COMMONWEALTH OF KENTUCKY
SUPREME COURT OF KENTUCKY
NO. 2016-SC-000591-D



SALLY CAROL GRASCH — APPELLANT

ON APPEAL FROM THE COURT OF APPEALS
ACTIONS NO. 2015-CA-000294 & NO. 2015-CA-000336

v.

AND THE FAYETTE CIRCUIT COURT
ACTION NO. 11-CI-05862

ALBERT FRANKLIN GRASCH — APPELLEE

** ** ** ** ** ** **

# REPLY BRIEF ON BEHALF OF APPELLANT SALLY CAROL GRASCH

Submitted by:

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## CERTIFICATE OF SERVICE

The undersigned hereby states that a copy of this document was served by U.S. Postal Service, first class postage paid, on this the 27th day of June, 2017 upon Fayette Family Court Judge, Sixth Division, 120 N. Limestone, Lexington, KY 40507, and Hon. Kara Read Marino and Meredith Schuh Fannin, Henry, Watz, Raine & Marino, PLLC, 401 West Main Street, Suite 314, Lexington, Kentucky 40507 and Hon. Sam Givens, Clerk, Kentucky Court of Appeals, 360 Democrat Drive, Farnkfort, Kentucky 40601-8209. The undersigned certifies that she did not withdraw the record on appeal from the Fayette County Circuit Court Clerk on or before this date.

Suzanne Baumgardner

## INTRODUCTION

This is an issue of first impression: whether a contingency fee contract may have value and be included as part of the marital estate. It is the position of the Appellant (hereinafter "Sally") that such contracts are marital property pursuant to KRS 403.190 and therefore is appropriate for valuation discovery, testimony and other evidence at a hearing upon remand. The ruling of the Trial Court granting summary judgment on the issue was in error. The finding of the Court of Appeals that such contracts are "not an asset" is also in error.

## STATEMENT OF POINTS AND AUTHORITIES

## ARGUMENT

### I. APPELLEE'S ANALYSIS OF SISTER STATE PRECEDENT REGARDING CONTINGENCY FEE CASES AS MARITAL PROPERTY IS MISCONSTRUED.

Appellee (hereinafter "Al") would have this Court begin down the slippery slope of excluding "property" from marital estates which is innately contrary to Kentucky's long held inclusive approach demonstrated by statute and case precedent. Al's reading of the sister state case law attempts to misconstrue the holdings and reasoning in those cases to support his position. It is paramount that Kentucky and sister state precedent be correctly presented and analyzed as this issue is one of first impression in the Commonwealth. To place the holding in this case based on the mistaken premises Al argues would be error.

#### A. Zells evidences that Illinois and Kentucky do not treat assets of the marital estate similarly.

The Court of Appeals and Al relied on In Re the Marriage of Zells, 572 N.E.2d 944 (Ill. 1991), in support of the position that contingency fee cases are not divisible marital property. In that same Opinion, the Supreme Court of Illinois also determined that goodwill in a business was not divisible marital property. The Illinois Court did **not** make the distinction between enterprise and personal goodwill as recognized by Kentucky. The Illinois Court ruled that goodwill--all goodwill--as an intangible, was not divisible property. The Illinois Court further held that contingency fee cases were similarly speculative in nature and not divisible property. Illinois has a fundamentally different approach to the definition of what constitutes property under KRS 403.190.

The Illinois Supreme Court's treatment of goodwill evidences its flawed rationale in defining property rights. This Court must not adhere to that position which is so inherently contradictory to the prior findings in the Commonwealth. Kentucky's law regarding goodwill has been that same is divisible marital asset in Kentucky since 1984. See Heller v. Heller, 672 S.W.2d 945 (Ky. App. 1984), Clark v. Clark, 782 S.W.2d 56 (Ky. App. 1990) and Gaskill v. Robbins, 282 S.W. 3d 306 (Ky. 2009). Heller first determined goodwill to be a divisible asset. Gaskill only heightened the analysis, detailing the difference between the types of goodwill: enterprise (marital) and personal (non-marital). It is most important that Gaskill clearly finds all goodwill to be a divisible asset, which is valued by the Courts in dissolution of marriage actions. It is during the valuation phase of the asset that our Courts then determine if any portion of the asset is personal. The mere fact that the asset is intangible or speculative does not preclude its inclusion in the marital esate.

