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Take Heed of *Sneed*: A Major Valuation Error

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Introduction. On August 14, 2026, the Supreme Court of North Carolina issued what many are touting as a landmark holding for North Carolina family law in *Sneed v. Johnston* (No. 130PA24). In the valuation of a solo law firm, the Supreme Court held that “the personal goodwill of a professional practice does not qualify as marital property for equitable distribution purposes.” The Supreme Court overturned decisions at the trial court and Court of Appeals (*Sneed v. Johnston*, 293 N.C. App 650 (2024)) that classified the entire goodwill value of the firm (personal and enterprise) as marital property for equitable distribution purposes.

After a brief discussion of goodwill in general and its two potential components (personal and enterprise), this article conducts a detailed analysis of the major error in the business valuation report (the “Valuation Report”) offered at the trial level and how that fundamental error results in unreliable conclusions as to both the value of the firm and the dollar allocations of personal and enterprise goodwill.

Goodwill. The total value of an entity is often comprised of tangible and intangible components. Tangible components (such as cash, accounts receivable, inventory, and equipment) are usually easily classified and valued. The intangible value of an entity (also known as goodwill) is typically the difference between the entity’s total value and the value of its tangible assets. By way of illustration, the Valuation Report determined the following tangible and intangible component “values” of the Sneed law firm:

Opinion of Value in <i>Sneed</i> Business Valuation Report		
Enterprise Goodwill Value (attributable to the Law Firm)	10.1%	\$302,436
Personal Goodwill Value (attributable to Mr. Sneed)	89.9%	\$2,688,321
Total Intangible (Goodwill) Value	100.0%	\$2,990,757
Plus: Value of the Tangible Assets of the Law Firm		\$109,243
Equals: Total Law Firm Value		\$3,100,000
Value of the Tangible Assets of the Law Firm		\$109,243
Plus: Enterprise Goodwill Value (attributable to the Law Firm)		\$302,436
Equals: Total Value Attributable to the Law Firm		\$411,679
Personal Goodwill Value (attributable to Mr. Sneed)		\$2,688,321
Total Value Attributable to Mr. Sneed		\$2,688,321

As seen above, the Valuation Report opined that the total value of the law firm was \$3,100,000. Of that total value, \$109,243 represented the tangible asset value (primarily cash and equipment). The \$2,990,757 difference between the \$3,100,000 total value and \$109,243 tangible asset value represented the intangible (or goodwill) value of the law firm. The Valuation Report then segregated this total goodwill value into enterprise and personal goodwill components. This segregation was done by using a goodwill allocation analysis known as the Multi-attribute Utility Model (or MUM). In applying the MUM, the Valuation Report opined that 10.1% of the total goodwill value was enterprise goodwill (attributable to the law firm as an entity) and 89.9% of the total goodwill value was personal goodwill (attributable to Mr. Sneed personally).

BVR's Guide to Personal v. Enterprise Goodwill (the *BVR Guide*) is a publication that is dedicated entirely to the issue of personal and enterprise goodwill. Published in 2009 by Business Valuation Resources, the *BVR Guide* consists of almost 650 pages of various articles, teleconference transcripts, court case abstracts, and other information addressing the classification and valuation of personal and enterprise goodwill. The definition of personal and enterprise goodwill is addressed numerous times in this document, including on the first page of the first article in the *BVR Guide*:

The distinction between personal (sometimes called professional) and enterprise goodwill (sometimes referred to as practice goodwill) is as follows:

- **Personal Goodwill.** The goodwill associated primarily with an individual.
- **Enterprise Goodwill.** The goodwill associated primarily with the enterprise or institution.

The existence of personal goodwill is based on the fact that people come to the individual. This may be based on, to some extent, the individual's skills, knowledge, reputation, personality, and other factors. The implied assumption is that if the individual were not there, the clients would go elsewhere. The existence of enterprise goodwill is based on the fact that people come to the enterprise. This may be based on location, staff, telephone number, facilities, reputation of the entity (as opposed to the individual's reputation), and other factors. *BVR's Guide to Personal v. Enterprise Goodwill*, "Personal Goodwill vs. Enterprise Goodwill," by Jay Fishman, FASA, CBA.

North Carolina Law. Prior to *Sneed*, North Carolina cases were somewhat opaque on the issue of personal and enterprise goodwill. Although not specifically stated in any case, the prevailing interpretation in many North Carolina cases and among practitioners was that there was no need to differentiate between personal and enterprise goodwill because goodwill was generally treated as marital. As pointed out in *Sneed*, however, this was never explicitly stated in any North Carolina case. Now with *Sneed*, we finally have clear direction in North Carolina that there is a need to differentiate between personal and enterprise goodwill.

