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Excess Earnings: Redefining the Professional Goodwill Doctrine

California courts have continued to expand the traditional definitions of community property.¹ Faced with difficult questions such as whether education,² enhanced earning capacity,³ and pensions⁴ may be considered subject to community property principles,⁵ the courts have considered whether the definition of community property should be broadened.⁶ One line of cases expanding the definition of community property is based upon a recognition that the marital community may have an interest in the goodwill of a business or professional practice.⁷

1. Under California law community property is "property acquired by husband and wife, or either, during marriage, when not acquired as the separate property of either." CAL. CIV. CODE §687. California Civil Code §5110 provides "Except as provided . . . all real property . . . and all personal property . . . acquired during the marriage . . . is community property . . ." *Id.* Separate property is defined as "property . . . owned . . . before marriage, and that acquired afterwards by gift, bequest, devise, or descent, with the rents, issues, and profits thereof . . ." CAL. CIV. CODE §§5107, 5108.

2. *Marriage of Sullivan*, 184 Cal. Rptr. 796 (1982), affirmed in part, reversed in part, 37 Cal. 3d 762, 209 Cal. Rptr. 354 (1984). The Fourth District Court of Appeal held that professional education was neither separate nor community property. 184 Cal. Rptr. at 800. On appeal to the California Supreme Court, a recent amendment to the Family Law Act, providing for reimbursement for "community contributions to education or training of a party that substantially enhances the earning capacity of the party," was held applicable and the case was remanded for a determination of whether and in what amount reimbursement should be awarded. 37 Cal. 3d at 767-68, 209 Cal. Rptr. at 359; CAL CIV. CODE §4800.3 (b)(1). The court did not address expressly the holding of the lower court that professional education was not property subject to community property principles. *See* 37 Cal. 3d at 767-68, 209 Cal. Rptr. at 356-59 (1984). Hence, the question in those cases reaching a determination that professional education is not subject to division in a marital dissolution proceeding remains unanswered expressly by the California Supreme Court. *Id.* *See generally* *Marriage of Aufmuth*, 89 Cal. App. 3d 446, 461, 152 Cal. Rptr. 668, 677 (1979) (ruling that the trial court did not err in refusing to admit evidence regarding value of legal education). *Todd v. Todd*, 272 Cal. App. 2d 786, 791, 78 Cal. Rptr. 131, 135 (1969) (holding that education is an intangible property right that cannot be valued for division between the spouses in a divorce proceeding).

3. *Sullivan*, 37 Cal. 3d 762, 209 Cal. Rptr. 354.

4. *Marriage of Brown*, 15 Cal. 3d 838, 544 P.2d 561, 126 Cal. Rptr. 633 (1976).

5. CAL. CIV. CODE §4800(a) "Except upon written agreement . . . or on oral stipulation . . . the court shall . . . divide the community property . . . equally." *Id.*

6. *See supra* notes 1-5 and accompanying text.

7. *See infra* notes 59-90 and accompanying text. Other jurisdictions have followed California in recognizing such an interest. *See, e.g.,* *Marriage of Lukens*, 558 P.2d 279, 282-83 (Wash. App. 1976), *Hurley v. Hurley*, 615 P.2d 256, 259 (N.M. 1980). *But cf. Nail v. Nail*, 486 S.W.2d 761, 764 (Tex. 1972) (concluding that the goodwill of a medical practitioner merely was an expectancy that was not property subject to division under a divorce decree).

Traditional definitions of goodwill include the expectation of continued public patronage by a business concern.⁸ Historically, competitive advantages enjoyed by an individual have not been regarded as goodwill.⁹ Appellate courts in California have recognized, however, that the goodwill of a professional may be subject to division upon marital dissolution, regardless of the fact that the professional is a sole practitioner and the existence of any goodwill is a result of personal skill, judgment, and reputation.¹⁰ Trial courts in California have found community goodwill in situations involving bankers, engineers, insurance agents, pharmacists, professors, sales representatives, and social workers.¹¹ As a result of these rulings, the appellate courts of California soon may be faced with the question whether goodwill, or a similar intangible asset, exists when the spouse is a salaried employee who has developed substantially greater earning capacity than other individuals in the same occupation in the same or similar community.¹²

Initially, this author will review the varying definitions of goodwill that cause confusion in this area of the law.¹³ A brief review of cases recognizing professional goodwill as subject to community property principles will be provided.¹⁴ This author next will establish that goodwill is personal in origin,¹⁵ and that court decisions holding that professional goodwill of the marital community can be subject to division upon marital dissolution implicitly recognize that excess earnings result from the existence of goodwill.¹⁶ Excess earnings can be defined as earnings in excess of a normal return on all assets, including labor and services.¹⁷ Recognition that excess earnings are property divisible upon dissolution of the marital community eliminates the potential for confusion in applying traditional goodwill definitions in the community property context.¹⁸ Since excess earnings are the result of the

8. See *infra* notes 24-49 and accompanying text.

9. *Id.* Earning capacity and future income potential are not the same as professional goodwill. *Aufmuth*, 89 Cal. App. 3d at 463, 152 Cal. Rptr. at 679. Future income potential and earning capacity may exist without the existence of goodwill. See *id.*

10. See *infra* notes 50-90 and accompanying text.

11. See Weitzman, *The Economics of Divorce: Social and Economic Consequences of Property, Alimony and Child Support Awards*, 28 UCLA L. REV. 1181, 1214 (1981).

