

COURT OF APPEALS
DIVISION ONE
OCT 20 2015

NO.737465-1-I

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON
DIVISION ONE

In re the Marriage of:

LILY MORELLI,

Appellant,

v.

KENNETH MORELLI,

Respondent.

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STATE OF WASHINGTON
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ON APPEAL FROM THE SUPERIOR COURT OF THE
STATE OF WASHINGTON FOR WHATCOM COUNTY,

The Honorable Deborah Garratt

OPENING BRIEF OF APPELLANT

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ORIGINAL

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A. SUMMARY OF ARGUMENT

In this divorce trial after an eight year committed intimate relationship and marriage, the trial court erred as a matter of law when it characterized the non-equipment assets of respondent Kenneth Morelli's business as his separate property, and failed to determine the existence of and properly characterize any goodwill. Further, the trial court applied an incorrect legal standard when valuing the business, using a book value-type approach not permitted under In re Marriage of Hall¹ and specifically prohibited under Fleege² and In re Marriage of Berg.³

Additionally, the trial court erred by failing to acknowledge, consider or set forth analysis of the Fleege factors. Insufficient evidence exists to support the trial court's finding that the equipment accumulated during the parties' marriage was worth only \$78,000. For these reasons, reversal of the valuation and remand for revaluation of the business and redivision of the property is required.

B. ASSIGNMENTS OF ERROR

1. The trial court committed legal error when it entered Finding of Fact 2.8 C, "The parties have the following real or personal community property: ... [v]ehicles and equipment that were purchased for the business

¹ 103 Wn.2d 236, 692 P.2d 175 (1984).

² Matter of Marriage of Fleege, 588 P.2d 1136, 91 Wn.2d 324 (1979).

³ 47 Wn. App. 754, 758, 737 P.2d 680 (1987).

known as Ken's Tree Service, LLC, during the period of the parties' marriage and committed intimate relationship." The court erred to the extent that this finding, taken together with the other findings and conclusions, indicates that the only community asset in Ken's Tree Service is its vehicles and equipment.

2. The trial court abused its discretion in entering Finding of Fact 2.8 F.2., "[t]he court finds that during the committed intimate relationship and during the period of the marriage, Ken's Tree Service accumulated vehicles and equipment that have a current community value of \$78,000."

3. The trial court committed legal error when it entered Finding of Fact 2.8 F.3., "[t]he court finds that the income generated by Ken's Tree Service is primarily based upon the personal services provided by Kenneth Morelli and does not have a value without the work being performed by Kenneth Morelli and is therefore not a divisible community asset."

4. The trial court abused its discretion in entering Finding of Fact 2.8 F.4., "Other assets acquired by Ken's Tree Service, during the period of the committed intimate (July '05 - August '07) were determined by the court to have a current value of \$50,000."

5. The trial court committed legal error when it entered Finding of Fact 2.9 A, "The husband has the following real or personal separate property: A. A tree cutting business that he established in 1994, before the

marriage, now known as Ken's Tree Service, LLC. This business includes but is not limited to, computers, phones, machinery, vehicles, tools and equipment."

6. The trial court committed legal error when it entered Decree of Dissolution paragraph 3.3, Property to be Awarded to the Wife, without making provision for awarding Ms. Morelli her share of the full value of the community asset Ken's Tree Service, including goodwill and other properly calculated business value.

C. ISSUES PERTAINING TO ASSIGNMENTS OF ERROR

1. In Fleege, our Supreme Court held that it is reversible error for a trial court to fail to include goodwill in a business as a community asset subject to distribution in dissolution. Here, the trial court found that Ken's Tree Service was not a divisible community asset, characterizing everything other than its vehicles and equipment as Mr. Morelli's separate property. Did the trial court commit legal error when it failed to value and characterize the business and all its assets, including goodwill, as a community asset? (Assignments of Error 1, 3-6.)

2. Berg and Fleege state that the value of a closely held corporation cannot be accurately determined by using only its book value. Here, the trial court valued Ken's Tree Service at the depreciated value of

its vehicles and equipment. Did the trial court commit legal error when it valued the business at book value? (Assignments of Error 1-3, 4, 6.)

3. Fleege requires that when valuing a business owned by a party to a dissolution, the trial court must consider the owner or practitioner's age, health, past demonstrated earning power, professional reputation in the community as to his judgments, skill, knowledge and his comparative professional success. In this case, the trial court did not make any findings regarding or refer in any way to the Fleege factors. Did the trial court commit legal error by failing to apply Fleege to this case? (Assignments of Error 1-3, 5, 6.)

