PT: SELECTED ANSWER 2

The Washington Law Group

7 Chadbourn Road

Fair Haven, Columbia

Wendy Burke

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Dear Ms. Burke,

I hope this letter finds you well. I am writing to follow-up on our discussion this morning with respect to Harlan Burke's proposed stipulation agreement for the DigitalAudio shares. Based on my analysis, I recommend that you do not accept Harlan's proposed joint stipulation. Although the DigitalAudio shares were originally separate property, the marital community acquired an interest in the increased value of the shares because the community, through your and Harlan's efforts, devoted more than a minimal effort to the increased value. Because the community has an interest in the increase, and the increase is largely due to the efforts of the community, not market forces, the court should apportion the shares as community property. If the court apportions the increase in the shares as community property, you would be entitled to 50% of the increase, or $100 million. Because this is greater than the proposed stipulation, I would recommend

that you do not accept the stipulation.

I. Harlan's shares are separate property.

As we have discussed throughout the course of these proceedings, the family court's division of property will depend on whether the property is characterized as community or separate property.

Community property belongs to the marital community, i.e., to both spouses, and will be divided equally at divorce. In contrast, separate property belongs to an individual spouse and will be allocated to that spouse at divorce. Property that either spouse acquires during the marriage is community property, and as such, belongs to both spouses equally. In contrast, property that either spouse acquired before marriage is separate property and belongs to that spouse. The proceeds of property acquired before marriage are also separate property.

For example, in a case that was similar to your case, the court found that shares of stock acquired by an individual spouse prior to the marriage are characterized as separate property. Similarly, here, because Harlan acquired the shares in 1983, prior to your marriage, the shares are separate property.

II. The community devoted more than a minimal effort to increasing the value of the shares, meaning that the community acquired an interest in a

value of the shares.

Although Harlan's shares may be characterized as separate property, the marital community may have acquired an interest in the shares, requiring that some portion of the shares be defined as community property and affording you a greater interest in the shares.

Because marriage is an egalitarian partnership, the law recognizes that whenever the community devotes "more than minimal effort involving a spouse's separate property during marriage, the community acquires an interest in any increase" in value of the separate property. That increase is community property, and therefore belongs to both spouses. *In re Marriage of Dekker* (Colum. Ct. App., 1993). Minimal effort in increasing the value of the shares can be due to either spouse's efforts, and it is irrelevant if only one spouse's efforts caused the increase because "the community acts whenever either of the spouses acts." *In re Marriage of Rand* (Colum. Ct. App., 2015). The court is primarily interested in whether the work of either spouse is the reason for the increase in value.

For example, in *In re Marriage of Rand,* another divorce case in this jurisdiction, the court held that the community had acquired an interest in a spouse's separate property company shares during the period that the spouse worked for the company because the spouse worked for the business and led to the increase in value.

In your case, Harlan worked throughout the entire period of your marriage, from 1989 - 2009, during which the shares increased from $0 to $200 million. Because Harlan dedicated his entire work life to DigitalAudio, "always at 110 percent," as Pamela Gardener mentioned in her deposition, and played a significant role in keeping DigitalAudio in business, thus increasing the value of its shares, the community has devoted more than minimal effort to the increase in value.

Harlan's counsel may argue that the community did not acquire an interest in the company because only Harlan worked for the company. However, even disregarding the work you performed during the early days of DigitalAudio and the support you provided to allow Harlan to work at DigitalAudio, this argument would fail because the effort of *any* spouse is sufficient for the community acquire an interest in the property. *In re Marriage of Rand* (Colum. Ct. App., 2015).

Because of your and Harlan's work in making DigitalAudio the success it is, and the resulting increase in value of its shares, the community has acquired an interest in the increase in value of Harlan's shares, and you are entitled to a portion of that increase.

III. The family court should apportion half of Harlan's shares to you - $100 million - because the increase in value of the shares is due to community

efforts.

When certain property is separate property that the community has gained an interest in, there are two main approaches that courts will use to determine how the increase in value of the separate property should be allocated: 1) the *Pereira* approach, and 2) the *Van Camp* approach. Ultimately, although these approaches are common, the court is not required to pursue either approach, and must simply divide in a way that achieves substantial justice between the spouses. The court will divide only the property that the community has gained an interest in through minimal effort and may use different approaches at different time periods.

Throughout the remainder of this section, I have outlined what approach the family court should apply to Harlan's shares, what the division of property would look like under either approach and general considerations.

a. Most Appropriate Approach

Generally, when the increase in the value of the property is largely due to the community efforts, such as hard work by either spouse, the court will take an approach known as the *Pereira* approach to divide increases in value to separate property. The *Pereira* approach favors the community and will allocate greater amounts to the community. In contrast, the court will take an approach known as the *Van Camp* approach when the increase in the value of the property is largely

due to factors outside of community efforts, such as market forces. The *Van Camp* approach favors the separate property estate and will allocate greater amounts to the owning spouse.

