

# The Treatment of Intellectual Property in Divorce

by Jonathan W. Wolfe and Kimber L. Gallo

The collision of intellectual property (IP) and divorce raises a host of issues for matrimonial practitioners. Is the IP an asset subject to equitable distribution in divorce? How is the value of the IP divided? What if the value of the IP can only be realized by the future efforts of one of the spouses? What if the IP was acquired prior to the marriage, but enhanced during the course of the marriage? Will the future income from IP, previously divided by way of equitable distribution, be considered when establishing (or modifying) support obligations?

This article provides a basic overview of some of the fundamental issues that must be addressed when considering the treatment of IP in divorce.

## Division of IP in Divorce

### Overview of Equitable Distribution

In New Jersey, the extent to which IP owned by either spouse will be divided in divorce will be governed by New Jersey's equitable distribution statute.<sup>1</sup> Originating with the Divorce Reform Act of 1971, the equitable distribution statute vests the court with broad discretion in distributing any "property...which was legally and beneficially acquired ... during the course of the marriage." The statute contains 16 factors for the court to consider in determining distribution of assets acquired during the marriage between the divorcing spouses.

The factors include:

- the duration of the marriage,
- the age of the parties,
- their economic circumstances at the time of division,
- each parties' income and earning capacity,
- the tax consequences of the division,
- the contribution of each party to the acquisition, dissipation, preservation, depreciation or appreciation in the amount or value of the marital property, and
- the contribution of a party as a homemaker.

Suffice it to say, the factors are broad enough to provide the court with significant flexibility in fashioning an equitable distribution award.

Because the statute only subjects assets acquired "during the course of the marriage" to equitable distribution, premarital assets will not be divided in divorce. Thus, if a spouse owns IP prior to the marriage, it will most likely be excluded from equitable distribution. Moreover, the statute exempts from equitable distribution any assets acquired by way of gifts or inheritance, even if acquired by one of the parties during the course of the marriage.<sup>2</sup>

However, in the case of either IP acquired during the marriage or assets acquired by way of gift or inheritance during the marriage, any increase in the value of the asset that results from marital efforts can be subject to equitable distribution.<sup>3</sup> Therefore, when one spouse enters the marriage with IP, an analysis must be made to determine whether its value increased during the course of the marriage, and whether the increase in value was a result of marital efforts.

Finally, even exempt assets (*i.e.*, premarital and/or assets acquired by gift or inheritance) can lose their exempt status if they are commingled with marital assets during the course of the marriage. Accordingly, matrimonial practitioners must examine the extent to which any commingling exists for any otherwise exempt IP. For example, were marital funds expended to market the IP during the course of the marriage? Were marital funds utilized to defend the owner's rights to the IP

during the course of the marriage? If marital funds were, in fact, utilized, the non-owner spouse will be able to assert an argument that the otherwise exempt IP has lost its exempt status, in which case the IP would be in the pot and subject to division in accordance with the factors detailed above.

### ***Consideration of Whether the Value of the IP is Dependent Upon Post-Marital Efforts***

One factor that must be analyzed is the extent that the realization of the IP value will require post-marital efforts. As detailed above, equitable distribution is designed solely to distribute the value of an asset acquired *during* the marriage based upon marital efforts. An argument can be made against an equal division of its value, if IP requires post-marital efforts to realize its value.

*In re Marriage of Monslow*, the Kansas Court ruled that the patents obtained by the husband during the marriage constituted marital property.<sup>4</sup> However, the Court recognized that the future income from the patents would be based upon a combination of: 1) the patents acquired during the marriage, and 2) continuing efforts following the divorce to market the patent and defend against any infringements.

The Court affirmed a disproportionate award in favor of the husband (60 percent), because he would be required to expend post-marital efforts to ensure the continued income stream from the patents, even though the patents themselves were acquired during the marriage.

A few years later, the Connecticut Court held a husband was not entitled to future royalties dependent upon the wife's post-marital efforts.<sup>5</sup>

Although this issue has not yet been addressed in New Jersey, courts will likely find guidance on it from the treatment of stock options and pension plans. For example, in 1995, the New Jersey Supreme Court held stock options

are subject to equitable distribution when "the nature of the asset is one that is the result of efforts put forth 'during the marriage' by the spouses jointly."<sup>6</sup>

### **Treatment of IP for Support Purposes Following Divorce**

#### ***Overview of Alimony and Child Support***

Courts will look to all sources of income, including the income generated from an IP right, when establishing support obligations. In New Jersey, the source of judicial authority to award alimony and child support is set forth in N.J.S.A. 2A:34-23.

The purpose of alimony is "to provide the dependent spouse with a level of support and standard of living generally commensurate with the quality of economic life that existed during the marriage."<sup>7</sup> The alimony statute sets forth 11 factors that provide the court with substantial discretion in establishing an alimony award for the supported spouse.

The factors include, but are not limited to:

- the actual need and ability of the parties to pay,
- the duration of the marriage,
- the parties' age,
- the standard of living established during the marriage and the likelihood that each party can maintain a reasonably comparable standard of living,
- the earning capacities of the parties,
- the history of the financial or non-financial contributions to the marriage of each party,
- the equitable distribution of property and any payouts on equitable distribution, and
- the income available to either party through investment of any assets.

