New Jersey Family Lawyer

VOLUME XII, Number 5

August 1992

Chair's Column

Common Aim Unites Bench and Bar

by Lynne Strober

Thank you, Chief Justice Wilentz. For the second year in a row, the officers of the Family Law Section have had the opportunity to maintain a dialogue with the Chief Justice of the New Jersey Supreme Court regarding the Family Part practice. This open discussion reflects the strong partnership between the bench and the Family Part bar. The topics were discussed in a cooperative spirit and reflected a joint agenda. The Chief Justice requested that the Section devote attention to the non-dissolution issues concerning children. We requested the right to provide input regarding the Family Division *Green Paper*, a report reorganizing the operation of the Family Part. That request was granted and the logistics were worked out on the spot. The officers advised the section's position that consent orders be permitted in domestic violence matters to enter restraints without a finding of domestic violence, when both parties are represented by counsel and the restraints are clearly defined. Other issues of policy were discussed, and the officers were honored by the Chief Justice's commitment to continue meeting with us.

The bench and bar share the common goal of working to improve the Family Part so that it can function at the highest possible level. As partners, both serve the public in times of difficulty, and this partnership is reflected in our committee work. The Family Law Section Executive Committee has five judges who serve—Judges Bozonelis, Fall, Segal, Ross and Zampino. They volunteer their time, attend the meetings, provide very valuable input, work on subcommittees, teach, guide, etc. The Supreme Court Family Division Practice Committee allows for the bench and bar dialogue to continue. Family Part judges and attorneys serve on the domestic violence working group

Continued on page 131

Determining Valuation of Property After Divorce

by Frank Louis

The existence of marriage as an economic partnership is well established as both a matter of law and public policy in New Jersey. It is based on the legislation establishing that upon divorce there would be an "equitable distribution" of property acquired during the marriage, and on the early Supreme Court decisions interpreting the law. See generally Painter v. Painter, 65 N.J. 196 (1974); Chalmers v. Chalmers, 65 N.J. 186 (1974); and Rothman v. Rothman, 65 N.J. 219 (1974). Yet, the legislation established only the broad policy, as the simple statutory language itself reveals:

> **In all actions where a Judgment of Divorce . . . is entered, the Court may make such award or awards to the parties, in addition to alimony and maintenance, to effectuate an equitable distribution of the property, both real and personal, which was legally and beneficially acquired by them or either of them during the marriage.** *See NJSA* 2A:34-23

The details of implementing the partnership theory were left to the courts. Not surprisingly, the Supreme Court was concerned with two separate and, at times, conflicting policies: implementing the legislative mandate while avoiding multiple hearings on issues of eligibility and valuation. In its reasoned attempt to balance these legitimate concerns, the Supreme Court established rules which for years worked well and seemed to satisfy both policies. It was certainly logical to assume that a complaint for divorce terminated the partnership, and assets acquired when the partnership was over should not be shared. That the acquisition of an asset subsequent to the filing of a complaint for divorce would not be subject to equitable distribution seemed an appropriate determination, and the establishment of a "cut-off" date was consistent with the legislative policy. The logic was so compelling that no one objected to the legal reality that the marriage subsisted until trial and the statute used the terms "dur-

Continued on page 115

© 1992 by the New Jersey State Bar Association

Determining Valuation of Property After Divorce

Continued from page 113

ing the marriage." *See N.J.S.A. 2A:34-23.* There did not seem to be any inconsistency between the filing date of the complaint and the statutory reference to the marriage.

Flowing from the cut-off date was the concept of a valuation date. If there was a cut-off for inclusion of assets because the marital partnership terminated, it was logical this date could also serve as the point at which the distributable assets were valued. Recognizing that there would be duplicitous hearings if the trial (as opposed to the filing date) were the valuation date, the *Painter* court selected the filing date as the valuation date. *Painter* at 217-18.

The Appellate Division then reaffirmed the basic legislative policy by observing that in the final analysis the distribution of property must be equitable. Scherzer v. Scherzer, 136 N.J. Super. 397, 400 (App. Div. 1975). By recognizing that the distribution needed to be equitable, the Appellate Division elevated that essential policy over the filing date rule. After *Scherzer, Painter* could no longer be read literally where use of the filing date made the distribution inequitable.