4. Hall states that when valuing a business like a professional practice, one or more of the five accepted methods of valuation must be employed. In Berg, this Court specified that book value is not an accepted method of valuing a corporation. Here, the trial court did not use one of the five accepted methods; instead, the court used book value. Did the trial court commit legal error when it used a prohibited valuation method? (Assignments of Error 1-6.)

5. The trial court found that the parties accumulated community assets for eight years. When calculating the value of Ken's Tree Service, the court totaled up equipment acquisitions as valued by Ms. Morelli's expert CPA witness for six of those years, then subtracted a certain

amount from the total, and decided that the result was the value of community equipment accumulated by Ken's Tree Service. Did the trial court abuse its discretion when it used this valuation method for equipment? (Assignment of Error 2.)

D. STATEMENT OF THE CASE

1. Procedural History. The parties began a committed intimate relationship that began on July 1, 2005 and culminated in marriage on August 1, 2007. CP 318-19. The parties separated on June 14, 2013. Id. Trial took place in March, 2015 and final orders were entered in May, 2015. CP 327. Ms. Morelli unsuccessfully moved for reconsideration and the order denying reconsideration was entered on June 19, 2015. This appeal timely followed on July 9 2015. CP 486.

2. Relevant Facts.

a. Background. Mr. and Ms. Morelli began dating in 1 RP 23.⁴ Ms. Morelli worked as a nurse in British Columbia yet soon began also contributing effort and some funds to Mr. Morelli's Whatcom County business, Ken's Tree Service. 2 RP 236-37. The same year, 2003, Ms.

⁴ The Verbatim Report of Proceedings has 4 volumes. The second volume is numbered consecutively to the first, the third volumes is numbered independently, and the fourth volume is numbered from 405-420. References to pages shall state the volume number, then RP, then the page number.

Morelli carefully reviewed the business' expenditures, income ratios, and advised Mr. Morelli how to cut expenses and raise his rates. 2 RP 235. She continued participating in the business in 2004, making bank deposits, acting as a spotter if needed, raking, moving tree limbs, and helping find new equipment like a bucket truck. 2 RP 237-39. In January 2005, Mr. Morelli wrote Ms. Morelli a letter thanking her for her contributions to his business. Exhibit 110.

In 2005, the parties began their committed intimate relationship, and Ms. Morelli gradually increased her efforts to help build the business. She accompanied Mr. Morelli on estimates, placed and made calls, performed occasional light bookkeeping, performed nursing and preventive services for the crew, provided business holiday dinners, located and purchased business equipment, and performed various other tasks. RP 86, 88, 133, 183-84, 195, 199, 220-21, 236. She became certified as a flagger to assist the crew and she regularly used her own personal funds to purchase business equipment and supplies. 1 RP 88.

Before marriage, Mr. and Ms. Morelli had an oral agreement that they were business partners in all things; rentals, investments, and the tree service. 2 RP 229. Ms. Morelli took community college classes regarding tax strategies for small businesses and understanding financial statements

to help her contribute to the business. CP 232. From 2003-2007 revenues for the business more than doubled. 2 RP 309.

In 2007, the parties married and Ms. Morelli moved to the United States. 1 RP 146. While she had accumulated a small pension from her Canadian nursing work, the parties agreed that they would not focus on further building her nursing pension, and that instead Ms. Morelli would focus on contributing to Mr. Morelli's business. 2 RP 229-30. Her involvement in the business continued. *Id.* In 2012 the parties' marriage experienced turmoil and in 2012, Mr. Morelli changed the locks on the business doors and the business passwords on the computers, filing for divorce shortly thereafter. 1 RP 187.

b. Ken's Tree Service. Mr. Morelli started Ken's Tree Service under a different name in 1994. Exhibit 121, p.4. Mr. Morelli is the sole owner of the business, which provides services for residential, commercial, and governmental customers primarily in Whatcom County. *Id.* In 2003, at the start of the parties' dating relationship, the business had gross revenues of \$194,102 and was valued by Michael Guerrero at trial at \$24,000. 2 RP 311, Exhibit 121 p 4, 5. Mr. Guerrero is a CPA with over 30 years' experience, is accredited in Business Valuation by the American Institute of Certified Public Accountants, certified by that institution in

Financial Forensics, and is a Certified Divorce Financial Analyst. Exhibit 121, p. 12.

