# Forensic Forum

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# Calendar

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**17** The Shenkman Series - Investigative Accounting (Teaneck)

## *February 2004*

**5** New Jersey Bureau of Securities - Using Tax Returns to Trace Funds & Find Assets (Newark)

**21** ICLE - Cutting Edge Financial Issues in Divorce (Fairfield)

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**16** The Shenkman Series - Shareholder Agreements (Teaneck)

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# *Goldman and Anti Goldman, – Going Both Ways*

Goldman has become somewhat of a buzz word, with that once proud family's surname being bandied about like an ignoble sack of potatoes. In a sense like Sheridan, it has become part of New Jersey divorce language, used, abused and perhaps misunderstood. However, accepting it for what it means in its broad context, it would appear that Goldman opens up the door for variations, expansion, and a fresh look. This article will attempt to address some of those areas in a fashion so as to bring out some of the potentials that exist.
Goldman is kind of a bright line - relatively easy - the company went bankrupt after the complaint date. Clearly, as an equitable financial issue, there was nothing left to distribute. How restricted are we in a Goldman world to such a bright line demarcation. Certainly, most if not all of our readers have seen, heard, or themselves used the Goldman weapon (or threatened same) in matters where there's definitely and clearly no bankruptcy, not one even likely or a modestly reasonable prospect. Rather, the business is now (allegedly?) not doing as well as it was just several months or a year or two ago at the date of complaint, and thus is, perhaps, worth less. How much less - how much of an alleged decrease succeeds in drawing the subject business under that favorable, but tragic, Goldman umbrella. Assuming that we can reasonably quantify a change (let alone get disparate interests to agree as to a change - forget even agreeing as to the merit of arguing a change), would a decline of 10% in value empower the use of a Goldman-type argument? Or, would it require a more substantial reduction in value - and if so, just how substantial? Need we go to say, 25%, 50%; need there be some evidence that bankruptcy is being considered or not remotely unlikely.
It is probably safe to assume that all of us would readily recognize and agree that the economy in general, and perhaps as a direct result, virtually all businesses in general, are subject to fluctuations - what some might call cycles. How would we distinguish between just a routine cycle (i.e. businesses doing worse now because there's a recession, or simply because of a routine cycle of the business) on one hand and a more permanent or structural change that bodes ill for the future. In the context of doing our work and representing our clients, how long of a period, how extended a timeframe, need a decline in business be in order to justify that it is a real decline, that it is permanent or at least something worthy of downward valuation consideration. If the complaint date is December 31, 2002, and we are now in early 2004 and have evidence that

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# Star Light, Star Bright

As yet, New Jersey does not recognize executive goodwill - though perhaps it is not quite that clear that it doesn't. Depending on how certain decisions are interpreted, elements of executive goodwill may already have been accepted - and even if not, it is an area worth exploring.

Perhaps it would be helpful first to try to define executive goodwill. The basic concept of goodwill, when applied to a business, is that it represents the quantifying of a financial benefit representing repeat business, or the tendency or customers or clients or patients to use or frequent the subject business entity in a fashion and to a degree that produces financial rewards in excess of what otherwise might a reasonable rate of return on the business assets (after allowing for all appropriate reasonable compensation and benefits). In other words, because of some intangible (goodwill), a business is making more than it would without the reputation, repeat business, following etc. than it would otherwise.

All well and good for a business - but can it be extended to fit the concept of executive goodwill. Here we are not dealing with a business, but rather with an employee - often thought in terms of an employee of a large company (though it need not be a large company), with that individual having some level of star quality, particular attraction, or some other set of attributes that arguably imbue this individual with an intangible value. Some major player in a corporation (let's assume a hypothetical CEO of a Fortune 500 company) possibly carries with him/her a value, the ability or power to receive certain monies, that are above and beyond what otherwise would be possible.

The typical knee jerk reaction is along the lines "you've got to be kidding - are you trying to tell me that this employee, no matter how well paid, who owns nothing, has a value, brings to the table something for equitable distribution, rather than a high level of income subject to alimony". That is certainly one interpretation of executive goodwill. It hypothesizes that there's some kind of star quality in this individual, something that we can quantify, that suggests there's an extra value. In a crude sense, it suggests this super employee carries with him/her sort of his/her own business - that business being a star employee who can demand a large salary, perhaps even an outsized salary, a signup bonus, or other emoluments that are particularly valuable, and above and outside of the pale.