Mrs. Scherzer, relying on such a rigid rule, argued that *Painter* must be accepted as written. She contended that her husband's interest in Baxter Die Works (equity and debt) had to be valued as a matter of law as of the filing date since that was what *Painter* required. *Scherzer* at 399-400. Unfortunately, Baxter had gone into bankruptcy before trial but after filing. *Painter*, literally read, meant that Mrs. Scherzer's argument would be correct. Since there was no contention that the bankruptcy was related to the divorce, the Appellate Division, relying on the need for the distribution to be equitable, did not require the husband to compensate his wife for a bankrupt asset. This correct decision had the effect of establishing two important principles. First and foremost, a court's primary obligation in distributing assets is to assure that the distribution is equitable. In effect, the court was sanctioning, where necessary, abrogation of *Painter's* rules if their application was inconsistent with the statute's purpose. Secondly, *Scherzer* introduced the good faith business decision rule. Mrs. Scherzer may have received a different result had the court believed that the change in value was caused by the deliberate action on the part of Mr. Scherzer. *Scherzer* at 400.

What was not discussed, however, was what would happen if the change in value was caused by a business decision made by Mr. Scherzer, in good faith, but after the filing date. The absence of what the Appellate Division characterized as the "deliberate action" of Mr. Scherzer did nothing more than repeat Footnote 6 in *Painter*, where the Supreme Court observed that "Any disposition of property in fraud of the other spouse could be promptly made the subject of appropriate judicial action." Fraud, if proven, is relatively simple. A more difficult issue is a good faith post-filing action that would cause a change in value. Even more difficult to deal with is a change in value caused by market forces, as opposed to the deliberate but good faith action of the owner spouse.

In 1977, the Supreme Court addressed the question of changes in value in distributable assets that occur subsequent to the execution of an agreement and trial. Smith v. Smith, 72 N.J. 350 (1977). The *Smith* court distinguished between a support and a property settlement agreement. In its decision the Court acknowledged that in many cases property "will have changed in nature and value between the date of the separation agreement and the date of the divorce decree." *Smith* at 362. Justice Mountain believed that if the changes were minor they could be ignored, but any unduly adverse effects that equitable distribution might have on the present circumstances of the parties could be "compensated for by adjusting the alimony provisions." *Smith*, 362. He went on to note that if a husband's assets have diminished since the date of the agreement, he may still be required to comply with the equitable distribution provisions of the agreement, but the diminution might be taken into consideration in regard to alimony. Conversely, he pointed out that if the husband's assets had increased he would not be required to divide the increase with his wife, but his more favorable situation would be considered in alimony.

Interestingly, he observed that situations might arise in which the change in financial position was so severe that the alimony adjustment alone might not be sufficient to do mutual justice. In such a case a party "must be permitted to apply to the court for appropriate equitable consideration of the special circumstances involved. *Smith* at 362. He emphasized, as did the Appellate Division in *Scherzer*, that the distribution, though made belatedly, must still be equitable. *Smith* dealt with a somewhat unique situation since there was an agreement and delay in obtaining the divorce. Obviously, there are significantly different policy considerations in modifying the executory equitable distribution provisions of an agreement and initially establishing equitable distribution at trial where there never has been an agreement.

Yet, this distinction was not mentioned by the Appellate Division in the 1978 decision in Borodinsky v. Borodinsky, 162 N.J. Super. 437 (App.

Div. 1978) which relied on *Smith*. *Borodinsky* reaffirmed the *Painter/Smith* rule that the termination date for determining eligible assets was also the valuation date. It went on to note, in reliance upon *Smith*, that:

> **Any increase or decrease in the value of eligible assets should be reflected in the alimony award, if at all, and not in the equitable distribution of assets.** *Borodinsky* at 447.

