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Earn-out payments are marital property

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Earn-out payments memorialized in a contract for the sale of marital property are themselves marital property, the Supreme Court has ruled in a 4-2 decision, In Re Gill v. Gill.

The property was sold after the valuation date for marital property but before the dissolution. The price was an initial payment of $180 million and two potential earn-out payments worth up to $170 million.

"Because the parties' interest in the company was marital property that was acquired before the valuation date, the consideration for the sale of the company, which occurred before the dissolution and included an amount paid at the time of the sale and a contractual right to receive future amounts, is also marital property," said the court in an opinion written by Justice Margaret Chutich. Chief Justice Lorie Gildea joined Justice G. Barry Anderson in a dissent, and Justice Paul Thissen did not participate.

A sweet deal

Francis Stephen Gill helped lead Talenti, a successful gelato company. In 2008, he and a business partner purchased a majority ownership interest in Talenti and set up Wyndmere LLC to hold his interest in Talenti. Twenty percent of his interest in Wyndmere was transferred to trusts created for the parties' children, with the remainder held in husband's name.

Over the next several years, Talenti's value grew significantly. During that time, David Goliath Group LLC was created and was the parent company of Talenti by 2014. Wyndmere held a membership interest in David Goliath. That year, David Goliath's members sold all of their membership units and David Goliath's assets, including Talenti, to Unilever N.V. and Conopco Inc. At the time of that sale, Steve Gill held an 80 percent interest in Wyndmere, which in turn owned just over 38 percent of David Goliath. David Goliath in turn owned Talenti outright.

Stephen Gill filed for divorce from his wife Gretchen in 2014. While that was happening, the Unilever/Conopco sale of David Goliath took place for $180 million, plus two earn-out payments over the next two years, according to a formula based on the amount by which yearly sales exceeded an established minimum times a set multiplier and minus some variable costs. Each member of David Goliath was to receive a portion of these payments equal to each's ownership interest. That was the same price of the company set in a letter of intent in July, 2014.

As part of the marriage dissolution, the District Court set a valuation date of Sept. 5, 2014. The sale of David Goliath closed on Dec. 2, 2014. Wyndmere received just over 38 percent of the $180 million upfront payment — not quite $70 million — as well as a right to the appropriate percentage of any future earn-out payments.

Stephen Gill argued, and the District Court agreed, that his and his wife's interest in the Wyndmere stake, as of the valuation date, was the $180 million paid at closing and that the future earn-out payments were husband's nonmarital property.

The Court of Appeals reversed and the Supreme Court affirmed the appellate court.

Payments in exchange for marital property

Under Minn. Stat. 518.003, subd. 3b, nonmarital property includes property acquired by a spouse after a valuation date. Stephen said that under that statute, he received the contractual right to the earn-out payments three months after the valuation date and they were therefore nonmarital property.

The court disagreed because the payments were received in exchange for marital property — Wyndmere's interest in David Goliath. "A sale of marital property during dissolution proceedings, regardless of when that sale occurs, results in the proceeds from the sale also being marital property, the value of which is defined by the contract selling that asset," Chutich said.

"In other words, Wyndmere received the contractual right to the upfront payment and the potential earn-out payments only by selling the parties' marital asset, which was acquired during the marriage and before the valuation date," the court continued.

The earn-out payments were separate from Stephen's employment agreement with Talenti, the court noted. "Under the purchase agreement every person with a financial interest in David Goliath shared in the payments," Chutich noted.

The appropriate way for the District Court to distribute the earn-out payments would have been to determine the appropriate percentage that would be allocated to Stephen and Gretchen if and when the payments were made to Wyndmere, the court said. The exact value of the earn-out payments would then be determined by the terms of the purchase agreement after the end of each earn-out period.

The court rejected the argument that the amount of the earn-out payments would be affected by Stephen's post-dissolution efforts. The issue is whether the right to the payments was received during the marriage, the court said.

"To the extent that the district court may consider one spouse's efforts and control over a marital asset, it considers these facts when equitably dividing the marital assets, not when classifying particular property as marital or nonmarital," the court continued.

The court also rejected the argument that it should defer to the District Court's finding that the earn-out payments are 'additional consideration' for Stephen's future labor. "We need not defer to the district court's purported findings of fact because they are instead conclusions of law based on the district court's interpretation of the purchase agreement," Chutich wrote.

'Legal gymnastics'

"The court's holding that the value of marital property as of the valuation date must include the value of a contractual right acquired after the valuation date requires considerable legal gymnastics, which includes disregarding the district court's factual findings, ignoring the valuation date, rewriting the statutory definition of "marital property," and misconstruing the purchase agreement based on scattered, isolated phrases," Anderson wrote in his dissent.

The record shows that the buyer paid $180 million in cash for Talenti, Anderson said, and also agreed to pay earn-outs contingent on sales targets. The District Court specifically found that Talenti was sold in whole on December 2, 2014, for $180 million, the dissent noted. Gretchen received more than $27 million from the sale.

Anderson said that the court's "creation of a new rule" to "ensure the equitable division of marital assets," is unnecessary and overreaching. "[T] he court is adopting a new hard and fast extra-textual rule — that all proceeds from the sale of marital property before dissolution constitute marital property as a matter of law— regardless of whether this produces an equitable result," Anderson said.

The court is also disregarding the District Court's factual findings, the dissent continued. "The court cannot simply substitute its own findings on value — basically, that the earn-out payments were a component of Talenti's value — for the district court's findings on value," Anderson wrote. The court also disregarded the use of the valuation date under the statute and looked only at whether the right to the earn-out payments was received during the marriage.

Finally, said Anderson, "I simply conclude that the district court's valuation of the marital asset, as of the valuation date, is not clearly erroneous."

Straightforward application of law

Minneapolis attorney Alan Eidsness, who represented Gretchen Gill, said that the value of the property was set in the letter of intent prior to the valuation date. "Nobody argued that the property had a different value at the date of sale," he said. The two types of payments were always part of the same deal, he said. The case is a straightforward application of Minnesota law, Eidsness said.

The "lynch pin" of the argument is that all the other Wyndmere owners received a share of the earn-out payments. Under Stephen's analysis, Gretchen would be the only Wyndmere owner who didn't receive a payment, he said. Eidsness also noted that the earn-out payment were treated as capital gains and not regular income for tax purposes.

The attorney for Stephen Gill could not be reached for comment.