A Systematic Approach to Valuing the Goodwill of Professional Practices

by

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Introduction

Property divisions have replaced alimony as the primary device for arranging the financial relationships between spouses at divorce.[2] However, the courts do not have a clear understanding of what is property and how it should be valued causing them to address these issues in an ad hoc manner.[3] They are not given much guidance because the equitable distribution statutes in the vast majority of jurisdictions define "marital property," but usually ignore the more basic definition of "property."[4] In no area is this ad hoc approach more visible than the courts' consideration of the goodwill of professional practices.[5] This goodwill has become an area of dispute in property settlements at divorce because of the lack of an understanding of what is goodwill, how it is created and how it should be valued. This chapter clarifies how goodwill should be treated at divorce by analyzing the difference between the business goodwill of the professional enterprise and the personal goodwill of the professional individual. Initially, the evolution of the legal concept of "professional goodwill" is discussed. Then, goodwill is reviewed from the perspective of economics and accounting--the disciplines that have addressed it in the past. Generally, economics has been used to explain why it exists, while accounting has been interested in

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[2] Homer H. Clark, Jr., *The Law of Domestic Relations in the United States, 2nd Ed.* 589 1988).

[3] Allen M. Parkman, "Human Capital as Property in Celebrity Divorces," 29 *Fam. L. Q.* 141 (1995), Allen M. Parkman, "A Systematic Approach to Property in Divorces," 12 *Fam. Advocate* 34 (1989), and Allen M. Parkman, "Human Capital as Property in Divorce Settlements," 40 *Ark. L. R* 439 (1987).

[4] Willard H. Da Silva, "Property Subject to Equitable Distribution," in John P. McCahey, ed., *Valuation & Distribution of Marital Property* 18-4 (1984).

[5] Allen M. Parkman, "The Treatment of Professional Goodwill in Divorce Proceedings," 18 *Fam. L. Q.* 213 (1984).

measuring its value. The framework provided by economics and accounting are then used to distinguish between the business and personal goodwill of professional practices and how they should be treated in property divisions.

The Legal Concept of Professional Goodwill

Goodwill in a business has long been recognized as property subject to division at divorce. The legal concept of goodwill is based on an old English case, which held that "goodwill is the probability that customers will return to the old stand."[6] Judge Cardozo expanded it to include the tendency for customers to return to the same location or company because of its name or other reasons regardless of its location.[7] The emerging legal concept of goodwill expands its sources to include employees and suppliers.[8] With the exception of monopoly power, the legal concept of goodwill focuses on the idea that goodwill is an asset which generates excess earnings.

Recent Cases on Goodwill

Initially, the legal concept of goodwill was only applied to businesses. Over the last thirty years, two lines of cases have developed considering goodwill in professional practices at divorce extending goodwill to consider individuals as well as businesses. Often these cases have not made a clear distinction between business and personal goodwill.[9] A number of courts have taken the position that goodwill exists in a professional practice often without making a distinction between

[6] Cruttwell v. Lye, 34 *Eng. Rep.* 129, 134 (1810).

[7] In re Brown, 242 *N.Y.* 1, 6, 150 *N.E.* 581, 582 (1926).

[8] Dennis R. Beresford and Richard H. Moseley, "Goodwill and Other Intangibles," in Sidney Davidson & Roman L. Weil, *Handbook of Modern Accounting 3rd ed.* 21-1 (1983).

[9] A review of cases on professional goodwill are available in Mary Kay Kisthardt, "Professional Goodwill in Marital Dissolution Cases: The State of the Law," in Ronald L. Brown, *Valuing Professional Practices and Licenses: A Guide for the Matrimonial Practitioner, Second Edition*, 2-1 (1996) and J. Thomas Oldham, *Divorce, Separation, and the Distribution of Property,* 10-23 (1997).

the business and the individual.[10] A second group of courts has restricted their interpretation of goodwill to that of a business.[11]

