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First: The Ubiquitous Disclaimer

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**NO SINGLE SET OF LEGAL
RULES CAN EVER CAPTURE
THE EVER CHANGING
COMPLEXITY OF HUMAN LIFE.**

Supreme Court Justice
Stephen Breyer

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**Roles, Goals
& Polls**

- **Roles:**
 - This topic gets complicated. All of us are smarter than any of us, so please join us in a discussion of asset & debt classification in marital dissolution.
- **Goals:**
 - Review relevant sections of Virginia Code, as amended;
 - Explore options to identify and quantify separate & marital contributions of property;
 - Work through “real-life” fact patterns to understand how different approaches are applied.
- **Polls:**
 - Stimulate discussion (and earn CPE credit).

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Equitable Distribution in Virginia: It's Simple



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Poll #1:

Facts:

- ❖ 1/1967: "A" purchased a home using the \$20,000 inheritance received from Grandma the prior year.
- ❖ 3/1967: "A" and "B" marry.
- ❖ The couple used earnings during the marriage to maintain the home and make basic improvements.
- ❖ The Parties separated in 1985, without debt on the marital home.

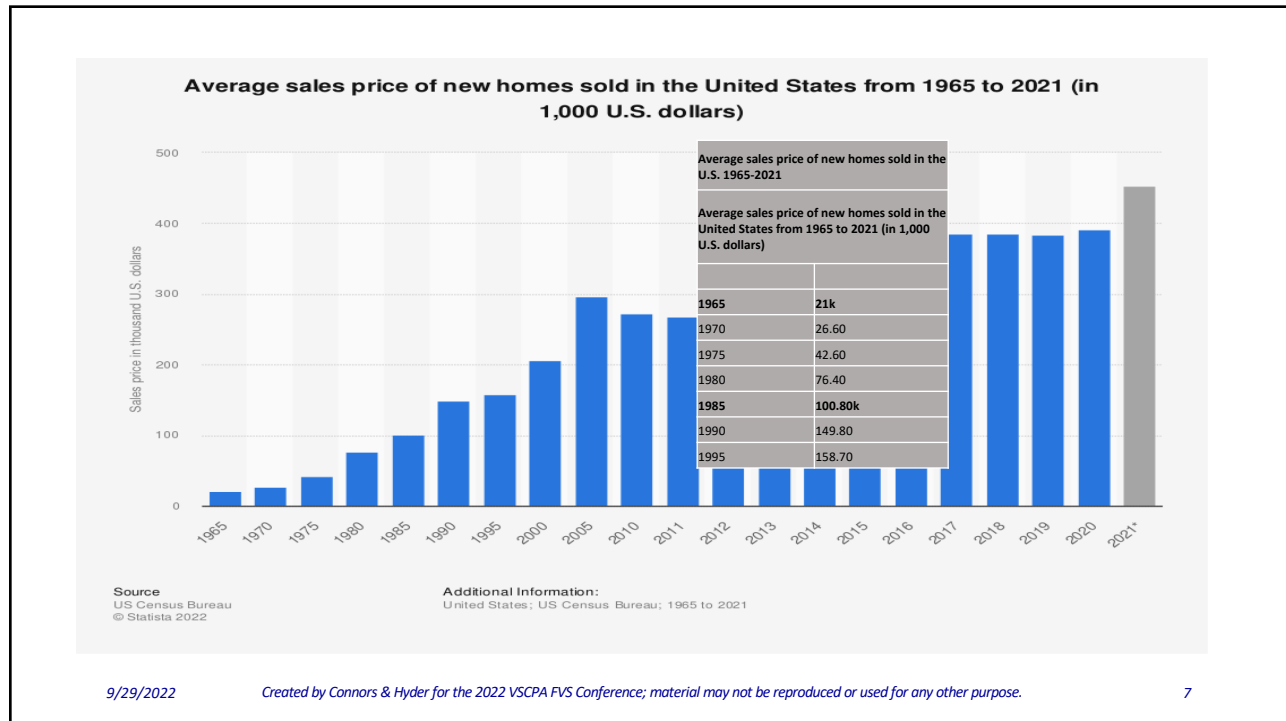
Question: What percentage of equity is marital?

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Kate – Poll #1

Question: What percentage of equity is marital?

- A: 0%
- B: 50%
- C: 75%
- D: 100%

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How did A's use
of the
inheritance
for the
home purchase
impact "B"?

| | |
|--------------------------|------------|
| DOM (Date of marriage) | Mar-67 |
| DOS (Date of separation) | Jan-85 |
| DOT (Date of trial) | Sep-85 |
| Purchase Price | \$ 20,000 |
| Current FMV | \$ 100,800 |

| Contributions | Party A | Party B | Marital | Total |
|-------------------------------|------------------|-------------|-------------|------------------|
| Before Marriage - Inheritance | \$ 20,000 | \$ - | \$ - | \$ 20,000 |
| Total | \$ 20,000 | \$ - | \$ - | \$ 20,000 |

| | Party A Separate | Party B | Marital | Total |
|--------------------|---------------------|---------|---------|-------|
| Hypothetical split | 100% | 0% | 0% | 100% |

| | Party A | Party B | Total |
|-------------------------------------|----------------------|--------------|----------------------|
| Hypothetical split of current value | \$ 100,800 100.0% | \$ - 0.0% | \$ 100,800 100.0% |

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Smoot & Its Progeny: Conflict in the Courts?

- Smoot (1987): Any increase in separate property is considered separate, for ED purposes.
- Lambert(1988): Any increase in value based on *active* efforts of either spouse transmutes the separate property into marital. Even if the amount commingled was immaterial.
- Ellington(1989): Active appreciation due to efforts of non-owning spouse requires the Court *to consider* whether these efforts were sufficient to convert the separate property to marital.
 - ❖ Ellington Appellate Court reversed the Trial Court's pre-Smoot result, and found appreciation was marital.

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VA Code §20-107.3A (effective July 1, 1990):

“... the court, upon request of either party, (i) shall determine ... the ownership and value of all property, real or personal, tangible or intangible, of the parties and shall consider which of such property is separate ..., marital ... , and which is part separate and part marital property in accordance with subdivision A 3 ...”