Borodinsky's broad language is perhaps unfortunate. It reflected a literal return to the rigid *Painter* tests and ignored the fundamental proposition that in the final analysis, literal and rigid application of the filing date rule had to bend if the end result was inequitable. Justice Mountain in *Smith* had acknowledged that the choice of a termination date "was dictated largely by pragmatic considerations." *Smith* at 361. Pragmatic considerations, while laudatory, must bend if implementation creates a result inconsistent with the fundamental legislative purpose. Thus, the *Borodinsky* court, by emphasizing the *Painter* rules, diverted attention from the imperative that the distribution be equitable.

It was not until 1984 that the practical problems created by *Painter* could no longer be ignored.

The Appellate Division, in Bednar v. Bednar, 193 N.J. Super. 330 (App. Div. 1984), was forced to depart from a strict application of the *Painter* principles. *Bednar* requires a thoughtful and careful analysis of the actual facts to examine how they interrelate with the legislative purpose of equitable distribution. *Bednar* raised the specific issue of the eligibility for distribution of post-filing date incremental changes. The Appellate Division was confronted with a unique situation since the complaint for divorce was filed in 1976 and the divorce granted six years later in 1982. The primary asset was a motel acquired in March of 1972 for $225,000. The motel was operated entirely by one spouse until it was sold in January, 1984. The net equity, eight years after filing, was stipulated to be $575,000. Despite *Painter*, *Smith* and *Borodinsky*, the *Bednar* court noted that there was "no absolutely iron-clad rule for determining a valuation date." According to *Bednar*, while use of a consistent date "such as the filing of the complaint" was preferable, in the final analysis it depended upon "the nature of the asset and any compelling equitable considerations." *Bednar* at 332.

In other words, the time of the hearing might well be the appropriate valuation date. It was a welcome return to the *Scherzer* principle that the statute, let alone fundamental fairness, required the distribution to be equitable.

Bednar also pointed out the distinction between enhancement or accretion in value subsequent to the valuation date and the value at filing. It recognized that this enhancement or accretion is separate and trial courts were directed to ascertain whether the increase was: "attributable to the personal industry of the party controlling the asset, apart from the non-possessory partner, or simply to fortuitous increases in value due merely to inflation." *Bednar* at 333.

If the interim accretion was due to the diligence and industry of one party independent of market forces, that accretion accrued to that party alone. In other words, it was not distributable. If this was unfair to any extent, *Borodinsky* provided a remedy through an adjustment in alimony. The *Bednar* rationale was predicated on the nature of the marital partnership.

If the partnership were truly over, why should the non-titled spouse share in any appreciation caused by the efforts of the former partner? If the partnership were terminated as of the filing date, the ex-partner should not share in the fruits of the spouse's efforts. Yet, if the increase in value was caused solely by market forces, then it would be unfair to allocate it to one or the other party since the marital asset increased not by virtue of anything either party did, but merely from passive forces. If neither party did anything to create the increase, it should not arbitrarily be awarded to one partner as opposed to the other. Thus, the distinction between active and passive appreciation was created. *See* Scavone v. Scavone, 230 N.J. Super. 482 (Ch. Div. 1988), *aff'd.* 243 N.J. Super. 134 (App. Div. 1990). Analytically, the active/passive dichotomy had to be viewed in light of the public policy embodied in the statute.

Not surprisingly, *Bednar*, which was decided in the non-recessionary 1980s, dealt primarily with assets that had appreciated. It never discussed what might happen to assets that decreased in value. Nor did Judge Krafte deal with what is now that unfortunate but common situation in his well-reasoned decision in *Scavone*. Judge Krafte perceptively recognized that equitable distribution was an evolving concept and he returned to *Scherzer* to observe that while use of a consistent valuation date such as the filing of the complaint had its advantages, such a date could not be deemed an absolute. *Scavone* at 485. He outlined the various standards to be applied to the distribution of assets that increased in value but as in *Bednar*, he never dealt with assets that decreased in value.

