THE CONFLICT BETWEEN PUBLIC POLICY AND VALUATION PRINCIPLES: WHAT WE CAN LEARN FROM BROWN.

INTRODUCTION

When the Appellate Division decided the issue of marketability discounts in Brown v. Brown, 348 N.J. Super. 466 (App. Div. 2002), it not only determined that the value of assets for equitable distribution cannot be reduced by virtue of a marketability discount it also provided a framework for analysis of other equitable distribution and support issues by basing its decision on policy grounds. Since the policy dictated the result, the implications of Brown are enormous in other areas of and, in particular whether marketability discounts still remain an issue in distributing assets under N.J.S.A. 2A:34-23.1. While the issue of deducting marketability discounts from the value of an asset seemingly has been addressed by the Appellate Division in Brown, that decision does not stand for the absolutist principle that marketability discounts are to be entirely disregarded and have no place in the equitable distribution analysis.

Secondly, Brown linkage between the ultimate result and the public policy issue provides the framework for resolution of previously undecided equitable distribution and support issues that will arise. Such issues require an examination of policy and its inter-relationship with how law develops. The correct legal result should always mirror the statutory policy upon which equitable distribution is based. Issues of policy have always been viewed uniquely; the word "idiot" comes from the Greek name for the man who ignored public policy matters. Edith Hamilton, the Greek Way (1930).

Whether the valuation standard in a divorce is fair market value, or a standard similar to equitable distribution value, fair value, or value to the holder, while interesting, is an issue that need not be resolved to determine whether a marketability discount should be utilized in determining the non-titled spouse's distributive share. The specific issue confronting the Brown Court was whether a Court should reduce the amount subject to distribution as a consequence of imposing a marketability discount as opposed to the economic reality which might require such discounts being considered as a factor in the fairness of a distribution under N.J.S.A. 2A:34-23.1. Phrased another way, the issue is whether the circumstances that normally suggest the applicability of a marketability discount nevertheless still create an issue as to valuation or distribution, an issue Brown did not address. This article will attempt to provide a broad overview of the policy consideration implicit in equitable distribution and their inter-relationship with a marketability discount and how, after Brown, the issue should be addressed. At the same time, the analysis may well provide the framework to resolve other issues that arise when accounting and valuation principles conflict with the policy of our dissolution statutes. How these conflicts have been resolved provides guidance and insight on how future issues should be addressed.

POLICY CONSIDERATIONS

Brown presented a direct conflict between accounting or valuation principles and divorce law. While an examination of how previous conflicts were resolved will be helpful, the broader based policies reflected by N.J.S.A. 2A:34-23.1 provide the appropriate context to analyze and ultimately resolve potentially conflicting principles. Equitable distribution, how it has been implemented by Courts and the policy it seeks to implement logically should first be reviewed. Distribution of assets is a reflection not only of a specific statutory provisions, N.J.S.A. 2A:34-23.1, but the policy imperative which mandates that when a marriage ends spouses must treat each other fairly. More than any other aspect of matrimonial law, asset distribution reflects what we as a society perceive a marriage to be and the responsibilities spouses have to each other when it ends. Houses are not sold because of the policy concern that a compelled divorce related sale may impact upon the children. Similarly, the percentage allocation is based on the fairness of the distribution since an appropriate and fair distribution requires not only an application of legal principles to a particular set of facts, but consideration of the public policy underpinning our equitable distribution statutes. Premarital assets which have appreciated have been treated differently than the marital assets, primarily because the policy considerations are arguably different. See Valentino v. Valentino, 309 N.J. Super. 334, 340 (App. Div. 1998) (the Appellate Division approved a 10% distribution of the incremental marital appreciation).

It is the implementation of this fundamental policy that goes to the very heart of who we are and the principles society values. Marriage is fundamental to our society; our law must reflect societal values and Courts should compel spouses at the end of this important relationship to treat each other fairly. Elevation of fairness as the sine qua non of any distribution does more than implement a statutory scheme; it reaffirms the type of society we believe we should be and the importance of marriage as an institution central to our cultural values.

