
LAW AND THE FAMILY

"MCSPARRON' REVISITED, REAFFIRMED AND REFINED"

Joel R. Brandes

[New York Law Journal](#)

August 22, 2000

In the 15 years since the formidable O'Brien [FN1] case was decided by the Court of Appeals, little else has dominated the thoughts and debates of judges, lawyers, scholars and the like when it comes to the distribution of professional licenses.

The Court of Appeals, in mandating in O'Brien that the Equitable Distribution Law be given a liberal interpretation, held that a professional degree or license was "marital property," subject to equitable distribution.

It affirmed the trial court's holding that Dr. O'Brien's medical degree and license, earned during the course of the marriage, had a present value of \$472,000 and awarded the wife 20 percent of that amount. That figure was computed by comparing the average income of a college graduate to that of a general surgeon (Dr. O'Brien's then-residency training) from 1985, when Dr. O'Brien anticipated the completion of his residency, until his 65th birthday. After considering federal income taxes, an inflation rate of 10 percent and a real interest rate of 3 percent, the court capitalized the difference in average earnings and reduced the amount to present value.

In McSparron v. McSparron, [FN2] decided 10 years later the Court of Appeals held that, even after a professional degree or license has been used by the licensee to establish and maintain a career, it does not "merge" with the career or ever lose its character as a separate, distributable asset.

'Merger' Concept Eliminated

It reaffirmed the holding of O'Brien, under which 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. McSparron held that where the licensee has already embarked on his or her career and has acquired a history of actual earnings, O'Brien's theoretical valuation method must be discarded in favor of a more pragmatic and individualized analysis, based on the particular licensee's remaining professional earnings potential.

In eliminating the concept of "merger," the court recognized the ongoing independent vitality that a professional license may have and focused solely on the problem of valuing that asset in a way that avoids duplicative awards. It cautioned that 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 derived from the license, such as the licensed spouse's professional practice. It emphasized that "courts must be meticulous in guarding against duplication in the form of maintenance awards that are premised on earnings derived from professional licenses."

Rather than limit the maintenance award, the Fourth Department in *Wadsworth v. Wadsworth* [FN3] "McSparronized" the property distribution by holding that, to avoid a double count, the income used in determining the present value of the law practice must be deducted from the calculation of future enhanced earning capacity, and that where there is a maintenance award, "the court [is] obliged to reduce the value of the enhanced earnings by the amount awarded in maintenance. Not to do so would involve a double counting of the same income."

Recently the Court of Appeals revisited, reaffirmed and refined its McSparron holding in *Grunfeld v. Grunfeld*. [FN4] In *Grunfeld* the Supreme Court [FN5] ordered the defendant to pay maintenance of \$15,000 per month until the sale of the marital home one year after the younger child was to enter college, in 2000. Thereafter, maintenance was to be reduced to \$8,500 per month. The court valued defendant's practice as of the date of commencement of the matrimonial action, using the "excess earnings" method. The court first determined the amount that defendant actually earned in excess of "reasonable compensation," which is the amount paid to an attorney of similar age and background, in the same geographic area, without any ownership interest in a law practice. After subtracting taxes and the income theoretically derived from defendant's share of the firm's tangible assets ("return on equity"), by agreement of the parties, the resulting amount was capitalized using a multiple of three. Then, defendant's interest in the firm's tangible assets was added to the capitalized earnings to arrive at defendant's interest in his practice, which the Supreme Court found to be more than \$2.58 million.

The Supreme Court also determined the value of defendant's license to practice law for equitable distribution purposes. It first computed the value of the "bare

license," that is, the present value of the difference between the average earnings of a first-year associate at a law firm and a person holding an undergraduate degree, for the remainder of defendant's work-lifetime, with an adjustment to take into consideration the possibility of defendant's death before reaching age 65, his anticipated retirement age. Because the parties did not marry until defendant was halfway through law school, only one half of the bare license was a marital asset. Thus, its value was multiplied by a 50 percent "coverture fraction."

Next, the court added the "enhanced earnings potential" created by the license. To avoid double counting, [FN6]since defendant's income in excess of "reasonable compensation" had already been considered in determining the value of defendant's interest in the practice, the court excluded that portion of defendant's future earnings from consideration. The enhanced earnings attributable to the license alone were the difference between reasonable compensation and the earnings of a first-year associate. The court calculated the present value of these earnings from the commencement date until the date of defendant's expected retirement, taking actuarial factors into account. The result was then reduced by 7 percent, "to reflect the premarital, separate property component of that figure." The sum of the license's bare value and enhanced earnings potential was found to be more than \$1.54 million.

Calculating Future Income

Thus, the Supreme Court determined the value of both defendant's law practice and license by calculating the current worth of different components of defendant's projected future income of \$1.2 million per year. To the extent that these "assets" were acquired during the marriage, they were correctly considered to be available for equitable distribution.

