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One Step Forward and Two Steps Backward - Goodwill as a Distributable Asset of a Law Partnership

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ONE STEP FORWARD AND TWO STEPS BACKWARD —
GOODWILL AS A DISTRIBUTABLE ASSET OF A LAW PARTNERSHIP

“A lawyer’s clients are neither chattel nor merchandise.”1 For years, that succinct statement was the reason that prohibited goodwill as an asset of a law partnership. Traditionally, the law regarded the goodwill of a business partnership as property, but it did not extend the same benefit to professional partnerships.2 However, the courts have gradually expanded goodwill as an asset. After initially recognizing goodwill in business partnerships, the courts then found that goodwill could attach to professional partnerships, and even to law partnerships, in limited circumstances.3 But, the courts did not expand goodwill to include being a distributable asset of a law partnership.4

The law’s reluctance to find goodwill as a distributable asset in professional and law partnerships stemmed, in part, from the very nature of goodwill itself. “Goodwill is a hope founded upon probability.”5 The goodwill of a business partnership was considered to be every advantage that the business had acquired which caused people to patronize the firm because of its favorable reputation.6 By describing goodwill as a “hope” or “every advantage,” goodwill was considered to be the “most intangible” of intangible property.7 This intangible asset could attach to a business partnership because the chief elements of the value of business goodwill were continuity of place and continuity of name.8 For most businesses, the value of a location or name

5Hart v. Smith, 159 Ind. 182, 64 N.E. 661 (1902).
613 O.JUR. 3d Business Relationships § 955 (1979). “Goodwill is a reasonable expectancy of preference in the race of competition derived from succession in place, name, or otherwise to a business that has won the favor of its customers. In re Brown, 242 N.Y. 1, 150 N.E. 581 (1926).
7Goodwill is intangible because it is essentially reputation that will generate business in the future. Dugan v. Dugan, 92 N.J. 423, 429, 457 A.2d 1, 3 (1983). Goodwill has an intangible nature and has no existence except in connection with a continuing business. Red Wing Malting Co. v. Willcuts, 15 F. 2d 626, 629 cert. denied, 273 U.S. 763 (1926).
8Brown. 242 N.Y. at 7, 150 N.E. at 583.

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could be determined. However, professional partnerships and law partnerships were not considered to have the "continuity of place and name" that business partnerships possessed. The courts felt that since law and professional partnerships depended on the individual skill and learning of each partner, goodwill was a personal asset and could not attach to the partnership.9

The Supreme Court of Ohio was first presented with the issue of whether goodwill could be included as an asset upon the dissolution of a law partnership in Spayd v. Turner, Granzow and Hollenkamp.10

On April 15, 1977, Attorney Spayd and the other parties to the lawsuit entered into a written partnership agreement.11 This partnership for the general practice of law existed until April 25, 1978.12 At that time, Spayd decided to withdraw from the firm because of "philosophical differences" with the other partners.13 On March 26, 1979, Spayd presented a counter-proposal in response to the firm's proposal for his separation compensation.14 Spayd's counter-proposal included payment for a share of the firm's goodwill.15 When no agreement was reached, Spayd commenced action against the firm, alleging that he had been "wrongfully expelled" and asked for an appraisal of the partnership's tangible and intangible assets.16 The trial court ruled that it was "impermissible and unethical" to include goodwill as an element of the law partnership's assets.17 The court of appeals agreed that goodwill could not be distributed upon the dissolution of a law partnership.18 Spayd appealed to the Ohio Supreme Court. He contended that the law firm did have a measurable element of goodwill and that ethical considerations did not prevent an accounting for this goodwill upon the partnership's dissolution.

The Ohio Supreme Court examined both the traditional and modern views of goodwill as an asset in a law partnership and held that it was not against public policy to include measurable goodwill as an asset upon the dissolution of a law partnership.19 The court also concluded that ethical considera-

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1019 Ohio St. 3d 55, 482 N.E.2d 1232 (1985).
11Id. at 55, 482 N.E.2d at 1233.
12Id. at 57, 482 N.E.2d at 1234.
13Id.
14Id. at 58, 482 N.E.2d at 1235.
15Id.
16Id.
17Id. Spayd brought suit in the Court of Common Pleas of Montgomery County.
18Id. Spayd appealed to the Court of Appeals for Montgomery County.
19Id. at 57, 482 N.E.2d at 1238. The court also looked to the general principles of Ohio Revised Code § 1775 and the Uniform Partnership Act.

At the outset, it is beneficial to set forth a number of general principles emanating from R.C. Chapter 1775, the Uniform Partnership Law, which are applicable to this case in controversy. It is of utmost importance to be reminded that the respective rights of partnership members depend primarily on the specific provisions contained within the partnership contract. This concept is recognized in R.C.
tions did not preclude finding goodwill in a law partnership. However, the court held that goodwill could be distributed upon the dissolution of the partnership only when it was specifically provided for in the partnership agreement. This paper will examine the Spayd court’s findings and the reasoning that led Ohio to expand the concept of goodwill in law and professional partnerships.

I. THE DEFINITION OF GOODWILL

"Undoubtedly, goodwill is valuable, but it is difficult to decide accurately what is included in the term." Simply stated, goodwill is the probability that "old customers will resort to the old place." Even stated simply, goodwill may be "a word of which very few people understand the meaning." Justice Cardozo amplified this traditional definition by stating, "Men will pay for any privilege that gives a reasonable expectancy of preference in the race of competition. Such expectancy may come from succession in place or name or otherwise to a business that has won the favor of its customers. It is then known as goodwill." By 1891, it was "well settled" that goodwill was legally considered to be property. The courts recognized that goodwill could inhere in the real property of the business because old customers would be attracted

1775.17 wherein the rights and duties of partners in relation to the partnership are specifically set forth "subject to any agreement between them."

