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I. INTRODUCTION

The United States has evolved from an industrial society to a post-industrial informational society in a period of just over twenty years. This social and economic transformation has caused legal scholars to rethink traditional conceptions of work, property, and capital. With the possible exception of land, tangible property often has fleeting value in this new economic regime. Rapid technological change makes equipment and machinery obsolete. International saturation advertising, made possible by instantaneous global communication, reduces the value of hedonic investments. Low-cost foreign production has reduced the value of mineral resources and raw materials.

Wealth has taken on a new meaning in today’s volatile economy. Joan Williams has pointed out that today even relatively wealthy individuals accumulate few net assets compared to


3 See Oakley, supra note 1, at 2242-43 (arguing that “soft property,” such as software and other intellectual property, is increasingly valuable as a means for making productive use of “hard property”).

their annual income. Wealth in today’s society is based on the ability to generate future income. This new wealth has taken two primary forms: financial assets (stocks, bonds, savings accounts and similar investments) and human capital. Human capital is an investment in skills and knowledge that generates income-earning capacity. Human capital may take the form of higher education, professional licenses, specialized skills, or even sales contacts.

The evolution of human capital as a primary source of wealth in the United States has created difficulties for family law courts attempting to distribute property at divorce or separation. Feminist writers have noted that gender roles necessarily lead to inequities in human capital because women typically disinvest in their careers to raise children or to promote a husband’s career opportunity, while men continue to enhance their careers.

This essay presents the thesis that the enhanced earnings capacity of a career (human capital) that results from the investment of community labor and community funds during a

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1 See Williams, supra note 4, at 393.

2 Cf. Robert C. Ellickson, Property in Land, 102 Yale L. J. 1315, 1353 & n.181 (1992), cited by Williams, id. at 393 n.62, (arguing that in the United States human capital makes up more than 75% of wealth because compensation of employees and income of sole proprietors amount to more than that fraction of national income).


4 See id.; Williams, supra note 4, at 393 (quoting Allen M. Parkman, No-Fault Divorce: What Went Wrong? 130 (1992): “Human capital exists when individuals have an income-earning capacity.”)

5 See Parkman, supra note 8, at 114-15. Parkman notes that no-fault divorce and the trend toward an equal distribution of property result in inequities when human capital is not considered to be property. See id, at 129-30.

marriage is an intangible asset, career goodwill,\textsuperscript{11} that can be valued in the same manner as other forms of goodwill. Other commentators, most notably Allen Parkman, have proposed valuing human capital in a similar manner.\textsuperscript{12} Courts have been inconsistent in their recognition of this goodwill because of conceptual difficulties in understanding the nature of goodwill and because courts fail to understand how to value this goodwill. The essay presents a principled approach to valuing this goodwill consistently, regardless of the type of career or form of business enterprise.

II. The Problem Presented: A Search for a Principled Treatment of Goodwill

Entrepreneurs have recognized goodwill as a property right for over 400 years.\textsuperscript{13} Today, goodwill constitutes the bulk of the value of the largest American companies.\textsuperscript{14} Yet, despite its

\textsuperscript{11}This paper will refer to the capitalized value of the enhanced earnings potential of a career as “career goodwill” independent of the form that the asset holds. Other authors have used slightly different terms to refer to career goodwill. See Lenore J. Weitzman, The Divorce Revolution 121-24 (1985) (using the term career assets); Davis, supra note 10, at 109 n.1 (defining human capital); Diane Green Smith, Note, 'Til Success Do Us Part: How Illinois Promotes Inequities in Property Distribution Pursuant to Divorce by Excluding Professional Goodwill, 26 J. Marshall L. Rev. 148 (1992) (using the term professional goodwill). Career goodwill is broader than human capital because it encompasses intangible assets that can be transferred, such as customer lists, contracts, and goodwill in professional corporations. Enhanced career earnings capacity may result from many different events or career attributes. For example, earnings capacity of a career may be enhanced by the attainment of a degree or a professional license, by obtaining an extensive clientele or developing an extensive network of contacts, by developing celebrity status, or even by obtaining a promotion to a new level of responsibilities. All of these events enhance the earnings capacity of a career in a more or less permanent way and therefore contribute to career goodwill.

\textsuperscript{12}See Parkman, supra note 8, at 130-32. Parkman proposes to value human capital by reducing the increase in the stream of expected future earnings during the marriage to present value by applying a discount factor. See id. at 132. Parkman also proposes compensating the spouse who “disinvests” in a career in order to support the other spouse. See id. at 132-34. This article modifies Parkman’s valuation approach by considering what portion of future enhanced earnings potential should be capitalized and what factors should enter into the capitalization formula to answer certain concerns of courts, particularly with respect to transferability of the career goodwill.

ubiquitous nature, the proper treatment of goodwill in divorce or separation proceedings continues to be a source of debate and disagreement between scholars. Nearly a quarter century ago, Dr. Lenore Weitzman began the scholarly debate over whether professional licenses, degrees, and other career assets should be treated as property capable of division upon divorce or separation. The problem cited by Dr. Weitzman and by other scholars is that the investment by married couples in the future earnings capability of one of the spouses is often the most valuable investment made during any marriage. If a marriage ends in divorce or separation, the spouse whose career has been enhanced leaves the marriage with a significant economic advantage over the other spouse. The economic advantage is even more pronounced if the marriage ends before the spouses have had the opportunity to acquire substantial tangible property or otherwise benefit from the career investment.

Despite the extensive scholarly debate, the problem appears as intractable as ever. Courts are becoming increasingly polarized on this issue. New York and New Jersey courts recognize not only professional degrees and licenses but also celebrity careers as marital

14 See discussion infra Part IV & notes 38-39.

15 Jana B. Singer credited Weitzman’s article, Legal Regulation of Marriage: Tradition and Change, 62 Cal. L. Rev. 1169 (1974), with coining the term “career assets” and beginning this debate. See Jana B. Singer, Husbands, Wives and Human Capital: Why the Shoe Won’t Fit, 31 Fam. L. Q. 119, 119 (1997). See also Lenore J. Weitzman, The Divorce Revolution ch. 5 (1985). Weitzman’s treatise included pensions, professional education and licenses to practice a profession or trade, fringe benefits of employment, and the goodwill of a business in her definition of career assets. See id. at 110. In chapter 5 of her treatise, Weitzman analyzed goodwill value of a business as a separate career asset from professional education and licenses rather than the same asset – goodwill. See id. at 121-24. I suggest that the failure of Weitzman and other commentators to treat career goodwill in a unified manner may contribute to the inconsistent treatment of these assets by the courts.


property capable of distribution. On the other extreme, Texas and Louisiana courts refuse to recognize all professional goodwill, including goodwill in professional corporations.\(^{19}\) Some commentators have called for such drastic measures as requiring equal post-divorce sharing of income for a number of years or a limited fault-based defense.\(^{20}\) Other commentators despair that judicial application of no-fault divorce laws sabotages the policy of equal division of community property by not considering certain assets in distributable community property.\(^{21}\) These commentators suggest that prospective spouses can protect themselves only through antenuptial agreements.\(^{22}\)

This essay presents the thesis that courts in most jurisdictions have dealt with this problem inconsistently because of a conceptual difficulty in understanding the nature of goodwill and how to value it. Spouses who practice their chosen careers through partnerships, closely held corporations, or some types of sole proprietorships, usually find the courts treating their enhanced earnings capacity as goodwill of the business enterprise and holding that it is a divisible asset. On the other hand, courts rarely find a divisible asset where a spouse practices a career as an employee or as a professional sole proprietor. There does not appear to be any principled reason why the form of the business enterprise (corporation versus sole proprietorship,


\(^{22}\) See id. at 518-19.
for example) or the nature of the career (professional manager versus attorney) should affect whether a court recognizes a property right in the enhanced earning potential.\textsuperscript{21}

Several equitable distribution states\textsuperscript{24} and three community property states\textsuperscript{25} provide a spouse who invests in the career of the other spouse an equitable right to reimbursement for some of the investment. This approach, when used by community property states, presents several analytical problems. First, why should it matter that the non-career spouse earned the funds used to support the career of the other spouse? For community property states, it is irrelevant which spouse works to earn the community assets. Second and most importantly, there is no reason for equitable reimbursement if the career investment is not property. A right to equitable reimbursement exists, in the context of community property, when community property is used to improve the separate property of one of the spouses. Therefore, the equitable reimbursement right is inherently contradictory. On the one hand, it arises because the career is held not to be community property. On the other hand, it is premised on the perception that the spouse possessing the career leaves the marriage unjustly enriched by an investment of community labor and funds in a separate asset.

