From *O'Brien* to *Keane*: Building on a Weak Foundation

By Peter E. Bronstein and David A. Typermass

Bad law typically breeds even worse law.

For nearly 25 years, courts in New York have struggled to apply the aberrational ruling of *O'Brien v. O'Brien*, 66 N.Y.2d 576 (1985), the case which gave birth to the concept that a person's professional degree, license or enhanced earnings capacity could be valued and distributed as marital property. In bypassing the simpler and more logical approach of compensating the lesser earning spouse with a greater maintenance award, *O'Brien* and its progeny needlessly created a new asset class and added an unnecessary level of complexity to the law.

The courts are now wrestling with distinctions without differences, an incomplete understanding of the appraisal process, and the effort to do what appears equitable for the needy spouse, all without fully understanding the consequences of the precedents being created. Lawyers and judges must now grapple with arcane financial issues that are frequently beyond their grasp, such as the tangible or intangible nature of a stream of future income payments. What started with a poorly reasoned decision in *O'Brien* has spawned a line of cases which have left the lower courts adrift in a sea of illogic.

In *O'Brien v. O'Brien*, the New York State Court of Appeals deviated from the vast experience of every other state in the country when it decided that professional licenses constituted marital property and that such licenses should be valued and divided between spouses. Two months after obtaining his medical license, Dr. Michael O'Brien commenced divorce proceedings against his wife Loretta. In *O'Brien*, the Court was rightly sympathetic to Mrs. O'Brien, who had helped support the family while Dr. O'Brien completed his bachelor's degree, his medical degree and his medical internship. Unfortunately, in its zeal to compensate Mrs. O'Brien, the Court made what is widely considered to be a bad decision.

Dr. O'Brien had no practice to speak of as a young doctor. By placing a value on his medical license and awarding a portion of that license to Mrs. O'Brien, the Court effectively forced Dr. O'Brien to use his medical license to earn a high income and eliminated any chance that he might have used that license to further the public good. Dr. O'Brien's license was valued at $472,000 by Mrs. O'Brien's expert, who had capitalized (and discounted to present value) the difference in average earnings between a college graduate and a general surgeon from 1985 to 2012 (the year when Dr. O'Brien would be 65). By upholding the lower court's decision that Mrs. O'Brien was entitled to her proportionate share of the "enhanced earnings capacity" inherent in Dr. O'Brien's medical license, the Court of Appeals ensured that for better or worse Dr. O'Brien, who had no other significant assets, would be using his medical license for years to be able to pay off Mrs. O'Brien's distributive award.

On this dubious pillar, which has been rejected by every other state, the courts in New York have made other bad decisions in the name of valuing an individual's enhanced earnings capacity.[1] In *Elkus v. Elkus*, 572 N.Y.S.2d 901 (1st Dep't 1991) the First Department held that a wife's career as an opera singer was a marital asset which could be valued and distributed. The *Elkus* court referred to a lower court ruling by Justice Silbermann in *Golub v. Golub*, 527 N.Y.S.2d 946 (Sup. Ct. N.Y. Co. 1988), which had held that a person's celebrity status—in that case a model / actress—could be a marital asset. In *Hougie v. Hougie*, 689 N.Y.S.2d 490 (1st Dept. 1999) the First Department held that an investment banking career could be valued as a marital asset and distributed.

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In the years following *O'Brien*, the lower courts, to avoid the problems of spouses being awarded a double recovery from a license and a professional practice, frequently merged the value of a professional license with a professional practice. The Court of Appeals in *McSparron v. McSparron*, 87 N.Y.2d 275 (1995) rejected this "merger principle" and held that a professional license should not be merged into a professional practice but rather they should be valued separately: "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." *Id.* at 286. The *McSparron* Court also recognized the potential for double dipping out of the same income stream when courts had to fashion maintenance awards in cases where a professional license was also being distributed: "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." *Id.* at 286

In *Grunfeld v. Grunfeld*, 94 N.Y.2d 696 (2000), the Court determined that in order to avoid double dipping courts had to "reduce either the income available to make maintenance payments or the marital assets available for distribution, or some combination of the two." *Id.* at 705. The Court held that it is impermissible to value and divide a professional practice, which is inherently based upon the future income stream of that practice, and then award maintenance as if the owner of that practice had access to the full income stream of the practice. In essence the Court recognized that the future income stream had been accounted for in the valuation process and could not be used again in fashioning a maintenance award. Any maintenance award had to be based upon other income which had not already been valued and distributed: "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." *Id.* at 705.

