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PROFESSIONAL GOODWILL: IS IT A  
SETTLED QUESTION OR IS THERE  
“VALUE” IN DISCUSSING IT?

## I. Introduction

With the advent of no-fault divorce approximately twenty years ago, the legal landscape of divorce changed significantly, presenting numerous challenges to the matrimonial lawyer. One such change has been a heightened focus on identifying property belonging to the marital unit.<sup>1</sup> Marriage is now viewed by the law as a partnership, both in community property states and equitable distribution states.<sup>2</sup> As in a business partnership, “it is presumed that the marital partners contribute equally to the acquisition of property and should therefore share in its distribution at dissolution.”<sup>3</sup> Consequently, it is important to identify and characterize, regardless of title, marital property subject to division when spouses end the partnership.<sup>4</sup> Also contributing to this emphasis on identifying what is marital property is a change in the balance of power between spouses under a no-fault system. Previously, one spouse had to prove fault to obtain a divorce, resulting in an unequal balance of power where one party held the control to negotiate a suitable settlement. No-fault divorce removed the leverage and “the importance of the legal and economic definitions of property increased.”<sup>5</sup> Traditional notions of what is “property” have expanded.

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<sup>1</sup> Allen M. Parkman, *The Economic Approach to Valuing A Sacrificed Career in Divorce Proceedings*, 2 J. AM. ACAD. MATRIM. LAW. 45 (1986); see also Mary Kay Kisthardt, *Professional Goodwill in Marital Dissolution Cases*, 44 J. MO. B. 457 (1988).

<sup>2</sup> Diane Green Smith, Note, *'Til Success Do Us Part: How Illinois Promotes Inequities in Property Distribution Pursuant to Divorce by Excluding Professional Goodwill*, 26 J. MARSHALL L. REV. 147, 153-57 (1992); see also Bea Ann Smith, *The Partnership Theory of Marriage: A Borrowed Solution Falls*, 68 TEX. L. REV. 689, 690 (1990).

<sup>3</sup> Kisthardt, *supra* note 1, at 457.

<sup>4</sup> Diane Green Smith, *supra* note 2, at 158.

<sup>5</sup> Parkman, *supra* note 1, at 46.

Under the partnership theory of marriage, interests not previously thought of as marital property have been identified. The “pie” has been expanded. One such interest is the professional goodwill of one spouse’s business. In the last ten to fifteen years, many state courts addressed the question of whether professional goodwill would be characterized as marital property.<sup>6</sup> Three approaches have been identified: (a) some courts held professional goodwill could never be characterized as marital property; (b) some courts held professional goodwill is marital property; and (c) some courts held only professional goodwill which is separate from the reputation of the professional spouse will be marital property.<sup>7</sup>

One the marital property “pie” expands to consider professional goodwill, an equally important question is its valuation. While the characterization of professional goodwill is largely settled, the valuation of goodwill is not. In valuation issues, the court has significant discretion.<sup>8</sup> This discretion provides an opportunity for matrimonial lawyers to present “the creative argument that captures the attention of the court and produces the desired. . . result.”<sup>9</sup> The first step is understanding the reasoning courts use to characterize goodwill. When courts reject professional goodwill as marital property, what are the concerns? Likewise, when courts are willing to find professional goodwill might be marital property, what must be proven? The second step is to

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<sup>6</sup> Mary Kay Kisthardt, *Professional Good in Marital Dissolution Cases: the State Of the Law*, in VALUING PROFESSIONAL PRACTICES AND LICENSES: A GUIDE FOR THE MATRIMONIAL PRACTITIONER § 2.01 (Ronald L. Brown ed., 1998).

<sup>7</sup> *Id.* For a comprehensive review of cases in each category, see also Martin J. McMahon, Annotation; *Divorce and Separation: Goodwill in Law Practice as Property Subject to Distribution on Dissolution of Marriage*, 79 A.L.R. 4th 171 (1990) [hereinafter McMahon, Law Practice] and Martin J. McMahon, Annotation, *Valuation of Goodwill in Medical or Dental Practice for Purposes of Divorce Court’s Property Distribution*, 78 A.L.R. 4th 853 (1990) [hereinafter McMahon, Medical or Dental Practice].

<sup>8</sup> See Andrew C. Mallor et. al., *A Professional’s Guide for Surviving Divorce in Indiana*, 37 RES GESTAE, 112 (1993); Thomas W. Crockett & J. Randall Patterson, *Dividing the Property in a Marital Dissolution*, 62 MISS. L.J. 57 (1992); See also Marsha Garrison, *How Do Judges Decide Divorce Cases? An Empirical Analysis of Discretionary Decision Making*, 74 N.C. L. REV. 401 (1996).

<sup>9</sup> Crockett & Patterson, *supra* note 8, at 58.

be familiar with common valuation methods. Matrimonial lawyers do not need to double as accountants or economists, but must understand the premises and assumptions of valuation methods. The third step is, with the foregoing information, to (a) choose that valuation method (or methods) most appropriate in the particular case and (b) articularly show the court why that method (or methods) addresses the court's concerns or requirements for proof. This article will address these steps, as well as review alternative means of conceptualizing professional goodwill and its valuation.

## II. Defining Professional Goodwill

While this article focuses on professional goodwill, it is important to understand the basic concept of goodwill. Defining goodwill is a complicated task. In part this is due to distinctions between the legal definition of goodwill and an accounting or economics definition. The accounting concept of goodwill measures or values goodwill, while the legal concept defines when the interest exists.<sup>10</sup> Courts addressing marital property issues at divorce use both concepts, often without making the distinction clear. The accounting concept measures goodwill using excess earnings and excess value.<sup>11</sup> Excess earnings refers to whether the business at issue has returns in excess of the "normal rate of return for the identifiable tangible and intangible assets used in [that] given business."<sup>12</sup> If so, the excess is goodwill. Also goodwill is present when a business is sold as a going concern and the price paid is in excess of the market value of its assets.<sup>13</sup> In economic terms goodwill is "the economic benefits that a going con-

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<sup>10</sup> Erich J. Wildman, Casenote & Comment, *Professional Goodwill as Divisible Community Property: How Should Idaho Approach the Issue?*, 30 IDAHO L. REV. 825, 828-29 (1994); see also Allen Parkman, *The Treatment of Professional Goodwill in Divorce Proceedings*, 18 FAM. L.Q. 213 (1984).

<sup>11</sup> Parkman, *supra* note 10, at 213-14. See also *Hanson v. Hanson*, 738 S.W.2d 429, 433 (Mo. 1987) (nothing accounting definition involves the economic advantage of a business which is worth more than its assets); *Russell v. Russell*, 399 S.E.2d 16, 168 (Va. Ct. App. 1990) ("Goodwill has been defined as 'the increased value of the business, over and above the value of its assets, that results from the expectation of continued public patronage.'")

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* See also Wildman, *supra* note 10, at 829.

cern may enjoy as compared to a new firm, from (1) established relations with all the markets - both output and input, (2) established relations with government departments and other non-commercial bodies, and (3) personal relationships.”<sup>14</sup> In both cases, the focus is on goodwill as an asset of the business.<sup>15</sup> In contrast, the legal definition of goodwill focuses on return patronage, the “tendency for customers to return to the same location or company because of its name or other reasons regardless of location.”<sup>16</sup> The legal concept explains why excess value, measured by the accounting definition, exists. The legal definition is criticized as “most frequently quoted in appellate decisions. . . [but] probably the most useless for valuation purposes,”<sup>17</sup> because it does not distinguish whether the benefit

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<sup>14</sup> Parkman, *supra* note 10, at 214.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* at 215. (citation omitted). See also *Butler v. Butler*, 621 A.2d 659, 665 (Pa. Super Ct. 1993) (“the favor which the management of a business has won from the public; and probability that old customers will continue their patronage”), *aff’d in part, rev’d in part*, 663 A.2d 148 (Pa. 1995); *Berger v. Berger*, 648 NE.2d 378, 383 (Ind. Ct. App. 1995)

(“The custom of patronage of any established trade or business; the benefit of advantage of having established a business and secured its patronage by the public. And as property incident to business sold, favor vendor has won from the public, and the probability that all customers will continue their patronage.”);

*Powell v. Powell*, 648 P.2d 218, 222 (Kan. 1982) (“The chief elements of goodwill are continuity of place and continuity of time. Goodwill means an established business at a given place with the patronage that attaches to the name and the location. It is the probability that old customers will resort to the old place.”); Michael G. Heyman, *Goodwill and the Ideal of Equality: Marital Property at the Crossroads*, 31 U. LOUISVILLE J. FAM.L. 1, 6-7 (1992/1993) (“the advantage one business has over its competition because of its favorable image for providing a good product”).

<sup>17</sup> James T. Friedman, *Professional Practice Goodwill: An Abused Value Concept*, 2 J. AM. ACAD. MATRIM. L. 23, 24 n.4 (1986). Friedman quotes as the most frequently used definition:

[Goodwill is] . . . 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 general public patronage and encouragement, which is 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.

from return customers is attributable to the individual or the business.<sup>18</sup>

Defining goodwill is also complicated because courts do not carefully define and distinguish different types. Goodwill may be commercial or professional, depending on the type of business. Goodwill may also be enterprise or personal, depending on the source of the goodwill. Unfortunately, the categories are not always clear or necessarily exclusive. Commercial goodwill is 'goodwill that derives from a commercial establishment such as a retail store,' and "is routinely divided as property in both marital and nonmarital situations."<sup>19</sup> Enterprise goodwill is a very similar concept. Enterprise goodwill is marketable, "associated with a recognizable name or product [and] can be delivered to the purchaser."<sup>20</sup> Examples are H&R Block or Lenscrafters.<sup>21</sup> Enterprise goodwill is associated with the "elements of a business separate and apart from the individual owners."<sup>22</sup> Conversely, personal goodwill is associated with individuals. It is . . . [the] part of increased earning capacity that results from the reputation, knowledge and skills of individual people," and is nontransferable and unmarketable.<sup>23</sup> Similar to personal goodwill, professional goodwill is often characterized as 'conceptually distinct from that associated with a trade or business' and attached to the individual.<sup>24</sup> As to professional goodwill:

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J. Storey, *Commentaries on the Law of Partnership* 170 (6th ed. 1868).

<sup>18</sup> Parkman, *supra* note 10, at 215.

<sup>19</sup> Carmen Valle Patel, *Treating Professional Goodwill as Marital Property in Equitable Distribution States*, 58 N.Y.U. L. REV. 554 (1983). *See also* Holbrook v. Holbrook, 309 N.W.2d 343, 352 (Wis. Ct. App. 1981) (explaining that originally goodwill was held only to exist in a commercial business); Skrabak v. Skrabak, No. 674, 1996 WL 143345 (Md. Ct. Spec. App. 1996); Kisthardt, *supra* note 1, at 458 (noting courts recognize commercial goodwill as an asset that cannot exist separately from the business and has been considered in dividing marital assets).

<sup>20</sup> Michael W. Kaicheim & Norah M. Plante, *Professional Goodwill in Divorce After Zells*, 79 ILL. B.J. 624 (1991).

<sup>21</sup> *Id.*

<sup>22</sup> Diane Green Smith, *supra* note 2, at 164.

<sup>23</sup> *Id.* at 165. However, Smith argues the lack of marketability may be a misconception. *See also* Friedman, *supra* note 17, at 25; Kaicheim & Plante, *supra* note 20, at 624.

<sup>24</sup> Guzman v. Guzman, 827 S.W.2d 445, 447 (Tex. Ct. App. 1992) (citations omitted).

[I]n most professional practices, goodwill is largely dependent upon the skills and attributes of the individual practitioners. This raises the difficulty courts have faced in determining whether or not professional goodwill is marital property: that is, where does one draw the line between the value of a business entity's goodwill and the value of a professional practitioner's personal reputation.<sup>25</sup>

As this definition recognizes; however, a definition of professional goodwill may span all the categories. In fact, a hard and fast distinction between commercial goodwill and professional goodwill may actually be misleading. Michael Heyman argues by looking at the source of both types of goodwill, it is clear that dividing goodwill into commercial and professional misconceives its nature, since "in each case, . . . is personal skill, knowledge and ability that initially created the reputation which draw in the business."<sup>26</sup> While generally the law has recognized goodwill may be found in both commercial and professional practices, family law has not yet caught up.<sup>27</sup> In addition to having commonality with commercial goodwill, professional goodwill may include elements of both personal and enterprise goodwill, even though courts generally assert it only includes personal goodwill.<sup>28</sup> Professional goodwill may be in part attributable to the individual's reputation and in part associated with the entity.