12. See *id.* at 1210, 1214-15.

13. See *infra* notes 24-49 and accompanying text.

14. See *infra* notes 50-90 and accompanying text.

15. See *infra* notes 106-19 and accompanying text.

16. See *infra* notes 120-29 and accompanying text.

17. See *id.*

18. See *id.*

existence of goodwill,¹⁹ excess earnings should be considered community property regardless of whether an ownership interest in a professional practice or business concurrently exists.²⁰

Recent California case law addressing the question whether the excess earnings of an employee are subject to division will be analyzed to illustrate that the courts may fail to divide properly all community assets unless excess earnings are recognized as divisible community property.²¹ Commensurate with this analysis, a brief review of factors giving rise to the existence of excess earnings will be provided.²² First, however, to understand the conceptual confusion that exists in a discussion regarding goodwill, traditional and current definitions will be surveyed.²³

TRADITIONAL GOODWILL DEFINITIONS

Definitions of goodwill are many and varied.²⁴ Goodwill, like many intangibles, has been regarded as a slippery, elusive, ephemeral, and speculative asset.²⁵ Definitions of goodwill generally include terms connoting above-average success and often associate goodwill with marked profitability.²⁶ Goodwill definitions largely have developed in commercial and business law settings.²⁷ Early common law cases restricted this concept by defining goodwill as a probability that an established clientele will resort to the customary place of business.²⁸ Modern

19. *See id.*

20. *See id.*

21. *See infra* notes 130-92 and accompanying text.

22. *See infra* notes 132-34 and accompanying text.

23. *See infra* notes 24-49 and accompanying text.

24. Foreman, *Conflicting Theories of Goodwill*, 22 COLUM. L. REV. 638, 646 (1922). Goodwill has been described as a benefit or advantage

. . . 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.

J. CRANE & A. BROMBERG, LAW OF PARTNERSHIP §84 (1968), quoting from J. STORY, PARTNERSHIP §99 (3d ed. 1950).

25. J. CRANE & A. BROMBERG, LAW OF PARTNERSHIP §84, 447 (1968); *see* Udinsky, *An Economist's View of Professional Goodwill in a Community Property Setting*, 5 COMMUNITY PROP. J. 91, 92 (1978).

26. *See, e.g.*, Driskill v. Thompson, 141 Cal. App. 2d 479, 484, 296 P.2d 834, 838 (1956); Blut v. Katz, 115 A.2d 119, 124 (N.J. Super 1955).

27. *See infra* notes 29-50 and accompanying text.

28. *Id.*

statutory definitions are more inclusive than the common law, defining goodwill as an expectation of public patronage.²⁹

The law of goodwill appears to have originated in an old English decision, which held that an individual could sell the right to compete along with a business.³⁰ Subsequently, the treatment and definition of goodwill evolved against the background of commercial and business settings.³¹ The cases reflecting this evolution generally hold that the goodwill of a business cannot exist independent of the physical assets to which they are incident,³² and that the goodwill of a business may not be sold separately from those physical assets.³³

Lord Eldon's definition of goodwill in *Crutwell v. Lye*³⁴ often is cited for the proposition that goodwill is "nothing more than the probability that the old customers will resort to the old place."³⁵ This definition has been criticized as limiting goodwill to benefits that derive from a well-known location.³⁶ These benefits have been referred to as "location goodwill."³⁷ In an early case, the California court, in *Dodge Stationary Co. v. Dodge*,³⁸ broadened the definition of goodwill to include the "well-founded expectation of continued public patronage."³⁹ A modern statutory definition that codifies the holding of *Dodge*⁴⁰ is provided in California Business and Professions Code section 14100, which defines goodwill simply as the "expectation of continued public patronage."⁴¹

The Business and Professions Code definition of goodwill is cited often in California case law recognizing goodwill as an asset subject

29. CAL. BUS. & PROF. CODE §14100; see *infra* notes 34-41 and accompanying text.

30. J. COMMONS, *LEGAL FOUNDATIONS OF CAPITALISM* 263 (1968). The case described by Commons involved a merchant who sold his stock of goods at a price in excess of their inventory value and simultaneously agreed not to compete with the business of the purchaser. *Id.* at 263-64. When the seller breached his promise not to compete, the buyer brought suit and obtained a favorable decision. *Id.* at 264. Prior to this decision, the courts consistently held that any contract in restraint of trade was void and even criminal. *Id.* By holding that an individual lawfully might sell the right to compete along with a business, this case laid the foundations for the modern concept of goodwill. See *id.* at 263-66.

31. Lurvey, *Professional Goodwill on Marital Dissolution: Is it Property or Another Name for Alimony?*, 52 CAL. ST. B.J. 27, 29 (1977).

32. See, e.g., *Dodge Stationery Co. v. Dodge*, 145 Cal. 380, 386-89, 78 P. 879, 881-82 (1904).

33. See *id.*

34. 17 Ves. 335, 34 Eng. Rep. 129 (1810).

35. *Id.* at 346, 34 Eng. Rep. at 134.

36. J. Commons, *supra* note 30, at 267.

37. *Id.*

38. 145 Cal. 380, 78 P. 879 (1904).

39. *Id.* at 388, 78 P. at 882.

40. *Id.*

41. CAL. BUS. & PROF. CODE §14100.

to division at marital dissolution.⁴² One example is the case of *Golden v. Golden*,⁴³ holding that the goodwill of a professional practice should be subject to division upon dissolution of the marriage.⁴⁴ Although the community property case law dealing with professional goodwill after *Golden*⁴⁵ frequently refers to the definition of goodwill contained in the Business and Professions Code,⁴⁶ reliance upon that definition is not required in the family law context.⁴⁷ As a result, this definition is not dispositive of all circumstances in which an award of goodwill can be made upon division of the marital community.⁴⁸ Thus, a brief examination of the case law concerning professional goodwill is necessary to determine whether the courts improperly have limited the instances in which an award of goodwill may be given in a marital dissolution.⁴⁹

THE PROFESSIONAL GOODWILL DOCTRINE

The divisibility of the goodwill of a sole practitioner professional or proprietor as community property is well established.⁵⁰ In 1969, the California appellate courts first recognized the divisibility of goodwill of a sole practitioner professional as an asset of the marital community.⁵¹ Subsequently, the appellate courts also recognized that a sole proprietor may have divisible goodwill.⁵² California courts first recognized that the marital community has an interest in the goodwill of a sole practitioner professional in *Golden v. Golden*.⁵³

A. *Golden v. Golden*

Several cases prior to *Golden v. Golden* recognized in *dicta* that the goodwill of a professional practice should be subject to division upon dissolution of the marital community.⁵⁴ *Golden*, however, was

42. See *infra* notes 43-49 and accompanying text.

43. 270 Cal. App. 2d 401, 75 Cal. Rptr. 735 (1969).

