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In Search of an Immutable Rule

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Divorce actions involving the equitable distribution of a spouse's interest in a closely held business can be dicey. At the outset, the trial court must providently exercise its broad discretion under Domestic Relations Law §236(B)(4)(b) in selecting the proper valuation date for a spouse's business interest.

Once that critical decision is made, the court must then value the interest and award an equitable portion of it to the non-titled spouse.

Finally, to avoid a reversal on appeal, the court must craft a reasoned decision demonstrating that its execution of its broad discretion was provident and not arbitrary.

To reduce inconsistency and unpredictability in assessing those decisions at the appellate level, either the Legislature or the Court of Appeals needs to establish a crystal clear rule requiring that a spouse's active marital business interests be valued as of the date of commencement, unless there is (1) a post-commencement value surge directly tied to pre-commencement marital efforts, or (2) an unforeseen post-commencement event occurs that would make choosing the commencement date inequitable.

From a historical perspective, the Second Department's 1986 decision in *Wegman v. Wegman,* 123 AD2d 220 (2d Dept 1986) has long served as a benchmark in valuation date jurisprudence. While *Wegman* thoughtfully acknowledges the challenges involved in choosing a proper valuation date, it also emphasizes that the date selected must be derived from the facts of each case, while, at the same time, honoring the statutory aim of equitable distribution.

In *Wegman*, the trial court selected the trial date to value the husband's business interest based on its finding that the post-commencement growth of the business stemmed primarily from the successful marketing of a product developed during the marriage.

This sensible fact-based outcome properly reflected the legal significance to be given to a post-commencement increase in the value of a spouse's business interest that is rooted in pre-commencement marital efforts.

Wegman left open a key question, however, that this article intends to answer: Should an active business asset be uniformly valued as of the date of commencement when no compelling reason exists to justify ignoring the intent of DRL§236 (B)(1)(c), which was enacted to limit what can be designated as marital property to only those assets and liabilities existing as of the date of commencement?

Five years after *Wegman* was decided, the First Department cited to the guidance provided in *Wegman* in deciding *Greenwald v. Greenwald*, 172 A.D.3d 860 (2d Dept. 2019), stating in pertinent part:

Passive assets should generally be valued as of the trial date so as to prevent a windfall to the titled spouse if the asset has increased in value; active assets should generally be valued as of the commencement date of the action in order to benefit the titled spouse, since any appreciation in value is the product of that spouse's labors.

In its subsequent decision in *Heine v. Heine,* 176 A.D.2d 77, 580 N.Y.S.2d 231 (1st Dept 1992), the First Department doubled down on the providence of the active-passive approach articulated in *Greenwald* as follows:

Assets that are passive, that is, whose values are affected by outside influences such as inflation or market forces, should generally be valued as closely as possible to the date of trial so as to avoid a windfall to the titles spouse and injustice to the other if the asset has increased in value. (See, *Greenwald v. Greenwald*, 164 A.D.2d 706, 716, 565 N.Y.S.2d 494, lv. den., 78 N.Y.2d 855, 573 N.Y.S.2d 645,578 N.E.2d 443.) On the other hand, assets whose values are affected by the active participation of the titled spouse should generally be valued as of the commencement of the action to reward that party's post-commencement efforts, to which the non-titled spouse did not contribute, either directly or indirectly. (Id at 87)

Not surprisingly, in both *Greenwald* and *Heine*, the husband's business interests were deemed active and were valued as of the date of commencement. Unless a very good reason is given to value an active business interests on a date other than the date of commencement, such as the reason relied on by the Second Department in *Wegman*, it appeared to most matrimonial attorneys familiar with *Heine* and *Greenwald* that a spouse's business interest would be valued as of the date of commencement. And then along came the Second Department's 2023 decision in *Lieberman-Massoni v. Massoni*, 215 A.D.3d 663 (2d Dept. 2023).

In contrast to its decision in *Wegman*, the appellate panel which decided *Massoni v. Lieberman-Massoni* took a far less didactic approach in determining the proper date to value the husband's business interest. In *Massoni*, the husband held an interest in a large outdoor advertising company that are called "B-Units," which were granted from time to time to key employees, but which had no value when granted and only accrued value if the company grew in value, thereby irrefutably linking the value of the husband's B-Units to the company's active appreciation. In addition, the calculation of the redemption value of the B-units that were granted key employees was governed by a formula in the company's operating agreement.

Early in the litigation, the original judge assigned to the case issued an order, consistent with DRL §236(B)(4)(b), setting the commencement date as the valuation date for the husband's B-Units, and inviting the parties to object to her order within 30 days. Neither did, ostensibly because DRL §236(B)(1)(c) firmly establishes the commencement date as the date on which the creation of marital property ends. As a result, at trial, the only value offered for the husband's B-Units was the formulaic value calculated as of the date of commencement by the neutral forensic accountant appointed by the court at the parties' preliminary conference.

