

Goodwill: Economic Nature and Legal Regulation From the *Lex Mercatoria* to the Italian Commercial Code of 1882

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Goodwill is a topic widely dealt with in business and accountancy literature. It has developed through a complex process over the centuries, being established as an empirical phenomenon in a first phase and obtaining legal recognition and scientific attention in a subsequent phase. Regarding its empirical affirmation, although it cannot be excluded a priori that original forms of goodwill have emerged since ancient times, the research carried out here focuses on the evolutions subsequent to the feudal age, for which significant evidence exists, both legal and economic. In relation to its legal recognition, Roman law had already acknowledged the existence of goodwill (though it excluded the right to compensation), especially in leases and in the relationship between landlord and tenant. From the *Lex Mercatoria* to the Italian civil and commercial codes, the right to compensation for goodwill has always been denied by the legal system. However, regardless of this attitude, which was clearly unfavorable to the tenant, legal doctrine and accounting studies developed increasingly evolved theories, reaching modern positions at the end of the 19th century that were similar to current ones in many respects. The aim of this research consists of reconstructing the salient phases of the above process through the analysis of the legal rules and literature.

Keywords: goodwill, legal system, economic literature, legal theories

Introduction

The investigation of the historical origins of goodwill requires making a preliminary distinction between goodwill understood as an empirical phenomenon, generally emerging in trade, and goodwill considered as a scientific concept by literature. In the first sense, goodwill results from commercial transactions and represents a constituent element of the price, which can be indistinctly included in the agreed amount or separately fixed as an explicit component of the agreed payment. In the second sense, the goodwill, once having emerged as an empirical fact, is also recognized by law as a legal fact and is analyzed by the economic doctrine as a scientific fact.

This distinction represents a central element for the analysis, especially for the reconstruction of the origins of goodwill, since through the study of Italian sources it is realistic to assume the following historical process:

(a) first, goodwill emerged in trade;

(b) second, goodwill was recognized by the legal system and almost simultaneously was studied in its economic dimension.

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In regard to Phase (a), it cannot be excluded a priori that the first concrete evidence of goodwill dates back to the dawn of economic activity. However, the scarcity of information, together with the lower frequency of exchanges, makes the verification of this hypothesis extremely complex.

On the contrary, in regard to Phase (b), the analysis of Italian literature allows us to trace the origins of goodwill as both a legal and an economic fact.

Purpose and Methodology

The purpose of this study is to reconstruct the history of goodwill in both economic interpretations and legal sources, from the *Lex Mercatoria* until the Italian commercial code of 1882.

The research carried out is qualitative and descriptive, and it does not make use of empirical evidence.

This methodological approach derives both from the scarcity of numerical data that can be used to reconstruct the quantitative dimension of the problem and from the chosen field of investigation, which mainly focuses on the analysis of theoretical contributions on the subject.

The period analyzed starts with the development of national and international trade in the late Middle Ages, when regulation was mainly represented by the *ius mercatorum*, and concludes with the end of the 19th century.

The choice of the starting point of the analysis derives from the lack of documentation, which, at least until the 11th century, does not allow for the exact reconstruction of the first empirical or legal evidence of goodwill. Therefore, the following analysis is based on the study of the major literary treatises that have spread since the *Lex Mercatoria*.

The choice to conclude the analysis at the end of the 19th century derives from the fact that a new phase began in the 20th century in which economic studies became more frequent and widespread, which was in part thanks to the birth and affirmation of Business Economics as an autonomous subject in Italy.

The research is based on the analysis of legislative sources, as well as on the study of literature, both economic and legal.

Search Limits

Regarding the limits of this study, first of all, the analysis does not consider the feudal period, the investigation of which would have been useful for a better reconstruction of the overall economic framework.

Secondly, the research carried out is purely deductive, while the presence of an empirical investigation would have made it possible to better appreciate the quantitative dimension that the goodwill assumed in the exchanges of the analyzed period.

Third, the analysis is based on the most significant literary works for the period examined and is therefore partial and limited, although still representative of the dominant strands of thought.