Major Valuation Error: No Market Compensation Adjustment in *Sneed*. If *Sneed* now tells me what I have to do as a business appraiser (i.e., quantify and classify personal and enterprise goodwill), it still falls upon me to determine how that is done. Unfortunately, the Valuation Report and opinion of value adopted by the trial court do not provide appropriate guidance due to a critical error: the failure to make an adjustment for a market level of compensation for Mr. Sneed. This error resulted in an overstated cash flow that was capitalized into an overstated value that was then allocated into overstated amounts of personal and enterprise goodwill.

We reviewed the Valuation Report, corporate tax returns, and other information provided at the North Carolina Court of Appeals website. None of the information provided indicates that any compensation or salary was paid to Mr. Sneed by the firm in the period between the firm's 7/18/11 date of incorporation and the 1/5/15 valuation date. Exhibit A, Schedule 2 (Historical Income Statements Annualized 2011-2014) of the Valuation Report indicates zero amounts each year for the line item "Jason Sneed Earnings: Compensation."

In that same schedule there is a line that indicates "Total Compensation for Services Provided," however, the amounts in that line reflect exactly the reported "Subcontract Services Expense" on the firm's income statement. At trial, Mr. Sneed testified that the firm employed various staff as well as additional lawyers on a contract basis during this time, including five staff attorneys at the beginning of 2015. The Subcontract Services Expense therefore appears to reflect the compensation paid to those individuals and not to Mr. Sneed. There is no indication in the Valuation Report that Mr. Sneed was paid as a subcontractor of the firm. In fact, in his testimony at trial, Mr. Sneed referred to his "personal income or compensation draws (which I sometimes refer to as the SNEED PLLC 'profits' during the corresponding years)." This suggests that Mr. Sneed took money out of the firm in the form of profits (i.e., distributions or draws) instead of as salary.

No other compensation expense line is indicated on the firm's income statement shown in Exhibit A, Schedule 2 of the Valuation Report. The only adjustments made in the Valuation Report to normalize the firm's net income were nominal adjustments for depreciation. In short, we did not find a discussion of or evidence for a market compensation adjustment for Mr. Sneed anywhere in the Valuation Report.

Business Valuation 101: the Market Compensation Adjustment. The market compensation adjustment is necessary to segregate the total return received by Mr. Sneed into its two components: (1) the fair market amount of compensation for the legal, managerial, and other services Mr. Sneed provides to his firm, and (2) the return on investment Mr. Sneed earns due to his ownership of the firm. This is a fundamental issue in business valuation. In fact, the importance of this adjustment is repeatedly emphasized in numerous business valuation textbooks:

The item that most often begs adjustment on the income statements of a privately held entity is the compensation to the owners. Actual compensation tends to be based on what the entity can afford or how the owners desire to be compensated, and may bear little or no relationship to the economic value of the services the owners actually perform. The general idea of the compensation adjustment is to substitute the cost of hiring and paying a non-owner employee for the compensation actually paid to the owner to perform the same function. Another way to look at it is to compare the actual compensation paid to some average amount that other people normally are compensated for performing similar services. *Valuing Small Businesses and Professional Practices, Third Edition*, by Shannon P. Pratt, DBA, CFA, FASA, CBA, Robert F. Reilly, CFA, ASA, CPA, and Robert P. Schweihs, ASA.

Keep in mind that the owner of a closely held business receives two forms of compensation. First, as an employee, that individual is entitled to a return on his or her labor (salary for the job being performed). Second, as an owner, that individual receives a return on investment (dividends or capital appreciation). Be very careful not to confuse the two. The officer's compensation adjustment is intended to restate the economic income statement of the company to a basis that includes the amount of salary that would be necessary to attract others who are qualified to perform the duties required by the company. *Understanding Business Valuation, A Practical Guide to Valuing Small to Medium Sized Businesses, Fifth Edition*, by Gary R. Trugman, CPA/ABV, MCBA, ASA, MVS.

Compensation adjustments are made as required to differentiate the portion of the shareholder's compensation for their personal service rendered to the subject company and the portion of the compensation attributed to their equity investment. Failure to develop the appropriate normalizing adjustments may result in a significant overstatement or understatement of value. *Financial Valuation*, by James R. Hitchner, CPA/ABV/CFF.

Officer and Shareholder-Related Compensation and Benefits Expenses. This category is well-known to anyone who has had experience with closely held companies. The level of compensation and benefits paid to key officers and shareholders often distorts privately held company earnings. To truly gauge the economic returns that buyers can expect, the financial statements need to be adjusted to reflect what the market would pay non-owner executives for their services to run the company. Regardless of the motivation or reason for the level of officer and shareholder compensation, it is essential to examine how these amounts relate to market levels and to make relevant adjustments. Otherwise, the reported earnings will not reflect the returns that a buyer can expect to realize. *Business Valuation Guide*, by George B. Hawkins, ASA, ABV, CFA, and Michael A. Paschall, ASA, ABV, CFA, JD.