The lower courts then had a problem reconciling the outcome in *McSparron* and *Grunfeld* with the Child Support Standards Act ("CSSA") guidelines. In *Holterman v. Holterman*, 3 N.Y. 3d 1 (2004) the Court of Appeals ruled, in a rigid application of the CSSA, that it was permissible to double count a payor spouse's income that was part of a distributive award in calculating the child support payable to the custodial parent, and impermissible to count the distribution of future income as part of the imputed income of the recipient for CSSA purposes. The *Holterman* decision, in making a distinction between maintenance and child support, watered down the whole concept of double dipping. If the income stream attributed to a professional license has already been distributed to the custodial parent in a capital award, why should the payee of that capital not be considered to have that income stream as a basis for the CSSA guidelines, especially in cases where the capital award may have to be paid out over time (and with interest) since the payor spouse doesn't have the money yet? Similarly, there is no reason to pretend that the capital award has not been made and to assume that the payor spouse received the benefits of 100% of the future income.

The dissent in *Holterman* correctly pointed out that the CSSA did not require the strict interpretation followed by the majority since the CSSA "expressly permits departure from its formula to avoid an 'unjust or inappropriate' result." *Id.* at 18. The dissent also noted that even the wife's expert recognized the intellectual dishonesty of double dipping from one income stream which is why, in making his child support calculation, the wife's expert reallocated to the wife the portion of the husband's income which was part of the distributive award. The dissent agreed with the approach taken by the Court in *Goodman v. Goodman*, 755 N.Y.S.2d 822 (Sup. Ct., Nassau Co. 2003) which had applied the CSSA's escape clause and reallocated income from a distributive award based on enhanced earnings capacity to the non-titled spouse and subtracted it from the income of the titled spouse. *Holterman* at 20.

In *Keane v. Keane*, 8 N.Y.3d 115, 861 N.E.2d 98, 828 N.Y.S.2d 283 (2006), the Court of Appeals demonstrated a similarly peculiar grasp of reality. Perhaps the Court in *Keane* did not fully understand the concept of valuing a future income stream, although frankly, *Grunfeld* provided hope that it did.

In *Keane* the Court makes what appears to be a distinction without a difference in holding that *Grunfeld*'s prohibition against double dipping only applies to intangible assets and not tangible assets. In *Keane* the parties owned a parcel of real property which was leased to a car repair shop until the year 2010 and that lease provided them with a stream of income. The husband's expert valued this property using two different valuation methods: 1) a capitalized income approach which valued the property at $290,000, and 2) a market value approach which valued the property at $324,000. The Supreme Court in *Keane* adopted the capitalized income valuation and distributed the value of the property between the parties. There was no indication that the appraiser did not correctly apply the capitalized income method and did not fully value the property. The Appellate Division majority seemed to understand this when it wrote: "The Supreme Court valued the body shop property at **full market value** by utilizing the capitalization of income method." *Keane v. Keane*, 809 N.Y.S.2d 133, 136 (2d Dep't 2006 (emphasis added). The capitalization of income method values the income stream produced by an asset into perpetuity and therefore such a valuation does not leave any residual value because there is no theoretical remainder period in which an owner would be holding title to an asset whose income stream has run out.

After equitably distributing the car repair shop property, the Supreme Court had improperly included the monthly rental income the husband was to receive from that property in fashioning a maintenance award for the wife. The Appellate Division held the inclusion of this income to be an improper double count of the same income stream. The Court of Appeals disagreed and reversed.

The Court of Appeals, along with the dissent in the Appellate Division, clearly misunderstood the valuation conclusions reached by the appraiser: "We do not see why an inquiry as to double counting should depend on the valuation method used." *Keane v. Keane*, 8 N.Y.3d 115, 121. The fact that the appraiser used two valuation methods which resulted in two different values did not mean that the appraiser carved out a separate value for the income stream generated by the property and a separate value for the residual value remaining in the property. Different valuation approaches usually result in different values but both theoretically would have captured the "full market value" of the asset as the Appellate Division majority seemed to understand.

The Court of Appeals adopted the *incorrect* reasoning of the Appellate Division's dissenting Justice Goldstein, who had concluded that the capitalized income approach, because its valuation was lower than the market value approach, did not fully value the property:

> The use of the lower value ascertained from the capitalization of income approach was appropriate since the de-

> fendant was retaining the property as income-producing property.…If the higher market value approach had been used, there would undoubtedly be no argument with respect to 'double counting'…When the cash flow from the current lease of this asset is exhausted and maintenance based thereon terminates, the defendant will retain a valuable asset which he may use to generate yet another stream of income or sell at market value. *Keane v. Keane*, 809 N.Y.S.2d 133 at 140.

