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NEVADA FAMILY LAW REPORT

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CHILD CUSTODY MODIFICATION

by Mary Anne Decaria, Esq.

For nearly forty years, the Nevada Supreme Court adhered to the child custody modification standard first articulated in *Murphy v. Murphy*, 84 Nev. 710, 711, 447 P.2d 664 (1968), which held that a change of primary physical custody is "warranted only when: (1) the circumstances of the parents have been materially altered; and (2) the child's welfare would be substantially enhanced by the change." The court veered sharply in 1994 when it created an analytical double standard between primary custody and shared custody modification cases by holding that in cases of shared physical custody, only the best interest of the child need be established. *Truax v. Truax*, 110 Nev. 437, 874 P.2d 10 (1994).

In *Ellis v. Carucci*, 123 Nev. Adv. Op. 18 (2007), the Nevada Supreme Court partially overruled the venerable *Murphy* to the extent it required a change in the circumstances of the parents and updated the two-prong test to state: "modification of primary physical custody is warranted only when (1) there has been a substantial change in circumstances affecting the welfare of the child, and (2) the modification serves the best interest of the child." *Id*. at 2; 9; 16.

When Melinda Ellis and Rod Carucci divorced in 2000, they agreed to share legal custody of their daughter, Geena, with Mom having primary physical custody and Dad, liberal visitation. In 2004, Dad filed two motions seeking primary physical custody of Geena, claiming changed circumstances in that Geena was not doing well in school. At hearing, her teacher testified that Geena, a very bright student, did well during the first two quarters of the school year, but between December and March, her weekly progress reports showed that she did not turn in homework and talked in class. Essentially, Geena stopped applying herself, refusing to complete assignments or revise her work. Dad spoke regularly with Geena's teacher

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CHILD CUSTODY MODIFICATION

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about her academic performance, but the teacher claimed to have little contact with Mom. The teacher recommended that Geena be given more encouragement from both parents to offset the deterioration in her school work.

A psychologist, Joann Lippert, performed a family evaluation and testified that Geena was strongly attached to both parents and recommended shared physical custody. Dr. Lippert believed that Geena's best interest would be met if both parents were actively involved in her education. The District Court found that Geena's drop in school performance was a significant change of circumstance warranting a change in custody from primary physical custody to joint physical custody, in the child's best interest.

On appeal, the Nevada Supreme Court noted that "the underlying premise behind the *Murphy* standard, which aims to promote stability by discouraging the frequent relitigation of custody disputes... unduly limits courts in their determination of whether a custody modification is in the best interest of the child." *Ellis* at 9. Because *Murphy* was decided long before the legislature changed NRS 125.480 and NRS 125.510 to "identify the 'best interest of the child' as *the* primary concern in custody determinations," *Id.*, the court decided it was time to restate the *Murphy* test.

> In reaching our conclusion, we overrule *Murphy* to the extent that it required a change in "the circumstances of the parents" alone, without regard to a change in the circumstances of the child or the family unit as a whole. We note, however, that under the revised test, there must still be a finding of a *substantial* change in circumstances. While the *Murphy* test is too restrictive because it improperly focuses on the circumstances of the parents and not the child, custodial stability is still of significant concern when considering a child's best interest. The "changed circumstances" prong of the revised test serves the important purpose of guaranteeing stability unless circumstances have changed to such an extent that a modification is appropriate. In determining whether the facts warrant a custody modification, courts should not take the "changed circumstances" prong lightly. Moreover, any change in circumstances must generally have occurred since the last custody determination because the "changed circumstance" prong "is based on the principle of res judicata" and "prevents 'persons dissatisfied with custody decrees [from filing] immediate, repetitive, serial motions until the right circumstances or the right judge allows them to achieve a different result, based on essentially the same facts.'" (citation omitted) *Id*. at 11, 12.

The Supreme Court stated that the change in the second prong of the test follows the legislative mandate that in custody determinations, the sole consideration of the court must be a child's best interest.

Applying the new modification standard to the facts of the case, the Supreme Court upheld the lower court's change of custody, finding the four-month record of Geena's sliding school performance to be a substantial change of circumstance and that changing custody to joint physical custody was in her best interest because it assured the involvement of both parents in her education.

