

No. 73746-5-I

**COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION ONE**

In re the Marriage of

LILY MORELLI,
Appellant,

v.

KENNETH MORELLI,
Respondent.

ON APPEAL FROM THE SUPERIOR COURT OF THE
STATE OF WASHINGTON FOR WHATCOM COUNTY
#13-3-00035-1

BRIEF OF RESPONDENT

2016 JAN 15 AM 11:30
COURT OF APPEALS DIV 1
STATE OF WASHINGTON

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INTRODUCTION

This divorce appeal relies on a claim never raised at trial. Appellant Lily Morelli faults Whatcom County Superior Court Judge Deborra Garrett for not considering whether Respondent Ken Morelli's tree-cutting business has intangible goodwill. Yet Ms. Morelli never raised the issue of goodwill in her answer, trial brief, expert testimony, or post-trial motion for reconsideration. The first mention of goodwill is on appeal.

Under RAP 2.5, this Court appropriately refuses to consider this new argument on appeal.

RAP 2.5(a) states the general rule for appellate disposition of issues not raised in the trial court: appellate courts will not entertain them. The rule reflects a policy of encouraging the efficient use of judicial resources. The appellate courts will not sanction a party's failure to point out at trial an error which the trial court, if given the opportunity, might have been able to correct to avoid an appeal and a consequent new trial.

State v. Scott, 110 Wn.2d 682, 685, 757 P.2d 492 (1988)

(citations omitted).

Furthermore, Judge Garrett made a reasonable division of the couple's property. This Court defers to the trial court's discretion in reaching a just and equitable division of assets. "Such decisions are difficult at best." Marriage of Landry, 103 Wn.2d 807, 809, 699 P.2d

214, 215 (1985). The Court leaves valuation “to the sound discretion of the trial court, after hearing any additional evidence that the trial court may deem relevant and material to the valuation of the [property], and after both parties have had the opportunity to reflect upon and argue all the relevant factors.” Marriage of Harrington, 85 Wn. App. 613, 630, 935 P.2d 1357 (1997).

Because the trial court did not abuse its discretion in this case, Respondent Ken Morelli respectfully requests this Court to dismiss this appeal and award him reasonable attorneys' fees on appeal.

I. RESTATEMENT OF ISSUES PRESENTED

A. “A party who fails to raise an issue at trial normally waives the right to raise that issue on appeal.” Brundridge v. Fluor Fed. Servs., Inc., 164 Wn.2d 432, 441, 191 P.3d 879 (2008). Neither Ms. Morelli’s trial counsel nor her expert witness raised or examined the issue of goodwill at trial. (Opening Brief at 21). Should this Court under RAP 2.5(a) refuse to consider this new argument on appeal?

B. “The court has broad discretion in awarding property in a dissolution action, and will be reversed only upon a showing of a manifest abuse of discretion.” Marriage of Harrington, 85 Wn. App. 613, 624, 935 P.2d 1357 (1997). At the close of trial, Judge Garrett awarded Ms. Morelli half the community real property and more than

half the value of Mr. Morelli's business, Ken's Tree Service. Was this division of property within the trial court's broad discretion?

II. STATEMENT OF FACTS

A. Goodwill Was Not An Issue At Trial

Ken Morelli met Lily Morrelli in February 2003. (VRP 23). Ms. Morelli was a licensed practical nurse, living in Langley, British Columbia. (VRP 23). Ken Morelli was a commercial logger, who on June 10, 1994, founded Ken's Tree Service. (VRP 18). At trial, he described what his company did.

We prune, remove, we don't spray, we don't plant, but we prune any trees large or small, we remove any tree large or small, we grind stumps, chip brush, we haul material to the dump.

(VRP 18).

The work is physically demanding.

A. If it's a take down for taking a tree down we wear our spurs and climb up the tree and cut one limb at a time. Depending on how much room we have we may have to rope every limb down and then the trunk and the top it comes down on ropes and pulleys and such.

And if we are doing pruning to large trees we have to, we don't use a hook so we don't damage the tree so we do spurless ascents. We have to shoot lines up into the tree and such and pull ourselves up.