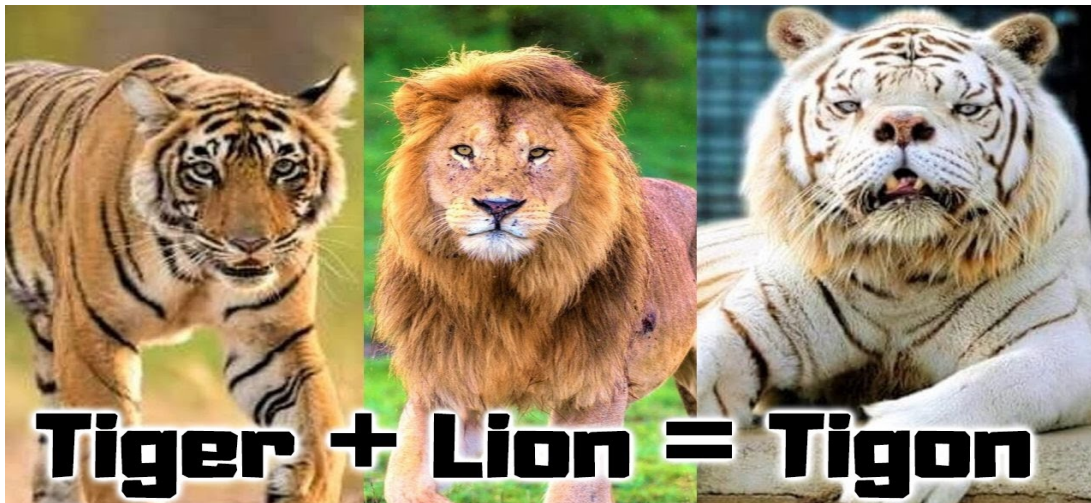
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Part This & Part That



<https://i.ytimg.com/vi/UNJRZ6r3ZhM/maxresdefault.jpg>

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Mixed Property: New Words!

➤ Commingle (verb)

- ❖ “to blend thoroughly into a harmonious whole”
- ❖ “to combine .. into a common fund or stock”

<https://www.merriam-webster.com/dictionary/commingle>

➤ Transmute (verb)

- ❖ “change or alter in form, appearance, or nature .. to a higher form”

<https://www.merriam-webster.com/dictionary/transmute>

➤ Hybrid (adjective)

- ❖ “having or produced by a combination of two or more distinct elements: marked by heterogeneity in origin, composition, or appearance”

<https://www.merriam-webster.com/dictionary/transmute>

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Mixed Property: New Concepts!

➤ Contributions to net worth may be positive or negative

- ❖ Change in FMV: Passage of time or extra-ordinary efforts
- ❖ Decrease in debt: Pay-down of mortgage
- ❖ Increase in debt: How were funds used
- ❖ Use of marital assets for non-marital purpose
- ❖ Other contributions: fact specific

➤ “Preponderance of the Evidence”

- ❖ Direct Evidence: Documents or anecdotal
- ❖ Reliable, credible & convincing inferential support

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Separate Property - VA Code §20-107.3A 1

- Acquired by either party prior to marriage
- Acquired during marriage, and
 - ❖ Received by inheritance or gift
 - ❖ In exchange for other property previously designated Separate
 - ❖ In exchange for proceeds from the sale of Separate property
 - ❖ Income attributed to the property, neither party's personal efforts
- Identified based on a credible analysis of available facts

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Marital Property - VA Code §20-107.3A 2

- Property acquired during marriage is presumed marital
 - ❖ Rebuttable presumption: source of funds
 - ❖ Rebuttable presumption: “contemporaneous intent”
 - ❖ Other Property Identified as Marital: *
 - ❖ “Hopelessly commingled”
 - ❖ Separate property retitled into joint names of the parties
 - ❖ Newly acquired property conveyed into joint ownership
- Identified based on a credible analysis of available facts
 - * No presumptive gifts, by statute (rebuttable)

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Mixed Property - VA Code §20-107.3A 3+

➤ Property is part marital / part separate **if:**

- ❖ One type of property is applied to acquire or enhance property of the other category; or
- ❖ Either spouse applies their personal efforts to separate property (owned by one spouse), and:
 - ✓ “Effort” is beyond what is considered routine, and
 - ✓ A significant increase in value results

*** Income received in respect of that property as a result of those efforts is marital*



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Mixed Property - VA Code §20-107.3A 3+

➤ When marital and separate property are both used to acquire property, the newly acquired property transmutes to marital.. *

- ❖ Separate property retitled into joint names transmutes to marital
- ❖ If each spouse's separate property commingles with the other is used to acquire new property, the only relief is “reimbursement” from the marital estate

** Exception: transactions / contributions which are not a gift & are retraceable by a preponderance of the evidence will retain the subject property's original classification*

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Equitable Distribution in Virginia: Is it Simple?

“The concept of hybrid property presupposes that separate property has not been segregated but rather, combined with marital property.”

- The absence of a segregation requirement does not cause property outside the marital estate to be classified as “separate” for equitable distribution purposes.
- “This Court has not yet established standards for tracing under the amended statute. On this issue, we are guided by both the language of the statute and principles developed in our sister states.”

Rahbaran v. Rahbaran, 26 Va. App. 195, 494 SE 2d 135 (1997)

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Equitable Distribution in Virginia: Is it Simple?

“In order to trace the separate portion of hybrid property, a party must prove ... (their assertion and the separate) portion is *identifiably derived* from a separate asset. This process involves two steps ... :

- (1) Establish(ing) the identity of a portion of hybrid property, and
- (2) Directly trace that portion to a separate asset.”

Rahbaran v. Rahbaran, 26 Va. App. 195, 494 SE 2d 135 (1997) (Emphasis added)

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Equitable Distribution in Virginia: Is it Simple?

- “Proving the classification ... requires an examination of where the withdrawn funds went, when and why they were transferred, for what purpose they may have been ultimately used, as well as what *contemporaneous* financial records show about each.”
 - ❖ “The whole point of tracing is to determine whether the owner of separate property has truly kept that property separate. This necessarily requires a focus on ‘*contemporaneous intent*’.”