Were there facts that the court did not articulate in its opinion, or did it really approve a change of custody solely upon Geena's short period of diminished school work? What were the circumstances underlying the rapid change in her academic behavior? Why did Geena excel before the Christmas break but not after? There had to be more to it than the fact that Mom did not consult with Geena's teacher and Dad did. The only portion of Dr. Lippert's testimony relayed to us by the Supreme Court is a statement of the obvious; it is good for children when both parents are actively involved in their education. Certainly, a parent need not be an equal custodian to be actively involved in his/her child's education. Why did the Supreme Court choose these minimal facts to upend 40-year-old precedent?

Ellis overruled *Murphy* "to the extent it required a change in 'the circumstances of the parents' alone." *Id.* at 11, 12. While the terminology may be slightly outdated, *Murphy*'s focus was never solely on the parents but on what was going on in the household and the materiality of its affect on the children. The court's determination that *Murphy* "improperly focuses on the circumstances of the parents and not the child" is inconsistent with Nevada law as analyzed in the removal cases, which recognize that the interests of the children are integrally intertwined with the circumstances of their parents. In fact, the Supreme Court has chided the lower courts for ignoring the needs of the parents when determining the best interest of the children. *See, McGuinness v. McGuinness*, 114 Nev. 1431, 1438, 970 P.2d 1074 (1998) ("The district court below, and numerous other judicial officers in this state have taken an approach to relocation motions brought under NRS 125A.350 that ignores the needs of the parents, even though these needs are vital to, and an integral part of, the considerations in determining the best interest of the children.").

Ellis appears to require a lesser burden of proof than does the *Murphy* test, in that it states "a modification of custody may serve a child's best interest even if the modification does not substantially enhance the child's welfare." *Id*. at 13, 14. In other words, custody may be modified without having to establish that the change necessarily advances the well-being of the child. While the first prong of the *Ellis* test requires proof of a substantial change in circumstances affecting a child's welfare, the best interest prong does not compel proof that modification would actually improve the child's situation. This does not make logical sense. How can something so substantial be going on that a child's welfare is adversely affected, yet the solution need not be proven to ameliorate the child's circumstances?

Perhaps the illogic of the analysis is in the mind of this author and not in the Supreme Court's attempt to rework the child custody modification standard. Perhaps *Ellis* and *Murphy* are identical in application and the court merely intended to rephrase the standard in 21st century parlance, making the variance one of style and not of substance; like trading in the old tie-dyed T-shirt and bell bottom jeans you wore in 1968 for the new tie-dyed muscle shirt and flare-legged jeans you just bought at Old Navy.

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HIDDEN MONEY IN MILITARY DIVORCE CASES

By Mark E. Sullivan, Esq.

Q. I'm representing Mrs. Roberts, the wife of Army Colonel Bill Roberts, in her divorce case. What are some of the overlooked sources of money and benefits?

A. When representing the nonmilitary spouse, the accrued leave of the servicemember (SM) is a valuable but often overlooked part of marital property division. Each person in military service on active duty accrues 30 days of paid leave per year, regardless of rank. This leave is worth what its equivalent would be at the monthly pay rate of the SM, and one can calculate this easily by using the pay tables available at the Defense Finance and Accounting Service (DFAS) website, www.dod.mil/dfas.

Thus, if Col. Roberts's gross pay is $6,600 per month and he has 45 days of accrued leave at the point of evaluation according to state law (i.e., date of separation, date of filing, date of divorce), his accrued leave would be worth about $9,900 [45/30 x $6,600], which represents gross pay before tax and other withholdings. Counsel for Mrs. Roberts should advocate use of the gross pay figure, whereas opposing counsel should use after-tax computations for the pay and eliminate any non-pay entitlements.

Counsel for the SM sometimes will attempt to confuse the issue by pointing out that the nonmilitary spouse cannot be awarded military leave. This argument misses the point. The issue is not who can use military leave but whether, under applicable state law, assets such as "vacation time" and "sick leave" are marital or community property if it is acquired during the marriage.

If the individual will not voluntarily produce his monthly LES, (Leave and Earnings Statement), counsel may resort to formal discovery procedures if the matter is in litigation. In addition, the DFAS office in Cleveland will honor a request for documents so long as it is in the form of a court order or a subpoena signed by a judge.

Sometimes the attorney for the retiree will disavow any knowledge of the existence of the LES, or the SM will claim that it was lost, misplaced, or "floated away in that big flood last month." All SMs are eligible for a free "myPay" account at the DFAS website. This secure website is found at https://mypay.dfas.mil. Once there, it is a simple matter for the member to obtain his current LES; he just enters his "LogIn ID" and password, and then goes to the screen for current pay information. Sometimes a judge, when frustrated with the refusal of a SM or his attorney to produce an LES, will issue an order requiring both attorneys and the SM to use a computer to access the current or past LES from the myPay website.