Q. It sounds pretty physical?

A. Yeah, it's pretty hard.

(VRP 19) (VRP 354) (“summer time it’s miserable, you have to drink lots of water”). And Mr. Morelli routinely worked 14 hour days.

For what I do usually always 10 to 12 hours in the field and then generally 2 hours of phone calls in the evening, and tack on 15 to 30 minutes of e-mails after that.

(VRP 354).

From February 2003 until the couple’s marriage in 2007, Ms. Morelli lived in British Columbia. (VRP 146) The trial court determined that the couple’s committed intimate relationship began in 2005. “Approximately half of the parties’ time together before the marriage was in a more casual relationship and I find that the latter half of their time before the marriage was a committed intimate relationship. (3/11/15 Oral Ruling at 7). Neither party disputes this finding. (Opening Brief at 5).

The couple’s relationship ended on August 16, 2012. While on vacation at Lake Chelan, Ms. Morelli became enraged at Mr. Morelli’s suggestion they go jet skiing. (VRP 57). She left the house and did not return until late at night. (VRP 57) Throughout the night “she just kept saying ‘jet ski, jet ski, jet ski’, she stood in the corner of the room until 4 a.m.” (VRP 58). For the next few months, they slept in separate parts of the house and did not reconcile. In January

2013, Mr. Morelli filed this dissolution action. (VRP 60). The couple had no children.

At trial, the primary controversy was the value of Ken's Tree Service. Throughout the dissolution proceedings, Ms. Morelli never alleged Ken's Tree Service had goodwill, never provided a valuation of goodwill, and never requested a division of goodwill. First, her response to the Petition for Dissolution merely requested the court to "equitably characterize, value and distribute the parties' property and liability." (Response to Petition; CP 14).

Second, her trial brief did not allege the existence of goodwill or request its valuation and division. In her opening brief, Ms. Morelli claims that her trial brief "did specifically request a community share of the business, including goodwill, as valued by her expert witness." (Opening Brief at 20). The trial brief never mentions goodwill. Instead, it alleged that the business was community property. "If Mr. Morelli fails to prove that the business equipment and investments came from some separate monetary fund, then all of the investments and business equipment are presumed community-like and belong to the relationship from the date when the Committed Intimate Relationship began." (Respondent's Trial Memorandum at 13; CP 288).

Third, Ms. Morelli's expert on business valuation did not consider or value goodwill in the business. Michael Guerrero, a Certified Public Account, submitted a report and expert testimony on the value of Ken's Tree Service. (Report; Exhibit 121) (VRP 307-336). In his report, Mr. Guerrero describes his scope of work as "to estimate the fair value of 100% equity interest in Ken's Tree Service, either as a sole proprietorship or as an LLC." (Report at 2; Exhibit 121). If goodwill existed in the business, this scope of work would include it.

Yet Mr. Guerrero did not find any goodwill in the business and did not assign it any value. Instead, he calculated a net cash flow from the business and multiplied it by a capitalization rate to come up with an annual value for the business. (Report at 7, Appendix 2; Exhibit 121). For example, in 2013 the Report calculates the company's net cash flow at \$55,208. It then multiplies this by a capitalization rate of 15.5% to reach a total value of \$356,182. (Report at 7; Appendix 2; Exhibit 121).

None of this involves finding or valuing goodwill. Mr. Guerrero's analysis relies only on the revenues and expenses of the business – its cash flow.

Mr. Guerrero also did not mention goodwill at all in his trial testimony. (VRP 307-336) Ms. Morelli's counsel did not ask any questions about goodwill during direct examination. And the issue did not come up in cross-examination. After counsel's questions, Judge Garrett questioned Mr. Guerrero extensively about his calculations. (VRP 327-336). Of particular concern was the capitalization factor.

What it means is if you found some tremendous investment at \$400,000, you knew it was high risk and so your expectation of return would have been 18 percent and so 18 percent of the \$400,000 would have been 72 or 75,000. And so what you've got in the capitalization rate is a way of quantifying the risk...

(VRP 335). None of this involved goodwill.

