



# In a divorce, don't get doubled up

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(Please note that the following article is **not intended to be a legal opinion** or to address other legal issues that might arise in the case of **MARRIAGE DISSOLUTION**. Typically, divorce law is governed by state statute and state legal precedence. Accordingly, one should seek competent legal advice from an attorney familiar with marriage dissolutions.)

There is a joke circulating that's the result of the recent economic turmoil. It goes, "The economic meltdown is worse than a divorce. My net worth has been cut in half, but I'm still married to my spouse."

Although this may give some people a chuckle, the unfortunate circumstances of marriage dissolution undoubtedly cause significant economic and emotional damage to a doctor. Many issues usually arise in marriage dissolution; however, the two most significant economic issues are spousal maintenance (commonly referred to as alimony) and property settlement.

The latter item usually involves a division of the spouses' assets, and hence the dental practice of the divorcing dentist. As part of the dissolution, the practice is typically appraised in order to ascertain its "fair market value," and is made part of the "marital estate" for purposes of the property settlement. The following are two approaches that can be used in order to mitigate the negative economic impact to a divorcing dentist.

The first approach is described as the "negation of a covenant not to compete." This theory revolves around the intrinsic nature of a personal service business (i.e., dental practice) where the stream of income is generated from patients attracted to a "key man or woman." For example, in the traditional sale of a dental practice, there is necessarily a covenant not to compete against the selling doctor that assures the buying doctor that there will be no competition. Obviously, in the absence of such a restrictive covenant, the "goodwill value" of the practice will be virtually negated. Therefore, the remaining value of a practice under these circumstances should equal the value of the hard assets (e.g., equipment and furnishings), plus a marginal value for goodwill.

Many courts have held that in an evaluation of a personal service business, the party in a divorce proceeding cannot

be compelled to agree to a covenant not to compete (see *Nardini v. Nardini* and *Rogers v. Rogers*). In the vast majority of cases, the "goodwill value" makes up 70% to 80% of the value of a doctor's dental practice. Yet because a divorcing dentist is not compelled to agree to a restrictive covenant, the value of such a dentist's practice is reduced substantially for purposes of the marital property settlement.

The second approach to negating the adverse economic impact of marriage dissolution is described as "doubling up on the practice's earnings." Notwithstanding the previous analysis, many times the value of a dental practice is based on an analysis described as the "capitalization of earnings." Simply put, the net earnings of the practice are applied to a "cap rate" in order to ascertain the value of the dental practice. For example, if the dental practice has "net earnings" of \$100,000 and a 25% cap rate is applied, the practice has a fair market value of \$400,000.

Some courts have ruled that this analysis of valuing a closely held business is actually "doubling up" the practice's earnings. Specifically, if the "net earnings" of a practice are used in order to determine the value of the practice for purposes of the property settlement, and the same "net earnings" are used in order to determine the proper amount of spousal maintenance, some courts have determined that there is a redundancy of these same economic factors (see *Lowe vs. Lowe* and *Sweere vs. Gilbert-Sweere*). According to these courts, it is unjust to use the dental practice's "net earnings" to determine the practice value, or the amount of spousal maintenance. The court's reasoning is that a doctor's compensation is the barometer used to ascertain spousal maintenance, and thus the same barometer should not be used for purposes of the practice's "fair market value."

Although the two theories alluded to in this article have been tested, they certainly are not a panacea to all troubles related to marriage dissolution. Moreover, like so many things in the law, they are not ironclad and are certainly subject to extenuating circumstances. Nevertheless, they may be useful in order to lessen the severe economic impact of marriage dissolution. **DE**

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