A *Keane* Double-Dipping Miscalculation and the Vanishing Monied Spouse

By Peter J. Galasso, Jeffrey L. Catterson and Joel Rakower

Exhaustive scholarly analyses on the double-dipping, or double-counting, phenomenon have adorned the pages of various legal publications since its initial recognition in *McSparron v. McSparron*.[1] As we all know, in *McSparron*, the Court of Appeals held that maintenance awards are not to be drawn from the income stream that was relied upon in the calculation of the value of an equitably distributed marital asset. And, as an integral part of that decision, the *McSparron* Court wisely cautioned the lower courts to be vigilant in fashioning maintenance awards to avoid double-dipping:

> Moreover, care must be taken to ensure that the monetary value assigned to the license does not overlap with the value assigned to other marital assets that are derived from the license such as the licensed spouse's professional practice. The courts must also be meticulous in guarding against duplication in the form of maintenance awards that are premised on earnings derived from professional licenses. *McSparron* at 286.

Five years later, in *Grunfeld v. Grunfeld*,[2] the Court of Appeals amplified the *McSparron* admonition as follows:

> Most significantly for the case at hand, *McSparron* also cautioned lower courts to "be meticulous in guarding against duplication in the form of maintenance awards that are premised on earnings derived from professional licenses" (*id.*). To allow such duplication would, in effect, result in inequitable, rather than equitable, distribution. In contrast to passive income-producing marital property having a market value, the value of a professional license as an asset of the marital partnership is a form of human capital dependant upon the future labor of the licensee. The asset is totally indistinguishable and has no existence separate from the projected professional earnings from which it is derived. To the extent, then, ***705** that those same projected earnings used to value the license also form the basis of an award of maintenance, the licensed spouse is being twice charged with distribution of the same marital asset value, or with sharing the same income with the nonlicensed spouse. *Grunfeld* at 704.

In both *McSparron* and *Grunfeld*, the proscription against double dipping was applied with equal force to the enhanced earnings that was produced by a law license. Those same double dipping safeguards were eventually applied to the dynamic between the value of a professional practice, like a law firm or medical practice, or of a business where the valuation was dependent on the conversion of the projected future income stream. As the Second Department held in both *Sodaro v. Sodaro*[3] and *Murphy v. Murphy*,[4] when a business or practice is valued by converting a projected future income stream into a present value, that income stream is not to be utilized in the calculation of a maintenance award.

Heeding the direction given by *McSparron, Grunfeld,* and its progeny, matrimonial practitioners began to get a handle on the double-dipping dynamic and the arithmetic to be invoked in cases where a spouse attained a professional license during the marriage and thereafter utilized that license to create a practice that further enhanced his or her earnings. In constructing the valuation equations, forensic accountants would first calculate the actual, as opposed to reported, annual income of the owner of the professional practice. From that amount, a statistically based "reasonable compensation" figure of the license holder is subtracted to arrive at the "excess earnings" that the owner derives from the practice. If the license was obtained before the marriage, the arithmetic pertinent to the forbidden income stream would end here. However, if the license was obtained during the marriage, then the license value would be equitably distributed as well, resulting in the exclusion of two distinct income streams from the calculation of maintenance. To compute the value of enhancement derived from the license, the income of a comparably situated college student would be subtracted from the statistically higher average income of the license holder, thereby identifying the projected future income stream that would be unavailable in calculating an award of maintenance.

By way of example, assume that:

(i) Jake attained his law license and established his law practice during the marriage;

(ii) Jake earns $400,000 per year from his practice;

(iii) A comparably situated associate earns $200,000 per year; and

(iv) A comparably situated college graduate earns $100,000 pear year.

Based upon *Sodaro*, if the value of Jake's practice is equally distributed to his wife, then only $200,000 will

be deemed available for an award of maintenance. If the value of Jake's license is also equally distributed to his wife, then a total of $100,000 of Jake's $400,000 annual income will be deemed available for an award of maintenance. Prior to *Keane v. Keane*, it seemed to make perfect sense that a spouse could not be permitted extract a share of the value of the title holder's license or practice, which are the vehicles that drive up one's earnings, and then also receive a second benefit from that asset, by sharing in the income created by that asset.

