A NEW APPROACH TO DETERMINING ENTERPRISE AND PERSONAL GOODWILL UPON DIVORCE

Richard R. Orsinger
richard@momnd.com

McCurley, Orsinger, McCurley,
Nelson & Downing, L.L.P.

Dallas Office:
5950 Sherry Lane, Suite 800
Dallas, Texas 75225
214-273-2400

and

San Antonio Office:
1717 Tower Life Building
San Antonio, Texas 78205
210-225-5567

State Bar of Texas
New Frontiers in Marital Property Course
October 13 & 14, 2011
San Diego, California

© 2011
Richard R. Orsinger
All Rights Reserved

CURRICULUM VITAE OF RICHARD R. ORSINGER

Education: Washington & Lee University, Lexington, Virginia (1968-70)
University of Texas (B.A., with Honors, 1972)
University of Texas School of Law (J.D., 1975)

Licensed: Texas Supreme Court (1975); U.S. District Court, Western District of Texas (1977-1992; 2000-present); U.S. District Court, Southern District of Texas (1979); U.S. Court of Appeals, Fifth Circuit (1979); U.S. Supreme Court (1981)

Certified: Board Certified by the Texas Board of Legal Specialization Family Law (1980), Civil Appellate Law (1987)

Organizations and Committees:

Chair, Family Law Section, State Bar of Texas (1999-2000)
Chair, Appellate Practice & Advocacy Section, State Bar of Texas (1996-97)
Chair, Continuing Legal Education Committee, State Bar of Texas (2000-02)
Vice-Chair, Continuing Legal Education Committee, State Bar of Texas (2002-03)
Member, Supreme Court Advisory Committee on Rules of Civil Procedure (1994-present); Chair, Subcommittee on Rules 16-165a
Member, Pattern Jury Charge Committee (Family Law), State Bar of Texas (1987-2000)
Supreme Court Liaison, Texas Judicial Committee on Information Technology (2001-present)
Tx. Bd. of Legal Specialization, Civil Appellate Law Advisory Commission (Member 1994-1997, 1999-2001, 2003-2006) and Civil Appellate Law Exam Committee (1990-present; Chair 1991-1995)
Tx. Bd. of Legal Specialization, Family Law Advisory Commission (1987-1993)
Member, Supreme Court Task Force on Jury Charges (1992-93)
Member, Supreme Court Advisory Committee on Child Support and Visitation Guidelines (1989, 1991; Co-Chair 1992-93; Chair 1994-98)
Member, Board of Directors, Texas Legal Resource Center on Child Abuse & Neglect, Inc. (1991-93)
President, Texas Academy of Family Law Specialists (1990-91)
President, San Antonio Family Lawyers Association (1989-90)
Associate, American Board of Trial Advocates
Fellow, American Academy of Matrimonial Lawyers
Director, San Antonio Bar Association (1997-1998)
Member, San Antonio, Dallas and Houston Bar Associations

Professional Activities and Honors:

Texas Academy of Family Law Specialists' *Sam Emison Award* (2003)
State Bar of Texas *Presidential Citation* "for innovative leadership and relentless pursuit of excellence for continuing legal education" (June, 2001)
State Bar of Texas Family Law Section's *Dan R. Price Award* for outstanding contributions to family law (2001)
State Bar of Texas *Gene Cavin Award for Excellence in Continuing Legal Education* (1996)
State Bar of Texas *Certificate of Merit*, June 1995, June 1996, June 1997 & June 2004
Listed in the BEST LAWYERS IN AMERICA (1987-to date)
2005 Listed in Texas' Top 100 Lawyers by Texas Monthly Superlawyers Survey

Continuing Legal Education and Administration:

Course Director, State Bar of Texas Practice Before the Supreme Court of Texas Course (2002, 2003, 2004, 2005)
Co-Course Director, State Bar of Texas *Enron, The Legal Issues* (March, 2002) [Won national ACLEA Award]
Course Director, State Bar of Texas Advanced Expert Witness Course (2001, 2002, 2003, 2004)
Course Director, State Bar of Texas 1999 Impact of the New Rules of Discovery
Course Director, State Bar of Texas 1998 Advanced Civil Appellate Practice Course
Course Director, State Bar of Texas 1991 Advanced Evidence and Discovery Course
Director, Computer Workshop at Advanced Family Law Course (1990-94)

and Advanced Civil Trial Course (1990-91)
Course Director, State Bar of Texas 1987 Advanced Family Law Course
Course Director, Texas Academy of Family Law Specialists First Annual Trial Institute, Las Vegas, Nevada (1987)

Books and Journal Articles:

—Chief Editor of the State Bar of Texas' TEXAS SUPREME COURT PRACTICE MANUAL (2005)
---Chief Editor of the State Bar of Texas Family Law Section's EXPERT WITNESS MANUAL (Vols. II & III) (1999)
---Author of Vol. 6 of McDonald Texas Civil Practice, on Texas Civil Appellate Practice, published by Bancroft-Whitney Co. (1992) (900 + pages)
---*A Guide to Proceedings Under the Texas Parent Notification Statute and Rules,* SOUTH TEXAS LAW REVIEW (2000) (co-authored)
---*Obligations of the Trial Lawyer Under Texas Law Toward the Client Relating to an Appeal,* 41 SOUTH TEXAS LAW REVIEW 111 (1999)
---*Asserting Claims for Intentionally or Recklessly Causing Severe Emotional Distress, in Connection With a Divorce*, 25 ST. MARY'S L.J. 1253 (1994), republished in the AMERICAN JOURNAL OF FAMILY LAW (Fall 1994) and Texas Family Law Service *NewsAlert* (Oct. & Dec., 1994 and Feb., 1995)
---Chapter 21 on *Business Interests* in Bancroft-Whitney's TEXAS FAMILY LAW SERVICE (Speer's 6th ed.)
---*Characterization of Marital Property*, 39 BAY. L. REV. 909 (1988) (co-authored)
---*Fitting a Round Peg Into A Square Hole: Section 3.63, Texas Family Code, and the Marriage That Crosses States Lines*, 13 ST. MARY'S L.J. 477 (1982)

SELECTED CLE SPEECHES AND ARTICLES

State Bar of Texas' [SBOT] Advanced Family Law Course: Intra and Inter Family Transactions (1983); Handling the Appeal: Procedures and Pitfalls (1984); Methods and Tools of Discovery (1985); Characterization and Reimbursement (1986); Trusts and Family Law (1986); The Family Law Case in the Appellate Court (1987); Post-Divorce Division of Property (1988); Marital Agreements: Enforcement and Defense (1989); Marital Liabilities (1990); Rules of Procedure (1991); Valuation Overview (1992); Deposition Use in Trial: Cassette Tapes, Video, Audio, Reading and Editing (1993); The Great Debate: Dividing Goodwill on Divorce (1994); Characterization (1995); Ordinary Reimbursement and Creative Theories of Reimbursement (1996); Qualifying and Rejecting Expert Witnesses (1997); New Developments in Civil Procedure and Evidence (1998); The Expert Witness Manual (1999); Reimbursement in the 21st Century (2000); Personal Goodwill vs. Commercial Goodwill: A Case Study (2000); What Representing the Judge or Contributing to Her Campaign Can Mean to Your Client: Proposed New Disqualification and Recusal Rules (2001); Tax Workshop: The Fundamentals (2001); Blue Sky or Book Value? Complex Issues in Business Valuation (2001); Private Justice: Arbitration as an Alternative to the Courthouse (2002); International & Cross Border Issues (2002); Premarital and Marital Agreements: Representing the Non-Monied Spouse (2003); *Those Other Texas Codes: Things the Family Lawyer Needs to Know About Codifications Outside the Family Code* (2004)

SBOT's Marriage Dissolution Course: Property Problems Created by Crossing State Lines (1982); Child Snatching and Interfering with Possess'n: Remedies (1986); Family Law and the Family Business: Proprietorships, Partnerships and Corporations (1987); Appellate Practice (Family Law) (1990); Discovery in Custody and Property Cases (1991); Discovery (1993); Identifying and Dealing With Illegal, Unethical and Harassing Practices (1994); Gender Issues in the Everyday Practice of Family Law (1995); Dialogue on Common Evidence Problems (1995); Handling the Divorce Involving Trusts or Family Limited Partnerships (1998); The Expert Witness Manual (1999); Focus on Experts: Close-up Interviews on Procedure, Mental Health and Financial Experts (2000); Activities in the Trial Court During Appeal and After Remand (2002)

UT School of Law: Trusts in Texas Law: What Are the Community Rights in Separately Created Trusts? (1985); Partnerships and Family Law (1986); Proving Up Separate and Community Property Claims Through Tracing (1987); Appealing Non-Jury Cases in State Court (1991); The New (Proposed) Texas Rules of Appellate Procedure (1995); The Effective Motion for Rehearing (1996); Intellectual Property (1997); Preservation of Error Update (1997); TRAPs Under the New T.R.A.P. (1998); Judicial Perspectives on Appellate Practice (2000)

SBOT's Advanced Evidence & Discovery Course: Successful Mandamus Approaches in Discovery (1988); Mandamus (1989); Preservation of Privileges, Exemptions and Objections (1990); Business and Public Records (1993); Grab Bag: Evidence & Discovery (1993); Common Evidence Problems (1994); Managing Documents--The Technology (1996); Evidence Grab Bag (1997); Evidence Grab Bag (1998); Making and Meeting Objections (1998-99); Evidentiary Issues Surrounding Expert Witnesses (1999); Predicates and Objections (2000); Predicates and Objections (2001); Building Blocks of Evidence (2002); Strategies in Making a Daubert Attack (2002); Predicates and Objections (2002); Building Blocks of Evidence (2003); Predicates & Objections (High Tech Emphasis) (2003)

SBOT's Advanced Civil Appellate Practice Course: Handling the Appeal from a Bench Trial in a Civil Case (1989); Appeal of Non-Jury Trials (1990); Successful Challenges to Legal/Factual Sufficiency (1991); In the Sup. Ct.: Reversing the Court of Appeals (1992); Brief Writing: Creatively Crafting for the Reader (1993); Interlocutory and Accelerated Appeals (1994); Non-Jury Appeals (1995); Technology and the Courtroom of the Future (1996); Are Non-Jury Trials Ever "Appealing"? (1998); Enforcing the Judgment, Including While on Appeal (1998); Judges vs. Juries: A Debate (2000); Appellate Squares (2000); Texas Supreme Court Trends (2002); New Appellate Rules and New Trial Rules (2003); *Supreme Court Trends* (2004)

SBOT's Annual Meeting: Objections (1991); Evidentiary Predicates and Objections (1992-93); Predicates for Documentary & Demonstrative Evidence (1994); "Don't Drink That! That's My Computer!" (1997); The Lawyer as Master of Technology: Communication With Automation (1997); Technology Positioning (1999); Objections Checklist (2000); Evidence from Soup to Nuts (2000)

Various CLE Providers: SBOT In-House Counsel Course: Marital Property Rights in Corporate Benefits for High-Level Employees (2002); SBOT 19th Annual Litigation Update Institute: Distinguishing Fact Testimony, Lay Opinion & Expert Testimony; Raising a Daubert Challenge (2003); State Bar College Spring Training: Current Events in Family Law (2003); SBOT Practice Before the Supreme Court: Texas Supreme Court Trends (2003); SBOT 26th Annual Advanced Civil Trial: Distinguishing Fact Testimony, Lay Opinion & Expert Testimony; Challenging Qualifications, Reliability, and Underlying Data (2003); SBOT New Frontiers in Marital Property: Busting Trusts Upon Divorce (2003); American Academy of Psychiatry and the Law: Daubert, Kumho Tire and the Forensic Child Expert (2003)

TABLE OF CONTENTS

I. INTRODUCTION. . . . 1
- A. THE IMPORTANCE OF INTANGIBLE ASSETS IN THE "NEW ECONOMY." 1
- B. HUMAN CAPITAL. . . . 2
- C. THE ACCOUNTANTS. . . . 2
- D. THE LAWYERS. . . . 3

II. HUMAN CAPITAL. . . . 3

III. THE LEGAL CONCEPTION OF GOODWILL. . . . 5
- A. WHAT IS GOODWILL? . . . 5
  - 1. Seeking a Better Legal Conception of Goodwill. . . . 5
  - 2. Goodwill as Residual Value. . . . 9

IV. THE ACCOUNTING CONCEPTION OF GOODWILL. . . . 9
- A. GOODWILL AS EXCESS PURCHASE PRICE. . . . 9
- B. DEFINITION OF PERSONAL GOODWILL. . . . 10
- C. PULLING IDENTIFIABLE INTANGIBLES OUT OF RESIDUAL GOODWILL. . . 10
  - 1. What Constitutes an Intangible Asset (for Accounting Purposes)? . . . 11
  - 2. Assembled Workforce is Part of Residual Goodwill. . . . 13
  - 3. Some Say that Assembled Workforce Can be Valued. . . . 18
  - 4. The Argument That Goodwill is not an Asset. . . . 18

IV. WHAT TAX LAW SAYS ABOUT GOODWILL AND SEPARABLE INTANGIBLE ASSETS. . . . 18

V. THE DIVISIBILITY OF GOODWILL UPON DIVORCE. . . . 20
- Arizona. . . . 21
- Arkansas. . . . 21
- California. . . . 22
- Colorado. . . . 22
- Connecticut. . . . 24
- District of Columbia. . . . 25
- Florida. . . . 25
- Illinois. . . . 25
- Indiana. . . . 25
- Kansas. . . . 26
- Kentucky. . . . 26
- Louisiana. . . . 27
- Maryland. . . . 28
- Massachusetts. . . . 28
- Michigan. . . . 29
- Missouri. . . . 30
- Nebraska. . . . 31
- Nevada. . . . 31
- New Jersey. . . . 31
- New York. . . . 33

Ohio. 35
Oklahoma. 37
Pennsylvania 37
South Carolina. 38
Tennessee. 39
Texas. 39
Utah. 40
Virginia. 40
Washington. 40
Wisconsin. 41

VI. TWO SUGGESTIONS ON HOW TO ATTACK THE PROBLEM OF GOODWILL UPON DIVORCE. 41
A. THESIS NO. ONE. 42
B. THESIS NO. TWO. 42

VII. VALUING GOODWILL. 43
A. GOODWILL OF THE GOING BUSINESS. 44
B. COMMERCIAL OR ENTERPRISE GOODWILL VS. PERSONAL GOODWILL. . . . 44
1. Valuing Other Intangible Assets. 44
2. Determining Personal Goodwill. 45
a. Adjusting for Knowledge, Skill and Experience. 45
b. Profits Tied to the Seller. 45
c. What's Left is Entity Goodwill. 46
C. HOW DOES PERSONAL GOODWILL COMPARE TO "HUMAN CAPITAL"? . . . 46

A New Approach to Determining Enterprise and Personal Goodwill Upon Divorce

by

Richard R. Orsinger
Board Certified in Family Law
& Civil Appellate Law by the
Texas Board of Legal Specialization

I. INTRODUCTION. Our society, in fact our world, is in the midst of a significant transformation in which the focus of our economic and personal lives is shifting away from what we call tangible assets and toward what we call intangible assets. A recent but telling indication is the fact that on August 10, 2011, for a brief moment, the market capitalization of Apple Corporation (which makes workplace tools and electronic toys but earns billions of dollars selling other people's intellectual property) exceeded that of Exxon Mobil Corporation (which uses a large number of heavy industrial assets to retrieve, transport, and refine oil from the ocean bottoms, deserts, and arctic wastelands). The accounting profession is making some effort to keep up with these changes, but it is a running a decade behind in some respects and isn't event trying in others. The legal profession has been extremely slow to react to these changes, and antiquated legal doctrines are causing injustices to occur of which the courts are unaware because the lawyers themselves are unaware of the changes.

A. THE IMPORTANCE OF INTANGIBLE ASSETS IN THE "NEW ECONOMY." In the mind of the law, the "goodwill" of a business is whatever it is that makes the business more than the sum of its parts. In the past, when all the assets of a business were physical things, the "extra value" of the business was associated with location, or buying habits, or personal connections between the business owner and sales staff and the customer. This is a visualization dating back to the general store on Main Street. In the present economy of shopping from mail order catalogues, on cable tv, and over the internet, with physical delivery by mail, Federal Express, or UPS, and delivery of software, entertainment and information over telephone lines, coaxial cable or microfiber wires, of free trade and world-wide price competition, of huge Walmarts replacing small stores, of HMOs and PPOs and hospitals controlling the flow of medical care, and of lawyer advertising, the old loyalty-based conception of goodwill of a business has been replaced by brand loyalty, convenience, and price, as the factors that keep customers coming.

In today's economy, the things that make most businesses valuable are intangible assets. Consider this: the richest man in America does not sell cars, or hamburgers, or oil. He sells CDs with 0's and 1's on them.

> The importance of intangible assets is the distinguishing feature of the new economy. By and large, existing financial statements recognize those assets only when they are acquired from others. Accounting standard setters should develop a basis for the recognition and measurement of internally generated intangible assets.

Wayne S. Upton, Jr., *Special Report: Business and Financial Reporting, Challenges from the New Economy*, FINANCIAL ACCOUNTING STANDARDS BOARD (April 2001), on line at <http://www.fasb.org /articles&reports/sr_new_economy.pdf#76>.

Internally-created intangible assets are becoming increasingly important in business and harder to ignore. An October 2001 report by Leonard I. Nakamura of the Federal Reserve Bank of Philadelphia estimated that U.S. companies invest in intangibles at a rate of $1 trillion per year, which means that "businesses are investing nearly as much in intangibles as they are in plant and equipment (business investment in fixed nonresidential plant and equipment in 2000 was $1.1 trillion)." Nakamura

also suggested that a third of the value of U.S. corporate assets are intangibles. By "intangibles" Nakamura means "private expenditures on assets that are intangible and necessary to the creation and sale of new or improved products and processes. These include designs, software, blueprints, ideas, artistic expressions, recipes, and the like. They also include the testing and marketing of new products that are a necessary sunk cost of their first sale to customers. It is the private expense to create private rights to sell new products." Leonard I. Nakamura, *What Is the U.S. Gross Investment in Intangibles? (At Least) One Trillion Dollars a Year!*, <http://www.phil.frb.org/files/wps/2001/wp01-15.pdf>.

According to investment researcher Jack Ciesielski: "For 168 companies in the S & P 500 that had intangibles in 1990 and in 1999, the average ratio of intangibles to total assets was 13% in 1990 and grew to 18% by 1999. The result is even more startling when intangibles are compared to common equity: in 1990, the average ratio was 49%, and it swelled to nearly 73% by 1999." <http://www.accountingobserver.com/commentary/briefs/2001/fasb-goodwill.asp>.

B. HUMAN CAPITAL. Economic theory at one time adhered to the view that land and labor were the only two components of economic life. Eventually accumulated capital entered the picture, so that land, labor, and capital became the three components of economic life. Until the 1950s, economic theory mostly assumed that labor power was static and could not be enhanced.[1] Beginning in the 1950s, economists developed the idea of "human capital," or education, training, medical care, and other additions to knowledge and health that improved the capabilities of the individual worker.[2] This view approached education and training as an investment rather than a "cultural experience."[3] University of Chicago Professor T. W. Schultz established that the American economy has long had a higher return on "human capital" than on physical capital.[4] In 1964, another University of Chicago Professor Gary Becker published his book HUMAN CAPITAL, which likened human capital to investments in factories and machines. Becker argued that one could invest in human capital (via education, training, medical treatment) and that a person's output depended partly on the rate of return on his or her human capital.[5]

Texas, along with most other states, considers a spouse's human capital to be personal to the spouse, and to amount to no more than post-divorce earnings which belong exclusively to the spouse who earns it after divorce. That human capital, which we in Texas call "personal goodwill," is not property and, even if that capital was developed during marriage, or enhanced during marriage, the other spouse has no claim to it upon divorce.

Human capital finds its way into the discussion of enterprise goodwill versus personal goodwill, in Section VI of this Article.

The business-owning spouse–who is the hypothetical seller in the hypothetical sale of the business at fair market value at the time of divorce–has personal goodwill, which to some extent includes his or her human capital. Most states exclude the value of this personal goodwill from the property division on divorce. But the business itself can also (and almost always does) have human capital, and in most states this human capital of the business is included in enterprise goodwill that has a value that can be divided in a divorce.

C. THE ACCOUNTANTS. The accounting profession has been making some effort to keep pace with the transition from a tangible toward an intangible based economy. In June of 2001 the Financial Accounting Standards Board (FASB) supplanted its outdated APB Opinion 17, *Intangible Assets*, with Financial Accounting Standard No. 142, *Goodwill and Other Intangible Assets*. Gone was the assumption of Opinion 17 that goodwill and other intangible assets were wasting assets that should be amortized over a 40-year period. Henceforth, goodwill and intangible assets with indefinite useful lives would be tested at least annually for impairment. Intangible assets with definite useful lives were to be amortized over those useful lives, not an arbitrary 40 years.

Also in June 2001 FASB issued Financial Accounting Standard No. 141, *Business Combinations* (updated 2007), which gave directions on how accountants should allocate the purchase

price when one business bought another, including how to allocate part of the purchase price to intangible assets and goodwill acquired by purchase. FAS 141 supplanted APB Opinion 16. Opinion 16 required that accountants separately recognize intangible assets when they could be identified and named–a crude concept in a world with a multiplicity of intangible assets that were new and strange. FAS No. 141 requires that intangible assets acquired through the purchase of a business be recognized as assets apart from goodwill if they are "identifiable," which means that they meet one of two criteria—the separability criterion or the contractual-legal criterion. These concepts are discussed in Section IV.B.1 below. FAS No. 141 also gives an illustrative list of intangible assets that meet either of those criteria.