44. *Id.* at 405, 75 Cal. Rptr. at 737.

45. See, e.g., *Marriage of Foster*, 42 Cal. App. 3d 577, 117 Cal. Rptr. 49 (1974).

46. CAL. BUS. & PROF. CODE §14100.

47. See *id.* §14000 (providing that section 14100 is not necessarily applicable to other sections of the Code).

48. See *infra* notes, 74-193 and accompanying text.

49. See *infra* notes 50-90 and accompanying text.

50. See *id.*; see also *Lurvey*, *supra* note 31, at 30.

51. See *infra* notes 54-71 and accompanying text.

52. See *infra* notes 72-90 and accompanying text.

53. 270 Cal. App. 2d 401, 75 Cal. Rptr. 735 (1969).

54. *Mueller v. Mueller*, 144 Cal. App. 2d 245, 251, 301 P.2d 90, 94-96 (1956); *Brawman*

the first case to decide whether the goodwill of a professional practice should be considered community property subject to division.⁵⁵ In *Golden*, the husband was a sole practitioner physician and the wife was a housewife.⁵⁶ Upon dissolution, the trial court made an elaborate division of the community property, including the allocation of \$32,500 for the goodwill of the medical practice of the husband.⁵⁷ The decree awarded the goodwill to the husband, but required him to make periodic payments until the wife received her one-half interest in the total community assets, including the value of the goodwill of the medical practice.⁵⁸

On appeal, the husband argued that the trial court erred in finding the goodwill of his practice to be community property.⁵⁹ He presented authority supporting the position that no allowance should be made for goodwill if the goodwill is dependent upon the personal reputation and skill of a particular person.⁶⁰ In rejecting this argument, the court cited with approval several prior cases which recognized in *dicta* that the goodwill of a professional practice must be considered in evaluating the extent and nature of community assets for purposes of property division.⁶¹

The *Golden* court held that the goodwill of a sole practitioner professional practice should be considered in determining the appropriate award of community property to the nonprofessional spouse.⁶² In the context of a marital dissolution, the court noted, the practice of the sole practitioner will continue with the same intangible value that existed during the marriage.⁶³ The court reasoned that this treatment was justified by community property principles requiring recompense for contributions made to increase the value of property during the marriage.⁶⁴ Acknowledging that the wife in *Golden* made a contribution to the value of the goodwill of the husband's medical practice, the court stated that the wife was entitled to compensation.⁶⁵

v. Brawman, 199 Cal. App. 2d 876, 882, 19 Cal. Rptr. 106, 109-10 (1962); Fritschi v. Teed, 213 Cal. App. 2d 718, 726, 29 Cal. Rptr. 114, 119 (1963).

55. 270 Cal. App. 2d 401, 75 Cal. Rptr. 735.

56. *Id.* at 404, 75 Cal. Rptr. at 737.

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.* at 405, 75 Cal. Rptr. at 737.

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.* at 405, 75 Cal. Rptr. at 738.

65. *Id.*

Subsequent cases have followed *Golden*, uniformly holding that the goodwill of a sole practitioner professional practice is community property subject to division upon marital dissolution.⁶⁶ Many of these later cases involved the traditional professional practices of medicine or law⁶⁷ and primarily decided whether an appropriate method was used to value the goodwill of the practice.⁶⁸ One case that followed *Golden*, however, did not involve a traditional professional practice.⁶⁹ In *Marriage of Rives*,⁷⁰ the professional goodwill doctrine elucidated in *Golden* was applied to a spouse involved in a business.⁷¹

B. *In re Marriage of Rives*

In *Marriage of Rives*, the husband was involved in the business of raising, selling, and making cages for queen bees.⁷² During the marriage, the primary responsibility of the husband was the queen bee breeding business and the primary responsibility of the wife was the queen bee cage business.⁷³ Upon dissolution, the trial court determined that the queen bee and the queen bee cage businesses were community property.⁷⁴ The trial court valued these assets and awarded the queen bee business to the husband and the cage business to the wife.⁷⁵ The trial court set the value and made community property divisions of the queen bee business, including values for the physical assets and the goodwill of the business.⁷⁶

On appeal, the husband argued that no goodwill existed in the queen bee business.⁷⁷ Moreover, he contended that even if any goodwill properly could be found, the valuation method employed was improper.⁷⁸

66. See *Marriage of Lopez*, 38 Cal. App. 3d 93, 113 Cal. Rptr. 58 (1974); *Marriage of Foster*, 42 Cal. App. 3d 577, 117 Cal. Rptr. 49 (1974); *Marriage of Barnert*, 85 Cal. App. 3d 413, 149 Cal. Rptr. 616 (1978); *Marriage of Aufmuth*, 89 Cal. App. 3d 446, 152 Cal. Rptr. 668 (1979); *Marriage of Slater*, 100 Cal. App. 3d 241, 160 Cal. Rptr. 686 (1979).

67. *Id.*

68. *Id.*

69. *Marriage of Rives*, 130 Cal. App. 3d 138, 181 Cal. Rptr. 572 (1982).

70. *Id.*

71. *Id.* at 145, 181 Cal. Rptr. at 575.

72. *Id.* at 146, 181 Cal. Rptr. at 575.

73. *Id.*

74. *Id.* at 148, 181 Cal. Rptr. at 576.

75. *Id.* at 148, 181 Cal. Rptr. at 577.

76. *Id.* The trial court set the value of the queen bee business at \$90,000, noting that this represented a value for the physical assets of \$9,185 and a value for the goodwill of the business of \$30,000. *Id.* at 149, 181 Cal. Rptr. at 577.