In addition to these general textbooks on business valuation, the importance of the market compensation adjustment and its resulting effect on personal and enterprise goodwill is also repeatedly emphasized in the *BVR Guide*:

We must first understand that “goodwill” only has value to the extent that it can generate earnings over and above a reasonable rate of return on the value of assets utilized plus adequate compensation to the labor employed. In other words, there can be conceptual goodwill in the sense that customers return, but there is no economic goodwill until those customers generate cash flow over and above a reasonable return on investment and reasonable compensation for the quantity and quality of services performed. [T]oo many “experts” underestimate the cost of a substitute entrepreneur who would provide truly comparable services in terms of both time and quality, again overstating the “excess” position of the earnings, and thus overvaluing the goodwill. In other words, they often attribute good earning power to “goodwill” rather than to the superior ability and competence of services performed. *BVR’s Guide to Personal v. Enterprise Goodwill*, “Overview of Enterprise and Personal Goodwill,” by Shannon Pratt, CFA, FASA, MCBA, CM&AA, MCBC.

The concepts and framework presented here can be of benefit in the assessment of reasonable compensation for other purposes, including the segregation and measurement of personal/professional versus enterprise goodwill. The opinion of value using an income approach hinges on the ability to support the computation of reasonable compensation for the controlling owner or professional practitioner. The adjustment for reasonable compensation is critical. It is also one of the most difficult adjustments to quantify. The goal is to find the salary that would be paid to perform the same services and duties as the current owner/employee. To determine a reasonable salary, the analyst needs to determine what a hypothetical replacement employee would be paid to perform the same services with the same skill level, education, and duties. *BVR’s Guide to Personal v. Enterprise Goodwill*, “Reasonable Compensation and the Productivity Adjustment: Tips & Techniques for Owner/Employee Compensation Determination and Adjustments,” by Kevin R. Yeanopolos, CPA/ABV/CFF, ASA, and Ronald L. Seigneur, MBA, CPA/ABV/CFF, CVA.

The accepted definition of “reasonable compensation” under the fair market value Standard is the amount required to hire a nonowner employee to perform the same functions as that done by the owner. Proper compensation analysis is critical to the overall quest to value goodwill because an understatement of reasonable compensation will result in an overstatement of enterprise goodwill. Alternatively stated, some portion of the personal goodwill issue can often be minimized by properly addressing reasonable compensation. *BVR’s Guide to Personal v. Enterprise Goodwill*, “The Interplay of Reasonable Compensation, Personal Goodwill and Enterprise Intangibles,” by Mark O. Dietrich, CPA/ABV.

North Carolina Family Law Cases. In addition to being a fundamental aspect of business valuation, the market compensation adjustment has been recognized in North Carolina family law cases, starting with the seminal case on professional practice valuation: *Poore v. Poore*, 75 N.C. App. 414, 331 S.E.2d 266, *disc. review denied*, 314 N.C. 543, 335 S.E.2d 316 (1985). The professional practice at issue in *Poore* was a dental practice. In examining the potential ways to quantify the goodwill value in that case, the North Carolina Court of Appeals noted:

“Another method that has been received favorably is a capitalization of excess earnings approach... Under this approach, the value of goodwill is based in part on the amount by which the earnings of the professional spouse exceed that which would have been earned by a person with similar education, experience, and skill as an employee in the same general locale.”

Said another way, the market compensation adjustment is the amount needed to pay that “person with similar education, experience, and skill as an employee in the same general locale” to do the same things that the owner of the professional practice does. The market compensation adjustment has been used and accepted in other North Carolina family law cases, such as in *Hamby v. Hamby*, 143 N.C. App. 635, 547 S.E.2d 110 (2001). While the market compensation adjustment amount made in *Hamby* was questionable, at least some adjustment was made. By contrast, no market compensation adjustment whatsoever was made in *Sneed*.

It has also been held in North Carolina that a salaried employee who has no ownership interest in an entity does not possess goodwill. In *Sonek v. Sonek*, 105 N.C. App. 247, 412 S.E.2d 917, *disc. review allowed*, 331 N.C. 287, 417 S.E.2d 255 (1992), the physician husband worked as a salaried employee at a medical practice. The wife argued, and the trial court held, that the medical practice had goodwill as of the date of separation that should be included as a marital asset, despite the fact that the husband had no ownership interest in the practice. The Court of Appeals reversed the trial court and held that “a salaried employee who maintains no ownership interest in the particular place of employment does not possess goodwill.”

An illustration of the market compensation adjustment is shown in the following table. For this illustration, I used the actual net cash flow, capitalization rate, and “value” used in the Valuation Report in *Sneed*. The “Incorrect Method (as in *Sneed*)” column reflects the actual calculations in the Valuation Report. The “Correct Method” column replicates the assumptions and calculations in the Valuation Report with one significant exception: a hypothetical market compensation adjustment for Mr. Sneed is made.