Defining goodwill must be done carefully, considering the purpose for the definition. Accounting or economics experts testifying about professional goodwill in the dissolution trial may be

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<sup>25</sup> Kisthardt, *supra* note 1, at 458. *See also* Wildman, *supra* note 10, at 829-31 (noting the problem occurs in professional practices when "the goodwill is found to inhere in the practitioner rather than in the professional practice," and courts generally do not find this goodwill to be marital property).

<sup>26</sup> Heyman, *supra* note 16, at 9. *See also* Patel, *supra* note 19, at 563-65 (explaining commercial goodwill, similarly to professional goodwill, depends on a manager's personal skills and attributes).

<sup>27</sup> *Id.* at 10. Heyman describes family law cases as "a hideous cacophony of angry rhetoric and invective; each court addressing the issue of the divisibility of professional goodwill. . . piously, while pointing out the frightful distortions created by courts elsewhere." *Id.* at 14. But see *Hanson v. Hanson*, 738 S.W.2d 429, 433 (Mo. 1987) (holding goodwill in an oral surgery partnership was a marital asset subject to division in dissolution proceedings). The Missouri Supreme Court did "catch up" about nine years ago when it noted goodwill in the professional setting was "no less property than that arising from a commercial setting." *Id.* at 433.

<sup>28</sup> Diane Green Smith, *supra* note 2, at 165.

implicitly using a definition with a different focus than the legal concept. In addition, professional goodwill itself is a multi-layered concept, with aspects of personal reputation and business reputation. Adding the overriding concern not to include an individual's personal efforts or skills as marital property explains much of the confusion among courts in characterizing and valuing professional goodwill. Understanding these dimensions helps clarify why courts treat professional goodwill in such diametrically opposed ways.

### III. Methods of Characterizing Goodwill

Courts generally adopt one of three viewpoints on professional goodwill. There is no consensus, either in characterizing or valuing professional goodwill. The purpose of this section is to explore the underlying rationales behind the viewpoints, not to categorize each state's holdings. Frequently, the arguments for each view seem to reverse mirror images of one another.

#### *Professional Goodwill is not Marital Property*

A number of rationales are given by courts who have held professional goodwill is not a marital asset and is therefore not distributed at divorce. Professional goodwill is said to be too speculative and hard to value to be marital property.<sup>29</sup> In *Sorensen*, the husband appealed, arguing the trial court should not have included goodwill and reputation in valuing his dental practice, where he was the sole practitioner.<sup>30</sup> While the total value of the practice was \$100,060, goodwill and reputation accounted for \$62,560.<sup>31</sup> The Utah Supreme Court "specifically [found] that such a determination is too speculative in nature and no amount of accounting gymnastics can give to such a computation the degree of credibility such that [the] Court would feel justified in setting a dollar figure. . . ."<sup>32</sup> Professional goodwill has also been

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<sup>29</sup> See *Hollander v. Hollander*, 597 A.2d 1012 (Md. 1991); *Travis v. Travis*, 795 P.2d 96 (Okla. 1990); *Hickum v. Hickum*, 463 S.E.2d 321 (S.C. Ct. App. 1995); *Sorensen v. Sorensen*, 839 P.2d 774 (Utah 1992); *Holbrook v. Holbrook*, 309 N.W.2d 343 (Wis. Ct. App. 1981).

<sup>30</sup> *Sorensen*, 839 P.2d at 775.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.* at 776.

described as “amorphous, ephemeral, elusive, and, by general definition, speculative and uncertain.”<sup>33</sup>

Professional goodwill is not marital property because it is not actually a distinct property interest from the individual. As evidence, goodwill disappears upon a professional’s retirement, relocation or death.<sup>34</sup> Professional goodwill is said to be simply the professional’s reputation.<sup>35</sup> The *Holbrook* court held professional goodwill of Mr. Holbrook’s partnership interest in a law firm would not be marital property because “although a professional business’s good reputation, which is essentially what its goodwill consists of, is certainly a thing of value, we do not believe that it bestows on those who have an ownership interest in the business, an actual, separate property interest.<sup>36</sup> A closely related argument is professional goodwill represents only future earning capacity.<sup>37</sup> The Supreme Court of Illinois held professional goodwill is not subject to valuation or distribution as marital property.<sup>38</sup> Because it is based on skill and reputation of an individual professional, professional goodwill “represents merely the ability to acquire future income.”<sup>39</sup> Professional goodwill benefits the owners of business only in the ability to increase future earnings, since it cannot be sold separately and “evanesces when one attempts to distinguish it from future earning capacity.”<sup>40</sup> Since professional goodwill is the same as future earning

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<sup>33</sup> *Holbrook*, 309 N.W.2d at 352.

<sup>34</sup> Diane Green Smith, *supra* note 2, at 167. *But see infra* note 77.

<sup>35</sup> See *Moebus v. Moebus*, 529 So. 2d 1163 (Fla. Dist. Ct. App. 1988), *review denied*, 539 So. 2d 475 (Fla. 1989); *Powell v. Powell*, 648 P.2d 218, 223 (Kan. 1982) (“The very nature of a professional practice is that it is totally dependent upon the professional”); *Buckl v. Buckl*, 542 A.2d 65 (Pa. 1988); *Beasley v. Beasley*, 518 A.2d 545 (Pa. Super. Ct. 1986), *appealed denied*, 533 A.2d 90 (Pa. 1987); *Sorensen v. Sorensen*, 839 P.2d 774 (Utah 1992); *Holbrook v. Holbrook*, 309 N.W.2d 343 (Wis. Ct. App. 1981).

<sup>36</sup> *Holbrook*, 309 N.W.2d at 354.

<sup>37</sup> See *Moebus v. Moebus*, 529 So. 2d 1163 (Fla. Dist. Ct. App. 1988), *review denied*, 539 So. 2d 475 (Fla. 1989); *In re Marriage of Zells*, 572 N.E.2d 944 (Ill. 1991); *Powell v. Powell*, 648 P.2d 218 (Kan. 1982); *Travis v. Travis*, 795 P.2d 96 (Okla. 1990); *Beasley v. Beasley*, 518 A.2d 545 (Pa. Super. Ct. 1986), *appeal denied*, 533 A.2d 90 (Pa. 1987); *Sorensen v. Sorensen*, 839 P.2d 774 (Utah 1992); *Holbrook v. Holbrook*, 309 N.W.2d 343 (Wis. Ct. App. 1981).

<sup>38</sup> *In re Marriage of Zells*, 572 N.E.2d at 945.

<sup>39</sup> *Id.*

<sup>40</sup> *Holbrook*, 309 N.W.2d at 354.



capacity, and future earning capacity represents post-divorce earnings, which are not marital property subject to division as a marital asset, professional goodwill is not subject to division as a marital asset.<sup>41</sup>

A frequently repeated justification for refusing to recognize professional goodwill as marital property is the concern its value will be counted twice, resulting in “double-dipping.”<sup>42</sup> If professional goodwill is simply reputation, and represents only future earning capacity, it is included in the basis for awarding support, maintenance and child support. To include goodwill in the valuation of an asset, the business, and as future income upon which support awards are based values the same capacity twice.<sup>43</sup> Rather than consider professional goodwill as property, “appropriate consideration of professional goodwill [is] as an aspect of income potential. The goodwill value is then reflected only in the maintenance and support awards. Any additional consideration of goodwill value is duplicative and improper.”<sup>44</sup>

Professional goodwill is analogous to a professional degree, which has been held not to be marital property.<sup>45</sup> The court in

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<sup>41</sup> Kisthardt, *supra* note 6, at 2-4.

<sup>42</sup> See *Moebus v. Moebus*, 529 So. 2d 1163 (Fla. Ct. App. 1988), *review denied*, 539 So. 2d 475 (Fla. 1989); *In re Marriage of Zells*, 572 N.E.2d 944 (Ill. 1991); *In re Marriage of Brenner*, 601 N.E.2d 1270 (Ill. App. Ct. 1992); *Powell v. Powell*, 648 P.2d 218 (Kan. 1982); *Holbrook v. Holbrook*, 309 N.W.2d 343 (Wis. Ct. App. 1981). See also Kisthardt, *supra* note 6, at 2-4; Heyman, *supra* note 16, at 21.

<sup>43</sup> *In re Marriage of Brenner*, 601 N.E.2d at 1275.

<sup>44</sup> *In re Marriage of Zells*, 572 N.E.2d at 946. See also *Beasley*, 518 A.2d at 553:

The good will of a sole proprietorship is related only to his future earnings, since an actual sale produces no value. To assess a value on future productivity and to award a proportionate amount to the spouse is akin to making a lump sum alimony payment since it is based on future earnings of the paying spouse. If, in addition to this payment, alimony is awarded, there is, in effect, a double charge on the future income of the paying spouse.

<sup>45</sup> See *Moebus v. Moebus*, 529 So. 2d 1163 (Fla. Dist. Ct. App. 1988), *review denied*, 539 So. 2d 475 (Fla. 1989); *Powell v. Powell*, 648 P.2d 218 (Kan. 1982); *Sorensen v. Sorensen*, 839 P.2d 744 (Utah 1992); *Holbrook v. Holbrook*, 309 N.W.2d 343 (Wis. Ct. App. 1981). *Simmons v. Simmons*, 708 A.2d 949 (Conn. 1998). However, jurisdictions' treatment of professional degrees and licenses may vary.

*Holbrook* cited two similarities between educational degrees and professional goodwill: (a) neither can be exchanged on the open market; (b) neither can be “assigned, sold, transferred, conveyed or pledged.”<sup>46</sup> In addition, the value of both terminates at the holder’s death.<sup>47</sup> The degree and reputation of the professional are both personal, and both serve to enhance earning power, therefore already being considered once in determining maintenance and child support.<sup>48</sup> For these reasons, professional goodwill should be given the same treatment as an educational degree and found not to be marital property.<sup>49</sup>

Refusing to characterize goodwill as marital property prevents inequity. If professional goodwill were marital property, the “professional goodwill or blue sky which was assigned to the [professional]” would be offset with an award of tangible assets to the nonprofessional spouse.<sup>50</sup> The *Holbrook* court noted, “[t]here is a disturbing inequity in compelling a professional practitioner to pay a spouse a share of intangible assets at a judicially determined value that could not be realized by a sale or another method of liquidating value.”<sup>51</sup>

The view of professional goodwill actually represents a minority of states.<sup>52</sup> It has been widely criticized. First, it does not correspond to the intent of equitable distribution statutes. The legislative intent of the partnership theory is “to recognize each spouse’s claim to marital assets regardless of who made direct contributions to specific assets and who holds title.”<sup>53</sup> Tangible marital contributions, such as providing funds to rent office space, and intangible contributions, such as taking responsibility for household chores, both increase the value of professional goodwill. Under principles of equitable distribution, that value

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<sup>46</sup> *Holbrook*, 309 N.W.2d at 354.

<sup>47</sup> *Id.*

<sup>48</sup> *Sorensen*, 839 P.2d at 776.

<sup>49</sup> *Holbrook*, 309 N.W.2d at 355. *But see*, *Lapham v. Ruffin*, 661 NYS2d 373 (AD 4th Dep’t, 1997); *Matloff v. Dobb*, 659 NYS2d 209 (AD 1st Dep’t, 1997).

<sup>50</sup> *In re Marriage of Zells*, 572 N.E.2d at 945-46 (citing *Holbrook v. Holbrook*, 309 N.W.2d 343 (Wis. Ct. App. 1981)).

<sup>51</sup> *Holbrook*, 309 N.W.2d at 355. *See also In re Marriage of White*, 502 N.E.2d 1084, 1087 (Ill. App. Ct. 1986).

