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By L. L. Briggs

The existence of goodwill is generally shown by profits above normal for the business under consideration. The continuance of these super-profits over a period of years is an essential indication of goodwill, so a new and untried concern can lay no valid claim to the possession of this form of property. There is, however, some conflict among court decisions on the necessity of profits for the presence of goodwill. In the case of *MacFadden* v. *Jenkins*, 40 N. D. 422 (1918), the court maintained that there may be goodwill in a business even though there have been no profits. The judge gave as an example a mortgage company which made loans to farmers at rates lower than those which were prevalent and profitable. This concern had the goodwill of its patrons, but still it lost money. Apparently Justice Grace considered that goodwill was merely a kindly feeling of the customer toward the business which he patronized and that profits were not concerned. This is not the general legal conception of goodwill. In *Halverson* v. *Walker*, 38 Utah 264 (1910), the court insisted that if the business were such that when properly managed it would not yield sufficient to pay debts it was not a desirable business and the goodwill thereof might not be considered as of any value to a prospective purchaser. There is another well known decision to the same effect. Most jurists accept this view.

That goodwill is property has been settled by a long line of decisions in both the English and the American courts. Circuit Judge LaCombe said: "That it is property is well established by authority." North Dakota has a section in its statutes stating: "The goodwill of a business is property." An Indiana court has qualified the general statement by saying that the goodwill of a business is not of itself property, but is only an incident that may attach to or be connected with property. The point involved in the case was whether or not the goodwill of a newspaper was property according to the constitution of that state. The court ruled that it was not property by itself. This in reality does not change the generally accepted idea because goodwill is understood to be an incident of other property.

The law protects goodwill to the same extent that tangible property is protected. Nearly half a century ago, Justice Clap-

ton said: "It is regarded as an appreciable and important interest which the law will protect." If goodwill is unlawfully destroyed or taken from the owner, the courts will award damages to the injured party. Justice Trimble, when rendering a decision concerning this phase of goodwill, said: " . . . the law will . . . award damages for injuries thereto." If a buyer is induced by fraud to purchase goodwill, he is entitled to damages from the seller. Even though there may be no statute covering this type of case, the precedents in the common law will govern. Goodwill is protected both by statute law and by common law in England, but in America, with a few exceptions, common law seems to be sufficient to give justice to the parties involved in goodwill litigation.

Numerous decisions have been rendered to the effect that goodwill is an asset. The English cases date from 1856, when Sir John Romilly, master of the rolls, said: "The goodwill of a trade, although inseparable from the business, is an appreciable part of the assets of a concern, both in fact and in estimation of a court of equity." Many American decisions follow the same line of thought. Of these the following words of Justice Spring are characteristic: "The element known as goodwill is held by the courts to be an asset in estimating the value of the property." Justice Brown of the United States supreme court has maintained that goodwill is a legitimate asset where it is actually existent. However, it is not an available asset in the sense that it can be turned into money by itself because it has no salable value apart from the tangible property with which it is connected. The courts have allowed it to be counted as an asset to decide whether or not a business was solvent. An exception occurred in the case of an insolvent insurance company, in which Justice Sheldon expressed his opinion as follows: "The goodwill of the company would be a poor species of assets to pay losses with, and it is funds that will pay losses that an insurance company is required to have by law." Generally, the goodwill of a decedent's business is considered a part of the assets of his estate. Several American rulings are to this effect. If the decedent's property is sold, the proceeds of the goodwill are divided as is the rest of the property. There is one notable exception to the general rule that goodwill is an asset. The court, in the case of *Seighman* v. *Marshall*, 17 Md. 550 (1861), ruled that the goodwill of a printing office was not an asset under the statutes of Maryland because the value was too uncertain and

contingent to be the subject of estimate. The majority opinion is that goodwill is an asset to the individual enterprise, to the partnership and to the business corporation.

Intangibility is generally a characteristic of goodwill. In a leading English decision, Sir John Romilly said: ". . . the goodwill . . . is never tangible unless it is connected with the business itself, from which it can not be separated, and I never knew a case in which it has been so treated." Chief Justice Fuller, speaking of the same subject, said: "It is tangible only as an incident, as connected with a going concern or business having a locality or name . . ." Several other jurists have taken the same position. There is at least one decision that does not concur. Judge Humphries gave his opinion in these words: "We think the goodwill of a business is a tangible thing." The learned justice seems to have a concept of goodwill which is different from that held by most jurists, because he made this statement: "We see no difference between the goodwill of a business and any other valuable asset possessed by it."