The Court of Appeals had no reason to assume that the property would have additional value in excess of its appraised value at the end of its lease term, although that is exactly what it concluded:

> 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. *Keane v. Keane,* 8 N.Y.3d 115, 122.

In fact, to assume there was residual value in the property in excess of the valuation would have been to alter the findings of fact, something the Court itself acknowledges it cannot do: "As a court of law we are precluded from reviewing affirmed findings of fact unless there is a question of legal sufficiency of the evidence" *Id.* at 122. We note that the property could actually turn out to have less value than its appraised value as would be the case if a significant liability, such as an oil leak, was later discovered on the property or if a tenant went bankrupt and the property could not be re-leased.

Ignoring the underlying reasoning of *Grunfeld*'s prohibition against double dipping, the Court in *Keane* made a distinction between cases involving intangible assets from cases involving tangible assets and held that this distinction alone justified a double count. Logically, however, this makes no sense because the same problem of double counting exists whether a court is distributing an intangible asset or a tangible asset. The Court failed to understand that the income stream from the car repair property, or any other tangible property for that matter, was not separate and distinct from the appraised value of that property which would have inherently included the full value of all future income streams. Rather than making a distinction between intangible and tangible assets, which was intellectually flawed, the Court should have made a distinction between assets that are fully capitalized and those that are not fully capitalized and have residual value (which the Court wrongly assumed was the case in *Keane*).

Like the Court in *O'Brien*, the Court of Appeals in *Keane* ignored established precedent and used faulty reasoning in order to fashion a result which it felt was right. Mrs. Keane, although she may have received half of the assets, was in need of cash flow because her assets were largely illiquid. Instead of double counting Mr. Keane's income from the real property, the Court should have offered a more intellectually honest solution to this dilemma, such as adjusting maintenance or equitable distribution accordingly, as *Grunfeld* suggested. Instead, the Court created a meaningless distinction between intangible and tangible assets which it used to justify its decision to double count the same dollars in a maintenance award which had already been distributed in a capital settlement. The result in *Keane* is that Mr. Keane had to pay maintenance from his half of a divided asset as if he had the benefit of the whole asset.

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As expected the flawed logic of the *Keane* decision has been adopted, without question, by the lower courts. In *Griggs v. Griggs*, 44 A.D.3d 710, 844 N.Y.S.2d 351 (2d Dep't 2007), the Second Department rejected the plaintiff-husband's argument that the lower court had improperly double counted the income from his medical practice in its maintenance award, since the practice had already been valued and distributed. The Second Department cited *Keane* in ruling 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." *Id.* at 713. The Second Department again followed *Keane* in *Groesbeck v. Groesbeck*, 51 A.D.3d 722, 723, 858 N.Y.2d 707, 709 (2d Dep't 2008) when it held that the *Grunfeld* rule prohibiting double counting did not apply to income derived from the defendant-husband's home improvement contracting business, which it found to be a "tangible income-producing asset." The Second Department failed to understand that if the full value of the defendant husband's businesses had already been valued and distributed, then, theoretically, there should have been nothing of value left to pay maintenance. The problem with bad precedent is that it tends to be adopted and applied without any reservations or examinations.

As a result of *Keane*, attorneys will have to explain the differences between intangible and tangible assets to their clients. They will also have to explain how if the payor spouse has a tangible asset a court can take half a pound of flesh from that payor spouse and give it to the other spouse in equitable distribution and then come back to the payor spouse and direct that his or her remaining half pound be used to make support payments. The client will readily understand that the payor spouse in such a case would have less than half of the value of the asset left.

The *Keane* decision is unfortunately probably not the last, tortured interpretation of the law regarding enhanced earnings capacity stemming from *O'Brien*. While the *O'Brien* Court may have had good intentions, the decisions which it spawned demonstrate the inconsistencies that will continue to arise from courts trying to craft desired results using the flawed concept of enhanced earnings capacity. The difficulty subsequent courts have had in applying these holdings is evidence that bad law doesn't tend to get better with age and more often than not produces even worse law.

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Endnote

1. "[I]t is only in New York where professional degrees, licenses, and career enhancement are considered marital property," Jay E. Fishman, Shannon P. Pratt, and William J. Morrison, *Standards of Value*, p. 232 (2007).

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