



“By Virtue of Her Position as Wife”¹¹

Goodwill in Divorces

How California law has been shaped by inconsistent logic to address antiquated societal notions of marriage

by Brigeda Bank

“GOODWILL OF A BUSINESS IS the expectation of continued public patronage.”² Under Business and Professions Code §14102, the goodwill of a business is property and is transferable. This intangible asset — that must necessarily attach to a business under California law³ — has for the past half century been valued as a marital asset in California dissolution actions. California has applied the valuation of intangible goodwill in divorces to manufacturing businesses and to professional practices alike, and has taken the position that goodwill exists in a professional practice often without making a distinction between the business and the individual.⁴

California is in the minority of jurisdictions. Twenty-five states hold that goodwill is valued in divorces only if it attaches to a business entity that is separate and apart from the professional or individual.⁵ Only 13 states, California included, recognize professional and enterprise goodwill as marital property.⁶

*Golden v. Golden*⁷ is still one of the most often cited cases for the policy underpinnings that justify finding that a professional practice has goodwill in a divorce. After reviewing the prior case law, some of which took a contrary view, the *Golden* court concluded:

We believe the better rule is that, in a divorce case, the good will of the husband’s professional practice as a sole practitioner should be taken into consideration in determining the award to the wife. Where, as in *Lyon*, the firm is being dissolved, it is understandable that a court cannot determine what, if any, of the good will of the firm will go to either partner. But, in a matrimonial

matter, the practice of the sole practitioner husband will continue, with the same intangible value as it had during the marriage. Under the principles of community property law, *the wife, by virtue of her position of wife*, made to that value the same contribution as does a wife to any of the husband’s earnings and accumulations during marriage. She is as much entitled to be recompensed for that contribution as if it were represented by the increased value of stock in a family business. *Golden v. Golden, supra*, 270 Cal. App.2d at p. 405 (emphasis added).

Thus, it is the *Golden* case that lays the theoretical and societal framework of California’s policy to treat goodwill in a professional practice as a community asset. It is founded on the concept that by virtue of a “wife’s position as wife” she contributed to her husband’s professional career. It presumes that a wife’s “job” or “position” is not to further her own employment and career, but to participate, support, and contribute to her husband’s career. This framework may have made sense or in some respect reflected societal reality in 1969, but it no longer does today.⁸

A more appropriate analysis would be whether the professional practice is transferable on the open market. The California statutory definition of the fair market value of property, which is derived from eminent domain law, is “the highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing, and able to buy but under no particular necessity for so doing, each dealing with the other with full knowledge of all

the uses and purposes for which the property is reasonably adaptable and available.”⁹ This valuation principal was approved in a divorce action by at least one California court of appeal.¹⁰

In *In re Marriage of Fortier*, the trial court concluded that the value of the goodwill of the medical practice in a divorce proceeding was what a willing buyer would pay for it—i.e., its market value. In reaching this conclusion the trial judge commented: “I cannot believe the goodwill of a medical practice upon divorce means one thing, and upon sale of the business means another. . .”¹¹

However, in order to recognize a “wife’s position” as set forth in *Golden*, over the past half century the courts of appeal have had to twist the logic to ludicrous extents in the rejection of the market value analysis in order to find professional goodwill. For example, in *In re Marriage of Foster*, which is considered California’s leading authority regarding the methodology of valuing professional goodwill in a divorce, the First District held that:

“[t]he value of community goodwill is not necessarily the specified amount of money that a willing buyer would pay for such goodwill. In view of exigencies that are ordinarily attendant to a marriage dissolution the amount obtainable in the marketplace might well be less than the true value of the goodwill. Community goodwill is a portion of the community value of the professional practice as a going concern on the date of the dissolution of the marriage.”¹²

Under the leading case in California, therefore, the concept of fair market value was rejected because of the supposed time

pressures of valuing goodwill in a divorce. Consequently, the *Foster* court approved any method of valuing goodwill that does not “take into account the post-marital efforts of either spouse” and that “contemplates any legitimate method of evaluation that measures its present value by taking into account some past result.”¹³ Notably, the expert — whose testimony was accepted by the *Foster* trial court — testified that: “*there is no definite method by which the value of goodwill can be determined and that it is always just somebody’s opinion.*”¹⁴

The fiction laid down by the *Foster* case — that a valuation method other than fair market value is necessary because of the pressures of the divorce — is replicated in dozens of subsequent decisions regarding the valuation of goodwill. At the very heart of this fiction is that professional goodwill is a transferable asset at all. Relying on cases such as *Golden* and *Foster*, subsequent cases have expanded goodwill to an unreasonable extreme by finding that a professional practice, which may not actually be transferable on the open market or which may be transferable at a nominal sum, nonetheless has goodwill of significant value in a divorce.¹⁵ The California Supreme Court has denied review every time on the issue of goodwill in marital dissolutions and to date there is no decision that settles the various differences in the court of appeal decisions.¹⁶