It has long been recognized that existing businesses can be more valuable than similar, but new, businesses with this additional value being assigned to goodwill. If this goodwill was created or increased during marriage, it could be a component of the marital property distributed at divorce. A strict definition of goodwill, only as an attribute of a business, started to deteriorate in *Mueller v. Mueller,*[12] in which the California court held that there was goodwill in a dental laboratory that could be considered in a divorce proceeding. Although some goodwill probably existed in the laboratory as a business, the court accepted that goodwill could exist in a personal service business. Professional goodwill was extended to a law practice in *Todd v. Todd* [13] and a sole practitioner medical business in *Golden v. Golden.*[14] The application of goodwill continued to be expanded as in *Foster v. Foster*[15] as an expert witness was asked to determine the fair value of goodwill of a medical practitioner, not of his business. Among the other attributes that the court felt should be considered was "the personality of the parties engaged in the business."[16] The focus of goodwill was shifting from the business to the people in the business.

The shift to reputation as goodwill is illustrated by a number of Washington and New Mexico cases. In *In re the Marriage of Lukens*[17] the Washington trial court found that the value of the goodwill in an osteopathic practice was $60,000. The appellate court held that factors

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[10] Mueller v. Mueller, 144 *Cal.App.* 2d 245, 301 *P.2d* 90 (1956); Todd v. Todd ,272 *Cal. App. 2d* 786, 78 *Cal. Rptr.* 131 (1969); Golden v. Golden, 270 *Cal. App. 2d* 401, 75 *Cal. Rptr.* 735 (1969); Foster v. Foster, 42 *Cal. App. 3d* 577, 117 *Cal. Rptr.* 49 (1974); In re the Marriage of Lukens, 16 *Wash. App.* 481, 558 *P.2d* 279 (1976); In re Marriage of Freedman, 23 *Wash. App.* 27, 592 *P.2d* 1124 (1979); Fleege v. Fleege, 91 *Wash. 2d* 324, 588 *P.2d* 1136 (I 979); Hurley v. Hurley, 94 *N. M.* 641, 615 *P. 2d* 256 (1980); Hertz v. Hertz, 99 *N. M.* 320, 657 *P.2d* 1169 (1983); Dugan v. Dugan, 92 *N.J.* 423, 457 *A.2d* 1 (1983).

[11] Nail v. Nail, 486 *S.W.2d* 761 (Tex. 1972), Geesbreght v. Geesbreght, 570 *S.W.2d* 427 (Tex.Civ.App.1978), Holbrook v. Holbrook, 103 *Wis.2d* 327, 309 *N.W.2d* 343 (Wis.Ct.App.1981), and Powell v. Powell, 231 *Kan. App. 2d* 456, 648 *P.2d* 218 (1982)..

[12] 144 *Cal. App. 2d* 245, 301 *P.2d* 90 (1956).

[13] 272 *Cal. App. 2d* 786. 78 *Cal. Rptr.* 131 (1969).

[14] 270 *Cal. App. 2d* 401, 75 *Cal. Rptr*. 735 (1969).

[15] 42 *Cal. App. 3d* 577, 117 *Cal. Rptr.* 49 (1974).

[16] 42 *Cal. App. 3d* 577 at 583, 117 *Cal. Rptr.* 49 at 53.

[17] 16 *Wash. App.* 481, 558 *P.2d* 279 (1976).

contributing to professional goodwill include the practitioner's age, health, past earning power, reputation in the community for judgment, skill, and knowledge, and his comparative professional success.[18] All of these factors relate to individuals, rather than to goodwill as it traditional had been defined. The court then went on to hold that the value of goodwill is not synonymous with the spouse's expectation of future earnings.[19] It, therefore, 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. The court in *Lukens* also held that his goodwill had value despite its unmarketability.[20]

A similar approach was used in *In re Marriage of Freedman*[21] in which the reputation of the spouse, who was a lawyer, was calculated based on his age, health, past earning power, reputation in the community, and comparative professional success. In *Fleege v. Fleege*[22] the court found there was professional goodwill in a dental practice, which subsequently to the trial was sold for an amount considerably in excess of the value of the equipment and accounts receivable of the firm.

