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Expert Analysis

Setting Valuation Dates for Marital Property in Global Economic Crisis

By **Allan E. Mayefsky** And **Alyssa A. Rower**

In *Wegman v. Wegman*, the Appellate Division, Second Department, discussed at length one of "'the most perplexing and difficult problems created by the equitable distribution law'—the issue of the date to be used for the valuation of marital property."[1] That decision encouraged courts to use flexibility in setting valuation dates, warning that: "in many situations a rigid rule regarding the valuation date would be undesirable." In the years since *Wegman*, however, the judicial analysis has grown consistently less flexible, to the point where courts formulaically categorize an asset as either "active" or "passive" and assign valuation dates based on that categorization.

While there are advantages to having uniformity in this difficult area of the law, the rules should not be rigidly applied so as to obviate the objectives of *Wegman*. This balance is especially important today—as we find ourselves in the midst of a global economic crisis with asset values fluctuating wildly from the date of commencement to the date of trial—in order to obtain true equity in the division of marital assets.

In *Wegman*, one of the main issues concerned setting a valuation date for the husband's business. The trial court valued the business as of the date the parties separated. The Second Department set a valuation date close to the date of trial, reasoning that the value of the business increased during the parties' cohabitation as well as post-separation. The court concluded that the rapid increase was not due to the efforts of the husband, but rather to the successful marketing of a product that was developed when the wife made substantial contributions to the parties' economic partnership. Thus, the court concluded that the wife should not be deprived of a share of the wealth eventually generated by the product.

ALLAN E. MAYEFSKY *is the managing partner of Sheresky Aronson Mayefsky & Sloan.* ALYSSA A. ROWER *is an associate at the firm.* NORMAN SHERESKY, LARRY TRACHTENBERG *and* JOHN KORNFELD, *partners of the firm, provided editing and guidance for this article.*

Wegman emphasized the importance of a trial court's discretion in selecting a valuation date on an asset-by-asset basis in light of the particular circumstances presented in each individual case. The court scratched below the surface and engaged in real analysis to set the valuation date instead of mechanically prescribing the valuation date based on the business' categorization as an actively managed asset.

After *Wegman*, trial and appellate courts, perhaps in an effort to create consistency and order, began categorizing assets as either "active" or "passive" and setting valuation dates based on this categorization—most often a date of commencement of the action for "active" assets, whose values are affected by the active participation of the title spouse, and a date of trial for "passive" assets, whose values are affected by outside influences such as inflation or market forces.

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Although courts have conjoined their adherence to the "active/passive" rule with the warning that it is not "absolute" and should not be applied "rigidly," courts after *Wegman* have often done just that: categorize an asset as either "active" or "passive" and then mechanically set a valuation date, without delving into a detailed discussion of the reason for the increase or decrease in the value of the asset. For example, in 2002, in *Ferraioli v. Ferraioli*, the First Department held that the trial court erred in valuing a securities account as of the date of trial when it was an "active" asset, disregarding the fact that "the overall stock market declined."[2] In *Fox v. Fox*, after determining that the husband's law practice was an "active" asset, the court refused to examine post-commencement events, concluding that any changes after the date of commencement "were not the result of economic or market forces outside defendant's control."[3] A similar result was reached in *Lipovsky v. Lipovsky*.[4]

Other Analyses Used

In some cases, circumstances have led courts to use a date other than the date of commencement or the date of trial. For example, the First Department departed from the "active/passive" formulation in 1991 in *Smerling v. Smerling* when it valued a movie chain as of the date of sale, as opposed to the date of commencement or the date of trial.[5] The Second Department took market forces into account in 1998 in *Sagarin v. Sagarin*, holding that the trial court did not improperly exercise its discretion in selecting the date of trial as the valuation date for the husband's (active) business when "adverse economic forces outside of the husband's control caused the decline in the value of the corporation"[6]

In 2005, in *Naimollah v. De Ugarte*, the First Department concluded that a securities account managed by the wife's broker constituted an "active" asset, but nonetheless considered a $69,420.54 "passive" decline in value when distributing the account.[7] The First Department did not distinguish its decision in *Naimollah* from its decision in *Ferraioli*, however, making it difficult to discern whether the First Department's decision in *Naimollah* represents an evolution in the law regarding valuation dates or just a different view by a different panel of judges.

Perhaps the best known departure from the "active/passive" rule took place in the Court of Appeals' decision in 1995 in *McSparron v. McSparron*. In selecting a valuation date for the husband's law license, the court held that, despite the license's classification as an "active" asset, post-commencement

events—most notably, the wife's sabotage of her husband's career—could be taken into account when setting a valuation date. The Court warned that the "active/passive" distinction "may prove too rigid to be useful in particular cases" and "they [the rules] should be regarded only as helpful guideposts and not as immutable rules of law."[8] Despite the *McSparron* court's admonition, however, and despite the exceptions to the general rule cited above, "the Appellate Division and the Trial Courts continue to regularly turn to the active/passive analysis in determining the most appropriate valuation dates for assets."[9]

Problems With Rigidity

The obvious weakness with the "active/passive" analysis is that it takes courts away from an individualized, case-by-case analysis and toward a rigid, inflexible approach that ceases to produce equitable results when economic conditions change. As Ralph Waldo Emerson has written, "A foolish consistency is the hobgoblin of little minds." There is growing evidence that bubbles and crashes are not anomalous and a steady legal framework is needed. Between 1945 and 2001, the average business cycle, the periodic but irregular up and down movement in economic activity, was a little over 5.5 years. Therefore, a New York divorce that often takes more than two or three years is likely to overlap a major shift in the economy. A rule that disregards business cycles and assumes that the rise and fall in the value of "active" assets is always caused by the efforts of one spouse is simply untenable.

