

Massachusetts Divorce Business Valuations: Are “Good Will” Discounts Allowed?

March 19, 2024 | By Jason V. Owens

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Are "good will" discounts allowed in business valuations for divorce cases? A recent unpublished Appeals Court opinion includes a departure from disfavoring discounts like “good will” in business valuations.

Valuing a business is often necessary to achieve the [division of assets](#) in a divorce case. Back in 2019, I blogged about the challenges faced by Probate & Family Court judges, attorneys, and litigants seeking to [determine the value of a small business in Massachusetts divorce cases](#). As I noted in that [blog](#), “[d]etermining the value of a small business in a divorce case is among the most complex tasks that family law attorneys face.” Much of my 2019 blog focused on business valuation “discounts” under the now legendary 2007 case, [Bernier v. Bernier](#):

Put simply, the main holding in [Bernier](#) prohibits valuers from applying certain “discounts” when valuing a company that the business owner does not intend to sell anytime soon. Such businesses are known as “ongoing concerns”, and for decades, business appraisers who have valued such businesses have decreased the value of such companies based on “discounts” ...

The discounts disfavored by [Bernier](#) included minority discounts, marketability discounts, and so-called “key man” discounts. Business valuers typically use each of these discounts

to *decrease* the fair market value of a business. For example, a marketability discount applies to minority shareholders with limited rights to sell their share of a business. Marketability discounts are like a minority discount but can also apply to majority shareholders in a small business or partnership and focus on a partial owner's inability to sell their share of a business easily. Finally, a "key man" discount is applied when the business owner is so crucially important to a company's success that the value of the business would be reduced if it were sold.

Under Bernier, each discount method is expressly disfavored when valuing a business that a spouse intends to continue owning/operating after the divorce. Despite Bernier's broad disapproval of discounts in the business valuation context, a recent unpublished opinion of the Appeals Court, Kwak v. Bozarth (2023), suggests that a discount for "good will" can fit within the Bernier framework.

How is a "Key Man" Discount Different from a "Good Will" Discount?

As noted above, a "key man" discount centers on a small business where the owner plays such a central role in the business's operations that the value of the business would be seriously reduced if the business were sold to a new owner. For example, if the only employee of "Al Smith Plumbing" was Al Smith, it stands to reason that much of the value of the business is bound up in Al Smith himself performing the plumbing tasks. Intuitively, we understand that if "Al Smith Plumbing" is purchased by a non-plumber named Mike Jones, the business is not going to be as valuable. Hence, the "key man" discount.

As noted above, the Bernier decision has become almost legendary due to its perceived complexity. However, a cursory review of Bernier reveals that the Supreme Judicial Court did not reject the concept of a key man discount in every divorce valuation; it only rejected a key man discount in the context of the Bernier case:

It is appropriate to assess a key man discount when an individual's "continued services are critical to the financial success: of the business being valued and may be or will be lost. ... Here, however, given the husband's uncontradicted testimony that he would maintain total ownership and control of the supermarkets, it is beyond reason to conclude that the business's value should be reduced to account for loss of the man who is "the whole show." ... The [Bernier] husband's role in the supermarkets, in contrast, is that of chief executive; his services are critical but not unique or irreplaceable, and in any event, as we have previously noted, the husband was not likely to be "lost" to the enterprise. In the circumstances of this case, the judge should not have adopted a key man discount in valuing the supermarkets.

The main takeaway from Bernier is that key man discount may be appropriate when the loss of the owner-employee would be potentially *catastrophic* to a business. The loss of a merely "critical" CEO, on the other hand, does not pass muster in the divorce valuation context.

Although similar, a "good will" discount differs from a "key man" discount in terms of focus. While the key man discount imagines the negative impact on business operations if owner-employee goes missing, the good will discount takes a more nuanced approach by seeking to

quantify the specific number of customers who would choose not to patronize the business if the owner departs. In Kwak, the Appeals Court characterized the good will discount as follows:

The judge also credited [Husband's business valuator David E. Consigli, Jr.'s] application of a twenty-one percent good will discount, reflecting the estimated loss of clients that would occur if the wife left the practice.

The Court went on to define good will as follows:

“Good will is necessarily attached to a going business and relates to the name, location and reputation, which tends to enable the business to retain the patronage” of its customers ... Here, Consigli testified that for the purpose of his valuation, good will represented the percentage of patients at the practice who “come to just [the wife] and wouldn't go to anybody else” if she were to leave the practice following a sale of the business. He determined that the appropriate good will discount was twenty-one percent, and reduced the value of the business by \$587,726 accordingly.

Although a good will discount is somewhat analytically distinct from a key man discount, the two discounts do seem intended to measure the same phenomenon: how much the value of a business would suffer if an important owner-employee left the business. Nor is it clear that a 20% reduction in business revenue – i.e. the amount of the good will discount in Kwak – is meaningfully different from the 10% “key man” discount rejected in Bernier. So why did the good will discount in Kwak pass muster when the similar key man discount in Bernier was rejected?

Does the Kwak Opinion Meaningfully Change Bernier's Limitation on Valuation Discounts?

One key structural factor in the Kwak decision is that Consigli's good will discount actually *benefited* the business-owning wife:

Indeed, had [Consigli] not used that alternative method, it is unclear whether he would have applied a good will discount at all, which would have resulted in a higher valuation to the wife's detriment.

In contrast, in Bernier, the key man discount *harmed* the position of the wife filing the appeal by reducing the value of the husband's business. In other words, the wife in Bernier was better positioned to challenge the key man discount directly, where the discount directly harmed her position. In Kwak, the business-owning wife was poorly positioned to attack a good will discount that actually benefitted her position by reducing the value of the wife's business by more \$500,000. As noted by the Court, rejecting the good will discount “would have resulted in a higher valuation to the wife's detriment”.

The different legal postures of the respective wives in Kwak and Bernier makes it difficult to say whether the Kwak Court's allowance of a good will discount fundamentally alters the Bernier Court's strong disapproval of the similar key man discount. Moreover,

while Bernier is a published opinion of the Supreme Judicial Court (SJC) and, therefore, binding precedent in Massachusetts, the Kwak decision is an unpublished opinion of the Appeals Court. Such unpublished opinions may be cited for persuasive value but are not binding on lower courts like that of a SJC decision like Bernier.



How Will Kwak Impact Business Valuations in Future Massachusetts Divorce Cases?

Despite the questions surrounding Kwak's applicability, there is simply no question that a decision by the Appeals Court (even an unpublished opinion) that favorably affirms a good will discount in the business valuation context is apt to “move the needle” in some Probate & Family Court cases involving similar issues. After all, the Kwak Court *could* have noted that good will discounts are generally disfavored in Massachusetts but chose not to. Instead, the case will likely be an example of when good will discounts are appropriate in business valuation cases. Such examples – which illustrate exceptions to the ordinary rule – can significantly impact how individual Probate & Family Court judges approach a given issue at the trial level.

It is fair to say that the Bernier decision has triggered a fair amount of criticism over the years, particularly by business valuers who feel that Bernier's prohibition on appropriate discounts undermines their ability to accurately calculate the value of a business in Massachusetts divorce cases. Although the Kwak opinion is not binding precedent, the decision will encourage attorneys and business valuers who believe that “good will” discounts allow appraisers to calculate a truer picture of a business's value than the rigid Bernier framework permits.

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