

FINANCIAL SETTLEMENT ON DIVORCE: TWO STEPS FORWARD, TWO TO GO

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In the companion cases of *Miller* and *McFarlane*, [2006] UKHL 24, the House of Lords made progress toward establishing rules to govern the financial claims between divorcing spouses. In *Miller* the question was what the husband, wealthy at their wedding and wealthier at their divorce, should provide the wife who earned £85,000 annually on her own. There were no children of their three-year marriage. The trial judge allowed Mrs. Miller £5 million, about 29% of the husband's marketable assets, but only 13% if one included in the pot restricted shares he held in a company begun during the marriage (valuing them at the average of two conflicting estimates given by consultants). The House affirmed the order, but rejected the Court of Appeal's explanation for it. In *McFarlane* the husband had built a very successful career as a partner in a major accountancy firm during the 16-year marriage, and was earning about £750,000 annually at the time of divorce. Ms. McFarlane had given up an equally promising career as a solicitor to care for the couple's three children. The McFarlanes agreed on a largely equal division of their £3 M in assets; the question was the amount and duration of an award of periodical payments in Mrs. McFarlane's favor. The trial judge had allowed £250,000 for her (beyond the £60,000 allowed for the children), and the husband appealed. Bennett J. reduced the award to £180,000; the Court of Appeal restored the £250,000 on the wife's appeal, but limited its term to five years. The Lords, again rejecting the Court of Appeal's reasoning, allowed Mrs. McFarlane a joint lives' order for £250,000. The disparate facts of these two cases provide both a challenge to, and test of, any common principles offered to resolve them both. The challenge is left to the courts by the Matrimonial Causes Act 1973, which itself

provides little guidance, as Lord Nicholls observed [5, 6].

The most comprehensive opinions, written by Lord Nicholls and Baroness Hale, agreed on both the result and most points, save for a small difference in their view about business assets, addressed below. Lords Hoffmann and Mance concurred with Baroness Hale, while Lord Hope concurred with both. They all agreed they should provide more certain standards than the statute itself offered. They were also unanimous that neither a spouse's conduct, nor an assessment of his or her contributions, should affect the judgment, exceptional cases aside. The Court of Appeal had believed it appropriate to penalize Mr. Miller for ending his marriage "without any remotely sufficient reason" [50]. But this conduct "fell far short" of the "obvious and gross" behavior Baroness Hale believed the statute required [145], a standard echoed by Lord Nicholls ["gross", 64-68] and Lord Mance ["egregious", 164]. As for contribution, Baroness Hale [146] pointed out that the Act does not refer to the contributions made to the parties' accumulated wealth, but to contributions to the welfare of the family, and in that respect each should be seen as doing their best in their own sphere. Only if there was such disparity in such contributions that it would be inequitable to disregard it should they be taken into consideration. Contribution in this broad sense is but the "other side of the coin" from conduct (Lord Mance, [164]) and would therefore require for its routine consideration an impractical and inappropriate "minute examination" of the marital life (Lord Nicholls, [67]).

In all these features the Lords adopted views very similar to those of the American Law Institute (ALI) (*Principles of the Law of Family Dissolution*, 2002), although the ALI reserves no exceptions for gross misconduct or highly imbalanced contribution. The Lords' formulation as to conduct seems close to New York's, which allows its consideration in only "egregious cases that

shock the conscience”. In practice New York never considers misconduct short of serious felonies such as rape and attempted murder (*Ellman et al., Family Law: Cases, Text, Problems, 4th edition 2004 at pp.294-95*), exceptions sufficiently rare to be limited in importance. As for contribution, the appropriate rule is related to the distinction between marital and separate property, the one point on which Baroness Hale and Lord Nicholls partially parted. He would include all assets earned during the marriage, while she would exclude business assets from the marital pot unless both spouses worked at the enterprise. But their difference may be semantic rather than real, as illustrated by their agreement on the judgment in *Miller*, in which the only question was the wife’s claim on the husband’s business assets.

