

FAIR AND EQUITABLE DISTRIBUTION OF GOODWILL IN AN OHIO DIVORCE PROCEEDING

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I. INTRODUCTION

The treatment of goodwill in a divorce proceeding has been hotly debated among the jurisdictions over the last twenty-five years.¹ This debate has resulted in a sharp, policy-oriented division among the states.² Ohio attorneys should be especially interested in this topic because the Supreme Court of Ohio has not yet decided how goodwill should be treated in a divorce proceeding. At a minimum, Ohio attorneys should be cognizant of the argument for bifurcating goodwill into enterprise goodwill and personal goodwill, because a successful claim has the potential to save a client hundreds, thousands, or even millions of dollars.³

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¹ Compare e.g. *Holbrook v. Holbrook*, 309 N.W.2d 343 (Wis. App. 1981) with e.g. *Dugan v. Dugan*, 457 A.2d 1 (N.J. 1983).

² See *infra* Sections II(B)(1)-(3) and accompanying text (discussing the three approaches that split the jurisdictions regarding the treatment of goodwill in a divorce proceeding).

³ Consider the following perspective posed by Grover Rutter, CPA/ABV, CVA, BVAL who specializes in business valuation litigation and divorce support in Ohio:

In the October 9, 2000 edition of Ohio Lawyers Weekly, I read with great interest the summary of *Clymer v. Clymer* (Lawyers Weekly No. 110-419-00). While the contentions of the case seemed to deal with the methodology of calculating practice/business goodwill, as opposed to specific arguments over personal professional goodwill, I found the outcome to be very telling. The trial court judge found that the proper use of the "capitalization of excess earnings method" was an acceptable method for determining the amount of, or lack of, professional goodwill to be allocated directly to the business entity. In this case, the capitalization of excess earnings method, based upon four years of actual earnings history, indicated there was no goodwill associated with the law practice. The final value, with practice/business goodwill calculated to be zero, amounted to \$65,471 which was only the value of the net tangible assets.

However, the wife's Columbus attorney said he found it "interesting" that the husband's expert found no goodwill value in the firm when, 30 days after the appraisal date, the husband signed a mutual buy-out agreement with a price term of around \$900,000.

An attorney representing a client in a divorce proceeding should always try to maximize the amount of separate property that is awarded to his or her client. This is important in divorce litigation because a spouse's separate property is not subject to division,⁴ while any property classified as marital property is subject to equitable distribution among the spouses.⁵ One successful strategy, used by attorneys in twenty-five states, is to claim as separate property any personal goodwill attributed to their client pursuant to the valuation of a professional practice or closely held business.⁶ Courts receptive to this argument hold that any personal goodwill attributed solely to the supporting spouse is deemed separate property.

Several Ohio appellate courts, however, have been hesitant to accept the argument for the bifurcation of goodwill into enterprise and personal goodwill.⁷ Conversely, some Ohio appellate courts hold that the goodwill of a professional practice or closely held business, attributable to the continued presence of the supporting spouse, should not be subject to equitable distribution pursuant to a divorce proceeding.⁸ The Supreme Court of Ohio will ultimately have to decide how the goodwill of a professional practice or closely held business should be treated in a divorce proceeding. The purpose of this comment is to survey the current law among the states regarding the treatment of goodwill in divorce proceedings, as well as to advocate the majority position which bifurcates goodwill into enterprise and personal goodwill.

I have one possible answer to the attorney's "interesting" comment about the high buyout amount of \$900,000. One should consider the possibility that the husband's expert was only trying to value professional practice/business goodwill value, and not the personal professional goodwill value that was actually attributable to the individual professional.

Grover Rutter, *Personal Professional Goodwill: Too Often Overlooked in Equitable Distribution Cases*, <http://www.divorcehq.com/articles/goodwill.html> (accessed April 6, 2005).

⁴ Ohio Rev. Code Ann. § 3105.171 (D) (Anderson, Lexis current through June 17, 2005).

⁵ *Id.* at § 3105.171 (C)(1).

⁶ 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 v. Richmond*, 779 P.2d 1211 (Alaska 1989); *Wilson v. Wilson*, 741 S.W.2d 640 (Ark. 1987); *Eslami v. Eslami*, 591 A.2d 411 (Conn. 1991); *E.E.C. v. E.J.C.*, 457 A.2d 688 (Del. 1983); *McDiarmid v. McDiarmid*, 649 A.2d 810 (D.C. 1994); *Thompson v. Thompson*, 576 So. 2d 267 (Fla. 1991); *Antolik v. Harvey*, 761 P.2d 305 (Haw. App. 1988); *In re Marriage of Talty*, 652 N.E.2d 330 (Ill. 1995); *Yoon v. Yoon*, 711 N.E.2d 1265 (Ind. 1999); *Prahinski v. Prahinski*, 540 A.2d 833 (Md. Spec. App. 1988); *Goldman v. Goldman*, 554 N.E.2d 860 (Mass. App. 1990); *Sweere v. Gilbert-Sweere*, 534 N.W.2d 294 (Minn. App. 1995); *Singley v. Singley*, 846 So. 2d 1004 (Miss. 2002); *Hanson v. Hanson*, 738 S.W.2d 429 (Mo. 1987); *Taylor v. Taylor*, 386 N.W.2d 851 (Neb. 1986); *In re Watterworth*, 821 A.2d 1107 (N.H. 2003); *Travis v. Travis*, 795 P.2d 96 (Okla. 1990); *In re Marriage of Lankford*, 720 P.2d 407 (Or. App. 1986); *Solomon v. Solomon*, 611 A.2d 686 (Pa. 1992); *Moretti v. Moretti*, 766 A.2d 925 (R.I. 2001); *Nail v. Nail*, 486 S.W.2d 761 (Tex. 1972); *Sorensen v. Sorensen*, 839 P.2d 774 (Utah 1992); *Howell v. Howell*, 523 S.E.2d 514 (Va. App. 2000); *Holbrook*, 309 N.W.2d 343 (Wis. App. 1981); *May v. May*, 589 S.E.2d 536 (W. Va. 2003); *Root v. Root*, 65 P.3d 41 (Wyo. 2003).

⁷ See *Kahn v. Kahn*, 536 N.E.2d 678 (Ohio App. 2d Dist. 1987); *Goswami v. Goswami*, 787 N.E.2d 26 (Ohio App. 7th Dist. 2003).

⁸ See *Flexman v. Flexman*, 1985 Ohio App. LEXIS 7061 (Ohio App. 2d Dist. Aug. 28, 1985); *Young v. Young*, 1999 Ohio App. LEXIS 1744 (Ohio App. 5th Dist. Apr. 19, 1999); *Arena v. Arena*, 1995 Ohio App. LEXIS 4261 (Ohio App. 10th Dist. Sept. 29, 1995).

