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Community Property

Court Did Not Err in Using *Van Camp* Method to Apportion the Increase in Value of Husband's Separate Property Stock

*By Carol Rothstein, J.D.**

In *In re Marriage of Brooks* (No. H043467; Ct. App., 6th Dist. 3/27/19) 33 Cal. App. 5th 576, __ Cal. Rptr. 3d __, 2019 Cal. App. LEXIS 270, the Sixth District Court of Appeal affirmed the use of the *Van Camp* method to apportion the appreciation in value of Husband's separate property stock in a business he started before the marriage. The trial court found that the growth of the business, and the concomitant increase in the value of the stock, were due to the efforts of others. Although Husband continued to work in the business, the court concluded that he did not contribute to its growth after the marriage.

In the opinion by Presiding Justice Greenwood (Grover, Danner, JJ., concurring), the appeals court found that substantial evidence supported the trial court's determination that Husband's effort during the marriage was not the "chief contributing factor" causing the increase in value, and that the *Van Camp* method was therefore appropriate, even though the appreciation was due to the active efforts of others, rather than market forces. The appeals court also found substantial evidence supported the trial court's determination that Husband's salary during the marriage adequately compensated the community.

Facts and Procedure. The parties married in June 1989 and separated in 2009. Prior to the marriage, in 1983, Husband started a technology company, DigiDesign, with his friend, Peter Gotcher. The two men each invested $7,000 in capital and received equal shares of the company's stock. DigiDesign became known for two

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digital sound editing products, Sound Tools and Pro Tools, which changed the nature of sound editing. Avid purchased DigiDesign for $200 million in 1995. At the time of the sale, Husband's stock was worth $38 million.

Gotcher ran the business side of DigiDesign, while Husband was the inventor and key developer of Sound Designer, the software component of Sound Tools. Sound Tools went to market before the parties married.

DigiDesign continued to modify Sound Tools until 1991, when it launched Pro Tools. Gotcher testified that the development of "new functionality" in Sound Designer was tapering off by the time of the parties' marriage. However, Husband remained heavily involved in the process of modifying Sound Tools between 1989 and 1991 and was the key software engineer for the product. A team of people worked on Sound Designer and Husband incorporated the team's work into the application.

The revenue from Sound Tools reached its peak in 1991. Husband's valuation expert testified that DigiDesign's value would have decreased after the date of marriage if Pro Tools had not been released. The release of Pro Tools had nothing to do with Husband's postmarriage efforts, which were no more than that of other DigiDesign employees. By 1996, when Avid acquired DigiDesign, Sound Tools accounted for only four percent of DigiDesign's revenue. Although Avid was interested in the hardware component of Sound Tools, it purchased DigiDesign primarily to acquire Pro Tools. Husband was not involved in negotiating the sale of DigiDesign to Avid.

Pro Tools' software was buggy when it was first released, and Pro Tools was not a market success for several years. The trial court found that DigiDesign might have lost market share when Pro Tools was released, without Husband's continued work on Sound Tools.

Gotcher testified that DigiDesign would not have existed without Husband and that the company maintained a "key man" life insurance policy on him. Gotcher also confirmed that the appreciation in DigiDesign's value between the parties' marriage and its sale to Avid was due to active, rather than passive, appreciation. Husband's compensation expert testified that Husband's work at DigiDesign helped make the company one of the best places to work. However, Husband's valuation expert testified that the increase in DigiDesign's value was not due to Husband's efforts, but rather was "due to the organization itself. . .and the products that the company [had] developed and sold."

Husband worked long hours at DigiDesign between the date of marriage and the date of sale. He received a yearly salary, ranging from $68,412 in 1989 to $140,675 in 1994, which all witnesses testifying on the subject agreed adequately compensated the community for his efforts. DigiDesign's chief operating officer from that time, Paul Lego, testified that Husband's function at the company was that of a very high level engineer, with no management duties, and that although he was on DigiDesign's board of directors, he did not take a leadership role. Husband's compensation expert stated that although Husband's job title was "chief technology officer," he did not have the "executive managerial functions he would expect from someone with that title."

Wife's expert did not qualify as a compensation expert and did not address whether Husband's compensation was reasonable. Husband's compensation expert testified that Husband received "competitive compensation" for his services during the marriage, both within DigiDesign and compared to similarly technology startups.

