

# New Jersey Business Divorce: Who Gets the Clients?

by Dan Brecher on May 15, 2012

In many cases, a New Jersey business divorce can be just as difficult as ending a marriage. In both situations, the parties have invested a great deal in the relationship and there are generally significant assets involved.

In fact, when a business breaks up, valuation of the business is often one of the most contentious legal issues. In many service-oriented industries such as law, health care, and accounting, clients may be the most important assets of the business. However, according to a recent New Jersey appellate decision, clients are often not subject to distribution.

## *The Facts of the Case*

The case, *Michael Gaines v. John Luongo*, involved an accounting firm governed by the New Jersey Limited Liability Company Act, N.J.S.A. 42:2B-1 to -70 (LLCA or the Act). Business partners Michael Gaines and John Luongo formalized the entity in an Operating Agreement executed in October 2004. The Operating Agreement provided that dissolution would be triggered by certain events, including the parties' unanimous agreement to dissolve the Company, the bankruptcy of the firm, or other events making it "impossible, unlawful or impractical" to carry on the business. It also contained a restrictive covenant that prohibited Luongo from competing with the firm for one year and within a 10-mile radius.

The legal dispute arose after the partners disagreed over whether they had agreed to break up the partnership or whether Luongo, the majority owner, had frozen Gaines out of the business. Gaines filed suit as an oppressed minority shareholder under N.J.S.A. 14A:2-7, asking the court to dissolve the LLC and enforce the restrictive covenant against Luongo. The trial court ruled that the parties had reached an agreement to dissolve the firm, but that the clients were not part of the assets to be distributed.

## *The Court's Decision*

The Appellate Division of the Superior Court of New Jersey affirmed. It agreed with the lower court's determination that an in-kind distribution was inconsistent with the nature of professional clients, whose value is found in personal goodwill.

The opinion states, "The value of clients in a professional corporation is found in the personal goodwill of the particular professional. Gaines and Luongo recognized this when they dissolved GGL and left it up to the clients to determine whom they wanted to utilize as their accountant. This Court finds that in a dissolution of GGL, clients are not

an asset which is to be revalued for the purposes of determining their fair market value when there is an in kind distribution.”

The Court further noted that the Operating Agreement did not support the classification of clients as assets. “Simply put, the Partnership’s clients were never carried on GGL’s books as an asset; no value was ever assigned to them on the Company’s balance sheets; and they were free to stay in business with either partner or neither,” the decision states.