Unbeknownst to the wife, however, about a year after the action began, the Company had initiated a confidential plan to sell its billboard division. Based in large part on the post-commencement efforts of the husband and other key employees, the billboard division of the Company was eventually sold for nearly $700 million two weeks after trial ended.

Upon learning of the sale, the wife moved to reopen the trial, alleging that the husband's strategic failure to apprise the court of the impending sale during his testimony at trial was duplicitous. Although the husband was not legally required to affirmatively disclose the pending deal, the judge who had tried the case eventually granted the wife's motion, thereby allowing a second trial, which was held before a different judge.

This decision overturned the original valuation date order set at the preliminary conference, arguably in contravention of the "law of the case" doctrine, and, most importantly, the active-passive asset approach promulgated by the First Department in setting the valuation date for the husband's B-Units.

After the second trial, the court chose to adopt as controlling the sale date value of the B-Units, resulting in an award to the wife of an additional $3 million more than what the date of commencement value would have garnered for her.

In upholding the lower court's decision to value the husband's B-Units as of the date of trial, which took place over two years after the divorce action began, the Second Department opined that it did not need nor did it require a specific reason from the lower court explaining why it valued the husband's business interest as of the date of trial rather than as of the date of commencement, despite the clearly active nature of the B-Units. It simply held that the lower court had "providently exercised its discretion," citing to unspecified equitable considerations but offering little substantive explanation.

In an apparent effort to bolster the wisdom behind its departure from the First Department's active-passive valuation date approach, the *Massoni* decision relied on the Second Department's mantra that valuation date determinations should not be disturbed unless shown to be an improvident exercise of discretion.

It also recited the familiar language distinguishing between "active" and "passive" assets and vapidly quoted from *Wegman* that these guideposts "should not be viewed as immutable rules." However, unlike *Wegman, Massoni* provided no direction whatsoever about when courts should adhere to these guideposts and when they should deviate from them. Instead, in affirming the lower court's valuation date decision, the Second Department arrived at a destination that is completely at odds with the First Department's decision in *Heine*, which involved a remarkably similar fact pattern.

In *Heine*, like in *Massoni*, the husband helped engineer a major corporate and financially lucrative transaction post-commencement. Also, in both cases, the husband worked together with a small group of key employees to achieve significant post-commencement growth in the value of the husband's business interest.

In *Massoni*, the billboard business was strategically marketed and sold. In *Heine*, the company was transformed from a public company into a private company. However, unlike in *Massoni*, the First Department in *Heine* affirmed the lower court's award to the wife of an equitable interest of the value of the husband's interest as of the date of commencement, holding that the gains tied to his active post-commencement efforts were not and should not be subject to equitable distribution.

The First Department decision in *Heine* applied the active-passive test with clarity: assets influenced by external market forces (passive) should generally be valued at trial; those affected by the owner's efforts (active) should be valued at commencement. Adhering to that rule, the First Department concluded that post-commencement increases in value driven in part by the titled spouse's post-commencement work are not to be treated as marital property.

It is noteworthy to point out that the appellate panel which decided *Massoni* did not even mention *Heine* in its decision, even though its facts were strikingly similar and despite the fact that the holding in *Heine* was extensively argued by the husband at trial and on appeal as being dispositive of the parties' dispute. This omission is telling; it suggests that the Second Department could not reconcile its decision with established First Department precedent. Worse than that, *Massoni* errantly sends the wrong message to business-owning spouses, discouraging them from engaging in any value-enhancing business decisions until after the entry of a Judgment of Divorce to ensure they do not enrich the other spouse in the process.

In contrast, *Heine* properly aligns its holding with DRL §236(B)(10)(c), that officially marks the end the parties' economic partnership upon commencement. Once the marriage ends legally, so too should the sharing of future business growth generated by the titled spouse's solo efforts. However, judicial recognition should be given to unforeseeable events—like the pandemic, an emergent disability, or an abrupt regulatory change—that can dramatically affect a business's value post-commencement.

In those rare instances, the lower court should retain the discretion to revisit whether its selection of the commencement date value would result in an inequity. This deviation from valuing active assets on the date of commencement should be the exception, not the rule.

Adopting an immutable rule that requires that the court articulates a good reason for valuing an active marital asset on a date other than the commencement date would also eliminate inconsistent outcomes across judicial departments that result from subjective interpretations of what is or is not “provident.”

Let’s hope that if another *Massoni*-type case arises, and no compelling reason is offered to justify departing from the active-passive guidepost, the Second Department will follow the lead of *Heine* and leave *Massoni* behind. Courts should respect precedent—but they should also recognize when it is time to evolve.

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