Baroness Hale explained that the short marital duration in *Miller* justified a downward adjustment from the benchmark of equal division, but not to zero. [151-152, 158]. So in practice her exclusion of business assets is really the reservation of greater discretion to depart from equality (her starting point) in their allocation. Lord Nicholls, by contrast, allowed Mrs. Miller’s claim *because of*, not *despite*, the contribution of Mr. Miller’s labor *during marriage* to the assets’ increased value. [71]. So he starts by excluding all separate property, including the business assets Mr. Miller had before the wedding, but then adding back the appreciation in their value that results from his marital labor. It thus seems that Lord Nicholls and Baroness Hale start from opposite ends of the field but meet in the middle, a meeting made easier by the fact that neither insisted on a precise location, allowing both to accept the trial judge’s choice as within acceptable bounds.

Lord Nicholls’ reasoning follows the standard community property approach, which is now also followed in many American common law states. It offers consistency in applying the principle that both spouses share the fruits of all labor that either performs during marriage, even when that

labor is applied to a separate asset—which will in consequence now have both separate and marital components. This is well down the path toward thinking about property allocation at divorce in property law terms. By contrast, Baroness Hale seems more inclined to frame the allocation question in equitable terms: the issue for her is not so much the nature of the property as the guideposts for the court’s exercise of its equitable power to redistribute it, and one such guidepost is the need to be cautious in reallocating business assets. If the American experience is any guide, this difference in framing the question reflects two different points in the evolution of marital property law from the common law system to a fully developed system of equitable distribution—the American term for the marital property reforms begun in the 1960’s and 1970’s. In the decades since those reforms began, American law has trended away from “equity-thinking” and toward “property-thinking”, with compensation remedies increasingly confined to maintenance payments. Much more recently, this trend in marital property law has been followed by increasing interest in the use of presumptions and guideposts to secure more predictability and consistency in maintenance awards.

Is this pattern in the development of American marital property law a guide to the English law’s future? Americans have been at this longer because our reforms came sooner. Virtually all American states, for example, have for decades included pensions earned during marriage in the pot of property that must be divided at divorce, facilitated by federal legislation that requires pension administrators to honor “qualified domestic relations orders” requiring them to pay directly to a former spouse his or her share of the employee-spouse’s annuity. But Americans may also be more hospitable to community property concepts. Eight American states, including California and Texas, have always had community property, owing to their Spanish or (in the case of Louisiana) French legal heritage. In those states the wife has always had equal ownership in a car, or shares, or land,

or a business that the husband buys with his earnings during marriage, even if he takes it titled in his name alone. So many American lawyers have always been familiar with such rules. While the other 42 states initially followed the English marital property system, they all moved to equitable distribution by the late 1970's. Most had statutes that distinguished marital and separate property at the outset, with definitions that mimic community property rules. Others, like the English law, made no distinction, and gave their courts equitable authority to allocate all property. Over time, however, the number of true "all property" states has declined to a handful. Some changed their statutes, while most of the rest accepted judicially-developed allocation rules that effectively replicate the marital-separate property distinction. This was possible because all the new statutes, like the English Matrimonial Causes Act 1973, gave judges wide leeway in exercising their new equitable power, whether it applied to all property or just marital property.

While general characterizations of these 42 reformed common law state systems is inherently hazardous, it is fair to say that despite some notable exceptions, the trend favors rules that presume equal division of marital property at divorce, with separate property left with its owner. (*ALI Principles, Reporter's Notes to § 4.09, Comment b.*) More importantly, the common law states have increasingly come to treat property claims of divorced spouses as *property* claims, rather than as appeals to the court's equitable conscience. They trace assets to their origins in marital or separate funds, but treat as marital the increased value of separate property arising from marital labor. (*ALI Principles, Reporter's Notes to § 4.05, Comment b and § 4.06, Comment b.*) They do all this even though they recognize no marital property interest during the intact marriage, nor at the death of either spouse, as do the eight true community property states. But at divorce they act as if, at that moment and that moment alone, a kind of community property interest exists. While they all once

regarded themselves as exercising a new equitable power to give one spouse a share of property that really belonged to the other, an increasing number now think like community property states, regarding themselves as dividing between the spouses property in which both have ownership. That change in mindset transforms the property claim from a plea for charity (“can you please allow me some of my spouse’s property?”) to a claim of entitlement (“as the partnership has ended, I’ll take my share now, thank you”). Lord Nicholls seems to favor this shift in thinking [9], but it is not clear if the other Lords are comfortable with it. What the American experience teaches, however, is that this shift is necessary to achieve horizontal justice (consistency across cases) in property allocations.

