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Commonwealth Of Kentucky

Court Of Appeals

NOS. 1998-CA-002123-MR & 1998-CA-002159-MR

MICHAEL J. GOODWIN — APPELLANT/CROSS-APPELLEE

v.

APPEALS FROM BOYD CIRCUIT COURT
HONORABLE C. DAVID HAGERMAN, JUDGE
ACTION NO. 1996-CI-01082

MARY GOODWIN — APPELLEE/CROSS-APPELLANT

OPINION
AFFIRMING IN PART, REVERSING IN PART, AND REMANDING
** ** ** ** **

BEFORE: GUIDUGLI, JOHNSON, AND KNOPF, JUDGES.

KNOPF, JUDGE: Michael J. Goodwin appeals from the judgment granting his petition for divorce. He objects to those portions of the judgment that value the marital estate--particularly Michael's medical practice--and order him to pay maintenance. Michael contends that the trial court fixed the wrong date for valuating the marital estate; that it abused its discretion by including business goodwill and post-decree earnings in the estate; and that it gave too little weight in its maintenance determination to the fact that the appellee, Mary Goodwin, is capable of earning substantial income, not only from her share of the marital property, but also from employment as a physician in

her own right. Mary has also appealed. She contends that the trial court incorrectly excluded from the marital estate a portion of the medical practice's accounts receivable. For the following reasons, we agree with Michael that the valuation date was incorrectly determined, but otherwise we reject these allegations of error. Accordingly we affirm in part and reverse in part the July 22, 1998, judgment of the Boyd Circuit Court.

The parties married in 1980, while both of them were in medical school. They saw one another through the rigors of residency, endured the early years of repaying educational loans and searching for careers, and then, in 1992, they settled with their four children in the Ashland, Kentucky, area where Michael had been recruited to open a practice. Michael quickly established himself as an orthopedic surgeon, while Mary, a pediatrician, withdrew from practice in order to devote more of her time to the couple's young children and to managing their household. She could well afford to do this, since already by the end of 1993 Michael's practice was earning in excess of a million dollars annually. The family occupied an $800,000.00 residence and enjoyed other amenities attendant upon Michael and Mary's success.

Despite this success, the parties developed differences which led to their separation in September 1996. Soon thereafter Michael petitioned for divorce. An interlocutory decree of dissolution was entered on February 7, 1997, pursuant to which, among other things, the parties were granted joint custody of their children. The children were to reside with Mary in the

marital home. Michael was granted liberal visitation and was ordered to pay child support in the amount of $6,300.00 per month. He was also ordered to make mortgage payments for Mary and to provide her with maintenance pending final settlement of the marital estate. Upon Michael's motion, the dissolution was made final by order entered January 28, 1998. By the same order the trial court also determined--over Michael's objection--that for settlement purposes the estate was to be deemed to have continued until that day, January 28, 1998. On May 12, 1998, the trial court conducted a settlement hearing. Principally at issue, as mentioned above, were Mary's entitlement to maintenance and the value of Michael's practice. The trial court's resolution of those issues, by judgment entered July 22, 1998, has given rise to these appeals.

As the parties acknowledge, our standard of review in domestic relations cases is generally a deferential one. Statutory procedures must be observed, and statutory standards must inform and guide the trial court's decisions. But within those constraints property valuation matters and maintenance determinations are within the sound discretion of the trial court. "In such matters, unless absolute abuse is shown, the appellate court must maintain confidence in the trial court and not disturb the findings of the trial judge." Clark v. Clark, Ky., 782 S.W.2d 56, 60 (1990).