By 2005, gross revenues had increased to \$397,200. Exhibit 121, p. 4. In 2007 when the parties married, gross revenues were \$585,354 and the business was valued at trial by Michael Guerrero at \$397,000. Exhibit 121, p. 4, 5. At the end of 2012, the year the parties separated, gross revenues were \$441,207 and Mr. Guerrero valued the business at \$356,000. Id. In 2014, gross revenues were \$467,531 and Mr. Guerrero valued the business at \$349,000. Id.; 2 RP 311. At the time of trial, the business employed three people other than Mr. Morelli. 1 RP 18. Mr. Guerrero testified that business records revealed no compensation paid to Ms. Morelli. 2 RP 312.

Mr. Guerrero testified to the court that he valued the business using the straight capitalization accounting method, the first of the five approved Hall methods, which was also referred to at trial as the "income approach." RP 310. He developed a "fair value," used an income approach to determine an estimated value, and also used an asset approach for comparison. 2 RP 310, Exhibit 121 p. 2. Mr. Guerrero valued the equipment and vehicles accumulated since July 1, 2005 to date of trial plus current cash on hand at \$133,257. Exhibit 121, p. 11. Mr. Guerrero attempted to conduct a site visit and to interview Mr. Morelli and key

personnel, but Mr. Morelli refused to cooperate with the valuation. Exhibit 121, p. 3; 2 RP 312, 323.

Mr. Guerrero based his valuation on U.S. Income Tax Returns for Mr. Morelli from 1999-2013, Profit and Loss statements for years ending December 31, 2006 - December 31, 2014, Balance Sheet statements for 2006-2013, corporate QuickBooks reports from mid-2006 to the end of 2013, Detailed General Ledgers for 2009-2014, and the Certificate of Incorporation. 2 RP 309; Exhibit 121, p. 6.

c. The trial court's rulings. The trial court found that the only community asset in Ken's Tree Service was the depreciated value of the equipment and vehicles. CP 324. The court found that the business itself was Mr. Morelli's separate property. CP 321. The court explained in its findings that "the income generated by Ken's Tree Service is primarily based upon the personal services provided by Kenneth Morelli and does not have a value without the work being performed by Kenneth Morelli and is therefore not a divisible community asset." CP 324.

In its first oral ruling, the trial court stated,

There is other value in the business but in my view it's difficult to quantify and not nearly as substantial as Mr. Guerrero's estimates which appear to be based on cash flow income to the business and capitalization factors that, frankly, the court did not find persuasive. The capitalization factor had to do with the level of risk that an independent investor would tolerate and, frankly, that's just not the

situation here. That's not at all the relationship between the parties. So I've not adopted those figures except as to equipment, but I do give some value to the business and I think the value that I would give to that business is somewhere in the area of \$50,000.

3 RP 9-10.

While Mr. Guerrero provided a depreciated value of \$133,257 for the equipment, vehicles, and cash on hand from July 1, 2005 to time of trial, the court developed a lower value, \$78,000. CP 324. The court's first oral ruling described how it had arrived at this figure by adding up the depreciated value of equipment purchased for 6 years of the parties' 8 year relationship, then further lowering some of the values:

I used Mr. Guerrero's estimates of the value of equipment in the business, that evidence of that testimony is at all essentially undisputed. ... what I did was I computed the value of the equipment that was purchased during the time period between starting in 2006 and ending in 2011. I would have gone to 2012 except there was no equipment purchased in 2012. I took the depreciated value of that equipment and in a couple of cases I felt that Mr. Guerrero's depreciated value figure was simply too high so I reduced a couple of items, not significantly however, the difference is probably about \$4,000. Adding those figures together I derived a figure of approximately \$78,000 in equipment that in the current depreciated value of equipment that was purchased between 2006 and 2011 and I believe that Ms. Morelli has a claim to one-half of that equipment and one-half of that \$78,000.

3 RP 8-9.

The court's second oral ruling changed the \$50,000 from being "other value in the business" to being the value of assets acquired during the two years of committed intimate relationship, arriving at a ruling which recognized no "other value" in the business beyond equipment:

I realize that the effect of this is that it's a coincidence that the value of those assets is so close to the \$50,000 that the court had ascribed to the value of the business, but really the more I thought about it the more I thought that it was not appropriate to award wages when the whole argument that the Respondent was making was that Ms. Morelli's services during that time were to contribute to the business.