Viewed in a broader sense, this single most important policy consideration was noted by the Supreme Court in Miller v. Miller, 160 N.S. 408, 418 (1999). In language that is eloquently simple, the Court crystallized the entire thrust of our dissolution law in terms elevating fairness not only as the goal, but as a fundamental bedrock principle. The concept of Miller fairness should be the prism through which the marketability discount should ultimately be addressed. The Miller Court when noting the equitable theory of Courts to modify agreements, emphasized spousal agreements "must reflect the strong public and statutory policy of ensuring fairness and equity in the dissolution of marriages". Miller at 418. As the issue of discounts is analyzed, a Court should always ask a simple question: "Would imposition of discounts on the facts presented in this case further the strong public and statutory purpose of ensuring fairness and equity in the dissolution of marriages" or, alternatively, is it an argument predicated on generalized accounting principles that have no relevance to the facts or the legal context in which the Court's decision is to be made?

An analysis of these broad based policy principles establish the legal context in which Courts have interpreted equitable distribution. For instance, in <u>Goldman v. Goldman</u>, 248 <u>N.J. Super.</u> 10 aff'd 275 <u>N.J. Super.</u> 452 (App. Div. 1994) Judge Glickman rejected certain legal principles since their rigid application would prevent him from carrying out "the legislative mandate to distribute assets equitably". <u>Goldman</u> at 16. In New Jersey, marriage is considered to be a "shared enterprise" and "akin to a partnership". <u>Rothman v. Rothman</u>, 65 <u>N.J.</u> 219, 229 (1974). As <u>Rothman</u> emphasized, only when it is "clearly understood that far more than economic factors are involved, will the resulting distribution be <u>equitable</u> within the true intent and meaning of the statute". <u>Rothman</u> at 229 (emphasis added)

The relationship between the development of divorce law and society's interest and concerns is in part a reflection of the role spouses play and the vital interest society has in those roles. Society's interest in parents, children and the institution of marriage cannot be overstated; that interest, quite properly, should be reflected in how the law develops. In every divorce the state has a legitimate interest in how issues are resolved and that interest must be reflected in how new issues are resolved. While, for instance, there is a strong interest in permitting parties to freely contract society, through the instrumentality of the Courts, will not allow parents to waive child support or to unilaterally terminate parental rights, emphasizing that when policies conflict the state's interest prevails. There is no better evidence of the societal impact on the development of divorce law than the long standing principle that Courts can only enforce spousal support agreements that are fair and equitable. Lepis v. Lepis, 83 N.J. 139, 149 (1980). That is a distinctly different standard than utilized in non-matrimonial settings, where concepts of free enterprise only allow the state to intervene if the contract is either unconscionable or void as being contrary to public policy.

This distinction in legal standards is warranted by disparate policy considerations. It highlights the importance of fairness in a divorce and focuses the Court's analysis on whether the state's interest in assuring that parties treat each other fairly when their marriage ends is advanced by mandating discounts predicated upon sales which will not only occur. Neither party wants, and in most cases there will not be, a sale of the assets being distributed. Given that factual reality, why impose a marketability discount which is predicated on a sale that will never occur? Two separate concepts converge - implementing the policy and fairness concepts embodied in N.J.S.A. 2A:34-23.1 and applying each to the evidence presented and factual reality of the case being decided.

With the issue placed in context it is appropriate to analyze the inter-relationship between law and policy; principles firmly rooted in our jurisprudence. Our law does not develop in a vacuum. There is a well-defined jurisprudential basis for resolution of unique judicial issues; if there is one consistent strain in the development of law in New Jersey, it is that our law evolves in response to what Courts perceive to be sound public policy. The genesis of this developmental principle might well have been Oliver Wendall Holmes' ("Holmes") landmark work "The Common Law" where he linked public policy and development of the law. Holmes, "The Common Law" (1881). New Jersey courts have recognized this linkage and have liberally quoted Holmes when confronted with a previously undecided issue. It is logical for there to be a rational relationship between public policy and concepts of justice. The two concepts should and do go hand in hand.

