets by Agreement, Decree, or Otherwise

Numerous cases mention this as a factor, but the valuation of this conduct presents a problem. It obviously influences the court.⁶⁷ The valuation of a spouse's prior dissipation of assets obviously would best be shown by an actual accounting of the assets so disposed of. In extreme cases, injunctive relief may be available.⁶⁸

C. The Market Value and the Emotional Value of the Assets Subject to Distribution

Here is where much of the action will take place. The court will require expert testimony on the valuation of these assets. In *Gray v. Gray*,⁶⁹ the concurring opinion stated that "the equitable division of marital assets may be impossible to achieve" without the opinion of such experts.⁷⁰ In *Carrow v. Carrow*,⁷¹ the court remanded a case to the chancellor stating that "[t]he appraisals of value on the disputed items are either out of date or are untrustworthy."⁷² The valuation issues are discussed in detail, *infra*.

D. The Value of Assets Not Ordinarily, Absent Equitable Factors to the Contrary, Subject to Such Distribution, Such As Property Brought to the Marriage by the Parties and Property Acquired by Inheritance or Inter Vivos Gift by or to an Individual Spouse

This guideline should be considered in conjunction with another guideline: the needs of the parties for financial security with due regard to the combination of assets, income, and earning capacity.

65. *Id.* at 503.

66. See *infra* Part II.F.

67. See, e.g., *Pratt v. Pratt*, 623 So. 2d 258, 264 (Miss. 1993).

68. See *Klumb v. Klumb*, 194 So. 2d 221, 223 (Miss. 1967); see also *Crockett & Patterson*, *supra* note 2, at 87-91.

69. 638 So. 2d 488 (Miss. 1994).

70. *Id.* at 492.

71. 642 So. 2d 901 (Miss. 1994).

72. *Id.* at 908.

Ferguson specifically held that existing law was not altered, and the chancery court could still award lump sum alimony.⁷³ These two guidelines, read together, place lump sum alimony in an equitable distribution context, and remind us not to forget the remedy of lump sum alimony simply because equitable distribution is available. This being so, the only differences between marital and separate assets are: (1) separate assets are not subject to divestiture of title (but of course are subject to execution on a judgment); and (2) lack of fault and need play a greater role in awarding a payment of lump sum alimony from separate assets than they do in an equitable division of marital assets.

This additional guideline has as its basis the principle set out in *Cheatham v. Cheatham*,⁷⁴ the leading case on lump sum alimony, which stated that "the single most important factor undoubtedly is the disparity of the separate estates."⁷⁵ Recall that in awarding lump sum alimony, as distinguished from equitable distribution, a judge considers the factors of both need and fault and is not restricted to the marital assets. It may be made from any asset in the hands of the payor spouse. Pre-*Ferguson* decisions on lump sum alimony provide authority on this issue. *Johnson v. Johnson*⁷⁶ also provides guidance on this issue, and cogently sums it up as follows:

If there are sufficient marital assets which, when equitably divided and considered with each spouse's nonmarital assets, will adequately provide for both parties, no more need be done. If the situation is such that an equitable division of marital property, considered with each party's nonmarital assets, leaves a deficit for one party, then alimony based on the value of nonmarital assets should be considered. This process does not require divestiture of inherited or gift-acquired nonmarital property.⁷⁷

This statement is consistent with the prior decision and makes sense. In all likelihood, this will be the rule in future cases involving both lump sum alimony and equitable distribution.

E. Tax and Other Economic Consequences, and Contractual or Legal Consequences to Third Parties, of the Proposed Distribution

The tax consequences of proposed distributions have been recognized as a factor since *Brabham v. Brabham*,⁷⁸ but have not made much of an impression on the court. The only case in which such consequences were mentioned was in *Draper v. Draper*,⁷⁹ where a dissenting justice commented that, considering the tax consequences of the withdrawal of funds from a pension plan, the paying spouse would

73. *Ferguson v. Ferguson*, 639 So. 2d 921, 929 (Miss. 1994).

74. 537 So. 2d 435 (Miss. 1988).

75. *Id.* at 438. See also *White v. White*, 557 So. 2d 480 (Miss. 1989).

76. No. 92-CA-00957, 1994 WL 707269 (Miss. Dec. 21, 1994).

77. *Id.* at *5 (footnote omitted).

78. 84 So. 2d 147, 153 (Miss. 1955).

79. 627 So. 2d 302 (Miss. 1993).

end up with a smaller estate than the payee spouse.⁸⁰ This factor impressed neither the chancellor nor the majority of the court. If an equitable distribution is made in kind, then these problems will not be as acute. However, if a spouse is awarded an in-kind distribution of an asset with a low basis and a high value, this should be considered. Whenever an equitable division is based on the value of an asset, the tax and other economic factors of being required to liquidate this asset should certainly be taken into account.