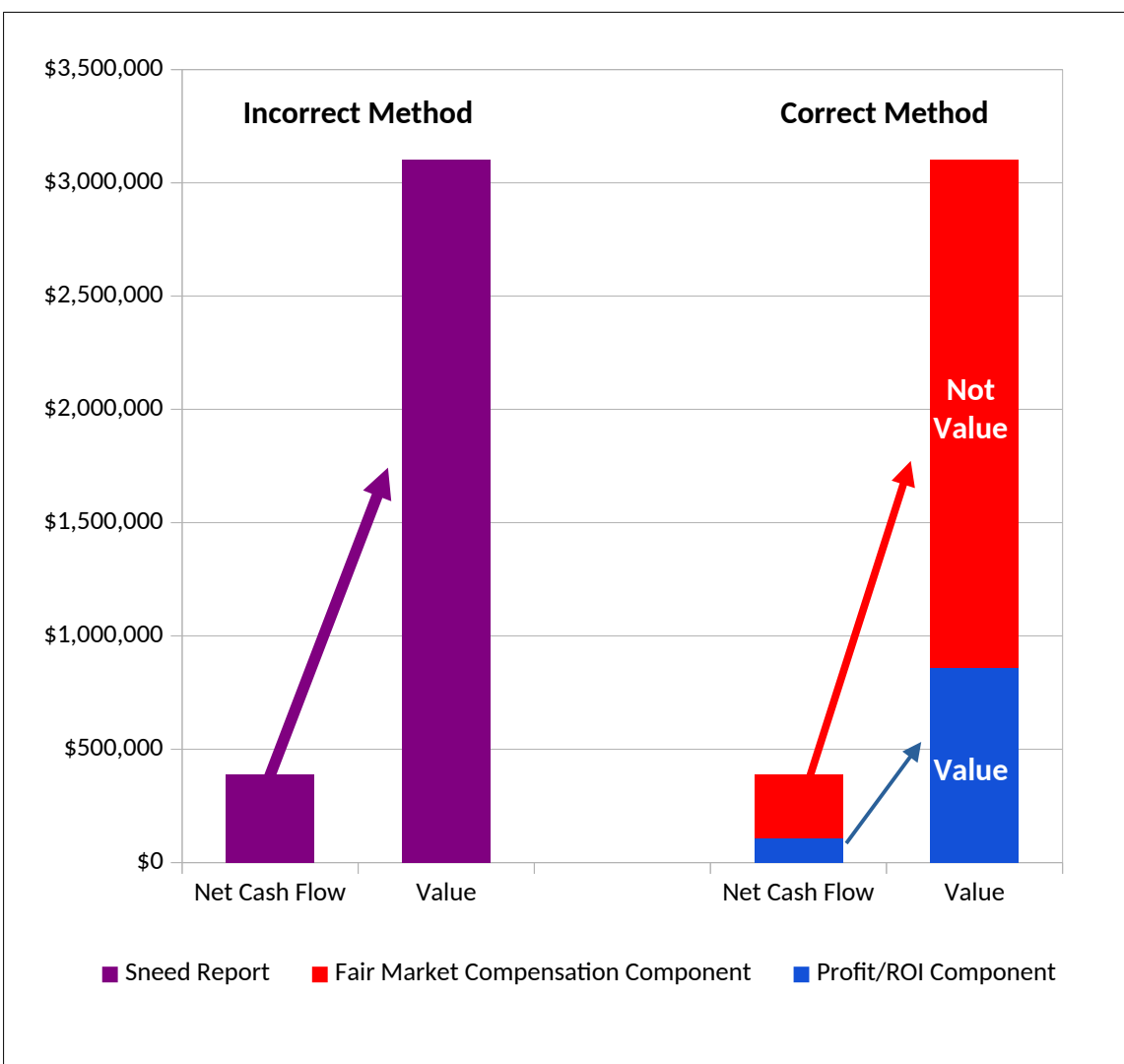
The calculations in the “Correct Method” column are shown for illustrative purposes only and do not represent this author’s opinion of the correct market compensation amount or the adjusted value of the law firm. They also do not represent this author’s concurrence with the assumptions made in the Valuation Report.

Illustration of Correct Compensation Adjustment in the Capitalization Method As Compared to the Incorrect Capitalization Method in <i>Sneed</i>			
Item		Incorrect Method (as in <i>Sneed</i>)	Correct Method
Weighted Average Annual Revenues (Collections)		\$1,078,776	\$1,078,776
Normalized Pre-tax Profit		\$614,788	\$614,788
Less: Market Compensation Adjustment		\$0	(\$431,510)
Adjusted Normalized Pre-tax Profit		\$614,788	\$183,278
Less: Income Taxes	36.8832%	(\$226,753)	(\$67,599)
Normalized Net Profit		\$388,035	\$115,679
Cash/Cap Ex/WC/Int Exp Adjustments		(\$11,056)	(\$11,056)
Net Cash Flow to Invested Capital		\$376,979	\$104,623
Expected Long-Term Growth Rate		3.0%	3.0%
Growth-Adjusted Net Cash Flow		\$388,288	\$107,762
Divided by: Cap Rate		12.5%	12.5%
Equals: Entity Value		\$3,106,304	\$862,096
Less: Interest-Bearing Debt		(\$1,482)	(\$1,482)
Equals: Equity Value		\$3,104,822	\$860,614
Total Equity Value (Rounded)		\$3,100,000	\$860,000
Market Comp as a % of Revenues			40%