An excellent example is Falcone v. Middlesex Co. Medical Society, 34 N.J. 582 (1961). Falcone involved a doctor's admission to a County Medical Society. Justice Jacobs went back to Holmes, emphasizing, "the vital part played by public policy considerations in the never ending growth and development of a common law". Falcone at 589. Holmes had noted, and it was cited by Justice Jacobs, that:

> "every important principle which is developed by litigation is in fact and at bottom the result of more or less definitively or definitely understood views of public policy". Holmes, "The Common Law", 35 (1881) cited in Falcone at 589.

In his analysis, Justice Jacobs concluded the "dominant factor" in development of our common law is the "common law principles" which "soundly serve the public welfare and the true interest of justice" citing Collopy v. Newark Eye and Ear Infirmary, 27 N.J. 29 (1959); Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358 (1960); Cardozo, The Nature of the Judicial Process, 10 (1921).

In recent years, our Supreme Court has followed Holmes' linkage of public policy and the development of law. In Shackil v. Lederle Laboratories, 116 N.J. 155, 177 (1989) the Supreme Court rejected the market share liability theory advanced by certain Plaintiff's concerning childhood vaccinations reasoning it would frustrate the public policy of development of safer vaccines. Similarly, in Kelly v. Gwinnell, 96 N.J. 538, 545 (1984) the Court, in an attempt to reduce the number of drunken drivers, concluded imposing social host liability would advance that salutary public policy. Kelly relied on Palsgraff v. Long Island R.R. Co., 248 N.Y. 399 (1928) for the proposition that in determining whether a duty of reasonable care existed the answer depended upon "an analysis of public policy". Kelly at 544. Support for the proposition that unique legal questions are determined on public policy considerations can also be found in cases decided by our Supreme Court in matrimonial law. In Kinsella v. Kinsella, 150 N.J. 276 the Court found the doctor/ client privilege was not absolute:

> "considerations of public policy and concern for proper judicial administration have led the legislature and the courts to fashion limited exceptions to the privilege. These exceptions attempt to limit the privilege to the purposes for which it exists." Kinsella at 298. emphasis added)

Justice Stein later noted courts should be mindful of the public policy considerations behind the psychologist/patient privilege concluding, in some respects, it was even more compelling than the attorney/client privilege. Kinsella at p. 329-330. Such reasoning reveals how Courts in determining unique legal issues mirror Holmes' perceptive reasoning and base their decisions on what sound public policy would be. That is precisely what Plaintiff asks this Court to do. By analyzing the legal issue in context, it's resolution will be more likely than not be consistent with the statute. Certainly, each party should be required to show <u>why</u> their position <u>advances</u> not <u>rejects</u> the policy reflected by <u>N.J.S.A.</u> 2A:34-23.1. A recent example of law following policy was the Appellate Division's rejection, on policy grounds, of permitting a position taken at a settlement conference to satisfy the "further acts" requirement of a malicious abuse of process claim. <u>Baglini v. Lauletta</u>, 338 <u>N.J. Super.</u> 282, 296 (App. Div. 2001)

A good example in an equitable distribution context is the already noted <u>Goldman v. Goldman</u>, 248 <u>N.J. Super.</u> 10 (1991) aff'd. 275 <u>N.J. Super.</u> 452 (App. Div. 1994) where Judge Glickman was confronted with a unique situation involving "special circumstances". <u>Goldman</u> at 248. In resolving the distributability of a car dealership which had significant value as of the valuation date but virtually none at trial , he not only analyzed the issue in the context of the existing law but the public policy considerations. He reached his result by implementing the policy reflected by <u>N.J.S.A.</u> 2A:34-.23.1. As the Appellate Division noted in affirming his decision:

> "...the Trial Court here correctly recognized that he was confronted with the unique situation and that application of a rigid categorical analysis would have only <u>hindered him in fulfilling his ultimate</u>

obligation to effectuate a distribution of marital assets which overall was equitable to both parties". Goldman at 457. (emphasis added)

Goldman stands for the proposition that in determining unique distribution issues, you first analyze the law then the public policy relating to equitable distribution and finally be assured the end result was fair. This concept of fairness, therefore, must be included as a criteria for determining the unique legal issues that arise. See Miller at 418.