For instance, in *McKee v. McKee*,⁸¹ the court affirmed a lump sum award of \$1,250,000 but held that the payor could delay paying this amount to avoid an oppressive liquidation of large land holdings.⁸² Also, the court should consider not only the consequences of a forced liquidation, but also the tax consequences upon a sale of an asset with a low basis and a high value to satisfy the award.

The problem of " 'contractual or legal consequences' to third parties" which loomed as such a large problem in the dissent in *Ferguson*⁸³ should have been resolved by the statement in the majority opinion that equitable distribution did not create a vested interest in the payee spouse, and the assurances that claims of third parties would not be affected.⁸⁴ It will be interesting to see how the court handles buy-sell agreements in the context of closely held corporations and partnerships, particularly the valuation provisions.

F. The Extent to Which Property Division May, with Equity to Both Parties, Be Utilized to Eliminate Periodic Payments and Other Potential Sources of Future Friction Between the Parties

This guideline, in contrast to the ones previously discussed, is new to Mississippi jurisprudence. It obviously recognizes the increased economic independence of women. The presence of this guideline, however, while expressing a desirable end, does not negate the importance, nor availability, of periodic alimony. *Ferguson* itself expressly stated that periodic alimony is available, and *Hemsley* included an award of a substantial amount. As noted, in connection with periodic alimony, fault, even adultery, is playing a decreasing role in the importance of this award.⁸⁵ The court has emphasized that periodic alimony and child support should be considered as part of the same award,⁸⁶ and when one part of the equation is increased, the other part must be decreased of necessity.

G. Any Other Factor Which in Equity Should Be Considered

As times and conditions change, new factors will come into play. Some of the factors which the Mississippi courts have not dealt with are inter vivos gifts

80. *Id.* at 307 (McRae, J., dissenting).

81. 418 So. 2d 764 (Miss. 1982).

82. *Id.* at 766.

83. *Ferguson v. Ferguson*, 639 So. 2d 921, 946 (Miss. 1994) (McRae, J., concurring in part, dissenting in part).

84. *Id.* at 928.

85. See discussion *supra* Part I.A.2.

86. See *Ferguson*, 639 So. 2d at 929.

between the spouses and the lost opportunity costs of one spouse's economic sacrifices to enable the other spouse to increase his or her future earning capacity.

As can be seen from the foregoing discussion, the question of valuation runs through all of these factors. This important, complex, and fascinating topic is considered next.

II. VALUATION PRINCIPLES

The fundamental principle underlying value, whether a closely held business, a professional practice, or the value of an education, is that value is driven by future cash flows or their equivalent. Many confusing issues make application of this principle difficult. An estimate of valuation of a business or opportunity to earn income depends among other things on the purpose of the valuation exercise, who is to receive certain benefits, and the relative size of the ownership interest. Unlike publicly available securities valuation, experts do not agree on appropriate ways to handle many of the issues involved with valuation of these businesses, practices, or intangible assets. Controversial issues which make valuation difficult include the standard of value, lack of information, lack of marketability, size of the asset to be valued, and whether interest is one of control or minority. The resolution of these controversies is especially relevant to matrimonial asset valuations.

A. Valuation Standards of Closely Held Businesses

Ferguson refers to the standard of value which is most often used: fair market value.⁸⁷ Fair market value implies an arm's length deal between informed investors who derive no special benefits from ownership. However, for marital dissolutions, different valuation standards can result in very different appraisals.

For divorces, an alternative standard, called investment value, as well as the fair value standard, is appropriate in some cases. Investment value⁸⁸ is the value to a specific investor, where fair market value is market value defined by informed investors who receive no special benefits. Special benefits include perks of ownership, unique costs of capital, and other characteristics which make investment value different from fair market value. Investment value has special applications in matrimonial cases. The operating spouse continues his or her job and retains an excessive salary and other benefits offered by controlling the business. The business or practice is worth more to one spouse than the fair market value to investors. Similarly, goodwill of a doctor's or lawyer's practice may not be sold, but it is valuable to the working doctor or lawyer. Discounts for lack of marketability or a minority interest may not be appropriate in these cases.