In its final statement of decision, the trial court concluded that it was required to use the *Van Camp* approach, because Sound Tools was a successful and mature product before the marriage, DigiDesign's

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growth after the marriage "did not stem from extraordinary contributions" by Husband, and Husband's earnings during marriage adequately compensated the community. The court also found that Husband contributed greatly to the company's success by constantly updating Sound Tools during the marriage and that DigiDesign might have lost market share had he not done so. Although Husband had not played a role as an executive leader of DigiDesign, his skills, talents, energy and labor were required to maintain the company's viability until at least 1992, when Pro Tools began to experience success.

The court concluded that it should apportion DigiDesign profits between the separate and community estates. The court stated that although Husband was important to the company and held an officer's position, he did not play a leadership role and did not contribute to the company's growth after the date of marriage. The court therefore adopted a *Van Camp* approach to apportioning the company's growth. The court found that the appreciation of the DigiDesign stock was return on Husband's separate property, because the shares were issued to him before marriage.

Wife appealed.

Abuse of Discretion Standard. The appeals court explained that issues pertaining to the allocation of the community's interest in a spouse's separate property business are reviewed for abuse of discretion. The abuse of discretion standard "measures whether, given the established evidence, the act of the lower tribunal falls within the permissible range of options set by the legal criteria." Even if there is only a "fairly debatable justification for the ruling," it will not be set aside on appeal.

***Van Camp* and *Pereira* Approaches.** The key issue in apportioning the postmarriage increase in the value of Husband's DigiDesign stock between his separate estate and the community was determining the appropriate method of apportionment. The *Pereira* approach, which is used when business profits are principally attributed to efforts of the community, allocates a fair return to the separate property investment and allocates the balance of the increased value to community property. The *Van Camp* approach is used when community effort is more than minimally involved in a separate business, but the business profits are attributed to the character of the separate asset. Under *Van Camp,* the court must allocate the "reasonable value of the community's services" to community property and the balance to separate property.

Courts have endeavored to use the approach that is most appropriate in a particular situation, depending on the "chief contributing factor" in the realization of profits. The court may select the formula that will "achieve substantial justice between the parties," including a hybrid approach [*see* In re Marriage of Brandes (2015) 239 Cal. App. 4th 1461 (applying *Pereira* to an early period of the marriage and *Van Camp* to a later period)].

Substantial Evidence Supported Finding that Husband Was Not Primary Factor in DigiDesign's Postmarriage Growth. The court applied *Van Camp* after finding that although Husband was important to the company and held an officer's position, he did not play a leadership role in the company and did not contribute to the company's growth after the date of marriage. Wife argued that this finding contradicted other findings made by the court that would support a ruling that Husband contributed significantly to the company's growth, including its findings that Husband was a critical member of the company, that he contributed greatly to the company's success during the life of Sound Tools, that the company could not have maintained and improved Sound Tools without Husband's work during marriage, and that Husband's efforts and talents were required to maintain the company's viability until at least 1992, when Pro Tools began to achieve success. Wife argued that substantial evidence supported these findings, which revealed that the court erred in applying *Van Camp* rather than *Pereira.*

The appeals court stated that the question was not whether substantial evidence supported Wife's argument, but whether substantial evidence supported the trial court's application of *Van Camp.* While the appeals court agreed with Wife that Husband made at least a minimal contribution to DigiDesign's growth after marriage, the relevant legal criteria did not require the court to find that Husband made *no* contribution to the increase in value. Instead, the trial court was required to consider whether Husband's efforts during the marriage were the "chief contributing factor" causing the increase.

The appeals court acknowledged that the trial court may have erred in finding that Husband made no postmarriage contribution to DigiDesign, but there was substantial evidence that his postmarriage contributions were not the chief factor in DigiDesign's growth. "Even if the trial court articulates the wrong reasons when arriving at a correct conclusion," the appeals court wrote, "we will presume the judgment correct and affirm it on any ground supported by the evidence, whether articulated by the trial court or not." In this case, substantial evidence supported the trial court's finding that the contributions of others caused the increase in DigiDesign's value after the date of marriage.

***Van Camp* Is Applicable When Increase of Business's Value is Due to Efforts of Others.** Wife argued that *Van Camp* applies only when market forces cause the postmarriage increase of the value of a separate property business. She argued that it was irrelevant that others at DigiDesign contributed to its growth, because Gotcher's testimony established that the appreciation was active rather than passive, in that it was due to activity within the company, rather than market forces.