\textsuperscript{21}Numerous courts and commentators have raised this issue. See, e.g., Mitchell v. Mitchell, 732 P.2d 208, 211 (Ariz. 1987) (recognizing that "[i]t would be inequitable to hold that the form of the business enterprise can defeat the community's interest in the professional goodwill.")

\textsuperscript{24}Equitable distribution states, for the purposes of this essay, are those states which do not treat property acquired during the marriage through the labors of the spouses as community property but instead provide for an equitable division of marital property upon divorce. Forty-one states and the District of Columbia are included in this category. See, e.g., Diane Green Smith, Note, 'Til Success Do Us Part: How Illinois Promotes Inequities in Property Distribution Pursuant to Divorce by Excluding Professional Goodwill, 26 J. Marshall L. Rev. 147, 157 (1992).

\textsuperscript{25}Community property states treat all property acquired during the marriage through the labors of the spouses as community property by default, with an equal distribution of community property the rule upon termination of the community by divorce or separation. Nine states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin) are community property states. See Linda D. Elrod & Robert G. Spector, A Review of the Year in Family Law: A Search for Definitions and Policy, 31 Fam. L. Q. 613, 654 table 5 (1998).
III. Three Hypothetical Cases as a Tool for Analysis

Consider three hypothetical professionals. Able, a medical doctor, establishes a professional corporation with another doctor. The professional corporation is organized under the New Mexico Professional Corporation Act, which prohibits non-physicians from owning shares in the corporation. Over a period of ten years, the corporation’s income has increased dramatically due to the fine reputation of the physicians. In a divorce or separation proceeding, Dr. Able’s spouse presents expert testimony that the corporation’s fair market value is twice the value of the tangible assets based on its ability to generate above-average earnings.

The second professional, Brenda, is a veterinarian who developed a private practice. Her practice, a sole proprietorship, thrived over ten years, similar to Dr. Able’s practice. However, she grew tired of the management and accounting headaches. A company that manages veterinary practices presented the following proposal to her. The company would pay her for the fair market value of the tangible assets of the practice, but would not pay for any goodwill. She would continue to work for the company as an employee, performing the exact same duties as before. She would receive as a salary an amount of money roughly equivalent to what she had earned as profits in the previous year with appropriate adjustment for the value of fringe benefits, and she would receive an annual bonus if the practice’s revenues increased in the future. Dr. Brenda immediately accepted the offer. A few months later, she divorces her spouse of 20 years. Her spouse presents expert testimony that she can expect to earn substantially more in income over the next 15 years because of her well-established practice.

The third professional, Chuck, is a corporate sales executive without a degree. A major corporation hires Chuck because of the sales contacts that he developed over the past ten years. He earns approximately the same annual income as the other professionals listed above. Chuck was married during the ten years that he developed those sales contacts. His spouse supported the family both financially and emotionally in the “lean” years while Chuck was on the road. Chuck files for divorce. His spouse presents expert testimony that Chuck can expect future
income considerably greater than other sales executives because of the sales contacts that he
developed during his years of marriage.

All three individuals listed above possess high earnings potential as they leave their
marriage based on skills, reputation, education, and other qualities that they obtained during
marriage. All three possess a career asset that is analogous to goodwill in the economic sense—an expectation of a stream of future earnings resulting from intangible factors. This paper will label this career asset “career goodwill.” Yet, there are some differences between the individuals. Dr. Able practices medicine in a professional corporation with another doctor. Dr. Brenda practices alone—initially, she practiced in a sole proprietorship, but at the time of divorce she was an employee. Chuck has always been an employee. Dr. Able and Dr. Brenda have professional licenses and degrees, but Chuck does not.

These three hypothetical examples illustrate the unprincipled nature of some of the
distinctions used by courts to support recognition of career goodwill in some cases but not in others. For example, Dr. Able practices medicine through a professional corporation while Dr. Brenda was a sole proprietor before selling the assets of her company. Why should the form of organization of the business enterprise (professional corporation versus sole proprietorship) affect the judicial decision to recognize goodwill?26 Dr. Able practices with another professional while Dr. Brenda is the sole professional. Yet, both business enterprises possess goodwill based on an established clientele. Is that customer loyalty personal goodwill to the sole proprietor (and therefore not community property) but business goodwill (and therefore community property) if the proprietor associates with another professional or hires an employee?27

Dr. Brenda’s sale of her practice’s tangible assets, but not the practice’s goodwill, illustrates the need to treat employees and sole proprietors consistently. After the sale of the practice’s tangible assets, Dr. Brenda retains the rights to the stream of excess income that results


from her practice's accrued goodwill. She is now an employee rather than a sole proprietor. If goodwill were recognized as community property before the transaction, why should goodwill no longer be recognized after the transaction?

Lastly, the comparison between Dr. Brenda and Chuck illustrates the conceptual difficulties that result when a court states that it is the professional degree or license that is the "property." Chuck does not have a professional degree or license. He is an employee, just as Dr. Brenda is. He has career goodwill (customer lists, sales contacts, etc.) that a business would regard as intangible property rights constituting goodwill. Does a court refuse to recognize goodwill because Chuck does not have a degree or license that it can point to as the "community property" subject to division?

These examples illustrate the need to treat career goodwill consistently and to develop a valuation methodology that accounts for career goodwill in all three cases. The similarities in the nature of the career goodwill between these three cases outweighs any differences based on artificial distinctions such as the form of ownership of a professional practice, the presence of a professional degree or license, or the transferability of the practice.

IV. The Problematic Treatment of Career Goodwill by Courts in Community Property States

Courts have had difficulty defining goodwill. Courts define goodwill as "the favor

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28 See Catlett & Olson, supra note 13, at 9. Courts are not alone in their difficulty, as Catlett and Olson note that the concept of goodwill is among the most difficult in accounting. See id. One reason why courts have had difficulty defining "goodwill" may have to do with the connotations of benevolence or kind feelings implicit in the term. See Webster's 3d Int'l Dictionary (1981) (providing one definition of "goodwill" as "kindly feeling: well-wishing, benevolence, friendliness"). In an economic sense, "goodwill" has little to do with benevolence or kind feelings, as Catlett and Olson note that the nature of goodwill has evolved over the years to include a much broader range of intangible assets. See Catlett & Olson, supra note 13, at 9-12.
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which the management of a business wins from the public,  

"the expectation of continued public patronage," the sum of all favorable attributes contributing to the earning power of a business, "advantages business has over competitors as a result of its name, location, and owner's reputation," and "any privilege that gives reasonable expectancy of preference in the race of competition." In fact, none of these definitions is broad enough when goodwill is used in the economic sense because goodwill is actually the value of earning power.

Goodwill in an economic or accounting context is the excess of a business' fair market value over its tangible asset value. Why would the market value a business in excess of its tangible asset value? The answer can be found in almost any investment publication: earnings potential. One of the principal indicators of a stock's value is the price to earnings multiple.

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29 Holbrook v. Holbrook, 309 N.W.2d 343, 345 (quoting Black's Law Dictionary 625 (5th ed. 1979)).


32 Marathon Petroleum Co. v. Chronister Oil Co., 687 F. Supp. 437, 440 (C.D. Ill.).


34 See Catlett & Olson, supra note 13, at 11-12.

35 See Black's Law Dictionary (stating that "[i]n the purchase of a business, goodwill generally is the difference between the purchase price and the value of the assets acquired.") See also Lanny M. Solomon et al., Accounting Principles 388 (3d ed. 1990) (stating that goodwill is the difference between current value of assets and purchase price of a business).

36 See Solomon et al., supra note 35, at 388 (stating that a purchaser of a business "[i]n all likelihood" paid more than a business' net asset value because of anticipations that the company's earnings record would continue).
The fact that the price to earnings multiple is the most widely recognized benchmark for determining a stock’s value provides compelling evidence that the right to share in future expected earnings is a recognized property interest.

Corporate goodwill – i.e., the right to share in the earnings potential of corporations – is, as an aggregate, the single most valuable asset in America today. The financial markets value the goodwill in the largest American corporations at over $3 trillion.