New Mexico joined this line of cases with *Hurley v. Hurley,*[23] in which the appellate court reversed a trial court that held that there was no goodwill in a medical practice consisting of two surgeons. The court held that some of the factors to be considered in arriving at the value of goodwill are: the length of time the professional has been practicing, his comparative success, his age and health, and any past profits of the practice.[24] In addition, it held that attention should be given to the physical and fixed resources of the practice. In *Hurley, Lukens* is cited with approval for the proposition that marketability is not required for goodwill.[25]

The rule in New Mexico was modified in *Hertz v. Hertz,*[26] in which the court found that the goodwill in a lawyer's practice was limited to the one dollar value established in a restrictive stock agreement. *Hertz* was distinguished from *Hurley* because of the existence of the stock

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[18] *Id.*

[19] 16 *Wash. App.* 481 at 486, 558 *P.2d* 279 at 282.

[20] *Id.*

[21] 23 *Wash. App.* 27, 592 *P.2d* 1124 (1979).

[22] 91 *Wash. 2d* 324, 588 *P.2d* 1136 (1979).

[23] 94 *N.M.* 641, 615 *P. 2d* 256 (1980).

[24] 94 *N.M.* 641 at 644, 615 *P.2d* 256 at. 259.

[25] *Id.*

[26] 99 *N.M.* 320, 657 *P.2d* 1169 (1983).

agreement, which did not exist in the *Hurley* case. The cases were also distinguished because Hertz's law practice was in "a legal professional association of over fifty persons that had been in existence for thirteen years before husband became employed with the firm, and for seventeen years before husband became a shareholder in the firm."[27]

New Jersey joined the states that recognize professional goodwill with *Dugan v. Dugan,*[28] in which the New Jersey Supreme Court recognized professional goodwill in the equitable distribution of marital property upon divorce. The case was remanded, however, because the court did not agree with the method used to calculate professional goodwill. The opinion goes into a detailed analysis of professional goodwill without acknowledging that it is actually placing a value on an individual's reputation. The court presents an approach for calculating professional goodwill which compares a lawyer's income to certain norms with the difference--after certain adjustments--being attributed to goodwill.

Other courts take a much narrow approach to goodwill usually limiting it to the business goodwill of the professional practice. In 1972, a Texas court in *Nail v. Nail*[29] held that the accrued goodwill of a medical practice based on personal skill, experience, and reputation, as well as upon the expectation that the doctor would continue to practice, did not constitute property that was subject to division in a divorce.[30] The court also held that it was not a vested property right at the time of the divorce and it was not separate from the individual.[31]

This approach continued in *Geesbreght v. Geesbreght*[32] in which the appellate court held that a medical corporation possessed goodwill as a valuable asset of the business, apart from the husband's person as a professional practitioner, which goodwill had to be considered in valuing the parties' estate on divorce.[33] The decision implied that the existence of goodwill was

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[27] 99 *N.M.* 320 at 325, 657 *P.2d* 1169 at 1174.

[28] 92 *N.J.* 423, 457 *A.2d* 1 (1983).

[29] 486 *S.W. 2d* 761 (Tex. 1972).

[30] Id. at 764.

[31] Id.

[32] 570 *S.W. 2d* 427 (Tex. Civ. App. 1978).

[33] *Id*. at 436.

determined by the form of business organization, and it would not have existed if it had been a sole practitioner. The Texas view has been followed in Wisconsin[34] and Kansas.[35]

A New York case presents an opportunity to clarify the difference between business and personal goodwill. In *Nehorayoff v. Nehorayoff*,[36] the primary asset under dispute was the husband's 50 percent ownership of a professional corporation which did abortions and related laboratory work. Although the husband worked in his capacity as a doctor at the clinic, the court recognized that "evidence indicated that the patient does not develop a personal relationship with the physician. One seeks out the clinic because of advertising, reputation or referral. There is no reason to expect that a change in physicians would lead to a significant decline in business as it might in a private practice."[37] While the court in this case cites a number of the cases discussed above, this is a case dealing exclusively with business goodwill. There is no attempt to place a value on the doctor, but only on the business.

What is Goodwill and How Should it Be Valued?

The confusion in the cases noted above would be reduced by a systematic review of what is goodwill, how it is created and how it should be valued. Economics provides a framework for understanding goodwill and how it is created, while accounting has developed methods for evaluating it.