Al, in his footnote attempted to analogize professional goodwill as discussed in Zells to "personal goodwill" identified in Gaskill. Al completely misses the point. One cannot differentiate between "personal" and "enterprise" goodwill if the underlying asset, the intangible asset of goodwill, is not first divisible marital property. Zells states "consideration of goodwill as a divisible marital asset results in gross inequity." 572 N.E.2d at 945. No matter how Al wishes Zells and Gaskill to be in alignment, the cases are clearly not. This demonstrates how Kentucky and Illinois have historically looked at property differently.

**B. Case law supports a finding that contingency fee contracts are property, to be valued as part of the marital estate.**

Maryland has ruled on contingency fee cases and the inclusion of same in the marital estate. See Quinn v. Quinn, 575 A.2d 764 (Md. Ct. Spec. App. 1990). In doing so, the Maryland Court states,

> Generally in valuing a professional partnership, the value of work in progress, along with other tangible factors, should be considered. See Stern v. Stern, 66 N.J. 340, 331 A.2d 257, 261 (1975). This is so because at any time the amount of work actually done on the work in progress can be itemized and its value calculated.

Id. While the Maryland Appellate Court disagreed with the valuation method approved by the Trial Judge, Al's claim that the Quinn Court "did not rule either way" (See Al's brief, page 12), is a misrepresentation to this Court. The Quinn Court specifically states, "we are not prepared to say that the value of a contingent fee can *never* be determined or considered as an asset of a law firm." Id. In fact, the holding of that Court was to remand the case back to the Trial Judge for further proceedings on the valuation of the contingency fee contracts to the law practice and thus to the marital estate. The holding in Quinn is directly similar and supportive of Sally's position. Sally requests to present evidence to the trial court as to the value of the contingency fee contracts to the marital estate.

The North Dakota Supreme Court held, "although Mary did not make a direct contribution to this contingent fee, it was accumulated during the marriage. The trial court therefore properly included the fee in the marital estate." Zuger. v. Zuger, 563 N.W. 2d 804, 806 (1997). Al attempts to differentiate this case by claiming the fee was received prior to the final Decree being entered. Again, his

attempted differentiation further demonstrates Sally's argument. Sally was not allowed to pursue further discovery or present evidence on the value of the contingency fee cases. Summary Judgment was entered, precluding the hearing she requested. This analysis further demonstrates the problem with the Court of Appeals' finding that said contracts are "not an asset". Receipt and retention of a contingency fee within the practice gives the divorcing attorney-spouse the ability to spend, borrow and otherwise utilize the funds without ever accounting to their spouse for same. Given the size of some contingency fees received, this creates the possibility of a large windfall solely for attorney-spouses who practice contingency fees.

New York Courts analyzing the issue have held that, "contingency fee cases defendant had commenced prior to the commencement of the instant divorce action are part of his firm's assets or value, and therefore constitute marital property." Block v. Block, 258 A.D.2d 324, 325 (N.Y. App. Div. 1999). Likewise in the case of Litman v. Litman, 123 A.D.2d 310 (N.Y. App. Div. 1986), it was found not only that the law practice, which was that of a specialist in personal injury (contingency fee contracts), was marital property subject to equitable division, but also that discovery would extend to all such contingency fee contracts started prior to the final hearing. The Court stated, "the value of pending contingent fee case files is likely not reflected in the ledgers, and the defendant is entitled to have such files considered by an expert." Id. at 312. Blechman v. Blechman, 234 A.D.2d 693 (N.Y. App. Div. 1996) found that contingency fee contracts were marital

property. To prove a "separate property claim" (in that case prior to the marriage but one can also make the leap that it applied to after the divorce) then the burden is on the spouse making that claim as to the work performed for the Court to make such an award. See generally Id. at 696. Again, the salient point before this Court is that Sally was never granted the opportunity to put evidence before the Trial Court due to the Summary Judgment award. The Court of Appeals finding that this asset was "not property" was in error.

