

# The Business of Relationships

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# Premarital Agreements Are Your Friend

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- As individuals and business owners, alike, often premarital, prenuptial, or antenuptial agreements are frowned upon.
- “Why get married if you are planning for the end?”
- I don’t subscribe to this characterization. But taking this premise to its logical conclusion,
  - why have medical insurance if you are healthy?
  - Car insurance, etc.

# Tailored Agreements

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- Premarital Agreements may be specifically tailored to provide as much or as little “protection” as the couple deems necessary.
- DC, MD, and VA each permit premarital agreements
  - DC and VA court’s enforce premarital agreement pursuant to the applicable statute
  - MD court’s reviews premarital agreements under the objective law of contract interpretation.



# Requirements for Validity

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- (1) In writing and signed by both parties;
  - MD doesn't specifically require that it be written but to comply with applicable contract law should be.
- (2) Voluntarily executed;
- (3) Not unconscionable when executed; (4) Either fair and reasonable disclosure of the property or financial obligations of the other party, voluntary and express written waiver of right to disclosure beyond that provided, or adequate knowledge of the property or financial obligations of the other party.

# Factors to Consider

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- Before the marriage is a great time to think about what you want your life to look like after the marriage.
  - Do you already own a business?
  - Is it successful?
  - Is it your sole source of income?
  - Are you looking to grow the business during the marriage?
  - Do you want it to remain a separate asset?



# Post Marital Agreements

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- Another opportunity to determine how your marital assets are divided is after marriage.
- Can be in a Marital Settlement Agreement resulting in divorce, of course
- Or in a Post Marital Agreement, wherein the parties plan to remain married afterward.
  - A great tool when you hit a rough patch in a marriage or things change such that the parties want to lay the groundwork for what may come in the future.

# Premarital Business Interest

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- Like other assets that you own prior to the date of marriage, a business interest you own prior to the marriage *may* remain your separate property, in some circumstances.
- In almost all circumstances – except as otherwise highlighted herein- the income therefrom, if used during the marriage will be considered for alimony and spousal support calculations.



# District of Columbia

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- Separate Property / non-marital
  - (a) Acquired before marriage or domestic partnership;
  - (b) Acquired by gift, bequest, devise, or descent;
  - (c) Excluded by valid antenuptial or postnuptial agreement;
  - (d) Any increase thereof, or property acquired in exchange therefor.
  
- D.C. Code § 16-910(a).



## DC cont.

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- Increases in value of separate property may also be separate.
  - *See* D.C. Code § 16-910(a) and *McDiarmid v. McDiarmid*, 649 A.2d 810 (D.C. 1994).

# Maryland

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- Property –
  - (a) Acquired before marriage;
  - (b) Acquired by inheritance or gift from a third party,
  - (c) Excluded by valid agreement; or
  - (d) Directly traceable to any of these sources.

Md. Code Ann., Fam. Law § 8- 201(e)(3).



## MD cont.

Increase from or increase in the value of separate property

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- *Active vs. passive approach.*
- **Where the efforts of a spouse during the marriage contribute to the increase, that increase in value for even a nonmarital asset is marital property.**
- “Active” participation cannot be “too tenuous and speculative.”  
Schweizer v. Schweizer, 462 A.2d 562 (Md. 1983).
- **Passive income from separate property is not marital property.**

# Virginia

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- Property -
  - (a) Acquired before marriage;
  - (b) Acquired by bequest, devise, descent, survivorship or gift from a source other than the other party;
  - (c) Acquired during the marriage in exchange for or from proceeds of sale of separate property, provided that such property acquired during the marriage is maintained as separate property;
  - (d) That part of property classified as separate pursuant to Va.'s dual classification amendments.

Va. Code Ann. § 20-107.3 (A)(1)



## VA cont.

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- Income from or increase in value of separate property during the marriage is separate property;
- it is only marital property to the extent that **significant personal efforts** resulted in such income or increase. Va. Code Ann. § 20- 107.3(A)(3)(a).
- Where separate property is **commingled** but traceable, an increase in value is presumed proportionately separate unless non-owning spouse proves that the increase in value was a result of personal effort or contributions from marital property. *Martin v. Martin*, 501 S.E.2d 450 (Va. Ct. App. 1998).
- For property to be hybrid, value must be generated by significant personal effort; amount of funds or effort expended are not dispositive. *See Moran v. Moran*, 512 S.E.2d 834 (Va. Ct. App. 1999).