DFAS even has a way that a third party can be given access to the secure website to view, but not to change, the SM's pay information. Here's what the DFAS website says:

> What is a restricted access Personal Identification Number (PIN)? You now have the ability to establish a Restricted Access PIN. The Restricted Access PIN may be given to others along with your Social Security Number to view your pay or tax statements without allowing them to create any pay changes. You may establish a restricted access PIN by clicking on the Personal Setting Page, and selecting the Restricted Access PIN option. You may delete the restricted access PIN at any time. If the user suspends their restricted access PIN you must reset the PIN and provide that new PIN number to the user.

Q. What else can we do for the non-military spouse?

A. Even with a short marriage of, say, five years, the pension share is worth something. Don't waive it without getting a trade. Assume that the husband is Sergeant First Class John Doe, in the pay grade of E-7, with 20 years of service, who will get an estimated $1,600 a month retired pay if he retires at the 20-year mark, which many SMs do. If there were only five years of marriage, his ex-wife would get 50% of 5/20 of $1,600, or $200 a month. If she is 40 when he retires and he were to live another 35 years, this would be worth $2,400 a year, or $84,000. That's a lot of money!

The lesson? If you want a pension waiver, you have to ask for it and pay for it. If your client is asked to waive military pension division, make sure she or he does it for a reasonable, fair trade—don't just give it away if the period of marriage is short. Look at the facts and calculate the numbers. Even if you trade the pension waiver for a washer, dryer and TV, you're doing better than just giving it away.

Q. What about reenlistment bonuses and other special pay?

A. "Reenlistment bonuses can be big money, especially when you consider the impact of signing reenlistment papers in a combat zone," according to Stephen T. Lynch, a Coast Guard legal assistance attorney in Cleveland. Lynch notes:

> For military members who are 1) about to get divorced, and 2) about to reenlist, counsel should be sensitive to the timing of both events, and the potential impact of one on the other. Many enlisted personnel are eligible for a reenlistment bonus. For example, assume that Petty Officer Jake Jones (PO2) is a Navy Seal Independent Duty Corpsman. He would be eligible for a reenlistment bonus totaling as much as $75,000— which will come free of state and federal income taxes, if reenlistment occurs in a combat zone. There are obvious advantages for this sailor if he were to obtain a divorce prior to signing the reenlistment papers, and obvious advantages to Mrs. Jones if she were to delay the divorce until after Jake reenlisted and received his bonus. How much of the bonus, if any, would accrue to Mrs. Jones is a matter of state law and artful negotiation. However, if counsel for Mrs. Jones is unaware of the pending bonus and the timing implications, then counsel surely will fail to assert Mrs. Jones' interest in a sizeable payment that can be made in a lump sum and just might serve as a ready source for alimony, child support, and the payment of pending bills (such as mortgages, car payments, and attorney fees). Information about reenlistment bonuses may be found at: http://usmilitary.about.com/od/enlistmentbonuses/l/bl01bonus.htm.

Q. Is there anything else for the spouse who is not in the military?

A. Yes, and it has to do with insurance. Many military members, including Guard and Reserve, choose USAA for their insurance needs. A little-known fact about USAA is that members have a Subscriber's Savings Account which contains moneys contributed through premiums for property and casualty insurance (such as car insurance) and distributed from time to time to the subscribers. These periodic distributions amount to a refund of money not needed for operating reserves and they come as a credit on the quarterly or yearly premium, thus saving money for the customer. If one of the parties will be retaining USAA membership and benefits, including the balance in the Subscriber's Savings Account, then it makes sense to ask how much is in the SSA and allocate the sum to that party, even though it is money which can't be spent. The USAA pamphlet, "Subscriber's Savings Account," states:

> An SSA is not a bank account. A member cannot make withdrawals from, or deposits to, an SSA. Since SSA funds are an integral part of USAA's capital structure, they remain with the association as long as the member has at least one P&C [property and casualty] policy. If a member terminates all P&C policies, the balance of the SSA is paid out approximately six months later.