In his cataloguing of the various types of assets, he made a distinction between passive and active assets. He believed that a change in the value of an active asset was, of necessity, the "direct result of the intention, time, energy and devotion of the sole owner." While *Scavone* represents a major advance

in equitable distribution law, it based its conclusion on an assumption that is not necessarily accurate. There may be situations, particularly in a recessionary economy, where despite the attention, time, energy and devotion of the owner, the value of an active asset decreases for reasons that can be characterized only as passive. Thus, the analysis becomes extremely complex since it does not automatically follow that any change in value of an active asset is caused by the efforts of the titled spouse. An active asset may change in value for passive reasons.

Assume that a McDonald's restaurant is valued at $500,000 as of the valuation date; assume further that the owner continues to devote the same time, attention, devotion and effort to the operation of a restaurant that was done previously; however, subsequent to the filing date and before trial a Wendy's and a Burger King both open within one mile. As a result of this increased competition, it is stipulated at trial that the value of the McDonald's restaurant is now $300,000, a decrease of $200,000.

Is it equitable to say that since the restaurant was an active asset, the titled spouse solely assumes the risk of a change in value between the filing date and trial, simply because it is an active asset notwithstanding the fact that the parties were married during the period of the decrease. The statute requires equitable distribution of assets acquired during the marriage, and in the example the titled spouse continued to work as industriously as before. The decrease in the value of the asset was in no way attributable to any action taken by the owner. Conversely, what if the value of the restaurant has increased to $700,000 because a new exit ramp was built from a major highway across from the restaurant, an occurrence entirely unrelated to any effort on the part of the owner?

Before attempting to answer these difficult questions, the recently adopted equitable distribution statute must be considered. The statute sets forth a series of factors a court must consider in equitably distributing properties. The intent of the drafters of the statute was not necessarily to alter existing law. Rather, they sought to incorporate the existing case law factors and to set forth in one central place an itemization of those factors so that litigants could have some objective criteria upon which the distribution of their property would be made. It was seen by the drafters as a fairer way of placing the public on notice as to what would happen to their assets upon divorce.

Notwithstanding the drafters' intent to leave the law unchanged, the statute is now the basis from which equitable distribution takes place and it mandates that courts consider two factors that virtually eliminate the filing date as being the only relevant date for equitable distribution. Now, a trial court is legislatively mandated to consider the following statutory criteria:

> **(f) The economic circumstances of each party at the time the division of property becomes effective;**
> **(k) The present value of the property.**
> *See NJSA* 2A:34-23.1

The statute further provides that in every case a court is obligated to make "specific findings of fact" on issues relating to asset valuation and equitable distribution including each and every one of the factors established in the statute. Given the legislative history of this statute, and the adoption of other standard statutes for alimony, child support and custody, it was not the legislative intent to change the valuation date from the filing date to trial by referring to the present value of the property. The factors set forth in the statute are not valuation criteria. Rather, they are the factors a court considers in making a distribution of the assets. The statute requires that the court consider the factors in deciding how to divide the assets that are subject to distribution. By virtue of the statute, this now requires a court to consider the present value of the property and the economic circumstances of each party at the time the division of the property becomes effective. Each of these is fact-sensitive and must be determined not as of the valuation date, but as a statutory imperative as of the trial date.

The legislature has now effectively eliminated the policy concern of the Supreme Court of adopting an equitable distribution scheme that had simplicity. Certainly, designation of the filing date simplified the process. Unfortunately, experience has taught family practitioners that simplification does not equate with justice.

One interpretation of the statutory language, for which there is a substantial argument, is that any change in value between the filing and trial is not a valuation issue. Instead, it is argued that since the legislature requires consideration of the present value of the property, the court's power is circumscribed to considering the change solely as a distribution factor. Thus, if the value of a business decreased between the filing date and trial, the non-recipient spouse might receive a lesser percentage than might otherwise have been received had the value remained the same.

The fundamental problem with such an approach is that, in many circumstances, it could result in an unfairness. In Goldman v. Goldman, 248 N.J. Super. 10 (Ch. Div. 1991), Judge Glickman correctly determined that when the husband's good faith operation

of the business was stipulated, the decrease in the value of a business to zero by trial meant a change in the valuation date. Many practitioners read *Goldman* simplistically as finding that in all cases the valuation date is now trial where there has been a decrease in value. *Goldman* should not be read too broadly since it represents nothing more than a common sense application of the statute and mirrors the same conclusion the Appellate Division reached in 1975 in *Scherzer*. If the titled spouse acted in good faith, and the asset is valueless at trial, what system of justice could conceivably require one spouse to pay the other spouse for an asset that is no longer in existence?