4 RP 417.

The trial court also changed the \$78,000 from being the value of Ken's Tree Service equipment from 2006-2011 to being the value of equipment purchased by Ken's Tree Service during the marriage. RP 415. The court decided that Ms. Morelli should be credited with half of what the court decided was the value of equipment acquired during the committed intimate relationship (half of \$50,000) and half of what the court decided was the value of equipment acquired by Ken's Tree Service during marriage (half of \$78,000), plus \$8,000 for uncompensated services Ms. Morelli rendered to Ken's Tree Service prior to the committed intimate relationship "to equalize awards." The total amount awarded to Ms. Morelli related to Ken's Tree Service was \$72,000. RP 417-18.

The final value assigned by the trial court to Ken's Tree Service was \$128,000. RP 415-16. The time-of-trial value assigned to it by Mr. Guerrero was \$349,000. 2 RP 311; Exhibit 121, p. 4, 5.

The court balanced the \$72,000 awarded to Ms. Morelli for Ken's Tree Service against community liabilities awarded to Mr. Morelli, and resulted in Mr. Morelli being awarded one residence with encumbrance, Ken's Tree Service, and his separate property Edward Jones account. RP 418. Ms. Morelli received an unencumbered residence and her separate property Canadian pension. RP 418.

The trial court repeatedly indicated its intention to create a 50/50 split of community assets. 3 RP 9, 10; 4 RP 408-10, 416.

d. The parties' positions on Ken's Tree Service. Mr. Morelli argued that Ken's Tree Service was and remained 100% separate property. CP 275-76. Citing Koher v. Morgan, 93 Wn. App. 398, 403-04, 968 P.2d 920, review denied, 137 Wn.2d 1035 (1999), Ms. Morelli argued that all the value accrued in Ken's Tree Service during the committed intimate relationship and that accrued during the marriage were community assets subject to a fair and equitable distribution. CP 287-88. Ms. Morelli also pointed to her extensive contributions to the business over the years as evidence of commingling which eliminated any residual separate character of the business CP 288-89.

E. ARGUMENT

THE TRIAL COURT'S CHARACTERIZATION AND VALUATION OF KEN'S TREE SERVICE FAILS TO CONFORM TO ACCEPTED METHODS AND MUST BE REVERSED AND REMANDED FOR REVALUATION AND REDISTRIBUTION OF ASSETS

1. THE TRIAL COURT COMMITTED REVERSIBLE ERROR WHEN IN CHARACTERIZED THE BUSINESS AS A SEPARATE ASSET

a. **Standard of Review.** The court's classification of property as separate or community is a question of law, to be reviewed *de novo*. In *re Marriage of Skarbek*, 100 Wn. App. 444, 447, 997 P.2d 447 (2000).

b. **The trial court failed to properly characterize Ken's Tree Service as a community asset.** Settled Washington law provides that assets accumulated due to labor of a spouse during marriage are community property. Our Supreme Court has addressed this point directly in the seminal case *Matter of Marriage of Fleege*, 91 Wn.2d 324, 588 P.2d 1136 (1979). In *Fleege*, the husband, a dentist, took the same position adopted by the trial court here, arguing unsuccessfully that his practice as a whole, including any goodwill it possessed, was separate property:

The respondent argues that the goodwill of a dental practice is not "true" goodwill, because it cannot be successfully transferred to a purchaser without certain services being performed by the practitioner. These services consist of introductions to the seller's patients and encouragement of

patients to accept the buyer as their dentist. He insists -- 327 -- that the amount purportedly paid for "goodwill" is in fact paid for these services, and represents "future earnings" which are not subject to division as community property.

91 Wn.2d at 326-27. The trial court here adopted precisely the same position expressed by the losing party in Fleege and explicitly rejected by our Supreme Court:

the income generated by Ken's Tree Service is primarily based upon the personal services provided by Kenneth Morelli and does not have a value without the work being performed by Kenneth Morelli and is therefore not a divisible community asset.

CP 324.

Our Supreme Court resoundingly rejected this approach. Id. at 228, 330. In unambiguous language, the court held that goodwill is community property and must be considered as such when distributing community property.