With this standard in mind, we turn to the issues on appeal. A trial court confronted with the need to value a marital estate must first determine at what point in time the

estate ended. We shall begin with the same question. Michael contends that the trial court valued the marital estate as of the wrong closing date and thus treated as belonging to the estate earnings of more than $400,000.00 that should have been characterized as his non-marital property. As noted above, Michael initiated this action on November 6, 1996. An interlocutory decree of dissolution was entered on February 7, 1997. Final judgment was entered July 22, 1998. In the interim, a dispute arose concerning the effect of the interlocutory decree on the marital estate. Michael argued that the date of the interlocutory decree marked the close of the estate and the valuation date for estate property, but Mary maintained that the estate continued to exist and to accrue property until entry of a final judgment. Somewhat reluctantly the trial court agreed with Mary, whereupon Michael moved that the dissolution decree be made final. An order to that effect was entered on January 28, 1998, and that date was designated as the close of the estate. In anticipation of this appeal and in light of the possibility that an earlier date should have been adopted, the trial court requested the parties to prepare schedules valuing the estate alternatively as of February 7, 1997, and January 27, 1998.[1]

Michael now duly contends that the date of the interlocutory decree marked the close of the marital estate. He relies on two cases, Clark v. Clark, Ky. App., 782 S.W.2d 56 (1990) and Stallings v. Stallings, Ky., 606 S.W.2d 163 (1980) in

[1]These are the dates respectively on which the interlocutory decree was executed and on which the order making that decree final was executed. Those orders were not entered until the dates indicated in the opinion.

which, without comment, the appellate courts seem to have condoned that procedure. Mary, on the other hand, cites Putnam v. Fanning, Ky., 495 S.W.2d 175 (1973) wherein the Court ruled that a contested dissolution decree did not become effective until entry of a judgment made final and appealable pursuant to CR 54. Confronted with this dilemma, the trial court in this case acknowledged the practicality of the procedure advocated by Michael and conceded that such a procedure may well have been employed in Clark and Stallings, but ruled that, absent an express holding to that effect, Putnam was controlling.

Although we certainly agree with the trial court that CR 54 applies to dissolution decrees no less than to any other sort of judgment, we are nonetheless persuaded that it has read Putnam too broadly. That case concerned a *contested* dissolution. Here, as in most other divorce cases, the dissolution itself is not contested. Rather, the parties have agreed to dissolve their marriage, but require the court's assistance in wrapping up their estate. Such assistance is governed largely by KRS 430.190. That statute provides in pertinent part that

> all property acquired by either spouse after the marriage and before a decree of legal separation is presumed to be marital property, [unless] [t]he presumption . . . is overcome by a showing that the property was acquired by a method listed in subsection (2) of this section.

One of the exceptions to marital property listed in subsection (2) is "(d) Property excluded by valid agreement of the parties." An uncontested dissolution decree is, we believe, a valid agreement by the parties to close the marital estate and

to exclude from it property thenceforth acquired. Were it otherwise, the settlement of marital estates would be unduly complicated, as in this case, by a needless flux and uncertainty. Although it is perhaps good practice to have the dissolution decree made final, in uncontested dissolution cases that step is not required in order to close the marital estate and to fix a date for the commencement of support obligations. The date so fixed by entry of the dissolution decree is presumptive and can be modified by valid agreement of the parties.[2]

In this case, by February 4, 1997, the date of the interlocutory dissolution decree, the parties had separated and had begun fashioning independent lives. Temporary child-support and maintenance orders had taken effect. Under KRS 403.190, therefore, the marital estate was closed by the uncontested decree of dissolution and was subject to valuation as of that date. The trial court erred by concluding otherwise, but thanks to its anticipation of this possible result, on remand it need only modify its judgment in light of the alternative property evaluations it has found.

Having determined the duration of the marital estate, we next consider its valuation. Michael maintains that the trial court erred in its valuation of his medical practice, Michael J. Goodwin, M.D., P.S.C.. The court determined that, as of the date

[2]In addition to Clark and Stallings, see Turley v. Turley, Ky. App., 562 S.W.2d 665 (1978) and Daniels v. Daniels, Ky. App., 726 S.W.2d 705 (1986) for examples of cases in which a similar procedure was employed.

of the dissolution (January 1997), the practice was worth $1,037,737.00, itemized as follows:

shareholders' equity	$127,635.00[3]
accounts receivable	$392,437.00
income tax liability	($40,773.00), and
goodwill	$558,438.00.[4]

Michael quarrels only with the inclusion of a value for goodwill. The rest--the equity, the accounts receivable, and the tax liability (the "book value" of $479,299.00)--is, Michael contends, the full extent of the practice's worth.

