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INCREASE IN VALUE OF PRE-MARITAL ASSETS

INTRODUCTION

The issues created in equitable distribution involving pre-marital assets raise fundamental questions that are not only intellectually interesting but go to the very essence of the purpose of our equitable distribution statutes. A review of the literature, at least in New Jersey, reveals this subject has not comprehensively been treated; therefore it seems an appropriate topic for the Family Law Symposium. Since I believe an analysis of legal principles primarily flows from identification of the policy considerations, it is appropriate to begin with the philosophy underpinning our equitable distribution statutes.

EQUITABLE DISTRIBUTION POLICY CONSIDERATIONS

Equitable distribution was first and fundamentally dealt with by our Supreme Court in the four seminal decisions which included the landmark Painter decision. Painter v. Painter, 65 N.J. 196 (1997) One of those cases, albeit not as well known as Painter explored the very essence of equitable distribution. When the Supreme Court commented on the statutory remedy in Chalmers v. Chalmers, 65 N.J. 186, 194 (1974) noting that equitable distribution was:

> "a recognition that each spouse contribute something to the establishment of the marital estate even though one or the other may actually acquire the particular property". (emphasis added)

The Legislature reemphasized that very principle when it adopted N.J.S.A. 2A:34-23.1, pointing out that it was a "rebuttable presumption" that each party made a substantial financial and non-financial contribution to the acquisition of both income and property during the marriage. In explaining why fault was irrelevant to this analysis, the Court noted that what was being effectuated when assets were distributed was an "allocation to each party of what really belongs to him or her". Chalmers at 194. The Court's elegant simplicity captured not only the essence of equitable distribution but the public policy it implements.

The distribution process is merely an allocation between spouses of their property acquired during the marriage. It is primarily based on concepts of fairness and implemented by well-defined and gender neutral statutory criteria in N.J.S.A. 2A:34-23.1. It reflects the philosophical view that marriage is a "shared enterprise" and is "akin to a partnership". Rothman v. Rothman, 65 N.J. 219, 229 (1974). As Rothman emphasized, only when it is "clearly understood that far more than economic factors are involved, will the result in distribution be equitable within the true intent and meaning of the statute". Rothman at 229.

These principles were reaffirmed by the Supreme Court in Carr v. Carr, 120 N.J. 336, 347 (1990) when the Court emphasized the

philosophical basis of equitable distribution that the entitlement to property was like the marriage, itself - "joint and mutual". Carr at 347. To emphasize the point, the Court noted that:

> "The entitlement to marital property is not dependent on economic contributions as such. Thus tangible efforts are recognized as equally valuable to the overall prosperity of the familial entity". Carr at 347. [emphasis added]

Yet perhaps the most cogent explanation is Judge Pressler's, who in Gibbons v. Gibbons, 174 N.J. Super. 107, 112-113 (1980) rev'd on other grounds, 86 N.J. 515 (1981) noted:

> "As we understand the concept of equitable distribution, it is a corollary of the principal concept that marriage is a joint enterprise whose vitality, success and endurance is dependent upon the conjunction of multiple components, only one of which is financial. The nonremunerated efforts of raising children, making a home, performing a myriad of personal services and providing physical and emotional support are, among other noneconomic ingredients of the marital relationship, at least as essential to its nature and maintenance as are the economic factors, and their worth is consequently entitled to substantial recognition. Thus, the extent to which each of the parties contributes to the marriage is not measurable only by the amount of money contributed to it during the period of its endurance but rather by the whole complex of financial and non-financial components contributed. The function of equitable distribution is to recognize that when the marriage ends, each of the spouses, based on the totality of the contribution made to it, has a stake in and right to a share of

the family assets accumulated while it endured, not because that share is needed but because those assets represent the capital product of what was essentially a partnership entity." (emphasis added)

POLICY CONSIDERATIONS

The basic premise of our law should be that people who marry are engaged in the most fundamental societal institution we have and have a responsibility at the end of their relationship to treat each other fairly; our law should develop so it compels such fair treatment and implements this fundamental public policy. There is a consistent strain in development of our law that it evolves in response to what courts perceive to be sound public policy. The genesis of this principle might well have been Oliver Wendall Holmes' ("Holmes") landmark work "The Common Law" where he discussed the linkage of public policy and the development of the law. Holmes, "The Common Law" (1881). New Jersey courts have recognized this linkage and have liberally quoted Holmes when confronted with an issue previously undecided. It is logical for there to be a rational relationship between sound public policy and simple concepts of justice. The two concepts should and do go hand in hand.