Section II of this comment defines the general concept of goodwill, and explains the definitions and distinctions between enterprise and personal goodwill. Additionally, Section II surveys the different approaches among courts in the United States regarding the classification of goodwill in the context of equitable distribution. Section III offers an effective argument strategy to Ohio attorneys wishing to advocate for a distinction between enterprise and personal goodwill when valuing a professional practice or closely held business in a divorce proceeding. This section also advocates the policy arguments supporting the bifurcation of enterprise and personal goodwill. Section IV will urge the Supreme Court of Ohio to step in line with the majority of states and hold that goodwill should be divided into enterprise goodwill and personal goodwill based upon the facts of each case and upon accepted accounting methodologies.

II. BACKGROUND

A. *Understanding the Concept of Goodwill in the Context of a Professional Practice or Closely Held Business.*⁹

This background section serves to educate the reader about the various concepts regarding goodwill and examines the three main approaches courts consider for the treatment of goodwill in divorce proceedings. The logical starting point is to define the concept of goodwill. Justice Story, in *Commentaries on the Law of Partnership*, offered the classic definition of goodwill: “The ‘good will’ of a business is the expectation of continued public patronage.”¹⁰ Courts in Ohio have adopted and expanded Justice Story’s definition of goodwill to include:

[T]he 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.¹¹

It is apparent from the preceding definitions that goodwill is an intangible asset. It is important to emphasize that absent the actual sale of a business, goodwill may only be realized through future profits. From an accounting perspective, goodwill is the excess of the value of a business

⁹ A closely held corporation is a “corporation whose stock is not freely traded and is held by only a few shareholders (often within the same family).” *Black’s Law Dictionary* 365 (Bryan A. Garner ed., 8th ed., West 2004).

¹⁰ Joseph Story, *Commentaries on the Law of Partnership* 170, § 99 (6th ed., W.S. Hein 1868).

¹¹ *Spayd v. Turner, Graznow & Hollenkamp*, 482 N.E.2d 1232, 1236 (Ohio 1985) (citing Story, *Commentaries on the Law of Partnership* at 170, § 99).

over the market value of the business's individual assets.¹² There are numerous valuation methods that are utilized to appraise goodwill.¹³ For the purposes of this article, however, a brief explanation is sufficient.

To calculate the goodwill of a professional practice or closely held business, all of the business's tangible assets must first be appraised.¹⁴ For example, a business valuation expert may determine that a certain business possesses \$50,000 in tangible assets consisting of furniture, machinery, and office supplies. Next, this figure must be compared to what a willing purchaser would pay for the business on the open market. For example, even though a business only possesses \$50,000 in tangible assets, a purchaser may be willing to pay \$150,000 for the business. The difference of \$100,000 represents the total goodwill of the business. In this situation the purchaser is willing to make the investment only because he believes that the return on investment is attractive enough to justify the cost. In other words, the purchaser is anticipating future earnings.

A majority of jurisdictions take an additional step when calculating goodwill and require the valuation expert to divide the overall goodwill between enterprise and personal goodwill.¹⁵ These jurisdictions generally look to the precise nature of the goodwill to partition the goodwill as the two separate components of enterprise goodwill and personal goodwill.¹⁶ According to these jurisdictions, enterprise goodwill is generally defined by case law as follows:

Enterprise goodwill attaches to a business entity and is

¹² John J. Young, *Analyzing the Economic Benefits of Goodwill, No Magic Formula Drives the Process but Methodologies Identify the Factors to Consider*, 229 N.Y. L. J. s4 col. 1 (May 27, 2003). "For example, if a business is determined to be valued at \$1 million and the aggregate value of its individual assets, both tangible and intangible, is determined to be \$600,000, then the excess, or \$400,000, would be considered the value of goodwill." *Id.*

¹³ A number of valuation methods are available to determine the value of goodwill in a professional practice or closely held business. The most commonly used methods are fair market value, capitalization methods, percentage of net gross or profits, and use of a buy-sell agreement or shareholder agreement. For an excellent explanation of each of these methods in the context of evaluating goodwill see the article by Helga White. Helga White, *Comment: Professional Goodwill: Is it a Settled Question or is There "Value" in Discussing it?*, 15 J. Am. Acad. Matrimonial Law. 495 (1998).

¹⁴ *Supra* n. 12.

¹⁵ *Supra* n. 6.

¹⁶ For example, in *Lopez v. Lopez* the court listed the following factors that should be considered when valuing personal goodwill: (1) the age and health of the professional; (2) the professional's demonstrated earning power; (3) the professional's reputation in the community for judgment, skill, and knowledge; (4) the professional's comparative professional success; and (5) the nature and duration of the professional's practice, either as sole proprietor or as a contributing member of a partnership or professional corporation. 1974 Cal. App. LEXIS 1040 at *23 (Mar. 26, 1974). Conversely, the following factors indicate the presence of enterprise goodwill: (1) a large business which has formalized its institutional structures and institutionalized its systems and controls; (2) the professional has a pre-existing covenant not to compete; (3) the business is not heavily dependent on personal services; (4) the business has significant capital investments in tangible assets; (5) the company has more than one owner, some of whom are not employees; (6) company sales result from the business name recognition, sales force, sales contracts, and other company-owned intangibles; and (7) the company has supplier contracts and formalized production methods, patents, copyrights, and business systems. *Tresco Dealerships, Inc., A Success Story in Reducing Tax Costs from an Asset Sale*, AZ Insights (newsletter of Anderson ZurMuehlen & Co.) 2 (Spring 2004) [hereinafter *Tresco Dealerships*].

associated separately from the reputation of the owners. Product names, business locations, and skilled labor forces are common examples of enterprise goodwill. The asset has a determinable value because the enterprise goodwill of an ongoing business will transfer upon sale of the business to a willing buyer.¹⁷

Similarly, personal goodwill is generally defined in the following manner:

[P]ersonal goodwill is associated with individuals. It is that part of increased earning capacity that results from the reputation, knowledge and skills of individual people. Accordingly, the goodwill of a service business, such as a professional practice, consists largely of personal goodwill.¹⁸

The legal implication of this distinction is that any value attributed to enterprise goodwill is classified as marital property, thus subject to equitable distribution.¹⁹ Conversely, any value attributed to personal goodwill is deemed to be separate property. Put simply, these jurisdictions consider personal goodwill to be an intangible asset that cannot be separated from the person, as it is not marketable or saleable.²⁰ Thus, those courts refuse to award a spouse one half of any value attributed to personal goodwill.²¹

B. *Approaches*

There is a split among states regarding the treatment of goodwill in a divorce proceeding. Eight states, including Ohio, have not decided the issue,²² 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.²³ The minority position holds that all

¹⁷ Courtney E. Beebe, *The Object of My Appraisal: Idaho's Approach to Valuing Goodwill as Community Property in Chandler v. Chandler*, 39 Idaho L. Rev. 77, 83-84 (2002). See also *Frazier v. Frazier*, 737 N.E.2d 1220, 1225 (Ind. App. 2000) ("Enterprise goodwill is based on the intangible, but generally marketable, existence in a business of established relations with employees, customers and suppliers, and may include a business location, its name recognition and its business reputation.").