Conceptually, how much different is the idea of executive goodwill than the well accepted situation of goodwill existing in any of a variety of professional practices. In a sense, would it be a fair argument (note that in this article, we are not advocating any position - we are only raising this as an item for consideration and discussion) that such a hypothetical star employee has its own element of professional goodwill not much different (if different at all) than that possessed by an attorney, doctor, accountant, you fill in the professional - who was similarly able to generate an income greater than his/her peers. Or, in a sense similarly to these other professionals, this CEO has the ability to carry with him/her kind of a book of business. For our commonplace professionals, having goodwill in their business, this "book" might represent "controlling" clients which generate a revenue stream that's more than enough to pay a reasonable salary, having a reputation or a following that generates additional business, or being able to take a client base (the portable "book") from job to job. Would it be possible to extend this concept now to a star CEO of a Fortune 500 company? Is there some equivalent to that CEO carrying with him/her a book, a following, an intangible which helps to generate superior results.

It may also be within the bounds of reasonableness to expect that this corporate star might have the ability (perhaps like an athlete) to reap some good fortune from endorsements or commercials. There are certainly existing examples. Could that be an avenue for consideration, completely apart and aside from that executive's existing compensation package.

There are various faults with this entire concept. For instance, while at least in theory someone who owns a business has something to sell or transfer, our beloved CEO, as high ranking and high paid as he/she is, truly has nothing to sell - right? But, in a sense, this CEO does have something to sell - the knowledge and resources that the CEO brings to the job. Granted, that is typically manifested in the compensation this person receives. However, what about the possibility of a signup bonus, stock options or restricted stock. Perhaps the even more intangible concept that this CEO, because of his/her executive "goodwill", is being placed in a position (is being hired and has reasonable prospects) of reaping considerable good fortune some years down the road. We could be talking here not of merely a nice raise in salary, not simply going from $300,000 a year to $400,000 a year, or from $800,000 to a million dollars a year -

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the business had a weak 2003, worse than 2002 and 2001, is that enough to establish a reduction in value? Or, do we need to see at least a second year, or half of a second year, of continued decline (or at least a leveling off at what might arguably be a new lower level). And, if we were to argue that, what does that mean in light of Best Practices - how long are we going to keep the case open to give us as much comfort level that there is a true "change in circumstances" warranting a revisit of the valuation issue.

From our experience, Goldman has only been used, or at least vigorously argued, in the context of a decline in value. However, in the broad sense of what Goldman might mean, it would seem logical that if a clear (let's allow for the moment undeniable) reduction in value is justification for allocating less value (a less valuable asset), wouldn't there be logic, equity and justice in

going in the other direction. If there was an undeniable increase in value, wouldn't the same measure of logic and justice dictate a comparable distribution of more value - a more valuable asset. This one may be a little harder to swallow - but is perhaps intellectually and equitably the same concept. Of course, arguments will be made as to post complaint efforts being responsible for the increase in value and therefore it shouldn't be shared. However, in

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but rather receiving a corporate bonus in the millions, or a rapid move up the corporate food chain to a base salary in the several million dollar range and bonus potential into the eight digits.

Another issue might simply deal with the practicalities of age. It is probably reasonable to accept that in comparing equal corporate stars, one aged 40 and the other 70, and in all other respects equal - the 40 year old probably has a greater likelihood of having executive goodwill and/or a greater likelihood of having a larger dollar amount of executive goodwill. After all, a company looking to hire these two people would recognize that the 40 year old probably has 20 or more years available to work magic with his/her executive goodwill on that company, as contrasted with many fewer years available to the 70 year old. This though is simply perhaps a matter of degree/amount rather than concept. Somewhat analogous (accepting this whole concept to begin with) is that, all other things being equal, two business owners, having the same company, in the same industry, and making the same money, but one 40 years old and the other 70 years old (or one in excellent health and the other in poor health) in all likelihood also have very different goodwill amounts, for some of the same reasons.

When you are dealing with a business owner, that owner controls the business, and has the ability to do many different things with it, and little likelihood of being fired. On the other hand, a corporate executive, no matter how much of a star, is certainly at greater exposure of being fired or otherwise disappointed (let's say by a Board that perhaps isn't as loyal to him/her as desired), as well as to the vagaries of the stock market. Also, a corporate executive is at the mercy of the company's stock performance, and a completely different and larger array of competition, as well as greater exposure to internal problems that are simply logically outside of that CEO's control. In a small, or even medium-size business, the owner is generally better able to control all elements so as not to become the victim of an errant employee. While generally remote, there is more risk in a larger operation, where the CEO is much more removed from such day-to-day controls.