It seems Baroness Hale may believe such a shift in judicial thinking is not possible in English law as it now stands. She observed that it retains individual rather than community ownership, and that a rationale is therefore required for redistribution at divorce [137]. Certainly, a shift to property thinking conflicts with the view that a redistribution rationale must be provided for each property allocation order, case by case, through a close examination of its facts. But such a strong commitment to vertical justice makes horizontal justice impossible to achieve, and all the Lords seem sensitive to this point, given their rejection of routine consideration of conduct and contribution. The solution is to shift from case by case justification to identifying a rationale for a particular redistribution rule. The American experience shows this is possible within the framework of a separate property system. Sharing, one of three rationales Baroness Hale offered for redistribution [138-141], is the obvious candidate for such a rationale. As Lord Nicholls suggested [16-20], it leads to a rule presuming an equal division of marital property. People embarked on any common endeavor normally expect a fair share of the proceeds upon its winding up, and even children understand, when dividing up a bag of candy, that the default meaning of fair is equal. Any

other allocation requires justification, and such justification will not often arise if we exclude consideration of conduct and contribution in all but extreme cases, as the Lords suggest.

But as Lord Nicholls also observed [21-23], a presumption of equal division makes sense only as to property earned during the marriage by the labors of either spouse--marital property. Separate property cannot be assumed part of the common endeavor. It can become so, however, if the spouses treat it as such, by commingling marital and separate property so fully they cannot be disentangled. This principle, long familiar in American community property states, has now been adopted in many of the common law states as well. (*Oldham, Tracing, Commingling, and Transmutation, Family Law Quarterly* 23 (1989) at pp 219, 223.) The ALI suggests that marital duration is a second way by which separate property is drawn into the common endeavor, because the longer spouses are together the more entwined and interdependent their lives ordinarily become. (*ALI Principles* § 4.12.) People married 30 years might usually assume, for example, that assets one of them brought into the marriage decades earlier are available for urgent family needs, should they arise. If most people assume that, then it is also reasonable for courts to assume such assets are in the pot when parties divorce after 30 years, in the absence of any evidence this particular couple had a contrary understanding. Both Lord Nicholls and Baroness Hale seem hospitable to this idea, although they approach it from opposite directions, Lord Nicholls saying that a presumption of equal division might not apply to separate property at the conclusion of a short marriage [24], and Baroness Hale suggesting that in allocating assets, the importance of their source will diminish as the marriage lengthens [152].

So I suggest the Lords are part way toward adopting two straightforward rules: marital property should be divided equally (with exceptions possible for egregious misconduct or an

extraordinary imbalance in contribution), while separate property should be confirmed to its owner in short marriages, thrown into the marital property pot in most long marriages, and given some intermediate treatment in marriages of intermediate length. These rules are quite similar to the recommendations of the ALI, with one important caveat: we have not discussed Baroness Hale's two other rationales: need and relationship-generated disadvantage. (Or mutual dependence and compensation, Lord Nicholls' terms for essentially the same concerns [11-15]). A fair vindication of these concerns would seem to require case-by-case examination of the marital relationship as well as the marital property, and is for this reason inconsistent with a property entitlement approach. The ALI therefore excludes them from property allocations. It instead considers such equitable claims separately, under the rubric of compensatory payments—the replacement for alimony or maintenance. The Lords are part way toward this result as well, as they endorse compensation (or “relationship-generated-disadvantage”, in Baroness Hale's terms) as a key ingredient of financial settlement—and in particular, as the best explanation for the periodic payment award to Mrs. McFarlane.

