

## **Valuing and Distributing the Professional Practice, License and Maintenance The "Double Dipping" Dilemma: New York vs. California**

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In a matrimonial action, the court is routinely asked to value a spouse's interests in both the professional license and the professional practice; and thereafter, distribute the marital proceeds equitably. In New York, the professional license and practice are characterized as "marital" property under Domestic Relations Law § 236 (DRL). Both the bench and bar will agree at the outset, there is no uniform rule for fixing the value of a going business for equitable distribution purposes. This article will explore the multitude of discretionary factors considered by the courts in the context of valuing a professional practice and professional license subsequent to divorce. From the bench's perspective, the determination of the value of professional practices is based upon the court's assessment of the credibility of the expert witnesses and the valuation techniques they employ.<sup>2</sup> In New York, following McSparron<sup>3</sup> and O'Brien,<sup>4</sup> the courts must avoid over-distributing the higher earner's income stream while valuing and distributing: (a) the professional practice, (b) the license and (c) maintenance. The discussion herein is primarily focused on the avoidance of double dipping or perhaps triple dipping by awarding a duplicative interest in the asset.

### **Valuing a Professional Practice**

Prior to trial, the retained expert valuation professional may take a number of approaches for valuing a professional practice. It is incumbent upon the practitioner to retain a competent professional who will persuade the court to utilize a particular methodology (while considering the possibility of offering several methods) for valuing a professional practice. Respecting the adjusted book value or asset approach, an appraiser reviews the professional practice's or company's assets. Assets and liabilities are typically adjusted to fair market value. One problem in using this method is that the intangible asset value of a going-concern business is not measurable. Consequently, the appraiser may use an asset approach method in combination with the excess earnings or other method. The market approach uses businesses in the same or similar industry to develop a multiplier. Depending on the nature of the company being valued, the appraiser might use information from the sale of private companies or, alternatively, the sale of public companies or the price of stock as of the date of valuation for comparable public companies. The income approach consists of two primary methods: (1) the capitalization of cash flow method and (2) the discounted cash flow method. The basic difference between the two is based on the stability or lack thereof of expected future income. The most difficult part of the income approach is the determination of the appropriate discount or capitalization rate to be used. A discount or capitalization rate measures the risk associated with achieving the projected income or cash flow in the future. This is where advocacy comes into play, since reasonable minds will differ where projected income is at issue. It should be noted that, in many states, the value of a business or professional practice in the divorce setting does not necessarily reflect the "fair market value" that the professional practice would sell for on the open market. In many states the courts disregard the difficulty of transferring the practice for valuation purposes.

## The New York Approach

### 1. Date of Valuation

Prior to the commencement of trial, counsel should attempt to negotiate a designated date of valuation. If unable to do so, counsel will set the matter for trial. In California, it is fairly common for counsel to request that the court bifurcate or hold a separate trial solely on the issue of the date of valuation. The advantage in a bifurcated trial is the cost savings realized by obviating the need for the valuation professional to run a multitude of calculations showing the value of the professional practice at the commencement of the action and the value at the date of commencement of the action. In New York, whether an asset is valued at the commencement of an action or date of trial ordinarily depends upon whether the asset is an active asset, to be valued . . . \*\* NYSBA Family Law Review [Spring 2002] Vol. 34 No. 1

At the commencement of the action, or a passive asset, valued at the date of trial. The New York Court of Appeals has clarified the distinction between passive and active assets. An active asset is one whose value depends on the labor of the spouse and a passive asset depends on market conditions. By statute, specifically DRL Section 236, the courts are empowered with discretion to determine the date of valuation of marital property by examining all the various facts and circumstances delineated in the statute. By contrast, the California statute permits the court to value assets either at the date of separation or at the date of trial, rather than the date of the commencement of the divorce action.

### 2. Valuation of Law License. Professional Practice and Award of Maintenance

In the Grunfeld case, the trial court examined the value of the marital interest in the husband's law firm. After the Grunfelds' trial was held, *McSparron v. McSparron* was decided, requiring a valuation of husband's license in addition to the valuation of his law practice. The New York Court of Appeals decision in *Grunfeld v. Grunfeld* is the most recent analysis of the need to avoid double dipping while: (a) distributing an interest in a professional practice, (b) valuing a license and (c) awarding spousal maintenance.<sup>7</sup> For the Grunfeld appeal, each of the appraisers utilized the excess earnings approach. The Court was faced with a determination of how much the husband earned in excess of "reasonable compensation" for an attorney similarly situated. From that figure, taxes and passive investment income are "backed out" and thereafter capitalized using an agreed-upon multiplier; then, the husband's interest in the law firm's assets are added to that amount, to arrive at an interest in the practice. The Court of Appeals suggested that the income available to make spousal maintenance payments should have been reduced to the extent that the income was awarded as a stream of income into an asset. Further, the Court of Appeals noted that where income from a professional license is considered in awarding spousal maintenance, the court can avoid double counting by reducing the distributive award or reducing maintenance. The California courts follow a somewhat different approach, as will be discussed in detail below.

## a. Analysis of the New York Court of Appeals Approach

To value a marital interest in a law practice using the excess earning approach (tangible assets are added to goodwill), it is necessary to make a determination of the reasonable compensation of a similarly situated attorney with similar skills. Thereafter, one compares the survey of compensation levels of senior associates in firms engaged in the same area of practice as plaintiff and adjusts the compensation upward to reflect the partner's higher billing rate.<sup>8</sup> For a goodwill calculation (of a professional practice), the court would examine the difference between reasonable compensation for a similarly situated attorney and the actual salary of the professional on the date of valuation. To arrive at a computation for the value of the professional license, the court would examine the difference in income of an individual with a bachelor's degree and reasonable compensation of an attorney similarly situated to the professional spouse. To compute the income stream that is available to pay maintenance, the court may award support based upon the income stream of an individual with a bachelor's degree. That is to say, the court may neither use the income stream that is "goodwill," nor may it use the income stream that is the professional license. By necessity, if the court uses a multiplier to calculate goodwill then it has already taken into account the titled spouse's future earnings. If the court uses the same earnings attributable to the law license to determine the value of the professional license as a marital asset, that would be double dipping, in violation of the McSparron holding. If the court has valued the stream of income flowing from a professional practice using a multiplier (thereby factoring in the professional's future income), then that income. st. \$25,000 would be shifted to the non-titled spouse and no longer available for maintenance payments. Consequently, a corresponding adjustment must be made for maintenance in accordance with Grunfeld.

## b. Post-Grunfeld Cases

Following the Court of Appeals decision in Grunfeld, there have been a number of appellate decisions which purport to follow the rules enunciated in Grunfeld. The Appellate Division found that where the trial court did not value the professional's license, but awarded maintenance based upon the professional spouse's actual income and "income had he not been licensed," as well as the undistributed portion of his license, to be amply sufficient to support such an award) <sup>9</sup> In Jarrell v. Jarrell, <sup>10</sup> the Appellate Division ruled that the trial court did not double count by awarding spousal maintenance along with a share of husband's MBA since after the distribution of wife's share of the value of husband's MBA, the court made a corresponding adjustment in the maintenance award. Several months ago, the Appellate Division examined the double counting problem in Siegel v. Siegel. <sup>11</sup> Siegel involved the distribution of wife's interest in the . . . \*\* NYSBA Family Law Review Spring 2002 Vol. 34 No. 1