



by HONEY KESSLER AMADO

# PERSONAL VALUES

*Should California follow the lead of other states in discarding the notion of personal goodwill as a community asset?*

California recognizes that goodwill may exist in the individual professional. But the hallmarks of goodwill—an ongoing business and continued patronage—correctly attach to an enterprise, not an individual. Thus, the absence of a market and of a real value for the individual’s personal goodwill are indicators that goodwill as a quantifiable asset does not exist in small and solo professional practices. Indeed, the legal basis for assuming that small and solo practices have goodwill is flawed.

Goodwill is the expectation of the continued popularity of a business. An intangible asset, it has been called the most intangible of intangibles.<sup>1</sup> Two hundred years ago, John Scott, Lord Eldon, chancellor of England, defined goodwill as “the probability that the old customers will resort to the old place.”<sup>2</sup> Echoing Lord Eldon, California and several

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other states succinctly define goodwill as “the expectation of continued public patronage.”<sup>3</sup> Goodwill has been more fully defined as:

The advantage or benefit 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.<sup>4</sup>

Thus, the significant attributes of goodwill are that: 1) it is acquired by a business, 2) its value is in excess of hard assets such as capital, stock, funds, or property, and 3) it is based on the likelihood of continued popularity and patronage resulting from the business’s reputation. The existence of an ongoing business is a crucial aspect of goodwill.

When first examining the issue of goodwill in a professional, California courts distinguished between goodwill in the individual and goodwill in the professional’s business.<sup>5</sup> Some states currently clarify the difference between individual and business goodwill by using separate nomenclature: The individual holds “personal goodwill,” and the business holds “enterprise goodwill.”<sup>6</sup> This nomenclature allows for more precise conceptualization of goodwill—and, ultimately, for more equitable resolution of the issue of goodwill.

In 1958, the California Supreme Court examined whether goodwill could attach to an advertising agency—a personal services company.<sup>7</sup> In resolving the question, the court distinguished between the work of a talented individual and the business created by that individual. The court concluded that although the goodwill of a business or company may be the result of the skill or reputation of an individual connected with the company, the resultant goodwill attached to the company and continued with it even after the skilled individual was no longer associated with the company.<sup>8</sup> Thus, the court acknowledged the distinction between a personal services organization and the person providing the personal service and allowed goodwill to attach only to the organization.<sup>9</sup>

Relatively contemporaneously, the California Court of Appeal also examined whether or not goodwill could attach to a business driven by the skills of its owner.<sup>10</sup> In a marital dissolution action, the husband, a dental technician, argued that goodwill could not attach to his dental laboratory business because, he alleged, the business depended solely on his personal skill and ability. He was

suggesting that, absent him, dentists would not choose his dental lab. The court rejected his argument, ironically tracing it to the “early and narrow definition given to goodwill by Lord Eldon.”<sup>11</sup> Yet it is precisely this “narrow definition” that is embraced by many states in their statutory definitions of goodwill.

The court endorsed what it believed was a better doctrine from *American Jurisprudence*, which suggested that goodwill could also exist in a professional practice or in a business that is founded upon personal skill or reputation because “winning the confidence of [the skilled individual’s] patrons and securing immunity from successful competition for their business” exemplifies the species of goodwill capable of being transferred.<sup>12</sup>

Thus, the two early California cases recognized goodwill that existed in a company in which the public patronage of the company survived the absence of its founding professional<sup>13</sup> and goodwill that could be transferred.<sup>14</sup> Transferable goodwill in the business was distinguished from the skill of the individual involved in founding the business. This distinction has been developed more fully in decisions by other states, but it became blurred in later California decisions.