Community goodwill is a portion of the community value of the professional practice as a going concern on the date of the dissolution of the marriage. As observed in [citation omitted], ". . . in a matrimonial matter, the practice of the sole practitioner husband will continue, with the same intangible value as it had during the marriage. Under the principles of community property law, the wife, by virtue of her position of wife, made to that value the same contribution as does a wife to any of the husband's earnings and accumulations during marriage. She is as much entitled to be recompensed for that contribution as if it were represented by the increased value of stock in a family business.

91 Wn.2d at 328.

The Supreme Court explicitly addressed and rejected the rationale employed by the trial court here: "[t]he important consideration in this marriage dissolution case is not whether the goodwill of the practice could be sold without the personal services of the respondent to effectuate its transfer, but whether it has a value to him. 91 Wn.2d at 327.

The Supreme Court further explained:

The value of goodwill to the professional spouse, enabling him to continue to enjoy the patronage engendered by that goodwill, constitutes a community asset and should be considered by the court in distributing the community property. That value is real, and the mere fact that it cannot be precisely determined should not deter the court from assigning it a reasonable value within the evidence. Just as in other areas of the law where precise proof cannot be made, such difficulty does not constitute an insurmountable obstacle. Where, as was the case here at the time of trial, a professional man is approaching retirement age, the salable value of his practice should also be approximately determinable and is a factor to be taken into account.

91 Wn.2d at 330.

The case at bar is exactly like Fleege. Because the trial court failed to correctly characterize the business here as community property, this case should be remanded as was Fleege, for recharacterization, revaluation, and redivision of the community property.

2. THE TRIAL COURT COMMITTED REVERSIBLE ERROR WHEN IT VALUED THE BUSINESS AT ITS BOOK VALUE

a. Standard of Review. Generally, when a trial court applies the wrong legal standard an abuse of discretion will necessarily be found and the case remanded for the trial court to apply the correct standard. Rufer v. Abbott Labs., 154 Wn.2d 530, 540, 114 P.3d 1182 (2005) (where the trial court based its decision on an improper rule, the appellate court will remand to the trial court to apply the correct rule). A manifest abuse of discretion occurs when the discretion was exercised on untenable grounds. In re Marriage of Muhammad, 153 Wn.2d 795, 803, 108 P.3d 779 (2005). A trial court abuses its discretion when it fails to apply the applicable law. In re Parentage of M.F., 141 Wn.App. 558, 572, 170 P.3d 601 (2007). To determine whether the legal standard applied by the trial court is the correct legal standard involves a question of law that is reviewed *de novo*. See Dreiling v. Jain, 151 Wn.2d 900, 908, 93 P.3d 861 (2004).

b. The trial court's book value valuation of the business must be reversed. The trial court valued the business at book value, the depreciated value of its equipment and vehicles. RP 415-16, 3 RP 7-9. This approach is directly contrary to Washington law. In In re Marriage of

Berg, 47 Wn. App. 754, 757-58, 737 P.2d 680 (Wn. App. 1987), the husband owned a company and testified that its book value was \$42,000. 47 Wn. App. at 756. The trial court accepted this valuation even though the wife's expert valued the corporation using accepted accounting methods at \$94,000. *Id.*

This Court reversed the trial court, finding the book value method particularly inappropriate for determining the value of a closely held corporation:

We note that numerous courts have rejected the contention that book value alone is an accurate measure of a corporation's actual value. As one court has stated: "[t]here are probably few assets whose valuation imposes as difficult, intricate and sophisticated a task as interests in close corporations. They cannot be realistically evaluated by a simplistic approach which is based solely on book value, which fails to deal with the realities of the good will concept, which does not consider investment value of a business in terms of actual profit, and which does not deal with the question of discounting the value of a minority interest." [citation omitted.]

Id. at 758-59. The case was remanded for redetermination of the value of the corporation and the court was authorized to take additional evidence on the value of the business and revise the division of property. *Id.*

The Berg court followed the Supreme Court's holding in Fleege, where the trial court had made a similar error. In Fleege, the trial court valued the husband's dental practice at the value of its equipment and

accounts receivable. 91 Wn.2d at 328. Our Supreme Court soundly rejected this approach , requiring the court upon remand to determine the value of goodwill and any other factors beyond book value. 91 Wn.2d at 330.

Here, the trial court not only resorted to book value for this closely held corporation, but it calculated book value for only 6 out of the 8 years the community accumulated assets. Further, it adjusted downward the already-depreciated values presented by Ms. Morelli's expert. These errors resulted in an underestimation of book value of \$55,257. The trial court provided no rationale except that it believed on some unspecified basis that some unspecified values were too high. The court did not explain which numbers it felt were too high, or by how much it had reduced each number or why.