Q. How can we save some money for Col. Roberts?

A. You can save money for Col. Roberts in several ways in negotiations over his pension or, if your trial judge allows it, in the courtroom. The first one is to use a *set dollar amount* in specifying the pension share for his wife upon divorce. This means that the spousal entitlement is calculated (usually with 50% of the marital share as the model) and then converted in today's dollars to a specific monetary amount, such as: "Mrs. Roberts shall receive $495 a month from the

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disposable retired pay of Col. Roberts, the defendant." This method of dividing the pension, if accepted by the other side, means that all future increases in Col. Roberts' pay belong to him, and upon retirement the cost-of-living adjustments (COLAs) which are applied to retired pay go solely to him. She receives none of these benefits.

Another option, if the first won't work, is freezing the benefit for Mrs. Roberts at the rank and years of service of her husband at divorce or separation, whichever is used under state law for the point of evaluation of marital assets. In this way, we will be fixing his rank at the date of separation or divorce. That will mean that we're dividing the pension of a colonel right now, not a two-star general, which he might be at the time of retirement.

Col. Roberts will also want to try to keep the denominator of the marital fraction as the total years of creditable military service, not the years up to the date of separation or divorce. In doing this, we are creating a marital fraction that is constantly shrinking in absolute value, not one that, in fairness, should be fixed as of the latter date.

A third step would be to state that we are dividing the retired pay of a colonel with a certain number of creditable years of service, fixing the years of service at the date of divorce or separation. The years of creditable service would usually be stated in even numbers, so we could say "a colonel over 20" or "a sergeant over 16" to show how many years of service at that rank. This likewise keeps the divisible pay down; we are fixing the benefit to be divided at the time of divorce or separation. Finally, we would want to fix the pay tables involved as of the date of the separation or divorce, whichever is appropriate under state law. In doing this, we insulate Mrs. Roberts from any future congressional pay raises; all of these accrue solely to the benefit of Col. Roberts.

If we specify these in the pension division clause for Col. Roberts, it could mean a savings of tens or hundreds of thousands of dollars for him, in comparison to using his final rank upon retirement, and the pay tables that would apply when he retires.

Q. What about military medical care— is there some money to be saved there? Is Mrs. Roberts eligible for that after divorce?

A. Yes, if the marriage and the military career were long enough. There must be 20 years of military service concurrent with 20 years of marriage to get full military medical benefits. This means medical insurance coverage through TRICARE, the military equivalent of Blue Cross, and some free medical care at military medical treatment facilities.

Pub. L. 98-525, the Department of Defense Authorization Act of 1985, expanded the medical (and other) privileges set out in Pub. L. 97-252 to extend certain rights and benefits to unremarried former spouses of military members. If the former spouse was married to a member or former member for at least 20 years during which he or she performed at least 20 years of creditable service (also called "20/20/20" spouses, which refers to 20 years of service, 20 years of marriage, and 20 years of overlap), then the former spouse is entitled to full military medical care, including TRICARE, if not enrolled in an employer-sponsored health plan. He or she is also entitled to commissary and exchange privileges. 10 USC §1062.

If the former spouse was married to a member or former member for at least 20 years during which the member or former member performed at least 15 years of creditable service (also called "20/20/15" spouses, for 20 years of service, 20 years of marriage and 15 years of overlap), and the former spouse is not enrolled in an employer-sponsored health plan, then the length of time that the former spouse is entitled to full military medical care, including TRICARE, depends upon the date of the divorce, dissolution or annulment, as set out below. No other benefits or privileges are available for this spouse.

If the date of the final decree of divorce, dissolution or annulment of marriage was before April 1, 1985, then the former spouse is authorized full military medical care for life, so long as he or she does not remarry. If the decree date is on or after April 1, 1985, then the former spouse is entitled to full military medical care, including TRICARE, for a period of one year from the date of divorce, dissolution or annulment.

If the former spouse for some reason loses eligibility to medical care, he or she may purchase a "conversion health policy" (10 USC §1086(a)) under the DOD Continued Health Care Benefit Program (CHCBP), a health insurance plan negotiated between the Secretary of Defense and a private insurer, within the 60-day period beginning on the later of the date that the former spouse ceases to meet the requirements for being considered a dependent or such other date as the Secretary of Defense may prescribe.