The key difference between property entitlements and compensatory payments is the interest being vindicated, not the form of remedy relied upon to vindicate it. A property allocation at divorce, like any property interest, can be satisfied by buying it out with installment payments (secured, if need be, by a lien on the property) as well as with an immediate transfer of assets. A compensable loss can sometimes be satisfied with a lump sum payment even though in most cases, as with the traditional alimony remedy, a claim against a spouse's post-divorce income is the only practical course. But whatever the remedy, claims to share in accumulated property are inherently different than equitable claims for compensation: the first is a claim to a *property interest in a thing*, while the second is a claim *against a person* who shares responsibility for a loss arising from a common

endeavor. The case for equal shares in property accumulated during a marriage is straightforward, but no similar case can be made to give one spouse an equal share in the fruits of other spouse's post-divorce labors—a point well-illustrated by New York's sorry experience with the *O'Brien* case (Ellman, *Do Americans Play Football?*, International Journal of Law, Policy and the Family 19 (2005), pp. 271-75). But of course one need not treat the spouse's post-divorce earnings as property to take them into account in providing an appropriate compensatory remedy. One hopes that Baroness Hale's reference to Mr. McFarlane's "earning power" as a "family asset" [154] was not meant to suggest otherwise. Property adjudications are appropriately final and nonmodifiable, but compensation for losses one is expected to realize over future years will sometimes require adjustments as future events unfold.

Certainly, the desire to achieve a clean break cannot be the basis for denying a compensation claim that can only be satisfied through periodic payments, a point Lord Nicholls made [39]. That is the problem with the rule of Scots law limiting all such payments to three years' duration, criticized at length by Lord Hope. His view is shared by both Lord Nicholls and Baroness Hale. Many longer marriages end with the parties in very disparate financial circumstances that cannot be addressed appropriately with a clean break philosophy. In America as well, the reforms in marital property law were accompanied by declarations favoring a clean break that were often taken to bar alimony awards for more than transitional assistance, but that goal was soon understood to be unrealistic in many marriages (Ellman, *Family Law*, pp 400-401).

Any system for compensatory awards must identify both the compensable losses and a method for measuring them. I have elsewhere explained how the ALI approaches this problem, why it concludes that compensation for losses is conceptually superior to need as the basis for valid

claims, and just how the ALI compensation rules would apply to *McFarlane*. (*Football*, pp.257-271). But two points are perhaps worth observing here. First, as John Eekelaar discusses in his comment on these cases (*Property and Financial Settlement at Divorce—Order Restored (Almost) Family Law* [2006]), the ALI focuses its compensatory remedies on the McFarlanes' income disparity at separation, not on her lost career, for practical reasons (the common difficulty of measuring lost career prospects), conceptual ones (the felt loss for many claimants is not a career but the chance to have children with a partner with whom one enjoys an enduring relationship) and to avoid an unacceptable result (requiring compensation to the *higher* earner when the marriage compromised his career prospects, as it surely sometimes does). Second, the *McFarlane* award I earlier estimated would follow from applying the ALI presumptions (*Football*, pp. 267-68) may in practice be equivalent to the award ordered by the Lords: if one assumes a 6 percent interest rate, the expected duration of a £250,000 award, in my *McFarlane* example, is nine years—perhaps close to the likely actual duration of this joint lives' order [96-97].

The principle advantage of the ALI approach is that it uses relatively ascertainable objective facts--the parties' incomes, the duration of their marriage, and the duration of period during which the claimant was the primary caregiver for the marital children--to generate a presumption of an award for a specific dollar figure and specific duration. So the point is not so much the similarity in result between this ALI example and the Lords' *McFarlane* order, but the fact that the ALI reaches the result with clear rules yielding predictable results. If policymakers prefer awards that are higher or lower, or longer or shorter, they can adjust the formulas accordingly. In all cases, however, the judge is free to alter the amount and duration to respond to the particulars of the parties' situation, so long as the altered award has an equivalent present value. The judge can also

override the presumption and order an award with a different present value, but must in that case provide a written explanation of the unusual facts presented by the case that justify the departure. It was the ALI's conclusion that such a system of rebuttable presumptions afforded the best compromise between the competing demands of horizontal and vertical justice. This feature of the ALI recommendations the Lords have of course not addressed.

In sum, the Lords have gone a good distance toward drawing clear lines between marital property and separate property, which will allow a shift in judicial thinking to a property and entitlement mindset. They have also moved toward a distinction between property claims and compensation claims, the second step necessary to realizing predictable orders and horizontal justice in property allocations. One can hope that future developments will bring consideration of a blending of marital and separate property as marital duration lengthens, and of presumptions based on income disparity and duration—points emphasized in these opinions—as the basis for compensatory awards.