As contrasted with the double dipping issue in the context of a professional practice or service-oriented business, *Keane v. Keane*[5] involved the equitable distribution of two real property assets. Specifically, the marital residence was awarded to the wife, while the parties' commercial building of comparable value was awarded to the husband. While the potential value of the marital residence as a rental was disregarded, the income actually generated by the commercial building was viewed as available income for the purposes of awarding the wife maintenance. Despite the husband's double-dipping lament, the Court of Appeals held:

> We do not see why an inquiry as to double counting should depend on the valuation method used. After all, any valuation of an income-producing property will necessarily take into account the income-producing capacity of that property. To prevent any income derived from any income-producing property from being "double counted" would, therefore, significantly limit the trial court's considerable discretion in equitably distributing marital property and awarding maintenance. Significantly, we have already differentiated between a professional license and tangible income-producing property, because "where a professional license is at issue, '[t]he asset is totally indistinguishable and has no existence separate from the projected professional earnings from which it is derived' (*Grunfeld v Grunfeld*, 94 NY2d 696, 704 [2000]). Hence, a trial court must convert the enhanced earnings attributable to the license into a monetary marital asset to achieve equitable distribution. In contrast, a court can transfer title to real or personal property in order to equitably distribute the asset" (*Holterman v. Holterman*, 3 NY3d 1, 9 n 5 [2004]).
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> We agree with dissenting Justice Goldstein that this distinction applies here.
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> Double counting may occur when marital property includes *intangible* assets such as professional licenses or goodwill, or the value of a service business. As we said in *Grunfeld*, "[i]n contrast to passive income-producing marital property having a market value, the value of a professional license as an asset of the marital partnership is a form of human capital dependant upon the future labor of the licensee" (94 NY2d at 704). It is only where "[t]he asset is totally indistinguishable and has no existence separate from the [income stream] from which it is derived" (*id.*) that double counting results.
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> Here, the rental property was split between the parties for distributive purposes. The rental income from that property was then considered in determining maintenance.
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> The property will continue to exist, quite possibly in the husband's hands, long after the lease term has expired, as a marketable asset separate and distinguishable from the lease payments. The mortgage payments, in contrast, were properly distributed as an asset and not counted for maintenance purposes because the payments themselves *were* the marital asset. (*Keane* at 121).

Many matrimonial practitioners were troubled by the *Keane* myopia, given the incongruency of awarding each party a $1 million asset, yet reserving for the wife a maintenance interest in the $1 million asset awarded to the husband. Clearly, the type of asset awarded should not confer an advantage upon one spouse over another. However, that is precisely what *Keane* concluded.

In *Griggs v. Griggs*,[6] the Second Department adapted the *Keane* analysis to the husband's medical practice and concluded that the husband's total income from the already equitably distributed practice was fair game in determining the maintenance to be awarded to the wife, which obviously conflicts with the Second Department's decision in *Sodaro*, where the value of a psychiatric practice was addressed and the double-dipping into its value proscribed. In rejecting the double-dipping contentions of the husband, the Second Department in *Griggs* stated:

> The plaintiff's contention that the court "double-counted" his Practice is without merit. The Court of Appeals recently held that the prohibition against double counting does not apply where, as here, the asset to be distributed is a "tangible income-producing asset," rather than an intangible asset, such as a professional license, the value of which can only be determined based on projected earnings (*see Keane v. Keane*, 8 N.Y.3d 115, 119, 828 N.Y.S.2d 283, 861 N.E.2d 98).

Judging by the absence of discussion on the issue, it appears that the *Griggs* panel failed to recognize that the hypothetical sale of a professional practice logically and economically relegates the titled spouse to a statistically based reasonable compensation level. In doing so, *Griggs* reversed the enlightened compartmentalization of the income of an owner or partner in a professional practice that was historically observed by forensic accountants in identifying the income stream created by a professional practice. The equation simply recognized the difference between the earnings of a business owner and a similarly experienced employee-professional.

Lawyers whose practices are substantial enough to justify hiring associates generally earn more than those lawyers who are their employees. Since law practices are not saleable except under certain defined circumstances, under *Griggs*, the Court can now award the non-titled spouse an interest in the value of the business, which is based on the same earnings that *Grigg*s will now allow the Court to consider in calculating the maintenance award. Before *Griggs*, the excess earnings of the professional derived from the practice would have been excluded from maintenance award consideration. Indeed, if *Griggs* is to be followed, the only income stream that is to be excluded going forward is the income stream created by the license acquired during the marriage and which was previously equitably distributed.

It should be noted that in *Griggs*, the valuation methodology adopted by the forensic accountant did not reference the excess earnings produced for the owner of the professional practice being valued. As a result, no "income stream" was identified in the valuation methodology that could be "double dipped." Misguidedly following *Keane,* the *Griggs* Court has effectively vitiated a double-dipping concern in cases involving the equitable distribution of the value of a medical practice. Hence, despite *Keane dicta* that double-dipping adjustments should not depend on the valuation methodology adopted by the valuator, the *Griggs'* Court applied *Keane* in narrowing the double dipping pool to cases involving licenses and other specified educational attainments that have the tendency to enhance one's earnings. By virtue of *Griggs*, professional practices that can be sold by reference to a formula that does not consider the owner's enhanced earnings will no longer warrant double-dipping adjustments in the calculation of a maintenance award.