As seen above, making a market compensation adjustment results in a materially different conclusion of value than was done in the Valuation Report. The market compensation adjustment in the above table is based on the relationship (i.e., percentage) between compensation and production (collections). There are a number of resources available to estimate a reasonable market compensation adjustment. In our experience with law firm valuations, we have observed a general compensation-to-collections range between 30% and 70%. An analysis of the proper percentage (or compensation amount) for Mr. Sneed is beyond the scope of this article, therefore a 40% ratio is used in the above table solely for illustrative purposes. It is noted that a higher compensation percentage results in a lower net cash flow and lower capitalized value.

By not making a market compensation adjustment, the Valuation Report capitalizes into “value” two very different things: (1) the fair market compensation earned by Mr. Sneed for the services he provides the firm, and (2) the return on investment Mr. Sneed enjoys due to his ownership interest in the firm. Capitalizing the fair market compensation amount (item 1) is not a business valuation – it is a “people valuation” (see “People Valuations” at www.businessvalue.com / Resources / Business Valuation Articles / Personal Versus Enterprise Goodwill). Only the capitalization of the firm’s net profit after the market compensation adjustment (item 2) can provide a supportable indication of the entity’s value under this method.

This principle is illustrated as follows:



The two sets of columns indicate the firm's net cash flow (short column) and value (tall column). For both sets of columns, the value column is determined by dividing the net cash flow column by the 12.5% cap rate used in the Valuation Report. The total amounts reflect the amounts used in the Valuation Report and are identical for each set of columns: \$388,288 in net cash flow and \$3,100,000 in value.

The purple columns illustrate what the Valuation Report did. The Valuation Report capitalized \$388,288 of net cash flow at a 12.5% cap rate to derive a purported firm "value" of \$3,100,000. That is the incorrect way to value the firm as the net cash flow that was capitalized included both the fair market compensation to Mr. Sneed as well as the profit (or return on investment) Mr. Sneed realized due to his ownership of the firm. The Valuation Report combined what should have been treated as separate compensation and investment-return components and capitalized the entire amount into a purported business "value."

The red and blue columns illustrate the correct way to value the firm. The shorter column segregates the net cash flow into its two components based on the market compensation adjustment shown earlier. The red portion of this column represents the hypothetical tax-adjusted fair market compensation figure for Mr. Sneed. The blue portion of this column represents the hypothetical profit (return on investment) portion of the net cash flow of the firm **after the market compensation adjustment is made**. For purposes of illustrating the source of the \$3,100,000 "value," each net cash flow component is divided by the same 12.5% capitalization rate to determine its proportional amount in the \$3,100,000 "value" column. The resulting red amount merely illustrates the portion of the reported \$3,100,000 "value" that is attributable to capitalizing compensation. **This is not an indication or component of value – it is an operating expense of the firm.** The resulting blue amount represents the value indication attributable to the firm's profit/ROI component.

Based on the hypothetical market compensation adjustment shown earlier, the hypothetical component values for the firm are calculated as follows:

1. The \$388,288 in total net cash flow is segregated into its two components: \$280,526 for the tax-affected market compensation adjustment (red portion) and \$107,762 for the profit/ROI component (blue portion). The \$107,762 profit/ROI component is calculated in the earlier table (after the market compensation adjustment is made). The \$280,526 tax-affected market compensation adjustment equals the \$388,288 total net cash flow figure less the \$107,762 profit/ROI component.
2. The \$280,526 tax-affected market compensation adjustment (red portion) is then capitalized at the same 12.5% cap rate into a (rounded) \$2,240,000 "value" (red portion). The \$107,762 profit/ROI component is also capitalized at the same 12.5% cap rate into a (rounded) \$860,000 value (blue portion).

3. These two components sum to the same \$3,100,000 total “value” in the Valuation Report, however, **only the blue portion of the value column represents the fair market value of the firm. The red portion of the value column is Mr. Sneed’s capitalized salary and is not a component of the fair market value of the firm.**

To summarize the above illustration:

- Blue is the VALUE of the entity as it is based solely on the entity’s profit.
- Red is NOT the value of the entity – it is the capitalized COMPENSATION to the owner.
- Purple is NOT the value of the entity – it improperly combines the red and blue.

Think about it this way: assume a permissible buyer purchases the Sneed firm as a pure investor and not a practitioner. In order to replicate the revenues and profits generated to enjoy a return on investment, the buyer would need to pay Mr. Sneed (or an individual who could replicate what Mr. Sneed does) a fair market rate of compensation. It is only after the buyer pays Mr. Sneed (or his clone) this fair market rate of compensation that the buyer derives his return on investment. **The compensation amount paid to Mr. Sneed (or his clone) is not part of the buyer’s return on investment – it is an expense the buyer must incur to derive his return on investment.** In fact, without this expense, the buyer has no return on investment as the firm collapses without the services of Mr. Sneed (or his clone).