To determine which approach to apply, the court will look at the reason for the increase in value of the shares. For example, in *In re Marriage of Rand,* the case mentioned above, which closely resembles your situation, the court held that the Pereira approach was the most appropriate during the period in which one of the spouse's was working at the company because the spouse dedicated extensive time and effort to the business. In contrast, the court applied the *Van Camp* approach to subsequent increases in value after the spouse withdrew from the business because the business operated essentially on autopilot, with increases in value coming from market forces.

As discussed above, Harlan worked for DigitalAudio throughout the entire period of your marriage, during which the shares increased the relevant $200 million.

As you and Pamela Gardner mentioned, Harlan dedicated endless hours to ensuring the success of DigitalAudio in his role as Chief Scientific Officer, as part of which he led the development of its first major product - SoundAudio. Without this work, DigitalAudio would likely not have been able to be the success it was and the shares would not have increased. Although Harlan started the company

in 1986 and likely designed some of SoundAudio before then, Harlan still performed work for SoundAudio while he was married and part of the marital community. The explosion of DigitalAudio as a result of SoundAudio was due to Harlan's work, and by extension the marital community. Therefore, at least up until the point at which SoundAudio was no longer marketable, the *Pereira* formula is most relevant, favoring an allocation of the shares to community property.

Harlan's counsel may argue that after SoundAudio was no longer marketable and ProAudio was DigitalAudio's main product, the increase in value of DigitalAudio was no longer due to Harlan's work, and therefore the *Van Camp* formula is most appropriate. If the court accepts this argument, it would favor a distribution of any subsequent increases in the value of the shares to Harlan. However, the family court should not accept this argument. As Pamela Gardner testified, even after SoundAudio was no longer marketable, Harlan remained with DigitalAudio working consistently and updating SoundAudio to allow DigitalAudio to remain in business until ProAudio became marketable.

Your situation is highly unlike situations where courts have applied the *Van Camp* formula, such as the *In re Marriage of Rand* case discussed above. In that case, the court applied the *Van Camp* formula once the spouse stopped working and left the company "essentially on autopilot," with subsequent increases in value coming from market forces. In contrast, here, up until 2009 when you and

Mr. Burke separated, Mr. Burke remained important to DigitalAudio, with increases in value coming from the work he performed while part of the marital community, not from market forces. Therefore, even after SoundAudio was no longer marketable, Mr. Burke's work was responsible in part for the increase in value of the shares, and the *Pereira* formula is most appropriate.

b. Subsequent Divisions of Property

As discussed, under the *Pereira* approach, increases in value due to the community efforts are community property. The court should apportion the shares under the *Pereira* formula because, as discussed above, Mr. Burke's efforts while part of the marital community were the primary source of the increases in value. If the increase in value is characterized as community property, you will be entitled to 50% of the increase, or $100 million. If the court finds that the *Van Camp* formula is most appropriate for any period of time, it would characterize any increase for that period as separate property. However, as discussed above, it is unlikely that that court would apply Van Camp, and likely that you would be entitled to $100 million upon division from the family court.

c. Substantial Injustice

As discussed above, although the formulas discussed above are the most common, the court is not required to apply either formula, but is simply required

to divide property to achieve substantial justice between the spouses. Even if the family court elects to go this route, we think it is likely that it would award you greater than the $50 million stipulated by Harlan's counsel.

Although substantial justice does not always require that a court divide an entire increase in value of separate property, it does require that the court divide the portion of the increase that was principally due to community efforts. As discussed above, the increase in value of the shares during your marriage was principally doing to Harlan's work in leading DigitalAudio and your work in supporting him to be able to do so. The efforts that you made to care for your children and take care of your home, enabled Harlan to dedicate his entire time to DigitalAudio. Therefore, it is substantially just to divide the $200 million increase equally as community property.

Courts have not found that an award is unjust where the court awards "tens of millions to one spouse" and "hundreds of millions" to another. *In re Marriage of Rand* (Colum. Ct. App., 2015). However, in your case, thus far, you have received nothing and are "barely getting by" while Harlan is, by his own admission, "getting by quite well." This factor may also point in your favor to ensure a greater grant of community property.

IV. Conclusion

In sum, although Harlan's shares were separate property, the community acquired an interest in the increased value of the shares because Harlan dedicated his efforts to increasing the value while he was a part of the marital community. Because the increase in value was largely due to his efforts as Chief Scientific Officer, not market forces, the court should apply the Pereira formula and characterize the increase as community property. In doing so, it should apportion you $100 million, or 50% of the increase. The stipulation offers a sure guarantee of $50 million. However, because we think it is highly likely that the family court will apportion you $100 million, I recommend that you do not accept the offer.

We look forward to hearing from you and welcome any questions you have regarding the matter.

Sincerely,

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Andrew Washington