FAS 141 and 142 thus represent a modernization of the accounting profession's approach to intangible assets, including goodwill. However, the accounting profession still lags behind the economy in that even this updated recognition of intangible assets only applies when one business acquires another business and pays more than the value of the tangible assets, which requires that the excess price paid must be allocated between intangible assets and residual goodwill. The accounting profession still does not recognize self-created intangible assets as separable from goodwill and it is still behind-the-times (but not nearly as behind as the legal profession).

D. THE LAWYERS. The lawyers, meaning both practitioners and judges, have lagged far behind the economists and the accountants in adapting to the change from tangible to intangible assets and the recognition of human capital. This is partly because there are 51 versions of family law in America, and partly because the law changes slowly through case decisions, or fitfully through infrequent statutory enactments. There is no governing body of lawyers or judges whose task it is to upgrade and modernize the legal conceptual framework relating to intangible assets and goodwill. This places the responsibility for change on the lawyers who litigate business valuation issues to be alert to these new developments in our economy, and to pursue them in the court system.

II. HUMAN CAPITAL. The use of the term "human capital" in modern neoclassical economic literature is said to date back to Jacob Mincer's pioneering article *Investment in Human Capital and Personal Income Distribution* in The Journal of Political Economy in 1958. Nobel Prize-winning Economist Gary Becker, in his book HUMAN CAPITAL, published in 1964, argues that a person invests in his or her own human capital (via education, training, medical treatment), and that person's income depends partly on the rate of return on that human capital. A discussion by Gary Becker of the concept of human capital is available on the internet, <http://www.econlib.org/library/Enc/Human Capital. html>. Some of Becker's important points are:

> To most people capital means a bank account, a hundred shares of IBM stock, assembly lines, or steel plants in the Chicago area. These are all forms of capital in the sense that they are assets that yield income and other useful outputs over long periods of time.
>
> But these tangible forms of capital are not the only ones. Schooling, a computer training course, expenditures of medical care, and lectures on the virtues of punctuality and honesty also are capital. That is because they raise earnings, improve health, or add to a person's good habits over much of his lifetime. Therefore, economists regard expenditures on education, training, medical care, and so on as investments in human capital. They are called human capital because people cannot be separated from their knowledge, skills, health, or values in the way they can be separated from their financial and physical assets.
>
> Education and training are the most important investments in human capital. Many studies have shown that high school and college education in the United States greatly raise a person's income, even after netting out direct and indirect costs of schooling, and even after adjusting for the fact that people with more education tend to have higher IQs and better-educated and richer parents. Similar evidence is now available for many years from over a hundred countries with different cultures and economic systems. The earnings of more

educated people are almost always well above average, although the gains are generally larger in less developed countries.

* * *

The economics of human capital have brought about a particularly dramatic change in the incentives for women to invest in college education in recent decades. Prior to the sixties American women were more likely than men to graduate from high school but less likely to continue on to college. Women who did go to college shunned or were excluded from math, sciences, economics, and law, and gravitated toward teaching, home economics, foreign languages, and literature. Because relatively few married women continued to work for pay, they rationally chose an education that helped in "household production"—and no doubt also in the marriage market—by improving their social skills and cultural interests.

All this has changed radically. The enormous increase in the labor participation of married women is the most important labor force change during the past twenty-five years. Many women now take little time off from their jobs even to have children. As a result the value to women of market skills has increased enormously, and they are bypassing traditional "women's" fields to enter accounting, law, medicine, engineering, and other subjects that pay well. Indeed, women now comprise one-third or so of enrollments in law, business, and medical schools, and many home economics departments have either shut down or are emphasizing the "new home economics." Improvements in the economic position of black women have been especially rapid, and they now earn just about as much as white women.

Of course, formal education is not the only way to invest in human capital. Workers also learn and are trained outside of schools, especially on jobs. Even college graduates are not fully prepared for the labor market when they leave school, and are fitted into their jobs through formal and informal training programs. The amount of on-the-job training ranges from an hour or so at simple jobs like dishwashing to several years at complicated tasks like engineering in an auto plant. The limited data available indicates that on-the-job training is an important source of the very large increase in earnings that workers get as they gain greater experience at work. Recent bold estimates by Columbia University economist Jacob Mincer suggest that the total investment in on-the-job training may be well over $100 billion a year, or almost 2 percent of GNP.

An article by John F. Tomer, *Personal Capital and Emotional Intelligence: an Increasingly Important Intangible Source of Economic Growth*, 29 EASTERN ECONOMIC JOURNAL p. 453 (2003), <http://www.findarticles.com/p/articles/mi_qa3620/is_200307/ai_n9247655>, discusses a trend among economists to look beyond physical capital, natural resources, and labor, as bases for wealth creation, and to consider human capital as a basis. Tomer says that "the term capital has increasingly come to refer to intangible factors such as the enhanced human capacities owing to education and training." While a long list of economists dating back several centuries recognized human capital, according to Tomer these economists were contemplating personal skills and abilities. For example, "Paul Romer [1990, 253] breaks down workers' human capital endowment into three types of skills that are relevant for production: (1) physical skills such as eye-hand coordination and strength, (2) educational skills acquired in primary and secondary school, and (3) scientific talent acquired in post-secondary education." Tomer focuses on a new type of human capital, what he calls social and organizational capital, that "are the product of activities that create social relationships." This type of capital reposes "not in individuals per se but in the relationships or connections between people."

Tomer discusses other terms used to describe human capital, including "social capital," and "psychological capital." Tomer chooses to use the term "personal capital," and says:

> Personal capital is a kind of human capital because it relates to a capacity embodied in individuals. However, personal capital differs from standard human capital in that the human capacity involved is not the type developed by academic education or by the usual types of

> job-related training. The personal capital capacities are fundamentally different from cognitive intelligence or intellectual knowledge. Personal capital relates to an individual's basic personal qualities and reflects the quality of an individual's psychological, physical, and spiritual functioning [Tomer, 1996, 626-27; Tomer, 2001, 251]. Further, it mirrors one's internal biochemical balance, physical health and conditioning, psychological strengths and weaknesses, and purpose in life. A person's stock of personal capital is partly a product of one's genetic inheritance, partly a result of the life-shaping events that one has encountered, and partly an outcome of one's efforts to mature and to grow in nonintellectual ways. It is in part produced intentionally. Personal capital qualities are related to a person's capacity to work or consume in that they underlie the more specific capacities (standard human capital and consumption capital) that a person invests in to be qualified for work tasks or to be able to enjoy consumer goods. Moreover, certain personal capital qualities are a prerequisite for developing successful organizational relationships (social and organizational capital) [Tomer, 1999a, 46-48]. Personal capital capacities expand one's achievement possibilities.

Tomer comments: "Unlike tangible capital, human capital cannot be removed or alienated from an individual to be sold." This type of capital is akin to the personal goodwill that so many states exclude from the property division upon divorce.

The foregoing economic description of "human capital" suggests that a property-based approach to dealing with disparate earning capacity upon divorce (such as putting a value on a professional degree or professional license) will encounter complexities that may overwhelm the legal analysis or the valuation process. The more natural way to address this issue is through post-divorce alimony.

III. THE LEGAL CONCEPTION OF GOODWILL. In some states enterprise goodwill (sometimes called commercial goodwill or professional goodwill) is divisible on divorce and in some states it is not. In some states personal goodwill is divisible on divorce and in some states it is not. Part of the differences in law results from differences in meaning of the term "goodwill." The following discussions break the term "goodwill" down into components that can be more accurately discussed. Because some appellate cases use the term "professional goodwill" to mean the enterprise goodwill of a professional business, and other cases use the term "professional goodwill" to mean the personal goodwill of a professional, in order to avoid confusion this Article will not use the term "professional goodwill."

A. WHAT IS GOODWILL? Goodwill can be viewed from both a legal perspective and an accounting perspective. Because family law in America consists of fifty-one different bodies of law, there is great variety in the legal approaches to goodwill upon divorce. There are some principles that are shared between states due to the common heritage of English law (Louisiana excepted) pertaining to goodwill. There are some principles that are shared between states because of common notions of what constitutes "property." But there are wide differences in the law of different states on the question of what constitutes goodwill, and what goodwill is divisible on divorce.

1. Seeking a Better Legal Conception of Goodwill. One member of Congress said this about goodwill, in connection with the savings and loan crisis: ""Goodwill is not cash. It is a concept, and a shadowy one at that." 135 Cong. Rec. 11795 (1989) (remarks of Rep. Barnard), cited in *U.S. v. Winstar Corp.*, 518 U.S. 839, 854, 116 S.Ct. 2432, 2445 (U.S. Sup. Ct. 1996).

The earliest English definition of "goodwill" was given by Lord Eldon in *Cruttwell v. Lye*, 34 Eng. Rep. 129 (Ch. 1810), which said: "The goodwill which has been the subject of sale is nothing more than the probability that the old customers will resort to the old place." The classic American legal definition of goodwill was given by Justice Story in his treatise on partnership law:

> the advantage or benefit, which is acquired by an establishment, beyond the mere value of the capital, stock, funds, or property employed therein, in consequence of the general public

> patronage and encouragement, which it receives from constant or habitual customers, on account of its local position, or common celebrity, or reputation for skill or affluence, or punctuality, or from other accidental circumstances or necessities, or even from ancient partialities or prejudices.

Story, COMMENTARIES ON THE LAW OF PARTNERSHIP § 99 (6th Ed.1868). This definition was cited by the U.S. Supreme Court in *Metropolitan Nat. Bank v. St. Louis Dispatch Co.*, 49 U.S. 436, 446, 13 S.Ct. 944, 948 (1893).

The U.S. Supreme Court once described goodwill as "that element of value which inheres in the fixed and favorable consideration of customers, arising from an established and well-known and well-conducted business," in *Des Moines Gas Co. v. City of Des Moines*, 238 U.S. 153, 165, 35 S.Ct. 811, 814 (U.S. Sup. Ct. 1915).

The U.S. Supreme Court more recently said this about goodwill:

> Although the definition of goodwill has taken different forms over the years, the shorthand description of good-will as "the expectancy of continued patronage," Boe v. Commissioner, 307 F.2d 339, 343 (CA9 1962), provides a useful label with which to identify the total of all the imponderable qualities that attract customers to the business. See Houston Chronicle Publishing Co. v. United States, 481 F.2d, at 1248, n. 5.

Newark Morning Ledger Co. v. U.S., 507 U.S. 546, 555-56, 113 S.Ct. 1670, 1675 (U.S. Sup. Ct. 1993).

The U.S. Court of Claims once said this about goodwill:

> Goodwill sometimes is used to describe the aggregate of all of the intangibles of a business.... Since a normal rate of return usually is calculated on tangible assets only, goodwill has been used as a synonym for the return on all the intangibles of a business. In a more restricted sense, goodwill is the expectancy that the old customers will resort to the old place. It is the sum total of all the imponderable qualities that attract customers and bring patronage to the business without contractual compulsion. Another definition equates goodwill with a rate of return on investment which is above normal returns in the industry and limits it to the residual intangible asset that generates earnings in excess of a normal return on all other tangible and intangible assets.

Richard S. Miller & Sons, Inc. v. United States, 537 F.2d 446, 450-51 (Ct. Cl. 1976) (citations omitted).

Other federal courts have described goodwill: *Houston Chronicle Publishing Co. v. United States*, 481 F.2d 1240, 1248 (5th Cir. 1973) (the "ongoing expectation that customers would utilize [a company's] services in the future"), *cert. denied*, 414 U.S. 1129 (1974); *Grace Bros., Inc. v. Commissioner*, 173 F.2d 170, 175-76 (9th Cir. 1949) ("the sum total of those imponderable qualities which attract the customer of a business--what brings patronage to the business"); *Dodge Bros., Inc. v. United States*, 118 F.2d 95, 101 (4th Cir. 1941) ("reasonable expectancy of preference in the race of competition"); *Ithaca Industries*, 97 T.C. 253 (slip op. at 17-18), 1991 WL 151392 (1991) ("While goodwill and going-concern value are often referred to conjunctively, technically going-concern value is the ability of a business to generate income without interruption, even though there has been a change in ownership; and goodwill is a 'preexisting' business relationship, based on a continuous course of dealing, which may be expected to continue indefinitely"), *aff'd*, *Ithaca Industries, Inc. v. Commissioner*, 17 F.3d 684 (4th Cir. 1992).

In *Canterbury v. Commissioner*, 99 T.C. 223, 247 (1999), the Tax Court said: "The essence of goodwill is a preexisting business relationship founded upon a continuous course of dealing that can be expected to continue indefinitely. Computing & Software, Inc. v. Commissioner, 64 T.C. 223, 233 (1975). Goodwill is characterized as 'the expectancy of continued patronage, for whatever reason.' Boe v. Commissioner, 307 F.2d 339, 343 (9th Cir.1962), affg. 35 T.C. 720 (1961); see Philip Morris, Inc. v. Commissioner, 96 T.C. 606, 634 (1991), affd. ---affd. 970 F.2d 897 (2d Cir., June 25, 1992)."

Rev. Rul. 59-60, § 4.02(f), 1959-1 C.B. 237, 241 says this about goodwill: "In the final analysis, goodwill is based upon earning capacity. The presence of goodwill and its value, therefore, rests upon the excess of net earnings over and above a fair return on the net tangible assets. While the element of goodwill may be based primarily on earnings, such factors as the prestige and renown of the business, the ownership of a trade or brand name, and a record of successful operation over a prolonged period in a particular locality, also may furnish support for the inclusion of intangible value. In some instances it may not be possible to make a separate appraisal of the tangible and intangible assets of the business. The enterprise has a value as an entity. Whatever intangible value there is, which is supportable by the facts, may be measured by the amount by which the appraised value of the tangible assets exceeds the net book value of such assets."

State court appellate opinions describe goodwill in various ways.

▸*In re Marriage of White*, 502 N.E.2d 1084, 1086 (Ill. Ct. App. 1986): "A workable definition of goodwill is that 'goodwill is the value of a business or practice that exceeds the combined value of the physical assets.' . . . The market value of goodwill is the amount a willing buyer would pay for a professional practice in excess of the value of the physical assets. . . . A value based upon the capitalization of excess earnings method is the capitalization at a fair rate of return of the amount by which the average income of the professional practitioner exceeds the hypothetical salary that would be earned as an employee with similar qualifications." [citations omitted]

▸*Yoon v. Yoon*, 711 N.E.2d 1265, 1268-69 (Ind. Sup. Ct. 1999): "Goodwill has been described as the value of a business or practice that exceeds the combined value of the net assets used in the business. . . . Goodwill in a professional practice may be attributable to the business enterprise itself by virtue of its existing arrangements with suppliers, customers or others, and its anticipated future customer base due to factors attributable to the business. It may also be attributable to the individual owner's personal skill, training or reputation. This distinction is sometimes reflected in the use of the term 'enterprise goodwill,' as opposed to 'personal goodwill.' Enterprise goodwill 'is based on the intangible, but generally marketable, existence in a business of established relations with employees, customers and suppliers.' . . . Factors affecting this goodwill may include a business's location, its name recognition, its business reputation, or a variety of other factors depending on the business. Ultimately these factors must, in one way or another, contribute to the anticipated future profitability of the business. Enterprise goodwill is an asset of the business and accordingly is property that is divisible in a dissolution to the extent that it inheres in the business, independent of any single individual's personal efforts and will outlast any person's involvement in the business. . . . It is not necessarily marketable in the sense that there is a ready and easily priced market for it, but it is in general transferrable to others and has a value to others."

▸*Dugan v. Dugan*, 457 A.2d 1, 4-6 (N.J. Sup. Ct. 1983): "Goodwill is generally regarded as the summation of all the special advantages, not otherwise identifiable, related to a going concern. It includes such items as a good name, capable staff and personnel, high credit standing, reputation for superior products and services, and favorable location. See also Accounting Principles Board, Op. 17, "Intangible Assets," in FASB Financial Accounting Standards 266-72 (1981). [FN3] In a broad sense goodwill includes a whole host of intangibles including the quality of management, the ability of the organization to produce and market efficiently, and the existence and nature of competition. Some writers have been careful to differentiate between going concern value and goodwill. See Paulsen, "Goodwill and Going Concern Value Reconsidered," Mergers & Acquisitions, Winter 1980, at 10. Goodwill is keyed to reputation; going concern value to the enhanced value of the assets due to their presence in an established firm. See Danzig & Robison, "Going Concern Value Reexamined," The Tax Adviser, Jan. 1980, at 32. Going concern value has many of the characteristics of goodwill and in many situations will constitute an asset enhancing the value of an enterprise. In that event it will be a component of the property subject to equitable distribution. Going concern value may be prevalent in some law firms.

It is probably not significant in an individual law practice. . . .

> FN3. APB Opinions are authoritative statements by the American Institute of Certified Public Accountants of generally accepted accounting principles. See "Forward," FASB Financial Accounting Standards, supra; 2 APB Acc'ting Principles (CCH) § 510.08, at 33 (1973).

“Goodwill can be translated into prospective earnings. From an accounting standpoint goodwill has also been perceived of in terms of the extent to which future estimated earnings exceed the normal return on the investment. Walker, "Why Purchased Goodwill Should be Amortized on a Systematic Basis," 95 J. Acc'tancy 210, 213 (1953); *accord*, Rev.Rul. 59-60, § 4.02(f), 1959-1 C.B. 237, 241 (stating that value of goodwill "rests upon the excess of net earnings over and above a fair return on the net tangible assets"). The price paid for goodwill then is equivalent to the excess of actual earnings over expected earnings based on a normal rate of return on investment. Walker, supra, at 213; see Kerley, "Intangible Assets," in 1 Accountants' Handbook 23-10 (L. Seidler & D. Carmichael 6th ed.1981). When goodwill exists, it has value and may well be the most lucrative asset of some enterprises.

“Variances in the forms of an enterprise do not eliminate goodwill, though they may affect its worth. Goodwill may be present whether that form is a partnership, corporation, joint venture, or individual proprietorship. See Grayer v. Grayer, 147 N.J.Super. 513, 520, 371 A.2d 753 (App. Div. 1977); Scherzer v. Scherzer, 136 N.J.Super. 397, 400, 346 A.2d 434 (App. Div.1975) (holding no essential difference so far as equitable distribution principle is concerned between an interest in an individual business and one held in corporate name: "The form should not control"), certif. den., 69 N.J. 391, 354 A.2d 319 (1976). Moreover, goodwill exists in personal service enterprises as well as other businesses. 2 B. Bittker, Federal Taxation of Income, Estates and Gifts ¶ 51.9.3, at 51-53 (1981).

“In a publicly held corporation one can determine the total value of a business whose stock is publicly traded and therefore its goodwill by the market price of the stock. G. Catlett & N. Olson, Accounting for Goodwill 14 (1968). The excess over the book or market value of its assets, however, may also be due to many and diverse conditions affecting the economy as a whole and an industry in particular. The value of stock in a closely held corporation is not fixed by public trading. Its computation depends primarily on the earning power of the business "since goodwill by nature encompasses all those intangible attributes of a business whose quality can be demonstrated only by a company's ability to make profits." Id. [Strike-over added to avoid confusion]

“The calculation of goodwill may depend upon the purpose for which the measurement is being made. The federal Internal Revenue Service has prescribed a formula approach for income, gift and estate tax purposes. See Rev.Rul. 68-609, 1968-2 C.B. 327. The market place, as noted above, may often provide a different figure. Accountants will usually not reflect goodwill on a balance sheet until after a business has been sold and then state goodwill in terms of the excess paid for the net assets over book value. G. Catlett & N. Olson,supra, at 17. Its evaluation may be complex and difficult. Judge Pressler in Lavene v. Lavene, 148 N.J. Super. 267, 275, 372 A.2d 629 (App. Div.), certif. den., 75 N.J. 28, 379 A.2d 259 (1977), commented:

“There are probably few assets whose valuation imposes as difficult, intricate and sophisticated a task as interests in close corporations. They cannot be realistically evaluated by a simplistic approach which is based solely on book value, which fails to deal with the realities of the good will concept, which does not consider investment value of a business in terms of actual profit, and which does not deal with the question of discounting the value of a minority interest.”

‣*Travis v. Travis*, 795 P.2d 96, 97 (Okla. Sup. Ct. 1990): “As distinguished from tangible assets, intangibles have no intrinsic value, but do have a value related to the ownership and possession of tangible assets. Some intangibles, such as a trademark, trade name or patent, are related to an identifiable tangible asset. Goodwill, which is another intangible, is not. Often referred to as "the most 'intangible' of the intangibles," D. Kieso & J. Weygandt, Intermediate Accounting 570 (3d ed.

1980), goodwill is essentially reputation that will probably generate future business."

▸*Matter of Marriage of Fleege*, 588 P.2d 1136, 1138 (Wash. Sup. Ct. 1979): "Goodwill is property of an intangible nature and is commonly defined as the expectation of continued public patronage. . . . Among the elements which engender goodwill are continuity of name, location, reputation for honest and fair dealing, and individual talent and ability." [Citations omitted]

Retired University of New Mexico Management Professor Allen M. Parkman, who had an economist legal background, discussed the legal conception of goodwill in his chapter *A Systematic Approach to Valuing the Goodwill of Professional Practices* (1998).[6]

2. Goodwill as Residual Value. The wide-ranging discussion over what constitutes divisible goodwill upon divorce can be narrowed by refining the concept of goodwill. In some older writings, the term "goodwill" is used to describe all value of a going business beyond the value of the tangible assets of the business, i.e., goodwill consists of all intangible value of the business. The measure of this form of goodwill is the difference between the price a buyer would pay to buy the going business as a whole and the prices buyers would pay to buy each individual tangible asset of the business sold separately. But this conception of goodwill is overbroad because it lumps into goodwill intangible assets that can be valued on an individual basis.