# Marital Property

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- DC, MD, and VA are each equitable distribution jurisdictions.
  - The courts of each jurisdiction will weigh the equities of several factors enumerated by Statute to arrive as an equitable division of marital property.
  - Each jurisdiction has similar factors
  - Equitable does not mean EQUAL.
  - What is fair?



# District of Columbia

## Equitable Distribution

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- D.C. Code § 16-910(b):  
Court shall value and distribute all property and debt in a manner that is equitable, just, and reasonable, after considering all relevant factors, including, but not limited to:
- (1) the duration of the marriage or domestic partnership;
- (2) the age, health, occupation, amount, and sources of income, vocational skills, employability, assets, debts, and needs of each of the parties;
- (3) provisions for the custody of minor children;
- (4) whether the distribution is in lieu of or in addition to alimony;
- (5) each party's obligation from a prior marriage, a prior domestic partnership, or for other children;
- (6) the opportunity of each party for future acquisition of assets and income;
- (7) each party's contribution as a homemaker or otherwise to the family unit;

# District of Columbia

## Classification of Marital Property

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- All property and debt accumulated during the marriage or domestic partnership (other than defined separate property) that has not been addressed in a valid antenuptial or postnuptial agreement or a decree of separation, **regardless of whether title is held individually** or by the parties in a form of joint tenancy or tenancy by the entireties. D.C. Code § 16-910(b).
- Jointly titled property is marital property even though a percentage of the jointly titled property was purchased with proceeds attributable to separate property. *Turpin v. Turpin*, 403 A.2d 1144 (D.C. App. 1979).
- Court can consider all expenditures made during the marriage in dividing marital property existing at time of divorce. *Bowser v. Bowser*, 515 A.2d 1128 (D.C. 1986); *Turner v. Turner*, 471 A.2d 1010 (D.C. 1984).



# Maryland

## Equitable Distribution

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- Md. Code Ann., Fam. Law § 8- 205(b)
  1. The contributions, monetary and non-monetary, of each party to the well-being of the family.
  2. The value of all property interests of each party.
  3. The economic circumstances of each party at the time the award is to be made.
  4. The circumstances that contributed to the estrangement of the parties.
  5. The duration of the marriage.
  6. The age of each party.
  7. The physical and mental condition of each party.

# Maryland

## Classification of Marital Property

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- (a) Property, **however titled**, acquired by one or both parties during the marriage, (except property defined as separate property);
- (b) Real property deeded as tenants by the entirety, unless excluded by valid agreement.

Md. Code Ann., Fam. Law § 8- 201(e).

- Dissipated property treated as existing marital property.



# Virginia

## Equitable Distribution Factors

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- Va. Code § 20-107.3(E):  
The amount of the award and the method of payment shall be determined by the court after consideration of the following factors:
  1. The contributions, monetary and nonmonetary, to the well-being of the family;
  2. The contributions, monetary and nonmonetary of each party in the acquisition and care and maintenance of such marital property of the parties;
  3. The duration of the marriage;
- 4. The ages and physical and mental conditions of the parties;

# Virginia

## Classification of Marital Property

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- Marital property is:
  - (i) all property titled in the names of both parties, whether as joint tenants, tenants by the entireties, or otherwise;
  - (ii) all other property acquired during the marriage which is not separate property as defined above.
  - (iii) part of any property classified as marital pursuant to (A)(3).

Va. Code Ann. § 20-107.3(A)(2).

- Statutory presumption that all property acquired by either spouse during the marriage and **before the last separation** of the parties where at least one party intends the separation to be permanent is marital property. Va. Code Ann. § 20-107.3(A)(2). Presumption is rebuttable.
- Income generated from marital property and property purchased with such funds is marital property.

Va. Code Ann. § 20-107.3(A)(3)



# Professional Goodwill

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- Goodwill can be separated into two buckets:
  - Personal goodwill and
  - Enterprise goodwill.

# You Can Keep Your Personal Goodwill

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- Personal goodwill, also called professional, individual or celebrity goodwill, relates to an individual person.
  - Personal relationships **with customers, suppliers, employees, or even competitors that enhance the earning power of a company.**
    - For example, if an attorney leaves a law firm, will key clients leave as well, regardless of the quality of service and work they would receive if she stayed?
    - Do employees stay at a company due to the personal charisma of its CEO?
  - Skill
  - Knowledge
  - Reputation



# Enterprise Goodwill Can be Valued

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- Enterprise goodwill, on the other hand, is associated with the subject.
- It is the part of goodwill attributable to the entity as opposed to the individual.
- Enterprise goodwill *may* be a marital asset

# When valuing a business in Divorce

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- When valuing a business as part of a divorce proceeding, it's critical to understand the distinction between personal and enterprise goodwill. Knowing how to distinguish between the two could have a significant impact on the financial outcome of the case.
- An increasing number of states operate under the principle that while enterprise goodwill is part of the marital estate, personal goodwill is not a marital asset subject to distribution. Instead, personal goodwill is the future earning potential associated with an individual's personal attributes and is excluded from the marital estate.



