LAW AND THE FAMILY

## "Valuation of a Professional License"

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**IN THE LANDMARK O'Brien case, [FN1] the Court of Appeals held that the enhanced earning capacity attributable to the attainment of a medical license, was "marital property"; it affirmed the trial court's valuation of the husband's "enhanced earning capacity" at $472,000. The trial court accepted the valuation methodology of Stanley Goodman, the wife's expert, the only expert to testify at trial.**

**Mr. Goodman explained at trial how he arrived at this value. He assumed that 1985 was the date that Dr. O'Brien was going to enter practice and that he would remain in practice until 2012, when he would become 65. The "measuring stick" was the average income of a college graduate, age 35, against the average income of a surgeon. [FN2] Mr. Goodman projected that difference in income throughout Dr. O'Brien's working life and then factored in inflation at 10 percent, a real interest rate of 3 percent and income taxes, to arrive at a figure that was the present value of the difference between what a college graduate's expected income and a surgeon's.**

**How Calculations Were Made**

**The data that he used were derived from 1977 government statistics. The statistics for a person 35 to 45 indicated that the average earnings of a college graduate in 1977 was $28,000 a year. At the time of the marriage Dr. O'Brien had almost completed college, so Mr. Goodman used earnings figures as if he had. He ascertained from Medical Economics, September 1981 edition, that the average income of a general surgeon for 1980 was $83,300. He then brought the $28,000 average earnings of a college graduate in 1977, and the $83,300 of a general surgeon in 1980, to 1985, by adjusting them upward in each year.**

**Mr. Goodman used government statistics for the prior three years, indicating an average annual increase in gross earnings throughout the country of 8 percent. In bringing the figures to 1985 levels he used 10 percent a year as an inflation factor. He then took into account federal income taxes. He testified that the Emergency Recovery Tax Act of 1981 promulgated income tax rates through 1984 and provided that, starting in 1985, the income tax tables would be indexed to the Consumer Price Index, so that the percentage of after- tax income in 1984 would be continued through the foreseeable future.**

**This approach made it statistically dependable to determine what percentage of after-tax income a college graduate would have in 1984, to figure what the surgeon would have at the same time and to apply that ratio on through his working career. The "real interest rate" was defined as that rate that is the nominal interest rate beyond the inflation rate, which had been 3 to 4 percent. He assumed that the trends were going to continue. He projected those rates and used them to arrive at present value.**

**Mr. Goodman stated that he gave no consideration to early or late retirement or to pre-retirement disability. State taxes were not taken into account because he could not project what they would be or where an individual would live. FICA was not taken into account because at the level of income he was talking about it would affect both workers equally. [FN3]**

**At the time of the marriage, the husband had completed 3 1/2 years of college. [FN4] He was licensed to practice medicine in October 1980. The action for divorce was commenced two months later. At the time of trial, in 1982, he was in surgical residency and did not expect to complete the requirements to be a general surgeon until 1985.**

**The Court of Appeals in O'Brien recognized that fixing the present value of enhanced earning capacity may present problems. [FN5] Even Mrs. O'Brien's expert acknowledged that his assumptions and calculations were speculative. [FN6] And the Court ignored the fact that the methodology used to value the doctor's enhanced earning capacity as a surgeon was based, in part, on his post-commencement efforts to become a surgeon. The value of these efforts would be his separate property under the Equitable Distribution Law, which limits "marital property" to "property acquired during the marriage and before the commencement of a matrimonial action. [FN7]**

**Rejecting Doctrine of 'Merger'**

**The Court of Appeals opinion in McSparron v. McSparron [FN8] was its second venture into this area. The McSparron Court created havoc for the matrimonial bar when it rejected the doctrine of "merger." It held it was error to find that the husband's law license "merged" into his career, and remitted the action to the Supreme Court so that a new distribution of the marital assets could be made "taking into account the residual value of the defendant's law license, independent of his career."**

**The Court stated that O'Brien permits the court to include in the marital estate the present value of any increased earning capacity attributable to a professional license earned during the marriage, which continues to exist throughout the life of the license. The Court specifically referred to and approved of the O'Brien valuation methodology, holding that the value of a newly earned license may be measured by simply comparing the average lifetime income of a college graduate and the average lifetime earnings of a person holding such a license and reducing the difference to its present value.**

**Where the licensee has already embarked on his or her career and has acquired a history of actual earnings, the foregoing theoretical valuation method must be discarded in favor of a more pragmatic and individualized analysis based on the particular licensee's remaining professional earning potential.**