77. *Id.*

78. *Id.*

The court of appeals found that the skill, experience, and reputation of the husband in the queen bee industry was similar to that of a professional practice.⁷⁹ The court observed that previous case law had not limited expressly community property goodwill to situations involving professional practices.⁸⁰ The court then concluded that the business involved was so similar to a professional practice that, as a matter of law, a determination that a queen bee business could not have divisible community property goodwill would be improper.⁸¹

By concluding that the business involved in *Rives* was so similar to a professional practice that the business could have divisible community property goodwill, the court made clear that the professional goodwill doctrine is not limited in application only to professional spouses.⁸² One important factual similarity between *Golden* and *Rives*, however, is the existence of an ownership interest in a business or professional practice.⁸³ This similarity demonstrates that the California courts are willing to recognize the existence of divisible goodwill in cases in which a spouse has an ownership interest in a business organization such as a partnership or corporation.⁸⁴

Also noteworthy is the fact that in both *Golden* and *Rives*, the spouse, against whom a claim for goodwill was made, was a sole practitioner.⁸⁵ The goodwill found to exist was dependent upon the individual skill, reputation, and judgment of the spouse and, therefore, could not be sold or otherwise transferred to a third party.⁸⁶ Transferability of goodwill, then, is not determinative in California regarding whether a spouse will have a successful claim to the goodwill of the community.⁸⁷

79. *Id.*

80. *See id.*

81. *See id.*; *see also* Marriage of Lotz, 120 Cal. App. 3d 379, 384, 174 Cal. Rptr. 618, 621 (1981) (holding that the goodwill of a closely held corporation is subject to division upon dissolution of the marital community).

82. *See* 130 Cal. App. 3d at 149, 181 Cal. Rptr. at 577.

83. *See* Golden v. Golden, 270 Cal. App. 2d 401, 405, 75 Cal. Rptr. 735, 737 (1969); Marriage of Rives, 130 Cal. App. 3d 138, 146, 181 Cal. Rptr. 572, 575 (1982).

84. *See id.*

85. *See id.*

86. *See* Geffen v. Moss, 53 Cal. App. 3d 215, 125 Cal. Rptr. 687 (1975). W. REPPY, COMMUNITY PROPERTY IN CALIFORNIA 169 (1980).

87. Hurley v. Hurley, 94 N.M. 641, 644, 615 P.2d 256, 259 (1980) (noting that salability of goodwill is not dispositive of the question whether goodwill is divisible community property); Note, *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, 233 (1979). Goodwill has value regardless of marketability. *Id.* Lurvey, *supra* note 31, at 30, argues that professional goodwill should not be divisible upon marital dissolution because the goodwill is only an entry on an accounting

What remains unclear is whether an award for goodwill is an award based upon the ownership interest of the spouse in the goodwill of a business organization or whether the goodwill award is a community property division of the goodwill incident to the skill, reputation, and judgment of the individual spouse.⁸⁸ Cases such as *Golden* and *Rives* do not address this issue since they involve sole practitioners.⁸⁹

Individuals without an ownership interest in a business organization that has goodwill may have a quantum of skill, reputation, and judgment tantamount to that of the sole practitioners in *Golden* and *Rives*.⁹⁰ Hence, the question whether skillful, reputable, and wise individuals may have divisible goodwill without having a concurrent ownership interest in a business organization remains unanswered. To arrive at a valid conclusion regarding that question, the constraints imposed by adherence to conventional goodwill definitions must be considered.

DEFINITIONAL CONSTRAINTS UPON EXPANSION OF THE PROFESSIONAL GOODWILL DOCTRINE

Conventional goodwill definitions may limit the application of the professional goodwill doctrine. To decide whether these limitations are appropriate in the community property context, the applicability of general goodwill definitions should be considered. Whether these general definitions are applicable in the community property setting can be resolved by examining the conceptual basis for goodwill.

A. Inapplicability of Traditional Goodwill Definitions

Traditionally, goodwill could not be separated from the physical assets that gave rise to the existence of this intangible asset.⁹¹ As an incident to physical assets of a business, goodwill could not exist absent an ownership interest in a going business concern or professional practice.⁹² A salaried employee generally does not have an ownership

statement until an actual sale. *Id.* This view incorrectly assumes that alienability must be an attribute of community property. See *Marriage of Brown*, 15 Cal. 3d 838, 847-48, 126 Cal. Rptr. 633, 638 (1976). For instance, non-vested pension rights are considered divisible community property despite the fact that such rights are only contingent and nontransferable. *Id.*

88. See *Golden*, 270 Cal. App. 2d at 405, 75 Cal. Rptr. at 737; *Rives*, 130 Cal. App. 3d at 146, 181 Cal. Rptr. at 575.

89. See *id.*

90. *Id.*

91. See, e.g., *Dodge Stationary Co. v. Dodge* 145 Cal. 380, 386-89, 78 P. 879, 881-82 (1904).

92. See *id.*

interest in the business of an employer.⁹³ Since the salaried employee is not involved in ownership of physical assets to which the goodwill is deemed incident, the employee has no claim to the goodwill of the business or professional practice if the traditional definition of goodwill is applied.⁹⁴ Assuming a traditional definition of goodwill is applied, the contention that a salaried employee may have divisible goodwill at dissolution seems inappropriate.⁹⁵

Whether the narrow, conventional definition of goodwill bars consideration of a claim that goodwill may exist absent an ownership interest in a business or professional practice was presented in a recent Los Angeles Superior Court divorce proceeding.⁹⁶ In this case the wife argued that the husband had "executive goodwill" as a result of his skill, reputation, personality, and judgment in the development and production of feature films for the companies that employed him.⁹⁷ The husband noted that all authority cited by the wife involved factual situations in which a spouse had some type of ownership interest in a professional practice or business, relying upon traditional definitions of goodwill.⁹⁸ Based upon that observation, the husband contended that an employee cannot have divisible goodwill.⁹⁹

The trial court concluded that the husband had no divisible goodwill.¹⁰⁰ The basis for this conclusion was undisclosed.¹⁰¹ The court, therefore, could have arrived at this decision based upon considerations of law or fact.¹⁰² The court may have decided, as a matter of law, that an executive does not have divisible goodwill because the executive does not have an ownership interest in the goodwill of the