The Economic Concept

Our understanding of goodwill will be enhanced by a clearer understanding of assets, which is a synonym for property. From an economic perspective, goodwill is an asset, whose value--as with all other assets--depends upon the future returns that it will generate.[38] For example, a share of common stock has a value based on the dividends that it will produce, while a house has a value based on the services that it will provide its occupants. It is important to recognize the difference between the value of an asset and future returns associated with it. A

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[34] Holbrook v. Holbrook, 103 *Wis. 2d* 327, 309 N.W. 2d 343 (Wis. Ct. App. 1981), Peerenboom v. Peerenboom, 43 *N.W.2d* 282 (Wis.Ct.App1988), and Sommerfield v. Sommerfield, 454 *N.W.2d* 55 (Wis.Ct.App1990).

[35] Powell v. Powell, 231 *Kan. App. 2d* 456, 648 *P.2d* 218 (1982).

[36] 108 *Misc. 2d* 311, 437 *N.Y.S. 2d* 584 (Sup. Ct. 1981).

[37] 108 *Misc.* 311 at 321, 437 *N.Y.S. 2d* 584 at 591.

[38] Cases such as In re the Marriage of Lukens, 16 *Wash.App.* 481, 558 *P.2d* 279 (1976), which hold that professional 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 thereby contradicting the financial framework for valuing assets, illustrate the problems when the courts recognize a concept from another field, in this case goodwill, and then establish an inappropriate method for its valuation.

company's stock shares can have a high market value even though it is paying no current dividends because of the high dividends expected in the future. Even with no change in its current dividends the price of the stock will increase if the expected future dividends increase. Alternatively, things that will provide no returns in the future have no value. It is important to recognize that future returns are the key to current value. A solid, comfortable house that is going to be destroyed today to make way for a freeway has no value as a house.

Similarly, individuals can also be viewed as assets--human capital--based on the income stream that they can expect in the future. Human capital is a term used to describe the capitalized value of the increased stream of earnings that will flow to an individual who has been the recipient of an investment in skills or knowledge.[39] In other words, human capital is an asset owned by an individual. In contrast to a share of common stock or a house, the stream of future income from human capital cannot be sold. Conceptually, however, they are all assets or property. Marketability has become a less common characteristic of assets because of the increase in the wealth consisting of their human capital. An asset has value not because it can be exchanged for money, but because it will provide a stream of future returns.[40] Another concern about assets is the predictability of future returns. If the future returns are less predictable that does not mean that the asset does not exist, it just means that it will have a lower value because the expected future returns will be discounted at a higher rate. Our wealth or property at any moment consists of the assets that provide us with future returns.

While the shares of stock or the house can be evaluated in isolation that is not true for goodwill, which can only exist in conjunction with other assets. The economic concept of goodwill is introduced when the future revenues of an organization cannot be assigned to the contribution of a finite list of assets.[41] Goodwill in the economic sense is another word for organization.[42] To be more specific, the value of goodwill is derived from the economic benefits that a going concern may enjoy as compared with a new firm from (1) established relations with all the markets-both output and input, (2) established relations with government departments and

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[39] The primary source for the development of human capital is Gary Becker, *Human Capital, 3d ed.* (1993).

[40] This difference can be illustrated by considering a share of common stock that has traditionally been recognized as property and a medical education that seldom has been treated similarly. Although a share of common stock can be exchanged, no rational investor would pay a positive price for the common stock of a corporation that was never expected to produce any profits or pay any dividends. Meanwhile, medical school can be an attractive investment resulting in a valuable asset--human capital--although the doctor cannot sell herself or the degree.

[41] Beresford and Moseley, supra note 8.

[42] H. C. Edey, "Business Valuation, Goodwill and the Super-profit Method," in W. T. Baxter & Sidney Davidson, *Studies in Accounting Theory* 201(1962).

other noncommercial bodies, and (3) personal relationships.[43] These relationships cannot be separated from the business and they are sold with the business just like plant and machinery. Basically, the economic concept focuses on the fact that established businesses can make greater profits than new businesses. The greater profits are based on the established internal and external relationships of the older business. Since these relationships produce additional profits, which can be capitalized, it can be viewed as an asset of the business, i.e., goodwill.