¹⁸ Diane Green Smith, *Til Success Do Us Part: How Illinois Promotes Inequities in Property Distribution Pursuant to Divorce by Excluding Professional Goodwill*, 26 John Marshall L. Rev. 147, 164-65 (1992).

¹⁹ See *infra* § II(B)(1).

²⁰ *Id.*

²¹ *Id.*

²² Alabama, Georgia, Idaho, Iowa, Maine, Ohio, South Dakota, Vermont.

²³ 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

goodwill is marital property.²⁴ Lastly, four states hold that goodwill is never marital property.²⁵

1. The Majority Position: Enterprise Goodwill is Properly Considered Marital Property, While Personal Goodwill is Separate Property.

Upon dissolution of a marriage, the majority position reasons that a spouse should be entitled to half of the marital assets and not half of the marital spouse. Therefore, if a portion of the goodwill can be attributed solely to the business and can be realized by sale, then that portion of the goodwill is marital property and properly subject to equitable distribution. Courts classify this type of goodwill as enterprise goodwill.²⁶

However, the majority position also allows evidence to prove what portion of value, if any, of the business is purely attributed to the reputation or presence of the supporting spouse. The majority holds that the goodwill that depends on the continued presence of the supporting spouse is personal

(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).

²⁴ 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); *Stuftt v. Stuftt*, 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).

²⁵ 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). It should be noted that scholars and courts, which have analyzed the states that do not include goodwill as marital property, have also asserted that the State of Mississippi takes this position. See *May*, 589 S.E.2d at 544 (stating that Mississippi takes the position that neither personal nor enterprise goodwill in a professional practice constitutes marital property). I decline to characterize Mississippi as a state that does not include goodwill as marital property because although the Supreme Court of Mississippi has held that “goodwill is simply not [marital] property[,] thus it cannot be deemed a divisible marital asset in a divorce action.” The Supreme Court of Mississippi has also stated the following:

We recognize however that regardless of what method an expert might choose to arrive at the value of a business, the bottom line is one must arrive at the “fair market value” or that price at which property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of the relevant facts.

Singley 846 So. 2d at 1011.

The characterization of Mississippi as a state that does not include goodwill as marital property is misplaced when one realizes that the “fair market value” of a professional practice or closely held business places a value on goodwill “only to the extent that goodwill is separable from the professional’s reputation.” *White*, *supra* n. 13, at 522. Thus, it is clear that Mississippi actually allows equitable distribution of enterprise goodwill, and disallows equitable distribution of personal goodwill. Therefore, for the purposes of this article, I include Mississippi as one of the states that follows the majority position that enterprise goodwill is properly considered marital property, while personal goodwill is separate property.

²⁶ *May*, 589 S.E.2d at 541. Enterprise goodwill is also called commercial goodwill. *Id.*

goodwill²⁷ and does not subject personal goodwill to equitable distribution.²⁸ These courts reason that personal goodwill is not a marketable asset capable of being separated from the individual.²⁹ Personal goodwill is not alienable, and the value of personal goodwill cannot survive the disassociation of the individual from the business.³⁰ Therefore, any value that attaches to a business as a result of personal goodwill represents nothing more than future earning capacity of the individual.³¹ While the future earning capacity of a supporting spouse is relevant in determining alimony, it is not a proper consideration in the division of marital property.³²

Similarly, some courts espousing the majority position reason that only items instilled with the traditional indicia of property are rightly subject to division by decree of the court.³³ More specifically, the economic value must be transferable, assignable, devisable, or subject to conveyance, sale, pledge, or inheritance in order for it to be subject to equitable distribution.³⁴ These courts adhere to the view that personal goodwill does not possess value, nor does it constitute an asset that can be separated from the individual or the individual's ability to practice his profession.³⁵ Therefore, they reason that at the time of divorce, there is no vested property right in personal goodwill because this value would be extinguished in the event of death, retirement, disability, or sale of the business.³⁶ These courts characterize personal goodwill as merely an expectancy interest that is wholly dependent upon the continuation of existing circumstances—mainly, the continued presence of the individual.³⁷ Thus, they refuse to make a division and award of a mere expectancy interest because it cannot actually be realized.³⁸

A good illustration of the majority position is *Butler v. Butler*.³⁹ Carol Butler and Leon Butler were married for twenty-four years.⁴⁰ On the date of divorce Mr. Butler was a certified public accountant and one of three partners in an accounting firm.⁴¹ A master heard evidence and submitted a recommendation as to the valuation of Mr. Butler's business interest in the accounting firm.⁴² The master assigned a value to the firm which included a large number that an expert classified as a goodwill value "attributable to

²⁷ *Id.* at 545. Personal goodwill is also sometimes called professional goodwill. *Id.* at 541.

²⁸ *Yoon*, 711 N.E.2d at 1269.

²⁹ *Butler v. Butler*, 663 A.2d 148, 155 (Pa. 1995).

³⁰ *Id.*

³¹ *Yoon*, 711 N.E.2d at 1269.

³² *Butler*, 663 A.2d at 156 (citing *Hodge v. Hodge*, 520 A.2d 15, 17 (Pa. 1986)).

³³ *Prahinski*, 540 A.2d at 840.

³⁴ *Id.*

³⁵ *Nail*, 486 S.W.2d at 764.

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ 663 A.2d 148.

⁴⁰ *Id.* at 150.

⁴¹ Therefore, Mr. Butler had a 33% interest in the accounting firm. *Id.*

⁴² *Id.*

the reputation and client base of the accounting firm as a whole.”⁴³

Evidence suggested that Mr. Butler had a particular client base consisting of the Greek community who were loyal to him and not the firm.⁴⁴ The evidence showed that if Mr. Butler were to leave the accounting firm, those clients would likely follow him.⁴⁵ Additionally, Ms. Butler’s expert testified that if Mr. Butler were to leave the partnership, he would receive a value of at least \$182,000, which would represent the client base that Mr. Butler could take with him.⁴⁶

On these facts the Supreme Court of Pennsylvania reversed and remanded the master’s conclusion as to the value of Mr. Butler’s interest in the accounting firm for the purpose of equitable distribution.⁴⁷ The court held that goodwill that is intrinsically tied to the attributes or skills of the individual is simply not subject to equitable distribution.⁴⁸ The court reasoned that goodwill of a personal nature, while capable of being realized as long as Mr. Butler continues to practice as a certified public accountant, cannot be viewed as a value to the business as a whole because it certainly is not alienable.⁴⁹ Therefore, goodwill of a personal nature is not presently capable of being realized and is not a proper consideration for the purpose of equitable distribution.⁵⁰

2. The Minority Position: All Goodwill is Properly Considered Marital Property.

The thirteen states that take the minority position hold, by means of judicial precedent or statute, that any goodwill value of a professional

⁴³ *Id.* at 151. The following is the exact findings of the master regarding Mr. Butler’s interest in the accounting firm:

[T]he master acknowledged the Wife’s expert’s valuation as being \$576,889. The master then notes that he would value this accounting firm at \$497,395, which represents the intangible value assigned by Mr. Plesic [(Ms. Butler’s expert)], and Husband’s interest therein as 1/3 of that figure or \$165,798.33. The master also determined that the shareholders themselves valued the partnership with its client base at \$300,000. In reaching this determination, the Master apparently relied upon the buy/sell provision contained in the shareholder agreement which relates to the death of a shareholder. In other words, since there were then three shareholders for whom life insurance policies of \$100,000 each were in effect, the Master believed the shareholders themselves had assigned a value to the firm, including its client base, of \$300,000. In his final analysis, however, the Master concluded that an average of this \$300,000 figure and that assigned by Mr. Plesic would be “closest to the fact and most fair to both parties.” In so doing, however, the master employed the value of \$546,889 rather than \$576,889 as he had initially noted. Thus, he assigned a value of \$423,444.50 to the entire firm and a value of \$141,148.16 as representing Husband’s one-third interest.

Id. (citations to the record omitted).

⁴⁴ *Id.* at 156.

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *Id.* at 157.

⁴⁸ *Id.* at 155.

⁴⁹ *Id.*

⁵⁰ *Id.*

practice or closely held business is marital property subject to division in a dissolution proceeding.⁵¹ Those states generally take the view that goodwill is property, and furthermore, that goodwill is transferable and marketable.⁵² This is true even though many of these courts recognize that goodwill has a limited marketability⁵³ and is not readily saleable.⁵⁴

The reasoning behind the minority position varies. Five of the thirteen states are community property states.⁵⁵ Under principles of community property law, to the extent that a business or practice has been developed during the marriage, there is a community property interest that must be apportioned pursuant to dissolution.⁵⁶ Even if the business cannot be sold on the open market, the law of these states assumes that the business will continue operating and will not lose any customers that would otherwise have been lost if it were sold to another owner.⁵⁷ These states assume that both spouses contributed equally to the goodwill value of the business; therefore, this value is subject to equal division between the spouses.

Other states that take the minority position reason that the marriage relationship is an economic partnership and that spouses have an equitable claim to “things of value” arising out of the marital relationship.⁵⁸ Goodwill is definitionally a *thing of value*. As such, the goodwill of the professional practice or closely held business is subject to equitable distribution.

3. Goodwill is never marital property.

Only four states take the position that goodwill is not marital property subject to distribution.⁵⁹ In relevant decisions, the courts in these states decide the issue in the context of the valuation of a professional practice.⁶⁰ The reasoning behind this position is analogous to those states

⁵¹ Arizona, California, Colorado, Kentucky, Michigan, Montana, Nevada, New Jersey, New Mexico, New York, North Carolina, North Dakota, Washington. See *Wisner*, 631 P.2d 115 (Arizona); *Lopez*, 1974 Cal. App. LEXIS 1040 (California); *Huff*, 834 P.2d 244 (Colorado); *Heller*, 672 S.W.2d 945 (Kentucky); *Kowalesky*, 384 N.W.2d 112 (Michigan); *Stufft*, 950 P.2d 1373 (Montana); *Ford*, 782 P.2d 1304 (Nevada); *Dugan*, 457 A.2d 1 (New Jersey); *Hurley*, 615 P.2d 256 (New Mexico); *Moll*, 722 N.Y.S.2d 732 (New York); *Poore*, 331 S.E.2d 266 (North Carolina); *Sommers*, 660 N.W.2d 586 (North Dakota); *Hall*, 692 P.2d 175 (Washington).

⁵² *Dugan*, 433 A.2d at 4.

⁵³ *Poore*, 331 S.E.2d at 271; *Ford*, 782 P.2d at 1310.

⁵⁴ *Hall*, 692 P.2d at 177.

⁵⁵ Arizona, California, Nevada, New Mexico, Washington. See *Wisner*, 631 P.2d 115 (Arizona); *Lopez*, 1974 Cal. App. LEXIS 1040 (California); *Ford*, 782 P.2d 1304 (Nevada); *Hurley*, 615 P.2d 256 (New Mexico); *Hall*, 692 P.2d 175 (Washington).

⁵⁶ Glen L. Rabenn, *California Community Property FAQs*, <http://www.divorcenet.com/states/california/cafaq03/view> (last updated Mar. 17, 2005, 9:13 a.m.).

⁵⁷ *Id.*

⁵⁸ *Moll*, 722 N.Y.S.2d at 735.

⁵⁹ Kansas, Louisiana, South Carolina, Tennessee. See *Powell*, 648 P.2d 218 (Kansas); *Pearce*, 482 So. 2d 108 (Louisiana); *Donahue*, 384 S.E.2d 741 (South Carolina); *Smith*, 709 S.W.2d 588 (Tennessee).

⁶⁰ *Powell*, 648 P.2d at 223-24 (holding that goodwill in a surgeon's professional practice is not an asset subject to division in a divorce action); *Chance*, 694 So. 2d at 617 (holding that goodwill does not form a part of the corporate assets of a medical practice); *Donahue*, 384 S.E.2d at 745 (holding that the family court erred in placing a value upon the goodwill of a dental practice); *Smith*, 709 S.W.2d at 591-92 (holding that the value of a law practice shall not include the goodwill of the firm). *But see Casey v.*

that refuse to include personal goodwill as a marital asset.⁶¹ The four states that take the position that goodwill is not a marital asset reason that the intrinsic nature of a professional practice is such that it is totally dependent on the professional.⁶² They focus on the intangibility of goodwill and conclude that any valuation of this intangible asset is purely speculative.⁶³ Consequently, these states refuse to place an economic value on the goodwill of a professional practice.⁶⁴ Under this view, the non-supporting spouse is often barred from collecting money from the professional practice, as many professional practices have little or no value apart from the goodwill.⁶⁵

III. ANALYSIS

The Supreme Court of Ohio, when faced with the issue of valuing goodwill in a divorce proceeding, should adopt the majority position which differentiates between personal goodwill and enterprise goodwill and should allocate personal goodwill as a separate asset. Ohio should adopt the majority position because the policy arguments supporting this position are rational and result in an equitable division of property. This section serves to guide Ohio attorneys in three areas. First, it will examine the way that goodwill has been treated among the Ohio appellate jurisdictions. Second, it will describe certain indicators of personal goodwill that an attorney can look to prior to an appraisal. Finally, this section will examine the main policy arguments for the treatment of goodwill that are advanced by the minority and majority positions.

Casey, 362 S.E.2d 6, 7 (S.C. 1987) (holding, with minimal discussion, that goodwill in a fireworks business does not constitute marital property subject to equitable distribution).

⁶¹ Indeed, many of these states adopt the reasoning and analysis of a case from the Wisconsin Court of Appeals which holds that personal goodwill is separate property while enterprise goodwill is marital property subject to distribution. *Holbrook*, 309 N.W.2d at 350-51. The Wisconsin Court of Appeals stated:

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.