Robbins v. Robbins, Court of Appeals of Virginia, Chesapeake. Record 2333-05-1, decided August 1, 2006 (emphasis added)

Retrieved from <https://caselaw.findlaw.com/va-court-of-appeals/1363149.html>

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Burdens of Proof: Asserting an Interest

- Rebuttable Presumptions:
 - ❖ Property appearing “Marital” may be Separate, if there is support for the carve-out
 - ❖ Separate property is presumed “separate” absent proof of:
 - ✓ “Marital contribution” – burden on non-owning spouse to prove
 - ✓ “Significant” personal effort directly related to “substantial” appreciation
 - ✓ Owning spouse will need to refute the causal relationship asserted



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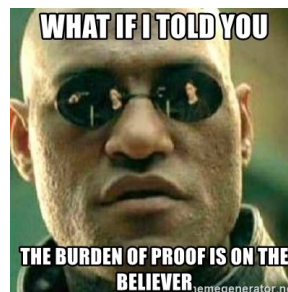
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Burdens of Proof: Asserting an Interest

➤ Criteria: “Preponderance of the Evidence”

- ❖ Party bearing the burden of proof must present evidence which is more credible and convincing than offered by the other party
 - ✓ Package
 - ✓ Production
 - ✓ Persuasion
- ❖ At least 51% likely the assertions are accurate
 - ✓ This is the lowest “standard of proof” available
- ❖ Higher standards of proof exist:
 - ✓ Probable: “Clear & convincing”
 - ✓ Most definitely: Beyond a reasonable doubt



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Contemporaneous Intent: Evidence

➤ Direct Evidence:

- ❖ Withdrawal from A's pre-marital investment account, \$600,000.
- ❖ Email, one week later: “I bought you a horse ranch.”
- ❖ Acquisition documents: Ranch was purchased & is titled in B's name.

➤ Circumstantial (Indirect) Evidence:

- ❖ A received an inheritance from her great uncle, 10 years ago.
- ❖ The only withdrawals since inheritance are account management fees
- ❖ 10/10/2021 withdrawal, \$600,000 (no information where it went)
- ❖ Closing documents dated 10/11/21 reflect B owns the ranch

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Anecdotal Evidence: Caution

Objection!- Hearsay

- Hearsay is not usually allowed as evidence.
- Hearsay is something a witness may have heard about, but did not hear or see firsthand.
- Example: In a case about missing apples, a witness testifies, "A neighbor told me that Kim was hanging around the apple tree."
- The opposing lawyer objects that the statement is hearsay.
- The witness did not actually see Kim near the apple tree.



<https://image1.slideserve.com/1940038/objection-hearsay-l.jpg>

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Poll #2:
What portion
of equity
is marital,
if DOS
was 1995?

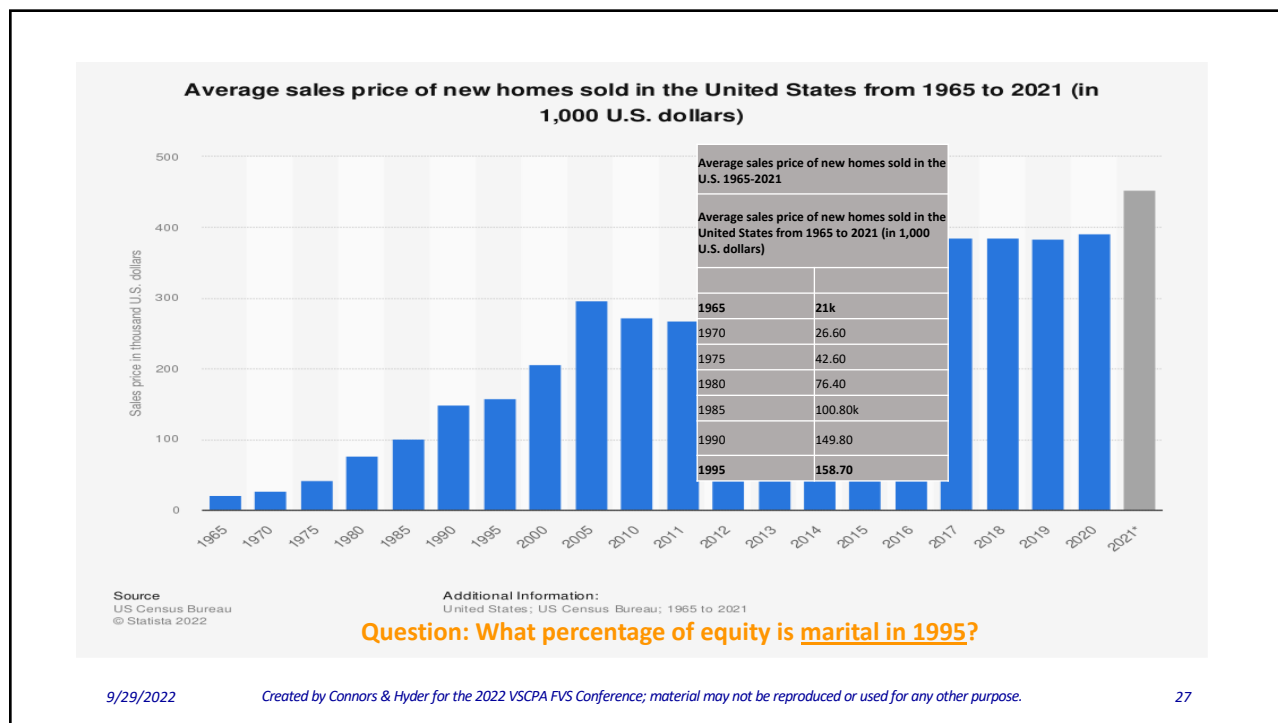
- Parties married in 1967, separated in 1995 & "A" filed for divorce in Fairfax County, 1996.
- The couple lived in a home purchased with a \$20,000 inheritance "A" received in 1968.
- Their current earnings were used to pay for improvements to the home during the marriage & totaled \$10,000.
- The Parties never incurred debt on the home they lived in for almost 30 years and was now worth about \$160,000

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Kate – Poll #2

Question: Approximately what percentage of equity is marital?