All community property states recognize the intangible goodwill of a business corporation that was acquired during a marriage to be capable of division as community property. The most obvious example is the goodwill component of publicly traded corporate stock. Certainly no court would countenance the argument that the portion of the value of

37 See George Lasry, Valuing Common Stock: The Power of Prudence 120 (1979). The price to earnings multiple is also known as price-earnings ratio or P/E ratio. The price to earnings multiple is most meaningful when it is expressed as the ratio of the stock’s price to the expected earnings per share for the next 12 months. The P/E ratio is positively correlated to a stock’s expected earnings growth and inversely correlated to the interest rate that investors could receive for debt investments of similar risk. See id. at 121. The P/E ratio is calculated for most listed stocks in the daily stock tables published in most major newspapers. See, e.g., Wall St. J., April 28, 1998, at C-3.

38 The five hundred large publicly traded corporations that make up the Standard and Poors 500 Stock index currently trade at market prices about 5 times their “book value,” or the value of their tangible assets. See Tom Walker, Atlanta J. & Const., April 11, 1998 at H1. This implies that the market values these companies as worth 5 to 6 times the value of their tangible assets – implying that goodwill makes up 80% or more of the value of the companies. Even assuming that the “book value” of the tangible assets understates their actual value by a factor of two, the S&P 500 price to actual tangible asset value would be 2.5 to 3, which implies that goodwill makes up over 60% of the market value of these companies.

39 See Bruce Burton, 144 Chicago Daily Law Bull. April 20, 1998 at 6 (stating that at the end of 1995, the combined S&P 500 companies’ market value exceeded the value of their fixed assets by $3.4 trillion). Based on a price to book ratio of 5 and an S&P 500 market value of $6 trillion, which would accurately reflect the increased market value of U.S. stocks from 1995 through April 1998, goodwill is presently approximately $4.8 trillion.
publicly traded common stock attributable to goodwill should not be included in community property because it represents an intangible asset.

Two community property states draw the line between recognizing goodwill as community property and treating it as personal to the career spouse based on whether the goodwill is attached to a business enterprise distinct from the spouse's personal reputation. For example, Louisiana courts refuse to recognize any goodwill in professional corporations as community property because the goodwill, in their view, is merely the reflection of the professional's reputation. Texas, similarly, refuses to recognize any goodwill in professional practices, even if the practice has a developed clientele and the practice may be transferred to another professional upon the retirement of the owner. The other seven community property states allow goodwill in professional corporations to be divided as community property.

No community property states recognize the goodwill inherent in a professional license or a degree to be a community property interest capable of division at divorce or separation. While the courts in these states agree that goodwill in a license or a degree is not a property interest capable of division, they do so for numerous different reasons. Texas, for example, rejects professional goodwill in all forms, holding that it is not a vested property right. In Nail v. Nail, the court refused to recognize the goodwill of the husband's medical practice as community property subject to division in a divorce proceeding. The court held that the accrued

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42 Id. at 761.
goodwill in the practice:

\[\text{did not possess value or constitute an asset separate and apart from his person, or from his individual ability to practice his profession. . . . The good will of the husband’s medical practice here . . . may not be characterized as an earned or vested right or one which fixes any benefit in any sum at any future time. That it would have value in the future is no more than an expectancy wholly dependent upon the continuation of existing circumstances.}\]

Several Texas appellate courts have interpreted \textit{Nail} to permit goodwill to be recognized where there is evidence of business goodwill apart from the personal reputation of the professional spouse.\(^{44}\) A number of courts in community property states and equitable distribution states have attempted to ameliorate the harsh effects\(^{45}\) of their failure to recognize professional goodwill as property available for distribution at divorce or separation. For example, the state of Washington provides a right of equitable reimbursement to a spouse who provided financial support for the professional spouse to earn a license or degree, but who did not benefit substantially from the fruits of the license or degree.\(^{46}\) In \textit{Washburn}, Washington’s Supreme Court decided two companion cases, both involving spouses who supported their husbands through veterinary

\[^{43}\text{Id. at 764.}\]


\[^{45}\text{The reader may question whether failure to reimburse a spouse for contributions to the education and training of the other spouse should be viewed as a harsh result if the degree or license that results from that training is not a property right but is a mere expectancy. The fact that courts view this result as harsh provides further support that career goodwill in any form is a property right that should be valued and included in the property distribution equation at divorce and separation.}\]

\[^{46}\text{See In re Marriage of Washburn, 677 P.2d 152, 158 (Wash. 1984).}\]
school.\(^7\) Both marriages ended in divorce; the Washburn marriage ended soon after the husband began his veterinary practice, while the Gillette parties separated just before Mr. Gillette obtained his degree.\(^8\) The court refused to find a property interest in a professional degree, stating that it was not “inclined to address at this time the somewhat metaphysical question of whether a professional degree is ‘property.’”\(^9\) Nonetheless, the Washburn court recognized an equitable right of the spouse to compensation for the contribution towards the cost of an education.\(^9\)

California provides a similar right of reimbursement by statute.\(^51\) Section 2641 of the California Family Code provides that the community is entitled to reimbursement for contributions to the education or training of a spouse upon divorce or legal separation unless “[t]he community has substantially benefited from the education, training, or loan incurred for the education or training of the party.”\(^52\) The same statute also provides that the right of reimbursement “is the exclusive remedy of the community or a party” for the education or training, thereby foreclosing the possibility of judicial recognition of an educational degree as community property.\(^53\)

\(^{47}\) See id. at 153-55.

\(^{48}\) See id. at 154-55.

\(^{49}\) See id. at 157.

\(^{50}\) See id. at 161. The Washburn court provided the trial court with broad discretion to determine the form of the compensation, stating that a lump-sum property distribution, periodic maintenance award, or installment payments of a lump-sum maintenance award would be proper. See id. at 158, 160.


\(^{52}\) Id. § 2641(c)(1).

\(^{53}\) See id. § 2641(d).
There are several difficulties with the “equitable reimbursement” approach when applied in the context of community property. First, the equitable reimbursement approach was grafted onto community property law from the equitable distribution jurisdictions without any discussion of its basis in community property law. Washington’s supreme court in Washburn borrowed heavily from decisions of courts in equitable distribution states to fashion its solution. In fact, the Washburn court quotes the New Jersey Supreme Court’s decision in Mahoney v. Mahoney to justify the need for reimbursement:

Where a partner to marriage takes the benefit of his spouse’s support in obtaining a professional degree or license with the understanding that future benefits will accrue and inure to both of them, and the marriage is then terminated without the supported spouse giving anything in return, an unfairness has occurred that calls for a remedy.

California’s statutory solution of imposing an equitable right of reimbursement appears to have been more of a compromise than a principled resolution of the issue because California’s community property law requires community property to be divided equally at divorce. The equitable distribution approach is not based on the general rule in community property states that presumes community property is to be equally divided upon dissolution of marriage or legal separation. Equitable distribution states do not require an equal distribution of marital property

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54 Washburn discussed reimbursement approaches used in Kentucky, Oklahoma, Minnesota, New Jersey, Michigan, Nebraska, Ohio, Colorado and Wisconsin (prior to Wisconsin’s adoption of the Uniform Marital Property Act in 1986), among others. See Washburn at 155-56.


56 Washburn, 677 P.2d at 160 (quoting Mahoney, 453 A.2d at 527).


58 See William A. Reppy & Cynthia A. Samuelson, Community Property in the United States 18-4 (1997). Reppy & Samuelson state that New Mexico, California, and Louisiana require an equal division of community property, while Idaho and Nevada require an equal division absent “compelling reasons.” Arizona authorizes an equitable division of community property, but the equitable division must be substantially equal. See id. at 18-4 n.1. Texas, Washington and Wisconsin permit equitable distribution of community property. See id. at 18-4.
upon divorce or separation, or even impose a rebuttable presumption that the marital property should be equally divided. Grafting equitable reimbursement requirements that are not based on the presumption of equal distribution of community property therefore violates a community property policy.