Goodwill is created by the standard economic method of investing current resources to increase future profits. These additional profits result from either higher revenues or lower costs. Future revenues can be enhanced by a variety of promotional activities now ranging from lower prices to advertising. Meanwhile, future costs can be reduced by spending funds now on training the business's staff to increase their future efficiency. When the profits of a business are greater than those of another business, often new, in which similar investments have not occurred that business possesses goodwill.

It is important to realize that goodwill is an asset of the business, not of any individual. To the extent that a business is more profitable than its competitors because of the superior abilities or business connections of an individual, those profits are attributable to the individual, not the business. The individual should be able to capture the higher profits in higher wages or will move to a competitor. In either case, the profits of the firm will return to a normal level and any enhanced profits will disappear.

The Accounting Concept

The accounting concept of goodwill is directed not so much to the nature of goodwill as to its measurement.[44] The general feeling is that verbal descriptions of goodwill are inadequate and that the only way to determine what is meant by goodwill is to observe the way that it is measured.[45] The two criteria, either of which serves as evidence of the existence of goodwill, that serve as general guides for thinking about accounting goodwill are: (1) a payment in excess of an established value of a resource and (2) enhanced earning power.[46] Essentially, these are the same thing approached from two different perspectives. The first approach goes directly to the asset value of goodwill. Since goodwill is an asset that is unique to each business, the most accurate calculation occurs if there is a market sale. If the business is sold, the difference between the market value of the identifiable assets and the sale price is attributable to unidentifiable intangible assets, i.e., goodwill.

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[43] *Id.*

[44] Beresford and Moseley, supra note 8.

[45] Goodwill is not defined in Accounting Principles Board Opinion 17, but the measurement process, deductive in nature, is described.

[46] Donald E. Kieso and Jerry J. Weygandt, *Intermediate Accounting 9th ed.* 602 & 618 (1998).

The second approach is more appropriate in divorce cases because it considers an on going business that is not being sold. First, the balance sheet of the business has to be adjusted to reflect the current market value of the business's tangible assets. Then, the intangible assets, generally goodwill, have to be considered. Any rate of return in excess of a normal return on the tangible assets is attributable to these intangible assets. To give an asset value to the enhanced profits requires a capitalization rate.[47] Goodwill is the capitalized value of these profits. So for example, if an established franchise of a fast food chain has annual profits of $500,000 when new franchises with a similar investment have profits of only $400,000, it's enhanced profits are $100,000. The asset's value is based on the current value of the future enhanced profits. If those profits are expected to continue for an extended period, the asset's value is equal to the initial annual profits divided by the expected rate of return on the investment minus the expected growth rate of the profits.[48] So in this case, if the expected rate of return is 20 percent and the enhanced profits are expected to grow by 10 percent per year, then the present value of these future enhanced profits, the goodwill, is worth $100,000/(.2 - .1) = $1,000,000. The inverse of the denominator in this equation, e.g., 1/(.2 - .1) = 10, is called the capitalization rate. This approach is used when the business is not being sold on the open market, e.g., the death of a partner or the continuation of a professional practice after a divorce. Both of the accounting approaches to goodwill focus on the same thing, the unidentifiable intangible assets of an ongoing business.

Because goodwill is a residual remaining after a return has been assigned to other assets, its value may reflect the return to other unidentified assets. Accountants recognize a variety of intangible assets that benefit a business such as patents, copyrights, trademarks and leaseholds,[49] but the value of these intangible assets often has not been computed, so their value is frequently attributed to goodwill.

In summary, based on the accounting and economic literature, goodwill is an asset based on the enhanced earnings of an established business. Traditionally, it has only been applied to businesses, although the concept can be extended to individuals. Business goodwill is based on the established relations with employees, customers, and suppliers that result in enhanced earnings for the business. In a similar manner, individuals could possess personal goodwill--professional

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[47] The capitalization rate is based on the rate at which a prudent investor would discount future profits. IRS rulings suggest capitalization rates of between 15 percent and 20 percent adjusted to take into consideration the nature of the business, the risk involved and the stability of earnings. *Rev. Rul. 59-60*, note 14, at 243. For a highly personalized business, a much higher capitalization rate would be appropriate.