**The court cautioned that care must be taken to ensure that the value given to the license "does not overlap with the valuation of other marital assets that are derived from the license such as a spouse's professional practice." It also cautioned that courts must "guard against duplication in the form of maintenance awards that are premised on earnings derived from professional licenses."**

**As a consequence it has been held that earnings attributable to the licenses of professionals must be deducted from a spouse's income before fixing maintenance awards. [FN9] We question why the earnings derived from the license of a professional are excluded from that spouse's income before fixing a maintenance award but earnings derived from other businesses are not similarly excluded from a spouse's income before fixing maintenance awards. It appears that professionals are being treated unequally by this aspect of the McSparron decision.**

**Surprisingly, the McSparron court apparently expanded the discretion of the trial court to consider in its valuation methodology post-commencement, post- trial and even post-judgment events. Recognizing that the question of valuation would probably have to be tried de novo, the Court turned "... to the question of whether the trial court may consider the post-commencement events which may have affected the value of defendant's license."**

**The Court went on to state that "..**

**whether the unusual post commencement events that led to defendant's job loss should be considered in assessing the residual value of his law license is a question that lies squarely within the trial court's discretion," and it held "only that the timing of these events should not by itself be a legal impediment to such consideration." [FN10]**

**The Court stated that "Domestic Relations Law s236 B (1)(c) provides that the classification of property as "marital" or "separate" is governed by the date on which the matrimonial action was commenced or the parties' separation agreement executed. However,**

**the equitable distribution statute does not specify the date that is to be used as the touchstone for measuring the value of the marital property .... Thus, the appropriate date for measuring the value of marital property has been left to the sound discretion of the trial courts, which should make their determinations with due regard for all of the relevant facts and circumstances ....**

**By stating that the trial court had the discretion to consider the post- commencement events that may have affected the value of defendant's license, specifically referring to the husband's 1992 job loss as one of these events, and that their timing should not by itself be a legal impediment to such consideration, the court appears to have held that the trial court can consider post-trial and post-judgment events in arriving at the value of the enhanced earning capacity attributable to defendant's law licensee.**

**DRL Provision**

**If the court held that post-trial and post-judgment events may be considered in fixing the value of the enhanced earning capacity attributable to defendant's law license, it overlooked that part of DRL s236(B)(4)(b) that provides that the date or dates the parties shall use for the valuation of each asset, "... may be anytime from the date of commencement of the action to the date of trial."**

**The McSparron action was commenced in 1989 and a judgment of divorce was granted, after trial, in 1991. The husband's 1992 job loss occurred more than a year after the trial and after the judgment of divorce was entered. DRL s 236(B)(4)(b) requires that the valuation date of the enhanced earning capacity attributable to his law license must be between the date of commencement in 1989 and the date of trial in 1991. In light of the statute and the lack of statutory authority to modify an equitable distribution or distributive award made in a final judgment, it would be improper to consider the husband's post- judgment efforts in the valuation methodology.**

**We believe that the Court of Appeals overlooked DRL s236(B)(4)(b) and the definition of "marital property" when it concluded that post-commencement events may be considered by the trial court in valuing the enhanced earning capacity attributable to a professional license. We believe that, contrary to the apparent holding in McSparron, existing statutory law does not permit post- trial and post-judgment events to be considered by the trial court in valuing an asset or making an equitable distribution award.**

**FN1. 114 Misc2d 233 (2d Dept.) 106 AD2d 223, 66 NY2d 576, 498, NE2d 712 (1985).**

**FN2. Dr. O'Brien was employed as a resident general surgeon at the time of trial, earning $17,000 a year, under contract until 1985.**

**FN3. Trial Transcript.**

**FN4. 452 NYS2d 802.**

**FN5. In his concurring opinion Judge Meyer expressed his concern for the "potential for unfairness involved in distributive awards based upon a license of a professional still in training."**

**FN6. He testified: "\*\*\* I mean, there is a degree of speculation. That speculative aspect is no more to be taken into account, cannot be taken into account, and it's a question, again, \*\*\* not for the expert but for the courts to decide. It's not my function nor could it be."**

**FN7. DRL s236(B)(1)(c).**

**FN8. 87 NY2d 275.**

**FN9. See Cadet v. Cadet, New York Law Journal, Dec. 11, 1996, p. 31, col. 6, Sup.Ct., Rockland Co. (Miller, J.); Wadsworth v. Wadsworth, \_\_\_ AD2d \_\_\_, 641 NYS2d 779.**

**FN10. 87 NY2d 275.**

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