A second, and perhaps more important, difficulty with the equitable reimbursement approach is its requirement that in order for the community to be reimbursed, the spouse whose career has not been advanced must have contributed to the development of the other spouse’s career. This requirement flies in the face of the community property policy that all income earned by the labors of the spouses during the marriage is community regardless of which spouse earned the income. For example, if the professional spouse paid for his or her education during the marriage by working at a night shift job while the other spouse watched television all day, the equitable reimbursement approach would deny reimbursement to the TV-addicted spouse. Proper application of community property law would refuse to make a distinction – the professional spouse’s night shift earnings that were used to pay for the education are community funds for which the community is entitled to reimbursement.

Consider one final hypothetical example that illuminates the problem further. Assume Wanda works at a salaried job as a western wear designer during a marriage to Horacio, while Horacio works at a hamburger business. The hamburger business is community property. The business never makes money and, in fact, periodic infusions of community funds are required to


60 The California statute, Cal. Fam. Code § 2641 (West 1994), does not follow this approach, but provides that if community funds are used to promote a spouse’s career, the spouse must reimburse the community. See id.
keep the business afloat. The business has no goodwill because it has no prospects of generating future income. When Wanda and Horacio decide to divorce, the couple has only the tangible property in the business and a sum of cash equal to the fair market value of the business' tangible assets. Horacio wishes to continue to run the business. He takes the business in the property distribution and Wanda takes an amount of cash equal to the value of the business' tangible assets. Should Wanda be entitled to an equitable reimbursement for the community funds that were sunk into the community business to keep it afloat during the marriage? Certainly not—Wanda has received half of the value of the tangible property and there is no remaining goodwill value.

This last example illustrates the fallacy of the equitable reimbursement approach in the community property context. The reason why courts in many jurisdictions require equitable reimbursement for use of community funds that enhance a spouse's career is because the career goodwill does have present value—it is, in fact, community property. Two questions remain to be answered—whether there are any valid policy reasons against recognizing this career goodwill and how to value that goodwill.

V. Policy Reasons Offered for Failing to Recognize Career Goodwill as Distributable Community Property

A number of courts have refused to recognize career goodwill based on the reasoning that it is a mere expectancy of future post-separation earnings. The future earnings would be the separate property of the spouse earning them if received after divorce or separation. The Nail court appears to be concerned with the possible injustice that might result from prematurely

61 The business may even have “negative goodwill.” See Shannon P. Pratt et al., Valuing a Business: The Analysis and Appraisal of Closely Held Companies 295 (3d ed. 1996). This phenomenon results when the tangible assets of a business are put to an economically inefficient use that results in less income produced than the assets would produce in the average business.

capitalizing and distributing a future stream of earnings that never actually results.63

This justification for refusing to recognize career goodwill has been criticized as being out of step with current economic reality. Investors determine the present value of future earnings every day when corporate stocks are purchased.64 Courts in all states recognize pension benefits as distributable marital or community property even though the benefits cannot be realized until some time in the future, cannot be calculated until retirement, and may even depend in part or whole on the employed spouse’s post-separation earnings.65 Some courts have attempted to distinguish pension plans from career goodwill because pension plans may be more easily valued.66 I suggest that this is merely a conceptual difficulty – career goodwill can be valued, as the Part VI of this essay illustrates.

Several courts have opined that career goodwill should not be treated as community property because the goodwill is not transferable.67 Goodwill may not be transferable for several

63 See id. (stating that the goodwill of a husband’s medical practice “would be extinguished in event of his death, or retirement, or disablement, as well as in event of the sale of his practice or the loss of his patients, whatever the cause.”)

64 See George Lasry, Valuing Common Stock: The Power of Prudence 113-14 (1979). See also Luigi Guatri, The Valuation of Firms 70-72 (1994). Guatri states that firms are valued not on their tangible assets but on the stream of earnings they are expected to produce. Guatri analogizes the present value of a firm using the stream of earnings method to a perpetual annuity or an annuity for a period of years depending on the period the earnings are expected to be realizable. See id.

65 An example is an unvested defined benefit pension plan that may be based on the employee’s highest earning years of employment.

66 See Nail v. Nail, 486 S.W.2d 761, 764 (Tex. 1972). Nail attempted to distinguish pension benefits, which it classified as a vested property right subject to divestment, with goodwill value of a medical practice, which it characterized as a mere expectancy, on the grounds that the goodwill does not “fix[] any benefit in any sum at any future time. That it would have value in the future is no more than an expectancy wholly dependent upon the continuation of existing circumstances.” Id.

67 See Hertz v. Hertz, 657 P.2d 1169, 1174 (N.M. 1983) (goodwill value of a law firm limited to $1 for division of community property at divorce because shareholder agreement provided that the only way to transfer goodwill was to sell it to other shareholder for $1); Holbrook v.
reasons. Career goodwill in the form of a professional license cannot be transferred or otherwise jointly owned. Ethical or legal restrictions on the transfer of a law practice or a professional corporation’s stock may also prevent the goodwill from being transferred. Louisiana courts reject distribution of professional goodwill on the policy grounds that it is personal to the holder and cannot be separated from an individual’s reputation. In Preis, the Louisiana Court of Appeal refused to find the goodwill of a multi-attorney law corporation to be community property because the goodwill “cannot be separately sold or pledged by the individual owners. . . . Clients of a law firm choose that firm based on its members and qualifications. Without its attorneys, a law firm has no separate goodwill.”

Marketability or transferability of goodwill is a proper concern in valuing the goodwill, but it should not be a concern in determining the existence of the asset or its treatment as community property. Lack of transferability should not affect the recognition of the goodwill as an asset because it does have substantial value – to the practicing spouse.

Holbrook, 309 N.W.2d 343 (Wis. App. 1981) (law practice goodwill is not divisible community property because it is not transferable)


See id.

See Pratt et al., supra note 61, ch. 15. Pratt points out that marketability affects the value of an asset and lists several techniques for factoring marketability into the value equation. See id. at 332-34, 363.

See In re Marriage of Luckey, 868 P.2d 189, 193 (Wash. App. 1994) (stating that “[a]lthough professional goodwill may not be readily marketable, the important consideration is not whether it can be sold to another party, but whether it has value to the professional.”)

See Reppy & Samuelson, supra note 58, at 13-7 to -8 and cases cited therein. Reppy and Samuelson note that Arizona, California and Washington courts do not reject goodwill as community property based on transferability. See id.
Rejecting career goodwill as community property because it is personal to the individual possessing it presents policy issues that are more difficult to answer. Community property states treat post-divorce income as the separate property of the spouse earning the income. If the career goodwill represents the entire future earnings stream of one of the spouses, the other spouse will receive a double recovery by collecting the present value of the future income stream that should be, at least in part, separate property. The solution to this problem is to value only a portion of the future earnings stream as community property goodwill. Again, the problem is one of valuation, not classification of the asset. The excess earnings method, which is a common business valuation technique discussed infra part VI, properly accounts for only the future earnings stream attributable to community investment in the career.

States such as Louisiana that refuse to value personal or reputational goodwill attempt to distinguish between goodwill that attaches to the person and goodwill that attaches to the business. In, for example, the goodwill of a multi-lawyer professional law corporation was excluded from distribution because the law firm had no “separate” goodwill apart from the reputation of the attorneys. I propose that the distinction made in is based on a mistaken

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75 See Robin P. Rosen, Note, A Critical Analysis of Celebrity Careers as Property upon Dissolution of Marriage, 61 Geo. Wash. L. Rev. 522, 554-55 (1993). Rosen argues that “[b]ecause celebrity careers have no economic value aside from their future earnings capacity, they should not be considered a separate asset for distribution upon divorce.” See id., at 555. I agree with Rosen to the extent that the entire future earnings stream should not be considered in the calculation of career goodwill. However, I propose that a well-defined enhancement to the future earnings stream that resulted from education, training, professional licensing, or acquiring a clientele can be valued separately from the entire future earnings stream. See infra part VI.

76 Cf. Pratt et al., supra note 61, at 291 (discussing the need to subtract from the income stream of the business all income not properly attributable to the goodwill being valued when using the excess earnings method to capitalize earnings.)


78 See id.
notion of what goodwill actually represents. The Preis court used goodwill interchangeably with reputation. Other courts have made the same error. Goodwill value is based on premium earnings of an enterprise, and is much broader than reputation alone. Certainly, a multi-lawyer corporation has economic efficiencies that generate premium income, including an established clientele, efficient office operations from sharing staff and caseloads, and professional synergies.