<sup>52</sup> Diane Green Smith, *supra* note 2, at 167.

<sup>53</sup> *Id.* at 180.

should be shared between the partners.<sup>54</sup> Second, support awards, in which goodwill is considered, are disfavored and terminate upon remarriage or cohabitation, resulting in the nonprofessional spouse's inability to completely recover his or her portion of the goodwill value.<sup>55</sup> In fact, the object of the property division is to eliminate a need for awards of support to the former spouse and to achieve a final disposition between the parties.<sup>56</sup> to realize the full value of the goodwill, the nonprofessional spouse would be forced to put the future on hold.<sup>57</sup> Third, professional goodwill does not merely represent future earning capacity. Future earnings can be divided into two parts. They include earnings traced to goodwill existing at the time of divorce and earnings attributed to post-divorce efforts; only the later should not be included as marital property.<sup>58</sup> As Alan Zipp explains, post-divorce income which can be traced to goodwill existing at the time of divorce, "is merely the fruit of a marital asset existing at the divorce."<sup>59</sup> Fourth, even if considering professional goodwill as marital property resulted in double-counting as some courts claim, "it is justified because it is an asset with a determinable value and it does confer greater income upon the professional possessing it."<sup>60</sup> These criticisms from the basis of the view that professional goodwill is in fact marital property that should be valued and distributed at divorce.

#### *Professional Goodwill is Marital Property*

The majority of courts find professional goodwill is marital property subject to distribution at divorce.<sup>61</sup> This view recognizes the "economic reality" that professional goodwill has value

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<sup>54</sup> *Id.*

<sup>55</sup> Bruce L. Richman, *How to Analyze a Valuation Report in a Divorce Situation*, ILL. L. TIMES, at 30 (March 1995).

<sup>56</sup> Diane Green Smith, *supra* note 2, at 181.

<sup>57</sup> Richman, *supra* note 56.

<sup>58</sup> Alan S. Zipp, *Divorce Valuation of Business Interests: A Capitalization of Earnings Approach*, 23 FAM. L.Q. 89, 103 (1989).

<sup>59</sup> *Id.*

<sup>60</sup> Heyman, *supra* note 16, at 21.

<sup>61</sup> *Russell v. Russell*, 399 S.E.2d 166, 158 (Va. Ct. App. 1990). See also Andrew S. Soshnick, *Valuing Business Goodwill in Marital Dissolution Actions: Boldly or Blindly Striving to Grab the Brass Ring from the Blue Sky*, 39 RES GESTAE 16 (1995).

to the professional spouse, and the division of that value at divorce conforms to the intent of equitable distribution statutes.<sup>62</sup> Reasoning that professional goodwill of the husband's law practice was a marital asset, the *Dugan* court noted,

“after divorce, the law practice will continue to benefit from that goodwill as it had during marriage. Much of the economic value produced during an attorney's marriage will inhere in the goodwill of the law practice. It would be inequitable to ignore the contribution of the non-attorney spouse to the development of that economic resource.”<sup>63</sup>

When evidence shows the professional practice has professional goodwill, that value must be included as part of the marital property; otherwise the professional spouse receives a “windfall.”<sup>64</sup> The nonprofessional spouse contributed to the value just as he or she contributed to other assets during the marriage, and “is as much entitled to be recompensated for that contribution as if it were represented by the increased value of stock in a family business.”<sup>65</sup> When the Colorado court faced the characterization of professional goodwill as a case of first impression, it noted the purpose of marital property division is “to allocate to each spouse that property which, as a result of the marriage, should properly belong to him or her,” and indicated property should be “liberally construed to be broadly inclusive.”<sup>66</sup> As long as the professional spouse practiced as a dentist, his goodwill would be part of the practice even after divorce and he would continue to benefit. Therefore, the value of professional goodwill was marital property.<sup>67</sup> Courts have also expressed this concern for equity by describing the nonprofessional spouse as a “silent

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<sup>62</sup> See *Molloy v. Molloy*, 761 P.2d 138 (Ariz. Ct. App. 1988), *appeal after remand, aff'd sub nom*, *In re Marriage of Molloy*, 888 P.2d 1333 (Ariz. Ct. App. 1994); *In re Marriage of Foster*, 117 Cal. Rptr. 49 (Cal. Ct. App. 1974); *In re Marriage of Nichols*, 606 P.2d 1314 (Colo. Ct. App. 1980); *Thompson v. Thompson*, 576 So. 2d 267 (Fla. 1991); *Prahinski v. Prahinski*, 582 A.2d 784 (Md. 1990); *Dugan v. Dugan*, 457 A.2d 1 (N.J. 1983); *Guzman v. Guzman*, 827 S.W.2d 445 (Tex. Ct. App. 1992); *Russell v. Russell*, 399 S.E.2d 166 (Va. Ct. App. 1990).

<sup>63</sup> *Dugan*, 457 A.2d at 6.

<sup>64</sup> *Russell*, 399 S.E.2d at 168-69.

<sup>65</sup> *In re Marriage of Foster*, 117 Cal. Rptr. at 53-54 (citing *Golden v. Golden*, 75 Cal. Rptr. 735, 738 (Cal. Ct. App. 1969)). See also *Mitchell*, 732 P.2d at 211; *Kisthardt*, *supra* note 6, at 2-16 to 2-17.

<sup>66</sup> *In re Marriage of Nichols*, 606 P.2d at 1315.

<sup>67</sup> *Id.* at 1316 (citations omitted). See also *Patel*, *supra* note 19, at 574:

partner” who is withdrawing from the business and deserves compensation for his or her share.<sup>68</sup>

Courts finding professional goodwill to be a marital asset also recognize while professional goodwill is unique and difficult to value, that does not justify ignoring its existence or inclusion as marital property, it only suggests need for caution in valuation.<sup>69</sup> The court in *Hollander* reviewed the major arguments against recognizing professional goodwill, and in response to the argument goodwill is difficult to value, notes, “the intricacy of the solution should not force any court to shirk its responsibility or ignore the basic fact that goodwill holds considerable value for the professional.”<sup>70</sup>

As noted in the previous section, some courts refuse to recognize professional goodwill as marital property because goodwill is only the ability to gain future income due to return business or repeat customers. However, courts characterizing professional goodwill as marital property argue goodwill and future earning capacity are in fact not the same. Future earning capacity is a broad concept, while professional goodwill requires an ownership interest before it can exist.<sup>71</sup> While both a practicing professional and a salaried professional have earning capacity, only the practicing professional has a business to which

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It is especially important to include the value of a professional practice in marital assets today, when married couples often live up to or beyond their incomes and may have little property aside from the value of the practice. Because the goodwill of a practice often is its principal asset, excluding this value from the ‘kitty’ will result in an understatement of the practice’s worth and leave little for distribution. This exclusion would be inconsistent with the equitable distribution of philosophy, which defines marital property as broadly as possible in order to achieve equity.

<sup>68</sup> Mitchell, 732 P.2d at 211. See also Kisthardt, *supra* note 6, at 2-17 to 2-18 (discussing *In re Marriage of Lopez*, 113 Cal. Rptr. 58 (Cal. Ct. App. 1974)).

<sup>69</sup> See *In re Marriage of Brenner*, 601 N.E.2d 1270, 1275 (Ill. App. Ct. 1992); *Clark v. Clark*, 782 S.W.2d 56 (Ky. Ct. App. 1990); *Hollander v. Hollander*, 597 A.2d 1012, 1018-19 (Md. 1991); *Prahinski v. Prahinski*, 582 A.2d 784 (Md. 1990) (dissenting opinion) (explaining the effect of ethical guidelines which prevent attorneys from selling goodwill is to complicate valuation, not prove professional goodwill is not an asset).

<sup>70</sup> *Hollander*, 597 A.2d at 1018-19.

<sup>71</sup> See *Sonek v. Sonek*, 412 S.E.2d 917, 919 (N.C. Ct. App. 1992); *In re Marriage of Hall*, 692 P.2d 175, 178 (Wash. 1984).

goodwill can attach. *In re Marriage of Hall* addressed the question of whether a trial court erred when it found one spouse who was a physician in private practice possessed goodwill valued at \$70,000 but the other spouse, also a physician, who was a salaried professor, did not possess goodwill.<sup>72</sup> The court held “as a matter of law a salaried employee. . . cannot have goodwill.”<sup>73</sup> The practicing physician had income from two sources, personal skill and goodwill; goodwill belonged to the business and was a marital asset.<sup>74</sup> Professional goodwill is a separate asset which *enhances* the earning capacity of the professional.<sup>75</sup> The New Jersey Supreme Court explained “when future earning capacity has been enhanced because reputation leads to probable future patronage from existing and potential clients, goodwill may exist and have value.”<sup>76</sup>

Professor goodwill is also distinguishable from future earning capacity and reputation because when the professional retires or dies, his earning capacity ends; however, goodwill “may continue in existence on the form of established patients or clients, referrals, trade name, location and association which now attached [sic] to . . . buyers of the practice.”<sup>77</sup> Likewise, names of deceased and withdrawn members are commonly retained by professional firms, indicating goodwill does not disappear.<sup>78</sup>

If professional goodwill is only future earning capacity, it could not be marital property under most state statutes, because future earnings would be property acquired after a divorce, therefore separate or nonmarital property.<sup>79</sup> Alan Zipp has clarified the murky waters of professional goodwill, future earnings and reputation by suggesting with the proper valuation method, earnings attributable to post-divorce efforts can be distinguished

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<sup>72</sup> *In re Marriage of Hall*, 692 P.2d at 176.

<sup>73</sup> *Id.* at 178.

<sup>74</sup> Kisthardt, *supra* note 6, at 2-19 to 2-20 (discussing *In re Marriage of Hall*, 692 P.2d 175 (Wash. 1984)).

<sup>75</sup> *Id.* “Goodwill is a property or asset which supplements the earning capacity of another asset, a business, or a professional, and, therefore, it is not the earning capacity itself. *Id.*”

<sup>76</sup> *Dugan*, 457 A.2d at 6.

<sup>77</sup> *Hollander v. Hollander*, 597 A.2d 1012, 1018 (Md. 1991).

<sup>78</sup> Melvyn B. Frumkes, *Valuation of Professional Practices*, 2 J. AM. ACAD. MATRIM. L. 1, 10 (1986).

<sup>79</sup> Zipp, *supra* note 59, at 103.

from earnings which are the “fruit” of the professional goodwill existing at divorce.<sup>80</sup> He distinguishes future earnings attributed to goodwill which existed at the time of the divorce from those earnings attributable to post-divorce efforts.<sup>81</sup> “Business goodwill for marital property valuation purposes is the reasonable value, in the hands of the current business owner, of the average excess earnings of the business, at the valuation date, based exclusively on the historical earnings of the business and without reference to projected future earnings.”<sup>82</sup>

Additionally, professional goodwill is marital property because it is analogous to pension rights, which have been held to be marital property.<sup>83</sup> Both professional goodwill and pension rights depend on future earnings and the continued existence of a professional practice or life of a person.<sup>84</sup> In addition, pension rights and professional goodwill are assets of the marriage, “even though their enjoyment may be deferred.”<sup>85</sup> After finding professional goodwill could be considered marital property, the New Mexico Court of Appeals suggested goodwill be treated on remand like “pension benefits, that is, to be paid in the future as and when it is actually received.”<sup>86</sup> The trial court would determine the specifics, including whether it would retain jurisdiction and what would happen if the professional spouse received the value of professional goodwill in a different form.<sup>87</sup>

Courts have found professional goodwill to be marital property subject to division at divorce in various settings, including law practices, medical practices, medical practices and dental practices.<sup>88</sup> They have not been persuaded by those courts who argue goodwill is too speculative or no different from the professional’s future earnings capacity. While some courts have whole-

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<sup>80</sup> *Id.*

<sup>81</sup> *Id.* at 103-104.

<sup>82</sup> *Id.* at 108.

<sup>83</sup> See *Mitchell v. Mitchell*, 732 P.2d 208, 211 (Ariz. 1987); *Mocnik v. Mocnik*, 838 P.2d 500, 510 (Okla. 1992).

<sup>84</sup> *Patel*, *supra* note 19, at 569.