Furthermore, all property originally brought into the partnership or subsequently acquired is defined as partnership property. R.C. 1775.07(A). The only property rights vested in a partner are his rights in specific partnership property, his interest in the partnership, and his right to participate in the management. R.C. 1775.23. The partner’s interest in the partnership is limited to his share of the profits and surplus. R.C. 1775.25.

The dissolution of a partnership, as distinguished from winding up the business, denotes the change in the relation of the partners caused by any partner’s discontinued association with the ongoing business. R.C. 1775.28. Pursuant to R.C. 1775.21, a partner is thereby entitled to a formal accounting concerning partnership affairs, "(A) [i]f he is wrongfully excluded from the partnership business or possession of its property by his partners; (B) [i]f the right exists under the terms of any agreement; [and/or] *** (D) [w]hensoever other circumstances render it just and reasonable." See, also, R.C. 1775.42. The statutory law fails to mention “goodwill” in all but one section and that is R.C. 1775.37 which sets forth rights of partners in dissolution. Subsection (B)(3) of that provision specifically provides that a partner who has wrongfully caused a dissolution shall not have goodwill considered in the determination of the value of his partnership interest.

Spayd at 59, 482 N.E.2d at 1236.

Id. at 63, 482 N.E.2d at 1239.

Id. at 64, 482 N.E.2d at 1240.

Metropolitan Bank v. St. Louis Dispatch Co., 149 U.S. 436 (1893). In this case, goodwill was found to attach to the name of a newspaper. The court relied on the "continuity of name."

This is a frequently quoted statement. See, e.g., Snyder Mfg. Co. v. Snyder, 54 Ohio St. 86, 43 N.E. 325 (1896); Norris and Cochran v. Howard, 41 Iowa 508, 511 (1875); Cruttwell v. Lyle, 17 Ves. 335 (1788); Mattis v. Lally, 138 Conn. 51, 54, 62 A.2d 155, 156 (1951); Jackson v. Caldwell, 18 Utah 2d 81, 85, 415 P.2d 667, 670 (1966); Engle v. Vernon, 215 N.W.2d 506, 513 (1974); J. Story, Commentaries on the Law of Partnership, § 99 (1868).


Quoted in Dugan v. Dugan, 92 N.J. 423, 429, 457 A.2d 1, 4 (1893).

Goodwill was, in fact, valuable property. “A large portion of the intrinsic or assessable value of a business consists of the goodwill maintained by it.” Wilmer v. Thomas, 74 Md. 485, 22 A. 403 (1891).
to an established business in a familiar location. By 1902, the courts recognized that the right to carry on an established business and to represent that it was a continuation of that business was also a valuable asset, even when the new business was not connected with the original real estate. While goodwill was considered to be a valuable asset, it could not be disposed of independently of an on-going business. Goodwill became an asset at the time a business was sold, when the purchaser bought the right to carry on the business. Thus, by the turn of the century, the chief elements of goodwill in a business partnership were considered to be continuity of place and name.

By defining goodwill as "continuity of place and name," it is more easily understood why goodwill was viewed as an asset of a business partnership, and not a professional partnership. A business has a familiar name and a familiar place, but as Abraham Lincoln said, a lawyer has "time and advice." This reasoning prompted the court in Rice v. Angell to hold that when a professional partnership ended, nothing of this "time" or "advice" would be left. Upon the dissolution of the [insurance agency] each partner took with him his chance of securing the patronage of the old firm, without any advantage over the other, except such as was purely personal to himself." Since it was viewed that goodwill attached to the personality and reputation of the individual partners, there could be no separate "partnership goodwill" in a professional partnership.

Several courts suggested that it might be fraud, or against public policy, for a professional partnership to attempt to create an appearance of continuity by preserving the personal goodwill of a former partner.

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27Hart v. Smith, 159 Ind. 182, 64 N.E. 661, 662 (1902). The local goodwill generated by old customers returning to the old place could inhere to real property and give it additional value.

28Id.

29Metropolitan Bank, 149 U.S. at 446.

30In re Anastos Estate, 45 Ohio Op. 91, 92, 100 N.E.2d 324, 326 (P. Ct. 1944). See also Brown, 242 N.Y. at 7, 150 N.E. at 583.

31Dwyer, 133 N.J. Super. at 346, 336 A.2d at 499. See also Altman, 15 Steps to Partnership, 10 Barrister 4, 60 (1983). (In more modern terms, a lawyer's time and advice may consist of "communication, judgment, interactional skills and managerial ability.").

3273 Tex. 350, 11 S.W. 338 (1889).

33Id.

34Id. at 354, 11 S.W. at 340.

35See, e.g., Jackson v. Caldwell, 18 Utah 2d 81, 86, 415 P.2d 667, 670 (1966); Lyon v. Lyon, 246 Cal. App. 2d 519, 54 Cal. Rptr. 829 (1966); Cook v. Lauten, 1 Ill. App. 2d 255, 117 N.E.2d 414 (1954); Annot., 65 A.L.R. 521 (1959). In Hunt v. Street, 182 Tenn. 167, 184 S.W.2d 553 (1945) the goodwill of a partnership of architects was held to be personal to the members of the firm, and thus had no value after the firm was dissolved. A partnership of two engineers was found not to have measurable goodwill in Harstad v. Metcalf, 56 Wash. 2d 239, 351 P.2d 1037 (1960) because each continued his own portion of the business after it was dissolved. In Kalez v. Miller, 10 Wash. 2d 362, 147 P.2d 506 (1944) four doctors dissolved their partnership. The business of the old partnership was not continued, no old business contracts were renewed and three of the former partners created a new partnership. Therefore, the court determined that there was no goodwill to be distributed.