HOW THE CONFLICT BETWEEN ACCOUNTING AND VALUATION PRINCIPLES HAVE BEEN RESOLVED

With the primacy of policy having been established it is useful to examine the instances where Courts have addressed the conflict between accounting principles and the public policy relating to matrimonial cases. Both legislatively and judicially, government has recognized that abstract, but nonetheless, legitimate and market based accounting principles, must nevertheless give way when they conflict with implementing the broader divorce related policy considerations.

It is a general accounting principle that when assets are sold, a taxable event occurs creating a liability for payment of capital gains taxes by the selling party. Yet, that broad based principle was not applied to divorces. The policy determination was made that it is inappropriate to tax people who are selling assets to each other "incident to a divorce". To implement this societal determination that people should not be taxed when they divide their assets in a divorce, Section 1041 of the Internal Revenue Code was adopted. That provision provides that sales, denominated as "transfers", between spouses are not taxable events so long as they are "incident to a divorce". This emphasized the principle that as long as the sale or transfer between spouses was related ("or incident to") to divorce, public policy considerations precluded treating such transactions as taxable events. Thus, if a transaction between former spouses occurs, even if it is the by product of a divorce, but nonetheless was not "incident to the divorce" the safe harbor provisions of Section 1041 do not apply. Certain time limits were established which were quite liberal to distinguish between transactions "incident to" or merely which might occur between former spouses. If the transfer occurs within six years it is presumed to be "incident to". See TEMP. TREAS.REG. SECTION 1.1041-1T; Q/A 7. If the transfer is more than six years after the divorce, it is presumed not to be related to the cessation of the marriage.

This policy determination was implemented in the Deficit

Reduction Act of 1984 where Congress over-ruled the 1962 Supreme Court Decision in the United States v. Davis, 370 U.S. 64 (1962). Davis had held transfer of property from one spouse to another incident to a divorce required recognition of gain or loss. By enacting Section 1041 of the Internal Revenue Code as part of the 1984 amendments, Congress made it clear that for income tax purposes, no gain or loss will be recognized by the parties when there was a transfer of properties "incident to a divorce". The policy determination to provide spouses special treatment is also exemplified by gift law, which is philosophically related to the Section 1041 transfers; in each instance spouses may make unlimited gifts to each other without gift tax consequences. Even children are not treated so liberally since parental gifts are subject to gift tax rules. Only spouses have the unrestricted freedom to do as they please and that determination flows from the status of marriage as a fundamental societal institution which policy considerations mandate be treated differently than commercial contracts.

Another illustration of divorce law trumping accounting principles was the provision in the regulations relating to Section 71 of the Internal Revenue Code ("IRC") permitting parties to designate otherwise taxable income, i.e. alimony, as non-taxable income. As with divorce related property transfers, the determination was made that in transactions involving spouses, there was no public policy reason to have a bright line rule that alimony must be deductible by the payor and includable in the recipient's income. This distinction is particularly significant; it emphasizes that divorce related transactions have traditionally been treated differently than other accounting transactions. For example, even if a person was an employee of a charitable organization, e.g. Mother Theresa, regardless of the societal benefits of the employer, the employee must report their salary as part of their gross taxable income. Only if people marry do they have the right to designate income as tax free income. See Reg. 1.71(T) Q8. A related, but different, area is child support income. It is an obvious policy determination to designate that cash flow to be tax free.

In fact, the alimony deduction itself is yet another example of policy dictating law. Until 1942 alimony was neither taxable to the recipient nor deductible by the payor. Gould v. Gould, 245 U.S. 151 (1917). In that year to relieve the financial hardship imposed on the payor of paying alimony with after-tax income Congress amended the Revenue Act to provide for deductibility. This provision was ultimately embodied in IRC Sec.

71 (215). Policy and the fairness it reflected, dictated the result.