The third alternative standard, fair value, is most often used in valuations of dissenting (usually minority) shareholders' rights. One difference between fair value and fair market value is that discounts for lack of marketability are often not

87. *Id.*

88. See SHANNON P. PRATT, VALUING A BUSINESS: THE ANALYSIS AND APPRAISAL OF CLOSELY HELD COMPANIES 22, 26-28 (2d ed. 1989) [hereinafter PRATT, VALUING A BUSINESS]; SHANNON P. PRATT, VALUING SMALL BUSINESSES AND PROFESSIONAL PRACTICES 27-29 (1993) [hereinafter PRATT, VALUING SMALL BUSINESSES].

applied to fair value cases.⁸⁹ Dissenting shareholders' rights depend on state statutes, not Internal Revenue Service rules. The fair value standard may or may not be relevant to marital situations.

B. Fair Market Value

Until *Ferguson* is modified, we must focus on fair market value, which, simply put, is what a willing buyer would pay and what a willing seller would accept when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of the relevant facts.⁹⁰

The fair market value of closely held companies is estimated using three basic approaches: (1) the market or comparative value approach; (2) the earnings value or discounted cash flow approach; and (3) the adjusted cost approach. *Rebelwood Ltd. v. Hinds County*,⁹¹ an ad valorem tax case, discusses at length these three approaches, and Shannon Pratt demonstrates how these approaches are used to value closely held businesses.⁹² Each of these approaches defines the value of an asset as the difference between the fair market value of the asset minus liabilities. *Ferguson* appears to emphasize the fair market value of assets. Justice Chuck McRae's opinion discusses the need to ascertain the value of "net assets," or assets minus liabilities.⁹³

The market approach bases value on the market prices of comparable firms. Market multiples of earnings or book value of similar traded companies are used to establish value. As such, the market approach is typically based on the valuation of minority interests, not control values. Financial analysis must ensure the comparability of the companies and their financial statements. For example, officer salaries may be adjusted to reasonable levels, causing income to rise or fall from reported levels. Market multiples of income, cash flow, or book value are applied to respective values of the company to be valued. The market approach is perhaps the most often-accepted method relied upon by courts to determine fair market value. The comparable company sales are required to be comparable, but not identical.⁹⁴ The earnings value or discounted cash flow approach to estimating fair market value bases value on the discounted value of the estimated future cash flows generated by the business. These cash flows are available to equity holders of a business, and may be calculated as follows: earnings after tax, plus depreciation, less necessary capital and working capital expenditures, less debt principal payments, plus the estimated terminal value at the end of the analysis period. These cash flows are discounted or capitalized using a rate of return which would be required by investors. The discount rate must include a real interest rate, a

89. See, e.g., *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137 (Del. 1989).

90. See Treas. Reg. § 20.2031-1(b) (as amended in 1965).

91. 544 So. 2d 1356 (Miss. 1989).

92. PRATT, VALUING A BUSINESS, *supra* note 88, at 22, 53-54, 83-85.

93. *Ferguson v. Ferguson*, 639 So. 2d 921, 946 (Miss. 1994) (McRae, J., concurring in part, dissenting in part).

94. See *Howell v. Mississippi State Highway Comm'n*, 573 So. 2d 754, 757 (Miss. 1990).

premium for expected inflation, and a risk premium, and subjective analysis is required of the appraiser. The cash flows may be projected year by year into the future, or a single year's cash flow may be assumed to be constant for future years. Multiple year cash flows or a single year cash flow may be capitalized directly. Direct capitalization is a device by which one capitalizes one year's income into an indication of value.⁹⁵

The adjusted cost approach to estimating fair market value is also called the adjusted net value approach. This approach relies on estimates of the values of each asset and liability category, with the value equal to the difference between the adjusted values of assets and liabilities. This approach may rely on appraisals of fixed assets such as land for components of the going concern valuation. Liquidation value is generally not relevant in adjusted book value valuations, unless the business is being liquidated, not to be sold as a going concern. The adjusted cost value method is best used for holding company valuations and is of limited applicability in divorce cases.

The most authoritative guide to the fair market value of stock in closely held companies is Revenue Ruling 59-60,⁹⁶ issued in 1959, which was initially applied only to estate and gift tax valuations of stock in closely held companies. In 1965, it became applicable for any tax-related valuation,⁹⁷ and now some states have accepted it as a guide in equitable distributions. This ruling, which codifies the application of good economic theory, requires the consideration of several factors:

- (1) the nature of the business and the history of the enterprise;
- (2) the economic outlook and the outlook for the specific industry;
- (3) the book value of the stock and the financial condition of the business;
- (4) the earnings capacity of the company or the present value of future cash flows discounted at the appropriate discount rate;
- (5) the dividend paying capacity;
- (6) whether or not the enterprise has goodwill or other intangible factors;
- (7) sales of stock and the size of the block to be valued; and
- (8) the market price of stocks of corporations engaged in the same or a similar line of business having their stocks traded actively in a free and open market.⁹⁸

Actual transactions in the stock of the closely held firms represent important evidence of fair market value. Transactions must be between informed sellers and buyers of a similar size to the block size being valued. Size and marketability of the closely held firm must be considered.