36Read v. Mackey, 47 Misc. 435, 95 N.Y.S. 595 (1905). The firm name of a business can become impersonal because it indicates the quality of the article, not the personal attributes of the dealer, so it is not deceptive to have a firm name continue. Weiner v. Weiner, 88 Misc. 3rd 920, 924, 390 N.Y.S.2d 359, 362 (1976). Normal-
In summing up the difference between business goodwill and professional goodwill, it seems that courts viewed business goodwill as being reflected in a firm’s name, location or products. These elements could be measured and valued with some specificity. The goodwill of a professional partnership was an intangible reflection of confidence in the ability of a particular individual. This individual skill was inseparable from the person and could not exist or be measured when the partnership dissolved.

The concept of goodwill as an asset began to expand as courts determined that the definition of “old customers and old place” was too narrow.

The definition of goodwill was gradually broadened to include a “host of intangibles.” Goodwill came to include all of the special advantages that related to a going concern. Therefore, goodwill encompassed the quality of management, the nature and existence of competition, capable staff, high credit standing, local position, common celebrity, reputation for skill and influence, affluence, punctuality, and even ancient prejudices and partialities.

While the earlier, more narrow definition of goodwill seemed to exclude professional partnerships, the broader definitions included intangibles, which seemed to include many elements that are found in professional partnerships. A professional partnership might not have a familiar location, but it should have capable staff or qualified management. “Goodwill can also be founded upon personal skill and reputation. The reputation for skill and learning in a particular professional can win the confidence of the [former or future] clients of a professional person.” As courts began to recognize that goodwill could exist as a property right in a professional partnership, the value of intangibles such as reputation and skill came to be viewed as triable questions of fact. However, to be considered as a measurable asset, the experience and goodwill of a professional partnership had to be capable of pecuniary estimation.

While the facts of this case indicated that the radiology practice in question had a substantial element of goodwill, it seems that courts viewed business goodwill as being reflected in a firm’s name, location or products. These elements could be measured and valued with some specificity. The goodwill of a professional partnership was an intangible reflection of confidence in the ability of a particular individual.

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certified public accountants had goodwill other than that which was personal to each of the partners. The court considered that issue to be a question of fact and considered testimony that most of the accounts were recurring, the partnership's files contained valuable history, clients remained with the firm for long periods, and whether other partners who had retired had received payments for goodwill. This evidence led the court to hold that goodwill had attached to the professional partnership. Similar evidence was considered by the court in Fine v. Laband when a medical partnership ended. The court phrased the issue, "Was there a goodwill of significance attributable to the corporation separately and apart from the goodwill enjoyed by each of the physicians separately?" The evidence in the case indicated that when the tangible partnership assets were divided, each physician took his own patient files and continued to practice medicine in his own name. Each physician continued to have a separate phone listing and continued to practice in the same building that the partnership used. Patients continued to see the same physician who had been treating them when the physicians were practicing as partners. The court determined, therefore, that the goodwill that existed flowed to each doctor individually. There was no partnership goodwill to be divided as an asset. However, courts in other jurisdictions found that goodwill could exist in professional partnerships, including medicine, accounting and veterinary medicine. Eventually, the leading medical association recognized goodwill as an asset and provided informational pamphlets on the subject to physicians.

A. Goodwill in a Law Partnership

Although there was a developing trend to find measurable goodwill in many professional partnerships, this trend did not extend to law partnerships. This was due to the unique attorney-client relationship. As one court has expressed, "clients are not merchandise. They cannot be bought, sold or traded. The attorney-client relationship is personal and confidential and the client's choice of attorneys in civil cases is never absolute. The client always has the option to substitute another attorney of his choice [Therefore any goodwill is

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4 Id. at 84, 135 A.2d at 131.
5 Id. at 88, 135 A.2d at 133.
7 Id. at 370, 667 P.2d 101:02.
8 Id. at 379, 667 P.2d at 107.
9 Id. at 379, 667 P.2d at 108.
10 Id.
11 Id.
12 Id.
personal to the individual attorney]." In Lyon v. Lyon, the court reasoned that "the personal and confidential relationship existing between each [lawyer] and client places such a partnership in a class apart from other businesses and professional partnerships." A client and his attorney are expected to have an individual relationship, which is separate from any partnership.

This personal, individual relationship between an attorney and client, and the goodwill that resulted, was the norm in the days of sole practitioners or small law partnerships. However, courts began to reason that large law partnerships, with many departments, computerized files and billing systems and impressive physical surroundings were becoming more common. Law partnerships were beginning to resemble other professional enterprises. As a result, goodwill began to be recognized as an asset of a law firm in some instances. "Goodwill is the ability of a particular law firm to attract clients either because of the firm's name, firm's physical location or the reputation of the lawyers employed by the firm and this goodwill may be ascertainable for certain purposes." Initially, goodwill was found to be a measurable asset in divorce property divisions. The goodwill of a law partnership was included as an asset in divorce community property settlements, because after the divorce, the law practice would continue with the same intangible value after the divorce. These intangibles were the spouse's skill and reputation as an attorney.