The consensus of opinion among judges is that goodwill can not exist independently but always must be connected with and rest upon some principal and tangible thing. It has no meaning except when applied to a continuing business, and to the property of such a going concern it is an incident. It is not separable from and generally can not be sold independently from the other assets. There are some exceptions which will be discussed later, but this has been the attitude of the majority of the jurists who have had the duty of making decisions involving this phase of goodwill. Justice Weaver gave an excellent statement of the legal view when he said: "Ordinarily, though perhaps not universally, goodwill is a thing having no existence except as it attaches to the tangible."

There is some variation among the statutes of the states in respect to the taxation of goodwill. As far as the common law is concerned, goodwill is taxable like any other form of property. The attitude of the courts was well expressed by Justice Cobb when he said: "Goodwill . . . may be taxed like any other form of property, if its value can be ascertained." The last clause suggests an obstacle which might cause the tax authorities some trouble. In New York it has been ruled that the transfer of goodwill is taxable under the law relating to taxable transfers. The courts of the same state handed down a decision to the effect

that the goodwill of a foreign corporation engaged in business within that state was taxable as property employed therein. This seems unjust to the foreign corporation that does only a small part of its business within the boundaries of New York, and it would be to the advantage of such a corporation to write off its goodwill.

Like any existing thing of recognized value, goodwill may be the subject of contract. Since it is a property right it may be transferred with the business to which it is an incident or upon which it depends. The statutes of North Dakota provide that: "The goodwill of a business is transferable." The sale of goodwill is authorized by statute in the same state. The proprietor may sell the asset or it may be sold by the court's order. However, it may not be sold by judicial decree or otherwise, unless it be as part of a sale of the business in which it exists.

Goodwill may not be sold separately from the business of which it is a part. Chief Justice Fuller has said that goodwill ". . . is not susceptible of being disposed of independently." This ruling has been followed in a majority of the cases. The underlying theory is that goodwill is inseparable from the business, and, consequently, it is impossible to convey it separately from the concern in which it is involved. However, there are some dissenting opinions. In the case of *Tennant* v. *Dunlop*, 97 Va. 234 (1899), the court maintained that the goodwill might be sold separately from the business plant or property. An analysis of the case reveals the fact that the goodwill in question adhered to certain trade-marks. The court reasoned that the trade-marks might be sold separately from the business and since the goodwill followed them it was sold separately from the business. The weakness of the reasoning lies in the failure to recognize that trade-marks are as much a part of the business property as are the buildings and the machinery. In one case it was held that the goodwill of a business may be sold when no material plant is involved. The same is true when the business transferred is one which is run without a plant. Justice Barrett, in discussing this point, said: "But the goodwill of a business may be sold independently. A physician may sell the goodwill of his practice without selling his office furniture or surgical instruments. So a lawyer may sell the goodwill of his clientage without selling his library. The same applies to the goodwill of a mercantile business, in fact, to goodwill generally." Very few jurists agree with Judge Barrett in his

contention that the goodwill of a mercantile business can be sold independently.

Since the goodwill of a business enterprise may adhere to particular assets, it is possible, in many cases, to obtain this intangible by buying the part of the property with which it is connected. According to Justice Holt: "It is not necessary to purchase all the assets to obtain the goodwill."

There are many decisions to the effect that the contract conveying the business which has the goodwill need not specifically mention that asset. It is understood that this intangible passes with the sale of the property to which it adheres. This may be considered the majority opinion. The few exceptions that are found in the court reports state or imply that the circumstances may be such that the parties concerned may reasonably understand that the goodwill is not included with the tangible assets of the business.

The purchaser who thinks he is buying goodwill with a business and later discovers that he has no such asset has no remedy unless he can prove that there has been fraudulent representation or suppression of facts by the vendor. The rule, "caveat emptor," applies.

The owner of goodwill may transfer it as a gift. Surrogate Fowler has said that ". . . it may be the subject of disposition . . . inter vivos."