Upon purchase of this policy the former spouse is entitled, upon request, to medical care until the date that is 36 months after (1) the date on which the final decree of divorce, dissolution or annulment occurs or (2) the date the one-year extension of dependency under 10 USC 1072(2)(H) (for 20/20/15 spouses with divorce decrees on or after April 1, 1985) expires, whichever is later. 10 USC §1078 a(g)(1)(c). Premiums must be paid three months in advance; rates are set for two rate groups, individual and group, by the Assistant Secretary of Defense (Health Affairs). CHCBP is not part of TRICARE. For further information on this program, contact a military medical treatment facility health benefits advisor, or contact the CHCBP Administrator, P.O. Box 1608, Rockville, MD 20849-1608 (1-800-809-6119).

A former spouse who qualifies for any of these benefits may apply for an ID card at any military ID card facility. He or she will be required to complete DD Form 1172, "Application for Uniformed Services Identification and Privilege Card." The former spouse should be sure to take along a current and valid picture ID card (such as a driver's license), a copy of the marriage certificate, the court decree, a statement of the member's service (if available) and a statement that he or she has not remarried and is not participating in an employer-sponsored health care plan.

It is important to remember that these are statutory entitlements; they belong to the nonmilitary spouse if she or he meets the requirements of federal law set out herein. They are not terms that may be given or withheld by the military member, and thus they should not be part of the "give and take" of pension and property negotiations since the military member has no control over these spousal benefits.

Q. You said that military medical benefits depend on the date of divorce. What if my client has all the other requirements but is just 6 months short of 20 years of marriage?

A. Since 20/20/20 medical coverage depends not on the date of separation or the date of filing, you might need to postpone the divorce for six months. This may not be easy, but if you look hard enough you might be able to find something that you can contest, that the other side did wrong in the pleadings, or that you can at least question through discovery. I had a case several years ago where there was a question about the domicile of the SM— he was the one filing for divorce. We were desperate to delay the granting of a divorce. I started with a set of interrogatories and document requests related to domicile, which of course is an essential jurisdictional element in divorce. The plaintiff got so busy fighting off my discovery requests and my motions to compel that he went through two separate civilian lawyers and a JAG officer at Ft. Totten, New York, before the court finally granted him a divorce. That was a year and a half after he'd filed for divorce!

Q. Are there any retirement benefits in the military similar to a 401(k) plan?

A. Yes. In addition to the military pension, which is a defined benefit plan that has existed all along, we now have another retirement benefit. This is the Thrift Savings Plan, or TSP. It's a voluntary defined contribution plan, it can be divided, and it's basically the same as the federal civil service TSP. Contributions are sheltered from taxes and are allowed to grow in a number of different funds selected by the servicemember.

Q. Are there any resources which can help attorneys understand the military TSP and how to divide it?

A. Yes. There's a 24-page booklet available online. Go to www.tsp.gov and click on *Military— Forms and Publications*, then click on *Publications*, then on *Booklets*, then on *Court Orders*. It's quite helpful and has sample clauses that'll make your work a lot easier and your TSP division order "rejection-proof."

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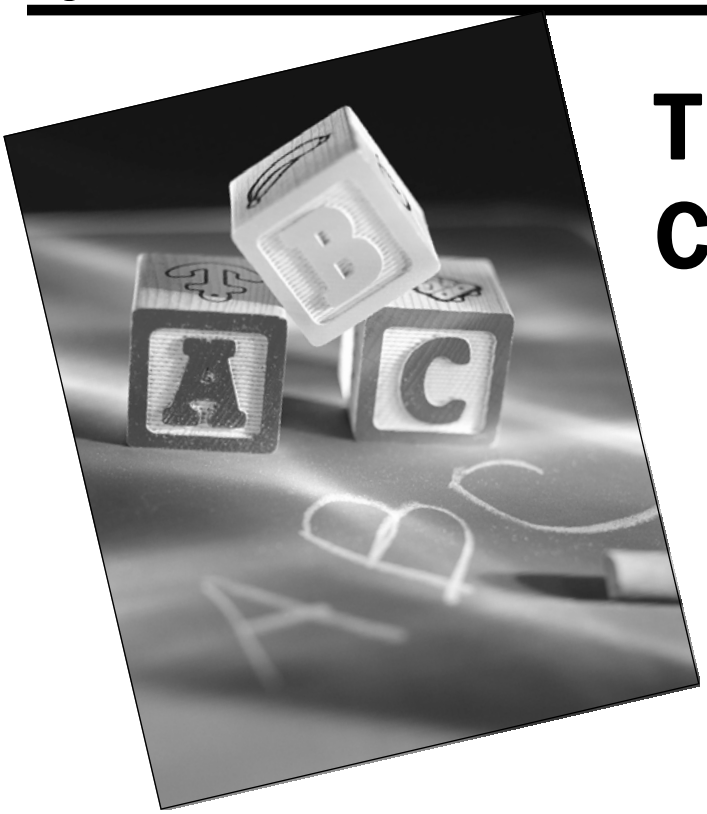


THE ABCs OF CLIENT SELECTION

By K. Beth Luna, Esq.