"Kohner v. Wales, 16 Wash. App. 304, 556 P.2d 233 (1976). This same reasoning was also reflected in a case involving a medical partnership, Jones v. Fakehany, 261 Cal.2d 298, 306, 67 Cal. Rptr. 810, 815, in which the court said, "The patient may not properly be regarded as the subject of 'ownership'. The practice of medicine is a business, not a profession."


"Id.

"See, e.g., Grayck, Compensation and Fringe Benefits, J. CORP. TAXN 258 (1981). Law partners are being encouraged to incorporate, so that they can reap the benefits of corporate retirement plan deductions, tax and fiscal year calendars and pension and profit sharing plans. See Hildebrandt and Santangelo, Partnership Compensation: Why Objective Formulas Don't Work, 10 LEGAL ECON. 39, 41 (Jan.-Feb. 1984):

All partners must understand that the distribution of profits in any law firm is an extremely difficult task and that no one year should be viewed alone when the partner's worth to the firm is being evaluated. When all is said and done, each partner should feel comfortable that those who are "dividing the pie" have put forth reasonable and prudent efforts in the equitable distribution of the firm's net profits. Such an approach requires a great deal of trust on the part of each partner, plus the sacrifice of his or her ego. This trust and sacrifice is essential to the well-being of today's law firm. A brief survey of law review journals shows that their table of contents frequently present articles on the "business" aspects of a law practice, including, Upgrading Your Law Office Computer System, 71 A.B.A.J. 1 (1985); The Professional Corporation for Lawyers, 87 CASE & COM. 27 (Jan.-Feb. 1982); Critical Factors in Acquiring a Computer, 58 FLA. B.J. 67 (1984). Advertisement for a seminar on Marketing and Selling of Legal Services, 19 GA. ST. B.J. 115 (1983); Improving Corporate Practice with a Staff Manual, 10 LEGAL ECON. 3 (1984). This "business" trend can also be seen in the MODEL RULES OF PROFESSIONAL CONDUCT, Rule 5.1 and Rule 5.2 (Law Firms and Associations).


It was this "dramatic change" in the legal profession that caused the Ohio Supreme Court to reconsider the status of goodwill in a law partnership. With law partnerships becoming more "business-oriented," the court felt that goodwill should not be precluded as a matter of law.\(^4\) The court reasoned that if law firms used computers, office managers, department heads and engaged in mergers and cost-effectiveness planning, that goodwill was just another "business-oriented" element.\(^5\) The majority held that "where the evidence established that a professional partnership, including a law partnership, has generated measurable goodwill, it is not against public policy to include that amount of goodwill as an asset upon dissolution of the business."\(^6\) Chief Justice Celebreeze, in his concurring opinion, agreed that the law firm in the instant case had loyal clients who were attracted to the firm itself.\(^6\)

The Spayd concurring opinion seemed to agree with the rationale in Bump v. Stewart, Wimer and Bump, P.C.\(^6\) That is, while the trend to include goodwill as an asset of a law partnership can extend to certain circumstances, such as divorce settlement valuations, it should not extend to the dissolution of a law partnership.\(^6\) At first, this reasoning might appear to be contradictory. If goodwill can be an asset in a law partnership in certain circumstances, why is it not an asset all of the time? An examination of the ethical considerations that are involved in a law partnership may offer an explanation.

B. Goodwill Under DR 2-107(B)

Courts must examine whether DR 2-107(B) of the Model Code of Professional Responsibility precludes finding the existence of goodwill in a law partnership upon its dissolution.

The rigid classification of goodwill into [business] and personal had obscured the issue in many cases. The question is not: Is the goodwill personal? The solution of any controversy regarding goodwill seems to be dependent upon two questions: 1) Does goodwill in fact exist? 2) May the benefit of it, under the circumstances, be made available ... without fraud upon the public?\(^7\)

The Spayd court answered the first question in the affirmative and held that measurable goodwill could exist in a law partnership. The court then turned to

\(^4\)Spayd, 19 Ohio St. 3d at 62, 482 N.E.2d at 1238.
\(^5\)Id. at 61, 482 N.E.2d at 1238.
\(^6\)Id. at 65, 482 N.E.2d at 1240.
\(^7\)Id. at 62, 482 N.E.2d at 1238 (Celebreeze, C.J., concurring).
\(^8\)Bump v. Stewart, Wimer and Bump, P.C., 336 N.W.2d 731 (Iowa 1983). This case, on appeal, involved problems generated by the separation of a lawyer (Bump) from a law firm operating as a professional corporation. The trial court had refused to include an amount for goodwill in the corporation's value because Bump had taken a substantial number of clients with him. The amount of their billings was more than his share of the goodwill.
\(^9\)Id.

the second question, which involved ethical considerations relevant to a law partnership practice. These ethical considerations focus primarily on DR 2-107(B). Under this Disciplinary Rule, lawyers who are not partners or associates are prohibited from dividing fees for legal services, unless the fee is based upon a division of services or responsibility.

Case law set forth the principle that payment for goodwill violated DR 2-107(B) because distribution of goodwill at the time of a dissolution of a law partnership was a payment based on future earnings. The partner who had left the law firm would receive payments for goodwill based on the firm's reputation to acquire future business. However, the departing partner would not have performed any service or had any responsibility for the future clients. According to DR 2-107(B), this seemed to be an impermissible sharing of future fees.