Id. at 354.

⁶² *Powell*, 648 P.2d at 223.

⁶³ *Donahue*, 384 S.E.2d at 745.

⁶⁴ *Id.*

⁶⁵ *Id.*

A. *The Ohio Appellate Courts' Treatment of Goodwill in a Divorce Proceeding.*

The treatment of goodwill for the purpose of equitable distribution in a divorce proceeding is an issue of first impression for the Supreme Court of Ohio. The approaches that the Ohio appellate courts have taken are widely varied.⁶⁶ Current precedent gives little guidance to the practicing attorney because it often fails to adequately explain the issue. Nonetheless, Ohio courts recognized the concept of personal goodwill as early as 1906.⁶⁷ In *Wheeling v. Parker*, the court stated that the value of the business of an insurance agent consisted of personal goodwill and described it as follows: “[I]t is that which he may be able to maintain if he lives and which is at once cut off if he dies, growing out of his affability, growing out of his capacity for business and his knowledge of insurance, and the clientage he has built up.”⁶⁸ The Supreme Court of Ohio has determined, however, that upon dissolution of a business partnership, it is not against public policy to include the “measurable” goodwill as an asset of a business.⁶⁹ In light of this decision, some Ohio appellate courts have held that professional

⁶⁶ See *infra* nn. 71-78 and accompanying text.

⁶⁷ *Wheeling v. Parker*, 9 Ohio C.C. (n.s.)28, 35 (6th Cir. 1906).

⁶⁸ *Id.* See also *Scranton v. Slack*, 1981 Ohio App. LEXIS 10387 at *5 (Ohio App. 6th Dist. May 1, 1981) (stating that the goodwill of a barber shop was personal to the plaintiff-beautician and other beauticians, and there is no duty to account for personal goodwill on dissolution of the partnership).

⁶⁹ *Spayd*, 482 N.E.2d at 1238. There are three points of interest in this case that should be addressed. First, the court never defined “measurable” goodwill. Instead, the court cited the following definition of goodwill in the opinion:

[T]he 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.

Id. at 1236 (citing Story, *Commentaries on the Law of Partnership* at 170, § 99). Second, the Supreme Court of Ohio agreed with the following “statements” made by the Supreme Court of New Jersey:

Though other elements may contribute to goodwill in the context of a professional service, such as locality and specialization, reputation is at the core 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.

Spayd, 482 N.E.2d at 1239 (citing *Dugan*, 457 A.2d at 6). Although the holding in *Dugan* is contrary to the argument that I advance in this comment, the Supreme Court of Ohio did not affirm that holding. Furthermore, the “statements” that the Supreme Court of Ohio did affirm merely illustrate that a professional practice may establish a reputation as a business entity and further that the reputation of a business entity that leads to probable future patronage is goodwill subject to equitable distribution. In the context of this comment, the goodwill that attaches to a business entity is referred to as enterprise goodwill and is properly subject to equitable distribution. Last, the court refused to address whether the goodwill of a sole practitioner in a law firm is a saleable asset. *Id.* at 1236.

goodwill is marital property and is an important part of the valuation of a professional practice in a divorce proceeding.⁷⁰

Notwithstanding, several Ohio appellate courts have concluded that the goodwill of a professional practice or closely held business that is attributed to the continued presence of the supporting spouse should not be subject to equitable distribution pursuant to a divorce proceeding. For example, in *Flexman v. Flexman*, the husband was the sole proprietor of a psychiatry practice.⁷¹ The court refused to include goodwill as a factor in determining the value of the professional corporation.⁷² The court stated that in such a personal corporation, the goodwill “attaches to the person and follows him wherever he may go.”⁷³ Similarly, in *Young v. Young*, the court determined that the husband’s involvement in a small newspaper business was an essential element of its value.⁷⁴ There was evidence that showed that the only revenue the newspaper earned was through advertising and that the personal relationships that the husband developed with his advertisers were extremely important for the purposes of valuation.⁷⁵ Thus, the court opined that the value of the business was diminished without the husband’s continued association and determined that the value of the business was a mere \$19,000.⁷⁶ Finally, in *Arena v. Arena*, the court held that the husband’s produce business had no goodwill value apart from the husband’s continued presence.⁷⁷ The court determined that there was credible evidence which established that any value above the tangible assets of the produce company could not be separated from the husband’s physical presence.⁷⁸

B. *Personal Goodwill Indicators.*

To make a successful argument for the bifurcation of goodwill, an

⁷⁰ *Kahn*, 536 N.E.2d at 682. See also *Reichert v. Reichert*, 1992 Ohio App. LEXIS 294 at *5 (Ohio App. 3d Dist. Jan. 17, 1992) (holding that goodwill of a professional enterprise is an asset to be considered in the trial court’s distribution of marital assets for purposes of property settlement in a divorce action).

⁷¹ 1985 Ohio App. LEXIS 7061 at *10.

⁷² *Id.* It should be noted that although this case was decided after the decision of the Supreme Court of Ohio in *Spayd*, 482 N.E.2d 1232, the judges in *Flexman* relied upon the lower court’s decision in *Spayd* which rejected goodwill as an asset pursuant to the dissolution of a professional partnership. *Flexman*, 1985 Ohio App. LEXIS 7061 at *10.

⁷³ *Id.* Additionally, the court emphasized the fact that “the right to practice professionally is a valuable personal right; however, it is not an asset that can be divided, transferred, or assigned to another.” *Id.* at *7.

⁷⁴ 1999 Ohio App. LEXIS 1744 at *15.

⁷⁵ *Id.*

⁷⁶ *Id.* at *16.

⁷⁷ 1995 Ohio App. LEXIS 4261 at *24.

⁷⁸ *Id.* at *20. See also *Moore v. Moore*, 2003 Ohio App. LEXIS 3047 at **6-7 (Ohio App. 3d Dist. June 26, 2003) (holding that the husband’s trucking business had zero value because the husband relied exclusively on another company for its business, and the husband’s business had a lack of customer and employee base, management team, ongoing contracts, longstanding relationships with financial institutions, established earning history, and maintenance facilities); *Battler v. Battler*, 1994 Ohio App. LEXIS 57 at *15 (Ohio App. 8th Dist. Jan. 13, 1994) (holding that there was no goodwill in the husband’s distributing company because the operational existence of the company was directly related to the continued presence of the husband); *Goswami*, 787 N.E.2d at 33 (stating in dicta: “[t]here are some problems, though, with valuing the goodwill of a one-person medical practice because any goodwill would be personal to the individual doctor such that it would be unalienable and untransferable”).