Modern property law recognizes many intangible assets as enforceable and transferrable property rights, and these enforceable and transferrable intangible property rights should be discussed and valued in the context of their specific legal framework (such as trademark law, trade secret law, contract law applied to long term employment agreements or covenants not to compete, etc.), rather than being lumped into the residual catch-all category of goodwill. This Article suggests that the term "goodwill" should used to describe the narrower category of the ineffable qualities of a particular business that contribute to profitability, beyond not only tangible assets but also beyond specifically identifiable intangible assets that are transferrable with or without the sale of a business. This Article also suggests that the true nature of "residual goodwill" of most companies in the present mobile, digital and world-wide economy, where goods and services are increasingly fungible, has shifted from stable supplier/customer relationship to self-created "human capital" that will stay with the business after a sale, including not only research and development, but also "enhanced human capacities owing to education and training," social and organizational capital of the business, and personal capital of employees who will stay with the business (see discussion of John Tomer, Section I.B. above). These investments, which the business has made in itself, are usually expensed and therefore are not carried as assets on the balance sheet and are not usually thought of as assets with separably determinable value. As we grow in our ability to identify and value the human capital intangible assets of businesses, then these intangible assets too can move out of "residual goodwill" and be recognized as assets of the business, further increasing the accuracy of what must be excluded in some states as personal goodwill in a divorce.

This "residual goodwill" must be subdivided in the context of divorce into a category called "commercial goodwill" or "enterprise goodwill" and a category called "personal goodwill." In many states, including Texas upon divorce, "commercial goodwill" or "enterprise goodwill" is part of the value to be divided in the property division, while "personal goodwill" is not.

IV. THE ACCOUNTING CONCEPTION OF GOODWILL.

The accounting profession has been developing and refining its conception of goodwill in recent years.

A. GOODWILL AS EXCESS PURCHASE PRICE.

Financial Accounting Standards Board Opinion No. 16, *Business Combinations* 316 (1970) says: "[T]he excess of the cost of the acquired company over the sum of the amounts assigned to identifiable assets acquired less liabilities assumed should be recorded as goodwill." In 2001, the Financial Accounting Standards Board (FASB) issued Financial Accounting Statement 142, which defines goodwill in its Glossary as "[t]he excess cost of an acquired entity over the net of the amounts

assigned to assets acquired and liabilities assumed." FAS 142, ¶ 21 provides that "[t]he implied fair value of goodwill shall be determined in the same manner as the amount of goodwill recognized in a business combination is determined. That is, an entity shall allocate the fair value of a reporting unit to all of the assets and liabilities of that unit (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the price paid to acquire the reporting unit. The excess of the fair value of a reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill."

B. DEFINITION OF PERSONAL GOODWILL. Mark O. Dietrich, in *Identifying and Measuring Personal Goodwill in a Professional Practice*, CPA EXPERT (Spring 2005) [reprinted in Dietrich, *Segregating Personal and Enterprise Goodwill*, THE FIRST EVER AICPA/ASA NATIONAL BUSINESS VALUATION CONFERENCE p. 30-14 (2005), hereafter called "the Dietrich *Segregating* article"], described *personal* goodwill in the following terms:

> Personal goodwill, then, is the asset that generates cash profits of the enterprise that are attributed to the business generating characteristics of the individual, and may include any profits that would be lost if the individual were not present.

Associate Professor of Law Darian M. Ibrahim said this about personal goodwill:

> Distinguishing personal goodwill from business goodwill is often difficult and always fact-specific. Personal goodwill may be mistaken for business goodwill, and vice versa. In addition, goodwill may belong to both a business and its owner, making valuation problematic. There is also a danger, due to the prevalence of business goodwill as a legal concept and the relative obscurity of personal goodwill as a legal concept, that buyers and sellers—not to mention the courts and the IRS—will routinely treat all goodwill as business goodwill. [Footnotes omitted].

Darian M. Ibrahim, *The Unique Benefits of Treating Personal Goodwill as Property in Corporate Acquisitions*, 30 DEL. J. OF CORPORATE LAW 1, 10-11 (2005).[7] Professor Ibrahim cited: *Bateman v. United States*, 490 F.2d 549 (9th Cir. 1973); *Martin Ice Cream Co. v. Commissioner*, 110 T.C. 189 (1998); and *Norwalk v. Commissioner*, 76 T.C.M. (CCH) 208 (1998), as cases that distinguished enterprise goodwill from personal goodwill.

C. PULLING IDENTIFIABLE INTANGIBLES OUT OF RESIDUAL GOODWILL. The lawyer and business valuator should account for intangible assets separately from residual goodwill, where possible. There may be market data to help value certain intangible assets, and if not then intangible assets may have discernable rates of return that can be subtracted from the income stream used to calculate overall value of the business, allowing such assets to be differentiated from goodwill. Also, identifiable intangible assets of the business are transferrable with the business, and thus are not part of personal goodwill. The desirability of removing identifiable intangible assets from residual goodwill has been recognized by the accounting profession in Financial Accounting Standard 141:[8]

> **The FASB's reasons for rejecting other recognition criteria suggested for Statement 141**
>
> B170. Some respondents suggested that the FASB eliminate the requirement to recognize intangible assets separately from goodwill. Others suggested that all intangible assets with characteristics similar to goodwill should be included in the amount recorded as goodwill. The FASB rejected those suggestions because they would diminish rather than improve the decision usefulness of reported financial information.

FAS 1414 ¶ B170, p. 135.

> B171. Some respondents doubted their ability to reliably measure the fair values of many intangible assets. They suggested that the only intangible assets that should be recognized separately from goodwill are those that have direct cash flows and those that are bought and sold in observable exchange transactions. The

> FASB rejected that suggestion. Although the fair value measures of some identifiable intangible assets might lack the precision of the measures for other assets, the FASB concluded that the information that will be provided by recognizing intangible assets at their estimated fair values is a more faithful representation than that which would be provided if those intangible assets were subsumed into goodwill. Moreover, including finite-lived intangible assets in goodwill that is not being amortized would further diminish the representational faithfulness of financial statements.

FAS 141 ¶ B171, p. 136.

The accounting profession is going to have to lead the legal profession in the effort to pull recognized intangible rights out of residual goodwill, because some appellate courts are still citing a 138-year-old mercantile definition of goodwill, and citing components of goodwill that prevailed before the advent of telecommunications, the automobile, the airplane, personal computers, and the internet. This is not to say that the accounting profession has fully adjusted to the "new economy," where intangibles are an important source of wealth. FASB now says to report intangible rights that are separable from goodwill when such rights are *purchased*, but not when such rights result from *self-investment*. Until self-created intangible assets are recognized as assets and included on the balance sheet, the balance sheet will continue to be of little use in valuing a business, and the entity value derived by business valuators from the normalized income statement, in conjunction with a cap rate or income multiplier, will continue to reflect value in excess of recognized assets, which people will continue to call "goodwill," which some courts will continue to say is not divisible upon divorce.

1. What Constitutes an Intangible Asset (for Accounting Purposes)? Accounting principles in the USA treat self-investment in intangibles as an expense rather than an investment, so the value of this self-investment does not show up on the balance sheet, and the income statement fails to capture this investment in future income. Thus a business's income appears to be attributable in a mysterious way to "goodwill" in instances when it is really attributable to self-investment in intangible assets that are not captured on either the balance sheet or the income statement. The accounting profession has partly rectified this problem, but only for intangible assets that are purchased, not self-created. And the accounting profession specifically excludes work force in place as an intangible, which is the repository for much of the human capital and social capital within the organization.

FASB Concepts Statement No. 6, *Elements of Financial Statements*, issued in December 1985, defined "assets" in the following way:

> 26. An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred. Assets commonly have other features that help identify them—for example, assets may be acquired at a cost and they may be tangible, exchangeable, or legally enforceable. However, those features are not essential characteristics of assets. Their absence, by itself, is not sufficient to preclude an item's qualifying as an asset. That is, assets may be acquired without cost, they may be intangible, and although not exchangeable they may be usable by the entity in producing or distributing other goods or services. Similarly, although the ability of an entity to obtain benefit from an asset and to control others' access to it generally rests on a foundation of legal rights, legal enforceability of a claim to the benefit is not a prerequisite for a benefit to qualify as an asset if the entity has the ability to obtain and control the benefit in other ways.

It is clear that many intangible assets meet this old FASB criteria for "asset," and thus should be considered as belonging to the business, separate and apart from goodwill.

In June, 2001, the Financial Accounting Standards

Board issued Financial Accounting Statements 141, *Business Combinations*,[9] and 142, *Goodwill and Other Intangible Assets*.[10] FAS 141 was updated in 2007. The stated reason for issuing FAS 141 and 142 was that "[a]nalysts and other users of financial statements, as well as company managements, noted that intangible assets are an increasingly important economic resource for many entities and are an increasing proportion of the assets acquired in many transactions."

FAS 141 defines an "intangible asset" in this way:

> An *intangible asset* is an asset (not including a financial asset) that lacks physical substance. As used in this Statement, the term intangible asset excludes goodwill.

FAS 141 ¶ 3(l), p. 3. Intangible assets are distinguished from goodwill:

> A19. The acquirer shall recognize separately from goodwill the identifiable intangible assets acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion described in paragraph 3(k).

FAS ¶ A19, p. 38.

FAS 141 discusses when an asset is "identifiable." This is important in determining when an intangible asset should be recognized separately from goodwill. As noted in FAS 141:

> A28. The identifiability criteria determine whether an intangible asset is recognized separately from goodwill.

FAS ¶ A28, p. 41. The identifiability criterion is based on either the separability criterion or the contractual-legal criterion:

> k. An asset is *identifiable* if it either:
>
> (1) Is separable, that is, capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, identifiable asset, or liability, regardless of whether the entity intends to do so; or
>
> (2) Arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

FAS 141 ¶ 3(k), p. 3. FAS 141 reiterates that the contractual-legal criterion is independent from the separability criterion:

> A20. An intangible asset that meets the contractual-legal criterion is identifiable even if the asset is not transferable or separable from the acquiree or from other rights and obligations.

FAS 141 ¶ A20, p. 38.

FAS 141 discusses the separability criterion:

> A21. The separability criterion means that an acquired intangible asset is capable of being separated or divided from the acquiree and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, identifiable asset, or liability. An intangible asset that the acquirer would be able to sell, license, or otherwise exchange for something else of value meets the separability criterion even if the acquirer does not intend to sell, license, or otherwise exchange it. An acquired intangible asset meets the separability criterion if there is evidence of exchange transactions for that type of asset or an asset of a similar type, even if those transactions are infrequent and regardless of whether the acquirer is involved in them.
>
> A22. An intangible asset that is not individually separable from the acquiree or combined entity meets the separability criterion if it is separable in combination with a related contract, identifiable asset, or liability.

FAS 141 ¶¶ A21 & A22, p. 39.

FAS 142 requires that intangible assets of acquired companies must be amortized over their useful lives,

or if the useful life is indefinite, that the intangible be tested annually for impairment. This alters the previous rule requiring intangible assets to be amortized over an arbitrary 40 year period. This also results in business valuators having to evaluate each intangible asset based on the attributes of that intangible asset. And it requires that residual goodwill be tested annually for impairment.

FAS 142 lists in Appendix A the following examples of intangible assets: customer lists, patents, copyright, broadcast licenses, airline route authority, and trademarks. FAS 142 only applies to acquired intangibles, and GAAP does not require that intangibles developed internally by a business must be disclosed on the balance sheet.

As mentioned above, a researcher for FASB authored a report that dealt in detail with intangible assets: Wayne S. Upton, Jr., *Special Report: Business and Financial Reporting, Challenges from the New Economy*, FINANCIAL ACCOUNTING STANDARDS BOARD (April 2001), on line at <http://www.fasb.org/articles&reports/sr_new_economy.pdf#76>. He describes intangible assets as follows:

> The Intangibles Research Center at New York University offers two possible definitions:
>
> Broad Definition—Intangibles are nonphysical sources of probable future economic benefits to an entity or alternatively all the elements of a business enterprise that exist in addition to monetary and tangible assets. [Footnote reference omitted.]
>
> Narrow Definition—Intangibles are nonphysical sources of probable future economic benefits to an entity that have been acquired in an exchange or developed internally from identifiable costs, have a finite life, have market value apart from the entity, and are owned or controlled by the entity.
>
> The FASB Exposure Draft, Business Combinations and Intangible Assets, offered: Intangible assets are noncurrent assets (not including financial instruments) that lack physical substance.

Id. at 68. [Footnote omitted] Upton describes the long list of intangible assets contained on Exhibit A to FASB Exposure Draft, *Business Combinations and Intangible Assets*, later shortened by FASB. *Id.* at 68-69. Upton observes: "The items on the list of potential intangible assets share a common characteristic. Each is separable from the entity or exists by virtue of contractual or legal rights. Separability and contractual/legal rights are not essential characteristics of an asset, but they are evidence of one characteristic that is essential—control." *Id.* 70-71. Upton's paper contains a thorough discussion of what constitutes an intangible asset of a business. This discussion is an excellent reference for intangible assets that might be differentiated from residual goodwill.

FAS 141 says "Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized."

2. Assembled Workforce is Part of Residual Goodwill. FAS 141 rejects assembled workforce as an identifiable intangible asset:

> A25. The acquirer subsumes into goodwill the value of an acquired intangible asset that is not identifiable as of the acquisition date. For example, an acquirer may attribute value to the existence of an assembled workforce, which is an existing collection of employees that permits the acquirer to continue to operate an acquired business from the acquisition date. An assembled workforce does not represent the intellectual capital of the skilled workforce—the (often specialized) knowledge and experience that employees of an acquiree bring to their jobs. Because the assembled workforce is not an identifiable asset to be recognized separately from goodwill, any value attributed to it is subsumed into goodwill.

FAS 141 continues:

> Assembled workforce
>
> B176. In developing Statement 141, the FASB

did not consider whether an assembled workforce met either the contractual-legal or the separability criterion for recognition as an identifiable intangible asset. Instead, Statement 141 precluded separate recognition of an assembled workforce because of the FASB's conclusion that techniques to measure the value of an assembled workforce with sufficient reliability were not currently available. IFRS 3 and IAS 38, on the other hand, did not explicitly preclude separate recognition of an assembled workforce. However, paragraph 15 of IAS 38 noted that an entity usually would not have sufficient control over the expected future economic benefits arising from an assembled workforce for it to meet the definition of a separate intangible asset.

B177. In developing the 2005 Exposure Draft, the Boards concluded that an acquirer should not recognize an assembled workforce as a separate intangible asset because it meets neither the contractual-legal nor the separability criterion. The views of respondents who commented on recognition of an assembled workforce were mixed.

Some agreed with its proposed recognition prohibition. Others suggested that the Boards reconsider that prohibition; they generally said that an assembled workforce is already valued in many situations for purposes of calculating a "contributory asset charge" in determining the fair value of some intangible assets. (In using an "excess earnings" income valuation technique, a contributory asset charge is required to isolate the cash flows generated by the intangible asset being valued from the contribution to those cash flows made by other assets, including other intangible assets. Contributory asset charges are hypothetical "rental" charges for the use of those other contributing assets.) Those respondents opposed a prohibition on recognizing an assembled workforce as a separate intangible asset; they favored permitting acquirers to assess whether an assembled workforce is separable in each situation and to recognize those that are separable.

B178. In reconsidering the proposal in the 2005 Exposure Draft, the Boards concluded that the prohibition of recognizing an assembled workforce should be retained. Because an assembled workforce is a collection of employees rather than an individual employee, it does not arise from contractual or legal rights. Although individual employees might have employment contracts with the employer, the collection of employees, as a whole, does not have such a contract. In addition, an assembled workforce is not separable, either as individual employees or together with a related contract, identifiable asset, or liability. An assembled workforce cannot be sold, transferred, licensed, rented, or otherwise exchanged without causing disruption to the acquirer's business. In contrast, an entity could continue to operate after transferring an identifiable asset. Therefore, an assembled workforce is not an identifiable intangible asset to be recognized separately from goodwill.

B179. The Boards observed that neither Statement 141 nor IAS 38 defined an assembled workforce and that inconsistencies have resulted in practice. In addition, some who objected to the recognition prohibition in the 2005 Exposure Draft apparently consider an assembled workforce to represent the intellectual capital of the skilled workforce—the (often specialized) knowledge and experience that employees of an acquiree bring to their jobs. However, the Boards view an assembled workforce as an existing collection of employees that permits an acquirer to continue to operate an acquired business from the acquisition date, and they decided to include that definition in this Statement (paragraph A25).

B180. The Boards observed that the value of intellectual capital, in effect, is recognized because it is part of the fair value of the entity's other intangible assets, such as proprietary technologies and processes and customer contracts and relationships. In that situation, a process or methodology can be documented and followed to the extent that the business would not be materially affected if a particular

employee left the entity. In most jurisdictions, the employer usually "owns" the intellectual capital of an employee. Most employment contracts stipulate that the employer retains the rights to and ownership of any intellectual property created by the employee. For example, a software program created by a particular employee (or group of employees) would be documented and generally would be the property of the entity. The particular programmer who created the program could be replaced by another software programmer with equivalent expertise without significantly affecting the ability of the entity to continue to operate. But the intellectual property created in the form of a software program is part of the fair value of that program and is an identifiable intangible asset if it is separable from the entity. In other words, the prohibition of recognizing an assembled workforce as an intangible asset does not apply to intellectual property; it only applies to the value of having a workforce in place on the acquisition date so that the acquirer can continue the acquiree's operations without having to hire and train a workforce.[11]

The rationales for this refusal to segregate assembled workforce from residual goodwill were expressed in the Revised Minutes of the October 18, 2006 FASB meeting.[12] The following lengthy excerpt is illuminating:

TOPIC 1: Assembled Workforce

1. Ms. Eastman stated that the Boards have reaffirmed that an identifiable (that is, contractual or separable) intangible asset can be measured with sufficient reliability and should be recognized separately from goodwill. However, the Exposure Draft specifically precludes the recognition of an acquired assembled workforce separately from goodwill, which is consistent with FASB Statement No. 141, Business Combinations. The staff believes that in a principles-based standard, all intangible assets should be subject to the same recognition criteria. Therefore, it would be inconsistent to preclude the recognition of any identifiable intangible asset, including an assembled workforce.

2. Regardless of what the Board decides on recognition, the staff believes the Board should clarify the meaning of an assembled workforce. Otherwise, there could be an inconsistency in the measurement of an assembled workforce when calculating contributory asset capital charges. Also, there is the potential for double counting in the valuation of intellectual property intangible assets when the fair value of the assembled workforce includes the intellectual capital related to the development of these other intangible assets. There are two general views for the meaning of an assembled workforce:

a. View 1: An assembled workforce is the intellectual capital of the skilled workforce of which the acquirer has obtained the benefit as a result of the acquisition. This view implies that the assembled workforce is the (specialized) knowledge and experience that the employees bring to their jobs.

b. View 2: An assembled workforce is a collection of employees that allows the acquirer to continue to operate on Day One. That is, the acquirer does not need to go through the process of finding, hiring, and training the employees because they are already in place and operating on a continuous "business as usual" basis. This view would eliminate the potential for double counting.

3. Some constituents have raised concerns about the decision usefulness, materiality, and costs of recognizing an assembled workforce separately from goodwill. However, the staff believes that in terms of decision usefulness and materiality, for some industries, particularly those that are service- or people-intensive, the separate recognition of an acquired assembled workforce would provide decision-useful information. The staff also noted that the fair value of an assembled workforce might be immaterial in some industries, particularly if View 2 is chosen, but to preclude recognition altogether is inconsistent with a principles-based standard. In fact, the difference in materiality by entity or industry is one of the reasons that

an assembled workforce should be recognized as it gives users an indication of the main value drivers of a business. In terms of the cost of preparation, the staff believes that because assembled workforces currently are valued for the purpose of calculating the contributory asset capital charges for the valuation of other intangible assets, there will be no additional costs involved if the exception for assembled workforce is removed. As for subsequent accounting, the useful life could be estimated from historical employee turnover data. An impairment of the assembled workforce would be evident, for example, when substantially higher turnover occurs than what was assumed in the initial determination of the useful life.

4. Ms. Eastman noted that at the October 19, 2006 IASB Board meeting, the IASB Board supported View 2 (all IASB Board members agreed) and agreed that a separable assembled workforce should be separately recognized (seven IASB Board members agreed; five did not).

5. The Board generally supported View 2 in clarifying the meaning of an assembled workforce (all Board members agreed). However, the Board concluded that an assembled workforce should not be recognized as an intangible asset separately from goodwill because it is generally not separable (all Board members agreed).

6. Mr. Trott stated that for an intangible asset to be identifiable, that intangible asset would have to either arise from a contractual-legal right or be separable. He believes that an assembled workforce neither meets the contractual-legal right criterion nor the separable criterion because an assembled workforce is not contractually based and cannot be sold separately from the business. Ms. Eastman stated that some constituents believe that an assembled workforce is separable in combination with other assets (for example, a division within an organization). An example of a separable assembled workforce would be a consulting firm that "leases" out its employees to other corporations for an extended period of time. She also clarified that the staff is not stating that an acquirer should always separately recognize an assembled workforce; if that assembled workforce is not separable, then the acquirer should not recognize it separately from goodwill. Mr. Trott responded by stating that if the Board was to agree that an assembled workforce is separable in combination with its other related assets, that would defeat the purpose of the separable criterion because the measurement of that assembled workforce would include the measurements of all the other related assets. In the case of the consulting firm "leasing" out its employees, Mr. Trott believes that the consulting firm's product is the services provided by its employees and, therefore, it is not possible to differentiate between the value of the employees and the value of the services provided by those employees. Mr. Crooch agreed with Mr. Trott. Ms. Seidman added that if the Board was to support the separate recognition for the consulting firm's assembled workforce, the Board would be supporting View 1, which is not the Board's view of the meaning of an assembled workforce.