Under a general assignment of all a firm's property for the benefit of creditors, the goodwill of the business passes to the purchaser at the assignee's sale. Any purchaser of a business with its goodwill may assign such business and its goodwill to another. In a leading case, the goodwill of a bank which had become insolvent passed to the assignee for the benefit of creditors and was allowed by the court to be transferred by him to third persons together with the real estate and other property to which the goodwill adhered.

In *Bradbury* v. *Wells*, 138 Iowa 673 (1908), the court decided that goodwill may be disposed of by means of a will. Thus, in this respect, goodwill is regarded by the law to be in the same category as other forms of property.

The goodwill of a business is property that may be mortgaged. It has been held that a mortgage of the entire assets of a company does not include the goodwill where such is not the inference and no mention is made of it in the instrument. However, in a case

involving a chattel mortgage of certain specified articles and all other property of every kind and description owned by the mortgagor in his printing office, the mortgage was held by the court to include the goodwill of the business.

If goodwill is an incident to property that is leased, it passes with that property to the lessee, even though it is not specifically mentioned. At the termination of the lease it reverts with the rest of the property to the lessor.

Since goodwill must ordinarily adhere to some principal property or right, the extinction of this property or right operates to extinguish the goodwill dependent upon it. Generally, goodwill terminates with the cessation of a business. It is usually lost when a concern is wound up, its liabilities discharged and its assets collected and distributed.

In case of bankruptcy, the goodwill of the business involved passes to the trustee with the rest of the assets. He is expressly authorized to sell it as part of the property of the bankrupt concern. The decisions touching this point are few in number but they are in agreement. A voluntary transfer estops the transferor from interfering with the value of the goodwill by competition; but, in the case of bankruptcy, when the transfer is involuntary on the part of the owner, the transferor may compete with the purchaser of the business. In a leading case involving a bankruptcy sale, the trustee sold the goods and chattels but made no attempt to sell the goodwill or to sell the business as a going concern. The court ruled that the goodwill did not survive. According to one court decision, the goodwill of a concern was impaired by the appointment of a receiver.

In regard to professional goodwill of the individual there has been considerable lack of uniformity of opinion among jurists. It has been said that goodwill does not enter a business or profession dependent solely on the personal ability, skill, integrity or other personal characteristics of the owner. This view is supported by numerous decisions. Chief Justice Hiscock, in one of the most recent cases involving this phase of goodwill, *Bailly* v. *Betti*, 241 N. Y. 22 (1925), said: "A business dependent solely on the personal skill and professional qualities of the person carrying it on does not possess goodwill." An insurance company was held to have had no goodwill. In this case there was nothing left of the business but the records and Justice Dever decided that it was impossible to reduce these to a money value.

The English courts assert that goodwill is inapplicable to the practice of a lawyer. Lord Chelmsford gave as his reason that the business had no local existence but was entirely personal. This decision was made at a time when locality was considered to be the essential element of goodwill. American courts have decided that commission merchants, lawyers and undertakers have no goodwill that survives. Other American courts have ruled that a professional business may have goodwill but it is attached to the person and not to the place. According to Justice Walker: "It has been stated to be a general rule that goodwill exists in a professional as well as a commercial business, subject to the distinction that it has no local existence, like the goodwill of a trader, but attaches to the person of a professional man as a result of confidence in his skill and ability." In a case regarding the sale of the practice of a dentist, it was held that there was goodwill attached to the person but not to the place of business. This idea was admirably expressed by Surrogate Fowler when he said: "But after a man who has acquired a reputation for great skill or knowledge is dead, persons who go to his office for the purpose of consulting him and availing themselves of his superior skill would not go there merely because the office was still open and occupied by another person who had no reputation for skill or knowledge." The English viewpoint is shown by the words of Vice-chancellor Steven: ". . . but the goodwill of the business of a successful professional man practising alone dies with him."

The constant expansion of the meaning of the term has been such that the present tendency of the courts is to allow goodwill to the professional man. Professional goodwill of an individual business has been sold and these sales have been lawful. According to Justice Cobb: "A physician may sell his goodwill, the goodwill being a property right, and the sale thereof not being against public policy." However, it is well settled that there can not be an involuntary sale of goodwill based upon professional reputation. The principle underlying this ruling is that a professional man has the right to select his clients or patients.