Ohio attorney must be confident that the client actually possesses personal goodwill.⁷⁹ Prior to an appraisal, there are certain factors that an attorney can look to that indicate the presence of personal goodwill. Each of the following personal goodwill indicators assist in determining how much of the business would be lost if any of the key individuals were to leave the business:⁸⁰ (1) the client-owner is personally involved with all of the business's customers;⁸¹ (2) the client-owner would have to agree to not compete with a potential purchaser of the business;⁸² and (3) the business is dependent on the client-owner's personal services and his or her ability to generate new work.⁸³

1. *Sales Largely Depend on the Employee-Owner's Personal Relationships with Customers.*⁸⁴

If a client is personally involved with all of the business's customers or with the business's major customers, he will most likely possess personal goodwill. Personal goodwill is present in this situation because, if a client were to leave the company, there is a great chance that those customers that he has developed a relationship with may leave as well. Put simply, there is a direct correlation between the continued presence of the individual and the earning capacity of the company. For example, in *Moretti v. Moretti*, the husband owned and operated a landscaping business.⁸⁵ The husband was the only person who dealt with the clients, and his only employees were six

⁷⁹ Even before an attorney determines that his or her client possesses personal goodwill, he or she must determine that goodwill actually exists in the client's professional practice or closely held business. From an accounting perspective, goodwill is the excess of the value of a business over the fair market value of the business's individual assets. Young, *supra* n. 12. Customarily, a business valuation expert is hired to value the goodwill of a professional practice or business. In Ohio, as in most jurisdictions, courts do not require the adoption of any particular method of valuation, nor are they prevented from using any method. *James v. James*, 656 N.E.2d 399, 407 (Ohio App. 2d Dist. 1995). However, it is in the best interest of the attorney who engages a business valuation expert to discuss upfront the argument that he or she is advancing for the treatment of goodwill in order to ensure that the proper methodology is utilized.

⁸⁰ Oftentimes business valuation experts only consider the value of personal goodwill that the client possesses. Yet, other key individuals within the business may hold personal goodwill as well. If those individuals are not considered, their personal goodwill will be included as the enterprise goodwill of the entity. To illustrate this, consider a situation where a:

[m]edical practice . . . contains three physicians in which one physician is getting a divorce. In this case, the business valuation expert would be asked to value the physician's interest in the practice excluding personal goodwill. To do this, the business valuation expert would need to exclude all personal goodwill of the practice and not just the personal goodwill of the physician getting divorced. This is a common mistake made in divorce valuations involving this issue.

National Legal Research Group, Inc., *Business Valuations in a Divorce Setting*, "Distinguishing Between Personal and Enterprise Goodwill," <http://www.divorcesource.com/research/dl/valuation/02jul128.shtml> (accessed March 12, 2005).

⁸¹ *Tresco Dealerships*, *supra* n. 16, at 1-2.

⁸² *Id.*

⁸³ *Lankford*, 720 P.2d at 408.

⁸⁴ *Tresco Dealerships*, *supra* n. 16, at 1-2.

⁸⁵ 766 A.2d at 927.

workers who spoke little or no English.⁸⁶ The valuation expert offered evidence that the earning capacity of the company was based on the husband's ability to maintain his relationships with the customers.⁸⁷ Furthermore, the evidence indicated that the business would only be worth the value of the tangible assets if the husband were to pass away.⁸⁸ The court held that this evidence signified personal goodwill and remanded the case so that enterprise goodwill and personal goodwill could be properly valued.⁸⁹

An attorney can obtain evidentiary proof that the sales of the supporting spouse's company largely depend on the supporting spouse's personal relationships simply by sending affidavits to the major clients. Through affidavits, an attorney should ask each of the business's clients what their intentions would be if the supporting spouse were to leave the business.⁹⁰ If the clients respond by stating that they would take their business elsewhere, then that client is obviously doing business with the supporting spouse because of his or her individual efforts, which equates to personal good will.⁹¹ This strategy can be successful for small businesses, professional practices, or those businesses with a few major clients representing a large portion of the business.⁹²

2. *No Pre-existing Covenant Not to Compete.*⁹³

A client most likely possesses personal goodwill if he would have to agree not to compete with a potential purchaser of the business.⁹⁴ A noncompetition covenant is a promise not to engage in the same type of business for a stated time in the same market as a buyer, partner, or employer.⁹⁵ In Ohio, money received for a covenant not to compete is considered a non-marital asset.⁹⁶ However, the amount paid for a covenant

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Id.* at 928. Other authorities have identified the following similar personal goodwill indicators:

- The business operations are inseparable from the employee owners; the business's stability (financial and otherwise) depends on the stability (financial and otherwise) of the individual equity owners.
- The business may not survive the tenure of the current equity owners; it may not have created institutional attributes that allow it to transcend the departure of the individual equity owners. . . .
- Personal service is an important selling feature in the company's product or services.

Tresco Dealerships, *supra* n. 16, at 1.

⁹⁰ *Id.*

⁹¹ *Id.* In this situation, if the customer were to respond that they would continue patronizing the business, then this indicates loyalty to the business and not the individual and equates to enterprise goodwill.

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Prahinski*, 540 A.2d at 843.

⁹⁵ *Black's Law Dictionary* at 392.

⁹⁶ *Blodgett v. Blodgett*, 1988 Ohio App. LEXIS 4216 at *5 (Ohio App. 9th Dist. Oct. 19, 1988).

not to compete must be reasonable in light of the facts.⁹⁷ If a valuation expert determines that a potential purchaser would require a significant noncompetition covenant, it equates to personal goodwill. This is because the value of the covenant is, in reality, the supporting spouse's reputation and future earning ability.⁹⁸

A good illustration of this point is *Prahinski v. Prahinski*, where the court held that a value for "goodwill" in an expert's valuation was actually a value of the husband's reputation and not marital property.⁹⁹ In *Prahinski*, the tangible assets of the husband's law practice had a negative net worth; however, the expert valued the business at \$450,000.¹⁰⁰ The expert conceded that the value would only be accurate if the husband agreed not to compete with the purchaser.¹⁰¹ Furthermore, the expert testified that the absence of a noncompetition covenant would have a "dramatic effect" on his valuation.¹⁰² The court found that the value of the business was *entirely* dependent either on the husband continuing the law practice or agreeing not to compete if he sold it.¹⁰³ The court held that the law practice was not marital property because the goodwill of the law practice consisted of the husband's reputation and actually represented a calculation of the husband's future earnings.¹⁰⁴

⁹⁷ See *Hoefl v. Hoefl*, 600 N.E.2d 746 (Ohio App. 6th Dist. 1991). In *Hoefl*, the appellate court determined that a noncompetition agreement of \$225,000 was not a reasonable price to pay for the covenant not to compete. *Id.* at 750. The evidence showed: (1) the husband sold the dental practice for \$60,000; (2) during the five years prior to the sale of the practice it had generated an annual income of \$125,000; and (3) it would cost the husband approximately \$100,000 just to purchase supplies and equipment necessary to start a new practice. *Id.* at 749. In addition, the husband testified that he had no intention of remaining in Ohio and that on the sale of his practice he planned to relocate to Northern Michigan (an area well outside of the twenty mile restriction contemplated in the covenant not to compete). *Id.* The appellate court held that it "defie[d] logic" for a buyer to pay \$225,000 for a noncompetition agreement to a seller who was planning to move far from the area and it was "per se unreasonable and unrealistic to value a covenant not to compete at \$225,000 for a \$60,000 business." *Id.* at 750. The case was remanded for a determination of the dental practice's fair market value and for a determination of what part of the \$225,000 was attributable to the purchase price of the dental practice. *Id.*

⁹⁸ To determine the value of a hypothetical noncompetition covenant:

[T]he appraiser must first value the business. Then the appraiser must estimate future cash flows that would be lost to the seller should the seller compete. Next, the appraiser must consider the probability that the appraiser would compete. This analysis would be applied over the estimate life of the hypothetical noncompete agreement and present valued to today's dollars.