<sup>85</sup> *Mocnik*, 838 P.2d at 510 (concurring in part and dissenting in part).

<sup>86</sup> *Cox v. Cox*, 775 P.2d 1315, 1318 (N.M. Ct. App. 1989), *cert. denied*, 776 P.2d 846 (N.M. 1989).

<sup>87</sup> *Id.*

<sup>88</sup> See *McMahon*, *Law Practice*, *supra* note 7; *McMahon*, *Medical and Dental Practice*, *supra* note 7.

heartedly adopted this view, others remain troubled by the possibility that personal skills, knowledge or ability, which are separate property of the individual, are being valued as marital property.

*The Caveat: Professional Goodwill is Marital Property Only to the Extent it is Separate from the Professional's Reputation*

This concern that professional goodwill may consist of both personal goodwill attributable to the individual and enterprise goodwill attributable to the business has led a number of courts to insist on a case by case approach recognizing only goodwill which is separate from the professional's reputation.<sup>89</sup> The inquiry has two steps.<sup>90</sup> The first is to determine whether any goodwill exists which is separate and apart from the reputation and personal skills of the individual practitioner.<sup>91</sup> If so, the second is to value the separate goodwill as marital property.<sup>92</sup> This approach is widely accepted.<sup>93</sup> To be defined as marital property,

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<sup>89</sup> See *Tortorich v. Tortorich*, 902 S.W.2d 247 (Ark. Ct. App. 1995); *Thompson v. Thompson*, 576 So. 2d 267 (Fla. 1991); *Walton v. Walton*, 657 So. 2d 1214 (Fla. Dist. Ct. App. 1995); *Young v. Young*, 600 So. 2d 1140 (Fla. Dist. Ct. App. 1992), *review denied*, 613 So. 2d 13 (Fla. 1992); *In re Marriage of Phillips*, 615 N.E.2d 1165 (Ill. App. Ct. 1993); *Strauss v. Strauss*, 647 A.2d 818 (Md. 1994); *Prahinski v. Prahinski*, 582 A.2d 784 (Md. 1990); *Skrabak v. Skrabak*, 673 A.2d 732 (Md. Ct. Spec. App. 1996); *Hanson v. Hanson*, 738 S.W.2d 429 (Mo. 1987); *Wilson v. Wilson*, 822 S.W.2d 917 (Mo. Ct. App. 1991); *In re Marriage of Hogan*, 796 S.W.2d 400 (Mo. Ct. App. 1990); *In re Marriage of Maxwell*, 876 P.2d 811 (Or. Ct. App. 1994); *Butler v. Butler*, 663 A.2d 148 (Pa. 1995), *aff'd in part, rev. in part*; *Buckl v. Buckl*, 542 A.2d 65 (Pa. 1988); *Guzman v. Guzman*, 827 S.W.2d 445 (Tex. Ct. App. 1992); *Finn v. Finn*, 658 S.W.2d 735 (Tex. Ct. App. 1983); *Peerenhoom v. Peereboom*, 433 N.W.2d 282 (Wis. Ct. App. 1988).

<sup>90</sup> *Walton*, 657 So. 2d at 1215. See also *Miles v. Miles*, 816 P.2d 129, 131 (Alaska 1991) (citations omitted); Elizabeth S. Baker & Shari J. Fein, *Establishing the Existence and Value of Professional Goodwill as a Marital Asset*, 68 FLA. B.J. 20 (1994).

<sup>91</sup> See *Finn*, 658 S.W.2d at 740-41 (noting a two-pronged test to determine whether professional goodwill is subject to distribution). See *Taylor v. Taylor*, 386 N.W.2d 851 (Neb. 1986); *Hanson v. Hanson*, *Graham v. Graham*, 738 S.W.2d 429 (Mo. 1987).

<sup>92</sup> *Id.* Note that the goodwill must otherwise meet the requirements to be marital property, such as being created during the marriage.

<sup>93</sup> In development a set of principles to guide courts in divorce issues, the American Law Institute included a provision explaining "business and professional goodwill earned during the marriage are marital property to the extent



the goodwill must be a “marketable business asset distinct from the personal reputation of a particular individual, as is usually the case with many commercial enterprises, that goodwill has an immediately discernible value as an asset of the business and may be identified as an amount reflected in the sale or transfer of such business.”<sup>94</sup> In *Young*, the Florida court reversed an award based on goodwill in the husband’s law practice, yet noted neither party suffered a loss which required it to reopen the property distribution:

Neither party has suffered any greater loss than the other by recognition of the fact that the husband’s professional association has no value separate and distinct from his reputation and presence and the value of tangible assets. The reason for this is that the invalidation of an equal division of a nonexistent asset cannot logically impair the equity in the remaining judgment. . . .<sup>95</sup>

There are several reasons for this view. It is argued personal goodwill, dependent on the presence of the professional spouse, represents future earning capacity and should be considered only in support awards.<sup>96</sup> This argument is used by courts entirely refusing to recognize professional goodwill as a marital asset.<sup>97</sup> If professional goodwill is not established as a separate asset from the practitioner’s reputation, “but merely a measure of earning capacity, its value would then improperly be taken into consideration more than once,” both in determining maintenance and in the property division.<sup>98</sup> In addition, goodwill tied to the individual “is not subject to equitable distribution because the value thereof does not survive the disassociation of those individuals from the business.”<sup>99</sup> In contrast, when goodwill value can be

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they have value apart from spousal earning capacity.” These provisions have received ‘widespread support.’ *ALI Approves Product Liability Draft, Takes First Step on New Family Law Project*, 63 U.S.L.W. (B.N.A.) 2734 (May 30, 1995).

<sup>94</sup> *Tortorich*, 902 S.W.2d at 249.

<sup>95</sup> *Young*, 600 So. 2d at 1143.

<sup>96</sup> *Thompson*, 576 So. 2d at 270.

<sup>97</sup> See *supra* notes 35-45.

<sup>98</sup> *Peerenboom*, 433 N.W.2d at 284. See also *Eslami v. Eslami*, 591 A.2d 411, 418 (Conn. 1991) (explaining if the distinction between a marketable asset and the professional’s reputation is not made, the asset will be counted twice, once as property and again as earning capacity to determine alimony).

<sup>99</sup> *Butler*, 663 A.2d at 155 (citing *Solomon v. Solomon*, 611 A.2d 686, 692 (Pa. 1992)), *aff’d in part, rev. in part*.

established and realized by sale, as when practices sell for more than tangible assets and accounts receivable, it is not inequitable to require the professional spouse to divide the value with the nonprofessional spouse.<sup>100</sup>

The challenge for attorneys is to prove the existence of professional goodwill. Several factors indicate the presence or absence of goodwill separate from reputation.<sup>101</sup> Being a sole practitioner can be evidence of the absence of professional goodwill. In *Tortorich*, the court found no evidence of goodwill independent of reputation because Mr. Tortorich was a sole practitioner dentist whose business was dependent on referrals from other dentists, based on reputation along.<sup>102</sup> Similarly, the court in *Prahinski* held the goodwill of a solo law practice was personal to the lawyer, and “goodwill in such circumstances is not severable from the reputation of the sole practitioner regardless of the contributions made to the practice by the spouse or employees.”<sup>103</sup> Law practices represent a somewhat unique situation due to ethical prohibitions against covenants not to compete, prohibitions on selling goodwill, and prohibitions on establishing a partnership with any non-attorney.<sup>104</sup> Also, expert testimony that no one would buy an accounting practice without

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<sup>100</sup> *Hollander*, 597 A.2d at 1018.

<sup>101</sup> See *Weinstock v. Weinstock*, 634 So. 2d 775 (Fla. Dist. Ct. App. 1994); *In re Marriage of Maxwell*, 876 P.2d 811 (Or. Ct. App. 1994) (noting evidence showed success of business was “completely dependent on the creative, personal services that [husband] provides”). *Id.*

<sup>102</sup> *Tortorich*, 902 S.W.2d at 250-51.

<sup>103</sup> *Prahinski*, 582 A.2d at 790. In arriving at this holding, the court relied on the *Taylor* case, which held professional goodwill may be divided as a marital asset if found to be “saleable or marketable” rather than dependent “upon the continued presence of the individual.” *Id.* (citing *Taylor v. Taylor*, 386 N.W.2d 851, 858 (Neb. 1986)). *But see* McMahon, *Law Practice*, *supra* note 7 (reviewing cases where courts have found goodwill to be distributable in solo law practices).

<sup>104</sup> See *Hollander*, 597 A.2d at 1017 (discussing the difference between goodwill in law practices as opposed to medical and dental practices); Strauss, 647 A.2d at 825-26 (reversing and remanding for use of a correct methodology to determine the value of husband’s goodwill in a private dental practice). *But see* Rita Henley Jensen, *Attorney Goodwill Increases Doors Slowly Open on Sales of Law Practices*, NAT’L L.J., Dec. 23, 1991, at col. 4. In 1990 the American Bar Association changed the model code of ethics to allow law practices to be sold with the restriction that the seller “not engage in the private practice of law in the area or jurisdiction in which the practice has been conducted.” *Id.*

a noncompete clause was “telling evidence” of the lack of goodwill.<sup>105</sup> An example of strong evidence goodwill was only personal to the accountant-husband was provided in *Butler*.<sup>106</sup> Evidence showed clients were personal to the husband and would follow him if he left the business; he had a particular client base, composed of members of the Greek community, who were loyal to him and not the firm; and he retained responsibility for the clients even though other employees were assigned work on details or accounts.<sup>107</sup> In the case of another accountant, no goodwill separate from the reputation existed in a sole CPA proprietorship because the husband-accountant’s name was the only one on the door; he brought in all the clients even though other CPAs did work; and the business would not be purchased without a noncompete clause.<sup>108</sup> In contrast, goodwill independent of reputation was where the husband-lawyer had been at the firm twenty-five years and was a senior partner for ten years, because the firm had been in existence for ninety years and a large part of the firm’s reputation was based on the husband’s predecessors.<sup>109</sup>

Some courts take a particularly “strict” view of the two-step process and require specific elements of proof to find goodwill exists separately from the professional’s reputation.<sup>110</sup> The Florida court indicated “the exclusive method of measuring the value of that goodwill entails a fair market value approach.”<sup>111</sup> The Missouri court has been very specific and narrow in the proof allowed to establish goodwill. The “only acceptable evidence of the existence of goodwill. . . is evidence that other professionals are willing to pay for goodwill when acquiring a practice.”<sup>112</sup> Three methods are acceptable: (a) evidence of a recent actual sale of similar practice; (b) evidence of the offer to purchase such a practice; or (c) expert testimony as to presence of goodwill in a similar practice “in the relevant geographic and professional

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<sup>105</sup> *Williams*, 667 So. 2d at 916.

<sup>106</sup> *Butler*, 663 A.2d at 156, *aff’d in part, rev. in part*.

<sup>107</sup> *Id.* (holding trial court erred in valuing goodwill for purposes of equitable distribution).

<sup>108</sup> *Walton*, 657 So. 2d at 12-14-16.

<sup>109</sup> *Finn v. Finn*, 658 S.W.2d 735, 741 (Tex. Ct. App. 1983), *but see* *Keith v. Keith*, 763 S.W.2d 950 (1989).

<sup>110</sup> *See* Diane Green Smith, *supra* note 2, at 170-71.

<sup>111</sup> *Young*, 600 So. 2d at 1141.