Finally, Ms. Morelli did not raise the issue of goodwill in her motion for reconsideration after trial. (Motion for Reconsideration; CP 328-336). She sought reconsideration of four issues: "(A) distribute the funds in the Ken's Tree Service, LLC business bank accounts held with the Bank of America...(B)...respondent did not receive Social Security credits for the work she did for Ken's Tree Service...(C) error not to include business equipment that was acquired after 2011....and (D) an award of attorney fees." (Motion for Reconsideration at 1; CP 328).

Ms. Morelli's alleged error on appeal – "the trial court applied an incorrect legal standard when valuing the business, using a book value-type approach not permitted under In re Marriage of Hall and specifically prohibited under Fleege and In re Marriage of Berg" – never came up at trial. (Opening Brief at 1). It is a new argument on appeal.

B. The Trial Court Made A Just And Equitable Division

Ms. Morelli's arguments at trial centered on two assertions: (1) Ken's Tree Service was a community asset; and (2) she deserved half of its \$349,000 total value. (Respondent's Trial Memorandum at 13-14; CP 288-289) (VRP 375-379) (closing argument). Although the trial court rejected both arguments, it awarded Ms. Morelli more than half of the reasonable value of Ken's Tree Service accumulated between 2005 and 2012.

The trial court's oral ruling on March 11, 2015 provides the rationale for its division of assets. The court began by identifying the issue regarding Ken's Tree Service.

The other item of property before the Court is the business that Mr. Morelli has operated for some 20 years now, Ken's Tree Service, and there is a claim for that business value that the Court finds to be community property or quasi-community property based on...the Respondent's claims.

(3/11/15 Oral Ruling at 5).

Next, as noted above, the court ruled that the couple's committed intimate relationship began in 2005 – two years before their marriage. (3/11/15 Oral Ruling at 7).

During the couple's relationship – from 2006 to 2013 – the income from Ken's Tree Service increased substantially. (3/11/15 Oral Ruling at 7). But this did not mean the value of the business increased also.

[T]he bulk of its income is attributable directly to Mr. Morelli's labor and in my view that's different from a business in which the value of the business is in the equipment and the facilities that the business owns. That's the kind of business that the owner could walk away from and the business would retain its value.

(3/11/15 Oral Ruling at 8). Because the primary asset of Ken's Tree Service was Mr. Morelli's labor, it did not have the stand-alone value that Mr. Guerrero estimated. "If Mr. Morelli were to stop working in his business the income of the business would decrease so substantially that the valuations of the expert simply don't make sense." (3/11/15 Oral Ruling at 8).

To value the business, Judge Garrett considered two components. First, what is the value of the equipment purchased during the couple's committed relationship and marriage?

I derived a figure of approximately \$78,000 in equipment that in the current depreciated value of equipment that was purchased between 2006 and 2011 and I believe that Ms. Morelli has a claim to one-half the value of that equipment and one-half of that \$78,000.

(3/11/15 Oral Ruling at 9). The court awarded Ms. Morelli *half* the value of the business' equipment.

Second, what is the value of the business as an entity, separate from the equipment? The court concluded that Mr. Guerrero overestimated this value.

There is other value in the business but in my view its difficult to quantify and not nearly as substantial as Mr. Guerrero's estimates, which appear to be based on cash flow income to the business and capitalization factors that, frankly, the Court did not find persuasive.

(3/11/15 Oral Ruling at 9-10). The court added \$50,000 to the equipment value of \$78,000 to come up with a total value of 128,000.

I do give some value to the business and I think the value that I would give to that business is somewhere in the area of \$50,000. I think rather than quantifying that directly I ordered an equalization payment that I believe will address the needs of both parties.

(3/11/15 Oral Ruling at 10). The court ordered an equalization payment to Ms. Morelli of \$48,000 paid in \$1000 monthly increments over four years. (3/11/15 Oral Ruling at 12).

Ms. Morelli received most of the \$50,000 additional value in Ken's Tree Service. In her Opening Brief, she concedes that the trial court awarded her \$72,000 of the \$128,000 value in the business during the marriage. (Opening Brief at 11-12).

Ms. Morelli now appeals.

ARGUMENT

III. STANDARD OF REVIEW

This Court reviews the trial court's valuations and division of property for an abuse of discretion.