[48] The expected rate of return will vary with the risk and marketability of the investment. Less certain returns have to provide a higher expected return to attract investors, while less marketable investments also command a premium return.

[49] Kieso and Weygandt, supra note 46, at 593.

goodwill in the case of a professional--if they have enhanced earnings because of established relationships.

Goodwill in a Professional Practice

Economic and accounting analysis can be used to clarify how the goodwill of a professional practice should be considered at divorce. Initially it is important to recognize that there can be two types of goodwill, as it has been traditionally defined in accounting and economics, in a professional practice: business goodwill and personal goodwill.

Business Goodwill

First, consider a professional practice with substantial business goodwill and little, if any, personal goodwill. It could be a clinic with no individual's name directly associated with it. Patients come to the clinic not because of any particular doctor, but because of the generally high quality of service that they have received in the past. In addition, it might have a laboratory associated with it that is well organized and provides rapid, high-quality service. The laboratory makes profits in excess of a normal return on its equipment. Because the patients do not return because of a particular doctor, none of the doctors--including any who are owners of the business--have any personal goodwill.

If the clinic and the laboratory were sold, they would command a price in excess of the value of the identifiable assets reflecting the existence of business goodwill. If the value of the business has to be computed without a sale, then the enhanced earnings have to be capitalized. While business goodwill is a straightforward concept, its calculation still presents a challenge because of the ambiguity about the amount of the enhanced profits and the appropriate capitalization rate.

Personal Goodwill

At the other extreme is a professional practice with very limited opportunities for business goodwill, but the potential for personal goodwill. It could be a sole practitioner with a small office, even if well-organized. His patients come to the doctor because they receive high-quality service from him. His office operates smoothly, but he has only a limited number of employees and equally qualified people are available on the open market. A new doctor would not pay a price very much in excess of the market value of accounts receivable and tangible assets for the practice. Patients would not return to the same location just because they had gone to a doctor there before. While there is little business goodwill, personal goodwill can exist.

The identification and calculation of personal goodwill in a professional practice present many more problems than those associated with business goodwill. First, it is difficult to adapt the standard method for calculating business goodwill in an on going enterprise to individuals. This calculation consists of capitalizing the enhanced or excess profits that the firm is generating. These profits are relative to a similar business without goodwill. This can be a challenging calculation with a business, but almost impossible for individuals. Ordinarily the enhanced profits of a retail business can be calculated by comparing it to a similar but new one, which would be assumed to have no goodwill. The difference in their returns would then be attributed to goodwill. But with individuals, no two are alike. Each tends to be unique in terms of willingness to accept risk, qualifications, ambition, and so forth. For example, a common technique used in divorce cases to estimate excess earnings of private practice doctors is to compare their earnings to those of doctors in salaried positions. However, the higher earnings will as likely reflect the inconveniences and risks inherent in private practice as the ability of the doctor to attract additional customers. Attempting to calculate the value of personal goodwill is an uncertain process. There are too many variables that can explain the difference between the incomes of salaried professionals and those in private practice and, also, among the private practitioners.

Second, what the courts is treating in many cases as professional goodwill is just personal goodwill based on the individual's reputation. If that is the case, everyone has a reputation. If a doctor has a reputation, then so do salesmen, administrators, and to some extent everyone. In fact, housewives have reputations just as do wage-earners. Being married to an ex-Miss America may provide valuable returns both financial and psychological to her husband. Therefore, if reputation is property to be considered in a divorce property settlement of a professional, it should be considered for all individuals.