In 1974, in the landmark case of *Marriage of Foster*, the California Court of Appeal stated confidently that “it is well-established that the goodwill of a husband’s professional practice as a sole practitioner is taken into consideration in determining the community property award to the wife.”<sup>15</sup> But this concept was not so well-established. The careful distinction made in the early cases between the individual and the individual’s company was omitted in later opinions and, ultimately, in finding the concept of goodwill in the solo practitioner to be well-established, the *Foster* court relied upon the abbreviated dicta of the later cases. Yet none of the cases cited as support by *Foster* held that goodwill exists in the solo practitioner or professional. In one case, the husband had not contested on appeal the finding that goodwill existed in his medical practice; he merely contested the valuation of the goodwill.<sup>16</sup> In a second case, the appellate court did not analyze whether goodwill existed in the husband’s medical practice but concluded that goodwill should be considered in determining the property award to the wife.<sup>17</sup> In a third case, the court simply acknowledged that the wife had an interest in her husband’s law practice that had been developed during the marriage. The case included no discussion of goodwill.<sup>18</sup>

### Ingrained Assumption versus Nuanced Analysis

The assumption that goodwill exists in a professional practice is so ingrained in California

law that the legal discussion in published opinions generally centers on valuation of that interest rather than on the existence of the interest.<sup>19</sup> In the 30 years since California courts first examined goodwill and distinguished the individual from his or her business or company, the distinction between personal goodwill and enterprise goodwill has almost disappeared.

Indeed, New York courts have sought to characterize a person’s talents and popularity as an asset. These courts have analogized a person’s expertise in a field that allowed him or her to become an exceptional wage earner to that of the goodwill of a business.<sup>20</sup> New York cases focused on a person’s “enhanced earning capacity,” calling it an asset of the marital estate.<sup>21</sup> (New York courts did not adopt the nomenclature “professional goodwill” or “personal goodwill.”) The source of that enhanced earning capacity was not relevant: It could be education, professional license, or fame.

New York’s concept of enhanced earning capacity as a divisible asset of the marriage is based upon the premise that marriage is “an economic partnership to which both parties contribute, as spouse, parent, wage earner or homemaker.”<sup>22</sup> Focusing on the enhanced earnings capability as the marital asset, New York courts have continued to expand the various training and professional resources that they recognize as an asset.<sup>23</sup> Indeed, New York courts have found the asset of enhanced earning capacity to exist in a supermodel/actress, an opera singer, a stockbroker, and a police lieutenant.<sup>24</sup>

Outside of the two giants—California (whose courts obscure the distinction between the goodwill in a business and the goodwill in an individual professional) and New York (whose courts view the enhanced earning capacity of the individual as personal goodwill)—other states have advanced the law on the issue of goodwill attaching to the individual in a more careful and thoughtful fashion.

In the state of Washington, the courts have recognized the distinction between goodwill and earning capacity—and their nuanced analysis exposes the notion of personal goodwill as a fiction. Goodwill is not the earning capacity itself; it is the asset that supplements the earning capacity of another asset, the business or profession.<sup>25</sup> Moreover, goodwill is a distinct asset of a business or professional practice that may influence or be influenced by earning capacity.<sup>26</sup> The concept of goodwill as the expectation of sustained business and continued patronage, of “old customers [resorting] to the old place,” must survive an individual, with patrons continuing to go to a store absent the original founders or to a law firm absent the found-

ing or named partners. In effect, goodwill requires an ongoing business or professional practice to which it can attach. In contrast, however, the earning capacity of an individual who constitutes his or her entire business is diminished or ceases altogether upon the individual's retirement or death.<sup>27</sup> The individual has no earning capacity beyond his or her working hours. As described by the Missouri Court of Appeals, Missouri's intermediate review court, "[The] [a]ppellant is a sole practitioner. Were he to terminate his activity, the lights would go out and the value of his practice would be extinguished."<sup>28</sup>

The Missouri Supreme Court also considered the issue of goodwill and held that the hallmark of goodwill is that it is an asset—albeit an intangible asset—that can be sold.<sup>29</sup> Because of its capacity to be sold, goodwill does not attach to an individual; it attaches only to a business. Also, goodwill only has value in connection with a continuing business.<sup>30</sup> Thus, the reputation of a professional as an individual and the reputation of a professional practice as a business entity are separate and distinct. Further, it is the goodwill of the professional practice that constitutes the marital asset and is subject to valuation and division. In the context of a professional practice, the Missouri Supreme Court defined goodwill to mean "the value of the practice which exceeds its tangible assets and which is the result of the tendency of clients [or] patients to return to and recommend the practice *irrespective of the reputation of the individual practitioner.*"<sup>31</sup>