Marriage and what it meant to our society, coupled with simple concepts of fairness have always trumped accounting principles developed for use in a commercial setting. Yet, another example involves theoretical taxes. According to the American Institute of Certified Public Accountants ("AICPA") accountants are required to treat theoretical taxes in a certain fashion on personal financial statements. For that reason audited financial statements must include provisions providing for theoretical taxes as a liability. From an accounting standpoint, the logic is clear and compelling; as a potential liability, accountants are required, in applying generally accepted accounting principles, to reflect the theoretical tax.

For a long time, theoretical taxes in divorces were treated disparately across the state. Accountants who applied basic accounting principles relied on the AICPA standards; it was common practice to deduct theoretical taxes from the gross value. In other words, applying accounting methodology if the asset was valued at $1,000,000.00 they subtracted $200,000.00 for theoretical taxes in every case. This meant the amount subject to distribution was $800,000.00 - not $1,000,000.00.

Many attorneys, in contrast, argued that such a strict application of accounting principles was contrary to the policy embodied by equitable distribution statute and was unfair and prejudicial to dependent spouses. The tax was not being incurred and for many reasons might never be incurred. I have previously argued the linkage between law, logic and policy in a somewhat related context. See Louis, Consideration of Theoretical Tax Consequences In Equitable Distribution, 8 N.J. Fam. Law, 153, 155 (1989) cited in Orgler v. Orgler, 237 N.J. Super. 342 (App. Div. 1989). Orgler was predicated on the distinction between marital and commercial transactions and was analyzed thru a prism of fairness. It provides not only the framework for analyzing marketability discounts but the methodology to be utilized.

Ultimately, the Appellate Division recognized the need to address this issue and did so in Orgler where the Husband appealed a trial court determination alleging error had been committed because the Court had not deducted the theoretical taxes involved with distribution of a Midas Muffler Shop. The Husband advanced the position of the accountants and relied specifically on the AICPA statement. Yet, the Court analyzed the issue from the standpoint of policy not accounting thus high-lighting the salutary approach taken by courts. Confronted with the conflict between unambiguous accounting principles and the policy reflected by equitable distribution, the Court declined to follow the AICPA ruling. Orgler was a triumph of statutory construction over accounting principles; it reaffirmed the principle that if fairness was the standard, equity, if not a sound dose of common sense, meant the AICPA mandated subtraction of theoretical costs from value when the asset was not being sold made no sense. Nonetheless, both the statute and Orgler suggest the contingency relating to sale (i.e., the hypothetical tax or the difficulty in selling) may still be considered on the fairness of the distribution.

Another example of the disparate treatment between matrimonial and accounting law are rules governing the passive/active dichotomy. For tax purposes, unless a taxpayer is engaged in the "trade or business" of owning and investing in real estate, (See IRC 469(C)(7)) the investment is deemed passive. As a consequence of it's passive treatment, losses generated are not available to the taxpayer for use in the year they are incurred. Yet, in matrimonial law, the legal consequences of a real estate asset being passive and active is different; they are bottomed upon disparate public policy considerations. The IRS's concern was to minimize deductibility and increase tax collections; the divorce related concern is to fairly compensate the non-titled spouse for appreciation caused by the active efforts of the party which created the value during the marriage. Given that goal, it was immaterial whether the titled owner was engaged in the "trade or business" of real estate or simply had one piece of property purchased for investment. It is yet another example of policy determining the legal standards to be applied.

Similarly, there is a substantial difference when addressing issues of depreciation. For tax purposes, a commercial real estate investment property, for example, may have it's book value decrease because the owners utilize depreciation, which reduces the book value. Yet, in a divorce case, where the goal is to fairly compensate spouses who acquire assets during a marriage, the depreciated value is not binding; rather, it is the actual value. Thus, the same asset made for tax purposes may have it's value decreased; yet, for marital purposes, it's value increases, once again linking the policy implicit in N.J.S.A. 2A:34-23.1 with a result which is directly contrary to the result applying strict accounting principles.