The most common methods of valuing goodwill in a professional business for divorce purposes are the multiple of earnings approach (used commonly in the medical industry) and the excess earnings approach.¹⁷ The excess earnings approach values the tangible assets and calculates a return on those assets and then deducts this result from the overall earning of the business. This figure is then compared with the reasonable compensation of an employee in the place of the owner. If there is an excess, this is capitalized (or multiplied) by a factor depending on the nature of the

business, i.e., the risks involved.¹⁸ The excess earnings method is based on predictions about the future earnings of the business. Although the excess earnings method has been criticized for being a method that necessarily values *future* earnings,¹⁹ this approach has been upheld in a number of cases to pass muster under *Foster*.²⁰

Unless the professional who is getting divorced can sell her practice on the open market, the better analysis would be to treat the intangible value of the professional’s practice in a manner similar to how a professional education or a celebrity’s career is treated. California courts have held that a professional education is not a community property asset to be divided in a divorce.²¹ The reasoning is as follows:

The value of a legal education lies in the potential for increase in the future earning capacity of the acquiring spouse made possible by the law degree and innumerable other factors and conditions which contribute to the development of a successful law practice. A determination that such an “asset” is community property would require a division of postdissolution earnings to the extent that they are attributable to the law degree, even though such earnings are by definition the separate property of the acquiring spouse. The value of a legal education lies in the potential for increase in the future earning capacity of the acquiring spouse made possible by the law degree and innumerable other factors and conditions which contribute to the development of a successful law practice.²²

California courts have also held that there is no personal goodwill in a spouse’s career.²³ For example, in *In re Marriage of McTiernan*, the court held that there is no divisible goodwill that exists apart from a business or professional practice:

“Endowing ‘a person doing business’ with the capacity to create goodwill, as opposed to limiting goodwill to ‘a business,’ has wide ramifications. ‘A person doing business’

includes much of the working population. Notably, there would be no principled distinction between husband in this case, who is a director, and actors, artists and musicians, all of whom could be said to be ‘persons doing business.’ Thus, all such persons who would have the ‘expectation of continued public patronage’ would possess goodwill. This would create a substantial liability, as in this case, without a guaranty that the liability would be funded. It is clear that, from an economic perspective, the ‘goodwill’ in this case is based on earnings, and that ‘goodwill’ is an expression of husband’s earning capacity. (FN 7.) While we acknowledge that the ‘excess earning’ method of valuing goodwill in a professional corporation is generally accepted, it is true that this method is not far removed from a prediction about future earnings. For good and sufficient reasons, the *expectancy of future earnings* may not be considered in determining goodwill. Whether categorized as ‘excess earnings’ or ‘future earnings,’ the point is that this type of goodwill is an expression of earnings that have not yet been paid. Thus, when, as here, a person ‘doing business’ is found to have goodwill and the goodwill is measured by the excess earnings approach, the ‘asset’ that is created is a prediction, not a fact. This is quite a distance from an established business enterprise with assets, and a clientele, that has generated goodwill in the traditional sense. However, there is no guaranty, especially in the arts, that earnings will not decline or even dry up, even though expectations were to the contrary. In such an event, a person would find him or herself saddled with a massive liability without the means of satisfying it. Putting it another way, endowing directly persons with the ability to create goodwill would create an ‘asset’ predicated on nothing other than predictions about earning capacity.”²⁴

A professional education is not a marital asset because it is not property separable

from the professional. A movie director has no goodwill because he is not associated with a business entity, he cannot transfer himself, and to ascribe goodwill to him would be based solely on the expectancy of future earnings, which are his separate property. These cases emphasize the logical fallacy of *Foster* and the cases following in its footsteps. The fact that a divorcing wife or husband has a career as an architect or attorney and practices his or her profession as a solo practitioner or as a partner in a firm, does not necessarily mean that the spouse-professional can sell his practice or that it has value. Service practices, such as attorneys, tend to be very much dependent on the individual and her reputation. Like the movie director, the professional cannot transfer himself, and his individual clients cannot be sold like stock or software or widgets.

If there is indeed actual evidence of fair market value of goodwill, then courts should include goodwill as a divisible asset in a divorce.²⁵ But when there is no evidence of fair market value of goodwill, courts should not resort to contradictory and incoherent logic founded on historic and antiquated views of marriage and spousal roles. California's expectations of spouses with respect to the determination of child and spousal support has changed with our evolving societal views of gender roles in marriage and in the workplace. It is time for California's treatment of professional goodwill to progress to the 21st century. ♦

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¹*Golden v. Golden* (1969) 270 Cal.App.2d 401, 405.

²Cal. Business and Professions Code §14102.

³*In re Marriage of McTiernan and Dubrow* (2005) 133 Cal.App.4th 1090. (The Second District held that no personal goodwill existed in husband's career as a successful movie director because his career did not exist as part of a business.)