A few years ago, I read an article from the Florida Bar Association Family Law Section about choosing the right clients to maximize your practice. At that time, I was managing the family law unit of a nonprofit organization. We frequently had too many potential clients and never enough staff to handle their cases. When I read the article it made sense not only for a nonprofit but also for private practice. The principle is that if you select the right clients, you can maximize your time, better represent them and essentially handle more clients effectively.

The advantages to selecting the right clients are numerous and the ability to recognize problem clients is critical. Problem clients tend to have a negative effect on both your time and emotion, but also have a negative effect upon your bottom line. These clients will fail to pay bills, take away time you could have spent with good clients and cause a great deal of personal stress. Since they will frequently tend to blame you for their legal troubles, you can rest assured they are not out generating additional clients, goodwill or business for your firm. In fact, the opposite is probably happening, as they bad-mouth you to anyone and everyone who will listen. See *How to Spot a Problem Client Before It's Too Late* by R. Jon Robins, at http://www.lawyerbillingtips.com/rjon_robins.html. Worst of all is the problem client who turns on you and files a report with the bar and/or sues you for malpractice.

Selecting the right client requires knowing how to identify a problem client and doing so early enough to prevent your acceptance of them as a client; or if identified after you are retained, early on enough in the case to withdraw. You should have in place a set screening system which defines and identifies those clients who will ultimately be a problem. Several sites and articles have ranked clients according to an A-F grading system. Ideally, one represents all "A" or "B" clients. However, the "C" client who can be reformed to an "A" or "B" client might be worth keeping. Any potential client that falls into the "D" or "F" categories should be considered a problem client and careful consideration should be used in accepting their case. If a "D" or "F" client has slipped past your screening system, carefully consider your ethical withdrawal.

I want to be clear that a client with a difficult case or challenging issues does not make an "F" client. Nor does a client with the perfect case make an "A" client. Client problems are due to personal idiosyncracies of the client and not the client's individual case. While everyone's definition of a problem client may vary, there are some general characteristics.

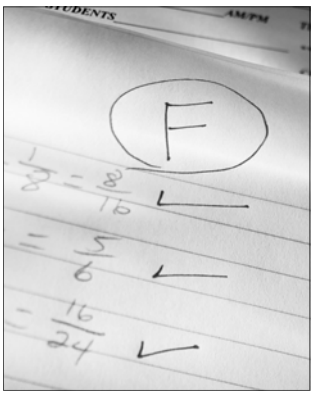
The perfect client, or "A" client, will appreciate you and your staff. They are involved and interested in their case. The "A" client understands that the attorney does not magically know all the facts and circumstances of the case. When you request documents or discovery from them, this client has no problem getting them to you in a timely manner or returning calls promptly. An "A" client will listen to your advice, be sensible about

the legal system and have realistic expectations about what can be obtained through your representation. This client pays his or her bills on time and keeps you updated on important facts that may affect the case. This client is a part of the team and understands that your role as an advocate is enhanced by their cooperation.

The "B" client is one who, while not difficult to deal with, may be a little slow returning phone calls or providing you with the information you need for their case. It may take a reminder to obtain requested documents, but this client will cooperate and comply with your requests.

"C" clients are the borderline clients. Many of these clients— when properly educated— can become an "A" or a "B" client. This client has unrealistic expectations about the legal system and what can be achieved. They tend not to volunteer important information and can even be lackadaisical about providing information and documents needed to prosecute or defend their case. The saving grace for this client is that they recognize that you are on their side and appreciate your services. As such, the "C" client may be reformed. Simple education and encouragement may make this client a "B" or even an "A" client.

Clients to avoid are "D" and "F" clients. These clients have little hope for reform even with education and encouragement. These clients are the ones who don't appreciate you or your work. Their expectations are unrealistic and, in some cases, their sole motivation in pursuing the case may be revenge or some unethical or unmoral reason. They will refuse to provide proper documents and records in response to discovery requests and may even choose to ignore your phone calls requesting information.