As Michael acknowledges, this Court has recognized goodwill as a type of property that is subject to division in marital dissolution actions. Clark v. Clark, *supra*; Heller v. Heller, Ky. App., 672 S.W.2d 945 (1984). Although the concept of goodwill has resisted precise definition, the general idea is straightforward enough. Businesses are often worth more than their tangible assets alone would suggest. To explain this anomaly, economists and accountants have posited the existence of intangible assets such as a firm's positive reputation, its accrued experience as a going concern, its favorable contractual relationships with suppliers or potential competitors. "Goodwill" is one of the terms employed in this context to signify a firm's value in excess of "book value."

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[3]Apparently Michael is the sole shareholder.

[4]We infer this amount for goodwill from the other items listed. The trial court, however, derived the goodwill from the estimated cash-flow deficit between 1991 and 1994 of $635,300.00. The court's calculations do not appear in the record.

That is the situation here. The trial court found that book value did not reflect the true worth of Michael's practice and that goodwill thus existed in a particular amount. Michael contests both aspects of this ruling. His practice does not contain any valuable goodwill, he argues; and if it be deemed to do so, the testimony the trial court relied upon to fix the amount was not reliable. We are persuaded by neither of these contentions.

Michael's practice generates net revenues in excess of $1,000,000.00 per year from tangible assets of approximately $100,000.00. If those revenues are capitalized at 40%, a figure fair to Michael, then he would have total assets of $2,500,000.00, of which $2,400,000.00 would be intangible. Alternatively, the record also indicates that at the relevant time a typical net income for orthopedic surgeons was $450,000.00 per year. If we take from Michael's million dollar revenue a generous return to his tangible assets, say $20,000.00, and this typical net return to the professional of $450,000.00, then we are left with $530,000.00 as the return to intangibles. Capitalizing this amount at 40% results in $1,325,000.00 as the value of those assets. As Mary's expert noted, these are standard techniques for estimating the value of a business and the amount of the intangible assets therein. Clark v. Clark, *supra*; Heller v. Heller, *supra*; Berger v. Berger, 648 N.E. 2d 378 (Ind. 1995); In re Marriage of Hall, 692 P. 2d 175 (Wash. 1984). The trial court did not err, therefore, by determining that Michael's practice contains asset value beyond its book value.

Michael argues to the contrary that his large revenues derive simply from his personal efforts and skills and not from any supposed intangible asset. The trial court's ruling to the contrary thus has the effect, Michael contends, of giving Mary an interest in his future, post-marital earnings, a result which is contrary to KRS 403.190. This argument raises a genuine concern, one that has led some of our sister states not to recognize business goodwill as an element of marital property or to limit that recognition strictly. Strauss v. Strauss, 647 A.2d 818 (Md. 1994); Powell v. Powell, 648 P.2d 218 (Kan. 1982); Holbrook v. Holbrook, 309 N.W.2d 343 (Wis. App. 1981).

As noted, however, under Heller v. Heller, *supra*, and Clark v. Clark, *supra*, the law in Kentucky, at least as far as this Court is concerned, is otherwise. Those cases expressly distinguish goodwill from both future earnings and professional degrees and licenses. To the extent that the trial court determined that Michael's practice has a value beyond its book value, therefore, that excess value was subject to division as marital property.

The record, furthermore, includes substantial evidence in support of the trial court's application of this rule. There was competent testimony that a portion of the medical practice's mature income is the result of institutional factors--supplier and referral networks, for example, patient acceptance, billing expertise, and lack of competition--that were either established during the marriage by the efforts of the parties or are the result of the practice's (and the marriage's) initial willingness

to locate in the chosen area. In light of these factors, the standard evaluation techniques testified to by Mary's expert readily permit the conclusion that the practice's tangible assets, even in conjunction with Michael's skill and dedication, do not account completely for the practice's unusually high earnings. The trial court did not clearly err, therefore, by finding that the practice includes an intangible asset or cluster of assets characterizable as goodwill and subject to disposition as marital property.