<sup>112</sup> *Hanson v. Hanson*, 738 S.W.2d 429 (Mo. 1987).

market.”<sup>113</sup> This view is so strict it has resulted in essentially no findings of professional goodwill as marital property in Missouri.<sup>114</sup>

There are a number of criticisms of courts who require goodwill to be separate and marketable, including those in Florida and Missouri. Viewing professional goodwill as partly a function of the individual's attributes relies on the artificial distinctions discussed above, commercial or enterprise goodwill versus personal goodwill.<sup>115</sup> It is artificial because in both commercial and professional goodwill, the competence and ability of individuals created the value.<sup>116</sup> This view is also criticized for seeing the professional's reputation and the business's goodwill as “inextricably interwoven,” therefore making professional goodwill unmarketable.<sup>117</sup> Property should not be defined in reference to what can be sold on the open market, but should be defined by the value it holds for the individual.<sup>118</sup> Further goodwill is in fact commonly sold in a number of settings, suggesting a court's reluctance to characterize it as property is actually a philosophical resistance to dividing up the “success” of a professional. Michael Heyman, explaining these criticism, argues marital property should be defined as property acquired after the marriage and before the divorce, and “if professional goodwill satisfies that predicate, its source in personal attributes is irrelevant to its divisibility.”<sup>119</sup> In addition, requiring goodwill to be separate from reputation results in a circular analysis. The existence of goodwill, which must be proven first, is dependent on proving its value, which is described as the second distinct element.<sup>120</sup> Nevertheless, finding value only in marketable goodwill addresses the reservations of valuing personal skills and reputation. It appears to be a trend among courts attempting to find an equitable, balance solution.

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<sup>113</sup> *Id.* at 434-35.

<sup>114</sup> Kisthardt, *supra* note 6, at 2-24.

<sup>115</sup> Heyman, *supra* note 16, at 8-9. *See also supra* notes 26-27.

<sup>116</sup> *Id.*

<sup>117</sup> Heyman, *supra* note 16, at 27.

<sup>118</sup> *Id.* at 27-31.

<sup>119</sup> *Id.* at 31-32.

<sup>120</sup> Kisthardt, *supra* note 6, at 2-26.

#### **IV. Importance of Understanding the Characterization of Professional Goodwill**

Matrimonial lawyers must be aware of which theory has been adopted in their jurisdiction. However, it is not enough simply to know which of the three categories applies. Understanding the rationale behind the theories allows a lawyer to specifically tailor evidence and argument to the court's considerations. For example, where goodwill is not recognized as marital property, a lawyer should be aware of the need to establish relevant and convincing evidence regarding the need for maintenance. Those courts refusing to recognize goodwill as property frequently allow its consideration in determining support awards. Likewise, if the state courts allow professional goodwill in a business to be valued as a marital asset only if separate from the professional's reputation, the attorney representing the nonprofessional spouse should investigate the extent to which the professional's business is due to his or her presence, or other factors, such as location or longstanding reputation of the business itself, and introduce relevant evidence on that point.

In addition, for those jurisdictions which allow proof of professional goodwill as marital property, the goodwill must be valued. This is a largely unsettled area, with most courts willing to adopt the valuation method or methods most appropriate to the case at hand, and a very small number requiring exclusive valuation methods.

##### *A. The Court's Role in Valuation of Professional Goodwill*

The valuation of professional goodwill is marked by two primary characteristics, it is: (a) subject to the court's broad discretion and (b) dependent on the facts and circumstances of the individual case. In addition, "experts are free to choose from a vast array of valuation techniques and must make many outcome-determinative assumptions, all of which may render strikingly divergent results."<sup>121</sup> While this creates tremendous uncertainty for attorneys, it also results in a wide latitude to argue for the most appropriate and beneficial valuation method for each client. Shannon Pratt cautions lawyers to be able to discern

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<sup>121</sup> Soshnick, *supra* note 61.

whether their expert or the opposing expert “has adhered to the definitions of value prescribed by the relevant jurisdiction’s case precedent” and when that precedent is unclear, be able to “formulate arguments as to what standard and premises of value should be applied in the case at bar.”<sup>122</sup>

The vast majority of courts decline to adopt one methodology as the means by which professional goodwill’s value must be proven.<sup>123</sup> “No rigid and unvarying rule for the determination of the value of goodwill has been laid down by prior case law and each case must be determined on its own facts and circumstances.”<sup>124</sup> Valuation of goodwill is a question of fact and while opinion evidence may be admitted, it is not conclusive.<sup>125</sup> The “national trend” has been to allow parties to argue for the most appropriate valuation method and to allow courts to base their findings on the evidence provided.<sup>126</sup> Since facts of individual cases differ, the offered proof will also differ, and rigid adherence to any one method would limit the court’s ability to make a fair determination.<sup>127</sup> In addition, this case by case method “is appropriate since in most cases the marital assets are not being sold and converted to cash, but rather are being divided between the divorcing parties.”<sup>128</sup>

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<sup>122</sup> Shannon P. Pratt, *What is Value*, FAM. ADVOC., Spring 1995, at 28.

<sup>123</sup> See *Mitchell v. Mitchell*, 732 P.2d 208 (Ariz. 1987); *In re Marriage of Foster*, 117 Cal. Rptr. 49 (Cal. Ct. App. 1974); *In re Marriage of White*, 502 N.E.2d 1084 (Ill. App. Ct. 1986); *Clark v. Clark*, 782 S.W.2d 56 (Ky. Ct. App. 1990); *Weaver v. Weaver*, 324 S.E.2d 915 (N.C. Ct. App. 1985); *Kell v. Kell*, 1993 WL 525003 (Ohio Ct. App. 1993); *Butler v. Butler*, 663 A.2d 148, 154 (Pa. 1955), *aff’d in part, rev. in part*; *Buckl v. Buckl*, 542 A.2d 65 (Pa. 1988); *Russell v. Russell*, 399 S.E.2d 166 (Va. Ct. App. 1990). *But see* *Hanson v. Hanson*, 738 S.W.2d 429 (Mo. 1987) (holding only acceptable evidence of goodwill is evidence of what other professionals will pay for the practice); *Thompson v. Thompson*, 576 So. 2d 267 (Fla. 1991) (holding the exclusive method for measuring professional goodwill is fair market value).

<sup>124</sup> *Mitchell*, 732 P.2d at 214. (citations omitted) or citing *Wisner v. Wisner*, 631 P.2d 115 (Ariz. Ct. App. 1981). See also *Soshnick*, *supra* note 61.

<sup>125</sup> *In re Foster’s Marriage*, 117 Cal. Rptr. 49, 52-53 (Cal. Ct. App. 1974).

<sup>126</sup> Harriet N. Cohen & Patricia Hennessey, *Valuation of Property in Marital Dissolutions*, 23 FAM. L.Q. 339, 379-80 (1989).

<sup>127</sup> *Id.* (citing *Bollenbach v. Bollenbach*, 175 N.W.2d 148, 156 n.5 (Minn. 1970)).

<sup>128</sup> Joseph W. Cunningham, *Equitable Distribution and Professional Practices: Case Specific Approach to Valuation*, 73 MICH. B.J. 666 (1994).

The trial court will weigh the expert's valuation method in light of the reliability of the evidence and testimony in a particular case.<sup>129</sup> The North Carolina Court of Appeals described its review as determining "whether the approach used. . .reasonably approximated the. . .value."<sup>130</sup> A similar standard was expressed by the Virginia Court of Appeals. After noting there were multiple acceptable methods to use in valuing goodwill, the Virginia court described its review as whether the court made a "reasonable approximation of the goodwill value. . .based on competent evidence and the use of a sound method supported by [the] evidence."<sup>131</sup> While courts have broad discretion, it is not unlimited and cannot be exercised in an arbitrary manner.<sup>132</sup> The trial court must base its finding on facts in the record.<sup>133</sup>

Valuation of professional goodwill is case specific and influenced by the trial court's minimal direction to ensure findings are based on reliable evidence. This is also an area in which experts are used heavily, adding to the responsibility of matrimonial lawyers to have a basic understanding of goodwill valuation, in order to direct or challenge experts.

#### B. *Basic Issues in Choosing a Valuation Method*

Certain considerations are present regardless of the method chosen. These are general rules lawyers should be aware of when presenting evidence of valuation.

Valuation requires great care by the court, since it forces the professional spouse to pay tangible dollars or assets in exchange for an intangible asset, goodwill.<sup>134</sup> In addition, it is a difficult task, with the confusing and amorphous nature of goodwill and its varying treatment among family law courts and between areas

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<sup>129</sup> See *In re Marriage of Bookout*, 833 P.2d 800, 804 (Colo. Ct. App. 1992); *In re Marriage of Keyser*, 820 P.2d 1194, 1197 (Colo. Ct. App. 1991).

<sup>130</sup> *Weaver*, 324 S.E.2d at 917-18.

<sup>131</sup> *Russell v. Russell*, 399 S.E.2d 166, 169 (Va. Ct. App. 1990) (citing *Poore v. Poore*, 331 S.W.2d 266, 272 (N.C. Ct. App. 1985)).

<sup>132</sup> *Sommerfield v. Sommerfield*, 454 N.W.2d 55, 60 (Wis. Ct. App. 1990) (citing *Peerenboom v. Peerenboom*, 433 N.W.2d 282, 285 (Wis. Ct. App. 1988)).

<sup>133</sup> *Id.*

<sup>134</sup> See *In re Marriage of White*, 502 N.E.2d 1084, 1087 (Ill. App. Ct. 1986); *Dugan v. Dugan*, 457 A.2d 1, 7 (N.J. 1983); *Poore v. Poore*, 331 S.E.2d 266, 270 (N.C. Ct. App. 1985).

of the law.<sup>135</sup> However, its elusive nature and difficulty valuing are not valid reasons to avoid its valuation.<sup>136</sup>

Post marital efforts should not be reflected in the method chosen or the assumptions upon which that method relies.<sup>137</sup> An early decision from California addressed both the question of how to characterize professional goodwill in a medical practice and how to value goodwill.<sup>138</sup> Although the appellate court was not entirely clear which method of valuation the wife's expert used, it was clear he did not take future efforts or earnings into account; therefore, the inclusion of goodwill as marital property was affirmed.<sup>139</sup> "Goodwill may not be valued by any method that takes into account the post-marital efforts of either spouse but. . . a proper means of arriving at the value of such goodwill contemplates any legitimate method of evaluation that measures its present value by taking into account some past result."<sup>140</sup>

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<sup>135</sup> See *Strauss v. Strauss*, 647 A.2d 818, 826 (Md. 1994); *Buckl v. Buckl*, 542 A.2d 65, 68-69 (Pa. 1988) (giving direction to the trial court to include goodwill in the value of husband's business, the court noted "goodwill is nebulous at best and consequently the placing of a dollar valuation is most difficult.")

<sup>136</sup> *In re Marriage of Nichols*, 606 P.2d 1314, 1316 (Colo. App. 1980) ("The fact that goodwill may be difficult to value, is elusive in nature, and is not easily marketable, is not a proper reason to disregard it in the valuation of the marital estate." See also *Clark v. Clark*, 782 S.W.2d 56, 60 (Ky. Ct. App. 1990); *Hurley v. Hurley*, 615 P.2d 256 (N.M. 1980); *Frumkes*, *supra* note 78 at 12 ("The value is real, and the mere fact that it cannot be precisely determined should not deter the court from assigning it a reasonable value with the evidence. Just as in other areas of the law where precise proof cannot be made, such difficult does not constitute an insurmountable obstacle." (citation omitted.))

<sup>137</sup> See *In re Marriage of Foster*, 117 Cal. Rptr. 49, 54 (Cal. Ct. App. 1974); *In re marriage of Fortier*, 109 Cal. Rptr. 915, 918 (Cal. Ct. App. 1973) (noting value of goodwill must exist at the time of divorce, be separate from future earnings and be established "without dependence upon the potential or continuing net income of the selling doctor"); *In re Marriage of Bookout*, 833 P.2d 800, 804-05 (Colo. Ct. App. 1992); *Malmquist v. Malmquist*, 792 P.2d 372, 386 (Nev. 1990) (noting the court was "free to use any legitimate method of valuation which measures the present value of goodwill by taking into account past earnings")(citations omitted) or *citing* *Ford v. Cord*, 782 P.2d 1304 (Nev. 1989); *Poore v. Poore*, 331 S.E.2d 266, 271 (N.C. Ct. App. 1985); *Russell v. Russell*, 399 S.E.2d 166, 169 (Va. Ct. App. 1990).

<sup>138</sup> *In re Marriage of Foster*, 117 Cal. Rptr. 49.

<sup>139</sup> *Id.*

<sup>140</sup> *Id.* at 54.