According to the weight of authority at the present time, the goodwill of a commercial partnership is an asset of the partnership as a whole. In case of dissolution it is partnership property subject to sale and the proceeds to distribution. It was formerly held that upon the dissolution of a partnership by the death of one of

its members, the goodwill thereof was not a partnership asset but belonged to the surviving partner or partners on the principle that partnership was similar to joint tenancy. Such was the opinion of Lord Eldon. The present-day doctrine is that the goodwill does not pass to the surviving partner or partners unless there is an express agreement to that effect. It forms a part of the general assets of the partnership in which the estate of the deceased partner is entitled to share. When a partnership is limited in time, the continuing partners are not compelled to make any allowance for the goodwill to a retiring partner because the goodwill is also limited. In an unlimited partnership with an agreement, the retiring partner may share according to that contract. If there is no agreement the courts will not permit the remaining partners to appropriate the goodwill without adequate compensation, and in order to obtain this, will order the goodwill with the other assets to be sold and the proceeds divided. One exception to this is found in a Nebraska decision in which the court allowed the surviving partners to carry on the old business at the old stand without legal liability to account for the goodwill to the representative of the deceased partner, because there was no agreement that they should be so liable. After dissolution each partner may use the old firm name if it does not expose the other partners to risks, provided there is no agreement to the contrary. A surviving partner would not be allowed to carry on a rival business in such a way as to lead the public to believe that it was the old partnership business and in this manner appropriate all the goodwill. If he so desires, a partner may sell his share of the goodwill with his share of the business to the other partners. The court held that the goodwill should not be taken into consideration in the accounting upon the dissolution of a partnership which had been conducted in the name of one partner although there were other partners who had kept their names secret. It is well settled that one partner, without express agreement to that effect, may not dispose of the entire goodwill of a firm.

The authorities on partnership agree that a professional partnership may have no goodwill. Judge Story said: "It seems that goodwill can constitute a part of the partnership effects or interests only in cases of mere commercial trade or business; and not in cases of professional business, which is almost necessarily connected with personal skill and confidence in the particular partner." According to Bates: "Goodwill is not strictly applicable

to a professional partnership, for the business has no local existence, but is entirely personal, consisting in a confidence in the integrity and ability of the individual." In a recent case, Justice Hiscock said: "It has, however, never been held that a business dependent solely on the personal skill and professional qualifications of the persons carrying it on possessed a goodwill or copartnership name which could be sold or transferred to any one who might desire to purchase on a sale. The contrary proposition is abundantly established." In a case involving a partnership engaged in a commission business, the court ruled that, in the absence of special contract, there was no such thing as goodwill in that type of partnership.

Business corporations may have goodwill connected with their property, business or other rights. It belongs to the corporation as an entity and may be transferred by the organization. The old theory was that goodwill could not enter into and form an element in the value of shares of stock. At present the courts allow it to be carried on the books as an asset and to be considered in determining the value of common stock. It has market value and may be accepted in payment of a stock obligation. A stockholder may not transfer the entire goodwill of a corporation. However, since the goodwill adheres to the corporate business, a stockholder sells whatever interest he may have in the goodwill of that business when he sells his stock.

Since goodwill is property and an asset, it must have value. Chief Justice Fuller, of the United States supreme court, has said: " . . . goodwill is in many cases a valuable thing . . ." Decisions of the American courts, before and after the one quoted, are in agreement on this idea. In some instances, as in the newspaper business, the goodwill may be the most valuable asset of the concern. A public-service monopoly is an exception. The rulings of the public-utility commissions have been that no allowance will be permitted for goodwill in a valuation for rate making. The theory is that where there is no competition there can be no goodwill because customers are retained under such conditions by compulsion, and not by their voluntary choice. However, where competition actually exists goodwill is as important an asset of a public-utility company as of any other concern.

In regard to the determination of the value of goodwill, the first question is whether or not that intangible asset is of such a nature that it may be valued. Justice Spring said: "While it is an in-

tangible asset it is susceptible of being measured at a money value." The same idea is brought out in an English decision of a much earlier date. The courts of both England and the United States agree on this point.