Nor did the court err in determining the amount of that goodwill. It relied for that purpose on yet a third technique for estimating such amounts as presented by Mary's expert witness. This third method, called the replacement method, purports to estimate the amount above book value a willing buyer would pay for an established practice such as Michael's in lieu of starting his own practice from scratch. This method is based on the fact that businesses typically require a period of years to begin generating the revenues they are capable of generating, and so the opportunity to bypass those years of uncertainty and lesser earnings has a value. By comparing Michael's net cash flow during the practices's first three years with the cash flow during an average mature year, Mary's expert witness estimated the value of these "lost earnings" to be $635,300.00. Although apparently not as common a technique for estimating goodwill as the two techniques described above, there was sufficient proof of this method's recognition among accountants and sufficient

explanation of its underlying rationale to justify the trial court's reliance thereon. Clark v. Clark, *supra*.

Michael complains that Mary's expert misapplied this replacement method by failing to account properly for the medical practice's accounts receivable; indeed, Mary's expert acknowledged that his application of the method deliberately deviated in regard to accounts receivable from the method of a chief author in the field. Michael has failed to show, however, that the deviation led to a prejudicially erroneous result. On the contrary, this method resulted in a goodwill value far smaller than any of the other valuation techniques presented at the hearing. Absent such a showing of prejudicial error, the deviation goes only to the weight of the expert's testimony, which was for the trial court to determine. Clark v. Clark, *supra; cf.* Sharp v. Sharp, 449 S.E.2d 39, (N.C. App. 1994) (observing that the mere assertion that an opposing expert "did it wrong" does not thereby render the expert's testimony inadmissible or immaterial).

Mary raises another valuation issue. In calculating the book value of Michael's medical practice, the trial court deducted approximately $320,000.00 as income tax due to be paid on accounts receivable. Mary has cross-appealed on the ground that this deduction was erroneous. She argues that, because the practice is not being liquidated, its assets, including its accounts receivable, are not to be adjusted for tax purposes but are to be given 100% of their value. In support of this argument Mary cites Stern v. Stern, 331 A. 2d 257 (N.J. 1975), in which

the New Jersey Supreme Court disallowed a similar deduction from a partnership's accounts receivable in anticipation of the income taxes the divorcing partner would eventually pay.

> The value of the [accounts receivable] is in no way diminished by the fact that defendant may thereafter be called upon to pay an income tax resulting in substantial part from his receipt of income from the partnership. . .

Id. at 261. The trial court rejected this argument and explained that the income tax liability in this case was sufficiently definite to permit accounting for it as a deduction from Michael's practice.

The gravamen of this issue, as we understand it, is whether, at the valuation date, there was a marital liability for income taxes. We agree with the trial court that there was, that the tax liability, as calculated by the parties, was certain enough at the date of valuation to be included within the marital estate notwithstanding the fact that technically the liability had been deferred. That liability, therefore, was then correctly set off against the medical practice's accounts receivable. This result is not inconsistent with Stern v. Stern, *supra*. That decision is premised upon the observation that the partnership's assets were not to be set off against the divorcing partner's individual and uncertain future liabilities. Those liabilities, the court noted, could be recognized for the sake of the divorce in other, more appropriate ways. Here, the tax liability was presently fixed and certain; there was no more appropriate way to account for it than simply to deduct it from the receivables. The trial court did not err, therefore, by doing so.

Finally, we come to the question of maintenance. Under this state's statutory domestic relations scheme, once the property division has been effected and child custody and support provided for, the trial court considers maintenance with an eye to ensuring the parties' successful transition to independence and to salvaging to the extent possible the reasonable expectations engendered by the marriage. In this case, the trial court awarded maintenance to Mary of $7,500.00 for forty-eight months and $2,040.00 for an additional forty-eight months. Michael contends that Mary is not entitled to maintenance at all.