Child support is awarded by the court to ensure that both parents contribute to the financial support of their children

until they are deemed emancipated. New Jersey utilizes mandatory child support guidelines to establish child support in cases where the combined net income of the parties does not exceed \$187,200 per year.<sup>8</sup> For cases where the combined net income of the parties exceeds this figure, the court must supplement the guidelines-based award with a discretionary amount based on the 10 factors set forth in the statute. Those factors include the needs of the child, standard of living and economic circumstances of each parent, earning ability of each parent, and any other factors the court may deem relevant.

Accordingly, when determining alimony and child support, the court will attribute the future IP income stream to whichever spouse is retaining the IP following the divorce. Significantly, even if IP is exempt from equitable distribution for one of the reasons detailed above, the income from the asset will nevertheless be considered for determining support.<sup>9</sup>

### ***Special Consideration for Support Based Upon the Income Stream From an Asset Previously Divided in Equitable Distribution***

Consider the following scenario. A patent is valued at \$1 million based upon its ability to generate \$1 million in income over the next five years. The wife is awarded the patent by way of equitable distribution, and the husband receives the marital residence valued at \$1 million to offset the value of the patent. Should the \$200,000 the wife receives from the patent each year for the next five years be considered as income available for determining her spousal support obligation to the husband? Isn't the income from the IP simply the distribution to the wife of her share of equitable distribution? If the husband receives a portion of the \$1 million over the next five years has he not, in fact, received more than 50 percent of

the value of the patent?

This issue is commonly referred to as double dipping, and must be considered when dividing IP in a divorce. A double dip can be broadly understood as counting the same income stream twice—once for the division of property and again for determination of support. Although not yet addressed in the IP context, the New Jersey Supreme Court decision in *Steneken v. Steneken*,<sup>10</sup> which addressed the double dip in the context of the division of a business, serves as a likely guide to the treatment of the division of IP in divorce.

In *Steneken*, the husband's business was valued using a capitalization of earnings method. The Court determined his reasonable compensation was \$150,000. Because Mr. Steneken had received annual distributions of \$208,000, the Court determined that he had excess earnings of \$58,000, and capitalized this money to determine the value of the business. Mr. Steneken retained the business and Mrs. Steneken was given other marital assets as an offset for her share of the value of the business.

The trial court was confronted with the question of whether the future excess earnings from Mr. Steneken's business—income that already had been valued and divided in equitable distribution—should again be considered for the purpose of establishing his alimony obligation. The trial court ruled that the excess income stream should not be included (because Mrs. Steneken had received her share of the value of excess income by way of equitable distribution), and therefore based Mr. Steneken's support obligation on his reasonable compensation of \$150,000.

The New Jersey Supreme Court reversed the trial court's decision. The Court found that alimony and equitable distribution serve distinct purposes, and therefore there is no prohibition against such a double dip. Accordingly, the Court concluded that Mr. Steneken's

actual income should be utilized for determining his alimony obligation. Arguably, Mrs. Steneken therefore received her share of the value of the business twice—first by way of equitable distribution and again by way of alimony paid from Mr. Steneken's share of the business.

Because the valuation of IP will in many instances be based on its ability to generate income in the future, the interplay between the division of IP and alimony will raise the identical issues and concerns evident in *Steneken*. Of course, these issues will be of particular concern where the IP represents a significant portion of the marital estate and the parties' future income stream. Practitioners addressing the division of IP in divorce must be cognizant of the problems posed by the double dip, and must counsel their clients accordingly.

### Conclusion

There is sparse case law in New Jersey addressing treatment of IP in divorce. Accordingly, practitioners will need to look to precedent from other jurisdictions and substantive New Jersey decisions on different but analogous types of property to craft their arguments concerning both the equitable division of IP and the availability of its future income stream for support purposes. ⚖️

### Endnotes

1. See N.J.S.A. 34:23.
2. See N.J.S.A. 2A:34-23 (excluding from equitable distribution property "legally or beneficially acquired during the marriage by either party by way of gift, devise, or intestate succession").
3. See *Sculler v. Sculler*, 348 N.J. Super. 374, 378 (Ch. Div. 2001) (holding increase in asset value caused by marital efforts subject to equitable distribution).
4. *In re Marriage of Monslow*, 259 Kan. 412 (1996).

5. See *Zander v. Zander*, 1999 WL 711503 (Conn. Super. Ct. 1999).
6. See *Pascale v. Pascale*, 140 N.J. 583 (1995).
7. See *Koelble v. Koelble*, 261 N.J. Super. 190, 192-193 (App. Div. 1992).
8. See Rule 5:6A.
9. See *Aronson v. Aronson*, 245 N.J. Super. 354, 363-364 (App. Div. 1991).
10. See *Steneken v. Steneken*, 183 N.J. 290 (2005).

**Jonathan W. Wolfe** is a member of Skoloff & Wolfe, P.C. in Livingston, where he concentrates his practice on complex civil litigation with a focus on family law. **Kimber L. Gallo** also practices at Skoloff & Wolfe, P.C. in Livingston, and devotes her practice exclusively to the areas of family and matrimonial law.