93. See *id.*

94. See *supra* notes 24-49 and accompanying text.

95. See *id.*; see also *Nastrom v. Nastrom*, 262 N.W.2d 487, 492-93 (N.D. 1978) (holding that entrepreneurial ability could not be considered an asset subject to division upon divorce). The *Nastrom* court, without explanation, concluded that entrepreneurial skills are analogous to, but not the same as, professional goodwill. *Id.* This conclusion demonstrates the difficulty courts have in applying traditional definitions of goodwill to a community property issue. See *id.* The analogy is apparent if excess earnings are seen as the result of goodwill. See *infra* notes 120-92 and accompanying text. The analogy exists because superior entrepreneurial ability, like professional goodwill, produces excess earnings. See Udinsky, *supra* note 25, at 95. The distinction lies in the fact that entrepreneurial skills do not give rise to an ownership interest of the type that exists in a traditional professional practice. See *supra* notes 50-90 and accompanying text.

96. Miller, *Divorce in the Entertainment Industry — Some Special Problems*, 5 COMM/ENT L.J. 43, 58-60 (1982).

97. *Id.* at 59.

98. *Id.*

99. *Id.* at 60.

100. *Id.*

101. *Id.*

102. See *id.*

company for which the executive works.¹⁰³ On the other hand, the court may have concluded, based upon the evidence presented, that the husband did not have any personal goodwill as a matter of fact.¹⁰⁴

Regardless of the rationale used by the trial court, the argument of the husband exemplifies the difficulty inherent in using traditional goodwill definitions in a community property setting. The question whether an ownership interest in a business or professional practice is required before a court properly may find that goodwill or a like intangible constitutes a community asset should not be resolved by mere reliance upon a definition of goodwill developed apart from considerations applicable to community property law. Fundamental principles of community property law require that all property acquired during marriage be considered and treated as community property.¹⁰⁵ If the historical concepts of goodwill are applied in the community property setting, the courts would be foreclosed from recognizing divisible goodwill except in the limited case of a spouse holding an ownership interest in a business organization that has goodwill.

Spouses of individuals who have skill, reputation, and judgment equivalent to the sole practitioners in *Golden* and *Rives* without a concurrent ownership interest in a business organization would not be allowed a recovery even though no economic differences exist between the person with an ownership interest and the person without the ownership interest. Rather than apply the historical notions of goodwill in the context of modern community property law, the conceptual basis of goodwill should be analyzed to determine whether the professional goodwill doctrine should be extended to include goodwill or a similar intangible of an employee as an asset of the marital community.

B. Personal Goodwill: The Goodwill of an Employee

The goodwill of a business always begins as personal goodwill.¹⁰⁶ Later, after a going business is established, a person may sell business or location goodwill without parting with personal goodwill.¹⁰⁷ Personal goodwill is sold when an individual covenants not to act in

103. See *id.*

104. See *id.*

105. CAL. CIV. CODE §4800(a) (providing for equal division of all community property).

106. J. Commons, *supra* note 30, at 267; see also Laube, *Goodwill in Professional Partnerships*, 12 CORNELL L.Q. 303, 326 (1927) (noting that goodwill is largely personal in origin).

107. J. Commons, *supra* note 30, at 267-68; Wright, *Nature and Basis of Legal Goodwill*, 24 ILL. L. REV. 20, 32 n.65 (1929).

a prescribed manner during some future time.¹⁰⁸ What actually is sold is the liberty to act in a manner that brings income in excess of what competitors are able to procure.¹⁰⁹ In a competitive market, personal goodwill exists as a result of the ability of the individual to overcome competition and obtain consent and reciprocity in the marketplace.¹¹⁰ As alternatives and competitive advantages decrease, goodwill also is diminished.¹¹¹ Conceptually, goodwill is the private property of a definite person or concern, resulting from successful past performance.¹¹² The return on the investment in time and effort that establishes goodwill carries a present value.¹¹³ Similar to other valuable investments, the individual or concern possessing goodwill has a reasonable expectation of continued future income.¹¹⁴ Thus, an employee may have goodwill that is personal and can be carried with the employee to a new employer.¹¹⁵

Consequently, goodwill can be described as a form of differential advantage.¹¹⁶ This differential advantage gives rise to earnings in excess of a normal return on assets including labor and services provided.¹¹⁷ The existence of goodwill, whether personal or commercial, results in excess earnings.¹¹⁸ The determination whether personal goodwill can be regarded as an asset subject to community property principles is made easier by recognizing that goodwill results in excess earnings.¹¹⁹

SOLUTION: RECOGNITION OF COMMUNITY EXCESS EARNINGS

Excess earnings can be defined as earnings over and above a normal return for similar services or tangible assets, primarily attributable to exclusive control over an economic resource.¹²⁰ In a business setting, this resource may be the location of the business or an established reputation for quality service.¹²¹ In a professional practice, the

108. J. Commons, *supra* note 30, at 267-68.

109. *See id.*

110. *Id.* at 271.

111. *Id.* at 272.

112. *Id.* at 272-73.

113. *See id.*

114. *Id.* at 273.

115. *See* Wright, *supra* note 107, at 32 n. 65.

116. *Id.* at 25.

117. *See* Udinsky, *supra* note 25, at 93.

118. *See id.* at 92-93.

119. *See id.* at 92-93, 95.

120. *Id.* at 93.