This theme that goodwill in a professional practice must survive the individual professional is reflected in the thinking of the Maryland courts as well. The Maryland Court of Appeals, Maryland's highest review court, noted that if the goodwill of a professional practice were marketable, it could be divided as a marital asset.<sup>32</sup> But if the value of the practice is dependent upon the continued presence of the individual, the goodwill is personal to the individual and has no separate value.<sup>33</sup> The court concluded that the goodwill of a solo law practice is personal to the individual practitioner. It is not severable from the individual regardless of the contributions made to the practice by a spouse of the professional or employees of the practice. Absent the individual, the practice has no value. Thus, the goodwill of the practice is not the kind of asset that can be divided as marital property.<sup>34</sup>

The most recent cases have moved the discussion about professional goodwill forward by ascribing a nomenclature to its two types: enterprise goodwill (known also as commercial or professional goodwill) and personal goodwill (also called professional goodwill).<sup>35</sup> Ironically, with courts and prac-

tioners referring to enterprise goodwill and personal goodwill as professional goodwill, confusion and muddled references can result. The best approaches are for the term "professional goodwill" to refer only to the individual or to be recognized as a broad category of goodwill with two separate components, personal goodwill and enterprise goodwill.

Enterprise goodwill is an asset with a determinable value, because the enterprise goodwill of an ongoing business will transfer upon sale of the business to a willing buyer.<sup>36</sup> By attaching to a business entity and remaining separate from the reputation of the owners, enterprise goodwill will survive the absence of any individual. In contrast, personal goodwill is part of the increased earn-

ing capacity "that results from the reputation, knowledge and skills of individual people. Accordingly, the goodwill of a service business, such as a professional practice, consists largely of personal goodwill."<sup>37</sup> Personal goodwill, which is intrinsically tied to the attributes or skills of an individual, is not a divisible asset subject to equitable distribution: "Assets that are 'uniquely personal' to the holder cannot, by their very nature, be held jointly with another person and, consequently, cannot be classified as marital property."<sup>38</sup> The majority of states now differentiate between enterprise goodwill and personal goodwill and hold that enterprise goodwill is an asset of the marital estate, while personal goodwill is not.<sup>39</sup>

## The Value of Celebrity

**A SUBSET OF PERSONAL GOODWILL** is celebrity goodwill, which generally refers to a person's fame or enhanced earning capacity. As with personal goodwill, celebrity goodwill should not be characterized as an asset. California does not recognize celebrity goodwill as an asset; only New Jersey has done so, declaring it to be a distributable asset.<sup>1</sup> The issue arose in the case of actor Joe Piscopo, best known for his work on *Saturday Night Live*. However, the Piscopo case is not authority for the legitimacy of the concept of celebrity goodwill because Joe Piscopo conceded at the appellate level that celebrity goodwill could be a distributable marital asset. Thus, the appellate court addressed itself exclusively to valuing the asset. It never examined—or struggled with—the problems inherent in the underlying concept of celebrity goodwill.

Celebrity goodwill should not be confused with the right to publicity, which is an individual's right to exploit his or her own name and likeness for commercial gain.<sup>2</sup> While goodwill is dependent on continued patronage by strangers, the right to publicity is entirely within the control of the individual celebrity.

Goodwill cannot be valued in any way that takes future earnings into consideration. However, a consideration of future earnings is not prohibited in all situations: Future earnings are relevant to determining the need or ability to pay child or spousal support.<sup>3</sup> Future earnings also are relevant to establishing a party's net worth for the purpose of imposing punitive damages. Because punitive damages may be punitive but not destructive, future income and net worth are critical to assessing a person's ability to pay the punitive damages and to weighing the impact of the damages.<sup>4</sup>

Although the question of whether an individual can be forced to exploit his or her celebrity status has not been fully explored in the case law, it is established that courts may include a present value for future commercial exploitation of name and likeness when determining a celebrity's net worth relative to punitive damages.<sup>5</sup>—H.K.A.