An easy argument against executive goodwill is that this CEO has nothing that he/she can really sell, there's nothing transferable about any such hypothetical executive goodwill. Indeed, even less than that, the CEO generally doesn't have the at least theoretical ability of a business owner to transfer customer relations to an associate, and have that associate buy in through sweat equity. Regardless, certainly in New Jersey, and perhaps in most other states, it is generally not considered all that relevant whether or not one can make a true argument for the ability to sell or market the specific business. We all recognize (whether or not we agree) that New Jersey has long held that a law practice, even a solo law practice, even in the days when there was no ability to sell same, subject of course to the level of income generated therefrom, did or could have goodwill.

Perhaps what we are really talking about - both as to the standard argument that nobody would buy this (hypothetical - alleged) "business" as well as the argument as to so called executive goodwill, that there is nothing transferable - it is that the business person has succeeded in developing a stream of income that is in excess of "reasonable compensation". This stream is likely to continue at that (or somewhat similar, greater or lesser) level for some period of time, perhaps indefinitely. The words "enhanced earnings power" might have some bearing in this sense. That New Jersey doesn't recognize "enhanced earnings power" as such is probably not relevant as to grasping the economic concept involved. That is one way (perhaps not the only way and perhaps not the best way) to conceptualize executive goodwill. Considering Piscopo, if that wasn't in a sense executive goodwill, what was it?

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Goldman the decline was despite reasonable good faith efforts to keep the business alive. Would there be logic in arguing in the opposite direction - that the same good faith that applies on the way down should apply on the way up. And then again, we will need to address much of the same analysis as described above - i.e. how much of a change, how permanent is it, etc.

While we're having fun speculating as to these interesting philosophical quandaries, perhaps we should reflect briefly on what this might mean to the fees of the attorneys and experts - and ultimately what is left for the litigants. The points being raised here are interesting and often very valid points, which under the right circumstances might save your client a lot of money, or when used effectively against you, cost your client a lot of money. However, all this requires extra work, perhaps significant extra work, by both attorney and expert. After all, on one simple level, it requires at least a second valuation. This might involve additional forensics; it will certainly involve additional efforts on the valuation front - even if combined into one report. And, it is not simply a matter of dumping a few numbers (i.e. the current financial information as contrasted with the past) into a simple equation to arrive at a value conclusion. It will require, typically, updating the economic (micro and macro) background information, getting into the industry again to have an understanding as to what might have happened - especially since you are arguing change; and probably doing at least a comparable if not increased level of analysis and investigation of the subject entity and the related figures. One reason that I suggest it may require an increased level of investigation is

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of investigation is that we are now not simply proffering a number based on the traditional date of complaint, but we are looking to be able to support the equity in using a more current date. Certainly we need to be able to provide enough support, analysis and the like to counter what is sure to be contrary type arguments. For instance, one side will argue that the business went down in value - the other side will argue that it is merely a cyclical change, value did not go down it merely looks down, but next year it will be back to where it was. Great theory, great intellectual arguments - great fees if you can collect them.

Clearly, there are situations where equity requires that we use, and thus allocate, a value based on something other than the date of complaint. However, from what we have seen, it would appear that argument is made much more forcefully, more strongly and more often in the case of a business that has decreased in value as contrasted with one that has increased in value. Logically, the tables will turn and we will see some sense of balancing. However, regardless of the direction of the change, how current do we make the new valuation, how many such valuations do we create, how much of a change (increase or decrease) warrants the use of other than the date of complaint, how well can we prove/show that the change is a real change rather than a temporary one. Be careful what you wish for.

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***Recent and Upcoming Media Situations:***

### *Ongoing*

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**BOOK - *Second edition of Investigative Accounting in Divorce*** by Kal Barson, published by John Wiley and Son

**CHAPTER** - ***Divorce Taxation*** - NJ Family Law by Lexislaw (April 2003) - To be updated early 2004

**ARTICLE - *Standard of Value in Divorce Business Valuation* -** by Marshall Morris - American Journal of Family Law (Spring 2003)

**ARTICLE - *Cursed Infirmities Impact on Valuation* -** New Jersey Family Lawyer (October 2003)

**ARTICLE - *Detecting and Preventing Workplace Fraud*** - by Marshall A. Morris - Middles County Bar Advocate (January 2004)

**ARTICLE - *Forensic Accounting - A Force For Good* -** to be in New Jersey Family Lawyer (early 2004)

**ARTICLE - *Value to the Holder - Valuation's Nadir?* -** to be in American Journal of Family Law (Spring 2004)

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