7. Mr. Batavick stated that although he agrees that an assembled workforce is a collection of employees that allows the acquirer to continue to operate on Day One (View 2), he also could envision some circumstances in which the intellectual capital (that is, the specialized skill set of the employees) could be valuable to the acquirer (View 1). As for whether an assembled workforce could be recognized separately from goodwill, he believes that an assembled workforce does not meet the separability criterion and should not be recognized separately from goodwill. Furthermore, he questions the value of the information provided by separately recognizing an assembled workforce from goodwill. Even if one could substantiate that there is value in that information, requiring the separate recognition of an assembled workforce would add complexity to the final Statement on business combinations because not only would the Board have to provide recognition and measurement guidance, it also would have to provide impairment and amortization guidance, which

would prolong the business combinations project. He concluded by stating that he believes that an assembled workforce does not meet the separability criterion as stated in existing guidance for intangible assets.

8. Ms. Seidman supported View 2. Paragraph B169 in Statement 141 states that ". . . replacement cost is not a representationally faithful measurement of the fair value of the intellectual capital acquired in a business combination." In response to the staff's question about whether that statement is valid, she noted that she believes that statement is outdated now that FASB Statement No. 157, Fair Value Measurements, has been issued. Consequently, she believes that statement should be deleted. As for whether the Board should remove the exception for separate recognition of assembled workforce, Ms. Seidman stated that,on-balance she would vote to keep the prohibition. She stated that if one believes that the nature of an assembled workforce is the cost of accumulating the employees, then there are two reasons for disallowing its separate recognition from goodwill. First, to the extent that an assembled workforce needs to be combined with other related assets to meet the definition of separable, not only would that be too broad of an interpretation of the term separable, the valuation of that assembled workforce would include a broad number of elements, which would not provide particularly useful information. Second, the nature of an assembled workforce seems to mirror a transaction cost (that is, the acquirer is basically reimbursing the acquiree for paying the acquirer's costs to assemble these employees). Ms. Seidman emphasized that one of the themes of the Statement on business combinations is that the cost of assembling an asset is not part of the fair value of the asset itself. By supporting View 2, the Board would essentially be clarifying that an assembled workforce is of a different nature than the other types of intangible assets that are separable and recognized separately from goodwill. Mr. Young agreed with Ms. Seidman.

9. Mr. Linsmeier stated that while he believes an assembled workforce has aspects of both Views 1 and 2, he supports View 2. Limiting the definition of an assembled workforce to View 2 would help acquirers account for an assembled workforce because the intellectual capital portion might be recognized in other assets at the acquisition date in a business combination. He stated that while he agreed with the other Board members that an assembled workforce is generally not separable, he questioned whether the Board should make that decision for preparers. If unique circumstances exist in the acquisition whereby the acquirer could separately value the workforce, that acquirer should be allowed to recognize that assembled workforce apart from goodwill. Although he understood the transaction cost notion as stated by Ms. Seidman, he believes that at the acquisition date, an acquirer is not recognizing a transaction cost. He believes that at the acquisition date, the acquirer is receiving an asset because the acquirer could continue operations without expending resources to construct a workforce. Mr. Linsmeier does not support prohibiting separate recognition. However, if the Board does prohibit recognition, the basis for conclusions should explain that the Board believes it would be a challenge for an assembled workforce to meet the separability criterion and that it would not be a common occurrence for an acquirer to be able to separately recognize an assembled workforce.

10. Mr. Herz agreed with Mr. Linsmeier. He stated that an acquirer is acquiring all the tangible and intangible assets of a business, including a workforce that is trained and ready to operate on the date of acquisition, and all those assets contribute to the value of the acquiree. He believes that whether an assembled workforce is separable would depend on the business model of the acquiree. Similar to Mr. Linsmeier, Mr. Herz stated that the staff should state the reason that the Board supports the prohibition is because it believes that an assembled workforce generally is not separable and should not be separately recognized, which is consistent with the principle that only identifiable intangible assets should be

recognized separately from goodwill. He clarified that he supports View 2, even though he believes that View 1 is correct from an economic point of view. However, the measurement issues associated with View 1 leads him to support View 2.

3. Some Say that Assembled Workforce Can be Valued. Willamette Management Associates, a nationwide business valuation firm founded in 1969, takes the view that assembled workforce can be valued. In Pamela J. Garland and David M. Chiang, *Valuation of the Assembled Workforce Intangible Asset for Property Taxation Purposes* p. 52 (Spring 2006),[13] the authors wrote this:

> Most industrial and commercial organizations recognize their employees—and other forms of human capital—as a valuable intangible asset. Recognizing the value of a company's assembled workforce is not a new concept. Companies often analyze the value of their human capital intellectual property (e.g., an assembled workforce) for a variety of transactional, financing, accounting, taxation, and litigation purposes.

Id. p. 52. The authors go on to say:

> Many corporate CEOs have publicly stated that the assembled workforce is one of their company's most valuable assets. However, few companies incur the effort or expense to periodically quantify the value of their assembled workforce intellectual property. Numerous court cases have concluded that an entity's assembled workforce is a discrete intangible asset that has a measurable value.

Id. at 54. The authors cite: *Ithaca Industries, Inc. v. C.I.R.*, 17 F.3d 684 (4th Cir. 1994); and *Burlington Northern R.R. Co. v. Bair*,815 F.Supp. 1223 (S.D. Iowa, 1993), *aff'd*, 60 F.3d 410 (8th Cir. 1995). The authors go on to discuss how to value workforce in place. If assembled workforce is valued, and it is established that it will stay with the company if the business is sold, then the value of assembled workforce can be withdrawn from the category of residual goodwill, and avoid being treated the way that undifferentiated goodwill is treated in litigation, including divorce.

4. The Argument That Goodwill is not an Asset. Walter P. Schuetze was the Chief Accountant, Division of Enforcement, at the U.S. Securities and Exchange Commission up until February, 2000, while FASB was considering the updated treatment of intangible assets. Mr. Schuetze was one of FASB's original seven members. Mr. Schutze for years spoke out against the reporting of imaginary assets on balance sheets, things he said "that only accountants call assets."[14] On August 17, 1998, Mr. Schuetze (a UT graduate who worked as an accountant in San Antonio) gave a speech in which he discussed the FASB's consideration of the question of whether the cost of goodwill should be recognizable as an asset. Walter P. Schuetze, *Enforcement Issues, and Is the Cost of Purchased Goodwill an Asset?*[15] Schuetze argued that goodwill did not fit the definition of an asset and could not have a specific cost assigned to it. Schuetze said:

> In paragraph 172 of Concepts Statement 6, the Board said, "Future economic benefit is the essence of an asset. An asset has the capacity to serve the entity by being exchanged for something of value to the entity, by being used to produce something of value to the entity, or by being used to settle its liabilities." The cost of purchased goodwill is simply the amount paid by one entity for the net assets of another entity, or for a controlling equity interest in another entity, in excess of the fair value of the individual, identifiable net assets (assets minus liabilities) of that other entity; the amount said to represent the cost of purchased goodwill is just the excess amount left over–in a word, the lump. But, the lump cannot be exchanged for anything. The lump cannot be used to produce anything of value. The lump cannot be used to settle a liability. I conclude, therefore, using the Board's own words, that the future economic benefit criterion is not met.

IV. WHAT TAX LAW SAYS ABOUT GOODWILL AND SEPARABLE INTANGIBLE ASSETS. Before the adoption of Internal Revenue Code § 197, there was much litigation over whether an intangible asset was or was not depreciable under IRC § 167. A deduction was allowed if the taxpayer

proved that the intangible asset (1) had an ascertainable value separate and distinct from goodwill, and (2) had a limited useful life, the duration of which could be ascertained with reasonable accuracy. *Newark Morning Ledger Co. v. U.S.*, 507 U.S. 546, 558, 113 S.Ct. 1670, 1676 (1993). This struggle was supplanted by IRC § 197, which specifies intangibles that can be amortized. Although not intended for this purpose, the list of intangible assets in Section 197(d) could be considered as a list of intangible assets of a business that are separable from goodwill in a divorce.

Internal Revenue Code § 197(d): Section 197 intangible.--For purposes of this section--

(1) In general.--Except as otherwise provided in this section, the term "section 197 intangible" means--

(A) goodwill,
(B) going concern value,
(C) any of the following intangible items:
(i) workforce in place including its composition and terms and conditions (contractual or otherwise) of its employment,
(ii) business books and records, operating systems, or any other information base (including lists or other information with respect to current or prospective customers),
(iii) any patent, copyright, formula, process, design, pattern, knowhow, format, or other similar item,
(iv) any customer-based intangible,
(v) any supplier-based intangible, and
(vi) any other similar item,
(D) any license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof,
(E) any covenant not to compete (or other arrangement to the extent such arrangement has substantially the same effect as a covenant not to compete) entered into in connection with an acquisition (directly or indirectly) of an interest in a trade or business or substantial portion thereof, and
(F) any franchise, trademark, or trade name.

The term "customer-based intangible" is defined in § 197(d)(2) to mean “(i) composition of market, (ii) market share, and (iii) any other value resulting from future provision of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with customers.” The term "supplier-based intangible" is defined in § 197(d)(3) to mean “any value resulting from future acquisitions of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with suppliers of goods or services to be used or sold by the taxpayer.” Note that workforce in place is listed as an amortizable intangible. In contrast, FAS 141 specifically excludes assembled workforce as a separable intangible asset, because replacement cost (the cost to hire and train a comparable assembled workforce) is “not a representationally faithful measurement of the fair value of the intellectual capital acquired in a business combination” and FASB believes that “techniques to measure the value of an assembled workforce and the related intellectual capital with sufficient reliability are not currently available.”

Business valuators must deal with an issue that tax accountants can ignore, and that is the effect that the business owner’s departing or competing will have on the workforce in place, customer-based intangibles, and supplier-based intangibles.

Treas. Reg. § 1.197-2(b)(2) defines “going concern value” as “the additional value that attaches to property by reason of its existence as an integral part of an ongoing business activity." Court cases recognize “going concern value” as distinguishable from goodwill. In *Citizens and Southern Corp. v. C.I.R.*, 91 T.C. 463, 481 n. 9, 1988 WL 90987 (1988), *aff'd*, 900 F.2d 266 (11th Cir. 1990), the court said:

> Going concern value as distinguished from goodwill is the additional element of value which attaches to property by reason of its existence as an integral part of a going concern. VGS Corp. v. Commissioner, 68 T.C. 563, 591 (1977). Going concern value is 'bottomed on the ability of the acquired business to generate

> sales without any interruption because of the take-over.' Winn-Dixie Montgomery Inc. v. United States, 444 F.2d 677, 685 n. 12 (5th Cir. 1971).

The Tax Court, in *UFE, Inc. v. Commissioner*, 92 T.C. 1314, 1323 (1989), said this:

> Going concern value is an intangible, nonamortizable capital asset that is often considered to be part of goodwill. Goodwill has been defined as the 'expectancy of BOTH continuous excess earning capacity and also of competitive advantage or continued patronage.' Wilmot Fleming Engineering Co. v. Commissioner, 65 T.C. 847, 861 (1976). (Emphasis added.) On the other hand, going concern value has also been described as related less to the business reputation and the strength of customer loyalty, than to the operating relationship of assets and personnel inherent in an ongoing business. Going concern value has been defined as 'the additional element of value which attaches to property by reason of its existence as an integral part of a going concern.' VGS Corp. v. Commissioner, 68 T.C. 563, 591 (1977); Conestoga Transportation Co. v. Commissioner, 17 T.C. 506, 514 (1951). Going concern value is manifested in the business' ability to resume business activity without interruption and to continue generating sales after an acquisition. Computing & Software Inc. v. Commissioner, 64 T.C. 223, 235 (1975). While courts have blurred these distinctions between goodwill and going concern value, they are different conceptually. See United States v. Cornish, 348 F.2d 175, 184 (9th Cir. 1965); Computing & Software Inc. v. Commissioner, supra at 234-235; Winn-Dixie Montgomery, Inc. v. United States, 444 F.2d 677, 685 (5th Cir. 1971).

V. THE DIVISIBILITY OF GOODWILL UPON DIVORCE. A law review article evaluated the law of goodwill and divorce, and had this to say:

> There is a split among states regarding the treatment of goodwill in a divorce proceeding. Eight states, including Ohio, have not decided the issue, [FN22] while the remaining states follow one of the following three approaches. The majority position, and the position advocated in this article, holds that enterprise goodwill is marital property, but personal goodwill is separate property. [FN23] The minority position holds that all goodwill is marital property. [FN24] Lastly, four states hold that goodwill is never marital property. [FN25]
>
> [FN22]. Alabama, Georgia, Idaho, Iowa, Maine, Ohio, South Dakota, Vermont.
>
> [FN23]. Alaska, Arkansas, Connecticut, Delaware, Florida, Hawaii, Illinois, Indiana, Maryland, Massachusetts, Minnesota, Mississippi, Missouri, Nebraska, New Hampshire, Oklahoma, Oregon, Pennsylvania, Rhode Island, Texas, Utah, Virginia, West Virginia, Wisconsin, Wyoming. See Richmond, 779 P.2d 1211 (Alaska); Wilson, 741 S.W.2d 640 (Arkansas); Eslami, 591 A.2d 411 (Connecticut); E.E.C., 457 A.2d 688 (Delaware); McDiarmid, 649 A.2d 810 (D.C.); Thompson, 576 So. 2d 267 (Florida); Antolik, 761 P.2d 305 (Hawaii); Talty, 652 N.E.2d 330 (Illinois); Yoon, 711 N.E.2d 1265 (Indiana); Prahinski, 540 A.2d 833 (Maryland); Goldman, 554 N.E.2d 860 (Massachusetts); Sweere, 534 N.W.2d 294 (Minnesota); Singley, 846 So. 2d 1004 (Mississippi); Hanson, 738 S.W.2d 429 (Missouri); Taylor, 386 N.W.2d 851 (Nebraska); Watterworth, 821 A.2d 1107 (New Hampshire); Travis, 795 P.2d 96 (Oklahoma); Lankford, 720 P.2d 407 (Oregon); Solomon, 611 A.2d 686 (Pennsylvania); Moretti, 766 A.2d 925 (Rhode Island); Nail, 486 S.W.2d 761 (Texas); Sorensen, 839 P.2d 774 (Utah); Howell, 523 S.E.2d 514 (Virginia); Holbrook, 309 N.W.2d 343 (Wisconsin); May, 589 S.E.2d 536 (West Virginia); Root, 65 P.3d 41 (Wyoming).
>
> [FN24]. Arizona, California, Colorado, Kentucky, Michigan, Montana, Nevada, New Jersey, New Mexico, New York, North Carolina, North Dakota, Washington. See Wisner v. Wisner, 631 P.2d 115 (Ariz. App. Div. 1 1981); Lopez, 1974 Cal. App. LEXIS 1040 (California); Huff v. Huff, 834 P.2d 244 (Colo. 1992); Heller v. Heller, 672 S.W.2d 945

(Ky. App. 1984); Kowalesky v. Kowalesky, 384 N.W.2d 112 (Mich. App. 1986); Stufft v. Stufft, 950 P.2d 1373 (Mont. 1997); Ford v. Ford, 782 P.2d 1304 (Nev. 1989); Dugan, 457 A.2d 1 (New Jersey); Hurley v. Hurley, 615 P.2d 256 (N.M. 1980), overruled on other grounds; Moll v. Moll, 722 N.Y.S.2d 732 (N.Y. 2001); Poore v. Poore, 331 S.E.2d 266 (N.C. 1985); Sommers v. Sommers, 660 N.W.2d 586 (N.D. 2003); Hall v. Hall, 692 P.2d 175 (Wash. 1984).

[FN25]. Kansas, Louisiana, South Carolina, Tennessee. See Powell v. Powell, 648 P.2d 218 (Kan. 1982); Pearce v. Pearce, 482 So. 2d 108 (La. App. 4th Cir. 1986); Donahue v. Donahue, 384 S.E.2d 741 (S.C. 1989); Smith v. Smith, 709 S.W.2d 588 (Tenn. App. 1985). . . .

Kelly Schroeder, *Fair and Equitable Distribution of Goodwill in an Ohio Divorce Proceeding,* 31 U. DAYTON L. REV. 83, 87-88 (2005).

The following list reflects the way various state appellate courts have dealt with goodwill for purposes of property division upon divorce. The cases reflect not only a conception of what constitutes goodwill, but also whether such goodwill is divisible. Where they occurred, descriptions of how goodwill should be valued are included.

Arizona.

▸*Mitchell v. Mitchell*, 732 P.2d 208, 211-12 (Ariz. 1987): "We note that some jurisdictions hold that the goodwill of a professional partnership or proprietorship is not a divisible marital asset. . . . However, because the professional practice of the sole practitioner or partner will continue after dissolution of the marriage, with the same goodwill as it had during the marriage, we find that a refusal to consider goodwill as a community asset does not comport with Arizona's statutory equitable distribution scheme. We prefer to accept the economic reality that the goodwill of a professional practice has value, and it should be treated as property upon dissolution of the community, regardless of the form of business." [citations omitted].

Arkansas.

▸*Wilson v. Wilson*, 741 S.W.2d 640, 646-47 (Ark. Sup. Ct. 1987): "The prevailing view appears to be that goodwill of a professional practice or business is a business asset with a determinable value and is marital property, subject to division in a divorce proceeding. . . . Some jurisdictions, however, have held that professional goodwill does not constitute property and should not be considered as marital property divisible in such proceedings. . . . We . . . conclude that, for goodwill to be marital property, it must be a business asset with value independent of the presence or reputation of a particular individual--an asset which may be sold, transferred, conveyed or pledged. Thus, whether goodwill is marital property is a fact question and a party, to establish goodwill as marital property and divisible as such, must produce evidence establishing the salability or marketability of that goodwill as a business asset of a professional practice."

▸*Williams v. Williams*, 108 S.W.3d 629, 642-43 (Ark. App. 2003): "[F]or goodwill to be marital property, it must be a business asset with value independent of the presence or reputation of a particular individual. . . . To establish goodwill as marital property and thus be divisible, the party must produce evidence establishing the salability or marketability of that goodwill as a business asset of a professional practice. The Tortorich and Wilson cases confirm that the burden is on the party who seeks to establish goodwill as a marital asset to produce convincing proof delineating between professional goodwill on the one hand and personal goodwill on the other. . . . Mr. Schwartz admitted in his testimony that he did not attribute any value to Dr. Alonzo Williams' personal reputation. He stated that he '... didn't distinguish between the goodwill that developed between any personal and any professional. . . . Dr. Williams attributes his draw of patients to various factors. Specifically, he testified that he has a group of twenty to thirty physicians with whom he maintains regular contact and from whom he receives referrals. Dr. Williams contends that he receives much of his business based upon referrals. He testified that these referrals keep coming because the referring doctors are his personal friends and know that he will treat the patient well regardless of financial circumstances. Dr. Alonzo Williams

testified that the racial makeup of his patient base is over 80% African American. Dr. Williams is one of the only two African American board certified gastroenterologists in Arkansas. The burden of proof is with the Plaintiff, not the Defendant, to delineate the facets of goodwill. The court finds that the Plaintiff has failed to do so.'"

California.

▸*In re Marriage of Fortier*, 109 Cal.Rptr. 915, 918 (Cal. App. 1973): " the goodwill of respondent's medical practice was, in fact, community property. . . . [S]ince community goodwill may be evaluated by no method that is dependent upon the post-marital efforts of either spouse, then, as a consequence, the value of community goodwill is simply the market value at which the goodwill could be sold upon dissolution of the marriage, taking into consideration the expectancy of the continuity of the practice."

▸*In re Marriage of Foster*, 117 Cal.Rptr. 49, 53-54 (Cal. App. 1974): "The 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 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. As observed in Golden, '. . . 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."

▸*In re Marriage of McTiernan and Dubrow*, 35 Cal.Rptr.3d 287, 295 (Cal. App. 2005): "Personal property may be incorporeal . . ., i.e., without tangible substance, and it may be intangible in the sense that it is a right rather than a physical object. . . . But, even if incorporeal or intangible, property must be capable of being transferred. '[I]t is a fundamental principle of law that one of the chief incidents of ownership in property is the right to transfer it.'. . . 'A common characteristic of a property right, is that it may be disposed of, transferred to another. . . .' Husband's 'earning capacity and reputation in his profession as a motion picture director which greatly exceeds that of most persons involved in that profession' or, in the trial court's shorthand, his 'elite professional standing,' cannot be sold or transferred. His high standing among other motion picture directors is entirely personal to him. He cannot confer on another director his standing as No. 13 in cumulative box office revenues during 1985- 1996. He cannot sell this standing to another, because a buyer would not be John McTiernan, no matter how much the buyer was willing to pay. For the same reason, and unlike a law or medical practice, husband cannot transfer his 'elite professional standing.' That standing is his, and his alone, and he cannot bestow it on someone else. Thus, an essential aspect of a property interest is absent. The fact that husband's 'elite professional standing' is not transferable effectively refutes the trial court's conclusion that husband's 'practice' as a motion picture director is like the 'practice' of an attorney or physician. The practice of an attorney, physician, dentist, or accountant is transferable, but husband's 'elite professional standing' is his alone, and not susceptible to being transferred or sold."