# District of Columbia

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- Goodwill of a professional practice (enterprise goodwill) acquired during a marriage **is marital property subject to valuation and distribution.**
- However, under the facts of a given case, a professional practice may have no goodwill value, *e.g.*, if the express terms of a partnership agreement make goodwill nonsalable, and there are no other factors that may make the goodwill valuable.

# Maryland

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- Professional goodwill is marital property if it has a value independent of the continued presence or reputation of a particular individual.
- A single person law firm has no goodwill.
- A dental practice can have goodwill that is separate from the reputation of the dentist, and is, therefore, properly characterized as marital property.
- Goodwill, an intangible asset that may be added to a business entity may be marital property unless uniquely personal.



## Maryland cont.

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- The court indicated that “for professional goodwill to be marital property, it must be a business asset having a value independent of the continued presence or reputation of any particular individual.”
- Accordingly, in order for it to be distributable in Maryland, goodwill must be shown to be an asset distinct from, and not dependent on, the reputation or continued presence of the individual professional.

# Virginia

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- Goodwill may be an asset of a professional practice, and if it is, it is subject to valuation for equitable distribution purposes.
- The value of the marital property is its intrinsic worth to the parties.
- A property's intrinsic value must be translated into a monetary amount.
- The item may still have a value even if sale may be restricted or forbidden.



# Virginia cont.

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- The Virginia courts have rejected a “fair market value” standard of value for divorce. Instead, Virginia’s courts look to the concept of “intrinsic value” when determining the value of a business.
- In 200, the Virginia Court of Appeals stated that “professional goodwill is attributable to the individual and is categorized as separate property in a divorce action.”
- In 2004, the Virginia courts indicated that as a matter of law, “goodwill attributable to personal characteristics is considered separate property and goodwill attributable to the business entity is considered marital property.”

# HYPOTHETICAL

## (RE: Impact of Goodwill)

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- The importance of personal goodwill to the marital estate can be shown in the following hypothetical divorce between Liam and Fatima. We'll look at two scenarios to illustrate the impact that personal goodwill has on the marital estate.
- Liam started LJ Company, Inc. shortly after marrying Fatima. Liam owns 100% of LJ Company, Inc. and Fatima worked outside of the business. They live in an equitable distribution state where marital assets are split 50/50. A business valuation was conducted to value LJ Company, Inc. for the purposes of the divorce proceedings. The value of LJ Company, Inc. was determined to be \$4 million.



# Scenario #1

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- In scenario #1, we assume that Liam does not possess any unique skills and/or business relationships that couldn't be transferred. As a result, we assume that there is no personal goodwill attributable to Liam. In this case, the entire \$4 million would be considered part of the marital estate.

## Scenario #2

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- Under scenario #2, Liam has significant relationships with some of LJ Company's major customers, who only trust Liam to handle their accounts.
- In addition, Liam's created a unique business process that is sought after in the industry. In this case, we might assume that a significant amount of personal goodwill is attributable to Liam.
- If the valuation analyst determined that the value of the personal goodwill was \$1 million, then \$3 million would be considered part of the marital estate.



# Outcome

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- Both Liam and Fatima's portion of the marital estate related to LJ Company under scenario #1 would be \$2 million.
- Under scenario #2, however, Fatima's portion drops to \$1.5 million and Liam's portion would be \$2.5 million.

# Power of the Court to Convey Property

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- D.C. Code § 16-910(b) provides that the court may convey real and personal marital property or proceeds derived from its sale, irrespective of how it is titled.
  - Separate property retitled to include both partners is dispositive factor supporting marital property classification.
- MD Sometimes the court may transfer the ownership of certain personal or real property from one party to the other under certain circumstances.
- VA Sometimes the court can only order the transfer or division of jointly owned marital property. The statute does not authorize the division or transfer of marital property that is not jointly titled, except court may transfer ownership of an interest in a pension, profit sharing or other retirement plan from one party to the other.



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# QUESTIONS