The argument that Mr. Sneed’s compensation should be included in the net cash flow capitalized into a value because the MUM (or some other goodwill allocation mechanism) will sort out the personal and enterprise goodwill components later is flawed as this does not cure the underlying valuation error. The market compensation adjustment is an **expense** of the entity – not part of its value. The red portion of the column in the preceding illustration is conceptually analogous to the distinction noted in the previously cited *Sonek* case: a “salaried employee who maintains no ownership interest” and therefore “does not possess goodwill.”

The market compensation adjustment is entirely attributable to Mr. Sneed’s personal services. It is an operating expense necessary to generate the firm’s revenues, not an investment return or an asset of the firm. Accordingly, it must be removed in determining the firm’s normalized earnings before any resulting goodwill is quantified or allocated between personal and enterprise goodwill. Capitalizing the amount attributable to Mr. Sneed’s personal services into a purported “value” and then applying the MUM or some other goodwill allocation mechanism makes no sense. The market compensation adjustment is not itself personal goodwill. Rather, it represents the economic cost of the owner’s labor that must be recognized before the residual economic earnings—and therefore any goodwill—can be valued. It is only when you have an accurate value of the entity (based on its

adjusted profit, after the market compensation expense) that the MUM (or some other model) can be applied to potentially determine any personal versus enterprise goodwill allocation.

The importance of starting with an accurate value before applying the MUM is emphasized in the *BVR Guide* by the individual (David Wood) who introduced the MUM to the business valuation community:

Regardless of the standard of value, or how a particular jurisdiction defines it, the valuator must establish a solid value of the subject company being valued before determining the value of goodwill as a separate component. I cannot stress this enough. *BVR's Guide to Personal v. Enterprise Goodwill*, "Goodwill: Where Are We? How Did We Get Here? What Do We Do About It?," by David Wood, CPA/ABV, CVA.

The Valuation Report's failure to make a market compensation adjustment is a fundamental methodological error that materially undermines the reliability of its resulting "value."

At trial, Mr. Sneed testified that, prior to his starting the firm in 2011, he was a salaried employee (i.e., non-owner) at another law firm. Had Mr. Sneed and Ms. Johnston separated while Mr. Sneed was working at his prior firm, his salary would not have been capitalized into any "value" for equitable distribution purposes (see earlier discussion of *Sonek*). The market compensation adjustment serves the analogous economic function of removing the return attributable to Mr. Sneed's labor from the earnings being capitalized into the value of the firm.

Mismatch with the Cap Rate Used. In addition to violating basic business valuation principles and North Carolina case law, the valuation methodology used in the Valuation Report has other major problems. The capitalization rate used in the Valuation Report is based on rates of return from publicly-traded entities. All of these entities report their profit (return) **after the subtraction of all the operating expenses that generate that return, including employee compensation.** The Valuation Report, however, applies this cap rate to a net cash flow figure that does not include an adjustment for a market compensation amount for Mr. Sneed. As such, the "profit" figure capitalized is much higher than it otherwise would be because it includes both Mr. Sneed's compensation as well as his return on investment due to his ownership of the firm. The Valuation Report is therefore applying a cap rate to an incorrect (and much higher) income number, resulting in an incorrect (and much higher) value. This creates an internal mismatch between the income measure being capitalized and the market-derived capitalization rate applied to it. In short, it is an apples-to-oranges comparison. We are not aware of any market-based cap rate information that is derived based on a "profit" figure that includes the profit of a company plus the compensation expense for its employees.

The Valuation Report itself acknowledges the importance of this issue:

[C]hoosing the right benefit stream for the particular valuation engagement is very critical and has a significant bearing on the determinate [sic] of value. One can choose the right method and the wrong benefit stream, or vice versa, and arrive at an incorrect determination of value...Another important component to valuing a business is that the benefit stream must be properly matched to the cost of capital determined for the company being valued. Matching the risk rate (Capitalization Rate) to the Benefit Stream is the second most important determination a valuator must make; the first being selecting the right benefit stream. Choosing the wrong benefit stream or miss-matching [sic] the benefit stream with the wrong risk rate will result in an incorrect value and the difference may be material.

The Valuation Report unfortunately violates both of these requirements as it: (1) chooses the wrong benefit stream (due to the lack of a market compensation adjustment) and then (2) applies a cost of capital that is not matched to that incorrect benefit stream.

Sanity Check with Comparable Transactions. When reaching an opinion of value using a certain methodology (such as the capitalization of income method used in *Sneed*), it is often helpful to cross-check the reliability of the result by consulting other methodologies. The Valuation Report considered but ultimately dismissed the market approach as it indicated there was only one transaction available that was sufficiently comparable to the firm. The price to revenues multiple for this transaction was 50%. The Valuation Report determined a preliminary value of \$609,841 for the firm using this multiple. The \$3,100,000 final opinion of value in the Valuation Report is **5.1 times** higher than this preliminary value under the market approach.