Attempting to distinguish between these types of goodwill results in three unprincipled distinctions: 1) distinctions based on the form of the business enterprise, 2) distinctions between professional versus non-professional corporations, and 3) distinctions between service and product enterprises. Courts have distinguished goodwill based on the form of business enterprise or whether the business enterprise had employees. One reason for this distinction is that sole proprietorship goodwill is more personal because it can be extinguished at death or retirement. A majority of recent court decisions have criticized a distinction based on the form

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79 See id. (refusing to recognize professional goodwill because “the reputation of a law firm is valuable to its individual owners to the extent it insures continued earnings in the future. . . . Clients of a law firm choose that firm based on its members and qualifications.”)

80 See Holbrook v. Holbrook, 309 N.W.2d 343, 350 (Wis. App. 1981) (“a professional business’s good reputation . . . is essentially what its goodwill consists of”). See also Nail v. Nail, 486 S.W.2d 761, 763 (Tex. 1972) (goodwill of a professional is “a result of confidence in his or her skill and ability”); Guzman v. Guzman, 827 S.W.2d 445, 447 (Tex. App. 1992) (defining professional goodwill “as that which: attaches to the person as a result of the clients’ confidence in professional skill or ability.”)

81 See George D. McCarthy & Robert E. Healy, Valuing a Company 121 (1971); Catlett & Olson, supra note 13, at 11. See also discussion supra Part IV.


84 Compare Finch, 825 S.W.2d at 224-25 (recognizing goodwill as divisible community property because the goodwill would not be extinguished completely upon death of the proprietor “because persons other than the appellant performed some of the work at the shop and fostered the good will toward the customers.”) with Guzman v. Guzman, 827 S.W.2d 445, 447 (finding no goodwill in a solo CPA practice that existed independently of the professional’s skills).
of the business enterprise because the community contribution to the success of the business is the same regardless of the form of ownership.\textsuperscript{85} If goodwill is viewed in a broader context than merely reputation, the death or retirement of the professional may not extinguish all goodwill. For example, the location, customer base, and operating efficiencies of a professional practice may contribute to earnings potential and may be transferable to a new professional. The possible death of a professional and the value of the corporate form are relevant to the valuation of the goodwill, as will be discussed \textit{infra} Part VI, but are not relevant to the classification of goodwill as divisible community property.

Professional/nonprofessional and product/service distinctions are also illusory when goodwill is viewed in its broader context as earnings capacity. Consider a sole proprietorship bakery without employees other than the owner. The bakery delivers a product rather than a service. The quality of the product, the development of the customer base, and the timely delivery of goods all depend on the efforts of the baker. The goodwill value of the bakery depends on its ability to produce income, and that income-producing capacity depends on the entrepreneurial skills of the baker. Why should a sole proprietorship bakery be held to have goodwill apart from the personal qualities of the baker, yet a professional practice’s earnings capacity is held to be too personal? The answer is that there is no principled distinction if goodwill is recognized to be enhanced earnings capacity.

VI. Developing a Valuation Methodology

Courts have used a number of methods to value goodwill.\textsuperscript{86} Several of the methods used by courts to value goodwill are not suitable for valuing career goodwill. For example, the market

\textsuperscript{85} See Mitchell, 732 P.2d at 211.

\textsuperscript{86} See \textit{In re} Marriage of Crosetto, 918 P.2d 954, 958 (Wash. App. 1996) (straight capitalization of earnings, capitalization of excess earnings, IRS valuation of capitalized excess earnings, market value, and buy/sell agreement make up a non-exclusive list of methods for valuing goodwill).
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value method is not suitable for valuing goodwill in professional practices that cannot be transferred. Relying on buy/sell agreements to set the value of goodwill can produce inequitable results when such agreements are intended to provide a method for a partner or shareholder to withdraw from the business rather than to establish a value for the goodwill. Therefore, a valuation method with general applicability should be based on one of the income approaches.

The preceding parts of this essay demonstrate that the value of career goodwill in whatever form—a professional corporation, sole proprietorship, advanced degree, professional license, regular sales contacts, or superior skills from specialized training—must be based on future earnings capacity. Similarly, this essay seeks to value career goodwill as a present property interest capable of distribution at time of divorce or separation. The starting point for valuation, therefore, is to capitalize the stream of future income. Capitalization is simply the process of converting an amount of income received over some period of time to its present value. The capitalized value of a stream of income is the value that an investor in the marketplace would be willing to pay for the right to receive that income. The main factors affecting that market value include the amount of income anticipated, the duration of income flow, whether the income is anticipated to increase or decrease with time, and the risk premium that an investor demands. Each of these factors must be analyzed separately in the context of

87 See Mitchell v. Mitchell, 719 P.2d 432, 437 (N.M. App. 1986) (holding that “[e]ven though goodwill may not be a salable asset, it can have value and should not be ignored.”)


89 This is consistent with the “clean break” doctrine and the policy reasons for avoiding continued dependency of a wife on alimony. See Davis, supra note 10, at 144-45 and discussion infra Part VII.

90 See Pratt et al., supra note 61, at 159.

91 See id. at 152. See also Lasry, supra note 37, at 113-14.

92 See e.g., Guatri, supra note 64, ch. 4.
career goodwill to be distributed as community property at divorce or separation to obtain a meaningful value.

1. Earnings that Should Be Included in the Capitalization Formula

When valuing the goodwill of a business by capitalizing earnings, only the excess earnings attributable to the intangible goodwill should be included in the capitalization formula. The term “excess” refers to the premium earnings capacity above what the business’ tangible assets would yield, and above what the proprietor of the business would earn as an employee performing the same work but without owning the business. This makes sense in a market valuation analysis – goodwill represents the excess value that an investor would pay to own the business above the tangible asset value. Those tangible assets have income generating potential – at the least, they can be liquidated and the proceeds invested in financial assets. Similarly, if the proprietor could earn a wage equivalent to the expected profits of the business, the proprietor could do better investing the purchase price in other financial assets and working as an employee.

This definition of “excess” earnings needs to be modified to be relevant to the problem of valuing the increased career goodwill that results from a community investment in human capital. Whereas the goodwill of the business capitalized the earnings in excess of the tangible assets’ earnings capacity and proprietor’s salary, the community career goodwill should reflect capitalization of the excess earnings that resulted from the investment in human capital during the marriage. Therefore, the future earnings capacity of the career spouse should be compared before and after the human capital investment. The difference in future earnings capacity should

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93 See Pratt et al., supra note 61, at 287, 291.

94 See GAAP Guide § 3.03 (1997).

95 Of course, this analysis is overly simplistic because it neglects other non-economic benefits of business ownership such as control over the business, job satisfaction, and employment security.
be the measure of the excess earnings to be capitalized.

2. Appropriate Duration of the Expected Income to be Capitalized

Courts that have recognized career goodwill as community property have been sensitive to the fact that career goodwill may have a finite life span. Capitalization of earnings formulas that are used to value the goodwill of small closely-held companies take into account the possibility that the duration of income may be linked to the life span of one or more persons. Of course, the life span of goodwill may approach perpetuity for some types of career goodwill. One example might be an interest in a professional corporation or partnership that is a well-established practice. Despite the reasoning of the Preis court98 that the goodwill of a well-established multi-attorney firm is based on the reputation of the attorneys in the firm, many well-established professional practices do survive their founders, and the entitlement to work for such a firm provides enhanced earnings to the partners or shareholders.

The duration of the career goodwill can often be determined from the form of ownership or the form of the career goodwill. For example, career goodwill based on advanced degrees, professional licenses, and employment entitlements is limited to the career life span of the individual. Transferable goodwill in professional practices may have a much longer duration. Goodwill of sole proprietorships, customer lists, marketing contacts or celebrity status pose more difficult problems because even though the death or retirement of the owner may affect the goodwill value, some of the goodwill may survive.99

The discussion above illustrates some of the confusion that courts have experienced in

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96 See In re Marriage of Luckey, 868 P.2d 189, 194 (Wash. App. 1994) (holding that goodwill of practice was properly set to zero because of the age, health and declining earning power of the practitioner).