However, in Spayd, the Ohio Supreme Court felt that a closer look at DR 2-107(B) indicated that goodwill would not be precluded as an asset of a law partnership upon dissolution. The majority reasoned that goodwill and future earnings were not identical. This reasoning had been reflected in other jurisdictions. In Dugan v. Dugan, the court said that "future earning capacity per se is not goodwill." In Smith v. Bull, the court emphasized that the...
allowance for partnership goodwill was not based upon a share of the profits of the new agency. Rather, the value was based upon the goodwill that the partnership possessed before its dissolution.\textsuperscript{81}

Divorce property settlements provided further reasoning for the existence of goodwill as a present, and not a future asset. In \textit{Foster v. Foster},\textsuperscript{82} the court noted that the goodwill of a spouse's partnership was taken into consideration in determining the other spouse's community property award. Since a community interest could only be acquired during the time of the marriage, the value of any goodwill must have existed at the time the marriage ended. That value must have been established without dependence on the potential or continuing net income of the professional spouse.\textsuperscript{83}

This concept of goodwill existing as a present and measurable asset can be further understood by examining the methods for computing goodwill. There are methods for determining the value of goodwill when an actual sale of partnership property has not occurred, which measure goodwill based on the sale price.\textsuperscript{84} These methods include:

1. Capitalization of earnings; or
2. Subtracting the value of the tangible assets of a business from the estimated sale price of that business.\textsuperscript{85}

However, those two formulas do not necessarily reflect the goodwill which is personal to some particular individual. Those elements of the goodwill asset that are attributable to the personality, skill or business acumen of an individual partner can be evaluated by comparing the profit margin of a similar firm where no such unusual personal elements of goodwill exist.\textsuperscript{86}

\textit{Lopez v. Lopez}\textsuperscript{87} involved determining the value of the goodwill of the attorney-husband's law practice for a divorce community property settlement. The \textit{Lopez} court considered the practitioner's age, health, past demonstrated earning power, professional reputation as to his judgment, skill and knowledge, and the nature and duration of the practice, in assessing the value of the partnership goodwill.\textsuperscript{88} The court in \textit{Aufmuth v. Aufmuth}\textsuperscript{89} was faced

\textsuperscript{11}Id.
\textsuperscript{147 Cal. App. 2d 338, 305 P.2d. 152 (1956).}
\textsuperscript{14}Id. See also \textit{Fortier v. Fortier}, 34 Cal. App. 384, 388, 109 Cal. Rptr. 915, 918 (1973).
\textsuperscript{15}Swann v. Mitchell, 435 So. 2d. 797, 800-01 (Fla. 1983).
\textsuperscript{16}Id.
\textsuperscript{17}See, e.g., \textit{Dugan}, 92 N.J. at 439, 457 A.2d at 6. Measurable goodwill can be determined by fixing the amount by which a law partner's earnings exceed that which would have been earned by an employee with similar qualifications of education, experience and capability. By determining what an attorney of comparable experience, expertise, education and age would be earning as an employee in the same locale, the difference can be attributed to the presence of the law partnership.
\textsuperscript{18}38 Cal. App. 3d 93, 113 Cal. Rptr. 58 (1974).
\textsuperscript{19}Id. at 109-10, 113 Cal. Rptr. at 68.
\textsuperscript{20}Cal. App. 3d 446, 452 Cal. Rptr. 669, 679 (1979).
with determining the value of a law partnership's goodwill for a divorce settlement. The lawyer spouse in that case was thirty-one years old and had been a member of the Bar for seven years and a member of the firm for five years. In view of his "youth and comparative inexperience," both the trial court and the appeals court concluded that he had not contributed in any substantial way to whatever goodwill the firm might have possessed.90

Thus, courts have been able to develop and use criteria for establishing a present and measurable value of the goodwill attributable to a law partnership. Therefore measurable goodwill can be distributed to the withdrawing partner without violating DR 2-107(B), if it exists at the time of the dissolution of the law partnership. This is because the departing partner is entitled to all tangible and intangible assets present at the time of dissolution. DR 2-107(B) does allow payment to a former partner or associate pursuant to a separation or retirement agreement.

The Spayd majority agreed that goodwill could be a present asset and did not depend entirely on future earnings.91 Their reasoning follows naturally from their holding on the first issue. If measurable goodwill is held to be an asset upon the dissolution of a law partnership and if it can be measured at the time of dissolution, then goodwill would not only be based on future earnings. The departing partner merely receives a final accounting, which is allowed under DR 2-107(B). He would not be involved in the impermissible sharing of future fees, which is prohibited by DR 2-107(B). Thus, considering goodwill to be a present and not a future asset removes the ethical roadblock. The Spayd majority specifically held, "we conclude as a matter of law the ethical standard within DR 2-107(B) does not preclude finding that goodwill exists in a law partnership upon dissolution of that association."92

Chief Justice Celebreeze, in his concurring opinion in Spayd did not agree with this reasoning.93 Although he believed goodwill existed and was measur-
able, he adopted a stricter division between what constituted a present payment and a future earning. Chief Justice Celebreeze allows a firm to gradually pay off a retiring partner’s tangible assets in the partnership, or to provide a retiring partner with reasonable retirement payments. These payments could be made with the ethical approval of DR 2-107(B) because the values could be determined at the time the partner left and the Disciplinary Rule allows for such payments to partners. However, Chief Justice Celebreeze reasoned that it is against public policy to permit “a former partner to receive a portion of future services rendered by the firm in settlement of goodwill.”

The differences in reasoning between the Spayd majority and concurring opinions focused on the issue of goodwill as a present or future asset. The better argument lies with the majority in Spayd. Both opinions agree that giving retiring partners gradual payments for tangible assets or reasonable retirement payments is acceptable under DR 2-107(B). There is little difference between those payments and payments for goodwill upon dissolution. All of those payment amounts could be determined at the time of the partnership dissolution, although the actual payments to the withdrawing partner might have to come from the firm’s future earnings. Therefore, payment for an asset that is determinable in the present, such as goodwill, should not be precluded by DR 2-107(B).

