

Goodwill Hunting Doesn't Work in Director's Divorce

By Mitchell A. Jacobs and David L. Marcus *

The court in In re Marriage of McTiernan and Dubrow (2005) 133 Cal. App. 4th 1090, was presented with the issue of whether the parties' community property included a movie director's professional goodwill. The court's decision not to recognize goodwill is consistent with prior California law. The unique reasoning of the case, however, was to find that only a traditional business with assets has goodwill, and a person who does business, such as a movie director, does not have goodwill.

Husband was an extremely successful movie director, whose work included Die Hard, The Hunt for Red October, and The Thomas Crown Affair. He was paid from six to high seven figure compensation per film. The community estate was substantial. During the approximately eight year marriage, husband earned approximately \$15.0 million, and wife earned approximately \$1.0 million.

The trial court found that at the time of separation husband had professional goodwill, which was valued at \$1.5 million. The trial court analogized a movie director to other professions, for which professional goodwill is a recognized community property asset: "[Husband's] success is dependent upon

his personal skill, experience and knowledge, and the Court finds that, in that respect, the profession which he practices is similar to that of an attorney, physician, dentist, accountant, editor, architect, or any other professional who has established a successful professional practice, with quantifiable expectation of future patronage, based upon his or her personal skill, experience and knowledge." Based on expert testimony that husband earns more than most other directors, the court determined the value of husband's professional goodwill.

The Court of Appeal reversed the trial court, finding that the husband had no "professional goodwill." The court began by adopting the definitions of goodwill as "the 'goodwill' of a business is the expectation of continued public patronage" (Bus. & Prof. Code, § 14100) and "the goodwill of a business is property and is transferable." (Bus. & Prof. Code, § 14102; emphasis in original).

In the central part of the opinion, the court explained what is meant by "a business" in the definition of professional goodwill. The Court found that a business "refers to a professional, commercial or industrial enterprise with assets, i.e., an entity other than a natural person." The Court of Appeal disagreed with the trial court's reasoning that a "business" includes a "person doing business."

The Court provided three reasons for its interpretation of "a business." First, historically professional goodwill was an incident of a business with assets, not a natural person. The court cited the 1892 United States Supreme Court case of Metropolitan Bank v. St. Louis Dispatch (1892) 149 U.S. 436, which stated, "[goodwill] is tangible only as an incident, as connected with a going concern or business having locality or name, and is not susceptible of being disposed of independently." Additionally, goodwill "is acquired by an establishment..."

California courts followed this view of goodwill, holding that goodwill does not attach to shares of stock. Courts have also held that "goodwill was not separable from the physical assets of the business that generated the goodwill." The court concluded that under existing California law, the definition of goodwill "predicates the existence of goodwill on the operations of a business entity with assets separate and distinct from the person or persons who operate, own or manage the business."

The court then concluded that California law has not changed on this issue, and "no California case has held that a natural person, apart and distinct from a 'business,' can create or generate goodwill. In the instance of professionals, the courts have spoke of the "the nature and duration of [the

professional's] business as a sole practitioner and the value of a 'professional practice.' It is the business, i.e., the practice, that generates goodwill, even if the practice is conducted by a sole practitioner..."

Second, the court relied on the plain language of Business and Professions code sections 14100 and 14100, which explicitly refers to a "business." The unambiguous, plain meaning of a "business" is "a noun, and means a professional, commercial or industrial enterprise with assets. It is also clear that 'a business' is not a natural person." The court held that it was not within the role of the judiciary to include in the statutory definition of goodwill, "a person doing business."

The court also reasoned that allowing "a person doing business" to have goodwill would effectively result in all people who have the "expectation of continued public patronage" to possess goodwill. Because goodwill is based on a prediction of future income which may not materialize, especially for those in the arts, this could create a "massive liability without the means of satisfying it."

Third, by definition, "goodwill" must be "property." To be divisible as "community property," this goodwill must be either real or personal property. "Personal property" is all property which is not real property. "Personal property" may be

intangible, but it must be capable of being transferred.

The "personal property" at issue was husband's "goodwill," which is essentially the husband's ability to earn more than other directors, and the premium he commands for his services. The court found that husband's earning ability is based on his "elite professional standing," which cannot be sold or transferred because it is unique to him. This is the point upon which the court distinguished a movie director from an attorney or physician; an attorney's practice or physician's practice can be transferred. So, "goodwill" cannot exist in husband's career as a movie director because his earning ability cannot be transferred to another person. By only including a "business" with assets as capable of having goodwill, ensures that the asset which is divided as "goodwill" is property.

The court rejected wife's argument that the existence of a business in the traditional sense is not a prerequisite to finding professional goodwill. The court reasoned that the statutes and case law limits goodwill to traditional business.

Second, wife argued that because husband had "an expectation of continued public patronage," he had goodwill. This begged the question of whether this expectation must only be generated by a business with assets, or an individual. The court previously concluded that only a business with assets may

generate goodwill.

Finally, wife argued that because a value can be determined by the "excess earnings" method of calculating goodwill, that husband must have goodwill. That method compares husband's earnings to his peers. The court reasoned that merely because this comparison can be done, does not mean that husband has goodwill.

The dissent (which should be studied by practitioners faced with this issue) argued that the lead opinion applied restrictive concepts of goodwill, and even under the lead opinion's analysis. It is very difficult to distinguish a movie director from an attorney in sole practice, whose only "business asset" may be a desk and a computer. There is no "goodwill" to the assets of the attorney. The real basis of the lead opinion could be its public policy reason of not wanting to impose liability in a dissolution proceeding on a spouse whose income "may decline or even dry up, even though expectations were to the contrary."

This case may support an argument that sole practitioners in other professions who operate with very few assets, such as attorneys, do not have professional goodwill. To make this analogy, the professional should argue that he/she, as a person, generates the earnings, not the "business" or the assets. If

possible, evidence could be offered from clients that they hired the professional to personally render services to them, not the business. If the professional has a sufficient reputation, it could also be argued that the attorney's standing and reputation cannot be sold. Also, a risk of a substantial decrease in income must be shown, at least the same risk as for a successful movie director.

The debate on this issue between the lead, concurring and dissenting opinions suggests that it is time for the Legislature to directly address this issue. Deciding if there is a community property value in the career of the director of Hunt for Red October, based on concepts of goodwill developed in the 1880's, is like trying to fit a round peg in a square hole.

- * Mitchell A. Jacobs, a certified family law specialist in Los Angeles, limits his practice to marital dissolution and other family law matters. David Marcus, an attorney with the Law Offices of Mitchell A. Jacobs, also practices exclusively in the area of family law.