121. *See id.*

economic resource may be the personality or unique talent of the professional.¹²² For an employee, excess earnings may result from education, personality, special talent, business acquaintances, and other qualifications that confer advantage, differential treatment, and a relatively greater number of future employment options.¹²³

In holding that goodwill of a sole practitioner professional practice or a sole proprietorship is subject to community property principles, the California courts implicitly recognize that the present value of community excess earnings is subject to division upon divorce.¹²⁴ Once the professional goodwill doctrine is recognized as dividing the present value of community excess earnings, the courts need not consider whether an ownership interest in a business or professional practice exists.¹²⁵ The realization that goodwill is personal and that goodwill results in excess earnings means that an ownership interest in a business or professional practice need not exist in order to claim that the marital community has an interest in the personal goodwill of an employee.¹²⁶ An acknowledgment that the professional goodwill doctrine actually is a recognition of excess earnings as a community asset would serve to eliminate confusion caused by use of the term "goodwill."¹²⁷ The confusion can be avoided by directing the attention of the court to the question whether excess earnings exist rather than focusing on goodwill.¹²⁸ Since the courts actually are dividing excess earnings of the marital community, rather than goodwill, the extension of the professional goodwill doctrine is appropriate and problems caused by application of historical and traditional definitions of goodwill in the community property setting are avoided more

122. *Id.*

123. *See id.* For example, an associate employed by a large national law firm does not have an ownership interest in the goodwill of the firm, but, depending on compensation received, the associate may have excess earnings. *See id.* The inequity in supposing that the professional goodwill doctrine requires an ownership interest in a professional practice or business may be seen under the facts of the following hypothetical. Two attorneys with essentially the same qualifications begin practice. One chooses to associate with a large, reputable law firm. The second chooses to begin practice as a sole practitioner. After several years of practice, they both achieve substantially similar and comparatively high levels of income. If the professional goodwill doctrine requires an ownership interest, only the spouse of the sole practitioner will have a claim upon the excess earnings even though both attorneys may have similar excess earnings. *See id.*

124. *See id.* at 95-96; *Marriage of Fenton*, 134 Cal. App. 3d 451, 463, 184 Cal. Rptr. 597, 602 (1982).

125. *See id.*

126. *See Udinsky, supra* note 25, at 93.

127. *See id.*; *see supra* notes 24-49, 91-119 and accompanying text.

128. *See Udinsky supra* note 25, at 95-96.

easily.¹²⁹ With this solution in mind, an examination of recent decisions in cases that considered whether the goodwill of an employee is divisible demonstrates the preferability of the proposed solution to limitation of the professional goodwill doctrine.

RECENT CASES AND EXCESS EARNINGS

Recent case law demonstrates the potential difficulty courts face when applying historical definitions of goodwill that have developed apart from community property law.¹³⁰ When excess earnings are recognized as community property, however, the decision of the court also should address the economic consequences of the monetarily successful marital community.¹³¹ Since excess earnings result from the existence of goodwill, the same factors currently used to determine whether goodwill exists can be used to decide the existence of excess earnings.¹³² Therefore, existing case law provides guidelines that can be employed to determine the existence of excess earnings.¹³³

Among the factors a trial court should consider to determine whether excess earnings exist are age, health, demonstrated past earnings power, skill, knowledge, comparative success, and reputation in the community for judgment.¹³⁴ If excess earnings are not recognized as community property, the economic consequences of the marital community will not be divided consistently and uniformly based upon the unrelated consideration of the business form under which the excess earnings

129. See *Fenton*, 134 Cal. App. 3d at 463, 184 Cal. Rptr. at 602.

130. See *infra* notes 130-92 and accompanying text.

131. See *infra* notes 174-192 and accompanying text.

132. See Udinsky, *supra* note 25, at 95. Excess earnings may exist regardless of whether an ownership interest in a business or professional practice is found. See *id.* If the courts recognize excess earnings rather than merely professional goodwill, guidelines already exist to aid in a determination of whether excess earnings exist. See, e.g., *Marriage of Lopez*, 38 Cal. App. 3d 93, 109-10, 113 Cal. Rptr. 58, 68 (1974).

133. See, e.g., *marriage of Lopez*, 38 Cal. App. 3d 93, 113 Cal. Rptr. 58.

134. *Id.* at 109, 113 Cal. Rptr. at 68. The trial court also should be required to determine whether the excess earnings, if any, are separate property, community property, or both, under the general rules for property division in a marital dissolution action. See *supra* note 1 and accompanying text. As with goodwill, the existence of excess earnings is a question of fact for determination by the trial court. *Marriage of King*, 150 Cal. App. 3d 304, 309, 197 Cal. Rptr. 716, 719 (1983). Valuation questions, although beyond the scope of this comment, also will be a question of fact for the trial court. See generally J. Stein, *Business Appraisers and Appraisals*, 1983 FAMILY LAW SYMPOSIUM, FAMILY LAW SECTION LOS ANGELES COUNTY BAR ASSOCIATION (providing an excellent review of professional goodwill valuation methods used in recent case law of California); Comment, *Valuation of Professional Goodwill Upon Marital Dissolution*, 7 Sw. U. L. REV. 186 (1975) (providing a review of valuation methods commonly used and suggesting two alternative valuation methods).

developed.¹³⁵ The case of *In re Rosan*¹³⁶ illustrates the inequities of failure to recognize excess earnings as community property.

A. *In re Rosan*

In *Rosan*, the husband began work as an employee in a jewelry firm shortly after marriage.¹³⁷ He was employed by the firm for sixteen years and at the time of trial was a sales manager and supervisor of two stores for several years.¹³⁸ During the marriage he also acquired fifteen percent of the capital stock of his corporate employer and was vice president of the corporation.¹³⁹ The wife was not employed during the marriage.¹⁴⁰ The court noted that the parties were accustomed to living in a style commensurate with the substantial earnings of the husband.¹⁴¹

The trial court made divisions of community assets and liabilities that included an award to the husband of the stock of the jewelry firm valued at \$30,711.¹⁴² Ownership of this stock was subject to a written agreement between the husband and the only other shareholder of the corporation, who owned eighty-five percent of the stock.¹⁴³ This agreement provided that the shares of the husband could not be transferred or sold to anyone other than the corporation or the other stockholder without prior written consent.¹⁴⁴ In the event that the husband desired to sell the stock, the corporation and the other stockholder, in that order, had the right to purchase the stock for its "computed value" or the price offered to the husband by a third party, whichever was lower.¹⁴⁵ "Computed value" was to be determined by a formula based upon the book asset value of the corporation with certain adjustments, but excluding any allowance for goodwill.¹⁴⁶ If the husband voluntarily quit his employment or was terminated for just cause, the corporation and the other stockholder, in that order, had a right to purchase the stock for seventy percent

135. See *infra* notes 137-73 and accompanying text.

136. 24 Cal. App. 3d 885, 101 Cal. Rptr. 295 (1972).