The Supreme Court stated that it had considered all of defendant's future income in setting the maintenance award. It noted that the methodology of determining the value of defendant's license was based on the earnings differential between reasonable compensation and the income of a nonlicensed college graduate. It then explained that it would violate the McSparron rule against double counting to actually award one half the value of the license, since the earnings differential upon which it was based had already been considered in fixing the award of maintenance. To avoid giving plaintiff two separate awards derived from the same stream of future income, the court excluded the license from the marital assets in determining the distributive award.

The Appellate Division modified, [FN7] directing that the one-half of the value of defendant's professional license - \$773,500 - should also have been distributed to plaintiff. The court held that the reduction of maintenance from \$15,000 to \$8,500

per month should begin following full payment of the distributive award. The Appellate Division also ordered defendant to pay plaintiff interest on the unpaid balance of the distributive award at the statutory rate.

The Court of Appeals

The Court of Appeals modified [FN8] the order of the Appellate Division because it double counted defendant's income in ordering that plaintiff should receive both undiminished maintenance and the full distributive award of one-half the value of plaintiff's law license.

The Court of Appeals noted that, 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, which is dependent 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 that those same projected earnings used to value the license also form the basis of an award of maintenance, the licensed spouse is being charged twice with distribution of the same marital asset value, or with sharing the same income with the non-licensed spouse.

In *Grunfeld*, when setting the level of maintenance, Supreme Court included as part of defendant's earning capacity the projected earnings derived from his professional license. The court also used the same earnings attributable to the law license to determine the present value of the license as a marital asset. The Court of Appeals held that, to comply with *McSparron*, Supreme Court had to reduce either the income available to make maintenance payments or the marital assets available for distribution, or some combination of the two.

Double-Counting

Once a court converts a specific stream of income into an asset, that income may no longer be calculated into the maintenance formula and payout. It stated that where license income is considered in setting maintenance, a court can avoid double-counting by reducing the distributive award based on that same income.

"The necessity of this reduction was recognized in *Wadsworth v. Wadsworth* (219 AD2d 410). Not to do so would involve a double counting of the same income." The court noted that "one advantage of this method is that the maintenance award

may be adjusted in the future if the licensed spouse's actual earnings turn out to be less than expected at the time of the divorce." It added: "This method is also consistent with our observation that in particular cases the value of the license 'may be nominal'." It also noted that "there may be cases where it is more equitable to avoid double counting by reducing the maintenance award (***)". Where the license is likely to retain its value in the future but the nonlicensed spouse may only be entitled to receive maintenance for a short period of time, it may be fairer actually to distribute the value of the license as marital property rather than to take the license income into consideration in determining the licensed spouse's capacity to pay maintenance."

The Court of Appeals found that the Appellate Division based its ruling, in part, on the fact that "defendant's future earnings" - which only could be expected to come from his own professional endeavors - were likely "to exceed \$1 million yearly." Additionally, that court apparently recognized that income from other resources could only be expected to support "a portion of the maintenance." It held that on the face of the Appellate Division's decision, by ordering full distribution of plaintiff's share of defendant's license without any adjustment of maintenance, the court engaged in double counting of income, which was inconsistent with McSparron. Therefore, it remitted the matter to the Supreme Court to recalculate the required reduction in the license distributive award, in accordance with McSparron and its opinion.

The Court of Appeals also pointed out that Courts have the discretion to value "active" assets, such as a professional practice, on the commencement date, while "passive" assets such as securities, which could change in value suddenly based on market fluctuations, may be valued at the date of trial. It noted that "Such formulations, however, may prove too rigid to be useful in particular cases. Thus, they should be regarded only as helpful guideposts and not as immutable rules of law." Here, the Trial Court correctly used the active/passive distinction as a "helpful guidepost."

FN(1) 66 NY2d 576, 498 NYS2d 743 (1985)

FN(2) 87 NY2d 275, 639 NYS2d 265 (1995)

FN(3) 219 AD2d 410, 641 NYS2d 779 (4th Dept, 1996)

FN(4) 255 AD2d 12, - NYS2d -, New York Law Journal, 6-12-2000, p. 27, col 1 (2000)

FN(5) Grunfeld v. Grunfield, 170 Misc 2d 808 (Sup. Ct., 1998)

FN(6) Justice Saxe of the Appellate Division explained (255 AD2d 12) that the term "double counting" is frequently used to refer to the use of the same stream of income to calculate the value of more than one asset, and that "double dipping" is sometimes used to refer to the court-ordered payment of more than one financial obligation from the same source. The potential for "double counting" arises because in determining the value of a spouse's interest in a law practice, the court takes into account not only the practice's tangible assets and liabilities, such as accounts receivable and inventory, but also the intangible value of the practice, known as its "goodwill."

FN(7) Grunfeld v. Grunfield, 255 AD2d 12, - NYS2d - (1st Sept. 1999)

FN(8) See N.4, Supra

Joel R. **Brandes** has law offices in Garden City and New York City. He co-authored the nine-volume Law and the Family New York and Law and the Family New York Forms (both, published by West Group). Bari R. **Brandes**, a member of the firm, co-authors the Annual Supplements to Law and the Family New York 2d and assisted in the preparation of this article.

8/22/2000 NYLJ 3, (col. 1)