<sup>1</sup> Piscopo v. Piscopo, 232 N.J. Super. 559, 557 A. 2d 1040 (1989).

<sup>2</sup> Civ. CODE §3344; KNB Enters. v. Matthews, 78 Cal. App. 4th 362, 366-67 (2000); Eastwood v. Superior Court (Nat'l Enquirer, Inc.), 149 Cal. App. 3d 409, 419-20 (1984), *superseded by statute on other grounds, as stated in* KNB Enters., 78 Cal. App. 4th at 367 n.5.

<sup>3</sup> FAM. CODE §§4053, 4320.

<sup>4</sup> Rufo v. Simpson, 86 Cal. App. 4th 573, 621-22 (2001). See Kirk A. Pasich, *Bad Faith: The New Generation Weapon*, AMERICAN LAW INSTITUTE-AMERICAN BAR ASSOCIATION CONTINUING LEGAL EDUCATION, ALI-ABA COURSE OF STUDY, SG102 ALI-ABA 201, 213-214 (June 13-14, 2002). In addition, the Model Punitive Damages Act §7(a) lists a defendant's present and future financial condition as a consideration for punitive damages.

<sup>5</sup> Rufo, 86 Cal. App. 4th at 621-22.

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Similarly, the uniquely personal skills of a celebrity cannot—by nature—be shared with another person. Thus, recognizing the distinction between personal and enterprise goodwill underscores that celebrity goodwill is not a marital asset. (See “The Value of Celebrity,” page 41.)

**Valuation and Future Earnings**

Goodwill presupposes continued patronage and continued popularity. But goodwill cannot be valued in any way that incorporates future earnings, because future earnings are the separate property of the earning spouse.<sup>40</sup> Future earnings represent the future effort and work of the individual and no longer belong to the community.<sup>41</sup> (In California, a community property state, earnings are separate property after the date of separation. In other states, the beginning of separate property earnings may be marked by the date of separation or the date of judgment. Whatever date is used, any asset that incorporates future earnings is reliant on separate property earnings.) While future earnings are relevant to determining spousal support and alimony, they are not a proper consideration for dividing marital assets.<sup>42</sup>

Indeed, as the Missouri Supreme Court noted, “[T]he concept of professional [personal] goodwill evanesces when one attempts to distinguish it from future earnings.”<sup>43</sup> The distinction cannot be made because goodwill assumes the continuation of work. Further, maintaining personal goodwill requires the individual to continue nurturing or honing and marketing his or her skills. Those efforts necessarily occur postseparation, giving rise to postseparation earnings.

The concept of personal goodwill as an asset evaporates further as one attempts to value it. Absent a recent actual sale of the professional practice or a real offer to purchase the practice, or absent evidence of the goodwill value in a similar practice in a relevant geographic and professional market, the existence and value of goodwill is entirely speculative.<sup>44</sup>

It is remarkable that some states, including California, have held that personal goodwill can be valued *even if it cannot be sold*.<sup>45</sup> But the fiction of value—notwithstanding the magical working of numbers by forensic accountants—has not been lost on some courts. Following the lead of the Missouri Supreme Court, the Missouri Court of Appeals held that “a professional practitioner is not required to pay a spouse a share of intangible assets at a judicially determined value that could not be realized by a sale or other method of liquidating value.”<sup>46</sup> In even stronger language, the District of Columbia Court of Appeals called this forced purchase of an intangible asset at a judicially deter-

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mined value a "disturbing inequity."<sup>47</sup>

The court could not have chosen a more apt phrase. No professional should be forced to pay a speculative price for the privilege of using his or her own talents. The law cannot sustain the concept of personal goodwill in the individual as a divisible asset. ■

<sup>1</sup> *Travis v. Travis*, 1990 Okla. 57, 795 P. 2d 96, 97 (1990) (citing D. KIESO & J. WEYGANDT, INTERMEDIATE ACCOUNTING 570 (3d ed. 1980)).

<sup>2</sup> *Cruttwell v. Lye*, 17 Ves. 335, 346, 34 Eng. Rep. 129, 134 (1810).