The appeals court explained that, under *Brandes,* the court can use the *Van Camp* method when the value of a company increases during the marriage because of the efforts of other people, rather than because of market forces. In *Brandes*, the husband started an investment advisory services company before the marriage. At the time of the marriage, the company managed $20 million in assets, which grew to $85 billion at the date of separation. The trial court found that the husband's efforts were the primary factor in the company's growth during the first five years of marriage, when he was the sole manager of the business. After that time, the company's new chief executive officer and chief operating officer proposed changes to the company's investment strategies and changed the management structure, taking decisions away from the husband. The new business strategies, together with market factors, drove the company's growth until the date of separation. The court adopted a hybrid approach to apportioning the postmarital growth, finding that *Pereira* applied to the first five years of the marriage and that *Van Camp* applied to the remainder. The Court of Appeal upheld the apportionment and did not express concern that the business grew for reasons other than market factors during the *Van Camp* period.

The appeals court analyzed the facts of the current case in the context of *Brandes* and found that substantial evidence supported the trial court's finding that *Van Camp* applied to the entire postmarriage appreciation in value. The appeals court reasoned that, unlike the *Pereira* period in *Brandes,* Husband did not have significant managerial duties at DigiDesign after the date of marriage. Although his involvement in the company attracted other employees, he had minimal involvement in hiring, training or directing them. Instead, his contributions to the company were akin to the work done by other senior software engineers in the company. While Husband was responsible for maintaining Sound Designer, a team of employees worked on upgrades and improvements. Moreover, DigiDesign was purchased primarily because of Pro Tools, with which Husband had minimal involvement. Although Husband was listed as the chief inventor on a patent related to Pro Tools, he did not come up with the idea, nor did he significantly contribute to the software or hardware. Had DigiDesign not developed Pro Tools, it would not have been as successful as it was.

Substantial Evidence Supported Finding that Community Was Adequately Compensated. Wife argued that applying the *Van Camp* apportionment method ignored Husband's contribution to DigiDesign during the marriage. The appeals court disagreed, explaining that under the *Van Camp* method, when the spouse's contributions are not the chief factor in the separate property business's growth during the marriage, the court must still consider the spouse's contribution to the business during the marriage by looking at his or her compensation. The trial court did so in this case, when it looked at whether Husband's compensation reflected a reasonable value for the community's services during the marriage. Substantial evidence supported the trial court's finding that Husband's postmarriage salary compensated him for his postmarriage contributions to the company. The testimony showed that the company used a well-regarded salary index to set salaries, that Husband received a competitive salary for his work, and that Husband's job duties were that of a regular employee, rather than an executive or management level employee. Wife did not offer contradictory testimony from her compensation expert, who focused only on the *Pereira* method.

The appeals court found no abuse of discretion in applying the *Van Camp* method of apportionment to find that the increase in stock value was Husband's separate property.

Commentary

Stacy Phillips and Kevin Martin

In re Marriage of Brooks is a must read for any family law practitioner facing the complex analysis associated with the deciding how to apportion the increase in value of a separate property business between community and separate property. The apportionment approach that is applied could make or break your client's case.

In *Brooks*, there was no disagreement that the business at issue was Husband's separate property. Similarly, both parties agreed that, post-marriage, the value of Husband's business increased dramatically. The trial court in *Brooks* found that Husband did not contribute to the growth of his separate property business after the date of marriage and, accordingly, applied the *Van Camp* apportionment method—a devastating blow to Wife. (Husband's initial capital contribution was $7,000, and the value of the stock he held in his business grew to $38,000,000 at the time of its sale). The primary issue before the Court of Appeal was whether the trial court improperly applied the *Van Camp* apportionment method (valuing a spouse's community property efforts devoted to the business, with the remainder constituting separate property income) in lieu of a *Pereira* apportionment method (calculating a fair return on the spouse's separate property investment in the businesses, with the remainder belonging to the community).

At first blush, the trial court's finding that Husband did not contribute to the growth of the business after the date of marriage appears at odds with the facts in *Brooks*. Consider the following: (i) Husband was one of the founders of his business; (ii) Husband held numerous formal and informal titles at his business, including vice-president, chief scientist, chief technology officer, and director; (iii) Husband was the inventor and key software developer for an important product offered by his business; (iv) Husband's work at the business helped create positive culture, making it one of the best places to work; and (v) Husband devoted a tremendous amount of time to his business. All of these facts appear to be indicia that Husband played a critical role in his separate property business.