As in Fleege and Berg, the trial court's book value valuation for Ken's Tree Service should be reversed and the case remanded for a valuation that includes all the business assets including goodwill.

3. THE CASE MUST BE REMANDED FOR ANALYSIS OF THE FLEEGE FACTORS TO DETERMINE THE EXISTENCE AND EXTENT OF GOODWILL IN THE BUSINESS

a. Standard of Review. Generally, when a trial court applies the wrong legal standard an abuse of discretion will necessarily be

found and the case remanded for the trial court to apply the correct standard. Rufer v. Abbott Labs., 154 Wn.2d 530, 540, 114 P.3d 1182 (2005) (where the trial court based its decision on an improper rule, the appellate court will remand to the trial court to apply the correct rule). A manifest abuse of discretion occurs when the discretion was exercised on untenable grounds. In re Marriage of Muhammad, 153 Wn.2d 795, 803, 108 P.3d 779 (2005). A trial court abuses its discretion when it fails to apply the applicable law. In re Parentage of M.F., 141 Wn.App. 558, 572, 170 P.3d 601 (2007). To determine whether the legal standard applied by the trial court is the correct legal standard involves a question of law that is reviewed *de novo*. See Dreiling v. Jain, 151 Wn.2d 900, 908, 93 P.3d 861 (2004).

b. The trial court failed to acknowledge or apply the Fleege factors, thus the valuation must be reversed and remanded to determine the existence and value of goodwill in compliance with

Fleege. Our Supreme Court has provided a clear definition of goodwill:

Justice Story has thoroughly defined professional goodwill as a benefit or advantage "which is acquired by an establishment beyond the mere value of the capital, stock, funds or property employed therein, in consequence of the general public patronage and encouragement, which it receives from constant or habitual customers on account of its local position, or common celebrity, or reputation for skill or affluence, or punctuality, or from other accidental

circumstances or necessities, or even from ancient partialities or prejudices."

Hall, 103 Wn.2d at 239, citing In re Marriage of Lukens, 16 Wn. App. 481, 483-84, 558 P.2d 279, (1976).

Our Supreme Court has further explained that trial courts must evaluate businesses with reference to certain specific factors:

As the Court of Appeals pointed out, while the goodwill of a professional practice may not be readily marketable and the determination of its exact value may be difficult, that element may nevertheless be found to exist in a given professional practice. The determination of its value can be reached with the aid of expert testimony and by consideration of such factors as the practitioner's age, health, past earning power, reputation in the community for judgment, skill, and knowledge, and his comparative professional success. These have become known as the "Fleege factors.

Hall, at 103 Wn.2d at 242. It is under these Fleege factors that the determination of the existence of goodwill and its evaluation must be made. Id. at 243.

The trial court here stated in its initial ruling that there was "other value" in the business beyond the equipment, adding that "but in my view it's difficult to quantify and not nearly as substantial as Mr. Guerrero's estimates ..." 3 RP 9-10. In its second ruling, the trial court decided that there was no "other value" in the business at all, redesignating the figure it

had previously attributed to "other value" as the value of assets acquired during the committed intimate relationship. 4 RP 417.

At no point in any of its rulings or in its written orders did the trial court acknowledge Fleege or refer to the Fleege factors in any way. The court did not simply forget to say the word "Fleege," rather the court failed to address or evaluate the factors in any way, even indirectly. While the trial attorneys did not mention Fleege or its factors by name, Ms. Morelli did specifically request a community share of the business, including goodwill, as valued by her expert witness. CP 288-89.

Pursuant to Fleege and Hall, consideration on the record of the Fleege factors is mandatory and the trial court has an independent duty to perform a Fleege analysis. The trial court must address a request for valuation of a closely held corporation in a dissolution by analyzing the Fleege factors and, as will be discussed in the next section, the acceptability of the valuation method under Hall. "...[W]e continue to require their usage when appropriate, i.e., when those factors are present ..." 103 Wn.2d at 243; "The danger of using any one method without regard to the Fleege factors is apparent in the present case ..." 103 Wn.2d 245. See also In re Marriage of Monaghan, 78 Wn. App. 918, 925, 899 P.2d 841 (1995)(trial court must establish and set forth the existence or nonexistence of determinative factual matters).