Colorado.

▸*Huff v. Huff*, 834 P.2d 244, 256-58 (Colo. 1992):

> The district court selected a value based on the excess earnings method, which is a generally accepted method for determining the present value of someone's interest in a business. See In re Marriage of Bookout, 833 P.2d 800, 804-805 (Colo. App. 1991) (affirming trial court's use of excess earnings approach); Dugan v. Dugan, 92 N.J. 423, 457 A.2d 1, 9 (1983) (adopting excess earnings approach in valuation of law practice for purposes of divorce proceeding); In re Marriage of Hall, 103 Wash.2d 236, 692 P.2d 175, 179-80 (1984) (trial court may consider various methods for valuing goodwill of spouse participating in partnership, including excess earnings method

or formula in partnership agreement); Alan S. Zipp, Divorce Valuation of Business Interests: A Capitalization of Earnings Approach, 23 Fam.L.Q. 89, 102 (1989) (capitalization of excess earnings approach is one of the methods recommended by the American Institute of Certified Public Accountants and is a method relied on by the Internal Revenue Service to value a business for tax purposes). The excess earnings approach capitalizes the amount by which the attorney's historical earnings exceed that which an attorney with similar education, experience and capabilities earned during that period. See Bookout, at 803, 805; Dugan, 457 A.2d at 9. This method results in a valuation that represents the value of both the tangible assets and goodwill of the husband's partnership interest on the dissolution date. [FN14] Zipp, supra, at 91, 102. The excess earnings valuation method is an appropriate valuation in a dissolution proceeding because it provides the present value of the partnership interest to the participating spouse and 'avoids the problem of valuing a business on the basis of postdivorce earnings and profits.' Id. at 89, 102. . . .

The husband also argues that the district court's use of the excess earnings method results in a "double dipping" by the wife into the husband's income. The husband contends that the excess earnings approach converts his future income into property which is then divided between the spouses. He contends that "double dipping" occurs because that same future income is the source from which the wife's maintenance is paid. The husband contends that the wife receives double benefits from the same source: the husband's future income. We disagree.

As stated above, the excess earnings approach is a valuation method which capitalizes the excess earnings based on a comparison of the husband's past earnings to the past earnings of an attorney in the same area with the same education, experience, and capabilities. Based on these historical earnings, this method provides a valuation which represents the present value of the husband's partnership interest. The excess earnings approach does not convert the husband's future income into property; on the contrary, it avoids valuing a business or partnership on the basis of postdivorce earnings and profits. See Bookout, at 804-805; Zipp, supra, at 102.

‣ *In re Marriage of Bookout*, 833 P.2d 800, 804-05 (Colo. Ct. App. 1992, cert. denied):

Next, husband notes that, in capitalizing excess income, his future income stream is valued and divided as property. Therefore, he argues that basing an order of maintenance and child support upon the same income inequitably awards wife a double recovery. We disagree.

The few courts that consider personal goodwill as nothing more than probable future earning capacity have concluded that goodwill is not a divisible marital asset. See Kimbrough v. Kimbrough, 228 Neb. 358, 422 N.W.2d 556 (1988); Holbrook v. Holbrook, 103 Wis.2d 327, 309 N.W.2d 343 (1981); see generally A.H. Rutkin, Family Law & Practice § 37.05(1) (1991). However, this minority view is contrary to the law which we have adopted in this jurisdiction. See In re Marriage of Nichols, 43 Colo.App. 383, 606 P.2d 1314 (1979) (the value of goodwill incident to a practice is an asset acquired during the marriage).

Furthermore, the value of goodwill which is to be determined at the time of dissolution is not synonymous with a spouse's expectation of future earnings. In re Marriage of Lukens, 16 Wash.App. 481, 558 P.2d 279 (1976); In re Marriage of Fortier, 34 Cal.App.3d 384, 109 Cal.Rptr. 915 (1973). See also Dugan v. Dugan, supra (future earning capacity per se is not goodwill). Such earnings are simply a factor which are considered to decide if goodwill exists, In re Marriage of Lopez, 38 Cal.App.3d 93, 113 Cal.Rptr. 58 (1974), and it is this latter asset that is valued and allocated between the parties to a dissolution. Stern v. Stern, 66 N.J. 340, 331 A.2d 257 (1975). Goodwill reflects not simply a possibility of future earnings, but a probability based on existing circumstances. Dugan v. Dugan, supra.

In a dissolution of marriage proceeding, the value of goodwill should be measured by arriving at a present value based upon past results and not by accounting for the postmarital efforts of the professional spouse. However, the method of valuation that, as here, capitalizes the historical past earnings of the business at an appropriate capitalization rate to identify a value of the goodwill possessed by the business at the date of dissolution avoids the problem of valuing a business on the basis of post-dissolution earnings and profits. See In re Marriage of Foster, 42 Cal.App.3d 577, 117 Cal.Rptr. 49 (1974).

Thus, a valuation on the basis of past earnings represents the advantage currently possessed by the business as shown by its historical ability to earn income in excess of that which would be earned if the owner had invested in tangible property and leased it to other businesses. Zipp, Divorce Valuation of Business Interests: A Capitalization of Earnings Approach, 23 Fam.L.Q. 89 at 109 & 111 (1989); see generally Udinsky, Putting a Value on Goodwill, 9 Fam.Adv. 37 (1986).

Goodwill is a property or asset which supplements the earning capacity of another asset, a business, or a profession, and, therefore, it is not the earning capacity itself. In re Marriage of Hall, 103 Wash.2d 236, 692 P.2d 175 (1984). Hence, while both a practicing professional and a salaried professional bring an earning capacity comprised of skill and education to their positions, the goodwill directly supplements the earning capacity only of the practicing professional. In re Marriage of Keyser, 820 P.2d 1194 (Colo. App. 1991).

Thus, we conclude that the identification, valuation, and division of husband's goodwill as a portion of his physical therapy practice did not divide husband's future income. Therefore, wife did not receive a double recovery.

Connecticut.

- *Eslami v. Eslami*, 591 A.2d 411, 418-19 (Conn. Sup. Ct. 1991): "It can hardly be doubted that the increment of value, loosely termed goodwill, that arises from the established reputation of a business for the quality of its goods or services may often be found to enhance the value of professional as well as other enterprises by increasing their ability to attract patrons. Relatively few courts have wholly rejected consideration of the goodwill of a professional practice in determining the value of the property held by the parties in a dissolution action. . . . Several courts have recognized that the goodwill of an established practice may have value, but disapprove of the capitalization of excess earnings method of valuation, insisting upon evidence of value based on comparable sales or partnership withdrawal agreements. . . . We agree with the cases that recognize that goodwill may constitute an element of value distinct from the tangible assets of a medical practice. Its value, however, must be determined on the basis of the price that a willing buyer would pay in excess of the tangible assets to acquire the practice. Obviously, the most persuasive evidence of such value would be prices obtained in comparable sales of similar medical practices, if sufficient information of that kind can be found. We reject the notion that professional goodwill may be evaluated without consideration of the saleability of the practice and the existence of a market for its purchase. . . . To the extent that the goodwill of the practice cannot be detached from the personal reputation and ability of the practitioner through a sale, it cannot be said to have any significant market value, even though it may enhance the earning power of the practitioner so long as he continues to work in the same community. '[I]f goodwill depends on the continued presence of a particular individual, such goodwill, by definition, is not a marketable asset distinct from the individual.' Taylor v. Taylor, supra, 222 Neb. at 731, 386 N.W.2d 851. A valuation method that does not differentiate between the goodwill of the practice as a saleable entity and the practitioner's own earning power as enhanced by such goodwill may well result in counting the same basis for a financial award in dissolution cases twice, once as an asset of his estate subject to allocation and again, as a component of his earning capacity forming the basis for alimony. In theory, at least, the capitalization of excess earnings method of evaluating goodwill seeks 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. In economic terms, if radiologists were so scarce that the demand for such services overwhelmed the supply, there would be little advantage in buying an established practice at a substantial price for the goodwill component rather than establishing a new practice. The supply-demand relationship is theoretically reflected in both components of the capitalization formula, the determination of excess earnings and the capitalization factor. Thus the formula is related to market value, but provides an alternative to the comparable sales method for determining that value. The difficulty lies not in the theory but in its application, particularly with respect to the basis for calculating the amount of excess income and selecting the capitalization rate. Although evidence of comparable sales would ordinarily be more persuasive, we hold that capitalization of excess income is a permissible method for determining the value of the goodwill of a professional practice, despite difficulties in its application. We have previously approved the capitalization of projected net income as a permissible accounting technique for determining the value of a closely held corporation characterized as a 'one-man' business." [Citations omitted]

<u>District of Columbia.</u>

▸*McDiarmid v. McDiarmid*, 649 A.2d 810, 814-15 (D.C. Ct. App. 1994): "As the District of Columbia has not heretofore addressed the question of whether professional goodwill is subject to distribution upon dissolution of marriage, we have examined the cases of our sister jurisdictions and considered how they have addressed and resolved this issue. We found that '[t]here is no specific consensus as to a definition of professional goodwill, whether a sole practitioner of any profession can have goodwill, or what method or methods should be used to value professional goodwill.' Thompson v. Thompson, 576 So.2d 267, 269 (Fla.1991). The jurisdictions are divided as to whether professional goodwill in a law practice may be marital property subject to distribution upon dissolution of marriage. A number of courts have concluded that professional goodwill in a law practice is not property subject to equitable distribution. These courts have concluded that the concept of goodwill is indistinguishable from future earning capacity and thus too remote and speculative to be valued. . . . A majority of the jurisdictions has concluded, however, that professional goodwill is marital property subject to equitable distribution. These courts classify goodwill as marital property because '[t]o hold otherwise would result in a windfall to the professional spouse.' . . . We adopt the majority view that goodwill of a professional practice acquired during a marriage is marital property subject to valuation and distribution. . . . We also recognize, however, that 'under the facts of a given case, a professional practice may have no goodwill value . . . , and that a case-by-case inquiry into valuation is preferable in these cases.'"

<u>Florida.</u>

▸*Thompson v. Thompson*, 576 So.2d 267, 270 (Fla. Sup. Ct. 1991): "If a law practice has monetary value over and above its tangible assets and cases in progress which is separate and distinct from the presence and reputation of the individual attorney, then a court should consider the goodwill accumulated during the marriage as a marital asset. The determination of the existence and value of goodwill is a question of fact and should be made on a case-by-case basis with the assistance of expert testimony." [Footnote omitted]

<u>Illinois.</u>

▸*In re Marriage of Talty*, 652 N.E.2d 330, 334 (1995): "To the extent that goodwill inheres in the business, existing independently of William's personal efforts, and will outlast his involvement with the enterprise, it should be considered an asset of the business, and hence of the marriage. In contrast, to the extent that goodwill of the business is personal to William, depends on his efforts, and will cease when his involvement with the dealership ends, it should not be considered property. "

<u>Indiana.</u>

▸*Yoon v. Yoon*, 711 N.E.2d 1265, 1268-69 (Ind. Sup. Ct. 1999): "Goodwill has been described as the value of a business or practice that exceeds the combined value of the net assets used in the business. . . . Goodwill in a professional practice may be

attributable to the business enterprise itself by virtue of its existing arrangements with suppliers, customers or others, and its anticipated future customer base due to factors attributable to the business. It may also be attributable to the individual owner's personal skill, training or reputation. This distinction is sometimes reflected in the use of the term 'enterprise goodwill,' as opposed to 'personal goodwill.' Enterprise goodwill 'is based on the intangible, but generally marketable, existence in a business of established relations with employees, customers and suppliers.' Allen Parkman, The Treatment of Professional Goodwill in Divorce Proceedings, 18 FAM. L.Q. 213, 215 (1984). Factors affecting this goodwill may include a business's location, its name recognition, its business reputation, or a variety of other factors depending on the business. Ultimately these factors must, in one way or another, contribute to the anticipated future profitability of the business. Enterprise goodwill is an asset of the business and accordingly is property that is divisible in a dissolution to the extent that it inheres in the business, independent of any single individual's personal efforts and will outlast any person's involvement in the business. . . . It is not necessarily marketable in the sense that there is a ready and easily priced market for it, but it is in general transferrable to others and has a value to others."

Kansas.

▸*Powell v. Powell*, 648 P.2d 218, 223-24 (Kan. Sup. Ct. 1982): " The question of whether this court should adopt the theory that good will of a professional practice is a marital asset to be divided at divorce is, in the final analysis, a public policy issue. . . . We are not persuaded a professional practice such as Dr. Powell's has a good will value. The practice is personal to the practitioner. When he or she dies or retires nothing remains. The professional's files and lists of clients are of no use to others. The very nature of a professional practice is that it is totally dependent upon the professional. We refuse to adopt the theory that good will in a professional practice is an asset subject to division in a divorce action."

Kentucky.

▸*Gomez v. Gomez*, 168 S.W.3d 51, 56 (Ky. App. 2005): "In this case the trial court found the practice of Bluegrass Radiology with respect to those physicians entering or exiting the practice to be significant. Eduardo testified and submitted affidavits from other physicians who had left the practice that when a physician joined or left the group an evaluation of the current accounts receivable was done. Based on that value a physician entering or leaving the practice had to pay or was paid a percentage of the accounts receivable value. No calculation for goodwill was included. The trial court found this evidence to be persuasive along with evidence that when the group had discontinued its practice at another hospital it did not receive any payment for goodwill. The description of how the practice had historically valued itself is, in essence, a buy-sell agreement. And while buy-sell agreements or corporate by-laws have been rejected as the basis for valuing a professional practice where this would not accurately reflect the value of the business, Clark, supra 782 S.W.2d at 60, they may be used as a factor in reaching a determination regarding the value of a professional business. . . . And while we would have reached a different conclusion on the evidence presented in this case, the trial court's determination that no goodwill existed because of the historical way in which the practice valued itself is supported by substantial evidence."

▸*Clark v. Clark*, 782 S.W.2d 56,59-60 (Ky. App. 1990):

"This Court, in Heller, supra, specifically ruled that the goodwill contained in a business or professional organization is a factor to be considered in arriving at the value of the practice. This Court explained goodwill in Heller. Specifically, professional practices that can be sold for more than the value of their fixtures and accounts receivable have goodwill. Heller, supra, at 948. Goodwill in essence is the expectation that patrons or patients will return because of the reputation of the business or firm. This goodwill has specific pecuniary value. Goodwill has also been defined as the excess of return in a given business over the average or norm that could be expected for that business. Hanson v. Hanson, 738 S.W.2d 429 (Mo.1987). The age, health and professional reputation of the practitioner, the nature of the practice, the length of time the practice has been in existence, past profits, comparative

professional success, and the value of its other assets, are all factors of goodwill. Poore, supra. It is the growing trend of courts in this country to consider goodwill in valuing a corporation. . . . Thus, the trial court was correct in considering goodwill.

"The trial court in the case at bar adopted a capitalization of excess earnings method for evaluating the goodwill of this professional corporation. Under this method, the goodwill value is based in part on the amount that the earnings of the professional spouse exceed those which would have been earned by a professional with similar education, experience, and skill as an employee in the same general area. Poore, supra, 331 S.E.2d at 271. Specifically, four steps are involved in the capitalization of excess earnings method. First, the court must ascertain what a professional of comparable experience, expertise, education and age would be earning as an employee in the same general locale, determine and average the professional's net income before federal and states income taxes for a period of approximately five years, compare the actual average with the employee norm, and multiply the excess by a capitalization factor. Taylor v. Taylor, 222 Neb. 721, 386 N.W.2d 851 (1986). Dr. Mackin, the appellee's expert who calculated the value of the goodwill, used these same steps outlined above. He specifically concentrated on a three-year period of Dr. Clark's earnings. He used a survey of doctors in appellant's OB-GYN specialty who had been surveyed by the American Medical Association. Dr. Mackin used a weighted multiplication factor to gain results that closely correlated with the methods used in the survey. Contrary to appellant's assertion, the method involves calculating the professional's past earnings, not future earnings. There is no indication from the evidence in the case at bar that the trial court incorrectly applied the capitalization of excess earnings method. The findings correctly show the true value of the corporation's goodwill.

"The capitalization of excess earnings method is a widely accepted method and the most often used. Taylor, supra, 386 N.W.2d at 857; Poore, supra, 331 S.E.2d at 271; Levy, supra, 397 A.2d at 380. There are a number of acceptable methods which courts may adopt. There is no definitive rule or best method for valuing goodwill. Poore, supra; Hurley v. Hurley, 94 N.M. 641, 615 P.2d 256, 259 (1980). The determination of goodwill is a question of fact rather than law, and each case must be determined on its own facts and circumstances. Poore, supra, Hurley, supra. Thus, the trial court was correct in adopting and applying the capitalization of excess earnings method."

<u>Louisiana.</u>

‣*Pearce v. Pearce*, 482 So.2d 108, 111 (La. App. 1986), *writ denied*, 484 So.2d 140 (La..1986): "Goodwill does not form a part of the corporate assets of a sole medical practitioner. Depner v. Depner, 478 So.2d 532 (La. App. 1st Cir.1985). The Depner court specified, and we agree:

Professional medical competence is personal to the physician and cannot be attributed to the corporation because it is a personal relationship between physician and patient, not between corporation and patient. Since goodwill must adhere to some principal property or right it is therefore dependent upon the property or right of either the corporation or the individual or both. In examining the goodwill in this case we find that it exists independent of the corporation. Absent the corporation it exists, absent the physician it does not exist. Therefore it is not an asset of the corporation. The corporation may profit from this relationship but it cannot share in it. The corporation cannot share in a personal relationship between physician and patient.

There is no basis on these facts to support Mrs. Pearce's concept and claim for corporate professional goodwill. Dr. Pearce's future earnings have no present value susceptible of partition as a community asset. Mrs. Pearce is not entitled to equity in her ex-husband's potential earnings by claiming one-half as goodwill."

‣*Rao v. Rao*, 2005 WL 2898066,*15 (La. App. 2005): "The evidence clearly supports the conclusion that the hypothetical value postulated by Mrs. Rao's expert accountant was largely based upon goodwill attributable to the personal qualities and patient relationships of Dr. Rao and his fellow stockholder physicians using the corporate facilities as part of their professional practice. Although Louisiana Endoscopy Center, Inc. is not a professional medical

corporation per se, we conclude it was intended by the parties to be an extension of a professional medical practice group in accordance with the federal "safe harbor" regulations. It is inappropriate to use such goodwill attributable to Dr. Rao in the valuation of community corporate stock. . . . Although the issue has not been specifically addressed by the legislature and seems to be res nova, we conclude it is likewise inappropriate to incorporate goodwill attributable to the personal, professional qualities of the other physician stockholders in such valuation." [Footnote omitted]

Maryland.

‣*Prahinski v. Prahinski*, 582 A.2d 784, 787-88 (Md. Sup. Ct. 1990): "Because the question of whether professional goodwill is marital property is one of first impression in Maryland, we found it beneficial to review the decisions of the courts of other states which have addressed the issue. This review revealed three positions. The view most often followed treats goodwill as marital property in all cases.] The next largest group considers goodwill to be personal to the practitioner, and therefore not marital property. Finally, a small group of states requires a case-by--case examination to determine how goodwill should be treated. It is interesting to note that the classification of a jurisdiction as a community property state or an equitable distribution state is not determinative of its treatment of goodwill. . . . After reviewing these three alternatives and the rationale of their respective supporting cases, we are of the opinion that the goodwill of a solo law practice is personal to the individual practitioner. 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. In order for goodwill to be marital property, it must be an asset having a separate value from the reputation of the practitioner. We are not convinced that the goodwill of a solo law practice can be separated from the reputation of the attorney. It is the attorney whose name, whether on the door or stationery, is the embodiment of the practice. We are cognizant that in this computer age many law practices, and in Leo's practice in particular, much of the research and "form" work is done by nonlawyers. In the final analysis, however, it is the attorney alone who is responsible for the work that comes out of the office. Rule of Professional Conduct 5.3(c). In the instant case, the responsibility is solely Leo's, and no amount of work done by Margaret will shift the responsibility to her. The attorney's signature or affidavit places his seal of approval on the work being done and makes the attorney liable for its accuracy and authenticity. This professional assurance is what might have convinced some clients to use Leo F.X. Prahinski, Attorney-at-Law, instead of going to a title company to have their settlements completed. The assurance would end should Leo somehow remove himself from the practice. Therefore, the goodwill generated by the attorney is personal to him and is not the kind of asset which can be divided as marital property.

Massachusetts.

‣*Goldman v. Goldman*, 554 N.E.2d 860 (Mass. Ct. App. 1990): "We reject the wife's most significant claim of error in valuation, the failure of the judge to allocate any amount to the goodwill of the husband's professional corporation. The judge was warranted in accepting the husband's accountant's opinion that there was no goodwill in this one-man professional corporation. For a discussion of the classification of professional goodwill, see generally Gregory, The Law of Equitable Distribution § 6.03 (1989)."

‣*Champion v. Champion*, 764 N.E.2d 898 (2002): "Whether a business takes the form of a corporation, partnership, or sole proprietorship, does not affect the valuation method that a court may use even though some methods may better lend themselves to particular types of business associations. See 2 McCahey, Valuation and Distribution of Marital Property § 22.08, at 22-102 & 22-103 (2001). The willing buyer/willing seller test is used to determine the fair market value of a sole proprietorship for Federal estate and gift tax purposes, see id. at § 24.07[2], and the guidelines established for such purposes are relevant in divorce litigation. [FN5] See 2 Budd & Zupcofska, Massachusetts Divorce Law Practice Manual § 14.4, at 14-23 (MCLE 2000). In the absence of a determinable market value, experts commonly value a closely held business by the assignment of value to the assets of the business, as was done here (inventory and receivables less liabilities), and by the capitalization of earnings. See

Kindregan & Inker, Family Law & Practice § 45.8, at 275 (2d ed.1996)."