An excellent example is Falcone v. Middlesex Co. Medical Society, 34 N.J. 582 (1961). Falcone involved the question of a

doctor's admission to a County Medical Society. In determining the issue, Justice Jacobs went back to Holmes, emphasizing, "the vital part played by public policy considerations in the never ending growth and development of a common law". Falcone at 589. Holmes had noted, and was cited by Justice Jacobs, that:

> "every important principle which is developed by litigation is in fact and at bottom the result of more or less definitively or definitely understood views of public policy". Holmes, "The Common Law", 35 (1881) cited in Falcone at 589.

In his analysis, Justice Jacobs concluded the "dominant factor" in development of our common law is the "common law principles" which "soundly serve the public welfare and the true interest of justice" citing Collopy v. Newark Eye and Ear Infirmary, 27 N.J. 29 (1959); Henningsen v. Bloomfield Motors, Inc., 32 N.J. 358 (1960); Cardozo, The Nature of the Judicial Process, 10 (1921).

In recent years, our Supreme Court has followed Holmes' linkage of public policy and the development of law. In Shackil v. Lederle Laboratories, 116 N.J. 155, 177 (1989) the Supreme Court rejected the market share liability theory advanced by certain Plaintiff's concerning childhood vaccinations reasoning it would frustrate the public policy of development of safer vaccines. Similarly, in Kelly v. Gwinnell, 96 N.J. 538, 545 (1984) the Court,

in an attempt to reduce the number of drunken drivers, concluded imposing social host liability would advance that salutary public policy. Kelly relied on Palsgraff v. Long Island R.R. Co., 248 N.Y. 399 (1928) for the proposition that in determining whether a duty of reasonable care existed the answer depended upon "an analysis of public policy". Kelly at 544. Support for the proposition that unique legal questions are determined on public policy considerations can also be found in a family case decided by our Supreme Court. In Kinsella v. Kinsella, 150 N.J. 276 the Court found the attorney/client privilege was not absolute:

> "considerations of public policy and concern for proper judicial administration have led the legislature and the courts to fashion limited exceptions to the privilege. These exceptions attempt to limit the privilege to the purposes for which it exists." Kinsella at 298. emphasis added)

Justice Stein later noted courts should be mindful of the public policy considerations behind the psychologist/patient privilege concluding, in some respects, it was even more compelling than the attorney/client privilege. Kinsella at p. 329-330. This confirms that in determining how to rule on unique legal issues the Court, mirroring Holmes' perceptive reasoning, ultimately based decisions on their perception of what the sound public policy was.

A consistent strain that runs through all aspects of our law

is that in making decisions arising from the most sensitive personal relationship, it is incumbent on Courts to assure in light of all of the factors the final decision is fair. While perhaps simplistic, this broad based fairness concept is and should be present in all aspects of Family Law. Its impact on how the law develops is best illustrated by our ever changing equitable distribution law although it is present throughout the case law on all issues. An excellent example, although certainly not the only one, of the impact of fairness on how the law develops is graphically illustrated by one of the participants in this Symposium, Judge Glickman.

In Goldman v. Goldman, 248 N.J. Super. 10 (1991) aff'd. 275 N.J. Super. 452 (App. Div. 1994) Judge Glickman was confronted with a unique situation. In fact, he, himself, characterized the case as presenting "special circumstances". Goldman at 248. In resolving the issue of how the value of a car dealership which had significant value as of the valuation date but virtually none at trial should be treated, he not only analyzed the issue in the context of the existing law but the policy considerations. He ultimately reached a result predicated on simple concepts of fairness that simultaneously recognized what was being effectuated when assets are distributed. As the Appellate Division noted in

affirming his decision:

> "...the Trial Court here correctly recognized that he was confronted with the unique situation and that application of a rigid categorical analysis would have only <u>hindered him in fulfilling his ultimate obligation to effectuate a distribution of marital assets which overall was equitable to both parties</u>". <u>Goldman</u> at 457. (emphasis added)

<u>Goldman</u> emphasizes the proposition that in determining unique legal issues, you must first analyze the law, the public policy relating to equitable distribution and be assured in the final analysis the end result was fair. This concept of fairness, therefore, must be included as a criteria for determining the unique legal issues that arise.