The price to revenue multiple in the Valuation Report was 254% (\$3,100,000 value divided by \$1,219,682 in 2014 revenues). An examination of 14 law firm sales available in transaction database *DealStats* as of the 1/5/15 valuation date indicated a median price to revenue multiple of 70%. This means that the price to revenue multiple in the Valuation Report is **3.6 times** higher than the median price to revenue multiple for comparable transactions. An examination of another 21 reported law firm transactions occurring after the 1/5/15 valuation date indicated an even lower median price to sales multiple of 58%, indicating that the price to revenue multiple in the Valuation Report is **4.4 times** higher than these comparables. Although this data was not available as of the 1/5/15 valuation date, they nonetheless serve as a reasonableness check to the other data.

The Valuation Report cites a rule of thumb in the *Business Reference Guide* that most law firms sell for 80% to 90% of revenues. The *Business Reference Guide* cautions, however, that these multiples must be applied with caution as the stability and transferability of the client base is critical. The Valuation Report unfortunately did not consider the one-off nature of many of the law firm's clients, or the fact that a majority of the law firm's 2014 revenues were from a single client on a single matter that was resolved later in 2015. The instability of the firm's client base was confirmed by evidence

presented later by Mr. Sneed that showed firm revenues declining from a peak of \$1,296,158 in 2016 to a range between \$483,037 and \$537,620 over the 2018-2020 period. Even applying the upper-end 90% figure to the firm's 2014 revenues of \$1,219,682 would imply a potential value of about \$1,100,000 for the firm, still far below the \$3,100,000 value in the Valuation Report.

The significant disparity between the much higher opinion of value in the Valuation Report and the much lower potential values under the various market approaches should have prompted further investigation and reconciliation with the income-approach conclusion, however, the Valuation Report does not provide a sufficient reconciliation of this disparity. A substantial portion of this disparity appears readily explainable by the Valuation Report capitalizing into "value" a net cash flow figure that is too high due to the failure to make a market compensation adjustment.

Seller's Discretionary Earnings (SDE). If a business appraiser wants to use a "profit" figure that includes the profit of a firm plus the compensation amount to its owner, there is an option in the transaction data available. Seller's Discretionary Earnings (SDE) is generally defined as an entity's profit plus the amount of compensation realized by the owner of that entity. Because Mr. Sneed did not receive a separately reported salary, the firm's reported profit necessarily includes both the economic return to ownership and the economic compensation attributable to Mr. Sneed's services. This is conceptually similar to the owner-benefit earnings measure reflected in SDE and is the same "profit" figure that the Valuation Report incorrectly capitalized into a "value." The Valuation Report noted that a price to SDE multiple for the one (rejected) transaction was reported, yet the Valuation Report did not employ this multiple. Applying the observed 2.28x price to SDE multiple to the same weighted-average normalized profit (i.e., what is really SDE) figure as in the capitalization method results in a preliminary value of \$884,720. Again, the \$3,100,000 value in the Valuation Report is **3.5 times** higher than this preliminary value yet there is no recognition or discussion of this significant disparity in the Valuation Report.

Starting with an Incorrect Value Renders the MUM Useless. After calculating a value that is materially overstated by the failure to make the market compensation adjustment, the Valuation Report then employs the Multi-attribute Utility Model (MUM) to attempt to allocate the goodwill value between personal goodwill and enterprise goodwill. The MUM is not a valuation methodology and does not determine the value of an entity – it is one of several goodwill allocation tools available. This article does not address whether the MUM itself is an analytically reliable method for allocating goodwill; that is a separate question, particularly given the subjective judgments required in selecting and weighting its inputs.

As noted in the David Wood quote earlier, in order to accurately allocate the total goodwill of an entity into its personal and enterprise components, it is imperative that the total goodwill figure be accurate before the model is applied. That did not happen in *Sneed* due to the overvaluation of the firm (which resulted from the overstated net cash flow since no market compensation adjustment

was made). As such, the resulting dollar allocations indicated by the MUM are unreliable, as are the corresponding indicated dollar amounts classified as marital or separate property.

Moreover, many of the MUM factors involve attributes of Mr. Sneed's personal services—ability, skill, judgment, reputation, and similar characteristics. Applying those factors to a purported "value" that already includes the capitalized amount attributable to compensation for those same personal services introduces an inherent risk of circularity and double-counting.

Is MUM the Word? Furthermore, if a correct market compensation adjustment is made, is the application of the MUM (or some other goodwill allocation mechanism) still necessary? The theory behind the market compensation adjustment is that you can replicate the services provided by the owner (Mr. Sneed) by another individual (Attorney A) who can provide those services. Attorney A is compensated at a fair market rate for those services (which include all the aspects of what Mr. Sneed did – practicing law, generating revenues, maintaining client relationships, managing staff, etc.). All of the firm's operating expenses, including Attorney A's salary, are deducted from the firm's revenues to determine the firm's profit that can then be capitalized into a value.