In addition to not valuing post marital efforts of the professional, the valuation method should be individualized to the particular professional. Consistent with the case by case focus, some factors have been commonly identified to consider which complement the use of a valuation method. Those factors are age of the professional, health, past earnings power, professional reputation in the community for judgment, skill and knowledge, the nature of the practice, length of time in the practice, past profits, comparative professional success and the value of other business assets.<sup>141</sup> The methods of valuation “are not exclusive, and one or more methods may be used in conjunction with [these] factors; the overall goal is to achieve a just and fair evaluation of the existence and value of a professional’s goodwill.”<sup>142</sup> A finding of zero value for goodwill in the husband’s plastic surgery practice was not error when the professional spouse, Dr. Luckey, was sixty-one and had numerous health impairments.<sup>143</sup> Similarly, a court approved of one expert’s valuation because it was based on both nationwide and local information, and considered the husband-ophthamologist’s age and earnings, the nature and duration of the group’s medical practice and the amount of repeat patronage.<sup>144</sup> Other factors that a trier of fact might consider are: the situation of the business premises; the amount of patronage; personalities engaged in business; length of time the business has existed; and the habit of customers in continuing to utilize the business.<sup>145</sup>

Another general consideration is whether the valuation method should be restricted to measuring only that value *realiza-*

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<sup>141</sup> See *Hertz v. Hertz*, 657 P.2d 1169, 1174 (N.M. 1983); *Sonek v. Sonek*, 412 S.E.2d 917, 919 (N.C. Ct. App. 1992); *Poore v. Poore*, 331 S.E.2d 266, 271 (N.C. Ct. App. 1985); *In re Marriage of Maxwell*, 876 P.2d 811, 813 (Or. Ct. App. 1994); *In re Marriage of Luckey*, 868 P.2d 189, 193 (Wash. Ct. App. 1994). See also *Frumkes*, *supra* note 77, at 11.

<sup>142</sup> *In re Marriage of Luckey*, 868 P.2d 189, 193 (Wash. Ct. App. 1994).

<sup>143</sup> *Id.*

<sup>144</sup> *In re Marriage of Keyser*, 820 P.2d 1194, 1197 (Colo. Ct. App. 1991). Compare the result in *In re Marriage of Reiling*, 673 P.2d 1360, 1363 (Or. Ct. App. 1983) where the court found testimony of the wife’s expert did not give a sufficient basis for including goodwill in valuation of the husband’s law practice because the expert did not consider the health, professional reputation, skill, knowledge, work habits and nature and duration of the husband’s law practice.

<sup>145</sup> *In re Marriage of Foster*, 117 Cal. Rptr. at 53.

ble by the professional spouse. This is primarily a consideration with partnership or similar arguments that restrict the goodwill value. The *Buckl* court, in determining whether goodwill of the husband's partnership interest in an architectural group was subject to equitable distribution, sought to avoid an "unrealistic valuation."<sup>146</sup> At issue was a partnership agreement limiting the ability to realize on goodwill.<sup>147</sup> If the value could not be realized, it was inappropriate to include its value as a marital asset.<sup>148</sup> In another case, Mr. Finn had been the senior partner in the law firm for ten years.<sup>149</sup> The partnership agreement provided for distribution of his capital account, earned income not already distributed and an interest in the firm's reserve, but no compensation for accrued goodwill.<sup>150</sup> Despite the court's explicit finding of firm goodwill separate from Mr. Finn's reputation, it refused to recognize a marital asset because Mr. Finn could not realize any value for the goodwill.<sup>151</sup> "The community estate is not entitled to a greater interest than that to which the husband is entitled in the firm's goodwill."<sup>152</sup>

Broad principles guide the choice of valuation method in light of the trial court's discretion and focus on offered proof. These principles recognize the difficulty in valuing an asset such as professional goodwill and provide limits for the valuation. Because marital property is at issue, the valuation should not include elements of post divorce efforts or earnings from the parties. In addition, individualized factors should be used in compliment with each valuation method to provide a full picture. Valuation may generally be restricted to benefits which are actually realizable by the professional, and this is most often an issue in cases of a partnership agreement or buy-sell agreement.

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<sup>146</sup> *Buckl v. Buckl*, 542 A.2d 65, 70 (Pa. 1988).

<sup>147</sup> *Id.* at 71 (concurring opinion).

<sup>148</sup> *Id.*

<sup>149</sup> *Finn v. Finn*, 658 S.W.2d 735 (Tex. Ct. App. 1983).

<sup>150</sup> *Id.*

<sup>151</sup> *Id.*

<sup>152</sup> *Id.* See also *In re Marriage of Molloy*, 888 P.2d 1333, 1338 (Ariz. Ct. App. 1994).

### C. Methods of Valuation

With these principles in mind, a number of methods are available to determine the value of professional goodwill.<sup>153</sup> The most commonly used methods are capitalization methods, percentage of net or gross profits, fair market value, and use of a buy-sell agreement or shareholder agreement.<sup>154</sup> This review will cover three methods in detail, exploring the arguments for and against their use: market value formulas, capitalization of excess earnings, and use of buy-sell agreements.

#### 1. Market Value

Fair market value is defined as “what would a willing buyer pay, and what would a willing seller accept, neither acting under duress for a sale of the business.”<sup>155</sup> Key is the arms-length bargain between willing parties.<sup>156</sup> The terms market value, cash value and fair market value represent the same concept.<sup>157</sup> Shannon Pratt has identified the basic elements of fair market value as: (a) the “most probable price” the property could bring; (b) and “open and competitive market;” (c) “prudent, well informed, typically motivated” buyer and seller; (d) “reasonable time allowed for exposure to the market;” and (e) no unique financing or sales opportunities.<sup>158</sup> Possible evidence of goodwill includes

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<sup>153</sup> For an overview of various methods see: Kisthardt, *supra* note 6, at 2-26 to 2-31; Soshnick, *supra* note 61; McMahon, *Medical or Dental Practice*, *supra* note 7; Frumkes, *supra* note 78, at 13-22; Pratt, *supra* note 122. In addition, see Dugan v. Dugan, 457 A.2d 1 (N.J. 1983); Poore v. Poore, 331 S.E.2d 266 (N.C. Ct. App. 1985); Kell v. Kell, 1993 WL 525003 (Ohio Ct. App. 1993); Endres v. Endres, 532 N.W.2d 65 (S.D. 1995) (although this case concerns a commercial business, it provides a extensive review of cases on professional goodwill); Russell v. Russell, 399 S.E.2d 166 (Va. Ct. App. 1990); *In re Marriage of Hall*, 692 P.2d 175 (Wash. 1984).

<sup>154</sup> Kisthardt, *supra* note 6, at 2-26.

<sup>155</sup> Thompson v. Thompson, 576 So. 2d 267, 270 (Fla. 1991). See also *In re Marriage of White*, 502 N.E.2d 1084, 1086 (Ill. App. Ct. 1986); Poore v. Poore, 331 S.E.2d 266, 270 (N.C. Ct. App. 1985).

<sup>156</sup> Thomas W. Crockett & Walter P. Neely, *Mississippi's New Equitable Distribution Rules: The Ferguson Guidelines and Valuation*, 15 MISS. C. L. REV. 415, 424 (1995) (fair market value “implies an arm’s length deal between informed investors who derive no special benefits from ownership.”).

<sup>157</sup> Pratt, *supra* note 122, at 29.

<sup>158</sup> *Id.*

proof of an actual arm's length sale,<sup>159</sup> "evidence of comparable sales,"<sup>160</sup> or use of market surveys.<sup>161</sup>

The fair market value method has several benefits. It eliminates consideration of future earnings or post divorce efforts.<sup>162</sup> This method also results in a value of goodwill only to the extent that goodwill is separable from the professional's reputation. Reputation, personal to the individual, is separated from other aspects of goodwill because:

It is obvious that a willing buyer would not pay for that which he is not getting. A willing seller of the assets of a professional association, once he sells, is not longer part of the business, and therefore the seller's reputation cannot be part of the goodwill a willing buyer is purchasing. Thus, the fair market value method has, by definition, separated personal reputation from the remaining elements of goodwill, such as established patients, referrals, location, associations, and office organizations which may attach to the buyer.<sup>163</sup>

In addition, if the value of goodwill is not based on fair market value, a couple of problems result.<sup>164</sup> First, the goodwill may be valued twice, both as earning capacity which influences support awards and as property, resulting in double-dipping.<sup>165</sup> Second, if fair market value is not used, putting a value on professional goodwill would be inconsistent with the treatment of professional licenses and degrees. Both result from human capital.<sup>166</sup> In many jurisdictions, neither licenses nor degrees are considered marital property "because their value is held to be exclusive to the holder as a result of their inability to be marketed or transferred."<sup>167</sup> Unless goodwill has a fair market value, it is an entity

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<sup>159</sup> *In re Marriage of Fortier*, 109 Cal. Rptr. 915 (Cal. Ct. App. 1973) (noting when husband purchased his associate's interest in the medical practice in 1965, it was doubtful when he sold his interest in 1969 to his new partner, nothing was paid for goodwill).

<sup>160</sup> *Eslami v. Eslami*, 591 A.2d 411 (Conn. 1991).

<sup>161</sup> *In re Marriage of Keyser*, 820 P.2d 1194, 1197 (Colo. Ct. App. 1991).

<sup>162</sup> *In re Marriage of Hall*, 692 P.2d at 179-80. *See also* Kisthardt, *supra* note 6, at 2-29 to 2-30 (Supp. 1995).

<sup>163</sup> *Young v. Young*, 600 So.2d 1140, 1143 (Fla. Dist. Ct. App. 1992) (concurring opinion).

<sup>164</sup> *Widman*, *supra* note 10, at 843-47.

<sup>165</sup> *Id.* at 843.

<sup>166</sup> *Id.* at 845.

<sup>167</sup> *Id.*

which is nontransferable and personal to the holder, but is being valued whereas professional licenses and degrees would not be.

A number of courts approve of fair market value as one option for valuing professional goodwill.<sup>168</sup> However, a limited number of courts go farther and hold fair market value is the exclusive method of valuing professional goodwill.<sup>169</sup> In Florida, courts have held fair market value will be the exclusive method for measuring goodwill, but do not require evidence of comparable sales, “so long as a reliable and reasonable basis exists for an expert to form an opinion.”<sup>170</sup> The Missouri Supreme Court requires more limited evidence even than Florida. The “only acceptable evidence” of professional goodwill is the fair market value.<sup>171</sup> Three exclusive methods of proof are allowed: (a) “when there is evidence of a recent actual sale of a similarly situated professional practice; (b) “an offer to purchase such a practice” or (c) “expert testimony and testimony of members of the subject profession as to the existence of goodwill in a similar practice in the relevant geographic and professional market.”<sup>172</sup>

However, the fair market value method has also been criticized. The fair market value may well be less than the “true” value of the asset.<sup>173</sup> When goodwill attaches to a professional, fair market value of the business will be based only on its tangible assets, such as furniture or computers. These tangible assets

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<sup>168</sup> See e.g., *In re Marriage of Fortier*, 109 Cal. Rptr. 915 (Cal. Ct. App. 1973); *In re Marriage of Nichols*, 606 P.2d 1314 (Colo. Ct. App. 1980); *Eslami v. Eslami*, 591 A.2d 411 (Conn. 1991); *Mocnik v. Mocnik*, 838 P.2d 500 (Okla. 1992). See also *Kisthardt*, *supra* note 6.

<sup>169</sup> See e.g., *Thompson v. Thompson*, 576 So. 2d 267 (Fla. 1991); *Weinstock v. Weinstock*, 634 So. 2d 775 (Fla. Dist. Ct. App. 1994); *Makowski v. Makowski*, 613 So. 2d 924 (Fla. Dist. Ct. App. 1993); *Hanson v. Hanson*, 738 S.W.2d 429 (Mo. 1987).

<sup>170</sup> *Makowski*, 613 So. 2d at 926. In addition, the dissent in *Weinstock* argued comparable sales in which the professional has stayed on for a period of time to facilitate a transition do not mean marketable goodwill is not present. *Weinstock*, 634 So. 2d at 779-80.

<sup>171</sup> *Hanson*, 738 S.W.2d at 434.

<sup>172</sup> *Id.* at 435.