I, therefore, believe in deciding novel issues the analysis must be based on a triad of considerations. This tripartite approach requires an analysis:

(A) Of policy issues and whether the proposed rule furthers sound public policy.

(B) Whether the proposed decision is consistent with existing law;

(C) Whether the proposed result is fundamentally fair.

It is in this analytical context the issue of valuation changes with pre-marital assets must be decided.

because of the partnership nature of a marriage and the contrary but fundamental right to enjoy the fruits of property owned before marriage. In the final analysis, the parties are treated fairly if the policy considerations are clearly identified and the facts dispassionately analyzed so that these two potentially conflicting policy considerations can reasonably be harmonized. Before undertaking that analysis, a review of the precedent is instructive.

Not surprisingly the analysis begins with the seminal Painter decision where the court noted, without explanation that:

> Clearly any property owned by a husband or wife at the time of marriage will remain the separate property of such spouse and in the event of divorce will not qualify as an asset eligible for distribution. As to this statute is explicit. We also hold that if such property owned at the time of the marriage, later increases in value, such increment enjoys a like immunity. Furthermore the income or other usufruct derived from such property may be exchanged or into which it, or the proceeds of its sale, may be traceable shall similarly be considered the separate property of the particular spouse. (Emphasis added)

That simple quote spawned years of litigation. As discussed later, ultimately, but not exclusively, many courts focused on to footnote #4 in Painter, which modified this language which otherwise appeared to establish a clear, unequivocal rule. Painter at 214. Several years after Painter, in dealing with a law firm

the Appellate Division simplistically noted the only portion of the practice subject to distribution "was the appreciation and the value of Defendant's interest in the firm during the course of the marriage and, more particularly, the difference in value as between the date of the marriage and the date of the filing of the Complaint". Grayer v. Grayer, 147 N.J. Super. 513, 520 (App. Div. 1977)

In it's holding, the Court relied on an earlier Appellate Division decision in Scherzer v. Scherzer, 136 N.J. Super. 397, 401 (App. Div. 1975) which also involved a spouse's interest in a corporation which pre-dated the marriage. The Court, in language not as broad as Grayer, noted the increase in value occurring after the marriage was eligible "to the extent that it may be attributable to the expenditures of the effort of the Plaintiff-Wife" relying, once again, on Painter. What was happening was the courts were focusing on the footnote which itself was somewhat ambiguous. Did the Supreme Court, in Painter, require a direct contribution to the asset or contribution to the marital partnership independent and distinct from the asset?

Interestingly, the Court characterized the theory justifying distributability of the increase as being predicated on the "homemaker's contribution" which could not be given a monetary

worth but it's value "may be gleaned from the earnings of the employed spouse". Scherzer at 401. In essence, the Court was reaffirming a concept central to the theory of equitable distribution. An increase was distributable even if there was no direct economic contribution by the Wife; non economic contributions were sufficient to render an increase in value during the marriage distributable In ordering a remand, the Court directed the Trial Judge "determine the extent to which Defendant's original investment has been enhanced by the contributions of either spouse. Scherzer at 401 (emphasis added). On remand, was the court to focus on contributions to the asset or the marriage?

The philosophy seemingly espoused by Scherzer was more clearly set forth in Weiss v. Weiss, 226 N.J. Super. 281 (App. Div. 1988) cert. den'd 114 N.J. 287 (1989). Citing both Scherzer and Grayer, the Court noted the Wife's efforts as a "homemaker" and "caretaker" of a child which enabled the Husband to work sixty hours a week entitled the Wife to share in an enhancement in the value of Defendant's interest which took place during the marriage. Thus, Weiss seemingly clarified footnote #4 - the contributions could be to the marriage, not only the asset.

Despite the level of sophistication in the practice in 1988 as opposed to the earlier years of equitable distribution, neither

expert expressed an opinion whether the business of selling insurance had increased in value during the marriage. Since the Court found it was clear the business had "substantial value" at the time it was acquired, (here done by gift thus the immunity was comparable to being pre-marital) how could the trial court award the Wife any specific amount when there was no expert testimony fixing the business' value as of the marriage and the valuation date. Weiss emphasizes a basic practice point. Before addressing legal principles the facts cannot be forgotten. The first job of an advocate is to quantify the value increase, i.e., how much of the value was created during the marriage. As discussed later, the expert should also express an opinion as to what caused the increase.