97 See Guatri, supra note 64, at 71-72.


99 See Guatri, supra note 64, at 72.
deciding not to recognize goodwill by holding that it is personal to the individual rather than associated with a business concern. Whether goodwill is personal to the holder is a factor to consider in valuing the goodwill by determining the duration of the income stream to be capitalized. As Guatri points out, uncertainties over whether the goodwill is tied to the career of one or more individuals is simply a risk associated with human capital that should be taken into account by the capitalization formula, and it is routinely taken into account by economists valuing businesses.100

3. Anticipated Increases or Decreases in Income

The income from a professional career can increase over time due to many factors, including the general inflation level, productivity increases, supply and demand imbalances for certain types of skills, and routine improvements in worker skill levels due to experience on the job. Income may also decrease, particularly as a professional approaches retirement and seeks greater leisure time. Goodwill capitalization formulas routinely include similar increases or decreases in income when valuing business goodwill.101

Career goodwill calculations must also take into account the anticipated growth (or decline) in future earnings. The difficulty is to determine what portion of the growth in earnings is a reflection of the present value of the investment in human capital as opposed to inflation or some other factor not representing a true property interest. Similarly, if part of the increase in future earnings results from greater experience or future continuing professional education, then the earnings may not reflect present human capital investments but future investments.

This paper suggests that future increases or decreases in total career earnings should be projected based on present career skills, with adjustments made for economically defensible forecasts of future earnings growth for the career. Even though inflation is included in this

100 See id.

101 See Lasry, supra note 37, at 114 (stating that the present value of stock is concerned with the future earnings trend of the company); Guatri, supra note 64, at 83.
A figure, inflation also enters into the risk-adjusted discount rate discussed in the next section. Thus, inflation is both included in the capitalization and then discounted when the capitalized earnings are reduced to present value.

The earnings of the individual before the investment of human capital must also be adjusted for anticipated increases or decreases. The approach used in this paper is to determine the present income potential of the individual with the skills and training available before the community investment. This pre-marriage career potential is then adjusted for future trends before it is subtracted from the anticipated income of the individual after the community investment in human capital.

It is possible that a spouse investing in human capital may enter a career with greater potential growth or lesser potential growth than the career for which he or she was qualified before marriage. In this case, it is appropriate to consider differences in future earning potential because these differences correctly represent a wise (or poor) investment in human capital—which is exactly what goodwill is meant to represent, i.e., premium earnings from efficient use of capital.

4. Discount Factor to Reflect Risk Premium

The discount factor that is used to reduce the future stream of income to present value is probably the most important factor in this calculation because it affects the final valuation more than any other factor and it is subject to wide variation. The process of discounting "is the very heart of valuation." Determining the proper discount rate requires estimating the risk-free interest rate that an investor would demand for capital (including estimates of future inflation and a rental value for the use of the capital), a risk premium that takes into account the uncertainty that the investor may not receive the expected income stream, and a premium for lack of

102Pratt et al., supra note 61, at 151.

103See id. at 162.

104See id. at 163.
marketability (for example, if the career goodwill could not be sold because it was a degree or license).  

A discussion of all of the factors that enter into the discount rate is beyond the scope of this paper. In an actual valuation, an expert economist's opinion would probably be required. However, it is important to note that the discount factor takes into account many of the objections raised in Part V of this paper. The discount factor mitigates the harshness of lack of transferability of the career goodwill because the value of the future stream of income is reduced to account for the risk that the stream of income may not be realized. The discount factor takes into account the risk that an individual or small proprietor may die or retire prematurely.

The discount factor generally ranges from 15% to as much as 50% depending on the form of the goodwill. IRS Revenue Ruling 68-609 suggested a 15 to 20% capitalization rate on excess earnings. However, the use of a 1968 capitalization rate is probably invalid today because inflation, interest rates, and market volatility has increased. Pratt suggests capitalization rates of 20 to 25% for small business valuation. Parkman suggests a value as high as 50% might be appropriate for certain forms of human capital where continued earnings prospects are uncertain.

\footnote{See id. at 332.}

\footnote{See Theodore P. Orenstein & Gary N. Skoloff, When a Professional Divorces: Strategies for Valuing Practices, Licenses and Degrees, 112 (1994).}

\footnote{Rev. Rul. 68-609, 1968-2 C.B. 327.}

\footnote{The capitalization rate is equal to the discount rate if the excess earnings are assumed to remain constant with time. If the earnings are expected to increase over time, then the capitalization rate is equal to the discount rate minus the expected annual rate of growth of the excess income. See Pratt et al., supra note 61, at 159.}

\footnote{See id. at 293.}

\footnote{See Parkman, supra note 8, at 130-32.}
After appropriate estimates are obtained for all of the factors listed above, the career goodwill may be valued. The procedure is as follows:

1) For each year for which the career goodwill is expected to generate future income, estimate the amount of future income from the career, adjusting for anticipated increases or decreases in earnings.

2) Subtract the anticipated future income that the spouse would have earned based on the skills and career potential before the community investment in human capital. Also, subtract the income generating potential of any tangible assets used in the business. This yields excess earnings.

3) Reduce the excess income for each year to net present value by dividing it by a factor that takes into account the discount rate and the number of years before the income will be generated.

4) Compute the sum of the net present value of each year's earnings over the duration of the career goodwill. For degrees, licenses, and other goodwill personal to the individual, this should be the expected remaining career life span. For transferable assets, an estimate is required for the number of years that the goodwill is expected to continue generating excess income.

These four steps are summarized mathematically by the following formula:

$$\text{Present Value} = \sum E_i / (1+k)^i$$

In the above equation, the summation operator, $\sum$, indicates that earnings in a given year $i$ (represented $E_i$) must be divided by a discount factor, $(1+k)^i$, summed over the number of years of the useful life of the goodwill. The discount factor merely represents the compound rate of interest that would have to be paid to attract the investor, with $k$ being a risk-adjusted interest rate.\footnote{The reader unfamiliar with the mathematical procedure of reducing income to present value should not be intimidated by this equation. Most computer spreadsheet programs perform this calculation automatically once the user supplies the excess income over a period of years, the}
It should be noted that the career goodwill valuation approach discussed in this part should not eliminate the burden of proof on the spouse seeking a division of career goodwill to prove that there has been an identifiable enhancement of human capital or other forms of career goodwill. The career goodwill valuation approach should only be used after the non-career spouse has satisfied the burden of proof on the threshold question of whether there has been an investment of community resources that enhanced the career goodwill of the other spouse. The spouse should be required to point to the specific manner by which the career goodwill has been enhanced. Acquiring a professional license or advanced degree, establishing a business, entering into a long-term employment contract, gaining celebrity status, developing established repeat clients that routinely generate sales commissions, or completing an internship are all possible ways to satisfy this burden. A step increase in pay or normal career progression due to longevity would not qualify as an increase in career goodwill in most circumstances. Such salary increases reflect factors independent of a human capital investment—such as the normal “draw down” of human capital that occurs as an individual approaches the end of employable life, increased productivity gains, or favorable collective bargaining results by a union.

A second problem may arise when an individual changes career during marriage. For example, assume that Bertha has a B.S. degree in physics and marries while employed as an entry-level physicist. Several years later, while still married, she enters law school. A week after graduating, Bertha is divorced. Is Bertha’s spouse entitled to a division of career goodwill because she acquired a law degree? The answer to this question depends on whether her human

discount factor, and the duration of the excess income.

Routine improvements in skills should not be included for two reasons, one pragmatic and the other theoretical. Routine improvements in skills from longevity on the job may be too difficult to value because higher salaries awarded workers may serve multiple purposes, such as reflecting less need of the employer to supervise and train these employees or greater job stability. From a theoretical view, routine on-the-job training may be viewed as an incidental benefit of the employment that was already included in the human capital of the career spouse and would be realized without any further community investment.
capital has been enhanced by the law degree. Here, the spouse claiming a share of the career goodwill must prove that Bertha’s future income as either a lawyer or as a physicist with a law degree is greater than it would have been as a physicist without the law degree.¹¹³

In the preceding hypothetical, the spouse seeking a division of career goodwill had the option of two methods to prove enhanced earnings, depending on the most economically efficient use of the career resource (i.e., employment as a lawyer or employment as a physicist with an advanced degree). The career spouse, similarly, should have the option of pro-rating a partially earned but incomplete form of career goodwill, such as a nearly completed professional degree, at the time of marriage. Because the asset, career goodwill, was partially earned with separate funds and partially earned with community funds, pro-rata apportionment of the career goodwill is appropriate.¹¹⁴ However, if the spouse entering the marriage with the partially completed degree could show employment at a salary exceeding that calculated from the pro-rata share of the degree, that spouse should elect to use the higher of the two figures for calculating initial career goodwill.¹¹⁵

VII. Policy Implications of Valuing Human Capital as Career Goodwill

Valuing human capital as career goodwill overcomes two problems of the present community property system. First, this approach overcomes the economic problem of externalities – wise economic decisions made by the marital partners if the community remains

¹¹³ A related problem cited by Reppy & Samuelson, supra note 58, at 13-9, involves multiple marriages of celebrities where separate labor and community labor from one or more of the marriages contribute to the human capital. The approach suggested in this Part requires each spouse seeking a distribution of career goodwill to show that the community investment in human capital produced an increase in value over the value at the beginning of the marriage.