The true "F" client will instruct you to advance positions that are unreasonable and without merit. Any client that is disrespectful to your staff should be considered an "F" client automatically. Your staff is a vital part of your ability to perform successfully and neither they nor you deserve to be treated in a disrespectful manner. These clients are mistrustful and frequently question your work. They will express disappointment in the work you are doing even though it is of good quality. The "F" client will never be happy and, frankly, will express that to others, despite your best efforts to the contrary. As such, the "F" client will often be a source of negative opinions about your practice and may steer clients from your office. The "F" client can essentially drain you and your staff emotionally and financially. These clients are best avoided.

The value in having cooperative clients who are team players in their case results in your increasing profits and more importantly, the enjoyment of your practice. While the above is just a short overview of the types of clients, you should take the time in your practice to develop the characteristics that formulate your perfect client and attempt to make those individuals the majority of your client base.

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Save the Date!

Annual Family Law Conference
Thurs., March 13 & Fri., March 14, 2008
Ely, NV - Bristlecone Convention Center

This Year's Theme:

Financial Wizadry

WHAT STANDARDS OF VALUE APPLY IN BUSINESS VALUATIONS?

Fair Market or Marital Value and the Question of Discounts When the Close-Held Business Is Not Sold

By Bob Cerceo, Esq.

"I should say something. The judge and opposing counsel are staring at me and my client just winked at me like I know something. But, that look on my face is really just indigestion from lunch. I wish I knew what they were talking about…" **This does not have to be you.** Following up *Business Valuation Approaches and Methods Boiled Down— The Basics*, Nev. Fam. L. Rep. Vol. 20, No. 1, 2007 at 10, we left off at Standard of Value and the question of Applicable Discounts.[1]

At its core, whether it is referred to as fair value,[2] marital value, investment value,[3] value to the holder,[4] or a like term, in a divorce case when there will not be a sale of the business after the Decree is entered, discounts are suspect and a hot topic for review. The business continues unchanged for the owner-spouse (the party in keeping the business). The basis of value for divorce purposes is, in reality, the value to the marital community in the hands of the owner-spouse under the circumstances existing at the time of the valuation date.

Discounts are relevant only if the business is being sold. If the owner-spouse retains possession of the business, then imposing a discount allows the owner-spouse to take the business at a lower value without paying for the benefit— it is a windfall. This flies in the face of the definition of fair market value, as defined by the ASA, "The amount at which property would change hands between a willing seller and a willing buyer when neither is acting under compulsion and when both have reasonable knowledge of the relevant facts." *See* Pratt at 28.

In a normal arms-length transaction for the sale of a close-held company, there is an actual buyer and an actual seller, and each will take the necessary steps to transition the business, *e.g.*, meeting clients with a "Joe is a good guy-" styled introduction, or extending the original owner as an employee for a year, or more. In a divorce, there is no buyer requiring a transition of knowledge or ramp-up period, therefore, applying a discount to fictionally acquire knowledge, like a key man discount, is an unnecessary step. The business simply continues its *status quo* operations.

A key man discount "quantifies" the impact to the value of the business as though the key man is not going to be involved in the business after the divorce. It is not just a question of owner-spouse's fictional unavailability, but how customers will respond to the business if the owner-spouse is no longer involved, how suppliers react or extend credit, who calls to collect accounts receivables, loyalty of the work force, etc. In assessing the key man discount, the court needs to ask "What does the key man really do?" And if that does not change after entry of the Decree, then there should be no reduction in value. Specific questions to assess the validity of a fictional key man discount include, in part: Will owner-spouse still be the "Boss?" Will owner-spouse still place bids for contracts? Will owner-spouse still hire and fire employees and manage the business? Will owner-spouse still be known to the business community? Will owner-spouse still decide on the number of managers, type of crews to perform work, amount and types of equipment used, and all other facets of the business? In short, if nothing about the business changes after the divorce, the fiction of a key man discount is defeated.

Although Nevada does not have a statute for which "value" to apply, fair market or marital, California takes the position that the standard of value should be the "investment value," rather than fair market value, and investment value is the "value to a particular buyer or seller." In a divorce case, the specific buyer is the owner-spouse. Family Law Act, Civ. Code,

§4800, Pratt at 834, 835. Under California case law, this results in the use of the higher of fair market value or investment value, a principle of not penalizing the outgoing spouse for a *status quo* continuation of the business. *In re Marriage of Foster*, 42 Cal. App. 3d 577, 117 Cal. Rptr. 49 (1974), *In re Marriage of Hewitson*, 142 Cal. App. 3d 874, 887, 191 Cal. Rptr. 392 (1983), and *Ronald v. 4C's Electronic Packaging, Inc.*, 168 Cal. App. 3d 290, 298, 214 Cal. Rptr. 225 (1985).