Finally, it is important to underline that in the time interval examined, the legal literature is much wider than the economic literature, which instead spreads with greater extension starting from the 20th century. For this reason, the mutual influences between economics and law can only be partially reconstructed.

Goodwill in the Medieval Economy and in *Lex Mercatoria*

Although economic activity has its roots in remote eras dating back to classical antiquity, the phenomenon of goodwill in its most complete configuration is, by its very nature, connected to organized business rather than occasional business.

For these reasons, evidently excluding primordial exchanges and productions, as well as Greco-Roman civilizations and the subsequent feudal age, the firm and its goodwill are typical phenomena of capitalism, which was first post-medieval and mercantile before evolving into manufacturing and finally industrialization (modern and contemporary) (Palermo, 2000).

Although it is not possible to empirically reconstruct the systematic nature of trading exchanges of goodwill in pre-modern history either alone or included in the firm, the regulatory codifications nevertheless allow the origins of the legal recognition of the phenomenon to be traced.

The lease represents, in particular, one of the first institutions to which the concept of goodwill is historically referred, being understood, according to an initial meaning, as the set of improvements made by the tenant to the leased asset.

The acknowledgment of the possible existence of an increase in value generated by the user of the asset could already be found indirectly in Roman law, although the term “goodwill” was not contemplated. Specifically, Roman law, while excluding that the tenant was entitled to compensation, recognized that the leased asset might have benefited from increases in value due to the tenant’s work.

It follows that, despite the vulgar proverb that states the old tenant is preferable to the new one, this right of pre-emption does not confer the right to goodwill nor to any other improvement (Montelatici, 1824).

A more advanced version, more favorable to the tenant, is contained in the Merchant Statutes, where the concept of goodwill is connected not to the physical improvement made by the tenant to the leased property but to the exercise of an organized economic activity. In fact, in this case, the recognition of the goodwill is up to the merchant who has used the property as a place of business.

The crisis of the feudal system and the release from the servile conditions of the Middle Ages led to free men, free craftsmen, and free merchants, who, within the Municipalities, protected their reasons through the guilds of arts and crafts and through the Statutes of Merchandise (the sources of the *Lex Mercatoria*).

The transition from denial to recognition of the right to goodwill can be clearly understood through the economic evolution that led from feudal servitude to freedom of the professions and which marked the starting point of industrial production. At the same time, this transition led to the progressive formation of the bourgeoisie class as the fundamental step for the affirmation of the enterprise.

The transformation described above is evidenced by the evolution of legal sources, in which the *ius mercatorum* (of the guilds of arts and crafts) represents the law as being not only applicable to merchants but also as being created by the merchants themselves (*mercatores*).

As a result of the evolution described, civil law is opposed to commercial law: Civil law is Roman private law which does not recognize goodwill; commercial law is the legal system formed by the statutes of the merchant corporations, the customs of the merchants and their jurisprudence, which, being self-referential, protects the interests of the merchants themselves, including through the provision of compensation for the loss of goodwill in favor of the merchant evicted from his shop (Galgano, 2007), with a rule similar to one still in force today in Italy (Law 392/78).

In this regard, it is useful to remember the *ius intraturae* provided by the law of the Municipalities, according to which an indemnity was due to the tenant in the event of termination of the lease for the improvements made to the leased property. In particular, this allowance was to include goodwill, especially where an economic activity had been carried out inside the leased property and the lessor had subsequently continued it, benefiting from the existing clientele (Lener, 2015).

Goodwill and Economic Activity: From the Albertine Civil Code (1837) to the Kingdom of Italy Civil Code (1865)

In subsequent regulatory codifications, goodwill is even closer to the concept of quality of the firm. In particular, in the Albertine Civil Code of 1837, the concept of goodwill is still linked to the lease contract, and the recognition of indemnity in the conductor's favor continues to be denied (Article 1730), as in Roman law.

This orientation is confirmed both by the Civil Code of the Kingdom of Italy of 1865 (Article 1578) and by the French Civil Code (Article 1722), which is also of Romanistic origin. Both, in fact, exclude, with similar provisions, any indemnity in the event that the leased property has perished by chance.