<sup>3</sup> See, e.g., BUS. & PROF. CODE §14100 (California); 60 OKLA. STAT. §315 (Oklahoma); MONT. CODE ANN. §30-13-121 (Montana); S.D. CODIFIED LAWS §43-35-6 (South Dakota).

<sup>4</sup> *Marriage of Foster*, 42 Cal. App. 3d 577, 581-82 (1974); *May v. May*, 214 W. Va. 394, 589 S.E. 2d 536, 541 (2003). See also WYO. STAT. ANN. §1-26-713 (1977) ("Goodwill" consists of the benefits that accrue to a business as a result of its location, reputation for dependability, skill or quality and any other circumstances resulting in probable retention of old or acquisition of new patronage.").

<sup>5</sup> See *Mueller v. Mueller*, 144 Cal. App. 2d 245 (1956); *Smith v. Bull*, 50 Cal. 2d 294 (1958).

<sup>6</sup> See, e.g., *May*, 589 S.E. 2d at 541.

<sup>7</sup> *Smith*, 50 Cal. 2d at 301.

<sup>8</sup> *Id.* at 302.

<sup>9</sup> *Id.*

<sup>10</sup> *Mueller*, 144 Cal. App. 2d 245.

<sup>11</sup> *Id.* at 251 (citing 24 AM. JUR. 808).

<sup>12</sup> *Id.* Ultimately, the court rejected the husband's claim that the business depended solely on his personal skill and abilities, noting that the business employed five technicians in addition to the husband.

<sup>13</sup> *Smith*, 50 Cal. 2d 294.

<sup>14</sup> *Mueller*, 144 Cal. App. 2d 245. This concept of transferability is especially important in any discussion of professional goodwill involving an attorney. In some states, law practices cannot be bought and sold like other professional practices. See *Hershewe v. Hershewe*, 931 S.W. 2d 198 (Mo. 1996); *Travis v. Travis*, 1990 Okla. 57, 795 P. 2d 96, 97 (1990).

<sup>15</sup> *Marriage of Foster*, 42 Cal. App. 3d 577, 582 (1974).

<sup>16</sup> *Marriage of Fortier*, 34 Cal. App. 3d 384 (1973).

<sup>17</sup> *Golden v. Golden*, 270 Cal. App. 2d 401, 405 (1969).

<sup>18</sup> *Brawman v. Brawman*, 199 Cal. App. 2d 876, 882 (1962).

<sup>19</sup> See, e.g., *Marriage of Watts*, 171 Cal. App. 3d 366 (1985); *Marriage of Kilbourne*, 232 Cal. App. 3d 1518 (1991); *Marriage of Rosen*, 105 Cal. App. 4th 808 (2002); *Marriage of Iredale & Cates*, 121 Cal. App. 4th 321 (2004).

<sup>20</sup> *Golub v. Golub*, 139 Misc. 2d 440, 445-46, 527 N.Y.S. 2d 946, 950 (1988).

<sup>21</sup> *Id.*, 139 Misc. 2d at 444, 527 N.Y.S. 2d at 949; *O'Brien v. O'Brien*, 66 N.Y. 2d 576, 498 N.Y.S. 2d 743, 489 N.E. 2d 712 (1985) ("A professional license is a valuable property right, reflected in the money, effort and lost opportunity for employment expended in its acquisition, and also the enhanced earning capacity it affords its holder, which may not be revoked without due process of law.").

<sup>22</sup> *Elkus v. Elkus*, 169 A.D. 2d 134, 138, 572 N.Y.S. 2d 901, 903 (1991).

<sup>23</sup> *Allocco v. Allocco*, 152 Misc. 2d 529, 578 N.Y.S. 2d 995 (1991) (police lieutenant) ("The two degrees [associate's and bachelor's degrees] obtained by the Defendant in this case constitute marital property, which enhanced the Defendant's earning capacity