95. *Crocker v. Mississippi State Highway Comm'n*, 534 So. 2d 549, 553 n.3 (Miss. 1988).

96. Rev. Rul. 59-60, 1959-1 C.B. 237.

97. See Rev. Rul. 68-609, 1968-2 C.B. 327.

98. Rev. Rul. 59-60, 1959-1 C.B. 237.

C. Discounts for Lack of Marketability

Discounts for lack of marketability are generally applied to closely held business values when the firm is compared to publicly-traded companies⁹⁹ with the market approach. Closely held business interests cannot be quickly sold for cash at the owner's volition. Once a market comparison value of a business or practice is established, it is appropriate to apply a discount for lack of marketability, which averages thirty to thirty-five percent. Discounts are not applied for valuations based on the discounted cash flow or adjusted cost approaches. If the basis for the closely held company valuation is a comparison with minority interests of public companies, a discount for lack of marketability is appropriate, but it is not appropriate to discount for a minority interest. The minority interest discount is already exhibited in the publicly-traded stock.

Minority interest deals with the interest being valued compared with the value of the enterprise. The degree of control over the enterprise is the primary factor affecting the effect of a minority interest on valuation of the business or practice being valued. Minority interests are worth less than controlling interests when valued by the fair market value standard. Marital cases involve a fifty percent interest, each with equal control. Such situations present complicated valuation issues. The best examples of minority interests are shares of stock traded in public markets like the New York Stock Exchange. When corporations are taken over, corporate control is transferred. Control premiums averaging twenty to fifty percent are often required over the minority interest prices. If valuation of closely held companies is based on sales of control transactions of comparable companies, then a minority interest discount is appropriate for non-control blocks of stock. Furthermore, a discount for lack of marketability may also be appropriate. While this discount may be appropriate in market comparison approach valuations, the discount may not be appropriate for professional practice valuations.

D. Professional Practice Valuation

Values of professional practices and other service firms are affected by the same factors as closely held businesses, but the valuation process must be modified to account for the specific characteristics of risk and return of the firm or practice being valued. For instance, in insurance, accounting, advertising, securities, or consulting firms or practices, the customer base and the employee base are of more importance. The appraiser must consider whether customers are repeat buyers and the loyalty of customers to the firm or to certain individuals. Medical, dental, and law practices may have goodwill valuation components. The goodwill may have value even when the practice cannot be sold. The "key-person" factor is especially important for small firms and practices. If an individual is key to the success of a business or practice, a significant discount is warranted to the value.

99. See Rev. Rul. 77-287, 1977-2 C.B. 319.

Individuals, firms, or practices may possess goodwill, an excess of market value over asset value. Goodwill may be either professional or business practice goodwill. Business practice goodwill is associated with the location, staff, and client base of the practice or entity. Professional goodwill derives from the personal reputation for judgment, skill, and knowledge of an individual.¹⁰⁰

In an important case, *Lopez v. Lopez*,¹⁰¹ the value of goodwill in a divorce situation was considered. Professional goodwill was said to be determined by the professional's age, past earning power, reputation, comparative success, and the nature and duration of his practice.¹⁰² Professional goodwill, compared to practice goodwill, is more difficult to transfer to a buyer. The Mississippi courts have offered no guidelines on this subject. In fact, in *Tutor v. Tutor*,¹⁰³ a case in which goodwill was obviously present, it was not mentioned. Goodwill is difficult to value, and depends on factors such as future earnings, competition, referrals or clients, riskiness of the practice, staff, age and work habits of the professional, marketability of the business practice, and similar considerations.

Professional practices may be valued using several approaches. The excess earnings or Treasury method approach¹⁰⁴ to goodwill valuation estimates the earnings in excess of earnings in an average comparative practice. These excess earnings are then capitalized at rates which often vary between twenty and one hundred percent, which correspond to multiples of one to five times, respectively. Other methods of professional practice valuation include the sales multiple or cash flow multiple approaches, sell or buy-in formulas when they exist, and comparative transaction approaches. Sales multiple approaches are often used when value is positive, but current earnings are negative. Formula approaches are most relevant to sales for the purpose of the formula (e.g., a buyout), and may be misleading for divorce valuation purposes. Comparative transaction sales prices can be important guides to valuation.