Yet, another example is the treatment of cash flow. In applying strict accounting principles, monies paid under an

Accumulated Adjustment Account in a Sub-Chapter S Corporation (the AAA Account) or repayment of an Officer Loan would have no effect from an accounting standpoint; it would nonetheless be highly relevant in a matrimonial setting. Once again, the conflict between accounting principles where the cash flow effectively does not exist since it is not reported as taxable income, and the matrimonial setting where not only does it exist but must be considered by the Court is patent. It is a reflection of the differing public policy considerations involved. The analysis of the discount issue is furthered by a review of what is really being valued under <u>N.J.S.A.</u>: 34.23.1.

Analyzing the issue from this logical standpoint, the Appellate Division's conclusion in <u>Brown</u> that it was inappropriate to utilize a marketability discount in the valuation analysis because, as in most cases, the asset is not and will not be sold, was not only logical but consistent with the <u>Miller</u> fairness imperative. It is similarly inappropriate to mandate a marketability discount as part of the Fair Market Value equation where, as in most cases, the asset is <u>not</u> and will <u>not</u> be sold. As <u>Orgler</u> rejected a reduction in value for a hypothetical tax <u>Brown</u> correctly refused to deduct a percentage from value because of a sale related marketability discount.

Importantly, an examination of the full panoply of equitable distribution cases decided by the Supreme Court, there is no suggestion in valuing assets there should be a "discount" for a marketability discount. Logically, if a marketability discount is to be applied in any case, it should be applied in every case, leaving the inevitable question of why our Courts, in all of the reported equitable distribution opinions, do not routinely suggest the discount be applied. The only time the highest Court mentioned discounts in the context of equitable distribution was in Lawson, Mardon, Wheaton, Inc. v. Douglas Frederick Smith, et. al., 160 N.J. 383, 399 when they noted, with approval, that one of the seminal equitable distribution cases, Lavene v. Lavene, 162 N.J. Super. 187, 202 (Ch. Div. 1978) declined to apply a discount in valuing a minority (not marketability) interest in a closely held corporation for equitable distribution purposes. It is not accounting that should dictate the correct policy result; matrimonial law should develop when viewed thru the prism of fairness after inter-relating the evidence and the facts presented. How such issues are resolved is critical and will affect divorce practice throughout the state. Simply put, it will effect every case courts hear. The Brown Court's conclusion that a marketability discount could not be utilized to reduce the value is correct since it is inconsistent with the purpose of N.J.S.A. 2A:34-23.1; as such, it is fundamentally unfair unless the asset by virtue of the facts or the distributive scheme is to be sold.

Equitable distribution is a statutory creation that has been reviewed twice by the Legislature - once in its initial formulation and again in 1988 when the statute was amended. Each time, the Legislature did not determine how assets subject to distribution were to be valued. The 1988 amendments required Courts "consider" the statutory factors "in making an equitable distribution of property". The factors, by virtue of a literal reading of the statute and how they have been interpreted (Orgler being a good example), are not valuation but distribution factors. Certainly, no one would argue that Factor K which directs Courts consider the "present value of the property" represents a Legislative determination that assets are to be valued at trial - thus overruling Painter. As the Appellate Division "considered" tax consequences as a factor in Orgler, the present value of property (immune or not) are factors evaluating the fairness of a distribution. Neither in the initial enactment or the subsequent amendment did the Legislature determine as a matter of law or policy that fair market value and the accounting principles that flow therefrom must be considered.

During a speech before the Monmouth County Bar Association, Associate Justice Virginia Long explained the difference between decision making on the Supreme Court and the process followed during her long tenure in the Appellate Division. Cases were selected to be heard by the Supreme Court because they involved questions of broad public policy that needed to be determined or required clarification. As Justice Long might have said in emphasizing the primacy of policy, it is not so much where we stand, but in which direction are we headed? The correct direction may be gleamed from the logic of the Supreme Court's decision in Dugan v. Dugan, 92 N.J. 423 (1983) which discusses what is being valued in a divorce case and why rigid adherence to propositions keyed to a sale, such as discounts, inevitably lead to an unfair result.