<sup>173</sup> *In re Marriage of Foster*, 117 Cal. Rptr. 49, 53 (Cal. Ct. App. 1974) (“value. . . is not necessarily the specified amount of money a willing buyer would pay for such goodwill.”). But see *In re Marriage of Hall*, 692 P.2d at 179-80 (fair market value “appears to be the most equitable and accurate measure of both existence and true value of goodwill of an enterprise.”).

are often not very valuable because the business is service-oriented.<sup>174</sup> The method is also criticized because the nonprofessional spouse contributed to the value of the professional goodwill “with the expectation of a return in the form of a higher standard of living in the future.”<sup>175</sup> Upon divorce, the professional spouse retains the business and can “either maintain or eventually realize the standard of living that was anticipated from his or her previous investment of community labor and industry.”<sup>176</sup> If the offset to the nonprofessional spouse is based simply on the tangible assets of the business, it “is not commensurate with the expected return.”<sup>177</sup> In addition, as a consequence of using fair market value, law practices in particular may result in a zero professional goodwill value due to ethical guidelines against sales.<sup>178</sup> Further, the use of fair market value is unrealistic for divorce valuations since there is no willing buyer, and the business is not actually sold.<sup>179</sup>

With a clear understanding of the advantages and disadvantages of using fair market value, a lawyer may effectively argue for or against this method. For example, if the jurisdiction adheres to the view professional goodwill should be considered marital property only to the extent it is separable from the professional’s reputation, and if the fair market value fits the goals of the representation, the lawyer should carefully argue to the court how fair market value eliminates concerns about valuing reputation.

## 2. *Capitalization of Excess Earnings*

The capitalization approach focuses on the extent to which the individual professional is earning more than comparable pro-

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<sup>174</sup> Wildman, *supra* note 10, at 840. See also Dugan v. Dugan, 547 A.2d 1, 7 (N.J. 1983) (“law office’s tangible asset value is so disproportionately small when compared to the value of the services rendered that measurement . . . would not be meaningful”).

<sup>175</sup> *Id.* at 832.

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*

<sup>178</sup> See *supra* note 105. See Cohen & Hennessey, *supra* note 126 at 367-68, arguing courts should use partnership agreements or accounting formulas in these cases.

<sup>179</sup> Zipp, *supra* note 58, at 102.

professionals or employees.<sup>180</sup> This “excess” is attributed to goodwill. The *Eslami* court explained the capitalization of excess earnings as seeking “to determine the price a prospective purchaser would pay to acquire the stream of income in excess of the amount he would expect to earn by engaging in the profession through other avenues.”<sup>181</sup> The steps of the method are as follows: first determine what a professional with “comparable experience, expertise, education and age” would earn as an employee in the general locale; second, determine the average net income before taxes for the previous five years for the professional at issue in the case; third, compare the professional’s average with the norm; fourth, multiply any excess by a capitalization factor.<sup>182</sup>

Another version of this capitalization formula is represented by I.R.S. Rev. Rul. 68-609, 1968-2 C.B. 327. Some argue this is the most appropriate capitalization formula because it considers only historical earnings.<sup>183</sup> Alan Zipp explains since goodwill cannot be purchased or sold as a separate asset, it must be valued indirectly as the excess in the value of a business as a whole, compared to its separate assets.<sup>184</sup> “The value in excess of the net assets of a business is the present value of the future flow of income to the business.”<sup>185</sup> As in the previous example, a weighted average of earnings over a five year period is determined. The normal return on investment, which is the cost of net assets multiplied by a factor of eight to ten percent, is subtracted. The sum represents excess earnings attributable to goodwill.<sup>186</sup> This sum is then capitalized, which “represents an approximation of the risks inherent in the business, whether it is a commercial business

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<sup>180</sup> See e.g., *In re Marriage of Huff*, 834 P.2d 244 (Colo. 1992); *In re Marriage of Bookout*, 833 P.2d 800 (Colo. Ct. App. 1992); *Eslami v. Eslami*, 591 A.2d 411 (Conn. 1991); *Clark v. Clark*, 782 S.W.2d 56 (Ky. Ct. App. 1990); *Mocnik v. Mocnik*, 838 P.2d 500 (Okla. 1992).

<sup>181</sup> *Eslami*, 591 A.2d at 418.

<sup>182</sup> *Clark*, 782 S.W.2d at 59-60. See also Gary Zimmer, *Professional Goodwill: A Contradiction in Terms, or Untapped Marital Asset*; 48 OR. ST. B. BULL. 18 (1988); Mallor, *supra* note 8.

<sup>183</sup> See Zipp, *supra* note 58.

<sup>184</sup> Zipp, *supra* note 58, at 96-97.

<sup>185</sup> *Id.* at 97.

<sup>186</sup> *Id.* at 112.

or a professional practice.”<sup>187</sup> The capitalization factor consider number of issues, including a safe interest rate, the expected profitability of the business, the industry and business risks, the business’ liquidity and management.<sup>188</sup>

Like fair market value, a capitalization approach can avoid valuing post divorce earnings and efforts. When the formula uses historical earnings, it “avoids the problem of valuing a business on the basis of postdivorce earnings and profits.”<sup>189</sup> Further, earnings of a business which can be attributed to professional goodwill *existing at the time of divorce*, are “merely the fruit of a marital asset.”<sup>190</sup> Use of capitalization formulas may be more appropriate when a law practice is being valued due to concerns mentioned earlier with ethical restrictions.<sup>191</sup> In addition, the capitalization approach “recognizes the economic reality that there is ‘something special’ about a professional practice that develops earnings about the norm. That ‘something special’ is recognized as goodwill.”<sup>192</sup> This recognition allows the nonprofessional spouse to share the value in the property distribution as the partnership theory of marriage presumes.<sup>193</sup>

As most methods, the capitalization methods also have been criticized. “Not only is the capitalization method speculative, it is simply a method of valuing future earnings. Future earnings are not marital property.”<sup>194</sup> It may produce unrealistic figures which

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<sup>187</sup> *Id.*

<sup>188</sup> *Id.* at 118-123.

<sup>189</sup> *In re Marriage of Huff*, 834 P.2d at 256-57 (citation omitted). *See also In re Marriage of Bookout*, 833 P.2d at 805; *Clark*, 782 S.W.2d at 60; *Kisthardt*, *supra* note 6, at 2-28 (“capitalized value assumes the asset will continue to produce earnings [and] income received after the divorce that is attributable to pre-divorce goodwill is not post divorce earnings”).

<sup>190</sup> *Zipp*, *supra* note 58 at 103.

<sup>191</sup> *See In re Marriage of Huff*, 834 P.2d at 256. *See also Mallor*, *supra* note 8.

<sup>192</sup> *Mallor*, *supra* note 8 at 113.

<sup>193</sup> *See supra* notes 63-69 discussing the argument that equity requires the recognition of professional goodwill as marital property.

<sup>194</sup> *Mocnik*, 838 P.2d at 505. *See also Strauss*, 647 A.2d at 826 (noting the court in *Hollander v. Hollander*, 597 A.2d 1012 (Md. 1991) discouraged the use of capitalization of excess earnings “Because the value arrived at under this calculation ‘represents nothing more than an entity’s future earning capacity.’”), *Zimmer*, *supra* note 177 (explaining capitalization of earnings converts future income into a property right and results in “two bites from the same



overvalue the goodwill, particularly problematic when the professional spouse is required to pay tangible assets in exchange for intangible goodwill value.<sup>195</sup> The capitalization method may be susceptible of tampering by the professional spouse if he or she endeavors to keep his or her earnings artificially low, resulting in no excess value, no goodwill value.<sup>196</sup> In addition, these formulas seem to confuse valuation with concepts of proof. The *Hanson* court noted that expert testimony of professional goodwill value as a result of capitalization formulas was not proof of goodwill, because experts could “simply assume the existence of goodwill and, using a capitalization formula, produce a value.”<sup>197</sup>

The capitalization formulas may be considerably more complicated than a measure of fair market value; however, they may be convincing to a court who understands their nature and ability to do equity for a nonprofessional spouse while at the same time measuring only marital asset value. If a court repeatedly express concern that goodwill is actually the same as future earning capacity, a creative advocate may use a capitalization of excess earnings formula based only on historical earnings to illustrate the difference between future earnings capacity and goodwill. In addition, if an opposing expert develops a high valuation of professional goodwill which is unrealistic for the professional spouse, the criticism above can be used to point out the flaws in the valuation.

### 3. Use of Buy-Sell or Shareholder Agreements

Buy-sell or shareholder agreements typically provide a formula to value the professional spouse's interest in the business, such as upon withdrawal, disability, termination or retirement. Courts approve the use of these formulas to measure goodwill because they limit the value available to the nonprofes-

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apple.”); Kisthardt, *supra* note 6, at 2-27 to 2-28 (citing *E.E.C. v. E.J.C.*, 457 A.2d 688 (Del. 1983)).

<sup>195</sup> Kisthardt, *supra* note 6, at 2-28. *See also* Holbrook, 309 N.W.2d at 355 (expressing concern over the “disturbing inequity in compelling a professional practitioner to pay a spouse a share of intangible assets at a judicially determined value that could not be realized by sale or another method of liquidating value.”)

<sup>196</sup> *Russell v. Russell*, 399 S.E.2d 166, 169-170 (Va. Ct. App. 1990).

<sup>197</sup> *Hanson*, 837 S.W.2d at 435. *See also* *Cohen v. Cohen*, 841 S.W.2d 782, 786 (Mo. Ct. App. 1992).

sional spouse to that which the professional spouse can actually realize. The purpose for using these agreements is “to insure that the non-shareholder spouse does not receive greater value than that of the shareholder.”<sup>198</sup> Like the fair market, value method, it also prevents the “disturbing inequity in compelling a professional practitioner to pay a spouse a share of intangible assets at a judicially determined value that could not be realized by a sale or another method of liquidating value.”<sup>199</sup>

A small minority of courts have held partnership agreements are controlling as to the measure of professional goodwill, even if they result in a zero value.<sup>200</sup> Other courts refer to these agreements as “only a presumptive value, which can be attacked by either plaintiff or defendant as not reflective of the true value.”<sup>201</sup> However, in discussing the partnership agreement of a lawyer, the *Stern* court explained,

once it is established that the books of the firm are well kept and that the value of the partners’ interests are in fact periodically and carefully reviewed, then the presumption to which we have referred should be subject to effective attack only upon the submission of clear and convincing proofs.”<sup>202</sup>

Still other courts consider buy-sell partnership agreements to be only one factor in determining the value of goodwill.<sup>203</sup> Us-

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<sup>198</sup> Cohen & Hennessey, *supra* note 126, at 369 (citations omitted). *See also* Hertz v. Hertz, 657 P.2d 1169, 1174 (N.M. 1983).

<sup>199</sup> *Holbrook*, 309 N.W.2d 355. Compare the *Cox* court’s response to this quote (quote reprinted in *Cox*); “It should be equally inequitable and disturbing to permit the shareholder spouse to retain the entire community interest in the goodwill by simply entering into a restrictive shareholders’ agreement and then later realizing the value upon resale of the professional association, change in the agreement, or otherwise.” *Cox*, 775 P.2d at 1318.

<sup>200</sup> *In re Marriage of Keyser*, 820 P.2d 1194, 1197 (Colo. Ct. App. 1991) (noting a minority find the agreements controlling, this court held the price in the buy-sell agreement was not “facially dispositive.”). *See also* Sweeney v. Sweeney, 534 A.2d 1290 (Me. 1987); Hertz v. Hertz, 657 P.2d 1169 (N.M. 1983); Mocnik b. Mocnik, 838 P.2d 500 (Okla. 1992); Finn v. Finn, 658 S.W.2d 735 (Tex. Ct. App. 1983).

<sup>201</sup> *Weaver v. Weaver*, 324 S.E.2d 915, 917 (N.C. Ct. App. 1985). *See also* *Stern v. Stern*, 331 A.2d 257 (N.J. 1975).

<sup>202</sup> *Stern*, 331 A.2d at 261.