With regard to foreign law, it is important to remember the Austrian law which provides for the tenant's right to withdraw from the contract before the expiry of the term in the event that a significant part of the rented property perishes or becomes unsuitable for use due to an accident (Paragraph 1117 of the Austrian Code).

During the period under review, there was increasing attention in the doctrine and in the jurisprudence towards the running of the enterprise and the prejudice that it may suffer in the event of termination of the lease.

For example, in the event that the destruction of the leased property was attributable to the lessor, the tenant had the right to obtain compensation for the damage suffered, and in such cases, the amount of compensation began to be commensurate with the firm's income (Ferrarotti, 1874).

Goodwill, therefore, began to be considered as an element distinct from the leased thing, that is, separate and separable from the value of the property. As such, the goodwill belonged not to the building but to the enterprise carried out in the building.

In this regard, the French doctrine (Pothier, Duvergier, Troplong) suggests qualifying the contract exactly, distinguishing whether it concerns only the building or an economic activity already fully operational and well established.

Specifically, Pothier (1835) suggests that "although the tenant enjoys all parts of the building, he has the right to ask for a reduction in the price, in the event that the use of that building has undergone an alteration and a notable decrease" (n. 152, p. 131).

Criticizing Pothier, Duvergier (1836) observes that "there is necessarily something random in a lease; the lessee cannot avoid the fate to which he voluntarily submitted himself" (n. 529, p. 543).

Finally, according to Troplong (1847), there is a third hypothesis that involves interpreting the contract exactly to establish whether the destination of the leased property is left to the choice of the tenant or, on the contrary, is provided for by the contract:

In the first case, the force majeure that modifies or opposes the use to which the thing is assigned must not be taken into consideration. In the second case, force majeure does not affect the tenant and the lessor must allow the contract to be terminated or the rental price to be reduced. (n. 234, p. 165)

It should also be noted that although the rules in question deny the right to compensation for goodwill, the doctrine and jurisprudence of the time (French Cassation, March 11, 1824) do not at all exclude the possibility that the parties may provide for it contractually.

As in the relationship between tenant and lessor, the issue of goodwill may also arise in relations between co-managers of the firm when one of them intends to withdraw and exercise the enterprise on his own. This

conduct, in fact, is potentially capable of depriving the firm of the accumulated goodwill (Court of Cassation of Florence, February 21, 1876).

The doctrine and jurisprudence considered up to now are particularly relevant because they ascertain the existence of a goodwill connected to the firm. On the contrary, the concepts that emerge from some judgments of legitimacy are still incomplete, in conformity with a patrimonial vision and inclined to consider goodwill not as an intangible asset, but as a movable, even divisible asset (Court of Cassation of Turin, August 25, 1866).

Nevertheless, starting from the 1870s, some judgments reflect a very modern vision of the problem and begin to consider the goodwill, and more precisely the customers, as assets not separable from the building (Court of Cassation of Turin, May 23, 1877), which form an integral and essential part of the factory. It follows that the overall price of the factory is equal to the sum of the value of the building and that of the goodwill, both in the purchase and sale transactions (Court of Cassation of Florence, March 29, 1874) and in the estimate of the bankrupt's assets (Court of Cassation of Rome, October 5, 1899).

Gianelli Castiglione (1873, p. 917) also confirms this interpretation and argues even more explicitly that goodwill should be attached to any business and that it corresponds to the share of the value that exceeds that of the furniture, funds, and buildings.

Literature at the Time of the Commercial Codes (1865 and 1882): Moving Towards a New Concept of Goodwill

With regard to legal discipline, the dichotomy considered above between Roman law and *Lex Mercatoria* was repeated both in the commercial code of 1865, which coexisted with the Albertine Civil Code, and, subsequently, in the Civil Code of the Kingdom of Italy, which coexisted with the commercial code of 1882, until the unification of 1942.

In the commercial code of 1865 (which was substantially inspired by the Albertine Code of 1842, which in turn was forged on the French Code de Commerce of 1807) and the commercial code of 1882, the weak reference to goodwill derives from the absence of full legal recognition of the firm as an organic entity.

The legally relevant economic activity was, on the contrary, the act of commerce considered individually, as in the tradition of French law, so that traders were those who habitually exercised the acts listed exhaustively in Article 2 of the 1865 Commercial Code.