137. *Id.* at 888, 101 Cal. Rptr. at 297.

138. *Id.*

139. *Id.*

140. *Id.* at 889, 101 Cal. Rptr. at 298.

141. *Id.* at 888, 101 Cal. Rptr. at 298.

142. *Id.* at 889, 101 Cal. Rptr. at 298.

143. *Id.* at 890, 101 Cal. Rptr. at 298.

144. *Id.*

145. *Id.*

146. *Id.*

of the computed value of the stock.¹⁴⁷ The trial court, in determining the value of the stock to be \$30,711, decided that the interest of the community in the stock was seventy percent of the computed value of the stock.¹⁴⁸

On appeal, the wife argued that the trial court erred by failing to give consideration to the possible existence of goodwill.¹⁴⁹ The wife contended that this valuation wrongly utilized the computed value as defined by the stock transfer agreement and that this method wrongly excluded an allowance for goodwill.¹⁵⁰ The wife suggested that if the jewelry firm were to be acquired by another corporation the stock would have a far greater value than the computed value.¹⁵¹ The court, however, concluded that since no evidence of any planned merger or acquisition was presented, and in view of the restrictive conditions placed upon the disposition of the stock, the trial court was justified in assessing the value of the stock at seventy percent of the computed value.¹⁵² The court did not consider, at this point in the opinion, whether the employee had goodwill or excess earnings that should have been subject to division.¹⁵³ The court only considered whether the goodwill of the business organization in which the employee held stock was to be included in the community property division.¹⁵⁴

Since the decision of the court foreclosed recovery of the value of any goodwill in the business in which the husband had an ownership interest, the only other possible theory for recovery of goodwill would have been a contention that the husband had goodwill subject to division as an employee.¹⁵⁵ The court then considered whether the husband could have divisible goodwill as an employee, referring to this type of individual goodwill as established employment.¹⁵⁶ In making this reference to established employment, the court cited portions of two opinions discussing goodwill.¹⁵⁷ The discussion of goodwill in these

147. *Id.* at 890, 101 Cal. Rptr. at 299.

148. *Id.*

149. *Id.*

150. *Id.*

151. *Id.*

152. *Id.*

153. *See id.*

154. *See id.*

155. *Id.* at 898, 101 Cal. Rptr. at 304. The court did not expressly define what constitutes established employment. *Id.* However, the court did consider the term to be synonymous with earning capacity. *Id.*

156. *Id.*; *Todd v. Todd*, 272 Cal. App. 2d 786, 793, 78 Cal. Rptr. 131, 136 (1969); *Brawman v. Brawman* 199 Cal. App. 2d 876, 882-83, 19 Cal. Rptr. 106, 109-10 (1962); *Lurvey, supra* note 31, at 82 n.63.

157. 24 Cal. App. 3d at 898, 101 Cal. Rptr. at 304; *Lurvey, supra* note 31, at 80-82.

opinions led the court to observe that in cases involving a self-employed professional or proprietor, the spouse may recover for contributions during the marriage made to the development of established employment.¹⁵⁸

The *Rosan* court viewed the finding of goodwill in professional practice cases as a way for the courts to divide established employment as community property.¹⁵⁹ Rather than divide any community excess earnings, the court chose to award to the wife, as increased support obligations, the equivalent of what would have been divisible excess earnings or goodwill had the husband been self-employed.¹⁶⁰ Reasoning that established employment cannot be considered divisible property like goodwill, the court concluded that established employment should be considered when determining the appropriate support award to the wife.¹⁶¹ Thus, the *Rosan* court believed that a division of goodwill as community property was the method employed to compensate a nonprofessional spouse for contributions during the marriage made to increase the earning capacity of the professional spouse to a level above that of other similarly situated professionals.¹⁶² As a result, this court subjected an asset, which would otherwise be community property, to the uncertainties of a support award based solely upon a consideration of the business form under which the excess earnings developed.¹⁶³

If excess earnings are considered divisible community property, California courts faced with circumstances similar to *Rosan* will not be forced to decide whether an individual litigant receives income under a particular business form before deciding if the marital community has a divisible interest in the economic result of goodwill.¹⁶⁴ Excess earnings exist regardless of whether a spouse is an employee or a sole practitioner.¹⁶⁵ Furthermore, this approach requires the courts

158. 24 Cal. App. 3d at 898, 101 Cal. Rptr. at 304; Lurvey, *supra* note 31, at 80-82.

159. *Id.*

160. 24 Cal. App. 3d at 898, 101 Cal. Rptr. at 304.

161. *Id.*, Lurvey, *supra* note 31, at 80-82.

162. *See id.*

163. *See* 24 Cal. App. 3d at 898, 101 Cal. Rptr. at 304; *see also* Bruch, *The Definition and Division of Marital Property in California: Towards Parity and Simplicity*, 33 HASTINGS L. J. 769, 816 (1982). Modifiable spousal support awards are not a proper method of compensating for inequitable community property divisions. *Id.* Significant spousal support orders rarely are entered and enforced. *Id.* The support award also may terminate before adequate recompense on death or remarriage of either spouse. *Id.* More importantly, determinations regarding characterization of property for purposes of marital dissolution should not be dependent on the discretion of the trial court as are determinations of spousal support. *Marriage of Brown*, 15 Cal. 3d 838, 848, 126 Cal. Rptr. 633, 639 (1976).

164. *See infra* notes 174-92 and accompanying text.