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because of the knowledge and other skills represented by those degrees. In addition, successful completion of the civil service examinations, which resulted from the knowledge represented by those degrees as well as the direct studies for such examinations, enhanced the Defendant's earning capacity, and should be considered as marital property subject to equitable distribution."); *Moll v. Moll*, 187 Misc. 2d 770, 774, 722 N.Y.S. 2d 732, 734 (2001) (stockbroker) ["[A]n interest in a profession or professional career potential is marital property which may be represented by direct or indirect contributions of the non-title-holding spouse, including financial contributions and nonfinancial contributions made by caring for the home and family."); <sup>24</sup> See *Golub*, 139 Misc. 2d 440, 527 N.Y.S. 2d 946 (model/actress); *Elkus*, 169 A.D. 2d 134, 572 N.Y.S. 2d 901 (opera singer); *Allocco*, 152 Misc. 2d 529, 578 N.Y.S. 2d 995; *Moll*, 187 Misc. 2d 770, 722 N.Y.S. 2d 732.

<sup>25</sup> *Hall v. Hall*, 103 Wash. 2d 236, 241, 692 P. 2d 175, 178 (1984), *disapproved on the issue of valuation only in Hanson v. Hanson*, 738 S.W. 2d 429, 436 (1987).

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Hershewe v. Hershewe*, 931 S.W. 2d 198, 204 (Mo. 1996).

<sup>29</sup> *Hanson*, 738 S.W. 2d at 433.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.* at 434 (emphasis added).

<sup>32</sup> *Prahinski v. Prahinski*, 321 Md. 227, 239, 582 A. 2d 784 (1990). *Prahinski* includes a wonderful discussion of the various ways that states treat professional goodwill. For a summary of the states recognizing goodwill in law practices and medical and dental practices, see also *Travis v. Travis*, 1990 Okla. 57, 795 P. 2d 96, 97 n.1 (1990).

<sup>33</sup> *Prahinski*, 321 Md. at 239.

<sup>34</sup> *Id.* at 239-40.

<sup>35</sup> *May v. May*, 214 W. Va. 394, 589 S.E. 2d 536, 541 (2003).

<sup>36</sup> *Id.*; see also *Williams v. Williams*, 82 Ark. App. 294, 314, 108 S.W. 3d 629, 642 (2003).

<sup>37</sup> *May*, 589 S.E. 2d at 542.

<sup>38</sup> *Id.* at 547.

<sup>39</sup> *Id.* at 545-46.

<sup>40</sup> *Marriage of Slater*, 100 Cal. App. 3d 241, 247 (1980); *Marriage of King*, 150 Cal. App. 3d 304, 309 (1984); *Hanson v. Hanson*, 738 S.W. 2d 429, 435 (1987). Valuing goodwill may also result in a "double dip" into a spouse's future earnings: The income stream used to value goodwill is distributed as property and is also used to pay support. See Donald J. Miod, *The Double Dip in Valuing Goodwill in Divorce*, CPA LITIGATION SERVICE COUNSELOR, vol. 1998, Issues 4 & 5, at 1 (Apr. & May 1998).

<sup>41</sup> *Marriage of Rives*, 130 Cal. App. 3d 138, 149 (1982); *Marriage of Lopez*, 38 Cal. App. 3d 93, 109-110 (1974).

<sup>42</sup> *Wilson v. Wilson*, 294 Ark. 194, 205, 741 S.W. 2d 640, 647 (1987); see also *Rufo v. Simpson*, 86 Cal. App. 4th 573, 621-22 (2001) (regarding future earnings relative to net worth and punitive damages).

<sup>43</sup> *Hanson*, 738 S.W. 2d at 434 (citing *Holbrook v. Holbrook*, 103 Wisc. 2d 327, 309 N.W. 2d 343, 354 (1981)).

<sup>44</sup> *Id.* at 435.

<sup>45</sup> *Marriage of Foster*, 42 Cal. App. 3d 577, 584 (1974); *Marriage of Watts*, 171 Cal. App. 3d 366, 372 (1985); *Hall v. Hall*, 103 Wash. 2d 236, 239 (1984), *disapproved on the issue of valuation only in Hanson*, 738 S.W. 2d 429.

<sup>46</sup> *Marriage of Hershewe*, 931 S.W. 2d 198, 203 (1996).

<sup>47</sup> *McDiarmid v. McDiarmid*, 649 A. 2d 810, 815 (1994).