II. NECESSITY OF A SPECIFIC CONTRACTUAL PROVISION FOR GOODWILL AS A DISTRIBUTABLE ASSET

Although Plaintiff-Spayd prevailed on the goodwill issues, he won only a moral victory. The court agreed with him that measurable goodwill could be an asset upon the dissolution of the business and that ethical considerations did not prevent the distribution of goodwill. However, the court also held that “provision for goodwill as an asset of a partnership which is to be distributed upon the dissolution of a business is a matter of contract between the partners and must be specifically set forth in the partnership agreement.” The partnership agreement that Spayd had with the law firm did not provide for the payment of goodwill, the accounting practice of the law firm did not include goodwill as an asset, nor had any previously retiring partner received a payment for goodwill. The Spayd court stated that “the provision for goodwill as an asset

"Id.
"Id.
"Id.

The concurring opinion found support for its reasoning in Siddall v. Keating, 8 App. Div. 2d 44, 185 N.Y.S.2d 630 (1959), aff’d 7 N.Y.2d 846, 196 N.Y.S.2d 986 (1959), which expressed policy and ethical concerns about distributable goodwill. The concurring opinion also looked to Bump v. Stewart, Wimer and Bump, P.C., 336 N.W.2d 731, 737 (Iowa 1983) (“Placing a price tag on the goodwill of a law practice is contrary to public policy.”)

"Spayd. 19 Ohio St. 3d at 64, 482 N.E.2d at 1240.
"Id.

http://ideaexchange.uakron.edu/akronlawreview/vol20/iss1/8
of a partnership which is to be distributed upon the dissolution of the business is a matter of contract which must be assented to by all parties involved. Therefore, Spayd did not receive payment for his share of the goodwill because the distribution of goodwill had not been specifically provided for in the partnership agreement and a provision for payments could not be implied from the partnership's conduct.

This holding is at odds with the accepted practice in business partnerships and may still be an area where professional and business partnerships differ. In business partnerships "ordinarily, goodwill is an asset of the partnership and is included in an accounting upon the dissolution or termination of the partnership agreement." Indeed the statement that goodwill must be included in the accounting if it is an asset of the partnership is, of course, all assets having any value must be accounted for.

Standard business practice is also contrary to the Spayd holding. "The goodwill of a partnership engaged in trading, manufacturing or publishing is an asset of the firm which must be accounted for upon dissolution of the firm . . . in the absence of any agreement to the contrary." The partnership agreement may specifically provide that goodwill shall not be taken into account on a dissolution in order for it to be excluded as an asset. Practically speaking, since accounting for goodwill is the rule in business partnerships, "the goodwill of a partnership should be converted into cash in the most advantageous way," so as to produce the largest sum for all parties interested.

While the Spayd court allowed goodwill to be distributed if a payment agreement was specifically provided for in the partnership agreement, business partnerships allow goodwill to be distributed unless prohibited by the partnership agreement. There are two circumstances which may prohibit the distribution of goodwill as an asset in business partnerships. These will be presented to show two alternative bases for the Spayd court's decision.

First, goodwill will not be considered in an accounting between partners where the dissolution was caused by the wrongful act of one of the partners. This appears to be the majority rule and is reflected in Ohio Revised Code § 1775.37(B)(3), which states that a partner who has caused the dissolution

100 Id.
101 Annot., 65 A.L.R.2d 523 (1959). (“The fruitful inquiry is, rather, when can it be said that the partnership does or does not have such an asset.”)
102 13 O. JUR. 3d. Business Relationships § 955 (1979); See, e.g., Wolf v. Murrane, 199 N.W.2d 92, 100 (Iowa, 1972); Whitman v. Jones, 322 Mass. 340, 343, 77 N.E.2d 315, 317 (1948). (“In the absence of an agreement to the contrary, the partner appropriating the firm’s goodwill to his own use must account for its value.”)
105 Id.
106 60 AM. JUR. 2d Partnership § 282 (1972).
wrongfully shall not receive the value of the goodwill of the business.\textsuperscript{107} The Uniform Partnership Act specifies sanctions for wrongfully causing a dissolution which include denial of goodwill.\textsuperscript{108} However, this denial of goodwill to the “wrong” partner appears to be losing favor because it currently seems to serve no compensatory or punitive function.\textsuperscript{109} The partnership in \textit{Spayd} was dissolved through a voluntary departure of one of the partners.\textsuperscript{110} Therefore, the rule denying goodwill to the partner who wrongfully caused the dissolution would not have applied. However, this rule is being applied on a less frequent basis. If even “wrongful” partners can receive their share of the partnership goodwill, it would seem that a partner, like \textit{Spayd}, should be entitled to payment for goodwill.

Goodwill is also denied to a partner who has already received the benefit of his interest in the goodwill.\textsuperscript{111} Therefore, a partner who has taken some of the firm’s business with him may already have received compensation for his share of the goodwill. \textit{Spayd} did succeed in taking one client of the partnership with him when he left the firm.\textsuperscript{112} Perhaps the \textit{Spayd} court should have denied

\textsuperscript{107}\textsc{Ohio Rev. Code Ann.} \S 1775.37 (Baldwin Supp. 1979).