- A: 0%
- B: 33%
- C: 67%
- D: 100%

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What portion of equity is marital, if DOS was 1995?

DOM (Date of marriage)
DOS (Date of separation)
DOT (Date of trial)

Purchase Price
Current FMV

Contributions

Hypothetical split

Hypothetical split of current value

Mar-67
Jan-95
Sep-97

\$ 20,000
\$ 158,700

| | Party A | Party B | Marital | Total |
|--------------------------------|-----------|---------|-----------|-----------|
| During Marriage - Inheritance | \$ 20,000 | \$ - | \$ - | \$ 20,000 |
| During Marriage - Improvements | \$ - | \$ - | \$ 10,000 | \$ 10,000 |
| Total | \$ 20,000 | \$ - | \$ 10,000 | \$ 30,000 |

| | Party A Separate | Party B | Marital | Total |
|--------------------|---------------------|---------|---------|-------|
| Hypothetical split | 67% | 0% | 33% | 100% |


| | Party A | Party B | Total |
|-------------------------------------|---------------------|--------------------|----------------------|
| Hypothetical split of current value | \$ 132,250 83.3% | \$ 26,450 16.7% | \$ 158,700 100.0% |

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Equitable Distribution in Virginia: Is it Simple?



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Eyes on the Prize: It Should be Simple

- Judges & Lawyers:
 - ❖ “I need information before I can make a decision”
 - ❖ “VA Code (as amended) doesn’t provide explicit direction – yikes!”
- “Traditional” Accountants:
 - ❖ “What did we do last year?”
 - ❖ “Let’s look at the tax returns and use those numbers!”
- Financial Expert Witnesses:
 - ❖ FRE 702: Experts apply specialized skills or knowledge to assist the trier of fact in ascertaining relevant information.
 - ❖ Kumho Tire: Admissible expert testimony must also be reliable & derived using the same “intellectual rigor” as in general practice.
 - ✓ “Within a reasonable degree of (accounting) certainty.”

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Poll Question #3:



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Kate: Poll Question 3

Can marital property be transmuted to separate, legally?

- A. Yes, by re-titling into one party's name
- B. Yes, by thinking about it
- C. No, because marital gifts are a fiction in divorce
- D. No, because it makes no sense

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Come to the dark side, join us:



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Hybrid Property: Common Scenarios

- Acquisition of Assets via Contributed Property
 - ❖ Liquid Assets
 - ❖ Real Property
 - ❖ Business Interests
 - ❖ Retirement Assets
- Appreciation (depreciation)
 - ❖ Assets owned prior to marriage
 - ❖ Assets acquired during the marriage
- Other hybrid property

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Measuring Hybrid Property: Directly

- Direct Identification
 - ❖ Identify marital and separate contributions, then “the court can compute the ratio and trace both interests.”
Rahbaran v. Rahbaran, 26 Va. App. 195, 494 SE 2d 135 (1997)
 - ❖ Fact-Specific Recapitulation May Involve:
 - ✓ “Net” contributions & withdrawals of marital / separate property, by year
 - ✓ “Clearinghouse” approach (specific deposit matched to withdrawals)
 - ✓ “Equivalence in time and amount”
 - ✓ “Net Balance” approach

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Measuring Hybrid Property: Indirectly

- “Multiple-Source, Multiple-Destination Model”
 - ❖ Uses *circumstantial* evidence to demonstrate separate intent
 - ❖ Non-speculative inferences are able to be drawn if:
 - ✓ Rational nexus between circumstances & inferences,
 - ✓ Ability to identify nature of deposits and withdrawals
- “Reasonable Rate of Return”
 - ❖ Recognizes use of separate property in lieu of investing
 - ❖ Considers both upticks and downturns in market

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Measuring Hybrid Property: Causation

- Net Assets = Total Acquired + Appreciation
 - ❖ Acquisition as Marital, Separate or “Mixed” Property
 - ❖ Appreciation of each can be active, passive or both
 - ❖ Follow the “Why”:
 - ✓ Efforts of the parties during marriage
 - ✓ Efforts of third parties before, during, after marriage
 - ✓ Opportunities available
 - ✓ Market forces are outside of control:
 - Inflation
 - Industry changes
 - Regulation

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Measuring Hybrid Property: Causation

- Qualitative
 - ❖ “Factors analysis”
 - ❖ “Professional judgement”
- Quantitative
 - ❖ With / without
 - ❖ Individual excess earnings
 - ❖ Toolkit for passive appreciation: Dr. Ashok Abbott, MBA PhD
 - ✓ Business Valuation Update, June 2022
 - ❖ Rate & Flow Analysis: Mercer

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Abbott's Toolkit Example: Part 1

Table 1: Full-Service Restaurant Industry Market Value

| Year | 1992 | 2019 |
|--|----------|----------|
| Free cash flows (in billions) | \$8.62 | \$33.43 |
| WACC | 12% | 12% |
| Growth rate | 5.15% | 5.15% |
| Market value (in billions) | \$132.32 | \$513.16 |
| Total growth in market value (in billions) | | \$380.84 |

*Market value = free cash flows * (1 + growth rate)/(WACC - growth rate)*

Abbott, Ashok MBA, Ph.D.; *Market Forces and Business Value: Measuring Passive Appreciation in Divorce Valuations, The Value Examiner (NACVA)*, November-December 2021. (Used with Permission)

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Abbott's Toolkit Example: Part 2

Table 2: Growth Rates for Market Forces

| Market Force | Geometric Average Annual Growth Rate 1992-2019 | Estimated Factor Elasticity | Revenue Growth Impact Per Factor |
|-------------------------------------|--|-----------------------------|----------------------------------|
| Population level 25-54 | 0.54% | 1.4959 | 0.80% |
| Population level 55-plus | 2.35% | 0.5612 | 1.32% |
| Real personal income per capita | 1.62% | 1.0073 | 1.63% |
| Compound annual passive growth rate | | | 3.75% |