▸*Sampson v. Sampson*, 369, 816 N.E.2d 999, 1007-08 (Mass. Ct. App. 2004): "In the instant case, unlike Champion v. Champion, supra, a capitalized income method was utilized by both parties' experts in valuing the wife's business. Such a method requires subtraction from business income of a reasonable salary expense for the operator of the business. . . . Without subtraction of a sum representing a reasonable salary, there is significant concern that the business may be overvalued. Moreover, where such a salary is subtracted, it facilitates the identification of those portions of a given asset providing separate bases of property assignment and alimony as articulated by Dalessio v. Dalessio, supra.

"Here, however, the expert whose testimony was credited by the judge did not adjust directly for the owner-operator's salary. Rather, while recognizing that an owner-operator's salary should be subtracted, the expert did not do so. Instead, the expert deducted the salary of the business's sole employee other than the wife, a customer services representative whose much lower annual salary had ranged from $17,532 to $23,264 over a five year period. Without explanation in his report, the expert concluded that the customer services representative's salary was an appropriate salary for a "part-time owner." The expert also summarily concluded that the part-time owner could do the work of the customer services representative as well as her own.

"Read closely, other parts of the report raise significant questions about the appropriateness of the smaller salary deduction. For example, the expert recognizes only that it "may be possible" to replace the owner, but not with someone with the owner's familiarity with the agency's operations. The expert's report is also inconsistent. On the one hand, it emphasizes the value of the two-person operation, particularly in terms of its ability simultaneously to maintain its high quality service, market to new customers, and position the agency for future growth; on the other hand, it finds that one part-time owner can perform all these functions for the small salary of the current customer services representative. The judge does not address these critical and questionable aspects of the expert's valuation. See Redding v. Redding, 398 Mass. 102, 108, 495 N.E.2d 297 (1986) ("Any failure in the decision-making process to consider and explain the effect of an important fact may require reversal of the judgment in order to permit consideration and explanation of the omitted subject"). The judge simply accepted the $175,000 valuation and assigned the husband $175,000 from the proceeds of the house to offset the value of the wife's business.

"Furthermore, when considering the wife's income for the purposes of determining her need for support, the judge made no adjustments, concluding that she would earn $41,912 a year. The $41,912 was based on what she was earning from the business without recognizing that some of that income had been attributed to the value of the business itself. For that additional income, the husband had already been compensated by providing him with an otherwise disproportionate share of the proceeds from the sale of the house. See Murphy v. Murphy, 6 A.D.3d 678, 775 N.Y.S.2d 370 (2004). Cf. Rattee v. Rattee, 146 N.H. at 47-48, 767 A.2d 415. Concerns are thereby raised that either the value of the business was inflated by artificially deflating the salary of the owner-operator or, conversely, that the wife's income was inflated when determining her need for support."

Michigan.

▸*Kowalesky v. Kowalesky*, 384 N.W.2d 112 (Mich. App. 1986): Kowalesky cite: "We believe that neither Revenue Ruling 59-60 nor any other single method should uniformly be applied in valuing a professional practice. Rather, this Court will review the method applied by the trial court, and its application of that method, to determine if the trial court's valuation was clearly erroneous. [FN1] . . .FN1. Our discussion should not be read as prohibiting trial courts from using Revenue Ruling 59-60 in their decisions if they find it helpful or as prohibiting parties from using it in presenting their cases. Since the trial court in the case at bar did not apply the ruling, we need not decide if doing so is erroneous. We only conclude that use thereof is not required."

▸*Conger v. Conger*, 2000 WL 33388397, *1-2 (Mich. Ct. App. 2000) (unpublished opinion): "The holder's interest method is utilized in divorce proceedings

to quantify the present value of a business to its proprietor. One commentator described this valuation method as follows: Applying the holder's interest measure of value to a personal service business such as a professional practice is simply an extension of the principles of case specific valuation commonly used by trial courts in dividing marital assets under equitable distribution principles. Stripped to its core, the holder's interest value means that: (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 ... (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 [fair market value].... [A]doption of the holder's interest measure of value simply brings into conformity the valuation of personal service businesses with the way most other marital assets have been valued for years. [Cunningham, Equitable Distribution and Professional Practices: Case Specific Approach to Valuation, 73 Mich. B J 666, 667 (July 1994).] In the present case, the circuit court recognized its own discretion in choosing the valuation method to apply. The court exercised that discretion by choosing the holder's interest method, reasoning that the closely held corporation was worth more to defendant than the fair market value of the business, based on the assumption that defendant would continue to operate the business after the parties' divorce. . . . Defendant next argues that proper application of the holder's interest method requires the circuit court to distinguish between personal and business goodwill. Although defendant acknowledges that no Michigan court has ever distinguished between business and personal goodwill, he urges this Court to accept the holdings of various foreign jurisdictions and to recognize a distinction between personal and business goodwill for the purpose of business asset valuations. Because defendant failed to raise this issue before the trial court, it is unpreserved for appeal. Further, we are unpersuaded of the need to adopt a distinction between personal and business goodwill, for purposes of valuing business assets in the context of a divorce action."

Missouri.

‣*Hanson v. Hanson*, 738 S.W.2d 429, 434-35 (Mo. Sup. Ct. 1987): "[G]oodwill is recognized as property in this state; that recognition is not dependent on a traditional mercantile setting. Goodwill may exist in both commercial and professional entities. Irrespective of the setting in which it is found, the meaning of goodwill does not change. It is property which attaches to and is dependent upon an existing business entity; the reputation and skill of an individual entrepreneur--be he a professional or a traditional businessman--is not a component of the intangible asset we identify generally as goodwill. With the caveats which follow, we hold that goodwill in a professional practice acquired during a marriage is marital property subject to division in a dissolution of marriage proceeding. We define goodwill within a professional setting to mean the value of the practice which exceeds its tangible assets and which is the result of the tendency of clients/patients to return to and recommend the practice irrespective of the reputation of the individual practitioner. Our understanding of goodwill is thus consistent with and no broader than the economic, accounting and legal definition which existed prior to the advent of *Dugan*, *Fleege* and cases reaching similar results. Goodwill is not dependent, however, on the manner in which the professional practice is organized nor the size of the practice itself. We recognize, as is implied in *Geesbreght*, 570 S.W.2d at 427, that goodwill will more likely exist in larger professional practices than in the offices of sole practitioners. This is so because reliance by patients/clients on the reputation and skill of the individual practitioner is, in most cases, inversely related to the number of practitioners in the practice. However, to the extent that, for instance, competent evidence exists that clients/patients will return to the place of the practice--or recommend it to acquaintances who have not yet patronized it--irrespective of the presence of the individual professional, goodwill exists in the solo practice. Professional goodwill may not be confused with future earning capacity. We have not declared future earning capacity to be marital property. We do not now do so. Instead, we leave to the trial court broad discretion in striking an appropriate balance between husband and wife in the division of property and any award of

maintenance."

Nebraska.

‣*Taylor v. Taylor*, 386 N.W.2d 851, 857-58 (1986): "Virtually any income-producing entity, regardless of the nature of the business organization, may have an asset of recognized value beyond the tangible assets of such entity, an intangible asset generally characterized as goodwill. To the extent that such intangible asset's value results from recurrent customer patronage, there is no question that goodwill is property which may be considered as a part of the marital estate for the purpose of a dissolution proceeding. . . . However, difficulty may arise in valuing a professional practice, because goodwill is likely to depend on the professional reputation and continuing presence of a particular individual in that practice. . . . The particularized question becomes: Is professional goodwill, solely dependent on the presence of a specific individual, marital property within § 42-365 and subject to equitable division in a dissolution proceeding? Courts answering that question in the affirmative have generally adopted a method of evaluation involving capitalization of excess earnings to determine the extent of goodwill as an asset in a professional practice. . . . The concept of professional goodwill evanesces when one attempts to distinguish it from future earning capacity. 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. The reputation of a law firm or some other professional business is valuable to its individual owners to the extent that it assures continued substantial earnings in the future. It cannot be separately sold or pledged by the individual owners. The goodwill or reputation of such a business accrues to the benefit of the owners only through increased salary. . . . [W]here goodwill is 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 a sale or transfer of such business. On the other hand, if goodwill depends on the continued presence of a particular individual, such goodwill, by definition, is not a marketable asset distinct from the individual. Any value which attaches to the entity solely as a result of personal goodwill represents nothing more than probable future earning capacity, which, although relevant in determining alimony, is not a proper consideration in dividing marital property in a dissolution proceeding."

Nevada.

‣*Ford v. Ford*, 782 P.2d 1304, 1309 (Nev. 1989): "Goodwill exists in a going professional practice, whether or not a sale is in the offing. . . . . In the instant case, the district court heard evidence of Dr. Ford's ongoing medical practice. Although Dr. Ford testified that his practice was not salable, potential problems in selling the practice will not eliminate the goodwill which attaches to it, nor its value as an asset to be considered in equitable distribution. *Dugan v. Dugan*, 92 N.J. 423, 457 A.2d 1, 6 (1983). Accordingly, the district court properly declined to follow the restrictive reasoning of *Hanson [v. Hanson*, 738 S.W.2d 429, 435 (Mo. Sup. Ct. 1987)] and correctly found that goodwill existed in Dr. Ford's surgical practice."

New Jersey.

‣*Dugan v. Dugan*, 457 A.2d 1, 6 (N.J. Sup. Ct. 1983): "Our limited concern involves the existence of goodwill as property and its evaluation for purposes of equitable distribution under *N.J.S.A.* 2A:34-23 with respect to attorneys and in particular individual practitioners. Though other elements may contribute to goodwill in the context of a professional service, such as locality and specialization, reputation is at the core. Paulsen, *supra,* at 10. It does not exist at the time professional qualifications and a license to practice are obtained. A good reputation is earned after accomplishment and performance. Field testing is an essential ingredient before goodwill comes into being. Future earning capacity *per se* is not goodwill. However, when that future earning capacity has been enhanced because reputation leads to probable future patronage from existing and potential clients, goodwill may exist and have value. When that occurs the resulting goodwill is property subject to equitable distribution.

“We held in *Lynn v. Lynn,* 91 *N.J.* 510, 453 *A.*2d 539 (1982), that a license to practice medicine and a medical degree were not property. They reflected only a possibility of future earnings. This holding was consonant with the proposition in *Stern v. Stern,* 66 *N.J.* 340, 345, 331 *A.*2d 257 (1975), that potential earning capacity is not property within the meaning of the statute, though relevant on the issues of alimony and of determining equitable proportions for the distribution of property.

“When, however, the opportunity provided by the license is exercised, then goodwill may come into existence. Goodwill is to be differentiated from earning capacity. It reflects not simply a possibility of future earnings, but a probability based on existing circumstances. Enhanced earnings reflected in goodwill are to be distinguished from a license to practice a profession and an educational degree. In that situation the enhanced future earnings are so remote and speculative that the license and degree have not been deemed to be property. The possibility of additional earnings is to be distinguished from the existence of goodwill in a law practice and the probability of its continuation. Moreover, unlike the license and the degree, goodwill is transferable and marketable. Though there is an apparent limitation on the part of an individual practitioner to sell a law practice, the same is not true in a law firm.

“After divorce, the law practice will continue to benefit from that goodwill as it had during the 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. An individual practitioner's inability to sell a law practice does not eliminate existence of goodwill and its value as an asset to be considered in equitable distribution.”

▸*Seiler v. Seiler*, 706 A.2d 249, 251-252 (N.J. Super. Ct. App. Div. 1998): “Whether the goodwill generated by a manager of a "captive insurance agency" is an asset of the manager or of the insurance company which the manager represents has not been addressed in New Jersey. Two other jurisdictions have addressed similar questions, with opposite results.

“In *In re Marriage of Zeigler*, 69 Wash. App. 602, 849 P.2d 695, 696 (1993), the husband was a "captive agent" of State Farm Insurance Company. The husband's agreement with State Farm provided that all sales were limited to State Farm approved products, all policyholder names and information pertaining to the policies were trade secrets of State Farm, the agency's leased computer system, software, and records were the sole property of State Farm, the agency's book of policyholders belonged to State Farm, and the agency could not assign or sell the book of policyholders to anyone. *Ibid*. The husband controlled the organization of and paid the expense of the agency. *Ibid*. The agreement also contained a no-compete clause. *Ibid*.

“The court concluded that "the Agency's captive status means that any reasonable expectation of continued patronage is indistinguishably intertwined with the reputation and goodwill of State Farm." *Id*. at 698. Because State Farm retained the vital rights to the policyholders and the stream of renewals from them, any goodwill attached primarily to State Farm, not its captive agent. *Ibid*. Thus, there was no goodwill in the Agency to equitably distribute. *Ibid*.

“The Colorado Court of Appeals faced a similar situation in *In re the Marriage of Graff*, 902 P.2d 402, 405 (Colo.Ct.App. 1994), and explicitly disagreed with *Zeigler*. *Graff* also involved a State Farm agency run by the husband. *Id*. at 404. The husband set his own hours, decided the location of his office, hired and fired his own employees and set their salary, selected and purchased his own supplies, was characterized in his State Farm contract as an independent contractor, and reported his income as that of a business on Schedule C of his tax return. *Ibid*. The husband was unable to sell his rights to the State Farm contract. *Ibid*. The court found that the restrictions on the transfer of the agency did not preclude the existence of goodwill. *Id*. at 405. Despite the restrictions on the husband's agency, the facts that he controlled his business expenses, that he had stated his interest as a business ownership with the Internal Revenue Service, that the net income of the business had increased substantially under the husband's ownership, and that the husband had no plans to discontinue his relationship,

supported the trial court's finding that the agency had goodwill. *Ibid*.

"Despite *Graff*'s criticism of *Zeigler*, we are satisfied that the *Zeigler* ruling is persuasive given the more comparable facts of *Zeigler* to this case. Allstate has established a sales structure to encourage individual initiative and the opportunity to earn significant income. Defendant's ability to earn a substantial income must not blind us to the fact that he is an employee of a major insurance company selling its insurance products in accordance with the terms and conditions established by his employer. The compensation scheme does not transform a person in defendant's position into an independent entrepreneur. He remains a salesman whose job is to aggressively solicit new clients and retain old clients.

"Certainly, defendant has much more discretion and control over the conditions of his employment than many employees; nevertheless, he remains an employee with significant limitations imposed on him by his employer. Unlike an independent insurance agent, he cannot hire and fire employees without the permission of Allstate. He can sell no product other than Allstate. He has no transferrable book of accounts. Like any employee, he can be terminated.

"Defendant's reputation in the community may have generated new business; however, that can be said for any salesman. We cannot ignore that the captive agent, like defendant, is selling a product of a major national insurance company which has fashioned its own reputation for price, quality and service over many years with the assistance of a formidable national, regional and local advertising campaign."

New York.

‣*Moll v. Moll*, 722 N.Y.S.2d 732, 735 (N.Y. Sup. Ct. 2001): "The O'Brien analysis is not limited to professional licenses and has been used to find a medical board certification (Savasta v. Savasta, 146 Misc.2d 101, 549 N.Y.S.2d 544 [S.Ct., Nassau County]), a law degree (Cronin v. Cronin, 131 Misc.2d 879, 502 N.Y.S.2d 368 [S.Ct., Nassau County]), an accounting degree (Vanasco v. Vanasco, 132 Misc.2d 227, 503 N.Y.S.2d 480 [S.Ct., Nassau County]), a podiatry practice (Morton v. Morton, 130 A.D.2d 558, 515 N.Y.S.2d 499), the licensing and certification of a physician's assistant (Morimando v. Morimando, 145 A.D.2d 609, 536 N.Y.S.2d 701), a Masters degree in teaching (McGowan v. McGowan, 142 A.D.2d 355, 535 N.Y.S.2d 990), a Master's degree and a permanent certificate in school administration (DiCaprio v. DiCaprio, 162 A.D.2d 944, 556 N.Y.S.2d 1011 [4th Dept.1990]), a fellowship in the Society of Actuaries (McAlpine v. McAlpine, 143 Misc.2d 30, 539 N.Y.S.2d 680 [S.Ct., Suffolk County]), the celebrity career of an opera singer (Elkus v. Elkus, 169 A.D.2d 134, 572 N.Y.S.2d 901), the increase in value of the wife's career as a model and actress (Golub v. Golub, 139 Misc.2d 440, 527 N.Y.S.2d 946 [S.Ct., N.Y. County]), the enhanced earning capacity attributed to a former Congressional career (Martin v. Martin, 200 A.D.2d 304, 614 N.Y.S.2d 775) and the enhanced earning capacity of an investment banker (Hougie v. Hougie, 261 A.D.2d 161, 689 N.Y.S.2d 490 [1st Dept.1999]) all to constitute marital property. All of these decisions, like O'Brien, base their finding of marital property on the "enhanced earning capacity" which the "thing of value" provided to its holder. See, e.g., McGowan v. McGowan, 142 A.D.2d 355, 535 N.Y.S.2d 990 (2d Dept. 1988)."

‣*Golub v. Golub*, 527 N.Y.S.2d 946,950 (Sup. Ct. New York County 1988): "There seems to be no rational basis upon which to distinguish between a degree, a license, or any other special skill that generates substantial income. In determining the value of marital property, all such income generating assets should be considered if they accumulated while the marriage endured. If one spouse has sacrificed and assisted the other in an effort to increase that other spouse's earning capacity, it should make no difference what shape or form that asset takes so long as it in fact results in an increased earning capacity. The rationale in both O'Brien and McGowan for awarding the spouse an economic interest in the intangible asset seems to have been based on a view of the asset as "investments in the economic partnership of the marriage and the product of the parties' joint efforts." (McGowan, supra).

"The noncelebrity spouse should be entitled to a share of the celebrity spouse's fame, limited, of course, by the degree to which that fame is

attributable to the non-celebrity spouse (25 UCLA Law Review, 1095). The source of the fame must still be traced to the marital efforts.

"Thus, as in O'Brien, if a spouse devotes himself or herself to the family throughout the marriage, giving up career opportunities, and no liquid assets exist, the court should compensate this spouse for his or her contribution enabling him or her to pursue his or her career and not just a terminable maintenance award. For example, if instead of medical school the spouse went to music school and became a celebrated pianist, in equity both accomplishments must be treated equally.

"The question, therefore, presented is should O'Brien be extended so as not to prejudice a spouse who is married to a non-professional?

"This court answers the question in the affirmative and holds that the skills of an artisan, actor, professional athlete or any person whose expertise in his or her career has enabled him or her to become an exceptional wage earner should be valued as marital property subject to equitable distribution. Thus, although plaintiff's celebrity status is neither "professional" nor a "license" (Morimando, supra) its increase in value is marital property; despite the difficulties presented in valuing such property."

▸*Kohl v. Kohl*, 800 N,.Y.S.2d 348 (Sup. Ct. N.Y. County, 2004), *aff'd*, 806 N.Y.S.2d 35 (2005): "The husband contends that the theoretical value of the sales and consultancy business is $315,622; the wife contends its value is $1,600,000. These disparate conclusions result from two major valuation differences. First, the parties disagree on the amount of reasonable compensation that should be deducted before determining the value of the business component of the husband's earnings. Only earnings over and above reasonable compensation can form the basis for the valuation of the ownership interest under the capitalization of earnings methodology. The wife argues that a reasonable compensation figure is $400,000 while the husband contends it is $750,000. . . . The court finds $400,000 to be the reasonable compensation figure. Both expert witnesses conceded that no direct, statistical source exists for persons holding comparable positions to that held by the husband. However, the court finds that the wife's expert presented cogent arguments to support his assessment of reasonable compensation. Mr. Johnson considered the compensation received by the IDI officers, related, statistical sources for corroborative comparison, and the husband's historical earnings. . . . In contrast, Mr. Friedman gave little justification for how he arrived at his $750,000 figure other than from his own experience in auditing and valuing businesses. Moreover, he gave few specifics to justify his conclusion . . . . In sum, the court found Mr. Johnson's assessment of the husband's reasonable compensation more credible.

"The second significant dispute in the valuation concerned what capitalization rate should be applied based on an assessment of the risk factors of the business. In the capitalization of earnings valuation method, after deduction of reasonable compensation, a capitalization rate must be applied to the remaining earnings to determine the value of the business. Both parties agree that the capitalization rate here should be determined using the "build-up method". This approach adds to a risk free investment rate all relevant risk factors, including for the overall market, the particular industry, and the specific business being valued, to ultimately determine the risk a hypothetical buyer of the business would have to assume. From this number, the valuator can calculate the rate of return a buyer would want to receive to assume that risk, thereby arriving at the fair market value of the business. The wife's expert concluded that a 25% capitalization rate (capitalization multiple of 4) was appropriate; the husband's expert proffered a capitalization rate of 44.3% (capitalization multiple of 2.25). . . .

"In performing the build up of the risk factors, the experts were in general agreement through assessing the historical risk premium (the risk factors from a risk free investment through a small capitalized corporation). The major discrepancies arose in determining the risk factors for the specific business being valued. Both experts conceded that the determination of those risk factors is largely subjective . . . . The court concludes that the assessment by Mr. Johnson is more credible and supported by the evidence.

FN9. Through that calculation, the wife

's expert found a 19% rate whereas the husband's expert found a 17.3% rate. . . .