\textsuperscript{108}A partner who has caused the dissolution wrongfully shall have:

\textit{(a)} If the business is not continued under division (B)(1)(b) of this section all the rights of a partner under division (A), subject to division (B)(1)(b) of the section:

\textit{(b)} If the business is continued under division (B)(2) of this section the right as against his partners and all claiming through them in respect of their interests in the partnership, to have the value of this interest in the partnership, less any damages caused to his partners by the dissolution, ascertained and paid to him in cash, or the payment secured by bond approved by the court, and to be released from all existing liabilities of the partnership; but in ascertaining the value of the partner’s interest the value of the goodwill of the business shall not be considered.

\textsuperscript{109}The liquidation provision of \S 381(1) is not applicable when dissolution is caused 'in contravention of the partnership agreement'. Section 381(2) outlines the consequences of a dissolution caused in contravention of the partnership agreement:

\textit{(c)} A partner who has caused the dissolution wrongfully shall have:

\textit{I.} If the business is not continued under the provisions of paragraph (2b) all the rights of a partner under paragraph (1), subject to clause (2a)(1) of this section.

\textit{II.} If the business is continued under paragraph (2b) of this section the right as against his co-partners and all claiming through them in respect of their interests in the partnership, to have the value of his interest in the partnership, less any damages caused to his co-partners by the dissolution, ascertained and paid to him in cash, or the payment secured by bond approved by the court, and to be released from all existing liabilities of the partnership; but in ascertaining the value of the partner’s interest the value of the goodwill of the business shall not be considered.


\textsuperscript{111}The UPA directive to disregard goodwill may be based on the perceived difficulties of valuation. At its best, goodwill is nebulous. The drafters of the UPA may have been attempting through this ‘forfeiture’ to prevent the assertion of inflated claims based upon such a vague concept as goodwill. Indeed, their concern in this regard was substantiated by the state of accounting practices at the turn of the century. The automatic forfeiture of this partnership asset currently serves no useful purpose.

Hillman, \textit{supra} note 108, at 535.

\textsuperscript{112}\textit{Spayd}, 19 Ohio St. 3d at 64, 482 N.E.2d at 1239.
Spayd the goodwill payment because he had already received the benefit of his interest in the goodwill. Denying the goodwill payment for this reason would have been in line with standard business procedure. But the Spayd court gave as its reason for requiring a prior agreement the fact that “the respective rights of partnership members depend primarily on the specific provisions contained within the partnership contract.” The court found support for this in Siddall v. Keating. The Siddall court denied payment of goodwill in a law partnership dissolution. The court found that the written partnership agreement it was considering had no provision for a distribution based on goodwill. Goodwill was never reflected as an asset in the partnership accounts and retiring partners had never received any payment for partnership goodwill. A contract for goodwill was not express and could not be implied. Similar factors were present in Spayd. The written partnership agreement specified the amount that was to be paid to a retiring or terminating partner, but did not include a provision for goodwill. Goodwill was not carried as an asset in the accounting practice and there was no evidence that goodwill payments had been made to any previously retiring partner.

The Spayd requirement of a specific provision in the partnership agreement for the distribution of goodwill is a rigid rule that is not frequently followed. In Engel v. Vernon, the court first looked to the partnership agreement covering the relation of the parties because it was a contract between them. However, when the Engel court felt that a “clear solution” was not apparent in the partnership agreement, the court looked to general principles of partnership law to decide the case. The Engel court seems to have adopted a more flexible approach by looking beyond the partnership agreement to general principles of law.

Support for the Spayd holding may come from DR 2-107(B) which permits retiring partners to be paid pursuant to a prior agreement. Otherwise, it would seem that the case law involving partnerships would not require the rigid rule of allowing payments for goodwill to be made only when specified in the partnership agreement.

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113 Id. at 64, 482 N.E.2d at 1240.
119 Id. at 47, 185 N.Y.S.2d at 633.
120 Id. See also Cook v. Lauten, 1 Ill. App. 255, 258, 117 N.E.2d 414, 416 (1954). A CPA partnership had no goodwill to be accounted for as an asset, where as here, there is no provision in the partnership agreement relating to goodwill as an asset.
121 Spayd, 19 Ohio St. 3d at 64, 482 N.E.2d at 1240.
122 215 N.W. 506 (Iowa 1974).
123 Id. at 513.
124 Id. See also In re Brown, 242 N. Y. 1, 150 N.E. 581, 582 (1926) where the court considered the “course of dealing” in addition to partnership law.
125 See, e.g., Jackson v. Caldwell, 18 Utah 2d 81, 415 P.2d 667 (1966) where the court considered whether goodwill could be implied in the partnership contract, as goodwill was not provided for expressly in the contract.
Perhaps provisions for the distribution of goodwill should be included in law partnership agreements since goodwill is not perceived as an intangible asset of a law firm. If measurable goodwill becomes more common as an asset of law firms, as it is in business firms, then a specific contractual provision for goodwill payments may no longer be necessary.

III. PRACTICAL CONSIDERATIONS AFTER SPAYD

The court’s decision in Spayd will probably have some practical effect on law partnerships in Ohio. Law firms must develop formulas for measuring goodwill. Law partners must provide for the distribution of goodwill in their partnership agreements. However, the Spayd holding, which permits measurable goodwill to be an asset upon the dissolution of a law partnership, will probably have the most impact on larger law firms. "Small firms generally have little if any goodwill in the firm’s name." \(^{122}\) In small firms, "attorney-client relationships often are quite personal and not easily transferable."\(^{123}\)

Permitting measurable goodwill to be a distributable asset of a law partnership is a concept of law that has emerged gradually. Other jurisdictions have gone one step further and have started to consider whether goodwill can be a saleable asset in the law practice of a sole practitioner or partnership.\(^{124}\) The Spayd court specifically stated that they had not reached the issue of selling goodwill.\(^{125}\)

The selling of a practice, including selling goodwill, brings more sharply into play ethical considerations. Ethics committees’ opinions have rejected goodwill as a saleable asset of a law firm.\(^{126}\) The sale of goodwill was considered in Geffen v. Moss.\(^{127}\) The California court determined that the sale of goodwill was unethical because attorneys were prohibited from compensating another

\(^{122}\) Bonner, supra note 108, at 62.