Dugan involved distribution of an interest of a one person law practice. Mr. Dugan argued since the then existing canon of ethics precluded sale of his practice, by definition, the practice could not have a "fair market value" since it could not be sold. He therefore reasoned there could be no good will. The Court was confronted with the practical problem. If the Court utilized the accepted definition of "fair market value" a willing buyer and willing seller were needed. Yet, if there could not ethically be a sale, how could there be a willing buyer or willing seller and how could Mrs. Dugan be fairly treated for the obvious good will that existed. In resolving the seemingly insolvable dilemma, the Court recognized the public policy considerations by finding it would be "inequitable to ignore the contribution of the non-attorney spouse to the development of that economic resource", i.e. the ability of the attorney to enjoy the good will (the enhanced earnings potential) after the divorce that was nonetheless developed during the marriage even though it could not be sold. Dugan at 434. The Court reasoned an inability to sell the asset did not eliminate good will and concluded "equitable distribution does not require conveyance or transfer of a particular asset". Quite obviously, the Court never reduced Mrs. Dugan's interest by a marketability discount nor should it have done so.

Dugan stands for a simple proposition; in resolving valuation and distribution questions under N.J.S.A. 2A:34-23.1, the answer is not found in rigid or mechanical accounting principles. The answer is in the policy sought to be implemented. Since Mr. Dugan's practice had value to him and since that value had been created during the marriage, it was of no moment the asset could not be sold. The parameters of a hypothetical sale are constrained by the statute's policy. If the fair market value standard is used, it may well not be the same fair market value applied in a commercial setting since the hypothetical or fictional nature of "transactions" must effect accounting rules developed for an actual not hypothetical transactions.

The issue presented highlights the uniqueness of valuation issues in equitable distribution. Traditionally, assets are valued as if they were being sold but with the recognition by everyone that asset is <u>not</u> being sold. The marketability discount claim, which is predicated on the difficulty of actually selling a closely held asset, highlights the ambiguous logic underpinning Defendant's position. Simply put, utilizing a marketability discount is to ask a Court to <u>decrease</u> the distributable value of an asset because of economic factors relating to sale when no party is requesting a sale.

It may well be useful from an analytical standpoint to step back and reflect what is really occurring when assets are distributed at the end of a marriage. The basic philosophy of our law is that marriage is a partnership and that at the end assets the partnership acquired must be divided in a fair way.

In other words, since the parties are not going to jointly own assets the non-titled spouse must fairly be compensated for their distributable share of what the partnership acquired, If they are not going to own the property going forward, the titled owner will continue to receive the benefits of ownership as did Mr. Dugan.

<u>Wadlow v. Wadlow</u>, 200 <u>N.J. Super.</u> 372, 384 (App. Div. 1985) provides some guidance on the issue. In <u>Wadlow</u>, the Appellate Division found "unwarranted" the Trial Judge's decision that a hypothetical brokerage commission was appropriate to be deducted from the parties' equity in the marital residence. <u>Wadlow</u> at 383. Courts should base their decision on the <u>facts</u> and the <u>record</u> presented. The Appellate Division concluded since there was nothing in the "record" to support the hypothesis that a real estate commission constituted "a reasonably foreseeable expense incident to the present and future disposition of the property", it should not be deducted. The Court noted that the record was "barren" of any intention to sell the property in the future or, if it did, that the real estate commission would be incurred. Therefore, following the <u>Wadlow</u> reasoning if there is nothing in the <u>record</u> to support a claim that an asset is being sold no marketability discount should be imposed.

Wadlow, interestingly, was decided before Orgler. A fair analysis of the Real Estate Commission would be to consider it as a factor in the fairness of the distribution if it is reasonable to assume that within a relatively short period of time the commission will be incurred. In other words, the testimony at trial is that the non-titled spouse wishes to receive the home so as not to disrupt a junior in high school but that the house would be sold after senior year, then is the Real Estate Commission truly "hypothetical". If it is not to be subtracted, should it not be considered in the fairness of the distribution, which would result in something other than a 50/50 allocation of the asset, particularly when it is transferred to one spouse as opposed to the other.