However, the doctrine of the time already glimpsed in that listed the absence of goodwill, which instead existed in reality and which could well be an object of exchange, as a set of things able to produce a profit, or, in other words, as a set of means “used to [...] make [the economic exercise] more splendid and fruitful. The owner of a great coffee warms his rooms, hangs sparkling lamps, uses silver trays: all this invites, produces competition, goodwill, profit” (Borsari, 1868, p. 53).

Goodwill can be the object of sale, transfer, and transaction, given that its intangible nature does not prevent it from being negotiated or valued in the form of a price:

Although goodwill is variable in nature, its cause and its present state can be appreciated, and its future calculated. And so nothing is opposed to it being the object of sale, transfer, transaction, since it is an integral part of a commercial fund, and sometimes the main part (Boccardo, 1876, p. 1262).

Goodwill is one of those properties that go “under the name of incorporeal properties. It is sold and negotiated as a material thing, because it has a value” (Boccardo, 1876, p. 1262).

In the force of the subsequent commercial code of 1882, the concept of goodwill became even more solid in the doctrine, and the first debates on its exact nature began (Occorsio, 2016).

Beyond the disputes over its qualification, goodwill constitutes an acquired concept and is assumed in numerous circumstances as a condition of the firm, even in the case in which the enterprise is collectively exercised in the form of a limited company. Among the aforementioned circumstances, the following three cases are relevant.

First, goodwill produces enrichment in the contract with which two or more people are obliged to certain contributions in order to establish the capital of a future anonymous company, given that each founder can legitimately expect certain advantages, including patrimonial, from the goodwill of the business.

Secondly, goodwill must be recognized in the event of expropriation for reasons of public utility that results in the termination of the lease, given that the lessor must pay the tenant who operates a business an indemnity calculated on the basis of the value of the income in progress, of the improvements and goodwill.

Finally, goodwill also emerges when the share capital is increased with a premium, given that the higher price paid by the subscribers with respect to the nominal value of the securities is due to a series of circumstances attributable to the good performance of the company, as the momentum of the business, social prosperity, the credit enjoyed by company, its flourishing conditions, its productive energy, of which the stock market price is a demonstration and measure. The social improvement is incorporated in the higher price that the security has assumed with respect to its nominal value.

Therefore, given that the share premium derives from the well-being of the business, the interest of the doctrine shifts towards the problem of the exact qualification of the nature of the premium. On the one hand, part of the literature argues that it has the nature of capital, and in particular, of a capital that serves to balance, on the part of the new shareholders, the participation allowed to them in a company's capital increased by the work of the old shareholders.

On the other hand, the opposite doctrine replies that by reasoning in this way, the share capital is confused with the firm's assets, while the greater value in which the share premium is reflected is due to the accumulated profits made by the enterprise. Therefore, the share premium is not capital but earned firm's profit, which, instead of being set aside in reserves or destined for other more cautious or profitable purposes, could be distributed as a dividend to shareholders.

The Modern Vision of Goodwill in Italian Accounting Literature at the End of the 19th Century

The most significant economic and accounting theories of goodwill spread in Italy towards the end of the 19th century; these appeared later and are less extensive compared to the legal theories.

The reasons for this different diffusion can mainly be attributed to the influence that the constraints and obligations imposed by the legal system have always exercised on the vision of phenomena, conditioning the freedom of the interpreter in proposing visions other than those provided for by the law.

As noted above, the legal system provided for a rather limited notion of goodwill, while legal doctrine and jurisprudence in the first half of the 19th century already showed more open tendencies to recognize both the existence and the measurability of goodwill.

Further progress was achieved with economic studies, particularly accounting studies, which began to develop a concept of the firm that was even more advanced than that proposed by 19th-century legal theories.

In this regard, it is first necessary to admit that the conception of the enterprise was still simplified in the accounting thought of the late 19th century, which tended to give priority emphasis to the material dimension of capital and its constituent elements.