E. Valuation of Projected Earnings

Economists view a marriage as an institution where partners exchange their goods or services.¹⁰⁵ Economic theory may be used to establish values of such marital property as pensions, household services, the economic value of an education, the cost of marriage to the homemaker, and the cost of raising a child. Forensic economists estimate such values by combining an individual's professional and economic attributes with national average statistics to project future earnings. Similar methods may be used to estimate foregone earnings of a non-working spouse. The projected earnings are then reduced to present value form. These

100. See PRATT, VALUING SMALL BUSINESSES, *supra* note 88, at 295.

101. 38 Cal. App. 3d 93 (Ct. App. 1974).

102. *Id.* at 109.

103. 494 So. 2d 362 (Miss. 1986).

104. See Rev. Rul. 68-609, 1968-2 C.B. 327.

105. Jerome M. Staller, *Use of Home Economist in Valuation of Marital Property*, in VALUATION AND DISTRIBUTION OF MARITAL PROPERTY 1, 3 (Maris Warfmun & Matthew Bender eds., 1994).

methods are extensively used in personal injury, wrongful death, and commercial litigation cases.¹⁰⁶

F. Use of Appraisers and Forensic Economists

Valuation specialists can be found through their various professional associations. *Valuing a Business*¹⁰⁷ is an excellent source of valuation information. The following is a list, though not extensive, of some sources of experts and research aides.

The Association for Investment Management and Research (P.O. Box 7947, Charlottesville, Virginia 22906) sponsors the Chartered Financial Analyst program, which is a widely recognized three-year sequential study and examination program for the practice of financial analysis. Charter holders must also have three years experience in financial analysis, including portfolio management and investment analysis, and adhere to standards of professional conduct. Members include securities firm research analysts and corporate finance specialists, equity and fixed income portfolio managers, finance professors, and other allied investment professionals. The organization publishes the *Financial Analysts Journal*. Chartered Financial Analysts provide valuation opinions on publicly-traded and closely held securities. Securities firms routinely provide fairness opinions and valuations of initial public offerings.

The American Society of Appraisers, through its Business Valuation Committee, sets standards and sponsors professional designation, which requires examinations and experience. Members specialize in the valuation of closely held businesses and practices, as well as valuation of other assets. The *Business Valuation Review* is published quarterly by the Business Valuation Committee.

Certified Public Accountants have long been interested in related work to their chief lines of business—audit and tax work. Today public accounting firms are developing consulting specialties in valuation of closely held companies. Journals such as the *CPA Journal* and *The Practical Accountant* contain articles on the subject.

Forensic economists are members of various professional associations of finance, economics, and accounting which provide directories of college and university professors as well as professional members. Some of the scholarly journals are: *Journal of Forensic Economics*, published by the National Association of Forensic Economics (P.O. Box 30067, Kansas City, Missouri 64112) and the *Journal of Legal Economics*, published by the American Academy of Economic and Financial Experts (P.O. Box 5077, Huntsville, Alabama 35632).

106. See *Shaw v. Ladner*, 447 So. 2d 1272, 1274 (Miss. 1984); *Graham v. City of Kosciusko*, 339 So. 2d 60, 62 (Miss. 1976); *Boyd Constr. Co. v. Bilbro*, 210 So. 2d 637, 643 (Miss. 1968).

107. PRATT, VALUING A BUSINESS, *supra* note 88.

III. CONCLUSION

The adoption of equitable distribution in Mississippi was a logical step in the development of case law governing the division of property in the event of divorce. That doctrine recognizes the property rights of the payee spouse to the marital property, rather than the duty of support arising from the marital relationship. The lack of emphasis on fault and need, and increase of emphasis on valuation of economic contributions and of the assets involved, will transform divorce cases into what they should be: commercial disputes measuring the economic contributions of parties to the accumulation of the assets involved, rather than domestic disputes imposing society's moral values on dollar and cents issues. Professional appraisers will replace private investigators and prying neighbors as the key witnesses. This should make the cases less emotional and easier to settle. If, however, they are tried, they may be more expensive, but at least the focus will be on what the litigation is really about — money. Fairness, rather than punishment, should be the business of the divorce court.

The *Ferguson* guidelines are not new; they are based either on Mississippi precedent or precedent from other equitable distribution jurisdictions. The fair market value standard is prescribed by *Ferguson*, and experts are required to deal with several valuation issues which must be resolved, such as goodwill valuation, the applicability of discounts for lack of marketability, the valuation of liabilities, or net assets, and the valuation of household services. The guidelines are workable, and, if followed, should yield reasonably fair decisions. This is about as much as one can hope for in divorce cases.