165. *See supra* notes 120-29 and accompanying text.

simply to consider the existence of excess earnings in making spousal support awards when the spouse happens to be an employee.¹⁶⁶ The economic consequences of the existence of excess earnings are the same in both circumstances, but excess earnings will be handled disparately based solely upon the unrelated coincidence of the business form under which a spouse earns income.¹⁶⁷ Recognition that excess earnings are divisible would preclude this arbitrary treatment and allow courts to divide equitably the community assets, rather than forcing the courts to increase spousal support awards depending upon whether the litigant is self-employed or an employee.¹⁶⁸

An approach similar to the one proposed by this author was employed ten years after *Rosan* in *Marriage of Fenton*.¹⁶⁹ *Fenton* presented facts similar to *Rosan* since both involved agreements excluding the value of goodwill upon disposition of the shares of the corporation held by an employee.¹⁷⁰ Both courts also separately considered whether the employee had goodwill that should be subject to division at dissolution of the marriage.¹⁷¹ *Fenton*, however, recognized excess earnings as being synonymous with goodwill. *Fenton* observed that the excess earnings resulting from the existence of goodwill would continue to benefit the husband whether he continued as an employee or became an independent contractor.¹⁷² An examination of the decision in *Fenton* establishes the preferability of recognizing excess earnings as community property to limitation of the professional goodwill doctrine.

B. *Marriage of Fenton*

In *Fenton*, the husband was a prominent attorney in the county where the couple resided.¹⁷³ The husband was noted for his good health and excellent professional reputation, with annual earnings in excess of \$100,000, the highest earnings in his law firm.¹⁷⁴ He had been in practice for more than twenty-five years, and expert testimony revealed that his earnings were considerably greater than that of his peers.¹⁷⁵

166. 24 Cal. App. 3d at 898, 101 Cal. Rptr. at 304.

167. *See id.*

168. *See infra* notes 170-73 and accompanying text.

169. 134 Cal. App. 3d 451, 184 Cal. Rptr. 597 (1982).

170. *Id.*

171. *Id.* at 463, 184 Cal. Rptr. at 602.

172. *Id.*

173. *Id.* at 456, 184 Cal. Rptr. at 598.

174. *Id.* at 457, 184 Cal. Rptr. at 599.

175. *Id.* at 463, 184 Cal. Rptr. at 602.

The husband owned approximately a five and one half percent interest in the law corporation that employed him.¹⁷⁶ This interest was held pursuant to a stock purchase agreement excluding any allowance for goodwill in sale of shares of the corporation.¹⁷⁷

Upon marital dissolution, the trial court concluded that since the stock purchase agreement precluded an allowance for goodwill of the corporation, no divisible community goodwill could exist.¹⁷⁸ The decision of the trial court was based upon the fact that ownership of an interest in the law corporation would not produce income.¹⁷⁹ The court noted that income could be produced only through an employment contract and believed that since the employment contract in this case did not transfer the benefit of whatever goodwill the law corporation possessed, the husband had no divisible goodwill.¹⁸⁰

On appeal, the court reversed and held that the community assets included both the goodwill of the husband and his interest in the law corporation.¹⁸¹ In considering the goodwill issue, the *Fenton* court specifically mentioned several factors important to the conclusion that the employee in this case had goodwill.¹⁸² First, the court observed that the husband was the highest wage earner employed by the firm.¹⁸³ Second, the court noted that the husband had been in practice for over twenty-five years and that he had an excellent reputation in the community.¹⁸⁴ Most notably, the court observed that the experience and excess earnings capacity of the husband was a community asset, indirectly creating excess earnings whether the husband continues as an employee of the law firm or begins a solo practice.¹⁸⁵ The court then held that the goodwill of the husband could not be eliminated by mere recitals in corporate documents and remanded the case for a determination of the value of the goodwill.¹⁸⁶

The *Fenton* decision represents a more practical approach than that taken by the court in *Rosan*.¹⁸⁷ By recognizing the economic consequences of the monetarily successful marital community, both spouses are compensated appropriately.¹⁸⁸ The court addressed the economic

176. *Id.* at 465, 184 Cal. Rptr. at 603.

177. *See id.* at 461, 184 Cal. Rptr. at 601.

178. *Id.* at 460, 184 Cal. Rptr. at 600.

179. *Id.*

180. *Id.*

181. *Id.* at 463-65, 184 Cal. Rptr. at 602-03.

182. *Id.* at 463, 184 Cal. Rptr. at 602.

183. *Id.*

184. *Id.*

185. *Id.*

186. *Id.*

187. *See id.*

188. *See id.*

realities of the marital community by separately considering the community interest in excess earnings and the community interest in the law corporation.¹⁸⁹ In considering whether the employee had any divisible goodwill, the court acknowledged that since the employed spouse will continue to enjoy the benefit of excess earnings after separation and dissolution, the excess earnings are to be considered a community asset.¹⁹⁰ Thus, the community property division of excess earnings in this case was not subject to the unrelated issue of whether the spouse was an employee or owner as in *Rosan*.¹⁹¹ Treatment of excess earnings as a community asset, therefore, avoids the vagaries associated with the application of historical definitions and treatment of goodwill.¹⁹²

CONCLUSION

Traditional definitions of goodwill require the existence of a conventional business concern prior to recognition that goodwill may exist. Similarly, a narrow reading of the professional goodwill doctrine requires a proprietary interest in a professional practice or business as a condition to recognition that divisible goodwill may exist in a marital dissolution proceeding. This author has established that traditional definitions of goodwill should not bar a finding that an employee may have goodwill subject to division as community property. A realization that the professional goodwill doctrine is an implicit recognition that excess earnings are divisible as community property allows the expansion of the professional goodwill doctrine to employees. Since excess earnings result from the existence of goodwill, courts can use the factors currently employed to decide whether goodwill exists in order to determine whether excess earnings exist in a particular case. In recent cases that have considered whether excess earnings of an employee should be subject to division as an asset of the marital community, the more well reasoned decisions have ignored the business form under which the excess earnings are produced. These decisions have addressed the economic consequences of the existence of community excess earnings by appropriate division of those earnings as community property.

James R. Harper

189. See *id.* at 460-65, 184 Cal. Rptr. at 600-03.

190. See *id.* at 463, 184 Cal. Rptr. at 602.

191. See *supra* notes 170-73 and accompanying text.

192. See *supra* notes 24-49, 91-105 and accompanying text.