These cases, when analyzed with the legal principles implicit in equitable distribution, seem not only logical but consistent with what the Legislature intended in assuring that items of value, i.e. assets acquired during the marriage, are fairly allocated between spouses. It reflects the fundamental partnership nature of a marriage and focuses on the communal efforts of the parties without providing exclusive legal significance to the efforts of the party engaged in renumerative efforts. It is further consistent with the presumption in the statute that "each party

made a substantial financial and non-financial contribution to the acquisition of income and property while the party was married". See N.J.S.A. 2A: 34-23.1. Weiss emphasized the sharing of an increase in value of a pre-marital asset was distributable for the same reasons assets acquired during the marriage were distributed. The logic of authorizing distributability of marital asset appreciation was based on the partnership theory. Since the efforts of the partnership created the marital increase.

Yet, there are cases whose language seemingly suggests the reverse and which create uncertainty, confusion and litigation. While they may have been correctly decided on the facts of each case, they inject an ambiguity in the law that is unfortunate. Part of the confusion stems from Scavone, which identified a classification of assets and established bright line rules for valuation changes. There were two categories of pre-marital assets and the passive/active dichotomy established by Scavone was applied to each. In an overly simplistic analysis, the trial court defined a "passive asset" as one whose value fluctuations are based "exclusively on market conditions." The Court reasoned any incremental increase is not subject to distribution relying on the bright line Painter language, that property owned at marriage will remain "separate property" and "not qualify as an asset eligible

for distribution and that if the property later increases in value, such increment enjoys a like immunity." Yet, what about footnote 4, which changed the bright line rule:

> "The <u>immunity</u> of incremental value to which we refer is <u>not necessarily intended to include elements of value contributed by the other spouse, nor those for which the husband and wife are jointly responsible</u>." <u>Painter</u> at 214 (Footnote 4)

The footnote made it clear that pre-marital assets are not automatically immune, yet ambiguity was created by the footnote language "contributed by the other spouse" or "for which they were jointly responsible." What did "jointly reasonable mean? <u>Scavone</u> did not mention the footnote and relied on <u>Painter's</u> rigid immune language.

The trial court's conclusion in <u>Scavone</u>, generally accepted as gospel, suggests if the pre-marital asset is passive "the Court will not be called upon to select a date for equitable distribution, as there will be none" definitively assuming that a change in value of a passive asset is simply not distributable. Conversely, the Court defined an active asset as one involving contributions and efforts towards their growth which <u>directly</u> increase their value treating changes in value in active assets as simplistically as it did changes in value in passive assets. It is this language that is troubling. Many lawyers and judges interpret

this language in Scavone to require the non-titled spouse to directly do something with the asset itself that creates the value. Weiss and footnote #4 suggest the contribution can be indirect, similar to the contributions spouses make to enhance and advance the marital partnership during a marriage. Weiss was supported by Griffith v. Griffith, 185 N.J. Super 382, 385 (Law Div. 1982) where inclusion of an increase in equity cased by pay down on a mortgage pay down on a pre-marital asset was distributable was justified by the Wife's non-economic contributions. Yet, in language seemingly contradicting the Scherzer, Grayer, Weiss line of cases, Scavone held that when an active immune asset increases in value which is created "solely through the efforts of the owner", the increase was not distributable. Scavone at 487. Conversely, the court argued that when value is derived "in whole or in part" from the efforts of the non-owner, it was distributable. Scavone at 488. The decision was silent on whether the non-owner's efforts could be provided to family, the home, and to the marital partnership in other ways other than direct involvement in the asset itself creating confusion in our law. Scavone was upheld on appeal, but arguably the cited portion of the opinion is nothing more than dicta. Clearly, Scherzer, Grayer and Weiss suggest, as does the statutory presumption, that these efforts need not be directly

linked to the appreciated asset, but merely created by the generalized non-economic contributions to the marital partnership. However, in another Appellate decision, the court noted there was "not a scintilla of evidence" that the enhanced value was "in any way attributable to defendant's efforts" emphasizing that the confusion continued. Wadlow v. Wadlow, 200, N. J. Super. Perhaps such language focusing on the need to link the enhancement with the other spouses efforts was appreciate in Wadlow since the asset was a security account managed by the Wife's father.