Source: *Federal Reserve Bank of St. Louis*.
Abbott, Ashok MBA, Ph.D.; *Market Forces and Business Value: Measuring Passive Appreciation in Divorce Valuations*, *The Value Examiner (NACVA)*, November-December 2021. (Used with Permission)

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Abbott's Toolkit Example: Part 3

Table 3: Passive Appreciation

| | | Total Growth | Passive Growth only |
|--|----------|--------------|---------------------|
| Year | 1992 | 2019 | 2019 |
| Free cash flows (in billions) | \$8.62 | \$33.43 | \$23.31 |
| WACC | 12% | 12% | 12% |
| Growth rate | 5.15% | 5.15% | 5.15% |
| Market value (in billions) | \$132.32 | \$513.16 | \$357.76 |
| Total increase in market value (in billions) | | \$380.84 | |
| Passive increase in market value (in billions) | | | \$225.44 |
| Passive growth fraction | | | 59.19% |

Abbott, Ashok MBA, Ph.D.; *Market Forces and Business Value: Measuring Passive Appreciation in Divorce Valuations*, *The Value Examiner (NACVA)*, November-December 2021. (Used with Permission)

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Kate: Poll Question 4

True or False:

Interest paid on acquisition indebtedness should always be considered when determining marital and non-marital contributions to the marital estate.

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Part-Separate, Part Marital Contributions to Equity:

“This Court has not yet established standards for tracing under the amended statute. On this issue, we are guided by both the language of the statute and principles developed in our sister states.”

Rahbaran v. Rahbaran, 26 Va. App. 195, 494 SE 2d 135 (1997)

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Part-Separate, Part Marital Contributions to Equity:

- **Newman v. Newman**, Ky., 597 S.W.2d 137 (1980)
 - ❖ The interests of the parties were "the same percentages as their respective contributions to the total equity in the property."
- **Brandenburg v. Brandenburg**, Ky. 617 SW 2d 871 (June 1981)
 - ❖ **Brandenburg Majority**: "We do not intend to imply by the adoption of (the Newman) formula that this Court will not approve other procedures utilized ... *as long as the relationship between the contributions of the parties is established.*" (emphasis added)
 - ❖ **Separate concurring opinion**: "... existence of such an approved formula may encourage trial courts to fail to .. exercise independent discretion .. even though the facts of the case may compel such a course. Similarly, the existence of such an approved formula may have a chilling effect upon other trial courts who may wish to exercise independent discretion and depart from the formula in a given case." (emphasis added)

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"The Brandenburg Formula"

$$\frac{\text{Separate Contributions}}{\text{Total Contributions}} \times \text{Total Equity} = \text{Separate Interest}$$

$$\frac{\text{Marital Contributions}}{\text{Total Contributions}} \times \text{Total Equity} = \text{Marital Interest}$$

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Brandenburg
Example

| | | |
|-------------------------|----|-----------|
| Purchase Price | \$ | 394,000 |
| Current FMV | \$ | 825,000 |
| Current Mortgage | \$ | (310,000) |
| Net Value Subject to ED | \$ | 515,000 |

| Using Brandenburg | | | | |
|--------------------------------------|------------|---------|----------|------------|
| Contributions | Party A | Party B | Marital | Total |
| Pre-Marital - Cash | \$ 109,000 | \$ - | \$ - | \$ 109,000 |
| During Marriage - Mortgage Reduction | \$ - | \$ - | \$ 9,000 | \$ 9,000 |
| Total | \$ 109,000 | \$ - | \$ 9,000 | \$ 118,000 |
| | 92.4% | 0.0% | 7.6% | 100.0% |

| | Party A | Party B | Marital | Total |
|---|----------|---------|---------|--------|
| | Separate | | | |
| Hypothetical split of current net value | 92.4% | 0.0% | 7.6% | 100.0% |

| | Party A | Party B | Total |
|-------------------------------------|------------|-----------|------------|
| Hypothetical split of current value | \$ 495,360 | \$ 19,640 | \$ 515,000 |
| | 96.2% | 3.8% | 100.0% |

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One Size Does
Not Fit All

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Part-Separate, Part Marital Contributions to Equity:

- **Keeling v. Keeling**, 47 Va. App. 484, 624 SE 2d 687 (Va. App. 2006)
 - ❖ Equity in home & separate contribution to equity are not disputed
 - ❖ What allocation methodology will be most equitable?
 - ✓ Comparison of each party's relative (cash) contributions
 - Inequitably benefits party contributing separate property
 - ✓ Credit separate contribution as % of acquisition cost, not current equity
 - Assume each party's obligation for debt is an indirect contribution
 - "Facts & circumstances" unique to case

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"The Keeling Formula"

$$\frac{\text{Separate Contributions}}{\text{Purchase Price}} \times \text{Total Equity} = \text{Separate Interest}$$

$$\text{Total Equity} - \text{Separate Interest} = \text{Marital Interest}$$

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Keeling Example: Facts

| | Amount | Joint | | Contribution (Cash) | |
|-------------------------------|-----------------|-------------------|-------------------|---------------------|-------------------|
| | | Property | Mortgage | Joint | H - Sep |
| Purchase Price - 1997 | \$ 394,000 | 394,000 | | | |
| Acquisition Costs (assumed) | 7,000 | 7,000 | | | |
| Mortgage | (315,000) | | 315,000 | | |
| Original Cash Outlay | <u>\$86,000</u> | <u>\$401,000</u> | <u>\$315,000</u> | <u>\$0</u> | <u>\$86,000</u> |
| Pre-Refi Principal Reduction | (3,000) | | (3,000) | | 3,000 |
| Pre-Refi Principal Reduction | (26,000) | - | (26,000) | 26,000 | |
| Add'l Principal Taken - Refi | 17,000 | - | 17,000 | (17,000) | |
| Costs of Refinance | 6,000 | | - | | 6,000 |
| Costs of Refinance | 500 | - | 500 | - | |
| DOS - 2003 | | | 303,500 | 9,000 | 95,000 |
| Post-DOS Mortgage reduction | | | (14,000) | | 14,000 |
| Other Increase in Mortgage | | | 20,500 | | |
| Increase in FMV to DOT (2004) | | 424,000 | | | |
| DOT - 2004 | | <u>\$ 825,000</u> | <u>\$ 310,000</u> | <u>\$ 9,000</u> | <u>\$ 109,000</u> |
| Equity - DOT | | | \$ 515,000 | 7.63% | 92.37% |