¹¹⁴ This is consistent with the pro-rata apportionment of community and separate ownership interests in an asset used by states such as California. See Marriage of Moore, 618 P.2d 208 (1980).

¹¹⁵ See example and discussion infra Part VIII for an illustration of this approach.
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intact may be thwarted by a decision of one of the partners acting in his or her own interest to the
detriment of the other partner. Pollution problems provide the classic illustration of externalities.
Consider two nations, Industrica and Naturis, that share a common border. Industrica has
polluting industrial plant on the border. The social and economic costs of pollution from the
plant is $300,000, while the cost of equipping the plant with pollution control equipment is
$200,000. The pollution control equipment would completely eliminate the social cost.
Installing the equipment would be a wise economic decision. But if half the pollution is blown
across the border so that Naturis bears half the burden of the pollution, then it would not be a
wise economic decision for Industrica to mandate the equipment because Industrica would
receive only $150,000 in benefits for the $200,000 in costs. The solution is to internalize the
externality by requiring Industrica to bear the cost of the pollution that blows across the border to
Naturis.

In the case of family law, the externality that needs to be internalized is the ability of a
spouse to leave the marriage with a disproportionate share of human capital paid for by the
community investment. The decision of one of the spouses to "disinvest" in his or her human
capital to promote the net human capital of the community might be a wise economic and social
decision if the community is assumed to remain intact.\(^\text{116}\) However, if one of the spouses is

\(^{116}\text{See Parkman, supra note 8, at 132. Parkman suggests that the reduction in human capital of the spouse who "disinvests" (usually the wife) should be compensated by the other spouse as if the decrease in human capital were a community debt to the separate estate. See id. at 133. I do not adopt this approach in my analysis because it is inconsistent with community property notions that the fruits of labor during marriage are community property. Human capital depreciates with time if not replenished (analogous to amortization of goodwill) due to decreased earning lifetime and obsolescence of skills. Therefore, the reduction in human capital is not really analogous to a community debt or a withdrawal of separate human capital but a failure to make additional human capital investments. Community property principles can be reconciled}
permitted to leave the marriage with separate human capital acquired through community labor and investment, several problems may arise. The system may unwittingly encourage divorce in marginal cases because the career spouse may make the economic decision (unwise to the interests of the community, but wise to the interests of the career spouse) to divorce and take as separate property his or her career goodwill.\textsuperscript{117} Alternatively, the spouses may choose to invest their labor during marriage as “separate labor” in their own human capital.\textsuperscript{118} This phenomenon of separate labor thwarts the policy goal of the community property system that all labor during the marriage should be for the benefit of the community.\textsuperscript{119}

Valuing human capital as career goodwill allows it to be divided at divorce or separation. This offers the possibility of eliminating the problem of dependency resulting from continued payments of alimony.\textsuperscript{120} Refusing to recognize human capital as property has forced several

with the notion of human capital only if the separate human capital that existed before marriage is impliedly transmuted over time into community labor by the spouse continuing the community. The disinvesting spouse essentially has transmuted separate human capital into community labor during the marriage, which can then be traced to an investment in community human capital. The community human capital investment can be valued as career goodwill at time of divorce or separation, fully compensating the disinvesting spouse.

\textsuperscript{117} See Ann Laquer Estin, Love and Obligation: Family Law and the Romance of Economics, 36 Wm. & Mary L. Rev. 989, 1057 & n.288 (1995). Estin cites a number of law and economics scholars who support the proposition that failure to consider human capital as property results in “distorting incentives” encouraging economically inefficient divorce. See id.

\textsuperscript{118} See Reppy & Samuelson, supra note 58, at 11-28 (pointing out the anomalous possibility of “separate labor” in community property states).

\textsuperscript{119} See Michael J. Vaughn, The Policy of Community Property and Inter-Spousal Transactions, 19 Baylor L. Rev. 20, 26 (1967) (citing Richard Ballinger, A Treatise on the Property Rights of Husband and Wife, Under the Community or Ganancial System, § 4 (1895)).

\textsuperscript{120} See Parkman, supra note 8, at 136-37 (arguing that human capital eliminates the need for alimony in many instances).
courts to deal with imbalances in human capital through alimony. But, as Joyce Davis forcefully states, "[h]uman capital is property and property is power." Dependence on alimony can exact a severe toll, by economically and psychologically, on the spouse without the career investment, most often the wife:

Requiring the husband to pay alimony to the wife does not contemplate parties in equal relationship to each other: one is dependent, subservient, one independent, more powerful.

Refusing to recognize that the husband’s human capital is marital property ties the wife to him in a way that maintains their unequal relationship. It keeps her dependent on him and allows him to exert power over her. It also impacts adversely on her view of herself and the world’s view of her. It denies her personhood, her autonomy, and her free agency. Whether intended or not, one of the results of the courts’ failure to call human capital property is to do exactly what George Gilder has suggested: keep women economically dependent on men.

Treating human capital as a present property interest, career goodwill, rather than a mere expectancy, prevents the psychology of dependence cited by Davis. It also eliminates the need for continuing jurisdiction of courts over the divorce (such as the concurring opinion in O’Brien v. O’Brien foresaw) or the need for cumbersome pooling arrangements proposed by other

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121 See Nora J. Lauerman, A Step Toward Enhancing Equality, Choice and Opportunity to Develop in Marriage and at Divorce, 56 U. Cin. L. Rev. 493, 498-99, 510-11 (1987) (pointing out that the refusal of courts to include career assets as distributable property, and their increasing reliance on rehabilitative alimony, has left many women at a severe economic disadvantage at divorce).

122 Davis, supra note 10, at 109.

123 Id. at 144-45 (footnote omitted) (citing George Gilder, Sexual Suicide (1973)).

Although some may criticize the harshness of assigning a present value to a career asset that may not be realized, our legal system routinely takes this approach through the single judgment rule in tort law and the civil procedure doctrine of merger. The approach presented in this paper mitigates the harshness somewhat by including a discount factor that should account for the probability that the career goodwill will not be realized.

VIII. Application of the Valuation Methodology

This section will illustrate how the career goodwill valuation methodology is applied by considering the hypothetical examples presented in Part III. The hypothetical examples were designed to test the career goodwill valuation approach on several levels: 1) whether career goodwill could be valued independent of the form of business organization; 2) whether changing the form of the goodwill from proprietary goodwill to employee goodwill made a difference; and 3) whether the approach produced consistent results for career goodwill of professionals and nonprofessionals.

In the first example, Dr. Able is a professional who owns career goodwill in several forms. He possesses an advanced medical degree, a license to practice medicine, and a

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125 See Singer, supra note 15, at 131 (proposing "income sharing rules that would require divorcing parents to continue to pool their joint incomes for a significant time period after divorce.").

126 See O’Brien, 498 N.Y. Supp. 2d at 751 (Meyer, J., concurring) (posing the hypothetical unfairness of awarding a portion of the career goodwill in a medical degree to a spouse should the “general surgery trainee accidentally lose the use of his hand.”).

127 See Restatement (Second) of Torts § 912 cmt. e, § 913A (1979).

128 See Restatement (Second) of Judgments § 18 (1982).

129 See supra Part VI.
reputation in the community as a fine physician. All of these attributes contribute to income earning capacity. He also shares in the goodwill of the professional corporation. This latter form of goodwill results from many factors, including the reputation of the medical clinic, the established lists of clients who will likely return due to inertia, the location of the clinic, possible synergies between the professionals, and possible management efficiencies. The goodwill of Dr. Able’s practice has limited transferability because Able’s interest may be sold to another physician, subject to contractual restrictions or restrictions placed in any applicable Professional Corporation Act. If a market value can be established for the professional corporation’s goodwill based on the price that a newly licensed physician would be willing to pay, that goodwill should be valued separately from the goodwill that is personal to Dr. Able.