<sup>203</sup> *See In re Marriage of Kells*, 897 P.2d 1366 (Ariz. Ct. App. 1995); *In re Marriage of Keyser*, 820 P.2d 1194 (Colo. Ct. App. 1991); *Moebus v. Moebus*, 529 So. 2d 1163 (Fla. Dist. Ct. App. 1988); *Poore v. Poore*, 331 S.E.2d 266 (N.C.

ing a buy-sell agreement as the “appropriate, controlling, legitimate and enforceable, good faith and binding agreement and indicator of the parties’ interest” was error; the trial court should have considered the agreement “nonconclusive [and] minimally relevant.”<sup>204</sup> While not always relevant or helpful, a partnership agreement should be considered to see if it meets basic criteria, such as representing the present day business interest. Still, the agreement is “only. . . a factor or possible aid in valuing that interest.”<sup>205</sup>

Agreements with certain characteristics are more likely to be relied upon for valuing professional goodwill. Partnership agreements are appropriately used in valuing goodwill when they: (a) accurately represent consistent transactions over time;<sup>206</sup> (b) are entered into at arm’s length without intent to deprive the nonprofessional spouse of marital property; (c) are comprehensive and clear in their valuation formula; and (d) represent a present day interest value. In holding a non-shareholder spouse to the terms of a shareholder valuation agreement with a total value for goodwill of \$1.00, the New Mexico court stressed the consistency of transactions occurring under the agreement.<sup>207</sup> Over one hundred and fifty purchases and sales of stock were consummated using the same value, \$1.00, for goodwill.<sup>208</sup> Likewise, a finding that a buy-sell agreement was consistent with the history of practice for one doctor’s medical corporation, provided an element of reliability for the valuation formula.<sup>209</sup> Courts should also look at whether the transaction between the shareholder spouse and business entity was an arm’s length transaction.<sup>210</sup> The shareholder’s agreement in *Cox* represented

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Ct. App. 1985); *Kell v. Kell*, 1993 WL 525003 (Ohio Ct. App. Dec. 14, 1993); *Butler v. Butler*, 663 A.2d 148 (Pa. 1995).

<sup>204</sup> *In re Marriage of Kells*, 897 P.2d at 1371 (citations omitted).

<sup>205</sup> *Butler*, 663 A.2d at 154, *aff’d in part, rev. in part*.

<sup>206</sup> See e.g., *In re Marriage of Huff*, 834 P.2d 244, 258 (Colo. 1992) (concurring/dissenting opinion reasons where a partnership agreement exists, “is consistently applied to all partners,” and “reflects the considered judgment of the partners as to the value of their interests, the value of a partner’s interest should be governed by that agreement.”).

<sup>207</sup> *Hertz*, 657 P.2d at 1174.

<sup>208</sup> *Id.*

<sup>209</sup> *Kell*, 1993 WL 525003, at 6.

<sup>210</sup> *In re Marriage of Hall*, 692 P.2d at 180.

the very elements which lead to a court's refusal to consider such an agreement.<sup>211</sup> That agreement was entered into twenty-nine days after the nonshareholder wife filed for divorce; it was not signed by the shareholder husband until six months later, and no record was made of any transactions under the terms of the agreement.<sup>212</sup> The court held, despite the agreement's provision that book value of the stock would not include goodwill, the value of goodwill would be a marital asset subject to division.<sup>213</sup> Formulas which represent present day value also carry more weight. The currency may be shown by evidence the "interests are in fact periodically and carefully reviewed."<sup>214</sup> Clarity and comprehensiveness are valued:

A buy/sell agreement will not always be beneficial for purposes of ascertaining a spouse's present interest in the business. The reason for this is clear: while certain buy/sell agreements. . . will, indeed, be sufficiently comprehensive and provide a clear formula for purposes of valuing a spouse's business interest, others may not be so comprehensive or may not reflect the current situation.<sup>215</sup>

While use of the agreements addresses certain concerns, there are arguments why partnership agreements should not be consulted at all to value professional goodwill upon divorce.<sup>216</sup> First, partnership agreements are not relevant to dividing assets *at divorce*. They are not intended to value assets at divorce, rather their purpose is to discourage sales and provide the terms for the relationship between the professional spouse and his or her partners.<sup>217</sup> A partnership agreement does not provide a share of goodwill value for the nonshareholder spouse; it does not change the status of property from marital to community and

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<sup>211</sup> Cox, 775 P.2d at 1317-18.

<sup>212</sup> *Id.*

<sup>213</sup> *Id.* at 1318.

<sup>214</sup> *Stern*, 331 A.2d at 261.

<sup>215</sup> *Butler*, 663 A.2d at 154, *aff'd in part, rev. in part*.

<sup>216</sup> However, these reasons may not convince the court to completely disregard consideration of the partnership agreement. Courts may simply use these reasons to look at the terms of the agreement as one factor in accurately valuing the professional goodwill interest. *See e.g., Mitchell*, 732 P.2d at 212.

<sup>217</sup> *See In re Marriage of Keyser*, 820 P.2d 1194, 1196-97 (Colo. Ct. App. 1991); *Mocnik v. Mocnik*, 838 P.2d 500, 510 (Okla. 1992) (concurring in part, dissenting in part).

it does not purport to divide property between spouses.<sup>218</sup> “[P]artnership agreements are designed to deal with particular aspects of the business, and simply do not address the considerations involved in valuation for a marital dissolution. . . . [T]hey are only minimally relevant when a partner’s business continues but the partner’s marriage ends.”<sup>219</sup> Second, the asset being divided at divorce is the shareholder spouse’s partnership interest; therefore, formulas commonly included to value the interest at deal or withdrawal should not control.<sup>220</sup> Third, the “professional spouse may. . .[be] influenced by many factors other than fair market value in negotiating the terms of. . .[such an] agreement.”<sup>221</sup> Therefore the agreement may not be a true measure of the goodwill’s value. Fourth, these agreements should not be used to value goodwill when they result in an ability to rob the nonprofessional spouse of value.<sup>222</sup> An asset of value exists and agreements which remove it from the equitable distribution perpetuate a kind of fraud on the nonprofessional spouse.

Whether professional goodwill will be valued according to the formula in a buy-sell agreements varies. Courts not considering the agreements conclusive of value look to factors increasing the reliability and validity of the agreements. In addition, even if the court accepts evidence of the agreement’s value for goodwill, it may be only one factor in the determination. Attorneys should not disregard an agreement’s relevance, as it may provide support for another method’s value.

## V. Importance of Understanding Valuation Methods

Fair market value, capitalization formulas and use of buy-sell agreements are only three methods for valuing professional goodwill upon divorce. They are not the exclusive methods. In

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<sup>218</sup> Mitchell v. Mitchell, 732 P.2d 208, 212 (Ariz. 1987).

<sup>219</sup> *Id.* at 212-13.

<sup>220</sup> Finn v. Finn, 658 S.W.2d 735, 749 (Tex. Ct. App. 1983) (concurring opinion) (arguing that instead of being controlled by the partnership agreement’s terms, the value of the husband’s interest should be based on the present value of the partnership as an ongoing business, including consideration of goodwill if present).

<sup>221</sup> *In re Marriage of Hall*, 692 P.2d at 180.

<sup>222</sup> *Cox*, 775 P.2d at 1318. *See supra* note 194.

addition, they do not need to be used in isolation from one another. The availability of valuations using several methods is instructive and used in conjunction may be more powerfully convincing to the court. In choosing a method or methods and presenting the evidence to the court, attorneys must have a working understanding of the assumptions behind, the advantages of and the traps in using each method.

#### A. *Alternative Methods of Dealing With Professional Goodwill*

Although most courts have addressed the characterization of professional goodwill as marital property or not and various valuation methods may be used, it remains valuable to explore new methods of conceptualizing the interest. The new viewpoints may result in courts revising their characterization of goodwill or may lead to inventive arguments by attorneys. “When complex financial or property right issues present themselves in the domestic relations context, virtually any equitable and just result may be achieved if prepared and argued under the appropriate theory.”<sup>223</sup>

One alternative addresses *valuation* of professional goodwill upon divorce. “Holder’s interest” values the professional spouse’s interest more consistently with the reality of the circumstances and the equities between the parties:

- (1) If an interest in a personal service business is worth considerably more to the owner (a) under the assumption that he or she will continue to operate the business — and, accordingly, continue to reap the financial benefits it provides, than (b) assuming the owner will sell the business to a third party (i.e., FMV);
- (2) then the appropriate value for divorce settlement purposes, that is, for determining the offsetting amount of cash or value of other property for the nonowner spouse, is the value to the owner, not the lower FMV.<sup>224</sup>

A similar concept is “value to the owner,” borrowed from eminent domain.<sup>225</sup> “To measure a law firm’s value to the owner find out how much the partner would be willing to pay to prevent

<sup>223</sup> Crockett & Patterson, *supra* note 8, at 57.

<sup>224</sup> Joseph W. Cunningham, *Equitable Distribution and Professional Practices: Case Specific Approach to Valuation*, 73 MICH. B.J. 666 (1994). Also see the discussion of “investment value” in Crockett & Neely, *supra* note 156.

<sup>225</sup> John E. Hempstead, *Putting a Value on a Law Practice*, SUM. FAM. ADVOC. 14, 1984, at 14, 18.

the income reduction (if any) that would result if he or she left the practice.”<sup>226</sup> Income available from continuing with the practice is compared to income in alternative employment. The present value of the “projected future stream of those differences is the value to the owner.”<sup>227</sup>

One concern about holder’s interest value is it will result in “excessive values which obstruct efforts to settle divorce cases.”<sup>228</sup> The answer is twofold: first, comparisons between holder’s interest value and a professional’s average net income have shown no excessive values and second, to the extent there is not sufficient property to offset 50% of the practice, the remaining value can be paid over a period of years.<sup>229</sup> Additional concerns are that the professional will not be able to benefit from the full holder’s value because of death or disability; that the professional’s income is again being unfairly used as property and as a source of maintenance; and that this concept of property will be used to value other marital assets.<sup>230</sup>

The benefits will this approach include its naturally case specific approach and its recognition the realities of property distribution are less about sales of property to third parties in arm’s length transactions as they are division of property between two spouses.<sup>231</sup>

Another alternative addresses the *characterization* of the partnership interests are issue incases of professional goodwill. While this theory of “sacrificed career” is not recent, it may provide “food” for imaginative argument. This theory suggests rather than focusing on the value of professional goodwill to the professional spouse, the analysis should focus on the losses to the nonprofessional spouse.<sup>232</sup> Sacrifices made by one spouse to take care of children or maintain the home, at the expense of marketable skills should be compensated with reimbursement plus interest once the parties divorce.<sup>233</sup> Upon divorce, “the

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<sup>226</sup> *Id.*

<sup>227</sup> *Id.*

<sup>228</sup> Cunningham, *supra* note 223 at 670.

<sup>229</sup> *Id.*

<sup>230</sup> at 671.

<sup>231</sup> *Id.*

<sup>232</sup> Parkman, *supra* note 1 at 48.

<sup>233</sup> *Id.*

usual definitions of separate and marital property do not provide for compensation for the type of sacrifices made by” the spouse who maintained the home and children.<sup>234</sup> The value to be compensated would be “the difference between the future income stream that the individual can then expect in contrast to the income stream that [he or she] could have expected if she had never left the labor force.”<sup>235</sup> The major concern with this theory is the uncertainty and difficulty in valuing those lost opportunities.<sup>236</sup> However, other areas of the law, such as personal injury law, may provide useful examples for this valuation.

## **VI. Conclusion**

Professional goodwill is a unique interest because it intuitively represents value, but is difficult to define and measure. Dealing with this interest equitably and effectively upon divorce requires consideration not only of whether the interest will be considered marital property, but if it is an interest belonging to the community, how will it be measured and valued for division. These issues arise in a setting of broad discretion, extensive use of experts and case specific inquiry. This review article does not distinguish which state follows which methods; however, it attempts to provide a basic understanding of the rationales underlying the characterization of goodwill and the choice of valuation methods. With these basic “tools,” practitioners should be able to build their own ingenious and resourceful arguments to zealously represent the best interests of their clients.

Helga White

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<sup>234</sup> *Id.* at 47.

<sup>235</sup> *Id.* at 51.

<sup>236</sup> *Id.* at 54.