A trial court in dissolution proceedings has broad discretion to make a just and equitable distribution of property based on the factors enumerated in RCW 26.09.080. The court may distribute all property, whether categorized as community or separate. This court will affirm unless an appellant demonstrates that the trial court manifestly abused its discretion.

In re Marriage of Wright, 179 Wn. App. 257, 261-62, 319 P.3d 45 (2013) (footnotes omitted).

IV. THE TRIAL COURT'S VALUATIONS AND DIVISION OF PROPERTY WERE REASONABLE.

A. Trial Courts Do Not Have An Independent Duty To Value Goodwill

Citing two cases, Ms. Morelli claims the trial court had an independent duty to value and divide any goodwill in Ken's Tree Service.

Pursuant to Fleege and Hall, consideration on the record of the Fleege factors is mandatory and the trial court has an independent duty to perform a Fleege analysis.

(Opening Brief at 21). This is incorrect. A trial court must evaluate goodwill only when a party claims it. Since Ms. Morelli did not ask for a division of goodwill or provide any evidence of it, the trial court should not speculate on the issue.

The two cases mentioned – Marriage of Fleege, 91 Wn.2d 324, 588 P.2d 1136 (1979) and Marriage of Hall, 103 Wn.2d 236, 692 P.2d 175 (1984) – both involved claims at trial for a division of goodwill. First, in Fleege, the wife presented expert evidence of the value of goodwill in her husband's dental practice.

At the trial, the appellant presented the testimony of two certified public accountants, both of whom served clients in the medical and dental professions, who testified that the value of the respondent's practice included a goodwill factor, which had a present value. One of these set the value of the practice (evidently including accounts receivable and tangible property) at approximately \$200,000. The other gave his opinion that the value of the goodwill would be equal to the gross receipts over a 2- to 3-month period. One of the experts stated that the respondent's net annual profits exceeded those of the average practitioner by approximately \$50,000.

Marriage of Fleege, 91 Wn.2d 324, 325, 588 P.2d 1136 (1979).

The Washington Supreme Court reversed the trial court's refusal to consider this evidence.

Despite the overwhelming evidence of the existence of an element of goodwill in the respondent's practice, the court refused to include it as an asset subject to distribution. In this the court erred.

Fleege, 91 Wn.2d at 325. The Court recognized that goodwill – if it exists – is a potential asset of the marital community. “That value is real, and the mere fact that it cannot be precisely determined should not deter the court from assigning it a reasonable value *within the evidence*.” Fleege, 91 Wn.2d at 330 (emphasis added).

Here, there is no evidence of goodwill. Because Ms. Morelli did not raise the issue at trial, let alone present evidence of goodwill, the trial court had nothing to rule on. The Court in Fleege did not require trial courts to initiate independent inquiries when the parties did not claim goodwill.

Second, in Marriage of Hall, two doctors – one salaried and one in private practice – disagreed over the existence of goodwill in their practices. After examining the parties' evidence, the trial court found goodwill only in a private practice.

The trial court found that Judith had no professional goodwill due to the fact that she was a salaried physician. The court found that Phillip had professional

goodwill in the amount of \$70,000. A decree of dissolution was entered accordingly.

Marriage of Hall, 103 Wn.2d 236, 238, 692 P.2d 175 (1984). As in Fleege, the parties raised the issue of goodwill at trial and presented evidence on its existence and value.

The Court in Hall did not create an independent duty for trial courts to address goodwill sua sponte. Instead, the Court refined the Fleege factors for cases where the parties offer conflicting evidence of goodwill.

The Fleege factors cannot be evaluated and valued in isolation. One or more of the accepted methods of valuation must be employed. *The particular method used by the trial court will depend on the offered proof.* Because evidence available to the court varies greatly from case to case, selection of any one method for all cases would unnecessarily limit the court in making a fair and just distribution.

Hall, 103 Wn.2d at 243 (emphasis added). Here, there is no offered proof.