However, despite this approach, accounting studies differ from legal ones in at least two aspects: First of all, they place the problem of the valuation of the firm's assets at the center of their attention and therefore deal with issues only partially analyzed by previous literature; secondly, accounting studies begin to understand the unitary nature of the firm, and although they focus on the evaluation of the individual elements of the firm's capital, they perceive the presence of economic connections, thanks to which the value of the enterprise is not simply the sum of the values of its assets.

It follows that this new and different approach also affects the conception of goodwill, which begins to be understood in accounting studies as a qualifying element of the company and as added value deriving from the exercise of the economic activity considered as a whole.

Among the most important Italian scholars of the late 19th century, we must remember Francesco Villa (1801-1884), Giovanni Rossi (1845-1921), and Giovanni Massa (1850-1918) (Bianchi Martini, 1996), who, although being proponents of different theories, are bearers of a unitary, systemic, and organic conception of the firm.

The importance of Francesco Villa's thinking lies, first of all, in the precise qualification of goodwill, which is defined as intangible capital (1853, p. 41) emerging in the exchanges of existing firms. However, it should not be overlooked that Villa's thinking is affected, at least in part, by the influence of legal studies, given that he defines goodwill as "commercial" and identifies it with the concept of customers.

Furthermore, the author clearly recognizes that the goodwill derives from the running of the firm and is not to be confused with the value of the assets belonging to the firm itself: The sum paid as goodwill does not in any way increase the firm's assets.

The modernity of Giovanni Rossi's thinking derives above all from his vision of goodwill as the result of the firm's ability to produce income (Rossi, 1895). The relevant element that characterizes goodwill, therefore, does not correspond to the capital available to the firm but rather to the income that the capital is capable of producing.

The author also confirms this interpretation in relation to the specific problem concerning the taxability of goodwill. Given the absence of regulations on this point, the problem must be solved in an interpretative way; that is, it is necessary to understand whether the goodwill, as well as the share premium, have the nature of capital or, on the contrary, income. In the first case, no taxation is applied, while in the second, the goodwill must be taxed. On closer inspection, the debate on which, as noted above, the legal doctrine had already intervened in the mid-19th century is re-proposed. Consistent with his vision, Rossi (1906) comes to the following conclusion: Goodwill must be taxed, as it is the result of the income accumulated by the company and does not have the nature of capital.

Finally, Massa (1883), who develops the concept of fictitious capital, underlines the immaterial nature of goodwill, thus sharing some of Francesco Villa's conceptions.

At the same time, the author correlates the concept of goodwill to the uncertain and future fruits of the enterprise, and therefore approaches Rossi's concepts, albeit in a different form.

Discussion and Conclusion

To fully understand the current concept of goodwill, it is necessary to go back to the origins of the

phenomenon, which, as noted above, date back to ancient times and have undergone continuous changes, which have been deeply influenced by the evolution of the legal system.

Goodwill, starting from Roman law, has received progressively increasing attention over the centuries and today represents a widely recognized and studied topic, especially in business and accounting literature.

Although the problem has an eminently economic nature, in the historical process reconstructed by this research, a significant scientific contribution was offered by the legal theories, which were perhaps the first in the Italian literary panorama to recognize in the exercise of organized economic activity the existence of an additional value to that of the firm's capital.

The accounting doctrine, which has also developed thanks to the contribution offered by legal studies, already proposed a modern conception of goodwill at the end of the 19th century, based in particular on a unitary vision of the enterprise, although it was still simplified.

However, the open problems are still numerous, and the field of analysis in which scholars must move is not only broad but also particularly complex, mainly due to the scarcity and low availability of sources.

For the same reason, the research carried out here leaves some problems open, which the future debate can focus on. These problems are mainly represented by the following: (i) the absence of a quantitative analysis of the phenomenon, which would be useful for understanding the absolute and relative size of transactions concerning goodwill; (ii) the absence of an analysis of the feudal period, which would be useful for better tracing the historical boundaries of the phenomenon; (iii) the need to verify the reliability of the conclusions reached in this study, given that the analysis of additional regulatory and literary sources could lead to different results.

In this sense and with the limits described, the historical reconstruction proposed in this research can offer a contribution, albeit a partial one, to studies aimed at reconstructing the origins of the problem in order to better understand the essence of the currently dominant visions of goodwill.

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