"The main difference arises from Mr. Friedman's assignment of a 32% risk factor for dependence upon a key person, that being the husband. The court finds that the assignment of such a high risk factor is not reflected in the reality of the business during the period subject to valuation. For instance, Mr. Friedman assigned as a high risk factor the stability of the business's earnings. He contended that the earnings of the business are entirely dependent on the husband and the real estate industry. . . . While this is true, during the period subject to valuation, the husband's earnings increased each year lending weight to the conclusion that the business has stable earnings. Similarly, Mr. Friedman included as a high risk factor the fact that there is no continuity of customer base. In point of fact, the husband often had repeat customers . . . and, both historically and through the valuation period, was able to obtain new jobs without any evidence of difficulty. In addition, although Mr. Friedman noted that the growth potential of the company might be a risk factor, he conceded that the husband's earnings had increased during the period under valuation. Thus, not only was this not a risk factor (Mr. Friedman subtracted 5% from his risk assessment because of the business's growth), but lent support to the conclusion that Mr. Friedman overstated the other risk factors. . . .

"Mr. Johnson acknowledged that certain risk factors exist (e.g. key-person, size premium, customer concentration, etc.) as well as lack of marketability. However, the court finds Mr. Johnson's assessment that a hypothetical buyer would seek to recapture the purchase price in 4 years reasonable not only with respect to the accounting methodology he employed, but also as supported by the evidence of the success of the business. . . . [Record references and footnotes omitted]"

‣*White v. White*, 611 N.Y.S.2d 951, 953 (N.Y. Supreme Court, Appellate Division 1994): "The first point of contention centers on Supreme Court's evaluation of defendant's interest in his law firm and the distribution of 15% of this asset to plaintiff. Supreme Court accepted the opinion of plaintiff's expert that, pursuant to the capitalization of earnings approach, defendant's interest as of April 2, 1990 had a value of $431,000. In contrast, defendant's expert, utilizing the net asset approach, fixed the value at $19,409. Parenthetically, we note that because defendant's professional practice is well established, the valuation of his license is not an issue as it is deemed to have merged and been subsumed by the practice (see, McSparron v. McSparron, 190 A.D.2d 74, 80-81, 597 N.Y.S.2d 743).

"The capitalization of earnings method is appropriate to use when evaluating a law practice and is apt to more accurately reflect its value than the net asset method (see, Nehorayoff v. Nehorayoff, 108 Misc.2d 311, 437 N.Y.S.2d 584; Annotation, Valuation of Goodwill in Law Practice for Purposes of Divorce Court's Property Distribution, 77 ALR4th 683). Thus, Supreme Court did not abuse its discretion in rejecting defendant's evaluation."

‣*Nehorayoff v. Nehorayoff*, 437 N.Y.S.2d 584, 588, 591 (Sup. Ct. Nassau Cty. 1981): "The most vigorously contested issue in this case was the value of Dr. Nehorayoff's half interest in Plaza Women's Medical Realty, Inc., a closely held corporation primarily engaged in the termination of pregnancies and related laboratory work. Each side called an expert witness as to value. Mrs. Nehorayoff's expert testified that in his expert opinion the value of the half interest was in the range of $675,000 to $1,350,000. The Doctor's expert testified that in his expert opinion the corporation had no value. The valuation of closely held and professional corporations is a difficult problem confronting the courts with increasing frequency. To date no consistent approach to valuation has been arrived at. . . . Taking into consideration the actual and imputed earnings of the enterprise, the value of Dr. Nehorayoff's interest in Plaza Women's Medical Realty, Inc. in terms of the capitalization of net earnings is $200,000."

Ohio.

‣*Hardy v. Hardy*, 2005 WL 2660627, *5 (Ohio Ct. App. 2005): "The parties both offered expert opinion evidence concerning the value of the consulting business. Nancy's expert opined that the business is worth $140,000, using past revenues and a multiplier factor to arrive at projected future revenues

on which her opinion was based. Lawrence's expert valued the business on the basis of its capital assets, as well as goodwill and future potential, and opined that the value of the business is only nominal. . . . The magistrate found that the valuation provided in the opinion of Lawrence's expert was more reliable. Nancy objected. The trial court overruled the objection, stating: 'The court finds that defendant's business, L.R. Hardy & Associates, has little or no market value. The business is effectively a consulting business providing personal service to various defense contractors. The business' only product is the personal service provided by Mr. Hardy. There are no capital assets in the business; he has no client base; and he has no individual contracts with any firm that could be sold. There are no appreciable business assets to be divided.' . . . .Lawrence's consulting business is marital property, to the extent that it represents an 'interest' Lawrence has that he acquired during the marriage. . . . Like a professional practice, its value when the marriage terminates may be determined in relation to anticipated future revenues. See Barone v. Barone, (Sept. 1, 2001), Lucas App. NO. L-98-1328. However, that depends on the particular facts, including the nature of the activity as well as the owner/spouse's expected capacity to generate revenues. Those are questions of fact for the trial court to determine. Lawrence was sixty-nine years of age at the time of the divorce. The future revenues of his consulting business are limited by his age and the nature of the business. The trial court could, in its discretion, find that evidence on which Nancy's expert relied is too tenuous to support a finding of any particular value, and instead adopt the valuation offered by Lawrence's expert. [Paragraph numbers omitted]

‣*Clymer v. Clymer*, 2000 WL 1357911, *2-3 (Ohio Ct. App. 2000): "Goodwill is an integral part of the valuation of a professional business in a divorce proceeding. Kahn v. Kahn (1987), 42 Ohio App.3d 61, 64. "The comprehensive definition of '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 the general public patronage and encouragement, which it receives from constant or habitual customers, on account of its local position, or common celebrity, or reputation for skill or affluence, or punctuality, or from other accidental circumstances or necessities, or even from ancient partialities or prejudices.' " Spayd v. Turner, Granzow & Hollenkamp (1985), 19 Ohio St.3d 55, 59.

"The experts' differing values of plaintiff's law practice arise from their assessment of the goodwill of the practice. Several methods for valuing professional goodwill are recognized, including: (1) capitalization of net profits (or straight capitalization), (2) capitalization of excess earnings, (3) the IRS meth od (known as the "formula" approach), which subtracts a reasonable rate of return on tangible assets and salary from average earnings, (4) market value, and (5) buy-sell agreements. Kell v. Kell (Dec. 14, 1993), Ross App. No. 92CA-1931, unreported. Nesser employed the "excess earnings" method to calculate the goodwill of plaintiff's law practice. In arriving at the conclusion that the practice had no goodwill, Nesser used plaintiff's actual earnings for each year between 1981 and 1984, initially subtracted the estimated return on assets, and then subtracted the estimated earnings for plaintiff's peer group of similarly situated attorneys. The estimated earnings of plaintiff's peer group was calculated with the help of the Altman & Weil and OSBA reports because the trial court's earlier calculation was criticized in Clymer III for not using factors to make the value representative of plaintiff's peer group. With those reports, the trial court's calculation, premised on Nesser's testimony, considers the factors Clymer III indicated would make the reasonable compensation calculation more accurate, such as the attorney's area of practice, firm size, experience and population where the practice is located.

"Nesser then weighed the difference between actual and reasonable earnings, less the return on assets, to arrive at an excess earnings number, that then was capitalized to arrive at the amount of goodwill possessed by defendant's law practice. In Nesser's calculations, plaintiff made less than the peer group Nesser compared him to in each year and therefore had no excess earnings and, accordingly, no goodwill. . . . The trial court did not abuse its discretion in adopting Nesser's analysis over the analysis of defendant's expert."

‣*Kahn v. Kahn*, 536 N.E.2d 678, 682 (Ohio Ct. App. 1987): "Another contention of the appellant is that by placing a value on the goodwill of a professional practice that we are placing a value on the defendant's medical degree. The Ohio Supreme Court has told us that "a professional degree cannot be categorized as 'property.' " . . . Looking back at the definitions of "goodwill" previously presented shows that much more than the degree is valued in a goodwill calculation. Goodwill is an intangible value of an ongoing medical practice. An ongoing sole professional medical practice, by definition, requires a professional physician with a degree, since it would be both unethical and illegal to have an uneducated or unlicensed doctor practicing medicine as sole practitioner. Furthermore, the value of goodwill can be calculated independently of the value of the degree. "A professional may not have any goodwill; for example, he may just be starting his practice or he may be a salaried employee. Yet, his professional degree and his license to practice are of substantial economic benefit to him." Kennedy & Thomas, Putting a Value on: Education and Professional Goodwill (1979), 2 Family Advocate 3, 5. Since goodwill can be calculated independently of the value of the degree it is erroneous to assume that by placing a value on the goodwill of a medical practice that we are treating the medical degree as marital property. . . . We, like the trial court, recognize that goodwill is an integral part of the valuation of a professional business in a divorce proceeding.

Oklahoma.

‣*Travis v. Travis*, 795 P.2d 96, 100 (Okla. Sup. Ct. 1990): "This Court has previously found that a law practice can be considered jointly acquired property subject to division as part of a marital estate. . . . In contrast to the physical assets of a law office, the reputation of the lawyer cannot be purchased by another seeking to acquire an established law practice. If Mr. Travis were to cease his practice of law, he would not be free to sell his files to a succeeding lawyer because such a sale would violate Rule 1.8(j) of the Rules of Professional Conduct which prohibits a lawyer acquiring a proprietary interest in a lawsuit. This general rule has its basis in common law champerty and maintenance. See, Comment, Rule 1.8. Mr. Travis would only be able to divide a fee with a succeeding lawyer depending upon the client's agreement to retain the succeeding lawyer, the client's agreement in writing to a fee division, both lawyers' assuming joint responsibility for the representation, and the total fee being reasonable. Rule 1.5, Rules of Professional Conduct, 5 O.S. Supp. 1989, ch. 1, app. 3-A. Establishing earning capacity is much less speculative than trying to establish a good will value of a law practice. Projected earnings can be considered in establishing support alimony which, unlike property division of good will, may be adjusted upward or downward at a later date. . . . Because Oklahoma law allows such an adjustment, and because law practices cannot be bought and sold as can other professional practices, we conclude that a consideration of the earning capacity of a lawyer and subsequent setting of support alimony based upon that earning capacity is more equitable than the speculative division of good will in the law practice of a sole practitioner." [Citations omitted]

Pennsylvania.

‣*Solomon v. Solomon*, 611 A.2d 686, 691-92 (Pa. Sup. Ct. 1992): "This is the first time this Court has been presented with the propriety of including the value of the good will of a business as a marital asset, where good will was not subject to the partnership agreement itself. Generally, we agree with the Superior Court that if a business qualifies as marital property pursuant to 23 P.S. § 401(e), then to the extent that such business has established good will, such value should be considered for purposes of equitable distribution." [Footnote omitted]

‣*Baker v. Baker*, 861 A.2d 298, 303(Pa. Super. 2004): "Wife's expert testified the goodwill he attributed to the value of the practice was not based on personal characteristics of Husband. Rather the goodwill value the expert attributed to the practice was based on criteria such as location and customer lists. This aspect of the practice's goodwill was properly subject to equitable distribution. . . . However, the determination of whether a business has established good will is controlled by the nature of the business itself. Since good will is essentially positive reputation, the factors that have given rise to the positive reputation will necessarily control

the determination of whether good will exists for purposes of equitable distribution. If the positive reputation is due only to the reputation of a single individual as opposed to the business entity in general, then the business has no good will for purposes of equitable distribution. The value is that of the single individual and not the entity in general, and this value is not capable of surviving the disassociation of the individual from the business entity. However, as the single individual's contributions become less substantial, the good reputation enjoyed by a business entity becomes less related to the single individual and more a product of the business entity in general, and thus, more capable of surviving the disassociation of the single individual. In the case sub judice, the record facts indicate that William was engaged as a sole practitioner of veterinary medicine specializing in the breeding of horses. The Superior Court determined that given the substantial record evidence that the success of William's business was dependent solely on his own expertise, the trial court did not abuse its discretion in finding that William's business had no good will value.

"Kathleen claims that the reputation of the business was based not only upon William's professional contributions, but also upon the contributions of other members of the staff, which included veterinarians, together with the general facilities and commodities of the business unrelated to veterinary practice or the breeding of horses. We disagree.

"It is evident that the trial court paid great attention to the conflicting evidence concerning good will value. The trial court found particularly persuasive the testimony of numerous clients concerning the importance of William's professional expertise in sustaining the various aspects of the business. In contrast, the trial court was not persuaded by Kathleen's claim that the other commodities of the business and the existence of other staff veterinarians supported a finding of good will separate and apart from William's professional reputation. The trial court specifically found that the contributions of other veterinarians were minor in that only two recently graduated veterinarians were employed for a brief period of time and they brought no new business to the practice. Accordingly, the trial court found that William's business possessed no good will value. As there was more than sufficient evidence to support a finding that William's business possessed no good will value outside his professional reputation, we hold that the Superior Court did not abuse its discretion in affirming the decision of the trial court on this issue."

<u>South Carolina.</u>

▸*Donahue v. Donahue*, 384 S.E.2d 741 (S.C. Sup. Ct. 1989): "The decision as to the inclusion of goodwill of a professional practice in a marital estate is, "in the final analysis, a public policy issue." . . . The following is a well-recognized definition of goodwill:

> Goodwill may be properly enough described to be the advantage or benefit which is acquired by an establishment beyond the mere value of the capital, stock, funds, or property employed therein, in consequence of the general public patronage and encouragement which it receives from constant or habitual customers, on account of its local position or common celebrity, or reputation for skill or affluence, or punctuality, or from other accidental circumstances or necessities, or even from ancient partialities or prejudices.

"More specifically, professional goodwill has been held to have the following attributes:

> It attaches to the person of the professional man or woman as a result of confidence in his or her skill and ability. [cite omitted] It does not possess value or constitute an asset separate and apart from the professional's person, or from his individual ability to practice his profession. It would be extinguished in the event of the professional's death, retirement or disablement.
>
> . . . 'The very nature of a professional practice is that it is totally dependent upon the professional.' [citation omitted] The definitions set forth above indicate the intangible nature of the goodwill asset. It is this intangibility which inevitably results in a speculative

valuation. The basis of this Court's concern in *Casey* was the speculative element involved in valuation of goodwill. In light of the definitions above, we see similar problems in the valuation of goodwill of a professional practice. Accordingly, we hold that the family court erred in placing a value upon, and consequently dividing the goodwill of the husband's dental practice."); Casey v. Casey, 362 S.E.2d 6, 6-7 (S.C. 1987) ("Courts from other jurisdictions are divided as to whether goodwill is marital property divisible upon divorce. . . . The issue is one of first impression in this state. . . . When the goodwill in a business is dependent upon the owner's future earnings, it is too speculative for inclusion in the marital estate. . . . Moreover, these future earnings are accounted for in an award of alimony. . . . We hold that goodwill in Husband's fireworks business does not constitute marital property subject to equitable distribution."). [citations omitted]

Tennessee.

‣*Smith v. Smith*, 709 S.W.2d 588, 591 (Tenn. App. 1985): "The next question is what elements of a profession are taken into account in arriving at the value of that profession for purposes of making an equitable division. The physical assets, of course, such as the furniture, buildings, library, etc., are things that have an ascertainable value and should be taken into account. The accounts receivable, properly weighted, should have a definite value. The most troublesome question involves the good will of the firm. Is that an asset that can be considered part of the marital property? Other states are split on the question, although a clear majority hold that the good will of the firm should be considered and evaluated in making a division of the marital property. See Annot. 52 A.L.R.3d 1344. We are not persuaded, however, that this state should adopt the rule that professional good will is a part of the marital estate. We find the position taken by the Wisconsin Court of Appeals in Holbrook v. Holbrook, 103 Wis.2d 327, 309 N.W.2d 343 (App.1981) to be persuasive."

Texas.

‣*Nail v. Nail*, 486 S.W.2d 761 (Tex. 1972): "[I]t cannot be said that the accrued good will in the medical practice of Dr. Nail was an earned or vested property right at the time of the divorce or that it qualifies as property subject to division by decree of the court. It did not possess value or constitute an asset separate and apart from his person, or from his individual ability to practice his profession. It would be extinguished in event of his death, or retirement, or disablement, as well as in event of the sale of his practice or the loss of his patients, whatever the cause."

‣*Geesbreght v. Geesbreght*, 570 S.W.2d 427, 435-36 (Tex. Civ. App.--Fort Worth 1978, writ dism'd): "'Good will' is sometimes difficult to define. In a personal service enterprise such as that of a professional person or firm, there is a difference in what it means as applied to 'John Doe' and as applied to 'The Doe Corporation' or 'The Doe Company'. If 'John Doe' builds up a reputation for service it is personal to him. If 'The Doe Company' builds up a reputation for service there may be a change in personnel performing the service upon a sale of its business but the sale of such business naturally involves the right to continue in business as "The Doe Company". The "good will" built up by the company would continue for a time and would last while the new management, performing the same personal services, would at least have the opportunity to justify confidence in such management while it attempted to retain the 'good will' of customer clients of the former operators. At least the opportunity to have time to try to preserve the 'good will' already existent and to use it as an entrance into the identical field of operations in a personal service type of business would be present where the name of the business is a company name as distinguished from the name of an individual. Therein does it have value, plus the value of the opportunity to justify confidence in the new management by the customer/clients of the predecessor owner(s). It is as applied to the foregoing that we consider Emergency Medicine to possess what we treat as 'good will' as part of its worth and value under the circumstances of this case, and therefore an asset which would have value to some extent apart from John's person as a professional practitioner."

▸*Austin v. Austin*, 619 S.W.2d 290, 291-92 (Tex. Civ. App.--Austin 1981, no writ): "The good will of an ongoing, noncorporate, professional practice is not the type of property that is divisible as community property in a divorce proceeding. [citing *Nail*.] . . . When good will is not attached to the person of the professional man or woman, it is property that may be divided as community property. [citing *Geesbreght*.] . . . Once a professional practice is sold, the good will is no longer attached to the person of the professional man or woman. The seller's actions will no longer have significant effect on the good will. The value of the good will is fixed and it is now property that may be divided as community property."

Utah.

▸*Sorensen v. Sorensen*, 839 P.2d 774, 775 (Utah Sup. Ct. 1992): "It would not be equitable to required him to pay his wife part of the value ascribed to the goodwill, because the goodwill of a sole practitioner is nothing more than his or her reputation for competency. . . . We believe . . . that unless the professional retires and his practice is sold, his reputation should not be treated differently from a professional degree or an advanced degree: both simply enhance the earning ability of the holder."

▸*Karlsson v. Karlsson*, 2005 WL 1119651 (Utah App. 2005): "Karlsson argues that this case falls within the scope of Sorensen. Karlsson, however, has not demonstrated that the goodwill of the catering business is solely attributable to his personal, professional reputation. See id. at 775. Rather, the catering business was cofounded by the parties and both worked in the business. Thus, we see no problem in the award of a limited amount for the goodwill of the catering business."

Virginia.

▸*Howell v. Howell*, 523 S.E.2d 514, 520 (Va. Ct. App. 2000): "Discounting future earnings is not an inherently flawed method of valuation because it is based on projected future earnings. The value of goodwill can have two components. Professional goodwill (also designated as individual, personal, or separate goodwill) is attributable to the individual and is categorized as separate property in a divorce action. Practice goodwill (also designated as business or commercial goodwill) is attributable to the business entity, the professional firm, and may be marital property. The commissioner and the trial court carefully distinguished between these two components and selected a value that was solely attributable to the husband being a partner in Hunton & Williams. It represented the premium due to the husband's association with Hunton & Williams, the economic advantage he enjoyed because he was a partner in that firm. It included no value attributable to him personally, and it did not rely upon any earnings due to the husband's own expertise, reputation, experience, skill, knowledge, or personality. As applied, the discounted future earnings method was not a flawed method of valuation. In valuing the goodwill of the partnership interest, courts must take special care not to confuse the owner spouse's personal future earning capacity with practice goodwill attributable to the law firm in order to avoid double counting. "Further, particular care must be given that future earnings capacity and reputation not be confused with professional goodwill.""

Washington.

▸*Hall v. Hall*, 692 P.2d 175 (Wash. Sup. Ct. 1984): "The husband here contends that the Fleege doctrine should be reconsidered because (1) it presents confusing and unfair criteria for identifying and evaluating the economic benefit to one spouse or the other, from a professional degree and career; and, (2) it is unfair where, as here, it requires the determination that only one of two spouses, with identical professional educations and earning capacities, has professional goodwill. These contentions are based on the failure to distinguish between professional goodwill and personal earning capacity of the professional. Goodwill is a property or asset which usually supplements the earning capacity of another asset, a business or a profession. Goodwill is not the earning capacity itself. It is a distinct asset of a professional practice, not just a factor contributing to the value or earning capacity of the practice. . . . Discontinuance of the business or profession may greatly diminish the value of the goodwill but it does not destroy its existence. When

a professional retires or dies, his earning capacity also either retires or dies. Nevertheless, the goodwill that once attached to his practice may continue in existence in the form of established patients or clients, referrals, trade name, location and associations which now attach to former partners or buyers of the practice."

▸*In re Marriage of Lukens*, 558 P.2d 279, 282 (Wash. App. 1976, rev. denied): "The value of goodwill, which is to be determined at the time of dissolution, is not synonymous with the spouse's expectation of future earnings. . . . Goodwill should be measured by arriving at a present value based upon past results and not by accounting for the postmarital efforts of the professional spouse. . . . Factors to be considered include the length of time the professional has been practicing, his comparative success, his age and health, and particularly the past profits of the practice, which would reflect any income previously generated by his goodwill. Additionally, because goodwill does not exist separately but is incidental to the other assets of the business, attention should be given to the physical and fixed resources of the practice." [Citations omitted]

▸*Matter of Marriage of Fleege*, 588 P.2d 1136, 1138 (Wash. Sup. Ct. 1979): "[W]hile the goodwill of a professional practice may not be readily marketable and the determination of its exact value may be difficult, that element may nevertheless be found to exist in a given professional practice. The determination of its value can be reached with the aid of expert testimony and by consideration of such factors as the practitioner's age, health, past earning power, reputation in the community for judgment, skill, and knowledge, and his comparative professional success. A dentist who has practiced many years and established a good reputation can expect his patients to return to him and to speak of him in a manner that enhances that reputation and encourages others to seek his services. Also, he can expect a large number, if not most, of these patients to accept as their dentist a person to whom he sells his practice. These prospects are a part of goodwill, and they have a real pecuniary value."