As noted, discussion of this issue begins with KRS 403.200, which instructs the trial court to determine first whether an award of maintenance is reasonably necessary. Only if the party seeking maintenance can demonstrate a reasonable need for it, must the court then determine the award's appropriate amount and duration. In the words of the statute,

> the court may grant a maintenance order for either spouse only if it finds that the spouse seeking maintenance:
> (a) Lacks sufficient property, including marital property apportioned to him, to provide for his reasonable needs; and
> (b) Is unable to support himself through appropriate employment or is the custodian of a child whose condition or circumstances make it appropriate that the custodian not be required to seek employment outside the home.

Michael, noting that Mary has been apportioned liquid assets of almost a million dollars plus equity in the marital residence of approximately $200,000.00, jewelry, automobiles, and child-support of $6,300.00 per month, argues that Mary has sufficient property to meet even her own estimate of her

reasonable expenses. In addition to which, he insists, Mary could, in a matter of months, renew her professional credentials and resume earning an income easily large enough to support herself. The trial court's maintenance award was, then, according to Michael, an abuse of discretion. We disagree.

As substantial as Mary's resources are, they are to be weighed here against the reasonable expectations engendered by the marriage. Lovett v. Lovett, Ky., 688 S.W.2d 329 (1985); Casper v. Casper, Ky., 510 S.W.2d 253 (1974); McGowan v. McGowan, Ky. App., 663 S.W.2d 219 (1983). Those expectations include far more than the capacity to meet expenses. The trial court did not abuse its discretion by determining that Mary could reasonably expect to postpone her return to full-time employment until her children need less of her attention and that, in the meantime, she could reasonably expect Michael's assistance in preserving the opportunities, including some of the investment opportunities, she enjoyed prior to the divorce.

Counter to this conclusion, Michael insists that the trial court failed to support its maintenance award with sufficient findings of fact as required by CR 52. Michael's assertion, however, begs the question it is meant to answer. If we assume, as Michael would have us do, that an award of maintenance is inappropriate unless it be shown that Mary could not meet her expenses without such an award, then, yes, the trial court's findings are wanting. The trial court's findings do not show that, without maintenance, Mary will be unable to afford her reasonable expenses. As we have explained, however, Mary's

expenses are not the measure of "reasonable need" in this unusual case. The measure, rather, is Mary's reasonable expectation of sharing in the wealth her efforts have helped to create. Against this standard, the trial court's findings, summarized above, and its conclusions based thereon fully satisfy KRS 403.200 and CR 52.

Similarly inapt factually are the cases Michael has brought to our attention. In Richie v. Richie, Ky. App., 596 S.W.2d 32 (1980), for example, this Court reversed an *open-ended* award of maintenance because the record indicated that the recipient spouse should have expected to return eventually to full self-support. Mary's award, of course, is not open ended. Rather, it ends in eight years, when the children will have attained their majorities, and Mary can be expected to devote full attention to providing for herself. To the extent that Richie may stand for a more general limitation on the right to maintenance--say, that ordinarily maintenance should not substitute for support the recipient spouse could, with reasonable effort, provide for her- or himself--we do not quarrel with the general rule. This general limitation on the right to maintenance, however, is not applicable in these circumstances, where the marital estate provides for far more than what is ordinarily understood as the divorcing couple's "reasonable needs." Sayre v. Sayre, Ky. App., 675 S.W.2d 647 (1984) and Inman v. Inman, Ky. App., 578 S.W.2d 266 (1979) are similarly distinguishable.

In sum, except for its decision to leave open the marital estate until the dissolution decree had been made final and appealable, the trial court's handling of this difficult case comports well with both the letter and the spirit of KRS Chapter 403. It divided fairly this gifted couple's marital property and ensured through a reasonable award of maintenance that each party will retain the ability to provide abundantly for their children, both now and in the future, and will likewise retain the opportunity to engage at a high level in their chosen careers. For these and the above reasons, we affirm the July 22, 1998, judgment of Boyd Circuit Court in all respects except its adoption of January 27, 1998, as the closing date of the marital estate. The closing date should have been February 7, 1997, the day the uncontested dissolution decree was entered. Accordingly, we reverse the judgment to that extent and remand for an appropriate adjustment of findings, conclusions, and awards.

ALL CONCUR.

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