The proper procedure to handle changes in value must flow from the equitable distribution statute and the public policy upon which it is based. If a court's application of the law is inconsistent with both the statute and the policy of a marital partnership, then common sense indicates that approach would be incorrect. Conversely, the goal must be a procedure that is consistent not only with the statute but with the fundamental nature of marriage as an economic partnership, and that is ultimately fair and equitable to both parties.

The statute refers to an equitable distribution of assets during the marriage. It does not refer to assets acquired as of the filing date of the complaint. The policy of the statute is that an economic partnership exists and that assets acquired (whether new assets or appreciation) under this economic partnership should be shared. Conversely, assets acquired when no partnership exists should not be shared as sharing would not further any public policy implicit in the statute. No one, I suggest, would question the fairness of a distribution of a marital home which, at trial is valued at $200,000 but as of the filing of the complaint was worth $300,000, when the decrease in value was caused solely by passive market forces.

The fairness of the distribution should not be based on the type of asset involved. It flows from the reason for the change in value. If the change in value is not attributable to the actions of either party and can thus be denominated as passive, that change should not automatically be allocated to one spouse or the other. Yet, if the change in value reflects the unique efforts and skill or diligence of one spouse when that spouse was no longer working for the partnership, which presumptively is over once a complaint for divorce is filed, then it would be equally unfair to allocate the change to the other spouse.

The internal validity of such a principle cannot be tested only in a recessionary economy, but in the rising marketplace in existence in the 1980s. If there were an increase in value that was not attributable to the work effort or skill of the titled spouse, then there would be no reason to allocate the increase to one spouse or the other. The logic of the proposal flows from the way equitable distribution of a marital home is handled. No one questions that the passive value change of a home should be allocated to one spouse or the other. It is generally acknowledged that it is fairest and most consistent with the public policy implicit in the equitable distribution statute to value a marital home as of the trial date. Such an approach focuses not on the nature of the asset, but the reason the value changed. This approach seems more consistent with the nature of a marital partnership than treating the change in value of a passive asset as a distribution as opposed to a valuation issue.

Taking this approach to its logical conclusion, it is immaterial whether an active asset decreases in value for passive reasons. Returning to the McDonald's restaurant example, what policy underpinning the equitable distribution statute is served by allocating the entire loss of value (because of passive market forces, i.e. increased competition), solely to one spouse? What public policy is served by allocating a decrease in value caused by the existing recession to one spouse? Similarly, if the increase in value is not attributable to the energy, expertise, or industriousness of the titled spouse, then why should that spouse receive the benefit of the increase? The increase, therefore, must be directed to the reason the value changed. This is a somewhat different approach than suggested by *Scavone*, which seemed to assume that a change in value of an active asset must be ascribed to the owner. Yet, as we've learned in this economy, active assets decrease for reasons entirely outside the control of the owner.

Mrs. Goldman argued to Judge Glickman that you could not use the value at trial because if the automobile dealership had increased in value, Mr. Goldman would be asserting that the increase was immune. Under this proposal, that increase, if proven, would be immune only if it could be proven that it was caused by the efforts of the titled spouse during a period when the marital partnership was no longer in existence. Such an approach eliminates the criticism that permitting a change in value for decreases prejudices women. Rather, judicial use of the passive/active dichotomy is fair to each spouse and is the only approach that is not only consistent with the statute (since the parties remain married), but the public policy underpinning equitable distribution.

A fair criticism of this proposal is that it complicates equitable distribution and may result in more expensive and ongoing discovery, in addition to longer trials. That is, in all probability, a true statement. The ultimate issue is whether this system is concerned fundamentally with reaching just results, or whether it is willing to sacrifice justice to the cross of expediency. ■