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Results Under Both Approaches

| | Total | Wife | Husband |
|--|-------------------|-------------------|-------------------|
| Allocation: Brandenburg | | | |
| Allocated share of Property - Marital | 7.63% | 3.81% | 3.81% |
| Allocated share of Property - Separate | 92.37% | - | 92.37% |
| | <u>100.00%</u> | <u>3.81%</u> | <u>96.19%</u> |
| Share of Equity | <u>\$ 515,000</u> | <u>\$ 20,000</u> | <u>\$ 495,000</u> |
| % of Equity | | 3.88% | 96.12% |
| Allocation: Keeling | | | |
| Property Contribution | \$ 109,000 | 0 | 109,000 |
| % of original purchase | <u>27.66%</u> | <u>0.00%</u> | <u>27.66%</u> |
| Separate Equity | 142,475 | - | 142,475 |
| Balance of Equity - Marital | <u>372,525</u> | <u>186,263</u> | <u>186,263</u> |
| Share of Equity | <u>\$ 515,000</u> | <u>\$ 186,263</u> | <u>\$ 328,737</u> |
| % of Equity | | 36.17% | 63.83% |

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Kate - Poll Question #5

Which of the following methods is your preferred approach to identify marital and separate elements of asset character?

- A. Brandenburg
- B. Keeling
- C. Regressive Python Algorithm
- D. Abagnale Identification Process

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Will Keeling Solve or Create More Problems?

... applying the Brandenburg formula, without considering the parties' joint loan **obligation** as a creditable contribution to acquiring and maintaining the property long enough to enjoy a significant increase in equity due primarily to market forces, 'would be harsh and inequitable'."

Keeling v. Keeling, 47 VA App 484, 624 S.E. 2d 687 (Docket 0913-05-4), 1/24/2006 (emphasis added)

➤ Keeling's "Perfect Storm":

- ❖ Significant down payment is sourced to Separate property
- ❖ Underlying acquisition requires joint obligation
- ❖ Appreciation is solely due to market forces
- ❖ Neither the joint obligation nor significant down payment were critical to acquisition

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Will Keeling Solve or Create More Problems?

- “A strict application of the Brandenburg formula does not take into account the extent to which the parties **are obligated** on a loan used to purchase the property; it considers only the degree to which payment on that loan reduces the loan principal, thereby resulting in the acquisition of equity, marital or nonmarital, in the property.”
- The Brandenburg formula defines ‘nonmarital contribution’ as ‘the equity in the property at the time of marriage, plus any amount expended after marriage by either spouse from **traceable** nonmarital funds in the reduction of mortgage principal, and/or the value of improvements made to the property from such nonmarital funds.’”

Keeling v. Keeling, 47 VA App 484, 624 S.E. 2d 687 (Docket 0913-05-4), 1/24/2006 (emphasis added)

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Will Keeling Solve or Create More Problems ?

“... the goal (of classifying property as marital or separate) is a fair and reasonable return rather than the application of a particular mathematic formulation. Comparison of the results of a *Brandenburg* and *Keeling* reflect proposed returns ... [n]either is reasonable under the facts of this case.”

Thomas v. Weise, 617 SE 2d. 427, 46 VA

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Kate: Poll Question 6

Do you use “black-box” software or any type of templates when analyzing transactions to identify and quantify marital and non-marital shares of an asset subject to equitable distribution?

___ Yes

___ No

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Valuation of a Closely-Held Business for ED

- What is subject to equitable distribution?
 - ❖ “Active” increase in value among relevant dates
 - ❖ Changes in ownership interests will impact marital / ED changes
 - ✓ Why & what is the source or use of funds involved?
 - ✓ Are there multiple owners?
 - ✓ Due to passive or active efforts?
 - ❖ Changes in value through “date closest to trial” are considered
 - ✓ Examine & understand what is driving (material) changes in value
 - ✓ Between DOM & DOS
 - ✓ Between DOS & DOT

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Decrease in Value After DOS – Example #1

| Selected Financial Information | | | | | | | |
|--------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| For the Twelve Months Ended, | 12/31/2017 | 12/31/2018 | 12/31/2019 | 12/31/2020 | 12/31/2021 | 5-Yr Average | 3-Yr Average |
| Revenue | \$ 6,200,000 | \$ 6,900,000 | \$ 7,700,000 | \$ 7,400,000 | \$ 7,300,000 | \$ 7,100,000 | \$ 7,466,667 |
| EBITDA | \$ 1,600,000 | \$ 1,400,000 | \$ 1,410,000 | \$ 1,750,000 | \$ (400,000) | \$ 1,152,000 | \$ 920,000 |
| % Margin | 25.8% | 20.3% | 18.3% | 23.6% | -5.5% | 16.2% | 12.3% |

| Projected Financial Information | | | | DOM | |
|---------------------------------|--------------|--------------|--------------|----------------------|--------------|
| For the Twelve Months Ending, | 12/31/2022 | 12/31/2023 | 12/31/2024 | DOS | 7/27/2003 |
| Revenue | \$ 5,250,000 | \$ 5,880,000 | \$ 6,585,600 | DOS | 7/28/2020 |
| EBITDA | \$ 670,000 | \$ 410,000 | \$ 600,000 | DOT | 5/1/2022 |
| % Margin | 12.8% | 7.0% | 9.1% | Value, based on COCF | \$ 4,600,000 |
| | | | | Value, based on DCF | \$ 2,800,000 |