Case law in other sister states eliminates discounts for lack of control and lack of marketability. For example, the Louisiana approach (a community property state) eliminates discounts for lack of marketability where a sale of the business is not contemplated. The value of the stock must be determined without discounts. *See Mexic v. Mexic*, 577 So. 2d. 1046, 1050 (La. App. 4th Cir. 1991). Many other cases can be cited rejecting a discount for lack of marketability. Pratt at 847. "Close corporations by their nature have less value to outsiders, but at the same time their value may be even greater to other shareholders who want to keep the business in the form of a close corporation." *Brown v. Brown*, 348 N.J. Super. 466 (App. Div. 2002).

The principle to be drawn from the cases on discounts (whether it is a key man discount, lack of marketability, lack of control, or otherwise), is that without an actual sale of the business, the business continues as a going concern unchanged for the owner-spouse, and the basis of value for divorce purposes is the value to the marital community in the hands of the owner-spouse under the circumstances existing at the time of the valuation date.

Exceptions exist and there will be instances when applying discounts is appropriate. Get friendly with your expert and ask questions. Now the look on your face when everyone is staring can be one of a wise and learned counsel, and not just the indigestion from lunch.

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Footnotes:

[1] As mentioned before, it is widely acknowledged that one of the leading authorities on business valuation is Dr. Shannon P. Pratt, and his most recent authoritative text on the subject is *Valuing a Business: The Analysis and Appraisal of Closely Held Companies*, Fourth Ed., Shannon P. Pratt, Robert F. Reilly and Robert P. Schweihs, McGraw Hill (2000), ISBN 0-07-135615-0. A condensed "handbook-style" overview is published by the American Bar Association, the *Lawyer's Business Valuation Handbook: Understanding Financial Statements, Appraisal Reports, and Expert Testimony,* Shannon P. Pratt ABA Section of Family law (2000), ISBN 1-57073-829-7.

[2] "Fair Value is not the same as, or short-hand for, 'fair market value.' 'Fair Value' carries with it statutory purpose that shareholders be fairly compensated, which may not equate with the market's judgment about the stock's value." *Brown v. Brown*, 348 N.J. Super. 466 (App. Div. 2002).

[3] "The specific value of an investment to a particular investor or class of investors, based on individual investment requirements; distinguished from market value, which is impersonal." The Dictionary of Real Estate Appraisal, 3rd ed. (Chicago Appraisal Institute, 1193) pg. 190. In other words, it is the value to a specific buyer (a subjective consideration), not a hypothetical buyer (an objective consideration).

[4] What the investment is worth to one of the marital litigants as opposed to the general population of fair market value buyers.

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SPECIALIZATION EXAMINATION

The State Bar of Nevada's Family Law Specialization Examination will be administered on December 8, 2007 at the State Bar offices (both Northern and Southern locations). A new application is available on the State bar of Nevada website, **www.nvbar.org**. Visit the Family Law Section page at: **http://www.nvbar.org/sections/sections_family_law.htm**

Invitation to Participate

The Family Law Section has been invited by the Nevada Supreme Court to participate as amicus curiae and to prepare and submit an amicus brief in the case of *Rivero v. Rivero*. This appeal involves the definitions of joint physical custody under Nevada law, and how such definitions impact awards of child support and modifications of custody and visitation. The amicus brief will be due in the fall/winter of 2007.

If you are a Family Law Section member and are interested in working on this brief, please send a letter of interest to **Bryce C. Duckworth, Family Law Section Chair**, State Bar of Nevada, 1935 Village Center Circle, Las Vegas, NV 89134, by no later than October 20, 2007. Please include in your interest letter the following information: 1) your experience with the issues; 2) your reasons for wanting to participate and a statement that you have no personal stake in the outcome of the *Rivero* case; and, 3) a brief outline of your trial and appellate experience. The working committee for the Executive Counsel has been formed, and your interest and efforts will be appreciated.

Articles Are Invited!

The next NFLR is expected in January, 2008, with a submission deadline of December 1, 2007. Please contact Bob Cerceo at bobcerceo@aol.com with your proposed articles any time before the next submission date. We're targeting articles between 350 words and 1500 words, but we're always flexible if the information requires more space.

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