Returning once again to the twisted dictum of *Keane*:

> Double counting may occur when marital property includes *intangible* assets such as professional licenses or goodwill, or the value of a service business. As we said in *Grunfeld*, "[i]n contrast to passive income-producing marital property having a market value, the value of a professional license as an asset of the marital partnership is a form of human capital dependant upon the future labor of the licensee" (94 NY2d at 704). It is only where "[t]he asset is totally indistinguishable and has no existence separate from the [income stream] from which it is derived" (*id.*) that double counting results.

A potential key to the *Keane*, *Griggs* debacle lies within an often overlooked segment of appraisal reports provided for professional practices. It is referred to as the standard of value. The standard and premise of value typically assigned to a business entity in a divorce action within New York State is "fair market value" on an ongoing basis and assumes the premise of value in use; that is, one considers the business on the basis of an ongoing enterprise, on an "as is, where is" basis. The term "fair market value" is often defined as the most probable price that the business should bring if exposed for sale on the open market as of the valuation date. It assumes that the buyer and seller are each acting prudently and knowledgeably and that the price is not affected by any undue stimulus.

Unfortunately, the term "fair market value," while holding standard acceptance by each of the four departments within New York as to non-service oriented businesses, is not so for professional or service- oriented businesses, e.g., a solo practice neurosurgeon who, for all intents and purposes, cannot sell his/her practice. As an additional example, prior to the adoption of DRL § 2-111 in 1996, a lawyer in New York could not sell a legal practice and recognize "goodwill" (that amount which exceeds the net tangible assets of the practice or equity). Yet for purposes of a matrimonial dissolution, each has been assigned a value at times associated with the "goodwill" of the practice under the guise of the definition of "fair market value. "However, the term "fair market value" is a misnomer in that said definition recognizes that the asset can indeed be sold, recognizing in certain instances the existence of various discounts, such as for a minority interest and marketability discounts.

A minority interest discount is measured in terms of the relative degree of control a minority owner has over the operation and important decisions made on behalf of the company. The concept of marketability, however, deals with the liquidity of an ownership interest; that is, how quickly and easily it can be converted to cash if the owner chooses to sell.

If one considers the fact that some professional practices cannot, in reality, be sold to a third party, then the resultant discount for lack of marketability would have to be 100%; hence, no value in terms of "fair market value" (at the very least, as to its application to the existence of goodwill). However, based upon case law in New York State, the application of discounts for minority interests and marketability have not been applied under the

standard of value known as "Value to the Holder," which recognizes personal or professional goodwill.

The concept of "Value to the Holder" recognizes a form of human capital dependent upon the future labor of the licensee which is totally indistinguishable and has no existence separate from the [income stream] from which it is derived. Thus, it would appear that should the appraiser deviate from the standard of "fair market value," the concept of double dipping reappears. It is then incumbent upon the attorney to work with the appraiser to identify if, and to what extent, the goodwill is personal in nature and not transferable, and again within the realm of double dipping and the spirit of *McSparron* and *Grunfeld*.

To suggest in this economic climate that the courts have lost their way would be a colossal understatement. The so-called monied spouse has already been beaten down unmercifully by the absurd judicial recognition of intangible assets that only New York State continues to include on the marital balance sheet. In that regard, Justice Smith's dissent in *Holterman v. Holterman,*[7] condemning the majority's misallocation of the monied spouse's earnings in that case, seems to have represented the beginning of the end of the monied spouse:

> [The majority has imposed] a very significant burden on defendant--to require him, for several years, to pay to his ex-wife more than two thirds of his net income, and even in the more distant future to pay her as much as he keeps for himself. Defendant's brief in this Court contains the following chart, which summarizes the burden on him in the first year following Supreme Court's award:

Income	$181,837
Minus FICA (1233)	($ 7,403)
Minus Maintenance	($35,000)
Minus Taxes	($46,882)
Minus Child Support	($34,875)
Minus Equitable Distribution (with interest)	($21,288)
Minus Attorneys' Fees	($20,000)
NET MONEY AVAILABLE FOR DEFENDANT APPELLANT	$16,389