This rigidity is especially problematic today—in the midst of what is universally recognized as a global economic crisis. For example, there are numerous cases in New York that were commenced prior to the recent economic downturn and are currently going to trial. Many of those cases involve traditionally "active" assets whose values have plummeted due to market forces. A pivotal question in these cases is whether these "active" assets should be valued as of the date of commencement or the date of trial. If courts refuse to look past the "active/passive" categorization as the *Fox* and *Lipovsky* courts did or make that categorization carefully, the asset would be valued as of the date of commencement, resulting in a windfall to the non-titled spouse and severe inequity to the titled spouse.

Another problem with the "active/passive" rule is that it encourages courts to put the asset into one box—an "active" box or a "passive" box. This approach disregards the fact that an asset often has both "active" and "passive" characteristics. For example, an asset is often both managed by a spouse and influenced by external forces. How much exposure to market forces does an asset have to have before it morphs from "active" into "passive"? Conversely, how much of a role does the titled spouse have to take before an asset morphs from "passive" into "active"? While securities accounts are generally considered "passive" assets, the First Department has held that, when these accounts are managed by a spouse, they become "active" assets, changing the valuation date.

There are advantages, however, to having rules in place to guide courts and litigants in this perplexing and complicated area of the law. There are reasons why the "active/passive" formulation arose in the first place—it streamlines and simplifies the process, reduces discovery costs, and provides predictability. Without guideposts, an area of the law "fraught with confusion" could become even more confusing, inconsistent, and unpredictable.

Alternative Approaches?

Where then, does that leave courts struggling to set valuation dates in the current economic climate? One approach that is not a huge departure from the current rule is to keep the "active/passive" classification system but with a re-emphasis on flexibility and an individualized case-by-case analysis. To depart from the "active/passive" formulation, the spouse seeking to have a different valuation date would have to make a prima facie showing that forces outside of his or her control caused the decrease in value of the asset. The burden of proof would then shift to the non-owner spouse to provide evidence that there was some other cause for the change in value. This guidepost, however, does not address the underlying problems with the "active/passive" rule.

Another potential guidepost is to use a date of trial valuation for all assets. Frequent commentator, Leonard Florescue, has argued that a date of trial valuation makes the most sense for all assets.[10] While this provides consistency and predictability, there are several downsides. First, it trades one rigid rule for a different rigid rule. Second, it does not allow for the situation when a post-commencement decline or increase in an asset's value is truly due to the efforts of the titled spouse. Third, litigants could seek to delay the proceedings in order to manipulate the valuation date.

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Alternatively, courts could cease categorizing assets as either "active" or "passive" and look instead at whether the change in value of the asset was "active," "passive" or a combination of both. This would involve expert valuations as of the date of commencement and the date of trial and then providing evidence or utilizing experts to evaluate the cause of the increase or decrease. For example, a spouse could have an ownership interest in a business (a typically "active" asset) where he or she does not formulate strategy or manage the business. Evidence of this spouse's role in the business would likely reveal that this spouse is not responsible for the fluctuations in value and that the change in value is actually outside his or her control.

Further, comparing the decline in the value of the business with the values of comparable businesses during the same time period would reveal whether the decline was the result of market fluctuations. The downside to this approach, however, is the added expense and resources it takes to perform these types of analyses and the difficulty of pinpointing data for a continually moving target—the market continues to fluctuate over the course of a trial that could span many months.

Conclusion

In conclusion, there does not seem to be one "perfect" approach that addresses all of the problems and still allows for equitable valuations under all circumstances. As the *Wegman* court stated, while guideposts are helpful in aiding courts and litigants, there can be no "rule" mandating a particular valuation date. Courts must exhibit discretion and fairness in setting valuation dates. It is not reasonable to hold one spouse responsible for the decline in a variable asset in the midst of the global economic crisis, just as it is not reasonable to give a non-titled spouse a share of post-commencement increase in the value of an asset when there is clear evidence that the titled spouse independently caused that increase. Each case and each asset will present unique and interesting problems that call for a studied and individualized solution.

1. 123 A.D.2d 220, 230 (2d Dept. 1987).
2. 295 A.D.2d 268, 270 (1st Dept. 2002).
3. 309 A.D.2d at 908-99.
4. NYLJ, Feb. 27. 1998, p. 30 (Sup. Ct. Kings 1998).
5. 177 A.D.2d 429, 430 (1st Dept. 1991).
6. 251 A.D.2d 396, 396 (2d Dept. 1998).
7. 18 A.D.3d 268, 270 (1st Dept. 2005).
8. 87 N.Y.2d 275, 287 (1995).
9. *Mahoney-Buntzman v. Buntzman*, 11 Misc.3d 869, 878 fn. 3 (Sup. Ct. 2006), affirmed in part and modified in part, 51 A.D.3d 732 (2d Dept. 2008), modified and remitted by *Mahoney-Buntzman v. Buntzman*, 12 N.Y.3d 415 (May 7, 2009).
10. See Leonard G. Florescue, "'Waste' Doctrine and So-Called 'Active/Passive Dichotomy,'" NYLJ, July 12, 2006.

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