Because the trial court failed in its duty to consider the Fleege factors and elucidate its Fleege analysis on the record, the valuation in this case must be reversed and the case remanded for revaluation and redistribution of community assets.

4. THE CASE MUST BE REMANDED FOR VALUATION USING ONE OF THE METHODS APPROVED BY HALL

a. Standard of Review. Generally, when a trial court applies the wrong legal standard an abuse of discretion will necessarily be found and the case remanded for the trial court to apply the correct standard. Rufer v. Abbott Labs., 154 Wn.2d 530, 540, 114 P.3d 1182 (2005) (where the trial court based its decision on an improper rule, the appellate court will remand to the trial court to apply the correct rule). A manifest abuse of discretion occurs when the discretion was exercised on untenable grounds. In re Marriage of Muhammad, 153 Wn.2d 795, 803, 108 P.3d 779 (2005). A trial court abuses its discretion when it fails to apply the applicable law. In re Parentage of M.F., 141 Wn.App. 558, 572, 170 P.3d 601 (2007). To determine whether the legal standard applied by the trial court is the correct legal standard involves a question of law that is reviewed *de novo*. See Dreiling v. Jain, 151 Wn.2d 900, 908, 93 P.3d 861 (2004).

b. Because the trial court failed to use one of the valuation methods approved in Hall, the valuation must be reversed and remanded for revaluation. Our Supreme Court has set forth five acceptable methods for valuing business goodwill. 103 Wn.2d at 244:

In valuing goodwill five major formulas have been articulated... [citations omitted.] There are three accounting formulas. Under the straight capitalization accounting method the average net profits of the practitioner are determined and this figure is capitalized at a definite rate, as, for example, 20 percent. This result is considered to be the total value of the business including both tangible and intangible assets. To determine the value of goodwill the book value of the business' assets are subtracted from the total value figure.

Id. at 243-44. This is the method used by Ms. Morelli's expert to value Ken's Tree Service. 2 RP 310-11; Exhibit 121, p. 2. Hall goes on to describe the other four acceptable methods for valuing goodwill; the capitalization of excess earnings method, the IRS variation of capitalized excess earnings method, the market value approach, and the buy/sell agreement method. Id. at 244.

As with the Fleege factors, our Supreme Court has held that it is mandatory to use one of the five valuation methods listed in Hall:

Although we continue to require [the Fleege factors'] usage when appropriate, i.e., when those factors are present, during valuation of goodwill, we now recognize various

methods which may be used in conjunction with these factors. The Fleege factors cannot be evaluated and valued in isolation. One or more of the accepted methods of valuation must be employed. The particular method used by the trial court will depend on the offered proof. Because evidence available to the court varies greatly from case to case, selection of any one method for all cases would unnecessarily limit the court in making a fair and just distribution.

103 Wn.2d at 243. (Emphasis added.)

This Court has consistently demonstrated its willingness to reverse and remand cases in which the trial court fails to apply Hall. Reversing in Berg, this Court stated that when a trial court values a closely held corporation for purposes of a dissolution it must set forth on the record which factors and method were used in reaching its finding of value, citing Hall. 47 Wn. App. 755. See also In re Marriage of Monaghan, 78 Wn. App. 918, 925, 899 P.2d 841 (1995)("In valuing a closely held business or a business largely dependent upon intangible assets associated with a professional practice, the trial court 'must set forth on the record which factors and methods were used in reaching its finding' of value.").

Here, the trial court failed to use one of the valuation methods specified in Hall. Instead, despite being presented with a valuation that used one of the Hall methods, it used book value, or rather its own modified version of book value, to place a value on the business, in direct

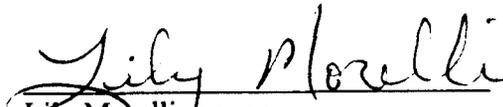
violation of Berg. Ultimately the court found that Ken's Tree Service, with current annual revenue of \$349,000 and a consistent history of such revenues and often more, was worth a book value total of \$128,000. Such a result is precisely what our appellate courts caution against in Hall and Berg. For this reason, the valuation must be reversed and remanded to superior court for revaluation in accordance with one of the five methods specified in Hall.

F. CONCLUSION

Ms. Morelli respectfully requests this court reverse the business valuation and property distribution and remand to the trial court for revaluation of the business, including determination of goodwill according to Fleege and Hall, and redistribution of the property.

DATED this 26th day of October, 2015.

Respectfully submitted:


Lily Morelli, *pro se*