Justice Garibaldi in Balsamides v. Protameen Chemicals, Inc., 160 N.J. 352 emphasized the distinction between a marketability and minority discount:

> "A minority discount adjusts for lack of control over the business entity, while a marketability discount adjusts for a lack of liquidity and one's interest in an entity. Even controlling interests in non-public companies may be eligible for marketability discounts, as the field of potential buyers is small, regardless of of the size of the interest being sold". (emphasis added)

Notwithstanding the conclusion in Brown that a marketability discount should not be applied in valuing an asset distributed under N.J.S.A. 2A:34-23.1, the economic reality reflected by the discount should not be ignored in the overall distributive scheme. Nonetheless, it should not rigidly be applied to an asset that is not being sold. It represents, along with all other factors, part of the risk of ongoing ownership which the titled spouse continues to be burdened with and thus must be considered in some fashion linked however to the facts of the individual case. As emphasized earlier, an analogy can be drawn to theoretical taxes addressed by the Appellate Division in Orgler v. Orgler, 237 N.J. Super. 342 (App. Div. 1989). If the impact of the marketability discount is reasonably foreseeable, either based upon the distributive scheme imposed by the Court or by other extrinsic facts including, importantly, the age of the title owner, it may be considered in one of two ways or perhaps even both.

When an appraiser reaches an opinion as to value, assuming the valuation methodology is Revenue Ruling 59-60 and Revenue Ruling 68-609, selection of an appropriate capitalization rate is part of the valuation process. One of the most significant factors that goes into selecting a capitalization rate is risk.

The risk contingency associated with an inability to readily market shares in a business is a legitimate factor to be considered in the capitalization rate. An even more direct and perhaps more appropriate recognition would be in the percentage allocation, although a Court must be aware of the risk of "double counting" the impact. Since the ultimate equitable distribution result is a reflection not only of the specific statutory factors (which are distribution and not valuation factors), but the view expressed by the Supreme Court in Miller that spouses must treat each other fairly at the end of the marriage, distribution is a reflection of society's perception of a marriage and the responsibilities spouses have to each other. Ignoring legitimate economic factors does not further the ultimate goal of assuring the distributive scheme is fair.

In an earlier article: "The Art of Equitable Distribution", I noted:

> "The essential element of any distribution is that it be fundamentally fair given the totality of the economic circumstances. "Equitable" distribution requires more than a narrow focus on how a particular asset is divided. Rather, the focus must be upon how fair is the distribution in light of all economic factors in the case. This article will address some of the considerations that bear on the fairness of a distribution. If the distribution is fair, not only has society's collective conscience and sound public policy been served; but courts, in

> the most graphic yet simple way, have reaffirmed the policy imperative that at the end of a marriage there is an obligation to deal with your spouse fairly. It is the implementation of this fundamental public policy that goes to the very heart of who we are and the kind of society we seek to be. Marriage is fundamental to our society; our law must reflect our societal values and courts should compel spouses, at the end of their relationship, to treat each other fairly. Elevation of fairness as the sine qua non of any distribution does more than implement a statutory scheme; it reaffirms the type of society we believe we should be."

The degree to which this legitimate distributive factor is to be considered is directly related to the facts of a particular case. If a fact finder reasonably believes the spouse's interest in the entity could and would be purchased by existing partners, the issue of marketability discounts is not only not significant, it may largely be irrelevant. If, however, the entity is owned solely by one person or the other partners are not found to be possible purchasers, then a Court should consider the difficulties the seller would have in actually marketing the property for sale, i.e. ultimately receiving the value which the Court is distributing to the non-titled spouse under N.J.S.A. 2A:34-23.1. Coupled with the likelihood of any sale in the near future, the degree of this difficulty must be considered in the distributive scheme, but in the percentage allocated to the non-titled spouse unless the difficulty is speculative or not reasonably foreseeable.

Inter-related with this analysis is timing since age and the likelihood of sale must also be considered. the significance of a marketability discount may well vary if the business owner is 62 as opposed to 35. In the final analysis, none of the policics which underpin distribution of assets is served by utilization of a marketability discount where no sale is sought or contemplated. Instead, the marketability discount is a <u>factor</u>, along with all other factors to be considered either in the capitalization rate selected by the expert, or in the fairness in the distribution with that later consideration reflected in the percentage allocation of the asset to the non-titled spouse.