Al had several contingency fee contracts, all acquired during the marriage, pending at the time Summary Judgment was rendered. Substantial costs had been expended from the law practice to further those cases. That was a cost paid wholly from the marital estate. Sally was not allowed to recoup her share of those costs. Thus she did contribute directly to pursuit of these cases.

Sally will agree that contingency fee cases are speculative. Sally will also agree that some of the cases may have required additional work by Al after the Decree was entered. Those facts do not preclude the designation of the assets as property, which can be valued. There was the ability to have an expert review the cases, the costs incurred and testify as to a value at a hearing before the Trial Court. Further, there were other methods such as delayed distribution and retained jurisdiction that would have allowed the Trial Court to value these assets. By declaring Summary Judgment, the Trial Court made an error of law. Substantial and material issues of both law and fact existed at that time and remain in dispute.

The Kentucky legislature addressed marital property in KRS 403.190. The

plain reading of the statute illustrates that this is an all-inclusive state as to all rights acquired during the marriage to be marital property. The only exceptions are specifically designated by the legislature in KRS 403.190(2). The Court of Appeals erred by making new law without legislative authority. Skirting the statute by finding a contract is "not an asset" is error.

## II. KRS 403.190 IS INCLUSIVE AS TO THE DEFINITON OF AN ASSET; THEREAFTER, VALUATION OF THE ASSET IS A FACTUAL DETERMINATION.

### A. Contingency fee contracts are assets; they meet no exception under KRS 403.190(2).

Kentucky Courts are charged with assigning each spouse their respective property and dividing the marital property under KRS 403.190(1). The statute is clear under KRS 403.190(2) that ""marital property" means **all** property acquired by either spouse subsequent to the marriage except ...(emphasis added)" The exceptions under this statute are very specific and do not include contingency fee contracts.

Non-marital property must meet the criteria of KRS 403.190(2)(a)-(e). The Court of Appeals has created a new "exception", an asset as "not property". Al repeatedly confuses these terms, "non-marital property" under KRS 403.190(2) and "not property" in his brief and in his arguments. No party to this action has claimed Al has a non-marital property claim to the contingency fee contracts. It is the burden of the party claiming the asset is non-marital to provide clear and convincing evidence that the property is non-marital and not part of the marital estate. Underwood v. Underwood, 836 S.W. 2d 439, 441 (Ky. App. 1992). No

such evidence was provided to the Trial Court or the Court of Appeals.

The Trial Court's finding of Summary Judgment that the contingency fee contracts were not to be included in the marital estate was error. The Court of Appeals Opinion affirmed that award, but also declared that there were "unresolved fact issues" surrounding the contingency fee contracts and their value. (Opinion, p. 13). That statement alone should have provided grounds for the Court of Appeals to reverse the Summary Judgment award by the Trial Court, and remand for a hearing. The Court of Appeals must be reversed on this issue.

Gaskill provides us some lingering thoughts about why including every asset within the marital estate is so important:

> All of the work done by either spouse during the marriage is done for the marital purpose: having someone, with bounds of law, with whom one shares a union that allows for joint homemaking, co-parenting if children are born, and experiencing life in general with one another. Within the marital arrangement, abilities are often unequal, the use of one's time varies according to present need, and each spouse does things to accommodate the other. How the parties earn money and build wealth is affected by these variables, but is done for common purpose.

282 S.W.3d at 317. The Graschs, just like every other couple, made decisions during their marriage, which for better or worse they would share in, including Al's contingency fee awards, if any. No court has held a hearing to determine otherwise. Sally deserves her day in Court to present evidence at a hearing for the determination of the unresolved property issue of contingency fee contracts.