Last, the issue of separate versus marital property has to be addressed. Often, when the courts have decided that there is goodwill in a professional practice there is no consideration of whether it is separate in contrast to marital property with its value usually being attributed to marital property. When property is acquired can be an important question at divorce because separate property is usually returned to its owner, but marital property is divided between the spouses. While property's value is based on its future returns, its acquisition is based on investments.[50] At marriage, individuals have an expected income stream based on their inherent abilities, their personality and the investments that have been made in their education and training. That income stream is the basis of their human capital and it is their separate property in very much the same way that a portfolio of stocks owned at that time is separate property. If the individuals eventually earn the income that could have been expected at marriage--even though it may have increased dramatically compared with the income at marriage, the marriage has not affected that income stream and it continues to be separate property as a return to that preexisting human capital. Only if the marriage has affected that income stream has marital property been created. An obvious example might be an increase in income that results from education during marriage that would not otherwise have occurred.[51]

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[50] Investment is the flow of expenditures devoted to projects producing goods which are not intended for immediate consumption. These investment projects may take the form of adding to both physical and human capital as well as inventories. See David W. Pearce, *The MIT Dictionary of Modern Economics 3d ed.* 216 (1986).

[51] Although the courts seem unwilling to recognize the degree itself as an asset, they have become willing to recognize the contribution of the spouse to the acquisition of the degree. For example, in Inman v. Inman, 578 *S.W. 2d* 266 (Ky. Ct. App. 1979), the wife was awarded an amount that covered the direct support and expenses incurred during the period of education, plus compensation for interest and inflation, for having supported her husband through dental school. In a case which looked at the value of the result rather than the value of the investment, O'Brien v.

Personal goodwill--the enhanced income of an individual--should only be treated as martial property if any increase in the individual's income can be attributed to the marriage. It is common for individuals' income to increase over time as they acquire skills that complement their existing attributes.[52] Only if the increase occurs because of the effects of the marriage should it be attributed to it, thereby, becoming marital property. For example, a doctor's habits prior to marriage alienated many patients resulting in a limited income. If it was acknowledged that her husband's influence during marriage improved her habits resulting in a higher income during--and expected to continue after--their marriage, the marriage enhanced her earnings creating personal goodwill.

While goodwill--business or personal--only has value if it increases future earnings, some courts have been reluctant to recognize goodwill--especially what is being called personal goodwill here-- as property because of the future effort associated with it. When goodwill exists, the same effort as expended by businesses or individuals without goodwill produces higher earnings. Business goodwill exists when one franchise with the same investment, employees and hours as a new franchise makes higher profits. Similarly, personal goodwill can exist if an individual expending the same effort with the same skills as other individuals earns more because of better habits or a higher fee paying clientele. This goodwill should be treated as a marital asset if the habits or the clientele can be attributed to the marriage. Again, let me emphasize that past efforts created goodwill, but its value is based on the future returns that it will produce.

Conclusion

The interpretation being placed on goodwill in professional practices by the courts creates substantial confusion. The first step toward a remedy is to clarify the distinction between business goodwill and personal goodwill. All businesses--professional and non-professional--potentially have business goodwill and, if that business goodwill was created or enhanced during marriage, it should be recognized as marital property at divorce. Alternatively, personal goodwill is associated with individuals not businesses and its analysis, computation and allocation between separate and marital property presents major problems. Given these problems, one has to wonder why it has been recognized as marital property. The answer probably lies with the limited recognition of human capital in contrast to other property at divorce. Injustices frequently occur at divorce if a spouse has provided educational support--created human capital--or limited a career--sacrificed separate property human capital, because the courts do not consistently recognized human capital as property. High income professional spouses may dissolve marriages from which their spouses normally cannot expect substantial financial settlements. This can occur

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O'Brien, 114 *Misc. 2d* 233, 452 *N.Y.S. 2d* 801 (Sup. Ct. 1982), a wife who supported her husband while he obtained his medical degree was awarded $188,800, which was 40 percent of the sale distribution assets acquired during the marriage. See Allen M. Parkman, "An Investment Approach to Valuing Spousal Support of Education," in Ronald L. Brown, *Valuing Professional Practices and License, 2nd Edition*, 18-1 (1994 Supp.).

[52] Becker, supra note 39.

if there is no significant property or justification for substantial child or spousal support because of the ages of the children and the spouse. In an attempt to remedy this injustice, the courts have been forced to look elsewhere for funds to compensate spouses for whom the normal financial arrangements will impose an injustice. Professional goodwill, applied in an ad hoc manner, often serves that purpose. A more systematic recognition of human capital and, therefore, personal goodwill at divorce will reduce this confusion.