Finally, Ms. Morelli cites a third case – Marriage of Berg – to claim that the trial court erred by valuing Ken's Tree Service at its book value. (Opening Brief at 18); Marriage of Berg, 47 Wn. App. 754, 737 P.2d 680 (1987). This argument has two flaws. First, the trial court expressly valued the business *above* its book value. Rather than value Ken's Tree Service solely as its equipment --

\$78,000 – the Court added \$50,000 because “there is other value in the business but in my view its difficult to quantify and not nearly as substantial as Mr. Guerrero’s estimates.” (3/11/15 Oral Ruling at 9).

Second, unlike the trial court in Berg, Judge Garrett gave a detailed explanation for valuing the business based on its income tax returns, profit and loss statements, and trial testimony. (3/11/15 Oral Ruling). The court recognized that the primary asset in Ken’s Tree Service was Mr. Morelli’s labor. This was not a complicated valuation of a closely-held corporation.

The entire legal argument in Ms. Morelli’s Opening Brief involves a new issue on appeal: the trial court should have examined Ken’s Tree Service for evidence of goodwill. Yet she provided no evidence of goodwill. Under RAP 2.5(a), Mr. Morelli respectfully requests the Court to disregard this new argument on appeal.

B. Substantial Evidence Supports The Trial Court’s Valuation

In her Assignments of Error, Ms. Morelli claims the trial court abused its discretion in finding that Ken’s Tree Service’s vehicles and equipment were worth \$78,000 and its other assets were worth \$50,000. (Opening Brief at 2) (Findings of Fact 2.8 F.2 and F.4; CP 318-320). Substantial evidence in the record supports both findings.

Judge Garrett determined the value of vehicles and equipment based on Michael Guerrero's estimates. (3/11/15 Oral Ruling at 8-9) ("I used Mr. Guerrero's estimates of the value of equipment"). Because she believed the depreciated value on some equipment was too high, Judge Garrett "reduced a couple of items, not significantly, however, the difference is probably about \$4000." (3/11/15 Oral Ruling at 9). Ms. Morelli cannot claim that her expert's report is not substantial evidence.

Next, Judge Garrett estimated the additional value of assets, \$50,000, based on the financial information introduced at trial – tax returns and profit and loss statements – coupled with testimony from Mr. Morelli, his bookkeeper, and Mr. Guerrero. (VRP 30; 95; 323, 339). Given the nature of Mr. Morelli's business, a valuation of \$128,000 is reasonable for a tree-cutting service.

Finally, the trial court's valuation of the business was only part of the division of the couple's assets. Ms. Morelli left this marriage with a residence, no debt, her retirement account, and monthly payments of \$1000 for four years. "The key to an equitable distribution ... is not mathematical preciseness, but fairness." Marriage of Clark, 13 Wn. App. 805, 810, 538 P.2d 145 (1975). The

trial court acted well within its discretion and reached a just and equitable division.

V. Mr. Morelli Deserves An Award Of Reasonable Attorneys' Fees on Appeal

Under RCW 26.09.140, "upon any appeal, the appellate court may, in its discretion, order a party to pay for the cost to the other party of maintaining the appeal and attorneys' fees in addition to statutory costs." This Court awards reasonable attorneys' fees after examining "the arguable merit of the issues on appeal and the financial resources of the respective parties." Marriage of Booth, 114 Wn.2d 772, 780, 791 P.2d 519 (1990).

An award is appropriate here for two reasons. First, Ms. Morelli's appeal raises new arguments not presented at trial and has misinterpreted caselaw on valuing goodwill. The appeal does not provide compelling arguments that the trial court abused its discretion. Second, the appeal has further delayed resolution of this controversy for no apparent gain. The trial court awarded Ms. Morelli most of what she requested. Mr. Morelli deserves reimbursement of his attorneys' fees for defending against her demands for more.

CONCLUSION

After a two-day trial on the merits, Whatcom County Superior Court Judge Deborra Garrett made a just and equitable division of the Morellis' assets. Because Appellant Lily Morelli fails to show that Judge Garrett abused her discretion, Respondent Ken Morelli respectfully requests this Court to dismiss this appeal and award him reasonable attorneys' fees on appeal.

DATED this 13th day of January, 2016.

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DECLARATION OF SERVICE

The undersigned declares under penalty of perjury under the laws of the State of Washington that on the date stated below, I mailed or caused delivery of Response Brief to:

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DATED this 13th day of January, 2016.


Heidi Main