John E. Barrett, Jr., *Bifurcating Enterprise and Personal Goodwill*, 16 Am. J. Fam. L. 129, 131 (2002). See Mark O. Dietrich, *Valuing Covenants Not to Compete in a Professional Practice*, AICPA's CPA Expert (Summer 2002) (providing an in-depth analysis of how to value noncompetition covenants).

⁹⁹ 540 A.2d at 844.

¹⁰⁰ *Id.* at 839, 843.

¹⁰¹ *Id.*

¹⁰² *Id.* at 844.

¹⁰³ *Id.* (emphasis added).

¹⁰⁴ *Id.*

3. Success of the supporting spouse's business is completely dependent on the personal service that he or she provides.

A client will most likely possess personal goodwill if his business is dependent on his personal services and his ability to generate new work.¹⁰⁵ A business consisting of the personal services of the supporting spouse has no value without him, and this equates to personal goodwill. For example, a court found that there was no goodwill that could be properly subject to equitable distribution in the husband's advertising copyright business because the success of his business was completely dependent on the creative personal service that he provided.¹⁰⁶ Similarly, a logging business was found to have no goodwill for the purposes of equitable distribution because the success or failure of his business was dependent on his personal services "and his ability to negotiate contracts in a fluctuating and depressed market."¹⁰⁷

An attorney can obtain evidentiary proof of the existence of personal goodwill in their client's personal service business if the client maintains documentation regarding referral patterns and the tracking of new business.¹⁰⁸ Often customers patronize a personal service business because they have heard through word of mouth that an individual is exceptionally talented. If documentation shows that a majority of clients have used the business based on the individual's reputation, then there is a large amount of personal goodwill in the business.¹⁰⁹

B. The Main Policy Arguments for the Treatment of Goodwill in Divorce Proceedings Advanced by the Minority and Majority Positions.

The sharp jurisdictional rift that divides the states on the treatment of goodwill in divorce proceedings is largely policy-oriented. The main policy arguments will be discussed in turn in the forthcoming sections. In short, the minority position advances a policy that leads to unequal results, while the majority advances policy arguments that are logical and equitable.

1. The Policy Argument Supporting the Minority Position.

The main policy argument advanced for equitably distributing all goodwill value of a professional practice or closely held business is best illustrated in *Dugan v. Dugan*:

After divorce, the law practice will continue to benefit from that goodwill as it had during the marriage. Much of the

¹⁰⁵ *Lankford*, 720 P.2d at 408.

¹⁰⁶ *In re Marriage of Maxwell*, 876 P.2d 811, 813 (Or. App. 1994).

¹⁰⁷ *Lankford*, 720 P.2d at 408. See also *In re Marriage of Rolie*, 873 P.2d 397, 433 (Or. App. 1994) (determining that husband's electrician business had no goodwill value for the purposes of equitable distribution because his business was a "one person shop").

¹⁰⁸ *Supra* n. 80.

¹⁰⁹ The opposite is also true. If the documentation suggests that a majority of new clients utilize the business because of its location, then this would indicate that the business possessed enterprise goodwill. *Id.*

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. Obviously, equitable distribution does not require conveyance or transfer of any particular asset. The other spouse, in this case the wife, is entitled to have that asset considered as any other property acquired during the marriage partnership.¹¹⁰

In sum, the minority position's policy is grounded in the belief that goodwill consists of future earnings traceable to the efforts of both spouses during the marriage—although realized after the divorce—and these earnings should be marital property. Although this line of reasoning sounds fair, in reality there are three reasons why it produces an inequitable result.

First, the value of goodwill attributed to a business existing at the date of divorce will not be received as earnings until after the date of divorce.¹¹¹ Future earnings of the business result not only from the goodwill existing at the date of the divorce, but also from post-divorce efforts of the supporting spouse remaining in the business.¹¹² For the purposes of equitable distribution, it is always improper to make a monetary award for post-divorce efforts and future earnings of the supporting spouse.¹¹³ Therefore, the minority position penalizes the supporting spouse because its valuation and award of goodwill fails to consider and segregate the post-divorce efforts and post-divorce earnings of the supporting spouse.

Second, the minority treatment of goodwill produces an inequitable result because it counts the same asset twice when making an award of alimony. It should be clear that the goodwill value of a business, in the absence of an actual sale, can only be realized by future earnings. In Ohio, the income of the parties and the relative earning abilities of the parties are proper considerations when making an award of alimony.¹¹⁴ When a court

¹¹⁰ 457 A.2d at 6.

¹¹¹ Alan S. Zipp, *Divorce Valuation of Business Interests: A Capitalization of Earnings Approach*, 23 Fam. L. Q. 89, 104 (1989).

¹¹² *Id.* at 103-04.

¹¹³ In Ohio, future earnings are not a marital asset. See *Burma v. Burma*, 1994 Ohio App. LEXIS 4487 at *5 (Ohio App. 8th Dist. Sept. 29, 1994) (citing *Hoelt*, 600 N.E.2d 746).

¹¹⁴ Ohio Rev. Code Am. § 3105.18 (Anderson, Lexis current through June 17, 2005).

(C)(1) In determining whether spousal support is appropriate and reasonable, and in determining the nature, amount, and terms of payment, and duration of spousal support, which is payable either in gross or in installments, the court shall consider all of the following factors:

equitably distributes the value of a business, including goodwill, but then awards alimony based upon future earnings generated from the supporting spouse's involvement in the business, it counts the same asset twice.¹¹⁵ Taking two bites at the apple is unfair and creates a financial hardship for the supporting spouse.¹¹⁶

Finally, the minority treatment of goodwill produces an inequitable result because personal goodwill cannot be assigned, sold, transferred, conveyed, or pledged.¹¹⁷ Thus, the equitable distribution of all goodwill—including personal goodwill—penalizes the supporting spouse because he or she can never actually recover the value of that goodwill on the open market.¹¹⁸ An often-quoted passage from *Holbrook v. Holbrook* best