Wisconsin.

▸*Holbrook v. Holbrook*, 309 N.W.2d 343, 345, 353-54 (Wis. Sup. Ct. 1981): "Originally, goodwill was said to exist only in commercial business, and not in a professional business which depends upon the skill and reputation of a particular person. . . . Because goodwill has no existence apart from the business to which it attaches, courts have determined that there can be no income tax deduction for loss of goodwill; the loss of goodwill cannot be compensated for in eminent domain proceedings; goodwill cannot be used to satisfy debts; nor is it subject to depreciation. . . . Even greater problems arise when, after it has been determined that professional goodwill is a marital asset divisible upon divorce, attempts are made to place a dollar value on the goodwill that is part of the marital estate. This would be especially problematic, where, as here, the business involved has several members, all of whom have presumably contributed to the goodwill of the business. Valuation of one individual's goodwill interest in the business would be almost pure speculation. . . . We are not persuaded that the concept of professional goodwill as a divisible marital asset should be adopted in Wisconsin. We are not obliged nor inclined to follow the twisted and illogical path that other jurisdictions have made in dealing with this concept in the context of divorce. . . . The concept of professional goodwill evanesces when one attempts to distinguish it from future earning capacity. 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. The reputation of a law firm or some other professional business is valuable to its individual owners to the extent that it assures continued substantial earnings in the future. It cannot be separately sold or pledged by the individual owners. The goodwill or reputation of such a business accrues to the benefit of the owners only through increased salary." [Footnotes omitted]

VI. TWO SUGGESTIONS ON HOW TO ATTACK THE PROBLEM OF GOODWILL UPON DIVORCE. The Author offers up two theses for discussion purposes, as a way to a clearer understanding of enterprise vs. personal goodwill in a Texas divorce.

A. THESIS NO. ONE. This Article proposes a thesis, that the value of a business as a going concern consists of (i) the value of tangible assets, plus (ii) the value of intangible assets that are recognized as identifiable components of the business, plus (iii) the commercial goodwill or enterprise goodwill of the business, plus (iv) the personal goodwill that is so identified with the selling owner that it is lost to the business when the seller leaves.

Restated in business valuation terms, valuing a business using the income method yields a value for the business based on the use of all tangible and intangible assets combined, including goodwill. The value of tangible assets can be determined by appraisals, and a reasonable rate of return on that invested capital can be determined. The value of intangible rights that are recognized under contract law or intellectual property law or are otherwise separable from goodwill can, admittedly with more difficulty, be valued and a reasonable rate of return on that invested capital can be determined. Out of the "residual goodwill," the value of the personal goodwill can be estimated based on projecting the drop in future profits of the business that will occur when the seller leaves the business or even competes with it. The loss in value associated with the drop in profits is the measure of the seller's personal goodwill, and the remaining unallocated intangible value of the business is commercial or enterprise goodwill. Restated more succinctly, category (iii) enterprise goodwill is what is left of profits after subtracting the profits attributable to categories (i), (ii), and (iv).

B. THESIS NO. TWO. This Article proposes a second thesis, that the reduction in future profits attributable to the business's loss of the seller's personal goodwill contains three components: (i) the loss associated with losing the seller's knowledge, skill and experience; (ii) the loss associated with losing suppliers, customers or referral sources as a result of the seller <u>leaving</u> the business; and (iii) the loss associated with losing suppliers, customers or referral sources as a result of the seller <u>competing</u> with the business. (Further discussion is warranted about whether the possible loss of valuable employees not under long term contracts, and who would leave with the owner, should be factored into personal goodwill.)

The first of these three components of personal goodwill should be assessed separately from the second and third components, because the seller's knowledge, skill and experience can be replaced by hiring a new employee with equivalent knowledge, skill and experience, while the loss of profits to the business resulting from the seller's leaving, or leaving and competing, cannot be made whole by hiring a new employee.

Note that the reasonable compensation assigned to the seller in normalizing the historical profits of the business is identical to the cost of hiring a replacement employee with similar knowledge, skill and experience, so there is no net loss to the business purely from the loss of the seller's knowledge, skill and experience. The knowledge, skill and experience component of the seller's personal goodwill can be fully accounted for by assessing reasonable compensation for the seller's services. See Section VII.B.2.a below. In other words, the familiar process of normalizing business profits, by adjusting the seller's compensation to a reasonable compensation level, effectively eliminates knowledge, skill and experience from the appraiser's calculation of the seller's personal goodwill. The net effect on the business is the same, whether the seller stays on as an employee or is replaced by a new employee, since the needed knowledge, skill and experience can be acquired by paying an employee compensation commensurate with the seller's level of knowledge, skill and experience.

The loss to the business of losing the seller's ties to suppliers, customers and sources of future business cannot be replaced by hiring a new employee with equivalent knowledge, skill and experience, since the new employee will have none of the seller's relationships with suppliers, customers, and sources of future business. See Section VII.B.2.a below. These are the types of relationships discussed above in connection with John Tomer's concept of "social capital," as distinguished from the more traditional concept of "standard human capital," such as knowledge, skill and experience. The only way to avoid this relationship-related loss is to keep the seller as an employee or consultant of the business,

or through some public relations arrangement to maintain the appearance of the seller's continued connection with the business (i.e, keeping his/her name on the door, face in advertisements, etc.). *See Martin Ice Cream Co. v. Commissioner*, 110 T.C. 189, 207 (1998) ("This court has long recognized that personal relationships of a shareholder--employee are not corporate assets when the employee has no employment contract with the corporation. Those personal assets are entirely distinct from the intangible corporate asset of corporate goodwill.).

Note that the relationship-based connections to suppliers, customers, and sources of future business are not necessarily based on *personal* relationships. They could be based on a perception arising from advertising, or word-of-mouth, or prominence in the community, or membership in a certain church, or race, gender or ethnicity, or any other attribute, so long as the attribute is perceived to be connected to the seller of the business, as opposed to the business or to an employee of the business, or to a trademark or brand name, etc.

The distinction between the effect of leaving versus the effect of competing is supported by the fact that a seller can leave a business without competing with it, such as by death, retirement, or relocation to another market. A buyer will pay more for the business when the seller has died, retires, or moves to a different market, than the buyer will pay if the seller is expected to compete with the business after the sale. Also, securing a covenant not to compete does not protect the business from losses resulting from the seller simply leaving the business. Any ties to the business that are based on the seller's personal relationships are at risk of loss just because the seller leaves, even if he or she does not compete.

If the seller competes with the business after the sale, then suppliers and customers and sources of future business may not just drift away to other businesses–they may actually follow the seller to his/her new business. This loss due to competition can be avoided by paying the seller for a covenant not to compete–in states where such covenants are enforceable. The value of the covenant not to compete can be measured by the projected loss in profits attributable to the seller's competing with the business.

Looked at from the opposite perspective, valuing the covenant not to compete does not measure the entire personal goodwill of the seller, because the covenant not to compete does not retain for the business the value of the seller's knowledge, skill, experience, and it does not allow the business to avoid the loss in suppliers, customers and sources of future business that "dry up" because the owner has left the business.

In sum, the loss of the seller's knowledge, skill or experience, traditionally viewed by courts as a component of the seller's personal goodwill, will have no effect on business profits *provided that* the seller's historical compensation is normalized to a level that matches the seller's level of knowledge, skill and experience, so that a suitable replacement employee can be hired at the same compensation level. However, the loss to the business which results from termination of personal relationships between the seller and suppliers, customers, and sources of future business, cannot be erased by hiring a new employee with equivalent knowledge, skill and experience, because the new employee will have none of these personal relationships. This loss of relationships must be gauged separately, by projecting the increased cost and lost revenue that the business will suffer because those historical ties have been severed. And the business may suffer a loss arising from the seller's mere departure, even if the seller does not compete. One the other hand, if the seller does compete, the losses occasioned by the seller's departure may be subsumed in the losses occasioned by the seller's competing.

VII. VALUING GOODWILL. The methods of valuing the goodwill of a business are well-known. In a sale, goodwill is the difference between the purchase price and the value of tangible assets plus identifiable intangible assets (leases, intellectual property rights, employment agreements, covenants not to compete, etc.). If there is a covenant not to compete the goodwill includes personal goodwill. If there is no covenant to compete, then personal goodwill is not included in the purchase price. In a divorce, there is no sale, so the valuator can only estimate the fair market value of the business. In

a personal service business, the valuator must not include in the date-of-divorce value any post-divorce labors, and, in most states the valuator must segregate commercial or enterprise goodwill from the personal goodwill of the owner. Goodwill in a professional practice is usually determined using the excess earnings method or a capitalization of earnings stream.

A. GOODWILL OF THE GOING BUSINESS. The Tax Court recognizes three ways to measure the value of goodwill of a business: (i) the bargain of the parties (where agreement was reached as a result of arm's-length bargaining between parties with adverse legal interests); (ii) the "residual" or "gap" method (subtract the value of the tangible assets, i.e. cash, cash equivalents and other tangible assets from the purchase price, and the remainder constitutes aggregate intangible asset value); (iii) the capitalization method (calculate the annual earnings of the business and subtract a fair return on tangible assets). *Concord Control, Inc. v. Commissioner*, 78 T.C. 742, 745-46 (1982). *See R.M. Smith, Inc. v. Commissioner*, 591 F.2d 248, 252-253 (3d Cir. 1979) (the residual method is inaccurate whenever the buyer paid too little or too much for the interest in the business); *Philip Morris, Inc. and Consol. Subs. v. Commissioner*, 96 T.C. 606 (1991), *affd. without published opinion*, 970 F.2d 897 (2d Cir. 1992) (residual method rejected because a control premium was included in price paid). Under the excess earnings approach to valuing goodwill reflected in Rev. Rul. 68-609, 1968-2 C.B. 327, the income attributable to tangible assets is deducted from net income of the business, and the remaining income is attributed to goodwill, which is then capitalized. *Philip Morris Inc. and Consol. Subsidiaries v. Commissioner*, 96 T.C. 606, 633 (1991).

B. COMMERCIAL OR ENTERPRISE GOODWILL VS. PERSONAL GOODWILL. Valuing the commercial or enterprise goodwill of a going business requires the valuator to differentiate the commercial or enterprise goodwill (or goodwill that can be transferred in a sale of the business) from the personal goodwill of the business owner (goodwill that cannot be transferred in the sale of the business if the owner leaves the business). This differentiation is complicated by the fact that some of the personal goodwill may actually transfer with the sale of the business if (i) the previous owner continues to work for the business, (ii) lends the use of his name or image to the business, or (iii) the previous owner has died, retires, relocates to another market or agrees not to compete with the business.

To determine commercial or enterprise goodwill the valuator must determine the fair market value of the business, then subtract the value of tangible assets and the value of intangible assets that are enforceable under contract or other law or are separable, leaving a residual goodwill. See Section III.A.2 above. The valuator next determines the reduction in profits resulting from the seller leaving the business, or competing with it, as the case may be. Capitalizing the remaining profit yields the business's commercial or enterprise goodwill.

1. Valuing Other Intangible Assets. An important step in the process of determining commercial or enterprise goodwill is assigning values to the intangible assets of the business other than goodwill. This reduces the portion of intangible value that must be allocated to residual goodwill. A checklist of non-goodwill intangible assets of a going business could be drawn from Internal Revenue Code § 197(d), including: going concern value; workforce in place; business books and records, operating systems, or any other information base; any patent, copyright, formula, process, design, pattern, knowhow, format, or other similar item; any customer-based intangible (i.e., composition of market, market share, and any other value resulting from future provision of goods or services pursuant to relationships, contractual or otherwise, in the ordinary course of business with customers); any supplier-based intangibles (i.e., value resulting from future acquisitions of goods or services pursuant to relationships, contractual or otherwise, in the ordinary course of business with suppliers of goods or services to be used or sold); any government-granted license, permit, or other right; any covenant not to compete entered into in connection with the acquisition of part or all of the business. In a divorce calculation, customer-based and supplier-based intangibles (and workforce in place) must be reduced to reflect the effect of the owner leaving the business

and even competing with it.

The valuation of intangible assets that are recognized as legally enforceable or separable is more concrete in the sense that these non-goodwill intangible assets are more susceptible to a replacement cost analysis or a market data analysis, and a reasonably accurate capitalization of earnings attributable to the asset can be achieved. For example, several cases have found that all goodwill of a franchise business resided in the franchise agreement. *See Canterbury v. Commissioner*, 99 T.C. 223, 249 (1992), and cased cited therein.

One might ask, if commercial or enterprise goodwill is considered to be what's left after subtracting the reduction in value resulting from the loss of the seller's personal goodwill, then why bother with the preliminary step of assigning values to other intangible assets? It is worthwhile to allocate intangible value between goodwill and other intangible assets in order to reduce the scope of the fight over what is commercial or enterprise goodwill and what is personal goodwill. Valuing non-goodwill intangible assets forces the valuator to be concrete on as many components of value as is possible, and it reduces the size of the "residual goodwill" that must be calculated by process of elimination. However, in many cases this may be a luxury that the client cannot afford.

The effort to individually value separable intangible assets can be time-consuming and therefore costly. Limited funding in a divorce may force the valuator to aggregate intangible assets for purposes of valuation.

2. Determining Personal Goodwill. This Article proposed that the first step in determining personal goodwill is to remove the factor of knowledge, skill and experience from the goodwill determination by including that factor in the adjustment made to normalize the owner's historical compensation. The remainder of the goodwill can then be divided into relationship-based personal goodwill and commercial or enterprise goodwill.

a. Adjusting for Knowledge, Skill and Experience. It is a thesis of this Article that, in using an excess earnings approach to valuing a business, the best way to account for the knowledge, skill, and experience component of personal goodwill is to adjust the level of reasonable compensation attributed to the owner. Dietrich, *Identifying and Measuring Personal Goodwill in a Professional Practice*, CPA EXPERT Spring 2005) [reprinted in the Dietrich *Segregating* article, p. 30-16] ("... some portion of the personal goodwill issue can often be minimized by properly addressing reasonable compensation"). A highly skilled, experienced professional perhaps is entitled to a higher level of compensation in national compensation surveys. For example, in a survey of all physicians, including all years of practice, an experienced physician would tend toward a higher percentile than younger physicians, and a specialist would tend toward a higher percentile than nonspecialists. If the physician in question is board certified, and the survey data reflects compensation of similar specialists, then a high level of skill may be assumed for all, and perhaps no special consideration of pushing the physician to the higher median levels is warranted, in that the level of skill is already expressed in the survey data. At any rate, in normalizing the seller's historical compensation, a compensation level will be reached that should permit the business to hire a replacement employee with knowledge, skill and experience comparable to the Seller's with no adverse effect on profitability.

b. Profits Tied to the Seller. It is another thesis of this Article that the relationship-based component of personal goodwill can best be measured by projecting the reduction in profits to the business that will occur after the seller leaves the business, or competes with it. If profits decline after the sale, and all other factors remain the same, then the amount of reduced profit is a measure of the relationship-based portion of the personal goodwill of the seller. This assumption is weakened in instances where the buyer brings personal goodwill to the business to replace the lost personal goodwill of the seller.

Mark Dietrich says that the lost-profits approach to determining personal goodwill is equivalent to the method of determining the value of a covenant not to compete. The Dietrich *Segregating* article p.

30-5 ("Measuring profits attributable to the seller is analogous to determining personal goodwill versus the enterprise (business) 'goodwill' or intangible value"). According to Dietrich, in determining the value of a covenant not to compete, the valuator must prepare an "alternate valuation" of the business, assuming that the seller leaves the business and competes with it. The Dietrich *Segregating* article, p. 30-5. The difference between the normal business valuation (assuming a continuation of historical profitability) and the alternate valuation is the value of the covenant not to compete. Where the seller leaves the business but does not intend to compete (death, retirement, relocation to another market), the "alternate valuation" would be made on the assumption that the seller leaves without competing.

The creation of an alternate-valuation could require some serious financial modeling that could cost more than the client wants or can afford to pay.

Determining how the seller's leaving the business, or competing with it, will affect that business will vary from business to business. When the valuation is undertaken in connection with divorce, the valuator cannot uncritically accept non-binding statements by the owner's "buddies" that favorable supply relationships, or customers, or sources of future business, or valued employees, will sever connections to the business if the owner sells. The risk of such severances should be objectively analyzed. While loyalty does exist, most people make business decisions based on self-interest, when the cost of loyalty is high.

A possible factor to consider in assessing the effect of future competition by the seller is any statutory or common law prohibitions against the seller's damaging the value of what he is selling, such as a common law protection of customer lists, prohibitions against soliciting employees or customers, a tort remedy for interference with business relations, a claim based on promissory estoppel, etc.

In states that do not tightly enforce covenants not to compete, the value of such a covenant, theoretically at least, should be diminished, and any market data regarding the sales of comparable businesses in that state would have increased importance in determining a value for divorce purposes, where the seller must factor in a loss of profits even with a covenant not to compete. An example is given in Dietrich, *Identifying and Measuring Personal Goodwill in a Professional Practice*, CPA EXPERT (Spring 2005) [reprinted in the Dietrich *Segregating* article, p. 30-15]. Dietrich discusses Texas Business & Commerce Code §15.50, which provides that covenants not to compete involving a physician cannot deny to the physician access to a list of his patients whom he has seen or treated within one year of the termination of employment. However, the language of the statute evidently relates to covenants not to compete incident to employment, and may or may not apply to covenants not to compete relating to the sale of a medical practice. Sales information from states with weak enforcement of covenants not to compete should be studied to see whether the combined sales price and cost of a covenant not to compete is less than in states that enforce such covenants. The factor of competition may prove to be less we imagine.

c. What's Left is Entity Goodwill. In an income approach, if the seller's historical compensation is adjusted to reflect his/her knowledge, skill and experience, and if the valuator adjusts the projection of future profits downward to reflect the loss of the seller's special relationships, then the personal goodwill portion of the overall goodwill of the business is measured by the reduction in future profits tied to the seller's leaving and competing. Any goodwill left after making these adjustments is, by process of elimination, commercial or enterprise goodwill.

C. HOW DOES PERSONAL GOODWILL COMPARE TO "HUMAN CAPITAL"? It is evident that the "human capital" of the seller has many of the earmarks of personal goodwill, which so many states say is not part of the marital estate to be divided upon divorce. It is legally easier to use alimony, and not property division, to address the income disparity arising from the spouses' investment during marriage in increasing the breadwinning spouse's human capital. But in property divisions, the community interest in a business should not be undervalued due to an

inaccurate view of what constitutes the tangible and intangible assets of the business, and what constitutes enterprise versus personal goodwill.

Even if the case law in a particular state has not recognized “human capital” as an asset to divide or as a factor to consider in awarding alimony upon divorce, a lawyer may want to prove up the value of the human capital or increased personal goodwill in support of an unequal property division, or some alternative theory of recovery, perhaps in equity, perhaps in some other area of law. Proving only the value of the business, including only enterprise goodwill, leaves the judge with no numbers to consider regarding the value of the personal goodwill of the breadwinning spouse.

In states that have long-term alimony, the forensic accountant may be asked to give opinion testimony about the actual cost of the spouses’ investment in human capital during marriage, the enhancement of the working spouse’s earning capacity, the loss in income-earning capacity of the spouse who did not develop a career during marriage, and the projected difference in post-divorce earnings.

Lastly, while the human capital of the business owner may not be divisible in a divorce in certain states, the human capital of employees of this business is part of enterprise goodwill, which is divisible in most states.

ENDNOTES

1. <http://home.uchicago.edu/~gbecker/Nobel/nobellecture.pdf> [8/20/2011].

2. <http://home.uchicago.edu/~gbecker/Nobel/nobellecture.pdf> [8/2/-2011].

3. <http://home.uchicago.edu/~gbecker/Nobel/nobellecture.pdf> [8/20/2011].

4. <http://www.nobelprize.org/nobel_prizes/economics/laureates/1979/presentation-speech.html> [8/20/2011].

5. <http://en.wikipedia.org/wiki/Human_capital> [9/20/2011].

6. Taken from Ronald L. Brown, VALUING PROFESSIONAL PRACTICES & LICENSES (3rd ed. Englewood Cliffs, NJ: Prentice-Hall, 1998) <http://www.unm.edu/~parkman/Goodwill.PDF> [9/20/2011].

7. <http://www.law.arizona.edu/faculty/FacultyPubs/Documents/Ibrahim/30DelJCorp%20L1.pdf> [9/20/2011].

8. <http://www.fasb.org> [9/20/2011].

9. <http://www.fasb.org> [9/20/2011].

10. <http://www.fasb.org> [9/20/2011].

11. <http://www.fasb.org> pp. 137-39 [9/20/2011].

12. <http://www.fasb.org/jsp/FASB/Page/10-18-06_bcam.pdf> [9/20/2011].

13. <http://www.willametteinsights.com/06/spring_2006_3.pdf> [9/20/2011].

14. <http://5317.vanbreda.org/readings/schuetze.pdf> ¶ 18, p. 8 [9/20/2011].

15. <http://www.sec.gov/news/speech/speecharchive/1998/spch219.htm> [9/20/2011].