The next question which arises is whether or not it is possible to value goodwill. On this point Circuit Judge LaCombe has expressed his opinion in these words: " . . . in some way or other it must be practically possible to determine what that value is." However, Justice Braley has maintained that " . . . no rule can be laid down by which the goodwill in all cases can be ascertained and its value fixed with mathematical precision and accuracy." Most jurists agree that it is possible to determine the approximate value of goodwill.

The placing of a value on goodwill may be far from an easy task. According to Chief Justice McBride: "It is very difficult to approximate the value of goodwill. . . . The data for estimating the value of the business are always more or less uncertain." In a recent case, Surrogate Fowler said: "There is no more speculative or intangible subject of valuation than goodwill. It is difficult to fix from its very nature."

The valuation of goodwill is so perplexing because it is necessary to look forward and to attempt to judge the future by the past, when the past is no sure guide to the future on account of the almost infinite number of possibilities of variation in the circumstances which have an influence on the value of this extremely shadowy form of property. Any slight change in the surrounding conditions will increase or diminish the value of goodwill.

The courts have not laid down any inflexible rule for the determination of goodwill value. The tendency seems to be to decide each case on its merits and circumstances. From the very nature of the property it is evident that the question must, within proper limits, be left to the jury. It is impossible to make a rule that will cover all the circumstances which it may be necessary to consider when this asset is given a value. When the matter is given over to the jury it is essential that the conclusion be based upon legitimate evidence establishing value and it is the concern of the court to see that this evidence is pertinent and adequate.

In a valuation of goodwill, the profits are necessarily taken into account. It might not be equitable to take the profits of any one year because extraordinary circumstances might cause the profits

for that year to be abnormally large or small. According to Allan in his *Law of Goodwill*, "The usual basis of valuation is the average net profits made during the few years preceding the sale." The courts of the United States have usually ruled that the average of the three preceding years be taken. In the matter of Halle, 170 N. Y. S. 898 (1918), Surrogate Fowler insisted that the profits of four years be used in determining the average. The United States treasury department, in computing the March 1, 1913, value of goodwill for income-tax purposes, has used A. R. M. 34 very extensively. This provides that the profits for the five years preceding the computation be used. Jurists maintain that exceptional profits have no place in the computation of this average and if there happens to be an abnormal year among those taken for the basis of the average there is good authority for excluding it from such computation.

In numerous decisions the courts have held that opinion evidence of experts in regard to the value of goodwill is incompetent. Nevertheless, it has been admitted in some cases. Chief Justice McBride expressed the majority viewpoint when he said: " . . . conditions being shown . . . are stronger evidence than the opinion of the so-called interested expert, yet the authorities seem to be generally to the effect that such testimony is admissible for what it is worth." Owners and operators of a business are considered competent witnesses of the value of the goodwill. In regard to other witnesses Justice Dunbar said: " . . . the goodwill of a concern is a character of property so indefinite that a statement of its value must necessarily be regarded by any man of any business acumen whatever as very largely a matter of opinion." However, it seems that the testimony of competent witnesses would aid the jury in arriving at an approximately correct valuation.

Absence of competition must be given careful consideration when goodwill is given a value. The part played by this factor will vary according to the type of the business. In some cases the value of this asset may depend almost entirely upon freedom from competition with the seller of the concern. In the United States, unless there is an agreement to the contrary, the courts allow the seller of a business with its goodwill to set up a similar business but do not permit him to solicit his old customers, although he may trade with them if they come without solicitation on his part. Justice Tyler, in speaking of goodwill valuation,

said: "How far its value may be affected by competition . . . is an element, of course, to be taken into consideration in the fixing of such value."

A few other factors affecting the value of the goodwill of a business have been recognized by the courts in their decisions. The reputation of a concern for fair dealing has an influence on the profits and the goodwill, so it must be given consideration in the valuation of that intangible asset. Length of time that the business has been in existence would ordinarily have an effect on the value of its goodwill. Great concerns like Marshall Field & Co., Tiffany & Co., and Montgomery Ward & Co., which have been successful over a long period of years, have a better basis for goodwill than the new and untried organization. If a business is dependent upon a lease, the length of time which the lease has yet to run, the chance of renewal and the terms thereof have an influence on the value of the goodwill of that business.