In light of the foregoing, what led the trial court to conclude and the Court of Appeal to affirm the application of the *Van Camp* apportionment method? Husband's counsel, through expert and percipient witness testimony, "peeled back the onion" and dug beneath the corporate titles and took the time to understand the economics of Husband's business. Counsel successfully demonstrated to the court that: (i) while Husband was a director, the board of directors did not exercise control over Husband's partner, who determined the business's products and services; (ii) Husband did not play a leadership role in the business; (iii) the growth of the business after the parties' marriage was driven by a new product that Husband had no involvement in; and (iv) Husband's partner was the primary decision maker at the business. In short, Husband established at trial that Husband's work at the business was akin to the work done by other senior software engineers in the business and the growth of the business was a result of the efforts of others within the company. In other words, Husband demonstrated he was not the chief contributing factor for the growth of his business – the key element for shifting to the *Pereira* apportionment method. In so doing, the Court of Appeal supports its decision in *Marriage of Brandes* (2015) 239 Cal. App. 4th 1461, holding that the *Van Camp* apportionment method applies when the increase in value is a result of the efforts of others within a company—as opposed to only applying to situations where market forces are the cause of increase.

The lesson learned from the Court of Appeals in *In re Marriage of Brooks* is clear—the facts on the ground will drive the determination of whether to apportion the increase in value of a separate property business through a *Pereira* approach or a *Van Camp* approach. As demonstrated by Husband in *Brooks*, in order to make the most effective apportionment argument, it is incumbent upon counsel to obtain a thorough understanding of the drivers of the client's business, as well the legal issues involved. In high stakes cases, the use of expert and percipient witnesses will be critical.

Commentary

Vanessa Kirker Wright

This opinion turns largely on the standard of review. At first reading, it might seem that it is a valuation case providing instruction on the use of *Pereira* or *Van Camp*. And it is that too. But when I read it through again, it becomes clear that the case could have (and might have) gone the other way if the Court adopted the "de novo" versus "abuse of discretion" standard of review.

Here is what the Court says: "If we adopted Wife's proposed de novo standard of review, we would determine anew which apportionment method best affords substantial justice between the parties. However, as we are reviewing the issue for abuse of discretion, we consider whether the trial court's action fell within the permissible range of options set by the legal criteria." Then the Court goes on to observe that Wife had a lot of good "de novo" arguments—if de novo had been the standard. But when applying the "abuse of discretion" standard, the Court actively searches the record for evidence to support the trial court's ruling. If there is a reasonable amount of support for the ruling (and "reasonable amount" usually means "some"), then it will be affirmed. Here, the Court confirmed that if "other people" (as opposed to the traditional "market forces") were the driving force behind the increase in valuation, then the trial court did not abuse its discretion in accepting a *Van Camp*-type valuation.

In addition, it looks like this is a good lesson to all of us regarding expert testimony. Likely as a result of a strategy call, Wife did not produce testimony of reasonable compensation, nor did her expert analyze Husband's job duties or look into whether Husband contributed to the company's increased sales during the marriage. The Court repeats Husband's evidence that "the company started from scratch" when it moved from the original product (Husband's idea) to the new product, Husband did not contribute to the new product, the new product was in a different computer language (not sure how this was important since computer languages change almost by the minute), Husband didn't direct or guide the work on the new product and the designer didn't consult with Husband on the new product. One has to wonder what Husband did all those years when he was working "more than full time" if he wasn't working on the company's flagship product. But, again, that is a matter of producing evidence and Wife apparently did not produce sufficient contrary evidence.

It is still difficult for me to understand how a guy who concededly drove the company's original product somehow had very little or nothing to do with its overall success with the follow-up product. And the idea that Wife saw little to no benefit of all of that work at the company for all of those years just doesn't sit right. But I can't say it was wrongly decided.

Finally, as we all recall, in *In re Marriage of Brandes* (2015) 239 Cal. App. 4th 1461 the Court held that the trial court could consider whether the "character of the capital investment in the separate property or the personal activity, ability, and capacity of the spouse is the chief contributing factor" in the increase in value. The *Brandes* Court also held that a trial court can apply whichever formula or combination of formulas (Pereira or Van Camp) would achieve "substantial justice" in the case. (Id at 1473). Following *Brandes*, *Brooks* confirms that *Van Camp* can be used if the increase in value is chiefly due to "other peoples" efforts. It truly appears that, as with tracing, these cases must be won or lost in the trial court.

References: California Family Law Practice and Procedure, 2nd ed., § 22.26[1][b] (*Van Camp* and *Pereira* methods of apportionment).