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Increase in Value After DOS – Example #2

| | % As of DOS 9/30/2020 | % As of DOT 9/30/2020 | Change |
|---|--------------------------|--------------------------|-----------|
| Estimated Value of the Company (based on adjusted net assets analysis) | \$2,500,000 | \$2,500,000 | \$0 |
| Total shares of common stock outstanding | 240 | 210 | (30) |
| Per share value of common stock, on a controlling, marketable basis | \$10,417 | \$11,905 | |
| Multiplied by # of shares of common stock owned by Mr. Smith ("Subject Interest") | 166 | 166 | - |
| % Ownership | 69.2% | 79.0% | 9.9% |
| Estimated Value of Subject Interest, on a controlling, marketable basis | \$1,729,167 | \$1,976,190 | \$247,024 |
| Estimated Value of Subject Interest, on a controlling, marketable basis (rounded) | \$1,729,200 | \$1,976,200 | \$247,000 |

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Increase in Value After DOS – What if

1. In actual case – The judge based his ruling on the % ownership as of DOS rather than DOT, even though H's # of shares did not change
2. What if #1: CFO of company negotiated the stock repurchases; majority owner's role was only to suggest to minority owning CFO this would benefit them both?
3. What if #2: The stock repurchases were based on a buy/sell formula in the Bylaws. Is this increase passive?

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"I Just Need a Simple Tracing"

- A & B Marry 12/23/1985
- DCHM Brokerage Opened
 - ❖ Wedding Gifts deposited
 - ❖ 3/31/16 balance, \$1,200,000
- A's Grandmother died 3/25/16
 - ❖ \$250,000 cash 4/1/17
 - ❖ Rental Property (monetized 5/1/17)
 - ✓ \$5,000/mo 3 years
 - ✓ + 6% escalation, 3 more years
- B withdrew \$600k from DCHM to purchase a ranch, 9/1/21
- Except:
 - ❖ B forgot to mention the purchase to A
 - ❖ A found out and immediately changed the locks; B moved out
 - ❖ A filed for divorce 10/1/2022
 - ❖ Attorneys want to resolve without trial: it's not that hard.
 - ✓ A is furious and feels betrayed
 - ✓ B moved out to the ranch and really doesn't care
 - ✓ Trial scheduled for 11/15/2023

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“I Just Need a Simple Tracing”

| | | |
|-------------------------------------|-------------|----------|
| DCHM Brokerage (Jt.) as of 12/31/15 | \$1,200,000 | 98.30% |
| Inherited Funds - A's Grandma | 250,000 | } 50.85% |
| Rents Deposited - A's property | 370,800 | |
| Amount Withdrawn by B | (600,000) | -49.15% |
| Net Transactions | \$1,220,800 | |
| As of DOS Account Balance is: | \$1,750,000 | |
| As of DOT Account Balance is: | \$2,100,000 | |

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“I Just Need a Simple Tracing” – Opinion of Expert 1

Is this an equitable result?

| | | |
|--------------------------------------|-------------|--------|
| DCHM Account - Separate | \$1,068,000 | 50.85% |
| DCHM Account - Marital | 1,032,000 | 49.13% |
| DCHM Account Distribution | \$2,100,000 | |
| Ranch (Assume purchase price is FMV) | 600,000 | |
| | \$2,700,000 | |

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"I Just Need a Simple Tracing" – Opinion of Expert 2

Is this an equitable result?

| | | |
|--------------------------------------|--------------------|--------|
| DCHM Account - Separate | 620,800 | |
| DCHM Account - Separate (+ 9.5%) | 304,200 | |
| Total DCHM - Separate | \$ 925,000 | 44.05% |
| DCHM Account - Marital | 1,175,000 | 55.95% |
| Ranch (Assume purchase price is FMV) | 600,000 | |
| | <u>\$2,700,000</u> | |

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"I Just Need a Simple Tracing" – Neutral Expert

Is this an equitable result?

| | | |
|--------------------------------------|--------------------|--------|
| DCHM Account - Sep., 2017 - current | \$ 20,800 | |
| Plus: Appreciation on Sep. Balance | 219,200 | |
| DCHM Account - Separate | 240,000 | |
| Ranch (Assume purchase price is FMV) | 600,000 | |
| Separate | \$ 840,000 | 31.11% |
| DCHM Account - Marital | \$1,860,000 | 68.89% |
| | <u>\$2,700,000</u> | |

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Poll Question #6:

If this case went to trial, the likely result would be:

- A. Cash: 50/50 split, Ranch to B (Intent)
- B. Cash: 75/25 split, Ranch to A (A's inheritance)
- C. Cash + proceeds from court-ordered sale of ranch are divided equally
- D. A gets ranch, attorneys & experts get the cash

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Is This Traceable?

- All rental properties purchased prior to marriage.
- Rents were sufficient to cover expenses related to owning and maintaining each individual property.
- All income and expenses were deposited into one jointly held checking account during marriage.
- The marital residence was funded with proceeds from the sale of each rental property as well as marital savings. There is no outstanding mortgage on the marital residence.
- There are bank statements showing sale proceeds being deposited into marital checking account and these funds later being used to pay down mortgage principal and ultimately fund purchase of marital residence.
- The current FMV of the marital residence is \$1.2 million.

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Is This Traceable?

DOM: 12/5/2012
DOS: 10/3/2019

| | Property #1 - Rental | Property #2 - Rental | Property #3 - Rental | Property #4 - Rental | Property #5 - Residence |
|--|-------------------------|-------------------------|-------------------------|-------------------------|----------------------------|
| Owner | Party A | Party A | Party A | Party B | Marital |
| Date Purchased | 1/28/2004 | 10/15/1999 | 8/17/2005 | 7/9/2008 | 10/17/2017 |
| Date Sold | 2/7/2014 | 2/27/2015 | 5/17/2019 | 2/7/2017 | N/A |
| Purchase Price | \$296,000 | \$148,000 | \$202,000 | \$250,000 | \$730,000 |
| Mortgage Balance at DOM | (180,000) | (59,000) | (82,000) | (205,000) | |
| Equity at DOM - Based on purchase price | \$116,000 | \$89,000 | \$120,000 | \$45,000 | |
| Fair Market Value ("FMV") at DOM | \$216,000 | \$49,000 | \$127,000 | \$70,000 | |
| Mortgage Balance at DOM | (180,000) | (59,000) | (82,000) | (205,000) | |
| Equity at DOM - Based on FMV | \$36,000 | (\$10,000) | \$45,000 | (\$135,000) | |
| Sale Price | \$270,000 | \$99,000 | \$334,000 | \$298,000 | |
| Net Cash Proceeds From Sale | \$83,000 | \$92,000 | \$308,000 | \$286,000 | |

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Poll Question #7

Given the information provided, do you believe the nature of each property can be determined for ED purposes and, if so, would you be comfortable giving an opinion?