In his brief, Al's position concedes the notion that the contingency fee contracts are property that may be quite valuable. Al just wants to skip over the

requisite analysis and run straight to valuation issues or identify the asset as non-marital property. The law of the case has not caught up with his position, that the contracts are first property.

Sally persuades this Court to focus where the Trial Court and Court of Appeals have failed, that this was an issue first of the classification of an asset as "property" and second that because there are inordinate material facts at issue and in question-- that summary judgment was not appropriate. For now the issue is simplified- is a contract, albeit for contingency fees, property under KRS 403.190? Sally prevails upon the Court to say yes, and find that Summary Judgment at the Trial Court was inappropriate in this first impression case. Valuation and classification issues are appropriate for remand, where the factual evidence can be presented.

**B. The fact that there are valuation issues with regard to contingency fee contracts supports Sally's position that these contracts are assets of the marital estate.**

Pursuant to KRS 403.190, Kentucky Courts routinely include speculative assets in the marital estate. Speculation is handled in the value of the asset, not in the definition of whether the item is or is not an asset. Contingency fee contracts are no different nor do they deserve substandard analysis. As previously discussed, this Court recognized that goodwill is a valuable property interest in Heller. That finding was refined in Gaskill, acknowledging that, "the valuation of a business is complicated, often speculative or assumptive, and at best subjective." 282 S.W.3d at 309. The Gaskill Court delineates that all goodwill is marital

property before allowing that some goodwill may not be transferrable when valuing the asset. The same can be said for contingency fee contracts, that first they must be included as "property", an issue which was not appropriate for summary judgment. Only after factual evidence is heard can a finding be made as to speculation or non-transferability of the asset during the valuation analysis by the Court.

Likewise, non-vested stock held in a closely held corporation is marital property in Kentucky and subject to division. McGinnis v. McGinnis, 920 S.W.2d 68 (Ky. App. 1995). McGinnis states, "The value of appellant's vested right of future participation in an employment benefit plan was a valuable deferred compensation right even though it might never be fully exercised." Id. at 71. The fact that the asset's value was speculative and may never be realized did not impact its initial classification as property. The speculation affected the valuation; not the finding that is was an asset.

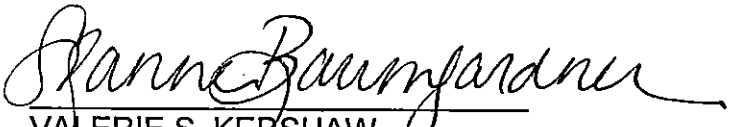
As Sally referenced in her underlying brief, the case of Armstrong v. Armstrong, 34 S.W.3d 83 (Ky. App. 2000) involved a defined benefit plan. The point arising out of that case, as well as Poe v. Poe, 711 S.W.2d 849 (Ky. 1986), and its speculative asset caselaw progeny is that the Court must first identify the asset in question. These assets may require additional participation—even after the Decree is entered—to fully vest or be valued. However, that additional time, effort and even contribution post-Decree does not change that the part of the asset accrued during the marriage is a marital asset. Herein, contingency fee contracts,

have been signed, work performed, costs expended, all during the marriage. There is an asset, an investment of time, work effort and money, acquired during the marriage, which must first be identified, then valued and equitably divided. Summary Judgement precluded the valuation and equitable division of this asset at the Trial court level. The finding of "not an asset" precluded this valuation by the Court of Appeals. Both findings are in error. This matter should be remanded for further discovery and an evidentiary hearing on the value of the contingency fee contracts to the marital estate and the equitable distribution of same.

## CONCLUSION

For the foregoing reasons, Appellant requests that the decision of the Court of Appeals issued September 23, 2016 be reversed as to the issue of contingency fee contracts and the case be remanded to the Trial Court for a factual hearing.

Respectfully submitted,



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