That firm value is presumably transferable as an owner of the firm can simply plug in individuals such as Attorney A to do the work previously done by Mr. Sneed. Since Attorney A is compensated at a fair market rate, any remaining profit after all expenses (including Attorney A's compensation) is the return on investment to the owner of the firm. If Attorney A exactly replicates what Mr. Sneed did, there should be no change to the firm's revenues or profit following the substitution of Attorney A for Mr. Sneed and the owner of the firm will continue to receive the same return on investment.

Said another way, the continued profits of the firm do not rely on Mr. Sneed's presence because his economic role is now filled by Attorney A. If Attorney A replaces all of the functions performed by Mr. Sneed that are necessary to generate the revenues and profits being capitalized, the firm operates economically the same way without Mr. Sneed as it did with him. Under these assumptions, no portion of the resulting goodwill would appear to depend upon Mr. Sneed's continued presence and, therefore, no portion would appear to constitute personal goodwill. In other words, a proper market compensation adjustment based upon the complete economic replacement of the owner potentially eliminates the personal goodwill component from the resulting firm value, resulting in that entire value being classified as enterprise goodwill. This raises the question of whether there remains anything for the MUM (or some other allocation model) to allocate.

Sneed Valuation Methodology Leads to Potential Double Dipping. The Valuation Report's methodology furthermore creates a potential double dipping issue as to the relationship between entity value and alimony. The erroneous "value" determined in the Valuation Report is based on the capitalization of a firm "profit" figure that includes 100% of Mr. Sneed's compensation. A specific alimony claim in *Sneed* was not discussed in the Court's opinion, however, if the "value" in the

Valuation Report had been accepted and alimony had been calculated based on Mr. Sneed's earnings, a material potential for double dipping exists as both alimony and a significant percentage of the purported "value" of the firm would have been based on Mr. Sneed's earnings.

***Sneed* is Getting Around.** Despite its issuance less than two months ago, *Sneed* has already crossed state lines and been cited in another case. In *Jordan v. Jordan*, 2026-Ohio-3610, the professional practice at issue was a solo dental practice owned and operated by the wife. The husband and wife each retained a qualified business valuation expert. Both experts used a capitalization approach and reached relatively similar opinions of the total equity value of the practice: \$1,019,000 and \$1,165,000. The Court's opinion specifically noted that the husband's expert made a market compensation adjustment but did not indicate whether the wife's expert made a similar adjustment. I contacted the wife's valuation expert and she confirmed that her valuation also included a market compensation adjustment. Thus, although the two experts differed in other aspects of their analyses, both recognized the need to account for the market value of the professional owner's services in using a capitalization approach to value the professional practice.

Lack of Competing Experts in Key Cases. *Sneed* is another important North Carolina family law case in which only one party presented valuation expert testimony at the trial court level. The same situation existed in *Poore*, *Hamby*, and others. Although no one can know at the trial court level which cases will ultimately become important appellate precedent, it is unfortunate that the important issues decided in these cases did not receive a full and thorough vetting in the form of opposing experts presenting and being cross-examined on different valuation theories at the trial court level. Although not a guarantee, having opposing experts at trial is the most likely way to catch and correct such significant valuation errors as occurred in *Sneed*. This vacuum at the trial level has unfortunately resulted in opinions of "value" (in *Hamby* and *Sneed* at least) that contained major errors in the form of either a poorly supported compensation adjustment (*Hamby*), or, even worse, no compensation adjustment at all (*Sneed*). Because those valuation assumptions were not tested through competing expert testimony at trial, those errors remained unchallenged as the cases proceeded through appellate review.

By contrast, when expert witness testimony is presented and questioned at trial, the Court has the ability to hear and test the various arguments made and to make its decision based on the validity of those arguments. It also goes to the reason for having expert witnesses. Judges and attorneys cannot reasonably be expected to possess the same familiarity with the technical intricacies of business valuation as experienced valuation professionals – it falls upon the expert witnesses to educate the court as to the proper application of accepted methodologies. That unfortunately did not happen in *Sneed*.

Summary. While *Sneed* may provide clarity concerning the need to classify personal and enterprise goodwill, it does not provide reliable guidance as far as the specific valuation methodology used. Importantly, the valuation methodology itself was not the issue on which the Supreme Court granted discretionary review. The question before the Court concerned the classification of personal and enterprise goodwill. *Sneed* therefore should not be read as Supreme Court approval of either the \$3,100,000 valuation or the methodology by which that value was derived. That is fortunate because the Valuation Report's failure to make an appropriate market compensation adjustment is a fundamental methodological error that materially undermines the reliability of both the resulting "value" as well as the subsequent goodwill allocation of that "value."