> Plaintiff's brief notes, correctly, that the $20,000 attorneys' fee payment is a one-time obligation. With that exception, however, plaintiff takes no issue with the above-quoted calculation. Even if the attorneys' fees are ignored, defendant is left with approximately $36,000 of a pretax income of $181,000.
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> It is true that the burden on defendant remains at this level only for four years after the award; after that, child support will be reduced because the parties' older child will become emancipated, and a year later maintenance will drop to a lower level pursuant to Supreme Court's order. But even then, the burden will be a major one. My own calculations suggest that, assuming defendant's income does not much change (and again ignoring the attorneys' fee award) defendant is required to pay more than two thirds of his after-tax income to plaintiff for the first four years; some 60% in the fifth year; about half of it in years 6 through 10; and nearly a third of it for five years after that. It is not until 15 years after the award that defendant's obligations (at that point consisting only of maintenance) diminish to something like 12% of his income (calculating both the income and the obligations on an after-tax basis).
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> When income-producing property is owned by a husband or wife who is divorced, it is often appropriate to order part or even all of it equitably distributed to the other spouse. When that is done, however, it makes no sense at all to calculate child support as though no such distribution had occurred--as though the transferring spouse still owned the asset and received the income it generated. Yet the majority concludes that this irrational procedure is required by the CSSA—as indeed it would be, except that the CSSA expressly permits departure from its formula to avoid an "unjust or inappropriate" result. *(Holterman* at 776).

To appreciate how pugnacious the law has become to the alleged monied spouse, the reader is invited to consider the following real-world scenario in the context of an oppressive body of law. Suppose a husband brings to the marriage a $300,000 annual income as a highly paid associate in a New York City law firm. Having had two children with his previous wife, the husband pays annual support totaling $100,000 to his first wife over the first seven years of his marriage to his second wife.

Five years into his second marriage, the husband goes out on his own and over the next five years establishes his own general practice on Long Island and earns $300,000 from the practice by year 10. In year 11, his second wife,

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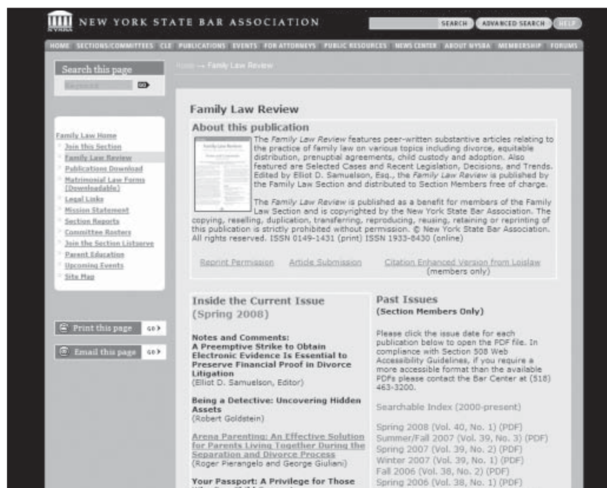

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who did not work during their marriage and who is now 53 years old, seeks a divorce, equitable distribution and lifetime maintenance.

As part of her attorney's letter-demand, the wife demands one-half of the $700,000 paid to the prior wife in support over their 10-year marriage. Amazingly, both the First and Second Departments have inexplicably decided that diverting marital earnings to pay obligations that stem from a prior marriage potentially entitles the new spouse to an equitable distribution of an amount of the marital estate so diverted.[8] She also seeks one-half the value of his practice, which the forensic accountant determines is saleable at 1 times gross revenue or $600,000. As the cherry on her sundae, the wife demands a maintenance award based on the $300,000 derived from the practice. After 11 years of marriage, assuming a 50-50 division of marital estate, your client could owe his second wife a distributive award of $650,000 with 9% interest, and pursuant to *Keane* be compelled to pay her lifetime maintenance based on income of $300,000.

If Dr. Holterman thought that he was left with virtually nothing for his own needs, consider the fate of the so-called monied spouse in our hypothetical, who now recognizes that being the monied spouse in New York State has become part of an evolving judicial vanishing act.

Endnotes

1. *McSparron v. McSparron*, 87 N.E.2d 275, 639 N.Y.S.2d 265, 662 N.E.2d 745 (1995).
2. *Grunfeld v. Grunfeld*, 94 N.Y.2d 696, 731 N.E.2d 142, 709 N.Y.S.2d 486 (2000).
3. *Sodaro v. Sodaro*, 729 N.Y.S.2d 731 (2d Dep't 2001).
4. *Murphy v. Murphy*, 6 A.D.3d 678, 775 N.Y.S.2d 370 (2d Dep't 2004).
5. *Keane v. Keane*, 8 N.Y.3d 115, 861 N.E.2d 98, 828 N.Y.S.2d 283 (2006).
6. *Griggs v. Griggs*, 44 A.D.3d 710, 844 N.Y.S.2d 351 (2d Dep't 2007).
7. *Holterman v. Holterman*, 3 N.Y.3d 1, 814 N.E.2d 765, 781 N.Y.S.2d 458 (2004).
8. *Johnson v. Chapin*, 49 A.D.3d 348, 854 N.Y.S.2d 18 (1st Dep't 2008); and *Mahoney-Buntzman v. Buntzman*, 51 A.D.3d 732, 858 N.Y.S.2d 698 (2d Dep't 2008).

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