- A. Yes
- B. No
- C. It depends
- D. How much am I getting paid?

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It was traceable:

| Marital Checking Activity | Dates | Beginning Balance | Increase | Decrease | Ending Balance |
|-----------------------------------|-----------------|-------------------|-----------|-----------|----------------|
| Sale of Property #1 | 2/11/14 | \$15,000 | \$83,000 | - | \$98,000 |
| Mortgage Payoff House #2 | 3/11/14 | 98,000 | | (31,000) | 67,000 |
| Net Account Activity | 3/11/14-3/9/15 | 67,000 | | (50,000) | 17,000 |
| Sale of Property #2 | 3/10/15 | 17,000 | 92,000 | | 109,000 |
| Mortgage Payoff House #3 | 4/9/15 | 109,000 | | (91,000) | 18,000 |
| Net Account Activity | 4/10/15-3/8/17 | 18,000 | 184,000 | | 202,000 |
| Sale of House #4 | 3/9/17 | 202,000 | 286,000 | | 488,000 |
| Net Account Activity | 3/10/17-11/9/17 | 488,000 | 20,000 | | 508,000 |
| Downpayment - Marital Residence | 4/11/17 | 508,000 | | (392,000) | 116,000 |
| Net Account Activity | 4/12/17-6/10/19 | 116,000 | | (63,000) | 53,000 |
| Sale of House #3 | 6/11/19 | 53,000 | 308,000 | | 361,000 |
| Mortgage Payoff Marital Residence | 6/11/19 | 361,000 | (180,000) | | 181,000 |

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Poll Question #8:

How does the marital residence identify for ED purposes?

- A. Marital
- B. Separate
- C. Hybrid

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Timeline:

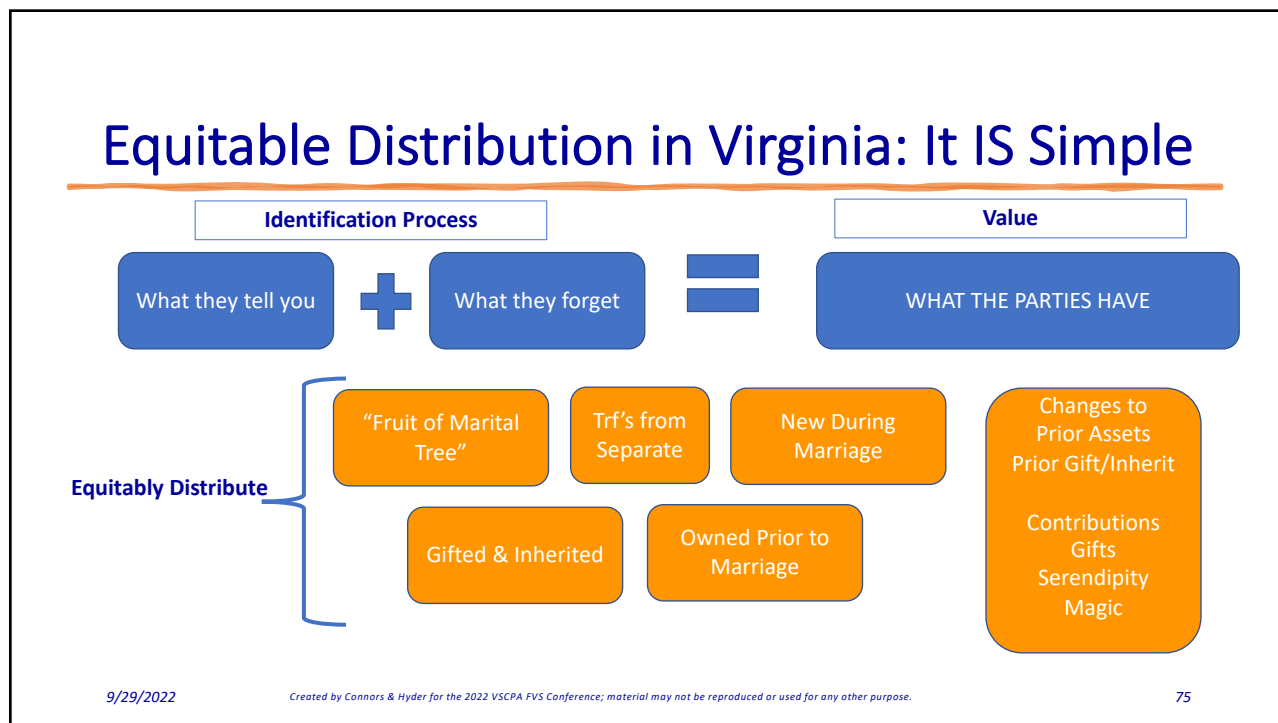
- Roger purchased UK Home for cash, 1/6/2005.
- Roger & Heather married, 5/25/2010.
- The parties purchased AUS Home, 10/1/2012, using joint savings for the down-payment and a mortgage for the balance of the purchase price (joint obligation).
- Roger transferred title to UK Home, to Heather, 9/13/13.
- Roger received money from his brother (Pete) on two separate occasions (9/1/14, 12/22/14). That money was applied to the AUS mortgage.
- Heather borrowed against the equity in the UK Home on 12/22/14; the proceeds were used to pay off the AUS Home mortgage.
- Heather & Roger purchased US Home 10/5/18, using money received from Steve, Heather's dad, for the down-payment. The related mortgage was a joint obligation of Heather's & Roger's.
- The parties separated 10/5/2018.
- Mediation Date: 11/30/2020.

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Questions? Final Thoughts to Share?

- Questions not answered during the last 100 minutes: Now
- Questions you may have later:
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