A recent case highlights the issue. In Valentino v. Valentino, 309 N.J. Super. 334 (App. Div. 1998) the Appellate Division quoted liberally from Scavone and reaffirmed the comment that an increase in value of an active asset brought "solely through the efforts of an owner" rendered the incremental increase "undistributable". Valentino at 338. The asset in Valentino was a mini strip mall which was then used as a gas station. While the parties had factual disputes whether the Wife was actively involved at the property and performed services for it, the court repeated the Painter language (without reference to the footnote) that property owned prior to the marriage "will remain a separate property of that party" noting, however, there are circumstances during the marriage that will subject property to distribution; the

first determinate is whether the asset was active or passive. Valentino at 338. Once again that language was potentially misleading; there was no reference to the footnote and it focused attention on the asset. Fortunately, the opinion, read in its entirety, was not ambiguous.

The Husband argued the center was entirely passive and not distributable; the Wife claimed the Trial Court's allocation of ten percent of the increase in value was deficient. The Appellate Division, while noting that she may have minimally worked at the gas station (i.e., contributed to the asset itself), significantly noted:

> "there is no doubt, however, that her contributions to the home and children allowed Defendant to work at his business and thus pay down the mortgage on the property, the Trial Judge properly found that Plaintiff was entitled to ten percent of this property". Valentino at 339.

Thus, the Court appropriately noted the Wife took care of the home and raised the parties' child therefore "allowing him to devote his time to the business" returning the analysis to the principles of Weiss and footnote 4 and reaffirming that generalized marital contributions warranted distributability. Valentino at 339. Thus, notwithstanding some non-precise language in earlier cases (and somewhat in Valentino also) the law appears to be (and

... contrasted with ...anges caused by inflation, market forces or factors unrelated to what either party did, the increase is distributable. Valentino clearly confirms that the non-economic contributions of a spouse can create a right to share in post-marital appreciation unless the appreciation was not created by either spouse, i.e., interest on a bank account, appreciation of real estate, or publicly traded stock. Marital effort, as Valentino confirms, includes non-economic contributions such as raising children, maintaining a home.

Yet, how this value is to be distributed should logically be effected by the fact that the asset itself was not created during the marriage. For example, in Valentino, the percentage received by the non-titled spouse was probably less than what she would have received had the asset been the initial product of the parties' hopes, dreams and marital efforts from the inception. Such a proposition emphasize the importance of marriage as the fundamental bedrock societal institution while simultaneously providing a rational distinction between parties who merely live together as opposed to those who marry. Thus, the principle is consistent with sound public policy and the statute; it is also fair, hence

satisfying the tripartite type test established earlier in this article.

PRACTICE POINTERS

Prudence dictates that whenever a pre-marital asset is involved, a multi-count complaint be filed to assure that a fair result is achieved. Equitable distribution as a remedy dealing with appreciation of pre-marital assets does require certain proofs. As made evident in an early but similar case, there must be an examination of what caused the appreciation since no one would argue the proposition that a pre-marital bank account with simply accrued interest during the marriage meant that this appreciation i.e., the interest was distributable. Mol v. Mol, 147 N.J. Super 5 (App. Div. 1977). Interestingly, Mol focused upon footnote 4 in Painter. Mol involved the claimed distributability of a pre-marital home. The court noted that since neither party were responsible for a valuation increased caused by inflation or other economic factors, the increase was not distributable. Mol at 7. In fact, Painter dealt specifically with the bank account issue noting "income or other usufruct derived from such property ...... shall similarly be considered a separate property of the particular spouse." Painter at 214., i.e., dividends on interest generated from an immune asset share the same immunity. Painter, also

by passive reasons, i.e., inflation, and market conditions consistent with the reasoning in Mol. Since this proof may well be difficult to prove resorting to equitable remedies may be appropriate. If you can demonstrate it would be "unfair" to allow the full incremental increase to be allocated to the owner, then use of constructive trusts (or where appropriate other equitable remedies) may be successful. It is for that reason a multi-count complaint is prudent since at the inception of the case it is hard to know what proofs one will be able to present at trial; it is certainly far easier to prove unfairness then demonstrate with specificity that an increase in an asset's value was caused by marital as opposed to market forces or inflation.

In response there is certainly a substantial argument by the titled spouse that it is only fair to allow some enjoyment of a pre-marital asset's appreciation. Should the law logically make such a firm and harsh distinction permitting a bank account's increase in value to be entirely immune while simultaneously depriving an owner of any return on a different type of asset. Resolution of that issue may be more of a question of distribution, i.e., fairness than valuation. The concept that someone having an asset at marriage should not lose all return on the asset merely because they are married seems beyond dispute.