If a market value cannot be established for the clinic, the professional corporation’s excess earnings can be computed by subtracting the average wages\(^{130}\) of an employed physician in the area from Able’s share of the profits\(^{131}\). Assume, for example, that Dr. Able’s share of the profits is $300,000 per year, while the wages and benefits that a physician with Dr. Able’s training would earn as an employee is $150,000. This equates to $150,000 of excess earnings per year. Next, assume that Dr. Able’s share of the net tangible assets of the corporation

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\(^{130}\) “Wages” here includes total employee remuneration, including standard fringe benefits in the profession. Whether or not taxes are subtracted from the wages should depend on the policies of the jurisdiction. Some jurisdictions do not adjust for taxes because they are too speculative, especially when the profits of a corporation may be reinvested tax-free for an extended period of time. See Grossnickle v. Grossnickle, 935 S.W.2d 830, 847 (Tex. App. 1996). Where taxes that will actually be paid at the professional’s tax rate can be estimated reasonably, they should be subtracted from income. See Orenstein & Skoloff, supra note 106, at 112.

\(^{131}\) Orenstein and Skoloff point out that these statistics are available from the United States Department of Labor, American Bar Association, American Medical Association, and similar groups. See id.
amounts to $500,000 and 10% return is considered fair for tangible assets. The tangible assets would generate another $50,000 in income per year that must be subtracted from the excess income to yield a net annual excess income of $100,000.

Once annual excess income is computed, the duration of the excess income must be projected. If the clinic’s ownership can be transferred to another physician without appreciable loss of goodwill, the stream of income may extend indefinitely beyond Dr. Able’s employable life span. If the clinic’s goodwill is so dependent on Dr. Able remaining with the clinic, then the duration of the excess earnings should be limited to Dr. Able’s employable life span.

The final step in computing the corporation’s goodwill is to reduce it to present value by including a discount rate. An appropriate discount rate should reflect the limited transferability of Dr. Able’s interest (resulting in a lower discount rate than if the goodwill could not be transferred but a higher discount rate than freely transferable goodwill), the stability of the excess income (more stable and predictable excess income flows implying lower discount rates) and the dependence of the excess income on the continued services of the key personnel (small clinics more dependent on key employees should be awarded higher discount rates). Let us assume for this example that a 25% discount rate is appropriate. The goodwill is then capitalized using the formula in Part VI, supra. Proper application of the math yields a value of $357,050 for a 10-year flow of $100,000 per year in excess income. If the excess income flow is assumed to be perpetual because Dr. Able’s interest can be transferred and survives his career life span, then its

132 For practical purposes, at discount rates of 25%, income more than 10 years in the future may be ignored because the difference between the net present value of a 10 year income flow and a perpetual income flow is only about 10%. For example, the net present value of a perpetual flow of income at $10,000 per year is $40,000 at a 25% discount rate, while the net present value of a 10-year income flow is $35,705. See spreadsheet calculations on file with author.
present value increases to $400,000.

The goodwill of the clinic is only the first part of the calculation. Next, the career goodwill value of Dr. Able's personal capital that accrued during the marriage must be determined. Assume that Dr. Able was a third-year medical student one year away from completing his degree at the time of marriage. A third-year medical student who does not complete a degree may be employed in several capacities at above-average income. Assume that Dr. Able could earn $30,000 without attending medical school at all, $50,000 a year without completing his degree, $80,000 upon completing his degree but not completing his residency or obtaining his license, and $150,000 as an employed physician. Dr. Able's career goodwill before the community investment in his education and training would be based on the greater of $50,000 per year potential annual income employed as a non-physician with three years of medical school training or $30,000 (earnings before medical school) plus three-fourths of the value of the medical degree ($50,000 per year increase in earnings). The latter value totals $67,500. Therefore, Dr. Able's earnings capacity has been increased by $82,500 per year due to the community investment in his human capital.

Dr. Able's career goodwill value is calculated by estimating his employable life span, estimating a discount factor, and reducing the excess income to present value. Let us assume a 10-year employable life span for Dr. Able. A relatively high annual discount factor should be used - perhaps 25% to 50% - for this type of career goodwill because its value cannot be realized through a sale or other transfer. Using a 30% discount rate, the net present value of the $82,500

133 Parkman suggests a 50% annual discount rate might be appropriate for professional goodwill that is "uncertain and unmarketable." See Parkman, supra note 8, at 132. This value appears high because it implies an investment in a professional career has an expected payback period of
annual excess earnings flow is $255,052.\footnote{134}

The total value of Dr. Able’s career goodwill is the sum of the professional practice’s
goodwill and the personal goodwill inherent in his medical degree, license, and specialized
training. In this example, the goodwill should be separated because the practice goodwill may be
transferable, giving it a greater life span than Dr. Able’s career. The transferability also affects
the discount rate to be applied – transferability reduces risk (and therefore the discount rate)
because there is a greater likelihood that the professional will realize its value.

The second hypothetical example presented in Part III illustrates the effect of a change in
the nature of the goodwill on its valuation. Dr. Brenda’s practice goodwill would be calculated
in the same manner as Dr. Able’s practice goodwill before the sale of the practice’s assets. After
the sale of the veterinary practice, Dr. Brenda retains the practice’s goodwill through her
employment contract. Dr. Brenda’s employment contract provides her with excess earnings
above what the usual practitioner would realize. In this example, Dr. Brenda’s career goodwill
from the entitlement of employment at premium earnings can be calculated based on the
expected duration of the employment and the excess income above the average veterinarian. In
addition, Dr. Brenda has career goodwill associated with her veterinary degree and license. The
career goodwill value of the degree and license may be calculated in the same manner as the
value of Dr. Able’s license and degree was calculated above.

\footnote{134}\footnote{See spreadsheet calculations performed by author (on file with author).}

only about two years. Pratt et al. Quote studies that show a total discount for lack of
marketability of 30% to 60% above the annual discount rate for restricted shares in private
placements. See \textit{Pratt et al.}, supra note 61, at 332. Total discount and annual discount rates are
not directly comparable. A 50% total discount rate for lack of marketability increases a 20% annual discount rate to 46.6% for a constant cash flow with 10-year life span. See spreadsheet
calculations performed by author (on file with author).
The third hypothetical example illustrates that nonprofessional employees may also acquire career goodwill by developing repeat customers, sales contacts, and similar intangible career assets. Chuck may acquire excess earnings through commissions, bonuses, and a premium salary based on the sales contacts developed during his marriage. Chuck’s excess earnings may be calculated by the difference in income that he receives compared to the typical entry-level sales employee. This excess earnings stream has a life span that can be estimated based on the duration of the average customer’s continued patronage. For example, if the average stockbroker’s customers continue to rely on her for investment services for an average of seven years, then seven years might be an appropriate estimate of the career goodwill life span.

These three examples indicate that career goodwill can be valued as the present value of a stream of future income. Admittedly, a number of simplifications were introduced in the calculations to avoid confusing the issue. For example, the excess income of all three individuals would be expected to increase or decrease over time. Taxes were also neglected in these examples; unless the jurisdiction refuses to consider tax consequences of a property award because of the speculative nature of the future tax rate, income taxes should be considered before excess earnings are determined. Despite these simplifications, this method of valuing career goodwill allows investments in human capital to be recognized consistently and independently of the form that the investment may take.

IX. Conclusion

The post-industrial informational economy requires our entire society to rethink traditional conceptions of wealth as tangible goods have less permanent value. Income generating capacity is the new standard of wealth in this age. Accountants and economists
recognize that income-generating capacity is a form of property, goodwill. Goodwill is a present property interest, as evidenced by the willingness of buyers to pay premium prices for businesses with above-average income generating capacity.

Courts must recognize that human capital is a form of goodwill that can be valued by reference to its income generating capacity. Goodwill is a present, intangible property interest rather than a mere expectancy. This article has presented a method for valuing human capital, in whatever form, as career goodwill. Courts may apply this method to value professional practices, advanced education and specialized training, professional licenses, customer lists, and any other intangible asset that provides an individual with superior income generating ability. Community investments in the human capital of one of the spouses must be valued as career goodwill and recognized as divisible community property if the policies underlying community property law are to be preserved for this type of property.