Several methods of determining the value of the goodwill of a business organization have been approved by jurists. In the matter of a decedent's estate the courts have ruled that the result of inventory and appraisal is prima facie evidence of the value of the goodwill. The supreme court of the United States, in a very unusual decision, maintained that goodwill could be computed by taking the difference between the amount actually invested and the market value of the stock. In this case the goodwill adhered to a franchise and the conditions were such that it was impossible to compute the value except by the method adopted. According to the majority of American court decisions, the most common basis for the valuation of this intangible is a number of years' purchase of the profits as averaged over a period of three normal years. The English view was given by Lord Chelmsford when he said: "Where a trade is established in a particular place, the goodwill of that trade means nothing more than the sum of money which any person would be willing to give for the chance of being able to keep the trade connected with the place where the business has been carried on."

As to the number of years' purchase of the average annual profits there has been much difference of opinion among the judges. Valuations based on more than five years' purchase have not ordinarily been sanctioned by the courts although there is a slight tendency to go beyond five years in cases of concerns that have a superior organization and executives who are unusually capable.

From a survey of the American cases in point, it seems that most of the jurists have used from two to six years; the number depending upon the type of the business, its duration at a particular location and its reputation.

The English courts, in a case involving a bank, decided that the goodwill was equal to one year's purchase of the annual profits. In the matter of Silkman, 105 N. Y. S. 872 (1907), it was ruled that two years' purchase of the average annual profits was proper. Surrogate Thomas made a similar decision in the matter of Rosenberg, 114 N. Y. S. 726 (1908). When the International Harvester Co. was organized there was a contract to the effect that the goodwill should equal the profits of the two preceding years plus ten per cent. The United States commissioner of corporations commented on this in the following words: "This method of valuing goodwill was more or less commonly used by manufacturers." In an English case, Justice Stirling said: "It seems to me that the competition and a desire to exclude rivals in trade would lead a brewer to give not less than three years' profit." Most of the American decisions approve of the use of three years' purchase of the average annual profits as the value of the goodwill of a business concern. In *Pett* v. *Spiegel*, 202 N. Y. S. 650 (1923), a case which concerned a real-estate corporation, the court considered that a five years' purchase of the average annual profits was fair to both parties. In *Von Au* v. *Magenheimer*, 110 N. Y. S. 629 (1908), which is considered to be one of the leading American cases on goodwill valuation, the jury decided that the goodwill was worth five times the average net earnings. The court approved of a ten years' purchase of the average annual profits in valuing the goodwill of a large New York jewelry concern.

After the average annual profits of the business have been determined and the number of years' purchase of such profits has been settled, the factor of interest on the invested capital arises. The accountant, in his computation of profits, does not include interest on the invested capital as an expense of the business. The result is that the interest is included in the profits as shown by the income statement. From the viewpoint of the purchaser the business is not making an excess profit until it makes more than enough to equal what he could obtain by investing his money in safe securities plus compensation for risk in the particular field. Consequently, in determining the amount of the net average

annual profits to serve as a basis for computation of the goodwill, it is necessary to deduct from the average annual profits, as shown by the statement of the accountant, a fair rate of interest on the invested capital. According to Justice McLaughlin: "There are several authorities which indicate that interest on capital ought to be deducted from the average profits of a business before using such profits as a basis for determining goodwill." This statement is supported by many decisions.

If the management which has developed the goodwill does not go with the business when it is sold a deduction must be made from the average net annual profits, as lessened by interest on the invested capital, of a fair salary for managerial services. In *Kindermann* v. *Kindermann*, 183 N. Y. S. 897 (1920), Justice Giergerick maintained that salaries of officers should not be included in profits for estimating goodwill even though such salaries absorbed the greater part of the operating profits. Several brothers were the officers and only stockholders and in anticipation of the goodwill valuation they voted themselves salaries large enough to reduce the operating profits to a low figure so that a low value would be placed upon the goodwill of the corporation. Justice Giergerick approved of this procedure and he is supported in his action by several New York decisions.

The law of goodwill valuation may be summarized as follows: Take the average annual profits of the three preceding years, deduct a fair rate of interest on the invested capital and a fair salary for management, and multiply the remainder by some arbitrary number which will depend upon the character of the business. It is permissible to capitalize the remainder at an arbitrary per cent. The final result should be the same under both methods.