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- (a) The income of the parties, from all sources, including, but not limited to, income derived from property divided, disbursed, or distributed under section 3105.171 [3105.17.1] of the Revised Code;
 - (b) The relative earning abilities of the parties;
 - (c) The ages and the physical, mental, and emotional conditions of the parties;
 - (d) The retirement benefits of the parties;
 - (e) The duration of the marriage;
 - (f) The extent to which it would be inappropriate for a party, because that party will be custodian of a minor child of the marriage, to seek employment outside the home;
 - (g) The standard of living of the parties established during the marriage;
 - (h) The relative extent of education of the parties;
 - (i) The relative assets and liabilities of the parties, including but not limited to any court-ordered payments by the parties;
 - (j) The contribution of each party to the education, training, or earning ability of the other party, including, but not limited to, any party's contribution to the acquisition of a professional degree of the other party;
 - (k) The time and expense necessary for the spouse who is seeking spousal support to acquire education, training, or job experience so that the spouse will be qualified to obtain appropriate employment, provided the education, training, or job experience, and employment is, in fact, sought;
 - (l) The tax consequences, for each party, of an award of spousal support;
 - (m) The lost income production capacity of either party that resulted from that party's marital responsibilities;
 - (n) Any other factor that the court expressly finds to be relevant and equitable.

¹¹⁵ See *Beasley v. Beasley*, 518 A.2d 545, 553 (Pa. Super. 1986):

The good will of a sole proprietorship is related only to his future earnings, since an actual sale produces no value. To assess a value on future productivity and to award a proportionate amount to the spouse is akin to making a lump sum alimony payment since it is based on future earnings of the paying spouse. If, in addition to this payment, alimony is awarded, there is, in effect, a double charge on the future income of the paying spouse. Even without an alimony award, a fixed sum, not having the designation as alimony, carries none of the flexibility of an alimony award derived from its modifiability and, therefore, may penalize the payor if he suffers reverses, unemployment or dies.

¹¹⁶ See Donald John Miod, *The Double Dip in Valuing Goodwill in Divorce*, http://www.expertlaw.com/library/family_law/double-dip.html (November 1999).

¹¹⁷ *Holbrook*, 309 N.W.2d at 355.

¹¹⁸ See Karen Angelini, *DIVORCE—Division of Property—Professional Corporation May Have Valuable Goodwill, Apart from Person of Individual Member, That Must Be Considered in Property Settlement on Divorce*, 11 St. Mary's L.J. 222, 230 (1979) (footnotes omitted):

A concern with the [minority position] is the propriety of requiring a professional practitioner to purchase, with a tangible asset such as money, an intangible asset of questionable value, particularly since any existent goodwill may subsequently diminish or be extinguished altogether. Awarding a spouse an amount representing goodwill upon divorce may conceivably force the professional

summarizes this injustice: “[t]here is a disturbing inequity in compelling a professional practitioner to pay a spouse a share of intangible assets at a judicially determined value that could not be realized by a sale or another method of liquidating value.”¹¹⁹

2. The Policy Argument Supporting the Majority Position.

When faced with the issue of valuing goodwill in a divorce proceeding, the Supreme Court of Ohio should not follow the “twisted and illogical path”¹²⁰ that the minority position advances for the treatment of goodwill. Instead, Ohio should adopt the majority position which allows the valuation expert to analyze and present the goodwill of a professional practice or closely held business as two separate components: enterprise goodwill and personal goodwill.

The policy arguments supporting the majority position are rational and result in an equitable division of property. First, the states that bifurcate goodwill into enterprise goodwill and personal goodwill do so because personal goodwill depends upon the continued presence of the supporting spouse; it is not a marketable asset distinct from the individual.¹²¹ The majority position reasons that any value attributed to personal goodwill represents nothing more than future earning capacity, which is not a proper consideration for dividing marital property in a divorce proceeding.¹²² Furthermore, these states emphasize that the supporting spouse who owns personal goodwill can never actually recover the value of that goodwill on the open market.¹²³ The only way that personal goodwill can be realized is through future earnings. Consequently, if the supporting spouse is ever going to realize the value of personal goodwill, he must continue to successfully practice his profession post-divorce. While the right to practice professionally is a valuable personal right, it is not an asset that can be divided, transferred, or assigned to another; thus, it should not be subject to equitable distribution.¹²⁴

Conversely, the majority position holds that any value attributed to enterprise goodwill is properly subject to equitable distribution. Therefore, any goodwill that is wholly attributed to the business itself is marital property and subject to distribution.¹²⁵ In addition, since future earnings and professional reputation form a large part of the supporting spouse’s income capacity, these will be awarded to the non-supporting spouse in the form of

practitioner to liquidate business assets to pay the judgment. If the value of the goodwill thereafter declines, the practitioner has realized nothing from the purchase of his spouse’s share in the goodwill.

¹¹⁹ *Holbrook*, 309 N.W.2d at 355.

¹²⁰ *Id.* at 354.

¹²¹ *Taylor*, 386 N.W.2d at 858. *See Butler*, 663 A.2d at 155 (stating that “goodwill value which is intrinsically tied to the attributes and/or skills of certain individuals is not subject to equitable distribution because the value thereof does not survive the disassociation of those individuals from the business”).

¹²² *Taylor*, 386 N.W.2d at 858.

¹²³ *Holbrook*, 309 N.W.2d at 355.

¹²⁴ *Flexman*, 1985 Ohio App. LEXIS 7061 at *7 (referring to *West v. West*, 1978 Ohio App. LEXIS 9217 (Ohio App. 2d Dist. June 23, 1978)).

¹²⁵ *Butler*, 663 A.2d at 155.

alimony.¹²⁶ In the end, the non-supporting spouse is not deprived of the benefit of a marital property asset, and the supporting spouse is not penalized by a valuation which includes an asset that can never be realized on the open market.

IV. CONCLUSION

The Supreme Court of Ohio may soon face the issue of how to allocate goodwill in a divorce proceeding. When confronted with the issue, the Supreme Court of Ohio should step in line with the majority of states and hold that goodwill should be divided between enterprise and personal goodwill based upon the facts of each case and upon accepted accounting methodologies. This treatment of goodwill has proven to be a successful approach that delivers equitable results in twenty-five states. Moreover, such Ohio appellate cases as *Flexman*,¹²⁷ *Young*,¹²⁸ and *Arena*¹²⁹ represent the Ohio appellate courts' willingness to adopt the majority position regarding the division of enterprise and personal goodwill in a divorce proceeding. This author sincerely urges the Supreme Court of Ohio to approve of this trend and adopt the majority approach which complies with the statutory requirement that property be distributed in a fair and equitable manner.¹³⁰

¹²⁶ *Courtright v. Courtright*, 507 N.E.2d 891, 894 (Ill. App. 3d Dist. 1987). *See supra* n. 114.

¹²⁷ 1985 Ohio App. LEXIS 7061 at **10-11.

¹²⁸ 1999 Ohio App. LEXIS 1744 at *15.

¹²⁹ 1995 Ohio App. LEXIS 4261 at *24.

¹³⁰ *See* Ohio Rev. Code Ann. § 3105.171.