⁴See e.g. *Mueller v. Mueller* (1956) 144 Cal.App.2d 245; *Golden v. Golden*, *Supra*, 270 Cal.App.3d 401; and *In re the Marriage of Foster* (1974) 42 Cal.App.3d 577.

⁵See *Present Positions on Professional Goodwill: More Focus or Simply More Hocus Pocus*, Christopher A. Tiso, *Journal of the American Academy of Matrimonial Lawyers*, Volume 20, Number 1 (2006).

⁶Five states do not recognize either professional or enterprise goodwill and six states have not yet definitively resolved the issue. *Id.*

⁷*Golden v. Golden*, *supra* at 270 Cal.App.2d 401.

⁸As noted by one family law expert, "The courts assigned an intrinsic value to the professional practices, called it goodwill, and awarded the practice to the professional, offsetting it against an award to the family residence and other assets to the nonprofessional spouse. In most cases, this was a fiction used to give wives some economic security. But now there are more professional women in the workplace than ever before.... Placing a high value on a law practice no longer necessarily benefits a woman in a marital dissolution." *Goodwill Hunting: The Valuation of a Law Firm in a Divorce Proceeding Should Be Measured by Fair Market Value*, Peter Walzer and Edward Poll (www.california-divorce.com).

⁹California Code of Civil Procedure §1263.320(a).

¹⁰See e.g., *In re Marriage of Fortier* (1973) 34 Cal.App.3d 384.

¹¹*Id.* at 387.

¹²*In re Marriage of Foster* (1974) 42 Cal.App.3d 577, at 584.

¹³*In re Marriage of Foster*, *supra*, 42 Cal.App.3d at p. 584.

¹⁴*Id.* at 580-581, emphasis added.

¹⁵See e.g., *In re Marriage of Lopez* (1974) 38 Cal.App.3d 93 ("We think it follows that in marital cases the expectancy of future earnings is not synonymous with, nor should it be the basis for, determining the value of goodwill of a professional practice, but is simply a factor to consider in deciding if such an asset exists." *Id.* at pp. 108-109. See also *In re Marriage of Tredale and Casus* (2004) 121 Cal.App.4th 321 which found that there was no goodwill of the law firm, but that the wife attorney had personal goodwill based upon her excess earnings; *In re Marriage of Wimu* (1979) 98 Cal.App.3d 363 which found that husband's horse slaughtering business had goodwill even though it had no sales value. But see *In re Marriage*

of King (1983) 150 Cal.App. 3d 304 in which the court reversed because the trial court's finding of goodwill was based "upon an incorrect method of calculation which took into consideration the postseparation efforts, earnings and accumulations of the husband and thus constituted an error in law." *Id.* at p. 310.

¹⁶But see, *Smith v. Bullcal* (1958) 50 Cal.2d 294, in which the California Supreme Court held in a probate action that the goodwill of an advertising agency could survive one of the partner's death.

¹⁷See *Goodwill Hunting: The Valuation of a Law Firm in a Divorce Proceeding Should Be Measured by Fair Market Value*, Peter Walzer and Edward Poll (www.california-divorce.com). Medical practices typically sell for three months' gross income. See Mark Kohn, *A Theoretical Basis for Using Three Practices*, *Family Law News*, Spring 1995, at 5, cited in Walzer and Poll, *fn* 19.

¹⁸Many thanks to Jeff Stegner, CPA-ABV, CVA of Armanino McKenna LLP for his assistance with this definition.

¹⁹Helga White, *Professional Goodwill: Is It a Settled Question or is There "Value" in Discussing it*, 15 *J. Am. Academy of Matrimonial Lawyers* 526-27 (1998). Rev. Rul. 56-60 states that the excess earnings should not be used if there is better evidence to determine intangible value.

²⁰See *fn.* 15.

²¹*In re Marriage of Aufmuth* (1979) 89 Cal.App.3d 446.

²²*Id.* at 461-462. See also *In re Marriage of Grabam* (1978) 194 Colo. 429 wherein "the Colorado Supreme Court concluded that an education degree has none of the attributes of "property" in the usual sense of that term: 'An educational degree, such as an M.B.A., is simply not encompassed even by the broad views of the concept of "property." It does not have an exchange value or any objective transferable value on an open market. It is personal to the holder. It terminates on the death of the holder and is not inheritable....It is simply an intellectual achievement that may potentially assist in the future acquisition of property.'" *In re Marriage of Aufmuth*, *supra*, 89 Cal. App. 3d 446, 462 citing *In re Marriage of Grabam*.

²³*In re Marriage of McTiernan and Dubrow*, *supra*, 133 Cal. App.4th 1090.

²⁴*Id.* at 1099, emphasis in original, citations omitted.

²⁵There is market data regarding the sale price of medical, veterinary, and other types of professional practices. This market data provides courts with actual evidence of the value of the asset — its tangible components and its intangible goodwill — that is not "just somebody's opinion." In 1989, the sale of law practices became legal in California and practitioners and courts alike should be looking to the value of law practices from market data of sales.