\(^{123}\) Id. ("And, trying to put a number on goodwill in a [small] personal service [firm] is like trying to nail a raindrop to a wall.")

\(^{124}\) Stewart, The Sale of a Law Practice, 19 PRAC. LAW. 63 (1975). ("In California, professional practice brokers have become more common and are used to arrange the purchase or sale of a law firm.") Martin, Selling the Goodwill of a Law Practice, 2 CALIF. LAW. 30, 32 (1982). (The California Bar Association has recommended allowing the sale of goodwill if provisions are followed so that clients are protected.)

\(^{125}\) Spayd, 19 Ohio St. 3d at 59, 482 N.E.2d at 1236.

\(^{126}\) See, e.g., ABA Comm. on Professional Ethics and Grievances, Formal Op. 300 (1961); Association of the Bar of the City of New York Comm. on Professional Ethics, Formal Op. 633 (1943), reprinted in OPINIONS OF THE COMMITTEE ON PROFESSIONAL ETHICS OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK AND THE NEW YORK COUNTY LAWYERS’ ASSOCIATION (1956). Committee on Professional Ethics of the New York County Lawyers’ Association in Op. 109 (1943): "Clients are not merchandise. Lawyers are not tradesmen. They have nothing to sell but personal service. An attempt, therefore, to barter in clients, would appear to be inconsistent with the best concepts of our professional status." MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 3-102(A) has been interpreted to allow "payments to a retired partner or for a fixed period to the estate of a deceased partner in accordance with a pre-existing retirement plan, the amount of those payments being measured by subsequent earnings of the firm." ABA Comm. on Ethics and Professional Responsibility, Formal Op. 327 (1971).
person for either soliciting or obtaining business.\textsuperscript{128}

The commentators have pointed out that by selling goodwill, an attorney would be compensated for transferring his clients' loyalties.\textsuperscript{129} Selling goodwill that has been generated through client loyalty could also be seen as violating Canon 2 of the Code of Professional Responsibility because it does not provide clients with the maximum opportunity to choose their own legal counsel.\textsuperscript{130}

Although the \textit{Spayd} court did not consider the ethics of selling goodwill, it seems that this might be the next issue in the area of goodwill in a law partnership that Ohio courts must confront, since other jurisdictions, such as California, are beginning to consider this issue. In Ohio, if goodwill can be measured and ethically distributed upon dissolution of a law partnership, law firms may feel encouraged to take the next step and attempt to sell all their partnership assets, including goodwill.

\textbf{CONCLUSION}

"Goodwill is a very flexible and intangible thing. It seems that the more research is made, the more confused one's mind becomes."\textsuperscript{131} This seems especially true in cases such as \textit{Spayd}, where the court followed the modern trend and departed from the black and white rule which flatly prohibited goodwill as an asset in a law partnership.\textsuperscript{132} Law partnerships seem to have come of age in the modern business world. At this point, the Ohio Supreme Court is allowing the existence of measurable goodwill to be determined as a question of fact.\textsuperscript{133} Ethical considerations, primarily DR 2-107(B), were held not to prohibit goodwill as a distributable asset in the dissolution of a law partnership, if provided for in the partnership agreement.\textsuperscript{134}

Other issues and considerations are raised by this decision. Many legal professionals may still feel that the rule about goodwill in a law partnership should not have been changed because the ethical considerations still apply to prohibit goodwill. Legal practitioners will have to become more business-oriented and begin to include provisions for goodwill in their partnership agreements. Future cases may consider the existence of goodwill in the sale of a law partnership, or solo practice, and whether goodwill must be mentioned in

\textsuperscript{128} \textit{id.} at 226, 125 Cal. Rptr. at 692. The attempted purchase of a law firm's goodwill includes the expectation of future patronage from former and current clients, but the attorney-client relationship is personal and confidential.

\textsuperscript{129} \textit{See} Detroit Bank and Trust Co. v. Coopes, 93 Mich. App. 459, 463, 287 N.W.2d 266, 268 (1979) The sale of goodwill would result in increased fees charged to clients in order to compensate the attorney for his purchase of that commodity. Clients can not be sold to the highest bidder.

\textsuperscript{130} \textit{MODEL CODE OF PROFESSIONAL RESPONSIBILITY} Canon 2: "A lawyer should assist the legal professional in fulfilling its duty to make legal counsel available."

\textsuperscript{131} \textit{In re Anastos' Estate}, 45 Ohio Op. 91, 92, 100 N.E.2d 324, 326 (P. Ct. 1944).

\textsuperscript{132} \textit{See} Rice v. Angell, 73 Tex. 350, 354, 11 S.W. 338, 340 (1889).

\textsuperscript{133} \textit{Spayd}, 19 Ohio St. 3d at 62, 482 N.E.2d at 1238.

\textsuperscript{134} \textit{id.} at 63, 482 N.E.2d at 1239.
professional partnership agreements.

The future will tell if the *Spayd* decision was just "one step forward in contract law and two steps backward in the realms of legal ethics and public policy."\(^{135}\)

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